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GLOBAL JOBS PACT

Working Paper

Supporting Strategies to Recover from the Crisis in CROATIA, the former Yugoslav Republic of MACEDONIA and SERBIA

CROSS-COUNTRY REPORT

Valli CORBANESE

Global Jobs Pact

DECENT WORK TECHNICAL SUPPORT TEAM AND COUNTRY OFFICE FOR CENTRAL AND EASTERN EUROPE

Supporting Strategies to Recover from the Crisis in Croatia, the former Yugoslav Republic of Macedonia and Serbia

Cross-Country Report

Valli Corbanese

Decent Work Technical Support Team and Country Office for Central and Eastern Europe

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Acronyms

ALMP	Active Labour Market Policy
CBS	Croatian Bureau of Statistics
CES	Croatian Employment Service
CIT	Corporate Income Tax
CNB	Croatian National Bank
ERP	Economic Recovery Plan
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HRK	Croatian Kuna
ILO	International Labour Office
LFS	Labour Force Survey
NBRM	National Bank of the former Yugoslav Republic of Macedonia
MKD	Macedonian denar
NEA	National Employment Agency (the former Yugoslav Republic of Macedonia)
NES	National Employment Service of Serbia
PCL	Precautionary Credit Line
PIT	Personal Income Tax
RSD	Serbian dinar
RSO	Republic Statistical Office of Serbia
SBA	Stand-By Arrangement
VAT	Value Added Tax

Foreword

The slowdown of world output triggered by the financial crisis of 2008 spilled over to the economies of South Eastern Europe through a number of transmission channels. Export growth decelerated sharply as a result of the recession in Western Europe and a decrease in domestic aggregate demand. Lending flows and foreign direct investment weakened and detrimentally affected those countries with large external deficits. A fall in remittances affected Gross Domestic Product (GDP) growth in countries where these played an important role in household consumption patterns. Many countries experienced rapid output declines, job losses, worsening conditions of work and mounting poverty rates. In some instances, pre-existing economic and fiscal vulnerabilities limited the policy space for large-scale anti-crisis packages. In short, the economic crisis threatened to endanger the gains in human development, stability and economic progress recorded by countries in the region over the last ten years.

At the International Labour Conference of June 2009, representatives of governments and employers' and workers' organizations adopted the *Global Jobs Pact* as a global policy instrument which places employment and social protection at the centre of crisis response. It is based on the ILO's Decent Work Agenda and the commitments made by the ILO constituents in the 2008 *Declaration on Social Justice for Fair Globalization.* The Global Jobs Pact addresses the social and economic impacts of the international economic crisis and proposes a portfolio of policies aimed at stimulating job creation, extending social protection, respecting international labour standards and promoting social dialogue for countries to adapt according to their national circumstances.

Against this backdrop, the ILO's Decent Work Technical Support Team and Country Office for Central and Eastern Europe (DWT/CO-Budapest) researched the impact of the crisis and the policy responses introduced by three countries in South Eastern Europe, namely Croatia, the former Yugoslav Republic of Macedonia and Serbia, to help constituents better understand the country-specific challenges brought about by the crisis, assist in the development of strategies to stimulate labour demand, expand social protection, and strengthen social dialogue and rights at work. The three national reports were presented during a cross country peer review workshop held in Zagreb on 21 April 2011. The meeting offered a platform for the ILO constituents of Croatia, the former Yugoslav Republic of Macedonia and Serbia to share knowledge on emerging challenges and policy responses with representatives of the government, employers' and workers' organizations of the Republic of Slovenia.

This cross-country report was prepared by Ms Vallì Corbanese and undertaken as part of the DWT/CO technical assistance package *Supporting strategies to recover from the crisis in South Eastern Europe* coordinated by Ms Natalia Popova, Employment Specialist of the DWT/CO. Using the *Global Jobs Pact* as an integrated framework for analysis and on the basis of the information stemming from the national reports as well as the feedback of peer countries, this study explores the main economic and labour markets developments in the three target countries during the economic downturn, reviews the responses undertaken by the respective governments and proposes some policy options to ensure that more and better jobs are created during economic recovery.

Mark Levin

Director
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Country Office for Central and Eastern Europe

Executive Summary

The positive economic performance witnessed by Croatia, the former Yugoslav Republic of Macedonia and Serbia before the onset of the global economic and financial crisis was characterized by very low – and even negative – job creation. During the transition to a market economy, the three countries experienced severe de-industrialization, stagnating or increasing employment in agriculture, coupled with rising employment in the service sector. Low employment and activity rates were mainly the consequence of insufficient demand for labour, mismatches in labour supply and demand, as well as low labour force participation rates of young people, women and elderly workers.

The spread of the crisis to the economies of Croatia, Serbia and the former Yugoslav Republic of Macedonia occurred at different times and to different degrees. The Serbian economy was the first to be affected, with negative output growth recorded as early as the second quarter of 2008. Croatia followed with decelerations of Gross Domestic Product (GDP) growth in the last two quarters of the same year. In the former Yugoslav Republic of Macedonia, GDP growth decelerated in the last quarter of 2008 and turned negative at the beginning of 2009. The crisis gathered pace in 2009, driven by a fall in consumption, domestic investment, foreign capital inflows and exports. Output declined by 5.9 percent in Croatia, 3 per cent in Serbia and 0.9 per cent in the former Yugoslav Republic of Macedonia.

In Serbia the impact of the economic downturn on employment was rapid and severe. Employment-to-population ratios started to decline as early as the end of 2008. Total employment reached its bottom value at the end of 2010, with a drop in the employment-to-population ratio of 21 percentage points compared to 2004. The unemployment rate soared to 20 per cent of the labour force, up from 14.8 per cent in 2008. The labour market figures also point to high flows from activity to inactivity, especially for women, young people and elderly workers.

In Croatia, employment initially fell at a slower pace than output, but as the crisis progressed, the drop drew close to GDP decline, driven by decreasing employment rates for men. The crisis swept away the progress made by Croatia in job creation since 2005, in particular the advances made in reducing youth unemployment. The employment-to-population ratio decreased from 57.8 per cent in 2008 to 54 per cent in 2010. Labour force participation rates also decreased (by 1.7 percentage points), partly as a result of the worker discouragement effect. Unemployment rose, with the unemployment rate increasing from 8.6 per cent in 2008 to 12.1 per cent in 2010. The youth (15 to 24 years old) unemployment rate increased from 21.9 per cent in 2008 to 32.5 per cent in 2010. Informal employment in both Serbia and Croatia dropped more quickly than formal employment, due to the pronounced duality of labour markets, where informal workers, employees on fixed-term contracts and workers in the traditional services sector are the most vulnerable and the first to lose their jobs during a downturn.

The loss of output recorded in 2009 does not appear to have affected the former Yugoslav Republic of Macedonia's labour market. In the period 2008–2010, employment continued to grow (from 41.9 per cent to 43.5 per cent) and the unemployment rate decreased (from 34 per cent to 32.2 per cent). However, youth employment dropped slightly (from 15.7 per cent in 2008 to 15.4 per cent in 2010), but the youth unemployment rate continued to decrease (from 56.4 per cent in 2008 to 53.7 per cent in 2010). The country's relatively good performance can be attributed, in part, to firstly, lower external imbalances that limited the loss of output, secondly, the structural reforms implemented prior to the crisis, and thirdly, an increase in employment in the public sector.

The monetary authorities of the three countries reacted to the crisis in a similar manner. The central banks intervened by relaxing reserve requirements, thus injecting liquidity into the market. Central banks also intervened to stabilize the exchange rate. The scope of these measures, however, was dictated by the prevailing exchange rate regime (pegs or near pegs in Croatia and the former Yugoslav Republic of Macedonia, and managed floats in Serbia).

The decline of public revenues and low prospects for realizing privatization proceeds reduced the scope for financing the fiscal deficit in Croatia and Serbia, while tight international financial markets made foreign borrowing more difficult. Public finances came quickly under pressure, with decreasing revenues and higher spending on automatic stabilizers. In both Croatia and Serbia, fiscal policy options were limited given the expansionary, and therefore pro-cyclical, stance adopted in the years prior to the crisis, and the already high level of taxation.

In Croatia, anti-crisis policies were shaped by the efforts to lower the budget deficit. To protect public finances the government introduced new taxes and increased existing ones. Overall, through a combination of expenditure reduction (equal to 2.1. per cent of GDP) and revenue increase (amounting to 0.4 per cent of GDP), the government managed to keep the deficit at around 4 per cent of GDP (3.3. per cent in 2009 and 4.7 per cent in 2010). The government introduced a special tax on salaries, pensions and other incomes in 2009 ("crisis tax") that was discontinued at the end of 2010 and increased the VAT rate by one percentage point. Public expenditures on unemployment and social assistance benefits increased, but low coverage and inaccurate targeting mechanisms limited their effectiveness as automatic stabilizers. Active labour market policies were restructured, mainly into training and public works schemes, to respond to the needs of the groups most likely to be more affected by the crisis (youth, long-term unemployed and low skilled workers). Funding, however, decreased as a result of fiscal consolidation efforts. In early 2010 the government unveiled its Economic Recovery Plan (ERP) aimed at enhancing liquidity, supporting enterprises as well as improving the efficiency of social and labour policies. The ERP introduced expenditure-led fiscal consolidation and reforms of the social sector, state aid and the public administration system. The Plan included: i) the reform of the public sector wage system; ii) a master plan for social welfare (mandatory mean-testing, improved targeting, consolidated system administration, activation mechanisms, strengthened community-based services); iii) improvements to the investment climate (increased labour market flexibility and incentives to labour force participation, removal of administrative barriers for private sector growth, faster privatization of non-strategic enterprises and strengthening of the research and innovation framework).

The policy responses adopted by the Serbian government were primarily focussed on efforts to stabilize the economy and put it back on a growth path. Supported by a €3 billion Stand-By-Arrangement, the government introduced a set of measures to guarantee liquidity and promote commercial credit to enterprises and households. The package also included cuts to public expenditures − freezing of public sector salaries and pensions, lower discretionary spending levels and shelving of large infrastructure investments – and tax increases (excise duties and tax on cellular phone calls). Despite these fiscal adjustment efforts, the budget deficit increased to 4.2 per cent in 2009 and 4. 8 per cent in 2010, up from 2.6 per cent in 2008. Spending on active labour market programmes increased, but funds were streamlined into only two measures: (*First Chance Programme* and public works), largely at the expense of labour market training and job subsidy programmes. Public expenditure on social protection measures, namely the unemployment and social assistance benefits, increased more as a result of long-planned reforms rather than through their operation as automatic stabilizers.

In the former Yugoslav Republic of Macedonia, the government responded to the crisis with an expansionary fiscal strategy and a tight monetary policy to protect the exchange rate. As a result of increased public spending the budget deficit increased from 1 per cent in 2008 to 2.5 per cent in both 2009 and 2010. The government introduced measures to support enterprises: – (lower tariffs, social contributions rates and profit taxes); – it approved a large infrastructure investment plan; – it established a Fund for agricultural land (to be distributed to eligible unemployed) and, finally, – it enacted a freeze in public sector wages. No specific labour market intervention was undertaken, besides the up-scaling of public works. Enterprises benefited from the reforms of the taxation and business regulatory framework implemented prior to the crisis, which appear to have cushioned employment from the fall of output.

The first quarter of 2011 showed signs of economy recovery in both the former Yugoslav Republic of Macedonia (5.1 per cent GDP increase) and Serbia (3.4 per cent increase), while growth continued to be negative in Croatia (–0.8 per cent). In the former Yugoslav Republic of Macedonia, employment continued to increase (by 0.8 percentage points) and unemployment to decrease (by 0.8 percentage points). In Croatia and Serbia, on the other hand, the job crisis continued also in the first quarter of 2011. In Croatia employment fell by an additional 1.6 percentage points, while the unemployment rate increased to 14.7 per cent (from 12.1 per cent in 2010). In Serbia, the employment-to-population ratio plummeted to 45.4 per cent (from the 47.1 per cent recorded in October 2010), and the unemployment rate increased by an additional 2.9 percentage points. The youth unemployment rate in the first quarter of 2011 reached unprecedented levels in both countries (40.3 per cent in Croatia and 49.9 per cent in Serbia).

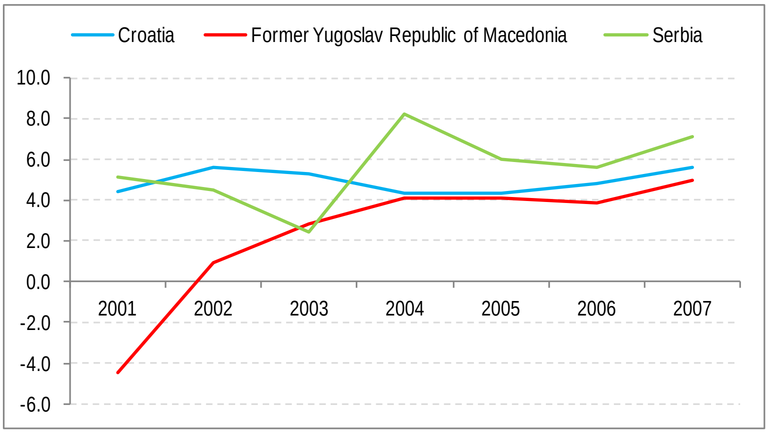
The crisis exposed the vulnerability of a growth model based on buoyant domestic consumption, fuelled by large inflows of foreign capital, to a large extent directed towards non-tradable sectors, and loose commercial credit policy. To make the recovery sustainable, a new growth paradigm based on enhancing domestic savings, investment and labour force participation to increase the contribution of capital and labour to economic growth is needed. In the decade prior to the crisis, employment was not central to national development plans and economic policies, but rather a residual outcome of private sector-led economic growth. Strong growth, however, failed to generate more and better jobs. Employment growth – together with the reduction of absolute and relative poverty – needs to become an explicit and overarching objective of the development strategy of the three countries for the next decade.

1. Overview of the Social and Economic Context

During the past decade, countries in South Eastern Europe (SEE) made considerable progress in terms of economic development, democratic reforms and integration into global economic and financial markets.[1] However, as a result of the turbulent disintegration of former Yugoslavia, the reform processes in Croatia, the former Yugoslav Republic of Macedonia and foremost Serbia, started later than in other countries of Central and Eastern Europe. In the early 1990s, the three countries experienced sharp contractions of Gross Domestic Product (GDP), driven by plummeting industrial output and declining employment (see Figure A.1. in the Statistical Annex). The sharpest negative GDP growth rates were recorded in 1991 in Croatia and the former Yugoslav Republic of Macedonia (28 per cent and 17.8 per cent, respectively) and in 1993 in Serbia (38.2 per cent).

The reform programmes introduced in the early 1990s in Croatia and the former Yugoslav Republic of Macedonia, but as late as 2001 in Serbia, centred on macroeconomic stabilization, price and foreign exchange liberalization, the restructuring of the banking system, the privatization of state- and socially-owned enterprises, and improvements in the business regulatory framework. GDP growth in Serbia and the former Yugoslav Republic of Macedonia started to accelerate in 2003, while in Croatia economic growth remained fairly stable at roughly 5 per cent per year throughout the period 2001-2007 (Figure 1). In the years between 2003 and 2007 the average output growth in the three countries (at approximately 5 per cent annually) was twice that recorded in the EU27 (2.3 per cent), but lower than that found in Bulgaria (6 per cent) and Romania (6.4 per cent).

Figure 1: Annual GDP growth rate, Croatia, the former Yugoslav Republic of Macedonia and Serbia (2001–2007)



Source: European Union, Directorate of Economic and Financial Affairs, *EU candidate and pre-accession countries. Economic Quarterly*, various years, (http://ec.europa.eu/economy_finance/db_indicators/cpaceq/index_en.htm).

[1] The grouping South Eastern Europe (SEE) comprises Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Montenegro, Romania and Serbia. This paper focuses on three SEE countries, namely Croatia, the Former Yugoslav Republic of Macedonia and Serbia.

Table 1 below shows that economic growth was mainly driven by private consumption (especially in the former Yugoslav Republic of Macedonia and Serbia), fixed capital formation (especially in Croatia and Serbia) and exports (especially in Croatia and the former Yugoslav Republic of Macedonia). [2]

Table 1: Sources of GDP creation (2003–2007)

	2003	2004	2005	2006	2007
Croatia					
Private consumption (% GDP) *	64.6	64.5	64.5	63.2	63.6
Gross fixed capital formation (%GDP)	27.3	26.7	27.3	29.4	29.4
Exports (%GDP)	42.6	42.9	42.3	42.7	42.1
Imports (% GDP)	50.4	49.3	48.7	49.8	49.8
The former Yugoslav Republic of Macedonia					
Private consumption (% GDP) *	73.7	76.4	77.6	79.1	82.0
Gross fixed capital formation (%GDP)	20.0	21.9	20.8	21.9	24.2
Exports (% GDP)	37.9	41.1	45.5	48.1	53.4
Imports (% GDP)	54.8	61.9	62.8	66.8	72.3
Serbia					
Private consumption (% GDP) *	73.8	79.3	79.0	77.9	80.9
Gross fixed capital formation (%GDP)	18.5	29.7	23.7	24.1	28.2
Exports (% GDP)	22.2	23.4	26.2	29.9	30.2
Imports (% GDP)	41.6	50.0	47.2	51.4	54.1

Source: World Bank, *Economic indicators*, (http://data.worldbank.org/indicator). (*) EU Directorate of Economic and Financial Affairs, *EU candidate and pre-accession countries. Economic Quarterly*, op.cit

In Croatia and Serbia investment growth was by far the most rapidly increasing demand component, contributing annually to GDP by an average of 28 and 24 per cent, respectively. In the former Yugoslav Republic of Macedonia investment dynamics were slightly weaker (with an annual average contribution to GDP of 21 per cent).[3]

On the supply side, the main feature of the pre-crisis period is the shift in value added from agriculture and industry towards services, with resources increasingly allocated in non-tradable sectors such as construction, wholesale and retail trade, financial intermediation and real estate at the expense of manufacturing (Figure 2). This is particularly true for Serbia, where the value added of

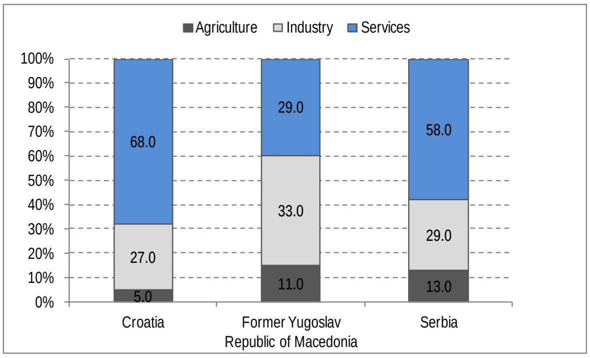
[2] European Commission, Directorate-General for Economic and Financial Affairs, *The pre-accession economies in the global crisis: from exogenous to endogenous growth?*, Occasional Paper No 62, Brussels, 2010
[3] EU Directorate of Economic and Financial Affairs, *EU candidate and pre-accession countries. Economic Quarterly*, op.cit.

agriculture declined from 20 per cent in 2000 to 13 per cent in 2007 and the share of services increased from 46 per cent to 58 per cent in the same period.

In Croatia, the decline in manufacturing as a share of gross value added was offset by increases in construction, financial intermediation and wholesale and retail trade. In Serbia, wholesale and retail trade increased from 6.6 per cent of gross value added in 2000 to 13.6 per cent in 2008.

Only the former Yugoslav Republic of Macedonia managed to maintain the relative importance of the manufacturing sector to over one third of total gross value added in the period 2000–2007.[4]

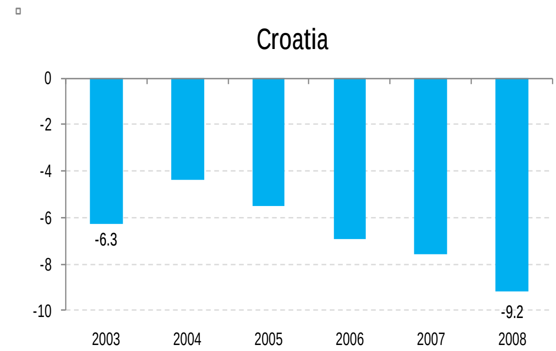
Figure 2: Gross Value Added, percentage (2007)

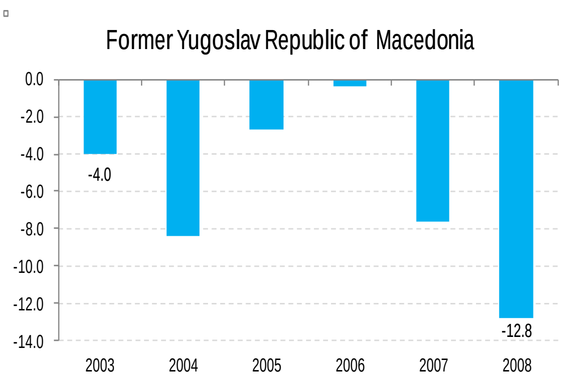


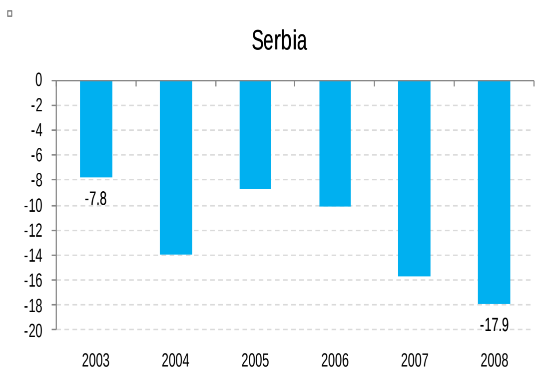
Source, World Bank, *Economic indicators* (http://data.worldbank.org/indicator)

Easy access to international financing in the pre-crisis period drove the current account balances to widening deficit positions. Over the period 2003-2008 Croatia's current account deficit widened by approximately 3 percentage points of GDP, while in Serbia the deficit more than doubled. In the former Yugoslav Republic of Macedonia the current account developments have been more volatile, with years of high deficit alternated with years of moderate ones (Figure 3).

Figure 3: Current account deficit, % GDP (2003–2008)







Source: European Bank for Reconstruction and Development, *Macroeconomic data*, op.cit

[4] The figures of the European Bank for Reconstruction and Development indicate that the sharpest decline in gross industrial production was recorded by Croatia and the Former Yugoslav Republic of Macedonia in 1991 (-28 per cent and -19.8 per cent). Industrial production dropped sharply in Serbia in 1992 (-17.7 per cent) and again in 2000 (-13.7 per cent).

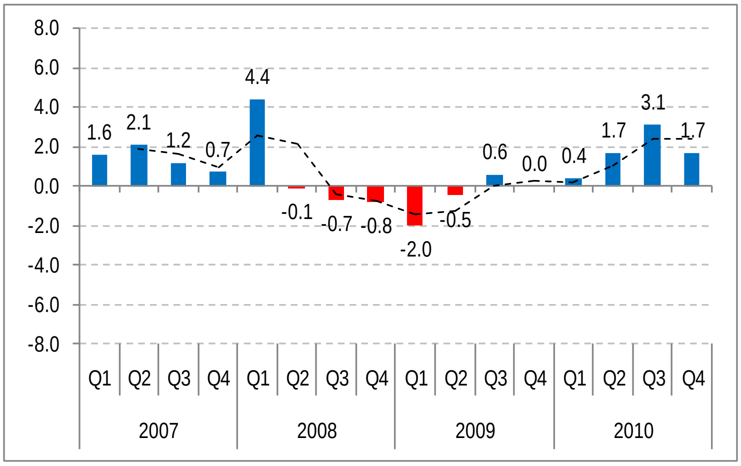
In the period 2003–2008, the structure of the current account balance in the three countries shows large merchandise trade deficits, averaging 24 per cent of GDP in Serbia, 22.5 per cent in Croatia and 21 per cent in the former Yugoslav Republic of Macedonia. The persistence of large trade deficits signals structural problems such as a weak industrial base, limited technological progress and slow pace of enterprise restructuring. In Croatia, large trade deficits have been financed by surpluses in the service account, especially those stemming from the tourism sector, while the former Yugoslav Republic of Macedonia and Serbia relied more on foreign transfers, also in the form of remittances.

The growth model in the period leading up to the economic crisis of 2008–2009, relied on increased exports and an expansion of domestic demand eased by inflows of Foreign Direct Investments (FDIs), remittances and credit expansion. Gross capital formation was mostly directed towards construction of residential housing, and foreign capital financed a significant part of this investment (through loans in foreign currency). Imports exceeded exports in all three countries, but especially in Serbia and the former Republic of Macedonia where imports grew faster than exports. Expansion of consumption, increasing external debts, trade deficit and a low saving rate made these economies more vulnerable to external shocks.[5] The economic crisis affected all three countries, to a different degree, with a lag of one-two quarters compared to the major EU economies. Among the three, Croatia suffered the sharpest GDP decline and the former Yugoslav Republic of Macedonia the mildest. Serbia, at 3 per cent in 2009, falls somewhere in between. Table A1 in the Statistical Annex shows GDP and current account balance developments in the crisis years (2008-2010).

The crisis hit Serbia in the second quarter of 2008, at first in the form of a mild bank panic episode.

Confronted with a sudden halt in foreign capital inflows, Serbia ran into the archetypical developing country problem of a balance of payments deficit. The "sudden stop" crisis consisted both of foreign inflows drying up and of the withdrawal of large amount of domestic currency savings.[6] Without such inflows, domestic demand dipped sharply, pulling down output in its wake.

Figure 4: Quarterly GDP growth rate, Serbia (2007–2010)



Source: Republic Statistical Office (RSO), *National accounts*, Belgrade, 2011

The second channel through which the economic crisis affected the Serbian economy was in the sharp decline in exports (see Figure A2 in the Statistical Annex). However, since the share of exports

[5] Bartlett, W. and Monastiriotis, V. (eds*) South Eastern Europe after the Crises: a New dawn or back to business as usual?,* London: London School of Economics, Research on South Eastern Europe, 2010

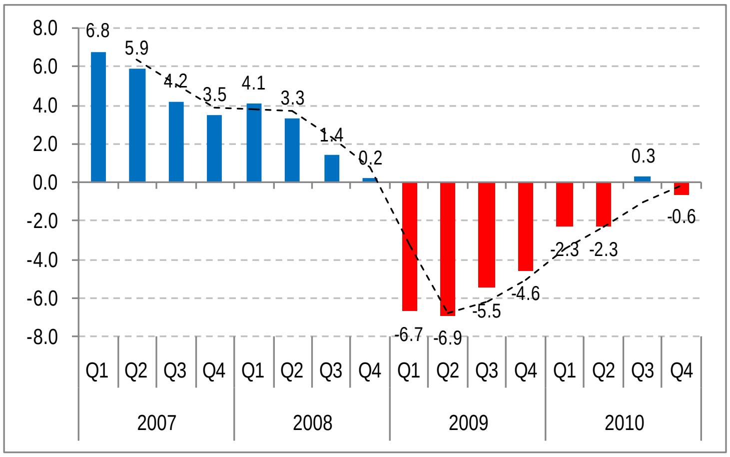
[6] Petrovic, P., "Economic crisis in Serbia: impacts and responses", in. W. Bartlett and V. Monastiriotis, *South Eastern Europe after the crisis*, op.cit.

in GDP was rather low, such an impact was only a secondary factor in output decline. The drop in aggregate demand in 2009 was more profound than the fall in output, reflecting the downward adjustment of the external deficit. The substantial decline in domestic demand led to fewer imports and a significant downward adjustment in the current account (from 18 per cent of GDP in 2008 to less than 5.6 per cent in 2009) and in the trade balance.

While the 3 per cent decline in output in 2009 was substantial, it was nevertheless lower than the decline experienced by other SEE countries such as Romania (7.1 per cent), Bulgaria (5 per cent) and Slovenia (7.8 per cent).[7] The Serbian economy started emerging from the recession in the first half of 2010. Positive output growth continued into the first quarter of 2011 (by 3.2 percentage points).

In Croatia, economic activity slowed down in the last two quarters of 2008 and then became negative for the following six consecutive quarters (Figure 5). Output contraction continued through 2010, but at a milder pace (1.2 per cent). Due to the collapse in export demand, industrial production fell even faster than GDP (by 9.2 per cent in 2009). Reduced private capital inflows and external demand aggravated the country's imbalances.[8] The first spill-over effects in Croatia materialized through a decline in both exports and imports.

Figure 5: Quarterly GDP growth rate, Croatia (2007-2010)



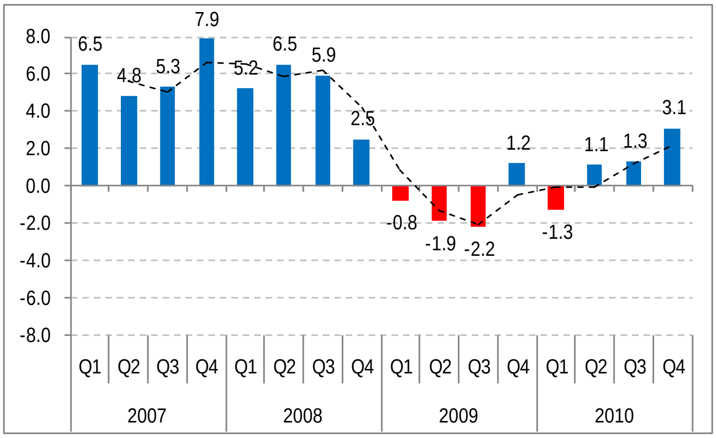
Source: Croatian Bureau of Statistics (CBS), *Quarterly Gross Domestic Product estimates*, CBS, First Release, Zagreb, 2011. http://www.dzs.hr/default_e.htm. Data are presented at market price.

In the period prior to the crisis exports were increasing, but at a slower pace compared to imports (Figure A2 in the Statistical Annex). This, coupled with a deterioration of the terms of trade, led to a widening of the current account deficit (from 4.4 per cent of GDP in 2004 to 9.2 per cent in 2008). Depressed domestic demand in 2009 led to a drop in imports, with a positive contribution of net foreign demand to real GDP. As a result, the current account deficit decreased to 5.2 per cent.

Croatia experienced the first signs of normalization in 2010, with a deceleration of output fall and a positive, albeit small, growth recorded in the third quarter. Seasonally adjusted data point to an increase in the manufacturing, trade and tourism sectors, whereas growth in the construction industry remained negative. The data on industrial turnover, exports and imports show that the modest growth was fuelled by a strengthening of domestic demand. The most recent economic data, however, show that stabilization in Croatia remains uneven and recovery sluggish. In the first quarter of 2011 GDP declined by a further 0.8 per cent.

[7] European Union, *Employment in Europe 2010*, Brussels, October 2010.
[8] World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, available at: www.worldbank.hr

Figure 6: Quarterly GDP growth rate, the former Yugoslav Republic of Macedonia (2007-2010)



Source: State Statistical Office, *Quarterly GDP data*, at http://www.stat.gov.mk/Default_en.aspx

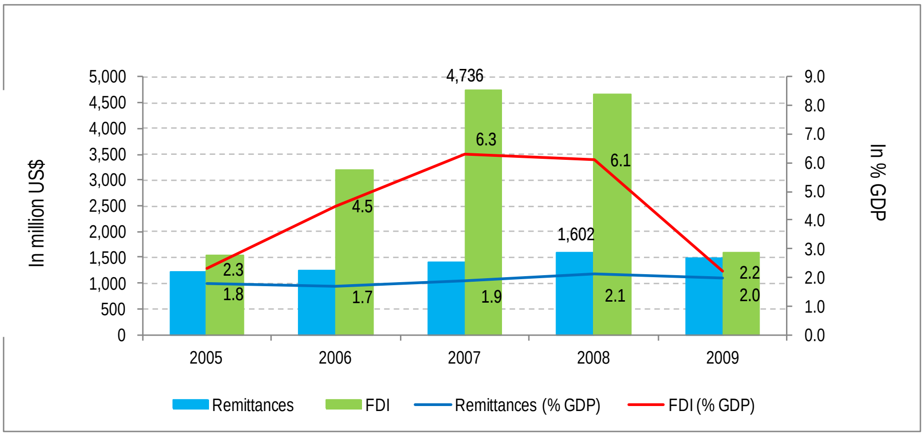
The former Yugoslav Republic of Macedonia was not affected by the financial crisis *per se*, due to its underdeveloped financial system. The first spill-over effects of the crisis materialized through a sharp fall in export demand that started in the fourth quarter of 2008. In the first two quarters of 2009 exports declined by more than 30 per cent. Imports also started to dwindle from the fourth quarter of 2008, but proportionally less than exports. As a result, the current account deficit decreased from 12.8 per cent in 2008 to 6.9 per cent in 2009.

The main risks for the former Yugoslav Republic of Macedonia in the short to medium-term stem from the uncertain economic prospects of its main trading partners, including the vulnerable Greek economy, as well as the volatility of international financial markets.[9] Negative events in EU economies could undermine the prospect of external financing. The economic and financial situation in Greece still poses a threat to the country's growth prospects, as Greece is a primary source of FDIs and one of the largest trading partners. As living standards in Greece are likely to fall due to the austerity programme, the income from cross-border trade, as well as from FDIs, may decline further. This negative scenario, however, has not materialized yet, as GDP increased in the first quarter of 2011 by 5.1 per cent.

The economic crisis also negatively affected foreign transfers to all three countries. FDI inflows in Croatia increased markedly in 2007 and 2008 (Figure 7), reaching over 8 per cent of GDP. Tight capital markets led to a sharp reduction in FDI inflows in 2009 (to slightly less than 3 per cent of GDP). Remittances remained mostly stable during the recession, with an increase in nominal terms in 2008. In relative terms, remittances decreased only marginally in 2009 compared to 2008 (from 2.1 per cent to 2 per cent of GDP).

[9] Bartlett, W. and Monastiriotis, V. (eds*) South Eastern Europe after the Crises: a New dawn or back to business as usual*, op.cit; International Monetary Fund (IMF), *FYR Macedonia: Article IV Consultation.* op.cit.

Figure 7: Trends in FDIs and remittances, Croatia (2005-2009)

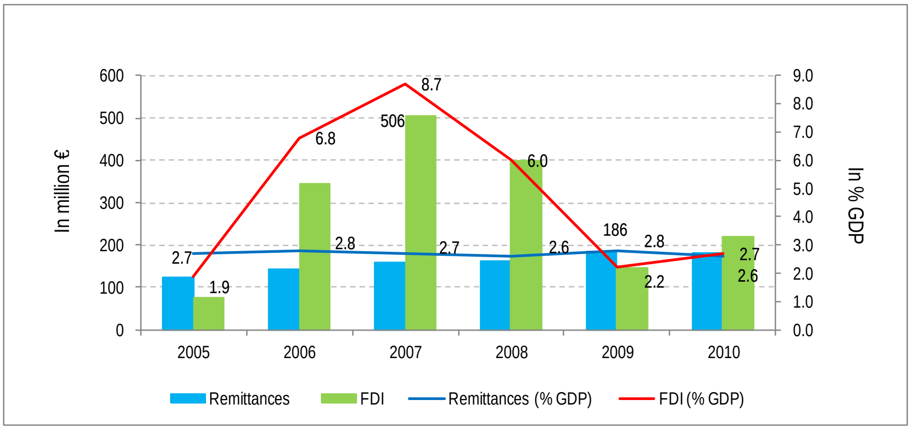


Source: World Bank, *Migration and remittances factbook 2011*, Washington D.C, 2011, Central Bank of Croatia, *Annual Report 2010*, Zagreb, 2010

In the former Yugoslav Republic of Macedonia, FDI inflows started to increase in 2006 (Figure 9), with the highest peak recorded in 2007 (at over 8.5 per cent of GDP). Still, the former Yugoslav Republic of Macedonia has a poor record of attracting FDIs compared to other countries in the region, especially Croatia.[10] FDI inflows declined from 6 per cent of GDP in 2008, to just over 2 per cent in 2009 to increase again in 2010 to just over 3 per cent of GDP.

Remittances to the former Yugoslav Republic of Macedonia remained constant during the recession, with an increase in nominal terms in 2009 (Figure 8). In relative terms, however, they declined slightly (from 2.8 per cent of GDP in 2005 to 2.6 per cent in 2010).

Figure 8: Trends in FDIs and remittances, the former Yugoslav Republic of Macedonia (2005-2010)



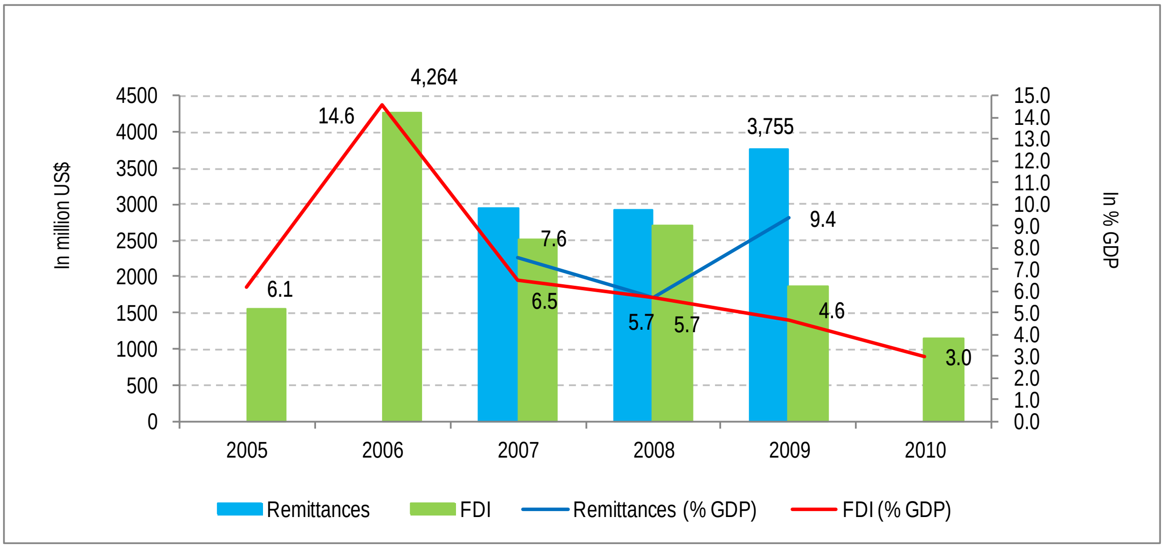
Source: National Bank of the former Yugoslav Republic of Macedonia, available at http://www.nbrm.mk/default-en.asp

[10] European Bank for Reconstruction and Development (EBRD). *Economic research and data*, op.cit.

The inflows of FDI in Serbia peaked in 2006 at 14.6 per cent of GDP. However, the large increase of foreign inflows since the early 2000s were largely directed towards the privatization of existing resources.

Figure 9 below shows the sharp deceleration of FDIs in 2009 and 2010, when FDIs amounted to just below 4 per cent of Serbian GDP. Remittances to Serbia, contrary to what occurred in other countries, increased sharply in 2009 to amount to 9.4 per cent of GDP compared to less than 6 per cent of GDP recorded in the prior year.

Figure 9: Trends in FDIs and remittances, Serbia (2005-2010)



Source: World Bank, *Migration and remittances factbook 2011*, Washington D.C, 2011, National Bank of Serbia, *Balance of payment data*, Belgrade, 2010, available at http://www.nbs.rs/internet/english/80/platni_bilans.html

The growth dynamics in Croatia and Serbia in the period leading to the crisis reflect a relatively high and fast growing share of private consumption in GDP, fuelled by large inflows of capital, directly to mainly the non-tradable sectors. The share of *greenfield* investment was rather low, with foreign capital mainly directed towards privatization of existing resources. In the period 2002-2007 the financial sector in Croatia and Serbia developed rapidly, albeit from a low base, fuelling the growth of domestic credit. Growth was accompanied by widening external imbalances and increasing reliance on external capital inflows. This made the Croatian and Serbian economies more vulnerable to external shocks compared to the former Yugoslav Republic of Macedonia that had a less developed financial sector and lower external balance deficits.

2. Impact of the Crisis on Employment, Enterprises and Workers

In the period leading up to the crisis, the main indicators of Croatia, the former Yugoslav Republic of Macedonia and Serbia show a weak performance of the labour market compared to the EU 27 (see Table A2 in the Statistical Annex). After years of relatively good economic performance, characterized by strong growth, but very low or non-existent job creation, Croatia and Serbia recorded a sharp decline in employment growth in 2009 and 2010, with significant job losses occurring across a number of economic sectors. The labour market of the former Yugoslav Republic of Macedonia, conversely, does not appear to have been affected by the 2009 slowdown of economic activity.

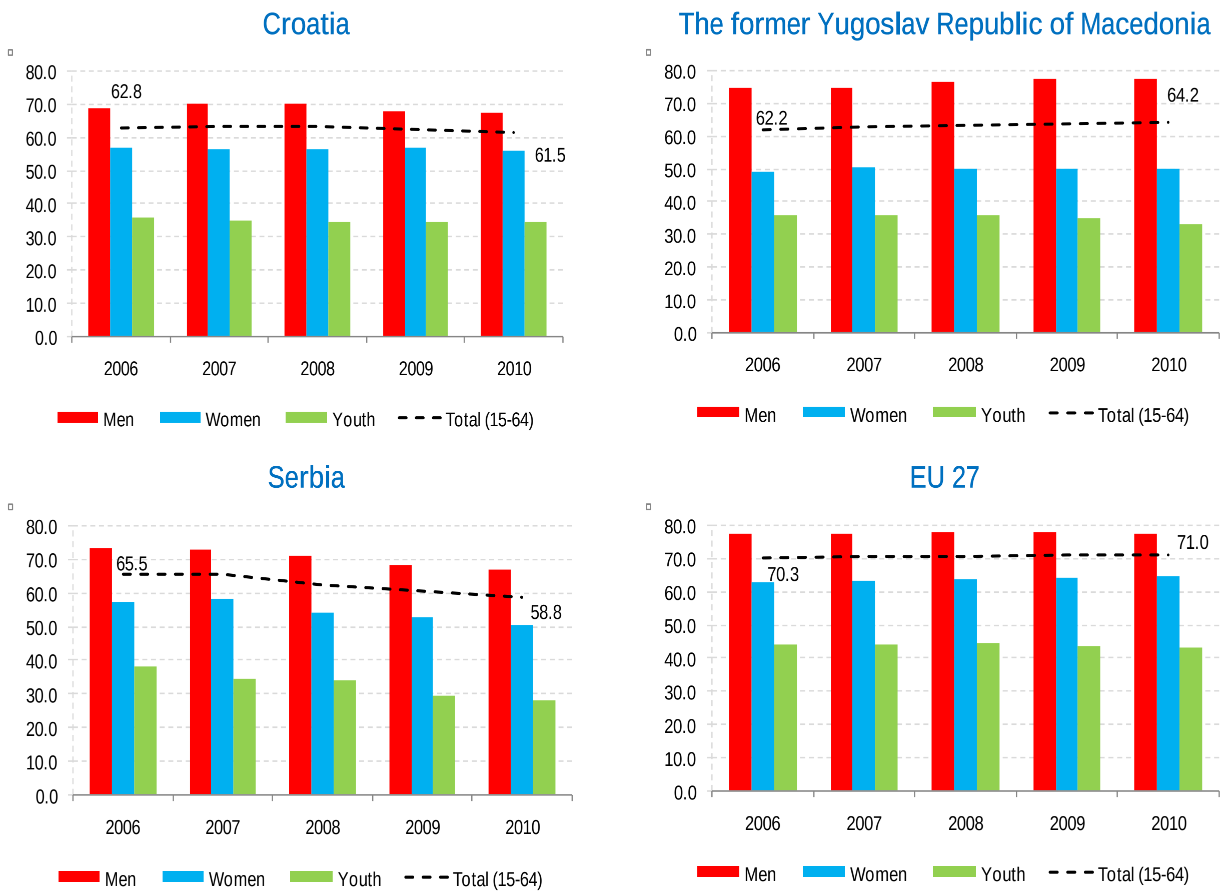
2.1 Labour Force Participation

The labour force participation rates of Croatia, the former Yugoslav Republic of Macedonia and Serbia remained below those recorded in the EU 27 counties throughout the last decade.

Low participation rates are mainly due to the low activity rates of women, young people and individuals over 50 years old in the three countries. In all three countries labour force participation is strongly related to educational attainment, with individuals with tertiary education much more likely to be active than those with lower education levels. In Croatia, for example, the participation rate of university-educated individuals is 20 percentage points higher than for individuals with secondary education, while in the former Yugoslav Republic of Macedonia, university graduates are almost two and half times more active than those with primary education or less.

In the period 2006–08, the labour force participation rate for the population aged 15 to 64years old in Croatia averaged 63 per cent. Activity, however, started to decline in 2008, moderately at first and then more pronounced, to reach in 2010 the lowest rate recorded in the country since the beginning of the decade (61.5 per cent). The activity rate of Croatian women is over 8 percentage points lower than in the EU 27 (56 per cent and 64.5 per cent, respectively), with significantly lower rates for young and elderly women compared to those in the prime age group (31.2 per cent, 40.6 per cent and 79.7 per cent, respectively). The activity rate for young people (15–24 years old) is approximately half that of adults (34.4 per cent and 67.8 per cent, respectively in 2010). Youth labour force participation rates declined in the period 2006-10 from 35.9 per cent to 34.3 per cent, mainly due to higher participation levels in education.

Figure 10: Labour force participation rates, (2006–2010)



Source: For Croatia, the former Yugoslav Republic of Macedonia and EU 27 data are from the Annual Labour Force Survey (2006–2010), posted in the EUROSTAT web page. For Serbia, data are from the Labour Force Survey (2006–2010).

The former Yugoslav Republic of Macedonia shows a fairly stable labour force participation rate for the period 2006–2010 averaging 63.3 per cent, with no visible effects of the downturn. However, only one in every two women aged 15 to 64 is active (50.4 per cent in 2010). Participation rates are especially low for women of Albanian and Roma origin due to the traditional role assigned to women in these communities. The most important reason for women's inactivity is household responsibilities.[11] Over 55 per cent of inactive women are housewives, with women with low educational attainment much more exposed to inactivity than those with higher educational attainment. Similarly to Croatia, the activity rate of young people is roughly half that of adults (33.3 per cent and 73 per cent, respectively in 2010). The participation of youth increased slightly in the period 2005–07 to then decline (from 35.9 per cent in 2008 to 33.3. per cent in 2010). Such a decline is due to a number of factors, including increasing enrolments in higher education, shrinking

[11] Angel-Urdinola, D. F. and Macias, V., *FYR Macedonia Labour Market Profile 2004–2007*, World Bank Policy Note, World Bank, Washington D.C. 2008.

employment opportunities, difficulties in transition from school to work, skills mismatch between employers' needs and the competencies acquired in the education system, and the unwillingness of employers to bear the cost of training young workers.

A continuous decline in labour force participation has characterized the Serbian labour market since the year 2000. In the period 2004-2010, the active population decreased by as much as 19 per cent, levelling at 58.8 per cent of the total working-age population (Figure 10 above). Such a drop is partly due to the 4.5 per cent decline of the working-age population, mainly as a result of negative natural growth and ageing of the population. Emigration also contributed to a decline of the working age population, but only marginally.[12] The activity rates for both men and women declined at a uniform pace, but the gender gap in activity rates recorded a slight increase (from 16.2 percentage points in 2006 to 16.6 percentage points in 2010). The youth activity rate declined by almost 30 per cent (from 37.8 per cent in 2004 to 28.2 per cent in 2010). This decline is the result of both increasing trends of youth participation in education, but also the deterioration of labour market opportunities for young people.[13] The labour force participation figures in Serbia do not show a significant trend break at any point before or after the crisis. The drop in the active population was slightly over 400,000 individuals in the period 2004-2008, while in the period 2008–2010 the active population decreased by 270,000 individuals. Activity rates in Serbia will be under further pressure in the next decade as the working age population is projected to drop by around 8 percentage points as the baby boomers exit the labour force.

2.2 Employment Trends

Employment-to-population ratios are well below those of the EU27 – ranging from 43.5 per cent in the former Yugoslav Republic of Macedonia to 54 per cent in Croatia. Throughout the past decade, employment growth has been low in Croatia and former Yugoslav Republic of Macedonia and negative in Serbia .

Croatia's strong economic performance in the period 2001–2008 slightly improved the labour market situation, with employment growth averaging 1.4 per cent annually.[14] Despite this, however, Croatia's employment level remained roughly 10 percentage points below that of EU-27 countries, due to a combination of high unemployment levels and low labour force participation rates. In the period 2001-08 the employment-to-population ratio for individuals aged 15-64 averaged around 55 per cent. The overall employment rate increased from 52.9 per cent in 2002 to 57.8 per cent in 2008, with a similar trend for both men and women.

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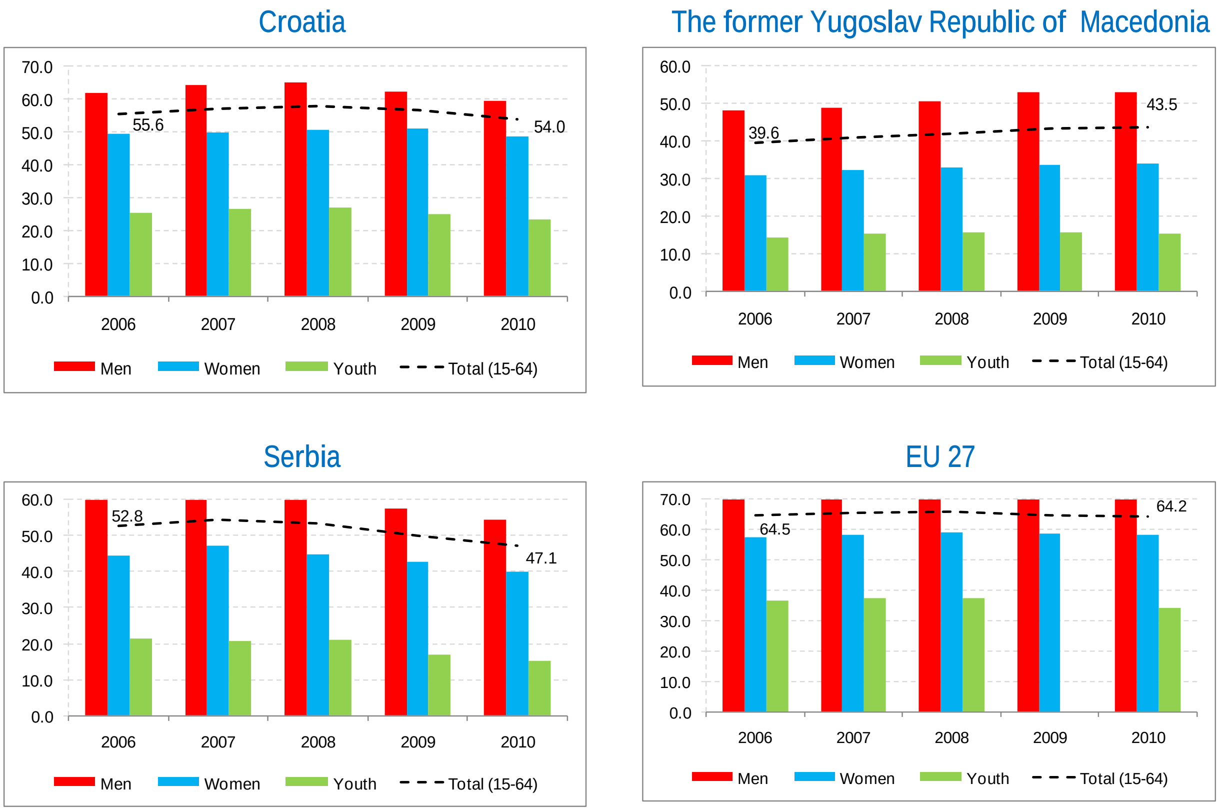
[12] The World Bank estimated the stock of emigrants as 2 per cent of the population in 2010, well below that of Albania (45.4 per cent), Bosnia and Herzegovina (38.9 per cent), Croatia (17.1 per cent) and the former Yugoslav Republic of Macedonia (21.9 per cent). However, Serbia is listed among the top remittances receivers in the world (13 per cent of GDP). World Bank, Migration and Remittances Factbook 2011, World bank, Washington D.C. , 2011.

[13] Arandarenko, M., Avlijaš, S., "Behind the veil of statistics: wage trends before and after the crisis in Serbia", in: Schmidt,V. and D. Voghan-Whitehead: *Wage policy during the economic crisis in the Western Balkans*, ILO Subregional Office for Central and Eastern Europe, Budapest, 2011

[14] Detail annual Labour Force Survey data are available on the web page of the Croatia Bureau of Statistics (http://www.dzs.hr) and at EUROSTAT (http://epp.eurostat.ec.europa.eu/). This paper mostly uses the data of quarterly and annual surveys as posted by EUROSTAT.

In the same period, youth employment remained stagnant at an average rate of 26 per cent. Interestingly, the pattern of youth employment in Croatia is very similar to that of overall employment, pointing to a strong dependency of youth employment on the trends of adult employment, at least in the period prior to the crisis.

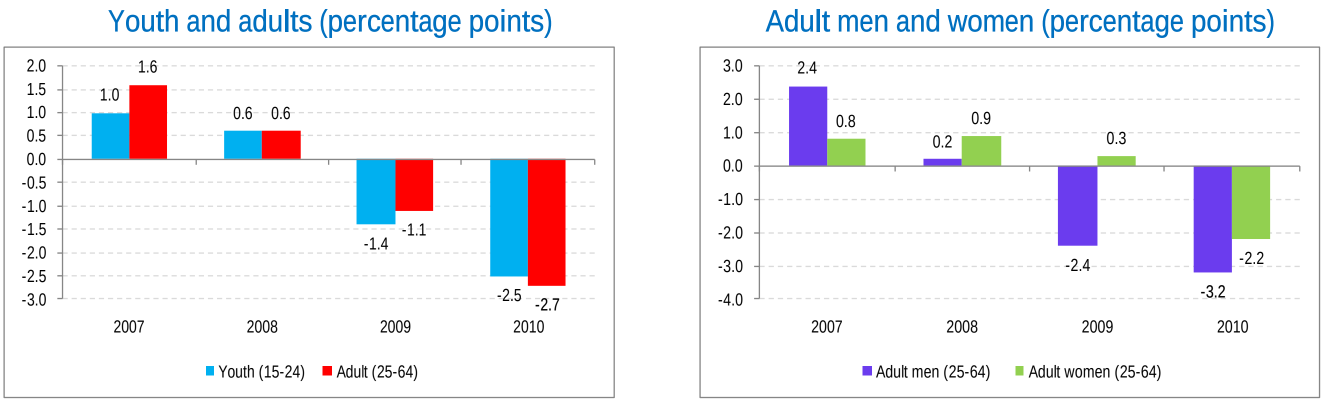
Figure 11: Employment-to-population ratios (2006–2010)



Source: For Croatia, the former Yugoslav Republic of Macedonia and EU 27 data are from the Annual Labour Force Survey (2006–2010), posted in the EUROSTAT web page. For Serbia, data are from the Labour Force Survey (2006–2010).

During the crisis, the overall employment rate in Croatia dropped by nearly 4 percentage points (from 57.8 per cent in 2008 to 54 per cent in 2010), reflecting the loss of more than 95,000 jobs in the period. Job losses in 2009–10 affected mostly adult men (25 to 54 years of age), while adult women started to experience increased employment losses only in 2010 and at a slower pace than men (2.2 percentage points and 3.2 percentage points, respectively). This difference reduced the gender gap in employment from 14.3 percentage points in 2008 to 10.6 percentage points in 2010. Youth employment decreased in both years, with young men more affected by employment losses compared to young women. Employment losses affected workers at all levels of educational attainment, but they were proportionally higher for workers with secondary education, whose employment rate decreased by 5.6 percentage points in the period 2008–10. The economic sectors more affected by job shedding were construction, manufacturing and certain service activities, excluding health and social services.

Figure 12: Croatia: Changes in employment, youth and adults, adult men and adult women (2007–2010)



Source: EUROSTAT, Annual Labour Force Survey data (2007–2010).

The key labour market indicators for Serbia in the period 2004-2010 show a common trend of declining activity and employment rates for men and women of all ages. The employment rate reached its historical minimum in 2010, at 47.1 per cent of the working age population. The employment rate declined by 2.9 percentage points in the span of 12 months (October 2009–October 2010). The decline in the overall number of workers since the onset of the crisis was dramatic (12.5 per cent between 2008 and 2010), much greater than the overall decline of GDP. Contrary to previous interpretations based on unadjusted LFS data, there was no double dip in employment – the first resulting from transition to a market economy and the second from the economic downturn. Hence, conclusions on the recovery of employment and the reversal of transition-induced employment decline in 2007 and the first half of 2008, were based only on statistically recorded, rather than real, employment growth.[15]

In short, Serbia experienced a virtually uninterrupted downward trend in employment, marking the entire decade starting in 2001. Still, unlike the labour force participation trend– in which there was a slightly faster shedding of the active population, but no visible trend break– the employment dynamics before and after the start of the crisis shows a clear break. Whereas in the period 2005-07 employment cumulatively declined by less than 100,000 individuals, the decrease recorded between October 2008 and April 2009 was of nearly 200,000 persons. The cumulative loss by October 2010 approached 400,000 units. A large part of this decline is due not only to the crisis, but also to the drop in the working age population and the impact of enterprise restructuring and privatization, which are still ongoing.

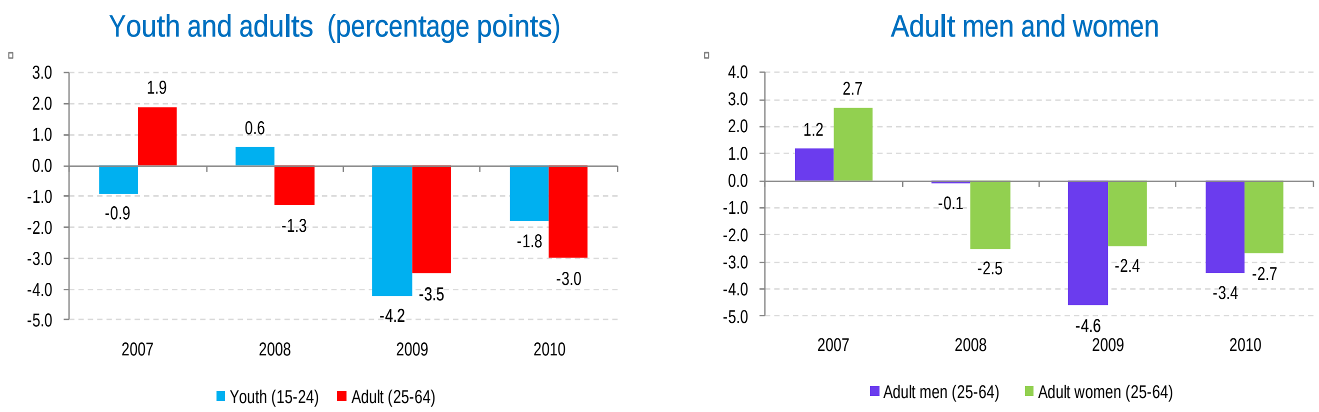
The employment losses experienced by Serbia in 2009-10 affected mostly young people (15 to 24 years old), and adult men (25 to 54 years of age). Adult women's employment decreased in 2009, along with the business cycle, but the drop was half that experienced by their male peers (Figure 13).

[15] See M. Arandarenko, *Supporting strategies to recover from the crisis in South Eastern Europe: Serbia*, ILO, (forthcoming).

Employment losses decelerated slightly for youth in 2010, equally for young women and men. The employment drop affected young men particularly hard, as the employment-to-population ratio for this group declined from 26.3 per cent in 2008 to 18.4 per cent in 2010. Research into the school-to-work transition conducted in 2009 indicates that young people with higher educational attainment were more severely affected by the crisis compared to low-skilled youth.[16] In the period April-October 2009, the average duration of transition doubled for youth with tertiary education (from 9 months to 18.5 months), while it remained unchanged for youth with primary education or less (52-53 months).

The economic sectors that suffered more losses were manufacturing (with losses of around 9 percentage points in both 2009 and 2010), construction (around 4.6 percentage points in 2009 and over 10 points in 2010), hotels and restaurants (5 percentage points in 2009 and 8 percentage points in 2010), while financial intermediation and real estate activities continued to increase the number of employees, albeit at a slower pace compared to prior years.

Figure 13: Serbia: Change in employment, youth and adults, adult men and adult women, (2007–2010)



Source: Labour Force Survey (2007–2010)

The employment trends of the former Yugoslav Republic of Macedonia show an uneven growth path, with sharp drops in the first years of transition (1990-1997), a recovery quickly reversed by the 2001 unrest and positive employment growth from 2005 onward. The overall employment-to-population ratio, however, remains, alongside that of Serbia, the lowest among the SEE countries, with a mere 43.5 per cent of the working age population employed in 2010. The employment rate of women is lower than men's by more than 10 percentage points (59.4 per cent for men in 2010 and 48.8 per cent for women). The difference in employment rates between the sexes, however, decreases with educational attainment. University educated women have only marginally lower employment rates compared to men, suggesting that educational attainment is a stronger determinant of employment probability than gender.

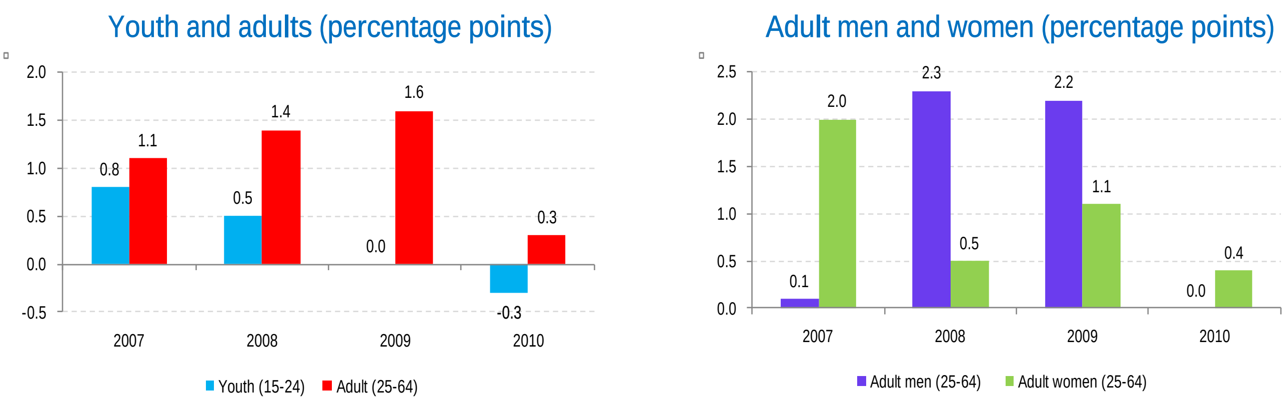
Youth have a very low employment rate (15.4 per cent in 2010) although their employment increased somewhat compared to 2006. Similarly to activity rates, low employment among youth in the former

[16] Krstić, G. *School-to-Work Transition in Serbia, 2009-2010*, ILO, Budapest 2011.

Yugoslav Republic of Macedonia can be attributed to the delayed entry in the world of work due to difficulties in finding the first job and high inactivity rates due to school attendance.[17] Educational attainment is the main determinant of the transition from unemployment into employment, with individuals with secondary and tertiary education more likely to shift to employment (7 and 18 per cent, respectively) compared to low educated workers.[18]

Labour market data shows that in the period 2005–2010, roughly 93,800 new jobs were created in the former Yugoslav Republic of Macedonia, that is 15 per cent of total employment. The relatively high job creation of the period 2005–09, decelerated considerably in 2010, with only 7,034 new jobs created. This means that the lower economic activity level of 2009 had an effect on job creation with a 12 month time lag. Employment growth remained positive, except for the slight decline in youth employment recorded in 2010 compared to 2009.

Figure 14: The former Yugoslav Republic of Macedonia: Change in employment, youth and adults, adult men and adult women (2007–2010)



Source: Labour Force Survey (2007–2010)

The analysis of the employment structure in the three countries offers additional insights into the overall impact of the economic slowdown on employment trends (see Tables 2 to 4).

In Croatia, the number of persons working under fixed-term contracts was decreasing prior to the downstream effects of the crisis on the labour market (from 12.9 per cent in 2006 to 11.6 per cent in 2009). As labour shedding accelerated, it affected both temporary and permanent workers alike (both rates decreased between 2009 and 2010 by 0.7 per cent). However, the figures disaggregated by age, group and gender show that young workers, and especially young women, working on temporary contracts lost their jobs in greater numbers compared to adults. Overall, the rate of temporary work for youth decreased by 3.2 per cent, with the rate of young men declining by half that of young women. One of the most troubling figures, however, is the share of involuntary temporary work. In

[17] Combining school and work is not common.

[18] Angel-Urdinola, D. F. and Macias, V., *FYR Macedonia Labour Market Profile 2004-2007*, World Bank Policy Note, World Bank, Washington D.C. 2008, op.cit. Mojsoska, N., *The public employment, education and labour markets in Macedonia*, Nam Press Skopje, 2006.

2009, one in every two workers in Croatia accepted temporary contracts because they could not find a permanent job.

The share of part-time employment in total employment remained largely stable, with a modest increase (from 6.9 per cent in 2008 to 7.6 per cent in 2010).[19] The share of youth working part-time is similar to that of adults (7.6 per cent and 7.5 per cent, respectively). However, the percentage of women working part time is twice that of men (10.1 per cent and 5.4 per cent, respectively in 2010), but the number of men that work part-time on an involuntary basis is twice that of women (in percentage terms 32.1 compared to 16.2 in 2010).

Table 2: Structure of employment, Croatia (2006–2010)

	2006	2007	2008	2009	2010
Economic sector					
Agriculture	11.5	10.9	11.3	11.7	12.9
Industry	30.4	31.4	30.8	29.0	27.2
Services	58.2	57.7	57.9	59.4	59.9
Status in employment					
Employees	79.9	80.6	80.8	81.0	79.8
Own account workers	18.3	17.5	17.4	17.2	18.0
Contributing family member	1.8	1.9	1.8	1.8	2.3
Type of contract					
Full-time	93.0	93.4	93.1	93.1	92.4
Part-time	7.0	6.6	6.9	6.9	7.6
Involuntary part-time	24.9	21.1	21.0	21.4	22.4
Permanent	87.1	87.4	87.9	88.4	87.7
Temporary	12.9	12.6	12.1	11.6	12.3
Involuntary temporary work	51.7	50.0	52.5	50.0	48.4

Source: EUROSTAT, Annual Labour Force Survey results 2006–2010.

In the period 2008-2010, industry reduced its contribution to employment by more than 16 per cent, mainly due to the sharp declines in the construction and manufacturing sectors (17 and 21.5 per cent, respectively), while the contribution of agriculture and the service sector increased (6.9 per cent and 2.2 per cent, respectively). Most likely, part of the workers laid off from the construction and manufacturing services moved to subsistence farming, as a coping strategy against open unemployment. The service sector also increased its contribution to total employment in the period, driven by employment increases in administrative and support services (15 per cent), health and social work (9.4 per cent), professional activities (6.3 per cent), arts and entertainment (7.9 per cent) and information and communication technology services (4.1 per cent). Employment in the wholesale and retail trade sector, conversely, contracted by 15.2 per cent. The 2008-10 figures on

[19] Franičević, Vojmir, "Croatia: Prolonged Crisis with an uncertain ending", in Vaughan-Whitehead, D*: Inequalities in the world of work: The effects of the crisis*,, International Labour Organization, Geneva 2011.

employment status reveal that the share of wage employment decreased, albeit moderately, while the shares of own account workers and contributing family members increased. This raised the share of vulnerable employment from 19.2 per cent in 2008 to 20.2 per cent in 2010.[20]

The structure of employment of the population aged 15 to 74 in the former Yugoslav Republic of Macedonia in the period 2006–10 reveals declining employment in industry, rather stable employment in agriculture and an increasing trend in employment in the service sector. In 2010, self-employment accounted for 13.1 per cent of total employment, higher than Slovenia (11.6 per cent) and Estonia (7.9 per cent), but lower than Croatia (18 per cent), Poland (18.5 per cent) and Romania (19.5 per cent).[21] The incidence of vulnerable employment remained fairly stable throughout the period, at around 23 per cent.

The share of part-time employment in total employment declined in the period 2006-10 from 6.3 per cent to 5.5 per cent, much lower than the 18.5 per cent recorded in EU 27 countries and half the rate found in Slovenia (10.3 per cent) in 2010. Till mid-2008 there were regulatory constraints making part-time work relatively expensive for enterprises. The legislation was amended in 2009, but with no apparent effect, as yet.[22] However, the World Bank estimated that in 2005 more than a third of part-time work in the country was involuntary (36.1 per cent).[23] This is higher than the rate recorded in the EU15 countries (21.8 per cent) in 2006. Of those employed part-time on a voluntary basis, only 7.1 per cent chose this form of work to combine family and work responsibilities. In 2010, approximately 7 per cent of total women's employment was part-time, compared to 4.5 per cent for men.

Young workers in the former Yugoslav Republic of Macedonia have the highest share of part-time work (10.7 per cent in 2010), but on a declining trend compared to 2005 (12.4 per cent). The share of workers employed on a temporary basis increased from 8.5 per cent in 2006 to 12 per cent in 2010. Temporary work increased more for women than for men (to 13.3 per cent and 9.9 per cent, respectively). Temporary work is more common among young workers (25.6 per cent of youth work on temporary contracts), but workers in the age group 50 to 64 experienced the largest increase in the period 2005–2010 (71 per cent).

[20] Vulnerable employment is the share of self-employment and unpaid family workers in total employment.
[21] Data for these countries can be downloaded at the EUROSTAT web page, http://epp.eurostat.cec.eu.int.
[22] Until 2008 the payment of social contributions was set at the minimum reference wage (50 per cent of the average wage in the economy). For health insurance purposes, this minimum floor was based on full-time employment, i.e. regular 40-hours working week, irrespective of actual working hours. In 2009, the legislation was amended and now health insurance is calculated on per hour basis. World Bank, *Labour Market in the former Yugoslav Republic of Macedonia*, World Bank, Washington D.C., 2009.
[23] World Bank, *Poverty assessment paper for the Republic of Macedonia*, World Bank, Washington D. C., mimeo, 2007

Table 3: Structure of employment, the former Yugoslav Republic of Macedonia (15–74), 2006–2010

	2006	2007	2008	2009	2010 (*)
Sector of employment					
Agriculture	20.1	18.3	19.7	18.5	19.3
Industry	32.6	31.3	31.3	29.7	28.9
Services	47.3	50.4	49.1	51.7	51.9
Status in employment					
Employee	70.8	72.3	71.8	72.0	71.5
Employers	5.9	5.5	4.9	5.2	5.4
Own account workers	12.4	12.1	12.9	12.7	13.1
Contributing family members	10.9	10.1	10.3	10.2	10.1
Ownership					
Private	66.1	69.0	71.4	73.7	73.7
Other	33.9	31.0	28.6	26.4	26.3
*Type of contract**					
Part-time	6.3	6.4	5.6	5.3	5.5
Full-time	93.7	93.6	94.4	94.7	94.5
Permanent	91.5	90.8	89.4	88.8	88.0
Temporary	8.5	9.2	10.6	11.2	12.0

Source: State Statistical Office, Labour Force Survey, 2005–2010.
(*) Data are an average for the period Q1–Q3, 2010.
NB: Figures are for the 15 to 74 years old population

In Serbia, the share of agricultural employment in total employment is exceptionally high. A comparison of employment by sectors with other European countries shows that only Romania has a higher share of agricultural employment (27.8 per cent in 2009).[24] On the other hand, the share of industrial employment is lower in Serbia than in other European countries, such as Slovenia (32.9 per cent) and Romania (31.3 per cent). As a result of these two figures, the share of employment in the service sector is slightly over half of total employment (51.7 per cent). In the past decade all agricultural and industrial activities recorded employment decreases in absolute terms. The decrease was most pronounced in manufacturing, which practically halved. In the private services sector, employment decreases were less pronounced, but they occurred in most economic activities (trade, food service industry, transport, financial intermediation and other service activities), while increases were recorded only in real estate activities and other social and personal services.

[24]European Union, *Employment in Europe 2010*, Brussels, October 2010.

Table 4: Structure of employment, Serbia (2006–2010)

	2006	2007	2008	2009	2010
Economic sector					
Agriculture	25.2	25.5	24.1	24.0	21.9
Industry	27.5	27.6	27.3	25.1	26.2
Services	47.2	46.7	48.5	50.8	51.7
Status in employment					
Employee	73.0	71.6	62.2	67.8	67.6
Own account workers	20.1	20.1	26.7	23.2	24.3
Contributing family member	6.9	8.3	11.1	8.9	8.0
Type of contract					
Full-time	92.8	93.1	89.3	90.8	90.9
Part-time	7.2	6.9	10.7	9.2	9.1
Permanent	86.9	88.0	87.6	88.4	88.5
Temporary	13.1	22.0	12.4	11.6	11.5

Source: Labour Force Survey 2006–2010.

Conversely, employment increased in two of the three service activities where the state is the prevailing employer – public administration and social insurance, and education. In the period 2001–2010 total employment in the public sector increased, with the share of the public sector in total formal employment increasing even more (from 19.7 per cent to 27 per cent). If employment in public enterprises (about 120,000 employees in 2010) is added to the count of employment in the public sector, this latter share in total formal wage employment reaches 35.9 per cent.

Compared to Croatia and the former Yugoslav Republic of Macedonia, the structure of employment in Serbia reveals a lower share of wage employment and a higher proportion of workers in vulnerable employment (28.5 per cent of total employment), due to the higher share of own account workers.[25] The data of 2008–2010 reveal that the share of temporary work on total employment decreased during the economic downturn, as these workers were the first to be dismissed. More alarmingly, however, are the figures on involuntary part-time and temporary work. According to the Labour Force Survey, over half of part-time workers could not find a full-time job, while nearly 80 per cent of temporary workers had to take up work on a temporary basis as they were unable to find a permanent job.[26]

The advanced stage of transition in Serbia is characterized by a consolidation of labour market duality, with dichotomies affecting formal vs. informal employment; public vs. private sector employment; wage employment vs. self-employment, standard vs. vulnerable employment; paid vs.

[25] This excludes own-account workers with employees. See Republic Statistical Office, Labour Force Survey Bulletin 2010, at http://webrzs.stat.gov.rs/WebSite/repository/documents/00/00/26/87/SB_533_ARS_2010_engl.pdf
[26] See Republic Statistical Office, Labour Force Survey Bulletin 2010, op.cit.

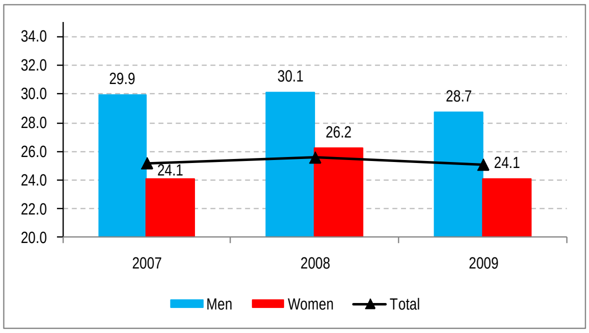
unpaid work. The primary labour market, characterized by job security, good working conditions and above average wage levels is limited to the public sector, modern services (such as banking and finance, information technology and marketing) and few large privatized enterprises with foreign ownership. The secondary labour market encompasses employees on flexible employment contracts (e.g. fixed-term), most private sector employees, own account workers, workers in traditional services, the best part of industry and agriculture. Jobs in this second tier labour market are, generally, precarious and poorly paid.

2.2.1 Informal Employment

Croatia's national accounts gap between income and expenditure shows that the scale of the informal economy diminished from 37 per cent of GDP in 1993 to 7 per cent in 2000. Figures for 2009 estimate the size of the informal economy at 15-19 per cent of GDP. Precise estimates on the share of informal employment are not available. However, the drop in formal (registered) employment in 2009–2010 was equal to the fall of GDP (roughly 6 percentage points), while total employment decreased by approximately 2.4 percentage points. This means that the share of informal employment increased during the crisis, but less than proportionally.[27]

According to the latest figures available for the the former Yugoslav Republic of Macedonia, informal employment accounted for 25.1 per cent of total employment in 2009. Women are less likely to work informally, as 24 per cent of women in 2009 were working informally compared to 28.7 per cent of men (Figure 15).[28]

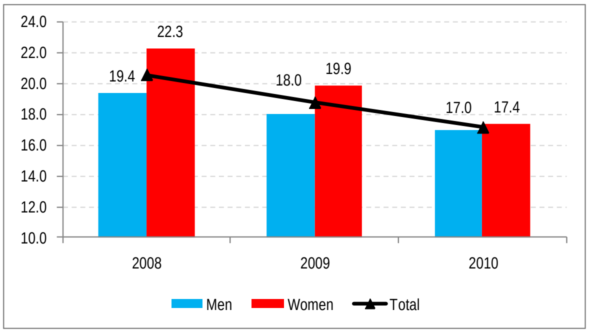
Figure 15: The former Yugoslav Republic of Macedonia, informal employment by sex (2007–2009)



Source: State Statistical Office, Labour Force Survey, 2007–2009, 2010.

[27] See World Bank, *Croatia. Social impact of the crisis and building resilience*, op.cit
[28] Data on informal employment are available only for the period 2007-2009

Figure 16: Serbia, informal employment by sex (2008–2010)



Source: Republic Statistical Office, Labour Force Survey, 2008–2010.

In Serbia, conversely, data of the LFS indicate that women are slightly more likely than men to be employed informally. Prior to 2008, figures on informal employment in Serbia were made available by the *Living Standards Measurement Survey* (LSMS).[29] The comparison of 2002 and 2007 data (which coincide with the early and mature transition stages in Serbia) provides a counter-intuitive result, i.e. that informal employment increased from 28 per cent to 35 per cent.[30] In other words, during the transition period in Serbia informal employment slipped towards the bottom of the wage distribution, in parallel with increases in volume. The LSMS assigns growing informal employment and increasing wage premiums for formal workers to the regressive taxation system that exists in the country.

Interestingly, the 2008 LFS data indicate a considerably lower informal employment level (23 per cent) than that recorded by LSMS. This difference, however, mostly stems from the different treatment of agricultural self-employment.[31]

2.3 Unemployment Trends

Prior to the onset of the crisis all three countries were experiencing declining unemployment rates, albeit to different degrees (Figure 17).

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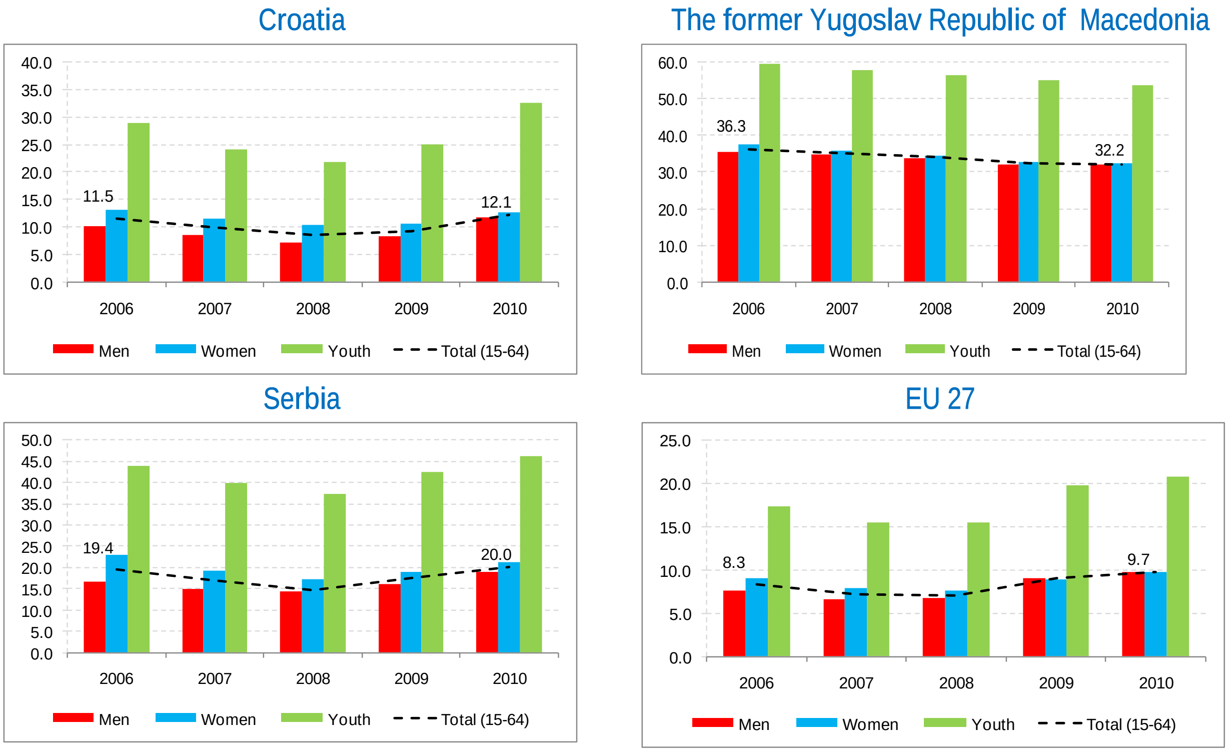
[29] The LSMs was carried out in 2002, 2005 and 2008. See Republic Statistical Office (RSO), *Living Standards Measurements Study. Serbia 2002 – 2007*, Republic Statistical Office, Belgrade, 2008.
[30] Krstić, G., Sanfey, P., Earnings inequality and the informal economy, *Economics of transition*, Vol. 19, 2011.
[31] While for the LSMS all self-employment in agriculture is informal, in the LFS it is considered formal if it occurs in a registered agricultural household. See M. Arandarenko, *Supporting strategies to recover from the crisis in South Eastern Europe. Serbia*, ILO; (forthcoming).

Figure 17: Unemployment rate (2006–2010)



Source: For Croatia, the former Yugoslav Republic of Macedonia and EU 27 data are from the Annual Labour Force Survey (2006–2010), posted in the EUROSTAT web page. For Serbia, data are from the Labour Force Survey (2006–2010).

In the period leading up to the crisis, Croatia experienced a significant easing in overall unemployment, with the unemployment rate for those aged 15–64 years old dropping from 15.4 per cent in 2002 to 8.6 per cent in 2008. The drop in unemployment was slightly more pronounced for women –whose unemployment rate decreased from 17.8 per cent in 2002 to 10.4 per cent in 2008 – than for men (from 13.5 per cent to 7.1 per cent in the same period). The country also managed to reduce the youth unemployment rate – from 36.3 per cent in 2002 to 21.9 per cent in 2008. The youth unemployment rate, however, remained well above that recorded in the EU-27 in the same year (15.5 per cent), with young women's unemployment rate consistently higher than their male peers (by roughly 5 percentage points). In addition, the ratio between youth and total unemployment rates deteriorated throughout the period, reflecting the worsening of the labour market position of young people. This is shown by the youth-to-adult unemployment rate ratio, which increased in Croatia from 2.7 in 2002 to 3 in 2007.

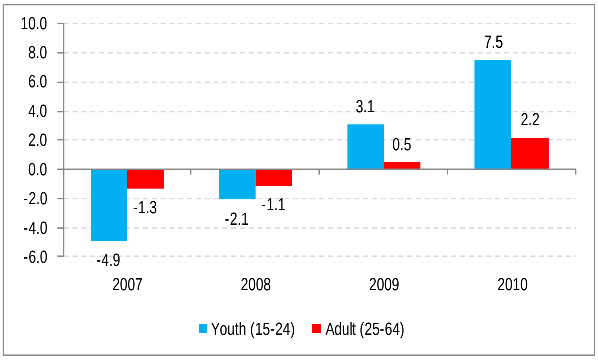
The positive link existing between the level of educational attainment and employment performance is valid also for unemployment. Adults with tertiary education levels experience unemployment rates that are approximately half those recorded for persons with primary education or less (4.1 per cent and 9.5 per cent in 2008, respectively). For young people, the unemployment rate among secondary-educated individuals is higher than for youth with primary education or less (20.6 per cent and 32.5 per cent in 2008).

The labour market gains made by Croatia since 2000 were swept away by the economic downturn. Although the initial effects on the labour market relative to the fall in output were modest, the pace of job shedding accelerated over time. In 2009 and 2010 the unemployment rate in Croatia increased to 9.3 and 12.1 per cent, respectively, from 8.6 per cent in 2008. Since the economic sectors that suffered most were male-dominated, the unemployment rate for men in the period 2008–10 increased by 4.6 percentage points (from 7.1 to 11.7 per cent), while for women it increased by 2.2 percentage points (from 10.4 to 12.6 per cent). Hence the gender gap in unemployment decreased from 3.3 percentage points in 2008 to 0.9 points in 2010.

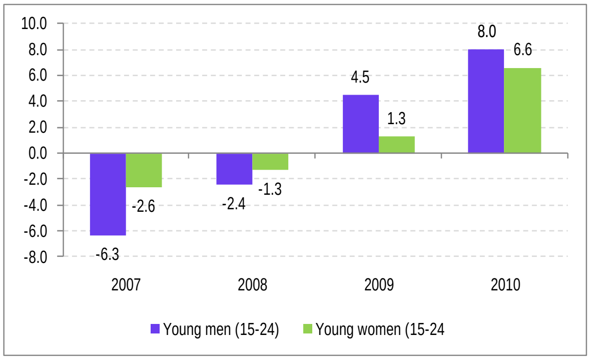
Figure 18 shows that young workers, and especially young men, were the most affected by unemployment, as the changes in their unemployment was three times as high as the change in the unemployment rate of adults. This increased the youth-to-adult unemployment rate ratio to 3.4 in 2010.

Figure 18: Croatia: Change in unemployment, youth and adults, young men and young women, (2007–2010)

Youth and adults (percentage points)



Young men and women (percentage points)



Source: EUROSTAT, Annual Labour Force Survey results (2007–2010)

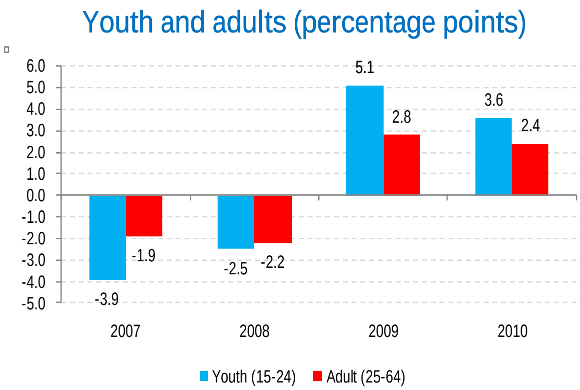
Employment remains a significant problem for young Croatians who are often employed on a short-term or casual basis and find it difficult to get a permanent, career job. Young people, however, usually find jobs faster than adult workers, albeit on a temporary basis, as evidenced by the share of long-term unemployment among youth (45.7 per cent in 2008) compared to that of adults (70.8 per cent in the same year) and by the higher share of young workers employed under temporary contracts compared to their adult peers (37.9 per cent and 9.2 per cent in 2008, respectively).

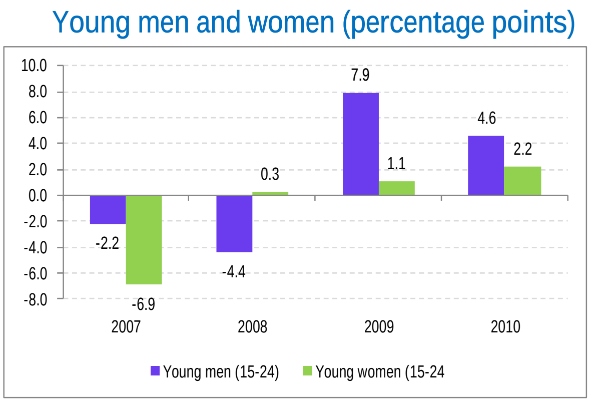
Total unemployment in Serbia decreased between 2004 and 2010, but the unemployment rate increased by 2.4 percentage points. This is primarily due to high flows from activity into inactivity. During the downturn, the number of unemployed persons increased by almost 60,000 individuals, with a surge in the unemployment rate from 14.7 per cent in 2008 to 20 per cent in 2010.

The figures show that Serbian women are more likely to be unemployed than men, despite their generally higher educational attainment. The gender gap in unemployment rates has shown a steady narrowing that has been further highlighted since the onset of the crisis (from 6.2 percentage points in 2006 to 2.2 percentage points in 2010). A possible explanation of this trend is that the public sector − which has a higher than average share of women employees − guarantees higher employment protection than the private one.

After decreasing between 2004 and 2007, the youth unemployment rate started growing again, reaching 46.1 per cent in 2010. Compared to adults, the labour market position of young people, and especially that of young men, deteriorated during the crisis at a faster pace, as the gap between the unemployment rates of youth compared to other age groups widened (Figure 19).

Figure 19: Serbia: Change in unemployment, youth and adults, young men and young women, (2007–2010)





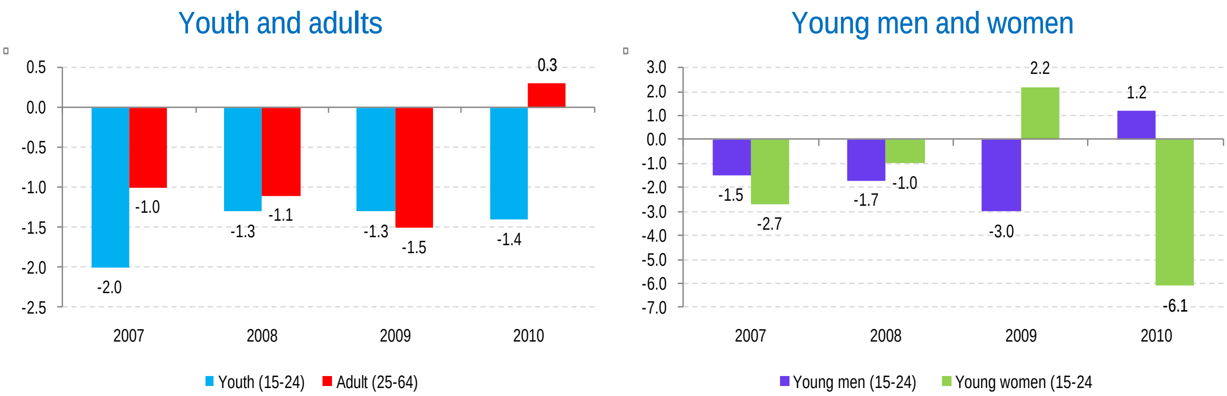
Source: Labour Force Survey (2007–2010)

Another group affected more than others in the Serbian labour market are workers 45 to 54 years old. Unlike for youth, experiencing higher inactivity rates, the employment decreases for this age-cohort were accompanied by a relatively large unemployment increases. Hence, the older group appears to be affected more by the completion of the privatization process and by the restructuring of enterprises, rather than by the impact of the economic downturn *per se*.

Cumulative job losses in the period 2008-2010 in Serbia amounted to approximately 12.5 per cent of total employment, while GDP decreased in the same period by 4.7 per cent (cumulative). This means that for each percentage point of GDP lost during the recession, employment fell by as much as 2.6 per cent. In most other countries of Central and Eastern Europe, the employment elasticity of growth since the start of the crisis has been in the typical range of 0 to 1, meaning that the relative drop in employment has been less severe than the drop in output. For instance, in Croatia the elasticity of total employment was about 0.4.[32] Although the decline in formal non-agricultural employment,–as recorded by the Serbian establishment survey data– was somewhat less severe, at around 7.5 per cent, it was still sharper than the GDP drop. This supports the hypothesis that, aside from the impact of the crisis, there are other, autonomous factors impacting negatively on employment. The climb in the unemployment rate continued throughout 2010 and in the first quarter of 2011. The latest figures of the LFS (April 2011) show an overall unemployment rate of 22.9 per cent and a youth unemployment rate of 49.9 per cent.

In the former Yugoslav Republic of Macedonia, the increasing trend in the unemployment rate started to reverse in 2006. Since then, the unemployment rate has been declining steadily, but at a slower pace in 2009 and 2010. Overall, the unemployment rate in the period 2005-10 declined by 14.3 percentage points, but, at 32.2 per cent of the labour force, it is still much higher than all other SEE countries. Whereas the participation and employment rates of women are much lower than men's, the unemployment rates are almost equally shared between the sexes (32.1 per cent for men and 32.5 per cent for women in 2010). Youth unemployment, at 53.7 per cent in 2010, is nearly twice the unemployment rate of the adult population. The youth unemployment rate, however, decreased by 14.5 percentage points in the period 2005-10, indicating that youth employment in the country moves alongside the business cycle. Unemployment of prime age workers declined by 14.4 percentage points in the same period, although it increased slightly in 2010 compared to 2009.

Figure 20: The former Yugoslav Republic of Macedonia: Change in unemployment, youth and adults, young men and young women (2007–2010)

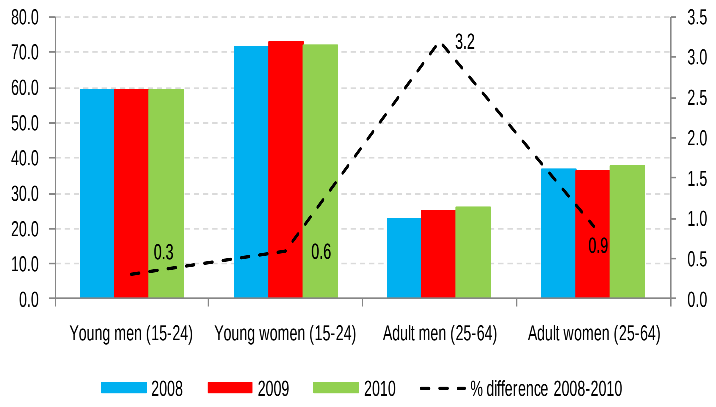


Source: EUROSTAT, Annual Labour Force Survey results (2007–2010)

[32] World Bank, *Croatia. Social impact of the crisis and building resilience*, op.cit

The key indicators of Croatia show that the economic downturn had a higher impact on adult men, compared to other groups. Not only did their employment rate decrease and unemployment increase, but they also experienced higher inflows into inactivity (Figure 21). This negative trend is driven by a fall of activity of men in the age cohort 25 to 49 years old (3.3 percentage points),partly due to the workers' discouragement effect.

Figure 21: Croatia: Inactivity rates and percentage change, youth and adults, % (2008–2010)



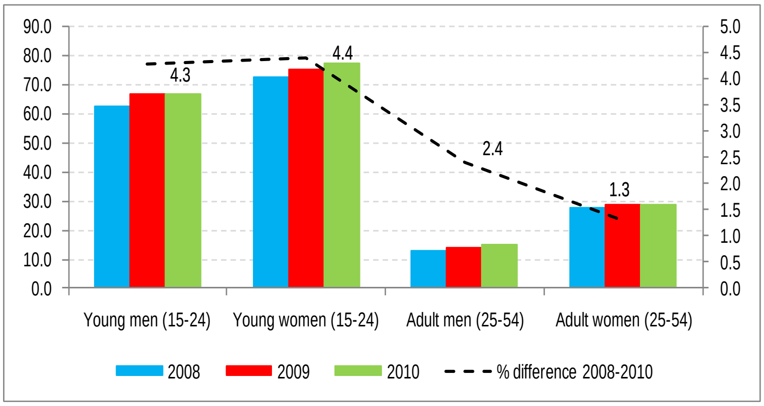
Source: Labour Force Survey (2008–2010)

Employment losses experienced by adult men (5.6 percentage points in the period 2008-10) partly reverted into unemployment (with an increase of 3.2 percentage points) and partly into inactivity (with an increase of 3.2 percentage points).

Youth unemployment levels were pushed upwards by the number of young men who lost their jobs (e.g. the 5.3 percentage point decrease in the employment rate for young men), due,–to a large ,– to the "last-in, first-out" effect, as well as the lower employment opportunities for youth looking for their first job. As youth are more exposed to temporary employment compared to adult workers, when enterprises started to shed jobs, young people were the first to be affected.

In Serbia, the smaller increase in unemployment compared to the decrease in employment suggest that many workers, once they lost their jobs, move into inactivity rather than into unemployment. This seems particularly the case for the younger cohort (15-24 years old). Young people most likely opted to prolong their education, rather than attempt an entry into a depressed labour market.

Figure 22: Serbia, Inactivity rates and percentage change, youth and adults, % (2008–2010)

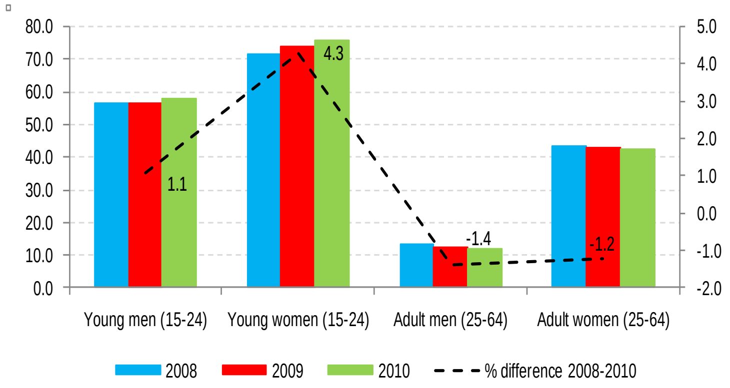


Source: Labour Force Survey (2008–2010)

The increase in inactivity among young men and women (4.3 and 4.4 per cent respectively) was twice the increase recorded for adults. Inactivity, however, increased more among men (2.4 percentage points) than among women (1.3 percentage points).

Contrary to what occurs in Croatia and Serbia, the inactivity figures of the former Yugoslav Republic of Macedonia reveal that inactivity for both adult men and women continued to decline also in the period 2008-2010, while the inactivity among young people (15-24 years old) kept on increasing, especially so for young women, due to rising enrolments into higher education (Figure 23).

Figure 23: The former Yugoslav Republic of Macedonia, Inactivity rates and percentage change, youth and adults, % (2008–2010)



Source: Labour Force Survey (2008–2010)

The labour market data of Croatia, the former Yugoslav Republic of Macedonia and Serbia compared to other Central and Eastern European countries, reveals that in terms of changes in the adult unemployment rates, the three countries are at the lower end of the scale (Figure 25), e.g. adult unemployment increased, but not as much as in other countries. For youth unemployment rates, both Croatia and Serbia are in the middle range, while the former Yugoslav Republic of Macedonia is at the lower end (Figure 24).

Figure 24: Changes in youth unemployment rates 2008–2010, selected countries

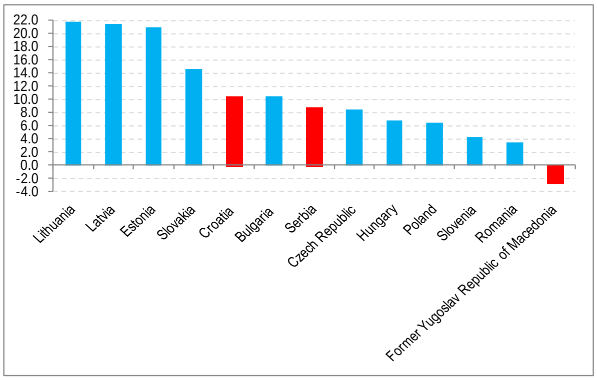
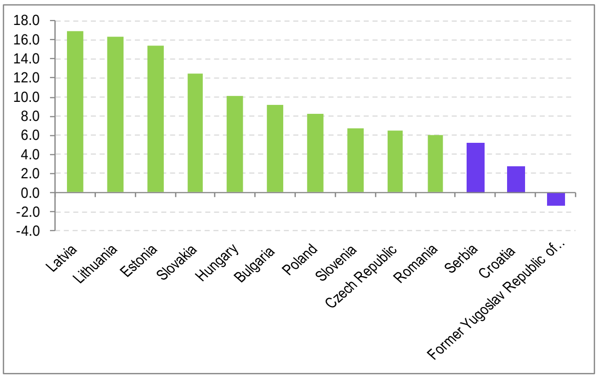


Figure 25:Changes in adult unemployment rates 2008–2010, selected countries



Source: EUROSTAT, Detailed annual Labour Force Survey results, 2008–2010; For Serbia, RSO Labour Force Survey, 2008–2010

In terms of employment changes, however, both Croatia and Serbia score amongst the worst performers, both in the adult and the youth labour market (Figure 26 and Figure 27).

Again, the former Yugoslav Republic of Macedonia is at the lower end of the scale, with positive employment growth and only slightly negative youth employment growth.

Figure 26: Changes in youth employment rates 2008–2010, selected countries

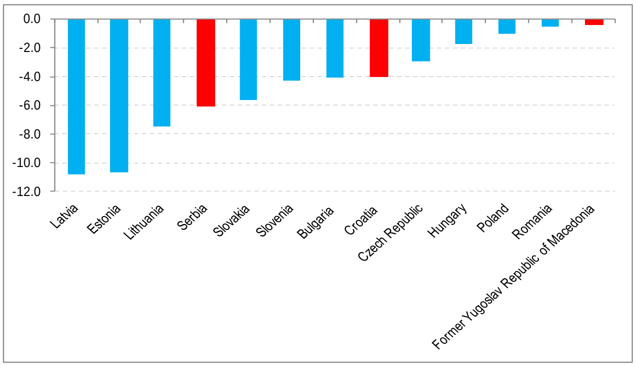
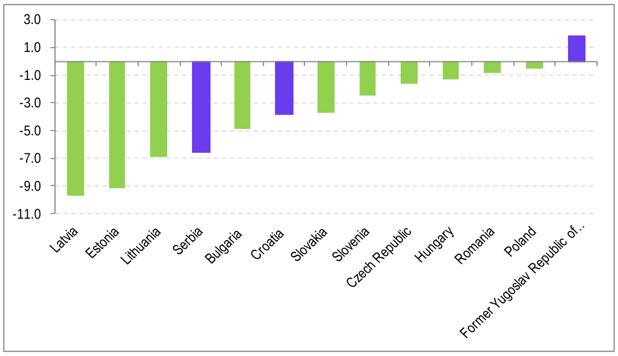


Figure 27: Changes in adult employment rates 2008–2010, selected countries



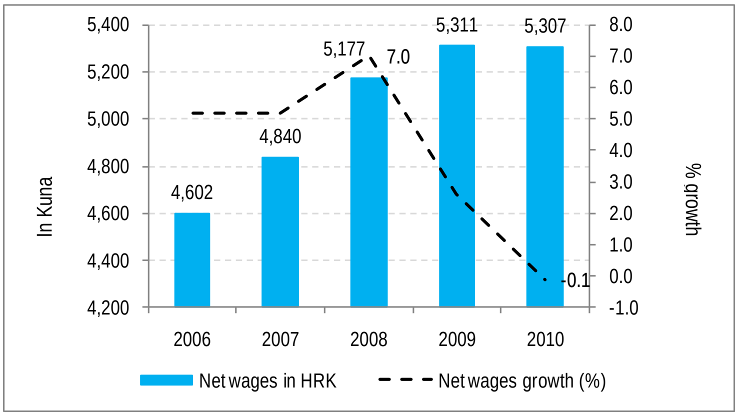
Source: EUROSTAT, Detailed annual Labour Force Survey results, 2008–2010; For Serbia, RSO Labour Force Survey, 2008–2010

2.4 Wage Developments

In Croatia, wage growth significantly slowed at the end of 2008, following the deceleration of GDP. In June 2008 the new *Act on Minimum Wage* prescribed that the share of the minimum wage in the average wage should amount to 39 per cent.[33] The proportion of full-time workers earning the minimum wage in Croatia has been relatively stable since its introduction (between 3 and 5 per cent of total employment). In April 2009 the government lowered salaries in the public sector (mainly in the education, health and public administration sector) in the range of 3 to 5 per cent. This meant that gross salaries in the public sector returned to the 2007 levels. The minimum wage legislation moved the average wage in the opposite direction and in the second and third quarter of 2009 wage growth turned mildly positive, to then decrease slightly in 2010 (Figure 28).

[33] Act on Minimal Wage (Official Gazette of Republic of Croatia 67/08). The minimum wage does not differentiate by work experience, age or region. However, the law stipulates some differences by sector. For workers in the labour-intensive textile, wood processing and leather industries the minimum wage is set at 94 per cent of the national minimum wage in the first year, 96 per cent in the second year, 97 per cent in the third year and 98 per cent in the fourth year of implementation.

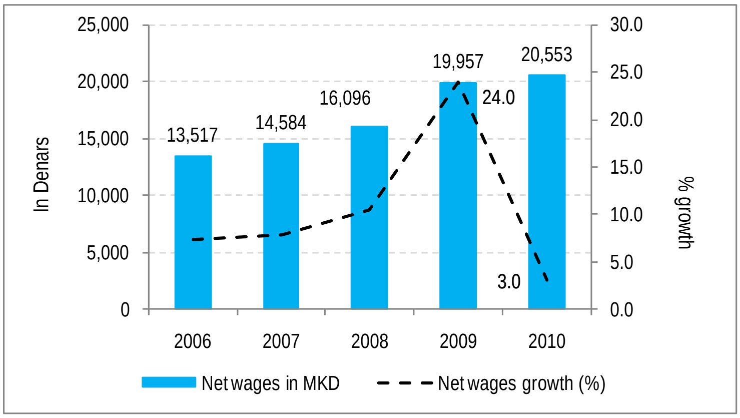
Figure 28: Croatia, Annual average net wages, level and percentage change (2006–2010)



Source: Croatian Bureau of Statistics, *Statistical report*, Zagreb, 2010

In the former Yugoslav Republic of Macedonia, real net wage growth was positive throughout the period 2005-10, with an average annual growth rate of 4.2 per cent. The highest increase was registered in 2009. However, the figures for that year should be interpreted with caution, due to the structural break caused by the deployment of the wage reform and the volatility of the inflation rate.[34] The reduction of the social contribution wedge has been estimated to impact employment in a range between 0.9 and 3.1. percentage points for each percentage point decrease.[35]

Figure 29: The former Yugoslav Republic of Macedonia, Annual average net wages, level and percentage change (2006–2010)



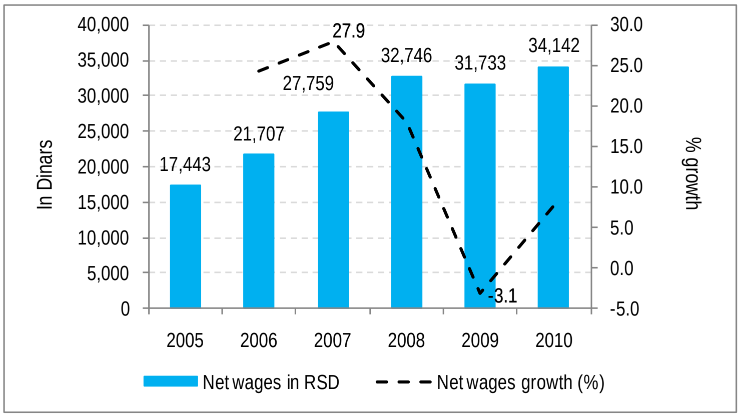
Source: State Statistical Office, A*verage net wages per employee*, Skopje, various years

[34] An adjustment of the monthly nominal growth rate of wages occurred in January, 2009, when the gross wage reforms started to remove the effect of the change in the wage definition (the incorporation of food and travel allowances into the wage).
[35] N. Mojsoska-Blazevski, "Detaxication: Labour cost effect on employment in Macedonia", (forthcoming).

In 2009, the highest real wage growth was recorded in the public sector, reflecting a 10 per cent across-the-board increase in wages for public sector employees. This was the second consecutive increase after the government announced a three-year gradual increase in public sector wages (10 per cent per year).[36] Furthermore, in 2009 the implementation of a new collective agreement for low-wage workers in the education sector also contributed to the increase.

In Serbia, average real wages have remained reasonably stable since the start of the crisis, with a decrease of 3.1 per cent recorded only in 2009. In January 2009, the public sector started to adjust through real wage cuts, but average wages in the private sector continued to grow at roughly the same pace. In the public sector, the wage fall has been most prominent in public administration (over 6 per cent by the end of 2009), given the government's decision to cut above-average wages by 10 per cent, as well as freeze all other wages in public administration. Hence, the increase in the average wage in public administration recorded in 2010 can be attributed to the cuts in the number of workers with lower levels of wages.

Figure 30: Serbia, Annual average net wages, level and percentage change (2006–2010)



Source: Republic Statistical Office, *Employment and earnings*, Belgrade, various years.

Still, it is counterintuitive to witness growing real wages in the private sector during a recession. This was caused by a number of factors. First, the minimum wage was raised by 11 per cent in nominal terms in January 2009, largely as compensation for the postponement of the full implementation of the *General Collective Agreement*. This postponement turned out to be indefinite. Since the number of minimum wage recipients – and those just above it – is rather high in the private sector, this pushed up average wages.[37] Second, the largest year-on real wage growth was registered in the period 2008-09 in the accommodation (17.8 per cent) and retail trade industries (12 per cent). Both are predominantly low-wage sectors, further confirming the hypothesis about the impact of the minimum wage increase on average wage trends after January 2009. Furthermore, due to the

[36] In 2009, the planned increase was not implemented due to weak government finances and the possible effect the increase could have on inflation.
[37] This is especially true for those who are employed by small businesses, since more than half of them receive salaries equal to the minimum wage. Many workers earn more, in the form of unreported, "envelope" wages, but this is impossible to capture with any reliability.

methodological changes in the classification of workers in small unincorporated businesses, their number fell by 20 per cent. Since most of these workers receive only the minimum wage, their reduced numbers contributed to increased overall average wages in the private sector.

Finally, because of the hiring and firing costs for employees on open-ended contracts in Serbia, most firms have developed a two-tier system, with employees on fixed-term contracts accounting for most labour turnover and occupying the second tier, characterized by job insecurity and lower wages. Some firms have responded to the crisis by cutting second-tier employment, as indirectly confirmed by the LFS data. As a result, average wages have increased.

2.5 Human Capital Formation

The impact of learning and training is of central importance in determining the employability of the labour force and influencing the investment climate of an economy. The economic transformation resulting from the transition to a market economy in the countries of South Eastern Europe resulted in a serious shock to their education and training systems, which had to be re-oriented to respond to the needs of increased globalization, trade liberalization and technological change.[38]

Since the 1990s, enrolment rates in secondary and tertiary education have increased in all three countries, including through the provision of education in private universities. Since 2000, public investment in education as a percentage of GDP has been increasing, with Croatia, the former Yugoslav Republic of Macedonia and Serbia achieving levels of expenditure on education similar to the EU countries in 2009–2010 (approximately 4.5 per cent of GDP). In particular, the former Yugoslav Republic of Macedonia increased public investment in education from 3 per cent of GDP in 2006 to 4.7 per cent in 2009. This reflects the government's effort to raise the education level of the population, as the country has a relatively high proportion of population aged 18-24 with primary education only (23 per cent in 2006 and 16.2 per cent in 2009). Such a policy was implemented by: i) extending the duration of basic education to nine years, ii) making secondary education compulsory, and iii) increasing subsidies to tertiary education.

All three countries have lower rates of pre-primary enrolment compared to the European Union (90 per cent), ranging from 20 per cent in the former Yugoslav Republic of Macedonia, to 51 per cent in Serbia and 54 per cent in Croatia.[39] In the former Yugoslav Republic of Macedonia, low enrolment in pre-school may be explained by the relatively low labour market activity of women, the tradition that grandparents take care of their grandchildren, as well as the underdeveloped network of public childcare facilities.

Net enrolment rates in basic education range from 91 per cent in Croatia and the former Yugoslav Republic of Macedonia to 94.2 per cent in Serbia. Prospects of progressing to secondary education are equal for both sexes in Croatia, while in the former Yugoslav Republic of Macedonia, girls have less opportunity than their male peers (89 per cent and 98 per cent progression, respectively). Progression in the former Yugoslav Republic of Macedonia improved in the academic year 2008-09,

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[38] ILO, *Youth employment in Eastern Europe: A crisis within the crisis*, A background paper for the Informal Meeting of Ministers of Labour and Social Affairs during the 100th Session of the International Labour Conference, June 2011.
[39] World Bank, *Economic and social indicators*, op.cit

as the result of the introduction of mandatory secondary education with substantial fines for violation.[40]In Serbia, conversely, girls are more likely to progress to secondary (91.4 per cent) and tertiary education (56.3 per cent) than boys (89.1 per cent and 43.6 per cent). Since 2004, tertiary enrolment has been increasing in all three countries, with young women's enrolment rates exceeding that of young men by as much as 10 percentage points.

The labour market statistics for the three countries indicate that most inactive and unemployed people, as well as discouraged jobseekers, are graduates from secondary education. This reveals that the link between the labour market and secondary education, including vocational education and training (VET), weakened during the transition years, is still unable to provide the skills that the labour market needs.

In the years leading to the crisis, Croatia faced skill mismatches as well as shortages.[41] Enterprises were experiencing difficulties in finding skilled workers, i.e. workers with secondary and tertiary technical education, reflecting a shortage of high and specialized skills and a surplus of low and general skills. In 2007, Croatian employers, and small and medium-size enterprises in particular, were reporting skill shortages as a significant obstacle to their competitiveness.

[40] According to the amendments to the former Yugoslav Republic of Macedonia Law on Secondary Education (Official Gazette No. 49/2007), parents have to pay a fine of approximately €1,000, if their children do not attend regular secondary education. This amount is about 3.5 times the average nominal net wage in 2010.

[41] World Bank, *Croatia's EU convergence report: Reaching and sustaining higher rates of economic growth*, World Bank, Washington D.C., 2009

Box 1: Skills mismatch

A simple method to measure *education and occupation mismatch* uses the level of educational attainment and one-digit occupational classification applied to the main job. A mismatch is defined as the situation where the educational attainment of the worker is higher than the educational level required by the current job. The measurement of mismatch may be represented schematically by the following matrix where the darker areas represent mismatch:

<table>
<tr><th colspan="2" rowspan="4">ISCO-08
Major Groups</th><th colspan="7">ISCED-97 Educational attainment</th></tr>
<tr><th>0</th><th>1</th><th>2</th><th>3</th><th>4</th><th>5</th><th>6</th></tr>
<tr><th colspan="7">ISCO-08 Skill level</th></tr>
<tr><th colspan="2">1st</th><th colspan="3">2nd</th><th>3rd</th><th>4th</th></tr>
<tr><td>1</td><td>Managers</td><td colspan="2"></td><td colspan="3"></td><td></td><td></td></tr>
<tr><td>2</td><td>Professionals</td><td colspan="2"></td><td colspan="3"></td><td></td><td></td></tr>
<tr><td>3</td><td>Technicians and associate professionals</td><td colspan="2"></td><td colspan="3"></td><td></td><td></td></tr>
<tr><td>4</td><td>Clerical support workers</td><td colspan="2"></td><td colspan="3"></td><td></td><td></td></tr>
<tr><td>5</td><td>Service and sales workers</td><td colspan="2"></td><td colspan="3"></td><td colspan="2" rowspan="2">Mismatch</td></tr>
<tr><td>6</td><td>Skilled agricultural, forestry, fishery workers</td><td colspan="2"></td><td colspan="3"></td></tr>
<tr><td>7</td><td>Craft and related trades workers</td><td colspan="2"></td><td colspan="3"></td><td></td><td></td></tr>
<tr><td>8</td><td>Plant and machine operators and assemblers</td><td colspan="2"></td><td colspan="3"></td><td></td><td></td></tr>
<tr><td>9</td><td>Elementary occupations</td><td colspan="2"></td><td colspan="3"></td><td></td><td></td></tr>
<tr><td>0</td><td>Armed forces occupations</td><td colspan="2"></td><td colspan="3"></td><td></td><td></td></tr>
</table>

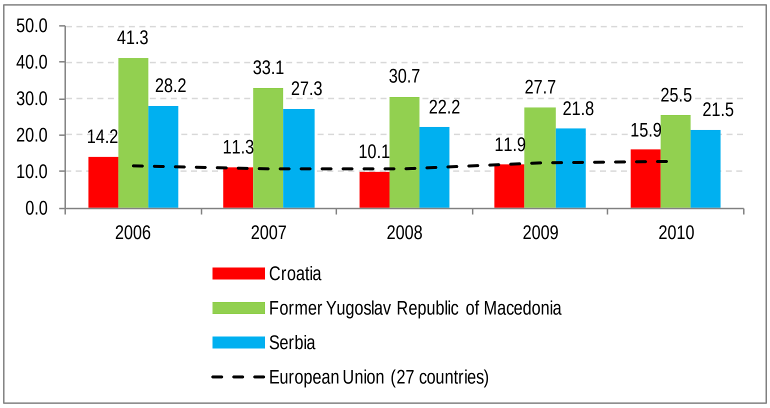
One of the consequences of skills mismatches is structural unemployment, expressed as the share of unemployed individuals at different education levels (ISCED 0-1, ISCED 2-3, ISCED 4-5 and ISCED 6). In recent years, several countries, like Slovenia, have been experiencing a higher share of the unemployed among university graduates. This has been caused, on the one hand, by public policies expressly promoting enrolment in tertiary education, while economic structures have been slow to adapt to higher level skills, and mismatches between the streams chosen by students and real labour market requirements. This can be measured by examining the occupations most recurring in the vacancies posted in a given period with the employment services. For instance, the vacancies posted with the employment service of Slovenia in 2009 were mostly in crafts and related trades, elementary occupations, service and shop and market sales occupations. All of these require skills that are below those provided by tertiary education.

One strategy to overcome skills mismatches is to provide incentives for the taking up of educational streams in occupations for which there is deficit in the labour market. This path is currently being undertaken by Slovenia, with the new Scholarship Act .

Source: Mehran F., *Youth employment. A training module on data requirements and analysis*, ILO (forthcoming); M. Ignatovic," Mismatch of labour market needs and skills in Slovenia", European Employment Observatory, April 2011.

In recent years, researchers have focussed attention on indicators measuring the percentage of youth who are neither in employment nor in education or training (NEET). The non-employment rate offers the advantage of calculating unemployment and inactivity that are not due to school attendance.

Figure 31: Young people not in employment, education or training (NEET), 2006–2010



Source: For Croatia and the former Yugoslav Republic of Macedonia: EUROSTAT, *Transition from school to work*, various years, For Serbia RSO, *Labour Force Survey*, various years

Youth who are not in employment, education or training in Croatia (see Figure 31 above) decreased considerably in the period 2005–08, and levelled out at just over 10 per cent, as per EU-27 rates. The combined effect of lower employment and higher unemployment rates pushed the NEET rate to nearly 16 per cent, which is four percentage points higher than that recorded in the EU-27 in the same year. Similarly, the share of young people who are NEET in Serbia and the former Yugoslav Republic of Macedonia has been decreasing steadily since 2006, as a result of higher shares of youth enrolled in education. The higher rates compared to the EU 27, however, are mostly caused by the high youth unemployment levels in the two countries.

3. Policy Responses to Counteract the Impact of the Economic Crisis

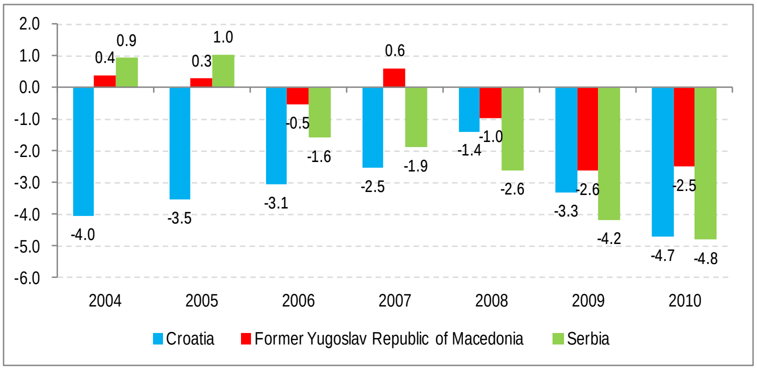
The economic crisis affected the countries in South Eastern Europe at different times and to different degrees. The economies of Serbia and Croatia experienced a sharp deceleration of growth already in mid 2008, while the slowdown in the former Yugoslav Republic of Macedonia occurred at a much slower pace and only in 2009.

Monetary authorities reacted in a broadly similar manner. The scope of monetary policy, however, was determined by the exchange rate regime of each country, i.e. pegs or near pegs in Croatia and the former Yugoslav Republic of Macedonia, and managed floats in Serbia. The national banks of Croatia and the former Yugoslav Republic of Macedonia intervened by relaxing reserve requirements, thus injecting liquidity into the market. The National Bank of Croatia also intervened in the foreign exchange market to stabilize the exchange rate, while the National Bank of the former Yugoslav Republic of Macedonia raised interest rates to “sterilize” the impact of the expansionary fiscal policy deployed by the government. In Serbia, to calm bank anxiety and restore confidence in the financial sector, the government raised deposit insurance coverage. After the sudden stop in capital inflows, the Serbian currency depreciated by 23 per cent in the period October 2008–March 2009 and then stabilized in the second half of 2009, also thanks to the interventions of the National Bank. Despite the sizeable and rapid depreciation of the Serbian currency, the pass-through into inflation was initially very modest, due to the concurrent drop in domestic demand that prevented a rise in inflation.[42] Inflation, however, raised in the first quarter of 2011 to 12.7 per cent.

In both Croatia and Serbia fiscal policy options were limited given the expansionary, and therefore pro-cyclical, stance adopted in the years prior to the crisis. The decline of public revenues and low prospects for realizing privatization proceeds reduced the scope for financing the fiscal deficit, while tight international financial markets made foreign borrowing more difficult. Space to increase taxes was also limited given the high degree of taxation already existing in both countries.

[42] For each percentage point of depreciation of the national currency, prices rose by less than 0.2 per cent.

Figure 32: Central government balance, % GDP (2004–2010)



Source: European Bank for Reconstruction and Development, *Macroeconomic indicators, 2004–2010*, op.cit.

As a result, the fiscal deficit widened significantly in both countries, despite the rebalancing efforts (Figure 32).

The government of the former Yugoslav Republic of Macedonia significantly increased spending in the last two months of 2008, turning a moderate fiscal surplus at the beginning of 2008 into a deficit of 1 per cent at the end of the year. In the same year, the government adjusted revenue and spending targets by nearly 10 per cent compared to the initial budget proposal, while maintaining a deficit target of 2.6 per cent of GDP. However, the starting position of the former Yugoslav Republic of Macedonia was different from that of Croatia and Serbia, as the country undertook a number of structural reforms prior and during the crisis that freed fiscal space to weather the worst of the downturn. In particular, the former Yugoslav Republic of Macedonia introduced a reform of the gross wage system in 2009 that included the gradual reduction of non-wage labour costs (from 32 per cent in 2008 to 27.9 per cent in 2009 and 22 per cent in 2011).[43] Although it is too early to assess the full impact of the cut of the social contribution wedge on employment outcomes, the reform may have helped enterprises overcome the difficult economic period and prevented a deterioration of youth employment. In comparison with other countries, youth unemployment actually fell by nearly 3 percentage points. In addition, the reform had a positive impact on earnings, as wages rose by 24 per cent in 2009 and 3 per cent in 2010, as well as on tax compliance. There is also anecdotal evidence that the reform may have reduced employment in the informal economy. However, such positive results may be short-lived, as the experience of other countries that introduced similar reforms show.[44]

[43] Mojsoska-Blazevski. N., *Supporting strategies to recover from the crisis in South-Eastern Europe: Country Assessment Report - The former Yugoslav Republic of Macedonia*, ILO, 2010.

[44] Slovakia introduced a similar reform in 2004 and the Czech Republic in 2008. Both countries, however, experienced large employment losses during the economic downturn.

3.1 General Stimulus Measures Introduced in Response to the Crisis

In Croatia, anti-crisis policies were shaped by the efforts to lower the budget deficit. The revenue shortfall and the spending pressures from automatic stabilizers required several revisions of the 2009 budget. To protect public finances –and having failed to agree on spending rationalization– the government introduced new taxes and increased existing ones, thus adopting a pro-cyclical stance.[45] Overall, through a combination of expenditure reduction (equal to 2.1. per cent of GDP) and revenue increase (amounting to 0.4 per cent of GDP), the government managed to keep the deficit at around 4 per cent of GDP (3.3. per cent in 2009 and 4.7 per cent in 2010). Social outlays – e.g. benefit for old age, survival and (partly) disability – remained at around 10.5 per cent of GDP, while expenditures for social welfare and unemployment benefits ranged from 1 to 2 per cent of GDP. Several measures for economic recovery were undertaken by the government, many aimed at supporting enterprises and preserving jobs. As part of the anti-recession package, the government adopted a number of measures in 2009, including: i) the introduction of a "crisis tax" applied on personal income (discontinued in 2011); ii) the increase in the value added tax (VAT) standard rate (from 22 to 23 per cent); iii) the provision of subsidies up to 20 per cent of the total salaries for enterprises introducing shorter work hours; iv) the alignment of the unemployment benefit to the minimum wage (first 90 days); and v) the introduction of new rules for the calculation of public sector wages.

In April 2010, Croatia adopted the *Economic Recovery Programme* (ERP) that contains measures aimed at enhancing liquidity, supporting enterprises, as well as improving the effectiveness of labour and social policies. By adopting the ERP, the Croatian Government openly recognized the limits of the previous growth model, centred on domestic demand and the accumulation of external imbalances. Rather than an anti-recession programme, the ERP is a structural reform plan aimed at downsizing the state's role in the economy. It includes the rationalization of the public administration, the reduction of budget expenditures, the simplification of the tax regime, the reshaping of state subsidies and the promotion of investment to foster growth and competitiveness. The ERP measures also include the financing of business projects, through venture capital funds, and the establishment of guarantee funds.[46]

[45] The government introduced a special tax on salaries, pensions and other incomes in 2009 ("crisis tax") that was discontinued at the end of 2010. The purpose was to collect additional revenues to reduce the budget deficit. *Act on Special Tax on Salaries, Pensions and Other Income* (94/09 and 56/10).

[46] *Decision on the Intention to Participate in the Establishment of Funds for Economic Co-operation* (Official Gazette of Republic of Croatia 08/10).

Box 2: Croatia Economic Recovery Programme, 2010

The Economic Recovery Programme includes a number of structural reforms to safeguard macroeconomic stability and increase the country competitiveness. These include: i) Fiscal Responsibility Law (reduction of expenditures by 1 per cent of GDP annually until the primary balance is reached); ii) revision of the public sector wage system (with the introduction of a merit-based system and the abolition of multiple bonuses); iii) the reform of social welfare (uniform system for benefit targeting, consolidated system administration, one-stop-shop delivery, activation mechanisms and linking of the poverty benefits to the poverty line to protect it from deterioration), iv) refocus of the government role from lender of the last resort to provider of an enabling environment (decrease administrative barriers to doing business, fight against corruption, faster privatization of non-strategic enterprises, investment in research and innovation).

The measures envisaged by the ERP to improve labour market policies include:

– Investing in vocational education and training programmes targeting the unemployed and inactive individuals to increase their occupational competencies;

– Introducing time limits to the full unemployment benefit entitlement to motivate the unemployed to actively search for a job and conditioning part of the unemployment benefit to the participation in training programmes. At the same time, unemployed at risk of long-term unemployment would benefit from a longer duration of the cash unemployment benefit;

– Expanding apprenticeship, internship and work practice programmes targeting young people to help them acquire work experience, highly valued by employers;

– Strengthening the capacity of the Croatian Employment Service to provide career information, counselling and guidance and improve service delivery to the most disadvantaged groups by enhancing cooperation with the Centres for Social Welfare and the Vocational Education and Training Agency.

Source: Government of the Republic of Croatia, *Plan provedbenih aktivnosti Programa gospodarskog oporavka*, May 2011

In 2009–2010 the policy of the Serbian government was centred on efforts to stabilize the economy and put it back on a growth path. In 2009, the government – with the support of a €3 billion Stand-by-Arrangement (SBA) signed with the International Monetary Fund (IMF)– introduced a number of measures to offset the sharp decrease in credit activity, as well as decelerating FDI inflows. The measures included subsidized credits to enterprises and households for the purchase of durable goods and the bailout of large firms.[47] Although the IMF package was flexible enough to include growth-supportive measures – such as interest rate subsidies and loan guarantees mentioned above– it also included public sector restrictions. Since fiscal policy in the period prior to the crisis was pro-cyclical, Serbia could not switch to a counter-cyclical (i.e. expansionary) fiscal policy when the crisis hit. Large capital inflows in the mid-2000s fuelled consumption and a surge in imports. This, in turn, generated exceptional tax revenues, further boosted by large privatization proceeds. Budget deficits at around 2 per cent of GDP in the period 2006-2008 were interpreted as a prudent fiscal policy,

[47] For example the bailout of the Bor copper mining complex.

while in reality there should have been budget surpluses, as tax revenues were increasing more than GDP growth. The contraction of domestic demand and imports caused an 8 per cent drop in public revenues − higher than the decrease in output. In line with the IMF recommendations, the fiscal policy response was accommodative, with the budget deficit rising from 2.6 per cent in 2008 to 4.2 per cent in 2009. The country, however, could not afford an increase of the deficit equal to the fall in tax revenues (which would have been a true anti-cyclical policy), so it was also necessary to cut some public expenditure. The cuts targeted mainly public sector salaries and pensions, frozen in both 2009 and 2010. Additional expenditure adjustments required by the agreement concluded with the IMF, such as the reduction in the number of public sector employees and cuts in discretionary government spending, did not materialize. Instead, public investments were shelved. This was a negative development, since these investments, such as the building of major transport networks, could have partly mitigated the drop in demand by boosting construction and associated industries. Due to a sluggish recovery in 2010, tax revenues were lower than expected. As a consequence, the deficit reached 4.8 per cent of GDP, with few prospects to drop below 4 per cent in 2011.

The main economic policy challenge faced by the former Yugoslav Republic of Macedonia during the downturn was in striking an appropriate balance between supporting economic growth and protecting against risks.[48] The fiscal policies adopted in the crisis period were focused on supporting aggregate demand, whereas the monetary policy used its instruments to preserve the economy from pressures on the current account and exchange rate. The fiscal stance and planned government deficits enacted in the period were broadly appropriate for supporting output and employment without threatening debt ratios. However, international financial institutions recommended the restoration of a balanced budget in the medium-term to preserve debt sustainability and to free some space for future economic cycles. The relatively good performance of the former Yugoslav Republic of Macedonia during the crisis can be attributed, *inter alia*, to the intensive pace of reforms implemented by the government in the period prior to the crisis.[49] These reforms focused on improving the business climate and included measures addressing market entry and exit; customs administration and barriers to trade; labour taxation; administrative burden for enterprises; streamlining of costs for doing business; regulatory guillotine and reform of the cadastre.

[48] International Monetary Fund (IMF), *FYR Macedonia: Article IV Consultation. Concluding Statement*, IMF, 2010 Available at http://www.imf.org/external/np/ms/2010/111710.htm.
[49] Bartlett, W. and Monastiriotis, V. (eds*) South Eastern Europe after the Crises: a New dawn or back to business as usual?*, London, op.cit.

Box 3: The four anti-crises packages in the former Yugoslav Republic of Macedonia

As a direct response to the slowdown in the country, the government launched four anti-crisis packages. The first package consisted of measures targeting: i) companies with liquidity problems (through a tax amnesty, payment of tax and social security debts in instalments and so on), and ii) enterprises in general, which were supported through reduced import tariffs and custom duties, reduced social contributions rates and changes in the profit tax system. In addition, taxation of farmers was reduced and simplified. The main goal of these measures was to support companies to overcome the period of depressed demand and to maintain the momentum of rising investments. This package came into effect in 2009 and was estimated at €330 million. The second stimulus package consisted of a large 8-year infrastructure investment plan (estimated at €8 billion). The third package comprises a revised budget with downwards adjusted revenues and expenditures (based on actual figures, as well as reduced GDP projections), credit support to companies and other measures (such as the easing of external trade). In March 2010, the Government announced a fourth stimulus package, including a freeze in public sector wages; an increase in the wage level of some low paid occupations in some public sector branches; and the establishment of a Fund for agricultural land, aimed at distributing land to eligible unemployed individuals (registered unemployed in rural areas).

The former Yugoslav Republic of Macedonia signed in early 2011 a two-year arrangement with the IMF, under the Precautionary Credit Line (PCL) for an amount equal to €475.6 million.

3.2 Measures Aimed at Supporting Jobseekers: Labour Market Policies

In the face of sharp GDP contractions, many Eastern European countries scaled up labour market and social policies, and introduced discretionary policy measures to cushion the negative effects of the crisis on workers and low-income households. Measures to protect affected households included gearing up passive and active labour market programmes and strengthening social assistance. Spending on unemployment benefits increased automatically as job losses mounted. However, the unemployment benefit coverage is generally low in all three countries and many unemployed people are ineligible for benefits. This means that the GDP stimulus effect of the unemployment benefit – through the consumption multiplier – has been very low as well.[50]

A relatively well established programme to respond to demand shocks is labour-intensive public work, which can be an effective counter-cyclical labour market measure. In the three countries under consideration, they served as a minimum safety net for the increasing number of unemployed not covered by the unemployment benefits. Other active labour market programmes, introduced or expanded during the crisis, included youth apprenticeship programmes (Serbia) and labour market

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[50] For example in Latvia a 144 per cent nominal increase in unemployment benefits amounted to a stimulus of 0.61 per cent of GDP given the likelihood of the benefit to be spend rather than saved or invested. Increases in unemployment benefit expenditures in countries with low coverage, however, are unlikely to have a measurable impact. For example, Armenia that increase spending by 74 per cent, but this resulted in a stimulus equal to 0.01 per cent of GDP. See World Bank, *The jobs crisis: household and government responses to the great recession in Eastern Europe and Central Asia*, World Bank, Washington D.C. 2011.

training to increase employability (Croatia), targeted to the hardest-hit groups of the population, namely young and older workers as well as low skilled men and women.

3.2.1 Passive Labour Market Policies

In Croatia labour market policies are financed by the state budget, with the unemployment benefit absorbing most of the available funds. Spending on labour market policies equals 0.4 per cent of GDP, with active labour market policies (ALMPs) accounting for 0.1 per cent of GDP, only. This is in sharp contrast to EU countries where expenditures on active labour market programmes, in most cases, represent at least one-third of total labour market expenditure.[51]

The unemployment benefit coverage in Croatia is rather low (23 per cent of the total registered unemployed in 2007).[52] In 2009, recipients of unemployment benefits increased by 22.4 per cent on an annual basis, but in 2010 the increase was marginal (1.9 per cent).The benefit covers only a small proportion of workers affected by the crisis, as young workers with limited job tenure, new labour market entrants and workers in the informal economy are not entitled. In addition, the prevalence of long-term unemployment implies that many in the unemployment pool had exhausted the unemployment benefit. However, persons in the bottom income quintile received 41 per cent of the total unemployment benefit expenditure, which appears generous enough to lift many recipients out of poverty.[53] In 2009, due to the fiscal constraints brought on by the crisis, Croatia had to implement measures to reduce unemployment benefit expenditures. This was done by linking the maximum benefit payable to the minimum wage (100 per cent in the first 90 days and 80 per cent thereafter) rather than the average wage.[54] As part of the anti-crisis measures included in the *Economic Recovery Programme* there is the introduction of time limits to the full unemployment benefit entitlement in order to motivate those unemployed to actively search for a job and making it conditional that part of the unemployment benefit was paid only on participation in training programmes.

In Serbia, total expenditures on unemployment benefits increased by 38 per cent (from RSD 18.5 billion in 2008 to RSD25.5 billion in 2010). This remarkable growth during the crisis, however, was due to the fact that in 2009 and 2010 all arrears, which amounted to 5 month lagged payments in 2008, were removed.[55] At the same time, as the data on overall spending indicate, unemployed individuals eligible for the benefits were protected more efficiently by the timely payment of entitlements. It should be noted that the new employment promotion framework was finalized before the crisis.

[51] Expenditure on the unemployment benefit is countercyclical, i.e. it increases during a downturn and decreases during an upturn. Spending on active labour market policies, on the other hand, may increase or decrease during a downturn, depending on the fiscal space available. In many countries of the EU the amount spent on ALMPs increased substantially during the recent downturn to mitigate negative labour market effects.

[52] World Bank, , UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, op.cit.

[53] World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, op.cit

[54] In 2010, the amendments to the Act on Employment Mediation and Unemployment Rights was derogated with the re-introduction of the average, and not minimum wage as a reference for the unemployment benefit.

[55] This was achieved through the provisions of the new law on employment promotion which introduced more restrictive criteria in terms of duration and replacement ratios, thus reducing the number of eligible beneficiaries and the average amount of the benefit. Republic of Serbia, *Law on Employment and Insurance against Unemployment,* April 2009.

The preliminary analysis conducted prior to the adoption of the *Law on Employment Promotion and Insurance against Unemployment* (March 2009) indicated that a slight reduction in unemployment benefits would not have a significant impact on poverty incidence, since the number of recipients had always been low (less than 10 per cent of registered unemployed) and recipients tended to be above the poverty line.[56] The unemployment benefit, payable for 12 months, amounts to 50 per cent of the average salary of the beneficiary in the last six months prior to the loss of employment. The amount of the benefit cannot be higher than 160 per cent or lower than 80 per cent of the minimum wage. Previously, the replacement ratio was 60 per cent for the first three months, decreasing to 50 per cent afterwards, and the benefit could range between the minimum and the average wage.

Although registered unemployment in the former Yugoslav Republic of Macedonia is relatively high, only few receive unemployment cash benefits (about 7.5 per cent of registered unemployed). The low coverage reflects a labour market situation where: i) a high proportion of unemployed do not have any prior work history (first time job-seekers); ii) there is a high share of long-term unemployed who have exhausted the benefit; iii) many registered unemployed are actually inactive or informally employed, and do not have "official" work experience. The low coverage of unemployment benefits is also due to the strict entitlement conditions that limit the benefits to people who have a sufficient work record (minimum 9 months continuous work or 12 months with breaks). Benefit duration ranges between 3 and 12 months, though maximum benefit duration was adjusted downwards from 18 months. Only a small proportion (10–15 per cent) of the entitled unemployed receive the "regular" unemployment benefit, while for most beneficiaries the scheme provides an early retirement allowance. During the economic slowdown, the authorities in the former Yugoslav Republic of Macedonia did not make any change in the eligibility criteria and/or level of the benefit.[57]

Short-time work arrangements were introduced in Croatia in mid 2009. In Serbia, the Ministry of Labour and Social Policy made a proposal that had to be abandoned due to the lack of funding. In Croatia the measure had a low take-up due to strict eligibility conditions, the low level of subsidies (reduction of social insurance contributions by 20 per cent) and onerous administrative requirements.

[56] Matkovic, T., Arandarenko, M., "The labour market impact of economic crisis in Croatia", Background paper prepared for the UNDP-World Bank Study *Croatia crisis impact: Poverty and labor markets*, mimeo, 2010.
[57] The replacement rate is initially 50 per cent to then decrease to 40 per cent.

Box 4: Short-time work programmes in Germany

In 2009, German output declined by 4.7 per cent, about twice the size of the GDP decline in the United States in that same year. Nevertheless, the recession did not translate into a strong employment decline in Germany. The slump in output was essentially limited to the export economy and domestic demand was only depressed by a small degree.

Recent empirical studies suggest that short-time work programmes have been quite successful in the recent downturn in preserving jobs and in keeping unemployment down. Short-time compensation (or short-time work) aims at reducing lay-offs by allowing employers to temporarily reduce hours worked while compensating workers for the induced loss of income. Short-time work is an option within the unemployment insurance systems that allows employers to reduce the hours of workers for economic reasons, while permitting workers to receive compensation for their partial layoff. Compensation is usually supported by the unemployment insurance schemes, in the form of partial unemployment benefits.

The instrument of short-time work was especially common in Germany's industrial sectors that rely heavily on exports as well as service sectors closely linked to industrial production. In the second quarter of 2009, the peak of the crisis in Germany, one in three employees with jobs that were subject to social security contributions in metal production experienced a reduction in working hours. Similarly, in the automobile industry, the ratio was one in four.

In November 2008, the maximum period of 12 months for short time work was increased to 18 months. In May 2009 this period was extended to 24 months, but only for short-time work which had started in 2009. For 2010 and 2011, the duration was decreased back to 18 and 12 months, respectively. The new regulations also abandoned the "one-third rule," which stipulated that short-time work could only be implemented when at least one third of employees incurred a 10 percent loss of earnings. Since 2009, it has been sufficient to have a single worker facing a reduction in working hours. Since January 2009, employers are also required to pay only 50 percent of the social security contributions in the first 6 months of short-time work, with the other 50 per cent being reimbursed by the Federal Employment Agency. For the remaining period, reimbursements are 100 per cent. If the worker is involved in further training, there are no costs in the first 6 months of the short-time work for the employer. An additional modification extended short-time work to also include temporary workers, who have been allowed to participate since the beginning of 2009. It is no longer required that workers have to "clock-in" a negative balance of hours worked before short-time work can commence.

This significantly helped to cushion the job losses by extending subsidies for a temporary reduction in working hours. In addition, the combination of short-time work and workers' training and re-training, helped prepare German companies for when the demand for their goods increased again.

K. Brenke, U. Rinne, K. F. Zimmermann, *Short-Time work: The German answer to the Great Recession*, IZA Discussion paper No. 5780 June 2011; P. Cahuc, S. Carcillo, *Is short-time work a good method to keep unemployment down*? IZA Discussion Paper No. 5430, January 2011

3.2.2 Active Labour Market Programmes

Active labour market programmes in Croatia were initially mostly oriented to subsidies that did not improve the skills of the unemployed and had high deadweight, substitution and displacement costs.[58] The situation improved substantially in the years prior to the crisis, with programmes increasingly targeting individuals with the lowest level of employability and persons at risk of long-term unemployment. Such programmes, however, still play a negligible role in Croatia: prior to the crisis, the coverage rate was slightly over 3 per cent, while at the peak of the downturn it fell to 2.5 per cent. The number of unemployed involved in active labour market programmes, therefore, is simply too small to have any impact on aggregate unemployment.

Due to budgetary constraints, funds for active labour market policies were reduced and most programmes were suspended in mid 2009.[59] Training and public works were the two main measures implemented during the crisis. All remaining programmes were scaled down (total participation fell by 26 per cent in 2009 relative to 2007). The programmes most affected were subsidies for elderly workers and other vulnerable groups. In 2009 training accounted for over 58 percent of total programme enrolment. Training was in fact the major programme before the crisis, but in response to labour demand contraction its relative importance was further enhanced. However, there was a shift from the so-called “training for a known employer”, which is usually provided to already employed workers, towards labour market training provided to the unemployed. Public works programmes were significantly expanded to provide temporary income support to those unemployed who were not (or were no longer) eligible for the unemployment benefit. In 2009 they accounted for 31 percent of total enrolment into programmes. Two new measures were also introduced. The first was the short-time work subsidy programme, intended to support labour demand in firms affected by the crisis and discourage lay-offs. The second was the work experience programme (2010) aimed at increasing the employability of first time jobseekers.

A number of measures, aimed at improving the effectiveness of labour market policies, were introduced by the *Economic Recovery Programme*, namely: i) investment in vocational education and training programmes targeting the unemployed and inactive individuals to increase their occupational competencies; ii) expansion of apprenticeship, internship and work practice programmes targeting young people to help them acquire work experience; and iii) strengthening of the capacity of the Croatian Employment Service to provide career information, counselling and guidance and improve service delivery by enhancing cooperation with the Centres for Social Welfare and the Vocational Education and Training Agency.[60]

In response to the crisis, the government of Serbia restructured the active labour market programmes implemented by the National Employment Service. The modest budget available remained officially unchanged (at some €35 million, or 0.1 per cent of GDP), but it was complemented by a similar amount spent exclusively in the Autonomous Province of Vojvodina, which channelled a significant

[58] Croatia launched ALMPs in the early 1990s, see ILO and Council of Europe, *Employment Policy Review, Croatia*, Strasbourg, 2006. *Deadweight loss* means that programme outcomes are not different from what would have happened in the absence of the programme. *Substitution effect* occurs when a worker hired in a subsidized job is substituted for an unsubsidized worker who would otherwise have been hired. The net employment effect is thus zero. *Displacement effect* usually refers to displacement in the product market. A firm with subsidized workers increases output, but displaces/reduces output among firms who do not have subsidized workers

[59] The coverage rate is the percentage of the unemployed that participated in any ALMP measures, such as training, subsidized employment or public works. As training is also provided to employed workers, the estimate of coverage is probably biased upwards.

[60] Government of the Republic of Croatia, *Plan provedbenih aktivnosti Programa gospodarskog oporavka*, May 2011

portion of its privatization proceeds to active labour market measures. The bulk of ALMP funds were streamlined into just two measures, a new apprenticeship programme (*First Chance*) targeting young people up to 30 years of age, and public works. This went largely at the expense of standard labour market training and job subsidy programmes. These two measures were aimed at the two groups expected to be the hardest hit by the crisis, namely young people with no prior work experience, and long-term unemployed individuals.

Some features of the *First Chance Programme* are rather questionable. First, the target group is young individuals with a high level of education. Second, with limited obligations on employers, and lack of monitoring and reporting, the subsidy is open to abuse.[61] Also, since there are no incentives for employers to enhance the skills of apprentices for a longer employment relationship (as there was till 2010 no obligation to employ at the end of the apprenticeship), the quality of training suffered. Finally, the programme is costly, with growing commitments over time, despite the slower pace of new entries. Discontinuation of the programme, therefore, will be long and costly, most likely with increasing deadweight effects. Indeed, costs are escalating fast – from RSD 1.3 billion in 2009 to RSD 2.6 billion allocated in 2011. The number of participants increased as well – from around 10,000 in 2009 to the planned 20,000 young persons in 2011 – a significant number compared with the average size of a yearly youth cohort (less than 70,000 youth).

Public works programmes were designed to provide immediate income relief to the most disadvantaged among the unemployed, typically in underdeveloped regions, by securing them a temporary, subsidized formal job and thus improving their chances for non-subsidized work. A recent assessment, however, finds that the scheme, as it is designed and implemented in Serbia, has had little impact on the re-employment prospects of the long-term unemployed. The financing of the programme was reduced in 2010 to a 'standard' amount of RSD 700 million.

Active labour market programmes in the former Yugoslav Republic of Macedonia were introduced in 2007 when the government started to prepare annual operational plans (OPs). In 2008 and 2009 the funding and scope of ALMPs increased considerably, from 0.1 per cent of GDP to 0.2 per cent. In both years, aside from the measures proposed in the OPs, business start-up incentives (self-employment with low-interest loans) were funded by the state budget. If this measure is computed, the annual allocation would reach MKD 370 million in the biennium. In May 2009 the Government amended the OP by introducing public works schemes (co-funded by the central and local governments) targeting 5,000 beneficiaries (long-term unemployed workers, workers with low skills and persons aged 55 and over) at a cost of MKD 230 million. The ALMPs allocation, however, declined in 2010 and 2011 mainly due to the discontinuation of public works and a cutback of the self-employment programme. The number of beneficiaries, however, remained stable and even increased in 2011. Overall, although progress has been made in the design and implementation of ALMPs, it seems that the employment policy is pro-cyclical, with increased spending and scope of programmes in a boom, and reduction in a recession.[62]

[61] The 2009 design of the *First Chance Programme* did not envisage an obligation on the employer to recruit the young beneficiary at the end of the apprenticeship.

[62] World Bank: *Active labour market programs in FYR Macedonia*, World Bank, Washington D.C., 2008.

Box 5:. Measures to support youth employment during the economic crisis

While stimulating demand is key for job creation, several employment measures were adopted by countries around the world to cushion the negative impact of the crisis on youth employment. Employment subsidies (e.g. contribution to salary, waivers to social security contributions, tax breaks) for hiring young people or *ad hoc* premiums to transform temporary contracts into permanent ones were introduced to sustain labour demand for young workers. Incentives to promote youth entrepreneurship – training and access to financial and non financial services – were used to create jobs. Some governments increased funding to programmes offering paid summer employment, while others supported youth employment through large-scale public works and community services programmes to improve infrastructure and the environment, as well as to provide income support. Additional resources were allocated to Public Employment Services for job-search assistance and other labour market services.

During the downturn, many countries sponsored skills development programmes to enhance the employability of disadvantaged youth, including through skills in emerging occupations (e.g. green jobs). Employers were encouraged to provide apprenticeships and other work-experience programmes through bonuses and other incentives. In the United Kingdom, for example, there has been an expansion in the number of apprenticeship places on offer, facilitated by the development of a new National Apprenticeship Service (NAS) that has streamlined the routes and application process, with the aim of increasing the reach of this form of training so that by 2020 around one in every five of all 16 and 17 year-olds will be in an apprenticeship.

In Slovenia, the government introduced a programme aimed at providing work experience and employment opportunities for university students before they graduate. The programme provides practical training (with mentorship) with an employer for a period ranging from one to six months. If the students graduates within six months from the end of the training programme and is employed by the enterprise that offered the training for at least six months, the employer becomes eligible for a subsidy of € 2,000.

Several EU countries have work experience and internship schemes for graduate and unemployed youth. In Poland, for instance, internships of up to 12 months are offered by the local labour office to young unemployed persons up to 25 years old and to unemployed university graduates up to 27 years old. The beneficiary receives the equivalent of 120 per cent of the unemployment benefit during the internship. In Spain, the 'School workshop and crafts programme' offers training for young unemployed less than 25 years of age, followed by a work placement stage. The programme lasts between one and two years and involves a labour contract for the work placement leg of the measure.

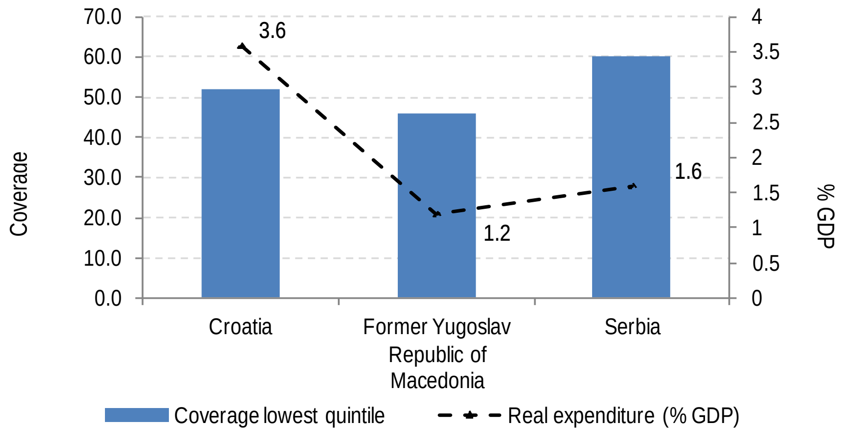
Source: ILO, *Policy options to support young workers during economic recovery. Policy brief*, ILO, Geneva, 2011; European Commission, Directorate-General for Employment, Social Affairs and Inclusion, *European Employment Observatory Review Youth employment measures,* Brussels, 2010.

3.3 Building Social Protection Systems and Potecting People

Except for Croatia, national expenditures on social assistance benefits are in line with the average of Central and Eastern Europe countries (1.6 per cent of GDP). In terms of coverage of the poorest quintile of the population, however, all three countries perform below countries such as Hungary (93 per cent coverage), Romania (91 per cent) and Poland (75 per cent).[63]

[63] World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, op.cit.

Figure 33: Social assistance programmes: expenditure (% GDP) and coverage of the poorest quintile (2008)



Source: World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, op.cit.

Overall spending on social assistance in Croatia is, at 3.6 per cent of GDP (Figure 33) double the amount of GDP invested by other countries in Central and Eastern Europe. However, despite such a large allocation, the coverage of the poorest quintile of the population is only 52 per cent. Such high costs are due to reliance on categorical benefits compared to needs-based ones, with means-tested programmes accounting for 7 per cent of total spending in 2009. The highest share of expenditures is for war veterans (1.8 percent of GDP) and families with children (0.8 percent of GDP). The social support programme and allowance for elderly and disabled persons' care amount to 0.28 percent of GDP. The social assistance system in Croatia is considered costly, complex and limited by administrative inefficiencies. The number of programmes on offer, the number of institutions involved and the lack of harmonization on eligibility criteria has led to a costly system to administer and causes unequal treatment of claimants.

To cover the poorest 10 per cent of population, the social assistance programme would need to be quadrupled. The number of social assistance beneficiaries was on a decreasing trend before the economic downturn (by 9.6 per cent between 2007 and 2008). However, the number of beneficiaries (at around 94,000) lagged behind the expected increases throughout 2009, underscoring the fact that the social assistance programme is not operating as an automatic stabilizer, i.e. expanding during a recession to assist increasing numbers of beneficiaries. This is due to the strict eligibility conditions and the low benefit threshold, which, at HRK500, is 40 percent lower than the poverty food basket.[64]

The *Economic Recovery Programme* recognized the need to improving the system's effectiveness. To this end, the *Social Welfare Act* envisages a rationalization of social assistance programmes, the adoption of a common methodology for means-testing, and the adoption of a one-stop-shop service delivery system .[65] Lastly, the government modified the pension insurance system in 2010. Early retirement is penalized, (the penalty increased from 1.8 per cent to 4.1 per cent per year), and retiring

[64] The *Social Welfare Act* proposes an increase of the monthly benefit threshold to HRK 600.
[65] *The Social Welfare* Act was adopted by the Croatian parliament in 2011 (Official Gazette 57/2011).

five years before the statutory retirement age entails a reduction of the pension benefit by around 15 per cent.

Serbia invests relatively little on social assistance, while it has been suggested that these programmes should be the only category in public spending to be expanded.[66] Only two programmes are targeted exclusively to the poor, namely the material support to households (called MOP) and child allowance. Both programmes were decreasing in relative terms before the crisis – child allowances from 0.4 per cent of GDP in 2005 to 0.3 of GDP in 2008, and MOP from 0.16 per cent to 0.14 per cent. The MOP benefit almost halved between 2002 and 2008 compared to the minimum wage.[67] During the crisis, however, the share of social assistance expenditures in GDP increased slightly, confirming their inherent stabilizing potential. In response to the worsening of the social situation and an increase in poverty, the government accelerated the enactment of the *Law on Social Welfare*.[68]

This law introduced a number of changes into the eligibility criteria of the MOP as well as the parametric change to the equivalence scale. The purpose was to make the programme more equitable and to link passive cash support to social and employment services. As a result, the government expects to increase budget expenditures on social assistance by some 50 per cent. The equivalence scale is to be changed to the modified OECD scale that accounts differently for children and adults within a household, assigning 100 per cent of the basic benefit amount to the first household member, 50 per cent to each additional adult, and 30 per cent to each child under 18 years of age. In addition, the programme eligibility criteria have been relaxed for large families. Access to these benefits by households from rural areas is also to be modified by easing the land ownership eligibility criteria (from 0.5 to 1 ha ownership per household assisted).

Despite the above-mentioned changes, the impact of the new social assistance framework on poverty reduction is likely to be modest. It is estimated that the new rules have the potential to reduce the number of the poor by some 4 per cent, which would not significantly change the poverty rate. Therefore, more generous initiatives are needed to effectively lift a greater number of poor individuals and households above the absolute poverty line.

Social assistance increased in the former Yugoslav Republic of Macedonia in 2008 and 2009. However, there is a general decline in the number of beneficiaries, including beneficiaries of social financial assistance (SFA), the main social assistance programme in the country.[69] The former Yugoslav Republic of Macedonia, along with Serbia, reacted rather promptly to the crisis by providing greater assistance for its citizens.[70] One of the first responses to the weakening of the domestic economy was a one-off monthly cash transfer of MKD1,000 (about €16) to 1,600 households in the period January–April, 2008.[71] Approximately 43 per cent of total social benefits in

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[66] World Bank, *Serbia: Doing more with less. Addressing the fiscal crisis by increasing public sector productivity*, World Bank, Washington D.C., 2009.

[67] Arandarenko, M., Avlijaš, S., "Behind the veil of statistics", op.cit.

[68] The Law was adopted in March 2011.

[69] Social assistance (i.e. non-contributory benefits) in the former Republic of Macedonia include eleven separate schemes, such as social financial assistance (the dominant one), assistance to children without parents, child allowance, financial assistance to mothers for the fourth born child and so on.

[70] Bartlett, W. and Monastiriotis, V. (eds*) South Eastern Europe after the Crises: a New dawn or back to business as usual?* op.cit.

[71] There were not specific eligibility criteria for this measure. Social assistance centres were asked to identify the most vulnerable individuals.

the former Yugoslav Republic of Macedonia are distributed to those in the lowest income quintile.[72] The operation of social assistance as an automatic stabilizer, however, is constrained by the system's design, which is based mainly on entitlements, instead of a minimum subsistence income. In the latter type of systems, as incomes decline more individuals and households become eligible. In the former Yugoslav Republic of Macedonia, on the other hand, households have to prove that they have acquired the right to social assistance. This makes the system cumbersome in protecting those groups that are most likely to experience the negative effects of downturns.

Box 6: Poverty in Croatia, Serbia and the former Yugoslav Republic of Macedonia

Before the crisis, the incidence of absolute poverty in Croatia was very low (2 per cent). Poverty was mainly associated with long-term unemployment and inactivity, concentrated among low skilled individuals. The crisis has had a substantial impact on both the poverty rate and the profile of poverty. This is because the crisis disproportionately affected primary earners and this is more likely to push households into poverty. The at-risk-of-poverty rate recorded in 2007-08 (17.5 per cent) was accentuated during the crisis (18 per cent in 2009). For 2010, estimations are that the poverty headcount rate increased by about 3.5 percentage points. The at-risk-of-poverty rate for women is higher by two percentage points compared to men. Individuals older than 65 years have an at-risk-of-poverty rate above average. It is estimated that the poverty rate among households headed by an employed person increased by 2.3 points and as much as 6.5 percentage points for households headed by an unemployed person.

In the period 2002-2007 the prevalence of absolute poverty in Serbia decreased from 14 per cent of the population to 6.6 per cent in 2007. The fall in employment and living standards caused by the economic crisis reversed such positive trends. Poverty increased from 6.1 per cent in 2008 to 6.9 per cent in 2009 and it is presently estimated at around 8 per cent. In terms of relative poverty, the rates have been stable at around 14 per cent in the second half of last decade. In 2009, children aged 0-17 were among the groups more at risk of relative poverty (around 22 per cent), followed by elderly persons 65 and over (18 per cent), while for the working age population the risk was below 17 per cent.

In the former Yugoslav Republic of Macedonia, despite increased spending on social assistance, the head count poverty index increased to 31.1 per cent in 2009 (from 28.7 per cent in 2008), and the poverty gap widened to 10.1 per cent (from 9.7 in 2005). Reduced poverty and inequality in 2008 was the result of the higher and more inclusive economic growth. Households with children under 7 years of age and those with more than four members are over represented among the poor. The figures also show that unemployment and educational attainment are important determinants of poverty. In particular, the poverty rate for households with unemployed members was 40.5 per cent in 2009, whereas it was 21 per cent for households with two or more employed persons. Similarly, poverty declines with the educational attainment of the head of the household, ranging between 54.2 per cent for households where the head is without education, to 11.7 per cent for households where the head has tertiary education.

3.4. Social dialogue

Industrial relations systems, in general, and collective bargaining, in particular, have an important role to play in dealing with the challenges wrought by the crisis. Unfortunately, social dialogue in all three countries suffered a number of setbacks throughout the period of the economic downturn.

[72] World Bank *Social safety net in FYR Macedonia*, World Bank, Washington D.C., 2010, op.cit.

In Serbia, social dialogue is weakened by the unresolved issue of representativeness of the social partners and widespread mistrust among them. Moreover, the input of social partners into the decision-making process and the drafting of legislation remains limited due to both the government's lack of strategic approach in the consultation process and to the limited capacities of the social partners. The efforts by the Socio-economic Council to provide guidance on national wage policy were unsuccessful, even within the formally valid, but effectively suspended, *General Collective Agreement*. Since 2008, some progress has been made in the operations of the Socio-economic Council, with the setting up of four working groups (economic issues; legislation; collective bargaining and peaceful settlement of disputes; and health and safety at work). In 2009, social dialogue intensified: a regular pattern of monthly meetings was established, but the tension among the partners remained. In 2010 the pace of progress slowed down again, only to recover somewhat in 2011 with the signature of a socio-economic agreement (see Box 6 below).

Box 7: The socio-economic agreement in Serbia (2011)

The socio-economic agreement was signed in April 2011 to tackle the economic and social challenges emerging from the crisis. The agreement serves as a framework for the government and the social partners to work together to:

– promote economic growth by improving the business environment and increasing the competitiveness of the Serbian economy, while preserving existing employment levels and macroeconomic stability;

– make the benefits of economic progress available to all while securing better protection for those most at risk;

– implement measures aimed at increasing economic activity and protecting vulnerable categories, in line with the fiscal space available;

– initiate the reforms needed for integration with the European Union.

Through this social pact, the government commits to promote a strategy focused on growth and jobs (invest the public resources of the Development Fund in high-priority sectors with a view to create new jobs; maintain price stability; provide incentives for agricultural production; support export-oriented sectors by establishing a Development Bank, give priority to domestic enterprises in public procurement, revise the legislative framework on enterprise development); social protection (increase the amount of the non-taxable part of earnings and the minimum hourly wage; invest additional resources towards the implementation of the measures of the *Law on Social Welfare* targeting unemployed individuals; strengthen the capacity of the labour inspection system); and social dialogue (negotiate and implement a new *General Collective Agreement*).

Employers' and workers' organizations, on their part, agreed to participate in the policy-making process; comply with the provisions of collective agreements; negotiate agreements at the branch level (metal processing, chemical, non-metal and accommodation sectors); and establish socio-economic councils at municipal level. In addition, employers committed to protect existing jobs; pay wages and social contributions regularly; and comply with corporate social responsibility principles. On their side, the trade unions committed to social dialogue in labour dispute resolution without restoring to social action.

Collective bargaining at sectoral level is largely underdeveloped, with agreements signed mainly in the public sector (health care, education and local administration). In the private sector, no branch-level agreement was signed during the period of the crisis. At the company level, collective agreements are signed mostly in larger firms where the trade unions are organized, while in small and medium size enterprises they are almost non-existent.

In Croatia, tripartite negotiations were undertaken at the onset of the downturn on issues such as the minimum wage and the introduction of the crisis tax. However, as the crisis progressed, social dialogue came to a virtual standstill. In the summer of 2010, the government initiated amendments to the *Labour Act* aimed at limiting the prolonged application of collective agreements and at introducing more flexible forms of employment – partially in response to calls from employers to ease the procedures for the termination of contracts.[73] Trade unions strongly opposed the proposal and called a national referendum. This caused a standstill in tripartite dialogue throughout 2009 and 2010. Tripartite dialogue was reinstated only in April 2011.

Discussion on the minimum wage took place almost exclusively at the national level and tripartite dialogue overrode bilateral talks. Unlike sector-level dialogue, company-level collective bargaining has been improving, albeit unevenly across industries.[74] Deteriorating liquidity positions and the reappearance of wage arrears in private enterprises, combined with broad support for the national referendum initiated by the trade unions, hindered consensus. Bipartite dialogue at branch level was especially neglected in those sectors most exposed to output contraction. Furthermore, the inability of employers to meet obligations stemming from collective bargaining agreements caused a breakdown in bilateral social dialogue. On the other hand, trade unions sought statutory protection for fixed-term workers, and challenged the compensation levels provided by the welfare system. In such a climate, bilateral negotiations deteriorated even further.

In the former Yugoslav Republic of Macedonia collective bargaining was ineffective during the recession due to disagreements about representativeness. The Economic and Social Council did not convene at all between May 2008 and September 2010. Amendments to the Labour Code to redefine representativeness criteria – in line with the ILO recommendations to reduce the 33 per cent representation requirement for employers' and workers' organisations for collective bargaining at all levels– saw the signing of a new Agreement on the Establishment of the Economic and Social Council in 2010. Although tripartite social dialogue at national level was not operational at the peak of the crisis, there were still improvements in bipartite dialogue. In particular, in the period from January 2008 to February 2010, eleven branch-level collective agreements were signed in the private sector; ten collective agreements were concluded at employer level; and national level collective agreements for the private and public sectors were re-negotiated. Moreover, the trade unions (Federation of Trade Unions of Macedonia, Confederation of Free Trade Unions of Macedonia and Union of Autonomous and Free Trade Unions) signed in February 2011 a Memorandum for joint action in organizing workers and negotiating social issues.

In general, the social partners in the former Yugoslav Republic of Macedonia consider the government's response to the economic slowdown as inappropriate in terms of the magnitude and measures undertaken, and biased towards certain production sectors (mainly construction). Both employers' and workers' organisations claim that they were not sufficiently consulted by the government about the measures and policies to be undertaken. During the crisis, dialogue between

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[73] Labour Act (Official Gazette of Republic of Croatia 149/09).
[74] Nestić D., Rašić Bakarić I., *Minimum wage systems and changing industrial relations in Europe: National report Croatia*, Institute of Economics, Zagreb, 2010

the government and the employers' organization on the economic outlook and available policy options intensified. Employers' views were taken into account in the design of the anti-crisis measures. However, experiences in other countries show that tripartite institutions – and not mere consultations – are most efficient in finding responses to the crisis and that centralized negotiations with comprehensive agendas work much better in protecting vulnerable groups than those with a narrow focus. [75]

[75] ILO, *Protecting people, promoting jobs: A survey of employment and social protection policy responses to the global economic crisis*, ILO report to the G20 Leaders' Summit, Pittsburgh, 24–25 September 2009.

4. Roadmap: Policy Priorities for Job Recovery

The global economic crisis has affected the economies of Croatia, Serbia and the former Yugoslav Republic of Macedonia to different degrees. The Serbian economy was hit the most rapidly, showing negative output growth already in the second quarter of 2008; Croatia followed with decelerations of GDP growth in the third and fourth quarter of the same year. The crisis gathered pace in 2009 wiping out much of the gains in economic growth witnesses by the two countries since the mid 2000s. In 2009, overall economic activity declined by 5.9 percent in Croatia and 3 per cent in Serbia, driven by a fall in consumption, domestic investment, foreign capital inflows and exports. The former Yugoslav Republic of Macedonia, conversely, was affected by the crisis –marginally − through the decline of exports and foreign capital inflows. Compared to Croatia and Serbia, the impact of the crisis on national output was limited, with a 0.9 per cent negative growth in output recorded in 2009.

The contraction of the Croatian economy led to a rapid worsening of the labour market with falling employment and rising unemployment rates. Although the initial impact of output contraction on employment was modest, the pace of job loss accelerated over time. Labour force participation rates also fell, partly as a result of the workers' discouragement effect. The crisis harmed mainly the manufacturing, trade and construction sectors, which are predominantly male-dominated. As a result, men were more affected by the economic crisis than women. This category of newly unemployed joined other groups of workers already at a disadvantage in the labour market, such as young people, workers with low skills level, women and elderly workers.

The impact of the crisis in Serbia was very severe in terms of job losses. Total employment reached its bottom value at the end of 2010, with a drop in the employment-to-population ratio of 21 per cent compared to the 2004 level. Total unemployment decreased, but the unemployment rate increased by 2.4 percentage points, due to high flows from activity to inactivity, especially for women, young people and workers at the margins of the labour market. During the crisis, informal employment contracted more quickly than formal employment. This is due to the pronounced duality of the Serbian labour market, where informal workers, employees on fixed-term contracts and workers in the traditional services sector are the most vulnerable to job losses and the first to be affected by an economic contraction.

The labour market figures of Croatia and Serbia indicate that young people, and especially young men, suffered most during the economic downturn. The young men unemployment rate soared in both countries, with increases in the range of 12.5 percentage points in the period 2008-2010. Youth employment also fell dramatically, by 5.3 percentage points in Croatia and 7.9 percentage points in Serbia in the same period.

To date, the labour market of the former Yugoslav Republic of Macedonia appears largely unaffected by the slowdown. The figures of the LFS for the first quarter of 2011 show that, compared to 2010, employment continued to increased (by 0.8 percentage points) and unemployment to decrease (by 0.6 percentage points). Whereas the employment increases are in line with the trends recorded prior to the downturn, the pace of unemployment decreases has decelerated markedly since 2008.

The fiscal position of countries affected by GDP decline deteriorated quickly. In Croatia, marked shortfalls in revenues in 2009 and increasing government spending caused several revisions of the government budget. The spending cuts affected public sector salaries, certain categories of social benefits and infrastructure investments. To limit the escalating fiscal deficit, the government increased the value added tax rate and introduced a special tax on salaries, pensions and other income (‘crisis tax’), discontinued later on. The impact of these measures was pro-cyclical and led to a contraction of consumption as well as investments. Overall, the combination of expenditure reduction (amounting to 2.1 per cent of GDP), and revenue increase (amounting to 0.4 per cent of GDP) kept Croatia’s deficit at around 4 percent.

The most immediate policy response of the Serbian government was to guarantee liquidity and re-start commercial lending to enterprises and households. Spending cuts mainly took the form of a freeze of public sector wages and pensions and the shelving of large infrastructure projects. The 8 per cent fall in public revenue was only partly recouped through increasing taxes (excise duties and tax on mobile phone calls). This resulted in a widening of the budget deficit in 2009 (4.2 per cent of GDP), carried over also in 2010 (4.8 per cent).

The former Yugoslav Republic of Macedonia addressed the downturn with an expansionary fiscal stance and a tight monetary policy to protect the nominal exchange rate. The government significantly increased spending as of the end of 2008, turning the accumulated fiscal surplus into a deficit (1 per cent). The deficit widened further in 2009 and 2010 to around 2.5 per cent. Revenue and spending targets in mid 2009 were adjusted by nearly 10 per cent, compared to the initial plan.

Signs of economic growth acceleration are noticeable in the first quarter of 2011 in the former Yugoslav Republic of Macedonia and in Serbia (with GDP growing by 5.1 per cent and 3.4 per cent, respectively), while in Croatia output declined by 0.8 per cent. The downward adjustment of the Serbian and Croatian labour markets continued in the period, indicating that the job crisis has not bottomed out yet. The figures of the first quarter of 2011 show that in Croatia, employment fell by an additional 1.6 percentage points, while the unemployment rate increased to 14.7 per cent (from 12.1 per cent in 2010). In Serbia, the employment rate in the first quarter of 2011 plummeted to 45.4 per cent (from the 47.1 per cent recorded in October 2010), and the unemployment rate increased by additional 2.9 percentage points. The youth unemployment rate reached unprecedented levels in both Croatia and Serbia in the first quarter of 2011 (40.3 per cent and 49.9 per cent, respectively). These figures raise serious concerns about the risk of a lost generation or, in other words, a cohort of disaffected and discouraged young people forced to live at the fringe of the labour market.

The economic downturn exposed the limits of growth based on buoyant domestic consumption, fuelled by large inflows of foreign capital, to a large extent directed towards non-tradable sectors, and loose credit policy of banks. Such a development strategy is vulnerable to sudden turnarounds, especially when large capital inflows fuel credit expansion and do not contribute to productive investment. The currency appreciation that normally goes with it, may also adversely affect the competitiveness of the tradable sector, like that which occurred in Serbia. To make the recovery sustainable, many are advocating for a new growth paradigm based on enhancing domestic savings, investment and labour force participation to increase the contribution of capital and labour to economic growth.[76] In the decade prior to the crisis, employment was not central to national development plans and economic policies. Job creation was seen as a residual outcome of private sector-led economic growth. But growth alone did not suffice to create decent and productive jobs. If a standard strategic approach is adopted – that is one that gives priority to macroeconomic objectives such as price stability, sharp reductions of the fiscal deficit, low level of public debt and improved balance of payments, but without proper attention to investment contributing to enterprise development and job creation – then there will be little space available to achieve the highest possible increase in the level of employment. Employment growth – together with the reduction of absolute and relative poverty – needs to be an explicit and overarching objective of the development strategy of the three countries for the next decade. The optimal policy mix will largely depend on national circumstances and on the trade-offs that different policy instruments have on growth. In practice, this means that among the alternative strategies ensuring an acceptable level of growth, priority should be given to those policy options that maximize employment and increase equality.

- Analysis of the macroeconomic developments during the crisis and the policy responses undertaken by the governments of Croatia, Serbia and the former Yugoslav Republic of Macedonia highlight a number of broad policy options that should be considered to ensure that the recovery addresses job creation challenges.[77] These can be summarized as:
- Efforts should be deployed to attract capital flows that can improve national competitiveness and productive capacity and moderate those flows more likely to fuel domestic and external imbalances. Improvements to the business environment would boost potential returns in the private sector and could shift the composition of investment from the non-tradable to the tradable sector. A comprehensive industrial policy and the acceleration of reforms to promote enterprise development (streamlining of business registration, reduction of non-tax revenues and judicial reforms to strengthen contract enforcement and bankruptcy procedures) would enhance private sector participation in the economy, as well as increase productivity and competitiveness. Croatia has already taken some of these steps under the aegis of the *Economic Recovery Programme*.
- The general financing strategy in the region has been to increasingly rely on indirect taxes, on the one hand, and relatively high rates of social security contributions as the predominant form of wage taxation, on the other. In Croatia and Serbia, a better ratio of direct to indirect taxation would reduce the regressivity of the tax system that places a higher burden on lower income groups. It has been shown how high taxes on salaries contribute, not only to higher unemployment, but also to lower participation in the labour market, whereas the size and quality of the labour supply are very important determinants of competitiveness of any given

[76] EU Directorate-General for Economic and Financial Affairs, *The pre-accession economies in the global crisis: from exogenous to endogenous growth?*, Brussels, October 2010.
[77] Given the diversity of the economic structures of the countries involved, the policy options proposed in this paper are rather broad. The national reports, conversely, offer country-specific proposals.

economy.[78] A careful revision of the social security tax wedge – negotiated with the social partners −would bring some advantages in this respect, particularly if combined with administrative reforms to broaden the tax base and reduce informality. Such an approach would reduce the tax burden on labour without endangering public revenues and, therefore, public spending. However, these measures need to ensure that cuts reduce labour cost of workers who earn at the minimum wage, thus expanding demand for this category. In addition, pension contributions should be retained as these directly affect the worker's future benefit entitlements, with cuts focused on those items where there is no link between contribution and subsequent entitlement. This type of measure would also contribute to make work pay and improve labour force participation rates. Measures creating disincentives for inactivity –like those introduced in Croatia −would include tax increases for non-labour incomes, restriction to early retirement and the introduction of lower replacement ratios for early retirees.

– During the last decade, employment protection legislation (EPL) has shown an easing of strictness, owing to reforms in labour legislation (see Table A3 in the Statistical Annex). There is, however, a high degree of heterogeneity among the three countries, with Serbia having the less restrictive regime for temporary contracts and the former Yugoslav Republic of Macedonia the highest. Despite the stricter regulation of temporary contracts in Serbia and the former Yugoslav Republic of Macedonia, compared with the EU-15, the incidence of temporary contracts has been increasing, with certain groups of workers, mainly young people, more exposed than others. This indicates lower enforcement of labour legislation. The labour market data recorded before and during the economic downturn seem to confirm the duality of the labour markets in all three countries, i.e. one for permanent employees (or insiders) with stable formal employment and security of tenure (mainly in the public sector or in large private enterprises), and another for temporary employees (outsiders, mainly young people) who tend to be trapped into temporary and informal jobs with precarious attachment to the labour market. This second-tier market is the one that seems to have taken the brunt of the recession, as evidenced by falling employment rates and increasing unemployment for youth and higher elasticity of informal employment compared to formal. Such an asymmetry between permanent and temporary or no contracts at all needs to be overcome, first through a better enforcement of existing rules and secondly by limiting the application of temporary contracts to specific circumstances. As the use of temporary contracts is not solely linked to legal aspects concerning employment relations, but is also affected by production patterns − social dialogue practices, and enterprises human resource development policies − these have to be scrutinized to identify gaps that may be addressed by public policy.

– The unemployment benefit is the single social protection programme which expanded during the crisis in all three countries, operating− albeit to different degrees – as an automatic stabilizer. Coverage, however, is low and reaches only a fraction of unemployed workers. Low coverage also means that the economic stimulus to be expected by its operations during a downturn is not significant. To make the unemployment benefits more responsive to economic downturns, public authorities may consider introducing mechanisms that allow temporary changes in

[78] S. Cazes, A. Nesporova (eds.), *Flexicurity: A relevant approach for Central and Eastern Europe*, International Labour Office, Geneva, 2007; A. Grdovic Gnip, I. Tomic, "How hard does the tax bite hurt? Croatian vs. European workers", 2010, available at http://www.ijf.hr/eng/FTP/2010/2/gnip-tomic.pdf.

eligibility criteria and/or replacement rates, accompanied by measures making income support conditional on participation in active labour market programmes. The effectiveness of the social protection system could be improved, especially in Croatia and the former Yugoslav Republic of Macedonia, by streamlining and simplifying the existing social protection programmes and enhancing targeting. This would improve the efficiency and quality of social assistance programmes and have a significant impact on poverty.[79] The reforms being introduced in the social welfare systems of Serbia and Croatia appear to be an important first step in this direction.

– The reform of the education and training system needs to be accelerated to remedy the growing skills gap, most of which is now hidden due to the general contraction of employment and investment. Such reforms require a high level of coordination between the government, the enterprise sector and trade unions, which has so far been absent. Constraints to both the supply and demand side of skills need to be identified and addressed. There is a mismatch between the skills provided to workers – both young people and adult workers – by the education and training system and those demanded by enterprises. A review of the available skills, the needs of enterprises and the operation of the education and training system would help identify such disparities and indicate policy options to address them. The work undertaken towards the establishment of National Qualification Frameworks in the three countries – including Recognition of Prior Learning mechanisms − represents a welcome progress. However reforms of the national technical vocational education and training systems will have a positive effect on labour market developments only in the medium to long-term. In the short term, the expansion of subsidized skill development programmes would improve employment prospects for workers with low or inadequate skill levels and address the erosion of competencies resulting from long unemployment spells.

– The jobs crisis has hit young people harder than other age groups. This is being felt mainly in terms of unemployment and longer job search periods. The human and social costs of youth unemployment are far-reaching.[80] These longer run impacts include loss of lifetime earnings and human capital, worker discouragement, adverse health outcome and loss of social cohesion. There is increasing empirical evidence that long spells of unemployment early in the working life are associated with an average 20 per cent loss of earnings for 15-20 years after the unemployment episode.[81] For some young workers, entering the labour market in a recession lowers earnings, can increase the likelihood of career instability, affects individuals' beliefs and family formation. These scars persist for ten years and over and are only partially mitigated by a recovery in the aggregate labour market. Labour market detachment for some categories of youth can also aggravate the labour force participation crisis the countries under review are facing. As young people are a heterogeneous group and face different types of labour market disadvantages, an early identification of individual risk factors and of the determinants of labour market disadvantage is of crucial importance to provide appropriate and effective employment assistance. Multi-component interventions that combine remedial education and training with

[79] ILO *Protecting people, promoting jobs: A survey of employment and social protection policy responses to the global economic crisis*, op.cit.

[80] *The Challenges of Growth, Employment and Social Cohesion*, Joint ILO-IMF conference in cooperation with the office of the Prime Minister of Norway, 2010.

[81] *The Challenges of Growth, Employment and Social Cohesion*, op.cit.

work-experience programmes and job-search assistance, as well as incentives for employers to hire young workers, have demonstrated to be more cost-effective than single measures.

- In contrast to the high levels of labour taxation, the GDP share invested in labour market policies – and especially active ones − is generally low. As a consequence, active labour market programmes in the three countries remain rather limited in scope, range and coverage. The only programmes significantly expanded during the economic crisis have been public works and youth apprenticeship programmes with a view to target the groups perceived as most likely to be affected by the impact of the crisis (long-term unemployed, low skilled workers and young people with no work experience). However, certain design features and targeting approaches limited the effectiveness of the measures implemented. In the short term, programmes such as employment subsidies, targeted reductions of social security contributions, public work programmes and entrepreneurship development schemes would support job creation or job preservation, in particular for less competitive groups of workers. In the medium term, and once labour demand recovers, more effort should be deployed in improving job search services that are universally recognized as the most cost-effective measures among ALMPs. In addition, all three countries should consider activation policies to re-integrate the long term unemployed and social welfare recipients into the labour market. Whereas it is important to have large scale active labour market programmes supporting employment recovery as long as the job crisis persists, there is also a need to gradually shift the emphasis to programmes that are well targeted, respond to labour market requirements and involve the social partners in their design, monitoring and evaluation.
- Industrial relations systems, in general, and collective bargaining, in particular, have an important role to play in dealing with the challenges wrought by the crisis. Unfortunately, tripartite negotiations on structural reforms have suffered setbacks, including the virtual cessation of national social dialogue institutions at the very peak of the crisis. As these countries still face a number of challenges in tackling the effects of the crisis on the labour market (especially Serbia and Croatia) and improving competitiveness (especially the former Yugoslav Republic of Macedonia), it is of key importance that social dialogue institutions be given a role in the monitoring of the implementation of anti-crisis measures on the one hand, and in shaping structural reforms on the other. In addition, existing practices of bipartite negotiations leading to collective agreements at branch and enterprise level should be further encouraged.

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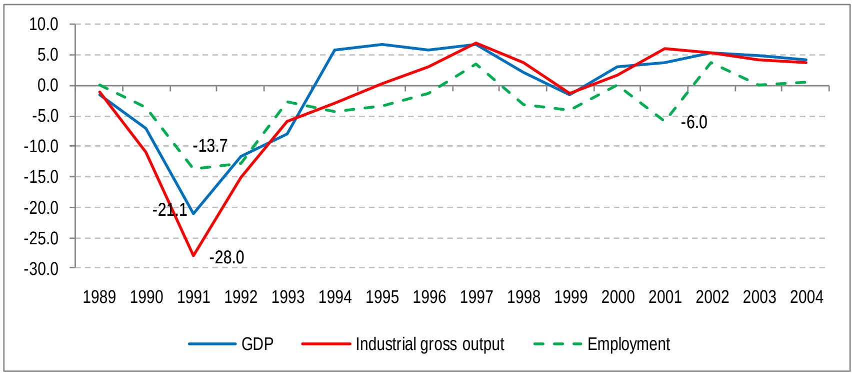
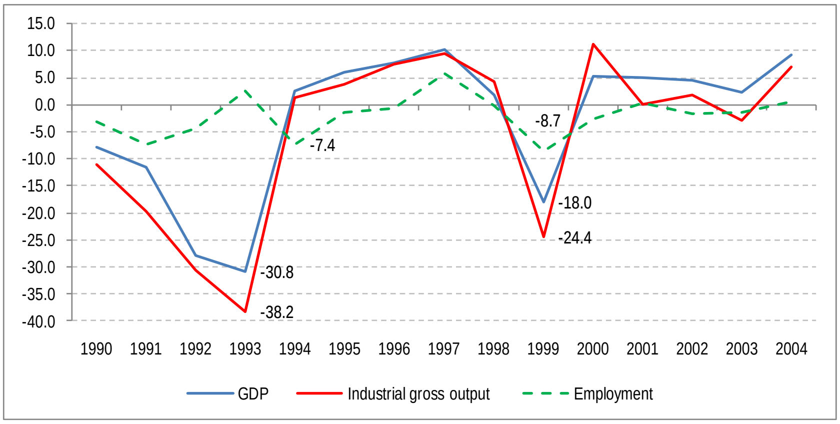
Statistical Annex

Figure A.1: GDP, industrial output and employment growth rates (Croatia, Serbia, the former Yugoslav Republic of Macedonia)

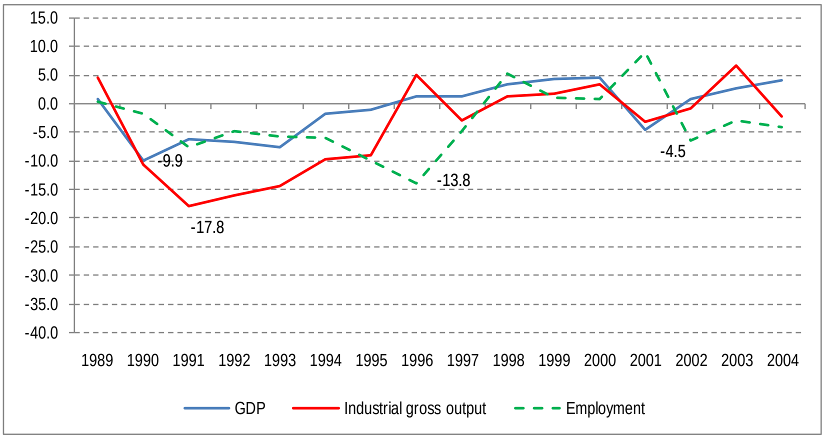
Croatia, 1989–2004



Serbia, 1990–2004



The former Yugoslav Republic of Macedonia, 1989–2004

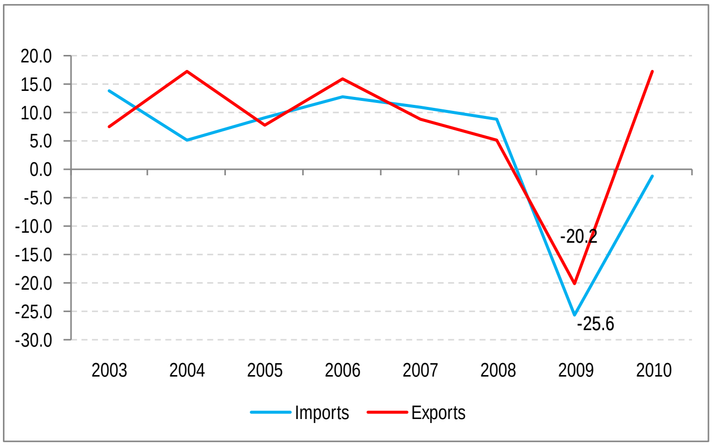


Source: European Bank for Reconstruction and Development (EBRD), *Economic research and data*, Paris, 2011, available at http://www.ebrd.com/pages/research.shtml

Figure A2: Annual percentage change in imports and exports (2003–2010), Serbia, Croatia, the former Yugoslav Republic of Macedonia

Serbia

Croatia



The former Yugoslav Republic of Macedonia

Source: European Bank for Reconstruction and Development (EBRD), *Economic research and data*, Paris, 2011, op.cit

Table A1: GDP, its components and current account developments, Croatia, Serbia and the former Yugoslav Republic of Macedonia (2008–2010)

	2008	2009	2010
Croatia			
GDP (ann.% change)	2.4	-5.8	-1.5
Private consumption (ann. % change) *	0.8	8.5	0.9
Gross fixed capital formation (ann. % change)	27.3	24.5	23.3
Exports (ann. % change)	5.1	-20.2	17.3
Imports (ann. % change)	8.9	-25.6	-1.1
Current account balance (% GDP)	-9.2	-5.2	-3.8
The former Yugoslav Republic of Macedonia			
GDP (ann.% change)	4.8	-0.8	0.8
Private consumption (ann. % change) *	8.1	-4.8	1.8
Gross fixed capital formation (ann. % change)	23.2	20.7	...
Exports (ann. % change)	8.9	-28.7	29.8
Imports (ann. % change)	21.9	-22.1	14.1
Current account balance (% GDP)	-12.8	-6.9	-3.9
Serbia			
GDP (ann.% change)	5.5	-3.1	1.6
Private consumption (ann. % change) *	...	...	...
Gross fixed capital formation (ann. % change)	23.2	24.5	25.3
Exports (ann. % change)	15.9	-19.6	24.0
Imports (ann. % change)	14.6	-26.1	9.9
Current account balance (% GDP)	-17.9	-5.6	-9.6

Source: World Bank, *Economic indicators*, (http://data.worldbank.org/indicator). (*) EU Directorate of Economic and Financial Affairs, *EU candidate and pre-accession countries. Economic Quarterly*, 2011.

Table A2: Key labour market indicators, Croatia, Serbia and the former Yugoslav Republic of Macedonia(2006–2011)

Croatia

	2006	2007	2008	2009	2010	2011(Q1)
All (15–64)						
Labour force participation	62.8	63.4	63.2	62.4	61.5	61.4
Employment-to-population ratio	55.6	57.1	57.8	56.6	54.0	52.4
Unemployment rate	11.5	9.8	8.6	9.3	12.1	14.7
Men (15–64)						
Labour force participation	68.9	70.4	70.0	68.0	67.3	68.3
Employment-to-population ratio	62.0	64.4	65.0	62.4	59.4	57.9
Unemployment rate	10.1	8.5	7.1	8.2	11.7	15.2
Women (15–64)						
Labour force participation	56.9	56.4	56.6	57.0	55.9	54.9
Employment-to-population ratio	49.4	50.0	50.7	51.0	48.8	47.2
Unemployment rate	13.2	11.4	10.4	10.6	12.6	14.0
Youth (15–24)						
Labour force participation	35.9	34.9	34.7	34.3	34.4	32.8
Employment-to-population ratio	25.5	26.5	27.1	25.7	23.2	19.6
Unemployment rate	28.9	24.0	21.9	25.0	32.5	40.3
Young men						
Labour force participation	39.9	39.9	40.7	40.5	40.4	39.2
Employment-to-population ratio	29.1	31.6	33.2	31.2	27.9	22.8
Unemployment rate	27.2	20.9	18.5	23.0	31.0	42.0
Young women						
Labour force participation	31.6	29.5	28.3	27.2	27.7	26.2
Employment-to-population ratio	21.8	21.1	20.6	19.4	18.0	16.3
Unemployment rate	31.1	28.5	27.2	28.5	35.1	37.5

Source: EUROSTAT, *Annual and quarterly Labour Force Survey results,* various years.

The former Yugoslav Republic of Macedonia

	2006	2007	2008	2009	2010	2011 (Q1)
All (15–64)						
Labour force participation	62.2	62.8	63.5	64.0	64.2	64.5
Employment-to-population ratio	39.6	40.7	41.9	43.3	43.5	44.3
Unemployment rate	36.3	35.2	34.0	32.3	32.2	31.4
Men (15–64)						
Labour force participation	75.0	74.8	76.6	77.6	77.7	68.3
Employment-to-population ratio	62.0	64.4	65.0	62.4	59.4	52.2
Unemployment rate	35.6	34.8	33.7	32.0	32.1	32.1
Women (15–64)						
Labour force participation	49.2	50.4	50.2	50.0	50.4	51.9
Employment-to-population ratio	49.4	50.0	50.7	51.0	48.8	36.1
Unemployment rate	37.5	35.8	34.3	32.9	32.5	30.4
Youth (15–24)						
Labour force participation	35.8	35.9	35.9	35.0	33.3	31.4
Employment-to-population ratio	14.4	15.2	15.7	15.7	15.4	14.9
Unemployment rate	59.7	57.7	56.4	55.1	53.7	52.5
Young men						
Labour force participation	42.0	43.8	43.3	43.4	42.2	38.9
Employment-to-population ratio	17.2	18.6	19.2	20.6	19.5	18.1
Unemployment rate	58.9	57.4	55.7	52.7	53.9	53.4
Young women						
Labour force participation	29.3	27.5	28.1	26.2	24.0	23.5
Employment-to-population ratio	11.4	11.5	12.0	10.6	11.2	11.5
Unemployment rate	60.9	58.2	57.2	59.4	53.3	51.0

Source: EUROSTAT, *Annual and quarterly Labour Force Survey results*, various years.

Serbia

	2006	2007	2008	2009	2010	2011 (Q1)
All (15–64)						
Labour force participation	65.5	65.5	62.6	60.5	58.8	68.9
Employment-to-population ratio	52.8	54.5	53.3	50.0	47.1	45.4
Unemployment rate	19.4	16.9	14.7	17.4	20.0	22.9
Men (15–64)						
Labour force participation	73.6	72.9	71.3	68.4	67.2	67.5
Employment-to-population ratio	61.3	62.0	62.2	57.4	54.4	52.2
Unemployment rate	16.7	14.9	14.3	16.1	19.0	22.7
Women (15–64)						
Labour force participation	57.4	58.3	54.1	52.8	50.6	50.4
Employment-to-population ratio	44.3	47.0	44.7	42.7	39.9	38.8
Unemployment rate	22.9	19.3	17.3	19.1	21.2	23.1
Youth (15–24)						
Labour force participation	38.3	34.3	33.8	29.5	28.2	28.9
Employment-to-population ratio	21.5	20.6	21.2	17.0	15.2	14.1
Unemployment rate	43.8	39.9	37.4	42.5	46.1	49.9
Young men						
Labour force participation	44.7	38.9	38.7	33.6	44.7	34.8
Employment-to-population ratio	27.4	24.6	26.3	20.2	18.4	18.0
Unemployment rate	38.8	36.6	32.2	40.1	44.7	48.2
Young women						
Labour force participation	31.1	29.2	28.5	24.8	31.1	20.7
Employment-to-population ratio	15.0	16.1	15.7	13.4	11.7	9.8
Unemployment rate	51.7	44.8	45.1	46.2	48.4	52.9

Source: Republic Statistical Office (RSO), Labour Force Survey 2006–2011, available at http://webrzs.stat.gov.rs/WebSite/. For the first quarter of 2011, results are preliminary.

Table A3: Employment Protection Legislation index, Croatia, Serbia, the former Yugoslav Republic of Macedonia and EU15

Country	EPL summary index (late 1990s	Year	Component indices			EPL summary index
			Regular contracts	Temporary contracts	Collective dismissal	
Croatia	3.6	2007	2.7	2.8	2.5	2.7
FYR of Macedonia	2.8	2007	2.1	3.8	3.8	3.1
Serbia	2.9	2007	2.0	1.9	3.6	2.2
EU-15 (2003)	2.5	2003	2.3	2.0	3.4	2.4

Source: ILO database on Employment Protection Legislation.

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