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Supporting Strategies to Recover from the Crisis in South Eastern Europe

COUNTRY ASSESSMENT REPORT

SERBIA

Mihail ARANDARENKO

Global Jobs Pact

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

Supporting Strategies to Recover from the Crisis in South Eastern Europe

Country Assessment Report: Serbia

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

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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. It is anticipated that the resulting reports will serve as an input for constituents to understand better 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 country assessment report of the Republic of Serbia was prepared by Mr Mihail Arandarenko, Professor at the Faculty of Economics of the University of Belgrade. This work was 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. It examines the country situation and policy responses using the Global Jobs Pact as an integrated framework for analysis.

The paper was 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, and employers' and workers' organizations of the Republic of Slovenia. We trust that this document will be a useful contribution to policy dialogue in the countries of South Eastern Europe.

Mark Levin

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

Introduction

The economic reforms introduced by the government of Serbia in the last decade succeeded in expanding output, improving living standards and reducing poverty. Notwithstanding sustained growth, averaging 5.4 per cent of GDP in the period 2001-2008, the historical trends of the 1990s of declining employment and increasing unemployment continued. The expansion of the private sector proved insufficient to absorb the labour shedding caused by economic restructuring and privatisation. The impact of the economic crisis in Serbia was mild in terms of output contraction, (3 per cent of GDP) but 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 and a decline of 2.9 percentage points in the period 2009 and 2010. The period 2004-2010 saw total unemployment decrease, but the unemployment rate increased by 2.4 percentage points. Lower employment and increasing unemployment rates point to high flows from activity to inactivity, especially for women, young people and workers at the fringe of the labour market. During the crisis, informal employment contracted more quickly than formal employment. This counter-intuitive development can be ascribed 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 and the first to lose their jobs.

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. It introduced a set of measures to guarantee liquidity and promote commercial credit to enterprises. Spending on active labour market programmes increased, but the expenditure was 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 in social protection measures, namely the unemployment benefit and social assistance, increased more as a result of long-planned reforms, rather than through their utilisation as automatic stabilizers.

The main challenges faced by the country in the post-crisis period are to assign priority to employment creation in national development strategies, rebalance labour market policy spending from passive to active measures; introduce more flexible forms of employment without undermining security for workers; make workforce participation pay and introduce disincentives to inactivity; accelerate reform of the education and training system to address the growing skills gap; and strengthen social dialogue as a means to support structural reforms and improve social cohesion.

1. Overview of the Pre-crisis Social and Economic Context

Serbia embarked on the transition to a market economy as late as the year 2000. The economic decline of the 1990s was a consequence of armed conflicts, sanctions imposed by the international community, and significant economic policy mismanagement. Additionally Serbia had one of the highest hyperinflations in Europe's modern history, so severe that its consequences are still being felt today. Major economic reforms were introduced in the last decade with the aim of increasing both household and public consumption and creating conditions for sustainable development through market reforms, privatization and inflow of foreign investments.

However, looking at the achievements of the period 2001–08, it can be we see that these reforms were more successful in increasing consumption rather than in creating the preconditions for sustainable growth. An average annual growth rate of real Gross Domestic Product (GDP) of 5.4 per cent appears satisfactory, but it was still insufficient to compensate for the large development gap stemming from the 1990s experiences. Even more importantly, this growth was not sustainable.

The country managed to improve macroeconomic stability and maintain high and sustained economic growth until 2008, when it entered a recession. In the period 2001–08, GDP grew at an average rate of about 5.4 per cent per year, with the highest rate, – 8.3 per cent, – recorded in 2004. Strong GDP growth was fuelled by the development of the service sector, particularly the financial and commercial segments, which grew at double-digit rates. Conversely, the contribution of industry to GDP decreased from 32.6 per cent in 2001 to 27.7 per cent in 2009 and that of agriculture from 21.4 per cent to 12.8 per cent in the same period.[1]

Since 2001 Serbian living standards have improved significantly. GDP per capita increased from €1,700 in 2001 to €4,190 in 2008, while the prevalence of absolute poverty halved (from14 per cent of the population in 2002, to 6.6 per cent in 2007).[2]

1 World Bank, *Socio-economic indicators*, at http://data.worldbank.org/country/serbia.

2 Republic Statistical Office (RSO), *Living Standards Measurements Study. Serbia 2002–2007*, Republic Statistical Office, Belgrade, 2008.

Inflation eased from 41 per cent in 2001 to 8 per cent in 2003 and, after the lowest rate registered in 2006 (around 6.6 per cent), it rose to two-digit levels again in 2007 (10.1 per cent). Higher inflation rates, despite the relatively tight monetary policy, were the consequence of growing domestic demand. Robust credit growth in the 2000s, driven by lending to households – which grew by more than 51 per cent in 2007 alone – translated into higher domestic demand and thus strong import growth.

Fiscal policy in the period 2000–08 was mostly expansionary and thus pro-cyclical. Consolidated general government spending reached 44.9 per cent of GDP in 2007, up from 42 per cent in 2005, driven by increases in both capital and current spending. Although there was a small budget surplus recorded in both 2006 and 2007, this was insufficient to neutralize large one-off capital inflows due to high privatisation proceeds.

Until 2008 the growth in domestic demand (7.5 per cent annually) and consumption (7.3 per cent) was significantly faster than GDP growth (5.4 per cent per year). Hence, in 2007 and 2008 the value of domestic demand exceeded the value of GDP by over 23 per cent. About one fifth of total domestic demand was covered by the excess of imports over exports, i.e. a deficit of goods and services, which grew by 10.9 per cent per year.[3]

Since the start of the transition to a market economy, Serbia has experienced rapid expansion of foreign trade. Between 2005 and 2007 exports increased by almost 30 per cent annually. However, the volume of exports expanded less rapidly than that of imports, leading to a deepening of the trade deficit (17.8 per cent of GDP in 2008). The country faced a large negative trade balance due to the overall weak export-orientation of its companies. Apart from the loss of traditional export markets during the 1990s, the lack of effective export promotion and exchange rate policies – which until 2008 allowed major appreciations of the national currency – played a role in reducing enterprises' incentives to export. Table 1 below presents some selected macroeconomic indicators for the period 2004–2010.

The impact of foreign trade imbalances on economic growth is best captured by the ratio of growth and the participation of tradable and non-tradable goods in output. In 2001, tradable goods (agriculture and manufacturing) contributed to GDP in the range of 54 per cent. In 2008, this share dropped to 41 per cent. This means lower supply of goods for exports and higher demand for imported goods. In addition, domestic demand and consumption grew faster than GDP, which contributed to the continued enlargement of the balance of payment deficit. Such a model is sustainable only if there are net inflows of foreign capital, creating a surplus in the balance of financial transactions. This growth is clearly not sustainable once the sources of capital account surplus are exhausted. The most serious problem was the unfavourable structure of output, which led to higher export imbalances due to growing foreign trade and balance of payments deficits. Economic growth was mainly generated by the non-tradable sector, fuelled by large capital inflows, which in turn led to large external imbalances, with a current account deficit of 15 per cent of GDP and a trade deficit of 22 per cent of GDP. In short, Serbia was consuming and investing well above its level of output.[4]

3 USAID et al, *Serbian post-crisis economic growth and development: Model 2011–2020*, USAID, Belgrade 2010.

4 USAID et al, *Serbian post-crisis economic growth and development*, op.cit.

Table 1

Selected macroeconomic indicators, Serbia (2004–2010)

	2004	2005	2006	2007	2008	2009	2010
Consumer price index	—	—	—	6.5	11.7	8.4	6.5
Retail price index	10.1	16.5	12.7	6.8	10.9	10.1	8.6
Exchange rate RSD/€ (avg. 2005 = 100)	100.5	100.0	92.1	83.9	79.7	84.1	86.5
GDP (% increase)	8.3	5.6	5.2	6.9	5.5	-3.1	1.8
Public revenues (% GDP)	41.2	42.1	42.4	42.1	41.5	38.6	–1.5
Public expenditures (% GDP)	40.0	39.7	42.7	42.8	43.7	42.7	–1.7
Current account (% GDP)	–11.6	–8.6	–12.9	–17.2	–21.1	–7.0	–6.9
Capital account (€, millions)	2,377	3,863	7,635	6,126	7,133	2,237	—
Foreign direct investments (€, millions)	773	1,248	4,348	1,942	1,824	1,402	860
Credit to non-government sector (% GDP)	23.9	29.6	28.6	35.0	42.0	45.8	53.8

Source: Foundation for the Advancement of Economics (FREN), *Quarterly Monitor*, 2004-2010, University of Belgrade.

The current account deficit was covered by foreign savings, as Serbia took advantage of financial integration with the European Union. This enabled banks from European countries (mainly from Austria, Italy and Greece) to dominate the local banking sector. However this ‘downhill’ flow of capital was quite excessive, taking into account Serbia’s underlying parameters (low per capita income and a low degree of financial integration).[5] Thus, the country exceeded its natural ‘speed limits’ of output growth and became vulnerable to external shocks. This experience revealed the downside of financial integration with the EU.[6]

The sizeable trade deficit confirms that the country did not achieve a high degree of trade integration with the EU and that domestic enterprises failed to connect with European networks. In this respect, the country is similar to other Western Balkan countries, but different from most Central European ones.[7] The inflows of capital were channelled into non-tradable sectors, including retail, banking, transport and telecommunications, which accounted for 80 per cent of overall growth in the last decade. This inflow abetted a continuous process of deindustrialization that led to a restructuring of the economy toward a higher apportion of services and the non-tradable sector in output.

5 Abiad A. et al., “Financial integration, capital mobility, and income convergence”, Economic Policy, Vol. 24, Issue 58 April, 2009.

6 Petrovic, P., “Economic crisis in Serbia: impacts and responses”, in. W. Bartlett and V. Monastiriotis, *South Eastern Europe after the crisis*, London School of Economics, London, 2010.

7 The grouping “Western Balkans” includes: Albania, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Montenegro and Serbia. Central Europe includes the Czech Republic, Hungary, Poland, Slovakia and Slovenia.

The large capital inflows that have ensued since 2005 prompted a strong appreciation of the national currency – approximately 26 per cent at the peak point in August 2008. This seriously reduced the competitiveness of the Serbian economy and further stimulated investments in the non-tradable sector. A further consequence was a very low level of exports (below 30 per cent of GDP). Nonetheless, weakened exports were also due to the fact that Serbia was a latecomer in the transition to a market economy. Still, the pace of export growth has been increasing substantially since 2004, suggesting that Serbia might, in the long run, achieve satisfying trade integration with the EU.

The sharp increase of foreign direct investment (FDIs) since the early 2000s is the consequence of privatization and the sale of existing resources, rather than *greenfield* investment.

1.2 Impact of the Economic Downturn on Macroeconomic Trends

The global economic crisis hit Serbia in the last quarter of 2008, at first in the form of a mild bank panic episode. However, the downturn soon spotlighted, and in a dramatic fashion, the root causes of the country's economic challenges. 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.[8] Before the crisis, the increased credit extended to the non-governmental sector (real sector and households) was approximately 20 per cent a year. Credits were based mainly on foreign savings. Without these inflows, domestic demand dipped sharply, pulling down output in its wake. The second channel through which the economic crisis affected the Serbian economy was the sharp decline in exports. However, since the share of exports in GDP was low, such impact was only a secondary factor in output decline (Figure 1).[9]

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 15 to less than 10 per cent of GDP) and trade deficit (from 22 to 15 per cent).

In the last quarter of 2008, consolidated general government spending dropped by 3.5 percentage points, due to the budgetary contraction triggered by the crisis. However, public spending remained high (around 44 per cent of GDP), with a budget deficit of around 4.5 per cent of GDP in both 2009 and 2010.

After the sudden abatement in capital inflows, the domestic currency depreciated by 23 per cent (October 2008–March 2009) but then stabilized in the second half of 2009. This was considered a positive adjustment from a macroeconomic point of view, as it probably slowed output decline. Thus, Serbia's experience adds to the mounting evidence that the recession has been weaker in countries

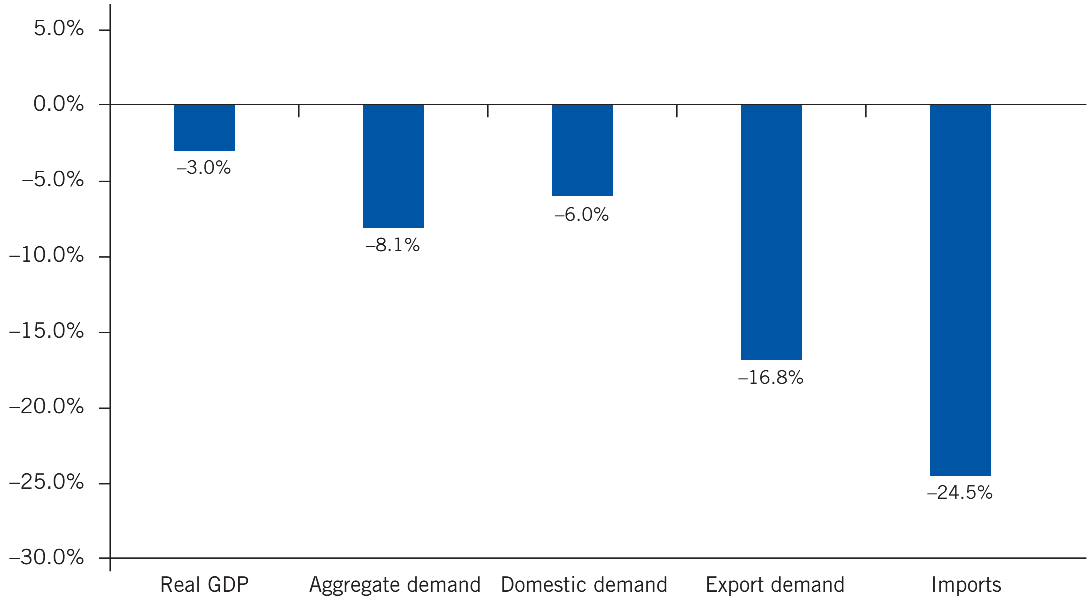
8 Petrovic, P., "Economic crisis in Serbia: impacts and responses", in. W. Bartlett and V.Monastiriotis, *South Eastern Europe after the crisis*, op.cit.

9 Ibid.

with flexible exchange regimes compared to those with fixed exchange rates.[10] While the three per cent decline in output in 2009 was substantial, it was nevertheless less than the decline experienced by other countries in South East Europe (Romania, Bulgaria, Croatia and Bosnia and Herzegovina). Furthermore, the Serbian economy started emerging from the recession in the first half of 2010 (Figure 2).

Figure 1

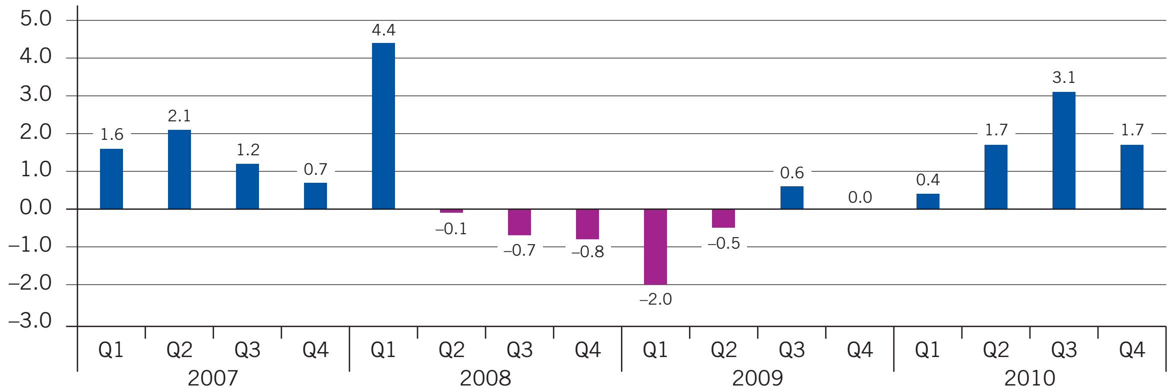
Real GDP growth and components of its decline, 2009 (% per year)



Source: Petrovic, P., "Economic crisis in Serbia: impacts and responses", op.cit, 2010 based on FREN, *Quarterly Monitor*, 2005–2010, University of Belgrade.

Figure 2

Seasonally adjusted GDP growth rates, Serbia (2007–2010)



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

10 Petrovic, P., "Economic crisis in Serbia: impacts and responses", in. W. Bartlett and V.Monastiriotis, *South Eastern Europe after the crisis*, op.cit.; Berkman, P. et al., *The global financial crisis: explaining cross-country differences in the output impact*, IMF, WP/09/280, Washington D.C., 2009

Despite the sizeable and rapid depreciation of the Serbian dinar (RSD), the pass-through into inflation was initially very modest (less than 20 per cent).[11] This low pass-through can be explained by the significant drop in domestic demand that prevented a rise in inflation. Finally, the exchange rate depreciation led to a partial recovery in Serbia's competitiveness, which had been lost during the period of surging capital inflows and real exchange rate appreciation (from 2005 to mid-2008).

To calm bank anxiety and restore confidence in the financial sector, the government raised deposit insurance coverage (from €3,000 to €50,000) and shortened the payout period (from 30 to 3 days). The currency's depreciation was kept under control, with central bank intervention in selling its foreign currency reserves. The aim of these interventions was threefold: to avoid sharp drops in the value of the domestic currency, and to prevent both panic and a possible overshooting of the exchange rate. This was a rather difficult task given the high level of 'euroization' of the financial sector in Serbia (about 70 per cent of all extended credits are euro-indexed). Hence, there was a danger that the currency depreciation could trigger massive credit defaults, as the cost of repayments of outstanding loans multiplied considerably in domestic currency terms. Fortunately, this pessimistic scenario did not materialize and the number of non-performing loans – concentrated mostly in manufacturing, retail and real estate sectors – increased from 11.3 per cent in 2008 to 16.5 per cent in mid-2009, which is high, but still manageable.[12]

Two factors contributed to stabilization. First, the €3bn Stand-by-Arrangement signed with the International Monetary Fund (IMF) which focused on achieving a sustainable budget deficit. The amount provided covered most of Serbia's foreign currency needs in 2009. Second, the Vienna Initiative – an agreement reached among the IMF, European banks operating in South Eastern Europe (SEE) and the countries in the region to preclude capital outflow – was vital in preventing a currency collapse. Thus, the downside of financial integration with the EU, associated with excessive capital inflows, also had an upside of preventing abrupt capital outflows. Additional measures were also taken by the Serbian Central Bank, such as removal of barriers to capital inflows and the provision of incentives to switch from euro-indexed to national currency credits. Nevertheless, the impact of these measures has been quite limited, since the level of FDIs decreased by 45 per cent in 2009 and the currency remained under pressure.[13]

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, which in turn generated exceptional tax revenues from both the value added tax (VAT) and import tariffs. Consequently, tax revenues grew even faster than GDP. Such above-average public revenues were considered by policy makers to be a normal and permanent feature of the economy. In addition, revenues were further boosted by large privatization proceeds. Unfortunately, low budget deficits – at around 2 per cent of GDP – were interpreted as a sign

11 Meaning that for each percentage point of depreciation of the national currency, prices rose by less than 0.2 per cent.

12 International Monetary Fund (IMF), *Republic of Serbia: Fourth review under the Stand-By Arrangment,* Country Report No. 10/210, June 2010.

13 The level of FDI recorded in 2008 was 2,717 million US$ and 1,864 million US$ in 2009.

of prudent fiscal policy, while in fact there should have been budget surpluses. Thus, the underlying deficit that would have corresponded to a normal, and lower, level of tax revenue was actually much higher than had been realized.[14]

In 2009, a sharp decline in domestic demand and imports caused an 8 per cent drop in public revenues, much higher than the decrease in output. In line with the IMF recommendations, the fiscal policy response was accommodative. The government introduced a set of measures to subsidize credits to enterprises and households to offset the sharp decrease in credit activities and the decelerating FDI inflows. The budget deficit was raised to 4.1 per cent in 2009, from less than 2 per cent in 2008. Unfortunately, the country 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 necessary to cut some public expenditure instead. Most public spending cuts targeted public sector salaries and pensions, which were frozen in 2009 and 2010. Additional expenditure adjustments required by the Stand-By-Arrangement in 2009, namely the reduction in public sector employees and cuts in discretionary government spending, mostly failed to materialize. Instead, public investments were shelved. This was not a positive outcome, since these investments, such as the building of major transport networks, could have mitigated the drop in demand and output by boosting construction and associated industries.

The accommodative fiscal policy and the increased government budget deficit were carried over into 2010. Due to a sluggish recovery, tax revenues were lower than expected. As a consequence, the deficit reached 4.8 per cent of GDP in 2010 and it is unlikely to drop below 4 per cent in 2011. Large deficits for three consecutive years led to a sharp increase in the public debt, albeit from a rather low level. The public debt, at around 40 per cent of GDP, is still acceptable, but it increased by over 10 percentage points since the onset of the crisis and will continue rising for some time.[15] In addition, there is always the threat of hidden debts. All these factors point to significant threats to sustainable recovery.

Substantial fiscal adjustments are needed to lower the budget deficit from almost 5 per cent to about 1 per cent of GDP by 2015.[16] This will be a challenging task. First, tax revenues as a share of GDP are bound to drop if the required rebalancing of the Serbian economy from consumption and imports to investments and exports occurs. The shrinking tax base (due to falling consumption and imports) with the same tax rates and lower import tariffs due to EU accession, will result in relatively lower revenues. This will require either additional expenditure cuts or increased tax rates. Secondly, the drop in public expenditures should be even deeper than currently planned to free up space for increased public investments and larger interest payments due to higher public debt levels. This applies especially to large-scale public infrastructure investments to be financed through foreign borrowings. Although public debt is still moderate, it must be kept under control due to the relatively high servicing costs.

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

15 The debt totals 40 per cent according to the IMF methodology, while it is computed at a slightly lower level by the Ministry of Finance.

16 This is also sanctioned in the new *Law on the Budgetary System of the Republic of Serbia.*

Moreover, the increase in public debt will also push up Serbia's external debt, which is already high (above 70 per cent of GDP).

To shrink the budget deficit, the government has introduced a fiscal responsibility legislative framework. This should reduce the medium-term deficit through a set of transitional rules until 2015 and, subsequently help maintain a prudent fiscal policy stance using permanent rules. A new three-member independent body, the Fiscal Council, is expected to become operational in the first half of 2011.

However, significant debate continues on how to achieve the necessary fiscal adjustment on the revenue side. A controversial tax reform proposal argues for the simultaneous reduction in labour taxes and an increase in the VAT rate, within the boundaries of overall revenue neutrality.[17] Such a reform would reduce social security contribution rates and basically keep the present flat income tax system, but it would introduce a more generous zero tax bracket to lower the tax wedge for low-wage workers. At the same time, the VAT rate would increase from 18 per cent to 21 or 22 per cent. Whereas it would be useful and desirable to cut the social security contribution rates, both the flat income tax and the VAT increase would have a strong regressive impact. Furthermore, households without formal employees would be the biggest losers in such a reform, since they would stand to lose from the VAT increase and will have nothing to gain (in the short to mid-term) from the decrease in labour taxes.

There are some signs that exports have started to recover and that output has begun to increase, albeit at a modest rate. To make recovery sustainable, however, the economic growth model of the country needs to driven by increasing exports and investments, rather than by consumption and capital inflows, as in the past.

The fall in employment and living standards, as a result of the crisis, reversed the positive trends in absolute poverty reduction. Poverty dropped from 8.8 per cent in 2006 to 6.1 per cent in 2008. It then increased 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+ (18 per cent), while for the working age population the risk was below 17 per cent.

17 USAID et al, *Serbian post-crisis economic growth and development: Model 2011–2020*, op.cit.

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

Unlike general macroeconomic trends, it is difficult to confidently distinguish the impact of the crisis on employment, enterprises and workers, from other factors. For example, the country was also at the time experiencing the effects of the advanced stage of transition and enterprise restructuring. In addition, there are complications related to the methodological changes introduced in the Labour Force Survey (LFS) in 2008 and in the establishment survey (RAD) in 2009.

Looking at unadjusted LFS data, one could conclude that the employment decline caused by enterprise restructuring started to reverse in 2007. If this interpretation were correct, then the drop in employment recorded since October 2008 could be fully ascribed to the crisis. However, when looking at adjusted data, it appears that the increase in employment in 2007 and first half of 2008 was largely artificial.[18] Thus, the interpretation of labour market indicators in the period of the crisis has to take into account that their worsening – and especially the large employment drop – is probably the result of *both* the crisis and the advanced stage of restructuring and privatization.

A test to verify whether labour market trends since October 2008 have been driven by the crisis, is to look more closely at the pattern of formal employment before and after the crisis. A clear link would suggest that the impact of the crisis was dominant. However, formal employment data is not of the highest quality (since the Serbian establishment survey has the primary role to report on wage dynamics), and more significantly, this data set was also affected by methodological changes. Since 2009, employment in self-proprietary units has been calculated on health insurance records, instead of administrative self-reporting. As a result, in the period from September 2008 to March 2009, the number of formally, non-agriculture, self-employed workers declined by over 100,000 (over 20 per cent). Unfortunately, it is not possible to distinguish between the ‘real’ and the ‘methodological’ decline.

18 The LFS was introduced in Serbia in 1994, but only in 2004 did it become internationally comparable. Yet a seemingly minor methodological problem remained, namely the delineation of some “marginally active” and “marginally employed” categories. In April 2008, the survey questionnaire was changed; new questions were introduced, which contributed to bringing the concept of employment in the Serbian LFS fully in line with the International Labour Organization recommendations. This resulted in a noticeable increase in some borderline forms of employment – primarily owing to better capturing of contributing family workers and persons about to start their own businesses – and, consequently, methodologically-induced improvement in all key labour market indicators.

The LFS data was recalculated for the period 2004–07.[19] Thanks to this, the main labour market trends stemming from the LFS series 2004–2010 are now fully comparable. In the paragraphs that follow, these data are often used and, therefore, the figures presented often differ from those published by the Republic Statistical Office (RSO).[20] Still, the LFS recalculations are mostly limited to main labour market indicators (employment, unemployment and inactivity) and some structures (such as sector and sex). Because of this, for pre- and post-crisis comparison, unadjusted data has been used when needed – implicitly assuming that structures related to personal characteristics were less affected by the LFS methodological changes than the aggregate labour market indicators. Table A1 in the Statistical Annex provides the main labour market indicators by sex and age group for the period 2005-2010.

2.1 Trends in Labour Force Participation (2004–2010)

Over the past decade, there has been a continuous decline in labour force participation and a virtually uninterrupted decline in employment, while unemployment has changed in a less linear fashion. The percentage drop in the number of active individuals is higher than the drop in the activity rate. Also, the drop in the activity rate of the adult population (15+) is greater than the decline in the activity rate of the working-age population (15–64). These findings are accounted for by demographic dynamics, i.e. the decline in the total adult population, as well as a greater decrease in the working-age population compared to the total adult population. Between 2004 and 2010 the working-age population diminished by 4.5 per cent, mainly as a result of negative natural growth and population ageing.

Between 2004 and 2010, the active population declined by as much as 19 per cent, levelling at 58.8 per cent of the total working-age population (Figure 3 and Table A1 in the Annex). The activity rate of the Serbian working-age population is considerably below the EU-27 average (71.3 per cent in 2009) and it is almost 10 percentage points below the 2004 level.

Such a low activity rate is primarily the result of low activity rates of women, young people (aged 15–24) and elderly persons (aged 55–64). The activity rates for both men and women declined at a uniform pace throughout the period. Yet the gender gap in activity rates recorded a slight increase. 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 and the deterioration of labour market opportunities for young people during the crisis.[21]

The labour force participation figures do not show significant trend break at any point before or after the crisis. The drop in the active population between 2004 and 2008 was slightly over 400,000. In the following two years (October 2008–October 2010) the active population decreased by 270,000.

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19 Mehran, F., *Developing consistent time series on employment and unemployment following the methodological changes of the Labour Force Survey of Serbia*, ILO Belgrade 2010 (unpublished).

20 The Statistical Office is expected to adjust its original series of LFS data for the period of 2004–2007.

21 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.

Figure 3
Active working age population, Serbia (2004–2010)

Source: Mehran, F., *Developing consistent time series,* 2010, op.cit.

The size of the active population will be under further pressure in the next decade, since its main reservoir, e.g. the working age population, is projected to drop cumulatively by around by 8 percentage points as the baby boomers exit the working age population.[22] In this respect, measures aimed at increasing labour force participation need to be addressed, including the extension of the minimum retirement age and initiating work pay policies.

2.2 Trends in Employment (2004–2010)

Total employment declined for the better part of the reference period and reached its bottom value in October 2010 (about 2,270,000 employed individuals), with a drop of 21 per cent compared to the 2004 level (Table A1 in the Annex). The employment rate is very low. In 2009 it reached an historical minimum, when only one in every two working-age individuals were employed. In 2010, the employment rate declined by a further 2.9 percentage points, which was the greatest annual dip since the onset of the crisis. The employment rate of 47.1 per cent recorded in 2010 is not only considerably

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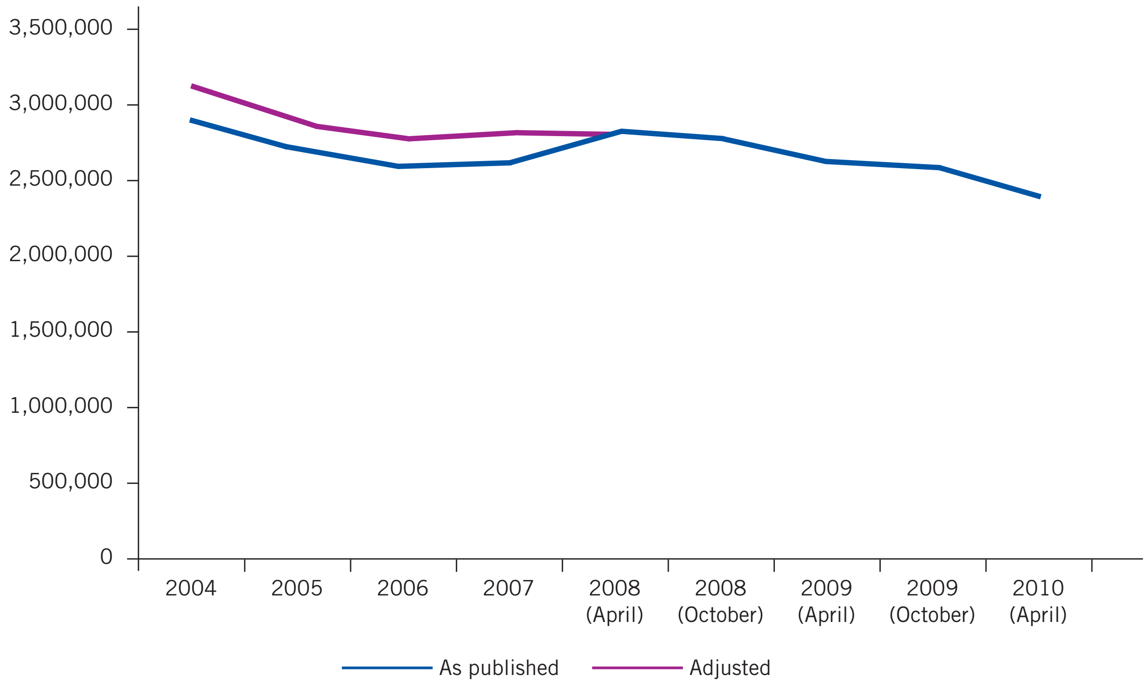
22 Arandarenko, M., Vujić V., Projekcije zaposlenosti na tržištu rada Srbije do 2020. godine, *Kvartalni monitor* br. 21, april-jun, FREN, Belgrade 2010.

lower than the EU-27 average (64.2 per cent), but also lower than the employment rates of some neighbouring countries (Croatia, Bulgaria and Romania).

Figure 4 below shows the difference between the LFS adjusted (dashed line) and unadjusted (solid line) employment series for the period of 2004–2010. The gap between the two lines indicates the extent to which employment data was underestimated in the period of 2004–2007.[23]

Figure 4

Employment in Serbia, 2004–2010



Source: Mehran, F., *Developing consistent time series*, 2010, op.cit.

The most interesting finding is that, contrary to previous interpretations based on unadjusted data, there was no double dip in employment – the first resulting from transition and the other from the crisis. This means that 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 registered, rather than real, employment growth. What the adjusted dashed line in Figure 4 shows, is a virtually uninterrupted downward trend of employment, marking the entire decade starting in 2001.

Still, unlike the labour force participation trend- in which there is a slightly faster shedding of active population, but no visible trend break- the employment dynamics before and after the start of the crisis shows a break. Whereas in the period 2005–07 employment cumulatively declined by less than 100,000

23 The gap amounts to about 230,000 workers in 2004, 210,000 in 2005, 175,000 in 2006 and 180,000 in 2007.

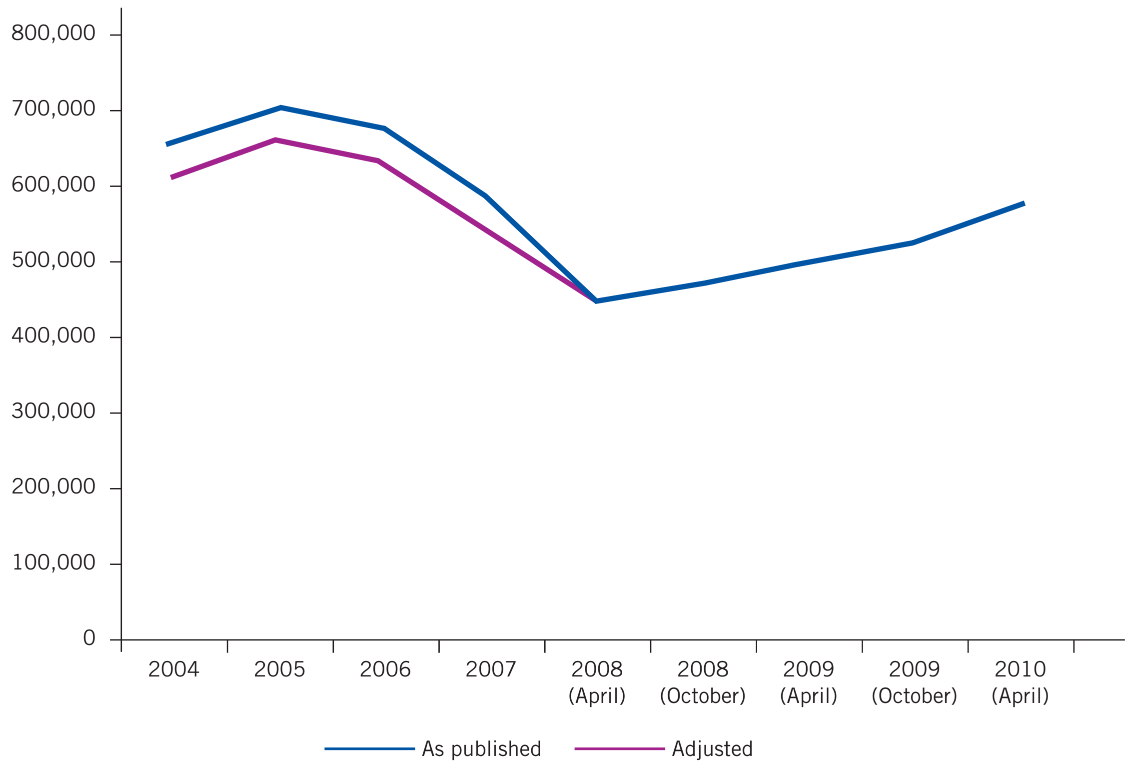
individuals, the decrease recorded between October 2008 and April 2009 was of nearly 200,000. The cumulative loss by October 2010 approached 400,000. A large part of this decline is due to the crisis, but also to the drop in the working age population and the impact of enterprise restructuring.

2.3 Trends in Unemployment (2004–2010)

Unemployment is very high in Serbia. Some 20 per cent of the labour force was unemployed in 2010 (Table A1 in the Annex). The unemployment rate is among the highest in the region and is considerably higher than that recorded in the EU-27 (9.7 per cent).

Total unemployment, however, decreased between 2004 and 2010 (by about 50,000 individuals), but the unemployment rate increased by 2.4 percentage points. Given the large decreases in both employment and the employment rate in the reference period it is clear that these trends are primarily due to high flows from activity into inactivity. The shrinking of unemployment is only partly due to new employment, since many discouraged workers became inactive. However, it should be highlighted that both total unemployment and the unemployment rate have been on a continuous increase since 2008, largely as a result of the impact of the crisis on the labour market. As shown in Figure 5, there is indeed a trend breakpoint, no matter whether adjusted or unadjusted figures are used.

Figure 5
Unemployment in Serbia, 2004–2010



Source: Mehran, F., *Developing consistent time series*, 2010, op.cit

Women are more affected by unemployment than men, despite their generally higher educational attainment. Interestingly, the gender gap in unemployment rates has shown a steady narrowing that has further accelerated since the onset of the crisis. A possible explanation of this trend is that stronger employment protection is found in the public sector, which has a higher than average share of women employees. The gap between male and female unemployment rates decreased from 7.1 per cent in 2004 to 2.2 per cent in 2010. Thus, women fared relatively better than men during the crisis.

The unemployment rate decreases considerably with age and it is highest for the youngest group (15–24). After decreasing between 2004 and 2007, the youth unemployment rate started growing again, reaching 46.1 per cent in 2010. Youth unemployment in Serbia is more than twice as high as in the EU-27 (20.8 per cent). Compared to adults, the labour market position of young people deteriorated during the crisis, as the gap between the unemployment rates of youth compared to other age groups widened.

2.4 Impact of the Economic Crisis on Key Labour Market Indicators

The decline in employment levels since the onset of the crisis in October 2008 was dramatic. The number of workers fell by about 15 per cent between 2008 and 2010. This caused a decline in the employment rate (from 53.3 per cent in 2008 to 47.1 per cent in 2010). The number of unemployed persons increased by almost 60,000, with a surge in the unemployment rate from 14.7 per cent to 20 per cent.

The smaller increase in unemployment compared to the decrease in employment suggests that many people who no longer worked moved into inactivity rather than into unemployment. The large drop in employment, as well as the decrease of unemployment for the youngest age group (15–24) confirms that, in a time of crisis, youth frequently opt to remain at school as an alternative to seeking employment. Another group affected more than most were workers 45 to 54 years old. Unlike for youth, the employment decreases for this age-group were accompanied by a relatively large unemployment increase. The impact of the crisis appears to be most pronounced for youth, as shown by both the fall in fixed-term contracts and in the number of jobs. The older group appear to be affected more by the completion of the privatization process and by restructuring of enterprises than by the impact of the crisis.

Cumulative job losses in 2008–2010 amounted to approximately 12.5 per cent, 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 percent. 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. Although the decline in formal non-agricultural employment,-as recorded by the 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 on employment decreases.

The April and October 2010 figures indicate a further deepening of the labour market crisis, although at a slower pace. This finding, which coincides with the formal end of the recession in mid-2010, suggests that a Serbian employment recovery will occur with a prolonged time lag after recovery of output.

2.5 Employment Structure by Sectors

The employment structure by main economic sectors usually provides indicators of a country's level of development. In developed countries, employment in services prevails, while employment in industry is modest and employment in agriculture is marginal. In medium-developed countries, the relative shares of the three sectors are more balanced.

Table 2 below shows adjusted (upper panel) and unadjusted (lower panel) LFS data on employment by sectors.

Table 2

Employment structure by economic sectors, adjusted and unadjusted data (2004–2010)

Adjusted	2004	2005	2006	2007	2008	2009	2010
Agriculture	29.4	28.5	25.2	25.5	24.1	24.0	21.9
Industry	25.0	25.7	27.5	27.6	27.3	25.1	26.2
Services	45.5	45.7	47.2	46.7	48.5	50.8	51.7
Unadjusted	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Agriculture	24.0	23.3	20.5	20.8	24.1	24.0	21.9
Industry	26.9	27.5	29.3	29.4	27.3	25.1	26.2
Services	49.0	49.1	50.1	49.7	48.5	50.8	51.7

Source: Mehran, F., *Developing consistent time series*, 2010, op.cit

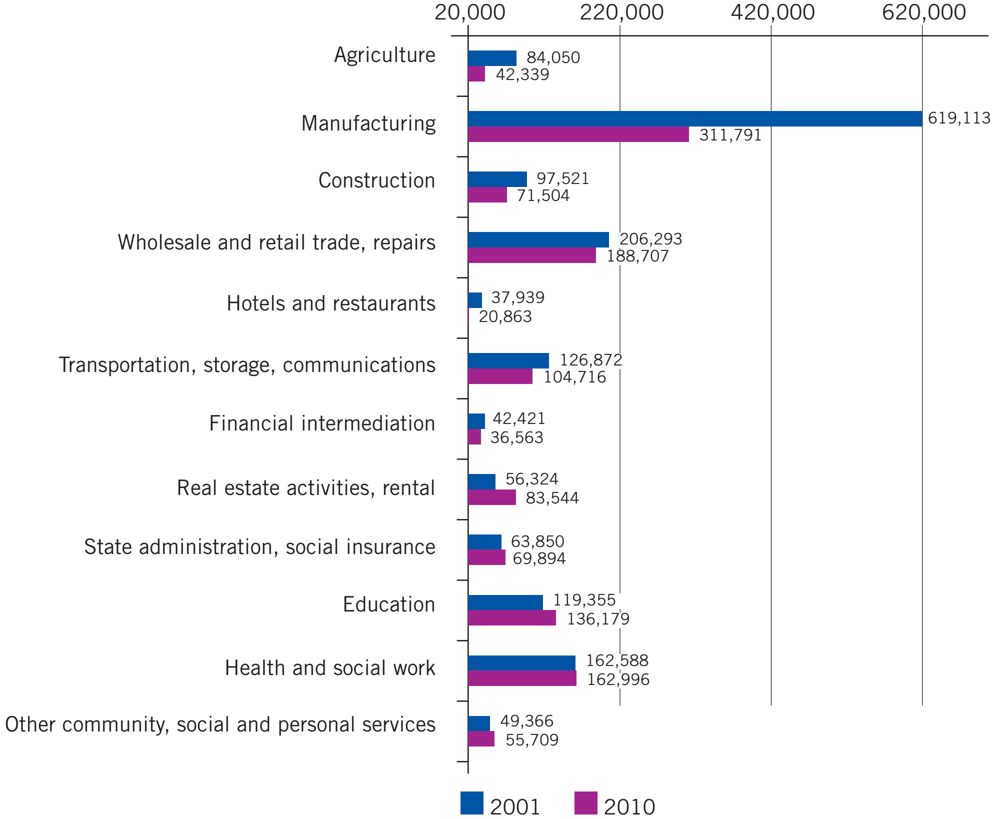
The figures indicate that agricultural employment was underestimated, and therefore higher than published, until 2008. According to the adjusted data, it was only in 2006 that industrial employment exceeded agricultural employment. The share of agricultural employment in total employment is exceptionally high in Serbia. 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). In some central European countries, this share is surprisingly low – for instance, in Hungary and Slovakia it is in the single-digit range. On the other hand, the share of industrial employment is lower in Serbia than in other European countries. As a result of these two extreme figures, the share of employment in the service sector is only slightly below those recorded in the EU-27. According to adjusted LFS data, the share of service sector employment increased from 45.5 per cent in 2004 to 51.8 per cent in 2010; the share of industrial employment increased from 25 per cent to 26.3 per cent, whereas agricultural employment decreased from 29.4 per cent to 22 per cent.

For analytical purposes, the service sector may be roughly divided into three segments – traditional services, modern services and public services. Figure 3 below provides some highlights of employment by economic sector. Table A2 in the Statistical Annex presents the employment levels by sector recorded in the period 2001–2010.

All agricultural and industrial activities recorded employment decreases in absolute terms in the past decade. The decrease was most pronounced in manufacturing, which practically halved. In the private services sector, decreased employment was less pronounced, but it 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.

Figure 6

Employment structure by economic sectors, Serbia (2001–2010)



Source: Republic Statistical Office (RSO), *Establishment Survey* (RAD), various years.

Conversely, employment increased in two of the three service activities where the state is the prevailing employer – public administration and social insurance, and education – but it remained mostly unchanged in health and social work.

In the period 2001–2010 total employment in the public sector increased, (see Table A3 in the Annex), but the share of the public sector in total formal employment increased even more (from 19.7 per cent to 27 per cent). The increase in the share of service sector employment is the result of two ranges of factors. Firstly, employment fell dramatically in agriculture, manufacturing, mining and construction. Secondly, employment increased in public administration, education, community and social services and real estate activities.

If employment in public enterprises (about 120,000 employees in 2010) is added to the count of employment in the public sector, its share in total formal wage employment would reach 35.9 per cent. In other words, almost two fifths of all wage earners in enterprises, institutions and organisations are employed in the broadly-defined public sector. Even more significantly, since the average wage in the public sector exceeds by at least one quarter wage levels in the private sector, the share of the public sector wage bill approaches one half of the total wage bill.

2.6 Development of Formal and Informal Employment

Informal employment is defined in various ways, but essentially, informally employed persons are those working without a formal contract or the possibility of exercising rights arising from mandatory social insurance. These workers may be wage earners, own account workers or contributing family workers, the last category being informal by definition.

Until 2008, the LFS did not contain specific questions to unambiguously classify employment into two mutually exclusive categories – formal and informal employment. Still, there have been attempts at measuring informal employment by means of indirect indicators using the Labour Force Survey (LFS). Research by the World Bank on the Serbian labour market found that in 2005 informality accounted for 43 per cent of all employment, and 27 per cent of wage employment. Although this figure is objectively inflated due to the classification used, the structural findings are supported by other analyses as well.[24] Namely, the research found that informal employment is linked to low income, poverty and vulnerability. In addition, it found that youth and the poorly educated accounted for an above average share of the work in the informal economy. Work experience and wages were much lower in the informal compared to the formal economy. The wage premium for those working formally was approximately 20 per cent. The study also showed by longitudinal analysis that flows between informal and formal employment were low.

Informal employment can be measured more directly through the results of the *Living Standards Measurement Survey* (LSMS).[25] This survey contains a module on economic activity, largely in line with the LFS, with a question on the payment of social insurance contributions, which facilitates the classification of workers as belonging to either one category or the other. The comparison of 2002 and

24 The research considered informally employed: i) all self-employed individuals who had not completed post-secondary education, ii) all contributing family workers, and iii) wage earners and owners in private firms with fewer than 10 employees. All wage earners in the state and socially-owned sector were considered to be formally employed. World Bank, *Serbia: Labor market assessment*, World Bank, Washington D.C., 2006

25 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.

2007 data (which coincide with the early and mature transition stages in Serbia) provides a counter-intuitive result, e.g. that informal employment increased from 28 per cent to 35 per cent.[26] Furthermore, informality was an important determinant of inequality in 2007, but not in 2002. In other words, during the transition informal employment slipped towards the bottom of the wage distribution, in parallel with increases in volume. The authors found that informal workers earned less than formal ones in net monthly terms. Seeking to identify potential causes of growing informal employment and increasing wage premiums of formal workers, the report points to the regressive taxation system as the likely cause of this trend. Interestingly, the 2008 LFS data indicate a considerably lower informal employment level (23 per cent). This difference, however, mostly stems from the different treatment of self-employment in the agricultural sector. 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.[27]

During the crisis, informal employment decreased faster than formal employment. According to the LFS, the share of informal employment in total employment decreased compared to 2008 (to 21 per cent in 2009 and 19.6 per cent in 2010). High informal job shedding during the crisis is difficult to explain, as it is contrary to the standard assumption about the counter-cyclical – or at least ambivalent – character of informal employment. The explanation could be in the duality of the Serbian labour market, where informal wage employees are the most vulnerable and the first to lose their jobs. At the same time, those marginally attached to the labour market, such as contributing family members, have probably opted out of the labour force to a larger degree.

2.7 Labour Market Vulnerability

The gender gap in the Serbian labour market, when put in an international perspective, is moderate. The key labour market indicators for women and men in the period 2004-2010 (Table A1 in the Annex) show a steady declining trend in the activity and employment rates of both sexes, along with a narrowing gender gap in unemployment rates. Men's activity rate declined by 8.9 percentage points (from 76.1 per cent to 67.2 per cent), while women's activity rate declined slightly faster (from 61.4 per cent to 50.6 per cent). Over the same period, men's employment rate declined by 10.7 percentage points, while women's employment rate decreased by 8.3 percentage points. As a result, differences in unemployment rates decreased from 7.1 percentage points in 2004 (21.5 per cent for women and 14.4 per cent for men) to only 2.2 percentage points in 2010 (21.2 per cent for women and 19 per cent for men).

These figures suggest that the deterioration of the key labour market indicators during the transition period affected men and women in a different, yet balanced, manner. While for men the transition was mostly from employment into unemployment, for women the shift was from employment into

26 Krstić, G., Sanfey, P., Earnings inequality and the informal economy, *Economics of transition*, Vol. 19, 2011.

27 Most likely, the share of informal employment in the country falls in between the rates recorded by the LFS and the LSMS, as neither method for classifying informality in the agricultural sector is fully accurate.

inactivity. Still, women's employment rates declined at a slower pace than men's, while employment for both sexes declined at a more uniform pace. It appears that changes in labour market status were, to a large extent, blind to gender differences, especially if the distinction is reduced to the employment/non-employment dichotomy. As regards the gender wage gap, there are strong indications that this narrowed further from the already low level recorded in the transition period.[28]

As regards the labour market performance of different age-groups, Table A1 in the Annex shows a common trend of declining activity and employment rates and growing unemployment for all cohorts in the reference period.

Young people (aged 15 to 24) recorded a sharp drop in labour force participation rate (from 37.9 per cent in 2004 to 28.2 per cent in 2010) and a somewhat smaller decrease in employment (from 21.1 per cent to 15.2 per cent). The youth unemployment rate remained at an extremely high level throughout the period (44.2 per cent in 2004 and 46.1 per cent in 2010). Positive developments recorded in the youth labour market in 2007 were reversed at the end of 2008 and have been deteriorating since.

The predicament of young people in the Serbian labour market prompts serious concern.[29] 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.[30] 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 only (52–53 months).

Workers aged 25–34 fared poorly during the transition period. Since 2004 they have lost the lead in labour force participation (from 85.5 per cent in 2004 to 77.7 per cent in 2010), to the group aged 35 to 54 years old, which recorded a slower decline – from 84 per cent to 78.1 per cent. The drop in the employment rate of individuals aged 25 to 34 was even steeper (from 67.4 per cent to 56.4 per cent), thus widening the gap with the 35–54 age-group. Similarly, the unemployment rate increased from 21.1 per cent to 27.5 per cent, more than for any other age group.

Elderly persons (aged 55 to 64) also fared poorly, with activity rates declining from 44.9 per cent to 37.7 per cent, employment decreasing from 41.4 per cent to 33.1 per cent and unemployment growing from 7.8 per cent to 12.2 per cent. While the position for all age groups deteriorated in the period considered, only workers aged 35 to 54 years old experienced a decline that was below average.

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28 See G. Krstić, in World Bank, *Living Standards Measurement Survey (LSMS): Life in Serbia through Survey Data*, Washington D.C., 2004

29 Arandarenko, M., Nojković, A., *Impact of global financial crisis on youth employment in the Western Balkans*, op.cit.; Arandarenko, M., *Transition from education to work: Serbia country report*, European Training Foundation, Turin 2007; *Krstić*, G., *Corbanese* V., *In search of more and better jobs for young people in Serbia*, ILO Subregional Office for Central and Eastern Europe, 2009; Krstić, G. et al., *Položaj ranjivih grupa na tržištu rada Srbije,* Foundation for the Advancement of Economics (FREN) and UNDP, Belgrade, 2010.

30 Krstić, G. et al., *Položaj ranjivih grupa na tržištu rada Srbije,* op.cit.

To summarize, statistics on women, youth and elderly persons show poorer labour market outcomes compared to the overall Serbian population. In addition to these broad categories of workers, there are other groups that are particularly vulnerable in the labour market. Based on research on living standards and poverty, Roma population groups, refugees and internally displaced persons, workers with disabilities, rural inhabitants of South-East Serbia and low-skilled individuals also face particular barriers.[31] Preliminary analysis of the impact of the crisis on these groups reveal that youth, Roma population groups and landless rural individuals suffered proportionally more than others.

2.8 Duality of the Serbian Labour Market

The labour market in Serbia appears more polarized and segmented than ever before, with dichotomies affecting formal vs. informal employment; public vs. private sector employment; modern vs. traditional labour market; wage employment vs. self-employment, standard vs. vulnerable employment; paid vs. unpaid work. The relative sizes of such dichotomies are shown in Table 3 below.

In order to constitute elements of labour market duality, these elements must fulfil two important conditions: i) there must be serious obstacles to the transition from the "lower" to the "higher" employment segment; and ii) both segments must be relevant, rather than marginal, in volume. While the second column of Table 2.7. clearly shows that the relevance condition is fulfilled by all dual structures, the first condition requires additional figures.

Table 3.

Dichotomies in the Serbian labour market (ca 2010)

Employment structures	Share of total employment (15+)
Public – private employment	25:75
Formal – informal employment	80:20
Modern – traditional labour market	65:35
Wage employment – self-employment	67:25*
Standard – vulnerable employment	67:33
Paid – unpaid work	92:8

Source: RSO, *Key Labour Market Indicators (KILM)*, Belgrade 2010 (unpublished) and author's estimates.

Note: * The total is lower than 100 since it does not include unpaid work of contributing family members.

The simplest test of the impenetrability of the primary labour market segments (public sector, formal employment, modern sector employment and wage work) is their absolute net increase. If this is negligible, vertical mobility is very limited. A more sophisticated test would involve measuring, at two

31 Krstić, G. et al., *Položaj ranjivih grupa na tržištu rada Srbije,* op.cit.

points in time, the movement of the same individuals from one labour market status and segment to another. This requires individual panel data, available only from 2004 onwards.

A longitudinal analysis of informal and formal employment conducted in 2004 and 2005 indicates that flow between the two segments was very low: only 10.5 per cent of informal wage earners in 2004 had moved to formal employment in 2005 and these included a disproportionately high number of highly-educated individuals. On the other hand, the vast majority of formal wage earners remained formal in the following year. Therefore, workers in the informal sector are mainly condemned to remain there.[32]

According to a recent analysis, the advanced stage of transition in Serbia is characterized by a consolidation of labour market duality.[33] The primary labour market 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. The primary labour market is characterized by job security, good working conditions and above average wage levels, while jobs in the secondary labour market are, generally, precarious and poorly paid.

32 World Bank, *Serbia: Labor market assessment*, World Bank, Washington D.C., 2006, op.cit.

33 Arandarenko, M., 'Politička ekonomija nezaposlenosti', in Arandarenko, M., Praščević A., and Cvejić, S. *Ekonomsko-socijalna struktura Srbije – učinak prve decenije tranzicije*, University of Belgrade, 2010.

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

The Serbian policy in 2009–10 was primarily shaped by efforts to stabilize the economy and put it back on a growth path. The main framework was the interaction of the government with the IMF and the signing of a €3billion Stand-by-Arrangement in early 2009. Although the package agreed upon with the IMF was flexible enough to include cautious growth-supportive measures – such as interest rate subsidies and loan guarantees to stimulate credit – it included public sector restrictions that negatively affected the short-term labour market outlook, on top of the crisis-driven decline in private sector employment.

3.1 General Stimulus Measures Introduced in Response to the Crisis

In 2009, the government introduced a set of measures to offset the sharp decrease in credit activity, as well the lack of foreign credits and FDI inflows. Some of the measures – with sometimes regressive impact on distribution, but positive effect on labour demand and supply – included subsidized credits to enterprises and households for the purchase of durable goods. Other measures however,– with potentially progressive impact on distribution, but perhaps crowding out more targeted measures aimed at the poor,– included bailouts of large firms.[34] These measures included subsidized credits to enterprises for liquidity and export (to be gradually phased out in 2011), with one year repayment period and interest rates ranging from 4.5 to 5.5. per cent.[35]

Credits were provided with a currency clause to avoid problems caused by exchange rate fluctuations. But most importantly, enterprises receiving these public incentives were obliged to preserve the number of workers. Interest rate subsidies were also introduced on consumer credits for the purchase of domestic products.[36]

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34 For example the bailout of the Bor copper mining complex.

35 The maximum loan amount was €20,000 for entrepreneurs, €50,000 for small enterprises, €500,000 for medium-sized enterprises and €2 million for large companies. In 2009, approximately 11,637 companies received credits for liquidity for a total of €936 million. Other € 30 million of the state budget were allocated to this subsidy in 2010 and 2011

36 In 2009, approximately 45,797 credits were provided totalling €169.4 million. In 2010, it was estimated that approximately €250 million in consumer credits would be provided by commercial banks.

3.2 Measures Aimed at Supporting Job Seekers

In April 2009, in response to the crisis, active labour market policies (ALMPs) implemented by the National Employment Service (NES) of Serbia were restructured. 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 portion of its privatization proceeds to active labour market programmes. The bulk of ALMP funds was streamlined into just two measures, the new apprenticeship programme (*First Chance*, see Box 1), and public works, largely at the expense of labour market training and job subsidy programmes. These two measures were aimed at two specific demographic groups expected to be the hardest hit by the crisis, namely youth with no work experience, and long-term unemployed individuals.

Box 1

First Chance Programme: targeting youth without work experience

The First Chance Programme (FCP), targeting youth up to 30 years of age with at least secondary education, aims at providing training and work experience to young workers by covering enterprises' training costs and the salaries of apprentices.

Programme design has evolved since 2009. Currently, apprentices receive a monthly remuneration of approximately €100 for the period of practice (3 months); if the employer is satisfied, an apprenticeship contract is signed (for one year) subsidized by the government (€200 a month for youth with tertiary education, €180 for those with college degree and € 160 for secondary-educated persons plus social security contributions). The employer is obliged to employ the beneficiary for an additional year and to preserve the total number of employees throughout the period. Only employers in the private sector are eligible to participate.

It is important to mention that the fall in total registered unemployment recorded since mid 2009 was due to a sharp decline in registered youth unemployment coinciding with the introduction of the programme. The programme was popular with both trainees and employers, since, in its original design, there was no additional employment obligation at the end of the apprenticeship period.

Some features of the First Chance Programme may be open to debate. 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. Also, since there are no incentives for employers to enhance the skills of apprentices for a longer employment relationship, the quality of training may be questionable. 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).

Box 2
Public works in Serbia

Public works target long-term unemployed at risk of poverty. The scheme is organized by employers in social, humanitarian, cultural and other activities as well as public infrastructure rehabilitation and environmental protection. The programme covers the salaries of beneficiaries at the minimum wage (increased by 15, 30 and 45 per cent for individuals with secondary, college and higher education respectively); travel, social security and operational costs (up to 10 per cent of total costs).
In response to the crisis, additional funds were allocated in 2009 (RSD1.3 billion, equivalent to €15 million). The programme involved approximately 10,000 individuals, which was twice as many as in 2008 and in 2010. Most of the projects focused on environmental protection (40 per cent, with 49 per cent of beneficiaries engaged), humanitarian and social activities (25 per cent and 18 per cent of beneficiaries), and public infrastructure (23 per cent and 28 per cent of beneficiaries). In 2009 and 2010, priority was given to projects:

- employing vulnerable categories of individuals such as long-term unemployed, beneficiaries of social assistance, workers with disabilities, older workers, women, Roma population groups, refugees and internally displaced persons;
- implemented in under-developed municipalities and areas experiencing unemployment rates over the national average;
- leveraging on co-financing from other sources; and
- offering permanent employment opportunities.

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, is much more successful in achieving the former rather than the latter objective. Hence, it is not surprising that public works have failed to have a significant long-term effect on employment. Partly due to the disappointing results, the financing of the programme was reduced in 2010 to a ‘standard’ amount of RSD 700 million.

The *Law on Employment and Insurance against Unemployment,*– drafted before the crisis,– explicitly prescribes the conclusion of an individual employment plan (IEP) as the key instrument for labour market (re)integration. The IEP is the gateway for ALMP participation, with less employable jobseekers having priority over those more easily employable in the open labour market. The individual assessment is based on individual characteristics and circumstances such as education, occupational profile, work experience, age, sex, unemployment spell, residence and so on. In 2010, given the worsening of the labour market, the assessment instrument was revised, and the previous four profiling categories were reduced to three (employable with less intensive services; employable with intensive services; in need of comprehensive support, that is, beyond the services provided by the labour offices alone). In the first half of 2010, the drafting of IEPs increased by almost 50 per cent.

The *Law on Professional Rehabilitation and Employment of Persons with Disabilities* (2009) introduced a quota system as a means to increase employment opportunities for this category of workers, and using funds levied from penalties to invest in professional rehabilitation services. The expected inflow of funds from penalties is projected to reach RSD2 billion in 2011. This will serve to subsidize employment, as well as expand the scope of rehabilitation services for workers with disabilities.

There is a long standing initiative to support employers by awarding them subsidies for the creation of new jobs. The subsidy is available to enterprises creating up to 50 new jobs. The level of subsidy depends on the development level of the municipality and the characteristics of the unemployed recruited (long-term unemployed, low-qualified workers, redundant workers, persons with disabilities, Roma population groups and so on) The total amount allocated was RSD 400 million in 2009 and RSD 600 million in 2010, with around 0.5 per cent of the total number of registered unemployed participating to the programme.

The *Law on Employment and Insurance against Unemployment* also envisages a new instrument for job creation at local level. Local governments are entitled to 50 per cent co-financing of the active labour market measures detailed in Local Employment Plans, provided that they secure at least 50 per cent of the necessary funds. In 2010, the interest of local communities was very modest. In 2011, however, 122 municipalities and the Province of Vojvodina applied to the programme, with their own funding totalling almost RSD800 million and matching funds from the central budget amounting to almost RSD900 million.

Although the scope of training programmes outside the *First Chance Programme* is modest (RSD 195 million in 2009 and RSD 295 million in 2010), there were some crisis-related adjustments to their design. The government is planning to use on-the-job training programmes to attract investors that would create a substantial number of new jobs (as in the case of Fiat Automobili Serbia and Yura Corporation). On-the-job training programmes were scaled up in 2010, focusing particularly on workers affected by enterprise restructuring. The programme covers training costs and employment subsidies for a period of three months.

In 2010, the government also introduced a pilot scheme targeting disadvantaged youth, e.g. young people 15-29 with no work experience, with disabilities, limited skill base, refugee status or belonging to minority groups.[37] These groups were offered on-the-job training organized with a private sector employer, employment subsidies and self-employment programmes.

Early in the crisis, the Ministry of Labour and Social Policy proposed to support employment retention measures by re-arranging hours of work (i.e. cuts in working hours to be compensated after the crisis, with stable wages throughout), with wages to be subsidized by the government and/or enterprises themselves. The proposal was abandoned due to lack of public funds and a low level of interest by private enterprises.[38]

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37 This measure is co-financed by the UN Joint Programme *Promotion of Youth Employment and Management of Migration*, funded by the Spanish MDG Achievement Fund and by the Serbian Government.

38 The only exception was US Steel. This company cut back the work week to 4 days in the period April-October 2009. The company partially compensated workers for the lost income (60per cent of the full salary for the fifth day). The decision was not the result of bargaining negotiated agreement with the trade unions.

3.3 Measures Aimed at Supporting Enterprises

The design of enterprise promotion measures did not change during the crisis. Start up business credits are provided by the government through the Development Fund. Amounts range from RSD 0.5–1.3 million for entrepreneurs to RSD 0.5–2.5 million for enterprises. Re-payment periods are from three to five years with one year grace. Priority is given to both young entrepreneurs (up to 25 years old) who have already participated in public-funded training programmes and to business owners below 40 years of age. In 2009, the allocation was RSD 4 billion, but dropped to only RSD 2.2 billion in 2010. According to Ministry of Economy and Regional Development estimates, approximately 9,000 new jobs were created in 2009 as a result of this measure.

The government also provides funding to promote equal regional development. This facility includes credits to promote:

- output and employment in poor municipalities (70 per cent of funds);
- enterprise development and entrepreneurship in less developed regions (10 per cent); and
- labour-intensive industries in under-developed municipalities (20 per cent of funds). Credits are provided for eight years, with 2–3 years grace period and average interest rates of approximately 2 per cent (based on the level of development of the target region).

This facility is further supplemented by specific employment subsidies that are granted by the National Employment Service, when borrowing enterprises recruit individuals from the unemployment register.

3.4 Building Social Protection Systems and Protecting People

Serbia spends relatively little on social protection, and even less on poor households. It has been suggested that social protection programmes should be the only category in public spending to be expanded.[39] 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 0.42 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.[40] During the crisis, however, the share of social protection expenditures in GDP increased slightly, confirming their inherent stabilizing potential. However, the increase was not the result of an expansion of existing programmes or the introduction of new measures.

In response to the worsening of the social situation and an increase in poverty, the government accelerated the process for the enactment of the *Law on Social Welfare* (adopted in March 2011). This law introduced a number of changes into the eligibility criteria of the MOP as well as the parametric

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

40 Arandarenko, M., Avlijaš, S., “Behind the veil of statistics: wage trends before and after the crisis in Serbia”, op.cit.

change to the equivalence scale. The purpose is to make the programme more equitable as well as 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 to be improved by easing the land ownership eligibility filter (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.[41] Using a micro-simulation model, it has been estimated that the new rules have the potential to reduce the number of poor by some 4 per cent, which would not significantly change the poverty rate. According to this model, more generous initiatives are needed to effectively lift a greater number of poor above the absolute poverty line.

Total expenditures on unemployment benefits increased from RSD18.5 billion in 2008 to RSD25.5 billion in 2010. However, behind this remarkable growth during the crisis there are substantial dynamics, reflecting the fact that in 2009 and 2010 all arrears, which amounted to 5 month lagged payments in 2008, were removed. 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. 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 employment promotion framework was finalized before the crisis and that the preliminary analysis indicated that a slight reduction in the 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.[42]

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.

Since early 2005, the minimum wage has been determined as a net hourly amount and expressed in monthly equivalents and gross amounts, according to rulings made twice a year by the tripartite Socio-economic Council. If no agreement can be reached on the amount, the government makes the final decision. The minimum wage growth was stable in the period 2002–10, keeping up with the

41 Arandarenko, M., 'Politička ekonomija nezaposlenosti', op.cit.

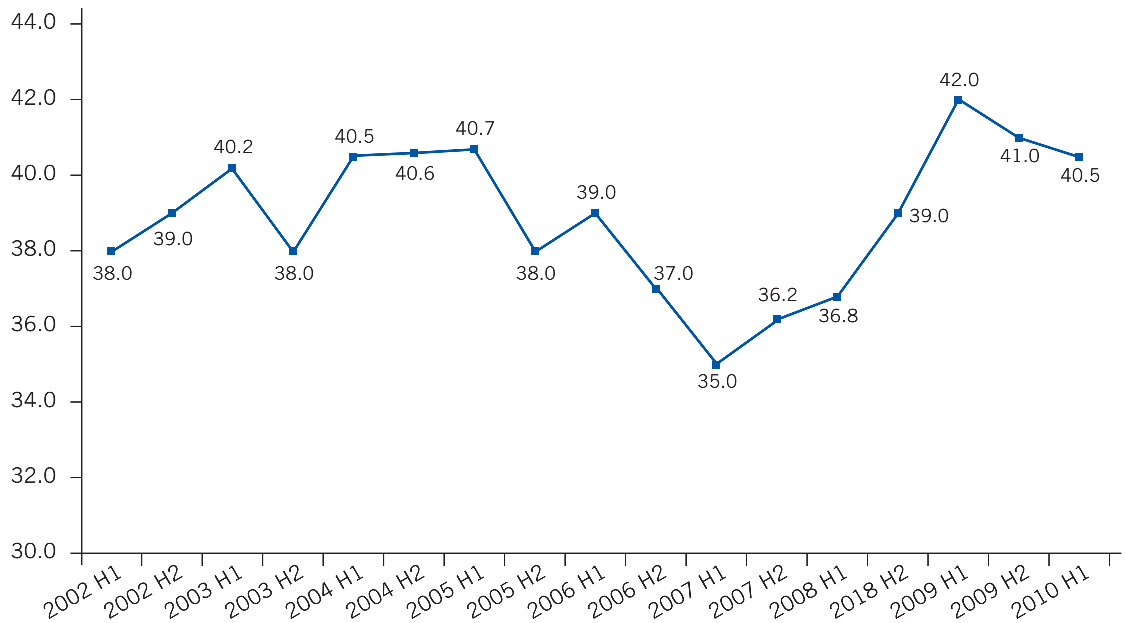
42 Matkovic, T., Arandarenko, M., "The labour market impact of economic crisis in Croatia", Background paper prepared for the UNDP-World Bank Study *Croatia crisis impact: Poverty and labor markets*, mimeo, 2010.

growth of the average wage. It remained at around 40 per cent of the average wage, albeit slowly and continuously decreasing (see Figure 7). Relative to average wages, the minimum wage in Serbia is in the middle of the range of regional standards.[43]

The minimum wage has proved to be less than fully binding on a number of employers. The official conditions for its payment are that the employee works the full number of hours per month, as well as undertake work according to a vaguely defined "standard productivity rate". This leaves much room for interpretation, especially in those sectors where the trade unions are weak (for instance, even the average wage paid in the textile industry is lower than the minimum wage). Therefore, in this scenario, the minimum wage puts no further pressure on the average wage nor it exerts a pronounced negative effect on formal low-wage employment. Much more damage was done by the minimum mandatory social security contribution policy. Social security contributions were set at 40 per cent of the average published wage until 2007. Since then, the minimum floor was reduced to 35 per cent of average wage.

Figure 7

Ratio minimum to average wage, Serbia (2002–2010)



Source: RSO, *Establishment surveys*, various years

Average real wages have remained reasonably stable since the start of the crisis. 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 administration. Hence, the increase in

43 World Bank, *Serbia: Labor market assessment*, op.cit.

the average wage in public administration recorded in 2010 can be attributed to the cuts in the number of workers with lower wages.

Still, it is counterintuitive to witness growing real wages in the private sector amid a recession. Some explanations for this are offered below. 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. 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.

In the private sector, 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 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 high hiring and firing costs for employees on open-ended contracts, 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, the average wage of first-tier workers rose.

3.5 Social Dialogue

Although tripartite institutions might be expected to become influential during a crisis particularly as regards to concession bargaining, initiatives in this area have been largely ineffective.[44] Institutions for social dialogue in Serbia tend to be weak and ineffective. Efforts by the Socio-economic Council to provide guidance for national wage policy have been unsuccessful, even within the formally valid, but effectively suspended, *General Collective Agreement*.

In November 2008 the Serbian Association of Employers (SAE) proposed eleven anti-crisis measures. Recognising the importance of a social pact, the Association emphasized the need for business-friendly reforms, such as the abolition of advance VAT payments, positive discrimination in favour of domestic firms in public procurement, and cuts in taxes and social security contributions. The lack of liquidity in the Serbian economy was highlighted as the single most important problem to be addressed.

44 In concession bargaining, the trade unions concede their standard wage rise claims, and can even accept real wage cuts and in exchange the employers concede their right to determine – or more precisely cut – the employment levels.

In 2009, trade unions organized a number of roundtables on the impact of the crisis on the Serbian labour market, analysing specifically the role of trade unions in the design of socio-economic reforms. The main concern was not to repeat the traumatic experience of the past, i.e. the ‘hard landing’ of the labour market. This outcome can take three forms: i) a massive devaluation of real incomes through high inflation; ii) widespread delays in wage payment; and iii) massive lay-offs.

Since September 2008, progress has been made in the functioning of the Socio-economic Council. It set up permanent premises and formed four working groups on 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 between the social partners due to the crisis remained. In 2010 the pace of progress slowed down again to recover somewhat in 2011 with the signature of a socio-economic agreement (see Box 3).

Box 3
The socio-economic agreement (2011)

This agreement was signed by the government, employers’ and workers’ organization 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 the 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 Developing 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 to the policy-making process; comply with the provision 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.

Another initiative aimed at enhancing social cohesion was the establishment, in April 2010, of a working group to monitor the policy responses taken to counter-act the crisis. It has twelve members (four for the government and four each for employers' and workers' representatives) and it is chaired by the Prime Minister.

Box 4
Labour, employment and social policies in Serbia

In 2009, the Government and the Parliament adopted a number of new legal instruments on economic and social rights (namely on employment and unemployment insurance, professional rehabilitation and employment of persons with disabilities, prohibition of discrimination, gender equality, mobbing and volunteering). The labour code was also amended and a new law on the peaceful settlement of labour disputes enacted.

This was accompanied by the formulation of policies on gender equality, health and safety in the workplace and employment promotion (National Action Plan on Employment).

The country also ratified a number of international conventions in the area of economic and social rights (Revised European Social Charter, European Convention on the Exercise of Children's Rights, United Nations Convention on the Rights of Persons with Disabilities and the Optional Protocol, ILO Convention No. 167 and No 187 on health and safety in the workplace).

With the enactment of the above mentioned policies, the government is also moving towards a better implementation of a number or core labour standards, namely on discrimination in employment and occupation, equal remuneration and minimum wages, as well as occupational health and safety.

The efficiency of the government and the National Assembly in adopting new laws, strategies and international Conventions on labour and social rights increased in 2009. This was an improvement planned for some time and does not relate directly to the economic crisis (see Box 4). Conversely, the efficiency of the *Agency for the Peaceful Settlement of Labour Disputes* increased thanks to the doubling of the number of mediators and the strengthening of amicable resolution mechanisms in labour disputes.[45]

Although significant, these regulatory improvements had a limited impact on job creation. For this to happen, more comprehensive reforms are needed. A number of proposals put forward by the social partners merit consideration, (reduction of the red tape for business operations, a review of the regressive labour taxation system that affect more workers with low salaries and improved enforcement of tax and labour law). A reform of the labour law could include measures aimed at encouraging employers and workers to enter into mutually beneficial employment contracts within a broader range of options – and different labour taxation regimes – and linking severance payments under indeterminate contracts to loyalty to the current employer rather than to overall work experience. Foremost, the duality of the labour market needs to be overcome, first by reducing the incentives that the second-tier labour market has compared to the first-tier one, and secondly by better enforcing labour and tax regulations.

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45 The most successful example of the efficient mediation of the Agency was the agreement between the representatives of employers and trade unions in the 'Knjaz Milos' company in April 2010.

4. Roadmap: Policy Priorities for Job Recovery

An overview of economic and labour market trends shows that the impact of the economic crisis in Serbia was rather mild in terms of output contraction, but very severe in terms of job losses. Hence, job recovery should have absolute priority in any comprehensive medium to long term economic development strategy.

The most immediate response of the Serbian government to the crisis was to guarantee liquidity and subsidize credits to enterprises and households. Spending cuts mainly took the form of a freeze of public sector wages and pensions and the postponement of large infrastructure projects. The fall in public revenues was only in part recovered through increasing taxes (excise duties and a new tax on cell phone calls). Economic growth started to rebound in mid 2010, driven by increasing exports fuelled by the depreciation of the currency. GDP growth in the first quarter of 2011 amounted to 3.4 per cent. The labour market measures enacted, however, do not appear to have had an impact, as employment continued to fall (to 45.5 per cent in the first quarter of 2011) and unemployment increase (to 22.9 per cent).

The challenges that Serbia faces on the road to recovery are multifaceted. If a standard strategic approach is adopted – that is, one that gives priority to macroeconomic objectives such as price stability, reduction in the fiscal deficit, low level of public debt and improved balance of payments – then there will be little space available to achieve the highest possible increase in the level of employment. Such reasoning is based on the experience of the past decade during which, despite substantial output growth, the number of employed fell cumulatively by at least 800,000 workers. 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 country for the next decade. 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.

The *New Growth Model* for Serbia encompasses a number of proposals that have been developed since the onset of the economic crisis at the end 2008. Such proposals emphasize the need to make a shift from consumption-oriented, demand- and import-driven development, to a new, savings- and investment-oriented, supply- and export-driven growth model. The most comprehensive proposal of this type was put forward by the *Serbian Post-Crisis Economic Growth and Development Model* (2011–2020), publicly endorsed by the Prime Minister in September 2010. The much shorter proposal

Serbia 2020, endorsed by the President of the Republic in November 2010, expands the essence of the economic strategy of the post-crisis model in the fields of education, social protection and regional policy.[46]

Still, these proposals do not represent a clean break from past strategies, since, quite conventionally, they derive employment growth from the overall growth in output. Such approaches have failed in the past to generate employment and may not be fully successful in the coming years. The post-crisis model, for instance, is predominantly concerned with the level of public debt and with the adjustment of the fiscal and balance of payment deficits. The stabilization measures recommended to be undertaken by 2015 will most likely slow down job recovery due to the target to keep public debt at 45 per cent of GDP. In addition, the fiscal adjustment is expected to be achieved through cuts in public spending, but public revenues are planned to remain at the current (high) level, in order to reduce the fiscal deficit to 1 per cent of GDP by 2015. Since the current level of revenues relies, in part, on high labour taxes, especially on low-wage labour, this will slow down the pace of job creation necessary to return to the pre-crisis levels and advance toward the labour market objectives set for 2020.

An alternative strategy would have to assess the preconditions for sustainable, employment-maximizing and equity-improving economic growth to enable convergence toward the economic and social indicators set by the European Union for 2020. Such an approach is enshrined in the Employment Strategy of Serbia (2011–2020), adopted by the Government in mid-2011. However, to deploy its fullest impact, such an approach should be integrated into the overall development strategy of the country.

Any long-term job recovery strategy should explicitly address two key questions. First, what employment policy is optimal for an employment-maximizing economic growth? In this regard, employment policy encompasses all sectoral economic policies that have an impact on employment – from fiscal, monetary and exchange rate policies, to industrial, foreign trade, regional, educational and enterprise development policy. Second, which labour market institutions are optimal for an employment-maximizing economic growth? Here labour market institutions comprise all rules, regulations and policies which have a direct impact on the way the labour market operates, such as minimum wages; collective bargaining and social dialogue; labour taxation; working time regulations; employment protection legislation; pension and social welfare policy; unemployment benefits; active labour market policy and so on.

Social dialogue, in particular, is more than just one of the institutions geared to improve labour market outcomes. Rather, it should be an instrument around which the consensus on other aspects of the economic and employment policy is to be shaped. For this to happen, measures to re-legitimize and empower employers' and workers' organizations are needed, including the widening of the remit of social dialogue institutions.

46 USAID et al, "Serbian Post-Crisis Economic Growth and Development: Model 2011-2020", USAID, Belgrade 2010.

As far as employment policy measures are concerned, it is more important to create the preconditions for a revival of job creation, rather than to abide to rigid rules. A moderate fiscal deficit should be tolerated, if this is aimed at providing space for enterprises to recover and for investment to rebound, which in turn would help job creation. On the labour market institutions side, lower labour taxes – and more specifically lower tax wedges for low-wage workers− would imply lower public revenues that would partly be compensated by the introduction of progressive income taxation. This, in Serbia would have the added value of serving as an effective tax-based income policy against (excessive) public sector wage claims.

Other improvements in employment policy and labour market institutions should be carefully explored and negotiated among the social partners and should -at a minimum – include:

– A shift of collective bargaining from the public to the private sector as a means to simultaneously support wage bargaining and the competitiveness of the national economy. While public sector trade unions are strong in Serbia, their private sector counterparts are rather weak. Therefore, wage setting dynamics are dictated by bargaining in the public sector. This has resulted in wage increases to the advantage of public sector workers. Comparative evidence shows that countries can achieve and sustain a very high level of international competitiveness provided that the bargaining process is dominated by negotiations in export industries rather than in the public sector. This change of focus should be investigated for application in Serbia.

– A re-balancing of labour market policy spending from passive to active measures. The foundations for such a shift were set by the 2009 *Law on Employment and Insurance against Unemployment*. The allocation for active labour market programmes increased from RSD 3.7 billion in 2010 to RSD 6.5 billion in 2011. The target, however, should be to invest 0.5 per cent of GDP by 2015, which needs to be achieved within a general tightening of the budget. In addition, while 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 targeting specifically the most vulnerable groups among the unemployed. For instance, general large-scale programmes targeting youth such as the *First Chance Programme* should be gradually phased out, while measures aimed at young people facing multiple layers of disadvantage (currently served only by donor-funded pilot programmes) should be phased in.

– Address the duality of the Serbian labour market and improve the enforcement of labour laws and regulations. In the last few year, the strictness of employment protection legislation (EPL) in the country was lowered, but the reform has been carried out mainly at the “margins”, i.e. by increasing labour market flexibility through the liberalization of temporary contracts, with little attention paid to other factors such as the quality of jobs, the competitiveness of enterprises and the extent of informal employment. The experience of countries that introduced flexible working time arrangements and more favourable tax treatment for certain types of employment contracts, as well as those that reformed their labour taxation system, may provide some insights of what may work in Serbia. A review of the current employment protection legislation would also help in promoting the re-employment of older workers. The most important step in this direction would be the revision of the rule granting severance pay based on total work experience. Although such a rule is designed to protect workers with long employment history, in practice it makes them almost unemployable when they lose their job, as employers are reluctant to face the risk of large severance payments. A possible solution would be to transfer the severance pay gained in each employment relation to a public or private fund that would release the total accumulated amount without burdening the last employer.

- Making work pay and creating disincentives to be inactive is critical to improve labour force participation rates. Measures to make work pay would include, for low wage earners, increases in the relative level of the net minimum wage by raising the zero income tax bracket to the full amount of the minimum wage, as well as introducing in-work benefits. In general, it is necessary to significantly reduce the current level of the tax wedge for those earning at the average wage or less. Measures creating disincentives for inactivity would include tax increases for non-labour incomes, restriction to early retirement and the introduction of lower replacement ratios for early retirees.
- 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 public sector and industry, which has so far been absent. The establishment of a national forum within the Socio-economic Council to negotiate the comprehensive reform of the education and training would be a necessary first step.
- The sharp reduction of the potential labour force of the country (projected at 8 percentage points by 2020) calls for a re-thinking of immigration policy. Although this topic may be controversial, given the current low employment and high unemployment among the Serbian population, workforce shortages may occur in expanding sectors. An immigration policy that plans for such occurrence would represent an instrument to offset this potential bottleneck for economic growth.

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Statistical Annex

Table A1

Key labour market indicators, Serbia 2005–2010

Labour force participation

	2005			2006			2007			2008			2009			2010		
	M	W	T	M	W	T	M	W	T	M	W	T	M	W	T	M	W	T
Total	**64.0**	**47.7**	**55.6**	**61.0**	**45.5**	**53.1**	**60.8**	**46.1**	**53.2**	**60.5**	**43.0**	**51.4**	**57.3**	**41.3**	**48.9**	**55.1**	**38.8**	**46.7**
15–24	41.7	31.9	36.8	44.7	31.1	38.3	38.9	29.2	34.3	38.7	28.5	33.8	33.6	24.8	29.5	33.3	22.7	28.2
25–34	91.3	76.1	84.0	90.5	73.7	82.2	90.5	76.8	83.5	86.4	70.7	78.7	84.0	70.6	77.6	83.5	71.1	77.7
35–54	91.0	76.8	83.8	88.7	75.8	82.1	90.5	77.6	84.0	87.8	71.6	79.5	87.5	72.0	79.4	85.6	71.2	78.1
55–64	57.0	29.7	42.8	52.8	27.0	39.1	53.3	29.4	40.6	55.3	27.9	41.0	52.1	26.9	38.9	51.8	24.8	37.7
65+	17.5	12.5	14.4	11.7	8.8	9.9	14.8	8.9	11.4	15.7	8.4	11.4	13.4	7.0	9.7	10.3	5.5	7.6
15–64	**75.2**	**59.0**	**67.1**	**73.6**	**57.4**	**65.5**	**72.9**	**58.3**	**65.5**	**71.3**	**54.1**	**62.6**	**68.4**	**52.8**	**60.5**	**67.2**	**50.6**	**58.8**

Employment to population ratio

	2005			2006			2007			2008			2009			2010		
	M	W	T	M	W	T	M	W	T	M	W	T	M	W	T	M	W	T
Total	**54.4**	**36.6**	**45.2**	**51.2**	**35.6**	**43.2**	**52.2**	**37.6**	**44.6**	**53.2**	**35.9**	**44.2**	**48.5**	**33.7**	**40.8**	**45.0**	**30.9**	**37.7**
15–24	24.8	16.6	20.8	27.4	15.0	21.5	24.6	16.1	20.6	26.3	15.7	21.2	20.2	13.4	17.0	18.4	11.7	15.2
25–34	73.5	49.6	62.0	72.2	52.4	62.4	73.8	58.0	65.8	71.7	54.7	63.4	67.1	53.6	60.6	63.0	48.7	56.4
35–54	81.3	61.9	71.6	77.7	62.1	69.8	81.0	65.2	73.0	80.7	62.3	71.2	77.5	60.2	68.5	73.4	59.9	66.4
55–64	51.3	27.8	39.1	48.8	24.6	36.0	47.9	27.4	37.0	50.6	26.3	37.9	45.9	25.0	35.0	45.4	21.9	33.1
65+	17.3	12.5	14.3	11.6	8.8	9.8	14.6	8.8	11.3	15.7	8.4	11.4	13.4	6.9	9.7	10.2	5.5	7.5
15–64	**63.3**	**44.5**	**53.9**	**61.3**	**44.3**	**52.8**	**62.0**	**47.0**	**54.5**	**62.2**	**44.7**	**53.3**	**57.4**	**42.7**	**50.0**	**54.4**	**39.9**	**47.1**

Unemployment rate

	2005			2006			2007			2008			2009			2010		
	M	W	T	M	W	T	M	W	T	M	W	T	M	W	T	M	W	T
Total	**15.1**	**23.2**	**18.6**	**16.1**	**21.8**	**18.6**	**14.2**	**18.5**	**16.1**	**12.1**	**16.5**	**14.0**	**15.3**	**18.4**	**16.6**	**18.3**	**20.4**	**19.2**
15–24	40.5	47.7	43.6	38.8	51.7	43.8	36.6	44.8	39.9	32.2	45.1	37.4	40.1	46.2	42.5	44.7	48.4	46.1
25–34	19.5	34.8	26.2	20.2	28.9	24.1	18.4	24.5	21.2	16.9	22.6	19.4	20.1	24.1	21.9	24.6	31.5	27.5
35–54	10.6	19.3	14.6	12.4	18.1	15.0	10.5	16.0	13.0	8.2	13.1	10.4	11.4	16.4	13.8	14.3	15.8	15.0
55–64	10.0	6.4	8.7	7.6	8.8	8.1	10.1	6.6	8.8	8.5	5.9	7.6	11.8	7.0	10.0	12.4	11.7	12.2
65+	1.1	0.0	0.5	1.0	0.5	0.8	0.9	0.6	0.8	0.0	0.0	0.0	0.0	0.7	0.3	1.3	0.0	0.7
15–64	**15.9**	**24.6**	**19.7**	**16.7**	**22.9**	**19.4**	**14.9**	**19.3**	**16.9**	**14.6**	**17.3**	**14.7**	**16.1**	**19.1**	**17.4**	**19.0**	**21.2**	**20.0**

Table A2

Employment structure by economic sectors (2001–2010)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	**1,752,226**	**1,676,835**	**1,611,632**	**1,580,140**	**1,546,471**	**1,471,750**	**1,432,851**	**1,428,457**	**1,396,792**	**1,354,637**
Agriculture	84,050	79,643	73,334	68,896	63,887	58,336	54,090	48,505	45,091	42,339
Fisheries	1,215	1,245	1,111	1,177	1,171	1,059	1,055	1,023	1,038	1,045
Mining and quarrying	36,628	33,999	32,881	32,120	30,552	28,664	23,498	23,317	22,287	22,948
Manufacturing	619,113	566,635	525,374	483,654	459,950	420,957	391,897	370,354	339,428	311,791
Electricity, gas and water supply	48,731	47,484	47,008	46,470	45,554	43,676	45,000	45,786	45,817	45,752
Construction	97,521	91,814	89,157	88,274	88,063	85,512	82,759	82,569	78,936	71,504
Wholesale and retail trade, repairs	206,293	202,695	201,321	208,279	204,730	197,808	196,216	199,495	193,065	188,707
Hotels and restaurants	37,939	35,905	30,166	27,869	26,964	24,736	24,290	23,644	22,520	20,863
Transport, storage, communications	126,872	123,652	119,403	119,028	115,961	110,161	109,066	108,431	106,739	104,716
Financial intermediation	42,421	32,147	30,068	29,381	29,264	29,979	30,663	32,775	36,670	36,653
Real estate activities, rental	56,324	56,255	54,896	58,895	62,942	67,139	66,636	74,662	79,783	83,544
State administration, social insurance	63,850	65,113	67,675	70,847	71,119	69,065	68,669	69,442	71,222	69,894
Education	119,355	127,865	127,871	131,101	129,149	125,437	129,421	132,982	134,795	136,179
Health and social work	162,588	163,293	163,104	164,743	166,174	157,720	157,080	160,587	162,369	162,996
Other community services	49,366	49,119	48,267	49,412	50,992	51,503	52,514	54,887	57,035	55,709

Table A3

Public sector employment as share of total formal non-agricultural employment

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Employment in the public sector (in ,000)	346	356	359	367	366	352	355	363	368	368
Total employment (in ,000)	2,102	2,067	2,041	2,051	2,069	2,026	2,002	1,999	1,889	1,817
% in total employment	16.5	17.2	17.6	17.9	17.7	17.4	17.7	18.2	19.5	20.3

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