INSTITUTIONAL CHANGES IN THE ECONOMIES OF CENTRAL AND EASTERN EUROPEAN COUNTRIES AND THE SITUATION OF THE LABOUR MARKET

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Abstract. *The object of the article is to assess the influence of economic and political institutions on the situation of the labour market in Central and Eastern European countries. In the initial phase of transformation, the debate in these countries focused on economic stabilization. In recent years, the focus shifted towards institutional solutions of economic processes, including the situation of the labour market.*

The emphasis is put on the particularities of the countries undergoing transformation, in which profound changes in economic and political institutions are taking place due to the implementation of economic reforms, on the one hand, and the democratization process, on the other hand. Undoubtedly, the process of institutional change was occurring at varying pace in Central and Eastern European Countries as a result of various problems of respective labour markets.

The analysis, based upon the data from 1995 to 2006, shows that the institutional structure has a great impact on the labour market. The existence of efficient and well-managed institutions help to reduce distortions in the allocation of the labour force as well as creating demand for labour.

Keywords: *labour market; labour market institutions; transformation; unemployment.*

Preliminary observations

The formation of a functional state institution is one of the main objectives of the transformation of the system in Eastern and Central European countries. This process, however, is not easy, as it involves dismantling of economic and social structures inherited from a previous regime. Also, it requires the creation of a new set of values that would be acceptable for public. It is worth underlining, that at the turn of the 80s and 90s, those countries faced a number of difficult challenges. At the same time they tried to create market economies with social aspects as well as democratic rule. Initially, it was thought, that with a number of actions taken the transformation towards democracy would be relatively fast. However, the course of system transformation in these countries turned out to be not very easy. For this to be successful, time is needed for the adoption of adequate institutional solutions.

In Central and Eastern Europe the institutional reform found its own reflection in the economic sphere, especially in the quantity and quality of market institutions. Apart from the State's influence on the free market, we could notice a strong correlation between these categories. Judging by that, we can observe the existence of a mutual interaction in this regard, which subsequently, served as evidence of multiple correlations in the process of forming a new institutional order.

Labour market instability, as shown by relatively high unemployment rates, is one of the most pressing issues of Central and Eastern European markets. Among many determinants of such situation is the institutional environment of the labour market. Therefore, the question arises whether labour market institutions affect upon the situation in the labour market. I will try to answer this question in the analysis of the relation between the levels of the minimum wage and the escalation of the unemployment rate in the countries in question.

In the paper I have stated two hypotheses:

1) Labour market institutions influenced on the situation in the labour markets in Central and Eastern European Countries;
2) Minimum wage is one of the main determinants of the unemployment rate in Central and Eastern European Countries.

Institutional aspects in the economy

The institutions of Central and Eastern European countries are faced with new geopolitical conditions; at the same time, they are undergoing the effects of three major macroeconomic processes: transformation, globalization and total integration to the EU together with an access to Euro zone. These countries are dealing with many problems, mainly political and economic. Having said that, other aspects such as cultural, tradition or national identity issues should not be overlooked either.

First of all, a country must be ensured to function in conditions of strong multi-aspect differentiation, and especially in the environment of massive financial inequalities (Adamczyk A., Włodarczyk R.W., 2005). The main line of division between people runs between the rich, who rapidly multiply their fortune, and the poor, who account for over 80 per cent of the world population. According to Arend Lijphart (1993), it is possible for democracy to exist in a divided society provided a country ensures the possibility of cooperation between representatives of all significant social groups. Lijphart believes that it is of great importance for a country to take action so as to form bonds between these groups, rather than allowing the existing situation to develop.

Another major problem that a country encounters is the process of progressive devaluation of the notion of national state, as a consequence of stronger international corporations and capital owners, whose only aim is the optimization of economic indicators and the maximization of profit. The objectives of corporations are often in line with the country's priorities, so the latter, in order not to lose a potential source of capital, will agree to far reaching concessions. As a result, when a country as an institution assumes a weaker role, it has a negative influence on the character and possibilities of its effective function, and therefore undermines the effectiveness of social and economic policy. In some cases, however, countries themselves purposely allow huge global corporations to develop, which in turn, having certain attributes can effectively affect on or weaken the position of other countries. A statement made by Australian philosopher and ethicist Peter Singer (2002, p. 233), that the USA as a country applies a brutal ethic, as they use their own power and influence in the world in order to satisfy the interests of their international corporations, confirms that. Dialogue and compromise between countries are a hope for the general public. However, for this to happen, an adequate maturity and country's responsibility should be present. A country must be decisive as well as capable of making 'controllable' concessions and negotiations in the light of contemporary problems. A number of unions and consultative committees should serve this purpose, which, according to organizer's views, should make propositions to bring solutions to the most difficult issues. We should not omit alternative opinions about the positive influence of globalization and international corporations on the effectiveness of the state. However, there are doubts in relation to the countries undergoing the process of transformation.

The third fundamental problem is then searching for an optimal institutional set up in the new socio-economic environment. The driving force that leads to such changes is the sheer pace of the globalization process in Central and Eastern European countries, as well as the transformation and integration to the EU. As a result, the whole perception and the role of the state as such have changed in a radical way. In these conditions, countries are like players, which compete fiercely for potential consumers markets, factors of production, political influence or international prestige (Duś E., pp. 94). In order to get into a team of winners, countries must take the issue of their national identity seriously and care for their competitiveness and image on the world arena. The efficiency of a country and the level of micro institution coherence are not meaningless in this regard, as they form the groundwork for the national institution. The nineties and the beginning of the new century were characterized by dynamic development in market economy and international relations in Eastern and Central Europe, mainly due to the relentless pursuit of political and economic power, the expansion of their spheres of influence, as well as the improvement of their image on the international stage. At national and even international level, a number of formal and informal mediation and pressure groups are forming, which aim at putting pressure on their partners or competitors.

One of the most fiercely debated issues among economists at the moment is the level of institutional development of the economic market system. This issue has been the focus of discussions in the last few years thanks to, among other things, new phenomena in terms of many macroeconomic categories, which were not found in up to date formed models and theories. Furthermore, a considerable change in attitude to this matter by the most important international organizations, such as: The World Bank or IMF (International Monetary Fund), had a substantial influence. In his article, Grzegorz W. Kołodko (2005) stresses that studying economic literature from world studies and that of the most important international organizations, we would notice a striking difference between the lack of institutional issues in previous studies (from the beginning of 90's), and the frequent reference to them at present. It means, then, that the importance of institutional environment was underlined in contemporary economic and political conditions.

In order to function in a market environment, a country requires a change in its institutional set up, not only to adopt a different model of management, but also, due to other purposes, which are expected by the general public, the necessity to inspire and monitor the institutions of the economic market system. New system conditions development around the market, which is an important institutional system by itself, where the so called "invisible hand of market." is the main regulatory mechanism. It was in agreement with the proposals for supporting liberalization in the economy, which were put forward by the advocates of the free market, both in theory and practice. Their essence is a definite reduction of public and administrative elements in the management process (Wojciechowski E., 1998). Leszek Balcerowicz (1997, pp. 101–144) presents a similar view, claiming that private companies demonstrate more ability to boost up efficiency, rather than other types of companies. He points out that the owner's character is an important and independent factor which determines how well a company fulfills its objectives. Further on, he sustains that the state has specific characteristics that make it a bad owner. However, the theory of infallibility of the market was coming up against harsh criticism due to a number of shortcomings. According to Paul A. Samuelson and William D. Nordhaus (1989, p. 47) those were: inefficiency, which is manifested by monopolistic tendencies, external effects or the necessity to provide public services; inequality in terms of income redistribution; instability in terms of fundamental macroeconomic aggregates, such as inflation, unemployment or economic growth. It is worth mentioning here Herbert A. Simon's views (1991), who claimed that there is no convincing theoretical argument to support the theory that big private organizations can solve motivational problems better than public organizations.

Further on, Simon argues that both public and private sectors have to face dilemmas in terms of information and incentives. A similar view is put forward by David Sappington and Joseph E. Stiglitz (1987, pp. 3-43), who state that conditions which give private property an advantage over public ownership are very limited and similar to conditions that assure that competitive markets will make companies efficient in Pareto's sense. We might argue with Fukuyama's view (2005), who believes in a system in which there is an optimal correlation between minimal state intervention and high institutional effectiveness. In my opinion such a view seems to be true in a classical or neoclassical economic perspective or a typically liberal approach whereby, in order to reach optimal function, state intervention has to be reduced to the bare minimum. Keynes' approach highlights the necessity of state intervention in the economy so as to help it function more efficiently. Therefore, restricting the role of the state increases institutional inefficiency, which, in turn, leads to the inefficiency in the whole economy. An entirely distinct controversial issue is the effectiveness of state intervention in the economy. Stiglitz (2004, pp. 10-12) warns that, in this case, there are four main causes of a failure to achieve targets: limited information available (information asymmetry); limited control over the function of private markets; limited control over bureaucracy; political restrictions. In spite of that, Stiglitz (pp. 7-10) is in favour of state intervention in the economy to correct the failings of the market .According to Andrzej Wojtyna (2001), there were at least three major factors that, at that time, restricted the scope and role of the state in the economy: the financial crisis in South East Asia; the debate in Europe over the so-called third way, together with the growing popularity of populist left-wing government, as was the case in Poland; the emergence of Anglo-Saxon style capitalism. The necessity to step up the importance of the state in the process of management results from that. The agnostic attitude of free market supporters to the positive role of the state in the economy is contradicted by the necessity to improve the quality of programs and projects that are introduced, with the meaningful role of efficient and mature institutions.

It is worth mentioning that the escalation of many economic problems in the period of transformation, for example income inequalities or a rise in unemployment, did not occur solely as a result of the weakening of the national institution in the political sphere, or due to too slow dynamics of its evolution, but as a result of institutional deformations in the economic system (Adamczyk A., Włodarczyk R.W., 2005). It is probably partly true that market institutions of the economic system were founded as a consequence of making or postponing certain decisions by political institutions. In many fields of the economy, institutions were established, but the mentality of the people managing them, having an influence on them or shaping their function through their behaviour, was not adapted to the new market environment. According to Kołodko's (2005), mentalities and market culture were not developed and that played a major part in the function of the newly formed institutions in the new economic environment.

The pace of institutional changes in the transforming economy was a source of debate. Most economists who studied the processes of transformation from the socialist economy to the market economy agreed to/with the necessity of carrying out institutional reforms at the very beginning of the transition. According to Jerzy Wilkin (1995), the main changes required are a new legal framework to regulate the main aspects of the economy, the establishment of institutions necessary to the market economy, and a new definition of role of the state in the economy. Jeffrey Sachs (1990), Janos Kornai (1991), Christopher Clague (1992) or Leszek Balcerowicz (1992) were of the same opinion. Also, international organizations, such as The World Bank (see Gelb A. H., Gray C. W., 1991), had similar views and stressed the necessity of a radical institutional conversion through privatization, dismantling of monopolies, restructurization, the formation of institutions on the labour market, the capital market, the banking system, and a reform of the property law. Adam Lipowski (2001) says that the rapid and pragmatic choice of an institutional way to reform institutions in Central and Eastern European countries helped the privatization of public sector conglomerates across the board, which saved them from general bankruptcy; it also contributed to the establishment of the stock exchange market, not by the private sector, but by the state. The state also had a role in restructuring mining, steel industries and other heavy industries. However, in many sectors of the economy, such as the labour market, the institutional solutions are still very conservative or are inexistent. The rapid pace of transformation caused problems, which resulted in the emergence of immature institutions in this regard. Due to a lack of mechanisms of control and regulation, labour market institutions were unable to manage the new socio-economic system as a whole and insure the coherence of dynamic changes. This caused heavy criticism.

Some economists highlighted the importance of a careful study of the institutional basis for the new system before embarking on the path of major economic reform, especially as far as reforming property laws is concerned. (Wilkin, 1995, p. 92). It is worth underlining that this last point, as Wilkin (1995, p. 92), was vastly underestimated by policy makers and reformers in the countries undergoing transition. But, we should prove how important the issue of respect of the law and social acceptance is for complex changes to be effective. According to Peter Murell (1992, p. 51) and Mancur Olson (1992, pp. 58-59), institutions in well-developed economic systems, though often regarded as insufficient, are not a symbol of the underdevelopment of the political system, but rather are an indicator of progress and democracy. Despite that, governments of developed countries are always searching for the optimal institutional structure. The analysis carried out by Murell and Olson reflects well how important institutional aspects are for governments in order to achieve macroeconomic stability and microeconomic efficiency. As far as transforming countries are concerned, they almost warn that the socialist institutions should only be dismantled when proper market institutions exist. They claim that we cannot accept a so-called "institutional vacuum", as it can lead to extensive disorder and incoherence, and also dynamic ineffeciency. Based on that, we may assume that institutions are necessary not only for the proper function of the market economy, but also that the transition itself from the socialist system to market economy requires them to be efficient and adequately developed as they will enable the market to function effectively but also blaze the optimal trail for the transformation process (Adamczyk A., Włodarczyk R.W., 2005). As Kołodko (2005) underlines, institutions "organize, steer and shape economic processes so that they could occur smoothly, with respect for all partners' interests of the social process of reproduction."

The issue of the impact of the state on the shape of the institutional environment in the economic sphere actually comes down to the evaluation of the level of the development of institutions on the labour market, financial institutions, the budget, as we assess the role of the institutional environment for the economic growth. We cannot forget what influence the institutions of the system of market economy have on the state. Although the state affects the level of market institutions and their development pace, the components of the state have to function within the framework of the market institutions rules and principles.

New phenomena that appeared on the labour markets in many countries prompted economists to look at the issue of the institutional environment. In many studies carried out on this subject, a complete set of institutional factors was taken into consideration. Tito Boeri and Katherine Terell (2002) enumerate trade unions, income policy based on taxes, minimum wages, employment protection and unemployment benefits; however, they stress that, among countries in transition significant differences were noted. In their opinion, the last factor had the strongest impact. It caused numerous deformations on the labour market in the form of an increase in long-term unemployment and a decrease in the economic activity of the society. It was due partly to the lack of mature institutional solutions in Poland. However, Michelle Riboud, Carolina Sanchez-Paramo and Carlos Silva-Jauregui (2002) think that, having partly copied the labour market institutions from Western to Eastern Europe does not give the effects that should be expected, as Eastern and central European countries are put behind by changes in macroeconomic policy, structural and system reforms. Also, they believe that as changes intensify in those countries, the labour market institutions will play a bigger role. O. Blanchard and J. Wolfers (1999), however, searching for the causes of the increase in unemployment in Europe over the last 40 years, concluded that institutions influence the level of unemployment, but only in indirect manner. Shocks in the economy are a direct factor in the unemployment issue. The same shocks have a larger and more permanent impact in countries which have less developed labour market institutions. Based on the study, carried out by R. Jackman and others (1991), S. Scarpetta (1996, pp. 43–98), S.J. Nickell (1997) and J. Elmeskov and others (1998), it can be stated that differences in unemployment rates between these countries can be explained by differences in labour market institutions. This is particularly visible in the period since the beginning of 80s. It will be harder and more difficult to confirm that in previous periods. It is, therefore, a certain proof of the importance of adequate institutional solutions in the fight against unemployment in recent years. The emergence of an adverse situation in labour markets in Central and Eastern European countries may be caused by a certain lack of maturity in the institutional environment. However, we must also take into account other important elements such as: very complex problems inherited from the past, lack of visibility of this market and low mobility.

Minimum wage in relation to the level of unemployment in Central and Eastern European countries

Empirical study

The main purpose of the empirical part of this study is to show fundamental changes and tendencies in terms of one of the most important institutions of the labour market: the level of minimum wage. In this analysis, ten countries of Central and Eastern Europe were compared: Bulgaria, The Czech Republic, Estonia, Lithuania, Latvia, Poland, Romania, Slovakia, Slovenia and Hungary. Variations in the minimum wage were shown in relation to the level of the unemployment rate, whereby the analysis was carried out assuming that we will convert the minimum wage from national currency to EURO according to the purchasing power parity (PPP) and the exchange rate. In order to analyze the above issue, standardized data in terms of minimum wage in EURO according to the purchasing power parity (PPP) and the exchange rate, and also unemployment rates were taken from EUROSTAT bases.

Empirical results

The data in terms of minimum wage in EURO according to the purchasing power parity (PPP) and the exchange rate, for the ten countries, is presented in tables 1 and 2, and changes in the unemployment rate between 2001–2007 in table 3.

Among Central and Eastern European countries, big differences in the level of minimum wage both according to the purchasing power parity (PPP), and also according to the exchange rate, are visible. The highest level of minimum wage according to the purchasing power parity (PPP) amounts to 679,1 EURO in 2006 in Slovenia, whereas the lowest level in the same period of time, was noted in Romania – 164,3 EURO (table 1). This difference was quite significant, as the wage was over four times higher in Slovenia than in Romania.

Even higher was the difference in terms of minimum wage according to the exchange rate. The lowest level was noted in Bulgaria in 2006, – 92 Euros, while the highest level was noted in Slovenia – 521.8 Euros (table 2). Taking into consideration the purchasing power, all these countries raised the level of minimum wage between 2001 and 2006, but this level was considerably different. The strongest increase in the wage was observed in Bulgaria (by 61.8%) and in Estonia (by 51.5%), whereas the weakest increase was observed in Slovakia (by 8.7%) and in Hungary (by 8.9%) (table 1). However, if we take into account changes of the minimum wage according to the purchasing power parity (PPP), we will note the strongest increase in Romania between 2001 and 2007 (by 124%) and in Bulgaria (by 109.1%), and the weakest in Poland (by 9.7%) and in Slovenia (by 16%) (table 2).

The relations between the level of minimum wage and the unemployment rate in Central and Eastern European countries that have been analyzed, are presented in chart 1 (the minimum wage according to the purchasing power parity (PPP) between 2001 and 2006), and chart 2 (the minimum wage according to the exchange rate between 2001 and 2007). They show strong relation between the macroeconomic aggregates under study and allow us to evaluate the strength of interaction between them.

Table 1. ***The level of minimum wage in EURO according to the purchasing power parity (PPP) in Central and Eastern European countries, between 2001 and 2006***

Country	Years						Change between 2001 and 2006 (in %)
	2001	2002	2003	2004	2005	2006	
Bulgaria	112,9	123,3	132,4	142,9	177,4	182,7	61.8
Czech Republic	–	338,1	350,8	381,9	417,7	456,6	35.0
Estonia	–	190,4	218,6	252,0	268,0	288,5	51.5
Lithuania	226,4	227,6	226,9	265,4	291,5	307,1	35.6
Latvia	184,2	179,4	197,1	213,4	202,5	213,4	15.9
Poland	329,0	331,4	340,8	347,3	354,2	371,6	12.9
Romania	–	135,9	160,4	159,9	161,3	164,3	20.9
Slovakia	–	292,5	266,1	276,8	292,4	317,9	8.7
Slovenia	529,2	595,6	569,0	615,1	642,4	679,1	28.3
Hungary	–	361,8	334,1	340,1	361,2	394,1	8.9

Source: own study.

Table 2. ***The level of minimum wage in EURO according to the exchange rate in Central and Eastern European countries, between 2001 and 2007***

Country	Years							Change between 2001 and 2007 (in %)
	2001	2002	2003	2004	2005	2006	2007	
Bulgaria	44	51	56	61	77	81,8	92	109.1
Czech Republic	–	188	197	212	239	280,2	280,3	49.1
Estonia	–	118	138	159	172	191,7	230,1	95.0
Lithuania	126	125	125	145	159	173,8	202,7	60.9
Latvia	111	103	107	122	114,9	129,3	172,3	55.2
Poland	224	197	180	180	207	223,3	245,8	9.7
Romania	–	54	66	69	86	93	121	124.1
Slovakia	–	126	134	152	169	181,3	223,5	77.4
Slovenia	–	450	444	466	491	511,6	521,8	16.0
Hungary	–	206	191	209	229	229,5	261,7	27.0

Source: own study.

Table 3. ***The unemployment rate in Central and Eastern European countries, between 2001 and 2007***

Country	Years							Change between 2001 and 2007 (in percentage points)
	2001	2002	2003	2004	2005	2006	2007	
Bulgaria	19.5	18.1	13.7	12	10.1	9	6.9	-12.6
Czech Republic	8	7.3	7.8	8.3	7.9	7.1	5.3	-2.7
Estonia	12.4	10.3	10	9.7	7.9	5.9	4.7	-7.7
Lithuania	16.5	13.5	12.4	11.4	8.3	5.6	4.3	-12.2
Latvia	12.9	12.2	10.5	10.4	8.9	6.8	6	-6.9
Poland	18.2	19.9	19.6	19	17.7	13.8	9.6	-8.6
Romania	6.6	8.4	7	8.1	7.2	7.3	6.4	-0.2
Slovakia	19.3	18.7	17.6	18.2	16.3	13.4	11.1	-8.2
Slovenia	6.2	6.3	6.7	6.3	6.5	6	4.8	-1.4
Hungary	5.7	5.8	5.9	6.1	7.2	7.5	7.4	1.7

Source: own study.

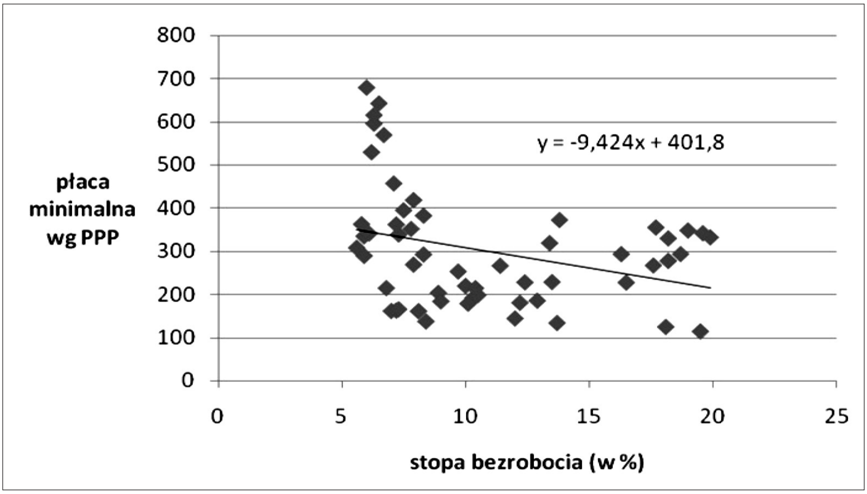

Chart 1. ***The level of the minimum wage in EURO according to the purchasing power parity (PPP) and the unemployment rate in Central and Eastern European countries, between 2001 and 2006***

Source: own study.

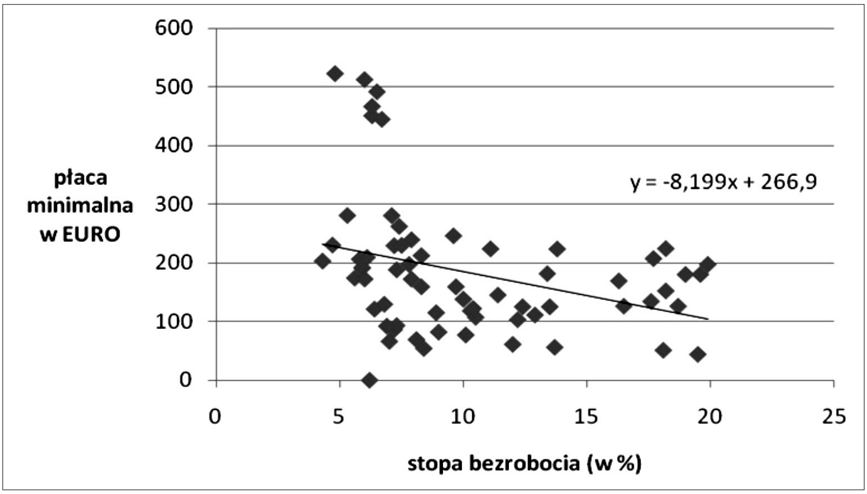

Chart 2. ***The level of minimum wage in EURO according to the exchange rate, and the unemployment rate in Central and Eastern European countries between 2001 and 2007***

Source: own study.

Conclusions

The analyses that were carried out in this study help to draw a few final conclusions. Firstly, the institutional environment shows a definite influence on the labour market situation, as proven by the correlation between the minimum wage and the unemployment rate in Central and Eastern European countries.

Secondly, in Central and Eastern European countries, there is a negative relation between unemployment rates and the level of the minimum wage. In other words, when the unemployment rate decreases, there is an increase in the lowest levels of remuneration for work in the economy both in terms of relative value of these wages according to the purchasing power parity (PPP) and the exchange rate. It confirms an impact of a higher (lower) unemployment rate on a decrease (increase) in the level of the minimum wage.

Third, a stronger relation between the level of unemployment and the level of the minimum wage was noted in case of the minimum wage according to the purchasing power parity (PPP) than the minimum wage according to the exchange rate.

Last, the lack of development in institutions is one of the main causes of adverse conditions such as income inequalities, unfair redistribution or labour exploitation. It is manifested by a lack of social consciousness of managers to play the role of institutional machine to address those adverse conditions. The modification of institutional environment is worth underlining during the period of changes in political, social and economic conditions. It means, therefore, that a static model in this regard is not acceptable.

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