



THE WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN BUSINESS SCHOOL

*What Can We Learn from the Experience
of Transitional Economies
with Labour Market Policies?*

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Working Paper Number 62
1997

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What Can we Learn from the Experience of Transitional Economies with Labour Market Policies?

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Abstract

Several lessons can be drawn from the natural experiments of central and eastern European countries with labour market policies. Two of them are particularly relevant also for OECD countries. First, it is not wise to reduce the duration of unemployment benefits when the length of unemployment spells are on the rise, unless i) unemployment is still low and there is the administrative capacity to implement active labour market policies on a wide scale or ii) there are income support schemes of the last resort in place and an administration capable of cost-effectively enforcing work-tests for those falling off unemployment benefit compensation rolls. The second and perhaps more positive lesson in the light of the above is that it is possible to transform institutions and create an efficient policy delivery mechanism within a short time span.

Forthcoming on the Oxford Review of Economic Policy

¹ The author wishes to thank Ken Mayhew and participants in a workshop in Oxford for their valuable comments on an initial draft and Randolph Bruno for his unflagging statistical assistance. Financial support for this research from the European Commission Phare-Ace Programme 1996 (Project P96-6150-R) and the Volkswagen Foundation within the project "Labour Market Policies in Transition Countries: Monitoring and Evaluation" is gratefully acknowledged.

I. INTRODUCTION

The experience of central and eastern European transitional economies with labour market policies is a very interesting case study. At the start of transition, “open” unemployment was virtually non-existent and no income support scheme for those losing their jobs in the course of economic transformation had been put in place. Thus, prior to imposing a hard budget constraint on state enterprises and putting them onto the privatisation track, it was necessary to establish a regulatory framework for the provision of insurance in the case of job loss (except in Hungary and Slovenia, where rather tiny unemployment benefit programmes had existed since the second half of the 1980s). Probably more important still was the creation of an administration capable of delivering income support, minimising the risks of abuse, providing brokerage functions for the unemployed and offering a rich battery of active labour market programmes. A number of lessons can be drawn from this rapid institution-building process, which all the countries in the region had to go through.

Building institutions and regulatory frameworks to cope with unemployment forced public authorities to learn about the incentive effects of policies and, like all learning processes, this involved trial and error. In most countries it soon became clear that the kind of unemployment benefit systems initially put in place were fiscally unsustainable. Hence, benefit systems had to be radically transformed. The effects of such policy changes offer another interesting dimension against which the experience of these countries can be evaluated. There is no precedent in the OECD arena of radical changes in unemployment benefit systems, as consolidated entitlements often prevent governments from significantly altering the design of unemployment benefit systems and shifting resources from passive to active labour market policies. Moreover, similarities in starting conditions and initial labour market regulations (if not implementation mechanisms) in the Czech and Slovak Republics also provide an interesting cross-country perspective for an appraisal of policy effectiveness.

The purpose of this paper is to draw from these “natural experiments” potentially valuable lessons also for western countries. The focus will be on policies promoting the reallocation of workers across sectors and firms of different ownership and cushioning the social costs of redundancies. Other papers in the present issue of this Review deal with social policies in a broader perspective and with enterprise restructuring and associated labour demand and wage setting issues.

The plan is as follows. Section 1 describes the rapid buildup of labour market policy institutions in central and eastern Europe and the natural experiments associated with learning about the consequences of policies. Section 2 reviews evidence of the effects of policy changes on labour market flows, notably exits from unemployment to jobs and flows to inactivity. Finally, Section 3 draws some tentative conclusions from the experience of transitional economies which may be of some relevance also to OECD countries.

II. THE NATURAL EXPERIMENTS

Prior to the start of economic transition, only Hungary and Slovenia had a (far from comprehensive) system of income support for the unemployed. In Hungary, earning-related benefits had been granted since 1986 only to workers involved in collective redundancies, which were, needless to say, a very rare event up until 1990. In Slovenia, as in the other former Yugoslav republics, the self-management system allowed compensation to be paid to job losers. The subsidy was administered by the local self-managed units and there were not always sufficient resources to pay all those eligible. In all the other countries of central and eastern Europe, unemployment was not even officially recognised. Hence, a legal framework for labour market policies and a network of labour offices where the unemployed could register, collect benefits and be assisted in their search for a job had to be created from scratch.

i) **Institution building**

As early as end-1990 (1989 for the fast reformer Poland), or the beginning of 1991, all the countries in the region adopted comprehensive regulations encompassing not only the provision of income support for the unemployed, but also the implementation by decentralised state administrations of a series of active labour programmes, ranging from training for the unemployed to subsidised employment schemes and public work programmes. Only in Bulgaria were these regulations put in place by governmental decree, rather than via parliamentary approval. The calendar of reforms in the labour market area was similar across countries: together with these Employment Acts, regulations covering labour relations between employers and employees and wage setting – albeit within the limits imposed by tax-based income policies – were introduced. Certainly the fear that unemployment would rise substantially in the aftermath of reforms played an important role in providing support and paving the way for reform. Bulgaria, which missed this opportunity, is in fact still awaiting parliamentary approval of its Employment Law.

Progress in building a policy delivery mechanism was even more impressive. A decentralised network of labour offices was established, staffed and endowed with the means to operate. Although inadequate to cope with the massive inflows of registered jobseekers in the early stages of reform, this network was sufficiently decentralised and, in some countries, not less efficient than in some best-practice OECD countries. Table 1 provides some basic information on the organisation, workload and performance of the Public Employment Service (PES) networks in central and eastern Europe and in selected OECD countries. As can be seen from column two of the table, the PES organisation is fairly decentralised in these countries, as the average number of members of the labour force served by each employment office is broadly similar to that prevailing in OECD countries with well-developed PES administrations. Yet workload indicators point to

inadequate staffing in most central and eastern European countries. In particular, the average number of registered unemployed (if not the number of benefit claimants, given the current low coverage of benefits in these countries) per staff member can be up to 10 times higher than in the UK.

Table 1

Building a Delivery Mechanism for Labour Market Policies
(indicators of the PES workload and market penetration; 1993 unless otherwise specified)

Country	Number of local offices	Labour Force per office	Labour Force per staff	Registered Unemployed per staff	Unemployment Benefit Recipient per Staff	Monthly Placements per staff(a)	Placements % hirings(b)
Bulgaria	122	31566	1803	270	102	2	n.a.
Czech Republic	141	35302	1133	30	17	5	26
Hungary	187	26100	1190	162	113	4	n.a.
Poland	356	50596	1601	235	141	5	32
Romania	190	58584	7172	675	618	6	n.a.
Slovak Republic	109	21493	1111	123	55	4	37
Slovenia	59	14688	1083	148	50	n.a.	8
Denmark	97	29463	1270	183	155	3	10
Norway	168	12685	761	56	41	2	10
Sweden	380	11226	488	42	38	18	16
UK	1216	23386	741	56	49	4	30

Sources:

OECD National Reviews of the Public Employment Service for data on OECD countries; Boeri (1996) for data on transitional economies.

Notes:

- (a) Estimates. Differences in the definition of placements across countries may bias results.
(b) Yearly hirings are estimated as persons in employment with tenures shorter than one year in national Labour Force Surveys. In the case of Slovenia percentage of those entering employment who declared to have found a job via the PES.

In spite of this limited staffing (and of insufficient training, especially in the early stages of transition) the PES in most of these countries would seem to have performed rather efficiently by western standards. The second last column on the right-hand side of Table 1 points to monthly placements of the order of 4-5 per PES staff member, which is quite remarkable if the rather poor re-employment opportunities offered to the unemployed in these countries is taken into account. Moreover, the number of placements as a percentage of total hiring – which can be considered as a broad measure of the market penetration of the PES – is large by western standards, although differences in the definition of placements make such international comparisons somewhat problematic. Unfortunately, no information is available on the quality of the placements made by the PES. LFS data suggest that most hirings occur via short-term contracts and this is likely to happen also for PES-intermediated placements. In some countries (e.g., the Czech and Slovak lands) a significant number of subsidised employment opportunities have also been offered to the unemployed by the PES. Finally, at early stages of transition these countries suffered a severe lack of vacancies, which means a low denominator in estimated placement/hiring ratios. But even bearing the above caveats in mind, the market penetration of these young administrations looks quite remarkable.

The enforcement of regulations, especially in the Czech lands, is fairly strict. In this country work-tests are actually enforced (although mainly among the ranks of unemployment benefit claimants rather than social assistance beneficiaries) and a significant proportion (in some years up to 10 per cent) of outflows from the register is, indeed, associated with persons struck off the register for lack of co-operation with labour offices (failure to report to the office or to accept a “suitable” job offer). All in all, these understaffed administrations often managed very well in coping with a new (and rapidly mounting) problem.

An important factor behind the remarkable performance of the PES in some central and eastern European countries would seem to be its client-oriented organisation, with a small share of the total staff allocated to central administrations. Rather than being deliberately chosen, such a small overhead organisation was often imposed by staff constraints and heavy pressure for registration and placement services on local employment offices. The stabilisation and then decline of the population of registered jobseekers is indeed being accompanied in some countries (e.g., Slovakia) by a reorganisation of the PES, putting greater emphasis on central or intermediate (regional) administrations at the expense of client-oriented activities. Such a reorganisation of the PES is sometimes justified on the grounds that greater co-ordination among local PES offices is needed to tackle the wide regional dispersion of unemployment in these countries. However, a strongly decentralised and client-oriented administration is not at odds with the pursuit of policies promoting the regional mobility of workers. On-line vacancy registers, covering a country (if not neighbouring countries) as a whole, and accessible by jobseekers on a self-service basis, can do most of the job.

The PES in these countries has a tripartite structure, in which employers' and employees' organisations are often heavily involved in the supervision, and sometimes even in the running, of the PES at the central, regional and local levels. The experience of OECD countries suggests that heavy involvement of social partners in the administration of the PES often hampers the efficiency of the service, as it delays important decisions. These negative effects of tripartism on the efficiency of the PES may have been mitigated by the ongoing reorganisation of employees' representations and the creation of new employers' associations, which has reduced the actual involvement of social partners in the decision-making process at the local, operational level.

ii) **Learning from Experience**

The design of unemployment benefit systems introduced at the start of transition in these countries, which reflected both social insurance and social assistance principles, was influenced by (not always sound) western recommendations and contained some naïveties. On the one hand, benefits were earning-related and the duration of entitlements dependent on the length of employment records, in keeping with insurance principles. On the other hand, rather high minima were established which actually put in place a flat rate unemployment benefit for those coming from the lower end of the wage distribution.

Moreover, school-leavers and other categories of jobseekers without previous employment records were generally entitled to benefits even without initial waiting periods. Replacement rates generally decreased over time in order to minimise work disincentives. Rather than a decline in nominal gross replacement rates, it was the lack of indexation of benefits in a context of rapid inflation that eroded the real value of benefits and pushed the majority of recipients down to minimum benefit levels. Hence, even if nominally benefits did not appear to be less generous than in OECD countries and were based mainly on insurance principles, they offered *de facto* benefit amounts close to the minimum wage and the weak link with past contributions that is typical of social assistance schemes. There were also some gross errors in the systems' design, perhaps induced by the hurry in which they were approved and implemented. For example, in Poland unemployment benefits were initially open-ended. This induced large inflows into unemployment compensation rolls of persons coming from the out-of-the-labour force. Although flow data for the early stages of transition are not available, Poland is, indeed, the only country where the initial increase in the number of registered unemployed largely outpaced aggregate employment losses.

Ongoing budgetary consolidation efforts and the lessons learned from the effects of their policies soon induced public authorities in central and eastern Europe to tighten eligibility to benefits and reduce their maximum duration. These quite radical changes in the design of unemployment benefits – which occurred in most of the countries at the end of 1991 – are outlined in Table 2. The maximum duration of UB was halved in the Czech and Slovak lands and in Hungary, and a maximum duration of one year was set in Poland. Gross statutory replacement rates were also decreased in Bulgaria, in the former CSFR and in Poland, where the earning-related system was turned into a flat-rate scheme. The lifting of benefit minima or the introduction of benefit ceilings ranging between 140 and 150 per cent of the minimum wage also contributed to reducing benefit levels. In the Czech and Slovak Republics, regulatory changes were enforced *retroactively*, while in Bulgaria, Poland and Hungary existing entitlements were grandfathered. Needless to say, in OECD countries cuts in the generosity of benefits are rarely made and when so, are much less radical and diluted over a longer time period.

Table 2

The Tightening of Unemployment Benefit Systems
(the design of unemployment insurance systems before and after the 1992 reforms)

Country	Maximum duration (months)	Benefit Minima (as a % of minimum wage)	Benefit Maxima	Gross Replacement Rates (a)			Coverage Rate (b)
				First 3 months	First year	Second year	
<i>Bulgaria</i>							
before	12	100	none	93	91	0	52
after	12	90	140	60	60	0	33
<i>Czech Republic</i>							
before	12	none	none	65	58	0	72
after	6	none	150	60	30	0	48
<i>Hungary</i>							
before	24	100	none	75	59	34	80
after	12	70 (c)	150 (c)	58	51	0	40
<i>Poland</i>							
before	open-ended	100	average wage	70	53	40	75
after	12	none	none	45	45	0	55
<i>Slovak Republic</i>							
before	12	none	none	65	58	0	82
after (d)	6	none	150	60	30	0	27

Notes:

(a) Gross benefit income in unemployment as a percentage of gross wages in previous employment; rates average those of two unemployed, aged 40, who have been working at the average wage continuously since age 18 with no interruptions and who were earning, respectively, the average wage and 2/3 of the average wage.

(b) Unemployment benefit recipients as a percentage of registered unemployment. Figures before the change refer to December 1991; after the change to December 1995.

(c) In Hungary benefit minima & maxima are not expressed as a percentage of the minimum wage, but fixed in levels; the figures reported in the table refer to relativities between benefit floors and ceilings and the minimum wage in 1995. Unemployed who were previously earning less than the benefit minima are entitled to 100% of the previous earnings.

(d) Since 1995 the maximum duration of benefits has been brought back to 12 months.

Source:

Boeri and Edwards (1996).

The impact of the tightening of benefits was made even more dramatic by the spread of long-term unemployment. The combined effect of a rising percentage of unemployed for more than one year and of a decreased duration of benefits was a dramatic decline in the proportion of registered jobseekers receiving unemployment benefits² (last column on the right-hand side of Table 2). At the time of start of reform, the Czech and Slovak Republics already had in place guaranteed minimum income schemes providing social support of the last resort to those falling outside unemployment compensation rolls. Poland and Hungary, had highly decentralised social assistance systems with wide regional differences in benefit amounts and coverage. In Hungary there were no national standards for the provision of social assistance. In Bulgaria and Romania, income support schemes of the last resort did not exist and had to be quickly introduced (together with hybrid "bridging" schemes between unemployment benefits and social assistance for

² It should be stressed that unemployment benefits for school-leavers were not discontinued, although in some countries benefit levels for this group were reduced. This means that the decrease in coverage rates documented in Table 2 cannot be attributed to inflows of large cohorts of jobseekers not eligible for unemployment benefits.

those entitled to shorter unemployment insurance spells) in order to reduce unemployment-related poverty.

Eligibility for social assistance is conditional on passing a means test, which is highly demanding on staff time and difficult to carry out under the conditions of transitional economies, which tend to have poor tax records and a large underground economy. These countries were not given the time to train social workers and prepare local authorities for their new tasks and indeed there is evidence of an initial “overshooting” in the number of beneficiaries of social assistance and of frequent abuses, especially before local elections. But also in countries with a decentralised network of social welfare centres and a longstanding tradition of local communities involved in the provision of social assistance, local institutions were not ready to cope with a large clientele of able-bodied individuals who had exhausted the maximum duration of benefits.

Generally speaking, quite radical changes in the design of income support schemes for the unemployed in central and eastern Europe were introduced. At first, unemployment benefit systems were significantly tightened. Then means-tested income support schemes of the last resort for those exhausting the maximum duration of unemployment benefits were introduced or the scope of existing social assistance schemes significantly broadened. Active policies underwent more changes in their implementation (with varying proportions of training, subsidised employment and public work programmes being funded) than in their design.

III. EVALUATING THE EFFECTS OF POLICY CHANGES

Although reforms in unemployment benefit systems were mainly inspired by budgetary restraint, policy-makers expected that the tightening of unemployment benefit systems would boost outflows from unemployment to employment. Economic theory also suggests that reductions in the generosity of a system should induce more “matches” between employers and jobseekers by reducing the “reservation wages” of the unemployed. Job creation should also be boosted by benefit cuts because of the stronger competition for jobs – and hence lower wages – between unemployed and employed jobseekers and because of the reductions in statutory contribution rates on top of the payroll, which could accompany expenditure savings.

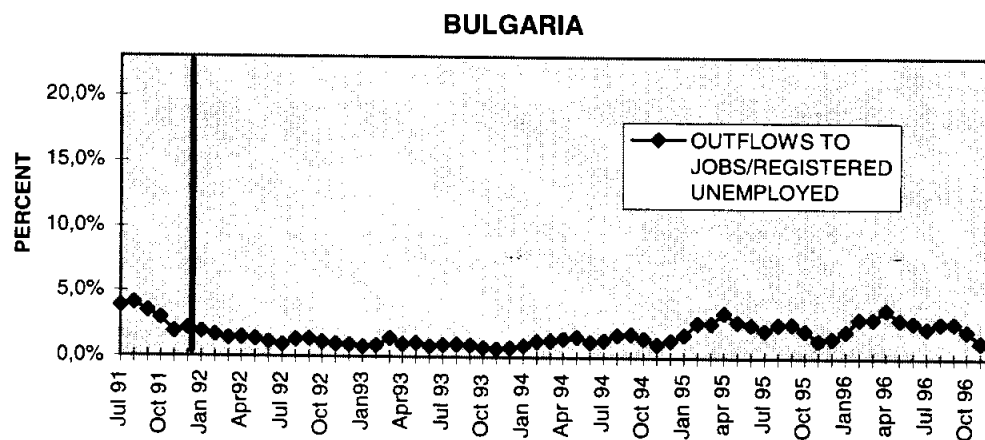
Five years after the tightening of benefits, a preliminary assessment of the effects of these reforms can be made. Aggregate data on unemployment outflows do not point to a significant increase in flows from unemployment to employment after the tightening of unemployment insurance systems. Figure 1 shows that, with the important exception of the Czech Republic – a case which is discussed further down – flows from registered unemployment to jobs have at best only marginally increased after the cuts made to benefits. Similar results can be obtained by using flow data from linked records across different waves of the national LFSs (Boeri, 1996), which, however, cover a shorter time period than registration data.

The effects of policy changes on aggregate outflows to jobs can also be assessed by testing the stability of matching functions, relating outflows to jobs to the stocks of unemployment and vacancies in the various countries (Burda, 1993; Boeri, 1994 and 1996). These tests seem to confirm that policy changes have not significantly boosted outflows to jobs, except in the case of the low-unemployment Czech Republic.

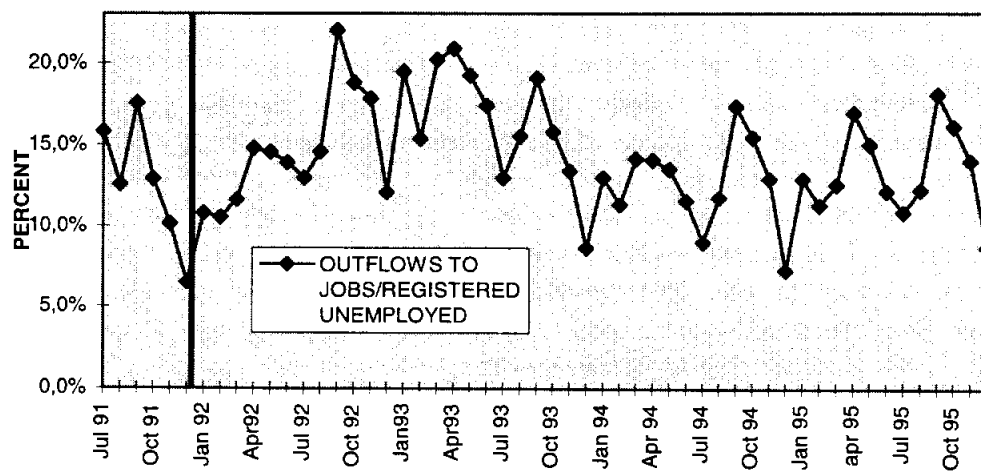
Unfortunately there are very few studies analysing the role played by benefit generosity on individuals' unemployment durations in these countries. Ham, Svejnar and Terrell (1994), on the basis of data from the unemployment register in the former CSFR, found very low elasticities of exits to jobs with respect to unemployment benefit levels and duration. Micklewright and Nagy (1996a) compared empirical hazards from unemployment to employment before and after the tightening of benefits in Hungary. They report that the cuts do not seem to have substantially increased re-employment probabilities. Similarly, multinomial logit estimates of transitions from unemployment to employment in Bulgaria (Jones and Kato, 1993; Kotzeva et al., 1996) do not suggest that an increase in outflows to jobs after the tightening of benefits has occurred, while they signal a strong increase in flows from unemployment to the out-of-the labour force in the past few years.

Figure 1

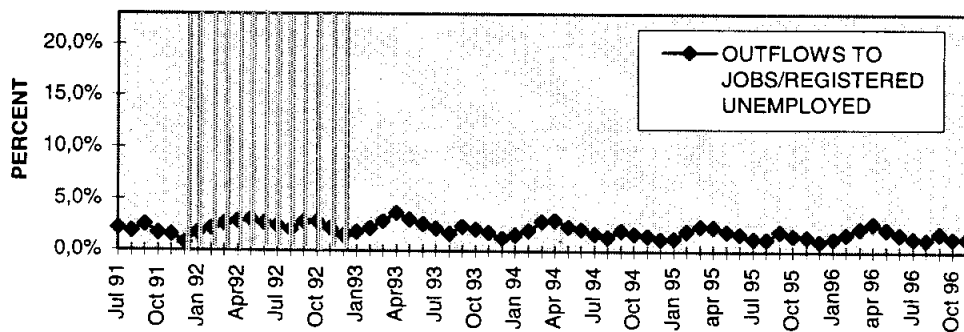
Outflow Rates from Registered Unemployment to Jobs and Policy Changes
(as a percentage of registered unemployment)



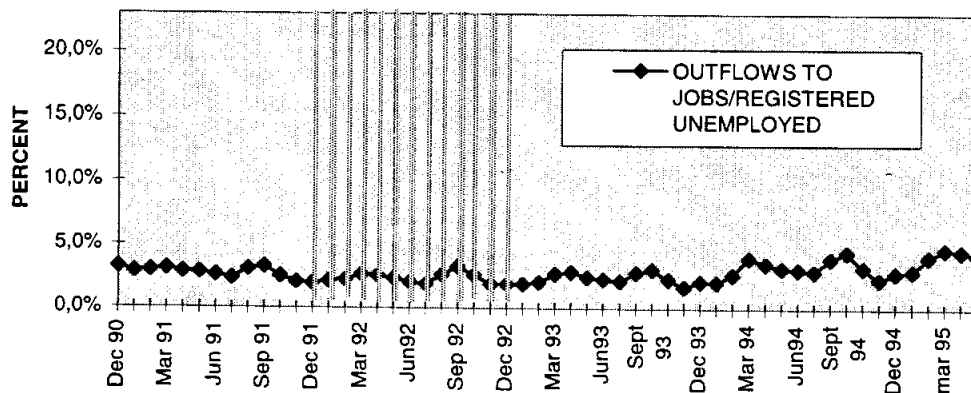
CZECH REPUBLIC

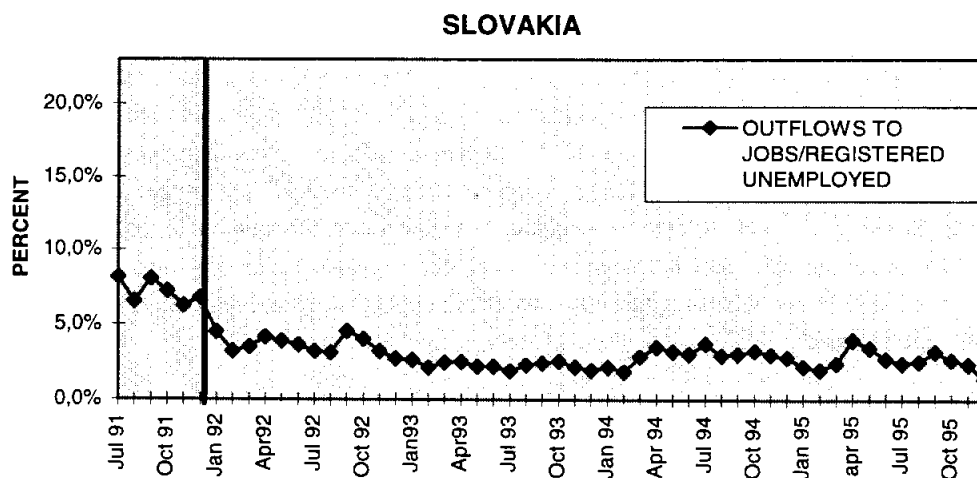


HUNGARY



POLAND





Notes: In Hungary and Poland changes in benefits systems described in table 2 were introduced while grandfathering existing entitlements. For this reason the break is depicted in the figure as lasting one year for these two countries.

Data for Hungary refer only to unemployment benefit recipients.

The reasons behind low unemployment in the Czech Republic have been extensively analysed by the literature (see OECD, 1995 for a summary) and are only partly related to the stance of labour market policies. However, two distinguishing features of labour market reforms in the Czech lands are worth mentioning. First, unemployment benefits were tightened when unemployment was still rather low. Second, cuts in benefit levels and duration were accompanied by the implementation on a large scale (in relation to the size of the unemployment pool) of active labour market programmes. The pace of growth of unemployment prior to reforms was not lower in the Czech Republic than in other central and eastern European countries and active policies have had a significant and strong *net* effect on outflows to jobs, as documented by estimates of “augmented” (that is, including active policy expenditure or intakes) matching functions (Boeri and Burda, 1996). Active policies, like subsidised employment schemes and public work programmes have been much less successful in the country’s former federal partner, the Slovak Republic, after the split (Burda and Lubyova, 1995). This is perhaps because active policies are most successful when properly targeted and when subsidised jobs and persons undergoing training are monitored or when public works are used as a work-test for the long-term unemployed – all things that are very difficult to achieve when there are few PES staff members per unemployed.

This crucial role of the delivery mechanism in enhancing the effectiveness of active policies may explain the rather unsatisfactory record of other central and eastern European countries with active policies, notably training and retraining for the unemployed. Microeconomic evidence from Hungary and Poland – the only two countries where some preliminary evaluations have been carried out of the impact of active labour market policies – is not altogether encouraging as to the effectiveness of

these schemes. Slots in training courses are often offered to jobseekers with rather favourable labour market characteristics (Micklewright and Nagy, 1994), who, most likely, would have found a job in any event. Participation in public works schemes actually reduces the chance of finding a regular job (Puhani and Steiner, 1996), perhaps because of the kind of signalling problems (employers attach a stigma to participation in these programmes) which have been documented in OECD countries. These problems are compounded in transitional economies by the poor signals offered to employers by educational attainments and previous employment records and by the scope of structural change, which makes it more difficult to predict the skill requirements of the new jobs being created (Boeri, 1997).

If the impact of policy changes on flows from unemployment to employment has been rather modest, at least outside the Czech lands, the reduced duration of benefits has resulted in larger flows from unemployment to non-participation. This is confirmed not only by the declining proportion of outflows to jobs as a percentage of total outflows from registered unemployment in most countries (Boeri, 1996), but also by evidence from matched records across different LFS waves, which are much more accurate than administrative statistics in disentangling unemployment from inactivity. In particular, Table 3 reports inflows into inactivity by origin in the countries and time periods for which data were available. These figures point to a sizeable increase in most countries in the proportion of flows to non-participation originating from an unemployment spell compared to those coming directly from employment.

Table 3

Composition of Inflows into Inactivity
(estimates from linked LFS records)

Country	time-period	E-OLF (a)	U-OLF (b)	(b)/(a) %
Bulgaria	9-93 to 6-94	10,6	5,6	53
	6-94 to 3-95	5,5	4,4	80
Czech Republic	Q2-93 to Q2-94	4,0	13,8	345
	Q2-94 to Q2-95	3,6	16,7	464
	Q2-95 to Q2-96	5,6	15,6	279
Poland	Q2-92 to Q2-93	9,2	17,8	193
	Q2-93 to Q2-94	6,6	16,0	242
	Q2-94 to Q2-95	5,5	15,6	284
Slovak Republic	Q1-94 to Q1-95	3,2	2,0	63
	Q1-95 to Q1-96	2,7	4,2	156
Slovenia	93 to 94	6,1	15,4	252
	94 to 95	5,8	19,4	334

Notes:

(a) Flows from employment (E) to out-of-the labour force (OLF) as a percentage of the initial period unemployment stock.

(b) Flows from unemployment (U) to out-of-the labour force as a percentage of the initial period unemployment stock.

Microeconomic evidence lends support to the significant effects of the tightening of unemployment benefits on flows to inactivity. In particular, Steiner and Kwiatowski (1995), found that the reduced duration of unemployment benefits in Poland induced larger proportions of unemployed women to leave the labour force. Other studies carried out in the central and eastern European countries (e.g., Vodopivec (1995)), found spikes in exits from unemployment shortly before termination of the unemployment benefit entitlement period, a phenomenon which has frequently been observed in many western countries. In transitional economies, however, these spikes are associated with flows from unemployment to non-participation, rather than flows to employment (except in the case of buoyant labour markets, like in Warsaw) (Boeri and Steiner, 1997). Finally, Lubyova and Van Ours (1997) found that reductions in the duration of unemployment benefits in Slovakia had a significant positive impact only on outflows to destinations other than placements by the PES. Lubyova and Van Ours also report results for the polar case – which occurred in the autumn of 1995 – when the duration of benefits was increased for the oldest unemployed workers (currently it is only for those with longer contribution records). They found that outflows to destinations other than employment declined as a result of the policy change, while it was not possible to detect a significant change in the probability of finding a job.

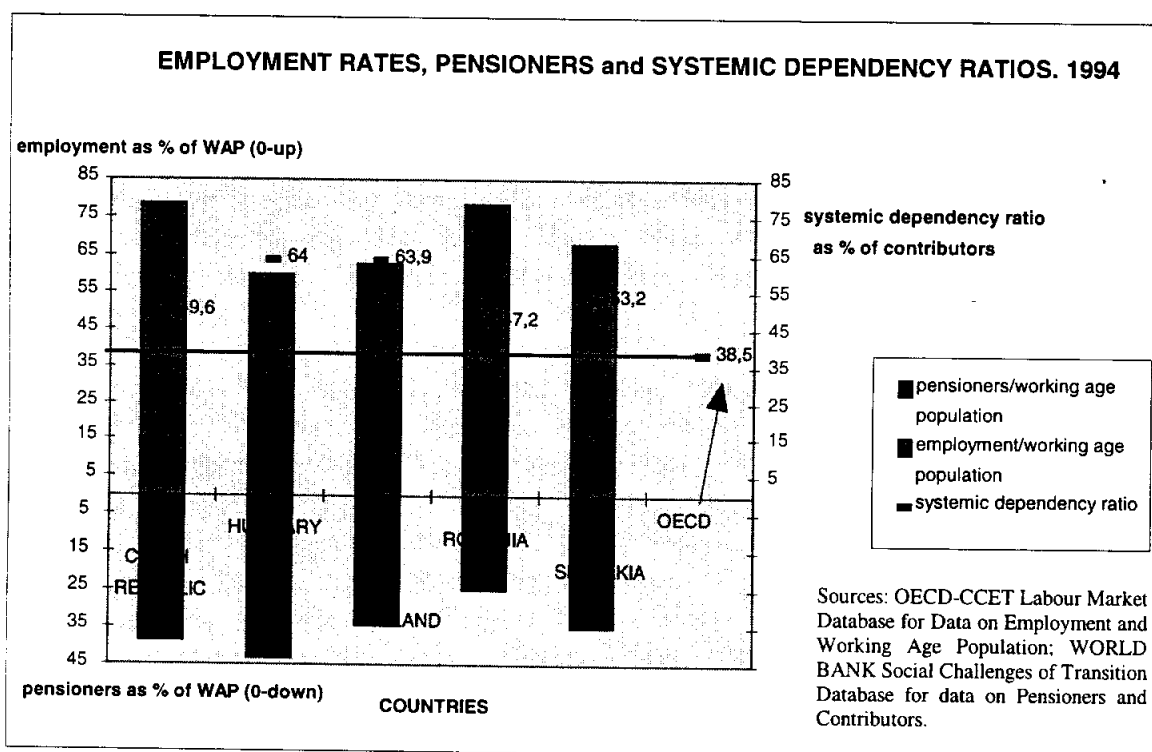
The fact that the tightening of unemployment benefits has been associated with large flows from unemployment insurance to social assistance may be partly responsible for the loosening of links between the unemployed and the world-of-work. Receipt of social assistance is conditional to passing a means test and hence has particularly adverse incentive effects. As in OECD countries, no-earner households and unemployed in households with numerous children are likely to fall into unemployment and poverty traps as a result of the shift to social assistance. Moreover, social assistance benefits are typically of unlimited duration and the PES administration has little, if any, incentive to enforce work-tests for able-bodied individuals in receipt of income transfers of the last resort. Social assistance is, indeed, generally paid out of general government revenues with an often significant involvement of local administration budgets. It follows that the shift from unemployment insurance to social assistance actually reduces the burden on the extra-budgetary funds financing unemployment benefits, active policies and the PES administration.

Unfortunately LFS data do not provide information on the change of benefit status of the unemployed and the administrative records of the PES censor all those who cease reporting to labour offices after benefit exhaustion. This rules out the possibility of evaluating econometrically the implications of the shift from unemployment benefits to social assistance on exit from unemployment. Some follow-up surveys of “exhaustees” have, however, been carried out in the Czech and Slovak Republics and in Hungary. The Czech and Slovak surveys (OECD, 1995 and 1996; Terrel, Lubyova and Strapec, 1996) point to very low exit rates from unemployment to jobs of exhaustees who are in receipt of social assistance. Significantly, semi-parametric estimates of hazards to employment show that exhaustees with an unemployed spouse are less likely to find a job, which may

be a byproduct of the traps associated with means-testing. Similarly, in Poland higher hazards from unemployment to jobs are detected -- after controlling for individuals' characteristics -- for unemployed in households with a working spouse (Lehmann and Wadsworth, 1996). The Hungarian surveys (Lazar and Szekely, 1994; Micklewright and Nagy, 1996b) do not point to stronger effects of household characteristics in outflows to jobs after the shift from unemployment insurance to social assistance. This may have to do with the fact that the means-tested unemployment assistance scheme in Hungary does not top-up family's income, but only that of the unemployed. Moreover, local administrations maintain fundamental discretion in deciding upon eligibility for general social assistance and benefit levels, and there is little redistribution of resources across local authorities. Micklewright and Nagy (1996b) report a significant negative effect of the regional unemployment rate on the probability of receiving social assistance after unemployment benefit exhaustion, which may indeed be an indication of particularly difficult access to social assistance in high-unemployment districts. Low benefit amounts for large families and uncertainty as to its duration may indeed reduce the disincentive effects typically associated with means-tested benefits (but also their adequacy).

Cuts in unemployment benefits also put considerable pressure on disability pensions and early retirement. In spite of better demographic conditions than the OECD average, central and eastern European countries are reaching higher *systemic* dependency ratios (the ratio of pensioners to contributors) than in the OECD area (Figure 2).

Figure 2



All in all, aggregate and microeconomic evidence produced so far of the consequences of the 1992 policy change does not point to significant effects of cuts in unemployment benefit generosity on flows from unemployment to employment in all countries except the Czech Republic, while it does suggest that the tightening of benefits may have stimulated larger flows from unemployment to non-participation. A possible interpretation for the limited effects of the tightening of benefits on re-employment probabilities is that stronger search intensity and lower reservation wages of the unemployed can do little under conditions like those prevailing in the transitional recession, where there is an aggregate lack of vacancies. Moreover, reductions in benefits, although sizeable, may be insufficient to boost outflows to jobs when the new private employers have little information as to the actual skills of workers and use the labour market status of job applicants (i.e. the fact that they come directly from state enterprises rather than from the unemployment ranks) as a screening device (Boeri, 1997). Finally, low labour supply elasticities could explain the little, if any, effect of the tightening of benefits on outflow to jobs rates. However, up to two thirds of the unemployed in these countries are women and/or persons aged less than 25, that is to say the two components of the working-age population the supply of which is typically more elastic.

Re-employment probabilities will likely increase with improvements in macroeconomic conditions and there are indications that in Poland this has already been happening in recent years (Figure 1). However, unemployment reductions associated with the recovery from the transitional recession are not that marked, pointing to a significant degree of persistence of unemployment in these countries. For example, Polish real GDP has been growing at a pace of more than 5 per cent per year since 1993, whilst unemployment declined by less than 1.5 percentage points over the whole period. There is a large stock of long-term unemployment, which will be difficult to absorb.

Disincentive effects consequent to having a large number of able-bodied individuals under social assistance schemes and other open-ended cash benefits may become more and more important as inflation slows down. The partial indexation of benefits under the pressure of galloping inflation may, indeed, have been a factor reducing disincentive effects (let alone the adequacy of benefits) associated with the receipt of benefits in these countries. The extent to which strong and continuous growth may lead to a fall in unemployment will very much depend on how the wage structure evolves over time, and where new employment opportunities will be located. The incidence of low pay -- whether measured in absolute or in relative terms -- has significantly increased in all countries reaching up to one-fifth of all workers, as the bottom decile group has experienced the sharpest falls in real wages under the transitional recession (Rutkowski, 1996a). Most new jobs being created are fixed-term engagements and tend to be low-paid especially for the unskilled, who are often paid more in the state sector than in private firms (Rutkowski, 1996b). Unless adequate incentives are provided to encourage social assistance recipients to take up short-term and possibly part-time jobs -- e.g. by making sure that the means test formula does not remove assistance on a dollar-for-dollar

basis in case of re-employment – there are high risks that recovery may leave aside a significant hard-core group of long-term unemployed.

Finally, means-testing may produce significant changes over time in the distribution of unemployment across households. So far the distribution of unemployment by household type in these countries has somewhat reduced the social costs of labour shedding associated with reforms. In particular, given the high incidence of youth unemployment, the unemployed are often not among the breadwinners and in most countries the case of no-earner households is rather limited (Förster, 1996). The increasing importance of means-testing may induce a stronger take-up of jobs on the part of the younger generation and reduce incentives for the unemployed in no-earner households and households with numerous children, as seems to be happening in countries like the UK (Gregg and Wadsworth, 1996).

IV. WHICH LESSONS THEN?

Learning lessons from labour market policies in Europe mainly means identifying policy design mistakes and implementation failures. Also in the case of transitional economies, most lessons are negative. They can be used as a warning of what should *not* be done rather than as blueprints for other countries.

The first lesson that can be learned from the natural experiments that have taken place in these countries since the beginning of the decade is that it is not wise to reduce the duration of unemployment benefits when the length of unemployment spells are on the rise, unless there are income support schemes of the last resort in place and an administration capable of cost-effectively enforcing work-tests for those falling off unemployment benefit compensation rolls. Short-duration benefits and long-duration unemployment inevitably increase pressures on other cash transfer mechanisms which are not properly designed to promote the reintegration of the unemployed in the world-of-work. If a last resort income support programme is not in place, public authorities may be obliged, sooner or later, to create “bridging” schemes between unemployment benefits and pensions, grant early retirements or broaden eligibility to various kind of disabilities. Needless to say, all such schemes are much more costly for public finance than social assistance and (even if of longer duration) unemployment benefits. When the social assistance administration is weak and its necessarily decentralised benefits provision is not adequately fed by the redistribution of resources across local administrations, public authorities may also be forced, as in Bulgaria, to introduce extensions of unemployment benefits to “exhaustees” passing a means test. This is highly inefficient, insofar as it duplicates administrative efforts in means-testing – which is carried out by both the PES and the network of social welfare centres – and ultimately changes the clientele of the labour market administration, who find themselves no longer dealing with individuals seeking a job, but with households looking for income support. Needless to say, the PES is generally ill-equipped for this task.

The second negative lesson to be learned from the experience of countries in transition is that careful consideration should be given to expanding the scope of training and re-training schemes for unemployed adults in cases where there is an overall lack of vacancies and no network of training providers (healthily competing with each other). Moreover, rapid structural change exacerbates moral hazard and the adverse selection problems typically associated with the provision of training. Under these conditions, resources allocated to PES-sponsored training may result in their gross wastage. This risk can be minimised by reaching agreements with employers who promise to hire the trainees prior to the start of courses, as happens frequently in the Czech Republic, helping, moreover, to keep the training budget within fairly modest proportions. The definition of a broader-based training curricula, developing flexible and widely marketable skills rather than promoting overly specific human capital, can also improve the chance of beneficiaries of finding a new job and prevent the benefits of training from not being fully internalised by the employer who hires the trainee.

But not all the lessons coming from central and eastern Europe are negative. There are three main positive indications that can be drawn from the transitional experiments reviewed in the first section.

To begin with, it is possible to transform institutions and create an efficient policy delivery mechanism within a short time span. A standard argument against the reform of social welfare systems in OECD countries is the lack of an administration capable of properly targeting the programmes and monitoring the clientele. Transitional economies certainly benefited from the climate of radical transformation and enthusiasm prevailing after the fall of the Berlin wall, but had to start without a tradition, and hence qualified staff, for income support and job brokering for the unemployed. Central and eastern European countries also chose for the most part a tripartite structure for the PES. Tripartism may have some advantages (mainly in terms of revenue collection), but certainly not that of facilitating quick decisions and rapid administrative change. Finally, these countries did not have a network of private service providers (e.g. private placement agencies) who could compete with the infant public administration, stimulating improvements in the quality of the services delivered. In spite of these obstacles, some countries – like the Czech and Slovak Republics – achieved remarkable success with their institution-building process and others (Hungary and Poland) made considerable progress, especially when compared with the lengthiness of these processes in OECD countries. Generally speaking, central and eastern Europe tell us that some widespread fatalistic attitudes towards the reform of public administrations are far from justified.

The second positive lesson is that the tightening of unemployment benefit systems is most successful in promoting flows from unemployment to jobs when is assisted by the wide-scale implementation of active labour market policy programmes. Large inflows into active programmes can partly substitute for a lack of vacancies and can, at least temporarily, boost outflows to jobs even during economic downturns. The “Czech miracle” story is enlightening in this respect. The simultaneous enforcement of

unemployment benefit cuts and the strong boost in the offer of subsidised employment schemes made the two measures self-reinforcing. Reductions in the length of entitlement stimulated a greater take-up of subsidised jobs, while active labour market programme involvement enhanced the effectiveness of job search also for those with more difficult re-employment prospects. Although much work still remains to be done in evaluating the effects of the so-called “Socially-Purposeful Jobs” (SPJ) and “Publicly Useful Jobs” (PUJ) and in weighing up the costs and benefits of these programmes, an overall lesson taught by the Czech experience is that there are relevant interactions between active and passive policies which should be duly exploited by policy-makers. This is important, as the two spheres – passive and active labour market programmes – are often addressed separately in OECD countries and sometimes managed by different administrations.

A corollary of the previous lesson is that when unemployment is high and there is a lack of vacancies, cutting unemployment benefits cannot be expected to boost outflows to jobs. Reforms were made in the Czech Republic when unemployment was still below 5 per cent, and hence slots in active programmes could be offered to more than 75 per cent of the unemployed (actually inflows into active programmes in 1992 exceeded the number of registered unemployed at the beginning of the year). The same reform was carried out in Slovakia, which was endowed with a likewise rather effective labour market administration and had at its disposal non-negligible resources for active programmes, channelled via the federal budget. However, owing to high unemployment, it was clearly impossible to reach proportions in the coverage of active programmes comparable to those attained in the Czech lands. This may seem to be a rather trivial lesson insofar as it states that, after all, unemployment can be successfully reabsorbed in employment when there is less need for it. But even in high-unemployment countries the Czech experience can be valuable, if adopted at the local level, e.g., in regions where unemployment is still rather low, but likely to rapidly increase in the future (e.g. because of planned mass redundancies). There is considerable scope in these cases for preventive, early warning strategies that combine short benefit duration with strong activism on the part of the PES, possibly before long-lasting entitlements are created.

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