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## Chapter 4

# POVERTY, INEQUALITY AND SOCIAL EXCLUSION IN THE EUROPEAN UNION AND CROATIA

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Believing that reunited Europe intends to continue along this path of civilisation, progress and prosperity, for the good of all its inhabitants, including the weakest and most deprived.

*The European Council meeting in Thesaloniki on 20 June 2003; Draft Treaty establishing a Constitution for Europe*

## ABSTRACT

The issue of co-ordination in welfare policy in the European Union (EU) has been the subject of many analyses and discussions, but still it has not attained the same level of importance given to the co-ordination of economic policy. The aim of the paper is to determine the situations and actions in Croatia and the EU in the eradication of poverty and social exclusion. The paper starts with the theoretical and methodological framework, which is followed by an account of the states of affairs in EU member-states. After the description of the situation in Croatia, especially of its advantages and disadvantages as compared to other transitional countries and future members of the EU, the paper ends with a conclusion and proposals for improvement.

### **Key words:**

poverty, inequality, social exclusion, European Union, Croatia

## INTRODUCTION

Debates about a common social and welfare policy and common actions have long been held at a national level and are slowly but surely taking shape at the European level. In political terms, Europe has achieved its greatest successes in fields other than social policy, with the creation of a common market and the transition to phase three of economic and monetary union with the introduction of the euro. This is, of course, not to say that these successes are not also of social significance. But it is often said that they have created more social problems than they have solved, thus prompting action at a European level.

The issue of co-ordination in welfare policy in the EU has been the subject of many analyses and discussions, but still has not managed to attain the same importance assigned to the co-ordination of economic policy. One of the most important reasons for intentions to harmonise social policy is the wish to enable and enhance labour force mobility because there is a belief that the (non)existence of an adequate *safety net* is an important factor in worker mobility. On the other hand, EU members often mention that because of the different levels of economic development it is very hard or almost impossible to harmonise different welfare systems. Harmonisation would require huge financial resources that are at present not available.

The aim of this paper is to determine the situations in the EU and Croatia and actions taken to eradicate poverty and social exclusion. We start with a brief explanation of the theoretical and methodological framework. In the second part we discuss the situation in EU member-states regarding poverty and inequality, as well as activities at the EU level for reducing these unfavourable situations. Section three describes the situation in Croatia, especially its advantages and disadvantages as compared to other transitional countries and future members of EU. The paper ends with a conclusion and proposals for improvement.

## THEORETICAL FRAMEWORK AND METHODOLOGICAL ISSUES

To understand poverty, it is essential to examine the economic and social context, including the institutions of the state, markets, communities, and households. The persistence of poverty is linked to its interlocking multidimensionality: it is dynamic, complex, institutional-

ly embedded, and also a gender and location-specific phenomenon. The patterns and shape of poverty vary by social group, season, location, and country. Poverty differences cut across gender, ethnicity, age, location (rural versus urban), and income source. Usually, in households, children and women suffer more than men. Poverty outcomes are the result of a complex interaction between policies and institutions in the economic and the political spheres. Poverty outcomes depend not only on what happens with the national income, but more fundamentally on how these changes in the national income translate into changes in household measures, and on what happens to the distribution of this consumption.

It is very important to fix on the manner of measuring poverty because this determines (or confuses) attempts to formulate sensible policies for helping the poor and for the redistribution of income. The most commonly used way for measuring poverty is based on income or consumption levels (for the main indicators and explanation, see Box 1. Information on consumption and income is obtained through sample surveys, during which households are asked to answer detailed questions on their spending habits and sources of income. Such surveys are conducted more or less regularly in most countries. These sample survey data collection methods are increasingly being complemented by participatory methods, where people are asked what their basic needs are and what poverty means for them. Interestingly, recent research shows a high degree of concordance between poverty lines based on objective and subjective assessments of needs.

It is common to measure inequality in living standards using income or expenditure across individuals in a given month. However, due to problems in measuring poverty, income or expenditure in a given month is only an imprecise measure of the living standard of a household. In order to obtain a more representative approximation of inequality, it is better (and more complicated) to reckon poverty and inequality using data over a longer period (presumably over four periods like, for example, the average in the current month, 12, 24 and 36 months ago) than data for a single month.

Especially for countries in transition, researchers mostly use measures of poverty and inequality based on consumption (money expenditures plus the value of food produced on the household plot). Grootaert and Braithwaite (1998) believe that this measure is more accurate than income due to the high volatility of current income, since people are paid very irregularly, with several months of wage arrears being common. Furthermore, income underreporting is widespread,

**Box 1 Main indicators of poverty, inequality and social exclusion**

*Absolute poverty* measures the proportion of a population surviving on less than a specific amount of income. This specific amount is *the poverty line*.

*Absolute poverty lines* set an absolute minimum standard of living and are typically based on a fixed basket of food products (deemed to represent the adequate minimum nutritional intake necessary for good health) plus an allowance for other expenditures (such as housing and clothing). Hence absolute lines can vary across countries, depending on the composition of the consumption basket. While there is clearly some arbitrariness in determining what is adequate, the notion of a poverty line still provides a useful benchmark.

*Relative poverty lines* define poverty relative to national living standards because irrespective of absolute needs, people may consider themselves poor when their living standards are substantially below those of others in their country. Relative poverty lines are usually set as a fixed percentage of median or mean equivalent household income. The World Bank (2000) calculates poverty profiles using 50% of median income as a base for international comparison.

The *poverty gap* measures how much income would have to be transferred to the poor population to raise every household's income to the poverty line (assuming the transfers have no effects on the recipients' work effort).

*Gini coefficient* is bounded between 0 and 1, with 0 indicating absolute equality and 1 indicating absolute inequality.

*Poverty intensity* is the common indicator taking into account the number of poor, the depth of poverty and inequality among the poor. For practical purposes, the percentage change in the poverty intensity can be approximated as the sum of the percentage changes of the poverty rate and the average poverty gap ratio.

*Social exclusion* is a multidimensional process which weakens the links between individuals and the rest of society. These links can take on economic, political, socio-cultural and spatial perspectives. The more dimensions by which a person is excluded, the more vulnerable this person becomes. The characteristics of exclusion are linked to accessing labour markets, basic services and social networks. Depending on the general level of development of an economy, the following dimensions can be of relevance: exclusion from goods and services, from labour market, from security and from human rights.

because survey respondents are not willing to fully disclose illegal or semi-legal income sources. Finally, produce from the household plot has become a mainstay of food consumption and this is not a standard component of money income. While consumption may be a more accurate measure of material well-being, examining income inequality offers two benefits. First, it is easier to make international comparisons using income inequality since income inequality statistics are available for more countries. Secondly, it can produce insights into the drivers of inequality by decomposing income inequality into the contributions of the various income sources (World Bank, 2000).

However, the above discussion suggests that it might be fruitful to consider income and expenditure not as alternative, but rather as complementary, measures of well-being. Support for this approach is provided by Atkinson (1989), who distinguishes between two conceptions of poverty: a *standard-of-living approach*, which emphasises minimum levels of consumption of goods and leads naturally to an expenditure-based measure, and a *minimum-rights approach*, which emphasises the provision of minimum incomes but does not prescribe how they should be spent.

## **POVERTY, INEQUALITY AND SOCIAL EXCLUSION IN THE EUROPEAN UNION**

The drive for solidarity and social integration found its initial expression in the Single European Act (1987), and subsequently in the Protocol on Social Policy in the Maastricht Treaty (signed 1992, applied from 1993). The idea was to refine social protection systems in order to improve everybody's chances in general without losing sight of the goal of more equal opportunities. The Treaty of Amsterdam (entry into force: 1st May 1999) gave concrete expression to this concern by including a title on employment and incorporating the protocol on social policy. This gave the Community some scope for action in the field of social policy, though this was somewhat restricted and bound by the principle of subsidiarity. Since then, the Commission and the Member States have had to review the employment situation annually and draw up employment policy guidelines. This has brought social policy much further into the limelight of European politics. In late 1997, when the situation in virtually all labour markets was giving cause for concern, the Luxembourg employment summit was held.

Measures were decided on to stimulate the efficiency of labour markets. The Cardiff summit (June 1998) focused on stepping up the pace of structural reform in the employment market, whilst Cologne (June 1999) concentrated on promoting sound, non-inflationary growth to create new jobs.<sup>i</sup>

However, it is really only since the Lisbon European Council meeting of March 2000 that we have deemed social policy to be on a par with economic, monetary and financial policy. In the course of this development, a common goal has emerged: the European social model must not just be maintained, it must also be adapted and consolidated. The EU set itself a new strategic goal for the current decade: "To become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion". Successful implementation of the Lisbon strategy depends upon simultaneous and coherent policy action being taken in a wide range of areas in the economic, social and environmental domains.

No doubt, the issues of poverty, inequality, social exclusion and welfare policy have the key role in reaching the mentioned goal. Social policy and social cohesion are directly included in the principal areas under the shared competence of EU members. On the other hand, there are huge differences in EU members in terms of current situation and policy towards the eradication of poverty and increasing social inclusion, as well as of general attitude to welfare policy and the role of state. Thus, it is probably neither desirable nor possible to develop a single comprehensive European definition of the content of welfare policy of general interest and its role. However, existing Community legislation on welfare policy of general economic and social interest contains a number of common elements that can be drawn on to define a useful Community concept of welfare policy and its realization. These elements should have such desirable characteristics as economic efficiency, social or territorial cohesion and safety and security for all citizens. The future desired concept should be used by all countries in proposing and implementing an adequate policy capable of reducing poverty and social exclusion.

The EU Summit in Nice in December 2000 reinforced a number of the proposals made in Lisbon. The most significant of these in relation to combating poverty and social exclusion is the approval of a new Social Policy Agenda (Official Journal of the European Communities, 2001). In setting out priorities for action in social policy over the next

five years, strategic guidelines were identified as follows, all of them having a bearing on anti-poverty policy: (1) more and better jobs; (2) anticipating and capitalizing on changes in the working environment by creating a new balance between flexibility and security; and (3) combating poverty, exclusion and discrimination in order to promote social integration.

One of the most significant developments has been the approval of the proposal for a National Action Plan against Poverty and Social Exclusion (NAPincl) in EU members.<sup>ii</sup> The NAPincl is intended to develop a common EU-wide basis for national actions against poverty and social exclusion. The NAPincl has four main objectives: (1) to facilitate participation in employment and access by all to resources, rights, goods and services; (2) to prevent the risks of exclusion; (3) to help the most vulnerable; and (4) to mobilize all relevant bodies.

The NAPincl is intended to bring social and employment policies closer together at both the national and EU level. An increased emphasis on indicators and monitoring of progress is evident in relation to the NAPincl. A bilateral meeting to discuss the NAPincl should take place between different social representatives (including Governments, Social Partners and relevant Agencies) and the European Commission.

All countries have national insurance systems which protect their citizens from major risks like unemployment, the loss of income or subsistence; special needs for sickness, family burdens or poverty. However, both the extent and the consignment of such social insurance differ widely among these countries. Many analyses have found empirical evidence for a high correlation between expenditures for social insurance and the incidence of poverty (for example Voges and Kazepov, 1998). It seems that the differences between countries concerning the reduction of poverty incidence result more from the *extent* of the welfare state than from the varying effectiveness of poverty reduction policies.

Over the last few decades, unemployment, poverty and inequality have generally increased in Europe, although there have been periods (notably the late 1980s) and countries (for example, the Netherlands and Denmark) where social conditions have improved or at least not deteriorated. In almost all EU members a main factor contributing to poverty and social exclusion is unemployment, especially long-term joblessness. The EU average unemployment rate increased from 2.3 in 1960 to 7.7% in the year 2001. But while some countries have managed to halt and even reverse the rise (notably the Nether-



lands, Ireland and the UK), others could only achieve partial success, which still leaves unemployment rates much higher than in the 1970s (for example, Sweden, Germany, France and Spain).

*Table 1 Unemployment rates in June 2003 (%)*

EU15	8.1	Sweden	5.4
Euro-zone	8.9	Portugal	7.3
Luxembourg	3.7	Belgium	8.0
Netherlands <sup>a</sup>	4.1	Finland	9.3
Austria	4.4	France	9.4
Ireland	4.7	Germany	9.4
Denmark <sup>a</sup>	5.2	Spain	11.4

<sup>a</sup> data for May

Source: Eurostat (2003)

As we can see in Table 1, the average unemployment rate is over 8% (higher in the Euro-zone than in the EU15). The lowest rate is in Luxembourg and the highest in Spain. The risk of social exclusion increases with the length of unemployment. So, long-term unemployment (waiting for job longer than one year) is regarded as a primary indicator of social exclusion. In 2001, 3% of EU's active population were unemployed for at least 12 months. Again, this percentage conceals differences: from less than 1% in Luxembourg, Denmark, Netherlands and Austria, to more than 5% in Greece and Italy.

Otto and Goebel (2002), using cross-sectional equivalent income, analyze the poverty rate (incidence) and intensity of poverty in European countries. The ranking of poverty incidence among the countries analyzed is relatively robust. The representatives of socio-democratic welfare states - Denmark and Finland - have the lowest rates of poverty incidence (more than 5%). The highest poverty incidence is found in southern European countries (Portugal and Greece more than 20%). With the exception of Ireland, the poverty intensity measure yields the same picture of poverty.

Spells of poverty are also important indicators of a particular situation. Regarding permanent poverty there are also huge differences among EU members. Extreme positions are found in Denmark and Portugal: permanent poverty is a small phenomenon in Denmark, while permanent poverty in Portugal is the highest. Thus, more than 20% of the Portuguese population can be described as permanently poor. In all other EU members less than 10% are permanently poor.

In spite of many surveys, (more about this in Dauderstädt, 2002), it is almost impossible to determine the trends of (in)equality in the EU.

Inequality (not only in Europe) cannot be sensibly studied only in terms of income distribution statistics - despite the importance they have - because there is the issue of political debate linked with an inequality of another kind, that of political participation. Thus, in analyzing unemployment, poverty and the related social exclusion there should be some attention to at least some of the distinct concerns for the person and society as a whole. Sen (1997) believes that the list of mentioned concerns would have to include among other things, for a society: loss of current output and fiscal burden; for a person: loss of freedom of decision (which goes well beyond decline in income); skill loss and long-term damage (just as people *learn by doing*, they also *unlearn by not doing* – by being out of work and out of practice); psychological harm, health problems and damage to morale; motivational loss and loss of future work; loss of human relations and family life (unemployment and poverty can be very disruptive for social relations and may also weaken the harmony and coherence within the family, as links with friends and relatives), and finally, loss of social values and responsibility (people in long term unemployment and poverty can develop cynicism about the fairness of social arrangements, and also a perception of dependence on others. These effects are not conducive to responsibility and self-reliance).

Inequality would be much higher without the correcting influence of *redistributive and social policies*. Social expenditure as a percentage of GDP increased significantly in most countries between 1960 and 2000, due to aging populations and higher unemployment. It continued to rise, especially in the poorer Southern European countries – including Italy – as well as in France and Finland. As a consequence, the EU average share of social benefit in GDP continued to increase as well, in spite of the relatively stable or even falling shares in some countries (Germany, Austria, Netherlands). The effect of social transfers (excluding pensions) in reducing the at-risk-of-poverty rate varied greatly between Member States. Social transfers had the strongest effect in Sweden and Denmark and the weakest in Italy and Greece (Eurostat News Release, 2003).

Results by Simón et al. (2003) suggest that there is no evidence of long-run or strong convergence in social protection expenditure on GDP ratios to imply equalisation of the importance of social transfers. However, they do find evidence of catching-up or weak convergence

with respect to both Germany and the EU-12 average for all countries, except Greece. These results, in turn, suggest that some countries have been making a stronger effort as far as social protection is concerned, resulting in their situation converging on that of other countries where social protection expenditure has been much more significant all through the period. The enlargement of the Union is bringing more heterogeneous, but particularly poorer players onto the leveled playing field. Competition from the numerous poorer regions will exacerbate problems of welfare systems that are already being subjected to massive pressures of adjustment as a result of demography and globalisation. There is a risk of increasing unemployment and inequality, and this often means that national governments are unable to implement the necessary painful reforms (Dauderstädt, 2002).

It is very hard to estimate future trends of poverty and inequality in new members of the EU, but something could be learned from previous EU enlargements. The Portuguese and the Spanish experiences after accession to the EU provide a natural field in which to search for the determinants of the distributive implications of economic integration. According to the results by Jimeno et al. (2000), inequality increased, with some exceptions, for both countries after their accession to EU.

We should stress that the EU is trying to eradicate poverty and reduce inequality and social exclusion. For new members of the EU an increased future polarisation of society can be predicted. On one hand, there is an important (growing) proportion of young and relatively well-educated people with rather good employment opportunities and relatively high wages. On the other side, there is persistent or increasing number of older unskilled or semi-skilled workers, participating mostly in the unofficial labour market, who are more likely to be made redundant, to have lower wages and temporary employment. With an adequate and well targeted welfare policy, the position of the latter group could be improved.

## **POVERTY, INEQUALITY AND SOCIAL EXCLUSION IN CROATIA**

Poverty increased dramatically in most of the transition countries of Europe during the past decade. Not only is the increase in poverty unprecedented, but it has taken place in the context of profound changes in economic, social, and political life. In most of Central and

South Eastern Europe certain subgroups of the population have a higher incidence of poverty than others - particularly the unemployed, the less educated and the rural population.

Poverty and inequality are serious obstacles to economic growth, especially in transitional countries, because high inequality leads to a *sharper crisis* in response to external shock as distributional conflicts between the rich and the poor impair the functioning of the newly established democracy. Higher inequality leads to significantly *higher rates of violent crime* because of the relatively higher pay-off from crime to those who are poor. Inequality also leads to *deterioration of the (already small) social capital* and *lower participation* in civil society, thus reducing opportunities for the poor to influence policies.

Although the collapse of output and increasing inequality can account for much of the quantitative rise in poverty, these two factors are in some sense just proximate causes, behind which lies a complex interaction of economic, social, and political processes. These underlying processes help explain why outcomes diverged as much as they did and are the key to how the worst outcomes may be improved. The question to answer is not so much whether poverty rose because output collapsed and inequality rose - the answer is an unambiguous yes - but why did output collapse so much more in some countries than in others? And why did inequality follow such different patterns? Almost the most important factor behind the path of output and incomes was the extent and quality of the economic reforms that countries chose to implement. There is a strong correlation between comprehensive reform and output performance (World Bank, 2000). Analysts, however, are beginning to realize that other factors may have mattered just as much: initial conditions (including location, initial economic distortions, and resource endowment); the state of institutions at the start of the transition; and the political system. These factors had a direct and strong impact on output as well. Moreover, these non-policy factors fundamentally affected the choice of reforms and the extent to which countries were able to implement them (EBRD, 1999). And these factors also had an independent impact on the distribution of income and consumption, and hence on the level of poverty.

## Poverty

Knowledge about the incidence and scope of poverty in Croatia was very limited until analytical work on poverty and vulnerability car-

ried out by the World Bank (2001) in collaboration with the Government became available. The analysis was based on the first post-war household budget survey in Croatia, carried out by the Croatian Bureau of Statistics in 1998. Results showed that poverty in Croatia is relatively low, i.e., lower than in most transition economies in the region (except for Slovenia) (Table 2). Only 4% of the population lived on less than US\$4.30 a day at PPP (*internationally comparable* standard across transition economies), and about 10% lived on less than US\$5.30 a day, which the study suggested as an appropriate absolute poverty line for Croatia.

*Table 2 Poverty rates according to an international poverty standard<sup>1</sup> (in %)*

Country	Year	Poverty rate
Belarus	1996	20.5
Croatia	1998	4.0
Estonia	1998	19.3
Hungary	1997	15.4
Latvia	1998	34.8
Lithuania	1998	22.5
Moldova	1997	68.6
Poland	1998	18.4
Romania	1998	44.5
Russia	1998	50.3
Slovenia	1993-95	Less than 1.0
Ukraine	1996	35.5

<sup>1</sup> US \$ 4.30 per person per day

Source: World Bank (2001); for Slovenia Milanovic (1998)

This international standard, however, may not adequately reflect the specific conditions of each society. For policy makers what matters is the extent of poverty based on nationally relevant standards. There is no national official poverty line in Croatia. The World Bank study has estimated the level of total expenditures (including non-food items) of households in Croatia at which families, after paying for essential non-food expenditures, just attain the minimal nutritional needs. This level of expenditure represents therefore an absolute poverty line and amounts to 41,500 kuna per year (in 1998 prices) for a couple with two children or 15,474 kuna for an “equivalent adult”. Around 10% of the population falls below this nationally specific poverty line.

However, poverty in Croatia is characterized by stagnancy - those who become poor take a great deal of time to escape from pover-

ty (World Bank, 2001). There are several dominant groups of poor: the unemployed and inactive persons, the poorly educated and the elderly. Although the unemployed and inactive represent a small share of the poor population in the Croatia (2.9% and 5.4%), they are exposed to the biggest threat from poverty, while employment is a fairly reliable protection against poverty. Almost three-fourths of the poor live in families whose head has primary education or less. These individuals are likely to have little prospect of finding work if they are not employed, or to have low earnings if they are employed. The risk of poverty is particularly high when poor education is combined with unemployment. Those living in households with unemployed or inactive household heads are around 3 times more likely to be poor than the population as a whole. Thus, *poverty in Croatia* - having become much more like poverty in Western Europe – *is highly correlated with the situation in the formal labour market and the skill of individuals* (Grootaert and Braithwaite, 1998).

There is a considerable body of information about welfare recipients in Croatia. Unfortunately, this does not cover detailed analysis of welfare recipients of working age registered as unemployed. The Croatian Employment Service does not identify those registrants in receipt of welfare. The Ministry of Labour and Social Policy has limited dis-aggregations of unemployed welfare clients. And there is little research on the characteristics of the group.

However, one study (Šućur, 2001) does offer some insights into the economic and demographic characteristics of unemployed welfare recipients in Croatia (the most important welfare right is the maintenance allowance - *pomoć za održavanje*). The first aim of the survey was to make distinctions between certain subgroups of users, particularly according to their working (in)activity and how long they had been receiving maintenance allowances. The second aim was to determine which factors were decisive in determining the duration of the period of receiving assistance. Šućur makes a distinction between *recipients* of social welfare (the individual appearing as the applicant for assistance) and *users* (includes formal applicants and all their family members using the received aid). The research was conducted on a sample of 500 recipients of social welfare. According to their employment status, welfare recipients can be categorized into two dominant groups: the unemployed and the incapacitated. In comparison to other transitional countries, Croatia has a higher share of unemployed in all welfare recipients. This is the consequence of structural changes that

have occurred in Croatia. It is important to stress that more than half of unemployed welfare recipients have been without a job for more than five years.

The duration of welfare assistance differs significantly in statistical terms, depending on age, level of education and region where the recipients originated. The older and less educated recipients are more likely to remain longer in the welfare scheme. The average period of welfare scheme usage is quite long (almost 5 years). According to regression analysis, it could be assumed that welfare assistance would be used for a longer period by applicants of higher age, of lower level of education, who are unmarried and living in incomplete families, who have no displaced person or refugee status and who receive other benefits available under the social welfare scheme. The finding of this research can serve to identify risk groups and to suggest certain measures aimed at improving the status of income support users.

However, despite the high percentage of social transfers in GDP (around 25%) Croatia has achieved little redistribution. This is because most social spending programmes are relatively poorly targeted, while the relatively well targeted social assistance programmes are fragmented and account for a small portion of total social spending. Instead of reducing inequality, the overall welfare system acts to enhance it (World Bank, 2001).

Poverty in Croatia is not only relatively low, but also shallow. The poverty gap is 1.8% and on average the consumption of a poor household is 20.7% below the poverty line. To raise all the poor out of poverty with perfect targeting (i.e., each poor person is given a transfer exactly equal to the poverty gap) would cost only about 1% of GDP. Croatia is thus perfectly able to eliminate absolute poverty.

Those who have the misfortune to be poor are seriously deprived. Life of the poor differs in many respects from the non-poor. The poor tend to live in overcrowded, poorly maintained dwellings; their diet is limited to basic staples (especially for the urban poor who can afford little beyond basic staples); and they are poorly educated. Only few have savings; they are often immobile, and their social networks are very limited. Poverty in Croatia has already many features of a permanent state: the poor are unlikely to escape poverty easily. This is due to two basic reasons:

- There are limited economic opportunities because growth so far has not generated enough jobs. Many old jobs have been destroyed and

very few new jobs have been created. Growth has benefited primarily those who kept their jobs. But for those locked outside employment, the effect was close to nil, if not negative. Furthermore, over-regulation of employment, especially constraints on layoffs, are limiting opportunities for small businesses and flexible working arrangements. Small businesses and flexible working arrangements could constitute a viable alternative to wage employment for the poor.

- The poor are at a disadvantage with respect to benefiting even from this limited set of opportunities. Once locked outside employment, the unemployed and economically inactive have limited capacities to break out of the circle of impoverishment. Over half of the unemployed are long-term unemployed, so analysis of labour market flows suggests that both the unemployed and the inactive are unlikely to find new jobs.

Most working-age individuals who are not employed have either very low educational endowments (primary) or narrowly formed skills (vocational school graduates). Those who are currently locked outside remunerative employment due to their level of education are also likely to see their limited opportunities perpetuated for their children.

The first national study of poverty was carried out in 1998 (World Bank, 2001). According to its findings, Croatia has relatively low poverty rates, especially compared to the other countries in transition. However, poverty in Croatia is of a persistent nature: those who become poor take a great deal of time to escape poverty. There are several dominant groups of the poor: the elderly and poorly educated, the unemployed and inactive persons.

## **Inequality**

According to the survey by the World Bank (2001) mentioned, income inequality measured by the Gini coefficient in 1998 is 0.39, which is higher than in most neighbouring transition countries. Nestić (2003) objects to the definition of income from self-employment, arguing that it results in overestimation of inequality. Contrary to the general perception that inequality increases rapidly over the last ten years, according to the data he presented there was no strong increase in income inequality. The compromise value of the Gini coefficient increased from 0.286 in 1988 to 0.297 in 1998.



Table 3 *Inequality and social spending in accession countries*

Country	Gini coefficient		Social spending (% of GDP)	
	1987–1990	1996–1998	Pensions (1997)	Health (2000)
Bulgaria	0.23	0.41	6.2	3.9
Croatia <sup>1</sup>	0.29 <sup>2</sup>	0.30 <sup>3</sup>	13.0	8.6
Czech Republic	0.19	0.25	8.9	7.2
Estonia	0.24	0.37	7.6 <sup>4</sup>	6.1
Hungary	0.21	0.25	9.4	6.8
Latvia	0.24	0.32	10.7	5.9
Lithuania	0.23	0.34	7.0	6.0
Poland	0.28	0.33	15.1	6.0
Romania	0.23	0.30	6.84 <sup>4</sup>	2.9
Slovakia	n.d.	n.d.	8.0	5.9
Slovenia	0.22	0.30	14.4	8.6

<sup>1</sup> *Compromise value* <sup>2</sup>1988 <sup>3</sup>1998 <sup>4</sup>1993

Source: World Bank, (2002); Barr, (2001); WHO (2002); Nestić (2003)

Inequality increased in all transitional countries, especially in Bulgaria and Estonia. In 1996–1998 the Gini coefficient for Croatia was higher than the coefficients for Czech Republic and Hungary, but much lower than the coefficients for the Baltic countries and Poland (future members of EU). Milanovic (1998) demonstrates that the increase in the Gini coefficient in transitional countries in central Europe was mainly influenced by the growth of the wage concentration coefficient,<sup>iii</sup> while the change in income structure contributed to the decrease in inequality. The sole change in the income composition in Croatia is similar to the changes in other transition economies. A decrease in the share of wages and an increase in the share of pensions, other social transfers and other personal income (excluding wages) during the transition period are obviously common to all transition economies. However, the changes in concentration coefficients were very unusual in Croatia. Milanovic (1998) shows that in transition countries there was a considerable increase in wage and pension concentration. A slight increase was observed in the concentration of other private income, while all other social transfers strongly contributed to the decrease in inequality. At the same time, Croatia saw a weak increase in wage concentration and a mild decline in pension concentration. The equalising effect of other social transfers weakened, while the concentration of other private income (income from self-employment and from property) grew markedly.

The percentage of pension and disability insurance and for health insurance in Croatia in GDP is high and is not sustainable in the long run. Croatia has almost concluded its pension reform, which should also be an important factor for providing security for older citizens. Of course, it will be necessary really to see its impacts on poverty and inequality in Croatia, as well as to look forward to the finalization of health reform.

In spite of the general perception that inequality in Croatia increased strongly during the transition period, according to the results of Nestić (2003) it did not rise tremendously. Thus, the Gini coefficient rose from 0.286 in 1988 to 0.297 in 1998. Decomposition of the Gini changes shows that the expansion of social transfers as well as the absence of any major rise in wage concentration account for there being only a mild increase in inequality.

## CONCLUSION

We might recall that absolute poverty in Croatia is low, but this diagnosis is deceptively consolatory. The characteristics of the poor in the Croatia are very similar to those of the deprived population in other transitional countries in Central and South East Europe, and are mostly determined by education, number of income earners, employment status. The risk of poverty is especially high for households where the main income earner is unemployed or inactive. There are several dominant groups of the poor, primarily the unemployed and inactive persons. The type of economic growth in Croatia has failed to generate enough economic opportunities for the poor, and they are at a disadvantage with respect to benefiting from these opportunities.

Generally, poverty cannot be reduced if long-term sustainable economic growth does not occur. Absolute poverty can be alleviated if at least two conditions are met: economic growth must occur - or mean income must rise - on a sustained basis; and economic growth must be neutral with respect to income distribution or it must reduce income inequality. Equitable growth is of the utmost importance for several reasons. Firstly, it will raise incomes of the working poor, giving them an opportunity to escape poverty. Secondly, it will provide employment opportunities for the unemployed and inactive workers – a group with an especially high risk of poverty. Thirdly, it will provide the tax base for programs to alleviate poverty among those who cannot escape poverty otherwise.

Three conditions are required to achieve equitable growth: sustaining macroeconomic stability, creating an enabling environment for private businesses, and increasing investment in human capital. This would involve redefining the frontier between the state and the market on efficiency grounds: the state should withdraw from activities that are inherently a market domain. A major problem with the economic policies advocated for the transition period is that they have been based on minimizing the role of the state. But because of the prolonged and complex nature of the transition, *the responsibilities of the state should increase rather than decrease*. This does not imply a return to an authoritarian, undemocratic state. It also does not mean that the state should be large relative to the private economy, and certainly not that it should try to dictate the direction of the economy. It does imply that the state should be activist and intervene in critical areas where market forces cannot ensure an efficient allocation of resources or where access to basic assets and opportunities for people's livelihoods is inequitable. In all these things mentioned, accession to the EU could be helpful, but one should be realistic and not expect too much. Further strengthening of democratic institutions and opening up Croatia to closer integration with European and global structures should also help to bring about a reduction in poverty.

## RECOMMENDATIONS

*Future EU membership will not be able to settle any possible Croatian inconsistencies and unwillingness to seriously formulate and implement a financially sustainable and efficient social policy and programme for poverty alleviation.* Although declining (Štulhofer and Rimac, 2002), there is still highly widespread and/or deeply rooted paternalism in Croatia – a belief that government should (or is obliged and able to) solve all existential problems of its citizens. However, there is no single model for the eradication of poverty, economic inequality and social exclusion that is optimal for all societies. Like every other country, Croatia has to find and develop constitutional and legal arrangements that best suit its own historical, social, cultural and economic situations, conditions and possibilities. From the abundant economic and social literature as well as from everyday practice it is quite obvious that government (not only Croatian) is incapable of solving the mentioned issues. Government could provide a stable legal

framework, the social infrastructure and with the co-operation of its citizens establish the rule of law. Otherwise, the poor and socially excluded will suffer most from the lack of clear laws and unwillingness of society to respect those that do exist. It is not so important to produce new laws and changes in the organization structure, but to enhance respect for the current laws. However, in order to make the laws work, political will and leadership commitment is vital. Just as important is the empowerment of citizens and their full participation in the political process. Such a paradigm shift takes time and is more likely to be attained through the younger generation.

Although recent economic performance has on the whole been satisfactory, Croatia *faces more demands than many former socialist states*. Both the demands of transition and of post-war reconstruction call for an increase in the level of investment. This, in turn, implies a need to raise the domestic savings rate and possibly to attract resources from abroad. This objective imposes limits on the type and scale of social programmes that can be adopted at the present time. Croatia's prospects for economic growth and job creation look good, provided that fiscal retrenchment and reforms continue. With continued political stability, the Government should be well positioned to advance reforms. There are risks, however, of policy slippage, and vulnerability to adverse external developments, including a risk of slower growth and constrained access to international capital markets.

Approaches to poverty reduction could be categorized into two alternatives: technocratic or institutional. The former emphasizes targeting and explores programme designs that try to direct limited resources to the people with the greatest need. The latter approach notes that the poor lack political power, and that administrative incompetence and corruption hinder government delivery of services. Poverty reduction therefore requires institutional development, and changed political structures, improved governance, and changed attitudes towards the poor.

*Substantial poverty reduction could thus be achieved in Croatia by careful reallocation of expenditures and improvement of coordination among existing social programmes.* The Government reviewed the policy and public expenditure implications, and accepted a National Poverty Reduction Strategy in early 2002 (Vlada RH, 2002). Two key recommendations emerged: (a) adopt a scheme to prompt a more comprehensive role for NGOs in providing services to the poor through outsourcing, and (b) ensure closer integration between social assistance

programmes and education and employment services, in order to enhance the chances of the poor and unemployed returning to work. Initiatives in these areas should improve the effectiveness of social spending over time. To achieve more efficient allocation of resources, free market mechanisms are vital, but so are mechanisms concerning social equity. Reforms to build thriving, sustainable market economies will only succeed if built on successful investment in people.

*Successful poverty alleviation is directly linked with consistent increase in decentralization of sources and services.* The structure of intergovernmental relations affects the efficiency and equity of service delivery, the social safety net, and poverty alleviation programmes. A further, more practical problem with central government failure is that often, because of poor performance at the local level, everyone who can afford it avoids governmental services. Instead of going to the public school or public hospital, citizens begin to look for private schools, private hospitals, and even private security firms. This not only weakens the role of the state but leaves the government with the weakest and most needy part of the population which increases the burdens on governmental services and often affects quality adversely. The allocation of poverty programme grants at the subnational level should be analyzed carefully within the particular Croatian context since lack of transparency, or inadequate specificity in transfer design, may sometimes result in wealthier areas receiving more resources than poorer areas.

Market forces alone can never be relied on to produce a fair or equitable society. The state must be committed to the reduction of poverty and inequality, and in order to do so, it must maintain a transparent and equitable system of social protection that relies on a foundation of universal coverage and non-discrimination. *It is necessary to strengthen the social safety net* through improved targeting and monitoring of social welfare programmes, empowering civil society in the provision of social services, decentralisation of some social services, improving the targeting of social assistance, and better design of employment policy measures. A primary aim of policy must be to get people into work - or back into work. For most people most of the time, dependency on state assistance cannot provide a satisfactory alternative to employment - in terms of either psychological satisfaction or material well-being. The opportunity of paid employment is among the simplest ways of escaping poverty and dependency. It is desirable, whenever possible, that people are found (or find themselves) jobs in the for-

mal sector. Not only are such jobs more secure, in general, they also offer more opportunities for training and the acquisition of skills. Further more, they will increase the tax base and, in some measure allow a reduction in indirect labour costs.

The low employment rate, or rather an increase in employment, currently represents one of the main priorities of economic policy in Croatia. There is clearly a strong association between poverty, education, employability and long term unemployment. The problem of long term unemployment is growing. There has been a continual rise in the share of the long-term unemployed - those who have been waiting for more than one year for a job now account for more than a half of all unemployed. *The task is to reduce both the flows into long-term unemployment and the stock of people already out of work for more than a year.* The problems faced by many of the long-term jobless are often multi-dimensional and frequently include low levels of education and of motivation. Croatia has a range of active and passive measures to assist the unemployed. The employability of the long-term unemployed should be enhanced and social exclusion reduced through participation in work related activities. There is also the lack of timely evaluation to assess the true effectiveness of policy measures on the labour market. This could be addressed through the introduction of new techniques (tracking studies) for collecting up-to-the-minute data about their impact.

*There is a need for two types of activities in order to improve public awareness of and access to social programs.* First, to support the reform of the whole social and welfare system, the Ministry of Labour and Welfare should create a plan for a public education campaign to inform members of the public about all changes in the legislation, procedures and new nation-wide social programmes. Then, social programmes available to the citizens under the reformed system and provided through the welfare centres by national, regional and local self-governments should be well publicized through the different systems of on-going publicity for the potential beneficiary. This system should include the dissemination of information through various means about the different benefits available through the particular welfare centre.

Collection of poverty indicators and an accompanying poverty analysis are important for the sake of acquiring a compact and detailed insight into the social situation in Croatia. One of the goals should be *to establish the official poverty rate.* Objective poverty analysis can help to put poverty issues in an adequate place on the political priority

list, at both a national and a local level. Poverty indicators can be a good base for defining and shaping different measures of social policy. Monitoring the effects of a social programme is also one of the purposes of these indicators.

Finally, one should recommend that some effort be invested in improving the quality, range and frequency of collecting data, information and social statistics as well as in enhancing research about poverty, economic inequality and social exclusion. Such information and research are required for social planning and for the formulation of appropriate policies. If the objective is for safety nets to reach the poor, information is required on who the poor are and where they are located, and how much of the benefits from the programme are reaching this target group. In most cases, (especially transitional) countries spend significant resources on safety nets but fail to collect data and monitor who receives the benefits and how they were affected by them. Such information should also be made available to the research community and general public. These two steps will help to make government at all levels more accountable to the electorate, by providing voters with more information about the impact of government policies, which should also raise the quality of public debate and increase the participation of citizens in the political decision-making process.

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<sup>i</sup> Details about all summits and related documents can be found on <http://europa.eu.int>.

<sup>ii</sup> For the activities of the Council of the European Union see <http://www.eapn.org>, for Finland <http://www.stm.fi/Resource.phx/eng/index.htm>, for Ireland <http://portal.welfare.ie> and <http://www.entemp.ie>.

<sup>iii</sup> The concentration coefficient shows inner inequality in distribution of particular income, but also its correlation with total income. The coefficient ranges from -1, when the entire income source is received by the poorest (by income) recipient; through 0, when all recipients receive the same amount; to 1, when the entire income source is received by the richest recipients. A concentration coefficient's negative (or positive) value shows that a given source is negatively (or positively) correlated with overall income (Milanovic, 1998:16).

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