

**Challenges to successful employment policy in the region:  
towards more jobs, quality labour force and greater  
competitiveness**

**DISCUSSION PAPER**

**November 2012**

## Contents

1. Introduction .....	1
2. Recent Economic Developments .....	2
3. Labour Markets of the Western Balkan Countries .....	3
4. Productivity and Competitiveness .....	10
5. Social Circumstances in the Western Balkans .....	14
6. Overcoming the Challenges .....	16
Annex 1 - Bibliography .....	18
Annex 2 - PISA results for the Western Balkan countries .....	20

## Table of Figures

Figure 1 - GDP per capita in PPS, 2011 (EU-27=100).....	2
Figure 2 – Real growth rates in Western Balkan countries, 2008-2012 .....	3
Figure 3 - Employment rates in the Western Balkans and EU27, 2011 .....	5
Figure 4 – Participation (top) and unemployment (bottom) rates in the Western.....	6
Balkans and EU27, 2011 .....	6
Figure 5 - Employment and Unemployment rates by education, 2011.....	8
Figure 6 – Spending on ALMPs, % of GDP .....	10
Figure 7 - Competitiveness of the Western Balkan countries .....	11
Figure 8 - Productivity and productivity gaps in selected Western Balkan countries .....	13
Figure 9 – Incidence of poverty in the Western Balkan countries (left panel) and recent trends.....	14

## Glossary

ALMPs	Active Labour Market Policies
BEEPS	Business Environment and Enterprise Performance Survey
BiH	Bosnia and Herzegovina
CEB	Council of Europe Development Bank
CEFTA	Central European Free Trade Agreement
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
EU	European Union
FDI	Foreign Direct Investment
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
IFIs	International Financial Institutions
ILO	International Labour Organisation
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Cooperation and Development
PESs	Public Employment Services
PISA	Program for International Students Assessment
PPP	Public Private Partnership
PPS	Purchasing Power Standard
R&D	Research and Development
RCC	Regional Cooperation Council
SEE	South East Europe
TIMSS	Trends in International Mathematics and Science Study
WB	World Bank
WBIF	Western Balkans Investment Framework

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## Purpose of this Report

This report has been prepared under the auspices of the IFI Coordination Office (IFI CO) to stimulate discussions in various fora that address social sector issues in the Western Balkans including the social sector workshop organised by IFI CO in October 2012, the meeting of the RCC's Social Agenda in November 2012 and the Western Balkan Investment Framework (WBIF) Steering Committee meeting in December 2012.

In preparing this report, the author has analysed and summarised the latest data on employment related issues from a range of sources both regional and international including the World Bank and the European Commission (see Annex 1 bibliography). The aim is to provide readers with a range of facts and statistics on the situation in the Western Balkans to inform their discussions and any decisions on actions to be taken to tackle the various issues that arise.

### 1. Introduction

Low job creation and high unemployment are major concerns in all Western Balkan countries. The economic and social prospects of these countries - with employment rates of about 50% and unemployment rates that exceed 30% - are significantly constrained with severe challenges for higher and more inclusive future growth. Strong and robust growth is essential for a substantial reduction of the unemployment levels.

After the recovery achieved in 2010 and 2011 with average GDP growth of 3% per year, the Western Balkan countries are showing a considerable slowdown in 2012, with the latest International Monetary Fund (IMF) projection for these countries being a low 0.9%.<sup>1</sup> Sluggish economic conditions and low growth prospects in the EU, the main trading partner of the Western Balkan countries, are also holding back growth prospects. The recent economic crisis caused a severe blow to the fragile economies and labour markets of the region, halting the positive development trends in the last decade. This has, in turn, intensified the future challenges.

The Western Balkan countries share a common legacy. They were part of the former Yugoslavia (with exception of Albania), have close trade relations as members of the reformed Central European Free Trade Agreement (CEFTA) and are likely to follow a similar path in terms of accession to the EU. The countries share similar economic systems characterised by growing service sectors; a relatively high proportion of value added from agriculture; substantial to pervasive informal economies; large remittances; poor labour market outcomes, with particularly high unemployment rates of young workers and large long-term unemployment; high dependency ratios; and, in most countries, an aging population.

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<sup>1</sup> IMF, World Economic Outlook, October 2012

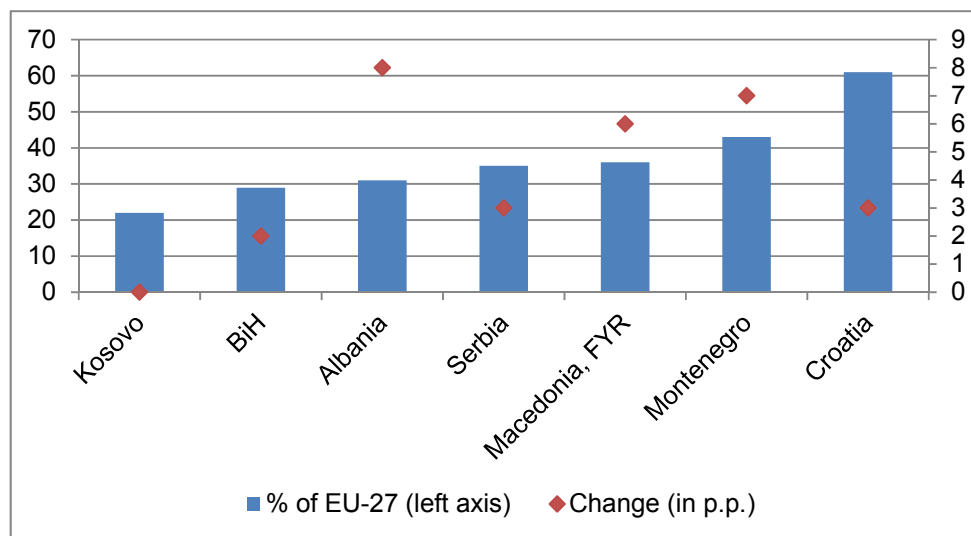
While a detailed and quality analysis of the region’s labour markets is constrained by scarce and flawed data, the analysis undoubtedly shows that there is a room for improvement in the social sector. This will require a combination of policy reform, capacity building and investment. Achieving the most effective and efficient outcomes will require the combined efforts of governments in the region and the international community.

## 2. Recent Economic Developments

The income gap between the Western Balkan countries and the EU27 is relatively large. Income levels in the region vary considerably, with Kosovo\* having the lowest living standard, as little as 22% of the EU27 average, to 61% in Croatia. The Former Yugoslav Republic of Macedonia, Montenegro and Serbia have GDP per capita at around a third of the EU27 average. In 2011, only Croatia had a GDP per capita of more than half the EU27 average (Figure 1).

Between 2006 and 2011 the countries made progress towards convergence with the EU, albeit at different rates, with Albania showing strongest improvement of an 8 percentage points (p.p.) increase on the relative living standard.

**Figure 1 - GDP per capita in PPS, 2011 (EU-27=100)**



Note: Data for Kosovo are for 2010; Source: Eurostat database, available at

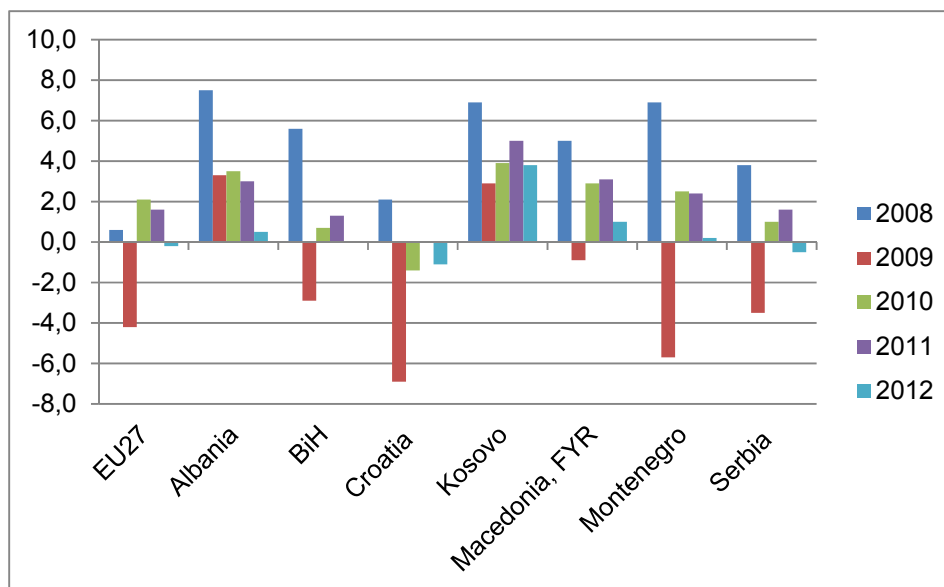
<http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/>

GDP data for Kosovo are available at <http://esk.rks-qov.net/eng/>

\* This designation is without prejudice to positions on status, and is in line with UNSCR 1244/99 and the ICJ Opinion on the Kosovo declaration of independence.

As noted, the recovery from the 2009 recession has been sluggish across the Western Balkan countries, and while some gains were made in 2010-2011, the latest figures indicate that Western Balkan GDP in 2012 will remain below the 2008 level, with Croatia, Bosnia and Herzegovina (BiH), Serbia and Montenegro being the most severely hit.

**Figure 2 – Real growth rates in Western Balkan countries, 2008-2012**



Source: IMF, World Economic Outlook, October 2012

The EU is the main export market for the Western Balkan countries, with a share of 56% of total exports in 2011<sup>3</sup>, of which about 30% go to only two EU economies, Italy and Germany<sup>4</sup>. Intra-regional trade under the CEFTA agreement accounts for about 23% of exports from the region. The high concentration of exports to the EU makes the economies of these countries highly exposed to the EU economic situation. In addition, FDI inflows from EU countries are an important source of financing, investment and growth in the region.

### 3. Labour Markets of the Western Balkan Countries

Although the period before the 2008 economic crisis can be qualified as rather successful in terms of stable and robust growth in the Western Balkans - GDP grew on average by 5% annually in real terms between 2000 and 2008 and GDP per capita almost doubled in the period - these favourable economic trends did not translate into higher employment. They did bring

<sup>3</sup> Data are for the South Eastern Economies (SEE6), i.e. Western Balkan countries except Croatia

<sup>4</sup> World Bank, 2012a

about higher wages and improved living standards, but the economic growth was largely jobless, and in some instances, like in Serbia, was even accompanied by a net loss of jobs.

The nascent recovery of 2010-11 was also jobless, and the poverty reductions achieved in the pre-crisis period were largely reversed. While in this period GDP in the six countries in South East Europe (SEE6) rose by between 2 and 3%, employment rates fell by between 0.5 and 1.5 percentage points. The estimated elasticity of unemployment with respect to growth in SEE6 countries is low at -0.2<sup>5</sup> implying that a 1 p.p. GDP growth would, on average, lead to a decline in unemployment of 0.2 p.p. The low elasticity of unemployment means that only strong and resilient growth can lead to a substantial decline in unemployment.

### Structure of Employment in the Western Balkans

Deep-rooted structural weaknesses in the labour markets of the Western Balkan countries translate into very low participation and employment rates, on the one hand, and high rates of youth and long-term unemployment on the other. Figure 3 below compares the employment rates of the working age population in the region with the un-weighted EU27 average of around 64%. Only in Croatia and Albania is the employment rate of the working age population above 50%.<sup>6</sup> In Montenegro, Serbia and the Former Yugoslav Republic of Macedonia the rate is between 40% and 50 %, while in BiH and Kosovo it is well below 40%. The gender employment gap in some of the Western Balkan countries is very large: the employment rate of females in Kosovo was 67% below that of the males, 41% in BiH, and above 30% in the Former Yugoslav Republic of Macedonia and Albania.

Low job creation in the region leads to a difficult school-to-work transition for young people, most of them entering the labour market following an initial spell of unemployment. Hence, young workers face very low employment rates of below 15%, with the exception of Croatia (20%) and Albania (37%), the latter being higher than the EU27 average.

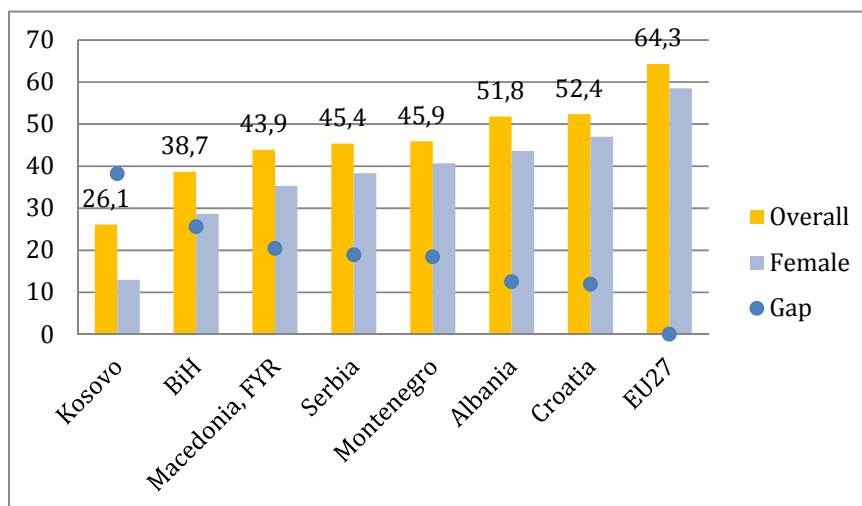
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<sup>5</sup> World Bank, 2012a

<sup>6</sup> Labour market data are based on the Labour Force Survey (LFS) methodology, and if not otherwise stated, refer to population aged 15-64



**Figure 3 - Employment rates in the Western Balkans and EU27, 2011**

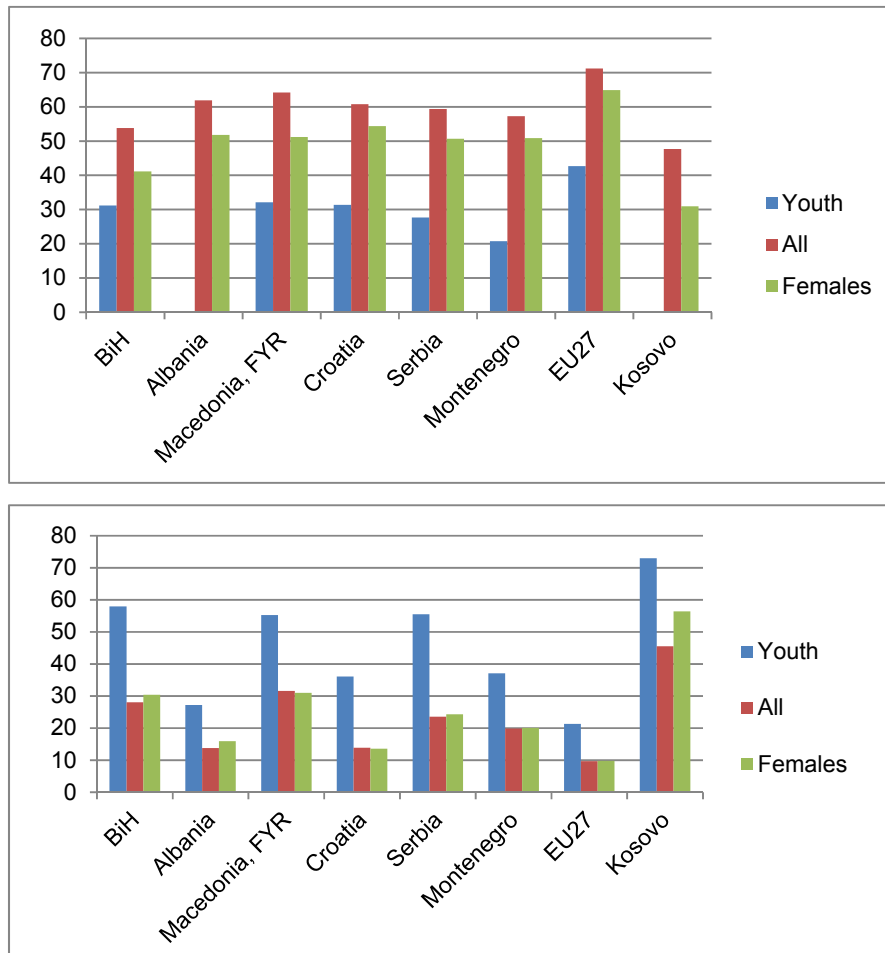


*Source: Eurostat for EU27, Croatia and Former Yugoslav Republic of Macedonia and National Statistical Offices for other countries. Data for Albania and for Kosovo are for 2009.*

Western Balkan countries also suffer comparatively low participation rates and unemployment rates are amongst the highest in the world. BiH and Montenegro have the lowest participation rates of 54 and 57%, respectively, whereas the Former Yugoslav Republic of Macedonia has the highest at 64% (see Figure 4, top).

The gender gap in labour market activity is high relative to the EU27. Whereas the average EU27 gender gap equals 16%, it is as high as 57% in Kosovo, 38% in BiH and 33% in the Former Yugoslav Republic of Macedonia. As with the employment rates, young workers have low participation rates, on average at about 29% (excluding Kosovo), compared to the EU27 average of 43%. The decline in participation rates of young workers in some countries can be partially attributed to increased enrolment in tertiary education.

**Figure 4 – Participation (top) and unemployment (bottom) rates in the Western Balkans and EU27, 2011**



Source: Eurostat for EU27, Croatia and Former Yugoslav Republic of Macedonia and National Statistical Offices for other countries. Data for Albania and Kosovo for 2009.

Unemployment rates in the region are amongst the highest in the world including among the countries covered by the 2013 World Development Report. In Kosovo, almost every second person active on the labour market is unemployed, while the same holds for every third individual in the Former Yugoslav Republic of Macedonia and BiH (Figure 4, bottom panel). Albania and Croatia have the lowest unemployment rates in the region at about 14%. The gender gap in unemployment is largest in Kosovo (almost 40%) and BiH (30%) whereas in some countries females have a lower probability of unemployment than males (The Former Yugoslav Republic of Macedonia and Croatia). The lack of job opportunities for young workers means that we observe simultaneously very low participation rates and very high unemployment rates. In Kosovo, a staggering 73% of young workers in 2009 were searching for a job but could

not find one. BiH, the Former Yugoslav Republic of Macedonia and Croatia all face youth unemployment rates above 50%, meaning that one in every two active young workers cannot find a job.

Labour markets in the Western Balkan countries can also be characterized as static, with high and persistent long-term unemployment. Structural changes that occurred during the transition have led to high rates of structural unemployment and a mismatch between the skills supplied in the labour market and the ones demanded by the emerging sectors (Bartlett, 2007; 2012 EC Progress Reports).<sup>7</sup> The problem of long-term unemployment is most pronounced in Albania where more than 90% of the unemployed in 2009 have remained so for more than 12 months. Similarly, in the Former Yugoslav Republic of Macedonia, BiH, Montenegro and Kosovo, long-term unemployment exceeds 80% of all unemployed (Vidovic et al., 2011) indicating the difficulty of finding a job. Croatia has the lowest rate of long-term unemployment in the region, at about 55%.

### Education and Employment in the Western Balkans

Education is a strong predictor of employment probability in the Western Balkan countries. Figure 5 shows that, in general, employment rates increase with the levels of education, whereas unemployment rates are negatively related to education levels. The exception here is BiH (also Serbia), where the unemployment rate is highest among workers with second level education.

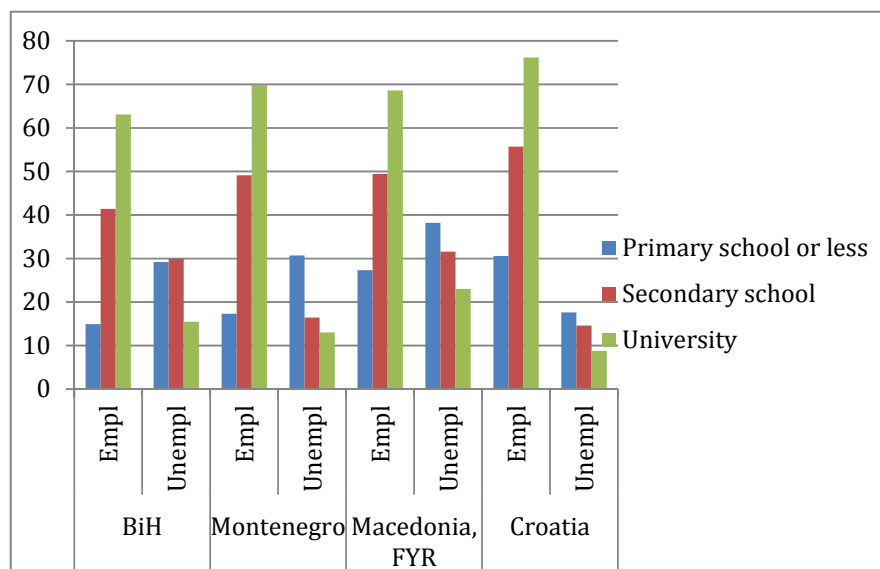
This might be related to the structure of jobs in the economy, possibly the high reservation wage of secondary educated workers<sup>8</sup> and/or the secondary schools' curriculum that do not match the required skills. Employment rates of tertiary educated individuals in this sample of Western Balkan countries is on average twice the employment rate of individuals with completed primary education or less, whereas the unemployment rate of university graduates is 50% of that of primary educated workers. In recent years, due to the expansion of higher education and the relatively increased supply of university graduates, an increase in the unemployment rate of tertiary educated workers is observed, for instance in the Former Yugoslav Republic of Macedonia and Croatia. Mojsoska-Blazevski and Ristevska (2012) shows that in line with this trend, there has been an increasing phenomenon of over-education.

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<sup>7</sup> The European Commission 2012 Progress Reports for the accession countries can be downloaded from the [http://ec.europa.eu/enlargement/countries/detailed-country-information/turkey/index\\_en.htm](http://ec.europa.eu/enlargement/countries/detailed-country-information/turkey/index_en.htm)

<sup>8</sup> The minimum wage rate at which an individual would accept job

**Figure 5 - Employment and Unemployment rates by education, 2011**



*Source: Eurostat for Croatia and the Former Yugoslav Republic of Macedonia and National Statistical Offices for other countries*

Besides the lack of jobs, some countries in the region face relatively high inequality of job opportunities. The World Bank (2012) assesses inequality of job opportunities as job opportunities that are related to i) circumstance at birth, such as gender, ethnicity, parental education and political affiliation, and ii) attributes (educational attainment and age), for a sample of 29 countries from Europe and Central Asia. The results show inequality in the Western Balkan countries between 3% and 20%, with the least inequality among Western Balkan countries in Serbia (second in Europe and Central Asia), followed by Croatia, BiH, Montenegro and the Former Yugoslav Republic of Macedonia. The highest inequality in job opportunities across the region (and third worse in Europe and Central Asia) appeared in Albania.<sup>9</sup>

### Impact of the Informal Sector

Rigidities and structural weaknesses lead to high informal sectors and employment across the Western Balkan countries (DG ECFIN, 2009). The incidence of informal employment in the region is large, with levels estimated to be between 30% and 40% (Arandarenko and Vukojevic, 2008).<sup>10</sup> At the highest end of the scale, 76% of all employment in Albania has been estimated

<sup>9</sup> For more details, see World Bank, 2012, p. 137, Figure 4.5.

<sup>10</sup> Estimates of the informal employment vary considerably between different approaches/methods. For instance, the 2012 Progress Report for Serbia indicates an undeclared work of size 17%. The State Statistical Office in the Former Yugoslav Republic of Macedonia estimated informal employment at 26%, with a greater incidence among men.

to be in the informal sector. High levels of informal employment in the region partly result from the large agricultural sector and it is more widespread among young workers and males. The ILO (2008) estimated that about 44% of young workers in the Western Balkans are engaged in informal employment. These workers are less likely to face decent work and prosperous employment and do not enjoy basic rights at work. In this regard, reducing the size of the informal employment (and economy) is a great challenge for the Western Balkan countries. A reduction of labour costs/taxation is one of the possible ways to reduce the costs of being formally employed with a possible positive effect on formal employment. Mojsoska-Blazevski (2012) argues that the reform of the wage system in the Former Yugoslav Republic of Macedonia and the consequent reduction of the labour costs caused some shift from informal to formal employment.

### **Fragmented Employment Policies**

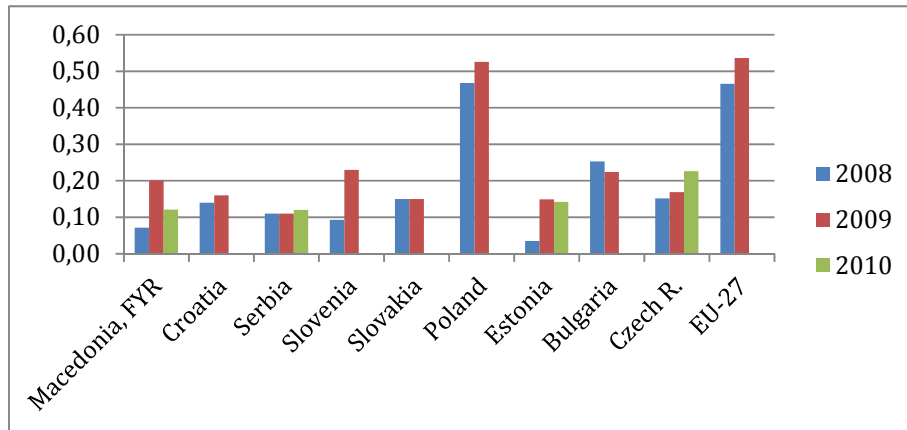
Employment policy in the Western Balkan countries can be characterised as fragmented, narrowly focused - mainly on Active Labour Market policies (ALMPs) - and with little coordination among different actors (DG ECFIN, 2012). It fails to pay attention to other important labour market policies/issues, such as skill mismatches and life-long learning. Moreover, the culture of monitoring and evaluating labour market policies is at embryonic stage, limiting the possibility for evidence-based policy-making.

Across the region, ALMPs have gained importance since 2007, if assessed through increased spending and participants in the programmes. After some years of gradually increasing spending on ALMPs, most of the countries in the region reduced spending in the last couple of years reflecting the limited availability of public finances. In 2010, spending was reduced to about 0.1% of GDP (in the Former Yugoslav Republic of Macedonia and Serbia), although it was preserved at a higher level in Croatia. As Figure 6 shows, such spending is comparable to that in some of the new EU Member States (for instance, Slovakia and Estonia). In general, spending on ALMPs per unemployed person is much lower in the Western Balkan region than in the EU countries. The scope of active programmes in the region is comparatively low. For those countries for which data are available, about 2% of unemployed workers in the Former Yugoslav Republic of Macedonia were engaged in active programs in 2011<sup>11</sup>, 11% in Croatia and 20% in Serbia.

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<sup>11</sup>If employment services (for instance, counseling) are added to the active labour market programs, then the scope of the ALMPs in the Former Yugoslav Republic of Macedonia increases to 25% of all unemployed.

**Figure 6 – Spending on ALMPs, % of GDP**



Note: Data are based on LMP measures 2-7.

Source: Author's calculations based on data from national sources for the Former Yugoslav Republic of Macedonia, Vidovic et al. (2011) for Croatia and Serbia and Eurostat for the EU Member States

The Public Employment Services (PESs) in the Western Balkan countries are largely understaffed and under-financed. The caseload of PES staff is very high, posing a crucial constraint to effective employment policies. The ratio of staff-to-unemployed in Kosovo, the Former Yugoslav Republic of Macedonia and BiH is above 1:600 (i.e. 1 staff member handling 600 unemployed persons), which is extremely high by international standards (see Vidovic et al., 2011, p.92). The ratio further deteriorates when considering only front-line officers (for instance, at 1:1,131 in the Former Yugoslav Republic of Macedonia in 2011). Montenegro has lowest ratio so that one PES staff member serves about 84 unemployed. The average ratio for the EU is one staff member serving 150 unemployed.

PESs in the region have been subject to reform and modernization in the past few years. Most have adopted an increased service orientation towards the clients, staff training, improvements in information systems, improved capacity for delivering better labour market information, etc. However, low financing and the high workload of staff, coupled with low job creation limit the role of the PES in improving job matching and reducing unemployment.

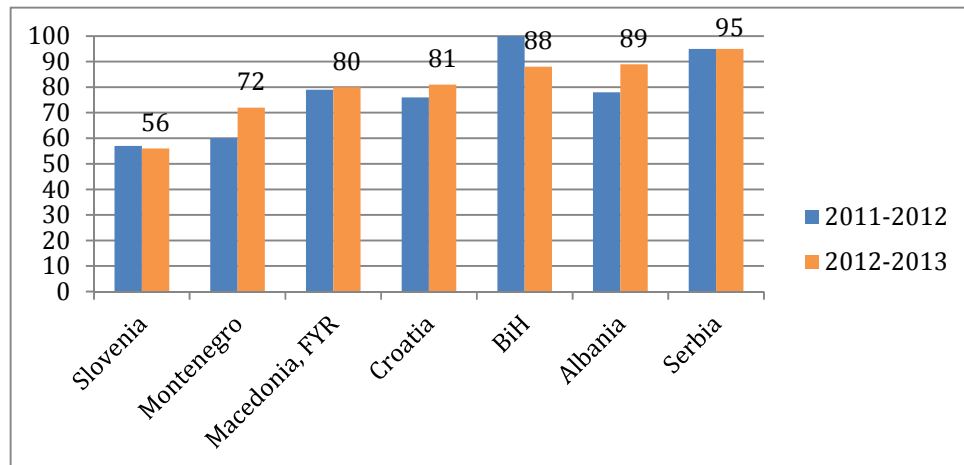
#### 4. Productivity and Competitiveness

Improving productivity levels and competitiveness are key challenges for the Western Balkan countries in order to achieve higher growth rates in the medium to long-run, and hence for substantially reducing unemployment.

The inherent structural weaknesses both on the goods markets and the labour markets across the region lead to relatively low competitiveness. As Figure 7 shows, Montenegro has the best rank among the Western Balkan countries, being placed at 72<sup>nd</sup> position out of 148 countries

covered in the Global Competitiveness Index (GCI)/Report. The lowest rank is held by Serbia, - 95<sup>th</sup> place. Between 2011 and 2012 competitiveness improved in BiH, was stable in Serbia but deteriorated in all other countries. For comparison, the EU27's average competitiveness score would rank it 30<sup>th</sup> place, whereas the average rank for the region would be 88<sup>th</sup> place.

**Figure 7 - Competitiveness of the Western Balkan countries**



Source: Global Competitiveness Index data platform, at <http://www.weforum.org/issues/competitiveness-0/qci2012-data-platform/> Slovenia is given for comparative purposes

The limited role of innovation in the region contributes significantly to low competitiveness. Public sector expenditure on research and development is well below 1% of GDP in all Western Balkan countries, except Montenegro with 1.1% of GDP (EC, 2012; World Bank, 2012a). In addition, businesses spend less on innovation than any other region in Europe. This combined with the relatively poor education attainment of the population (both in terms of quantity and quality), contributes to low value added exports from Western Balkan countries: intermediate goods and traditional services form the major part of their exports.

The Western Balkans are in general characterised by low enrolment rates in pre-primary, primary and upper-secondary education, lower overall completion rates and poor grading standards (Snoy and Kadric, 2012).<sup>12</sup> Further, data from the GCI shows that the public perceives the quality of primary and secondary education specifically, as well as the overall quality of the education system as being relatively low. The Serbian education system has the lowest rank among the countries in the region in the education-related indicators.

Tertiary education attainment among the region's population aged 30-34 was the lowest in Europe, amounting to an average of 15% (among the SEE6 countries, as reported by the World Bank, 2012a) in comparison to the EU27 average of 35% in 2011 (and the Europe 2020 target of

<sup>12</sup> Educational data for the Western Balkan countries (including the enrollment rates) are provided by UNICEF-TransMonEE, from <http://www.transmonee.org>

40%). In recent years the governments are increasingly prioritizing education (especially tertiary education) through expanding access and subsidizing public universities. This has led to a sharp increase in the share of tertiary educated population (aged 30-34) in the total population. For instance, between 2006 and 2011, this share has increased by 76% in the Former Yugoslav Republic of Macedonia and by 47% in Croatia, though there is still large gap with the EU27 average.

Equally important as the “quantity gap” in educational attainment of the Western Balkan population relative to the EU27, is the quality of education issue. A recent study by Sondergard et al. (2012) argues that the region ranks even worse in terms of quality than on quantity of education. Low quality education “breaks” the link between a country’s endowment of an educated population and the speed of economic growth and development (Olaniyan and Okamakinde, 2008). The educational systems suffer from long periods of underinvestment and input-based educational policy. The output of the education process, that is students’ achievements, have been largely overlooked. It is estimated that a large proportion of students finish lower secondary school with a minimal command of literacy and numeracy.

For example, the Program for International Students Assessment (PISA) and Trends in International Mathematics and Science Study (TIMSS) show that Western Balkan countries have large proportions of 15-year-olds with poor numeracy and literacy skills such that they would be unable to function in the modern workplace (see Annex 1 for PISA results for Western Balkan countries). According to the PISA results in math, science and reading, pupils from Albania and the Former Yugoslav Republic of Macedonia are the worst performers among the Western Balkan countries with average scoring close to 355 points, which is considered as an upper bound for the lowest level of competencies.<sup>13</sup>

The region spends less on education than the EU27. Public expenditure on education in Croatia, the Former Yugoslav Republic of Macedonia and Serbia are at about 4.5% of GDP, compared to an average of 5.4% for the EU 27 in 2009.<sup>14</sup> Closing the quantity and quality gap in education between the Western Balkan countries and the EU27 will undoubtedly require increased spending on education in the region. This is critical in the long-term when the labour force from the Western Balkan countries will compete with other EU citizens for jobs.

The low quality of education increasingly constrains the growth of businesses. In 2008 skilled labour shortages came second only to tax rates as the most common constraint to growth in the Western Balkans reported by businesses to the EBRD/World Bank’s Business Environment and Enterprise Performance Survey (BEEPS). Between the 2005 and the 2008 round of the

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<sup>13</sup> Pupils scoring at or below Level one are assessed as having basic reading competency.

<sup>14</sup> Data for the EU and Croatia taken from Eurostat, at

[http://epp.eurostat.ec.europa.eu/statistics\\_explained/index.php?title=File:Expenditure\\_on\\_educational\\_institutions,\\_2004\\_and\\_2009\\_\(1\).png&filetimestamp=20121001105841](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Expenditure_on_educational_institutions,_2004_and_2009_(1).png&filetimestamp=20121001105841) data for Serbia from WBIF, 2012.



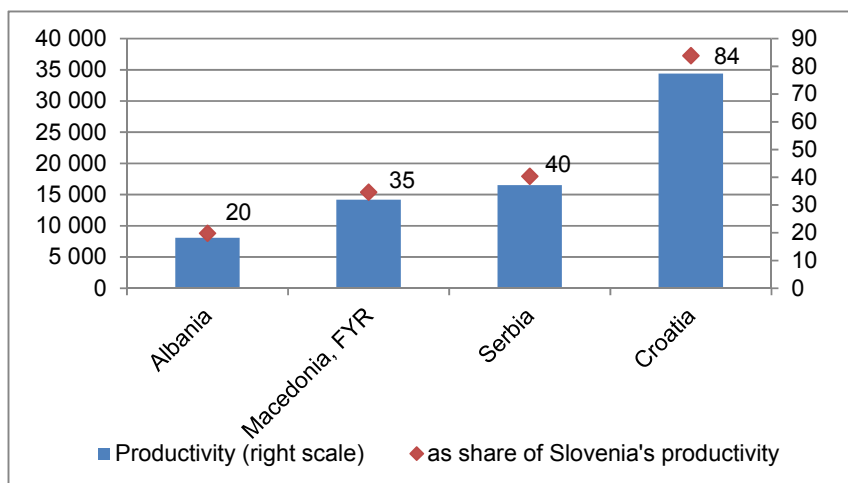
BEEPS, skilled labour force has increased its importance as a constraint. This is likely to be related to the expanding economies and increase labour demand during that period. For example, in Albania and Serbia 'skilled labour' moved from 9<sup>th</sup> place for its importance as an obstacle for firms, to the 3<sup>rd</sup> and 4<sup>th</sup> place respectively. As economies pick up and production structure switches to higher value-added products, skills shortages will increase even further.

The ageing of population in countries of the region requires education systems to meet the challenge of preparing a higher - productivity population. Education systems could play an important role in offsetting the possible negative effects of demographic change on economic growth and productivity, while contributing to the productivity gains that will be needed in the global economic context. To maintain productivity and to increase the employability of older workers - which are essential to counteract the falling number of total workers - ageing labour forces will require improvements in education and new forms of education throughout workers' active lives.

Lifelong learning is limited at present in the Western Balkan countries - the participation of adults (aged 18-64) in education and training is only 8 and 10% respectively in Croatia and the Former Yugoslav Republic of Macedonia, compared to 37% in Denmark or 15% in the EU 15.

Productivity in the region is relatively low, limiting the country's competitiveness and growth potential. Figure 8 shows the productivity of workers in selected Western Balkan countries, expressed as value added per workers in the industry (in 2005 USD per year). For a comparison purposes, the left hand scale shows the ratio of country's productivity to the productivity of a Slovenian worker.

**Figure 8 - Productivity and productivity gaps in selected Western Balkan countries**



Source: World Development Report 2013, at

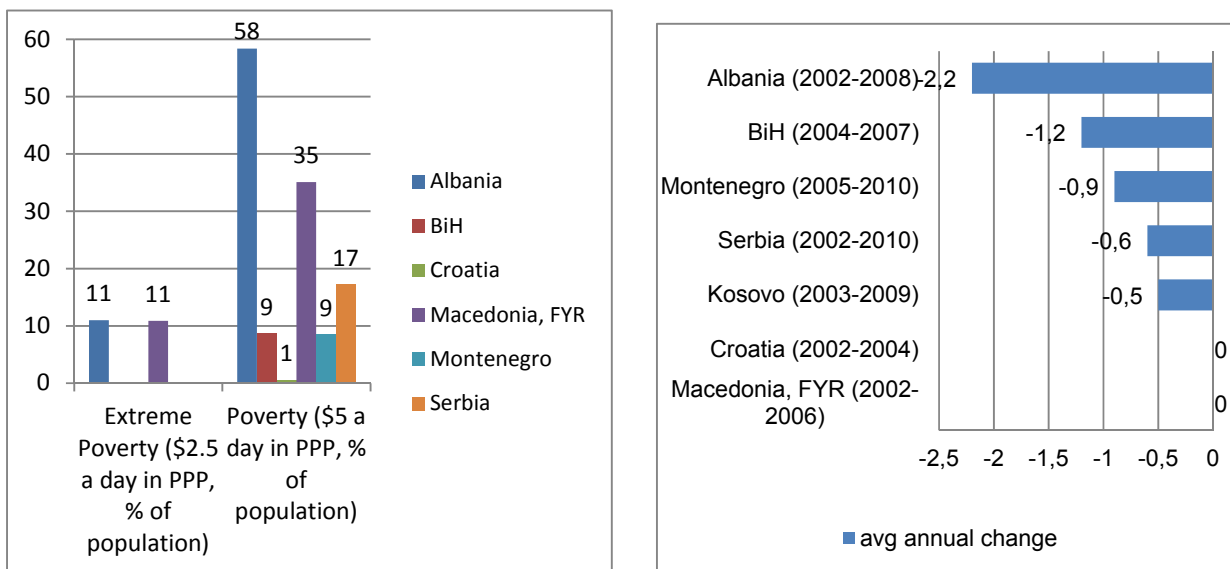
<http://econ.worldbank.org/external/default/main?contentMDK=23044836&theSitePK=8258025&piPK=8258412&pagePK=8258258>

Based on this information, it appears that there is a large productivity gap between Albania, Former Yugoslav Republic of Macedonia and Serbia on one hand and Slovenia, on the other hand. For instance, a typical Albanian worker from the manufacturing industry can produce only one fifth of what a typical Slovenian worker produces per year. Low quality of the labour force and skills mismatches contribute to such low productivity levels, which in turn affect the international competitiveness of the countries.

## 5. Social Circumstances in the Western Balkans

The high incidence of joblessness in the region affects the overall poverty profile. The World Bank (2012a) reports that poverty rates in Kosovo, Albania, and the Former Yugoslav Republic of Macedonia are among the highest in Europe. As Figure 9 shows, the incidence of poverty is relatively high in the region, with the exception of Croatia. About 60% of Albanian citizens and 35% of citizens of the Former Yugoslav Republic of Macedonia live under the (subjective) poverty line of 5USD in PPP. Though the data show a relatively low incidence of poverty in BiH, the indicator is probably underestimated.

**Figure 9 – Incidence of poverty in the Western Balkan countries (left panel) and recent trends**



Source: World Development Indicators, at <http://data.worldbank.org/topic/poverty>

Poverty in the region is also highly persistent (right panel). The Former Yugoslav Republic of Macedonia has had the lowest levels of poverty reduction across the Central and Eastern European countries, followed by Kosovo, Serbia, etc.

Western Balkan countries also show high poverty levels when looking at more subjective poverty measures. The Life in Transition Survey carried out by the EBRD and the World Bank in

2010 investigated subjective measures of poverty as well as perceptions about the impact of the crises on people's living standards (EBRD, 2011).<sup>15</sup> Across the Western Balkan countries, on average about 60% of adults surveyed reported that the crisis affected them a great deal or a fair amount, compared to around 50% in transition economies in general, and 31% in Western Europe. In most of the Western Balkan countries, the effect has been least pronounced for older people and high-income households. The main mechanisms behind the poverty increases were the reductions in wages or work hours, decreases in remittances and job losses.

Spending on social assistance in the Western Balkan countries is comparable to countries at similar stages of development and the targeting is relatively good, notwithstanding the limited coverage (World Bank, 2012a). The generosity of social assistance is relatively low when measured as a share of the minimum wage, ranging between 7% and 20%, the exception being Montenegro where it amounts to 75% of the minimum wage. In some countries, most notably BiH, high benefits for war veterans push up overall expenditures on social assistance. A World Bank evaluation of the social safety nets in the SEE6 countries in the aftermath of the crises has pointed out that the main areas for reforms in the social protection systems are: to switch the systems towards means-tested social assistance and reduce work disincentives that arise from the structure of the systems (which supports inactivity and unemployment, combined with informal work).

Access to housing is another feature that needs to be taken in to account in the Western Balkans. While the situation has improved over the years, poor infrastructure, lack of investment, growth of illegal housing, increasing migration to urban areas, polarised tenure structures and a substantial number of displaced people still remain as challenges in the region.

There is the danger of the emergence of a 'housing underclass' of people who in other circumstances would have been able to purchase their own dwelling. With little financial means, young people cannot hold out much hope of obtaining housing at current market prices. At the same time, their participation in the labour market, especially in areas of intense economic activity (the cities), depend largely on their ability to settle.

High emigration and an aging population present additional constraints to the long-term growth of the Western Balkan countries and pose long-term fiscal challenges (EC, 2012). The World Bank (2012a) argues that one of the main reasons behind emigration is scarce job opportunities. Emigration levels are higher for tertiary educated workers; with on average one in five emigrating abroad. The World Bank estimated that one in three tertiary educated Macedonian workers leave the country. The concept of circular migration – i.e. whereby migration has a positive effect on the country of origin through remittances and the acquisition

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<sup>15</sup> Data from the survey are available from <http://www.ebrd.com/pages/research/publications/special/transitionII.shtml>

of skills abroad that can be used later on if migrants return does apply to the Western Balkans but in the short-term the Western Balkans are losing skilled labour.

The aging nations of the Western Balkan countries will not only lead to a shrinking labour force but also to large increase in the dependency rates, and pressure on the pension and health systems.

## 6. Overcoming the Challenges

A combination of high unemployment and low employment and participation rates present large challenges for employment policy and overall economic policies of the Western Balkan countries. Increasing job creation and substantially reducing unemployment requires a comprehensive reform agenda on several fronts, directed towards (i) growth-enhancing economic and structural policies and (ii) improving the functioning of labour markets.

The analysis presented in this report lends itself to the following general recommendations for policy-makers:

- Western Balkan countries need to advance structural reforms towards improving the business environment and exploiting the long-run growth potential, with an emphasis on labour-absorbing growth;
- Employment policy must be strengthened and made more comprehensive, instead of being focused on individual components, such as ALMPs. It should be designed on evidence-based grounds and monitored regularly. Both spending and the scope of ALMPs, which are currently at comparatively low levels, should be increased only in the wake of positive results/evaluation of the programmes. There is much room for improvement in the quantity and quality of the services delivered by the PES, some of the crucial areas being increased staffing and funding;
- Authorities must find ways to increase the incentives and hence attractiveness of formal employment. Some elements of the social protection systems support inactivity and unemployment, which is sometimes combined with informal work;
- Educational attainment of the population should be further improved, putting more emphasis on the quality rather than quantity of education, i.e. human capital. The focus should be re-directed (back) to early levels of education (pre and primary). Low quality of education and inappropriate teaching curricula lead to mismatches on the labour markets, which according to employers, present a large and important obstacle to growth;

- If the labour force of Western Balkans is to become competitive within the EU (once full membership is achieved), public spending on education has to be increased and quality improved;
- Increasing the availability of life long learning could increase the employability of older workers which is essential to counteract the falling numbers of total workers;
- The Western Balkans should not compete on the basis of low salaries and should aspire to enhancing the knowledge economy. This implies policy development in line with the EU's approach to develop the "knowledge triangle" that links education, research and development (R&D) and innovation; and
- Competitiveness and productivity of the region are very low, in part due to a low innovation capacity, and inappropriate skills of the labour force. Structural reforms in the goods and labour markets, greater inflows of FDI, more appropriate education and training systems, etc. would all contribute to achieving higher competitiveness and productivity and hence faster long-run growth.

In summary, in order to secure new, sustainable growth, the key issues for the governments of the region and the international community that supports them are the completion of the structural reforms and transition agenda. Efforts on this transition agenda slowed in the relatively high growth period up to 2008. As outlined in the IFI CO Synopsis of Findings on the Need for a New Growth Agenda in the Western Balkans<sup>16</sup>, there is general consensus that so-called new growth agenda for the region is to a large extent a revised and reinforced version of the old agenda of structural reform, but accompanied by an even greater sense of urgency.

The current efforts of governments of the region to respond to the EC's request to use an specifically tailored version of the EU 2020 agenda - the so-called SEE 2020 - to provide a framework for policy reforms provide an opportunity to draw more attention to the social agenda given its focus on smart, sustainable and inclusive growth. Achieving the targets agreed by the governments in these areas will require actions in the field of education, human capital and employment policy.

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<sup>16</sup>[http://www.wbif.eu/uploads/lib\\_document/attachment/68/Synopsis\\_of\\_Findings\\_on\\_the\\_Need\\_for\\_New\\_Growth\\_Initiatives\\_in\\_the\\_Western\\_Balkans.pdf](http://www.wbif.eu/uploads/lib_document/attachment/68/Synopsis_of_Findings_on_the_Need_for_New_Growth_Initiatives_in_the_Western_Balkans.pdf)

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## Annex 2 - PISA results for the Western Balkan countries

Country name	Math				Science				Reading			
	2000	2003	2006	2009	2000	2003	2006	2009	2000	2003	2006	2009
Former Yugoslav Republic of Macedonia	381				401				373			
Croatia			467	460			493	486			477	476
Albania	381			377	376			391	349			385
Montenegro			399	403			411	401			391	408
Serbia		437	435	442		436	435	443		412	401	442
<i>Comparator countries</i>												
Slovenia			504	501			518	512			494	483
Czech Republic	498	516	509	493	511	523	512	500	492	489	482	478



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