

# THE SOCIAL CONSEQUENCES OF THE GLOBAL ECONOMIC CRISIS IN SOUTH EAST EUROPE

*Edited by*  
**Will Bartlett and Milica Uvalić**



THE LONDON SCHOOL  
OF ECONOMICS AND  
POLITICAL SCIENCE ■

**LSEE**  
Research on  
South Eastern Europe

# **The Social Consequences of the Global Economic Crisis in South East Europe**

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**Will Bartlett & Milica Uvalić**



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## Contents

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ch.1	<b>Introduction</b>	<b>1</b>
	Will Bartlett and Milica Uvalić	
ch.2	<b>Financing Social Sector Projects in the Western Balkans - Challenges and Opportunities for the WBIF</b>	<b>15</b>
	Bernard Snoy and Emina Kadric	
ch.3	<b>Social Agenda 2020 for the Western Balkans at the Time of the Economic Crisis: a Regional Perspective</b>	<b>27</b>
	Nand Shani	
ch.4	<b>Past imperfect, present tense: institutional challenges in Albania at a time of uncertainty</b>	<b>35</b>
	Enkeleida Tahiraj	
ch.5	<b>Increasing Unemployment and Inactivity Stocks in Bosnia and Herzegovina</b>	<b>49</b>
	Vjekoslav Domljan	
ch.6	<b>The Social Impact of the Global Crisis in Bulgaria</b>	<b>63</b>
	Todor Todorov	
ch.7	<b>Croatia's Troubled Economy and Society</b>	<b>75</b>
	Vojmir Franičević	
ch.8	<b>The Impact of the Crisis on Social Inclusion and Social Protection in Kosovo</b>	<b>95</b>
	Ardiana Gashi	
ch.9	<b>The Impact of the Global Economic Crisis on the Labour Market and Social Services in Macedonia</b>	<b>109</b>
	Maja Gerovska Mitev	
ch.10	<b>Impact of the Financial Global Crisis on the Domestic Labour Market in Moldova</b>	<b>121</b>
	Ana Popa	
ch.11	<b>Impact of the Global Financial Crisis on the Labour Market and Citizens Social Status in Montenegro</b>	<b>131</b>
	Nikola Fabris	
ch.12	<b>Romania: The need for a New Development Model</b>	<b>143</b>
	Liviu Voinea and Irina Ion	
ch.13	<b>Effects of the Global Financial Crisis and the Eurozone Crisis on the Social Sector in Serbia</b>	<b>159</b>
	Ivana Prica	





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**Ardiana Gashi** completed her Master and PhD in Economics in the UK. Since 2008 Ardiana has been Dean of the Economic Faculty and Professor at FAMA College in Macroeconomics, Research Methods and Econometrics. Ardiana is engaged as second PhD supervisor at Staffordshire University in UK and since 2008 has acted as a local expert/consultant from the World Bank supporting the Statistical Office of Kosovo. Currently, Ardiana is Director of Economic Analyses and Policies Department at the Kosovo Chamber of Commerce. Ardiana is an active researcher, engaged in national, regional and international research projects and has published in international peer reviewed journals. Ardiana's interest is mainly in macroeconomics, labour economics and public policies.

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**Milica Uvalić**, has been Professor of Economics, at the Department of Economics Finance and Statistics, Faculty of Political Sciences, University of Perugia since 1992. From 2007-2012 she was a member of the UN Committee for Development Policy. She was a Public Policy Scholar at the Woodrow Wilson Center in Washington DC (2009), Vice Minister for Foreign Economic Relations in the government of FR Yugoslavia (January - August 2001), Research Fellow at the European University Institute, Florence (1984-92) and Researcher at the Institute for International Politics and Economics (Belgrade, Yugoslavia) (1978-80). She was President of the Italian Association for Comparative Economic Studies (AISSEC) (2009-11), President of the European Association for Comparative Economic Systems (2004-06, now Honorary Member) and President of the International Association for the Economics of Participation. She holds an MA in Economics from the University of Belgrade, a Post-Graduate Diploma in International Relations from the University of Florence, and a Ph.D. in Economics from the European University Institute. She has acted as a consultant to various international organisations, including the European Commission, ILO, UNDP, UNESCO, GTZ, National Bank of Yugoslavia, Bertelsmann Foundation, and the Vienna Institute for International Economics.

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# CHAPTER 1.

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## Introduction

Will Bartlett and Milica Uvalić

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### 1. BACKGROUND

Over the last two decades the countries of South East Europe (SEE) have been undergoing lengthy structural reforms as a consequence of the combined processes of economic transition, preparations for accession to the EU, post-conflict reconstruction and development. Moreover, these countries are located within a region that over the last twenty years has suffered from political instability, multiple economic crises, growing social polarization, ethnic fragmentation and increasing spatial inequalities. By late 2008 at the start of the global economic crisis, the Western Balkan countries in particular were facing a number of structural problems, despite significant achievements in the 2000s that included macroeconomic stabilization, strong growth, increasing FDI, and acceleration in transition-related reforms and EU integration. The two countries of the region that had joined the EU in 2007, Bulgaria and Romania, faced many of the same problems but were to some extent protected by their EU membership and the inflow of structural funds which this implied (despite their low absorption capacities).

Overall, the growth model that had been based on trade and financial opening, rapid credit expansion and increasing dependence on foreign capital has been much less successful in SEE than in Central Eastern Europe (CEE) (Uvalić, 2012). Since the early 2000s, SEE countries experienced rising trade and current account deficits, which were associated with a pattern of consumption financed mainly through foreign borrowing. They also experienced high unemployment rates (especially long-term and youth unemployment), low employment rates and the persistence of informal economic activity. Structural changes favoured the rapid expansion of services, many of which were in labour-saving sectors. The process of de-industrialization was more extreme in SEE than in CEE, a process which continued throughout the decade after the 'democratic turn' which occurred in 2000 with the fall of authoritarian regimes in Croatia and Serbia. The limited foreign direct investment that was attracted to the region mainly went into non-tradable services such as commercial banking, telecommunications, and real estate, rather



than into manufacturing (Uvalić, 2010). The process of catching up with the more developed European countries has been slow, with GDP per capita in most SEE countries in 2011 at about one third of the EU-27 average, ranging from 21% (Kosovo) to 61% (Croatia).

Thus the effects of the global crisis in SEE came on top of many structural problems that accumulated over the past decades. Although not at the centre of the recent global economic crisis, since 2009 these countries have been badly affected and many have been kept afloat only by determined intervention and support from the international financial institutions. Moreover, in 2012 they encountered a second round of recession as a consequence of the deepening crisis in the Euro area (Bartlett and Prica, 2012). They also face a worsening of their social climate as a result of austerity measures undertaken in response to the crisis, which have led to further increases in unemployment, poverty and inequality, problems that were already pronounced even before the onset of the economic crisis.

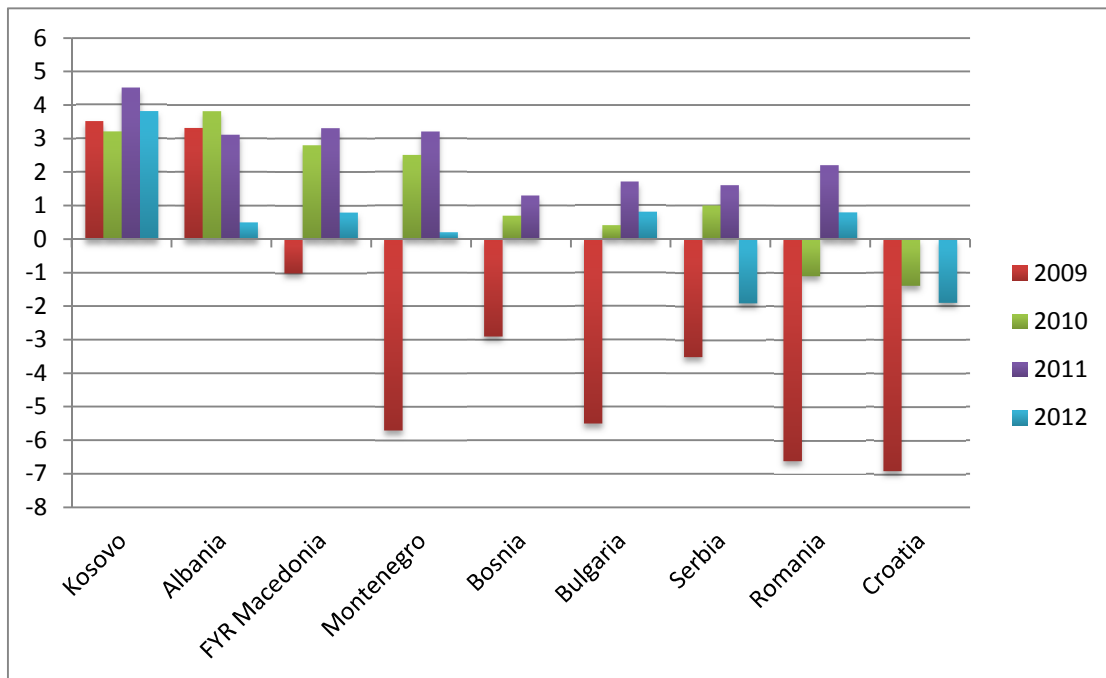
Despite the importance of these issues, the study of social cohesion has not developed sufficiently in SEE, in comparison with West Europe or the Central East European countries. In most SEE countries the consequences of growing social problems have been underestimated and social issues have generally remained in the shadow of other priorities on the policy agenda. In what follows we will briefly recall the effects of the economic and social crisis in the SEE region, discuss the likely prospects and give an overview of the contributions.

## **2. THE ECONOMIC CRISIS**

The global economic crisis hit the SEE region at a time when various deep structural problems were already evident. As is well known, the transmission belts of the global economic crisis to the countries of SEE have come through the negative impact of declining demand for exports from the region, declining inflows of credit and foreign direct investment and declining flows of migrant worker remittances (Prica and Uvalić, 2009; Sanfey, 2010; Bartlett and Prica 2011). All this led to a sharp contraction in most of the region's economies in 2009 with the sole exception of Albania and Kosovo, after which a shallow recovery followed. However, since early 2010, the global economic crisis transformed itself into a specific crisis of the Eurozone, the onset of which led to a further knock-on effect in SEE with a double dip recession in 2012 in several of the Western Balkan countries (see Figure 1) (see also World Bank, 2012a).

Economic growth in South East Europe underperformed earlier expectations in 2012 due to the bigger than expected slowdown in the Eurozone where GDP contracted by -0.4% in 2012 and is forecast by the IMF to fall by a further -0.2% in 2013 (IMF 2012a). This contraction has quickly spilt over into South East Europe where growth forecasts of major international institutions were downgraded accordingly. The latest economic data indeed reveal that in major economies the prolonged effect of the slowdown as well as the renewed recession in the Eurozone have had a deepening impact with a severe growth slowdown, and with two large countries, Croatia and Serbia, in recession in 2012 (see Figure 1). Croatia, already struggling, saw its GDP plunge once again with a contraction of -1.9% in 2012, mainly due to a fall in exports to the Eurozone. Serbia experienced a similar contraction, while all other countries apart from Kosovo saw growth falling below 1%.

**FIGURE 1: Double Dip Recession - Real GDP Growth (%)**



Source: EU Candidate and Pre-Accession Countries Economic Quarterly, Q4 2012, European Commission, ECFIN-D-1 and (for Bulgaria and Romania) Eurostat online data January 2013; for Albania, Bosnia and Herzegovina and Kosovo, data are taken from IMF World Economic Outlook online data.

The Western Balkan countries are especially vulnerable to the effects of the Eurozone crisis because of the high degree of Euroisation.<sup>1</sup> In Serbia, for example, more than 80% of all private sector loans are denominated in a foreign currency (Brown and De Haas, 2012), while in Montenegro and Kosovo the Euro is officially legal tender. Euroisation makes it hard for countries to achieve a real devaluation, and so internal devaluation through domestic recession and reduction of unit labour costs is the only way to restore international competitiveness. Moreover, these countries did not have support from the various EU bailout funds, the European Central Bank (ECB) and other policy instruments that are available to ease the impact of the crisis on the 'peripheral' EU Member States such as Greece, Ireland, Spain, Portugal and Italy. In other words, while the Eurozone crisis has had a damaging effect on its weaker members in the EU periphery, it has not been widely recognised that it has had an even more damaging effect on countries outside the zone, especially those in the volatile European 'super-periphery' (Bartlett and Prica 2012). In several of these countries (Bosnia and Herzegovina, Macedonia, Serbia) unemployment currently approaches or exceeds 25% - a position far worse than in Greece or Spain.

A significant new factor in relation to the developing Eurozone crisis is the phenomenon of deleveraging by Eurozone parent banks that operate in the Western Balkans. According to the IMF (2012), "Central and Eastern Europe are the most exposed to the euro area and could suffer

<sup>1</sup> Montenegro and Kosovo have adopted the Euro as legal tender without the approval of the European Central Bank, Bosnia and Herzegovina has a currency board which ties its currency to the Euro. Other countries in the region have little room for manoeuvre as a large proportion of domestic liabilities are denominated in Euro. Croatia and Macedonia have fixed pegs to the Euro. Only Serbia and Albania have flexible exchange rates.

disproportionately from an accelerated withdrawal of bank funding or portfolio capital". Deleveraging can come about through reductions in cross border flows of interbank funding, nonbank private credit including trade finance and also through reduced public sector lending (World Bank, 2012).

The economic downturn associated with the crisis and the subsequent double-dip linked to the recession in the Eurozone have led to increasing pressure on state-funded social programmes in South East Europe. Most countries have adopted austerity programmes in an attempt to contain burgeoning budget deficits. Some of these, as Bosnia, Romania and Serbia, have been under the supervision of the IMF and the European Commission. Bosnia has implemented an austerity programme designed to cut public expenditure and reform social programmes with financial support from the IMF subject to strong conditionality under a Stand-by Arrangement.<sup>2</sup> Romania received a €20 billion bailout package in 2009 to which the EU contributed €5 billion as balance of payments assistance, with the remainder coming from the IMF and the international development banks. The conditions were a reduction in the budget deficit to below 3% of GDP, cuts in public sector wages and employment, pension reforms and a range of other structural reforms (EC 2012). In 2008, Serbia agreed a €3 billion Stand-by Arrangement with the IMF, and a further Precautionary Credit Line (PCL) of €1 billion in September 2011. Under the agreement, the budget deficit should not exceed 4.25% of GDP, while debt should not rise above 45% of GDP. However, the agreement was suspended in February 2012, as pre-election government spending breached the agreed limits, also enshrined in a Fiscal Responsibility Law.

Avoiding assistance from the IMF, the Croatian government launched an Economic Recovery Programme in 2010<sup>3</sup> that involved pension reforms and cuts in unemployment benefits. A Fiscal Responsibility Law was adopted to reduce public expenditure by one percentage point annually until a primary general government budget balance is achieved. However, as recession deepened, in March 2012 VAT was increased from 23% to 25%<sup>4</sup> in an attempt to maintain government spending. Macedonia has kept a tight rein on public expenditure but has built up arrears to the private sector. Only Albania and Kosovo have been exceptions to austerity, in allowing budget deficits to widen on the back of ambitious public infrastructure investments, principally highways.

### **3. THE SOCIAL CRISIS**

The austerity programmes have had increasingly negative effects on labour markets in SEE and have led to sharply worsening employment outcomes. As the economic crisis has been through successive stages, the social problems in South East Europe have deepened, leading to deterioration in the quality of life (Bartlett, 2009). Education services have come under increasing pressure leading to difficulty in providing the labour market with required skills (Arandarenko and Bartlett, 2012). Public health services have also come under pressure as budgets have been squeezed and market-based reforms have undermined resources for investment in public health facilities (Bartlett et al. 2012). In many countries, local governments have been burdened with

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<sup>2</sup> Statement by the IMF Mission in Bosnia and Herzegovina, Press Release No. 12/195, May 29, 2012

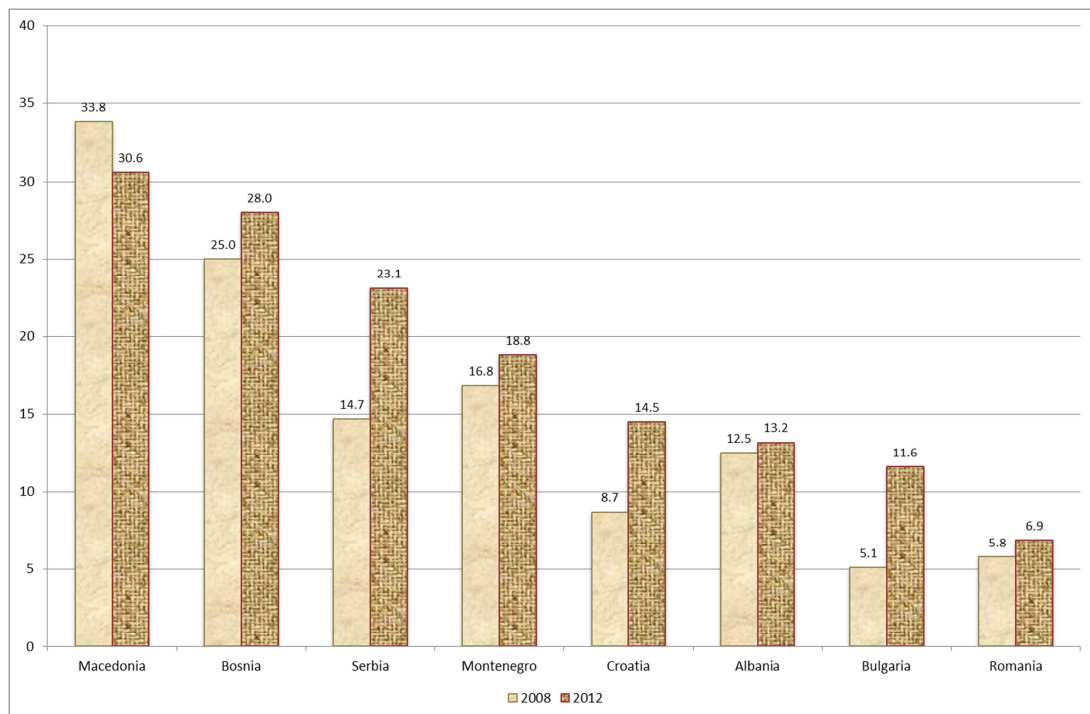
<sup>3</sup> IMF (2011) Country Report No. 11/159, June

<sup>4</sup> Croatian National Bank Bulletin No. 183, 2012, p. 14

additional responsibilities through policies of decentralisation, which in countries such as Bosnia and Herzegovina, Kosovo and Macedonia have been designed to support ethnic conflict resolution programmes (Bartlett et al. 2013). However, with the deepening of the crisis, these local governments have seen their budgets sharply reduced and in consequence the quality of local social services has fallen.

However, none of these social problems will be resolved unless the underlying problem of rapidly increasing unemployment and a worsening jobs crisis is not urgently addressed. Without an increase in employment rates to provide a boost to economic growth and the additional output to meet the growing social needs to the combined effects of economic crisis and ageing populations, the resources needed to finance the improvements in public social services will not be forthcoming.

**FIGURE 2: Unemployment rate (%)**



Source: Data are taken from Labour Force Surveys from the national statistics agencies for each country. The data for 2012 are the latest available: for Croatia Q4, Macedonia Q3, Montenegro Q3, Romania Q2; Serbia - October; for Bulgaria – Q4; for Albania and Bosnia and Herzegovina - annual data.

These data reveal that unemployment has reached far worse proportions in the Western Balkans than in those countries of the EU periphery that have been worst affected by the Eurozone crisis. In the Eurozone as a whole, the unemployment rate reached 11.2% in mid-2012 (Eurostat, 2012). In Greece the unemployment rate reached 22.5% in April 2012 while in Spain it reached 24.8% in June 2012, the worst in the Eurozone. These extremes were however exceeded in Macedonia (30.6%), Bosnia and Herzegovina (28%), and Serbia (23.1%) providing further evidence of the dire position of the Western Balkan countries in the European ‘super-periphery’ of SEE. The increase in unemployment rates has been even more dramatic, with unemployment rates more than doubling in Bulgaria between 2008 and 2012, and increasing substantially in Croatia and Serbia. It

is noticeable that unemployment fell only in one country over the crisis period – Macedonia. One possible explanation is the aggressive flat tax policy pursued by the Macedonian government, which has succeeded in attracting some large foreign investments to special industrial zones where corporate tax rates have been reduced to zero per cent and large subsidies have been offered to foreign investors who build new greenfield factories in these tax-free zones.

Youth unemployment has also increased to dramatic levels. The unemployment rate of those aged 15-24 in Bosnia and Herzegovina reached 57.9% in 2011,<sup>5</sup> in Montenegro it was 40.4% in Q1 2012,<sup>6</sup> in Croatia it was 45.2% in Q1 2012<sup>7</sup> and In Serbia in April 2012 it was 50.9%.<sup>8</sup> In comparison, in the Eurozone the youth unemployment among under-25s was 22.4%.<sup>9</sup> The rising youth unemployment rate has come about in a situation of already high youth unemployment and is leading to a 'lost generation' of socially excluded young people who provide fertile ground for the rise of extremist political parties and threaten the future political stability of the entire region. The social effects of long-term youth unemployment are likely to be long-lasting, as they imply a loss of skills and a deep entrenchment of social exclusion among a large section of the community.

The crisis has had significant gender bias in the way it has impacted on unemployment rates, which in some countries have increased far more sharply for men than for women. This effect is especially noticeable in Croatia, where the unemployment rate for men increased three times more than that for women. The unemployment rate of men also rose significantly more than for women in Bosnia and Herzegovina, Bulgaria, Montenegro and Serbia. This may be explained by the differential sectoral impact of the crisis which has affected manufacturing and construction industries due to the contraction of trade and credit far more than it has affected the public sector in fields such as health services, education and administration where women's jobs are mostly concentrated. A similar effect seems to be operating in Macedonia, which as noted above was the only country in which unemployment actually fell during the crisis, with a larger fall in unemployment for women than for men. Romania is the only country in the region where the female unemployment rate has increased by more than the male unemployment rate.

The other side of high and rising unemployment has been the very low level of employment rates. For the working aged population aged over 15, employment rates in 2012 ranged from as low as 31.7% in Bosnia and Herzegovina in 2012 and 34.3% in Serbia to 39.1% in Macedonia and 42.2% in Montenegro.<sup>10</sup> For the age group 15-64 the employment rates are naturally higher, but still relatively low, for example in Serbia the employment rate for this age group in April 2012 was 43.9%. These employment rates are far away from the Europe 2020 targets of 75% employment rates aspired to in the EU. The EU member states in the region have a rather better performance

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<sup>5</sup> Agency for Statistics of Bosnia and Herzegovina, "Labour Force Survey: Final Results", November, Thematic Bulletin TB10, 2011

<sup>6</sup> Montenegro Statistical Office "Labour Force Survey 1<sup>st</sup> Quarter 2012", *Release* No. 159, 15 June 2012

<sup>7</sup> Croatian Bureau of Statistics, "Labour Force Survey", *First Release*, No. 9.2.7/1, 19 July 2012

<sup>8</sup> Statistical Office of the Republic of Serbia, Labour Force Survey, First Release No. 181, 29/6/2012

<sup>9</sup> In Greece and in Spain, youth unemployment reached 51.5% and 52.7%, respectively in June 2012, even higher than in Western Balkan countries with the exception of Bosnia and Herzegovina.

<sup>10</sup> These data are taken from the most recent Labour Force Surveys in each country at the time of writing: Bosnia, 2012; Macedonia, Q3 2012; Montenegro, Q3 2012 and Serbia, April 2012.

with employment rates in 2012 reaching 58.5% in both Bulgaria and Romania<sup>11</sup>. Even in the latter countries a considerable distance remains to the respective targets. For comparison, the average employment rate in the EU-27 in 2011 was 64.3% while in Germany it reached 72.5%<sup>12</sup>. Overall the data indicate a severe crisis in job creation in the region, and the need, but also the potential, for raising substantially the job creating performance of the economies. Unfortunately the economic crisis has plunged the region in the opposite direction, with large-scale job losses and plant closures leading to even worse labour market performance in most countries.

#### **4. PROSPECTS**

Most observers doubt that the period of rapid growth that took place before the onset of the crisis will return. Consequently the SEE countries are likely to face a protracted period of slow growth leading to widening social problems and deepening social exclusion of significant proportions of their populations. In a context of insecure statehood of several countries, widespread informal economies and organised crime and with often weak state administrations at both central and local level, the prospect of deepening social problems raises concerns for the future stability of the region.

At present, many issues remain beyond SEE governments' control. Given the high degree of integration with the EU, economic recovery in SEE will to a large extent depend on prospects in the EU and especially in the Eurozone. Nevertheless, there are many areas, particularly in the social sphere, where respective governments will need to implement more efficient policies. Countries of the region will also have to be more reliant on their own resources, given the uncertain prospects of recovery of FDI and far more limited privatization opportunities.

Differences in level of development may also affect the pace of future growth. The poorer countries, Kosovo and Albania, have done quite well during the crisis and still have respectable growth rates; whereas the most developed country of the region, Croatia, has suffered prolonged recession and increasing indebtedness.

In SEE countries with high external debt and high government deficits and public debt, in addition to austerity programmes, tax reform is needed to raise additional revenue. This also involves reducing tax evasion and therefore policies to formalise the informal sector, as well as increasing progressivity of tax system. This may be seen to be an argument against the flat tax reforms that have been implemented in some SEE countries in recent years. However, there is some argument in favour of such reforms in that they may attract investment and business from other countries; for example, many Greek companies are relocating into Bulgaria where taxes are lower. Macedonia, which has a low tax regime, has performed quite well during the crisis. There may be a trade off between need to raise revenue through higher taxes, and need to improve competitiveness through lower taxes.

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<sup>11</sup> The data for Bulgaria and Romania are taken from Eurostat online database and refer to the 15-64 age group and are for 2011.

<sup>12</sup> The employment rates for EU-27 and Germany are taken from Eurostat online database and refer to the situation in 2011.

Overall, austerity should be offset primarily by measures that could lead to higher growth rather than higher taxes. The new growth model discussion is therefore important. The economic crisis has reduced fiscal space for public spending, in this way negatively affecting the social sector. In 2012 the fiscal situation in most Western Balkan countries deteriorated further. In addition to already high fiscal deficits, there was a sharp increase in public debt in most countries, leading to a further shrinkage of fiscal space. If fiscal consolidation is delayed, public debt could become unsustainable. Yet the timing of fiscal consolidation is essential. Too rapid fiscal consolidation risks bringing economic recovery to a halt, making it extremely costly in terms of employment and output. A recent IMF Working Paper (Batini et al, 2012) suggests that a fiscal consolidation is substantially more contractionary if made during a recession than during an expansion. Spending multipliers in recessions are several times larger than spending multipliers during expansionary phases. This may have important implications especially for those SEE countries in recession. Too quick reduction of fiscal deficits through increased taxes or sharp reduction of public spending carries the risk of delayed economic recovery.

Another element is the relationship between social inclusion and growth, as some recent evidence suggests that inequality reduces growth (Stiglitz 2012). An obvious way to raise growth is to increase the disastrously low employment rates in SEE, bringing into the labour force those who have become discouraged, early retirees, women, Roma and so on. This in effect means that it is important for a new growth policy to include measures to improve the inclusion of the most disadvantaged groups.

The degree of EU integration is also a factor here, as more integration exposes countries to stronger effects of the Eurozone crisis. The region includes countries with very different degrees of EU integration – members, candidates and potential candidates - each with different degrees of access to the EU structural funds, including the European Social Fund. The EU 2020 headline targets include reducing school dropout rates, increasing employment rates, and reducing numbers of people who are living in poverty. These apply to EU member states Romania and Bulgaria directly (see their National Reform Programmes), and rather indirectly to candidates who have signed Joint Social Inclusion memoranda. Since access to EU funds and specific programmes depends directly on a country's status, the more integrated a country is with the EU, the more attention is likely to be given to social inclusion policies.

## **5. OVERVIEW OF CHAPTERS**

This book presents studies on the social consequences of the economic crisis by leading scholars from SEE as well as by representatives of international organisations active in the region on current policy thinking about regional policy and strategy development for social cohesion. Several of the chapters in this book were presented at a conference organised by LSEE in December 2011 on the Social Consequences of the Global Economic Crisis. Two of the chapters are by representatives of international organizations active in the region, while a further ten chapters focus on individual SEE countries – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia, Moldova, Montenegro, Romania and Serbia.

In chapter 2, Bernard Snoy and Emina Kadrić present an overview of regional programmes funded by International Financial Institutions in the Western Balkans that focus on social issues. A recent report prepared by the IFI Coordination Office for the Western Balkans Investment Framework stresses the need to enlarge the financing of social sector projects. Although it is widely acknowledged that investing in human capital, primarily through better access to health care, lifelong education, employment, housing and other social services, paves the way for growth and social cohesion, projects in the social sector face a number of specific challenges which make their financing more difficult. The chapter discusses some of the key challenges and provides some recommendations that are relevant to a broader discussion on prioritizing social sector actions in the region. The experience so far has demonstrated that certain reforms are better addressed horizontally rather than on a country-by-country basis. Since the countries in question have relatively small economies, regional cooperation seems highly appropriate in a number of areas.

In chapter 3, Nand Shani discusses the Social Agenda 2020 for the Western Balkans which has been adopted by the Regional Cooperation Council (RCC - the successor organisation to the former Stability Pact). This Social Agenda aims to strengthen regional cooperation in employment and social policy-making and develop a regionally owned response to the social policy elements of the Europe 2020 Strategy. The chapter highlights the most important regional initiatives for the social sector, including three specific initiatives organized by the RCC and inspired by the Europe 2020 Strategy - New Skills for New Jobs, Women's Entrepreneurship and Social Entrepreneurship. Shani argues that regional cooperation can be an important tool for promoting social development in these areas, for jointly addressing the challenges of the crisis and for preparation and adjustment for EU membership. Regional cooperation can produce positive reform spill-over effects at national level, while countries can exploit economies of scale in addressing common issues.

The remaining chapters focus on the social impact of the recent economic crisis in individual countries. In chapter 4, Enkeleida Tahiraj examines current challenges facing Albanian state institutions tackling issues of social cohesion. While the Albanian economy has avoided the worst impact of the crisis due mainly to its relative insulation from world markets, poor and marginal groups remain vulnerable due to a combination of price volatility, social exclusion and risks to their livelihood strategies. This is happening at a time when government resources are stretched and the resilience of the social protection system is under threat. The recently changed context offers an opportunity to reframe social policies to better address issues of social cohesion. In particular, given the continuing economic uncertainty, the chapter argues for promoting the developmental aspects of social protection, targeting aspects of cohesion beyond material provision, such as equality and inclusion, to achieve greater social gains. This can most realistically be achieved through refocusing current policy through new policy linkages and increased collaboration both inside government and with external donor and civil society partners.

The impact of the global crisis on the labour market in Bosnia and Herzegovina is the main focus of chapter 5 by Vjekoslav Domljan. Unemployment is one of the most pressing economic and social problems as labour markets have weakened substantially since 2008. Prior to the global crisis, unemployment had been on a falling trend as employment increased. Since then, however,



the unemployment rate has increased substantially reaching over a quarter of the active labour force. The crisis has destroyed many jobs in the relatively small private sector and increased pessimism regarding employment prospects. With high and growing unemployment, a further increase in inequality, poverty and social exclusion could be expected unless effective counter measures are taken. Since such measures are still missing, the author suggests an economic strategy that could underpin job generation through a set of more adequate employment and social policies.

Todor Todorov, in [chapter 6](#), gives an overview of the impact of the global crisis on poverty, social inclusion and social protection in Bulgaria. The analysis is placed in a broader context of overall economic development in times of recession and more particularly the labour market situation in Bulgaria. The chapter focuses on the employment integration of vulnerable groups, including young people and long-term unemployed, and highlights the persistent regional labour market disparities in Bulgaria. The effect of the economic downturn on the population at risk of poverty and social exclusion is analysed using the most recent poverty and social inclusion indicators at both national and regional level. The social impact of the crisis is further explored through data on receipts and expenditure of the social protection system, demonstrating that the economic downturn has led to a reduction in many social protection benefits.

In [chapter 7](#), Vojmir Franicevic describes the severe effects of the global crisis on the Croatian economy and society. The analysis focuses on the economic and social consequences of the economic crisis, while also highlighting the underlying social and political challenges. The chapter discusses in detail the problems of the Croatian labour market, poverty trends, and social policies. It illustrates the negative trends regarding economic growth, fiscal and foreign trade deficits, and the main labour market indicators. The deteriorating situation makes the present level and structure of commitments to various social groups hardly credible, while social conditions have worsened for an increasing number of Croatian citizens. Particular attention is devoted to the situation of youth and older people, concluding that the most serious problems are long-term unemployment and the worsening dependency ratio in the pensions system.

In [chapter 8](#), Ardiana Gashi discusses the social effects of the global crisis in Kosovo. Kosovo remains one of the poorest countries in Europe and the poorest in the Western Balkans, while economic growth has been insufficient to support economic and social development. In 2009, slightly more than one-third of the population lived below the absolute poverty line and 12% lived below the extreme poverty line. The unemployment rate is estimated at around 40% and is highest among youth and women. Although Kosovo was one of the few countries (along with Albania) in SEE to maintain economic growth in 2009, the crisis has brought about a number of negative trends. Remittances have declined; since these have been mostly used for consumption, education and health care, their further reduction will have an adverse impact on the basic consumption of households. In addition, declining FDI and limited and declining export revenues have worsened living standards, particularly among vulnerable groups including youth, women and returnees.

Maja Gerovska Mitev, in [chapter 9](#), analyses the impact of the global economic crisis on the labour market and basic social services in Macedonia. The economic downturn has had visible effects on people's well-being, especially among the more vulnerable households, while also

challenging the existing public support measures and their effectiveness. The author analyses trends in access to the labour market, in social protection, and in education and health care in 2008-09, based on a quantitative household survey carried out in 2009. This analysis shows that labour market participation, already very low before the crisis, has further decreased and that people's perception of the effectiveness of social protection have deteriorated. The crisis has also increased the costs of education, affecting school attendance rates. Gaps in access to health care have widened and most people are dissatisfied with the quality of public health provision.

In chapter 10, Ana Popa discusses the impact of the global economic crisis on the Moldovan labour market. Although most of labour market indicators worsened in 2009, they had already been on a negative trend for over a decade with high rates of job destruction. Since Moldova is heavily dependent on exports and remittances from abroad, a significant negative impact of the crisis was seen in 2010, with new lows in activity and employment registered. The unemployment rate rose mainly due to the return of migrants from the countries most affected by the economic crisis. Although the employment rate has not fallen significantly, working conditions have deteriorated, informal employment and under-employment has increased, and salaries have been both delayed and reduced. The weaknesses of the Moldovan labour market have therefore been aggravated by the global economic crisis, its vulnerability being determined by the weak economic structure and poor quality of economic growth.

In chapter 11, Nikola Fabris examines the impact of the global economic crisis in Montenegro. During the three years before the global crisis, Montenegro had the highest economic growth rate in the region. The global crisis hit Montenegro's economy severely, pushing it into recession, with an average GDP growth between 2009 and 2011 of -0.15%. This plunge in economic activity had an especially negative impact on the labour market and on the social position of employees. The accumulation of social problems led to an increasing number of social welfare recipients and an increase in social welfare payments, with an alarming increase in child poverty. The impact of the crisis also had a regional dimension, as the northern part of the country, where almost half of the socially deprived population is concentrated, was most severely hit. One of the consequences has been population migration from the northern to the central and southern regions of Montenegro.

In chapter 12, Liviu Voinea and Irina Ion discuss the impact of the crisis on Romania. Prior to the crisis, Romania enjoyed a decade of high rates of economic growth. Unfortunately, that growth was consumption-driven, leading to a large current account deficit. The public policy mix was pro-cyclical and the budget deficit also deepened, while the benefits of the lax fiscal policy were reaped by a small group of high-income individuals. Already on course for a collision, the Romanian economy collapsed when foreign financing suddenly dropped. The adjustment was severe in terms of austerity measures. The vast majority of the population, which did not benefit from the previous boom years, supported the burden of this adjustment. In this process, major splits emerged in the society: public sector versus private sector employees; labour productivity versus social assistance; more governance versus less state; private initiative versus fiscal evasion. While the middle class was squeezed, the ideological struggle between social classes reappeared. The author concludes that economic stagnation is so severe, and the consequent social cleavages

are so deep, that they can only be overcome by the adoption of an entirely new development model.

In chapter 13 Ivana Prica discusses the effect of the global economic crisis on Serbia. She shows how devastating have been the effects of the financial crisis and the Eurozone crisis for the Serbian economy. She argues that the crisis is likely to take a more sinister turn because the domestic buffers in the form of additional tax rises to dampen the crisis have been exhausted, or in the form of additional borrowing are prohibitively expensive or unsustainable. At the same time, she demonstrates that economic performance is getting worse. Serbia has entered into a double dip recession following the worsening of the Eurozone crisis with dramatic effects on labour market indicators. Since 2008, one fifth of labour force lost their jobs, while unemployment has risen to affect nearly one quarter of the labour force. The demands on public expenditure have increased as public sector employment has been protected. As private sector employment has been falling sharply, the number of social security dependants and pensioners has grown. Prica concludes that lacking a pro-active policy and in the face of possibly rising social unrest due to severe economic conditions, the Serbian government is resigned to additional borrowing in order to sustain the current levels of spending.

The twelve contributions to this volume illustrate very convincingly how deeply the global economic crisis and the Eurozone crisis have affected the SEE region, contributing to a deterioration of labour market indicators in most countries and worsening in the provision of social services. We hope the book may raise awareness about the importance of social cohesion in a region where the underlying problems are far worse than elsewhere in Europe.

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## CHAPTER 2.

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### **Financing Social Sector Projects in the Western Balkans - Challenges and Opportunities for the WBIF**

Bernard Snoy and Emina Kadric

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#### **1. INTRODUCTION**

In June 2012, the IFI Coordination Office<sup>13</sup> published their report *Financing Social Sector Projects in the Western Balkans – Challenges and Opportunities for the WBIF*. The purpose of the report was to provide *food for thought* for the Western Balkans Investment Framework (WBIF)<sup>14</sup> stakeholders on: i) the need to enhance financing of social sector projects in the Western Balkans; ii) the particular challenges faced by such projects and iii) options for how to proceed within the framework of the WBIF, including the potential to expand the use of WBIF funds in the social sector.

This chapter provides a summary of the report, including key challenges, recommendations and implications. While these have been formulated for consideration under the WBIF, the information provided is nevertheless both timely and relevant for a broader discussion on

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<sup>13</sup> The IFI Coordination Office was established in February 2010 under the EC-financed project “Support to IFI Coordination in the Western Balkans and Turkey”. It focuses on coordination, cooperation and communication between IFIs, EC, bilateral donors and beneficiary countries across four key sectors – energy, environment, transport and socio-economic issues. The Office undertakes a number of activities including, but not limited to: (i) research and analysis, (ii) preparation of thematic reports, (iii) contribution to strategy and policy discussions under the Western Balkan Investment Framework, (iv) contribution to activities undertaken by sectoral organisations e.g. SEETO, Energy Community, Regional Environmental Network for Accession etc., and (v) development and maintenance of a database on investment flows into the Western Balkans in the four key sectors.

<sup>14</sup> Since its establishment in December 2009, the WBIF has proved a very useful framework to enhance cooperation among beneficiaries, bilateral donors, IFIs and the European Commission (EC) in the Western Balkans. In so doing, it has increased the effectiveness of the financial and technical assistance provided to the region. The WBIF works by pooling grant resources in order to leverage loans for the financing of priority infrastructure in the Western Balkans. Its scope was expanded in 2011 to include private sector development and to provide a small facility for conducting sectoral studies.

prioritizing social sector actions in the region. WBIF experience has also demonstrated that certain reforms are better addressed horizontally rather than on a country-by-country basis. Given that the economies in question are small, countries need to cooperate and come up with joint ideas and proposals on how to address the key challenges they face. Education is just one of many examples of areas that can be addressed on a cross border basis in order to apply economies of scale. Hence, the regional aspect in this sector should not be underestimated.

The importance of appropriate needs based definitions of social sector interventions/projects such as education, health and social security reforms also needs to be emphasized as it has a notable impact on human capital development and ultimately the growth capacity of the countries. The authors have attempted to contribute to advancing this process. The full text of the report can be found at <http://www.wbif.eu/Social+Sector>.

## **2. BACKGROUND**

It is broadly acknowledged that investing in human capital, primarily through better access to health care, lifelong education, employment, housing and other social services, paves the way for growth and social cohesion. At the same time, projects in the social sector face a number of specific challenges, which make their financing more difficult:

- Investment in social sector projects is in general given less priority than in sectors such as transport and energy as their link with economic growth is more difficult to demonstrate;
- There is a lack of quantifiable marginal cash flow that could be pledged or 'ring-fenced' as collateral for loans;
- Social sector projects are rarely suited to being exclusively funded by loans; all or part of the funding has to be concessional;
- It is more difficult to leverage grants with loans and public sector resources than with private resources for example through PPPs; and
- The success of these projects is closely linked to the quality of the legal, regulatory and overall policy environment.

### **2.1 A brief overview of social indicators and projects in the Western Balkans**

The available data and indices on the social sector point to the existence of significant space for improvement in the quality of social sector related services across the Western Balkans region. This is in terms of both additional financing requirements and the need for improvement in effectiveness and efficiency.

In comparison with the European Union (EU), in the Western Balkan countries:

- Unemployment is much higher;
- Public spending on education (expressed as % of GDP) is lower;

- The primary education completion rate is generally lower as is school enrolment, especially in terms of tertiary education. There are fewer repeat students in both primary and secondary education, which may imply poorer standards in grading;
- Public spending on health is lower, while private spending on health is higher. Overall health expenditure per capita in Purchasing Power Parity terms is significantly lower; and
- Rural populations of Western Balkan countries show lower access to sanitation facilities. Life expectancy is significantly lower and the mortality rates for children under the age of five are significantly higher.

Social sector deficiencies also translate into competitiveness deficiencies, as evident from the ranking of Western Balkan countries in the 2011 Global Competitiveness Index (GCI).

In general, governments in the region have recognised the need for investment in the social sector. However, the capacity of the governments to make these and other related investments are constrained by a number of factors, in particular the fact that most countries already have high total government expenditure.

This implies that there is a substantial need for external financing, particularly for capital expenditure in this sector. However, the level of expenditure is less important than improving the structure, effectiveness, and efficient use of funds. There is an urgent need to improve labour skills (in terms of matching labour force skills to market needs), increase productivity and focus on higher value-added products and services. Last, but not least, alignment with EU/international norms is crucial. Policy alignment with the EU (Europe 2020) is a key issue that should be taken into account when looking at grant funding in the social area.

## **2.2 Selected Social Sector Projects in the Western Balkans**

The report identified 147 projects approved since 2007 that can be considered to be of a social nature, funded by external financiers such as the EU, the Council of Europe Development Bank (CEB), European Investment Bank (EIB) and the World Bank (WB) in the Western Balkans<sup>15</sup>. The total value of these projects amount to approximately €3.7 billion<sup>16</sup> and the breakdown across sub-sectors is 54 educational projects, 28 health projects, 11 social infrastructure projects, 43 social policy projects and 11 judicial infrastructure projects. Of the 147 projects, 19 have a regional character, 70% are investment projects and 30% are Technical Assistance (TA).

## **3. MAIN CHALLENGES**

The challenges to financing social sector projects in the region are numerous. We have divided them into: sector related and financing sources and structures.

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<sup>15</sup> The report focused on the WBIF financiers that are active in the region in this sector. It is important to note that there are also many other bilateral donors working in the region.

<sup>16</sup> The total of grants and loans amounts to €2.567 billion.



### 3.1 Main sector-related challenges

The most important challenge is the need to put in place sectoral strategies to guide investments. Data on social sector projects financed in the Western Balkan countries indicate that while individual projects are well designed and address genuine needs, they may reflect specific country and sectoral circumstances, as well as the particular expertise and policy orientations of the individual IFIs or of the EC. The data also highlights some of the demographic and policy issues facing the countries, for example ageing populations, skills gaps, lack of research and innovation where priority investment requirements can really only be determined as part of a much broader strategic approach to the individual sectors. The fiscal and social demands on governments in the region, particularly in view of the on-going economic crisis, places even greater pressure on the need to ensure that scarce resources are targeted in a strategic and coordinated manner in order to yield the best results possible. Thus comprehensive sectoral strategies need to combine policy reforms with capital investments.

A review of various reports and documents prepared by IFIs and other relevant organisations points to a number of common challenges in financing investments, particularly in the **sectors of education, health and social housing**.

With regard to **educational projects**, a recurring recommendation of ex post evaluation reports on projects is that to increase their relevance and external coherence, preference should be given to projects embedded in broader education policies. If one concentrates on policies, a key challenge is how to adapt education systems to the needs of the twenty-first century, moving away from formal education to lifelong learning and skills development, as well as anticipating the impact of the on-going demographic transition on the demand for education. While the availability of lifelong learning needs to be substantially boosted, closing the skills gaps in the region requires a fundamental change of approach so that education and training systems refocus their attention from schooling inputs to learning outcomes. Policy instruments have to be designed to measure the skills that students and adults have, give more flexibility to schools and local authorities and encourage them to 'spend smarter', addressing sector inefficiencies.

Regarding health projects, the review confirms that projects should also be seen in the context of a wider set of health services in the region. The focus of any project appraisal should be whether investments being financed contribute to a cost-effective improvement in the health of the people for whom they are designed. They should also be part of a clearly articulated health strategy aimed at improving the efficiency and/or the quality of health care delivery, including the sustainability of its financing. There is a need to shift from the narrow idea of public sector health, as reflected in the institutions focusing on hygiene and sanitation, towards a new public health that focuses on the main population health scourges of the time, including non-communicable diseases, mental health and injuries. It is also essential to anticipate the pressure on long-term care that will result from an ageing population.

Social housing challenges in the Western Balkans are severe: lack of access to piped water and sanitation, chronic under-investment and inadequate maintenance of buildings, low level of new housing production, massive illegal housing construction and numerous displaced persons still in need of a long-term solution, the difficulty or inability to ensure adequate heating in dwellings.

There is a real danger of a housing underclass emerging, which includes young people, whose participation in the labour market depends largely on their ability to settle. The success of social housing projects depends largely on the quality of fiscal, financial and real estate policies. Policy challenges include a more efficient use of public resources in this sector, the transition from a highly centralised and subsidised system of housing finance to a system driven by private initiative and the real cost of housing services to consumers, as well as encouraging the competitive provision of housing services. Here again the impact of ageing populations should be anticipated as this will increase demand for new housing services characterised by specific needs in terms of accessibility, design, infrastructure, technologies, etc.

In view of strengthening social integration, a number of projects have been designed to address the roots of exclusion of vulnerable groups, for example migrants, displaced persons and minorities. Of note in this respect are a number of projects aimed at ensuring the access of Roma to education, employment, health care and social housing services. Experience shows that, to be successful, these projects need to be part of integrated strategies such as the *EU Framework for National Integration Strategies up to 2020*, including the identification of appropriate and cost-effective policies and programmes enhancing integration, as well as a monitoring and evaluation framework. For example, projects can be designed to link cash transfers to the registration of children in, and their actual attendance of, schools.

Only a few projects have been designed to improve the delivery of social security and other social services to the populations of the Western Balkan countries. The main challenge here is to improve the quality, performance and effectiveness of social safety nets; systems presently in place have impressive targeting overall but a low coverage and provide low average transfer amounts. In other instances, social transfers are high but not properly focused as is often the case with war veterans. Incentives need to be introduced for 'active inclusion' and investing in human capital by providing additional benefits linked to school enrolment and attendance for families with school-age children (conditional cash transfers programmes). It is also important to create a unified registry of beneficiaries of social assistance programmes, among others, to avoid overlapping programmes.

Very few projects so far deal with another type of social service, namely labour market interventions, for example efforts aimed at improving both policy design and delivery of retraining services and reintegration into labour markets for workers who have lost their jobs. It is an area which the recent crisis has made more important.

**Pension reform** will be vital to the overall socioeconomic environment in the region. The key challenge here is ensuring fiscal, financial and social sustainability, while anticipating the consequences of an ageing population. This in turn requires capacity building of social security institutions, creation of a unified beneficiary database and of a central registry of records and collection of wage histories, as well as the development of mechanisms for effective oversight and control.

### 3.2 Main challenges: financial sources and structures

A second group of challenges arise in terms of financing sources and structures. The appropriate blending of concessional and non-concessional financing structures is a key issue for social projects that are more reliant on grant financing than loan financing. Determining the appropriate level of blending between grants and loans, reflecting the public/private nature of the benefits resulting from these projects and the mix of cash-flow versus non cash-flow benefits accruing to the legal entity (person or institution) once they having obtained the financing is a complex task. In general, weak or inexistent cash-flow generation is translated into the need for grant financing or at least lower leverage in the relation between grants and loans.

Having in mind the scarcity of public funding sources, as well as the limits imposed by the current fiscal crisis and the limited development of the local currency capital markets in the Western Balkan countries, another issue concerns the feasibility of public private partnerships (PPPs) in supporting social sector projects. Whereas they appear as an attractive way to involve private investors in the financing and provision of specific public goods, in particular infrastructure services, PPPs are, in reality, relatively difficult to implement, even in advanced economies. They require an appropriate legislative and regulatory framework as well as specific expertise, which cannot be put in place overnight. PPPs are just emerging in the Western Balkans and further efforts are required to develop sufficient expertise. The elusive character of the incremental cash flow makes it even more difficult to set up PPPs in the social sector, with the exception perhaps of some more specialised health services for which specific payments can be levied.

There is an increasing recognition all over the world that social entrepreneurship and social enterprises are likely to play an increasing role in the achievement of social goals. What defines social enterprise is the use of entrepreneurial drive and a market-driven business model to address key social or environmental issues. In the EU and in the Western Balkan countries, as in the rest of the world, the social economy sector has become increasingly market driven due to constraints on the public social budget and efficiency considerations in the public sector. The recent economic and financial crisis has increased this trend. In this context, social enterprises are likely to play an increasing role in the pursuit of social goals, including the conception, implementation and funding of social sector projects, and are deserving of support from national governments and European and international organisations. The concept of social entrepreneurship is not yet very developed in the Western Balkans although it is gaining more attention through the efforts of the Regional Cooperation Council (RCC).

Investment lending versus *sectoral approach* is an important issue for social sector projects in the Western Balkans. This has an impact in terms of what is being financed and how conditionality is defined. Traditionally, the IFIs and the EC have concentrated on 'investment lending', supporting specific projects in the social sub-sectors of education, health and social housing. In this context the funds being lent or granted have been disbursed for construction costs or for the procurement of specific furniture, equipment, teaching materials, drugs or specialised services, including training, directly related to a specific social sector infrastructure, such as schools, hospitals or other health centres, or particular blocks of social housing or penitentiary facilities. However, in some cases, conditionality is not exclusively linked to the content and the management of the specific project being financed, but to broader policy reforms so that some of

these operations can genuinely be seen as sectoral operations supporting the overall sector reforms in the context of a *sectoral approach*.

#### **4. EXPERIENCE OF THE NEW EU MEMBER STATES AND OECD COUNTRIES**

It is useful to compare the current situation in the Western Balkans in terms of social sector quality and investment to that of the new EU Member States (NMS) as they moved towards EU membership.

It appears that public spending on education in NMS increased during the accession period in comparison with the pre-accession period, both expressed as a percentage of GDP and as a percentage of total government expenditure, indicating the recognition in the NMS of the importance of investing in education, partly to be able to compete with the EU labour force once integrated. In contrast, the Western Balkan countries currently spend a lower percentage of their GDP on education. In terms of indicators of education quality, the primary education completion rate increased in all NMS during the accession period, and was higher on average in NMS at accession time in comparison to the current situation in the Western Balkans. In terms of primary school enrolment, the current situation in the Western Balkans is on average somewhat better in comparison to the situation in NMS in the eighties and early nineties. In terms of tertiary school enrolment, it is currently higher in the Western Balkans on average, than in NMS after accession. The current average level of health expenditure per capita in Purchasing Power Parity terms is actually comparable to the average in NMS upon their accession. This may indicate that the main issue in the health sector is not so much the volume of resources, as the efficiency of spending in the health sector in the Western Balkans.

A range of new formulas have already been tried in various Organisation for Economic Cooperation and Development (OECD) countries in addressing complex social needs, in particular social integration, poverty alleviation and the provision of education, health, social housing and other social services to the population, including the most vulnerable groups. Social entrepreneurship and social enterprises for example flourished in some OECD countries, in particular in the USA, but work mostly at the local level on a rather small scale.

PPPs deserve a special mention in the context of reviewing the experience of NMS and/or OECD countries, particularly in the social sector, as they have to be tested first in more advanced market economies before they can be transposed to transition countries such as NMS or the Western Balkan countries. For PPPs in the social sector, it is crucial to have strict regulation and monitoring, as this area affects basic human rights and needs, especially since in a market-oriented partnership the poor and vulnerable are not usually the focus of the private partner. Consequently, while the popularity of PPPs in the social sector is on the rise, PPPs in this sector must be approached with maximum care, as their success is conditional upon comprehensive planning and hands-on monitoring by the public sector. This may pose a problem, especially in developing or transition economies such as those of the Western Balkans, with weaker/less capable public sector partners.

## 5. CONCLUSIONS

Some implications for financing social sector projects in the Western Balkans are the outlined below.

### 5.1 Building the intellectual case for a higher level of social sector project financing

Attention to the social needs of the population and investment in social infrastructure are of vital importance for the balanced development of the Western Balkan countries. Indeed, these social needs and related infrastructure may not be given the necessary degree of priority in national policies in the face of vested interests. There is a real need for support from external financiers. Financial incentives from financiers could be coordinated more effectively, and might help national governments to focus more effectively on social policies.

Keeping in mind the crisis, which has widened and exacerbated the existing gap between the need and means for social inclusion, one of the first tasks of external financiers should be to sustain, if not expand, their level of activity in the social sector, using moral suasion if necessary to persuade governments in the Western Balkan countries to change their approach. To give a more solid basis to this suasion, the intellectual case for financing social sector projects needs to be strengthened. As shown in the report, important elements can be found in the various reports already prepared by several WBIF partners. In addition, the new window within WBIF for sectoral studies could provide a valuable opportunity for WBIF financiers and beneficiaries to undertake specific, tailored studies to guide the choice of investments in the different areas of the social sector.

### 5.2 Adopting a more strategic approach

As outlined above, projects in the Western Balkan countries need to be designed in the framework of sectoral strategies. With the EC proposal to move to sector-based programming in the framework of IPA 2 and to make even greater use of loan/grant blending mechanisms such as the WBIF, it seems that the moment is right for the introduction of a more strategic approach under the WBIF in its support for reforms and investments in the social sectors in the Western Balkans. This does not mean that all IFIs have to adopt a specific *sectoral approach* in each of the Western Balkan countries, but all investment loans should be consistent with such a *sectoral approach* and contribute through their design and/or conditionality to its achievement. The report includes specific recommendations on how this approach could be implemented in the various social sectors.

### 5.3 Better blending of loans and grants, financial and technical assistance

The prevailing crisis situation only increases the need for more systematic combinations of loans and grants in support of investment and technical assistance components of

social sector projects. With the borrowing capacity of the Western Balkan countries more and more constrained for fiscal reasons, leveraging with concessional or grant resources will be more necessary than ever. What matters most, however, is consistency in the pursuit of policy reforms that would enable the Western Balkan countries to achieve as much as possible in terms of the effective delivery of social services and poverty alleviation with possibly fewer resources. This also means that sometimes the proper balance between investment and technical assistance is as, or even more, important than the balance between market related and concessional resources. Institution building and capacity development are the key to success in the complex fields of education, health, social housing and other areas involving the delivery of social services. The capacity to design and implement projects or programmes involving significant policy reform and which benefit from a strong local and/or national ownership is something that can only be home-grown. However, such capacity development can greatly benefit from appropriate financial and technical support from the WBIF.

#### **5.4 More consistency with the EU enlargement strategy**

The most recent Communication from the Commission to the EP and the Council on the *Enlargement Strategy and Main Challenges 2011–2012* recalls that the Commission ‘emphasises employment and social policies in its policy dialogue and encourages enlargement countries to set clear and realistic targets in these two areas and to better prioritise social spending’, adding that ‘the European Platform against Poverty and Social Exclusion should be taken up as appropriate’. It also highlighted that ‘little real investment has occurred in the social sector and that cooperation with international donors faced obstacles in strategic planning’. The Commission has proposed, among others, to develop a Western Balkans Platform on education and training, based on the open method of coordination, to allow for the participation of all enlargement countries. This will enhance dialogue on key policy challenges and contribute to securing effective implementation and monitoring. The countries of the Western Balkans have also been invited to participate in the centralised activities of the EU’s Lifelong Learning Programme. These countries should utilise these opportunities with the support of the relevant financing instruments such as IPA and possibly WBIF.

#### **5.5 Consistency with Europe 2020 Strategy**

The Europe 2020 Strategy for Smart, Sustainable and Inclusive Growth can provide the Western Balkan countries with a framework to anchor policy reforms and to mainstream an enhanced attention to reforms in the social sectors, which need to be associated with economic reforms and which will not happen without adequate financing. There is a definite convergence between the three pillars of the Europe 2020 Strategy and the financing of social sector projects.

However, although Europe 2020 points to the general direction in which the EU is heading by the end of this decade, the Western Balkan countries cannot simply transpose Europe 2020 targets

and policy objectives into their development strategies, for its goals are far removed from what is realistically achievable in the region. Countries can emulate the strategy individually, and some have already embarked on this path. However, given the shared challenges faced by SEE and the nature of the strategy's governance for reform, coordination between countries is imperative and essential. As at EU level, a strong case can be made for a regional, Western Balkan dimension to Europe 2020, both in terms of setting regionally relevant targets and in establishing benchmarks and monitoring implementation. The RCC has been mandated to facilitate the development of regional targets for a Europe 2020 approach in the Western Balkans - the so-called SEE 2020 and this should be supported by the WBIF as appropriate.

### **5.6 Be innovative and involve the private sector and NGOs in implementing social sector projects**

The social sector and more specifically social inclusion projects have some features that make them most appropriate for the involvement of Non-governmental organisations (NGOs). These types of projects are quite often the sum of several small or even tiny projects requiring a deep level of involvement at the point of delivery, while also demanding organisational and social skills. This is clearly out of reach for a large-scale institution such as a bank, be it public or commercial. However, finding ways to link the financial capacity and experience of a financial institution with the in-the-field experience of focused NGOs remains a major challenge.

More generally, attention should be given to the financing of 'social entrepreneurs' and 'social enterprises', i.e. entrepreneurs and enterprises who recognise a social problem and use market-based business principles to organise, create and manage a venture to achieve social change. While a business entrepreneur typically measures performance in profit and return, a social entrepreneur focuses on creating social capital.

Another formula is social services delivery through 'community based projects'. These are projects that supply services to vulnerable individuals and families to reduce or escape poverty and exclusion and lead to a fuller and/or more satisfying life. Most decisions on how to run a subproject, including responsibility for its implementation, rest at the community level, either with local government or civil society (again NGOs and local social entrepreneurs). In the context of the EU countries and to a certain extent the Western Balkans, quite often it is not the lack of funds available European Regional Development Funds (ERDF) or Instruments for Pre-Accession Assistance (IPA) funds but the lack of organisational knowledge and/or the lack of basic skills to deliver administrative requirements that hamper access to these funds. Here again, NGOs could play an increased role, and to a degree are slowly doing so. Such a role is essential in helping local groups to tap these financial resources. Linking the work of these NGOs with local communities and the financial strength and expertise of financial institutions would unleash an enormous potential for what could be called 'social leverage' as opposed to mere financial leverage. The WBIF should examine innovative ways to support such an approach.

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## CHAPTER 3.

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### **Social Agenda 2020 for the Western Balkans at the Time of the Economic Crisis: a Regional Perspective**

Nand Shani

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#### **1. INTRODUCTION**

The past two decades have been characterized by rapid and substantial economic and social changes in South East Europe. Liberalization and privatization have created new job and business opportunities but have also increased unemployment and wage disparities. Structural changes have greatly affected relatively inflexible labor markets, resulting in a fall in employment and considerable underutilization of labor. Starting from a roughly egalitarian base at the onset of transition, inequality has increased mostly due to changes in labor market outcomes. On the other hand, social transfers have moderated income inequality. However, the sustainability of social insurance systems, which has had a tendency to defend full access to old age pension, disability payments and health protection, is currently being questioned across the region. The unemployed, rural population, women, youth, those with disabilities and other disadvantaged social groups have been confronted with difficult social challenges. Many of them have been unable to fully benefit from current social policies and join others in reaping the benefits of economic growth. Furthermore, the recent economic crisis has put a strain on budgetary resources and the shrinkage of fiscal space not only prevents governments from expanding expensive social programs, but also threatens the sustainability of current programs. After a surge in the first half of transition, poverty incidence has declined substantially, but the trend has more recently reversed due to the economic crisis. Quality public health service delivery remains a challenge.

The recent economic crisis has highlighted the vulnerability of the current model of growth fueled by domestic consumption and cheap capital inflows, and the need for further reform. A major challenge for the South East European (SEE) countries is to implement economic and social reforms aimed at sustainable development, increasing living standards, greater economic

adaptability to the changing global economy, labor market reforms, improving working conditions and better social protection.

Full EU membership stands as a strong incentive for these countries to implement reforms along a path that has to be clearly defined along that direction. A considerable portion of the European *acquis communautaire* contains requirements related to social policy issues (e.g. employment, social dialogue, occupational health and safety, public health etc.). While there is no single ideal social model, many EU countries' experiences provide a good base against which the countries of SEE can measure progress in their social policies' deliberation and implementation.

Regional cooperation can be an important tool for accelerating economic growth, improving productivity and competitiveness, increasing employment and advancing governance standards. It can produce positive reform spillover effects at national level, while countries can exploit economies of scale in addressing common issues.

Countries in SEE have long recognized the importance of regional cooperation. The Regional Cooperation Council (RCC) was established in 2008, succeeding the Stability Pact for SEE and providing operational capacities to the SEE Cooperation Process (SEECp). It constitutes the major focal point for regionally-owned cooperation in SEE, through assisting the SEECp, representing the region as a whole, guiding and monitoring regional activities, exerting leadership in regional cooperation, providing a regional perspective in donor assistance – notably the EU's Instrument for Pre-accession Assistance (IPA) programme – and supporting increased involvement of civil society and bottom up approaches in regional activities in the areas of economic and social development, energy and infrastructure, justice and home affairs, security cooperation, building human capital and cross-cutting issues, and media development.

SEE is also densely populated with numerous regional cooperation taskforces and initiatives. They constitute an important asset for the region in supporting reforms through coordinated efforts. Several of them address key social development issues.

National Employment Services meet regularly in the framework of the Center of Public Employment Services of South East Europe. The Center promotes the exchange of information and experiences related to providing relevant services to employers and those seeking jobs, as well as the improvement of public employment services' capacities in South East Europe.

Health is seen as an important contributor to economic development through its impact on productivity and public spending on illness. All countries are working towards strengthening the primary health care sector, sustained by investment in physical and human resources. Public health services remain under-funded and remain in need of further reform.

The South-eastern Europe Health Network (SEEHN) is a forum of high level officials of the Ministries of Health of South East Europe (SEE). It has been a very active regional cooperation mechanism in the realm of public health during the past decade. Several regional technical health projects are implemented in close coordination among member countries (mental health, communicable diseases surveillance and response, food safety and nutrition, tobacco control, blood safety and blood components, social and health information systems, maternal and

neonatal health, strengthening public health services). The Banja Luka pledge, signed in October 2011 at the Third Health Ministers' Forum, ensured renewed political commitment for regional cooperation on public health in SEE, with a special focus on health in all policies approach. The on-going establishment of Regional Health Development Centers is contributing to transforming the earlier regional projects into long-term health programs and centers of excellence.

The SEE Trade Union Forum and the Adriatic Region Employers' Center provide platforms for trade unions and employers' organizations respectively to meet at regional level to jointly strengthen organizational capacities and contribute to on-going economic reforms in the region.

The London School of Economics Social Cohesion Research Network also provides a much needed regional forum where academics and researchers from the region contribute with their work on social development topics. Such analytical work at the regional level is crucial to informing social policy making in the context of a post-crisis SEE, the impact of which is not yet fully realized.

Information and communication technologies carry a horizontal function across different development priorities and play an important role in improving people's quality of life, by contributing to economic, social, and human development. RCC focuses its efforts on promoting and supporting the implementation of the Electronic South East Europe Initiative (eSEE) Agenda Plus, which identifies the achievement of an inclusive information society as a major priority for poverty reduction and economic development. It includes access to technology and equal opportunities, e-Government issues, digital libraries and heritage, as well as e-business, e-participation and e-democracy. The most recent high level Information Society conference, held in November 2011 in Tirana, Albania, reiterated the importance of fostering the inclusive aspect of ICT, and the readiness to take concerted action in the area of e-accessibility.

## **2. SOCIAL AGENDA 2020 FOR THE WESTERN BALKANS**

The core of the development model in the region will continue to be the deep integration with the EU. The EU accession process provides a legal and institutional anchor and a strong driver for systemic reforms. In this context, RCC has started a discussion on how countries from the region can work together towards establishing a long-term vision of development and action plan that will help align the Western Balkans with the EU agenda and specifically the Europe 2020 Strategy.

The SEE Investment Committee, which operates under the RCC auspices, aims to strengthen regional cooperation in investment and competitiveness related reforms. Its recent activities have focused on the goal of formulating the role and objectives of a SEE 2020 strategy compliant to the strategic needs of the countries. This joint effort is to ultimately lead to the determination of regional headline objectives and targets, with indicators for their attainment, in the priority areas determined by the EU 2020 Strategy but also taking into account the specificities of the region: integrated, smart, inclusive, and sustainable growth within a good governance framework.

In the context of its Strategy and Work Programme for the period 2011-2013, RCC has also recognized the importance of mainstreaming social considerations in all economic reforms implemented in the region through a broad consultative process. In cooperation with Friedrich

Ebert Foundation (FES), RCC has initiated a structured regional dialogue with the governments, social partners and civil society organizations on establishing a long term social development vision for the Western Balkans, the so called Social Agenda 2020, with the aim to strengthen regional cooperation in employment and social policy-making in the Western Balkan and developing a regionally owned response to the social aspects of the Europe 2020 Strategy, which will ensure the sustainability, comprehensiveness, equity, efficiency, and effectiveness of social policies, as well as link and mainstream such policies into current and future economic reform processes.

This process aims to identify social policy priorities, elaborate a social development vision and action plan closely integrated with economic policy reforms and determine social policy targets that could then be measured across the region. Important concrete social priorities have been discussed and agreed upon in regional events (employment generation with a focus on new skills for new jobs, social entrepreneurship as a tool to address social challenges, labor mobility, social protection and security, social inclusion and adoption of social *acquis*/preparation for utilization of pre-accession EU funds). The regular events organized by RCC and FES in this framework have also helped raise the awareness of different stakeholders about the importance of social policies and constitute building blocks of the regional vision for the future of social policies in SEE.

Social Agenda 2020 will contribute to developing a regional sector approach in the area of social development as well as to coordinating and expediting social policy reforms through establishing a sustainable regional network with clear commitments and mandate anchored in the SEE 2020 process that will compile a policy toolkit to implement that mandate.

A set of regional social headline targets and measurable indicators for 2020 monitored within a transparent governance mechanism will need to be established. Countries will identify priority areas and adopt a set of quantifiable, measurable and time-bound targets and indicators at a political level. Regular annual reporting on progress will be conducted and concrete actions will be identified to address the main challenges.

In light of the accession process, target-setting for the Western Balkan countries will help them to better align with EU policies and strategies. Such targets are important because they would demonstrate commitment to address selected priority issues and help governments focus attention, resources and ensure greater accountability of their actions. It will also be important to create a regional momentum for reform, building on existing national priorities and strategies. Setting targets at the regional level is however a complex process that requires a lot of preparation since the targets should be relevant, well-defined, time-bound, comparable and verifiable.

In order to improve policy design and implementation in the area of employment and social policy, a set of possible tools could be used such as: policy analysis and research, period peer reviews, regional training workshops, e-platforms for knowledge sharing and promoting best practice; regional social indicators databases/information systems, and concrete regional programs that can contribute to employment generation, poverty reduction and social inclusion (such as matching skills demand and supply, enabling environment for social entrepreneurship, sustainable development of least developed regions, regional labor mobility, etc.).

Social Agenda 2020 will also contribute to increasing the capacity of beneficiaries in adoption of *acquis* and absorption of pre-accession EU assistance relating to social development.

While government stakeholders are the main target of RCC activities, the need for stronger social partnership is eminent so that social development is promoted through an all-inclusive approach. There is broad consensus that the reform process should include all stakeholders in order to ensure real ownership and greater engagement and contribution. Permanent consultations with relevant stakeholders are essential to ensuring transparent and consensus-based decision-making. In this context, it is also important for social partners to be better organized and have stronger dialogue and coordination among them.

Given the similar structural landscape of the SEE countries, the continuous exchange of know-how and experience will also make the reform process more efficient and cost-effective. Furthermore, in view of the interdependence created by the regional integration and globalization trends, they also provide the ground for exploring the scope for transnational social policies. RCC will coordinate the activities and serve as a platform for advocacy as well as dissemination and promotion of conclusions. Through stimulating action at the regional level that enables policymakers leverage change at the national level, RCC will continue to support national social models by helping to build consensus on the need for economic and social reform.

#### AREAS FOR FOCUSED REGIONAL COOPERATION

During the past 2 years the Western Balkan countries have agreed on the following **objectives of social policies** in the region and on the need for concerted action to that end:

- Broaden the focus of social policies from traditional sector approaches and poverty alleviation programs toward a more comprehensive and integrated view of social, human, and economic development - **addressing the central goal of human development.**
- **Employment goals should be at the core of economic and social policy**, thus full and productive employment must be made a key objective of overall national economic policies. A special focus should be given to the needs of those most vulnerable to unemployment, especially youth and long term unemployed.
- **Develop inclusive labor markets and social cohesion** require special focus on marginalized social groups (disabled, women, youth, minorities etc.), in order to eliminate discrimination and assist them to overcome their disadvantages. Social security systems must be designed to advance employment promotion, while providing decent income support for those without a job.
- Strengthen **governance** of labor markets and social protection systems (laws, institutions and processes).
- Protect the **safety, health and welfare** of workers through the implementation of international occupational safety and health standards.
- **Strengthen bipartite and tripartite social dialogue** – The region of Southeast Europe lacks a strong tradition of social dialogue. Basic institutional structures have been created over the past two decades and considerable investment has gone into the capacity building of social partners since. Given the on-going efforts of regional governments to develop measures aimed at ameliorating the economic crisis, the time is also ripe to insert the social partners into the current economic policy debate.

- Social policies must also be **financially sustainable** for long-term results. Pensions and health insurance need to both contribute to wellbeing and be sustainable over time.
- **Labor mobility** is an important contributor to employment generation and economic development, but the effects on different countries and the region as a whole must also be taken into account.

### 3. SOME CONCRETE INITIATIVES

#### 3.1 New Skills for New Jobs

Inspired by the Europe 2020 Strategy, RCC has facilitated the organization of two regional events on new skills for new jobs. There is common agreement and prompt action needs to be taken in order to better integrate employment, skills provision, and industrial/investment policies for promoting decent work; improve capacities to anticipate and align skills provision through sector approaches; ensure the faster responsiveness of education and training systems to the needs of labour market; set up government incentives for educational and training institutions to respond quickly to provide skills for sectors of potential growth for our economies; increase focus on key competences, while striking a reasonable balance between higher education and vocational education and training; re-skill people over their lifetime and enhance the employability of older workers; develop the capacities to collect, process, use and monitor data and information on skills needs in key and strategic sectors. Grey economy remains a big concern because informal employment is associated with low skills and incomes, poverty and vulnerability, but also prevents a good understanding of labor market.

#### 3.2 Women Entrepreneurship – A Job Creation Engine for SEE

The project, coordinated by RCC, implemented by the SEE Center for Entrepreneurial Learning and Gender Task Force and financed by Swedish International Development Cooperation Agency, aims to boost women entrepreneurship in SEE through combined public and private sector efforts, with a focus on promoting best policy practices in women entrepreneurship and capacity building of women entrepreneurs associations.

The project is contributing to raising awareness and initiating dialogue on women entrepreneurship policies in accordance with relevant Small Business Act principles and enhancing of capacities of women entrepreneurs' associations/networks.

#### 3.3 Social entrepreneurship

Social entrepreneurship is a powerful and effective instrument for addressing social problems. Many such problems take an acute form in our region, including unemployment, health and sanitation, pollution, old age, needs of disadvantaged groups etc. A better understanding of the current situation of social entrepreneurship development in the region is required. Strengthened networking and exchange of experience can contribute to promote the social entrepreneurship concept, enable a

stronger voice in support of a social enterprise friendly business environment and build capacities of social entrepreneurs. RCC is actively cooperating with the eco-social economy network in SEE to promote social entrepreneurship.

#### **4. CONCLUSIONS**

The global economic crisis has been strongly felt in SEE. As countries work on finding ways to mitigate its impact and identify new paths of growth and development, while fully engaged in the EU accession process, it remains important to mainstream social development in economic policy reforms. Regional cooperation can be an important tool for promoting social development, for jointly addressing the challenges of the crisis and for good preparation and adjustment for EU membership. Full alignment with the Europe 2020 inclusive growth agenda is a mandatory approach for successfully defining and implementing a regional social development agenda in the Western Balkans. RCC is committed to working with the countries in the region towards jointly pursuing overall and balanced social development in the region.





## CHAPTER 4.

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### **Past imperfect, present tense: institutional challenges in Albania at a time of uncertainty**

Enkeleida Tahiraj

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#### **1. INTRODUCTION**

The global downturn due to the financial crisis has given a new dimension to old problems across the social policy domain, especially as regards responses to poverty and social cohesion. This chapter addresses the economic and social impacts of the on-going crisis in Albania and seeks to gain a perspective on how the continuing climate of economic uncertainty is affecting policy making, especially as concerns social cohesion.

Social cohesion involves many aspects of social and political life, however the scope of this chapter is restricted to key institutional concerns in employment and welfare. The chapter's opening review of the economic and social impact of the crisis in Albania investigates the 'business as usual' approach in policy making despite slowing economic growth. On closer inspection, the crisis has revealed deep structural problems and fissures in the social and political structure, both predating and consequent to the crisis.

The economic slowdown has shown that Albania's growth has been heavily dependent upon external conditions. With poverty reduction strategies predicated on continuing economic growth, no longer assured, the challenge for social policy becomes one of maintaining past social gains, at a time in which material prospects appear to be diminishing. An examination of the performance of the social safety net identifies some characteristics of the current system that present internal and external challenges for state institutions, especially in the context of harmonisation with European values and concepts.

The prospect of EU membership has offered a point of reference for government and citizens. It has been indeed a key driver for change with the former instigating reform and the latter influencing policy trajectories by way of consultations. The EU-2020 Strategy has brought fresh

impetus to efforts to improve social cohesion as a crucial dimension in furthering social and economic development. This poses multiple challenges for policy makers, hastening the need to design and implement policies that incorporate social cohesion. All this is taking place in the face of increased pressures such as the effect of price shocks on vulnerable people and increasing resource and budget constraints in an already weak welfare system. In closing, the chapter discusses ways to address institutional and policy legacies head of future challenges.

## 2. MACRO-ECONOMIC ENVIRONMENT

Given the centrality of economic growth to Albanian social policy it is crucial to understand the nature and extent of growth historically and the consequences of expectations for future growth. The fallout from the global crisis came to Albania belatedly and somewhat mutedly: the economy avoided recession and is the only SEE country to not experience a decline in annual GDP in the period 2007 to 2012. However, long-term vulnerabilities remain, including increasing public debt, growing trade and current account deficits, reduced credit growth and continued fiscal expansion in the face of weak tax collection capacities. Given also that growth was highly contingent on the performance of the wider regional economy, particularly the EU markets of Italy and Greece, the strong economic growth of recent years is not expected to resume in the short term.

Prior to 2007/08 Albania enjoyed an impressive decade of economic growth with headline indicators of GDP growth averaging 6.3% per annum for the period 1994 to 2003 and 6% from 2004-2008 (Table 1). Albania's GDP per capita<sup>17</sup> increased from US \$7,182 in 2000 to an estimated US \$8,592 in 2010. While some of this growth originated from the outward processing trade, expanding tourism and mining sectors, a large part was due to a construction boom and increasing consumer demand, met mostly by imports and funded by remittances and credit expansion.

All the indicators are that while Albania is the only SEE country not to experience contraction since the crisis took hold, the trend of growth has fallen. Real GDP growth since 2008 remain below the rapid rates experienced in the past, falling to 3.3% in 2009 and 3.5% in 2010 and 2.0% in 2011 (Table 1).

**TABLE 1: Real GDP growth in Albania: actual and projected**

	Average	2004	2005	2006	2007	2008	2009	2010	2011	Projections		
	1994-2003									2012	2013	2017
Albania	6.3	5.7	5.8	5.4	5.9	7.5	3.3	3.5	2.0	0.5	1.7	2.5

Source: World Economic Outlook, IMF 2012a

It is clear that the government has been an increasingly important driver of previous high growth rates since 2007. It is also apparent that such opportunities will be limited going

<sup>17</sup> In current dollars on an international purchasing-power parity basis.

forward. Private sector growth since 2008 has underperformed chiefly due to stagnant consumer demand, a contraction in private credit and decreases in exports. In the face of this, Government has expanded its program of capital investments funded by external borrowing and fiscal consolidation. The Government has attempted to maintain unsupervised continuation of IMF<sup>18</sup>-sponsored policies in the short to medium term. However, balancing the requirements of fiscal policy with the need to maintain macroeconomic stability (Tahiraj and Kaser, 2012) has proved a challenge and recent years have seen a growing budget deficit. The general government debt ratio, at 59.4% of GDP (INSTAT, 2011), while relatively low against Western European levels remains high compared to the region average of 40%. This level is close to the GoA statutory limit of 60% and well above the 50% ratio considered sustainable (IMF 2011). Indeed, the situation is considered so critical that on September 2012 a reported IMF mission reportedly arrived to Albania to advise the GoA again on the urgent need to reduce the level of debt and budget deficit. The possibilities for stimulating demand and growth through further public investment are therefore constrained.

### **3. SOCIAL COSTS**

In spite of the relatively benign apparent effects of the crisis thus far presented, it is well to remember that the burden of crisis effects is distributed unequally on the population and its impact will vary greatly between regions, groups and over time (Davies et al., 2009). That said, there is precious little official data to offer more than a glimpse into the complete picture and social impacts, in terms of life opportunities and living standards. Therefore, conditions and trends in the labour market among others will serve as basis for analysis.

Seemingly almost resistant to any reform, the labour market remains weakly developed, with high levels of informality, low activity and employment rates and high levels of structural unemployment. Unsurprisingly given the weak private sector growth already noted, job creation in manufacturing, construction and service sectors has been insufficient to recover fully from the wholesale labour shedding that occurred during the early years of transition.

In the private sector, the generally low level of qualifications of the labour force hampers competitiveness. Continued weak linkages between education and employment add to a mismatch of supply and demand which institutions such as the National Employment Service and an outdated VET system have been unable to adequately address. In the absence of a vibrant job market in the private sector graduates either look to the more secure public sector or abroad, the latter resulting to a 'brain drain' which is significant in terms of lost human capital. In contrast to the private sector, which has seen a fall in real incomes in the last decade, the public sector has burgeoned in numbers and in remuneration with public sector employees enjoying annual wage rises between 8% and 15% since 2001. As a result, the public sector has accommodated much of recent graduate supply.

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<sup>18</sup> Since 2009 IMF maintains only an advisory role with no resident representative in Albania (Article IV).

The labour market cannot be considered inclusive. It remains characterised by high, albeit declining, levels of subsistence engagement in the agricultural private sector. Equally, participation rates for young people, people with disabilities and ethnic minorities such as Roma in particular remain very low. Even the closing of the gap in employment rates across gender post-2010 (Figure 1) looks less positive on closer inspection: although we are without data, it can be expected that discriminatory pay differentials remain intact and might be a causal factor as entities seek to reduce labour costs.

**FIGURE 1: Labour Force Balance, 2000-2011**



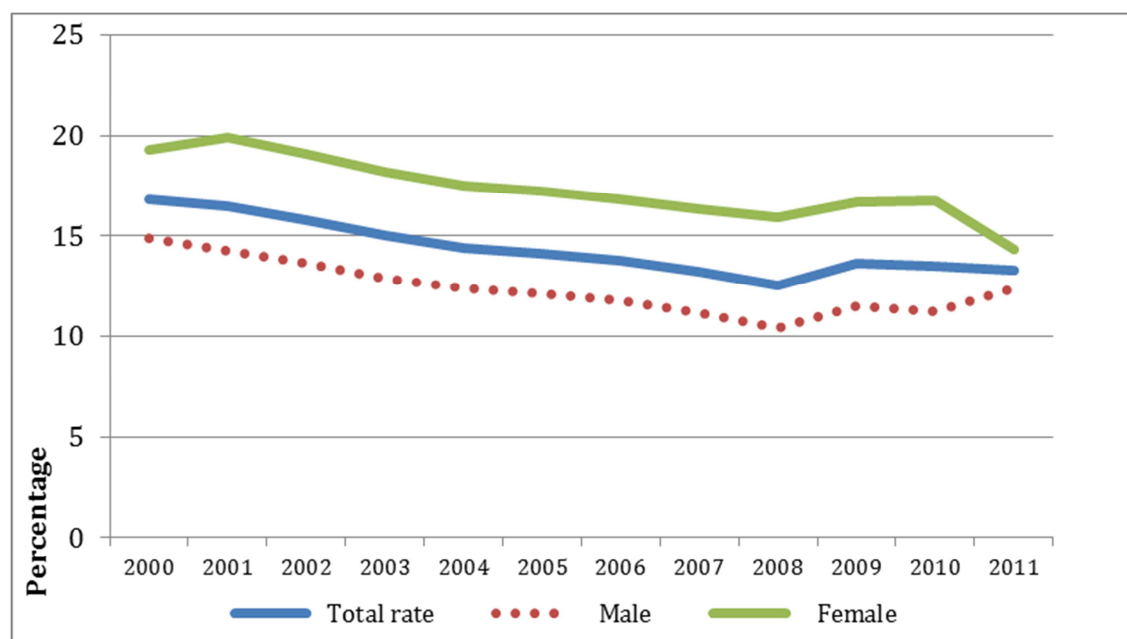
Source: INSTAT, Administrative Data & Labour Force Survey 2009.

Data on unemployment reinforces this suspicion, with increases in male unemployment almost matching declines in female unemployment. Seemingly on a secular downward trend until 2008 (Figure 2), long-term unemployment has decreased to 62.3% of the total number of unemployed people in 2011 from 89.6% in 2000 (INSTAT, 2012). However, total registered unemployment is now above its low point of 12% to stand at 13.3% in 2011. Unemployment rates remain particularly elevated for those with low educational attainments, those aged 35 years or more, people with disabilities and on an ethnic basis. Equally, levels of discouraged workers remain high, in 2009 comprising 16.8% of the inactive population compared to the EU27 average of 4.2% in that year. This is especially so among young people, with 10.6% discouraged and inactive (compared to 4% in EU27), despite reductions in youth unemployment over the last decade.

The education system delivers a high literacy rate for those aged over 15 (99% in 2011). However, although this might be expected to provide a sound basis for a competitive labour market, short school careers of 8.6 years (INSTAT, 2012) and low educational attainments of the majority depress that prospect, and current low levels of educational expenditure risk seeing the Albanian educational system fall further behind (IMF, 2011). Issues remain with the quality of service delivery in the education system and in the value of having a degree, while the number of private schools and universities is increasing. The seeds of discouragement among youth are perhaps sown early. State education has remained free at point of delivery but, as with health care, much

is provided in dilapidated<sup>19</sup> facilities and access is difficult for many outside major conurbations and especially problematic for the poor. International aid in the field of education has for long focused on building infrastructure, yet, little attention has been paid to quality of the outcome, or issues of sustainability. Extreme cases have shown examples where schools have been built in villages and left there, not handed over to local communities- a result of box-ticking-projects in much international grassroots aid. Again as with health care, the system is inefficient and inequitable, fraught with corruption and incurring frequent out-of-pocket expenditures, with the poor suffering the most.

**FIGURE 2: Unemployment rates for the period 2000-2011**



Source: INSTAT and Administrative Data, 2012.

Poverty and inequality remain important determinants of social cohesion and although we lack national studies since 2008, there is objective and subjective evidence that the crisis won't help the national objective to reduce poverty headcount to below 10% by 2013 and eliminate extreme poverty (12.4% in 2010 from 18.5% in 2005) as part of its Millennium Goals (UNDP, 2010). The period of economic slowdown in growth has also seen a global rise in consumer prices due to inflationary pressures. Although the Albanian Government has been successful in targeting moderate official price inflation of 2-4%, domestic energy prices doubled in the period 2007-2011 (INSTAT, 2011). Nevertheless, expectations of raises in input costs remain low and the prices of domestic goods have not risen as fast as the prices of imported goods. This has somewhat favorably insulated the Albanian consumers from the price shocks experienced by other countries in the region. However, consumption is sensitive to global price levels, particularly in energy, and further increases could lead to lower demand and reduced lifestyle standards.

Additionally, the crisis has created new 'at risk' groups with more vulnerable middle and lower classes, attested to anecdotally although data is lacking. These include diverse groups such as

<sup>19</sup> Sometimes, due to constructions and renovations of poor quality.

émigrés returning from Greece and Italy having lost jobs in the host country, whose reintegration poses a challenge for policymakers to ensure sustainable return. Another group is composed of credit-burdened lower income households who, having enjoyed access to the opening up of new lines of consumer credit during the good times, are now facing rising costs of debt service. Coupled with income insecurity, as a result of it, the financial sector is seeing increasing numbers of non-performing loans and defaults. Indeed the announcement of the Bank of Albania in the early summer 2012 for the establishment of the bridge-bank shows that there is a risk the banks themselves are subject to internal risks too.

#### **4. PERFORMANCE OF THE SYSTEM**

Albania's welfare system has long suffered from evident flaws in design and deficiencies in resources, which the crisis has laid bare. However, we should be mindful how relatively new the institutions and policy frameworks of post-communist countries remain. The labour market and poverty-focused social policies for instance, were freshly established in transitional Albania, the previous communist regime upholding the achievement of 'full employment' and paying no official recognition to poverty. Such fantasies could not be sustained long into transition and new institutions of government were established with the technical and financial aid of external donors as part and parcel of political and economic reforms. Of course, the nature of state and donor interventions has evolved in the last twenty years, following the common path from crisis relief, to projects and programmes, to the current strategic approaches. In Albania, this has evolved to the current National Strategy for Development and Integration (NSDI, 2007). The NSDI subsumed the two broad schemes of Social Assistance and Social Security into an overarching strategy with social and economic development as its goal. Under this umbrella, social assistance became a properly residual scheme, sharply demarcated for poverty alleviation. This was to be achieved by virtue of inclusive economic growth. The success of this strategy was dependent on two conditions, ultimately linked and not so far adequately met:

- Continued real economic growth.
- Development of a viable system of social insurance and strengthened social service provision.

The first condition we have seen has been setback since 2008 and is far from assured going forward. The second condition we shall see was never adequately secured. The 'jobless' nature of growth, especially since 2008 (IMF, 2011) underscored its lack of inclusiveness and belied its poverty impact, once heralded as the key to poverty reduction. Indeed, the World Bank states that impact of growth on poverty has been achieved mainly through three ways. First, sectoral reallocations of employment which means people moving from private employment to jobs in the public sector, or from agriculture to jobs in the private sector. Such re-allocations mean that growth was not associated with new job creation. Second, migrant remittances sent to their families have served as a direct mechanism for coping with poverty. Third, increases in pensions and public sector wages have played a role with the former being part of a long effort to reform the unsustainable pension system" (ibid.). Since it is difficult to see how sectoral shifts contribute to poverty reduction or public sector pay relates to poverty as civil servants do not constitute a

category in poverty, of all these, only *remittances* and *pension rises* appear plausible explanations that growth has had an impact on poverty. And among remittances and pensions –only pension rise- is directly under the control of official policy.

Perhaps because of the survival of extended family in Albania, pensions are arguably the single most important instrument in the social policy regime. However, the pensions system has long been in need of reform (Vaso, 2003) without which questions of viability will only increase. The current system has issues in terms of benefit structure, which though somewhat redistributive remains compressed. This provides little incentive for people to contribute at all and/or declare correct income, resulting in low number of contributors (Bartlett et al., 2007). The burden of inter-generational transfer falls ill-proportionately and shows poor design and contingency planning. Present contributors are financing several generations of elderly beneficiaries, most of which have full pension rights irrespective of their own level of contribution. This issue weighs more heavily in the face of an uptick, if not trend, in unemployment as reported by INSTAT in May 2012<sup>20</sup>. Coupled with sizable 'longevity risk' - more people living longer - further pressures can be expected on the system that is not prepared for such demographic changes (IMF, 2012b).

A fundamental weakness in the system remains the low level of private provision, with a consequent almost total dependence on the state scheme. Therefore, at the administrative level proposals exist for a second pillar - a mandated, funded and privately managed defined contribution system- wherein contributions in the private sector would be mandatory. Yet, issues presently pertain to second pillar pensions that might call for further consideration before introduction of the pillar. For example, the climate since the onset of the financial crisis is not conducive to confidence in the ability of pension funds to sustain a return on investment that could offer provision at pensionable age. While created based on defined contribution, entitlements would greatly fluctuate over time and between funds. Without establishment of a strict regulatory environment concerning consumer choice, protection, fund management etc. - individuals and the pillar itself may be exposed to unacceptable risk (Vonk, 2007). No such environment is extant and, given prevailing institutional limitations in administering the current system, this development would not be playing to known strengths.<sup>21</sup> The potential success of this scheme is predicated on, among other things, employee rights, which remain friable. For example, in the current climate some larger commercial entities have been reportedly rewriting employee contracts to circumvent insurance obligations, so it is not clear that the extra burden of this scheme will be borne appropriately. Despite strong grounds for increasing private provision, the SII will need to establish a solid case for this introduction.

Necessary pension reforms are especially problematic due to low levels of private provision and the fact that state pensions form an important component of household income and poverty reduction. Irrespective of establishment of a secondary pillar, in order for the state pension to continue to provide anything similar to current levels of support to beneficiaries, it is imperative to achieve a substantial increase in the contribution ratio.

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<sup>20</sup> This trend may be related to the reported increases in return of émigrés from Italy and Greece as opportunities there dry up.

<sup>21</sup> Consider the social fallout from the 'pyramid scheme' style investment funds in the 1990's.



Additionally, other elements of welfare provision have not subsequently been adequately strengthened. Social service decentralisation has had limited success, perhaps because it was not accompanied by any deconsolidation of powers. Finances are still decided at the central level, while local units have to submit requests for funds according to locally identified needs. This has led to reported cases of 'mis-communication' as was non-payment of disability benefits in December 2011 in one region due to 'requests not being submitted in time'. Needless to say, that the effects of non-functioning decentralisation are felt directly on people in need. Officials at the central level, on the other hand express clear lack of faith in the existing capacities at the local level to handle decentralised power. There is a real need to strengthen local capacities, yet, commitment is wanting.

A closer look on social policy development shows that policy trajectory has been defined by resource constraints and input oriented budgeting. Social budget has been continuously low in relation to government expenditure and GDP, mainly due to economic domain prevailing over the social one. Being as a cause or result also to the design of social assistance as a residual regime. The steady decline in social expenditure in proportion to GDP has inhibited positive spillovers between social expenditure, productivity and poverty reduction (Cichon et al., 2009). In this way, a policy framework has been established in which institutional efforts, with varying levels of success across schemes, have been directed to mainly rationalising budgets. Two significant examples include the tightening of eligibility and the increased reliance on targeting of social assistance. The intention has been to reduce 'leakage' to non-poor social groups and increase the share of the poor who are covered by social assistance (IMF, 2011). This approach has resulted in a radical reduction in the number of beneficiaries and in curbing the scheme's poverty impact (UNICEF 2012). Such changes follow a long line of experiments to achieve a reported reduction in the number of beneficiaries, as was for example in 2002 introducing migration and emigration as an excluding criteria, when neither was officially regulated to accommodate positive outcomes for families. In the pension scheme, legal and fiscal measures to reduce the size of the informal economy and decrease the dependency ratio and state budget subsidies have not gained sufficient traction to counter the scheme's negative trends.

As a result, a volte-face in which service provision became prioritized over cash transfers effectively excluded many people in need. The social outcome of these policy developments has been a degree of welfare retrenchment and, at least from the perspective of service users, a mounting inefficacy of some programs. For example, fewer than 6% of the registered unemployed receive unemployment benefit (INSTAT, 2012). The costs of large numbers of citizens remaining outside insurance schemes are inevitably shifted to increased pressures on other programs. For instance, legal loopholes that had allowed people to benefit from various schemes, will be, starting from 2012, considered unconstitutional, hence all welfare sources are pooled together making it ineligible that one person can benefit from two schemes from the same source. So a recipient of disability benefit is not entitled to economic aid at the same time. This raises the undiscussed issue whether benefits should be a rights or budget based policy. Indeed, institutions must tackle many iatrogenic<sup>22</sup> artifacts in the wake of policy initiatives such as

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<sup>22</sup> Complications, unwanted effects following an intervention to improve a situation. The term is borrowed from the medical field.

scheme migration<sup>23</sup> and demand surges<sup>24</sup> as households rearrange living circumstances and develop stratagems to maximize utility. It remains to be seen what changed outcomes will be reported on the schemes following the recent changes.

#### Sources of resilience in the safety net

The second cost of weakened social insurance is in terms of social quality, chiefly through the consequent increase in reliance on informal means of welfare. Household strategies are a clear source of strength in the context of current welfare arrangements, providing flexibility in overcoming poverty traps and in cushioning the impact of the crisis. Given the strength of these informal coping systems, the prospects for poverty reduction and social cohesion are less bleak than would be suggested by consideration of official policy alone. A comparison of the impacts of pensions and remittance income on poverty reduction attest to this: pensions and remittances have been more influential, even crucial, in families coping with poverty than have the official programs aimed at reducing poverty. The formal welfare system has seen a role reversal in terms of poverty effect between social assistance and insurance, most notably for larger rural families (World Bank, 2004), whereby social insurance has in fact had the impact of a safety net., whereas the safety net itself has had little to no impact on poor families. This is due to small allocations, bureaucratic procedures, over-tightening of eligibility criteria as well as arbitrary subjective decision making on eligibility at the local level. Budgetary pressures imply a need for reform in the troubled pension system, but the costs of that reform may be expected to fall on participants in the form of increasing contributions allied to diminished and rescheduled entitlements, which in turn can be expected to weaken the future poverty reduction impact of pension schemes.

In contrast, although the crisis has affected migratory livelihood strategies and raised concerns for their sustainability, informal mechanisms in Albania appear to be more resilient. Paramount among coping strategies in Albania has been the flow of remittances, which although declining more than 10% from their 2008 peak of around €1m<sup>25</sup> remain among the highest in the world in relation to GDP. Remittances are a major source of private income, received by 22% of households; they amount to 47 % of average monthly income of recipients (IMF, 2006). They are especially important for poverty reduction as their impact overshadows official programs<sup>26</sup> and it is likely that the success of the informal part of the social safety net has played a large part in keeping welfare issues low down in the public policy agenda.

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<sup>23</sup> A near two-fold rise in disability cases over the last decade indicates the possibility of this migration, as people seek to avoid the compulsory workfare that is to be attached to Economic Aid.

<sup>24</sup> For instance, the requirement of ten years of contribution before retirement is believed to explain the notable step increase in levels of contracted employment of women age 45, before the official female retirement age of 55.

<sup>25</sup> FDI totalled €460m and exports €785m that year.

<sup>26</sup> Remittances appear to have a larger poverty reduction impact than all public transfers. While the latter have a greater impact in reducing the poverty head count, private transfers reduce the poverty gap and the severity of poverty much more than public transfers (WB, 2004).

## 5. INSTITUTIONAL CHALLENGES: TOWARDS A SOCIAL COHESION AGENDA

Given Albania's EU membership ambitions, it is expected that the process of harmonisation will play a crucial role in shaping social policy. Particularly, the still evolving framework of EU2020, with its rights based approach and focus on social cohesion will play an increasingly important and normative role. The degree to which Albanian stakeholders wish to or are able to achieve harmonisation will be a chief determinant of the rate of progress of Albanian accession.

The question for domestic actors in harmonising with EU frameworks is whether the social cohesion agenda should be an aim *per se*, if it can offer a new paradigm for growth and poverty reduction, or be some mixture of both. Moreover, which model of social cohesion - liberal or social market – should policy makers draw on? (Green and Janmaat, 2011). Evidence is mounting that a well-formed social cohesion agenda can be a positive factor in periods of crisis, and that appropriate policy reform in this area can stimulate growth (OECD, 2012) and hence reduce poverty. While integrated labour market policies, access to social safety nets and quality public services reinforce social cohesion (GIZ, 2011), cohesion is not simply plugging gaps but also about addressing issues with the social sphere. Cohesion is crucial in preventing weak states turning into fragile and unstable states (Kaplan, 2008) - a path down which economic shocks have previously led the country. This becomes imperative as recent studies on the social unrest in the EU member states show to be a result of disillusionment of democracy as practiced today, rather than financial austerity as portrayed by the political elites (Kaldor et al. 2012). Albania faces multiple challenges apart from an uncertain global economic recovery, a much needed judicial reform, 'including political instability' that could potentially deter foreign investment and stall European ambitions (European Commission, 2010). In this context, a social agenda may increase confidence in reform implementation and reduce discouragement among the inactive labour force (Easterly, et al. 2006).

The residual welfare system adopted in Albania was designed within a specific national context, notably in accommodating widespread informal welfare strategies. It effectively became a scheme composed of both explicit aim at helping people and implicit welfare aspects, which are often anomic<sup>27</sup> (Tahiraj, 2007). The implicit aspects of welfare include 'acceptance' that people use informal work, subsistence agriculture and migration among other coping mechanisms. These remain beyond the reach of policymakers but define the policy landscape -we accept they exist and that justifies limited policy intervention, - diluting so efforts at formalization and fiscal consolidation. They also weaken the social insurance system that forms a central aspect of the residual welfare regime and impede more active measures of social assistance, which have continually failed to develop beyond the pilot phase. Moreover, initiatives designed to strengthen the formal safety net have been undermined by the necessity to avoid the 'crowding out' of informal transfers. For instance, continued reliance on informal labour has been a major block on increasing coverage of social insurance.

In addition to policy risks, there are also institutional risks to the agenda of social cohesion. While strategic frameworks promote the ideals of continuity, integration in policy design and

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<sup>27</sup> Here meaning as socially unstable.

implementation (IMF, 2006), following Murdoch (1999) it would not be unfair to characterise many policy developments as efforts to patch a weak safety net with limited tools. Low domestic capacities have diminished institutional effectiveness, becoming most apparent in the almost complete reliance on foreign technical aid across the policy making cycle (IMF, 2006)<sup>28</sup>.

This chapter has shown that the Albanian economy and social protection system as a whole has so far suffered only a limited impact from the recent crisis and economic downturn – ironically, aided in part by the comparative lack of economic development and resulting insulation from the world of high finance. However, the poor are not impervious to global changes, especially to rises in basic food prices. The strategy for poverty reduction through economic growth was always subject to the risk that economic growth would falter. This was reflected in the adoption of the residual system combining formal and informal mechanisms and de-linking poverty reduction expected from economic growth -hence left to the market, from poverty alleviation which is based on passive social protection measures. In Albania, pension reform is also likely to be difficult since private provision is low and pensions form an important component of household income and make a major contribution to poverty reduction.

The response of social policy to the economic downturn has so far been muted and the programme of improving the targeting of social assistance has continued in its old route of patching holes but making little progress. While addressing some existing flaws, there has been little preparation for the road ahead due to institutional inertia, a lack of political imperative the strength of informal strategies and the resilience of a population habituated to hard times. Circumstances are changing rapidly however and both formal and informal tiers of the social protection mechanism are undoubtedly weakened. Despite fiscal consolidation, budgetary pressures weigh down on formal social protection mechanisms while decreasing remittances offer less informal social protection than before. The crisis has revealed and exacerbated such systemic flaws. It has called into question the sustainability of the social insurance scheme in its current form. The low levels of support that have been provided by formal social assistance imply that households have continued to rely on traditional informal strategies. Going forward, therefore, this situation poses a sizeable risk to any meaningful cohesion agenda, the establishment of which may stretch the ability of institutions to contend with the growing problems of social exclusion.

## 6. CONCLUSION

Considerable success in poverty alleviation was achieved in the ‘good times’ but in the form of social policy mildly complementing household strategies. This system was based on balanced measures of poverty reduction. In the current climate policy makers will need to respond to need where it arises most, to improve social cohesion and to ensure the rights and status of vulnerable and marginalized at-risk groups and individuals.

That social protection should seek to transform lives through addressing issues of equity, empowerment and rights (Devereux et al., 2008) is an attractive proposition. It also sets many

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<sup>28</sup> We should be mindful however that foreign TA is typically a conditionality for aid delivery

challenges in implementation. The Government's ambitions for EU membership favour a shift towards a more rights-based paradigm that has the potential to meet these challenges. This would widen the scope of social policy and sets a challenge for institutions rooted in supply led policy and for which, social protection is largely seen in terms of operating safety net programs with greater resource efficiency. The timing for a new approach to conceptualizing social policy in the country couldn't be better.

It is doubtful if much will be gained by simply adopting a working definition of cohesion and patching it onto current initiatives. The complexity of contributing factors are likely to require some level of rethink among policymakers in terms of priorities and a consequent retooling of policy instruments. The dominant paradigm that economic growth alone can tackle poverty reduction merits investigation, at least to the extent that it may benefit from additional support from new approaches such as social cohesion. The promotional and transformative potential of social policy needs to be explored through new linkages and innovations, aimed at enhancing the status and strengthening the rights of marginalised groups while addressing risks to the vulnerable.

It is difficult for institutions to adapt to a new reality, especially when no one knows yet quite what that reality will be. In order to adequately address social cohesion, institutional capacities and resources will need to be improved. Obstacles to social development such as the reliance on the informal safety net needs to be addressed. Although this offers much support to the social safety net it often, albeit inadvertently, promotes outcomes such as migration and informality that undermine the effectiveness of rights-based policies and weaken social cohesion. Domestic innovations that manage the interaction between formal and informal safety nets will be crucial to increasing social cohesion and therefore to Albania's further social and economic development. The time is ripe to increase efforts that contribute to institutional development, to draw on all the resources available from donor institutions and civil society in order to reframe social policies to assist those most at risk on the margins of society. Most fundamentally, a new social policy paradigm that is based on rights will refocus efforts on positive outcomes in achieving social cohesion, instead of negative outputs of cutting down recipient numbers, and will be in line with Albania's potentially close membership to the EU. The progressive future policies should respond to the challenges of the current times and imperfections of the past.

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## CHAPTER 5.

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### **Increasing Unemployment and Inactivity Stocks in Bosnia and Herzegovina**

Vjekoslav Domljan

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#### **1. INTRODUCTION**

In the pre-crisis period unemployment and inactivity rates were very high in Bosnia and Herzegovina (BiH) in the comparison to regional and economic comparators countries.<sup>29</sup> However, it should be emphasised that BiH has not been able to organise itself under any of political and economic orders ever since the first industrial revolution, having always had high unemployment and inactivity rates.

The challenge is to find a proper strategy and policies to achieve this fundamental goal. The global crisis has just sharpened this goal making it more acute. It is difficult to achieve the aim in a current economic environment characterised by severe fiscal and foreign trade unbalances, or rather by high level of public consumption, high budgetary deficit, high public debt, and high current account deficit.

The labour markets have been weakened in BiH since the global crisis broke out in October 2008. The crisis has increased the number of the unemployed and the discouraged by destroying a wide number of formal jobs in the relatively small private sector. Unemployment hits the already

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<sup>29</sup> For the purpose of conducting benchmark analysis, two groups of countries are formed. The first one consists of economic comparators i.e. of a group of small - in terms of size and population - south and central European economies, namely; (i) Macedonia, FYR and Croatia (the EU candidate countries), (ii) Slovakia and Slovenia (advanced transition countries), (iii) Greece and Portugal (advanced market economies), and (iv) Austria and Switzerland (developed federal countries with robust market economies). The second group consists of regional countries comparators i.e. of small Balkan countries (Macedonia, FYR; Croatia, Serbia, Montenegro etc.). If BiH progresses well, gaps (in terms of employment rate etc.) between her and its economic comparators as a whole and particularly by specific groups will become narrower. So will gaps be between her and its regional comparators countries.



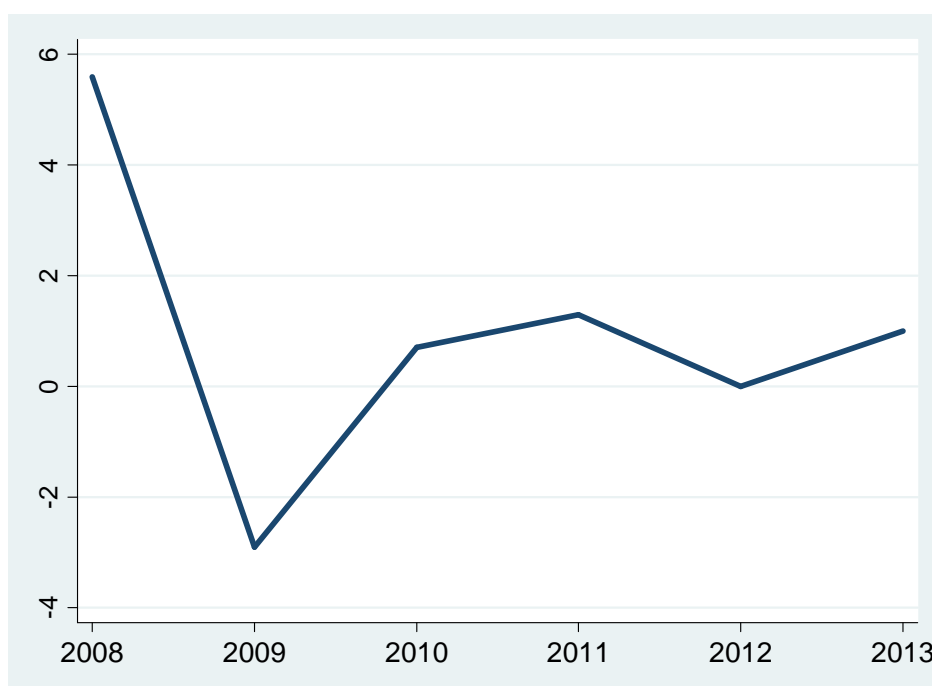
disadvantaged groups in society: the young, the unskilled, the disabled, the displaced and minorities by reducing employment prospects.

Among European countries, BiH, with Kosovo and Macedonia, has the highest unemployment rate, and with Moldova the highest poverty rate in Europe. Therefore, BiH has not yet (but should be) engaged in a “war” on long term unemployment and inactivity.

## 2. IMPACT OF GLOBAL CRISIS

The global economic crisis has undermined BiH economic growth, with a consequent risk to its social stability. Average output in BiH is still well below pre-crisis levels. Its economy is highly vulnerable to a new recession in the euro zone.

**FIGURE 1: GDP growth rate in BiH, 2007-2013**



Source: IMF.

Note: Estimate for 2012, projection for 2013.

BiH could not have avoided exposure to the global crisis. About 40-60% of investments in the pre-crisis period were financed by “imported savings” as national savings rates are very low. Thus, relatively high investments (about 24-28% of GDP in 2000-07) were financed by inflows of workers’ remittances, FDI and loans. Decrease in these inflows contributed to the crisis in BiH in October 2008.

Among the adverse social consequences brought by the crisis are raising unemployment, decreasing employment, and worsening life conditions for many. A particularly vulnerable group

are the internally displaced 117,000 persons, including 7,500 people in refugee camps (DEP, 2011) whose access to health and social care is very limited.

These labour market developments are set against a backdrop of a high outbound migration, the highest in Europe, worsening standard of living of pensioners that are being less supported by relatives from abroad, increasing number of recipients of food from public kitchens, and specific worsening of the position of disabled persons.

A consequence of rising unemployment and poverty is the incidence of social unrest, which remained limited thus far, as individual frustrations have been converted into collective, ethnoreligious frictions. In a deep rooted conflicts society frictions are understood as having the character of a “zero-sum game” with high stakes, with each side becoming easily convinced that they can only win at the expense of the other. The deep-rooted rivalry in BiH has caused a strong decline in support for compromise and unity in the nation building process.

### 3. MAIN SOCIAL CONSEQUENCES OF THE CRISIS

#### 3.1 Long-term increase in unemployment

The global crisis influenced the labour market in BiH in such a way that the labour market trends were reversed. Employment stopped increasing and has started decreasing since 2008. As for unemployment, the trend is just the opposite: unemployment stopped increasing and started increasing (see Table 1).

**TABLE 1: Working-age population and its components in BiH, 2006-2011**

Year	Working-age population (15-64)	Inactive	Labour force	Employed	Unemployed
<b>2006</b>	2242	1065	1177	811	366
<b>2007</b>	2235	1039	1196	850	347
<b>2008</b>	2120	958	1162	890	272
<b>2009</b>	2088	956	1132	859	272
<b>2010</b>	2101	943	1158	843	315
<b>2011</b>	2062	935	1127	816	311

Source: Own calculations based on BHAS LFSS.

Over the last several years proceeding to the global economic crisis, BiH faced relatively high economic growth of 5-6% per year, but the gains were not sufficient. Inactivity, oscillating around one million of persons or around one third of the population, remains a highly pertinent concern for the economy. The same applies to unemployment oscillating around one third of the labour force (Khare, Ronnås, and Shamchiyeva, 2011).

**TABLE 2: Activity, employment and unemployment rates in BiH, 2006-2011**

Year	Activity rates	Employment rates	Unemployment rates
2006	52.5	36.2	31.1
2007	53.5	38.0	29.0
2008	54.8	42.0	23.4
2009	54.2	41.1	24.0
2010	55.1	40.1	27.2
2011	54.7	39.6	27.6

Source: Own calculations based on BHAS LFSSs.

The unemployment rate in 2011 was 27.6%,<sup>30</sup> significantly higher than in comparators countries. At the same time, the employment rate was about 39.6%,<sup>31</sup> while among the comparators countries it oscillates between 40 and 82%.

The gender dimension is of special importance, as women tend to be more inactive and face a greater prospect of unemployment. The female employment rate is 2-3 times higher in the comparators countries, than in BiH.

In the BiH population surveys, unemployment is listed as the main problem, followed by corruption (UNDP, 2007). Unemployment is to a certain degree less painful as the informal economy is a significant unemployment absorber that has absorbed in the post-crisis period some of the new entrants and laid-off workers.

What makes the situation worse is persistent unemployment. Out of total number of the unemployed in 2011, over four fifths are without a job for more than one year, up for approximately 15,000 than in 2008. At the same time, labour force shrunk for approximately 5,000 persons. According to some anecdotal evidence<sup>32</sup>, an unemployed person on average waits for a job four and a half years.

Our estimation for 2012 is that approximately 85% of the unemployed is without a job for more than one year, a situation affecting about 260,000 people. Accordingly, many of the unemployed can hardly be considered economically active (Khare, Ronnås and Shamchiyeva, 2011).

<sup>30</sup> In BiH, labour force surveys are conducted once a year, in April, and results are announced usually in September.

<sup>31</sup> According to the BHAS, the employment rate is 31.9%, significantly lower than our calculations. The difference appears due to the different definition of working age population. The BHAS defines working age population as 15+, in contrast to the working age population consisting of those who are 15-64 as used in this paper.

<sup>32</sup> Interview with Petar Golemac, former Director of the Hercegovina-Neretva Canton's Employment Services conducted on 15 June 2012.

**TABLE 3: Long term unemployment in BiH, 2006-2011**

	2006	2007	2008	2009	2010	2011
<b>Labour force</b>	1177	1196	1162	1132	1158	1127
<b>Unemployed, total</b>	366	347	272	272	315	311
<b>Unemployed up to 12 months</b>	51	47	37	45	57	61
<b>Unemployed over 12 months</b>	315	300	235	227	258	250
<b>Long term unemployed (% of total)</b>	86.1	86.5	86.4	83.5	81.9	80.4
<b>Long term unemployment rate</b>	26.8	25.1	20.2	20.1	22.3	22.2

Source: BHAS LFSs (various years).

In BiH the youth (people 15-24 years of age) are facing exceptionally high unemployment rates, being highest among all age groups. Youth unemployment in 2011 reached 57.9 % (56.4% for male and 60.5 % for female), over twice that of total unemployment and for one fifth above its own level of 2008.

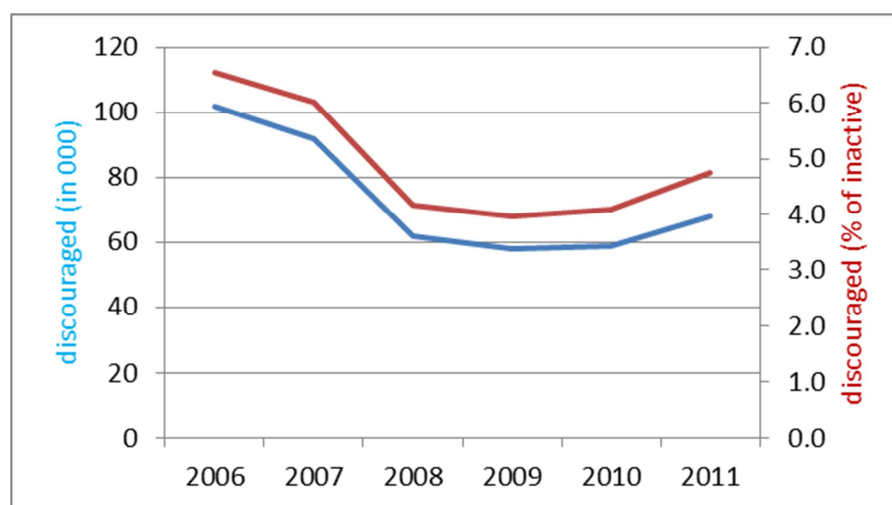
**TABLE 4: Youth unemployment in BiH, 2006-2011**

	2006	2007	2008	2009	2010	2011
<b>Labour force</b>	165	162	148	141	139	127
<b>Unemployed</b>	103	95	70	69	80	73
<b>Unemployment rate</b>	62.3	58.4	47.5	48.7	57.5	57.9

Source: BHAS LFSs (various years).

The number of “discouraged” inactive persons, presumably young people (otherwise, they would be registered as unemployed to have access to health care secured), has been increasing since the crisis started (see Figure 2).

**FIGURE 2: Discouraged inactive persons in BiH, 2006-2011**



Source: Own calculations based on BHAS LFSs.

According to the UNDP research about two thirds of young people would like to go abroad to work and live. With the population consistently declining, as suggested by the Labour Force Surveys (LFSs) data (the number of deaths has been higher than the number of births since 2003), outbound emigration encouraged by the crisis makes things much worse.

Highly-skilled young people, so called go-getters, are especially prone to seek employment abroad. Some 20 per cent of those aged 25 or more of BiH origin and who have tertiary education presently live in one of the OECD countries. The well-established migrant networks facilitate a high mobility of people, whether formal or undocumented, the latter becoming of a growing concern in the recipient countries (Khare, Ronnås, and Shamchiyeva, 2011).

**TABLE 5: Youth Activity Status in BiH, 2011(in 000)**

Youth Population (15-24): 404			
Not in labour force: 277		Labour force: 126	
In education: 209	The “discouraged” (neither in education nor in labour force): 18	Employed: 53	Unemployed: 73
▪ Secondary: 163			
▪ Tertiary: 46			

Source: Own calculations based on BHAS LFSs and database.

### 3.2 Pensioners

Pension spending in four years has risen from 7.6% of GDP in 2005 to 9.4% of GDP in 2009, what could be partly attributed to the GDP decline due to the global crisis. Pension spending in BiH as a share of GDP is higher than in many high income countries which have both a substantially older population and a higher income per capita than BiH, and it is in the top third of pension spenders among transition countries (World Bank, 2012a).

**TABLE 6: Transfers as a share of GDP in BiH, 2005-2011**

	2005	2006	2007	2008	2009	2010	2011
<b>Transfers</b>	11.9	12.2	14.3	15.5	15.5	15	15
▪ <b>Pensions</b>	7.4	7.8	8.0	9.1	10.1	10.1	10.2
▪ <b>Social benefits</b>	0.4	0.4	1.1	1.5	1.1	0.8	0.8
▪ <b>Other transfers</b> (veterans, unemployment)	4.1	4.0	5.2	4.9	4.3	4.1	4.0

Source: IMF and BiH Authorities (as cited in World Bank. 2012a).

Note: Data for 2010 are preliminary while for 2011 are estimates.

Nevertheless, when pension spending is considered at per capita basis, BiH has, in comparison to the neighbouring countries, relatively less pensioners and average pensions, despite the war having hit it harder. The underlying problems are not pension population size or pension spending, but the low level of employment (and productivity), decreased due to the crisis, and worsening position of pensioners.

**TABLE 7: Pensioners in Western Balkan countries, 2011**

Country	Pensioners (in 000)	Population (in 000)	Pensioners/Pop ulation (in %)	Average pension (in EUR)
<b>BiH</b>	609	3843	15.8	175
<b>Croatia</b>	1213	4290	28.2	278
<b>Montenegro</b>	100	620	16.1	279
<b>Serbia</b>	1600	7121	22.5	196

Source: Various national sources (as cited in Sladojević, 2012).

The critical issue for pensioners is how to survive with an average pension of just 175 EUR per month as it is not much above the official poverty line.<sup>33</sup> Evidence of pensioners stopping to buy necessary medicines, living without adequate food, not being able to finance even minor repairs in respective apartments etc. is plentiful (World Bank, 2011).

### 3.3 Citizens increasing requests for social assistance

In the pre-crisis period, BiH was spending about 3.9% of GDP on social assistance (benefits financed not from social insurance contributions but from tax revenues) (2012a).<sup>34</sup> Even this level of spending, i.e. without the inclusion of spending at regional and local level, is the highest among the Western Balkan countries and the whole Europe and Central Asia (ECA) region. If these were included, overall social assistance expenditure would be as high as 7% of GDP (World Bank, 2012a).

<sup>33</sup> Absolute poverty is defined as the consumption level of 205 BAM (approximately 105 EUR) per person per month (World Bank, 2011).

<sup>34</sup> Social welfare benefits in the Federation of BiH include: medical insurance for the claimant and the family members; financial assistance amounting to 114 KM (57 EUR) for one member household plus 10% for each additional household member; 50 KM (25 EUR) per month for utilities (water, sewage, electricity etc.). However, some cantons and municipalities are unable to provide such commitments. In the Republic of Srpska, social welfare assistance includes medical insurance for the claimant and the family members and financial assistance amounts up to 41 BAM (21 EUR) per household member and for two people 49 KM (25 EUR).

**TABLE 8: Spending on social assistance in BiH at the entity level,\* 2006-2011**

	2006	2007	2008	2009	2010	2011e
<b>Civilian Benefits</b>	1.5	1.4	1.58	1.52	1.46	
<b>Veterans' Benefits</b>	2.6	2.6	2.23	2.38	2.44	2.05
<b>Total as % of GDP</b>	4.1	3.9	3.81	3.9	3.9	

Note: \*BiH is a federal country consisting of two entities, namely Federation of Bosnia and Herzegovina and Republika Srpska.

Source: Central Bank of BiH (as cited in World Bank, 2012).

The World Bank (2011) estimates that the headcount poverty rate in BiH was reduced during the pre-crisis period from 18% in 2004 to 14% in 2007<sup>35</sup> and that the crisis halted poverty reduction. The consequences of the decline in the population's purchasing power are described as follows:

“A quarter of the population (30% in rural areas) reported having reduced the consumption of staple foods such as milk, fruits, vegetables or bread, and 10 percent of the population had to delay payment of utilities (3% had utilities cut due to non-payment). Almost 10 percent of the population report having had to delay medical visits when sick, and 4 percent of the population report having to stop buying necessary medicines.”

One of the indicators that show that the proportion of those living close to or below the poverty line increased significantly is the number of recipients of food from public kitchens. Almost 2% of the Sarajevo population (6,050 out of 304,614 inhabitants) use the services of public kitchens. In the municipality of Stari Grad (the hearth of Sarajevo), the number of recipients has increased from the for many years stable figure of 1,000 persons, to the current 1,500. In the city of Zenica, the number of recipients, mainly the elderly and the unemployed, has increased from 2,000 to 3,000 (Nuhanović, 2012).

### **3.4 Disabled persons without employment**

About 350.000 people estimated to be with disabilities, especially women, are less likely to have access to education, training and employment of any kind. Their unemployment rate is around 85% (Alić, 2012).

It took five years for the Federation of BiH parliament to pass the Law on Professional Rehabilitation, Training and Employment of Persons with Disabilities, and another year to implement it. The law was adopted in early 2010 and parliament pledged to form a special fund for its maintenance, which came through in April 2011. In the Republika Srpska the law and the corresponding fund were implemented in 2005. Since then, according to Alić (2012),

<sup>35</sup> There are no works on poverty rate estimation, partly due to the lack of recent household budget surveys. The most recent available poverty data are from the 2007 Household Budget Survey.

approximately 1,000 disabled persons have found jobs, but only 250 according to BHAS (see Table 9).

**TABLE 9: The Employment of Disabled Persons in BiH, 2006-2009**

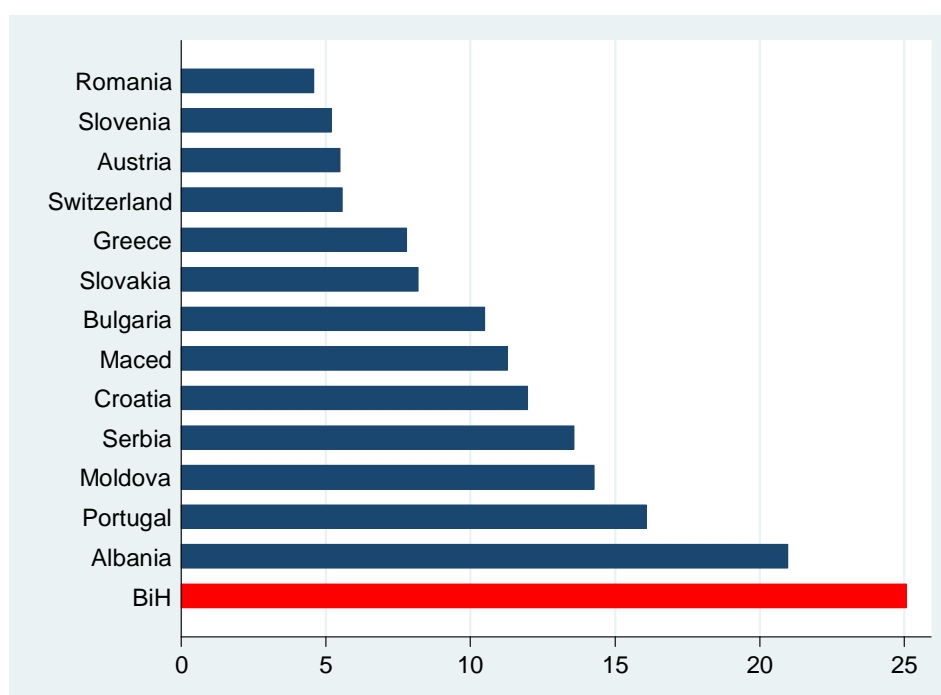
		2006	2007	2008	2009
<b>Employed, total</b>	<b>BH</b>	144	146	140	143
	<b>FBiH</b>	80	89	77	77
	<b>RS</b>	64	57	63	66
<b>Work at special working conditions</b>	<b>BH</b>	137	145	139	135
	<b>FBiH</b>	80	89	77	77
	<b>RS</b>	57	56	62	58
<b>Work at home</b>	<b>BH</b>	7	1	1	8
	<b>FBiH</b>	0	0	0	0
	<b>RS</b>	7	1	1	8

Source: BHAS, communications from the Directorate for Economic Planning, 6 October, 2011.

### 3.5 Emigration and remittances

BiH ranked first in Europe for outbound migration with an emigration rate of 25 per cent (Khare, Ronnås, and Shamchiyeva, 2011). One of advantages of having Bosnian citizens going abroad to work is that they send remittances to their relatives in BiH, particularly the elderly and pensioners.

**FIGURE 3: Emigration rate in BiH and comparators, 2000-02**

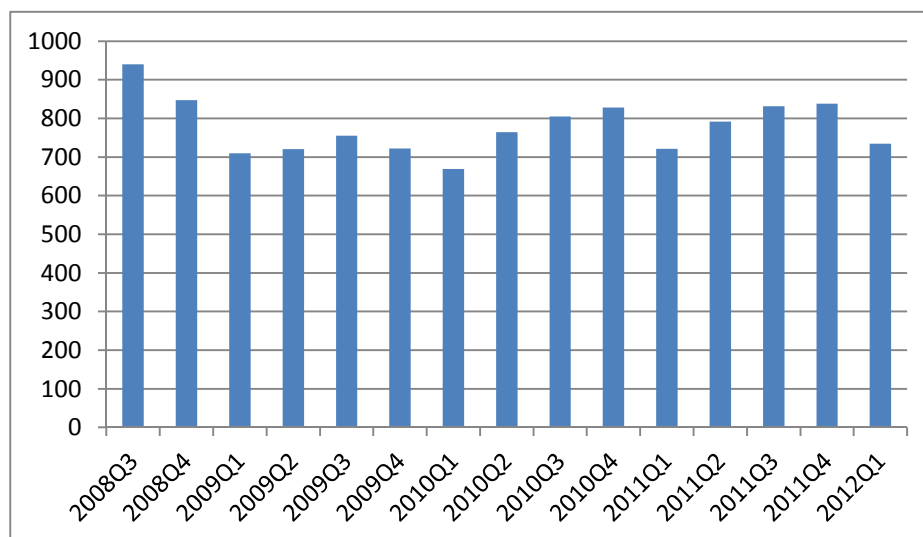


Source: Own elaboration based on UNDP (2009).



Due to the crisis remittances inflows to BiH are decreased by 10-15 %. The remittances are around 3.2-3.5 billion KM a year, which is equivalent to 31.8 per cent of the GDP in 2007 and 12.1 per cent in 2011.

**FIGURE 4: Net remittances in BiH, 2008-2012**



Source: Own elaboration based on Central Bank of BiH (2012).

#### 4. THE CRISIS AND GOVERNMENT FAILURES

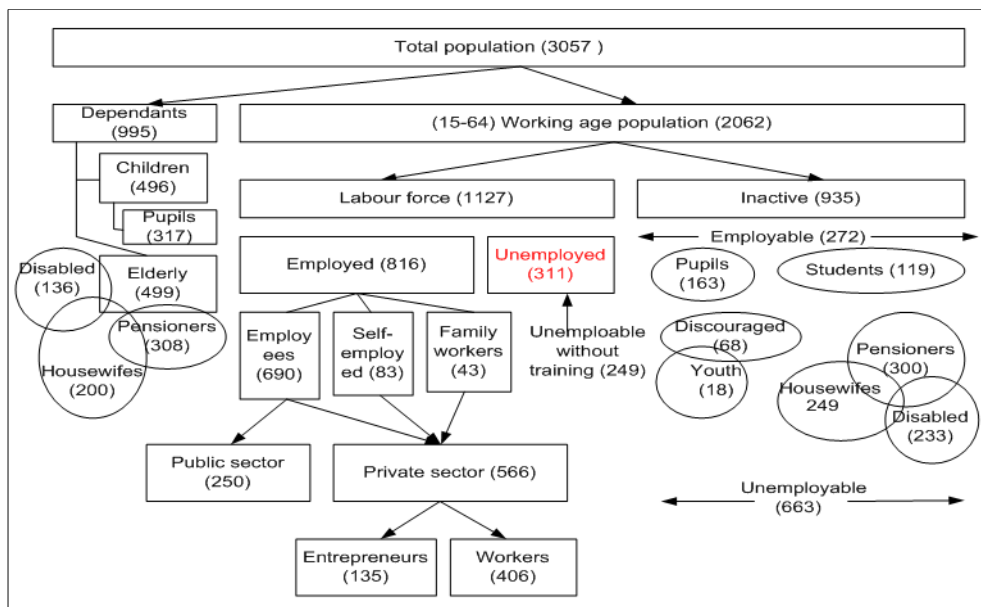
If each BiH municipality created two jobs per working day, unemployment could disappear over just one 4-year political mandate. The math formula is: 2 (persons) x 140 (municipalities) x 250 (working days) = 70,000 x 4 (years) = 280,000. However, the math formula is not realistic at all.

BiH does not have the necessary persons readily available for the fulfilment of the mentioned aim.<sup>36</sup> It has only 62,000 unemployed who are readily available, as they have been unemployed for less than 12 months. The other subgroup of the unemployed, consisting of 249,000 people, might be employed only after attending training, as they have been unemployed for longer than 12 months.

Even the total of unemployment equalling to 311,000 persons is not enough for doubling the employment rate, which would be needed for reaching the EU employment targets. This task requires a mass transfer from the inactive to the employed, which is hardly feasible. The inactive population consists of 70% of those who are unemployable, even if they wish to work, as they are too low-skilled. Approximately 65% of the inactive population completed only elementary education or less (BHAS, 2011).

<sup>36</sup> The latest census was organised in 1991 while the labour force surveys have been conducted since 2006.

**FIGURE 5: The Structure of the BiH Population (in 000)**



Source: Own elaboration based on BHAS publications.

To a certain degree it would be feasible to mobilize some of the inactive into the employed, primarily students and the discouraged inactive persons, but it would not be possible to mobilize the rest. The inactive population consists of 47% of inactive males who consider themselves 'retired'; 21% of inactive males and females who consider themselves 'unable to work'; and a good portion of the 46% of inactive females who consider themselves 'housewives' (World Bank, 2009).

If students were singled out as employable (which is questionable due to mismatch between education and labour market), it would be difficult to engage even the discouraged inactive persons because of their low skills, insufficient motivation etc. (World Bank, 2009).

**TABLE 10: Searching for Employable Persons in BiH, 2011 (in 000)**

Needed for doubling the employment rate: 38.7x2=77.4	Where to look for them (816)			
	Currently unemployed (311)		To be sought for among the inactive (505)	
	Ready available (62)	Available with proper training (249)	Available with proper training (187)	Students (119 )
				Discouraged (68 )
			Theoretically available (163)	Pupils, 163
Almost miraculously available (155)			These 'missing' are to be sought among the unemployable: <ul style="list-style-type: none"><li>the early retired</li><li>housewives</li><li>the disabled</li></ul>	

Source: Own elaboration based on BHAS (2011).

The previous analysis took many conditions as granted. However, in reality there are no monetary helicopters. It is necessary to invest in job creation on average 15,000 EUR.

Another huge barrier to employment increase is the business environment. Among European countries, BiH is the second only to Ukraine regarding business environment (World Bank, 2012b).

Proper training centres and training programmes are missing, while Employment Services are transforming themselves into social protection institutions, providing primarily passive policy of paying unemployment benefits.

**TABLE 11: Political Approaches to Development in BiH, 1998-2020**

	1998 – 2012	2013 – 2020
Policy approach	opinion based	evidence based
Type of economic system	non-existing hand	invisible hand
Policy aim	none	full employment
Policy indicators	none	employment rate
Approach to building up the market economy	top-down (non-organic i.e. privatization)	bottom-up (organic entrepreneurship)
Economic sector	intermediation (trade)	production of ideas
Key economic resource and its purpose	(public) physical capital, to be stripped	knowledge, to be increased
Purpose of the public sector	employing “our men”, rents extracting, decapitalization ('privatized' state firms serve as a collateral for not repaying loans deliberately)	producing public goods
Type of internationalization	Import-led	Export-led
Firm type	hyena-type and wolf-type	cow-type
Firms' orientation	profiteering	value creation
Economic turbulence	<ul style="list-style-type: none"> <li>▪ privatization</li> <li>▪ ethno-cartels</li> <li>▪ black economy</li> </ul>	<ul style="list-style-type: none"> <li>▪ mass entrepreneurship</li> <li>▪ strong clusterpreneurship</li> <li>▪ fast start-ups and bankruptcy</li> </ul>
Pillars of the economic system	<ul style="list-style-type: none"> <li>▪ public sector</li> <li>▪ tycoons (rent-seeking entrepreneurs)</li> <li>▪ public 'development banks'</li> </ul>	<ul style="list-style-type: none"> <li>▪ private sector</li> <li>▪ productive entrepreneurs</li> <li>▪ research institutes</li> </ul>
Economic drivers	<ul style="list-style-type: none"> <li>▪ public expenditure</li> <li>▪ remittances</li> <li>▪ international assistance (IMF, World Bank, EU)</li> </ul>	<ul style="list-style-type: none"> <li>▪ private investment</li> <li>▪ export</li> <li>▪ foreign direct investment</li> </ul>
Legal orientation	lawlessness	rule of law
Policy appraisal	2 x 'seven mean years'	'seven good years'

Source: Own elaboration.

At the moment none of political pa Thus, policies against high long-term unemployment and inactivity must become a priority. Active economic policies conducted at the mezzo (entity) level and aimed at supply side of the economy should be conducted. To emerge from the 'middle income trap' in the global crisis BiH needs a new economic and social strategy (NESS), as described in column 3 of Table 11, in contrast with the policies that have been conducted since the post-war reconstruction completed in 1998.

erty emphasises the importance of building up unity and finding solutions to urgent problems (mass inactivity, huge unemployment, vast underemployment etc.) – problems that global crises only sharpened.

The ethnoreligious nationalists, or rather ethno-cartels, are primarily interested in institutions they may have under their own control, ruling over territory where their own ethnic group is a majority. Consequently, BiH, with a population the size of, say, half of London, still has many organizations, including those for operating three parallel infrastructures, but lacks a single legal system fighting the huge and growing black economy.

## **5. CONCLUSIONS**

This paper explains why the BiH policy makers should be seriously concerned about employment and inactivity, particularly long-term unemployment, how the present difficulties of people entering the labour market could be reduced and what useful messages could be conveyed to policy makers to guide them in future policies regarding youth unemployment.

There are two causes of unemployment and inactivity in BiH: education system, supplying what is not demanded at the labour market, and business sector, not providing enough jobs which are desperately needed for the massively unemployed and inactive population. The fundamental cause of mass long-term unemployment is inefficiency of the whole system of BiH, that cannot be resolved without its resetting, starting with the overhaul of the Dayton peace agreement. In economic terms, the system is inefficient in static terms (poor allocative efficiency) and dynamic terms (low accumulation of all assets, primarily infrastructure).

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## CHAPTER 6.

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### **The Social Impact of the Global Crisis in Bulgaria**

Todor Todorov

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#### **1. INTRODUCTION**

In the years since 2005, two major events have had a significant influence on the social and economic development of Bulgaria – EU accession in 2007 and the global crisis which hit the Bulgarian economy in the fourth quarter of 2008. The economic downturn was expressed through reduced foreign demand for Bulgarian products, a decrease in the export prices of basic commodities, reduced credit activity and an abrupt decrease of foreign direct investments in the economy as a result of the higher risk for investors. At the beginning of 2009 the Bulgarian economy registered its first negative growth of -4.5% on a yearly basis since 1997, while in 2009, GDP decreased by -5.5%.<sup>37</sup> All economic sectors suffered the negative consequences of the economic downturn; the industrial sector was first and most severely affected.

With the onset of the crisis, companies started to register lower revenues and were faced with the need to adjust their labour costs. Until the third quarter of 2009, employers refrained from laying off their personnel expecting an improvement of sales, but gradually turned to mass dismissals. As a result, in 2010 unemployment exceeded the level experienced in 2005 reaching 10.2%<sup>38</sup> with negative consequences for the income level of the population and for social protection receipts and expenditure.

#### **2. LABOUR MARKET SITUATION**

Data from the Labour Force Survey conducted by the Bulgarian National Statistical Institute (NSI) show that in 2010 the number of people employed aged 15-64 decreased by nearly 195,000

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<sup>37</sup> NSI (2011) Gross Domestic Product for 2009 – Final Data.

<sup>38</sup> NSI (2011) Labour Force Survey 2010, Main results.

compared to 2009 (when the positive labour market trend that started in 2002 was interrupted) to reach almost 3.6 million persons, while the employment rate for the same age group fell by 2.9 percentage points to 59.7%. Because of the negative effects of the crisis on the labour market, the employment decrease was greater for men than for women. This was a result of the intensive lay-offs in sectors of the economy that use predominantly male labour. Nevertheless, the employment rate for men (63.0% for 2010) continued to prevail over that for women (56.4%). In 2010 the number of unemployed reached 348,000, which was 110,000 more than in 2009. The unemployment rate increased by 3.4 percentage points over the year to reach 10.2% in 2010.

The economic downturn has had a markedly negative impact on disadvantaged groups<sup>39</sup> in the labour market, who face increasing risk of poverty and social exclusion. In 2009 and 2010 together with the increase in the total number of registered unemployed, there was also an increase in registered youth unemployment. The ageing of the active population and the very high emigration, predominantly of young people, makes youth unemployment a basic priority of the employment policy implemented by the Bulgarian Ministry of Labour and Social Policy through the National Employment Agency (NEA). Young people under 29 years of age are among the most vulnerable groups on the labour market due to the fact that most of them have a low educational level and lack qualifications<sup>40</sup> while in times of economic crisis employers prefer to lay off young workers who do not have relevant experience.

During the period 1999-2008 the share of unemployed persons over 50 years old increased. Since 2009 this trend was reversed, and in 2010 the share of elderly unemployed fell to 37.6% compared to 39.6% in 2008; the reason was the intensive lay-offs among workers in the lower age groups (35-44 years).

In 2010 the number of long-term unemployed with unemployment spells of more than 12 months increased by 39% compared to the previous year, reaching 31.6% of all registered unemployed. This gives a clear indication of the persistence of the negative influence that the global crisis continues to exert on the labour market in Bulgaria.

The unemployed with disabilities are the most vulnerable group on the labour market. For them, the Local Employment Offices provide the main (and in most cases the only) opportunity for successful employment integration and social inclusion. Although in 2010 the share of this group within the total number of unemployed continued to decrease for a second successive year (from 4.5% in 2009 to 3.9% in 2010), their absolute number actually increased by 6.9% on a yearly basis.

According to NEA data, in 2010 was the first year since the onset of the crisis that the unemployment rate increased in all 28 districts in Bulgaria (NUTS 3 level)<sup>41</sup> compared to the previous year. In 2010 the long-term fall in the range of variation in the unemployment rate by districts was interrupted. The range of variation measures the difference between the registered

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<sup>39</sup> According to the Employment Action Plan for 2010 implemented by the NEA, the disadvantaged groups on the labour market include young people aged 29 years and younger, unemployed of 50 years of age and older, long-term unemployed and people with disabilities.

<sup>40</sup> NEA (2011) Yearbook 2010.

<sup>41</sup> NSI (2009) Classification of the territorial units for statistical purposes in Bulgaria.

maximum and minimum values of the unemployment rate by districts. In 2010 the highest unemployment rate was 17.3% in Smolyan district and the lowest was 3.5% in the Sofia capital district. The range of variation increased by 2.2 percentage points from 11.7 in 2009 to 13.9 in 2010.

### 3. POVERTY AND SOCIAL INCLUSION DYNAMICS IN TIMES OF ECONOMIC CRISIS

This section investigates the trends in poverty and social inclusion in Bulgaria over the period 2005-2009 using indicators provided by the NSI <sup>42</sup> based on the European Survey on Income and Living Conditions (EU-SILC). This survey is key instrument used to measure the common quantitative goals for reducing poverty within the EU. The survey on income and living conditions is a major source of data for income and social inclusion as well as for the calculation of common indicators.

#### 3.1 General poverty and social inclusion indicators

The poverty line is a monetary indicator used to identify the poor in society. In the above mentioned survey carried out by the NSI, the poverty line is set at 60% of the average total disposable net income<sup>43</sup> per equivalent unit. According to latest available data referring to 2009 the poverty line was EUR 150.8 average per month per person. Taking into account this poverty line, in 2009 almost 1.6 million persons, representing 20.7% of the Bulgarian population lived below the poverty line (see Table 1 below). Bulgaria continued to be among the countries with the highest at-risk-of-poverty rate in the EU along with Latvia (21.3%), Romania (21.1%), Greece (20.1%), Lithuania (20.2%) and Spain (20.7%).

**TABLE 1: Poverty and social inclusion indicators**

SURVEY YEAR	2006	2007	2008	2009	2010
INCOME REFERENCE YEAR	2005	2006	2007	2008	2009
At-risk-of-poverty threshold - monthly average in EUR	69.2	74.0	108.6	141.4	150.8
Number of persons below at-risk-of-poverty threshold - 1000 persons	1,417	1,691	1,632	1,657	1,564
At-risk-of-poverty rate, % of population	18.4	22.0	21.4	21.8	20.7

Source: NSI.

During the period 2005-2009 the poverty line more than doubled (from EUR 69.2 in 2005 to EUR 150.8 in 2009). Due to the negative effects of the economic downturn however, in 2009 the annual growth rate of the poverty line was lower than in the previous two years and reached the level of 2006.

<sup>42</sup> NSI (2011) Poverty and social inclusion indicators based on the European survey on income and living conditions (EU-SILC) in the context of the open method for coordination.

<sup>43</sup> Average total disposable income is calculated as median income. This is the income that divides the population into two equal parts. 50% of the households have higher income and 50% have income lower than this value.



### 3.2 People at risk of poverty by activity status

The main factor for increasing the risk of poverty for most people is their economic activity and participation in the labour market. For as long as data is available the share of the poor was highest among the unemployed (Table 2).

**TABLE 2: At-risk-of-poverty rate (% of population 18 years and over) by most frequent activity status**

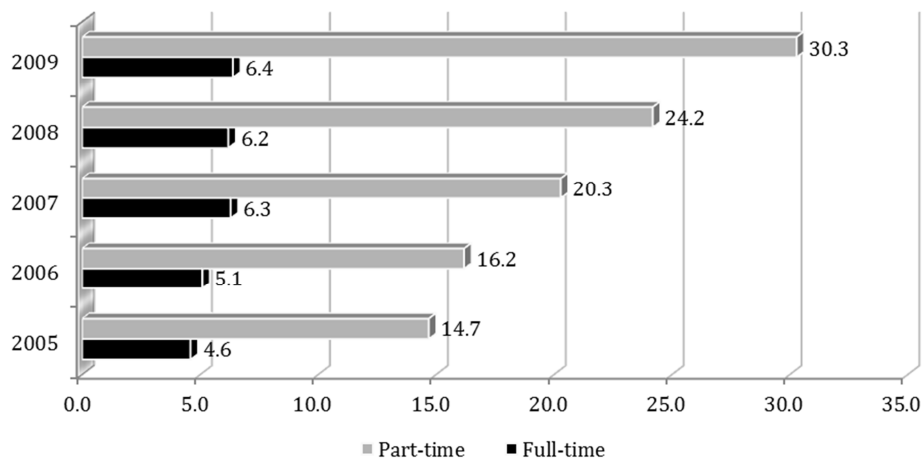
SURVEY YEAR	2006	2007	2008	2009	2010
INCOME REFERENCE YEAR	2005	2006	2007	2008	2009
Activity status					
Employed	5.4	5.8	7.5	7.4	7.7
Unemployed	47.7	55.9	55.0	52.2	48.3
Retired	18.3	23.6	31.7	36.5	30.0
Inactive population – other	16.9	19.3	23.9	24.0	24.4

Source: NSI.

Poverty risk was also especially high among economically inactive persons. By tracing the at-risk-of-poverty rate trends for the major groups by activity status it turns out that although the share of poor was greatest among unemployed and retired persons, their relative income position actually improved in 2009 compared to the remaining two groups – the employed and other inactive people. This can partly be ascribed to the role that the social protection systems play in providing a subsistence (or better) income to people in need of support, especially in times of economic crisis. It is a dramatic feature of the crisis that employees experienced an increase in the poverty rate from 7.4% in 2008 to 7.7% in 2009.

### 3.3 People at risk of poverty by type of work

In recent years, analysis and policies on poverty and social exclusion have given more attention to the phenomenon of the “working poor”. The working poor are defined against two criteria – first, that they work and second, by they are members of poor households. Thus the definition is based on two statistical units – the single individual and the household. The former is the starting point for the classification of “employed” and “unemployed” while the latter is the basis for the classification “poor” and “non-poor”. In this sense there is a category of people who live in poor households but whose individual income is above the poverty line. Similarly, there is another category of people whose individual income is below this threshold and they live in poor households. Data show that for the period 2007-2009 over 7% of employed persons lived in households with incomes below the poverty line. Additionally, the risk of poverty for those working part-time in 2009 was five times greater than for those working full-time (see Figure 1) – a fact indicative of the unfavourable position of part-time employees on the labour market during the recession.

**FIGURE 1: In-work at-risk-of-poverty rate (% of population 18-64) by full-time and part-time work**

Source: NSI.

### 3.4 Employed persons by risk of poverty and by education

A person's level of education, which largely determines access to better paid jobs, is directly correlated with poverty among employed persons. Of the workers with lower-secondary or lower education the share of poor in 2009 increased by 3.8 percentage points compared to the previous year to reach 26.5%, while for the other education groups (levels 3, 4 and 5, 6 respectively) the at-risk-of-poverty rate was not affected by the negative effects of the global crisis in 2009. As in the case of part-time employees, people with a low education level cannot entirely depend on their incomes to maintain a decent standard of living.

**TABLE 3: In-work at-risk-of-poverty rate (% of population 18-64) by education**

SURVEY YEAR	2006	2007	2008	2009	2010
INCOME REFERENCE YEAR	2005	2006	2007	2008	2009
<b>Level of education (ISCED 97)</b>					
Pre-primary, primary and lower secondary education (levels 0-2)	14.9	20.7	21.4	22.7	26.5
Upper secondary and post-secondary education (levels 3 and 4)	4.6	3.9	5.2	5.4	5.3
First and second stage of tertiary education (levels 5 and 6)	1.1	1.5	1.3	1.6	1.6

Source: EUROSTAT.

### 3.5 People at risk of poverty before and after social transfers

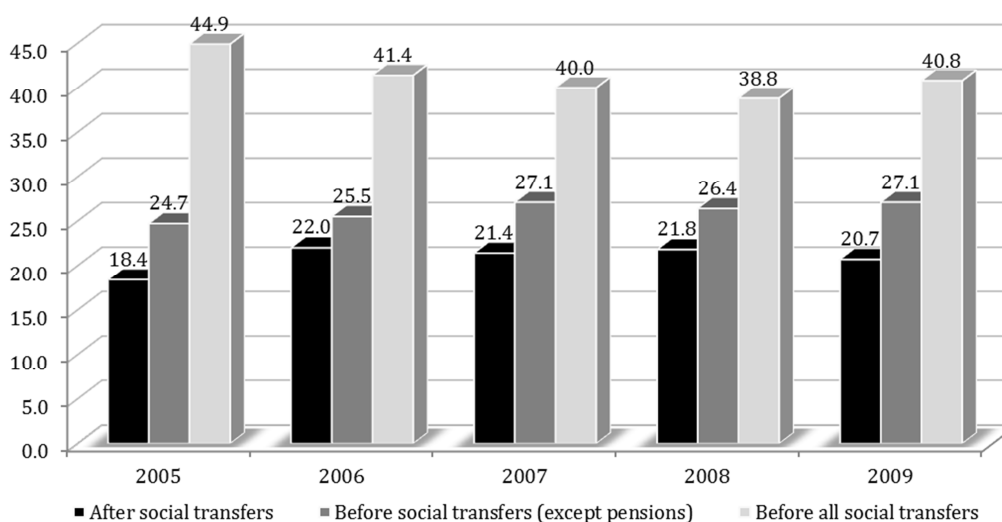
The social protection system is essential for tackling poverty. Social transfers have a significant impact on reducing the risk of poverty, while pensions remain an essential element in this

respect.

Data show that pensions alone are able to markedly reduce the poverty rate, as their positive effect on the at-risk-of-poverty rate varied from 20.2 (in 2005) to 12.4 percentage points (in 2008).

Accordingly, excluding pensions and other social transfers from household income the poverty rate would increase sharply by around 20 percentage points for 2005-09 (see Figure 2). A clear manifestation of the influence of the crisis is the substantial increase (by 2 percentage points) of the at-risk-of-poverty rate before social transfers in 2009 after a four-year downward trend.

**FIGURE 2: At-risk-of-poverty rate (% of population) before and after social transfers**



Source: NSI.

### 3.6 Population at risk of poverty or social exclusion

In relation to the goals set out in the “Europe 2020” strategy, a combined indicator for monitoring individual countries’ progress in reaching their national targets can be calculated using data from the survey of income and living conditions. The indicator includes the at-risk-of-poverty rate, the severe material deprivation rate<sup>44</sup> and the rate of people living in households with low work intensity<sup>45</sup>. Combining the three indicators reveals that in 2009 almost half of the population

<sup>44</sup> The general indicators of poverty assessment include subjective indicators related to material deprivation. They show the subjective assessment and personal attitude of the persons and households related to the possibility to meet individual needs. The subjective indicators are formed from the answers of nine questions related to the consumption of specific goods and services.

<sup>45</sup> Jobless households are households where no member has been in employment over the last four weeks, i.e. all members of the household aged 16 years old or more have been either unemployed or inactive. Joblessness in EU-SILC are calculated as the percentage of persons in a given age group living in a household whose “work intensity” is below or equal to 0.20 over the total population in the same group.

(49.2%), or 3.7 million people, were in need of special care to combat poverty, social inequality and exclusion from active work. In fact, the negative trend with respect to the size and share of population at risk or poverty or social exclusion started in 2008, but in the following year it significantly increased due to the economic downturn, by more than twofold from 1.4 in 2008 to 3.0 percentage points in 2009. The situation of men has been more seriously affected by the global crisis, as in 2009 the share of men at risk of poverty or social exclusion increased by 3.2 percentage points compared to 2.8 for women. A year earlier, in 2008 the respective figures were 1.1 and 1.7 percentage points, which suggests that the industrial sector (with a mainly male labour force) suffered the most from the negative effects of the recession in terms of reduced demand, production cuts and mass lay-offs.

**TABLE 4: Population at risk of poverty or social exclusion**

SURVEY YEAR		2006	2007	2008	2009	2010
INCOME REFERENCE YEAR		2005	2006	2007	2008	2009
<b>TOTAL</b>	1000 persons	4,734	4,663	3,421	3,511	3,719
	% of population	61.3	60.7	44.8	46.2	49.2
<b>MALE</b>	1000 persons	2,266	2,203	1,592	1,624	1,729
	% of population	60.5	59.4	43.0	44.1	47.3
<b>FEMALE</b>	1000 persons	2,469	2,460	1,829	1,887	1,990
	% of population	62.1	61.9	46.4	48.1	50.9

Source: NSI.

### 3.7 Poverty and social exclusion at regional level

Poverty assessment at regional level is an important aspect in the study of poverty and social inclusion. The same method as for the poverty line at national level has been applied by the NSI in calculating the poverty line for each district in Bulgaria - 60% of the average disposable net income of the households in the respective district.

For the three years from 2008-10, the poverty line (monthly average) was highest in the Sofia capital district, growing from EUR 160.6 in 2007 to EUR 223.6 in 2009. The lowest values of the poverty line for 2007 and 2008 (EUR 62.9 and 92.5 respectively) were registered in Vidin district, located in one of the most underdeveloped territories in the EU – the North West Statistical Region of Bulgaria, while for 2009 Razgrad district occupied the last place with a poverty line of EUR 94.3 (Table 5). As the data show, the economic crisis led to a growing discrepancy between the minimum and maximum values of the poverty line among different districts and to an increase in the standard deviation of the at-risk-of-poverty threshold which is indicative of widening regional disproportions in income levels. Compared to the national average, only three districts maintained values above the poverty line – Burgas, Sofia district and Sofia capital, all situated in the most economically developed regions in the country.

**TABLE 5: At-risk-of-poverty threshold (monthly average in EUR) - regional disparities**

SURVEY YEAR	2008		2009		2010	
INCOME REFERENCE YEAR	2007		2008		2009	
<b>National average</b>	<b>108.6</b>		<b>141.4</b>		<b>150.8</b>	
Minimum values	62.9	Vidin	92.5	Vidin	94.3	Razgrad
Maximum values	160.6	Sofia cap.	201.6	Sofia cap.	223.6	Sofia cap.
Standard deviation	19.2		22.3		26.3	

Source: NSI.

#### 4. THE ECONOMIC DOWNTURN AND THE SOCIAL PROTECTION SYSTEM

Information on the trends of the social protection system in Bulgaria is provided by the National Statistical Institute through the survey on the “European System of Integrated Social Protection Statistics” (ESSPROS), the latest available data being for 2009. The social protection system is financed mainly through social insurance contributions and direct funding from the state budget. The funding share from the first source has continuously decreased to reach 49.6% in 2009 (Table 6).<sup>46</sup> The negative trend is particularly evident in 2008-09 due to the adverse effects of the crisis on the level of employment and the growing share of the grey economy.

**TABLE 6: Receipts of the social protection system**

		2005	2006	2007	2008	2009
<b>TOTAL RECEIPTS</b>	<b>Millions EUR</b>	<b>3,598.48</b>	<b>3,827.53</b>	<b>4,664.49</b>	<b>5,947.39</b>	<b>6,616.48</b>
	<b>%</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Social contributions	Millions EUR	2,186.00	2,219.09	2,724.54	3,251.51	3,280.13
	%	60.7	58.0	58.4	54.7	49.6
Government contributions	Millions EUR	1,299.49	1,511.58	1,866.07	2,606.14	3,220.22
	%	36.1	39.5	40.0	43.8	48.7
Other receipts	Millions EUR	113.00	96.86	73.88	89.73	116.12
	%	3.1	2.5	1.6	1.5	1.8

Source: NSI.

In 2009 Bulgaria spent EUR 6.0 billion for social protection, which represented 17.2% of GDP. Expenditure on pensions accounted for the highest share in total benefits, followed by expenditure on healthcare and sickness benefits. Expenditure on family and child benefits had a continuous upward trend with a share of 10.3% and 12.0% of total social benefits in 2008 and 2009 respectively (Table 7). This increase was partly due to the lump sum benefit for bringing up a

<sup>46</sup> NSI (2011) European System of Integrated Social Protection Statistics (ESSPROS) - 2009.

child by a mother-student and a lump sum benefit for bringing up twins that was introduced in 2009.

**TABLE 7: Share of social protection benefits by function**

		2005	2006	2007	2008	2009
<b>Total</b>	<b>Millions EUR</b>	<b>3,391.11</b>	<b>3,646.93</b>	<b>4,260.84</b>	<b>5,393.99</b>	<b>5,820.26</b>
	<b>%</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>BY FUNCTION</b>						
Sickness/ Healthcare	Millions EUR	984.42	951.36	1,139.59	1,563.23	1,370.03
	%	29.0	26.1	26.7	29.0	23.5
Disability	Millions EUR	285.45	333.21	348.65	408.42	483.87
	%	8.4	9.1	8.2	7.6	8.3
Old age	Millions EUR	1,612.72	1,743.71	1,971.77	2,386.90	2,721.34
	%	47.6	47.8	46.3	44.3	46.8
Survivors	Millions EUR	121.47	176.56	195.33	236.20	292.12
	%	3.6	4.8	4.6	4.4	5.0
Family/ Children	Millions EUR	230.72	270.06	415.01	553.86	696.55
	%	6.8	7.4	9.7	10.3	12.0
Unemployment	Millions EUR	64.02	79.98	84.62	122.35	182.56
	%	1.9	2.2	2.0	2.3	3.1
Housing and soc. exclusion not elsewhere classified	Millions EUR	92.33	92.04	105.66	121.62	71.55
	%	2.7	2.5	2.5	2.3	1.2

Source: NSI.

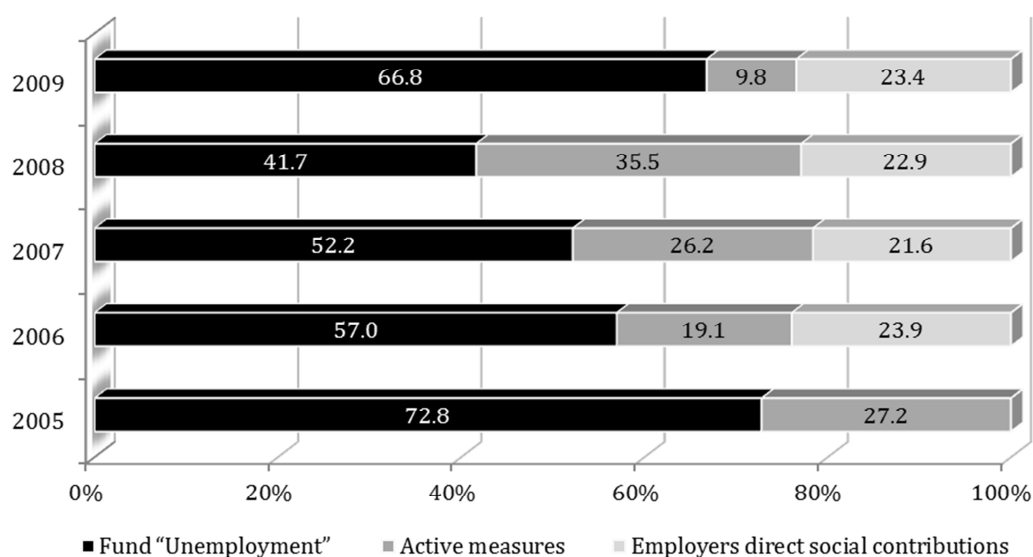
Unemployment benefits<sup>47</sup> represent only a small part of social benefits (just 0.3% of GDP) and their share of total social protection benefits remained at about 2% during the period 2005-2008. In 2009 however, there was a marked increase of the share of unemployment benefits to 3.1% of total social protection benefits (and 0.5% of GDP) reflecting the adverse impact of the economic crisis on employment.<sup>48</sup>

<sup>47</sup> The ESSPROS Manual of EUROSTAT defines benefits under the “Unemployment” function that: “replace in whole or in part income lost by a worker due to the loss of gainful employment; provide a subsistence (or better) income to persons entering or re-entering the labour market; compensate for the loss of earnings due to partial unemployment; contribute to the cost of training or re-training people looking for employment; help unemployed persons meet the cost of travelling or relocating to obtain employment; provide help and relief by providing appropriate goods and services.”

<sup>48</sup> Protection against unemployment is realized through fund “Unemployment” administered the National Social Security Institute (passive measures – unemployment benefits and early retirement benefits) and through active measures for encouragement of employment implemented by the NEA (benefits and allowances). All benefits under the “Unemployment” function are non means-tested, i.e. they are not

The changes in the labour market observed since the onset of the crisis were also reflected in a significant increase in the share of cash benefits associated with passive labour market measures, which increased by more than 1.3 percentage points between 2008-09. The share of passive benefits, which accounted for 72.8% of all cash benefits in 2005, fell to 41.7% in 2008. However by 2009 these benefits had increased by more than 25 percentage points to reach 66.8% of all expenditure on passive measures. At the same time, the share of benefits in kind, referring mainly to active measures in the labour market (mobility and resettlement, vocational training, placement services and job-search assistance) decreased from 35.5% in 2008 to only 9.8% in 2009, reflecting the growing number of unemployed entitled to cash benefits.

**FIGURE 3: Share of expenditure under the function “Unemployment” by schemes**



Source: NSI.

## 5. CONCLUDING REMARKS

The economic downturn has posed a serious challenge to the successful integration of disadvantaged groups in the labour market. In the years to come the effective inclusion of young people, long-term unemployed, people with disabilities and other vulnerable groups in social and economic life will be one of the necessary conditions for economic growth, full employment and social cohesion and should be considered as an integral element of the way out of the crisis.

Increasing the quality of employment has to be considered as the most effective measure in combating poverty and social exclusion, which in periods of recession requires the elaboration and implementation of special policies targeted at disadvantaged groups. In the light of the active population ageing, the very high emigration of young people, and the constantly growing youth unemployment during the last few years, one group of initiatives should be focused on the

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associated with the requirement to cover any additional conditions on their receipt as a result of participation in the social protection system.

inclusion of young people in the economy and expanding their capabilities on the labour market.

The austerity measures and public expenditure cuts introduced by the Bulgarian Government in order to sustain low budget deficit substantially reduce the financial resources necessary to cover social protection system spending. The low rates of economic recovery and the difficulties associated with the collectability of social contributions in times of crisis limit the opportunities of the social protection system to reduce the negative effects that the economic downturn exerts on the population income and standard of living. For the effective functioning of the social protection system it is necessary to speed up the government reforms in the pension and healthcare systems and to effectively implement measures directed at defining more precisely social insurance payments, social protection benefits and the coverage of provided social services.



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## CHAPTER 7.

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### **Croatia's Troubled Economy and Society**

Vojmir Franičević

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#### **1. INTRODUCTION**

In the 1990s shocks of transition, war and SFRY dissolution brought a dramatic fall of output and employment, but also problematic political and moral economies of emerging capitalism. After the troubling 1990s, ending with a recession and crisis of 'crony capitalism', in the 2000s Croatia embarked on the path of Europeanization, which until 2008 was accompanied with economic growth and improved social and living standards. However, and independently of global trends, it became clear that this growth, as well as public spending, were not sustainable due to economic and institutional deficits built into the foundations of the model. Instead of model change, the 2000s will bring normalization and consolidation (Franičević and Bičanić 2007). While European and IFIs-led modernization will be influential, path-dependencies and legacies of the socialist period and particularly of the 1990s will remain important too. Weaknesses of this particular institutional set-up will clearly be exposed by the global crisis of 2008.

Throughout South East Europe during the first half of 2008 'there was a feeling that SEE would be able to escape the worst of the contagion from the (global) crisis' (Sanfey 2010: 2). However, the impact has been stronger and more durable than expected, although variable (see Bartlett and Prica 2012), while on-going Euro-zone crisis is only increasing uncertainty about the future. Worsening of economic performance by the 2d half of 2008 had immediate yet lasting consequences on vulnerable social groups, regions, communities, firms, households and individuals. Instead of recovery, as hoped for during 2011, the crisis is deepening again and with no visible ending, thus opening some critical issues concerning viability of Croatia's political/social-economic model.

Populism and clientelism embedded in paternalistic political economy, widespread corruption and cronyism as well as state capture have dominated the new political and economic elites'

attempts to promote their interests and power and consolidate their weak legitimacy in a society where many have remained and/or became *dependent on the state* – from war veterans to new entrepreneurs, farmers, pensioners, state-owned firms and public sector employees.

Dependence on the state is further accentuated by *demographic trends*. Croatia belongs to countries with most pronounced ageing: median age of 41.5 years in 2010 is expected to increase to 45.2 in 2025 (Čipin 2012). This is coupled with decreasing activity rates (Figure 1 below). Low fertility will lead to further population decrease of some 5 per cent in 2005–2025. Population aging (the share of 65+ is set to increase by 23 per cent - to 22.3 per cent in 2025, while 0-40 contingent is expected to decrease both absolutely and relatively), and shrinkage of the working age population (15-65) by a further 10 per cent in 2025, with greatest fall in 20-24/25-29/30-34 groups by some 25/20/18 per cent respectively) are sources of long-term changes and challenges (Čipin 2012).

Already low activity rate of 63.2 per cent in 2008 (15–64) decreased to 60.8 per cent in 2011, adding to concerns about the system's fiscal and economic viability. Could depopulation trends be compensated by immigration surplus of needed 200,000 (Čipin 2012) when the crisis is leading so many (mostly younger) citizens the opposite way? Could ageing be compensated with greater activity and fertility, besides immigration (Čipin 2012)? Is Croatia able to embark on growth path founded on much greater productivity? These issues, particularly in the context of present crisis, are the critical ones.

In this chapter I shall focus on the crisis' consequences but also on underlying challenges facing polity and society. In section two I focus on labour markets and poverty trends as well as on social policies. In third section two social groups will be singled-out - young and aged ones - as well as two major issues: long-term unemployment and worsening dependency ratio in the pensions system. I end with a concluding discussion.

## **2. THE 2008-12 CRISIS: A DEEP SOCIAL IMPACT**

After a period of growth in the 2000s, a deep recession set in by the second half of 2008 with no clear prospect of coming to an end: not only forecasts for 2012 are negative, but uncertainty concerning mid-term evolution is high as well. Underlying these cyclical phenomena are a number of unresolved structural issues and institutional deficits, only made worse (internally) by delay of reforms and (externally) by worrisome developments both in Euro-zone and the Western Balkans, where the Croatian main trading partners are. The first phase austerity policies (2009/2010) did not lead to serious cuts in social spending, or to cuts in public sector employment. While the parliamentary elections in 2011 strongly influenced (old) government policies to avoid moves that could alienate voters, in the second austerity phase of 2012, due to worsened economic trends and increasing foreign risks, major cuts proved to be much harder to avoid, but to impose too. As Table 1 illustrates, major negative trends are present: growth (negative or zero growth from 2009 with expected cumulative decrease of about -10 per cent by 2012), fiscal and foreign deficits, making present level and structure of commitments to various social groups hardly viable and credible, while social conditions are deteriorating for an increasing number of Croatian citizens.

**TABLE 1: Macroeconomic data of Croatia, 2001-2011**

	2005	2006	2007	2008	2009	2010	2011e
GDP change rate	4.3	4.9	5.1	2.1	-6.9	-1.4	0.0
Consolidated general government expenditure (% GDP)	41.1	40.1	41.0	40.1	42.2	42.3	41.3
Consolidated general government fiscal balance (% GDP)	-3.5	-3.4	-3.0	-2.1	-4.6	-5.4	-5.4
Public debt (% GDP)*	38.2	35.4	32.9	29.3	35.8	42.1	46.7
With government guaranteed debt	45.5	42.9	41.3	42.3	51.3	60.3	64.6
Foreign debt (% GDP)	72.1	74.8	77.7	85.0	101.0	103.6	101.8
Unemployment rate – ILO	12.7	11.2	9.6	8.4	9.1	11.8	13.5
Unemployment rate-administrative	17.9	16.6	14.9	13.2	14.9	17.4	17.8

Notes: \*GFS 2001 including debt to pensioners.

Sources: CBS, CNB and Ministry of Finance.

## 2.1 Labour market deterioration

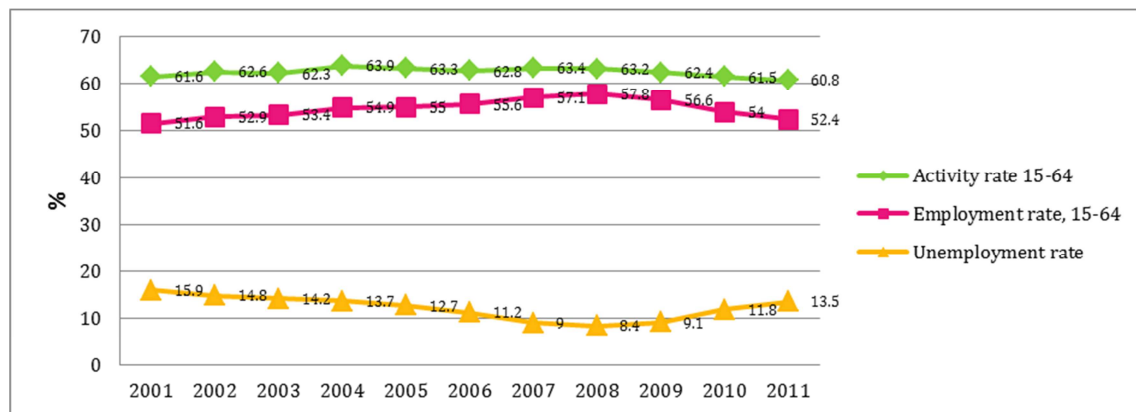
Croatia entered the recession with important labour markets weaknesses: (i) low activity/employment rates; (ii) high long-term unemployment rates; (iii) flexibility at the margin, leading to dualization of labour markets, making temporary workers particularly vulnerable to cyclical adjustments; (iv) pronounced regional differences (not dealt with here) concerning employment/unemployment. The recession led to significant job-losses, reduction in activity/employment rates, but strong increase in unemployment and inactivity (Table 2 and Figure 1).

**TABLE 2: Activity, employment and unemployment in Croatia, 2001-2011**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Employment total, LFS	1469	1528	1537	1563	1573	1586	1614	1636	1605	1541	1492
-change in%	-5.7	4.0	0.6	1.7	0.6	0.8	1.8	1.4	-1.9	-4.0	-3.2
Unemployment, LFS	277	266	256	250	229	199	171	149	160	206	232
-change in%	-7.6	-4.0	-3.8	-2.3	-8.4	-13.1	-14.1	-12.9	7.4	28.8	12.6
Employment registered, in 000	1338	1359	1393	1409	1420	1468	1517	1555	1499	1432	1411
<i>In legal entities</i>	1056	1060	1088	1103	1113	1160	1212	1252	1211	1168	1160
Unemployment registered	380	390	330	310	309	292	264	237	263	302	305

Sources: CBS, CES.

**FIGURE 1: Activity, employment and unemployment rates, 2001-2011, LFS**



Source: CBS.

The impact of the recession on employment was strong, particularly in the real sector. Those on temporary contracts were affected hardest, but increasingly the 'core' workforce was affected too. Due to the differential sectoral impact, males were hit more, but with incoming public sector austerity females are likely to be more affected. The youth has been affected strongly: 15-24 age groups' unemployment rate increased from 22.0 per cent in 2008 to 36.2 per cent in 2011. However, in many affected businesses workforce cuts were often targeted to aged workers too (to these two groups I will return later).

**TABLE 3: Real wage trends in main industrial sectors, 2001–2011**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total	2.6	3.2	4.0	3.7	1.5	1.9	2.2	0.8	0.2	-0.5	-0.4
Manufacturing	6.5	4.3	4.5	2.1	2.6	3.2	1.6	0.8	-1.2	-0.1	-0.6
Construction	6.5	10.8	6.4	1.7	-0.6	2.9	4.5	0.5	-1.5	-3.8	-0.6
Trade	4.9	7.5	4.9	3.4	1.4	1.5	2.3	0.8	-1.7	0.6	-0.6
Real estate, renting and business services*	0.7	1.4	4.9	4.8	3.2	3.5	0.3	0.5	-0.2	-3.6	-2.6
Public administration	-6.1	0.1	5.0	1.0	-0.3	1.3	4.4	3.1	1.9	-0.7	-0.7
Education	1.7	0.6	4.3	3.3	-0.5	0.7	3.1	1.6	0.7	-0.3	0.1
Health	-0.9	-1.2	2.6	2.7	3.5	0.8	2.7	0.3	0.0	-1.2	-1.5

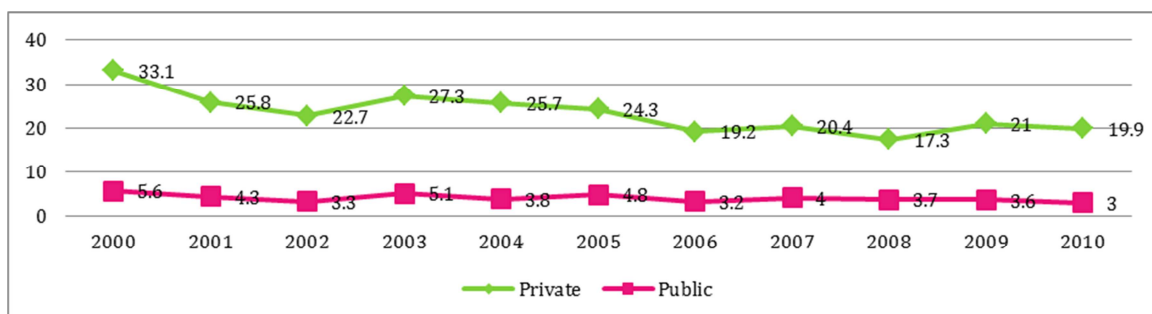
Note: \* ISIC 3 (up to 2008): K, ISIC 4 (2009 to 2011): 63, 64, L,M,N. Incorporated businesses only.

Source: CBS (from Franičević and Matković 2012).

So far, employment stability characterised the public sector, with the private sector taking most of the job losses. This opened a particular dividing line between public/private sector employees, strongly influencing the present public discourse as well as policies, where some experts and private media in particular stress the need for 'levelling-down' working conditions in the public sector. Behind such demand is an argument (contested by public sector unions) that public sector has not taken a fair share of the crisis burden (more in Franičević 2011 and Franičević and Matković, 2012). In addition to employment adjustments, downward wage and benefits adjustments were taking place as well, although unevenly (Table 3).

Low pay incidence has increased with the crisis (Figure 2). For many this means an increase in poverty risk.

**FIGURE 2: Share of employees reporting income below 60% total mean, LFS**



Source: CBS (from Franičević and Matković (2012)).

The minimum wage which increased in June 2009 (and remained frozen on that level), has acted as a safeguard against poverty and deprivation for many exposed to low pay, particularly in the private sector. While in 2008 some 11 per cent were receiving the minimum wage in the private sector, the respective percentage was only 2 per cent in the public sector (8 per cent for total) (Nestić and Rašić Bakarić 2012). My estimation (Franičević 2011) from REGOS data on gross wages showed, however, a decrease of the share from 7 per cent in January-November 2009 to some 4.5-4.7 per cent in March-September 2010. It could be, however inconclusive, an indication of greater job losses among the low paid (and/or move to informality).

Being employed does not provide insurance against the non-payment of wages. Namely, the crisis has deeply affected a number of businesses and crafts that ended with 'blocked accounts'. Average annual number of employed in such establishments strongly increased with the recession: from 46,798 in 2007 and 48,491 in 2008 to 63,419 in 2009 (74,405 in October); 69,347 in 2010; 70,610 in 2011; and 68,902 in q1 of 2012 (HGK/FINA monthly data). Common are desperate employees' actions to recover their wages from failing employers. As illiquidity is increasing and reaching critical proportions, vulnerability of employees to non-payment of wages is increasing too. Better protection of workers' rights (a major unions' demand) in failing firms has become one of the policy priorities as reflected in the February 2012 changes to the Law on Bankruptcy. Yet, new revisions are in the making.

## 2.2 Poverty risk

If put in a comparative perspective, particularly related to post-socialist EU countries, Croatia is not an outlier. Concerning poverty and inequality indicators, Croatia is close to southern tier transition countries, some Mediterranean and Baltic countries, but its position is worse than in the EU 15 (Table 4). Poverty and exclusion are a matter for serious concern that have not always been properly addressed. As 'poverty profile is dominated by unemployed and inactive, this leads to the conclusion that poverty is of long-term nature' in a low job creation economy (Malenica 2011, 77). The 2008-2012 crisis has created additional concerns.

**TABLE 4: Poverty and inequality indicators 2010, selected countries, SILC**

	At-risk-of-poverty rate, %	S80/S20)	Gini	At-risk-of-poverty rate, before social transfers, %	At-risk-of-poverty rate, pensions and social transfers excluded, %
<b>Croatia</b>	<b>20,5</b>	<b>5,6</b>	<b>0,32</b>	<b>30.2</b>	<b>44.6</b>
<i>Romania</i>	<i>21,1</i>	<i>6,0</i>	<i>0,33</i>	<i>27,5</i>	<i>47,4</i>
<i>Bulgaria</i>	<i>20,7</i>	<i>5,9</i>	<i>0,33</i>	<i>27,1</i>	<i>40,8</i>
Slovenia	12,7	3,4	0,24	24,2	39,9
Czech Republic	9,0	3,5	0,25	18,1	37,2
Slovakia	12,0	3,8	0,26	19,8	38,2
Hungary	12,3	3,4	0,24	28,4	51,4
<i>Estonia</i>	<i>15,8</i>	<i>5,0</i>	<i>0,31</i>	<i>24,9</i>	<i>40,8</i>
<i>Latvia</i>	<i>21,3</i>	<i>6,9</i>	<i>0,36</i>	<i>29,1</i>	<i>43,7</i>
<i>Lithuania</i>	<i>20,2</i>	<i>7,3</i>	<i>0,37</i>	<i>31,8</i>	<i>48,1</i>
<b>EU 27</b>	<b>16,4</b>	<b>5,0</b>	<b>0,31</b>	<b>25,7</b>	<b>43,4</b>

Source: CBS First Release, No. 14.1.2, 2010.

One particular issue is the emergence of 'new poor'. Namely, 'a newly unemployed person is more likely to be a prime-age skilled blue-collar male worker' (World Bank 2010, 8; Matković 2010). 'The crisis disproportionately hit primary earners (prime-age men) who are likely to be household heads', which differs from the pre-crisis period when 'predominantly secondary earners (youth, women) . . . bore the brunt of labour market adjustment' (World Bank 2010, 24, 38). The study argued that for the 'new poor' their condition is likely to be difficult, but 'transitory'; once job prospects improve they stand a better chance of re-employment (World bank 2010, 9). However, with the recovery delayed, many ended in long-term unemployment while many jobs will not be recovered at all (e.g. manufacturing and construction) making the situation a permanent one.

As poverty-risk data show, being an employed person is the main insurance against poverty risk, being unemployed or inactive is a major liability. In 2010, against 20.5 per cent poverty risk for total population, see Table 5 above, employed/self-employed persons enjoyed much lower

(5.0/12.7 per cent) risk, while unemployed and other inactive persons suffered high (i.e. 44.7 / 34.9 per cent respectively) poverty risk – being particularly exposed to social exclusion and material deprivation. Retired persons' poverty risk of 22.9 per cent is lower, but still higher than for the overall population.

Concerning households, at high poverty risks are particularly one-person households (44.8 per cent), especially aged ones (50.2 per cent for 65+); single parent households with one or more dependent children (34.6 per cent) or households with three or more dependent children; households with no work intensity (44.7 per cent), particularly with dependent children (77.7 per cent) (CBS-SILC).

Social transfers, as Table 5 shows, play a major role in risk reduction, as do pensions. Due to stability of pensions throughout the crisis period, 'households headed by the economically active workers... were more likely to be affected by the crisis than those headed by retired workers' (World Bank 2010, 37).

**TABLE 5: Poverty risk, Croatia 2003-2010, in %**

	2003	2004	2005	2006	2007	2008	2009	2010*
Total population	18	18	18	17	18	17.3	17.9	20.5
Social transfers excluded	31	31	26	25	25	25.3	25.5	30.2
Social transfers and pensions excluded	39	38	43	42	42	42.8	40.9	44.6

Source: CBS First Release, No. 14.1.2, 2011; Note: cut-off point 60 per cent of median; Note\*: 2003-2009 based on HBS; 2010 based on SILC ('not directly comparable').

*Crisis has brought an increase in deprivation and exclusion.* There are many statistical indications to that effect, surveys, anecdotal evidence, media reports but 'street evidence' too. Table 6 provides some comparative data for 2010:

**TABLE 6: Deprivation and exclusion, 2010, SILC, in %**

	Persons aged less than 18 living in households with very low work intensity	Aged less than 60	Persons at risk of poverty or social exclusion	Aged 65+	Aged 65+ females	Persons exposed to material deprivation of 4 items or more	3 items or more	5 items or more
EU 27	9.1	10.0	23.5	19.8	22.6	8.1	17.5	3.3
NMS	6.5	7.8	30.2	28.4	31.8	19.2	34.5	9.3
<b>Croatia</b>	<b>13.0</b>	<b>15.4</b>	<b>31.3</b>	<b>34.7</b>	<b>38.3</b>	<b>14.5</b>	<b>32.4</b>	<b>5.3</b>

Source: Eurostat-SILC.

Note: Percentage of persons in total population or in a particular age-group.

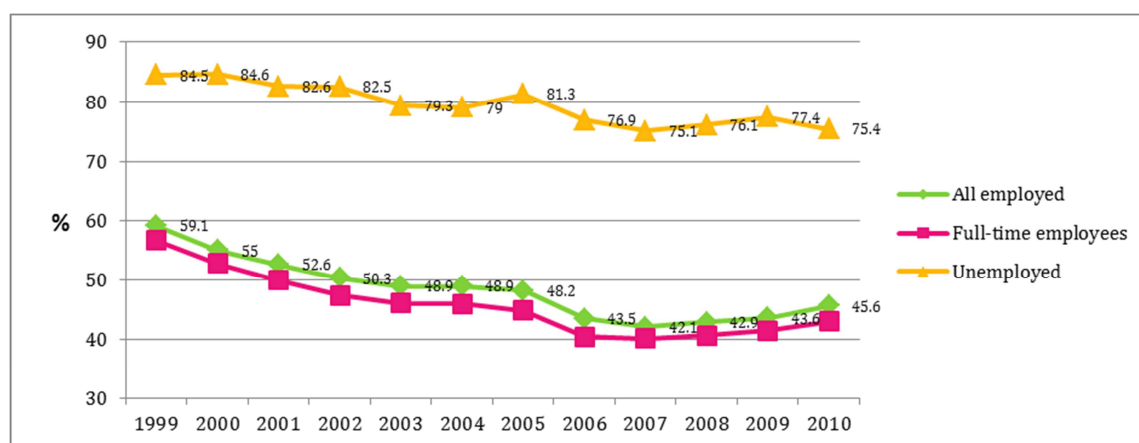


At risk of major deprivation and exclusion are particularly persons living in jobless households: share of those aged 18-59 living in such households increased from 10.8 per cent to 11.2 per cent and 12.5 per cent in 2008-2010 period (CBS-LFS), and for those aged 17 or less it increased from 7.2 to 8.2 per cent and further to 10.2 per cent (CBS-LFS).

*Crisis is felt at working places and homes.* Recent research found that the quality of working life in 2008-2011 'deteriorated'. Mostly affected is 'the perception of extrinsic job aspects such as adequate pay, fair pay and job security'. The strongest was the impact on those with lower education (Galić and Plećaš 2012, 31 and 33) The positive trend regarding the quality of working life improvement notable from 1993 to 2008 (Šverko and Galić 2009), has been reversed with the crisis.

Adverse effects of the crisis are felt in many Croatian households. *Households' financial situation worsened* (Figure 3) for all employed and full time employees; and remained very precarious *for the unemployed*.

**FIGURE 3: Households' financial situation as 'mostly bad' or 'bad', 1999-2010, LFS**



Source: CBS.

In the 2010 employees survey (n=1519, non-representative), 46 per cent reported that *crisis strongly affected their living conditions*, and a further 50 per cent felt that effect lightly (Moj Posao, 2010). In the April 2010 Gfk survey (representative, n=800), 71 per cent said they felt the crisis directly or in the household: 37 per cent through wage cuts; 16 per cent received wages with delay; 14 per cent were dismissed; 57 per cent reported living harder, though still 'normally'; but 18 per cent 'very hard'. Gfk surveys on realised and needed households incomes show increasing 'needs deficit': while from 2002 to 2008 the *share of those needing higher incomes* (to cover households needs) was falling from 80/82 per cent in 2002/2003 to 68 per cent in 2008, in 2009-2011 the shares were 71/77/72 per cent in the three years respectively.

Due to falling employment and disposable incomes, vulnerability of indebted households (some 30 per cent of all households) to macroeconomic and financial shocks is increasing (dominant are loans with flexible interest rates and tied to foreign currency exchange rates). Simulations done in a CNB-EIZ project show an increase in the share of vulnerable households (in total indebted ones)

from 5.3 per cent in 2008 to 9.6 in 2009, 11.3 in 2010 and 13.7 per cent in 2011 (CNB, *Financial Stability*, No.9, July 2012, pp. 26-29).

*Stress and fear of losing one's job* was reported by most employees interviewed for Franičević (2011) report. Particularly those on lower wages, but supporting larger families, have major difficulties in meeting their ends. Consumption cuts, postponement of important moves (having a child, buying an apartment ...), and increases in family tensions were reported. Various coping strategies are used: moonlighting, gardening, asking relatives help... Even if habituated to very modest living, most are vulnerable.

While one particular business has been mushrooming around depressed Croatia - agencies engaged in buying gold from citizens - 'competition' around garbage containers, as well as for welfare assistance, has been increasing.

Social welfare is under pressure of viability and reform. The crisis has increased demand for social protection. For unemployed the most important is the unemployment benefit which is 'an effective anti-poverty policy program' (World Bank 2010, 41) – yet its coverage is too low due to restrictive eligibility and limited duration; its replacement ratio is low for the majority (but uneven too, due to changing regimes) (more in Franičević 2011, 175-6). In 2010, only 20 per cent unemployed reported receiving benefits/assistance (19.4 per cent in 2009; and 15.4 per cent in 2008) (LFS data). Among registered unemployed the share of those receiving unemployment benefits somewhat increased in 2009 and 2010 but decreased in 2011, as the 2007-2011 shares show (22.6/24.2/26.3/25.9/24.4 per cent, CES). A policy challenge is not only to increase coverage and replacement rates but to integrate protection of the unemployed with re-employment policies. In both respects, Croatia is lagging behind, while spending on Active Labour Market Policies ALMP (and coverage by them) is too small to produce notable effects (both on passive and active labour market programs spending is about 0.4 per cent GDP only - World Bank 2010, 42). Lack of re-employment opportunities leads to increase in long- term unemployment, non-employability and social exclusion. With too many unemployed being without adequate income and re-employment policy support, the informal economy is their only alternative. The precarious situation of the unemployed is certainly a critical social and political issue, hard to deal with - even if recognised by the government.

There is a developed and stable social welfare system in Croatia, and overall spending on social assistance is high by regional standards (World Bank 2010, 49-50). The crisis did not bring reductions in most social welfare programmes or in pensions (but indexation was suspended in 2009 and restored only in 2012). However, there was no increase in funds or new welfare programs related to growing (new) needs due to the crisis (Zrinščak 2012, 5). While this combination of stability and passivity helped many persons through the crisis, some critical issues emerged: viability, adequacy and efficiency/targeting of most programs. The excessive reliance on categorical benefits was criticised, as opposed to needs-based ones (leading to high costs, poor targeting and social waste) (World Bank 2010, 49-55). More fundamental criticism regards the following issues: (i) 'captured social policy', with dominance of some groups and public discourses (e.g. war veterans and pensioners) while other issues, such as poverty and exclusion, are relegated to the margin of public/key actors interests; and (ii) 'social clientelism', characterised by

‘particularity, asymmetry, differentiated and politically very calculated affording of particular or disproportional rights to some groups, but not all’ (Stubbs and Zrinščak 2012, 13 and 16). Both issues, in presence of increasing fiscal constraints, make social spending reforms urgent, yet highly uncertain.

As expected, ‘there is a growing number of the beneficiaries of social assistance and other welfare payments’ (Zrinščak 2012, 2). Table 7 presents data on important means-tested cash program (together with child allowance – the best targeted ones) for those in need. However, the program’s coverage is poor (it covers ‘only a fraction of poor’); strict eligibility criteria ‘limited its immediate poverty mitigation role during the current crisis’; ‘arbitrarily set income threshold... diminishes (its role)...as the automatic fiscal stabilizer’; and due to its relative generosity it ‘may create labour supply disincentives’ (World Bank 2010: 52-53). ‘Inactivity trap’ is more likely for households of the following categories: whose member, if employed, is looking for a low wage only; when all adult members are unemployed; those with more children (Bejaković et al., 2012).

**TABLE 7: Permanent social assistance recipients**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Recipients	112,034	121,778	121,515	120,916	119,470	112,508	102,953	92,819	94,849	102,668	104,179
Share in population	2.52	2.74	2.74	2.72	2.69	2.56	2.32	2.09	2.14	2.32	n.a

Source: Ministry of health and social care and CBS.

There is increasing evidence of welfare funds inadequacy to meet growing demand (e.g. for one-off cash or in-kind assistance) (Zrinščak 2012, 9), as well as evidence on mounting difficulties of many local governments that have to finance local welfare programmes (controversial due to major differences among them in scope and generosity), leading to reductions and cuts. In addition, funding of NGOs active in this field has recently been cut considerably (in 2012 budget), with negative effects on their ability to provide services to those in need, including the most vulnerable ones. Also Caritas, a major Catholic Church charity, ‘has been faced with a huge number of new claimants who have asked for different types of help’ (Zrinščak 2012, 11). As Zrinščak puts it: in spite of the fact that ‘the basic safety net has been protected....an overall social deterioration has happened and would continue to affect people in line with the prolonged crisis (2012, 16). This prolongation of the crisis is producing pressures on the government to design coping strategies, in case of a major further deterioration, as well as social policy reforms aimed at targeting, re-activation and equity (concerning marginalised groups in particular).

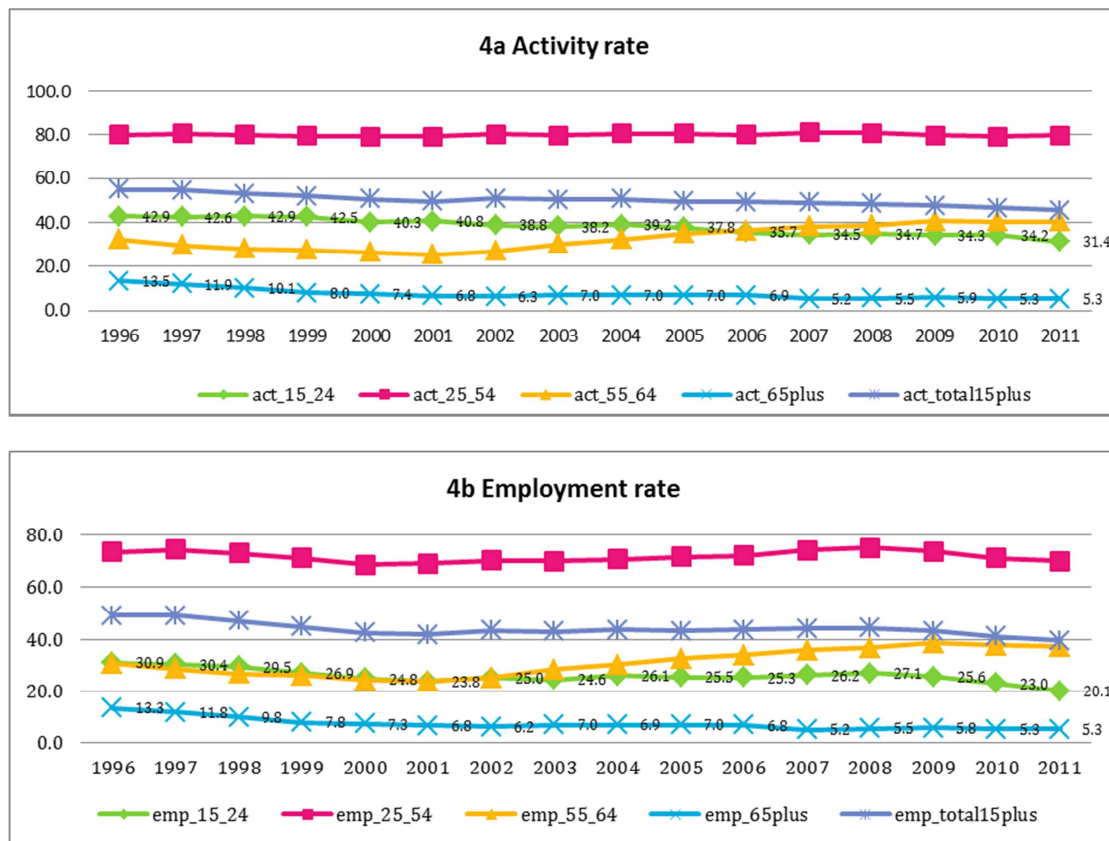
### 3. TWO SOCIAL BOMBS: YOUNG AND AGED

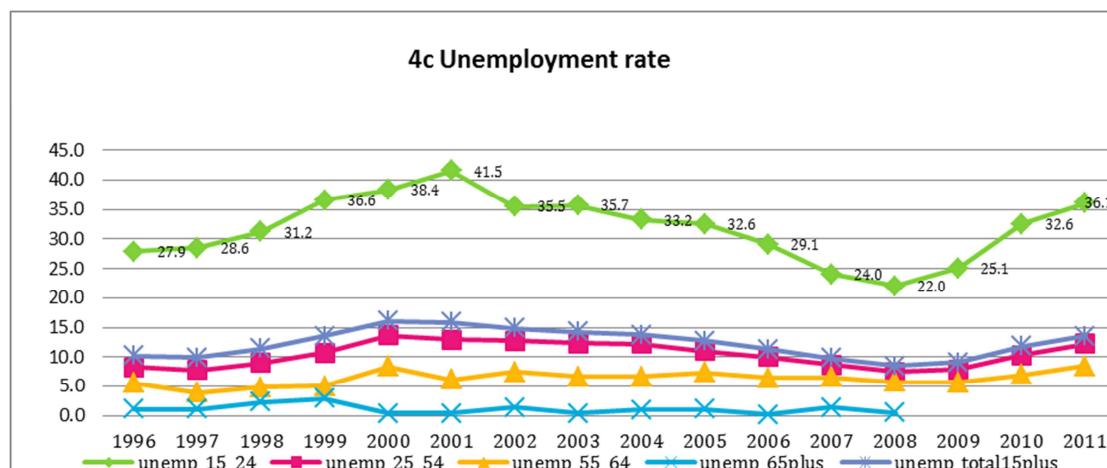
Two social bombs are ‘ticking’. One relates to youth unemployment, another to worsening position of aged groups whose share in population is increasing.

#### 3.1 Youth unemployment: a ticking social bomb?

With the 2008 recession, the youth employment rate started to decrease and unemployment to increase, reaching levels of late 1990s/early 2000s. In combination with major structural deficiencies concerning educational output and entrepreneurial deficits, such trends present society with major social and demographic problems. Croatia is facing a major loss of human capital due to crisis-led emigration, as there is accumulating evidence on the young opting for emigration. World Bank ‘Golden Growth’ (2012, 479) report puts Croatia among the top European countries when it comes to emigration of those with tertiary education. While negative effects on fertility rates in an ageing society have long-term consequences, in the short term youth unemployment severely increases risks of social instability and might lead to new waves of protest (as were those in spring 2011). Policy challenges are multiple: they concern active labour market policies, educational reforms, entrepreneurship (demand side deficits on labour market are under-estimated in policy discussions on skills mismatches), and population policies. Low employability of young is certainly a major challenge Croatia is facing – failure to deal with it is causing very serious social and developmental consequences.

**FIGURES 4 (a- c): Activity, employment and unemployment by age groups, 1996-2011, LFS**





Source: CBS.

### 3.2 Reduced job opportunities

There is plenty of evidence that 'cost-cutting' workforce reorganization has been a dominant strategy of private sector firms in adapting to recession (and it is a favoured public sector strategy too; Franičević and Matković 2012). Defensive restructuring in Croatia has been much more pronounced than in Western Europe and CEE (Ronald Berger 2010). This contributed to major job losses in the private sector during the 2008-2011 period (of some 150,000), with stable employment in the public sector, opening major social cleavages along public/private line. While for all age groups of workers the job-loss risk has increased considerably, the impact was strongest on those on temporary contracts. Yet, as the core workforce had to be cut too, the situation for aged workers became particularly precarious due to low re-employability in case of dismissals (Table 8).

**TABLE 8: Job-loss risk 2005-2010 (in %)**

	'I might lose my job in next 6 months' - agree	'I might lose my job in next 6 months' - agree	'If I were to lose or quit my job, it would be easy for me to find a job of similar salary' - disagree
	<b>2005</b>	<b>2010</b>	
<b>CROATIA TOTAL</b>	<b>19.3</b>	<b>26.7</b>	<b>61.6</b>
Males	20.1	29.5	64.9
Females	18.6	23.2	59.9
Under 30	25.2	36.0	49.7
30-49	18.2	26.5	60.6
50+	17.7	21.8	72.0
Permanent contracts	15.4	21.3	64.7
Other contracts	45.9	54.5	54.1
Self-employed	9.0	26.5	50.7
EU15	11.3	14.6	47.2
EU27	13.7	16.4	48.3

Source: <http://www.eurofound.europa.eu/ewco/surveys/ewcs2010/results.htm>

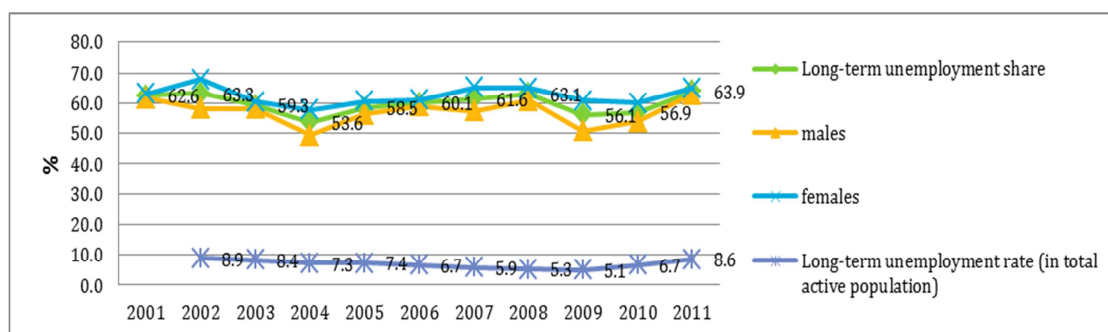
Firms often targeted aged workers, offering them financial incentives, but pressuring them too to early retirement (until November 2010 penalty for early retirement was very low), or dismissing them (often through programs of ‘technological surplus’) (Franičević 2011). Once unemployed, aged workers can hardly get re-employed, not only due to reduced job opportunities, but to strong age discrimination (Franc et al. 2010).

Thus, two major ‘pathologies’ increased with the 2008-12 crisis: long-term unemployment, and inactivity coupled with worsening of employed/retired ratio.

### Long-term unemployment

Croatia exited the 1990s with high long-term unemployment (LTU). This indicates structural, mobility and job-creation deficits. If the first recession shock of 2008/2009, resulting in major outflows to unemployment, led to a decrease in LTU, lack of recovery in ensuing years has led to a major increase (Figure 5) Prolongation of the crisis is leading to further increase in LTU, coupled with non-employability, de-activation, and social marginalization. Loss of human capital is imminent too. LTU is presenting policy-makers with major challenges concerning re-employment (through ALMP) and new jobs creation (i.e. dealing with serious entrepreneurship deficits), but prevention of poverty increase and marginalization too.

**FIGURE 5: Long-term unemployment 2001-2011, LFS**



Source: CBS.

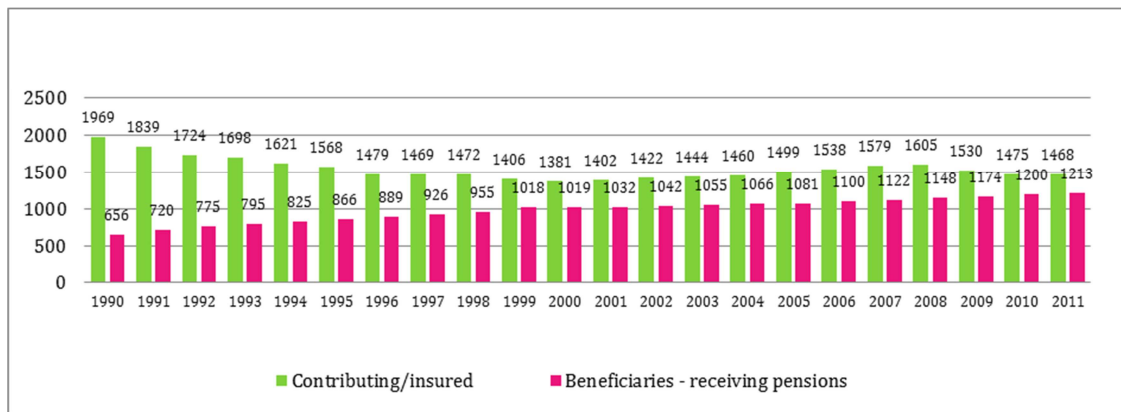
### **3.3 Dependency and paternalism: is it viable?**

The 1990s brought major economic and social shocks, resulting in social dislocations, job destruction and de-activation. The growth period in the 2000s will not be able to make up for that loss and the 2008 recession will lead to new pressures to decrease employment but increase unemployment and inactivity. Behind such processes a particular paternalistic political economy consolidated, based on populism and clientelism. This led to dependency on the state of some large social groups and development of business-modes dependent on deals with the state; while the state ended captured by special interests thus created. However, with the mounting fiscal crisis of the state (Table 1) and likely further rating downgrade, viability and credibility of such

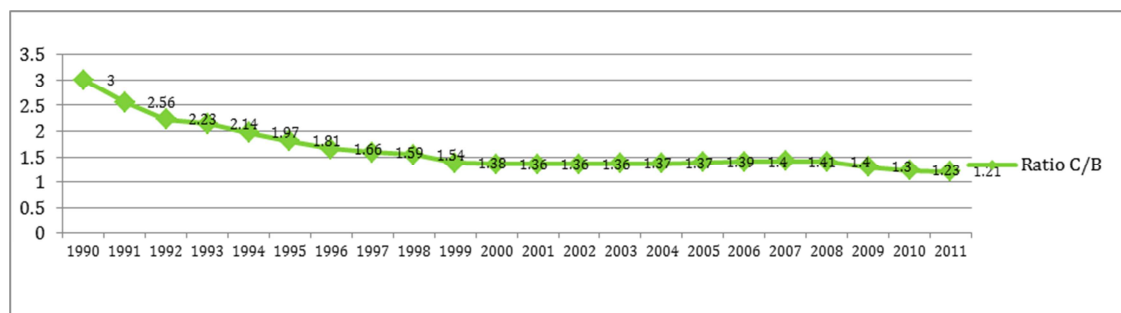
arrangements is diminishing. This may lead to new business failures, government austerity measures and structural crisis, requiring far-reaching reforms.

In the long term particularly worrisome, in connection with demographic trends, is the future of the pension system. Namely, the long-term trend of increased number of pensioners, coupled with falling number of contributors (i.e. employed), has led to a dramatic decline of the ratio of contributors to pensioners in 1990s, to be checked by the growth episode of the 2000s, but to resume with the recession with new energy (Figure 6). With further economic and fiscal weakening, short-term viability may become questionable too (the system relies on the government budget), while long-term challenges presented by such trends are most formidable both concerning pension reforms and sustainable productivity increases in an ageing society.

**FIGURE 6a: Pensions - Contributors vs. Beneficiaries, HZMO data, year end**



**FIGURE 6b: Ratio C/B, HZMO data**



Source: Croatian Pension Insurance Institute - HZMO.

As recent simulation shows, under present rules (as defined by pension reform that started in 1999) and given future conditions (e.g. real wage growth of 2.5 per cent), the 'typical workers' replacement rate will be even lower than presently – at the EU bottom - which would 'considerably' increase pensioners' poverty risk' (Nestić and Tomić 2012). Moreover, differences between groups of pensioners are important, creating many 'distortions' (Bađun 2011) but injustices too. Pensions are inferior of those retired under two pillars compared to those under the first pillar only. In recent years, there was a notable fall in the replacement rate. Calculations done by Ž. Šemper show (quoted in the press but in more detail provided to the author by e-mail

communication) that the replacement rate for all retired by the end of December 2011 was 39.2 (share of average pension in the average net wage), but for those retired between 2008 and 2011, only 33.6. In his comment, he attributes such trends also to changes in the law: since January 2009 old age pension is not based on full work tenure (40/35 for males/females), as it has become enough to have a minimum of 65 years (males; 60 females) and 15 years of work tenure. This led to a strong decrease in average work tenure of old age pensioners (from more than 33 years in December 2008 to close to 29 years in later years). With a decreasing replacement rate, pensioners' poverty vulnerability (often including unemployed dependent adult children) is increasing.

A major source of controversies is the preferential treatment of some groups receiving beneficial pensions (15 per cent of total), often above the wage they would receive if employed (more in Bađun 2010 and 2011). A related issue is corruption, particularly in connection with disability pensions (which make 22.6 per cent of total pensioners by 2011) and war veteran's status.

In view of the unsustainable contributors/beneficiaries ratio, necessary and urgent reforms of the pension system dealing with both efficiency/sustainability but equity issues too, may not suffice. Labour market reforms are needed in parallel, in order to stimulate longer work tenure, to develop more flexible work arrangements for aged workers, to increase their employability through life-long learning, and, generally to increase population activity rate (Bađun 2010). The last point is the hardest in a society with pronounced ageing, particularly without major inflow of younger immigration population – a challenge Croatia is hardly able to face.

#### **4. IN CONCLUSION: MULTIPLE CHALLENGES AND RISKS**

With five crisis years, without any clear road to recovery, Croatia looks as a highly troubled society. Major systemic deficits are present, policy capacities and credibility are still low, social dissatisfaction and pessimism are increasing. Reforms are badly needed, yet political risks abound.

Moreover, the international setting is much less favourable than in the wake of the 1999 recession (including access to foreign credit for a highly indebted country); there is much less to expect, at least in the short term, from the European integration effect than was the case with the NMS-10. This is putting more pressure on domestic actors and resources, including painful redistributions (while the GDP cake is shrinking or stagnating), which is politically risky and may lead to social conflicts, particularly in the absence of social consensus (as happens in a society divided along multiple lines). Moreover, short-term policies preoccupied primarily with fiscal viability and stability, where avoiding rating downgrade is the major government priority, while seemingly 'rational', have a pro-recessionary impact and increase pressures for social protection, without necessarily providing beneficial terrain for entrepreneurship, profitable investments and new jobs creation.

Unfavourable trends on labour markets create needs for reforms and for existing policies upgrading, including capacity increase both concerning passive and active labour market policies.



A major part of these are educational reforms (tuned to labour market needs), including incentives for on-the-job training and life-long learning (in Croatia both close to the EU bottom). However, demand side should be approached in parallel: concerning business creation, their growth, as well as capacity for innovation and high-value production. Critical issues of youth unemployment might require bolder government intervention. Demands for re-industrialisation via industrial policies are often voiced; however, there is high risk of falling, once again, into the 'etatism' trap, while private investments are low and 'waiting'. Building viable export sectors, while necessary, takes much more than providing state support to exports..

Only sustainable growth can alleviate social pressures coming from high unemployment (particularly youth and long-term), low activity but high dependency, poverty and exclusion, and long-term ageing. To achieve this, formidable challenges should be confronted head-on: of productivity increase and reforms and policies leading to these aims; of structural transformation and global competitiveness; of social dialogue and partnership; of social solidarity (regarding losers, the excluded, marginalised and vulnerable groups; between generations), i.e. of moral economy to be.

An inclusive to all stakeholders 'social compact' (explicit and/or implicit) on productivity increase (coupled with sustainable GDP and employment increase) at all levels (from overall society to firms and particular social groups and communities) requires much more in relations between labour and capital and private and public interests from what the neo-liberal fiction of free markets is able to provide as answers. It implies a change of the 'rules of the game' and different incentives, but also inter-groups, inter-generational and inter-temporal (re)distributions and compensations. Yet, as the two decades of Croatian capitalism show, neither paternalistic fiction on the state's ability to provide and insure (workers, firms, industries, local economies) from markets' vagaries and uncertainties, from wrong decisions risks or from sheer lack of luck, should be relied upon.

Dismantling state capture and clientelism is necessary both on economic and moral grounds (i.e. equity and legitimacy), yet, politically it is risky. Even reform-prone governments, as the current one, will typically shy-away from this task, as if waiting until the system breaks down by itself as a consequence of the failing provider-state.

While asking for immediate policy responses to cyclical movements, including some unorthodox measures, the crisis has underlined the urgency of standard reforms, typically advised by IFIs and/or EU, particularly when it comes to the labour market, social welfare, and public sectors reforms. However, the crisis is increasingly bringing to the light inherent inadequacies of the Croatian political economy and social model to ensure both sustainable accumulation and solid legitimation. To reform the model is the most formidable task. This is where greatest hopes, but also barriers and uncertainties, are. No guarantee for success exists, since it is not a matter of social engineering but of political agency and collective action. As Edward Hugh put it frankly after reviewing Croatia's imbalances, structural deficits and ageing: '...after living for many years on borrowed money and borrowed time... Croats are now likely to be faced with the harsh reality of living in a rapidly ageing society at a time when external competitiveness has been severely undermined ... At this key moment in the country's history it is hardly difficult to recognise that

Croatia is effectively on the brink of something, but whether that something is going to be long term sustainability rather than something that it is better not to think about, well, the answer to that question can only be given by the Croats themselves' (Hugh 2010). The answer is not only about the economy, but about the society at first place. Is an idea of 'good and fair society' just a pure fiction or viable organising concept? Yet, as experience warns, just 'muddling-through', as long as it goes, may remain the preferred option, including short-sighted avoidance of the most critical issues, while further travelling through the inferior path.

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## CHAPTER 8.

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### **The Impact of the Crisis on Social Inclusion and Social Protection in Kosovo**

Ardiana Gashi

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#### **1. INTRODUCTION**

After the 1999 conflict, GDP grew at double-digit rates, largely due to donor-funded reconstruction efforts (World Bank, 2011a). After 2005 economic growth slowed to more moderate pace. GDP growth rates were around 4 percent from 2005 through 2008, driven mostly by donor financing, remittances, and a recovery in economic activity (World Bank, 2011a).

Kosovo and Albania were the only countries in South East Europe that registered positive GDP growth in 2009, despite the global economic crisis (World Bank, 2011a). Kosovo's economy has remained largely unaffected by financial turbulences in the euro area, owing to Kosovo's low degree of integration into global goods and financial markets. The recent global economic downturn affected Kosovo through a decline in exports, foreign investment and remittances (World Bank, 2011a). Given that exports of goods only account for about 5 percent of GDP, the impact has been small relative to the impact in neighbouring countries.

The 2009 White Paper, Kosovo on Social Inclusion Challenges, is a declaration of political commitment by the Assembly of Kosovo which maps out social inclusion issues. The Assembly of Kosovo uses the EU definition of social inclusion, as a *process which ensures that those at risk of poverty and social exclusion gain the opportunities and resources necessary to participate fully in economic, social and cultural life and enjoy a standard of living and wellbeing that is considered normal in the society in which they live. It ensures that they have a greater participation in decision making which affects their lives and access to their fundamental rights.*" The White Paper identified the reasons why social exclusion should be considered: poverty; long-term unemployment; lack of access to public services; ethnic and cultural factors; low level of

education; lack of civil registration; lack of infrastructure; internal displacement; regional dimension; gender and age.

In this chapter the main causes of social exclusion will be discussed. Besides poverty and unemployment as the main factors for social exclusion, additional measures are used to highlight the scope and size of social exclusion. Kosovo remains the poorest country in Europe and the region with the highest unemployment rate, with higher rates among youth and women and with a large share of long-term unemployed. One disadvantaged group is returnees who are forced to return to Kosovo, but given the present economic conditions in Kosovo they are faced with many problems in almost all areas of economic and social life. According to a recent study (Knaus et al., 2012), there is an alarming situation for repatriated children, since many returned children live in poverty, 70 percent of minority children drop out of school upon return, and the mental health care system in Kosovo is simply unable to meet the treatment needs identified by repatriated children and parents.

The Chapter analyses two main mechanisms which support and aim to reduce social exclusion. Given the size of the remittances in Kosovo, we focus on the role of remittances, indicating that due to the crisis remittances have declined and may further decline, which would greatly affect the economic position of many Kosovars. The social protection system is discussed in the light of its size and importance for poverty reduction and the potential impact of the crisis. The Chapter aims to analyse the main impact that the crisis has had and may have in Kosovo, by indicating the main drivers of social exclusion, the role of the social protection system and remittances, and the impact of the crisis on both. The Chapter will end with recommendations on how the impact of the crisis could be minimised as much as possible for the socially excluded groups.

## **2. IMPACT OF THE CRISIS AND ECONOMIC OUTLOOK OF KOSOVO**

Due to the low level of integration in international markets, Kosovo has been among the transition countries less influenced by the global economic crisis. Projections for Kosovo's short-term growth remain robust, with activity supported by domestic demand, although real growth in 2012 has been marked down in response to the weaker outlook for the euro area (IMF, 2011). The forecast for real GDP growth in 2011 has been reduced by 0.3 percentage points to 5 percent and estimates for 2012 are marked down to 4 percent—from 5 percent—as weaker expected growth in Germany and Switzerland is likely to reduce remittances and FDI from Kosovars living abroad (IMF, 2011).

Economic forecasts for Kosovo are mainly on the downside and relate primarily to transfers from the Kosovar Diaspora and the financial system (IMF, 2011). Considering that the vast majority of Kosovo Diaspora lives in Germany and Switzerland, a deeper downturn and higher unemployment in Germany and Switzerland could depress remittances and FDI and provoke a sharper than anticipated deceleration in domestic demand. The impact of the crisis may as well derive from financial turmoil, and strains on the German, Austrian and Slovenian financial institutions that operate the largest banks in Kosovo (IMF, 2011).

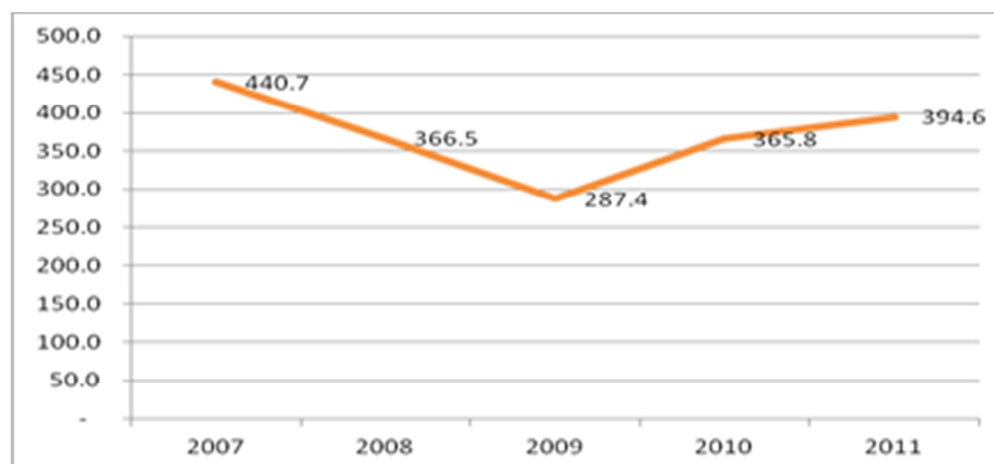
**TABLE 1: GDP growth in Kosovo, 2008-2013**

	2008	2009	2010	2011		2012	2013
				SMP	Proj.	Projections	
Real growth rates							
GDP	6.9	2.9	3.9	5.3	5.0	4.0	4.1
GDP per capita	5.6	1.4	2.4	3.7	3.4	2.5	2.6
GDP (millions of euros)	3,851	3,912	4,216	4,672	4,649	4,966	5,275
GDP per capita (euros)	2,323	2,325	2,468	2,070	2,682	2,822	2,953
GNDI per capita (euros)	2,749	3,650	2,829	2,376	3,079	3,224	3,386

Source: IMF, 2011.

According to data from the Central Bank of Kosovo (CBK) (2012), in 2009 foreign direct investment (FDI) in Kosovo declined by 22 percent with respect to 2008 (from 367 million EUR in 2008 to 287 million EUR in 2009), since the global financial crisis negatively affected investors interest in major destinations for FDI, including the energy sector (Figure 1). However, FDI has shown an increase from 2009 onwards (Figure 1). Remittances, the single largest inflow category in the balance of payments, have not yet witnessed a decline as some have feared: from 2007 until 2009 remittances have increased but have shown a declining trend since then, although not a sharp decline as it was feared.

**FIGURE 1: FDI in Kosovo, 2007-2011**



Source: CBK, 2012.

Considering that remittances are an important source of income for households in Kosovo and given the forecasts that countries where the Kosovo Diaspora reside will be subject to continued economic crisis we can expect a decline in remittances, which in turn will negatively influence the incomes of Kosovars and hence further increase social exclusion. The potential decline in FDI will also potentially negatively influence economic growth and employment generation.

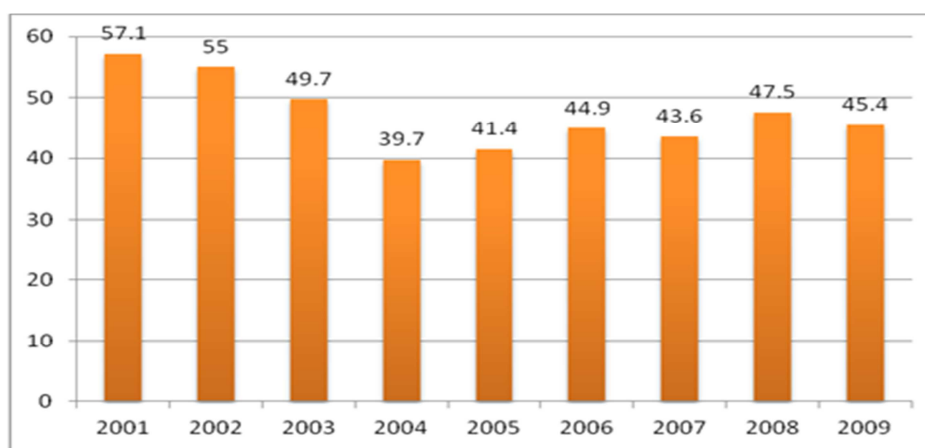


### 3. ECONOMIC AND SOCIAL EXCLUSION IN KOSOVO

#### 3.1 Unemployment in Kosovo

Kosovo has the highest rate of unemployment in Europe and the Balkans. According to the latest Labour Force Survey in 2009 the unemployment rate in Kosovo is around 45% (SAK, 2010). As can be noted from Figure 2, since 2006 unemployment remained almost unchanged with a small decline from 2008 to 2009, but due to the lack of data there is no information about developments in 2010 and 2011.

**FIGURE 2: Unemployment rate in Kosovo, 2001-2009**



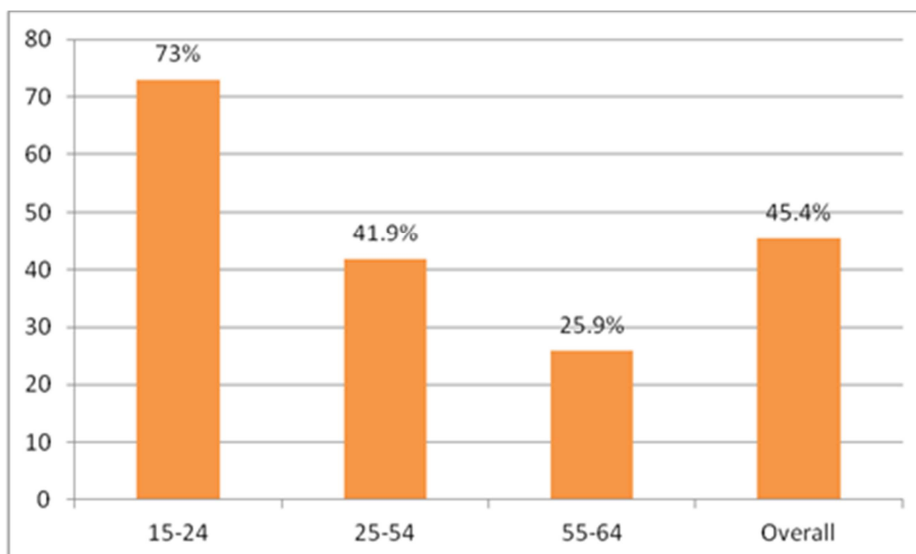
Source: KAS, 2009.

Despite the lack of data since 2010, there are no signs that the high rate of unemployment has declined and there are no promising options or strategies on how to combat unemployment. Agriculture is one field of employment generation in rural areas but due to the limited government budget has not fulfilled its potential. According to the Ministry of Labour and Social Welfare in 2011 there were 325,261 registered jobseekers (although unemployment is in fact far higher), compared to just 9,778 employment vacancies, while only 7,484 jobs were filled through the Public Employment Centres. These data highlight the low probability of finding a job in Kosovo.

According to the 2009 LFS, two thirds of young males and four fifths of young females are unemployed (Figure 3), while 82% of unemployed people are unemployed for longer than 12 months, which highlights the lack of new jobs available.

There is a positive link between employment and educational level, which holds for both males and females (see Figure 4). However, women in Kosovo are less likely to find a job compared to men a difference that is very stark at the lowest level of education, suggesting the importance of education in improving the employment prospects of women.

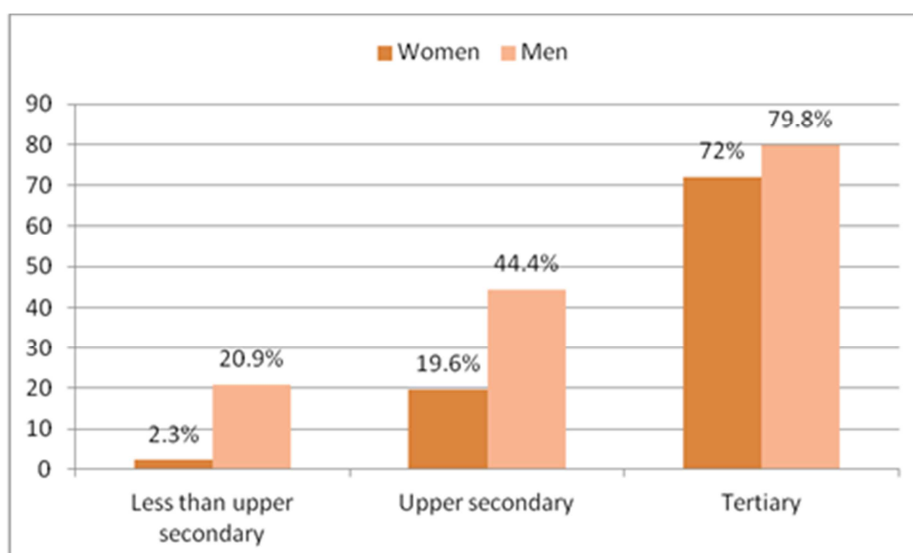
**FIGURE 3: Unemployment rate by age groups**



Source: KAS, 2010.

Furthermore, it seems that the employment rate of women might have worsened since 2010 when a new Labour Law extended maternity leave from three to nine months (six months paid by employers; three months by the state and a further three months can be taken as unpaid leave). This has made it unprofitable for businesses to employ women and might also have as well reduced investment in female human capital. Currently, there are discussions to reduce the extent of maternity leave in order to support the employment of women.

**FIGURE 4: Employment rate by gender**

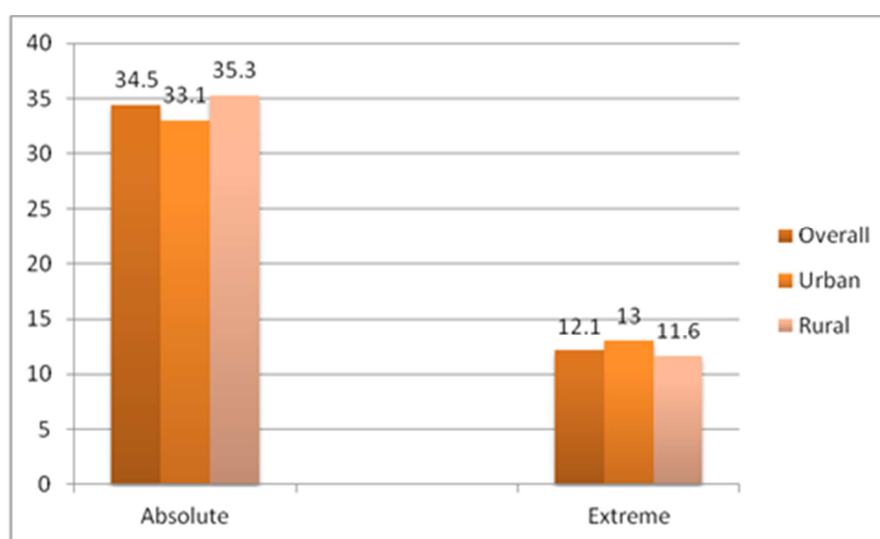


Source: KAS, 2010.

### 3.2 Poverty in Kosovo

Based on Household Budget Survey (HBS) data from 2009, just above one-third of the population (34 percent) lived below the absolute poverty line of €1.55 per adult equivalent per day, and 12 percent lived below the extreme poverty line of €1.02 as shown in Figure 5 (World Bank, 2011). Although poverty levels are almost equal in urban and rural areas the rate varies widely across Kosovo's seven regions. Absolute consumption poverty levels are lower than those reported from the 2005–06 HBS in the most recent World Bank poverty assessment (although the two surveys are not comparable due to different methodologies this suggests some poverty reduction due to a moderate GDP per capita growth rate) (World Bank, 2011).

**FIGURE 5: Poverty and extreme poverty headcount, 2009**



Source: World Bank, 2011 (using HBS 2009 data).

The poverty rate is higher among youth. Given that Kosovo has a young population, over 40 percent of poor people are below the age of 20, and 60 percent of the poor are less than 30 years old (compared to 38 and 56 percent of the overall population below those ages, respectively) (World Bank, 2011). Less educated people have a higher probability of being poor: the poverty headcount rate in 2009 was 38 percent among those who had only completed primary school, compared to 28 percent among those with secondary education and 11 percent for those with tertiary education. Unemployment is strongly linked to poverty. The unemployed in Kosovo are disproportionately young and women, with education levels better than the overall population, but not as good as those who have regular employment. As could be expected, poverty rates are highest among those whose main source of income is social assistance. Poverty rates are lowest among households that depend primarily on remittances from abroad, public sector wage employment, and household businesses (self-employment) (WB, 2011).

Persons living in female-headed households tend to be slightly poorer than those in male-headed households. According to the 2009 HBS approximately five percent of the population lives in households headed by women, and poverty is 3 percentage points higher in those households

than in households headed by men. About 11 percent of households in Kosovo have 10 or more persons, accounting for approximately 23 percent of the population. Given that the poverty rates are higher in large households, approximately one-quarter of poor people live in households of ten or more people.

### **3.3 Returnees: a group considered socially excluded**

The overlap between those excluded from factor markets and those excluded from basic goods and services is surprisingly small: of the total 7.6 percent of households excluded from all factor markets, more than half (about 60 percent) are able to meet their critical needs. This discrepancy can be explained by the fact that between 20-27 percent of households receive remittances and around 8 percent of households receive social protection transfers. In Kosovo, the role of social protection transfers is limited to improving the welfare of the population because the current social protection system is characterised by very limited benefits and low coverage of the poor. However, studies have shown that migration and remittances have been the most effective mechanisms for reducing the poverty of recipient families (UNDP, 2011, HDI 2010).

Today, the major challenge for the central and local authorities of Kosovo is to ensure reintegration of Kosovars who continue to return from European countries. The number of Kosovars without legal status abroad is estimated at around 100,000 many of whom entered a country illegally, or whose asylum claim was rejected, or who overstayed their visa entitlement, or whose residence permit was cancelled (Kupiszewski et al., 2009). Returnees are considered to be a vulnerable and excluded group which needs careful attention in all economic and social areas of life. Given the high unemployment rate in Kosovo, returnees will put further pressure on unemployment, and probably on the social protection system as well.

In 2010 a total of 5,198 persons were returned of which 60% were forcibly returned, whereas between January and August 2011 a total of 2,872 persons returned, far fewer than for the same period in 2010 (3,464 persons). In 2011 the highest number of forcibly returnees was from Germany, Sweden and Switzerland, whereas the majority of readmitted people came from Belgium, Austria and France. The majority of returnees were Albanians (75%), male (79%) and aged between 18-34 years old (61%) (un-published report of Assessment team of EC). The reintegration fund allocated by the Kosovo Government for 2011 amounted to 3.4 million Euros (including allocation at the local level and expenditure plan). All citizens repatriated before 28<sup>th</sup> of July were eligible to apply to this fund. The Assessment Team on the Reintegration Process from the European Commission<sup>49</sup> conducted a visit from 12-16 September 2011. Their report noted the following areas for further improvement: better use of the reintegration fund, information sharing on availability of the fund and development of business start-ups for returnees. Another criticism has been that in some cases people are sent back from receiving countries without any documentation. Education has been mentioned as the weakest service provided to returnees. The Ministry of Education, Science and Technology has recently established a Working group for the implementation of the Reintegration Strategy, so more progress in the education area is

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<sup>49</sup> Unpublished report provided by the MLSW on 4<sup>th</sup> of October 2011.

expected. In the first three months of 2010 alone, 114 Roma and 72 Ashkali were repatriated to Kosovo (Knaus and Widman, 2010).

#### **4. SOCIAL PROTECTION AS A MECHANISM TO SUPPORT EXCLUDED GROUPS**

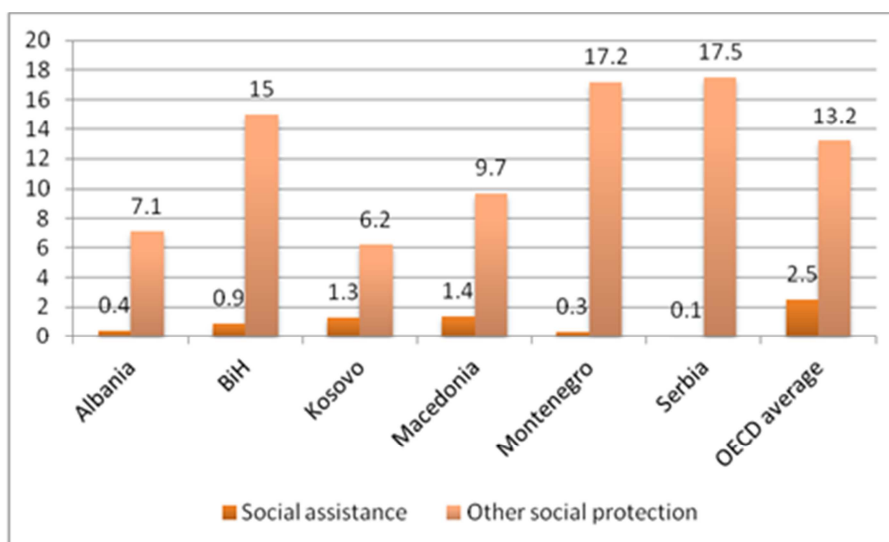
In Kosovo, the social protection system mainly fails to provide protection against deprivation (UNDP, 2012, HDR). In 2009 83 percent of population living in households in which the main source of income is social assistance lived below the poverty line, compared to 34 percent for the whole of Kosovo (World Bank, 2011, poverty assessment). The World Bank calculated that in the absence of social assistance, poverty would be about 2 percentage points higher, whereas in the absence of pensions poverty would be about 4 percentage points higher (World Bank, 2007). This highlights that the current social protection system is characterised by very limited benefits and low coverage of the poor.

With regard to social protection, Kosovo has no unemployment benefits scheme, only a limited maternity allowance (an allowance of approximately €150 per month is paid by the state to employed women for three months starting from the seventh month - the first six months are paid by employer), and no child benefit scheme (except for the social assistance as described in Category II below) The social protection system in Kosovo is thus very limited. Social assistance consists of (a) disability pension, (b) war veteran benefits and (c) a narrowly targeted social assistance scheme. Along with the social assistance transfers, the overall safety net also includes social services for families and individuals at risk. The Last Resort Income Support (LRIS) program, aimed to reduce poverty, has the lowest share in the social assistance spending. The social assistance program consists of two categories: Category I covers poor households where no member is capable of work or where the only adult capable of work is permanently caring for a dependent. Category II covers eligible households where the adult family members are unemployed and where at least one child is aged 5 or below or is an orphan up to age 15. In 2009, rates were raised, so that the gross standard rate of social assistance for a one-person household is €40 per month, and €55 for a two-person household, with an additional €5 per month paid for each additional household member, up to a maximum of €80 for households with seven or more members. In each year up to 2008, the numbers receiving social assistance fell significantly. Following increases in benefits in January 2009 and the transfer of Centres of Social Work to the responsibility of municipalities, the number of claimants rose, although the numbers of Category II claimants continued to fall. Kosovo's public expenditure on social protection is the lowest in the region, with only 3.7 percent of GDP or 12.7 percent of total institutional expenditures allocated for social protection (UNDP, 2011). Additionally, the current social protection system is characterised by low coverage of the poor. Only 34 percent of those who are being reached by social protection transfers are extremely poor (UNDP, 2011).

Figure 7 shows the percentage of GDP spent on social assistance compared to neighbours, the wider region and the OECD countries. It can be noted that Kosovo spends the lowest share of expenditures on the social protection system despite the high poverty rates.

For poor children, there are no schemes to reach children in poverty in wage-earning households. There are also no schemes to reach those who would be eligible for category II assistance but whose youngest child is not 5 or under. During 2009, almost 3,000 poor households lost their entire benefit because their youngest child turned 6 years of age. In 2011 social assistance amounted to €28.3 million, less than in 2010 and 2009 (Government of Kosovo, 2012).

**FIGURE 7: Social assistance expenditures as a share of GDP**



Source: UNICEF, 2010.

The spending on the only poverty-targeted program (LRIS) declined, from 1.1% of GDP in 2004 to 0.7% of GDP in 2009 (Table 3). As a result, as of 2009 the LRIS program accounts only for 47% of the total spending on safety nets, while it accounted for 73% of the total safety net spending in 2004, reflecting the economic and fiscal constraints the country faces (World Bank, n.d.).

**TABLE 3: Spending on non-contributory social benefits in Kosovo, 2004-2010 as a share of GDP**

Programs	2004	2005	2006	2007	2008	2009*	2010*
Last Resort Income Support	1.08	1.01	0.95	0.81	0.70	0.72	0.70
Disability Pension	0.24	0.50	0.46	0.29	0.27	0.28	0.29
War Veteran Related Benefits	0.15	0.16	0.17	0.26	0.48	0.52	0.52
Total Safety Nets	1.47	1.68	1.58	1.37	1.45	1.52	1.51

Source: MoLSW, MoFE, and IMF (taken DFID, 2011).

Based on most recent data in (January to May 2012) just over 16 percent of total spending on social protection was attributed to social assistance, a decrease of almost half a percentage point compared to 2011. From discussions with CSW this can be attributed to more efforts in checking criteria for social assistance claims. As a result, the average spending per month in 2012 on social assistance has fallen to around €27,000.

Data in Table 4 show that the number of families benefiting from social assistance has declined through time. Despite GDP growth, social assistance has not contributed to poverty reduction since even in 2009 one-third of Kosovo population lived below the poverty line.

**TABLE 4: Social assistance beneficiaries, 2009-2011**

	2009	2010	2011	Change in % 2010/11
<b>Number of families</b>	36,654	36,129	34,867	-3.5
<b>Number of members in the families</b>	152,508	157,329	151,767	-3.5
<b>Amount spent on social assistance</b>	30,412,081	28,577,179	28,257,596	-1.1
<b>Amount spent on pensions</b>	67,075,225	92,188,273	104,005,090	12.8
<b>Amount spent on war invalids</b>	19,374,722	23,509,062	29,249,970	24.4
<b>% for social assistance</b>	35	25	21	-3.5

Source: KAS, 2011 and 2012 (KAS obtained data from the Ministry of Labour and Social Welfare).

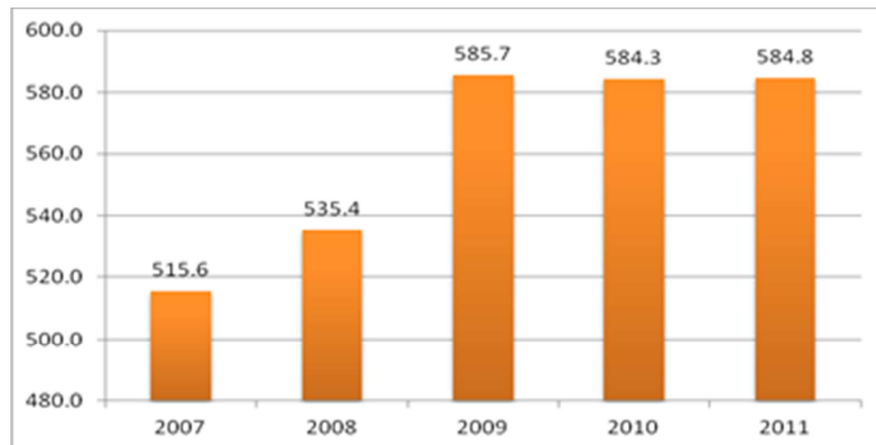
To summarise, it can be noted that social assistance has declined across the years as a share of social protection spending and the number of families benefiting from the system has diminished. However, this is not a result of improved economic prospects in Kosovo. Given the poor macroeconomic expectations and the crisis in Europe, the Kosovo budget is likely to be lower in the future and social assistance programs can expected to be category to be hit especially hard, which although of a small size and scope will worsen the economic prospects of poor people. One of the social assistance officers in a Centre for Social Work in Kosovo interviewed in one visit by the author indicated that due to budget constraints there are is strong pressure not to increase the number of social assistance beneficiaries.

## 5. REMITTANCES AS A SOURCE OF INCOME AND SOCIAL INCLUSION

Out-migration of labour from Kosovo has traditionally been high, one of the largest international migration flows in the world (World Bank, 2011) with the main destination countries being Germany and Switzerland. It is estimated that in 2011 remittances from migrants totalled approximately €585 million (CBK, 2012), making remittances the largest source of external income.

Migration and the resulting remittances have been a safety valve for many Kosovars - almost one third of Kosovo households receive remittances (UNDP, 2012, Remittance Survey). The share of recipients is higher among women headed households (31 percent), compared to those headed by men (24 percent) (UNDP, 2011, Fast fact remittance survey). The share of households receiving remittances in rural areas is 26 percent, whereas for urban areas this figure is 24 percent (UNDP, 2011, Remittance survey). The flow of remittances has ensured a source of income for many households in a country with the highest unemployment and poverty rates in Europe.

**FIGURE 8: Remittance flows in Kosovo 2007-2011**



Source: CBK, 2012.

All surveys conducted so far indicate that most remittances in Kosovo are used for immediate consumption: over 90 percent of households buy food and clothing; 18 percent invest part of remittances in business; and 25 percent use some part to repair or build homes (World Bank, 2011b Migration study). The widespread use of remittances for consumption indicates that remittances are crucial in supporting households' basic needs.

Despite the significance of migration to Kosovo's economic and social landscape, few if any public policies are designed to maximize its contribution to economic development. In 2009 the Government of Kosovo adopted a National Strategy and Action Plan on Migration for 2009-12, but it deals primarily with irregular migration and administration of legal migration. No government document of any kind contains policies related to the economic aspects of migration.

## 6. CONCLUSION

Kosovo remains the poorest country in South Eastern Europe; GDP per capita of €2,325 in 2009 (IMF, 2011) is the lowest in the region. Based on a recent study by the World Bank (2011a), just above one third of the population live below the poverty line and around 12 percent below the extreme poverty line, making Kosovo the poorest country in Europe (World bank, 2011a). One important financial source for Kosovo households has been remittances from the Diaspora averaging about 13% of GDP, one of the highest level of remittances in the world (World Bank, 2011a).

The main drivers of exclusion in Kosovo are considered poverty, unemployment and the weak social protection system. The slow growth in employment is due to the low growth rate of per capita real GDP and the pattern of growth. Economic growth between 2003 and 2005 was only slightly above population growth, so that GDP per capita remained essentially stagnant (UNDP, 2011). Between 2003 and 2009, GDP per capita grew by just 1.8 percent per annum. An average annual growth in per capita income of less than 2 percent has simply not been high enough to



induce strong demand for labour and enable a reduction in poverty – particularly without institutional mechanisms for an equitable and poverty focused redistribution of government revenues (UNDP, 2011). Therefore, improving job prospects is crucial to reducing poverty and raising living standards through more rapid and more inclusive growth.

This chapter has emphasised that returnees are an excluded group, which policy needs to prioritise in order to improve their education, employment and fully integrate them in society. Employment prospects of this group, like that of all Kosovars, are likely to become even worse given the downside expectations for the economy

In order for economic growth to be socially inclusive, employment of those most in need should be supported. One way for this to be done would be by linking social assistance benefits to critical measures incentivising the development of human capabilities, job seeking and private enterprise. Social assistance benefits could be linked to measures to support unemployed members of households through social benefits linked to jobseeker programmes, or measures to target those with learning or literacy issues, particularly women. As discussed above the social assistance Category II which is designed to target poor families, ends once a child becomes six years old; this does not make much sense given that once the child enters school, family needs increase with higher education expenses. Therefore it would be critical to eliminate the age limit on benefits, which push families further into poverty just as their children approach school age. The introduction of child benefits beyond this point could be linked to school attendance. This would mean that the children of the poor would be more likely to stay in school, improving the skills of future labour force and reducing the risk of inter-generational dependency.

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## CHAPTER 9.

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### **The Impact of the Global Economic Crisis on the Labour Market and Social Services in Macedonia**

Maja Gerovska Mitev

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#### **1. INTRODUCTION**

Despite initial optimistic forecasts that the global economic and financial crisis that began in 2008 would end in 2010, its effects continue across the European Union through the developing euro crisis, and a rise in poverty and unemployment in individual EU member states and EU candidate countries. Similarly, the different waves of the economic crisis – global, regional (the Greek crisis) and national (economic transition since 1991), have taken their toll on economic growth and have hindered Macedonia's social development. These various crises have had visible implications on individuals affecting their well-being, and have also posed significant challenges to the effectiveness of the social welfare system.

In this context, it is interesting to identify individual perceptions concerning the social dimension of the economic crises. For that purpose, this chapter focuses on people's attitudes and on their access to the labour market, social protection, education and health during 2009. In addition to data from official statistics and administrative sources, the analysis is based on the findings from a household survey undertaken in September 2009 (FES, 2009). The survey used a standardized questionnaire delivered to a representative sample of 1,068 households in Macedonia<sup>50</sup>.

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<sup>50</sup> The basic aim of this public opinion research was to obtain information with standardized questionnaire in the following areas of interest: (1) The degree to which households, feel the effects from the global financial crises; (2) The impact of the crisis on the process of further stratification and increase of the social differences in the country; (3) The nature and the intensity of the basic fears and concerns of citizens in terms of crisis; (4) Confidence in the institutions and subjects with greatest power to overcome the crisis, or reduce its consequences/effects and (5) The social aspect of the crises and its impact on the education, social services and employment. This paper analyses only the fifth domain - the social aspect. The survey was financed by Friedrich Ebert Foundation and undertaken by the Rating Agency, Skopje. The author of

## 2. LABOUR MARKET

Even before the global economic crisis, the conditions of the Macedonian labour market were difficult. Since 1996, the rate of unemployment has not fallen below 30%. Large informal economy, labor migration as well as high inactivity among specific ethnic communities (i.e. among Turkish and Albanian women), contribute toward one of the highest unemployment rates in Europe.

However, comparisons of official statistics in the last few years show that the global economic crisis has not contributed towards increase of unemployment, but rather there is an evident albeit negligible decline in the unemployment rate.

**TABLE 1: Labour force in R. Macedonia, 2008-2011**

	Total pop- ulation	Labour Force			Activity rate	Employ- ment rate	Unem- ployment rate
	aged 15 and above	Total	Employed	Unem- ployed			
<b>2008</b>	1,633,341	919,424	609,015	310,409	56.3	37.3	33.8
<b>2009</b>	1,638,869	928,775	629,901	298,873	56.7	38.4	32.2
<b>2010</b>	1,648,522	938,294	637,855	300,439	56.9	38.7	32
<b>2011</b>	1,656,215	940,048	645,085	294,963	56.8	38	31.4

Source: State Statistical Office, Labour Force Surveys 2009-2011.

The unemployment increase is evident when the labour force participation is analyzed according to different quarters from 2009 to 2011. As seen from Table 2, at the end of 2009 and beginning of 2010 the rate of unemployment was highest.

Since then, there is a continual but limited decrease in the unemployment rate and then a rise in unemployment is also significant for the first two and the fourth quarter in 2011.

**TABLE 2: Unemployment rate in R. Macedonia, 2009-2011**

Year/ quarter	2009				2010				2011			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
<b>Unem- ployment rate</b>	32.7	31.9	31.7	32.4	33.5	32.1	31.7	30.9	31.2	31.3	31.2	31.8

Source: State Statistical Office, Labour Force Surveys 2009-2011.

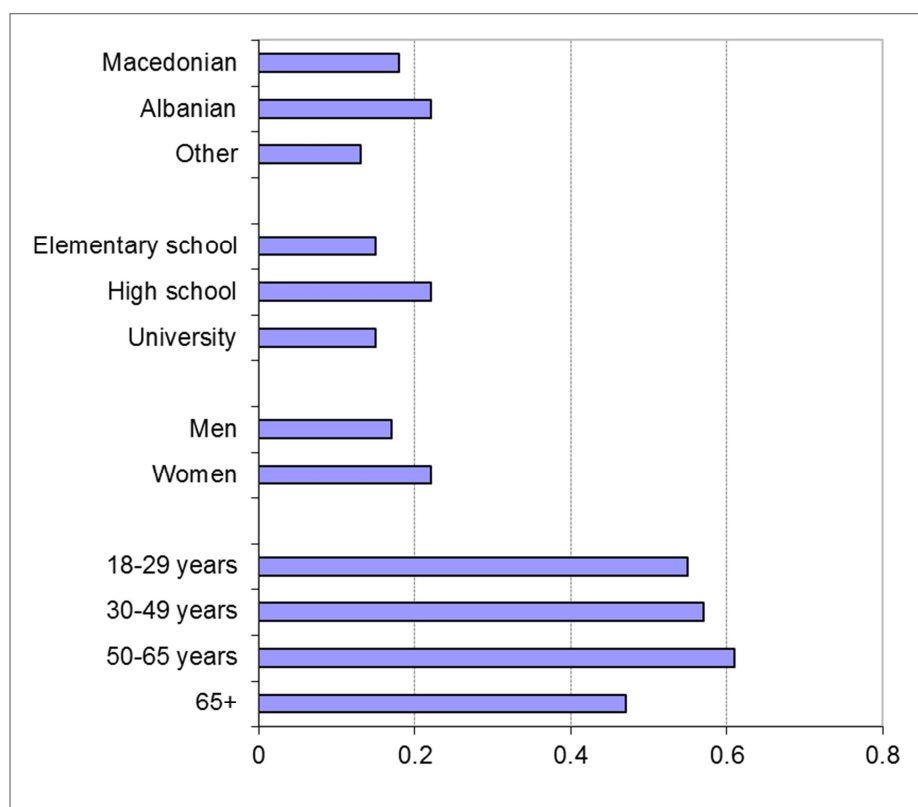
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this chapter is one of the researchers/authors of this survey and the consequent report on *The Impact of the Global Financial Crisis on the Macedonian Economy and the Economic Situation in the Macedonian Households: Perceptions of the Citizens about the Nature of the Crisis and its Impact*.

Despite the negligible decline in the official unemployment rate revealed by the Labour Force Survey data, the results from the 2009 representative survey reveal a different situation. Almost half of the respondents (48%) did not participated in the labour market (i.e. they were pensioners, students or housewives), two thirds (66.7%) lived in households in which at least one person was unemployed, while 3.9% of the respondents lived in households in which all the adult members were unemployed.

The same research shows that during the period of most intense effects of the global economic crisis (from October 2008 - September 2009) the actual loss of jobs was experienced by 19% of the respondents, among which the majority were people with ethnic Albanian background. The largest number of jobs was lost in the Western region of Macedonia, involving mostly those with secondary education as well as households with monthly income up to 10,000 MKD (164 Euro). More than half of respondents (57%) said that they knew at least one person who had lost their job as a result of the economic crisis.

**GRAPH 1: Profile of people who lost their job in 2009 in Macedonia**



Source: FES, 2009

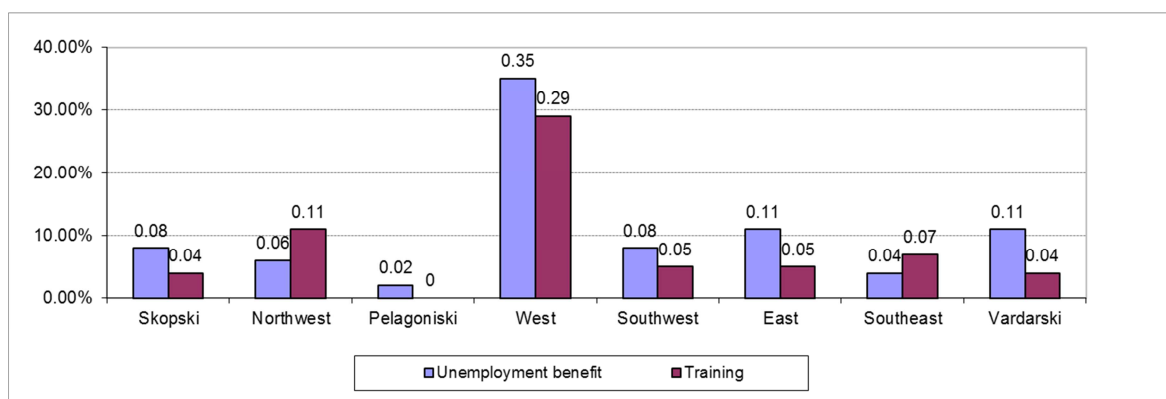
Note: The above graph gives results only for those respondents that have lost jobs during the past 12 months. For example 18% of ethnic Macedonians have lost their job (while 82% didn't).

It is evident that those with lower educational status, older workers (50-65 years) as well as women, suffered the most during the economic crisis. This is not surprising because the crisis was mostly felt in industries where a majority of people had less than university education, worked in

industries where large groups of women were employed (i.e. textiles) and in which many older workers could be found (mining and metal industry). The finding that a higher proportion of Albanians than other ethnic groups had lost their jobs may be interpreted as a result of the increased number of returnees from abroad (who tend to have mainly Albanian ethnicity), who had lost their jobs in the more developed European countries.

The survey results also show that unemployment protection has provided an important but imperfect safety net during the period of economic crisis, as 11% of the respondents (fewer than the 19% who had lost their job during the previous 12 months) had applied for the benefit. The survey also showed a lack of information and knowledge about the rights to benefits and services available from the Employment Centres, with 7% of all unemployed respondents being unaware of the possibility of applying for unemployment benefit. The use of training and retraining services (which is a right for all unemployed), was lower than the demand for unemployment benefit; only 8% of the respondents applied for retraining. Again, a significant number – 12% - were not aware of this right, implying a need for the promotion of training opportunities offered by Employment Centres.

**GRAPH 2: Applicants for unemployment benefits and training services**



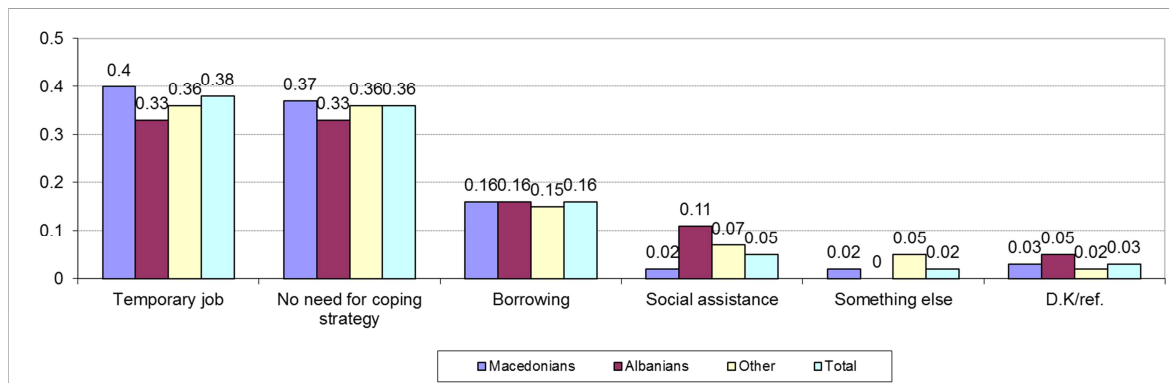
Source: FES, 2009.

The results shown in Figure 2 indicate that cash transfers or passive unemployment measures were in greater use in all regions during the period of economic crisis in comparison with active employment measures such as training and retraining with the exception of the Northwest and Southeast regions). It should be noted that the regions where these benefits are in least demand (i.e. Pelagoniski), are also regions with many people who lack information about these rights. Therefore, it is of particular importance to improve public awareness, especially during periods of economic crisis, about the opportunities unemployment insurance and retraining, which could present an important tool to improve the conditions on the labour market.

The coping strategies adopted during the economic crisis included looking for a temporary job (38% of the respondents), and borrowing money from relatives and friends (16%). The reliance on social assistance as a coping strategy was significant only for 5% of the respondents, raising concern about its relevance as a support mechanism, particularly in times of economic crisis. As

Graph 3 shows, analysis of use of social assistance as a coping mechanism was mostly evident among the Albanian ethnic community.

**GRAPH 3: Coping strategies during economic crises according to ethnicity**



Source: FES (2009).

Note: The above graph gives results according to ethnicity grouped according to each strategy. For example, among Macedonians 40% are looking for temporary job, 37% have no need for coping strategy, 16% borrow, 2% rely on social assistance, 2% on something else and 3% declined to answer = 100%.

The findings of the survey indicate that there is a need to improve access to available support mechanisms especially for agricultural workers and those who are not very well informed about the various opportunities for support such as those living in the Pelagoniski region. There is also a need to promote both passive and active employment measures so that people can mitigate negative effects during times of unemployment. In addition, the active labour market measures should also focus on providing more incentives for part-time jobs and flexible employment which can substitute for the loss of full-time jobs. In addition, ways of ensuring prolonged duration of support from unemployment insurance as well as higher benefits should be considered, in order to provide more effective support for the beneficiaries during periods of decreased labour demand and decreased household incomes. Contributions from the local municipal sources (i.e. local taxes) may be used to contribute to this end.

### 3. SOCIAL PROTECTION

The system of social protection in Macedonia consists of both contributory and non-contributory benefits. In this chapter I will only consider social assistance (a non-contributory benefit) and unemployment compensation (a contributory benefit).

Official data on the take-up of social assistance suggest that during the global economic crisis there was no increase in the number of social assistance beneficiaries. On the contrary, according to State Statistical Office data on households receiving social assistance, it can be seen that since 2008 there has been a continuous decrease in the number of households receiving this benefit. However, this should not be interpreted as a reduced need for social assistance, but rather as a tightening of the eligibility rules as well as due to the adoption of more rigorous means-testing



procedures. The number of households receiving social assistance declined from 49,515 households in 2009 to 44,940 in 2010 which represents around 8% to 9% respectively of all households in the country.

**TABLE 3: Social assistance recipients in R. Macedonia, 2008-2011**

Year	Number of households	Household members (together with the household head)
<b>2008</b>	52,974	208,797
<b>2009</b>	49,515	193,220
<b>2010</b>	44,940	176,431

Source: State Statistical Office, 2010-2011.

Unlike social assistance, the take-up of contributory unemployment benefits in Macedonia increased during the period of the global economic crisis. According to the Agency for Employment, in 2009 there was an increase in the number of unemployment compensation beneficiaries, which continued to rise in the following years.

**TABLE 4: Beneficiaries of unemployment compensation, 2008-2011**

Unemployment insurance beneficiaries	2008	2009	2010	2011
<b>TOTAL</b>	23,565	24,648	24,263	25,486
<b>% of registered unemployed</b>	6.90%	7.20%	7.50%	9.10%

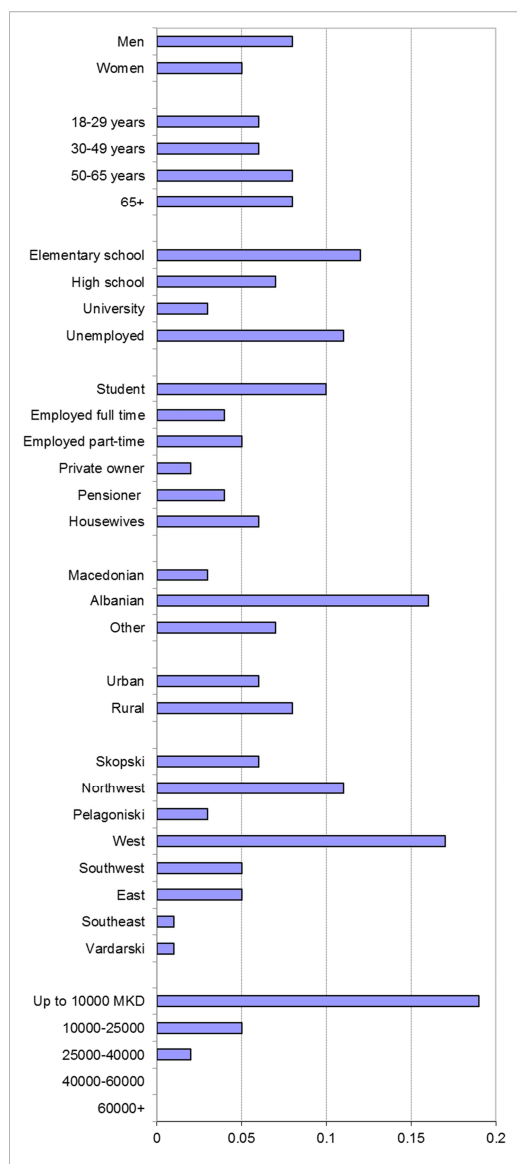
Source: Agency for employment, Statistics, [www.zvrm.gov.mk](http://www.zvrm.gov.mk)

Data from the survey (FES, 2009) reveal that among 1,068 respondents, about 7% were in receipt of social assistance, a similar proportion to that indicated by the official data. Among them, most were unemployed Albanian men, aged over 50, with only primary education, living in rural areas in the Western region and belonging to households with a monthly income below 10,000 denars (164 Euro).

Administrative sources and the perceptions of survey respondents concerning the take-up of social protection benefits indicate that social transfers (particularly social assistance) in Macedonia are not an important cushion during economic crises. In addition to the stricter eligibility rules, this is also probably due to the low level of social assistance benefit, which does not support the basic needs of vulnerable households. Therefore, it is not surprising that majority of the respondents believe that during economic crises this benefit should be increased. The actual increase of the social benefits during periods of crises is also part of the EU social package regarding crises, in which member states are encouraged to prolong the time duration and amount of benefits so as to cater for the decreased incomes of vulnerable groups. The socio-demographic characteristics of the social assistance recipients during the economic crisis can

serve as an important indicator and profile towards which more comprehensive social measures and support should be provided.

**GRAPH 4: Socio-demographic characteristics of social assistance recipients during the economic crisis, 2009**



Source: FES (2009).

## 4. EDUCATION

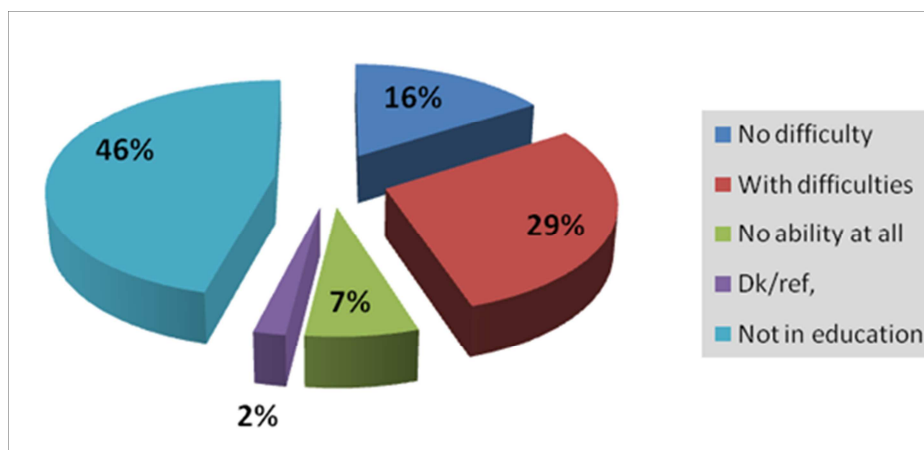
The formal education system in Macedonia is composed of pre-school education, primary education, secondary education, higher education and tertiary/university education. Despite recent policies that have made secondary education compulsory as well as the increase of tertiary education facilities throughout the country (which will probably show its effects in the long run), the data on educational enrolment still give reasons for concern. According to the State Statistical Office, the number of students in primary schools decreased by 2.8% between 2009-10 and by

3.4% between 2011-12; in secondary schools, enrolment decreased by 1.3% in 2009-10 and by 1.5% in 2011-12. Although the demographic trends have an impact on these figures, still additional set of factors need to be further investigated, in order to assess whether increase in labor migration, increase in the number of street children have any impact on these declining enrolment rates during economic crisis.

The perceptions of the survey respondents in relation to education show that the economic crisis has had a significant impact on the household expenditure on education, school attendance, attainment of further educational levels, as well as in general on lowering the government investments in education. Data from the FES survey (2009) reveal that among those who were attending or had a family member that is attending some level of education, 28% experienced an increase in household costs for education in the previous year. This implies that despite greater government subsidies for education in 2009 (i.e. free text books and transport), more than one quarter of families in Macedonia still faced difficulties in meeting the costs of education for their children.

Similarly, school attendance also proved difficult during 2008/2009 for 28% of the respondents. The major reasons given were the general expense of education (19% of respondents), costs of study material (7%) and travelling costs (2%). One worrying aspect is the difficulties experienced in pursuing further education. More than a quarter of respondents (29%) said that they would be faced with financial difficulties in providing further education for themselves or for members of their family, while 7% said they will not be able at all to support their personal or a household's member further education. In the latter category are those with a part time job, housewives, unemployed people, people of Albanian ethnic origin, people living in Northwest and Western regions, and those with monthly income below 10,000 MKD (164 Euro).

**GRAPH 5: Financial ability to pursue further education in 2009**



Source: FES (2009).

Note: The results given in this graph are from the 54% of respondents who were in education, which as is not representative for the whole country, but still it can be taken as an indicative figure.

Finally, in relation to future investment in education, 60% of respondents considered that the crisis would have a negative effect on the government's investment in education. Such perception prevailed among all households, with no differences regarding ethnicity, gender, or region of living. These negative perceptions on educational spending suggest that the government could have been more proactive in informing people about the availability of free text books and transport which were provided as a measure to increase expenditure on education of vulnerable households during the times of increased economic insecurity, particularly in 2009.

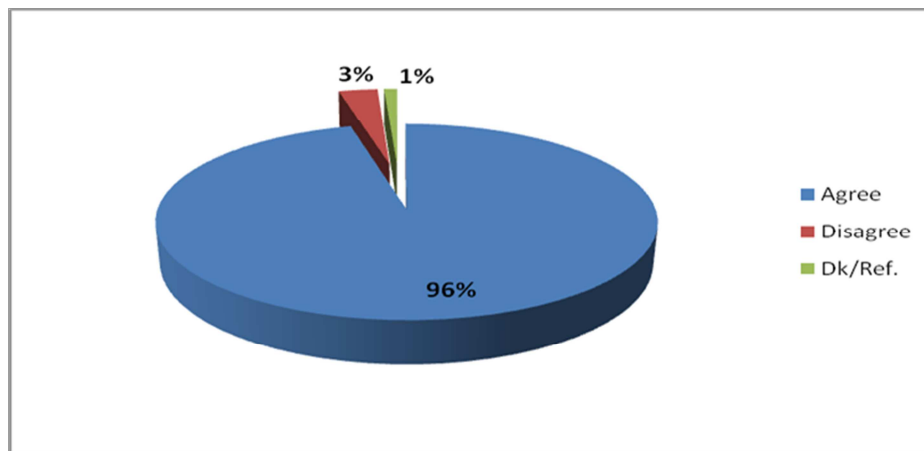
## 5. HEALTH

Access to health care and health insurance in Macedonia according to the Constitution and Laws is one of the basic social rights of the citizens, implying that the coverage of the health system should be universal. However, some estimates indicate that approximately 150,000 citizens of Macedonia are for one reason or another not covered by social health insurance. Representatives of some ethnic communities (i.e. Roma, ethnic Albanians), as well as some vulnerable groups, (i.e. undeclared workers, seasonal workers) are among the uninsured. Aiming to provide basic health care services to some vulnerable groups the government through a special program provides resources from the budget to cover the health care costs of this group. However, in practice those funds provided by the government are insufficient to fulfil the commitment (Donevska et al. 2007).

Data from the household survey (FES, 2009) also show that access to health insurance is not universal. In 2009, out of all respondents, 9% had no health insurance at all. Their economic and socio-demographic characteristics indicate that those excluded from health insurance in Macedonia are mainly those with elementary school, the unemployed, those with part time jobs, those that come from minority ethnic groups such as the Roma, and those that live in rural areas and in the Pelagoniski region. In addition, among those who do have health insurance, 11% have made irregular payment of their health contributions, diminishing their access to health services. The respondent's perceptions given in the survey reveal that the overwhelming majority (96%) supports free health insurance for all. Unfortunately, these perceptions are far from the current reality.

Responses in relation to use and satisfaction with public health institutions reveal that despite having health insurance, in cases of need 58% rarely use public health institutions, while 6% do not use them at all. Similarly, 45% were dissatisfied with the services provided in public health institutions, while a significant majority (88%) believed that without a bribe you cannot get good and timely service. More than half (51%) said that they could not afford the services of private health institutions, while 37% said that they could do so occasionally. These results show a rather negative picture of the health care system in Macedonia, in which access is not the only problem, but also its quality and responsiveness. Moreover few members of the socially vulnerable groups can benefit from private health care services.

**GRAPH 6: Support for increased financial assistance for health care for the most vulnerable citizens, during economic crisis**



Source: FES (2009).

Finally, more than half (52%) of respondents considered that during the economic crisis, the conditions within the health care system did not change while 20% thought that the crisis brought about a worsening of the situation in the health care system. As shown in the Graph 6, almost all (96%) of respondents said that in times of financial crisis the state should allocate more money for health care aimed at the most vulnerable people. Despite this universal perception, the government did not introduce any new health measures in response to the economic crisis. Even those that were planned and announced, intended to improve immunization and pre-natal health care were not implemented. Hence, improved access to health care and support for health costs for the most marginalized social groups remained a serious problem during the period of the economic crisis.

## 6. CONCLUSIONS

This paper has shown that the global economic crisis contributed towards worsening of the position of certain vulnerable groups in Macedonia in relation to their employment status, social protection, education and health. Although the official data do not provide evidence about high rates of unemployment growth, still its negligible decline, coupled with the evidence from the representative survey data, which showed loss of jobs among 19% of the population in 2009, speak about increased difficulties on the labor market demand. Difficulties related to high unemployment were accompanied with a reduction in the number of social assistance beneficiaries, a decrease in school attendance, and an increase in unemployment compensation. As indicated at the beginning of this paper, all these features cannot be attributed to the global financial crisis only, but they also represent an outcome of other factors, such as neighbouring crisis (i.e. socio-economic conditions in Greece) as well as previously existing difficult economic and social conditions in Macedonia.

Improving the country's performance in areas such as employment, education and poverty is not an easy task. In this respect, the EU 'Agenda 2020' provides additional support to its member and candidate countries. Namely, it stipulates agreed goals, targets and indicators in the field of employment, education and poverty, (see Gerovska and Stubbs 2012), and challenges candidate countries to update and amend their policies in the field of poverty and social exclusion.

Taking into consideration the current socio-economic conditions in the country, a renewed approach towards tackling problems of unemployment, educational exclusion and poverty should be based on more systematic and targeted policy measures. In this respect, taking into account all three EU 2020 indicators when stipulating national targets in the field of poverty and social exclusion; then targeting not only those "traditionally vulnerable categories", such as unemployed, long-term unemployed, but also others such as people experiencing in-work poverty and those materially deprived; and finally a greater alignment of policy measures with the profile of vulnerable categories, should be among the priorities within the overall socio-economic agenda of the government in Macedonia.

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## CHAPTER 10.

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### **Impact of the Financial Global Crisis on the Domestic Labour Market in Moldova**

Ana Popa

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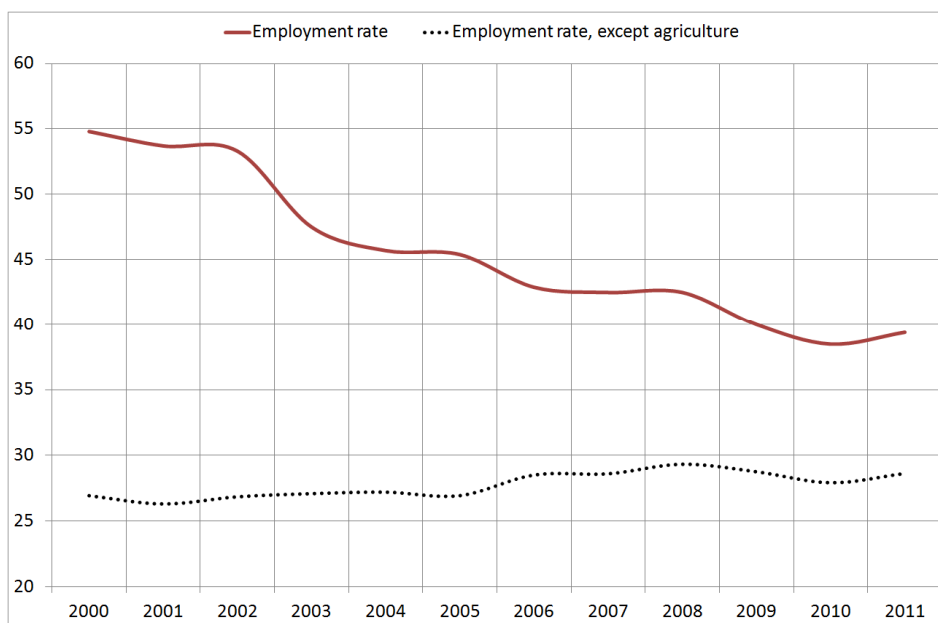
#### **1. LABOUR MARKET IN CRISIS BEFORE THE GLOBAL ECONOMIC CRISIS?**

The situation on the labour market in Moldova worsened throughout the whole transition period. Since 2000, when the Labour Force Survey (LFS) was begun, until 2008, the year in which the global financial crisis began, Moldova lost 263,000 jobs, or 18% of its employed population. This was the most significant contraction of employment in all the countries in the South East Europe region as well as the Commonwealth of Independent States. The evolution was mainly determined by the reduction of employment in the agricultural sector, where more than half of the labour force was concentrated at the beginning of the century. After the collapse of the Soviet Union, the agricultural sector was exposed to a new framework that has given almost all citizens the opportunity to work in the sector. However, this opportunity has not translated into a profitable economic activity due to many other deficiencies of the reform and the system. Thus, failing to provide decent incomes, the population started to leave the sector, especially when migration opportunities widened. In 2011, only 27.5% of the employed population worked in the agricultural sector. Even this number is high by regional and European standards and, therefore, agricultural employment is still on its natural downward trend.

On the other side, non-agricultural employment increased only slightly during this period and could not compensate for the loss of jobs in the agricultural sector (Figure 1). Only construction and market services sectors showed a positive employment trend. Over the last decade, growth of these sectors has mainly been supported by remittances from abroad.



**FIGURE 1: Employment rate, 2000-2011, %**

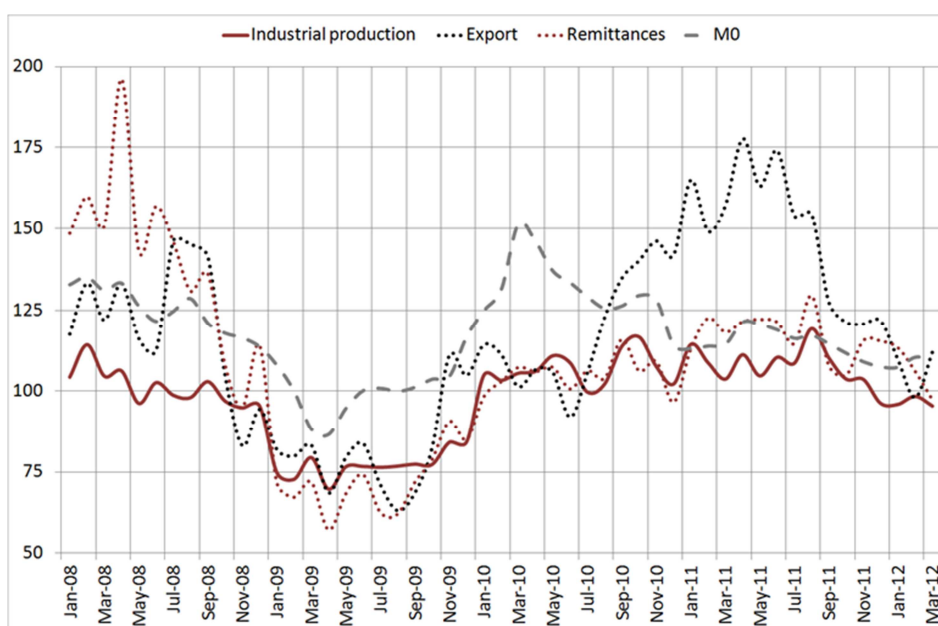


Note: Employment rate, except agriculture was calculated as ration between employment in non-agricultural activities and total working age population.

Source: National Bureau of Statistics.

In late 2008, the evolution of the main macroeconomic indicators in Moldova reflected the onset of the crisis (Figure 2).

**FIGURE 2: Evolution of main macroeconomic indicators in 2008-2012, % compared to previous year level**



Source: National Bureau of Statistics, National Bank of Moldova.

Industrial production experienced a negative trend since July, exports and remittances started to fall in November and a strong deceleration of the money supply was registered from October. These were clear signs of an approaching decline, even though the economy was still growing in the last quarter of 2008.

Despite the obviously worsening economic conditions, the labour market did not seem to present serious concerns. Firstly, most labour market indicators were already on a negative trend during the whole decade and, therefore, the decline could have been interpreted as the continuation of the general pattern of the labour market. Secondly, social indicators generally respond to economic trends with a lag, and this was also the case in Moldova. Many employers used layoffs as solutions to the difficulties faced by their companies, only after applying other measures in reaction to declining demand and shrinking profits such as wage cuts, decrease in working hours, forced unpaid leaves and so on.

## **2. FIRST SIGNS OF THE CRISIS ON THE MOLDOVAN LABOUR MARKET: CHANGES IN EMPLOYMENT**

However, by the first quarter of 2009 both employment and unemployment rate deviated from the trend-line in a negative direction<sup>51</sup>. While agricultural employment continued to decline, several other sectors also began to be affected. The most important ways in which the global crisis was transmitted to the Moldovan economy in general, and the labour market in particular, were as follows:

- Decline in external demand, causing exports to shrink. This resulted in lower industrial activity (mainly processing industry oriented to export) and losses for transportation companies.
- Decrease in remittances coming from abroad. For several years Moldova had been listed among the top three countries according to the share of remittances in GDP, which reached as high as 35% of GDP before the crisis. Remittances were the main source that fuelled consumption since the economic rebound in 2000, explaining more than 50% of variation in households' final consumption<sup>52</sup>. It ensured a constant growth of the service sector, though comprising mainly low value added activities, and a growth of the construction sector. Since the demand for residential construction is mainly generated by migrants and their families, the decline in remittances was immediately transmitted to these sectors.
- Collapse of FDI. Empirical studies suggest that foreign companies or mixed companies, with higher foreign contribution are more efficient in hiring and keeping the staff, and also in new-

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<sup>51</sup> In the first quarter of 2009 real derivative employment rate (calculated by excluding the labour force working abroad from the group of inactive population) was 3.1 p.p. lower than the forecasted one using a dynamic model SARIMA. In the same period, the real derivative unemployment rate was 4.6% higher than the forecasted one. Calculations from Expert-Grup (2009) "Impact of the global financial crisis on local communities in Moldova", UNDP Moldova;

<sup>52</sup> Popa, A., Lupusor, A., Prohntichi, V. (2012) "Moldova Economic Growth Analysis no.6", Expert-Grup;

job creation<sup>53</sup>. This is determined by higher wages offered on average and their expansion plans. The importance of FDI is also due to the sectors in which it creates employment, which mainly involve higher value-added activities and increased labour productivity.

- Returning migrants. Migration became a feature of Moldovan economy in late '90s and, on the one side saved Moldova from a further decline by providing financial resources for domestic consumption; but, on the other side created serious dysfunctions on the labour market through the induced labour supply deficit due to both direct (i.e. physical absence of the individuals in the country) indirect (i.e. higher reservation wage of individuals receiving remittances from a family member abroad) factors. Migration actually helped Moldova to achieve a quite low unemployment rate comparing to any country in the region. Due to the worsening situation in most of the destination countries for Moldovan emigrants, some of them lost their jobs abroad and were forced to return back to Moldova. In 2008 and 2009 the number of Moldovan citizens working abroad decreased by 8% and 5% respectively. As the situation on the domestic labour market also worsened, many of the returning migrants entered the unemployed category, distorting even more the national labour market.

While the crisis has touched almost all economic sectors, the impact has been disproportional in length of time it has lasted and in its magnitude. The sectors suffering the most from the effects crisis have been construction (with the most significant impact in 2008), industry (with the most significant impact in 2009) and market services (in 2009). Within the industrial sector, the strongest decline in employment was registered in the branches of mining and quarrying, the food and drinks industry, textiles, clothing and leather and shoe production (the last three industries rely on subcontracts, employing a significant share of the labour force), paper and paperboard production, the chemical industry, rubber, metals, electric machinery and equipment and furniture. Some of these branches have not managed to recover following the 2008-2009 crisis and are still on a downward trend with weak potential to reverse the trend given new economic uncertainties coming from the Euro area.

Most of the affected activities were located in urban areas, and therefore the impact of the crisis on urban employment was more prominent; while employment in rural areas also fell due to the structural factors mentioned above. An interesting particularity is that the young population was less affected during the crisis. Despite the general difficulties faced by the young people when they enter the labour market, during the crisis they seemed more attractive to employers who sought greater flexibility. Thus, the employment among the 15-34 age group decreased the least, but this does not tell much about the quality of the work performed.

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<sup>53</sup> Popa, A., Lupusor, A., Prohnitchi, V. (2010) "Impact of Foreign Direct Investment on the Moldovan Economy", Expert-Group;

### 3. LABOUR MARKET DISTORTIONS FOLLOWING THE GLOBAL ECONOMIC CRISIS

Beside changes in employment, a few other important features reflect the serious repercussions that the global crisis had for the labour market in Moldova:

- Evolution of wages. While real wages were still on a positive path in 2009, this was determined by the administrative increases in salaries of many public employees, as 2009 was an electoral year and in Moldova such "pre-election" bonuses are not uncommon. Meanwhile, wages in the real sector increased only slightly and wages in the private domestic sector even decreased in real terms, especially in the industrial and construction sectors. In a business survey conducted in 2009, 18% of employers reported a cut in wages in order to cope with the crisis and 8% of respondents were considering this measure for the near future<sup>54</sup>. Some other sectors tried to resist the pressures and kept wages at the level of the previous year. However, as the effects of the crisis persisted in the following year, other sectors also experienced wage reductions in 2010 (e.g. financial activities). Moreover, delays in wage payments were also registered during early 2009. In the same survey, 11% of employers had already accumulated wage arrears and other 3% were planning to do so in the following three months<sup>55</sup>.
- Increase in unemployment. As already mentioned above, the unemployment rate was relatively low before the crisis. However, in the case on Moldova, the use of the unemployment rate to describe the situation on the labour market may be misleading. According to ILO standards, for a person to be considered unemployed he or she must be "undertaking active measures for seeking a job". As the Moldovan labour market provides few opportunities to find a well-paid job, many Moldovan citizens do not look for a job, remaining inactive or leaving for a job abroad. Moreover, the widespread ownership of agricultural land, coupled with the limited job opportunities, lead many individuals to work on their small plots in order to survive. Therefore, they are considered employed, while in fact they would like, and sometimes even look for, a job. As result of this, the unemployed population in Moldova was surprisingly small. However, in 2009, the unemployment rate increased significantly by 2.4 percentage points due to both the contraction of employment and the return of many migrants (Figure 3). Also, during 2009 the increase in the number of unemployed registered at National Employment Agency was related to some policy decisions such as a new compensation scheme for heating expenditures during winter and the entrance into force of the new law on social aid for which the registration with NEA was mandatory.
- Rise in underemployment<sup>56</sup>. While the employment rate was less sensitive to the crisis, as layoffs are considered to be a last solution by employers (due to restrictive labour legislation

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<sup>54</sup> Business survey conducted in July 2009 for assessment of impact of the crisis on the local communities. Results from Expert-Grup (2009) "Impact of the global financial crisis on local communities in Moldova", UNDP Moldova;

<sup>55</sup> Ibid.;

<sup>56</sup> According to National Bureau of Statistics Methodology, underemployment comprises persons who are employed, but: (i) willing to work additional hours; (ii) available to work additional hours; (iii) hours actually worked in all jobs during the reference period were below a threshold determined according national circumstances;

in Moldova), other methods to react to the crisis effects were fully used. Thus the decrease in hours worked, with a corresponding cut in wages was considered by many employers. The underemployment rate reached its peak in 2010, with 9.3% of employed population, ready to work more hours for higher payment (Figure 3).

**FIGURE 3: Unemployment and underemployment rate, 2000-2011, %**



Source: National Bureau of Statistics.

The above mentioned business survey showed that 14% of employers had slashed the working hours and 15% were considering these measure within the next three months<sup>57</sup>.

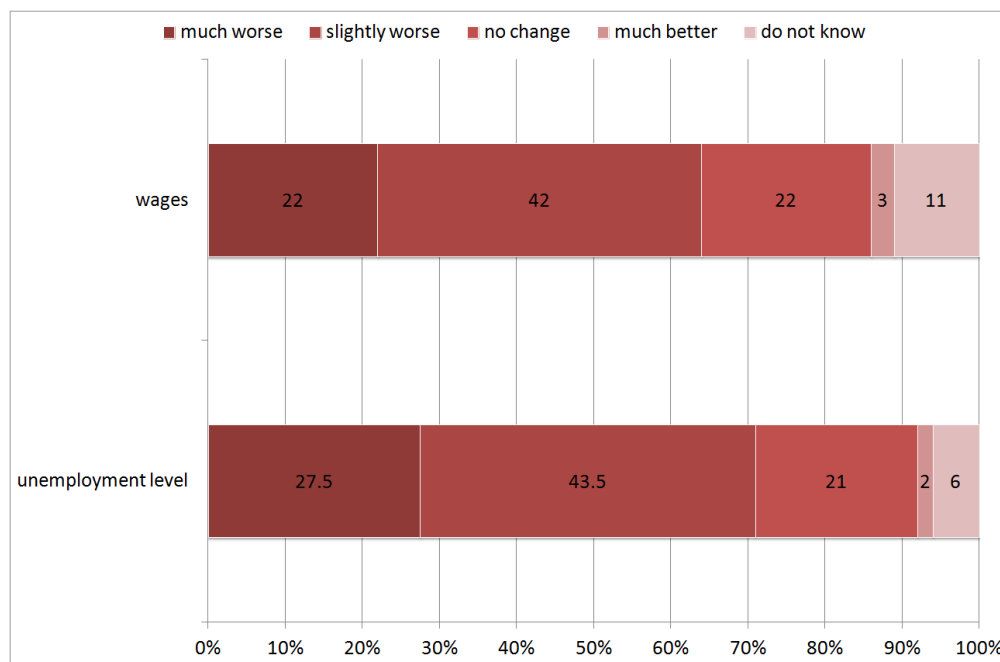
- Meanwhile, the number of discouraged people almost doubled. Many of those who lost their jobs or returned to Moldova, although they needed a job, considered the effort of looking for a job to be meaningless. The individual survey conducted in 2009 on the impact of the global financial crisis on local communities, shows that 83% of the respondents considered that in mid-2009 it was more difficult to find a job than it had been six months previously<sup>58</sup>.
- The rise in informal employment. For some of the people who lost their jobs, self-employment and activity in their own households replaced their previous job. Additionally, companies were also seeking cost reductions by increasing the share of undeclared work (both undeclared employees and undeclared wages), which is still a defining feature of Moldovan economy.

All these trends contributed to the widely held pessimistic view in 2009 that the trends in the labour market were among top three worsening factors in the community (Figure 4).

<sup>57</sup> Business survey conducted in July 2009 for assessment of impact of the crisis on the local communities. Results from Expert-Grup (2009) "Impact of the global financial crisis on local communities in Moldova", UNDP Moldova;

<sup>58</sup> Individual survey conducted in July 2009 for assessment of impact of the crisis on the local communities. Results from Expert-Grup (2009) "Impact of the global financial crisis on local communities in Moldova", UNDP Moldova;

**FIGURE 4: Distribution of answers to the question “To your opinion what is the current situation in your communities as compared with 6 months ago regarding the following aspects?”**



Source: Individual survey conducted in July 2009 for assessment of impact of the crisis on the local communities. Results from Expert-Grup (2009) "Impact of the global financial crisis on local communities in Moldova", UNDP Moldova.

At the same time, some positive changes can also be seen despite the decrease in employment. These mainly occurred in the industrial sector, where data show that it was mostly older and low-educated individuals that lost their jobs in 2009-2010, which can be treated as a sign of an optimization process in some enterprises that mainly shed auxiliary personnel. Similar evolutions took place in other transition countries leading later to productivity gains.

Also, the crisis revealed the existence of mismatches on labour market between the supply and demand of the labour force. While it was known before the crisis that serious mismatches dominated the labour market, the stable demand for higher-educated specialists (graduates of tertiary education) in contrast to the decreasing demand for secondary-education graduates, showed the weakness and lack of foundation for the policy view held by the government that there are too many higher education graduates in Moldova.

## 4. POLICY RECOMMENDATIONS

The Moldovan labour market is very weak and the situation has worsened throughout the whole transition period. The crisis has only aggravated the situation, revealing the full extent of current vulnerabilities. It is true that a small open economy cannot be immune to external shocks, but higher domestic economic activity may reduce the magnitude of the impact. Therefore, three directions of intervention are needed in order to change the situation on the labour market:

#### **4.1 Creating a favourable business environment**

Low employment is associated with the low level of economic activity in the country. Although the state is concerned about job creation, labour market and employment strategies may be a blunt instrument for job creation if business activity is very low. Therefore, the main recommendation for the medium term is to improve the business climate through the protection of fair competition, elimination of trade barriers and an easing of administrative burdens over the private sector.

Some particular recommendations refer to:

- Rapid interventions to improve the business environment in agriculture and the food processing industry, which employ mostly the rural population that is the most vulnerable to external shocks;
- Interventions for elimination of non-tariff trade barriers and ensuring proper protection of investors in order to attract more FDI, which has proved to have had a higher and more beneficial impact on employment;
- The revision of labour legislation through the introduction of greater flexibility in work contracts, which is especially important in the case of seasonal works, the Moldovan economy being highly seasonal, not only because of the agricultural sector, but also the food-processing sector;
- At the same time the state should ensure proper control of incomes generated in the economy and fulfil its task of revenue collection. The state should intervene to reduce the shadow economy and undeclared work, not only through higher control and additional burdens but also through incentives. Some concessions are needed from the side of the state too, which should make the process of public spending as transparent as possible.

#### **4.2 Investment in human capital**

Actually, the level of public investment in education (as a share of GDP) is relatively high in Moldova. But the management of human capital formation over recent decades has been ineffective and today as many as 41% of employers identify the level of skills of the labour force as a major constraint to their activity<sup>59</sup>. Even during the crisis employers could not find the necessary staff. Therefore it is imperative to:

- Reform the professional and higher education system through the introduction of new curricula that are in line with the current needs of the economy;
- Involve the business sector more in human capital creation through internships, participation in elaboration of the curricula and more in-work training programmes;
- Provide greater motivation for life-long learning. Currently, the share of adults participating in any kind of training is below 1% in Moldova. Life-long learning should be promoted at

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<sup>59</sup> Enterprise Survey data 2009, World Bank;

enterprise level, but also some joint programmes between the National Employment Agency and business sector should be launched;

- In the medium-term, Moldova will be left with a growing number of unemployed people, and the government and development partners should take immediate actions with targeted training programs for these people. These programs have to provide the necessary skills for people to be able to find other jobs or to become self-employed. Particular attention should be given to rural youth who have experienced even more significant hurdles in entering the labour market during this crisis;
- Change the R&D system that currently fails to respond to the needs of the economy and is a major constraint to competitiveness. The universities, which are currently almost absent from the R&D process, should be given more responsibilities and funds in order to involve students in R&D and to develop innovation activities that ultimately will lead to higher productivity and a more competitive economy.

#### **4.3 Social policy should be adapted to respond to the current situation on the labour market**

Therefore, several issues should be addressed:

- As migration is expected to be a widespread phenomenon in the short- and mid- term, the government should put more effort into the protection of its citizens' rights abroad. This refers especially to social protection: bilateral agreements on social protection and insurance should be signed with countries where Moldovan citizens work and the Moldovan government should be the one launching the negotiations;
- Low employment and a high share of undeclared work reduce the sustainability of the whole social system and the pension system in particular. Therefore, it is necessary to continue with the means-tested mechanism of social aid schemes and to improve that mechanism in order to ensure that it reaches the most vulnerable. At the same time, the pension system should be urgently reformed through equalization of the retirement age of men and women in the multi-pillar pension system;
- Changing the functional approach of the current social protection system addressing only physiological needs of the vulnerable groups of the population to their active involvement in social and economic life. Currently the social aid level is under the value of cost of living, being close to the cost of food basket ensuring minimum need in calories. Therefore, even under social protection schemes, poor individuals have limited access to important services (i.e. health, education, etc.) making them vulnerable in medium and long term by limiting their ability to integrate further in the society.



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## CHAPTER 11.

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### **Impact of the Global Financial Crisis on the Labour Market and Citizens Social Status in Montenegro**

Nikola Fabris

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#### **1. INTRODUCTION**

After World War II, Montenegro was an underdeveloped agrarian region, with traditionally organised economic life where 85 percent of population made their living by farming, while just about 15 percent of the population engaged in handicrafts, trade and other businesses. The mode of production dictated a small and limited exchange in which exports consisted of surpluses of primary agricultural products and some handicrafts products.

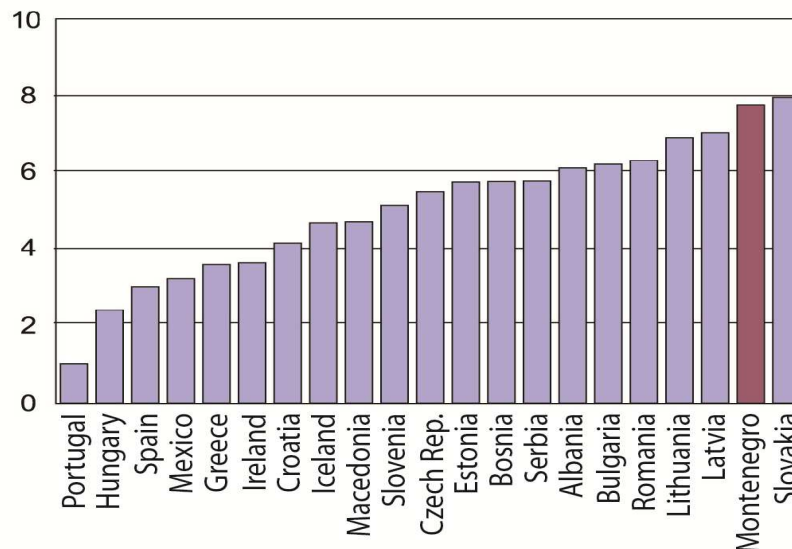
In the post-World War II period, in line with socialist concept of industrialisation, Montenegro's development was directed towards stimulating the production of energy-based industrial branches (energy, mining, metal industry) and accelerated transport development. In this respect, the Montenegrin investment policy followed the course of the general Yugoslav policy oriented towards heavy industry.

A new stage in the development of Montenegrin economy started with the dawning of the 21<sup>st</sup> century. As a result of all the problems accumulated in the 1990s and the absence of proper investments, the majority of industrial companies faced serious difficulties. Numerous industrial companies went bankrupt, while metal industry, regardless of privatisation, survived solely owing to generous government subsidies.

A new phase of extremely rapid growth began in 2006 coinciding with the restoration of Montenegro's independence. Rather impressive results had been achieved over the pre-crisis period: remarkably high rates of growth of GDP, large inflows of foreign direct investments, an increase in the living standard and an accelerated growth experienced by certain sectors such as construction, tourism and the financial system. During the three-year period prior to the global financial crisis, Montenegro was recording an average rate of GDP growth of 8%, thus belonged to

the group of economies in transition experiencing the most rapid growth; Slovakia was the only country whose GDP growth rate was higher.

**FIGURE 1: Average GDP growth of selected European countries in transition (in %), 2006 - 2008**



Source: Fabris, N. and Mitrović, M. (2012).

The economy has been severely shaken by the crisis that erupted in the last months of 2008, interrupting the increasing growth trend and bringing up many questions of structural imbalances which have led to the deterioration of social status of citizens. The average GDP rate of growth in the next three years (2009-2011) was -0.15%. One should also have in mind that the recession in Montenegro lasted only for a year.

Such a plunge in economic activity has had a negative impact on the labour market, as well as the social position of employees. The accumulation of social problems is also supported by data indicating a growing number of social welfare recipients and an increase in the total amount of disbursed social welfare expenditure.

The aim of this paper is to analyze the impact of the global financial crisis on the social status of citizens and the labour market trends in Montenegro. The paper consists of two parts. The first part analyzes the impact of the global financial crisis on deterioration of social status. In the second part, specific recommendations will be given about what should be done to alleviate social problems in Montenegro.

## 2. IMPACT OF THE GLOBAL FINANCIAL CRISIS ON CITIZENS SOCIAL STATUS

As a result of the crisis many companies fell into serious difficulties, which are manifested by declining levels of economic activity, insolvency increase, delays in settling wages and other obligations, as well as downsizing the number of employees.

As usual, the crisis hit the labour market, but the labour market did not react immediately, but with a certain delay. The explanation of this phenomenon can be found in the fact that during the boom years the companies accumulated certain reserves, so that their adaptation to the situation in the form of layoffs had been applied with a certain time delay, as the effects of the crisis deepened.

**TABLE 1: Number of workers and unemployed in Montenegro (end of year)**

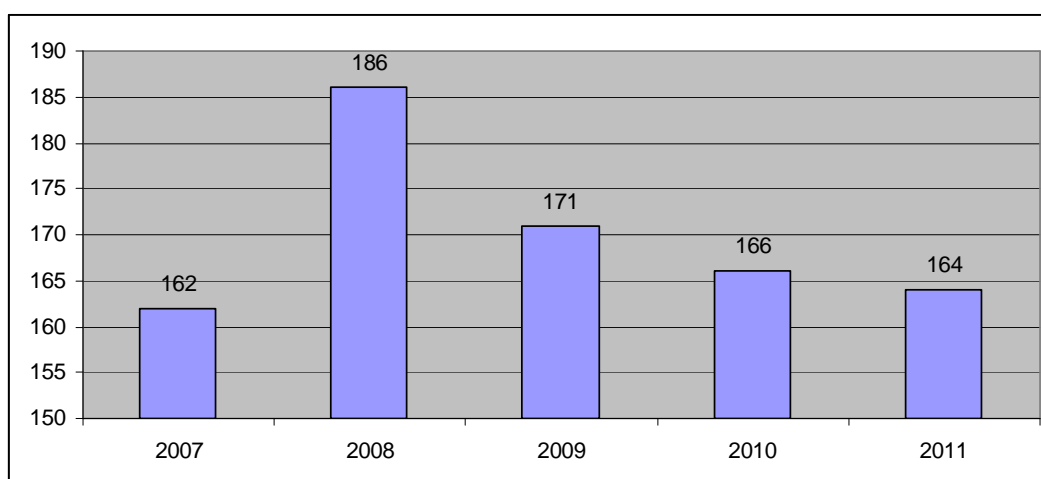
Year	Number of workers	Number of unemployed
<b>2007</b>	159,223	31,469
<b>2008</b>	169,160	28,366
<b>2009</b>	169,859	30,169
<b>2010</b>	157,679	32,106
<b>2011</b>	162,450	30,552

Source: Monstat and Labour market office.

As shown in table 1, at the end of 2011 the number of employees decreased by almost 7000 in comparison with the maximum achieved in 2009. On the other hand, the number of unemployed is almost higher than 2000.<sup>60</sup> The demand for labour reacted in a similar way, but with no time delay. Thus, the demand for labour in 2009 was lower by 25.3% in comparison with 2008, and in 2010 was lower by 19.6% in comparison with 2009, or about 40% in comparison with 2008 (Bakrač, 2011).

One of the consequences is that from 2008 onwards there was a continuous decline in personal consumption, as shown in figure 1.

**FIGURE 1: Personal consumption (average by household members in €)**



Source: Monstat, Household Budget Survey for observed years.

<sup>60</sup> The difference between an increase in unemployment and decrease in the number of employed can be explained by the release of certain number of workers from the workforce contingent.

As a result of these developments, a deterioration of social status of citizens occurred together with the increase in the number of poor people. After a period of rapid economic growth in which the poverty rate decreased from 11.3% in 2006 to 4.9% in 2008, as the direct consequence of the crisis the poverty rate rose to 6.8% in 2009 and 6.6% in 2010.

**TABLE 2: Indicators of poverty**

	National absolute poverty line (in €, monthly per adult equivalent)	Poverty rate (in %)	Poverty gap (in %)	Poverty severity (in %)	Gini coefficient
<b>2006</b>	144,68	11,3	1,9	0,6	24,4
<b>2007</b>	150,76	8,0	1,4	0,4	26,4
<b>2008</b>	163,57	4,9	0,9	0,3	25,3
<b>2009</b>	169,13	6,8	1,4	0,5	26,4
<b>2010</b>	169,98	6,6	1,1	0,3	24,3

Source: Monstat, poverty analysis in Montenegro for observed years.

The data in table2 clearly show that in comparison with the pre-crisis year 2008, there was an increase in poverty rates. Although as a result of economic growth, the number of poor declined in 2010, nevertheless it has not returned to the pre-crisis level. Therefore, this issue should be taken into account within a new model of development; as highlighted by Melamed et al. (Melamed et. al., 2010), economic growth is a necessary but not sufficient condition for poverty reduction. The statistics show that poverty is present in Montenegro, but it is not as pronounced as in some other countries of the region.

The Gini coefficient, as an indicator of inequality in income distribution, decreased from 26.4% in 2009 to 24.3% in 2010 (Monstat, 2010). This ratio is significantly better than in the EU, where in 2010 it amounted to 30.4% (Eurostat, 2011) or in Serbia, where it amounted to 28.2% (The Economist, 2011). However, these statistics should not deceive us that the social problems are not pronounced in Montenegro. In late 2011 and early 2012 Montenegro was hit by a wave of social protests of trade unions, student organizations, NGOs and others.

The study conducted by UNICEF (2011) shown that there has been significant poverty growth among children. The survey concluded that 14 500 children in Montenegro live in poverty (or every tenth child), and that poverty affects mostly children. The study also showed that in 2009, the poverty rate of 10% was the highest among children up to 17 years, among the population over 18 years it was 6.1%, while the national average was 6.6%.

As a result of increased number of poor people, an increase in the number of social welfare beneficiaries was reasonably expected. The following table 3 illustrates well how the crisis led to an increase in the number of social welfare beneficiaries for all observed types of social welfare.

**TABLE 3: Social assistance beneficiaries in Montenegro**

TYPE OF ASSISTANCE		2007	2008	2009	2010	2011
<b>Family allowance</b>	Number of families	12.741	12.830	13.130	13.746	14.135
	Number of family members	39.281	39.383	40.222	41.816	42.879
<b>Allowance for children</b>	Number of holders	9.475	9.430	9.734	9.922	10.444
	Number of children	18.524	18.370	18.949	19.131	20.057
<b>Care and assistance for other person</b>	Number of users	5.376	6.002	6.089	7.299	7.733
<b>Persons with disabilities</b>	Number of users	1.299	1.422	1.467	1.613	1.698

Data: Ministry of Economy.

Therefore, it is not surprising that there was an increase in weight of social policy in the budget. Thus, for example, social welfare expenditure in the budget amounted to 28 million Euros in 2007, but in 2011 this amount increased by almost three quarters, reaching 47 million Euros.

Montenegro has distinct regional differences in the level of development. The data presented in table 4 show pronounced disparities in regional terms. There is one developed region (central), one region corresponding to the country's average (coastal) and one underdeveloped region (northern). The northern region lags far behind the level of economic development - its income per capita is 3.5 times lower than in the central region and almost two times lower than in the coastal region. In addition, the unemployment rate is more than twice higher than in the central and coastal region.

**TABLE 4: Selected regional indicators in Montenegro**

	Northern region	Central region	Coastal region
<b>Change in population (between two censuses<sup>61</sup>)</b>	-7.4%	8.3%	1.9%
<b>Total income (annual financial statements) in euros</b>	1,229,272,155	3,766,084,497	1,435,715,988
<b>Total income per capita (in euros)</b>	4,911.6	17,036.0	9,656.2
<b>Number of employed persons</b>	44,119	71,424	46,199
<b>Number of unemployed persons</b>	15,809	10,434	5,783
<b>Unemployment rate</b>	26.37%	12.74%	12.51%

Source: Fabris and Žugić (2012).

Therefore it is not surprising that poverty in Montenegro has a distinct regional component. Most poor people are concentrated in the northern region, which is the least developed and most

<sup>61</sup> The last two censuses were in 2003 and 2011.

affected by the crisis and transition, since the majority of industrial enterprises from the region went bankrupt. The poverty rate in the northern region is almost twice the rate in the central region and four times the poverty rate in the southern region. In the northern region in 2010 the poverty rate was 10.3%; this is the region where 28.9% of the population of Montenegro live, or 45.2% of all poor. The poverty rate in the central region is 5.9% and in the coastal region only 2.6% (Monstat, 2010). Also, in urban areas, poverty is significantly lower and amounted only 4% in 2010, and in rural areas even 11.2% (Monstat, 2010).

**TABLE 6: Poverty by regions in Monenegro in 2010, (in %)**

Region	Poverty rate	Share of the poor	Share of total population
North	10.3	45.2	28.9
Central	5.9	47.9	53.6
Coastal	2.6	6.9	17.5

Source: Monstat (2010).

Therefore, the results of the last census (Monstat 2011) in Montenegro show significant emigration from the northern region (population between two censuses decreased by 7.4%) towards the central region (population growth by 8.3%) and coastal region (growth by 1.9%). In this way, overpopulation has been created in these regions causing pressure on the infrastructure.

Significant differences in the regional development have influenced the quality of the workforce. One should have in mind that it was not possible to use the educational structure of population as the labour force quality indicator because in the 2011 census data on this indicator were not available. Therefore, two indicators were used to show labour force skilfulness: the share of computer literate persons over 15 and the share of population over 15 who speak one foreign language (the survey targeted English, Russian, Italian, German and French)<sup>62</sup> in total population. The results obtained, based on the 2011 census data are presented in the following table 7.

**TABLE 7: Population over 15 being computer literate and speaking at least one foreign language (in %)**

	% of persons who speak one foreign language	% of computer literate persons
<b>Montenegro</b>	45.2	34.5
<b>Coastal region</b>	56.7	38.6
<b>Central region</b>	47.7	38.3
<b>Northern region</b>	30.9	24.7

Source: The author's calculations based on the population census (Monstat 2012 and Monstat 2012c).

<sup>62</sup> In the previous 2003 population census, these indicators were not targeted by the census, so a comparative analysis could not be performed.

The trend of concentration of highest quality labour force in developed regions is not characteristic only for Montenegro, but also for other countries. In a very influential research, Siebert and Zaidi (1980) showed that new development centres (industrial cities) attract the highest quality labour force. On the example of Great Britain (27 large cities), Champion et al. (2007) demonstrated that developed cities primarily attract skilled labour force. On the example of China, Yumming and Gabriel (2010) found that educated population is more mobile and tends to move towards developed regions. The connection between the labour force quality and development of a region was also confirmed in a number of other studies (see Bhorat et al. 2002, Khadira 2006, Bhagwati and Hanson 2009, Nagel 2005). Such features present also in Montenegro create a "vicious circle", because the low quality of labour in the northern region will bring reduced employment opportunities and lower wages.

Therefore it is not surprising that the crucial structural changes in the economy have been followed by the changes in the demographic structure. For example, the share of agricultural population declined from 71.6% after World War II, to only 5.3% according to the latest census in 2011. This trend was followed by changes in urbanization, so the share of the total urban population, in the same period, increased from 14% to 62% (Žugić, 2011).

In addition, the agricultural census data indicate that regardless of an ongoing decline in the share of agricultural production in GDP, the number of agricultural holdings has increased. Recent data (Monstat, 2010a) showed that in the period between 2003 and 2010, the number of agricultural households increased by 5,631 (from 43,216 to 58,847). These results may seem contradictory at first glance; however, bearing in mind the average salary level (484 euros) (Monstat, 2012b) and the minimum consumer basket (770 euros) (Monstat, 2012a) at end-2011, it becomes clear that one part of the population had to seek a source of additional income and found it in the agricultural sector. Therefore it is not surprising that among self-employed persons (predominantly engaged in subsistence agriculture) the poverty rate declined to 5.4%, which is below the national average (Monstat, 2010).

### **3. RECOMMENDATIONS FOR THE FUTURE**

Although poverty reduction is associated with economic growth and development, there are a number of other measures that can be taken to alleviate this problem. The first step should definitely be a strengthening of social dialogue which, although present to some extent, cannot be assessed as satisfactory. It is also necessary to adopt a new strategy for poverty reduction since a whole decade passed from the adoption of the previous (2002).

The key problem of the social welfare system in Montenegro refers to the inability of the system to include all those in need. Therefore, it is necessary to examine both the social status of all beneficiaries of social assistance, as well as to expand the beneficiaries' scope.

A change in the structure of subsidies should also be considered. IMF (2002) recommends replacing those subsidies which benefit everyone, with subsidies targeting only poor people. This mode of subsidy has been implemented in Montenegro but only with respect to subsidies for electricity, and it should be applied to other areas.



Since statistics show that poverty is most prevalent among the uneducated population, it is necessary to increase the coverage of the population with higher levels of education. Also, the reduction of regional differences may contribute to the problem of poverty, because it is concentrated in the north of Montenegro. It is useful to encourage investments in underdeveloped region by granting other benefits as well. It is possible to deploy a wide range of measures to provide tax exemptions for a certain number of years, income tax exemption for a certain number of years, allocation of free sites, the release of utility charges, free access to water and electricity and similar. At the same time subsidizing agricultural production programs could help to alleviate the problem of poverty, given that the agricultural production is concentrated in the north of Montenegro where the greatest social problems are present.

While it is necessary to allocate more social assistance to vulnerable groups, by merely increasing the amount will not solve all problems. It is necessary to pay attention to the inclusion of vulnerable groups into economic and social life. It should be noted that the period of rapid and sudden changes in a society leads to an increase in the number of beneficiaries of social and child assistance, that many beneficiaries enter the system early and remain too long in it, so the chain of social exclusion is transferred in a transgenerational manner, that the beneficiaries are passive and insufficiently encouraged to activate their potential with the support of the system in order to overcome adverse circumstances in which they and their families are. As emphasized in the Strategy for Social and Child Protection (2008), the reaction to the social and child welfare was often retrospective and belated, partial and not efficient enough.

Among other measures, it would be important to implement the following:

- Involvement of all social actors in the creation of social policy (public institutions, beneficiaries, businessmen, civil society, media);
- Improvements in the creation and implementation of social policy at the local level with the formation of mixed groups (including all stakeholders) that can better target social needs on the local level;
- Improving communication and coordination mechanisms between social actors in planning and implementation of social policies in the local community;
- Work on increasing public awareness about the needs of beneficiaries of social and child assistance.

Of particular importance for the efficiency of financial support is the development of a database primarily for the system of social and child welfare, as well as other databases in other systems, and linking databases of all institutions.

Finally, it is necessary to pursue policies that will encourage economic growth and thus contribute to the improvement of citizens' social position. Creation of a conducive macroeconomic environment<sup>63</sup> involves policies that should contribute to the country's growth, including development of underdeveloped regions. The objective is to create a similar environment to those existing in developed countries. This means that a country should ensure fiscal stability, a

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<sup>63</sup> For more details see the Central Bank of Montenegro's *Recommendations to the Government of Montenegro Regarding Economic Policy for 2012*.

low share of public debt in GDP, low inflation and a predictable business environment. Considering the current situation in Montenegro, the creation of such an environment would require the following economic policy measures: fiscal consolidation<sup>64</sup>, the cut in public spending to the level of actual possibilities, a gradual change of the growth model, improvement of competitiveness of the Montenegrin economy, acceleration of EU accession, continuation of reforms and privatisation, enactment of systemic laws in line with best international practices, continuation of deregulation, removal of business barriers, and so on.

#### **4. CONCLUDING REMARKS**

The global financial crisis has stopped the three-year trend of rapid growth of the Montenegrin economy. The crisis has brought a decline in economic activity, worsening economic situation of many enterprises and increasing overall insolvency. These significant negative shocks worsened the social situation in Montenegro.

As a consequence of the crisis there was an increase in the number of poor, where the highest poverty rate is present among children. In the observed period there was also a decline in personal consumption. However, it should be noted that while poverty is present in Montenegro, it is not as pronounced as in some other countries in the region and large inequalities in income distribution are not registered.

The crisis has affected the labour market and resulted in the growth of unemployment. All these problems were reflected in the increased number of welfare beneficiaries and consequently increased the budget for social welfare, which made additional pressure on the budget during the recession. Poverty in Montenegro has a distinct regional dimension, since 40% of the poor are concentrated in the least developed region, which also has twice the unemployment rate of the other two regions. Also, the quality of labour force in the undeveloped region is much worse, which makes the reduction of poverty more difficult. Between the two censuses, there was emigration from the underdeveloped to the two more developed regions.

The basic prerequisite for reducing poverty and improving social status will be faster economic development. However, there are a number of measures for economic recovery which should be taken by economic policy makers. Among others, the following should be emphasized: the development of social records and determining the actual needs, designing social programs for those to whom social assistance is really necessary, strengthening social dialogue, social budget increase, programs of economic assistance to the undeveloped region, improvement of social policy at the local level, etc.

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<sup>64</sup> In the long term, it is necessary to reduce the share of public spending in GDP, as well as gradually reduce the share of current budgetary expenditure in favour of capital expenditure.

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## CHAPTER 12.

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### **Romania: The Need for a New Development Model**

Liviu Voinea and Irina Ion

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#### **1. INTRODUCTION**

The recent financial crisis has raised concerns about whether capitalism in its current form needs revision (Gruenewald, 2010, pp. 69). The crisis has frequently been considered a failure of the neo-liberalism. Wade (2009) and Frenckel and Rapetti (2009) argue that while the crisis in the developed core has had largely domestic causes, externally mandated neoliberal policies in general and the liberalization of the current account in particular have been to blame for the crisis in developing countries.

One of the most powerful effects of this crisis has been the deepening of social and income inequalities: “one of the most troubling developments in recent years has been the widening of income inequality, not only in the United States, but also in many other countries” (Zalewski and Whalen, 2010: 757), “as safety nets were shredded” (Wray, 2009: 305).

In the European Union, most European governments have chosen to cut spending in order to diminish fiscal deficits and public debt. The low and middle-income countries have been the most affected, as austerity measures implemented across-the-board have had a similar impact as introducing regressive taxes.

Romania, a former transition economy and the second poorest European country, which joined the European Union in 2007, experienced an abrupt adjustment to the effects of the crisis. The main reasons for this were its previous large macroeconomic imbalances, corruption and lack of political vision. Voinea (2012) holds that bad domestic policies were the real crisis generators, while exogenous crisis mechanisms including contagion from the global financial crisis were just the trigger. The Romanian crisis can be considered not just a temporary economic recession, but a structural crisis, a crisis of vision, reforms and leadership.

In this paper, we undertake a holistic qualitative analysis of the main social and economic effects of the austerity measures imposed by the Romanian government. The data used covers generally the period 2000-2011/2012 and are based mainly on official statistics from the National Institute of Statistics, the Public Finance Ministry and the National Bank. Section 2 identifies the peculiarities of the Romanian crisis, as compared to the world recession. The purpose is to present a deeper understanding of the macroeconomic imbalances and improper public policy mix that characterized the Romanian economy until 2009. These peculiarities reveal why the Romanian crisis is less linked to the external crisis, and is more an internal, structural and authentically Romanian one. Section 3 analyses the situation before and after the crisis covering a set of economic and social dimensions, such as inequality issues, public debt and the level of salaries. The main policy responses are identified together with their main social and economic consequences. Section 4 draws some conclusions on crisis management, analyzing possible sources of future growth and development.

## 2. A CRISIS OF ITS OWN

In Romania, the adjustment to the crisis was more severe than anywhere else in Europe in terms of austerity measures. The burden of this adjustment was supported by the vast majority of the population that had not previously benefited from the boom years. A comparative assessment of the magnitude of the austerity programme in Romania and in other European countries is presented in Table 1 below:

**TABLE 1: A comparative assessment of austerity programmes**

Austerity programme/ Country	Germany	Estonia	Greece	UK	Romania	Island
% of GDP	3.3	8.5	10.5	7.2	13.9	12
% of GDP per year	0.8	2-3	3	1.8-2	7	2.4
Billions, national currency	<b>80</b> (2010-4)	<b>85</b> (2010-3)	<b>24</b> (2010-3)	<b>No data</b> (2010- 12/13)	<b>74.6 lei</b> (2009-10)	<b>179 ISK</b> (2009-13)
<b>1. Revenues increases</b>	<b>33</b>	<b>41.2</b>	<b>42.9</b>	<b>31</b>	<b>15</b>	<b>36</b>
Corporate taxes	7.5	-1.6	8.5	-8.5	-	1.4
Income taxes	-	-	-	-11.56	-	32.3
VAT	-	11.4	23.4	44.9	10	4.6
<b>2. Spending cuts</b>	<b>52</b>	<b>58.8</b>	<b>57.1</b>	<b>69</b>	<b>85</b>	<b>64</b>
Social security (5Without long-term structural reforms in the health care sector and pension system)	34	5.4	-	21.9	-	15.6

Source: Heise and Lierse (2011) p.505.

According to the above data, we can see that in the period 2009-2010, the Romanian austerity programme accounted for 13.9% of GDP, more than in Germany, Estonia, Greece, UK or Iceland. Also, the annual consolidation effect represented 7% GDP, followed by Greece, Iceland and Estonia. What problems did such a significant austerity programme aim to solve in Romania? Voinea (2009) identifies a set of common explanatory factors of the financial crisis in Romania and the global downturn including:

- a) *the deregulation processes*, following the liberalization of the current account in 2004. Despite this, mortgages have not been of much importance in household credits. Moreover, derivatives instruments are almost absent; in consequence, the government has deregulated and liberalized a market that almost does not exist in Romania;
- b) *the high level of corruption* that has been present in the public sector since 1989 when Romania became a democratic capitalist country has led to misallocation of resources, an erosion of inter-personal trust and a negative image for foreign investors. Subjective perceptions regarding corruption are relevant: in 2010, the Transparency International Barometer on Corruption for Romania showed that 87% of the respondents believed that corruption had increased in the previous three years and only 11% believed that it had remained the same.
- c) *the polarization of incomes* due to the existence of a weak middle class, formed on the basis of debt accumulation rather than capital accumulation. Another cause can be related to the introduction of the flat tax of 16% in 2005;
- d) *the speculative bubble in the real estate market*, that begun in Romania in 2003 and finished in 2008.

Other causes of the Romanian crisis are the *procyclical budgetary and fiscal policies*, such as the flat tax, the large increases of civil servants' salaries, the delay of structural reforms, the reduced absorption of European funds and a generalized political incapacity of anticipating and managing the crisis. These factors can be synthesized into the aspects shown in Table 2:

**TABLE 2: A comparison of the Romanian crisis and world economic recession**

Causes of the crisis	World economic crisis	Romanian economic crisis
<b>Structural causes</b>	<ul style="list-style-type: none"> <li>Excess of financial investment</li> </ul>	<ul style="list-style-type: none"> <li>Over-consumption on debt</li> <li>Increase of salaries more than productivity</li> </ul>
	<ul style="list-style-type: none"> <li>Speculative bubbles on several markets (information technology, real estate, financial innovations, the stock exchange, etc.)</li> </ul>	<ul style="list-style-type: none"> <li>Speculative bubble on the real estate market</li> </ul>
<b>Transmission mechanism</b>	<ul style="list-style-type: none"> <li>Toxic assets (bank exposures to non-performing derivatives)</li> </ul>	<ul style="list-style-type: none"> <li>Financing of the current account deficit by private debt</li> </ul>

Source: Voinea, L. (2009) *Sfarsitul economiei iluziei. Criza si anticriza*, Bucuresti: Ed. Publica, p. 29.



The above data show that the drivers of the Romanian crisis are essentially different from those that explain the major features of the world crisis. These factors are mainly derived from structural characteristics of developed and wealthy societies, primarily the United States, but also Spain, Italy, Great Britain, and on another scale Greece and Portugal. There are also different views on transmission mechanisms of the crisis that explain the Romanian recession mainly through the effects of spreading and contagion (Potecea and Cebuc, 2010: 128). In our opinion, the Romanian peculiarities indicate a de-connection of the economy from the international financial markets and an internal transmission mechanism – that of inappropriate public policies and a lack of sustainable competitive advantages. As a consequence of the chaotic development model, major competitive disadvantages have crystallized in consumption led growth and increasing current account imbalances. Romanian society was blinded by an illusionary booming economy, materialized in a decade of economic growth as illustrated bellow in Table 3.

**TABLE 3: GDP at current market prices, 2000-2011 (€ billions)**

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
GDP at current prices	40.6	45.3	48.6	52.6	61.10	79.7	97.8	124.7	139.8	118.3	124.1	136.5

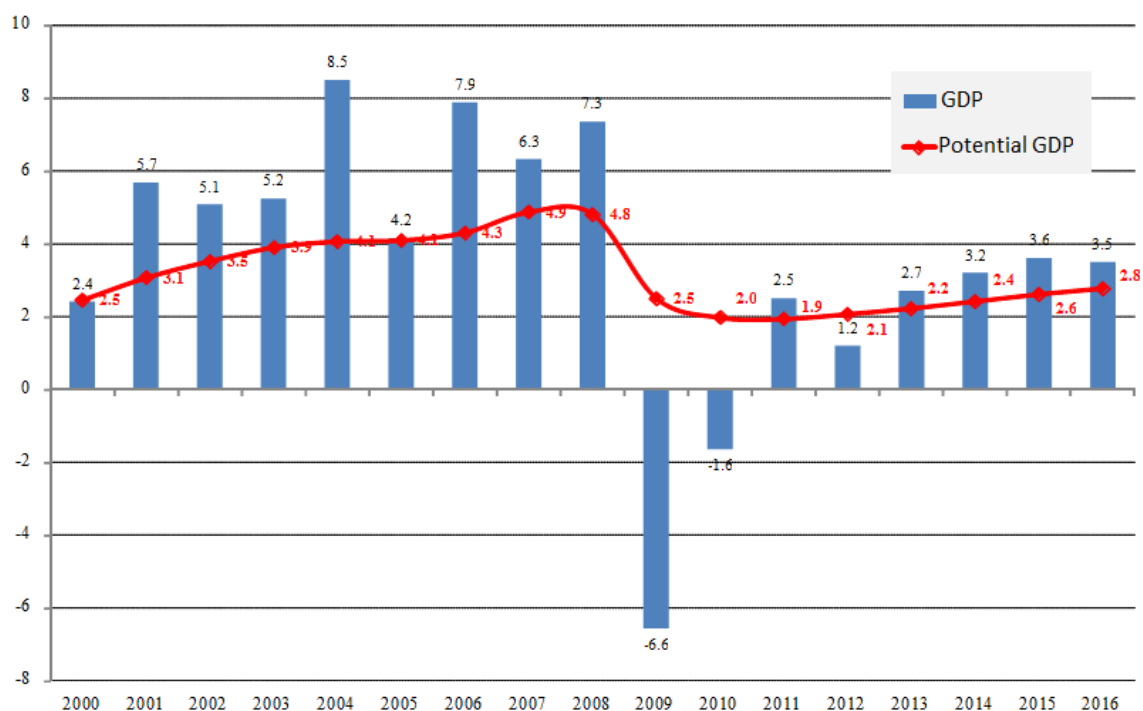
Source: National Institute of Statistics.

The nine-year period of growth was the most prosperous period after the fall of the communist regime in 1989. Unfortunately, it was chaotic growth, developed without a strategic vision and sensitive to political influence and corruption which diminished the normal economic cycle, turning into a recession in 2009 (the last trimester of 2008).

The analysis of the main drivers of growth reveals the lack of long-term planning and lack of a sustainable growth model. The main drivers of economic growth in the period 2000-2008 was household consumption, that increased by 10-15% annually while gross fixed capital formation increased by 20-30% annually, mainly due to the investment in the automobile components industry and in speculative real estate (Voinea, 2009: 64). As a consequence, real GDP growth increased from 2.4% in 2000 to 7.3% in 2008, with a peak of 8.5% in 2004.

This rapid growth was also supported by the introduction of the flat tax of 16% in 2005 that stimulated aggregated demand but not aggregated supply as four-fifths of the additional revenues gained from the imposition of the flat tax were spent on consumption. Also, budgetary incomes became dependent on the collection of consumption taxes, that is the value added tax (VAT) and excises. The stimulation of aggregated demand caused real GDP to surpass potential output in a typical economic cycle of growth, as shown in Figure 1.

**FIGURE 1: Real and potential GDP growth, 2000-2016**



Source: The National Institute of Statistics, the Public Finance Minister. Note: data for 2013-2016 are estimates.

The rapid consumption led growth had many macroeconomic and social implications, such as current account imbalances and increased short-term private debt. Before the crisis, the economic picture was also completed by (i) current account imbalances, (ii) large budget deficits translated in government dissaving, (iii) a lax fiscal policy and a lax implementation of fiscal regulations, (iv) a high level of inequality, with an unequal distributed growth, (v) a low level of public debt with a short term private debt and (vi) increasing unit labour costs (ULC).

### 3. PUBLIC POLICY RESPONSES AND ITS SOCIAL ECONOMIC EFFECTS

#### 3.1 Current Account Imbalances

Consumption-driven growth has led to a large current account deficit, as shown in Table 4.

**TABLE 4: The current account deficit , 2000-2011 (% of GDP)**

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Current account deficit	-3.7	-5.5	-3.3	-5.8	-8.4	-8.6	-10.4	-13.4	-11.6	-4.2	-4.4	-4.4

Source: INS, MFP, BNR.

One of the factors that simulated the deepening of the current account deficit were the increasing short term yields of the national Romanian currency, that encouraged foreigners to deposit money in Romanian banks. At the same time, Romanian affiliates of foreign companies started to borrow abroad on a short-term basis for speculative investments in Romania. Despite its apparent attractiveness, this practice proved to be extremely volatile and sensitive to alterations of the national and international market conditions. This is why, in 2007 and 2008, when the RON (the national currency) started to depreciate, especially in 2008 and during 2009 there was a drastic adjustment in imports which further deepened macroeconomic imbalances.

Other factors that contributed to the current account deficit were the low saving rate, together together with the high investment rate (partly in untenable sectors of the economy such as real estate).

This contributed to the high current account deficit, as shown in Table 5.

**TABLE 5: Invest and saving rates and the current account deficit, 2000-2011 (% of GDP)**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Saving rate (Rs)</b>	15,7	16,7	18,7	16,2	15,3	14,7	16,1	17,6	19,7	21,2	20,4	24,5
<b>Investment rate (Ri)</b>	19,4	22,2	22,0	22,0	23,7	23,3	26,5	31,0	31,3	25,4	24,8	28,8
<b>Rs-Ri =Current Account def.</b>	-3,7	-5,5	-3,3	-5,8	-8,4	-8,6	-10,4	-13,4	-11,6	-4,2	-4,4	-4,4

Source: Ministry of Public Finance.

The response to these imbalances was a pro-cyclical policy mix; one explanation being that more corrupt governments may be more inclined towards such pro-cyclical measures (Alesina and Tabellini, 2005). These policy measures and their effects are analyzed below.

### 3.2 Budget Deficit Issues

Before the crisis, the Romanian economy was characterized by large budget deficits and government dissaving (see Table 6).

**Table 6: Budget deficit**

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Budgetary deficit*(consolidated general budget), as% in the GDP	-4.7	-3.5	-2.0	-1.5	-1.2	-1.2	-2.2	-2.9	-5.7	-9.0	-6.8	-5.2 **

Source: National Institute of Statistics and Ministry of Public Finance.

Note: \*SEC95 Methodology, \*\*according to the EDP Notification (the procedure of excessive fiscal deficit), of April 2012

As a response, the government implemented a sharp adjustment of the budget deficit, reducing investment and cutting social spending in the period 2010-2011. The most important reductions of public spending began in July 2010, and included the following measures:

- a 25% reduction of salaries in the public sector;
- a 15% reduction of social transfers;
- collective dismissals in the public sector;
- limitation of current expenses;
- increase of the VAT from 19% to 24%.

These measures are the core of one of the most painful austerity measures applied by any European government, and have been applied in the second poorest country of the EU. They were designed to decrease aggregate demand, the main growth driver before recession. There is no evidence of any prior systematic and rigorous analysis of the effects of such austerity measures, which is the first indicator of yet another chaotic policy measure. The austerity philosophy was borrowed without any critical examination or relevant correlation with the main specificities of the Romanian crisis. Moreover, the government measures were based on mainly on expenditure cuts (Heise and Lierse, 2011: 508). Also, “while it is true that the IMF demanded further budgetary consolidation to the value of 2.3 per cent of GDP in 2010 there were no specific guidelines concerning the shape restructuring was supposed to take” (Heise and Lierse, 2011: 508). As a consequence in the post-crisis period, the most important source of previous growth was “efficiently” oriented into a prolonged and deep decline resulting in an impoverished population.

The recession was followed by a period of stagnation not only because the past growth driver was severely affected, but also because there was no other new driver of economic growth to replace households’ consumption. In 2009, consumption was jeopardized by factors such as: “decreases in wealth, tighter credit constraints and high uncertainty” (Pop, 2009: 124). Even in 2011 household consumption continued to contract by 3.2 percentage points as compared to 2010, while public consumption decreased by 0.9 percentage points. As no other economic sector was able to contribute more to economic growth this led to a continuation of the recession.

**TABLE 7: Composition of GDP, 2010-2011, (% of GDP)**

Year	Households total consumption	Public administration consumption	Gross fix capital	Net export	Stock variation
2010	73.2	7.2.	24.0	-5.2	0.9
2011	70.0	6.3	24.6	-5.1	4.2

Source: National Institute of Statistics and the National Bank of Romania.

The drastic austerity measures based on cutting social costs resulted in repeated and violent street manifestations and in generalized public unrest. If the short- and medium-term effects can

be described as a decrease in purchasing power, the long-term effects are an increase in inequality and a consequent decrease of social cohesion and the emergence deepening social divides between different groups in society.

Another consequence of the crisis was a general convergence towards the need of governance rules for public spending that supported a new set of policy measures. This time the measures were directed towards cutting inefficient public investments and a reform of state-owned enterprises (SOEs)<sup>65</sup>. Also, the support of the IMF in the direction of reforming public governance mechanisms was also determinant. In 2009, in the Romanian Government's Letter of Intent for IMF, the Romanian Government indicated explicitly that: "crucial to our fiscal strategy will be a series of measures to produce longer-term savings and improve the quality of public finances via public sector reforms is action in the area of public enterprise reform" (Letter of Intent and Technical Memorandum of Understanding, September 2009).

### **3.3 Fiscal Policy Issues**

Before the recession, there was an process of governmental dissaving, with a strong trend of an increase in the fiscal deficit starting in 2006. The yearly increases reached a peak in 2009, when the fiscal deficit reached -7.3% of GDP. The most important cause of the fiscal deficit was not only the lax fiscal policy, but also, a lax implementation of the fiscal regulations. Equally important, the benefits of the lax fiscal policy were reaped by a small group of high income individuals.

The main policy instruments used to tackle this imbalance during the crisis were based on increases in VAT and a tighter fiscal policy. Unfortunately, these measures were not accompanied by a improved implementation. The result of this set of policy measures was increased fiscal evasion and low levels of tax collection. The most efficient tax collection was for income tax and VAT, and the lowest for profits taxes as they are easier to evade. The decrease in the rate of collection efficiency was drastic for corporate profits, which fell from 36.5% in the fourth quarter of 2008 to 29.1% in the first quarter of 2009 while VAT receipts fell from 63.6% to 54.9% over the same period. On the positive side, it should be noted that public awareness of the need to tackle fiscal evasion increased. This was materialized in the Fiscal Budgetary Strategy for 2011-2013 that established a decrease of fiscal evasion as an objective.

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<sup>65</sup> As Voinea (2012) shows in his scientific research within the project entitled Business Elites in Romania: Their Social and Educational Determinants and their Impact on Economic Performance, financed by the New Europe College. A series of factors have contributed to a better understanding of the need to raise the efficiency of SOEs. One the most important factors are: a) the fact that the SOEs represent an important sector of the Romanian economy, b) the need to reduce fiscal deficits, c) the pressure of the effects of the 2008 financial crisis, d) the increased political competitions that has raised the transparency expectations of the electors, e) the increased attention of public policies and the research agenda on the need of fostering governance in the public sector, as a response to the challenges posed by the financial crisis and the need to reduce fiscal deficits.

### 3.4 Inequality issues

Before the crisis, Romania was characterized by a high level of inequality and an unequal distribution of the proceeds of growth. Gini coefficients were significantly higher than in the EU, especially in 2007 and 2008, as shown in Table 8.

**TABLE 8: Gini coefficient, 2001-2008**

Country/Year	2001	2002	2003	2004	2005	2006	2007	2008
European Union (27 countries)	:	:	:	:	30,6	30,2	30,6	30,8
European Union (15 countries)	29	:	30	30	29,9	29,5	30,2	30,7
<b>Romania</b>	30	30	30	31	31	33	37,8	36,0

Source: Eurostat.

Income inequality increased from 1995-2008, especially in the periods of recession and growth (Molnar, 2010). One source of this increased inequality was “the growth of property income and of wage earnings and income from independent activity, related to some professions and jobs, and the persistence of a large proportion of households with low and very low incomes, related to missing qualifications and employment opportunities as well as to family burden” (Molnar, 2010: 28). The same research indicates “an extent of bipolarization higher in 2008 compared with 1995 and 2000”. In other words, before the crisis, Romanian society was already characterized by a high level of inequality, generated by an unequal distribution of economic growth.

The response of the government, justified by the context of crisis, was a regressive package of measures, including a 25% reduction of salaries in the public sector and a 15% reduction of social transfers as mentioned above. The VAT increase and the cuts in social expenditure were considered by the population as an unfair adjustment, mostly because they were not targeted. The measures were characterized by “no differentiation between income groups; the across-the-board cuts will leave those on low incomes comparatively worse off” and “high-income and wealthy strata are exempted from collective responsibility for correcting the budget deficit (Heise and Lierse, 2011: 508). The unequal distribution of the costs of adjustment to the crisis increased social inequality, and 89% of the respondents to the European Barometer on poverty and social exclusion of 2010 considered that poverty had strongly increased.

This situation also illustrates the problem that the flat tax cannot generate enough revenue for redistribution to decrease inequality. Some groups benefited before the crisis, while the vast majority paid the costs afterward. Actually, “the Romanian government’s austerity plan can therefore be considered a renunciation by the state of redistributive and social policy goals” (Heise and Lierse, 2011: 508).

### 3.5 Public Debt Issues

Before the crises, Romania had a low public debt and a large private short-term debt, mainly generated by a high level of exposures of foreign banks on the local market through short-term credit lines for their affiliates. A prominent feature of private credit in Romania was its rapid increase; non-governmental credit soared dramatically, from 10% of the GDP in 2001 to 39% of the GDP in 2008. Non-government credit, of which the household credit was the most important, surpassing the one of the private companies sector in 2008, to reach 70% of the available income of the population, seven times more than in 2001 (Voinea, 2009: 69).

Moreover, household credits were mainly used to finance durable consumption goods and to cover temporary liquidity problems (Voinea, 2009: 71). Total external credit increased from about €18 billion in 2004 to €72 billion in 2008, so that at the peak of the boom short-term external debt reached €33 billion Euros, most of which in private hands. In other words, before the beginning of the crisis, each Romanian had a debt on average of about €3,000 (Voinea, 2009: 69). In this context, the Romanian economy entered in recession as soon as external financing decreased. Equity investments and foreign direct investments have also declined sharply since 2008, leading to a reduction in foreign financing of approximately €11 billion in just three years.

The policy instruments used to tackle the debt problems were based on the negotiation of a €12.95 billion loan from the International Monetary Fund, €5 billion from the EU and €1 billion from the World Bank. Thus, Romania became the third European country to received IMF aid, after Hungary and Latvia. The loan had the objective to cover the external financing deficit, to limit economic contraction and to maintain the stability of the exchange rate.

The main consequence was a large, doubled, public debt and an increased dependency on foreign financing. In other words, economic responsibilities and risks moved from the private to the state sector. The structure of the total external debt, on medium and long term, is presented in Table 9, which shows the increasing share of public debt in the total.

**TABLE 9: The structure of total medium- and long-term external debt, (% of GDP)**

Type of debt	2003	2004	2005	2006	2007	2008	2009	2010	2011	June 2012
Public debt and publicly guaranteed debt	9.7	10.0	11.3	10.7	10.2	10.7	13.5	17.9	21.1	22.3
Private debt	6.0	7.9	12.4	17.0	25.3	35.5	39.2	37.2	35.8	37.5
Non-residents deposits	0.2	0.4	0.9	1.0	3.2	5.5	5.7	9.1	10.2	10.4
IMF loans	-	-	-	-	-	-	5.7	9.1	10.2	10.4

Source: National Bank of Romania.

### 3.6 Increasing Unit Labour Costs

For many years, Romania developed a competitive advantage based on low salaries. Year by year, unit labour costs have increased, although at a decreasing pace (see Table 10).

**TABLE 10: Labour cost index, nominal value - annual data**

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Labour cost index, nominal value - annual data	46.7	26.5	16.4	16.8	14.3	19.1	21.1	20.4	12.0	5.2	7.0

Source: Eurostat.

Starting with 2001, both gross and net salaries started to rise. The increasing salaries were considered a major source of inflation in Romania, despite the fact that this increase generally followed productivity.

In 2008 salaries adjusted sharply to the effects of the crisis, and from 2010 they began to decrease causing a loss of purchasing power and a contraction in aggregate demand. Starting in 2008, the gap between salaries and productivity increased exponentially, with productivity much greater than salaries.

This trend is in line with a widening gap between wages and labour productivity on a global level, that strongly affects workers' perceptions of fairness at work. Another negative effect of the post-crisis period, has been the dangerous application of productivity standards in areas such as health, education and some areas of public service. The temptation to evaluate results and establish benefits in non-productive, non-industrial sectors of activity based on an industrial understanding of productivity is detrimental to the smooth functioning of hospitals, universities, schools and other institutions. The mechanistic view on productivity when applied to social, educational or health services or assistance is unable to improve the quality of these services, over-emphasizes costs and results, and discourages a more flexible development of these services centred on their core social mission.

Together with the 25% cut in the public sector, other important measures to tackle the effects of the crisis have been the flexibilization of the Labour Code, reducing firing costs for employers and reducing the power of the trade unions. This has resulted in a lowering of protection for employees and increasing unemployment, as shown in the Table 11.

Unemployment increased sharply in 2009 and continues to grow reaching a maximum in 2011 of 23.7%. Youth unemployment is also worryingly high. Overall, the measures taken to tackle increasing unit costs have led to higher unemployment and less protection of employees' rights. Unemployment will increase the number of the low-income families and "it is likely that those located at the bottom side of the distribution become poorer in absolute terms, leading to an increase in inequality.



**TABLE 11: Unemployment rate (%)**

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Unemployment rate	6.8	6.6	7.5	6.8	8.0	7.2	7.3	6.4	5.8	6.9	7.3	7.4
Unemployment rate < 25 years	17.2	17.6	21.0	19.5	21.0	19.7	21.0	20.1	18.6	20.8	22.1	23.7
Unemployment rate 25 - 74 years	5.3	5.1	5.6	5.2	6.2	5.6	5.7	4.9	4.4	5.4	5.8	5.8

Source: Eurostat.

However these developments hit also persons with middle and high income levels, therefore it is difficult to say if the income distribution became more or less unequal and/or polarized compared with the previous one” (Molnar, 2010: 28).

#### **4. CONCLUDING REMARKS: A TENTATIVE ANALYTICAL FRAMEWORK**

This chapter has proposed an in depth analysis of the specificities of the Romanian recession. We have showed that the Romanian crisis can be considered not just a temporary economic recession, but is more a structural crisis and one of political leadership. Thus, we have explained why the main drivers of the Romanian recession are of a different nature to those of the external crisis. In Section 3, we examined a series of significant issues in Romanian society and economy and described the most important policy measures that were undertaken and analysed their main socio economic consequences.

In the Table 12 we make a synthesis of the main issues analyzed in Section 3.

In this process, major splits emerged in the society that are eroding social cohesion and restricting the convergence towards better living standards. In the post-crisis period, Romanian public opinion is built on uncertainties and a general decrease in the quality of life.

Voices that support the false idea that the crisis comes from the public sector are to be contrasted with the empirical evidence that shows that the Romanian crisis is predominantly a matter of the private sector. But it is also obvious that the austerity measures and the general governmental response to the challenges of the recession have deepened the prior structural deficiencies of the Romanian economy and society, such as income inequality, corruption and fiscal evasion. Dichotomies between public and private employees have strengthened this debate, although it is obvious that both are trying to protect the few things that are still able to be protected, such as their ideology.

**TABLE 12: Socio economic consequences of the crisis in Romania**

Before the crisis	Public policy during the crisis	Consequences of the crisis
<ul style="list-style-type: none"> <li>Consumption – most important driver of growth</li> </ul>	<ul style="list-style-type: none"> <li>Large drop in consumption, due to lower foreign financing for imports and lower aggregate domestic demand</li> </ul>	<ul style="list-style-type: none"> <li>-Recession followed by stagnation: no new driver of growth to replace households' consumption</li> </ul>
<ul style="list-style-type: none"> <li>Large budget deficit (govt. dissaving)</li> </ul>	<ul style="list-style-type: none"> <li>Sharp adjustment of the budget deficit</li> <li>2010-2011: adjustment based on cutting social spending</li> <li>2012: adjustment based on cutting inefficient public investments and SOEs reform</li> </ul>	<ul style="list-style-type: none"> <li>Convergence towards governance rules</li> <li>Less social cohesion, appearance of social divides</li> </ul>
<ul style="list-style-type: none"> <li>Lax fiscal policy, lax implementation of the law</li> </ul>	<ul style="list-style-type: none"> <li>Tax increases, tighten fiscal policy but not tighter implementation</li> </ul>	<ul style="list-style-type: none"> <li>Higher fiscal evasion</li> <li>Implicit Tax collection at a minimum</li> <li>Increased awareness of the need to tackle fiscal evasion</li> </ul>
<ul style="list-style-type: none"> <li>Inequality - unequal distributed growth</li> </ul>	<ul style="list-style-type: none"> <li>Unfair adjustment (not targeted): VAT increase, 25% public wages cut across the board</li> </ul>	<ul style="list-style-type: none"> <li>Unequal distributed adjustments costs: even more inequality</li> <li>Some benefited before, the rest (vast majority) paid the costs afterward</li> </ul>
<ul style="list-style-type: none"> <li>Low public debt, large private short term debt (high level of exposures of foreign banks on the local market through short term credit lines for their affiliates)</li> </ul>	<ul style="list-style-type: none"> <li>Large loan from IMF</li> </ul>	<ul style="list-style-type: none"> <li>Large public debt, (double)</li> <li>Increased dependency of foreign financing and external constraints</li> </ul>
<ul style="list-style-type: none"> <li>Increasing ULC</li> </ul>	<ul style="list-style-type: none"> <li>Labour code flexibilization in the sense of reducing firing costs and the unions' power</li> </ul>	<ul style="list-style-type: none"> <li>Less protection for employees</li> </ul>

Source: the authors.

The strong emphasis that officials have put on salaries and productivity, especially in health, education or social services, are examples of a market approach to non-market sectors of activity. The orthodox, monetarist view on the relation between salaries and productivity and the inability to properly manage a consumption-driven growth model has decoupled salaries from productivity. This disconnection has created an increasing gap between the reward that labour receives relative to its productivity, raising questions of fairness.

Another divide has emerged between those who support the need for more governance rules, and those who blame these rules for the lack of efficiency in Romanian organizations and systems.

Societal groups are also driven by divergent views regarding the protection of property. Stakeholders of a primitive capital accumulation make efforts to protect their *status quo*,

meanwhile other groups signal the need to better control private business and private fortunes, asking for a strengthening of the rules regarding fiscal evasion. The economic losses in the Romanian economy are about €10 billions, the majority of them being in the private sector.

What is for sure in this context is that there is a common consequence of all the measures applied as a response to the crisis, which is an increased inequality, mainly due to the unequally distributed adjustment costs. Greater income inequality, higher poverty and societal splits are generating a deterioration of social solidarity and social cohesion. While the middle and lower income class was squeezed, an ideological struggle between social classes has reappeared. In December 2012, the results of Parliamentary elections reflected the general popular discontent with past public policies, with an unprecedented two-thirds majority for the Coalition of socialists and liberals. The popular vote is a consequence of social divides and increasing uncertainty, generated mainly by the lack of a political vision for future growth. With consumption effectively slowed down, export markets in recession, foreign direct investment sharply contracting, all the previous factors that have supported economic growth are weakened. Which force is going to restart the economic engine in a sustainable and socially acceptable way? The truth is that economic stagnation and social cleavages can only be overcome by a new development model that Romania must build in the years to come.

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## CHAPTER 13.

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### **Effects of the Global Financial Crisis and the Eurozone Crisis on the Social Sector in Serbia**

Ivana Prica

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#### **1. INTRODUCTION**

The global economic crisis that began in 2007 has, since early in 2010, transformed itself into a specific crisis of the Eurozone. While the Eurozone crisis has had a widely-known devastating effect on its weaker members in the EU periphery (Greece, Spain, Italy) it has had an even more devastating effect on countries outside the zone especially those in the European 'super-periphery', i.e. ex-socialist European countries that are not EU members yet whose economies are closely integrated to that of the EU. Serbia is a typical example in this respect. Its economy was first hit by the financial crisis in late 2008, with an almost two-year delay (Prica and Uvalić, 2009). Nevertheless, at the end of 2008 politicians and economists in the Government believed that the crisis will, in the worst case, minimally affect Serbia. Actually, that was widely believed in the whole region (Sanfey, 2010). The shortsightedness of economic policy makers was revealed in 2009, when GDP and employment plummeted. There was slight recovery in the following two years, mainly financed by additional borrowing. Then, in 2012, the full effects of the Eurozone crisis were felt in Serbia as it enters a second dip of the recession.

While the situation in Serbia is dire today, as in many other EU super-periphery countries, it still has not been widely discussed in the global expert or professional fora. The problem is that these highly euroised, small and open economies at the European super-periphery, through their high integration in the EU economy are importing the effects of the Eurozone crisis. While the economic situation in some of these countries is far worse than in the worst affected EU countries, the European super-periphery countries must survive without any recourse to the EU rescue mechanisms and funds (Bartlett and Prica, 2012). The next section of this chapter will examine the effects of the Eurozone crisis on the Serbian economy; the following section will discuss in more detail the consequences that the crisis had in the social sector. The data sources

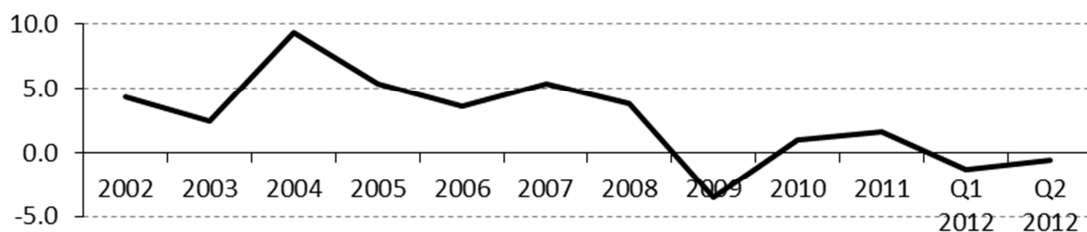
used are: Statistical Office of the Republic of Serbia (SORS), National Bank of Serbia (NBS), Labour Force Survey (LFS),<sup>66</sup> Republic of Serbia Fund for Pension and Invalidity Insurance (RS Pension Fund) and *Quarterly Monitor of Economic Trends and Policies in Serbia* (QM) which is produced by Foundation for the Advancement of Economics (Fond za razvoj ekonomske nauke, FREN) at the Faculty of Economics, University of Belgrade.

## 2. EFFECTS OF THE CRISIS ON SERBIAN ECONOMY

After a decade of conflict, international sanctions, economic distress, hyperinflation and NATO bombing, from 2001 Serbia displayed very high rates of economic growth for almost a decade.<sup>67</sup> This period of rapid growth came to an end with the start of the global economic crisis, and will probably not be repeated in the foreseeable future. The first effects of the global financial crisis affected Serbia with a significant lag and were first felt in late 2008 and early 2009, so GDP in 2009 officially dropped by 3.5%, as illustrated in Figure 1 below (Prica and Backović, 2009). This was a grave shock for the Serbian economy. While the politicians tried to convince the citizens and businesses that the crisis would not be felt in Serbia, in 2009 the Serbian economy was almost halted, as illustrated by the plummeting GDP growth of at least<sup>68</sup> 8.3 percentage points compared to the previous year.

After the initial shock in 2009, Serbia displayed positive GDP growth in 2010 and 2011, but at very low levels as compared to the pre-crisis period (see Figure 1).

**FIGURE 1: Real GDP growth rates in Serbia, 2002-Q2 2012, %**



Source: NBS, <http://www.nbs.rs/internet/english/80/index.html>

In 2012, however, the full effects of the Eurozone crisis began to be felt and the Serbian economy entered the second dip of the recession, as illustrated by Figure 1. So far we have figures only for the first two quarters of 2012; looking at other aspects it is likely that the fall in the GDP growth

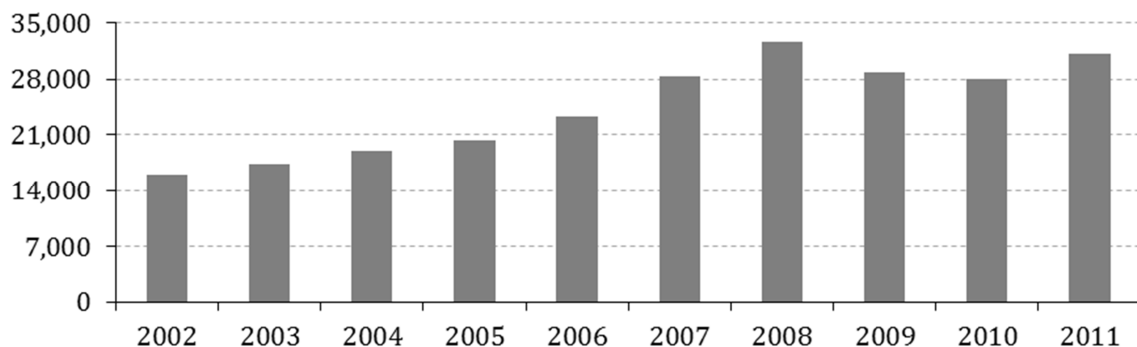
<sup>66</sup> While it is being performed by SORS, LFS is using a different data gathering methodology than the SORS statistics on employment and is therefore listed separately. LFS gives better quality of information regarding employment, which is why we are using it here. SORS gives more detailed data on some other aspects, as we will see later.

<sup>67</sup> An excellent analysis of the development of Serbian economy for period 1989-2009 can be found in (Uvalić, 2010).

<sup>68</sup> The original official figure for the drop in GDP in 2009 was lower, but careful scrutiny proved it to be higher so the official figure was revised to -3.5%.

rate is not going to be as high as that of 2009 (mainly due to the low base start), but the absolute level of GDP expressed in euro terms could easily be below 2009 levels (see Figure 2). The reasons for this presumption will be clear when other economic performance indicators for Serbia are examined that provide a background against which the effects of the crisis on the social sector can be examined.

**FIGURE 2: Serbian GDP, 2002-2011, million euro**



Source: NBS, <http://www.nbs.rs/internet/english/80/index.html>

Lacking internal sources of growth, the high pre-crisis levels of GDP growth in Serbia were mainly due to external growth drivers. Due to the global financial crisis these sources of growth have diminished considerably and, not being ready or capable to adopt an austerity programme, the government intervened mainly through additional borrowing.

In 2009, the global financial crisis also led to far lower FDI inflows in Serbia, while the collapse of world trade in 2009 depressed export markets for its goods and services (see Figure 3). In fact, the high and often rising foreign trade deficit has been and will remain a chronic problem of Serbian economy. Over the observed period the trade deficit had a growing trend reaching its peak of almost 9 billion Euros in 2008. In 2009, due to lower levels of both imports and exports, the trade deficit decreased in absolute terms and remained at lower levels, albeit at five billion euros, for the subsequent three years.

The trade deficit contributes heavily to the current account deficit in Serbia, which has been at rather high levels throughout the observed period (see Table 1). Expressed as a percentage of GDP it was highest in 2008 when it reached almost 22% of GDP. In 2009 as economic activity came to a halt, the current account deficit fell to just 7% of GDP. It began to grow again, in 2011 approaching double-digit levels, which will be repeated in 2012.<sup>69</sup> At the same time the budget deficit has grown; the Fiscal Council announced that by the end of 2012 the public debt was likely to be more than 60% of GDP while the budget deficit was expected to reach 6.7% of GDP, a level which is not sustainable.<sup>70</sup> Nevertheless, according to available data (NBS), the budget deficit in

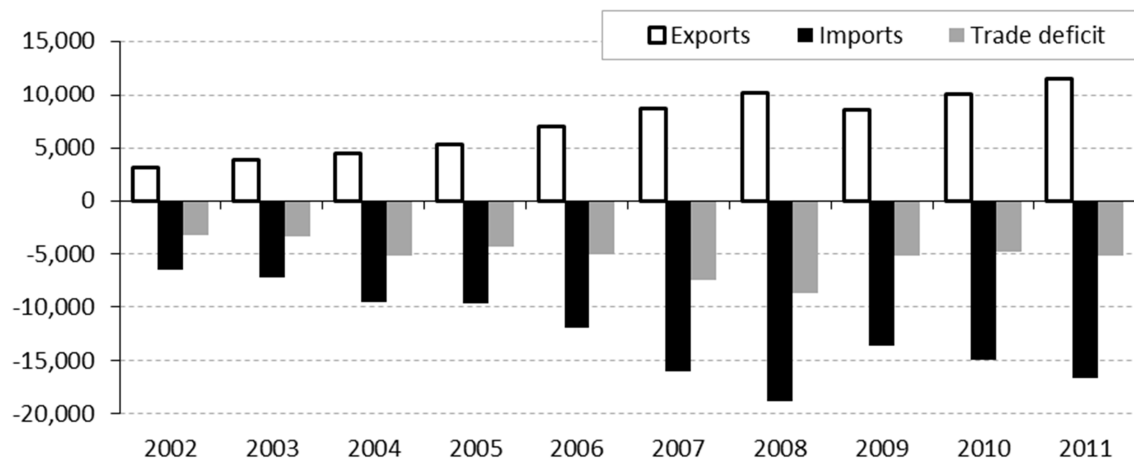
<sup>69</sup> Data source is the National Bank of Serbia, the data can be found on the following web page: <http://www.nbs.rs/internet/english/80/index.html>

<sup>70</sup> Tanjug, November 13, 2012



the first two quarters was already over 7% and the public debt was almost 55% of GDP, so even the Fiscal Council prediction seems conservative.

**FIGURE 3: Exports, imports and trade deficit in Serbia, 2002-2011, million euro<sup>71</sup>**



Source: NBS, <http://www.nbs.rs/internet/english/80/index.html>

Table 1 also shows that while domestic economic activity fell, inflation accelerated in 2012. In fact, latest data show that the inflation rate in November 2012 (year-on-year) was 11.9%, well in excess of the inflation target of  $4\% \pm 1.5\%$  (NBS). The increase in food prices only partially accounted for this. The analysis in *Quarterly Monitor* (QM No. 29, April-June 2012) shows that “market inflation, i.e. inflation calculated excluding the prices of food, energy, alcoholic beverages and cigarettes from the overall increase in the prices of food, significantly accelerates, especially from June.” They argue that this should be accounted for by other factors, including the strong depreciation of the domestic currency (Dinar, RSD) and a very expansive fiscal policy.<sup>72</sup> The dinar exchange rates, both in relation to Euro and to Dollar, are illustrated in the last two rows of Table 1.

Much of the banking sector in Serbia is controlled by western-based banks, which in 2008-2009 started reducing their lending to daughter companies leading to a credit crunch in the region. Serbia had to rely on IMF assistance. In a coordinated policy initiative, the EBRD, the IMF and home country governments supported the western banks that had high exposure to Eastern Europe through the Vienna Initiative which ensured that western banks did not pull out of the region. This was a most significant initiative at the time that helped Serbia pull through in 2009, otherwise the whole economy would have been halted since the domestic, but foreign-owned banks were already pulling their capital out of Serbia and were not rolling over some of the

<sup>71</sup> In 2010 SORS, which is the original source of this data, changed the methodology by accepting a wider approach for calculating exports and imports of goods, as recommended by the UN. The data for 2007, 2008 and 2009 have been recalculated to take that into account (i.e. are comparable to the ones for 2010 and onwards) but not the other years. Also, trade with Montenegro has been included since 2003.

<sup>72</sup> QM No. 29, April-June 2012, page 7.

credits which led to low solvency of the economy and an increase in the rate of non-performing loans. In the second dip of the crisis in 2012, however, Serbia can no longer rely on such support since Vienna Initiative 2 has not been so successfully negotiated and, more importantly, the new financial regulations in the EU demand high deleveraging of these banks (Prca and Bartlett, 2012).

**TABLE 1: Economic performance indicators for Serbia, 2008-July 2012**

Indicator	2008	2009	2010	2011	2012		
					Q1	Q2	July
Consumer prices growth, %	8.6	6.6	10.3	7	3.2	5.5	6.1
Current account balance*:							
- million euro	-7,054	-2,084	-2,082	-2,770	-1,177	-738	-150
- % of GDP	-21.6	-7.2	-7.4	-8.9	-16.8	-10.3	
Unemployment, %	13.6	16.1	19.2	23.0	25.5		
Wages in euro**	402.4	337.9	330.1	372.5	357.6	363.5	349.8
Budget deficit, % of GDP	-1.7	-3.4	-3.7	-4.2	-7.0	-7.2	
Public debt, % of GDP	29.2	34.5	44.0	47.7	50.7	54.7	
RSD/USD exchange rate***	62.90	66.73	79.28	80.87	83.31	92.15	95.80
RSD/EUR exchange rate***	88.60	95.89	105.50	104.64	111.36	115.82	117.73

\* In accordance with Balance of Payment Manual 5, a portion of estimated remittances was transferred from the financial account to the current account.

\*\* Average for the period

\*\*\* At the end of the period

Source: NBS

Furthermore, since the start of the crisis in 2009, Serbia has pretty much exhausted all buffers it used to cushion the crisis. The most important of these was government borrowing that, as discussed above, has already reached dangerously high and soon, possibly, unsustainable levels (see data in Table 1). The high public spending relative to GDP was not significantly reduced and was in fact one of the drivers for additional borrowing, especially before the elections that were in the beginning of 2012 (see Table 1). The same period showed a sudden depreciation of the domestic currency, dinar (RSD), with respect to euro (see Table 1) that was overdue for some time. Nevertheless, the extremely high euroisation of Serbian economy and especially undertaking credit commitments under the foreign exchange clause<sup>73</sup> (*de facto* in euros) increased the cost of living as well as the cost of doing business in Serbia. At the same time, due to the depreciation of dinar against euro and even higher depreciation against the US dollar,

<sup>73</sup> In Serbia more than 80% of credits to private sector are denominated in a foreign currency (Brown and De Haas 2012).

imports became more expensive. This further increased the cost of living – since many consumer goods are imported. It also increased the cost of doing business – as many inputs are also imported.

### **3. EFFECTS OF THE CRISIS ON THE LABOUR MARKET AND SOCIAL SECTOR IN SERBIA**

As explained above, in 2012 Serbia is facing another blow of the crisis, this time the Eurozone crisis, with an economy that is already exhausted by the first phase of the global financial crisis in 2009. This is a highly euroised, small and open economy, land-locked geographically, that is quite deeply integrated into the EU economy not only due to its geographical position but also due to extensive economic links in trade, investment and finance. The contraction of the markets of the Eurozone countries resulted in lower demand for Serbian exports, which led in turn to lower production and employment, i.e. a wide-ranging and sudden drop in economic activity in Serbia's exporting sector. Secondly, the slowing down of economic activity was due to a dramatic fall or even withdrawal of foreign investment from Serbia. Finally, a similar pattern of collapse of inflows from abroad due to the crisis was visible in all areas, resulting in further lowering of economic activity. In short, the Eurozone crisis is being imported to Serbia and there is little the government can do to prevent it, other than alleviate the risks for the most vulnerable parts of the society and adopt policies to improve economic competitiveness through systemic reforms and investment in infrastructure and labour force skills in preparation for the end of the crisis and eventual resumption of economic growth.

Before proceeding further it is important to stress two more specificities of the Serbian economy and society that are relevant for further analysis. First of all, the economy is characterised by extremely high public spending that is not in line with its economic potential. Public spending in Serbia is extremely inflexible due to political and social constraints and has been one of the factors driving additional borrowing during the crisis period. In addition to social protection spending (which includes spending on social assistance and pensions), public sector spending is mainly related to the high employment levels in the state sector and the state administration. The high public spending is adversely connected to the chronic problem of high trade and current account deficits that was discussed in the previous section. And all of these problems are being made worse by the crisis.

High public spending is exacerbated by the fact that the size of the vulnerable group of the elderly is growing. The Serbian population is one of the oldest in Europe, and is the oldest in the region. Furthermore, the population in Serbia is growingly older. Table 2 shows that over the period 2008-2012, there was a loss of 1.1% of the population older than 15. The last column of the table shows the structure of population loss or growth by population age groups for the observed period (during the crisis). All segments had a population loss (between 2% and 4%), except for a dramatic growth in numbers of those aged over 75 (26.2%). This has implications on public spending both with respect to the high share of pensioners in the population (and in relation to

the number of employed), as well as with respect to increasing social and health demands of this vulnerable segment of the society.

**TABLE 2: Population over 15 by age groups, Serbia, 2008-2012**

Population age group	Period*					Difference 2012-2008	
	2008	2009	2010	2011	2012	No. of people	% of 2008
Over 15, total	6350329	6350328	6326511	6301261	6283107	-67222	-1.1
Working age (15-64)	4911729	4893579	4822936	4820870	4718878	-192851	-3.9
Age group 65-69	433352	422417	416244	385323	424486	-8866	-2.0
Age group 70-74	438918	432139	430073	420201	425009	-13909	-3.2
Over 75	566329	602194	657258	674868	714735	148406	26.2

\* Data provided are for April of each year.

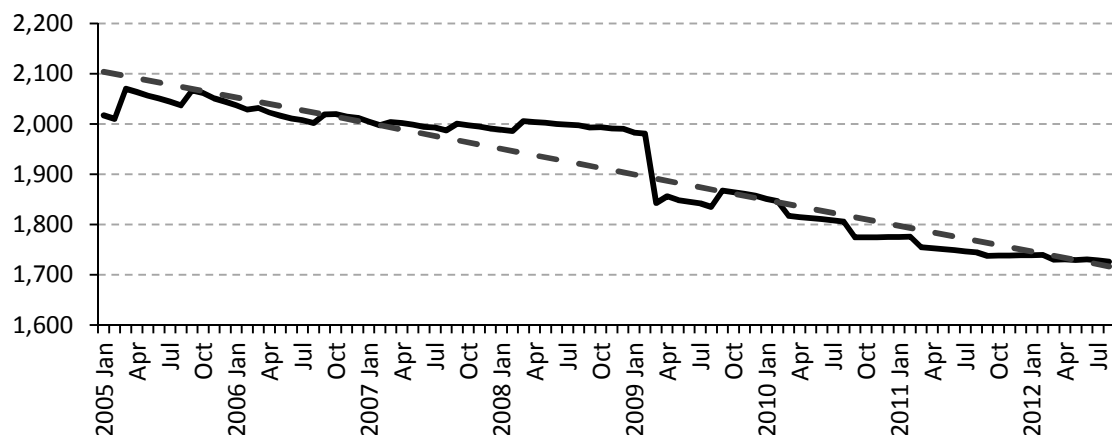
Source: SORS and our calculations

As could be expected, there was a significant job loss in the Serbian economy since the crisis started and currently more than a quarter of the active population is without employment. This is mirrored in both the SORS official data and the LFS data. While Labour Force Survey is also performed by SORS, these two data sources use different methodologies and have different coverage and hence give different results. Without going into detailed technical explanations of their intricacies, suffice it to say that the LFS data on employment are always higher than SORS data mainly due to the fact that LFS data encompass employment in the grey economy.

Figure 4 presents the trend in the number of employed in Serbia according to the SORS data produced monthly for the period of January 2005 until August 2012. A dramatic drop in employment is observed in March 2009, which is just after the financial crisis hit Serbia (end of 2008 and beginning of 2009, as we explained in the previous section). The negative trend has continued throughout 2011 and 2012 reflecting the effects of the Eurozone crisis. In fact the negative trend (dashed line in Figure 4) in the number of employed predates the crisis, since it began at least as early as 2005, resulting from the restructuring of the economy as a consequence of privatisation. While this earlier trend of employment losses came to an end in 2008, the effects of the global crisis led to its continuation over the subsequent years.

The LFS data in Table 3 provide more precise information about employment during the crisis period (2008-12). It shows that the total job loss during the crisis was almost 570,000 – in other words, employment since 2008 has dropped by more than one fifth (21%). This speaks volumes about the contraction of the Serbian economy due to the crisis.

**FIGURE 4: Number of persons employed, Serbia, January 2005 – August 2012**



Source: SORS

Table 3 shows that the unemployment rate in April 2012 was a staggering 26.1%. During the crisis (2008-12) unemployment has grown by 12.1 percentage points, and has almost doubled its 2008 percentage value. According to the LFS data, unemployment dropped sharply in 2009 when the financial crisis hit Serbia the first time, fell slightly in 2010, and then started to grow sharply again in 2011 as the effects of Eurozone crisis were felt. The negative trend has continued until the end of the observed period (see Table 3).

**TABLE 3: Employment and unemployment indicators, Serbia, 2008-2012**

		Total Employment	Total Unemployment	Unemployment rate, %		
				Total	Male	Female
2008	April	2,652,429	432,730	14.0	12.4	16.1
	October	2,646,215	457,204	14.7	12.7	17.3
2009	April	2,486,734	486,858	16.4	15.0	18.1
	October	2,450,643	516,990	17.4	16.1	19.1
2010	April	2,278,504	572,501	20.1	19.4	21.0
	October	2,269,565	565,880	20.0	19.0	21.2
2011	April	2,191,392	649,155	22.9	22.7	23.1
	October	2,141,920	690,782	24.4	23.5	25.6
2012	April	2,083,604	735,209	26.1	25.6	26.7
April 2012-April 2008		-568,825	302,479	12.1	13.2	10.6

Source: QM No. 29, April-June 2012; the original source is LFS

The employment loss was not equal across genders and, in fact, more men lost their jobs during the period 2008-2012 than women; the unemployment rates between men and women have never been more equal (25.6% vs. 26.7%, only 1.1 percentage point difference, see Table 3). This may be due to the lower pay of women than for men, and it may be that employers have laid off

more expensive workers. There may also be a structural cause if sectors that employ more men than women (such as construction) have been more severely affected by the crisis, while women's jobs in the public sector (education, health and administration) have been relatively protected due to the continuing high level of public spending.

As mentioned earlier, the Serbian economy is characterised by high and inflexible public sector spending. This is mirrored by the data on public sector employment presented in Table 4 (the data are based on QM analysis of SORS data<sup>74</sup>). This data shows that, compared to the whole economy, there was no matching drop in the public sector employment. The total public sector employment dropped by some 2%, as opposed to 21% in the whole economy.

The picture looks even worse when observing the sector composition of the drop in public sector employment in the last row of Table 4. The employment is completely rigid with respect to those who are financed directly from the budget (the first three categories). Of all public sector employment categories listed here the highest growth rate for this period (2008-12) is in the state administration (about 5%). Public employment is stable in all categories; the only significant drop in employment in percentage terms for this period is in public enterprises at national level, which amounts to around 14%.<sup>75</sup> Even this figure is far below the drop in total employment for that period (21%).

**TABLE 4: Public sector employment in Serbia, in '000, March 2008 – March 2012**

		Admini- stration, all levels	Education and culture	Health and social work	Public enterprises, national	Public enterprises, local	Total
<b>2008</b>	<b>March</b>	60	124	140	99	58	481
	<b>September</b>	61	122	141	100	58	482
<b>2009</b>	<b>March</b>	64	125	142	89	57	478
	<b>September</b>	64	123	142	88	57	473
<b>2010</b>	<b>March</b>	62	124	142	87	56	472
	<b>September</b>	63	122	143	86	56	470
<b>2011</b>	<b>March</b>	61	124	143	84	57	469
	<b>September</b>	62	122	143	84	57	469
<b>2012</b>	<b>March</b>	63	122	143	85	57	470
<b>March 2012- March 2008</b>		<b>3</b>	<b>-2</b>	<b>3</b>	<b>-14</b>	<b>-1</b>	<b>-11</b>

Source: QM No. 28, January-March 2012; the original source is SORS database

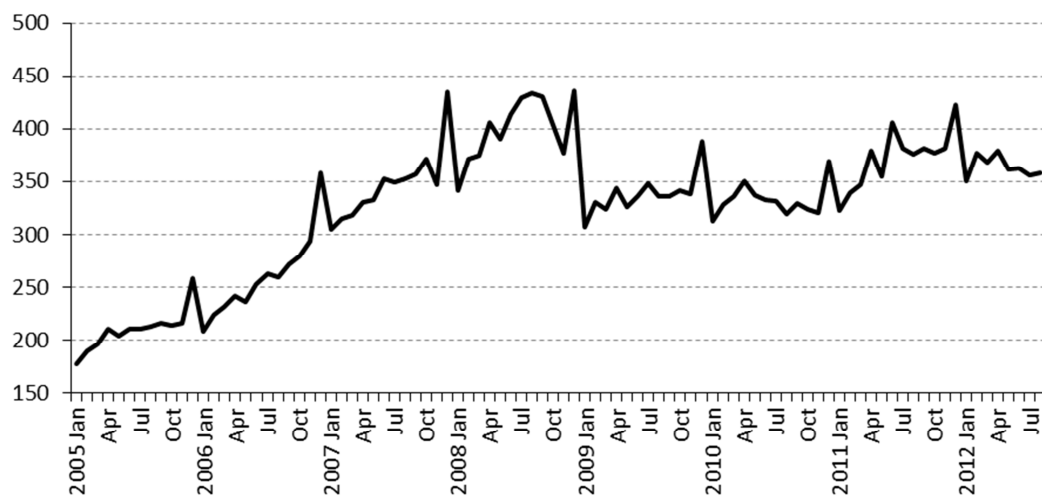
As shown in Table 1 reported earlier, there has been a drop of about 50 EUR in the average wage in the observed period (from around 400 EUR in 2008 to about 350 EUR in July 2012). The dynamics of monthly average net wages in Euros for the period 2005 – Aug 2012 is depicted in Figure 5. It shows that net wages expressed in Euro terms were less responsive to economic

<sup>74</sup> QM No. 28, January-March 2012, pp. 18-24.

<sup>75</sup> It would require checking if some of this employment loss is simply due to some on-going privatisations or restructuring prior to privatisations.

trends during the crisis. First, one should observe that there is a seasonal pattern in these figures: there is a growth of wages in December (many employers give bonuses to employees in December before Christmas and New Year holidays) and a sudden drop in January in each year (one of the reasons is the many non-working days due to the New Year and Serbian Christmas, in the first half of January). The seasonal effect and the overall trend should not be confused. Comparing the seasonal December/January dip across the years shows that the seasonal effect was the most pronounced in 2009, at exactly the time the financial crisis really hit Serbia for the first time (see previous section).

**FIGURE 5: Average net wage in EUR, Serbia, January 2005 - August 2012**



Source: Calculations based on SORS data

Unlike the previous case (number of employed), there is no obvious negative trend during the crisis period in the average Euro wage data series. Instead, as further analysis of the data shows, there is a statistically highly relevant growing trend for period 2005-08, then a sudden drop in 2009 due to the crisis, and since then there is no visible trend. The average net wage increased from 200 EUR in 2005 to over 400 EUR in 2008, and since then, even during the crisis, it has not fallen below 300 EUR exhibiting certain inelasticity.

In the pension sector Serbia still has an official mandatory pension insurance scheme structured as a pay-as-you-go system. A voluntary private pension insurance system was introduced but has never taken roots. The RS Pension and Invalidity Insurance Fund (RS Pension Fund) is in charge of the mandatory pension insurance (we are presenting their data here).

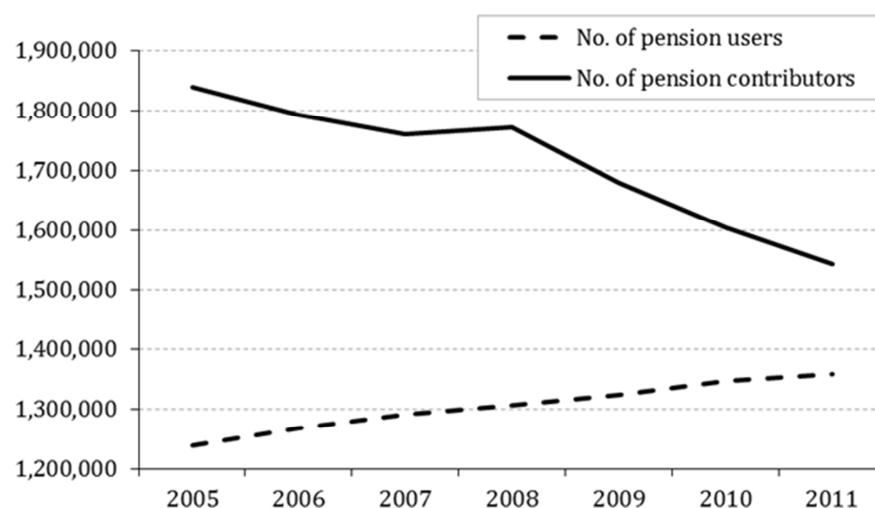
As shown in Table 5, there was an increase of 8.6% in total number of pensioners from 2005 to 2011, which is mirroring the data in Table 2. The highest growth was among those who retired due to the maximum working age limit (see Table 5), whose numbers increased over the period 2005-2011 by 20%. However, at the same time, there was a decrease of almost 11% in the number of invalidity pensioners as the terms for invalidity pensions became far more stringent.

**TABLE 5: Number of pensioners by type of pension, Serbia, 2005-2011**

Year	Old-age pensioners	Invalidity pensioners	Surviving pensioners	Total
2005	780,030	386,692	342,254	1,508,976
2006	819,076	377,936	347,036	1,544,048
2007	851,341	368,922	349,292	1,569,555
2008	868,534	362,180	349,625	1,580,339
2009	893,332	358,115	352,221	1,603,668
2010	919,711	352,961	353,909	1,626,581
2011	938,702	345,300	354,643	1,638,645
<b>Difference 2011-2005:</b>				
<b>No. pensioners</b>	158,672	-41,392	12,389	129,669
<b>% of 2005</b>	20.3%	-10.7%	3.6%	8.6%

Source: RS Pension Fund

The Serbian pension system differentiates between employment pensions (83% of pensioners in 2011), self-employment pensions (3.8% of total number of pensioners in 2011) and farmers' pensions (13.4% in 2011). Being a pay-as-you-go system, the question of its viability arises if the number of employees who pay contributions is not sufficient to cover the costs of pension users. This is exactly where Serbia has been for a long time, in fact since the early 1990s. In the recent crisis years this has become a burning issue, as illustrated by Figure 6.

**FIGURE 6: Employment pensions in Serbia: numbers of users and contributors, 2005-2011**

Source: RS Pension Fund

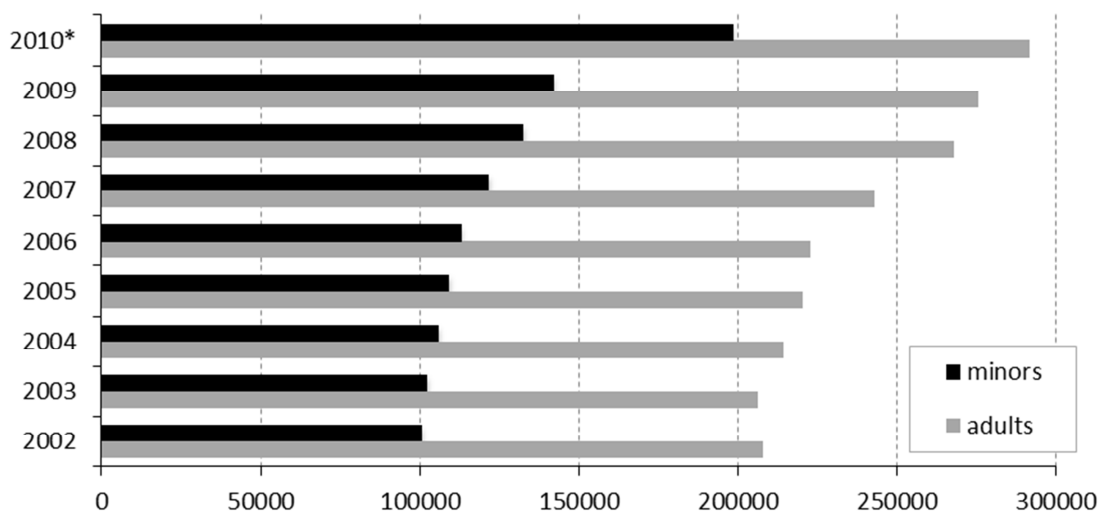
While the number of pension users was growing steadily over the observed period, there is an opposite (and steeper) trend in the number of employees who pay contributions for these pensions. The data of RS Pension Fund further show that in 2011 the ratio of employee to



pensioners was only 1:1.1. This ratio was dropping rapidly during the crisis period, as follows implicitly from the two trends depicted by Figure 6. The ratio of pension contributors to pension users in self-employment pension fund is 1:3.3 and for farmers it is 1:1.0.

Finally, the number of users of social protection schemes is illustrated by Figure 7, showing an increase in the number of social protection beneficiaries during the crisis period. In fact, a more pronounced increase in the number of beneficiaries was visible in both 2007 and 2008 (between 7% and 10% of annual growth in each category and in each year), even before the crisis effects were visible in GDP growth rates.

**FIGURE 7: Number of users of social protection schemes in Serbia, 2002-2010**



\* There was a change in the data gathering and methodology starting from 2010.

Source: SORS

To sum up, during the crisis period (2008-12) there was a dramatic contraction of the economy as measured by the 21% drop in total employment. The fall in total employment took place almost solely in the private sector, while the public sector employment has been mainly inflexible. This means that the decapitated private sector, that lost more than one fifth of its employment, is supposed to finance a similar number of employees in the public sector. Not only that, it has to finance the growing social sector needs (see Figure 7) that arise due to the crisis as well as due to the steadily growing demands of the pension fund (see Figure 6) and the aging population (see Table 2).

## 4. CONCLUSIONS

The effects of the global financial crisis and the Eurozone crisis have been devastating for the Serbian economy. Both the national professional and foreign scientific discussions are not taking this situation seriously enough. The crisis is very likely to take a more sinister turn imminently for

two main reasons: the domestic (and foreign borrowed) buffers to dampen the crisis have either been exhausted (like increased taxing of the domestic private sector) or are prohibitively expensive or unsustainable (like additional borrowing).

At the same time Serbia's economic performance is getting worse. The country entered into the second dip of the recession following the worsening of the Eurozone crisis. More dramatic than the drop in GDP are the figures on employment. The analysis shows that since 2008, one fifth of labour force lost their jobs, with the negative trend continuing, while the current unemployment rate reached a staggering 26.1%. At the same time, public sector employment has remained rigid, the number of social security dependants has grown and there is a pronounced growth in both the number of elderly and pensioners. This exerts further pressure on already devastated private sector; lacking pro-active policy goals and in the face of possibly rising social unrest due to severe economic conditions as well as the current EU crisis, the government is resigned to additional borrowing in order to sustain the current levels of spending.

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The impact of the Eurozone crisis on the peripheral countries of the EU has been well documented, with much commentary and debate about the social and economic impact on EU Member States such as Greece, Spain and Portugal. However, the serious social consequences of the economic crisis on the countries of South East Europe have been far less in the spotlight of public awareness. The global economic crisis, followed in swift succession by the Eurozone crisis, has left a deep imprint on the countries of the region, as trade and investment flows have been severely disrupted. As businesses find it increasingly hard to obtain credit, and as governments throughout the region have adopted austerity measures, unemployment has increased sharply. In several countries of the region youth unemployment has become a significant issue, with rates of youth unemployment rising well above 50% in Bosnia and Herzegovina and Serbia, and other countries not far behind. In 2012, several countries experienced a double dip recession. Being highly integrated into the EU the region is susceptible to the ongoing economic crisis of the Eurozone. New policies for growth, relying far more than in the past on the region's own resources, on more effective regional cooperation, as well as on a speedier path of EU accession will be essential to overcome some of the more intractable social problems that the region faces.

The book presents a comprehensive snapshot of the social situation in the region of South East Europe, and sheds new light on the nature and depth of the social challenges that the region faces.

The authors of the chapters in the book are members of the LSEE Research Network on Social Cohesion that was established in 2011. Several of the chapters were presented at a conference on the social consequences of the global economic crisis held at the LSE in December 2011 and subsequently revised for publication in this volume.

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