

**UNEMPLOYMENT AND LABOUR MARKET FLEXIBILITY
IN THE TRANSITION TO A MARKET ECONOMY:
THE CASE OF CROATIA**

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Introduction

Croatia is a small, Middle European country which was only recently able to reinstate itself as a sovereign state. Having been a part of the Austro-Hungarian empire up to the First World War and within the Yugoslav state after that, it shares with Austria its Middle European heritage, while at the same time bearing the stamp of post World War II socialist development of a very specific kind. At the point of dismantling of socialism, the degree of congruence with East European post communist regimes hinges on the following features: dominance of political and not economic decision making in the economic sphere, absence of private ownership of capital, disregard for private sectors of the economy especially private agriculture, a soft budget constraint at the enterprize level, low levels of economic efficiency and labour productivity, no capital and bond markets. Features which made Croatia stand apart from the main body of iron curtain countries are: free movement of people and free inflow of capital across borders after 1965, high levels of autonomous decision making, including investment decisions by firms, some sectors of the economy were open to foreign competition, an export sector oriented to the foreign exchange markets.

It follows from the above that, given the much more open nature of the economy, the transition to a market economy in Croatia should be less painful than in ex-iron curtain countries. There is, however, the disastrous effect of the Serb occupation of a part of Croatia which has disrupted the normal transition process and incurred tremendous additional costs both in material terms and in terms of human life.

Estimates indicate that war damages amount to US\$ 20-30 billion, exceeding the country's annual GDP more than twice. There are, in addition, 500,000 refugees and displaced persons from Bosnia and Hercegovina in the country.

The aim

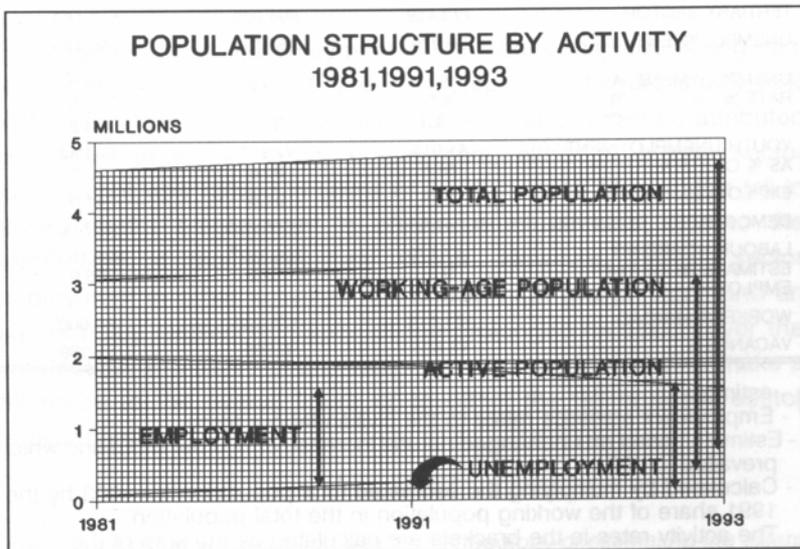
The purpose of this paper is to highlight some of the current problems faced by decision makers on the labour market in Croatia. The central dilemma focuses on devising the most efficient, timely and socially as well as financially acceptable transition to a fully fledged market economy. This task has potentially highest social costs on the labour market for the following reasons: privatization (which is seen as an essential stepping stone to a market economy) coupled with a pro-employer oriented labour legislation will potentially replace a lot of present job holders; restructuring - a gargantuan task of reallocating productive resources, will render many skills redundant and a major reskilling of the labour force is in order. In this paper we propose to proceed with a snapshot of the Croatian labour market, with relevant reflections from the past which are important for understanding its present features. We shall point to some of the characteristics which will need to be changed in order to achieve some of the desirable qualities of an efficient labour market. Following that, we review some of the basic characteristics of the two antipodes, the Swedish and the US labour markets and reflect on the direction which the Croatian labour market development should take.

A. The labour market: some facts and figures

From a total population of 4,78 million in 1991, 67.5% is of working age (15-64 yrs.) Figure 1 shows some basic facts about the demographic framework of the Croatian labour market as well as employment and unemployment from 1981, 1991 to 1993. Both the total population and the working age population have a negative growth rate since 1991.

The activity rates have changed significantly since 1981, the major trend being in the reduction of the male activity rate from 77.4% in 1981 to 75.5% in 1991 (censal years). The female activity rates, on the other hand, have risen from 52.0% of the 1981 working-age population, to 55.1 % in 1991. By definition, the employment and unemployment figures should, roughly, add up to the active population figure but in Croatia there is a difference between the two figures as can be seen by the widening gap between active population and the sum of the employed and the unemployed. It seems that this difference may be attributed to several factors. Firstly, the private sector is underrepresented in official statistics. Employment in private agriculture is completely missing while being only partially present for other activities in the private sector. Most of the shadow economy employment takes place in the private sector, since labour costs are prohibitive for small scale employers and part of their workers are habitually not registered. This is the long term effect which contributes to the dissonance between the active population and the labour force.

Figure 1



There is, however, the short term effect which has to do with the low level of labour demand, and, most recently, with the reduction in the social sector employment and the decrease in unemployment. This considerable difference is thus a relatively good indicator of unregistered employment. Official employment has been falling since 1990, with a simultaneous rise in unemployment figures. Table 1 shows some of the more interesting elements of the Croatian labour market.

Table 1
LABOUR MARKET INDICATORS

	1981	1991	1993
TOTAL POPULATION	4,601	4,784	4,780 ¹
POPULATION OF WORKING AGE (15-64)	3,077	3,230	3,227 ²
ACTIVITY RATES ³			
Total	45.2 (64.5)	45.4 (57.0)	
Male	55.6 (77.4)	53.9 (75.5)	
Female	35.6 (52.0)	37.4 (55.1)	
TOTAL EMPLOYMENT	1,826,386	1,614,384	1,270,290
-social sector	1,417,644	1,311,153	1,065,897
-private sector	408,742	303,231	204,393
PRIMARY SECTOR	451,365	219,553	156,793
SECONDARY SECTOR	648,900	676,056	547,772
TERTIARY SECTOR	773,459	694,000	512,180
UNEMPLOYMENT	86,279	253,669	250,779
UNEMPLOYMENT RATE %			
A	5.2	15.2	18.7
B	4.5	13.6	16.5
C	13.3	30.0	38.2
YOUTH UNEMPLOYMENT AS % OF TOTAL	41,913	77,711	80,243
EMPLOYMENT RATIO	48.6	30.6	32.0
DEMOGRAPHIC RESERVES	59.4	51.5	41.8
LABOUR HOARDING ESTIMATE (% OF THE EMPLOYED)	1,247,939	1,565,620	1,877,000
WORKERS ABROAD	167,879	306,797 ^e	329,155 ^e
VACANCIES	9.2	19.0	25.9
	151,619	175,338	180,000 ^e
	16,624	6,598	11,389

e - estimate

* - Employment statistics relate to the civilian labour force.

¹ - Estimate based on unchanged natural increase of -1,0 per thousand which prevailed in 1991.

² - Calculated by multiplying the estimated total population for 1993 by the 1991 share of the working population in the total population.

³ - The activity rates in the brackets are calculated as the sum of the employed and the unemployed in relation to the working age and not the total population.

***Total population** includes Croat citizens temporarily abroad.*

***Activity rates** are calculated as the total domestic civilian active population (censal data) divided by the total domestic population.*

***Unemployment rates** A - is the official unemployment rate calculated as the number of the unemployed over the sum of the employed and the unemployed as official statistics register. B - is the unemployment rate when employment in private agriculture is added in the denominator and C is the unemployment rate when the number of the "unemployed" among the employed is added to the official number of the unemployed.*

***Employment ratio** is the relation between the employed and the working age population.*

***Demographic reserves** represent the difference between the working age and the active populations.*

***Labour hoarding.** The extent of labour surplus among the employed was calculated basically by extrapolating the historically attained highest labour productivity to consecutive levels of production and comparing the number of workers which produced that output with the number of workers who could have produced the same output had the highest, historically attained level of labour productivity been achieved. The difference represents the extent of labour hoarding.¹*

A.1. Employment

The negative trend in employment is the most conspicuous segment of both Table 1 and Figure 1. The 1993 employment figure is only 69% of the 1981 level. The greater part of this reduction can be attributed to the fall in social sector employment, although private sector employment was halved in terms of its 1981 level. Most of the fall in private sector employment is of the structural kind, due to the contraction of the agricultural sector. However, private sector employment in other activities has shown high growth rates and an extraordinary resilience in spite of the prolonged recession over the last decade. The share of this sector is, however, too small to make a

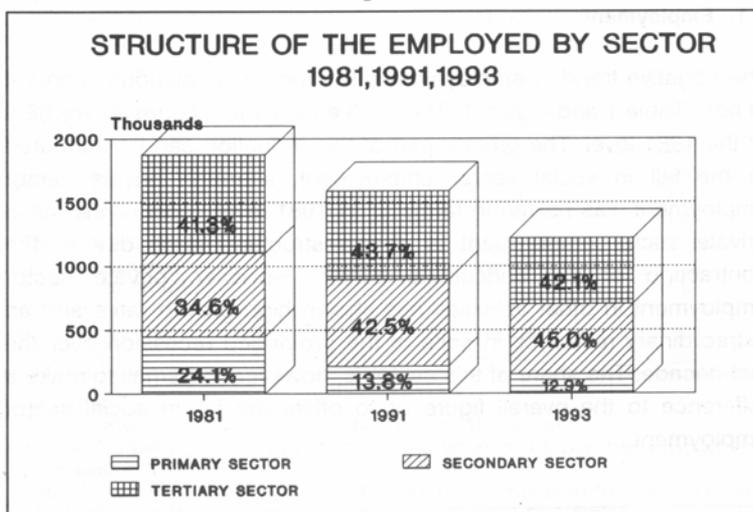
¹ For a more detailed discussion on the methodology of estimating the extent of labour hoarding see Crnković-Pozaić S. et al: *Tržište rada u Hrvatskoj (The Labour Market in Croatia)*, EIZ, Zagreb, 1994.

difference to the overall figure or to offset the fall in social sector employment.

The reduction in social sector employment is the effect of legislation which allowed for lay-offs in bankrupt enterprises. There has been a slow down in closures of enterprises since then but it is unlikely that the entire surplus of workers among the employed has been eradicated. What seems to have happened is that the sudden surge of unemployment benefit claimants increased government transfers to such an extent that it proved more expensive to sustain them than to keep them underemployed in their places of work.

Figure 2 shows the structure of employment by major sectors in 1981, 1991 and 1993. The histograms clearly show the contraction of the employed labour force, as well as, its changing structure. The share of the primary sector has decreased from 24.1 % in 1981 to 12.9% in 1993. The secondary sector has increased its share from 34.8% to 45% in the same time period, while the tertiary sector, after an initial increase in its share, settled down to 42.1 % of total employment.

Figure 2



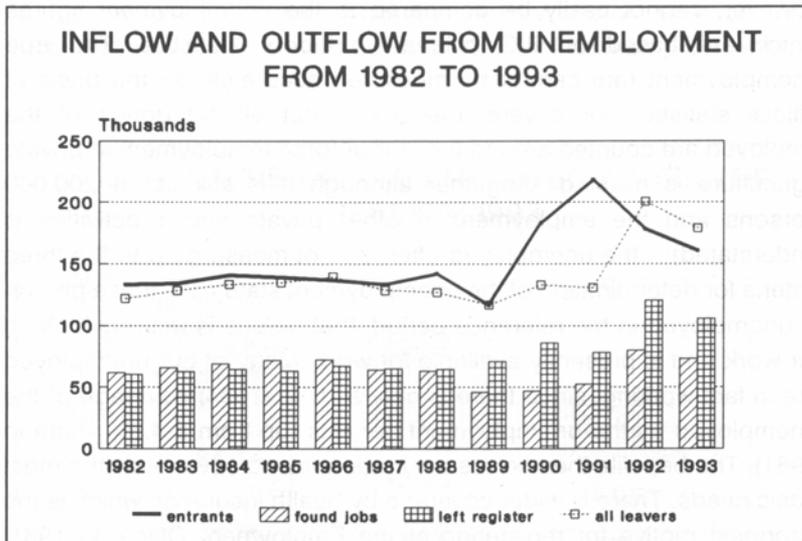
If we look at the change in the employment ratio which shows the share of the employed in the working age population we can see that it fell from 59.4% to 41.8% in 1993 which is a very low level. At the present level of GDP per capita it is very unlikely that a society could survive with such a small share of the employed in the working age population. In fact, official employment statistics are becoming a poor indicator of true employment levels as an increasing share of economic activity becomes untransparent in the shadow economy.

A.2. The Unemployed

We have seen that unemployment, as it is officially measured, rose from 4.5% in 1981 to 15.7% of the labour force. These figures, however, cannot easily be compared to the unemployment figures which are based on ILO criteria for labour statistics. The true unemployment rate cannot be measured accurately on the basis of official statistics for several reasons: - not all categories of the employed are counted among the labour force (employment in private agriculture is missing altogether although it is still about 200,000 persons and the employment in other private sector activities is understated); - the unemployed often do not measure up to the three criteria for determination of the unemployment status, i.e. that a person is unemployed in the reference period, that he/she is actively looking for work and is presently available for work. Many of our unemployed are in fact working, since there is only a 10% (1994) coverage of the unemployed by the unemployment benefits (up from a 4.5% share in 1981). The benefits themselves are inadequate to cover even the most basic needs. There is wider coverage by health insurance which is the strongest motive for registering at the Employment Office. In 1981, 39.3% of the unemployed had health insurance while in 1994, their share rose to 63.7%. Furthermore, some of the unemployed are not prepared to take up a job offer, since the level of pay may be too low or the job may be unacceptably far away. The unemployed are allowed to refuse employment, but only a relatively small number do so. However, there is a regular

phenomenon of the unemployed leaving the unemployment status on a relatively large scale as can be seen on Figure 3. The outflow from the unemployment status is shown desegregated into two components. Some of the leavers find employment, mainly through efforts of the Employment Office, while others simply leave the register. There is no evidence as to whether these persons enter unregistered employment or leave the labour force all together. It seems that the unemployed simply fail to appear at the Employment Office at the obligatory intervals and they are taken off the register. Up to 1987, a greater share of the leavers found jobs, but thereafter, a greater share left the register with destination unknown. There are indications that these persons left the register at the point when they lost unemployment benefit or health insurance rights.

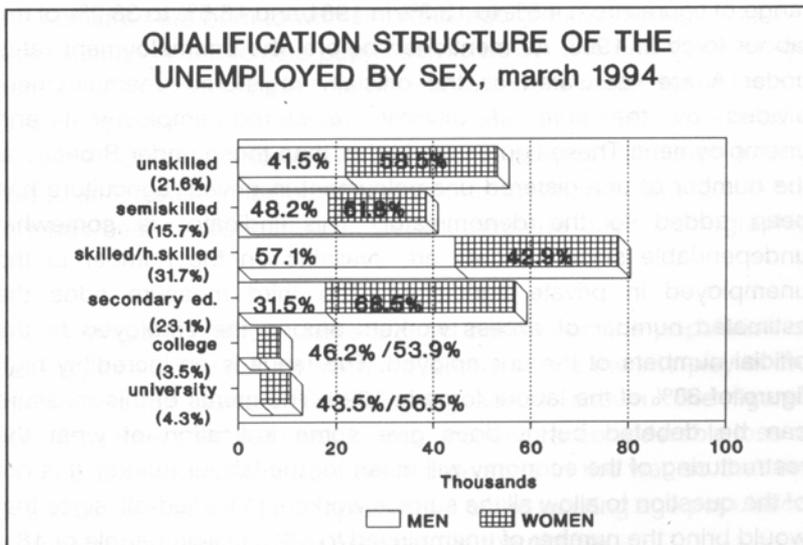
Figure 3



Roughly up to 1989, the inflow and the outflow from unemployment was equal; from 1989 to 1992, the inflow rate was higher than the outflow and thereafter the outflow exceeded the inflow, reducing total unemployment figures. It is precisely at this time that the share of those who left the register increased in relation to all leavers, which seems to indicate that the unemployed have given up the attempt to solve their employment problem through the official channels.

Figure 4. presents the qualification structure of the unemployed in March 1994. The majority of the unemployed are women (55.2%), but the highest percentage of the unemployed are skilled and highly skilled workers. They are followed by secondary school or technical (vocational) school leavers (23.1 %) and the unskilled workers (21.6%). Women dominate in all skill categories except the skilled/highly skilled, which happens to have the greatest share. Only 7.9% of the unemployed have a college or university education and almost two-thirds of this category are women.

Figure 4



If we take a look at the number of those who are seeking work for the first time in their working lives, their share fell from 49.3% of the average yearly unemployment to 32% in 1994. Before the introduction of more flexible labour legislation, when lay-offs were practically non-existent, unemployment was mostly youth unemployment. This category was demographically determined to a large extent by the size of the yearly inflow into the working age population times the activity rate of the youngest active age group. Since there were no lay-offs, youth employment depended on the outflow rate from the labour force and the creation of new jobs which was very low over the last decade. However, the relative share of youth unemployment in total employment dropped as the level of unemployment rose due to large scale redundancies, increasing the heretofore low share of other age-specific unemployment categories.

A.3. Labour Hoarding, Vacancies, Unemployment Rates

Table 1 offers three types of unemployment rates which display a wide range of figures from 4.5% to 13.3% in 1981 and 16.5% to 38.2% of the labour force in 1993. As mentioned before, the unemployment rates under A are calculated as the officially registered unemployment divided by the sum of officially registered employment and unemployment. These figures are higher than those under B because the number of unregistered unemployment in private agriculture has been added to the denominator. This indicator is somewhat undependable since no data are available on the number of the unemployed in private agriculture. The third measure adds the estimated number of excess workers among the employed to the official numbers of the unemployed. The result is an incredibly high figure of 38% of the labour force in 1993. The merits of this measure can be debated but it does give some indication of what the restructuring of the economy will mean for the labour market. It is out of the question to allow all the surplus workers to be laid-off, since that would bring the number of unemployed to 1 /2 a million people or 18% of the working age population. As it stands, the demographic

reserves have increased by 19.9% from 1991 to 1993, indicating that the discouraged worker effect or demand deficient unemployment is indeed enormous.

When we look at what is happening to labour demand there is not much room for optimism. A meager 16,624 vacancies were registered in 1981, which was only 19.3% of the unemployed. In 1993, that percentage was down to 4.5%.

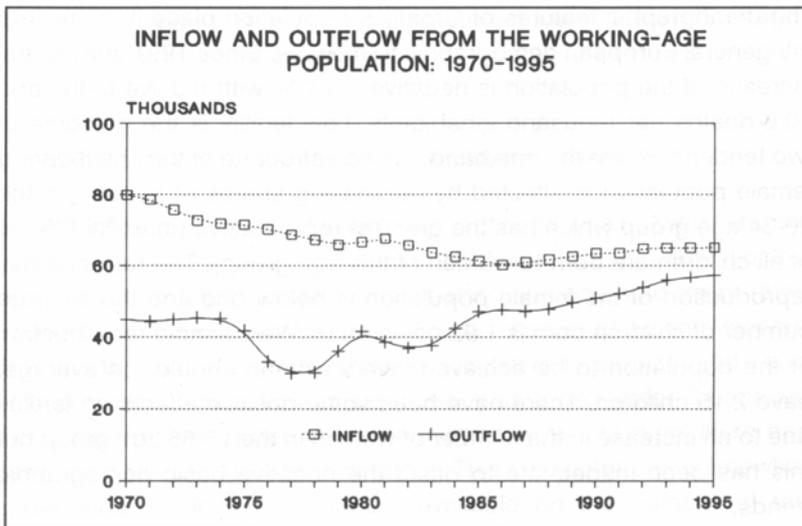
B. The demographic framework

The demographic features of Croatia's population place it neatly into the general European demographic framework. Since 1991, the natural increase of the population is negative - -1.0%, with 9.8 live births and 10.8 deaths per thousand inhabitants. Low fertility is the outcome of two tendencies. On the one hand, the age structure of the childbearing female population is affected by decreasing shares of females in the 20-34 age group which has the greatest reproductive potential (85.4% of all children are born to women of this age group). The rate of gross reproduction of the female population is below one and the average number of children born is 1.92 per woman. Were simple reproduction of the population to be achieved, every woman should, on average, have 2.15 children. There have been some positive effects on fertility due to an increase in the number of women in the 15-55 age group but this has been inadequate to offset the negative basic demographic trends.

The demographic factors have a direct bearing on the population of working age which can be seen in Figure 5 where the interplay of the inflow and the outflow from working age is shown. The figures projected from 1990 did not take into account the considerable loss of life and displacement of able bodied persons in the war so that the actual picture, as far as the replacement of the working age population is concerned, is worse than portrayed in the picture.

The share of the active in the working age population is 64.8% with relatively little variation in time but very dynamic structural change in the male and female activity rates. The decline in male activity rates in all age groups is just about offset by the increase in female activity rates. Both sexes share a decline in activity rates of the very young and the old active persons which is a feature common to most European countries. Most of the activity rate dynamics are due to changes in work behavioural patterns of males and females while the demographic factors which approach steady state values, are less influential.

Figure 5



The mechanical component of population dynamics in Croatia is quite important in its own right. There is a traditional out-migration of labour from Croatia since before the turn of the century motivated mainly by bleak economic prospects in the country at various times. Destinations are mostly Western Europe, the Americas and Australia. According to the 1991 Census, there were 175,338 Croatian workers abroad, 53% thereof in Germany, and a further 22% in the rest of Europe. However, since the oil crisis in 1973, the ratio of emigrants to

returnees is less than one but not all of them consequently appear on the labour market.

Thus, as far as demographic determinants of the labour market framework are concerned the following factors stand out.

1. Due to the decrease in the natural increase of the population, as well as emigration flows, the replacement of the working age population will, in absence of immigration flows, be a long-term constraint on labour supply development. However, the large numbers of refugees and displaced persons presently residing in Croatia from Bosnia and Hercegovina may show a reluctance to return to their destroyed homes and will remain a part of our labour force. There are also ample demographic reserves in the short and medium term as well as high levels of unemployment.
2. Activity rates of males have decreased in all age groups and especially in the 15-24 and the 55 and over age groups. While female activity rates are also falling in these age groups, on the whole there has been a substantial rise in aggregate and prime age female activity rates. These tendencies are expected to continue albeit at a slower pace in the long term but the greatest changes will take place in the short term adjustment of labour force size in response to cyclical fluctuations.

C. Interplay of labour demand and supply

The Croatian labour market can be said to be in permanent disequilibrium with varying quantities of excess labour. The large scale restructuring from a predominantly agrarian to an industrial economy is over and the changing structure of the active population which is showing considerable growth in the tertiary sector is a good indicator of the changing structure of the economy as a whole. The rate of job creation in the modern sector has, by and large, proved inadequate to absorb the spontaneous move out of agriculture, but the only gauge

of the extent of the change was the growth of social sector employment and the growing number of emigrant workers. The unemployment figures simply did not register labour force surplus due to inadequate motivation for the unemployed to register.²

It is important to realize what the official unemployment figures actually convey. In the past, unemployment rates were positively related to employment rates. Katz,³ has called this "growth-induced unemployment" which fits quite well into the Harris-Todaro model of the labour market in Third World countries. Under conditions of permanent job scarcity, in periods of fast growth, job creation is dynamic and employment swells. Since high growth rates speed up restructuring of the economy there are large scale movements of the active population from more passive to more propulsive sectors and their pressure raises both the employment and the unemployment figures. The opposite happens when the economy slows down and job prospects are low. Some of the surplus labour remains employed but performs at low levels of labour productivity or is simply idle, while unemployment stagnates or even falls as the lack of job opportunities reduces the prospects of getting a job through the Employment Offices. The category of discouraged workers swells outside the officially monitored labour force. Now, when a wave of redundancies

² *Among the possible motives for registering at an Employment Office, the most important was health insurance. About 60-70% of the unemployed were covered by this form of social security while only 15% received unemployment benefits. However, the replacement ratio is about 30% and it is reasonable to suppose that unemployed males of working age had to supplement their income in some way. Some of the unemployed who have no other sources of income are also legible for social security payments. However, a large share of the unemployed attempt to supplement their income by working in the shadow economy and, as such, do not satisfy one of the three ILO recommendations for classification of the unemployed. On the other hand, part of the unemployed really have no intention of taking a job. This would indicate that unemployment figures are inflated but there are also indications that the number of discouraged workers who are not in the labour force and potentially unemployed could easily outrun the number of the quasi unemployed.*

³ *See Katz, Arnold:1985.*

appeared in 1990, all of them registered as unemployed as they could claim both unemployment benefits and health insurance for a time. As soon as the rate of increase of redundancies fell and the unemployment benefit receipt period ran out, unemployment and employment both started to fall. Thus, very unfavourable conditions on the labour market have created a situation where the labour force is apparently contracting, but both the employed and the unemployed alike are working in the shadow economy in order to survive. The existent methods of data collection are inadequate and the relevant institutions should organize labour force surveys based on households which would catch most of the unrecorded economic activity of the working age population. It is very important also to express the work effort in terms of hours of work and not individual workers since persons often hold several jobs and work longer than usual working hours.

D. The institutional features of the labour market

According to the latest version of the Labour Law a tripartite arrangement of the various groups on and around the labour market is envisaged. On the one hand, there are the representative organizations of workers, the trade unions, which can be organized according to occupations or sectors or both, with the type of hierarchy of their own choosing. On the other hand, there are the various organizations of employers and finally the government itself through its Ministry of Labour. The Central Employment Office with its network of regional supportive offices is a part of the Ministry of Labour. There is a Central office in Zagreb, 18 regional offices and 88 branches. Regional offices are present in all administrative regions and organizationally the network seems to be adequate for the type of activity which is presently carried out by the Employment Office. Its functions are: information dissemination, collection and processing of statistics, carrying out measures of active labour market policy which includes professional orientation, financing of retraining, supplementing labour costs for target categories of workers,

unemployment benefit payments and minimal wage payments to those workers whose income is below that level.

There is also a standing Committee for Social and Economic Disputes (Gospodarsko-socijalno vijeće) whose prime purpose is arbitration between representatives of employers and employees and government in conflicts. Its' other duties are to monitor labour market developments both in the legislative and economic policy segments.

D.1. The Legislature

The parliament has, on more than one occasion, declined to pass the draft of the Labour Law and demanded its revision. At this moment we can lay out the pros and the cons of the final version of the Labour Law as it will appear at one of the coming parliamentary debates. As it stands, it is an unnecessarily large document containing 242 articles.

The logic behind changing the existing work legislature is the belief that the laws inherited from the socialist system are not appropriate in a market economy, that they give the worker a degree of job security which interferes with the right of employers to vary their labour force according to economic circumstances. Labour rights are seen to be at odds with a flexible labour market in which the employer must be able to manage his labour resources in line with economic criteria. There is also the intention of making labour regulation similar to that in other Western European countries so that future investors find similar forms of labour organizations in Croatia as in their own countries. The present draft of the Labour Law is the brain-child of lawyers who made a concoction of West European legislature, leaning most heavily on German Labour Law. The draft has received approval from ILO staff who gave several suggestions which were later included in the draft of the Law. It can, therefore, safely be maintained that most of the civilizational achievements in the field of labour relations in Europe are represented in the Law. It is another matter whether the Law takes into account the specific labour market situation in this country

and the challenges of economic restructuring which lie ahead. At this point in time, trade unions are only beginning to test their strength against employers, the government and other entities in their field of interest. It is quite appropriate to ask how legitimate the trade unions are among the workers as well as how they can and will use their potential power. These are political considerations and their course is still a matter of speculation, but the Labour Law has given the trade unions the place which they have in more developed countries as an equal partner in labour negotiations at every level. In this sense, the Law is somewhat ahead of happenings and the government is creating its own partner in negotiations giving him perhaps the legitimacy it has yet to prove to its electoral base.

Another feature of the labour market in Croatia also tests the adequacy of the legislature. Namely, most trade unions seek to organize workers in the state owned sector so that any tripartite negotiations will end up with a two to one vote for the government which is still the biggest employer. In perspective, as the private sector increases its relative share either through privatization or autonomous growth, this problem will recede as trade unions come to represent individual employers.

The existence of a large shadow economy also tests the relevance of the technically well defined Labour Law. We have seen above that the chronic dearth of jobs in the formal sector caused a decrease in the officially registered labour force, simultaneously swelling employment in the shadow economy. The Labour Law relates only to the formal sector and the workers rights and obligations which it determines can be enjoyed only by the formally employed. In this sense, the Law deepens the existing segmentation of the labour market making some jobs more secure, providing a whole series of services to workers in the formal sector which are non-existent in the shadow economy. The question arises who benefits from the Law and who remains outside it? The workers in the shadow economy have no security, no redundancy payments, no social security and health insurance

arrangements, no training possibilities, no maternity leave and no unemployment benefits. The workers in the social/state sectors, regardless of their decreasing numbers, continue to enjoy a similar level of security and other rights which they had in the socialist system and yet it is precisely this sector of the economy which is expected to undergo the greatest changes in terms of labour force retraining and production restructuring. If a rigid legislature is superimposed on this sector of employment it will make the transition process even more difficult if trade unions pursue the path of conflict rather than cooperation. This is not to say that all of the employees organizations and the legislature which regulate their activity should be suspended. They should instead be defined in such a way as to be able to fulfill the restructuring tasks which lie ahead more efficiently.

E. Major impediments to creating an efficient labour market

In view of the above, we can deduce which of the features of the Croatian labour market are a major impediment to developing an efficient labour market. Efficiency in the labour market can be defined as the ability to adapt to long and short term changes in demand. By long term changes we mean structural adjustment whereby whole sectors of the economy gain and loose importance in line with long term changes in the content of demand for commodities. On the other hand, cyclical fluctuations are caused by short term changes in demand. Of course, it is difficult to distinguish between the two types of change in real life, but the type of adjustment which needs to be made requires action on several different levels. Firstly, the macro aspects of flexibility. They include institutional arrangements, the legislature, and labour market policy. Secondly, and perhaps most importantly is flexibility at the intra enterprize micro levels. Still, the most serious impediment to creating an efficient labour market is the present recession itself. The work force is immobilized in their present places of work since labour demand is very low. There is almost no job mobility, little retraining, and the level of average wages is so low

that sometimes two earners in a household cannot support a family of four. Until this trend is reversed, no measures of creating a more efficient labour market can be expected to meet with any success.

E.1. Macro Impediments to Labour Market Efficiency

The Employment Office is, at present, adequately equipped for carrying out data collection, processing and dissemination and it serves this purpose well. The other functions, however, such as analysis of unemployment trends and the formulation of labour market policies are not satisfactory due to a lack of adequately trained personnel both for setting the strategy and implementing it. What is sorely needed is more expertise "at the top" in order for a clear formulation of the concept of labour market regulation to crystalize. At the moment, employment and unemployment are looked at as almost separate phenomena and the concept of labour market as a single economic entity with its actors, behaviour and environment is still not clear to many decision makers. However, even when this hurdle is circumvented there is still the need to introduce labour force surveys in order to be able to analyze true trends on the labour market. Thereafter, labour market research should receive adequate funds to make up for lost time as far as labour economics research activities are concerned.

The labour market regulating legislature, regardless of content, is also an impediment to labour market restructuring in that the process of political negotiation surrounding it is time consuming. The trade unions, who are not satisfied with the level of worker protection in the Labour Law as well as other political forces are preventing the Law from being passed in parliament. It is, of course, of considerable importance for an all around acceptable final draft to surface in order to minimize future conflict from the start. However, the Law is a battering ram used for the various political actors to test their strength and it may be some time before the consensus is decided on.

Thirdly, although there are provisions in the Labour Law on the active role of employers in reallocating and retraining superfluous workers, support mechanisms on the part of the government as well as trade unions are not adequate. There is a trade-off between the level of worker protection and the level of government involvement in the labour market. If there is high worker protection as well as wage rigidity, such as most workers in Sweden enjoy, then the achievement of flexibility in the most general sense, depends on the ability of relevant factors to replace the market mechanism. We shall see later how this works in practice.

Fourthly, the cost of labour is prohibitive. The difference between the gross and the net wage is 120%, i.e. in order to pay a wage of 100, the cost to the employer is 220. All workers still enjoy complete health insurance as well and make regular payments towards the state pension fund and other forms of solidarity (for the unemployed, child benefits for the needy, as well as local taxes which vary from region to region). But that is still not the entire labour cost to the employer. There are many non-wage benefits from employment which range from travel expenses, food coupons to cheaper holiday arrangements, etc. The prohibitive cost of labour has a decisive negative effect both on employment creation and it impairs the ability of the employer to stimulate the already employed worker more efficiently. For each dinar of efficiency wages the employer might want to pay he has to add 1.2 dinars for benefit payments which he rarely wants to do. In the private sector most firms have a steady, registered part of their labour force and its unregistered workers who have agreed to waive their health insurance and pension payments in return for a higher net wage. The effects are bad for the worker who can be exploited in conditions of labour surplus (he cannot insure himself as there are no non-state health insurance firms or pension schemes), worse for the state, which doesn't get its cut and bad for the employer who is forced to brake the law for the most routine activities. What is more, unemployed workers who have to become employed in the private sector where there is no trade union activity and no legal protection,

they face intense competition from employed persons. Since these underemployed persons enjoy all benefits from their primary employment, private employers prefer to employ them to the truly unemployed so as to transfer some of the labour cost on the primary employer who is usually in the state/social sectors.

The relatively low level of demand for labour restricts labour mobility. Present jobs are filled because no other are available regardless of how disagreeable or unsatisfactory they may be. Labour mobility is also curtailed through firm specific housing or credit arrangements which are not transferable and can only be enjoyed if employment is maintained. Since these non-wage benefits are very important not only for individuals but their families as well, mobility is discouraged. On the other hand, regional labour mobility has, on the whole been quite dynamic, to the detriment of more equitable regional development. Some regions are facing dramatic demographic decline induced by excessive out-migration, while a handful of towns (Zagreb is way ahead in that respect) account for up to 60% of overall employment (depending on type of economic activity).

E.2. Micro Impediments to Labour Market Efficiency

The internal flexibility in enterprises is also rigid. It is still considered unacceptable to allocate new jobs to employees within the firm and there is a lot of resistance to such moves by the management. The main agenda for the management is short-term survival and long term manpower development plans are rare. Formal qualifications are considered the prime allocator of manpower in the firm and wage formation is also largely qualification dependant. No efforts are made to match individual abilities with specific job requirements at the firm level. Individuals are stuck with their jobs for life although there is ample opportunity for managers to assess individual capabilities and match them with suitable jobs.

There is also limited vertical mobility in firms. Intra firm labour relations are size dependant. Large firms have very hierarchical

management systems while small firms do not. Nevertheless, there is usually an unproductive lack of communication and distrust between workers and management. Managers are seen as individuals with no scruples whose prime aim is self-enrichment and attainment of privileges. Workers feel exploited and underpaid and their work ethic is low. The work effort is dependent on individual sense of obligation and motivation. This is the dominant situation in the social/state sector. In the private sector the role of manager is very much closer to the Western blueprint.

F. Which role model for Croatia: Sweden or the USA?

The main feature of the US labour market is its ability to create jobs. From 1982, 18 million jobs were created and the unemployment rate was reduced from 10.6% to 5.3% in 1989. Most of the new jobs (88.1 %) opened in firms of up to 20 workers and there was substantial growth of self-employment. This success has mainly been attributed to both upward and downward flexibility of wages, a flexible labour legislature which does not regulate either hiring nor firing and no general coverage of workers by health insurance or old-age provisions. The US labour market, especially after the deregulation of the Reagan era became less susceptible to the usual trade union pressures⁴ which are taken for granted in the European setting. The supply side orthodoxy has many supporters in the US. The usual contentions apply, namely, that high and inflexible real wages have been one of the principal causes of high and persistent unemployment in Western Europe; that centralized collective bargaining has contributed to that pattern so that a decentralization would ensure not only overall wage flexibility but greater allocative efficiency in the labour market; and finally, that reduced wage differentials have strongly contributed to the unemployment of particular groups, notably youths, and have

⁴ *The unsuccessful strike by Professional Air Traffic Controllers Organization (PATCO) considerably slacked union perspectives for leverage in labour market negotiations.*

severely impeded labour mobility. The prescription of the supply side economic orthodoxy is that to reduce unemployment, wages should be allowed to fall, wage differentials increased and wage bargaining decentralized. There are, however, much criticized attempts by the present administration to bring some of the fruits of the European labour relations heritage to the working American. President Clinton extended unemployment benefits as well as the duration of unemployment benefits by twenty weeks in states with low unemployment rates and twenty-six weeks in states with high rates. There is also the Americans with Disabilities Act which prevents discrimination by employers of workers with disabilities (persons with a history of drug or alcohol abuse and AIDS victims fall into this category), the Family and Medical Leave Act which allows for unpaid leave for workers with protracted family problems, and finally the Plant Closures Act from 1988, whereby advance notice of any closure or layoff involving fifty or more full-time workers has to be given. Orthodox economics will argue that all these pieces of legislature will restrict job-creation and bring the US nearer to its own version of Eurosclerosis. In Sweden, the whole way of looking at the problem of labour market functioning is seen from an entirely different angle.

Table 2 shows some comparative labour market data for Sweden and the USA from 1983-1992. The unemployment rates have the same trend but the Swedish figures are on a much lower general level. The employment creation dynamics have greater amplitudes in the USA than in Sweden and the general conclusion is that the Swedish labour market has much less fluctuation than the American. Some of the difference in the unemployment rates is due to the Swedish practice of not counting the workers undergoing training or other forms of education as being unemployed. These statistical effects have been pointed to in the literature as the being the entire substance of the low Swedish unemployment rates. Although there is some truth in this, the argument has to be placed in the right framework, i.e. if large numbers of the unemployed are in one way or another taken out of unemployment and given the opportunity to reenter the labour force

with new marketable skills and eventually find employment, that is not a much better solution than to have the unemployed fend for themselves. Their skill, self-esteem, and the material position of their dependants are deteriorating while job search is going on and the time spend in search which could be used to improve those skills which seem to have become less marketable, is lost. Obviously, there is something radically different in the Swedish model.

Table 2
LABOUR MARKET PERFORMANCE: SWEDEN AND THE US

	Unemployment rates %		Employment growth rates %	
	Sweden	USA	Sweden	USA
1983	3.45	9.6	-	-
1984	3.10	7.52	0.73	4.14
1985	2.85	7.20	1.03	2.04
1986	2.65	6.99	0.0	2.28
1987	1.9	6.19	0.9	2.59
1988	1.61	5.5	1.4	2.3
1989	1.35	5.27	1.5	2.07
1990	1.53	5.51	0.9	0.49
1991	2.68	6.72	-1.7	-0.88
1992	4.79	7.39	-4.1	0.69

Source: Yearbook of Labour Statistics 1993.

Some of the interesting features of the Swedish experiment are a direct challenge to the neoclassical postulates. The aim of Swedish economists who laid the foundations of the Swedish model was the following: to achieve and maintain a maximum 2% unemployment rate by stimulating private investment, while regulating private enterprise; to "socialize" consumption through the development of an extensive Welfare state; to involve the government in the production process primarily through an active labour market policy which would

be designed to operate on the supply side of the labour market by improving labour mobility, reducing skill "bottle-necks" through labour market training, mopping up surplus labour through public relief jobs and providing work incentives through the democratization of working life. This aim was formulated on the basis of a negative evaluation of the Keynesian approach to full employment, which was that the expansionary and fiscal policies to boost aggregate demand, would create unmanageable inflationary pressures. This would occur partly because there would be no check on nominal wage rises and partly because in stimulating demand during a mild recession, the short-term mobility of labour and capital would be limited leading to inflationary excess demand for factors of production in some sectors and areas of the economy.

The second principle was that active labour market policy should complement the restrictive demand policy to obtain full employment, absorb labour slack and promote structural adjustment through selective measures designed to secure labour mobility, overcome labour bottle-necks and to get the unemployed into temporary jobs or enable them to be hired by means of employment subsidies in recessions.

The third principle is a solidaristic wage policy and the objective of gradually achieving equal pay for equal work based on centralized collective bargaining between the employer and union confederations, the SAF and LO.

The fourth principle of the Swedish model was that of welfare capitalism. Social democracy implied the pursuit of equality and a steadily growing provision of social services which, in turn, implied a large and growing public sector, coupled with progressive taxation. The assumption was that socialism could be achieved by a strong socialist state based on an efficient capitalist base i.e. firms are efficient but the market system is not.

F.1. Lessons for Croatia

Experiences of other countries usually cannot easily be copied. Nor should they be, since a different setting may produce unexpected responses to what seems to be the cure. For a country in transition, the basic dilemma can be reduced to the following. In order to develop a self-sustaining private enterprise sector, a new class of entrepreneur and pave the way to a wider privatization process it is necessary to create a competitive climate with simple and equal rules for all the actors. A lack of competition is the crux of the socialist heritage and it is the precondition for economic success in the future. On the other hand, to allow market elements to dictate the pace of the restructuring process, the human as well as overall economic cost would be too great. Therefore, it would seem that some intelligent combination of the two approaches has to be chosen. Since there are no well developed employers and employees associations with any experience of useful negotiation and bargaining, the State will have to play a more active role than it did in Sweden. Its main aim should be to give opportunities for the two interest groups on the labour market to come together around subjects of interest. The new Labour legislature was a good opportunity for that but the government seems to be more on a collision course with the trade unions than trying to create a framework for fruitful cooperation.

In the first stages of restructuring, the main approach should be to allow for competition in all the markets except the labour market. The scope of change is so great in this segment that a great national effort needs to be made to change the present economic structure of the working population. It is neither economically or politically feasible to allow large scale redundancies to occur, incurring even greater rates of unemployment than at present. Firstly, the state is too poor to offer an adequate safety net for the unemployed. Secondly, no new jobs are being created and the long duration of unemployment will deplete existing skill levels and on-the-job-training capabilities of workers. Thirdly, restructuring also means the acquisition of new skills to cope

with new production and organizational techniques, new technologies and work environments. The burden of this element of restructuring must be borne by all three parties: the employer, the State and the employee. The State needs to tailor its institutions and legislature in such a way as to give maximum support to employers and the employees in their search for "the right man for the right job". Matching has been exceptionally poor in ex-socialist countries and achieving labour mobility without the risk of redundancy would itself enhance labour productivity considerably.

The Labour Law has made certain provisions which have to be honoured if the employer wants to lay-off more than 10% of his workers (in firms numbering more than 20 workers). Before laying them off he needs to submit a plan to the Employment office for either employing them on other jobs in the firm, retraining them or employing them with other employers. These plans also have to be discussed with "workers councils."⁵ There are also provisions for redundancy payments to be paid to all workers with more than two years of employment with the firm which amount to at least a half of the average pay over the three months prior to the lay-off for each year of employment. The lay-off plan has to be approved by the Employment Office before it can be put into effect. Although these provisions seem to give ample scope for an efficient solution to problems of labour transfer, in practice they will only act as brakes on lay-offs and not an adequate process of labour restructuring. The commitment to changing the structure of the labour force should be a conscious undertaking in which surplus workers should actively be helped by the previous employers and the state to develop new marketable skills and consequently new employment. The Employment Office should set up training centers for the attainment of skills for which there is demand. Employers should prepare plans for

⁵ *The role of workers councils as they existed in the socialist era has changed considerably. They have lost most of their managerial role and are now mostly just representatives of employees who mediate on their behalf with the management.*

retraining of their work forces and receive co-financing of training programs by the state. This sort of approach should also receive support from the trade unions who should, together with workers councils and employers, participate in the drawing up of employment plans. In this way cooperation can take the place of conflict to the benefit of all parties. This approach places stress on internal adjustment and pre-lay-off activity and retraining so it is not a preventive set of measures which either prevent lay-offs (in case the workers are retained) or prepare workers for new jobs elsewhere. The state of redundancy and long term unemployment is a wasteful and costly way of "managing" human resources especially in counties such as Croatia which face a long term demographic constraint in labour supply. Such employment plans have already been drawn up in Germany and France⁶ and they should receive due attention in Croatia.

In summary, when considering the pros and cons of the US and the Swedish approaches to solving labour market problems, Croatia should lean more heavily on the Swedish experience including new types of structural adjustment experiences in other European countries. The trend seems to be towards more control of and active participation in labour market functioning and away from laissez faire random walk inherent in the market mechanism.

⁶ See: *Bosch:1990*.

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