

Combining flexibility and security for employment and decent work in the Western Balkans

1. Introduction

Globalisation, with its accompaniment of new trade arrangements, strong but unstable capital flows and increasing labour migration, as well as accelerating technological change, is exposing national economies to intense competition. Firms have therefore to make frequent adjustments to their operations and their labour force in order to adjust to fluctuations in demand and to productivity growth. But simply responding to firms' need for flexibility, without taking care of the workers' need for security, would be socially inefficient and would have adverse macroeconomic repercussions, quite apart from the negative effects at the individual and household level. In Central and Eastern Europe (CEE), for example, the widespread policy of deregulation that has been promoted in the region has not improved labour market performance. On the contrary, according to ILO research, in some countries it has even led to negative effects on employment, labour reallocation and labour productivity (Cazes, Nesporova, 2003). Hence, there is a need for a balanced policy that can lower adjustment barriers while at the same time ensuring employment security for workers. Policy-makers and the social partners are accordingly searching for new forms of balanced regulation, allowing for adjustment while at the same time protecting workers and applicable to rapidly evolving labour markets in the globalised economy.

This search for a better combination of flexibility and security has also been increasingly emphasised within the European Union as being indispensable to improve competitiveness and at the same time maintain the European Social Model. The Austrian Government has responded to this challenge by including flexicurity among the key topics for its EU presidency. It has organised two events on this topic – an Informal Meeting of Employment and Social Ministers and a Meeting of the Troika and Social Partners – on the topic “Flexicurity – Flexibility Through Security” held in Villach early this year. Both meetings emphasized that globalization, technological progress and demographic changes brought about an increased need for flexibility. The availability of adequate social security and active labour market policies would enable the labour force to be more flexible without raising the level of insecurity. The flexicurity approach should thus be based on a policy mix negotiated and agreed between the government and the social partners in each country that would require appropriate reforms of their labour markets and their institutional frameworks, of education and training systems in accordance with the lifelong learning principle, and of social security systems. The relevance of this negotiated flexicurity approach for European labour market reforms is also the reason why the informal ministerial meeting at this year's International Labour Conference (ILC) is to be devoted to this topic, this time in relation to the Western Balkan countries moving towards EU membership. As the ILO is now completing the second phase of its flexicurity project in Central and Eastern

Europe (the first phase started already in 2000), its findings and the lessons learnt can be useful for extending this approach to this sub-region¹

This paper advocates the flexicurity approach for the Western Balkan countries. It starts by a description of the concept and the main elements of the flexicurity approach, which advocates a policy mix combining employment protection legislation, collective bargaining, training, unemployment insurance and active labour market policies as a response to the new employment and social challenges. Further, it provides a brief analysis of recent labour market developments and changes in employment patterns in the Western Balkan countries in comparison with the new EU members, Bulgaria and Romania. It then discusses the possibility that rigidity of employment protection legislation (EPL) may be one possible reason for the poor labour market performance of these countries, as is often claimed by some economists. More generally, evidence on the effect of labour market policy and institutional settings on labour market performance is then presented for the Central and Eastern European countries, since this seems highly relevant for the Western Balkan countries as well. The last chapter contains conclusions and policy implications.

2. The concept and the main elements of the flexicurity approach

The term “flexicurity” stems originally from a Dutch law (Wet Flexibiliteit en Zekerheid dated 1999) that holds out the prospect of permanent employment to temporary agency workers after two years' work, and thus links employment security with flexible assignments of staff. However, the term has been extended to mean, more generally, labour market settings that provide security for more flexible employment relations. The extended concept implies a new combination of employment security provided at the firm level (through EPL and collective agreements) and protection provided through the social protection (SP) system in the form of unemployment insurance/assistance and active labour market policies. The flexicurity approach advocates a certain degree of rearrangement between EPL and SP so as to permit an optimal combination of labour market performance and workers' security but not at the expense of economic performance (see Auer, Berg, Coulibaly, 2005). However, there is no one-size-fits-all flexicurity model and different combinations of EPL and SP (also with different forms of SP, i.e. combinations of active and passive labour market policies), associated with national differences in tradition and culture but also with variations in the structure of national economies and other factors, might produce results acceptable for all the parties concerned.

Both employment protection and labour market policies are important in providing security for workers. However, in labour markets exposed to globalisation employment protection is often hard to maintain and lay-offs tend to occur frequently. Labour market policies then help to limit the negative effects of layoffs on individual incomes and hence on consumer spending and aggregate demand growth. Another fundamental role of labour market policies is that labour market transitions are better

¹ Croatia has been part of the second phase of the project and a study on the topic has been launched in the Former Yugoslav Republic of Macedonia.

protected, permitting mobility in the labour market. Workers should not feel locked into a poor-quality job for fear of alternatives that might be even worse, or feel that they must take the first job available because they are with poor, if any, social protection². Similarly, firms should not be burdened with high dismissal costs when they are themselves in difficulty and are having to adjust their workforce to changed market conditions. For example, a high lay-off cost in the form of several months' severance payments to a substantial number of workers might merely accelerate the firm's insolvency. However, non-payment of severance pay also means poverty and deprivation for workers and their families. In such cases, flexicurity settings offer a way out: for example collective severance pay funds financed through employers' contributions, or alternatively an unemployment protection system and/or active labour market policies co-financed by workers and employers and the state, mean that firms can adjust while workers remain protected.³ If job search and adaptation to new jobs is "activated", reallocation of workers is more efficient than under a "passive" severance pay regime. Thus, active labour market policies make mobility possible, since they encourage workers to take up new opportunities and allow firms to adjust at relatively low cost⁴.

An additional benefit of labour market policies is macro-economic. When joblessness increases during an economic downturn, it is not just the displaced workers who suffer but the economy in general as the result of the weakening of consumption. Thus an important benefit of labour market policies – unemployment insurance, in particular – is that it operates as a stabilising mechanism for the economy as well as providing for the needs of laid-off workers.

Recent policy debates have emphasised the importance of promoting active as opposed to passive labour market policies. For example, the European Employment Strategy dated 1997 has set out an "activation strategy" which requires a more active stance on the part of both public employment services and the unemployed regarding participation in job training and educational programmes. Activation strategies, while more costly, have the benefit of improving workers' skills, but are also effective in reducing the moral hazard effects associated with unemployment insurance.

Tripartite social dialogue is instrumental in designing and implementing effective flexibility-cum-security programmes. Unions are concerned about their members' employment security but will accept changes in protection at the firm level for adjustment purposes, if credible compensatory protection through the social protection system is provided. Employers are concerned about their increased adjustment needs, but will also accept better and more active social protection for those laid-off. The state in turn will provide a better and more effective social protection system, when this results in

² In Central and Eastern Europe countries, for example, many workers were hesitant to quit their jobs voluntarily, even in periods of economic recovery during the 90s; one hypothesis to explain this inefficient labour reallocation is the heightened perception of job insecurity that prevailed in the region after widespread deregulation policy (Cazes, Nesporova, 2001).

³ Such new forms of collectively-organised severance pay funds were recently established in such diverse countries as Austria and Columbia and exist also in Brazil.

⁴ However, a lay-off tax should be levied on firms, as firms might otherwise have an incentive to have recourse to lay-offs. (see Blanchard, 2005)

better adjustment and better reallocation of workers, and more security throughout the economy, also because of the macroeconomic effects that micro-agents might not be concerned with. Training is a case in point: negotiating the training needs of workers and firms, with the state providing efficient policies and institutions, could reduce the incentive problem inherent in specific training provided by firms, since, in the absence of negotiations and institutions, firms might be hesitant to train workers beyond what is strictly necessary, for fear that they might leave the firm or be poached by a competitor (Soskice, 1990). Social dialogue can also be used to enhance functional flexibility. Through constructive labour-management relationships, firms can more easily adopt technologies aimed at increasing productivity, since provision for union approval is then no longer an obstacle to implementing productivity and enhancing change. Flexibility that arises collectively, i.e., in consultation with workers, as opposed to unilaterally is better for productivity, since it adds legitimacy (Ozaki, 1999). Tripartism is also important for financing labour market policies, since it ensures that the costs of the policies are shared among workers, employers and the state.

Finally, an important ingredient for the success of a “flexicurity” system is the institutionalisation of the combination of labour market policies with income support through unemployment benefits/assistance. If we accept that structural changes and labour market adjustment have today become quasi-permanent, then the labour market and social protection systems should accompany them and provide appropriate support to workers adversely affected by these changes and thus contribute to the stabilisation of the economic and social situation on the one hand and to their perception of security on the other.

3. Recent labour market and employment developments

After the period of turbulence resulting from the effect of the transition crisis, common to all the former socialist countries, but combined for the ex-Yugoslav states with the break-up of the former production and trade links within Yugoslavia and the direct or indirect impact of the armed conflicts, the Western Balkan countries finally returned to economic growth in the mid-1990s. Economic recovery was relatively fast for all the countries, with a short-lived crisis in Albania in 1997 due to a collapse of the financial system. The only exception was Serbia and Montenegro, adversely affected by the economic embargo imposed by Europe and the US and by the Kosovo war.

Table 1 compares the economic performance of this sub-region with that of the ten EU accession countries, eight of which (EU8) became new EU member states on 1 May 2004. Except for Serbia and Montenegro, in terms of economic dynamics the Western Balkan countries compared favourably with Bulgaria and Romania, which continued to struggle with the adverse impact of inconsistent economic reforms. Extraordinary growth rates in Bosnia&Herzegovina reflected the emergence of the economy from the civil war. In general, economic performance accelerated further after 2000. Only FYRO Macedonia faced a slowdown in economic growth, caused by ethnic conflicts in 2001-02. Nevertheless, in 2004, out of all the Balkan countries only Albania

was able to exceed its 1989 GDP level (by 30%) and Romania finally reached that level while other Balkan countries still remained below the pre-transition level.

Table 1 GDP and employment trends, 1995-2004 (average annual growth rates in %)

Country/subregion	Real GDP annual (%)		Employment (LFS)	
	1995-99	2000-04	1995-99	2000-04
Albania	+ 5.3	+ 5.8	- 1.6	-2.7
Bosnia&Herzegovina	+ 22.9	+ 4.2	+ 30.2	-1.0
Croatia	+ 3.4	+ 4.1	+ 2.3	+ 0.7
FYRO Macedonia	+ 3.0	+ 1.3	- 2.7	- 3.9
Serbia&Montenegro*	+ 0.4	+ 4.9	- 1.2	- 0.9
EU8**	+ 4.1	+ 4.9	- 0.9	+ 0.2
Bulgaria	- 0.8	+ 4.9	- 1.9	+ 1.1
Romania	- 1.3	+ 5.3	- 0.4***	- 1.7

Source : UNECE database, authors' calculations.

* Since 1999 excluding Kosovo and Metohia.

** Non-weighted average of eight new EU member countries

*** 1996-1999

A comparison of GDP and employment growth rates reveals that this dynamic economic development was, however, jobless not only in the Western Balkans but also in the whole of Central and South Eastern Europe (CSEE). Only Croatia recorded a slight employment recovery after 1995, as did Bulgaria after 2001, albeit after having lost 25 and 30%, respectively, of their jobs after 1989. The transition crisis in the first half of the 1990s was in general accompanied by massive job destruction. Job destruction only slowed down in the subsequent period of economic boom, which was combined with restructuring, privatisation and further downsizing of large enterprises and was only partially compensated by job creation in new, mostly small, enterprises. Job losses and depressed demand for new labour resulted in a dramatic decline in labour market participation, on the one hand, and a sharp increase in open unemployment on the other.

Table 2 illustrates that, unlike the new EU member and candidate countries, the Western Balkans is particularly troubled by high unemployment, which has increased further since 2000, despite robust economic growth, and reveals a particular weakness of

Table 2. Unemployment trends, 1997 – 2004 (% of unemployment in total labour force, Labour Force Survey data if not otherwise stated)

Country	Unemployment rates		
	1997	2000	2004
Albania (Regist.)	14.9	16.9	14.4
Bosnia&Herzegovina (Regist.)	39.0	39.4	44.9
Croatia	17.6	16.1	13.6
FYRO Macedonia	36.0	32.2	37.2
Serbia&Montenegro (Regist.)	25.6	26.6	27.5
EU8*	9.9	12.3	11.2
Bulgaria	14.4	16.7	11.7
Romania	5.3	6.8	7.6

Source: UNECE, ILO LABORSTA.

* Unweighted average.

their labour markets. Most of their unemployment rates are in double figures, but climb to over one-fourth of the whole labour force in the case of Serbia and Montenegro, over one-third in Macedonia and almost one-half in Bosnia&Herzegovina!

Youth unemployment rates are – as in most countries of the world – twice as high as the rates for the adult population or even higher, pointing to an additional very serious labour market challenge facing all these countries. Furthermore, long-term unemployment (joblessness for more than one year) has reached alarming levels – 64.8% of total LFS unemployment in Macedonia in 2004, 82% in Serbia and Montenegro and 76% in Bosnia&Herzegovina (both these latter figures are for 2000).

Another important characteristic of the Western Balkan labour markets is the high degree of informal employment, only partly reflected in LFS employment figures so that actual economic activity of the population is higher than shown in the labour statistics. Statistics regarding the size of informal employment are naturally scarce. In 1999, the Macedonian LFS included a special bloc on informal sector employment, which put the level of informal employment at 28% of total employment. However, some other sources estimate that informal employment can even reach 60% of formal employment in this country (see Novkovska, 2006). In Croatia, the level of employment in the informal sector has been estimated at 11.8% in 2002 (see Crnkovic-Pozaic, 2005). Even though informal employment may improve the labour market situation in quantitative terms and provide households with additional income, it is above all a precarious form of employment with no protection of informal workers against any labour-related risks and with no employment and income security. This labour market segment is thus fully flexible.

However, even formal employment has become more flexible owing to an increase in flexible, irregular forms of employment. For one of these forms – self-employment – Cazes and Nesporova (2006) show that in the new EU member and candidate countries self-employment increased sharply in the first years of the transition period but then stabilised as economies recovered. The acceleration of economic growth after 2000 has led in most countries to a decline in the proportion of own-account workers in total employment. Nevertheless, the share of self-employment is on average higher than in EU15 (19% versus 14.9% in 2004). Macedonia followed a similar development, as the share of self-employment declined from 13% in 1997 to 5.9% of total employment in 2004. In Croatia, the proportion of own-account workers remained stable – 22.9% in 1997 and 22.6% in 2003. It seems that the high hopes that self-employment would become very attractive for workers in line with the country's transition to a market economy and would absorb increasing numbers of persons leaving wage employment have not materialised. Many workers took up self-employment because of a lack of dependent jobs and once the economy has recovered and new jobs have been created many own-account workers give up their small businesses. Moreover, many of them are actually forced to close their shops, restaurants and family boarding-houses in response to severe competition from international retail, catering and hotel chains.

Quite frequently, self-employment hides regular employment relations between employers and workers because employers force workers to accept civil contracts, which permit them to avoid the payment of social contributions, insurance against occupational accidents, etc. There have been serious efforts by at least some CSEE governments to reduce this misuse of civil contracts,⁵ and this could also contribute to an overall decline in self-employment figures.

Data on temporary employment (fixed-term contracts) show, following the stagnation of its share in total employment over the 1990s, its growing incidence since the end of the 1990s in the majority of the new EU member and candidate countries. This seems also to be the case for the Western Balkan countries. In Macedonia, for example, the proportion of fixed-term contracts rose from 13.6% in 1998 to 18.1% in 2003. Moreover, their share has particularly increased among newly concluded contracts, much more than their share in all contracts, while at the same time their duration is shorter (for example, in Croatia over half the new contracts were signed for periods of less than 6 months in 2002 compared with less than one-quarter five years earlier - see Crnkovic-Pozaic, 2004). These trends reveal increasing labour market segmentation, in which a certain group of workers (usually young people and lower skilled persons) are confined to this type of precarious high-turnover job while the majority of workers (albeit a declining proportion) enjoy jobs without limit of time that are thus more stable and secure. Interestingly, the use of fixed-term contracts has stagnated in the EU15 since 2000 while the overall tendency in Central and South-Eastern Europe is towards higher temporary employment, although their share in total employment is still lower in the latter group of countries (only Slovenia, Poland and Macedonia have higher shares, while Croatia with 12.2% is close to the EU15 average of 13.6% – both figures are for 2004).

Another flexible form of employment – part-time employment – is much less frequent in Central and South-Eastern Europe than in the EU15, where it averaged 19.4% of total employment in 2004. For example, in Macedonia this share was 5.3% and in Croatia 8.5% in 2004. The main reason for the low incidence of part-time employment is the lack of interest on the part of both employers and employees. Employers claim that, due to high labour taxation and other fixed labour costs, part-time employment (allowing, among other things, job sharing) is not profitable for them and is not viewed favourably by customers. Workers maintain that rising living costs mean that they cannot afford shorter working hours and the wage losses entailed. A low birth rate, on the one hand, and availability of long maternity and parental benefits against a background of relatively expensive childcare facilities, also contribute to low part-time employment, as women (only very rarely men) prefer to stay longer with their children at home instead of combining an early return to work with shorter working hours.

⁵ Recently, the Hungarian Government has introduced new rules on the use of independent contractors and on so called “labour loan” arrangements (workers are lent by one company to perform work for another company) as of 1 January 2006. Among other things, these rules explicitly define the differences between regular contracts and independent/civil contracts, which can be concluded only for the provision of one precise product or service. Breaking the labour law can result in a fine of up to HUF 20 million. *Industrial Relations*, Vol. XXXIV, No. 406, Issue 2/2006.

All this analysis confirms that there is indeed a tendency towards flexibilisation of employment in Central and South-Eastern Europe, but that it has not as yet contributed to any substantial improvement in employment performance in the sub-region, despite the increasing precariousness of employment.

4. Is employment protection legislation in the Western Balkans too strict?

One important aspect of economic and social reforms undertaken in the course of the transition of CEE centrally planned economies to a market system was to modify their national legislations so as to reflect new labour market realities. The objective of these far-reaching modifications was to enable enterprises to terminate employment for economic reasons, including financial problems, bankruptcy, and complete or partial liquidation of the enterprise, but at the same time to protect workers against unjustified termination, give them time to look for a new job during the notice period and compensate them for harshness in the form of severance pay. Also, the possibility of temporary employment was extended to make it possible for employers to recruit workers only for a fixed period and at the same time to prevent any misuse of temporary contracts. Finally, in view of the adverse social consequences of large-scale corporate restructuring, many countries introduced special rules for collective dismissals, in order to limit massive redundancies and give special protection to workers hit by such an event. Modifications to employment protection legislation (EPL) were clearly inspired by labour legislation reforms in economically advanced countries and especially the EU15 countries.

When unemployment worsened in the sub-region, some economists started to blame over-restrictive employment protection legislation as one of the main reasons for its depth and persistence. According to them, strict EPL is blocking new recruitment, especially for jobs based on indefinite contracts, because termination of such jobs has become too costly for employers. The situation is further aggravated if regulation of temporary contracts is so strict that such contracts can only be issued exceptionally or that repeated renewal is not allowed.

To confirm or reject this statement by empirical evidence, EPL strictness indexes have been developed by the OECD (Employment Outlook, OECD, 1999). These indexes cover both permanent and temporary contracts, as well as collective dismissals, and look at a range of detailed information, such as procedural inconveniences, notice and severance pay, etc. They quantify their strictness directly (e.g. the length of notice period or severance pay measured in the number of months) or indirectly, converting them into a scale of cardinal numbers ranging from 0 (no restriction) to a maximum figure of 6 (full restriction). The summary EPL strictness index aggregates the indices for permanent contracts, temporary contracts and collective dismissals, attributing to them the weights of 5/12, 5/12 and 2/12 respectively. The value of all three partial indices as well as of the summary EPL index ranges from 0 – indicating very liberal EPL – to 6 – meaning very

restrictive EPL (a schematic table of the EPL calculation described here is presented in Annex 1).

Table 3 provides EPL indices for seven new EU member countries (only Latvia is missing), Bulgaria, Romania and the five Western Balkan countries, mostly for 2003, compared with the OECD average in the late 1990s.

Table 3. EPL strictness indices for the Western Balkan countries, new EU members, Bulgaria, Romania, EU15 and OECD countries*

Country	Year	Index for contracts without limit of time	Index for temporary contracts	Index for collective dismissals	EPL summary index
Albania	1995	2.1	3.0	2.8	2.6
Bosnia&Herzegovina	2003	1.8	3.1	3.3	2.6
Croatia	2003	2.7	2.8	2.5	2.7
FYRO Macedonia	2003	2.0	3.1	4.0	2.8
Serbia&Montenegro	2001	2.2	3.1	3.8	2.9
Bulgaria	2003	2.1	0.9	4.1	2.0
Romania	2003	1.7	3.0	4.8	2.8
Western Balkans average	See above	2.2	3.0	3.3	2.7
EU7 average	2003	2.6	1.2	3.3	2.1
EU15 average	Late 1990s	2.4	2.0	3.4	2.4
OECD average	Late 1990s	2.0	1.8	2.5	2.0

* All the indices range from 0 indicating very liberal regulation to 6 meaning very restrictive regulation of the respective parts of EPL.

Sources: Calculations based on national Labour Codes for Albania, Bosnia&Herzegovina, FYROM and Serbia&Montenegro made by Micevska (2004), and for all other countries see Cazes, Nesporova (2006).

Table 3 shows, first of all, that the Western Balkan countries have on average more rigid EPL than all the other country groupings but the differences are rather minor. It also reveals that the new EU member countries have on average more liberal legislation than the “old” Europe and are now very close to the OECD average. This conclusion shows that national labour legislations in the former socialist countries, which used to have very protective legislation under the old regime, have indeed developed in the direction of reducing workers’ protection against employment termination and allowing employers more labour input adjustment. Importantly, the tendency towards deregulation concerns, in particular, contracts without limit of time and this is also the aspect where cross-country differences are smallest.

By contrast, regulation of temporary contracts is significantly more restrictive for the Western Balkan countries than the EU15 and OECD averages. However, the most marked difference is in relation to the new EU member countries, which have the most liberal legislation concerning the use and termination of temporary contracts of all these country groupings. This may be a logical consequence of generally weaker enforcement of labour legislation in these countries so that the decision-makers may have opted for greater adherence of employers to more liberal regulation rather than more restrictive

legislation accompanied by massive evasion. This alternative could also be preferable for the Western Balkan countries, as it would support their gradual return towards more respect for the rule of law.

Regulation of collective dismissals is on average rather high, as mass redundancies may indeed have a serious negative impact on local labour markets in the event of restructuring of large enterprises – major employers in the community. This is compatible with the principles of the European Social Model and in all probability the regulation of collective dismissals, combined with the requirement of intensive assistance to redundant workers, will not diminish in the near future. Owing to its high political visibility, this aspect of the legislation also seems to be better enforced than the parts concerning individual contracts.

To sum up, employment protection legislation has been significantly liberalised in the former socialist countries of Europe over the last fifteen years so that they are now on a par with OECD countries. Nevertheless, the Western Balkan countries remain more restrictive regarding termination of individual contracts than other countries; this concerns predominantly temporary contracts and may lead to non-observance of legislation instead of better protection of workers against precarious contracts. In such cases, it could act against the objectives of the EU accession process, which stimulates the countries to adopt and enforce the *acquis communautaire* in their legislation. It would therefore be advisable to revise this part of the legislation.

5. Impact of labour market institutions and policies on labour market developments

This section discusses the operation of various labour market institutions in Central and South Eastern Europe and their possible effects on employment performance. By “labour market institutions” we mean those institutions and policies that are designed to intervene in the labour market in order to improve the match between labour demand and labour supply, protect employment in current jobs, move workers to new jobs, encourage transition of persons between different employment statuses, and help restore equality and equity for diverse social groups in the labour market. They include employment protection legislation, active labour market policies, unemployment benefit schemes, taxes on labour and collective bargaining. We go on to discuss the findings of a regression analysis estimating the impacts of labour market institutions on key labour market indicators. Owing to a lack of consistent and comprehensive information on labour market institutions in the Western Balkan countries, we base our analysis on evidence gathered for countries of Central and South Eastern Europe and argue that our main findings should be relevant also for the Western Balkans because of similar experience with the transition process.

Current state of labour market institutions and policies in Central and South-Eastern Europe and Western Balkans countries

Central and South Eastern European countries modified their labour market institutions and policies substantially during the transition process in order to respond to emerging and mounting employment challenges. In view of their impending accession to the European Union, they designed them in line with the experience of the EU countries. This process accelerated as the date of the EU entry approached. Table 4 summarises the main parameters of labour market institutions and policies in the selected CSEE and Western Balkans countries in 2003 (as EPL was presented in the previous chapter we omit information on this aspect here).

Table 4. Main characteristics of labour market institutions and policies (2003)

Country	Unemployment benefit as % of average wage	Share of registered unemployed receiving benefits	Total expenditure on labour market policies as % of GDP	Of which on active measures	Payroll tax as % of wages contributed by employers and workers	Trade union density as % of TU members among all workers
Albania	18	7	n.a.	0.028	41.9	22
Fed of BiH	40	1.7	n.a.	n.a.	47.3	68
Rep. Srpska	26	2	n.a.	n.a.	52	66
Bulgaria	33	20	0.97	0.67	42.7	25
Croatia	25	22	0.55	0.06	37.2	42.5
Czech Rep.	22	34	0.44	0.17	35.2	30
Estonia	7	50	0.30	0.08	35.0	15
FYROM	50	12	n.a.	0.09	32.0	45
Hungary	26	34	0.88	0.51	36.8	25
Latvia	21	44	0.64	0.14	28.6	19
Lithuania	16	11	0.28	0.16	46.0	14
Poland	22	19	1.25	0.11	38.1	18
Serbia	60	9.6	n.a.	0.12	20.9	41
Slovakia	26	17	0.96	0.47	36.2	35
Slovenia	39	24	1.00	0.44	38.0	42

Sources: National sources; World Bank; UNECE (2003); OCDE (2003); Freedom House (2001), data for the Federation of BiH are for 2005, Employment Service; data for RS are for 2005, Employment service. (payroll tax: on the basis of the net wage for FBiH).

Table 4 shows significant differences among the countries with regard to the parameters of the unemployment benefit schemes (unemployment benefit replacement rates and shares of benefit recipients among jobseekers), expenditure on labour market policies and its distribution between active and passive policies, labour taxation and trade union coverage. These variations are only weakly correlated with the unemployment levels of these countries, which points to an uneven attention of the decision makers to employment challenges and their frequent lack of trust in their effective solution by labour market institutions and policies. It also shows that the trade unions are rather

weak in many of these countries so that social dialogue may not help much in addressing high unemployment.

However, some important characteristics are shared by the CEE countries and the Western Balkans and may distinguish them from other EU and OECD countries. First of all, the unemployment insurance schemes are not generous in terms of the benefit replacement rates (the proportion of average unemployment benefits to the average wage), which do not even reach 40% of the average national wage in any of these countries. Also, the share of unemployment benefit recipients among all jobseekers, i.e. not only those covered by unemployment registers, is very low.⁶ Coverage rates for unemployment insurance benefits were, for example, around 10% or less in the early 2000s in Albania, Bosnia and Herzegovina and FYRO Macedonia, and have even declined recently. Second, the funds devoted to labour market policies as a percentage of GDP are very limited. Moreover, in the majority of the CSEE countries, but in particular in those with high unemployment, the share of these funds spent on active labour market programmes is also low, since passive labour market policies, which are considered as entitlements required by law, absorb most of the available resources. The tax burden on labour is very high and employers and economists miss no opportunity to blame it for depressed labour demand and low new-job creation. Despite recent reductions in payroll taxes in a number of these countries, their levels compare unfavourably with most other EU and OECD countries.

It can therefore be concluded that increased flexibilisation of labour markets in the CSEE and Western Balkans countries has not been sufficiently compensated by stronger protection of workers affected by redundancy through better assistance in re-employment provided by public employment services, broader access to active labour market programmes or decent income support in unemployment, despite high taxes on labour, which may work against new recruitments and raise the level and duration of unemployment.

Impact of labour market institutions on labour market performance

Multivariate regressions have been used to assess the impact of employment protection legislation, parameters of unemployment benefit schemes, active labour market policies, labour taxation and social dialogue on unemployment, employment and labour force participation. This analysis was first undertaken for the end of the 1990s.⁷ Since it was statistically not possible to conduct a multivariate analysis on a sample of 8

⁶ The difference between the numbers of registered unemployed persons and those identified as unemployed by labour force surveys is small in countries like the Czech Republic, Hungary, Poland and Slovakia but very high in Croatia and Slovenia (where registered unemployment exceeds LFS unemployment) as well as Estonia, Latvia or Lithuania (where LFS unemployment is much higher than registered unemployment).

⁷ A detailed description of the model, its estimates and results is given in Cazes and Nesporova (2003).

CEE countries, we made and tested⁸ the hypothesis of no differential impact of the labour market institutions and policies on the labour market indicators of the OECD countries and the CEE countries.⁹

The results for the end of the 1990s confirm that labour market institutions and policies do have an impact on labour market performance in the selected countries. All the five key labour market indicators were significantly affected by active labour market policies and collective bargaining: aggregate unemployment, youth unemployment and long-term unemployment declined and employment and labour market participation increased with higher expenditure on active labour market policies and higher collective bargaining coverage (two other social dialogue indicators were not significant). In addition, all three unemployment indicators tended to increase with higher labour taxation, whereas this factor had no impact on employment and labour market participation. Parameters of the unemployment benefit schemes were insignificant for all the dependent variables.

Also, it was found that the strictness of employment protection legislation had no statistically significant impact on unemployment (aggregate, youth and long-term unemployment). However, EPL was significantly correlated with employment and labour force participation, but with opposite signs for the OECD countries, on the one hand, and the CEE countries, on the other: while in the first case stricter employment protection was negatively correlated with employment and labour force participation, in the CEE sub-region the correlation was positive, suggesting that more protection could increase labour force participation rates. The explanation should be sought in the widespread non-observance of labour legislation as well as in the large informal sector in the latter countries, features that tend to drive workers away from formal employment. If employment protection legislation is stricter or better enforced, employers have to observe the rules and offer workers regular labour contracts rather than irregular or no contracts so that employment and participation rates increase and informal employment declines.

Since the end of the 1990s, labour market institutions in the CSEE countries have matured as a result of, among other things, the completion of legislative changes required for the accession of the first eight countries to the EU and the advanced stage of adjustment in the EU candidate countries. In order to test whether these developments affected our previous findings, we ran the same regressions for the year 2003. The estimates are not fully comparable, however, as the CEE countries' sample differs

⁸ The Chow test permitted comparison of the stability of the regression coefficients and to reveal whether there were any differences in the impact of labour market institutions as between the OECD and the CEE countries

⁹ The regression was first run for a group of 19 OECD countries (this OECD group covered only its old members, i.e. without South Korea, Mexico, Czech Republic, Slovakia, Poland and Hungary) and 8 CEE countries (Bulgaria, Czech Republic, Estonia, Hungary, Poland, Russian Federation, Slovakia and Slovenia).

slightly from that used for our previous analysis ¹⁰. Despite that, they are capable of revealing any important modifications that may have occurred in development trends in the CEE country group.¹¹

The main result of our more recent econometric exercise is that five years later, in 2003, the new EU member and candidate countries no longer differ from the OECD countries as to the overall effects of labour market institutions on labour market participation, employment and unemployment developments. Employment protection legislation still has no significant impact on unemployment levels. Nor does it any longer affect labour market participation and employment levels. The diversity between the two groups of countries with regard to the impact of EPL on economic activity and employment trends identified in the late 1990s has completely disappeared. Active labour market policies have strengthened their positive effect on reducing unemployment and promoting employment and labour market participation. High payroll taxes are found to have a negative (but smaller) effect not only on unemployment as before but also on employment and labour force participation.

Unlike in previous estimations, social dialogue has lost its significance in promoting employment and labour force participation and alleviating unemployment. The only effect found was a negative correlation between the “union density” variable, one aspect of the collective bargaining, and youth unemployment; this result could reflect the fact that strong protection of core workers (to preserve jobs) may be at the expense of young, inexperienced workers (last in-first out), and thus contribute to higher youth unemployment.

Another interesting finding is the effect of the duration of payment of unemployment benefit variable, which tends to increase both youth and long-term unemployment and reduce both employment and labour force participation, but does not affect aggregate unemployment. This rather surprising outcome may be driven mostly by the OECD countries, as the benefit system is much less generous in the new EU countries. It may also indicate that in the situation of low overall labour demand that characterises the CEE countries, particular difficulties regarding job search and very poor quality of available jobs induce less competitive people to stay on unemployment benefits as long as possible. Many of these people may also accept informal employment in order to supplement their low unemployment benefits. This results in higher youth and long-term unemployment and lower employment but also contributes to lower labour market participation, as these people are actually discouraged jobseekers and some are even informally employed without disclosing it to LFS interviewers so that they figure as inactive according to the ILO definition.

¹⁰ While the sample of the OECD countries has not changed, the CEE countries’ sample includes only the new EU member and candidate countries, which are 10 in all (Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia).

¹¹ New estimates of the model and a detailed analysis of the results can be found in Cazes and Nesporova (2006).

6. Concluding remarks

The analysis of labour market developments in the Western Balkans reveals serious employment challenges facing these countries: jobless economic growth, despite solid GDP growth rates, low formal employment combined with relatively extensive informal employment, and very high and persistent unemployment. Employment relationships have also become much more flexible, as the share of time-bound contracts has significantly increased and many workers have been forced to accept civil contracts or work without any contract at all. In contrast, part-time employment has remained very limited and self-employment, after a steep initial rise, seems to have declined in this period of economic boom in most of the countries.

These labour market and employment changes, combined with greater movement of workers between jobs and between different labour market statuses, seem to be a logical consequence of the process of globalisation, technological change and transition of the economy to a market system. The national enterprise sector has to adjust to the new market conditions and restore competitiveness through enterprise restructuring, closures, mergers and emergence of new firms, and this brings along with it massive job destruction but also new job creation. This is the reason why employers, backed by some macroeconomists, have asked that labour market regulation be made more liberal, in particular regulation of employment termination and use of temporary contracts, on the grounds of the negative impact of rigid legislation on labour demand and high unemployment. For workers, however, this has meant reduced protection against loss of jobs and income and has thus called for new forms of security outside the enterprise, through public employment services and social protection schemes.

Our analysis has found that employment protection legislation in the Western Balkans, although slightly more rigid than in the CEE countries, has been liberalised to a considerable extent. At the same time, employment, employability and income protection through employment services and labour market policies have remained poor in this subregion, despite rather high payroll taxes. We cite the evidence from the CEE countries to argue that EPL alone cannot be blamed for poor labour market performances and that generally weak protection may have a negative impact on labour reallocation and productivity in increasing workers' perception of insecurity. In contrast, more extensive use of active labour market policies has a significant and positive impact on economic activity and employment levels and reduces unemployment, while long-term reliance on unemployment benefits may have negative effects on all these labour market indicators. These findings imply that the countries should use active labour market programmes more extensively and urge unemployed persons to undertake more intensive job search and/or participation in these programmes in order to speed up their new (re-) employment. However, these programmes are effective in improving employability and promoting employment of jobseekers only when they are well designed and targeted, which requires good supervision by the parties concerned, i.e. governments and the social partners.

All this emphasises the importance of the flexicurity approach. Increasingly, there is a recognition of the need to find the right combination of adjustment flexibility for enterprises, as it is they who create new productive jobs, and employment and income security for workers, to support their motivation to engage in productive work and if necessary, to move to new jobs, improve their skills through training and/or participate in other employment promotion activities. However, this balance may be different for different countries. Therefore, only engagement of the three partners – the government and the representatives of employers and workers – in a true social dialogue can lead to the identification and implementation of appropriate policy options, acceptable to all sides and financially affordable, for restoring the optimum combination of flexibility and security.

Annex 1. Employment Protection Index: Selection of indicators and weighting scheme

Level 1			Level 2		Level 3	Level 4
Procedures		(1/2)	RC1		RC <u>Regular contracts</u> (5/12)	EPL Overall Summary Indicator
Delay to start a notice		(1/2)	Procedural Inconveniences	(1/3)		
Notice period after	9 months	(1/7)	RC2 Notice and severance pay for no-fault individual dismissals	(1/3)		
	4 years	(1/7)				
	20 years	(1/7)				
Severance pay after	9 months	(4/21)				
	4 years	(4/21)				
	20 years	(4/21)				
Definition of unfair dismissal		(1/4)	RC3			
trial period		(1/4)	Difficulty of dismissal	(1/3)		
compensation		(1/4)				
reinstatement		(1/4)				
valid cases other than objective		(1/2)	TC1		TC <u>Temporary contracts</u> (5/12)	
max number of successive contracts		(1/4)	Fixed-term contracts	(1/2)		
max cumulated duration		(1/4)				
types of work for which is legal		(1/2)	TC2			
restrictions on number of renewal		(1/4)	Temporary Work Agency	(1/2)		
max cumulated duration		(1/4)				
definition of collective dismissal		(1/4)	<u>CD Collective Dismissals (2/12)</u>			
additional notification requirements		(1/4)				
additional delays involved		(1/4)				
other special costs to employers		(1/4)				