

The Quest for Equitable Growth in the Slovak Republic; A World Bank Living Standards Assessment

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The World Bank report *The Quest for Equitable Growth in the Slovak Republic* was created as part of a project to provide technical assistance to the Ministry of Labour, Social Affairs and Family (1.12.) However, the perceptive reader will discover that the report is not an independent analysis of the needs of the state executive. Rather, it is a sophisticated defence of the new social and tax policies that constitute the nuts and bolts of the so-called structural reforms made in Slovakia.

Structural reforms are a long-term priority of the World Bank in countries considered to be clients of the so-called Bretton-Woods institutions. Structural reforms consist mainly of administering pressure on fiscal discipline which means pushing through a balanced budget. The recipe for providing a country with economic health should be cutting public expenses, placing an emphasis on trade balance (low demand, restrictions on imports, and supporting exports), wage restrictions, limits on currency in circulation, and tax reform. An important part of the structural reforms are institutional reforms which deal in market liberalisation and privatisation, perhaps because of the conviction that the market is effective in the allocation of resources. These policies, which embody an ideologised neo-classical economic theory, are paradoxically applied mostly in the Third world. The most developed countries, mainly those of the European social model, adopt such methods more or less selectively. Structural reforms are relatively accepted by governments in the politically submissive small Central European countries.

The report is, as an analytical material, only of slight importance for the needs of the ministry and other experts. It does not evaluate the living standards in the country as it declares in its title (A World Bank Living Standards Assessment) and as was presented by some Slovak media and politicians. The report only defends the post-2004 social and tax reforms carried out by the government. Both in its style and spirit, rather, it is material designed as propaganda and as a means of positively presenting the reforms to the public. It is no accident that the double role of consultant as well as reviewer is performed by a high official of the Ministry, one of the proponents of the reforms.

The subjective language of the study gives evidence of its partiality: “There is a wide agreement that the radical and comprehensive package of reforms, implemented by the 2002 government, has positioned the Slovak Republic well...” (1) “The very demanding political reforms implemented after the 2002 election, in particular, have been praised by many for the depth and speed of the changes and the sharp increase in competitiveness and economic dynamism that they have brought about” (1) “In an attempt to break this vicious circle (of disincentive to work), the government undertook a set of politically demanding and far-reaching structural reforms ... to foster growth and increase average living standards...” (6) “The government’s strategy

for tackling social exclusion is complex, radical, and visionary. All the mechanisms seem to be in place to address poverty...” (17)

In several passages the text is reminiscent of the language used by a football commentator who supports a strongly contested national team with his whole heart: “The economy reacted well, with economic growth rising to well above 4 percent in 2003, and reaching an impressive 5,5% in 2004...” (6) Probably as an attempt at objectivity, the authors, although somewhat ridiculously, also give space to dissenting voices: “a concern sometimes expressed is that the reforms may not have been equally successful...” and that “... [they] may have further increased the social exclusion of those who for whatever reason may not be able to find or seek employment “. (7) However, they are quick to insinuate that it is the vulnerable groups themselves who are to blame: “in the flexible and competitive economy that has emerged over the last year, the inability of these groups to benefit from the country’s high growth rate, the overall improvement in living conditions and the increase in targeted measures such as activation programs and other labour market policies... may have increased their economic vulnerability.” (7) In my opinion, such subjective language (at times exultant, at other times apologetic) has no place in an independent analytical study.

The report consists of several different parts, both in content and in methodology:

- A baseline analysis of the current performance of the Slovak economy in the areas of employment, labour market segmentation, and social exclusion.
- An assessment of the impact of the structural reforms on (i) the living standards of the most vulnerable; (ii) the distribution of income and welfare; (iii) job creation and employment opportunities and (iv) the income levels and inequalities.
- Advice on measures to increase the effectiveness of the reforms in terms of strategy for promoting social inclusion.
- Recommendations concerning the setting up of an institutional structure for the regular monitoring of employment, living standards and social exclusion.

I think, however, that the cardinal problem of the study is its inadequate methodology concerning the questions it intends to examine. The baseline analysis of the current state of the economy with regards to employment, labour market segmentation and social exclusion draws primarily on macro-economic data and data gleaned from the 2003 micro-census and also includes the latest data from the regular labour force survey completed by the Statistical office of the Slovak Republic. The main part of the report, an assessment on the impact of the structural reforms, does not draw on empirical data, but instead makes use of only two simulations that indicate what the impact of an ideal reform should look like. The first model counts the income levels of various types of households before and after the 2004 reform. In comparing these two levels, the model computes the impact. The second model, which deals with taxes and benefits, serves to compare the income levels of all households in the sample before the reform with the simulated levels after the reform, “so as to identify the gainers and losers as well as the distributional and poverty changes” (6.8.). Thus, the content of the report is not, by any means, an assessment of what in

fact happened after the implementation of reforms, as has been falsely interpreted by the media and later by many politicians. The report, in its nature, is rather a feasibility study, i.e. an impact study that is usually produced before a project is implemented.

The analysis of the reforms is developed from a starting point which, for reasons quite unclear to me, happens to be “the election year “2002: “The government that emerged from the 2002 elections inherited a country deeply divided between a relatively prosperous majority... and relatively small group that ... had become increasingly trapped in a vicious circle of low skill – low employment opportunities – state dependency – low intensity of job search. A crucial link in this chain was the disincentive to work created by the generous social assistance program of the 1990s, which led to some household typologies (typically, those with large numbers of children and potentially low-earning adults) being financially better off when out of work“ (5). Not only does the language remind one of the agenda of a political party, it is also debatable whether this image of the situation adequately reflects its reality.

It is clear, however, that the authors care about the language: the frequent use of the phrase “the generous social assistance system“ is an example. The word “generous“ is not an appropriate one. A more apt, value-neutral word („non-adequate“, for example) would have been better. The word “generous“ is probably meant to connote certain implicit values: both the government’s good will and its naïve, unwise extravagance. The fact that this “generous social assistance system” has never provided benefits higher than the living minimum, might also be familiar to foreign analysts.

Let’s look at some areas of the analysis. How has the income level developed since 1998? The report claims that in 2003, real incomes were about 5,3% higher than in 1999. Their level was different depending on the job sector and type of work. The differences between regions deepened. The nominal wages increased about 17,8% in Bratislava, and about 5,3% in the other regions. These findings are confirmed also by the regular survey of sectoral indexes of real wages made by the Statistical Office of the Slovak Republic (EIRO), according to which, the wage rise continued in 2005. The increase in real wages in the first half of 2005, in comparison with that in 2004, more than doubled, amounts to a total increase of 5,6%. This is the highest wage rise during the relative low inflation in recent years. It is important to note that wages rose in all economic spheres.

Thus, the fact that the economy performed well in the period described in the report is undisputable. Economic growth in 2003 rose to above 4,6% and reached 5,5% in 2004. But which factors played a part in this growth? Even there are usually multidimensional factors at play in order for there to be an increase in growth, for the authors of report the answer is uncompromising: “the reforms have clearly been very successful in promoting growth and in improving the average living standard“ (paragraph 6, note 3). However, a discerning reader knows that the correlation between the economic growth and reforms has not been proved. Surprisingly, the authors admit as much in another passage of the report: “to what extent this is the

beginning of a positive trend and whether it is attributable to the 2004 reforms it is too early to determine...” (3.50)

The conclusions on the impact of changes in the tax system seem to be the most controversial to me (4.31. and 4.32.). Concerns regarding the redistributive consequences of the flat tax implementation were, according to the authors unfounded because, “the new tax system is more progressive than the old one. (Policy note 2 3.41) The claim that the poorest benefit from the changed tax system the most could be truthful in a narrow sense. Although in absolute numbers, having this available sum given the level of prices, the situation certainly looks different. Moreover, these claims are based on a simulated model and they do not take into consideration the rise of indirect taxes and their projection in household expenditures. The progressivity of the tax system is understood in a very narrow sense: „the new system is more progressive than the old one“ – by using the so-called Kakwani index (Policy note 2) (3.42.). The index says that the tax system is progressive if the poorer individuals pay less than they would have to pay under a revenue-equivalent proportional tax. The report explicitly states that that “there is possibility to actually increase the progressivity of the tax system while replacing five tax brackets by a single one” (4.32.). Unfortunately, such methodological incorrectness is typical for the whole chapter on tax reform (4): the presentation of data using relative values, the use of schematic graphs without numbers, or the representation of graphs in percentages such as the reality of the numbers is camouflaged.

I do not understand the meaning of the endless enumeration of new social benefits (Policy note 2) while not giving any mention to the fact that these benefits are not automatically applicable and, for many reasons, often not even asked for. However, the authors suppose that all the households eligible for social benefits actually receive them (Policy note 2, Table 3.2.). Ignoring common sociological sense, all the benefits become merely a part of a simulation used to compute the level of household income. (Table 4.5) They also form part of a simulation used to compare the year 2002 to 2004 (Table 4.4). Based on this, the authors conclude that the only households that might have lost out are those households with three and more children in which all adults are unemployed.

The report claims that after the elections in 2002, employment rises. “...after a sharp drop in the second half of 2003 (-0.3% and 0.4% in the third and fourth quarters, respectively), overall employment began to increase in 2004, with a total increase of 46,200 jobs and a 0.4% increase in the employment rate in the period from the second quarter of 2004 to the first quarter in 2005.“ (24) Thus “combined with the trends in employment, this resulted in the rate of unemployment peaking during the first quarter of 2004 at 19.5%.“ (26)

However, employment growth may have occurred for many reasons. The authors’ interpretation that the increase, which „is driven exclusively by the growth of self-employment... points to economic liberalisation as the main driver and has important implications for policy making“ (25), is problematic, particularly if we know Slovak

reality and the employers' pressure to individualise working contracts and forcing employees to get registered business licences, including those of blue-collar workers. In spite of its effort to portray all new Active Labour Market Policies' measures positively, the report does state that it is very difficult to estimate the chances of the participants in the "activation works" to find a job, because "the international evidence regarding the success of these types of interventions is contradictory" (27).

Now I should like to approach the chief mystery of the text: this is its Alain Robbe-Grillet-like dimensions, its repetition of descriptions, its peculiar attention to odd details. This approach is mostly associated with the trend of the French 'nouveau roman'. The text of the report runs in circular argumentation based on the formulation of conclusions, their relativisation and subsequent reformulation. It seems as if the goal of the authors was to make a good impression while distancing themselves from their own judgements. This is very suggestive indeed. Thus it is very difficult for opponents to criticise particular conclusions and numbers since the authors themselves relativise them – claim by claim, sentence by sentence. What they state in the first paragraph is no longer completely valid in the second.

Although the report claims that "half a year is clearly too short a period for a full evaluation of the impact of a structural far-reaching reform of the labour market and the social assistance system" (3.48), it also states that "positive trend is confirmed by the quarter-to-quarter data..." (3.50). Though "to what extent this is the beginning of a positive trend and whether it is attributable to the 2004 reforms is too early to determine ... signs are encouraging" (3.50).

There are some unusual notes made at several places in the report that the study did not fulfil its purpose: "The initial rationale for this study was to verify the empirical relevance of this claim [of the critics of the reform, who claim that economic liberalisation may further increase both poverty and inequality] by quantifying and analyzing the changes in the levels of poverty and inequality... unfortunately, the lack of reliable, nationally representative data with which to calculate the basic indicators made it impossible to derive a profile of poverty which was multidimensional in nature, representative of the Slovak population ." (5.4.) "It is still too early to pass final judgment as to whether the politically demanding strategy adopted by the Slovak government after 2002 election for reducing poverty and social exclusion has worked. This is partly due to data limitations and partly to the fact that the full impact of the new policies is not yet fully reflected in the available data". (29) Thus, "while it is too early to assess the full impact of the reform, the findings of this report suggest that overall the strategy seems to have been reasonably effective" (6.6). However, "given the short time-frame of the analysis, it is difficult to establish whether the recent positive trends are the results of the reforms or the effect of the short term trends"(6.7). Moreover, "owing to the lack of adequate post-reform data, the impact of the reform on income and poverty cannot be evaluated but can only be simulated" (6.8). The reader inevitably questions how the authors, whilst relativising to that extent, were able to draw any conclusions at all.

Let's look at the conclusions which the authors finally decided to declare (21, 4.22., 4.23.): (i) „the combined effect of the reform of the tax and benefits regime has increased the disposable income of the majority of households that are entitled to benefits; (ii) the only households that may have lost out are those with three and more children where all of the adults are unemployed, and that were entitled before the reform to higher benefits schedule; (iii) even for the most affected households the maximum potential loss in disposable income is limited“. The second conclusion directly implies Roma and supports the maintenance of popular negative stereotypes about Roma parasitizing on the social system. Should that implicit reference to Roma make the impact of the reforms more attractive for the majority population?

On the basis of the second simulation taxes-benefits, the authors arrived at an ambivalent conclusion: „(iv) the reform has only a small potential first-round effect on the incidence of poverty with (v) the poverty headcount reduced by 2-3% according to simulations based on the 2003 Microcensus“.

It is indisputable, in my opinion, that from the point of view of its proponents, the structural reforms in Slovakia already are believed to have fulfilled their prime goal - to cut public expenditures. The overall expenditures on social benefits have declined from about 11.5% GDP in 2002 to 9.9% GDP in 2004 (4.12.) The amount of transfers paid to individuals dropped by 16% between 2002 and 2004 (Policy note 2 3.50.). From 1999 to 2003, income inequality has increased considerably and the Gini coefficient has increased from 0.236 to 0.279, an 18% increase (3.42.).

But wait! These facts cannot be called by their real names. Therefore it is necessary to pack the reforms into an attractive package complete with labels, such as "equity" and "justice". Why? One possible explanation is that the ideal of social justice is so deeply embedded in people's value systems that those policies that effectively undermine this ideal have to be sold under a different name. Since asocial policies cannot be called by their real names, it is necessary to make use of a simple trick to persuade the reader that white is black and that the curve on the graph that is visually parallel with the horizontal axis is actually steeply climbing. This is the task of the text *The Quest for Equitable Growth*, as well.

Anyone who knows just a little about the methodology of social research will be able to see that all is not right with this report. The conclusions are based on a model which only simulates the impact of the reform. The empirical post-2004 data are missing. The only thing that remains to say is: Thanks for a report that explicitly names the problem of poverty in Slovakia, does not avoid it and deals with it. Thanks for the constructive suggestions, sophisticated formulations, calculations, numbers, and for the important warning that there are too few reliable data and that poverty is not sufficiently monitored (Chapter 5). However, let us please talk about the issue of poverty non-ideologically and, most importantly of all, in a methodologically correct way.

Daniel Škobla