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# The labour market crisis and the road to job recovery in Serbia

## Abstract

The impact of the economic crisis in Serbia has been rather mild in terms of impact on the contraction of output, but it has been very severe in terms of job losses, which have seen an already difficult labour market situation deteriorate significantly. Under such circumstances, employment growth, alongside a reduction in absolute and relative poverty, needs to be defined as an explicit final objective of any development strategy for the next decade. Macroeconomic and sectoral policies and institutional reforms need to create an environment which is conducive to job growth. Labour taxes for low wage labour need to be substantially reduced, while making work pay policies need to be introduced. Education policy should improve the quality and efficiency of education and tackle the growing skills gap, while more funds are required for active labour market programmes. Social dialogue should be given more prominence, while collective bargaining in the private sector should additionally be encouraged.

**Keywords:** economic crisis, employment rate, unemployment, dual labour market, labour taxation, education policy, demographic challenge, qualifications frameworks, active labour programmes, job subsidies, job creation, unemployment benefits

## Labour market situation in Serbia

Since the revival of the transition in Serbia, following the democratic changes in 2000, a continuing decline of activity and virtually uninterrupted decline of employment have been observed, while unemployment has developed in a less linear fashion, but has also grown overall. The crisis from 2008 has worsened these already very unfavourable trends. Clearly, there are multiple problems related to the labour market situation in Serbia that need to be addressed. The analysis of labour market trends which will be presented here points to the decisive role played by challenges to the generation of employment with regard to macroeconomic and structural demand in Serbia. Transition- and privatisation-induced de-industrialisation and lack of investment in the real sector have caused a general decline in the demand for labour. Furthermore, the drop in demand was not uniform within the country – areas that suffered the most during the transition were under-developed regions relying on traditional manufacturing industries and a skilled and semi-skilled workforce. This has led to the further deepening of regional disparities in GDP and employment and in other labour market indicators.

General demand for labour is weak because of a variety of mutually-reinforcing reasons, which include:

- very high levels of labour hoarding (excess employment) in former socialist enterprises, causing prolonged employment shedding in the processes of restructuring and privatisation
- a demand and consumption-driven growth model
- high non-wage labour costs (taxes and social security contributions)
- in particular, a low demand for low-skilled, low-wage labour because of the very high tax wedge involved
- an unfavourable general business climate (the high costs of doing business), preventing the creation of new business entities and the growth of existing ones
- the lack of a co-ordinated and regionally differentiated employment policy.

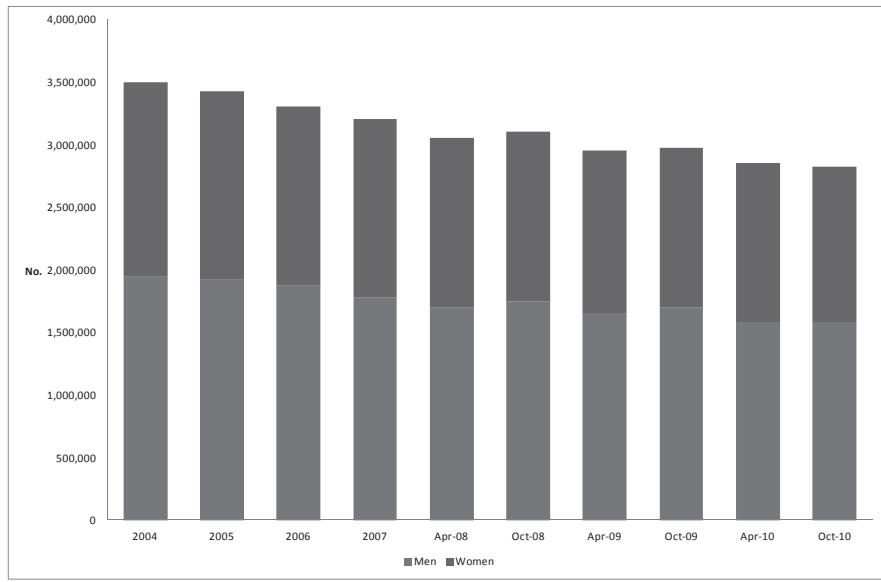
#### *Trends in participation in the labour market*

Mainly as a result of negative natural growth and population aging, the working-age population declined by 4.5 % between 2004 and 2010; thus, the estimated number of residents aged between 15 and 64 totalled 4 820 000 in 2010. The percentage drop in the number of active people is disproportionately higher than the drop in the activity rate; also, the drop in the activity rate of the adult population (aged 15+) is greater than the drop in the activity rate of the working-age population (aged 15-64). These findings are accounted for by demographic dynamics, i.e. a decline in the total adult population as well as a greater decline in the working-age population in comparison with the total adult population.

Between 2004 and 2010, the active population declined by as much as 19 % and, in October 2010, the active working-age population totalled 2 835 000 people, or only 58.8 % of the total population of working age. This activity rate of the Serbian population of working age is considerably below the EU-27 average of October 2009 (71.3 %). It is also almost ten percentage points below the 2004 level, owing to the active population decreasing in number considerably faster than the working-age population.

Such a low activity rate is primarily the result of low activity rates among women, young people (aged 15-24) and older people (aged 55-64). Men's and women's activity rates declined at a mostly uniform pace in the period observed; yet the gender gap in activity rates recorded a slight increase. On the other hand, the activity rate among young people declined considerably – by almost one-third – over the same period: from 37.8 % in 2004 to 28.2 % in 2010. This decline is a combined result of the secular trend of an increase in the participation of young people in education (and, thus, their non-participation in the labour force), driven by positive factors such as increased returns to education and the worsening of labour market opportunities for young people after the start of the crisis.

**Figure 1 – Population of active working age in Serbia, 2004-2010**



Source: Statistical Office of the Republic of Serbia (SORS) Labour Force Survey, with Mehran's (2010) recalculations for 2004-2007.<sup>1</sup>

Pre- and post-crisis activity data do not show a significant trend break at any point after the eruption of the crisis. It is visible from Figure 1 that the downwards trend has remained rather stable. The drop in the active population between 2004 and 2008 was slightly over 400 000 people; in the following two years (October 2008- October 2010) the active population diminished by a further 270 000 people.

The size of the active population will be under further pressure in the next decade, since its main reservoir – the population of working age – will, according to a recent estimate, drop cumulatively by as much as around 400 000 people, or by some 8 %, as the large cohorts of baby boomers exit the population of working age (Arandarenko and Vujić, 2010). In this respect, measures aimed at increasing the active population of working age need to be considered and promoted including, for example, an extension of the minimum age of retirement; policies aimed at making work pay; and, possibly, the liberalisation of immigration procedures.

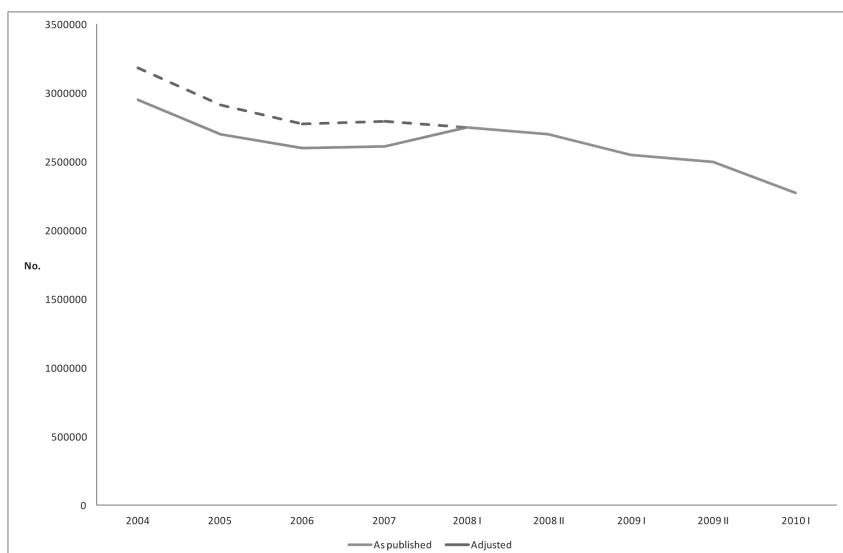
1 Mehran (2010) has carried out ‘backwards’ recalculations of LFS data for the period 2004-2007, adjusting them for the methodological changes that took place in 2008. Thanks to Mehran’s recalculations, the LFS series for the entire period of 2004-2010 is now fully comparable, at least as regards the trends in the main labour market contingents. We will use these recalculated data for the period of 2004-2007 whenever possible throughout this text.

### Employment trends, 2004-2010

The total employed population of working age (aged 15-64) declined for the better part of the period observed, reaching its lowest value of about 2 270 000 in October 2010, i.e. it declined by about 22 % in comparison with the 2004 level. The employment rate in Serbia is very low: in 2009, it reached its record low point for the period in which it had been monitored by the Labour Force Survey; in that year, only one in two people of working age were actually in work. In 2010, the employment rate declined by a further 2.9 percentage points, which was the largest yearly drop since the onset of the economic crisis in 2008. This employment rate was considerably lower than the EU-27 average (of 64.6 % in 2009) and was also lower than the employment rates of some neighbouring countries (Croatia, Bulgaria and Romania). Serbia is still lagging far behind; in fact, it is falling further and further behind the employment rate of 70 % – the EU target for 2010 set by the Lisbon Strategy in 2000.

It is useful to draw a comparison between the employment series based on the adjusted data presented here and the employment series based on unadjusted data, as presented by the Statistical Office of the Republic of Serbia. Figure 2 shows the difference between these two series in the period 2004-2007. The adjustment effects are clearly shown as the difference between the dashed line, indicating the adjusted series, and the solid line, indicating the unadjusted series. This gap, which indicates the extent to which employment data were under-estimated in the period 2004-2007, amounts to about 230 000 for 2004, 210 000 for 2005, 175 000 for 2006 and 180 000 for 2007.

**Figure 2 – Employment in Serbia, 2004-2010**



Source: LFS, Statistical Office of the Republic of Serbia (SORS) with Mehran's (2010) recalculations for 2004-2007.

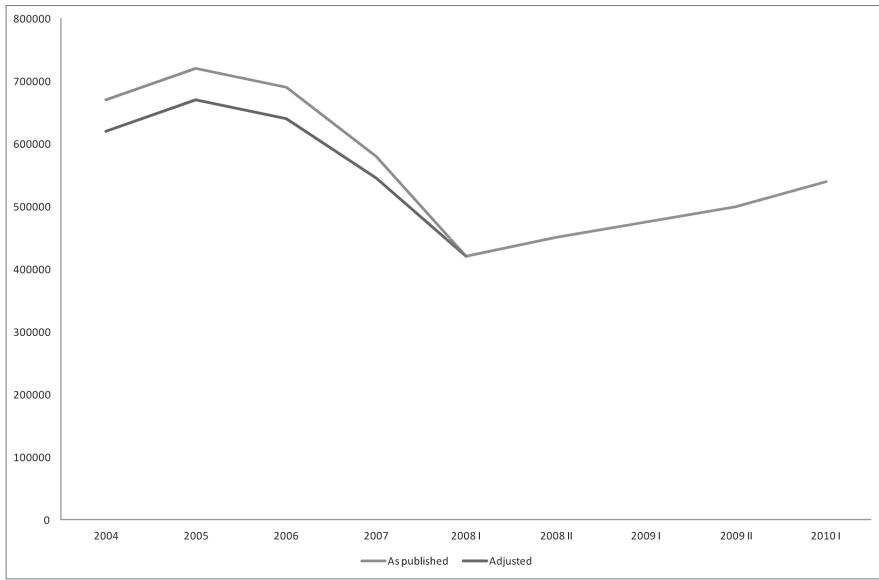
The most interesting finding of this comparison is that, contrary to previous interpretations based on unadjusted data, no double dip in employment actually occurred – first, presumably, as a result of the transition; and then another as a result of the economic crisis. It means that prior conclusions on employment recovery and the beginning of the reversal of the transition-induced employment decline in 2007 and in the first half of 2008 were based only on statistically registered, rather than ‘true’ employment growth. What the adjusted, dashed line in Figure 2 shows is a virtually uninterrupted downwards trend of employment marking the second half of the decade and actually going back beyond the chart to cover the entire decade starting in 2001.

Still, unlike the trend in labour market participation, in which there has been a slightly faster ‘shedding’ of the active population, but no visible trend break, looking at the dynamics of employment before and after the start of the crisis, it is clear that there is a crisis-related break. From 2005 to 2007, employment cumulatively dropped by less than 100 000 people, but between October 2008 and April 2009 alone, the drop was almost 200 000, while the cumulative drop up to October 2010 approached 400 000. So we can conclude that a major part of this decline is due to the crisis, but other factors have certainly played a role – an autonomous drop in the working age population and the impact of transition restructuring being possibly the most prominent.

#### *Unemployment trends, 2004-2010*

Unemployment is very high in Serbia: 20 % of the population of active working age (aged 15-64), or about 566 000 people in absolute terms, were unemployed in October 2010. Unemployment actually decreased by about 50 000 people between 2004 and 2010, although the unemployment rate increased by 2.4 percentage points. In view of the large decrease in both employment and the employment rate over this period, it is clear that the decrease in unemployment and the slight increase in the unemployment rate are primarily due to a high flow of the labour force into inactivity. The decrease in unemployment in this period is only partly due to new employment, since many discouraged workers became inactive.

Nevertheless, it should be highlighted that both unemployment and the unemployment rate have been on the increase continuously since 2008, largely as a result of the impact of the economic crisis on the labour market. Figure 3 shows that there is indeed a trend breakpoint, no matter whether adjusted or unadjusted data are used. The Serbian unemployment rate is among the highest in the region and is considerably higher than the EU-27 unemployment rate (9.4 % in October 2009).

**Figure 3 – Unemployment in Serbia, 2004-2010**

Source: Mehran (2010).

Women are more affected by unemployment than men, in spite of their somewhat higher average level of education: the unemployment rate was higher for women than it was for men throughout this period. However, it is interesting that the gap between women's and men's unemployment rates has shown a steady downwards trend, which has further accelerated since the onset of the economic crisis. The difference between male and female unemployment rates decreased from 7.1 percentage points in October 2004 to 4.6 percentage points in 2008, and then to 2.2 percentage points in 2010 – thus it could be said that, in this regard, women have fared relatively better than men during the crisis. Higher employment protection within the public sector, which traditionally has an above-average proportion of women, is a probable explanation for these equalising tendencies.

The unemployment rate decreases considerably with age – it is highest for the youngest age group (15-24). After decreasing between 2004 and 2007, the unemployment rate amongst the 15-24 age group started growing again, reaching 46.4 % in 2010. The unemployment rate for 15-24 year-olds in Serbia is more than twice as high as it is in the EU-27, where it amounted to 20.4 % in October 2009. Compared to adults, the labour market position of young people deteriorated during the crisis, and the gap between the unemployment rates of young people and of other groups in the population of working age widened in the period observed.

*Impact of the economic crisis on the development of key labour market indicators*

The decline in employment since the onset of the crisis in October 2008 has been dramatic. The number of employed people of working age (aged 15-64) fell by almost 380 000, or about 15 %, between October 2008 and October 2010. This brought about a decline in the relevant employment rate from 53.3 % to 47.1 %. Over the same period, the number of unemployed people who are of working age increased by almost 60 000, leading to an increase in the unemployment rate from 14.7 % to 20 %. It should be emphasised that the differences in key labour market indicators ‘before’ and ‘after’ the crisis reflect not only the impact of the crisis itself, but also that of autonomous economic factors – the most important being the transition and privatisation process, which is already at an advanced stage.

The significantly smaller increase in unemployment compared to the large decrease in employment suggests that many people who were no longer in work moved into inactivity rather than into unemployment. A large decrease in employment was recorded among the 15-24 age group while, at the same time, this group’s unemployment also decreased, confirming that, in a time of crisis, young people frequently opt to continue in education as an alternative to seeking employment. Another group affected to an above-average extent are those aged between 45 and 54. Unlike with young people, a decrease in employment among this group is accompanied by a relatively large increase in unemployment.

The causes of the decrease in employment differ for these two groups. A hypothesis may be formulated that the impact of the crisis is most pronounced in the 15-24 age group and that it has manifested itself among young people both in the termination of, or the failure to extend, fixed-term employment contracts and service contracts, as well as in a declining number of newly-created jobs which are suitable for young people. On the other hand, the 45-54 age group is affected by the completion of the privatisation process and by the pre- and post-privatisation restructuring of enterprises which has been marked by a growing number of bankruptcies and liquidations. This process has, perhaps, had an even greater impact than the crisis.

The cumulative loss of jobs between October 2008 and April 2010 was in the order of 12.5 %. The cumulative loss in GDP between these months was 4.7 %, after which a modest GDP recovery started. This means that, for each one per cent of GDP lost during the recession, employment fell by as much as 2.7 percentage points. In most other countries of central and eastern Europe, the employment elasticity of growth since the start of the crisis has been in a more typical range of between 0 and 1, meaning that the relative drop in employment has been less severe than the drop in GDP.

The drop in formal non-agricultural employment, as recorded by established survey data, was somewhat less severe, at around 7.5 %, but it was still much faster than the drop in GDP. This supports the notion that, apart from the crisis, there exist autonomous causes of this sharp drop in employment. On one hand, the remaining firms yet to be privatised tend to be among the least attractive to investors and the least successful; on the other hand, some recently privatised firms had been shedding labour after the expiry of a temporary ban on lay-offs. In some cases, the new owners have miscalculated their chances on the market and become unable to finance their debts, opting for bankruptcy, or, sometimes, voluntarily handing their firms back to the government.

### *Employment structure by sector*

Employment structure by main economic sectors usually provides sound indications of a country's level of development. In developed countries, employment in services absolutely prevails, while employment in industry is modest and employment in agriculture is, as a rule, marginal, typically having only a single-digit percentage share of overall employment. In medium-developed countries, the relative shares of the three sectors are somewhat more balanced, while in under-developed countries, agriculture takes the highest share of total employment.

Table 1 shows adjusted (upper panel) and unadjusted (lower panel) Labour Force Survey data on employment figures in the three broad sectors – agriculture, industry and services. Based on Mehran's recalculation, this indicates that agricultural employment was systematically under-estimated, and therefore higher than was officially presented, until 2008. According to the adjusted data, it was only in 2006 that industrial employment exceeded agricultural employment.

From a European perspective, the share of agricultural employment in total employment is exceptionally high in Serbia. Comparisons of the employment structure by sector with other European countries in 2010 show that only Romania has a somewhat higher share of agricultural employment in total employment than Serbia. In some central European countries, this share is surprisingly low – for instance, in Hungary and Slovakia, it is in the single-digit range. On the other hand, the share of industrial employment is very low in Serbia in comparison with other European countries. The result of these two extreme figures is that the share of service sector employment in total employment in Serbia is only slightly below the European average.

According to adjusted Labour Force Survey data for the population over 15, the share of service sector employment in Serbia increased from 45.5 % in 2004 to 51.8 % in 2010, while the share of industrial employment increased from 25.0 % to 26.3 % over the same period. Meanwhile, the share of agricultural employment decreased from 29.4 % to 22.0 %.

The increase in the share of service sector employment in total formal employment has occurred as a result of two groups of factors. Firstly, employment fell dramatically in agriculture (among agribusiness complexes and co-operatives), as well as in manufacturing industry, mining and construction. Secondly, employment increased in public administration, education, communal and social services and in real estate activities.

**Table 1 – Employment and employment structure by broad industry sector, adjusted and unadjusted data**

Adjusted							
	2004	2005	2006	2007	2008	2009	2010
Agriculture	931 375	839 031	707 123	725 421	674 276	622 186	522 658
Industry	791 853	756 375	773 443	784 711	650 661	650 661	626 207
Services	1 439 580	1 346 895	1 324 279	1 325 789	1 317 341	1 317 341	1 233 439
Shares in total employment							
Agriculture	29.45 %	28.52 %	25.21 %	25.58 %	24.10 %	24.02 %	21.94 %
Industry	25.04 %	25.71 %	27.58 %	27.67 %	27.33 %	25.12 %	26.29 %
Services	45.52 %	45.78 %	47.21 %	46.75 %	48.57 %	50.86 %	51.78 %
Unadjusted							
	2004	2005	2006	2007	2008	2009	2010
Agriculture	704 029	637 454	540 295	552 592	674 276	622 186	522 658
Industry	788 888	753 935	770 829	782 217	764 661	650 661	626 207
Services	1 437 931	1 342 023	1 319 570	1 320 927	1 359 043	1 317 341	1 233 439
Shares in total employment							
Agriculture	24.02 %	23.32 %	20.54 %	20.81 %	24.10 %	24.02 %	21.94 %
Industry	26.92 %	27.58 %	29.30 %	29.45 %	29.45 %	25.12 %	26.29 %
Services	49.06 %	49.10 %	50.16 %	49.74 %	49.74 %	50.86 %	51.78 %

Source: LFS, Statistical Office of the Republic of Serbia (SORS) with Mehran's (2010) recalculations for 2004-2007.

#### *Development of formal and informal employment*

Informal employment is linked to low income, poverty and vulnerability, as well as to a lower education level. This is the main source of labour market flexibility providing, at the same time, an important safety net, but it still represents predominantly an involuntary form of employment of last resort. According to a World Bank study, young people and the poorly-educated account for an above-average share of employ-

ees in the informal sector; work experience is much lower in the informal than the formal sector; wages are lower in the informal than the formal sector, especially when working hours are considered; the wage premium for those working in the formal sector, when other determinants are taken into account, is approximately 20 %; and, finally, longitudinal analysis shows that flows between the informal and the formal sector are low (World Bank, 2006).

Krstić and Sanfey (2010) compared LSMS data on informal employment at two points in time, in 2002 and 2007, which coincide with the early and mature transition stages in Serbia. They obtained a counter-intuitive result: the informal level of employment had increased considerably in those five years, from 28 % of total employment in 2002 to 35 % in 2007. They found that informality was an important determinant of inequality in 2007, but not in 2002 – in other words, during the transition, informal employment sank towards the bottom of the wage distribution in parallel with its increase in volume. Furthermore, the educational structure of informal workers worsened relative to the educational structure of formal ones. Still, the authors found that informal workers earned less than formal ones, even after controlling for other characteristics, such as education level.

According to the Labour Force Survey, the share of informal employment in the total employment of the adult population amounted to 23 % in 2008, decreased to 21 % in 2009 and dropped even further to 19.6 % in 2010. The finding of high job destruction in the informal sector at a time of economic crisis is both interesting and difficult to explain, as it is contrary to the standard assumption of the counter-cyclical, or at least ambivalent, character of informal employment. The explanation should point to the dual characteristics of the Serbian labour market, in which informal employees are the most vulnerable and the first to lose their jobs. At the same time, those marginally attached to the labour market, such as family helpers, who are by definition informal, have probably opted out of the labour force to a larger degree than other workers.

### *Women and men in the labour market*

The differences between men and women that are found in aggregate labour market status indicators are a universal characteristic of labour market statistics worldwide. Male activity and employment rates are higher, and unemployment rates lower, compared to the corresponding indicators for women. These differences are present in Serbia as well although, when put in international perspective, they are moderate, partly as a result of the socialist heritage which contributed significantly to improving the status of women in traditional Balkan societies.

A steady trend of decline in both male and female activity and employment rates can be identified in the period 2004-2010, along with the considerable narrowing of the gender gap in unemployment rates that we identified above. The male activity rate declined by 8.9 percentage points, from 76.1 % to 67.2 % in this period, while the female activity rate declined slightly faster, by 10.8 percentage points, from 61.4 % to 50.6 %. At the same time, the male employment rate declined by 10.7 percentage points to 54.4 %, while the female employment rate declined by 8.3 percentage points to 39.9 %. The result of these trends is that the difference between the male and the female

unemployment rates decreased from 21.5 % for women and 14.4 % for men in 2004 to 21.2 % for women and 19.0 % for men in 2010.

These data give rise to the conclusion that the deterioration in the key labour market indicators during the transition period for which comparable data are available – from 2004 to 2010 – affected men and women in a differentiated, yet balanced manner. For men, the main net negative transition of status was that from employment into unemployment, while for women it was from employment into inactivity. Still, the female employment rate declined by slightly fewer percentage points compared to the male employment rate, while female and male employment itself declined at a more uniform pace.

It appears that, as regards changes in labour market status, the transition was, to a great extent, blind to gender differences, especially if status distinction is reduced to the employment/non-employment dichotomy. Concerning the wage gap between women and men, there are strong indications that these decreased further from an already low initial level (Krstić, 2003) during the transition period in Serbia (Blunch, 2010).

#### *Age groups in the labour market*

The development of labour market indicators for the population of working age disaggregated by age groups between 2004 and 2010 reveals a common trend of declining activity and employment rates and growing unemployment rates for all cohorts grouped by age. These developments, marked by a uniformly negative sign, differ to a certain extent only in intensity.

We have noted already that young people (aged 15-24) have been hit hard, seeing a decline in the activity rate from 37.9 % in 2004 to 28.2 % in 2010 alongside a somewhat smaller drop in the employment rate, from 21.1 % to 15.2 %. The youth unemployment rate has consistently been at an extremely high level at this time: 44.2 % in 2004 and 46.1 % in 2010. Around 2007, there were some favourable labour market developments for young people, but these were reversed by the onset of the economic crisis in late 2008 and the deterioration of the position has accelerated since then (Arandarenko and Nojković, 2010).

The labour market position for young people in Serbia rightly gives rise to great concern and has, therefore, been the subject of numerous analyses and studies offering policy recommendations (Arandarenko, 2007; Krstić *et al.* 2010). Research into the school-to-work transition of young people during 2009 indicates that highly-educated young people were more severely affected by the crisis than those who were poorly-educated (Krstić, 2010): in October 2009, the average duration of the transition doubled for young people with university degrees or above compared to the figure in April 2009 (from nine months to 18.5 months); while it remained unchanged for young people with only primary education (52-53 months).

Young adult members of the labour force (aged 25-34) also fared relatively worse during the transition. In the 2004-2010 period, they lost the lead in terms of activity rate, which declined from 85.5 % to 77.7 %, to those aged 35-54, amongst whom the decline was less steep – from 84.0 % to 78.1 %. The decline in the employment rate for the 25-34 group was even steeper – from 67.4 % in 2004 to 56.4 % in 2010, thus further deepening the gap in comparison with the middle-aged group. Similarly, the unem-

ployment rate of 25-34 year-olds increased from 21.1 % in 2004 to 27.5 % in 2010 – a bigger deterioration, in terms of the percentage change, than any other age group.

Older workers (in the 55-64 age group) also fared relatively worse between 2004 and 2010, recording a decline in activity rate from 44.9 % to 37.7 %, a decline in employment rate from 41.4 % to 33.1 % and a growth in unemployment rate from 7.8 % to 12.2 %.

All age groups thus recorded a deterioration in all characteristics, but only the middle aged group, those aged between 35 and 54, showed a below-average decline in labour market status characteristics; for all other age groups the decline was above-average.

### *Vulnerable groups in the labour market*

Certain demographic groups in the labour force, such as women, young people and older workers, systematically show poorer labour market indicators compared to the overall population. In addition to these broad groups, there are specific, narrower groups in the labour market, such as people with disabilities, refugees and internally displaced people, the Roma population, etc. who are particularly vulnerable. Naturally, vulnerability in the labour market is a relative concept and vulnerable groups may include working-age population groups whose key labour market position indicators (participation rate, employment rate, unemployment rate, share of vulnerable employment) are significantly less favourable than the corresponding averages for the overall working-age population.

On the basis of specific features of the Serbian labour market and prior research into poverty and living standards, Krstić *et al.* (2010) recently classified the following working-age population groups as vulnerable: Roma; refugees and internally displaced people; people with disabilities; the rural population in south-east Serbia; the landless rural population; people with low education levels; women; young people (aged 15-24); and older workers (aged 50-64).

Krstić *et al.* (2010) also concluded that preliminary analysis of the impact of the crisis on vulnerable groups saw the most pronounced negative impact on young people, followed by Roma and the landless rural population.

### *Multifaceted duality of the Serbian labour market*

The labour market in Serbia nowadays seems to be more polarised and segmented than perhaps ever before. Dichotomies in the Serbian labour market include at least the following divisions: formal versus the informal labour market; public versus private sector employment (including the remaining socially-owned sector); modern versus the traditional labour market; waged employment versus self-employment; standard versus vulnerable employment; and paid versus unpaid work (Arandarenko, 2011). The approximate relative sizes of these different categories are shown in Table 2.

**Table 2 – Dichotomies in the Serbian labour market, around 2010**

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

\*The total is lower than 100 % since it does not include unpaid work of contributing family workers

Source: SORS KILM database for 2010, and own estimates

Naturally, these structures also exist in other countries. In order to constitute elements of labour market duality, they must fulfil two important conditions – there must be serious obstacles to the transition from the ‘lower’ to the ‘higher’ employment segment and both market segments must be relevant, rather than marginal, in volume. The second column of Table 2 clearly shows that the relevance condition is fulfilled by all dual structures; while the first condition requires additional data.

The simplest operational test of the impenetrability of ‘primary’ labour market segments (public sector; formal employment; modern labour market; waged employment; paid work) is their absolute net increase – if this is negligible, it suggests that vertical mobility in the labour market is very limited.

A more sophisticated test would involve monitoring, at a minimum of two points in time, the movement of the same members of the workforce from one labour market status to another, and also from one market segment to another within the status of being employed. This requires individual panel data, which is available in the Labour Force Survey from 2004 onwards. Detailed longitudinal analysis of the flow between the formal and informal sectors in, for instance, 2004 and 2005 indicated that such mobility was very low. Only 10.5 % of informal wage earners in 2004 moved to formal employment in 2005, and this included a disproportionately high number of highly-educated people. On the other hand, a vast majority of formal wage earners remained in the formal sector in the following year. A World Bank study (2006) concludes that workers in the informal sector are mainly condemned to stay there.

According to a synthesis which we have recently elaborated, the advanced transition in Serbia is characterised by a consolidation of the dual labour market (Arandarenko, 2010). The primary labour market remains restricted to the entire public sector, modern services (such as banking and finance, information technology and marketing) and a few large privatised enterprises with foreign owners. The secondary labour market encompasses employees on ‘flexible’ contracts (e.g. fixed-term employment contracts or service contracts), most private sector employees, the self-employed, those em-

ployed in traditional services, a large part of industry, and agriculture. The primary labour market is characterised by job security, good working conditions and above-average wages, while jobs in the secondary labour market are, as a rule, precarious and poorly-paid.

### Employment policies and labour market institutions

There is a growing recognition among the public and policy-makers that Serbia needs to change its growth model from one based on demand, consumption and imports to one based on supply, production and exports; from non-tradables to tradables. Additionally, public spending needs to be cut, with consequent cuts or freezes in public sector employment and wages. If a shift toward such a ‘new growth model’ is indeed to be realised, it would require greater flexibility of formal and informal education to facilitate skill creation and skill restructuring, which would have to follow the sectoral restructuring implicit in the transition to the new growth paradigm.

There are multiple problems related to labour market developments in Serbia that need to be addressed. The analysis of labour market trends presented in the previous section points to the decisive role of macroeconomic and structural demand side challenges to the generation of employment in Serbia. Transition- and privatisation-induced de-industrialisation and a lack of investment in the non-governmental sector have caused a general decline in demand for labour. Furthermore, the drop in demand has not been uniform within the country – the areas that suffered the most during the transition were under-developed regions relying on traditional manufacturing industries and a skilled and semi-skilled workforce. This has led to a further deepening of regional disparities in GDP and employment, as well as in other labour market indicators.

### *Fiscal and taxation policy*

The share of GDP taken by public spending in Serbia has been around 45 % during the last decade, which is above average compared even with developed countries. But, unlike in developed countries, higher public spending in Serbia 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. In welfare states, public spending ensures relatively large transfers from wealthier to poorer social strata, but its primary role in Serbia is to provide for an ‘adequate’ standard of living for public sector employees and for pensioners, as representatives of powerful and numerous interest groups. Furthermore, the total expenditure from public sources on education, health and pensions, expressed as a share of GDP, are around, or above, the average values for OECD or EU countries; whereas the share of GDP going to expenditure on social assistance and on active and passive labour market programmes was less than half the average in the OECD and the EU (World Bank, 2009).

The government’s economic and, notably, fiscal policy has created incentives and directed resources in such a manner as to make traditional and export-oriented sectors of economy (industry and agriculture) more feeble and economically unappealing. In contrast, the labour force and investors have, rightly, seen the service sector as more attractive.

This has had two simultaneous negative effects, on both equity and efficiency. Firstly, the result of such an economic policy is that the middle and upper classes have improved their relative positions whereas the lower strata has become disadvantaged. Secondly, the structure of the economy has become imbalanced, being oriented too greatly towards services. This has had a negative bearing on development, growth and employment since Serbian service sector firms, as strong as they are in local markets, are too weak to compete on international markets and, of course, their products are often not tradable at all. 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.

Tax policy was among the most important instruments of the new political elites with which to accomplish redistribution after 2000. A progressive income tax rate was already standard in the EU, but the 2001 tax reform in Serbia introduced a flat rate of income tax, in an extreme form, set at a universal rate of 14 % and without even a basic personal allowance. The flat income tax rate was coupled with high, and effectively regressive, social security contribution rates. Such an income tax system has been more harmful to the working poor and has favoured the well-off, because its relative burden is higher for those with lower incomes than it is for those with higher incomes. For instance, the tax wedge for a worker who received only one-third of the average wage until 2006 was 47 %. In contrast, the tax wedge for a person earning eight times the average gross wage was only 34 % (Arandarenko, 2010).

A small personal allowance was introduced in 2007 but, in comparative perspective, low-wage workers and the firms employing them are still heavily taxed; while people with higher salaries and the firms employing them, such as banks, enjoy a comparative advantage.

The sum of the contribution rates levied on gross wages stands at 35.8 %, with the income tax rate standing at a mere 12 % and accompanied by a small tax-free threshold. Consequently, social insurance contribution revenues account for over three-quarters, and income tax revenues for less than one-quarter, of overall labour tax revenues. 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 and Vukovjević, 2008) first showed that the labour taxation system in Serbia has quite a few regressive features. Even if equity is disregarded, this *inter alia* lowers the profitability of labour investment and increases the costs of labour of low-skilled workers; discourages the formalisation of informal employment; has adverse 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 out of total collected labour taxes is much smaller in Serbia and, consequently, that the share of contributions is considerably greater than in other European countries, especially in comparison with old EU member states.

Over the past ten years, much government 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 rate of VAT from 18 % to 21 or even 22 %. The reform has been postponed but will, most likely, be implemented after the elections in 2012. This is again likely to deepen inequalities and increase poverty. The worse-off usually have to spend their whole income, while the better-off are inclined to save some of it, meaning that a higher VAT rate will hit the worse-off harder.

Tax reform should take a very different course. Reform of personal income tax, with the introduction of progressive synthetic taxation ensuring greater equity, is a necessary prerequisite to eliminate or, at least, to alleviate the multiple negative effects of the current labour taxation system. In addition, the government should 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 three million and corporate private sector wage employment barely exceeding 900 000.

The first-rate economic goals that the country has will be achievable only once the parameters regarding social insurance contributions are changed in the context of labour tax reform. These ideas have led us to the formulation of some preliminary guidelines for the comprehensive reform of labour taxation in Serbia. These include:

- an increase in the relative share of wage tax revenues, and a decrease in the relative share of revenues from social insurance contributions, in the overall revenues coming from labour taxation
- a reduction in the tax burden on the labour of low-wage workers by a raising of the tax-free threshold and a lowering of social insurance contribution rates in order to increase demand for less-skilled labour, encourage investment in labour-intensive low-wage sectors and cut the costs of formalising informal employment
- increasing labour tax progressivity by introducing three progressive non-zero tax rates on labour income, with the top rate not exceeding 30 %
- cutting the overall combined social insurance contributions rate from 35.8 % to a maximum of 30 % of the gross wage.

The above measures would reduce the tax wedge on labour to a level below the European 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 the fiscal deficit. In a static context, there are two basic complementary ways of keeping the proposed reform fiscally neutral: firstly, increasing the revenues from capital income tax; and secondly, increasing the revenues from value added tax.

An increase in the capital income tax rate would automatically improve equity, since this tax is paid mostly by the well-off. However, any overall increase in VAT revenues ought to be achieved without hurting the poor. This could be done by differentiating VAT tax rates by classes of products and services. At present, there are only two VAT rates in Serbia, a basic rate of 18 % and a reduced rate of 8 % which is limited to staple goods 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 the consumption of lower income groups is above average.

The simultaneous reconfiguration of income tax, contribution rates and the rate of VAT would ensure that the overall macroeconomic and distributive effects of comprehensive tax reform are positive. In the dynamic context, expanding the labour tax base by formalising informal employment and stepping up the growth of employment due to greater international competitiveness ought to help preserve the previous level of tax revenues notwithstanding cuts in the average and total burden on labour.

#### *Education policy*

One of the most often emphasised weaknesses of the Serbian education system is a clear lack of connection between ‘school’ and ‘work’. This is one of the main reasons why the transition from school to work is so difficult for young people in Serbia (Kogan, 2011). The scope for improved co-operation between education and the economy has been mapped out by various strategic documents, and concrete proposals have been made on how to ensure it. However, institutional separation still exists and there are no joint bodies which would work together towards the reduction of skill mismatches.

In a country with very high unemployment, it might seem that general labour supply potential would not represent a significant bottleneck, but this is not entirely true in Serbia. On the supply side, overall human capital endowment in the country could be characterised as modest at best compared to other European countries – both in terms of the formal educational achievements of the population of working age and in terms of the qualifications and skills necessary for the workplace.

Table 3 presents the educational structure of the active population (employed and unemployed). It shows a normal distribution of educational attainment, with around 20 % of the active population having primary education or less, and the same percentage having post-secondary education or more, while the remaining 60 % of the active population have secondary education.

According to the recent assessment of the Foreign Investors Council (FIC) in Serbia, the labour market and human capital remain among the biggest challenges, despite some proactive measures which have been taken by the government. The magnitude of the problem is such that much more needs to be done to reduce it. FIC’s key recommendation is to improve the education system and align it better with labour market needs.

In the view of the European Training Foundation (ETF) (2010), the best advice is to develop flexible skills across the board. It recommends avoiding the design of too narrow a set of technical-vocational skills and, instead, a broadening of VET (vocational education and training) curricula and an opening up of training for a number of key relevant competences. However, this is not only a curriculum issue, but one that depends even more on how learning is organised in classrooms and workshops and, hence, on the continuous professional development of VET teachers.

**Table 3 – Educational attainment of the active population in Serbia, April 2011**

Total population 15-64		
	No.	Share
No schooling	12 120	0.4
Less than primary	88 718	3.1
Primary education	445 621	15.7
Secondary education	1 731 478	61.0
Tertiary education	562 610	19.8
Active	2 840 547	100.0
Total population 15+		
	No.	Share
No schooling	20 642	0.7
Less than primary	139 856	4.8
Primary education*	460 078	15.7
Secondary education	1 740 428	59.4
Tertiary education	571 349	19.5
Active	2 932 353	100.0

Source: SORS(2011) Labour Force Survey April.

The National Employment Strategy pays significant attention to the issue of better alignment between education and work. The educational challenge is defined in the Strategy as the mismatch between labour demand and supply, as well as the discrepancy between qualifications and the vocational education system compared to the EU.

The education challenge is closely associated with the demographic one. A considerably decreased labour force is expected, in the optimal growth scenario, to generate average annual GDP growth of 5.8 % which, in turn, is expected to create over 400 000 new jobs. This calls for a substantial improvement of available and future human capital and the way it is used. In the forthcoming period, proportionally more numerous, but less educated, older people will leave the population of working age to be replaced by less numerous, but better educated, younger individuals. This will improve indicators related to the share of university-educated people in the population aged 25-54 and will decrease the number of unskilled workers in the population of working age. This charges Serbia with developing the education system in such a way as to make lifelong learning a reality.

The educational challenge is even more difficult to address when the delays in education reform are considered. If no strategy is developed and, more importantly, implemented for the long-term improvement of human capital to accompany new opportunities for productive employment, Serbia will face the risk of experiencing an increasing brain drain.

According to the Strategy, the key challenges to be addressed by education policy are: the lack of alignment of development strategies in employment, education, science and technology; the lack of a legal framework governing adult education and the link between formal and informal education and training; and the absence of institutions to set and enforce quality standards. Co-operation and collaboration between the line ministries responsible for education and employment, but also other relevant institutions and social partners – such as employers' and workers' organisations, chambers of commerce, the Standing Conference of Towns and Municipalities – will be important if all these challenges are to be met.

Another crucial task for the forthcoming period is the adjustment of the national qualifications framework to the needs of the economy and the labour market. The development of a national qualifications framework will ease transfers to the EU education system and encourage mobility in the enlarged labour market. The National Council on Higher Education has already adopted the text of the National Higher Education Qualifications Framework, and the Council for Vocational and Adult Education has agreed upon an Action Plan for the development of an NQF for secondary vocational education and vocational adult education.

The National Employment Strategy calls for the development of VET as this will lead to the increased employability of the labour force; to the alignment of labour supply and demand; the matching of educational and training outcomes to labour market needs; and better access to lifelong learning, in particular for vulnerable groups. Modern VET in Serbia should be based on specific learning outcomes, e.g. vocational competencies the achievement of which represents the basic indicator of success of the education process. Education programmes must be flexible in content, length and learning methods to facilitate attendance and prevent dropouts. The starting point should be the National Qualifications Framework, established through partnership between all stakeholders. Improving the quality of VET requires the introduction of a European quality insurance benchmark framework, which will allow progress to be followed through transparent quality criteria, benchmarks and indicators, and internal and external monitoring mechanisms which are uniformly applied to all VET providers (ETF, 2010).

Closely linked to the NQF is a system for the national classification of occupations. Current occupational titles are outdated and qualifications are still based on the Nomenclature of Occupations that – despite technological changes and the emergence of new and the disappearance of old occupations – has not been updated in almost twenty years. A system for the national classification of occupations is currently being developed in line with international occupation and education standards (ISCO and ISCED).

The target of reducing the share of the population with no primary education requires the introduction of functional primary education programmes for adults, to enable individuals who dropped out of primary school to acquire functional literacy and basic qualifications, either through labour market training or the education system, in

order to increase their competitiveness on the labour market. Additional education and training programmes, offered as part of active labour market measures – additional training, re-training, functional primary education for adults and so on – should be expanded and targeted at the most vulnerable groups and individuals facing multiple vulnerability risks, primarily through the building of local capacities for education and training development. These education and training programmes should also be responsive to the needs of employers.

The development of tools to forecast labour market needs, and to monitor and evaluate education and training programmes, should be among the government's top priorities. The identification of the skills required by the labour market is crucial to plan education policies and training programmes that respond to real needs.

The National Education Council has prepared an initial concept for overall education reform. The document is based on a lifelong learning perspective and aims at an integrated approach to education reform, emphasising key competences and the role of teachers. It is planned to be built on the development of broad partnerships as well as consensus between the political parties. The Ministry of Education has confirmed the importance of initiating an overall education/lifelong learning development strategy, as it sees the need for substantial mid- and long-term modernisation across all sectors of education.

According to an analysis of education at the level of local self-government, there is no sufficiently developed awareness of the relationship between education and the prosperity of the community. It is important that investment in education brings the expected effects to society as a whole. The goal should not be the acquisition of formal degrees, as it is now, but the competitiveness of knowledge and skills on the labour market. However, a recent workforce development review has identified:

*Closed mind-sets to lifelong learning among SME and the general public. (USAID, 2009)*

## Active and passive labour market policies

### *Recent active labour market policies*

In response to the crisis, the active labour market policy programmes operated by the National Employment Service were restructured and refocused in April 2009. The available, modestly allocated budget for ALMPs remained officially unchanged (at some €35m, or 0.1 % of GDP), but this was augmented by the same amount being spent exclusively in the province of Vojvodina, which channelled a significant proportion of its privatisation proceeds to ALMPs. In spring 2009, the government announced that the ALMP budget would be restructured to respond to the new reality – the bulk of funds was to be streamlined to focus only on two measures: the new apprenticeship programme called 'First Chance'; and the public works programme. These measures were aimed respectively at the two groups within the labour force expected to be hardest hit by the crisis – young people without previous work experience; and the long-term unemployed at significant risk of poverty. The bulk of funds were streamlined to these two measures, largely at the expense of standard training and job subsidy programmes.

### *Training programmes*

#### ‘First Chance’

The ‘First Chance’ programme is aimed at young people up to thirty years of age who have completed at least secondary school education but who have no relevant work experience.

The scheme has slightly evolved since its inception in early 2009 and its current design is as follows. During volunteer practice (three months), participants receive a monthly remuneration to the amount of approximately €100. If an employer is satisfied with their work, they sign trainee employment contracts for a period of one year. At this point, the government pays around €200 per month to trainees with a university degree, €180 to those with a college qualification (drawn from post-secondary school education lasting up to three years), and around €160 to those with secondary school education. The costs of trainees’ social insurance are also paid from the budget, while employers must pay taxes on their salaries. After a period of vocational training lasting one year, employers must retain the trainees in salaried employment for at least twelve more months and they must not reduce the total number of employees during that period. Only employers in the private sector are eligible for the subsidies and preference is given to employers who regularly pay taxes and contributions, who have not incurred any debts and who are ready to employ more than one trainee.

It is important to note that the fall in total registered unemployment since mid-2009 was due to a sharp decline in youth unemployment and that this, in turn, coincided with the introduction of ‘First Chance’. It proved to be popular with both trainees and, unlike with previous schemes, employers because, in its original version, there were no strings attached in terms of the requirement to keep trainees once the apprenticeship was completed.

However, some of the features of ‘First Chance’ have been called into question.

Firstly, the target group is composed exclusively of skilled young people. The scheme seems well-suited to have lasting effects on the development of skills and on the practice of lifelong learning, but its exclusive focus on well-educated young people makes it susceptible to deadweight and other undesirable effects. On the other hand, it clearly neglects the most disadvantaged section of young people – those without secondary education.

Secondly, with few obligations for employers, and a lack of monitoring and reporting, the subsidy scheme is vulnerable to abuse. Additionally, with no incentives for employers to build the skills and competences of apprentices for a longer-term employment relationship, the quality of on-the-job training provided is debatable.

Finally, the scheme is expensive, with a growing total commitment as time passes, despite a slower pace of new entrants to the scheme. Thus, the discontinuation of the scheme will be long and costly, and will most likely be accompanied by growing dead-weight effects. Indeed, the costs of the scheme are growing at a fast pace – from 1.3 billion dinars (RSD) in 2009, to RSD 1.8bn in 2010 and an allocated RSD 2.6bn in 2011. The number of participants is increasing as well – from around 10 000 in 2009 to 16 000 in 2010 and to an expected 20 000 in 2011: a significant number indeed, compared with the average size of an annual youth cohort of less than 70 000 people.

In any case, a detailed evaluation of the programme is necessary in order to draw conclusions about its true net impact.

### Other training programmes

Training programmes outside ‘First Chance’ are of modest size (RSD 195m in 2009 and RSD 295m in 2010), but there have been some crisis-related adjustments in this regard. In order to attract big investors, the government is trying with this measure to attract those that are likely to create a substantial number of new jobs. Examples of on-the-job training schemes include the biggest on-going restructuring case in Serbia – Fiat Automobili Serbia, a joint venture between Italian Fiat and the Serbian government; as well as a South Korean investment by the Yura Corporation in nearby Rača, which produces car parts and components.

Out of the total number of offered training schemes, on-the-job training was scaled up in 2010, focusing especially on cases of restructuring. The National Employment Service is co-financing the training programmes required by employers, covering training costs for 1 400 unemployed people (slightly below 0.2 % of the total number of the registered unemployed), in accordance with employers’ needs. The NES will meet training costs amounting to up to RSD 80 000 per unemployed person and will also later provide employment subsidies on the termination of training amounting to three months minimum salary or up to six months minimum salary for people with disabilities.

### *Job subsidy programmes*

#### Public works programmes

Public works programmes are aimed at the second of the two groups within the labour force expected to be hardest hit by the crisis – the long-term unemployed at risk of poverty. Public works are carried out by employers appointed by the National Employment Service based on public competition and can be organised in the fields of social, humanitarian, cultural and other activities, as well as public infrastructure rehabilitation, and environmental and natural maintenance and protection. The duration of public works is limited to six months. The public works programme covers the salaries of the beneficiaries of public works to the amount of the minimum wage, increased by 15 %, 30 % and 45 % for people with secondary, college and higher education respectively, as well as travel costs, health and safety costs, and the costs of implementation up to 10 % of the total cost (for necessary equipment, etc.).

In response to the crisis, additional funds were allocated to public works in 2009, with a total amount of RSD 1.3bn (€15m) dedicated to them, engaging slightly over 10 000 people. This was twice as much as was the case in 2008 and then afterwards in 2010. Most of the projects were focused on environmental protection (around 40 %), followed by those in humanitarian and social fields (some 25 %) and public infrastructure (around 23 %). The number of beneficiaries only partly follows this path: roughly 49 % were engaged in environmental protection, while around 28 % and 18 % respectively were employed in projects in public infrastructure and the social field.

In 2009 and 2010, priorities were given to projects based on several criteria:

- employment of vulnerable categories of people such as the long-term unemployed, MOP recipients (material support for low-income households), people with disabilities, older workers, women, people from the Roma community, refugees and internally displaced people, etc.
- under-developed and the least-developed municipalities, as well as municipalities where the unemployment rate is higher than the Serbian average
- the level of co-financing from other sources
- the possibility of participants finding permanent employment
- the duration of the public works and the number of people employed.

Public works programmes have been designed with the aim of providing immediate income relief for the most disadvantaged workers, typically in under-developed regions, by securing them a temporary subsidised formal job and a means of improving their chances of non-subsidised employment after the expiry of the temporary job. The most recent process assessments, however, find that the scheme, as it is designed and implemented in Serbia, is much more successful in achieving the former objective than the latter one. It is not surprising that the programme has not had a significant long-term effect as regards employment; this simply repeats the experiences of other countries where it has been introduced. For instance, only 19 people found regular employment at the end of the public works programme in 2009. Partly because of these disappointing results, the financing of public works programmes was cut in 2010 back to the ‘standard’ amount of RSD 700m.

#### Job creation across sectors and regions

The National Employment Service has a long-standing programme to support employers by awarding subsidies to those who create new jobs. A subsidy may be granted to employers creating up to fifty new jobs. The amount of subsidy depends on the development level of the municipality in which people are employed and could also be related to the relevant characteristics of the unemployed themselves. Priority is given to under-developed municipalities and the long-term unemployed, unemployed people without qualifications or low-skilled workers, those under notice of redundancy, people with disabilities, people from the Roma community, internally displaced people and those returning according to the re-admission agreement. The total amount allocated in 2009 was RSD 400m in 2009 and RSD 600m in 2010, with 2 879 people employed in 2009 and over 4 000 in 2010 (around 0.5 per cent of the total number of the registered unemployed).

The new Employment Law contains an important new instrument for job creation at municipal and regional levels. Provided that they secure at least 51 % of the funds required for job creation programmes which have been developed in the context of local or provincial action plans for employment, they can count on matching funds from the central budget. In 2010, the interest of local communities was very modest, with only ten out of over 160 participating and with the total funds allocated from the central budget amounting only to around €700 000. In 2011, however, as many as 122 municipalities and the province of Vojvodina have applied, with their own funding to-

talling almost RSD 800m and triggering matching funds from the central budget of almost RSD 900m.

#### Other job subsidy programmes

In 2010, the Ministry of the Economy and Regional Development and the National Employment Service introduced a small programme aiming to support disadvantaged young people by providing assistance with self-employment. Disadvantaged young people (young women and men with no work experience, a limited skills base, disabilities, with returnee or refugee status, and from a minority ethnic group) who are between fifteen and thirty years old are eligible for subsidies towards opening a new business of up to RSD 160 000. Moreover, they may also receive additional subsidies of up to RSD 80 000 if there is a need for adaptation of the working space and/or RSD 80 000 if there is a need to equip the new working place specially.

Another scheme within this programme has introduced support for employers under which subsidies may be awarded where employers create new jobs for disadvantaged young people (aged between fifteen and thirty; criteria as above). The employer may receive a monthly subsidy of up to RSD 25 000 for each disadvantaged young person that they employ. The amount is increased to RSD 32 500 per month in cases where the disadvantaged young person in question has a level of education (a maximum record of qualifications resulting from two years of post-secondary schooling). Employers may also receive additional subsidies of up to RSD 80 000 if there is a need to adapt the work place and/or RSD 80 000 for each person employed (limited to RSD 400 000) if there is a need to adapt the workplace specially. The subsidies are available to employers for a period of up to six months and there is an obligation to employ the person for a period twice as long as that of the subsidy.

These interventions target disadvantaged young people in the districts of South Bačka, Belgrade and Pčinjski, which are highly affected by youth unemployment and poverty. In the course of the project implementation, two more districts were included, namely Pomoravski and Niški.

The new Law on Professional Rehabilitation and the Employment of People with Disabilities (2009) creates the necessary preconditions for the integration into employment of people with disabilities. It introduces a quota system as a means to increase the employment of people with disabilities and, at the same time, uses the funds from the fines imposed on firms that do not meet minimum requirements to finance professional rehabilitation. As of 2010, employers with 20-49 employees are obliged to employ at least one person with a disability; while those with fifty or more employees are required to employ one person with a disability per each fifty additional workers. The expected inflow into the Treasury from fines in 2011 is over RSD 2bn, which should serve to subsidise the salaries of people with disabilities who are employed, as well as widening the scope of the active programmes of the National Employment Service targeted specifically at people with disabilities.

#### *Passive labour market policies*

The unemployment benefit system in Serbia is designed in the form of unemployment insurance and is, therefore, primarily financed through the contributions paid by

employees and employers to an unemployment insurance fund operated outside the Treasury by the National Employment Service, which collects the compulsory payroll taxes earmarked for unemployment benefits. Eligibility is consequently limited to those who lose their jobs and who have previously paid unemployment insurance contributions. The entitlement criteria for unemployment benefits, according to the current Law on Employment and Unemployment Insurance, are as follows:

- a) three months, if the unemployed person has an insurance span from one to five years
- b) six months, if the unemployed person has an insurance span from five to fifteen years
- c) nine months, if the unemployed person has an insurance span from fifteen to 25 years
- d) twelve months, if the unemployed person has an insurance span longer than 25 years.

Exceptionally, an unemployed person is entitled to unemployment benefit for 24 months, where he or she needs up to two years to fulfil the nearest retirement requirement in accordance with the regulations governing pensions and disability insurance.

The unemployment benefit replacement rate is 50 % of the average wage of the unemployed person, but it cannot be higher than 160 % or lower than 80 % of the minimum wage determined in labour regulations for the month in which the unemployment benefit is paid.

It is important to note that the current Law was passed in May 2009 and that entitlement criteria and, especially, the benefit replacement rates are now less generous compared with the previous Law on Employment and Unemployment Insurance, which was in force from 2003 to 2009.

The unemployment benefit system in Serbia comprises only an unemployment insurance component – there is no second-tier protection in the form of unemployment assistance, for example. At the same time, able-bodied beneficiaries of social assistance need to prove that they are actively looking for a job in order to qualify for social assistance. However, the weakest link in the current arrangements is the low actual job search activity of the recipients of unemployment benefit, especially those who enjoy extremely generous rights stemming from the pre-2003 Law on Employment and Unemployment Insurance.

According to the law, unemployment benefits are suspended for the duration of a temporary or casual work contract. After the expiry of the contract, unemployed people regain entitlement to an unemployment benefit payment for the remaining period for which the right to benefit is recognised, provided they register and file an application within thirty days. However, a novel incentive was introduced in 2009, allowing a subsidy to benefit recipients who find a new job before the expiry of their entitlement of up to 30 % of their remaining net benefits.

Overall, it could be said that the unemployment benefit system in Serbia is an efficient insurance scheme for the unemployed; but it is much less of a vehicle for their motivation.

## Conclusions

Overall, as shown in the overview of economic and labour market trends, the impact of the economic crisis in Serbia has been rather mild in terms of output contraction, but very severe in terms of job losses. Clearly, job recovery needs to be given absolute priority in any comprehensive medium- or long-term economic growth development strategy.

However, the challenges that Serbia is facing on its road to economic recovery are multi-faceted. If a standard strategic approach is adopted, giving priority to macroeconomic objectives such as price stability, reduction in the fiscal deficit, lowering the level of public debt, improving the trade balance and balance of payments, etc., then there will be little space left to achieve the maximum possible increase in employment. This reasoning is based on past experience. After a decade in which, despite substantial output growth, employment cumulatively fell by at least 800 000 people, all efforts need to be made to reverse this trend.

We are, therefore, of the opinion that employment growth, alongside a reduction in absolute and relative poverty, needs to be defined as an explicit ultimate objective for any development strategy over the next decade. In practice, if there are several alternative strategies that bring about an acceptable level of growth, clear emphasis should be given to a strategy that optimises these two objectives – giving a maximum increase in employment and in improved equality.

This is our main conceptual reservation regarding several of the otherwise sound recovery and reform proposals which have been offered recently. The ‘new growth model’ is a generic expression for a number of proposals which have been developed since the start of the economic crisis in the autumn of 2008 and which seem to reflect a wide ‘diagnostic’ consensus of economic experts in Serbia. In essence, these proposals emphasise the need to make a decisive shift from a consumption-oriented, demand- and import-driven development paradigm to a new, savings- and investment-oriented, supply- and export-driven growth and development model, for all the reasons presented above.

The most comprehensive proposal of this type was put forward within the 300+ pages of the *Serbian Post-Crisis Economic Growth and Development Model 2011-2020* (USAID *et al.* 2010), which was publicly presented and endorsed by the Prime Minister in September 2010. At the same time, the much shorter proposal *Serbia 2020*, endorsed by the President of Serbia in November 2010, expands the essence of the economic strategy developed within the *Post-Crisis Model* in the fields of education, social and regional policy, etc.

Even so, these proposals do not represent what they claim to be – that is, a full break with the development strategy which has been in place up to now – because, among other compromises that they make with the past, they quite conventionally derive employment growth from the overall growth in output, although this time economic growth will, admittedly, be based on healthier foundations. This ‘implicit’ employment strategy has failed in the past decade and may not be fully successful in the coming one either.

The *Post-Crisis Model*, for example, is predominantly concerned with the level of public debt and with the balancing of the fiscal and payment deficits. The stabilisation measures that are recommended by 2015 will, most likely, slow down job recovery because of the arbitrarily set goal of not allowing public debt to surpass the level of 45 % of GDP. Furthermore, fiscal adjustment is expected to be achieved through cuts in public expenditure, but public revenues are planned to remain at the current elevated level in order to reduce the fiscal deficit to 1 % of GDP by 2015. The current level of revenues is dependent on comparatively high taxes on labour, and especially on low-wage labour, so this will slow down the pace of job creation necessary to return to pre-crisis levels and advance toward the labour market goals set for 2020.

A truly alternative strategy would have to assess the preconditions for sustainable, employment-maximising and equity-improving economic growth, which would be able to secure convincing convergence toward the corresponding economic and social indicators of the European Union by 2020. True, such an approach is present in the Employment Strategy of Serbia for 2020, passed by the government in May 2011, but, to make the full impact, it should be integrated into the overall development strategy of Serbia.

Therefore, the two key questions which should be explicitly answered by any long-term job recovery strategy should be: firstly, what employment policy is optimal for an employment-maximising period of economic growth? And, secondly, what labour market institutions and configurations are optimal for an employment-maximising period of economic growth?

Under employment policy we consider all those sectoral economic policies which have an impact on employment – from fiscal, monetary and exchange rate policies, to industrial, foreign trade, regional, educational and SME development policies, etc. Under labour market institutions, we consider all those rules, regulations and policies which have a direct impact on the way the labour market operates, such as minimum wages; collective bargaining and social dialogue; labour taxation rules; working time regulations; the employment protection regime; migration policy; retirement policy; social welfare policy; unemployment benefits; active labour market policy; etc.

In any case, social dialogue is more than just one of the institutions or policies which aim to improve labour market indicators. Rather, it should be a very important encompassing instrument around which consensus on other aspects of economic and employment policy may be reached. For this to happen, measures to re-legitimise and empower unions and employer organisations are needed – from symbolic steps by the government to a legal widening of the remit of the social dialogue institutions.

In terms of employment policy measures, it is more important to create the pre-conditions for a revival in job creation than to stick to artificially-created rigid rules such as, for example, the capping of the allowed level of public debt which, in any case, cannot be adhered to for more than a year or two. However, a moderate level of fiscal deficit should be tolerated only if it is achieved because of substantial parallel cuts in public expenditure and in public revenues. The cut in public revenues is important because it should provide a much needed release to businesses as well as a means of recovering investment sentiment. On the labour market institutions side, this cut would mean lower labour taxes; more specifically, much lower tax wedges for low-wage

workers and general cuts in social security contributions. Partial compensation for lost revenues should be achieved by introducing progressive income taxation of the western European type which would, in Serbia, have an added value, serving as an effective tax-based incomes policy against excessive wage claims in the public sector.

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