



EMPLOYMENT AND SOCIAL AFFAIRS PLATFORM

# LABOUR MARKETS IN THE WESTERN BALKANS

Performance, Causes and Policy Options

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Performance, Causes and Policy Options

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# Labour Markets in the Western Balkans:

## Performance, Causes and Policy Options

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Sarajevo, 2018

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\*This designation throughout this document is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence

# Executive summary

Improving the effectiveness of the labour market is one of the greatest challenges for economic and social development in the Western Balkan region. Despite recent improvements in the labour market situation and a steady increase in the number of jobs that have been created in the region in the last five years, employment and activity rates remain relatively low, and unemployment rates relatively high, in comparison with the situation in most EU economies. Youth unemployment and inactivity, women's inactivity and the share of the long-term unemployed in total unemployment are especially high. Besides employment levels and trends, the quality of jobs is also a challenge, given the widespread informal economy in the region. Labour Force Surveys show that in Montenegro, Serbia, and The Former Yugoslav Republic of Macedonia, one in five employed people works in the informal economy, and in Albania one in three of those employed in the non-agricultural sector does so. These people are mainly recruited from poorer social strata, have limited access to social insurance and social protection, often earn less than others and do not contribute to social funds that provide access to social entitlements.

Institutions of the labour market play an important role in determining labour market outcomes. Fortunately, reforms that have taken place during the transition period in most of the six Western Balkan (WB6)<sup>1</sup> economies have reduced redundancy costs and increased the flexibility of wage negotiation systems. The WB6 economies have made progress in increasing the flexibility of labour markets and reducing the restrictiveness of employment protection legislation, although differences between the economies remain. Most economies in the WB6 region have implemented reforms to improve the

business environment and ease the entry of new firms, and most have progressed in the ease of doing business. However, firms' survival and growth is weak and hence job creation is low. The WB6 economies should do more to unlock the development potential of competitive companies and to support companies to improve their business sophistication.

Labour supply conditions are unfavourable throughout the region. The region mainly faces low fertility rates and negative natural growth, emigration and ageing. The natural growth rate of the population is negative in Bosnia and Herzegovina and Serbia, while in Albania and Kosovo\*, natural population growth has been offset by migration. The migration rate is high in all economies, and over the past two decades almost one quarter of the population has left the region. As a result, the population of the region is shrinking and ageing.

In the context of a low supply of labour the quality of labour supply is especially important. However, the supply of skilled labour is inadequate. The poor quality of education is a major cause of the high youth unemployment rate. Many young people, especially those from poor families, stay out of education or drop out of education too early. This suggests that the improvement of skills through life-long learning programmes is an important policy issue. Specific problems face the education systems at both secondary and tertiary levels. Vocational school graduates are disproportionately represented among the unemployed and generally find it difficult to get a job. The poor quality of education is largely a consequence of the lack of formal relations between secondary schools and companies. At the same time, the quality and effectiveness of higher education

systems in the WB6 region is low. Students in higher education do not accumulate sufficient human capital, leading to large skill gaps especially in the field of interactive skills. In the absence of an adequate policy response, such skill gaps are expected to increase in the future. It is therefore crucially important that the supply of skilled labour should be increased through improvements to education systems, both at secondary school and at higher education levels. This should be based on curriculum reform, improvements in teaching quality based upon incentives and training programmes to stimulate educators' productivity, and on a closer interrelationship between education institutions and the business sector. In this respect, the importance of work-based learning for secondary school students along the lines of the Serbian programme for cooperative education based on the German dual education approach is a best practice example that should be diffused throughout the region. Correspondingly, at tertiary level, measures to encourage university-business cooperation should be introduced or scaled up to ensure that university students and graduates have opportunities for periods of internship or project work within companies. At the same time, the business sector should be included in decision-making processes in university management systems in order to modernise curricula and to improve the relevance of teaching methods to the needs of the business sector.

Alongside the inadequate supply of labour, the demand for labour is also problematic and the labour markets have failed to generate a sufficient number of jobs or resolve structural problems such as frictional and structural unemployment. The main determinants of the demand for labour are the business cycle, investment, the cost of labour, and structural change in the economy. Political instability in the entire WB6 region, and the inability of political decision makers to define and implement integrated medium-term reform strategies, has hindered job creation and economic development. It has reduced domestic investment and FDI inflows leading to a low demand for labour, although FDI inflows appear to have raised productivity before the on-

set of the economic crisis. Labour costs in the region are relatively low and provide an attraction factor for FDI, which has been on an increasing trend in recent years. Wage bargaining institutions are becoming more cooperative and less confrontational than in the past, which supports the growth of labour demand. Finally, structural change has had a major impact on the nature of the demand for labour. With the transition to a service economy, the main challenge now is to move the economies towards more high-skill knowledge-intensive sectors of production and services than in the past.

The encouragement of investment by the business sector is of crucial importance in raising the demand for labour and improving productivity. Investment that is linked to manufacturing and to integration of the region into global value chains can be especially important in this respect. This would require the economies of the region to adopt effective measures to attract FDI. In order to make a success of such a policy, it is critically important to ensure that there is a positive spillover from FDI activities into the local economy in the form of job creation, skill development and technology transfer. Therefore, governments should ensure that they have policies in place to develop the local supply base. Such policies should be designed to ensure that the inputs into the production processes of foreign multinationals are supplied by local companies, which could have an important multiplier effect on local economies in generating new demand for highly skilled jobs.

Employment policy has traditionally been passive rather than active throughout the region, although recent policy reforms have promoted the idea of active labour market policies. However, the expenditure on these policies remains relatively low in comparison with EU averages and this is an area that should be developed much more in the future to support both the supply and demand sides of the labour market, supporting the creation of a job-friendly growth model, the continuing reduction of unemployment, and improvements in the quality of jobs in the region.

<sup>1</sup> The term WB6 refers to the six economies of the Western Balkans: Albania, Bosnia and Herzegovina, Kosovo\*, Montenegro, Serbia and The Former Yugoslav Republic of Macedonia

# 1 Introduction

The main aim of this report is to present an analysis of trends in the WB6 labour markets since 2010 and provide recommendations for improving labour market conditions. The report focuses on conditions for job creation and factors leading to the employment problems of the region. The approach rests on the assumption that conditions for labour supply and demand affect the labour market and job creation. For example, an unfavourable business environment or a poorly developed private sector might constrain the demand for labour. On the supply side, low employability of part of the labour force may lead to structural unemployment coexisting with job vacancies. Deficits in the education system may hinder the matching of labour supply and demand. The report is based on economic theory and empirical evidence of special relevance to labour markets. This is a joint endeavour of researchers from the region and is the first comparative analysis of this kind covering recent years and made available to the regional and international audience in the English language.

The report is structured as follows. Section 2 presents a brief review of the main indicators, trends and characteristics of the labour markets in the WB6 economies. Particular attention is given to the analysis of specific target groups, such as youth, women, informally employed, and low-skilled individuals. Secondly, it analyses in more detail the sector specific conditions for labour demand and the key sectors for employment generation, including the role of the public sector and public-private wage differentials. Section 3 discusses the role of the institutional framework and the regulatory environment in supporting labour markets in the WB6 region.

Sections 4 and 5 cover the supply and demand for labour in the WB6 economies. Section 4 focuses on labour supply, addressing demographic trends and migration. It also analyses the educational system in the WB6

economies, the qualifications of the labour force and the extent of skill mismatches that affect employment and labour market developments. It addresses the major challenges that prevent the education systems from providing an adequate supply of skilled labour. Section 5 focuses on the demand for labour. It first presents the key factors determining employment generation, focusing on the business cycle, labour costs, tax and benefit systems, wage setting process, and the role of structural change in shifting the demand for labour over time. The analysis is mainly based on a review of government reports and previously published studies. Section 6 reviews labour market policies, particularly related to active labour market policies (ALMPs). Section 7 provides conclusions and some policy recommendations.

# 2 Labour market performance

This section presents the current situation on the labour market by analysing key labour market indicators for the WB6 region. They show similar characteristics and trends for each economy including persistently low activity and employment rates.

## 2.1 Labour market participation and activity rates

Labour force participation rates (activity rates) have been relatively low over the period from 2010-2016, due to the low activity rates of women, young people and less well-educated people.<sup>2</sup> In some economies, female activity is only half the male inactivity rate. The lowest participation in the labour market is among young people (15-24 years). Female labour force participation rates are extremely low, indicating gender inequalities in the labour market and a potentially high level of gender discrimination. The overall inactivity rate in the WB6 was 40% in 2015 and thus considerably higher than in the EU (World Bank & WIIW, 2017). The share of people outside the labour market was highest in Kosovo\* (61.8%) and Bosnia and Herzegovina (45.4%) and lowest in Albania and The Former Yugoslav Republic of Macedonia, where it was close to 36% in each economy. Inactivity among young people is even higher for those with low education. There are several explanations for this including subdued economic growth and high migration.

## 2.2 Employment

Over the entire sixteen year period from 2000 to 2016, total employment fell by -1.7%, from 6,608,000 to

6,496,000.<sup>3</sup> The absence of overall employment growth despite the general improvement in economic conditions (with the exception of the crisis period) is a remarkable phenomenon that requires some discussion. Figure 1 presents data on the change in the total number of jobs in the WB6 economies since 2010 (with the exception of Kosovo\* for which data are not available for the entire period). Over the whole period from 2000 to 2016, two economies experienced an overall expansion in the number of jobs (Montenegro at 28.1% and The Former Yugoslav Republic of Macedonia at 18.2%), while two experienced an overall decline in the number of jobs (Bosnia and Herzegovina at -4.1% and Serbia at -9.5%). Albania experienced a modest increase in jobs of 8.9% over the whole period.

The economic growth that took place over the period of economic boom from 2000 to 2008 was effectively “jobless growth”. In the WB6 region, although average growth rates of real GDP were around 5% per annum, total employment in the WB6 region as a whole fell from 6.6 million to 6.5 million. During the period of greatest impact of the economic crisis from 2008 to 2011, employment levels in the WB6 region fell by 588,000, equivalent to a fall of -8.8% in the total employment. The situation recovered over the subsequent five years and by 2016 total employment had again reached 6.5 million, representing an increase of 8.9% over the period 2012-2016. A significant proportion of this increase took place among older workers aged 55-64, as this age group has experienced considerable population growth. Employment also increased among the highly educated, suggesting that higher education is a pathway into stable employment. In the years of rapid economic growth

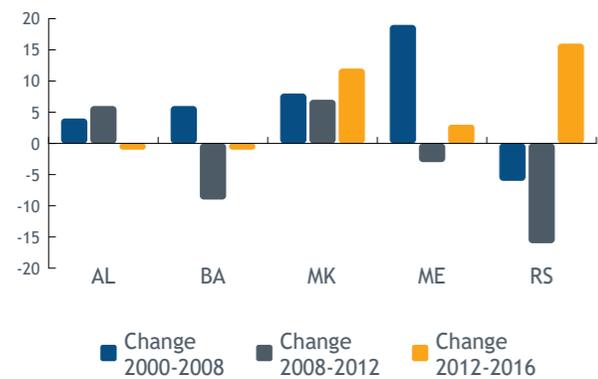
<sup>2</sup> The labour force participation rate, also known as the activity rate, is the ratio between the active labour force and the total working age population

<sup>3</sup> These data are taken from the ILO online database, but do not include Kosovo\* for which longitudinal data on employment is not available.

from 2000 to 2008, employment growth was relatively high in Montenegro and The Former Yugoslav Republic of Macedonia. Elsewhere, employment growth was more modest and there was a net reduction in the number of jobs in Serbia connected to the delayed process of privatisation that began after 2000.

During the period of economic crisis from 2008-2012 the number of jobs continued to fall dramatically in Serbia and also fell in Bosnia and Herzegovina and Montenegro. In contrast, Albania and The Former Yugoslav Republic of Macedonia managed to weather the crisis, maintaining job growth at 5% overall. Since 2012 the economies have begun to recover from the crisis and job growth has taken off in Serbia and continued at a respectable rate in The Former Yugoslav Republic of Macedonia. However, even in this recovery period employment growth stagnated in Albania, Bosnia and Herzegovina and Montenegro.

Figure 1: Net job creation between 1993 and 2015



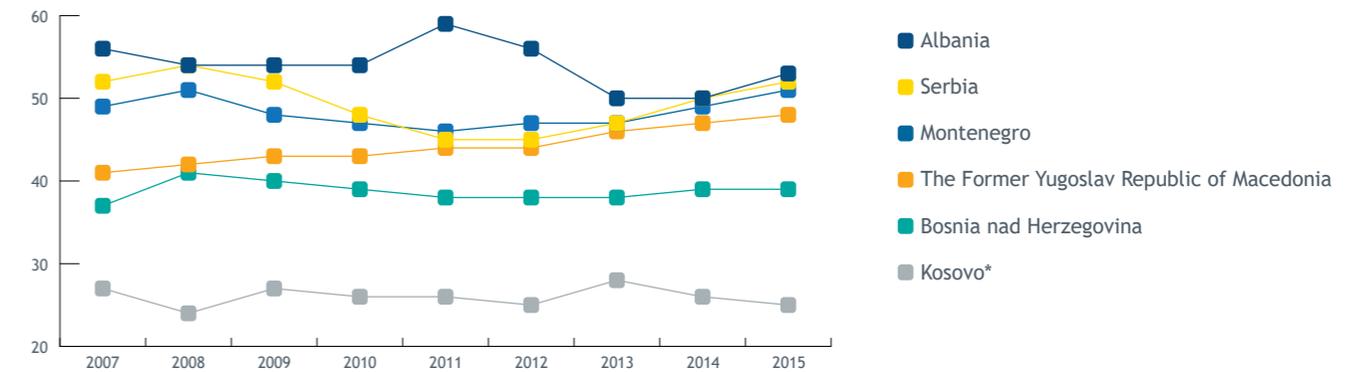
Source: ILO online data. Note: Data refer to total job change including employment and self-employment. Data for Kosovo\* are not available for the whole period and from that data source.

How can these diverse patterns of job growth be explained? Firstly, the period of rapid economic growth

after 2000 had a positive effect on job growth in most economies except Serbia where privatisation was delayed and only began to take off after 2000, leading to widespread layoffs. Second, the economies most affected by the economic crisis experienced the most adverse impact on jobs, while those least affected saw jobs continuing to increase in number between 2008 and 2012 (Albania and The Former Yugoslav Republic of Macedonia). Thirdly, in the recovery phase, since 2012, job growth has been surprisingly muted except in Serbia, which may reflect the stultifying effect of austerity policies on public sector job growth. It is notable that Serbia only began to apply genuine austerity policies following the Stand-by Agreement with the IMF in 2015, and so we may expect that rapid job growth that Serbia has experienced since 2012 may slow down as these policies begin to take effect.

Changes in the number of jobs created are reflected in the employment rate. As can be seen from Figure 2, the employment rate fell in several economies (Bosnia and Herzegovina, Montenegro and Serbia) in the period after the onset of the economic crisis, but has recovered somewhat since 2012. The overall ranking of the economies has stayed the same, with the highest employment rate in Albania and the lowest in Kosovo\*. The average employment rate of 15-64 year olds in the WB6 region was just 44.8% in 2015, and around 52% in the top three performing economies (Albania, Montenegro and Serbia). Even in the latter economies the employment rate is far below the average employment rate of 15-64 year olds in the EU, which was 65.6% in the same year. The female employment rate is particularly low in Kosovo\* (11.9%) and in Bosnia and Herzegovina (29.5%). In Kosovo\*, it is lowest for young women (15-24 years), at 3.8%, and highest for women aged 25-54 years, at 16%. Women with low education have the lowest employment rate at 3.8%, compared to 43.2% for highly educated women. Similar patterns of female employment rates are observed in Bosnia and Herzegovina.

Figure 2: Employment rates in the WB6 economies, 15-64 years of age



Source: Eurostat online data variable code [cpc\_siemp]

The problem of low employment rates is a critical problem for the Western Balkans economies as it implies a large untapped pool of human resources that could be brought into effect to boost economic growth and prosperity, and is a sign of allocative inefficiency in these economies. The positive aspect of this is that measures can be taken to reduce structural unemployment and raise employment rates using active labour market policies, and these can be relatively easy to introduced given the requisite political will.

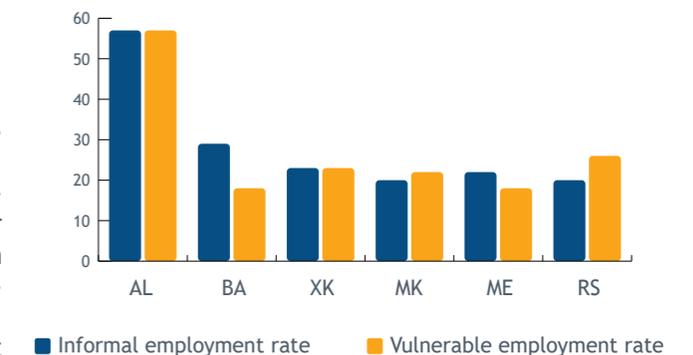
### 2.2.1 Informal Employment

The WB6 economies have relatively high shares of informal employment in total employment (see Figure 3). Informal employment is high among the most vulnerable groups, such as young people, women and the older age groups. Informal workers are subject to exclusion and vulnerability, and informal employment has a persistent, forced and occasionally desperate character. Unpaid family employment accounts for a significant share of informal employment in most WB6 economies.

Labour force surveys do not always contain appropriate questions to clearly identify informal employment based on the ILO definition (Krstić and Gashi, 2016). Consequently, vulnerable employment, comprising un-

paid family members and self-employed without employees, are used as a proxy for informal employment in Albania and Kosovo\*. Furthermore, informal employment in Kosovo\* is underestimated compared to other economies since Kosovo\* does not report on the labour force over 64 years of age, for whom informal employment rates are relatively high.

Figure 3: Informal employment and vulnerable employment rates



Source: Adapted from Krstić and Gashi, 2016. Data on informal employment: 2014 LFS for Bosnia and Herzegovina; 2015 LFS for Kosovo\*, the Former Yugoslav Republic of Macedonia, Serbia and Albania. Data on vulnerable employment relate to 2014, KILM 9th Edition, ILO.

More men than women are informally employed (55% vs. 45%) in Serbia, but women are more likely to be in informal employment. In Bosnia and Herzegovina and The Former Yugoslav Republic of Macedonia, men account for nearly two thirds of informally employed persons, and compared to women and they are also more likely to be informally employed due to the higher share of men engaged in agriculture. In Kosovo\* and Montenegro men are also more likely to hold informal jobs, while in Albania there is no gender difference.

The oldest and youngest workers are most likely to be informally employed in Bosnia and Herzegovina, Montenegro, Serbia and The Former Yugoslav Republic of Macedonia (Krstić and Gashi, 2016). Among the working age population (15-64 years old), young people (15-24 years old) are most likely to be informally employed. Youth informality rate ranges from 38.6% in The Former Yugoslav Republic of Macedonia to 30.8% in Serbia. The next age group more exposed to informal employment are workers between 55-64 years old. All this suggests that those most likely to engage in informal employment are at the margin of the labour market, namely the youngest, who have just entered it, and the oldest, who are about to leave it.

The rate of informal employment varies inversely with the level of education. The highest rate of informality among low-educated workers is in Bosnia and Herzegovina, where around 86% of workers with no education and 62% of those with only primary education work informally. Serbia has the lowest informality rate among workers with tertiary education and Montenegro has the highest. Workers with primary or lower education and those employed in agriculture are more exposed to informal employment in Albania, Bosnia and Herzegovina, Montenegro and Serbia. In all economies, informal employment is most prevalent in agriculture, since unpaid family workers, who are by definition informal, are mostly concentrated in this sector. In Albania and Serbia, informal workers account for about two thirds of all workers in agriculture.

### 2.2.2 Public sector employment and wage premiums

Given the scarcity of well-paid formal jobs in the private sector, public sector employment has traditionally been considered a privilege in the WB6 economies (Arandarenko, 2016). Public sector jobs pay higher wages (at least at entry level), provide better working conditions including the protection of workers' rights, and require less effort and overtime work compared with private sector employment.

Table 1: Public sector shares of employment and wages

	Share of public sector employment <sup>a</sup>	Share of public sector wage bill in total government expenditure <sup>b</sup>	Share of public sector wage bill in GDP <sup>c</sup>
Albania	16.6%	24.2%	6.9%
Bosnia and Herzegovina	30.2%	27.5%	10.6%
Kosovo*	32.6%	28.0%	8.0%
Montenegro	30.4%	26.9%	9.3%
Serbia	28.4%	24.7%	9.8%
The Former Yugoslav Republic of Macedonia	22.4%	18.6%	5.9%
<b>OECD Average</b>	<b>22.0%</b>	<b>14.7%</b>	<b>5.4%</b>

Sources: (a) Vladislavljević et al. (2016) and for Montenegro LFS 2015 and Tax Administration data; (b) Albania and Kosovo\* (Shehaj et al, 2015), Bosnia and Herzegovina (Djukić, 2009), Montenegro, Serbia and The Former Yugoslav Republic of Macedonia (Avlijaš et al, 2013); (c) World Bank data except for Kosovo\* (based on Ministry of Finance data) and Montenegro (based on Ministry of Finance data).

The most striking indicators of public sector privileges are the size of public sector employment and the public sector wage bill in comparison with the average for OECD countries (see Table 1). The Former Yugoslav Republic of Macedonia is the only country with similar size of public sector employment and a comparable public sector wage bill to the OECD economies. In contrast, Bosnia and Herzegovina, Kosovo\* and Montenegro have relatively large public sectors.<sup>4</sup> Of course, having a relatively large public sector sizes not imply any judgement about relative efficiency of the public sector. The more wealthy countries of the OECD are likely to have lower share of public sector employment simply because wages are higher relative to capital, and it is more costly to employ public employees rather than replacing their

jobs with computers and other labour-saving machinery. In contrast, in the WB6 economies where labour costs are relatively lower, it may make good sense to employ relatively more people in the public sector than is the case in the OECD.

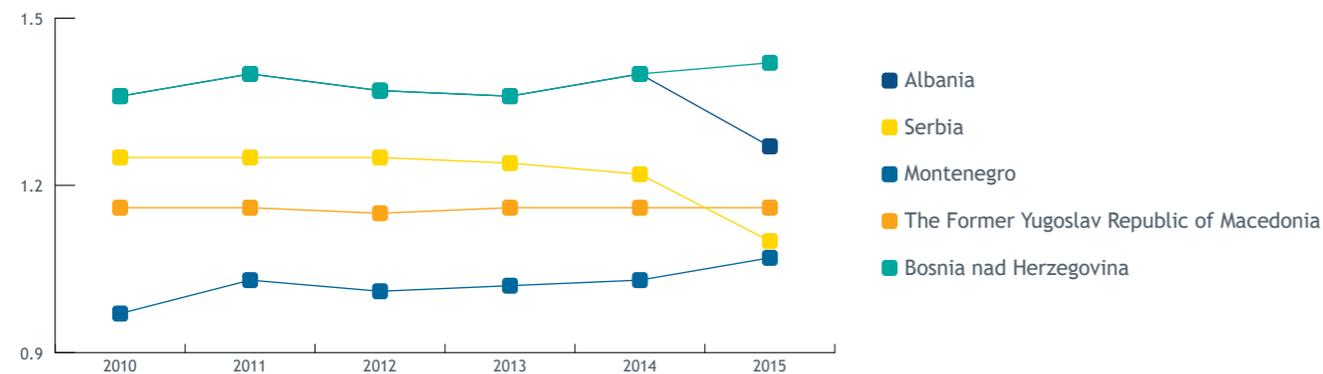
The public sector wage premium in the WB6 region is higher than the EU average (Vladislavljević et al., 2016). Moreover, the difference between public and private sector wages is greater for lower wage earners in each economy. Unlike private sector wages, which are mainly determined by market forces, wages in the public sector are set by political decisions. Governments often set wages for low-skilled workers in the public sector above the wages in the private sector in order to gain political support (Giordano et al., 2011).

The relative average net wage in public administration is especially high in Bosnia and Herzegovina, where it averaged around 1.4 over the period from 2010-2015 (see Figure 4). It has been the lowest in Montenegro where the relative wages in the public sector have been

<sup>4</sup> The reasons for this differ. In the case of Bosnia and Herzegovina is partly due to the complex territorial organization and institutional setting.

more or less on a par with the private sector, though having a tendency to increase over time. In both Albania and Serbia the relative average net wage in the public sector began to fall in 2014.

Figure 4: Relative average net wage in public administration, 2008-2015



Source: Adapted from Vladislavljević et al, 2016, based on data from national statistical offices of WB6. Note: data for Kosovo\* are not available. The Figure compares the average levels of the public sector wages in the economies, expressed as the ratio of the public sector wages to the average wage.

The differences in wages between the public and private sectors have policy implications, since inequality of wages in the two sectors causes distortions on the labour market (European Commission, 2014). Higher wages in the public sector, together with better working conditions, may result in a “brain drain” of talented and innovative persons to the public sector, which could result in distorting incentives for skill acquisition and thus potentially impede the pace of economic growth and structural transformation of the economy. Moreover, it may complicate the transition of young people to the labour market by extending the duration of unemployment, since they may delay searching for a job in the private sector in the hope of getting a public sector job.

## 2.3 Unemployment

Unemployment in the WB6 region has declined by 200,000 people from an estimated 1.7 million in 2010 to 1.5 million in 2016, although it is not clear how many these people made the transition from unemployment to employment rather than to inactivity (World Bank and WIIW, 2017). As a result, the average unweighted unemployment rate decreased from 23% in 2010 to 21% in 2016. The unemployment rate in 2016 was highest at 25.4% in Bosnia and Herzegovina and lowest at 17.1% in Serbia. Gender differences in unemployment rates are less evident because women are more likely to be outside the labour force. The decline in unemployment rates was especially high for low and medium skilled persons, with differences between economies. Long-term unemployment accounted for about two-thirds of unemployment over the period 2010-2016, being at the level of 85% in Bosnia and Herzegovina in 2015. It was also high in Montenegro (78%) and The Former Yugoslav Republic of Macedonia (84%). Between 2010 and 2016, long-term unemployment only fell in Albania and Serbia, although it still accounted for about two-thirds of

total unemployment. When we look at the gender differences, we can see that the figures for women were very close to that of men in Bosnia and Herzegovina, Montenegro and Serbia, whereas they were higher in Albania, Kosovo\* and The Former Yugoslav Republic of Macedonia.

Youth unemployment is particularly high in the WB6 region compared to the EU. A recent report on youth employment in the Western Balkans (World Bank 2016) finds that many young people are in the NEET (not in Education, Employment, or Training) category, and that young women in particular have a weak attachment to the labour market. Moreover, young people experience very long transitions from school to work. Available data show that, on average, it takes 21 months for a young person in Montenegro to find their first job (Djurić, 2016), 24 months in Serbia (Marjanović, 2016) and 25 months in the Former Yugoslav Republic of Macedonia (Mojsovska-Blazevski, 2016). The labour market outcomes of young people are closely linked to the business cycle, leading to higher job losses during downturns, but job gains during period of economic upswing. This can be explained by the fact that youth employment represents a more flexible segment of the labour market, with a higher share of temporary contracts and informal employment. Reforming labour regulations could have a positive impact on youth employment, but there are also other important constraints, like skills mismatches, low levels of entrepreneurship skills and access to productive inputs such as finance for self-employment, as well as social norms and attitudes particularly regarding child care responsibilities for women.

## 2.4 Summary

The evidence presented above suggests that some positive trends can be observed in the labour market situation in the WB6 region, as unemployment rates have recently begun to decline (with the exception of Albania), while employment has begun to increase. The de-

cline in unemployment rates has been greater for low and medium skilled workers. However, despite these positive trends, a number of issues remain the subject of concern. The labour market participation of women, young people and people with lower levels of education is inadequate. Women generally have lower rates of activity than men, while the activity rate of young people is also low, especially for those with lower levels of education. At the same time, youth unemployment is unacceptably high. Labour market outcomes of young people are closely linked to the business cycle, leading to higher job losses during downturns, and high job gains during upswings. About two-thirds of total unemployment is accounted for by long-term unemployment, with young people being over-represented in this category. Gender differences in unemployment rates are less evident because women are more likely to be outside the labour force. Informal employment is predominant among the most vulnerable groups, such as young people, women and the older age group, with the exception of The Former Yugoslav Republic of Macedonia where men are more affected by informal employment than women. The public sector employs a large share of the available labour force in most WB6 economies. By offering higher wages, at least for entry level jobs, better working conditions including protection of workers’ rights, and requiring less effort and overtime work compared with the private sector, it attracts “the best and brightest”, creates queues for jobs in the public sector, and consequently delays young people’s transition to the labour market.

### 3 Institutional framework

The legal environment and institutional framework are important for labour market performance. Most economies in the WB6 region have implemented reforms to improve the business environment and ease the entry of new firms. Although there has been some progress in terms of easing the market entry of firms, there has been less progress in improving firms' survival and growth, which are important for job creation (Mojsoska-Blazevski, 2016). Kovtun et al. (2014) identify three groups of factors to explain low levels of job creation in the WB6 region since 2000 including i) labour market institutions which affect the matching process and the adjustment capacity of firms, ii) cost factors that prevent wages to adjust downwards to reflect the over-supply of labour, and iii) structural factors which accompany the transition of the WB6 economies and their association to the EU, including industrial and SMEs policies. We extend the analyses to additional factors affecting labour demand.

In this section we present a set of available indicators related to the progress of WB6 economies towards EU integration, indicators about the quality of governance, and ranking of countries in global indices on governance and competitiveness. One of the indicators of improvement in the legal and institutional environment is the degree of progress towards EU integration, based on criteria for the establishment of functioning market economies. Since 2015, EU progress reports examine the state of play and progress of the economies. Table 2 shows large variations between the economies and within economies in the three areas in which the assessment was made: public sector reform, rule of law and economic criteria. The Former Yugoslav Republic of Macedonia and Montenegro are the most advanced in their reforms, whereas Kosovo\* is the least advanced.

Table 2: Progress in EU accession

		Albania	Bosnia and Herzegovina	Kosovo*	Montenegro	Serbia	The Former Yugoslav Republic of Macedonia
Public sector reform		3	1	2	3	3	3
Rule of law	Legal system	1	2	1	3	2	2
	Fight against corruption	2	2	1	2	2	2
	Fight against organised crime	2	2	1	2	2	2
Economic criteria	Functioning market economy	3	1	1	3	4	3
	Ability to cope with competitive pressure and market forces within the Union	2	1	1	3	3	3

Source: Mojsoska-Blazevski (2016), based on the 2015 Progress Report for each EU Candidate country. Note: Early stage - Some level of preparation - Moderately prepared - Good level of preparation - Well advanced

As the above table shows, none of the WB6 economies have yet managed to establish a functioning market economy even 25 years since the start of transition process.

A further set of indicators is taken from rankings of WB6 countries in relevant worldwide indices (see Table 3). As can be seen, the economies of the WB6 perform relatively poorly on the Global Competitiveness Index, showing bottlenecks in some important aspects of the competitiveness. They have further to go to unlock their development potential and to support companies in improving their business sophistication. Furthermore, the ranking of all WB6 countries are rather low in the Transparency International's Corruption Perception (CPI) Index, the Heritage Foundation's Index of Eco-

nomics Freedom. On the other hand, in the case of the World Bank Ease of Doing Business Ranking, The former Yugoslav Republic of Macedonia is among the best performing economies in the world.

**Table 3: Selected rankings of WB6 economies**

	Albania	Bosnia and Herzegovina	Kosovo*	Montenegro	Serbia	The Former Yugoslav Republic of Macedonia
Global Competitiveness Report 2016 (out of 138 economies)	80	107	-	82	90	68
Transparency International Corruption Perception (CPI) Index 2016 (out of 176 economies)	83	83	95	64	72	90
The Heritage Foundation Index of Economic Freedom (out of 186)	59	108	84	65	77	47
World Bank Ease of Doing Business Ranking (out of 190 economies)	58	81	60	51	47	10

Sources: <https://www.weforum.org/reports/the-global-competitiveness-report-2017-2018>; <https://www.transparency.org/research/cpi/overview>; <http://www.heritage.org/index/>; <http://www.doingbusiness.org/rankings>

**Table 4: Efficiency and effectiveness of WB6 governments, 2016**

	Albania	Bosnia and Herzegovina	Kosovo*	Montenegro	Serbia	The Former Yugoslav Republic of Macedonia
Government effectiveness**	0.00	-0.43	-0.44	0.10	0.09	0.09
Government efficiency	3.9	3.1	-	3.9	3.4	3.7*
Labour market efficiency	4.0	3.5	-	4.2	4.0	4.1*

Sources: “Government effectiveness” indicator from the World Bank database: <http://info.worldbank.org/governance/wgi/index.aspx#home>; “Government efficiency” and “Labour market efficiency” indicators from the World Economic Forum database: <http://reports.weforum.org/global-competitiveness-index/downloads>.

Note: \* Data for 2015, since data for 2016 are not available. \*\* The estimated value of the indicator is presented in units of a standard normal distribution, i.e. ranging from approximately -2.5 to 2.5.

Another set of indicators measures the quality of governance using different indicators, including government effectiveness (see Table 4). The indicator “perception of government effectiveness” is especially low in Bosnia and Herzegovina and Kosovo\*. The government effectiveness indicator includes quality of public services, quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation and the credibility of the government’s commitment to such policies. The perceptions of government efficiency are calculated on a scale 1 to 7, where 1 corresponds to the worst possible outcomes and 7 corresponds to the best possible outcomes.<sup>5</sup> The scores for the WB6 economies are less favourable than in most EU economies. By this indicator, three of the WB6 economies are around the middle of the list of economies, with average ratings of 3.6 and 3.7. The other three economies are near the bottom of the list. The scores of the perceptions of labour market efficiency follow a similar pattern. All WB6 economies appear to rank relatively low on the index of labour market efficiency, with Montenegro ranked best at 74th place.<sup>6</sup>

in the WB6 economies was very strict at the beginning of the transition and may have slowed the reallocation of labour, following recent labour market reforms most WB6 economies have reduced redundancy costs and increased the flexibility of wage negotiation systems. In the most recent rankings of the Global Competitiveness Index (GCI), Serbia ranks 17th and Bosnia and Herzegovina at 28th place in the world out of 138 economies, while Albania has made less progress with reforming EPL and is ranked at 95th place (Global Competitiveness Report 2015). The GCI index of labour market flexibility ranks The Former Yugoslav Republic of Macedonia at 33rd place and Montenegro 48th, while Bosnia and Herzegovina is on the 101st place and Albania and Serbia close to 90th place. These data show that there has been some progress in terms of increasing the flexibility of the labour markets and making EPL less restrictive, although there are differences between the economies in the region. However, there is no clear evidence that less strict EPL brings higher job creation.

### 3.1 Employment protection legislation

Employment protection legislation (EPL) can affect both labour supply and labour demand. Strict EPL restricts hiring and firing workers, and hinders firms’ adjustment to shocks through changing the level of employment. On the supply side, strict EPL may inhibit workers from switching jobs and can cause long-term unemployment, although few studies find evidence for such an effect. Although it has been argued that EPL

<sup>5</sup> More details about calculation of these indicators are available at <http://reports.weforum.org/global-competitiveness-index-2017-2018/appendix-a-methodology-and-computation-of-the-global-competitiveness-index-2017-2018/>.

<sup>6</sup> Using a regression analyses based on 32 European economies (including the WB6 economies), Mojsoska-Blazevski and Kurtisi (2012) found that an increase of 1 unit in labour market efficiency would bring about an increase of employment rate by 7.8 percentage points

**Table 5: OECD indicators on employment protection legislation**

	Year	Protection of permanent workers against individual and collective dismissals
Albania	2015	2.49
Bosnia and Herzegovina	2015	2.58
Kosovo*	2014	2.08
The Former Yugoslav Republic of Macedonia	2015	2.29
Montenegro	2013	2.88
Serbia	2015	2.23
OECD	2013**	2.27

Source: OECD/IAB Employment Protection Database, 2013 update: [www.oecd.org/employment/protection](http://www.oecd.org/employment/protection). Note: For all economies: scale from 0 (least restrictions) to 6 (most restrictions), most recent year available. \*\* 2014 for Slovenia and United Kingdom, no data for Germany and Portugal.

Table 5 compares the employment protection in the WB6 region, according to OECD Employment Protection Legislation indicator. The indicator is based on 21 items classified in three main areas: (i) protection of regular workers against individual dismissal, (ii) regulation of temporary forms of employment and (iii) additional, specific requirements for collective dismissals. Each item is assessed on a scale 1-7, where 1 means less and 7 more employment protection, using review of national legislation. According to these data, the easiest dismissals of private sector workers are in Kosovo\*, where the level of protection is significantly lower than the OECD average. For Serbia and The Former Yugoslav Republic of Macedonia, the employment protection is at the average OECD level, while in Albania, Bosnia and Herzegovina and especially Montenegro, private sector employers face more difficulties to dismiss their workers.

### 3.2 Summary

The legal environment and institutional framework are important for labour market performance. One of the indicators of improvement in the legal and institutional environment is the degree of progress towards EU integration, based on criteria for the establishment of functioning market economies. However, in official EU reports, none of the economies are yet classified as functioning market economies. The WB6 economies also experience bottlenecks in important aspects of the competitiveness and have further to go to unlock their job creation potential. Moreover, government effectiveness appears to be relatively weak in the WB6 economies, which may explain to some extent the inability of governments in the region to introduce effective job creation measures. Perceptions of government efficiency and labour market efficiency are below the perception scores in most EU economies.

However, substantial progress with institutional reforms for the labour market has been made in recent years. It has often been claimed that employment protection legislation in the WB6 economies was quite protective of workers at the beginning of the transition, which may have slowed down the reallocation of labour. How-

ever, under recent reforms, most of the WB6 economies have reduced redundancy costs and increased the flexibility of wage negotiation systems. The WB6 economies have increased the flexibility of their labour markets

and made EPL less restrictive, although there are differences among the economies. Moreover, there is no clear evidence that less strict EPL causes higher rates of job creation.

# 4 Labour supply

This section analyses the supply of labour and its quality in the WB6 economies. First, the demographic features of the economies are discussed, emphasising the role of labour force ageing and migration. Secondly, the section considers the supply of skilled labour from the education systems in the region.<sup>7</sup>

## 4.1 Demographic trends

Demographic trends in the WB6 region are driven by a natural decrease in population, which is consequence of an adverse age structure, and migration. Some key demographic indicators are presented in Table 6.

Table 6: Selected demographic features, of the WB6 economies, 2015

	Albania	Bosnia and Herzegovina	Kosovo*	The Former Yugoslav Republic of Macedonia	Montenegro	Serbia
Estimated population size (million)	2.89	3.82	1.77	2.07	0.62	7.11
Natural growth rate (%)	3.7	-1.5**	12.4	1.3	1.7	-5.4
Net migration plus adjustment (per 1.000)	-5.9	0.0**	-31.1	-0.2	-1.5	0.0
Total fertility rate	1.67	1.24	2,2 <sup>1</sup>	1.50	1.74	1.46
Share of the elderly (65+) (%)	12.4	15,8 <sup>1</sup>	6,8 <sup>1</sup>	12.7	13.7	18.5

Sources: Eurostat online database and Agencija za statistiku Bosne i Hercegovine, 2016; Note: \*\* 2014

According to UN projections, population will decrease in the WB6 economies until 2050, with the greatest declines occurring in Bosnia and Herzegovina and Serbia. The share of the population aged over 80 will increase from its current level of over 2% to between 9% and 10%, even in Albania and The Former Yugoslav Republic of Macedonia (UNFPA, 2015: 27-30). These demographic processes may cause the labour force to decline and increase the old age dependency ratio, affecting eco-

nomical performance and reducing social security funding, which relies on revenues from taxes on labour. The pressure on pension funds and health funds are increasing due to population ageing. In the longer term, labour force ageing may require higher financial allocations for retraining and for unemployment and disability benefits, as the length of working lives increases. The ageing population will most likely also require the WB6 economies to focus more on activating the population.

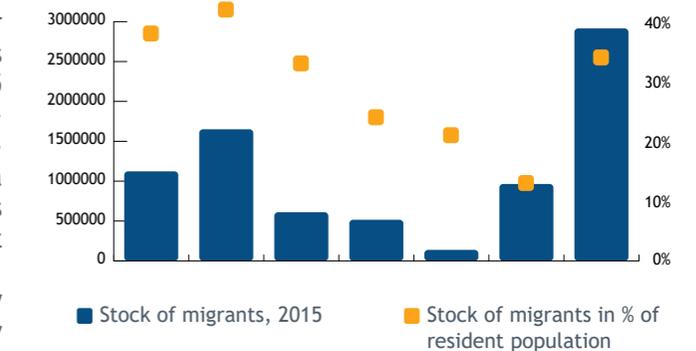
<sup>7</sup> The main sources of information for this section come from Bartlett et al. (2013) for analysis of secondary education, and from Bartlett et al. (2017) for analysis of higher education in WB6.

### 4.1.1 Migration

The WB6 region has traditionally been source of labour migration with the exception of Albania, which was closed during the period of communist rule from 1945 to 1990, while former Yugoslavia exported unskilled labour to Germany and other Western European economies since 1960s. Migration peaked in the 1990s as a result of opening borders in Albania and the conflicts in the Yugoslav successor states. In 1990s Albania lost more than a third of its population through migration. The wars in the Yugoslav successor states created new waves of migrants, including refugees and internally displaced persons. The total number of emigrants from the WB6 region doubled from 2.2 million in 1990 to 4.4 million in 2015, equivalent to 24% of the region's population in 2015 (Mara and Oruč, 2016). The data include first-generation emigrants, i.e. the ones who were born in a country of WB6 and then moved abroad. Emigration continued after 2010, but unfortunately accurate emigration figures are not available, since administrative data cover only a small portion of actual migration flows.

Emigration from the WB6 region is no longer related to war, conflict and human rights abuses, but is caused by the deterioration in economic conditions and a lack of appropriate jobs, especially for medium-skilled and highly skilled workers. Over the last decade, most economies experienced a gradual transition from unstable large-scale outflows to lower and more stable migration rates (International Organization for Migration, 2009). As a consequence of these different patterns of migration, the structure of migrants from former Yugoslavia is more mature than of migrants from Albania. This has implications for return as well as for harnessing development potential of diaspora, which usually needs a certain number of years for its "maturity" and ability to contribute to its home country's development.

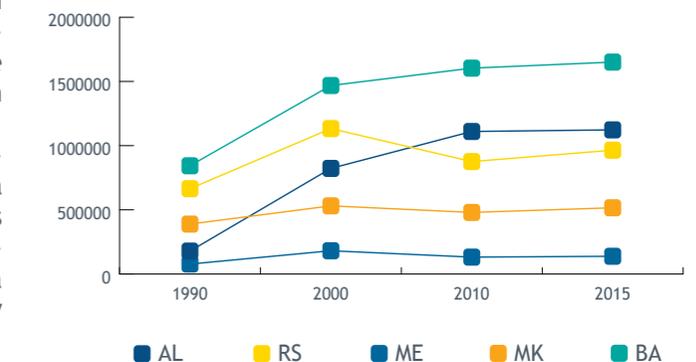
Figure 5: Stock of migrants from WB6 economies, 2015



Source: Adapted from Mara and Oruč (2016) based on elaboration of UN Statistics (2015). Data for Kosovo\* from IOM Migration Profile (2014). The stock of migrants includes intra-regional migration in the WB6.

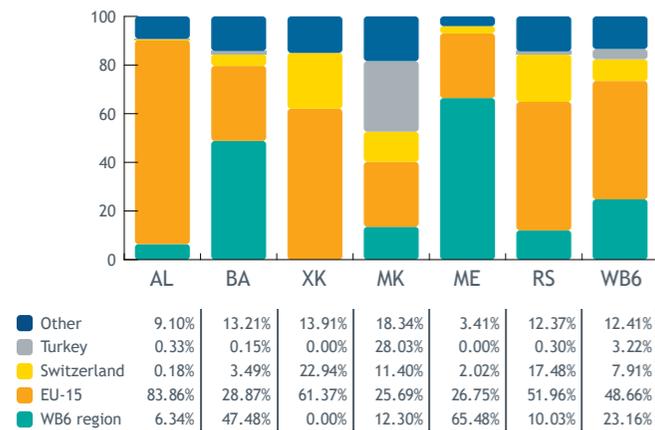
The stock of emigrants varies from 43% of the resident population in Bosnia and Herzegovina to 14% in Serbia, with all other economies having more than 20% of population outside their borders (see Figure 5). The largest increases in the stocks of emigrants since 1990 have taken place in Albania and Bosnia and Herzegovina.

Figure 6: Change in the stock of emigrants, 1990-2015



Source: Own elaboration using UN Statistics (2015)

**Figure 7: Main destination economies of emigrants from WB6 region, 2015**



Source: Own elaboration using UN Statistics (2015)

Overall, 23% of emigration has occurred within the region (see Figure 7). About half of emigrants from Bosnia and Herzegovina and two thirds of emigrants from Montenegro have moved to another country within the region. However, almost half of emigrants from the WB6 region have moved outside the region, mainly to the EU15, which has been the main destination for 84% of Albanian emigrants (mainly to Greece and Italy), 51% of Serbian emigrants (mainly to Austria and Germany), 61% of Kosovo\* emigrants (mainly to Germany). Switzerland has hosted many emigrants from the WB6 region, including 17% of Serbian emigrants, 22% of Kosovo\* emigrants and 11% of emigrants from The Former Yugoslav Republic of Macedonia. More distant destinations such as the USA, Canada and Australia have been the preferred destination for 11% of emigrants from the region. The USA has attracted 7% of emigrants from Albania and Bosnia and Herzegovina, and Australia has attracted 4% of emigrants from Serbia and 10% of emigrants from The Former Yugoslav Republic of Macedonia. Turkey has attracted 28% of the emigrants from The

Former Yugoslav Republic of Macedonia.

Emigration contributes to population ageing in the WB6 economies, since most emigrants are young and of working age. It undermines traditional multigenerational households, increases the proportion of elderly households and creates an increased demand for care services, which were previously provided within the extended family. On the other hand, the increased inflow of remittance payments from emigrants to their family members at home has a positive effect on living standards in the WB6 region, reducing poverty and the need for state support. For example, in 2013 in Kosovo\* remittances increased the income of recipient households by almost 40% (Kosovo Agency of Statistics, 2013). Remittances form a relatively high share of GDP in the WB6 region, being 16.7% of GDP in Kosovo\* and between 9% and 11% in Albania, Bosnia and Herzegovina, Montenegro, and Serbia. Remittances, also potentially contribute to labour market rigidities by increasing reservation wages (Kovtun, et al., 2014). In most WB6 economies, emigration creates a brain drain which should be dealt with by better prioritising investments within the education system (such as emphasising investment in early childhood development rather than higher education, attracting returnees members of the highly-educated diaspora (Gedeshi and Jorgoni, 2012; Zeneli, et al., 2013).

## 4.2 The supply of skilled labour

The supply of skilled labour depends upon the formal education system and its effectiveness. While in most advanced economies, the supply of skilled labour also depends upon the extent of training carried out by companies and the arrangements in place for life-long learning, these systems are relatively underdeveloped in the WB6 region. For example, the proportion of 35-44 year olds that had engaged in education or training in over a four week period in 2015 in the EU was 10.8%, whereas in The Former Yugoslav Republic of Macedo-

nia it was just 1.3%.<sup>8</sup> Therefore, the formal education systems have a particularly important influence on the supply of skilled labour in the WB6 region.

### 4.2.1 Educational systems

Education systems in the WB6 economies share many similar features, mainly due to a shared inheritance of the former Yugoslav educational system with exception of Albania. Secondary education is provided in high schools (gymnasia), vocational schools and art schools. Access to the different types of secondary education depends on the results of the entrance exams. General education and specialised high schools (science-mathematics and languages) offer four-year programmes. Secondary vocational schools offer general and vocational (theoretical and practical) education programmes last-

ing two, three (without direct access to higher education) or four years, and prepare students for work or further education. Vocational school programmes cover fields such as construction, mechanical engineering, agriculture, forestry, health, economy, catering, and trade. Higher education is provided by colleges of applied sciences or academic studies and public or private universities (faculties and art academies). Colleges of applied sciences offer three-year programmes leading to a professional diploma or bachelor degree, and one additional year leads to the award of a specialist diploma. Doctoral degree programmes take at least three years to complete. The academic year is usually divided into two semesters each comprising 15 weeks or three ten-week terms.

**Table 7: Selected education quality indicators, 2014 and 2015**

	Albania	Bosnia and Herzegovina	Kosovo*	The Former Yugoslav Republic of Macedonia	Montenegro	Serbia
Early school leavers (2015) (%)	21.3	26.3	-	11.3	5.7	7.5
% of age group 30-34 with tertiary education attainment (2014)	16.8 <sup>2</sup>	18.9	-	24.9	28.3	27.2
Share of students with low achievements (below level 2) in all three test areas (2015) (in %)	31.1	-	60.4	52.2	33	28,5 <sup>2</sup>

Sources: Share of students with low achievements - PISA (OECD, 2016); % of age group 30-34 with tertiary education attainment and early school leaving - Eurostat database, Tables Candidate economies and potential candidates: education.

Early school leaving is a problem in Albania and Bosnia and Herzegovina, as over 20% of young people (18-24) who have finished lower secondary education do not participate in further education or training. There is

clear positive correlation between low achievement and dropouts, with exception of Albania, which should be investigated further. In addition, the share of individuals aged 30-34 who have attained tertiary educa-

<sup>8</sup> Eurostat online data variable code [trng\_lfse\_01]

tion is low in all economies, especially Albania and Bosnia and Herzegovina (see Table 7). The enrolment rates for children from poor households whose parents have low levels of education are much lower than average, places them at a continuing high risk of poverty (ETF, 2013).

The Programme for International Student Assessment (PISA) survey results can be used to assess the quality and efficiency of education. The share of students having simultaneously low achievements in scientific, reading and mathematical literacy is high in all WB6 economies when compared to the EU. In The Former Yugoslav Republic of Macedonia and Kosovo\*, the share of students with low achievements in all three areas exceeds 50% (OECD, 2016).

#### 4.2.2 The quality of education systems

The quality of the education system is very important for youth employment. Despite recent progress in providing education in line with labour market requirements in several economies, the profiles taught in vocational schools are often based on outdated curricula and teaching methods. The lack of effective vocational education and the poor alignment of educational outcomes with the requirements of the economy result in skills mismatches and bottlenecks on the labour market and a low employability of the labour force, which underpins high unemployment and inactivity rates. In this context, policies for increasing the competitiveness of the economy and attracting foreign direct investment (FDI) are difficult to achieve.

The poor quality of education is also a consequence of the lack of formal relations between schools and companies. Although legislation provides a basis and a requirement for schools to communicate and coordinate design of their curricula with businesses and parents through tripartite councils or similar arrangements, in practice this does not happen to a sufficient extent. It is difficult to ensure high-quality practical classes for students, which is sometimes achieved informally through

the good will of teaching staff and company managers. On the other hand, employers are not often interested in cooperating with schools, which may be due to the low demand for workers, which is often satisfied through informal channels such as connections with friends and relatives rather than through a rigorous selection process. Hence, few schools receive feedback on the labour market results of the education they provide and therefore are unable to introduce new school curricula based on the needs of the labour market. At the same time, employers are rarely willing to bear the cost of initial on-the-job training of new staff. Only students who have received practical training in companies have much chance of being employed without additional training. Recently, governments have stepped into this process by providing internship schemes for secondary and tertiary school graduates through active labour market policies (ALMPs).

VET graduates are disproportionately represented in the unemployed and they generally find it difficult to find a job. Analysis of VET policies and practices in the WB6 (ETF, 2013) has shown that pupils in vocational secondary schools are in general given insufficient support in making their decision to either continue further the education (and the choice of track), or for entering the labour market. There should be greater effort to improve life-skills of the pupils, equip them with the skills necessary for successful labour market experience, and knowledge for continuing education. The low quality of education is partly a consequence of the lack of formal relationships between secondary schools and companies. A best practice example has been adopted in Serbia through the project “Reform of Vocational Education and Training in Serbia”, managed by GIZ, which has introduced elements of the German dual education system. Rather than adopting a company-based approach as in traditional dual education, this is a school-based approach adapted to the Serbian legal and economic environment. The project has engaged secondary vocational schools in partnership with companies and has modernised several 3-year vocational profiles with the

assistance of participating companies.<sup>9</sup> Under this work-based learning approach secondary vocational students are given day release to participating companies where they receive work-based learning supervised by trained mentors. The project has been successful in meeting its aims of improving the employability of secondary vocational school graduates. The participating companies employed the entire first batch of graduated secondary vocational students that participated in the project.

Similar problems affect the transition from higher education (HE) to work. Relatively few HE graduates make use of support from formal institutions such as career centres of higher education institutions or the Public Employment Services (PES). A major barrier facing HE students in their transition from higher education to the labour market is their lack of work experience, which is highly valued by employers in graduate recruitment decisions. Graduates with some prior work experience are more likely to find employment than others. In order to ease graduate entry to the labour market, cooperation between higher education institutions (HEIs) and businesses should be increased, graduate career guidance services should be better developed, and more opportunities should be provided for students to gain work experience before entering the labour market after graduation.

The quality and effectiveness of HE in the WB6 region is also rather low. While only 53% of students complete their study programme; of those that do complete their course only 52% find a job; and of these, only 48% find a job that is well matched to their level of education (Bartlett et al., 2016). Of every hundred new students entering the HE systems in any one year, it can be expected that only 13 will eventually graduate and find a well-matched job. This indicates the low level of efficiency of the HE systems in the WB6 in providing students with the skills needed to find a well matched and

stable job, and the ineffectiveness of labour markets in providing a sufficient number of appropriate jobs for the graduates supplied by the HE systems. In order for the HE systems to make a better contribution to building human capital and to the competitiveness and growth of the economy, significant reforms of the HE systems and the graduate labour markets are needed, and better cooperation between employers and HEIs should be encouraged.

Figure 8 presents the results of a survey of employers that employ HE graduates conducted as part of a project on HE systems and the graduate labour markets in the WB6 (Bartlett et al. (2016). The survey asked employers to assess the actual skills of their graduate employees along a range of skill dimensions and the level of skills they consider necessary to carry out the job. The difference between these two measures is the estimated gap in each skill dimension.

<sup>9</sup> Secondary vocational schools in Serbia offer both 3-year or 4-year study programmes. The latter offer a route to higher education and tend to be more theoretical than practical in content. The former offer a direct entry to the labour market and tend to have a higher practical content.

Figure 8: Graduate skill gaps - current and future (%)



Source: Bartlett et al., 2016:45

Graduate students' skill gaps in the WB6 region, both the current and expected in the future, are found in all dimensions of skills (see Figure 8). The blue line shows that there are relatively high current skill gaps in analytical and problem-solving skills, adaptability and decision-making skills. All types of skill gaps are expected to increase in the future. The red line show that relatively high skill gaps are expected in the future in interactive skills such as planning and organisational skills, decision-making skills, analytical and problem-solving skills and adaptability. All this points to deficiencies in the quality of HE systems, especially in relation to teaching "interactive" skills.<sup>10</sup>

### 4.3 Summary

Poor quality of education, which fails to meet the demands of the labour markets, is one of the major causes of the high youth unemployment rate in the WB6.

The analysis suggests that education systems in WB6 economies are not efficient in that many young people especially those from poor families stay out of the education, or drop out too early. In addition, few of those that stay in education accumulate sufficient human capital i.e. education does not produce sufficient knowledge and skills for the labour market. This suggests that the improvement of skills through life-long learning programmes is an important policy issue.

Vocational school graduates are disproportionately represented among the unemployed and generally find it difficult to get a job. The low quality of education is partly a consequence of the lack of formal relationships between secondary schools and companies. The quality and effectiveness of HE in the WB6 region is also rather low. The data presented in this chapter suggest that the education systems are not efficient in that many young people especially those from poor families stay out of higher education, or drop out too early. In order for the HE systems to make a better contribution to building human capital and to the competitiveness and growth of the economy, significant reforms are needed, and better cooperation between employers and HE institutions should be encouraged. In support of this policy approach is it also crucially important that the supply of skilled labour should be increased through the education systems, both at secondary school of higher education levels. This should be based on curriculum reform, improvements in teaching quality based upon incentive and training programmes to stimulate educators' productivity, and on and on a much closer interrelationship between education institutions and the business sector.

<sup>10</sup> Cognitive skills include the following: numeracy, literacy, foreign language skills, computer skills, and sector-specific skills (e.g. engineering skills). Interactive skills include communication skills, analytical and problem solving skills, ability to adapt to and act in new situations, decision-making skills, team working skills, and planning and organisational skills.

## 5 Labour demand

Available studies suggest that job destruction and job creation was low in the WB6 economies in the 1990s (Mojsoska-Blazevski, 2016). In this environment, the WB6 economies failed to reallocate resources towards more productive sectors, which meant that job destruction from the state-owned enterprises and the privatised companies was not accompanied by increasing job creation in the new private sector. The political and economic difficulties faced by the WB6 economies at the onset of transition hindered the process of structural change. In particular, capital flows into the WB6 economies were smaller than expected given the geographic proximity of these economies to the EU (Bartlett, 2009; Kovtun et al., 2014).

The demand for labour is a function of the demand for goods and services, given the technology in use. Therefore, the demand for labour is expected to be greater in a growing economy than during periods of recession. One of the key determinants of economic growth is the level of investment in an economy, which in turn is affected by the expectations of future growth and the general business environment. Investment may create jobs, but when investment introduces new labour saving technologies, investment may also destroy jobs. This latter aspect underlies current concerns about the introduction of robots to replace human labour in many advanced economies. Given the demand for labour generated by the level and growth of aggregate demand, the price of labour may also influence the demand for labour in the case where wages are sticky and do not respond rapidly to the changes in the labour market. In conditions of large-scale unemployment, it is often thought that high labour costs may price workers out of jobs. On the other hand, it should also be recalled that the aggregate wages paid in an economy contribute to aggregate demand and hence to economic growth and in turn generate labour demand. Consequently, simplis-

tic arguments that relate the conditions on the labour market to the level of wages should be treated with caution. Furthermore, structural change can affect the demand for labour since economic growth often involves structural change between sectors, each of which have different demands for labour. Finally, structural change can be driven by technological progress, which in turn can have an impact on the demand for labour in either direction depending on whether the new technologies are labour saving or labour using. New technologies may favour demand for skilled labour compared to unskilled labour, through skill-biased technical change. This type of change places large pressures on education systems to adapt to the newly emerging labour market demands in growing economies.

### 5.1 The business cycle and the demand for labour

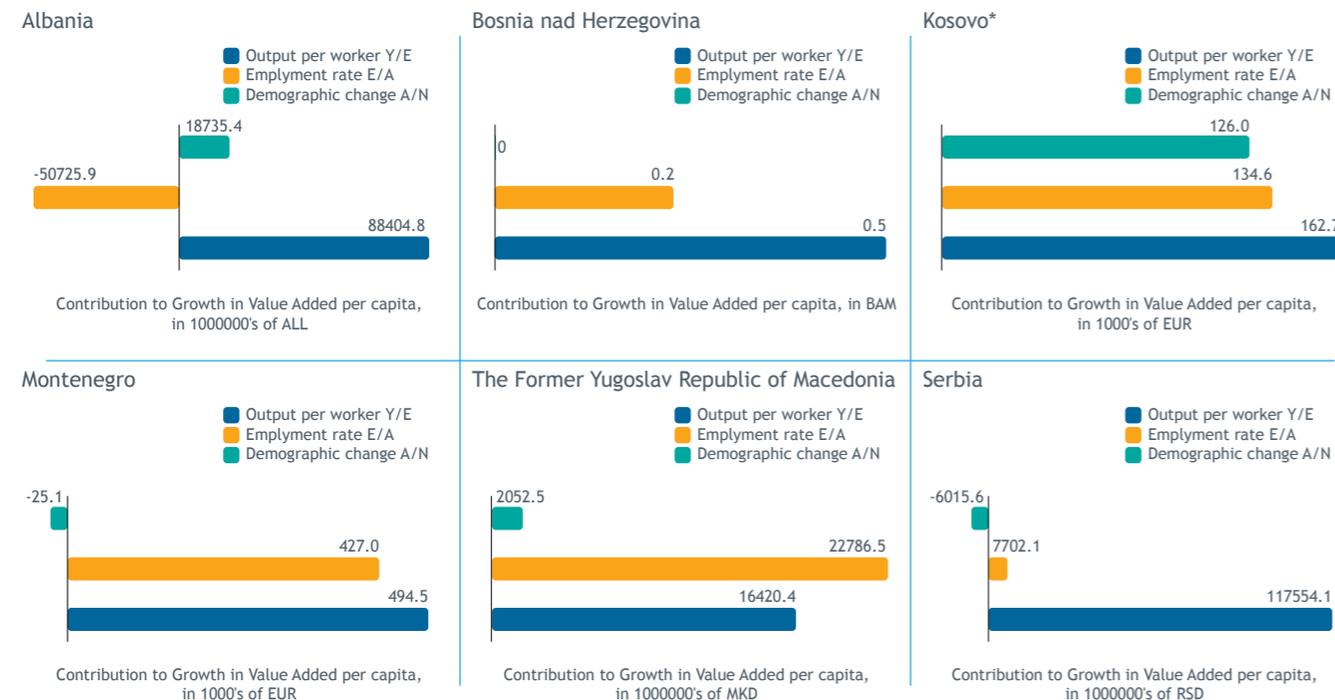
The linkages between economic growth, employment and unemployment trends provide a useful way to understand labour market demand. Economic growth can usually be expected to create an increased demand for labour, depending on the rate of change of labour productivity. Hence, the rate of economic growth and growth in labour productivity set the limits within which growth in employment can take place. Prior to the global financial crisis the WB6 region experienced relatively high rates of GDP growth. However, the onset of the economic crisis in 2009 revealed the weaknesses of the economic development model pursued in the boom period, which relied on external resource inflows and failed to transform the economies into knowledge-based economies. Moreover, the rapid growth of the post-2000 period did not bring significant employment gains. In Bosnia and Herzegovina, the elasticity of unemployment with respect to GDP over 2000-

2010 was negative at -0.2 (World Bank, 2012), while the employment elasticity to GDP growth in the WB6 and Turkey over the period 1995-2010 ranged between 0.1 and 0.25 (Richter and Witkowski, 2014). Such low responsiveness of employment and unemployment to growth may reflect structural weaknesses in the WB6 economies' labour markets, such as the poor quality of education and training systems, technical inefficiency of rent-seeking business sectors and allocative inefficiency of quasi-monopolised markets that limit compe-

titution, all contributing to a failure to generate sufficient demand for labour. Consequently, tackling employment problems involves both improving the quality of labour supply and boosting the demand for labour.

In order to understand how economic growth is associated with increased employment, per capita GDP growth can be decomposed into three components: (i) productivity changes; (ii) employment rate changes; and (iii) demographic change measured as a ratio of the active population to the total population.<sup>11</sup>

Figure 9: Factors explaining economic growth change



Source: Own calculations using JoGGs Decomposition tool and data from annual report of national statistical offices

11 The portion of observed growth that can be attributed to changes in output per worker is obtained by calculating the growth in output per capita between two points in time under the hypothetical scenario in which one component has changed as observed, while the other two components are held constant. The calculations were made using World Bank's JoGGs decomposition tool, which uses Shapley's formula for the decomposition.

In Figure 9 above, Bosnia and Herzegovina, Montenegro and Serbia are in one group on the right-hand side, while Albania, Kosovo\* and The Former Yugoslav Republic of Macedonia are in another group on the left hand side. In the former group, demographic decline led to stagnation in the ratio of active population to the total population, while in the latter group the increased ratio of active population to total population contributed to the increase in output per capita. Demographic change had a positive effect on the growth of output per capita in economies of the second group. The demographic gain was equal to the contributions of other factors in Kosovo\*, while in the other economies it was lower. Kosovo\* achieved around 30% of growth due to the contribution of the demographic changes, as an increase in the activity rate increased per capita output.

As can be seen from Figure 9, the growth of the employment rate has been a major determinant of increased output per capita in most WB6 economies. Thus, economic growth has not been entirely "jobless", except in Albania and Serbia. The contribution of employment has been the most important factor determining growth of output per capita in The Former Yugoslav Republic of

Macedonia, where increased employment has generated around 60% of growth of output per capita. The contribution of increased productivity (output per worker) was the most important factor of growth in output per capita in all economies except in The Former Yugoslav Republic of Macedonia. Without increased output per worker, growth in output per capita would not have been observed in Albania and Serbia at all, while in other economies it would have been only a half or less of the observed growth.

## 5.2 Investment and productivity

Investment is an important factor determining labour market demand and job creation. The ratio of investment to GDP in the WB6 economies has declined or at best stagnated during the period from 2010 to 2016 (see Table 8). The relatively low level of investment, both public and private, especially in Bosnia and Herzegovina, Montenegro and Serbia may be a factor explaining the low growth of firms and the weak demand for labour in those economies.

Table 8: Gross fixed capital formation (% of GDP)

	2010	2011	2012	2013	2014	2015	2016
Albania	28.4	29.4	26.5	26.1	24.2	24.6	:
Bosnia and Herzegovina	16.6	17.9	17.5	16.8	:	:	:
Kosovo*	29.6	30.7	26.0	24.8	23.2	25.8	26.0
Montenegro	21.6	19.5	19.8	20.2	19.0	20.3	:
Serbia	18.6	18.4	21.2	17.2	16.7	17.7	17.7
The Former Yugoslav Republic of Macedonia	23.1	23.5	23.4	23.7	23.4	23.8	24.0

Source: Eurostat online data, variable code [cpc\_ecnagdp]

During the 1990s, the WB6 economies attracted relatively little FDI due to the political and economic instability and competition from more prosperous tran-

sition economies in Central and Eastern Europe (CEE) and instability in the WB6 region (Brada et al., 2006). WB6 economies, with exception of Montenegro and Serbia, attracted less FDI than the economies of CEE. In

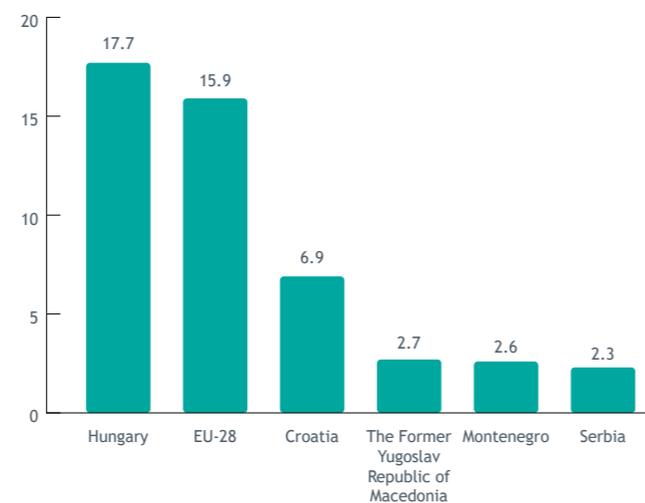
late 1990s and the 2000s, FDI was mainly related to the privatisation process in non-tradable sectors such as financial services and telecommunications. The effect of such FDI inflows on employment was weak and had a negligible effect on WB6 economies' exports (Sanfey et al., 2016). Although FDI contributed to structural changes in some transition economies, it had a lesser effect in the WB6 economies, because most FDI went into the services sector rather than manufacturing. This type of FDI also led to little integration of the WB6 economies into global value chains (Handjiski et al. 2010). This situation may now be changing as substantial FDI to special economic zones in Serbia and The Former Yugoslav Republic of Macedonia in recent years have begun to develop manufacturing activities in global value chains linked especially to the motor car components industries (Bartlett et al., 2017).

Estrin and Uvalić (2014) argued that there are two main groups of factors affecting FDI in the WB6 economies: factors related to the size of the domestic economy and distance that are commonly analysed through "gravity" models, and factors related to institutional quality such as privatisation, investor freedom and property rights. They concluded that there is a persistent negative tendency for the WB6 to receive less FDI, which can be mainly explained by political and economic instability. They also found that FDI made a substantial contribution to investment in the WB6 economies after 2003.

Delayed reforms and low capital inflows negatively affected the diversification of the economies of these economies from traditional to modern sectors and to services. Indeed, the traditional, low-productivity sectors still dominate in WB6 exports, with a relatively small share of exports of high technology products (see Figure 10). In the CEE region, Hungary is a leading exporter of high-tech products in the CEE region, mainly due to its large FDI inflow, which has mainly been attracted to capital-intensive sectors. The share of high tech exports from Hungary is above the EU average, and about seven times that for the Western Balkans for

which data is available. Croatia, a regional neighbour has almost three times as much high technology exports as the WB6 economies.

**Figure 10: High-tech exports as % total exports (average 2010-2015)**



**Source: Eurostat online data: Exports of high technology products as a share of total exports (from 2007, SITC Rev. 4) [htec\_si\_exp4]**

In addition the encouragement of investment by the business sector is of crucial importance in raising the demand for labour and improving productivity. Investment that is linked to manufacturing and to integration of the region into global value chains can be especially important in this respect. This would require the economies of the region to adopt effective measures to attract foreign direct investment. The examples of the special economic zones in Serbia and The Former Yugoslavia Republic of Macedonia are good examples of this type of policy (OECD, 2017). In recent years these have begun to attract FDI into high technology manufacturing sectors, especially in the automobile components industry (Shimbov, et al., 2016). In order to make a success of such a policy, it is critically important to en-

sure the spillover from FDI activities to the local economy in the form of job creation, skill development and technology transfer. Therefore, governments should ensure that they have a policy in place to develop the local supply base to ensure that the inputs in to the production processes of foreign multinationals are supplied by local companies and not simply imported from abroad. In the latter case, FDI will have little impact on

the local labour market. However, if the supply capacity is developed though active government policies to support local SMEs that can supply foreign companies based in the WB6 region that are linked into global value chains then this could have an important multiplier effect on local economies in generating new demand for highly skilled jobs.

**Table 9: Labour productivity**

	2000		2015		Productivity (2000=100)
	Productivity	% of regional average	Productivity	% of regional average	
Albania	28.4	29.4	26.5	26.1	24.2
Bosnia and Herzegovina	16.6	17.9	17.5	16.8	:
Montenegro	29.6	30.7	26.0	24.8	23.2
Serbia	21.6	19.5	19.8	20.2	19.0
The Former Yugoslav Republic of Macedonia	18.6	18.4	21.2	17.2	16.7
WB6 Average	23.1	23.5	23.4	23.7	23.4

**Source: KILM database of ILO. Note: Productivity is defined as output per worker (GDP constant 2011 international \$ in PPP).**

Higher levels of investment could be expected to generate improvements in productivity. Productivity in the WB6 economies has also increased due to structural changes in the economies that have shifted resources from agriculture and manufacturing to service. In the period prior to the onset of the economic crisis, most productivity growth was based on total factor productivity growth, rather than increases in investment and employment (World Bank, 2008).<sup>12</sup> This may partly explain why the employment impact of growth was so weak during that period. However, Kovtun et al. (2014) argue that the relatively large capital flows prior to the financial crisis were not accompanied by productivi-

ty gains, which seems inconsistent with the idea that growth in this period was due to total factor productivity gains. The data reported in Table 9 suggests that productivity growth has been achieved in the WB6 region over the entire transition period, with real GDP per worker increasing from \$22,621 in 2000 to \$35,499.8 in 2015. However, there are large differences among the economies, both in initial productivity and in productivity growth during these years. Albania has made most significant progress in the productivity since 2010 (see final column of Table 9), whereas Montenegro has progressed the least.

<sup>12</sup> Total factor productivity (TFP) is the residual of the Cobb/Douglas production function and represents the portion of output not explained by traditionally measured inputs of labour and capital used in production.

### 5.3 Cost of labour and wage bargaining institutions

Another factor that may affect the labour demand is the cost of the labour. Wage levels (or generally, labour costs) in the WB6 economies are important given that these economies mainly produce and export low-value added products and have small profit margins (Kathuria, 2008). Hence, high wage or labour costs can be an important constraint to investment and growth. However, Sanfey et al. (2016) argue that low unit labour costs relative to the EU are one of the major competitive advantages of the region and potential for future growth. In some economies of the region the large number of unemployed persons does not put a downward pressure on the wages (for more discussion, see Kovtun et al., 2014). This may be related to labour market institutions rigidities including strict employment protection legislation that gives bargaining power of incumbent workers, although as argued above this has diminished over time.

Figure 11: Labour-employer relations



Source: Global Competitiveness Index database. Note: (1=generally confrontational, 7=generally cooperative).

High levels of long-term unemployment also give rise to downward wage rigidities, as the long-term unemployed are not effective competition for the scarce jobs available in the economy. Wage costs among the low skilled in the WB6 region are lower than in the CEE region (Kathuria, 2008), but relatively high labour taxes for low-wage earners offset this advantage to some extent, creating incentives for informality among low-skilled workers (Koettl and Weber, 2012) as well as hindering job creation (Arandarenko and Vukojević, 2008).

Relations between employees and employers are an institutional factor that affects the demand for labour. In the past, the WB6 region was characterised by rather confrontational relations between employees and employers, unlike the social partnership model in Western European Economies. Recent data suggests that this confrontational aspect has diminished (see Figure 11). The Global Competitiveness Report provides scores for labour-employer relations. The values of this indicator are lower for economies with more confrontational relations and higher for those with more cooperative relations. Comparison of the 2010 and 2016 data on labour-employer relations shows that Albania, Serbia and The Former Yugoslav Republic of Macedonia recorded reduced levels of confrontation and more cooperative levels of employer-labour cooperation during this period.

### 5.4 Sectoral change and the demand for labour

The impact of economic growth on job creation depends on a range of factors, such as the sector composition of growth and the capital/labour ratio within the individual sectors. The World Bank & WIIW (2017) argues that the unemployment in the WB6 economies is primarily of a structural nature (see also Bartlett, 2013). Hence, economic growth alone will not be suffi-

cient to reduce high unemployment, particularly among the most disadvantaged citizens. Their estimates of the effect of growth on employment show that it is rather small. Consequently, creating more jobs requires addressing structural issues.

The set out analysis is performed using the World Bank’s “Job Generation and Growth Decomposition tool”.<sup>13</sup> It is an Excel-based macro-spreadsheet that allows users to easily decompose growth in GDP per capita in two consecutive periods, in its employment, productivity and demographic components, both at the aggregate and sectoral level. The analysis was based on data collected from national statistics offices of the WB6 economies.

Table 10 shows that the main contributors to change in employment between 2010 and 2016 in the WB6 economies are Manufacturing, Construction, Education, Professional and Scientific activities and Public Administration. The exception is Albania, where agriculture is the main contributor to employment growth in the analysed period. Moreover, employment is dominated

by non-tradable sectors, which suggests that the region is facing low competitiveness and should improve its market orientation, as well as building and strengthening existing value chains.

The relationship between growth and employment can be analysed focusing on the following indicators per sector: labour productivity,<sup>14</sup> employment elasticity of growth and changes in productivity.<sup>15</sup> The relevant Tables can be found in the Annex. The results show that the most productive sectors in Albania are mining, electricity and water supply, as well as construction. In Bosnia and Herzegovina, the most productive sectors are the information technology (IT) sector and financial services, while in Kosovo\* the most productive sectors are real estate activities, mining, electricity and water supply and financial services. The most productive sectors in The Former Yugoslav Republic of Macedonia are real estate activities, financial services and IT. In Montenegro and in Serbia they are real estate, electricity and water supply. Kosovo\* and Serbia have many sectors with an employment elasticity above 1, suggesting that employment growth is related to a fall of productivity

in these sectors. In other economies, most sectors have an elasticity between 0 and 1.

Table 10: Contribution of sectors to employment growth (%)

Indicator	Albania	Bosnia and Herzegovina	Kosovo	The Former Yugoslav Republic of Macedonia	Montenegro	Serbia
Agriculture, forestry and fishing	60.6	2.6	-1.6	-2.8	0.2	-18.0
Mining and quarrying		-3.5	-0.9		-2.7	-0.8
Manufacturing		26.1	-5.7	19.9 <sup>16</sup>	-20.7	-38.2

<sup>13</sup> More details about the tool can be found at: <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTPROGRAMS/EXTTRADERESEARCH/0,,contentMDK:22042518~pagePK:148956~piPK:216618~theSitePK:544849,00.html>

<sup>14</sup> Measured as a share of sector in total GDP over share of sector in total employment,

<sup>15</sup> Measured as a change of sector’s GDP over sector’s employment

<sup>16</sup> Data include also Mining and quarrying; Electricity, gas, steam and air conditioning supply; Water supply; sewerage, waste management and remediation activities.

Indicator	Albania	Bosnia and Herzegovina	Kosovo	The Former Yugoslav Republic of Macedonia	Montenegro	Serbia
Electricity, gas, steam and air conditioning supply	-1.0 <sup>17</sup>	1.6	-10.6		-1.1	3.1
Water supply; sewerage, waste management and remediation activities		1.7	17.6		2.4	14.6
Construction	17.2	-22.6	50.1	5.2	13.7	-31.3
Wholesale and retail trade; repair of motor vehicles	7.5 <sup>18</sup>	-10.7	41.9	34.3 <sup>19</sup>	-7.7	4.4
Transportation and storage		4.4	-2.5		8.2	0.8
Accommodation and food service activities		4.7	38.2		15.0	-0.8
Information and communication		5.5	0.7	4.6	2.3	24.4
Financial and insurance activities		0.4	-3.4	0.9	1.5	-10.5
Real estate activities		-1.3	-2.5	1.1	2.5	2.1
Professional, scientific and technical activities		12.1	4.6	17.5 <sup>20</sup>	10.5	20.3
Administrative and support service activities		10.3	-23.7		34.4	36.0
Public administration and defence; compulsory social security	9.1 <sup>21</sup>	15.2	53.4	12.6 <sup>22</sup>	13.1	23.2
Education		21.3	-16.5		10.3	43.2

<sup>17</sup> Data include also Mining and quarrying.

<sup>18</sup> Data include also Transportation and storage; Accommodation and food service activities; Administrative and support service activities.

<sup>19</sup> Data include also Transportation and storage; Accommodation and food service activities.

<sup>20</sup> Data include also Administrative and support service activities

<sup>21</sup> Data include also Education; Human health and social work activities; Other service activities

<sup>22</sup> Data include also Education; Human health and social work activities

Indicator	Albania	Bosnia and Herzegovina	Kosovo	The Former Yugoslav Republic of Macedonia	Montenegro	Serbia
Human health and social work activities		18.6	-29.2		7.6	23.3
Arts, entertainment and recreation		7.6	-8.1	6.6 <sup>23</sup>	6.1	6.7
Other service activities		6.0	-1.7		4.6	-2.6
<b>TOTAL employment growth</b>		<b>100.0</b>	<b>100.0</b>		<b>100.0</b>	<b>100.0</b>

Source: Own calculations using JoGGs Decomposition tool and data from annual report of national statistical offices

## 5.5 Summary

Economic growth in the WB6 region has failed to produce sufficient growth in the demand for labour. This section has argued that the main determinants of the demand for labour are the business cycle, investment, the cost of labour, wage bargaining institutions and structural change in the economy. Political instability in the entire region of WB6, accompanied by the inability of political decision makers to systematically define and implement integrated medium-term reform strategies pose real hindrances to employment generation. Moreover, it reduces both domestic investments and FDI inflows, thus having a negative impact on growth rates and new job creation. The encouragement of investment by the business sector is therefore of crucial importance in raising the demand for labour and improving productivity. Investment that is linked to manufacturing and to integration of the region into global value chains can be especially important in this respect. This would require the countries of the region to adopt effective measures to attract foreign direct investment, as is already being done in Serbia and The Former Yugoslav

Republic of Macedonia. Other economies in the region could learn useful lessons from these experiences. In order to make a success of such a policy, it is critically important to ensure the spillover from FDI activities to the local economy in the form of job creation, skill development and technology transfer. Therefore, governments should ensure that they have a policy in place to develop the local supply base to ensure that the inputs in to the production processes of foreign multinationals are supplied by local companies, which could have an important multiplier effect on local economies in generating new demand for highly skilled jobs. Labour costs in the region are relatively low and provide an attraction factor for FDI, which has been increasing in recent years. Wage bargaining institutions have become more cooperative and less confrontational than in the past, which has supported the growth of labour demand to some extent. Finally, structural change has had a major impact on the nature of the demand for labour. With the transition to a service economy, the main challenge now is to move towards more high-skill knowledge-intensive sectors of production and services than has been the case in the past.

<sup>23</sup> Data include also Other service activities

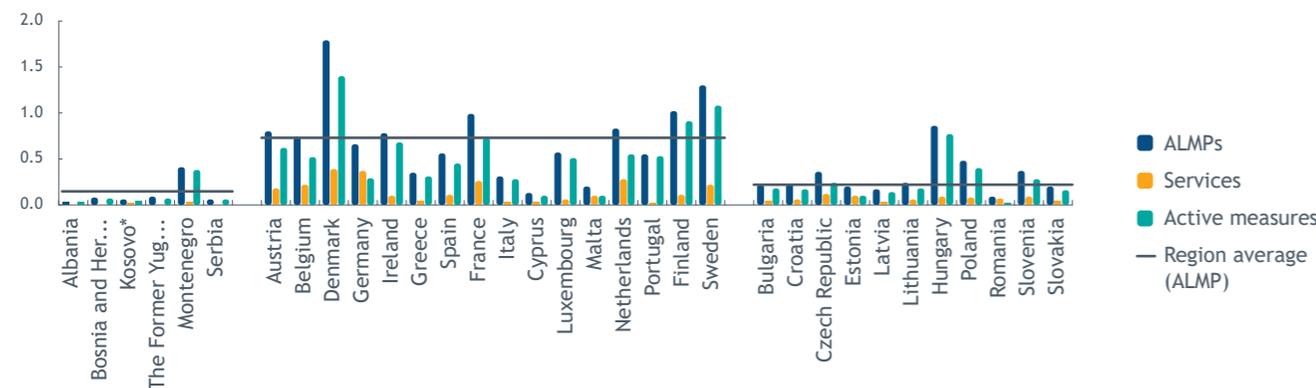
# 6 Labour market policies

Active labour market policies (ALMPs) constitute the main tools in the hands of Public Employment Offices with the aim of addressing mismatches in the labour market. On the whole (see Figure 12 below), expenditures in ALMPs in the WB6 are low, both by comparison to the EU average and by comparison to other economies from the wider region which are now member states of the EU (Bulgaria, Romania, Croatia and Slovenia). On average (unweighted) across the Western Balkans, ALMP spending represents around 0.12% of GDP, a figure which is significantly skewed by the expenditures in Montenegro, which reached 0.41% of GDP - for the rest of the region, the figure ranges between 0.03% (in Albania) and 0.09% (in The Former Yugoslav Republic of Macedonia). However, due to the fact that labour market policy statistics are not collected and presented in line with the Eurostat methodology, the data presented here most likely somewhat underestimate total

expenditures on ALMP interventions. On the whole, although on the basis of actual expenditures as a share of GDP, the WB6 economies form a distinct group of generally low effort with regard to ALMPs, the analysis of the distribution of expenditures reveals a rather high degree of diversity.

In Albania ALMPs during the period 2008-2016 have concentrated on provision of training (mainly on-the-job) and subsidised placements for registered unemployed, with emphasis on some targeted groups, including both standard vulnerable categories (e.g., females, Roma, youth) and categories specific to the context of the Albanian labour market (e.g., university graduates). Indeed, two specific measures (workplace training and recruitment incentives for temporary employment) take up the vast majority of ALMP expenditures, with around 45% of the total each.

Figure 12: ALMP spending as a share of GDP, total and by category



Notes: Regional averages calculated for Western Balkans Six, former transition EU states and all remaining EU states (excluding the UK, for which data is not available). Data for the Western Balkans Six are from own data collection and concern the year 2015. Data for EU MS are from the Eurostat LMP database and concern the year 2014.

In the Federation of Bosnia and Herzegovina, the main bulk of expenditures concerns recruitment incentives, which covered 62% of total spending in 2015- with measures for temporary employment representing half of the total in this category at 31% of the grand total. Start-up incentives represented the other large component of expenditures at 29% of the total. Training and direct job creation attracted a much smaller share of expenditures (1% and 4%, respectively) while, based on the available information, labour market services accounted for only 4% of total expenditure. In the case of Republika Srpska, incentives for start-ups cover the bulk of the expenditure, while recruitment incentives cover almost a third of all spending - i.e., half of the percentage seen in the Federation of Bosnia and Herzegovina.

In Kosovo\*, the range of measures seems reasonably diverse, as it includes measures such as start-up incentives, direct job-creation, support for apprenticeships (including by placements in Germany) and various forms of training, recruitment incentives and, more recently (since 2014), job-rotation. However, services seem to have absorbed a large share of actual expenditures (ranging from 60% in 2013 to 39% in 2015).

In Montenegro, ALMP expenditures are rather heavily concentrated in the area of temporary employment. This category accounted for 59% of annual expenditures in the period 2013-2015. The second biggest category is direct job creation, accounting for 19% of total expenditures in the same period. On average, training measures account for only 5% of the total annual expenditure, while recruitment incentives (excluding temporary employment) and start-up incentives make up an even smaller share (about 3%, jointly). Measures on sheltered and supported employment account for another 5% of expenditure, while services account for 8%.

In Serbia, overall interventions seem rather diverse, covering a range of measures from training and employment incentives to supported employment, direct job

creation and start-up incentives. Rather uncharacteristically in comparison to allocations elsewhere in the WB6 region, in Serbia special support for apprenticeships occupies a rather large proportion of expenditures on labour market measures (16% on the basis of average annualised values for the period 2013-2015), making it the economy in the region with the highest share of expenditures in this field. This is by far the largest expenditure category in the broader area of training, with institutional and workplace training occupying a mere 2% of total expenditure each. Employment incentives account for a quarter of total expenditures, of which 40% (10% of total expenditure) cover general recruitment and employment incentives. Amongst the remaining expenditures, for which the associated measures can be identified as supporting permanent or temporary jobs, the vast majority goes to recruitment incentives for permanent employment (14% of total expenditure), with only a very small proportion going to incentives for temporary employment (1% of total).

In The Former Yugoslav Republic of Macedonia, ALMP measures show sizeable diversity, covering not only various forms of training and employment incentives but also start-up incentives and schemes for direct job creation, and for sheltered and supported employment. The latter seems to cover the largest part of ALMP expenditures, at around 44% of the total. The various employment incentives represent the second largest expenditure category (around 30% of the total), while training occupies less than 10% of total ALMP expenditure in the economy.

## 7 Conclusions and recommendations

The report presents a comprehensive overview of available evidence on the characteristics and underlying factors of the labour market situation in the WB6 economies. It covers labour market indicators, factors affecting the labour market situation from both supply and demand side, and the scope for active labour market policies. The evidence presented above shows that some positive trends could be observed in the labour market in the WB6 region in the period 2010-2016. Unemployment rates have begun to decline recently with the exception of Albania, while employment has increased. However, despite these positive trends, a number of issues remain, such as a high share of informal employment, high youth unemployment, a high share of long-term unemployment and a low rate of female labour force participation.

There are some positive trends in the WB6 labour markets as unemployment rates have recently begun to decline in most economies, while employment has begun to increase. The decline in unemployment rates has been greater for low and medium skilled workers. However, despite these positive trends, a number of issues remain the subject of concern. The labour market participation of women, young people and people with lower levels of education is inadequate. Women generally have lower rates of activity than men, while the activity rate of young people is also low, especially for those with lower levels of education. At the same time, youth unemployment is unacceptably high. About two-thirds of total unemployment is accounted for by long-term unemployment, with young people being over-represented in this category. Informal employment is predominant among the most vulnerable groups, such as young people, women and the older age group. The public sector employs a large share of the available labour force. By offering higher wages, and better working conditions it attracts “the best and brightest”, and

delays young people’s transition to the labour market.

Institutions of the labour market play an important role in determining labour market outcomes. Fortunately, reforms that have taken place during the transition period in most of the WB6 economies have reduced redundancy costs and increased the flexibility of wage negotiation systems. The WB6 economies have made progress in increasing the flexibility of labour markets and reducing the restrictiveness of employment protection legislation, although differences between the economies remain. Most economies in the WB6 region have implemented reforms to improve the business environment and ease the entry of new firms, and most have progressed in the ease of doing business. However, firms’ survival and growth is weak and hence job creation is low. The WB6 economies should do more to unlock the development potential of competitive companies and to support companies to improve their business sophistication.

Labour supply conditions are unfavourable throughout the region. The region mainly faces low fertility rates and negative natural growth, emigration and ageing. The natural growth rate of the population is negative in Bosnia and Herzegovina and Serbia, while in Albania and Kosovo\*, natural population growth has been offset by migration. The migration rate is high in all economies, and over the past two decades almost one quarter of the population has left the region. As a result, the population of the region is shrinking and ageing.

In the context of a low supply of labour the quality of the labour supply is especially important. However, the supply of skilled labour is inadequate. Poor quality of education, which fails to meet the demands of the labour markets, is a major cause of the high youth unemployment rate. Education systems are not efficient in that many young people especially those from poor

families stay out of the education, or drop out too early. Such a labour force is often equipped with the wrong skills and needs better qualifications, training and vocational education. Education needs to be more adapted to labour market needs and to structural changes in the labour market. Education policies should follow the requirements of industries that are identified as having the most employment potential. Such a role of the education system should be implemented not only through formal education, but also through more active participation in non-formal education and skills upgrading. In particular, there is room for qualitative improvements to the VET system, which should in particular address the high unemployment among less educated, youth and women. This suggests that the improvement of skills through life-long learning programmes is an important policy issue. Specific problems face the education systems at secondary school level and at tertiary levels. The quality and effectiveness of higher education systems in the WB6 region is rather low. Students in higher education do not accumulate sufficient human capital leading to high skill gaps especially in the field of interactive skills; these skill gaps are expected to increase in the future. Reducing the skill gaps of graduates would increase their employability.

Alongside the problems with the supply of labour, the demand for labour is also problematic and economic growth has often failed to produce a sufficient growth in the number of jobs. The WB6 economies have not resolved many of their structural problems such as frictional and structural unemployment. The main determinants of the demand for labour are the business cycle, investment ratios, the cost of labour and structural change in the economy. Political instability in the entire region of WB6 and the inability of political decision makers to systematically define and implement integrated medium-term reform strategies hinders employment generation, investment and FDI inflows that has a negative impact on new job creation. Low investment rates have led to a low demand for labour, although inflows of FDI have raised productivity growth. Labour

costs in the region are relatively low and provide an attraction factor for FDI, which has been increasing in recent years. Wage bargaining institutions are becoming more cooperative and less confrontational than in the past, which supports the growth of labour demand. Finally, structural change has had a major impact on the nature of the demand for labour. With the transition to a service economy, the main challenge now is to move towards a more high-skill knowledge intensive sectors of production and services than in the past.

Addressing the issue of high unemployment in the WB6 region requires a range of policies that should address the issue from different angles and not only treat symptoms but also the different causes discussed in this report. Furthermore, coordination among these policies needs to be established and assured. This requires more investments in active labour market policies (ALMPs), which could be better designed and targeted towards groups in need, such as young people, women and less skilled individuals. Moreover, improvements in management practices and design of ALMPs, particularly using the results of impact evaluations, could be highly recommended to all WB6 economies. ALMPs can encourage labour-market participation, provide short-term employment opportunities and spur entrepreneurship, but they need to be financially sustainable and coordinated with policies that increase the demand for labour. However, expenditure on these policies remains relatively low in comparison with EU averages and this is an area that should be developed much more in the future to support both the supply and demand sides of the labour market, support the creation of a job-friendly growth model, and enable the continuing reduction of unemployment and the improvement in the quality of jobs in the region.

In addition, the encouragement of investment by the business sector is of crucial importance in raising the demand for labour and improving productivity. Investment that is linked to manufacturing and to integration of the region into global value chains can be es-

pecially important in this respect. This would require the countries of the region to adopt effective measures to attract FDI. The examples of the special economic zones in Serbia and The Former Yugoslavia Republic of Macedonia are good examples of this type of policy. In order to make a success of such a policy, it is critically important to ensure that FDI activities spill over to the local economy in the form of job creation, skill development and technology transfer. Therefore, governments should ensure that they have policies in place to develop the local supply base to ensure that the inputs into the production processes of foreign multinationals are supplied by local companies rather than imported from abroad. In the latter case, FDI will have little impact on the local labour market. However, if supply capacity can be developed through active government policies to support local SMEs that can supply foreign companies in the region that are linked into global value chains then this could have an important multiplier effect and generate new demand for highly skilled jobs.

In support of this policy approach is it also crucially important that the supply of skilled labour should be increased through improvements to the education systems, both at secondary school and at higher education

levels. This should be based on curriculum reform, improvements in teaching quality based upon incentive and training programmes to stimulate educators' productivity, and on a much closer interrelationship between education institutions and the business sector. In this respect, the importance of work based learning for secondary school students along the lines of the Serbian programme to develop cooperative education, (based on the German dual education approach) should be considered to be a best practice example that should be diffused throughout the region. Correspondingly, at the tertiary level, measures to encourage university-business cooperation should be introduced or scaled up in order to ensure that university students and graduates have opportunities for periods of internship or project work within companies, and that the business sector can be included in decision making processes in university management systems. This should contribute to the modernisation of curricula and the improvement of the quality of labour supply which is an important attraction factor for FDI, the increase of which should increase the demand for skilled labour and facilitate a structural change towards a higher value added and more export oriented growth path in the region.

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## 8 Annex. Sectoral analysis of employment elasticity and productivity by country

### A1. Albania

Sector	GDP per sector, million ALL, 2015	Employment per sector, 2015	% Change in GDP, 2015/2011	% Change in employment, 2015/2011	Employment elasticity, 2015/2011	Change in productivity, 2015/2011
Agriculture	286,458	465,185	20.84	-14.75	-1.41	41.74
Manufacturing	81,205	103,392	10.27	7.18	1.43	2.89
Construction	128,228	67,563	-22.46	-26.07	0.86	4.88
Mining and quarrying; electricity gas and water supply	164,765	26,616	107.43	-28.49	-3.77	190.06
Trade, transportation, accommodation and food and business and administrative services	256,279	248,756	18.19	-0.26	-69.93	18.50
Public administration, community, social and other services and activities	110,249	164,814	14.08	-3.48	-4.05	18.19
<b>TOTAL</b>	<b>1,027,184</b>	<b>1,157,177</b>	<b>18.20</b>	<b>6.49</b>	<b>-1.41</b>	<b>41.74</b>

## A2. Bosnia and Herzegovina

Sector	GDP per sector, in 000 of BAM, 2016	Employment per sector, 2016	% change in GDP, 2016/2011	% change in employment 2016/2011	Employment elasticity, 2016/2011	Change in productivity, 2016/2011
Agriculture, forestry and fishing	1,907,344	25,809	7.60	9.40	1.24	0.01
Mining and quarrying	567,035	23,765	-1.11	-5.96	5.38	25.49
Manufacturing	3,697,294	192,863	29.12	9.75	0.33	23.58
Electricity, gas, steam and air conditioning supply	1,171,239	24,689	14.32	3.00	0.21	7.92
Water supply; sewerage, waste management	310,966	17,646	9.53	3.82	0.40	9.21
Construction	1,172,668	44,191	10.77	-9.39	-0.87	25.85
Wholesale and retail trade; repair of motor vehicles	4,031,739	172,423	17.89	1.81	0.10	20.91
Transportation and storage	1,078,703	46,505	25.60	3.87	0.15	27.41
Accommodation and food service activities	593,009	46,380	8.86	15.58	1.76	-0.79
Information and communication	1,306,953	23,280	6.31	5.96	0.94	2.75
Financial and insurance activities	1,119,416	21,087	12.39	-2.43	-0.20	21.70
Real estate activities	1,472,090	3,344	11.30	12.01	1.06	12.11
Professional, scientific and technical activities	860,727	29,171	17.73	19.94	1.12	2.21
Administrative and support service activities	251,124	14,843	48.45	37.53	0.77	3.20

Sector	GDP per sector, in 000 of BAM, 2016	Employment per sector, 2016	% change in GDP, 2016/2011	% change in employment 2016/2011	Employment elasticity, 2016/2011	Change in productivity, 2016/2011
Public administration and defense; compulsory social security	2,436,658	96,672	2.13	3.71	1.75	2.12
Education	1,317,366	85,862	4.48	6.16	1.38	0.81
Human health and social work activities	1,372,858	65,785	13.18	8.91	0.68	7.67
Arts, entertainment and recreation	404,634	13,329	84.91	33.14	0.39	48.10
Other service activities	345,173	16,940	12.04	29.86	2.48	-10.25
<b>TOTAL</b>	<b>25,416,997</b>	<b>964,584</b>	<b>14.31</b>	<b>4.65</b>	<b>0.32</b>	<b>13.59</b>

## A3. Kosovo\*

Sector	GDP per sector, 000 EUR, 2016	Employment per sector, in 000, 2016	% change in GDP, 2016/2011	% change in employment 2016/2011	Employment elasticity, 2016/2011	Change in productivity, 2016/2011
Agriculture, forestry and fishing	635,044	14.2	2.83	2.16	0.76	0.65
Mining and quarrying	126,698	3.6	2.10	0.00	0.00	11.09
Manufacturing	665,852	44.2	34.80	1.84	0.05	19.03
Electricity, gas, steam and air conditioning supply	211,821	5.5	71.58	-21.43	-0.30	110.16
Water supply; sewerage, waste management	44,870	6.7	30.87	86.11	2.79	-34.16
Construction	395,438	38.6	9.27	33.10	3.57	-12.93
Wholesale and retail trade; repair of motor vehicles	746,731	49.5	39.52	21.32	0.54	0.64

Sector	GDP per sector, 000 EUR, 2016	Employment per sector, in 000, 2016	% change in GDP, 2016/2011	% change in employment, 2016/2011	Employment elasticity, 2016/2011	Change in productivity, 2016/2011
Transportation and storage	220,501	10.6	18.18	0.00	0.00	17.48
Accommodation and food service activities	71,861	21.3	106.24	48.95	0.46	23.44
Information and communication	111,556	7.3	164.90	5.80	0.04	93.98
Financial and insurance activities	175,836	6.5	1.33	-4.41	-3.31	-4.50
Real estate activities	483,836	0.3	16.07	-57.14	-3.56	158.23
Professional, scientific and technical activities	93,868	6.6	51.19	17.86	0.35	10.46
Administrative and support service activities	37,189	11	89.40	-23.61	-0.26	117.13
Public administration and defense; social security	465,893	24.8	-2.32	63.16	-27.18	-42.64
Education	242,634	35.4	56.68	-3.54	-0.06	55.27
Human health and social work activities	112,584	18.8	67.09	-17.54	-0.26	89.62
Arts, entertainment and recreation	24,955	5.6	62.11	-16.42	-0.26	47.35
Other service activities	12,871	12.1	71.98	1.68	0.02	16.15
<b>TOTAL</b>	<b>6,070,113</b>	<b>322.6</b>	<b>26.08</b>	<b>9.77</b>	<b>0.37</b>	<b>9.32</b>

#### A4. The Former Yugoslav Republic of Macedonia

Sector	GDP per sector, mil MKD, 2015	Employment per sector, 2015	% change in GDP, 2015/2011	% change in employment, 2015/2011	Employment elasticity, 2015/2011	Change in productivity, 2015/2011
Agriculture, forestry and fishing	55,623	11,133	3.58	-10.17	-0.36	42.66
Mining and quarrying; Manufacturing; Electricity, gas, steam and air conditioning supply; Water supply; sewerage, waste management	91,263	133,630	8.82	10.32	0.51	8.83
Construction	38,551	29,264	5.46	12.10	0.20	42.02
Wholesale and retail trade; repair of motor vehicles and motor-cycles; Transportation and storage; Accommodation and food	104,276	146,524	8.62	15.92	0.51	13.26
Information and communication	17,817	12,388	11.41	26.11	2.22	-11.38
Financial and insurance activities	16,901	9,150	9.62	7.48	0.15	38.82
Real estate activities	61,757	2,334	3.04	36.17	4.03	-19.96
Professional, scientific and technical activities; Administrative and support service activities	17,787	36,746	4.71	35.58	1.50	-8.71
Public administration and defence; compulsory social security; Education; Human health and social work activities	68,367	120,346	4.77	7.58	2.70	-4.43

Sector	GDP per sector, mil MKD, 2015	Employment per sector, 2015	% change in GDP, 2015/2011	% change in employment, 2015/2011	Employment elasticity, 2015/2011	Change in productivity, 2015/2011
Arts, entertainment and recreation; Other service activities; Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use	15,355	17,516	6.49	26.68	0.80	5.24
<b>TOTAL</b>	<b>487,697</b>	<b>519,031</b>	<b>6.45</b>	<b>13.11</b>	<b>0.59</b>	<b>7.96</b>

#### A5. Montenegro

Sector	GDP per sector, in 000 EUR, 2016	Employment per sector, 2016	% change in GDP, 2016/2011	% change in employment, 2016/2011	Employment elasticity, 2016/2011	Change in productivity, 2016/2011
Agriculture, forestry and fishing	295,472	2,312	15.09	0.87	0.06	14.10
Mining and quarrying	42,795	1,562	19.79	-20.91	-1.06	51.46
Manufacturing	149,495	11,197	-8.02	-22.07	2.75	18.03
Electricity, gas, steam and air conditioning supply	141,592	2,657	37.27	-5.95	-0.16	45.95
Water supply; sewerage, waste management	69,777	4,951	3.79	7.70	2.03	-3.63
Construction	222,242	10,112	40.59	25.63	0.63	11.91
Wholesale and retail trade; repair of motor vehicles	484,097	36,576	23.59	-3.29	-0.14	27.80
Transportation and storage	160,334	10,405	6.27	13.25	2.11	-6.16

Sector	GDP per sector, in 000 EUR, 2016	Employment per sector, 2016	% change in GDP, 2016/2011	% change in employment, 2016/2011	Employment elasticity, 2016/2011	Change in productivity, 2016/2011
Accommodation and food service activities	281,124	14,684	74.43	18.14	0.24	47.64
Information and communication	154,717	5,050	-6.21	7.04	-1.13	-12.37
Financial and insurance activities	174,982	4,403	32.72	5.26	0.16	26.09
Real estate activities	236,407	1,650	7.52	29.82	3.97	-17.18
Professional, scientific and technical activities	96,859	7,943	9.85	24.69	2.51	-11.91
Administrative and support service activities	49,826	8,554	86.23	155.57	1.80	-27.13
Public administration and defense; social security	292,307	21,134	14.40	10.10	0.70	3.90
Education	168,507	13,759	20.99	12.57	0.60	7.49
Human health and social work activities	152,105	11,695	15.53	10.70	0.69	4.37
Arts, entertainment and recreation	58,060	5,122	45.85	21.63	0.47	19.91
Other service activities	40,291	4,142	105.18	19.85	0.19	71.20
<b>TOTAL</b>	<b>3,954,212</b>	<b>177,908</b>	<b>22.27</b>	<b>9.09</b>	<b>0.41</b>	<b>12.08</b>

## A6. Serbia

Sector	GDP per sector, 000 RSD, 2014	Employment per sector, 2014	% change in GDP, 2014/2010	% change in employment 2014/2010	Employment elasticity, 2014/2010	Change in productivity, 2014/2010
Agriculture, forestry and fishing	302,226.3	31,288	23.29	-16.32	-0.70	47.35
Mining and quarrying	43,385.8	21,812	2.48	-4.98	-2.01	7.84
Manufacturing	613,437.3	279,289	57.31	-7.35	-0.13	69.80
Electricity, gas, steam and air conditioning supply	112,643.5	27,476	24.99	-1.36	-0.05	26.71
Water supply; sewerage, waste management and remediation activities	47,908.4	34,603	42.01	7.33	0.17	32.31
Construction	167,087.8	63,490	45.91	-14.79	-0.32	71.23
Wholesale and retail trade; repair of motor vehicles and motorcycles	387,046.2	180,123	44.44	-3.55	-0.08	49.75
Transportation and storage	152,258.5	85,527	14.84	-3.91	-0.26	19.51
Accommodation and food service activities	41,578.5	19,791	51.15	-5.14	-0.10	59.34
Information and communication	168,225.6	41,162	35.87	12.76	0.36	20.49
Financial and insurance activities	119,669.0	35,023	26.23	-10.89	-0.42	41.66
Real estate activities	350,769.3	3,502	8.87	13.08	1.47	-3.72
Professional, scientific and technical activities	124,294.3	54,747	26.93	5.77	0.21	20.00
Administrative and support service activities	58,105.1	38,490	35.31	25.65	0.73	7.69

Sector	GDP per sector, 000 RSD, 2014	Employment per sector, 2014	% change in GDP, 2014/2010	% change in employment 2014/2010	Employment elasticity, 2014/2010	Change in productivity, 2014/2010
Public administration and defense; compulsory social security	148,958.3	72,889	48.75	4.28	0.09	42.65
Education	131,111.5	141,487	7.94	3.90	0.49	3.89
Human health and social work activities	188,811.1	158,732	25.03	-0.45	-0.02	25.60
Arts, entertainment and recreation	41,484.2	22,173	7.13	3.84	0.54	3.16
Other service activities	54,560.8	12,225	46.61	-9.13	-0.20	61.34
<b>TOTAL</b>	<b>3,257,176.8</b>	<b>1,323,831</b>	<b>19.71</b>	<b>-2.27</b>	<b>-0.12</b>	<b>22.50</b>



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