EMPLOYMENT OBSERVATORY

Central & Eastern Europe

Employment Trends and Developments

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European Commission

Directorate-General for Employment, Industrial Relations and Social Affairs

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Employment developments in Central and Eastern Europe

The improvement in the economic situation in Central and Eastern Europe, of which there were tentative signs in 1993, became much more evident and more widespread in 1994, especially as the year progressed. All 7 countries covered by this Bulletin experienced an increase in GDP during the year, in most cases for the first time since the process of transition got underway, and all, except Albania, an even larger rise in industrial production. In all countries, apart from Slovakia and the Czech Republic, where there was little change, unemployment was lower at the end of 1994 than at the beginning. Nevertheless, employment went up in only three countries - Albania, the Czech Republic and Poland - and elsewhere, falling unemployment was associated more with declining rates of labour force participation than higher rates of job creation. In addition, the problem of long-term unemployment continued to increase in importance. In all countries, the proportion who had been out of work for a year or more was higher at the end of 1994 than a year earlier. Unlike in earlier years, however, there were more countries where real wages went up than where they went down.

At the same time, despite the generally more favourable conditions and the greater optimism about prospects in the near future, there were continuing signs of underlying problems which could slow down or even halt the recovery which is now undoubtedly underway in all countries. In two of the countries, Albania and Bulgaria, the average rate of inflation was higher in 1994 than in 1993, in the latter considerably so, and in both cases reached 3 digits, while in two other countries, Hungary and Poland, inflation was higher at the end of the year than at the beginning, and in both cases remained stubbornly above 20%.

Moreover, three of the countries, Albania, Hungary and Poland, continued to experience serious balance of payments problems, while Romania, which has been in almost continuous deficit on trade since the transition began, still had a sizeable deficit in 1994, despite a significant improvement in trade performance as compared with the year before. On the other hand, Bulgaria, which started the transition period with large foreign debts and has accumulated more since, had a trade surplus in 1994 for the first time for many years, which was also true of Slovakia.

Output

For the first time since the process of political and economic reform began in Central and Eastern Europe, all countries experienced a growth in GDP. This is estimated to have been as high as $7^1/_2$% in Albania (though it is hard to judge how comparable the national accounts estimates there are with the others in the region), which is in fact lower than in 1993, when it reached 11%. In both Poland and Slovakia, growth was around 5%, which in the latter represents a sharp improvement over the performance a year earlier when GDP fell by 4%. In Poland, it represents the third year of GDP growth, and encouragingly, the highest rate attained during the transition period.

In Romania, while growth in 1994 was slightly lower at $3^1/_2$%, it, nevertheless, followed an increase of just under $1^1/_2$% in 1993. Similarly in the three other countries, though growth was relatively modest - $2^1/_2$% in the Czech Republic, 2% in Hungary and $1^1/_2$% in Bulgaria - it represented in each case a significant improvement over previous years.

The indications are that the recovery is strengthening in all countries except Albania. Where quarterly GDP figures are available, these show higher growth in the second half of 1994 than in the first half, a tendency confirmed elsewhere by the figures for industrial output, described below (Graph 1). Moreover, recovery seems to be underpinned by growth of investment and, to some extent of net exports, rather than simply of consumption in many of the countries. In Hungary, for example, fixed investment was 10% higher in real terms in 1994 than in 1993 (and by even more in the public sector), while in Poland it was up by 6% and in the Czech Republic by $4^1/_2$%. In Romania also, investment went up significantly during the year (by $15^1/_2$%). On the other hand, in Slovakia, investment was $7^1/_2$% lower in 1994 than the year before (though in the private sector, it rose by $17^1/_2$%) and in Bulgaria, investment fell as a share of GDP.

Despite the growth of GDP, however, the level of economic output in all the countries was still much lower in 1994 than before the transition began. Even in Poland, after three years of growth, GDP was some [illegible] below its level in 1989. In the other countries, GDP was down by significantly more than this - in Albania, Romania, and Slovakia, by as much as 20% and in Bulgaria, the Czech Republic and Hungary, by around 15%. Since the resident population either rose (in four of the countries) or fell by considerably less than this - in Bulgaria where the reduction was greatest it was nevertheless only some 4% - it means that average GDP per head has declined substantially over the transition period and there is still is some way to go before it gets back to the pre-reform levels.

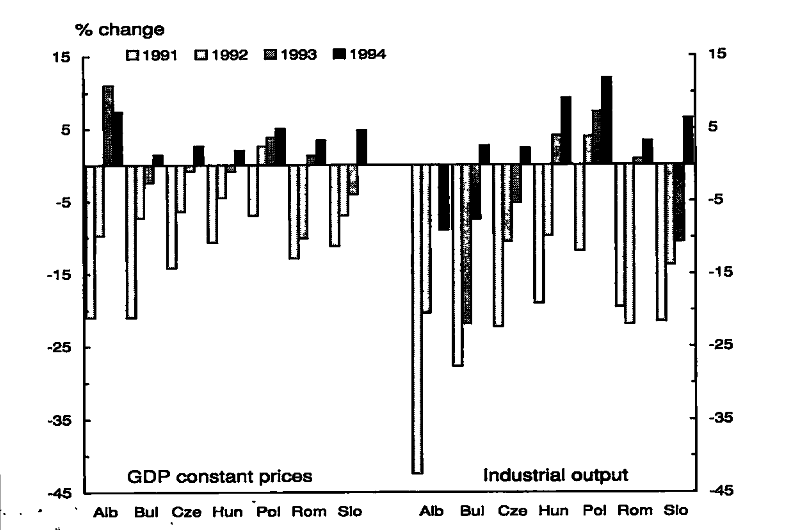
Nevertheless, although GDP per head is the usual measure of real income, the reduction which has occurred needs to be interpreted with some caution. While it may reasonably reflect the fall in the total goods and services produced, in the case of the transition countries, where the composition of what was produced was heavily affected by the system of central planning, it does not necessarily provide a good indication of what has happened to living standards. To the extent that what is now produced under a market system better accords with consumer demand and the long-term needs of economic development, the fall in GDP will give a misleading impression of the effective loss of output and, accordingly, the loss of real income. In other words, the change in GDP which has occurred leaves out of account the gain to consumers of a wider choice of goods and services available for purchase. At the same time, there is no effective way of measuring this and it cannot necessarily be assumed that it is sufficiently important to outweigh the lower volume of output.

Within GDP, industrial output increased in all countries apart from Albania, where estimates suggest that it fell by 9% in 1994 following much larger falls in 1992 and 1991 (no estimates are available for 1993). In both Poland and Hungary, the rise in industrial production was the main factor underlying the growth of GDP. In the former it increased by 12% in volume terms in 1994 following a rise of over 7% in 1993, while in the latter, it rose by 9% after an increase of 4% in 1993. In Slovakia, also, industrial output went up by more than the rise in GDP as a whole, by $6^1/_2$%, which in this case, came after a fall of $10^1/_2$% the year before. In the other countries, though the rise was smaller, it was still significant - around $3^1/_2$% in Romania and around $2^1/_2$% in the Czech Republic and Bulgaria - and in each case the performance represented a significant improvement over what had gone before.

In most countries, moreover, there was an acceleration in industrial output growth during 1994, in the sense that the rate of increase in the second half of the year was greater than in the first half. In Bulgaria and Romania, in particular, the growth achieved in the second half of 1994 was considerably above that in the first half - indeed, in the former, a fall in production was transformed into a rise of over 8% in relation to a year earlier (and growth in the first quarter of 1995 increased to $10^1/_2$%), while in the latter, an increase of 1% in the first half became a rise of 10% in the second.

Within industry, the sectoral breakdown of growth varied a good deal from country to country. In Romania, for example, construction output increased by 19% in 1994 and in Bulgaria, by 9%, whereas in Slovakia, it fell by over 5%. Oil refining, the production of chemicals, electricity, gas and water and paper and printing, however, seem to have risen in most countries by more than average.

1 Changes in GDP and industrial output, 1991-1994



As in the case of GDP as a whole, however, the growth in industrial production in 1994 still leaves the level of production substantially down as compared with the pre-transition period in all the countries. In Poland, after three years of growth, the reduction in industrial output was much smaller than elsewhere in Central and Eastern Europe, but it still amounted to a cumulative loss of 15% over the transition period. In Hungary, the level of industrial production in 1994 was 24% below the level in 1989, while in the Czech Republic and Slovakia, it was 35% and 37% lower, respectively. In the other three countries, the loss in industrial production was even larger. In

Romania, it amounted to 47% since 1989 and in Bulgaria and Albania to well over 50%.

In contrast to the growth of industrial production, the experience as regards agricultural production in 1994 was much more diverse. In Albania, it rose substantially, more than compensating for the fall of output in industry, while it also increased in Romania, in part because of favourable weather conditions, and Slovakia - by as much as 12%. Moreover in Hungary, the large fall in agricultural output which occurred between 1985 and 1993, of around 30%, came to an end in 1994. In the Czech Republic and Poland, on the other hand, agricultural production fell significantly during the year. In Poland, the fall was some 10% and in the Czech Republic, 5-6%, in both cases, partly because of bad weather conditions, though the privatisation process in the latter and the associated reorganisation of production was also considered a factor in depressing output.

In most countries, there was a significant rise in service output during 1994, though in Romania, there was a fall in the contribution of services to GDP, largely due to a decline in passenger transport, hotels and restaurants.

In all countries, however, without exception, the private sector continued to expand markedly in 1994 and was responsible for a growing proportion of output as the privatisation process and transition to a market economy proceeded. In the Czech Republic, for example, most of the legal and institutional changes required for the transition to a market economy were completed during the year and by the end of 1994, the private sector accounted for an estimated 60% or so of GDP. At the same time, the share of manufacturing in total output declined while the share of services - both market and non-market - increased, with the contribution of the retailing trade to total economic output rising by 5%.

In Slovakia, the share of output going to the private sector was only slightly lower, at around 58% of GDP, with the cooperative sector accounting for a further 14%. As in other countries in the region, private firms were especially important in retailing, accounting for 89% of sales, though they were also significant in construction, where they were responsible for 74% of turnover, well above their share of industry as a whole (54%).

In Bulgaria, where the privatisation process has progressed more slowly, the share of GDP accounted for by the private sector, nevertheless, increased from $19^1/_2$% to $27^1/_2$% between 1993 and 1994 as the output of private industry rose by 30%. As a result, the private sector accounted for 20% of total industrial production in 1994, not much below its share of service output (23%) - though in the retail trade the share was much higher at some 70%. The private sector, however, remained strongest in agriculture where it was responsible for 80% of production.

In Romania also privatisation has not proceeded as far as in a number of the other countries, but still increased markedly in 1994, when the private sector accounted for 35% of GDP as a whole and 46% of service output. Moreover, estimates suggest that in the first quarter of 1995, private companies were responsible for almost a third of exports and 40% of imports.

In all of the countries, most of the private businesses created have been small. Moreover, in Hungary at least, the average size of firm declined significantly during 1994. Whereas at the beginning of the year, 52% of companies ('economic units with legal entity') had 10 or fewer employees, by February 1995, this figure had risen to 73%, while the number with over 50 employees declined from $8^1/_2$% of the total to only 6%.

Privatisation in Poland

Poland's Mass Privatisation Scheme (MPP), the country's privatising great leap forward, looks set to be implemented this year.

The plan was originally announced in 1991 and is designed to combine the best features of coupon privatisation programmes elsewhere in former communist Europe. But in its Polish version the plan includes assurances that the companies involved will actually have the improved management and capital inputs which are generally associated with private sector corporate governance.

Under the plan ...., equity in 444 state sector companies is to be handed over to 15 closed-end investment funds which are to be run by local and foreign fund managers for a period of 10 years.

Towards the end of 1995 the shares in the funds themselves are to be distributed to the population at large, or at least to those who are willing to pay a nominal fee equal to a month's average wage.

The fund managers' ... initial costs are to be covered by a $50 m loan from the European Bank for Reconstruction and Development and they are to be paid an annual fee for their efforts as well as a bonus at the end of the period. The bonus will be linked to the value of the fund at that time.

From the Financial Times, 29/03/95

Foreign investment

Direct investment by foreign companies in Central and Eastern Europe varies significantly in importance as between countries. Though in most cases it has so far been on a relatively small scale in relation to domestic investment, there were clear signs of a marked growth during 1994 in a number of countries, especially in those where had been relatively unimportant before.

In Romania, for example, foreign investment was substantially larger in 1994 than in 1993, in part due to a change in the legal framework and the introduction of tax concessions to favour foreign investors. In total, up to April 1995, the value of foreign investment amounted to some $1,350 million, 76% of this going into projects of over 1$ million.

Similarly in Slovakia, direct investment from abroad rose by 54% between the beginning and end of the year, three-quarters of the increase occurring in the second half. In total, investment amounted to $520 million up to December 1994, going into 7,200 enterprises and originating mainly from Germany, the Czech Republic, Austria, France and the US.

Direct investment flows also increased into the Czech Republic, which has been a major destination from the beginning of the transition period. Flows rose by 45% in 1994 to $870 million, much more than the total stock of foreign investment in Slovakia and around two-thirds of that in Romania. Of the inflow during the year, 30% went into car and other transport equipment manufacture, while 15% went into banking. Half of the total came from Germany, just under 10% from Austria and France and 5% from the US . This contrasts markedly with 1993, when the latter accounted for 45% of inflows (and some 20% of cumulative inflows over the period 1991 to 1994, as against 36% from Germany and 12% from France). With large privatisation programmes planned for petro-chemicals and telecommunications, and with continuing economic recovery in the European Union, the prospects for a further increase in investment inflows in 1995 seem extremely favourable.

Bulgaria is an exception to this favourable trend. In 1994, foreign direct investment inflows fell by almost 20% to just $46^1/_2$ million, barely 5% of those into the Czech Republic and well below those into Slovakia or Romania. Moreover, in contrast to Romania, only 38 individual projects up to the end of 1994 have involved investment of more than $1 million, while 1,420 out of the total of 2,200 - almost two-thirds - have involved investment of only $1,000 or less.

International trade developments

The visible trade balance was in deficit in 1994 in five of the seven Central and Eastern European countries covered here. This represents a slight improvement over 1993 when all but the Czech Republic were in deficit. The latter, however, was the country showing the most marked deterioration in trade performance between the two years, at least on visible trade, a surplus of $345 million being transformed into a deficit of $436 million. Even taking account of the Czech surplus on invisibles through its significant earnings from tourism and transport, this meant that the current account overall was in small deficit, though it still managed to increase its convertible currency reserves to almost $9 billion (a surplus on convertible currency trade being offset by a deficit on other trade).

Nevertheless, there is concern about the apparent deterioration in Czech competitiveness in 1994. The exchange rate, unlike in other countries in the region, has remained largely unchanged against the US dollar and Deutschmark and since inflation, as noted below, has been higher than in Western Europe, the major market for Czech exports, this has led to an appreciation in real terms of 8-10%. As a result, though exports rose by 7% between 1993 and 1994, this was considerably less than the growth of imports - the composition of which shifted towards machinery and transport equipment, though imports of consumer goods also expanded significantly - and the trade deficit with Western Europe increased from $600 million to $900 million.

The apparent effect of the deterioration in cost competitiveness is reflected in the decline in the growth of exports to developed market economies, from 25% in the first half of 1994 to 15% in the second half and only 5% in the first quarter 1995. At the same time, imports from these economies increased by 40% in the latter period.

In the other countries, Hungary apart, there was either some fall in the trade deficit or, in the case of Bulgaria and Slovakia, a deficit was converted into a surplus. In Hungary, though the rise in the trade deficit was comparatively small between 1993 and 1994, it was nevertheless from a high base. As a result, the current account deficit in 1994 reached $9^1/_2$% of GDP, which was a major reason for the subsequent introduction of restrictive measures in March 1995. At the same time, the deterioration in the trade balance accompanied a marked growth of exports amounting to $2^1/_2$% year on year in US dollar terms and to 23% between the second first half of 1993 and the second half of 1994. Indeed, the growth of exports was greater than that of imports which meant that the deficit declined in relation to the value of trade, though the deficit still amounted to 36% of the value of exports in 1994.

The severity of the Hungarian balance of payments problem, however, is nothing as compared with that of Albania. Here, though there was no further rise in the trade deficit and exports increased in US dollar terms by 26% between 1993 and 1994, imports in value terms were over four times larger than exports. Without a significant strengthening of the industrial base - and, as noted above, industrial production fell substantially in 1994 - it will be difficult if not impossible to close this massive gap without greatly slowing down the development process, let alone to halt the escalation of foreign debt.

In the other four countries, there was also a substantial increase in exports, but in these cases, it was accompanied by a much smaller growth of imports despite the growth of GDP. In most cases, the improvement in trade performance was associated with a significant depreciation of the exchange rate.

In Poland, exports rose at the same rate as in Hungary in US dollar terms, 20$^1/_2$%, as against an increase in imports of 13$^1/_2$%, so achieving a reduction in the trade deficit for the first time since 1990. In Romania, the rise in exports was even greater at over 25%, which in this case was achieved without a marked depreciation in the currency, and substantially in excess of the expansion in imports (9%). As a result, the trade deficit narrowed appreciably. In Slovakia, exports increased by somewhat less - 13$^1/_2$% in US dollar terms - though still by a significant amount and at over twice the rate of import growth. In consequence, the trade balance which had been in deficit since the transition began was transformed into a surplus.

This was also the case in Bulgaria, which had also been in deficit throughout the transition period and which as a result had accumulated considerable foreign debts giving rise to acute debt servicing problems. Here, however, a trade surplus was attained for the first time for many years not so much through export growth, which amounted to under 5% in US dollar terms, as through a reduction in the dollar value of imports which declined by 7% between 1993 and 1994.

In all countries for which details are available, the pattern of trade continued to shift towards Western Europe during 1994 and away from traditional markets both in Central and Eastern Europe itself and the in the former Soviet Union. In the case of the Czech Republic, for example, exports to European Union and EFTA countries in 1994 grew by 18%, more than twice the overall growth of exports. In Romania, around 50% of exports went to the European Union in the same year, while only 14% went to countries in transition, though the latter accounted for 26$^1/_2$% of Romanian imports. In Bulgaria, almost half of exports went to Western Europe as opposed to under 40% to countries in Central and Eastern Europe, including Russia which still represented the most important trading partner in the region.

In Slovakia, on the other hand, the Czech Republic represents by far the main trading partner, accounting for 37% of its exports in 1994 - and for 30% of imports - well in excess of the second most important market, Germany, which accounted for 17%. Russia, however, remained an important source of imports, if much less significant than before the transition, accounting for 18% of the total.

Labour force participation

All countries covered here experienced a growth of working-age population between 1993 and 1994, even Albania, Bulgaria and Romania, where population of working age fell in the early years of the transition. This rise was accompanied by a growth in active population - ie in those people working or actively looking for work - in all but two countries, Bulgaria and Hungary (no data on active population are as yet available for Romania for 1994). In the former, active population declined by 3%, in the latter, by 4%, in both cases, continuing a downward trend from the beginning of the reform process, interrupted briefly in 1993 in the case of Bulgaria. In two other countries, Albania and the Czech Republic, 1994 was the first year of labour force growth since the transition began.

In both Bulgaria and Hungary, therefore, the proportion of working-age population participating in economic activity - ie the participation rate - continued to fall in 1994, in the case of both men and women. The participation rate also declined in Slovakia, though by much less, and here the fall was confined to men, the rate for women increasing slightly. In all the other countries, the rate rose. This was especially true in Poland, where the participation of men, in particular, increased significantly during the year (from 78.4% to 80.8%), and in Albania, where the rise was confined to men (going from 75$^1/_2$% to 80%) and the rate for women declined (from 70% to 68%).

Employment developments

In most countries in the region, information about employment has improved significantly with the introduction of labour force surveys (all of the countries now have regular surveys apart from Albania, where as yet there are no plans to introduce one). These have done great deal to fill the information gap which opened up