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Adjustment capacity to external shocks of EU candidate and potential EU candidate countries of the Western Balkans, with a focus on labour markets

Volume II

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Volume II

This study is based on the final report of a study by The Vienna Institute for International Economic Studies, carried out within the contract ECFIN/169/2007/473194. The final version of this study was received on 13 October 2008.

Due to its size, we publish the study in two volumes:

Volume I contains the bulk of the report which has been drafted by an expert team of The Vienna Institute for International Economic Studies (wiiw), consisting of Vladimir Gligorov, Anna Iara, Michael Landesmann, Robert Stehrer and Hermine Vidovic.

Volume II contains the background studies which were elaborated by a team of local experts: Arsena Gjipali, University of Tirana, Albania; Miroslav Tomic, Office of The High Representatives, Bosnia and Herzegovina; Valerija Botric, Institute of Economics, Zagreb, Croatia; Avdullah Hoti, University of Pristina, Kosovo; Maja Micevska, University of Klagenfurt, Austria; Ana Krsmanovic, Institute for Strategic Studies and Prognoses, Podgorica, Montenegro; Kosovka Ognjenovic, Economic and Social Policy Institute, Belgrade, Serbia; and Nataša Kump, Institute for Economic Research, Ljubljana, Slovenia.

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Contents Volume II

SLOVENIA

Nataša Kump

1. CONTRIBUTION TO THE LITERATURE REVIEW

Authors	*Kump, Nataša; Stropnik, Nada*
Title	*Sistem kazalnikov za ugotavljanje, ali se delo izplača*
Reference (journal, publisher, ...)	*Institute for Economic Research, Ljubljana*
Year	*2007*

The study investigates the "may work pay" indicators: unemployment trap, inactivity trap and poverty trap. It analyses the characteristics of individual transfers and income tax that have impact on the attractiveness of employment/activity. It presents the indicators for six family types and four income levels. The OECD methodology is applied.

The disposable income of a single unemployed person who takes a job paying 67% of the average production worker (APW) wage (the same as before unemployment) increases by 17%; and by only 1% if the job pays a half of the APW wage. A single parent with two children (with previous earnings at the level of an average APW wage) looses 21.3% of the disposable income after taking up a job paying a half of the APW wage. The net replacement rates have not significantly changed due to abandoning the unemployment assistance. This is due to the fact that financial social assistance exceeds the former unemployment assistance (and in fact was supplementing it). Families with two children face the inactivity trap, too, if their probable earnings are below a half of average wage. Apart from social assistance and unemployment benefit, the social security contributions are the most important component of the traps.

Authors	*Vodopivec, Milan*
Title	*Analiza mobilnosti dela in fleskibilnost sistema plač izplača*
Reference (journal, publisher, ...)	*Manuscript*
Year	*2005*

Index of job protection decreased from 4.1 in 1995 to 3.1 in 1998 (when the Employment and Unemployment Insurance Act was revised), and to 2.7 in 2003 and 2004. In 1998, temporary work agencies were regulated. New Labour Relations Act (2003) shortened periods of notice and lowered severance payments. Collective dismissals became more flexible too. On the other hand, restrictions regarding temporary employment increased the index. Through decreasing the restrictiveness of the employment regulation, the revised Employment and Unemployment Insurance Act (1998) significantly contributed to a decrease in the differences between exits from employment of workers with permanent and temporary contracts. Index of job protection also indicates changes towards smaller rigidity, though at some points the legislations still does not allow for sufficient flexibility.

Authors	*Kajzer, Alenka*
Title	*Spremembe na trgu dela v Sloveniji v obdobju 1995-2005*
Reference (journal, publisher, ...)	*Institute for Macroeconomic Analysis and Development*

Year	*Delovni zvezek 5/2006, 2006*

The study describes trends in Slovenian labour market; employment, unemployment, educational structure, labour market flexibility, wages, the institutional regulation of labour market and active labour market policy programmes.

Authors	*Kajzer, Alenka*
Title	*The problem of ageing and labour market flexibility in Slovenia*
Reference (journal, publisher, ...)	*International Social Security Association*
	5th International Research Conference on Social Security
Year	*2007*

The Slovene labour market is often considered as rigid. The labour market situation is relatively favourable at the moment. A notable rise was observed particularly in fixed-term jobs, while the incidence of part-time work remained relatively modest. Flexibility mostly affects younger people (15-24 years), particularly young women. The paper shows age-related labour market segregation in Slovenia. The problem of the low employment rate of the elderly population (aged 55-64 years) in the context of population ageing brings forward the role of the social security system (pension system) and employment policy in Slovenia in coping with the demands for increased labour market flexibility also for the elderly population.

2. DESCRIPTION OF LABOUR MARKETS

Brief summary of main characteristics

Slovenia has undergone vast political, economic and social changes in the 1990s. The transition to a full-fledged market economy resulted in large changes on the labour market. The figures from administrative sources are telling: the number of labour active persons decreased from 909 thousand in 1990 to 743 thousand in 1997. Since then, there has been a gradual increase, to 825 thousand in 2006. Registered unemployment increased from 45 thousand in 1990 to the peak value of 129 thousand in 1993. A gradual decrease followed, so that by the end of 2006 there were some 86 thousand registered unemployed in Slovenia. Needless to say, much of the labour withdrawal was absorbed by the pension system, through generous early retirement schemes.

Pension system of Slovenia also underwent a number of changes. In 1992, the Pension and Disability Insurance Act (PDIA) was passed. This was a comprehensive act: it did not introduce sweeping changes, but rather sought to establish full national sovereignty in this important area of social insurance. The 1992 PDIA gradually tightened eligibility criteria for pensioning. Early retirement was still possible at age 55 for men and 50 for women, provided certain conditions were met[1]. The tightening of conditions for early retirement came somewhat late in the day, as the large wave of early retirees already entered the pension system in 1990 and 1991. Preparations for a full-fledged reform started soon after the passage of the 1992 PDIA, and the reform was finally enacted at the end of 1999, with the passage of the PDIA. Full pensionable age is set at 63 for men and 61 for women. This means that insured persons retiring prior to the full pensionable age receive »penalties« i.e. lower than normal or even negative accrual rates, and persons retiring after the full pensionable age receive accrual rates which are higher than the normal

[1] Similarly to the 1983 PDIA, the 1992 PDIA required, besides the age condition, also a condition of minimum pension qualifying period – 35 for men and 30 for women. However, the 1992 added some further conditions, such as bankruptcy of the firm, long term unemployment or disability.

accrual rates. Changes will be introduced very gradually; full pensionable age will be in reached in 2009 for men and not earlier than in 2023 for women.

Although there is some difference between administrative sources (Statistical Register of Employment - SRDAP) and statistics based on the labour force survey, we reach the same common conclusions, regardless which data we consider: the number of active and employed persons increased from mid nineties to 2006, meanwhile the number of unemployed persons noticeably declined in the same period. In between, there were some "less favourable" years, when economic growth slowed down and caused negative effect on labour market (years 2001 - 2003). Activity of working age population is evident from table 1.

Table 1: Working age population (15-64) by activity, Slovenia, 2000-2005

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Labour Force Survey											
Labour force	920	932	950	933	939	945	958	939	985	991	998
Persons in employment	857	869	878	863	873	890	900	877	924	925	937
Unemployed persons	64	64	72	70	66	55	58	62	61	66	61
Activity rate	*66.3*	*67.4*	*68.8*	*67.6*	*67.4*	*67.5*	*68.5*	*66.9*	*69.9*	*70.7*	*70.9*
Employment rate	*61.7*	*62.8*	*63.5*	*62.5*	*62.7*	*63.6*	*64.3*	*62.5*	*65.6*	*66.0*	*66.6*
Unemployment rate	*6.9*	*6.8*	*7.6*	*7.5*	*7.1*	*5.8*	*6.1*	*6.6*	*6.1*	*6.7*	*6.1*
Statistical Register of Employment											
Labour force	862	869	871	877	907	908	911	899	900	905	911
Persons in employment	742	743	745	758	801	806	809	801	807	813	825
• Persons in paid employment	633	651	652	671	715	722	721	722	724	732	742
• Self-employed persons	110	92	93	88	85	84	87	79	83	82	83
Registered unemployed persons	120	125	126	119	107	102	103	98	93	92	86
Unemployment rate	*13.9*	*14.4*	*14.5*	*13.6*	*11.8*	*11.2*	*11.2*	*11.0*	*10.3*	*10.2*	*9.4*

Source: Eurostat, Labour Force Survey; SORS, Rapid Reports (1997, 2007); Employment Service of Slovenia, Annual Report 2005.

The overall activity rate in Slovenia - which was 70.9 percent in 2006 – is slightly higher than EU 25 average with an activity rate of 70.6 percent in 2006. Namely activity rate in Slovenia has been increasing since 1996 (with some intermediary drops) and reached EU average level as early as in 2004.

We note that the activity rates for men and women differ from the EU averages. As seen from table 2, the activity rate of Slovenian women amounted to 66.7 percent in 2006, which is more than the average female activity rate in European Union - 63.2 percent. In contrast, the male activity rate in Slovenia is lower than the EU average. In 2006, 74.9 percent of Slovenian men were active as compared to 78.0 percent of active men in the EU.

Table 2: Activity measures of the population aged 15–64, by gender, Slovenia, 1996 - 2006

Year	Activity rate, %			Employment rate, %			Unemployment rate, %		
	Total	Male	Female	Total	Male	Female	Total	Male	Female
1996	66.3	71.1	61.5	61.7	66.0	57.5	6.9	7.2	6.6
1997	67.4	71.8	62.9	62.8	67.1	58.4	6.8	6.5	7.2
1998	68.8	73.0	64.4	63.5	67.5	59.5	7.6	7.5	7.7
1999	67.6	72.2	63.0	62.5	66.8	58.1	7.5	7.4	7.7
2000	67.4	71.7	63.1	62.7	66.7	58.5	7.1	6.9	7.2
2001	67.5	72.5	62.5	63.6	68.5	58.6	5.8	5.5	6.2
2002	68.5	72.9	63.9	64.3	68.7	59.8	6.1	5.7	6.4
2003	66.9	71.6	62.1	62.5	67.2	57.7	6.6	6.1	7.1
2004	69.9	74.2	65.6	65.6	69.9	61.3	6.1	5.8	6.5
2005	70.7	75.1	66.1	66.0	70.4	61.3	6.7	6.2	7.2
2006	70.9	74.9	66.7	66.6	71.1	61.8	6.1	5.0	7.4

Source: Eurostat, Labour Force Survey.

These findings are reflected in gender gaps in employment and unemployment in Slovenia. Due to relatively high employment rates among women and relatively low employment rates among men, the gender gap in employment rates (the difference between men's and women's employment rates) is considerably below European average; in 2006 it amounted to 9.3 percent, compared to the EU average of 14.7 percent.

Employment in total population has increased and reached a record high in the third quarter of 2006 when 948 thousands of persons (out of working age population) were employed, mainly as a result of robust GDP growth. The exception to this favourable trend was the secular decline in employment in labour-intensive industrial sectors such as textiles and leather. The strongest growth in employment in 2000-2006 was registered in real estate, renting and other business services, financial intermediation (especially insurance and pension funds which is obviously the effect of pension reform) and education. It is worth mentioning that between 2003 and 2006 over a quarter of the increase in employment in the business service sector was derived from the higher number of employees in temporary employment agencies, which are an important factor of employment flexibility, while the people employed in them actually work in different sectors[2]. Construction has been showing growth in employment since 2005 caused by accelerated residential and motorway construction. Within manufacturing, the biggest increase in the number of persons in employment was observed in the metal industry, manufacture of machinery and equipment, manufacture of transport equipment and manufacture of rubber and plastic products. However, the diminishing share of employment in industry and increasing share in services is a long term trend, evident also from table 3. Slovenia still lags behind EU average in terms of share of people employed in service sector.

[2] IMAD, Spring forecast.

Table 3: Employment by broad economic sectors, population aged 15-64, Slovenia, 2000- 2006

Year	Agriculture		Industry		Services	
	Thousands	%	Thousands	%	Thousands	%
1996	77.2	9.0	364.3	42.5	414.1	48.3
1997	87.9	10.1	358.8	41.3	419.6	48.3
1998	86.1	9.8	354.8	40.4	433.2	49.3
1999	73.5	8.5	333.4	38.7	452.9	52.5
2000	68.1	7.8	333.1	38.2	466.0	53.4
2001	68.5	7.7	348.6	39.2	463.2	52.0
2002	68.9	7.7	354.4	39.4	470.7	52.3
2003	58.8	6.7	329.4	37.6	483.1	55.1
2004	74.3	8.0	339.4	36.7	501.0	54.2
2005	67.2	7.3	349.1	37.7	504.3	54.5
2006	72.3	7.7	338.5	36.1	521.7	55.7

Source: Eurostat, Labour Force Survey.

The Slovenian unemployment rate (6.1 percent in 2006) was considerably below the European average of 8.3%. Unemployment rates for whole Slovenian population decreased in period 1996-2006, but we come to different conclusions if we consider unemployment rates for men and women separately. Female unemployment rates increased in comparison to decreased male unemployment rates in observed period. Up to 1996, female unemployment was lower than that of men[3]; since then, female unemployment has been consistently higher than that of men. It seems that the first wave of transition affected men in the labour market more than women, partly because male-dominated industries (such as metallurgy, metal industry) were hardest hit in the first years of transition. In the following years, female-dominated industries (especially textile and footwear industry) became more exposed to competitive pressure, and this reflected in a larger increase in female unemployment.

The activity measures can be analysed in greater detail by observing the activity and unemployment rates by age groups. Considerable increase in activity rates for women and men in the age group 50-54 is evident from table 4. In 1996 only 45.4 percent of women aged 50-54 were active; this share increased to 73.6 percent in 2006. The increase of male activity rate in this period was much smaller; from 72.9 to 81.5 percent. A particularly high increase in activity rates for men between 1996 and 2006 is evident for the age group 55-59, when it increased from 38.7 to 61.8 percent. Activity rates for women for this age group are much lower, although there was also an increase: from 14.6 in 1996 to 30.2 percent in 2006. One must bear in mind that massive early retirement occurred in the beginning of the 1990s, up to 1993; this caused a large withdrawal of this age group from the labour market. Following the transition shock, activity rates among persons in the "elderly" age group increased; this can to a large degree be ascribed to the tightening of eligibility conditions for retirement, following the passage of the 1992 Pension and Disability Insurance Act (PDIA) and the 1999 PDIA. In comparison to EU average the activity rates of elderly (55-64) is still rather low.

In contrast to the elderly age groups, the activity rate for the youngest age group 15-24 decreased from 42.6 in 1996 to 40.6 percent in 2006. The decrease was more pronounced for young women, while activity rates for young men in 2006 were almost the same as in 1996. The main cause for decline is the large increase in the number of students; the number of undergraduate students increased from 33,565 in 1990/91 to 91,229 in 2004/05. Besides extending studies into higher education before joining the labour market, the young (age group 15-24) also face an increasingly difficult transition from education to work.

[3] See Stanovnik, Čok, Kump (2005): The Gender Dimension of Social Security Reform in Slovenia.

Table 4: Activity measures of the working age population by age groups and gender, Slovenia, 1996 - 2006

Year	Total	15-24	25-49	50-54	55-59	60-64
	Total					
1996	66.3	42.6	90.6	59.3	26.1	14.6
1997	67.4	46.1	89.6	60.5	28.6	18.2
1998	68.8	44.0	91.0	64.6	34.2	17.9
1999	67.6	40.4	90.9	65.0	29.9	17.7
2000	67.4	37.3	90.6	70.0	31.6	15.3
2001	67.5	36.0	91.0	70.2	34.7	14.7
2002	68.5	36.6	91.4	73.3	36.8	15.7
2003	66.9	33.8	91.0	70.8	33.7	13.5
2004	69.9	39.3	91.4	75.3	45.4	16.4
2005	70.7	40.5	91.6	74.8	45.6	16.0
2006	70.9	40.6	91.4	77.6	46.2	16.0
	Male					
1996	71.1	44.6	93.1	72.9	38.7	18.1
1997	71.8	49.6	91.4	72.4	37.0	24.1
1998	73.0	46.3	93.1	79.9	44.3	20.8
1999	72.2	41.9	92.8	79.9	43.5	22.6
2000	71.7	40.7	91.7	84.2	44.5	20.3
2001	72.5	40.1	92.9	82.2	48.6	19.8
2002	72.9	40.2	93.1	82.9	53.3	21.4
2003	71.6	38.3	92.5	80.7	48.0	17.5
2004	74.2	43.1	92.8	81.9	62.1	21.5
2005	75.1	44.5	93.4	79.3	62.7	22.9
2006	74.9	44.4	93.0	81.5	61.8	22.3
	Female					
1996	61.5	40.7	88.0	45.4	14.6	11.7
1997	62.9	42.4	87.7	49.0	20.2	13.4
1998	64.4	41.6	88.9	49.9	23.9	15.3
1999	63.0	39.0	88.8	49.9	17.0	12.9
2000	63.1	33.6	89.5	55.9	18.4	11.2
2001	62.5	31.7	88.9	58.3	20.3	10.4
2002	63.9	32.6	89.6	63.6	20.1	10.6
2003	62.1	28.9	89.3	60.0	20.1	10.1
2004	65.6	35.4	89.9	68.4	28.4	11.9
2005	66.1	36.3	89.7	70.3	27.3	9.8
2006	66.7	36.4	89.7	73.6	30.2	10.3

Source: Eurostat, Labour force survey.

The increase in employment rates for highly skilled persons seen in period 1996-2006 indicate, that education is a significant factor affecting one's position on the labour market. However, high employments rates of highly skilled people are also the result of relatively low share of people with tertiary education in total population. As seen from table 5, the employment rate of low-skilled people rose moderately while people with a completed secondary education experienced a drop in employment rate in observed period. The employment rate of low-skilled people is lower than the EU average, which can be to some extent attributed to low labour activity of elderly and insufficiently developed service sector in comparison to EU.

Table 5: Employment and unemployment by attained level of education, population aged 15-64 1996-2006

Year	Pre-primary, primary and lower secondary			Upper secondary and post-secondary non-tertiary			Tertiary education		
	% of all employed	Empl. rate	Unempl. rate	% of all employed	Empl. rate	Unempl. rate	% of all employed	Empl. rate	Unempl. rate
1996	22.1	39.6	9.9	63.0	71.3	6.7	14.9	83.5	2.8
1997	22.7	42.5	9.2	62.9	70.8	6.7	14.4	84.3	3.3
1998	21.4	43.2	10.1	63.3	70.8	7.8	15.3	83.5	2.8
1999	19.2	39.4	11.0	63.9	70.3	7.6	16.9	84.8	3.1
2000	18.6	39.7	11.5	63.9	69.5	7.0	17.4	85.8	2.2
2001	18.8	42.0	9.8	63.7	69.3	5.5	15.0	85.7	2.3
2002	17.4	41.8	9.4	64.6	69.5	6.1	15.7	86.4	2.5
2003	15.8	38.2	11.2	64.6	67.5	6.3	19.6	85.2	3.8
2004	16.0	41.2	10.1	63.7	70.7	6.1	20.4	86.8	2.8
2005	15.3	42.0	10.2	62.9	69.8	6.9	21.9	86.6	3.2
2006	14.4	41.9	8.4	62.2	69.7	6.6	23.4	87.8	3.3

Source: Eurostat, Labour force survey.

Table 6 presents unemployment rates by age groups and gender. Despite the decline in unemployment of the young (15-24), their unemployment rate with 13.9 percent in 2006 far exceeds unemployment rate of total population. The gender gap is also largest for the age group 15-24; in 2006 it amounted to 5.2 percentage points. Obviously, labour market conditions are less favourable for younger women, as employers prefer to employ young men. It seems that absences due to maternity leave and leave for child-care represent a disadvantage for younger women entering the labour market[4]. On the other hand, in observed period only the oldest age group 50-64 experienced growth in unemployment as overall unemployment rate decreased which is another problem of Slovenian labour market. Unemployment rates in age group 50-64 increased for both, men and women, although the increase was more pronounced for female unemployment rate.

Table 6: Unemployment rates, by age groups and gender, Slovenia, 1996 – 2006, (%)

Year	Total			15-24			25-49			50-64		
	Total	Male	Female	Total	Male	Female	Total	Male	Female	Total	Male	Female
1996	6.9	7.2	6.6	16.6	16.7	16.5	5.5	5.9	5.0	3.6	3.7	3.4
1997	6.8	6.5	7.2	16.3	14.1	19.1	5.5	5.5	5.5	2.8	3.1	2.4
1998	7.6	7.5	7.7	17.6	17.0	18.2	6.3	6.3	6.3	4.2	4.4	3.9
1999	7.5	7.4	7.7	18.5	17.2	19.8	6.1	6.2	6.0	5.0	5.0	4.8
2000	7.1	6.9	7.2	16.4	14.8	18.5	5.6	5.4	5.7	7.3	7.7	6.7
2001	5.8	5.5	6.2	15.7	15.0	16.6	4.7	4.4	4.9	4.2	3.6	5.1
2002	6.1	5.7	6.4	14.8	13.5	16.7	5.1	4.8	5.5	4.3	4.6	3.8
2003	6.6	6.1	7.1	15.3	13.1	18.4	5.9	5.5	6.4	4.2	4.4	4.0
2004	6.1	5.8	6.5	14.0	11.2	17.7	5.3	5.0	5.6	4.5	5.4	3.3
2005	6.7	6.2	7.2	15.9	14.5	17.8	5.8	5.2	6.6	4.3	5.1	3.3
2006	6.1	5.0	7.4	13.9	11.6	16.8	5.5	4.4	6.8	3.9	3.5	4.3

Source: Eurostat, Labour force survey.

Worsening position of women employability is also evident from table 7, as their share among unemployed was continuously increasing. In 2006 women represented 54.8 percent of all unemployed in comparison to 48.1 percent in 1996.

[4] This has also been observed by Trbanc , 2005, p.181.

Table 7: Typical groups of unemployed registered at Employment Service of Slovenia, 1996 -2006

Year	Registered unemployed persons	Particular groups as percentage of all unemployed					
		Age: -26	Looking for first employment	Women	Unemployment duration: over a year	Education - only primary school	Age: 50+
1996	119,799	31.4	19.4	48.1	56.1	47.0	14,1
1997	125,189	29.1	18.3	48.8	57.4	47.1	16.4
1998	126,080	26.3	18.1	49.9	61.7	46.9	20.7
1999	118,951	25.8	18.7	50.6	63.7	47.5	23.8
2000	106,601	23.4	17.9	50.7	62.9	47.2	27.3
2001	101,857	24.1	18.8	50.8	58.9	47.0	27.0
2002	102,635	24.0	19.6	51.2	54.4	47.0	25.4
2003	97,674	26.1	23.2	52.8	48.6	44.2	21.4
2004	92,826	26.2	25.2	53.1	46.2	41.6	21.0
2005	91,889	24.2	24.3	53.8	47.3	40.8	22.7
2006	85,836	21.2	22.3	54.8	48.8	39.3	25.4

Source: Employment Service of Slovenia, Annual report 2006.

Table 7 confirms the already indicated structural unemployment problem. In 2006, the share of unemployed persons aged over 50 exceeded 25 percent of all unemployed, while the share of long-term unemployed persons was almost 49 percent. The share of unemployed persons without any qualifications has been around 47% for quite some time but it dropped to 39% in last years. All three phenomena are mutually related, as unemployment duration affects mostly unemployed people aged over 40 and unemployed people without qualifications. Among all three problematical categories "elderly" (over 50) unemployed persons represent the only category which increased its share since 1996. Actually, we can say that this is the category with very low and limited employment opportunities and many of these persons are actually waiting to fulfill the minimal retirement conditions. Young persons who look for a job for very first time face difficulties too; their share among unemployed increased in observed period and amounted to 22.3 percent in 2006. Highly educated people represent the only group facing increasing unemployment rate (considering attained education criteria) which is evident from table 5. They have also rapidly increased their share in unemployment to 9.0 percent in the first half of 2006 in comparison to 7.8 percent in June 2005 and 8.0 percent in December 2005 (IMAD, Autumn report 2006). A plausible explanation for this is prolonging education of young caused by poor employment prospects. After finishing studies an increasingly difficult transition from education to work still remains a worrying issue. Disproportionate share of students at non-technical studies, resulting in an increasing mismatch between laobur supply and demand, should also be mentioned.

Table 8 shows that number of vacancies form 2001 to 2006 increased by 65 percent. However, the number of occupied vacancies did not follow this trend fast enough. Therefore in 2006 31.5 percent of vacancies remained unoccupied compared to 23.2 percent of unoccupied vacancies in 2001. These findings indicate discrepancy between labour supply and demand. Employers have no difficulties finding labour force for vacancies where general or technical secondary education is needed, as all registered vacancies are occupied (ratio even exceeds 100 percent). On the contrary, the shares of occupied vacancies for unskilled workers and for workers with secondary vocational education are decreasing. For the latter there is evident discrepancy between labour demand and supply as a result of increasing number of tertiary students. Unoccupied vacancies for unskilled workers, despite high share of unskilled workers among unemployed, might be explained by relatively high social benefits and activity in shadow economy.

Table 8: Registered and occupied job vacancies, by education, 2001 – 2006[5]

		Total vacancies	No education	Secondary vocational education	Secondary education (technical, general)	Post-secondary education	Higher education
2001	**Registered**	135,896	43,660	47,323	23,604	6,063	15,246
	Occupied	104,544	33,720	33,350	24,520	4,060	8,894
	Ratio	76.9	77.2	70.5	103.9	67.0	58.3
2002	**Registered**	132,055	39,793	47,069	23,811	5,613	15,769
	Occupied	105,478	32,163	33,894	25,779	3,725	9,917
	Ratio	79.9	80.8	72.0	108.3	66.4	62.9
2003	**Registered**	140,326	43,333	49,541	24,140	5,549	17,763
	Occupied	112,848	34,886	34,884	27,183	3,808	12,087
	Ratio	80.4	80.5	70.4	112.6	68.6	68.0
2004	**Registered**	164,782	49,399	58,871	28,675	5,928	21,909
	Occupied	118,207	35,379	35,571	36,102	3,869	13,886
	Ratio	71.7	71.6	60.4	125.9	65.3	63.4
2005	**Registered**	198,280	60,028	71,690	35,115	6,448	24,999
	Occupied	133,631	39,130	39,013	34,924	4,142	16,422
	Ratio	67.4	65.2	54.4	99.5	64.2	65.7
2006	**Registered**	223,513	69,040	83,460	38,657	6,638	25,718
	Occupied	153,057	46,721	44,986	39,537	4,311	17,502
	Ratio	68.5	67.7	53.9	102.3	64.9	68.1

Source: Employment Service of Slovenia, Annual reports 2002-2006.

However, the explanation of trends in registered unemployment demands some precaution, as the flows shaping registered unemployment show that deletions from unemployment registers remained the main reason behind the drop in registered unemployment. As evident form table 9, in 1998 70.2 percent of persons were struck off unemployment registers as they entered into employment, compared to 58.2 percent in 2005 and 55.3 percent in 2006. Deletion from unemployment register notably increased after enforcement of the amended Employment and Insurance Against Unemployment Act in 1998. In 2005 more than 40 percent of "deleted" unemployed were struck off from the register for reasons other than employment; not being available for a work (main reason), refusing a job, not seeking work, refusing to participate or neglecting duties in active labour market schemes. Transition to various types of inactivity (education, retirement, maternity leave, etc) was the reason for striking off around one third of the "deleted" unemployed for reason other than work.

The influx of people having lost their jobs was on rising trend, mainly owing to the growing inflow of people who lost a fixed-term job. Their share in the inflow increased from 27.1 in 1996 to 36.5 percent in 2006. This group was followed by first-time job seekers who represented around quarter of the total inflow into registered unemployment.

[5] Without apprentices.

Table 9: Registered unemployment flows

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
1. Number at the beginning of the year, thousands	**126.8**	**124.5**	**128.6**	**126.6**	**114.3**	**104.6**	**104.3**	**99.6**	**96.0**	**90.7**
2. Total inflows during the year, thousands	**86.5**	**78.5**	**77.0**	**80.8**	**82.3**	**87.7**	**87.4**	**94.2**	**95.6**	**94.4**
• first-time job-seekers	21.1	17.9	18.6	19.6	20.5	21.9	21.4	25.4	26.0	21.7
• termination of fixed-term job	23.4	23.7	29.5	30.8	28.2	32.1	32.9	32.2	33.1	34.5
• voluntary resignation	8.9	9.8	9.9	8.4	9.8	10.0	8.8	8.3	8.3	7.0
• bankruptcy	11.6	8.0	6.7	6.6	6.9	5.8	7.5	7.0	4.7	4.6
• permanent redundancies and-business reasons	12.5	14.4	10.6	6.9	5.2	5.4	6.1	10.0	11.0	10.6
• other reasons-	9.0	4.7	1.7	8.4	11.9	12.5	10.7	11.3	12.6	16.0
3. Total registered unemployed people during the year (3=1+2), thousands	**213.2**	**202.9**	**205.6**	**207.4**	**196.7**	**192.3**	**191.7**	**193.9**	**191.6**	**185.1**
4. Total outflows during the year (4=5+6), thousands	**88.7**	**74.4**	**79.0**	**93.1**	**92.1**	**87.9**	**92.1**	**97.9**	**100.8**	**92.6**
5. found work	54.6	56.1	55.4	62.4	60.2	52.7	52.2	50.5	54.3	53.9
as a % of (3)	25.6	27.6	27.0	30.1	30.6	27.4	27.2	26.1	28.3	29.1
• Community employment programme-	4.7	5.4	10.6	10.3	10.5	9.4	7.6	6.7	6.1	5.7
• self-employment promotion-programme	2.3	1.6	1.6	1.6	1.7	1.7	1.0	1.2	1.7	1.7
• other subsidised employment-schemes	7.6	10.7	15.8	10.9	11.7	10.3	4.0	4.5	8.3	5.8
• unsubsidised jobs-	40.0	38.4	27.4	39.5	36.4	31.2	39.6	38.1	38.1	40.7
6. struck off for other reasons	34.1	18.3	23.5	30.7	31.9	35.3	39.9	47.3	46.6	38.7
as a % of (3)	16.0	9.0	11.4	14.8	16.2	18.3	20.8	24.4	24.3	20.9

Source: IMAD, Spring report 2006; Employment Service of Slovenia, Annual Report (2003-2006).

Labour code / employment law

Employment relationship act (*ERA*) was enforced in 2003 after the negotiations between the social partners. The main issues of negotiations were:

- to complete regulation or employment relationship as a contractual relationship between the employee and the employer,
- regulation of minimum guaranteed rights and duties of such a relationship and
- set legal basis for flexibility.

Hiring procedure

Employment relationship is entered into by employment contract. The employment contract can be concluded for an indefinite period of time unless stipulated otherwise. A fixed-term employment contract can be concluded in cases determined by ERA (temporarily increased volume of work, managerial staff, seasonal work, employment for a definite period of time due to working during the accommodation period preparation or realization of work organised as a project, etc.). The branch collective agreement may stipulate that a smaller employer can conclude fixed-term employment contracts for a definite period regardless of the listed restrictions.

The employer may not conclude one or more successive fixed-term employment contracts with the same worker and for the same job, the uninterrupted period of which would last longer than two years, except in some cases (replacing temporary absent worker, managerial staff, employment of foreigner and project work). Act also states that an interruption of three months

or less does not represent an interruption of the uninterrupted two-year period. However, the branch collective agreement may stipulate otherwise.

In spite of contract for an indefinite period, employers and employees can insure themselves with a probation period in the employment contract, which may not last longer than 6 months. During the probation, the worker may give notice with a notice period of seven days. On the basis of assessment of an unsuccessfully performed probation, the employer may extraordinarily terminate the employment contract upon the expiry of the probation period.

Firing procedure

ERA divides the termination of the employment contract to ordinary (with a period of notice) and extraordinary termination (without a period of notice) that both may be initiated by the contractual parties. The worker may ordinarily terminate the employment contract without explanation.

The act determines the procedure prior the termination by the employer. Prior to the ordinary termination of the employment contract for a fault reason, the employer must in writing call the worker's attention to the fulfilment of obligations and to the possibility of termination in the case of repeating the violation. Prior to the ordinary termination for the reason of incapacity or for a fault reason and prior to the extraordinary termination of the employment contract, the employer must provide the worker an opportunity to defend himself. The employer must inform the worker about the intended ordinary termination for the business reason in writing.

If thus requested by the worker, the employer must inform in writing the trade union, whose member the worker is at the time of the introduction of the procedure, about the intended ordinary or extraordinary termination of the employment contract. If the trade union does not give any opinion within eight days, it is considered that it does not oppose the termination; however, the trade union may oppose the termination if it deems that the reason for the termination is not fulfilled and if the union considers that the rules of proceedings were violated. In the event the union disagrees with the termination clauses submitted by the employer, the union must file all objections in written form and the topic(s) in question will have to be discussed by both parties. If the union acknowledges the employer’s given reasons to terminate the employee, a postponement of termination may be requested by the worker. Termination does not take effect until judicial ruling or arbitration has taken due course. If the employee is not a member of the trade union, he or she cannot ask for a postponing of the effect of termination of the employment contract, but he or she may inform the labour inspectorate. The labour inspector may postpone the effect of termination of the employment contract, if the employer was considered to have acted arbitrarily, and as well as to prevent irreparable damage.

In the time of postponing of termination, a worker remains in the employment relation until a ruling by a court of justice or an arbitration has been reached. During this time, the employer may prevent the employee to carry out work, but must pay a subsidy in lieu of the salary (50% of the employee’s average salary in the last three months prior to termination).

ERA determines three groups of reasons for the *ordinary termination* of the employment contract at the initiative of the employer:

- when there is a founded business reason;
  ERA especially determines unfounded reasons for ordinary termination: absence from work due to illness or injury, parental leave or care for children or family members, membership or participation in trade unions, strikes, reasons relating to discrimination, etc..

- when there is a reason of incapacity;
  the reason of incapacity means that the worker does not achieve the expected work results (a subjective reason) or that the worker does not meet the requirements to carry out work (an objective reason).
- when there is a "fault" reason;
  when the worker violates contractual or other obligations. These are the cases of worker's guilty conduct resulting in the "fault" reason for termination.

In the case of terminating the employment contract for the reason of incapacity or for the business reason, the employer must check whether it is possible to employ the worker under changed conditions or to transfer him to another post, and/or whether it is possible to additionally train the worker for the work he carries out or to retrain the worker. If such possibility exists, the employer must offer the worker to conclude a new contract. If the worker refuses the employer's offer to conclude a new employment contract for appropriate work and for an indefinite period of time and his employment relationship terminates, he shall have no right to the severance pay. Employers are exempt from this provision if the employment contract lasted less than six months or if employer classifies among smaller employers.

An employee is also entitled to unemployment allowance during the time of unemployment for a maximum of two years, depending on the working time of the employee. The amount of the unemployment allowance for the first three months of unemployment is 70% of the employee's average monthly salary received within twelve months before the date of termination of employment; and 60% of the same base for the months thereafter. The employee is not entitled to severance or unemployment pay in the case of dismissal for "fault".

Reasons for *extraordinary termination* may emerge from both the worker and the employer. In certain cases, where one of the parties severely violates the rights of the other to an extent that their relationship is damaged and thus the employment relationship cannot continue, either one of the parties may terminate the contract without prior notice. In order for the extraordinary termination to be in accordance with the law, reasons, which are exhaustively listed in ERA, must exist.

Proceedings of extraordinary termination at the initiative of the employer are the same as regular termination for breach/violation of contract reasons (written accusation, information to the trade union, and if the employee so demands, a possibility of postponing the termination of the employment contract). The employee does not have the right to severance/unemployment allowance or financial subsidy during his or her unemployment; but, he or she has the right to immediate judicial protection or protection by arbitration.

ERA also protects older workers.The employer may not terminate the employment contract for a business reason to the older worker, without written consent of this worker, until this worker completes the minimum conditions upon which the right to old-age pension is conditioned, unless he is assured the right to the unemployment benefit until the fulfilment of minimum conditions for old-age pension.

Collective redundancy

The employer is obliged to elaborate the dismissal programme for redundant workers if he establishes that due to business reasons within the period of 30 days the work shall become redundant for:

- at least 10 workers with the employer employing more than 20 and less than 100 workers,

- at least 10 % of workers with the employer employing at least 100 workers, and less than 300 workers,
- at least 30 workers with the employer employing 300 or more workers.

The employer must as soon as possible inform the trade unions on the reasons for the redundancies, the number and the categories of all employed workers, the foreseen categories of redundant workers, the foreseen term in which the need for the work of workers will cease, and the proposed criteria for the determination of redundant workers. The employer also has to inform the employment agency to search for new jobs for the terminated employees.

In the case of bankruptcy liquidation proceedings executed by court, the receiver in bankruptcy or in liquidation may with a 15-day period of notice terminate the employment contracts to employed workers whose work became redundant due to the introduction of bankruptcy proceedings or liquidation with the employer.

Severance pay

The employer who terminates the employment contract due to business reasons or due to the reason of incapacity is obliged to pay the worker severance pay. The basis for the calculation of severance pay is the average monthly wage which was received by the worker in the last three months before the termination. The amount of severance payment depends on the period of employment with the employer and ranges from 1/5 to 1/3 of average monthly wage for each year of employment with the employer. However, the level of the severance pay may not exceed the tenfold amount of average monthly wage, unless otherwise stipulated by the branch collective agreement.

In case of retirement, upon termination of the employment contract, the worker is entitled to severance pay in the amount of two average monthly wages in the Republic of Slovenia for the past three months or in the amount of two average monthly wages of the worker for the past three months, whatever is more favourable to the worker.

Temporary work agencies

ERA has introduced temporary work agencies. The employer who engages in the activity of providing workers to another employer (temporary work agency) shall conclude an employment contract with such workers. Temporary work agency may not refer workers to the following workplaces:

- in cases when this would represent replacement of workers employed with the user who are on strike,
- in cases when the user has during the period of the past 12 months terminated employment contracts to a large number of workers employed with him,
- in cases of workplaces for which the user's risk assessment shows that workers working there are exposed to dangers and risks due to which measures are provided for reducing and/or limiting the time of exposure, and
- in other cases which can be laid down by branch collective agreement.

A rule also exist fixing the maximum duration of employment through TWA; the employer may not provide workers to the user continuously or with interruptions of up to one month for more than one year in case of performing the same work by the same worker.

Wage setting and the role of trade unions

Wage policy framework is one of the main issues of the Social agreement which was signed in October 2007 (for the period 2007-2009) after the year and a half of negotiations between social partners: unions, employers and government. The previous wage policy framework was set out in the Social Agreement 2003-2005. Wage policy guideline in the previous social agreement, whereby the growth of real wages had to lag behind the growth of labour productivity by at least one percentage point, was abandoned in the current Social Agreement 2007-2009. Social partners has agreed that from 2007 on, wages in Slovenia should gradually approach wages in well-developed countries and that wage growth should take into account inflation and labour productivity growth. Social partners also agreed that wage growth in public sector should not exceed wage growth in private sector.

Thus, social dialogue – between employees (represented by trade unions), employers and government is very important is Slovenia. Coverage of workers/sectors by collective bargaining agreements in Slovenia is 100 percent due to existence of collective agreements for private and public sector. In June 2006 the social partners for the private sector reached an agreement on the wage adjustment mechanism for 2006 and 2007. In the same month the negotiations on public sector wage policy for 2006-2009 were closed.

The social partners for the private sector have defined minimum standards of the wage policy in 2006-2007 in Collective Agreement on the Wage Adjustment Mechanism, Reimbursement of the Work-Related Costs and Holliday Allowances. This agreement on wage adjustment mechanism was for the first time negotiated at the bipartite rather tripartite level, without the governmental involvement. This agreement succeeded previous one for years 2004-2005, specified the basis for starting-level wages and minimum base wages subject to adjustment mechanism. It was agreed that wages would be raised by 2 percent in both years (minimum wage increase) in payments for August, with a safeguard clause in case that actual inflation should exceed 2.3 percent. The agreement also set the minimum amounts of holiday allowances, minimum standards for overtime work and other remunerations. The minimum standards of the wage policy set in this collective agreement apply primarily to workers not covered by any sectoral collective agreement. The negotiated standards in sectoral and company collective agreements concluded thereafter are higher and adjustment percentages are above 2 percent. However, collective agreement for private sector regulates around nine thousands companies which are not covered by any sectoral collective agreements

The adjustment mechanism for public sector wages in 2006 negotiated by social partners was laid down in Act Amending the Salary System in the Public Sector Act. Lower growth of starting-level wages in comparison to private sector - 1.3 percent - was realized for 2006 and 1.05 percent of wage adjustment was set aside to eliminate wage disparities within the public sector. Wage adjustment mechanism for period 2007-2009 was set out in Agreement on the Base Wage Adjustment Mechanism and the Level of Expenditure for the Elimination of Wage Disparities in 2007-2009. The annual wage adjustment in July takes into account the estimated inflation of current year. The agreement also specifies proportion of adjustment percentage that will be used for wage adjustment in general and the proportion intended for elimination of wage disparities within public sector.

Therefore unions in Slovenia have a very important role in social dialogue. At the beginning of transition (early 90's) two main blocks of unions sprung up: a right oriented Independence, the Confederation of Independent Trade Unions of Slovenia ("*Neodvisnost – Konfederacija neodvisnih sindikatov Slovenije*") and left oriented Free Trade Unions of Slovenia ("*Zveza*

svobodnih sindikatov Slovenije"). At that period around 60 percent of active persons were members of one of the unions. In the second half of the decade union membership declined to 42.8 percent (in 1998). Last survey which was carried out in 2005 showed that 37.1 percent of respondents (active population: employed and unemployed) were members of one of unions (Stanojević et.al., 2006).

Taxes on labour

The total direct and indirect tax burden on labour (social contributions, payroll and personal income taxes) is relatively high. A common indicator of labour costs is tax wedge - a measure of the difference between labour costs to the employer and the corresponding net take-home pay of the employee – which is calculated by expressing the sum of personal income tax, employee plus employer social security contributions together with any payroll tax, minus benefits as a percentage of labour costs. Calculations show that total tax wedge (between total labour costs to the employer and the corresponding net take-home pay) for single workers without children, at 67 percent of average earnings decreased from 42.2 percent in 2001 to 41.2 percent in 2006. In the following years the tax wedge is expected to decline further due to abolishing payroll tax. Nevertheless, the total tax wedge brings Slovenia among the countries with the highest labour costs.

Total social security contributions amount to 38.2 percent; employer's rate amounts 16.1 percent and employee's 22.1%. There is no upper ceiling. The base for contributions is the amount of the gross wage, which includes gross leave pay, fringe benefits and remuneration of expenses related to work above a certain threshold.

Personal income tax has undergone a reform and new rules are valid form 2007. The number of income tax brackets were reduced from five (16%, 33%, 37%, 41% and 50%) to three (16%, 27% and 41%). The general tax relief was increased, while special allowance for selected expenses was abolished. Average personal income tax rate (calculated as the ratio between personal income tax and tax base) in 2005 amounted to 21.7 percent. Microsimulation study (Bayar, Mohora, et.al., 2006) shows that average effective tax rate would drop from 22.1 percent to 20.2 percent[6] due to new PIT rules.

A new law on payroll tax from December 2005 gradually abolishes the tax till 2009. Payroll tax is levied on employers who disburse wages but it is not applied to the self-employed. Tax schedule is presented in table 10:

Table 10: Payroll tax schedule, 2006-2008

Tax bracket	Tax base		Tax rate for year		
	From	To	2006	2007	2008
1.	0 SIT	165,000 SIT (688 EUR)	0.0	0.0	0.0
2.	165,001 SIT (688 EUR)	400,000 SIT (1,669 EUR)	3.0	2.3	1.1
3.	400,001 SIT (1,669 EUR)	750,000 SIT (3,130 EUR)	6.3	4.7	2.3
4.	750,001 SIT (3,130 EUR)		11.8	8.9	4.4

Source: Zakon o davku na izplačane plače, 2006.

[6] For year 2006 and slightly different predicted PIT rules (tax rates 16%, 28% and 39%).

Payroll tax is very progressive as the appropriate tax rate is applied to the whole gross wage and not just amount above tax bracket limit. Consequently, marginal tax rate exceeds 100 percent.

Industrial actions

Systematic collection of statistical data related to labour disputes in Slovenia is being prepared. Last data on labor disputes were published in 2004 by IMAD and were based on data of Association of Free Trade Unions of Slovenia. The deficiency of the existing data is, first, that they are collected without any concept or definition. Second, data given in the tables and graph do not show how many strikes were organised in a particular sector or sectors. Instead, they only show how many strikes were organised by a particular sectoral trade union, a member of the AFTUS. Hence, data do not include strikes in the public service sectors (education, health, railways etc) and not all strikes organised in the private service sectors (banking, transport etc) as AFTUS has few members in these sectors and other trade unions prevail. The given data are a reliable indicator of strike trends for production industries only although the strikes organised by other small trade unions are excluded. Third, these data do not include general strikes and strikes organised at the level of sectors (teachers, medical doctors).

The main wave of strikes hit Slovenia in 1991-1997, when over 100 strikes were organised each year, except in 1997. The number of strikes dropped in 1998 and continued to decline up until 2002. According to the table, the largest number of strikes was organised in enterprises of the metal and electro-industry, followed by textiles and leather-processing industries, construction and the wood-processing industry. The main cause of strikes was unpaid wages.

Table11: Number of strikes in Slovenia in 1998-2002 according to AFTUS sectoral member unions

Sectoral member union – industry	1998	1999	2000	2001	2002	Total
Financial organisations	1	0	0	0	0	1
Catering and tourism	1	1	0	1	0	3
Construction	6	2	3	2	3	16
Chemical, rubber and non-metal	2	1	0	0	0	3
Agriculture and food production	1	2	0	0	1	4
Metal and electro-industry	6	8	6	7	8	35
Wood-processing	4	4	3	2	1	14
Crafts	1	1	3	0	1	6
Transport and communications	2	0	0	0	0	2
Textiles and leather-processing	10	3	3	3	4	23
Retail	0	0	0	1	1	2
Fire fighting	0	1	1	0	0	2
TOTAL	34	23	19	16	19	111

Notes: figures cover the period from 1 January to 7 November 2002;
the number excludes general, sectoral and occupational strikes organised by other trade unions;
a strike is any deliberate stoppage of work.

Source: IMAD, Slovenian Economic Mirror, No. 3/2004.

Unfortunately, there is no data on strikes after 2002. Since then there were some warning strikes organized at the sectoral or professional level (policemen, catering workers, journalists). There were also large demonstrations on nationwide level. On 26 November 2005, trade unions jointly organised the largest demonstrations since Slovenia independence, in opposition to the

government's reform programme. Around 40,000 people took part in the demonstrations, which were held under the slogan 'For the preservation of the social state in Slovenia'.

Large demonstrations are announced again for 17th November of this year. Main reason for demonstration is demand for higher wage rise. More precisely, unions demand that wage increase should cover the growth of living expenses and that workers should also participate in relatively high labour productivity growth, especially in companies with above average profitability.

Labour market policies

Slovenia's expenditure on active labour market policy (ALMP) has been relatively low in the last few years compared to other countries. Many years expenses for ALMP amounted around 0.4 percent of GDB; in 2004 and 2005 they dropped to 0.34% of GDP (Kajzer, 2006).

The main ALMP programmes are the following:

1. *Labour market services*
   The unemployed person must have an employment plan and appropriate referral to the programme. This program is intended to motivate participants for a more active approach to getting a job and thus increasing own responsibility for own professional future. Participants also obtain information on the possibility of education and employment on the labour market and increase their employability through this programme. Other labour market services are: job seeking workshops, workshops for discovering vocational goals, job seekers clubs, work trial, information centres for job seekers, centres for vocational information and counseling, medical employment counseling for disabled, general services and counseling and project learning for younger adults.

2. *Training*
   - Development and training programmes with aim to raise the abilities so that inappropriate knowledge and training will no longer represent a barrier to employment and vocational development of the individual;
   - Programmes for obtaining professional education; the basic condition for inclusion in training is the employment plan. In including unemployed persons the following criteria are taken into account: the situation on the labour market in a particular area and occupation; personal, vocational, working and other abilities of the unemployed person; the possibility to successfully finish the programme; wishes of unemployed persons regarding the type of program in which they would like to participate if their wishes are founded and if it is reasonable to take them into account regarding the possibility of employment in a certain environment and period; costs of inclusion in the program;
   - Work funds which prevent the transition of surplus workers into open unemployment, increase the employment prospects of surplus workers or workers whose contracts have been terminated for commercial reasons;
   - Training for a successful life: a bridge to education where participants acquire basic knowledge and skills, social skills, training for life-long learning and active citizenship;
   - National professional qualifications where unemployed persons having appropriate work experience, functional knowledge and skills in a certain area

of individual national professional qualifications can participate. Program helps them to acquire a document showing their professional qualification and the level of complexity of work that they can perform;
- On the job and integrated training programmes;
- Co-financing education and training of employees in branches undergoing restructuring;
- On-the-job training and integrated training programmes for disabled people;
- On-the-job training programme in learning workshops and learning enterprises.

3. *Employment incentives*
   - Pay supplement for disabled and disadvantaged persons which create equal employment opportunities and promote employment of disabled persons and disadvantaged groups of unemployed persons;
   - Cofinancing part-time employment;
   - Promotion of new employment for older people;
   - Reimbursement of employer contributions.

4. *Supported employment and rehabilitation*
   - Employment rehabilitation for disabled unemployed persons and disadvantaged unemployed persons with impediments and special needs deriving from sickness, infirmity or functional limitation or hindrance;
   - Labour inclusion for most severely disabled persons.

5. *Direct job creation*
   - Subsiding employment in providing home help and personal assistance and care for the disabled: The "Disabled for disabled" programme;
   - Public works;
   - Assistance in employing long-term unemployed women;
   - Projects of non-profit employment programmes.

6. *Start-up incentives*
   - Promoting self-employment / entrepreneurship implemented by the Employment Service of Slovenia;
   - Promoting self-employment implemented by the Small BusinessDevelopment Centre: assistance in self-employment.

The structure of APMP expenditure shifted in favour of training programmes on account of employment incentives in the private sector in last ten years. In 2005 for training programmes represented 18.5 percent of all ALMP expenditure. This relatively high share is due to structural unemployment problems. Public work and local employment programes represent high share among total ALMP expenditure in comparison to other countries – 26 percent. Work incentives were especially important for Slovenian ALMP in mid 90's, afterward their share in total ALMP expenditure started dropping and reached 13.3 percent (Kajzer, 2006).

Slovenian expenditure on passive labour market policies represents much higher share of GDP in comparison to ALMP as seen from table 12.

Table 12: Share of expenditures on passive measures in GDP, 2005

Passive measures	as % of GDP
Unemployment benefits	0.40
Social assistance	0.51
Family benefits	0.03
Total	0.95

Source: Author own calculations based Annual report of National Employment Service of Slovenia, Internal data of Ministry of Labour, Family and Social Affairs and Statistical Yearbook.

The highest expenditure on passive measures in 2005 was for social assistance. It was followed by unemployment benefits, i.e. unemployment wage compensation and unemployment assistance. There are also few family benefits that are actually wage compensations and can be considered as passive measures. Namely, these are: compensation for lost income due to care of child who need special care, paid social contributions up to full working time for parents of children under three working part-time (new legislation raises age limit of children to six) and parental allowance (for parents who are not entitled to parental wage compensation)[7].

Unemployment wage compensation is a benefit for the unemployed who were employed for at least 12 months in the last 18 months prior to the termination of employment and are covered by unemployment insurance. The basis for determining the level of unemployment compensation is a twelve months' average gross wage of the unemployed person prior to unemployment. The benefit level amounts to 70% of the basis in the first three months and 60% thereafter. The minimum benefit level is equal to the guaranteed wage[8] net of contributions and taxes while the maximum level is three times the lowest possible unemployment compensation. The beneficiaries are paid health-, pension- and disability insurance.

Length of provision depends on insurance period:

Insurance record	Duration of the entitlement
1-5 years	3 months
5-15 years	6 months
15-25 years	9 months
Over 25 years	12 months
Over 25 years and over age of 50	18 months
Over 25 years and over age of 55	24 months

Those unemployed who are older than 55 and are lacking up to three years to retirement have their pension and disability insurance contributions paid by the employment service until they retire. Unemployment compensation is subject to personal income tax.

[7] Above measures do not include wage compensations from invalidity/disability as statistics do not make possible to separate invalidity benefits for active population.

[8] The guaranteed wage used to be the lowest possible pay for a full-time job in Slovenia. It had lost its connection to the labour market, but has remained a basis for determining the level of some social benefits, without its name being adapted to its only retaining function. Until the mid 1997 the government had a discretionary right to adjust the guaranteed wage level, and during that period the real value of the guaranteed wage decreased considerably. It amounted to 43% of the average gross wage in 1991 and to only 24% in 1997. Since the mid 1997 the guaranteed wage has been adjusted once a year according to the consumer price index (as a rule, by 85% of the rise in consumer prices). Currently, the guaranteed wage is at the level of 245.34 EUR – app. 20% of the average gross wage.

Unemployment assistance, a means-tested contributory benefit payable for 15 months once the unemployment wage compensation has been exhausted, was abolished in 2006. Eligible persons can apply directly for social assistance.

Table 13: Net replacement rate for unemployment traps, for different family types, 2005 and 2006

	No children											
	Single person				Couple, one earner				Couple, two earners			
New wage as % of AW wage	**50%**	**67%**	**100%**	**150%**	**50%**	**67%**	**100%**	**150%**	**50%**	**67%**	**100%**	**150%**
2005	98.3	75.3	53.9	38.9	95.6	79.3	62.8	45.8	97.5	85.9	71.7	58.5
2006	98.3	75.6	54.3	39.1	95.7	80.5	64.2	46.9	97.5	85.9	71.8	58.6
	Two children											
	Single person				Couple, one earner				Couple, two earners			
New wage as % of AW wage	**50%**	**67%**	**100%**	**150%**	**50%**	**67%**	**100%**	**150%**	**50%**	**67%**	**100%**	**150%**
2005	100.5	83.9	78.4	61.0	100.0	89.8	75.3	61.7	98.0	90.0	75.9	63.1
2006	100.4	84.2	79.3	61.7	100.0	88.3	74.9	61.6	97.9	89.9	75.7	63.1

Note: wage before unemployment is 67 percent of average worker wage (AW wage);
in two-earner couple: the level of the first earner is fixed at 67 percent of AW, while the wage level of the second
earner after unemployment is indicated in each column.

Source: Kump, Stropnik (2007).

Net replacement rates at low wage levels (67 percent of the AW wage) for childless households in 2006 range from 75.6 percent for single person to 85.9 percent for two earner couple. Net replacement rates for households with children are higher due to family benefits and range from 84.2 to 89.9 respective. The picture given by the net replacement rats reveals the generosity of benefit system. Notwithstanding we have to bear in our minds that the level of unemployment benefits is reduced after three months and that its duration is limited.

Labour mobility

Labour mobility consists of changes in the location of workers both across physical space (geographic mobility) and across a set of jobs (occupational mobility).

Traditionally low labour mobility is characteristic for the Slovenian population (also due to the issues related to housing), leading to regional labour imbalances. The situation has been changing with better and quicker transport facilities, which can be confirmed by the increasing number of daily commuters between administrative units (from 288 thousands or 24.6 percent of all employed in 2000 to 333 thousands or 42.5 percent). Employers may be less in favour of commuters because collective agreements oblige them to reimburse their employees' travel costs to and from work. There is a concentration of problems in certain regions (Pomurska, Zasavje, SE Slovenia) where the unemployment rate has been high and even increasing (in the Pomurska region the unemployment rate is exceeding 15.7%). As seen from table 14, despite facts, the difference in unemployment rates is shrinking; the ratio between the highest and lowest unemployment rates by region declined by 0.6 p.p. in period 2000-2006. If we look at the coefficient of variation, which is also an indicator of regional differences, we see that it dropped to 30 percent[9] in 2006, which is the lowest value since 2000.

[9] IMAD, Development Report 2007, Indicators of Slovenia's development

Table 14: Regional registered unemployment rates

Statistical region	2000	2001	2002	2003	2004	2005	2006
Slovenia	11.8	11.2	11.3	11.2	10.6	10.2	9.4
Pomurska	8.8	8.0	7.7	17.5	16.8	17.1	15.7
Podravska	8.8	8.7	8.3	16.2	14.6	13.5	12.7
Koroška	9.7	8.7	8.2	12.6	11.7	10.6	10.1
Savinjska	5.9	5.6	6.1	13.5	12.9	12.7	11.6
Zasavska	13.1	13.1	13.6	16.1	14.9	13.8	12.0
Spodnjeposavska	10.4	9.6	9.7	14.9	13.0	11.5	10.5
Jugovzhodna Slovenija	16.7	16.3	17.7	8.6	8.5	8.8	8.6
Osrednjeslovenska	10.4	9.4	8.8	7.8	7.8	7.6	7.2
Gorenjska	18.1	17.4	17.1	8.3	7.8	7.3	6.4
Notranjsko-kraška	9.9	9.9	11.3	8.8	8.3	7.9	7.0
Goriška	13.4	13.9	14.1	6.4	6.9	6.5	6.2
Obalno-kraška	14.9	14.3	14.8	8.3	8.1	7.5	7.2

Source: IMAD, 2007.

The Slovenian labour market is characterized by structural imbalances between labour supply and demand. Employer demands and, consequently, qualifications required of the employed are changing rapidly, which requires changes in the contents of training programmes and types of provision. There is a shortage of labour force with vocational education in many sectors; construction, wood sector, metal industry, transport are the most noticeabl ones. On the other hand, structural imbalance is evident also at the same educational levels: social sciences are much more favoured by students than technical ones.

Those who lost jobs in manufacturing branches are, in most cases, not directly employable in services or in the SME sector, which are the sectors with increasing labour demand. Labour market dynamics in terms of greater occupational mobility are partly hindered also by the present methods and practice of regulation of occupations. Detailed provisions for performing over 360 rather narrowly defined occupations/specialisations (in terms of type and level of education, special qualifications and examinations, preliminary work experience, etc.) have a negative impact on labour mobility. Data in Table 8 confirm that occupational mobility has not improved. On the contrary, the shortage of unskilled workers and workers with secondary vocational education has been even more pronounced, despite high share of low educated persons among unemployed.

Slovenian officially published data on mobility between different labour market states are rather limited. However, some conclusions can be inferred from table 15. As data show, there is an increasing flow into and from unemployment. Namely, the number of newly registered persons has increased in period from 1996 to 2006, despite a decreasing unemployment rate. In addition, unemployed under 6 months increased their share in total unemployment, meaning that more persons find new job in six months after unemployment. The share of persons unemployed between three and five years decreased considerably; form 14.5 to 9.7 percent of all unemployed, which also indicates shorter unemployment spells on average.

Table 15: Newly registered unemployed, persons employed by the Employment Service of Slovenia and duration of unemployment for registered unemployed persons in months, as % of all unemployed,1996-2006

	Newly registered unemployed	Persons employed with help of ESS	-6	6-9	9-12	12-36	36-60	60+
1996	86,448	51,108	29.6	8.6	7.7	29.8	14.5	9.7
1997	78,468	56,076	25.6	7.2	7.6	34.5	13.1	12.0
1998	77,016	55,452	24.5	6.5	6.5	35.3	12.4	14.7
1999	80,778	62,350	26.0	6.0	5.1	31.7	15.2	16.1
2000	82,329	60,191	28.0	5.5	5.2	27.3	16.4	17.7
2001	87,673	52,664	33.4	6.2	5.8	23.3	13.5	17.9
2002	87,380	52,178	33.3	7.0	7.5	26.6	10.2	15.4
2003	94,249	50,520	37.6	8.4	8.0	28.8	7.3	9.8
2004	95,565	54,257	39.8	8.2	7.5	28.5	7.7	8.3
2005	94,404	53,857	36.6	8.8	8.3	27.8	8.8	9.7
2006	90,217	57,423	33.7	8.1	7.5	30.1	9.7	10.8

Note: Data refer to 31th December of each year.

Source: Employment Service of Slovenia, Annual reports 2003 – 2006.

Informal sector employment

In simplified terms, informal sector employment is estimated as the difference between the number of employed people according to survey and the number of formally employed people, i.e. people in paid employment and licensed self-employment workers[10]. The difference between the statistics based on the labour force survey and between administrative sources shows that informal employment in 2006 still ranges around 12% of all employed persons, although there were some drops between 2000 and 2003 which can be explained by lower economic growth[11].

Table 16: Informal employment

Year	Number of persons in informal employment	Informal employed persons as % of all employment	Unpaid family workers, as % of all employment
1996	115	13.4	3.8
1997	126	14.5	5.4
1998	133	15.1	5.4
1999	104	12.1	4.5
2000	72	8.2	3.9
2001	84	9.4	3.9
2002	91	10.1	3.4
2003	76	8.7	3.1
2004	117	12.7	4.3
2005	112	12.1	3.9
2006	112	12.0	3.9

Source: authors own calculations based on: Eurostat, Labour Force Survey; SORS, Rapid Reports (1997 - 2007); Employment Service of Slovenia, Annual Report 2005

[10] Registered unemployment still includes persons who cannot be classified as unemployed according to ILO's definition, either because they perform odd jobs, are not looking for work or are not prepared to accept work. Estimating informal employment we assume that registered unemployed persons perform odd jobs or work as unpaid family members (IMAD, Spring Report, 2007)..

[11] Another reason for the difference between ILO and registered unemployment rates was also that participants in public works and on-the-job training programmes were registered as unemployed until the end of 1998.

Thus, people in informal employment work either as unpaid family worker, on contractual basis or in the grey market. Unfortunately there is not much data on informal work but we can come to some conclusions from other data sources. Slovenia has a relatively high share of unpaid family worker which varies from 3.1 to 5.4 percent of all employment in observed period.

In connection with informal work one must mention student work which is very high. Secondary-school students, who have reached 15 years of age, and university students may carry out temporary or occasional work on the basis of a student's referral note from an authorised organisation, which carries out an activity of providing work to secondary-school and university students in accordance with the regulations in the domain of employment. This student's income is very favourably taxed with personal income tax (due to special tax allowances it is often not taxed at all), not to mention exemption from social security contributions. Moreover, this type of work is very flexible as there is no minimum period of notice nor severance pay.

A large cohort of persons in informal employment is active in the shadow economy. It is also believed that undeclared work (grey market) is one of the main reasons why the survey unemployment rate (6.1% in 2006) has been considerably lower than the registered one (9.4%). There are different estimates of undeclared work in Slovenia. In Slovenian Report on activity and effects of prevention of black labour and employment (2006) there is an estimate that undeclared work amounts from 7.3% to 11.8% of GDP. The European Commission (2004) estimated that the undeclared work in Slovenia in 2003 produced around 17 % of the official GDP and that undeclared work is in decline. The sectors with the highest shares of undeclared work are construction (SMEs) and agriculture, where illegal immigrants do labour intensive work like picking strawberries, and services (in trade, hotels and restaurants, transport, security, etc.).

Undeclared work in Slovenia is driven mostly by the following factors:

- the relatively high costs of labour in legal segments of employment,
- long and complicated employment procedures (in particular for foreign labour), complex and long procedures to gain permissions in construction,
- an inadequate information system and the low number of inspection institutions/qualified inspectors,
- the slow judicial system and inadequate system for collecting penalty fees.

Among socio-economic factors should also be mentioned unemployment - though ILO unemployment rate is low, misuse of benefit system (receiving social transfers and payment for undeclared work at the same time), poverty and army of young pensioners.

Slovenia has a long history of informal economy. European Commission (2004) states that "the present level of undeclared work is tolerated by politics and politicians, who see it as a measure against mass unemployment, preventing socioeconomic tensions, and no serious action is launched against it." However, the Slovenian government has delivered a coherent package of policy measures to fight undeclared work since 1996 when a special Committee for the Exposure of Undeclared Work has been established. The parliament passed a law on undeclared work ("Law on prevention of black labour and employment") in 2000. In 2005 measures were taken against 1,890 subjects compared to 2504 subjects in 2004 and 2742 subjects in 2003. It is also worth mentioning that the percentage of "success" inspections is declining; in 1997 undeclared work was revealed at 68.9% inspections compared to 13 – 17 % rate valid in following years.

3. DISCUSSION OF MOST RELEVANT COUNTRY SPECIFIC FACTORS

The situation in the Slovenian labour market has improved since mid 90's. Main reforms concerning labour market were:

1. reduction of employment protection and the legislation of temporary work agencies with the new ERA Act,
2. shortening of periods of entitlement to unemployment benefit,
3. reform of pension system.

Change of legislation reduced employment protection and legalized temporary work agencies, shorten the duration of unemployment benefit entitlement and strengthen retirement conditions. But still, there are some issues which should be addressed in this section.

The share of temporary employment in Slovenia more than doubled in the period 1996-2006. This substantial increase in temporary employment is connected to high employment protection, which was lowered only in 2003. We can speak about age segregation of Slovenian labour market (Ignjatović, 2002), which is more flexible for the young. Namely, almost two thirds of young employees have fix-term employment compared to 17.1 percent of temporary employees among all employed aged 15-64, as seen from table 17. Young women (15-24) are particularly affected with increasing flexibility in terms of temporary employment; 74.9 percent of all employed young women were employed temporary in 2006.

Table 17: Temporary employees as percentage of total number of employees by age groups (%)

Year	15-24	25-49	50-64	15-64
1996	29.7	5.3	3.4	8.4
1997	42.4	9.1	10.3	14.1
1998	41.4	8.3	1.7	11.5
1999	38.4	8.0	2.8	10.8
2000	43.2	9.5	6.6	12.8
2001	51.0	9.3	4.8	13.0
2002	52.9	10.8	6.0	14.6
2003	53.0	10.2	4.4	13.5
2004	63.1	13.6	7.7	17.8
2005	62.5	13.5	6.3	17.2
2006	64.2	13.1	6.5	17.1

Source: Eurostat, Labour force survey.

Incidence of part-time employment in Slovenia, another indicator of labour market flexibility, is relatively low, though there was an increase – the share of persons employed part-time increased from 6.2 percent in 1996 to 8.0 percent of total employment in 2006. This might be due to the low compatibility of pension system and part-time employment, the fact that employees can not afford to forego earnings and the fact that part-time jobs are relatively expensive. Part-time employees are entitled to full fringe benefits (full reimbursement of cost for meal and commuting, full amount of holiday bonus) instead of benefit proportion to working hours.

Besides, part-time employment is rarely used as a way exiting labour market, since legislation is not flexible enough. According to the 1999 PDIA, flexible retirement is possible is Slovenia for persons fulfilling conditions for old-age pension. Such persons working half-time may raise a partial pension, which is exactly half of the person's old-age pension, meaning that other options (one or two days a week, for example) are not possible.

Fringe benefits (reimbursement of cost for meal and commuting, paid half an hour break, holiday bonus) were on the agenda during negotiations on law amendment to Employment

Relationship Act. Employers argued that fringe benefits increase labour costs and hinder employers from hiring new workers. Extra payment for years of service (in-work benefit which amounts to 0.5 percent of basic salary for each year of service) is also a specific characteristic of Slovenian labour market, which increases labour costs especially of older workers. In spite of dissenting opinions of employers and unions, entitlement to fringe benefits and senior allowance still remain in place as unions strongly opposed their abolishment. In fact, fringe benefits represent a relatively high proportion of net take-home pay especially for low-wage workers and therefore any attempt to abolish them will be faced with strong resistance.

Student work is another specific characteristic of Slovenian labour market. Although it's primary intention is to ease transition from education to employment it is often misused and in many cases it is actual replacement for regular employment. Due to high flexibility and very favorable taxation (without social security contributions and payroll tax, only concession fee which amounts to 16.8 percent on payment), student work is in fact unfair competition to regular employment. According to calculations of The Association of Employers of Slovenia, employers pay around 334 millions EUR for student work which could, in their opinion, provide for 33 thousands additional regular employees. Any attempts to put taxation of student work near wage taxation were strongly opposed by student organizations and unions.

During negotiations on the amendment to Employment Relationship Act (2006-2007) employers associations also stressed need for increased labour market flexibility and lower labour cost. They exposed the following most binding restrictions: high labor costs (paid break, fringe benefits, and seniority allowance), long periods of notice, complicated firing procedures and high severance payments. During negotiations it became clear that introducing radical changes, which would decrease employment protection and firmly grounded benefits, is very difficult and currently an unattainable task. It was met by strong opposition and even mass demonstrations supported by unions.

Kajzer (2006) analyzed responsiveness of employment to economic activity in Slovenia. The results reveal structural rigidities of Slovenian labour market since an increase in economic activity is mainly accompanied by an increase in wages while the response in employment is much smaller. However, the increase in temporary employment and the weak response of employment to stronger economic activity indicate that regular employment is still fairly protected in Slovenia and employers are still careful when hiring new employees. According to Kajzer, Slovenian labour market appears to show signs of "hysteresis". Greater employment could be achieved only through labour market reform which would increase labour market flexibility. However, the adoption of such unpopular changes as decreased employment protection, higher taxation of student work and lower benefits would most probably result as higher employment prospects in Slovenia.

4. POLICY RECOMMENDATIONS

Amendment to Employment Relationship Act is in parliament procedure and is expected to be enacted at the beginning of 2008. Introduced changes are not as radical as employers demanded and consequently they named them "cosmetic corrections". Foreseen changes are:

1. introduction of project work as an alternative to permanent employment,
2. in-work benefits will be proportional (and no more over-proportional) to hours worked,
3. increased allowed overtime,
4. somewhat simplified firing procedure,

5. shorter notice period (10 days shorter for employees with at least 15 years of service with employer and 30 days shorter for employees with at least 25 years of service with employer,
6. severance payment – worker, whose employment contract is terminated due to business reasons and who is offered a new job by his last employer or Employment Service of Slovenia, is not entitled to severance payment.

The scope of changes is far below employers expectations. In fact, changes are closer to union's position and consequently increase in labour flexibility is minor.

Changes concerning Pension and Disability Insurance Act are also proposed and discussed. Changes are aimed at prolonging the active period of individuals:

1. higher and progressive (currently regressive) bonuses for extending active period, and for longer period (now up to 5 years);
2. employers will pay just some of the social security contributions for elderly employees;
3. flexible retirement at employment ranging form one to seven hours per day (currently up to four hours).

Reforms in the pipeline will improve the labour market situation. In addition, there are still issues to address:

1. A further decrease in the employment protection legislation is needed. Rigid legislation concerning termination of employment is a disincentive for employment. It also protects bad workers because it is very hard to prove that they are not able to perform their tasks in a satisfactory way. Fearing sanctions, employers hesitate to terminate such persons' employment contracts.

2. Educational programmes should be organised in co-operation with employers in order to alleviate future imbalances between labour demand and supply and improve employability of young people. Continuous training and lifelong learning should be much more practiced by both companies and individuals in order to unemployment of the older people and prolong their activity if wished so.

3. Formal employment should be stimulated by lower marginal tax rates; personal income tax reform has already somewhat reduced marginal tax rate, but labour costs are still very high. Introduction of upper ceiling for social security contributions would lower labour costs, especially for high-qualified workers. Introduction of in-work benefits that would directly financially stimulate unemployed to join formal employment would result in higher formal employment as well.

4. Workers in the shadow economy are at disadvantage, as their access to current and future social rights is rather limited. Formal employment should be promoted through strict prohibition of undeclared work that is still favoured particularly by small employers and higher taxation of student work that is unfair competition to regular employment.

5. Labour market flexibility should focus also on the elderly population and more opportunities to combine pension and flexible forms of work should be offered in order to increase employment among the elderly (55-64 years of age). Regulation regarding the combining of retirement and part-time employment should be changed (on-going reform). There is a very limited possibility to earn additional income while receiving a pension, and additional earnings are subject to payment of all social security

contributions. This should be changed; otherwise many potentially active elderly persons will remain out of the labour market.

6. Elderly workers are expensive for employers although often less productive than the younger ones. Wages are supplemented according to years of service rather than years with the employer.

7. Legislation governing social benefits allows for abuse since there is no order of applying for benefits while definitions of household and its own income varies across individual acts covering particular benefit. Many enjoy higher disposable income while on social assistance than after taking a job. The reform of the social benefits legislation has been undergoing revisions aimed at achieving more fairness while still sufficiently protecting those who cannot be expected to earn income.

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Romania

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1. Introduction

Labour market flexibility is becoming a central topic in the literature on the impact of EU enlargement on the NMS and candidate countries due to its growing importance with the decrease of degrees of freedom for national monetary policies imposed by Economic and Monetary Union (EMU). After joining the EU, the NMS are required to observe a number of obligations embodied in the EMU architecture, to participate in the exchange rate mechanism governed by common EU rules and to adopt euro as the final step of monetary integration. In this process, as the optimum currency area theory suggests (Mundel, 1961), the flexible labour markets become crucial for adjusting to the idiosyncratic shocks that the integration may trigger.

For the labour market to be considered flexible, it has to operate freely, with an ability to adapt to any shocks that may arise and a capacity to adjust to a constantly changing economic environment. This flexibility is important, because it provides for the changes needed to deal either with surpluses or shortages of labour when some industries are in decline while others expand. Labour market flexibility plays also a decisive role for the successful continuation of the process of economic restructuring and reallocation of labour in line with common EU structure (Paas et.al, 2003). All transition countries have undertaken significant economic transformations and are in need of further adjustments in order to be able to cope with the competitive pressures brought by EU accession. Since restructuring requires a substantial reallocation of workers across sectors, occupations, regions it will impact the labour markets inevitably.

Several papers have focused on the labour market flexibility as a pre-condition for successful labour market adjustment to the potential shocks that transition countries may experience after joining EU. Several studies have provided evidence on substantial asymmetric macro shocks between old and would-be member states (Horvath, 2001; Egert et.al. 2003). Gruber (2004) analyses the labour market developments and labour market flexibility in five Central European countries and finds a higher labour-cost flexibility in them than in the EU in general, but small and even insignificant supply side flexibility, notably occupational and regional mobility. Thus, the paper suggests that the NMS have to make further efforts to enhance labour market flexibility otherwise the early participation in the euro area may not be an optimal option for some of them. Huber (2004) investigates the capability of regional labour markets in the candidate countries (as they were defined in

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late 1990s) to adjust to the potential asymmetric shocks and concludes that regional wage flexibility is more effective labour market adjustment mechanism than internal migration.

Kotzeva and Pauna (2006) attempt to measure empirically the response of the two most often analysed labour market indicators - unemployment and employment in each country to a series of macroeconomic shocks using structural co-integrated VAR model. Estimates show that Bulgarian labour market is more sensitive to macro-economic shocks than the Romanian one. While in Romania labour supply shocks dominate the variability of unemployment rate, in Bulgaria technology shocks, pushes to prices and demand shocks contribute considerably (accounting together for almost 75% of the forecast error variance at long-term horizon) to the forecast error variance in unemployment. Whereas in Romania the variability of employment is attributable mainly to its own shocks and to a much lesser extent to pushes to wages, in Bulgaria the forecast error variance of employment due to various sources. The largest contribution comes from technology shocks followed by shocks to labour supply.

The findings of empirical estimates of the co-integrated VAR model suggest that the attention has to be paid on the stimulating aggregate demand in both countries because it would play a crucial role in decreasing unemployment. Moreover there are favourable conditions of sustainable economic growth that the two countries have enjoined and a further trade liberalisation and increase of foreign direct investment is expected after joining EU. In case of Bulgaria these is a room for improving wage flexibility and use it for coping with the potential shocks.

This paper attempts to assess the flexibility of labour market in Romania drawing on statistical data and findings from deferent studies conducted so far. Although labour market flexibility has been discussed widely, it has been defined in a number of different ways. This paper considers two related aspects of labour market flexibility. The first relates to the institutional environment including employment protection legislation, tax-benefit system, policies towards labour market, wage setting and collective bargaining. All these elements influence both equilibrium unemployment and how well the economy adjusts to the shocks. The second aspect relates to the way the labour market responses to a period of disequilibrium using a combination of adjustments in wages, labour supply and labour demand. In this interpretation, flexibility is characterized by a quick mobility across sectors, regions and occupations, wage adjustments as well as implementation of a wide variety of working practices including party-time and flexible working arrangements.

The rest of the paper is organized as follows. Section 2 reviews the recent labour market developments in Romania and derives implications for the flexibility of the labour market under continuing economic restructuring and increased competition in the globalize world. Next section considers institutional framework for labour market performance trying to

asses whether it is conducive to labour market flexibility. Section 4 looks at specific forms of adjustments to the changing economic conditions that are currently used in Romania (wage flexibility, geographical mobility, ability of employers to adapt working patterns to the changing demands, ability of the labour force to acquire and apply different skills, enabling them to adapt readily to technological changes). Final section concludes with the major challenges remaining for further increase of labour market flexibility perceived in a broad sense as an ability of the labour market to adapt to external shocks and periods of disequilibrium.

2. Labour Market Performance: Trends and Challenges

In its post-socialist history Romanian economy has seen ups and downs resulting from inconsistent and often inadequate economic reforms. Until 2000 Romania had been considered as one of the poorly performing economies in Central and Eastern Europe (World Bank, 2006). Starting with 2001, the new Government adopted a pragmatic market-economy-oriented approach. Boosting economic growth has become the absolute priority of macroeconomic policy, both in terms of preparing the ground for the EU integration of Romania and of improving the quality of life. During the last 6 years the economy grew robustly at an average rate of 4-5% annually, due primarily to investments and exports and in part to the increased demand, reflecting macroeconomic stabilization and rise in the confidence in banking system. Inflation declined from 40% in 2000 to 4.87% in 2006, the lowest level since the beginning of transition. While in recent years overall macroeconomic and structural performance has improved compared to the 90s, Romania continues to face serious challenges in the labour market and social policy developments.

Employment

Romania was one of the few countries in Central and Eastern Europe (CEE) where the initial adjustments occurred more in real wages than in employment decline. Limited progress in pursuing economic reforms was a central explanation for this pattern. Still, in the period 1996-2003 the country had seen a decreasing trend in the activity/employment population rate. This negative trend was reversed only in 2004, which was the first year of net employment expansion (table1). The increase was marginal, but yet a good sign that enterprise restructuring as well as structural reforms in the public sector were yielding results. Some of the reverse in the employment trend in 2004 was attributable to the economic growth of around 4-5% per annum that Romania has experienced since 2001. The fiscal relaxation introduced in 2005 through the adoption of the 16% flat income and profit tax rate have led to a further expansion of employment since then.

Despite the slight positive changes in the last 3 years, today's level of employment rate in Romania (58.8%) is still well below those observed in other NMS-10 and EU-15 countries

(66.0%). Furthermore the pace of increase is very slow compared to other countries. For example Bulgaria, a country that is usually used as a benchmark in the economic and labour market analyses for Romania, has registered a robust growth of employment rate of 2-2.5% annually. Increasing overall employment in accordance with the Lisbon Agenda targets appears to be a major challenge for the Romanian labour market. Government Convergence Program 2006-2009 aims at increasing the annual participation rate for the working age population (15-64) by 0.3 percentage points. Consequently, the activity and the employment rates are expected to increase, reaching approximately 63.3% and 59% respectively in 2009. The increase in employment will narrow the income gap and will facilitate the convergence with the EU. Efforts toward achieving the Lisbon objectives will contribute also towards meeting the demographic challenges that Romania is currently facing.

Table 1

Employment rate of population aged 15-64 in the EU, NMS and candidate countries

In percents

Employment rates	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
EU (25 countries)	62.4	62.8	62.8	62.9	63.3	63.9	64.7
EU (15 countries)	63.4	64	64.2	64.3	64.7	65.3	66.0
Euro-zone	61.7	:	62.4	62.6	63	63.7	64.6
Euro-zone (12 countries)	:	62.2	62.4	62.6	63	63.7	64.6
Czech Republic	65	65	65.4	64.7	64.2	64.8	65.3
Estonia	60.4	61	62	62.9	63	64.4	68.1
Latvia	57.5	58.6	60.4	61.8	62.3	63.3	66.3
Lithuania	59.1	57.5	59.9	61.1	61.2	62.6	63.6
Hungary	56.3	56.2	56.2	57	56.8	56.9	57.3
Poland	55	53.4	51.5	51.2	51.7	52.8	54.5
Slovenia	62.8	63.8	63.4	62.6	65.3	66.0	66.6
Slovakia	56.8	56.8	56.8	57.7	57	57.7	59.4
Bulgaria	50.4	49.7	50.6	52.5	54.2	55.8	58.6
Croatia	:	:	:	53.4	54.7	55.0	55.6
Romania	**63**	**62.4**	**57.6**	**57.6**	**57.7**	**57.6**	**58.8**

Source: Eurostat, National Labour Force Surveys.

As regards to female employment in 2000 Romania started with a rate very close to the Lisbon target of female employment, but similarly to the overall employment rate, it decreased by 5% from 2001 to 2003 before starting to pick up in 2004 (table 2). Employment rate of women is about 10% lower than that of men and around 4% lower the EU-15 average in 2006. Females have better chances of finding jobs compared to men in the last three years due mainly to the expansion of the service sector, fact reflected in the

quicker raise of female employment rate than that of men. Shrinking of the traditional industrial sectors such as mining and manufacturing generates higher incidence of unemployment among men compared to women (given the similar dynamics of inactivity rates of both sexes).

Table 2

Employment rate and Unemployment Rate by Gender, Population Aged 15-64, Romania (annual averages)

In percent

Years	Employment rate			Unemployment rate		
	Males	Females	Total	Males	Females	Total
1997	71.9	59.1	65.4	5.0	5.7	5.3
1998	70.4	58.2	64.2	5.5	5.3	5.4
1999	69.0	:57.5	63.2	7.3	5.8	6.6
2000	68.6	57.5	63.0	7.8	6.4	7.2
2001	67.8	57.1	62.4	7.2	5.9	6.6
2002	63.6	51.8	57.6	9.1	7.7	8.4
2003	63.8	51.5	57.6	7.6	6.4	7.0
2004	63.4	52.1	57.7	9.1	6.9	8.1
2005	63.7	51.5	57.6	7.8	6.4	7.2
2006	64.6	53.0	58.8	8.2	6.1	7.3

Source: Eurostat, Labour Force Survey

Similarity to the majority of NMS employment participation of older workers is far away from the Lisbon targets. In the case of Romania, one can conclude that the employment policies pursued were not effective in increasing older worker employment rate, since the rates have been decreasing most of the time. One needs to be cautious in interpreting the recent dynamics of the employment rates of women and older workers. First, the two rates have been decreasing since the beginning of transition in Romania that unlike many of the current EU members, had a tradition of high women participation rates. The drop in the activity of women was largely involuntary, attributable to the decline in output and employment opportunities following the collapse of communism, and the concomitant severe deterioration in living standards and increase in long-term unemployment. Therefore, an increasing percentage of inactive women are expected to return back to work when labour market conditions start improving.

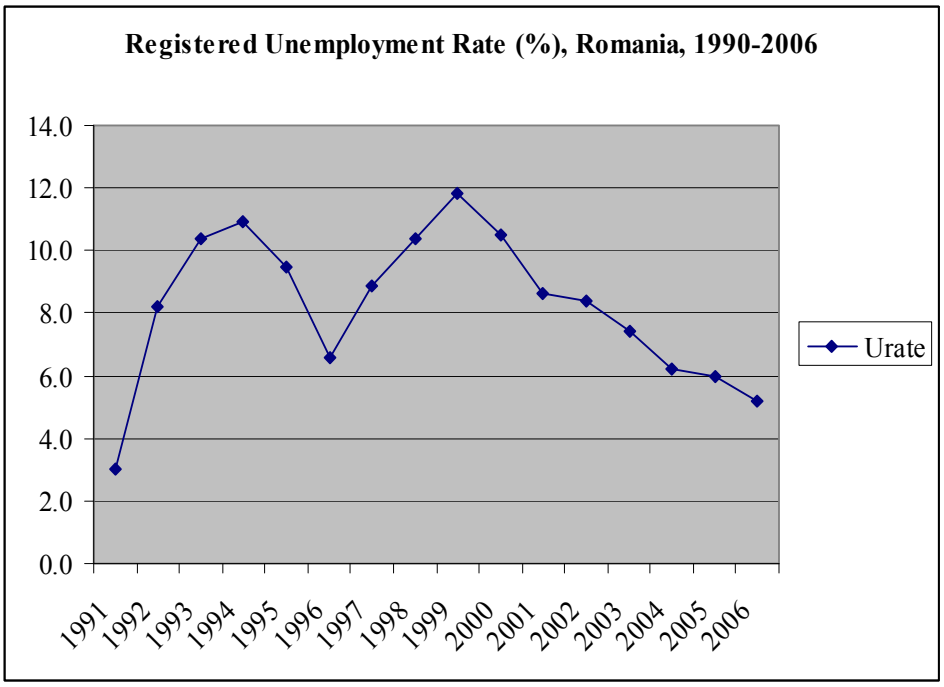
At the same time, the participation of women and older workers in the subsistence agricultural sector is larger than in the case of men. The correlation between the decrease in agricultural employment on one hand, and the decrease in female and older worker participation, on the other hand, can not be coincidental. This suggests that the

employment figures in the two cases might hide larger imbalances than observable at a first glance. Increasing employment of women and old persons in accordance with the Lisbon Agenda appears to be a major challenge for the Romanian labour market.

Unemployment

A real surge in registered unemployment, emerging from the output contraction, had been seen in the first years of Romanian transition with a peak of 10.9% in 1994 (as of the end of the year). In the next 3 years the registered unemployment declined and since the end of 1997, had started to rise again, as a consequence of restructuring processes and the closure of inefficient enterprises (in particular in the mining sector), reaching a new pick of 11.8% by the end of 1999. In recent years, following the rapid and sustained GDP expansion after 2000, the registered unemployment rate started to decline again reaching the level of 5.2% at the end of 2006. (figure1).

Figure 1



The low unemployment/higher employment figures in Romania compared to other transition countries are indication of the limited pace and scale of economic restructuring. At the same time decrease in employment has not been matched by a proportional increase in unemployment. Limited employment opportunities have pushed people out of the labour force, in the subsistence agriculture or in the urban informal sector. Estimates of the informal economic sector in Romania range between 20% and 30% of GDP. Surveys suggest that the informal economic activities provide a large number of low paid jobs to unskilled individuals who cannot find formal employment. Another important factor that

explains the low unemployment is the large external migration. Romania has experienced in the last four years high net outflows of workers, who were attracted by higher wages and better job prospects in the EU. Estimates suggest that more than 1.5 million Romanians currently work abroad. They send around Euro 4.3 bn per annum back to their country, which represents around 5% of GDP.

Unemployment in Romania is long-term, characterized by low inflows and outflows, and a prolonged average duration. Almost 60% of the unemployed in Romania are long term (table 3). This indicates a significant mismatch between skills and jobs, and between the location of unemployed and the location of jobs. At the same time, long-term unemployment affects the population asymmetrically. The most affected categories are newly graduates, the less educated and older age workers. Data suggest that long-term unemployment and youth unemployment affects more men than women.

Table 3

Unemployment Indicators, Romania (annual averages)

In percent

Years	Share of long-term unemployed in the total number of unemployed			Unemployment rate among youth (younger than 25)		
	Males	Females	Total	Males	Females	Total
1997	71.9	59.1	65.4	14.8	18.2	16.3
1998	70.4	58.2	64.2	15.6	16.1	15.8
1999	69.0	:57.5	63.2	20.1	17.0	18.7
2000	68.6	57.5	63.0	22.2	17.2	20.0
2001	67.8	57.1	62.4	19.7	17.4	18.6
2002	63.6	51.8	57.6	24.3	21.8	23.2
2003	63.8	51.5	57.6	20.3	18.7	19.6
2004	63.4	52.1	57.7	24.2	18.9	21.9
2005	63.7	51.5	57.6	21.6	18.4	20.2
2006	64.6	53.0	58.8	22.3	20.2	21.4

Source: Eurostat, Labour Force Survey

Structure of Employment

Romania started the transition to a market economy with a substantially different employment breakdown than the EU members, and in particular with much higher agricultural employment. In fact, the country had the largest share of agricultural employment among Central Eastern European countries (CEEs), although marginally larger than Poland (table 4). Under central planning the accent was on increasing material output, while services were largely neglected.

In the period 1990-2000 the structure of the employment across branches of the national economy has changed considerably, reflecting the de-industrialisation of the economy and return to agriculture with a modest shift to the service sector. In fact, a large proportion of people made redundant from the restructured industry had not been found in other branches of the economy, but they had just joined either the large pool of unemployed or subsistence agriculture. The case of rural household possessing a small piece of land, has prevailed and resulted in diminishing capacity utilisation of the work force in agriculture.

Agriculture needs a special focus in Romania due to its largest contribution to employment. While its share in GDP is around 10-14%, the sector still provides jobs to 30% of the labour force in the country, mostly in the subsistence agriculture. The high age and low educational level of people working currently in agriculture reduces substantially their chances of moving to other sectors and jobs. Under such circumstances it is quite likely that the tendency of displaced from agriculture to leave for inactivity will continue in the inevitably productivity-oriented restructuring of agriculture. A serious challenge for the government will be to design and implement a policy-mix aimed at cushioning adverse implications on the households affected by the agriculture restructuring. The Minimum Guarantee Income Program, introduced in 2002 is an example of a successful step towards alleviating extreme rural poverty in the country. However further initiatives providing mainly alternative employment opportunities to those dismissed from the agriculture have to be launched.

Table 4

Sectoral employment in 1989 in Romania, Bulgaria and selected EU countries (%)

	Bulgaria	Romania	Poland	Italy	Spain	UK
Agriculture	18.7	27.9	25.3	9.2	13.0	2.1
Mining	2.6	2.8	3.4	1.1	0.6	0.8
Manufacturing	34.3	34.7	25.7	22.4	22.3	20.4
Electricity, gas, water	0.8	0.5	1.1	0.0	0.7	1.1
Construction	7.6	7.0	7.9	8.5	9.3	6.8
Trade	9.6	5.9	9.8	21.1	20.1	20.1
Transportation	6.6	6.9	7.2	5.5	5.8	5.7
Finance	1.4	0.3	2.2	4.1	5.2	11.2
Community services	18.4	13.8	16.8	28.2	23.0	30.6
Other	0.0	0.0	0.8	0.0	0.0	1.2

Source: ILO

Following methodology of Jackman (1997) Kotzeva and Pauna (2006) measure the potential restructuring Romania and Bulgaria need in order to reach the structure of

employment similar to the average employment structure in the EU in the long run. The restructuring index is defined as the proportion of the employed that would need to change sectors in order to attain a structure of employment similar to the EU. The decrease of the values of restructuring indices in 1995, 1999 and 2003 indicates improvements in the sectoral composition of employed, although there is still significant caching up that both Romania and Bulgaria need to do. For example in 2003 33% and 24% of the employed in Romania has to shift to different sector in order to reach a structure of employment similar to the EU-average and NMS-10 respectively.

In sum, to continue and deepen economic restructuring and labour reallocation from low to high productivity sectors (combined with enhancing participation and employment in the view of the re-launched Lisbon targets) remains to be a major challenge for Romania in the coming years. Labour market flexibility is crucial to the improvement of companies' performance in the context of globalisation and increased competition.

3. Institutional Environment

This section provides analysis of the institutional environment including employment protection legislation, tax-benefit system, policies towards labour market, wage setting and collective bargaining that have shown to influence both equilibrium unemployment and how well the economy adjusts to shocks.

3.1. Employment Protection Legislation (EPL)

An appropriate degree of regulation can improve the flexibility of the labour market by improving the quality of job matching and reducing the cost of labour turnover to firms. EPL sets out the rules governing hiring and firing in the workplace as well as the constraints on employers related to dismissals and severance payments. Therefore, if EPL is well designed, it offers clear benefits to both employers and employees. EPL affects both job creation and job destruction. An employer may be reluctant to dismiss personnel due to substantial firing costs involved. She may similarly be discouraged from hiring workers if she believes that it will be required to retain staff who will eventually become surplus to requirements. In practice it is not clear which effect (positive or negative will prevail) but there is a clear evidence among countries that the more tight EPL is the more detrimental impact it has on the labour market functioning and in particular on labour turnover.

The 1998 OECD Economic Survey of Romania (OECD, 1998) concludes that the basic legislation governing employment conditions and termination of job contracts is liberal by international standards, especially compared to many continental European countries. The Labor Code, the main body of legislation regulating labor relations in Romania remained unchanged till 2003. Romania's new Labour Code came into force in March 2003, laying

down a revised legal framework for industrial relations. The new Code – made up of 13 titles, 37 chapters, 17 sections and 298 articles aimed to replace Romania's previous industrial relations rules, which had been dominated by the assumptions of the former 'command economy' based on centralised planning. The arguments behind the new regulations include: establishment of more flexible work relationships; ensuring protection of employees; and creating the conditions to harmonise the Labour Code's provisions with the EU 'acquis communautaire' in terms of working time, collective redundancies and keeping workers informed, in line with the engagements assumed by Romania under chapter 13 on 'employment and social policies' of its EU accession negotiations.

The most significant changes introduced by the revised Labour Code include:

- *wider use of fixed-term contracts* - Fixed-term employment contracts had rarely been used and had been little regulated before 2003. The new regulations extend the maximum duration of a fixed-term contract from 18 to 24 months and impose restriction of no more than three successive fixed-term contracts within this period.
- *easing individual dismissal and collective redundancies* - After the trial period has ended both the employer and the employee may terminate the individual employment contract by giving written notice. The minimum number of redundant employees increases from 5 to 10 in enterprises with 20 to 100 employees. An employer is no longer compelled to present a programme of social security, training and development measures before resorting to collective redundancies. Written notification of redundancy decisions to trade unions is shortened from 45 to 30 days. Trade unions or employee representatives may now propose measures to be taken by employers in order to avoid redundancies or to reduce the number of redundant employees within a shorter period of time from the date of notification receipt (from 20 down to 15 days) and the employer must respond within five days (compared with 10 days, as previously stipulated). The local employment inspectorate may order a delay of no more than 10 days (compared with the 15 days as previously stipulated) of the date of issuing the decision. The employer may not fill vacancies resulting from redundancies for a period of nine months (compared with the 12 months stipulated in the former Labour Code).
- *changes in working time regulations* – the Law sets a limit of a 48 hour working week on average beyond which limited overtime is officially acknowledged. It has been extended from three weeks to one month and to 12 months for certain sectors. Over this limit, an employer may request overtime hours from employees only by invoking absolute necessity or emergency situations.
- *introduction of additional provisions on contraventions and penalties related to work relationships*, such as fines for non-observance of overtime regulations, for failure to pay an indemnity for temporary interruption of activity, or breaching of provisions on night work. Non-observance of regulations on employment of under-age workers or

giving them jobs that run counter to regulations on work conditions for minors are punishable by one to three years in prison;

- *removing the common law based service provision contracts* ("Conventii civile de prestari servicii") that had been widely used before. These contracts had been exempted from social contributions for a certain period. With their removal from the legislation the government hopes to reduce the share of undeclared and in particular under-declared labour in the economy.

Some parts of the Code had been criticised by employers as being inconsistent with the principle of a free market[13] and in particular that it had favoured employees excessively. In summer 2004 the government made a commitment to the International Monetary Fund (IMF) to make several liberalising changes to the Code. In January 2005 it proposed substantial amendments to it aimed at enhancing labour market flexibility. Negotiations with trade unions and employers' organisations delayed the process and the revised Labour Code came into force on 5 July 2005 (by Emergency Ordinance no. 65, published in the Official Gazette no. 576). The approved text came as result of lengthy negotiations with representative trade union and employers' organisations and included considerably fewer amendments than those proposed in January 2005 by the Ministry of Labour, Social Solidarity and Family. The Labour Code was once again revised in 2006. In particular the provisions regarding the flexibility of collective lay-offs have been expand3ed allowing the companies to swiftly resize their activity in line with their needs, ensuring at the same time protection of the workers going to be made redundant.

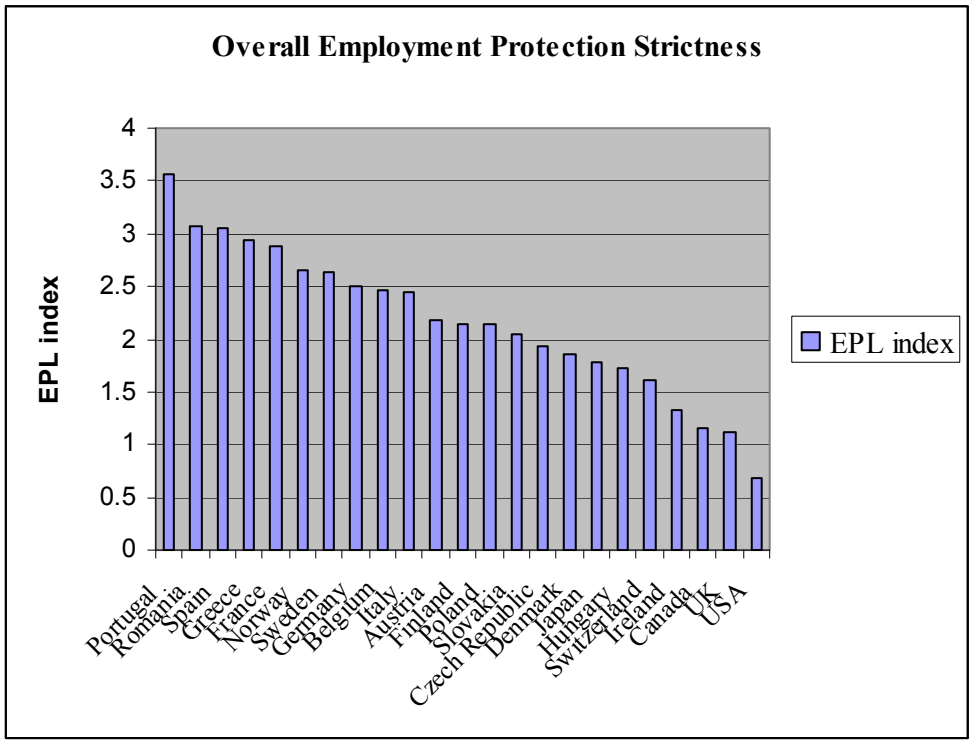
Adoption of the new Labour Code in 2003 and its subsequent amendments in 2005 and 2006 certainly enhanced flexibility of the labour market in Romania. At the same the necessary labour adjustments have been taking place very slowly in Romanian economy. The main reason for this delay lies within the complications of corporate governance in the state-owned enterprises. The liberal Labour Code regulations concerning the reasons, decision powers and severance pay in case of dismissals (especially collective) have become restrictive as regards to the state sector. The State Ownership Fund and several

13 The day after the law was adopted, 54 members of parliament referred to the Constitutional Court nine articles of the new law, which they claimed violated the Constitution. After debate over these complaints, the Constitutional Court issued its definitive decision (No. 124) on 22 January 2003, concluding that all the articles concerned are in accordance with the Constitution. The decision was submitted to the President of Romania, who promulgated the Labour Code Law. On 10 June 2003, with the law in force, 33 companies, employers' and professional associations held a public meeting entitled 'Labour Code – changing the regulations which hinder business administration'. The issues of concern raised relate to 47 of the law's 298 articles. On 16 July 2003, the Council of Foreign Investors in Romania (Consiliul Investitorilor Străini, CIS) organised a meeting with the Delegate Minister for relations with the social partners. CIS representatives stated that 'some Labour Code clauses are restrictive and incompatible with companies acting in a functional free market'. Their main concerns are related to the: obliging companies to set up a 'wage guarantee fund', guaranteeing workers' pay in the case of bankruptcy; placing a 48-hour ceiling on weekly working time, which limits employees' overtime work; making recruitment and dismissal procedures more complicated; involving trade unions in drawing up 'standard work norms'; and introducing 'excessive' requirements regarding employees' rights to annual training.

line ministries have had a say in most important issues. They have had to improve the company's restructuring plans as a precondition for severance pays. The process of approving the suggested number of the workers to be dismissed has been often delayed and accompanied with uncertainty. Under these circumstances managers have been reluctant to speed economic restructuring. In sum, Romanian experience has shown that liberal employment protection legislation is necessary but not enough condition for dynamic labour market. Imposing different conditions for state-owned enterprises and conducting inconsistent social protection policy of dismissed workers creates high risk of jeopardizing the speed of labour market adjustments.

How much flexible is the Romanian employment protection legislation compared to other countries? There is a common understanding that disappointed labour outcomes in particular high unemployment, jobless economic growth and size of informal economy have been determined to a great extent by the strict employment protection regulations. Nesporova (2002) finds that tight EPL is associated with lower job turnover, lower flows into unemployment and longer unemployment spells, but not with longer job tenure. As figure 2[14] shows Romania is still among the countries with the most restrictive employment protection legislation. In particular it is most restrictive concerning temporary employment and collective dismissals.

Figure 2



[14] Source: Cuica et al (2005)

The still rigid character of labour market regulations in Romania is also confirmed by the recently published fifth annual report of the study "Doing Business 2008" covering 178 countries across the world and investigating the regulations that enhance business activity and those that constrain it. Romania is ranking 145 overall for the criterion "Employing workers". Table 5 shows the values of the three indexes that measure the strictness of the labour market regulations for comparator economies. The main source of the rigidity of employment index are regulations on working hours especially the restrictions on night work, "weekly holiday" work and on the possibility to extend working week to 50 hours in order to response to seasonal production needs. Non-wage costs are also high compared to other transition economies.

Table 5

Rigidity of Labour Regulations, 2007

Country	Rigidity of Employment Index (%)	Non-wage Labour Costs (% of salary)	Firing Costs (weeks of wages)	Overall Rigidity (global rank)
Bulgaria	29	23	9	75
Czech Republic	31	35	22	57
Hungary	30	34	35	81
Moldova	38	28	37	93
Poland	37	21	13	78
Slovakia	36	35	13	75
Slovenia	63	19	40	166
Romania	66	31	8	145

Source: "Doing Business 2008"

Note: Employing workers indices are calculated on a basis of survey responses to questions related to employment regulations. Each index can take values between 0 and 100 with higher values representing more rigid regulations. The overall Rigidity of Employment Index is average of the three measures.

Table 6

Romania's raking on "Doing Business, 2008"

Criteria	Rank
Ease of Doing Business	48
Start of Business	26
Dealing with Licenses	80
Employing Workers	145
Registering Property	123
Getting Credit	13
Protecting Investors	33
Paying Taxes	134
Trading Across Borders	38
Enforcing Contracts	37
Closing a Business	81

Source: "Doing Business 2008"

It is interesting to note that labour market regulations are the most rigid part of all regulations affecting 10 different stages of the business life, investigated by the "Doing Business 2008" report (table 6). Flexibility of hiring, working arrangements and firing are extremely important for SMEs that are particularly labour intensive.

Non-standard forms of employment

There are many indications that current labour regulations are not fully conducive to the flexible forms of employment. Almost 9% of the employed work part-time (less than 30 hours per week) compared to 20.2% on average in EU15 countries in 2006 (table 7). Part-time is generally undertaken by females. Across Europe about 2/3 of employees in part time work are women. In Romania part-time work is equally distributed among men and women. This fact reflects the limited flexible working conditions but is also result from the precarious nature of part-time work in transition economies, meaning generally lower pay and more limited training and career progression prospects. According to LFS data in 2006 as many as 55.8% of the part-time workers in Romania reported that this type of job is involuntary and 48% that they had accepted it due to the lack of full-time jobs. This finding suggests that even in case of liberal working arrangements the non-standard forms of employment will not prevail in the economy while they are low-paid and non-attractive to employees. Under conditions of still limited labour demand and concentration of part-time jobs in low-productivity and low-paid sectors the non-standard forms of employment will increase their share if the easing of legal regulations is accompanied by policies aimed at making part-time lobs more attractive for both employers and employees.

Table 7

Incidence and Composition of Part-time Employment, 2006

in percent

Country	Total	Men	Women
Bulgaria	1.8	1.3	2.3
Czech Republic	4.9	1.7	8.0
Hungary	3.8	2.4	5.4
Poland	8.9	6.2	12.2
Romania	**8.6**	**8.7**	**8.5**
Slovakia	2.7	1.2	4.5
Estonia	6.7	3.7	9.7
Latvia	5.8	4.3	7.4
Portugal	8.1	4.1	12.7
UK	24.5	9.2	41.9
EU15	20.2	7.4	36.3
NMS10	6.9	4.5	9.8

Source: Eurostat

The incidence of fixed-term contracts is also well below the lowest EU-15 value and the NMS-10 lowest value. Only 1.8% of the employed hold temporary (fixed-term) jobs in 2006. Fixed-term contracts may assist labour market adjustment by enabling workers to move jobs more quickly. They may also provide a bridge to permanent employment by enabling novice workers to gain experience. In addition, employers may be more willing to offer fixed-term contracts when the economic conditions are more unfavorable. However, a very high proportion of temporary workers may be detrimental to the economy if it reduces the incentives for employers to offer training and career development to employees. Having in mind these contrasting arguments it is necessary to be cautious when drawing conclusions about the correlation between fixed-term contracts in the economy and the flexibility of the labour market.

Data in table 8 show that working from home is also very rare form of employment in Romania. In 2006 Romania reported the lowest proportion of persons working from home in the total number of employed among European countries.

Table 8

Share of Fixed-term Employment and Working from Home Employment in Total Employment, 2006

In percent

Country	Fixed-term	Working from Home
Bulgaria	6.9	2.2
Czech Republic	8.0	3.3
Hungary	6.7	2.2
Poland	27.3	2.7
Romania	**1.8**	**0.6**
Slovakia	5.0	4.1
Estonia	6.7	4.4
Latvia	7.2	3.1
Portugal	20.6	1.2
UK	5.6	2.9
EU15	14.4	5.0
NMS10	16.2	2.9

Source: Eurostat

In conclusion, Romanian economy demonstrates a relatively low incidence of part-time and temporary work that reflects in part not enough degree of flexibility but also the lack of enough full-time jobs in the country.

3.2. Tax and benefit system

The interaction of the tax and benefit system is an important determinant of labour market flexibility via its impact on labour supply and wages. The poor employment outcomes in the

countries of the Europe and Central Asia region – including low participation rate, high unemployment and substantial informal employment are often blamed on high taxes on labour (Rutkowski, 2007). The high tax burden on labour discourages both labour demand (by raising labour costs to the employers) and labour supply (by lowering the real consumption wage of workers). Are labour taxes high in Romania compared to the other European countries and in particular compared to the NMS-10 and Bulgaria?

The flat business and income tax of 16% was introduced in 2005 intended to spur investments and create new employment opportunities as well as to reduce the share of informal labour. The total social security contributions were decreased by 5% in 2003 and by further 2% in 2006. In Convergence Program 2006-2009 Romanian government declares its intention to continue the reduction of the labour burden by diminishing gradually social security rates.

Despite the cuts in income tax and social contributions Romania still belongs to the group of countries with high labour costs. Tax wedge, i.e. the difference between labour costs to the employer and the net take-home pay of a single-earner employee, is high in Romania, accounting for 44.1% of the total labour costs in 2006[15]. The unweighted average 'tax wedge' for the 30 member countries of the OECD was calculated at 37.28% in 2005 (down from 37.42% in 2004). Calculated for a single person on average earnings the 'tax wedge,'[16] is the largest in Belgium (55.4%), Germany (51.8%), Hungary (50.5%) and France (50.1%) and the lowest in New Zealand (20.5%), Mexico (18.2%) and Korea (17.3%). The US registered 29.1%, the UK 33.5% and Japan 27.7% (OECD, 2007).

Taxes and benefits may interact to generate disincentives that discourage from participation in the labour market or reduce the number of working hours that the individuals willing to offer. In particular, there are two main effects that have adverse impact on aggregate labour supply – unemployment trap and poverty (low wage) trap. The first one refers to the situation when the unemployed find that difference between in-and out-of-work incomes is very small to create incentive to take a job. The low-wage trap refers to the situation when those who work are discouraged from working longer or taking a better paid job because simultaneously paying higher taxes and receiving less benefits may leave them little better off.

According to Eurostat calculations in Romania in 2006 a single person without children who earns 67% of the average wage when he works, is exposed to the unemployment trap amounting to 69% of the gross income when he returns to employment due to paying taxes and social contributions and stopping to receive social benefits. The unemployment trap of 69% places Romania in the down tail of the distribution of EU countries according to

[15] This structural indicator is available only for single persons without children earning 67% of the AW.

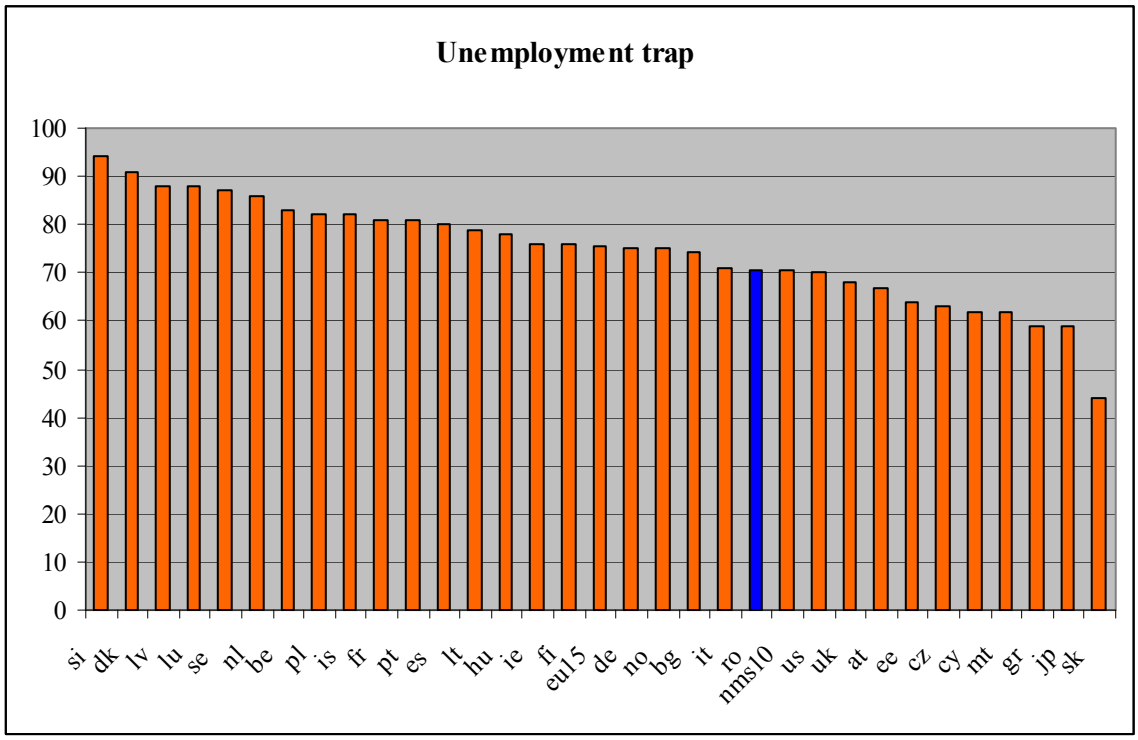
[16] The calculation includes all cash benefits received from government welfare programmes.

the value of this indicator (figure 3). The general solution to the welfare trap is to make the difference between welfare income and the typical income one would receive from a low-paying job larger, either by increasing the revenue of people in low-end jobs or by reducing welfare payments (or both).

As regards to low-wage trap[17], the data show that tax rate on low-wage earners of 41% in 2005 in Romania is among the highest observed in Europe. Therefore, once the worker enters the labour market the tax burden on labour is higher than the EU-25 average.

Figure 3

Tax rate on Low Wage Earners: Unemployment Trap[18]



Unemployment benefits

At the beginning of the changes Romania introduced unemployment compensation system similar in terms of restrictiveness to the ones implemented in most OECD and transition economies. Employees who had worked for six months in the last year and self-employed who had paid social contributions for at least one year were entitled to unemployment benefits. The size of UB varies between 40 and 60% of the applicants' average wage in the last three months depending on the length of work history. Initially the maximum duration of UB (27 months) in Romania was longer than in other transition economies (for

[17] This structural indicator is available for single persons without children and one-earner couples with two children.

[18] This structural indicator is available only for single persons without children earning 67% of the AW when in work.

example 12 months in Bulgaria, 24 months in Hungary, 6 months in Czech Republic, Estonia, Lithuania).

Gradually the UB system has been changed towards less generosity and stimulating active job search. For example in 1997 the average wage was substituted for the national statutory minimum wage as a reference point for benefit calculation. The Unemployment Insurance Act/Law No72/2002 adopted in 2002 introduced fixed, tax-free UB equal to 75% of the national statutory minimum gross wage regardless of the period of contribution of the unemployed. It was very restrictive measure that came as a response to the massive economic restructuring in the late nineties that left Unemployment Fund in deficit. The main goal of the change was to stimulate active job search and boost employment rate, although little changes have taken place in this direction[19].

In late 2005, the Romanian government introduced new rules[20] aimed at granting unemployment benefits (UB) in a more equitable manner depending on the length of the contribution period. An unemployed person is eligible for UB for six months if she has paid contributions for at least one year (compared with a mandatory five-year contribution period previously) and for nine months if she has paid contributions for at least five years (compared with the 5 to 10 years stipulated in the previous regulations). Monthly UB amounts to 75% of the national minimum gross wage in force at the date of entitlement (previously the phrase 'in force' was not included), for people with a contribution history of at least one year. According to the new regulations, the amount of the unemployment benefit differs depending on the length of contribution, by adding certain percentages to the national monthly average gross wage earned over the past 12 months (referring to the monthly income stipulated in the unemployment insurance contract): 3% in the case of a period of a contribution history of at least three years; 5% for five years' contributions; 7% for 10 years' contributions; and 10% for a contribution period of 20 or more years.

The unemployment benefit ceases when the recipient earns from authorized activities a monthly income higher than the national minimum gross wage (and not at the moment of starting a new job, as stipulated in the previous law). Unemployed people who start full-time employment before the expiry date of the unemployment benefit period may receive 30% of the monthly indemnity for the remainder of their initially set unemployment benefit period.

Unemployment benefit system in Romania is not generous by international standards and is not likely to create disincentives for the unemployed not to seek actively for a job.

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[19] It is worth to remind that at that time redundant workers collected simultaneously severance pay and unemployment benefits.

[20] The Romanian system of unemployment benefits and employment promotion, regulated by Law no. 76/2002, was amended by Government Emergency Ordinance no. 144/2005.

However, existing studies on the impact of strictness of unemployment compensation schemes on the labour supply indicate that it is difficult to implement UB regulations in countries with large proportion of rural population and informal economy such as Romania. Various sources have provided evidence that as many as 50% of those who received UB are not LFS-unemployed (being either employed or economically inactive) and this phenomenon is most frequently observed in rural areas.

Severance Pay

When the impact of tax-benefit system on labour supply in Romania is disscused one has to take into account the role of severance payments used to compensate workers for dismissals acompanying restructuring and privatisation of the state-owned enterprises. In the second half of 90s government adopted a number of legal acts (Emergency ordinances[21]) that stipulate the right of the dismissed workers to receive monthly severance benefits with size that varies from 6 to 15 monthly average wages in the sector depending on the length of service. Collective redundancy has triggered several regulations drafted specifically for certain companies and sectors in difficult situations at various times.

The 2006 Labour Code includes amendments that regulate, in general, the rights of redundant workers and the social partners to introduce provisions to this effect in collective agreements. As of 31 January 2007, previous regulations on the restructuring, reorganisation and privatisation of societies and companies with a majority state ownership are no longer valid. The companies, restructuring programmes and the number of workers to be made redundant are approved by government decision, according to the proposals of the ministries responsible or the Authority for State Assets Recovery (Autoritatea pentru Valorificarea Activelor Statului, AVAS). The deadline for finalising current restructuring programmes and planned collective redundancies has been set for 31 December 2010 in the case of the mining sector – in line with the 2004–2010 strategy for the mining industry and 31 December 2008 for the remaining sectors.

Redundant workers are entitled to the following protection measures[22]:

- a month's severance pay equal to the national average net wage as it stands in January of the redundancy year;
- unemployment benefit according to the legislation in force;
- a monthly compensation income, calculated as the difference between the amount of unemployment benefit and the individual average net wage in the three months prior to

[21] Ordinance 13/1995 introduced the concept of severance pay in case of mass layoffs. Emergency Ordinance No9 and No22 in 1997 offered higher benefits and Emergency Ordinance 98/1999 provides the benefit regardless of the ownership of the enterprise. Emergency Ordinance (GEO) No. 8/2003.

[22] The provisions of the new ordinance apply to workers whose individual employment contracts are concluded at least 24 months before the date of the planned collective redundancy.

redundancy, which must not exceed the national average net wage. This income is granted for a period of 20–24 months, depending on employees' length of service in the job: 20 months for up to 15 years of service, 22 months for 15–25 years of service, and 24 months for over 25 years of service.

After the expiry of the unemployment benefit period, the compensation income is granted in full with no deductions. If workers who become unemployed as a result of collective redundancies find employment in the course of the period when they are entitled to the above mentioned protection measures, they may continue to receive up to the half of the compensation income; however, in the case of retirement, the payment ceases altogether[23].

Romanian experience has shown that severance payments may have adverse impact on the pace of economic restructuring and on the incentives of labour market participation. In many cases the decisions on restructuring and providing severance payments have been so economicaly overdue that they appear as deadweight effect for enterpirses. The possibility to collect simulataneously UBs and severance benefits makes the total compensation for dissmissals extraordinary high – up to about 1,5 times their previous wage at the beginning of the unemployment spell. Finally, paying more generous severance benefits to certain groups, for example to minors, creates social tensions among general public and hence undermines support to the reforms.

Overall, evidence suggests that tax and benefit reforms introduced since 2003 have improved flexibility of the labour market in Romania. However the tax wedge is still among the highest in the region and across Europe. Therefore continued tax and benefit reform presents a serious challenge for the Romanina economy. Moreover Romania is facing increasing financial pressure on the pension and social safety net generated by the negative demographic trends and high emigration.

3.3. Active labour Market Policy (ALMPs)

In addition to creating an environment that is conducive to taking a job and to rewarding the work it is important to raise effectiveness of the unemployed and to smooth their reentering into the labour market, as well as to facilitate the matching of the labour deamnd and labour supply as means for smooth and quick response to economic shocks. ALMPs have critical role in this respect.

Up to 2002 ALMPs had covered a modest share of registered unemployed in Romania. The main programes comprise training, support to small business, community works and

[23] Approximately 10,000 workers are expected to be affected by restructuring measures in 2007, as well as a further 1,500 workers in 2009 and 5,500 workers in 2010.

hiring subsidies for youth. The need for an wider scop and higher differentiation of the policies has increased over the years and became more pronounced in 1996 and 1997 when restructuring and privatization of state-owned enterpises accelarated and resulted in mass layoffs. In the late 90s Romanian government sighed a loan agreement with World Bank, thus marking a real launch of ALMPs in the country. The Unemployment Insurance Act/Law No72/2002 adopted in 2002 sets a new framework for active labour market policy in the country and extends the mix of programs. Since 2007 employers hiring school leavers over the age of 16 for a period of more than 12 months may receive an indemnity equal to the national minimum gross wage in force at the date of employment as well as are exempt for a period of 12 months from the payment of the unemployment insurance contribution for these employees. School leavers entitled to unemployment benefits who start work before the expiry date of the unemployment benefit period will continue to receive the indemnity for the remainder of the initially set unemployment benefit period on condition that they remain employed for a minimum of 12 months from the date of employment.

Figures suggest that spending on ALMPs is still low in Romania compared to other countries. In 2005 Romania spent 0.097% of GDP on active labour market programs compared to the EU15 average of 0.55% of GDP. However, what is more important is the effectiveness of spending. Unfortunatey the evaluation studies of the net impact of active labour market programs and measures is scarce in Romania. Rodgriguez-Planas and Benos (2007) using rich follow-up survey and propensity-score matching approach find that in late 90s three programs (training and retraining, self-employment assistance and employment and reallocation service) had success in improving participants' outcomes and were cost-beneficial from society's perspective. In contrast public works were found to be detrimental for the employment perspective of participants. Currently the funding covers a multitude of programs the outcomes of which have not been rigorously evaluated recently.

There are two salient features of the labour market development in Romania that need to receive a special attention in the future design of ALMPs . These are the long-term character of unemployment and the low participation rate combined with high proportion of subsistence agriculture. Both characteristics call for making employment services more demand-oreinted and better targeted. Using activition policies that include personalised service for each unemployed seems to be a successful option in Romanian context.

3.4. Wage setting and collective bargaining

A vast literature has discussed the impact of collective bargaining on the finctioning of the labour market and on the overall economic performance. The most cited work is that of Calforms and Driffill (1998) who examine the impact of centralised and decentralised systems on the performance of labour market and found a non-linear relationship between the two.

Centralisation refers to the level at which the wages are bargained. Wage negotations in Romania are mostly decentralised to enterprises regrdaless private or state-owned. The government seldom intervenes directly in wage setting apart from its role as employer in public admnistration and a few *regies autonomes*[24]. In each enterprise the annual agreement sets the enterprise specific minimum wage that must not be lower than the national statory minimum wage and by the minimum wage fixed by the higher-level collective agreements. The agreement at firm level fixes also a set of qualification coefficients that can not be lower than the same coeficients set in higher level agreements. As a result the individuals' wage is sum of minimum wage multiplied by qualification coefficent and locally determined bonus.

The government signs annual national collective agreement the main purpose of which is to lay down the framework that has to be followed at branch and enterprise level bargaining. The Law permits only one collective agreement in each enterprise. This single agreement covers all the workers regardless of their union membership. As regards to public administration the government sets wages after consultation with trade unions. The prevailing decentralised system of wage setting is conducive to relative wage flexibility in Romania, i.e. wages can adapt more readily to prevaling conditions in a given industry.

Besides the degree of centralisation, the degree of coordination (degree of consensus among bargainers) trade union density(trade union membership as percentage of all employees) and trade union coverage (the proportions of workers whose wage is affected by the collective agreements) determine wage flexibility.

Since the end of the communist regime in 1989, the Romanian trade unions have experienced different stages, mirroring the country's transition to a market economy. The first stage, covering period 1990-1991 was marked by the end of the UGSR monopoly (General Union of Trade Unions in Romania –Uniunea Generală a Sindicatelor din România) and a proliferation of new trade unions. It became common to have several trade unions with diverging orientations in the same company, but this was often thought to have negative effects, in that: i) in order to attract members, unions made promises which were hard to achieve within a fragile economic environment, at the expense of a real and efficient participation in solving enterprises' problems; and ii) negotiations and conflicts were largely oriented towards the government, so the development of dialogue within companies was retarded and the emergence of employers' organisations was hindered.

The second stage began with the introduction of the Trade Unions Law in 1991 (Law No. 54/1991), which acted as an incentive to strengthen the process of unifying trade unions into federations and confederations. A stronger participation of trade unions in decision-

[24] The term refers to state-owned enterprises organised as public utilities.

making process in general also occurred, including on matters of major importance for the future of the economy and society as a whole.

The present stage, according to some observers, can be denoted as a crisis in the trade union movement, especially when compared to its previous patterns. This involves a decline in union membership, due to a a greater willingness among workers to give up trade union membership and to some legal restrictions making setting up and expanding trade union organisations difficult, particularly with respect to small and medium-sized enterprises (a minimum of 15 people is required to set up an enterprise-level union). These tendencies are inevitably exerting strong pressures on trade union confederations to change their strategies The prevailing wage-oriented negotiations have begun to shift towards other economic and social problems –minimising the effects of job losses; achieving stable incomes supported by productivity; improving the quality of working life; and improving social protection for the most vulnerable groups. In this respect, turning union activists into professional staff has became an important part of trade unions' work and programmes.

At present, five trade union confederations meet the representativeness criteria at the national level[25]. According to the results of a project coordinated by the International Labour Organisation (ILO), in partnership with four representative union confederations – CNSLR-Frăția, BNS, Cartel Alfa and CSDR – the Romanian unionisation rate now stands at only 44%, compared with 80% at the beginning of the 1990s (these findings are based on a survey conducted among 1,293 people in December 2001-February 2002). In sectoral terms the highest density rates are found in mining (85%), heavy industry (83%), oil, gas and chemicals (76%), while in trade, tourism, public services and forestry the decline of union presence has been quite sharp (to below 40%). As the private sector becomes dominant, a steady fall in union density and the stabilisation of the unionisation rate at lower levels have proved to be the rule.

In conlcusion, the Romanin system of industrial relations appears to be conducive to wage flexibility. The decentralised and uncoordinated nature of the collective bargaining means that wages can adjust readily to condistions across sectors and regions.

Minimum wage

Minimum wage can reduce flexibility of the labour market if it imposes an “inappropriate going rate” for wages in general and if wage floors are set above market clearing level. Employers will not find it worth hiring workers whose productivity fails to match the rising costs they generate.

[25] These are the National Confederation of Free Trade Unions of Romania 'Brotherhood' (Confederația Națională a Sindicatelor Libere din România Frăția, CNSLR Frăția); the National Trade Unions Bloc (Blocul Național Sindical, BNS); the Democratic Trade Union Confederation of Romania (Confederația Sindicatelor Democratice din România, CSDR); Cartel Alfa; and Meridian.

The minimum wage was regulated for the first time by Law no.14/08.02.1991. Each year a guaranteed national gross minimum wage is fixed by government decision, following consultation with trade unions and employers' organisations. Employers cannot negotiate and set basic wages below the national gross minimum wage and must guarantee the payment of a monthly gross wage at least equal to the national gross minimum basic wage. The minimum wage provisions are applied to all employees.

In the period 1991-2005 minimum wage was modified 32 times. In recent years, however, the minimum wage defined by government decision was different from the amount negotiated by the social partners. The year 2007 is the third year for Romania to have two simultaneous national gross minimum wage levels. For instance, for 2006, the government-defined minimum wage was RON 330 (€94), and the minimum wage negotiated through the collective agreement was RON 370 (€109). In 2007 the government issued a decision setting the level of the national gross minimum monthly wage, for a full-time employee working 170 hours a month, at RON 390 (about €115 as at 12 February 2007) and the national collective agreement set the gross minimum monthly wage resulting from collective bargaining at RON 440 (€130).

According to Eurostat data on minimum wages in 2006, the minimum wage in Romania was 14.4 times lower than in Ireland, 5.7 times lower than in Slovakia, 3.1 times lower than in Estonia, 2.9 times lower than in the Czech Republic and 2.6–2.7 times lower than in Poland and Hungary. Based on the same Eurostat data, from 2003 to 2006, the minimum wage increased by 23% in Romania, compared with a rise of 39% in Estonia, 38% in Slovakia, 31% in the Czech Republic and 20% in Spain. In comparison with the average national trend of labour productivity in terms of gross domestic product (GDP) per employee, for the non-agricultural sectors during the last decade 1996–2006, the level of annual productivity per worker was five times higher, while the net monthly minimum wage increased by about 3.5 times the previous amount.

Romania's government and trade unions agreed on 13.11.2007 to a 28 percent rise in the minimum monthly wage to 500 lei ($212) after prolonged negotiations. Romania has seen double-digit wage rises in the last two years, as the European Union newcomer struggles to catch up with the wealthy bloc's living standards, now at a third of EU's average in terms of gross domestic product per capita.

High minimum wages have been found to have negative effects on employment. In case of Romania this seems not to be the case. In 2005 Romania belongs to the group of countries for which minimum wages represented between a third of the average monthly gross earnings in industry and services (together with Estonia, Latvia, Poland and Slovakia).

Table 9

Statutory minimum wages in January 2007

	Euro	PPS	National currency	% of employees receiving the minimum wage, 2005	Minimum wage as % of the average monthly gross earnings in industry and services, 2005
Belgium	1 259	1 203	1259	:	:
Bulgaria	92	216	180	16.0	50
Czech Republic	288	465	8 000	2.0	39
Estonia	230	362	3 600	4.8	33
Greece**	668	768	668	:	:
Spain	666	724	666	0.8	40
France	1 254	1 150	1 254	16.8	:
Ireland	1 403	1 141	1 403	3.3	52
Latvia	172	310	120	12.0	34
Lithuania	174	324	600	10.3	38
Luxembourg	1 570	1 503	1 570	11.0	51
Hungary	258	423	65 500	8.0	38
Malta	585	805	251	1.5	51
Netherlands	1 301	1 244	1 301	2.2	46
Poland	246	389	936	2.9	34
Portugal	470	546	470	4.7	41
Romania	114	204	390	9.7	33
Slovenia	522	701	522	2.8	46
Slovakia	217	351	7 600	1.7	34
United Kingdom	1 361	1 292	916	1.8	37
Turkey	298	498	563	:	:
USA	676	779	893	1.3	32

Source: Eurostat, Statistics in Focus, Population and social conditions, 71/2007

Notes: As figures refer to statutory minimum wages applicable on 1 January, the average exchange rate for December 2006 has been used to convert to euros. The figures for Greece refer to the minimum wage for non-manual workers. A different rate applies to manual workers. Data refer to July 2006

4. Labour Adjustment Mechanisms

4.1. Wage dynamics

This section looks at the curent use of several forms of labour adjustment in Romania that have been most often used by other countries. In most markets the prices are the main factor enabling the market to function effectively. The labour market is not an exception with the wage levels being a major determinant of labour supply and demand.

The relative wage flexibility have to be sufficiently high to provide the necessary incentives for the labour to move out from the contracting industries into expanding ones. Real wage flexibility describes the degree to which the real wage responses to unemployment or to various economic shocks. The real wage can adjust through changes in the price level or

through changes in the nominal wage. The decentralised wage negotation system in Romania creates a considerable scope for variations in wage settlements in order to reflect particular conditions among individual sectors and regions. In addition wages are adjusted annualy providing a scope for relatively high nominal wage flexibility. The bonus component of wages has also allowed private sector to adjust wages to changing economic conditions. The institutional framework is conducive to relative and real wage flexibility in Romania but how much flexible are the wages in practice?

As it was mentioned in section 2 unlike other CEE countries the output contraction during the transition to a market economy in Romania had not been accompanied by the porportional decline in employment. While in the period 1989-1994 the output drop by 21%, employment fell down by only 9% - the smallest decline registered among transition countries. Wages took over the responsibility for adjustment and declined by 37% in the same period. Romania's strategy of preserving employment in the period 1989-1994 shifted to the average wage preserve strategy in the period 1995-2001. Despite the restrictive wage policy imposed mainly on Regies Autonomies the wages are still higher in the sectors caharcterised by monopol position in the market and little economic restriucturing. Coal mining, pterroleum extraction, energy sectors reported wages that are higher by 50% than the national average wage in 2006. Wages are also high in public administration[26] unlike the ones in trade services and hotels-restaurants that reported the lowest wages in recent years. In sum, Romanian labour market needs greater relative wage flexibility in order to stimulate the redemployment from declining low-productivity to expanding high productivity sectors. In addition there is a room for improving the wage setting mechanisim at enterprise level towards better reflection of productivity level in the earnings level.

Relative wages can also help in adjusting to shift in demand for, or the supply of, highly skilled jobs. In the case of excess demand for skilled workers or an excess supply of unskilled workers flexible economies shoud display increasing relative wages for skilled workers. Evidence suggests that in Romania returns to education have increased over the last 15 years as a response to rise in the deamnd for skilled labour. Arandarenko et.al (2006) using data from household budget survey 2003 find that in Romania the male university degree holders earn with 60.2% more than those with the lowest education do.

There is emerging information that the level of real wage flexibility has improved and that the wage dynamics have better reflected labour productivity at macro level in Romania. However, a more rigorous econometric test on the real wage flexibility is still needed. Currently an upward pressure on wages, an unavoidable effect of the steadily falling unemployment rate, have been observed. According to some estimates, more then two

[26] For 2007, the healthcare and education sectors have been granted an increase in wages of 20%–24% from the state budget.

million Romanians work abroad, mostly in EU member countries. Labour shortages are getting more pronounced especially in certain sectors such as construction. The rise in wages would be felt in both the private and public sector too. Should that happen, unintended negative effects could emerge. Rising wages, if unaccompanied by adequate productivity gains, will cause inflation to creep up again and lead to larger, menacing, external deficit.

4.2. Geographical mobility

Wage flexibility is not the only one adjusting mechnism operating in the labour market. The adjustment may take place through the reallocation of labour force between different sectors, regions and occupations. Geographical labour mobility refers to the ability of workers to move within and beetwin the regions. It is well know that geographical labour mobility has been low in all transition economies and it is also likely to remain low due to the variety of cultural and economic reasons. Romania is not an excetion in this respect. According to the sttaistical data from LFS annual net mobility flows between counties have never exceeded 0.5% in last 15 years. Commuting appears to be an increasingly popular form of labour mobility in Romania. Ability of workforce to move between regions is considered to be an important adjusment mechanism to relative shocks in the commonly currency area[27]. The importance of geographical mobility however depends also on the ability of other forms of labour adgustment to function and to improve the labour market functioning. For example high relative wage flexibility, wider use of non-standard forms of employment and high functional flexibility (the ability of the work force to acquire and apply new skills) may reduce the need for geographical mobility.

4.3. Functional mobility (the ability of the work force to acquire and apply new skills)

The ability fo workers to acquire new skills in response to technological changes ensures flexibility in the labour market and therefore is becoming increasingly important in a knowledge-based economy and a global marketplace. Romania reports a very low rate of particpation in life long learning of the in the 15-64 age group – 1.6% in 2005 accroding to the LFS data. As a response to the challenge the Government Convergance Program 2006-2009 sets a priority of modernising the national education system and public employment services. The national Reform Program includes a set of measures aimed at developing skills for digital economy, encouraging employment mobility and participating in initial and lifelong learning.

Skills imbalances remain in particular regarding to the low level of intermediate skills and correspondigly high number of persons with low skills.

[27] The work of Blanchard and Katz (1992) is most often cited as evidence that for monetary unions to be successful the labour has to be mobile.

Eghbal (2007) points out that currently Romania is facing labour shortages in a number of sectors due to the combined effects of the country's economic boom and mass emigration[28]. While migration keeps unemployment low and remittances high, shortages in the labour market cause economic losses and create wage pressures for businesses[29]. Moreover, the migration of Romania's labour force concerns mainly skilled white and blue collar workers. The labour market is lacking staff in the healthcare, agricultural and construction sectors.

5. Conclusions

This study has disscussed the flexibility of Romanian labour market, perceived in a broad view as a capability of the market to adjust to the changing economic conditions. The topic of labour market flexibility takes increasing importance in the perspecetive of the challenges that future Romanian membership in the EMU can trigger. The paper looked at the institutional environment including employment protection legislation, tax-benefit system, policies towards labour market, wage setting and collective bargaining and at various mechanisms by which the labour market can adjust to shocks.

The analysis points to the improvement in the functioning of Romanian labour market since 2003. Macroeconomic stability and sustainable economic growth have undoubtedly contributed to these favourable outcomes. However the increased labour market flexibility appears to be another reason for positive developments. Adoption of the new Labour code in 2003 and its subsequent amendments in 2005 and 2006 certainly have made legal regulations of labour market more conducive to the market flexibility. Tax and befit system steps towards ensuring more incentives to enter the labour market and to work longer also have contributed to the improvement of labour market flexibility. The decentralised and uncoordinated nature of the collective bargaining means that wages can adjust readily to conditions across sectors and regions.

Despite the evidence of improvement in the Romanian labour market major challenges still remain. More progress is needed to advance the Lisbon targets of employment, in particular to increase participation rate and reduce the share of informal activities. Overall the EPL has registered improvement in recent years, but compared to other countries there is room for making legal regulations less strict especialy concerning the restrictions on night work, “weekly holiday” work and on the possibility to extend working week to 50 hours in order to response to seasonal production needs. Non-wage costs are also high compared to other transition economies. Analysis shows that current labour regulations are

[28] Since 1989 Romania has lost between 2.0 and 2.5 million of its workforce. Considering Romania's population of 21.6 million in 2006, this is about 10% of the country's population.

[29] A clothing factory in Romania's textile centre Bacau, for example, hired 670 Chinese workers in April 2007 after failing to attract local staff despite offering double the average minimum wage.

not fully conducive to the flexible forms of employment. The non-standard forms of employment will increase their share if the easing of legal regulations is accompanied by policies aimed at making part-time lobs more attractive for both employers and employees. Overall, evidence suggests that tax and benefit reforms introduced since 2003 have improved flexibility of the labour market in Romania. However the tax wedge is still among the highest in the region and across Europe. Therefore continued tax and benefit reform presents a serious challenge for the Romanian economy. Moreover Romania is facing increasing financial pressure on the pension and social safety net generated by the negative demographic trends and high emigration.

Several key findings stemmed out from the analysis that can serve as benchmarks in the study of flexibility of the labour markets in the Western Balkan countries:

- we support the view that the practical importance of geographical mobility, while a relevant factor, has been overestimated in the literature devoted to the monetary unions in general and on EMU in particular. Wage flexibility, flexible working arrangements and ability of workers to acquire and apply new skills can compensate for the low level of geographical mobility and allow labour markets to function effectively.
- while institutional environment conducive to labour market flexibility is crucial condition for economy's ability to respond to the economic shocks, the practical implementation and enforcement of legal rules is the one that eventually determines the labour market outcomes. Romanian experience has shown that severance payments may have adverse impact on the pace of economic restructuring and on the incentives of labour market participation. In addition paying more generous severance benefits to certain groups creates social tensions among general public and hence undermines support to the reforms.
- The view that jobless economic growth is due to the rigid character of labour markets in transition countries can be questioned. We support the hypothesis that tight fiscal policy may actually imporve the labour market performance rather than being detrimental to job creation. Boeri and Garibaldi (2006) find that loose fiscal policies weaken the confidence of investors and crowd-out private employment through generous rises in the wages of civil servants.

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Albania

1. Introduction

The introduction of market principles to the allocation of labour has had positive results on productivity but was accompanied by negative side effects, of which unemployment was the most important (Mickiewicz, 2005). As unemployment increased throughout transition countries during the 1990s, an increase in rural households' self-employment in farming became widespread (Rizov and Swinnen, 2004; Voicu, 2002; Clunies-Ross and Sudar, 1997). This could mostly be the case for Albania, where the agriculture sector employs more than half the labour force and is characterized by labour hoarding. Therefore, the official double-digit unemployment rates reported for certain transition economies are thought to underestimate actual unemployment. Hence, during this presentation, we should be aware that measured employment and unemployment rates are quite sensitive to definition, particularly the treatment of household production (subsistence agriculture), unpaid family helpers, and discouraged workers, though part-time work is still relatively unimportant in most CEEEs (Brown et al., 2006). Taking these into account, we make use of several indicators and explain the degree of labour market flexibility and labour mobility geographically and across regions in Albania.

On the other hand, since there is a sizeable informal sector and relatively weak enforcement of job search rules for beneficiaries in the TEs (Boeri et al., 1998; Schneider, 2006), official figures could be an overestimation of the actual unemployment rate. Dimova et al. (2005) find that during the rapid downsizing of the public sector, the informal sector expanded more rapidly than the formal private sector in Bulgaria and in many other transition countries as well. Schneider (2006) also records a rapid development of the underground economy during transition, which he estimates to be about 35% of the GDP on average for the SEEEs, about 25% in the Central Europe and higher than 45% in the CIS countries. However, assuming that not all the unemployed are registered especially when unemployment benefits are modest, as was generally the case after the first stage of transition (Bruno, 2006), then despite widespread informal activities, registered unemployment may still be an underestimation. Notwithstanding these uncertainties, unemployment rates still remain relatively high in the TEs when compared to the EU15, and are accompanied by especially long durations of unemployment.

As a matter of arithmetic, a high unemployment rate may be the result of either a high inflow or a low outflow, in the later case implying a high average duration of unemployment (Blanchard, 2006). Given the low rate of job creation, the long-term unemployed in TEs have found it difficult to exit unemployment into employment (Svejnar, 1999). This negative duration dependence may be typically attributed to longer spells of unemployment

reducing the effective human capital of the unemployed and their motivation. The long-term rate of unemployment in TEs, the proportion of the unemployed who have been out of work for more than one year, is generally around 40-60 percent (Rutkowski, 2006; Schiff et al., 2006), and as we show further, even higher in Albania.

In Section 2 of this presentation, we illustrate the general path of output and employment in Albania. In Section 3, we emphasize potentiality of Albanian labour supply and use main indicators to highlight characteristics of the labour market. In order to capture its flexibility to adjust to the transitory shocks, we perform alternative measures in Section 4. Poor labour reallocation and job creation indicate for the labour market rigidity are further explained in this Section. Section 5 presents institutions that regulate the emerging market of human capital in Albania. Section 6 concludes by providing general recommendations.

2. General characteristics of output and labour market in Albania

2.1 Output and employment

As was generally expected, transition started with a recession caused by restrictive macroeconomic policies and the restructuring of the economy required by the shift to a market economy (Fischer et al., 1996). An additional cause was the adverse initial conditions, particularly trade dependency and initial over-industrialisation (Blanchard, 1997a). Hence, all the transition economies experienced a fall in output at the start of the 1990s.

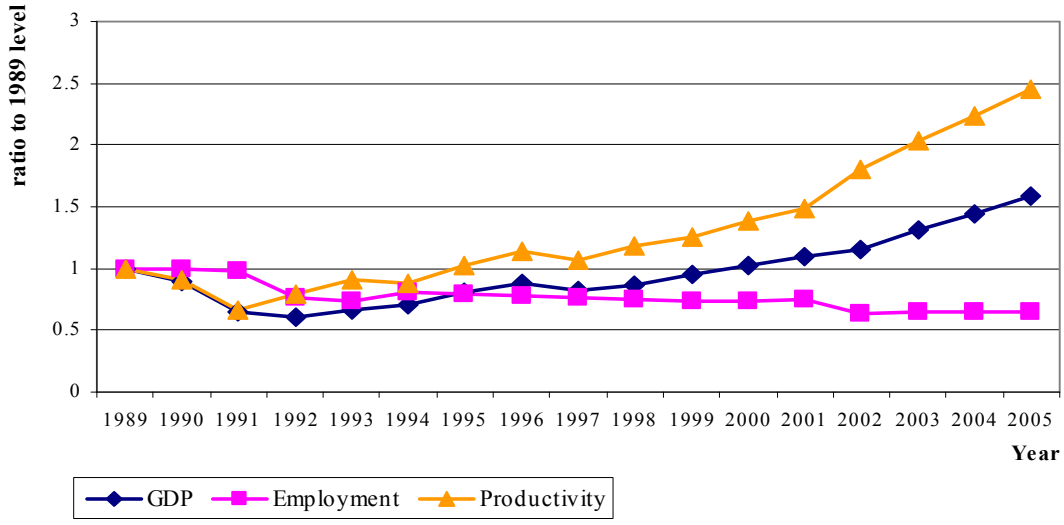
Figure 1 demonstrates the evolution of Albanian GDP (measured at 1999 constant prices), employment and productivity, as a ratio of each of these measures to their value in 1989. We find the U-shaped pattern of the GDP and productivity evolution and an L-shaped pattern of employment as found in other non-CIS transition economies in Blanchard (1997). Albania has suffered a drastic output collapse in the early transition; GDP declined to 60 percent of its 1989 level by 1992. However, despite the subsequent growth experienced during recent years, compared to other countries the Albanian economy has a lower level of GDP per capita than its SEE neighbours and other CEE countries. Moreover, recent GDP growth has been partly fuelled by inflows of emigrants' remittances and foreign aid, which are only likely to be temporary phenomena (BoA, 2007). Figure 1 shows that an initial decline in GDP and employment was followed by a recovery of the GDP from 1992. This increase in production was associated with falling employment and by 2005 employment in Albania was at almost half its 1989 level.

Although labour productivity is merely the ratio of aggregate production to total employment, the behaviour of this ratio can be misleading as GDP and employment growth in industry and agriculture follow opposite paths. The growth in productivity, whenever its pattern does not closely converges to that of GDP growth, may be more a

reflection of employment trends. Direct measures of productivity, rather than just a mere ratio of aggregate output with the employment level, are not available, and we cannot compare this productivity level to that in other TEs. However, comparative estimates assembled by the World Bank (2006b) indicate that Albania's net wage (in Euros, public sector only) was 73.5 percent of the (unweighted) regional mean in 2004. This reflects the relative low levels of productivity that characterise Albania.

Figure 1

The Evolution of GDP, aggregate employment and productivity



Source: Refer to Table A1 in the Appendix.

Judging from the employment and production share of an economic sector to the aggregate level, productivity growth in Albania has been concentrated in the two most developing sectors: construction and services (Table A2 and A3). However, despite the growth in Albanian GDP and productivity we are concerned that the small stock and low generation of high productivity jobs is unlikely to sustain this trend. This may be related to the predominance of employment in the low productivity agricultural sector and the inadequate quality of labour supply to meet the potential demand for labour in an increasingly competitive market economy. Participation in upper secondary schooling is relatively low (less than 60% of the upper secondary age group children currently attend school according to the Ministry of Education) and the training programmes are almost absent.

As can be observed in Table A1, output in agriculture has decreased as a percentage of total output, though employment in this sector has been broadly constant[30]. Whereas,

[30] This relates to the privatisation of the agricultural cooperatives in early 1990s and to the more than half of the population living in rural areas by that time. The poor productivity is partly due to very small, by European standards, individual holdings averaging about 1.5 hectares (Hashi and Xhillari, 1999).

construction and services demonstrate relative high productivity levels compared to agriculture and heavy industry, contributing much higher shares in the GDP relative to their smaller share of total employment (Table A2).

Table 1

Output and employment shares across economic sectors

	Agriculture[1)]		Industry[2)]		Construction		Services[3)]	
	1996	2004	1996	2004	1996	2004	1996	2004
Employment	70.3	58.6	7.6	8.1	2.0	5.6	9.4	12.5
Output	36.1	21.9	9.7	8.7	5	14.7	32.6	32.1

1) Agriculture, forestry and fishery. – 2) Extracting, manufacturing, electrical power and water industry, heavy industry. – 3) Trade, hotels & restaurants, transport, post & telecommunications, for 2003.

Source: Bank of Albania (2006), INSTAT (2000-2006), own calculations.

Recognising transition challenges of the emerging labour market in Albania, in the following we assess its main key features. First, we highlight the potentiality of Albanian labour supply due to the relatively young demographic structure as compared to other countries of the region.

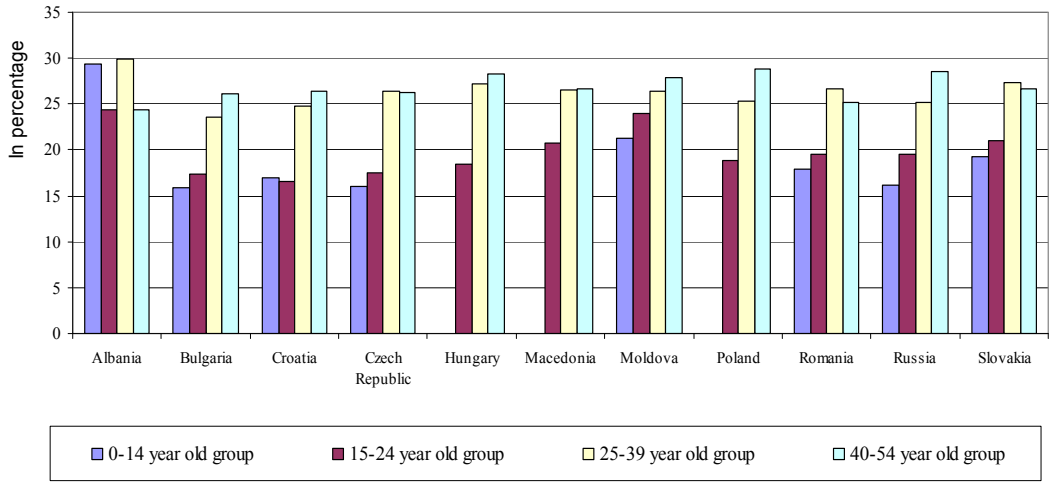
2.2 Demographic structure in Albania

A comprehensive analysis of the Albanian labour market and its human capital problems requires recognition of the country's demographic structure. The proportion of young people of up to 14 years old in the total population is higher in Albania than in other TE countries, excluding countries of the Commonwealth of Independent States (CIS) (Figure 2). Moreover, there is also a larger share of the younger groups (15-24 and 25-39) in the working age population. The Albanian young of 20 to 24 years old have slightly higher activity rates as compared to their cohorts elsewhere in the TEs (Figure 3).

Despite significant emigration, Albania's population is growing at a faster pace than in most countries in the region, adding pressure on the labour market. As of 2001, the total fertility rates in most of the CEE and SEE countries were less than 1.5 (Daróczi (2005), compared with about 2 children per woman in Albania (Muça et al., 2004). Population growth during 1997-2005 has been higher in Albania than in the SEE (IMF, 2006b), while IMF (2004) has estimated a "moderately ageing" stage of the demographic transition for Albania against a "rapidly ageing" stage for the remaining SEE and CEE countries. Given such a young demographic structure, the labour market challenges and the importance of human capital formation are more pronounced for Albania, and population trends indicate that they will remain so for the immediate future.

Figure 2

Percentage share of various age groups in the population of selected CEE countries

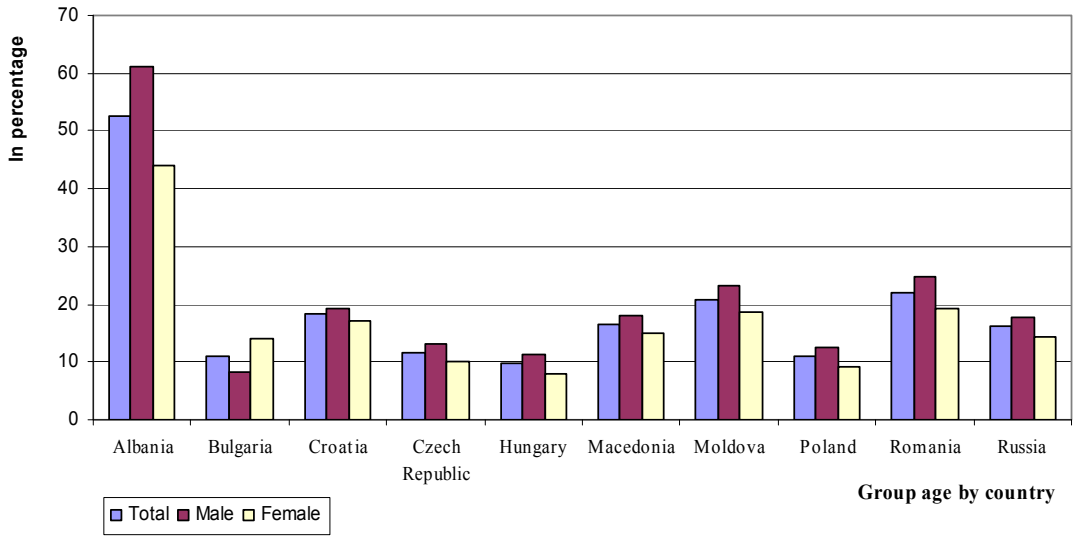


Note: 0-14 year-old age group as a share of total population; Other age groups are calculated as a share of population over 15 years old.

Source: Own calculations from Laborsta (2006). The data for each country are for: 2000 (Bulgaria), 2001 (Albania, Croatia, the Czech Republic, Hungary, Poland, Romania, Slovakia), and 2002 (Macedonia, Moldova, Russia).

Figure 3

Activity rate of 15-19 year olds in selected TEs (in 2001)



Source: Labousta (2006)

2.3 General trends of the labour market

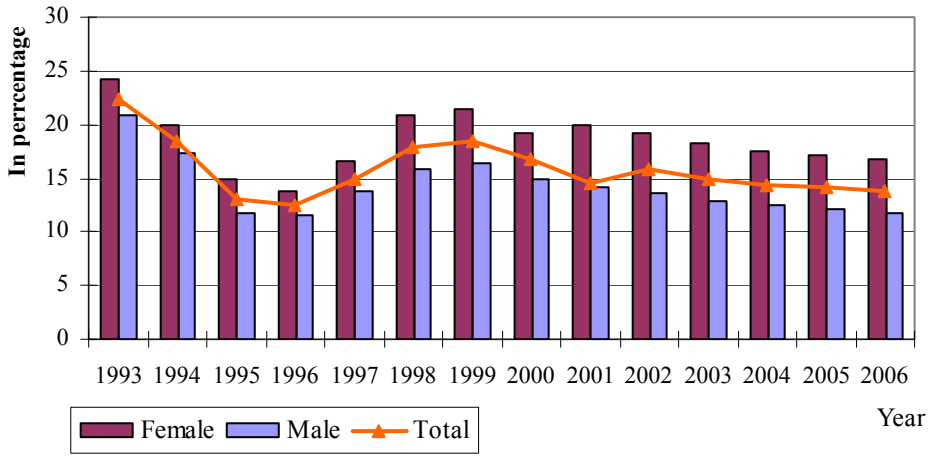
Though unemployment rate has been slightly declining during the recent years, it continues to be above the 10 percent level. However, as will be explored in the following section, its relatively low rate compared to other countries of SEE hides the true nature of the Albanian depressed labour market. Unemployment in Albania, notwithstanding the

outflow to inactivity, is of very long average duration, reflecting its stagnant labour market. During the whole period from the emergence of the high unemployment rates, the long-term unemployed have constituted more than 80 percent of total unemployment (even more than 90% after 2000) (INSTAT, 2000-2007).

There is evidence of significant segregation by gender in the Albanian labour markets. Firstly, the gap between male and female participation rates in the labour market is among the highest in the TEs. Secondly, for those of working age, male employment rates have been about twenty points higher than those for females (60% versus 40% in 2006) (Table 2). Thirdly, women suffer higher unemployment rates (17%) compared to men (12% in 2006; INSTAT, 2007) (Figure 4). However, in the long-term unemployment pool, men made up the majority in 2005 (INSTAT, 2000-2006). Regarding gender differentials in the occupational structure of the economy, this is a challenging task to investigate since data exist only for the public sector which employs almost half the non-agricultural employees. According to data available from INSTAT (2002-2007), more than half of the employed in the public sector are males, and they occupy two thirds of the higher level job positions and more than 60 percent blue collar jobs in the public sector.

Figure 4

Unemployment rate by gender



Source: INSTAT (2000-2007)

In Albania, periodic data on the educational attainment of the labour force, employed and unemployed are not available. However, information from LSMS (2002) suggest that employment rates are significantly higher for those with a tertiary diploma than for those with lower levels of formal qualification. Moreover, there is a larger proportion of tertiary educated in the public sector jobs as compared to workers with other levels of qualification (Table 3). However, those workers whose highest level of schooling was upper secondary have the highest unemployment rate. According to LSMS (2002), young adults of 15 to 24

years old who have completed upper secondary school suffer higher unemployment rates (34.1 and 42.8 respectively for females and males) than those who only completed compulsory schooling (24.8 and 25.1 respectively for females and males) (INSTAT, 2006b). However, this could partly be due to the greater likelihood of the latter being employed in the agricultural sector.

In the following section we investigate labour market adjustments in Albania to the relatively low employment rates during transition.

Table 2

Labour market indicators during transition

Indicator	Category	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Female	24.2	19.9	15.0	13.7	16.6	20.9	21.4	19.3	19.9	19.1	18.2	17.5	17.2	16.8
Unemployment rate	Male	20.9	17.3	11.7	11.5	13.9	15.8	16.4	15.0	14.2	13.6	12.9	12.4	12.1	11.8
	Total	22.3	18.4	13.1	12.4	14.9	17.8	18.4	16.8	14.5	15.8	15	14.4	14.1	13.8
	Female	50.6	55	50.2	47.9	45.0	43.0	42.0	44.1	39.6	39.7	38.2	38.3	38.5	38.1
Employment rate	Male	67.9	74.8	74.7	72.6	74.0	71.0	69.0	66.0	64.0	63.9	61.4	60.1	51.4	58.8
	Total	59.3	65	62.5	60.3	59.0	57.0	56.0	55.1	52.1	52.1	50.1	49.4	45.6	48.7
	Female	66.9	68.7	59.1	55.5	54.3	54.8	53.9	54.6	49.4	49.1	46.7	46.4	44	43.6
Activity rate	Male	85.9	90.4	84.6	82.1	85.6	85.0	82.7	77.7	74.6	74.0	70.5	68.6	63.8	63.4
	Total	76.4	79.7	71.9	68.9	69.9	69.9	68.3	66.2	62.3	61.8	58.9	57.7	54.2	53.7

Source: INSTAT (2000-2007)

Table 3

Educational attainment of those employed in the Albanian public sector (total number and in percentage)

Educational attainment of employed	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2004	2005	2006
Tertiary	93389	89156	79731	74045	59340	58507	56804	66530	68762	69000	68000	68781	67722
In percentage	24.9	28.9	28.9	31	26.2	27.5	28.2	34.8	36.4	37.1	38.6	39.3	40.1
Upper secondary	180394	148040	136012	117992	116983	108715	102728	94501	94410	93000	87000	85057	81600
In percentage	48.1	48.1	49.3	49.4	51.7	51.1	51	49.4	50	50	49.4	48.6	48.3
Tertiary+Upper Secondary	273783	237196	215743	192037	176323	167222	159532	161031	163172	162000	155000	153838	149322
In percentage	72.9	77	78.2	80.4	77.9	78.6	79.2	84.2	86.4	87.1	88.1	87.9	88.4

Source: INSTAT (2000-2007).

3. Assessing the adjustment capacity of the Albanian labour market

Statistical data concerning the unemployment rate pertain to registered unemployed since Albania does not conduct labour force surveys. Registered unemployment in Albania may not be an appropriate measure of real unemployment due to the high rate of hidden unemployment in agriculture, the importance of emigration and relatively large informal economy as explained below, and the significant number of jobless people who failed to register. In this section we introduce some alternative labour market indicators with the purpose of understanding the nature of its adjustment process during transition and explain the degree of labour market reallocation in Albania during transition.

3.1 Alternative labour market indicators

The question rises whether the unemployment rate is in fact a good indicator of the general state of the labour market in transition countries. Faced with poor employment prospects, people may decide not to join or remain in the labour force, e.g. students may decide to stay longer at the university[31], others may prematurely withdraw from the workforce as 'discouraged workers' or early retirees. These decisions will show up, as will be explained below, as lower participation rates not as higher unemployment rates.

Non-employment

Since out of the labour force affects the real unemployment rate, economists sometimes focus on the non-employment rate (Blanchard, 1997b). In order to provide an alternative view of the labour market, we have calculated this indicator for Albania in Table 4. It is interesting to note how the trends in the unemployment rate diverge from the non-employment rates, which is suggestive of a continuously increasing share of inactivity in Albania. Hence, the moderate decrease of unemployment is more a result of higher non-participation than increased employment. The big jump in the Albanian non-employment rate after 2001 may be attributed to changing measurement methodologies and techniques from the Institute of Statistics after the Population Census 2001 and the Living Standard Measurement Survey of 2002[32].

Non- participation:

Although in the early transition enterprises laid-off labour, measured unemployment rates did not fully reflect the level of initial labour hoarding (Mickiewicz, 2005), as labour was

[31] Indeed, enrolment rates in universities have significantly increased in face of low upper secondary enrolment rates. Those who do not complete the latter may join the labour market in the agriculture sector or informal economy.

[32] The main changes between the labour market indicators before and after 2000 result from taking into consideration a different figure for the labour market in agriculture. The Registration of Population and Houses in 2001 has reported a distinctly different population structure and residence from that previously assumed. The estimated urban and rural population ratios in 2001 changed from 39.8% and 60.2% to 42.2% and 57.8% respectively. As a result, after 2001 the number of those estimated to be employed in agriculture fell from 761,000 to only 526,000, a big reduction from the previous year.

reallocated, either to the new emerging sectors or to non-participation. The decline in participation which cushioned the impact of the crisis in unemployment in TEs, was achieved via a number of avenues, including exit from the market by discouraged job seekers; early retirement; entrance onto disability registers; participation in subsistence farming and other informal activities; and increased participation in post-compulsory education (Nešporová, 2002, Polanec, 2004; Schiff et al., 2006). Hence, some of these outflows represent a positive phenomena resulting from adjustment to the new market conditions, i.e., a natural adjustment in activity rates consistent with preferences, following the dismantling of the command economy system.

Table 4

Non-employment rates (non-employed from the working age pool as a percentage of the number of working age population)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Albania	37	40	41	43	44	45	40	48	49	50	50	54

Source: INSTAT (2000-2007).

The activity rates in CEECs at the beginning of transition process were much higher than those in economies with a similar level of income per capita in different parts of the world (Mickiewicz, 2005; Rutkowski, 2006; Schiff et al., 2006). However, as Bruno (2006) observes, in general TEs now suffer from having to support too high a proportion of the non-productive population, i.e. too many people of working age are out of the labour force. In Albania the overall dependency ratio (ratio of 0-14 and 60+ population to 15-59 population) is the highest among the TEs (excluding the CIS) due also to its young population structure (TransMONEE, 2006). Moreover, activity rates have been continuously falling up to slightly above 50 percent of working age population in 2006 (Table 2). The large decline in participation rate may be due, to some extent, to the fact that these rates were unusually high in centrally planned economies.

Geographical mobility of labour

Apart from high aggregate unemployment, the transition countries have suffered from large regional disparities in unemployment (Kállai and Traistaru, 1998; Nešporová, 2002; Bornhorst and Commander, 2004; Cazes and Nešporová, 2004; Schiff et al., 2006; Rutkowski, 2006), which have generally been highly stable during transition (Huber, 2006). Structural shocks have contributed to these differences, with rural areas, and predominantly mining and armament districts suffering higher unemployment. According to Boeri et al. (1998), up to 40% of unemployment in the first stage of transition was structural in that its elimination would require increased regional mobility on the part of workers and/or enterprises.

As Huber (2006) explains, the regional mismatch of workers and work opportunities may be a cause of high and persistent unemployment in some countries. Moreover, high and persistent regional disparities may have political repercussions which go beyond narrow economic analysis and weaken social, and sometimes national, cohesion. These regional disparities in transition countries in all likelihood reflect long-term influences on regional development and are unlikely to disappear in the short run. Hence, unemployed workers in areas with depressed labour markets are at high risk of losing their labour market attachment, weakening their motivation to update skills (Schiff et al., 2006).

A special feature of unemployment patterns in Albania is the strong variation across regions. Certain districts have suffered unemployment rates of just above 50 percent (in 2001) while in other districts unemployment is as low as 4 percent (INSTAT, 2000-2007). Table 5 reports the average and limits of unemployment rate across regions for a group of countries and a measurement of the standard deviation of the unemployment rate in various regions within a country. It seems that Albania displays the largest coefficient of variation in regional unemployment rates among the TEs studied. Differences between the regions with the highest and the lowest unemployment rate exceeded a factor of 9 in Albania. These figures suggest that structural shocks have been asymmetric across regions and that geographical capital and labour mobility remain low in these countries. Note, however, that comparisons of the above indicator between countries should be made with caution since the number of districts varies across countries reported in Table 5. There are 36 districts in Albania and less than 8-11 regions in Poland and the Czech Republic. As Bornhhorst and Commander (2004) find, regions exposed to a fall in labour demand do not tend to recover employment quickly. Moreover, differences in starting conditions and market access seem to be the major reasons for persisting regional divergence in transition (Huber, 2006). In Albania, areas with a higher concentration of heavy industry (either mineral extracting or armaments manufacturing) are those with the highest unemployment rates. At least half of the recent internal movements (54%) have been towards Tirana, the capital city, and 17.7 percent to its neighbouring coastal city (Galanxhi et al., 2004).

Table 5

Range of registered unemployment rates across regions (2003)

	Average	Min	Max	Standard deviation
Albania	15.0	3.6	44.0	9.6
Czech Republic	7.5	4.2	14.8	3.01
Hungary	6.3	3.3	11.3	1.96
Poland	20.1	8.5	33.4	5.19
Romania	7.0	5.9	8.6	1.04
Russia*	8.0	1.4	44.0	4.50

Source: Huber (2006), INSTAT (2004), own calculations. (* 2002)

Along with structural changes in Albania a high unemployment has accompanied the transition since 1992. In the domestic labour market population movements are reflected in increasing the labour force in the big cities. However, most of the geographical mobility in the TEs embraced emigration to the western economies labour markets (Schiff et al., 2006). In Albania, emigration has also played a crucial role in labour supply developments. Net external migration was generally higher at the beginning of the transformation process. In 2004 the OECD (2006) estimated that 19 percent of those born in Albania who were over the age of 15 were living abroad, Bulgaria has the next largest emigration rate at 8 percent (Table 6). That meaning part of the population living (and working) abroad at a given time. In this context, emigration has acted as an adjustment mechanism to the increased unemployment and non-participation in the domestic labour markets (Fidrmuc, 2004).

Table 6

Emigration rates in selected TEs (as of 2004)

Country	Of population 15+	Of total population
Albania	19.0	16.7
Bulgaria	8.0	7.5
Hungary	3.6	3.2
Poland	3.9	3.4
Romania	3.6	3.3

Source: OECD (2006)

Box:

Measuring the adjustment mechanism of the Albanian labour market

Although employment rates in Albania fell substantially during transition, its unemployment rate did not really reflect the scarcity of jobs in the labour market. The pattern of changes in the labour force is roughly similar to that of changes in the number of unemployed. Given that the Albanian unemployment rates do not show the degree of non-employment among the working age population, in this section we investigate how the Albanian labour market has adjusted to contracting employment opportunities.

By using Blanchard's (1997a) analysis, we can discover more about Albania's labour force adjustment during transition. We calculate changes in the participation of the working age population and other related indicators of the labour market according to the following:

$$\Delta P = \Delta N + \Delta U + \Delta O, \quad \textbf{(1)}$$

where P is the population of working age, N is employment, U is unemployment and O is non-participation. We initially neglect the role of emigration as an alternative state of the working age population. Considering the ratio $x \equiv \Delta U/ (\Delta P - \Delta N)$, a value of 1 for x indicates that the entire adjustment to the contraction of employment has been through higher unemployment. A value of 0 indicates that the entire adjustment has been through participation. Calculations of this ratio for Albania, where Δ denotes the difference between the value of the variable in a year during transition (beginning with 1992) and its value in 1991, are shown in Table A1. The value of x being close to 1 between 1992-1994 indicates that the adjustment was through unemployment rather than participation, which coincides with the highest rate of unemployment (about 20% or above). The low figures for x-ratio during 1995-1997 indicate that employment decreases in that period were not primarily associated with an increase in the unemployment rate. This suggests outflows from the labour force towards non-participation. However, further declines in employment in 1998-1999 were associated with higher unemployment rates and a slight increase in the x-ratio. Such changing values of x indicate the dynamics of labour market adjustment in Albania: first into unemployment and then out of the labour force, as individuals adjusted their expectations and behaviour to the stagnant labour market. For the period 2000 onwards, there is a much greater adjustment in the form of a reduction in participation.

The values calculated by Blanchard (x = 0.27 for the Czech Republic; 0.66 for the Slovak Republic; 0.85 for Poland; 0.41 for Hungary; 0.75 for Bulgaria) for 1994 and by and Kállai and Traistaru (1998) for Romania (0.51) indicate that the change in employment resulted in proportionately more unemployment in Poland, Bulgaria, and the Slovak Republic, while reductions in participation were relatively more important in the Czech Republic and Hungary during the first stage of transition. In Romania only half of the decline in employment since the beginning of transition is reflected in unemployment growth (Kállai and Traistaru, 1998). However, the pattern of labour market adjustment over time in these TEs is generally not available in the literature, and we cannot tell the way their labour markets adjusted for the whole period from 1990.

We can suggest three main reasons for the behaviour of the x ratio indicator in Albania, related to changes in labour force participation. First, the shock therapy in the first years of transition induced, high unemployment rates. Since this was an unusual state for many of the labour force, time was needed for individuals to adjust to it, hence we have initially a high x-ratio. The lengthening of the average duration of unemployment after 1994 is likely to have triggered some unemployed to become ‘discouraged’ and choose non-participation. Second, until 1994 rather generous social benefits and soft budget constraints to enterprises helped create low incentives for the unemployed to search for a new job. The less generous social benefits after 1994 drove many of these unemployed into non-participation. Third, waves of emigrants in the early 1990s may have not been accurately accounted for in the statistics. Temporary emigration has been

included in the calculation of the unemployment (Çuka et al., 2003) and as non-participants later on (Galanxhi et al., 2004). Moreover, emigrants have helped to support an increasing number of households through remittances and hence an increase in non-participation especially amongst women. This analysis however has its limitations in not considering the large grey economy and measurement errors in all of these variables; it also assumes 100% retirement rate above working age, no net inflow of young workers, no emigration and that all the working age population would be willing to work at the given market wage. Most of these assumptions are not appropriate for Albania during this period.

As noted above, Albania has experienced significant permanent emigration during transition. Moreover, Çuka et al. (2003) argue that the temporary emigration has served as a transition buffer to employment flows from the state to the private sector. Here we refer to the value of *x*-ratio in the presence of labour outflows to foreign markets, arguing that a part of the change in the working age population comes about because of emigration. This adds ΔE to our first equation:

$$\Delta P = \Delta N + \Delta U + \Delta O + \Delta E \quad \textbf{(2)}$$

Therefore, we can now calculate the *x* ratio as an indicator of the labour market adjustment to unemployment and emigration simultaneously, $x \equiv (\Delta U + \Delta E) / (\Delta P - \Delta N)$. The last row in Table A1 gives the calculated values, indicating that emigration has to some extent cushioned the increase of non-employment in the Albanian labour market. This is shown by the newly calculated X_E ratio after 1995 being larger than the net emigration value of *X*, suggesting that adjustment to non-participation has been partly absorbed by flows to emigration.

3.2 Labour reallocation

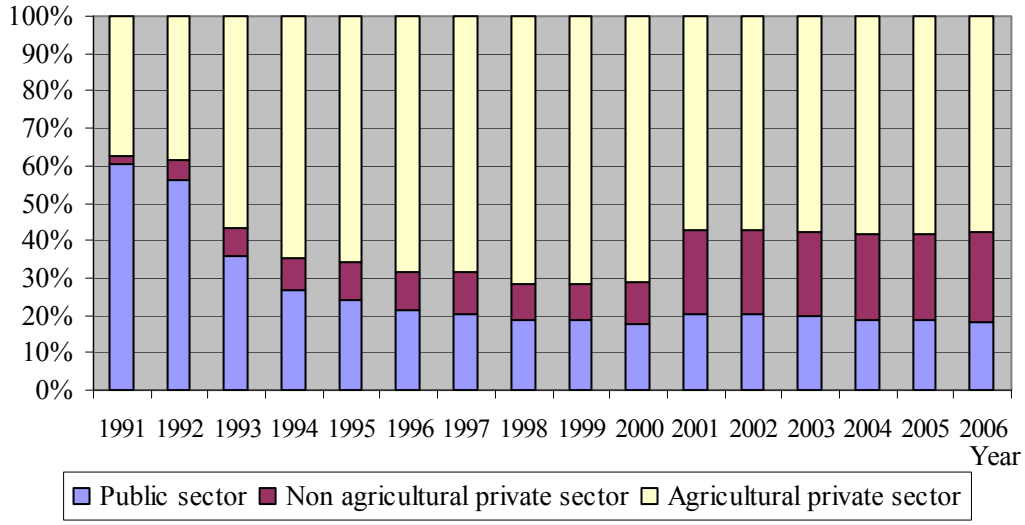
Economic transformation required the TEs to adopt new products and techniques in order to achieve competitiveness in world markets. A process of creative destruction is important in successful labour market development in which there is an on-going reallocation of factors of production from contracting firms and sectors to expanding ones (Caballero and Hammour, 1996). If productive and innovative firms expand and less productive firms downsize, the process of destruction is thought to be overall creative, raising average productivity and contributing to long-term economic growth (Huttunen et al., 2006). In TEs increased job creation in these new sectors remains the only efficient means of suppressing unemployment in the medium to long-term (Mickiewicz, 2005). We investigate these dimensions of transition labour markets, beginning with an analysis of the reallocation from the state to the private sector and emphasise the importance of job creation in Albania in order to overcome the depressed situation of the labour market.

Reallocation from the public to the private sector

The collapse of state firms needs to be accompanied by the creation of new private ones in order to absorb the newly jobless (Blanchard, 1997a; Jurajda and Terrell, 2002). Restructuring has two main consequences: it increases productivity and output but tends to decrease employment, and thus increases unemployment and non-participation (Blanchard 1997a). Throughout early transition in CEECs labour shedding in the state sector was combined with a fragile new private sector, which could not create additional job opportunities immediately (Boeri, 2000). In Albania, the contraction of the public sector led a large increase in the share of agricultural employment and, as illustrated in Figure 5, the slow development of the private non-agriculture sector has continued to constrain its economic growth.

Table 7

Share of employment in public and private (non-agriculture and agriculture) sectors.



Source: INSTAT (2000-2007).

As Nešporová (1999) indicates, although some reallocation of labour did indeed occur in the TEs, the number of newly created jobs was much lower than the number of jobs lost, due both to supply and demand restrictions in the market. Particularly in Albania, the sharp decrease in public sector employment and the slower increase in the non-agricultural private one is indicative of the low level of job creation. The change of employment distribution among the three sectors in 2001, as explained in footnote 3, is largely a statistical anomaly, rather than the indicator of a change in the economic and employment structure.

The size of the sectoral reallocation from the public to the private sectors may be highly correlated with the timing of the privatisation process in all the TEs. In Albania, the privatisation of land of the collective and state farms into about 450 thousand size units

began spontaneously and was completed under official auspices by the end of 1993 (Agaj, 2001). Other substantial privatisation of the larger state enterprises followed up to 1997, whilst privatisation of the largest concerns including banks followed mainly after 2000 (Shehaj, 2006). It was expected though that a growth in the emerging new private sector would increase the speed of restructuring, which would lead to an increased outflow from unemployment to employment and reduced unemployment duration.

Reallocation of labour across industrial sectors

Figure 5 reflects the low labour mobility between the agricultural and non-agricultural sectors, whilst Table A3 reports the poor labour reallocation between non-agricultural sectors. Sectoral reallocation of labour is the process leading to changes in sectoral employment distributions (Žižmond and Novak, 2006) and should facilitate the transition process to a market economy (Lehmann and Walsh, 1999). In the face of massive job destructions during the first stage of transition due to the changing nature of jobs in the TEs (Blanchard and Kremer, 1997), job creation incentives would increase the pace of reallocation (Caballero and Hammour, 1996).

Poirson (2000) highlights the importance of factor reallocation for growth in the low-income countries. The review of the burgeoning literature of the first decade of transition on job and worker flows in Haltiwanger et al. (2003), emphasises that these flows are part of the on-going creative destruction process that is ubiquitous in market economies. However, although the transition labour markets exhibit more dynamic features than the OECD's (Leon and McAdam, 2003), sectoral reallocation in the TEs during the first decade of transition has mostly taken the form of workers flows from state to the private enterprises rather than from unemployment to the private sector (Lehmann and Walsh, 1999) or within rather than between sectors, pointing to less flexible behaviour of employers and workers (Svejnar, 2002b). More generally, the sectoral reallocation in TEs has been associated with job destruction in the traditionally old and job creation in the new sectors. Job destruction arises from the contraction of existing units and company deaths (Barnes and Haskel, 2002). On the other side, generating greater entrepreneurship is likely to produce large net social benefits in terms of greater job creation, which arise from expansion of existing units and births of new firms. In order to examine the extent of these processes in an economy, one needs a data set that is longitudinal, tracks all business units and identifies births and deaths. Since such a dataset does not exist for Albanian firms, we are unable to draw conclusions on the degree of job turnover between the dead and new firms.

Earlier evidence from Lati (2001) indicates that reallocation initially predominantly resulted in more disorganisation rather than a redistribution of the workforce to induce higher productivity. Figure 5 and Table A1 indicate that throughout the transition period, employment in agriculture continued to grow in relative terms in Albania and employment

in industry - particularly manufacturing - continued to decline. Although the majority of new private enterprises were concentrated in trade and services (Gërxhani, 2003), employment share of services in total employment has only slightly increased during the transition period (INSTAT 2000-2007).

Research suggests that since the beginning of transition the degree of job creation and destruction has varied across the CEEE and over time. Bilsen and Konings (1998) and Lehmann and Wadsworth (2000) provide us with a theoretical explanation and empirical examination of job to job movements. Bilsen and Konings (1998) find that there has occurred more within-sector job reallocation than between-sector job reallocation in Hungary, Bulgaria and Romania, although we would have expected the vice-versa to be true in the light of structural changes. Moreover, Jurajda and Terrell (2003) find that job growth within industries is quantitatively more important than job growth due to across-industry reallocation in Estonia and the Czech Republic during the first stage of transition. Whilst in Slovenia, Haltiwanger and Vodopivec (2002) find that most job reallocation is between small firms in the private sector during the same period. However, combining the results of relatively high economic growth in the face of generally stable unemployment rates, a noted finding is that firms in the TEs have been rapidly increasing labour productivity, often without a major net creation of jobs (Svejnar and Münich, 2007).

Nešporová (2002) emphasise that new jobs in the TEs have been mainly created by (i) foreign direct investment through privatization of existing enterprises or (ii) the setting up of new firms (independent, or the subsidiaries of foreign companies). First, the former type of firm is found to display relatively higher productivity than domestic owned enterprises (Peter et al., 2004). However, although increasing, capital flows through the FDIs have been particularly low in Albania during the whole period of transition as compared to other SEE countries (EBRD, 2000; Bank of Albania, 2007; IMF, 2006a). FDI in Albania has been estimated to be only 3.5 percent of the GDP during 2000-2006 (BoA, 2007). The reasons for the foreign investors' hold-up include political instability, lack of a legal framework and of a proper infrastructure.

Second, the most important source of job creation is through the birth of small enterprises. The small enterprise sector experienced explosive growth in the first years of transformation changes in Central and Eastern Europe (Nešporová, 1999) and the small start-up firms were considered the engine of job creation in early transition (Jurajda and Terrell, 2003). As Dutz et al. (2001) point out, entrepreneurship is highly rewarded in the labour market and is more significant in the advanced transition countries of Central Europe. However, many small firms and self-employed persons are locked in low productive activities because their lack of skills and capital prevents their expansion (Nešporová, 2002). Altogether, decreasing employment rates suggest that job creation in the Albanian private sector has been weak. Gërxhani (2003) suggests that only a few of

the new enterprises in Albania could generate a surplus that could be invested in other private businesses and in enlarging the scope of the private sector as a whole, particularly to include capital-intensive sectors. However, data on the labour demand and the death of jobs is lacking to investigate this weakness more fully. Some mere evidence though is available from Muço et al. (2004) analysis, according to which the number of firms that have labour movements, i.e., job-creation or destruction, relative to the total number of firms for the same period is implausibly small.

Alternative to formal employment

It could be that the missing labour market flexibility with regard to sectoral reallocation has affected the Albanian labour market during transition bringing about an informalisation of employment. The main source of statistical information on employment are administrative records of General Directorate of Taxation. Although the time series of data exist from 1994, this register is limited because of under declaration of enterprises in the moment of creation. These may go informal in order to evade taxes, to circumvent regulations and licensing requirements, and preventing inflexibility of the formal labour market. Such a behaviour of agents to improve their welfare during transition in unregulated markets, suggest that falling employment rates in the formal economy has been associated with informality. Tolerated informal labour market activities as a part of a necessary coping strategy at the emerge of transition promoted the seeds of an entrepreneurship culture that are inherent to informal business. Part of the economy relies on the informal sector creating jobs in the retail services and agriculture, with the self-employment as a promising alternative to non-existing wage employment.

Furthermore, the important decline suffered by the female labour force leads one to suspect that a number of women who are inactive in the labour force are actually "discouraged unemployed" people, or that they carry out temporary jobs or activities in the informal economy, which were not declared in the Census (INSTAT 2004). Hence, much employment is informal and unregistered, complicating measurement of the "unemployment rate", though the exact size of the informal labour market is unknown. Schneider (2006) study estimates that the informal economy generates more than 30 percent of Albanian GDP. According to Christie and Holzner (2004), undeclared household income share of GDP is about 30 percent.

The large extent of informal employment (in agriculture or in other sectors) suggests a high degree of precariousness, limited access to social rights (e.g. pensions) and low incomes from labour (as demonstrated by the large number of people in poverty). Although informality is linked to the (lack of) demand for labour it also affects the supply side as informality becomes a lifestyle and people simply get used to being employed informally. A good indication of part of the informal economy that is incorporated in the legal but informal labour market, is the difference between the number of employees that

count for the payment of the social contributions (who are less than) with the number of officially employed. That means that many of those who are formally employed do not pay their dues. For example, until 2002, less than 50 percent of employed paid the payroll tax, although excluding the agricultural sector the figure is less worrisome (refer to Exceel sheet "unemployment benefits" and calculations). With the agricultural sector self-employed included in the payroll schemes by regularly paying the payroll taxes, the share of employed who do not pay has decrease to 12 percent in 2005. Whereas, employer dues are usually paid regularly by state jobs but the same behaviour is not observed in the private sector. Evasion is widespread.

To some extent, these developments and labour flows may have been affected by labour market institutions, the type and implications of which we discuss in the following section.

4. Labour market institutions

4.1 Wages

As the transition process set in, high inflation rates and declining output, followed with a lag by falling employment, resulted in a sharp decline in real wages in almost all the TEs (Jackman, 1994; Rutkowski, 1996; Vaughan-Whitehead, 1998; Svejnar, 2002a; Rutkowski, 2006). Moreover, TEs inherited relatively low levels of real wages and low wage differentials compared with those in the Western Europe economies (Nešporová, 1999).

In Albania, wage levels have been the lowest in Europe before the transition, and the economic crisis of the early 1990s further aggravated this situation (ILO, 2006). Real wages fell by more than 30 percent before 1994 followed by a curb wage increases during the crisis period of 1997, and slightly changing up and down afterwards (INSTAT 2003-2007). However, these trends relate to the public sector wages, since information on wages in the private sector is almost non-existent.

As everywhere else in the TEs, centralized wage controls in Albania were initially intended to produce a decline in real wages, or more particularly of unit labour costs, as a way of counterbalancing the adverse economic developments (Svejnar, 1999, Vaughan-Whitehead, 1998). The economic stabilization programs in the early transition often contained a tax-based income policy operating through two main variants: i) direct control of the overall wage fund of an enterprise; ii) and control of the average wage of the enterprise (Nešporová, 1999 and Vaughan-Whitehead, 1998). Evidence from transition countries suggests that the wage control tax was generally binding whenever private firms wanted to pay higher wages. This policy and the relatively low level of wages in the state sector helped to keep real wages low in the first years of transition.

There is some evidence of a trade-off between unemployment and wage levels, very low wages being used as a substitute for a fall in employment (Vaughan-Whitehead, 1998). Wage regulations by preventing well-performing enterprises from increasing their wages and keeping labour costs at very low levels did partially restrain the growth in unemployment. However these centralised controls have generally prevented the adjustment of wages to the new market forces during early transition (Svejnar, 2002b), and with their abolition the association between wages and productivity would increase.

Wage inequality has been increasing in all the TEs during transition across various dimensions (Rutkowski, 1996; Brainerd, 1998; Boeri and Terrell, 2002; Jurajda and Paligorova, 2006). Regarding wage earnings in different economic sectors, Münich et al. (2000) found that the male inter-industry wage structure changed substantially between 1989 and 1996, with men working in mining and quarrying losing much of their former wage premium, while those in trade, transport and telecommunications, light manufacturing and "other" activities gaining significantly. Newell (2001) also emphasises rising relative wages and employment in the service sector, as well as falling employment and rising wages in the production sector, and in agriculture rapidly declining relative wages. Increased differences are also shown in the form of rising regional wage differentials, with declines in relative wages in the regions where heavy industries were previously concentrated (Kertesi and Köllő, 2003). Moreover, wage and employment premia attached to education, and to a lesser degree to experience, rose sharply in transition (Jurajda, 2005; Münich et al., 2005).

Statistical evidence from Albania is available only for the state sector. Here, economic activities that pay the most are education, transport and manufacturing industry (INSTAT, 2000-2007). The highly educated and managers are paid higher wages. Whilst, another source of increasing wage inequality during transition deriving from a persistent gender wage gap (Jurajda, 2005; Jurajda and Paligorova, 2006), is not statistically available for Albania.

4.2 Labour market policies

Reforms to labour market policies were introduced in all transition economies as part of the initial economic reforms. Income support for people searching for work did not exist prior to the 1990s due to the general absence of open unemployment in planned economies (Micklewright and Nagy, 2005). In the presence of the mass shedding of labour, unemployment benefits were implemented as the first passive labour market policy (PLMP). All countries reformed their labour exchange systems in the early 1990s and started to register the unemployed and offer income support and active labour market programmes (Verme, 2006), providing benefits paid for a period generally ranging from six months up to one year (two years in Hungary) (Nešporová, 1999).

Though these unemployment compensation and social benefit schemes were originally relatively generous in terms of replacement rates, they tended to become more modest over time and there was also a tightening of eligibility for, and reduction in duration of payments (Bruno, 2006).

These later curtailments of benefits increased the opportunity cost of being unemployed (Bruno, 2006) and, given the lack of job creation, the outcome has been a gradual drop in the overall incentive to participate in the labour force. Therefore, as noted above, relatively low registered unemployment figures often reflect the relative value of the income compensation and services on offer to those registering as unemployed rather than the actual labour market status of potential applicants (Verme, 2006; Bruno, 2006).

Given the emergence of massive unemployment after the 1990, the Albanian government initiated the provision of a monthly stipend to the unemployed through the law on unemployment benefits. This was first enacted only in October 1991. Unemployment benefits are funded by the state budget and social security contributions. The proportion of unemployed receiving unemployment benefits has decreased from 35 percent in 1993, to about 7% between 2000 and 2006 (INSTAT, 2002-2007). It is widely recognised that these payments are insufficient. Benefit claims were initially almost equal to the official minimum wage and have sharply fallen after first introduced (after 1993) up to less than 40 per cent of the official minimum wage from 1999 and on.

Recognizing problems in economic aid to poor families when recipients of unemployment benefits were unable to find work after one year with many families remaining without income, economic aid was introduced as a second safety-net of social protection. The monthly allowance paid by economic aid is however low (see Exceel sheet “Family Protection”). The law on social aid and assistance establishes the criteria through which financial aid is made available to needy families. The General Administration of Economic Aid under the Ministry of Labour and Social Affairs is responsible for coordinating assistance through its municipal offices. Local government bodies – municipal and communes councils – decide on aid distribution.

Active labour market policies on the other hand target an improvement in the job prospects of the unemployed (Schiff et al., 2006). Active labour market policies (ALMPs), which according to Boeri et al. (1998) were designed to facilitate the reintegration of identifiable groups who tended to dominate long-term unemployment, were introduced later than the passive policies in TEs and have operated on a much smaller scale than PLMPs. Active measures were recorded in the early 1990s in most central European countries, but only after 1997 in Albania (MoLSA, 2003). While ALMPs represent a potentially important weapon in the fight against unemployment (Martin, 2000), evidence on the size and effectiveness of these policies is mixed for the recent years of transition (Schiff et al., 2006). As Blanchard (2006) remarks, the effect of labour market institutions

is often complex in the sense that a specific targeted labour market policy may affect other areas of the labour market or indeed outcomes outside of it.

4.3 Other regulatory tools

The new Albanian Labour Code for the regulation of the emerging labour market was first approved in 1995, under the Law 7961. It created the legal background for the institutionalisation of tripartite relations through the establishment of a National Labour Council. In November 1996, a tripartite general agreement was concluded for the first time concerning the creation of a tripartite wage committee with the task of reaching agreement on adjustment of the minimum wage. The main tasks of the tripartite wage committee were set to be managing discussions on the issues of: level of minimum payment, public sector wages, real wages in the whole economy, association of wage to the productivity levels in the economy, statistical sources and information for wages negotiations (Vaughan-Whitehead, 1997).

Article 176 of the Labour Code recognizes the rights that employees and employers have to organize in trade unions. In Albania, the two main trade union confederations are the KSSH and the BSPSH. Furthermore, employees are organized in sectoral trade unions. However, the role of trade unions is generally considered to be weak, and having achieved some results only in the public sector agreements. Moreover, official data on the workers adhering to the trade unions is totally absent.

Labour Code also sets the conditions for the collective contracts. According to Article 160, the contracting parties are one or some employers or employers' organizations on one side, and one or some employees' trade unions on the other.

According to Article 148 of the Labour Code, Collective dismissal is the closure of the labour relationship with the initiative of the employer for one or more than one reason that do not relate to the employees, when the number of workers' dismissal within 90 days is not less than 20 regardless of number of workers employed in the enterprise. In case the employer will carry out a collective dismissal, in order to reach an agreement, employer has to consult the trade union representing the employees or even employees themselves in case of absent trade union. Employer has to notify the trade union, and give a copy of the notification to the Ministry of Labour and Social Affairs, all the reasons for the collective dismissal, the number of employees dismissed and the timing for dismissing, the number of the employees to be employed. Annulment of the contract cannot be reached within the 30 days from the handling of the notification from the employer to the competent authorities as described above.

In order for the labour market legislation to approach the EU legislation conditions, the following amendments to the Labour Code have been amended:

- Law no. 9148 of date 30 October 2003, ratifies the protocol of year 2002 of the convent number 155 of the International Labour Organization for the “Safety working conditions, health and job environment, 1981”.
- Law no. 8938 of date 12 September 2002, ratifies the convent number 176 of the International Labour Organization for the “Safety working conditions in mines, 1995”. The safety of job activities in mines is regulated by the Law no. 8741 of 2001.
- In order to regulate the execution of the safety conditions at working place, Law no. 9634 of 30 October 2006 amends the role of the State Inspectorate of Work.

6. Conclusions

Unemployment in Albania has remained high. Moreover, human capital is experiencing difficulties in adjusting to a depressed labour market. Level of employment and job creation is relatively low, and labour reallocation has been sluggish. Apparently there is a scarce demand for skilled human capital and a mismatch of skills would be the outcome of poor labour market flexibility in a competitive regional environment and aspirations to adhere into the EU. We suggest that this is due to a lack of large investments, a relatively large informal market, a lack of efficient state policies on employment, and inefficient labour market institutions. We showed that private non-agricultural sector is concentrated mostly at the services and retail sector, and FDIs have been the lowest in the region. Although the existence of informal economy distorts labour market indicators, low benefits at subsistent level are indicative of the poor prospects of the human capital in Albania.

Albania still does not have a coherent employment policy. Adoption of a strategy aimed at reducing the area of informality in the economy and increase employment is necessary. The establishment of the proper legal and institutional framework accompanied by the appropriate monitoring and enforcement procedures, is the first step to the legal development of the private sector and the whole economy of a country like Albania.

Implementation and evaluation of active labour market measure should be accompanied by a national education strategy in order to identify the demand for labour and design and shape the labour supply. Setting the conditions for providing training at the workplace and performing vocational schools would be more efficient strategies than just the expansion of the tertiary education system. It will also mean improving the quality of the education system in order to attract more young people to education and training.

It is certain though that, without comprehensive statistical information, the knowledge on the Albanian labour market performance is less efficient and any policy recommendations would not be complete.

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Appendix

Table A 1

Main indicators of output and the labour market in Albania during transition

Years	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
GDP[1] at Constant Prices (referring 1990)	18,681	16,813	12,105	11,235	12,309	13,331	15,107	16,478	15,325	16,556	17,765	19151*	20549*	21,515	24506	26981	29679
Percentage change in real term	na	-10	-28	-7.2	9.6	8.3	13.3	9.1	-7	8	3.3	5.9	9.6	13.2	13.9	10.1	10
GDP evolution	1	0.9	0.65	0.6	0.66	0.71	0.81	0.88	0.82	0.87	0.95	1.025	1.1	1.15	1.31	1.44	1.59
Employed[3]	1439	1429	1404	1095	1,046	1,161	1,138	1,116	1,107	1,085	1,065	1,068	1,063	921	926	931	932
Unemployment rate[5]	na	na	8.3	27.9	28.9	19.6	16.9	12.4	14.9	17.8	18	16.86	14.66	15.8	15	14.4	14.1
Employment Evolution	1	0.99	0.98	0.76	0.73	0.81	0.79	0.78	0.77	0.75	0.74	0.74	0.75	0.64	0.64	0.65	0.65
GDP/Employed = Productivity	12.98	11.77	8.62	10.26	11.77	11.48	13.28	14.77	13.84	15.26	16.22	17.93	19.33	23.36	26.46	28.98	31.84
Productivity evolution (from 1989)	1	0.91	0.66	79	91	88	1.02	1.14	1.07	1.18	1.25	1.38	1.49	1.8	1.89	2.01	2.12
Unemployed3	na	na	140	394	301	262	171	158	194	235	240	215	181	173	163	157	153
Labour Force[3]	na	na	1544	1489	1347	1423	1309	1274	1301	1320	1305	1283	1244	1094	1089	1088	1085
Activity rate	na	na	0.8	0.81	0.76	0.8	0.72	0.69	0.7	0.7	0.68	0.66	0.7	0.62	0.59	0.58	0.58
Emigration	na	na	243	351	381	353	413	476	571	690	na	na	na	na	na	na	na
ΔU	na	na	na	254	161	122	31	18	54	95	100	75	41	32	23	17	13
ΔP	na	na	na	-76	-162	-139	-105	-75	-64	-37	-14	14	-158	-158	-99	-75	-48
ΔN	na	na	na	-309	-358	-243	-266	-288	-297	-319	-339	-336	-341	-484	-478	-473	-472
ΔO	na	na	na	-21	35	-18	130	195	179	187	225	275	142	294	356	381	411
ΔE	na	na	na	108	138	110	170	233	328	447	na	na	Na	na	na	na	na
X	na	na	na	**1.09**	**0.82**	**1.31**	**0.19**	**0.08**	**0.23**	**0.34**	**0.31**	**0.21**	**0.22**	**0.1**	**0.06**	**0.04**	**0.03**
X_E	na	na	na	**1.06**	**0.9**	**1.08**	**0.61**	**0.56**	**0.68**	**0.74**	na	na	na	na	na	na	na

1) In millions of Leks. Source: Bank of Albania (2002, 2003, 2006). IMF (2006a). – 2) EBRD (May 2002), Transition Report Update. – 3) In Thousands. Source: INSTAT (2000-2006). – 4) INSTAT (1991). – 5) Source: EBRD 2000, Transition Report. – 6) Source: Bank of Albania (February 2003), Monthly statistical report. – 7) Source: Bank of Albania, Yearly Report 2002.

Source: Own calculations of GDP for 2000-2006, from the Percentage change in real terms.

Table A 2

Share of employment and otuput accross economic sectors

Sector	Indicator of	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Agriculture, forestry, fishery	Employment	67.2	68.4	70.3	69.6	70.8	72.1	71.8	57.8	57.8	58.2	58.6	58.5	58.0
	Output			36.1	31.6	28.9	25.9	25.5	23.8	23.6	23.3	21.9		
Industry Total	Employment	9.5	8.3	7.6	7.9	7.7	7.7	5.4	7.7	7.6	7.3	8.1	8.0	7.9
	Output			9.7	8.6	7.2	7.1	7.6	7.2	6.8	8.4	8.7		
Construction	Employment	1.6	1.8	2.0	1.4	1.0	1.0	1.2	6.1	6.1	5.9	5.6	5.6	5.7
	Output			5	6	4.9	5.9	8.1	10.3	11.9	13.3	14.7	14.8	
Services	Employment	6.0	8.1	9.4	7.7	6.2	7.0	8.8	12.5	12.6	12.5	13.7	13.5	11.0
	Output			32.6	33.9	36.3	39.7	36.6	36.4	33.9	32.1			

Source: BoA (2006), INSTAT (2000-2007).

Table A 3

Employment share across sectors as a percentage of total employment in Albania

Economic Sector	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Agriculture, forestry, fishery	67.2	68.4	70.3	69.6	70.8	72.1	71.8	57.8	57.8	58.2	58.6	58.5	58
Extracting industry	1.7	1.8	1.6	1.4	1.5	1.5	0.8	0.8	0.8	0.7	0.7	0.7	0.5
Manufacturing industry	7	5.7	5.1	5.2	5	5	3.2	5.1	5.1	5	6	6	6.2
Electric power, water industry	0.8	0.8	0.9	1.3	1.3	1.2	1.4	1.8	1.8	1.6	1.4	1.3	1.2
Construction	1.6	1.8	2	1.4	1	1	1.2	6.1	6.1	5.9	5.6	5.6	5.7
Trade	2.8	4.5	5.2	4.2	1.9	2.7	4.6	7.3	7.3	7.3	6.9	6.9	7.3
Hotels, restaurants	0.9	1	1.8	1	1.2	1.3	1.8	1.7	1.7	1.7	4.7	4.6	1.7
Transport communication	2.4	2.6	2.4	2.4	3	3	2.4	3.5	3.5	3.5	2.1	2	2
Education	4.7	4.7	4.1	4.4	4.5	4.5	4.4	5.5	5.4	5.3	5.2	5.1	5.2
Health	2.8	2.3	2.1	2.3	2.6	2.4	2.2	2.9	2.9	2.9	3	2.6	2.7
Others	8.3	6.4	4.6	6.7	7.2	5.2	6.2	7.7	7.8	7.8	5.9	6.8	9.6

Source: INSTAT (2000-2007).

Abbreviations

ALMP	Active Labour Market Policy
CEEC	Central and East European Country
CIS	Commonwealth of Independent States
EBRD	European Bank of Reconstruction and Development
ETF	European Training Foundation
ILO	International Labour Organisation
IMF	International Monetary Fund
INSTAT	Albanian Institute of Statistics
LSMS	Living Standards Measurements Survey
MoLSA	Ministry of Labour and Social Affairs
PLMP	Passive Labour Market Policy
SEEE	South and East European Economy
TE	Transition Economy

Bosnia & Herzegovina

Description of labour markets

Background info

At the highest level of generalization and summary, Bosnian labour market can said to be characterised by administrative unemployment rate above 40%, young population aged between 15-24 highly unemployed, one third of unemployed being unskilled, women substantially less active then man, and over 75% of the unemployed longer then 24 months out of work.

Since the Constitution of Bosnia and Herzegovina assigns the competency for labour market regulation to entities and Brcko District the proper labour market research requires analyses of at least two different markets, with separate legislation, institutions and to a certain degree, its own dynamics.

Labour market in figures

Back in 1990s Bosnia and Herzegovina had around 1,000,000 officially employed persons[33] in total population of 4,377,000 but making comparison and drawing inference with today's data has only limited value since both population and economic capacities have undergone substantial changes. In addition, no census was done after the war and in most cases only rough estimates of interesting variables are available. According to Bosnia and Herzegovina Statistic Agency (BHAS), present population in Bosnia and Herzegovina was estimated at 3,842,537 persons on 30 June 2005. Different estimates are found in LFS for 2006. Main LFS estimates are presented in Table 1.

In addition, while inactivity rate stands low in general, women are much less active then male.

Skill structure of unemployed reveals that skilled labour and persons with high school education dominate. However, still more then 35% of the unemployed are in category of unskilled and semi skilled category. In addition, given the fact that more then 75% of the unemployed persons are registered as unemployed for more then 24 months, the skills and competencies possessed by the potential and available labour supply are questionable.

[33] Rajko Tomas (2007) "Da li je RS bolji dio BiH?" http://intermezzo.ba/latn/?page=68&kat=34&vijest=3367

Table 1

Estimates of labour market variables

Bosnia and Herzegovina	**2006**	**2007**
Total population	3,372,000	-
Working age population	2,733,000	2,725,184
Inactive population	1,556,000	1,528,870
Labor force	1,177,000	1,196,314
Employed	811,000	849,570
Unemployed	366,000	346,744
Activity rate (Labor force/Working age population)	43.07%	43.90%
Employment rates (Employed/Working Age population)	29.67%	31.17%
Unemployment rates (Unemployed/Labor force)	31.10%	28.98%

Source: LFS 2007 (preliminary), LFS 2006

Table 2

LFS 2006 estimates on woman activity in labour market

Category	**Woman share in total**
Total population	51,2%
Working Age population	51.6%
Inactive population	62.8%
Employed	34.9%
Unemployed	41.3%

Table 3

Skill structure of persons registered as unemployed

Structure of unemployed as of 31.12.2006	Number	Share in total
University education (Bachelor, Masters, PhD)	9,984	1.90%
Higher education (2years after high school)	7,877	1.50%
Secondary	120,749	23.01%
Elementary	2,366	0.45%
Highly skilled (VKV)	5,079	0.97%
Skilled labor (KV)	193,472	36.86%
Semi- skilled (PKV)	15,238	2.90%
Unskilled labor	170,074	32.41%
Total	524,839	

Source: Agency for work and employment of Bosnia and Herzegovina

The data presented in above tables summarised general description of the labour market given at the outset. But as hinted there, the fragmented structure of Bosnian and Herzegovina administrative architecture may be reflected in different labour market dynamics and merits further exploration.

Although based on final LFS data for 2006 and preliminary data for 2007, there seems to exist different movements in the Federation BiH, Republika Srpska and Brcko District.

Table 4

Entity labour markets comparison

	Federation BiH		Republika Srpska		Brcko Distrikt	
	2006	2007	2006	2007	2006	2007
1. Activity rate	43.1	42.3	43.3	47.0	37.6	39.0
2. Employment rate	29.1	29.2	30.9	35.1	23.7	23.4
3. Unemployment rate	32.4	31.1	28.5	25.2	37.1	40.0

Source: LFS 2007 (preliminary data) and 2006 reports

In period from 2006 to 2007, activity rate in Federation BiH decreased while in Republika Srpska and Brcko District increased; unemployment rate fell in Federation BiH and Republika Srpska, whereas unemployment rate in Brcko District rose. Employment rate substantially increased in Republika Srpska, Federation BiH experienced negligible increase of 0,1 percentage point, while Brcko District employment rate fell for 0,3 percentage points.

Table 5

Administrative data on employment, unemployment and employment rates in period 1998-2007

Number of employed	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**IX/2006**	**VIII/2007**
Bosnia and Herzegovina (BiH)	651314	630890	640553	625643	637660	634046	638984		662481	674865
Federation of BiH	407047	410104	411305	405689	390201	387294	389523	388418	391498	
Republika Srpska	244267	220786	227748	219954	234713	234685	236940		257110	
Brcko District	-	-	-	-	-	-	12.521		13873	
Registered unemployment	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**IX/2006**	**VIII/2007**
Bosnia and Herzegovina	398496	409290	421197	422155	441875	459604	484307	508039	518471	521720
Federation of BiH	256487	261793	261773	269004	290715	304830	323984	347478	359177	
Republika Srpska	142009	147497	153264	137949	134990	138111	142462	142331	141348	
Brcko District							17861		17946	
Unemployment rates (%)	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**IX/2006**	**VIII/2007**
Bosnia and Hercegovina	38	39.3	39.7	40.3	40.9	42	43.12		44.2	42.7
Federation of BiH	38.7	39	38.9	39.9	42.7	44	44.85			
Republika Srpska	36.8	40	40.2	38.5	36.5	37	37.46			
Brcko Distrikt	-	-	-	-	-	-	36.38			

Note: 1998-2004 are data for December of respective year
Data for 2005-stil to be found
Data for 2006 are for September and data for 2007 are for August

Sources: Agency for work and employment, Bulletin No 1 and Bulletin No 2; BHAS Bulletin No 6/2007

Unfortunately, the LFS data exist only for 2006 and 2007 so in order to explore the different dynamics of entity labour markets over the longer period, we are left only with administrative data, presented in Table 5.

Again, different trends in two entities are observable from the administrative data on employment and unemployment: while registered unemployment in Republika Srpska remained stable, in absolute figures around 142000 people, Federation BiH number of administratively unemployed increased for more then 100,000 people driving overall official unemployment figures up. With

respect to administrative employment data, RS employment increased for circa 13000 persons, while Federation BiH official employment dropped for circa 16000.

This could imply that jobs lost in the RS were at least offset by newly created jobs whereas in Federation BiH, either jobs were created in informal economy or jobs lost were not offset by newly created jobs. Average GDP growth rates of 5% in the last couple of years and overall macroeconomic stability secured through the currency board arrangement was insufficient to reduce unemployment rate.

Observed different trends in employment and unemployment data in two entities not only in two years comparison based on LFS data but also in longer series of administrative data justify examination of the labour market regulation, a subject of the next chapter.

Labour market regulation

Although there are four separate labour codes, one for each entity, one for Brcko District and one for employees in the Institutions of Bosnia and Herzegovina, temporary employment, hiring and firing procedures, dismissals etc, are regulated similarly.

Federation BiH labour code allows for maximum 2 year 'definite' employment period; after that period, if the employment continues, it is considered indefinite. (Federation BiH labour Code, Art 19) In addition, for seasonal and ad hoc jobs, there is possibility to hire temporary workers, for the period up to 60 days per year. Republika Srpska, Brcko District and labor code of institutions BiH also allow up to 2 year for non-permanent ('definite') employment, in specific cases such as temporary increase in work volume, substituting temporarily absent employee, performing the job duties whose duration is a priori determined by the type and nature of work. (RS Labor code, article 16)

Working week is 40 working hours with possibility of extending it for 10 additional hours per week if the employees voluntarily accept.

With respect to firing, labour codes oblige employer to give firing decision in written form and decision has to have explanation of the reasons for breaking the employment contract. The reasons for firing are summarised under three broad categories for terminating the employment contract:

1) technical, economic or organizational
2) inability to perform contracted working obligations
3) violation of the contracted duties

The minimum period for notification is two weeks, except in the cases when the employee has substantially violated the labour contract.

General Collective Agreement34 (GCA) in Republika Srpska envisages, however longer notice of contract termination, depending on the years of services; the longer the duration of the contract in the past, the longer is termination period:

Law on labour in institutions of Bosnia and Herzegovina which is applicable only for the employees of the state institutions envisages 30 days notification period, allowing internal acts of the institution to further regulate this area.

Table 6

Notification period according to the RS GCA

Years of service	Contract termination notice (days)
2-10	30
10-20	45
20-30	75
30 and up	90 days

If fired employee has been employed with the employer for two years, according to labour code she is entitled to severance package which can not be less then one third of the average monthly salary paid in the three month preceding the termination of labour contract for each year of employment with the employer.

The RS GCA is much more generous to the employees whose employment contract has been terminated linking level of severance payment to the time spend in employment with same employee. The relationship between years of service and percentage of the average salary is summarised in the table below:

If the employer employs more then 15 employees and has a plan to decrease at least 10% of the labour force in the three month period, or at least 5 people, employer has a legal obligation to consult with Council of Workers, or in if such a Council does not exist, a trade union. Employer is obliged to provide detailed explanation of the reasons for labour force diminishing plans, qualifications and job position to be cut, possible measures for avoiding the implementation of downsizing as well as suggestions to the persons to be fired of the activities that could help them find employment in shortest possible period. In addition, if within a period of one year after firing employees, employers plan to hire the workers with same qualifications and skills, he is obliged to offer employment contract to the workers that has been fired before.

Due to the drastic reduction of activities caused by the civil war, many employees were put on so called waiting lists- de facto they were not working but still have remind de iure in employment with the employer. This was regular practice of the many socially owned enterprises.

[34] Singed on 21 March 2006

Table 7

Severance payment according to the RS GCA

Years of service	% share of average salary for each year of service
Between 2-10	35
10-20	40
20-30	45
30and up	50

"Waiting list" and fictitious employment

Labour law allowed the employers to cut this practice within a six months period after entering into the force, obliging them to pay severance package to those employees put at the waiting lists depending on the work experience individual worker had. The severance package will be calculated by multiplying average salary and coefficient 1,33, 2, 2,66 and 3, for work experience up to 5, up to 10, up to 20 and above 20 years, respectively.

In addition, many workers have left the place of residency due to the war activities and in most cases their employment ceased. In order to nullify this aspect of war , Labour laws had provision under which employee that had labour contract on the 01 December 1991 had the right to be re-instated into his 1991 job position. If employer failed to re-hire employee within 90 days, he was obliged to pay severance package as if worker was put on the waiting list. In this respect, the labour code imposed on a companies not only social security function but also function of reducing consequences of the interethnic conflict.

Trade unions and wage setting process

The trade unions, together with Employers Association play important normative role in determining minimum wage as it is binding part of the General Collective Agreement[35]. Consistent with overall labor regulation, there is no single GCA that would be binding across the territory of the whole country but rather each entity trade union is negotiating an entity GCA with its counterparts.

The manner of minimum wage specification is however different in two entities; In Federation BiH, the minimum gross wage is set at 2,96 KM (circa 1,51 Euro) per hour, and lowest net wage determined as 1,75 KM (0.9 Euro) per hour with exemption for certain extraordinary circumstances under which minimum wage can not go below 1,25 KM per hour. The Federation BiH GCA prescribes automatic indexing in case of cost of living increase or general economic improvement once a year by Federation Government decision. In case that cost of living are increased for at least 5% in the three previous months, the corrections of the gross wage per hour is mandatory.

[35] Current Federation BiH GCA was signed on 27 August 2005 and RS GCA was signed on 21 March 2006.

In Republika Srpska, GCA prescribes that trade unions, employers association and government make a decision in the last trimester of the current for the next year. No indexing is envisaged. In both entities, the provisions are binding for all companies, even those that did not take part in negotiations.

In Brcko District there is no collective agreement signed yet. Similarly, the trade union of the employees working in the institutions of Bosnia and Herzegovina has been established only recently and had no impact on the determination of the wages in Institutions of Bosnia and Herzegovina. Besides GCA, there are also sectoral specific collective agreements, which usually offer better terms then GCA. The influence of trade union is lowest in newly established private firms whereas the strongest activities in recent years were registered in education and health sector.

Behavior of nominal wages in presented in the Table 8.

Table 8

Average net wage behavior 1998-2006

Average net wage (EURO)	1998	1999	2000	2001	2002	2003	2004	2005	2006
Republika Srpska	87.0	110.5	140.7	158.1	177.5	193.9	216.4	237.9	266.5
Federation BiH	168.3	191.3	211.3	227.1	247.1	268.0	272.6	285.4	308.4
Bosnia and Herzegovina	151.4	175.4	190.3	208.7	228.1	247.6	258.3	275.2	299.7

Source: BHAS

Level of wages are higher in Federation BiH then in Republika Srpska but net wage increase was faster in Republika Srpska and absolute difference has decreased over time. Despite the increase in unemployment, average net wage has been constantly increasing. In addition, in the presence of sizeable informal employment and strong incentive to under report net salary in order to decrease labor tax and contributions, the above data and possible conclusion should not be taken for granted. The average net wage reported reflects probably correctly reported wages in state and other public entity companies and institutions, and underreported salaries from the private sector.

Taxes and contributions on labor

In accordance to constitutional assignment of competency, labor taxation is regulated at the entity level. Taxes and contributions for the state employees are regulated by the territorial residence of employees.

Separate regulation created different approach in choice of taxable base- namely in Republika Srpska total take home is taxable (both net wage and allowances such as hot meal allowance) whereas in Federation BiH, allowances are not taxable. In both cases, minimum taxable wage is determined as a percentage of average salary from the previous months as published by the entity statistics office.

Table 9

Social contribution rates

Contribution	Federation BiH[36]	Republika Srpska
Pension and disability	35,294%	24%
Health	25%	15%
Unemployment	3,676	1%
Child protection fund	-	2%
Tax	5%	0 %up to 105 (EURO) 10% (105-1060) EURO 15% above 1060 EUROS

The minimum net salary is defined as 55% of the average net salary paid in the Federation BiH for the previous months.

Labor market policies

Active and passive labor market policies are implemented through the entity employment bureaus. In Bosnia and Herzegovina there are 13 employment bureaus: Employment Bureau of Republika Srpska, organizationally divided into 6 regional offices and one central office, Employment bureau of Federation BiH and Employment Bureau for each of the ten Cantons, and recently established Brcko District Employment Bureau. Main source of revenues comes from unemployment contributions. In Federation BiH, 30% of each individual contribution goes to Federal Bureau while 70% goes to cantonal Bureaus registered in the place of residence of the employee.

The illustration of the labor market policies is presented in more details for the Federation BiH. Share of total consolidated expenditures of employment bureaus in Federation BiH as percentage of GDP in period 2006-2010 are given in the Table

Table 10

Share of total consolidated expenditures of employment bureaus in Federation BiH as percentage of GDP in period 2006-2010

2006	2007	2008	2009	2010
0.98%	0.84%	0.81%	0.79%	0.78%

Note: 2006 data represent actual whereas 2007-2010 are planned figures

Source: Federation BiH Draft Framework Budget Document 2008-2010

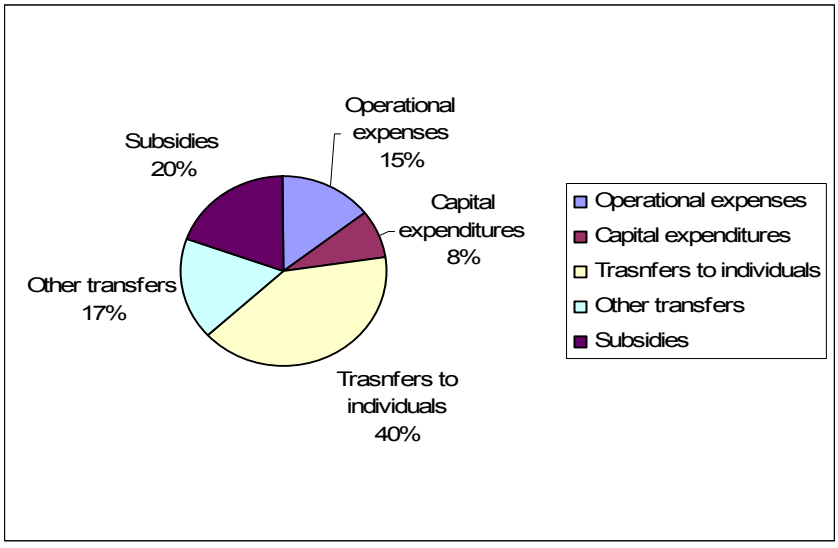
[36] The system is much more complicated then presented here as there is distinction between contributions paid “on” the salaries and “out” of salaries, part that burden employer and part that burdens employee. These re-calculated rates are simplest way both to compare it to the RS as well as to calculate tax wedge.

In absolute figures, out of 108,4 million KM total expenditures in 2006, 15,4 m KM represent operational expenses (wages and material costs) of employment bureaus, 8,7 m KM are capital expenditures leaving 83,8 m KM for active and passive labor policy.

Out of this 83,8 m KM subsides represent 21,5 m KM or 0,20% of the Federation BiH GDP for 2006, while transfers to individuals represent 62.3 m KM, or 0,57% of the Federation BiH GDP. Concrete programs financed by the Federation Employment Buero in 2006 include

1. Subsidized employment of unemployed persons in duration 6-12 months in private sector after which period employers should keep employees for additional 12-24 months; part of this program targeted young and qualified persons, and disabled persons
2. Public works and provision of home assistance to old people by persons registered as unemployed for period of at least two months
3. Self-employment- start up of private business by unemployed persons
4. Financing change in education and skills of the unemployed
5. Providing (revolving) credits through the commercial banks under based on deposits secured through Federation Investment bank for the companies that have the opportunity to increase business capacities and hire new employees
6. Project for employing person age 45 and above (decreased to 40 years) (SESP)

Federation BiH: structure of 2006 consolidated expenditures of employment bureaus



Source: Federation BiH, Framework Budget Document 2008-2010

According to rough estimates, the effect of subsidized employment results in 40-90% of newly employed persons being kept employed after the program was finished.

Unemployment benefit duration directly depends on the number of working years prior to coming into unemployment status. The benefit is determined as 40% of the officially published average net salary for the three months prior to coming into unemployment. The duration of unemployment benefit entitlement is summarized in table below:

Table 11

duration of unemployment benefits

Number of years of work experience prior to becoming unemployed	Duration of monetary benefits (in months)
From 8 months to 5 years	3
5- 10 years	6
10-15 years	9
15-25 years	12
25-30 years	15
30-35 yrs	18
More then 35 yrs	24

Source: Law on intermediation in employment and social security of unemployed persons (Official Gazette no 41/01, 22/05 article 30)

Positive legislation envisages three types of benefits for unemployed persons:

1. Monetary unemployment benefit
2. Health insurance
3. Pension insurance if unemployed person has three or less years before retirement

Detailed breakdown of the activities and costs of the employment bureaus in Federation are presented in Table below.

Table 12

Breakdown of cost and activities of Federation Bureau for Employment in 2006

Description	Amount (EURO)	Share in GDP	Number of persons targeted
Active labor policy-total	**15,038,363.17**	**0.27%**	**9,021**
Subsidized employment	12,276,214.83		6,719
Demobilized soldiers: credit under favorable conditions	2,046,035.81		-
Subsidized employment: Disabled persons	716,112.53		102
SESP (above 40 years)	1,485,902.81		2,200
Support to unemployed-total	**21,782,651.66**	**0.38%**	**220,123**
Monetary compensation for unemployed	10,213,539.13	18.05%	5,786
Health insurance for unemployed	10,391,541.69	18.37%	212,912
Pension insurance (less then 3 yrs before retirement)	753,911.00	1.33%	1,425
Support due to VAT introduciton	423,659.85	0.38%	5,800
Memorandum item Federation BiH 2006 GDP (EURO)	5,658,312,020.46		

Source: Bulletin No 02./07, Federal Employment Service
Federation BiH GDP for 2006 taken from the Budget Framework document 2008-2010
Share in GDP- own calculation

Besides the monetary and non monetary benefits for the persons in the unemployment status, there are certain privileges that state provides for the unemployed person if these persons are

demobilized soldiers, war veterans or family of fallen soldiers based on The Law on Rights of Demobilized Soldiers enacted in October 2006. According to this law, if registered as unemployed, demobilized soldier is entitled to receive 25% of the average net salary from the previous year for a period that depends on the number of years of service in the army during the war. In addition, demobilized soldiers are also entitled to privileged position in both employment vacancies as well as when applying for credits for self-employment.

The Law on Rights of Demobilized Soldiers was enacted in October 2006 with overall effect that in the Federation BiH number of unemployed demobilized soldiers increased from 59,750 as of August 2006 to 85,970 persons in August 2007, or 43% increase in registered unemployment of the demobilized soldier category.

Informal sector employment

According to latest available research on informal sector employment done by the Prism[37] Research the share of employed in informal sector is almost 30%: out of 810 792 employed both in formal and informal sectors in Bosnia and Herzegovina, 241 740 are employed in informal sector. The informal economy employs 7,7% of citizens above age of 18 years in Federation BiH and 3,3% of Republika Srpska population. According to Prism research, done on the sample of 1550 person, out of total number of persons working in informal sector, 58,9% are between 25-49 years old, 67,2% are males, 78,7% live in rural area, and 68,7% of the persons working in informal sector are registered as unemployed.

Discussion of the most relevant country specific factors

Labour market in Bosnia and Herzegovina is characterised with fragmented regulation, separate pension, health and social net provision, but with similar social functions assigned to companies in both entities and Brcko District, as well as rigid and centralised wage setting process mostly relevant in the public institutions. In addition, public employment both by wage level and number of employees has an important role.

The fact that informal employment is estimated around 30% of total employment suggests that burden on labour is too high and that market forces are avoiding formal sector.

In addition, despite constant increase in overall unemployment, both nominal and real wages went up, suggesting that average wage is non flexible and is not reacting to the movements in labour supply. This information however has limited value unless structure of labour supply, i.e. skills offered, are contrasted with labour demanded. It could be the case that those that are unemployed for more then couple of years have very low productivity, and that the chances of finding employment are non existent, leaving them dependent on social assistance.

[37] Prizma Research quoted from http://www.cin.ba/Stories/P11_Labor/pdf/Prism%20Research_BCS.pdf

Organized groups that easily solve collective action problem, such as demobilised soldiers, managed to make registered unemployment a profitable activity, which could be negatively reflected in the mid run participation rate.

Besides regulatory rigidities, regional immobility is additionally complicated by the non-economic and war related interethnic relations- such different educational programs.

However, the prospects of the labour market mobility and behaviour of the wage bill can not be fully understood without examining public sector employment and wages in budget institutions as presented in the table above.

Salaries of the Institutions of Bosnia and Herzegovina employees has been highest in public salary system for several years in the past. For example, back in 2004 average salary in Federation BiH was only at the 56% level of the average salary in state institutions; for the Republika Srpska, the ratio was even less favourable, at the level of 45%. After defence reform by which military issues sector from the entity budgets and competence was transferred to the state level, average salary in state institutions dropped in relative terms but kept its dominance. The number of employees on the state budget increased from circa 8000 to 22000 from 2004 to 2006.

Table 13

Average net salary in Institutions of Bosnia and Herzegovina and selected sectors
Comparison: Salary in Institutions of BiH taken as benchmark (100%)

Year	Institutions of Bosnia and Herzegovina	Federation BiH	Education in Federation BiH	Health and social welfare in Federation BiH	Republika Srpska	Education in Republika Srpska	Health and welfare in Republika Srpska
2004	482.05	272.6	273.09	326.43	216.4	-	-
2005	497.86	285.4	279.54	335.12	237.9	213.81	242.97
2006	384.96	308.4	313.68	350.98	266.5	234.27	270.27
2004	100	56.55%	56.65%	67.72%	44.89%	-	-
2005	100	57.33%	56.15%	67.31%	47.78%	42.95%	48.80%
2006	100	80.11%	81.48%	91.17%	69.23%	60.86%	70.21%

Source: Ministry of Finance and Treasury of Bosnia and Herzegovina; BHAS, Institute for Statistics of Republika Srpska, Federal Statistic Agency, various bulletins
Own calculations

However, with increased revenues collection after successful introduction of the VAT, other levels of government tried to level up wages to the state institutions level. Latest information available hints that average salary for budget users, for example, in Federation BiH (average for all employees at Federation central budgets, cantons and municipalities) will reach net average level circa 468 Euros in 2008; for Republika Srpska expected average wage in Republika Srpska institutions will be 418 Euros already in 2008.

The fact that number of employees paid from the various public budgets represent close to 18%[38] of total registered employment as well as the estimates that in consolidated expenditures all level of governments in Bosnia have spent already in 2006 10,25% of the GDP on salaries and wages, or close to 30% of overall consolidated expenditures[39], may have serious negative spillover effects for salaries in the private sector and therefore overall competitiveness of economy of Bosnia and Herzegovina. In case of revenue fall, the share of wage bill in consolidated budget would increase leaving less fiscal space available for other policy measures. During the work on this research, the Working group of the Council of Ministers of Bosnia and Herzegovina was discussing a law on wages in state institutions. Currently, the net wage is determined by multiplication of the base fixed at 240 KM (123 Euros) and coefficient assigned to each position, mostly depended on education. In addition, each year of work experience, increases net salary for 0,5%. More modern and transparent approach- such as gross salary that would be expressed in absolute monetary figures, no additional allowances, etc. that would widen the taxable base was not possible since it would substantially increase the costs of employees in state institutions that are residence of Federation BiH which applies higher rates to narrower base. This is an example of the two negative spillover effects that occur in non-adequately coordinated fragmented system.

Due to the fact that trade unions are probably the most influential in certain public sectors such as education, health, railways etc. unless the public wage bill issue is dealt properly, there could be serious implications: high percentage of public employment in case of salary increase drives overall average salary up, causing the increase in base on which contributions are paid to increase. This has negative effects for the least productive categories or lowest paid employees: the taxes and contribution on hiring them is increasing making the difference between what they cost the employer and what they take home bigger in relative terms.

Policy recommendations-what policy makers should address

Unemployment issue is frequently described as single biggest problem facing Bosnia and Herzegovina. Apart form objective industrial capacity destruction during the war, failures form slow privatisation, poor targeting in social sector, non-flexible educational system, cultural obstacles for higher mobility, etc. contribute to high unemployment rates and economic waste. Therefore, weaknesses discussed in the previous chapters are consequence of bad policies in many sectors, and are reflected in the high unemployment rate and non flexible labour market.

Labour market flexibility is essential for securing healthy long run prospects for any economy, particularly in countries under currency board regime and high trade account deficit. However, increasing flexibility of the labour market requires painful changes in many sectors.

[38] State Institutions employ around 22000, Brcko 3500, Federation (consolidated) 65,000, RS (consolidated) 31000 employees;

[39] MAU, Bulletin 26 September, 2007

The several reforms currently discussed, such as pension and health reform, education reform, direct tax reform in Federation BiH, and improvements in fiscal policy coordination could contribute to better functioning of the labour market.

Pension and health system reform could allow lower contributions; education reform should contribute to the better responsiveness of the education system to the market needs; Fiscal policy coordination could contribute to optimal usage of the fiscal instruments. However, these are medium to long run goals. In the mean time several small steps could be undertaken discussed below.

1. Governments should resist temptation to increase wages to budget users; instead, and in shortest possible time, governments should harmonize contribution regulation that would allow reform in public system salary policy

As explained, when the government paid average salary increases, it triggers up a base for contribution calculation which has negative impact on the employment prospects and position of the least productive persons at the labour market.

In addition, departing from the coefficient based system of wage determination in the state institution and introducing modern and accountable system requires harmonised base and coefficient in both entities, unless implicit cross-subsidizing to the extra budgetary funds of the entity (Federation BiH) were higher rates are applied is to occur.

Instead of planning to increase wages that would benefit currently employed in the government institutions, governments should harmonize and decrease contributions rate, a measure that would encourage new employment.

2. In order to improve active labour market policy making, incentive for registering with unemployment agencies should be re-structured

The evidence base for understanding and analysing unemployment problem has substantially improved in last two years. Not only that policy makers are now having besides administrative data also unemployment estimates from labour survey data, but within the administrative data, due to introduction of so called “double registry” they can distinguish between persons registered as unemployed and looking for job (“active supply of labour”) and those registered for other reasons, mostly social benefits. In Republika Srpska, for example, out of 134 957 persons registered as unemployed with the Employment bureau as of September 2007, almost 30% admitted that registration to employment bureau was for reasons not related to employment searching.

The situation is similar in Federation BiH where number of demobilised soldiers registered as unemployed increased for 43% on year to year basis as monetary compensation for this category of population in case of their employment became granted.

Policy makers should consider setting up incentive structure in such a manner that only those searching for a job are registering with Employment bureau. That would contribute to better usage of the limited resources Employment bureaus have at their disposal for utilization in employment enhancing process rather then serving social security activities.
If persons that register for other then employment finding activities are removed from the unemployment registry, administrative unemployment figures would decrease and that could indirectly contribute to the increase in participation rate since reported high official unemployment rates contribute to the increase in the inactive population.

Specially sensitive and powerful groups such as demobilised soldiers should be rewarded for successful integration in the market rather then if registered as unemployed.

3. Compare jobs offered (labour demand) with qualification of the unemployed for the whole country and accommodate legislation in accordance to labour demand

After labour market research on a sample of 2 626 companies Employment bureaus of Republika Srpska found that companies need 37% of the offered position filled by temporary workers and 67% permanent employment[40].

This finding could lead to amendments to the labour code that would allow more regular taking of the temporary worker and releasing them.

In addition, in the same research, detailed educational and experience requirements from the employers were collected and should be communicated to ministries of education at all levels of government. Proper understanding of the market needs in overall BiH labour market is essential for improving educational plans and programs.

Taken together decreasing contribution rate and making temporary employment easier for companies would result in diminishing informal economy.

4. Minimum wage should not be universal

The main motive of persons working in informal economy while being registered as unemployed is health insurance.

In a recent report by the RS labour Inspectorate, during 18 months period over 14 000 labour inspections have been done in order to find illegally employed persons. Out of 107 703 inspected employees only 7857 were working illegally, or 7,2%. Similarly in Federation BiH during July 2007 in 12 358 companies inspected and 65 381 employees controlled, 2,907 or 4,4% non registered workers were found. Apparently, in July 2007, during the inspection campaign over 40000 employees were registered with Federation pension fund, that is become officially

[40] RS Employment Buero, Bulletin no.33

employed, but within 2 months period several thousand of the newly employed persons de-registered from the pension registry, i.e. became unemployed again[41].
This picture should be accompanied with the information of the number of companies that are incapable of paying contributions in timely manner.

The fact that estimated employment in informal sector is at such a huge level could imply that certain binding provisions related to minimum wage as a base for contribution payment are not observed and actually creates perverse effects both for employment and for collection of contributions as a source of revenues for extra-budgetary funds. It could be the case that many employed in informal sector are actually working in the industries in which labour productivity is lower then required by the cost of labour imposed by the regulations. If this is true, then inspections are not the best means to deal with informal employment. Rather, minimum base used for contribution calculation could be differentiated for either lower productivity sectors or lower productivity employees (young, unskilled etc).

If informal employment is present in mainly lowest average paying salary sectors (retail, catering, construction) that means that centrally set up minimum wage is counterproductive and detrimental for these sectors developments.

Conclusion

In this paper main characteristics of the Bosnia and Herzegovina labour market were analysed, possible sources and reasons of found rigidities discussed and certain measure proposed that potentially could contribute to increase labour market flexibility.

Although improved in recent years, the data of labour market still should be taken with caution. With high degree of certainty, although labour market is characterised with unemployment rate above 40% when administrative data are considered, more likely unemployment rate is below 30% as suggested by labour survey data. Lower female participation, long duration of unemployment, fragmented labour regulation, high and specific role of public system wages were analysed as prominent features of the Bosnian labour market.
Few simple recommendations: such as avoid increasing public wages in the next budget year(s), harmonising contribution base, decreasing contribution rates, decreasing minimum wage for certain categories were proposed, allow more flexible firing and hiring were proposed.

If undertaken simultaneously, the proposed measures could be implemented in fiscally neutral manner- instead of funding increases in wages in public sector, respective governments could estimate possible affordable decrease in contribution rates that can be funded from the savings in the wage bill. If appropriately coordinated, these measures would substantially improve labour market adjustment capacity and make Bosnian economy more resilient to external shocks.

[41] Info from www.portal.ba, employment related portal.

Croatia

1 Literature review

The relative inflexibility of the Croatian labour market was addressed within the latest process of changing the Labour Code, which came in effect in 2004. One of the aims of changing the legislation was to introduce more flexibility on the labour market, as prior to the new regulations Croatia was one of the countries with the highest Employment Protection Legislation index (EPL) reaching approximately 3.6. Biondić and Matković (2003) argue that, even after these changes, Croatia, with the EPL index being 2.76, still has more regulated labour market than the average EU country.

The process of introducing more flexibility on the labour market was not welcomed by all the social partners, and in order to achieve more flexibility other changes in regulation had to be introduced, to incline the social partners to accept more flexible working conditions.

2 Description of Croatian labour market

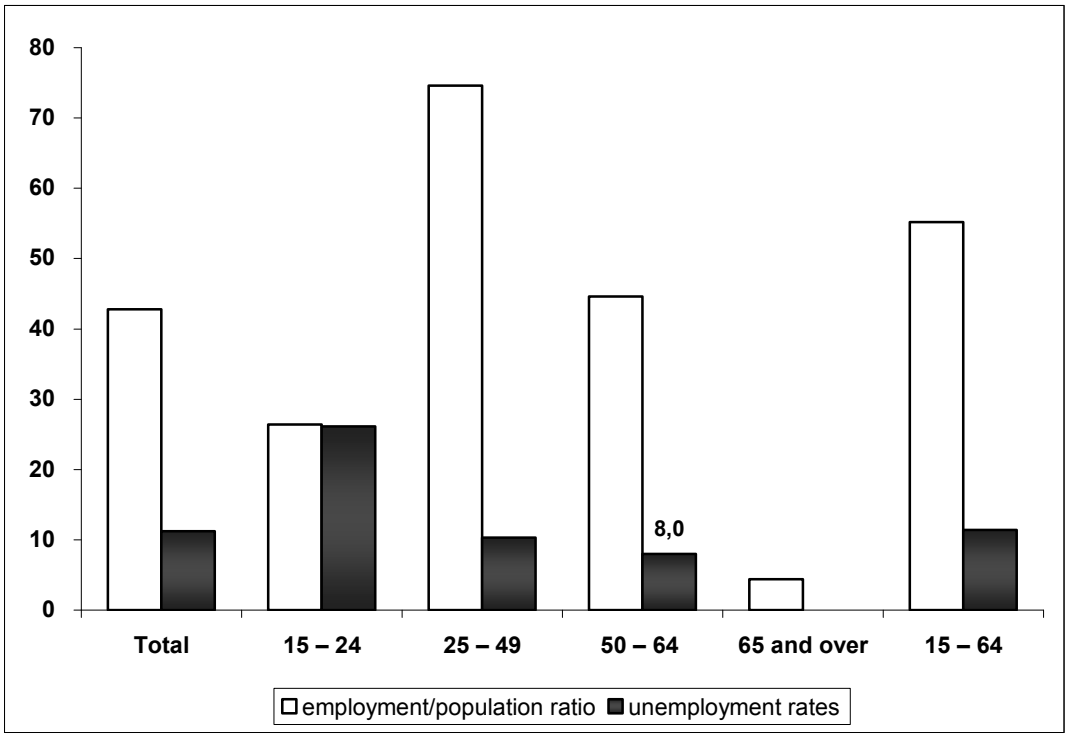
The Labour Force Survey data for Croatia reveals relatively low activity rate and even lower employment rate. The latest data for the first quarter of the year 2007 implicate that only 48.2 percent of the available workforce (aged 15 and more) was active on the labour market. The employment rate for the same period was consequently also very low – reaching only 42.8 percent, while the unemployment rate reached 11.2 percent. The gender differences in these indicators show the usual pattern – activity and employment rates for women are constantly lower, and the unemployment rates constantly higher than comparative data for men. Based on the data presented, it is obvious that Croatia is far from reaching the Lisbon targets, although steps have been taken to incorporate the targets in the labour market policies.

Even though the overall activity rate has not changed significantly since the second half of the 2001 (when it was 50.3), there were significant changes in the age structure of active population. The age group 15-24 had 41.9 percent activity rate in the year 2001, which decreased to 35.7 percent in the first quarter of 2007. The decrease in activity rates for young people is more pronounced in female population, than for men.

The trend was quite reversed for the age group 50-64, which recorded the activity rate of 40.9 percent in the year 2001, and this rate grew to 48.5 percent in the first quarter of 2007. The increase of the activity rates of the older population is more pronounced for the female population, than men. These findings are in line with the usual theoretic assumptions, where female labour force reacts more strongly to the changes on the labour market, both in terms of stronger participation, and changes in employment. However, the decrease in activity of younger women and increase of the older groups might indicate the orientation towards education on one side, and reaction to positive overall economic growth on the other.

Figure 1

EMPLOYMENT AND UNEMPLOYMENT RATES BY AGE GROUPS, I-III 2007.



Source: Croatian Bureau of Statistics, Labour Force Survey.

From the data presented in previous figure, it can be seen that within the age group 25-49, the employment rate is the highest, it drops significantly for the age group 50-64, and the lowest is within the group of 15-24 years old. The fact that the employment is the highest for the age group 25-49 is expected, and this data should only be supplemented by more usual findings – the employment rate for women (68.6) is, as in all age groups, lower than that for men (80.8). The lower employment for the age group 50-64 is under the influence of early retirement schemes, favourized in Croatia at the beginning of 1990s. The aging population and its consequences on the Croatia's fiscal position has only recently been recognized as potential problem[42]. The changes in the legislation has throughout the years increased the minimal legal age for retirement, which should translate itself gradually into the increased activity rates for the older population. Whether this will increase the employment rates as well, depends on the demand side of the market.

Employment rates have also not changed significantly since the second half of 2001. The recorded rate for that period was 42.1 which is not far from the one observed in previous graph where the data for 2007 are presented, even though in the meantime during some periods it was

[42] The analysis of long-term fiscal effects aging population might have in Croatian case has been recently analyzed at the Institute of Economics, Zagreb (Nestić, ed., 2006). The study is available only in Croatian, but the main results implicate that special concern should be put on the increase in the activity rates and productivity of older workers, in order to avoid potential fiscal constraints.

recorded higher than 44 percent. Total employment rate was also influenced by the age structure dynamics. The highest growth in the employment rate was recorded for the age group 50-64, following by 25-49. Employment rate for those aging 15-24 also increased, while the highest volatility in the data is observed for those older than 65, where actually a decrease was recorded. This increased employment for the employment group aged 50-64 confirms the previously discussed changes in retirement requirements legislation. But it also implies that the strongest revival on the labour market does not necessarily always have to stem from the prime-age population.

The unemployment rate has recorded a significant decrease since the second half of 2001, when it stood at 16.3 percent according to the LFS data[43]. The largest contribution to such a high unemployment rate came from the youth unemployment, where the age group 15-24 recorded 41.7 percent rate of unemployment. Although the youth unemployment rate at the beginning of the year 2007 was still high, it can be said that the improvement for this age group was significant, as the unemployment rate fell to 26.1 percent. The age group 25-49 also recorded a decrease in the unemployment rate from 14.2 percent, while the group 50-64 remained approximately the same throughout the period.

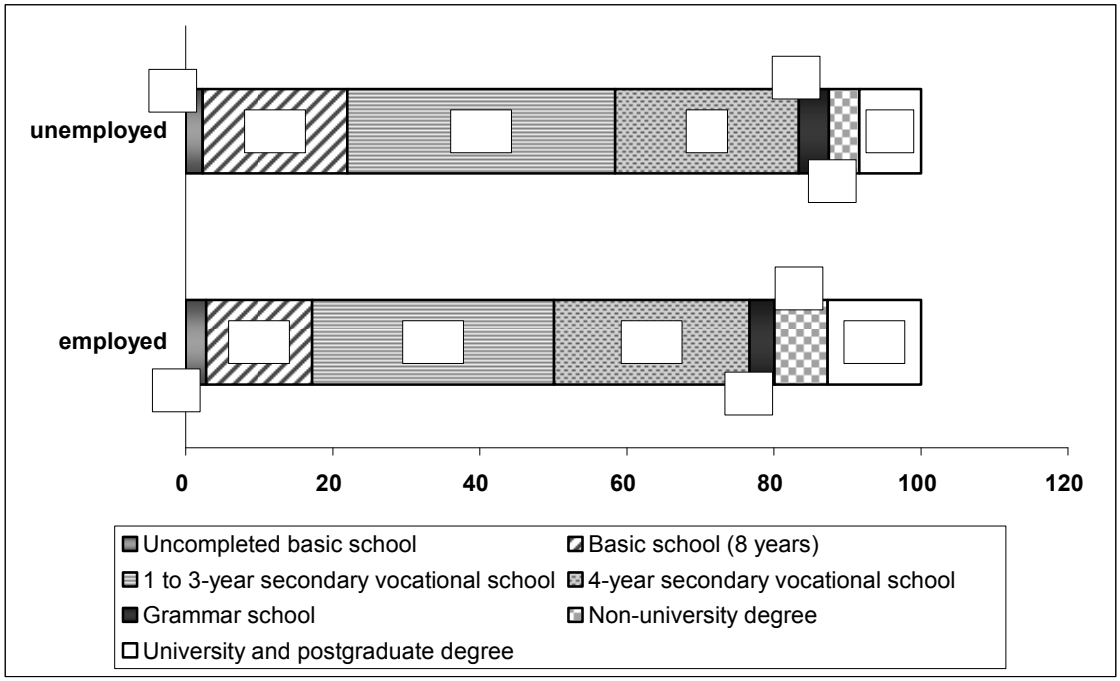
Within the context of Croatian labour market, significant differences in structure of demand and supply are frequently emphasized. Obadić (2005) analyzes the matching function for different type of workers, and is unable to find a general conclusion. At the same time, when it comes to the qualifications of workers, there exist excess demand and excess supply. Consequently, improvements in the matching process – through the increased efficiency of the intermediators, should improve the overall conditions on the labour market. Before extending this argument any further, it has to be noticed that Obadić (2005) performs the analysis for the data during the 1992-2002 period. Certain increases in efficiency, in particular deregulation on the intermediation market, were introduced in the system since then. Therefore, the matching process might shown improvement in the latest period, resulting in more efficient functioning of the labour market.

When referring to the more recent situation on the labour market, it is useful to compare the structure of employed with those of unemployed, according to the level of education. At the first glance, the differences in educational attainment of unemployed are not strikingly distinguished from those of the employed. Therefore, the perception that the unemployed are necessarily significantly less educated than employed is not completely true. Within the unemployed, there is a larger share of those with basic school (8 years), those with 1 to 3-year vocational school, and those with grammar school. However, within the unemployed, there are also 8.4 percent persons with university or postgraduate degree, showing that university education is no guarantee for a certain job. Skills required by the employers are not necessarily related to the formal education. Based on the survey conducted on 88 employers, it can be argued that employers value communication and presentation skills as the most important ones (www.moj-posao.hr).

[43] The unemployment rate according to the administrative sources – Croatian Employment Service register – was the highest in the first quarter of 2002, when more than 400.000 persons were registered as unemployed.

Figure 2

SHARE IN WORKING AGE POPULATION, BY EDUCATIONAL ATTAINMENT, I-III 2007

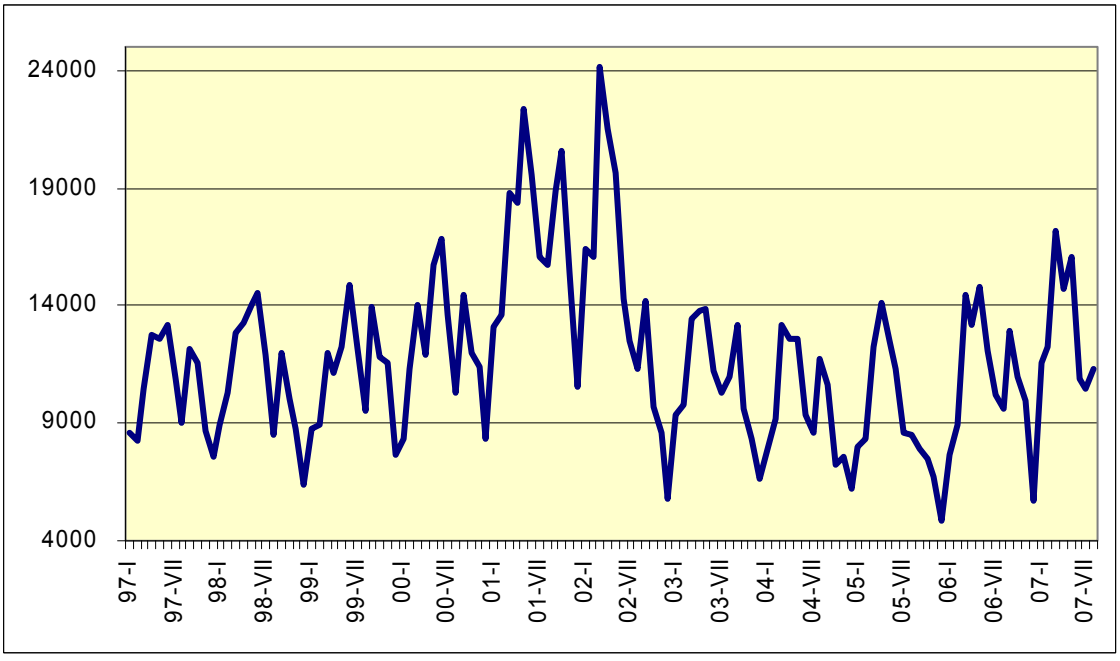


Source: Croatian Bureau of Statistics, Labour Force Survey.

The unemployed are in general faced with the relatively low demand. This is represented by the vacancies data. The average number of vacancies during the 2006 amount to only 3.8 percent of the average number of unemployed.

Figure 3

CROATIAN EMPLOYMENT SERVICE VACANCIES, MONTHLY DATA, 1997-VIII/2007



Source: Croatian Employment Service.

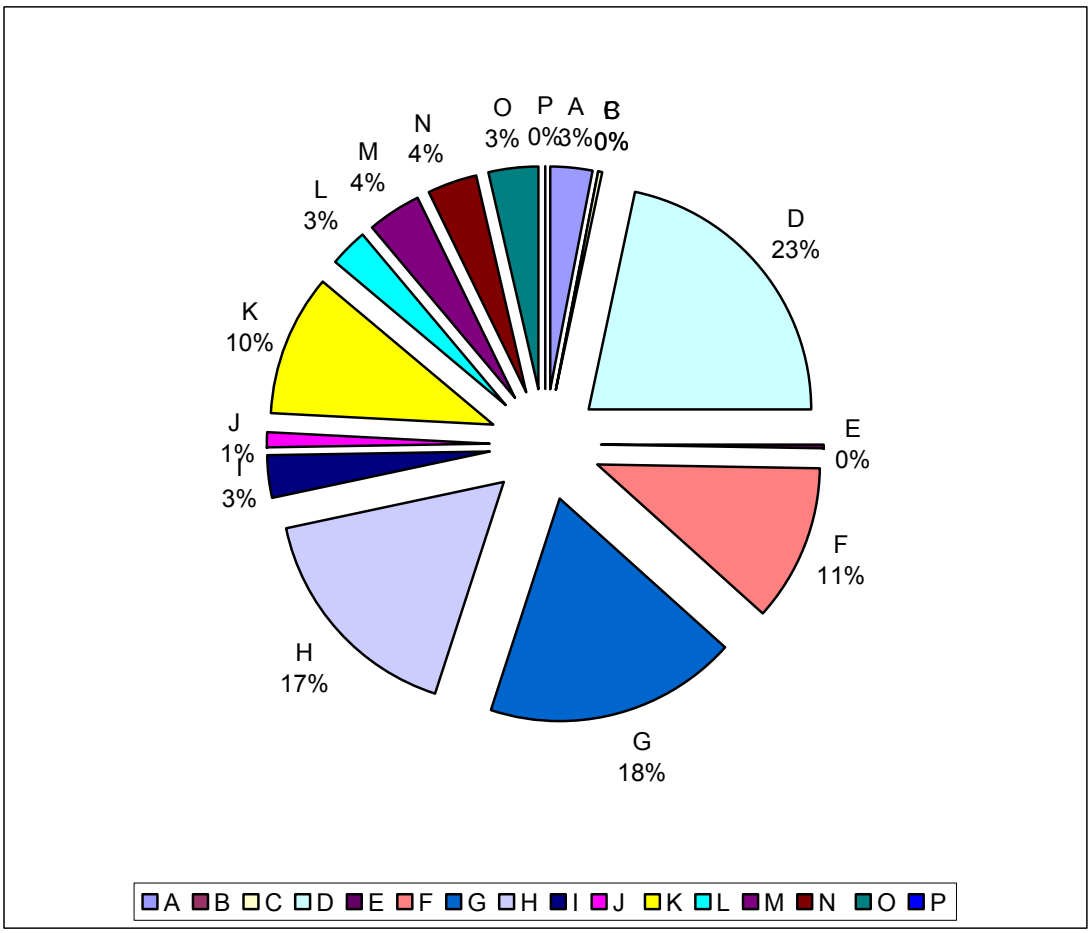
The data presented at the previous graph reveal a strong seasonal pattern of vacancies reported at Croatian Employment Service. The mirror image of the vacancies data is the unemployment rate, which also has a pronounced cyclical behaviour. Overall trend in the vacancies reported by the Croatian Employment Service has changed – up to the year 2001, the total number of reported vacancies was slightly increasing. The change of the Law on intermediation on the labour market decreased the role of the Croatian Employment Service as the main intermediator, and consequently not all the vacancies were reported through this institution. In the year 2006 a slight increase in the CES activity was recorded, and it carried on during the first eight months of 2007. Since at the same time Croatia has recorded high rates of economic growth, this has influenced the increased demand on the labour market.

The new Law on intermediation on the labour market introduced new agencies, which offered also “head hunting” services. The new agencies, being profit oriented institutions, were more interested in the most intensive segment of the labour market – matching the demand for skilled professionals, usually those already having a job, who have proven themselves as being successful, and are looking for better job opportunities. The employers were also willing to pay commission to the agencies for finding “just the right person for the job”. The unemployed, in particular those long-term unemployed, with low employment probability, were mostly left under the care of Employment Service.

The structure of the vacancies according to the economic activities is shown on the following graph:

Figure 4

STRUCTURE OF THE REPORTED VACANCIES BY THE CROATIAN EMPLOYMENT SERVICE, I-VIII 2007



A - Agriculture, hunting and forestry, B – Fishing, C - Mining and quarrying, D – Manufacturing, E - Electricity, gas and water supply, F – Construction, G - Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods, H - Hotels and restaurants, I - Transport, storage and communication, J - Financial intermediation, K - Real estate, renting and business activities, L - Public administration and defence; compulsory social security, M – Education, N - Health and social work, O - Other community, social and personal service activities, P - Activities of households

Source: Croatian Employment Service.

According to the data presented in the previous figure, it can be seen that the demand for labour is still the highest in the manufacturing industry, but the trade and hotels and restaurant activities together, i.e. the service sector is revealing the strongest preferences to new employment. The next two activities are construction and real estate, with remaining representing only a small share in the overall vacancies. This data can be supplemented by the findings from Obadić (2005), who argues that in terms of the estimated matching function, the most efficient process of filling the vacant work posts are in the manufacturing industry, then trade following by other community, social and personal service activities. Therefore, those activities with high demand are at the same time those in which the matching efficiency is the highest.

After brief presentation of the current status of the key indicators on the labour market in Croatia, as well as their dynamics during recent period, we turn our attention to the current legislative that determines the degree of Croatian labour market flexibility.

Labour code/employment law

For the employer, it is highly relevant how strict are the hiring and firing procedures. These were in Croatia relatively recently relaxed. However, as presented below, the procedures are still not easy to implement. Even the recently published World Bank (2007) report on "doing business" implies that things can be further changed in the "employing workers" processes.

According to current legislation, employer can fire the employee due to:

- business reasons – the specific job is no longer required, in this case another worker for the same job must not be hired within the next 6 months
- personal reasons – the worker is not capable to perform the tasks required by the job
- the worker does not obey work relation provisions; the employer has to warn in written form the employee on his behaviour and possible termination of the contract prior to firing.

In the first two cases, the termination of the contract is considered valid only if the employer was not able to find another suitable job for the worker, if the employer is no able to train the worker for other jobs within the same firm. Only in these casee, the firing is considered regular. The mentioned additional conditions are not required for the small enterprises, with less than 20 employees.

In the case of regular firing procedures, the notice period duration is related to the years of service with the same employer. The precise information is presented in the following table.

Table 1

Notification requirements according to the Labour Code (Official Gazette, 137/04)

Year(s) of service with the same employer	Notice period
Under 1 year	2 weeks
1 year	1 month
2 years	1 month 2 weeks
5 years	2 months
10 years	2 months 2 weeks
20 years	3 months*

*this period is prolonged by 2 additional week if the worker has reached 50 years and one month if the worker is older than 55

In addition to these, there are also cases when special rules apply. For instance, it is forbidden by the law to terminate the employment agreement during worker's pregnancy and 15 days after the pregnancy, during the use of shorter working hours period for parents, or when the parental leave is used by persons with children that have serious health difficulties.

When hiring, employer can stipulate that during the period of maximum 6 months, the new employee is on probation. In the case the employee is on probation, the notice period must be at least 7 days.

In addition to regular firing procedures, there is also the case of the termination of the contract in special circumstances, which can both the employee and employer put forward whenever they consider the continuation of the work relationship not longer possible. The notice period in that case is 15 days, and the party responsible for breaking the contract could be sued if the termination of the contract is not justifiable.

Severance payments are limited from below and above. According to the legal provisions, it cannot be beneath the one third of the average monthly wage paid to the worker during the last three months before the termination of the contract, for each year of service. Unless otherwise stipulated in the collective agreement or contract, severance payment cannot exceed 6 average monthly wages paid to the worker during the 3 months prior to the termination of employment.

Box 1 Why do employees quit jobs in Croatia?

One of the new intermediators on the Croatian labour market has in January 2006 conducted a survey on a small sample of 1284 persons, 60 percent females, with mostly permanent employment contracts (69 percent), highly educated (44 percent), and from the city of Zagreb or Zagreb county (56 percent).

The results imply that 64 percent of the employees think about changing a job, and when they have done it in the past, they have managed to obtain a better paid position in 70 percent of the cases. However, higher wages are not the main reasons for looking for another job, but rather:

- insufficient opportunities for professional development – 54 percent
- lack of promotion chances – 49 percent
- inadequate wage – 47 percent
- not enough recognition for the work done – 46 percent
- bad relationships with the supervisors/employer – 34 percent
- work conditions that affect health negatively – 24 percent
- insufficient other benefits – 24 percent
- non-challenging job (boredom) – 21 percent
- not enough autonomy at work – 21 percent
- too many overtime – 20 percent

When gender differences are looked into, it seems that men value wage conditions more, and insufficient opportunities for professional development are more important to women.

Source: www.moj-posao.hr

Collective redundancy is regulated in the Labour Code as an event in which an employer due to economic, technological or organizational reasons intends to cancel at least 20 labour contracts in the period of 90 days. In that event the employer must prepare a redundancy social security plan which must state the following:

- the reasons why the redundancies occurred,
- the possibility of introducing changes in technology and organization of work in order to provide for redundant workers,
- the possibility of assigning workers to other jobs,
- the possibility of finding employment with other employers,
- the possibility of retraining or additional training for workers,
- the possibility of reducing working hours.

The social security plan has to be within 8 days after receipt approved by the employment service, which can postpone the implementation of the plan for up to 3 months. During the postponement, the employer has to keep the workers on the job. In addition, employment service might require changes in the social security plan, when they do not consider some of the proposed actions justifiable. In that case, the employer must revise the plan, and act according to the requirements by the employment service.

Temporary employment is restricted within the current legislation. Although the law allows temporary employment contracts, this type of contract should be justified by «objective reasons», such as final deadline for the project the worker will work on, or work related to specific event in the future. In all the cases, the maximum duration of one or more temporary contracts with the same employee should not exceed the period of three years, even if during this time breaks in contracted period shorter than 2 months existed (unless otherwise stated in the collective agreements). If the period of employment exceeds 3 years, than it is automatically considered that employer has signed a permanent contract with employee.

According to the Eurostat data (which relies on the national Labour Force Surveys), Croatia had 12.9 percent of employees working under temporary contracts during the 2006. The gender difference was not significant, as 13.1 percent of male employees and 12.6 percent of female employees had been working under these arrangements. This is somewhat lower than the average of EU-27, which for the same year amounted to 14.7 in total, 14.1 for male and 15.3 percent for female employees. However, the temporary contracts in Croatia are slowly gaining on popularity, as the Labour Code was set in place and released some of the restrictions on this type of employment. This fact can be confirmed by the data, as the temporary contracts during the year 2002 (prior to the new legislation) accounted for 10.9 percent of all the contracts.

Crnković-Pozaić (2006) already pointed out that the share of the permanent employment contracts for the persons employed from the unemployment register is constantly decreasing throughout the 1995-2003 period. The permanent employment contracts' share the previously unemployed signed at the beginning of the 1995 was more than 50 percent. The latest available data from the Croatian Employment Service, covering the first 9 months of the 2007, imply that the unemployed can count with a permanent employment in only 16 percent of all the cases. Therefore, the unemployed are already faced with the "flexibility" in employment, as when they do manage to find a job, in 84 percent of the cases it will be only temporary employment.

Wage setting and the role of trade unions

Social dialogue mechanisms in Croatia have been established on the national level, regional level, as well as on the level of companies. The foundations for the social dialogue were laid down within the Labour Code that was effective since 1996. This framework regulated worker-employer relations, including the procedures for bipartite collective bargaining.

The tripartite collective bargaining was introduced in 1993, through a voluntary agreement including the government, the chamber of commerce (which was later replaced by the

association of employers) and union associations. The National Economic and Social Council was formed, and it played a significant role in forming the labour market policies, in particular whenever the new provisions in the Labour Code were introduced. However, Economic and Social Council was also the place were issues of wider economic concern were discussed – from the privatization of the state-owned companied, through the restructuring of some companies, to pensions and health system reforms. Since these early times, the original structure of the Economic and Social Council has expanded, and new commissions have been established, for specific areas, such as:

- Commission for Salary Policy and the Tax System,
- Commission for Employment and Social Policy,
- Commission for Collective Bargaining,
- Commission for Privatisation,
- Commission for Employment, Education and Coordination with the Labour Market,
- Commission for Legislation, Regulations Implementation and the Accomplishment of Legal Protection,
- Commission for International Relations and the Preparation for Accession of Croatia to the EU,
- Commission for the National Budget,
- Commission for Pension and the Health Care System,
- Commission for Alternative Resolutions of Labour Disputes

In addition, Economic and Social Councils were formed on the county levels, in order to address specific regional issues.

Notwithstanding this new and elaborated structure, within the tripartite collective bargaining process the most comprehensive agreement that was reached, was the so called “Partnership for Development”, which was signed in December 2001. The agreement covered the 2002-2003 period, with aim of speeding up the restructuring processes, enhancing competitiveness and reducing the high unemployment rate. Although the initial reaction of all social partners to this agreement was positive, in its implementation it did not last.

One of the obstacles to more efficient collective bargaining on the national level comes from the fact that the union scene in Croatia is segmented. There are more than 250 unions, and there are no official information on their membership. Consequently, unions on occasions have difficulties in reaching the agreement among them. This results in a situation where tripartite dialogue becomes multipartite, and even when a formal agreement is reached, the implementation of the agreement might not suit all the parties.

Results obtained at the national level in the tripartite collective bargaining process, even though not always fully implemented, are spread through the economy, as they serve as a signal to all the other participants on the labour market. And even though there is no official data regarding the coverage of employees by collective agreements, some estimates report under 50 percent of all the employees might be covered. These estimates include those covered by sectoral

agreements as well as national collective bargaining agreements. For the sectoral agreement, usual formulation is that the general collective agreement applies, but some provisions relevant for the special sector (related to special working conditions, etc.) are extra stipulated.

The autonomous bipartite social dialogue is achieved in certain companies (enterprises) and institutions, but also within certain branches and activities between trade union associations and employer associations, whether these employers belong to the private sector, or are on the level of certain ministries.

For the ones that are not covered within the collective bargaining process, the wages are set either at the company level, or even on individual level, within direct negotiations between the employer and the employee. These are mostly concentrated in the private sector, and more often than not in the small enterprises.

Previous presentation of the social dialogue process in Croatia leads to the conclusion that the labour market is highly segmented. One segment of the labour market is characterised by the relatively highly regulated working relationships – including the wage dynamics, different benefits, education and training requirements, promotion criteria etc. These provisions are regularly discussed within the collective bargaining process, and in most cases implemented in government institutions, public companies, etc. For a certain segment of the private companies, collective bargaining results also apply, whether formally, or taken informally as a signal. The last segment of the labour market is dominated by private companies, usually although not exclusively small enterprises, where the wages are negotiated on the individual level, or some company rules are followed.

Taxes on labour

Taxes on labour are frequently considered as one of the key impediments to increased employment. This is especially emphasized in the literature on the labour markets in transition countries, due to the inherited mechanism of financing social contributions (health insurance, pension system) through wages. Therefore, in addition to taxes on wages, we discuss all the elements of the labour costs in Croatia.

The taxes on wages in Croatia have been revised on several occasions. Most of the time the changes are related to the amount of tax exemptions (tax deductibles), but the tax base (tax brackets) and rates have also been revised44. Currently, there are 4 tax rates on income tax in Croatia. These are listed in the following table:

[44] Just as an illustration, we mention few changes in the taxes on wages. At the beginning of the year 2000, only 2 tax brackets existed, with tax rates of 20 and 35 percent. During that year, the tax brackets widened. For the years 2001 and 2002, three tax rates existed – 15, 20 and 35 percent. The forth rate, 45 percent, was introduced in the year 2003.

Table 2

Taxing wages in Croatia – tax brackets and rates

Monthly tax base (HRK)	Tax rate
Up to 3.200,00	15
3.200,00-8.000,00	25
8.000,00-22.400,00	35
Higher than 22.400,00	45

Note: Croatian National Bank's EUR middle exchange rate on the October 15th was 7.32.

To estimate the difference between the gross wage and the net wage, other factors also have to be taken into consideration, such as social contributions and municipal surtaxes. Social contributions are used to finance the health system in Croatia, although the funds collected through wages are not sufficient to entirely cover expenses, as the system is running deficits each year. The estimation of the total taxes and contributions paid by the Croatian worker will be illustrated in the following table on the example of the average gross wage in Croatia for July 2007.

It has to be noted that for this example we have applied rather extreme assumptions: person with no additional tax exemptions, no registered children, and living in Zagreb which has the highest municipal surtax rate. The fact that we have come up with only the 66 percent of the average nominal net wage the Croatian Bureau of Statistics has reported for the same month, only supports this view. If we consider the average net wage according to the CBS data and compare it to the total labour cost illustrated in the previous table (because the upper part of calculations on the gross wage remain the same non regarding other elements of calculation), then we could estimate the average tax wedge in Croatia to be 41.4 percent.

Table 3

Illustration of the taxes on wages in Croatia

	Amount in HRK
Labour Cost	**8282,52**
Social contributions on gross wage - total	**1215,52**
Social contributions – health insurance: 15 %	1060,05
Social contributions – work safety: 0.5%	35,33
Social contributions – employment: 1.7%	120,14
Gross wage*	**7067,00**
Compulsory pension insurance – generation solidarity: 15%	1060,05
Compulsory pension insurance – mandatory individual savings: 5%	353,35
Compulsory pension insurance – total**	**1413,40**
Tax exemptions***	
Personal exemptions	1600,00
Exemptions for the family members****	
Tax base	**4053,60**

Income tax – up to 3200 HRK: 15%	480,00
Income tax – 3200-8000 HRK: 25%	213,40
Income tax – 8000-22400 HRK: 35%	
Income tax – above 22400 HRK: 45%	
Total income tax	**693,40**
Municipal surtax*** 18%**	**124,81**
Net Wage	**3235,39**

* Source: Central Bureau of Statistics

** For some workers, only the generation solidarity applies, but in that case up to the 20%, so the total amount remains the same.

*** Different tax exemptions or deductibles – like life insurance or health insurance premiums are applied in Croatia, up to the total amount of 12000 HRK annually. They are, however, not included in this example

**** These are related to the number of children. Special factors apply to the personal exemptions amount: 0.5 % for the first child, 0.7% for the second and 1% for the third.

***** Municipal surtaxes are revenues of the local government. We apply the maximum rate here, which is valid in the city of Zagreb.

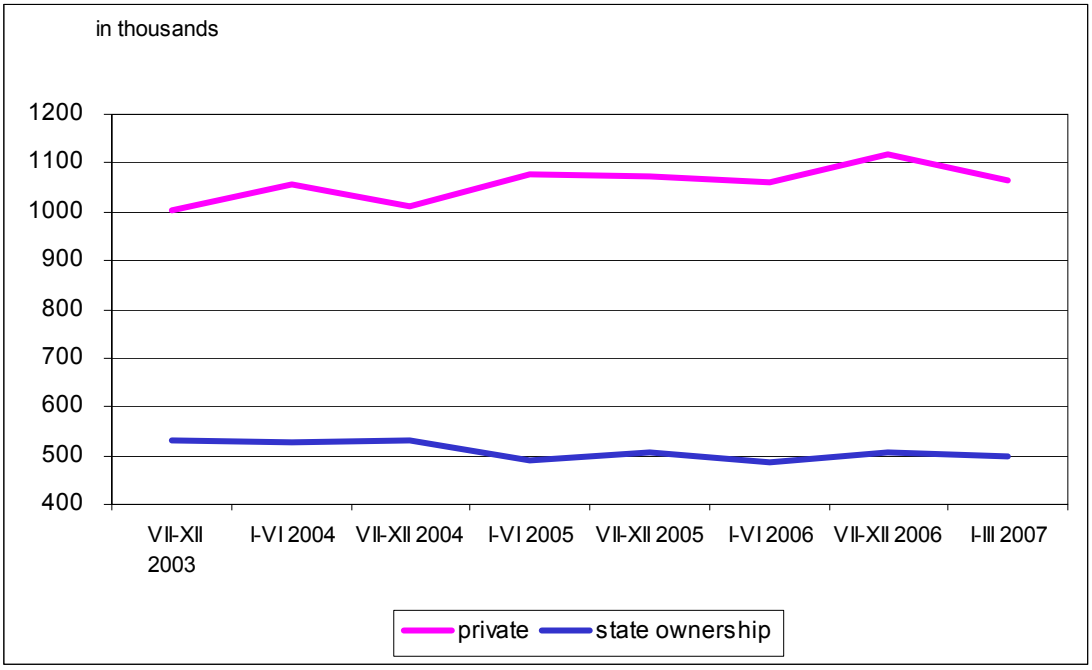
This presentation can be compared to the similar exercise preformed by Rutkowski (2003). Rutkowski (2003) estimates tax wedge in Croatia for the years 1995, 2000 and 2002 and the results imply that it was the highest in the first year – 48.3, and dropped down significantly to 41.3 for the year 2002. Our results imply that the tax wedge has not changed significantly in the following years, and Rutkowski (2003) argues that in comparison to other countries, Croatia did not have excessive taxes on wages.

Increased Croatian labour costs in comparison with other countries within the region come consequently not from excessive taxation, but rather from relatively higher wages. When compared in nominal terms, average net wage in Croatia is higher than in almost all new member states (with exception of Slovenia). The average net wage for July 2007 was EUR 663, and the gross wage EUR 965. Curbing down taxation on wages has remained one of the governments' tasks, as the relatively high labour costs have been recognized as significant impediment to foreign investments.

When discussing wages, few additional points should be made. The first are the gender differences, which are in line with those in other countries within the region, and not excessive when considered in comparison to EU countries. Nestić (2007) reports the raw (unadjusted) gap for the year 2005 at 12.5 percent. Furthermore, the analysis brings conclusion that gender wage gap is relatively mild at the lower part of the wage distribution and is increasing at the higher end. Consequently, even though the average gap is not high, the highest paid jobs are related to increased gender wage gap.

Figure 5

EMPLOYMENT ACCORDING TO FIRM-OWNERSHIP, LFS DATA



Source: Central Bureau of Statistics, Labour Force Survey.

Another study by Nestić (2004) looked into public-private sector wage gap, based on the Labour Force Survey data for 2003. The analysis revealed that there was a substantial public sector wage premium, and it was the highest for low-paid, low-to-medium-skilled and female employees. Even though there have been some changes on the labour market since the time of the analysis, the implication that the employees in the public sector are obtaining some form of premium – in terms of wages, job security, working hours, etc. – might still hold, and support the segmentation of the labour market hypothesis. The anecdotal evidence has it that female employees value public sector employment, as it provides more security in terms of decreased firing probabilities, easier obtaining sick-leave connected with child-illness, but on general lower wage. Within the same family, male may opt for higher risk-higher paid jobs, located within the private sector. The choices are made not based on discrimination on the labour market, but rather on rational behaviour when the whole family is taken into consideration.

From the data presented in previous figure, it can be seen that the employment in private sector more than doubles the employment in state-owned sector. Even though the changes have not been dramatic during the period shown, it can still be seen that the state-owned enterprises are shedding the employees, while the private sector is gaining more weight. It also has to be said that within the private sector, approximately 28 percent in the first quarter of 2007 were self-employed, among which more than 2/3 were those with no other employees in addition to themselves. This implies that the development of the small businesses is highly significant, and the future developments in this segment of the economy are crucial for the total employment dynamics in Croatia.

When analyzed on the level of economic activity (NACE classification), the data reveal that significant state-owned employment is in the areas of public administration and defense: compulsory social security; health sector, education. These are easily explained by the fact that education and health systems have only recently become open to competition from private sector. And, even though the impact of the private firms in those sectors are increasing, they do not employ much, and sometimes even «borrow» part-time workers from the state-owned companies. The other sectors in which the employment in the state-owned enterprises is still significant are transport and manufacturing, although latter one is on total more privately oriented. Within the structure of private sector employment, the most significant sectors in addition to manufacturing are trade, agriculture and construction.

Industrial action

There are no official data on strikes in Croatia, within the reports published by neither the ILO nor Croatian statistical offices. This does not imply that there are no strike activities in Croatia. Most of the activity of the unions in this segment is related to the collective bargaining process, in particular related to the situations where the government is the employer. Quite common have become strikes by school teachers, which are sometimes extended to the science and high education employees, around the time the new annex for collective agreement is due to be signed. The time spent in the strike is usually then “worked-out”, meaning that the school year is prolonged, in order to enable the teachers to fulfill the curriculum requirements.

The other example is the strike in hospitals, which was suppressed by the government by proclaiming the obligation to work in order to keep the health system running. The main motive behind this strike was the inability of social partners to reach the agreement and sign the collective agreement.

Schools and hospitals are examples most visible in public, but unions in other sectors might also from time to time organize strikes. In addition to strikes, unions sometimes organize protests, for instance for “saving the jobs” in the firm that is currently going through restructuring or privatization program. The target of such actions in most of the cases is the government.

Labour market policies

Active labour market policies in Croatia were introduced at the beginning of 2002, as the country was facing the highest recorded level of unemployment. Different programmes for different target groups were designed, and Croatian Employment Service was the agency that administrated all the programmes, which were:

- Programme A “From College to Work”. The programme offered vouchers to the final year students at 85 colleges, upon the condition of completing their studies on time. Vouchers could have been used for different sub-programmes: replacement in government administration or public enterprises of retiring workers (with the idea of mentoring these new employees); subsidised employment in research projects in government administration or public or private enterprises; subsidised employment in selected regions or regions with

labour shortages in certain occupations; subsidised employment in local administration and private enterprises; and provision of loans and other assistance for starting own-account activities.

- Programme B “From Classroom to Workshop” was designed to provide the support to those who have finished vocational education and/or training, but have no prior work experience.
- Programme C “By Learining towards Jobs for All” provided subsidies for people under 30 years of age with minimal work experiences. Two types of subsidies were offered – internship in the duration of 12 months or on-the-job training followed by employment for a fixed period related to the period of subsidy.
- Programme D “With Experience towards Profit” provided subsidies for older jobless workers during the 18 months of employment.
- Programme E “There are Chances for Us Too” promoted employment of disabled persons for a period of 24 months.
- Programme F “Work for Veterans” subsidized employment of veterans or spouses and children of dead or missing veterans for a period of 36 months.

In all these programmes, employers received subsidies in the form of a certain percentage of the gross or net salary of the worker. In certain components, employers may have received a premium for keeping the worker for an extended period. Programme participants eligible for the self-employment component of programme A were granted a start-up loan plus other assistance free of charge while those benefiting from subsidised employment in selected regions or regions with labour shortages could have obtained a relocation subsidy.

The evaluation of the programme measures showed that they were not very carefully designed – as for each measure 95 percent of the unemployed could have applied. Consequently, the target groups were too wide (see, for instance, Babić, 2003). This view is further emphasized by Crnković-Pozaić (2006), who argues that severe discrepancies between the planned and financed programmes occurred – the ratio of spent to planned was around 14 percent for programme A up to 359 percent for programme D.

Due to these and other reasons, the programme was stopped in August 2005, with the final result of employing more than 80000 persons. The details across different programmes can be seen in the following table.

Table 4

Persons employed in the period from March 2002 to August 2005 through active labour marker policies measures

Programme	Total	Women	Share of women
A – "From College to Work"	5,745	3,667	63.8
B – "From Classroom to Workshop"	1,874	611	32.6
C – "By Learning towards Jobs for All"	57,044	29,211	51.2
C1 – internship	*6,609*	*3,331*	*50.4*

C2 – on-the-job training	*50,435*	*25,880*	*51.3*
D – "With Experience towards Profit"	6,216	3,980	64.0
E – "There are Chances for Us Too"	339	153	56.9
F – "Work for Veterans"	9,153	328	3.6
Total	**80,371**	**37,950**	**47.2**

Source: Croatian Employment Service.

For these measures a total of HRK 991924079.42 (EUR 135323885.32) was spent during the whole period of implementation. In the first year, the expenditures amounted to 0.0006 percent of GDP (while at the same time passive labour market measures accounted for 0.49 percent of GDP). The whole amount spent on these measures throughout the implementation period amounted to 0.43 percent of the estimated GDP for the year 2005.

After the measures have been stopped, the National Employment Action Plan for Croatia has come into effect. The Government has adopted this plan, which is valid for a 2005-2008 period, and according to the plan annual measures are prescribed. All of the measures prescribed follow the EU guidelines and are comparable to the similar National Employment Action Plans in member countries. Not all the measures are within the responsibility of the Croatian Employment Service, but other institutions participate in the implementation of different measures (Ministry of Economy, Labour and Entrepreneurship; Ministry of Family, Veterans' Affairs and Intergenerational Solidarity; Ministry the Sea, Tourism, Transport and Development; Ministry of Health and Social Welfare; Ministry of Science, Education and Sports; and Ministry of Finance). For the year 2006, the funds reserved for the Employment Promotion amounted to HRK 179178142.80 which was approximately 0.07 percent of the GDP estimated for the year 2006. Most of the funds were reserved for employment incentives, while the least ones were for the training.

As for the new measures in the Croatian Employment Service during the 2007, they include subsidies for employment, targeted to:

- M1 – young people without working experience
- M2 – long-term unemployed
- M3 – female workers older than 45, and male workers older than 50
- M4 – special groups of unemployed persons

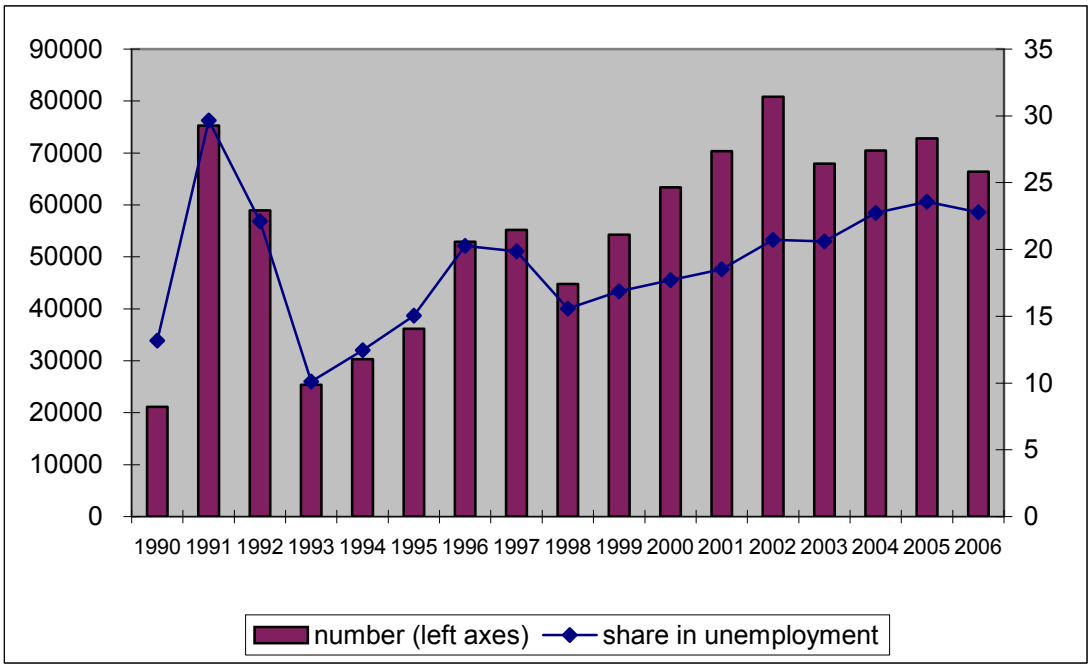
In addition to employment subsidies, there are also subsidies for training and education both when the worker is already working (and needs the additional training to keep the job, or is the newly employed person) as well as training and education of the unemployed in order to enhance their chances in finding the job.

The measures implemented by the Croatian Employment Service for the first nine months of 2007, which include public works as well, were used in 5889 cases. The most popular measures were education and training of the unemployed, and subsidizing the employment of the long-term unemployed.

When it comes to the passive labour market policy measures, it has already been noted that in the amount spent they supersede the active labour market policy measures. However, the share of the beneficiaries of the unemployment benefit system in the total number of the unemployed is not large, as can be seen on the following graph. As can be seen from the date presented at the previous graph, the dynamics of the average annual number of beneficiaries of the unemployment benefits system in Croatia exhibits somewhat volatile pattern, determined by the overall unemployment dynamics, but also changes in the relevant legislation. The share of the number of beneficiaries in total unemployment also varies. However, it can be seen that, with exception of the year 1991, this share was less than 25 percent. This relatively low percentage stems from the fact that a large share of unemployed has been too long registered, and therefore they have exceeded the maximum duration for benefit receipt.

Figure 6

NUMBER OF UNEMPLOYMENT BENEFITS BENEFICIARIES AND THEIR SHARE IN THE NUMBER OF REGISTERED UNEMPLOYED



Source: Croatian Employment Service.

A certain stimulus to the unemployment benefit system came at the beginning of the 2004, with the introduction of the new Labour Code. Since the government was keen to reduce the EPL index, it was willing to compensate the new provisions in the Labour Code with the extension in benefit duration period (from 12 to 15 months) and increase in the maximum unemployment benefit amount (from HRK 900 to 1000). However, these changes had only minor reflections in the number of beneficiaries.

Duration of the unemployment benefit is related to the previous employment duration. The right to unemployment benefit is granted to an unemployed person who has completed 9 months of

employment in the 24 months preceding the unemployment, provided that he or she registers with the employment service and files an application for benefit within 30 days of the termination of work. Consequently, minimum duration of the unemployment benefit is 78 days and maximum duration can be obtained if a person had previously been employed for longer than 20 years. In that last mentioned case, he or she can rely on the unemployment benefit for 390 days45. However, for the males who have been previously employed for a period of 35 years, and females for a period of 30 years, the duration of the unemployment benefits could even be prolonged until they have reached the legal age for retiring.

According to the legislation, the minimum level of the unemployment benefit is 20 percent of the average wage in Croatia, and the maximum unemployment benefit is established by a government's decision, upon the proposal of the minister responsible for labour. The maximum unemployment benefit has been until recently set to HRK 1000, but the latest government decision increased it from October 2007 to HRK 1200. Croatian Employment Service data for September 2007 report that the average unemployment benefit paid was 996.84 HRK. If this amount is compared to the average net wage in July (the latest available data published by the Croatian Bureau of Statistics), we come up with the replacement ratio of 20.5 percent.

According to the Croatian Employment Service data (Hrvatski zavod za zapošljavanje, 2007), the total amount spent for the unemployment benefits in the year 2006 was HRK 815 747 224.00 which is approximately 0.32 percent of the GDP estimated for the same year. The same data source reports that for the implementation of the measures within the National Employment Action Plan during the 2006, the amount of HRK 93 728 389.00 was spent, which is approximately 11 percent of the amount spent on unemployment benefits. The conclusion is that the passive labour market policy measures still dominate in the structure of government financed employment programmes.

Labour mobility

Regional mobility in Croatia is rather low. Recent LFS data imply that more than 60 percent of the employed work within their residing area, with additional 28 percent working within the same county46. The effect of the lack of regional mobility on the persistence of regional unemployment rate differences has recently been emphasized by Botrić (2007). The analysis based on the LFS data has shown that when the county is resided by less geographically mobile people (larger percentage of those unwilling to accept the job outside the boundaries of the county) it is associated with the increased unemployment rate within the county. Therefore, the lack of geographical mobility can severely influence the persistence of the unemployment in certain Croatian regions.

[45] The calculation of days for the duration of benefits excludes Sundays.

[46] Croatia is administratively divided in 20 counties and city of Zagreb, each territorial unit having population according to the 2001 census from 53677 (Ličko-senjska) to 779145 (City of Zagreb).

Box 2 Immobility equals unemployment?

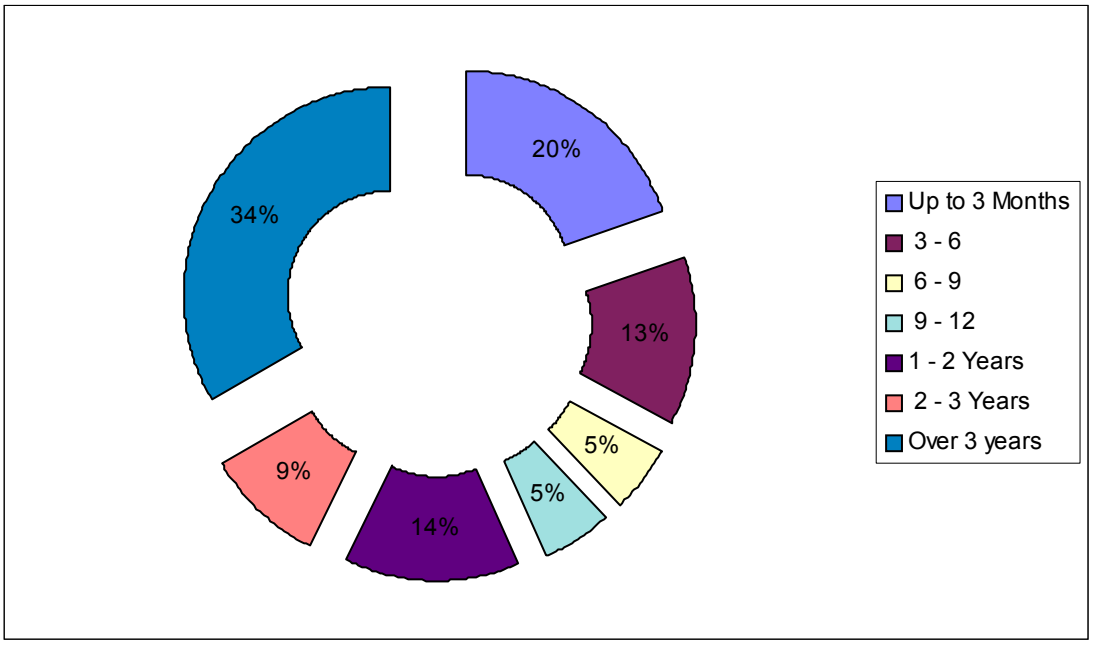
Small survey with 296 participants, young and highly educated, single or married without children across Croatia was conducted. The participants were asked whether they would be willing to move in search for a better job. The results imply that employed are more willing to move than the unemployed. However, they would be willing to move only if this is financially compensated. The average expected increase in wages that would motivate the participant to move is 59 percent.

Source: www.moj-posao.hr

The large contribution to the problem of persistent unemployment is the large share of the long-term unemployed in the total unemployment. As known from the literature, the long-term unemployed have lost touch with the labour market, they might not be having skills required by the labour market, and are frequently perceived by the employers as unemployable. Duration of unemployment is significant problem for Croatia. There is an increased number of long term unemployed, making the average time of waiting for the job relatively high. Available data indicates that 34 percent of all the registered unemployed are unemployed for longer than 3 years, and the share of those unemployed for longer than 1 year is 57 percent.

Figure 7

DURATION OF THE UNEMPLOYMENT, 2006



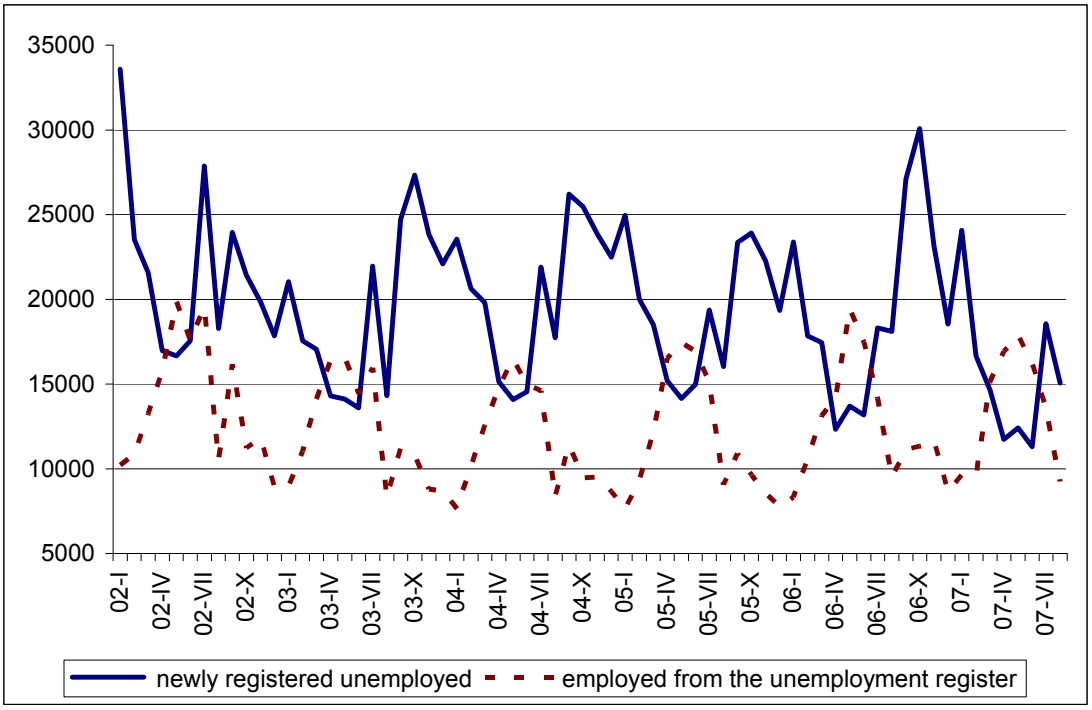
Source: Croatian Employment Service.

During the last few years, Croatian Employment Service has designed new policy measures to improve this statistics. However, as is the usual case, the measures to improve the employability through increased skills of the long-term unemployed, have effects only in the long time. In the meantime, although not easily confirmed by the available data sources, it can be assumed that at least some part of this group exhibits discouraged worker effect, and has withdrawn from actively searching the new job.

In addition to the long-term unemployed, who form the persistence in the unemployment data, the dynamics of the overall series stems from the newly unemployed, and it is interesting to see how this part of the total is formed. Croatian Employment Service data on newly registered unemployed persons reveal that most of the new unemployment comes directly from employment. For the period since January 2002 until August 2007, almost 58 percent of the newly unemployed on average came from employment. The next largest contribution is from the inactivity – during the same period 30.6 percent on average. Those coming directly from education accounted only around 10 percent of newly unemployed47. This implies that the dynamics in the unemployment series comes mostly from the job destruction process. That process can be mostly attributed to the restructuring of the economy, as well as privatization of previously public-owned firms.

Figure 8

NEW UNEMPLOYMENT AND EMPLOYMENT OF THE REGISTERED UNEMPLOYED, 2002-VIII 2007



Source: Croatian Employment Service.

As can be seen from the graph, the series representing new entrants to the unemployment register as well as employment from the register, exhibit strong seasonal patterns. Since the new entrants on the unemployment register are predominately under the influence of the diminishing employment, it is not surprising that the increased demand for employment (peak) is associated with decreased number of newly unemployed. It has to be noticed that during most of the analyzed period, the employment in some months was just barely over the decrease in new

[47] Segmentation of labour market in Croatia is also confirmed by the fact that the young professionals can expect better chances for finding a job. According to another survey conducted in June 2006 with 774 participants, 40 percent of young people have received a job offer during their university years, as compared to 26 percent of those in high-schools. In addition, those with university degrees had to wait for a job longer than 2 years in only 4 percent of the cases, while for those with high-school diploma the comparative percentage was 13 percent (www.moj-posao.hr).

unemployment. This situation has somewhat changed during 2007, when the new hiring of the registered unemployed was more significant than during the previous years. This is related to the revival in the overall economic activity, and the employment from the unemployment register follows the increased employment data for the country as a whole.

Informal sector employment

According to the latest available estimates of underground economy in Croatia, its share has decreased to 15.6 percent in 200248. Although the unofficial sector is difficult to pin-down precisely, the available estimates imply that the unofficial sector is decreasing in Croatia. The informal sector employment is not the only means of unrecorded activity, as the under-reporting of certain activities might be more relevant type of unofficial activity. This is precisely what Lovrinčević, Marić and Mikulić (2007) estimates reveal – N1 type of underground economy (that relates to non-registered producers) is decreasing, while N6 (mis-reporting by the producer) is increasing its share in total estimated underground economy during the 1998-2002 period.

Informal sector employment was for the first time directly estimated in Croatia by Crnković-Pozaić (1997). Using the pilot Labour Force Survey for the year 1995, the informal in total employment is estimated at 25.8 percent, by assuming that all of those who have stated that they have been working, but have not declared themselves as employees (like retired persons, students, housewives) were considered to be informally employed. Šošić (2004) applies similar methodology in estimating informal sector employment. By using the "narrow" definition of informal employment, which excludes second job holders, but includes unpaid family workers as well as the formally unemployed and inactive (this category further collapses into retired persons, pupils and students and housewives) informal employment in 2002 declined to 12 percent of total employment (which is a significant decrease from the previous estimates by Crnković-Pozaić, 1997). Šošić (2004) extends this analysis to claim that informal employment does not differ significantly to formal employment, when it comes to flexibility.

Applying the similar methodology to more recent data reveals that the informal sector is further decreasing. The estimates are not shown due to the comparability issues. Specifically, the labour legislation has changed, the possibilities with different types of work-related contracts have widened, the registration of income from different types of work has increased, and the assumption that all those not having fix-termed or permanent contract are automatically illegally working, cannot be considered valid. If we add the additional condition – those that are at the same time registered at the Croatian Employment Service, therefore they declare themselves as unemployed – the percentage of persons in informal employment in comparison to total employment becomes relatively small.

[48] Lovrinčević, Marić and Mikulić (2007) estimate the size of the unofficial sector by applying the Eurostat's exhaustiveness methodology. The new methodology implies a significantly higher share of unofficial sector in GDP in the year 2000 (16.6 percent) than previously estimated by the similar national accounting system methodology for the same year (6.8 percent) by Madžarević-Šujster and Mikulić (2002).

In addition to these considerations, it has to be noted that the data on uncovered illegal employment are also showing the decrease in numbers. Data from the Croatian State Inspectorate (Državni inspektorat) confirm that the overall number of illegally employed is decreasing. As an illustration, in the year 2000, the overall number of inspections was 18223, the number of illegally employed domestic workers 7789 and 803 foreign workers. The results of the inspection for the year 2003 in 13785 cases revealed 4046 domestic and 1373 foreign illegal employees. The 2006 data in 12962 cases only 1431 domestic and 1284 foreign illegal employees were found.

The illegal employment in numbers of domestic workers is decreasing, however, the unions warn, and the State Inspectorate's reports confirm that the largest problems in obeying the Labour Code are related to the non-recorded overtime, employment without official documentation (confirming the obligation of the employer to pay for the mandatory social contributions), increased share of fix-termed contracts in the cases not adequate according to the current Labour Code, and not allowing the workers agreed day or week – holiday. This information states only once more that the form of the unofficial activity has changed, the predominated model is not simply non-declaring the employees, but rather declaring them and not honoring some of their rights.

3 Specific issues and new labour market policies

It should be emphasized once more that the general opinion on the further flexibilization of the labour market in Croatia is probably mostly under the influence of the unions' leaders. The unions opposed the latest flexibilization round within the adoption of the new Labour Code in 2003 quite fiercely, and were able to mobilize the public against the "loss in security of jobs". This was easily done, as the increased unemployment is perceived as a mirror image of privatization failures during the 1990s, and the perceived increased income inequalities that followed.

Implementation of existing legislation poses a severe problem in Croatia due to the inefficient judiciary system. This is not only related to the work-related court cases, which tend to last too long. According to the Croatian State Attorney Office (Državno odvjetništvo Republike Hrvatske), in 2005 there were 14754 open cases with workers demanding the total amount of 2 billion HRK. More than 80 percent of the cases are related to non-fulfilling the provisions of the collective agreement. This, in addition to the questionable implementation of existing legislation, puts the effectiveness of the social dialogue process in another perspective.

The inefficient judiciary system and underdeveloped out-of-court settlement system have the consequence that even though the workers should receive the entitled compensations, the firm-employer has in the meantime in many cases either gone bankrupt or ceased to exist. This further increases the mistrust between the social partners, and brings additional pressures from the union's side to guard the established positions.

The implementation of the legislation is a wider problem in the context of Croatia's EU accession. The transposition of the acquis communautaire is a lengthy process, and newly introduced legislation in Croatia adds to the difficulties in implementation, as the terms of "doing business" are changing. Even if we assume that all of the changes in legislation are "for the better", the adjustment of the system to the changes always require time.

The new policies on the Croatian labour market are focused around the National Employment Action Plan, and the annual measures adopted within the concept of the EU guidelines. The main emphasis is put on the importance of education and training, not only in the context of the increased employment and employability, but also in the context of the economic growth and increase competitiveness of the Croatian economy.

It has to be noted that the reform of the education system in Croatia includes considerations of the labour market's needs. The emphasis is put on the lifelong learning, but also more comprehensive changes, including moving the focus of the secondary education system from narrow vocational courses towards acquiring more general skills that will result in higher flexibility in profession selection. The effects of the changes in education system are also visible only in the long-term, as the labour force acquires more "human capital".

The adjustments to possible integration shocks in the short run are probably not going to be equally spread across the working population, as the labour market is segmented. The employees in the public sector and at the same time unionized are through unions probably going to exert additional pressures on the social partners to oppose the additional flexibilization on the labour market. At the other side, the employers in the private sector demand and are willing to pay for certain type of workers, making this segment of the labour market already highly flexible. The potential room for adjustment is probably within the current mode of operations – the relatively low job creation and not too many chances for the long-term unemployed.

Another form of adjustment will probably be through the self-employed – whether those registered as employed or free-lancers. The increase in the employment during the recent period was vigorous in the crafts and free lances - during the 2002-2007 period almost 50000 people were employed, or nearly 20 percent increase occurred. The increase in the free-lance registered employment was enabled through the changes in the unemployment register, but also in the income tax reporting system. The adjustment to adverse shocks might in these cases come from the loss in contracting opportunities for free lancers, instead of firing the employed protected by the costly firing procedures. Thereby, the inflexible segment of the labour market might remain inflexible, while the flexible segment will bear the costs of the adjustments to the adverse shocks.

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Former Yugoslav Republic of Macedonia

1 Contribution to the literature review

Labour markets in transition countries have received continued attention in the economic literature. Amidst the mounting interest in labour market outcomes in transition economies, this paper takes a comprehensive view of the labour market performance in Macedonia. Although Macedonia is a country with an extremely high unemployment rate and an apparent outlier even in the group of high-unemployment transition countries (World Bank, 2005), it has not been subject to many studies. Most of the existing studies dealing with labour market issues in Macedonia are of descriptive nature and there are hardly any analytical studies.

Micevska (2004) and Mojsoska-Blazevski (2004) compare the strictness of the Macedonian labour legislation with that of other transition countries. Both studies find that Macedonia has relatively less strict legislation on regular employment. On the contrary, legislation on temporary employment has been relatively strict. Micevska's regression analyses show that this factor tends to be related with higher female, youth, and long-term unemployment. That is, less flexible labour markets seem to impair labour market prospects of those who are in greatest need for flexible labour markets.

Nikolov (2005) claims that the high unemployment rate in Macedonia is not to be attributed to strict labour market regulations, but to structural problems: lack of adequate education of the labour force, inefficient privatization, weak institutions, and unfavourable investment climate. The author is particularly concerned with the lack of relevant and adequate data on the Macedonian labour market. This present a particular difficulty in conducting elaborated analyses of the most relevant factors specific for the Macedonian labour market.

In a recent background paper prepared for a World Bank study on unemployment issues in Macedonia, Petreski (2005) identifies the lack of labour demand resulting from the low rate of economic growth as the main culprit behind the Macedonian high rate of unemployment. In addition to providing a comprehensive overview of the state of the labour market, including the informal sector, the study provides a critical assessment of the 2004-2005 National Action Plan for Employment (NAPE) aimed at increasing the employment in Macedonia and proposes further institutional reforms in the labour market.

Micevska (2007) is among the scarce analytical studies dealing with the Macedonian labour market. The study examines job creation and job destruction using firm-level data and estimates short-term and long-term elasticities of the labour demand. The analysis concludes that there are regulatory barriers to the labour market flexibility and that the privatization of socially-owned enterprises has failed to promote job creation. Nevertheless, labour market problems seem to stem from factors other than substantial sluggishness of firms in adjusting employment to variations in wages.

The focus of this paper is on understanding the reasons for the poor labour market outcomes in Macedonia and the role played by the labour market flexibility. The ultimate objective is to delineate policy implications. These include among others changes in legislation, reduction of the taxes on labour, and combating the pervasive informal sector employment.

2 Description of the Macedonian labour market

2.1 Brief summary of main characteristics of the labour market

The pattern of real GDP in Macedonia during transition has more or less matched that observed in the other Western Balkan countries. The recession was less pronounced at the beginning of the transition, but subsequently the output declined for four consecutive years with a cumulative decline of almost 20 percent. The recovery was slow and the pre-transition GDP level was reached only in 2005. Besides the usual problems encountered by transition countries in general, additional difficulties for Macedonia included an economic embargo by Greece in a dispute over the country's name, UN sanctions against the neighbouring Serbia, and the Kosovo crisis. These factors contributed to an unfavourable business climate.

While the pattern of the Macedonian GDP growth is not overly unusual compared to that of the other Western Balkan countries, the Macedonia labour market performance is. Unemployment is particularly high, however measured, leaving Macedonia an apparent outlier among the transition countries (Figure 1).[49] The unemployment rate as measured in the Labour Force Surveys (LFS) hovers above 30 percent, while the registered unemployment rate is over 50 percent.[50] The reasons for the discrepancy between the ILO unemployment rates and the registered unemployment rates are discussed below. It suffices to mention here that, unlike in other transition countries that were immune to unemployment problems before the 1990s, unemployment has been an issue in Macedonia for a long time.[51]

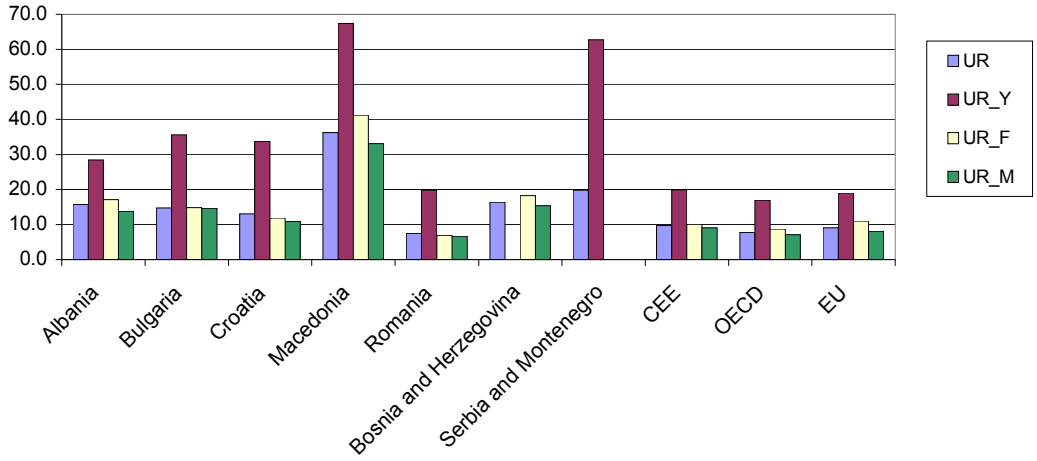
[49] IMF (2006) discusses possible measurement problems that contribute to the high unemployment rate. Using alternative sources of data, the study concludes that unemployment rate fluctuates between 15 and 51 percent, with the most reliable estimate of around 25 percent. However, the study also finds significant hidden unemployment within firms as reflected in high wage arrears.

[50] The LFS have been conducted since 1996. Macedonia has had registered unemployment rates of over 20 percent since the 1980s.

[51] While a fundamental feature of the Soviet-type economies was the nonexistence of open unemployment, the system of worker self-management in the Socialist Federal Republic of Yugoslavia allowed unemployment. This, together with the politically complex circumstances and the war turmoil, is the factor behind the high unemployment in Serbia as well.

Figure 1

Unemployment Rates (late 1990s)



Notes: The youth unemployment rate (UR_Y) denotes % of labour force ages 15-24. UR_F denotes the female unemployment rate, while UR_M denotes male unemployment rate.
CEE is an averaged index for the following Central European countries: Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia.

The unemployment rates are based on the LFS concept and are averaged using available data over the period 1995-2000, except for the figure for Bosnia and Herzegovina which is based on the 2001 LSMS.

Sources: World Development Indicators database (2003), TransMONEE database (2002) for youth unemployment, and World Bank (2002) for Bosnia and Herzegovina.

The average unemployment rate is higher for women (38 percent) than for men (36 percent) as in most European countries. The gender gap is largest for low skilled labour. Overall, low skilled workers are more likely to be unemployed.[52] Unemployment rates also differ significantly among ethnicities, with the Roma, Albanians, and Turks being particularly affected.[53] Youths are especially affected by unemployment in Macedonia: the youth unemployment rate is almost 70 percent. The long duration of unemployment is particularly worrisome: majority of the unemployed (over 80 percent) are jobless for over one year, that is, are long-term unemployed. Moreover, the long-term unemployment is primarily of young individuals rather than older workers.[54] The long-term unemployment is almost evenly distributed between men and women.

Although Macedonia's labour force participation rate has been quite low (about 60 percent), it has been stable during the transition period.[55] This is probably a result of the declining living standards, which did not allow for significant manifestation of the discouraged worker effect and

[52] Educated workers also face problems finding jobs, and the reason lies often in the education system that does not provide skills needed by the labour market (Mojsoska-Blaevski, 2006).

[53] The Vlachs and Serbs, on the other hand, have lower unemployment rates than the average.

[54] Contrary to many other transition countries, firms in Macedonia have tended to resist shedding labour until they go bankrupt, pushing the burden of adjustment to smaller labour demand onto new entrants in the labour force.

[55] It should be noted, however, that the low participation rate mainly reflects ethnic factors, i.e., the very low participation rate among ethnic Albanian women.

of other factors behind the decreasing activity in other transition countries (e.g., voluntary and semi-voluntary quits, forced withdrawals, etc.). Female participation rate has been traditionally lower than that of males and has been declining during the transition period, mainly due to deteriorating access to childcare facilities and discriminating practices by potential employers.

High unemployment along with a low participation rate suggests low employment-to-population ratio. Only 40 percent of the population of working age (aged 15-65) is employed. Employment of women is particularly low (only about 30 percent of working age women are employed).[56] Not surprisingly, employment rates increase significantly with higher education. As a result of insufficient employment opportunities and greater risk in the private sector, there is a relatively high share of public administration in total employment (above 5 percent). Nevertheless, the share of private employment in total employment increased significantly. Part-time and fixed-term employment have been on the rise, with relatively higher representation of women and youth. At the same time, although precise national data are not available, it is obvious that very few vacancies are reported by employers to the Employment Service Agency.

The above mentioned characteristics of the composition of unemployment – mainly long-term, young, women, and unskilled - indicate that labour market rigidities might have played an important role in the dismal performance of the Macedonian labour market. For example, Scarpetta (1996) finds that youths are the most adversely affected by labour market rigidities, especially in a context of wage compression. Nickell (1997) and OECD (1999) observe that long-term unemployment is an indicator of the presence of labour market rigidities, due to lower inflows and outflows, and longer duration of unemployment spells. In the next subsections, I examine possible rigidities and distortions of the labour market in Macedonia.

2.2 Labour code

One of the key tasks at the beginning of the transition was to dismantle the "job monopoly," a fundamental feature of the previous system of self-management. Macedonia embarked on multiple reforms of the labour code. An assessment of Macedonia's EPL index during the 1990s and the early 2000s is provided in Table 1. This assessment uses methodology developed by the OECD that provides a systematic treatment of the labour code, covering numerous aspects of regular and fixed-term contracts and collective dismissal procedures. The comparison with the Central European countries, on the one hand, and with the EU and OECD countries, on the other, shows that Macedonia's EPL was relatively restrictive during the transition period. This rigidity was mainly a result of the regulation on temporary employment and collective dismissals. Indeed, when adopting and amending new labour legislation during the transition period, Macedonia and the other Southeast European (SEE) countries were mainly focusing on relaxing the regular employment restrictions, while insufficient attention was paid to the benefits of adopting more flexible legislation on temporary employment and collective dismissals.

[56] The labour force participation rate and the employment rates have been adjusted to match the international definition of working age population (aged 15-65). The Macedonian definition includes population aged 15-80 years.

Table 1

Employment Protection Legislation in Selected Countries

	Year	Regular employment	Temporary employment	Collective dismissals	EPL index
Macedonia[1]	1995	2.1	4.3	4.8	3.4
	2000	2.1	4.3	4.0	3.3
	2003	2.0	3.1	4.0	2.8
SEE average	late '90s	2.2	3.9	3.6	3.1
	early '00s	2.1	2.9	3.7	2.7
CEE average	late 1990s	2.7	1.2	4.1	2.4
EU average	late 1990s	2.4	2.3	3.2	2.5
OECD average	late 1990s	2.1	2.0	2.9	2.2

***Notes*: Using a scale from 0-6, where a higher score indicates more restrictive legislation.**

SEE is an averaged index for the following Southeast European countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, and Serbia and Montenegro.

CEE is an averaged index for the following Central and Eastern European countries: Czech Republic, Estonia, Hungary, Poland, Slovak Republic and Slovenia.

1/ The Macedonian labour code was adopted in 1993 and has been amended many times since then. Only the amendments that had an effect on the EPL index are presented in the table.

Sources: Micevska (2004) for SEE countries, Riboud et al. (2002) for CEE countries, OECD (1999) for OECD and EU countries.

The 2005 labour market reform introduced a significant progress in the flexibility of the EPL. To shed additional light on the reform results and on the current legislative flexibility of the Macedonian labour market, the following analysis elaborates on all three components of the EPL index.

Regular employment legislation establishes the rules for hiring and firing procedures concerning permanent workers, notification requirements, and severance payments. The hiring procedures have been relatively flexible for some time: Employers can hire workers without previous formal announcement of the vacancies. The labour market reform streamlined the complicated layoff procedures which were often challenged in courts, causing long delays and unpredictable outcomes. According to the current regulations, the dismissal comes into effect through a written statement to an employee. The notification period has been reduced to one month, regardless of how long the employee has been working for the employer. The severance payment depends on the duration of employment of the employee: for up to 5 years, the severance payment is one salary; for up to 10 years, 2 salaries; for up to 15 years, 3 salaries; for up to 20 years, 4 salaries; for up to 25 years, 5 salaries; and for more than 25 years of employment, the severance payment is 6 salaries. Dismissals are justified on the basis of capacity or conduct of the employee, and because of economic redundancy. If the dismissal is because of capacity or conduct of the employee, the employer is obliged to give the employee a written warning before the dismissal notification. Courts may order reinstatement after a finding of unfair dismissal, or award compensation payments in the amount of minimum three and maximum twelve average

monthly salaries. The length of the trial employment period, during which unfair dismissal claims by the employee cannot be made, has been capped at six months.

Temporary employment legislation regulates the use of fixed-term contracts, their renewal and maximum duration, as well as the functioning of temporary work agencies. The 2005 labour market code allows the use of temporary contracts without any significant restrictions. Concerning duration, contracts can be renewed at will, with a maximum cumulative duration of four years. The labour code still does not stipulate the existence of temporary work agencies. It should be emphasized that, while the 2005 reform made an effort to ease restrictions on temporary employment, deterrent to employment of part-time employees is the floor set for social contributions (65 percent of the average sectoral wage for full-time work), which increases the effective payroll tax for part-timers and drives most part-time employment to the informal sector.

Collective dismissal legislation defines the term "collective," as opposed to "individual," and stipulates notification requirements and payments associated with such dismissals. The size of redundancy which is required to trigger the application of the collective dismissal regulation is not precisely determined. If the number of dismissed workers is greater than 150 or more than 5 percent of the total number of employees, the employers has to notify the workers about the dismissal at least two months in advance. In case of a dismissal of "greater number of workers," the labour code stipulates that the employer is obliged to notify and to consult with the trade union or another workers' representative at least of 30 days in advance. In addition, the employer has to notify the Employment Service Agency.

The analysis indicates that there are certain regulatory barriers to the labour market flexibility. Although Macedonia has achieved a significant progress in enhancing labour market flexibility, the remaining rigidities need to be further addressed. In particular, this implies more flexibility in the modality of employment (e.g., by regulating the functioning of temporary work agencies, by abolishing the minimum social security contributions that employers have to pay for employing part-time workers) and streamlining the legislation on collective dismissals.

2.3 Wage setting and the role of trade unions

The Federation of Trade Unions of Macedonia (SSM) is a national trade union center. It is the successor to the official trade unions of the former Yugoslav era. The federation has 18 affiliated sectoral unions. The other two federations of trade unions are the Confederation of Free Trade Unions of Macedonia (KSS) and the Trade Union of Education, Science and Culture (SONK). Instead of cooperating, the three federations of trade unions have been competing for membership and funds, and have been mostly at odds with each other. This has led to their questionable credibility in protecting the workers' rights.

During the course of transition, the bargaining power of trade unions has declined at the national, branch, and enterprise level. It should be noted, however, that there is a large difference between public firms and private firms regarding the role of trade unions (World Bank, 2003). In the public sector and in large privatized companies, union coverage and union power remain

important and wages tend to be determined mostly through collective bargaining. In the private sector and in small firms, trade unions are almost nonexistent and wage levels are mostly determined at the enterprise level, reflecting the firm's ability to pay and the workers' bargaining power. These developments have been followed by a sharp decline in unionization rate to only 45 percent of the salaried workers.[57] Nevertheless, trade unions retained their influence on creation of new labour legislation in the process of negotiations and coordination with employer associations and the government. In contrast, the representation of employers' interests has suffered from a weak employer's association with mandatory membership.

There are no data that would allow for a more elaborated analysis of the role of trade unions in Macedonia. Anecdotal evidence about the issue has been mixed. There have been instances when the trade unions have successfully organized strikes that yielded to fulfilment of workers' requests (see subsection 2.5 for more information). On the other hand, in quite a few cases the efforts of trade unions have proved fruitless. For instance, despite the notable disagreement by the trade union representing the medical workers, the government did proceed with the privatisation of the national health care service, including all sectors in the primary health care. Overall, the popular impression is that the trade unions do not have the strength or ability to lead the labour movement.

All in all, Macedonia has failed to develop strong social partners that would have a sizeable impact in collective bargaining and in creating labour market policies. To some extent this results from the current situation of the Macedonia labour market with its large share of informal employment. The other reason could lie in the reluctance of the central government to allow outside influence in the process of policy making.
It is noteworthy to mention that the loss of workplaces due to redundancies and bankruptcies has been so massive that a new institution called the Autonomous Trade Union of Bankrupt Firms and Redundant Workers was created. This body was supposed to work closely with the SSM to secure more rights for redundant and dismissed workers. However, the problems of these workers are still awaiting a solution. Tents set up by these workers around the parliament have become a permanent sight for the last years. The strikers also refuse to cooperate with the SSM, and they claim that the SSM does not represent and protect their rights.

As another peculiarity, it should be noted that the trade unions in Macedonia have been divided along ethnic lines, as the labour market in general. A notable exception has been the SONK, which has been re-organized as a multi-ethnic trade union after the 2001 ethnic conflict.

2.4 Taxes on labour

Wages in Macedonia are higher than in other Balkan countries, which is surprising in view of the high unemployment rate. There has been a trend of continuous salary increase since 1996. This has been mainly due to the increasing share of the private sector in the economy.[58] Wage costs

[57] This is comparable to the average unionization rate of about two-fifths of the salaried workers in the Western Balkan countries (Arandarenko, 2004).

[58] The increase of salaries in the public sector and in firms with less than 51 percent of private capital has been limited by law.

(defined as gross wages plus employers' social security contributions) in manufacturing of about EUR 450 are twice as high as in Bulgaria, and about 40 percent higher than in Serbia (IMF, 2006).[59] These high labour costs are likely to contribute to limited job creation in existing firms and to discourage entry of new firms. This also creates incentives for increasing informal sector employment. Although a minimum wage is stipulated in the labour laws, it was defined for the first time in 2002 only for the public sector and at a low level of about 45 percent of the monthly average wage.

The high wage costs might be explained by the relatively high tax wedge of about 40 percent.[60] This high tax wedge merits further explanation. In Macedonia, the basis for estimation of personal income tax is the net wage rather than the gross wage. Personal income tax rates were previously set at 23 percent, reduced to 15 percent in 2002, and further reduced to 12 percent in 2007. The gross wage (net wage plus personal income tax) is then used as the basis for estimation of social contributions, which are paid by the employer. The social contribution is calculated at an aggregate rate of 32 percent, and includes pension, healthcare and unemployment benefits. The combination of taxation and social contribution makes up for a significant difference between the cost of employing workers as perceived by employers and the actual net wage received by workers. The system seems to bear relatively more severely on low-paid and part-time workers. This in turn creates an important deterrent to job creation. The high tax wedge is often a particularly acute problem for small private firms, which may opt for the informal sector instead, thereby limiting their potential for growth and for formal job creation.[61]

Even in the formal sector, the high tax wedge encourages employers and employees to come to (according to anecdotal evidence quite widespread) arrangements where a portion of the wage is paid in cash. Another evidence for the negative impact of the high tax wedge on the formal sector employment is related to the extensive use of the so-called "civil law contracts." While employers using this type of contracts are still liable for the employee's personal income tax deductions, they are not liable to pay social contributions. This reduces substantially the labour cost for the employer. In an effort to reduce the wage costs, the government itself has become the chief user of the civil law contracts. This type of contracts is, however, undesirable for high-skilled workers since they have no entitlement to health and pension insurance and to unemployment benefits.

2.5 Industrial action

Data on the number of strikes in Macedonia are missing. Anecdotal evidence suggests that strikes are numerous, and until 2001, strikes were mostly non-violent and confined to company grounds. A new page in the history of labour movement in Macedonia was opened with a massive strike by the judicial administration, organized by the Union of Administration and Judiciary Workers, with a requirement for full payment of back wages. The strike lasted for 80

[59] Only Slovenia and Croatia have higher wage costs than Macedonia in the region.

[60] The tax wage is defined as the sum of personal income tax plus social security contributions as a percentage of total labour cost.

[61] Even in the formal sector, the high tax wedge encourages employers and employees to come to (according to anecdotal evidence quite widespread) arrangements where a portion of the wage is paid in cash.

days, December 2000 until the end of February 2001. After a long struggle involving a lot of marching on the streets of Skopje, the strike gave an impetus to the labour movement.

The industrial action was brought to a halt by the ethnic conflict in 2001. Nevertheless, in 2002 a new wave of strikes was back on the agenda. Workers of the so-called "loss-making enterprises" protested, by organizing road blocks, marches on the streets and other forms of demonstration.[62] Their requests included payment of back wages, coverage of social, medical and pension insurance, and help in rebuilding their lives. The workers' revolt culminated in the demonstrations of April 2002, when the ruling parties rejected dialogue with the Unions. As a response, the workers tried to enter the parliament building and clashed with the police.[63] The workers continued with their protests in the following months, blocking some major roads connecting cities in Macedonia. The government agreed to a concession on the social and medical insurance, but did not succumb to the workers' request to restart the "loss-making enterprises."
In May 2002 workers in four public sectors – education, science, and culture; defence; administration and judiciary; health care – started a general strike with the main demand for setting of a minimal wage of 120 euros per month. The strikers moved onto the streets and the workers from the "loss-making enterprises" joined the protests. As a result, the government did pass a law that stipulated a minimal wage at about 45 percent of the monthly average wage. The strikes, however, were accompanied by a lot of pressure on the workers exercised by the employers. For instance, workers in education and the judicial sector were threatened with 60 percent wage cuts if they went out on strike.

In November and December of 2002, a new wave of massive strikes involving textile, tobacco, printing, mining, and railroad workers took place. Workers in the private sector joined the strike wave. All rail connections in and out of Macedonia were blocked. Lead and zinc miners went on a hunger strike to protest four months unpaid wages. The government ceded to the workers' demands and sold some of the mines' produce to pay a portion of the back wages.

While far from being complete, the above examples of industrial action demonstrate that the Macedonian governments have been having an intense confrontation with the working class. The whole economic restructuring project included reduction of social protection and labour rights of workers, and this has been constantly threatened by social upheaval that particularly intensified in the early 2000s. At the beginning of the transition, the labour movement involved the public sector workers, but later on it spread to the private sector. At several instances, the government conceded to worker's requests.

2.6 Labour market policies

Registered unemployment in Macedonia has been rising since the early 1960s, standing at about 20 percent at the time of independence in 1991. Registered unemployment rate continued to rise during transition, reaching over 50 percent (about two-thirds higher than the respective LFS

[62] About 40, practically bankrupt, factories were classified as "loss-making enterprises," employing about 37,000 workers.

[63] Specially trained ant-terrorist police forces were used during the conflict.

unemployment rate) by 2000. This reflects a relatively high propensity to register at the Employment Service Agency (ESA), which may seem surprising in view of the parsimonious unemployment benefits. Few unemployed receive unemployment benefits. The benefit coverage rate (percentage of unemployed who receive benefits) has been only about 10 percent of registered unemployed, since most of the unemployed are either new entrants to the labour market or long-term unemployed, and as such do not qualify for unemployment benefits.[64] The benefit replacement rate (that is, benefit/earnings ratio) is low, as unemployment benefit amounts to only 37 percent of the average wage. Although unemployment benefits are low and their duration is limited (unemployment benefit duration is capped at 14 months), registration rates at the ESA are high because eligibility criteria are not enforced, and many of the registered unemployed are working informally and register to receive free health insurance.[65] The share of expenditures on passive measures in GDP is about 2.5 percent, which is relatively high according to the OECD standards. Most of these expenditures are financed out of the budget.

The unemployed who receive unemployment benefits are obliged to visit the local ESA office once a month. Those receiving only health insurance benefits are required to visit the ESA every two months, while those who do not receive benefits and register as unemployed for other reasons are obliged to renew their registration every four months. Under these conditions, the actual role of the ESA has been reduced to perfunctory interviews with the unemployed. Efforts devoted to job counselling, advice, and job-search support have been rather limited.

There have been a number of active labour market programs in Macedonia, most supported by donors and focused on job counselling, training, public works, and measures that encourage the start-up of businesses. The programs have had mainly a short-term focus. For instance, a number UNDP projects on short-term employment generation and vocational training for disadvantaged groups were undertaken during the period 1999-2003. The 2003 active labour market policy measure (the so-called “Branko’s Law” after the Prime Minister who introduced it) that provided a lump-sum wage subsidy of around 70 euros per month paid over 24 months to employers who would employ workers from certain categories of the registered unemployed (such as long-term unemployed, redundant workers, workers from bankrupt enterprises and social assistance beneficiaries) was suspended after a few months due to substitution effects and deadweight costs. Once the legal obligation for employment expired, workers were often laid-off again and the long-term impact on employment was minimal.[66] Altogether, the share of expenditures on active labour market policies in GDP has been extremely low relative to OECD countries and spending has had little long-term impact on employment. Between 1996 and 2002, the amount spent on active labour market policies was less than 0.05 percent of GDP, compared with 0.7 percent in OECD countries (OECD, 2002). Active labour market interventions accounted for only 4 percent of the ESA budget in 2003.

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[64] There are also no available analyses of the profiles of beneficiaries, their wellbeing, employment opportunities, etc.

[65] Although data on the number of unemployed who register at the ESA purely for health and other benefits are not available, unofficial estimates suggest that about 70 percent of the registered unemployed fall into this category.

[66] It should be mentioned here that no evaluation on the effectiveness of passive and active labour market policies in Macedonia is available.

As a result of low spending on active labour market policies, the participation rate of adults (aged 25 to 64) in education and training has been very limited (about 2 percent). This is aggravated by the fact that very few enterprises train staff on a regular basis. With the 2005 labour market reform the workers' rights to training have been regulated for the first time. However, the awareness among employers about the positive effects of training on productivity of workers is yet to be developed.

2.7 Labour mobility

The transition has been accompanied by large movement of labour towards agriculture, as agriculture has served as a buffer against unemployment. The majority of the agricultural workers work on small, private farms averaging less than three hectares, many of which support families on a subsistence basis. Employment fell in industry and increased in the services sector. There has been also growing wage variation across sectors, with highest wages paid in the financial intermediation sector.

Analysis of regional labour mobility is constrained by the lack of relevant data, but available evidence suggests that this type of labour mobility is quite limited. Labour mainly flows from rural regions to urban areas, in particular to the capital city of Skopje. The limited inland labour mobility results in a strong regional dimension of the Macedonian unemployment. The extremes are in the Tetovo region (with a high share of ethnic Albanian population) which has the highest unemployment rate and in the Strumica region (with predominantly ethnic Macedonian population) with the lowest unemployment rate. These facts and anecdotal evidence both suggest that ethnic factors create barriers to regional labour mobility. Other factors include the underdeveloped housing market, ID cards tied to residence for distribution of social benefits, as well as bad road infrastructure and public transport.

Flow data between different labour market states have not been subject to an elaborated analysis. Scant evidence from the LFS data reveals very low mobility from unemployment to employment: about 90 percent of the unemployed in a given years had the same status a year earlier. Unofficial estimates by the ESA suggest that inflows of new registered unemployed and outflows of registrants leaving the unemployment register are about 0.2 percent of the total stock of registered unemployed. These low outflows from unemployment result in a very high rate of long-term unemployment. There has been also no pronounced movement of labour from low-productivity to high-productivity sectors.

Given the difficult situation in the labour market, the incentives for international migration should not be ignored. Despite severe constraints on travelling, labour outflow from Macedonia has continued throughout the transition period (Markiewicz, 2006). Some workers emigrate only temporarily to western European countries. Particularly among the ethnic Albanians this type of migration often takes the "guest-worker" form, where the head of the household works abroad while the rest of the family stays at home. While this has resulted in a significant inflow of remittances ($155 million in 2005, which is higher than the total FDI amount), the negative effect

of the potential “brain drain” on the Macedonian economy resulting from permanent emigration from high-skilled labour is yet to be investigated.

2.8 Informal sector economy

Estimates regarding the size of the informal economy fluctuate between 30 and 45 percent of the GDP (and informal employment is estimated as high as 60 percent of formal employment). This suggests informal employment is almost as common as a formal job in Macedonia. The informal work is mostly seasonal or occasional in nature. Sectors with relatively high share of informal employment include trade, the textile and leather industry, catering, tourism, craftsmanship, local transportation, agriculture and servicing businesses. Informal employment exists also in firms with formal status (Petreski, 2005). Recently, the informal sector has been also found in places where it would not be typically expected, such as in the health care, state ministries and other governmental bodies, and in public enterprises (Jankulovska, 2002). The incidence of informality has been growing during the transition period, driven by incentives for evasion of taxes and labour regulations as well as by the failure of the formal sector to provide jobs.

From the business perspective, the incentive for formality in Macedonia low. Costs of paying taxes and complying with regulations often outweigh the benefits from being formal. Pervasive and confusing business regulation imposes high costs on formal businesses. The low quality of the judicial system has also contributed to the large informal economy. Ineffective judicial system cannot provide reliable enforcement of contracts. Indeed, survey based indicators in the World Bank Doing Business database reveal that inability to enforce contracts is considered one of the most important obstacles to doing business by enterprises in the formal sector in Macedonia. The state’s weak enforcement and insufficient inspection activities are another reason for the large informal sector.

From the worker perspective, low skilled workers - who were most affected by the disintegration of the formal job market – have higher incentives to rely on employment in the informal sector which is in line with employment patterns in other transition economies. Furthermore, the system of labour taxation (as described in subsection 2.4) tends to discourage flexible forms of employment and to push them to the informal sector. First of all, while the labour market reform of 2005 eased conditions for part-time employment, the employers are still obliged to pay a minimum social security contribution that is based on the average full-time monthly sectoral wage. This high social contribution wedge drives most part-time employment to the informal sector. Second, self-employed workers cannot register to make social contributions. The only way for the self-employed to get health insurance is to register as unemployed with the ESA (see subsection 2.6 for more details). In addition to the unemployed, part-time workers and the self-employed, other segments of the population that are most likely to participate in the informal sector include employed workers with low or irregular income, pensioners, and students. Although their share in the informal sector is much lower, there are also informal workers whose skills are demanded (interpreters, computer scientists, other experts) and who do not have an

incentive to search for a formal job since they can make more money by working informally.[67] Participation in the informal sector also differs among ethnicities: ethnic Albanians tend to participate to a greater extent in the informal labour market (Nikolov, 2005).

As already discussed in subsection 2.6, most of the low-skilled and part-time workers who are active in the grey economy register as unemployed at the ESA to obtain free health insurance. As most of the unemployed receive only health insurance and not unemployment insurance benefits, the effect of unemployment benefits on the reservation wage is probably negligible.

Wages in the informal sector are typically very low and the working hours are not fixed, ranging from 10 to 14 hours. Informal workers are not insured at all and are exploited by the employers. This has caught an increasing attention of the trade unions, which have recently started insisting on a debate between social partners aimed at resolving the problems of informal workers. The SSM has asked for regulation of informal employment and for creation of legal possibilities for recognition of informal work as work experience, with the possibility that employers pay informal workers' social security contributions and taxes retroactively.

3 Discussion of the most relevant country specific factors

As outlined in the preceding section, institutional weaknesses in the labour market have likely contributed to the meagre employment creation and to the low adjustment capacity to shocks of the Macedonian economy. There has been as yet only limited analysis of the relative importance of the most binding restrictions and the most likely impact of removal of those restrictions. This in turn makes it difficult to set priorities between different areas of regulatory reform or to identify the reforms that would be most urgent. Below I try to summarize the special features of the Macedonian labour market and to identify the most binding restrictions, which should underpin future regulatory reforms.

To summarize briefly, until recently the Macedonian EPL was relatively restrictive. The rigidity mainly stemmed from the legislation on temporary employment and collective dismissals, while the legislation on regular employment was quite flexible. The 2005 labour market reform eased the restrictions on temporary employment, though the impact on employment is yet to be identified. Macedonia operates unemployment insurance system that is comparable to the systems of other countries in the region and spends little on active labour market policies. In comparison with other transition countries, Macedonia falls into the middle of the range in terms of union density and has relatively high wage costs.

Overall, the high labour costs seem to be one of the most binding restrictions of the labour market flexibility in Macedonia. Gross salaries remain comparatively higher relative to other countries in the region. This influences the international competitiveness of the Macedonian economy, the terms of trade, and the adjustment capacity to external shocks. This is especially

[67] These are mainly young people who are able to acquire the appropriate knowledge and skills and who often plan to migrate abroad.

important since the Western Balkan countries are the main competitors to each other in attracting FDI.

Of course, the regulations that are most distorting “on paper” may well be the least enforced “in practice” (Squire and Suthiwart-Narueput, 1997). In the context of Macedonia, it has often been argued that the legal protection of employees has rarely been respected and that there is considerable room for employers to informally hire and fire workers. Due to the difficulty to evaluate the degree of the enforcement of regulations and policies, a measure of underground economy could be used to account for labor rigidities “in practice” (e.g., Micevska, 2004). With the informal economy estimated at around on third to almost one half of the formal sector, the rigidity of labour market regulations “in practice” is understandably questionable. Also, wage costs depend on how easily a business can hide its activities.

Despite the fact that the informal sector can be regarded as an off-setting flexibility to excessively regulated labor markets, the negative effect on the Macedonian economy cannot be ignored. In particular, the growth of informal firms and their contribution to the employment growth is limited by their restricted access to credit, their short-time horizons, and their limited ability to invest in human and physical capital. The informal sector also erodes the tax base which results in well-known negative effects on the formal sector.

Better understanding of features of the Macedonian labour market and of the most biding restrictions could be obtained from surveys. Survey based indicators in the World Bank Doing Business database reveal structural impediments to Macedonia’s adjustment capacity to shocks. Macedonia’s low rankings show difficulties in hiring and firing workers, protecting investors, paying taxes, and closing a business relative to other countries in the region. Moreover, the evolution of the ranking indicates that the structural reforms undertaken have still to improve the adjustment capacity to shocks.

4 Policy recommendations

The problem of extremely high unemployment in Macedonia cannot be ignored. First, very high levels of unemployment reduce the adjustment capacity to shocks and may add to the delay of needed structural reforms. Second, since the exchange rate has been pegged to the Euro, flexibility of the economy to preserve competitiveness in the face of shocks should come primarily from the flexibility of the labour market. The Macedonian government has already undertaken reforms aimed at tackling unemployment through creating more flexible labour market institutions and a more favourable investment climate. Below I review the undergoing policy plans and reforms and include my opinion about issues that need to be addressed in the future.

Although the labour code has already undergone much reform in Macedonia, further actions could contribute to flexibility and dynamism of the job market. Particular attention should be paid to progressive harmonization with EU labour legislation.

Making efforts to improve the investment climate, the government has already achieved significant reduction in procedures and costs needed for company registration. The paid-in minimum capital requirement has been eliminated and the government is working on online registration system for business start-up.[68] This should be accompanied by further reducing the number of licenses required to open a business. Small and medium-sized companies, which are usually the most dynamic job creators, should particularly benefit from this measure.

While the rules for the representation of employers' and employees rights were liberalized in the 2005 labour market reform, implementation has been lagging behind. Employers still lack effective organizations. Trade unions are mainly engaged in negotiating higher wages in the formal sector, without constructive involvement at the firm level so that higher wages could be balanced by greater coordination with management and easier dispute resolution. These are certainly not favourable preconditions for a coordinated and fast response in periods of larger economic shocks (Aidt and Tzannatos, 2003). Improved collective bargaining at the national, branch, and firm level through better representation of employers and of workers is necessary. It will be therefore important that the social partners take an advantage of the new opportunities offered with the labour market reform by making constructive inputs in the process of policy making.

Several measures have been undertaken to reduce the effective tax rate. In 2007 the corporate tax rate was lowered from 15 to 12 percent and further reduction to 10 percent is planned for 2008.[69] Flat personal income tax rate of 12 percent was introduced in 2007 and further reduction to 10 percent is planned for 2008. The government has introduced a new e-tax service. It has also announced its intention to abolish the burdensome minimum social security contributions that employers have to pay for employing part-time workers. These measures should influence the investment climate as they impact on business start-ups and expansions. The measures should be accompanying by efforts to widen the tax base by better enforcement and by stronger application of the income tax rules to all forms of income (including earnings in the informal sector and non-labour income), rather than focusing mainly on formal labour income.

While job counselling and training services can have a positive impact on employment, currently very little such services are provided. Recent research indicates that cost effectiveness seems to be best in training and counselling programs and least in public works programs. Altogether, taking into account the role that active market policies can play in fighting unemployment (e.g., Boeri and Burda, 1996), fiscal resources should be shifted from passive to active labour market programs. Also, the role and resources of the ESA should be shifted from unemployment benefits administration to more active policies. These policies should include expanded training programmes for the unemployed as well as programmes to promote and support self-employment as an option for the registered unemployed.

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[68] A "one-stop-shop" for the registration of businesses came into force in January 2006, reducing significantly the time and money needed to start up a business.

[69] The income corporate income tax was quiet high in the 1990s at a level of 30 percent.

Several policy recommendations can be delineated in relation to the fairly large informal sector. First, in 2005 the government began with a comprehensive judicial reform by changing the constitution and numerous laws. However, the implementation is still in the pipeline. Indeed, both the Business Environment and Enterprise Performance Survey (BEEPS) and UNDP surveys on the public perception of state institutions indicate that Macedonian citizens and companies do not trust the judicial sector. Companies have been observed as doing business rarely by signing contracts. Better training of judges and continuing the fight against corruption and political influence in the judicial sector could make the current situation better.

Second, free health care for the registered unemployed discourages formal sector employment. The government has started public works in cooperation with UNDP, but the unemployed have shown little interest which suggests that many registered unemployed are actually working in the grey economy. Therefore, free health insurance for the unemployed should be detached from registration status at the ESA. Access to the social contribution system should be made available for the self-employed.

Third, the loss of tax revenues from informal activities is substantial. This in turn leads to low quality of public services, corruption in the public sector due to low wages, and pressures to increase the tax burden on the formal sector. Thus, improved screening instruments (e.g., through public works programs) to limit access to free health care and to unemployment benefits by those unemployed who are actually employed in the informal sector should be an integral part of reform efforts. So should be the strengthened audit and inspection activities by the government aimed at detecting grey economy companies. Creating incentive for formal sector activities could also contribute to FDI promotion, since foreign investors usually depend more on the conditions in the formal economy.

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Kosovo (under UNSCR 1244/1999)

Avdullah Hoti *

1. Introduction

This country report for Kosova is prepared as part of the 'Study on the adjustment capacity to external shocks of EU candidate and potential candidate countries of the Western Balkans, with a focus on labour markets' that is implemented by WIIW.

The report first provides an overview of country specific factors that affect labour market developments, which helps to better understand the analysis in the following sections. Second, proceeded by a discussion on key features of the labour market in Kosova, a detailed analysis of labour market is provided including: participation, employment, unemployment, skills' structure of the population, public employment services and labour market, wage settings, labour market legislation and labour relations in Kosova. Finally, the report provides a discussion regarding the most relevant country specific factors.

2. Country specific factors affecting labour market

Kosova has a unique history during both the socialist system and the transition process. During the 1970s, Kosova experienced a significant economic growth estimated at 7.5 percent per annum (1971-1975) and 3.6 percent per annum (1976-1980) in real terms (data from the Statistical Office of Kosova, Riinvest Institute, 2005). Nonetheless, Kosova remained the poorest region in the former Yugoslavia with a per capita social product of a quarter of the Yugoslav average in 1989 (SOK, 1989; Bevc, 1993).

The existing data indicate that during 1990-1995, GDP contracted by 50 percent compared to its pre-transition level with further contractions due to the war of 1999. Estimated at 2003 prices, GDP per capita fell from around €1,500 in 1987 to below €300 in the late 1990s (World Bank, 2004; Moalla-Fetini et al., 2005).[70] Unlike in other European Transition Economies (ETCs), in Kosova the decline in output was largely due to the absence of reforms and the political unrest. In the early 1990s, some 145,000 Kosovar Albanian workers were forcibly dismissed from public services (mainly in health and education).

Since the end of the war in June 1999, Kosova has moved towards adopting legal and institutional reforms aiming to establish an open market economy. Therefore, the labour market transition as seen in other former socialist economies did not start until after the war of 1999. Since emerging from the military conflict and a decade of disinvestment, modest economic

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[70] Though, the very high inflation rates during the 1990s puts some doubts on these estimates.

growth has been recorded that is mainly attributed to immense international donor support (during 2000-2003 this support totalled €4.1 billion). GDP is recovering and it is estimated to have reached the level of €1.9 billion in 2005, nearly €1,000 in per capita terms. Despite this increase, GDP per capita in Kosova is the lowest of all SEE countries.[71]

Overall, despite the complexity and uniqueness of the political situation, significant progress is being made with regard to structural reforms. A legal labour market framework that is supportive of private sector development is in place, even though as KCBS[72] (2005) argues, other mechanisms are still needed to help the growth of the private sector. The fiscal framework is simple with low tax rates and few exemptions, which are likely to limit its distortionary effects. As found in the quarterly opinion polls conducted by the UNDP Office in Kosova (as part of the UNDP's Early Warning Reports), there has been an increasing confidence in the financial system. The adoption of the Euro as the legal tender in Kosova from January 1, 2002 and the conservative management policies that oversee this system are expected to have contributed to this. The privatisation of the Socially Owned Enterprises (SOEs) is well underway and is expected to be completed by the end of 2007. This process is affect the existing employment/unemployment figures as usually all privatised enterprises experienced a downfall in employment.

3. Key features of the labour market in Kosova

Labour market developments in Kosova since the end of the socialist system are different in many respects from those found in other transition economies. In addition, Kosova's labour force composition is also significantly different. We start this section by examining how these key features influence labour market outcomes.

As mentioned above, in the early 1990s some 145,000 workers, which constituted about 60 percent of employment in 1989, were violently dismissed from their jobs. This large-scale dismissal of workers had implications for their labour market status both during the 1990s and in the post-war period by which time their skills were likely to have deteriorated. Note that elsewhere in transition economies labour was shed from the state sector gradually or at least at a much slower pace. More importantly, the process of job reallocation from the state to the private sector elsewhere was a result of policy choices and not of violent measures by the regime.

Kosova is known for its young population and large-scale emigration, which both influence the size and the age composition of its domestic labour force. First, nearly one-third of the population is under the age of 15 (Table 1). This implies a large number of new entrants into the labour force each year, which is estimated by the Riinvest Institute (2003) at 21-25 thousand or 7-8 percent of current employment (these are net inflows). Second, because of its recent history, young

[71] In 2005 per capita GDP (in Euro at exchange rates) for SEE countries were: Albania €2,140, Bosnia and Herzegovina €1,961, Bulgaria €2,771, Croatia €6,972, Macedonia €2,280, Romania €3,665, Slovenia €13,675, Serbia €2,583 and Montenegro €2,600 (WIIW, 2007).

[72] KCBS stands for the 'Kosovo Cluster and Business Support', which is an organization established by the United States Agency for International Development (USAID) with the aim of supporting the development of private businesses in Kosova.

population and persistent high unemployment, Kosova has experienced both temporary and permanent mass emigration during the last two decades.

Estimates suggest that approximately 20 percent of the population (that is half a million people) are emigrants, whose remittances are equal to 13 percent of GDP (Moalla-Fetini et al., 2005; BPK, 2006). Emigration can be thought of as reducing unemployment in Kosova since it reduces the labour supply. Nearly 80 percent of emigrants are of working age (16-64) compared to only 62 percent of the resident population of that age. Through remittances, emigration also helps to alleviate the financial constraints on households in Kosova and to fund private business investments. In addition, permanent emigration is likely to influence the labour supply in the long run as well through reducing potential future labour force inflows. The World Bank (2004) argues that the decrease in the natural growth rate of population in Kosova in the late 1990s and after the war was, to a large extent, due to the emigration of young persons (the net annual increase of population went down from 46,000 in the early 1980s to 36,000 in the 1990s).

To discuss labour market participation, employment and unemployment from 2001 onwards we use data from SOK annual reports (SOK, 2002, 2003, 2004b, 2005a) that are prepared based on its annual Labour Force Surveys (LFS) for the period 2001-2004. The latter fully comply with ILO methodology that makes the data reliable, consistent across years and comparable with that of other countries that utilise this type of survey. These reports are the most comprehensive and reliable data source on the labour market in Kosova, though the data reported is rarely disaggregated which limits our analysis (and there is no public access to the raw data). Another shortcoming relates to the timing of these surveys (December 2001, November 2002, October-November 2003 and September 2004 respectively), which makes the data subject to seasonality effects. This is because employment in agriculture and some other seasonal activities is likely to be relatively low during November and December and therefore changes across years might be partly attributed to the seasonality effects.

The data on the total population and labour force activity and employment and unemployment for population of age 15-64 are presented in Table 1. We also present data for the year 1989, although data is missing for a number of indicators.

The main observations from this table are the following: (i) there are large gender differences in all indicators; (ii) females' activity rate is very low compared to males and also in terms of regional comparisons; (iii) on average only 4 out of 10 males and 1 out of 10 females of working age are employed; (iv) the unemployment rate is relatively high especially among females and young persons; and (v) on average around 85 percent of the unemployed are long term unemployed.

Table 1

Labour market indicators in Kosova for 1989 and 2001-2004

	1989#	2001	2002	2003	2004	2005
	[1]	[2]	[3]	[4]	[5]	[6]
Population, in thousands *	1,939.(	1,867.8	1,900.3	1,932.3	1,965.8	
0-14, in percent	n.a	30.4	30.6	32.1	31.9	30.6
15-64, in percent	56.9	61.2	62.8	61.6	62.(	62.9
65 and over, in percent	n.a	6.9	6.9	6.3	6.(	6.9
Working age population (15-64), in thousands**	1,095.(	1,153.8	1,193.4	1,190.3	1,218.8	
Labour force, in thousands **	382.4	385.1	482.9	598.1	559.4	
Employment	243.4	226.6	254.8	301.1	340.(	
Unemployment	139.(	158.9	227.1	297.6	222.1	
Labour force participation rate						
Total	34.9	46.1	41.3	50.3	45.9	48.1
Men	51.9	66.(	55.9	71.1	67.8	68.3
Women	17.9	27.4	26.9	29.9	25.2	29.9
Employment rate						
Total	22.2	20.(	23.8	25.3	27.9	28.9
Men	33.2	31.8	39.4	42.8	46.8	45.8
Women	10.1	8.2	8.8	8.3	9.9	11.1
Employment rate by age						
15-24	n.a	7.6	10.(	10.1	11.3	
25-54	n.a	28.2	32.8	34.8	37.6	
55-64	n.a	16.1	18.4	20.1	23.9	
Employment rate by education						
Less than upper-secondary education	n.a	8.6	10.3	12.9	14.2	
Upper-secondary education	n.a	28.(	34.9	37.1	39.1	
Higher education	n.a	71.1	75.1	75.2	80.1	
Unemployment rate						
Total	36.3	57.1	55.(	49.1	39.1	41.4
Men	35.9	51.1	45.2	40.3	31.9	32.9
Women	39.(	69.9	74.9	71.9	60.1	60.9
Unemployment rate by age						
15-24	n.a	79.9	77.1	74.9	66.9	
25-54	n.a	54.8	47.1	41.9	32.6	
55-64	n.a	31.1	34.1	22.(	18.1	
Unemployment rate by education						
Less than upper-secondary education	n.a	62.9	70.1	60.8	47.9	
Upper-secondary education	n.a	40.4	52.1	49.6	41.1	
Higher education	n.a	12.9	16.1	15.3	11.3	
Youth unemployment (% of unemp. of age 15-24)						
Total	n.a	40.6	77.1	74.9	66.9	70.9
Men	n.a	n.a	67.6	65.8	57.9	63.1
Women	n.a	n.a	89.1	90.9	82.9	80.6
Long term unemp. (% of unemp. 12+ months)						
Total	n.a	87.(	85.9	85.9	87.9	83.1
Men	n.a	n.a	82.6	86.1	86.9	84.(
Women	n.a	n.a	89.9	85.9	89.2	83.9
Sample size in SOKs' LFS						
Households		3,23(	3,11(	3,17(	3,19(	3,20(
Individuals		20,50(	19,36(	19,51(	19,90(	19,59(

Source of data: SOK (2002, 2003, 2004b, 2005a); * Population is estimated by the World Bank (2003b) using the population (net) growth rates, because the last population census in Kosova was in 1981. These estimates do not include emigrants; ** Own calculations based on the population estimates and using LFP, employment and unemployment rates from SOK's LFSs; # All data for 1989 is from the World Bank (2003b); Note that SOK's LFSs define the working age population as the population aged 15-64.

4. Participation

Data in Table 1 indicates that a large source of potential employment remains untapped. Females' labour force participation (LFP) rate is on average lower by 30 percentage points than that of males and is a major source of labour underutilisation, which is likely to affect the observed unemployment rate. Although, a lower female LFP rate is common in most of transition economies, gender differences elsewhere are much smaller than in Kosova. Unlike elsewhere ETCs, in Kosova this is not an outcome of the transition process since female LFP rate was only 17.5 percent in 1989.

The World Bank (2003b) argues that females may be more heavily influenced by the traditional nature of the Kosovan society, whereby the male has a dominant role in the household as the main breadwinner and the main decision-maker even on issues that affect other household members. About 70 percent of households live in single (nuclear) family units. The rest are multiple family households with 2, 3 or more nuclear families of different generations living together. The society is built on strong household units, with the household head having strong influence regarding decision-making, decisions which in more modern societies would be left to individuals. This may influence the decision of individuals about their labour market participation (particularly females), the priority of individuals within the family in accessing jobs as well as the type of work that individuals may undertake (for example, work in the state vs. the private sector). Urban-rural differences regarding LFP rate are not as large as gender differences, though for rural residents the LFP rate is generally lower. As expected, the LFP rate for young male and female cohorts is considerably lower than the overall average.

5. Employment

Changes in employment in Kosova since the end of the socialism are distinctive when compared to those experienced by other ETCs. As we discussed above, in the early of 1990s some 60 percent of employees were dismissed at the same time. After the 1999 war, employment soon reached the level of 1989 with some 70,000 people getting jobs in the newly established state institutions including education and health sectors. The employment level of 340,000 in 2004 (and also for the previous years) presented in Table 1 is an estimation using the data from SOK's LFSs and data on population from the World Bank (2003b). Given that the definition of participation, employment and unemployment rates follow the ILO guidelines, then employment estimates include informal employment.

Regarding the formal employment sector, in 2004 there were 146,000 people employed with half of them working in the private sector (MEF, 2005a). The very large difference between these two figures (total employment of 340,000 and formal employment of 146,000) does not necessarily constitute just informal employment, but is also due to the inaccuracy of the official statistics which do not include those working in agriculture on their family farms that pay annual taxes on their land. From the LFS data for 2004, 20 percent of employment consisted of family workers, 20 percent self-employed workers (sole-proprietors) and just 55 percent were salaried workers. Employment in the informal sector is difficult to define, though the large number of own account workers hints at the presence of a substantial informal economy. The Riinvest Institute (2003)

argues that about a third of total employment is in the informal sector (defined as being employed but not paying taxes).

As in other ETCs, the sectoral distribution of employment changed following the introduction of the market economy. From the LFS 2004 data, agriculture accounts for nearly a quarter of total employment. The other main sectors are education and health (15 percent), the wholesale/retail trade (14 percent), manufacturing (9 percent), construction (7 percent) and public administration (6 percent). The main changes in the structure of employment between 1988 and 2004 are the following. First, there has been a large increase in employment in agriculture from around 5 percent to nearly a quarter of total employment (although note that this is partly due to employment in household farms not being included in employment during socialism). This large increase in employment in agriculture suggests that this sector in Kosova is regarded as the last resort of employment. Second, the share of manufacturing (or industry and mining as it was called in 1988) in total employment has decreased significantly. Third, employment in education and health has decreased from around 20 percent of total employment in 1988 to 15 percent in 2004.

About 60 percent of the employed have less than 5 years of working experience and this percentage is even higher in the private sector. Although we are discussing a situation nearly 15 years on, this might imply that those that have some experience during the previous system (probably those that were dismissed in the early 1990), are experiencing difficulties in re-entering employment. About 60 percent of total employment, including informal employment, is in the private sector.

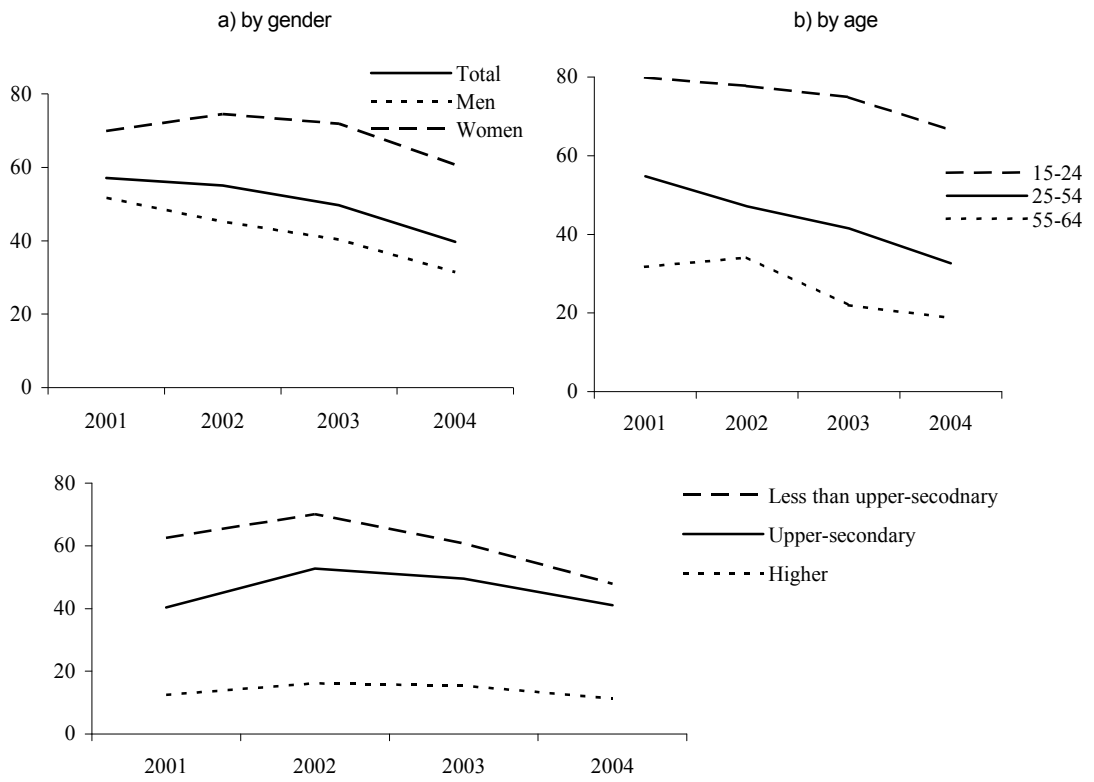
The age profiles of employment ratio for both genders have an inverted U-shape. Like in other ETCs, the employment ratio increase monotonically with education but the differences are striking. In 2004, for those with higher education the employment ratio was 80.7 percent as compared to just 39.1 percent and 14.2 percent for those with upper-secondary and less then upper-secondary education respectively. This implies that education is an important determinant of a person's employment status and that differences with regard to education translate into significant differences in employment prospects.

6. Unemployment

Kosova suffers from chronic labour market failure, with the young, females and the long-term unemployed bearing a disproportionate burden of the costs of this failure. The unemployment rate in Kosova of around 40 percent is higher than in all other ETCs. Unlike in other ETCs, such a high unemployment rate in Kosova is not a new phenomenon since it was already 36.3 percent even in 1989. As Figure 1 indicates, there are large gender, age and education related differences in unemployment rates.

Figure 1

The unemployment rate in Kosova by gender, age and education (2001-2004)



Source of data: SOK (2002, 2003, 2004b, 2005a).

Unemployment is predominantly long-term (in 2005, 83.7 percent were unemployed for one year or more) and the unemployed are mainly youths of age 15-24. The evidence from many ETCs suggests that the probability of escaping unemployment and moving into employment decreases with the length of unemployment spells (Foley, 1997; Ham et al., 1999; Voicu, 2002). The World Bank (2003b) estimated that in 2002, 88 percent of the unemployed in Kosova were first time job seekers, while only 2 percent had been laid-off. This indicates that, unlike in other transition economies, unemployment in Kosova is not predominantly a consequence of restructuring but of structural imbalances, low job creation and large labour inflows.

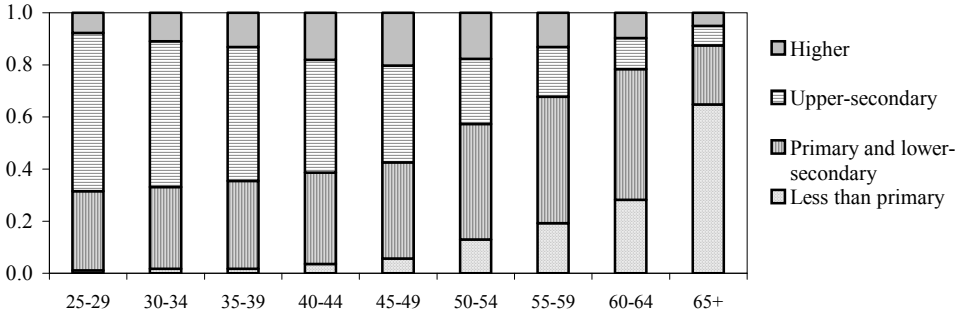
7. Skills' structure of the working age population

The adult population in Kosova of age 25-64 compared to the population in other ETCs has a low average level of educational attainment. The Riinvest Institute (2004) finds that only 13 percent of persons of age 25-64 hold a higher education qualification (18 percent of males and 8 percent of females) (Figure 2).[73] This is due partly to the difficulties in attending higher education during the 'parallel system' of education of the 1990s that decelerated the pace of skills formation.

[73] This is low compared to 23 percent of males and 20 percent of females in the EU, 36 percent of males and 32 percent of females in Japan and 37 percent of the US overall population.

Figure 2

The educational attainment of the population 25 and over in Kosova (2002)



Source of data: Riinvest HLFS of December 2002.

The number of new graduates from higher education decreased from more 2,200 in 1989/90 to around 1,000 in 1995/96. This is reflected into a lower educational attainment of those entering the labour market compared to their older cohorts. This decrease in the number of new graduates during the 'parallel system' is important in relative terms given the size of the active labour force in Kosova. Assuming a constant number of new graduates from higher education of 2,200 per year, then, due to the 'parallel system' that lasted for 9 years, the labour market currently is short of approximately 10,000 individuals with higher education qualifications.

In line with the trend elsewhere in transition economies, a larger number of students in upper-secondary in Kosova are opting for general education (Riinvest Institute, 2004), while in higher education the number of students in Social Sciences (in Business and Law in particular) has increased as well. This implies that changes in the labour market are influencing the distribution of students across the educational pathways, which in the future should affect the relative skills composition of the labour force. However, the limited capacities to accommodate all those wanting to enrol in higher education pose a constraint to increasing the educational level of the future labour force.

8. The role of public employment service

Seven Regional Employment offices are being set up throughout Kosova (Prishtina, Prizren, Peja, Mitrovica, Gjilan and Ferizaj). Their activities are co-ordinated by the Central Employment Office in Prishtina and by the Ministry of Labour and Social Welfare. These offices have an important role to play on linking businesses with the unemployed people waiting to get jobs.

Starting from 2000, the Ministry of Labour and Social Welfare (MLSW) in Kosova through these Employment Offices has registered the unemployed persons through its employment offices. The number of these persons has increased continuously to more than 324 thousand by 2006 (Table 2). Less than half are females and nearly two thirds are with elementary education only. However, this data is not a very reliable measure of active job-seekers since people may decide to get listed in order to be eligible for drawing benefits from the existing programme of social assistance in Kosova that targets poor households. One of the conditions for drawing these

benefits is to have no employed person in the household and that the working age household members should be registered as unemployed. These benefits are low and are unlikely to have a significant effect regarding employment/non-employment choices of individuals through affecting their reservation wage. However, these benefits are likely to be inflating the number of registered unemployed (for instance comparing the unemployed for 2004 given in Table 1 with registered job-seekers given below gives a ratio of 1:1.36).

Table 2

Registered unemployed in Kosova and their characteristics (2000-2004)

(as of December)

	2000	2001	2002	2003	2004	2005	2006*
	[1]	[2]	[3]	[4]	[5]	[6]	[7]
Registered job-seekers	208,07	237,95	257,50	282,30	301,98	319,72	324,53
Increase (in percentage)		14.	8.	9.	7.	5.	4.3*
Gender (in percentage)							
Females	43.	44.	44.	45.	45.	46.	46.
Males	56.	55.	55.	54.	54.	53.	53.
Education level (in percentage)							
Lower than upper-secondary education	58.	60.	61.	63.	63.	63.	63.
Upper-secondary education	38.	37.	36.	35.	35.	35.	35.
Higher education	3.	2.	2.	1.	1.	1.	1.

Source of data: MLSW (2002, 2003, 2004a, 2005, 2006a, 2006b); *Data as of May 2006; ** The increase compared to May 2005.

The World Bank (2003b) using the raw LFS data for 2002 argues that according to the ILO definition of unemployment (of active job search), less than 30 percent of the registered unemployed can be counted as the ILO defined unemployed. Others can be considered as inactive or underemployed. This finding also implies that a significant number of the 'real' unemployed are not registered due probably to the limited role of employment offices in placing the unemployed in jobs, providing training and providing benefits.

Regional Employment Offices play an intermediary role between employers and unemployed people. They propose the appropriate workers for the vacancies. However, employers are reporting a small proportion of vacancies at the Employment Offices, the reason being that most of the vacancies are filled by unemployed people from family and friends. This statement is supported by Riinvest SME survey, where most of the hiring in private firms takes place through recommendations of family and friends. In 2004, the employment offices managed to find jobs for just 6,290 individuals (which was 2 percent of the registered unemployed) and these were mainly public short-term jobs (e.g. forestation, cleaning rivers etc.).

Apart from the lack of financial means, the public employment service suffers from the lack of trained and experienced staff. This is turn imposes constrains to offering better services to unemployed people. Not all officials serving at these offices have gone through training programs to help them serve better the unemployed and link them with the latter with the businesses. These Offices are offering no unemployment benefits and this is having direct impact on the number of registered unemployed.

9. Wages

In this section, we examine the patterns of wages using the Riinvest Household and Labour Force Survey (Riinvest HLFS) conducted in December 2002. The reason that we use this data is that SOK's annual reports on key labour market indicators do not present data on wages at a disaggregated level (apart from the average net monthly wage and that only for 2001 and 2002). Nonetheless, there has not been any significant change since then, therefore this data may be taken as representing the existing wage setting in the labour market.

Table 3

Average gross monthly wages and wage differentials in Kosova (2002)

	Average wage in Euro			Wage differentials	
	Females	Males	Total	Total average wage=100 *	Female to male wage ratio *
	[1]	[2]	[3]	[4]	[5]
Overall average	178	229	215	100	0.78
Ownership of firm					
Private sector	186	264	247	115	0.70
Public sector	146	181	170	79	0.80
Socially Owned Enterprises	167	192	187	87	0.87
Foreign firms	452	575	532	247	0.79
Non-Governmental Organisations	100	623	518	241	0.16
Sector of employment					
Agriculture	n.a.	167	167	77	n.a.
Mining	n.a.	190	190	88	n.a.
Industry	147	188	183	85	0.78
Construction	444	275	281	131	1.61
Transportation and communications	230	236	235	109	0.98
Utilities (water, electricity, waste disposal, etc.)	185	206	203	94	0.90
Trade and storage	170	230	213	99	0.74
Finance (banking, insurance, real estate, etc.)	237	400	352	164	0.60
Administration, justice and police	233	229	230	107	1.02
Health and education	142	166	155	72	0.86
Restaurants and hotels	158	256	244	113	0.62
Gas stations and car repair	251	258	256	119	0.98
Other services	137	142	141	65	0.97
Observations	*222*	*609*	*831*	-	-

Source of data: Riinvest HLFS (December 2002); Data regarding wages relates to the salaried workers only (self-employed workers, owners of the company and those working in family businesses and family farms are not included); * Own calculations.

After the war in 1999, all previous labour market legislation in Kosova was abandoned. With little labour legislation enacted since, the labour market has functioned mainly in an unregulated way (World Bank, 2004). The low rate of payroll taxes (5 percent) contributed to keeping labour costs down. Table 3 shows the average gross monthly wage by gender, sector of employment and type of employer. The overall average wage in December 2002 was estimated at €215, being lower in the public sector and for females compared to their respective counterparts.

Sectors with higher average wages are finance, construction and services. Education and health sectors (which are almost entirely public sectors) have the lowest average wage. From column 4, the average wage in the public sector is at the level of 79 percent of the national average (and at the level of 60 percent of the average wage in the private sector). From column 5, the average wage for females is around 20 percent lower than that of males. A similar wage pattern is reported by the MEF (2005a) using official data on employment and wages (i.e. formal employment only). Only in construction do females get on average higher wages, which is likely to be due to the very few females engaging in this sector being mostly in high profile jobs.

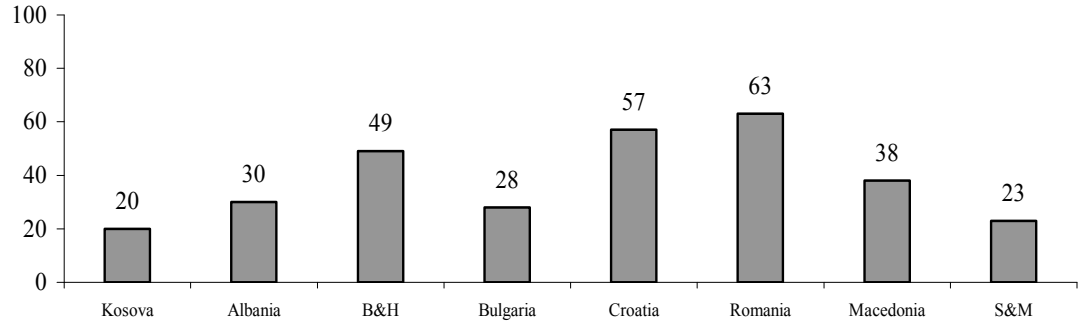
The World Bank (2003b) using the raw data from SOK's LFS for 2002 calculates the net average monthly wage at €197, which when adjusted for labour taxation and pension contribution (which we discuss below) is comparable to that presented in our table above. The World Bank also finds that the wage dispersion in the private sector is larger than in the public sector, on average men's wages exceed women's by 10 percent and the better educated workers earn higher wages both in private and public sectors.

10. Labour market legislation

Following the events of 1999, the labour market institutions introduced to Kosova have been extremely liberal and have therefore imposed little constraints on the demand for labour. Most importantly, employment protection was less limiting then in other transition as well as most OECD countries. Wage determination was largely left to market forces, with taxes on labour set at internationally low levels, with no mandatory private sector minimum wage, and with the social partners still finding the ways to launch the process of collective bargaining.

Figure 3

Rigidity of employment index in South East European countries (2005)



Source of data: The World Bank (2005) for SEE countries; KCBS (2005) for Kosova.

KCBS (2005) finds that Kosova has the least rigid employment regulations of all SEE countries (Figure 3). This is based on the estimated 'Rigidity of Employment Index' using the World Bank's methodology of 'Doing Business'. This index is an average of three sub-indices (the difficulty of hiring index, the rigidity of hours index and the difficulty of firing index) and varies from 0 to 100 with higher values indicating more rigid regulations.[74] The evidence from many countries in the

[74] For more information on this methodology see the World Bank (2005).

world provided by the World Bank (2005) suggests that the extent and enforcement of these regulations are the third most important factor for foreign companies in dissuading investment (after high corporate taxes and corruption).

The Labour Code (Regulation 2001/27) is very basic, providing standards for: non-discrimination, prohibition of compulsory labour, working hours, minimum age for work, the form of the employment contract, termination of employment contract and some general rules concerning the social obligations of the employer towards the employees. For instance, the severance payment shall be paid to the employee on the date of termination at the following scale: (i) from 2 to 4 years of service, 1 months' salary; (ii) from 5 to 9 years of service, 2 months' salary; (iii) from 10 to 19 years of service, 3 months' salary; (iv) from 20 to 29 years of service, 4 months' salary; and (v) 30 years of service or more, 5 months' salary. The termination of contract may arise: when an employer made economic, technological, or structural changes in production, programming, organization, structure of technology . Where minimum of 50 employees are discharged within a 6 month period, it shall be considered a large scale-layoff. The employer should notify its employees in written of the termination of the labour contract at least 3 months prior to the date of termination. An employer shall notify the employment offices in writing when his layoffs workers. Also when an employer introduces the lay off should take into account the employees' performance, vocational training and skills, work experience and position.

All these issues are subject of the Collective Agreement (CA) that cover all employees in Kosova that was signed in February 2004 by three social partners (the Ministry of Labour and Social Welfare, the Chamber of Commerce of Kosova and the Confederation of Independent Trade Unions). This CA it is still not enforced and there no date set as to when it will be enforced, which is likely to bring about the social unrest in the time to come.

11. The existing program of social policies affecting labour market

In Kosova, there is no unemployment benefits paid to the registered unemployed which limits their distortionary effects on the individuals' labour market behaviour.

The only social assistance programme in Kosova was introduced in 2000 and was designed to target poor households, such as: (i) families without resources where no one is capable of work, and (ii) families without resources with at least one child under 5 where no one is working but with adult members registered as unemployed (Regulation 2003/28). The benefit is set at €33 per month for the first family member, an additional €13 per month is provided for the second member and the benefit then increases by €5 for each additional member up to five members. Therefore, an eligible household of five members receives €60 per month, which is only 28 percent of the average wage. In 2005, there were around 45,000 households with 190,000 individuals (or around 9 percent of the population) receiving these benefits. Spending on this programme consisted of around 5.5 percent of total government expenditures in 2005 or 1.9 percent of GDP (Government of Kosova, 2006).

With regard to pensions, the legal pension age is set at 65 for both males and females and there is no scheme in place that allows retirement before this age. The current pension system is based on three pillars (Regulation 2001/35). The first two that are funded from general revenues and contributions are: (i) the Basic Citizens' Pension that offers basic pension for all citizens regardless whether they have worked or not; and (ii) the Contributory Citizens' Pension for those who did pay contributions whilst in employment. The third pillar consists of voluntary contributions. An early retirement scheme for "Trepça" miners is in place, which only influences activity rate of those miners. The pension benefits are set at a very level of 40 Euro/month regardless the previous contribution by some retired people. Some reforms are expected as of 2008, which we discuss below. This level of basic pension of 40 Euro/month is only 20 percent of the average wage in the economy. The problem is these pension benefits are not indexed to account for changing prices.

12. Labour relations in Kosova

Labour market institutions have a role to play in facilitating labour mobility. The labour market in Kosova is still taking its shape regarding institutions. The Ministry of Labour and Social Welfare (MLSW) has been very much engaged in promoting social dialogue in Kosova, which is centred on the so-called Tripartite Advisory Council. The Kosova Chamber of Commerce represents employers and the Confederation of Independent Trade Unions (BSPK) the employees' side. In general the aim of the council is to discuss all issues regarding the situation in the labour market such as: legal activities in the fields of social and labour policy, current social assistance activities and actions to combat unemployment, and also the creation of the countrywide collective agreement.

BSPK that represents employees has 17 branches based on economic activities. It is a member of International Confederation of Free Trade Unions (ICFTU) which is based in Brussels. BSPK has 13 staff members with its headquarter in Prishtina. BSPK claims to have some 126,000 members, but is not clear whether all these are paying membership fees and to which extent they are effective members. Though, in a BSKP document it is stated that only 83,000 of these 123,000 are working. It is mainly employees from the public sectors that are members of BSKP and some employees from recently privatised Socially Owned Enterprises (SOEs).

BSPK which has branches based on economic sectors declares its support for the market reforms in the country, i.e. supports the privatisation process. However, based on some anecdotal evidence, understanding of the functioning of a market economy and especially of the economics of transition is still insufficient amongst the representatives of the Kosova trade unions.

BSPK is considered to be in an inferior position regarding social dialogue in Kosova. Among the reasons is considered to be the insufficient professional expertise of BPSK's staff to heavily engage and influence the social dialogue. Though, the inferior role of BSPK regarding its position vis-à-vis other social partners is due to very moderate means that BSPK uses when negotiating with them. There is also some criticism regarding how BSPK is organised in terms of its

branches and its hierarchy, which affect its position vis-à-vis other social partners. Among the regional branches of BSPK, there is not enough support for BSPK's management/leading staff in the centre. Moreover, membership is not very effective since many people do not pay membership fees.
Three partners of the social dialogue in Kosova (BPSK, Chamber of Commerce of Kosova, and the Ministry of Labour and Social Welfare) have signed the Tripartite General Agreement (TGA) in the first part of 2004. Although this agreement was meant to be implemented from January 2005, it is still under discussions as to when it is going to be mandatory to the social partners. There a number of issues that needs clarifications regarding this agreement, which we discuss below.

The TGA tends to be all inclusive, i.e. almost all issues related to labour relations are covered. It does not refer very much to the existing laws regarding the labour market, such as the Law on Labour Inspectorate, Law on Social Assistance etc. It is not clear if the TGA covers all employees in the labour market. It is stated in the agreement that public servants sign another general agreement with their employer. Among the issues regulated by this TGA are: hiring and firing procedures, internships, compensations and procedures for massive layoffs, working time, night shifts, changing the workplace, annual leave, sick leave, education/training of employees, information dissemination, trade unions' organisations in the workplace, wage settlements, etc. In general, TGA still needs to be refined as there are many clauses that are: not clear, not easy to implement (as might be great costs involved) or not necessary. For example, trying to regulate internships causes problems to enterprises making them reluctant to hire employees based on internship contracts. The TGA proposes a sort of wage grid, which was suitable during the previous system, which system was more or less stable across time. Given that many jobs are created and maintained in the SME sector, this wage grid is not easy to be implemented. Though, it can be implemented in the public sector.

The TGA involves great costs to all of the social partners. These costs seem to have been neglected when the TGA was signed last year. There is no analysis whatsoever as to what the costs of implementing the TGA are. What is needed is a carefully designed research to evaluate the costs to the private sector, the government, and employment that would result from this agreement. Regarding these costs, our first observation is that the GTA increases labour costs. From the economic theory we know that as labour costs increase firms tend to substitute labour with other inputs. As such, this TGA decreases employment, or lowers the rate of new job creation.

Our second observation is that government expenditures have to be increased as a result of the TGA. In order to cover extra costs, the government has three options: (i) increase taxes now, (ii) borrow now and increase taxes later, or (iii) reduce expenses elsewhere. We now that in the case of Kosova the second option is not possible. So the government has to increase taxes or reduce some other costs in order to finance the costs imposed by the TGA. As there is little scope for the government to decrease expenditure in other sectors (due probably to the emergency/reconstruction phase that Kosova is undergoing), then the only option left to

government is to increase taxes. In such a case, payroll taxes will increase along with corporate taxes. This in turn makes downward pressure on employment growth.

Nonetheless, the government can make some specific tax arrangements that would help create funds to finance the TGA. Such a tax arrangement would be for example linking the tax on tobacco, alcohol and some other specific goods to the expenses that the TGA involves for the government. Note that these two observations regarding the social costs of implementing the TGA are hypothesised. It remains to future research to show whether and how much the implementation of TGA decreases employment and to what extent the TGA can be financed by special tax arrangements.

13. Conclusions and discussion of the most relevant country specific factors

The political crisis in Kosova following the dismantling of the socialist Yugoslavia resulted in 145,000 workers being laid-off at once. They had long-term consequences for the functioning of the labour market. The lack of jobs and the political unrest contributed to large-scale emigration. In spite of the economic upturn brought by the post-war economic reconstruction and large inflows of foreign aid, unemployment remains high due to the large number of new entrants coupled with low job creation in the private sector. In addition, the lack of jobs is pushing many people into inactivity. These special features make Kosova a special case among transition economies.

Unlike in other ETCs, high unemployment and inactivity rates in Kosova are not entirely a consequence of transition, since they were high even under socialism (unemployment was 36 percent in 1989). The large number of entrants into the labour market each year (estimated at 21,000-25,000 that is 7-8 of current employment) is contributing to persisting high unemployment.

While developing any labour market related policy proposal one should consider the following major constraints. The first constraint is that policies are needed in Kosova to overcome both transitional and post-conflict crises and to set the stage for future development. Sustained international assistance to develop such policies and support their implementation is necessary. Second, in a post-conflict and recently emerging country such as Kosova, the legislative framework regarding the labour market needs to be built from the very beginning. The experience of other post-conflict countries suggests that such developments are vital for sustained economic growth. Finally, while designing and implementing labour market policies, policy complementarities should be exploited. This requires the design of a mutually reinforcing package of policies (Aziz and Wescott, 1997; Orszag and Snower, 1999; Amable and Gatti, 2004). The limited experiences from the EU-15 regarding policies to stimulate job creation and job search, surveyed by Orszag and Snower (1999), suggest that many of these policies produced little or no effect due to the failure in many countries to implement broad-based policies and exploit the policy complementarities.

The observed high inactivity rate in Kosova indicates that poor employment prospects and other market failures are affecting people's ability to supply labour to the market. In such a situation, it is difficult to draw policy conclusions focusing only on the supply-side of the labour market, since the problem largely comes from the lack of jobs even at the market wage. Although providing short-term training for those who are more prone to unemployment (and inactivity) may improve their employment prospects, such training is unlikely to be cost-effective unless it is associated with policies that target job creation. Evidence for transition economies suggests that the most effective policies to boost job creation are policies that ease access to finance, lower taxes and the start-up costs for new firms and ensure effective implementation of regulations at large (Lopez-Garcia, 2006).

For the time being there are no unemployment benefits paid to the unemployed people in Kosova. The introduction of such benefits (although desirable from the social point of view) might not yet be sustainable in Kosova given the existing large number of the unemployed. Assuming an unemployment rate of 40 percent (SOK, 2005a) gives the number of the unemployed of around 250,000 individuals. Even if benefit replacement ratio was set at only 30 percent of the average monthly wage of €215 and assuming a coverage rate of 50 percent (as found in many ETCs, Cazes and Nespororva, 2003), annual spending on the unemployment insurance would amount to €96.7 million. This is equivalent to 5.1 percent of GDP or 14.9 percent of government expenditure in 2004, which corresponds to total government spending on all levels of education. In other ETCs, spending on all passive labour market policies as a proportion of GDP ranges from only 0.1 percent in Estonia to 0.9 percent in Hungary.

Around a fifth of wage employees are working in the existing Socially Owned Enterprises (SOEs) that are to be privatised. The undergoing privatisation process is likely to result in more job cuts. Since a great number of them are elderly, it is expected (based on our findings on the probability of being ILO unemployed as opposed to being a discouraged worker) that a number of them will move into inactivity. This has implications for social assistance programmes. Any policy aiming to reduce unemployment should target these workers as well.

Although the TGA was planned to be implemented from January 2005, it still not in force. The Government of Kosova claims that there are no funds to cover the costs of TGA that rest with the government budget (that are estimated at 60 million Euro annually). Nonetheless, the existing disputes, it is of general interest to start implementing the TGA for the sake of maintaining the social stability in this very critical phase that Kosova is going through. It is clear that the TGA cannot be implemented immediately as it involves great costs to all social partners. As such, a strategy is needed to start implanting it phases which strategy would involve a timeframe of TGA implementation. The first step would be to implement those points/articles of TGA that can be implemented, which do not impose great costs to the governments and that are acceptable by the employers' side. The second step would be make a list of disagreements and establish a joint committee to discuss them and find ways to solve them.

Another policy action that is expected to affect the labour market is the increase in pension benefits from 40 to 75 Euro/month for previous pension contributors (i.e. those aged 65 and over that have contributed to pension fund before 1999. For the rest of persons aged 65 and over, the pension benefits will remain at 40 Euro/month. This is expected to affect the government budget along with the payment of pension benefits for 'to be retired' members of the Kosovo Protection Troops (around 2,000 people).

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Montenegro

Ana Krsmanovic*

1. Main characteristics of Montenegrin labour market

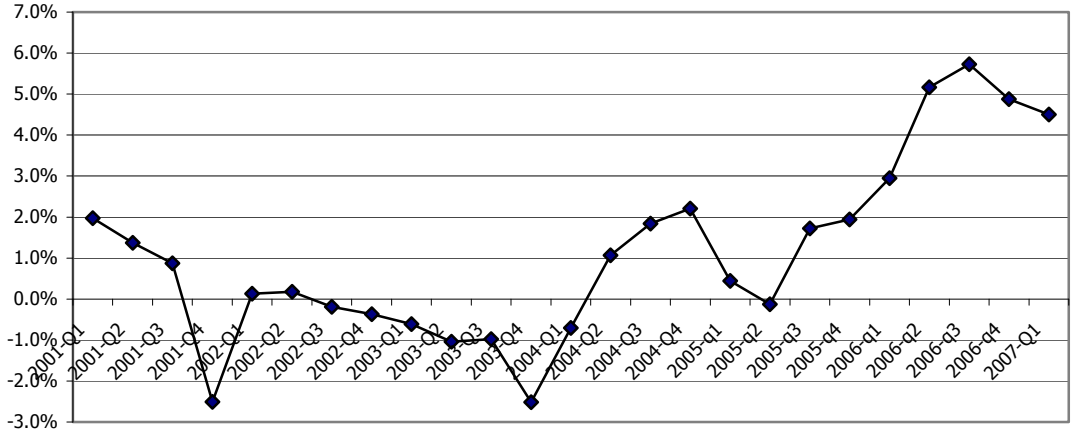
There are several sources of labour market information in Montenegro. The first source are the official statistics, published by the Statistical Office of Montenegro which include the data on registered employment as well as labour force survey data. Second source of labour market data are those published by Employment Office of Montenegro (EOM), which provides number of registered unemployed persons, as well as unemployment rate figure, which is treated as relevant by Montenegrin government. Also, the Institute for Strategic Studies and Prognoses[75] has its own estimates of employment and unemployment, which are often used in official documents.

1.1. Employment

Depending on the source of data, employment in Montenegro in 2006 ranges from 150.8 thousands (registered employment) to 204.9 according to ISSP estimates. MONSTAT Labour Force Survey showed that the employment in Montenegro in 2006 is about 178.3 thousands. EOM/ISSP Labour Force Survey conducted in June 2007 showed that the employment in June amounted 218.6 thousands. Employment Office estimates[76] indicate that the number of employed persons in 2006 was close to 210.0 thousands.

Graph 1

Annual employment growth rates (2001-2007)



Source: Monstat, Monthly statistical reviews, 2000-2007

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[75] Independent economic think-thank .

[76] Obtained using number of unemployed persons and published unemployment rate

Regardless to the data source, except for the MONSTAT labour force survey, employment records positive annual growth rates since fourth quarter of 2003. In 2006 employment increased by 5.4%, while growth rate of employment in 2005 was 1%.

Among employed persons in 2007 females make 41.7%, which makes a one percentage point increase as compared to 1999, when the share of females was 40.1%.

Observing employment by sectors, it is obvious that the services sector dominates, and its share in total employment increases over time. Employment in services sector made 71.8% in 1999 and has increased to 76.5% in 2007. Also, share of employed in agriculture has increased from 6.9% in 1999 to 8.9% in 2007, while share of industry has declined from 21.3% of overall employment to 14.6% of overall employment.

Also, besides change in employment by sectors the employment structure by ownership has also changed. According to ISSP household survey data, share of employed in the public sector amounted 59.6% in 2001, and has reduced to 36.6% in 2007. On the other hand share of private sector employment has increased from 34.8% in 2001 (same source) to 61.6% in 2007. Other types of ownership make 5.6 and 1.8%, respectively.

The majority of employees are engaged in the sector of small and medium sized enterprises (with less than 250 employees), in 2007 share of SME sector employment in total was 88.0%. Small sized companies (up to 49 employees) employ 50.4% out of total employed persons, while medium sized companies' employment makes 27.6% out of total. Remaining 22% of employed persons is engaged in large companies.

1.2. Unemployment

According to Employment Office data on registered unemployment in Montenegro, number of unemployed persons has reached its maximum level in 2000, when average registered unemployment was over 80.0 thousands. After that, unemployment is constantly falling, and has been reduced by half in 2006.

On the other hand, estimates based on LFS data from Federal Statistical Office of Yugoslavia (later Serbia and Montenegro), ISSP household survey data and official registers, indicate that the unemployment rate in Montenegro, in the period from 1995 to 2007, reached its maximum level in 2003 (22.7%). After 2003, an unemployment rate record constant decreases and has been reduced to 12.6% in 2007[77].

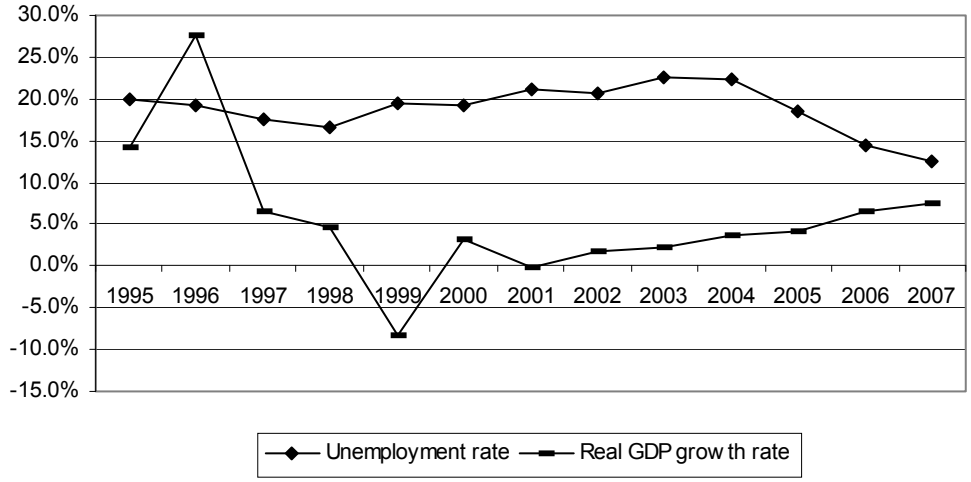
This decrease in unemployment rate is the consequence of the economic recovery and stabilization of Montenegrin economy (decrease of government deficit and inflation, increase in saving and investments, strong growth of services sector industries). In the period up to 2004, unemployment trends did not follow the GDP decline due to high level of employment protection,

[77] ISSP LFS data 2007

as well as engagement in the shadow economy, which was one of means to cope with economic setback.

Graph 1

Unemployment rate in Montenegro (1992-2007)



Sources: Statistical Office Serbia and Montenegro, MONSTAT, Employment Office of Montenegro and ISSP

Among unemployed female made 45.6%, while this share in 1999 was 64.4%. Also, unemployment rate among female labour force in 2007 was lower than unemployment among male labour force. In 1999 unemployment rate among females was 27.5%, while unemployment rate of males was 12.6%[78], in 2007 unemployment rate among females was 11.7%, while unemployment rate among males was 13.5%. This difference in unemployment rate is also partly caused by lower activity rates among females (49.1% among females and 62.1% among males).

Besides relatively high unemployment, one of main characteristics of unemployment in Montenegro is its duration. Share of long-term unemployed in Montenegro in 2007 was 55.7%, meaning that more than half of unemployed is waiting for a job for more than one year. The average unemployment duration in Montenegro among unemployed person is 3.7 years.

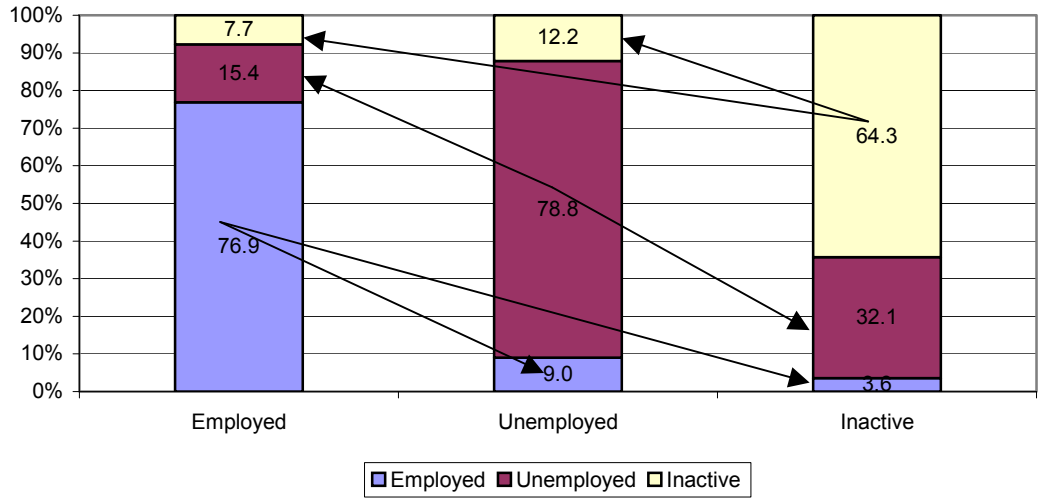
1.3. Labour market mobility

Labour market mobility in Montenegro, since there is a lack of good data, can be observed from the aspect of mobility across sectors and between different labour market statuses. Mobility across sectors is evidenced through increased shares of employees in service sector industries. Also, the share of employees in agriculture has increased, while share of industry sector employees has decreased.

[78] Federal Statistical Office LFS 1999

Graph

Change in labour force status as compared to previous year (2007)[79]



Second source of data on labour mobility is information from LFS on the status one year before the survey (see graph), however these data should be treated cautiously. In 2007, 8.9% of unemployed were employed during previous year; almost 80% of them were unemployed while remaining percentage was inactive. On the other hand among employed persons 15.4% were unemployed one year prior to survey, while among unemployed 9% make those who lost their job.

2. Labour code

The Labour Code, General Collective Agreement and the Employment Law regulate labour market in Montenegro. The Labour Code regulates issues related to employees' rights and termination of labour contracts, General Collective Agreement deals with leaves and wage setting, while Employment Law regulates the process of employment (vacancies) and unemployment protection (passive and active labour market measures).

Current Labour Code in Montenegro has been passed in 2003, and has represented an attempt to increase flexibility on the labour market. However, there are two main changes that were introduced by this law which have not impacted the flexibility/rigidity of market. First change is reduction in the severance payments for redundant workers from 24 to 6 average wages. Second change refers to reduction in maternity leave from 18 for second and 24 months for third child to 12 months for every child.

Mentioned changes in the law have not contributed to increase in labour market flexibility, namely the labour regulations in Montenegro, as compared to regional and EU average are quite rigid, as measured by OECD Employment Protection Legislation (EPL) rigidity index.

[79] X-axis current status

The value of overall EPL index for Montenegro is 4.1, which puts Montenegrin labour market among the rigid labour markets. The value of index for permanent employment is 3.2. The permanent contracts cannot be cancelled without following the legal procedure – one-month notice (written), provision or rights (employment in the same or other company on the different working position which match the education or retraining or pre-qualification, or 6 months salary as severance payment). The law does not make difference in the notice periods and severance payments depending on the working experience of employees.

The temporary contracts regulation in Montenegro is even stricter than for the permanent contracts. The law allows for nine months regular contracts, which cannot be renewed. According to the law, and the opinions form the labour inspectorate, if the need for particular worker exists after nine months period, than this contract should be treated as permanent labour contract. The law allows temporary contracts only for objective reasons (temporary increase of workload, replacing absent worker, work on project, etc).

The collective dismissals regulation is the strictest part of labour regulation in Montenegro. The value of index measuring the rigidity of collective dismissals is 5 in Montenegro. The collective dismissal is defined as dismissal of five or more workers, regardless to the size of company. The workers, workers union and the Employment Office of Montenegro should be informed about planed dismissal three months in advance. Besides this the employer must draft a program of employees rights – employment with the same or different employer on different working position, retraining and payment of severance payment. The employer is obliged to offer them some of these rights, while the workers can choose which rights to use.

This rigid regulations and practice of job protection were inherited from the past, while unfavourable political situation and poor standard of living experienced after the start of transition process contributed to status quo. Namely, labour market policy (or lack of labour market reforms) was aimed towards preserving social peace, regardless to economic outcomes.

Despite, the high rigidity of regulations, the level of law compliance is low, especially in the private sector. The low level of compliance is evidenced through high share of informal economy on the labour market, which ranged from 30% in 2001 to 22.6% in 2007[80]. According to the 2007 LFS survey results, the 22.6% of employee's works in unregistered companies of are unregistered workers in formal sector companies. In addition, 17.5% out of registered employees has a partly registered wage, employers register minimum amount of wage, which is set by the General Collective Agreement and pay social security contributions and taxes on this amount, while employees receive higher amount. On average employers register 50% of the employees wages[81].

[80] Share of shadow economy on the labour market in 2001 is estimated from the ISSP Household Survey data, while 2007 percentage is obtained from the Labour Force Survey, which ISSP has conducted for Employment Agency of Montenegro.

[81] ISSP LFS Survey 2007.

Table 1

Aggregated indicators of EPL rigidity in Montenegro in comparison to OECD countries.

	Regulative of permanent employment (scale 0-6)	Regulative of temporary employment (scale 0-6)	Regulative of collective dismissals (scale 0-6)	Employment Protection Legislation Index – EPL Index (scale 0-6)
			Index	
Montenegro	**3.2**	**4.0**	**5.0**	**4.1**
Croatia	2.8	3.9	5.0	3.6
Czech Rep.	3.3	0.5	2.1	1.9
Estonia	3.1	1.4	4.1	2.6
Slovenia	2.9	0.6	4.9	2.3
Poland	2.2	1.3	4.1	2.1
Slovak Republic	3.5	0.4	2.5	2.0
Hungary	1.9	1.1	2.9	1.7
Ireland	1.6	0.6	2.4	1.3
Italy	1.8	2.1	4.9	2.4
Portugal	4.3	2.8	3.6	3.5
Turkey	2.6	4.9	2.4	3.5
France	2.5	3.6	2.1	2.9
Germany	2.7	1.8	3.8	2.5
USA	0.2	0.3	2.0	0.7

Sources: OECD- "Employment Outlook", Paris, 2004; ISSP calculations for Montenegro

The private sector employees (employed in companies which are established as private) have different perception of the labour regulations, and accept to work although they are not provided with all the rights prescribed in the Labour Code and other regulations (annual and weekly leaves, other benefits, etc). The highest level of labour law compliance is observed in the public sector and public companies, as well as in privatised public companies. This is result of strong influence of unions in these sectors.

This indicate that the strict labour code protects public servants and employees in public companies, while the private sector employees are in practice not protected at all, or the level of protection is quite low. Currently, in some private companies it is a practice to force an employee to sign an undated statement on voluntary termination of the labour contract on the same day as the labour contract is concluded. So as soon as an employer finds himself in the difficulties it is very easy to dismiss a redundant worker, just inserting the date.

3. Wage setting and the role of trade unions

Main elements of wage bargaining and the role of trade unions in the process are set by the Labour Code and General Collective agreement. The social dialog/bargaining tripartite, and includes three partners – Alliance of Independent Trade Unions (central union organization, later in the text referred as Union), the government and representatives of employers.

3.1. Role of trade union on Montenegrin Labour Market

Union is organized as centralized alliance of the 14 branch trade unions[82],. Membership in the trade union is voluntary. Workers in every company (organization) can establish its own union association. Despite the fact that the membership in the union was voluntary, until the new General Collective Agreement (GCA) was signed in the 2003, every employee had to pay a compulsory contribution of 0.2% of its gross wage to the trade union. Every employee, regardless to being member of the union or not, had to pay this contribution and employer was obliged to withhold and pay this amount. These funds were used for operation of the union and recreation of workers. Currently only Union Members pay their contribution. The employer is also obliged to provide conditions for union operations free of charge (office, office equipment and supplies), to provide union activists with amount of paid hours they need for their union activities. Also, if company has over 1000 employees an employer has to employ one additional person to run union activities and to pay this person a full salary.

The Union has an important role in Montenegrin labour market. The role of union is especially important in the General Collective Agreement bargaining process with the Government and the representatives of employers, which is the second key labour market regulation, besides the Labour Code. Wage setting procedure is also part of the general collective agreement.

Taking the number of members as revealed by the Union itself, the union's density can be estimated to between 45% (if LFS employment figure is used as denominator) and 58% (if registered employment figure is taken as denominator). On the other hand, taking into account current quite dynamic situation on the labour market, the data on union membership obtained from the Union might be overestimated. Using disclosed Union revenues from the members' contributions in 2005 and the average wage in Montenegro, the resulting union density in Montenegro can be estimated to 28%-34%. It would mean the real union density to be close to this prevailing in most of transition economies.

Union membership in Montenegro is practically limited to the former public-owned companies as well as to the public sector services. Employees in the new private companies being mainly Small and Medium Companies (SME) usually are not members of the union. Hence one may expect that as the process of privatisation and economic restructuring goes on resulting in increasing share of those employed in SMEs and in market services the number of union members will decrease. So will probably the real power of Unions as representation of employees. Weakening of statutory power of the Union seems therefore to be the natural consequence of the process of economic restructuring resulting in increasing share of workers in non-unionised sectors. .

Trade Unions have the monopoly to run negotiations similarly as in most of European countries. The results of national agreement negotiations are extended to whole economy, while in the

[82] Until recently, there was 19 branch organizations in the central union. Due to some organizational disputes, 5 branch unions have stepped out the central organization

case of branch agreement to all companies in the branch. The results of company agreements are not automatically extended to other companies.

3.2. Wage setting process in Montenegro

Collective bargaining in Montenegro is multi-tiered; the Labor Code anticipates national level, branch level, and company level bargaining agreements. On the national level the negotiations are tripartite, meaning that the government, representative of employers and representative of workers (The Alliance of Independent Trade Unions) is negotiation on the General Bargaining Agreement, which sets benchmark for employees rights in terms of wage formation, leave, and other rights. The General Bargaining Agreement anticipates minimum rights, and the branch and company level agreements could not anticipate fewer rights, they can only include more rights to employees. The branch level and company level agreements are negotiated among representatives of the employers and union representatives (branch union, company union). In case that in company workers have not organized a union, the branch or national level collective agreement is applied.

As mentioned, General Collective Agreement (GCA) is the most important regulation that refers to the labor market in Montenegro. The GCA is negotiated on the national level between representatives of the government, union and the employers.

The most important part of GCA relates to regulation of level of wages in the economy. GCA defines the national minimum wage, or basic price of unqualified labor, which serves as a benchmark for calculation of other wages according the employee education level.

The wage bargaining in Montenegro is mixture of centralized and decentralized bargaining. Namely, the Alliance of Independent Trade Unions negotiates with social partners (the government and authorized representative of employers) on the national minimum. Also, the Alliance is negotiation about general conditions, such as other rights, wage coefficients, etc. In the same time, on the branch level, the unions and employers negotiate on the minimum wages; wage coefficients and other issues related to the workers rights.

Due to specificity of labour market, dominant type of bargaining (intersectoral, sectoral, company) in Montenegro cannot be clearly differentiated. National minimum wage is binding for public sector services, while the private sector employees are partly covered by this wage. Namely, in many cases for private sector employers register the minimum wages for employees[83] (as set Bargaining Agreement) and pay the corresponding taxes, while employees actually receive more.

So in one hand the national level bargaining is binding, having in mind that the registered wages in the part of private sector employment (especially SME) are dependant on the minimum wage,

[83] In 2004 ISSP Household Survey the share of employees who stated that they wages are partly or completely unregistered was 10.6, while the share of those whose wages are just partly registered was 6.4

and public services sector. So, observed by the registered wages, the national level bargaining is the most dominant. On the other hand, if we observe actual situation in Montenegro, than the company level bargaining is the most dominant and covers 50-60% of all employees. However, due to special role of GCA Montenegro cannot be clearly categorized. On the one hand, due to general importance of results of CGA and the special construction of the minimum wage system the central level should be considered as dominating one. On the other hand, however, the actual wages are obviously negotiated mainly on company level either individually by employers (in SMEs) or by company trade unions (in bigger companies). It means that the system of wage bargaining in Montenegro should be classified as mixed with important roles of both national and company level but with limited role of branch level.

3.3. Minimum wage

Regulations concerning the minimum wage in Montenegro are slightly different from those observed in most of European countries. The minimum wage differs depending on the education level of an employee. The basic amount is set by the General Collective Agreement (GCA) between the Trade Unions and the Government and applies only to workers with primary education. Then the same agreement gives also the set of coefficients this basic amount is to be multiplied by depending on the education level of an employee. This system is inherited from the past. It represents an attempt to correlate wages with education as in socialist's times the unqualified workers tended to earn more than the workers with the university degree.

Basically every wage coefficient represents an assessment of the labour value, relative to the unqualified labour. The wage coefficient for unqualified (elementary school only) workers is 1 and means that their minimum wage is equal to the general (national) minimum wage (equal currently 50€). The minimum for each level of education is calculated by multiplying national minimum wage by corresponding wage coefficient. Workers with 6-month education above the elementary level have the coefficient 1.2 that means that at the minimum they should be paid by 20% more. The highest coefficient (4.0) has been set for employees with PHD level (see Table 2).

The minimum wage concept is binding for all companies in economy. However, the highest and direct impact of minimum wage concept is in the public services sector (public administration, education, public security, and health). The wages in this sector are linked directly, through system of wage coefficients, to the national minimum wage. The wage in public administration are actually regulated by the Law on Wages of Public Servants and Clerks, according to which their wage is obtained by multiplying wage coefficient with the value of one wage point. However, in the practice this wage point is still equal to the national minimum wage.

Table 2

Wage coefficients according to the GCA

Qualification (education)	Wage coefficients	Minimum net wage according to the CCA[84]
Unqualified work	1.00	50.00
Qualification 6 months	1.25	62.50
Qualification from 6 months to 2 years	1.60	80.00
High school education (2 - 3 years)	1.95	97.50
High school education (4 years) - qualified worker	2.20	110.00
High school education (4 years) with specialization – (high-qualified worker)	2.45	122.50
College education - 2 years	2.80	140.00
College education - 4 years	3.30	165.00
Master degree	3.60	180.00
Doctorate	4.00	200.00

Source: General Bargaining Agreement, 2003, ISSP calculations

As for the private sector, the minimum wage has influence of the wages trough unofficial wage accounting practices prevalent at Montenegrin enterprises. It is common practice for employers to pay their employees the official minimum wage along with an unofficial supplement on which no wage-related taxes have to be paid. The resulting earnings of the employee are much higher than the minimum wage and they represent a much lower cost to the employers since the official tax burden is only levied on the legal, minimum-wage-based portion of the earnings . In this case, increasing the minimum wage means higher tax burden for the employers, as they have to pay taxes on the now higher, legally registered portion of the salary. Thus, following the official increase in the minimum wage, wage expenditures increase even in those enterprises that pay their employers much more than the minimum.

4. Tax wedge on labour

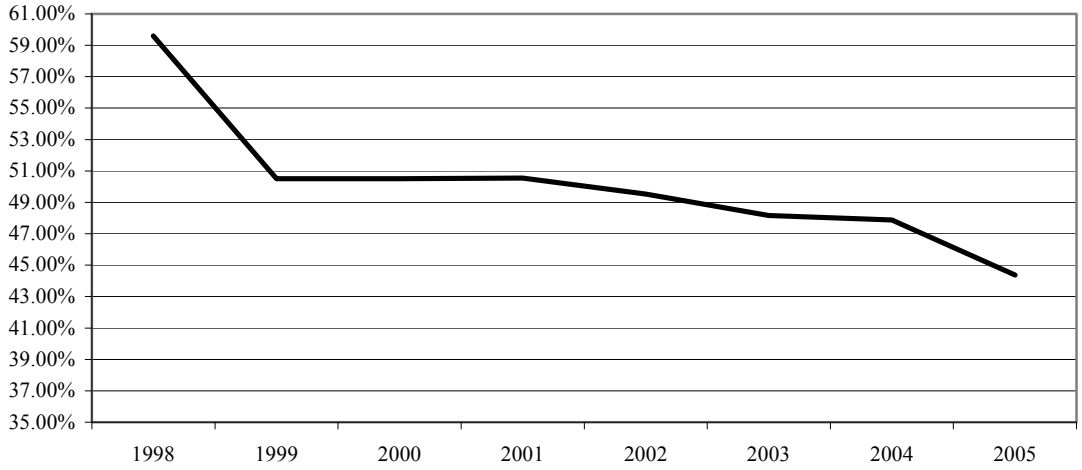
In Montenegro, the average tax wedge on labor, calculated based on average wage of average production worker in manufacturing industry (APW) in Montenegro as published by Monstat, is constantly declining. A huge decrease in the tax wedge in Montenegro occurred in 1999 of roughly 10 percentage points, or from 59.6% to 50.5%. Namely, in 1999, the proportional taxation of income, by the rate of 19%, was introduced and this replaced progressive taxation, where the average effective tax rates amounted to around 30%.

A shift from proportional to progressive taxation in 2002 did not increase the tax wedge because the effective rates of taxation by the new system were lower than the 19% flat rate of the previous system.

[84] Minimum wage according to GCA = national minimum wage 50€ * wage coefficient

Graph

Tax wedge on APW in Montenegro (1998-2005)

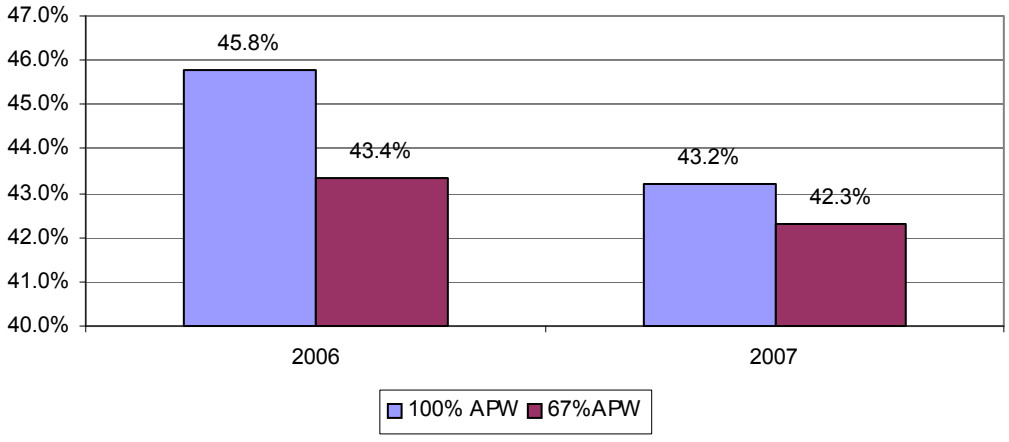


Source: Monstat, ISSP calculations

The tax wedge on wage of average production worker in manufacturing industry in first half of 2007 amounted 43.2%, and represents a 2.6 percentage points decrease as compared to average 2006 (45.8% for 100%APW). In 2007 tax wedge has decreased as a consequence of change in personal income taxation. The progressive taxation with tax rates 15%, 19% and 23%, has been replaced with single rate of 15%, and tax exempted income of €840 per year. This tax rate will be decreased to 12% in 2009 and 9% in 2010. The Government has prepared a draft law on social security contributions, according to which the social contributions should be decreased.

Graph

Tax wedge for 100% APW and 67%APW in 2006 and 2007



Source: MONSTAT and ISSP calculations

In 2006, increase in tax wedge as compared to 2005 is consequence of change in methodology for calculation of average wage in Montenegro[85]. Average wage calculated using new methodology is by approximately 25-30% higher as compared to wage according to old methodology, which due to progressive taxation has resulted in higher tax wedge.

Government plans anticipate further decrease of social security contributions, and personal income tax rates, which will result in further decrease of the tax wedge. Especially important part of this anticipated reform is decrease in social security contributions, which make over 70% of total tax wedge. The Law on Social Security Contributions has been passed in December 2007, and is effective since January 2008.

Table

Personal income tax and social security contributions rates (2006-2010)

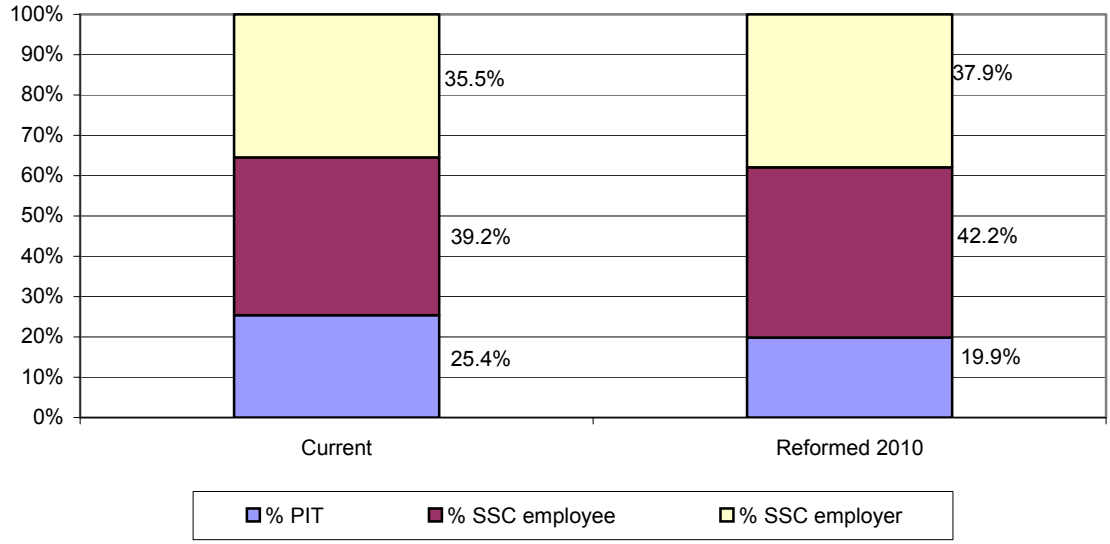
	2006	2007	2008	2009	2010
	% of gross wage				
Employee					
Personal Income tax	0-23	15.0	15.0	12.0	9.0
Pension contribution	12.0	12.0	12.0	12.0	12.0
Health insurance contribution	7.5	7.5	6.5	5.0	4.0
Unemployment contribution	0.5	0.5	0.5	0.5	0.5
Employer					
Pension contribution	9.6	9.6	9.0	8.5	8.0
Health insurance contribution	6.0	6.0	5.5	5.5	5.0
Unemployment contribution	0.5	0.5	0.5	0.5	0.5
Chamber of commerce contribution	0.32	0.32	0.32	0.32	0.32
Surtax on personal income tax	13-15%PIT	13-15%PIT	13-15%PIT	13-15%PIT	13-15%PIT

Source: PIT Law (2006), Law on Social Security Contributions (2007), PIO Law (2003), Health Insurance Law (2004), Employment Law (2002)

[85] Up to January 2007, MONSTAT has calculated average wage by dividing total sum of paid wages with estimated number of employees in Montenegro. This resulted in underestimation of average wage in the Republic, since the sample of workers for which MONSTAT had sum of paid wages was lower then the number of employed in Montenegro. Currently MONSATAT calculates average wages taking into account number of workers to which these wages were paid.

Graph

Structure of tax wedge for 100%APW



Taking into account current wage levels the structure of tax wedge and its amount will change significantly. Tax wedge will be reduced to 34%, while share of social security contributions will increase to over 80% of total tax wedge.

Main concern regarding tax wedge on labour in Montenegro, besides it level, is its compound influence with minimum wage. In the 2006 OECD Employment Outlook was indicated that in countries with high minimum wages the influence of tax wedge tends to be more destructive for employment. Since the minimum wage is binding any increase of the tax wedge is transformed directly into the labour costs.

5. Industrial actions

After the start of the transition process and especially in the period from 1998 to 2003, there have been many strikes organized by the union organizations in Montenegro, usually on company level.

In 2003 the strikes have been organized in 150 companies, mainly in manufacturing industry and in former state-owned companies. In 2004 number of organized strikes decreased to 67, while in 2005 there have been 72 strikes. Majority of these strikes relate to poor performing companies in which were privatised through mass voucher privatisation or some other method, where there are some unsolved labour disputes. Some of disputes related to severance payments for some categories of workers, issues of persons with disabilities, issues of free shares which were distributed to all workers in the process of transformation of company. Good example of such dispute and strike is a textile company, which gone through “programmed bankruptcy procedure”, meaning that all employees are fired and later some of old workers are recalled to work. The workers which were not recalled, after 15 years have initiated strike asking from government to provide them with severance payment (24 average wages), to distribute them free

shares and share in revenues from sale of some property of company. The government has fulfilled their requests. The strike lasted for one year.

Majority of strikes are usually organized in companies that were in the former public ownership or still the state is major owner, whose status is still unclear, and there are issues with workers.

However, the most important strikes are usually organized during the privatisation process, every large privatisation was followed by the general strike of workers (brewery in Niksic in 1996, Telecom in 2005, Aluminium Plant 2005, Steel company in 2004 and 2006). These strikes were manly organized with main goal to improve provisions in company collective agreements, i.e. to increase the rights of workers (usually wages, severance payments).

6. Labour market policies

The total spending on active and passive LM policies in Montenegro in 2006 amounted 1.6% of GDP. The share of active LM policies in the EAM spending is 0.8% of GDP, while passive policies make 0.3% of GDP, staff cost 0.2% of GDP and other expenditures 0.3% of GDP. The biggest spending category in EAM budget is loans for self-employment and the unemployment benefits. The staff cost and costs of materials and services amounted to EAM amount to 22.7% of total spending. However, one part of this costs should be transferred to active policy measures, since staff cost include actually cost of counselling and other support to unemployed by servants in the labour bureaus.

Table

Budget of Employment Office of Montenegro, 2006

Spending category	In € million	In % GDP
Unemployment benefits	5.45	0.3
Apprentices	3.10	0.2
Preparation for employment	4.78	0.2
Self-employment loans	7.46	0.4
Mortgage loans	1.05	0.1
Cost of material services, etc	2.94	0.2
Staff cost	3.95	0.2
Repayments of loans	1.45	0.1
Other expenditures	0.45	0.0
Total	**30.63**	1.6

Source: EOM Performance Report for 2006

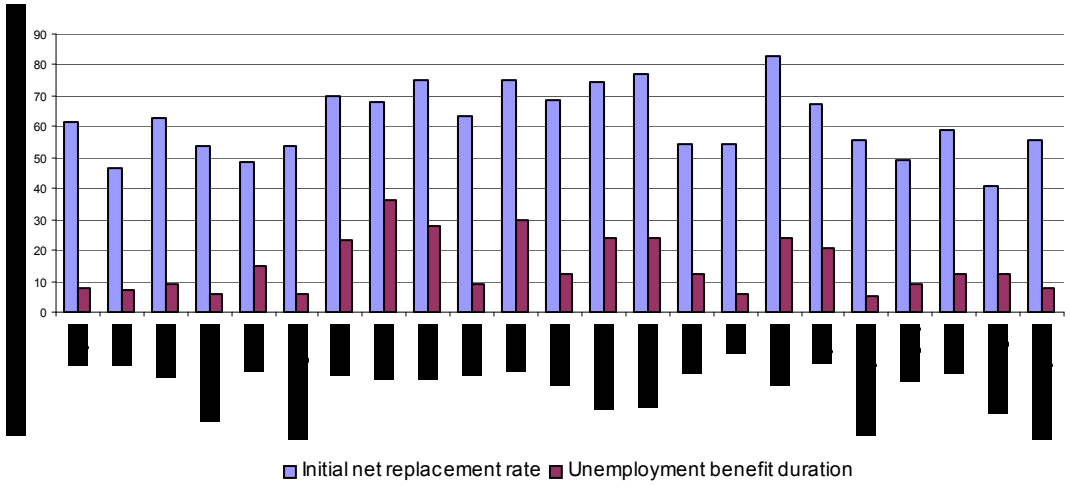
The size of unemployment benefit in Montenegro is relatively low. Eligibility for unemployment benefits is linked to unemployment insurance contribution payments, while duration of unemployment benefit depends on job tenure. The benefit duration is

- 3 months for insurance period of 9 month continuously, or 12 months with breaks in the last 18 months;
- 6 months for continued 30 months insurance or 50 months with breaks in the last 5 years;
- 9 months for insurance period from 5 to 15 years;
- 12 months for insurance over 15 years, and
- insured person that has over 30 years of working experience is entitled for unemployment benefit until its employment or fulfilling conditions for retirement.

The amount of unemployment benefit is set to 65% of the national basic minimum wage, and currently amounts 35.75€ (net terms), and on top of this the social security contributions are paid. Relative to the average wage, the unemployment benefit is quite low, and thus it does not seem it can have influence on prevailing low activity level in the country. The average ex-ante duration of benefit in Montenegro is about 12 months. Obviously if only those who are currently obtaining the benefit are taken into account the average duration increases to 48 month. It stems from the fact that most of current recipients belong to the last groups (with open ended benefit). These are mainly older workers from former public companies, which went bankrupt.

Graph 5

Average duration of unemployment benefits and average net replacement rates of non-employment incomes in Montenegro as compared to OECD countries.



Note: The Net Replacement Rate in Montenegro is calculated according to the methodology applied by OECD. It is the average of the expected incomes of the single person without children, a couple without children and a family of four (parents + 2 children) as compared to the single average wage, i.e. one breadwinner is assumed in each case.

Taking into account solely the unemployment benefit, than initial net replacement rate in Montenegro is approximately 10% (10.9% in 2006 and 10.4% in the first half of 2007). Besides unemployment benefit, the only social transfer the unemployed persons can apply for is the Family Material Support (FMS). FMS is an income and means tested benefit. It is paid as an addition to other family's incomes until the total income reaches a fixed amount depending on the number of family members. For example if the single unemployed person receives the unemployment benefit, which is 32.5€ it is eligible to receive difference between this amount and

the amount of FMS for single member family - 50€ per month – it gives the actual benefit of 17.5€. On top of this, FMS beneficiary families are entitled to child benefits for the first three children amounting 15€ for each child.

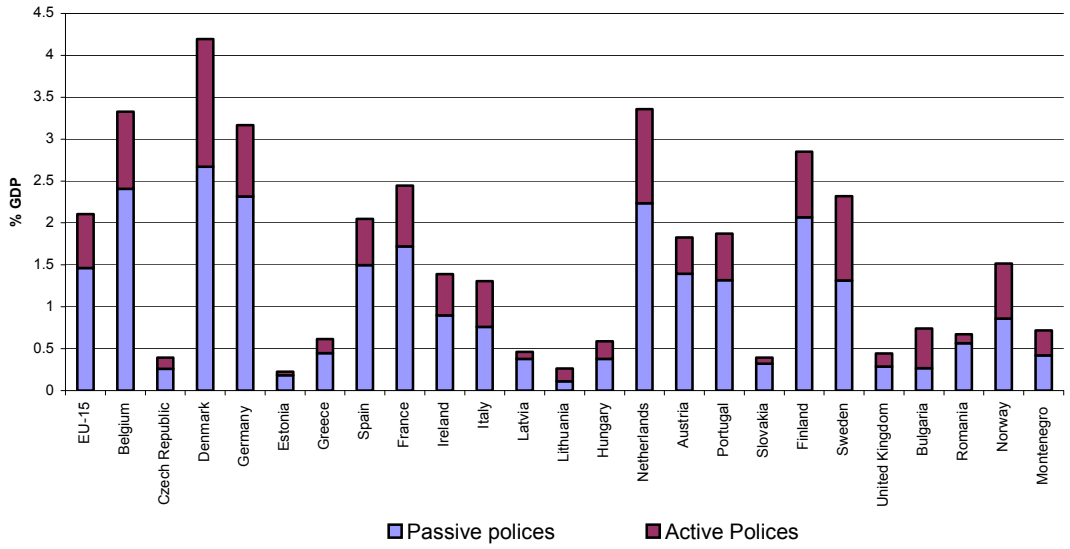
The active labour market programs are defined as such in the Employment Law, while their detailed description is provided in the Decree on Preparation for employment. Active policy measures include:

- Financing of new jobs opening;
- Co-financing of public works;
- Scholarships;
- Establishment of the Labour Fund;
- Partly compensation of labour cost for the productive jobs;
- Loans for investments in employment;
- Co-financing of seasonal employment in tourism, constructing, agriculture,
- Help in new employees training;
- Co-financing of the apprentices wages;
- Creation of employment plans for disabled and long-term unemployed;
- Creation of programs for space and professional mobility of labour force;
- Co-financing of education and work enabling;
- Co-financing of space and equipment adjustment to the needs of disabled;
- Designing programs for adjustment of work places to certain categories of workers;
- Other measures.

Relatively large number of programs offered by Employment Office in Montenegro results in high participation of unemployed.

Graph

Spending on LM policies as % of GDP in 2005



Sources: ISSP for Montenegro and OECD data for other countries.

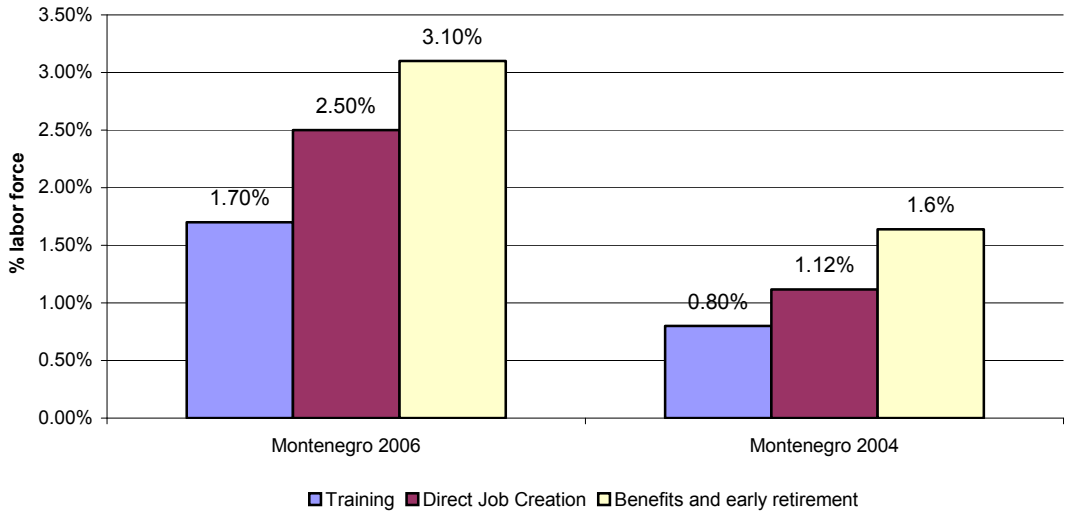
The program of continuous incentive to employment end entrepreneurship is actually a credit line provided to unemployed persons for jobs openings. Special attention in this program is placed on the redundant labour and persons lost their job due to company insolvency. The loans are to be repaid within 3 years with one year of grace period, the amount of loan is 3000€ per one job opening. Since February 1999, when the program was launched, up to June 2006 the 7630 loans have been approved, and 12,615 new jobs created.

Legalization of existing and new jobs openings program included the reduction in the employer share of social contribution from March 2003 until December 2005. Employers were relieved from paying social contributions for one year for newly registered employees in this period. Credit lines for companies, which were agreed between banks and the government, are the second part of this program. Up to date 10.1 million of euro was approved, which resulted in 1472 new jobs opening. The employers were obliged to hire people from the unemployment register. According to the Employment Office data this program also resulted in 30.000 new registered jobs. However one can suspect that most of these new jobs meant simply legalization of earlier existing shadow workplaces.

Other active measures implemented by Montenegrin Employment Office include: public works implemented for the first time in 2004, up to date 1450 unemployed persons was engaged in some of these works, programs of training, retraining and pre-qualification with several training centres established in the period since 2000 to 2006 and over 14,000 of unemployed persons covered, financing the salaries of apprentices in the private and the public sector with the university graduates receiving full annual salary compensation and the high-school graduates and college graduates receiving half of annual salary.

Graph

Participants in labour market programs as % of labour force



Sources: EOM and ISSP calculations

There are also special programs for unemployed with disabilities. They include incentives to employers that hire persons with disabilities such as free training, co-financing of wage for apprentices, covering cost to adjust working environment, or financing social contributions for two years and one fourth for every next year, etc.

The Employment Office is to tighten the rules regarding the unemployment status. Some new requirements have been introduced including: regular reporting, attending consultation with vocational advisors etc. Mainly thanks to strict application of these new rules Employment Office has managed to half the number of registered unemployed persons from over 80000 in 2001 to less than 40000 in 2006. Obviously such tightening of rules can be criticized as an easy way to "artificially" decrease the number of unemployed. On the other hand however, taking into account the limited resources, the Employment Office should work only with those unemployed who are really looking for jobs and not with those for whom having their health insurance covered is the only reason for being registered. Therefore such tightening has to be appreciated.

7. Informal sector employment

Strict labour regulations and flexible government policy toward the issue of shadow economy have contributed to high shares of shadow economy on Montenegrin labour market. Namely, after start of transition process and wars in surroundings, ands economic recession engagement in informal sector was one of the main coping mechanisms for both private sector companies and individuals.

Informal economy on the Montenegrin labour market is recorded in the three main forms: employment in the informal sector, informal employment in formal sector and employment in formal sector with underreported wages (partly registered wages[86]). Employment in informal sector implies work arrangements in the unregistered companies, or activities of self-employed individuals that do not register their activity. Second form, informal employment in formal sector implies employment in the registered companies without registration for social security. Third form is partly registered employment, i.e. individual who or they employer pay social security contributions only on the part of income from employment, usually on the minimum amount set by the labour regulations.

Two first forms of the informal economy are included by indicator of informal economy employment in Montenegro, i.e. 22.6% out of total number of employed persons is employed in the informal sector companies or hold an informal employment in formal sector companies. Thus 49,442 people are engaged as unregistered employees in formal companies of engaged in informal companies.

[86] Social security contributions are paid on the usually minimum amount of salary as determined by the Labour code and collective agreement, while actual wage is higher.

Among formal sector employees, partly registered wages has 17.5%, while on average 50% of salary is registered.

Structure of employed in shadow economy by activity indicates that largest share have employees in hotels and restaurants activity (19.1%), employees in agriculture (18.0%), as well as those engaged in wholesale and retail activity (15.7%).

Main contributing factors to prevalence of informal sector on labour market are high fiscal burden imposed on wages, rigid labour regulation and low level of compliance. According to opinions of business owners taxes and contributions are the most important barriers for employment, and especially employment in registered economy.

Table

Structure of employees in informal sector by activity

Activity	%
Agriculture	18.0
Production	3.6
Electricity, water and gas supply	0.7
Construction	4.7
Wholesale and retail	15.7
Hotels and restaurants	19.1
Transport and warehousing	9.7
Banking and finance	0.9
Business services	2.3
Real-estate and renting	0.2
Telecommunications and media	1.0
Education and culture	1.9
Health services	0.7
Craft services	11.6
NGO	1.2
Communal services	1.2
Other	7.7

Source: EOM/ISSP Labour Force Survey 2007

Main causes of shadow economy

High taxes and contributions	70.5%
Complicated procedure of employment	14.1%
Complicated dismissals in case of workers surplus	6.1%
Other	9.3%

Source: EOM/ISSP Labour Force Survey 2007

In the period from 2003 to 2005 the Government has initiated a tax relief for new employees. Namely every company, which registers new employees, is relieved from paying employer's share of contribution and personal income tax. In the same time Labour inspection was active and has undertake extensive control of companies. This program resulted in new employment partly, but mainly in legalization of approximately 30,000 jobs.

8. Montenegro specific factors and key issues

Having in mind all characteristics of the labour market in Montenegro, it is evident that some major issues exist. First of all, lack of reliable, timely data on labour market is one of the core issues, which inhibits policy decision-making. The strict regulations and high fiscal burden, and as a consequence low level of compliance and high share of shadow economy, are the most important issue.

The most inflexible aspect of Montenegrin labour market represents Labour Code and especially collective dismissals procedure. However, this issue is one might freely say linked to will become less relevant after the privatisation process in Montenegro is finished.

As the most important obstacle to job creation and especially job creation in formal sector employers see high fiscal burden imposed on labour cost. However, government plan anticipate considerable reduction in fiscal burden (tax wedge), so this would not be issue in the future.

On the other hand, minimum wage regulations, as they are, present and will be in the future the most difficult part of regulation to change. The Government has drafted a new Labor Code, which would bring significant improvements in the regulatory aspect of the Montenegrin labor market. This draft law presents a significant improvement as compared to existing law. The new draft law decreases degree of employment protection and thus increases labor market flexibility. However, collective dismissals are still the most regulated as compared to neighboring and European countries. But, regardless to collective dismissals, Montenegrin labor market would be the most flexible labor market in Europe in the case that this law is adopted.

Country	Permanent contracts	Fixed term contracts	Collective dismissals	Overall EPL
Montenegro – draft law	1,7	0,7	4,1	1,7
Montenegro – existing law	3,2	4,0	5,0	4,1
SEE average	2,1	2,9	3,7	2,7
Western Balkans average	2,3	3,0	3,9	2,9
OECD average	2,0	1,8	2,9	2,0

The Law is currently in the public debate, and the first reactions from employers were positive, while workers unions have many remarks on the draft law. It is still not clear whether this law will be adopted and whether it will suffer from significant changes in the tripartite dialog.

Taking into account all facts on labour market in Montenegro, one can conclude that private companies (established as private) will face fewer difficulties in adapting to external shocks, if this

adaptation assumes collective dismissals and wage moderation. Also, small and medium sized companies show higher degree of adaptability, which is probably caused partly by the relatively weak position of the union in these companies. In companies that are established as private, union organizations are not even established.

On the other hand, large companies, since they are mainly former or still public companies with strong position of company level union will face more difficulties.

From other perspective, social protection services, especially unemployment protection is still not sophisticated enough and cannot provide adequate initial assistance to those who lost their job. The initial replacement rate, or share of unemployment benefit in average wage is around 10%, which is quite low. Only social protection benefit that could be offered to those who lost their jobs is family material support, but eligibility criteria for this benefit are rather strict.

9. Policy recommendations

In order to improve adaptability of domestic economy and especially labour market on external shocks, the authorities in Montenegro should consider following:

1. increase labour market flexibility be relaxing the Labour Code provision relating permanent labour contracts, temporary contracts and collective dismissals
2. reduce tax wedge
3. improve social protection system in terms of providing better targeted and more adequate assistance to those in need, without increasing significantly social protection spending
4. ensure law compliance

Review of national literature on labour market flexibility

1. Economic Reform Agenda 2002-2007 - Government of Montenegro, 2005
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3. Employment Office of Montenegro – National Employment Strategy (draft), 2007
4. ISSP- Household Budget Survey, Podgorica, April 2004.
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8. Krsmanovic A., Walewski M. – Labour Market Institutions in Montenegro – A barier to Employment?, ISSP/CASE, 2006
9. MONSTAT – Labour Force Survey 2004, 2005, Podgorica, 2004-2005
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11. Sukovic D. – Unemployment and Labor Market Flexibility, Labor Market publication, Employment Office of Montenegro, 2006

Table

Statistical annex

	Montenegro	North	Center	South
Total population	627,078	228,647	261,690	136,742
Less than 15 years	128,561	51,105	54,399	23,056
15 years and over	498,517	177,541	207,291	113,686
Population aged 15-64	422,509	151,435	174,331	96,743
Active population	261,721	88,015	102,913	70,793
Employed	229,108	72,437	91,415	65,256
Unemployed	32,613	15,578	11,498	5,537
Inactive population	236,796	89,526	104,377	42,893
		Male		
Population aged 15 and over	247,355	87,355	102,948	56,999
Active population	153,672	52,983	59,274	41,314
Employed	133,432	43,668	52,253	37,660
Unemployed	21,163	9,315	7,021	3,654
Inactive population	93,704	34,372	43,674	15,685
		Female		
Population aged 15 and over	251,162	90,186	104,342	56,687
Active population	108,049	35,032	43,639	29,479
Employed	95,676	28,768	39,163	27,596
Unemployed	11,450	6,264	4,477	1,883
Inactive population	143,092	55,154	60,703	27,208

Serbia

Kosovka Ognjenović

1. INTRODUCTION

Labour market in Serbia is characterized by low participation and employment rates and by high unemployment rates in general. Particularly, during the 1990s due to the economic hardships[87] and political crises the labour market was developing by unfavourable trends[88]. Rigidity of that time labour regulation and the other legal forms of abandoning of the firing of workers – particularly in the socially-owned enterprises – and braking-up of the privatization process have induced the problem of hidden unemployment. When the reforms started – at the end of 2000 beginning of 2001 – the labour regulation and related legislatives have been sequentially changed. New authorities have been meeting by a huge problem of redundant work in the public and socially-owned enterprises, by restructuring of the corporate sector and by the preparation of the companies for commercial privatization. Searching for new policies to solve the arising problems of unemployment the authorities adopted the National Labour Market Strategy and National Action Plan of Employment in 2005.

In this paper is given an overview of key characteristics of the Serbian labour market with special emphasis on the labour force development and related demographic trends, problems related to employment and unemployment by pointing out to the structural characteristics of employment and unemployment, then an analysis of the Labour Code in terms of in/flexibility of employment forms, system of labour taxation, wage setting, role of collective bargaining and industrial actions, actual labour market policies, restrictions of geographical labour mobility and informal sector employment. Additionally, two sections about the restrictions of the labour market in Serbia, key findings and derived conclusions and recommendations are given at the end of the paper. The analysis in this paper is based on the relevant sources of data such as the Republic Statistical Office's Labour Force Survey, on data from the National Employment Service register, and on the other relevant studies and findings related to this subject.

2. MAIN CHARACTERISTICS OF THE LABOUR MARKET IN SERBIA

2.1. Labour Force

According to the 2002 Census in Serbia live 7,498,001 inhabitants and share of women is 51.4 per cent. Additionally, the share of the working age population (15-64 years) in the total population is 64 per cent. Main characteristics of the demographic trends in Serbia are low

[87] A comparative analysis of the poverty shows that in the mid-1990 about 30 per cent of the population in Serbia live in the income poverty and further that share rose at 1/3 in 2000 (Bogićević *et al*. (2003)). Now in Serbia live about 10 per cent of the poor.

[88] About the history of labour market development and of relevant labour market policies, before the institutional, economic, and social reforms of the Serbian society started in 2001 as well as in the following period of the reforms, has been discussed by Arandarenko (2004), Mijatović (2005), Arandarenko and Paunović (2005), ETF (2005), World Bank (2006), Arandarenko (2007), Arandarenko and Golicin (2007), *etc*.

fertility rate, rapid ageing of the population and rising trend in the life expectancy. The median age of the total population is 40.2 years (and for women 41.5) while the population ageing index is 99.1 per cent. The total fertility rate (or the total number of live births per women) is 1.5. The life expectancy for men is lower in comparison with women. The last available Census data show that the life expectancy for men and women are 69.7 and 75.1 years, respectively.

More than a half of the labour force in Serbia, according to the 2006 Labour Force Survey (LFS)[89], is within the 35-54 age cohorts. The share of those who belong to the 25-34 age interval is 23 per cent, while the rest of 22 per cent of the labour force is uniformly distributed between the youngest and the oldest generations. As Table 2.1 shows the labour force in Serbia has decreasing during the last three years and in 2006 stood at 3,208,671 of active participants on the labour market.

Table 2.1

Labour Force by Age Structure and Gender

		15-19	20-24	25-34	35-54	55-64	Total
Total							
	2004	82035	280581	840153	1824612	372597	3399978
	2005	91329	255674	790718	1784134	371058	3292913
	2006	92321	261662	743673	1751110	359905	3208671
Male							
	2004	47344	149313	464305	991308	245006	1897276
	2005	55206	146273	443697	971126	253361	1869663
	2006	60383	158930	415607	948123	243755	1826798
Female							
	2004	34691	131268	375848	833300	127591	1502698
	2005	36123	109401	347021	813005	117697	1423247
	2006	31938	102732	328066	802987	116150	1381873

Source: RSO, LFS 2004-6.

According to the educational structure the majority of the labour force in Serbia accomplished secondary schools (see Table 2.2). In 2006, share of individuals who finished secondary schools was 62 per cent of the total labour force. Additionally, 22 per cent of the labour force have no formal education or accomplished the primary schools, while only 16 per cent of the labour force completed higher school, university or more. The educational attainment of the labour force in Serbia will stay unchanged in the following few years. The reform of education is developing very slowly and educational system will probable continue yields occupations that have low perspectives on the labour market.

[89] Due to methodological adjustment of the LFS with the ILO and Eurostat definitions since 2004, and the changes of the sampling framework based on the two Censuses, we decided to use the three last LFS data sets.

Table 2.2

Labour Force by Educational Attainment and Gender

		Less than primary	Primary	Secondary	College, University or more	Total
Total						
	2004	202532	585219	2032685	579542	3399978
	2005	169290	564828	2012762	546033	3292913
	2006	141661	566669	1982043	518298	3208671
Male						
	2004	98883	324100	1182235	292058	1897276
	2005	82661	322807	1175690	288505	1869663
	2006	77054	324035	1172813	252896	1826798
Female						
	2004	103649	261119	850448	287482	1502698
	2005	86628	242020	837072	257527	1423247
	2006	64609	242634	809229	265401	1381873

Source: RSO, LFS 2004-6.

2.2. Employment

Labour market in Serbia is characterized by permanent slowly decreasing in participation and employment rates (see Table 2.3). In 2006, participation and employment rates amounted 63.6 and 49.9 per cent, respectively. According to the age structure, a decreasing trend in participation and employment is recognized for all age intervals, except for the youth of 15 to 24 years of age. The participation and employment rates for this category of population stagnated during the last three years. Particularly, the significant decrease of employment and activity is characteristic for those who belong to 55-64 age interval and who are probable excluded from the labour market in process of structural adjustment of the corporate sector, so that for this population category we cannot expect progressive rates of employment or activation in the incoming period.

Taking into the consideration that the unemployment is raising by upward trend in the observed period, the employment decreasing is additionally concerning. With a less than a half of working age population who have a job, Serbia is far away from the EU-15 employment rate that in 2006 was estimated at 66 per cent.

Table 2.3

Participation and Employment Rates by Age Structure, %

	15-24	25-34	35-54	55-64	15-64
2004					
Participation rate	37.0	83.3	81.9	41.1	66.4
Employment rate	19.2	64.2	70.1	37.3	53.4
2005					
Participation rate	35.8	82.3	81.9	39.5	65.2

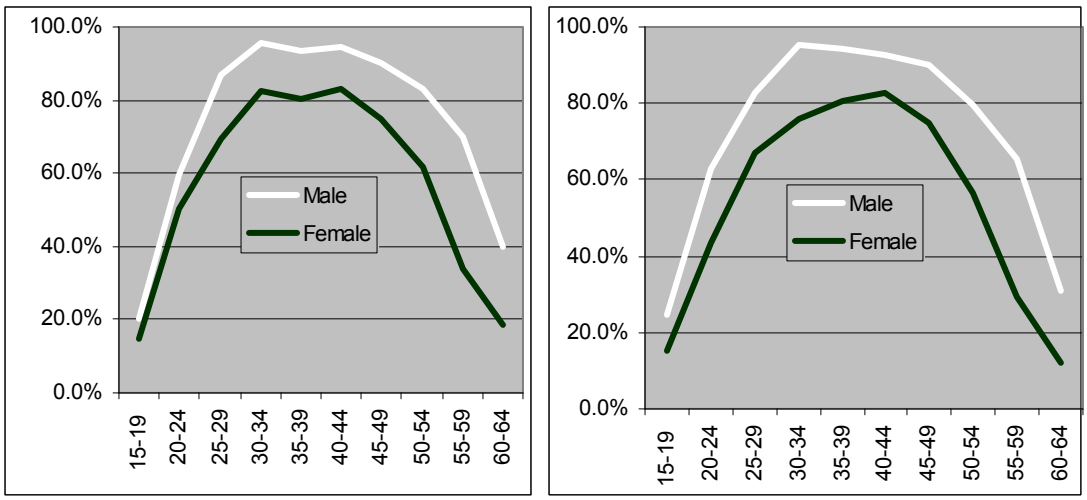
Employment rate	18.7	59.0	68.6	35.4	51.0
2006					
Participation rate	37.4	80.5	80.3	36.1	63.6
Employment rate	19.5	59.4	66.9	32.6	49.9

Source: RSO, LFS 2004-6.

Figure 2.1

Participation Rates by Age Structure and Gender

a) 2004 (left graph) b) 2006 (right graph)



Source: RSO, LFS 2004, 2006.

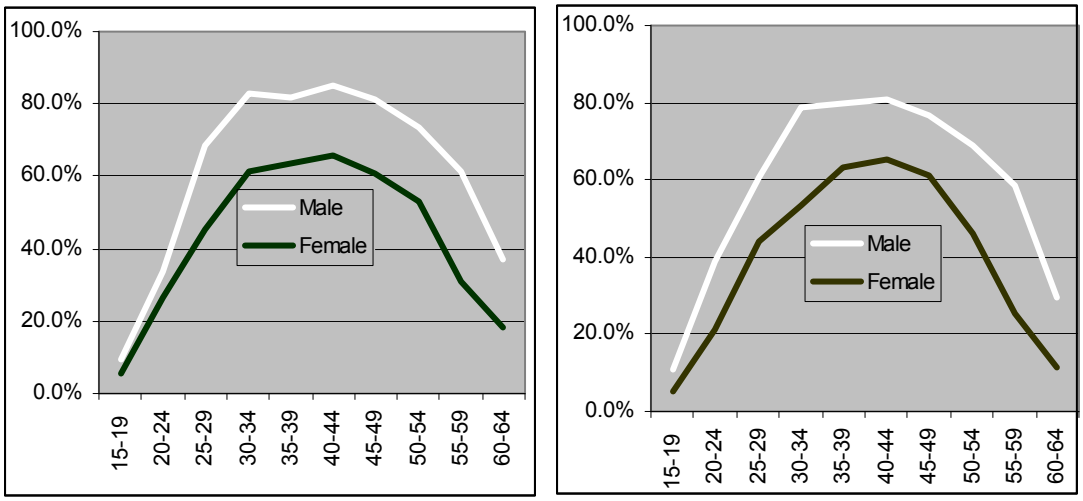
Men have higher participation rates than women have. As Figure 2.1 shows there are no significant changes in male and female participation rates in the two observed years, except for those of 55-64 years of age who more rapidly abandon the labour market due to known reasons (not because of corporate sector restructuring only, but also due to illness or other reasons relating with the regular conditions for retirement). In 2006, participation rates for male and female were as follows: 72.7 and 54.5 per cent, respectively.

Women have sharper distribution of employment rates by age intervals than men have. The highest employment rates of women are in period of 35 to 49 years of age, while a rapid increase in employment of men starts in their thirtieth (see Figure 2.2). In general, women start to work later due to maternity and family planning. In 2006, employment rates of men and women of working-age population were 59.2 and 40.6 per cent, respectively. Employment rates of their counterparts in EU-15 at the same time were 73.5 (men) and 58.6 (women) per cent.

Figure 2.2

Employment Rates by Age Structure and Gender

a) 2004 (left graph) b) 2006 (right graph)



Source: RSO, LFS 2004, 2006.

On the level of macro regions or type of settlements there are no significant differences through the labour market participation rates (see Table 2.4). Women in general have lower participation rates than men have, but their activity is especially low on the local labour markets of Central Serbia and in no urban areas. On the other side, total employment rates are the lowest in the Central Serbia region and in urban areas. Higher employment rates in no urban areas are result of additional engagement of the population in agriculture. This is characteristic of men, particularly if they live in Vojvodina. Women have lower employment opportunities particularly if they live in Central Serbia and in no urban areas.

Table 2.4

Participation and Employment Rates by Region, Type of Settlements and Gender, %

	Belgrade	Central Serbia[1]	Total Vojodina	Urban	Other
			Total		
Participation rate	63.8	63.0	64.3	63.0	64.4
Employment rate	52.7	47.3	52.5	49.1	51.0
			Male		
Participation rate	71.0	72.9	73.7	70.5	75.6
Employment rate	60.4	57.0	62.5	56.3	63.1
			Female		
Participation rate	57.0	53.2	54.8	56.0	52.0
Employment rate	45.3	37.6	42.4	42.5	37.6

[1] Without Belgrade

Source: RSO, LFS 2006.

Table 2.5 shows a structure of employment by age in total and divided by gender. Working age population from 35 to 54 years constitute almost 3/5 of total employment. Regarding to the gender, women of those age are in higher percentage employed than men are and in the last

three years an upward trend of employed of women who belong to this age interval is present. This dynamic is followed by decreasing of share of employed women older than 55 years and younger than 24. During the last three years there is also a positive trend in terms of smoothing increase of share of the youth in the total employment.

Table 2.5

Structure of Employment by Age and Gender, %

		15-19	20-24	25-34	35-54	55-64	Total
Total							
	2004	1.1	5.4	23.5	57.3	12.7	100.0
	2005	1.7	5.3	22.0	58.0	12.9	100.0
	2006	1.5	5.9	21.8	57.9	12.9	100.0
Male							
	2004	1.2	5.1	24.1	55.7	14.0	100.0
	2005	1.9	5.3	22.8	55.4	14.6	100.0
	2006	3.3	8.7	22.8	51.9	13.3	100.0
Female							
	2004	1.0	5.9	22.7	59.5	10.8	100.0
	2005	1.4	5.4	20.9	61.9	10.4	100.0
	2006	1.0	4.8	21.8	62.4	10.0	100.0

Source: RSO, LFS 2004-6.

Educational structure of employed in Serbia is weak. Almost 60 per cent of the employed have accomplished the secondary schools (see Table 2.6). As we already saw, the majority of unemployed have secondary education what means that the Serbian schools, particularly vocational secondary schools, do not provide labour market with appropriate level of knowledge of working age population. In the female employment structure is present a favourable development in terms of slow rising of employee with higher education what is in accordance with raising enrolment rates of young women in the tertiary education. Additionally, concerning situation is related with the raising share of employed who accomplished primary school and stagnant share of people with higher education in the total. It could not be expected that these redistribution of educational attainment have any positive influence to resolving the primary problem of the Serbian labour market, i.e. high unemployment rates.

Table 2.6

Structure of Employed by Educational Attainment and Gender, %

		Less than primary	Primary	Secondary	College, University or more	Total
Total						
	2004	6.5	16.9	58.0	18.6	100.0
	2005	5.4	17.2	59.2	18.1	100.0
	2006	4.9	17.3	59.6	18.2	100.0
Male						
	2004	5.5	17.2	60.9	16.4	100.0

	2005	4.6	17.5	61.2	16.7	100.0
	2006	4.5	17.5	62.7	15.3	100.0
Female						
	2004	7.9	16.6	53.9	21.7	100.0
	2005	6.8	16.7	56.2	20.3	100.0
	2006	5.4	16.9	55.3	22.4	100.0

Source: RSO, LFS 2004-6.

Progressive employment in the private sector was followed by a rapid decrease of employment in the socially-owned enterprises and enterprises of mixed ownership during the last three years (see Table 2.7). In addition, even if the state sector needs downsizing to become more efficient, contrary to this the public sector employed new workers in observed period. Both, men and women participate in the private sector employment by similar percentage. Additionally, women faster leaved the socially-owned and mixed enterprises, but share of women employed in the state and private sectors is approaching. So that we could conclude that women more often exchange their old employment in the socially-owned enterprises with the new one in the public (state) sector looking for a safe job.

Majority of employed in Serbia are wage earners. Share of employees in the total employment has been increasing during the last three years and in 2006 stood at the level of 76.1 per cent (see Table 2.8). Share of self-employed (including farmers) is changeable, and now takes 18 per cent of the total employment. Helpers in the household (including small businesses and agricultural households) stood at the level of around 6 per cent. Men are more frequently entrepreneurs than women are – almost one quarter of men possess own firm. Women are frequently employed with another employer and percentage of those who choose to establish their own firm is slowly decreasing.

Table 2.7

Structure of Employed by Type of Ownership and Gender, %

		State ownership	Private ownership	Social ownership	Other types of ownership	Total
Total						
	2004	33.1	38.7	21.8	6.5	100.0
	2005	33.5	44.1	17.0	5.4	100.0
	2006	36.0	48.2	12.2	3.5	100.0
Male						
	2004	31.6	38.2	23.2	7.0	100.0
	2005	30.8	45.5	17.7	6.0	100.0
	2006	31.1	49.7	15.0	4.1	100.0
Female						
	2004	35.0	39.2	20.0	5.8	100.0
	2005	37.4	42.1	15.9	4.7	100.0
	2006	42.4	46.2	8.7	2.7	100.0

Source: RSO, LFS 2004-6.

Table 2.8

Structure of Employed by Employment Status and Gender, %

	Total			Male			Female		
	2004	2005	2006	2004	2005	2006	2004	2005	2006
Self-employed	19.3	17.8	18.0	25.0	22.7	23.8	11.3	10.5	9.6
Employees	74.7	75.4	76.1	71.9	73.6	72.7	78.7	78.2	80.9
Family workers	6.0	6.8	5.9	3.1	3.7	3.5	10.1	11.3	9.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

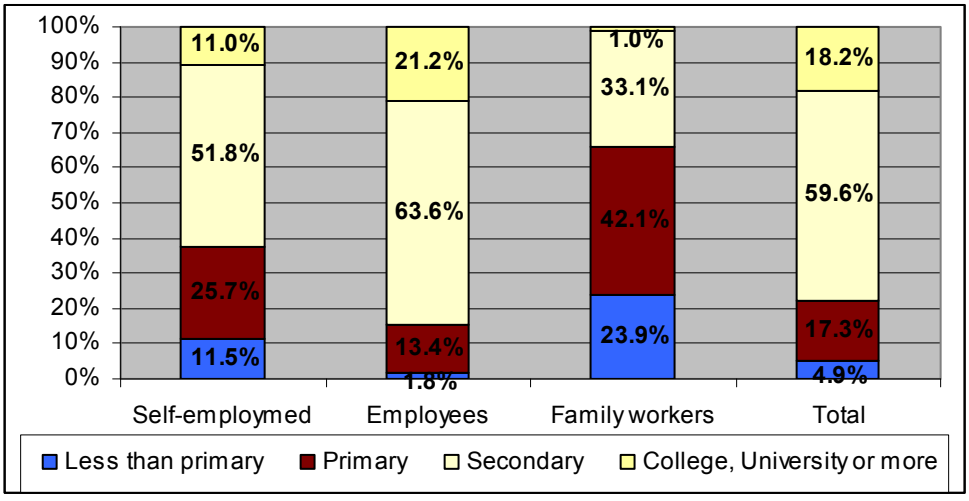
Source: RSO, LFS 2004-6.

Low educational attainment is characteristic for the self-employed in Serbia (see Figure 2.3). Only 11 per cent have accomplished the post-secondary non-tertiary and tertiary education, while more than 37 per cent have primary education or less. On the other side, employees have better educational structure, but majority of employees are middle-skilled workers.

Most frequently occupations of women in Serbia are technicians and associate professionals, service workers and skilled workers in agriculture. In addition to these occupation men very often choose craft or they are engaged as plant and machine operators and assemblers. Legislators, senior officials and managers as well as professionals appear less frequently among the employed, but percentage of women professionals is higher in comparison with men. This development is positive in the long-term and could stop negative tendencies on the labour market reserved for women[90].

Figure 2.3

Structure of Employed by Educational Attainment and Employment Status, 2006



Source: RSO, LFS 2006.

[90] Arandarenko *et al*. (2006) by analysing three Balkan's countries (Bulgaria, Romania and Serbia) have shown that high returns to education are characteristics of both men and women, while for men every additional year of schooling increases wage premium. Women have significant returns to education only for higher educational attainment.

Table 2.9

Structure of Employed by Occupation and Gender, %

	2004			2005			2006		
	Total	Male	Female	Total	Male	Female	Total	Male	Female
Legislators, senior officials and directors – managers	3.8	4.8	2.4	3.9	4.9	2.4	3.4	4.3	2.1
Professionals	9.5	7.9	11.7	9.7	8.3	11.7	10.5	8.4	13.6
Technicians and associate professionals	16.7	12.0	23.2	15.6	10.9	22.5	16.7	11.6	24.1
Clerks	6.4	5.8	7.2	6.2	5.5	7.3	5.5	4.6	6.8
Service workers and shop and market sales workers	15.6	11.8	21.0	14.6	10.6	20.6	14.6	11.4	19.2
Skilled agricultural and fishery workers	16.3	16.0	16.6	15.2	14.9	15.7	13.8	14.2	13.1
Craft and related trades workers	14.3	20.6	5.6	15.0	21.0	6.0	15.3	21.8	6.0
Plant and machine operators and assemblers	8.5	12.9	2.3	8.3	12.6	2.0	8.3	12.5	2.3
Elementary occupations	8.2	6.9	10.0	10.7	10.0	11.7	11.3	10.3	12.8
Armed forces	0.7	1.2	0.0	0.8	1.3	0.0	0.5	0.9	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: RSO, LFS 2004-6.

2.3. Unemployment

Serbia has a long-term and steadily unemployment. Using the LFS data the estimated unemployment rate of working-age population (15-64 years) in Serbia increased from 2004 to 2006 by several percentage points standing at 21.6 per cent in 2006 (see Table 2.10). This percentage is far away from the EU-15 unemployment rate that in 2006 was 7.4 per cent[91]. The tendencies on the Serbian labour market are not surprising because of propulsive restructuring of the socially-owned enterprises which took significant part of the economic reforms in the last several years. Structural adjustment of the corporate sector is not finished yet (accomplishment is planned to the end of 2008), so that could be expected much better results on the labour market in this period.

Especially unfavourable trends on the labour market are characteristic for the youth scholars who finish their education. The unemployment rate of the youth (15-24 years) in 2006 reached 47.8 per cent. The youth-to-total-unemployment ratio in 2006 was 2.2 indicated small improvements regarding to 2004 when it was 2.5.

[91] Labour market indicators are taken from the Eurostat data sets: http://epp.eurostat.ec.europa.eu.

Table 2.10

Unemployment and Inactivity Rates by Age, %

	15-24	25-34	35-54	55-64	15-64
2004					
Unemployment rate	48.1	22.9	14.4	9.2	19.5
Inactivity rate	63.0	16.7	18.1	58.9	33.6
2005					
Unemployment rate	47.7	28.4	16.3	10.3	21.8
Inactivity rate	64.2	17.7	18.1	60.5	34.8
2006					
Unemployment rate	47.8	26.1	16.8	9.5	21.6
Inactivity rate	62.6	19.5	19.7	63.9	36.4

Source: RSO, LFS 2004-6.

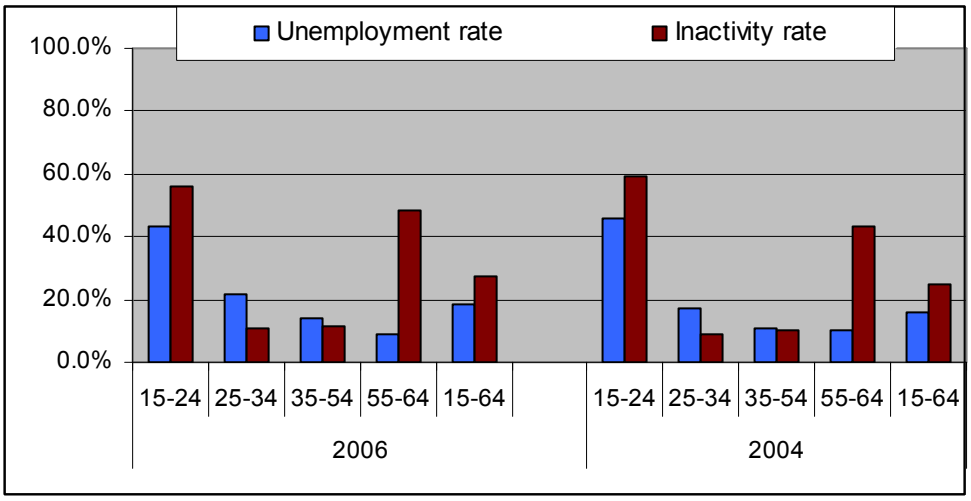
Another problem of the working-age population in Serbia is the high level of inactivity. As Table 2.10 shows the inactivity rates of working-age population has been rising during the three-year period meaning that the low activity on the labour market could partly explain an increasing unemployment development. Inactivity is especially characteristic for the youngest and the oldest cohorts of workers due to schooling of the youth and probably encouragement and some legal preconditions (dismissal workers registered on the employment service who are waiting for pensioning) of the older workers generation[92].

Male unemployment rate in period 2004-2005 increased by several percentage points, i.e. the unemployment rates in 2004 and 2006 were 15.9 and 18.6 per cent, respectively (see Figure 2.4). In the EU-15, male unemployment rate in 2006 amounted 6.5 per cent and it has tendency of slow decreasing. Additionally, more than one quarter of working age male is inactive on the labour market.

[92] The pension system in Serbia was generous particularly for workers employed with the public and the social sector. Since 2002 the Law on Pension and Disability Insurance has been changed several times. One of the main changes was related to sequential movement of the age boundaries for retirement. Now, rights on the old age pension have every men and women who are 65 and 60 years old and who paid pension and disability insurance for at least 15 years.

Figure 2.4

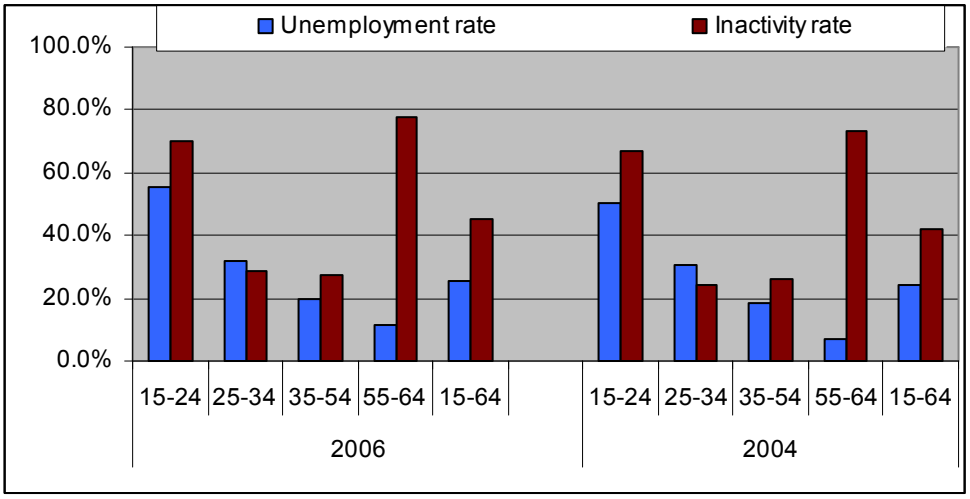
Unemployment and Inactivity Rates - Male



Source: RSO, LFS 2006, 2004.

Figure 2.5

Unemployment and Inactivity Rates - Female



Source: RSO, LFS 2006, 2004.

Unemployment rate of women also rose during the period 2004-2006 (see Figure 2.5), reaching level of 25.5 per cent of the female working age population in 2006. At the same time, the EU-15 female unemployment rate was 8.5 per cent and also slowly decreased in the observed period. Female inactivity on the labour market is very high. In 2006, 45.5 per cent of female was out of the labour force. For both male and female inactivity rates are particularly high for the 55-64 aging group because lot of workers in this interval is preparing for pensioning or they are excluded from the labour market after losing their jobs in enterprises of the social sector.

There are significant regional differences in terms of unemployment and inactivity rates across Serbia, in total as well as by gender (see Table 2.11). The highest unemployment rates are measured in the Central Serbia region while the capital city provides working age population by more jobs and in Vojvodina region higher percentage of people are engaged in agriculture. The

huge problem of the Serbian labour market is high long-term unemployment. This is especially characteristic of the labour force in Central Serbia where more than 83 per cent of unemployed are searching for a job one year and more. Usually, the urban population is more related with the labour market than the rural is, so that the unemployment and inactivity rates are higher for urban citizens.

Table 2.11

Unemployment and Inactivity Rates by Region, Type of Settlements and Gender, %

	Belgrade	Central Serbia[1]	Vojodina	Urban	Other
			Total		
Unemployment rate	17.4	25.0	18.4	22.0	20.9
Long-term unemployment[2]	80.9	83.1	73.8	n.a.	n.a.
Inactivity rate	36.2	37.0	35.7	37.0	35.6
			Male		
Unemployment rate	14.9	21.8	15.2	20.2	16.6
Long-term unemployment[2]	78.4	79.2	68.7	n.a.	n.a.
Inactivity rate	29.0	27.1	26.3	29.5	24.4
			Female		
Unemployment rate	20.4	29.4	22.6	24.2	27.8
Long-term unemployment[2]	83.1	87.1	78.5	n.a.	n.a.
Inactivity rate	43.0	46.8	45.2	44.0	48.0

[1] Without Belgrade - [2] Share of unemployed persons seeking for a job 12 months and more.

Source: RSO, LFS 2006.

Taking into the consideration gender, as Table 2.11 shows male are in much better position than female are. Female who live in Central Serbia have lower chances to find appropriate job in comparison with men, so that the long-term unemployment status is much higher expressed for women. The female inactivity rates are high in both the urban and the other centres, but weak skills and family obstacles of women who do not live in the urban areas could explain their higher inactivity rates.

Table 2.12 shows the unemployment structure by age intervals and by gender. Besides their high unemployment rates, the youth (15-24 years) represent almost one quarter of the unemployed in Serbia, so that the youth are potential resource of the labour force. The majority of unemployed are between 25 and 54 years old and then the share of unemployed rapidly decrease for those who are between 55 and 64 years old. The similar pattern is characteristic of both genders.

Table 2.12

Structure of Unemployment by Age and Gender, %

	15-19	20-24	25-34	35-54	55-64	Total
Total						
2004	6.6	18.9	29.5	39.6	5.4	100.0
2005	6.6	16.4	31.2	40.4	5.3	100.0
2006	8.0	16.6	28.3	42.8	4.4	100.0

Male						
2004	7.8	20.9	27.3	35.2	8.8	100.0
2005	7.8	19.7	28.3	35.5	8.6	100.0
2006	10.0	18.0	26.8	39.6	5.5	100.0
Female						
2004	5.5	17.2	31.4	43.4	2.5	100.0
2005	5.7	13.7	33.8	44.7	2.1	100.0
2006	6.1	15.2	29.7	45.8	3.3	100.0

Source: RSO, LFS 2004-6.

The structure of unemployed by educational attainment is also unfavourable (see Table 2.13). The majority of unemployed have accomplished the secondary education (but most of them graduated from the secondary vocational education schools). Also, more than one-fifth of unemployed have no appropriate qualifications (completed or no completed primary schools). In overall, that conclusion means that a huge number of unemployed needs trainings and retraining to be capable to find a job. Additionally, very concerning figure is that around 9 per cent of the university degree persons have no job. A variety of the possible reasons for that could be explained by the young scholars' higher standards and criteria in terms of supplied job places and working conditions (quality of labour contracts, *etc.*).

Table 2.13

Structure of Unemployed by Educational Attainment and Gender, %

		Less than primary	Primary	Secondary	College, University or more	Total
Total						
	2004	3.6	18.4	67.2	10.8	100.0
	2005	4.1	16.9	68.0	11.0	100.0
	2006	2.8	19.0	69.5	8.7	100.0
Male						
	2004	3.5	16.5	69.7	10.3	100.0
	2005	3.8	16.0	70.8	9.3	100.0
	2006	2.9	18.6	70.9	7.7	100.0
Female						
	2004	3.8	20.0	65.1	11.1	100.0
	2005	4.3	17.7	65.6	12.4	100.0
	2006	2.6	19.4	68.2	9.8	100.0

Source: RSO, LFS 2004-6.

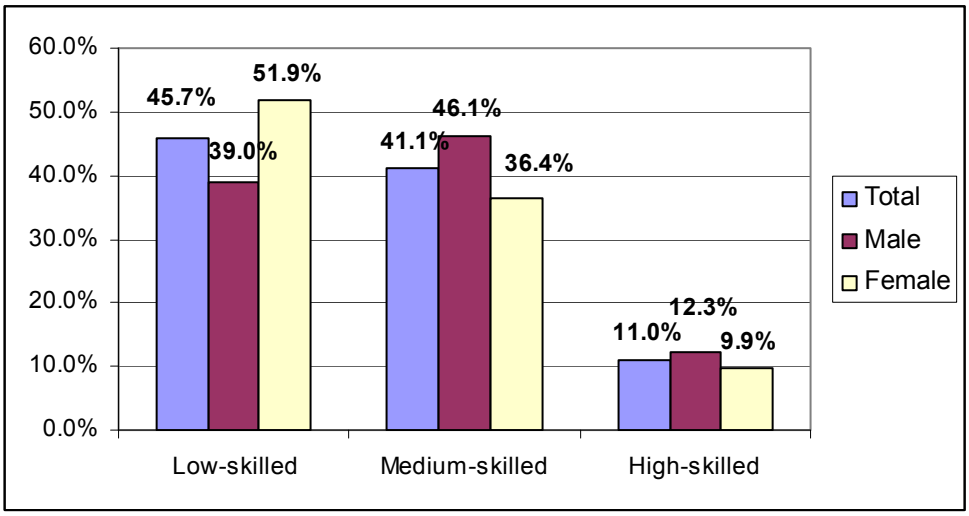
2.4. Skill Structure

Active population in Serbia have unfavourable skill structure. Additionally, skill structure is especially unfavourable among the oldest workers. The data provided by the 2002 Census shows that 45.7 per cent of the active population in Serbia have low educational attainment (primary school or less) with no sufficiently qualified skills. As Figure 2.6 shows, in total women are less skilled in comparison with men, i.e. higher percentage of women is in category of low-skilled population and lower percentage are of medium-skilled active population comparing to men. Somewhat better situation is in group of women who completed post-secondary non-

tertiary and tertiary education meaning that every year an additional number of young women invest in higher education expecting rise of their competitiveness on the labour market.

Figure 2.6

Skill Structure by Gender (population aged 15 years and over)



Notes: Difference from the total represents unknown educational attainment.
Low-skilled - Completed pre-primary and primary education.
Medium-skilled - Completed secondary education.
High-skilled - Completed post-secondary non-tertiary and tertiary education.

Source: RSO, Census 2002.

2.5. Vacancies

There is significant gap between the demand and supply of the labour force in Serbia. According to the National Employment Service data, in 2006 difference between vacancies and number of employed people was in total 75,605. These differences are uniquely distributed among the main economic sectors (see Table 2.14). In total, the number of registered employers' demand for workers increased in 2006 relative to the previous year by 17.4 per cent. At the same time, employment increased by 17.6 per cent in total. The main problem with a fulfilment of the vacancies is a skill structure. Actually, the problems arise with these occupations that need skilled workers.

Table 2.14

Vacancies and Employment by Economic Activities, 2006

	Vacancies	% change 2005-2006	Employment	% change 2005-2006
Agriculture	17,804	3.1	16,286	2.8
Industry	183,928	12.1	166,481	13.6
Construction	49,283	13.5	43,554	17.5
Services	456,125	20.7	405,214	20.0
Total	707,140	17.4	631,535	17.6

Source: National Employment Service, 2006 Business Report.

The number of vacancies registered by the National Employment Service is probably lower from the actual because employers do not have an obligation to publicly announce every vacancy. So that there is certain likelihood that one number of job seekers found their employment through the social contacts or on the other ways.

2.6. Labour Code

Labour relations in Serbia are regulated by the Labour Code. In the case of collective dismissals, for redundant workers are provided severance payments. The lower limits for severance payments are determined by Labour Code so that the employer have to pay amount of the one-third of the average wage to employee for every year of work in the first ten years of employment and one-fourth of the average wage for every additional year of employment. Additionally, the redundant workers who lost their job due to technological, economic or organizational changes during the restructuring of the companies have extended rights on unemployment benefits and pension and disability insurance scheme according to the Law on Employment and Unemployment Insurance.

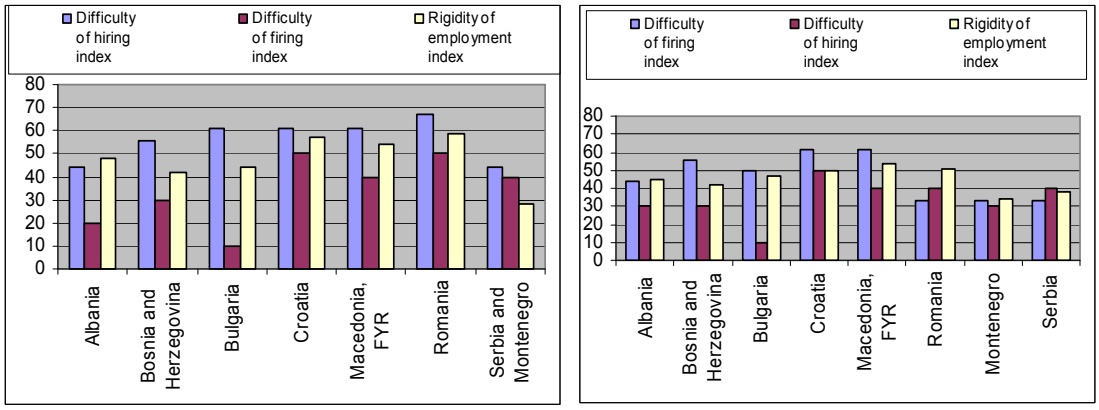
On the other side, hiring procedures of new workers require permanent payment of all social protection allowances and payroll taxes. In certain cases (employment of the youth up to 30 years of age, persons with disabilities, and the oldest workers who have 45 or 50 years of age) the employers are exempt of payment of compulsory social insurance contributions for certain period of time. These issues will be discussed in the next sections.

Serbia has one of the less rigid employment regulations in the SEE countries. Figure 2.7 shows that Serbia and Montenegro are ranged at the last position in terms of difficulties of firing procedures and rigidity of employment. In 2006 the difficulty of firing and rigidity of employment indices were 40 and 38, respectively. Besides that, the rigidity of employment index rose by several indices points for both countries indicated certain increase of inflexibility in practice. Countries with the most rigid labour regulations are Croatia and Macedonia. In terms of difficulty of hiring Serbia, Croatia, Macedonia and Romania have the most rigid regulation in the region of the SEE countries.

Figure 2.7

Indexes of Hiring, Firing and Rigidity of Employment

a) 2005 (left graph) b) 2006 (right graph)



Notes: indices are ranged from 0 (flexible regulation) to 100 (high rigidity of regulation).

Source: World Bank (2005, 2006b), Doing Business 2006 & 2007.

According to the 2005 EBRD Transition Report the perception about the labour regulation in Serbia and Montenegro was deteriorated in 2005 regarding to 2002. If statistically insignificant the percentage change of 0.12 points in the enterprises attitudes indicates more inflexibility in terms of labour regulation in general.

Duration of temporary employment is determined by the Labour Code. According to the current legislation maximum duration of temporary employment is limited at 12 months[93]. The Foreign Investors Council in Serbia complains on the formal procedures related to the duration of the temporary employment[94]. Taking into consideration the high rates of unemployment and significant enrolment rates into the illegal work the Council considers that the time constraints could be abolished.

The majority of workers in Serbia have permanent employment (see Table 2.15). The percentage of permanently employed has been increasing during the last three years and in 2006 reached almost 89 per cent of the total employment. One of the possible explanations for such dynamic could be related with the shortening of the temporary employment duration from 36 to 12 months that was introduced by the new Labour Code in 2005. At the same time, the flexible forms of employment have been decreasing. Table 2.15 shows that the share of temporary employed workers decreased from 8.5 per cent in 2004 to 6.6 per cent in 2006. Seasonal and causal employment with the share of 4.6 per cent in the total is insignificant form of workers engagement. Structure of permanency of employment by gender shows that women look at a safe job, but share of temporary employed women is higher than men is. One of the key reasons for more frequently engagement of women in temporary employment is related to the family planning, maternity leave, *etc*. On the other side, women usually have smaller propensity

[93] In period 2001-2005, before the new 2005 Labour Code was passed, the duration of permanent employment extended at 36 months.

[94] For more details see the Foreign Investors Council's *White Book*, 2007.

to risk because their share in seasonal and casual employment is much lower comparing to men or because of nature of such a job (hard physic jobs, construction, *etc*.).

Table 2.15

Structure of Employment by Permanency of the Employment and Gender, %

		Permanent employment	Temporary employment	Seasonal employment	Casual employment	Total
Total						
	2004	85.8	8.5	3.0	2.7	100.0
	2005	86.9	7.7	3.3	2.0	100.0
	2006	88.8	6.6	2.9	1.7	100.0
Male						
	2004	85.2	7.9	3.6	3.3	100.0
	2005	85.9	7.4	4.3	2.4	100.0
	2006	88.0	6.3	3.8	1.9	100.0
Female						
	2004	86.5	9.4	2.1	2.0	100.0
	2005	88.4	8.2	1.9	1.5	100.0
	2006	89.8	7.0	1.8	1.4	100.0

Source: RSO, LFS 2004-6.

2.7. Wage Setting and the Role of Trade Unions

The role of social partners in the collective bargaining process in Serbia could be discussed through the activities of the legally established body named at the Socio-Economic Council. The Socio-Economic Council, as a tripartite body gathers representatives from the Government, the most significant trade unions[95], and the Serbian Union of employers. This body operates in accordance with the Law on Socio-Economic Council. But the level of significance of the role of social partners, assessed on the ground of their activities and mandates given them through the legal framework are questionable. According to the some estimates the Council does not have unique influence on a social dialog, but the predominant role of the Government is recognized with the passive position of the employers' representatives and with the conditioning position of the trade unions. Additionally, Mijatović (2005) estimates, that the social dialog in Serbia has two main characteristics. Firstly, the social dialog possesses the attributes of the lobbing of the interest groups. And secondly, the informative and counselling role of the social dialog is desirable, but it cannot have as a purpose that the participants bringing the obligatory decisions.

The Socio-Economic Council is actively involved in the process of the wage bargaining on the national level. Minimum wage in Serbia is determined by the Labour Code. The minimum wage is establishing on the semi-annual level, and the minimum wage coverage is universal. According to the Labour Code, the minimum wage is expanded by the materialized labour, by the labour in time of state holidays, by the labour during the nights and overworked labour, and as for

[95] Three most significant trade unions in Serbia today are: Ujedinjeni granski sindikat "Nezavisnost" [United Branch Trade Union 'Independence'], "Asocijacija slobodnih i nezavisnih sindikata" [Association of the Free and Independent Trade Unions] and Savez samostalnih sindikata Srbije [Independent Trade Union Confederation of Serbia].

January 1 2006, the minimum wage is expanded by food allowances and compensations for the holidays. The minimum wage is determined at the level of about 40 per cent of the average net wage in Serbia. During the period January-June 2007, monthly minimum net wage was 9,570 RSD or 55 RSD per hour of work (in the period January-June 2006 minimum net wage per hour was 46 RSD, and from July to December 2006 49 RSD).

Wage bargaining on the level of the companies between employers and workers is also questionable according to some analytical estimates. In accordance with the specific situation in the corporate sector of Serbia, Mijatović (2005) concludes that the level of collective bargaining depends on sector ownerships so that we have three common situations. Firstly, in the sector of socially-owned and mixed (in process of privatization) enterprises the wage-setting depends on available funds. Secondly, in the real private sector mainly composed of SMEs and private entrepreneurs, the wage-setting is determined by the unilateral owners' decision. And in the privatized companies, there are some cases that the wage-setting is usually followed by strikes and that finally represents a deal between trade union and management.

Besides of the all mentioned above, the wage-setting in Serbia, especially in the public (state) and socially-owned enterprises is limited by the budget constraints[96] and targeted inflation rates, so that it is primarily addressed to the economic policy makers, and the trade unions' role in the wage-setting in the both public and public sector is rather small.

Bargaining power of the trade unions in Serbia has declined during the transition period, not only at the national level but also at the level of an enterprise, while the role of trade unions in the private sector is rather low. There is no precise data about union density in the public and the private companies in Serbia, but according to the estimates for the SEE countries provided by Arandarenko (2004), the percentage of wage earners with a unionship is about 40. The union coverage index for the SEE is 2.66. This indictor shows that the coverage of workers by collective bargaining agreements in the SEE countries is near to the EU average (2.85) and that around 70 per cent of wage earners are covered by the collective bargaining.

2.8. Taxes on Labour

Tax rate on the labour use in Serbia consists of 12 per cent of a flat wage income tax on the gross wage in addition to the payroll tax rate of 35.8 per cent of compulsory social insurance contributions[97]. The wage income tax is reduced from 14 to 12 per cent since January of 2007, but the obligatory social insurance contributions stayed unchanged from their last alteration in mid-2004 when they have been increased[98]. According to the 2004 Law on Compulsory Social

[96] The wage growth in the public (state) sector in Serbia was under the permanent control of the International Monetary Fund and its monitoring of the structural adjustment of economy. Usually, through the annually planned growth rates of the wage bill, recoded in the state budget, there was no much space for the negotiations with the social partners (trade unions and employers).

[97] The payroll taxes in Serbia are even less in comparison with the neighbouring countries except in Macedonia which has one of the lowest rates of social contributions in the region. In general, the average rate of payroll taxes in the SEE countries is extremely high – 46.5 per cent of gross wages (World Bank (2006a), pp.64).

[98] Up to mid-2004 the payroll taxes amounted 33.6 per cent.

Insurance Contributions, the system of payroll taxes in Serbia consists of three sorts of obligatory social insurance contributions: pension and disability insurance contribution (11 per cent), health insurance contribution (6.15 per cent), and unemployment insurance contribution (0.75 per cent). The social insurance contributions are accounted by the equal rates for employer and employee, but they are settled and paid only by employer, so that in total the compulsory contributions amounted 35.8 per cent.

Besides the reduction of wage income tax since January of 2007, the lowest monthly base for social contributions has been also reduced from 40 to 35 per cent of the average gross wage in Serbia. In addition, the untaxed initial amount of 5,000 RSD per month is introduced. The monthly exemption from the wage income tax has been introduced with the intention to violate the Serbian regressive taxation system[99]. By introduction of these changes in the Serbian labour tax system since beginning of 2007, the tax wedge is also reduced. Measured on the level of the average wage the labour tax wedge is reduced from 42.2 to 38.5 per cent. The current tax wedge in Serbia is lower in comparison with the CEE countries – for majority of the CEE countries the labour tax wedge is above 40 per cent.

2.9. Industrial Action

Besides of very high frequency of strikes there is no comprehensive data about the industrial actions in Serbia. Strikes are mainly organized by representatives of trade unions and they are narrowly related to the privatization of socially-owned enterprises. Industrial actions of workers employed with the private sector are infrequent because of workers who are not organized through the trade unions at the level of an enterprise, so that workers do not have any influence on wage-setting[100]. Another reason is that the majority of employed in the private sector still has an illegal job.

Novaković (2005) has collected information about strikes in Serbia during the period 2000 to 2005 and results shown that the significant part of them were strikes at the level of enterprises and institutions, in the both social and public sectors. Workers employed with the textile, construction and metal industry have organized the strikes most frequently before the privatization of their enterprises. After them, the public enterprises (workers employed with the petroleum industry, energy supply industry, telecommunication sector and transport (railway and air transport)) very often openly express their negative attitude in terms of Government measures. Farmers, medical officers, teachers and providers of other public services very often publicly introduced their requirements ahead of the Government. In general, strikers' claims were different depending on sector, but mainly they demanded payment of delayed earnings and other in cash allowances, insurance of jobs, brake of firm management, to stop of collective dismissals, introduction of social programmes in big socially-owned enterprises, revision of finished privatizations, and amendments to the Privatization Law, *etc*.

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[99] An analysis of the history of the Serbian regressive taxation system is given by Arandarenko (2007).

[100] It is weird and unexpected result that employed in the public and socially-owned enterprises earn higher wages than their counterparts in private sector. The estimated wage gap between public and social sector and private sector is ranged from 11 to 14 per cent (World Bank (2006a), pp. 31).

2.10. Labour Market Policies

Implementation of labour market policies in Serbia is within the competence of relevant Ministries and National Employment Service. Serbia has developed a generous system of workers social safety net consisted of passive labour market measures in addition to the active labour market measures. Even besides the National Employment Service has introduced the active measures through the 2003 Law on Employment and Unemployment Insurance as obligatory part of the labour market policies, these measures are implemented for a longer period of time.

Table 2.16

ALMP Expenditures (RSD million), 2006

ALMP	Plan	Realized	% change
Active job search	2.180	2.959	35.8
Job fairs	3.000	3.057	1.9
Training and retraining	400.000	533.759	33.4
Entrepreneurship development and employment programmes	768.820	970.014	26.2
Public works	100.000	4.387	-95.6
Project participation	26.000	26.132	0.5
Total	1,300.0	1,540.3	18.5

Source: National Employment Service, 2006 Business Report.

In 2006, the National Employment Service spent on active labour market policies 1,540 million of RSD (see Table 2.16) or only 7.3 per cent of the annual budget of the National Employment Service[101]. The significant part of realized expenditures is spent on subsidies for entrepreneurship development and regional employment programmes (63 per cent). Share of expenditures on training and retraining programmes in the total amounts 35 per cent, while on measures of active job searching and job fairs is spent only 0.4 per cent of the total expenditures. In 2006, 128,634 beneficiaries have participated in active labour market measures. This number includes 3,547 individuals who received the micro-credits for start-up provided by the Serbian Development Fund. Additionally, 550,436 individuals used services like group informing (267,337), information of carrier development (20,744), assessment of employability and individual employment plans (243,339), counselling (8,459), selection and classification (10,557), all provided by the National Employment Services staff.

On the passive labour market measures in 2006 were spent 17,665 million of RSD (see Table 2.17, upper panel) or 83.9 per cent of the 2006 budget of the National Employment Service. Additionally, 75.3 per cent of the total public expenditures were spent on full unemployment benefits from which the social transfers to the pension and health insurance funds amounted 28.2 per cent.

[101] The National Employment Service has no developed the system of net impact evaluation of active labour market measures so that their effects on employment or cost-effectiveness of active policies are not measurable.

The amounts for the passive and active labour market policies implementation have been significantly increased during 2005 and 2006 as it is shown in Table 2.17, but still Serbia does not spend high amounts on active labour market policies. During the four-year period, the share of public expenditures on active labour market measures in GDP was only 0.1 per cent, while the share of public expenditures on passive measures does not exceed 1 per cent of GDP.

In comparison with the some of CEE countries, expenditures on active labour market measures in Serbia are very low. According to the last OECD published data, the share of public expenditures on active labour market measures in GDP was 0.25, 0.29, and 0.43 per cent for Czech Republic, Hungary, and Poland, respectively[102]. While on the other hand, public expenditures on passive measures as percentage of GDP for Czech Republic (0.24 per cent), Hungary (0.39 per cent) and Poland (0.86 per cent) are somewhat lower in comparison to Serbia.

Table 2.17

Expenditures for Active and Passive Labour Market Policies

	Expenditures (million RSD)			
	2003[1]	2004[1]	2005[1]	2006[2]
Active measures	880.7	410.3	1,545.0	1,540.3
Passive measures	7,890.9	12,964.0	14,392.9	17,664.8
Total	8,771.6	13,374.3	15,937.9	19,205.1
	Percentage of GDP			
	2003[1]	2004[1]	2005[1]	2006[2]
Active measures	0.1	0.0	0.1	0.1
Passive measures	0.7	1.0	0.9	0.8
Total	0.8	1.0	1.0	0.9

Source: [1] World Bank (2006a), pp. 81.
[2] National Employment Service, 2006 Business Report.

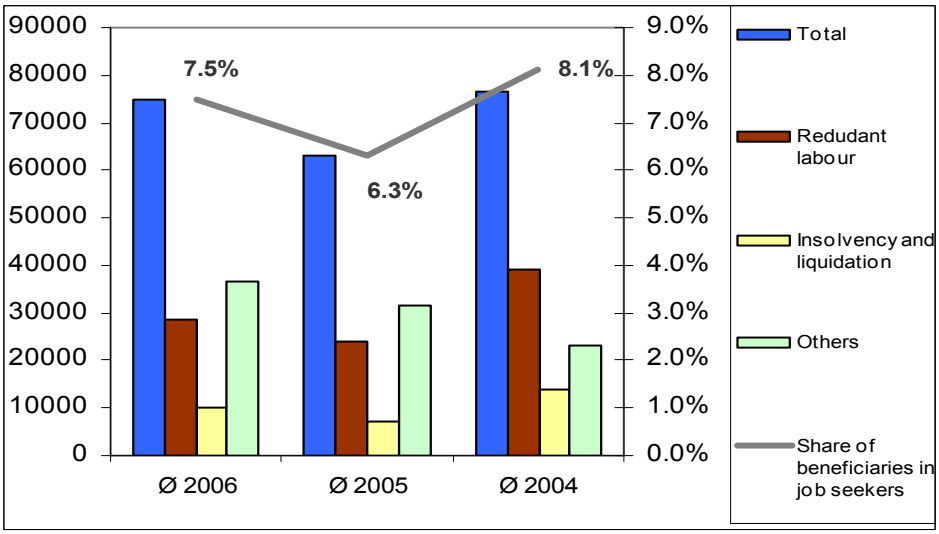
Number of unemployment insurance beneficiaries in 2006 was about 75,000 at monthly level or only 7.5 per cent of actively job seekers[103]. The right to unemployment benefits is related to the number of years of unemployment insurance payment, but besides of that by the system of unemployment benefits is covered a small number of unemployed (see Figure 2.8). In the structure of unemployment insurance beneficiaries about a half of total beneficiaries are unemployed who lost their job due to different reasons; nearly 40 per cent are redundant workers who lost their job due to enterprises restructuring and about 10 per cent of beneficiaries consist of inflow of workers from the bankrupted firms.

[102] OECD (2007), pp. 271-276.

[103] In 2006, average number of job seekers registered by the National Employment Service was 1,005,595. During the last three years this number permanently raised from 945,027 in 2004 and 991,807 in 2005.

Figure 2.8

Unemployment Insurance Beneficiaries (left scale) and Share of Beneficiaries in Job Seekers (right scale)



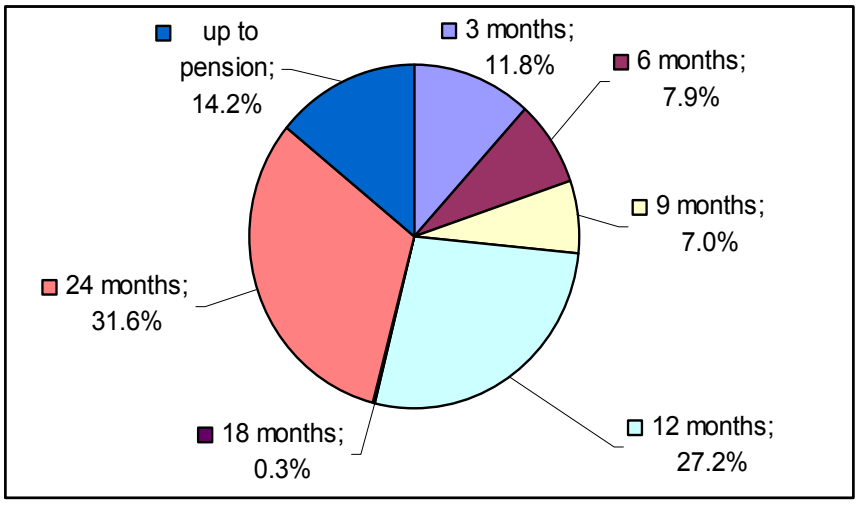
Source: National Employment Service, 2006 Business Report.

Maximum unemployment benefit duration is restricted at 24 months so that we could conclude that the time period of receiving of the unemployment benefit is too long. Duration of unemployment benefit depends on period of unemployment insurance contributions payment. According to the Law on Employment and Unemployment Insurance the dynamic of unemployment benefit duration is as follows: 3 months for unemployment insurance contributions payment of 1-5 years; 6 months for period of unemployment insurance contributions payment of 5-15 years; 9 months for period of payment of 15-20 years; 12 months for period of payment of at least 20 years; 24 months for period of continues payment of at least 20 years (and 61 or 56 years of age for men and women, respectively), 38 (men) or 33 (women) years of continuous unemployment insurance payment (and at least 51 years of age for both genders); 24 months for beneficiaries who are older than 55 years and who paid unemployment insurance at least 25 years.

Figure 2.9 shows that significant part of beneficiaries of unemployment benefits are the oldest workers. More than 2/5 of beneficiaries are workers who paid for unemployment insurance contributions more than 20 years continuously and who will receive the unemployment benefits up to pension. If we exclude unemployed/beneficiaries who are very near to the pension we could additionally conclude that this kind of financial assistance for job searching is intended to a very small number of unemployed.

Figure 2.9

Structure of Unemployment Insurance Beneficiaries by Benefit Duration, Ø2006



Source: National Employment Service.

The benefit replacement rate is settled at a level of 60 per cent of previously earned wage (for the first three months of unemployment insurance payment) and for the rest of certain period the unemployment benefit is reduced at 50 per cent of the average net wage. Additionally, for those who are participants in training and retraining programmes organized by the National Employment Service the unemployment benefit is extended by 10 per cent during the enrolment period. During the whole period of receiving of the unemployment benefit, the National Employment Service additionally covered pension and health insurance to the beneficiaries.

In 2006, delay period of unemployment benefit payment was reduced at 4 months (during the previous years that period was even longer – 6 months). Even besides of shortening of delaying period of unemployment benefit payment it is very hard to conclude that the unemployment benefit is an efficient instrument of the labour market policies because of its purpose to serve as a financial support to unemployed during their period of searching for a job.

2.11. Labour Mobility

Regional mobility of labour force in Serbia is still at low level. Arandarenko *et al*. (2006) discussed about the factors which cause the limited movement of the working-age population in Serbia. According to their assessments the relatively high costs of living of standard outside of the place of permanent residence (for instance housing, *etc*.), and also the cultural factors are main causes of restricted mobility of working-age population. Consequently, the relatively slow mobility of labour force influences the spread of regional differences among districts and has an additional negative effect on deepening of regional differences[104]. So that the underdeveloped regions with high unemployment rates have even less growth rates and additionally those regions are characterized by problems of depopulation and low participation rates of working-age population. Similar conclusions are derived for the SEE countries in Rutkowski and Scarpetta (2005) as well.

[104] Registered unemployment rates among the certain districts yield the ratio 1:3 (Arandarenko *et al*. (2006)).

Additionally, according to these authors very important factor of low geographical mobility of working-age population is weak supply of the vacancies across the regions.

To get more precise picture of mobility between different labour market states it is necessary to follow dynamic of inactivity, employment, and unemployment through the panel of individuals. ETF (2005) study based on the 2002 and 2003 LSMS data gave an estimate of mobility between different labour market states. General conclusion is that the movements between employment (formal and informal), unemployment and inactivity of working-age population are significant. By using the LSMS data set authors estimated that about 38 per cent of population of 15 to 64 years of age flows between different labour market states in two observed years. It is obviously that the high level of labour mobility is not result of good labour market conditions but it is result of significant share of informal employment in the total.

Table 2.18

Average Waiting Time for a Job by Gender, %

	Less than 1 year	1-2 years	2-3 years	3 years and more	Total
2004					
Total	22.0	17.9	13.6	46.5	100.0
Male	23.7	18.4	13.6	44.3	100.0
Female	20.6	17.5	13.5	48.3	100.0
2005					
Total	20.6	14.5	13.7	51.2	100.0
Male	21.3	13.6	14.7	50.3	100.0
Female	20.0	15.2	12.8	52.0	100.0
2006					
Total	19.3	13.7	11.3	55.8	100.0
Male	23.1	14.6	10.1	52.2	100.0
Female	15.6	12.8	12.4	59.2	100.0

Source: RSO, LFS 2004-6.

By progress of privatization of big socially-owned enterprises the average waiting time for a job has increased. This trend is in accordance with the permanent decrease in total employment. Namely, the number of short-term unemployed has decreased during the three-year period, while at the same time the number of discouraged workers who lost their jobs has rapidly increased (see Table 2.18). This means that someone could expect that workers who are registered as unemployed in a shorter period of time will have higher chances to find another job than the workers who are less active. Women are affected more by the long-term unemployment than men are. The female long-term unemployment rate is extremely high for those who are seeking for a job two years and more – near 72 per cent of women in Serbia. This situation is not unexpected because it was estimated that around 80 per cent of socially-owned enterprises before their entrance in the privatization process had a problem with the hidden unemployment[105].

[105] See for instance: World Bank (2004), pp. 101.

2.12. Informal Sector Employment

Informal sector in Serbia takes significant part of the total employment. The informal employment[106] amounts 43 per cent for all employees or 27 per cent for wage earners, without farmers[107]. The number of employed in the informal sector has increased during the last few years. For instance, in 2004 two rates of informal sector employment for both all workers and wage earners were 41.5 and 24 per cent, respectively. Backward looking, during the period 2002-2003, the informal employment for all workers was even less i.e. between 31 and 35 per cent[108] what means that the informal sector employment has had an upward trend during the five-year period of economic reforms and that Serbia has one of the highest rates of informal employment in the region. Through the informal economy are mainly engaged the youth up to 24 years of age who have a low educational attainment (primary school or less) and women also with the weak education.

Rates of entry to or exit from the informal employment are very low. According to the LFS data the probability of wage earners transition from informal to formal employment was about 10.5 per cent[109]. The same probability of transition was estimated for opposite movement i.e. for entry from formal to informal sector employment. Among the wage earners, those who have a lower chance to move from informal to formal employment are women, workers of low level of education and the youngest and the oldest workers. At the same time, workers who exit from the formal and enter to the informal sector are mainly low-skilled workers and workers of old generations, i.e. workers who lost their jobs during the restructuring of the economy. We also could conclude that the probability of exit from informal employment becomes somewhat higher with the progress of transition but still unfavourable for low-skilled young and old worker cohorts. By using the panel 2002 and 2003 LSMS data set, ETF (2005, pp.14) estimated that the percentage of wage earners who moved from informal to formal sector was only about 5 per cent[110].

As we already saw in the previous sections, the effects of unemployment benefits to reduction of informal employment are negative. This is because the system of unemployment benefit besides the allowances in cash also provides unemployed by the pension and health insurance during the whole period of the benefit receiving. Such a system could additionally prolong a period of informal sector employment. In addition to the unemployment benefit, as an element of the social protection net of workers, the highly determined level of minimum wage could also cause negative effects in terms of informal employment and reduced rates of transition from informal to formal sector employment.

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[106] Employed in the informal economy, according to the World Bank definition, are self-employed with no tertiary education, helpers in the household, wage earners, and the owners of the micro firms (up to ten employed). On the other hand, the formally employed are all workers who have a job in the public (state) and socially-owned enterprises (World Bank 2006a, pp. 33).

[107] World Bank (2006a), pp. 33.

[108] The World Bank estimate is based on the 2002 and 2003 LSMS data (World Bank, 2004, pp. 102).

[109] World Bank (2006a), pp. 36-37.

[110] For the similar analyses see also Arandarenko and Paunović (2005).

3. RESTRICTIONS OF THE LABOUR MARKET IN SERBIA

Labour market in Serbia is characterized by numerous restrictions. These restrictions induce slow movement in employment and steadily rise of unemployment. Factors outside of the labour market such as macroeconomic policy and institutional framework for new business start-up are also important and it is good to know could they yield stimulate effects on a new job creation. Regarding to the tax incentives, during the past several years Serbia made significant changes by reduction of the income corporate tax from 20 to 10 per cent, by introduction of the value added tax of 18 per cent (with an exemption of the 8 per cent tax rate for some goods), but obviously they are not enough to stimulate companies to hire additional workers. The main idea of these incentives was to broadening of the tax base, to suppress illegal activities and to establish the prerequisites for further reduction of tax rates.

Serbia attracted significant amount of foreign capital during the last several years[111], but foreign direct investments are not distributed equally neither regionally nor across economic sectors. So that the regions with higher economic growth further growing continuously, and underdeveloped regions stagnate because of low geographical mobility of the labour factor. Foreign capital meets with the obstacles caused by unsolved property issues, instable political conditions, and even by huge possibilities of choice among different countries in the Western Balkan region that offer similar business opportunities to the foreign capital. The main prerequisites to foreign capital entrance are low costs of productions factors (first of all labour), well absorption power of the local market and accessibility of the other (regional) markets.

All in all, that what we have in practice suggest that the business climate in Serbia is not enough encouraging for new businesses opening.

From the above passages it could be concluded that all of the mentioned factors result in significant widening of gap between demand and supply side of the labour force further inducing permanent reduction in employment and participation rates and increase in unemployment and inactivity rates.

One of the identified restrictions that suppress faster hiring of the new workers is complicated procedure of firing that appears in practice even if it is not recognized as an obstacle. Employers' obligation to pay certain amount of severance payment for redundant worker is an obstacle because employer has to pay certain amount of previously earned average wages to every redundant worker even if there is no need for such working place due to organizational, economic or other reasons. This situation is a fruitful filed for informal engagement of workers and "good reason" for employers. But, from this situation only employers made substantial gains, while state lose a part of tax revenues and employee's duration of pension insurance is diminished by the tenure during the informal engagement.

[111] According to the National Bank of Serbia, during the period 2000-2006 total net inflow of the foreign investment amounted near 8 billion USD.

Low levels of collective bargaining and workers unionization and weak role of trade unions on the both national and company levels are also obstacles for creating more flexible labour market. This situation will last for a while, but more flexible labour market truly needs significant role of the social partners not on paper only but in practice also, so that it could be expected that much higher attention will be given to collective bargaining agreements and to individual labour contracts.

Flexible employment forms are attractive for employers but they are restricted by the Labour Code. Although the trial work was extended from 3 to at least 6 months by changes of the Labour Code made in 2005, the temporary employment is truncated from 36 to 12 months. From the survey given in the previous sections, it is obvious that the restriction given to the duration of temporary forms of employment induce an increase in the total number of workers who have fixed contracts, but it has little effect on increase in the total employment, what is opposite to the main purpose of introduction of such forms of employment.

Skills of the labour force in Serbia are rather weak what mean that both employed and unemployed need an additional education. Policy of low level of participation of the redundant workers[112] and other unemployed in the active labour market measures and programmes will not solve the problem of low qualifications in general. Besides of the low level of individual incentive, the budget constraints are an additional reason for small-scale participation of unemployed in active labour market measures. Except of the National Employment Service annually budget, an additional source of financing of the pilot programmes is provided by the donors and EU funds, but besides that the implementation of active labour market policies should be clearly planed and the targeting of unemployed should be carefully undertaken. An additional problem with the active labour market polices implementation arise because of absence of system of permanent evaluation of their effectiveness, particularly of those measures that have high implementation costs per beneficiaries.

By removal of above mentioned restrictions, the effects on employment on the short and long-term will be positive. Capacity building of the labour force is needed through the careful planning of the curriculum of educational profiles that will ensure high level of employability. Additionally, because the process of commercial privatization is very near to this end it is necessary to made detail revision of the provisions of current labour regulation in terms of introduction of more flexible framework of the labour relations regulation. The clear determination of the role of the National Employment Service and unification of its activities is also important for removal of restrictions that might be more easily adjusted.

[112] About 5 per cent of the workers who received the severance payment during the restructuring of their enterprises are included into the active measures organized by the National Employment Service (World Bank (2006a), pp. 75).

4. CONCLUSIONS AND POLICY RECOMMENDATIONS

From the analysis given in this paper following conclusions and recommendations could be suggested.

Firstly, it is necessary to suppress the problem of informal employment by removal of all obstacles to the flexible forms of employment. According to the most recent data the share of wage earners engaged in the informal sector is 27 per cent, while the share of total employment in the informal sector amounts about 43 per cent. However, an additional concerning situation is that the informal sector employment made significant progress during the several past years. For instance, in 2002 the share of informal engagement for all workers in the total was about 30 per cent, what means that informal employment has been increased by about 1/3 during the five-year period. Unfortunately, it looks like that informal employment is attractive both for employer and for worker. But it yields negative effects on the labour force engagement meaning less secure job, exclusion from the system of social security, low level of wages, absence of skills upgrading, *etc*. An additional unfavourable fact is that the youth and women both with the weak educational attainment are most frequently engaged in the informal sector.

Secondly, the significant place in the National Employment Strategy and National Action Plan of Employment is given to the employment policies oriented towards the youth employment and reemployment of the labour surplus inflow on the labour market from the companies under restructuring, as well as to the policies oriented towards the other marginalized groups identified by the National Strategy of Poverty Reduction (persons with disabilities, Roma population, refugees and internally displaced persons, minorities *etc.*). To reach the goals determined by the Employment Strategy it is necessary to create sustainable employment programs of inclusion of the categories with the lowest employment perspectives on the labour market. Up to now this programmes are mainly financed and organized by donors support but without long-term perspectives.

Thirdly, it is necessary to place on the practice more flexible forms of employment and allow more room for decision making on the company level. Even if the Labour Code allows the flexible ways of workers engagement it is obvious that it is not flexible enough because a significant number of workers are engaged through the informal sector. It is necessary to put more flexibility in the labour regulation regarding to the duration of temporary and part-time employment. The provision of limitation of the length of the flexible forms of employment duration should be removed from the Labour Code and it could be solved through the individual contracts depending on specific situation, working conditions, *etc*. To the monitoring of the labour relations given through the labour contracts it is necessary to improve capacities of the labour inspections.

Fourthly, to collective bargaining should be given more significant role not only on the paper but in practice also. Further, problem of representativeness of the both trade unions and unions of employers could be solved through the better organization and higher level of activation of the bodies that represents two important sides in the process of social dialog. Government should

leave much more room for active participation of the other two sides in negotiations, including minimum wage setting and other important issues.

Fifthly, it is necessary to carefully redistribute the National Employment Service budget between passive and active labour market policies and lobbing for the private incentives in terms of investment in the human capital. In general, share of unemployment benefit beneficiaries in the total number of job seekers is small (only about 7 per cent). But additionally the unemployment benefit replacement rate is initially set at a high level of an average net wage – 60 per cent. Taking into consideration high benefit replacement rate, long period of the unemployment benefit duration (3-24 months), then 4-6 months of delay in benefit payment and all of the additional duties related to the social insurance (pension and health insurance) that are paid in the package "full unemployment benefit" it could be concluded that this passive measure does not satisfy its main purpose to serve as a financial support during the active searching for a job, but rather to push unemployed to find an informal employment. Regarding to the active labour market policies, they should be well financially planed, very well addressed to unemployed with low chances to find a job without assistance but with a high probability to keep a job. The active labour market policies should be followed by their permanent effectiveness assessment.

Sixthly, role and type of services provided by the National Employment Service have to be precisely determined, and the employees in the Service should be equipped by appropriate knowledge of how to serve to their clients. The process of the restructuring and modernization of the National Employment Service started in 2005 and based on the Strategy of changes of the National Employment Service should be accelerated, while in contrary absence of the appropriate services to unemployed will devastated the fragile efficiency of this public Service.
Seventhly, it is necessary to significantly improve the level of labour force skills through the formal education reform, but also through the better coverage by the programmes of vocational education and education of the adults, that are outside of the National Employment Service's active labour market measures assigned to unemployed.

Eighthly, much attention should be given to the gender policy and prevention of discrimination. High level of working-age women is unemployed or even out of the labour force. By restructuring of the corporate sector significant number of women lost their job in the socially-owned enterprises, but the share of women employment in the private sector is rather low. Particularly small numbers of women are entrepreneurs, why women searching for a safe job due to family reasons, or expensive services of the child care facilities, or why certain labour places are "reserved" for men. In general, women are about 20 per cent less paid for the same job than men are.

Ninthly, by developing of the real estate market, by given possibilities to higher earn and by better offer of the vacancies across regions, the labour geographical mobility will be more stimulated. Relatively high costs of living of standard outside of the place of permanent residence, including expenses for housing, ethno-cultural differences, weak infrastructure in

developing districts, as well as thin supply of vacancies across regions, all of those are the main obstacles to more propulsive labour mobility.

Tenthly, taxes on labour are not too high in comparison with the other neighbouring countries but taxation system yields unfavourable structure in terms of tax wedge. Additional tax incentives should be given to encourage small business and entrepreneurs. Much more attention should be paid on the SMEs and entrepreneurs sector development, not only on establishing of start-ups but also on sustainable growth of the old enterprises.

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