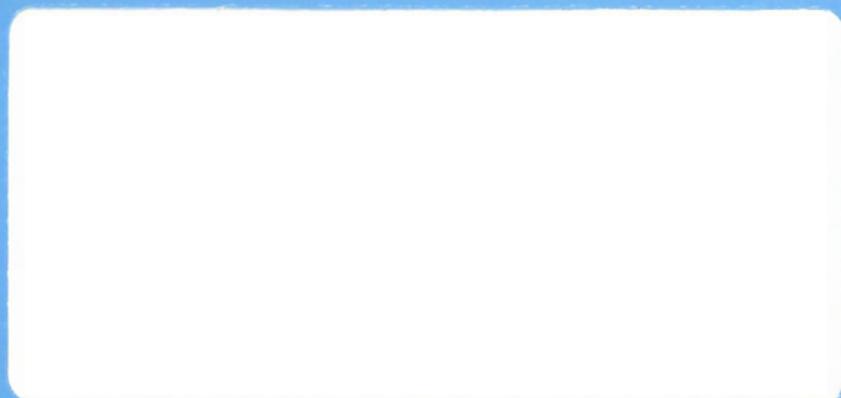




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**MARKET REFORMS AND SOCIAL WELFARE IN THE  
CZECH REPUBLIC: A TRUE SUCCESS STORY?**

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## EXECUTIVE SUMMARY

This paper reports on economic and social policy and the development of social conditions in the Czech Republic since the November 1989 "Velvet Revolution".

Czechoslovakia was one of the most developed countries of the former Council for Mutual Economic Assistance. In 1990 there was a high degree of consensus on the necessity for a radical and swift transformation of the Czech economy. The aim of the freely elected "Government of Civic Forum" included the transition from a centrally planned economy to a "market society" which is socially and ecologically oriented. The attitude of trade unions toward the reforms was very positive in the beginning, and the unions succeeded in having their demands included in the tripartite (Government-unions-employers) General Agreement for 1991.

However, at the same time, a quick liberalization of prices and external trade was assigned absolute priority in economic policy. This approach was adopted by the political forces which won the elections in June 1992 in the Czech Lands; it was bound to the idea of the market as a panacea. This orientation was fully reflected in Government policy after the independent Czech state came into existence in January 1993.

In the sphere of prices, the Government, especially in 1991 and 1993, did not succeed in maintaining inflation at the targeted level. The decrease in the purchasing power of the average citizen was greater than that which had been announced. Economically inactive people, especially pensioners and a large portion of families with children, were struck heavily and for a long time. Differences among households in income and property became very significant; for Czech society, this was a new and unusual phenomenon which had not been seen in 50 years.

After 40 years of Communist Party rule, there is a great disillusionment with socialist ideas; the compatibility of these ideas with democracy and human rights is questioned. This has been the cause of a significant wave of individualism in Czech society and is the reason the right wing has prevailed in politics. The social problems of the last two years and the solutions implemented by the right-wing Government have meant that ordinary people are experiencing the mechanisms of a "pure market economy" and its social consequences. This has led to some changes of views among the public, especially among trade union members and pensioners.

For the present Government, the participation of voluntary associations of citizens in political matters in ways other than through parliamentary political parties is not a good idea. According to this philosophy, trade unions should limit themselves to activities within enterprises and have no right to intervene in debates on public policy. This Government perceives social peace less and less as an agreement or consensus among social partners and various elements in society on the question of the acceptable approaches to public issues. Rather, it views social peace as a result of the subordination of citizens and their associations to Government decisions.

Besides the limited incidence of extreme poverty and the low level of unemployment, the maintenance of social peace must be counted among the merits of social policy in the Czech Republic. However, this social peace is now endangered by the refusal of the Government to negotiate with trade unions on new social legislation and on wage problems in the public sector.

Current Czech social policy is narrow because it is subordinated to purely pragmatic general political objectives. The content of social policy is determined by a purely fiscal consideration: to keep the Government budget balanced.

If the current approach to social policy is retained for much longer, it will lead to the emergence of a society for the privileged. Only a minority of Czech citizens would be able to benefit from a standard of living comparable to that in Western Europe. Therefore, from the point of view of the majority of the Czech people, the results obtained by the conservative approach toward the process of the transformation of society to the market economy could not be said to represent a "true success story".



## I. SOCIAL POLICY IN THE LAST YEARS OF SOCIALISM

Watching developments in the period before November 1989, one had to acknowledge that the Communist regime seemed interested in providing a politically acceptable measure of material well-being to the entire population. Evidence for this is offered by the comparatively high level of material consumption and by the efforts during periods of stagnation (especially in the 1980s) to prefer final consumption over other areas of the national economy.

However, this also led to the deterioration of the crucial conditions for social reproduction, above all in such fields as the environment, housing, health care and education.

Statistical data on living standards demonstrate comparatively good results, particularly for some "material" indicators (Table 1). However, the cost of achieving these results has been too high. The burden of this enormous "internal debt" will have to be borne by future generations.

A characteristic feature of the evolution of living standards in the Czech Republic has been the preference of consumers for quantity.

Table 1: SELECTED INDICATORS OF LIVING STANDARDS  
(Number Of Consumer Durables Per 100 Households, 1970-90)

	1970	1980	1985	1990
Passenger cars	19	45	53	62
Television sets <sup>a</sup>	84	116	125	132
Electric washing machines <sup>b</sup>	85	130	152	156
Refrigerators <sup>c</sup>	70	92	116	118
Second dwellings	6 <sup>d</sup>	10 <sup>e</sup>	14	12
Consumption of meat <sup>f</sup>	71.9	90.3	89.3	96.5
Consumption of vegetables <sup>f</sup>	76.3	61.3	68.1	66.6
Life expectancy at birth <sup>g</sup>				
Males	66.1	66.8	67.5	67.5 <sup>h</sup>
Females	73.0	73.9	74.7	76.1 <sup>i</sup>
Infant mortality rate <sup>j</sup>	20.2	16.9	12.5	10.8 <sup>k</sup>
Inhabitants per flat <sup>l</sup>	3.3	3.1	2.7 <sup>m</sup>	2.7

Sources: CSO (1993a), calculations of the authors.

<sup>a</sup> Includes leased sets. <sup>b</sup> Includes spin driers. <sup>c</sup> Includes freezers. <sup>d</sup> 1973. <sup>e</sup> 1979. <sup>f</sup> Kilogrammes per capita. <sup>g</sup> In years. <sup>h</sup> In Austria the figure was 72.5. <sup>i</sup> In Austria the figure was 79.0. <sup>j</sup> Per 1,000 live births. <sup>k</sup> In Austria the figure was 8, in Italy, 9. <sup>l</sup> Averages. The data are for Czechoslovakia. <sup>m</sup> In Austria the figure was 2.4 in 1984.

The most burdensome inheritance from the past is probably to be found in the environment. The problem of *pollution* in many regions exceeds all critical, acceptable limits. The relative economic balance was assured in the past at the expense of an *ecological imbalance*. It is clear that the damage to the ecological potential of the Czech economy has reached the point that it will have a negative impact on the dynamics and the quality of future development.

Also alarming has been the deterioration in the health of the Czech population. This can be demonstrated by the unfavourable developments in some general health indicators. The average age of the population in the Czech Republic is significantly lower than that in developed countries. The rise in mortality among certain age groups of males, especially those of productive age, has been dramatic.

A characteristic feature of the period before November 1989 was the gap between supply and demand on the *internal market*. This resulted from the economic division between manufacturers and consumers in the centrally planned system. As a consequence, a "shadow" economy, with all the attendant economic, social and moral distortions, was omnipresent.

The situation in *housing* was very complicated in that the shortage was significant relative to the level of other indicators of the standard of living.

The central planning, administration and control of all social processes generated a rather complicated tangle. On the one side, wages were regulated by the Government at an extremely egalitarian level, which was more "flat" than it was in any other country of the former Soviet Bloc. On the other side, a very complex system of subsidies and support mechanisms fostered the dependency of citizens on Government decisions rather than on the results of their own efforts.

Indirect subsidies were widespread and were distributed on a very egalitarian basis with a view to maintaining an acceptable standard of living among the population. One such subsidy was a Government grant for so-called "social consumption" (especially housing, transport and health care), and another was the so-called "negative turnover tax", which allowed prices for some basic foodstuffs to be fixed below the cost of production.

Because of the very low level of wages, the various allowances and benefits represented a necessary, stable complement to wages rather than a purpose-oriented tool.

The Government pension-security scheme was also based on egalitarian principles. However, it was not able to react quickly to price increases and the changing level of wages. As a consequence, living standards among the elderly were negatively affected.

The labour market at the end of the 1980s and the beginning of the 90s was, as a result of the central control over the economy, rather different compared with the labour markets in countries with a developed market economy. Central planning created a strongly deformed relationship between people and the workplace. The policy of full employment and the egalitarian system of wages assured a fair standard of living and "social security" to the entire population. However, this security was not supported by the performance of the economy. The system did not motivate individuals to realize themselves and to seek better jobs based on their own abilities. Wages were not applied as a tool to encourage the more efficient distribution of the labour force. Combined with the housing shortage, this tended to dampen the mobility of the labour force.

The planned and the actual increments in employment only followed the growth of the labour force that resulted from demographic changes. As a result, a high rate of economic activity (almost 50 percent) was achieved among the population, and the female labour force participation rate was very high. Among the 25-55 age group, the rate of economic activity was 90 percent.

The efficiency of the usage of this labour potential was very low. The average level of labour productivity reached only one-half of that in developed countries. As a result, overemployment touched 10 to 20 percent of the economically active population in the Czech Republic.

In the former Czechoslovakia, the highest share of employment was recorded in industry and construction. The service sector was underdeveloped.

Full employment, the extended system of social benefits and the low prices for basic necessities such as food and housing meant that, even at the low level of wages, the share of households with incomes under one-half the average income in 1989 was very small, only 4-5 percent.

The private sector played no visible role. The natural creativity and traditional entrepreneurial spirit of the population were not being expressed, and concepts like entrepreneurial risk and responsibility for the results of one's own work were being forgotten.

Some fundamental problems also arose in the area of *leisure activities*. Significantly, the longer working hours relative to advanced countries meant that there was a general lack of free time.

## II. ECONOMIC AND SOCIAL REFORMS, 1990-4

### Main Characteristics

The definitive political acknowledgment of the social changes initiated in the former Czechoslovakia by the revolutionary events in November 1989 was represented by the unambiguous victory of reform powers in elections in 1990. Preparatory steps undertaken in 1990 preceded the implementation of economic reforms.

In September 1990 the Federal Assembly adopted the "Scenario of Economic Reform". In accordance with this programme, a complex set of radical and swift measures aimed at the transformation of the economy and the adoption of legal and institutional mechanisms usual in a market system were introduced.

The main elements of the economic transformation included the following.

- Rapid price liberalization and cuts in subsidies for enterprises, especially in agriculture and housing.
- The liberalization of foreign trade and the convertibility of the Czech crown made possible by a significant devaluation in the exchange rate. In the second half of 1990, the crown was devalued by more than 80 percent in relation to freely convertible currencies. Following this measure, the value of the crown dropped appreciably relative to convertible currencies. The exchange rate differentiation index of the crown amounted to 3.2 relative to the German mark. This means that the purchasing power represented by the crown on the internal market was 3.2 times higher than the official crown-mark exchange rate.
- Wage regulations were implemented in order to improve the international competitiveness of the economy and to control inflation.
- Restrictive monetary and fiscal policies were adopted so as to retain macroeconomic stability in the course of the liberalization manoeuvre.
- The modernization of economic institutions in order to establish a new regulatory environment (for example, a new commercial code, new rules and regulations to govern banking, foreign investment, economic competition, taxation, social security and environmental protection, and corresponding changes in administration).

A special feature of the reform strategy in the former Czechoslovakia was the *rapid privatization*—without prior restructuring—of many large state-owned enterprises. In parallel with standard methods, the "voucher privatization" method was widely applied (see later).

A "scenario flow chart" was adopted for the basic measures to be carried out in the course of 1991. Some of the more complicated steps were expanded to 1992. In particular, this was the case for the completion of the first wave of large-scale privatization, which was to transfer a substantial portion of the state-owned sector to private hands.

### **Brief Outline of the Principal Socioeconomic Policies**

In a situation of the overhang of aggregate demand over aggregate supply (especially on capital and labour markets, but also between domestic and foreign markets) that had arisen during the long-term development of the economy within a nonmarket environment, it was very important to carry out the reform measures in a context of relative macroeconomic stability. There was thus an emphasis on adequate internal and external balance, the maintenance of the exchange rate of the domestic currency and control over inflation.

1. **Economic policy** at the beginning of the transformation was based particularly on restrictive measures in the areas of budgetary credit and income. It was oriented above all at the timely realization of external resources to maintain the balance of payments, the stability of the exchange rate, the internal convertibility of the Czech currency and control over the expected rise in inflation.

The "Scenario of Economic Reform" also included a brief section on the "social consequences of economic reform", in which the main priorities of Government social policy in the opening stage of the transformation were formulated. This section was eventually expanded into a more detailed document, the "Scenario of Social Reform". However, this "social scenario" never became legally binding.

An official aim included in the Government's programme in summer 1990 was the transition to a socially and ecologically oriented "market society".

2. **Social policy** at the very beginning of the transformation was grounded on the idea that it should function as a safety net during the process of profound economic change and transformation of society. The main priorities of the policy included the following.

- The creation of an institutional system and framework for employment policy.
- The development of tools to offset the negative consequences of inflation on vulnerable groups like children, the handicapped and the elderly (the social safety net).

The Government was aware that the successful completion of the economic reforms would require a certain amount of consensus among "social partners". Anticipating the sharp decline in real wages and real incomes following price liberalization and the large devaluation of the Czech crown, it tried to reach an understanding with social partners in advance on the inevitable sacrifices. This led to the establishment of an institution—the Council for Economic and Social Agreement—to manage negotiations among the Government, trade unions and employers.

3. **The attitude of trade unions** toward the reforms was very positive at the beginning of the transformation. Trade unions naturally stressed the social dimension of the reforms as an area of urgent need and requested guarantees for explicit minimum criteria. They partly succeeded, and their demands were included in the General Agreement for 1991 among the Government, the unions and employer associations.

The support for economic reforms was very high among the people, and the climate was favourable for carrying out the complicated transformation operation. There were several historical, social and economic reasons for this "affirmative" attitude.

- The existence of positive expectations regarding a speedy and successful transformation that were heavily promoted through the statements of political leaders and in other public declarations.

- The public was warned in advance about the difficulties accompanying reform but was assured that these difficulties would not be excessive and would not last long. Thus, over a period of about one year, the public was able to prepare for the transformation.

- Enterprises, the Government and the majority of households were able to set aside resources in preparation for the reforms.

- Unlike the people in Hungary and Poland, for instance, people in the Czech Republic had no recent experience with the impact of market-oriented economic reform.

- Representatives of the conservative Communist regime who were opposed even to Gorbachev's perestroika had lost the confidence of the public. Any approach smacking of the left wing, including social democratic ideas and any form of "social-oriented" market economy, had likewise been discredited in the eyes of potential voters.

- There was a long historical tradition among the Czech population of maturity, relatively high ambition and trust in one's own abilities.

## The Direction of Policy Changes

1. **Fiscal policy.** At the beginning of the economic transformation, fiscal policy was a very important, integrated part of restrictive macroeconomic policy. Its role was to prevent the onset of an inflationary spiral after price liberalization. Fiscal policy aimed at a balanced state budget. In 1991 the political goal was added of generating a budgetary surplus.

In comparison with developments in the state budgets in Hungary and Poland, the decline in Government economic activity has been deeper in the Czech Republic. The ratio of total expenditures in the whole budgetary system (that is, including local budgets) to GDP during the period 1989-94 fell from 50.1 percent to 44.6 percent. In 1995 the ratio is expected to drop another 1-1.5 percent, bringing the rate of budget reallocations in the Czech Republic roughly down to the average level in the European Union.

Fiscal policy became one of the principal factors in the balance in the economy. It contributed to a decrease in the risk of price imbalances and to the neutralization of superfluous liquidity.

The significance of the balanced budgets achieved since 1993 may be cast in doubt because of the fact that the earnings from privatization have been used to finance current Government operations. In the Government budgets of 1993 and 1994, resources of the National Property Fund amounting to 18 billion crowns (around 2 percent and 1.8 percent of GDP in 1993 and 1994, respectively) were used especially to cover debt servicing. In 1995, it is anticipated that 10.7 billion crowns (around 0.9 percent of estimated GDP) from this source will be used in the state budget for current operations. In 1993 and 1994 resources from surpluses of the social insurance system were also used in the state budget. Nonetheless, the deficits in the Czech state budget remain significantly low in international comparisons. The balanced budget and the low external indebtedness are positive signs. On the other hand, there is still a clear danger that economic growth will be hampered.

2. **Price and wage policy.** The *inflation* characterizing the first years of the transformation has been accompanied by periods of hard shocks caused by the introduction of successive steps in the reform process and alternating with periods of relative stability.

During the period under analysis, 1990-4, several measures were carried out in the pricing system. In 1990 the negative turnover tax on food was removed, a surcharge on 20 percent of the customs duty on imports was introduced, world prices began to be used in

trading with countries of the former Council for Mutual Economic Assistance and the exchange rate of the Czech crown was devalued.

The heaviest shock came at the beginning of 1991. Price liberalization led to a sharp jump in prices. Average annual inflation reached 56.6 percent. As a consequence, average real incomes among the population plunged by 27 percent, and the average real wage fell by 26 percent. Furthermore, the savings of the population lost about 30 percent of their value.

However, despite the fact that the actual inflation rate (56 percent) was higher than the rate predicted publicly (30 percent), "social peace" was maintained. This was due not only to the relatively high quantitative level of consumption among the population at the beginning of the transformation process, but also to the following factors.

- The existence of a universal consensus on the necessity to face the debt of the past, that is, acceptance of a temporary decline in living standards as a precondition for the success of the fundamental macroeconomic measures as the basis for growth in the future.
- The sudden quantitative and qualitative changes in consumption among the population that began as early as 1990 and accelerated after the price liberalization. These included a decline in consumption, structural changes in consumption, substitution, shrinkage, a drop in quality, a halt to the "renewal cycle" among households, an increase in the consumption in-kind of foodstuffs and the emergence of "do-it-yourself" services).
- During this first phase of reform, the survival of a low level of differentiation in income and property ownership and the lack of widespread, conspicuous consumption among upper income groups also helped to keep social peace. This encouraged the common feeling that the burden of the social costs of economic reform was being borne by all citizens.

After a period of relatively quiet development in 1992 came, at the very beginning of 1993, another shock due this time to the introduction of a new system of taxation, involving in particular the change from a turnover tax to a value-added tax. This led to a price increase of 20 percent. In this way, the savings of the population fell in value in real terms from 1990 to 1992 by an additional 100 crowns for each 1,000 crowns in savings.

After the shock at the beginning of 1993 it was clear that the period of recovery in the standard of living after the shocks of 1990-1 had been too short and weak to offset the negative influence of the long-term impacts which started to emerge at the end of 1992.

The negative effects of the reductions in the quality and quantity of private consumption during the previous period now became apparent. In combination with the negative influence of a sharp differentiation in incomes and property, these effects caused a

rise in 1993 in dissatisfaction with the economic shocks. The perception was growing that the burden of the economic transformation was being borne only by particular segments of the population, mostly people with low or below average incomes. A significant role was played in this perception by the fact that, despite the evident increase in real wages and real incomes in 1992, the level of real incomes and real wages was lower by some 21 percent and 19 percent, respectively, at the beginning of 1993 than it had been in 1990.

In 1994 the annual inflation rate began to stabilize (probably for an extended period) at roughly 10 percent. Central Government initiatives concerning prices, through, for example, the restriction of subsidies, were now playing a less important role.

Throughout this time, the central Government had a great influence on the level of wages. In 1990, wage regulations from the era of central planning were still in force. In 1991, industrial relations began to be liberalized, and the introduction of collective bargaining became inevitable. However, wages remained subject to a system of central administrative control. This centralized system of wage regulation had been introduced as part of the fight against inflation, as an anchor in the course of the liberalization manoeuvre at the beginning of 1991 and to promote an increase in the competitiveness of Czech goods.

The system of wage regulation has been changed several times. In 1991 it was essentially a centralized directive system which set wage growth for each quarter. The regulatory authority covered all enterprises with more than 24 employees. According to the original Government estimates of inflation (about 30 percent), the real decrease in wages was anticipated to be in the range of 10 to 12 percent. In fact, the real decrease was more than twice this amount in 1991.

Since then, wage regulation has been significantly reduced, allowing wages in enterprises with a better record of performance to be raised by 5 percent or even more.

3. **Labour market policy.** In the course of 1990, the institutional basis of an active labour market policy was implemented. As a result, 76 labour offices were opened at the district level. The number of branch offices was subsequently extended, leading to the creation of a complete nationwide network. These offices represent a system of employment services covered by the Employment Services Administration within the Ministry of Labour and Social Affairs. Starting in 1991, in accordance with the Law on Employment, the labour offices have been carrying out selected elements of an active employment policy.

- *Socially meaningful jobs.* This programme involves the provision of financial assistance and credit for employers for the creation of new jobs, as well as the provision of assistance

to unemployed individuals so that they can become self-employed. The programme was responsible for the creation of 62,500 jobs in 1991 and almost 93,700 in 1992, but only 9,550 new jobs in 1993 and 9,440 in 1994. The results in these last two years were so low because of the decrease in the unemployment rate and pressure to use the available financial resources more efficiently.

- *Public service jobs* are organized especially in cooperation with municipalities. This programme offers jobs to unemployed people for a period of up to six months. It was responsible for the creation of 20,000 jobs in 1991, 29,000 in 1992, only 9,000 in 1993 and 13,400 in 1994.

- The *jobs for new graduates* programme offers training to improve theoretical and practical knowledge, skills and experience. The labour offices assist in covering the personal costs connected with the employment of graduates registered with the offices. The programme created 8,160 new jobs for graduates in 1993 and 7,025 in 1994.

- *Retraining* is a very important programme, which should be expanded. Here, too, however, fluctuations have been recorded (Table 2).

Table 2: PARTICIPANTS IN THE RETRAINING PROGRAMME  
(1991-4)

	1991	1992	1993	1994
New job applicants in retraining	8,000	17,600	12,095	14,814
Retraining leavers	3,700	18,400	12,521	15,167

Source: MLSA (1991), (1992), (1993), (1994a).

- The programme aimed at the *creation of jobs for the disabled* includes Government assistance in the establishment of job protection for the disabled. This kind of activity is important not only in terms of the economy, but also from the point of view of health care and humanitarian concerns. The programme involved the creation of 1,415 new jobs for disabled individuals in 1992, 1,005 in 1993 and 851 in 1994.

4. **Income transfers and benefits.** The real value of the average retirement pension fell between 1989 and 1991 by 18 percent (Table 3). This was significantly less than the drop of 25-30 percent in the real value of the net wage over the same period. The more moderate decline in the average pension was due to the fact that pensions were indexed in March and

July 1991 and that in May 1991 the Government income support allowance became higher (220 crowns each month) for pensioners. The Government income support allowance increased the average pension by 11 percent.

Table 3: SELECTED INDEXES OF THE RETIREMENT PENSION\*  
(In Crowns And Percentages, 1989-95)

period	monthly crowns	nominal index	real purch.power	cost of living index
1989 XII	1 616	101.3	101.3	100.0
total	1 596	100.0	100.0	100.0
1990 VI	1 616	101.3	97.9	103.4
VII	1 756	110.0	95.7	115.0
IX	1 756	110.0	94.7	116.2
X	1 876	117.5	98.8	119.0
XII	1 882	117.9	98.8	119.4
total	1 717	107.6	97.5	110.4
1991 II	1 882	117.9	75.9	155.4
III	2 089	130.9	82.6	158.5
IV	2 089	130.9	81.4	160.8
V	2 169	135.9	82.3	165.2
VI	2 169	135.9	79.8	170.3
VII	2 291	143.6	84.5	169.9
XII	2 307	144.6	80.6	179.3
total	2 170	136.0	81.6	166.6
1992 V	2 307	144.6	78.5	184.3
VI	2 482	155.5	84.3	184.5
XII	2 486	155.8	77.1	202.1
total	2 409	150.9	80.8	188.8
1993 II	2 486	155.8	70.4	221.2
II	2 712	169.9	76.7	221.5
X	2 712	169.9	73.1	232.6
XI	3 026	189.6	81.4	233.0
XII	3 026	189.6	80.7	235.1
total	2 727	170.9	75.7	225.6
1994 XI	3 026	189.6	72.1	262.9
XII	3 373	211.3	80.0	264.0
total	3 055	191.4	76.4	250.5
1995 VI	3 373	211.3	76.7	275.7
VII	3 783	237.0	85.2	(278.3)x
XII	3 783	237.0	80.9	(293.0)x
Total	3 578	224.2	81.3	(275.7)x

Sources: MLSA (1994b), (1994c); CSO (1989a), (1990a), (1991a), (1992a), (1993b), (1994a).

\* Including the Government income support allowance. x Estimates based on the proposed law for the increase in pensions in 1995.

During this period, the process of adjusting the differences among pensions due to the level of pensions during the year of the first pension payment was completed. The longest term pensions, especially those paid out to pensioners who depended on them as their only source of income, were raised by the highest amounts. The relative purchasing power of the minimum pension was equivalent in 1989 and 1991-2. In contrast, the maximum

nominal pension did not change, so that its relative purchasing power dropped by 57 percent. Between 1989 and the end of 1994, even after it had been raised several times, the relative value of the maximum pension had decreased by 48 percent. Once pensions had been adjusted, the system was more equitable. At the end of 1993, 64 percent of all pension payments were within 500 crowns ( $\pm 17$  percent) of the average.

The real value of pensions in June 1992, after indexation had been completed, was 84 percent of the real value in 1989. Pensions have not been raised back to the real 1989 level under the Administration of Prime Minister Václav Klaus. The purchasing power of the average retirement pension in 1993-4 was never more than 70-80 percent of that of the average pension in 1989. The 85 percent level—in other words, a real value equivalent to that in June 1992—was reached again only in July and August 1995.

The relative position of pensioners worsened significantly in 1993-4. The real net wage rose by 8 percent between 1992 and 1994, and in 1995 it is expected to grow by another 5 percent. Thus, the real net wage will have fallen by only 10 percent between 1989 and 1995.

The living standard of pensioners has been negatively influenced by the relative drop in job opportunities. More and more pensioners are becoming dependent on pensions as their only source of income. According to a microcensus conducted in 1988 (CSO 1990b), 53 percent of pensioners were living in households with no income from employment. By 1992 the figure had increased to 67 percent. On the other hand, the share of pensioners employed declined from 22 percent to 8 percent.

Due to the political opposition and the protests of trade unions and pensioner organizations against the indexation of pensions only according to the rise in consumer prices (and even then with some delay), the Government promised that adjustments in indexation in July 1995 would also take into account the rise in wages. Because of parliamentary elections, it may be expected that a similar procedure will be applied in spring 1996.

As a group families with children lost the most in terms of the decrease in real net incomes (Table 4). The decline in incomes among these families in 1994 was 20 percent, while that for pensioners was 16 percent and childless families, 12 percent. The relative purchasing power of families with children fell by 2 percent between 1992 and 1994, while that of childless families rose by 8 percent.

An important factor in the unfavourable trend in the incomes of families with children was the restriction placed by the Government on income from social benefits. The share of social benefits in the total net incomes of these families was 13 percent in 1989. In 1991 it rose

Table 4: INDEX OF TOTAL REAL NET INCOMES PER CAPITA\*  
(In Crowns And Percentages, 1989-94)

year	quarter	Employees with children		Childless employees		Pensioners	
		Crowns	Index	Crowns	Index	Crowns	Index
1989		1 849	100.0	2 828	100.0	1 730	100.0
1990		1 985	97.8	3 063	98.6	1 881	98.9
1991		2 323	74.8	3 687	77.6	2 440	85.1
1992		2 814	81.4	4 313	81.6	2 797	86.0
1993		3 284	78.7	5 297	83.0	3 199	82.4
1994		3 702	80.1	6 248	88.4	3 575	82.5
1990	I.	1 729	90.7	2 770	95.0	1 667	94.1
	II.	1 830	95.5	2 905	99.2	1 752	98.4
	III.	2 074	98.6	3 058	95.0	1 936	97.1
	IV.	2 306	105.2	3 519	105.0	2 168	106.0
1991	I.	2 040	70.7	3 269	74.1	2 112	79.3
	II.	2 242	71.9	3 498	73.3	2 397	84.2
	III.	2 349	70.4	3 796	78.2	2 608	89.1
	IV.	2 661	82.2	4 184	84.5	2 641	87.1
1992	I.	2 473	74.3	3 592	70.6	2 578	82.1
	II.	2 690	79.6	3 990	77.2	2 671	84.2
	III.	2 802	80.7	4 687	88.3	2 898	89.1
	IV.	3 290	90.2	4 983	89.3	3 042	88.5
1993	I.	2 892	71.5	4 851	78.4	2 767	72.9
	II.	3 208	78.0	4 943	78.6	3 075	80.5
	III.	3 321	79.0	5 431	84.5	3 242	83.3
	IV.	3 715	85.8	5 962	90.1	3 710	92.0
1994	I.	3 330	74.6	5 542	81.2	3 276	78.8
	II.	3 593	79.4	6 270	90.6	3 453	81.7
	III.	3 708	79.5	6 329	88.9	3 637	83.0
	IV.	4 178	86.9	6 852	93.2	3 935	86.6

Source: CSO (1989a), (1989b), (1990a), (1990c), (1991a), (1991b), (1992a), (1992b), (1993b), (1993c), (1994a), (1994b), (1995a).  
\* Total net incomes include consumption in-kind, the positive rate of savings, withdrawals of loans and other sources. The share of consumption in-kind stagnated among families with children and pensioner families during this period, but it increased among childless families. The share of this type of consumption in 1993 was: families with children, 6.4 percent of total net income, childless families, 4.9 percent, and pensioner families, 5.8 percent.

briefly to 19 percent. Since 1992 it has been steadily decreasing.

The purchasing power represented by the total amount of child benefits and Government income support for children dropped by 28 percent between 1989 and 1994. This was due to the fact that child benefits were not indexed and that the Government income support allowance was restricted to families with incomes under twice the subsistence minimum ("životní minimum", or "minimum standard of living").

A drop in the number of marriages and a tendency to postpone marriage were caused by restrictions in the provision of advantageous loans for newly married couples, a halt in communal and cooperative housing starts, a rise in school costs and a decline in social

benefits and allowances. There was also a notable decrease in the number of births, despite the fact that the generation born during the Czech baby boom of 1971-7 was reaching the age of fertility. As a consequence, the number of deaths exceeded the number of live births in 1994, and there was no natural increase in population.

A system of supplementary social benefits connected with an officially recognized level of minimum needs had already existed before November 1989. In 1991 a law establishing a subsistence minimum was adopted to offer protection against material want, and a law on poverty was passed to define the eligibility requirements for families to receive social assistance (Table 5).

Table 5: INDEX OF THE OFFICIAL SUBSISTENCE MINIMUM\*  
(Per Month Per Household, In Crowns And Percentages, 1989-94)

	A		B		C	
	Crowns	Real	Crowns	Real	Crowns	Real
1989	3700	100.0	2000	100.0	4100	100.0
1990	3980	98.0	2140	97.5	4450	98.9
1991	4563	73.4	2415	72.0	5162	75.0
1992	5600	80.2	2850	75.5	6250	80.7
1993	6267	75.1	3200	70.9	6992	75.5
1994	7005	75.7	3573	71.5	7800	76.1

Source: Compiled by the authors.

\* "Životní minimum" ("minimum standard of living"), the official Czech poverty line, has been translated in this paper as "subsistence minimum". A = a family with four members, including two 10-to-15-year-olds. B = a one-parent family with one 6-to-10-year-old. C = a family with five members, including one under-6-year-old and two 6-to-10-year-olds.

Even if the nominal level of the subsistence minimum was higher by 80-90 percent in 1994 than it had been in 1989, the purchasing power it represented was less by 24-8 percent. Starting in 1993 the decline in the purchasing power of the subsistence minimum was greater than the loss in average real income among the families of the economically active. As a consequence, the ratio of the subsistence minimum for a four-member family to the average income dropped from 44 percent in 1989-90 to 40 percent in 1993-4. In 1990 a group of experts recommended that the subsistence minimum for families with children be set at one-half the average income in the country. In the course of the economic reforms, this recommendation was never realized.

5. **Access to basic public services.** Essential changes have occurred in the education and public health care systems since 1989. The abolishment of the monopoly of the state fostered

wide-ranging diversity in the provision of services. As a result, substantial modifications in financing and administration have been undertaken. Before 1989 education and public health care services were fully funded through public resources, and service provision to the population was free of charge. Under the reforms, citizens began to pay for these services in various ways. Moreover, new nongovernment institutions have emerged to supply or finance such services. Other new providers are profit-oriented and offer services for fees.

The transformation of the *public health care system* began with the introduction of a new compulsory health insurance scheme. A rather large number of companies has appeared to offer insurance to be paid for through contributions from employers, employees and the Government. The insurance contracts cover the cost of medicines and care through health care establishments and professionals. Five percent of the costs of drugs and some types of dental care are passed on to the public.

The changes in health care establishments and the provision of services have been influenced by ownership transfers. Some institutions are now owned by communities, while others have been sold off to private companies, individuals or groups of doctors.

The situation is similar in the *education system*. Several types of nongovernment institutions have emerged to provide educational services, including private schooling. An initial goal—to divorce education and ideology—has been reached. The autonomy of schools has been expanded. Costs are now shared among Government, communities, students and parents, and other institutions (like employers in the case of job training). The share of education costs covered by the parents of pupils, students and apprentices has been growing. In 1989 the portion of the costs of primary education borne by families was equivalent to about 2 percent of the average gross wage; the corresponding figure for secondary education was 4 percent, and for tertiary education, 8 percent. In 1993 the respective figures were 3 percent, 8 percent and 15 percent. Nursery school fees and charges for schoolbooks at the secondary level have been introduced more recently.

### **Analysis of the Main Policy Changes**

1. **Fiscal policy.** Despite the radical change in the economic and political orientation of the country in 1989-94, the Czechoslovak and then the Czech Government budgets continued to reflect a cautious, conservative and restrained approach. There were none of the significant budget deficits so typical of other economies in transition.

In the course of the transition to the market system, the reallocation function of Government budgets has been heavily curtailed. A comparison of budget indicators for the Czech economy during this period is rendered rather complicated because of the existence of three Government budgets (Czech, Slovak and Federal) and complex redistribution procedures under the federation. In any case, restrictions on subsidies to enterprises and for final consumption were evident. Thus, the share of subsidies in total expenditures in public budgets dropped from 32 percent to only 7 percent between 1989 and 1994.

Over the same period the share of expenditures on social security also declined, from 42 percent to 33.1 percent, while expenditures on education fell from 14.3 percent to 10.3 percent. In contrast, the share of expenditures on public health increased from 9.5 percent to 15.2 percent relative to total budget expenditures. This occurred despite the fact that a general health insurance scheme, separate from the Government budget, was introduced in 1993. Economically active people contribute a percentage of gross wages to the scheme (Table 6).

Table 6: RATES OF CONTRIBUTIONS FOR HEALTH AND SOCIAL INSURANCE  
(In Percentages Of Gross Wages, 1 January 1993-31 December 1995)

Insurance	Employee	Employer	Total
Health	4.5	9.0	13.5
Sickness	1.2	3.6	4.8
Retirement	6.8	20.4	27.2
Unemployment*	0.75	2.25	3.0
Total	13.25	35.25	48.5

Source: Parliament (1992a), (1992b).

\* In 1993 the contributions for unemployment insurance were: employee, 1 percent, and employer, 3 percent, for a total of 4 percent.

Except for health insurance, all types of insurance are financed through the Government budget, although the original "Scenario of Social Reform" (see earlier) and even the 1992 declaration of the programme of the current Government that was approved by Parliament called for public pension funds, an employment policy and the creation of social insurance institutions independent of state budgets. Today, pleading theoretical and practical obstacles, the Government is refusing this solution. Indeed, the retirement and sickness fund recorded surpluses in 1993 and 1994 (of 16.6 billion crowns and 22.8 billion crowns, respectively), and these surpluses were used as a resource for Government fiscal policy.

2. **Price and wage policy.** The consumer price level jumped by 166 percent between January 1989 and December 1994. The increases in consumer price indexes reached during these years were 188.7 percent for services, 173.5 percent for industrial goods, 175.5 percent for meals in restaurants and "only" 139.8 percent for foodstuffs.

In 1994 the next stage of price deregulation was undertaken, and subsidies were cut for fuel, energy and housing rents. Because of new pressures, mainly revolving around price rises for foodstuffs that had been put off for a long time, the "scenario" of price deregulation had to be changed slightly. The weight of central deregulation assumed in the state budget (2.5 percent) was lowered in 1994 to about 1 percent.

The following were the main *trends evident in the growth of nominal and real wages* in 1990-4 (Table 7).

Table 7: MAIN INDICATORS OF THE GROWTH IN WAGES AND INCOMES  
(1990-4)

	1990	1991	1992	1993	1994
Wage incomes (billions crowns)	203.7	213.1	232.6	294.5	380.4
In 1990 prices	203.7	136.2	133.7	140.1	164.5
Wage share in money incomes (%)	56.9	50.9	46.9	46.6	46.9
Average earnings (crowns/month)	3,278	3,826	4,671	5,889	6,896
Average inflation rate (%)	9.9	56.6	11.1	20.8	10.0
Growth of average real wage (%/year)	-5.6	-25.5	9.9	4.4	6.5
Index, real purchasing power of 1 crown	100	63.9	57.5	47.6	43.3
Average wage at 1990 prices (crowns/month)	3,278	2,443	2,682	2,778	2,983
GDP, 1990 prices (billions crowns)	567.3	486.7	455.6	451.3	463.1
Share of real wage incomes in real GDP (%)	35.9	28.0	29.3	31.0	35.5
Wage efficiency (GDP/wages in real terms)	2.8	3.6	3.4	3.2	2.8

Sources: CSO (1995b), CNB (1994), calculations of the authors.

- The volume of wage incomes rose considerably more slowly than did the total money incomes of the population. The share of wage incomes in total incomes fell by approximately ten percentage points. The dominant cause of this was the absolute and relative decrease in the number of workers earning wages among the economically active population.

- Measured as the share of real wage incomes in GDP in constant prices, a substantial *decline took place in macroeconomic wage costs*. This means that macroeconomic wage costs dropped more rapidly than did GDP, and the efficiency of wage outlays thus rose in the national economy. The main reason for the climb in macroeconomic wage efficiency was the very sharp decline in real incomes and real wages during the first year of the economic

transformation. This created a cushion between internal and external market prices. This trend is being rapidly exhausted with the decrease in GDP and the necessary increase in real wages. Indeed, the reduction in private consumption at the beginning of the transformation process was too large, and the dampening factors, especially the decline and structural changes in the consumption of households, were too weak and had only a limited effect.

- In the context of the very rapid rise in "other incomes", the *growth in wage incomes* has been in an inflation-neutral position during the whole transformation period. No inflationary pressures have appeared because of a supply "push" or a demand "pull".

- Compared with pre-reform times, the *increase in nominal wages* (average earnings) has been unprecedented. At the same time, relative to the rise in prices, the *fall in real wages* has been very sharp, particularly at the beginning of the economic reform in 1991. Despite the gradual reduction in this trend in 1992, the real wage was lower in 1993 than it had been in 1990 by 15.3 percent (and relative to 1989 by 20 percent). Meanwhile, the real income of households was lower by 18.2 percent.

- The rapid change from an egalitarian wage and salary system to the significant differentiation of the market economy was very striking. While for decades up until 1990, social equality and wage distribution patterns were comparable with those in the Scandinavian countries, the gaps in income and ownership generated with lightning speed during the transition were more similar to those in the US. The range in individual incomes under the Communist regime was fairly consistent at a constant level. Between the 1960s and 80s, the ratio of the lowest to the highest wage decile was 1 to 2.3-2.4.

Official data on the distribution of income and property are not currently available. The only source of information is provided by the estimates generated by sociological surveys. Empirical data were gathered by the Sociological Institute in the process of undertaking sample surveys on economic expectations (Večerník 1994). According to the subjective testimonies of the respondents, the income differentiation in 1993 was substantially wider than that found in a microcensus conducted in 1988 (CSO 1990b). The share of the highest decile had grown disproportionately, reaching more than 23 percent of all incomes, which was six percentage points more than the corresponding figure in 1988. Among this decile, the average monthly income per household member in 1993 was 8,230 crowns. This was 2.5 times as much as the relevant figure in 1988. This means that the purchasing power of these incomes had risen by 16 percent at a time when the overall income of the population was declining by 14 percent. The real incomes of 30 percent of the population (from the sixth

to the ninth richest deciles) fell to the same extent as did the real incomes of the entire population. In contrast, the real incomes of the poorest decile and of those deciles with below average incomes declined substantially more, by 22-6 percent.

However, this is a cross-sectional and momentary view. Only a portion of those who had the highest incomes in 1988 were within the highest (tenth) decile in 1993. Some fell back into a lower decile because of a loss of professional position or a change in their living conditions, for example, by being pensioned. Others rose from an average or slightly above average position (fifth to seventh deciles) into a peak position. The real incomes of the latter jumped by a factor of two.

Despite the lack of statistical data on wage differentiation, the ratio of the minimum wage of 2,200 crowns to the salaries of top managers can be estimated at one to ten.

*Above average wage growth* is notable in areas connected with the transformation boom (commercial banking and insurance, the food industry, commerce and restaurants) and in businesses offering professional services.

*Below average wage growth* was recorded in industries registering a drop in demand, sales difficulties, a negative impact from restrictive Government policies, or a fall in economic performance due to the impact of the transformation. Such situations characterized coal mining and the extraction of other raw materials, machinery producers, the textile industry and, especially, agriculture.

Changes in the regional structure of average wages were a result of many factors, including regional specialization, the regional distribution of industries, vicinity to transport centres or markets, and the ratio of supply and demand on the local labour market. The growth in wages in Prague was extraordinary, while the traditional wage advantages of Northern Moravia (the area of Ostrava), with its important mining and heavy industries, disappeared. The lowest wage levels were found once more in Southern and Eastern Bohemia and Southern Moravia. The gap between the average wages in these regions and the national average increased.

Socioeconomic analyses have repeatedly recorded substantial differences in earnings between males and females (Baštýř 1993, Hiršl 1994a). The average hourly wage among women is more than one-fourth less than that among men. The status of women as career professionals, housewives and mothers is not adequately recognized. The position of women on the labour market and their relative position in terms of job earnings are unfavourable. Employed women with children must often be absent from work in order to care for their

families. Even among childless families the difference in gross wages between men and women is 19 percent. Among families with one child the difference is 28 percent, and among families with two children, almost 40 percent.

3. **Labour market policy.** A labour "market" was first created in 1990-4. The switch from full employment and overemployment to a (relatively liberal) labour market was more smooth in the Czech Republic than it was in other economies in transition. The Czech Republic has one of the lowest unemployment rates in Europe, even when the rate is measured according to the methodology of the International Labour Organization (4 percent).

One of the positive factors influencing the situation on the labour market has been the rapid development of the private sector, especially in services. Another is the existence of a relatively rich industrial structure, including the country's advantageous geographical position. An important role has been played by the rather low wage levels and the "harshness" of the social security system for the unemployed. The changes in the pension system also represented a handicap for the unemployed.

A Government decree of 1988 allowed the early retirement of employees (two and sometimes five years early)—without restrictions in terms of retirement pensions—in the case of the closing or basic reorganization of an enterprise. This measure helped to keep down the number of the unemployed between 1990 and 1992. However, fresh legislation on early retirement introduced in March 1994 has had an opposite effect. Now, to be eligible for a pension, an early retiree must have been registered with a labour office as a jobseeker for at least 180 days. Thereafter, until the early retiree reaches the normal retirement age, the pension is reduced 1 percent for every 90 days of early retirement. After the early retiree has reached the normal retirement age, this "penalty" no longer applies. However, any period not worked cannot be included in the pension base. Moreover, in any case, early retirement can only be taken by those who are within two years of reaching the normal retirement age.

The significant drop in the extent of unemployment has also resulted from policies adopted by enterprises, which have intentionally reduced the hiring of people of pension age. A microcensus has found that between 1988 and 1992 the number of people in this age group who were employed fell from 497,000 to only 233,000 (CSO 1990b, 1994c). The number of employees in the pensionable age group has since stabilized at around 225,000-240,000 (CSO 1995b). Since 1993, early retirement and the restrictions on the economic activity of pensioners have no longer been a factor in lowering the supply of people on the labour market.

Some people have disappeared from the rolls of the employed and unemployed because they have become active in the "shadow" economy and are evading the payment of taxes and insurance contributions. This second economy involves, for instance, the illegal renting of houses and apartments to foreigners, unregistered jobs in small businesses and prostitution and other activities on the margin of the law and society.

Many thousands of persons are employed in neighbouring West European countries. This offsets somewhat the unemployment in the regions bordering on Austria and Germany.

4. **Income transfers and benefits.** A significant role in dampening the social impacts of the economic transformation was played, particularly in 1990-1, by the state compensation benefit. This universal income support payment was introduced in July 1990 as a compensation for the removal of retail food subsidies that was associated with price increases. It covered more than 20 percent of all food expenditures at that time. However, the nominal increase in the prices of foodstuffs was only 10 percent in autumn 1990. This meant that a portion of the state compensation benefit was being used for other purposes and that the benefit probably helped prepare the population for the "shock" rise in prices in 1991. Overall food consumption declined, and the change in the structure of food expenditures was initiated, for instance, by means of the replacement in diets of butter by plant oils. Since May 1991, pensioners and children have each received a higher state compensation benefit of 220 crowns (140 crowns, plus an additional 80 crowns) per month to offset the partial removal of subsidies for fuel, energy consumption and central heating.

The universal state compensation benefit was discontinued in 1992. The benefit became available only to pensioners, children and people receiving the parental leave benefit. The benefit for the first two groups was fixed at 220 crowns per month, while for the third group it was set at 140 crowns. Since October 1993 the benefit has been discontinued for children living in families with incomes above twice the subsistence minimum. In October 1994 the benefit was boosted to 320 crowns per child for families with incomes below 1.5 times the subsistence minimum.

Since 1992, the benefit has no longer been available to pensioners with incomes from employment greater than the minimum wage (2,200 crowns). In December 1994 the nominal benefit was finally discontinued for all pensioners, and 220 crowns was added to each pension. Together with another 200-crown payment, this is an important slice of the average pension. However, because they are now a direct part of the pension, the 220 crowns are

provided not from taxes, but through pension insurance contributions. This accounted for a shift amounting to 5.7 billion crowns in 1995.

Between July 1990 and December 1991 the state compensation benefit represented an increase of 140 crowns per month, or roughly 4-5 percent, in the net wage. The benefit was not financed by enterprises, but through the Government budget. This ought to be borne in mind if one compares the growth of nominal and real wages in 1991 and 1992.

5. **Access to basic public services.** The transformation of *public health care* has involved several measures to increase the responsibility of citizens for their own health, transfer financing from the Government budget to the insurance system and carry out privatization.

The overall financing of public health care is changing. The role of Government budget expenditures has been declining, and alternative sources of financing have become more important. For example, in 1993 the share of payments from health insurance companies in the incomes of health care institutions was 82.6 percent, while that of investments and expenditures from the Government budget was 10 percent, that of the earnings of these institutions and the payments of patients was 6.9 percent, and that of grants and gifts from sponsors, endowments and foundations was only 0.5 percent.

The large number of health insurance companies is resulting in a sharp jump in the costs of public health care. This is clear from data on the expenditures for public health care in 1991-4 (Table 8).

Table 8: EXPENDITURE ON PUBLIC HEALTH CARE  
(1991-4)

	1991	1992	1993	1994	Inter-annual rates		
					92/91	93/92	94/93
Total costs (crowns, billions)	36.7	43.6	85.3	70.4	118.8	133.7	120.8
Share of GDP (%)	5.1	5.5	6.4	6.8	--	--	--

Source: MOF (1991), (1992), (1993), (1994).

Health care establishments are constantly suffering from the lack of financing to renew infrastructure. They are under pressure because of the credit policies of commercial banks. Some have proposed an increase to around 15 percent in the direct share of patients in the burden of the costs of treatment.

After having decreased between 1989 and 1992, the number of children placed in *kindergartens* began to rise again in 1993. This has been due to the very low wage levels, which have meant that families must now rely more frequently on two incomes. Nonetheless, though the number of children in kindergarten has grown, the number of educators has fallen because of spending cuts and other economy measures of the Government and municipalities. Likewise, investment in the construction of new kindergartens has been practically halted, and many existing establishments are now being used for other purposes. The share of parents in meeting costs is going up; starting with the 1993-4 school year it stood at 30 percent.

A new "free-teaching" programme framework has been introduced in *primary schools*, enabling teachers to work independently and select and employ more creative approaches in the education process. Compulsory schooling has been cut from ten to nine years. A majority of all primary schools is still being run by communities.

As an alternative education method at *the secondary level*, multigrade schools (gymnasiums) have appeared and attracted the interest of many students and parents.

The number of secondary school students is dropping as a consequence of the population decline. A reduction in the number of classes and teachers is being caused by a downturn in the number of students and spending cuts by the Government and communities. There is relatively little interest in the establishment of private schools.

*Job training* is being deeply influenced by the way the economy is developing and by the changes in enterprises. Few new entrepreneurs have a large capital base, and most will not or can not organize and finance job training programmes. Up to 1989, enterprises were required to cover most of the costs associated with the preparation and training of personnel in training centres; this is no longer the case. There is a danger that pupils who do not enter secondary school will lose any chance to participate in ongoing education and training programmes. The Government therefore supports job training programmes for those apprentices who would not otherwise receive organized training.

*Professional schools* have been dealing with new types of demand for educated, skilled and trained individuals. The Government is playing the major role in financing. However, family budgets are covering a mounting share of the costs. Starting with the 1993-4 school year, students have been paying for schoolbooks and a variety of teaching aids.

*Institutions of higher learning* have been subject to dramatic changes since the passage of a new law on university education in 1990. The law extended the autonomy of these

institutions and their faculties, enabling them to put an end to the rigid central control and influence of ideology that were characteristic of the past. The new autonomy has had an impact on all dimensions of the internal life of these institutions, including education programmes, tuition schemes, organization, management and administration, personnel policy and the allocation of financial resources. Academic leaders now have a greater say, and decentralization has led to a fragmentation in educational approaches.

Since 1989, the total number of new entrants and their share in the population have risen. A growth in the overall number of university students has also been recorded. The regional distribution of university institutions is becoming more equitable because of the establishment of new schools and faculties. However, the average number of students per instructor is climbing. Due to the restricted capacities of universities and graduate studies programmes, one-half of applicants can not be enrolled. On the other hand, the number of unemployed graduates remains low.

The Government covers most of the routine costs. Students pay for schoolbooks and associated costs (meals, accommodation, transport and so on). Starting in 1996-7 fees are to be introduced for university education.

### **III. POLICY ASSESSMENT: SUCCESSES AND FAILURES**

#### **Expected and Observed Policy Impacts**

Increased inequality in the distribution of incomes was also being predicted on the basis of the extraordinary income levelling which occurred during the period before the reform. The longstanding very narrow income differentials have contributed to the perception held by the majority of the country that the current distribution of incomes is a serious social problem. Czech society has traditionally been rather egalitarian. Moreover, the fact that a great deal of money is being made illegally or within the shadow economy by former members of the "nomenklatura" is viewed very negatively. These people had the opportunity to prepare financially to establish businesses on the emerging free market. Likewise, by abusing their power, they were able to profit from the privatization of attractive segments of the property of the Communist state.

The decline in the purchasing power of the ordinary citizen was greater than that originally forecast by the Government, and the economically inactive were hit very hard. While the real average wage fell only in 1991 and since then has been climbing, the purchasing power of pensions and other social benefits has been diminishing since 1991 because indexation has lagged behind the rise in prices. For example, in December 1994 the real value of the average retirement pension was 20 percent lower than that in 1989. Thus, economically inactive retirees have been struck severely over the long term in the course of the transformation. Many families with children (especially large families and broken or incomplete families) have also suffered, as the indexation of the family allowance has been even less efficient than the indexation of pensions.

In contrast, in the course of the economic reform the position of higher level employees improved. In particular, the job opportunities and earning power of managers and entrepreneurs—and their families—advanced significantly.

The voucher privatization programme also represented a means of profiting from the transition. It involved the transfer of a significant portion of public property to residents. To a certain extent, it was a compensation for the losses to residents that resulted from the decrease in real incomes and the devaluation in savings due to the significant inflation in 1991. The level of "compensation" depended greatly on the success or failure of individual investors in their selection and purchase of shares in specific enterprises. However, on average, a certain profit was realized, and this contributed to the stability of the transformation in the Czech Republic. Approximately six million people participated in the voucher privatization programme during its two phases. By the end of 1994, two million shareholders had already sold off all the shares they had acquired during the first phase of the programme. In this way they earned approximately 20,000 to 25,000 crowns each, that is, approximately five or six times the average net monthly income per household member of an economically active household in 1994.

The Government has not succeeded in maintaining inflation at the level it targeted. Even in those years when inflation was as the Government had expected, this was achieved only because the Government backed away from its goals in price deregulation and cuts in price subsidies.

The intention of the Government to maintain wages at a noninflationary level was essentially fulfilled. Despite resistance from its "social partners", the Government managed to realize its aim of maintaining wage regulation as long as possible.

The widening gap in the incomes of households has been very significant and represents a new phenomenon in Czech society. The gap has not been due mainly to differences in job performance, but rather to differences in the ownership of property. This is not yet reflected in social statistics, but it is nonetheless obvious empirically. It can be demonstrated through a comparison of the shift in the total real private consumption of households and the growth in the total net real incomes of the households of employees and pensioners. Between 1989 and 1994 the purchasing power of employee households fell by 17 percent, while that of families with children dropped by 20 percent (see, for instance, CSO 1995a). The loss among the households of pensioners was only 16 percent. On the other hand, the index of private consumption per inhabitant at constant prices over the same period decreased by only 5 percent (CSO 1995c). There was an extraordinarily large difference in the changes in these indicators between 1992 and 1994. Private consumption in real terms rose in these years by 8.4 percent, while the real incomes of employees increased by only 1.5 percent. The incomes of pensioners even declined by 2 percent.

The changes in net real wages were also sharply differentiated. In 1994 the average annual growth rate was 5 percent. However, the average net real wage fell slightly, by 0.7 percent, among the first decile, stagnated (at +1.1 percent) among the first quartile, and increased only slightly (+2.3 percent) at the median. In contrast, the highest 10 percent of wages rose in real terms by 9.7 percent.

The real wage dropped among 10 percent of employees and stagnated among 36 percent in a sample survey of 285,000 employees in 1994 (Trexima 1994, 1995). It rose slightly (by 1-3 percent) among 27 percent of the employees and more significantly (3-5 percent) among 11 percent. A more rapid increase (of 5 percent or more) occurred among 16 percent of the employees. These hard data have been confirmed by public opinion polls, which found that in 1994 only 14 percent of all respondents described their real incomes as having increased over the previous year, while 58 percent said that they had decreased (IVVM 1995).

The purchasing power represented by the subsistence minimum (the official poverty line) has been decreasing more rapidly than has that of the average real income of households (compare Table 4, page 13, and Table 5, page 14). In real terms, the subsistence minimum has fallen by 24-8 percent since 1989. The share of the minimum in the average per capita income is thus smaller now than it was in 1989. This and the fact that the minimum pension is above the official poverty line explain why the portion of the population living below the poverty line is small.

Childless households rank among the poor only in extraordinary cases. Among families with children, the share of households under the official poverty line was 3 percent in 1992. These households accounted for 4 percent of all children. However, if the real value of the subsistence minimum had remained at the level of 1989, the share of the poor would be 12-13 percent of the population.

Among the poor are found not only households with no income, but also households with only one income, that is, broken or incomplete families, families with small children and mothers receiving the child-rearing allowance. Unusually, families with one member among the long-term unemployed are found there as well. On the other hand, much more frequently than has been the case in the past, people with few skills and inhabitants of regions with high rates of unemployment also rank among the poor. The share among the poor of gypsy families with low incomes is extraordinarily high.

In any case, the feeling that their standard of living is good rather than bad continues to prevail among most people (Table 9). At the same time the share of extreme evaluations ("very good" or "very bad") is increasing, though it is still marginal.

Table 9: PERSONAL EVALUATIONS OF INDIVIDUALS OF THEIR OWN STANDARD OF LIVING  
(In Percentages, 1990-4)

period	very good	rather good	rather bad	very bad
II 90	2	56	38	4
VII 92	2	51	42	5
VII 94	4	54	36	6
XII 94	5	55	32	6

Source: IVVM (1995).

People are tending more and more to count themselves within the average as expressed by the sentence: "The household has sufficient income so as not to have to restrict too much the satisfaction of current needs, but, should more be wanted, it must economize in another area". Only 33 percent of all respondents answered this way in summer 1992, while 47 percent did so in summer 1994 (Hiršl 1994b).

During these years the share rose (from 27 to 36 percent) of those who felt that the sentence "We live modestly, saving also on current expenditures, and can hardly afford to attempt anything better" described accurately their situation. This sentence appears to reflect a status close to the official poverty line.

Meanwhile, the share decreased (from 26 to 11 percent) of those who believed, "We do not need to restrict the satisfaction of our current needs, and from time to time we can also afford better things". People answering in this way appear to be enjoying an above-average standard of living.

Only 1 percent of all respondent household felt that they were living under no pressure whatsoever to restrict in any way their spending. This was less than the share in 1991-2 (3 to 4 percent).

The proportion of respondents who felt that the sentence "We have insufficient money even to meet our essential needs" described their households well declined from 9-11 percent to 5 percent.

### **Factors Responsible for the Divergence between Expectations and Results**

In terms of living standards the difference between the "official" results and expectations was not very dramatic in the Czech Republic except in 1991. The public appeared to be well prepared for some sacrifice, especially with regard to the decline in consumption.

The main causes of the steep economic recession after 1990 were the following.

- The implementation of a strategy of economic reform that definitely preferred the restoration of monetary and fiscal balance over the maintenance of overall economic output.
- The almost total disappearance of trade among the countries of the former Council for Mutual Economic Assistance. The Czech economy suffered more than most former Communist countries from this state of affairs.
- The period of preparation for privatization, when the state continued to exercise its ownership function over enterprises while awaiting the identification of new owners, had a negative impact on economic development during the first years of the transformation. This period witnessed spontaneous privatization, a drop in the value of enterprises and so on.

In 1992-3 two significant phenomena contributed to ongoing economic recession in the Czech Republic.

- The division of the Czech and Slovak Federative Republic, at midnight on 31 December 1992, generated a substantial downturn in trade between the Czech and Slovak Republics. The decrease of the GDP of the Czech Republic resulting from the division has been estimated at 1-2 percent. In the Slovak Republic the losses were even greater. The decline in commerce continued into 1994, and this also had an unfavourable impact on the overall dynamics of the economy.

- The recession in the countries of the European Union that had become the most important trading partners of the Czech Republic after the disappearance of the Council for Mutual Economic Assistance.

### **Government Aims in Social Policy**

From 1990 to June 1992 the Government of Czechoslovakia and then that of the Czech Republic strived hard to protect poor and vulnerable groups against the exorbitant social costs connected with the transition to the market economy. The programmes of these Governments were aimed at creating the proper conditions for the transformation of the centralized economy based on state ownership to a modern market economy with a social and "ecological" orientation.

However, at the same time, already in 1991 quick price and external trade liberalization measures were introduced, and the most rapid possible privatization was assigned absolute priority in economic policy. This approach was supported by the political forces which won the election held in June 1992 in the Czech Republic and which were tied to the idea of the market as a panacea and of an unrestricted market economy. It came to be fully reflected in Government policy after the independent Czech Republic came into existence in 1993. This had an impact on the social position of pensioners and the majority of wage-earners (see earlier). It was also adopted within a broader social and political context.

After 40 years of rule by the Communist Party, which claimed that social justice was its aim, but which during the last 20 years had, through its practices, persuaded almost the entire population that it sought only to protect its privileged position, the disillusion with socialist ideas and their compatibility with democracy and human rights was great, and a wave of individualism swept over Czech society. Right-wing political sentiments prevailed. The majority of people believed that they would be among those who would quickly become rich if the state created no obstacles. Consequently, the Civic Democratic Party, claiming that

the political relationship between the state and the citizen is fulfilled by the mere participation of the citizen at elections every four years, gained broad support.

For the present Government the participation of voluntary associations in political affairs in any way other than through elected members of Parliament is pointless. According to this philosophy, the activities of trade unions, for example, should remain confined to the particular interests of unions within specific enterprises. Nonetheless, the vast majority of entrepreneurs bar them even from this. According to the prime minister, trade unions have in no case the right to meddle in general economic and social policy. The political supporters of the Government consider as entirely wrong the idea that citizens should decide on basic political questions through referendums (for instance, the division of Czechoslovakia). Such referendums are viewed by these politicians as a case of direct democracy undermining the principles of classic parliamentary democracy. However, even among the principles of parliamentary democracy, they recognize only the rights of the "winners", on the basis of which the person who has gained the majority of votes assumes full powers. Thus, the old claim that the ruling party is omniscient and knows the only correct avenue to success has not yet been set aside for good.

At the same time the Government's actions in the social sector are highly pragmatic, because the Government wants to win the next elections. It is striving to appeal particularly to pensioners, who represent a significant number of voters. The Government is much less interested in cooperation with trade unions and other voluntary organizations which have no direct say in Parliament.

The current Government perceives "social peace" less and less as an agreement or consensus among social partners and various elements in society about the most acceptable way to arrange public matters. It does not view social peace as an outcome of dialogue within society, but as the result of the bending of citizens and their various associations to the will and decisions of the Government. According to the Government, social peace should be based on the resignation of citizens and the apathy and impotence of their organizations whenever they do not support the ruling political parties. Such a conception of social peace condemns those who do not agree with the policies of the Government to play the role of rebels and "social enemies" deserving the general disapproval of decent people.

The fight over the character of Czech society has in no case been decided. However, according to public opinion polls and the results of communal elections held in November 1994, the support for the most powerful Governmental party, which propounds the above

ideas, is the strongest and typically represents about 25 percent of voters (STEM 1995). This is somewhat contradictory in that, during the same period (1992-4), the share of the population preferring the "social" market economy, with the state playing a significant role, was greater than that advocating the view of Prime Minister Klaus that a pure market approach is the best solution. In spring 1992, before the elections, the situation was reversed (Večerník 1994). This internal contradiction among social and political attitudes will be tested in the course of 1995, when the reforms in the social sector are to be determined.

### **The Merits, Limitations and Shortcomings of Government Social Policy**

An undoubted *merit* of the social policy of the Government is the fact that, despite the rapidly widening differentiation in incomes and the ownership of property, the incidence of extreme poverty in the Czech Republic is still small. Another positive feature is the low rate of unemployment. The maintenance of social peace should also be considered a "plus", in spite of the fact that from the side of the Government there is a strong tendency to understand it very peculiarly. On the other hand, future social peace is endangered by recent actions of the Government concerning the passage of new social legislation.

A *limitation* of present social policy resides in the fact that it has been subordinated to purely pragmatic, general political objectives, including the goal of the ruling party to win the next elections. Likewise, the content of social policy is considered secondary to fiscal concerns, especially a balanced budget.

A main *shortcoming* of current social policy is the fact that it does not offer adequate support for long-term decisionmaking by individuals regarding the arrangement of their future lives. For example, the determination of the real amount of retirement pensions should remain in the hands of the Government; it should not be fixed by law (Parliament 1995). Another shortcoming revolves around the effort of the Government to transfer almost all consequences of the decision to have children to parents, including those whose incomes are less than average. The Government is also disregarding the need for significant public sector contributions to resolve the housing problem.

If current social policy continues to be implemented for much longer, it will cause the creation not merely of a "two-thirds" society, but of a "one-third" society in which only a minority of the Czech people can afford to live at a level comparable with that of people in Western Europe. According to a public opinion poll at the end of 1994, 63 percent of

households considered their standard of living lower than that in 1989, while only 20 percent considered it higher and, of these, only 9 percent significantly higher (IVVM 1995). This in spite of the fact that living standards in the Czech Republic before 1989 lagged significantly behind those of neighbouring Western countries.

The shortcomings of current social policy in protecting the most vulnerable groups in society have become manifest especially in the following ways.

- The unemployment dole is insufficient in terms of amount (50-60 percent of the last wage received), as well as the period of eligibility (six months).
- The official subsistence minimum is very low, representing only 40 percent of the average income in the households of the economically active and less than 35 percent of per capita consumption.
- The measures aimed at fostering the social reintegration of groups living at the margins of society, especially gypsies, are insufficient. The emergence of ghettos of hereditary poverty with high crime rates and an explosion of racial violence are a resulting risk.

Although not explicitly expressed in its programme, the "residual" principle prevails in the entire concept of social policy of this Government. New laws and measures are not determined primarily by a desire to satisfy the proper social needs of individuals, but by a desire to fulfil objectives outside the social sphere, such as the enhancement of the political support for the ruling party or a balanced budget.

These are the reasons why the question in the title of this paper can not be answered "yes". The methods used in the transformation to a market economy have thus far not led to a success story.

#### **IV. POLICY CHANGES ARE URGENTLY REQUIRED**

No thoroughgoing proposals clearly contrary to the direction of current Government policy have yet appeared. Rather, the majority of alternative proposals has been aimed at moderating the intensity of measures which have not been sufficiently thought out and which reflect a lack of sensitivity to social problems. Together with trade unions, the political opposition to the left of the current Government finds negative impacts of policy in the quick reduction of social benefits and the erosion in service access as a result of the privatization of health care services. In the area of fiscal policy, opponents have raised alternative

proposals against the fundamentalism of the current Government, which considers a balanced budget the highest priority. They insist that a balanced budget can not be the only important goal over the long term. They point out that the public sector is being neglected and that social transfers and the construction of housing are being curtailed.

For quite some time, trade unions have been lobbying for the elimination of the regulation of wages. The regulation of wages within the current context of very low labour costs and rapidly widening wage and income gaps tends to place the financial burden of the economic transformation more and more on labour. In spring 1995 a conflict arose between the Government and unions representing public sector employees (railway workers, teachers, hospital workers and so on) over the level of wage increases.

In 1995 unresolved problems in social reform have come to the fore. During the first half of the year Parliament dealt with basic bills on the pension insurance scheme, Government social benefits and social assistance. It passed a law on Government social support in May and a law on the pension insurance scheme in June. In these areas the standpoint of the Government, especially the most powerful ruling party, the Civic Democratic Party, as well as Prime Minister Klaus, differed appreciably from the views of trade unions, pensioner organizations and opposition parliamentary parties.

For example, should the basic obligatory pension be provided through the state pension security scheme or through a public social insurance company which would manage contributions fixed by Parliament, but held in a fund separate from the Government budget? Between 1993 and 1995 pension insurance contributions remained part of the revenue in the Government budget, and the surplus (more than 20 billion crowns) from pension contributions for the past two years has been used to cover other Government expenditures. It was not used to create a reserve fund for future needs of the pension insurance system.

Or what should be the respective roles of the obligatory basic pension insurance scheme and the voluntary supplementary pension scheme? Trade unions support the idea that the value of the basic obligatory average pension should not fall below 50 percent of the average gross wage and that pensions should be fully indexed to wages. The Government has guaranteed that over the next ten years the basic pension will be maintained at 45 percent of the gross wage. After that, the basic pension would drop to 35 percent, the level of the subsistence minimum.

Meanwhile, Government experts claim that a decrease in insurance contributions by four to seven percentage points (from 27.2 percent) would enable workers themselves to pay

for the supplementary pension insurance scheme, to which the Government now supplies the equivalent of 0.5-1.5 percent of the wage. According to the experts, this additional insurance could in this way cover the loss of 10-15 percent of original gross earnings arising from the decline of the basic obligatory pension relative to the average wage.

However, this would not solve the problem, since the gain for employees from the lower obligatory contribution for retirement and the extra Governmental allowance for the voluntary supplementary pension scheme would be only 3 percent of the average gross wage.

Trade unions back the more classic employer supplementary pension insurance scheme, which could be financed not only by insurees, but also by enterprises as part of their production costs. Trade unions are also demanding that the decision to raise the retirement age by five years be postponed. In this they are supported not only by opposition parties, but also by the Christian Democratic Union-Czechoslovak People's Party, which is one of the parties in the Government.

Should all families with children be entitled to the basic social benefits for such families like the family allowance, the parental leave and the birth grant, or should these benefits be targeted according to family income? The Government proposed providing the family allowance only to those households with incomes below 1.8 times the subsistence minimum, or approximately 70-5 percent of the average income per capita. Realization of this proposal would have meant that one-third of all children would be ineligible. The main purpose of the Government in its proposals was to save 6 billion to 7 billion crowns on the social benefits for families with children.

After long, complicated negotiations, the leaders of the political parties in the Government agreed to increase the limit for the family allowance to three times the subsistence minimum. This means that only 5 percent of all children will be ineligible for the allowance as of January 1996. Moreover, the level of this benefit for other households with children is to be set according to income. Thus, a complex income-testing procedure will have to be introduced for the family allowance. Meanwhile, the parental leave will be prolonged to four years, and the birth grant will be paid out without regard to family income.

The law on public social support that was passed by Parliament in May includes 50 amendments proposed by the Ministry of Labour. The implementation of the law will mean, on the one hand, savings of 3 billion crowns in the Government budget due to a lower level of coverage in the social transfers for children, but, on the other hand, fresh expenditures from the Government budget of more than 1 billion crowns as an initial investment in social

service offices and of approximately 1.5 billion crowns per year to cover the routine costs of the new administrative system.

Disagreement also surrounds the level of the official poverty line. Union leaders fear that the present level does not guarantee families against material need and poverty. This problem concerns not just poor families, since, according to the law on public social support, the subsistence minimum is used as a very important threshold in determining eligibility for the family allowance and other social benefits for families with children.

## ANNEX: IMPORTANT SOCIAL AND ECONOMIC POLICY PROVISIONS

1993

**January.** A new tax system is introduced, including a value added tax with two rates, the general rate of 23 percent and a lower rate of 5 percent for foodstuffs and some basic services. The system is harmonized with that prevailing in the European Union.

A new system of local budget financing enables local administrations to enhance their own income sources and reduce refinancing from the Government budget.

A new general health insurance law and an act on social insurance and employment insurance contributions go into force.

The regulated prices are increased for fuel and oil, solid fuel, domestic bus transportation, telecommunications and radio services, and central heating.

**February.** As of 2 February the law governing the monetary separation of the Czech Republic and the Slovak Republic goes into force, and the Czech crown becomes the only valid currency on the territory of the Czech Republic.

**March.** On 1 March, pensions are indexed by 10 percent.

Also on 1 March the subsistence minimum for individuals is raised under certain conditions by an average 13.4 percent.

**April.** The law on special savings systems for the construction of housing with the Government allowance goes into force.

Only families with children and with per capita incomes less than twice the subsistence minimum remain eligible for the Government income support programme. Pensioners with incomes from employment that are above the minimum wage (2,200 crowns per month) are no longer eligible.

The maximum bus transport fare is raised by an average 10 percent, and the fees for international telecommunication services are increased by 5 percent.

On 22 April the law on bankruptcy goes into force.

**May.** On 15 May the fees for water are increased on average by 20 percent.

On 24 May the results of the first phase of the voucher privatization programme are announced to the participants.

**June.** The value of the birth grant and of the parental leave benefit is raised.

**July.** Automobile fuel prices and the maximum prices for medicines, drugs and other health care products go up.

Wage regulation is reintroduced.

On 29 July the law on one-time social assistance payments for families with dependent children and low incomes goes into effect. The Government budget will be used to cover payments totalling 1 billion crowns to dependent children in families whose incomes are below 1.25 times the subsistence minimum.

**September.** The ceiling on the cost of a single ticket for domestic bus transportation and of student fares on trains is increased.

**October.** The maximum fees for telecommunication services are raised by 15-22 percent.

On 4 October registration begins for individual investors in the second phase of the voucher privatization programme.

**November.** The law governing a second rise in pensions in 1993 and the criteria for increasing new pensions in 1994 goes into effect. The average growth in rates is 12 percent.

The law on the maternity leave and the maternity leave benefit is amended so that the benefit can be extended through health insurance. Family allowance payments are adjusted according to the age of the child.

## 1994

**January.** On 1 January contributions for employment insurance are reduced by one percentage point.

The income tax rate is cut for legal persons from 45 to 42 percent and for physical persons from 47 to 44 percent.

The nontaxable income minimum for physical persons is raised by 6 percent, and the standard deduction for every child is increased by 20 percent. The tax-free minimum for transportation to the workplace is eliminated.

Consumer taxes go up on petrol, spirits and cigarettes.

A rent allowance is introduced.

The maximum sickness benefit is boosted.

**February.** The parental leave benefit is increased.

The official poverty line is raised by 10 percent on average.

The minimum pension goes up for individuals for whom it represents the only source of income.

**July.** The law on the voluntary supplementary retirement pension insurance scheme and the relevant Government allowance, is passed.

The law changing the eligibility for the early retirement pension goes into effect.

**September.** The provision of free schoolbooks in secondary schools is discontinued.

**October.** The parental leave benefit and the birth grant are raised.

Government income support assistance is increased for families with children and with incomes under 1.5 times the subsistence minimum.

**November.** The ordering of shares ends in the second phase of the voucher privatization programme.

**December.** Paid pensions are raised on average by 11 percent.

The Government income support allowance for pensioners (220 crowns per month) is eliminated.

A base amount of 420 crowns per month is added to every pension.

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