

# Equity vs. efficiency : possibilities to lessen the trade-off in social, employment and education policy in South-East Europe

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# Equity vs. Efficiency

Possibilities to Lessen the Trade-Off in Social,  
Employment and Education Policy in South-East Europe

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## Foreword

With the end of socialism, South East European societies experienced a most dramatic increase in poverty and socio-economic inequality. Some might have hoped that the transition from the generalized inefficiency of bureaucratic socialism to Western-style capitalist market economies would bring Western-style mass prosperity to South Eastern Europe, but the actual experience of social polarization prove the opposite.

It is much less clear how social inclusion can be re-established in economies that have productive employment only for a reduced part of the country's work force and in states that no longer are able to appropriate and redistribute much of the national product. On the other hand, the protracted existence of large-scale social exclusion is a blatant offense to the ideal of a "good" society and of a democratic state that is at the service of all its citizens. It is entirely out of tune with the "European Social Model" and with the region's European aspirations. Moreover, it threatens to erode the legitimacy of the capitalist market economy and – especially important in the post-Yugoslavian countries – it can reinforce destabilizing identity politics. In fact, the quest for social inclusion defines one of the key challenges of the post-communist countries of South Eastern Europe.

It is before this background that the Friedrich Ebert Foundation (FES) through its regional project "Dialogue South East Europe" in 2007 launched a project "Towards Social Inclusion in South Eastern Europe". The project was conceived of as a means to direct public debate in the various countries towards the challenge of social exclusion and to policy options of responding to it. It resulted in a series of country studies, a regional conference in October 2009 and a subsequent publication, presenting all the papers and findings

presented at the conference (Pfaller, A., Meinardus, M. (eds.), 2010: Social Inclusion in South-East Europe – National and Regional Policy Priorities for a Social Europe, download available on [www.fes.bg](http://www.fes.bg)).

It was during this conference, that the participants agreed, that there is need for more research and debate on the issues of social policy in the region. The FES regional project consequently decided to broaden the original project "Social Inclusion" to a more permanent working line on "Social Policy in South-East-Europe", coordinated by the FES office in Sofia. A number of thematic ideas were put forward, of which the proposal by Predrag Bejakovic from the Institute for Public Finance in Zagreb, Croatia, participant in the first regional conference, was chosen for the next research cycle. He proposed to study more in detail the theoretically assumed trade-off between "equity" and "efficiency" in the countries of the region.

On the basis of a framework paper and an exemplary country study Croatia, elaborated by Predrag Bejakovic, academic research coordinator of the project, the FES through its network of offices in the region identified competent scholars of social sciences and economics that would participate in the regional research and elaborate the respective country case studies. This time all of the 10 countries included in the FES-network participated and submitted full-scale country studies, i.e. Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia, Moldova, Montenegro, Rumania, and Serbia. Predrag Bejakovic summarized these findings into a regional overview.

The final highlight of the project cycle was the regional conference "Equity vs. Efficiency – Possibilities to lessen the trade off in social, employment and education policy in South-East Europe", held on 7 April 2011 in Zagreb, Croatia. It brought together about 40



experts, academics trade unionists and politicians from ten countries of the region as well as from the EU. In addition to the country studies, a view on “Post-Crisis Lessons from a European Perspective” and a comment from “New Europe” (in this case from Slovenia) were presented.

The present volume, the second one in our series of regional studies with a focus on social policy, combines all the studies and comments of the research cycle. The aim of the book is both to analyse and propose measures for alleviating the widespread existing conflict between equity and efficiency in social policy in the broader sense: including social welfare, education and employment. Education, social welfare and the labour market are closely intertwined and mutually reinforcing. Efficiency and adequacy (or lack of it) in one field has many positive (or negative) consequences in other subsystems. The book consists of four sections. After first section *Conceptual framework* by co-editor Predrag Bejakovic, follows section two prepared by Bela Galgoczi dedicated to post-crisis lessons from a European perspective. Perspectives from South-East Europe are given in section three where 11 authors provide their vision on trade-off between efficiency and equity. Each approach has national specificity according to local problems but there are also similarities common to all observed countries. Erisa Çela describes problems related to education, employment and social policies in Albania. Svetlana Cenic analyses development and progress in Bosnia and Herzegovina. Krastjo Petkov and Atanas Vladikov provided an overview of the political, economic and social transformations of the last 20 years in Bulgaria, while Predrag Bejakovic writing on social policy in Croatia underlined the need of the systematic analysis and evaluation of policy outcomes. Shpend Ahmeti explains that Kosovo is the newest state in South-East-

ern Europe with deep and complex problems. Neda Milevska Kostova and Biljana Kotevska illuminate situation of education vs. Unemployment in Macedonia. Cornel Ciurea clarifies system survival vs. long-term viability in Moldova. Jadranka Kaludjerovic in her contribution explains the path from equity towards efficiency in Montenegro. Gabriela Cretu underlines an economic failure of scarce social policies in Romania. Dušan Pavlović and Mihail Arandarenko elucidate the situation with equity and efficiency in Serbia. Predrag Bejakovic in his overview of the situation in South-East Europe explains that despite many theoretical models analysing sources of inefficiency and inequity in social policies, empirical literature on the determinants of the efficient functioning of the labour market, education and social policy is still uncommon, particularly for the transitional and post-transitional countries. Therefore, one of the major contributions of this book is to study the performance of the social policies in a broader sense in a group of observed countries. The book in section four provides two comments. In first, David Parkes gives a view through the prism of Vocational Education and Training, while Tine Stanovnik from Slovenia gives a view from New-Europe.

It certainly is interesting reading. But its main function is meant to be more. It is meant to be part of the ongoing endeavour to de-legitimize political inertia, timidity and myopic “realism” vis-à-vis the problem of social exclusion. The message is clear: Social policies are not *per se* generators of inefficiency, instead they create the societal fundament on which economic growth and efficiency can prosper. Implementation of these policies might be inefficient and need administrative strengthening, policies might be too general and without focus and need reform – but without well elaborated and targeted policies in social welfare, in employment and

labour market and in education, (one might add the health sector) there will be no sustainable, long-term development of neither the economy nor the society.

The FES is aware that more is needed and it intends to continue its efforts to contribute to the build-up of political pressure for effective policies of social inclusion in South East-

ern Europe. The next research cycle is already being elaborated, this time the focus will be on employment policies.

We wish to extend our sincere gratitude and appreciation to all the contributors of the present volume, as well to the language proofreaders and the technical staff that have made this publication possible.

The editors, Zagreb and Sofia in May 2011

Predrag Bejakovic

Marc Meinardus



# 1. Conceptual Framework

Predrag Bejakovic

*We know that equality of individual ability has never existed and never will,  
but we do insist that equality of opportunity must be sought.*

Franklin Delano Roosevelt

## Abstract

The article explores this efficiency and equity trade-off. While efficiency generally relates to how well an economy allocates scarce resources to meet the needs and wants of consumers, equity concerns the distribution of resources and is inevitably linked with concepts of fairness and social justice. The goal is to identify those circumstances under which equity and efficiency may not trade-off against each other. The topic of analysis is the possible reconciliation of equity and efficiency among social and employment policy and education. Economic, political and socio-cultural inequalities fuel differences in life chances, perpetuating them across generations. It is necessary to expand people's capacities to lead fuller lives through investing in their education, health, employment and professional advancement. To prosper, a society must create incentives for the vast majority of the population to invest and innovate. Each society must decide the relative weight it ascribes to each of the principles of equity and to the efficient expansion of total production and socio-economic development.

## 1.1. Introduction

Across the developed world and in most transition and post-transition countries, in the context of public budget constraints and the challenges of globalisation, demographic change (particularly population ageing) and technological innovation, greater emphasis is being placed on improving efficiency in providing public services, particularly education, health protection and social welfare. This is, of course, highly desirable, but it is frequently assumed that efficiency and equity objectives are mutually exclusive. However, there are cases where equity and efficiency may not trade off against each other.

Redistributive policies can reduce inequality and its persistence across generations by mitigating the impact of market imperfections. Two widespread policies are money transfers and educational transfers. Money transfers are mainly targeted at the poor and may be used by recipients to increase their

consumption, leave additional bequests, or spend more on their children's education. Scientists and politicians worldwide disagree greatly about the effectiveness of welfare programmes and transfers, for it's often said that welfare, like other good intentions, contains the seeds of its own destruction. Furthermore, formal large outlays for welfare are no guarantee that they will be effectively targeted and used. Most economists take for granted the idea that equity and efficiency cannot be achieved together: greater equity must come at the inevitable cost of a loss of efficiency. Thus, equity and efficiency are seen as mutually conflicting goals: *the big trade off*.

This introductory article explores the efficiency and equity trade-off. The goal is to identify those circumstances under which equity and efficiency may not trade-off against each other. The topic of analysis is the possible reconciliation of equity and efficiency in social and employment policy and education. Markets often work imperfectly in many situ-

ations, whether because of intrinsic failures – such as those associated with asymmetric information – and/or because of policy-imposed distortions. With imperfect markets, inequalities in power and wealth translate into unequal opportunities, leading to wasted productive potential and to an inefficient allocation of resources. The idea is to discover policy situations that promote greater equity but have little effect on efficiency or – even better – policy situations where equity and efficiency complement each other and where government policies, mostly transfers from richer to poorer individuals, may even perhaps produce a more efficient society than would occur in the absence of those activities.

After introductory notes, in Section 2 the theoretical framework is presented. Section 3 deals with the equity and efficiency trade-off in social welfare policy, Section 4 analyses its role in employment policy. In Section 5, the author examines the possibilities of reducing equity and efficiency conflict in education. The paper finishes with some general conclusions and recommendations for the improvement of social, employment and educational policies.

## 1.2. Theoretical Basics

In public finance literature, *efficiency* as well as *equity* has a number of possible definitions. Most of them state that *efficiency* generally relates to how well an economy allocates scarce resources to meet the needs and wants of consumers. Efficiency means that all goods or services are allocated to someone (there's none left over). The criterion for economic efficiency is value. A change that increases value is an efficient change and any change that decreases value is an inefficient change. A situation that is economically efficient may be inefficient when judged on different criteria. The socially efficient level of output and/

or consumption occurs when social marginal benefit is equal to social marginal cost.

*Equity* concerns the distribution of resources and is inevitably linked with concepts of fairness and social justice. When market equilibrium is efficient, there is no way to re-allocate the good or service without hurting someone. Head (1993) distinguishes between horizontal equity in the sense of similar individuals being treated in a similar fashion, vertical equity in the sense of taxation in accordance with the ability to pay and the “benefit principle” of equity - taxpayers should pay for public services in the same proportion that they use them. Osberg (1993) reminds us that public policy must also consider inter-generational equity and the legal principles of procedural equity.

By equity in social welfare, we follow Roemer (1998) and the World Bank approach (2005) that individuals should have equal opportunities to pursue a life of their choosing and be spared from extreme deprivation in outcomes. For Roemer, strict equality of opportunity obtains when people, irrespective of circumstances beyond their control, have the same ability to achieve advantage through their free choices. Roemer sorts people with similar circumstances into types and takes their free choices to be represented by their behaviour relative to other members of the same type or, as he calls it, by their *relative effort*. Afterwards, he proposes that society should maximize the average advantage of all whose circumstances cause them to be least well-off relative to others who have expended the same degree of relative effort.

In some fundamental respects, equity is complementary to the pursuit of long-term prosperity. Institutions and policies that promote a level playing field - where all members of society have similar chances to become socially active, politically influential, and economically productive - contribute

to sustainable growth and development. Greater equity is, thus, doubly good for poverty reduction: through potential beneficial effects on aggregate long-run development and through greater opportunities for poorer groups within any society.

Roemer (1998) believes that there are two views of equality of opportunity. The first, which he calls the non-discrimination principle, states that in the competition for positions in society, individuals should be judged only on attributes relevant for the performance of the duties of the position in question. Attributes such as race or sex should generally not be taken into account. The second states that society should do what it can to level the playing field among persons who compete for positions, especially during their formative years, so that all those who have the relevant potential attributes can be considered. Common to both positions is that at some point the principle of equal opportunity holds individuals accountable for the achievement of particular objectives, whether they are education, employment, health, or income. Thus, consequently there is a “before” and an “after” in the notion of equality of opportunity: before the competition starts, opportunities must be equalized, by social intervention if need be; but after it begins, individuals are on their own. He acknowledged that individuals bear some responsibility for their own welfare, but also that circumstances over which they have no control affect both how much effort they invest and the level of welfare they eventually attain. Thus, public action should aim to equalise *advantages* among people from groups with different circumstances.

Equity can be defined in terms of two basic principles:

- Equal opportunity – the outcome of one’s life in its many dimensions, should mostly reflect the person’s efforts and talents, not his or her background. In other words,

predetermined circumstances at birth – gender, race, place of birth, family origins and the social group a person is born into should not matter for the person’s chances in life and his or her economic, social and political success.

- Avoidance of absolute deprivation – following the Rawlsian theory of moderate redistribution on the basis of a social agreement and the form of inequality aversion in the space of outcome (Rawls, 1971). The individuals who conclude that agreement incorporate in it an insurance against failure and special protection for the worst in life just because of the risk of outcome of economic activity. Rawls implies that society may decide to intervene in the protection of the livelihoods of its neediest members, even if the equal opportunity principle has been respected. In that way, Rawls tried to preserve the free market economy, but also to enable redistribution in favour of the poorest. He stresses that outcomes may be insufficient and/or undesired because of bad luck, or even because of a person’s own failings. Society may decide that its members will not be allowed to starve, even if they enjoy their adequate part of equal opportunity, but things somehow turned bad for them.

The complementarities between equity and prosperity arise for two broad sets of reasons (World Bank, 2005). First, there are many market failures, particularly in the labour market and in building human capital. As a result, resources may not flow where returns are highest. For example, some highly capable children may drop-out of regular schooling, while others, who are less able, may finish university and obtain their PhD. When markets are missing or imperfect, the distribution of resources and power affect the allocation of investment and developing opportunities. The ideal response is to correct the market

failures; but where this is not practical, or far too costly, some forms of redistribution and/or ensured access to services, assets, or political influence can increase economic efficiency.

The second set of reasons why equity and long-term prosperity can be complementary follows from the fact that high levels of economic and political inequality tend to lead to economic institutions and social arrangements that systematically favour the interests of social strata (groups) with more influence. Such inequitable institutions can generate economic costs. When budgetary allocations benefit mainly the politically influential and/or when the distribution of public services favours the wealthy, all other middle and poorer social layers end up with unused possibilities and talent. These adverse effects, of unequal opportunities and political power, on development are all the more damaging because economic, political and social inequalities tend to reproduce themselves over time and across generations.

Such phenomena are called *inequality traps* because they cause social immobility that is particularly pronounced for low-income citizens. Education and employment are of intrinsic value and affect the capacity of individuals to engage in economic, social, and political life. Yet children face considerably different opportunities to learn and to lead healthy lives in almost all populations, depending on asset ownership, geographic location, or parental education, among others. These inequities are usually associated with differences in an individual's "agency" - the socio-economically, culturally and politically determined ability to shape and influence the world around oneself. Such differences create biases in the institutions and rules in favour of more powerful and privileged groups because the poor usually have less voice, less income, weaker networks, and finally, less access to services than most other people.

The persistence of inequality traps – with mutual reinforcing inequalities in the political, social, economic and cultural areas – has many consequences. The most important is that, because of market failure and the way in which institutions evolve inequality traps can influence not only the distribution but also the aggregate dynamics of economic growth and socio-political development. This in turn means that, in the long run, equity and efficiency may be complements, not substitutes.

At least three considerations are important at the outset. First, while more even playing fields are likely to lead to lower observed inequalities in educational attainment, health status, and incomes, the policy aim is not equality in outcomes. Indeed, even with true equality of opportunities, one would always expect to observe some differences in outcomes owing to differences in preferences, talents, effort and luck. This is consistent with the important role of income differences in providing incentives to invest in education and physical capital, to achieve employability, find decent work, and take risks. People are clearly aware that income differentials can provide incentives for work and investment, including in education, if they are coupled with opportunities for rewards to those actions. Outcomes matter, but one should be concerned with them mostly for their influence on absolute deprivation and their role in shaping opportunities.

Second, a concern with equality of opportunity implies that public action should focus on the distributions of assets, economic opportunities, and political voice, rather than directly on inequality in incomes. Policies can contribute to the move from an "inequality trap" to a virtuous circle of equity and growth by levelling the playing field - through greater investment in the human resources of the poorest; greater and more equal access to public services – largely education and health

protection - and information. The distribution of opportunities and the growth process are jointly determined. Policies that affect one will probably affect the other.

Third, there may be various short-run, policy-level trade-offs between equity and efficiency. These are well recognized and extensively documented. The point is that the (often implicit) cost-benefit calculus that policymakers use to assess the merits of various policies too often ignores the long-term, hard-to-measure but real benefits of greater equity<sup>1</sup>. Greater equity implies more efficient economic functioning, reduced conflict, greater trust, and better institutions, with dynamic benefits for investment and growth. To the extent that such benefits are ignored, policymakers may end up choosing too little equity. One should be aware that in large part some of the economic and behavioural responses to a policy change can take time. What is fixed in the short term may be variable in the longer term or vice versa. Understanding and explaining how short-run losses may result in long-run gains for given groups, or how immediate gains may lead to eventual losses, is one of the challenges inherent in social sciences.

One of the first questions is: "Why do inequalities of opportunity persist, if they are both unfair and inimical to the long-term prosperity"? A possible answer is that political systems do not always ascribe equal weight to everyone's preferences. Economic and political inequalities are embedded in unequal social and cultural institutions. Policies and institutions do not arise from a benign social planner

whose goal is to maximize the present value of social welfare. They are the result of a political economy process in which various groups try to protect their own interest. Some groups are more powerful than others and their interests prevail. Subordinate groups may face adverse *terms of recognition*, the framework within which they negotiate their interaction with other social groups. Explicit discrimination can lead to denial of opportunities and to a rational choice to invest less at the margin.

The history of the 20<sup>th</sup> century is littered with examples of ill-designed policies pursued in the name of equity; by ignoring individual incentives these policies seriously curtail, rather than spur, economic growth processes. A balance must be sought, taking into account both the immediate costs to individual incentives and the long-term benefits of cohesive societies, with inclusive institutions and broad opportunities. While careful assessment of policy design in local contexts is always important, equity considerations need to be brought squarely into the centre of both diagnosis and policy. Equity is an instrument to the pursuit of long-term prosperity in aggregate terms for a society as a whole.

### 1.3. The Case for a Trade-Off in Social Welfare Policy

Efficient and broader social protection systems can help prevent today's inequalities - sometimes generated by bad luck - from becoming entrenched and leading to tomorrow's inequities. Just as safety nets can spur households to engage in riskier activities that can yield higher returns, they can also help complement reforms that produce losers. Safety nets usually target three groups: the working poor, people viewed as unable to work or for whom work is undesirable, and special vulnerable groups. If safety nets are designed in a manner appropriate to the local

<sup>1</sup> Example for that could be that inadequacies of the Labour Code through high employment protection regulation can in the short-term help employed *insiders* (increasing their tenure), and reduce the employment possibilities for unemployed *outsiders*, but in the long-term it could cause a labour market resistant to changes, inflexible labour force with a lack of employability and low level of economic efficiency and competitiveness. Increased efficiency may later result in economic growth, and some of the laid-off workers may find jobs in the expanding economic sectors. The combination of all these effects will determine the net impact on different groups over the long term.



realities on the ground in each country, individual targeted interventions in these three categories can be combined to provide an effective universal public insurance system.

The best-known discussion of the trade-offs between equity and efficiency is in the highly influential book by A. Okun (1975) *“Equity and Efficiency: The Big Trade-off”*. There he introduced the famous *leaky bucket* analogy - a dead-weight loss in redistribution transfers from rich to poor. Any pecuniary unit (dollar or euro) transferred from a richer individual to a poorer individual, will result in an increase in income for the recipient that will be smaller than the transferred amount of money. Okun believes there are four reasons for leaky buckets:

- the administrative costs of redistribution,
- changes in work effort induced by redistribution,
- changes in savings and investment behaviour induced by redistribution, and
- changes in attitudes (for instance, motivation to acquire human capital) induced by redistribution.

The result is that government efforts to achieve equity inevitably result in a smaller level of total income and the less efficient use of resources.

Blank (2002) asks whether there are policies and circumstances in which equity-increasing transfers can occur – without seriously reducing efficiency. If they exist, knowing what theory implies and what the data suggest is feasible, the public and policymakers will be better prepared to reform public service finance subject to political reality and to their own values. She believes that there are three policy areas where transfers seem to produce future gains. First, transfers that provide health assistance may be viewed as an investment if they reduce future health problems. Public campaigns to immunize children, for instance, appear to have substantial long-

term benefits in terms of lower future health expenditures. Public expenditure programmes focused on poor children’s health appear to produce substantial future returns. Second, human capital outlays may have similar investment-type properties. Indeed, many transfer programmes to subsidize child care or education are supported because they are considered investments in the future. The third example of how transfer programmes might induce long-term efficiency gains is in the area of attitudinal change. It is often argued that anti-discrimination programmes in the workplace produce substantial gains to minority populations. Some of this may occur through human capital avenues, if such programmes open up new training and job opportunities. On the other hand, the equity / efficiency trade-off may be low: when transfers go to populations with no capacity to change their behaviour; when transfers go to programmes that limit efficiency losses through behavioural requirements; and when commodities are subsidized that function as long-term investments and create future income gains.

Each group of vulnerable people requires similar, but mostly different ways and means of aid. The working poor or unemployed people want unemployment insurance and social welfare benefits. People viewed as unable to work and/or special vulnerable groups need disability insurance and different types of other social transfers. For some groups cash/material benefit is not enough as they also need social services – such as care and aid in the user’s home or residential accommodation for older and infirm people.

But, as public resources are limited, one has to keep in mind the efficiency and equity trade-off in expenditures for social welfare. How to direct the benefits and services to those with the highest level of need? One of the major challenges of social care service delivery is how to effectively target scarce

resources. Even in the most affluent societies the demand for social care outstrips the resources provided by Government. In order to ensure the equitable allocation of free of charge/ subsidised resources the following principles must be applied:

- Targeting towards those most in need;
- Financial contribution according to means;
- Transparency to ensure that it is clear to everyone how decisions are made, why some people receive services free of charge and some do not and what the service actually costs.

If services are to be targeted effectively it is important that eligibility criteria are clearly defined. The proposed drafting of a new social welfare law offers an opportunity to review existing criteria for all types of service provision to determine whether (a) eligibility criteria need to be tightened or (b) further guidance and training on how to apply the criteria should be provided in order to improve the targeting of services towards those most in need. The criteria for obtaining some rights should be published and made available to the general public to increase awareness of the how the system operates, to improve transparency and to provide clear grounds for appealing against decisions made by state bodies.

In the UK, for example, there is a national framework which identifies four levels of need: 1) Critical, 2) Substantial, 3) Moderate and 4) Low (Details and criteria for particular level are given in Annex 1).

Owing to resource constraints a significant number of Local Authorities in the UK state that they only provide services to those who meet the critical or substantial need criteria. The proportion of councils in England who set their threshold at "substantial" increased from 53% to 62% in 2006-07. The trend continued with 73% of all councils operating at substantial or critical level in 2007-08.

The disadvantage of this approach is that the preventative role of service provision is virtually absent. If support can be provided when the level of need is low or moderate it may prevent the level of need becoming substantial or critical. The situation in the UK serves to illustrate that the targeting of services is about difficult choices. More expenditure at the preventative end of the spectrum means fewer resources are available for those in the most critical need. The choices are often stark but unavoidable.

Furthermore, significant savings and efficiency as well as equity could be realised through careful and better decision making on residential care. It should not be assumed, however, that there is over-provision throughout the residential sector. The picture is a more complex one and needs to be considered in relation to each of the main groups of service users. There appears to be an over-reliance on residential care for children and people with mental health problems. For some groups, the targeting of residential care is not necessarily orientated towards those who are most in need. Older people and people with intellectual disabilities who could be supported in the community fall into this group. For them it is necessary to provide out-of-institutions types of services such as daily care and care and aid in user's home. These services are usually cheaper and enable one to stay in one's home, as preferred by the huge majority of people.

Finally, for a social welfare system it is necessary to develop a national performance framework which includes various dimensions such as National Priorities and Strategic Objectives, Cost and Efficiency, Effectiveness of Service Delivery and Outcomes, Quality of Services for Users and Carers, and Fair Access (Annex 2 gives an example for a national performance framework in England).

#### 1.4. The Case for a Trade-Off in Employment Policy

Employment plays a fundamental role in every society. For most of the world's people, economic opportunities are primarily determined, or at least mediated by the labour market – in formal and informal work. People are often defined, and define themselves, through what they do for a living. Scientific studies emphasise that not only is employment a primary source of status in every country, but it is also significant in providing purpose, income, social support, structure to life and a means of participating in society. Wages and employment conditions in the labour market affect the quality of life of workers and their families, sometimes in ways that are ruthless or unfair.

The functioning of the labour market has a profound effect on equity – for workers, in patterns of access to work and between workers and employers as well as on the efficiency and competitiveness of the whole economy. Unlike the markets for many goods and services, labour markets are not fully competitive. They may be characterised by uneven market power (between employers and workers), by imperfect mobility, by production factors (particularly workers), by in-

sufficient information, or by discrimination. These imperfections generate fissures in the employment relationship, which both sides can try to optimize for themselves. This can lead to unfair and inefficient outcomes when the bargaining position of the worker is weak.

All governments, irrespective of income, intervene heavily in the labour market, mostly to protect workers and endow them with rights and a voice in the employment relationship, to insure compliance with labour laws and regulations and to provide insurance against income shocks. The argument is that labour market interventions reduce inequality in labour incomes by (1) maintaining earnings at the lower end of the income distribution above the level at which they would have been in an unregulated market, and (2) reducing the vulnerability of earnings (Coudouel and Paci, 2006). Public intervention can improve market outcomes and lead to significant equity gains: more equal opportunities for workers, better working conditions and less discrimination. It can also produce gains in efficiency: by allowing the full use of the labour of discriminated groups, by enhancing labour mobility and better managing income risks. Examples of types of failures in the labour market are given below.

##### **BOX 1 Types of Market Failures in the Market for Labour**

**Asymmetric information:** In the labour market in many situations, information is available asymmetrically - one party to a transaction has more or better information than the other party. This is a particular problem in markets with less effective reputation effects, that is, markets characterised by small firms, mobile workers, and informal contractual arrangements. Firms may find that it is expensive to discover the true characteristics of applicants, and job-seekers may find that it is difficult to discover the true characteristics of job offers. Employees may be unable to obtain full information on job-security arrangements in their current jobs. They may make inefficient decisions about training and job-seeking. Firms may conceal their difficult financial situations in order to prevent new job-seeking and departures by their most valuable workers.

**Externalities:** There are many examples of externalities in this area.

In deciding whether or not to close a branch, firms are unlikely to internalize the costs to local workers or to the government in the form of lost tax revenues and increased benefit payments. In deciding whether or not to accept jobs, unemployed job-seekers are unlikely to take into account the costs of their refusal for firms or for the government.

If firms or workers are prepared to internalize these costs, free-riders who have failed to do so may nevertheless share in the resulting benefits. Private decision-making in the unregulated labour market is inefficient because it does not internalize these costs.

**Monopoly power** may result from a number of factors both in the labour market and the product market and affect both demand and supply.

The existence of technologies idiosyncratic to a particular firm means that skills obtained through on-the-job training cannot be transferred to other employers. This makes labour turnover costly. Virtually all employees and firms possess some degree of monopoly power. Labour mobility is restricted; the labour market is not competitive, and wages may not be clear.

Trade unions or monopolistic behaviour - improving wages and work conditions for their members at the expense of consumers and non-union members - may lead to similar distortions in the wage and employment equilibrium. Particularly, when unions are co-opted by political elites or by the state, their actions can have significant costs for efficiency.

**Absence of markets for goods and services** may distort the operation of both the demand side and the supply side of the labour market.

The investment decisions of individuals may be distorted by the inability of workers to realise the value of their human capital in the same way that they sell their financial assets. Consequently, there will be underinvestment in education and training.

The inability to obtain full insurance against redundancy because of the risk of moral hazard may distort interfirm mobility.

Source: Coudouel and Paci (2006), World Bank (2005)

But, on the other hand, inappropriate government interventions to achieve greater equity could create costs and losses in terms of efficiency: excessive protection of formal sector insiders can cause the *rationing* of jobs in the formal sector and making competition in the labour market almost impossible. The rigidity of the labour market can be seen in the long, complex and expensive system involved in dismissals (including the cancellation of the employment contract, the legally set notice period and the amount of severance pay). This makes turnover in the labour force much more expensive, and the high level of protection for employment reduces the flows in the labour market, and lengthens the average

duration of employment. The reason for this is that the complex and expensive laying-off process means that the employer will not take on workers if he does not really believe that their work will be long-lasting and productive enough to cover the high costs incurred. The result of the complex and expensive manner of firing workers, and the formality of registering newly-hired workers, is that employers, particularly those in the category of small employers, will often not take on a replacement for a dismissed worker but rather make use of informal workers. For the outsiders, on the other hand, including workers in the informal, uncovered sectors, the unemployed, and workers with fixed-term contracts strict labour

legislation has a negative impact in a low hiring rate and, hence, limits their chances to enter employment as insiders. These groups are unlikely to have sufficient political power to bring about the required reforms, and poorer, marginalized workers (youth, women, the unemployed, or the discouraged) will tend to become more marginalized.

On the labour market there is clearly a strong association between efficiency and equity that can be primarily seen and influenced by long term unemployment and vulnerability to social exclusion. The problem of long term unemployment is significant and in many countries there is a high share of the long-term unemployed - those who have been waiting for more than one two year for a job – in the total of unemployed. Very often, inadequate attention and/or insufficient resources are devoted to these groups. Thus, there are difficult issues to address which present a considerable challenge to policy makers everywhere. They are long standing and concern both deficiencies in education and skills and behavioural and attitudinal barriers to getting and keeping jobs.

The range of policies for mitigating long-term unemployment should be the focus of social and political discussion, but it is clear that the existing range of policies needs adjusting to concentrate more intensively on addressing long-term unemployment. Policies combining job search assistance efforts with job development, working activation (including *Workfare*, i.e. the obligation of recipients of social welfare cash benefits and unemployment benefits to participate in working activities for the common benefit), training and wage subsidies appear to have been somewhat successful in improving the employment and earnings of specific targeted disadvantaged groups (see Annex 3).

There is a need to find the optimum ratio between the desired labour market flexibility

and the required social protection. Flexibility need not be conceived in such a way as to undermine the standards of labour law, but as an expansion of the far-reaching consequences of the regulatory content of labour and social law and improving employability. An important factor in high employability is the improvement of the education system through enhancing accessibility and increasing the quality of outcomes.

### 1.5. The Case for a Trade-Off in Education

At least in theory, education is a means by which democracies attempt to equalize opportunities for economic success among citizens. Education and training policies could have a significant positive impact on economic and social outcomes, including sustainable development and social cohesion. It is commonly thought that opportunity equalization, in that dimension, is implemented by the provision of equal access to public resources to all citizens.

However, very often this is not so and often existing public services - like education systems - reproduce or even compound existing inequities. For example, Betts and Roemer (1999) examine the relative effectiveness of changing educational expenditures along both the intensive and the extensive margins. Their central point is that for the USA *mere equalization achieves little*. Disadvantaged children from families at the bottom of wealth distribution usually do not have the same opportunities as children from wealthier families to receive quality education and achieve higher levels of attainment. Because of their minimal education, these disadvantaged children can expect to find badly paid jobs and earn less as adults. As badly educated citizens they will have less voice and power in the political process and will not be able to influence spending decisions to improve public schools for their children. Thus, with respect to eq-

uity, the gap in quality between rich and poor districts may widen over time (Fiske, 1996).

These assumptions are confirmed by a survey of Galor and Zeira (1993) in a model of overlapping generations characterized by intergenerational altruism. Even if all individuals are of equal ability and identical preferences, the bequest of the parent determines whether the child will be a skilled or an unskilled worker, which determines in turn the size of the child's bequest to the grandchild. They suppose that there is an indivisible minimum size to human capital investment. As a result, the initial distribution of wealth determines the aggregate amount of human capital investment and the long-run growth rate. In conclusion, they state, *countries with a more equal initial distribution of wealth grow more rapidly and have a higher income level in the long run...and adjust better to new technology.*

Disadvantage in one dimension of opportunity is generally reinforced by disadvantage in others, combined in a way that perpetuates the stark inequalities and the cycle of underachievement continues. The important instrumental function of education implies that inequality in education often translates into inequality in other dimension of welfare, but also the person's achievements in education are under the influences of inequalities in other spheres. The difference of various health outcomes for children of parents with higher or lower education is a well known fact. Infant mortality rates are sharply differentiated across population groups, defined by various educational attainments. On the other hand, economic well-being can contribute to improved educational outcomes, but in turn good education is a typically important determinant of economic status.

This situation is worsened by the social networks that influence decisions on investing in education. Calvò-Armengol and Jackson (2005) developed a model where an in-

dividual sees higher returns to investments in human capital when their neighbours in a social network have higher levels of human capital. They show that the correlation of human capital across generations of a given family is directly related to the sensitivity of individual investment decisions to the state of the social network. Increasing the sensitivity leads to increased intergenerational correlation, as well as more costly investment decisions on average in society. As the badly educated mostly socialise with similar badly educated peers, there are only limited possibilities that they will profit in their behaviour from their better educated neighbours. Calvò-Armengol and Jackson conclude that the dependence on a social channel leads to inefficient human capital investment decisions.

If the opportunities faced by children from poor families are so much more limited than those faced by children from rich strata, and if this hurts development progress in the aggregate, then public action has a legitimate role in seeking to broaden the opportunities of those who face the most adverse choices. But how to ensure that actions outlined will respect principles of efficiency and equity? The realisation of an efficiency and equity trade-off in education could be obtained through improving accessibility and enhancing quality. For medium-level developed countries, with a high participation in primary and secondary education, particular attention should be focused to increase participation in tertiary education and enhance its efficiency.

Excluding a number of professional and management reforms (such as curriculum reform or teacher training) that do not have an explicit documented impact on distribution, efficiency and equity, Tiongson (2005) stresses that there are several broad changes to education policy that are directly related to equity and efficiency of educational systems. They are:

- *Expenditure reform:* A government may choose to restructure its expenditures to reallocate spending from higher education to a lower level of education or vice versa.
- *Financing reform:* A government may choose to reform the financing of education by introducing user fees (cost recovery).
- *Management and institutional reforms:* A country in which there is centralized management of the education system may choose to implement management reforms by decentralizing the administration of education.

Although, possible decentralisation of an educational system is an important form of management and institutional reform, we would like to direct attention to the question of introducing student fees as a category of financing reform. A common assumption has been that a *free* system of higher education (one funded entirely by the state) is, of itself, equitable because it can guarantee accessibility. In fact, this assumption has not been borne out by reality, since the main determining factor in participation is socio-economic background.

The bulk of evidence shows that there are usually significant private returns to those who participate in higher education (the average private rate of return from higher education is close to 9% across ten OECD countries - Commission of the European Communities Brussels, 2006), and that these are not entirely offset by progressive tax systems. This can have a reverse redistribution effect. This regressive effect is particularly acute where school systems exacerbate the effects of socio-economic background on educational attainment.

In order to bring about a more equitable balance between the costs funded by individuals and society and the benefits accrued by each, and to contribute to providing universities with the extra funding they need, many countries are turning to the main di-

rect beneficiaries of higher education, the students, to invest in their own futures by paying tuition fees. Evidence also suggests that the market effects of tuition fees may improve the quality of teaching and management in universities, and reinforce student motivation. Most economists maintain that tuition fees – assuming some means tested grants and/or sufficient available students loans – are actually more equitable than free higher education in that students are everywhere disproportionately from the middle and upper classes and the taxing systems in most countries tend to be proportional or even regressive (Teixeira, Johnstone, Rosa, Vossensteyn, 2008).

Clearly, the development of tuition fees without accompanying financial support for poorer students risks aggravating inequity in access to higher education. The most disadvantaged are frequently the most risk and debt-averse, and are more likely to balk at spending time studying, rather than earning, when private returns after graduation are not assured. The costs of higher education could be made more bearable through the availability of various types of student financial support, be it in the form of grants, scholarship, loans or the deferred payment of tuitions fees. Other financial incentives could be premium grants to excellent students and/or those who choose science and engineering programmes.

Given the traditional concern with limited public resources for education, and the commonly accepted objectives of expanding access and improving quality, policymakers face a particularly unpleasant dilemma. They must choose between expanding the availability of education and providing high quality educational institutions. Analysis of the costs and benefits of educational system reform clearly shows investments that improve the quality of institutions offer exceptional rewards to soci-

ety. However, higher public spending does not always translate into better student learning. Some progress can be made by countering the stranglehold of the interest group on the equality-enhancing reform, such as improving accountability from clients directly to frontline providers. The crucial steps are to enhance the school's accountability for performance and to insure the availability of relevant information to monitor their work. The underlying reason is that it might be more salient to note that more could be achieved through re-targeting programme money and a clearer knowledge of the cost of such programmes.

Furthermore, inequities in education and training also have huge hidden costs which are rarely shown in public accounting systems. Policies which reduce such costs can deliver both equity and efficiency benefits. Thus, to achieve equity, one should take into account all the costs as well as the benefits of successful data collection, analysis and prudent cost-management. According to McKeown-Moak (2000), this approach is a self-evident precondition both with regard to enhancing efficiency and cost effectiveness and in making a case for more equitable resources usage.

Access to schooling matters - especially for very poor families - but very often, it is only a small part of the problem. Greater access needs to be complemented by supply-side policies (to raise quality) and demand-side policies (to correct for the possibility that parents may underinvest in the education of their children for various reasons). Some of the possible reasons for such underinvestment are that resource constrained households lack money to keep their children healthy and in school and/or that some groups only see insignificant returns to schooling because of discrimination. Thus, providing financial possibilities and incentives for education is necessary, but not sufficient because it is important to eliminate the perception of discrimination,

conscious or not, that can affect investment in human capital.

Human capital decisions are more a product of culture and traditions than of a cold calculation of benefits. Benefits are relevant, but the responsiveness to them may not be as large as one might have expected because negative stereotypes cause loss of self-confidence, create anxiety and affect early decisions about prospective careers and attitudes towards society. If enforcing anti-discrimination laws today reduces the taste for discrimination throughout society in the future, then there could be beneficial income and productivity gains for the minority population that more than outweigh the costs of the programme.

## 1.6. Conclusion and Recommendation

To economists, efficiency is a relationship between ends and means. When a situation is called inefficient, we believe that we could achieve the desired ends with less means, or that the means employed could produce more of the ends desired. *Less* and *more* in this context necessarily refer to less and more value. Thus, economic efficiency is measured not by the relationship between the physical quantities of ends and means, but by the relationship between the value of the ends and the value of the means.

Unfortunately, in many countries - particularly developing and/or post-transitional - in providing services the state magnifies - rather than attenuates - inequalities at birth. Economic, political and socio-cultural inequalities fuel differences in life chances, perpetuating them across generations. For a long-run and sustainable economic and social development, the situation should be drastically changed. A guiding principle is to shape public action so that the acquisition of human capacities is not driven by circumstances of their birth, although it can reflect people's preferences,



tastes, and talents. It is necessary to expand people's capacities to lead fuller lives through investing in their education, health, employment and professional advance. Predetermined circumstances should not constrain anyone's innovation or professional development opportunities. This implies that a good institutional environment will not block entry into new business activities and the political system will provide access to public services and goods for all.

The policy question becomes how much leakage a society is willing to accept in order to achieve a certain level of equity. While Okun's leaky bucket is a reality for many transfers programmes, with adequate organization, targeting and evaluation, the level of leakage can vary substantially across programmes and can be significantly reduced. Average estimates of the inefficiencies induced by redistributive social policies do not adequately characterize the diversity of efficiency costs across individual policies. In a number of real-world policy situations, equity and efficiency are not inevitably in conflict with each other.

There may be induced income losses in the first period generated by behavioural changes among the poor (increased subsidies for children's schooling or health may reduce parental labour supply or savings); in addition it is not enough that a programme simply have positive benefits in order to argue that efficiency is enhanced. Its benefits must outweigh all of the costs associated with its required level of transfers. Probably fewer programmes actually enhance efficiency than many advocates would like to claim. The investment argument is used broadly for a wide range of child and school-related transfers; only long-term and serious programme evaluation studies can prove which policies actually do function as investments.

In the labour market, the challenge for governments is to shift more jobs towards better

working conditions and higher wages – but not at the expense of efficiency. Labour measures should be targeted towards those more distant from the labour market, they should offer flexible and localised programmes, and must develop long-term “personalized progression routes” back to employment. Other initiatives to reduce long-term unemployment should also include special programmes to re-train workers, and to update older employees with a skill set needed for competing in a modern economy. High priority should also be given to job training for single parents from jobless households, and parents with large families. More family-friendly policies, such as flexible time and child day-care services are also needed. Further efforts should be made to address job discrimination, including new legislation and more education and public awareness campaigns, and should be combined with eradicating physical barriers to buildings and transport.

Free access to higher education does not necessarily guarantee equity. To strengthen both efficiency and equity it is necessary to create appropriate conditions and incentives to generate higher investment from public and private sources, including, where possible through tuition fees combined with accompanying financial measures for the disadvantaged.

The aggregate effects of any reform, including social welfare and labour market reforms on efficiency and equity are not always clear. Whether diverse impacts translate into inequalities in opportunities depends on how new activities open up and are accepted by the wider community, but certainly there will be winners and losers. Outcomes depend on the ability and willingness of government to mitigate losses to particularly hard-hit social groups, possible by redistributing some of the gains accruing from winners.

To prosper, a society must create incentives for the vast majority of the population to

invest and innovate. The best specific policy mix is a function of country context. Each society must decide the relative weight it ascribes to each of the principles of equity and to the efficient expansion of total production and socio-economic development. Acknowledging history as well as social and political institutions is crucial to avoid policy mistakes.

There are some golden rules and a critical relation in every programme: creating jobs that will more probably increase future earnings is generally more expensive and harder to implement, while preparation for and creation of jobs that are closer to *real* jobs and which are apparently more useful for the community also have a greater tendency towards the replacement of workers in the public sector. Less extensive employment and educational programmes should be planned and conducted, from which the lessons learned may help in the better application of larger programmes in the future. Furthermore, extensive additional training and education

programmes, directed towards large groups of the unemployed, have rarely proven to be good investments, either for the community or for the programme participants. On the other hand, the thorough and precise targeting of programmes certainly pays off.

Finally, we need to get a better handle on what works and what does not. Too often, there is no regular evaluation of policies and programmes. And when evaluations are conducted, they frequently focus on inputs to the system rather than on user achievement and long-term outcomes. This underscores the need to assess user outcomes that are related to both new and existing programmes. The key element is measuring user performance directly. Without objective data about student achievement, programmes and policies often proceed in unproductive directions. Indeed, past research amply demonstrates that many good guesses about policies did not in the end prove successful - making regular monitoring essential.

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## Annex 1

The national framework in the UK identifies four levels of need:

1. Need is assessed as **critical** when:
  - life is, or will be, threatened; and/or
  - significant health problems have developed or will develop; and/or
  - there is, or will be, little or no choice and control over vital aspects of the immediate environment; and/or
  - serious abuse or neglect has occurred or will occur; and/or
  - there is, or will be, an inability to carry out vital personal care or domestic routines; and/or
  - vital involvement in work, education or learning cannot or will not be sustained; and/or
  - vital social support systems and relationships cannot or will not be sustained; and/or
  - vital family and other social roles and responsibilities cannot or will not be undertaken.
2. Need is assessed as **substantial** when:
  - there is, or will be, only partial choice and control over the immediate environment; and/or
  - abuse or neglect has occurred or will occur; and/or
  - there is, or will be, an inability to carry out the majority of personal care or domestic routines; and/or
  - involvement in many aspects of work, education or learning cannot or will not be sustained; and/or
  - the majority of social support systems and relationships cannot or will not be sustained; and/or
  - the majority of family and other social roles and responsibilities cannot or will not be undertaken.
3. Need is assessed as **moderate** when:
  - there is, or will be, an inability to carry out several personal care or domestic routines; and/or
  - involvement in several aspects of work, education or learning cannot or will not be sustained; and/or
  - several social support systems and relationships cannot or will not be sustained; and/or
  - several family and other social roles and responsibilities cannot or will not be undertaken.
4. Needs is assessed as **low** when:
  - there is, or will be, an inability to carry out one or two personal care or domestic routines; and/or
  - involvement in one or two aspects of work, education or learning cannot or will not be sustained; and/or
  - one or two social support systems and relationships cannot or will not be sustained; and/or
  - one or two family and other social roles and responsibilities cannot or will not be undertaken.

## Annex 2

The national performance framework of England includes the following dimensions:

- **National Priorities and Strategic Objectives:** the extent to which local level authorities with responsibility for social care services responsibilities are delivering the national priorities for social care and their own local strategic objectives

- **Cost and Efficiency:** the extent to which local level authorities with social care services responsibilities provide cost- effective and efficient services;
- **Effectiveness of Service Delivery and Outcomes:** The extent to which services are appropriate to need; in line with best practice; to agreed standards; timely; delivered by appropriately trained staff and the local authority's success in using its resources to increase self-sufficiency, social and economic participation; to increase life chances of looked after children; to provide safe and supportive services;
- **Quality of Services for Users and Carers:** User / carer perceptions and experiences of services; responsiveness of services to individual needs; continuity of provision; involvement of users / carers in assessment and review
- **Fair Access:** The fairness of provision in relation to need, the existence of clear eligibility criteria, the provision of accessible information about the provision of services.

### Annex 3

Explanations about employment activation policies and the introduction of workfare in Croatia from the standpoint of efficiency and equity

Conventional welfare programmes allow the welfare recipients to choose their hours of work. An alternative scheme is workfare. Able-bodied individuals receive transfer payments only if they agree to participate in work-related activity and accept the employment offered. Workfare is a system that requires work-based activities as a condition of claiming benefits. It should ensure that welfare recipients follow a regular, work-based structure to their lives every day and that they do not have long gaps in their work histories. This should prevent them becoming defeatist and ill-disciplined and make them more employable. It should also encourage people to take private sector jobs, preventing dependency from arising in the first place. Some countries have avoided the use of workfare while introducing an increasingly rigorous activation agenda for long term unemployed people. There are strong sentiments about workfare. To some it is simply the articulation of reciprocal arrangements between the individual and the community; to others it is tantamount to public humiliation. The main points are as follows:

#### Advantages

- (1) *Workfare is based on a claim of reciprocity* – the view that social rights are conditional on labour obligation.
- (2) *Workfare cuts welfare spending* by requiring welfare recipients to work.
- (3) By making it harder to collect welfare, it reduces caseloads and lowers the costs of welfare by reducing fraud and the black economy.
- (4) Welfare is often viewed as corroding the work ethic. Workfare, on the other hand, gives people the opportunity *to gain work experience and skills* and/or *to increase level of labour discipline*, allowing them ultimately to gain the necessary preconditions for an escape from poverty.
- (5) Workfare reduces dependency.
- (6) Workfare lifts people out of poverty.
- (7) Workfare could increase the ability of government to improve the functioning of its citizens and could enhance social order and rule of law.

The most common criticisms are:

- (1) There are *two counter-arguments against the opinion of workfare as social reciprocity*. First, the right to do something can only be a right if there is a corresponding right not to do it. Second, that the presumption of balanced reciprocity is unfair because of those on the margin on society; there are no fair opportunities or the prospect of them.
- (2) Workfare really does not cut welfare spending.
- (3) *Workfare reduces fraud and the black economy* but due to the lack of convincing evidence to the contrary one can presume that the effect is of minor significance.
- (4) The programme not only fails to provide useful training, it also erodes the skills development of its participants because the types of jobs involved provide little more than orientation or work preparation training, rather than serious training for a craft or occupation.
- (5) Workfare as presently organized *does nothing seriously to advance the economic status or standard of living* of those forced to rely upon it because it offers unstable jobs and very little besides subsistence wages for those locked into the programme.
- (6) The programme does not represent an adequate solution to the widespread jobs crisis.
- (7) Regarding *workfare's role in promoting functional government* it is questionable whether the state should presume to turn individuals into "functioning citizens" by obliging the poorer group to do specific activities.
- (8) Workfare is unlikely to be effective because no group directly involved favours it.

According to different programmes (like the *Beautiful Bulgaria Programme*), one third or one fourth of participants find permanent jobs. Especially successful employment-focused programmes like *Riverside model* and *Portland NEWWS* have even better results and bigger savings of public funds (around 3,000\$ per welfare recipient). If programmes enable only one third of the results claimed this would enable valuable short- and especially important long-term savings. These should be assessed through properly structured piloting and evaluation of workfare and its effects.

## 2. Post-Crisis Lessons from a European Perspective

*Béla Galgóczi*

### Abstract

The article provides a critical review of the assumption that an equality-efficiency trade-off would generally exist. We argue that this hypothesis looks at the relation between equality and efficiency in a narrow sense: it does not examine the process of the generation of inequality and only focuses on the income redistribution side.

By presenting stylised facts on the development in income inequality in Europe in the last decades we show that the burning problems of our current societies are caused more by a lack of equality, than by an excess of it.

We will also demonstrate that the equality-efficiency trade-off assumption does not stand up to evidence even if focusing on income redistribution only, as it misses the positive external effects of more equality for the whole society. Performance indicators of more equal societies support the positive effect of these transfers as examples in the article will show.

The recent worldwide crisis provided convincing evidence of how growing inequality can lead to huge economic and social loss.

The article concludes that while the efficiency of transfers and public services needs to be improved, more efficiency in our societies does not require more inequality. This is even more so in the south-east Europe region where inequality of incomes has a broader basis and poses a threat to social cohesion and progress.

While we acknowledge that performance needs incentives and must be rewarded and that an egalitarian society necessarily lacks efficiency, the problems of our contemporary societies are of a different kind.

### 2.1. Introduction

We make an attempt here to challenge the assumption that there is generally a trade-off between equality and efficiency. The argumentation is built up along the following lines. Starting with a critical review of the equality-efficiency trade-off assumption we highlight its limits, pointing to the different manifestations and origins of inequality in various forms of market economies. Some stylised facts on the development in income inequality in Europe would show that the burning problems of our current societies are caused more by the lack of equality, than by an excess of it. Moreover, lessons from the 2008-2010 crisis show us that decade-long

accumulation of inequality backed by irresponsible financial practices was one of the major causes of the deepest economic crisis in the post-World War II world and led to an unprecedented loss of efficiency.

### 2.2. Limits of the Equality-Efficiency Trade-Off Assumption

The most pronounced formulation of an equality-efficiency trade-off comes from Arthur Okun (Okun, 1975). In his view, societies simply had to choose between an efficient economy and an egalitarian society. Equality undermines incentives, pro-equality policies distort market allocation and economic performance can only be improved



at the expense of a less equitable distribution of income. This interpretation looks at the relation of equality and efficiency in a very narrow context. First, it only addresses equality in terms of market interference and redistribution in a simplistic manner using the “leaky bucket” analogy. Thus, the generation of inequality (before social transfers) is not addressed at all although such inequality might have been caused by a lack of efficiency in the allocation of resources or by distorted incentives (among other reasons). Even within his narrow interpretation, the ‘leaky bucket’ analogy that reckons a dead-weight loss of transfers between the rich and the poor individual, misses the positive external effects of more equality for the whole society. This is why the original and generalised equality-efficiency trade-off can only be interpreted in the context of free-market economies and even there with restrictions. Karl Polanyi’s approach to the relationship between markets and society took a totally different angle, namely that ‘the more embedded markets are in society the better the outcomes they produce’ (Polanyi 1957).

Regulating the market to produce greater equality through processes of de-commodification (Esping-Andersen 1990) may well complement rather than retard efficiency. This is a matter of value choice and the way market economy in a given society functions.

The equality-efficiency trade-off as Okun has put it might partially work in free-market economies (Anglo-Saxon countries), while this cannot be said about most of continental Europe and the Nordic countries, which have a co-ordinated (social) market

economy. Moreover, most of the developing countries from Latin-America to Africa illustrate a case where high inequality goes hand in hand with low levels of economic efficiency. Certain transformation economies of central and eastern Europe give examples of increasing inequality that accumulated in the course of a loosely controlled process of the reallocation of productive resources (e.g. privatisation) that is often related to corruption and even to criminal economy. Needless to say, this kind of inequality is not closely linked with efficiency.

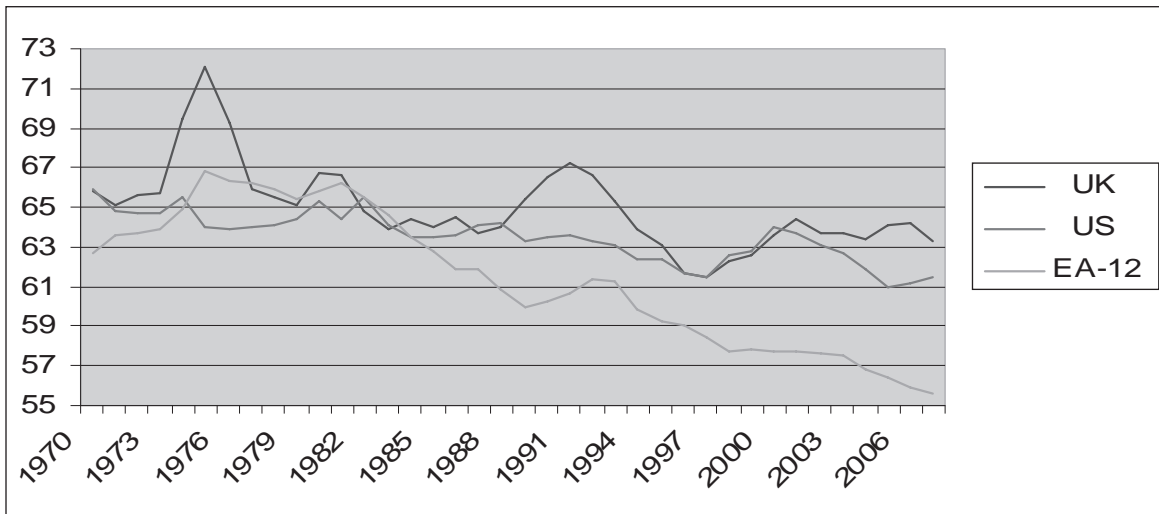
A short review of different kinds of inequalities and their development in the last decades will give us further evidence to underline the limited usefulness of the concept of an equality-efficiency trade-off in the post-crisis European context.

### **2.3. Different Sorts and Manifestations of Inequality**

#### *Growing inequality – the major trend*

Growing inequality of incomes was the major global trend of the last decades and this was true for Europe as well. Share of wages in GDP is a general indicator for income distribution on a macro level. It indicates the extent to which employees participate in the accumulated wealth of the country or region. Figure 1 shows that employees have received a continuously shrinking share of the produced wealth over the last decades. The 56% wage share of EU12 countries in their GDP by 2007 came as a result of a long-term trend of persistent erosion from a level of close to 67% in the mid 1970-s.

Figure 1 Wage share of GDP in the EU12, UK and US (1970-2007)



Source: AMECO database

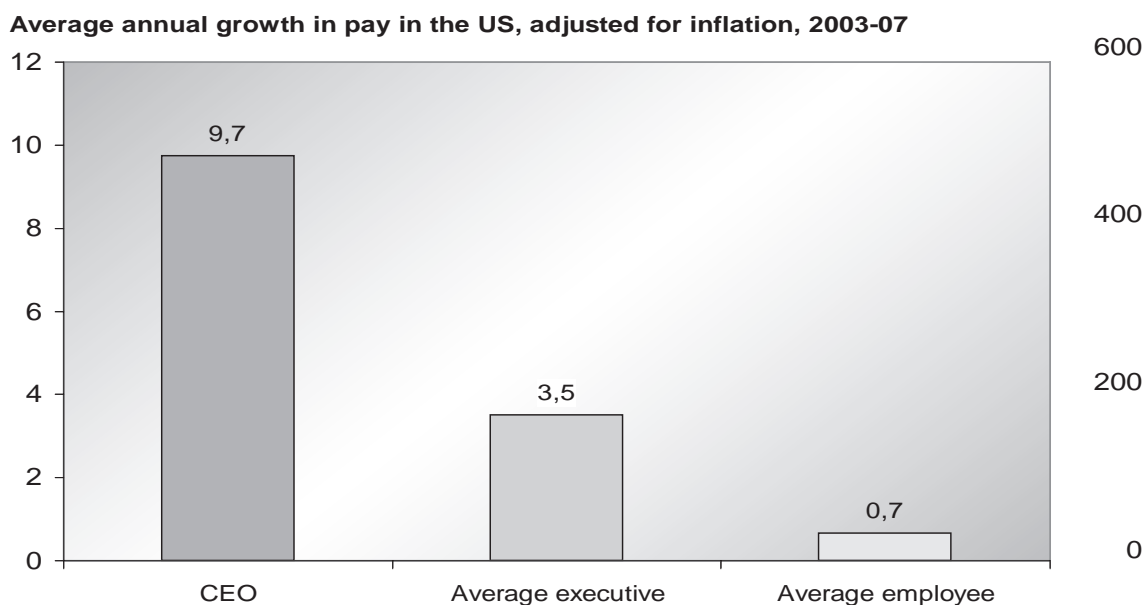
Inequality of incomes is rooted in the value-generating mechanism of the economy. Access to production factors (skills, capital and markets) has a decisive role in the final outcome and depends above all on co-ordination mechanisms and institutions.

Whereas the US and the UK have indicated a less dramatic fall of the wage share in GDP, this does not mean inequality did not grow over time. The dynamism of growing inequality among wage earners in the US has

picked up enormously in the last decade. Figure 2 shows how the compensation of higher management grew ten times faster than that of an average employee (Ebert et al, 2008).

A US research paper by Feller and Stone also shows that while in the late 1970s the richest 1 percent of American families took in about 9 percent of the national total income, by 2007, the top 1 percent took in 23.5 percent of total income (Feller, A – Stone, Ch, 2009).

Figure 2: Average annual real growth of pay in the US, 2003-2007



Source: Ebert et al., 2008

Inequality in Europe has also grown in the last period, especially in Germany. The Gini coefficient is a measure of income inequality showing inequality across the whole income distribution over time or between different regions and countries. It ranges between 0 (absence of inequality) and 1 (total inequality). While EU countries have a significantly lower measure of inequality than the US as expressed by the Gini coefficient, changes over time underline the general trend of growing inequality (Table 1). In Germany e.g. inequality, as evidenced by this measure, had increased by 20% in the two decades between the mid 80-s and the mid 2000-s.

Table 1 Growing inequality – Gini coefficient in a number of countries (1985-2005)

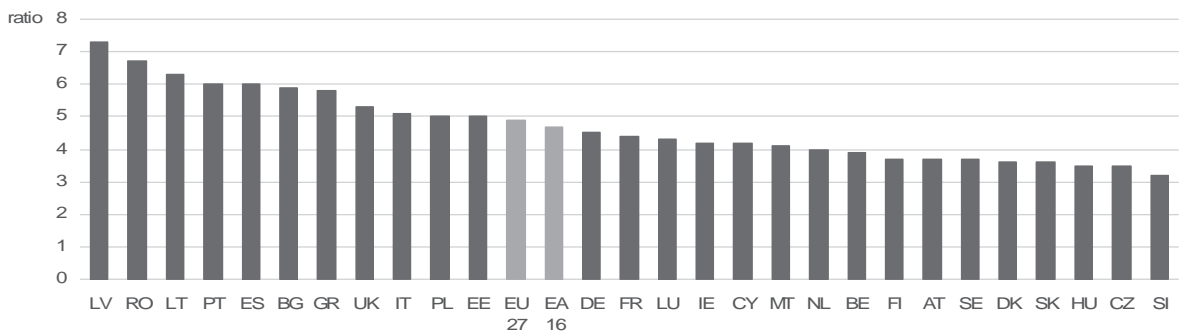
	1985	1995	2005
Denmark	0.221	0.215	0.232
Germany	0.257	0.272	0.298
United Kingdom	0.325	0.354	0.335
United States	0.338	0.361	0.381

Source: OECD, 2008

#### *The extent and features of inequality in the EU*

There are large differences in income distribution among EU member states and that is demonstrated by figure 3 here through the 80/20 income quintile ratio. While in Latvia the highest 20% earners had more than seven times higher income than that of the lowest 20%, in Slovenia this ratio was slightly above 3.

Figure 3: Inequality of income distribution 2009 (80/20 income quintile share ratio)



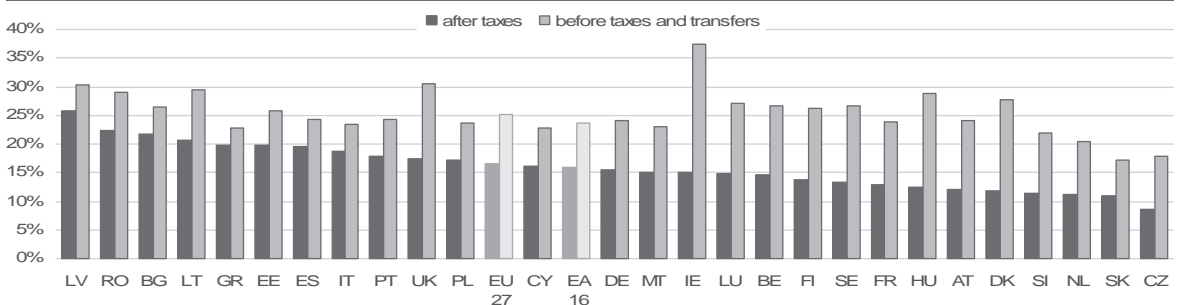
Data source: Eurostat (Labour Force Survey) 2010.  
Note: 2008 data for DK, EA16, EU27 and IT.

Source: O'Farrell (2011)

Redistribution is an important factor that determines inequality by the end as it modifies initial income dispersion. Figure 4 shows risk of poverty rates before and after taxes

and transfers. It is not only the levels of poverty risk that vary greatly by member state, but the differences between the before and after transfer levels.

Figure 4: At risk of poverty rate, 2009



Data source: Eurostat (Labour Force Survey) 2010.  
Note: 2008 figures for DK, EA16, EU27 and IT. Pensions are excluded from social transfers

Source: O'Farrell (2011)

A determining factor in the position of an individual on the inequality scale is his/her position on the labour market. The spread of atypical forms of employment has become a major source of inequality in Europe in the last decade. Across the EU-27 temporary,

part-time and seasonal workers were at notably higher risks of poverty than permanent and fulltime workers. The gap in wages between workers with permanent and temporary contracts varies between member states, with particularly high gaps in Sweden.

Table 2: Wage gap between workers with permanent and temporary contracts in a number of MS-s, 2008 (%)

SE	FR	EL	AT	BE	PT	PL	IT	ES	LU	IE	SI	LT	CZ	UK	EE	LV
37.6	28	26.4	23.4	22.5	21.6	21	18.8	16.7	16.3	16	10.8	8	7.4	4.5	1.9	1

Source: CRISS (2009) INEQ Policy Brief

### *Cross-country income differences in the EU*

The European Union is a unique conglomerate of nation states with an economic and political, but not a fiscal union; it is also an entity with shared values and co-ordination mechanisms. Even if income inequality between citizens of different member states is not measured by Eurostat statistics, it is relevant to pay attention to this measure of inequality within the EU. A publication of the Friedrich Ebert Stiftung has looked at this hidden dimension of inequality in Europe and found that in 2005 inequality in the EU was higher than in India (Dauderstädt, 2010).

A major determinant of income inequalities within Europe are cross-country differences. In 2008 the average income of the top twenty per cent of earners in Romania was actually lower than that of the bottom twenty percent in Italy. Since 1999 the current 27 members of the EU have been converging in terms of average income per person.

It seems paradoxical that cross-country inequality among EU citizens, a historical heritage, while not being subject to wide-scale redistribution mechanisms, is still the only measure of inequality that shrunk substantially in the EU. While regional inequality within member states is growing and inequality of citizens

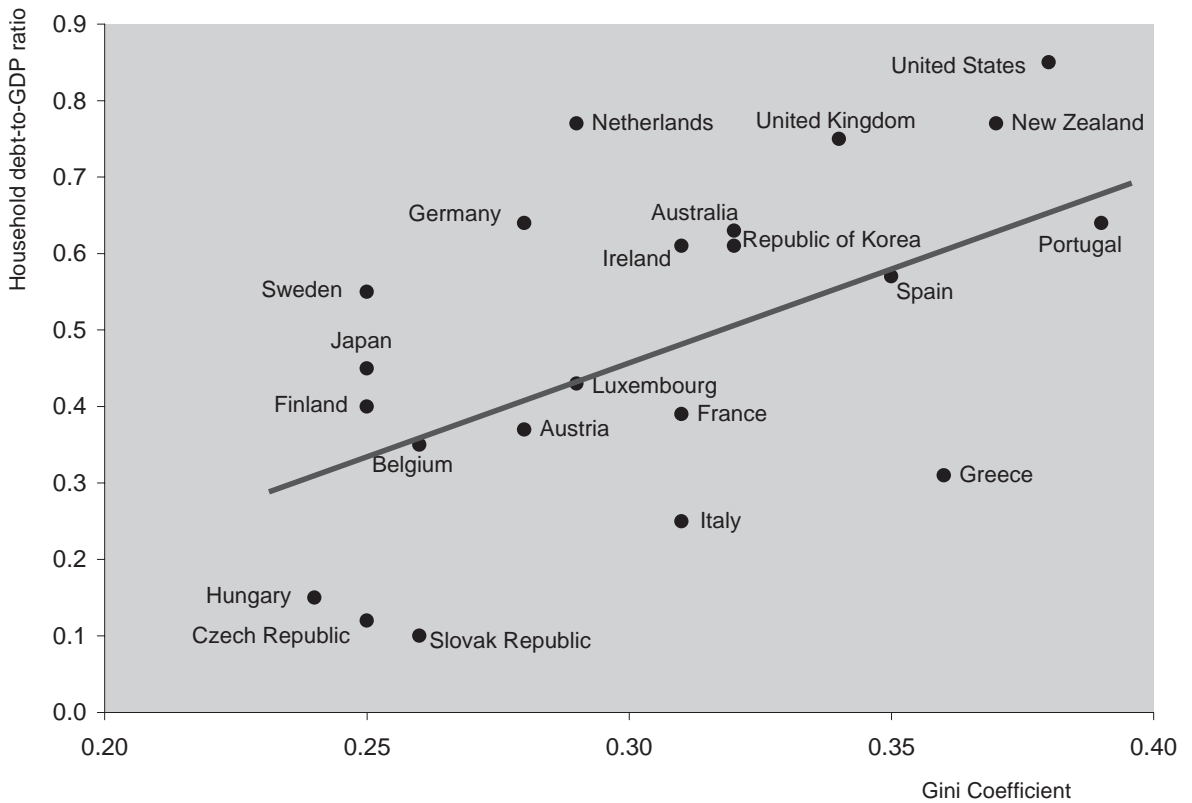
within individual countries also tends to grow, convergence between member states is a clear phenomenon. This is also an example that a reduction of inequality can well be accommodated with increasing efficiency.

### **2.4. Equality and Efficiency**

We showed that growing inequality was the main general trend in Europe and in the leading economies of the world in the last decades. We also showed some aspects of inequality in the European context. None of these trends seem to support the assumption of an equality-efficiency trade-off. On the contrary, the crisis has demonstrated what efficiency loss resulted from depressed wage levels and rising profits in the longer run. Purchasing power of the population was often maintained through credits that contributed to unsustainable trends and ended up in a debt crisis.

Figure 5 illustrates how the accumulated household debt of the population shows a high correlation with inequality (as measured by the Gini coefficient). The more unequal the incomes in an economy were, the more indebtedness of households had been built up, making these countries and their populations especially vulnerable in the financial crisis.

Figure 5: Household debt in share of GDP and Gini-coefficient in OECD countries, 2005



Source: Torres, 2009, based on OECD data

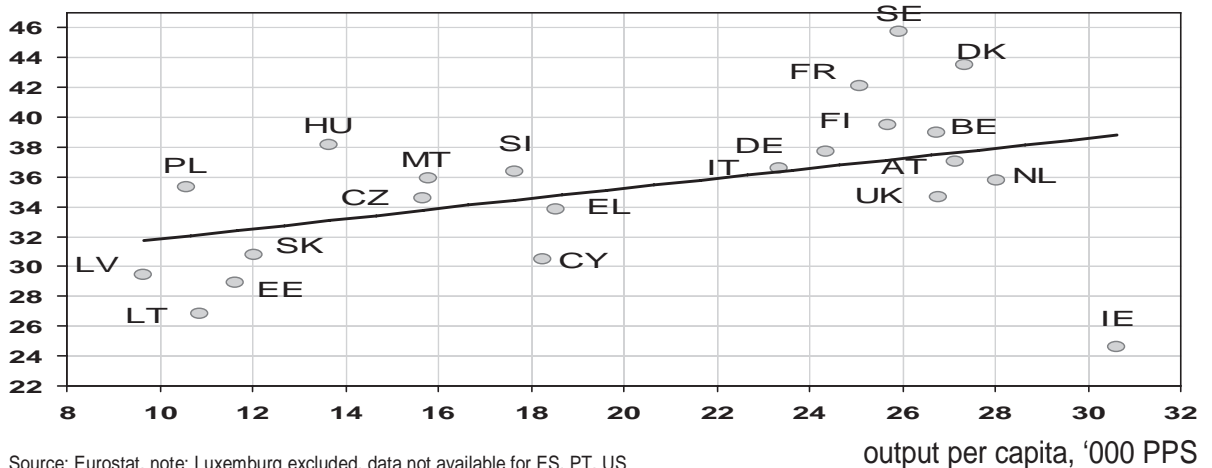
Profits and excessive incomes on the other hand were not invested into the real economy and thus into job creation as theory would have supposed, but were invested into synthetic financial products and were simply burnt off during the financial crisis.

There are also some other facts that show a reverse relation between equality and effi-

ciency, showing better performance by countries with higher equality.

Figure 6 shows a positive correlation between GDP/capita and income redistribution in Europe, showing that higher spending on welfare is not necessarily detrimental to economic efficiency.

Figure 6: Positive income and 'social spending' correlation, 2006 (social spending, % GDP)



Source: Eurostat, note: Luxemburg excluded, data not available for ES, PT, US

These disparities reflect differences in living standards, but are also indicative of the diversity of national social protection systems and of the demographic, economic, social and institutional structures specific to each Member State. An efficiency-redistribution trade-off does not appear here, although we need to emphasise that the efficiency of income redistribution and the quality of public institutions matters a lot.

More equality does not necessarily mean a simple transfer from rich to poor. There are also benefits for the whole society. A recent publication by Wilkinson and Pickett refers to this common benefit. They used a composed health indicator for OECD countries (consisting of nine health-related variables) and showed that this measure of the health of the total population is in strong correlation with the equality of a society, but does not show any correlation with the income level (richness) of the given society (Wilkinson and Pickett, 2010).

## 2.5. Conclusions

The interpretation that assumes that more equality undermines economic efficiency and that economic performance can only be improved at the expense of a less equitable distribution of income looks at the relation of equality and efficiency in a very narrow context. While we acknowledge that perfor-

mance needs incentives and must be rewarded and that an egalitarian society necessarily lacks efficiency, the problems of our contemporary societies are of a different kind. Inequality of most developed economies has persistently grown over the last decades. The recent worldwide crisis provided convincing evidence of how growing inequality can lead to huge economic and social loss.

The original thesis of the equality-efficiency trade-off assumption has its roots in free-market economies and has less relevance for the co-ordinated market economies that we have in Europe. Moreover, it addresses the 'inefficiency' that arises through income redistribution but does not speak of the origins of inequality in the phase of income generation.

Even if reducing the debate about equality to redistribution, the "leaky bucket" analogy does not stand up to evidence, as it misses the positive external effects of more equality for the whole society. Performance indicators of more equal societies support the positive effect of these transfers, as stylised facts from a number of countries have shown.

Too much equality is thus not the real problem in Europe and while the efficiency of transfers and public services needs to be improved, more efficiency in our societies does not require more inequality. This is even more true in the south-east Europe region where inequality of incomes has a broader basis and poses a challenge for social cohesion and progress.

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### 3. Perspectives from South-East Europe

#### 3.1. Albania: Education, Employment and Social Policies - Lost in Translation

*Erisa Çela*

##### Abstract

Employment constitutes one of the most crucial economic and social issues of the Albanian society. Although in the last decade Albania has made progress in its social, economic and political development, it still remains among the poorest countries in Europe and faces a number of challenges. One of the major issues that negatively influence the Albanian economy is the widespread phenomenon of the informal economy. This causes losses in revenues from tax evasion, distortions of the labour market, hides the true unemployment figures and encourages unfair competition. The informal economy at large and in Albania in particular specific has serious costs for individuals, enterprises and society as a whole.

Increasing employment should become a priority of the socio-economic policies in the country. This would have a direct effect on poverty reduction as well as on inclusion of all citizens in the social, economic and political life of the country. Policies facilitating participation in employment of specific groups, growth of the labour market, lifelong learning and vocational training should be taking a larger importance and focus.

The present situation is also significant if linked to the low level of education in the country. In fact, the present education system fails to produce a critical mass of human capital that generates external positive factors for the labour market. Consequently, the poor quality of education has a direct negative impact on the economic growth in Albania. It is disturbing that even in the presence of these disadvantages in qualifying the labour force, Albania is yet to invest sufficiently in education. Indeed, it spends significantly less on education than the countries in the region. Policies for employment should be accompanied by investment in improving the skills and human capital necessary to positively impact the labour market.

##### 3.1.1. Introduction

The Republic of Albania is situated in the South-East region of Europe, South-West of the Balkan Peninsula, along the Adriatic and the Ionian Seas. The territory of Albania is 28 748 km<sup>2</sup> and its population is 3,170,048.<sup>2</sup> The population is growing at a low rate and the main factors for this are migration, which is relatively high, and the continuous decrease of the number of births.

The communist regime collapsed in 1990, and the Republic of Albania was founded in 1991. The Albanian Republic is a parliamentary democracy established under a constitution renewed in 1998. The administrative division of the country consists of 12 prefectures, 36 districts, and 374 communes/municipalities.

Albania is a largely ethnically homogeneous country with only small minorities. The large majority of the population is ethnically Albanian. The exact size of ethnic minorities is not known, as the last census that contained ethnographic data was held in 1989. According to the latest news, the next census

<sup>2</sup> INSTAT –Albanian National Institute of Statistics [www.instat.gov.al](http://www.instat.gov.al), Retrieved January 20th 2011. The statistics for 2001 are taken from the results of the Population and Household Census accomplished in April 2001.



containing ethnographic data will begin in April 2011 with EU counsels assisting in certain fields.<sup>3</sup> Minorities include Greeks, Vlachs, Macedonians, Serbs, Bulgarians, Balkan Egyptians, and Roma.

The transition from a planned to a free-market economy has proven challenging as successive governments have tried to deal with high unemployment, widespread corruption, a decaying physical infrastructure, and widespread social problems, especially in rural areas. Although Albania's economy continues to grow, the country is still one of the poorest in Europe, hampered by a large informal economy and an inadequate energy and transportation infrastructure.

The Albanian economy has recorded a growth of 6% in the first quarter of 2009, mainly driven by large public investments in the road network. So far, the international financial and economic crisis has resulted in lower demand for Albanian exports, a fall in net inflows of monetary transfers in the form of remittances, and a marked slowdown in credit growth. There are some improvements in labour market outcomes. However, unemployment remains high and labour market data continue to be poor.<sup>4</sup> The most recent EU progress report on Albania indicates that there has been little progress in the field of social policies.<sup>5</sup>

Regional disparity is present in an extreme form in Albania: Poverty is 66% higher in rural areas than in Tirana and 50% higher in rural areas than in other major urban centres. Internal migration is resulting from such massive internal disparities: between 2005 and 2006 alone the population of Tirana increased by 137,000. The measurement of disadvantage

at district level indicates that regional disparity is unequally distributed. The same pattern of unequal distribution is shown at commune level – within the district – demonstrating that disadvantaged communes exist even within less disadvantaged counties.<sup>6</sup>

Albania is now a member of the United Nations, NATO, the Organization for Security and Co-operation in Europe, Council of Europe, World Trade Organization, Organisation of the Islamic Conference and one of the founding members of the Union for the Mediterranean. Albania has been a potential candidate for accession to the European Union since January 2003, and it formally applied for EU membership on 28 April 2009.

### 3.1.2. The Case for a Trade-Off in Employment Policy

Employment constitutes one of the most crucial economic and social issues of the Albanian society. It is a multi-sectorial phenomenon, which should encompass macro-economic policies, business - friendly policies; education policies; and social policies. Although in the last decade Albania has made progress in its social, economic and political development, it still remains among the poorest countries in Europe and faces a number of challenges. Albania has a per capita national income of just 2,960 USD per year and is classified as a below the middle-income country.<sup>7</sup>

After the deep recession of 1997-1998, Albania has achieved macroeconomic stability in the early 2000s together with economic growth, which goes on average 5% percentage yearly. Poverty has dropped from 25.4% in 2002 to 18.5% in 2005. This can be marked as a progress in achieving Millennium Development Goal Nr 1, which in Albania aims to cut

<sup>3</sup> "Albania to hold census in 2011". <http://www.balkans.com/open-news.php?uniquenumber=47384> Retrieved January 20th 2011

<sup>4</sup> "Albania 2009 Progress report", Commission of the European Communities: Enlargement Strategy and Main Challenges 2009-2010.

<sup>5</sup> IDEM

<sup>6</sup> "Regional development crosscutting Strategy" October 2007, Ministry Of Economy, Trade And Energy

<sup>7</sup> "Analysis of the youth labor market in Albania" International Labour Organization ILO 2010.

the poverty rate to 13% by 2015.<sup>8</sup> Nevertheless, these figures of progress do not necessarily translate into opening of new jobs. In fact, much of the present consumption is mainly sustained by emigrant remittances as well as by increased access to loans from second-level banks.<sup>9</sup> According to the Labour Force Survey 2009<sup>10</sup> the working age population in Albania comprises 87.9 % of the total population aged 15 years and over and this involves the country's working-age population that engages actively in the labour market, either by working or looking for a job. This being explained, the labour force participation rate in Albania in 2009 is 61.9 % and the female worker participation rate has a decreasing trend from 2007 to 2009 while the male employment rate has increased compared to 2008.<sup>11</sup>

If we examine further these very data, it will be noticed that the employment rate is higher for those belonging to the age-group 35 to 54 years old and the trend is comparatively the same. According to the same survey, the employment structure by sectors reveals that there is a declining tendency in employment in the agricultural private sector, while employment in non-agricultural private sector has an increasing tendency.

As for the unemployment rate, the latest Labour Force Survey in 2009 shows it to be 13.8%. The youth unemployment rate in 2009 is 27.2% and the adult unemployment rate (25-64) is 11.3 %. The ratio of youth unemployment rate (aged 15-24) to the adult unemployment rate (aged 25-64) for 2009 is 2.4 which means that young people are 2.4 times less likely than the adult people to find a job in the labour market. Whereas the non-economically active population or persons out of

labour force constitutes 38.1% of the working age population. This contingent consists of persons who are classified neither as employed nor as unemployed. The Labour Force Survey for 2009 discloses these data relating to the non-economically active population:

- 36.1 percent are pupils and students
- 19.8 percent are in retirement
- 16 percent are discouraged unemployed
- 14.5 percent are fulfilling domestic tasks.<sup>12</sup>

Pensions have significantly lost their real value due to rapid inflation in the past. The low level of pensions has increased old-age poverty and, consequently, recipients of social assistance. The financing of the pension scheme per se presents problems. Currently, due to insufficient contribution income, about 25% of the urban pensions and 70%<sup>13</sup> of the rural pensions are subsidized by the Albanian government. It is thus indispensable to start a pension reform in order to provide benefits for this vulnerable category of the population and to finally establish sustainable schemes for the future as well.

When elaborating on the key employment issues in Albania, we cannot avoid bringing in the issue of child labour. According to the Albanian Institute of Statistics, 32 % of children between 6 and 17 years old in the country are working. The worst forms of child labour are working street children, trafficking in children, children involved in illicit activities, children working in the formal sector and children working in the agriculture sector. The main reasons for child labour are poverty, their parents' unemployment or migration, disrupted family environment, education related reasons, such as: poor school attendance, lack of schools near the residence area, expulsion from school, poor performance at school, and dislike of school.<sup>14</sup> This

<sup>8</sup> "Albania Country Brief 2007" World Bank.

<sup>9</sup> "Challenges facing Albanian youth on the road towards Employment" Agenda Institute, Tirana 2008.

<sup>10</sup> "Labor Force Survey 2009" Albanian Institute of Statistics, 2009. [www.instat.gov.al](http://www.instat.gov.al), retrieved 23 January 2011

<sup>11</sup> IDEM.

<sup>12</sup> IDEM.

<sup>13</sup> Albanian Institute of Statistics, [www.instat.gov.al](http://www.instat.gov.al), retrieved 23 January 2011.

<sup>14</sup> "Decent Work Country Program 2008-2010" ILO-International Labor Organization.

automatically causes the lack of, or ill-education of this contingent, which in the near future will have fatal consequences on them as individuals with no skills to compete in the labour market. If continued, this phenomenon will have an important impact on the perpetuation of the cycle of poverty over generations in Albania.

Generally, throughout the entire past decade the youth unemployment rate has been consistently higher than that of adults. Employment prospects for young people are rather insufficient.<sup>15</sup> The trend shows that the employment rate of young women is 5% lower than that of young men. In addition, employment figures show that most youth living in rural areas are engaged in farming, either as self-employed or as contributing family members.

One of the major issues that negatively influence the Albanian economy is the widespread phenomenon of the informal economy. This causes losses in revenues from tax evasion, distortions of the labour market, hides the true unemployment figures and encourages unfair competition. Common features of work in the informal economy are represented by the lack of an employment contract, paid annual and sick leave and other social security benefits. The informal economy at large and in Albania in specific has serious costs for individuals, enterprises and society as a whole. In Albania, the informal economy is estimated to contribute to about one third of total gross domestic product (GDP). About 55 % per cent of workers in the non-agricultural sector are engaged in low-productivity jobs in the informal economy.<sup>16</sup> The informal sector in Albania is bigger in urban areas (24%) than in rural areas (5%). About 15% of the employees in Tirana, the capital, work

on their own or work on non-farming family enterprises.<sup>17</sup> Young workers take a large stake in the informal economy. The likelihood of being an informal worker is significantly correlated with being young, male and with low educational attainment.<sup>18</sup>

The employment landscape in Albania would not be complete if not giving information and data on self-employment, which as a concept in Albania was introduced for the first time after the closure of the public industrial enterprises and the reconstruction of the country's economy. Self-employment in Albania has a family business character, mainly in trade and family inherited craftsmanship. 62% of employees work full time and 39% part time, more full time employees are men (70%) than women (51%). Estimates run much higher for workers in agriculture, where most of them are self-employed and own-account workers, with half of them being poor.<sup>19</sup>

Over the past two decades, Albania has experienced high migration and emigration rates. It is estimated that about 40% of the working-age population is working abroad.<sup>20</sup> Migration has been for years a way to counter low-paid jobs, unemployment and poverty. Data on poverty indicate that the categories of the population facing higher risk of poverty are the unemployed, the less educated and people living in rural areas with less public services.

#### *Related Legal and Institutional Infrastructure*

The priorities of the Ministry of Labour, Social Affairs and Equal Opportunities for the period 2007-2013 are set out in the *Strategies on Employment and Vocational Training*,

<sup>15</sup> "Living Standard Measurement Survey 2005" Elaboration is based on this survey. Albanian Institute of Statistics, www.instat.gov.al, retrieved 23 January 2011.

<sup>16</sup> "Strategy for Social Inclusion 2007-2013" Ministry of Labor Social Affairs and Equal Opportunities.

<sup>17</sup> IDEM.

<sup>18</sup> "Living Standard Measurement Survey 2005" Elaboration is based on this survey. Albanian Institute of Statistics, www.instat.gov.al, Numerical estimates based on this survey, retrieved 23 January 2011.

<sup>19</sup> Strategy for Social Inclusion 2007-2013" Ministry of Labor Social Affairs and Equal Opportunities.

<sup>20</sup> "Decent Work Country Program 2008-2010" ILO-International Labor Organization.

*Social Inclusion, Gender Equality and Domestic Violence that were approved in 2007, as well as in the National Strategy on Migration that was approved in 2004.* The objectives of the Employment and Vocational Training Strategy are centred on the promotion of an active policy of employment through the establishment of a modern system of employment services, the development of an active policy of employment, the strengthening of the vocational education and training system, the reduction of informal employment, the improvement of conditions of work and the promotion of social dialogue.<sup>21</sup> This policy of employment is also backed by the Strategy on Gender Equality and Domestic Violence, while the Social Inclusion Strategy pays special attention to measures for reducing the vulnerability of informal workers.

The fundamental law in the employment field is the Law no. 7995, dated 30. 09. 1995 "On the encouragement of employment". This law supports both the implementation of programs for the development of employment and the establishment of the National Employment Service and the National Employment Fund. The Law has also created the first basis of a package of programs, such as: (i) intermediation for job and profession, (ii) job and profession counselling, (iii) vocational training, (iv) employment encouragement programs, etc. The last changes of the law, approved in July 2006, have improved some issues related to (i) the improvement of its definitions and the inclusion of new definitions related to different programs and categories of persons benefiting from this law; (ii) the introduction of counselling and professional orientation concept as part of the employment services; (iii) the creation of new programs such as the one on professional

practices for young people; (iv) the change of the management procedures for vocational training funds, which is a consequence of the entry into force of the Law No. 8872 dated 19.03.2002 "On the vocational education and training in the Republic of Albania" and the approval of the statute template of public vocational training centres.

The public employment service in the labour market is implemented by the *National Employment Service*. The National Employment Service is an autonomous public service, with the status of a central state administration, reporting to Minister of Labour, Social Affairs and Equal Opportunities. The highest decision-making authority of the National Employment Service is the *Trilateral Administrative Council* with the participation of three employer's representatives, three employees' representatives and seven representatives of the state. Services offered by the NES include activities like: (i) registration of jobseekers, (ii) job intermediation (job supply and demand matching) (iii) jobseekers' orientation and counselling, (iv) preparation of the documentation for unemployment benefits, (v) orientation and appointments in the vocational training courses, (vi) collecting information on the labour market, (vii) implementation of employment encouragement programs. Despite shifting from passive policies into active ones, it is evident that the employment services should be oriented toward the ownership and improvement of the labour market situation. Currently about 47% of the total number of the Employment Offices staff work and provide services to 149 000 unemployed jobseekers registered in the Employment Offices, while in the EU countries this percentage is 62-65%.<sup>22</sup>

In October 2007, the government of Albania launched the *National Strategy for*

<sup>21</sup> "Sectoral Strategy on Employment and Vocational Training (2007-2013)", Ministry of Labor, Social Affairs and Equal Opportunities.

<sup>22</sup> IDEM

*Development and Integration (NSDI)* for the period 2007-2013. The Strategy in itself aims to achieve rapid, balanced and sustainable economic, social and human development. Among others, the strategy assigns high priority to policies giving a stronger role to young people in the economy.

The *National Labour Council (NLC)* was established in 1996 with the aim to serve as a forum for tripartite consultations between the government and social partners. At present, the council meets, though not very regularly, to discuss substantive issues such as employment strategies, social security measures and equal opportunities and non-discrimination in the labour market. Seven government ministers participate at its sessions including the Minister of Labour, Social Affairs and Equal Opportunities; Minister of Finance, Minister of Health, Minister of Education and Sciences, Minister of Justice, Minister of Economy, Trade and Energy, Minister of Public Works, Transportation and Telecommunication.

### 3.1.3. The Case for a Trade-Off in Social Policy

Equitable and inclusive growth is very important for promoting economic and social development. It is important that the development processes do not exclude or leave anybody out. There are groups in Albanian society who are at risk of deprivation or barriers exist that do not allow them to be fully included in society, and for this reason if policies are to be effective, they must be targeted to these groups' needs. The poverty rate in Albania is among the highest in Europe. Data analysis shows that poverty reduction could have been faster had inequality not increased and had all of the poor benefited equally from the economic growth.<sup>23</sup>

Social protection programs have a significant impact on poverty in Albania. Social protection system includes (i) social security scheme based on contributions (pensions); (ii) labour market programs funded from the incomes and iii) social assistance in the state budget transfers' form.

The total value of public transfers for social protection constitutes 28% of consumption by the poorest from 20 % of rural families and 38 % of consumption by the poorest of 20 % of urban areas families. In the absence of social protection programmes, the poverty rate would have been 11% higher for the population and 20 % higher for the beneficiaries.<sup>24</sup>

In the field of social assistance, the State offers: *Economic Assistance*, by helping approximately 120,000 households with a monthly cash payment, 69,000 of whom are from rural areas and 51,000 from urban areas (2005). Economic assistance is provided in the lower level or secondary level for 57 % of households (mainly in rural areas) and in a highest level for 43 % of households (mainly in the city). The coverage of the poor has increased but there are problems with the amount of economic aid which partially covers the needs of poor families (67 % of them are not covered). The real value of payments has decreased in 27 % of urban areas and 17 % of rural areas and on average represents 15 % of the poverty line.<sup>25</sup> *Payment of Disability* for people with disabilities is the largest program of social assistance with a rapid expansion of beneficiaries in recent years.

Recently, it is under implementation the *Law for Assistance and Social Services (2005)*. The law expands the limits for payments to all vulnerable groups, creates the space needed for decentralization and expands the competences of local governance and civil society's

<sup>23</sup> "Business Environment Snapshot for Albania" 2006 World Bank

<sup>24</sup> IDEM

<sup>25</sup> IDEM

participation in the provision of social care services. The infrastructure of public service delivery, including social care services, health and education services, is very poor in rural areas, especially in urban and semi-urban areas where there are large informal settlements caused by informal migration. The destruction of infrastructure in the nineties and the migration of professionals have exacerbated the situation. A policy of decentralization of services in some sectors such as health, education and social services has been implemented.<sup>26</sup> However, the traditional formulas used for allocating investment and current spending by the central government in local government do not necessarily respond to the needs of the poor.

Traditionally, Albania has not used the institutionalization of social care as a way of providing services to the elderly, orphans or people with disabilities. Throughout the country there are 26 institutions (23 residential ones). Being located in the largest urban centres, the needs for services in remote areas are partially covered. These services are currently offered by the central government and are in the process of decentralization towards local government. Existing community-services are provided from international and local NGOs. However, even these services are concentrated mainly in Tirana and in other cities that have a better infrastructure or in areas where NGOs are more active and have the capacities to absorb funds. Meanwhile there is a lack of a regulatory framework for the services provided by NGOs.

*The Strategy of Social Services (2005-2010)* and *the Law on Assistance and Social Services (2005)* opens the way to deinstitutionalization and decentralization of social care institutions to local governance, where the services will be closer to family and com-

munity. This reform will encourage civil society in ensuring and developing new social care services in partnership with local government. *The Strategy of Social Inclusion* is one of the components of the *National Strategy for Development and Integration*. It focuses on poverty and social exclusion, and risks remaining even after economic growth. Being a cross-cutting strategy, it stems from the strategy of Social Protection, Employment, Education, Health, Transport, Water Supply, Urban Planning and Justice, which have been approved or are in the drafting process. We should see this strategy in relation to the cross-cutting strategies of Urban Development, counter Organized Crime, Terrorism and Trafficking, Information and Communications Technology and Decentralization. The Strategy itself aims to help vulnerable groups, families and groups in the community, so they can act independently, provide income and have the same rights as other members of society.

*Key issues to be addressed:*

*Increase of employment* should become a priority task of the socio-economic policies in the country. This would directly have an effect on poverty reduction, as well as on the inclusion of all citizens in the social, economic and political life of the country. Policies facilitating participation in employment of specific groups, growth of the labour market and lifelong learning and vocational training should be taking a larger importance and focus.

*Increase women's participation in the labour market:* Figures and percentages disclosed in the chapter of employment prove that labour force in Albania has decreased. There are data that women are not sufficiently encouraged to enter the market and as a consequence are less active in searching for a job. Although the *Labour Code of 1995*<sup>27</sup> and

<sup>26</sup> "National Strategy on Decentralization and Local Governance" Ministry of Interior, retrieved 24th January 2011

<sup>27</sup> "Labour Code of the Republic of Albania" 1995, <http://www.sli.gov.al>, retrieved 24 January 2011

the Law on Gender Equality of 2004<sup>28</sup> legitimate the equal treatment of men and women, on average women's incomes are lower than those of men, as is their participation in the labour market.<sup>29</sup> In fact, specific policies included in the Employment Sector Strategy do reflect commitment for equity and non-discrimination in favour of groups in need (women included), however they need to be enforced efficiently and accompanied by an allocated specific budget, as for instance specific assistance for training and employment of given groups in need, reduction of taxes for specific groups that have been excluded from the labour market. In the case of Albania, groups to be taken into consideration are: *youth, victims of traffic, former prisoners, Roma and Egyptian women.*<sup>30</sup>

As far as transparency and enforcement of tax law is concerned, there are many drawbacks and many unreported cases from employers due to Personal Income Tax and dodging Social Security Contributions. Generally, those who work in the informal sector originate from poor families with limited education, work extended hours with a low salary and are not paid social securities. Consequently, they have no right to complain based on the Labour Code. Companies that operate in the informal market do not invest in the qualification of their employees. A better cooperation among National Employment Service, State Labour Inspectorate, Tax and Customs office, would bring about a better control of the market. The Strategy of Finance Sector 2007-2013<sup>31</sup> predicts an equal distribution of taxes by formulating a specific policy and a set of administrative measures that would reduce the lack of motivation for infor-

mal employment by so reaching a higher level of adoption. An emphasis should be placed on the reduction of tax policies on labour, mainly through reducing social security taxes which have been among the highest in the region.

*Financing of secondary education* has been insufficient and as a result has hampered the development of education at large and that of vocational training in particular. Such a situation implies classes with too many pupils, and schools operating in shifts.<sup>32</sup> There is a need for policies in this sector that encourage equity and inclusion, such as: free academic books and tools for special groups in need that attend elementary and secondary education; transport for children who live far away from the school environment (very often in poor rural areas) and special incentives for teacher positions in these remote and difficult areas. In order to break the poverty inheritance through generations, policies should dedicate special attention to professional formation of children from poor families. In accordance also with the economic regional trends of the labour market, priority should be given to vocational qualification in the sphere of pre-university education. A series of professional schools should be built and opened in rural areas, with the aim to attract 40% of pupils that conclude basic education.

*Infrastructure of public service delivery*, which includes social care services, health and education, is very scarce in rural areas, and especially in urban and semi-urban areas where there are large informal settlements due to internal migration. The policy of decentralization of service delivery in several sectors such as, health, education and social services is currently being implemented.<sup>33</sup> Nevertheless, the traditional formulas that have been used for

<sup>28</sup> "Law on Gender Equality in Albania no. 9198, dated 1.7.2004" <http://www.sli.gov.al>, retrieved 24 January 2011

<sup>29</sup> Albanian Institute of Statistics, [www.instat.gov.al](http://www.instat.gov.al),

<sup>30</sup> "System of tariffs for professional Education" within the Strategy for Social Inclusion 2007-2013" Ministry of Labor Social Affairs and Equal Opportunities, retrieved 24 January 2011

<sup>31</sup> "Public Finance Sector Strategy" Ministry of Finance

<sup>32</sup> "Business Environment Snapshot for Albania" 2006 World Bank

<sup>33</sup> "National Strategy on Decentralization and Local Governance" Ministry of Interior, retrieved 24th January 2011

the investment allocations and current expenditures from central to local government are not necessarily linked to the needs of the poor.

### 3.1.4. The Case for a Trade-Off in Education Policy

A core condition for Albania becoming an EU member, among others, is having a market economy that is competitive within the EU. Education and research contribute to economic growth and competitiveness by providing highly skilled graduates prepared to play their role in an open economy and democratic society, as well as by the creation, transfer, and adaptation of knowledge. Albania has a factor-driven economy and to facilitate growth, the country has to shift its resources toward investment-driven, and ultimately toward innovation-driven growth. Both types, especially innovation-driven require better performance of the education system, which can produce an increased number of high school and university graduates with the skills and knowledge necessary to respond to the demands of the market. To create a competitive economy, one that is growing and generating future-oriented jobs, requires policy measures across many sectors, including education, particularly higher education. Research done by the World Bank since the early 1990s shows that the development of higher education of a country is correlated with its economic development.<sup>34</sup>

In Albania, The Ministry of Education and Science (MOES) is the central institution dealing with the drafting of state policy in pre-university education. In order to ensure a proper processing of educational policy, MOES creates a consultation entity made up of personalities in various fields as well as leaders of education and recognized teachers. By means of special

acts, it defines curricula and teaching plans, which are accomplished at various levels of pre-university education. MOES and its subordinate institutions approve the fundamental documents that include plans, programs, and teaching texts, conduct inspections, and are entitled to the right to experiment for the improvement of quality in education in compliance with international standards.

Pre-university education is undergoing a continuous reformation and is engaged in the process of decentralization seeking to increase the quality of this service, as it is highly important to the country's cultural development and economic growth. This service is currently a shared function between the local and central government. As such, it is coping with problems related to the sharing of functions and responsibilities by regional education departments, and office and local government units.

Albania undertook a decentralization reform since 2000 and set the Local government unit's competencies in the education area to operation and maintenance of pre-university education buildings, payment of teachers' salaries and capital investments in school buildings and related infrastructure. According to the *European Charter of Local Government*<sup>35</sup>, *Constitution of the Republic of Albania*<sup>36</sup>, and *Law on Local Government*,<sup>37</sup> each function and authority transferred from the central government to the local one should be accompanied by the respective financial bill. However, local government representatives state that central government does not provide funding for the full accomplishment of functions and competencies transferred to local government.<sup>38</sup>

<sup>35</sup> European Charter of Local Self-Government, Council of Europe, <http://conventions.coe.int/treaty/en/treaties/html/122.htm>, retrieved on 25th January 2011

<sup>36</sup> Constitution of the Republic of Albania, <http://legislationline.org/documents/section/constitutions>, retrieved on 25th January 2011

<sup>37</sup> "National Strategy on Decentralization and Local Governance" Ministry of Interior, retrieved 24th January 2011

<sup>38</sup> "Moving towards Consolidated Interactions between the Local Government and Central Institutions at Local Level", Institute for Democracy and Mediation, Tirana, July 2008

<sup>34</sup> World Bank [www.worldbank.org](http://www.worldbank.org) retrieved 25th January 2011



There are allocated related *Competitive Grants* (as decided in 2007) which are defined in the form of competitive grants, and according to which local units are entitled to funding by submitting their projects to MOES and after the relevant commission established for this very purpose has evaluated them. Nevertheless, the capacity of local staff to elaborate quality projects and to absorb these funds is very limited.

The most important documents on pre-university education are “*National Strategy on Education 2004-2015*”<sup>39</sup>; “*National Strategy on Pre-education*”<sup>40</sup> which lays priorities till 2013 for the pre-education, basic (obligatory) education, secondary education and professional education; “*Decentralization Policy in the Sector of Pre-University Education*”. These strategies and policies aim to segregate responsibilities and functions in the education sector among levels of governance, as well as to identify conditions for the increase of accountability for functions expected to be decentralized. However, much remains to be done in terms of organization of work for the drafting and monitoring of implementation as the only way to improve the quality of the decentralization process and the provision of this service to the community. Besides these documents, there are a series of laws and sub-regulatory acts that aim to regulate the relationships in pre-university education at central and local level.

Generally, access to pre-university education in Albania displays a low level of participation if compared to OECD countries. This result explains the low rate of attendance of secondary and higher education.<sup>41</sup> There is also a variation when regions within Albania are compared. An adult in Tirana, for instance,

attends education institutions for 3.5 years longer as compared with the national average.<sup>42</sup> In analyzing the figures further, we will see that the biggest discrepancy stands between urban and rural areas, where the latter suffer from less access to public services generally and to education in particular. School drop-out rates at a national level amount to 0.94%, but the most affected are children coming from families in need, the Roma community, children from remote areas, and girls residing in remote areas where patriarchic mentality and social problems prevent them from accessing education.<sup>43</sup>

Nevertheless, if we are to consider the general national level, there is a small increase of enrolment rate for school-aged population as compared with previous years: from 68% in 2007-2008 to 68.1% for the period 2008-2009. However, the percentage of expenditure for education as part of the state budget and GDP has decreased. Regarding the total expenditures of the Budget it has decreased from 11.1% in 2007 to 10.4% in 2009.<sup>44</sup> Something that needs to be addressed is the actual system of vocational education and formation. Such system continues to be very weak in Albania: it does not respond to labour market demands and continues to have fragile links with the social partners and interested stakeholders at large. Despite the reforms undertaken in the last years, this system has a very low reputation from the quality perspective and the percentage of those engaged in it is very low.<sup>45</sup>

During the past few years, Albania has undertaken serious reforms in the field of higher education, research, science and technology, aiming at a quick economic devel-

<sup>39</sup> “National Education Strategy 2004-2015”, Ministry of Education and Science

<sup>40</sup> “National Pre-university education development Strategy”, Ministry of Education and Science

<sup>41</sup> IDEM

<sup>42</sup> IDEM

<sup>43</sup> IDEM

<sup>44</sup> “Albania in Figures” 2010, Albanian Institute of Statistics, www.instat.gov.al, retrieved 27th January 2011

<sup>45</sup> “National Pre-university education development Strategy”, Ministry of Education and Science

opment of the country and its integration in the European Union. The new Law on Higher Education<sup>46</sup> introduced greater flexibility and objectivity regarding funding of universities, while the Higher Education Strategy sets out a number of ambitious goals to improve the performance of the university sector. Albania has currently 11 public higher education institutions and 18 private licensed ones, and the trend is towards rapid growth.<sup>47</sup> The public universities are older and financed mostly by the State, in addition to registration and other fees that they draw from students. Private universities are new, established after the year 2000 and self-financed through student fees determined by the institution itself, or through donations.

The basic legal document on which higher education in Albania is based is *Law No. 9741, 2007 on Higher Education in Albania, amended recently in 2010*. All higher education public institutions operate on the basis of this law. It allows for the founding and development of non-public higher education institutions. Under this law, a private institution of higher education begins its operation only after obtaining a license. Its licensing is done only upon fulfilment of the state criteria and standards adopted by the Council of Ministers, upon proposal of the Ministry of Education and Science. Also, according to this law the Minister of Education and Science, based on the recommendations of the *Accreditation Council* gives the final decision on institutional accreditation and higher public and private education programs.

In all the universities of the country operates the national system of tariffs. It should be noted that the system of tariffs has been

implemented in the recent years. The establishment of the tariff system is a ministerial competence. The national system of tariffs is based on the country's economic level. This amount is very low for higher education and is common to all students regardless the level of study, nationality, etc. These tariffs are higher in graduate education.

A recent report by the World Bank<sup>48</sup> warns that the poor quality of education is threatening economic growth in Albania. According to this report in 2009, over 51% of large firms in Albania, particularly exporters have reported the lack of knowledge among employees as their greatest obstacle. This situation is critical because these firms are a potential source of economic growth in the future. Nevertheless, despite these disadvantages in qualifying the labour force, Albania is not only not investing more than other countries, but instead spends significantly less than the region on education. The Albanian Government gave 3.4% of its Gross Domestic Product for education in 2009, as compared to 3.5% in 2008 and to 4.6%, which is the average for the Balkans<sup>49</sup>. Expenditures for scientific research are in low levels, at only 0.2% of the Gross Domestic Product, or at least 10 times less than the EU average.

A survey undertaken in 2010 nationally with the specific aim to analyze the research capacities of universities in Albania<sup>50</sup> concludes that apart from the overall identified need for more intensive research activity, additional problems arise, such as: lack of infrastructure to develop research (referring to public universities); Shortcoming in the number of full time academic staff, as a re-

<sup>46</sup> "Law on Higher Education" amended in 2010, Ministry of Education and Science

<sup>47</sup> "The Assessment of Research Capacities in Social Sciences in Albania", March 2010, Regional Research Promotion Program in the Western Balkans (RRPP), Swiss Agency for Development and Cooperation

<sup>48</sup> "Trade and Development Report", World Bank [www.worldbank.org](http://www.worldbank.org) retrieved 25th January 2011

<sup>49</sup> "Albania in Figures" 2010, Albanian Institute of Statistics, [www.instat.gov.al](http://www.instat.gov.al), retrieved 27th January 2011

<sup>50</sup> "The Assessment of Research Capacities in Social Sciences in Albania", March 2010, Regional Research Promotion Program in the Western Balkans (RRPP), Swiss Agency for Development and Cooperation

sult of the refusal of the Ministry of Education to approve an additional number of required academic staff (referring to public universities); Lack of funds for the development of scientific research activities; Limited possibilities for further qualification of the academic staff, especially for advanced studies, PhD programs, experience exchange with similar universities abroad. The governments indeed have undertaken some reforms, which mainly consisted in opening the market to new universities, which has led to an increase in the number of students. However the benefits of this increase are threatened by the ongoing decrease of teaching quality.

An essential condition for addressing the above-described issues is the organizational restructuring of public universities. In addition, public funding systems need to provide incentives for these institutions to fulfil their respective missions of enhancing competitiveness and social cohesion. These will require moving increasingly towards performance-based funding systems. Public subsidies for university fees, for example, should be targeted toward students from poorer backgrounds and, over the longer term, linked to student loan systems. Such changes will require political determination from governments and significant enhancement of the management capacity of public universities.

Albania faces multiple challenges in improving its research and development system, but the foundations for their longer-term effectiveness need to be established now. Adaptation of existing knowledge should be emphasized, rather than innovation and the creation of new knowledge. In relation to research and development, links should be strengthened between public universities and private enterprises, as the biggest contribution that a research sector can make to a country is to help companies adopt and adapt new ideas and technologies from else-

where. At the same time, private funding for research and development needs to increase together with the employment of researchers in the private sector.

### 3.1.5. Conclusions and Recommendations

Albania lacks clear strategies for the labour market. Nowadays, employment is the citizens' main problem in everyday conversations or public surveys. This is noticeable because so far, the economic model in transition has been ineffective in creating new jobs in the last decade. Participation in the labour market is extremely low for women and young people; this is significant if linked to the low level of education. There is a chance that the situation will deteriorate in the future, considering the aging of the population and consequently the coming off the labour market of a considerable part of population.

The failure to create new jobs, besides being the main source of inequalities that pervade Albanian society, is also a macroeconomic misuse that should be faced by correcting the main causes generating it: low qualification of employees, the informal economy and its interaction with high-cost labour.

The main problem stands in the education at large and professional/vocational schools in specific. The present education system fails to produce a critical mass of human capital that generates external positive factors for the entrepreneurship system. If compared to other countries in the region, Albania shows significant setback, especially in the second level of education, where registration in the school system is very low compared to other countries of the region. Therefore, the private sector remains locked in a low quality human capital balance, which brings low productivity of firms, a small demand for skilled employment, and few incentives for young people to invest in their education.

On the other hand, this vicious circle partially explains the emigration of skilled workers as well as that of the less qualified. This happens because the overall production of the system and consequently, its aggregate demand for work, are limited by these phenomena.

For its part, extension of the informal economy makes employment policy interventions more fragile, exposing the active and indispensable policies to the risk of tax evasion and corruption. This causes an inefficient use of public resources, which are dedicated to improvements of the employ-

ment conditions for the most disadvantaged segments of the population.

In line with the above-mentioned practice, it is advised to foster growth of the employment capability of the economy, harmonized with a skilled and professionally educated human capital. As long as economic policies are not oriented towards structural adjustments to improve the labour market, employment will be the constant illness of an economy that lacks the appropriate dynamic to improve the living conditions and incomes of Albanian society.

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## 3.2. Bosnia and Herzegovina: Development vs. Progress

*Svetlana Cenić*

### Abstract

Bosnia and Herzegovina has thirteen constitutions: one for each entity, canton, and the state. There are thirteen governments and thirteen assemblies, operating through approximately 150 ministries. The system of social protection and social assistance in BiH is highly fragmented and comprises 13 almost independent systems, with a low level of coordination and cooperation between them. Even within the "single" system, functions are overlapped and division of responsibilities is unclear. These are just some of the reasons preventing equal access to all to resources and services provided by the system. Poverty in BiH is deeper and more widespread than in any other country of former Yugoslavia (it is more widespread only in Kosovo), and some 20% of the poor suffer serious shortages in all or almost all key aspects of welfare, ranging from acceptable housing and sanitary conditions and access to health care services, to literacy and integration into society. Extremely complex structures together with the high level of poverty indicate that the country cannot be compared with any of the other former Yugoslav republics or other countries in the region. Thus for Bosnia and Herzegovina it is more a question of development vs. progress while the question of equity vs. efficiency is highlighted by the political structure of 13 constitutions and 13 almost independent social security systems – it is a highly ineffective system that produces inequality in many ways.

It has been the experience of several developing economies that the level of inequality in the distribution of income increases over the initial phases of development. The responses to such a rise in inequality have been varied, both across economies as well as within the same economy at different points of time, and they have ranged from an enthusiastic acceptance of the growth process that accompanied the rise of inequality, to violent protests against it in the form of social and political upheaval. Such differences in the tolerance for inequality may be explained with the help of a tunnel analogy, which can be applied both to inequality in the distribution and the feeling of inequality in exercising national interests (mainly the populist nationalisms of local politicians and war-leaders.)

The social and financial causes of public dissatisfaction that are likely to cause public unrest are more important, at least to some degree, than the political i.e., ethnic factors that are normally considered to play the dominant role in Bosnian and Herzegovinian society. The percentage of the public who would take to the streets over their national rights was considerably smaller than the percentage that would do so over job losses. The data from the reporting period thus confirms the primacy for the individual of social/financial status over political rights in BiH. Similarly, there is interesting data which indicates that those most prepared to protest come from the 36-50 age group; one might have expected, as a general principle, that the younger generation would generally be more ready to resort to such a form and expression of public discontent. - This is a quote from the UNDP *Early warning system 2009*, and is the best description of the current situation in BiH.

### 3.2.1. Basic Facts about Bosnia and Herzegovina

The land that makes up today's B&H was under the domination first of the Ottoman Empire (1463-1878) followed by the Austro-Hungarian Empire (1878-1918). Then followed monarchical rule under the First Yugoslavia (1918-1941) followed by integration into the quivering Croatian state during the Second World War, then Yugoslav communism until the free elections in 1990 and the fragmentation of Yugoslavia. This was followed by internationally recognized independence in 1992 leading to war and – most recently – the imposition of an external international administration.

In these circumstances, private entrepreneurship simply did not exist until the early 1980s and civil society was limited to small intellectual circles, respected but isolated, with no real social movements to speak of.

Then in the late 1980s, opening up political expression for Yugoslav society at large unleashed the contained pressure of national identities – distorted, repressed, and manipulated under communism.

Until the early 1990s, "democratization" was the loose term for describing the process of establishing liberal or constitutional democracies along the lines of Western European or US models.

The republic election held in Bosnia, in November 1990 – the only free elections before the imposition of the Dayton Peace Agreement - have been seen, nearly universally, as demonstrating the failure of democracy. The reason for this was the success of the nationalist parties at the expense of the cross-Yugoslav liberal-reform and reform-communist parties. Two hundred and two out of 240 seats in the republic's two-chamber legislature, or 84 per cent, were won by the three leading ethnic party organizations: (Muslim) Party of Democratic Actions (SDA),

Serbian Democratic Party (SDS), and Croatian Democratic union (HDZ).

Prior to these elections, Bosnia and Herzegovina had been recognized internationally as a model of multicultural co-existence, symbolic of federal Yugoslavia's progressive minority policies.

The 1990 election took place as the Yugoslav state was fragmenting. The key political question was that of constitutional reform and a looser confederal arrangement. In Bosnia, the reform of the constitutional framework questioned the guarantees of security and equal treatment for the three ethnic groups. Croats, the smallest of three ethnic groups, were in favor of a looser confederation and believed their interests would be more secure through closer links with Croatia. The Muslims (now called Bosniacs) were more divided over the question of constitutional change. The Serbs feared that any separation of Bosnia from Yugoslavia would place them in a worse position.

Therefore, voting along nationalist lines (i.e. for nationalist parties) was a rational response to the uncertainties of Bosnia's constitutional situation. Nationalism was an expression of identity, and via identity, of dignity and self-esteem. When one's country becomes smaller, one's self becomes smaller.

Furthermore, the political structure in Bosnia set by the Dayton Peace Agreement is extremely complicated, and is something that is, in a way, an experiment and a legal novelty. It divided Bosnia into two entities, the Serb, Republika Srpska and Federacija Bosne i Hercegovine (the Bosniac-Croat Federation) which have 'quasi state status' with governments independent of one another. Republika Srpska is composed of municipalities, and the Federation is further administratively divided into ten cantons, where six are predominantly Bosniac (Muslim), two are Croat, and two are mixed. Each canton is then di-

vided into municipal governments, with independent ministries, and judicial systems, which requires judicial cooperation laws between cantons and entities such as those in place between sovereign states. In addition, there is Brčko District, which is a small self-governing region managed by the three ethnicities together with the international community. Finally, there is a government at the state level, the Council of Ministers.

The Chair of the Presidency of Bosnia and Herzegovina rotates among three members (Bosniak, Serb, Croat), each elected for an eight-month term within their four-year term as a member. The three members of the Presidency are elected directly by the people (Federation votes for the Bosniak/Croat, Republika Srpska for the Serb).

The Chair of the Council of Ministers is nominated by the Presidency and approved by the House of Representatives. He or she is then responsible for appointing a Foreign Minister, Minister of Foreign Trade, and others as appropriate.

The Parliamentary Assembly is the law-making body in Bosnia and Herzegovina. It consists of two houses: the House of Peoples and the House of Representatives. The House of Peoples has 15 delegates, two-thirds of which come from the Federation (5 Croat and 5 Bosniaks) and one-third from the Republika Srpska (5 Serbs). The House of Representatives is composed of 42 Members, two-thirds elected from the Federation and one-third elected from the Republika Srpska.

The Constitutional Court of Bosnia and Herzegovina is the supreme, final arbiter of legal matters. It is composed of nine members: four members are selected by the House of Representatives of the Federation, two by the Assembly of the Republika Srpska, and three by the President of the European Court of Human Rights after consultation with the Presidency.

However, the highest political authority in the country is the High Representative in Bosnia and Herzegovina, the chief executive officer for the international civilian presence in the country. Since 1995, the High Representative has been able to bypass the elected parliamentary assembly, and since 1997 has been able to remove elected officials. The methods selected by the High Representative have been criticized as undemocratic. International supervision will end when the country is deemed politically and democratically stable and self-sustaining.

The role of the OHR in post-Dayton Bosnia was not just about state-building, but was equally aimed at the building and stabilisation of a democratic institutional framework for Bosnia. From its very beginnings, this task was extremely hard, having in mind that the solutions had to be acceptable to all three ethnic groups, in order to set the grounds for the country's inclusion in institutions of trans-European cooperation. Satisfying all three parties was exceptionally difficult considering that they were divided and polarised on the most basic issues, such as the question of legitimacy of the state, its common institutions and its borders (Bose, 2002).

Bosnia has thirteen constitutions: one for each entity, canton, and the state. There are thirteen governments and thirteen assemblies, operating through approximately 150 ministries (Popović, 2005).

Cooperation between the two entities was minimal, "with the institutions of the state little more than phantoms on paper" (Huddleston, 1999). The parties were not ready yet to cooperate with each other, and Carl Bildt, the first High Representative, in his first Report to the Secretary-General of the UN, expressed major concern about the will of Bosnian parties to cooperate: "What is required for peace to last is not only formal compliance with the provisions of the Peace Agreement,



but a genuine commitment to reconciliation and to the building of a future in common. Without an active effort at reconciliation and cooperation, there will be distinct limits to what the international community can do.”<sup>51</sup>

While Bosnia was formally a unitary state, the two entities within it enjoyed many of the privileges of a sovereign state, in so far that they possessed separate administrations, distinct citizenship (as well as common citizenship), their own armies, and the right to form ‘special parallel relationships with neighbouring states’. Local politicians had consistently opposed legislation that would enhance the capacity of the state at the expense of the entities. Even political authorities at the state level had refused to cooperate in support of the functioning of the central government institutions (Caplan, 2004).

Although in theory it seemed as an effective solution to Bosnia’s internal conflicts, at least from some perspectives, this ‘federation within a federation’ form of governance presented serious problems. Both local and international officials had no experience with this model of intergovernmental relations and the constitutional allocations of authority within Bosnia, while clear enough on the surface, were considerably vague underneath (Huddleston, 1999).

According to the 1991 census, Bosnia and Herzegovina had a population of 4,377,033. Ethnically, 1,902,956 (43%) were Muslim, 1,366,104 (31%) Serbs, and 760,852 (17%) Croats, with 242,682 (6%) Yugoslavs. The remaining 2% of the population – numbering 104,439 – consisted of various other ethnicities. 99% of the population spoke Serbo-Croatian. According to 2000 data from the CIA World Factbook, Bosnia’s largest ethnic

groups are Bosniaks (48%), Serbs (37.1%) and Croats (14.3%).<sup>[58]</sup> There is a strong correlation between ethnic identity and religion in Bosnia and Herzegovina: Muslims constitute 45% of the population, Serb Orthodox 36%, Roman Catholics 15%, and other groups, including Jews and Protestants, 4%.<sup>[59]</sup>

Large population migrations during the Yugoslav wars in the 1990s have caused demographic shifts in the country. No census has been taken since 1991, and political disagreements have made it impossible to organize one. Nevertheless, a census has been planned for 2011, but due to the present political circumstances and the fact that no such law has been passed so far, the chances of having one are very small. As almost all of the post-war data is simply an estimate, a census would be a statistical, inclusive, and objective way to analyze the demographics of Bosnia and Herzegovina. Most sources, however, estimate the population to be about four million, representing a decrease of 350,000 since 1991.

According to BHAS (Agency for Statistics of BiH) the estimation of the population done on 30 June 2009 is 3,842,566.

The national currency is the (Euro-pegged) Convertible Mark (KM), controlled by the currency board.

The war in the 1990s caused a dramatic change in the Bosnian economy. GDP fell 75% and the destruction of physical infrastructure devastated the economy. The Bosnian economy still faces considerable difficulties.

#### **I B&H in brief** **General facts**

- Population: 3,8 mio (est.)
- Capital: Sarajevo
- Area: 51.197 km<sup>2</sup>
- Currency (€1 = KM1.95583)
- Complex state structure
  - 3 nations
  - 2 entities+1 district
  - 13 governments



<sup>51</sup> Office of the High Representative (1996) *1st Report of the High Representative for Implementation of the Bosnian Peace Agreement to the Secretary-General of the United Nations*. Sarajevo, March 14, 1996.

### 3.2.2. Development vs. Poverty

One crucial area for analysis of all such developing societies is the relationship between poverty and development. It might at first appear that the two are virtually opposites: surely poverty means a lack of development, whereas development implies moving towards getting rid of poverty, as the Copenhagen Summit's target noted. However, in practice it has proved quite possible historically for development to occur without alleviating poverty.

Over the past decades, the increasing inequality in wealth between different parts of the world, the spread of localized wars, and the new importance of issues such as environmental degradation, international debt, religious fundamentalism and other forms of competing collective identity, all demonstrate the potential for social dislocation turning into worldwide chaos. Thus, it is ever more urgent to address such issues, and declarations such as that at Copenhagen are to be expected. Indeed, since 1995 development goals and targets have been reiterated in several areas related to poverty alleviation. Nevertheless, national governments and international agencies remain apparently unable to mount a concerted and successful development effort to remedy the situation.

By whom is development being done? To whom? These questions should be particularly asked when solutions are put forward that start with "We should", without making it clear who "We" are and what interests "We" represent.

We have to bear in mind that poverty applies to individuals and households, whereas development also refers to large-scale processes of change at societal level. The World Bank does this in economic terms, by measuring a person's income and establishing a 'poverty line' which represents an income level below which a person is held to be in

extreme poverty. The global target for reducing poverty uses a single poverty line for the whole world; those in extreme poverty are those whose incomes are less than US\$ 1 per day (measured in 1985 PPP dollars). It is then possible to think of measuring the proportion a country's population below that poverty line, or estimating it, since there are enormous difficulties associated with direct measurement of individuals' incomes on a large scale. I.e. in Bosnia and Herzegovina the census has not been held since 1991, and normally we are talking about estimations, not exact or reliable data.

The corresponding indicator used by the World Bank as a measure of the development of different countries is gross national product (GNP). GNP uses market valuations, and is in practice a measure of national income. GNP per capita gives an indication of the average material living standard of a nation's people. An increase in GNP per capita could mean development that implies an increase in prosperity or economic well-being and hence less poverty. However, a measure such as GNP per capita has limitations in this regard. GNP per capita is a measure of average income based on market valuations, and hence there are several ways in which the measure fails to give a full indication of the incidence of poverty. Being an average, GNP per capita says nothing about the distribution of wealth between rich and poor. Also, in general, GNP as an indicator underestimates both subsistence and collective goods, whereas it overvalues whatever is commercialized, individualized and organized.

The idea of who is poor is different in different societies, and is likely to depend on value systems as well as economic factors.

"For long, and in many cultures of the world, poor was not always the opposite of rich. Other considerations such as falling from one's station in life, being deprived of one's

instruments of labor, the loss of one's status or the marks of one's profession...lack of protection, exclusion from one's community, abandonment, infirmity, or public humiliation defined the poor." (Rahnema, 1992, p.158)

There are some inadequacies in using income as the sole way of measuring poverty (or development). One point is that what is regarded as poverty may differ relative to the norms of each particular society. A second is that income measures only one dimension of well-being, so that a broader view would take it to form only part of any definition of poverty (or vision of development). The notion of relative poverty has gained widespread acceptance. Thus, the World Bank uses a figure of US\$ 14,40 per day (in 1985 PPP dollars) to calculate the numbers in poverty in industrialized countries (rather than the \$1 per day for the world as a whole).

Development may entail disruption of established patterns of living, and there are huge disagreements about how it is achieved or whether it is occurring. Nevertheless, over the long term it implies increased living standards, improved health and well-being for all, and the achievement of whatever is regarded as a general good for society at large.

The two words "good change" already combine quite different ideas, which can cause confusion between different meanings of the term "development". "Good" implies a vision of a desirable society ("well-being for all"); something to aim at, a state of being with certain positive attributes which can be measured so that we can talk of "more" or "less" development. "Change", on the other hand, is a process, which may entail disruption and which it may or may not be possible to direct. The term "development" also embodies competing political aims and social values and contrasting theories of social change.

We can distinguish three main senses in which the term "development" is used:

1. as a vision, description, or measure of the state of being of a desirable society;
2. as an historical process of social change in which societies are transformed over long periods;
3. as consisting of deliberate efforts aimed at improvement on the part of various agencies, including governments, all kinds of organizations and social movements.

The three senses in which "development" is used are, of course, related. The state of being a desirable society is supposedly the result of the historical process of development; and the vision of a desirable society may form an aim towards which to direct efforts at improvement. The idea of development as historical social change does not negate the importance of "doing development". Historical processes incorporate millions of deliberate actions. Conversely, one's view of what efforts are likely to succeed in leading to "improvement" is bound to be coloured by one's view of history and how social change occurs. A vision of desirable society already hides a number of debates. Different political ideas clearly lead to different visions of what is desirable, and one person's utopia could be a nightmare for another. For example, what aspects should be included when considering development, and how should it be measured? Is it primarily an economic concept? Or should social aspects be of equal or even of greater importance? Should questions about what is politically feasible be allowed to constrain one's vision of a desirable, "developed" society? If, for example, ideals such as equity, political participation and so on may be in conflict with the achievement of development in an economic sense, should the former be included in a definition of development - or regarded as additional desirable elements?

For many proponents of development as economic well-being, a developed society is

a modern industrial society, and this is not just one which has reached certain levels of wealth, but one which is continually growing in economic terms and thus improving further. To some extent, the same is true of those who base their vision more on social factors or on human needs. A third, more prosaic vision could be of the amelioration of poverty and other problems via measurable improvements of a number of indicators (possibly including GNP per capita, but certainly not only that).

In his paper "The meaning of development" Dudley Seers pointed out the importance of value judgments in deciding what is or is not "development". Seers suggested that "the realization of the potential of human personality...is a universally acceptable aim", and development must therefore entail ensuring the conditions for achieving this aim. The first three conditions were:

- the capacity to obtain physical necessities (particularly food);
- a job (not necessarily paid employment, but including studying, working on a family farm or keeping house); and
- equality, which should be considered an objective in its own right.

Seers also recognized the political dimension and suggested further conditions for development in addition to those mentioned above:

- participation in government;
- belonging to a nation that is truly independent, both economically and politically;
- adequate educational levels (especially literacy).

Seers' formulation was designed to challenge the economic basis of the type of vision of development outlined above, with its emphasis on productivity, growth, and increasing GNP per capita. Economic development of this type does not necessarily reduce the numbers in poverty, let alone meet other human needs such as those pointed by Seers.

However, Seers was an economist arguing for an emphasis on human needs and equity alongside economic growth, and as such did not go far enough for many seeking an alternative which would provide a clearer break from economic development thinking. Since Seers wrote his article in 1969, three further aspects have gained recognition:

- relatively equal status for and participation by women in society;
- sustainable development (safeguarding the environment);
- freedom from social dislocation, violence and war.

This makes nine conditions for what we might call *human needs-centred development*.

### 3.2.3. The Effects of Civil War and Ethnic Essentialism on Development

Several studies have convincingly demonstrated that civil wars can have a highly negative effect on economic growth and welfare indicators. But it would be an error to only see war as the cause of impoverishment. Economic deprivation is also, in itself, a cause of war. Obviously, social dissatisfaction linked to highly inequitable distributions of income is not something new, and has often been a cause of violent conflict in the past. In recent decades, however, the exclusion of the population from the benefits of economic growth has taken on a more overly structured and regional dimension.

In recent decades, open market economic strategies, multinational companies, the large-scale migration of populations, and the far-reaching new media technology have all helped undermine the notion of national sovereignty. So have international aid agencies. In some places, and former Yugoslavia is an example, the lifting of Cold War constraints has combined with these factors in encouraging demands for greater autonomy for popu-

lations within the states, and the restricting of central government controls.

One effect of the weakening of the institutions of statehood has been to highlight the superficiality of formally (internationally) recognized national collective identities. With the collapse of services and the inability of the central government to maintain the rule of law, the tendency is for the people to emphasize other notions of ethnicity. It is very important to recognize that ethnic distinctions do not always relate to long-standing social divisions. It is, for example, bad history to suggest that the ending of the Cold War has lifted a lid on a pressure cooker of ancient ethnic divisions in Eastern Europe. Current politicized ethnic categories are largely the product of policies implemented under Communist rule, media coverage, and the machinations of leaders seeking a power base. However, when ethnicity is asserted to be a primary reason for conflict by many of the protagonists themselves, perceived ethnic differences are likely to be essentialized (i.e. qualities associated with an ethnicity are articulated as if they are primordial or natural). Once the ideologies of internal wars become closely bound up with such localized notions of ethnic essentialism, it is exceedingly difficult to contain the spread of violence. Whatever an individual's own views, participation in the struggle or migration are likely to be the only options. Whereas enemies during the Cold War era often used to label each other as politically misguided imperialists or communists, partly to obtain Soviet or Western support, now they can vigorously promote views of each other as inherently inferior or evil. National or international constraints on such assertions have been eroded. Combatants have always found ways of emphasizing the brutality of their opponents, and ethnic genocide is nothing new. Now war can only be explained with references to iden-

ties. To suggest that people kill each other in Bosnia and Herzegovina because, Serbs are Serbs, Croats are Croats and Bosniacs are Bosniacs is no more insightful than to suggest that the Iran/Iraq war was fought because Iranians were Iranian and the Iraqis were Iraqi. Nevertheless, the protagonists themselves openly place greater emphasis on apparently immutable ethnic characteristics as justifications for slaughter – something which can make conciliation all but impossible.

Another aspect of overtly ethnicized wars is that they are likely to spread into more stable areas. Refugees provide information about atrocities, engendering sympathy, anger and fear among groups culturally related to those caught up in the fighting. Nowadays this tendency is exacerbated by widespread vicarious participation in violent events through the media. The superficiality of much international reporting is such that it can also have an important influence on the fighting itself. This is particularly so where coverage makes no effort to look beyond the public ideologies of combatants or highlights what appear to be exotic aspects of a conflict. In former Yugoslavia, for example, the national media played a part in encouraging the emergence of populist nationalisms, and in the creation of mass panics, which reinforced closed definitions of community. Little was done to reverse this trend in international coverage as warfare spread. The ethnicity of Serbs, Croats and Muslims was reported as if these were immutable, obvious, and a natural focus for group division. Although some newspapers and reporters tried to dig deeper into events, the main thrust of international coverage was not to provide an alternative, more objective commentary on fighting, but to confirm as "facts" the constructed populist nationalisms of local politicians and war-leaders.

### 3.2.4. Good Governance

The World Bank (1992) defined good governance as synonymous with sound development management in four areas:

1. Public sector management – Government must manage its financial and personnel resources effectively through appropriate budgeting, accounting and reporting systems and by rooting systems and by rooting out inefficiency, particularly in the parastatal sector.
2. Accountability – Public officials must be held responsible for their actions. This involves effective accounting and auditing, decentralization, micro-level accountability to consumers and a role for non-governmental organizations.
3. The legal framework for development – There must be a set of rules known in advance, these must be enforced, conflicts must be resolved by independent judicial bodies and there must be mechanisms for amending rules when they no longer serve their purposes.
4. Information and transparency – There are three main areas for improvement: (a) information on economic efficiency; (b) transparency as a means of preventing corruption, and (c) publicly available information for policy analysis and debate.

Leftwich (1993) says that good governance for the World Bank involved an efficient public service, an independent judicial system and legal framework to enforce contracts; the accountable administration of public funds; an independent public auditor, responsible to a representative legislature, respect for the law and human rights at all levels of government; a pluralistic institutional structure, and a free press. He identifies three strands of good governance: (a) systematic (governance is broader than government, involving the distribution of both internal and

external political and economic power; (b) political (governance refers to a state enjoying both legitimacy and authority, derived from democratic mandate, and (c) administrative (governance involves an efficient, open, accountable and audited public service which has the bureaucratic competence to help design and implement appropriate policies and manage whatever public sector there is.

### 3.2.5. The Tunnel Effect

Hirschman and Rothschild (1973) used the example of a tunnel with a traffic jam to discuss an apparently very different issue: the tolerance for inequality in income distribution along the path toward economic development.

You are driving through a two-lane tunnel where both lanes are in the same direction and, guess what, you are caught in a serious traffic jam. No car is moving in either lane as far as you can see. You are in the left lane and your spirits are not exactly high. After a while, however, the cars in the right lane begin to move. Do you feel better or worse? It depends on how long the right lane has been moving. At first, you know that the jam has cleared further ahead and that your turn to move will come soon. Given the imminent prospect of movement, your spirits lift considerably, even though you have not yet moved. However, if the right lane keeps moving for long enough with no sign of things clearing up on the left lane, you soon end up frustrated and maybe just gate crash into the right lane yourself. Of course, if there are many people gate-crashing, everything will probably come to a halt anyway.

It has been experienced by several developing economies that the level of inequality in the distribution of income increases over the initial phases of development. The responses to such a rise in inequality have been varied, both across economies as well as within the same econo-

my at different points of time, and they have ranged from an enthusiastic acceptance of the growth process that accompanied the rise of inequality to violent protests against it in the form of social and political upheaval. Such differences in the tolerance for inequality may be explained with the help of the tunnel analogy.

Hirschman's tunnel effect hypothesis conveys an important lesson. If growth and equity in income distribution are considered to be the two principal objectives of the process of economic development, the development strategy has to be devised by keeping in mind the social and political context. If, given the social structure, the tunnel effect is weak (i.e., tolerance for inequality is low), a strategy of "grow first, distribute later" is unlikely to meet with success. Even with strong initial tunnel effects, the development process may be thwarted if ruling groups and policy makers are insensitive to the erosion of these effects over time.

### **3.2.6. And where is Bosnia and Herzegovina today in this respect?**

There are ongoing efforts to establish a new national constitution (failed so far) which would form the basis for increased cohesion and countrywide cooperation. Work is in progress to replace the rotating presidential system with a system based on one elected president and two vice presidents for four years. Steps have also been taken to forge closer ties with Europe politically and economically, and in terms of security. In June 2008 Bosnia and Herzegovina signed a stabilization and association agreement with the European Union (EU).

Political endeavours are, however, progressing slowly as divisions and mistrust still persist. The political impasse has had adverse effects on economic and social development.

The country has a modest GDP per capita, at slightly above USD 4,800.-; unemployment is exceptionally high and corruption is a major challenge. Poverty is widespread and sev-

eral groups face hardship and vulnerabilities. In 2009 the country experienced sharp increases in social spending and a fiscal crisis precipitated by the global economic downturn and bad governance (mismanagement). Both those causes are thus currently taking their toll on the country's economy. Although there are no national accounts statistics to confirm it (statistics is fragmented and unreliable), the available data indicate that the economy is in recession.

Public sector and tax revenues have been dropping rapidly. As spending on social protection schemes is large by international standards, these trends may have serious social and humanitarian consequences if the sustainability of the social safety system is put at risk. The public pension is below the official threshold of relative poverty and other state allowances are low, and thus already inadequate for maintaining a satisfactory standard of living for many. Thus, Bosnia and Herzegovina's most immediate task remains economic revitalization. The country needs meaningful progress in structural reforms to strengthen the basis for sustained growth.

Private sector growth – especially small and medium enterprises (SMEs) – and increased foreign direct investments (FDI) are needed to spur economic growth and job creation. The government's top economic priorities are to accelerate EU integration; strengthen the fiscal system; public administration reform; World Trade Organization (WTO) membership; and securing economic growth by fostering a dynamic, competitive private sector. To date, work on these priorities has been inconsistent. The country has received a substantial amount of foreign assistance and needs to demonstrate its ability to implement its economic reform agenda in order to advance its stated goal of EU accession. In 2009, the country has undertaken an International Monetary Fund (IMF) standby arrangement in order to cope with a sharp increase in social spending and a fiscal crisis precipitated by the global economic downturn.

## I B&amp;H in brief

## Key Macroeconomic Data

Data Source: Thomson Reuters

	2006	2007	2008	2009e	2010f
Nominal GDP (EUR bn)	9,8	11,1	12,6	12,2	12,6
Real GDP (% yoy)	6,9	6,8	5,4	-4,0	1,0
Household consumption (real, % yoy)	4,5	8,3	7,1	-5,7	2,0
Industrial output (% yoy)	11,0	6,0	10,2	-5,0	3,0
Consumer prices (avg.% yoy)	6,9	1,5	7,4	0,5	1,3
Unemployment rate (avg, %)	45,5	43,9	40,1	42,0	41,0
General budget balance (% of GDP)	2,9	1,3	-2,0	-4,2	-3,6
Current Account balance (% of GDP)	-7,9	-10,4	-14,9	-9,3	-10,8
Public debt (% of GDP)	21,3	29,8	27,5	35,0	40,0
Official FX reserves (EUR bn)	2,8	3,4	3,2	3,2	3,4

With an unemployment rate of 40 %, with about 20 % of the population living below the poverty line and about 40% living on the brink of poverty, the most pressing need for people is the creation of jobs and income, i.e. the recovery of the economy.

The high rate of unemployment in Bosnia and Herzegovina must surely represent one of the country's greatest macroeconomic problems. It is true that the increase in the number of the registered unemployed noted over recent years came to a halt during 2008 and that the number of unemployed had begun to gradually reduce during the year. Unfortunately, in 2009 we again saw an increase in the number of the unemployed in Bosnia and Herzegovina com-

pared to the previous year, no doubt as a consequence of global economic events. Thus, while some 480,000 people were unemployed at the end of 2008, the number had passed above 500,000 again by October 2009, while that number in June 2010 was officially 516.045, but the estimate is around 600.000.

Unemployment is probably the major problem affecting the young generation, equally in urban and rural areas of BiH. When this is combined with housing problems, the lasting economic crisis and political manipulation, young people become depressed and desperate and turn to drugs and alcohol, or make plans to emigrate as the only way to secure a better future.

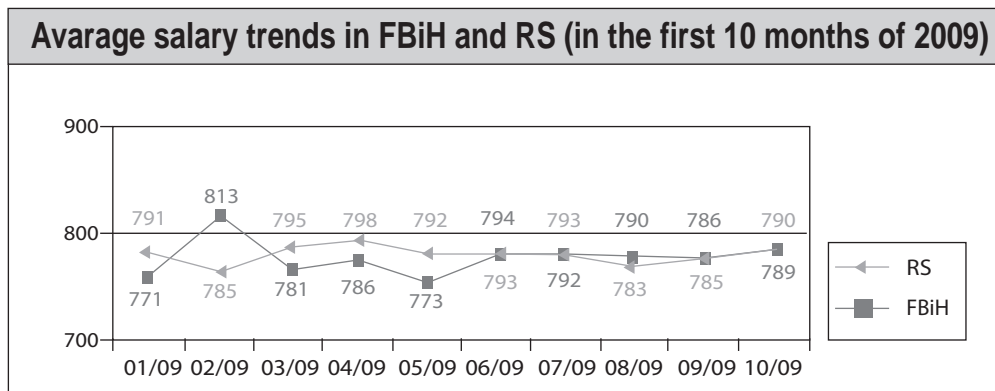
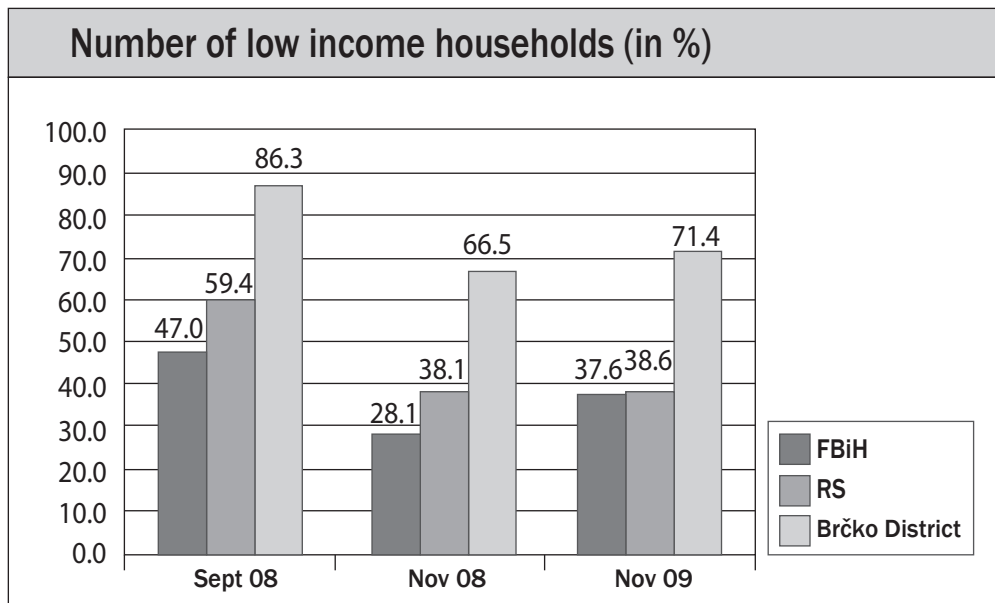
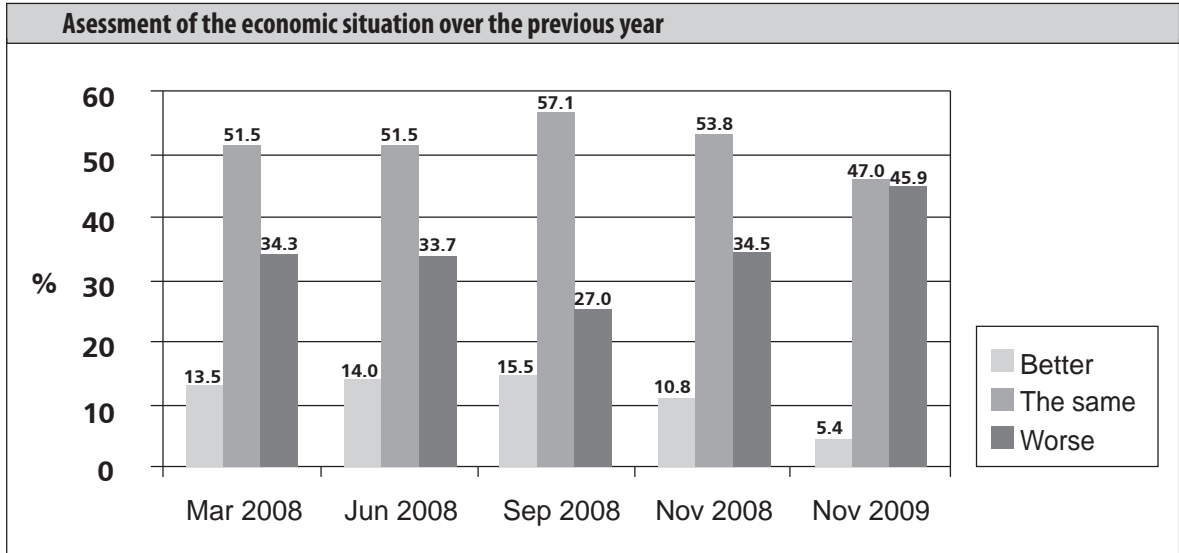
Bosnia and Herzegovina	2007	2008	January 2009	October 2009
<b>Total Unemployment in BiH</b>	<b>520,432</b>	<b>480,313</b>	<b>488,496</b>	<b>503,979</b>
<b>Unemployed Women in BiH</b>			<b>247,279</b>	<b>254,274</b>
<b>Unemployed Men in BiH</b>			<b>241,217</b>	<b>249,705</b>
<b>Unemployed Highly Skilled in BiH</b>			<b>12,516</b>	<b>16,083</b>
<b>Federation of BiH</b>			<b>342,174</b>	<b>351,444</b>
<b>Republika Srpska</b>			<b>134,798</b>	<b>143,305</b>

Sources: Statistics Agency of BiH Statement: *Registrirana nezaposlenost u Oktobru* 2009, No. 10, Year III; Federal Statistics Office *Mjesečni statistički pregled broj 12*, Year XIII, December 2009; Statistics Office of Republika Srpska, ([www.zzrs.org](http://www.zzrs.org)), December 2009.



The report Early Warning System 2009 by UNPD concluded that this is the worst assessment of the economic situation in Bosnia and Herzegovina to date. Some 46% of the overall

sample expressed the view that the situation in the economy had worsened, while the percentage describing it as having improved was the lowest to date (5%) (See the Tunnel Effect)



### Monthly household income, including all household salaries and receipts, child allowance, pensions, and any other sources of income (in %)

BiH														
	Urban		Rural		Male		Female		18 35		36 50		51 +	
	Nov 08	Nov 09	Nov 08	Nov 09	Nov 08	Nov 09	Nov 08	Nov 09	Nov 08	Nov 09	Nov 08	Nov 09	Nov 08	Nov 09
No income		3.9	4.4	5.0	2.8	5.7	3.9	3.4	3.3	4.7	2.9	4.7	3.8	4.3
< 100	1.3	1.9	2.7	3.7	1.9	3.0	2.3	2.9	0.9	2.0	0.5	2.5	4.4	3.9
101 200	2.4	8.6	6.8	12.6	4.6	9.5	5.3	12.2	0.6	3.4	4.4	4.5	9.8	20.0
201 300	6.6	5.5	8.9	8.6	6.9	6.4	8.8	8.1	2.0	4.8	5.5	2.1	15.6	11.7
301 400	10.7	10.3	14.5	11.1	13.9	10.9	11.9	10.5	9.4	9.2	12.5	14.5	16.8	10.1
401 500	2.3	2.7	1.4	2.7	1.6	2.3	2.0	3.1	1.0	2.6	1.4	3.5	2.8	2.3
Number of low income households	25.3	32.8	38.6	43.7	31.7	37.8	34.1	40.1	17.1	26.7	27.2	31.8	53.2	52.3

Source: Public opinion polls conducted by PRISM Research

### The Social Stability Index for BiH

Survey	Chain index	Composite index
Feb 05	92.00	46
Jun 05	97.83	45
Sep 05	93.33	42
Nov 05	102.38	43
Apr 06	104.65	45
Jun 06	102.22	46
Sep 06	100.00	46
Nov 06	102.17	47
Apr 07	104.26	49
Sep 07	91.84	45
Nov 07	95.56	43
Mar 08	106.98	46
Jun 08	97.83	45
Oct 08	102.22	46
Nov 08	100.00	46
Nov 09	100.00	46

Source: Public opinion polls conducted by PRISM Research.

Poverty in BiH is deeper and more widespread than in any other country of the former Yugoslavia (it is more prevalent only in Kosovo), and some 20% of the poor suffer serious shortages in all or almost all key aspects of welfare, ranging from acceptable housing and sanitary conditions and access to health care services, to literacy and integration into society. In addition, the current rela-

tively low poverty rate of the population is the result of expenditures far exceeding current production capacities.

So far, extensive international aid allowed this level of consumption, but it will soon cease to be possible. Thus, it is extremely important to increase the rate of economic growth, because the danger of a dramatic increase in the poverty rate is very real.

Household status - self-described (%)										
	Urban		Rural		Bosniak majority areas		Croat majority areas		Serb majority areas	
	Nov 08	Nov 09	Nov 08	Nov 09	Nov 08	Nov 09	Nov 08	Nov 09	Nov 08	Nov 09
Barely surviving	5.9	11.3	9.7	17.7	5.1	8.2	5.1	8.7	11.5	23.7
Well below average	10.9	10.8	11.8	13.0	9.4	11.7	8.6	11.4	14.3	11.6
A bit below average	23.3	17.4	25.0	25.5	26.3	24.3	17.0	28.1	24.1	17.7
<b>TOTAL below average</b>	<b>40.0</b>	<b>39.6</b>	<b>46.6</b>	<b>56.2</b>	<b>40.7</b>	<b>44.1</b>	<b>30.7</b>	<b>48.2</b>	<b>49.9</b>	<b>53.0</b>

Source: Public opinion polls conducted by PRISM Research

Among the most vulnerable in Bosnia and Herzegovina are poor families with children, pensioners and elderly people, disabled people, internally displaced persons (IDPs) and minorities. A substantial number of IDPs have returned, but face legal, social, economic or political obstacles to reintegration. People at risk of being trafficked have emerged as a serious challenge. In addition to political and socio-economic issues, various natural and man-made disasters hit the country almost every year; floods, for example, are becoming increasingly frequent. The level of poverty and existing vulnerabilities in the country also increase the risk, and the potential destructive effects of these phenomena for the most vulnerable.

The social protection and social assistance system in BiH is highly fragmented and comprises 13 almost independent systems, with a low level of coordination and cooperation among them. Even within the “single” system, functions are overlapping and the division of responsibilities is unclear. These are just some of the issues preventing equal access to all resources and services provided by the system.

In an attempt to address and deal with the grave consequences of the war, which head the list of priorities of policy makers, a regulatory framework that gives preference to certain groups of the population was created. This approach resulted in a status-based

social protection system, which has limited capacity to assist the most vulnerable groups of the population, thus limiting their access to resources and services. There are many examples of vulnerable groups of the population which are not covered by the social protection and social assistance system due to deficiencies in the existing legal and regulatory framework. According to the representative of the Association of the mentally handicapped, people with mental illness who need assistance from other persons are discriminated since the existing legal framework does not provide them with the status of persons with special needs, thus excluding them from the system of social assistance. Also, the system allows for granting or limiting access to certain groups of the population (ethnic minorities, Roma population, DPs and returnees) on an arbitrary basis, thus openly discriminating against these groups. The existing fragmentation of the system only reinforces such practices.

The State-level institutions are not involved in the regulation or provision of social protection and social assistance in Bosnia and Herzegovina. To some extent, the State is involved in refugee, health, employment and labour issues through the Ministry of Human Rights and Refugees of Bosnia and Herzegovina and Ministry of Civil Affairs of Bosnia and Herzegovina. However, the role of a State-level institution, even in the area of coordination of the

system and setting up of basic principles and standards, is minimal or non-existent.

Social protection assistance and social service policies are defined at the Entity level (and Cantonal level in FBiH) while responsibility for their implementation resides with lower government tiers. Fragmentation and deconcentration of the system creates large territorial disparities in availability and accessibility of social assistance and services. Due to a lack of financial resources, lower administrative levels and the poorest communities are mostly unable to fulfil their mandated obligations (especially in FBiH). In the Federation of Bosnia and Herzegovina, the main institutions within the social protection and social assistance system are: (i) the Ministry of Labour and Social Policy of FBiH (MoLSP FBiH), (ii) the Ministry of War Veterans and Invalids of the Federation of Bosnia and Herzegovina (MoWVI FBiH), (iii) the Ministry of Displaced Persons and Refugees of FBiH (MoDPR of FBiH), (iv) the Ministry of Health of the Federation of Bosnia and Herzegovina which is only responsible for the coordination of the health care system while policies are created by health ministries on cantonal level, (v) the Federal Health Insurance and Reinsurance Fund and Cantonal level health funds, (vi) the Institute for Pension and Invalidity Insurance of the Federation of Bosnia and Herzegovina, (vii) the Employment Agency of the Federation of Bosnia and Herzegovina and Cantonal Employment Services and (viii) Centres for Social Work (CSWs).

Each canton has its own ministries in charge of areas of protection of war invalids and their families, displaced persons and refugees, labour and employment, health care and social protection. Although Cantons have legislative powers to adopt their own legislation in social security areas, not all of them have Social Security Laws, nor have the ones that have adopted such laws, harmonized them with the Social Security Law of the Fed-

eration of Bosnia and Herzegovina. In some cases, even when there is a Cantonal Law on Social Security, they failed to adopt the necessary by-laws, thus blocking implementation of the legislation to its full extent.

Absence of a legal framework at Cantonal level results in the exclusion of certain vulnerable categories of the population. In these Cantons, civilian war victims, although having documentation confirming their disability, do not receive any assistance due to the absence of the Social Security Law. The absence of the Law also prevents access to some benefits such as maternity leave, health care during maternity leave and access to health care for some groups of the population in a state of social need. In addition, one of the most vulnerable groups of the population comprises households with dependent children (especially households with two or more children) - in some Cantons in FBiH no benefits are provided to these households, despite their need. Republika Srpska has a more centralized system of social protection and social assistance and the main institutions are: (i) the Ministry of Labour and War Veterans of Republika Srpska, (ii) the Ministry of Health and Social Protection of the Republika Srpska, (iii) the Ministry for Refugees and Displaced Persons of the Republika Srpska (iv) the Pension and Invalidity Insurance Fund of the Republika Srpska, (v) the Employment Agency of the Republika Srpska, (vi) the Health Insurance Fund of the Republika Srpska (vii) the Public Fund for Child Protection of the Republika Srpska and (viii) Centres for Social Work at Municipality level. Due to centralization of the system in RS, access to some aspects of social protection is equal for all throughout the territory of RS, but when it comes to services provided by the CSWs, the picture is quite different and there are significant territorial discrepancies in availability and accessibility of social assistance and services.

The system comprises a social protection system based on social insurance schemes funded from social contributions on wages (pension, health, unemployment and family and child protection benefits in the RS) and social assistance and services schemes financed from governments' general revenues. When it comes to contributory social protection schemes, the issues are mainly related to adequacy and quality of assistance, but when we talk about social assistance financed from general budgets, the first issue is inequality in access to these services throughout the territory of Bosnia and Herzegovina.

Main characteristics of social exclusion in BiH are: (i) high unemployment, high inactivity rates, large informal sector employment and poor quality jobs that lead to economic exclusion which results in poverty, (ii) a large share of the population with low education attainment, which leads to inactivity, long-term unemployment or employment in the informal sector thus resulting in poverty (iii) ethnic exclusion and discrimination of "minority" groups and returnee communities, (iv) an inadequate system of social protection with poor targeting and low effective coverage, resulting with inequalities in access to resources and services. Lack of financial resources for provision of social assistance and inefficiencies inherent to the functioning of Centres for Social Work reinforce social exclusion.

A large percentage of the population is below the poverty threshold. Especially worrisome is the information that the level of persistence of poverty with over 70% of population remaining below the poverty threshold over the period of three years. This is closely linked with long-term unemployment where 76% of all unemployed have been unemployed for more than two years. A high percentage (41.7%) of the population has a low level of education attainment, lacks life-long learning policies and limited opportunities for a new

start, which significantly reduces the chances of this population group to break out from the poverty cycle. The rural population, suffering from limited access to the labour market, limited access to resources, to public services, and the unresolved status of farmers, is by far the most affected segment of the population.

The most affected groups are households from rural areas, households headed by a person with primary or less than primary level of education, households with elderly members, households with two or more dependent children, female headed households and single-parent households with dependent children, the Roma population, people with disabilities and ethnic minorities, DPs and returnees.

There are no social inclusion policies at any level of government in Bosnia and Herzegovina that would, in a structured way, address the underlying causes of poverty and social exclusion. As already mentioned, the system is poorly coordinated, vertically as well as horizontally, and is not capable of responding to numerous challenges. Inherent flaws in the system, institutional and regulatory, are to some extent reinforcing social exclusion. This results in measures which are rather reactive than proactive, addressing only the consequences instead of the causes of poverty and social exclusion.

The pension system in BiH has a long tradition. It has operated as a public pension PAYG financed system in BiH since the late 19<sup>th</sup> century. It is organized as a typical Bismarckian type of system. According to the constitution of BiH, the pension system, as with other subsystems of the social insurance system, is organized at the entity level. For these reasons, one can discuss two separate pension systems, with a minimal capacity at the state level that is in charge mainly for the representation of BiH abroad and coordination between the entities. Although the systems are separated in organizational and funding terms, both entity

pension systems are organized and function in almost identical ways.

There are only minor differences between the two entity systems, such as: (a) funding of the system, where RS has budgetary financing and the Federation is fully contribution financed; (b) the level of pension benefit is slightly higher in Federation BiH due to differences in the level of economic activity; (c) in RS, the pension fund is in possession of significant assets as a result of the privatization process, where 10% of the privatized assets value was transferred to the pension fund, while there is no similar provision in Federation BiH; (d) minor legal provision differences, such as eligibility of some groups, "missing years buy-out" etc.

The legal framework for the pension system is well-defined. The system is defined by two entity pension laws, and a set of related legislation (law on contributions, law on central records etc). The pension system parameters are already adjusted to very sharp levels – moving the pensionable age to 65 for both genders (previously 55/60) with a very short transition period, and defining the full working age as a referent period for pension base calculation (previously best 10/15 years).

In terms of financing, the main source of revenue for the pension system is contribution revenues – almost 100% of revenue in Federation BiH, and 65% of revenue in RS. Apart from this, RS pension funds receive budget subsidies (35%), and pension funds also collect up to 2% of their source revenue by issuing certificates and providing other services.

The health care system in Bosnia and Herzegovina is organised in accordance with the administrative country borders of entities, cantons and Brcko District. The current organisation of the health system evolved from three main health finance systems that emerged at the end of the war. Two were in the Federation (Bosniak and Croat) and the third in the RS. At present, Bosnia and Herzegovina has 13

health ministries, 13 health funds and numerous institutes. In the Federation of B&H each canton has its own health ministry and health fund and the health ministry at the entity level together with the solidarity health fund. Republika Srpska has its own health ministry and a special health insurance fund covers the whole territory of Republika Srpska, while Brcko District has its own separate health fund existing since 2002. It is well known that various social groups are not covered by the health insurance. Those are primarily various groups of unemployed but not registered as such, as well as those that are employed but their contributions are not paid regularly by their employer. Also, the Roma population and ethnic minorities in different parts of the country are usually in this group of the excluded from the system. Currently there are some ideas for issuing special legislation in order to ensure minorities' health care rights. Most people believe that governments should subsidise health care expenses from general revenues and make health care accessible for everybody at least in terms of a basic package of health rights. The government will need to find an appropriate and better way of financing health care, so that the burden of financing will be better levied across the population and universal accessibility and basic health rights for everybody will be guaranteed. This can be achieved only through financing from general revenues. The government will also need to introduce supplementary health insurance on a voluntary basis.

According to the Labour Force Survey 2007, the situation with the level of education of the working age population is to some extent improved in comparison with 1991. While the percentage of population with tertiary level education remained almost the same, the percentage of the working age population with secondary level education increased significantly (from 33% in 1991 to 46% in 2007).

However, an exceptionally high percentage (48%) of the working age population has primary or less than primary school education. Despite evident improvements and an overall increase in the level of education of the working age population, discrepancies in the education level of the male and female working age population remain high.

Compared to the EU-8 average and other countries in transition, BiH spends a higher proportion of GDP for public expenditure than any other country. In all the analyzed areas, except for social protection, where BiH spends slightly less than the EU-8 average, the same percentage as Croatia and a significantly lower percentage than Slovenia and Poland; and economic affairs, where BiH spends slightly less than EU-8 countries and Slovakia, BiH spends a higher proportion of its GDP than other countries taken in comparison (EU-8 countries, Croatia, Slovenia, Poland and Slovakia). Having in mind that all the countries compared have a significantly higher GDP than BiH, and that the quality of services provided in BiH is incomparable to the EU-8 average and better performing transition countries like Slovenia, one can estimate that social and other public expenditures in BiH are too high.

### 3.2.7. Conclusions

The social and financial causes of public dissatisfaction that are likely to cause public unrest are more important, at least to some degree, than the political i.e., ethnic factors that are normally considered to play the dominant role in Bosnian and Herzegovinian society. The percentage of the public who would take to the streets over their national rights was considerably smaller than the percentage that would do so over job losses. The data from the reporting period thus confirms the primacy for the individual of social/financial status over political rights in BiH. Similarly, there is interesting data which indicates that those most prepared to protest come from the 36-50 age group; one might have expected, as a general principle, that the younger generation would be more ready to resort to such a form and expression of public discontent. - This is a quote from the UNDP *Early warning system 2009*, and the best description of the current situation in BiH. Also, that gives the answer to the development vs. Poverty question, says a lot about the quality of governance, and proves the presence of the tunnel effect so obvious now in Bosnia and Herzegovina.

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### 3.3. Bulgaria: Transition Revised – Social Fragmentation and Poverty Increase

*Krastyo Petkov, Atanas Vladikov*

#### Abstract

The political, economic and social transformations of the last 20 years in Bulgaria “knifed” the societal stratum into very many fragmented pieces, such as: low-cost labour, a low-technological level, low investment and return rates, lost markets, doomed pensioners, failed businesses, inadequate salaries, failed reforms in the public sector, and, maybe, most importantly, a new increase in poverty level and social disequilibrium, added to the increased purchases of one-way tickets for the ever-increasing share of young labour migrants.

Although the country is already in its fourth year of full membership in the EU, it has too many obstacles to overcome, including accrued destructive Euro-scepticism and a general disbelief in the true intentions of the political class and their economic action plans. Statistics show that the worst-case scenario is not a mere “Excel”-based simulation, but a way of living for the majority of Bulgarian households. Nothing is the way it is presented to the European institutions. For example, the National Statistical Institute (NSI) in October 2010 was pushed to announce the true figures of the Bulgarian economy; and it so happened that all figures for all the years of the so-called “transition period” need more than a serious revision. Being a member of the EU-27, the majority of corporate agents demanded price levelling, without wage levelling, which automatically had results on the economy – Bulgaria is the poorest member of the EU-27.

Social conditionalities, which are necessary to build sustainable social relations, and prevent age-based disputes on tax burdens and distribution and re-distribution of national income, just failed. Currently, according to certain estimates, the official figure for the size of the shadow economy as a percentage of GDP of the country is 38%. Many analysts believe that this figure is lower than the actual figure. And mainly, this figure is due to labour malpractices and the setting of improper wage rates.

In addition, Government education policies seem very controversial and the expected results do not materialize, and do not have an impact on the social environment, or on individuals’ prospects on the labour market. Here is why: numerous individuals happen to be highly qualified, and be remunerated at very low wages. At the same time, many low-skilled, low-qualified, and low-educated individuals easily switch jobs (labour mobility) and have greater bargaining power on the labour market, due to the fact that the technological level of the economy is comparatively low.

Therefore, the economic situation in Bulgaria offers two paradoxes to the modern world, and civilized Europe – an education market paradox (expensive state-funded educational services, marketed as “social goals”), and a labour market paradox (pay rates of salaried workers to be equal or less than the pay rates of waged workers).

Thus, efficiency on the labour market, which should be a result of the quality of educated individuals, is ambiguous and controversial.

Although Bulgaria used to adopt egalitarian policies during the years of communism, today’s reality has not changed much. Equality is understood as a situation in which all working individuals are entitled to equal incomes. This, obviously, contradicts the vision of the EU to establish a knowledge-based economy, as it is irrelevant to the case of Bulgaria, at present. And it results in the distorted relation between formal education and official pay rates, as well as in inadequate social policies, that do not target individuals, or groups of individuals (socially disadvantaged, minorities, orphans, etc.), which truly do need to be monetarily assisted.

### 3.3.1. Introduction

The two central problems of Bulgarian society, which directly affect the trade-off between efficiency and equity, are: first, the demographic crisis (which is accelerated by two other factors, low-cost labour migration and the brain drain) and second, economic and social transformation coupled with the issue of levelling up both the standard of living and incomes of individuals and households to some acceptable level. The demographic problem has been an issue for many years, and as it will be clarified below, it was unsuccessfully addressed by a series of governments not only in the period of transition, but even priorly. Economic and social reforms, however, are new phenomena – their effects were tested for the first time in the period after the initiation of the crisis in 2008; and these reforms totally failed.

Bulgaria is a country situated in the very South-East corner of the EU-27, with a population of 7,563,710 million people, as of January 1<sup>st</sup>, 2010. Currently, Bulgaria suffers a severe demographic cataclysm, as a result of 20 years of a negative natural growth rate. For example, the birth rate in 2009 was 10.7‰, while the death rate was 14.2 ‰.

The demographic picture during a comparatively longtime-frame – from the beginning of the 20<sup>th</sup> century until now, is even more catastrophic. For instance, in 1900 there were 130,000 marriages and 240,000 children born, while in 2009, marriages numbered only 25,923 and the children born were 80'956. Marriage and divorce statistics show that the marriage coefficient dropped from 4.4‰ in 2004 to 3.68‰ in 2009, and the divorce coefficient dropped from 1.61‰ to 1.56‰ for the same years.

Another worrisome fact is that more than 53% of the new-born Bulgarian children were born out of wedlock. This fact demon-

strates that public perceptions of the values of marriage have changed. In addition to the population statistics, the average age of male individuals going into a first marriage is 29.6 years, and of female individuals – 26.4 years; and the average marriage duration decreased to 14 consecutive years.

Therefore, the Bulgarian nation is slowly declining and the population is aging at faster rates, as compared with other European Union States. Moreover, the labour potential of the population is diminishing. Having in mind the negative demographic growth and the decline of the marriage rate, it is worth mentioning that the average life expectancy of a Bulgarian male is 69 years, while in the EU-27 this figure is 70.4 years; for females, the average is 76 years, compared to 78.7 years in the EU-27.

Demographic distortions in Bulgarian society led to significant structural problems for the labour market, as well. Both diminution in social mobility and increase in income inequalities, coupled with social tensions among different age generations, have become a central issue for public finances and mechanisms for distribution and re-distribution of public wealth and tax-burden.

Another dimension to consider in analyzing what has really changed in Bulgarian society is the economy. As the country is still in a process of transition from a command-administrative economy to a market-driven one, it has to be pointed out that the leading sector of the economy now is the services sector, which creates jobs for more than 70% of the labour force. However, this was not the case just a couple of decades ago. For example, in the 1950s the agricultural sector was adding 31.3% to the GDP of the country, the industrial sector 40.6%, and the services sector 28.1%<sup>52</sup>.

<sup>52</sup> National Statistical Yearbooks of Bulgaria /Statisticheski godishnitsi na Balgaria/ – selected years

The “Industrial Leap” of the country occurred in the 1960s and 1970s, when about two-thirds of the GDP of Bulgaria was a result of massive industrial production.

And hence, job positions, which were related to industrial and agricultural production, such as tractor-drivers, farmers, miners, builders, et cetera, during the time of “state socialism”, were far more promoted than jobs related to services, education, and science. The present pyramidal structure of incomes, generated by job occupations, which are financed through the state budget, remains essentially the way it used to be. Wage differentials between the highest and lowest wages in the public sector and the highest and lowest pensions distributed are not very significant. In addition to the lack of adequate wage differentials, the minimum wage and minimum level of pensions lag behind the inflation rate and do not even meet poverty criteria successfully.

For 2011 legislators set the minimal pension at 136 BGN (€ 68) per month, and the maximum pension at 700 BGN (€ 350). The present level of the so-called “poverty line” in the country (as of 2010; it is set to be the same for 2011) is 211 BGN per month (€ 105). Another important indicator for the national economy is the minimum wage, which is still defined by a command-administrative mechanism (The Council of Ministers issues a Decision for minimum monthly pay rate), and it is set at 240 BGN (€ 120) for 2010, and 2011. A recent discussion in the EU Parliament (October 2010) stating that the lowest possible minimum wage in a given country should be set at 60% of the average wage rate for that country, triggered much tension and disputes in Bulgaria. This rule would set the minimum wage in Bulgaria at about 360 BGN per month (€ 180), which is considered to be a “very high” wage by Bulgarian employers and the ruling Government.

In addition, since 1997, that is, since the introduction of the Currency Board, a policy of periodic “freezing” of wages in the public sector, social allowances, pensions, and other payments financed through the state budget is consistently followed. The argument, which is presented to the general public to justify such policies, is that incremental indexation of public expenditures will destroy both the financial and budgetary stability of the country. These neo-liberal innovative policies seem to be the main reason why Bulgaria occupies the very last position in the EU ranking in terms of levels of poverty and income disequilibrium.

Another reason for employment of such neo-liberal policies is that through the years all governments intentionally maintained wage rates low, believing this type of policy would create a true competitive advantage, which would strategically allow Bulgaria to perform better economically when compared with other Central and Eastern European countries. These particular specifics of the socio-economic transition explain why the trade-off issue of efficiency and equity in the Bulgarian case may not be interpreted through the prism of dominant concepts and criteria, which academic literature instructs to follow. And even in practical guides for building “prosperous societies” and “welfare states” in a United Europe, the policies do not serve these needs<sup>53</sup>.

The imported neo-liberal model in Bulgaria is not of an EU-type, and this is why the restrictions of the model for budgeting, and fiscal and monetary management do not include the trade-off idea in the setup. Instead, this trade-off is replaced with pre-set standardized criteria for efficiency evaluation. Standardized bonus-points for the efficiency of economic and social policies are rated by dependence on the macro parameters of the

<sup>53</sup> Nicholas Barr, *Economics of Welfare State*, Oxford University Press, 2004

country. For example, the lower the inflation rate, the higher the bonus-points for efficiency, or the lower state expenditures, the greater the bonus-points, and so on. Thus, this simplified framework for efficiency evaluation altered the very essence of the trade-off debate in Bulgaria. The very first thing, which needs to be done, is to conduct nationwide field research and then to build comparative analyses and answer different questions. One of the central questions to be researched is whether market fundamentalism was fruitful in strategic planning, in terms of bringing the country more competitive advantages in a globalized world; or was it just the contrary – whether the social gap between developed EU states and Bulgaria was preserved, widened or diminished. And the very three dimensions of the trade-off: incomes, employment, and education, seem to have a rather negative interpretation in the Bulgarian case.

The focal point of the analysis is founded on the comparison between two time periods: (a) the pre-accession period /from the mid 1990s to 01.01.2007, when Bulgaria became a full-fledged member of the EU/; and (b) post-accession – which, in fact, covers the very beginning of the economic crisis till now.

### **3.3.2. The Case for a Trade-Off in Social Policy**

Although strong social and egalitarian perceptions and policies used to prevail in Bulgaria, currently, that is no longer the case. Political considerations rather than economic and social criteria give a new impetus to the way social policies are elaborated and adopted in the public and private sectors of the country.

It has to be pointed out though, that there is a “National Council on Tripartite Cooperation”, which is meant to serve not only as a consulting body, but also as a decision-making one. During the last one to two years

this body for national social partnership was blamed by statesmen and analysts apparently attempting to construct a second centre of executive power.

Consequently, “the social partners”, who participate in this Council (representatives of the state, representatives of nationally recognized trade union organizations, and representatives of nationally recognized organizations of employers), should bear significant responsibilities for setting social targets and policies. However, it is understood that social and pension reforms at the dawn of the political changes in the early 1990s have already failed. In addition the national economy and the social sphere mismatch the country now is situated in a new locus – Bulgaria ought to abide by the stricter EU regulations and policies recommended by the International Financial Institutions (IFIs), which accrue a substantial monetary and fiscal burden for the population of the country.

The other institutional factor, which may seem, at first, to have an indirect impact on the country, is the IFI. However, in recent years, IFIs happen to have more direct impact than was expected. In Bulgaria, as it is the case with almost all states from South East Europe, the IMF and the World Bank imposed multi-annual projects aimed at social-engineering and transformation of national economies and social systems, driven by market mechanisms. It is reasonable, however, to look for whether the market mechanisms imposed in South East Europe are the same as those adopted in the developed EU states. And the only correct answer is that in the South East Europe region a very specific design of economic mechanisms was adopted, which may be considered as an ultra-neo-liberal model, which does not exist in the developed EU states<sup>54</sup>.

<sup>54</sup> Daniel G. Wogan-Whitehead, *EU Enlargement Versus Social Europe*, Edward Elgar, 2003

Simply said, it is not the European social model that is applied in the region of South East Europe, but the Anglo-Saxon one. And it was this Anglo-Saxon model (which had been tested in very many third-world countries and did not produce the expected results) that was presented as a benchmark for all post-socialist states to reform.

In Bulgaria, a network of lobbyists happen to provide active and in given cases aggressive support to the neo-liberal orthodoxy. This support includes involvement of (a) “institutes” for market analyses and strategies, designed particularly and financed by foreign funds, originating from Anglo-Saxon territories; (b) think-tank centres supported both by Bulgarian and foreign businesses; (c) opinion leaders and media, which take the position of market fundamentalism.

It must be recognized that all those who implemented the neo-liberal concepts onto Bulgarian soil, succeeded in their efforts. It is another issue, however, to detect and name the losers of the neo-liberal experiments. These losers happen to be the middle class, the working poor, and the remaining low-income groups in Bulgaria.

The “economic success” of Bulgaria, measured by the neo-liberal criteria for effectiveness may be seen in all dimensions of social policy: (1) low wages result in greater competitiveness; (2) low corporative taxes result in much freer capital for enterprises; (3) low social security charges result in more disposable income for individuals. Regrettably, what had been expected was not achieved, because: (1) competitiveness did not improve, but wages remained inadequately low; (2) free capital was not re-invested, but consumed in very many “prestigious” ways; (3) low social security charges happen to be among the lowest in all EU states and, virtually, ruined the social security system.

There is much accrual of costs in the ways social and pension reforms are conducted, as a result of the requirements, which Bulgaria must meet, in terms of introducing modern social facilities, modern social services, new technologies in the servicing sectors, new working modes and so on.

Recently, there was much discussion on when a re-start of the reforms would be announced; and it seems this re-start is delayed, in practice, for 2012, as the suggested new laws are expected to be adopted in 2011. In any case, changes in both the Labour Code and the Social Security Code must be initiated and implemented.

A modernized social security system requires a modernized Labour Code, and this seems to be one of the factors that frustrate many Bulgarians. Essentially, change in social security is a resultant of the change in labour laws.

Traditionally, Bulgarian workers are classified in three categories, according to different factors (complexity of job duties, work-under-stress, work in dangerous conditions, etc.). Workers in the third labour category prevail, as this is the category of labour duties, which least affects an individual’s life in a negative way. And the foreseen changes in the social security sector are initiated for this third category of workers, as the new law will stipulate the working period for legal retirement to be increased by four months each year. Thus, the total accrual of working years for an individual to reach the legal age of retirement, and, respectively, be entitled to a pension, must be 37 years for females, and 40 years for males; and, this target is set for 2020.

The budget of the country for 2011 is estimated at a GDP equal to 77 bn. BGN (€33.5 bn.), but the budget-2009 failed, and the budget-2010 was revised twice; hence, the popular belief is that this figure is quite unreachable, given the country is in a state of severe crisis. In addition to the official fore-

cast, there are some other estimates for the social sector. It is estimated that in 2011 there will be only 2,815,005 individuals who will pay social security taxes, and be considered as “socially secured”. And, statistically, security charges are estimated to be applied to an average monthly income of 610 BGN (€ 305).

The minimal income level, at which a citizen must pay his/her social security charges, is set at 240 BGN (€ 120), which is the minimal level for the labour pay rate per month. However, it must be underlined that the minimum gross wage of 240 BGN is subject to social security deductions and income taxes and, therefore, the minimum net wage comes to about 189 BGN (€ 95), that is, below the poverty line of € 105 set by the Government. Moreover, in very many outlying places of residence, as well as in small villages and towns, close to the borders of the country, there have been registered cases of 4-hour working shifts per day, which in practice means that the net income of some individuals is halved from € 95 to €48 per month.

Currently discussions focus on what type of pension plans and schemes should be applied, including whether a pension should be a result of both the length of the working period of an individual, and the size of the contribution to the social security system of the country, which is a very controversial idea in Bulgarian society. In Bulgarian society during the years of socialism there was no special social security fund established. Even today, the idea of having a specialized fund, which is deemed to pay higher pensions to those who contributed more, is not very much liked by the general public. In practice, to pay the pensions of this population of 2,2 million retired people, State officials must impose higher social security charges on the currently working individuals, as the monetary contributions of the elderly generation had never been deposited and managed into a single social fund.

Here is why, state officials seriously discuss another condition for a person to be entitled to receiving a pension – and it is the increase of the legal age for retirement. This age for females is planned to be increased to 63 years, and for males – to 65 years. The targets are set for 2026 for females, and 2024 for males. Thus, the monetary size of an individual’s pension would depend on three primary factors: (1) the period of working at which social contributions are made; (2) monetary size of the social contribution; (3) age of the individual.

The situation in the social security sector is actually worse; for no matter that the planned reforms may start as early as 2012, there will be still a large budgetary deficit in the National Fund “Pensions” until 2016, inclusive. Presently, this deficit is estimated at 2 bn. BGN (€ 1 bn.). In 2017, the balance sheet of this NF “Pensions” is estimated to equalize the in-flows and out-flows for executing pension plans with no continuing deficit. Basically, 2017 is considered to be the milestone year for the pension system of the country, given that the estimates today happen to be correct.

Although the country has adopted two main documents for social protection (1) the National Report on the Strategies for Social Protection and Social Inclusion of the Republic of Bulgaria- 2006-2008<sup>55</sup>, and (2) the National Report on Strategies for Social Protection and Social Inclusion 2008-2010<sup>56</sup>, it is the finances of the State, which will not allow these strategies to be executed properly.

For example, as a result of budget restrictions and limited funds for social protection, low-income families happen to be the most affected ones. A low-income family in Bulgaria is considered to be a family, which has

<sup>55</sup> National Report on The Strategies for Social Protection and Social Inclusion of the Republic of Bulgaria-2006-2008, /In English/, [http://www.mlsp.government.bg/en/docs/National\\_Report\\_SPSI\\_Final\\_EN.doc](http://www.mlsp.government.bg/en/docs/National_Report_SPSI_Final_EN.doc)

<sup>56</sup> National Report on Strategies for Social Protection and Social Inclusion-2008-2010, <http://www.mlsp.government.bg/en/docs/EN%20NSR%202008-2010.rar>

an income of less than 350 BGN (€ 175) per month per person. In order to provide social assistance to these people, in a situation of reduced budgets and limited funds, the statistics for December 2008 shows that there were 572,963 families whose income classifies them as socially disadvantaged. For this reason the State distributed to 844,522 children from these poor families, a monthly allowance of 35 BGN (€ 17,5) per month per child. In December 2009 the number of disadvantaged families grew to 584,635, and the number of children, who were entitled to a monthly allowance of €17.5 increased to 851,006<sup>57</sup>.

Virtually, the social security sector in Bulgaria at present is administratively (top-down) regulated and the principles of command-administrative decision-making and decision-imposition are still preserved. Personal or community involvement in the processes of planning, providing, and controlling social security processes, are totally eliminated, and the modes of the so-called “central-planning” way of doing things have been revitalized.

Official estimates for 2011 demonstrate that the Social Services Sector (which is commanded primarily by the Council of Ministers) will be entitled to 8.2 bn. BGN (€4.1 bn.), which equates to about 5.3% of the GDP of the country. A significant percentage of this amount – about 85%, will be paid out for pensions only. The remaining 15% will be distributed at the discretion of the Government on an as-needed and on-going basis.

The NF “Pensions” of the country (which is still called by the strange name “State Community Social Security Provision”) is estimated to accumulate 5,56 bn. BGN (€ 2.78 bn.) in 2011, but must pay out 6.7 bn. BGN (€ 3.35) for the very same year. Therefore, there will be some deficit of about 1.2 bn. BGN (€ 0.6 bn.). And for this deficit, it is as yet unclear

how it will be settled – by a subsidy from the National Budget of the country, by a credit-line from foreign institutions, by credits from the banking sector, by the issuance of state bonds and securities, or in some other ways.

In practice, the Social Services Sector in Bulgaria is primarily related to accumulating, managing, and paying-out cash-flows, incurred by the currently applied pension scheme. All other aspects of the social policies of the Government, such as policies to combat poverty, policies to de-institutionalize places for public care (to change command-administrative mechanisms to private management mechanisms), policies to “humanize” public care for disabled people (such as introducing special telephones, special institutions, special vehicles and other things, which might ease the way of living of socially deprived people), policies aimed at helping single-mother families, and other socially-oriented policies are delayed for the “bright future”.

As was stated earlier, changes in the Bulgarian tax code, initiated immediately after the country joined the EU and in the dawn of the economic crisis, aimed (1) for radical improvements of the competitive potential of the nation; (2) increased new in-flows of foreign investments; (3) the creation of incentives for national capital to turn into productive investments; (4) the creation of new jobs.

At first glance, a single tax rate of 10% on corporate profits and incomes of individuals (cancelling the minimum non-levied income level) had to serve as a fiscal warranty that all stated aims will be achieved. However, the actual data for the period 2007-2010 mismatched the estimates. For instance, for the period of 2009 and 2010 Foreign Direct Investments (FDIs) decreased a couple of times. Some analysts expect FDIs to drop from about €3 bn. in 2008 to about €1 bn. at the end of 2010. Both Bulgarian and foreign businesses limited (to the greatest possible minimum)

<sup>57</sup> Agency for Social Support, Annual Statistics, <http://www.asp.government.bg>



their investments in new production capacities, and retained the use of credits, sending capital abroad.

It was the middle class and low-income individuals, who were, in the main, burdened by tax collections in 2008, 2009 and 2010, according to fiscal statistics. Income inequalities worsened, as a result of the introduction of flat tax rates.

The political class and the so-called “new rich” will defend, for sure, all that was conquered in the transition period, building a new social and economic agenda for the country. In their agenda, tax privileges are for the rich, priority access to EU funds is for the big companies, and a limited re-distribution only of the national income to poorer social strata.

In summary, modification of the social pyramid in Bulgaria has already been completed. However, this was neither completed in accordance to the values and principles of the social market economy, nor focussed on the European traditions of social solidarity. Social policies in the country remain rudimentary, and they happen to have become a sub-domain of “strategically important” market-oriented reforms with no end. Finally, reforms in the health-care system, social security system, educational system, and other cornerstone systems, which normalize social justice in the country, seem to have more complementary importance in governmental strategies rather than to be of first priority for statesmen.

### **3.3.3. The Case for a Trade-Off in Employment Policy**

Employment policies were among the top governmental priorities before 1989. Being a command-administrative system the country utilized numerous “institutional measures” to create jobs and to “place” workers the way the then-ruling party considered being the

right one. Currently, these command-administrative mechanisms do not exist, as in a market economy ‘Employment-At-Will’ should prevail, and individuals should sign their labour contracts, guided primarily by their free will and interests.

In the days before the big political change in 1989 virtually all workers were members of the (affiliated to the) ruling party Trade Union, and the country had about 4 million workers (in 1988), all members of the Trade Union. In addition to that “the working class” was considered to be of a “proletarian kind” and to bring all progress to the country. Political propaganda, being synchronized with the Soviet labour propaganda, considered hard-workers the best productive part of the Bulgarian society. In those days, a University graduate in education, for example, could start his professional career as a teacher in mathematics, and was “entitled” to receive a monthly wage of 120 to 150 BGN, while a miner could easily start with more than 300 BGN.

Unlike the present day, where unemployment is considered to be a natural phenomenon of the market economy, in socialist Bulgaria unemployment did not exist, in exchange, there were employment surpluses and hidden unemployment. Being at a very low technological level, the country easily created many job positions, related to general labour as well as job positions, which did not require much skills and education. For the positions, which required formal education or special skills and knowledge, it was the principle of “appointment” utilized, and not the principle of “free competition”. And, in practice, when no private enterprise existed and private entrepreneurship was criminalized, it was the local party leader who decided whether an individual is not only capable of doing a job, but also loyal to the ruling party, so that the proper decision is taken, when decision-making is part of the job duties.

Another distortion of natural labour relations was the general view that social equality could be achieved only by equal incomes. Here is why, the system did not differentiate between the hard-workers and the “lazy” ones – all received equal pay. And having no monetary incentives for better performance at the working place, labour malpractices started to prevail. Having virtually no wage differentials in the national state-funded and state-administered economy Bulgarian society did not have many opportunities to benefit from the intellectual capacity of the nation. Job occupations in the service sector, and primary professions, which required specialized skills and knowledge, such as surgeons, lawyers, financial analysts, aviators, et cetera, were much undervalued (having in mind that private practice did not exist at that time).

Taking into consideration that wages for industrial job occupations, and job occupations in the agricultural sector were significantly greater than the pay rates for job occupations in the service sector, one could easily comprehend why now the country is the least developed state in the EU-27. And, in addition to the legacy of socialism, during the last 20 years of political and economic transformation a “market economy without the middle class<sup>58</sup>” was established in Bulgaria.

Analyzing the dynamics of employment after 1989, one could easily detect three periods: The first period relates to the industrial and sectoral re-structuring – from 1990 to 2001. During this period privatization of most of the big Bulgarian enterprises was completed. Privatization of enterprises on a smaller scale was also conducted. The private sector reached nearly 70% of the GDP of the country. The social result from this unprecedented transformation was the loss of more than 1 million job places, and mass unemployment of over 20% on an annual basis.

The second period encompasses the interval from 2001 to 2007, when Bulgaria demonstrated a stable and onward economic growth, which was due primarily to the greater speed of sectoral development, particularly due to the construction sector, the real estate sector, and trade and merchandize services. At this period the re-structuring of the labour market occurred – some sectors of the economy diminished their labour demand, while in other sectors new jobs were created. The Bulgarian labour market became more segmented than it was before; regional segmentation, sector segmentation, segmentation of physical and intellectual labour was induced. Thus, segmentation on the labour market created much unemployment, but this unemployment was primarily reduced in this second period by the higher rate of migrants, leaving the country.

In 2007 annual unemployment was near 6%, and some politicians and analysts took this as a sign of forthcoming stabilization and prosperity.

The third period is one of the economic crisis, when this crisis entered Bulgarian economic space with a lag of 6 to 10 months, depending on the region in the country, and the sector of the economy. The unemployment rate started to increase slowly, but steadily, and currently (October 2010), it is over 9%, which means that, statistically, the country has about 340,000 registered unemployed.

Although the EU initiated the so-called “Luxembourg Process” and placed the framework of the European Employment Strategy (EES) in 1997<sup>59</sup>, there is not much evidence that Bulgaria gets the full advantage from following the already established EU principles of managing the processes in the labour market. The very first attempts to modernize, which occurred on the labour market in Bulgaria, were made in 2003, when the Govern-

<sup>58</sup> Mitev P-E, 2002, Popularity of Hadzhiuski, Publishing House: LIK, p.11

<sup>59</sup> Employment Summit, [http://ec.europa.eu/employment\\_social/elm/summit/en/](http://ec.europa.eu/employment_social/elm/summit/en/)

ment approved the so-called “National Action Plan for Employment” (NAPE). Since that year the Council of Ministers of Bulgaria approves new measures and policies to stimulate employment through governmental subsidies.

In 2007 these governmental subsidies were budgeted at 190 mil. BGN (€ 95 mil.), in 2008 were budgeted at 197 mil. BGN (€ 100 mil.), and in 2009 the subsidy was set again at € 100 mil.

Recent labour market statistics for the first half of 2009 shows that the number of individuals employed in the industry sector is 1,177,900 (or about 36% of all employed), while the number of employed in the services sector is 1,873,100 individuals (or about 57% of all employed). The rest 7% of all employed (or 230 thousand individuals) occupy jobs in the agricultural sector.

The philosophy of the employment policy in NAPE-2010 is to combat the negative consequences of the economic crisis on the labour market. Employment policy is targeted at the secondary labour market, where the state provides monthly subsidies for the creation of jobs. For each unemployed individual, who gets a job through the secondary labour market, the monthly payment is set at 240 BGN (€ 120), or at the minimum monthly wage level.

NAPE-2010 also stimulates employment of young College and University graduates through a special programme, called “Start a Career”; the state subsidy for such an individual is budgeted at 400 BGN (€ 200) per month. There are some other programmes to stimulate employment, such as “Support Maternity Programme”, for instance, where an individual would get a subsidy of 350 BGN (€ 175) per month, if being employed. There are also subsidies for disabled individuals to reintegrate on the labour market, which are set at 350 BGN (€ 175).

In NAPE-2010 the state has budgeted additional subsidies for education of the unemployed, where the state subsidy per unemployed is set at 600 BGN (€ 300) per month. For educational purposes for the employed, the state subsidy is set at 300 BGN (€ 150) per month.

There are already summaries released of The National Reform Programme of Bulgaria 2007-2009<sup>60</sup>, the Report<sup>61</sup> for Year-2007, and the Commission’s Assessment<sup>62</sup>. The reports of the rest of the members of the EU-27, have also been published<sup>63</sup> and comparisons between the state of labour in Bulgaria and in the rest EU states may be conducted.

Considering the recent data for the labour market in Bulgaria during the first quarter of 2010 (Q1/2010)<sup>64</sup>, the statistics show the following trend.

Individuals, who are not included in the workforce are 1,744 thousand (age group 15-64), while individuals, who compose the workforce of the country number 3,308 thousand (age group 15-64). Although official statistics counts the children in the age group 15 to 18 as “capable of working”, it is not the case with Bulgaria, as the General Inspection of Labour must have the permission of parents/guardians and then authorize the labour contracts of such minors at nominated preferable working conditions. It is a general practice, however, for these minors to work illegally, or not to work at all, although the national statistics considers them “capable of working”.

<sup>60</sup> Summary of the National Reform Program of Bulgaria 2007-2009, [http://www.aeaf.minfin.bg/en/documents/NRP/summary\\_en.pdf](http://www.aeaf.minfin.bg/en/documents/NRP/summary_en.pdf)

<sup>61</sup> Progress Report on the National Reform Program 2007-2009, [http://www.aeaf.minfin.bg/en/documents/NRP/progress\\_report\\_en\\_2007.pdf](http://www.aeaf.minfin.bg/en/documents/NRP/progress_report_en_2007.pdf)

<sup>62</sup> The Commission’s Assessment of the National Reform Program 2007-2009, [http://ec.europa.eu/growthandjobs/pdf/european-dimension-200712-annual-progress-report/200712-annual-progress-report-BG\\_en.pdf](http://ec.europa.eu/growthandjobs/pdf/european-dimension-200712-annual-progress-report/200712-annual-progress-report-BG_en.pdf)

<sup>63</sup> Implementation Reports of EU-27 on their National Reform Programs related to the Labor Market, [http://ec.europa.eu/growthandjobs/national-dimension/member-states-autumn-2007-reports/index\\_en.htm](http://ec.europa.eu/growthandjobs/national-dimension/member-states-autumn-2007-reports/index_en.htm)

<sup>64</sup> National Statistics Institute of Bulgaria, [www.nsi.bg/EPDOCS/RabSila2010q1.pdf](http://www.nsi.bg/EPDOCS/RabSila2010q1.pdf)

Another important issue on the labour market is that the workforce of the State is composed of the employed – 2,969,000, and the unemployed – 339,000. Of all the employed, the national statistics considers the category of “employers”, as of “working status” and this category gets about 4% of the total employment of the country. There are 1% to 2% “non-paid family workers” in total employment. There is another statistical difference here between Bulgaria and Eurostat. Eurostat considers this category of workers as “family workers”, while Bulgarian statistics considers them “non-paid family workers”. The third category of workers, according to “working status” is the category of self-employed, which consists of about 7% to 8% of the total number of the employed. Hence, the fourth largest group, according to working status, becomes the group of “employed workers” (“the working class” concept is still widely used in the country), which varies between 85% and 88%. And, therefore, statistically, in Q1/2010, the total number of “employed workers” approximated to 2.6 mio individuals.

Of all “employed workers” in the Bulgarian economy in 2009 the greatest share of employed individuals – 24.6%, are involved in the processing industry; the second largest share is those, who are employed in trade – 16%; the third largest sector – of about 9.8%, is assigned to those who are employed in the construction sector. And the next sectors of the economy with similar percentages of employment are: education sector – 6.9%, transportation & logistics sector – 6%, state governance – 5.2%, medical and social services – 5.1%, hotels & restaurants – 4%, and others.

Sectors of the national economy, which involve much intellectual capital, such as the IT, financial, and real estate sectors, have the following employment share – 2.4%, 2.2%, and 1%, correspondingly.

Although about two-thirds of the GDP of the country is due to the services sector nowadays, the economy is at very low technological level, and it is still believed that market competitiveness is primarily due to the lowcost of labour. This is why, the economy of Bulgaria is more labour-intensive, coupled with a comparatively low level of productivity. Manufactured goods are not competitive at all, and services provided are of very low quality and unreasonably priced. Beside the structural problems of the economy, there is another more significant problem. The working style of an average Bulgarian worker may be described as “not very well thought of type of work; a badly started job; no decision-making rationale; a half-done job”<sup>65</sup>.

Another intrinsic problem on the labour market is the perception of the owners of capital and their “appointed” managers that the only right human management strategy is the strategy of “the carrot and the stick” without the carrot. Numerous are the managers, who believe that only an authoritarian style of management will help them achieve the goals set. However, the greater percentage of present managers does not have the necessary management skills and knowledge to motivate their employees to work more productively. And the research suggests that Bulgarian employees are among the most unmotivated workers in the world<sup>66</sup>.

Although the EU aims at introducing fair labour standards and practices (in a series of EU Directives and EU Reports), this framework of fairness in labour relations meets strong opposition from many Bulgarians. Put simply, the parties involved in a contractual relation for labour do not share similar values. As monetary relations now prevail in the Bul-

<sup>65</sup> Mitev P-E, 2002, Popularity of Hadzhiuski, Publishing House: LIK, p.14

<sup>66</sup> Research of Taylor Nelson Sofres, published in newspaper “Dnevnik” of 26.11.2002.

garian economy, most employers and workers compute their well-being on the basis of costs and incomes. And most employers, believing that reducing labour costs will give them competitive advantages on the market have reduced pay-rates of workers to almost the survival minimum.

There are some estimates from one of the Bulgarian trade unions, which show that about 400,000 workers get the minimum gross wage of € 120 (net €45); and the average gross pay rate in the economy is € 300 (net € 230), while the living standard is estimated at € 250 per month.

The central problem for the employment policies of all Governments is that they introduced and followed too liberal a course of actions, bearing in mind economic rationality, and leaving aside the real social dialogue, and balance of interests. Even though certain legal steps were initiated to modernize and adapt employment policies in the country (such as introducing the Law for Employment Promotion (LEP)<sup>67</sup> in 2002, for example), there is little evidence that actual state policies on the labour market help people find better and well paid jobs.

Considering the state of economic and financial crisis, which lowered the living standard of most Bulgarians, more and more workers consider labour migration within the EU as the primary work-and-life option to level up their standard of living, their well-being, and to satisfy their needs and consumption preferences.

Surely, Bulgaria offers some other options to its labour force, such as self-employment, or employment in the shadow (unregistered) economy.

Unregistered employment was viewed by the common workers, initially, as an economic crime, but rates of unregistered employment,

although statistically undetected, happen to increase in time. This phenomenon can be explained by the series of economic “shocks”, which the country has had to survive. Since the first “shock wave” of the privatization of Bulgarian enterprises, followed by intentional restructuring of the sectors of the Bulgarian industry, the average worker started to change his opinion about occupying a job in the informal sector. The informal sector, and respectively, informal employment, turned into a safe economic zone for irresponsible entrepreneurship, labour malpractices, tax evasion and other economic and financial misdeeds, but surely, it was a zone where free capital was available to all involved.

Although statistically undetected, some analysts believe that the unregistered employed composed 30% to 35% of the labour force of the country. The country initiated some administrative and legislative measures to prevent this process.

Recent research, conducted by the Bulgarian Industrial Capital Association (BICA)<sup>68</sup> in 2010 demonstrated that 48% of businessmen interviewed and 52% of individuals interviewed firmly believe that the share of shadow economy in Bulgaria is significantly large – larger than 38%.

The other category on the labour market – the self-employed, initially composed 3%-4% of the labour force of the country, while now their share is stabilized at about 8%. Having in mind that the total labour force of Bulgaria for the first quarter of 2010 is about 3 million, the share of self-employed individuals is then about 240,000 individuals. This figure is really huge by Bulgarian standards, as it is almost similar to discouraged workers, which totalled 227,000 individuals (age group 15-64, Q1/2010).

<sup>67</sup> Law for Employment Promotion, 2002, In English, [http://www.bcnl.org/doc\\_en.php?DID=307](http://www.bcnl.org/doc_en.php?DID=307), information checked on 01.04.2009

<sup>68</sup> The Bulgarian Association of Industrial Capital /BICA/, <http://www.bica-bg.org>

Therefore, since the very moment of accession of Bulgaria to the EU, individuals who departed their job occupations as workers, and tried to establish their own micro-businesses increased; and now these individuals compose a very significant segment of the Bulgarian labour market. Although it is challenging to establish a successfully operated business in Bulgaria, many people demonstrated, indeed, a real spirit of entrepreneurship, which is expected to increase in the near future if the present trends of enlargement of this labour segment are preserved.

### 3.3.4. The Case for a Trade-Off in Education

For any modern State education plays a central role in the economic growth of the country and for the well-being of its citizens. Recent research in 2007 and 2008 shows that in Bulgaria the share of employed in the private sector, who have a degree from an institution of higher education is about 25% to 27% from all those employed in the private sector; while for the public sector employed individuals who have a higher education degree compose about 75% to 80% of all employed in the public sector<sup>69</sup>.

The services sector accumulates about 72% of all the employed in the country at present (Q1/2010), and this sector also demonstrates a very dynamic growth. Distribution of the employed by educational degree varies from year to year, but in any case employed individuals who have completed college or a university (tertiary education) compose about 25% of all the employed in the country. Individuals who have just a high school diploma (secondary education) consist of about 60%

of all the employed in Bulgaria and the remaining percentages about 15% refer to individuals who have primary or no education. Therefore, the national economy is endowed with much low-skilled and low-qualified labour. Labour-intensive processes are related to really low costs of production – about 1.5 to 2 BGN (€ 0.80 to € 1) per working hour. And as most employers follow the classical rule of wage formation where wage should be equalized to the marginal product of labour, low salary and wage levels prevail in the national economy.

As a result of the low costs of labour, there are low wage levels, and hence, less intensive private consumption. Low wages do not induce consumption processes intensive enough to stimulate businesses to produce more – and a vicious circle is created: low wages – low consumption, low consumption – low production, low production – low market, low market – low sales, low sales – low wages, and the circle starts again. And, consequently, the percentage of unemployed individuals, who have a higher education degree, varies between 5% and 8% from all unemployed, while unemployed who have completed secondary education compose about 50% of all unemployed, and the remaining percentages relate to individuals who have lower or no education.

In the early 90s there were no private educational institutions, while for the academic year 2009/2010, the country has 43 Universities, 42 Colleges and 23 specialized schools of higher education. Therefore, there are at present 108 institutions, which provide, in one way or another, higher educational services to the general public. This growth of educational institutions is paralleled with an intensive process of college enrolment. For example, for the academic year 2000/2001 the net enrolment coefficient of the population at age group 19-23 is 26%, while in the

<sup>69</sup> Collected Works, 2010, In Bulgarian: "Konkurentni pozicii na universitetite i vishite uchilishta na pazara na truda v Bulgaria" / Competitive Positions of the Universities and Schools of Higher Education on the Labor Market in Bulgaria/, Publishing House of the University of Plovdiv, p.20

academic year 2009/2010 this net enrolment coefficient for the same age group is 41.1%<sup>70</sup>.

Currently, the number of all enrolled students in Bulgarian Colleges and Universities for the academic year 2009/2010 totals 287,086, and about 95% of all these enrolled students are of Bulgarian origin. As of January 2010 Bulgaria has 3,850 students, enrolled in PhD programmes.

In 2009 in Bulgaria, according to statistical data, there were 69,302 high school graduates and 57,803 college and/or university graduates.

The growth of educational institutions and student enrolment, particularly in the tertiary system of education in the country is due primarily to the fact that educational services provided by the institutions of higher education happen to provide more monetary benefits for all graduates, unlike the way it was before.

Employers recruiting a labour force on the labour market now value to a different extent the acquired educational knowledge, skills, and experience of individuals. Thus, wage differentiation started to appear as a natural phenomenon on the Bulgarian labour market, although these wage differentials are not yet very significant.

For example, the average gross monthly wage in March 2010 in the national economy was 636 BGN (€ 318)<sup>71</sup>, while for the first quarter of 2010 – Q1/2010, it is 619 BGN (€ 309). Using these figures for benchmarks for the national economy, it is easy to see from the national statistics that the average gross salary for Q1/2010 for the Transportation and Storage Sector of the economy was 679 BGN (€ 340). Employers from this sector traditionally employ individuals with secondary education, not with tertiary education. And for Q1/2010 in the sector of Medical & Social Services the average gross monthly salary was

672 BGN (€ 336). The very same low salary level relates to the sector of Education Services, where this average gross monthly salary for the same quarter was 647 BGN (€ 323). In the Extraction Industry, which demands more low-skill and low-qualified labour than the Real Estate Sector, for example, the gross average monthly salary was 987 BGN (€ 494), while in the Real Estate Sector this salary was 708 BGN (€ 354) for Q1/2010.

Obviously, in many cases in the national economy low-skilled labour is priced as high as high-skilled labour or even higher. The idea of socialism that all people should be equal, which was taken to mean all people to have equal incomes, is still alive in Bulgarian society. The very low technological level of the industries of the Bulgarian economy creates more jobs for low-skilled and low-educated individuals. Thus, highly educated individuals, and individuals who have specific knowledge and skills happen to be less in demand on the labour market, and in very many cases they accept job positions, which do not correspond to their high professional status.

As there are not very many jobs created for highly-educated individuals, many of them try to search for job opportunities outside the national labour market and particularly in EU countries. However, although Bulgaria is considered a full-member of this Union, there are still strong barriers for high-skilled work migration within the EU for educated Bulgarians.

Strangely, the EU seems to have set a double-standard for treating work migration originating from countries such as Bulgaria, and other less developed countries in the EU. It indeed liberalized the segment of the labour market, which demands low-skilled workers, such as builders, pizza-delivery boys, errand-boys, or said in slang – liberalized competition for McDonald's jobs. Some states of the Union, however, did not fully liberalize those segments of their labour markets, which require

<sup>70</sup> National Statistics Institute of Bulgaria, [www.nsi.bg](http://www.nsi.bg)

<sup>71</sup> National Statistics Institute of Bulgaria, <http://www.nsi.bg/EP-DOCS/EmplsSalary10q1.pdf>

intellectual capital. And surely, individuals of Bulgarian origin, who have more intellectual capital, would ask for higher pay rates, when searching for jobs in a developed EU state.

At times, when the EU Parliament discusses the introduction of the “Blue Card” for intellectuals from China, India, Brazil, and other countries, it is the very citizens of this Union (Bulgarians in this particular case), who pay taxes and thus, finance the EU’s Treasury, but get no advantage on the EU labour market. And the country is still excluded from the Schengen territories of the EU, and is outside of the monetary union.

But despite certain barriers on the EU labour market for educated and high-skilled Bulgarians, there is much evidence that Bulgaria faces a severe brain-drain. Simply said, educated Bulgarians depart their jobs in the national economy with an average monthly salary of €300 and search for whatever job positions they may find in developed EU states. And this is, surely, a process of indirect financing from poor Bulgaria to the richer states of the EU.

An issue to be especially considered is the very sharp increase in educated migrants leaving Bulgaria and heading to the more developed EU states, the US, as well as some new labour destinations, such as Canada, Australia, New Zealand, or South-East Asia. And in recent years these migration patterns shifted significantly. Alongside those, who were looking for permanent job opportunities abroad, the category of young individuals and students was added. For example, in Germany the Bulgarian students are the second largest group after the Chinese.

Some analysts are already alarmed by systematic attempts of the developed states of the EU to attract individuals, who have acquired intellectual capacity and skills in their countries of origin, through provision of fee-waivers for studying, monthly allowances, or

even free-of-charge higher education (some Scandinavian states).

As a result of the labour market distortions in the national economy, not only is the economic growth of the country endangered, but so is the intellectual endowment of Bulgaria.

The problem for Bulgaria in terms of education is, that initially a unilateral educational reform was started, administered by three Bulgarian governments in turn with the active assistance of the World Bank. The unilateral character of the educational reform was to change the profile and the number of educational institutions in accordance with selected fiscal and monetary criteria. Thus, some savings in the national budget were reached in various years, indeed, at the expense, however, of the limited budget for educational institutions in the country.

Finally, the outcome has been reached: in 2011, for the first time in its modern development Bulgaria is about to spend only 3.3% of its GDP for education and science. This figure is two to three times less than the the spending by the rest of the EU member states. Setting monetary and financial goals to achieve in the educational sector, mainly through massive cost-cuts, the access to educational services was strongly reduced and the quality of education was severely affected. Due to the austere administrative and financial restrictions, officially, the school drop-out rate now reached 15%, and for the Roma minority group this figure is above 50%<sup>72</sup>.

Sluggish labour markets’ integration between developed and developing states of the EU emits controversial signals to the general public and the ordinary citizen. There is no doubt that Bulgarian citizens do correlate their EU citizenship with higher wage levels and standards of living, but this correlation seems to be rather media-fuelled than real.

<sup>72</sup> Nikolay Tilkidzhiev, “Otpadashtite Romi”, Publishing House “Iztok/Zapad”, 2010



### 3.3.5. Conclusions

In conclusion, it could be stated that the trade-off between efficiency and equity in Bulgaria may have only one strategically and politically correct solution. This solution should totally alter the wrongly-set model of socio-economic transition. The new model should adopt pro-EU approaches supported by EU decisions in the spheres of social politics, employment and education. More specifically, the country needs to establish new conditions, by which the European social model and EU set of values must be adopted, accordingly. In this radical way Bulgaria's priorities will set an EU-style of decision-making and resource-allocation as a norm for political and business behaviour. In order for change to happen, the following combination of events should occur:

(1) Bulgaria must disassemble the neo-liberal model, which defines, presently, the policies in the educational sector, in the employment sector, and in the incomes sector. This neo-liberal model must be altered through transfers and infusion of such type of decision-making processes and procedures, which have passed the test of time in the developed EU states. For example, the dogma for low wages as a pre-condition for establishment of competitive economy must be totally abolished. The idea has to be introduced that, to have a sustainable growth in economy, a country should have higher productivity rates and quality of labour, which must be adequately financed. This type of employment policy may be initiated by the State, and national consensus on setting higher pay-rates should be achieved. Businessmen and opinion leaders should be much more involved in popularizing the idea of decent incomes, and a decent life for working individuals. Work should not be a mode of survival, as is the reality for numerous workers at present, but a value, and a way to legally achieve a de-

cent standard of life. And, most importantly, greater social and labour demands should be set year after year, so that Bulgarians could reach the standard of living, which individuals from the rest of the EU states enjoy.

(2) The EU must revise its strategy and criteria, which it applies to value social effectiveness and social equality in Bulgaria and in other member states of the EU. It has been proven that national governments should not be left alone, particularly in times of crisis. The EU should not allow national governments to be misled by models, which produce short-term or questionable effects, or models, which have never been tested elsewhere. Said straightforwardly, social policy cannot be proclaimed as the domain of national sovereignty, when drastic differences exist among the member states of the EU. In cases of obvious failures of economic and financial performance of a state (the Greek case, for instance), or in cases of the availability of a plethora of evidence that social regression induces crime, corruption, bribery, usury etc. the EU must have a direct hands-on approach.

(3) The big issue for Bulgaria and most of the states from South East Europe is that these countries provided full access to the International Financial Institutions (IFIs) to their national databases and critical information, so that these institutions may suggest economic and social reforms. For example, the IMF and the World Bank return in Bulgaria, having left the country once, after a period of over 15 years of supervision. And, their return is again coupled with the very same austerity measures and programmes, and decisions, full of conditionalities, similar to those imposed during the pre-crisis period. To prevent proliferation of this phenomenon, it is high time that the EU starts playing a more pivotal role through setting the economic, political, and social agenda in the less developed Member-states of the Union.

### 3.4. Croatia: A Paradise Lost

*Predrag Bejakovic*

#### Abstract

Absolute poverty in Croatia is low, but this diagnosis is only deceptively consolatory. Poverty in Croatia is characterized by stagnancy - those who become poor take a great deal of time to escape from indigence. In Croatia many people are unemployed and/or with low employability and are seriously exposed to economic poverty and social exclusion. Work is widely regarded as the best form of welfare, so increasing the employment rate has become a key objective of social as well as of labour market policy. For most people unemployment is a dynamic transitional state but for some it becomes a wearisome constant companion. This is especially true in Croatia where a large proportion of able-bodied welfare recipients are very long-term unemployed. The effects are damaging and costly.

As a mean to ensure equity and efficiency in social policy, the task is to reduce both the flows into long-term unemployment and the stock of people already out of work for more than a year, primarily by improving their employability. The problems faced by many of the long term jobless are often multi-dimensional and frequently include low levels of education and of motivation. Croatia has a range of active and passive measures to assist the unemployed. To be more effective, these measures should be adjusted and carefully targeted through social planning and the systematic analysis and evaluation of policy outcomes.

#### 3.4.1. Introduction

Croatia is a relatively small country in South-Eastern Europe, surrounded by Slovenia, Hungary, Serbia, Montenegro, Bosnia and Herzegovina and (sea border) Italy. According to the 2001 Census Croatia has about 4.4 million inhabitants. The capital is Zagreb with 780 thousand inhabitants. Recent Croatian history has been almost completely defined by three political factors: the fall of communism (the first free elections in 1990), the declaration of independence from Yugoslavia (1991), and the War of Independence (which started in 1991 and ended in 1995, when Croatia regained much of its occupied territories by military force). The aggression over Croatia in the early 1990's and the transition to a market economy have strongly affected the economic, as well as the social situation in the country. One third of Croatian territory remained occupied until 1995, while Gross Domestic

Product shrank up to 1993 to less than 60 percent of 1990 levels. The living standard fell significantly due to hyperinflation, destruction of household assets and growing unemployment; transitional problems coupled with war-related problems meant the country experienced a slower democratisation process than many other post-communist countries. Croatia became a member of the Council of Europe in 1996 and established its relations with the EU by signing the Stabilisation and Association Agreement in 2001. It was granted candidate status in 2004 and the negotiation process with the EU began in October 2005 after Croatia met all preconditions. However, due to limited Croatian cooperation with the International tribunal in Den Haag, negotiations for full EU membership are still not finished, and will probably not be completed till the year 2011. In the following text we will analyse the trade-off for Croatian social policy, labour market and education.

### 3.4.2. The Case for a Trade-Off in Social Policy

It is almost unnecessary to recall that poverty is multidimensional. It is complex, institutionally embedded, and also a gender- and location-specific phenomenon. Usually, in households, children and women suffer more than men. Poverty is the result of a complex interaction between policies and institutions in the economic and the political spheres. Knowledge of the incidence and scope of poverty in Croatia was very limited until the analytical work on poverty and vulnerability carried out by the World Bank (2001) in collaboration with the Government became available. The analysis was based on the first post-war household expenditure survey in Croatia, carried out by the Croatian Bureau of Statistics in 1998. Results showed that poverty in Croatia is relatively low, i.e., lower than in most transition economies in the region (except for Slovenia). Only four percent of the population lived on less than US\$4.30 a day at PPP (*internationally comparable* standard across transition economies), and about 10 percent lived on less than US\$5.30 a day, which the study suggested as an appropriate absolute poverty line for Croatia.

While absolute poverty in Croatia is low, this diagnosis is only deceptively consolatory. Poverty in Croatia is characterized by stagnancy - those who become poor take a great deal of time to escape from indigence (World Bank, 2001). There are several dominant groups of poor: the unemployed and inactive persons, the poorly educated, and the elderly. Although the unemployed and the inactive groups represent a relatively small share of the poor population in Croatia (2.9% and 5.4%, respectively), they are most exposed to poverty, while employment is a fairly reliable protection. Almost three-quarters of the poor live in families whose head completed primary education at most. These individuals are likely to have little

prospect of finding work if they are not employed, or to have low earnings if they are. The risk of poverty is particularly high when poor education is combined with unemployment. Those living in households with unemployed or inactive household heads are around 3 times more likely to be poor than the population as a whole. Thus, poverty in Croatia - having become much like poverty in Western Europe - is highly correlated with the situation in the formal labour market and the skills of individuals (Grootaert and Braithwaite, 1998). Also, the elderly, especially those without pensions, make up a significant part of the poor.

In the last few years poverty has mostly stagnated or slightly increased. The at-risk-of-poverty rate in 2008 was identical to the one in 2007 (17.4%), but the relative at-risk-of-poverty gap increased from 21.9% in 2007 to 24.9% in 2008. Of all age groups, only the oldest age group (65+) had an at-risk-of-poverty rate above the national average, and in this age group the difference between the rates of men and women was the biggest. In 2008, in comparison with 2007, the at-risk-of-poverty rates with the highest growth were those of single households and single-parent families (in other types of households the at-risk-of-poverty rate was mostly reduced or remained the same). Relative poverty data and indicators for 2009 are not yet available. The World Bank analyses and simulations show that poverty grew during 2009. It is estimated that the 2009 absolute poverty rate grew by 35%, or by 3 to 4 percentage points in comparison with 2008, when it was approximately 10%.

There is currently a concern that social care services in Croatia are not necessarily targeted to those most in need. Despite the high percentage of social transfers in GDP (around 25%), Croatia has achieved little redistribution. This is because most social spending programmes are relatively poorly targeted, while the relatively well-targeted programmes are fragmented and

account for a small portion of total social spending. The benefits in programmes where the majority of social expenditure is spent (primary pensions and health insurance) are relatively badly targeted, while programmes that use a smaller part of social expenditures (such as rights in the welfare system and unemployment benefit) are better directed towards the poor.

Furthermore, residential care is the predominant form of care provided by the Croatian social welfare system. Not enough attention has been dedicated to deinstitutionalisation and half-day or day-care centres and provision of services in the user's home. However, in the last few years, particularly in 2009, there has been some modest progress in terms of the deinstitutionalisation of people who are already placed in institutions. Nevertheless, this is a longer-term process on which intense efforts are concentrated. Thus, in 2009 as many as 70% of surveyed social welfare homes and 74% Centres for Social Welfare undertook activities aimed at reducing the number of beneficiaries in permanent institutional accommodation, 61% of homes (36/60) have organised the provision of non-institutional services, whereas 53% of them in the last year expanded the range of such services, with homes for disabled children, youth and adults taking the lead. One-fifth of the surveyed homes (12/60) have special posts for non-institutional services (The Ministry of Health and Social Welfare, 2010).

The key obstacles for deinstitutionalisation from the point of view of the service providers (social welfare institutions) include a lack of earmarked financing of the transformation, an insufficient degree of development of relevant services in the communities, a shortage of operational guidelines for the transformation of institutions, a lack of integration services in education institutions and inadequate rules and standards for the modernisation of institutions. These five most distinct obstacles can be

removed relatively quickly through the development of a network of priority social services. That can be achieved by social planning and financial support for the provision of services in communities by the Ministry of Health and Social welfare and the counties, but also through a parallel, systemic promotion of the transformation of institutions on the basis of the action plan currently under preparation.

The perspective of the transformation of institutions into a resource centre in the community or region, exclusively for non-institutional services, is a preferred option by the majority of stakeholders - institutions, particularly by homes for disabled persons and mentally-ill adult persons, as well as users. Some institutions proposed another form of operation, with the focus on a combined provision (mix) of institutional and non-institutional services, with services of accommodation and permanent care targeting long-term or palliative care.

Succinctly, we might recall that the characteristics of the poor in Croatia are very similar to those of the deprived population in other transitional countries in Central and South East Europe, and are mostly determined by education, the number of income earners, and employment status. There are several dominant groups among the poor, primarily the unemployed and inactive persons, as well as older people without pension rights. The economic growth in Croatia has failed to generate enough economic opportunities for the poor, and they are at a disadvantage with respect to benefiting from these opportunities.

From the standpoint of trade-off between equity and efficiency sometimes the impression is created that if only more funds became available for such measures, poverty could be eradicated in no time. We would regard it as much more appropriate for transitional countries like Croatia to invest in the "quality" of social policy rather than in quantity. There is clearly a strong association among poverty,

education, employability and long-term unemployment. Employment is the best protection against poverty and social exclusion. Also, paid jobs from home enable social integration and the realisation of full citizenship. People, who earn, participate more easily in social, political, even sporting activities. There is not enough work for all, to a certain extent because a part of the population does not have the knowledge and skills sought by employers. Thus, in the subsequent text, attention is dedicated to the analysis of the trade-off between equity and efficiency in employment policy.

### 3.4.3. The Case for a Trade-Off in Employment Policy

Croatia, like many other of the Central and Eastern Europe countries (CEECs), in the past 20 years was characterized by U-shaped trends in GDP, strong and persistent declines in employment rates and stagnation of unemployment pools in spite of the rapid structural change taking place. In Croatia there has been a remarkable increase in unemployment (more than threefold - from 123,000 in 1986 to 380,000 in 2001), and henceforth a decline until the second half of 2008. That was not accompanied by adequate scientific and political attempts to understand the causes of the rise in unemployment that took place, or by proposals for the reduction of unemployment and improving the transfer from unemployment to employment.

A relatively new and important area of research is the *political economy* of unemployment and employment policy (Calmfors and Holmlund, 2000). The key idea in this strand of research is that persistent unemployment may be explained by political mechanisms that prevent labour-market reforms. A successful strategy to fight unemployment must, according to this view, also recognize the prevailing political restrictions and offer proposals that can overcome

them. Most of the time the labour market is not perfect, unemployment and open demand co-exist. This implies that, particularly in countries like Croatia with high current unemployment, there is room for the improved functioning of the labour market by bringing unemployment nearer to the minimum of labour demand and supply, thus reducing both unemployment and vacancies. Research on unemployment around the world has identified a number of plausible determinants of unemployment situations and rates. Among others, these factors include: employment protection regulation, unemployment insurance, active labour-market policies, product market competition, taxes, systems of wage bargaining, working time, etc.

The inflexibility of the Croatian labour market was reflected in a high value of the composite index of the strictness of employment protection legislation (EPL) developed by OECD. The EPL index is calculated as a weighted average of 22 indicators that quantify different procedures, costs, limitations and terms related to the cancellation of the employment contract. Croatia was assessed by some researchers (Biondić et al., 2002) as among the strictest in Europe. When compared to other countries, Croatia had the second highest value of the index (3.6), which was significantly higher than the OECD average (2.0), EU countries (2.4) and the transition countries for which data exists (2.2). All these factors led to the Labour Code changes in 2003. Current reform has detached Croatia from the group of countries with the most protective EPL index – yet, it remains among the most protected transitional labour markets (Matkovic and Biondic, 2003).

In the Croatian labour market, and in the regulation of labour relations, much greater attention is devoted to maintaining existing jobs than to the creation of new employment opportunities. Legislative solutions and political figures in Croatia have been more inclined to extend the lives of unprofitable firms in-

stead of stimulating the creation of new and sound businesses. This persistent, and exaggerated, maintenance of current employment produces the diametrically opposite result from that desired, and the uncompetitiveness and inflexibility of the labour market have resulted in a reduction of the number of existing jobs, and at the same time restricted the space for new employment. Thus, there is a polarisation of society into the relatively safe (though, with respect to the cost of living, underpaid) employed (the insiders) and the unemployed (the outsiders), a very considerable number of whom are long-term unemployed with very slight chances and likelihood of finding work. This shows a total failure to understand (or even to know) the trends towards greater flexibility that mark both the global and the regional EU economy, in which the emphasis is not upon saving jobs, but on creating the conditions for employability.

Labour market data indicate that rising unemployment has mostly hit first-time job seekers, particularly those with a secondary education. This suggests that unemployment is predominantly the result not of economic restructuring but, rather, of the countries' inability to create jobs fast enough to accommodate new entrants into the labour force. It may also reflect the willingness of educated youths to wait for jobs in the formal and public sectors to open up and to register themselves as unemployed in the interim, as well as the educational system's failure to provide its students with the kinds of skills needed for private sector jobs.

A particular problem is long-term unemployment - more than half of the unemployed are waiting for a job for longer than a year, while one third is waiting more than two years - because after an unsuccessful job search, long-term unemployed persons really tend to lose any prospect of finding a job. Partially, they lose the skills and knowledge gained through their education; other skills

and knowledge become obsolete, and job-seekers' self-esteem and hope for the future disappears. Some of the young turn to crime, while older persons become discouraged and apparently withdraw from the labour market.

Active labour market policy (ALMP) could redistribute job opportunities so that fewer people become long-term unemployment benefit and/or welfare assistance recipients. When total employment and total labour supply are given, this would imply distributing the unemployment burden among more people (assuming that it is not the same people who are experiencing more unemployment periods as a result of the policy intervention). Clearly, an increase in total employment as a result of ALMP would be preferable to a redistribution of unemployment to a greater number of people. Economic theory states that ALMP hardly affects total employment directly. But if ALMP succeeds in reintegrating long-term unemployed persons or welfare recipients, the effective labour supply increases. Therefore, reintegrating the long-term unemployed and preventing long-term unemployment are certainly worthwhile goals. There are other meaningful activities in addition to paid employment, which can be a source of social integration and individual fulfilment. Nevertheless, the prevention of long-term and recurring unemployment would be a major contribution towards combating poverty and social exclusion and/or large numbers of social welfare recipients. This is especially important when the employability of the long-time unemployed is increased, or they become attractive to potential employers.

It would of course be helpful to all unemployed people if there were more jobs. However, there is clear international evidence and examples in Croatia, that labour supply shortages can exist alongside high levels of long term unemployment. Furthermore, each business cycle creates additional long term unemployment that is not extinguished by the following

business cycle. Until recently, long-term unemployment was ratcheted upwards and more and more unemployed people were dropping out of the effective labour supply. That has negative influences on the efficiency of the labour market, and on the material position of exposed persons. It also increases the costs of the welfare system. One should stress that in Croatia there is a range of active labour market measures. They are comparatively small-scale and suffer from a funding mechanism that treats them as residual once the costs of passive measures are met. This has the perverse effect of diminishing funding for ALMP as unemployment rises. Active labour market measures in Croatia have been monitored but not evaluated for their net effect, i.e. what would have happened to the individuals had they not gone on an active measures such as training. Only for the public works programme has there been this kind of evaluation; it showed that the public works projects examined had almost no effect in improving the success of participants subsequently getting jobs on the open labour market (Dorenbos et al., 2002). Babic (2003), using comparative analyses of expenditure on ALMP programmes showed that the structure of ALMP programmes is inappropriate for the Croatian labour market.

Because of the lack of real evaluation of outcomes (as opposed to mentoring take up and outputs), it is not possible to draw clear and firm conclusions about the value of individual active labour market measures. What is apparent is that the measures are not sufficiently integrated with the administration of unemployment compensation or the activation agenda. Nor are they targeted at groups at risk of long term joblessness and others likely to get the most real benefit. The funding of active measures is too uncertain and the mechanism is perverse in its effect. Rising unemployment causes an increase of expenditure on unemployment benefits, which di-

minishes the scope for active measures. Consequently, there are problems related to *their short duration* and *relatively low consistency*. Different programmes started and enabled results that were better than expected, but the implementation of the programmes ceased (mostly because of insufficient financial possibilities or restrictions). This has a damaging impact on the infrastructure of providers of active measures and on the ability of the Croatian Employment Service to find ways of helping people out of unemployment.

The task is to reduce both the flows into long-term unemployment and the stock of people already out of work for more than a year. The problems faced by many of the long-term jobless are often multi-dimensional and frequently include low levels of education and of motivation. Croatia has a range of active and passive measures to assist the unemployed. The employability of the long-term unemployed should be enhanced and social exclusion reduced through participation in work-related activities. There is the lack of timely evaluation to assess the true effectiveness of policy measures on the labour market. This could be addressed through the introduction of new techniques (tracking studies) for collecting up-to-date data about their impact. It is important to enhance the employability of these people – especially increasing their human capital, or improving their knowledge and skills, and to enhance work attractiveness for them by the realisation of measures that make *work pay*.

Regarding a trade-off between equity versus efficiency, active labour market measures are diverse and recognised as useful instruments of labour market policy. They are not yet sufficiently targeted to where most international evidence indicates they are effective i.e. disadvantaged people at risk of, or in, long-term unemployment. Their scale is small and their availability is made particularly uncertain by the funding arrangements. They are not yet

integrated as closely as possible with benefit (administration of unemployment compensation) and placement work. Also crucial is the creation of an adequate entrepreneur and investment climate. This means improved governance, incentives for economic openness to foreign direct investment and foreign trade exchange, and creation of an adequate organisational infrastructure that enables investments. Better availability of public services and employment enable social inclusion of the poor citizen, which is so important for full participation in society. An important precondition is improved human capital, so we direct our attention towards the trade-off in education.

#### 3.4.4. The Case for a Trade-Off in Education

Education is the most important determinant of employability – in Croatia, more highly educated persons find jobs more easily and faster – but it also doubtlessly carries ancillary non-market effects (for example, easier access to information, greater care for personal health, more active participation in social life which encourages responsible democratic civic behaviour, election of democratic authorities and actualization of the rule of law). Non-participation in education is especially precarious for the children of poor citizens. According to the World Bank (2001), the children of the poor in Croatia are very likely to drop out of the schooling system early, and differences in access to higher education are now very stark. The lack of access to levels of education that are highly valued on the market tends to lower their employability and increase the danger of staying in poverty. These factors perpetuate existing inequalities in earning prospects between the poor and non-poor and create the potential for the intergenerational persistence of poverty. A considerable number of youths in Croatia drop out of secondary and higher

educational institutions. This is, among other reasons, caused by a serious lack of a network of “second chance” schools, aimed at young people who have either been excluded from education or are on the verge of exclusion. High drop-out rates drive up the costs per graduate. The school drop-out rate should be reduced, and an apprenticeship system should be created or the existing system improved.

Systematic prevention of youth exclusion from education could be realized by optimal *flexibility* and the *passability* of the education system at all levels. Flexibility implies sensitivity of the educational system to changes in the needs of the environment and the needs of pupils and adult learners. Flexibility in education can be accomplished by recertification of the existing competences of an individual and by recognition of the results of non-formal education and self-education, i.e. by introducing a system of non-formally and formally acquired qualifications (introducing *identity cards* for acquired knowledge and skills). *Passability implies* avoiding “dead ends”. Dead ends in education are those educational streams (types of programmes) which do not allow for the transfer to a higher degree of education or to a different programme of the same educational level. *Dead ends* decrease the availability (democracy) of education and utilization of human resources. *Passability* is achieved by establishing a sufficient number of vertical and horizontal links among various directions in the system, which decreases its selectivity and avoids the “averaging” of pupils’ achievements. *Passability* of the system particularly depends on the pathways that make possible transfers between general education and vocational education at the level of higher secondary education, higher secondary vocational education and tertiary education, in order to enable the continuation of education at a higher education level; and non-university and university tertiary edu-



cation, in order to enable easier transfer from one type of higher education to another.

With the goal of lessening the number of drop-outs from the educational system and preventing low employability and poverty, it is necessary to establish counsellors for the employment of the young drop-out and provide measures for the ongoing training of the counsellors. Counsellors should assist in preparing the young drop-out for entering the labour market. To solve the employment problems of the young drop-out, an additional collaboration network should be established comprising various state institutions, private and non-profit organisations involved in employment issues.

Regarding youth education and employment, measures that increase the return and participation in secondary and particularly in tertiary education could enhance employability, reduce unemployment, prevent (or reduce) long-term unemployment, poverty and social exclusion. In all EU Member States and developed European countries, participation in education has increased in the last 25 years, but there are huge differences among countries and among particular regions in countries, and among particular socio-economic and ethnic groups. Although the situation and causes of unemployment in Croatia differ from those in the EU, similarly, the unemployment rates are lower for persons with higher education and qualification levels. Because of this, it could be assumed that, as in France and Finland, Croatia would also profit from motivating youth towards further education, while, like in Spain and Italy, there would also be benefits from increasing the possibilities and programmes of vocational education, and participation of youth in it. The education aspect is crucial in increasing their employability, which in turn is the most important determinant in evading poverty.

Due to many factors, it is hard and complex to evaluate the trade-off between equity

and efficiency in education. In the absence of domestic research and data and according to the situation in many countries (Wolf, 2002), we can be relatively certain that educational programmes in fact increase existing social differences, because poor citizens profit relatively little from participation in education, while children from richer social strata complete better and higher quality schools that provide entry into advantageous possibilities in further education, employment and professional promotion. In most transition countries, existing educational systems are expensive and ineffective with regard to their results. Students are forced to learn more data, but are weaker in their use of available knowledge and skills in unusual circumstances. Thus, at all levels of education, it is necessary to emphasize the active participation of students, and to improve efficiency and modernization, as well as to enhance teaching methods.

### 3.4.5. Conclusions

There is a strong and permanent link between social policy, the labour market and education. Undoubtedly, many long-term unemployed and poor people have completed at best a low level of education and/or have knowledge and skills that are not sought on the labour market. It would be reasonable to assume that many do not have the basic skills of literacy and numeracy; some have had no formal education whatsoever. There are many indicators and reports that stress insufficient incentives for lower paid workers to find jobs and leave the system of protection during unemployment or welfare.

Employers complain of the difficulty of finding an adequate work-force even in regions with high unemployment rates. Long-term unemployed people are in a further adverse position due to the depreciation of knowledge and skills during the period of their unemployment, as well as negative attitudes

by employers. Therefore, it is necessary, in a coordinated way, to improve the basic knowledge and skills of long-term unemployed people, develop new programmes so that these people will acquire work experience, and expand reorientation programmes (courses).

Apart from a better convergence of labour supply and demand, the focus should be on making labour relationships cheaper and more flexible, in order to increase the likelihood that more labour will be taken on. It is not necessary in a hit-or-miss manner to deregulate the employment and work relationships system, but rather to attempt to find the optimum ratio between the desired labour market flexibility and the required social protection. Flexibility need considered in such a way to undermine the standards of labour law, but as an expansion of the far-reaching consequences of the regulatory matter of labour and social law. The point of making employment relations cheaper and more flexible is in getting labour and social (establishing medical and retirement insurance) legislation to work in the same direction and in harmony, and in the procedures for the handling of labour conflicts.

For the sake of reducing tax pressure, and the broadening of the tax base and the cheapening of labour – which are conditions for greater employment – it is necessary to bring as many as possible of the economic activities of the working population within the limits of labour legislation, and to carry out the legalisation of those activities of the grey or underground economy which should be brought within the embrace of the law.

For employment and social policy, we could say that Croatia is on the whole moving in the direction of the policies that are current in Europe. These policies are marked by a narrowing of rights through the implementation of more stringent conditions, and a stronger emphasis on active measures in employment policy, with unemployment benefits being more linked to

participation in training and re-qualification programmes. What remains is the rather fraught task of encouraging a more flexible labour legislation and the removal of organisational and administrative barriers to the foundation of new small and medium-sized enterprises, which should be of the most help in the mitigation of unemployment in Croatia. Within the context of Croatian association with and ultimate membership of the EU, constant attention is required in the consideration of the labour market and labour legislation.

Activities related to professional orientation, lifelong-learning and qualification, professional development and the increase of the total stock of knowledge in society ought to be enhanced, and this would increase the adaptability of the labour force to the requirements of the labour market. Active labour market policy measures must be more strongly directed at persons between the ages of 15 and 24, among whom the rates of unemployment are the highest (and for this group, the return from investment in human resources is probably the highest), with the emphasis on training and further qualifications. Training programmes should be matched, as much as possible, to the demand for given occupations and capacities that will be sought in the future, that is, the emphasis should be placed on qualifying for a *known* employer.

The labour market, social and education policy must be monitored continually, and measures should ensure that men and women obtain equal opportunities and responsibilities. It is important to constantly evaluate the effects and influences of the different measures and of social and education policies on the labour market. This implies determining improvements in the possibilities of employing people who have come out of educational programmes. It is also necessary to consider the costs of obtaining these results, or the cost-effectiveness of given programmes.

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### 3.5. Kosovo: New Country, Old Problems

*Jeton Mehmeti*

#### Abstract

Poverty in Kosovo, although shallow, is persistent and widespread. Nearly half of the population is estimated to live below the national poverty line. Economic growth has been solid since the end of the war. Foreign assistance and remittances are declining, while export and foreign investments have not improved much. With its current GDP, Kosovo remains one of the poorest countries in Europe. Living standards are not improving, social assistance programmes seem to be inadequate, and exports are still facing legal problems with neighbouring countries. On the other hand, the number of people entering the job market is increasing, while job opportunities remain low. Inadequate training and skills of the job seekers add to long-term unemployment. The level of participation in compulsory education is not bad, but the quality of education is poor. In order to ensure equity and efficiency in a social policy context, an increase in economic growth would result in a decrease in the poverty level. To reduce the unemployment rate, the creation of new jobs is required. Creating jobs requires better governance, improved infrastructure, attracting foreign investors, encouraging entrepreneurship and agriculture as well as investing in education.

#### 3.5.1. Introduction

Kosovo is the newest state in South-Eastern Europe and the smallest in terms of territory. Kosovo shares its borders with Serbia, Macedonia, Albania and Montenegro. The last census in Kosovo was conducted in 1981. Hence, there is no single source that provides an accurate count of the population, but it is estimated to be about 2 million, of which the rural share is about 65% and the urban share is about 35%. The capital city is Prishtina with roughly 500,000 inhabitants. The political developments in the last two decades are connected with today's poor social and economic situation in Kosovo. As part of Yugoslavia since 1919, Kosovo was given the status of Autonomous Province of Yugoslavia in 1974. Until 1989, when Slobodan Milosevic stripped Kosovo of its autonomy, Kosovo enjoyed almost the same rights as the other six Socialist Republics that made up the Federation of Yugoslavia. Losing its autonomy had severe social and eco-

nomic consequences for Kosovo. The unemployment among Kosovo Albanians mounted, a large number of ethnic Albanians working in socially-owned enterprises were expelled, students were no longer allowed to study in the Albanian language and ordinary people faced harassment by the Serbian authorities. A large number of people saw migration as an option for survival, economically and socially.

The 1998-1999 war resulted in many human victims and much property loss. The number of Kosovo Albanian victims was more than 8,700 dead and over 3,500 people declared missing.<sup>73</sup> In terms of property damage, it was estimated that around 120,000 houses were partially or totally destroyed throughout Kosovo.<sup>74</sup> From 1999 till 2008 Kosovo was a UN protectorate, under the official administration of the United Nations Mission in Kosovo (UNMIK). After the first national election of 2001, UNMIK helped in the creation of the Provi-

<sup>73</sup> IKS (2007) "Post war reconstruction – Country Description"

<sup>74</sup> Ibid.

sional Institutions of Self-Government (PISG). Gradually, the governing power was transferred from UNMIK to local institutions. The declaration of Independence in 2008 marked a new beginning of political history. The new State of Kosovo has so far been recognized by 70 countries, including 22 EU countries. Becoming a member of both the World Bank and the International Monetary Fund in 2009 was perhaps the best achievement of the new country. On the other hand, the high level of poverty, huge unemployment rates and slow economic growth are among the most pressing challenges the people of the newest European country face every day. With such problems, EU integration, for the time being, remains only a dream.

### 3.5.2. The Case for a Trade-Off in Social Policy

Around 45% of Kosovo's population is considered poor. Slow growth, low incomes and tight expenditure constraints are among the factors that lead to such a large poverty rate. Living standards in Kosovo have stagnated and not much improvement is in sight. The World Bank (2010) estimates that 17% of the population is considered as extremely poor; these are individuals who have difficulty meeting their basic nutritional

needs. As one of the least capable countries in Europe to provide employment opportunities, the unemployment rate in Kosovo has reached 48%, while the employment rate continues to be extremely low (26%). As of August 2010, there were 335,347 job seekers officially registered at the Department of Labour and Employment.<sup>75</sup>

Compared to other neighbouring countries, poverty rates are very high. While other countries of Southern Europe have been growing faster, Kosovo's economic growth in the past decade has been solid. With a gross domestic product (GDP) per capita of 1,760 euro, the country remains one of the poorest in Europe.<sup>76</sup> Although the employment rate stands at 26%, this does not mean that all the employed are free from poverty. In fact, around 70% of all the poor are either employed or inactive. While urban poverty has declined, most of the poor live in rural areas (two-thirds).

**Table No.1: Real GDP growth (%)**

Years	Grow according to Ministry of Economy and Finance	Grow according to IMF
2009	4,4	3,8
2010	4,8	4,6
2011	6,1	5,9
2012	5,8	n/a
2013	4,9	n/a

Source: MEF and IMF

**Table No. 2: GDP in Balkan countries**

Country	2005	2006	2007	2008	2009	GDP/per capita (\$)
Albania	5,5	5,0	6,0	6,5	2,2	4.016
Bosnia and Hercegovina	5,0	6,2	6,8	5,4	-3,4	4.907
Croatia	4,2	4,7	5,5	2,4	-5,8	15.637
R. of Macedonia	4,1	4,0	5,9	4,8	-0,7	4.650
<b>Kosova</b>	<b>3,8</b>	<b>3,9</b>	<b>5,0</b>	<b>5,4</b>	<b>4</b>	<b>2.618</b>
Montenegro	n/a	8,6	10,3	6,9	-7,0	7.925
Serbia	n/a	5,2	6,9	5,5	-2,9	6.713

Source: World Bank

<sup>75</sup> Ministry of Labour and Social Welfare – "Data on Labour Market in Kosovo – August 2010"

<sup>76</sup> World Bank (2010) "Kosovo-Unlocking growth potential: Strategies, Policies, Actions".

Living standards have not improved because macro-economic conditions have not improved either. The rapid economic growth of the post-conflict period, which saw a large inflow of resources for reconstruction, began to slow down. World Bank estimates that this is because industrial output has not yet recovered and agriculture remains a low-productivity activity. Agriculture contributes a large share to the GDP. Agriculture, which provides the livelihood for the majority of the population, today faces high input costs and poor infrastructure. Agricultural activity could be further developed by strengthening property rights, complementing the privatization process and providing more active support to farmers. All of these activities are currently developing very slowly.

On the other hand, social assistance programmes are inadequate. Difficult macro-economic conditions create a challenge for balancing huge investment needs and social priorities, especially given a restrictive fiscal rule and conservatism. In this climate, many poor people do not benefit from public support. Even the social assistance programme which does exist has low coverage due to the tight fiscal space; hence, over 60% of the poor are not reached by this programme.<sup>77</sup> Besides, even those who benefit from it receive insufficient benefits. As such, the programme has not resulted in improving the welfare of the population. Social assistance (a money transfer of 61 euro per month per household) is given only to those families meeting strict eligibility criteria (none of the family members is able to work due to age, disability, etc). War veterans and families of civilian war invalids also benefit from the social assistance spending. The pension system in Kosovo includes all persons over the age of 65, regardless of previous earning and contribution history. The

basic pension is 45 euro per month. However, those who can prove at least fifteen years of contribution under the former Yugoslav pension system are entitled to additional 35 euro. Nevertheless, this category of people has often expressed their dissatisfaction with the low pension, which does not award their working contribution and is not enough even for covering medical expenses.

While only 15 % of the population receives social assistance benefits, targeted at the poorest group, a great portion of the population benefits from remittances. Indeed, migration and remittances have been an effective mechanism for reducing poverty in Kosovo. Nearly a quarter of Kosovars, around 400,000 people, have migrated abroad. The World Bank shows that 1 in 4 Kosovars report having at least one household member who is a migrant abroad.<sup>78</sup> The same reported having received remittances from abroad. It is also reported that those with emigrants abroad have a higher level of consumption and are estimated to be less poor. Without migration (remittances), poverty would be higher and more widespread, especially in rural areas. The World Bank also reports that Kosovo is the 3<sup>rd</sup> highest remittance recipient in the Western Balkans (after Bosnia and Herzegovina and Serbia) and according to a 2004 survey, 11<sup>th</sup> in the world with a 13.6 % as share of GDP.

So far migration has proven vital to reducing poverty in the country. Its impact is immediate. However, the level of remittances has started to decline. In 2009 remittances were about €500 million, which is 8% less than the previous year<sup>79</sup>. One reason for the decline could be due to global financial crises. Besides, the flow of migration is slowing down since the traditional receiving countries have changed their migration policies, mak-

<sup>78</sup> World Bank (2010) "Kosovo-Unlocking growth potential: Strategies, Policies, Actions"

<sup>79</sup> Ibid.

<sup>77</sup> World Bank (2010) "Kosovo public expenditure review"

ing it harder to cross their borders. Nevertheless, remittances have aided in reducing poverty by helping individual families (as they have been mostly private transfers); remittances have not been used to finance public investments in infrastructure, social services, or job-creating mechanisms. The slow growth of Kosovo's economy, associated with a high level of unemployment and poverty, has attracted the attention of international organizations, such as the World Bank, to conduct intensive research in suggesting better policies. To improve living standards and make progress towards European integration, the World Bank has suggested strategies through which welfare gains can be made. The first thing is to generate high and sustainable growth. The World Bank considers that if the GDP grows by 5% in the next 5 years that would lead to a 38% poverty reduction. This is achievable, since many countries around the world with living conditions similar to Kosovo's succeeded in reducing poverty on a massive scale when they were able to generate high and inclusive growth. Albania, for instance, with a 6% growth rate per year between 2002 and 2005, managed to reduce the poverty percentage from 25% in 2002 to about 18.5% in 2005<sup>80</sup>.

Poverty reduction through growth can be achieved only through strategies that lead to high employment-generating growth. The most important sectors in Kosovo that could generate employment include transport and communication infrastructure, construction, and services; an improved investment climate for small and medium enterprises would also be beneficial. Policies that generate employment are correlated with poverty reduction. It is estimated that a 10% reduction in the prevailing unemployment in the population is associated with a 6% point reduction in poverty.

Perhaps one of the main pillars for growth could be exports. Three production factors: labour, land and energy are currently not being utilized very much. Kosovo's products have free market access to the European Union and the Central European Free Trade Agreement (CEFTA) countries, despite the fact that political barriers block Kosovo's exports. Taking goods outside its borders has become a major challenge for Kosovo exporters. Trucks with Kosovo license plates can only enter Albania, Macedonia and Montenegro, while the customs stamp of Kosovo's Custom Authority is not recognized by Bosnia and Herzegovina, Serbia and Montenegro.<sup>81</sup>

With regard to equity versus efficiency one may assume that economic growth could be the best strategy to reduce the high level of poverty in the country. Indeed, the high percentage of the poor, the majority of whom live in rural areas, requires more attention and a change of government and capital investments priorities. Rural provinces need better education opportunities, an improved infrastructure and subsidies to farmers to encourage agriculture. While in rural areas there is a need for increasing the quantity of investments, social assistance programmes require improvement in terms of quality. There are only a small number of those benefiting from it, and even they cannot meet even their most basic needs. This too requires a review of spending of the national budget, especially with regard to the money spent for the highway construction which will cost 980 million euro,<sup>82</sup> more than half of the 2010 budget of 1.47 billion euro. In Kosovo, there is clearly a connection between poverty reduction, employment opportunities and remittances. The former cannot improve without improving the latter two. Hence, in the next section we will elaborate on the trade-off in employment policy.

<sup>80</sup> World Bank (2007) "Kosovo Poverty Assessment"

<sup>81</sup> World Bank (2010) "Kosovo-Unlocking growth potential: Strategies, Policies, Actions"

<sup>82</sup> World Bank (2010) "Kosovo public expenditure review"

### 3.5.3. The Case for a Trade-Off in Employment Policy

The employment level in Kosovo is very low compared to that in neighbouring countries and those in the EU. In 2009 the employment rate in Kosovo was 26.1%, which is quite lower than Albania's 53.8% (2008), Montenegro's 41.3%, Serbia's 53.7% (2008), and Bosnia and Herzegovina's 33.1%.<sup>83</sup> On a larger scale, the employment level in Kosovo is very low especially compared to the 27 EU states – 64.6%. Kosovo has the highest unemployment level in Europe and the greatest demand for job opportunities.. Additionally, Kosovo has the youngest population in Europe. Around 70% of the population is younger than 30 and around 50% is younger than 25.<sup>84</sup> That means Kosovo has a work force which, demographically speaking, is unrivalled. The World Bank predicts that the number of the work force will continue to rise. In the next five years roughly 200,000 people will reach working age, while the number of people reaching retirement age will be approximately 60,000.<sup>85</sup> Youth unemployment is a problem in itself. This category of people accounts for 40% of the pool of unemployed in Kosovo.

Even those employed are not protected properly since employment protection regulations are still weak in Kosovo. Since 2001, employment in Kosovo was regulated by UNMIK Regulation 2001/27, named the Essential Labour Law. Although far from being a completed law, it regulated the labour relationship in Kosovo until today. This regulation prohibits discrimination at work; describes the minimum work age; prohibits forced labour; guarantees the right to labour union organization or other forms of collective organization

and agreement; defines labour relationships; labour contracts and the form of contracts; termination of contract; method of payment; working hours; annual leave; official holidays; maternity leave, sick leave, unpaid leave or other cases of family issue leave; inspection by authorities and fines in case the employer does not follow this Regulation.<sup>86</sup> This regulation was approved in October 2001, before the provisional institutions of self-government (PISG) were established. After the establishment of PISG, the Government and the Assembly tried to pass a more advanced labour law, but failed to do so. Among the justifications for not passing it were the high financial costs of the law, the country's undeveloped economy, lack of foreign investments, pressure from the IMF, etc. On April 30, 2010 the Government of Kosovo passed the Draft Law on Labour. This is the third time, since 2006 and 2008, that the Government has passed this Draft Law, each time with some changes in the content. Currently, the Assembly is awaiting the final approval before converging to the first Law on Labour passed by Kosovo Institutions. Even if passed, the law will not enter into force until January 2011.

The government proposed a draft-law on labour, and if it is passed by the Assembly in its original form, without taking into consideration criticisms and suggestions from civil society, it will have major discrepancies. The current draft-law has major problems that relate to employment protection. First, it maintains that the employment contract may be in written or oral form. Oral contracts are not a good practice since they allow ambiguity in cases of dispute between the two parties involved and leave room for abuses since they do not specify the type of work, the working hours, working conditions, basic salary, and other specific information found in written

<sup>83</sup> Statistical Office of Kosovo (2010) "Statistikat Sociale"

<sup>84</sup> GAP Institute (2008) "A review of private higher education in Kosovo"

<sup>85</sup> World Bank (2008) "Kosovo youth in jeopardy – being young, unemployed and poor in Kosovo"

<sup>86</sup> GAP Institute (2010) "Regulating employment in Kosovo – Labour law and its implementation"



contracts. Second, the maternity leave is set at 12 weeks of paid leave, including a period of 6 weeks compulsory leave from the day of childbirth. This period is very short, since 12 weeks does not even amount to 3 months, but 2 months and 23 days (84 days leave). According to this article, an employee who gives birth needs to return to work in less than two months after the delivery. This time-frame is medically contestable. Other problems with this draft-law include: the trial period that should not last more than six months where the termination of a work relationship can be done with a prior notification of two days, working overtime is allowed for a maximum of eight hours at the request of the employer, and the employee is entitled to a daily break of only 30 minutes.

Even if the Labour Law is passed and Kosovo finally obtains its own law that regulates the employer and employee relationship, there would be problems with the implementation of this law. One issue is the incapacity of the Labour Inspectorate. The Labour Inspectorate is a body within the Ministry of Labour, responsible for supervising the application of the Labour Law in the field. This institution lacks human capital and institutional resources. There are only 49 inspectors operating throughout Kosovo responsible for inspecting 99,647 businesses registered at the Agency for the Registration of Businesses in Kosovo. Since the Labour Inspectorate has to inspect every business at least once a year, on average every single inspector should inspect 2,033 businesses per year, which is practically impossible. Besides, the Labour Inspectorate faces technical problems; it has only ten cars available and lacks proper offices, computers, telecommunication devices, transportation etc. These problems undermine the authority of this institution as the implementer of Labour Law.

Employment Protection Legislation (EPL), and especially the set of rules governing the

hiring and firing process, has yet to improve in Kosovo. With regard to the procedures of hiring and firing, Kosovo is not in a bad ranking position; it stands at 34<sup>th</sup> place. This is obviously much better compared to the overall ranking of 'most preferred countries to do business in' where Kosovo is ranked at 113<sup>th</sup> place.<sup>87</sup> These ranking criteria include the minimum salary, working hours, employer's obligations, mass firing of people, etc. It is hard to assess the difficulty of dismissal which shows whether a dismissal is "justified" or "fair", because there is no competent court in Kosovo to resolve employment disputes. Indeed, the lack of competent courts is a major problem related to EPL. Kosovo courts are overloaded with files. Currently there are 217,758 cases to be resolved by the courts, 93.7% of which belong to the municipal courts.<sup>88</sup> Kosovo needs Labour Courts that will deal specifically with labour disputes, as some of the OECD countries have such as Germany, Finland, France, Italy etc.<sup>89</sup>

The speed of starting a business in Kosovo is very low, leaving the country far behind OECD countries. Kosovo ranks at 164 in terms of starting a business. On average it takes 52 days to launch a business in Kosovo, while in OECD countries it takes approximately 13 days. In other words, it takes around seven weeks, plus the cost and minimum capital which are substantial. In comparison, to start a business in Macedonia takes less than four days and no minimum capital is required.<sup>90</sup> This not only discourages the growth of firms, but also makes many firms operate in the informal sector. Thus, the private sector appears weak and unstable, while the public sector remains the largest employer in Kosovo with

<sup>87</sup> According to: [www.doingbusiness.org](http://www.doingbusiness.org)

<sup>88</sup> GAP Institute (2010) "Regulating employment in Kosovo – Labour law and its implementation"

<sup>89</sup> OECD (2004) "Employment protection regulation and labour market performance"

<sup>90</sup> World Bank (2010) "Kosovo-Unlocking growth potential: Strategies, Policies, Actions"

70,159 people employed.<sup>91</sup> Kosovo does not have a good ranking either when it comes to protecting investors, as it is ranked at 172.<sup>92</sup> This is not entirely due to the lack of investment opportunities, but rather to Kosovo's image perceived negatively by foreign investors. Hence, improving Kosovo's image is very essential. A World Bank survey<sup>93</sup> on foreign investors shows that foreign investors have more or less the same concern about Kosovo's investment climate as domestic firms. There is a perception among them that public administration is inefficient, there are complex regulations with regard to starting a business and there is a fear of widespread corruption. The same perception is not shared by foreign firms already in Kosovo, who have a much more positive view of Kosovo's investment opportunities. Foreign direct investments (FDI) have been declining in Kosovo. It is estimated that in 2009 FDI dropped by 20.4%, a trend which continuing.

Long term unemployment is yet another negative reality in Kosovo. Finding a job may take a long time, especially when the job seeker lacks experience or proper skills. The unemployment period is often defined as the period since one has lost his/her last job or has started looking for a job. According to the Kosovo Statistical Office in 2009, 6 out of 7 unemployed persons in Kosovo, male and female, have been unemployed for more than a year. This situation has not changed since 2004, which supports our conclusion that finding a job in Kosovo is a real challenge.

With regard to the equity versus efficiency trade-off much improvement is required in effective labour regulation. A more efficient labour law will improve labour relationships and guarantee better protection and more

benefits for the employees. The high unemployment level in this country suggests that jobs are scarce and long term unemployment is present. The problem is not only with the inefficient distribution of job places, but with the creation of job opportunities too. The lack of foreign investments should be dealt with by improving the investment climate. That requires improving governance and improving the country's image. Much should be done towards increasing Kosovo's exports too, since Kosovo's exporters have suffered due to political disputes and customs disagreements with neighbouring countries. Lastly, the government needs to come up with special training programmes for a large number of job seekers who lack training skills and educational preparation. Encouraging entrepreneurship is yet another good way to reduce unemployment. This too requires good education, which is why in the following section we direct our attention to the trade-off in education.

#### **3.5.4. The Case for a Trade-Off in Education**

Poverty reduction and growth require not only specific programmes for improving employability but also a well-educated, adaptable and healthy work force. In Kosovo the access to primary and secondary education is quite satisfactory. Almost 9 in 10 children of primary education age and about 3 in 4 children of secondary education age are enrolled in school.<sup>94</sup> However, despite the high enrolment, there are obstacles that prevent establishing a well-educated population. First, there are differences in terms of enrolment between the poorest and richest and between urban and rural families. Second, girls' enrolment in secondary education continues to be at least 20% lower than boys'. And the

<sup>91</sup> GAP Institute (2010) "Regulating employment in Kosovo – Labour law and its implementation"

<sup>92</sup> According to: [www.doingbusiness.org](http://www.doingbusiness.org)

<sup>93</sup> World Bank (2010) "Kosovo-Unlocking growth potential: Strategies, Policies, Actions"

<sup>94</sup> World Bank (2007) "Kosovo Poverty Assessment"

third reason is that the quality of schooling is generally poor, which is why the drop-out rates are high.

Education is linked to one's employment opportunity. The Department of Labour and Employment shows that out of 335,348 registered job seekers, 201,281 are unqualified persons, while only 3,345 have a university degree. The employability of less well educated people is very unlikely. Statistics show that 64% of less qualified people will most likely remain unemployed.<sup>95</sup> Besides the lack of university qualifications, most unemployed, especially among the youth, lack special training or job experience. The number of first-time job seekers is very high, especially among those aged 15-24. The 2009 statistics show that the majority of job seekers registered at the Labour Department have never worked before; 79% of males and 87% of females. The Ministry of Labour, on the other hand, does not provide any programmes of professional training.<sup>96</sup>

The skill attainment of the population is another important factor in determining labour market performance. The demand for higher skills is increasing and many firms often find it difficult to find people with appropriate skills. Tertiary education among the population is far from satisfactory. It is estimated that only 1 out of every 12 Kosovars holds a tertiary degree.<sup>97</sup> The University of Pristina (UP), the largest public university in Kosovo, in the 2009/2010 academic year had 37,646 bachelor students and 3,532 master students, which altogether makes 41,178 students.<sup>98</sup> This makes UP the largest university in country, also producing the largest number of graduates every year. Yet, the number of

fresh graduates finding jobs is very small. One of the reasons for that is poor preparation for the job market. Studies show that there are certain problems with this university: UP has failed in adopting modern teaching and evaluation methods; practical work or internships are not obligatory and the majority of students have never done an internship during their studies; proper text-books are either missing or not updated.<sup>99</sup> Meanwhile, there are around 19,000 students<sup>100</sup> also enrolled in private colleges and universities. Private providers of higher education (PPHE), which consist of 18 accredited private colleges and high schools, tend to provide a better preparation for the job market in the sense that they provide more attractive programmes that respond to the demands of the job market. However, the general reputation of PPHE is low, making it very hard for their students to convince employers of their qualifications' value. Perhaps the only exception is the American University in Kosovo which provides higher teaching standards and whose graduating students are more likely to find jobs.

The lack of data makes it hard to make a proper assessment of equity versus efficiency in education. While we have the rough number of the overall number of students in Kosovo, it is hard to estimate how many of them manage to find a job after graduation. There is a general assumption among employers that graduate students lack professional training, since the education system, especially in the largest public university, has been very theoretical in the last decades. Students of the University of Pristina traditionally have spent years memorizing data and theories but are weak in implementing their knowledge in practice. Lack of training and skills is still a problem undermining graduates' opportunities in finding jobs.

<sup>95</sup> Statistical Office of Kosovo (2010) "Statistikat Sociale"

<sup>96</sup> Ministry's website does contain a section for Professional Training, but it is blank.

<sup>97</sup> World Bank (2010) "Kosovo-Unlocking growth potential: Strategies, Policies, Actions"

<sup>98</sup> Data obtained by GAP Institute from the University of Pristina.

<sup>99</sup> BIRN (2009) "Situation and problems at the University of Pristina"

<sup>100</sup> GAP Institute (2008) "A review of private higher education in Kosovo"

Hence, job seekers with a degree obtained abroad or in private universities have some advantage. In general, reforms are necessary in teaching methods at all levels of education. The active participation of students, modernization of education and more responsible public and private universities could help in creating a knowledge-based society and hence improve the social welfare of the country.

### 3.5.5. Conclusion

In every country there are links among social policy, the labour market and education. In Kosovo these are even more connected. Today Kosovo can be characterized by slow economic growth, a high poverty rate, bad living standards and an unproductive tertiary provision. Above all, the high unemployment rate is worrisome. Finding a job in Kosovo is more than a challenge, especially for the less educated and less skilled job seekers. The number of university students is high and increasing, but only a small number of them manage to find jobs. Education standards need improvement, modernization and more commitment from the government.

As a country composed of different ethnic groups, Kosovo is successful in retaining social harmony. The threat, however, comes from the socio-economic situation the country is currently in. The high unemployment level is a 'ticking-time bomb', posing a permanent threat of social instability. Creating jobs is a major challenge that needs an imme-

diated solution. The government shares its part of the responsibility for the current situation. It should be the government's responsibility to improve the country's image and attract foreign investors. A precondition to that is in fighting corruption, improving employment protection regulation and easing the business start up regulations. Exporting Kosovo's products is of paramount importance in order to boost domestic production. The lack of export opportunities discourages Kosovo farmers, especially the horticulture sector that needs a wider market. This year's protest of winegrowers, who had no adequate market in which to sell tons of grapes, should be a lesson for particular institutions to engage more in cross-border cooperation.

Better policies are also required in improving social assistance programmes. The dissatisfaction of those benefiting from social assistance is increasing. To do this, a more careful revision of capital investments is needed. In short, generating economic growth, improving social policies and providing a better education are the most pressing challenges to address. These are not only necessary for creating a better social welfare; they are also some of the cardinal requirements for European Union integration. The European Union Progress Report for Kosovo seems not to improve at all, while the visa liberalization process has not yet started, making Kosovo the most isolated country in Southeast Europe. Kosovo might be a new country, but it is facing many "old" problems.

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### 3.6. Macedonia: Education vs. Unemployment –a Way out of Poverty?

*Neda Milevska Kostova, Biljana Kotevska*

#### Abstract

In Macedonia, the unemployment rate and levels of relative poverty are very high – almost the highest in the region. In relation to this, the country is putting forward measures to increase the employability of the long-term unemployed and first-time job seekers by reducing illiteracy and providing mandatory primary and secondary education. But, simultaneously striking is the fact that the number of persons enrolled in higher education is very high and showing an increasing trend, which is encouraged and well-funded by the government – either as a long-term policy for labour quality improvement, or as a short-term reduction and postponement of unemployment.

Massive higher education enrolment will start to give short-term results in reducing the number of jobless and in postponing active employment; but unfortunately, this is only deceptively consolatory, as for this approach to become a long-term policy for labour quality improvement it needs to be coupled with education policy changes and assessments of and adapting to the labour market. Macedonia is in danger of entering the spiral of unemployment, where the number of persons that are well-educated but long-term unemployed is increasing at the expense of their skills to respond to the actual needs of employers and the labour market.

To sum up, in order to lessen the trade-off in social, employment and education policy, the following actions should be considered: an increase in coordination among the institutions dealing with these policies both in the process of their design and in their implementation; ensuring their coherence; strategic realistic planning in the short, medium and long term; regular research and analysis of the past, current and anticipated developments; the design and full utilisation of monitoring mechanisms for the implementation of these policies that will enable timely and prompt reactions and on the other side - sufficient allocation of financial and human resources.

#### 3.6.1. Introduction

The Republic of Macedonia (Macedonia) is, under its 1991 Constitution, a sovereign, independent, democratic and social state that has as its fundamental values, among others, humanity, social justice and solidarity; and freedom of the market and of entrepreneurship.<sup>101</sup> This South-East European landlocked country has a territory of 25.713 km<sup>2</sup> border-

ing (north to west) Kosovo, Serbia, Bulgaria, Greece and Albania.

According to the 2002 Census,<sup>102</sup> Macedonia has 2,022,547 inhabitants, 1,015,377 (50.2%) male and 1,007,170 (49.8%) female. The population in the country at the end of 2009 was estimated at 2,052,722<sup>103</sup> inhabitants. The majority of the population is between fifteen and sixty four years of age, followed by the group zero to fourteen,

<sup>101</sup> Constitution of the Republic of Macedonia. Official Gazette of the Republic of Macedonia no. 52/91, 1/92, 31/98, 91/01, 84/03, 107/05, 3/09. *Official Gazette of the Republic of Macedonia Website*. <<http://www.slvesnik.com.mk/WBStorage/Files/USTAV-eng.pdf>>. Accessed on: 06 November 2010. Art. 1 and 8.

<sup>102</sup> These numbers are from the last census that took place in 2002. The new census is scheduled for 2012.

<sup>103</sup> Table of indicators. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk>>. Last accessed: 07 November 2010.

and then the group above sixty five years of age.<sup>104</sup> The activity rate is 56%, out of which 38.1% are employed and 32.1% are unemployed. The majority of the unemployed come from the 20-29 age group and are female. The majority of the inactive population is also female – 64.9%, for men 35.1%.<sup>105</sup> Over 25% live below the poverty line.<sup>106</sup> The number of underage recipients of social welfare is 21,836, and 53,233 of adult recipients.<sup>107</sup> Illiteracy rates are higher among the female population compared to males, and the illiteracy rate of the population over ten years of age is 3.6%. The highest share – 36.9% of the population, has a completed high school education, followed by 35.1% with primary education, 13.8% without any completed education, and 10% of the population with higher education.<sup>108</sup> The ethnic composition is as follows: 1,297,981 Macedonians, 509,083 Albanians, 77,959 Turks, 53,879 Roma, 35,939 Serbs, 17,018 Bosnians, 9,695 Vlachs and 20,993 of other or unstated ethnicity.<sup>109</sup>

Before proclaiming its independence, Macedonia was part of the Socialist Federal Republic of Yugoslavia (SFRY). It was one of the least developed republics of the SFRY (including the one with highest rates of unemployment), and the only one that was not directly drawn into the vortex of the Yugoslav wars in the 1990s. However, this does not mean that it had a smooth transition from socialism to democracy. Macedonia also suffered greatly

from the events of the 1990s. The country had a very difficult transition from planned to market economy, with a highly contested privatisation process. Its economic development was hindered until 1996 by the lack of infrastructure in the country, the UN weapons embargo, the war heating up in the north, and a southern neighbour opposing the very existence of the new state. It received refugees fleeing from the wars and opened its doors for all holders of SFRY citizenship who wanted to acquire Macedonian citizenship. The overall security situation called for international protection of Macedonia until it was able to stand on its own feet as an independent country. Thus, the UN sent two missions<sup>110</sup> in the period 1992-1999 to prevent spill-over from the conflict. In the meantime, Macedonia was admitted as a member of the UN, the Council of Europe and the OSCE.<sup>111</sup> After 1996, a rise in the GDP was registered<sup>112</sup> and lasted until 2000.

In 1999, the Kosovo crisis brought an influx of over 350,000 refugees<sup>113</sup> into the country. These events hindered the economic development of the country and halted the growth of its GDP. The Kosovo crisis was followed by a conflict in Macedonia in 2001. At the beginning of the conflict, the country signed a Stabilisation and Association Agreement (SAA) with the European Union (EU), paving the way for deepening cooperation with the EU, as well as receiving a more solid promise of future EU membership. However, the conflict was escalating, and brought the country

<sup>105</sup> Active Population in the Republic of Macedonia - Results from the Labour Force Survey, 2nd quarter 2010. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/2.1.10.28.pdf>>. Last accessed: 07 November 2010.

<sup>106</sup> Poverty Line - News Release 4.1.10.64. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/4.1.10.64.pdf>>. Last accessed: 07 November 2010.

<sup>107</sup> Social Statistics - News Release 2.1.10.19. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/2.1.10.19.pdf>>. Last accessed: 07 November 2010.

<sup>108</sup> Census 2002 – Book V: Educational Characteristics. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/publikacii/knigaV.pdf>>. Last accessed: 07 November 2010.

<sup>109</sup> Census 2002 – Book X: Total population according to the ethnic affiliation, mother tongue and religion. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/publikacii/knigaX.pdf>>. Last accessed: 07 November 2010.

<sup>110</sup> United Nations Protection Force (1992-1995) and its successor - the United Nations Preventive Deployment Force mission (1995-1999).

<sup>111</sup> Republic of Macedonia was admitted in these organizations under the temporary reference “the Former Yugoslav Republic of Macedonia” because of the opposition of Greece to the right of the country to use its constitutional name. The name dispute is still open.

<sup>112</sup> Gross Domestic Product - News Release 3.1.10.08. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/3.1.10.08.pdf>>. Last accessed: 07 November 2010.

<sup>113</sup> Refugees and Others of Concern to UNHCR - 1999 Statistical Overview. United Nations High Commissioner for Refugees. UNHCR Website. <<http://www.unhcr.org/3ae6bc834.html>>. Last accessed: 09 November 2010.

to the brink of civil war. Under international mediation, further intensification of the conflict was prevented by the Ohrid Framework Agreement (OFA) signed by the major party leaders.<sup>114</sup> The OFA foresees a series of reforms towards decentralisation, and in many areas meant to increase the rights of the ethnic communities through their increased, equitable and just representation in the political and administrative governance of the country.

OFA implementation together with the progress of reforms which are ultimately to lead to full NATO and EU membership mark the reform efforts of all of the governments in the past decade. The GDP continuously rose after 2001 until 2009, when a fall in GDP was registered. The country implemented a series of economic reforms. However, the majority of the reform efforts post-2001 was directed at the OFA, a large percentage of them focused on the decentralisation of the country (an on-going process). Eventually, these reforms brought Macedonia the status of candidate country for EU membership (but without a recommendation for opening negotiations).

However, reforms in public administration and the judiciary – which are often pointed out as the areas in the most burning need of reforms – do not seem to be delivering the expected results. Moreover, the dynamics and effectiveness of these reforms have slowed down in the last two years. This, coupled with the open name dispute with Greece, caused stagnation in the Euro-Atlantic integration agenda of the country. In 2008, Macedonia was the only country of the Adriatic charter that was not extended an invitation to join the organization; it received only a promise of extension of invitation once the name dispute with Greece is closed. The same dispute

was also part of the reasoning why, although a recommendation for start of accession negotiations was given by the European Commission (EC), there is still no date set for the official opening of the accession negotiations.

### 3.6.2. The Case for a Trade-Off in Social Policy

In order to look into the case for a trade-off in social policy in Macedonia, we first need to look into several parameters that can assist us. First of all, we will examine the main aspects of the legislative, policy and institutional framework on social policy that will help in assessing the trade-off. Afterwards, we need to take a look at the situation with poverty (both relative and absolute) in Macedonia, as well as aspects influencing poverty, such as family structure, gender aspects, education aspects, span of poverty for children, as well as territorial distribution of poverty (rural/urban areas). This section will close with an overview of the aspects where there can be interventions to assist in reducing the trade-off between equity and efficiency in social policy.

The social policy of Macedonia is outlined in the laws and policies adopted in this area. The legislative framework is of importance for this policy and comprised of the following laws: The 2009 Law on social protection; laws regulating protection and promotion of the principles of equality and non-discrimination (such as the 2006 Law on equal opportunities of women and men, and the 2010 Law on prevention and protection against discrimination); The 1992 Law on the family; the 2000 Law on protection of children (and laws amending this law); the 2003 Law on asylum and temporary protection (and laws amending this law); the law on juvenile justice (and laws amending this law); laws pertaining to the rights of people with disability; laws on pensions (on insurance and documentation);

<sup>114</sup> Ohrid Framework Agreement. Republic of Macedonia – Agency of Information. *Council of Europe Website*. <[http://www.coe.int/t/e/legal\\_affairs/legal\\_co-operation/police\\_and\\_internal\\_security/OHRID%20Agreement%2013august2001.asp](http://www.coe.int/t/e/legal_affairs/legal_co-operation/police_and_internal_security/OHRID%20Agreement%2013august2001.asp)>. Last accessed: 07 November 2010.



laws related to the rights of persons left without employment in the process of privatisation of enterprises, as well as rights of persons as fighters and the members of their families.

A number of policy and strategic documents in this area have also been adopted: the National employment strategy 2010, the National programme for the development of social protection 2010-2021, the National strategy for deinstitutionalisation of the system of social protection in the Republic of Macedonia 2008-2018, the National strategy for gender equality, the National strategy on equality of rights of people with disabilities 2010-2018, the Strategy on poverty reduction and social inclusion – obviously, most of the social issues and socially vulnerable groups are targeted, however, as in many other fields, the implementation of these documents is very limited and their full operationalisation remains a goal for some distant future.

The main institutions involved in the implementation of these documents, aside from the judicial and the executive branch, are the various public institutions of social protection, such as institutions for asylum seekers, unemployed persons, children without parents or parental care, children with various forms of handicap, children demonstrating deviant behaviour. There are also deinstitutionalised forms of social protection, such as foster families and day-care centres.

These documents foresee the following rights and services to be at the disposal of the potential users: social prevention, the possibility for institutional protection, the possibility for deinstitutionalised protection, and the right to social assistance. Statistics are available for the amounts spent on social welfare. However, frequent amendments to the laws can cause a degree of uncertainty for the users, and uncertainty about the costs of the services. And indeed, many reforms are underway in the area, but one can rightly argue that

these changes were more than needed in order to reform the system of social protection.

Budget austerity cuts the already low administrative and financial resources that were at the disposal to the institutions in charge, and their implementation is further put under question. The Law on social protection foresees new mechanisms in relation to social welfare benefits; however, its implementation is very slow. Administrative capacity is still insufficient to develop a sustainable and equitable social protection system.<sup>115</sup> Deinstitutionalisation of social protection is underway, and although at present it is very much underdeveloped, there are grounds to believe that there will soon be improvements. With the amendments of the Law on social protection and the two major strategic documents that were adopted (on social protection and on deinstitutionalisation), the framework is slowly being erected. The first instances of such protection to start functioning are the foster families and the care centres, mentioned above.

The percentage of relative poverty<sup>116</sup> in Macedonia in 2010, according to the State Statistical Office, is 31.1%, representing a rising trend as compared to previous years.<sup>117</sup> In 2008 and 2007, this percentage was 28.7% and 29.4% respectively. The Poverty gap in-

<sup>115</sup> The Former Yugoslav Republic of Macedonia 2010 progress report accompanying the communication from the Commission to the European Parliament and the Council - Enlargement Strategy and Main Challenges 2010 - 2011. European Commission. *EUROPA Website*. <[http://ec.europa.eu/enlargement/pdf/key\\_documents/2010/package/mk\\_rapport\\_2010\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2010/package/mk_rapport_2010_en.pdf)>. Last accessed: 09 November 2010.

<sup>116</sup> The poverty statistics is as presented by the State Statistical office of the Republic of Macedonia. It uses the EUROSTAT definitions of poverty and poverty line. This means that they define poor to mean "persons, families, and groups of persons whose resources (material, cultural and social) are so limited as to exclude them from minimum acceptable way of life in the Member State in which they live", and poverty lines as "level of living standard, which should to be attained for one person/household to not be classified as poor." Relative poverty line is relative standard of subsistence determined as necessity level of expenditures; and subjective poverty line is the subjective standard of subsistence based on opinion of whole population for level of income necessity to avoid poverty. Source:

<sup>117</sup> Poverty Line - News Release 4.1.10.64. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/4.1.10.64.pdf>>. Last accessed: 07 November 2010.

dex has also increased to 10.1% in 2010, compared to 9.7% in 2007 and 9.2% in 2008. There is also a need to look into absolute poverty – or the condition characterized by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information, depending not only on income but also on access to social services.<sup>118</sup> According to the data available from the World Bank, the percentage of absolute poverty in Macedonia has stayed below 2.0%, except in 2000 when the percentage rose to 2.94%.<sup>119</sup>

The largest number of families living in relative poverty is those in which none of the members are employed, followed by those with only one employed person, and the ones with two or more employed persons. The largest percentage of the poor are without completed education, followed by those that dropped out from primary education. The other groups that participate in this percentage have completed (in the given order): primary, secondary, higher, and post higher education. Additionally, the largest percentage of these people lives in rural areas. Households with three and more children represent almost half of the percentage of people that live in poverty, followed by the ones with two children, and households with one child. An estimated 34.1% of children live in relative poverty, the largest number of which live in the rural areas.

The methodology for allocation of social assistance when it comes to poverty should be revised. In the current methodology, the structure of the family (i.e. the number of women and children) is not a criterion for the amount of social assistance awarded to the

family, but rather the number of members of the family. This should be revised because, as the statistics above show, the largest percentage of families living in poverty is those with the larger number of children in the family. Consideration should also be taken with regard to the area where these people live – people in rural areas usually have fewer opportunities and are more likely to fall into poverty than the ones living in urban areas.

Given the number of people living in poverty in the country, the amount of social assistance provided to them, as well as the recent tendency for institutionalisation of social protection in the country, one cannot say that, until recently, there has been much of either effectiveness nor of equity in social policy. The principle of equity fails when it comes to the amount of assistance provided to families in need (the ones living in poverty). This financial assistance does add a substantial amount to their close to non-existent family budgets. However, it is not bringing them closer to a position of being able to pay for all monthly expenses, let alone to consider undertaking activities that will assist them in improving their position, such as increasing their employability or opportunities for employment.

As noted in the assessment of the current state included in some of the policy documents mentioned, the current situation does not provide the best value for the funds spent. The strategic documents do acknowledge the side effects of the system as it was (especially regarding the institutionalisation of persons in need of social protection). These documents also foresee a larger decentralisation of these services and a more influential say by the municipalities and the communities in shaping and implementation of social policy. Additionally, they encourage good management of funds. This means that the funds that have been allocated to a social protection institution, but have not been spent in total due

<sup>118</sup> World Summit for Social Development: Report of the World Summit for Social Development. United Nations. *UN Website*. <http://www.un.org/documents/ga/conf166/aconf166-9.htm>. Last accessed: 07 November 2010.

<sup>119</sup> World Bank Data Bank on Macedonia, FYR. World Bank. *World Bank Website*. [http://data.worldbank.org/sites/default/files/countries/en/macedonia-fyr\\_en.xls](http://data.worldbank.org/sites/default/files/countries/en/macedonia-fyr_en.xls). Last accessed: 07 November 2010.

to the savings assured by good management, are not to be returned and can be redirected to another activity. Thus, this type of savings cannot be argument/grounds for a decrease of the budget for the following year, but a motive for better management.

### 3.6.3. The Case for a Trade-Off in Employment Policy

Employment greatly influences everyone's life and to a considerable extent. As shown in the text above, poverty and unemployment are interrelated. Also, as will be shown in the next subchapter, this interrelatedness is substantial when it comes to the degree of education and employability, level of wages, as well as the very status of being employed or unemployed. In order to assess the trade-off between equity and efficiency in employment policy, we will start by looking into the aspects of the legislative, policy and institutional framework important for assessing this trade-off. To see the situation on the ground, we will look into the relevant statistics, which can serve us as pointers in this process. The subchapter will close with conclusions on the trade-off and recommendations for lessening it.

The employment legislative and policy framework is determined by several major laws and policies, and is being implemented by several main institutions. The most important laws in this regard are: the Law on labour relations, the Law on employment of foreigners, and the Law on employment of persons with disability. An applied policy framework devised to answer issues in this area is outlined by the following documents: the National employment strategy for 2010; the National action plan for employment (2006-2008 and 2009-2010, including the annual operative programmes for employment); Action plans for reduction of the grey economy; as well as

a policy document targeting gender equality which also contains measures on employment.

Macedonia has high rates of unemployment, as do most of the economies in transition. Even in SFRY it had the highest unemployment rate (overall unemployment rate in SFRY was 15%,<sup>120</sup> while Macedonia's unemployment rate was 24%<sup>121</sup>). This hasn't changed much even today, since the rates of unemployment in Macedonia are much higher than those in the countries of the region (aside from Kosovo, which has an unemployment rate of 45.4%<sup>122</sup>). Unemployment rates were on the rise from independence until 2000, when a falling trend was observed until 2002, returning to an increasing trend until 2006. After 2006, the policies implemented have shown a positive change, since for the first time the rates of employment were higher than those for unemployment. This dynamic coincides with the developments in percentages of the active labour force, which are much higher among men than women, as are the rates of employment.

Some of these documents and measures are rather recently adopted so it is too soon to judge their effectiveness. What can be seen from the current situation is that the government does make efforts to open up the labour market as much as possible (both to citizens and to foreigners). However, what also needs to be taken into special consideration are several issues which can be expected to present problems for implementation, based on previous research done. We will take a

<sup>120</sup> CIA World Fact Book 1990. *Project Gutenberg Website*. <<http://www.gutenberg.org/cache/epub/14/pg14.html>>. Last accessed: 10 November 2010.

<sup>121</sup> EU Candidate and Pre-Accession Countries Economies Quarterly – CCEQ – Special Edition 2005. European Commission. *EUROPA Website*. <[http://ec.europa.eu/economy\\_finance/international/non\\_eu/candidate/fyrom\\_en.htm](http://ec.europa.eu/economy_finance/international/non_eu/candidate/fyrom_en.htm)>. Last accessed: 08 November 2010. p.5

<sup>122</sup> Results of the labour force survey 2009. Statistical Office of Kosovo. *Ministry of Public Administration Website*. <[http://esk.rks-gov.net/eng/index.php?option=com\\_docman&task=doc\\_download&gid=870&Itemid=8](http://esk.rks-gov.net/eng/index.php?option=com_docman&task=doc_download&gid=870&Itemid=8)>. Last accessed: 10 November 2010.

look into the aspects pertaining to effectiveness and equality.

A labour market profile of Macedonia done by the World Bank for the period 2004-2007 shows that highest number of the unemployed are people that enter the market for the first time. This type of unemployment needs to be fought with active labour measures, which should enable these people to re-qualify and equip themselves with skills demanded on the market – accompanied by active labour measures. However, budget austerity measures also cut down the already insufficient active labour measures, putting their effectiveness under question.<sup>123</sup> Additionally, over 90% of people that are first-time job seekers and of the unemployed fall into the category of long-term unemployed.<sup>124</sup>

What is important to point out, and is underlined in this research, are the methodological deficiencies which should be addressed (and some of them are). One of these methodological issues was determining a precise description of persons that actively seek employment, as many of the people that were reporting themselves as unemployed and as actively seeking employment were only doing so in order to obtain free state-paid health insurance. It was expected that the amendments in the Law on health insurance would cause a decrease of the number of unemployed, since this condition was lifted and the so-called citizenship-based health insurance was introduced in 2009. However, this has

not happened. The reasons might be multiple, including the coinciding global economic crisis, which hadn't avoided Macedonia.

Another reason for the high rates of unemployment is usually tied to the grey economy and the informal labour market (pertaining to the jobs that are not registered in the pension funds). Measures to mitigate this situation were additionally implemented. Lower tax rates for new employment and for employment of young persons, as well as general and targeted fringe benefits' reduction policies were introduced. But these also do not seem to have the desired and expected effects.

The third reason that can be attributed to the high unemployment rates is the discrepancy between supply and demand; some studies have shown that the unemployed persons do not have the skills demanded on the labour market. The underlying cause of this is often sought in the adequacy of the curricula of higher education as well as that of vocational education programmes. This also coincides with the fact that the largest share of unemployed persons are with no education or primary education only. Thus, in the case of Macedonia it seems that there is a return on investment when it comes to education. Additionally, there seems to be a positive correlation between the level of education and the average net wage. Employees with university and higher education display significantly higher than average net wage rates.<sup>125</sup>

This also leads us to another occurrence relevant to labour markets in transition economies. On one side, the unemployment rates are very high; on the other, the employers are signifying the fact that they cannot find suitable employees – thus the labour force that

<sup>123</sup> The Former Yugoslav Republic of Macedonia 2010 progress report accompanying the communication from the Commission to the European Parliament and the Council - Enlargement Strategy and Main Challenges 2010 - 2011. European Commission. *EUROPA Website*. <[http://ec.europa.eu/enlargement/pdf/key\\_documents/2010/package/mk\\_rapport\\_2010\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2010/package/mk_rapport_2010_en.pdf)>. Last accessed: 09 November 2010.

<sup>124</sup> Labour market profile of Macedonia for the period 2004-2007. World Bank. *World Bank Website*. <<http://www.google.com/url?sa=t&source=web&cd=2&ved=0CBYQFjAB&url=http%3A%2F%2Fsiteresources.worldbank.org%2FMACEDONIAE%2FResources%2FMK.LMprofile.doc&ei=n9fZTNecGpH0sgaxzMjHCw&usg=AFQjCNEaaUrx8xu3ibrzohd914Pky9h3A>>. Last accessed: 09 November 2010.

<sup>125</sup> Labour market profile of Macedonia for the period 2004-2007. World Bank. *World Bank Website*. <<http://www.google.com/url?sa=t&source=web&cd=2&ved=0CBYQFjAB&url=http%3A%2F%2Fsiteresources.worldbank.org%2FMACEDONIAE%2FResources%2FMK.LMprofile.doc&ei=n9fZTNecGpH0sgaxzMjHCw&usg=AFQjCNEaaUrx8xu3ibrzohd914Pky9h3A>>. Last accessed: 09 November 2010.

is at the disposal on the market does not suit the needs of the market. This emphasizes the need for a close examination of education policy in order to understand the complex interdependence of the measures adopted within any of these policies, and on effectiveness and equity within it.

#### **3.6.4. The Case for a Trade-Off in Education Policy**

As shown in the previous section on employment, education and the degree of education is undoubtedly linked with employment. Education acts as a determinant, to a certain extent, on whether a person is employed, the length of unemployment, as well as the level of the wage, and to an extent the return on education.

The education policy in Macedonia is determined with separate laws for primary, secondary and higher education. Additionally, special define the conditions and framework for volunteering, professional exams and vocational training. Macedonia's main strategic document is the National Programme for Development of Education 2006-2015, and the recently adopted Strategy on Integrated Education.

Statistics show that in 2009/2010, a total of 210,381 pupils (out of which 101,765 female pupils) enrolled in primary education (including those enrolled in special schools and in primary education for adults). At the end of the school year, the number of students that completed the grade dropped by 2.6% compared to the previous school year. For the same school year, 93,843 students (out of which 44,595 female students) enrolled into high school (including those enrolled in private schools).<sup>126</sup> At the end of the school year,

the number of students that completed the secondary education year dropped by 0.4% compared to the previous year.<sup>127</sup> In higher education, for the academic 2008/2009, a total of 63,437 students enrolled, of which 51,795 in public and 11,425 in private universities.<sup>128</sup> There were 10,232 graduates in 2009, of which 8,131 from public and 2,090 from private universities.<sup>129</sup>

In Macedonia, both primary and secondary education is mandatory. While primary education is still solely provided by the State, secondary education is provided by both state and privately-owned schools. For the state schools, the State provides targeted funding for books and transport, as well as funds for other administrative costs in state secondary education, so that all students can complete this educational degree as well. Additionally, as of school year 2010/2011 and with funds secured for the programme until 2014<sup>130</sup>, a conditional cash transfer (CCT) system was established for all recipients of social financial assistance whose children are enrolled in secondary education; the amount of the CCT is 1,000 MKD (approx. 17 EUR) per month. The underpinning aim of the programme is assisting in alleviation of intergenerational poverty, yet its more obvious and measurable effect is lessening the dropout rates, since the condition for these transfers is regular attendance, confirmed by the school management. The ministry estimates that 15,000 students can use this benefit.

<sup>127</sup> Education - News Release 2.1.10.08. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/2.1.10.08.pdf>>. Last accessed: 07 November 2010.

<sup>128</sup> Education - News Release 2.1.10.01. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/2.1.10.01.pdf>>. Last accessed: 07 November 2010.

<sup>129</sup> Education - News Release 2.1.10.26. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/2.1.10.26.pdf>>. Last accessed: 07 November 2010.

<sup>130</sup> These funds were secured through a 25 million USD loan from the World Bank. Source: Start of the application process for conditional cash transfers for high-school students from families at social risk [*Стартува аплицирањето за условен паричен надоместок за средношколците од социјално загрозуени семејства*]. Ministry of Labour and Social Policy. *MLSP Website*. <<http://www.mtsp.gov.mk/?itemID=6DB8ABBF2A6E5C4BBDD37DEDBEF8944B>>. Last accessed: 09 November 2010.

<sup>126</sup> Education - News Release 2.1.10.10. State Statistical Office. *State Statistical Office Website*. <<http://www.stat.gov.mk/pdf/2010/2.1.10.10.pdf>>. Last accessed: 07 November 2010.

Higher education is also offered by both public and private universities. The recent two years show a rise in the numbers of high-school graduates that opt for higher education. Notably, in 2009 this number rose to a staggering 85%. In recent years, there has been a noted rise in the number of higher education institutions in the country – in the past five years it increased from 38 to 99 faculties and universities.<sup>131</sup> Besides the expansion of private investment in the education sector, another reason is the government's focus on extending the public universities into a dispersed system of studying in multiple cities in the country, trying to improve equal opportunities for all and making higher education closer to the citizens. The rationale behind this was that education costs will be transferred from the student (and their family) to the State, where the costs of opening and maintenance of new branches of state universities are taken over at the expense of the living and studying costs for students in another city. Yet, what this policy had so clearly stated is that by encouraging the whole population to enrol in higher education, including multiple enrolments, the unemployment rate is artificially decreased, and worse – the lack of jobs on the market is only postponed for a short period of time. Instead of a more profound improvement of the quality of education vis-à-vis the requirements of the labour market, the policy framework is mainly dealing with making extensive and redundant investments in persons with unwanted skills and capacities.

However, this step made towards equity, has shown in practice to be a step away from efficiency. The quality of the education provided in these institutions has been publicly challenged on several occasions, both in terms of the technical conditions of these institu-

tions and in the teaching staff. This decreases the likelihood that these individuals will profit from their education, once they try to enter the labour market, since their qualities and profiles will not correspond to those demanded by the labour market. Thus, a supposition of one entering the higher education system is usually equalised with postponing the moment when one becomes unemployed, and not because of a real belief in the benefits education can bring to an individual.

When speaking about effectiveness and equality, one needs to limit oneself to public education facilities. Thus, when reading the above statistics, one has to take into consideration that, in higher education, students studying in private universities comprise almost 20% of the total number of students in the country. Thus, this is a part of the labour force that should also be considered in the upper section. Differences in opting for one type of education over another are diverse. Studies show that the reasons vary on personal preferences for reputation, curricula offered, technical capacities, financial constraints, preferences for learning methods, devotion to studies, reasons for opting for education in general, and so on.<sup>132</sup>

Judging by the current feedback from the labour market, as already explained, it is arguable that there is a need for undertaking more seriously planned reforms in education policy, starting with vocational secondary and higher education. These reforms must ensure, as an end result that individuals undergoing education in these institutions will enter the labour market as professionals equipped with qualities that will present a response to the demands of the labour market, and with skills to assist them to swiftly adjust to these demands.

<sup>131</sup> To higher degrees with lower education [До високи титули со ниско образование] Daily Newspaper Dnevnik, 24.08.2010 <http://www.dnevnik.com.mk/default.asp?itemID=286AA3779F05CA4DB037545E53F140D3&arc=1>, last accessed: 14 November 2010.

<sup>132</sup> For more, please see: Linking higher education and the labour market. Centre for Research and Policy Making. *CRPM Website*. <http://www.facebook.com/l.php?u=http%3A%2F%2Fwww.crpm.org.mk%2FPapers%2FeducationENG.pdf&h=7067c>, last accessed: 09 November 2010.

### 3.6.5. Conclusion and recommendations

Although by-far a leader in unemployment (after Kosovo), one can say that Macedonia is no different than other transition countries. Additionally, it struggles to find the most suitable model for social policy, employment and education that will optimally fit its context. Struggling with poverty, unemployment, drop-out rates and to some extent illiteracy (especially among its ethnic minorities); facing politization of its administration which is on the rise with every change of government; striving to enhance decentralisation, and achieve better development in every region throughout the country, thus reducing the gaps of the quality of life between the urban and rural areas; go in parallel in this SEE country with the desire to shape its laws and policies according to the standards existing in EU countries, to open up the economy and attract foreign investments, and to increase the quality of education and the competitiveness of the workforce in the country.

As presented above, the interconnectedness between the three areas is more than evident. Measures undertaken in each of them reflect upon the others. Education acts as a determinant (to a certain extent) on whether a person is employed, on the length of unemployment status, as well as the level of earnings, and to an extent the return on education.

Social policy is being thoroughly revised over and in the past several years. Deinstitutionalisation is underway, and social assistance is striving to be more directed towards those in most need. However, the strategic documents and actions plans need to be put into practice. There has to be a continuity and consistency in the implementation of the actions foreseen in these documents, together with regular monitoring of progress and constructive measures for improvement.

Enhancing the capacity of the administration and of the personnel working in the institutions for social protection and unemployment is a step that needs to be made for both policies.

This goes in hand with the proven low capacity of these institutions to provide adequate services to their users. Although a strategic step was taken in planning, the economic crisis had its impact on these plans and their actualization.

Employment policy still lacks sufficient active labour measures. Furthermore, Macedonia is one of the countries that is in danger of falling into the spiral of unemployment with both very high unemployment rates on the one side, yet the problem of employers in finding adequately skilled employees – thus the labour force which is at the disposal on the market does not suit the needs of the market - on the other, exist at the same time. This indicates the need for radical changes in education and employment policies – based on the evidence, such as acquired education and skills, and the needs of the labour market, especially in the service sector.

Education policy needs change in order to be able to include the greatest number of individuals in the educational process, and ensure, at the same time, a return on investment. Expanding the network of state universities should go hand-in-hand with maintaining a certain level of quality of the education provided in these institutions that will ensure that the individuals undergoing it will be able to enter the labour market equipped with qualities responding to the demands of the labour market, and with skills to assist them to swiftly adjust to these demands.

To sum up, in order to lessen the trade-off in social, employment and education policy, the following actions should be considered: an increase in coordination among the institutions dealing with these policies both in their design and in their implementation; ensuring their coherence; strategic realistic planning for the short, medium and long term; regular research and analysis of the past, current and anticipated developments; design and full utilisation of monitoring mechanisms for the implementation of these policies that will enable timely and prompt reactions and on the other side - sufficient allocation of financial and human resources.

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## 3.7. Moldova: System Survival vs. Long-Term Viability

*Cornel Ciurea*

### Abstract

One of the most important issues faced by the Moldovan government is the long-term reconciliation of two socio-economic objectives which seem to be apparently contradictory – efficiency and equity. Reasonable trade-offs could be found in order to reconcile the long-term desire to ensure the viability of the system and the short-term imperative to guarantee the system's survival after the severe shock caused by the rampant economic crisis.

This fact is especially evident in such fields as unemployment, education, social services and health care. There are two basic aims which must be targeted by the Moldovan government in order to lessen this trade-off – the Social Assistance System Reform and the Pension System Reform. The education and health care systems are strongly influenced by the informal practices of out-of-pocket payments, which reflect the inherent tendency towards self-adjustment of the entire system. These informal practices increase the general efficiency of the system but, at the same time, create additional perverse consequences which spoil it.

### 3.7.1. Introduction

Moldova has been an independent state since the collapse of the Soviet Union in 1991. As part of the ambitious reform effort adopted after independence, Moldova introduced a convertible currency, freed prices, stopped issuing preferential credits to state enterprises, backed land privatization, removed export controls and liberalized interest rates. The government also entered into agreements with the World Bank and the IMF to promote growth and reduce poverty.

However, the reform process was accompanied by a prolonged recession and a drop in living standards for ordinary Moldovans as the shock from the break-up of the Soviet Union and loss of centralized subsidies took effect. Complicating the economic picture was the fact that the eastern border region of Moldova decided to forcefully secede from Chisinau in 1990, forming the separatist region of Transdnestr, which is not recognized internationally. As much of the Moldovan industry, particularly steel is located in the eastern part of the country, the loss of control over Transdnestr meant that the country has been unable to exploit this

industrial base. Lack of sound economic and social reforms, coupled with political instability in the first phase of transition, has led to economic recession and increased poverty, thus qualifying Moldova as the poorest country in Europe.

Since 2000, Moldova's economy has been recovering, mainly due to migrant remittances, which currently represent about one third of GDP. Remittances increased population incomes, raising aggregate demand and consumption. Consumption is satisfied largely by imported goods, with their more competitive prices and quality, dramatically increasing the trade and current account deficits.

Remittance-based economic growth was accompanied by poverty reduction, but the related population exodus created disruption within the domestic labour market. The population declined by more than a fifth during transition; the emigration of almost a quarter of the active population has threatened the labour market. Thus, there has been a decrease in the economically active population and the population employed within the economy (also by almost one-fifth), whereas the inactive population has dramatically increased.

At the moment, the Moldovan economy is recovering from the severe slowdown amid the international financial crisis. Weak external demand is forcing a sharp contraction of industrial production, exports, and inventories. Meanwhile, investment and household demand have been affected by tightening credit conditions and falling inflows of remittances from Moldovans working abroad.

The political crisis in the country, which emerged after Parliamentary elections were held in April 2009, and the associated budget expenditures, represents a threat to the sharply declining economy, obstructing the proper implementation of anti-crisis policies to support the private sector and vulnerable groups. Response to the economic crisis was late and incomplete, mainly due to the political situation.

The last parliamentary elections were held in Moldova on 5 April 2009. However, these were marred by post-election violence and allegations of fraud directed at the victorious Communist Party (PCM) by the opposition. Despite its success in the polls, the PCM lacked the necessary 61 seats in the 101-seat parliament to elect a new president unopposed. The failure to achieve this in two consecutive votes meant that, in line with the constitution, fresh parliamentary elections had to be called.

These were held on 29 July 2009, under much international scrutiny. On this occasion, the four main opposition parties were able to gain enough seats to form a governing coalition, called the Alliance for European Integration (AEI). However, this coalition again lacked the necessary seats to elect their presidential candidate in the face of a PCM boycott. Fresh parliamentary elections were once again called, although amendments to the electoral law made by the AEI meant that these will not be held until the latter half of 2010 or first half of 2011.

All these hardships impede considerably the process of increasing the living standards

of the ordinary Moldovan people and create difficult dilemmas. One of the most important issues which are faced by Moldova's government refers to a long-term reconciliation of two socio-economic objectives which seem to be apparently contradictory – efficiency and equity. Being compelled to put the emphasis on efficiency, Moldova's government should not forget about the need to preserve socially acceptable discrepancies between different strata and to prevent undesirable protest movements which could result due to the unrestrained interplay of market forces.

### **3.7.2. Social Policy in the Republic of Moldova from the Point of View of the Trade-Off between Efficiency and Equity**

Poverty is an acute social problem, which affects the entire society by bringing suffering to the people affected by it. At the same time, reasonable trade-offs could be found in order to reconcile the long-term desire to ensure the viability of the system and the short term imperative to guarantee the system's survival after being severely shocked by a rampant economic crisis.

In the first three years after independence, poverty had registered the fastest decline in Moldova, reaching the highest scores in Europe and Asia amongst countries in transition. Poverty reached its peak after the economic crisis in Russia in 1998, when over 53% of the population were living on an income of less than 2.15 USD per day. In 2000 the Moldovan economy returned to a positive trajectory, adjusted to the economic growth of the countries in the region, supported by incomes sent home by Moldovan emigrants together with macroeconomic stabilization.<sup>133</sup> Absolute and extreme poverties were decreasing until 2004, but in 2005 they moderately in-

<sup>133</sup> See National Human Development Report – Chişinău, 2006.

creased, even so the economic growth trend remained positive.

In spite of the fact that in 2005 the tendency of economic growth remained the same as in previous years, this fact did not have an impact, however, on poverty reduction in the country, especially in the rural areas where poverty rates kept going up. Thus, in 2005, the absolute poverty rate increased by 3%, i.e. 29% of the population of the Republic of Moldova was under the absolute poverty threshold, while 16% were under the extreme poverty threshold. Other poverty measuring indexes registered similar results. The depths of extreme and absolute poverties in 2005 were 4% and 8% respectively. That means that poor people had an average deficit of 11 lei for consumption to reach the extreme poverty threshold and 28 lei to reach the absolute poverty threshold. In 2005, the level of inequality in the Republic of Moldova registered a slight increase. This tendency is reflected in the evolution of Gini coefficient, which measures inequality in consumption amongst households at the country level. The higher the coefficient, the bigger is the inequality. Hence, inequality, in terms of population consumption, remained at the relatively high level, the Gini coefficient being in 2005 – 0.38, in 2006 – 0.315, while in 2007 – 0.298. That brings forward the fact that disparity of incomes between the rich and poor decreased.

According to the Human Development Report for 2009 published by the United Nations Development Programme, Moldova was placed at 117 in 2009, with six positions lower than in 2008, alongside Guinea, Viet Nam and Mongolia, in the category of countries with a medium index of human development. The residence environment is one of the factors most linked with poverty. The rural population makes about 59% of the country population and nearly 66% of all poor people living in the countryside. Assessments of poverty rates according to the residence area show the same general profiles

of poverty as in the previous years, with significant differences between urban and rural areas. The population in big cities continues to run the lowest risk of living in poverty, its level being of 20.6%. Poverty rates in the countryside are the highest (34.1%). In comparing with big cities, absolute poverty in rural areas is with 13.5 p.p. higher, while comparing with small towns – with 4 p.p. High distribution of poverty in rural areas is due to low agricultural production and lack of opportunities for employment in other fields but agriculture.

The level of poverty grows with the number of members in households – from households with few members to those with 5 and more. The share of people living in large households (5 and more), in the total share of the population, is nearly 22%, while the share of all poor households – 34%. Yet, the risk of poverty persists in the households with one member (29.6%), however the share in the total of population is just 7%. The highest absolute poverty rates are registered in the households formed of 4 members – 28.4%, 5 members – 38.5%, as well as 6 and more members – 55.9%. The poverty tendency linked to the number of children remained the same as in previous years. Poverty risk increases with the increase in the number of kids in families. Almost 67% of all households are families with a single or no child. These households are less poor, while the most affected are households with 4 and more children. The absolute poverty rate in these families is 65.4%. Extreme poverty is also higher in these households, reaching a level of 14.8% or 10% higher than the average per country.<sup>134</sup>

Data analysis by social-economic groups shows that poverty risk is higher amongst agricultural sector employees (42.8%). High poverty risk amongst farmers and people employed in agriculture is closely linked to the development of this sector. The agricultural

<sup>134</sup> Marcela Dilion, "Social concerns and responses to them" in Early Warning Report, No 1, August-December, 2009

sector of the Republic of Moldova continues to be considered as one with the lowest level of production and labour remuneration. Moreover, substantial dependence of incomes on climatic conditions determines their instability and represents an additional specific risk factor for poor rural households.

The increase in the ratio between average incomes of the population and main sources of income (salaries, pensions) against the minimum existence costs is explained by the fact that population incomes increased within the period between the 2<sup>nd</sup> quarter of 2008 and the 2<sup>nd</sup> quarter of 2009 in circumstances of overall price stability. On some agricultural products, prices even went down.

One especially important factor in monitoring poverty is the share of the poorest quintile in national consumption.

This index represents the income/ consumption part which belongs to the poorest 20% of the population, in total consumption per country. Household consumption expenditures dispersal by quintile is done in order to compare the consumption of poor strata and rich ones. In this respect, we notice a high polarization of incomes in the Republic of Moldova.

The existing social assistance structure is based on a system of nominative compensation, which remains the most expensive social programme making up 38% of all expenses for social assistance in 2006. It has been recognized that this system has been inefficiently directed towards the people most in need. The system equally covers all quintile of incomes. A report drafted by the World Bank „Moldova: Policies Notes for the Government” (May 2009) mentions that less than half of the people belonging to the two poorest quintile (40%) of the consumption expenditures distribution received any of the available social help in 2007, which made less than 40% of the total value of social assistance. That means that more than 60% of social assistance payments

are directed to medium and rich quintiles, thus making these payments regressive.

This situation limits the efforts on reducing poverty, playing as a constraint on the implementation of necessary reforms for future economic development. The National Development Strategy for the years 2008–2011 (Law No. 295 from 21.12.2007) is the main internal document for strategic planning for the mid term, which outlines objectives for the development of the Republic of Moldova until 2011 and stipulates measures and actions to reach those objectives. The Strategy serves as a single tool for the integration of the existing strategic framework, correlation of the budgetary planning process (CCTM) with the policies framework and the framework for technical and financial external assistance. In order to concentrate available resources for the implementation of the objectives and other measures with a high impact on social and economic development of the country, the Strategy focuses on a limited number of strategic priorities. The fundamental objective of the Strategy is to create conditions for the improvement of the quality of the population though consolidating the base for robust, lasting and inclusive economic growth. In the mid-term, till 2011, the Government will make every effort to recover at least 7% from the disparity in incomes compared with the average in the EU and to reduce the absolute poverty rate down to 24%. The dependency of the poverty reduction process on economic growth was taken into consideration when fixing milestones. Poverty elasticity of -1.4 in respect to economic growth was used, which was a regional average figure and, respectively relevant in the context of the Republic of Moldova.

Although the GDP increased by 5%, applied simulations reveal that the poverty rate may reach nearly 21% by 2011, the target was adjusted considering non-linear correlation between economic growth and poverty reduction. In the long run, until 2015, through the

Strategy the Government will make efforts to recover at least 12% of income disparity comparing the average figure in the EU and reducing the absolute poverty rate down to 20%.

Based on all this, we could draw the conclusion that the Republic of Moldova is facing a series of problems leading to poverty increase, which may result in social protest:

- A slowed rate of economic growth;
- Heightened disparity between the level of development in rural areas and in urban settlements;
- Continuous growth of inequalities;
- Dependence of the economy on climatic conditions, etc.

Although there is a slight improvement in some social indicators, the increase in living standards of the population is very slow. The 2009 economy drop made the incomes of population return to the indicators similar to the pre-crisis period more difficult. Such a conclusion comes from the analysis of the evolution of real incomes per capita, which accounts for the consumption capacity of the population. A similar situation is present in the case of per capita incomes denominated in U.S. dollars. In 2010, this indicator is expected to decline, of course, being influenced by the depreciation of the national currency.

Compared to other countries in Europe, the living standards in Moldova are the lowest. With EUR 46.29 per month, the minimum gross wage in Moldova remains the lowest in Europe, being almost 34 times lower than that of employees in Luxembourg, which holds the first position in a ranking conducted by the Federation of European Employers.

A relatively similar level to the minimum wage in Moldova is recorded in countries such as Montenegro (Euro 55.00) and the Ukraine (Euro 68.21).<sup>135</sup> The structure of consumption expenditure also reveals that the population

lives in poverty. In Europe, as regards living standards, Moldova is part of "the group of losers", along with Serbia, Bosnia, Macedonia and Albania, followed at a significant distance by the Ukraine and Belarus.

A critical situation concerning poverty is also shown by the ratio of disposable income per capita to living subsistence. According to this indicator a citizen of Moldova can hardly cover the living subsistence. Although the evolution of certain indicators regarding the social sector show a slight increase in 2010, the living standards in Moldova will remain unsatisfactory. A slight improvement in the situation is expected in the medium run, but an obvious improvement in living standards could be possible only after achieving major economic improvement.

From the point of view of the trade-off between efficiency and equity there are two major risks which affect social policy in Moldova. Before listing them, mention should be made that this trade-off has been aggravated seriously since the year 2009 due to the economic crisis. A substantial drop in the budget revenues creates difficulties in expanding social programmes, the government being compelled to search for rapid short-term and mid-term solutions and being less prospective, frequently missing the long-term vision. The social sector continues to have a high priority, the truth of this statement being confirmed by the increase in social expenses in 2010 compared to 2009, this allowing retention of the same share in GDP for this category of expenses. Nevertheless, in order to find additional sources for development the government had to resort to measures with a negative social impact. Thus, the following was provided to optimize personnel expenses:

- decrease the number of staff in the budget sector by 5 per cent;
- decrease staff expenditures on account of temporary inappropriate work leave by 2 per cent;

<sup>135</sup> "Depreciation of currency Exchange rates in Eastern Europe", [www.agenda.rolimageseditions/111084\\_16541.pdf](http://www.agenda.rolimageseditions/111084_16541.pdf)

- decrease the material aid provided to some categories of employees from 2 salaries per year to one salary per year.

These measures are not very popular and they reflect an attempt to increase the efficiency of the public sector, being at the same time concerned with the issue of equity, due to the fact that the additional revenues obtained by these means should be reallocated to the social sector. Mention should be made that the government found a short-term compromise between efficiency and equity in providing a minimum level of social protection guaranteed by the State. The problem of long-term trade-offs between efficiency and equity should be solved by addressing two major issues of social policy in Moldova.

1. Social Assistance System Reform. The nominal compensation system will be replaced by the social aid system. Such a measure is a rational one; the nominal compensation system was not very efficient and this is also mentioned in the National Development Strategy, approved in 2007: “The nominal compensation system is recognized as being directed inefficiently towards poor people. Its benefits cover equally all revenue quintiles.” The reasons for this inefficiency have been discussed in this chapter and in this respect an efficient social assistance system will mean at the same time an equitable system. The main purpose of such a new system will be to target the people most in need. Unfortunately this is not the case in the current system.
2. The Retirement System. There are several reasons that raise questions on the future national retirement system:
  - Population ageing;
  - High degree of tax evasion, with respect to the effectiveness of the individual income tax system, by using the practice of “wage in the envelope”, thus diminishing the basis for collection of income

to the national public budget (including the social insurance budget);

- Slow development of private pension funds.

Such a range of reasons puts significant pressure on the national public finance system. The State Social Insurance Budget has previously faced situations where it finished the budgetary year in deficit.

- In 2007 this amounted to MDL 87.4 million;
- In 2009, MDL 823.87 million from the State Budget were transferred to cover the deficit of the State Social Insurance Budget.
- For 2010, the Law on the State Social Insurance Budget provides expressly an amount of MDL 941.4 million, which will be used as transfer from the State Budget to cover the deficit of the State Social Insurance Budget.<sup>136</sup>

The pension system reform has become a necessity for the Republic of Moldova. Postponement of the deep transformation of the pension system could generate serious constraints both for the public finance system and for the social sector. In this regard, the solution of gradually increasing the retirement age as has been done in other Eastern European States should be considered as a possibility to reconcile efficiency and equity. Despite its unpopularity, this measure could lessen the burden on the State Social Insurance Budget and provide the possibility of increasing the efficiency of the whole system.

### **3.7.3. The Trade-Off between Efficiency and Equity in Employment**

At present, the labour market is in the process of transformation due to the transition to the market economy. The creation of the labour

<sup>136</sup> Alexandru Fala, “Social Sector – Developments with inconclusive effects”, in Early Warning Report No 2, January-April

market requires additional work on the legal framework and certain economic structures. These factors make the labour market formation process sustainable and less complicated.

The changes which occurred after the declaration of independence on August 27, 1991, led to:

- an increase in the number of unemployed as a result of contraction of all economic sectors;
- an increase in the number of employees in the private sector and decrease of those occupied in the public sector;
- the passage from stable and badly remunerated jobs to less stable but better paid ones;
- an increase in labour force migration.

The link between poverty and unemployment is well known. In the Republic of Moldova, in addition a strong link emerges between poverty, on the one hand, and unemployment and migration among the youth on the other. Although the youth unemployment rate in Moldova is comparable with that in the European Union (16% as of October 2008), youngsters in Moldova suffer in an obvious way from the consequences of the existing disadvantages on the labour market. There is a negative correlation between age and the risk of becoming unemployed.

Hence, people between 15 and 24 years of age face a double risk of becoming unemployed as opposed to people from the next age category (25-34 years old).<sup>137</sup> In the first quarter of 2009, most unemployed young people had only high school education, which placed them in a disadvantageous position in the country. The current economic crisis has badly affected unemployed youth. In the first quarter of 2009, the unemployment rate amongst the youth (for example, those belonging to 15-24 category of age) increased up to 16% (compared to the trend in the past, which witnessed a decrease

in the unemployment rate amongst the youth from 17% in 2006 down to 14% in 2007). The unemployment rate amongst youth (18%) is higher than amongst women (14%), even though the employed labour force is higher amongst men (17%) than amongst women (15%). The unemployment rate amongst youth is higher in the rural areas (17%, in the first quarter of 2009; in urban areas – 15%). That is why it should be of no surprise that migration in Moldova is rooted in rural areas, and embraces mainly young people. Thus, while the average age of migrants in 2006 was nearly 35 years old, 37% were up to 30 years old.

According to the data offered by the National Bureau of Statistics, in the II quarter of 2009, the economically active population (both employed and unemployed) of the Republic of Moldova was 1358,1 thousands people, decreasing by 2,9% (-41.1 thousand) compared to II Qtr of 2008. This change is due mainly to the decrease in the employed population (-81.4 thousands), especially the population employed in agriculture (-52.6 thousands). The pattern of active population suffered as a result of the change: the share of the employed population decreased from 97.0% to 93.9%, while the share of unemployed rose from 3.0% to 6.1%. No disparities were registered between genders and for the environment of the active population: the share of men (51.1%) exceeded the share of women (48.9%), while the share of active population in rural areas was higher compared to the active population in urban areas (55.6% and 44.4% respectively).

The percentage of the active population aged 15 years and older (proportion of active population aged 15 years and older in the total share of the population aging 15 years and older) was 45.9%, being lower compared to the rate in the same quarter of the previous year (47.5%). This index scored higher among the male population – 49.7%, compared with females – 42.5%. The average occupation rates

<sup>137</sup> 2005, "Moldova – Educational policy note".



were 47.9% in urban areas and 44.5% in rural area. In the age category of 15-29 this index was 30,5%, while in the category of 15-64 years of age (work age applicable in European Union countries according to the Eurostat methodology) – 50.8%, decreasing by 1.9% compared with the level of the 2nd quarter of 2008.

The employment rate of the population aged 15 years and older (proportion of people employed aging 15 years and older in the total share of the population of the same age) was 43.1%, registering a decrease by 3.0% compared with the 2<sup>nd</sup> quarter of 2008. Men had a higher rate (46.1%) compared to women – 40.4%. For residential areas the employment rates were 44.0% in urban areas and 42.4% in rural areas. The employment rate of the population of working age (16- 56/61 years old) was 49.8%, the population aged 15-64 years old – 47.6% and in the category of age 15-29 this indicator had a value of 27.1%.

According to the distribution of employed people by sectors of the national economy, the number of people employed in agriculture was 412.5 thousand people (32.3% of the total share of the employed population). Compared with the 2<sup>nd</sup> quarter of 2008 the number of the population employed in agriculture significantly decreased – by nearly 53 thousand, or by 11.3%, which means that every eighth person employed in agriculture quit their job. In the meantime, every second person employed in agriculture continues to work on its private household.

In non-agricultural sectors the number of employed people was nearly 863 thousand, less by 28.8 thousand (3.2%) compared with the 2<sup>nd</sup> quarter of 2008. The share of employed people in the industry accounted for 12.0% (12.6% in 2008) and in construction -5.7% (6.6% in 2008). People employed in industry and constructions registered 90.2% and 80.7% respectively from the level of the previous year. The service sector employed 49.9% of total em-

ployment, this share having increased by 3.4% compared with the 2<sup>nd</sup> quarter of 2008. Mention should be made that not only the share, but also the absolute number of employed people in the service sector increased compared with the similar period of the previous year (+5.1 thousand). By the category of distribution, 69.8% of the population were employed in private enterprises, 25.7% - in public enterprises and 4.5% - in enterprises with a mixed form of category (public and private) and with foreign capital. The pattern of the employed population structured according to professional status shows that the number of public servants accounts for 67.2% of the total number.

12.1% were employed in the informal sector out of all employed people in the economy, while 30.7% had an informal job. Out of all employed people, public servants accounted for more than a quarter (27.4%), while nearly 12.5% of all public servants also had an informal job.

The number of unemployed assessed according to the methodology of the International Labour Bureau (BIM) was nearly 82.8 thousand, being 40,3 thousand more compared with the 2<sup>nd</sup> quarter of 2008. Unemployment hit the male population hardest – 60.9% of all unemployed, as well as people living in urban areas – 57.9%.

The unemployment rate (the share of BIM unemployed in the share of the entire active population) country-wide reached 6.1%, being higher than in the 2<sup>nd</sup> quarter of 2008 (3.0%). The unemployment rates for men and women were: 7.3% and 4.9%. Disparities were registered between unemployment rates in urban areas – 8.0%, and rural areas – 4,6%. Among the youth (15-24 years of age) the unemployment rate accounted for 15.4%. In the category of age ranging between 15 and 29, the rate was 11.1%.

Recent forecasts for the labour market suggest an unprecedented rise in unemployment,

due to the crisis, which will rise from 29 million people worldwide in 2007 up to 59 million. In Central and South-East Europe, as well as in the Commonwealth of Independent States (CIS), the forecasts predict an increase in unemployment of up to 35%, while the number of employed people will decrease by 1-2.8%.

These assessments suggest that youth will be much more affected, thus, the number of unemployed young people will expand between 11 and 17 million people in 2008-2009, representing an increase in the unemployment rate amongst youth worldwide of up to 14-15%. Countries such as the Republic of Moldova, which recently witnessed improvements in youth employment, now face a setback as a direct impact of the crisis.

The main problem in Moldova is that the old work places are not replaced sufficiently quickly by more productive place. The great lack of balance between work places creation and closing down negatively affects the employers' opportunities to pass from a less productive job to a more productive activity. The main factor establishing the slow rate of work place creation is the high cost to launch a new business in Moldova. The red tape, the corruption, and high tax are other reasons for the reduced contractual entrepreneurial activity.<sup>138</sup>

Another main dysfunction on the labour market is the disparity between the supply side of the education system and the labour market needs and requests. This is the explanation from the experts: a surplus (law, economy and foreign languages) on the one hand, and for the insufficiency of seamstresses, house painters, plasterers, welders, electricians etc., on the other hand. Under these conditions, there is a mass migration of those whose absence is felt through the "deficit" on the market.

In the Republic of Moldova, the work force has not become a merchandize yet and its price

is not at the cost level, although from the year 2000 there have been increases in the monthly average salary not only in the private but also the budgetary sector. In accordance with a classification elaborated by the European Employers Federation (FedEE), which included 48 European states, the citizens of the Republic of Moldova are the most badly paid. The gross minimum salary for the work hour is 3.27 lei (about 0.20 Euro) with a maximum amount of 336.43 lei/hour (about 21.5 Euro). The hourly salary is 70 times smaller than that in Denmark, which ranks first in the classification. Another characteristic of the labour market in the Republic of Moldova is the big lack of balance between the salaries of those with leading functions and those with inferior positions.

According to the same study conducted by FedEE, this difference is more than 100. The workers receive the lowest hourly salaries (3.27 Lei), while the company presidents get the highest salaries (336.43 Lei/ hour). The FedEE data shows that those who work in international companies are by 2.6% better paid than those who work in local firms. According to another classification made by FedEE, the minimum salary legislated for in the Republic of Moldova is the lowest minimum salary in Europe accounting for 29 Euro per month, while in Russia it is 32 Euro, in Ukraine-59 Euro and Romania-97 Euro per month. Given these conditions, the population is not motivated to work at home where the small salaries do not cover their essential needs and do not ensure a decent life. Thus, people prefer to work in other labour markets.

Another labour market feature is the existence of a significant segment of persons engaged in the informal economy. Because labour supply exceeds demand, many individuals accept working without labour contracts and that their position is not subject to work legislation and income tax. At the same time, they renounce social protection and certain benefits (notice in the case of dismissal, al-

<sup>138</sup> Adriana Tatarciuc "Labour Market in Moldova: Falling Apart", IDIS Viitorul, 2007

lowances in the case of dismissal, yearly paid leave, medical leave etc.).

In conclusion, an attempt should be made to find the optimum ratio between the desired labour market flexibility and the required social protection. Significant social protection promoted by the State encourages employers to create an informal shadow economy which engulfs a lot of workers. This means that the principle of efficiency overwhelms the equity norms and the state regulations are doomed to failure. At the same time, the low rate of job creation significantly impedes the process of labour market consolidation. That is why, the official low rates of unemployment do not say much about the real state of affairs on the market. It could be said that despite the substantial degree of worker protection, the efficiency criterion, which prompts employees to circumvent the official regulations, is much stronger. Under these circumstances officials should try to employ solutions such as flexicurity, which will provide an important degree of flexibility to those who hire workers.

#### **3.7.4. The Trade-Off between Efficiency and Equity in Education**

Over the past fifteen years, the Moldovan educational system has undergone a number of reforms intended to modernize and democratize education, as well as to establish appropriate conditions for making full use of each child's potential, regardless of its family's material standing, place of residence, ethnicity, spoken language, or religious beliefs. The major intervention areas of the reform were the doctrine of the educational system, the educational system structure, the written curriculum, the taught curriculum and learned curriculum, the evaluation concepts and methods, and the management and financing of education. In this respect, the idea of equity was more important for officials in the 2000's, despite the

fact that in the 1990's the processes of privatization were much more influential, which resulted in the establishment of a multitude of private educational institutions.

The further reformation of the educational system to ensure the right of every child to a quality education implies an appropriate and truthful evaluation of education from the perspective of requirements set out for child-friendly schools. Promoted at the international level, the concept of the child-friendly school focuses on five dimensions: inclusion and equity; efficiency of learning; safety, protection and health of pupils; gender equality and involvement of pupils, families and communities in the life of the school.<sup>139</sup>

Education in the Republic of Moldova, including access to education, is indissolubly related to living standards. Since 1990 the most affected social categories have been the people employed in agriculture and education. The long economic crisis, poverty, unemployment and corruption have deeply affected the quality of education. The most vulnerable families in the Republic of Moldova are families with children, which are most affected by poverty. The recent data on poverty are not at all encouraging and the situation continues to worsen.

Access to quality education in the existing conditions of the Republic of Moldova depends in most cases upon the number of children in the family. The poverty risk goes up with an increase in the number of household members, from small households to those with five and more members. Persons living in large households (five or more members) represent 17 per cent of the total of the population, while these households represent 25 per cent of poor households. People living in smaller households have a lower representation among the poor than the national average. One-person

<sup>139</sup> Baseline Study on Basic Education in the Republic of Moldova from the perspective of child friendly schools", IPP, 2009

households make up the lowest share (nine per cent) of poor households, and two-person households have a poverty rate of 23 per cent. The higher rates of absolute poverty are recorded in cases of households with four members (34 per cent), five members (38 per cent), and six or more members (57 per cent).

It is important to mention that families with children under 18 years of age, i.e. school-aged children, together with other households with children under 18 years of age, represent 60 per cent of the number of poor households and 52 per cent of the total number of households, having a level of absolute poverty rate of 34 per cent on average and the extreme poverty level of 20 per cent.

According to the data of the National Bureau of Statistics made public at the end of 2007, in 2006 the total poverty threshold was MDL 747, and the extreme poverty threshold MDL 404. The total poverty rate was 30.2 per cent and the extreme poverty rate 4.5 per cent. Regretfully, this data cannot be compared with the 2005 data because the computation methodology was changed.

Nevertheless, we can firmly assert that poverty predominates mostly in rural areas (34.1 per cent of households compared with 24.8 per cent in urban areas) and the poorest are:

- people living in large households (five and more persons), with a poverty rate of 39 per cent;
- people living in households with three or more children, with a poverty rate of 48 per cent;
- people living in households with three or more children, and with people of different generations, with a poverty rate of 35 per cent;
- households consisting of farmers and pensioners, with a poverty rate of 42 per cent.

Education expenditures are the lowest among all expenditure categories (1.5 per cent); expenditures for foodstuffs have the

largest share (44.4 per cent). Rural inhabitants spend only 1.9 per cent of their total consumption expenditures on education, while the inhabitants of large towns spent 4.4 per cent and those of small towns spent 3.1 per cent.

At the same time, according to the data provided by the Ministry of Economy and Trade, in 2006, the volume of expenditures on education varied significantly between quintiles and place of residence. Thus, wealthy families spend about four times more on these services than poor families and people living in cities spend about 2.7 times more than people living in villages. But if the analysis focuses on the expenditures of families from the lower quintile it is evident that foodstuffs, housing and public utilities take the largest share of the family budget (about 73 per cent) with expenditures on education representing only 0.4 per cent. This data shows once more the limited possibilities of poor families to afford to keep their children within the educational system.

Families with many children face the greatest difficulties. In addition to having many children to support, many also lack well-paid jobs or adequate qualifications. A large number of these families live under the poverty line, in conditions that are harmful to child development.

The problems caused by poverty are aggravated by the fact that during the past ten years the educational system of the Republic of the Moldova has faced a critical lack of money. In 2009, the expenditures on education increased in absolute figures almost five times in comparison with 1997, while in relation to Gross Domestic Product they decreased by about two percentage points. Still, even in these conditions, the share of expenditures on education in the general consolidated budget of the Republic of Moldova is comparable to the share allocated by the majority of European and Central Asian states.

A detailed analysis by expenditure categories indicates that the financial means allocat-

ed for education are used with relatively low efficiency. The main causes of this phenomenon are the following:

- imperfect school financing mechanisms, based on indicators centered on institutions and not on pupils;
- imperfect mechanisms for the remuneration of the teaching staff, based mainly on the seniority of staff and not on performance, leading to the exodus of young teaching staff from the educational system;
- low wages of the teaching staff, leading to the employment of teachers for 1.5-2.0 standard workloads, with immediate consequences on the quality of education;
- disproportion in the distribution of financial means by different expenditure categories, the share of expenditures that are not directly related to the teaching-learning process being exaggerated;
- the decrease in the number of pupils per teacher and in the number of students per nonteaching staff;
- the high share of non-teaching staff in the total number of employees of the educational system.

Therefore, the educational financing system needs to be fundamentally streamlined, especially in primary and secondary education. This is directly related to the efficiency/equity dilemma. The new financing mechanism must be based on indicators related to pupils, in accordance with the principle 'the money follows the child'. This mechanism, which is focused on efficiency, will also offer opportunities for public authorities to encourage school managers and educational institutions to produce good results in ensuring access to education, including pupils with special educational requirements, and improving the quality of the teaching-learning process. Obviously, school managers must also have possibilities to motivate teaching staff and, especially, to have a certain autonomy in establishing the wages of

their educational institutions' employees, depending on individual performance.

The shortage of financing is partially compensated by the contribution of parents through informal payments. The IPP Study 'Informal Payments in Pre-University Education and Equal Access to Education' provides relevant data on the way schools currently try to settle the issues related to the lack of financial means.

The data collected from a representative sample consisting of parents, teachers and headmasters during December 2006 to February 2007 shows that additional payments made by parents during one academic year amount to MDL 209 million, which is 13.3 per cent of the financial means allocated by the State for the respective academic year. Parents pay for tutorials, additional lessons (in groups), the school fund, security services, repair works to classrooms and heating systems, exams, processing of graduation certificates, gifts for teachers, school events and better marks for students. This way of co-financing creates problems for the equitable delivery of education services, because many parents are unable to offer money for their children's education, which puts them in an extremely unfavourable position.<sup>140</sup>

At the same time, this additional contribution is vital for the pupils' education. In the opinion of most parents, it is impossible for their children to obtain a quality education without contributions on their part. One in seven teachers and headmasters support the parents' opinion. Many parents (48.6 per cent) say that teachers dedicate more time and efforts to children whose parents contribute more to the school's needs. At the same time, parents and a number of teachers acknowledge that under these conditions some pupils from poor families are disadvantaged, and do not receive the teacher's attention because their parents cannot afford additional

<sup>140</sup> Baseline Study on Basic Education in the Republic of Moldova from the perspective of child friendly schools", IPP, 2009

payments to the school, a fact quoted by almost half of the interviewed parents (49.9 per cent) and some of the teachers and headmasters (12.6 per cent and 16.7 per cent respectively). In some cases, a child's dignity is also affected when his or her parents cannot manage to make the required payments.

The negative impact of informal payments on the educational process is recognized by 35 per cent of parents, 25 per cent of headmasters and 25 per cent of teachers. At the same time, 80-90 per cent of teachers and headmasters deny that pupils from poor families are underprivileged, whilst 50 per cent of the parents affirm the contrary.

The relatively low wages of the teaching staff force them to wait for and even ask for money from parents. Obviously, the attitude of the teaching staff and parents with respect to this phenomenon varies, but parents, teaching staff and headmasters think that this phenomenon is adverse to a child-friendly atmosphere.

Thus, we ascertain that the complicated economic situation in the Republic of Moldova, coupled with inappropriate attitudes towards education, expressed through decisions that limit the education budget, create conditions within the educational system that negatively influence the educational process and limit the access of children from underprivileged families to quality education. The principle of short-term efficiency takes precedence over any other norm and idea, which grossly disfavours the state objective of equality of opportunity, which should contribute to unrestrained human development in Moldova.

### **3.7.5. The Trade-Off between Efficiency and Equity in the Health-Care System**

The Moldovan health care system aims to provide the entire population with universal access to a basic package of health care services. Previous state guarantees for universal access to

the full range of health care services free at the point of use proved unsustainable in the economic climate of post-Soviet Moldova. The reality was that state declaration of universal access was not implemented, and access was severely restricted by informal out-of-pocket payments.

Consequently, these commitments have been substantially revised and have been substituted by a more limited universal package with a clearly defined parcel of services covered by mandatory social health insurance. In the first year following the introduction of social health insurance, this pragmatic approach succeeded in extending the accessibility of health care services free at the point of use to the population, although it is not yet universal. There is already growing political pressure to widen the state guarantees though it is not clear that this is economically sustainable at this stage.

Equity is a key performance measure for a health system. Payments for health services should be progressive, with richer households paying proportionally more towards financing the system than poorer households, as well as horizontally equitable, with households of the same ability to pay making an equal contribution. The consistently high levels of out-of-pocket payments in the financing of health care in Moldova meant that the poorest households had more limited access and paid a much higher percentage of their income. Average out-of-pocket expenditure for hospitalization was more than three times average household expenditure, so the poorest households bore a potentially catastrophic financial risk where ill-health required hospitalization. Results from a UNICEF survey in 1997 found that nearly 50% of people requiring hospital services financed out-of-pocket payments by selling assets or incurring debt.<sup>141</sup> Because unofficial user fees and the need to pay full cost for pharmaceuticals were essentially universal phenomena, the

<sup>141</sup> [siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf](http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf)

poor simply forewent health care because of resource constraints. By the end of the 1990s, when the health care financing crisis was at its peak, the poorest sections of Moldovan society were paying a significantly higher proportion of their household budget on accessing care, which reflected catastrophic inequities in the system. Against this background, the need to develop a financial risk-pooling mechanism to mitigate risk among the poorest populations became compelling.<sup>142</sup>

The introduction of mandatory social health insurance has helped to protect the population from the financial risks associated with ill health. For example, in 2004, the average direct household expenditure on health for the poorest 20% of the population fell 21% in real terms compared with 2003 (Government of the Republic of Moldova and World Bank 2006). Also, the share of out-of-pocket payment for health fell from 51.5% in 2003 to 42.3% in 2005, for both official and unofficial payments. This was achieved because the government undertook to pay the contributions of certain groups, and these contributions are meaningful as they relate to the actual cost of care and are linked to employee contributions. Nevertheless, even though the magnitude of out-of-pocket payments has decreased owing to recent reforms, out-of-pocket payments for health are still relatively high for the European Region (WHO Regional Office for Europe 2007). Research into the cost of hospitalization has also shown that health insurance effectively provides financial protection to insured families; on average, the costs of hospitalization are 83% higher for an uninsured person (Government of the Republic of Moldova and World Bank 2006).

However, while the poorest households are now spending less on health care, the utilization of health services by the poorest

households has also fallen (Government of the Republic of Moldova and World Bank 2006; Shishkin et al. 2006). Also, the high out-of-pocket cost of pharmaceuticals erodes financial protection for the poor (Government of the Republic of Moldova and World Bank 2006).

Although regional differences in per capita funding for health care has decreased following the recentralization of resource pooling, and despite ample coverage of health facilities, more remote regions are still served inadequately and the rural poor are less likely to gain access to services. Poor rural households are also those that are least likely to have insurance and so are most likely to have to pay for treatment and consultations. Rural services are also the ones that are most acutely understaffed.

Consequently, it can be said that, while recent reforms have had a very positive impact on equity in the health system's costs and benefits overall, the current system of health financing does not ensure effective protection of the whole population from financial risks. Out-of-pocket payments are still high, and a sizeable proportion of the population (20–25%) is not covered by social health insurance; many of these people belong to the country's poorest households.<sup>143</sup>

Consequently, households with higher income are benefiting more from health services than those with lower incomes. However, the Moldovan Government has undertaken to address these inequities and support social solidarity in the National Health Policy.

In the Soviet era, the level of revenue a facility received depended on the number of officially registered beds and the number of staff employed. Performance, in terms of productivity of facilities, quality of care and patient satisfaction were not considered in the funding equation. This led to inappropriate incentives to retain unnecessary beds; to ad-

<sup>142</sup> Dina Balabanova, "Health Sector Reform and Equity in Transition", July 2007

<sup>143</sup> Dina Balabanova, "Health Sector Reform and Equity in Transition", July 2007

mit patients with little or no need for hospital care and to keep these patients hospitalized for as long as possible; and to invest little in improving the quality, appropriateness or efficiency of their care. Moreover, as resource allocations were made on the basis of capacity rather than health need, the bulk of public resources went to urban centres where the largest number of health facilities was located.

These Soviet legacies have determined the nature of inefficiencies in the post-Soviet Moldovan health care system. Efficiency in Moldova has been limited by excessive and inefficient infrastructure, the limited use of appropriate clinical protocols and a lack of capacity in the primary health care system.

Profound hospital restructuring took place after the financial crisis, and much of the excess capacity in the Moldovan health care system was reduced. In just one year, 1998–1999, the number of hospitals fell from 276 to 150, and between 1991 and 2006 the hospital stock was reduced by 75%: in 2006 there were 84 hospitals in Moldova (WHO Regional Office for Europe 2007).

However, much of the consolidation meant the closure of rural hospitals, while secondary care hospitals in Chisinau, the republican-level specialist hospitals, were broadly unaffected. Consequently, the hospital sector still absorbs a significant amount of funding relative to primary care, despite concerted reform efforts to change resource allocation mechanisms. However, this may well change now that family medicine centres are no longer integrated into other local health services under the management of rayon (county) chief doctors.

The parallel health systems under the control of other ministries are also a source of great inefficiency in the system and there is currently no strategy for consolidating or restructuring those facilities that have remained outside the reform programme. The focus on developing primary health care and the substantial invest-

ment in the training and retraining of personnel and reallocation of resources away from inpatient care has served to build capacity in the primary health care system, which historically had been extremely weak. However, there are still problems with attracting and retaining staff to work in primary care, particularly in rural areas. The development of health technology assessment and the introduction of evidence-based medicine remain key concerns in reforming the Moldovan health care system, both in terms of ensuring efficient use of resources and in terms of improving the quality of care.

Common to other countries in the CIS, in Moldova there is a need to improve the quality of health care services through the implementation of evidence-based approaches to clinical decision-making and to improve the incentives for service providers to comply with good practice standards. To achieve improvements in the quality of care, there is a need to strengthen the role of the MOH in stewardship: in policymaking, evaluation and the regulation and monitoring of the system.

It is also important that effective strengthening of primary care continues; this requires continued shifts in resource allocation away from inpatient care so that ambulatory health centres are resourced and empowered to deal with the vast majority of the population's health care needs, which can indeed be met at the primary health care level. There is also a need to increase the efficiency of the system and to ensure that the health financing system has appropriate incentives for health care providers. For example, the current hospital payment system provides republican hospitals with an incentive to treat simple, non-complex cases because they will be paid more for this than would a rayon hospital, which could treat the same patient equally well. Hence the "profit margin" (the difference between reimbursement and average case cost) is greater for the republican hospitals and they are discouraged from treating more "expensive"



complex cases – that is, those that republican hospitals are designed to treat.

However, the central lesson to be learnt from the Moldovan experience of introducing mandatory social health insurance is that this can be highly effective where it is introduced as a means of initiating root and branch reforms of the system by using contracting as a mechanism to improve accountability, transparency and quality, even though mandatory social health insurance does not necessarily provide universal access or coverage. The introduction of mandatory social health insurance in Moldova has improved transparency in the system and reduced the magnitude of informal payments. Approximately 30% of respondents in a household survey conducted in 2005 mentioned that the practice of informal payments completely or partially disappeared once social health insurance was introduced, although 52.9% of respondents did mention that it had not disappeared altogether.

Nevertheless, this same survey also showed that the level of information the general population had on health insurance, the understanding of the benefit package, the acceptance of reform and satisfaction with reform, was very low. Inequality in access, benefits and outcomes are the key challenges to be addressed in future health care reforms, and improving population knowledge of the social health insurance system and its credibility are major tasks associated with this challenge. The population needs to be informed more adequately about the nature of the reforms, the reasons for the changes, their rights and the expected benefits.

There is also growing concern about the distance between policy makers and the practitioners who are at the forefront of reform initiatives, yet without always being included in and informed about the reasons for change.<sup>144</sup> Experience from many countries confirms the

importance of adopting a systemic approach to reforms and combining bottom-up and top-down approaches, with simultaneous developments at both policy and operational levels to create shared ownership, to reduce resistance and to enable lesson sharing at different levels of the health system. However, for this to occur there needs to be adequate and appropriate management capacity at these levels. Management capacity at MOH, NHIC and health care provider levels in Moldova needs to be substantially augmented to enable implementation of planned reforms and to improve planning and management functions in the health system.

Nevertheless, the need to achieve greater coverage in the social health insurance system is acute and well recognized by the Moldovan Government. Disparities in health insurance coverage have both socio-economic and geographical dimensions, with coverage lower in rural areas than in urban areas and with poor or extremely poor households most at risk of being uninsured.

The most vulnerable sectors would appear to be the rural poor and extremely poor households, as these are the only sectors that appear to have been adversely affected by the introduction of mandatory social health insurance, with utilization rates actually falling in 2004 (Government of the Republic of Moldova and World Bank 2006). Drug costs are a major contributor to the lack of financial protection in the system, and therefore the drug benefit package should be carefully expanded; however, there is a very real need to resist the populist extension of health care guarantees that are unsustainable. These would, in fact, promote informal payments in the system and threaten equity while undermining the credibility of the new system.

<sup>144</sup> [www.euro.who.int/en/what-we-do/.../republic-of-moldova-2008](http://www.euro.who.int/en/what-we-do/.../republic-of-moldova-2008)

### 3.7.6. Conclusions

The present paper aims at unveiling the possible trade-offs between efficiency and equity in different areas of social policy in Moldova. The topic of analysis was the possible reconciliation of equity and efficiency in social and employment policies, health care and education. The idea is to discover policy situations that promote greater equity but have little effect on efficiency or - even better - policy situations where equity and efficiency complement each other and where government policies, mostly transfers from richer to poorer individuals, may perhaps even produce a more efficient society than would occur in the absence of those activities.

In employment and social policies, we could say that Moldova is on the whole moving towards policies carried out in Europe at large. Equity is narrowing its scope and is considered mostly in the context of the implementation of more stringent conditions, and a stronger emphasis on active measures in employment policy, with unemployment benefits being more linked to participation in training and re-qualification programmes. The same is true for health care, education and other social policies. We could speak about a sort of state disengagement in this field due to a more liberal approach which emphasises efficiency to the detriment of equity. In these circumstances it is important not to let social policies be overwhelmed by market forces, which could create severe inequalities, increasing the gap between poor and rich people and creating protest movements which could disrupt the social equilibrium.

The education and health care systems are strongly influenced by the informal practices

of out-of-pocket payments which reflect the inherent tendency of self-adjustment of the entire system. In order to avoid the extremely inefficient practices of exclusive state financing of these branches, which create a vicious practice of permanent inadequate provision of resources, these branches tend to attract additional financial support from non-conventional sources. These informal practices increase the general efficiency of the system but, at the same time, create additional perverse consequences which spoil the whole system. This self-adjustment generates gross inequalities and creates marginalized people with very limited access to the services provided.

The trade-off between efficiency and equity has been seriously aggravated since 2009 due to the economic crises. A substantial drop in budget revenues creates difficulties in expanding social programmes, the government being compelled to search for rapid short-term and mid-term solutions and being less prospective, frequently missing the long-term vision. The social sector continues to have a high priority, the truth of this statement being confirmed by the increase in social expenses in 2010 in comparison with 2009, permitted retaining the same share in GDP for this category of expense. We should be aware of the fact that these solutions are temporary and in the long run they must be supplemented by more sustainable reforms which could include the pension system reform, the introduction of flexicurity in the labour market or the optimization of the schools system by finding the optimal ratio of financing them. The adoption of these measures depends on the ability of the state agencies to undertake ambitious efforts in order to create a more equitable society but not at the expense of efficiency.

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## 3.8. Montenegro: From Equity towards Efficiency

*Jadranka Kaludjerovic*

### Abstract

A transition for a society impacts on all aspects of human life. However, this process in the case of Montenegro was additionally burdened by armed conflict in the surrounding countries, alongside sanctions, as well as inappropriate economic policies. All this contributed to a significant decrease in living standards, especially of those population groups with low levels of education, skills and working performance. In addition, the inflow of Roma, refugees and internally displaced people increased the percentage of the population considered vulnerable.

Positive economic trends that have been evident since the beginning of this century had positive implications on living standards. Also, they made possible the mobilization of resources that could be invested in the reforms of the labour market, education and social systems. Significant steps have been made in legislation reform and the preparation of strategies and action plans. However, implementation of active measures, decentralization, as well as systems of control and monitoring are still lacking. Social policy is not well targeted; labour market measures are not focused on the most vulnerable populations, while education reform is still not giving positive results in terms of the quality of education and fulfilment of the needs of the labour market. Thus, there is room for further improvement in all three policy areas.

### 3.8.1. Introduction

Montenegro is a small Balkan country (620,740 inhabitants according to the 2003 census) and was the least developed country in the former Socialist Federal Republic of Yugoslavia. During the nineties, economic activity in Montenegro (due to the dissolution of the Socialist Federal Republic of Yugoslavia, war and sanctions) was at a very low level. For the first three years of that decade economic activity decreased by more than 50%. This was followed by a few years of slight economic recovery, which was again disturbed by external factors such as the NATO bombing, as well as political disputes between Serbia and Montenegro (at that time Montenegro was part of the Federal Republic of Yugoslavia, a state created from Serbia and Montenegro after the SFRY's dissolution). In 1997 the Montenegro government distanced itself from Serbia and

commenced independent economic reforms. The year 2000 was the year in which, thanks to overall transition efforts, the first glimpses of economic recovery in Montenegro were noticed. In 2006 Montenegro voted for independence in a referendum and became an independent state in June 2006. At the end of 2008 Montenegro applied for, and subsequently obtained, the status of an EU candidate country.

Low economic activity during the nineties had consequences on the high unemployment rate and low living standards of the Montenegrin population. From the year 2000 economic activity recorded a positive growth path and the structure of the economy changed towards an increasing share of services in overall economic activity. Some sectors, such as construction and tourism, experienced significant growth and became the engines of economic expansion. These positive trends

improved the living standards of the population but also created new requirements and opportunities for human capital in Montenegro. On the other hand thanks to increased economic activity, the budget experienced a surplus for the first time in recent history. The additional resources could then be used for the improvement of the social and education systems, as well as for other policies.

### 3.8.2. The Case for a Trade-Off in Social Policy

The first Poverty Assessment for Montenegro was produced in 2003 and was based on the household survey conducted by the independent economic think tank Institute for Strategic Studies and Prognoses (ISSP), with the support of the World Bank. In 2004 the same survey, fully representative of the population, as it included marginalized groups such as Roma, refugees and internally displaced persons, showed that 12.2 percent of the population lived in absolute material poverty (under the poverty line, which was calculated at the level of 107 Euros per month). The newest comparable data that can be obtained from the UNDP ISSP Social Exclusion Survey conducted in April 2008 showed that the poverty rate is at the level of 10.8 percent. Although data shows that the percentage of population living below the poverty line has declined during the period observed, poverty remains stable, despite the recorded economic growth and wage increase.<sup>145</sup>

It may be concluded that poverty in Montenegro is low. However, poverty estimates are very sensitive to the poverty threshold. Almost one third of the population (28 percent) is classified as economically vulnerable, i.e. living under the vulnerability line which was set at the level of 50% of the poverty line. The poverty

gap is equal to 2.7 percent, while the severity of poverty is 0.9 according to the 2008 data.

One of the characteristics of Montenegro is the significant difference in the extent of poverty among the regions. Poverty is lowest in the south and central regions. Poverty rates (19.2%), poverty gap (4.9%) and poverty severity (1.7) are significantly higher in the north. More than half of the poor population (62 percent) live in the north. This situation is not surprising as the northern part of Montenegro is the least economically developed region; tourism and construction activities, the two fastest growing sectors, are concentrated in other regions. As a consequence, the segment of the population considered poor is 26.5 percent in the central part of the country, and 11.1 percent in southern regions. The poverty profile shows that the size of the household, activity status, and education level of the household head are the main determinants of living standard. Less than 4 percent of people living in households with three or less members are poor, while this percentage among the households with 4 or more members is 13.7%. Slightly above 20 percent of households whose head is not employed and not retired are poor, while 10.7 percent of the households whose head members are retired and non-employed are in the same position. However, poverty exists in many households where the head is employed and those households represent slightly more than one third of poor households. Out of a total number of households whose heads have only primary education, 15.3 percent are poor.

Data for 2008 shows that poverty rates vary among the different vulnerable groups. The highest poverty rate is among the RAE population (36%), displaced persons (34%), and social welfare system beneficiaries (30%). Poverty is not so significantly high for pensioners (15.7%), the long term unemployed (12.9%) and people with disabilities (11.9%).

<sup>145</sup> Issp, undp National Human Development Report for 2008

In order to better target its activities on combating poverty, the Montenegrin Government in 2003 adopted a Poverty Reduction Strategy (PRSP). However, this very ambitious set of activities and projects was only partially implemented. The reform of the social protection system in Montenegro started with the pension system reform (2003), and continued with the reform of social and child protection (2004). In 2007, the Government adopted the Strategy for Development of Social and Child Welfare System (2008-2012). The reform of the social protection system is focused on reforming financial benefits and enhancing the system's accountability for providing a social welfare system. Social protection spending in Montenegro made up around 11% of the GDP in 2008 and 16% in 2009. Compared with EU member states Montenegro falls into the category of countries with mid-level social protection expenditures. Social welfare benefit spending was at the level of 1% of GDP in 2008 and 1.3% of GDP in 2009. One third of social welfare benefits goes to family allowance, whose purpose is to provide minimum income.

The social protection system is very centralized, while social services are provided by state institutions. The main institution responsible for social protection is the Ministry of Labour and Social Welfare. Aside from the Ministry, there are a number of institutions (such as ten Centres for Social Work and other residential institutions) charged with social protection at the local level. The services provided at the local level are very underdeveloped due to the fact that high financial and managerial centralization discourage local authorities from initiating new services. Moreover, staffs on the level are generally educated but need additional training in order to fulfil very complex requirements from service users. Data from the 2008 UNDP ISSP survey shows that in general social welfare beneficiaries are dis-

satisfied with social welfare services (3.6 on a scale 1 to 10). An additional problem is the underdeveloped cooperation and communication of the social system with other systems in the country, such as health, education, etc.

Analysis conducted by ISSP in 2006 showed that allocation of social welfare benefits among the poor is very low, as only 13.3% of the families from the poorest quintile receive them, while 54.2% of total family allowances benefits funds go to the families in the poorest quintile. The share of family allowance in total consumption is 10.5% for poor households, which is due to the poorly targeted and inadequate social programmes. If we consider these facts as well as information that 30% of the recipients of household benefits are poor, we may conclude that targeting of the social welfare benefits is very low.

According to the data presented in the Development Strategy of Social and Child Welfare,<sup>146</sup> the monthly family material support amounts range from 55€ (for single a family) to 104.5€ (for families with five or more members). Child allowance amounts range from 16.5 € to 27.5€. Previous analysis done by ISSP<sup>147</sup> shows that if we assume that only income that families have is the social assistance benefits, then the FMS and the children allowance, where applicable, compensate below 50% of the poverty line. This leads to the conclusion that the social benefits are not sufficient and only reduce the vulnerability of households, which means that they are then better off, but remain poor.

In addition, the timing of social assistance benefits is poor and all allowances are paid to beneficiaries with significant delays. The delay depends on the type of benefit; the family material support and the child allowance are paid with six month-delays while other persons on care benefit may have to wait 12 months for the first payment.

<sup>146</sup> Strategy

<sup>147</sup> Poverty and Social Exclusion in Montenegro

The previous analysis showed that there is significant room for the improvement of social protection effectiveness in Montenegro, primarily in terms of the targeting of social protection and the adequacy of social benefits, as well as in improvement of transparency and accessibility of data and information. This would require a new design of the social protection system, revision of the eligibility criteria, simplification of the administrative procedures, in addition to an improvement of the authorization of service issuance and delivery. Decentralization of management and funding, together with the improvement of the human capacities of service providers should enable an increase in the quality of existing services, the development of new services, and their effective use by different client groups. Also, the development of residential care would significantly contribute to an increased efficiency as well as equity of the social protection system.

### **3.8.3. The Case for a Trade-Off in Employment Policy**

The transition process and political changes that occurred in the Western Balkan region over the last 20 years have significantly impacted on the performance of the Montenegrin labour market. Already at the beginning of the transition process in the early nineties of the last century, unemployment in Montenegro stood at a relatively high level, with one fifth of the active population being unemployed. At the same time, employment was on a relatively low level, with roughly one half of the working age population being active. In the period following 1991, unemployment has increased, following the major setback in economic activity. However, the decrease in unemployment was not as sharp as the decline in economic activity, due to a high level of employment protection. Also, employment

in the informal sector, tolerated by the authorities, has compensated job losses in the public sector companies, which have been dominant employers. The growing private sector has generated new jobs; however, the pace of job creation in the private sector was not as fast as job destruction in the public sector.

Registered unemployment recorded its highest level in 2000, reaching 83,500 individuals, while at the same time registered employment counted 140,000 individuals. On the other hand, due to the high incidence of undeclared work, the employment situation was not as drastic as presented by the official figures, however the labour market was characterized by some serious imbalances, of which some are still present, such as the high incidence of long-term unemployment, the imbalance between labour supply and demand, the lack of quality jobs in terms of good working conditions and wages, the low level of compliance with employees' rights, etc.

The value of the overall EPL index for Montenegro until 2008 was 4.1, making the Montenegrin labour market among the most rigid labour markets in Europe. The index value for permanent employment was 3.2. Permanent contracts couldn't be cancelled without following the legal procedure – one-month's notice (written), provision or rights (employment in the same or another company on a different post, which match the education or retraining or pre-qualification, or 6 months' salary as severance payment). The law did not differentiate in the notice periods and severance payments based on the working experience of employees.

The temporary contracts regulations in Montenegro were even stricter than for permanent contracts. The law allowed for a nine-month regular contract, which cannot be renewed. According to the law, and the opinions from the labour inspectorate, if the need for a particular worker existed after the

nine-month period, then this contract should be treated as a permanent labour contract. The law allows temporary contracts only for objective reasons (a temporary increase of workload, replacing an absent worker, work on a project, etc).

The collective dismissals regulation was the strictest part of labour regulation in Montenegro. The index value of the rigidity of collective dismissals in Montenegro was 5. Collective dismissal is defined as dismissal of five or more workers, regardless of the size of the company. The workers, workers' union and the Employment Office of Montenegro should be informed about planned dismissals three months in advance. Besides, the employer must draft a programme of employees' rights – employment with the same or different employer on different working positions, retraining and severance payment. The employer was obliged to offer workers some of these rights, while they can choose which rights to use.

As mentioned, despite the high rigidity of regulation, the level of compliance with the law is low, especially in the private sector. This is evidenced through the high share of the informal economy in the labour market, which ranged from 30% in 2001 to 22.6% in 2007. According to the 2007 LFS survey results, 22.6% of employees work in unregistered companies or are unregistered workers in formal sector companies. In addition, 17.5% of registered employees have a partly registered wage: employers register a minimum amount of wage, which is set by the General Collective Agreement and pay social security contributions and taxes on this amount, while employees actually receive a higher amount.

In 2008 the Parliament of Montenegro adopted a new Labour Code, which brings significant improvements in the regulatory aspects of the Montenegrin labour market. This law presents a significant improvement over the old law. The new law decreases the

degree of employment protection and thus increases labour market flexibility. However, collective dismissals in Montenegro are still the most regulated as compared with neighbouring and European countries. But, regardless of collective dismissals, the Montenegrin labour market is among the most flexible in Europe, as indicated both by the value of the EPL index (Employment Protection by Legislation Index) and the WB Doing Business Employing Workers index.

In the period from 2006 to 2008, along with the strong growth of the Montenegrin economy, the situation on the labour market improved with strong growth in employment and strong decrease in unemployment. The number of announced vacancies exceeded the number of registered unemployed, and the mismatch between labour supply and labour demand became more evident. On the other hand, a huge number, over 50 thousand of non-resident workers were engaged in mainly seasonal jobs in construction, tourism and agriculture. There are many reasons for such a situation among which predominate the lack of skills in the domestic workforce, the propensity of employers to hire non-residents whose services/labour is cheaper and the poor quality of the posts offered (low salaries, lack of basic occupational health and safety regulations, non-compliance with the regulations in terms of holiday and vacation days, etc).

Data on registered unemployment indicate that the percentage of male unemployed is higher than female, mainly due to the lower activity of the female population and the fact that job destruction was highest in the industry sector, which predominately employed male labour force. On the other hand the job creation in Montenegro over the past several years was mainly in the services sector, such as trade and tourism which predominately engages a female labour force. The high incidence of long-term unemployment, with over



60% of the unemployed waiting for a job for over a year, is also an important issue, especially having in mind that those long-term unemployed mainly consist of redundant labour from industrial companies.

The employment Agency of Montenegro (EAM) has implemented many active labour market measures, among which dominate loans for self-employment, apprenticeships programmes, training and retraining for the labour market and the known employer, and public works. However, it is very difficult to assess the success of these programmes, given that a proper monitoring mechanism is still lacking. According to the EAM the most successful ALMP in Montenegro is the apprenticeship programme, since approximately 60% of beneficiaries stay on the job; the second most successful programme is training provided at the request of an employer.

Despite the success in some ALMPs, the focus on hard-to-employ individuals is still lacking, or to be precise, is not giving any results. The needs-based approach to policy formation and the development of partnerships among key stakeholder employers, education institutions and public employment services is still missing. The high numbers of vacancies which can be filled by the domestic labour force indicate that ALMPs and the education system in Montenegro have not fulfilled their primary aim and that scarce resources have not been used efficiently. A more coordinated approach to improving the labour supply and demand in Montenegro, through ALMPs and education, could and should play an important role in the future development of the market in order to achieve some efficiency gains. On the other hand, by improving the functioning of the whole system, especially in education, and focusing more on future demand and not wasting resources on providing qualifications which do not have a demand, the public employment service could make significant

changes by focusing on disadvantaged individuals, by providing them with opportunities to fully participate in the labour market.

#### **3.8.4. The Case of Trade-Off in Education**

Montenegro started its education reform in 2001 by the adoption of a blue-printe document entitled „Book for change“. The main principles on which this reform is based are: decentralization of the education system, equal education rights for all, no matter what gender, socio-cultural origins ethnicity, physical or philological characteristics and choice in accordance with abilities. The new education system is designed to respond to the individual needs of each child, as well as the needs of specific target groups.

According to the existing legislation all children have equal access to education, while primary education is compulsory and free for all. Equal access to secondary and higher education is based on competition for enrolment that is based on competitiveness. The net attendance ratio for primary schools is 98%, while the NAR for secondary schools is 84%. This is according to the UNICEF Multiple Indicator Cluster Survey analysis, (for primary schools above the average and for secondary school on the average in the region) and may be considered as satisfactory. However, the pre-primary enrolment ratio is 29% which is significantly lower than in the region. Also, the percentage of early school leavers among the young population is 9.2% for females and 15.5% for males which is better than for the EU 15. The major change introduced by the education reform is the development of primary education from eight to nine years, which is expected to affect the overall education system. The figures show that compulsory schooling requirements are giving positive results.

Despite the legislation for equal access, some population groups face difficulties in

enrolling into the educational system. Among those groups are RAE population, people with disabilities, children from poor families, the long-term unemployed, etc.

According to the existing data only 7% of the Roma school-age population has been enrolled in the school system — 85% of them in primary school, 8% in secondary school and 7% in tertiary education.. One of the main reasons for this is the bad economic situation (only 10% of this population has some kind of employment), given that parents cannot afford basic items such as clothes and footwear for their children. Also, as the educational level of the parents themselves is low and they do not understand the importance of education, the RAE population needs significant support in the education process. Moreover, the lack of teaching staff that would be able to teach the RAE language is a significant barrier for enrolment of REA children in schools. The GOM adopted a strategy for Improvement of the position of the RAE population 2008/2012, which prescribes a set of actions to be implemented in order to support this population group, such as: creating the necessary conditions for inclusion of REA in preschool, developing a specific enrolment policy for RAE children, transferring RAE children who have been wrongly enrolled in special schools into regular schools, fostering motivation for education, providing an adequate human resource base for work with the RAE, upgrading public awareness on the need to include RAE population in regular education, free scholarships at all education levels, the education of the parents, etc.

There are no exact data on the number of children with special needs in Montenegro. According to estimates prepared by the Ministry of Health, Labour and Social Welfare, their number is in the range of 6000 to 7000. According to the data from the Ministry of Education and Science, 3416 children with

special needs are enrolled in the education system. The Montenegrin Government adopted in 2008 the Law on the Education of Children with Special Needs, as well as the Strategy for Inclusive Education. Some of the measures proposed by these documents are already implemented, such as the training of teachers at all school levels, the establishment of mobile teams in support of inclusion, improvements in the facilities, including docks and entrances for pupils with disabilities. However, there is a need to further improve conditions for children with special needs.

The ISSP UNDP survey showed that one of the biggest barriers for the long-term unemployed population is the lack of education and training necessary to compete on the labour market. This survey as well as some other sources shows that the majority of the long-term unemployed has secondary education (more than 80%). Only small numbers of these people (less than 10%) are attending some type of training. Others are not motivated or do not have the money to invest in the improvement of their education. The education of the elderly is a measure for the solution to unemployment, especially long-term. Through the Strategy for the Education of the Elderly, three centres for education and training were established. The new programme for primary school education for the elderly is one improvement in this area. Also, the government adopted a Vocational Education Development Strategy 2010-2014, aimed at the development of the vocational education system in such a way that it provides individuals with the possibility to obtain the qualifications necessary for equal participation in the labour market and for an advance in career, personal development and further education. However, some concrete steps in the implementation of the strategy are still not evident.

Financing of the education system was on the level of around 4% of GDP in 2008. Howev-

er, financing is still fully centralized. Decentralization was set as one of the main goals in all the strategic documents adopted, but implementation, in the first line transfer of the financing on local governments has not yet been done.

The Ministry of Education is preparing its budget plan in accordance with the programme budgeting principles: however, a very high proportion of spending on education is still on wages. The share for OECD countries for the share of non-staff costs in total recurrent expenditure is 25.6%, while this share in Montenegro is below 19%. Thus one of the major challenges is to increase spending on non-salary expenditures and to improve the quality of education more generally, while reducing staffing costs in the context of rising average salaries and falling numbers of pupils in primary and secondary education.

On the other hand, learning outcomes are not satisfactory. According to the results of the PISA assessment conducted in 2006 (in mathematics, language and science), Montenegro was ranked 48th out of 57 countries. Data shows that 91.1% of students complete primary school while 98% these students enrol in secondary school. Also, 70.8% of the students enrolled in secondary schools are enrolled in vocational schools.

Thus, while we may conclude that significant efforts have been made to increase access to education, it is evident that the system is still inefficient, as learning outcomes are very low and labour market needs are not fulfilled. In addition, globalization brings new challenges for human capital. In order to respond to these challenges, the efficiency of the education system has to be improved in order to increase the quality of education at all levels. In these terms, possibilities such as the financing of pupils in higher education abroad instead of opening new faculties in the country or the financing of pupils to study in private faculties should be considered as an

option. Additionally, the education of teachers and the improvement of the curricula, especially in vocational schools, have to be among the priorities. In general, the settled goals and adopted strategies present a good basis for development but in order to prevent them being only dead documents, concrete actions are needed to be implemented immediately while an education and monitoring system has to be developed. Actions have to be focused on further enrolment of children in pre-primary education institutions and on increase of enrolment, attendance rates and quality of education at all levels. Special attention should be paid to Roma, children with special needs and children from poor families.

### 3.8.5. Conclusions

Transition from one economic system to another is difficult and challenging, primarily because it sets new standards and requirements for the whole population, in terms of knowledge, skills and working performance. How someone uses these opportunities depends on personal capabilities, but also on the ability of make the best possible relation between equity and efficiency in the provision of state services. However, we also have to keep in mind that a main precondition for that is an environment conducive to wealth creation in the most efficient way.

In the case of the Montenegro labour market, social and education policy have been more focused on the fulfilment of the equity criteria than on the efficient allocation of resources. In that respect, further improvement has to be made in order to increase the efficiency of Government programmes in these areas. The starting point has to be the education system, as good education is the precondition for a better position on the labour market and at the same time decreases the need for support from the social welfare

system. Dedicating more resources to the education system (primarily high quality education and training programmes) has positive effects on the overall economic and social system in the country. Also, a decentralization of the financing of all three systems should be implemented in order to mobilize funds from different sources and involve more stakeholders to take active roles in the reform process.

Thus, in the education system, resources have to be employed in order to provide higher quality education and training to those who are interested, but also to give incentives

to those groups who have limited access, caused mainly by their poor economic situation. In the area of social policy a new system should be designed in order to better target the most vulnerable population (Roma, the poor, disabled, the long term unemployed) and provide them with sufficient resources for living. In the area of the labour market, measures should be targeted towards those who are in the most difficult position, as an increase in their employment possibilities decreases the costs for welfare services provided to those groups in the long run.

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- Ministry of Health, Labour and Social Welfare – *Strategy for Social and Child Protection 2008 -2012, 2007*
- Ministry of Health, Labour and Social Welfare – *Strategy for Social and Child Protection 2008 -2012, 2007*
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- Ministry of Education and Science- *Vocational Education Development Strategy 2010-2014, 2009*

### 3.9. Romania: The Cost of Scarce Social Policies - Economic Failure

*Gabriela Cretu*

#### Abstract

This article questions the supposed efficiency and equity trade-off using concrete examples, data and arguments underpinning its theoretical foundation. The Romanian case is presented as an illustration of its failure, despite it still being very influential at the political level in many countries, including Romania itself. Quite recently, Romanian researchers started providing analyses that doubt the functioning of this relationship and demonstrate its limits. However, after the latest global financial crisis, everybody admits that challenging this trade-off is not as an audacious of an undertaking as it was before.

Scarce social policies have not made the Romanian economy more efficient; on the contrary, they have contributed to reducing productivity and speeding up recessions, endangering the future long-term development of the country. The current Romanian social indicators are worrisome. Poverty is high. Inequalities are growing. People's trust in institutions, in each other and in the future has reached its lowest level ever. Migration has been the solution chosen by many, especially by young active qualified persons, to overcome the difficulties of transition. Between two and three million people decided to leave the country. The social capital is damaged. The domestic labour market faces penury of skilled labour in many sectors, in spite of really high unemployment. New social problems have emerged. The health care system is in danger because of a lack of personnel (doctors and nurses) and of chronic underfunding. The education system suffers deterioration in terms of quality and credibility. Far from being a solution for the future improvement of the situation, the recent measures taken by the government to reduce deficits and balance the public budget will negatively affect the economy and retard the possibility of a more equitable society.

#### 3.9.1. Introduction

Romania, with a population of 21.5 million people and an area of 238,391 km<sup>2</sup>, is the second largest country in Central and Eastern Europe and the seventh largest country among the 27 Member States of the European Union (EU). Currently, Romania has to secure quite a long external border of the EU with neighbouring countries Moldova, Serbia, Ukraine and the Black Sea; the other neighbours are Bulgaria and Hungary. Bucharest, having more than 2 million inhabitants, is the capital city, as well as the industrial, cultural and financial centre of the country.

The events that changed the direction of recent Romanian history are, without doubt,

the Revolution of 1989 and Romania's accession to NATO and the EU. After the fall of the totalitarian regime, the country decided to join the Western organizations and has finally succeeded in doing so. In 2004, Romania became a member of NATO and then joined the EU on January 1st, 2007, following the completion of the negotiations in 2004 and the signing of the Accession Treaty in 2005.

The prospect of becoming an EU member constituted, for more than a decade, a solid external incentive for the transformation of the country throughout its transition and offered a concrete target and coherence for political measures. For the population, many of these measures were harsh, as they meant: losing jobs, closing down economic

activities, introducing different rules than those people were used to; restructuring the economy turned into a synonym for firing employees. The opportunity cost of change was high. As *The Economist* study estimates, "Assuming, generously, future regional growth of 4-5% a year, it would take another decade for the transition to have been economically "worth it". "

Despite these difficulties, there was huge support for the accession to the EU. Romania registered the highest percentage of pro-European citizens. For Romanians, as for many others, joining the EU was the equivalent to a better quality of life, more and better jobs, freedom of movement, the feeling of participating in important decisions, playing a political role; their expectations were high.

However, accession to the Union and the adoption of European standards was neither the beginning nor the end of the integration process; sustained efforts were needed in many fields to ensure real as well as nominal convergence with the EU. The attempts to speed up the process of integration were, unfortunately, undermined by many factors. The disillusionment after accession was even greater than the hopefulness that preceded it.

In 2009, after eight years of economic growth and absolute poverty reduction, the shockwave of the global economic and financial crisis has exposed the imbalances and economic vulnerabilities of Romania. The government decided to ask for the support of international financial organizations. The International Monetary Fund, the European Commission and the World Bank have agreed to cushion the effects of the sharp drop in capital inflows while addressing Romania's external and fiscal imbalances and strengthening the financial sector with a package which totalled Euro 19.95 billion over the period 2009-2010. The multilateral support programme seeks to:

- strengthen fiscal policy
- maintain adequate capitalization of banks and liquidity in domestic financial markets
- reduce inflation
- secure external financing and improve confidence.

Nothing about economic recovery or how to face social problems during the crisis was negotiated in the agreement. As a consequence, Romania currently faces the difficult task of reconciling short-term fiscal consolidation conditionality with the need to mitigate the social costs of the crisis and restore the sources of sustainable and equitable growth. Success in mitigating the impact of the crisis depends on the commitment of the political establishment and the capacity of the public sector institutions to work together and to mobilize key stakeholders and the population behind them; it also depends on public expenditure for recovery. Unfortunately, after the 2007 achievements, no other socially or politically significant goal has come to replace accession to the EU as a unifying national effort; suffering, if it is the case, must have a sense. Moreover, austerity measures work against an economic upturn.

Recently, in order to control the budgetary deficit, the government decided to reduce all public sector wages by 25% and increase VAT from 19% to 24%. These are the harshest measures taken by a European Member State; no other, including those in a very difficult financial situation, such as Greece, went so far. Hard times lie ahead!

### **3.9.2. The Case of Trade-Off in Social Policies**

Romania is not yet a welfare state, in spite of the accession to the richest "club" in the world and the big expectations of the Romanian population; on the contrary, the current economic and social data show a deteriora-

tion of the situation due to the recent crisis and the many difficulties of integration. This statement is necessary because the background of the trade-off between economic efficiency and equity is related to a dispute that commonly takes place in the functioning of welfare states.

As far as this alleged trade-off is concerned, we consider, as many have already shown, that it is based on a short-sighted understanding of economic mechanisms; the arguments against it are theoretical and empirical as well (Fouarge, D., 2003). With no further debate in this respect, we have to underscore a fact: its supporters cannot use any statistical data as confirmation of the ideology referring to the efficiency–equity “trade-off”; on the contrary, the facts prove that the most equitable societies have built strong and healthy economies and even succeeded in overcoming the current crisis more easily and faster than the others; the Nordic European countries are a relevant example.

Nevertheless, the theory is very influential in Romania; one of the biggest debates of latter years concerns the so-called dimension of the state, which seems to be too “fat”, undermining the “real economy”; this is the specific manner of dealing with the topic. Many public decisions nowadays are based on the hypothesis that the state is too big because of social expenses (the poor consume too much public money), and because the state is too involved in society as a whole (taxation is especially construed as endangering the private sector).

The facts do not support these allegations; efficiency is not low because of too much care for equity, but because of hardly any concern in this respect. Total government revenue has been, during the period, around 30% of GDP, placing the state in the last rank in the European Union for capacity of intervention; this indicator shows that Romania is a weak state, not a strong one. The current

structure of GDP (70% private revenue, 30% government revenue) is not undermining only for social programme development, but for investment in public services and other economic activities of general interest.

In our analysis, equity can go hand in hand with more efficiency. In other words, a generous level of social protection does not necessarily lead to inferior economic results. On the contrary, social policies based on investment in human and social capital are conducive to higher economic efficiency for they improve the productivity and the quality of the labour force. Social policy is therefore a productive factor, even though its costs are generally visible in the short term, while its benefits are often only apparent in the long term. The lack of coherent social policies and a low level of social spending put economic development at risk and create/preserve third-world models of development, based on a “cheap” labour force, exports of raw materials, a high dependence on foreign capital movement and external markets. A “cheap” labour force does not mean having lower costs; the prices for goods and services, as a consequence of liberalization, are more or less similar to other European countries; “cheap” means only being paid worse. The Romanian governments have made such a choice.

Of course, which policies are needed and how much public involvement is considered necessary are political choices; the “optimal policy” assessment comes from value judgments; but, when speaking about social policies, surprisingly, among these judgments, we still notice the notion that wealthy people are wealthy because of their intrinsic merits, and that social policies rely on the latter’s generosity, proving their concern for social justice.

Far from being an expression of the generosity of wealthy people or governments, social benefits are the result of a moral and ethical choice made in many of our Europe-



an societies and a few other non-European countries; economic and ethical points of view cannot be separated, being tightly connected and, as a consequence, the economic order cannot be in itself disconnected from the social and political order. In this context, inequality is a subject with moral, economic and political implications; it is not at all a „social issue“ that wealthy people try to deal with for philanthropic reasons or that the government should only take into account if there are extra budgetary resources remaining.

In this conceptual framework, the real problem is not *“how to lessen the trade-offs”*; the real issue is *“how to describe in appropriate terms reality in order to uncover the real problems we face”* and to draft the most suitable policies; it indicates an awareness of the reality that economic activities are created for providing people with goods and services, as a means for general human development; it rejects the idea, frequent among economists, that people are born to provide companies with a labour force.

The assessment of any economic system is based on two criteria – efficiency and equity; John Rawls, an outstanding theoretical reference for this topic, says explicitly that we have to give priority to the reduction of poverty in the case of a contradiction between poverty and efficiency. Unfortunately, he also offers legitimacy to larger and larger income gaps; actually, any gap is justified on the condition that it improves a little the situation of the poorest. In practice, we are aware that the first criterion has always been considered while the second is often forgotten; a few new European Member States could be used as an example for this amnesia; Romania is among them.

Political decisions are increasingly based on economic science and economic interests. While it seems natural for economics to play such a role, it is not. On one hand, politics has to deal with people; and human beings

are not a commodity like any other, and are not subject to the same rules of supply and demand, if such rules exist at all. On the other hand, economics tries to find an optimal use for limited resources. There is nothing wrong with these definitions, except that they are only theoretically valid. Practically, as it has already been proven many times by now, economics is not at all a natural science and, in fact, different economic theories try to justify different ethical choices. Despite this difficult relation between economics and politics, a large number of sociological studies in Romania have already revealed, especially during the last decade, that public opinion has cut the *Gordian knot* and very much approves of two sentences - *economics is true, politics is bad*, including social policies... This kind of thinking could be a part of the explanation of the current social conditions.

After the fall of the totalitarian regime in 1989, its economic and political ideology was immediately replaced by the neoliberal theory of free markets; the attempts to introduce the social market economy as a model for Romania's future development were unsuccessful; the free market was conceived as a universal rule for the allocation of economic resources and results and, in a strange way, for social relations and human lives, as well. From the moderate left to the right (the left no longer exists in Romania), politicians adopted the discourse of free markets, setting up and following related goals - free trade, less state intervention, the privatization of public services and companies, deregulation, freedom of movement for everything – capital, goods, services, labour force, etc. The international organizations offered good marks and support for the priests of the new religion; *The Market Says, The Market Can, The Market Regulates Itself* and, especially, *The Market is Efficient*, were considered undoubtedly true statements. Neither accession

to the European Union, nor the reality of the many losers changed that attitude. Almost no one took seriously enough the problem of the market's collateral victims; except the victims themselves... There was an excessively optimistic approach towards the future and a lack of critical thinking about social sciences. Or, a less human social environment renders many interventions ineffective, even though they take place; this is the case in Romania where the transition has turned money into a core value and competition without minimal ethical standards into a rule.

Based on such an approach, it was often said that the transition from socialism to free market economy has been among the most peaceful revolutions in history. This is certainly not true for Romania; the well-known bloody events of December 1989 are not the only proof. There has also been a largely unseen death toll; as in most Eastern European countries, the mortality rate has increased after 1989; meanwhile, life expectancy at birth has declined, especially for men; many fewer births and an outsized migration also contributed to the current disturbing demographic situation. (*Source - World Bank Data*) Such demographic changes are clear indicators of a society in extreme stress and have been observed previously only in wartime. Such a reaction from society is not unexpected as long as "the competition laws" are seen as some kind of "jungle laws", where the strongest is allowed to take everything and the less powerful feels ever more insecure. If the goal of more economic efficiency has implicitly been the reason of all these painful changes, even if not achieved, then the other ideal, of more social justice, has only rarely been present when drafting policies and taking decisions.

As far as equity is concerned, at least three aspects are important when evaluating the country situation: a) if those with equal incomes pay the same level of tax and have

similar advantages, b) if those who have more pay more and c) if we have a correct distribution of results. Certainly, the means used to achieve a more equitable society are variable, as well as the manner of assessing the results of intervention; unfortunately, often, they are not the most suitable. In spite of this variability and freedom to choose, a fact has to be taken into consideration - not only "specific" social policies have social effects; fiscal or monetary policies may equally have direct effects.

In Romania, the progressive taxation system in force was replaced in 2005 by a flat tax rate of 16%; the first concrete social result was a deepening of inequalities. Inequality of income distribution (GINI coefficient) has increased only in a few years of application from 36.3 (in 2004) to 37.8 (in 2007); for a clearer image of the situation, in most of the European Member States, this coefficient varies between 23 and 30. The other indicator measuring the inequality of income distribution (S80/S20 income quintile share ratio) shows the same evolution/involution - it was 7 in 2008, after achieving a level of 7.8 in 2007, the highest in the European Union; the average indicator for EU27 is 5. (*Source - Eurostat*)

Rich people have become richer and the poor people poorer than they were before. Immediately after the December 1989 events, a period of economic decline began and lasted until 1992; GDP lost more than 40%. The situation began to improve slightly afterwards, but poverty deepened once again between 1997 and 1999. At the beginning of 2000, the number of poor people had grown by four times compared to the 1989 number. 35.9% of the population lived in absolute poverty in 2000. The period between 2000 and 2008, however, was one of continuous economic growth. In spite of this rapid GDP growth, the country was characterized by a slightly increasing level of those earning less than 1.17 euro per hour, the current calculated threshold.

In 2000, using relative poverty as a measure, 17% of the Romanian population was poor. According to the official governmental data (*INS, 2007*), after seven years of growth, 18.5 % of the Romanian citizens had been living under the poverty threshold; a small gender gap has been registered (18.3% poor men and 18.8 poor women). The dominant groups among the poor are a) single persons, any category of age, but with a larger representation of the elderly singles, b) monoparental families, and c) families with more than three children. 70% of poor people live in rural areas. Unemployed, pensioners, and independent workers live in poverty more than other categories. North Eastern and Southern regions of the country face this problem the most. The ethnic group that is most affected by poverty is the Roma population; up to 70% of them live in poverty.

There is another fact that is more worrying than poverty itself; Romanian society is characterised by a large category of “working poor”. Many “full-time activity” employees and independent workers fall into this category. In Romania - as in Europe, generally - it is typical to think of ‘the poor’ as non-working people; a poor person is thought to be a jobless, a pensioner, a child in a large family, people whose ability to work is restricted because of reasons related to their personal capacity (having disabilities) or a social responsibility (being a single parent). In contrast to this general opinion, various studies (Peña-Casas and Latta, 2004; European Commission, 2008; regarding the extreme poor in Romania, Stanculescu and Berevoescu, coord., 2004) showed that a substantial share of the poor work and that the majority of the poor in Europe live in households with at least one household member working.

Romanian national statistics do not include studies on the extent and characteristics of the working poor. It is estimated that

more than two million people in the Romanian economy are working in and living on subsistence agriculture, and can therefore be termed as ‘working poor’. The phenomenon began to increase rapidly in 2009, when Romania entered recession and poverty reached 23.5%; the rising trend has been maintained in 2010. And the level of poverty might grow even further in 2011 after the cuts in public spending. Unprecedented austerity measures to counter Romania’s public budget deficit, including a five point increase in value-added taxes (VAT) from 19% to 24%, and a 25% wage reduction in all public sectors, will speed up the process. These measures, together with the effects of the economic crisis in the European Union, which impact on remittances to Romania, threaten to plunge vulnerable and impoverished families even deeper into poverty; a large percentage of working people are not immune to this threat.

The change in VAT is expected to generate a severe increase in the prices of food, fuel, and basic necessities, and decrease the consumption level, which producers say will impact on or bankrupt several businesses in the food and agricultural industries. In addition to the tax increases and wage reduction, the government plans to cut state benefits for disadvantaged categories (maternity leave allowance, unemployment allowance, the allowance that personal caregivers (of persons with disabilities) receive, etc.). Significant reductions in the number of civil servant jobs have also been announced, with more than 100,000 jobs expected to be cut by the end of the year.

In 2009, a study entitled ‘*Romania - a rapid assessment on the impact of economic crisis on poverty*’, issued by UNICEF and the World Bank, anticipated that the economic crisis and recession will most probably lead to an increase in the number of children living in absolute poverty - from 256,000 to approximately 350,000 children, while the number

of people living in absolute poverty will reach 1.6 million (that means 7.4 % of the population). The report also states that 75% of these children will be from rural areas, under the age of 14 and from families with three or more children. Before 1990, child allowance was an important tool for balancing a family's income and it was the equivalent of 10 percent of the average wage. The allowance was maintained after 1990 too but its quantum dropped to less than half. At the moment, a child's allowance is 43 lei, not even ten percent of the minimum wage. The study also shows that a family with two children, who relies on two minimum wages, will always face severe poverty. More precisely, they will have to manage with 50 percent of the minimum income needed for a decent living.

Before 1989, the children living in public institutions had been in the worst situation; afterwards, the reform of the child protection system together with much better funding have succeeded in improving the living conditions for many of them. A new problem has emerged instead - children living in poverty in their own families and children living alone, because of the huge economic migration in the latest years, a phenomenon we shall describe later.

The prognosis made by UNICEF and the World Bank also states that the growing recession in EU countries, which affects major sectors in which Romanians work abroad (constructions and agriculture), will decrease the flow of funds transferred from abroad to Romanian families living in the country, which was previously around five to six percent of the country's GDP. "This will affect the well-being of Romanian emigrants' families, including the well-being of the significant number of children left in the country". Regrettably the facts show that the prognosis has been correct.

All these statistical data describing poverty are useful for our understanding; nevertheless,

we cannot avoid noticing, as sociologists, the strange image of reality that we have based on the different instruments that we use to assess the situation. The absolute poverty indicator (used by World Bank or UNICEF) has decreased since 2001 (except the crisis period, when it started rising again). Relative poverty has increased continuously. It is a fact that, for many years, absolute poverty has been higher than relative poverty; the theoretical consequence is clear and paradoxical - somebody has been living in absolute poverty, on less than \$ 3 per day, without being considered (relatively) poor. This theoretical paradox can be found in many poorer countries with large income inequalities among citizens.

However, these considerations concerning statistics do not change the real social situation. Such a situation has to be dealt with through coherent policies; for both social and economic reasons. Reducing income inequality and poverty may expand and stabilize consumers demand, increase poor people's investment in education, and heighten workers' motivation and workplace cooperation, speeding up recovery.

Usually, we consider the share of total social spending within GDP as a general measure for the efforts of the State to produce a more equitable society. If that is true, Romanian governments have taken few responsibilities in this respect during recent years; public social spending registers a very low level compared to the other EU Member States; it represents only 12.8% of GDP (rank 25 out of 27, just behind Estonia and Latvia). The European Union average is more than twice higher. Romania spent 741 Euros per inhabitant for social protection in 2007 (before the crisis and austerity measures), while Denmark spent 11570, and Hungary, which is closer to Romania and shares a similar recent history, spent 1927 Euros.

Legislative measures are also important for achieving a more equitable society. *Romania's*

*Labour Code* has been assigned a special role in addressing the issue of poverty and correct distribution; more specifically, the provisions therein related to the guaranteed payment of a national minimum wage. Another important tool in tackling poverty is the guaranteed minimum income, enshrined by the *Law No. 416/2001*. Both measures can be legally considered as assuring sufficient social protection for low-skilled working persons or for those who have no job. A content scrutiny provides another perspective. Currently, the Minimum Gross Wage is 600 RON monthly, which means more or less 140 euro, according to the variations in the currency exchange rates; the net minimum wage is approximately 100 euro. The guaranteed minimum income for a single person is 125 RON (26 Euros) monthly and can achieve the level of a net minimum wage for a family of five without any other means of earning their living (approximately 100 Euros). These levels are minimal indeed and they can neither assure a living, nor be incentives/disincentives for working; instead, they are a strong incentive for leaving the country.

However, Romania does not have a culture of assessing public policies; for this reason, it is quite difficult to speak about their success or their malfunction. Despite the criticism against it as being a disincentive for employment, the guaranteed minimum income must have contributed to the rapid reduction of absolute poverty after 2000. We may suppose that remittances from abroad have been another reason of this decrease. As relative poverty has already shown, the GDP growth during the period has had no significant direct input, due to the more and more unequal growth distribution.

There are two tendencies in Romanian social policies that prevent better results because there has been no overview; i.e. the *accumulation of many* different small measures and the fact that they are *modified regularly*.

The main social benefits which have been established make up a long list which includes the allowance for newly born children, the children's allowance, incentives for parents who, although benefiting from parental leave, choose to resume work, the complementary family allowance, the support allowance for single-parent families and the foster-family allowance, the newly-weds support programme, including a unique contribution of €200 upon marriage, the home heating allowance programme for the cold season, etc. Up to 7 million persons are apparently beneficiaries. The situation creates the false impression that those in need enjoy strong public support by receiving many social benefits; but since each separate public institution deals with its own beneficiaries, the government has no overview of the situation - how many they were and how much each of them receives as social support. In order to overcome this difficulty and manage all social benefits in a unitary manner, a new institution has been set up - the *National Agency for Social Benefits*, whose results are expected in the future.

The inadequate amount of social expenditure is not the only problem; the concrete aspects of each policy implementation show a limited capacity to solve the problems it has been created to solve. The social benefits, as they are, take a monetary form; the government and the municipalities failed in creating and providing the required social services. Therefore, beneficiaries receive a small amount of money and they have to buy the services they need on the free market; in this way, the result is quite limited. For example, there is a very poor network of public affordable child-care services for children under three years old; a baby sitter or a private solution is too expensive, even for those earning a medium wage. As a consequence, women are practically forced to leave the labour market for a long time, los-

ing skills and promotion opportunities, or to abandon giving birth to a child.

Many doubts are also related to social programmes focusing on children living with their families, as there are no guarantees that parents use monetary support to improve their children's lives; this is the main weak point used by those who reject the idea of a guaranteed minimum income and condemn it as stimulating laziness.

An intermediate conclusion is evident; efforts have to be made to improve social policies when limits have been noticed in their drafting or implementation; an appropriate definition of the issue they intend to solve is essential. However, the difficulties we face in having more effective social policies should not justify the argument that by doing nothing we cannot make mistakes. The costs of such a choice are undermining the economy and society as a whole.

### 3.9.3. The Case of Trade-Off in Employment Policy

*"A society without unemployment is not a utopia at all; an ethical plan for erasing unemployment is a government obligation"*

Amartya Sen

The country's development over the past 20 years, as described by the GDP evolution, has been a sinuous one, characterized by two successive W-shaped trends and a long-lasting recovery after the big economic decline in the early 90's when GDP decreased by more than 40%; the 1989 level was regained only in 2004. The implemented economic reforms have radically modified the work-related structure of the population. The number of employees was more than 8.2 million in 1990, the majority working in industry; it is official-

ly less than 5 million today. Meanwhile, the number of pensioners increased by 2 million, another 2 or 3 million left the country looking for a job in the European Union or elsewhere; the number of independent workers and freelancers is surprisingly high.

The companies operating at the beginning of the transition period have been restructured (based on the strict selection of the very profitable activities and on drastic personnel cuts) and privatized afterwards; many of these companies were shut down by the new owners (old competitors of the firms on the market) after their privatization. Other activities have been abandoned on account of missing markets, with no privatization attempts whatsoever. The number of people fired was extremely high in both situations. The Romanian economy has had a limited capacity of resolving unemployment.

The new companies have been established, with several notable exceptions, in miserably paid working fields, with jobs of poor quality and with no prospects. For a decade or so, most jobs have been created in the garment industry; small and middle towns' populations have survived due to the work of thousands of new employees – most of them women – in this industry, which provided up to 40% of the Romanian exports at the beginning of 2000. These factories have been set-up as a consequence of a western delocalization process of labour-intensive activities; raw-material suppliers also provided the 'selling-off' on the western markets. Therefore, the long-term sustainability of these activities depended on two factors – a) maintaining a labour force at a very low price in order to avoid a new delocalization towards the East of the East (Ukraine, Moldova, etc.), and b) the western markets' capacity of buying these products.

The EU accession and the economic crisis have generated a significantly decreased demand. The internal market is not capable of

replacing it. The GDP crash at the beginning of the 90's, liberalization of prices and the rapid inflation have drastically reduced purchasing power and, therefore, its absorption capacity; it slowly and gradually started to recover, but Romanian companies have to deal with the competition of imported products, which are cheaper or of better quality. The impoverished part of the population is used to buying cheap Chinese products, while the new rich prefer the European markets for their consumption purchases. The inland manufacturer faces obvious difficulties, with consequences for the ability to maintain existing jobs or to create new ones.

This is also quite obvious with the excessive dependency of the building sector on public investments. Building companies manage to become prosperous and job-providing only in two ways – if they sign contracts with the public authorities (central or local ones) to build schools, hospitals, etc., or if they work as subcontractors for bigger foreign companies that outsource labour-intensive activities. There is not a sufficiently powerful internal market to secure their viability; therefore, the labour market registers an emphasized insecurity as far as the maintenance of a job is concerned.

The pressure on industry was followed by a rapid deprofessionalization phenomenon of the qualified labour force. Some of them re-oriented towards professions that were very different from the ones they had skills and experience for; engineers belonging to the old socialist industries turned themselves into service suppliers – insurance policy agents, cosmetics salesmen or clerks.

In order to reduce the pressure existing on the labour market, in the middle of the 90's, authorities decided on the premature retirement of workers who had practically no employment opportunities on account of their age and the lack of jobs. Some of these "young" pensioners, as well as a significant

part of those impoverished by the loss of their better paid industry jobs, left towns generating a unique phenomenon, a reversal of the urbanization phenomenon in the 60's and 70's – the re-ruralization of Romania. Almost 47% of the people in Romania live in rural areas, where employment is almost non-existent. Their only alternative was to find a job abroad. The Romanian labour migration became a widespread phenomenon in the post-communist period. Over one third of Romanian households (approx. 2 500 000) had at least one person working abroad after 1989. Labour migration intensified after 2002, given the new Schengen regulations. In 2006, labour migration was three times that in 2002.

Afterwards, statistics on labour migration, which was becoming a way of escaping poverty for many, were no longer kept. Receiving countries may have better data on immigration, but a first striking issue for Romanian governments is that no institution or organization has (for a long time) tried to approximate the number of people working abroad; 3 million persons seems to be the most correct estimate today.

For a few years, governments presented the phenomenon as a political success, calling it "freedom of movement"; the fact that many other Europeans enjoy this freedom and do not leave in such a high number is grounds for reconsideration of the issue. What does "freedom to move" in Europe actually mean for workers? At least three conditions have to be accomplished: a) to have rights and opportunities in their own countries and to choose to go abroad; b) to be allowed to enter another country's labour market when they need it, and c) to be able to come back home when they want. How could we explain in appropriate economic terms the fact of working in another European Member State for Romanian people in the circumstances we have just described? It seems more appropriate to speak

about the constraint of leaving the country than the freedom to move throughout Europe. The phenomenon is not at all new. The old phenomenon was called "brain drain". Given the recent awareness about demographic challenges and the value of human resources, this current brain and hand drain has even worse effects than before. Romania is now facing huge difficulties concerning its further development because of this drain of human resources. The government offers evidence that it has not yet realized the danger of pushing down wages. A new wave of migration is expected.

The remittances which have entered the country during the last years have helped many poor families survive; it was a short-term solution with obvious effects – three million less contributors to the social security system; more difficulties to pay pensions because of a dramatic change of the rapport between employee contributions and retired persons, the necessity of developing new social services to support the children left home in order to avoid school drop-out and the danger of anti-social behaviour; the fact that qualified and experienced persons found opportunities and left, has had, as a main result, lower productivity and worse quality for the goods and services provided at home, etc. We cannot find a good plumber anywhere, a Romanian or even a Polish one.

Long-term consequences are not yet apparent, but we can predict at least two of them. Many people work abroad without a legal contract and, as a consequence, have no social security; this category, the less skilled one, will return in the future and increase the burden on an already stretched social assistance system. The second category, highly skilled professionals, will not come back at all, as many studies have already revealed. In spite of this worrisome social situation, migration has reduced the pressure on the labour

market; unemployment is less of a concern, and domestic demand has diminished.

The main problem for the government continues to be unemployment; all governments concur on this; Romania is not an exception. Creating enough jobs for those willing to work is still an unachieved goal, bigger factor than making the jobless occupy the unoccupied jobs; the real economic deficit of the labour force generally occurs only in specific areas of activity, regions or periods; but on the contrary, the population is forced to leave their homes because they lack the opportunity of a job. If this is the case, two questions require an answer: 1) is the government able to offer enough jobs for all those willing to work, and what should be done in order to achieve this objective (dividing work, creating new jobs, in which fields, through which means, etc.), 2) is there an authentic desire to create jobs for everyone, or is the jobless category necessary for the functioning of the current economic orthodoxy?

For many years, both political decision and scientific social research have used a few ready-made ideas and concepts that have actually prevented governments from achieving better results in facing unemployment. Artificial causal relations have been supposed in order to prove new ideologies. For example, many used Denmark as an example for the positive results of "flexibility", stating that a deregulated labour market explains the Danish economic and social success; therefore, the assumption that many other economic winners will emerge by multiplying deregulated markets.

The explanation for Danish achievements is quite different and it concerns human and institutional relations, not the content of legal provisions or the absence of such legal provisions on the labour market. Denmark did not regulate the labour market in an excessive manner because it is useless to do so. The society was built on everyone's rights and du-



ties and on mutual respect. The trust among social partners is higher than elsewhere and verified through agreements that have been respected for more than a century; confidence among citizens is one of the highest in the world. It is not about sticks, in Denmark; it is about carrots. Moreover, in Denmark there are legal provisions guaranteeing high unemployment benefits (90% of the person's previous income) for a very long period; it can attain a maximum of four years out of six. The feeling of personal and economic security makes employment change easier; losing the job is not such a catastrophic event as in Romania where employment benefit is paid for a much shorter period (between 9 and 15 months) and the general amount is 75% of the minimum wage together with a bonus from 3% to 10% of previous income, according to the years of contribution; the lack of new opportunities puts the jobless in a even more precarious position.

OECD promoted strongly the composite index of the strictness of employment protection legislation (EPL) as an instrument to enforce the idea that flexibility would reduce unemployment. Despite the efforts which have been made, a correlation between EPL level and unemployment reduction could not be proven. Unfortunately, the labour market is not an autonomous market; there is a total dependence, in fact, on other markets and the jobs provided by the public sector; nobody hires a new employee disregarding the demand of goods and services. Fall in demand-generated unemployment in the United States, even if the EPL is one of the lowest in the world; meanwhile, many European countries succeeded in better managing the situation in spite of having stricter legislation (Montousse, 2008).

Many political decisions based on scientific studies also insist in underscoring the role of active measures in diminishing unemploy-

ment. The importance of ALMP is real but not as high as we are used to think. In the short run, they are truly useful for occupying existing jobs faster; they have only a marginal effect in reducing unemployment; actually, it is a statistical solution, not an economic one, as long as during the training programmes the persons involved are not considered unemployed anymore. In the long run, the approach might be more effective if new jobs appear and if employment services have adequately anticipated the future needs of the market, suitably targeting their activity.

Another aspect that we may be dubious about is the practice of referring to social contributions as being a simple burden and not a part of security protection, and therefore, a part of everyone's salary. Cutting contributions is currently seen as a mean of reducing labour costs and also unemployment. As there are no concrete obligations for employers to create jobs when cutting social contributions, whenever such policies have been implemented, the results were deceiving - neither the price level has decreased, nor the number of jobs has increased, at least not enough to justify the effort. This is another piece of evidence for the weak link existing between labour cost and employment. In Romania, the number of those earning the minimum wage has almost doubled during the past ten years; the number of employees remained constant; moreover, the informal economy has not decreased at all.

Certainly, we may notice different concerns according to different possible perspectives – employees, employers, working people, jobless, active or retired persons. However, as Amartya Sen and other thinkers have been trying to persuade us for a long time already, it is important to place these diverse concerns within a comprehensive assessment, so that unemployment may not be treated as a reason for doing away with reasonable conditions of work for those already employed;

nor should the protection of exiting employed workers be used as an excuse to keep the jobless in a state of social exclusion from the labour market and employment.

The need for trade-offs is often exaggerated and is typically based on very short-sighted reasoning. Furthermore, even when trade-offs have to be faced, they can be more reasonably — and more justly — addressed by taking an inclusive approach, which balances competing concerns, than by simply giving full priority to just one group over another. Proceeding as Romania did - defending competition with the risk of increasing exclusion - could have higher costs for society and could undermine economic efficiency more than we usually accept, based on arguments used by a few trendy theories.

#### **3.9.4. The Case of Trade-Off in Education**

Education is an important area of concern due to the role that it plays in the social economic life of a country. Rising employability and a growing value on the labour market of human resource are only the direct quantifiable effects; improving a persons' well-being, increasing vertical mobility in society, strengthening social capital and, more generally, a rising social status are some of the other aspects strongly related to a good education.

In Romania, as everywhere, employability for educated persons is higher than the capacity of finding a job for those who are less skilled; the explanation of a generally lower unemployment rate for this category of people comes from their having access to information, their better health, richer social capital, and other characteristics that are usually linked to a good education; moreover, it comes from their availability to accept less qualified job offers when labour market supply is inappropriate for their professional level and skills; upside-down mobility is frequent. It has

often been the case for Romania during the transition that researchers, engineers, or other highly qualified persons have agreed to work in areas where their competences are irrelevant, instead of not having a job at all. For the labour market's current rules, such a situation seems to be progress as long as higher employability and mobility are featured. Another perspective might reveal it to be a misuse of human capital and an ineffective spending of public money, given their former education.

Equal and affordable education for all, disregarding income or age, is a vital condition for the country's progress and for economic efficiency. We believe that a better society has the following characteristics: equality of opportunity, limited income inequalities, the capability to deliver sustainable development, fostering human capital, creativity and innovation, security, social security and solidarity, social capital and trust, respect for the environment and a civil democratic society. For all these features people's education is a necessary pre-condition.

Unfortunately, instead of defending some areas of social life – such as education - against market forces, successive governments have not even started this struggle; on the contrary, they relieved privatization a solution for an improved functioning of the education system; this attitude resulted in the exclusion of those who have no money to pay and in an unexpected decrease in the quality of education. What a short-term perspective can justify in term of competition and efficiency, a long-term perspective can totally reject; what works in one field does not work at all in another one. This rule has been ignored when many decisions concerning education have been taken. Education was a field for uncompleted but permanent reforms, each government having many good intentions but very bad results.

Nowadays, almost everybody who is able to pay taxes could have a higher education degree; the biggest university in the world is

a Romanian university (300.000 students in 2009); it provided the market with people having many diplomas but less required skills.

Of course, public compulsory education exists in Romania; as well as public educational institutions of any level. Unfortunately, as social sciences have warned us for a long time, education structure is a mirror of society structure. Income inequalities reflect themselves in education inequalities. Poor people, who live in rural areas or in poor urban districts, are used to sending their children to schools that are less well equipped for a good education; many face hard economic limitations to be able to send their children to school at all. As a consequence, a real poverty trap emerges, for many generations. Only 1-2% of the current students in universities come from families living from agricultural activities in rural areas and only 5% from rural areas, in general.

Attempts to raise employability through active measures, such as organizing training and lifelong learning face strange and regrettable situations because of poverty effects. For example, a training programme failed, even though it was well targeted and well-funded, and was required by the labour market, because not enough persons with primary school level have been found among the jobless in need; poverty had made these young people drop-out from the educational system before graduating from compulsory primary school; in other words, illiteracy prevented them from attending the training course and from increasing their chances of employment. The real inequalities are always more profound than those on the surface.

Teachers' advice is very useful in order to reduce early drop-out behaviour; however, it could sometimes be even simpler. The most successful programme for improving school attendance among poor children, especially Roma children, has been the provision of a

bread stick and some milk every day, for every child in primary school. In spite of the criticism of this programme, after eight years, "*Laptele și cornul*" (*Milk and Bread Stick*) has left a realist example of good when drafting policies; better nourishment and better school attendance for children are equally important and have long-term consequences.

Different assessments of the Romanian educational system actually failed in providing a clear picture because of missing the larger perspective. A few conclusions are, nevertheless, disturbing: there is continually increasing lack of trust in the education system; the confidence that education, in general, can ensure personal progress is very low; a large majority of students in universities wants to leave the country immediately after graduation; managers do not wish to organize workplace qualification courses anymore because, after acquiring the needed skills, many workers look for a job abroad and leave the country... The very low monthly salary is, of course, one explanation for their leaving as well as low efficiency.

### 3.9.5. Conclusions

When discussing social policies we have to disconnect two different problems and, as a consequence, two different approaches: a) social policies' effectiveness and b) the effects of having/not having social policies on economic efficiency. Social policies have to be conceived to target real needs and to maximise their effects. We could have poor social programmes (with restricted access and little money) but bringing relatively good results, as evaluated through the reduction of poverty and exclusion after the transfer has been done. We could notice a worse situation, when little money are spent ineffectively – the administration costs are too high, the selection of the social target is not appropriate, implementation is substandard or, frequently,

there is a misinterpretation of the problem that the administration has to cope with.

There are reasons to suppose that the economic effects of social welfare policies may be considerably less detrimental than assumed by the trade-off thesis; we considered that they are beneficial for both economic and social reasons. Reducing income inequality may expand and stabilize consumer demand, increase poor people's investment in education, and heighten worker motivation and cooperation. In Romania, higher social expenditure would have prevented the human resource drain; for many, a good education for their children or better health care provision constituted the decisive reason for leaving the country. Constant attention paid to social protection during the transition would have avoided the country going into economic recession as deeply, by strengthening domestic demand and limiting the very high dependence on external markets.

Furthermore, expansive social security programmes may enhance firms' flexibility in labour deployment, facilitating labour mobility if this is necessary. In addition, social services could become a significant source of new jobs, helping the country to absorb female unemployment, especially.

A job for everyone is a sensitive goal for each government because having a job, a quality and satisfactory one, clearly defines a person's status; losing a job means losing status, not only income. A human being is a social animal whose self-respect is tied to status; for this reason, inequality and long-term unemployment have many practical implications. Poor or jobless people feel incapable of earning their living, or having a life; this causes depression, and generates the adoption of bad behaviours such as alcohol, drug use and criminality. These behaviours are clearly undermining for over all economic efficiency; moreover, the government cannot "save money" by maintaining inequality and exclusion; less redistribution does not necessarily result in lower expenditure on social services, as what is not spent on reducing inequalities ends up being spent on dealing with their results (for example crime, drug treatments, health care).

The Eastern European countries, but especially Romania, have to pay attention to human development and spend a larger part of their revenue for this purpose; investing more in cohesion policies could be a balanced solution for dealing with both goals – higher efficiency and a more equitable society.

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## Data

EUROSTAT, INS, WORLD BANK, ICCV, MMPS, OECD

### 3.10. Serbia: Equity and Efficiency - Hand in Hand

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#### Abstract

This paper is not an attempt to provide a comprehensive analysis of all the major aspects of the efficiency-equity nexus in Serbia in the areas of economic and social policy. Rather, it draws on metaphors, illustrative examples, and some evidence, to present our main thesis that, at least in the present Serbian context, the equity-efficiency trade-off is not really relevant. We argue that applying explicitly or implicitly policies tailored in favour of the worse-off in labour, welfare, and education policy would simultaneously improve both the efficiency and equity of the Serbian economy. Our main contribution is progressive income taxation that is demonstrated to favour not only the equity factor, but also the competitiveness of the economy. In addition, we argue that spending more on social assistance and less on hefty public sector salaries would reduce poverty but also reduce queues of labour force members attracted by the public sector's winner-takes-all allure. Restructuring, spending on education so that teachers get relatively less and students get relatively more, would again be a socially desirable outcome enhancing simultaneously the efficiency of the Serbian education system.

#### 3.10.1. Introduction

In the period 2001-2008 the Serbian economy grew at an average rate of almost 6%.<sup>148</sup> The real growth was boosted by a privatization programme (that brought in a steady inflow of foreign investments), massive foreign borrowings, expansive fiscal policy, and a strong inflow of remittances. All this enabled strong private consumption, but also resulted in low saving and investment rates. This caused severe imbalances, the most dangerous of which have been high fiscal and trade deficits.

Although private consumption in 2001-2008 was strong, it did not lead to more job creation. In fact, since 2001, Serbia has been experiencing jobless growth: while the economy was growing, employment was, for the most part, steadily declining. Eventually, in 2009, the growth rate too slumped, and became negative (-3%). Since the start of the crisis, jobless growth has turned into a

dramatic loss of jobs, unseen in comparative perspective – although the cumulative drop in GDP from October 2008 to April 2010 was 4.7%, the cumulative drop in employment during the same period was as much as 12.5% - with the negative elasticity of employment with regard to growth of only 2.6%, while normal values (observed in other European countries) are in the range from 0.1 to 0.9%. Although the slump was largely a consequence of the global financial crisis, recent forecasts suggest that in 2011-2013 Serbia cannot expect to get back to the pre-crisis growth rates anytime soon.<sup>149</sup>

The reasons for the huge drop in the employment rate and the overall poor performance of the Serbian economy are numerous. In this paper we look into how the misallocation of resources, stemming from the disregard for equity considerations, and a very simplistic idea of efficiency, contributed to the failure of Serbian transition to create more jobs and a

<sup>148</sup> The data in this paper, unless otherwise indicated, are from the EIU database for Serbia.

<sup>149</sup> The recent forecast by the Economist Intelligence Unit for Serbia predicts 1.5% growth in 2010, and 3.5% in 2011.

sustainable economy. We claim that the 2001 privatization programme that mandated the sell-off of the old, loss-making and (usually) inefficient socially-owned enterprises enabled the redistribution of resources, and the assets' redeployment in trade and services. The attractiveness of the trade and service sectors was additionally shored up by economic policy designed by the new political, economic and technocratic elite who wanted to reverse economic policy from the 1990s that, in relative terms, benefited the lower classes, largely at the expense of the middle class (Arandarenko 2010). The creation of a large service sector after 2000 came at a price: it was paid by the gradual devastation of manufacturing and agriculture. In addition, the boom of the service sector – most prominent in financial services, but also in predominantly public services such as education and health, and its alluring reward structure attracted too many entrants. At the same time, the so called real sector, especially labour intensive sectors, was made much less attractive, via a combination of fiscal rules and barriers to doing business, which, in turn, reduced the labour force that could have been deployed in industry.

Such kinds of disproportionality created serious problems because the growth in an economy that mainly provides services and produces very little of something that can fall on your leg is not sustainable in the long run. In this paper we explain market and state failures that created the misallocation of resources (sections 2 and 3), and put forward some general ideas in the area of labour taxation, social and welfare, and education policy that would correct the imbalances and improve the overall efficiency of the Serbian economy (sections 4-6).

### 3.10.2. The Winner-Take-All Metaphor

An economy can always be more efficient and more equitable. The goal of this paper is to explore if, in the Serbian context, higher efficiency can be achieved without the usual trade-off between equity and efficiency. In general, efficiency can be improved if it is shown that there are some market and state failures. Removing such failures would lead to less waste and the more efficient allocation of resources. A more efficient economy would enlarge the economic pie, which would enable economic policies (notably, fiscal policy) to distribute resources without reducing efficiency. Thus, we begin with market and state failures. In this section, we lay out a concept<sup>150</sup> of a competitive market called a winner-take-all economy that we see as a suitable metaphor for the current state of the Serbian economy. In section 3, we point to some state (policy-making) failures that brought about large market inefficiencies in terms of misallocating factors of production.

The winner-take-all metaphor is contrasted with Adam Smith's invisible hand. Smith claimed that, provided individuals are rational and there is no external interference, the free market will most of the time lead to efficient outcomes. In other words, the market is efficient in that it directs human and physical capital to where they are most needed. It is also self-correcting: if there is an abundance of goods, prices fall and the production slows down; if there is a shortage, prices go up and supply expands (Smith 1976, 48ff). Thus, we only have to leave economic agents alone (no legal constraint on their trading and exchange, no price controls, etc), and the inter-

<sup>150</sup> We adopt the major outline of the model from Robert H. Frank's and Phillip J. Cook's *The Winner-Take-All Society* (New York, The Free Press, 1995). The metaphor was also used in some Frank's later works (Frank 1999; 2007). We put forward this metaphor in some more detail because it is largely unfamiliar to our academic public.

action of people's self-interest, as if guided by the invisible hand, will stimulate technological innovation, satisfy human wants, and minimize wasteful activity (*Ibid.* 456)

Smith's popular phrase that social value is created out of individuals' self-love rather than their benevolence (*Ibid.* 27) became a building block of contemporary economics (Friedman & Friedman 1980, 5). Yet, this is exactly what we want to challenge here by the winner-take-all metaphor. When reward structure depends on absolute performance – which is the standard presumption in mainstream economics – the invisible hand metaphor works fine, and the interaction of individual choices usually results in efficient outcomes. However, when reward depends on relative performance, the invisible hand stops functioning and unrestrained choice by economic actors leads to inefficient outcomes (Frank 2009, 74). In such cases physical and human capital is not directed where it is most needed. In what follows, we show that even if we presuppose that economic agents are fully rational, their interaction can lead to a division of labour whose outcome is not efficient. Serbia after 2000 can be seen as an example of such an economy.

Here's the metaphor. Imagine a hypothetical economy with only a dozen participants, who are self-employed, i. e. at the same time employers (firms) and employees. They can grow blueberries, or, alternatively, sing, act, play tennis, engage in investment banking, etc. The blueberry growers earn a fixed amount of money for each kilo of blueberries. Their salary depends on their productivity: if this year they grow twice as many blueberries as yesteryear, they will earn twice as much. In contrast, the market for say, tennis players is based on the relative performance of economic actors. This is the essence of the winner-take-all metaphor. For instance, if you win the 2009 Roland Gaross tournament,

you'll get €1 million. If you come in second, you'll get half that much. However, it does not necessarily mean that the champion is twice as good as the one who came in second. Actually, the vice-champion is usually only a tiny bit worse, or sometimes is even better but could have lost due to bad luck. The player who came in third gets  $\frac{1}{4}$  of what the winner receives, although he is surely not  $\frac{3}{4}$  times worse than the winner. This is the logic of the winner-take-all economy: it is driven by a few agents who can make the difference, for which they receive fat rewards; the majority are paid several times less (Frank & Cook 1995, 1-22).

Such kind of a market, as a rule, suffers from overcrowding: it attracts too many competitors and produces social waste. The phenomenon is similar to what Garrett Hardin described as the tragedy of the commons (Hardin 1968). *If everyone sends their steer to no-one's land to graze, the land will soon be used up, and no-one will be able to use it in the future.* It is so because each farmer ignores the cost he creates for others; anytime he sends his own steers to the common (thus satisfying private utility), he pays no attention to the whole, thus diminishing social utility. Similarly, when another young CEO, market expert, trade or firm manager, organizer, TV hostess, folk singer, fashion model, tennis player, lawyer or public administrator enters the already crowded market, he/she reduces the chances of winning of the existing contestants on these markets.

The theory of an efficient market would claim that, provided individuals are rational and external intervention is absent, the market for any profession is generally efficient: the invisible hand efficiently allocates resources, deciding who will grow blueberries and who will be a tennis player. However, even when the two conditions (rational individuals, no external intervention) are met, the market might



not efficiently allocate resources. In other words, it is quite likely that the whole dozen people from our example go after top prizes in tennis, thus abandoning blueberry growing.

If this happens (and we argue this is happening in Serbia today, and far beyond the labour market), it cannot be said that it happened because economic actors were irrational or fools. Quite the contrary, imagine you are at a cocktail party where everyone talks loudly in order to hear each other. It is in your (rational) interest to talk louder so that your interlocutor can hear you. But this behaviour only makes things worse because this is how everyone else is thinking. Eventually, everyone is shouting and no-one hears any better than before. Similarly, participants on the market typically do not assess their participation according to social utility but according to their personal utility. But this is precisely the problem, because sometimes the individual rationality of many individuals, when combined, produces socially irrational outcomes. If the tennis competition offers only one prize, it turns out that entry into the tennis market is misleadingly attractive for participants because those who end up losing have abandoned productive alternatives elsewhere. This is clearly inefficient, for it creates waste; something Smith said would not happen if markets were left alone.

The waste-creation can be explained by Martin Shubik's Dollar auction game, sometimes also called the entrapment game (Shubik 1971; Frank & Cook 1995, 128). If you offer on auction a \$20 dollar bill but specify that, after the auction is over, you will collect the first and the second bid, unless there is a coordinated activity on the part of the bidders (which means the bidders must overcome the collective action problem), you will usually end up having more than you offered. For instance, if the highest bid is \$15, and the second-highest bid is \$14, the auctioneer collects \$29 and

gives up \$20. Note that the "social" loss here is much higher. The winner gains \$5, but the second-highest bidder loses \$14. This expressly exemplifies the central problem of today's Serbian economy: there is too much investment in activities in which there can only be one or few winners, meaning that others who pursue the top prize waste their investment in terms of time and money. This is a crucial theoretical finding, for an economy that produces such kinds of waste is inefficient. It would have been more efficient if these persons took up these jobs immediately after high school, or chose other occupations (e.g. blueberry grower) from the very beginning.

Occupations based on relative performance can mainly be found in services (entertainment, sports, management, business, banking and finance, insurance, law, health etc). These are the sectors in which advertisements frequently pick one or a few persons to represent the whole sector. These individuals—such as top financial and business managers, businessmen, top models and designers, doctors, publishers, novelists, tennis players or singers<sup>151</sup>—are usually extremely well-paid, but their appearance in public sends a misleading message to the rest of the workforce - that they can be as successful as the top performers. Although in such top-reward occupations there are already too many competitors, which reduces the chances for each to get top prizes, psychological and behavioural economics research (Gilovich 1991, 75-87) demonstrated that the trend of overestimating one's chances can easily lead individuals to believe that it is just them who can be the winners in such kind of competition.

Society's total income would be higher if fewer people and firms competed in the markets where what you can win depends on your relative performance (i.e. on whether

<sup>151</sup> Some of these professions are not that successful in the Serbian context, but are in the US and Western European economies.

others can lose). Instead, economic actors should be nudged to choose sectors and occupations in which what one can win primarily depends on one's absolute performance. We argue that the Serbian economy after 2001 developed into the kind of economy in which the winner-take-all activities attracted too many competitors who fight for fewer prizes, thus making them abandon pursuing productive alternatives which, from a social point of view, would create higher total utility (i.e. larger social pie).

The essence of our proposal is to put forward some measures that would help create an economy that would attract more economic actors into activities depending on absolute, rather than on relative advantage. We believe that increasing investment and employment in economic sectors whose growth is driven by productivity, rather than the pursuit of 'winner-take-all' extra profits, and monopolistic and speculative gains, is the best policy from which everyone stands to gain. We want, however, to shy away from suggesting measures that would weaken trade and services in favour of industry, manufacturing, and agriculture. What the Serbian economy needs is an optimal mix of investment decisions and career choices that maximize the combined value of services and industry. And in the realm of distribution, it needs a system of incentives and penalties — basically, reward structures and a tax system — which would replace the winner-take-all economy with a healthier, more efficient, and more equitable economic system.

As may be seen, our proposal resists the claim — exemplified by Arthur Okun's 1975 book *Equity and Efficiency - The Big-Trade-off* — that more efficiency can be achieved only at the cost of less equity. We do not want to enlarge the pie for some by reducing it for others. Thus, when we say that the winner-take-all market attracts too many contes-

tants, we mean that society's total income would be higher if fewer people competed in these markets and chose alternative sectors and occupations instead. We maintain that no trade-off between efficiency and equity is needed but rather that the whole economy is inefficient (i.e. it lies below its full production potential), and that Pareto improvement is possible by improving both the efficiency and the equity of the system.

### 3.10.3. State Failures

Our main criticism of economic and social policy developments and of the emerging socio-economic system in Serbia during the last decade is that they have intentionally supported the spread of a "winner-take-all economy" instead of - what other governments usually do - taking measures to subdue and correct for imbalances, inequities and waste, which are responsible for winner-take-all activities.

As mentioned in section 1, inefficiency in the Serbian market was a product of two kinds of imperfections: market and state failures. In the previous section, we looked into market failures. We claimed that, even when the market is free, allocation of labour and capital may not always be the most efficient. Here we put forward a complementary claim: the ineffective allocation of resources in Serbia is also brought about by the State's actions. Therefore, in this section we look at how the Serbian government's economic policy since 2001 created inefficiencies.

The Serbian government's economic policy after 2001 created fiscal and trade imbalances and a misallocation of capital and labour. Ten years after the regime change, the employment rate in Serbia hit its historical minimum, reaching 47,2% of the total population (the current employment rate in the EU is about 65%), while the unemployment rate in April 2010, reaching 20.1%, appeared to be going

back to the 2005/2006 levels. The structure and quality of jobs in Serbia is even more worrisome. The primary labour market is reduced to state administration, modern services (banking, finance, IT, marketing), and a small number of privatized companies bought up by foreign firms. The secondary labour market is reserved for most workers in private firms as well as the self-employed. The former is characterized by higher job safety and higher salaries; the latter by higher job insecurity and lower salaries (Arandarenko 2010, 71).

The whole private corporate sector, which was supposed to become the backbone of the Serbian economy, when the privatization programme is completed, accounted in 2010 for some 900,000 of the 2,278,504 total workforce. Potential employees have been steadily losing interest in looking for jobs in the private corporate sector, but have shown increasing interest in public sector work, state administration, and various kinds of services. However, since the capacity of these sectors is limited, the workforce has overcrowded the service sector. A part of the workforce could be re-directed towards industry and manufacturing, but these sectors appear to be underdeveloped and thus unappealing to the workforce.

We maintain that the ten years of economic reforms in Serbia have failed to create an economy that would provide for productive employment and an increase in welfare for the majority of the population. A policy analysis in this section reveals that the post-Milošević political elite has never had an interest in creating an efficient economy that would provide “the greatest happiness for the greatest number”, but was rather engaged in redistributing wealth by means of economic policy and privatization. The economic history of Serbia after 2000 can be understood as the struggle of distributive coalitions for resource control, which, in the long run, has an adverse impact on creating a viable economy (Olson 1982).

We already mentioned at the outset that the current model of growth in Serbia in 2001–2008 was based on massive foreign inflows into banking, insurance, real estate, the trade sector, and other various types of services. Shored up by an expansionary fiscal policy and strong local currency, such an economic policy enabled large private consumer spending which fuelled economic growth. Private consumption encouraged the import of various kinds of consumables, which created a large trade sector. As a result, the trade and banking sectors (which financed the imports) thrived after 2001, while industry, manufacturing, and agriculture suffered from underinvestment and a production slump during the same period.<sup>152</sup> The labour force was attracted to services, turning away from traditional sectors of the economy.

The growth of services was enabled by the 2001 privatization model that was based on tender and auction sales. The aim of the model (previously implemented with some success in countries like Hungary and Estonia, and suggested to Serbia by the World Bank) was to do away with unprofitable socially-owned enterprises, thereby making room for new private corporate property. However, the real effect of the programme, in the way it was embedded into Serbian circumstances, was the relocation of resources from industry and agriculture to services, as well as the relocation of wealth from an abstract ‘society’ to a privileged minority. In addition, the model was lax in its implementation in that it mandated different criteria for different cases. There were three weighting factors - price, investment level, and social programme - that determined who will

<sup>152</sup> Interestingly enough, a production slump took place even in those sectors that have received the most subventions from the government since 2001. This is the case with the Serbian agriculture sector. Although in sectoral terms, the largest programme of subsidies in 2008 consisted of subsidies to agriculture (around 40%) (WB 2009, 53), some agricultural sectors, such as dairy production, suffered harsh destruction in terms of the reduction of the cattle livestock.

buy the company, but the weight for each of them differed from case to case. This created a huge leeway for the political, economic and technocratic elite, and even the mafia, to manipulate the sale procedures and take advantage in relocating resources for various purposes. The political elite manipulated the privatization process before each electoral phase; the economic elite and the mafia had a chance to buy some of the resources on the cheap; and the technocratic elite received fat fees for its consultative services. These were the winners. The losers became the workers and former owners (Arandarenko 2010, 79).<sup>153</sup>

The structure of the government encouraged this inefficient relocation of resources. The privatization agency, the government's body tasked with the implementation of the privatization policy, did not always require from the new owner the continuation of the original activity of the firm which was up for sale (except in cases in which the socially-owned firm was already successful). When the new owner transformed the activity of the company (for example, from producing wool to mobile phone services), used the land for a different purpose (to build real estate and offices), or simply bought the whole of a company on the cheap and sold it for ten times more in pieces, the Agency simply failed to act. In many cases, the government bodies did not even bother to check the origin of the money used for purchase, which explains why many socially-owned firms were bought up by the mafia.

Monetary and exchange rate policy also played a role. The dinar was allowed to appreciate in real terms by some 100% against the basket of currencies between 2000 and 2008, thus favouring imports, trade and the consumption of foreign tradable goods and

affecting exports and the consumption of local products. The dinar started to depreciate only in 2009, when the effects of the global financial crisis reached Serbia.

The growth of the Serbian economy after 2001 was, in a way, a consequence of a bubble. The trade and service sector that swelled after 2001, did not reflect growth in the fundamentals, but rather grew as a consequence of strong imports after 2001. For example, in the period 2002-2008 the current account deficit swelled from -4.0% of GDP to 17.7%. It halved in 2009, but as a consequence of the global fiscal crisis, not as a consequence of changes in the fundamentals.<sup>154</sup>

Fiscal policy after 2000 was also a function of redistributing resources from lower to middle and upper strata. Although Serbia's public spending exceeds 45% of GDP (which is close to the European standard), it has not been directed toward reducing existing inequalities. Around 78% of the Serbian budget consolidated expenditures in 2008 accounted for pensions, health, education, security, transport infrastructure, and social assistance (which itself accounts for around 5% of the budget) (World Bank 2009, 7-8). However, the structure of public spending in these areas is directed toward final consumption rather than toward capital investment: almost everything is used to finance pensions and salaries in the public sector. Whereas in welfare economies high fiscal spending enables redistribution of well-off to badly-off, in Serbia massive public spending is directed to maintaining a huge public sector that employs a huge proportion of the electorate<sup>155</sup>, and to the pensioners, an ever-more significant electoral group in an ageing society.

<sup>153</sup> Speaking of old owners and relocation of resources, it is surely worth noting that Serbia is among the last post-communist societies that, 20 years after the breakdown of communism in Central and Eastern Europe, still did not pass the restitution law.

<sup>154</sup> Although Serbia's current account deficit has come down sharply from 17.7% of GDP in 2008 to 5.4% in 2009, the trade deficit is still high, and it was not a result of a change in trade policy: Serbia still has rather poor export that is not able to compete on the competitive European market (Serbia generates 55% of its export revenue in the EU).

<sup>155</sup> According to a labour force survey from March 2010, the public sector employed around 472,000 people.

Tax policy was among the most important instruments of the new political elites for redistribution after 2000. Although a progressive income tax rate was already a standard in the EU, the 2001 tax reform in Serbia introduced a flat income tax rate, without even a basic personal allowance. Flat income tax was coupled with high and intrinsically regressive social security contribution rates. Such an income tax system has been more harmful to the working poor, while favourable to the well-off because its relative burden is higher for those with lower incomes than for those with higher incomes. For instance, the tax wedge for a worker who received only a third of the average wage until 2006 was 47%. In contrast, the tax wedge for a person making eight times the average gross wage was only 34% (Arandarenko & Stanić 2006; Arandarenko 2010, 78).

On the other hand, much of the government's revenue has been collected from the sales tax and later on from the value-added tax that was introduced in 2005. In 2010, the Finance Ministry announced it would implement yet another tax reform that would raise the VAT rate from 18% to 21 or 22%. This is again likely to deepen inequalities and increase poverty. The poorer usually have to spend their whole income, while the wealthier are inclined to save more of it. Therefore, with a higher income, the propensity to save rises, meaning that a higher VAT rate will affect the poorer the most.

To sum up: the Serbian government's economic policy (notably the privatization and fiscal and exchange rate policy) created incentives and directed resources in such a manner that traditional and export-oriented sectors of economy (industry and agriculture) were weakened and became economically unappealing. In contrast, the labour force and investors rightly saw the service sector as more attractive. This had two simultaneous

negative effects—on both equity and efficiency. First, due to such economic policy, the middle and upper classes improved their relative positions, whereas the lower strata were disadvantaged. Second, the structure of the economy became unbalanced, as it was too oriented towards services. This had a negative bearing on development, growth, and employment, for the Serbian service sector firms, while strong in local markets, are weak for competition on the international markets—and often their products are not at all tradable. Serbia cannot excel in exporting services such as mobile phones, finance, trade, entertainment, and public administration. Yet, these are the companies that have made the largest profits over the past five years. (See the publication of the *300 most successful* and the *300 most profitable* companies published annually by the *ekonom: east group*.)

At the end of section 2 we claimed that occupations that are mostly based on relative performance and the winner-take-all metaphor are usually related to reward structures in finance, law, business, entertainment, sports, etc. Overcrowding in these sectors is a natural outcome of the competitive market's failure. The major reason for this is that such occupations are based on relative rather than on absolute performance. This section, however, showed that there are a number of occupations which, while based on absolute rather than on relative performance, were made attractive by the government's policy. These are the occupations in the public sector and services. Relocation of resources undertaken by the government's privatization policy, unequal fiscal burden brought about by fiscal policy, and the direct influence on wages in public sector, public administration, and education made these occupations more appealing than occupations in traditional sectors of the economy.

### 3.10.4. Labour Taxation Policy

In the second part of the paper we put forward our brief analyses of and proposals for labour taxation (this section), social and welfare (section 5), and education policy (section 6). We begin with taxation policy which, in our mind, has the largest impact on labour and welfare policy.

Serbia introduced a flat wage tax in 2001, with a universal rate of 14 per cent. It was an extreme version of a flat tax, without a personal allowance (zero tax-bracket). Coupled with very high social security rates, and with a high minimum basic amount of social contributions, this regulation introduced regressivity in income taxation. Although a small personal allowance was introduced in 2007, in a comparative perspective low-wage workers and the firms employing them (like those in the textile industry) are still heavily taxed, while persons with higher salaries and firms employing them, such as banks, enjoy a comparative advantage.

The sum of contribution rates on gross wages stands at 35.8%, while the wage tax rate stands at merely 12%, with a small, tax-free threshold. Consequently, social insurance contribution revenues account for over three-fourths and wage tax revenues for less than a fourth of the overall labour tax revenues. The contribution rates are by definition strictly proportional to wages within the minimum to maximum base range—their redistributive effects on wages below and above that range are manifestly regressive.

A broader regional study (Arandarenko & Vukojević 2008) first showed that the labour taxation system in Serbia has quite a few regressive features, which, even if equity is disregarded, *inter alia* lowers the profitability of labour investment and increases the costs of labour of low-skilled workers, discourages the formalization of informal employment, has ad-

verse effects on the competitiveness of labour-intensive branches and investments in them, and increases inter-sectoral and inter-regional differences in wages, employment and development. The study also demonstrated that the share of collected wage taxes in the total of collected labour taxes is much smaller in Serbia and, consequently, that the share of the contributions is considerably greater than in other European countries, especially in comparison with the old EU member-states.

A personal income tax reform ensuring greater equity is a necessary but insufficient prerequisite to eliminate or at least alleviate the multiple negative effects of the current labour taxation system. However, even an optimal reform of income taxation cannot lead to significant cuts in labour costs, a significant increase in overall labour demand or demand for less skilled labour or the significant improvement of Serbia's international competitiveness. Apart from reforming income taxation, the government must also slash the current level of fiscal burden on labour if it wants to improve international competitiveness and boost aggregate labour demand—an obvious priority for a country with an economically active population of five million and corporate private sector wage employment barely exceeding 900,000.

These first-rate economic goals will be achievable only once the parameters regarding social insurance contributions are changed in the context of the labour tax reform. These ideas have led us to formulating the following preliminary guidelines for the comprehensive reform of labour taxation in Serbia:

1. Increase the relative share of wage tax revenues and decrease the relative share of revenues from social insurance contributions in the overall labour tax revenue.
2. Reduce the tax burden on labour of low-wage workers by raising the tax-free threshold and lowering the social insurance contribution rates. The target value

- of the tax wedge<sup>156</sup> at the minimum wage level, now standing at 37%, ought to be slashed to between 25 and 28 percent. Such a radical cut would increase demand for less skilled labour, encourage investments in labour-intensive low-wage sectors and cut the costs of formalizing informal employment.
3. Ensure labour tax progressivity by introducing three progressive non-zero tax rates on labour income (wages). The three rates are needed not only for ensuring vertical equity and yielding sufficient revenues; they would also serve as an instrument for conducting a tax-based incomes policy given the dual labour market and monopolized sectors pushing wage inflation. The tax-free threshold (i.e. the zero income tax rates) needs to be set relatively high, approximately up to the minimum wage level (around 40% of the average wage). The first non-zero nominal rate (set at around 20 percent) would also be the only rate levied on around two-thirds of the workers earning below-average wages. The second nominal tax rate (set at around 25%) would cover wages immediately above average and would be the main tax instrument for controlling wage inflation. The third, highest nominal rate (at 35%), applied to incomes exceeding five average wages not burdened by contributions, would only serve to ensure that top earners pay wage taxes which are not much lower than those levied on the middle class.
  4. Cut the overall combined social insurance contributions rate from 35.8% to maximum 30.0% of the gross wage.

The above measures would reduce the tax wedge on labour to a level below the Europe-

an average, which would significantly boost international competitiveness and aggregate labour demand, but this would *ceteris paribus* entail lower labour tax revenues and an increase in fiscal deficit.

In a static context, there are two basic complementary ways to keep the proposed reform fiscally neutral: first, to increase revenues from capital income tax, and second, to increase revenues from the value added tax. Increase in capital income tax rate would automatically improve equity, since this tax is paid mostly by the well-off. However, the overall increase in VAT revenues, if indeed necessary, ought to be achieved without hurting the poor. It could be done by differentiating the VAT tax rates by classes of products and services. At present, there are only two VAT rates in Serbia, the basic of 18% and the reduced of 8%, limited to staples and a few other items. Any increase in the basic VAT rate, if indeed necessary at all, should be asymmetrical, keeping the reduced rate unchanged, and possibly broadening the range of products taxed at that rate if their share in consumption by lower income groups is above average.

The simultaneous reconfiguration of income tax, contribution rates and the VAT rate would ensure that the overall macroeconomic and distributive effects of the comprehensive tax reform are positive. In the dynamic context, expanding the labour tax base by formalizing informal employment and stepping upgrowth in employment due to greater international competitiveness ought to help preserve the previous level of tax revenues notwithstanding the cuts in the average and total burdens on labour.

International competitiveness of the Serbian labour force is critical for our concept, because it is part of the overall competitiveness of the Serbian economy. A "cheaper" labour force attracts more foreign investors. A foreign

<sup>156</sup> The tax wedge is the ratio of total labor taxes (i.e. income taxes and contributions paid partly by employers and partly by employees) to total labor costs, which comprise the net wage and all labor taxes.

investor is more likely to become an exporter, rather than to produce solely for local needs. (Take as a good example the US Steel-Serbia, whose export in 2006 accounted for 10% of the total Serbian exports.) Therefore, the tax reform would, in the end, have a positive impact on the whole economy. The economy would become more efficient, growth could return to the pre-crisis growth rate, the structure of the economy would change, and the social pie would become larger. When the pie is larger, it is easier to implement more redistributive policies without trading off efficiency for equity.

### 3.10.5. Social and Welfare Policy

Serbia's social assistance reform initiated in 2001 aimed at improving targeting and reaching those who are most needy, while trying to cut general-type social programmes, such as universal child allowance. However, that goal was only partially achieved. Recent analyses show that the main social assistance programme, so-called material support of the family, is very well targeted, with the poor receiving over 90% of the total funds from the programme, the rest representing so called leakage, assistance given to the non-poor. This result is very good in a comparative perspective.

However, another side of the coin is that such a result has been achieved at the expense of the poor themselves. The rules for social assistance eligibility are so draconian that even many people who are poor on any reasonable count are technically not eligible for assistance. Since 2003, the maximum amount of social assistance has been legally exclusively bound to cost of living changes. In effect, in only 5 years the amount of maximum available assistance for a family of 5 has dropped from 32% of the average wage to only 16%. In addition, the means tested child allowance was made available for a maximum

of three children, meaning that families with more than three children receive less assistance per child. Child benefits are adjusted only semi-annually to costs of living, so they deteriorate even more sharply in relation to average wages. These reductions meant that although Serbian public outlays on social assistance programmes as a whole have increased as share of GDP from 1.3 percent of GDP in 2006 to 1.8 percent in 2008, spending on programmes targeted to the poor and allocations for the MOP and the income-tested monthly child allowances have declined.

The share of public spending in GDP in Serbia was at around 45% during the last decade, which is above average compared even with developed countries. But, unlike developed countries, in Serbia higher public spending is not correlated with lower inequality. Looking at the structure of public spending, it becomes clear that it is very different from that found in welfare states. While in welfare states public spending ensures relatively large transfers from the wealthier to the poorer social strata, its primary role in Serbia is to provide for an "adequate" living standard of public sector employees and pensioners, as representatives of powerful and numerous interest groups. For example, while the total expenditures from public sources on education, health and pensions expressed as share of GDP were around or above the average values for OECD or EU countries, the share of social assistance expenditures and active and passive labour market programmes of GDP was less than half of the average in the OECD and EU countries (World Bank, 2009).

### 3.10.6. Education Policy

Serbia's education system has also suffered from inefficiencies and inequities. In 2008, education accounted for about 5% of GDP. Yet, a restructuring of spending within this overall



share could improve public investment in education. Primary and secondary education suffers from having too many teachers. Tertiary (higher) education suffers from the opposite trend: Serbian universities have too few teachers, and too little teaching space. This creates inefficiencies such as waste and overcrowding.

The primary and secondary school system can be rationalized if the number of teaching staff were reduced. Primary school enrolment has been in decline over the last 15 years, simply because the school age generational cohorts are smaller and smaller, and will continue to decline (WB 2009, 36). The decline created a constant fall in the size of the average class. The number of classes, however, since 2000, has continued to rise (*ibid.* 37). The World Bank suggests reducing the num-

ber of teachers and increasing the number of pupils per class, so that the optimal number of pupils per class is anywhere between 30-34 (*ibid.* 39). "If a minimum class of 30 is accepted, the calculation shows that Serbia has 11,000 too many classes (37%) in primary education. A calculation for secondary education show a surplus 1,300 classes (13%)" (*ibid.*). The solution would be to cut the number of classes by a third, which would free up resources for improving the quality of teaching in the remaining classes.

In higher education the trend is the opposite. There we have too many students per teaching staff. Table 2 shows that both the number of applicants for higher education and the number of teachers have been on the rise since 2000 in approximately the same proportion.

	Faculties and Higher Schools	Students	Teachers
2002/03	135	197.322	6511
2003/04	201	203.909	6992
2004/05	223	218.368	7534
2005/06	243	229.355	7737
2006/07	272	238.710	8150
2007/08	194	237.958	7459

Yet, both tendencies did not seem to have made the higher education system more efficient. The existing system still appears to be in short supply compared to the increasing demand. The efficiency is documented by the two pieces of information provided recently by the Serbian Statistical Office: in 2009, the average number of years of study was 7.6<sup>157</sup>, whereas 40% of the enrolled students never finish. Such a long period of studying hinders teachers from dedicating more time to each

student. When someone spends 7.6 years in a classroom by taking up the space and energy of the teacher that could have been used for other students, she creates two kinds of inefficiencies. First, she occupies the professor's time by repeating lectures and seminars and retaking exams.<sup>158</sup> For the time spent to engage each student twice, a professor could educate another student. Secondly, as every university professor knows, it is one thing to have 50 stu-

<sup>157</sup> The average number of years per undergraduate programme at Serbian universities is 4.

<sup>158</sup> Under the 2005 university law, each student can retake each exam five times per year. Most of the exams at the Serbian universities are verbal, which means that each student's examination rarely lasts under ten minutes.

dents in a class, and quite another to lecture in the amphitheatre that packs in 500 people twice a week. The overcrowding effect significantly reduces the quality of teaching at universities and adversely affects their "production": as a consequence of overcrowding, less and less quality students complete their studies.

Higher demand for higher education is a product of an increased interest since the year 2000. But the demand has not been driven by any apparent rise in a knowledge-based economy. Rather, it has been driven by the rise of the winner-take-all economy which was enabled by the allocation of resources that took place in Serbia in the same period: the rise of services, the entertainment industry, and the public sector have sent the message to the labour market that landing a job in these spheres pays off better than landing a job in, say, blueberry growing.

Although the number of private universities has grown since 2000, the existing facilities seem sufficient to meet the existing demand for higher education. Since 2001, the Serbian government invested very little in enlarging physical space for teaching and expanding teaching staff at the state-funded universities. Instead, it mandated that universities take in more and more students per existing teaching space and teaching staff. What it did with such a policy was to replicate the tragedy of the commons phenomenon in education.

The solution is either to allow universities to limit the number of students each faculty takes in, or to allow the university administration to raise scholarships with which to finance the expansion of teaching space and teaching staff. In case a better level of scholarship is not possible, the government should undertake measures that would, in time, lead to expanding both teaching space and teaching staff.

At the end of section 3, we claimed that some professions were made attractive by the government's policy. Education is one of them.

As the analysis of the World Bank showed, the primary education sector has swollen in the number of teachers and number of classes, although the number of pupils decreased. The reason for the overcrowding of teaching in education is largely political: the government behaved economically irrationally because this was one of the ways to create a segment of the electorate that is dependant on government-controlled wages. Our proposal would even put an end to such a policy.

### 3.10.7. Conclusion

This paper is not an attempt to provide a comprehensive analysis of all the major aspects of the efficiency-equity nexus in Serbia in the areas of economic and social policy. Rather, it uses metaphors, illustrative examples and some evidence to present our main thesis that, at least in the present Serbian context, the equity-efficiency trade off is not really relevant. The current socio-economic system and policies are far enough away from an optimal situation in which a tension between the two goals might arise. We hope we have shown that applying explicit or implicit pro-poor policies in Serbia would simultaneously improve efficiency and equity. Introducing progressive income taxation would be beneficial not only for equity but also for competitiveness. Spending more on social assistance and less on hefty public sector salaries would concurrently reduce poverty and the queues of people attracted by the public sector's winner-take-all allure. Restructuring spending on education so that teachers get relatively less, and students get relatively more, would again be a socially desirable outcome, simultaneously enhancing the efficiency of the education system.

Actually, we might even question that the trade-off between efficiency and equity exists at all beyond the realm of abstract theoretical modelling. But discussing this claim would entail an entirely different paper.

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### 3.11. South-East Europe: United in Problems, Divided in Solutions

*Predrag Bejakovic*

#### Abstract

The aim of the book is both to analyse and propose measures for alleviating the widespread existing conflict between equity and efficiency in social policy in the broader sense: including social welfare, education and employment. Education, social welfare and the labour market are closely intertwined and mutually reinforcing. Efficiency and adequacy (or lack of it) in one field has many positive (or negative) consequences in other sub systems. In South-East Europe (SEE) the discourse on social policy in the broader sense of equity versus efficiency is a new agenda, an agenda of transformational politics. Social policy in SEE has been created by economic discourse on market-making versus market-correcting policies. South East European states have relatively *weak governments*. They have a limited capacity to collect taxes, to tackle the unofficial or grey economy (a financially weak state) and thus, limited resources for the provision of public goods and services. The situation in SEE is far from satisfactory or optimistic. South-East European countries have to find and develop constitutional and legal arrangements that best suit their own historical, social, cultural and economic situations, conditions and possibilities. The government could and should provide a stable legal framework, the social infrastructure and with the co-operation of its citizens, establish the rule of law. Otherwise, the social groups in unfavourable conditions, primarily the poor and socially excluded, will suffer most from the lack of clear laws and the unwillingness of society to respect those that do exist.

#### 3.11.1. Introduction

One lands on a very peculiar political social and economic space on arriving in South-East Europe, with a unique but also variable institutional landscape, with a special culture of governance and with numerous socialist legacies.

The aim of the book is both to analyse and propose measures for alleviating the existing widespread conflict between equity and efficiency in social policy in the broader sense: including social welfare, education and employment. Why education, social welfare, the labour market situation and consequent policies? The topics are specific, but also interconnected, so various terms could be used under different topics. There are many links among the various aspects of these public policies. Education, social welfare and the labour mar-

ket are closely intertwined and mutually reinforcing. Efficiency and adequacy (or lack of it) in one field has many positive (or negative) consequences on other sub-systems. High expenditure for social welfare measures will limit investment in education and technological development, which will result in undesirable consequences for economic growth and development in the long run. Successful employment policies will reduce the risk of poverty and social exclusion, as will effective social and health insurance. High efficiency in social policy has many positive side effects on the economy; primarily there would not be widespread unemployment and poverty traps<sup>159</sup>.

<sup>159</sup> The unemployment trap happens when there is no incentive to get a job at all, while the poverty trap occurs when people have little or no incentive to get a better paid job or work longer hours

Furthermore, participation in education and formal education has a positive impact on individual personal as well as social development, social inclusion and social cohesion. For example, among people with upper secondary and tertiary education, the unemployment rate is on average lower than among less well educated people (persons who finished primary school at most). Better-educated and qualified persons also wait less time (as unemployed) for a job and have a higher income when they find a job and better possibilities for professional promotion. Also, the risk-of-poverty rate is significantly lower among better educated persons. Measures for an increase in employment affect the number of employed but also increase the number of insured persons who pay contributions, which reduces expenditure for social care, and increases public revenues which in turn enables easier financing of public goods and services, etc. Inadequate social services could cause bad health in the population or some social groups (for example, the poor or national minorities). That lowers personal employability, reduces chances for employment, and increases the risk of long-term unemployment, poverty and social exclusion.

In South-East Europe (SEE) the discourse on social policy in the broader sense of equity versus efficiency is a new agenda, an agenda of transformational politics. Social policy in SEE has been created by economic discourse on market-making versus market-correcting policies. These countries were particularly exposed to neo-liberal economic and implicit societal policies. Deacon argues (2000), however, that it is *not economic, but instead, political globalisation* that impacted heavily on social policy development in SEE; by that, he meant global actors, such as the World Bank, who promote a particular social policy, driven by ideological reasons and views on how social policy should position itself in relation

to the market. Similar to European-level social policy, post-communist social policy was dominated by market-making features and seriously lacked market-correcting mechanisms.

It is well known that South-East European states have relatively *weak governments*. They have a limited capacity to collect taxes, to tackle the unofficial or grey economy (a financially weak state) and thus, limited resources for the provision of public goods and services – including education, social welfare and labour market policy. Almost all of the SEE countries are characterised by deeply rooted corruption and lack of transparency in political decision-making processes. Most of them have little (if any) public discussion related to public policies and budgetary processes. These countries have quite widespread uneconomic behaviour in government for the spending of public funds. All probably discourage the payment of taxes and increase tax evasion, and reduce the possibilities for collection of public resources needed for the provision of public goods and services. Exclusion of citizens from the decision-making process indirectly affects the deterioration in the quality of public services, increases poverty, social exclusion and inequity of income.

Furthermore, these countries are caught in a *legislation trap*: their Parliaments undertake massive legislation which puts a heavy burden on the whole range of the policy-making machinery (weak regulatory state). As a result, there is insufficient capacity to follow up, to evaluate, and to monitor the implementation of even major legislation, particularly related to education, social welfare and labour market policy. Additionally, there is unrealistic normative optimism that all problems could be solved with new laws, various strategies of governmental regulation and the establishment of new governmental bodies, agencies and institutions. In assessing the reformulation of social policy in Eastern

Europe some important factors are forgotten: there is a huge implementation gap between accepted laws and their real implementation and a limited capacity of institutions that are often weak and/or ineffective.

As social policies in the broader sense (education, social welfare and labour market) are closely linked both to the State (as a necessary authority to correct market failures and promote the public good) and market-making mechanisms (negative social policy that is aiming to remove the boundaries of market competitiveness), the question of trade-off between efficiency and equity should be in the centre of political discussion and social analysis. However, it is very often neglected and/or almost forgotten.

Simultaneously, the two processes are occurring in very different circumstances. There has been no history of equity-efficiency choices in the framework of the market economy. In the case of many SEE countries there is the trade-off of focus on what is called the *pre-mature welfare state*. It is argued that compared to the level of economic development and the national GDP, as far as the fiscal capacity of the SEE welfare states is concerned, it is over-muscled. The level of welfare spending is not supported by economic performance, therefore it pre-empts fiscal policy space and endangers investments and economic restructuring.

### 3.11.2. Most Important Characteristics and the Situation in the Countries Covered

The authors of the national case studies provide an interesting range of human stories and data for and against the education, social and employment situations in their countries. The individual articles give very different weight to the three main themes: education, social and employment (sometimes almost none at all) and most have a polemic touch (or sometimes

even a 'greedy grasp'). A number of themes begin to offer themselves up - the long versus short term implications on the equity side; the English speaking influence (described as Anglo-Saxon in some of the pieces) from and on policy influencers, whether the World Bank or European Union as opposed to "European' mainstream" however defined; the advisability of some EU Commission approaches; the sheer weight of post-Keynes 'animal spirits' - versus phenomenology; the small 'p' political versus bureaucratic versus academic/objective perspectives; the immediate lack of all real resource and so on.

Due to various socio-economic situations in the countries (differences among them are almost bigger than the similarities) as well as different contributions of authors to the book, it is almost impossible to provide inter-country comparisons regarding situations, problems and solutions for the efficiency and equity trade-off. However, it is possible to repeat what has been analysed, summarise the most important messages from each contribution and finish with recommendations and proposals for future research.

While it is straightforwardly apparent what *equity* and what *efficiency* is, the relation between those two phenomena is not so obvious. Succinctly, the efficiency and equity trade-off is that adequate equity enhances the poverty reduction agenda and thus, socio-economic efficiency. The poor generally have less influence, less income, and less access to services than other better-off social groups. As stated in the *conceptual framework* of this book, when societies become more equitable in ways that lead to greater opportunities for all, the poor usually have double benefits. First, expanded opportunities help the poor directly through greater participation in the development process. Second, the development process itself may become more successful and resilient as greater equity leads

to better institutions, more effective conflict management, and a better use of all potential resources in society, including those of the poor. A modern equality approach tends to require equality of something, but not necessarily equality of outcome in the material sphere (in fact, plain equality of resources is a claim very few theorists of justice would be willing to defend, since people have different needs, are confronted with different circumstances and, if they are given the same opportunities, are likely to make different use of them) (Robeyns, 2009).

Even from its first days of independence in 1912, **Albania** was plagued by a host of ills: pervasive poverty, overwhelming illiteracy, blood feuds, epidemics of disease, and gross subjugation of women. Stitched into the ever-convulsive Balkans, Albania was Europe's most isolated and deprived country, overwhelmed by instability and poverty. After a long-term communist regime that lasted from the end of the Second World War till 1991 (when the first multiparty elections were held since the 1920s and predestined the end of communist rule), Albania entered a turbulent period of political and economic change. Almost two decades after democracy and privatization were supposed to deliver undreamed-of life in today's Albania is marked by massive unemployment and disillusionment. So it is not surprising that disappointment and low expectations pervade conversations with many Albanians. Radical changes of the Albanian economy after the downfall of the communist regime have produced not only a change in the structure of the production of goods, but also in the make up of the structure of the producers, as well as the prices of goods. There were also changes in the forms of ownership and the organization of production resources. After the collapse of the centralized economic system, many economic sectors failed, thus generating greater

unemployment. During the transition, unemployment in Albania has been higher than the average for other countries in transition. The situation was partially mitigated by a pervasive informal sector and by remittances from abroad sent by relatives from West Europe. It is assessed that the informal economy produces more than 50% of the GDP (Gërzhani, 2001). The existence of the informal sector – very often a lifeboat for many and a mean for the majority of the population to secure their living or income - is a result of radical changes in the economy that resulted in huge modification in the labour force and the population's income, vacuums in the legal structure, lack of implementation of the laws by governmental structures, and a confused tax policy with high costs. All these factors contribute to an unfavourable social picture with no easy solution.

Fifteen years after the Dayton peace agreement ended the ferocious ethnic war in **Bosnia and Herzegovina** (B&H), the country is still not prosperous and united, but remains poor and divided into two entities, a Muslim-Croat Federation and a Serbian Republic. Thus, the social protection and social assistance system in B&H is highly fragmented and comprises 13 almost independent systems, with a low level of coordination and cooperation among them. Furthermore, functions are overlapping and the division of responsibilities is unclear. Therefore, the main problems of Bosnia's development since 1995 are the consistent dominance of nationalist parties and the practice of voting along national lines, which results in political elites that focus on the well-being of their own national group rather than on the well-being of all. Only recently have leading politicians in Bosnia and Herzegovina made statements suggesting attempts at reconciliation, essential for unblocking the political deadlock and accelerating economic growth. Regardless of the fact

that a large share of the population is below the poverty threshold, there are no social inclusion policies at any level of government in B&H that would systematically try to solve the basic causes of poverty and social exclusion. Bosnia's prospects for stability would be helped if it joined the European Union, and soon, but progress in that direction has not been encouraging.

Supported by more than a decade of consistent macroeconomic policies and deep structural reforms, **Bulgaria** joined the European Union in 2007. However, the country still has to overcome many obstacles, including a harsh social situation, a low technological development of the economy, a significant productivity gap and low labour remuneration in comparison with the rest of the EU plus a widespread and deeply rooted unofficial economy, etc. Analysing a trade-off in social policy, Bulgarian authors particularly emphasised the pension system because about 85% of all social welfare outlays has been paid out for pensions. Bulgaria's labour market has improved over the last few years, but the global economic crisis has interrupted and reversed this progress. Paradoxically, in many cases Bulgaria, in spite of (or because of) its socialist past, has paid low-skilled labour as much as high-skilled labour or even higher. The low technological level of the national economy creates more jobs for people with lower educational and qualification attainments. Thus, highly educated and/or people with specific knowledge and skills happen to be less in demand on the Bulgarian labour market, and in many cases they accept job positions, which do not match their high professional status. Thus, educational policy seems to be controversial and the results do not positively influence the social environment and individuals' labour market opportunities.

In the chapter on **Croatia** it is mentioned that absolute poverty in Croatia is low and poverty is highly correlated with the situation in the formal labour market and the skills of individuals. Thus, the most important exit from poverty is better education and acquiring knowledge, skills and experience for adequate employability. It looks as though unemployment is mostly the consequence of the countries' inability to create jobs fast enough to accommodate new entrants into the labour force. There is an overall deficiency of jobs and substantial unemployment, but people with jobs stay in them for unusually long periods. Furthermore, not enough attention is given to the long-term unemployed (that is an entry ticket to poverty and social exclusion) and to the evaluation of labour market policy. There is also, currently, a concern that social care services in Croatia are not necessarily targeted to those most in need. Thus, for Croatia it is much more important to invest in the "quality" of social and employment policies rather than in quantity.

**Kosovo** is the smallest state in terms of territory and the newest state in South-Eastern Europe, but with very old, deep and serious economic and social problems. Kosovo began its post-conflict transition from a very difficult starting point. During the 1990s, its economy had already suffered from poor economic policies, lack of domestic institutions, broken external trade and financial links, international sanctions, underinvestment, and ethnic conflict. Output fell by a half in the early 1990s, and additionally by at least another 20% as a result of the conflict at the end of the decade. Furthermore, Kosovo maintains some of the worst social indicators in the region. Almost one half of the population is estimated to be poor, while 15% live in extreme poverty. The poverty rate is very high compared to neighbouring economies, and has not significantly



changed over time. Around 70% of all the poor are either unemployed or inactive. Employment possibilities are very limited and unemployment remains broadly stable on an exceptionally high level (above 40% with youth unemployment at almost 80%). As the author for Kosovo underlines, *poverty reduction through growth could be achieved only through strategies that lead to high employment-generating growth* Important steps towards enhancing economic growth and reducing existing high unemployment would be improvements of the country's image and attraction of foreign investors. The importance of eliminating (or at least reducing) corruption is emphasized, as well as improving labour regulation and its implementation, and enhancing business start up regulations.

In **Macedonia**, apart from the troubles typically attributable to the transition process, there were also other problems which prevailed long before transition and contributed to the overall deterioration of living conditions in the transition period. Among these is the generally low economic development of the country, higher unemployment levels, as well as lower investments. Furthermore, economic emigration and low levels of education and training have aggravated the transition process. Macedonia submitted its application for EU membership in 2004, but the European Commission's recommendation to open negotiations with Macedonia was blocked by Greece's objection to the new republic's name. High unemployment could be at least lowered through active labour market policies (ALMP) – skilling, requalification and education of unemployed persons. ALMP have been implemented to enhance labour supply (e.g., training); increase labour demand (for example, wage and/or employment subsidies, and public works); and improve the functioning of the labour market (primarily, employment

services). In addition to the quality of design and implementation of the programmes themselves, these variables include external factors, such as stable macroeconomic conditions, a favourable investment climate and enabling a business environment, and a competitive product market, all preconditions that should and could be achieved in Macedonia.

The contribution for **Moldova** explains a complex socio-economic situation, primarily linked with an increase of poverty after the country proclaimed independence. Moldova's transition process had devastatingly impacted on the country's social situation. The unfavourable economic situation is further worsened by political instability in the breakaway territory of Transdnestr. The country is highly dependent on migrant remittances, which represent about one third of GDP. The population in big cities has a significantly lower risk of living in poverty in comparison with those living in rural areas, mostly due to the fact that the agricultural sector has very low levels of production and labour remuneration. From the point of view of the trade-off between efficiency and equity there are various risks which affect the social policy of Moldova, very often linked with the fact that the government is forced to search for hasty short-term and mid-term solutions and being less 'prospective', frequently missing the long-term vision. As in many other SEE countries, in Moldova there is also a significant gap between the supply of the education system and labour market demands. Due to specific national problems, the author dedicated attention to the trade-off between efficiency and equity in the health-care system, emphasising that reforms have had a very positive impact on equity in the health system's costs and benefits overall. However, the present system of health financing does not guarantee the effective protection of the whole

population from financial risks, primarily because of out-of-pocket payments and a sizeable proportion of the population that is not covered by social health insurance.

**Montenegro** achieved independence in 2006, signed a Stabilisation and Association Agreement with the EU in 2007, applied for membership a year later, and received candidate status in 2010. Montenegro has achieved remarkable economic growth in recent years, which has created opportunities and brought about some progress in the social situation and equity question. Poverty in Montenegro is low, but there are significant differences in the extent of poverty among the regions. There is a favourable situation in the south and central regions, and much higher poverty rates in the north of the country. Poverty in Montenegro has a multidimensional character: it is characterised by chronic poverty; sub-standard living conditions; lack of availability of basic services; lack of educational attainment etc. Poverty is directly linked to the person's position on the labour market. Montenegro had been characterised by a highly regulated and very rigid labour market, which probably contributed to the extensive informal economy and the high percentage of long-term unemployment. The Parliament of Montenegro recently adopted a new Labour Code, which has enabled improvements in the regulatory aspect of the labour market. This law presents a significant improvement over the old law. The author in the analysis underlined that *there is significant room for improvement in social protection effectiveness in Montenegro, primarily in terms of the targeting of social protection and the adequacy of social benefits, as well as improvement in transparency and accessibility of data and information.*

Experiences in **Romania** demonstrate the unrealistic expectations of many transi-

tion countries that all social problems will be solved with EU accession. Romania is, in spite of the accession to the EU, faced with a serious and overwhelming economic crisis and the many difficulties of integration. Thus, current economic and social data show deterioration in the situation. What is particularly worrisome is the large category of "working poor" in Romanian society because many full-time employees and self-employed persons belong to this category. A way of escaping poverty for many Romanians was labour migrations that in the short-term could alleviate poverty and, due to remittances, the unfavourable social picture. But in the long-run these can endanger family links, tear the social fabric and due to the lack of labour force (particularly the educated and qualified) menace economic development and progress. The valuable message from the Romanian contribution is that a *generous level of social protection does not necessarily lead to worse economic results. On the contrary, social policies based on investment in human and social capital are conducive to higher economic efficiency as they improve productivity and the quality of the labour force.*

In **Serbia**, after political changes caused by the fall of the Milosević regime, the new Government commenced, from the year 2001, more serious reforms in the field of price liberalization, the abolition of control of foreign trade, privatization of social enterprises, comprehensive fiscal reforms (including the introduction of a new taxation system - primarily Value Added Tax), improvement of Tax Administration and budget consolidation, strict monetary policy, reform of the banking and financial system, etc. Non-payment or irregular payment of salaries, the bankruptcy of big public companies, delays in payment and/or non-payment of social aid and pensions forced a large part of the population to live

in conditions of poverty, scarcity and despair. The new Government prepared a package of proposals for economic reform including social measures to assist the poor and vulnerable that face difficulties caused by the restructuring. The destruction of non-productive and artificially maintained jobs in the formal sector increased the number of people who lost their jobs. Agriculture and small and medium enterprises (SME) have been the main source of net job creation in Serbia but these sectors are most developed in the informal economy. Due to its being a relatively privileged sector there is constant pressure for employment in the public sector. The goal of social measures has been only partially achieved. Analyses show that the Serbian main social assistance programmes - so called material assistance to the family (MAF) - is very well targeted, with the poor receiving over 90% of the total funds from the programmes. Limited duration of the right to MAF, the introduction of which was motivated by activating recipients, has been significantly jeopardized by lack of sufficient jobs and problems in the equity vs. efficiency trade off in education, primarily differences of labour market needs with inadequate education or low qualifications of cash benefit recipients. The authors of the Serbian contribution believe that *applying explicitly or implicitly pro-poor policies in Serbia would simultaneously improve efficiency and equity.*

### 3.11.3. Conclusions and Recommendations

After reading all the contributions collected in this study an honest reader should be in a quite grim mood, because the situation in them is far from satisfactory or optimistic. The reasons for that are manifold: path dependency, (it is not easy to relieve the heavy socialistic burden and paternalism), unfavourable political instability and/or (post)war conditions and reconciliations, corrupt or weak

public government and administration (including regulatory authorities and judiciary systems), ineffective private governance. All these elements hinder economic and social development in South-East Europe.

Analysis of the impact of market adjustment on the social sectors and particularly on the trade-off equity vs. efficiency is difficult because it involves evaluating a counterfactual situation in which the population is affected by new (or significantly changed) socio-economic systems, including public services, resources and prices, with the possibility of substantial substitutions and complicated concurrent and delayed interactions. While inevitable in nature, the speed and extremity of these new policies left many of the *losers* of economic structural change destitute, particularly those who were already poor at the beginning of the changes.

To respond to constantly changing circumstances quickly, economic and social policy reform design should be embedded in up-to-date, country-specific analysis. This is especially important in the context of a global economic and financial crisis. Three conditions are required to achieve equitable growth: sustaining macroeconomic stability, creating an enabling environment for private businesses, and increasing investment in human capital. This would involve redefining the frontier between the state and the market on equity and efficiency grounds: the state should withdraw from activities that are inherently a market domain. A major problem with the economic policies advocated for the transition period is that they have been based on minimizing the role of the state. But because of the prolonged and complex nature of the transition, the responsibilities of the state should increase rather than decrease.

This does not mean a return to an authoritarian, undemocratic state. It also does not signify that the state should be large

relative to the private economy, and certainly not that it should try to dictate the direction of the economy. It does imply that the state should be activist and intervene in critical areas where market forces cannot ensure an efficient allocation of resources or where access to basic assets and opportunities for people's livelihoods is inequitable.

Like all others, South-East European countries have to find and develop constitutional and legal arrangements that best suit their own historical, social, cultural and economic situations, conditions and possibilities. From the abundant economic and social literature as well as from everyday practice it is quite obvious that government (not only in South-East Europe) is incapable of solving all economic and social problems and insuring the preconditions for sustainable and long-term economic and social prosperity. Government could provide a stable legal framework, the social infrastructure and with the co-operation of its citizens, establish the rule of law. Otherwise, the social groups in unfavourable conditions, primarily the poor and socially excluded, will suffer most from the lack of clear laws and the unwillingness of society to respect the existing laws.

It is not so important to produce new laws and changes in the organizational structure, but to enhance respect for the laws in place. Institutional reforms with regard to transparency, accountability and good governance are also critical. Transparency and openness in decision-making about public expenditure are necessary for the determination of the competence, responsibility, efficiency and legitimacy as well as for the better determination of policy and evaluation of decisions on the range and the manner of providing public services. In general, informational broadening, in one form or another, is an effective way of overcoming social choice pessimism and of avoiding impossibilities, and it leads

directly to constructive approaches with viability and reach.

However, in order to make the laws work, political will and leadership commitment are vital. Just as important are the empowerment of citizens and their full participation in the political process. In all these things, accession to the EU could be helpful, but one should be realistic and according to Romanian and Bulgarian experience, not expect too much. Further strengthening of democratic institutions and the opening up of the SEE countries to closer integration with European and global structures should also help to bring these countries a step forward in the trade off between equity vs. efficiency, primarily in poverty reduction, better educational outcomes and improved labour markets.

Targeted government spending can provide effective relief to vulnerable households affected by the economic crisis. The recession lowered household income through increased unemployment, a contraction of the informal economy, and cutbacks in wages. The sectors of social policies - education, social welfare and employment - face numerous challenges and need to be modernised if SEE is to become more competitive and promote excellence. One challenge is to create diversified systems which allow equitable participation for all, while remaining financially viable and functioning more efficiently.

One should recommend that some effort should be invested in improving the quality, range and frequency of collecting data, information and social statistics, as well as in enhancing research about poverty, economic inequality and social exclusion. Such information and research are required for social planning and for the formulation of appropriate policies. If the objective is for safety nets to reach the poor, information is required on who the poor are and where they are located, and how much of the benefits from the

programme are reaching this target group. In most cases, (especially observed in SEE) countries spend significant resources on safety nets but fail to collect data and monitor who receives the benefits and how they affect the recipients. Such information should also be made available to the research community and general public. These two steps will help to make government at all levels more accountable to the electorate, by providing voters with more and current information about the impact of government policies, which should also raise the quality of public debate and increase the participation of citizens in the political decision-making process.

According to the various sources, primarily OECD, in the observed SEE countries the considerable problems faced by the educational system are: the lack of emphasis on developing analytical and problem-solving abilities, very weak links between education and the professional world, and the partial development of lifelong learning, mostly oriented toward vocational education and vocational skills (neglected are non-formal education and key competencies). Lacking skills prevents the unemployed from reintegration in the labour market and hampers labour mobility. Skills matter even more during the crisis. Thus, there is a need to continue with education reform to raise labour productivity. Also, there is a need to increase labour market flexibility to support the reallocation of resources from the non-traded to traded goods and the service sectors.

Better management and delivery of tertiary education would help countries achieve their economic and social objectives. A common assumption has been that a *free* system of education, particularly tertiary (one funded entirely by the state) is, of itself, equitable. In fact, this assumption has not been borne out by reality, since the crucial determining factor for participation is socio-economic back-

ground. The bulk of the evidence shows that there are usually significant private returns to those who participate in higher education, and that these are not entirely offset by progressive tax systems. This can have a reverse redistribution effect. This regressive effect is particularly acute where school systems intensify the effects of socio-economic background on educational attainment. In order to bring about a more equitable balance between the costs funded by individuals and society and the benefits accrued by each, and to contribute to providing tertiary educational institutions with the extra funding they need, many countries are turning to the main direct beneficiaries of higher education, the students, to invest in their own futures by paying tuition fees which may also improve the quality of teaching and the management in universities, and reinforce student motivation.

In SEE countries there are insufficient links between the education arena, the economy and the labour market and not enough attention is given to the estimation of the future trends and needs of the labour force, which causes problems in providing education and skills programmes compatible with the skills and occupations sought on the labour market. The high proportion of workers with fixed term contracts limits the incentives for both firms and employees to develop skills. Insufficient opportunities for education are not the principal reason why many adults do not engage in learning: evidence on barriers to participation suggests that under-investment in adult learning is due more to the demand side than to lack of supply of learning opportunities. Many adults are simply not interested. This may be because they are not aware of the need for training or because of lack of information, lack of incentives, or a perceived lack of returns. SEE countries should develop flexible and clear pathways through adult education and lifelong learning to increase

employability and assure easy entry into (or return to) the labour market.

Market forces alone can never be relied on to produce a fair or equitable society. The state must be committed to the reduction of poverty and inequality, and in order to do so, it must maintain a transparent and equitable system of social protection that relies on a foundation of universal coverage and non-discrimination. It is necessary to strengthen the social safety net through improved targeting and monitoring of social welfare programmes and social assistance, empowering civil society in the provision of social services, decentralisation of some social services and the better design of employment policy measures.

A primary aim of policy must be to get people into work - or back into work. For most people most of the time, dependency on state assistance cannot provide a satisfactory alternative to employment - in terms of either psychological satisfaction or material well-being. The opportunity of paid employment is among the simplest ways of escaping poverty and dependency. It is desirable, wherever possible, that people are found (or find themselves) jobs in the formal sector. Not only are such jobs more secure, in general, but they also offer more opportunities for training and the acquisition of skills. Furthermore, they will increase the tax base and, in some measure, allow a reduction in indirect labour costs.

The low employment rate, or rather an increase in unemployment, currently - particularly in the conditions of economic crisis - represents one of the main priorities for economic policy in South-East Europe. There is clearly a strong association among poverty, education, employability and long-term unemployment. In the majority of the countries the problem of long term unemployment - those who have been waiting for more than one year - is not diminishing. The task is to reduce both the flows into long-term unem-

ployment and the stock of people already out of work for more than a year. The problems faced by many of the long-term jobless are often multi-dimensional and frequently include low levels of education and of motivation.

SEE countries have a range of active and passive measures to assist the unemployed. The employability of the long-term unemployed should be enhanced and social exclusion reduced through participation in work related activities. The key ingredient to boosting employment in the course of the crisis is to promote the upgrading of the skills of laid-off workers and those at risk of lay-off through new training programmes designed together with employers' representatives and through incentive schemes for companies and individuals. There is also a lack of timely evaluation to assess the true effectiveness of policy measures on the labour market. This could be addressed through the introduction of new techniques (tracking studies) for collecting up-to-the-minute data about their impact.

The economies of South East Europe have suffered from the impact of the global recession more than most other regions around the world (Mitra et al., 2009). However, while some countries within the SEE region have been very deeply affected, others appear to have been relatively lightly touched by the crisis. While GDP fell significantly in 2009 in Romania (by 8%), Albania escaped relatively unscathed with positive, albeit reduced growth in the worst recession year. The effects of the crisis on the economic and social situation in SEE have been deeper than most analysts thought at the end of 2009 (Bartlett and Monastiriotis 2010). However, countries in South-East Europe did make some recent progress on structural and institutional reforms. Let us hope that the whole region will live in peace, stability and security, that the institutions will be more powerful and oriented towards ordinary citizens and that with

adequate cooperation and collaboration of government, citizens, private and public sectors the future of South East countries will be bright, characterised by wisdom, responsibility and prosperity as well as by adequate trade-offs between equity and efficiency.

In further analysis it would be useful to broaden some issues that have been just touched on by several contributions to the book, such as equity vs. efficiency in health care and protection that was tackled in the report for Moldavia and nicely analysed by Shakarishvili (2006). Furthermore, it will be

valuable to provide deeper analysis of equity and efficiency in pension insurance, mentioned in the report for Bulgaria, but excellently explained by Grosh *et al* (2008). Finally, there is an open (or everlasting) issue of equity and efficiency in the tax system, shortly explained in the Serbian report, but also analysed in the classically famous book by Musgrave (1985) and recently by OECD (2010). Succinctly, there are more open issues related to the trade-off between equity and efficiency than there are researchers willing to analyse them.

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## 4. Comments

### 4.1. A View through the Prism of Vocational Education and Training

*David Parkes*

#### Abstract

This overview (from old Europe) comes from the perspective of vocational education and training (VET) policy experienced over all the SE European countries covered in the book as well across the EU current 27. VET is seen as a natural bridge between training and the labour market and a bell weather indicator of social context. Among the questions raised are those of parity of esteem among different education and training sub sectors as well as student choice among the sub sectors; the issue of the use by the European Commission of English speaking country approaches; convergence and divergence among individual country approaches; the author's personal perspective from experiencing each country; an organisational overview differentiating among political/policy, organisational administrative and technical dimensions; reflection on the varied social/economic models in place across EU member states; the administrative capacity to implement reform; policy led by European Social Fund priorities.

#### 4.1.1. Introduction

In writing a commentary on the overall text (from a European perspective however defined) I am taking up two principal positions: firstly I am an educationist with a principal interest in vocational education and training (VET); secondly, over the past 20 years I have lived (from time to time) and worked in all of the South East European countries reviewed in the book; in some cases with intermittent continuity, for example BIH from 1996 to 2011, while some only occasionally, starting with Albania in 1993. Consequently, I have a view (while personal) both of the present as well as through a series of archeological layers. I confess to being the editor or author of much of the bibliography and leaning heavily on one of the references – *Investing in and financing VET in an efficient and sustainable way*: DG Education and Culture, 2008

I start by mentioning Albania in 1993 because although it was a time of startling crisis it had, still, few motor cars, no traffic to speak

of, cattle in Tirana's parks and a small railway system constructed by the Chinese. I once rode the engine from Durres to Tirana which went so slowly that friends of the engine driver got on and off the footplate to greet him (and me) as it chugged along. I mention this because in the pre revolutionary period Albania's literacy level matched that of the UK and life expectation was the same as for French men and women. One can put this down to climate, Meditteranaean diet, basic literacy and basic health care. One's question is what then constituted 'well being' in this, the poorest of European countries? In Albania, too, I coordinated projects funded variously by the World Bank, the EU, SOROS and UNESCO/UNDP; material for analysis both of donor values (very different) and donor coordination.

The themes set out below are: *Vet as a major player; Definition; The English speaking influence; Convergence and divergence in the EU; The Personal perspective; An organisational overview; Socio/Economic models in Europe; Strategic considerations;*

*Administrative capacity; The European Social Fund, archeological layers.*

While looking through the lens of VET, I have tried to tie conclusions to all three sub themes.

#### **4.1.2. VET as a Major Player among Choices of Education Pathways**

VET, hardly mentioned in any of the nine country texts, is a natural bridge between training and the labour market as well as a bell weather indicator of social context. The system of vocational education and training can be an efficient and effective vehicle for economic and social development of a country, through the strengthening and enhancement of human capital and development paths, flexible employment and professionalization. Investing in VET can produce positive effects, both for individuals, for businesses, for the entire socio-economic system of reference (as well as for the European Union as a whole).

The economic and social policies developed in the Western world in recent years, show increasing investment in targeted vocational education and training attempting to provide open access to all citizens (if not always succeeding). Financial investment policies for VET and their return in social and economic terms, is one level of intervention among others but considered essential to ensure the overall development of a country and its ability to respond competitively to the challenges of globalisation and the overall crisis of the European social model (or models). But, investment in VET raises the question of *parity of esteem* (from students, parents and politicians) among the selection of VET streams as opposed to general education. In other words, the debate continues as to whether life opportunities (and lifetime income) are best served by entry into a general education stream (and then university) or into work via

vocational skills (or both of course). EU member states struggle to give equal weight and therefore social importance to enhance the attractiveness of VET.

Historically, the German Dual System, for example, is important in terms of how far the tripartite secondary system of *Hauptschule*, *Realschule* and *Gymnasium* acts to distribute students among occupations; for France, how far the common label of *baccalauréat* in France gives equal status to students emerging from *lycées*, *lycées technologiques* and *lycées professionnels* and whether students are progressing to higher education or into work; equally, how the Netherlands manages parity of esteem among general, vocational and technical provision.

What is apparent is the attempt in many European countries to fill the gaps between the sub-systems of education and work or general education and technical education and vocational training. The alternative terminology to filling gaps is making connections and building bridges.

In Germany, the value given by society to skilled worker status and relative economic security over the last 40 years in Germany gives an important symbolic social value to dualization.

In the three countries considered, the key issue for young people is *when* to opt for VET training. Categorisation and differentiation becomes a question of not «what route to opt for» but «what facet to take» at different moments in time - *not a decision but a sequence*. Young people may opt to acquire as much general education as possible before opting for VET because it leaves room for choice which a narrowly-focused VET route does not. As a result, young people may stay longer in the education/training system with increasing numbers opting for mixed experiences to reach a given level of qualification with the average age of entry into the labour market rising. It has been made easier

to progress to higher education via the VET system in all three countries.

In its time, the then Further Education Development Agency in the UK commissioned a study in the late 1990s (Geoff Stanton and William Richardson (EDS); *Qualifications for the future: a study of tripartite and other divisions in post 16 education and training*; FEDA 1997) of which I contributed the comparative article. It reviews the justification of dividing students among general, technical and vocational streams. The perspectives are historical, consumer, psychological, sociological, curriculum, employment and international. The conclusion was that the tripartite divisions are hard to justify objectively by any of these perspectives except perhaps historical and sociological; *that is social engineering*.

#### 4.1.3. Definition

According to one CEDEFOP definition “...VET is independent of venue, age or other characteristics of participants and previous level of qualifications. VET may be job-specific or directed at a broader range of occupations. It may also include elements of general education. The major importance of VET for individuals, enterprises and society is widely acknowledged, and is perceived as a key element of lifelong learning”

There is a background issue which resonates with the other two themes of the book – social policy and the labour market. From the ETF 2006 peer review on VET finance as one peer put it:

*“In general, (reform) interventions, while relatively successful in important aspects of VET development such as curriculum, teacher training, school environment, etc. are difficult to make systemic maybe because the financial issues (a) are going beyond the traditional pedagogic aspects of education; (b) have a broad cross-sector impact, that asks for the consen-*

*sus of many actors (not easy to be achieved); and (c) traditionally, legislation and finance are very rigid in nature, in comparison with the flexibility of pedagogical experiments.”*

Manifestly, the same paradigm impacts on financing other social and economic sectors and priorities.

#### 4.1.4. The English Speaking Influence

All European countries adapt their own financing systems to their national social, economic and educational contexts and trends, therefore investment in VET sustainability can be more easily understood if financing mechanisms are associated with qualitative and strategic targets set both at national and European levels; Ditto again for our other themes. Here there occurs an issue in the reports it is important to pick up: the perceived influence of the English speaking countries (referred to in the reports as Anglo Saxon – a term inimical to English speakers of Celtic origin) as opposed to those from central Europe. It is true that the Commission seems to favour English-speaking country approaches both to VET and to management in general. This is odd in that Continental VET systems are seen, even by the British themselves, as superior (particularly Germany, Denmark, the Netherlands and France).

There is a possible explanation. Traditionally, the English in particular have not had a consolidated system but a series of policy and strategic shifts with each incoming government. Institutions come and go almost over parliamentary periods. What the English have developed are effective mechanisms and tools almost independent of a system as such. And as such they are easily transferable to systems in transition, in this case in SE Europe, as they are (relatively) criteria-free. Besides this element, of course, is the substantial donor influence of the World Bank which

is quite different in philosophy, mechanisms and outlook to those of the EU (as many of the reports comment).

#### 4.1.5. Convergence and Divergence

The EU Member States in the 2000s indicated that neither the common factors pressing on national policy determination for education and training nor the priorities that most EU member states share are leading to a uniform pattern of convergence. In short, member state VET systems are becoming more different rather than less. A major issue is to tease out those points of possible convergence and cooperation that exist and also to review the key underlying factors which impinge on all systems in order to focus on priorities for Commission funding. This would include European Structural funds and the European Social Fund for member states and *acquis communitaires* and IPA funds for pre accession funding.

*“...As countries have to reconcile limited available public/private budgets with the need to spread it out more thinly over the lifecycle, the debate focuses on increasing the volume of financing from private stakeholders (mainly enterprises and individuals), while improving efficiency and distribution of public funding. The emphasis on efficiency should however not lead to an equity-efficiency trade-off. Investment and financing policies and mechanisms need to ensure that equity and efficiency complement each other. Finding an appropriate and feasible mix of financial and non-financial incentives and arrangements to support widespread sharing of costs and access to education and training is a major challenge”*

*The answer to these questions would inform where funding should go who should pay and who benefits. However we did not come across a study of this kind (SIANESI B and REENEN J, 2005). That is for VET but it echoes across our other two sub themes.*

One problem is the lack of information and statistical data concerning VET financing and expenditure. A further difficulty in responding to the question is the relative lack of data collection and analysis for VET as a whole.

*“The specific role of VET in economic growth has scarcely been addressed by macro economic growth studies. Is it secondary, upper secondary, general education or VET which contributes more to growth and productivity? Does school or company based VET yield a higher impact on economic performance?”*

Difficulties encountered in isolating financing measures for IVET (Initial VET) are even greater when analysing CVET (Continuing VET). For example, the OECD definition of adult and “non formal” learning diverges from the one adopted by most European policy documents. It’s not surprising, therefore, that data on participation in CVET and life-long learning is neither easy to obtain nor to analyse. An international perspective would facilitate the evaluation of financing policies in the light of pre defined criteria of efficiency, effectiveness, sustainability, etc.

#### 4.1.5. The Personal Prism

If I stand back and reflect on the countries reported in the text, what comes to mind? (In a sentence or two)

In *Albania*, the ability to absorb regional VET schools based on different donor philosophies (Italian agriculture, French catering, British business schools – because at the time there was no other option);

In *BIH*, the ability to reach agreement among the constituent peoples (green and white Papers) but the inability to implement, despite the interventions of the Office of the High Representative);

In *Bulgaria*, actually something quite positive – the giving up of an EU PHARE programme for VET in favour of a country solu-

tion – the NAVET -National Agency for VET- a coming together of the social partners under the umbrella, not of the line Ministries of education and labour, but of the Council of Ministers (see addendum);

In *Croatia*, trust at local level (county and region) but not yet towards national institutions;

In *Kosovo*, an agreement between the ministries of education and finance on earned income retention by VET schools but its non-implementation because half -way down the MOF tower block the news had not yet reached the bureaucrats;

In *Moldova*, the inability to decide on influence from the WEST (EU) or the EAST (Russia) resulting in a white paper (on VET) passing through Parliament as a bill, but rejected by the incoming government before it could become an act.

In *Montenegro*, the will towards decentralization to municipal level ('these are our parents and our children') but the lack of means to implement;

In *Romania*, the development of sophisticated national institutions over 15 years (quality/qualifications/data/ monitoring and evaluation; labour market responsiveness at pilot level, etc) but as yet question marks over consolidation at systemic level;

In *Serbia*, a sophisticated approach to VET infrastructure but interrupted by changes of government and direction and a consequent lack of connection to economic and social planning.

If we examine these (admittedly photo flash) issues, they mix specific policy/strategic issues (finance; coherence; coordination; trust; bureaucratic indifference; decentralization; consolidation and sustainability; changes of government priorities) with big and little 'p' political reality (not to mention wars and civil conflict). At the time of the break-up of Yugoslavia, the Albanians were very ambivalent about the war ending because they knew

that *their* donor money would go to BiH. There being, seemingly, a constant amount circulating among changing priorities.

In the regional context (while also remembering that Turkey is included regionally in SE Europe) one is reminded of the Ivo Andric short story, *A Letter from 1920*:

*Whoever lies awake at night in Sarajevo hears the voices of the Sarajevo night. The clock on the Catholic cathedral strikes the hour with weighty confidence: 2 am. More than a minute passes (to be exact, seventy-five seconds - 1 counted) and only then with a rather weaker, but piercing 'sound does the Orthodox Church announce the hour, and chime its own 2 am.*

*A moment after it the tower dock on the BEY's mosque strikes the hour in a hoarse, faraway voice, and that strikes 11, the ghostly Turkish hour, by the strange calculation of distant and alien parts of the world. The Jews have no clock to sound their hour, so God alone knows what time it is by the Sephardic reckoning or the Ashkenazy. Thus at night, while everyone is sleeping, division keeps vigil in the counting of the late hours, and separates these sleeping people who, awake, rejoice, feast and fast by four different and antagonistic calendars, and send all their prayers and wishes to one heaven in four different ecclesiastical languages. And this difference, sometimes visible and open, sometimes invisible and hidden, is always similar to hatred, and often completely identical with it.<sup>160</sup>*

#### 4.1.6. An Organizational Overview

Moving away from VET, it is possible to employ a paradigm, dividing the key issues analysed (in the three sub themes) among three categories:

<sup>160</sup> Note from the author: My flat in Sarajevo in the mid 2000s overlooked the city. The two clocks were still 75 seconds apart. I counted!

- a. *political/policy*: the political will at policy level for commitment to and investment in a field of activity;
- b. *organisational review*: the organisational possibilities and constraints which exist in individual countries and trans-nationally which might advance or impede the strategic implementation of policy;
- c. *technical solutions*: the structures and technical solutions which might be feasible in the context of a. and b.

The paradigm described above, provides a simple frame to help work through the complexity and to assist both policy influencers (and readers of the report in general) to respond to the following question:

*“Do we have technical dilemmas in an organisational context looking for political resolution or do we have political dilemmas in an organisational context looking for technical solutions?”*

It is not always clear in which direction the country reports are facing or whether they have a common framework.

The issue that does emerge clearly from the reports is political/policy complexity and its relation with the technicalities of financing mechanisms. What emerges less clearly is the relative lack of command (by most actors) of organisational theory and practice to bring about change (even when desired). There is a polemic tendency in the reports (which are not necessarily consistent in their coverage of the sub-themes, nor indeed of the basic trade off issues between efficiency and equity (let alone the third ‘e’ of effectiveness). There is, occasionally, a tendency in the reports towards railing at the political dimension and assuming a mono discipline approach to the content. In short, there is a technocratic emphasis which does not always reach a phenomenological perspective – post Keynes’ animal spirits.

Not many initiatives work as they are intended. There is a not very positive view of weak

government in the reports but perhaps an over-expectation of what government (whether corrupt government or not) can do. I was involved in research of the impact of the British Youth Training Scheme (YTS) in the 1980s; a period of high youth unemployment across Europe and declining heavy industries. This was a massive scheme across two different governments. YTS policy was sufficiently ambiguous for different individuals and agencies to act on different interpretations of it. Four main themes emerged from the research: YTS was a new function to be accommodated; the policy was ambiguous; the basis for planning was unclear; existing implementation networks (the local delivery system) had to be assessed and in many cases changed. Most retrospective analysis came to the conclusion that the investment in YTS worked only in keeping young people off the streets. Employability depended on the economy picking up (for a variety of reasons). One argument for VET is that its provision requires maintaining and developing in the medium term in order to be available when the economy improves. In short, it is stocking skills rather than influencing growth in itself. The arguments for long term investment in social and labour market structures (rather than short term-ism) come through most of the nine reports but of course the arguments are finance-dependent.

#### **4.1.7. Social and Economic Models in Europe**

In recent years, in the face of significant processes of change and the evolution of social and economic systems that have involved the European States, the idea has strengthened that the welfare of (the) people depends heavily on a welfare state sufficiently efficient to contain and manage inequalities (the hoped for Nirvana of the nine country articles).

The notion of “the European welfare state - European social model” focused on “social

security guarantees” offered by welfare - depends on the confidence of Europeans in the power of the state. Two pillars appear as essential parts of the system in terms of European values (expressed through the Commission). They embody 1. the concept of state intervention developed and financed by taxation levels that are relatively high; 2 a strong welfare system which can provide effective social protection measures consistent for all but especially for the most needy, together with the limitation or containment of economic inequality and higher forms of inequality.

The development of the European social model is complex; one major issue, for example, is the need to combine social justice with superior economic performance (as above). The social dimension needs to be shaped both in the light of the values of social justice but also in its contribution to growth and competitiveness.

The Social Model provides a vision of society that combines sustainable economic growth with ever-improving living and working conditions. This implies full employment, good quality jobs, equal opportunities, social protection for all, social inclusion, and involving citizens in the decisions that affect them. It might be suggested (as below) that while there is no such thing as one European social model there is a variety of models with some common features. It is likely that some of these models are doing better than others

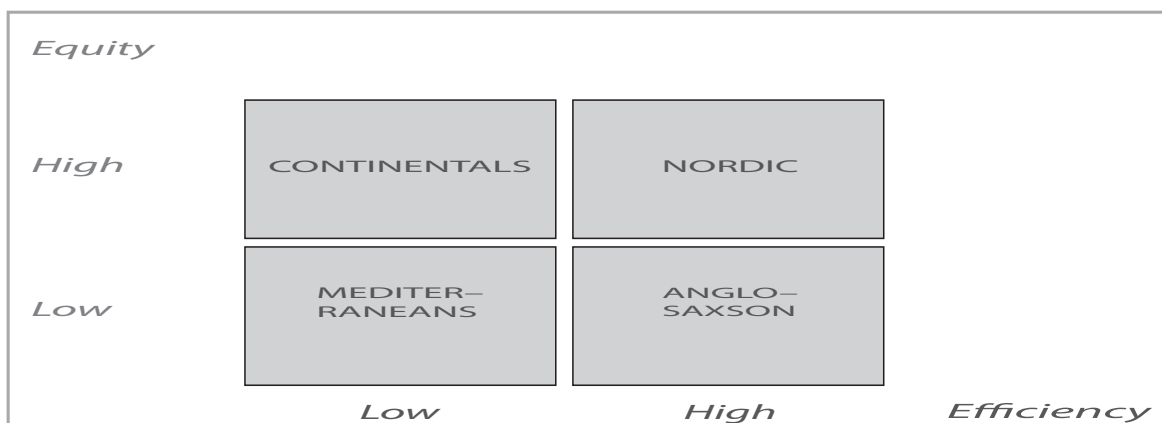
in dealing with unemployment, poverty and the financing of healthcare.

Andre Sapir (2006) in his study “Globalisation and the reform of the European social models” argues that there are in fact four European social models: the Nordic (Denmark, Finland, Sweden and the Netherlands); the Anglo-Saxon (Ireland, United Kingdom); the Mediterranean (Greece, Italy, Portugal and Spain) and the Continental (Austria, Belgium, France, Germany and Luxembourg)

The Nordic model is characterised by a welfare state, a high level of social protection, a high level of taxation and extensive intervention in the labour market, mostly in the form of job-seeking incentives. The Anglo-Saxon model features a more limited collective provision of social protection to mitigate the impacts of events that would lead to poverty. The Continental model is typified by the provision of social assistance through public insurance-based systems and a more limited role of the market in the provision of social assistance. The fourth model is the Mediterranean social welfare system, with high (legal) employment protection, lower levels of unemployment benefit and spending concentrated on pensions.

According to Sapir, the Nordic and the Anglo-Saxon models are both efficient, but only the former manages to combine equity and efficiency. He suggests that the Continental and Mediterranean models are inefficient and unsustainable and should therefore be reformed.

Figure 2.1: The Four European Models





Some key issues remain common for all four models:

- increasing general access to education and training;
- general access to social protection and health care;
- active policies for social inclusion;
- regulated labour contracts;
- social dialogue procedures;
- the predominance of public funding via taxes or social contributions with a redistribution effect

Given four (or more) models, the question for the Commission is how to encourage cooperation and development on these key issues across the 27 Member States bearing in mind the likely need to promote a plurality of financing models, in order to encourage different contexts for participation and universal access.

And how do our nine countries fit and how (as actual or prospective members of the European Union) do they locate themselves?

#### 4.1.8. Strategic Comments

A study for groups at risk (carried out in Canada) suggests a number of strategic considerations that need to be taken into account in devising poverty and social exclusion policies.

Financial elements include:

- Successful strategies to address poverty and exclusion requiring sustained investments that target not just income and employment but abilities, assets, attitudes, and aspirations.
- Income support continues to play a crucial role in alleviating deprivation and poverty. Research shows that transfers produce sizeable reductions in long-term poverty among the groups at-risk.
- Universality in the form of tax relief, national child benefits and (passive) information/ education strategies, needing to be complemented by active policies targeting

individual circumstances and focusing on groups at-risk.

#### 4.1.9. Administrative Capacity

Different groups at-risk require different policies. These policies engage different levels of government, different public agencies, and different civil groups. As a result, consultation, co-ordination, and delivery strategies are also required. Flexible working arrangements, effective active labour market policies and concrete lifelong learning policies can contribute in making labour market arrangements (for example) more flexible, without having workers lose out in the process.

The nine reports, therefore, are obliged to touch upon administrative capacity. Indeed a (if not the) major question is the administrative and managerial capacity to deal with strategic outcomes from policy priorities. In the case of VET, internationally, most successful systems have an organisational framework for VET divided among three separated functions:

1. Departments within ministries of Education and Labour managing the VET and training sub systems;
2. National Advisory Bodies or Councils usually representing government and social or regional partners;
3. Technical Guidance and Support Structures providing services to both VET managers (categories 1 and 2) and providers (schools and training centres). These include occupational standards, labour market information, curriculum development, assessment, certification, qualifications, teacher accreditation etc.)

The advantage of separation between policy / management and technical services is to avoid ministry responsibilities becoming too complex and to avoid confusion between policy and technical implementation issues. Equally, centralised inflexibility militates

against flexible responses to largely local labour markets.

So we return to the question of capacity and institutional infrastructure in the nine SE European countries and how long they take to evolve.

Associated are issues of legislation and finance. In each of the nine reports the following questions arise (explicitly or implicitly):

Can reform take place without a comprehensive review of the *financing* of the system?

Three sub-questions are:

- 1 What are the current and future sources of finance?
- 2 How are/will they be collected and by whom?
- 3 How are/will they be dispersed, by whom and by what criteria?

The question for *legislation* is how far there is a case for new legislation and how far revised regulation is sufficient.

Here I have a codicil. Sitting with a group of peers (a deputy minister and senior civil servants from four SE countries) during an ETF peer review I was struck by the intervention of the Minister (also an elected member of his parliament). He in turn was struck by the relative naive perceptions of his professional colleagues towards the reality of the political process vis-à-vis evolving legislation. Basically, his view was 'that this is a rough old world of which you internalise little'.

#### **4.1.10. The European Social Fund (ESF): Archaeological Layers**

For the ESF, its historical contribution to the Member States' human resource and labour market development programmes was defined (for the 2000s) by five policy fields (in accordance with the guidelines contained in the Regulation (EC) No 1784/1999 of the European Parliament and of the Council of 12 July 1999, on the European Social Fund):

A. Developing and promoting active labour market policies;

- combating unemployment and preventing both women and men from moving into long-term unemployment;
- facilitating the reintegration of the long-term unemployed into the labour market;
- supporting the occupational integration of young people and of persons returning to the labour market after a period of absence;

B. Promoting equal opportunities for all in accessing the labour market, with particular emphasis on those exposed to social exclusion;

C. Promoting and improving training, education and counselling as part of a lifelong learning policy to:

- facilitate and improve access to, and integration into, the labour market;
- improve and maintain employability, and promote job mobility

D. Promoting a skilled, trained and adaptable workforce, innovation and adaptability in work organisation, developing entrepreneurship and conditions facilitating job creation, and enhancing skills and boosting human potential in research, science and technology.

E. Improving women's access to and participation in the labour market, supporting their career development and their access to new job and business start-up opportunities, as well as reducing vertical and horizontal segregation on the basis of sex in the labour market.

These policies were grant aided from the Commission (including matching funds from member states). There are a whole variety of case study schemes which fit the criteria. Post 2010 the priorities have changed but the financing procedures remain similar or even more complicated. The priorities represent an effort towards convergence. The difficulty is complexity of procedure. As above, the French do not always collect their entitlement (to the criteria) because the procedures are more expensive to collect than the benefits.

This may be true in a parallel manner with individual states. In Croatia, for example, employers take the same line with tax benefits for employee training. The regulations are too complex to bother. In Romania, where I am party to an ESF funded project, it has taken 12 months for the first payments to appear and the project has had to be extended to cover the endless procedural complications both at national and Commission levels.

One is reminded of the decline of the Roman Empire where ambition exceeded administrative capacity, but at least the process was over hundreds of years.

## Addendum

### BULGARIA

NAVET is an example of a national coordinating body with existing financial influence but with the potential (given its constitution and organisation nationally) to become a major player in determining financing priorities

Despite the many reforming initiatives, it is still necessary to free the system from 'procedural centralism' in order to allow the schools to be responsive to the local environment and local employers via regulation, statutes, financial flexibility (retaining earned income) and by greater capacity for a supply response to identified local demand. In terms of unit costs the schools lack equipment, materials and texts. The establishment of NAVET has its roots in the Law on VET from 1999, activating the framework of activities derived from the EU PHARE VET Project. NAVET per-

forms a coordinating function in TVET and it is the place where the efforts and interests of the Ministry of Education and Science (MOES) and the Ministry of Labour and Social Policy (MLSP) are joined. It is intended to hold the system together and provide sustainability thus its financing policy potential.

NAVET has three main functions:

- Coordination of processes related to standards and framework curricular implementation;
- Preparation of TVET documents;
- Issuing licenses for centres for CVT (adult training centres from which it obtains income).

NAVET is managed by a Management Board established on a tripartite basis with equal participation of representatives from the government, trade unions and the unions of employers. Although having a tripartite governing body and answering to the Council of Ministers (not directly to either MOES or MOLSP), its legality appears to be via the MOES.

As NAVET is focused on the preparation and design of occupational standards, it is also the responsible body for the certification of non-formal CVET short courses prepared and provided by different CVT centres based on State Education Requirements (SER). The system of certification is also established by NAVET, which manages the evaluation of licensed programmes and courses while MOES provides approval for the TVET curricula. The actual and prospective role of NAVET also illustrates the interconnection between policy initiatives, implementation strategies and financing implications.

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## 4.2. A View from New Europe

Tine Stanovnik

### Abstract

Equity and efficiency do not necessarily trade off against each other, but the allocation of resources is an important factor in the relationship between the two. The concepts of efficiency and equity are not straight-forward, especially when they concern rights of individuals and of society. Of the different types of rights (political, economic, and social), social rights present the most complex challenges. Social rights are costly and thus require an efficient allocation of resources. Yet, the principle of equity cannot be overlooked and a balance of equity and efficiency should be sought. This paper considers two social rights in the context of equity and efficiency – namely, health care and education. In both domains can be observed competing notions of equity and numerous indicators of efficiency. In the Western Balkans particularly, where scarce resources are a fact of life, the provision of social services can be subject to a trade-off.

Equity vs. Efficiency implies a trade-off, meaning that more equity results in less efficiency. This trade-off issue has first been raised (to my knowledge) by Arthur Okun in his celebrated essay *Equality and Efficiency*, subtitled: *The Big Trade-Off*. Note that Okun is using the term equality and not equity. Okun was keenly aware that a trade-off between equality and efficiency is not the norm. Indeed, on p. 4 he states that:

*»The presence of a trade-off between efficiency and equality does not mean that everything that is good for one is necessarily bad for the other. Measures that might soak the rich so much as to destroy investment and hence impair the quality and quantity of jobs for the poor could worsen both efficiency and equality. On the other hand, techniques that improve the productivity and earnings potential of unskilled workers might benefit society with greater efficiency and greater equality. Nonetheless, there are places where the two goals conflict, and those pose the problems.« (Arthur Okun, *Equality and Efficiency: The Big Trade-Off*, p.4).*

Notions of efficiency and equity are not all that clear. There are different kinds of efficiency and different kinds of equity. Generally speaking, efficiency is about the optimal use of scarce resources, i.e. maximizing output or outcome with a given amount of input. If we speak about social services, output or outcome will mean social welfare. *Technical efficiency* is achieved if a given product or service is produced with minimum costs, i.e. with an efficient use of productive factors (inputs). This type of efficiency looks at the supply or »production« side. *Allocative efficiency* is achieved if the welfare of the population is maximized, given the available productive factors (inputs). Here we are looking at the demand side. The optimality conditions for the consumer state that at optimum

$$\frac{MU_1}{p_1} = \frac{MU_2}{p_2} = \frac{MU_3}{p_3} = \dots$$

here  $MU_i$  is marginal utility of good »i«, and  $p_i$  is price of good »i«. The optimality conditions for allocative efficiency could be written as

$$\frac{MB_1}{MC_1} = \frac{MB_2}{MC_2} = \frac{MB_3}{MC_3} = \dots$$

Where  $MB_i$  is marginal social benefit of social intervention »i« and  $MC_i$  is marginal social cost of social intervention »i«. Of course, these definitions are hardly of any use in setting rules for allocation of scarce resources. A more operational goal is to achieve *macro allocative efficiency*, i.e. to allocate funds across various social interventions and programs (health care, pensions, child care, education etc). *Micro allocative efficiency* is concerned with the optimal allocation of resources within a given social program (for example, in health care). Both aspects of allocative efficiency are relevant for policy makers. For example, comparisons of health care expenditures show that the US devotes – in comparison with other developed countries – »too much« resources to health care – in other words, macro-allocative efficiency is not achieved. Similarly, in Slovenia, there is a widespread view of education experts that »too much« resources are devoted to primary education and »too little« to tertiary education.

In discussing the equity dimension, there is a need to »step back«, and survey the concept of rights.

Following Miller (1976), there are three dimensions of rights:

- Political and civil rights-such as political rights, equality before the law, freedom of speech, etc.;
- Economic rights-these are rewards for productive contributions and take the form of individuals' remuneration (wages, salaries, etc);
- Social rights-these are rights based on need: need for health care, educational needs, income-replacement needs (pensions, etc).

Political and civil rights are fairly well defined and there is not much disagreement in democratic societies on what these rights should constitute. However, there is much more diversity with regard to social rights. Unlike political rights, social rights are also resource- intensive. Health care requires the use of resources, pen-

sioners receive cash payments-pensions, etc. Physical and financial resources all have alternative uses. These resources have to come from »somewhere«: they come from »chipping off« economic rights of the active population, in the form of taxes or contributions.

There are different »mixes« of these three groups of rights. One is reminded of communist societies, which were quite weak in the domain of political and civil rights, fairly weak in the domain of economic rights (in effect, the state determined wages and wage differentials) but quite strong in the domain of social rights. The experience of communist countries shows that strong state intervention in the domain of economic rights (quite large deviations from remuneration according to labour productivity) does have consequences for the overall efficiency of the economy.

The concept of equity (fairness) can span all three of the domains-political, economic and social. With regard to the political domain, one usually uses the term equality-equal political rights, equality before the law, etc. Also, equality is more »invariant«: for example, the meaning of »equality before the law« is not subject to various interpretations. With regard to principles of equity or fairness, there are always a number of alternative definitions on hand. In practice, the equity principle is operationalized through two »sub-principles«, the principle of horizontal equity and principle of vertical equity. The principle of horizontal equity states that individuals who are in an equal position (with regard to relevant characteristics) should be treated equally. The principle of vertical equity states that individuals who are in different positions (with regard to relevant characteristics) should be treated differently. The principle of horizontal equity is frequently labelled as the principle of non-discrimination. In reality, this principle does allow for discrimination, but only with regard to relevant characteristics. For example, with regard to voting rights, the relevant characteristics (in most countries) are

age and nationality. Incidentally, one is reminded that in a not-too-distant past there were other »relevant characteristics« with regard to voting: sex (women were not allowed to vote), race, etc. So, in Slovenia, all persons above age 18 and of Slovene nationality are permitted to vote, whereas those that do not satisfy these two conditions do not have the right to vote. The principle of vertical equity is less precise, as it is not clear how differently should persons be treated if they are in a different position with regard to the relevant characteristics. However, with regard to voting this »different treatment« is quite straightforward: if you do not have the required relevant characteristics, you cannot vote.

When dealing with social rights, the concepts of equity or fairness are less universal. For example, with regard to the financing of social protection systems, if the system is contribution-financed (i.e. is a social insurance system) the principle of horizontal equity would be formulated as follows: those who have the same wage should pay equal amounts of contributions. With regard to the financing of public goods, there are even two equity principles which coexist. Thus according to the »ability to pay« principle, the principle of horizontal equity is formulated thus: persons who have the same ability to pay should pay the same taxes. With regard to the benefit principle, the principle of horizontal equity is formulated as: persons who receive the same benefit from a public service should pay the same amount. Though this latter principle is of lesser importance, user fees (for highways, passports etc) are still charged for a number of public services.

Various sectors that provide social services develop their »own« principles of equity and instruments for measuring efficiency.

For example, there are three possibilities for defining equity in health care. These are: equality of health, equality of use of health care and equality of access to health care (Mooney, 1994, p. 69). For a number of reasons, the equality of access to health care is the »preferred« eq-

uity principle. However, this is a purely »supply« side principle, which is supplemented by a demand- side factor: need. So, the principle of horizontal equity in health care could be formulated as: equal access to health care for persons who have equal (health) needs. The principle of horizontal equity must be taken seriously. Just to give an example, the dialysis centre in Mali Lošinj, on the Croatian Island of Lošinj, caters to only 10 patients. If such a centre were not to exist, these patients would have to travel to a hospital on the mainland, with ferries sometimes not operating due to the wind bora.

Though in health care we can also speak about the formal conditions for allocative efficiency, namely that the ratio marginal benefits/marginal costs for each intervention and program has to be the same, in practice this is achieved through priority setting. As stated by Mooney (p. 38) »priority setting is about working out where best to allocate scarce resources, and forming that judgement needs an assessment not only of the benefit of one intervention over another, but also an assessment of the costs-the benefits foregone-elsewhere«. However, the efficiency objective in health care can collide with equity principles. For example, from the efficiency point of view, hip surgery of the elderly population is less efficient (as it results in a smaller increase in some measurable dimension of health, such as quality adjusted life years) than similar surgery performed on a younger patient. Thus, if the dimension of efficiency were strictly pursued, it would result in a systematic discrimination of one group of persons, and this would violate the principle of horizontal equity. Access to health care cannot be systematically denied to one group of persons!

With regard to education, primary and secondary education are universal and publicly financed. Tertiary education is not universal, though it is publicly financed in most European countries. Equity is also relevant here, and again, there are several »competing« equity principles.



A sensible principle of horizontal equity (non-discrimination) would require that discrimination is not permissible with regard to characteristics that are not related to the aptitude of the student. In other words, equal access for students with equal scholastic aptitude. This means that the material and financial position of a student should not be a »relevant characteristic«. Much attention-perhaps too much-has been devoted to the fact that tertiary education is publicly financed, whereas benefits reaped by the graduates are mostly private, and that

this is »unfair«. This view concerns the equity concept in the financing of higher education. Yes, private individuals do benefit from publicly financed tertiary education, but these individuals earn higher incomes and contribute more to society - not only in terms of economic development, but also through higher taxes that are collected from their incomes. An analysis of four Central and East European countries shows that labour-active persons with attained tertiary education do indeed have much higher incomes than other labour-active persons.

**Table 1: Relative equivalized income by education levels of labour-active persons aged between 25 and 64 years**

	Bulgaria		Hungary		Romania		Slovenia	
	1992	2002	1993	2002	1995	2004	1993	2002
Primary	0.94	0.61	0.86	0.78	0.82	0.71	0.70	0.76
Vocational	1.03	0.91	0.94	0.90	0.92	0.87	0.90	0.85
Secondary	0.97	0.98	1.12	1.10	1.12	1.07	1.11	1.02
Tertiary	1.04	1.20	1.37	1.44	1.68	1.81	1.39	1.37
All	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

Note: for Hungary, all persons aged between 25 and 64 years

Source: Stănculescu, Stanovnik (eds.), 2009. *Activity, Incomes and Social Welfare*, Ashgate.

Efficiency in education is defined through external and internal efficiency. External efficiency is judged by the relation between inputs and outcomes, where outcomes represent increased social welfare of the population-frequently measured as the increased social rate of return on investment in education. This term, used specifically in education, would correspond to the general term of allocative efficiency. Internal efficiency is concerned with a narrower concept, i.e. the relation between inputs and outputs, where outputs represent (for example) the number of students that have completed schooling, or the number of students who have advanced through the educational system (have successfully passed their examinations). Needless to say, there are a number of indicators that

aim to measure both internal and external efficiency. For example, one indicator of internal efficiency is the average duration of university study; for external efficiency, a frequently used indicator is the social rate of return to tertiary education (see Bevc et al. 2010).

For countries of the Western Balkans both equity and efficiency in the provision of social services are problematic. Social rights require resources; in countries characterized by low productivity and low value-added, there are insufficient resources for social programs. In such an environment, the allocation of resources-both at the macro level and at the level of specific programs-can be inefficient, as the state can become "captive" to special interests. Such inefficiency would also directly reflect on inequity.

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