

SOME NOTES ON THE RELATION BETWEEN STATE AND SOCIAL SECURITY IN THE TRANSFORMATION PROCESS

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This paper integrates a number of aspects that have become evident in the course of the analysis of the economic transformation process in Eastern Europe and which are of importance not only for further empirical studies and for the formulation of pertinent theories, but also for future political/strategic courses of action. As became clear from the Panel III discussions, the author broadly agrees with the propositions of Dr. Héthy's paper but applies a wider regional context and covers further problems within the scope of his reflections.

The primary aim of economic transformation in the reforming countries of Central and Eastern Europe and the successor states to the USSR is to trigger economic dynamism by means of the transition to democracy, market economies, and societal pluralism. A major step towards achieving this aim lies in dismantling the state functions and institutions that were characteristic of the now defunct administrative planned economies. In line with the main concern of restructuring, contemporary transformation studies in East and West alike have concentrated especially on the progress made in liberalisation and in the institutional change leading to a market economy. By contrast, little attention has been paid to the role of the state in the transformation process, especially in the empirical analysis of the economic and political development of individual reforming countries. The relationship between the state and the economy is, however, of crucial importance to the future evolution of the countries in transformation, both with regard to the pace and efficiency of transformation as a process of change and with regard to the institutional structure of the economic order that is the intended outcome of that change.

Seen from the normative aspect, what is needed is a state which on the one hand plays an active, formative role in shaping the processes of institutional change and in particular in overcoming the many burdens and deficits that the transforming countries have inherited from their socialist past (i.e. a strong state), but one which at the same time imposes limits on itself, both in the transformation process and in the post-transformation period (i.e. a state that is willing to step back when the time comes) to prevent the emergence of a

functionally weak, interventionist hybrid system. A particular problem in most transforming countries is that the new state has to reconstitute itself in institutional, functional and personnel terms out of the old structures of administrative socialism. Though some of the countries of the region can by now be assumed to have achieved a relatively satisfactory development in terms of the emergence of a “functional statehood” capable of promoting and sustaining transformation, as a general rule the relationship between the state and the business world in the economic reality of the transforming countries still leaves much to be desired. In particular, there are three types of problematic development that can be identified: (1) the continuation of old forms of administrative regulation, with the former social elites (the nomenklatura) regaining influence under changing institutional conditions (“too much old state”); (2) the often spontaneous course taken by transformation as a dysfunctional mixture of creativity and chaos in what is largely a statehood vacuum (“too little central state authority”); (3) despite theoretically adequate centralised power on the part of the state, a still incomplete process of change towards effective institutions and instruments of economic order and policy (“inadequate and belated reconstruction of an effective state”).

In the past years, various branches of economic research have made major contributions to studying the activities of the state in transforming countries: for a long time, the literature on transformation was dominated by research orientated towards public order policy, and these works centred on the question as to the pace and sequence of the steps involved in reform policy. State spending and revenue were of interest primarily from the aspect of their contribution to macro-economic stabilisation. Another field of research which has by now produced a large number of analyses is that dealing with the evolution of the banking system in the transforming countries. The particular attention dedicated to this field by academic research reflects not only the great material significance of the financial institutions for the transformation process but also the fact that the international banking institutions (the EBRD, the World Bank, the IMF) have become deeply involved in the countries of Central and Eastern Europe since the collapse of communism.

Analyses on purely financial topics were at first relatively scarce in transformation studies - not least because of the shortage of data and the language barriers faced by western financial researchers. Such studies as there are were dedicated primarily to the precarious financial basis of state activities, the evolution of state spending and of the public debt. There is, however, another side of state activity which plays a cardinal role in transformation studies, namely the group of questions concerned with privatisation (designs, the course of the privatisation process, privatisation and micro-economic restructuring). This is the field in which both eastern and western European transformation studies have produced perhaps the most noteworthy results. However, the problems in connection with the micro-economic restructuring of the privatised businesses still pose numerous

questions which will continue to occupy transformation research for a long time to come (corporate governance, competition policy).

Studies on the function of structural policy, and in particular policy on industry, within the transformation process were a less prominent feature especially of western transformation literature in the early years following the change of system. This is surprising given the fact that considerable importance is attached to structural policy conceptions and experiments in many transforming countries. Even where - as in the Czech Republic - wholesale abstinence from formulated structural policy is part of the economic-policy credo, state institutions are attempting to a certain extent to influence the process of structural change. And finally, it should be mentioned that numerous works have dealt with the role of the state in the foreign economic activities of the transforming countries. On the other hand, social aspects and the role of the state in promoting social security have attracted greater attention only comparatively late¹. The reasons why they are discussed more often today are connected primarily with the difficult and lengthy transition process in many countries, the increasing social hardships connected with this process and the political reactions of the population that showed their dissatisfaction in elections, strikes and other forms of public discontent.

The functions of the state and the role of budgetary expenditures have indeed undergone profound change in the course of the transition process in Eastern Europe and the countries of the CIS.² There are many reasons for this, some of them conceptional/strategic, but most of them factual. In conceptional terms, the transition from an administrative planned economy to a market economy presupposes that the state is willing to relinquish its former omnipresence and restrict itself to performing, but efficiently, a limited range of tasks and functions, foremost among them functions concerned with providing social security. In factual terms, the transition states, embroiled in the process of political and economic upheaval, had no choice but to embark on a retreat, if not a flight, from their traditional all-embracing activities. The institutions and instruments of intervention (especially the Communist Party hierarchies) collapsed, the hitherto accustomed direct access to economic and social resources was no longer possible, and the more or less severe transformation-induced recession drastically curtailed the funds available for spending. For all these reasons, public consumption in the transition region dropped, in some cases considerably, both in relative terms (ratio of state spending to national income) and in absolute terms (by volume). However, this was by no means an orderly, steady withdrawal; instead, the state sector in the reforming countries today differs widely in size and structure, and the task of reducing the state to a "reasonable" size while at the same time providing it with the resources it needs to perform its essential functions - including but not limited to the social security field of activity - can hardly be considered to have been successfully achieved anywhere in the region.

The social security systems rank among those public sectors that are often - in the only partly interrupted tradition of previous policy "priority for today's welfare, security and calm" (J. Kornai)³ - still over-sized, highly inefficient and over-spenders. On the whole, state expenditure on social security within the reform process in many of the countries in transition is tending, if anything, to rise. In some ways, such a development is by all means warranted: systemic transition places great burdens on people and these hardships must be cushioned by old and new mechanisms if the reform process is to continue to enjoy public acceptance. If living conditions do not improve in the long-term, there is a danger of non-cooperation, resistance and defiance becoming endemic. In the context of his analysis of socio-economic evolution processes, Albert O. Hirschmann speaks of an "antagonistic potential" that rushes to fruition if the expectations aroused in broad sections of the population in the initial phases of rapid processes of change are not quickly fulfilled.⁴ New forms of financial support for energy and accommodation (instead of the old price subsidies), higher social welfare benefits and adequate unemployment assistance, rising direct state expenditure on education and health (instead of the previous indirect funding via state enterprises, which is no longer possible following their privatization): all these are desirable but, because of financial constraints, nowhere adequately available. On the other hand, there are also areas within the social sector where over-spending is the order of the day. These include especially the superannuation and other pension funds. In the countries of Eastern Europe, especially, social security expenditure has stagnated at a high level in absolute terms, has increased considerably in relative terms (because of the drop in GDP), and has made (or is going to make) drastic cut-backs in the pensions systems necessary. This in turn has incited the people - most recently in Hungary and before that in Poland - to punish the incumbent governments by giving the respective opposition a majority and bringing it to power in the next national elections.

Any assessment of the options available for cushioning transformation shocks by means of social-policy measures and thus reducing the risk of political instability or even turbulence must take into account the low level of economic development in the eastern transforming countries. Of the 27 countries undergoing transition in the region, four countries (Albania, Azerbaijan, Armenia and Georgia) are "low income" countries according to the UN classification (per capita GDP less than US\$750 in 1994), most of the rest (including Russia) are in the "lower middle income" group (per capita GDP up to US\$3,000). Only three countries (the Czech Republic, Hungary and Slovenia) are in the "higher middle income" group and there is no transforming country at all in the "high income" category. Besides the low per capita income levels, the problems in these countries have been exacerbated by the negative dynamic trend in their national incomes. The "transformation recession" (J. Kornai) that set in as of 1989 was especially pronounced in the successor states to the USSR and in many has persisted to this day. Ukraine's national product, for example, was about 60% lower in

1997 than in 1989, Russia's about 50% lower. In East Central Europe, by contrast, the transformation recession was much milder, which in turn was a major factor facilitating a relatively early return to economic growth.

The precipitate collapse of the communist political and economic system, the disintegration of states, the low level of development of the new economies, the continuing effects of inherited burdens, and the transformation recession which these triggered and which in many countries is still in progress are the main reasons for many adverse socio-economic trends which - again subject to considerable differences from country to country - are acting as potential factors of domestic destabilization.⁵ To name just a few: rising unemployment, especially among younger people and women, as a result of the process of economic restructuring (privatization); the emergence of distinct income and ownership disparities within the population and the pauperization of whole social groups such as the military; the worsening poverty of those sections of the population that are not able to adapt to the changing economic situation and working conditions, such as the elderly and single mothers; deteriorating and by now clearly inadequate medical care, which has in many countries caused or at least greatly contributed to falling life expectancies; the frequently severe environmental burdens with their detrimental effects on health and the quality of living in general; and last but not least the high and tendentially rising crime rate, itself at least in part the result of abject poverty. All these negative economic, social and ecological factors are impeding the transition to "normal functioning" civil societies, pose a risk of political instability or even of reactionary communist or authoritarian nationalistic reversals in domestic policy, give reason to fear international spill-over effects, and are a potential threat to domestic and international security.

The return of post-communist groups to government power in many, though not all, of the transition countries in the second series of parliamentary elections after 1989 was just as much the expression of widespread dissatisfaction with the course of economic and social development as was the more recent return to the right or at least to the right-of-centre, for instance in Poland or Hungary. More dramatic examples of economically motivated unrest were provided by the events in Albania and Bulgaria. And in Russia, the ongoing escalation of strike activity is jeopardizing the latest attempts to put economic reform policy on a firmer footing. Conversely, it can be assumed that the security risks as outlined will recede if systemic transformation towards democracy and a market economy proves successful and if it can gain an adequate consensus among the population by virtue of economic recovery and social consolidation.

As regards people's attitudes and responses, however, it is important to bear in mind that - no matter how functional, efficient and socially oriented the governments and state institutions in the transition countries might be - the cardinal elements of the system to which transformation is intended to lead, such as democracy, constitutionality, market economy and entrepreneurial initiative, cannot be managed, much less ordained "from above". Of course, the centres

of policymaking must produce clear policy (including social policy) designs and must exercise authority and forcefulness in their implementation. But equally necessary is the corresponding “demand” on the part of society. This depends on the one hand on the inherited politico-economic culture in the transforming countries, that is to say the totality of the knowledge, experience, perceptions, value systems and attitudes of individual nations or of certain functional elites and population groups within a given society, all seen in the context of politics and the economy. Here there are historically evolved differences between the various countries, and seen from this perspective there is a much better chance of transformation being consolidated in East Central Europe than in the CIS and some countries of South-East Europe. On the other hand, it also depends on the current elites realizing that both a weak institutionalisation of economic/political and legal rules and controls and inadequate social security are equally fraught with high personal political risks for themselves.

Full employment - even if often accompanied by low wages and low labour productivity - was an essential element of the administrative planned economy. Rising unemployment trends, by contrast, are creating a serious social-policy problem in the transforming countries and posing a challenge to state activities, especially if the employment problem complex is extended to include cases - such as that of the Russian miners - where people are still theoretically in employment but no wages are paid. Nor is the comparison with similar high unemployment figures in many western industrialised nations any consolation for the custodians of social policy in the reforming countries. For in the West the general level of affluence is many times higher and the social assistance available to the unemployed much better. But not only is the elevated level of unemployment in Eastern Europe (the ratio lying between 10 and 15% in most countries) highly problematical, the breakdown of the unemployment figures by age, sex and duration of unemployment also gives a cause for concern.⁶ Here, too, there are similarities with the situation in western Europe. In almost all transition countries, unemployment is higher among women than among men, and juvenile unemployment is one of the most pressing social problems. The statistics indicate that unemployment is particularly high among young people below 25 years of age. And as regards the long-term unemployed, their relative numbers appear no longer to be rising as quickly as in the first years of the post-communist transformation but have reached a high plateau that demands special attention from the makers of social policy. Long-term unemployment is slow to respond to upturns in the economic cycle, is economically particularly wasteful, and constitutes a permanent threat to political stability. Like recent manifestations of the same phenomenon in some western market economies, experience in the transition countries also documents that the chances of combating unemployment dwindle considerably the higher the proportion of long-term unemployed is, while the cost of unemployment itself and of the policies introduced to combat it also rises disproportionately.

As regards the organization of and the instruments used in assuring the social welfare of the unemployed and in employment policy, planned-economy methods and tools have been abandoned everywhere in eastern Europe and the successor states to the USSR in favour of post-socialist forms that are more in keeping with a market economy environment. Some countries have adopted western unemployment insurance and assistance structures, western forms of employment promotion and an active labour market policy. On the other hand, even these countries lack organizational experience, socialist patterns of behaviour are hard to eradicate, there are too few clear facts to indicate what would constitute an economically expedient employment policy, and finally the chronic shortage of funds limits the options available for the fight against unemployment and for pursuing an active employment policy. Thus, the state has not been relieved of its responsibilities, but its scope of action is restricted and it remains dependent upon domestic private support and assistance from abroad.

As far as poverty and social inequality are concerned, the countries of Central and Eastern Europe and the successor states to the former USSR have experienced a rise in poverty in the course of the transformation process, even though many of the people living there have been able to chalk up material and immaterial gains. The elderly, in particular, have been hit hard both by the transformation-induced recession (drop in GDP) and by the socially unsympathetic aspects of the newly established market-economy systems. Unlike younger people, they can profit little from the long-term benefits of reform. Nor were they able during the socialist period to build up any wealth that would enable them to cushion their own individual transformation shock. On the contrary, inflation has robbed many older people of their life savings. Worsening poverty is accompanied by a widening divergence of incomes. This is *de facto* and especially in the perception of those on the wrong blade of the scissor movement a social problem with considerable disruptive potential, but it is going to be difficult to reverse the trend. It is an inevitable consequence of transformation and - to give a benchmark - is not much more (often even less) pronounced a phenomenon than in established western market economies. Ultimately, the effects of widening income differentials can only be mitigated by growth of the economy as a whole as achieved during the post-war period in countries like West Germany, which managed to link up a similar process of rapid income and property differentiation to "wealth for all" (Ludwig Erhard).

A further cornerstone of the social security edifice is the health system. Here, too, all the transforming countries have had to break with the communist past in which everybody had essentially free access (albeit subject to some elements of discrimination and distortion due to special privileges) to generally reasonable medical care financed directly by the state. In the course of the transformation process, medical care has tended to deteriorate significantly, but to different extents from country to country. This is true of Russia, too, where sick people - unless they belong to the "nouveaux riches" - are nowadays regularly confronted

with a situation in which they have to put up with long waiting lists and qualitatively poorer treatment, hospital patients sometimes have to arrange for their own food, bedding and even medicines, and are faced with high treatment costs which effectively constitute strict discrimination in terms of access to treatment.⁷ The outer signs of this deterioration in the health systems are declining life expectancies for men and women alike, high mother and child mortalities during childbirth, and the frequent recurrence of infectious diseases which had previously been almost eradicated.

Since the early nineties, various attempts have been made in Russia to reform the health system on the one hand by developing new legal and organizational structures and on the other by establishing a sound financial basis following the state's retreat from its direct (funding out of the state budget) and indirect (funding via the state-owned enterprises) financial responsibility. In Russia, as in other transforming countries, the chosen route has been towards an insurance system on the basis of off-budget health insurance funds at the regional and federal levels. These funds are financed by the employers, employees and public subsidies, whilst private insurance companies have been given licenses to operate such funds and more than 100 million Russians by now hold policies. Even if the approach to providing security against the risk of illness is thus one which has proved successful in the West (for instance in Germany and the Netherlands), many difficulties still remain unresolved. This is hardly surprising given the complexity of the transition problems to be surmounted. These difficulties are not only characteristic of the Russian health system reform but are typical of the general transformation problem complex in this and other areas of the social security system. Wherever one looks, these difficulties always circle around two basic quandaries: *firstly* the substantial obstacles to the implementation of new legal and organizational solutions (because of the persistence of traditional thinking structures, the shortage of know-how, and the vested interests of old and new political and economic elites that are often opposed to any reform); and *secondly* the lack of adequate financial resources for even the most propitious legal and organizational terms of reference are without substance if they are unaffordable. A comparison with western market economies ultimately reveals the full scale of the dilemma facing the transforming countries in their attempts to reform their health care systems: despite their much higher levels of affluence, even western countries are finding it extremely difficult to overhaul and maintain their health systems in line with the three inalienable principles: *social, efficient and affordable*.

Besides providing security against the risks of unemployment, illness and poverty, another cardinal duty of the social welfare system is to make provision for adequate standards of living in old age. Like all other sectors of social security, the pensions system in administrative socialism was one that offered often meager but comprehensive benefits and one that relieved the individual citizen of virtually all responsibility for his own well-being. The breakdown of

this extensive state paternalism made it necessary to reorganize the superannuation benefits system in such a way as to accommodate both the beneficiaries' need for support and the state's limited financial scope, to put the social security system as a whole on a more input-related basis, and at the same time to encourage the individual to make his own provisions for old age. The decline in employment levels in the course of the transformation process, official retirement ages that are low by comparison with those in Western European countries, and the generous early retirement practices common in some countries have led to a pronounced increase in the number of people drawing benefits. At the same time, the level of benefits has been declining, having peaked with pension rises granted in the initial phase of transformation. Since private revenue from property or non-state superannuation schemes is a rare exception rather than the rule, from the point of view of the pensioner, retirement means a sharp drop in income.

So the system is in urgent need of reform in all the transforming countries.⁸ However, all the potential solutions - lowering the level of pensions, raising the social security contributions, granting state subsidies, limiting the numbers of beneficiaries and mobilizing additional private efforts - involve political and economic problems and, above all, are always coming up against financial constraints. The principal task, that of disentangling the social security systems of the socialist era from the state budget and of putting them on an independent, input-related funding basis, has been tackled nearly everywhere but by no means fully achieved. The reorganizations have been incomplete because the pensions systems have not been given the requisite independence from the government and parliament and because the underlying organizational principle of any modern social insurance system, that of self-management, has not been fully implemented. Thus, the systems that have emerged are hybrid systems that combine western organizational principles with old state interventionist elements inherited from the communist systems and that, on the whole, represent not so much solutions as starting points for further reform. Hungary's resolute approach to the reorganization of its pensions system proves that it is indeed possible to undertake radical reform. However, it is doubtful whether the Hungarian example can be generalized since such highly advanced financial markets are hardly to be found anywhere else. What is more, the result of the Hungarian parliamentary elections of the spring of 1998 shows that radical reforms evidently claim their political price.

To conclude and sum up: the task of creating an adequate measure of social security in the transitional societies is an extremely complex one. Solving the urgent problems described above will require not only considerable financial resources but also expedient institutional rules and strong leadership. A strong state would without doubt serve as a powerful motive force to this end. Moreover, liquidationist views of the role of the state in post-communist societies, such as were advanced in and for the transforming countries at the turn of the nineties,

are now obsolete. This does not imply a return to the economic and social policy conceptions and strategies of administrative economic planning, but it does mean searching for the appropriate function of the state in transformation economies or in market economies in general. Even if only because of its limited resources and because of the limited controllability of social processes, the state cannot be a super-state. But neither must it degenerate into a stand-by-and-watch institution. What is called for - as is rightly pointed out in the EBRD's Transition Report - is a partnership between the public and the private sector which is based on the comparative advantages of both sectors and in practice leads to different structures and mixtures of state and private activity, depending on the branch of the social welfare system concerned (employment management, provision for old age, health care, education). Because of the shortage of funds, to which reference has already been made in various contexts, and because of the inadequacies of traditional systems of state intervention, what is now needed is to bring private resources and private initiative into play for social purposes by promoting appropriate markets.

The West should offer its technical assistance. Also, the western systems of social security, their present-day problems and the efforts being made to eliminate their difficulties by means of reforms should be duly examined as study objects to help identify what might also be possible in the transforming countries and what certainly would not work. On this basis, an West-East partnership based on mutual learning processes could gradually emerge and develop. One outcome of this is likely to be the realization that evolution in the field of social security depends strongly on prevailing social values. These values are of high political relevance and are not a matter just for the social philosophers. Nor do social values drop like manna from heaven. They have to be cultivated by people on the basis of their experience and they have to take root in society. Thus, the future of social security in the transforming countries will depend on how these countries manage to sort out the confusion of values that is currently being characterized by consumerism, frustration over transformation, and globalization.

Notes

1. Giovanni Andrea Cornia, „belated Focus on the ‘Social Issue’”, in: *Most, Economic Policy in Transitional Economies*, Volume 6, 1996, p. 1
2. Cf. Hans-Hermann Höhmann, „Gemeinsamkeiten und Divergenzen im Prozeß der osteuropäischen Wirtschaftsreformen: Stichworte für eine Zwischenbilanz”, in: Biost (ed.), *Der Osten Europas im Prozeß der Differenzierung*, München 1997, pp. 189-201.
3. János Kornai, „Paying the Bill for Goulsh-Communism”, Harvard Institute of Economic Research, Discussion Paper Series, No. 1748, February 1996, pp. 5-24.
4. Albert O. Hirschman, *Entwicklung, Markt und Moral. Abweichende Betrachtungen*, München 1989, p. 125.
5. Cf. Hans-Hermann Höhmann, op. cit., pp. 198-199.
6. Cf. „Unemployment”, in: Economic Commission for Europe (ed.), *Economic Survey of Europe in 1996-1997*, New York and Geneva 1997, pp. 114-118.
7. Cf. Judyth L. Twigg, *Russian Health Care in Critical Condition*, in: *Transitions*, Vol. 4, No. 3, 1997, pp. 56-61.
8. Cf. Maria Lodahl, *Renten im Transformationsprozeß: Zur Lage in Ungarn, Tschechien und der Slowakei*, in: Deutsches Institut für Wirtschaftsforschung, *Wochenbericht* 41, 1997, pp. 763-770.