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Wilfried Boroch*

Social Policy as an Institutional Transformation Problem

In the transition from the command economy to the market economy it is becoming more and more urgent for the countries of Central and Eastern Europe to readjust their social policies and reorganise their social security systems. In doing so, the conflict between social solidarity and individual self-responsibility must be solved.

Poverty is a sensitive topic in the transformation countries of Central and Eastern Europe. Restructuring the socialist economic systems has led to massive falls in production, high rates of inflation and, for the first time, official unemployment (Table 1), which have greatly increased the number of people with incomes below the subsistence level. Representatives of the Russian government spoke of 30% of the domestic population living under the poverty line at the start of 1995.¹ Those affected feel their indigence subjectively all the more acutely because they see a small number of winners who reap considerable benefits from the economic restructuring process. This pattern of income redistribution, together with an insufficient battery of sanctions and controls available to the reform governments for reminding the *nouveaux riches* of their social responsibility, are whipping up social discontent in broad sectors of the population.

The rise in poverty caused by the transformation process is all the more disturbing in that it is diametrically opposed to the expectations of the population which accepted and even urged the reformation of the Central and Eastern European economies in the hope that a new economic system would bring a higher standard of living. After all, they only needed to look to their wealthy Western neighbours to convince themselves of the social and economic superiority of a market economy – a hope which rapidly faded as the reshaping of their systems began.

As reform euphoria began to wane, the population became increasingly sceptical towards the process of economic renewal. Rekindled yearnings for the

"blessings" of the communist welfare state have been expressed in the legitimate return to power in democratic elections of former communists in Poland, Hungary and Lithuania. While there is no reason to expect a complete reversal of the reform process at the present time, reductions or delays in reform programmes due to greater priority now being given to social policy requirements can have dampening effects on businesses and on the national economy as a whole. The transformation of the former socialist systems is thus taking place in an area of conflict between economic and social policy which requires closer analysis and which, it should be noted at this point, comprises three dilemmas:

- ☐ the institutional dilemma²
- ☐ the macroeconomic stabilisation dilemma, and
- ☐ the politico-economic dilemma.

The main focus in the following will be placed on the first of these dilemmas. The other two will be dealt with elsewhere in a future article.

The Transition of Socialist Social Policy

In the former CMEA countries, social security and socio-political activities played a different role from that in the West, largely on ideological grounds. According to Marxist-Leninist teachings there was no particular need for social policy in socialist countries

¹ M. Ziener: Die Betriebe als wichtigster sozialer Anker, in: Handelsblatt (1995) 33, p. 10. However, the figure quoted by Ziener probably masks the true extent of Russian poverty. Other studies show that, in mid-1992, 70% of the Russian population were living at or near the subsistence level. V. George, N. Rimacchevskaya: Armut in Russland, in: Internationale Revue für soziale Sicherheit, 46 (1993), p. 82. Should this estimate more accurately mirror the reality of previous years, it should be fundamentally admissible to apply it to recent social conditions since it is unlikely that poverty has been reduced in the intervening years, given that the economic situation has worsened still further.

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Table 1

Key Economic and Social Data for Selected Central and Eastern European Transformation Economies, 1990-1994

		Russia	Poland	Czech. Rep.	Slovakia	Estonia	Latvia	Lithuania
GDP 1994	(1990 = 100)	53.1	103.3	81.0	79.4	71.9	48.8	40.1
Consumer prices 1994	(1990 = 100)	197,964.0	435.6	223.1	241.0	4,919.8	8,127.4	25,501.9
Real wages 1994	(1990 = 100)	–	95.8	91.5	80.8	–	54.4	42.8
Unemployment	1990, %	4.7 ^a	6.3	0.8	1.8	0.1 ^a	2.3 ^a	0.3
	1994, %	7.0	16.0	3.2	14.8	4.5	6.5	3.8

^a 1992.^b 1991.

Sources: Bundesministerium für Wirtschaft (ed.): *Wirtschaftslage und Reformprozesse in Mittel- und Osteuropa*, Berlin 1995; K. Bolz, W. Boroch et al.: *Die wirtschaftliche Lage der baltischen Staaten. Estland, Lettland, Litauen, Gutachten im Auftrag des Bundesministerium für Wirtschaft*, Hamburg, 11. April 1996; author's own calculations.

since political action was to be geared to the welfare of the entire population as a matter of principle. To accord no further significance to social policy for the functioning of a socialist society was entirely in keeping with this logic and the need for social policy was denied on principle up to the 1970s.³

Not until the standard of living in the Eastern and Western economies began to drift ever further apart did social policy become a key topic in the CMEA countries. It was not possible, however, to detach its theoretical formulation from the basic socialist idea: while some theoretical arguments justifying social policy were formulated, intentions legitimating existing power and authority continued to be pursued in the main.⁴ At best, therefore, social policy in the former socialist states of Eastern Europe was aimed at satisfying the social needs "objectified" in the central plan.⁵ This was above all reflected in their social security systems which were expanded and contracted not according to a comprehensive

programme consistent with the system as a whole, but in a series of selective and successive individual measures.⁶

The main reason for the irreconcilable theoretical conflict was that it was impossible to separate the state's functions of employer on the one hand and social policy maker on the other. This also meant that there was a close association between economic and social aims, a fact expressed in the former GDR as the "unity of economic and social policy".⁷ The main points of this integral approach to economic and social policy were the following:⁸

□ Social policy was primarily intended to improve the conditions for economic growth in the socialist countries. Its aim was to strengthen, maintain and restore the workers' ability to work and perform.

□ The availability of social security benefits was linked on principle to economic performance according to the formula, "a state can only consume (or distribute) that which has been produced." State benefits for the population were thus directly limited by economic development.

² The word "institutional" is used in this paper in the sense in which it is used by German *ordo-liberalism*. It refers to the creation of a legal-institutional framework ("rechtlich-institutionelle Rahmenbedingungen") which determines the individual's scope for decision-making and action against the background of the "constitutive and regulative principles" ("konstituierende und regulierende Prinzipien") for a market economy based on competition, which were developed by Walter Eucken. Cf. Walter Eucken: *Grundsätze der Wirtschaftspolitik*, sixth edition, Tübingen 1990 (first published 1952).

³ F. Haffner: *Ökonomische Rahmenbedingungen der Systeme sozialer Sicherheit in Ostmittel- und Osteuropa*, in: B. Baron von Maydell, E.-M. Hohnerlein (eds.): *Die Umgestaltung der Systeme sozialer Sicherheit in den Staaten Mittel- und Osteuropas. Fragen und Lösungsansätze*, Berlin 1993, p.58.

⁴ See i.a. F. Haffner, *op. cit.*, p.59.

⁵ D. Kath: *Sozialpolitik*, in: D. Bender, et. al. (ed.): *Vahlens Kompendium der Wirtschaftstheorie und Wirtschaftspolitik*, Vol. 2, 4th edition, Munich 1990, p. 405.

⁶ H. E. Haase: *Sozialpolitische Programme in der DDR und anderen RGW-Staaten. Aspekte sozialistischer Sozialpolitik in den 80er Jahren*, in: *Sonderhefte des Deutschland Archivs: Der X. Parteitag der SED. 35 Jahre SED-Politik. Versuch einer Bilanz, Vierzehnte Tagung zum Stand der DDR-Forschung in der Bundesrepublik Deutschland*, 9. bis 12. Juni 1981. Cologne 1981, p. 162.

⁷ F. Haffner, *op. cit.*, p. 59.

⁸ H. E. Haase, *op. cit.*, pp.147-163; Queisser: *Reformpolitik in Osteuropa; Reißt das soziale Netz?*, in: *Ifo Schnelldienst* (1992) 20, p. 14 f.; B. Baron von Maydell: *Die Systeme der sozialen Sicherheit in den Staaten Mittel- und Osteuropas*, in: *ZfW* (1992) 13, p. 312 ff.; W. Boroch, D. Lösch: *Litauen. Die Entwicklung der Wirtschafts- und Sozialpolitik – Studie IV -*, HWWA-Report No. 146, Hamburg 1994, p. 78.

□ Furthermore, there were a large number of indirect benefits (the so-called "second pay packet") whose existence derived from the inseparable nature of economic and social targets. Far more often than in (social) market economies, for example, price intervention was used simply as an instrument of indirect income redistribution policy. In a broad sense, therefore, the social security network included numerous subsidies covering basic needs such as food, housing, energy and transport. Moreover, indirect transfer payments were made in the form of so-called non-wage benefits. State enterprises supplied their workforces with highly subsidised products in their own shops, as well as with non-cash benefits such as hospitals, rest homes, childrens' nurseries, training and other welfare facilities.

□ In general, social security benefits, both cash and non-cash, were only provided to social groups unable to work for "justifiable" reasons. Justifiable reasons were illness, handicap, invalidity, motherhood, raising children and reaching retirement age. There were no unemployed to support since unemployment was by definition an unknown phenomenon in the socialist countries. The real purpose of social policy in the sense of Western market economy ideology, i.e. to provide security for disadvantaged members of society who are in need as a result of insufficient income, thus played a very small role indeed. There were no social assistance benefits-transfer payments were made whenever those affected satisfied one or more of the criteria mentioned above.

□ Finally, there was no incentive to separate, organisationally, social security expenditure from the state budget. Membership in the security systems was obligatory for all workers, which meant that the social security system encompassed virtually the entire population. State enterprises passed on contributions from monthly wages to the social insurance fund which was not, however, administered by a legally independent body.

As far as the basic principle is concerned, the integral approach to economic and social policy meant the introduction of a stabilising social policy. As a logical consequence, the marked economic decline in the late 1970s and early 1980s should have led only to negligible expansion – or even contraction – of the social security benefit systems. Given the poor economic performance of the time, a repetition of social improvements on the scale seen in the 1970s was impossible. Such a situation, however, contradicted the socialist utopia of a continuous increase

in economic welfare.⁹ It is not surprising, therefore, that the actual implementation of the integral approach to economic and social policy led to a reversal of causalities. Rather than the availability of social security benefits and social services being determined by the strength of the economy, social policy in fact took on an increasingly dominant position in relation to economic policy. The consequences for the economy were ignored. Maintaining and extending politically desirable social security benefits and social services inevitably weakened the chances of economic growth in the socialist countries. As far as the notions of the politically responsible were concerned – this was true of the GDR at least¹⁰ – planning the economy focused less on what was economically possible and more on the desired extent of improvements within the sphere of social policy. This can be paraphrased in the naive formula that a 5% increase in social security benefits requires ...% growth in produced national income (net material product).

The decision to move from a socialist planned economy to a market economy renders both the basic "theoretical" principles of the integral approach to economic and social policy and its practical interpretation untenable. Rather, economic and social policy need to be separated; the need for social policy has to be argumentatively based on the market economy. The operative principle here is that social policy should be implemented in order to guarantee decent living conditions for disadvantaged members of society, albeit against a background of the greatest possible individual freedom of choice and action as well as of the greatest possible opportunities for individual self-responsibility – for since freedom of competition is a necessary condition for advantageous market results, the system's competitive order should be restricted as little as possible.¹¹ The state, if at all, should only intervene in the decentral market process either where allocative peculiarities of insurance markets (e.g. adverse selection) are suspected or where the market does not allow optimal factor allocation. The latter is necessary because, according to the Böhm-Bawerk law that people put a lower value on future goods than on

⁹ H. E. Haase, *op. cit.*

¹⁰ P. Plötz: Das Sozialpaket der DDR, in: Wirtschaftsdienst, Vol. 52 (1972), No.10, pp. 536-540.

¹¹ R. Clapham: Das wettbewerbspolitische Konzept der Wettbewerbsfreiheit, in: H. Cox, U. Jens, K. Markert (eds.): Handbuch des Wettbewerbs. Wettbewerbstheorie, Wettbewerbspolitik, Wettbewerbsfreiheit, Munich 1981, p. 136.

present goods, demand for certain services relating to provision for old age, sickness, accident, invalidity and unemployment is too low and there is furthermore a danger that members of society will earn too little to be able to afford goods or insurance of the kinds mentioned above.¹²

In this case, the social policy alternative to the market solution is a system of social security which protects the general public from the material consequences of economically weak members of society who are threatened by illness, accident and loss of employment and from those members of society who are either underinsured or have no insurance at all. In this sense, elements of the welfare state are compatible with a market economy. The transformation economies of Central and Eastern Europe must adjust their social policies to the requirements of their new economic and social order, whereby the inclusion of anything which is inconsistent with the system should be avoided as far as possible. This largely institutional "transformation problem" is outlined below.

The Institutional Dilemma

In order to understand the trade-off between economic and social policy involved in the transition from a planned to a market economy, it is appropriate to choose a basic problem of economic ethics as a point of departure: the conflict between "social solidarity" and "individual self-responsibility". This conflict is of major significance because, given the fundamental structure of socialist systems, any reform towards a market economy is also a social reform – often involving an increase in self-responsibility for the individual. The path involved is a narrow one as far as the transformation process is concerned, because while greater individual rights of self-determination and self-responsibility are certainly important for an efficient economic and social system, they appear strange to citizens whose thinking and behaviour have been conditioned for decades by socialism. By indirectly assuming all the tasks of social solidarity, the state, as the only legitimate employer, made the individual members of society almost completely dependent on it. Thus voluntary and family self-help arrangements were largely paralysed, such that the individual self-responsibility demanded today and the corresponding market-oriented behaviour require training.

The economic effect of social policy in the area of conflict between solidarity and self-responsibility can be elucidated by considering the so-called Samaritan

dilemma. Here, help must be accorded to anyone who cannot help him or herself, yet too much help results in a lack of independence and the inability to provide for one's own wellbeing; instead, reliance on others increases. Well-meaning aid can be damaging if it weakens those it is meant to help; furthermore, it has negative net returns if, in addition, provision against future contingencies is neglected and voluntary charity repressed.¹³

In economic terms this means that, regardless of the question of the financing of state social security benefits, a social security system which optimizes welfare can only be achieved by means of a hybrid system of individual and collective provision. Figure 1 shows the degree of welfare utility in relation to the level of social security benefits privately acquired or provided by the state. Since the particularities of a "social market" mean that competition cannot achieve optimum welfare with exclusively private provision (point A), the state must intervene by means of social policy. However, an entirely collective solution would also fail to achieve optimum welfare. The individual insured party would then have an incentive to get a maximum satisfaction of wants from the social security system; he or she could behave negligently with regard both to provision for future contingencies and to his or her life-style in general and could possibly omit to provide "help for self-help" (point G). This clearly demonstrates that the welfare optimum in the Samaritan dilemma, i.e. the point at which the marginal utility of social security consumption is zero, must lie between the completely competitive and the totally collective solutions (point E).¹⁴

In the Samaritan dilemma, though, scarcity is ignored.¹⁵ Scarcity is important because the available resources are never sufficient to satisfy all the needs

¹² P. Herder-Dorneich: Gesundheitspolitik als Ordnungspolitik, in: G. Gäfgen (ed.): Ökonomie des Gesundheitswesens, Berlin 1985, pp. 55-70; D. Cassel: Wirtschaftliche und soziale Auswirkungen von Wahlmodellen in der gesetzlichen Krankenversicherung. Ergebnisse einer Simulation regionaler Mitgliederwanderungen bei freier Kassenwahl und alternativen Formen des Risikostrukturausgleichs, Baden-Baden 1992.

¹³ W. von Humboldt: Ideen zu einem Versuch, die Grenzen der Wirksamkeit des Staates zu bestimmen, first published 1792, Stuttgart 1962, quoted in: B. Molitor: Wirtschaftsethik, Munich 1989, p. 139.

¹⁴ D. Cassel, W. Boroch: Free Choice of Sickness Funds: Economic Implications and Ethical Aspects of the 1992 Health Care Reform in Germany, in: Special Issue of the Journal of Medicine and Philosophy, forthcoming.

¹⁵ Sachverständigenrat für die konzertierte Aktion im Gesundheitswesen: Sachstandsbericht 1994. Gesundheitsversorgung und Krankenversicherung 2000. Eigenverantwortung, Subsidiarität und Solidarität bei sich ändernden Rahmenbedingungen, Baden-Baden 1994.

of all the members of society. In order to fulfil as many wishes as possible, the resources must be allocated. The economic consequence is to allocate resources in such a way that the utility gained from the last unit of spending is equal, no matter on what it is spent. Economically, the optimum level of social security is found at point C, i.e. where utility and cost increments are identical (Figure 1). This point is to the left of the welfare optimum in the Samaritan dilemma. Due to the peculiarities of social markets it, too, cannot be attained by a purely competitive solution.

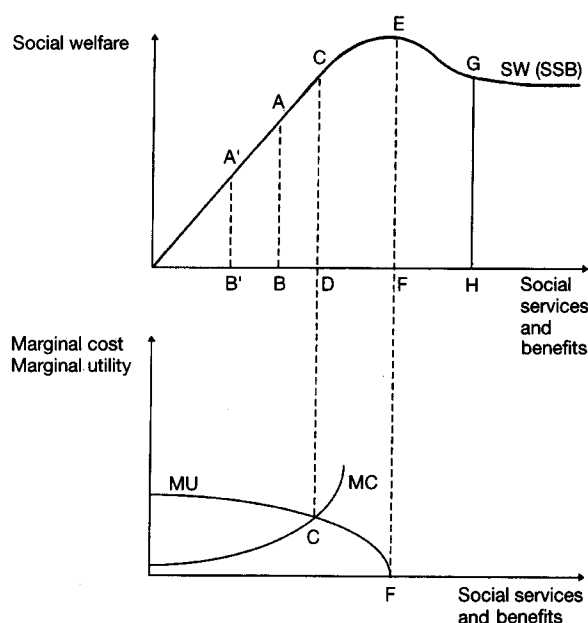
In complex systems, however, no one can determine the exact location of the optimum point C. It probably depends, among other things, on the stage of development – in terms of per capita income – of the national economy in question and can only be found in a process of trial and error in which the following holds true:¹⁶ if the state regulates too much, it permits a form of individual behaviour which threatens to take advantage of the principle of solidarity with regard to social security provisions; if, on the other hand, it regulates too little, then it creates social hardship and is open to reproach for abandoning its moral obligations towards the sick, the old and the weak. *Et vice versa* as far as deregulation is concerned.

This is precisely the institutional dilemma now facing the reform states of Central and Eastern Europe. If, in the medium and long term, they wish to create a regulative framework for a functional social security system which includes an increasing number of elements of self-responsibility and which attempts to exclude adverse incentive structures from the start, then there is a danger, given the current low level – and in many countries falling level – of development, of social friction being set in motion. Any reduction of the welfare state which leads to a level of welfare to

the left of point C (for example point A') involves social hardship for the individual. An increasing number of members of society fall unchecked into poverty, which is expressed in Figure 1 by the loss of welfare equal to at least A'C.¹⁷

If, on the other hand, the government attempts to use social policy measures to compensate for the effects of the economic crisis – whereby we are only interested here in the institutional design of the social system and not in whether it would even be possible to finance such measures – it creates conditions in which the system of social security is misdirected and exploited by free-riders. At the same time it inevitably runs the risk of delaying or even preventing the structural adjustment process, since any unreasonable restrictions to freedom of competition due to social policy regulation will inevitably lead to a worsening of market results. This is because competition, as a process of discovery, can only develop its full economic functions of allocation, innovation and distribution if enterprises on the supply side are given sufficient competitive latitude. Extensive social regulation will negatively affect

Figure 1
The Optimal Social Security System



¹⁶ It is assumed that there exists a representative cost-benefit function for social security benefits and social services for all members of society, independent of regional, income-related or other personal differences.

¹⁷ The subjective feeling of poverty in the transformation economies probably ranks higher than A'C. In the socialist states, the economic allocation of scarce resources never played a central role and members of society were used – as mentioned above – to the state, as the only legitimate employer, assuming all the tasks of social solidarity apparently without charge, with the result that individual self-determination and self-responsibility were left by the wayside. Both need to be re-learned. As long as members of society in the reform economies recognise no direct connection between social security benefits and social costs, they gear themselves towards the welfare optimum which emerges when scarcity is disregarded (point E); it is even more likely that they gear themselves towards the theoretically maximum financing limit of social security provisions (point G). Subjectively, they feel a burden of at least A'E – and probably A'G – which is thus greater than in the merely economic analysis (A'C).

- A, A' : optimal level of private social security provision with a given per capita income
- C : economically optimum level of social security
- E : welfare optimum ignoring scarcity
- G-H : financing limit of solidarity-based social security provisions
- SW : social welfare in relation to SSB
- SSB : level of social services and benefits

business activity by private enterprise, especially when the reform economies have surmounted the transformation shock and wage levels begin to rise as prosperity increases. Social policy will then become an important locational factor, just as it is in the Western market economies. Setting social standards so high that they stifle investment from abroad means discouraging the most important instrument in the process of technology transfer. The chances of a speedy and self-sustaining economic catching-up process will then inevitably worsen.¹⁸

This outlines one of the most important areas of conflict in the transformation of Central and Eastern Europe. The European Union which, with its aid programmes Phare and Tacis, is making considerable efforts to advance the transformation and European integration of the reform countries of Central and Eastern Europe, also underlines the importance of the trade-off between economic and social policy: "In the context of the entire transformation process, there is no doubt that the task of building a social dimension is arduous and involves making sensitive political choices ... The challenge is to strike the right balance between economic issues and the social consequences of economic reform."¹⁹

Economic Limits to Social Policy

It can be concluded from the above that state social policy assumes a particularly important function in the transformation process. Since its task is to guarantee decent conditions for disadvantaged members of society in particular, it counteracts impoverishment in the population and makes an essential contribution to political and social stability during transformation. Given the scarcity of government resources, however, social policy is in permanent competition with all the other goals and tasks of government and must be coordinated with economic policy as a matter of principle. This requirement, as has already been shown, can be justified by the fact that it is a constitutive condition of market economies not to unduly restrict individual economic freedom of action.

Moreover, social policy is subject to substantial practical constraints. As a result of transformation, both private households and the state are struggling to cope with considerable losses of income which make it virtually impossible at present to reconcile the institutional dilemma between economic and social policy outlined above. As their real incomes have fallen sharply, private households are unable to pay for an increase in the costs of the social security

system from their own purse, which at the same time means that individual members of society have little chance of covering life's risks with additional private insurance. In order to achieve the point of optimum welfare (point C in Figure 1), the state would now have to take action. In view of the current budget limitations, however, the state cannot practise a sufficient degree of social responsibility. Social hardship results.

At first glance, the high rates of social insurance contributions in Central and Eastern Europe appear to contradict the preceding observations. As early as 1993, they were already considerably higher in some transformation countries (Table 2) such as Slovakia (36.0%) or the Baltic states of Lithuania (39.9%) and Latvia (42.0%), than in the OECD (average 28.2%), the USA (29.2%) or Japan (33.6%). Yet these high figures merely create the illusion that the reform governments have a degree of latitude with regard to social policy; at best, however, these figures are only partially the result of measures aimed at bolstering the social security network during the process of transformation – the establishment of unemployment insurance for example. In the main, however, they are due to the continued existence of welfare elements from the socialist era, and to economic recession during the years of radical change. The latter makes its presence felt on the expenditure side in that a growing number of poor and unemployed are making claims on the social security system. On the revenue side, on the other hand, holes are being torn in the state coffers as a result of ineffective fiscal administration, tax evasion, the shrinking of the tax basis etc. Given such divergent developments in tax revenue and social expenditure it is hardly surprising that rising rates of social insurance contributions can indeed go hand in hand with declining social security benefits, a fact which the Latvian example impressively documents, where social monetary transfers rose as a proportion of GNP from 11.4% in 1991 to 15.1% in 1993 but this nonetheless meant a 34% fall in transfers in real terms.²⁰

For these reasons it is practically impossible at present for the Central and Eastern European governments to adopt, independently, a social policy which is capable of adequately cushioning the social

¹⁸ W. Boroch, *op. cit.* p. 65.

¹⁹ Phare: Building the foundations for a sustainable future, in: *info Phare* (1995) 7, p. 8.

²⁰ Altogether, cash transfers in Central and Eastern Europe rose from an average of over 10% of GDP (1987) to around 15% (1993). K. Krumm, B. Milanovic, M. Walton: Transfers and the Transition From Central Planning, in: *Finance & Development*, Vol. 32 (1995), No. 3, p. 27.

consequences of transformation. The restructuring of the social systems cannot, and should not, at present include any expansion in the level of benefits provided. Indeed, the social security system should be reshaped in such a way as to allow the efficient utilisation of the available resources and to make them accessible to the appropriate target groups. Misuse of benefits must be strictly combatted. An institutional framework is of prime importance to this end; efficient organisational structures must be created.

Given the principles of social policy in transformation countries presented at the beginning of this article and the experience these countries have gained to date, a number of general adjustment reforms are conceivable:

Firstly, social policy and social insurance must be organised according to uniform principles. In a number of transformation economies, an attempt was made soon after the fall of socialism to reform the

social security system which was largely inherited from the former Soviet Union. The aim was to transform the existing social security system into a "genuine" social insurance system.²¹ To this end, the social insurance funds which existed in many countries were separated from the state budget. While this represented a first step towards a Western style social insurance system, the reform in most cases remained incomplete because the funds were not given the necessary legal autonomy and independence from government, parliament and state authorities. The essential organisational principle of a social insurance system, the principle of self-administration, did not come to fruition, with the result that transitional hybrid social security systems exist today which embrace both organisational elements of Western style state-regulated insurance and elements of state-run social security systems taken from the Soviet model. Concurrent social security sub-systems financed partially by taxes and partially by contributions, such as those in many of the former Soviet states (Table 2) are particularly precarious. Considerable adjustments to the institutional framework are required here because the existing organisation prevents the financial transparency of the system as a whole and impedes the implementation of coherent social reforms.

Secondly, thought must be given to the distribution of the costs of financing social security. While neither the state nor private households nor companies can currently cope with further financial burdens, this is only true from a static point of view. Over a period of time, a change in the distribution of social security burdens will be possible, since employees' contributions in particular can be increased as economic development improves. There is scope for this, for at present employees in a number of transformation economies pay contributions of 0% to 1% while employers bear the "lion's share" of social insurance contributions (Table 2). Raising employees' contributions is also important because they are still labouring under the illusion that social security is free of charge and so demand without hesitation that the state assume the provision of further social security benefits.²²

²¹ On reforms in the social security systems in Central and Eastern European states see S. Strunk et al.: Die Sozialversicherung in Mittel- und Osteuropa, in: GVG (Gesellschaft für Versicherungswirtschaft und -gestaltung), (ed.): Soziale Sicherung in West-, Mittel- und Osteuropa, Baden-Baden 1994, pp. 200-302.

²² W. Schmähl: Grundfragen der Gestaltung der Finanzierung sozialer Sicherung im Transformationsprozeß ehemals sozialistischer Volkswirtschaften, in: B. Baron von Maydell, E.-M. Hohnerlein (eds.), op. cit., pp. 375-425.

Table 2

Social Security Revenue and Expenditure in Selected Central and Eastern European Countries, 1994/95

	Social insurance contributions as a percentage of basic wage (gross wage plus employer's contributions)		Government social security expenditure rate ¹
	Employer's share	Employee's share	
Russia	28.0	1.0	-
Poland	48.2 ²	0.0	-
Czech Rep.			
PI ³	20.6	6.8	-
HI ⁴	12.6	5.7	
UI ⁵	2.25	0.75	
Slovakia			
PI ³	20.4	6.8	36.0 ⁶
HI ⁴	12.6	5.7	
UI ⁵	2.25	0.75	
Estonia			
PI ³	20.0	0.0	c. 50.0 ⁷
HI ⁴	13.0	0.0	
Latvia	37.0	1.0	41.6 ⁶
Lithuania	31.0	1.0	39.9 ⁶

¹ Defined here as social security expenditures financed by taxes and contributions as a proportion of total revenue from taxation and social security contributions.

² Employees pay only income tax (21%, 33%, 45%) on their gross wages. Employers bear the costs of all social insurance payments, paying 100% of all contributions.

³ PI = pension insurance.

⁴ HI = health insurance.

⁵ UI = unemployment insurance.

⁶ 1993.

⁷ 1992.

Sources: GVG (Gesellschaft für Versicherungswirtschaft und -gestaltung); W. Boroch, D. Lösch: Litauen. Die Entwicklung der Wirtschafts- und Sozialpolitik – Studie IV –, HWWA Report No. 146, Hamburg 1994, p. 78.

Thirdly, new consideration must be given to the benefits provided. Given existing state budget constraints, benefits should not be set too high, which might occur if they are geared to Western standards. Moreover, lessons should be learnt from the deregulation debate in the industrialised countries and from the requirements governing deregulation which have emerged from that debate. Depending on its level of economic development, each country should set an upper limit to the standard of social security which on the one hand allows sufficient scope for individual self-responsibility, and on the other hand contains the social insurance burden borne by companies at a low level. In this connection, new rules governing access to cash and non-cash social services should also be drawn up.

This means that social support should no longer be distributed along the lines of giving everyone a slice of the cake, since a partial allocation of social security regardless of need is inefficient. In order to provide economic incentives and to avoid unjustified receipt of benefits, in future individual claims to social security benefits must be made relative to per capita (family) income. Otherwise there is a danger that benefits could be approved which contradict the criteria of achieving just distribution and matching true need and so force government social expenditure ever higher, to the detriment of the entire economy.

Fourthly, government and social insurance revenue systems should be organised more efficiently, for the financial situation of a social security institution can be improved decisively if tax and contribution losses resulting from fraud, payment evasion and arrears can be reduced. More efficient sanctions and control mechanisms are primarily required here.

In close connection with these considerations and the recommendations drawn from them it is, fifthly, proposed that the further development of state social security systems be linked to the further economic development of the transformation countries (indexation of contributions and benefits). This is assured on the revenue side by rising wages, given constant contribution rates, while on the expenditure side safeguards must be implemented to ensure that benefits develop in line with rising income. The latter could be most easily achieved by linking the expansion of benefits to GDP growth, at least for a

transitional period. Since consequently, given the current key economic data, many social policy measures can only be implemented in stages, the social economic welfare optimum (point C in Figure 1) can be achieved at best only in the medium to long term.

Economic and Socio-political Summary

In their quest for new, efficient and socially acceptable social structures, the transformation countries are faced with the task of reconciling the institutional conflicts outlined above by staking out an intelligent framework of socio-political conditions. They are free in so doing to be guided by the known forms of Western social security – for example the American, German or Swedish models. It is a matter for each national government alone to decide which particular model is to be chosen for the actual transition process, whether or not country-specific peculiarities are taken into account, and whether experiments should be made with a new model. What is important is that reshaping social policy concepts and the subsequent rebuilding of the social security system are carried out quickly from within the existing framework of opportunities. It is important to always bear in mind that compatibility with a market economy must be maintained and that social security arrangements be found which reinforce the cohesion of economic and social policy. This is above all necessary because a framework of stable conditions is an essential prerequisite for gaining public confidence in the new economic system. Social policy measures should on no account be carried out on a short-term, ad hoc basis, as the danger is too great that conditions and institutions could develop which from the very start lay the foundation stone for potential market distortions and inefficiencies in the medium and long term.

Finally, it should be noted that the conclusions drawn here according to the criterion of "economic efficiency" must also be evaluated against a background of politico-economic considerations. It can be shown that, with regard to the behaviour of voters, a redistributive social policy which is quantitatively limited is important for the stability of the young democracies in Central and Eastern Europe because it facilitates the implementation of system transformation.²³ While on the one hand this implies a need for greater social measures to accompany the transformation process in Central and Eastern Europe, it must not on the other hand be allowed to lead to deviation from the path described here of restructuring the social security systems.

²³ M. Kremer, A. Kuck, F. Trosky: *Politökonomie und Wirtschaftsreformen: Eine gleichgewichtstheoretische Modellanalyse zur Rolle der Sozialpolitik in der Systemtransformation*, Diskussionsbeiträge des Fachbereichs Wirtschaftswissenschaft der Gerhard-Mercator Universität, Duisburg 1994.