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#FivePointsOn

Inequality in Southeast Europe



Income inequality in Southeast Europe is high and may pose a significant threat to economic prosperity, societal well-being and democracy.

Labor markets are a major cause of inequality in the region. Income inequality is driven by unemployment and inactivity, precarious and informal work.

Tax systems are generally insufficiently progressive and redistributive, while social transfers tend to be meagre and cover only a small segment of the population.

Lack of access to quality education increases inequality of opportunity and outcome.

Governments have neglected economic inequality in their socioeconomic reforms. Labor market flexibilization and deregulation policies, along with the erosion of social safety nets, have been detrimental to equality.

INTRODUCTION

In recent decades, within-country inequality of income and wealth has been on a worldwide rise.¹ The issue has gained a prominent place on political agendas following the recognition of inequality's grave social repercussions, not limited to poverty and social exclusion, a decline in economic growth and opportunity, and social conflict.² Inequality is seen to be fueled, *inter alia*, by macroeconomic forces such as technological change and globalization. Its rise is also attributed to reforms such as labor market deregulation and the subsequent rise of non-standard work, a lack of access to quality education and investment in human capital, and insufficiently redistributive tax-and-transfer systems.³

In Southeast Europe (SEE), a region undergoing challenging economic and political transitions, levels of income inequality tend to be among the highest in Europe. Despite inequality's serious repercussions, governments in the region have not devoted sufficient attention to this issue. Rather, socioeconomic reforms, formulated in light of countries' EU accession prospects, tend to stress fiscal consolidation and labor market deregulation. Focusing on Albania, Bosnia and Herzegovina (BiH), Croatia, Kosovo, Macedonia and Serbia, this brief looks at the current state of economic inequality,⁴ its potential root causes, as well as remedies offered in current reform documents. It provides general recommendations on ways in which inequality in the region could be reduced.

¹ For instance, see Facundo Alvaredo et al, *World Inequality Report 2018* (Paris: World Inequality Lab, 2017), p. 9.

² E.g. see: OECD, *In it Together: Why Less Inequality Benefits All* (Paris: OECD, 2015), p. 15. Hanspeter Kriesi and Takis S. Pappas (eds), *European Populism in the Shadow of the Great Recession* (Colchester, UK: ECPR Press, 2015).

³ OECD, *In it Together*, p. 16.

⁴ Attention is primarily devoted to income inequality. Wealth inequality is not discussed due to a lack of data.

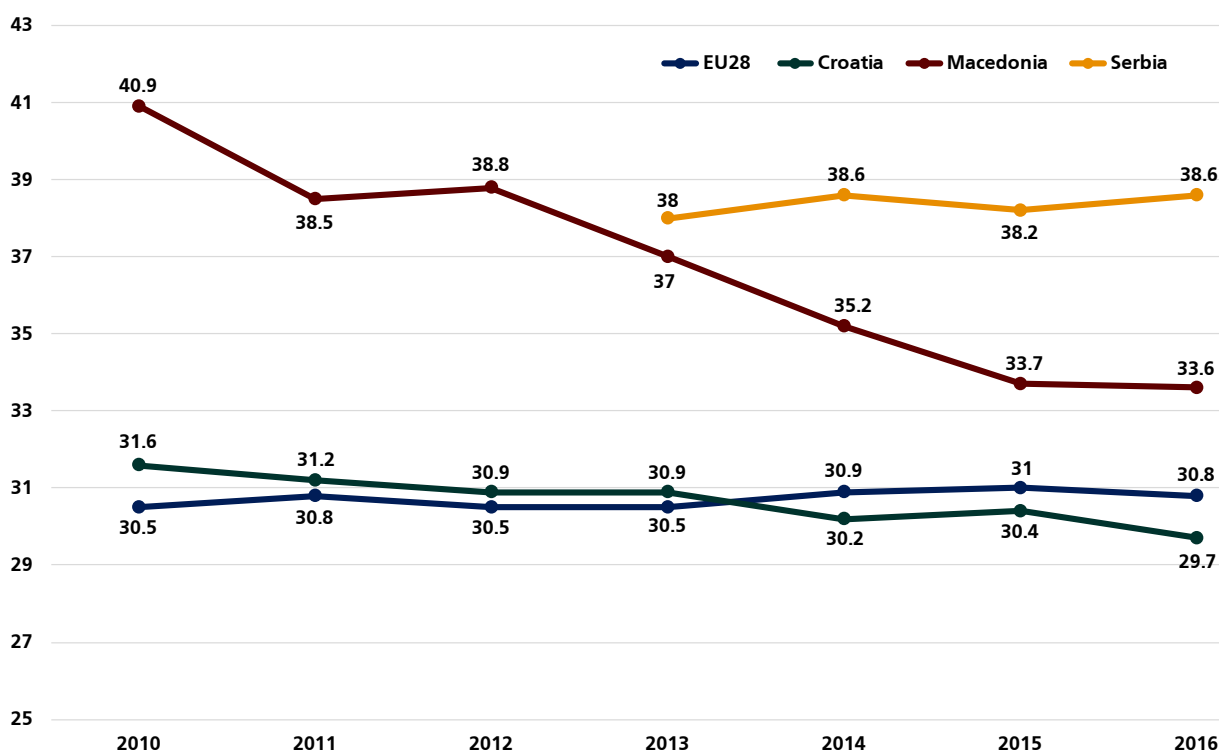
I. INCOME INEQUALITY IN THE SEE REGION IS HIGH

Challenges remain with respect to data comparability in the region, given that estimates of inequality rely on different data sources. The European Union Statistics on Income and Living Conditions (EU-SILC) surveys, which collect comprehensive information on incomes, living conditions and labor market characteristics, are only available for Croatia, Macedonia and Serbia, while other types of surveys – such as living standards measurement surveys (LSMS) or household budget surveys (HBS) – which tend to record household consumption better than income, are conducted in the other countries.

Income and consumption inequality captured by the Gini coefficient⁵ are shown in Figures 1 and 2.

Available indicators since 2000 paint a rather uneven picture of inequality in the region. Income inequality levels in Croatia are moderate to low, showing a gradual downward trend, converging with the EU28 average in recent years. While income inequality has risen and remained high in recent years in Serbia, it peaked during the 2008 economic crisis in Macedonia and has declined since. With some fluctuations, consumption inequality appears to be low and falling in Kosovo.⁶ It is on a gradual decline and relatively low in Albania, while in BiH, it appears to have risen since 2000 and has remained constant at moderate levels.⁷

Figure 1: Gini coefficients of equivalized disposable income, 2010–2016



Source: EU-SILC data, Eurostat⁸

⁵ Zero points denote equally distributed income and 100 points income accrued to one person.

⁶ Recent indicators for Kosovo, calculated on an equivalized, rather than per capita basis, suggest that its consumption-based inequality was as low as 23.2 Gini points in 2015. World Bank and Kosovo Agency of Statistics, *Consumption Poverty in the Republic of Kosovo 2012-2015* (Washington, D.C: World Bank, 2017), p. 6.

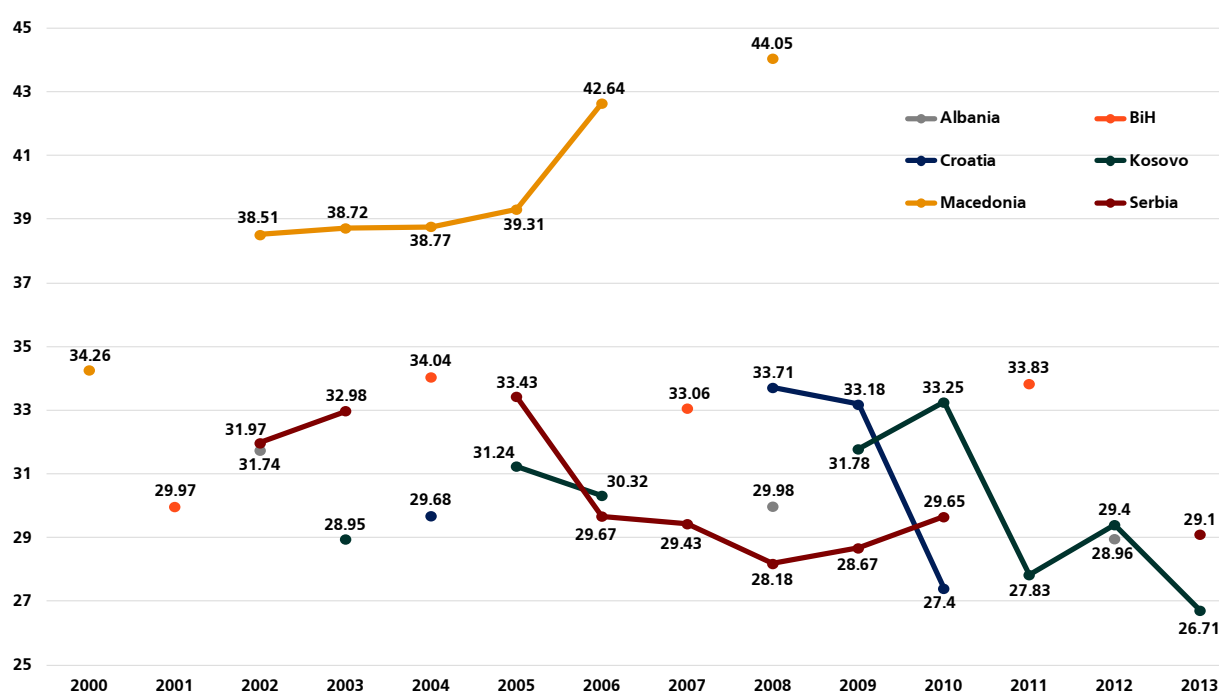
⁷ A Gini coefficient of 31.2 points for 2015, calculated based on equivalized consumption using the extended HBS, showed that the inequality had remained constant in BiH. Agency for Statistics of BiH, "First Release: Household Budget Survey 2015," 28 July, 2017, p. 8.

⁸ Eurostat, "Gini coefficient of equivalised disposable income - EU-SILC survey." 2010/2011 based on Republic of Macedonia State Statistical Office, *Survey of Income and Living Conditions 2012* (Skopje: State Statistical Office, 2015). No EU-SILC data for Albania, BiH, Kosovo.

While EU-SILC data are not available, limited income data from other surveys suggests that income inequality could also be high in Albania, BiH and Kosovo. For instance, estimates of the Gini coefficient for Kosovo calculated on a equivalized disposable household income basis using income data from a nationally representative survey on remittances,⁹ suggest that the Gini coefficient was as high as 39.5 points in 2010.¹⁰ Calculations based on the 2015 Extended HBS, calculated on an equivalized disposable household income basis, suggest it was 41.4 Gini points in 2015 in BiH.¹¹ Similarly, estimates of income inequality in Albania, relying on equivalized household income data from the 2012 LSMS, suggest income inequality was 38.1 Gini points. Levels of inequality appear lower when relying on consumption rather than income data from various survey sources. This is not surprising: “given that the marginal propensity to consume declines with income, or that savings increase with income, consumption expenditure tends to be more equally distributed than income.”¹²

Where do such estimates place countries from the region in a comparative perspective? Relying on an international categorization of inequality by Alvaredo and Gasparini,¹³ countries predominantly fall in the “middle range” category (30–40 Gini points). Croatia joins mainly EU countries in the ‘low’ inequality group (20–30 Gini points). Conversely, Serbia has the highest income inequality out of the countries covered by the EU-SILC (EU28 and candidate countries) in 2016, edging close to the ‘high’ inequality category (40–50 Gini points), a group that includes China, India and Brazil. Consumption-based indicators suggest that Kosovo and Albania are in the ‘low’ inequality category, while limited income-based estimates place them into the ‘middle range.’ While its consumption inequality may be moderate, various estimates of income inequality based on limited income data place BiH in the ‘high inequality’ category, making it the region’s most unequal country.

Figure 2: Gini coefficients, household consumption per capita, 2000–2013



Source: World Bank Povcal Database¹⁴

9 United Nations Development Programme (UNDP), *Kosovo Remittance Study 2010* (Prishtina: UNDP, 2010). Also see: Judith Möllers and Wiebke Meyer, “The effects of migration on poverty and inequality in rural Kosovo,” *IZA Journal of Labor & Development* 3, no. 16 (2014).

10 Calculations based on the OECD modified equivalence scale. Calculations for Albania, BiH and Kosovo provided for this paper by Nermin Oruč, Director of Centre for Development Evaluation and Social Science Research (CDESS) from Sarajevo.

11 Previous estimates, relying on income data from the 2011 Extended HBS, suggest income inequality was as high as 44 points. Ognjen Đukić and Nikolina Obradović, *Nejednakost u BiH: Od praznih džepova do punih sefova* (Banja Luka: GEA, 2016), p. 12.

12 World Bank, *Poverty and Shared Prosperity 2016: Taking on Inequality* (Washington, D.C.: World Bank Group, 2016), p. 79.

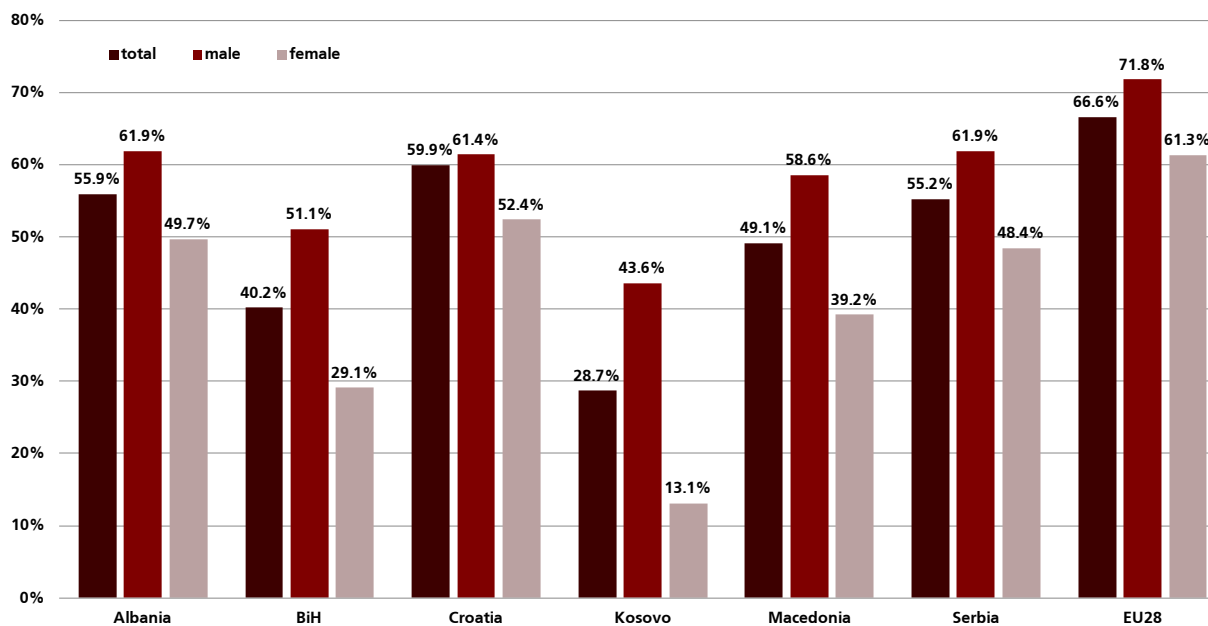
13 Facundo Alvaredo and Leonardo Gasparini, “Recent Trends in Inequality and Poverty in Developing Countries,” CEDLAS Document no. 151, Nov. 2013.

14 For Albania, based on LSMS data, HBS data for other countries. World Bank Povcal database (<http://iresearch.worldbank.org/PovcalNet/>).

II. LABOR MARKETS – A MAJOR CULPRIT OF INEQUALITY

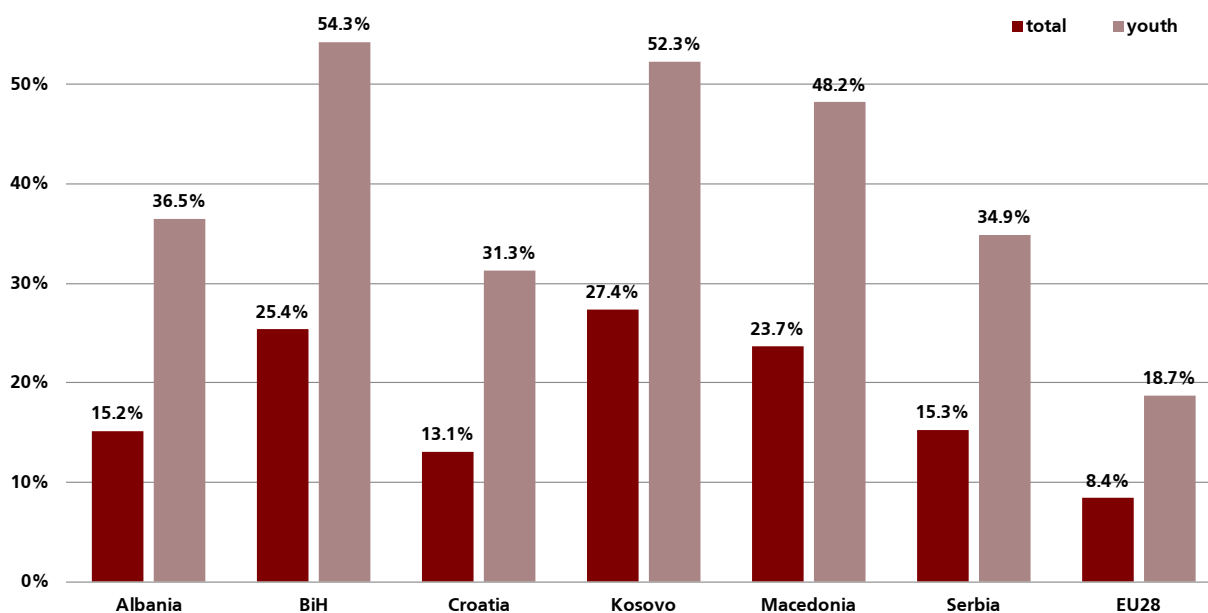
As in other parts of the world, being excluded from the labor market or working in low-paying jobs are important causes of inequality in the SEE region. Across the region, labor force participation and employment rates are lower than the EU28 average, sizably so in BiH and Kosovo. Unemployment is high in most countries, and young people are especially hit by joblessness (Figures 3 and 4).

Figure 3: Employment rates, 2016, % of working-age population (15–64)



Source: SEE Jobs Gateway/Eurostat¹⁵

Figure 4: General (15+ SEE, 15–74 EU), youth (15–24) unemployment rates, 2016, % of labor force



Source: SEE Jobs Gateway/Eurostat

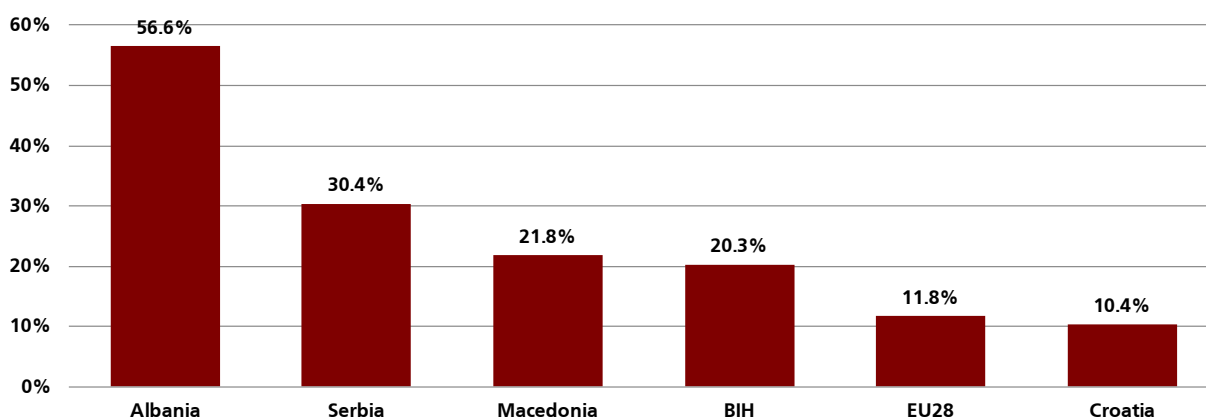
¹⁵ World Bank and wiiw, “The Jobs Gateway in South Eastern Europe” database (www.seejobsgateway.net/charts). Eurostat, “Employment and unemployment statistics” (<http://ec.europa.eu/eurostat/web/lfs/data/database>). Both based on labor force survey (LFS) data.

Reports on working conditions point to a multi-faceted duality of SEE labor markets, including standard vs. temporary, formal vs. informal, and public vs. private sector employment.¹⁶ The share of vulnerable (Figure 5) and informal employment is significant in most countries.

Research from the region shows that inactivity and unemployment have a significant impact on inequality, increasing the income share of those at the top and reducing the share of those at the bottom.¹⁷ Country-level evidence suggests that the rise of non-standard work, which lends itself to lower wages, more irregular working hours and insecure working conditions,¹⁸ contributes to an increase in income inequality due to differences in earnings,¹⁹ as does informal employment.²⁰

Individuals in the SEE region face unequal access to jobs and discrimination in labor markets based on characteristics such as gender, ethnicity, age, bodily ability, educational attainment or place of residence. A number of these attributes intersect and may further compound the levels of inequality and discrimination experienced.²¹ Significant gender gaps in activity and employment rates, gender pay gaps²² and gender-based sectoral segregation prevail.²³ Women remain overrepresented in unpaid care work.²⁴ The Roma are more likely to be unemployed, earn lower wages and work in the informal sector than non-Roma.²⁵ The high incidence of youth not in employment, education or training signals young people's exclusion from socioeconomic life.²⁶ Persons with disabilities are another group substantially affected by structural discrimination in labor markets of the region.²⁷

Figure 5: Vulnerable employment (own-account and unpaid family workers) as % of total employment



Source: Author's calculations based on ILOSTAT database²⁸

- 16 E.g. see UNDP, *Regional Human Development Report 2016, Progress at Risk* (Istanbul: UNDP, 2016), p. 32.
- 17 Zsoka Koczan, "Being Poor, Feeling Poorer: Inequality, Poverty and Poverty Perceptions in the Western Balkans," WP/16/31 (Washington, D.C.: International Monetary Fund, 2016). Also: Mihail Arandarenko, Gorana Krstić and Jelena Žarković Rakić, "Analysing Income Inequality in Serbia: From Data to Policy," Executive Summary (Belgrade: Friedrich-Ebert-Stiftung, 2017), pp. 4–5; Gorana Krstić, "Why income inequality is so high in Serbia: Empirical evidence and a measurement of the key factors," *Economic Annals* (2016), no. 61 (210), p. 33.
- 18 OECD, *In it Together*, p. 16.
- 19 E.g., Krstić, "Why income inequality is so high in Serbia," pp. 35–36; Mitja Čok and Ivica Urban, "Distribution of Income and Taxes in Slovenia and Croatia," *Post-Communist Economies* (2007), no. 19(3): pp. 299–316. Đukić and Obradović, *Nejednakost u BiH*.
- 20 Krstić, "Why income inequality is so high in Serbia," p. 35. See also: Gorana Krstić and Peter Sanfey, *Earnings inequality and the informal economy: evidence from Serbia* (London: EBRD, 2010).
- 21 UNDP, *Regional Human Development Report 2016*, p. 62.
- 22 Sonja Avlijaš et al., *Gender Pay Gap in the Western Balkan Countries: Evidence from Serbia, Montenegro and Macedonia* (Belgrade: FREN, 2013). Cesar Cancho and Nihal Elwan, *Bosnia and Herzegovina: Gender Disparities in Endowments, Access to Economic Opportunities and Agency* (Washington, D.C.: World Bank Group, 2015), pp. 52–53. Juna Miluka, *Gender Wage Gap in Albania: Sources and Recommendations* (Tirana: UN Women and Albanian Ministry of Labour and Social Affairs, 2011), p. 44. Hana Baca, *The Role of Women in the Economy of Kosovo* [Thesis] (Prishtina: Rochester Institute of Technology Kosovo, 2017). Tajana Broz and Dora Levačić, "Some Facts about the Gender Pay Gap in Croatia," Country fact sheet, Genderpaygap.eu, 2015.
- 23 UNDP, *Regional Human Development Report 2016*, pp. 64–65, p. 70.
- 24 UN Women and UNDP, "Investing in social care for gender equality and inclusive growth in Europe and Central Asia," Policy brief 2017/1.
- 25 UNDP, World Bank and European Commission regional Roma survey (2011).
- 26 Mirna Jusić and Amar Numanović, *The Excluded Generation: Youth in Southeast Europe* (Sarajevo: FES Dialogue SoE, 2017).
- 27 UNDP, *Regional Human Development Report 2016*, p. 47, p. 38.
- 28 ILO modelled estimates and projections as of November 2016. ILO Stat database (www.ilo.org/ilostat/).

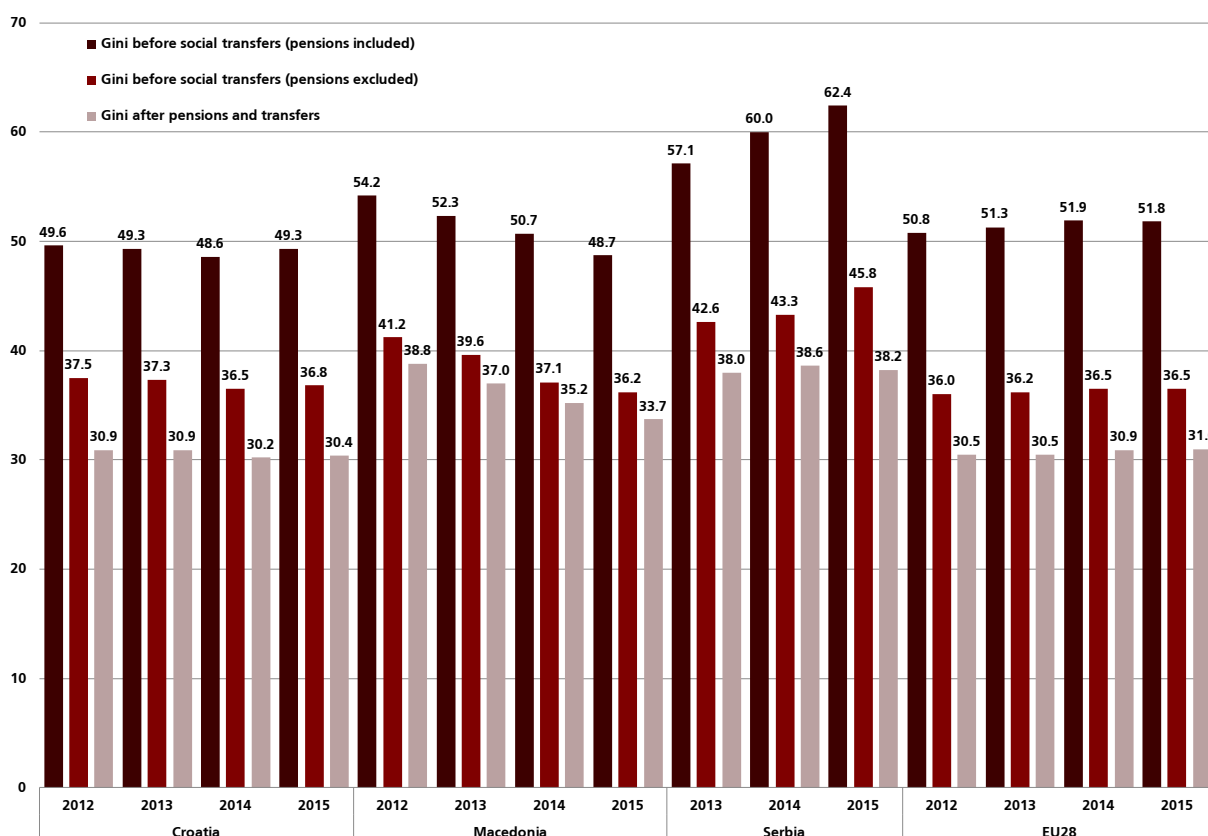
III. TAX AND TRANSFER SYSTEMS DO LITTLE TO REDUCE INEQUALITY

Social protection and tax systems are seen to offset increases in market income inequality. In the region, progressive tax systems that would alleviate the tax burden on those worse off are largely absent.

Because of no or low progressivity, personal income taxation has been shown to achieve a moderate to low redistributive effect,²⁹ with the exception of Croatia,³⁰ and could do more to decrease inequality. While the tax wedge on labor in SEE is not high in comparison to the EU28 average, the tax burden on low-wage earners is seen to be significant and may create disincentives to engage in (formal) work.³¹

Although social protection in the region certainly has a positive effect in terms of reducing inequality and poverty, this effect could be greater. Available data suggests that old-age pensions contribute the most to a reduction in inequality (Figures 6 & 7). Other forms of social transfers – including social assistance – generally make less of a difference, and expenditures on these schemes are low.³²

Figure 6: Gini coefficient of equivalized disposable income before and after social transfers, 2012–2015



Source: Eurostat³²

²⁹ E. g. Silda Mara and Edlira Narazani, "The Effects of Flat Tax on Inequality and Informal Employment: The Case of Albania" (Vienna: wiiw, 2011). Dželila Kramer, *Personal income tax reform in the Federation of Bosnia and Herzegovina*, Doctoral Dissertation, University of Ljubljana, 2016. Sasho Kozuharov, Vladimir Pektovski, and Natasha Ristovska, "The Impact of Taxes Measured by Gini Index in Macedonia," *UTMS Journal of Economics* 6, no. 1 (2015), pp. 41–52. Krstić, "Why income inequality is so high in Serbia," pp. 23–46.

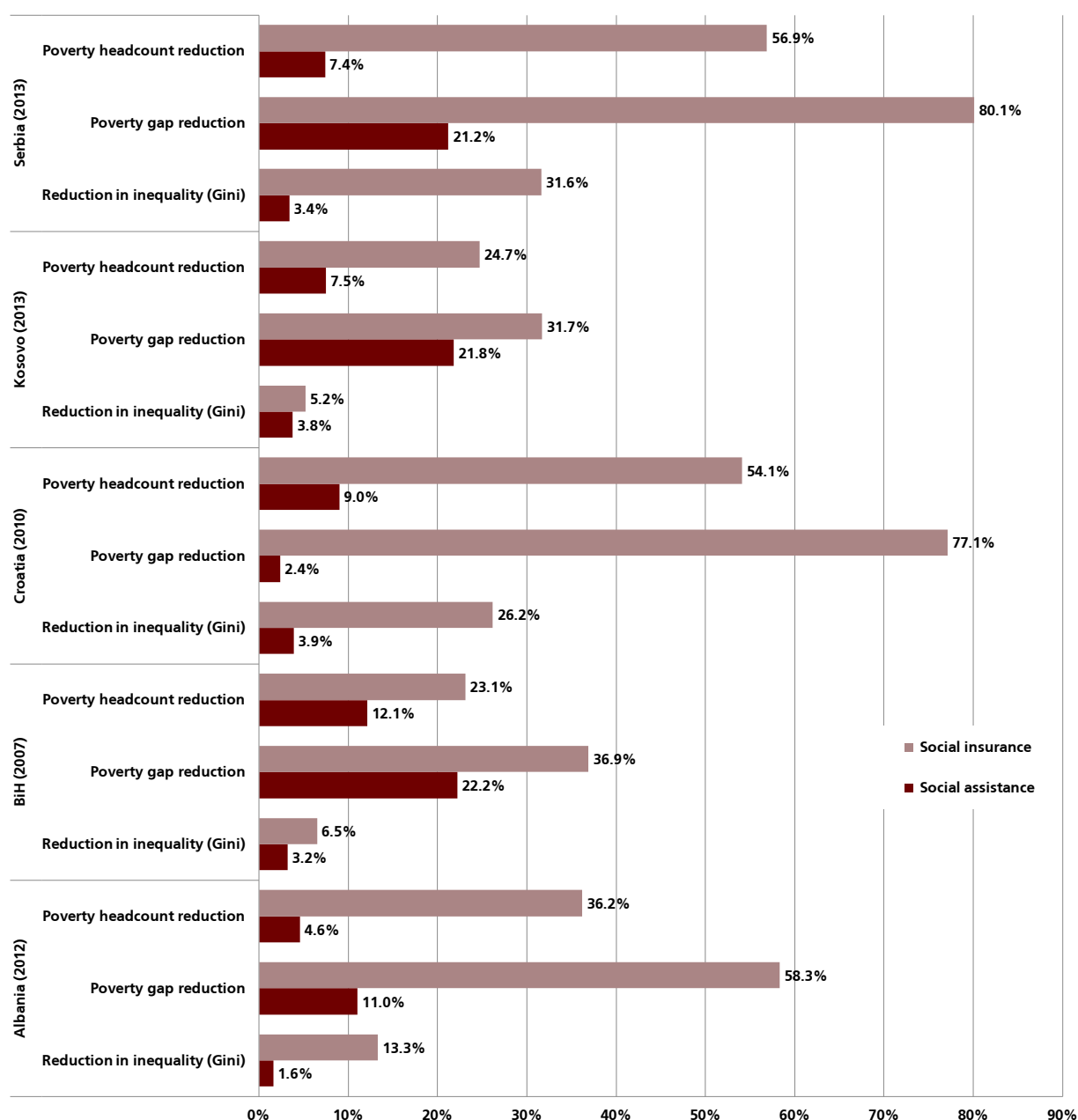
³⁰ Mitja Čok, Ivica Urban and Miroslav Verbič, "Income Redistribution through Taxes and Social Benefits: The Case of Slovenia and Croatia," *Panoeconomicus* 60, no. 5 (2013), pp. 667–686.

³¹ Ruben Atoyan and Jesmin Rahman, "Western Balkans: Increasing Women's Role in the Economy," IMF Working Paper, WP/17/194, (Washington, D.C.: IMF, 2017), pp.12–13; Mihail Arandarenko and Vladimir Vukojević, *Labor Costs and Labor Taxes in the Western Balkans* (Washington, D.C.: World Bank, 2008), p. 3.

³² Based on EU-SILC. No data available for Albania, BiH and Kosovo. Eurostat, "Income and living conditions database" (<http://ec.europa.eu/eurostat/web/income-and-living-conditions/data/database>).

Social assistance is marked by low coverage and meagre benefits in most countries.³³ Despite the high incidence of the long-term unemployed, social protection systems in the region fail to protect individuals against the risk of unemployment, as countries do not provide non-contributory unemployment assistance, and coverage of the unemployed with unemployment benefits in the region is among the lowest globally.³⁴ Notwithstanding differences between countries, most reports also point to services, especially various types of community-based services, as being inadequate and underdeveloped.³⁵

Figure 7: Impact of social protection on poverty and inequality reduction, poorest quintile



Source: World Bank ASPIRE database³⁶

³³ See World Bank ASPIRE database. Also see: Boryana Gotcheva and Ramya Sundaram, "Social Safety Nets in the Western Balkans: Design, Implementation and Performance," *Poverty and Exclusion in the Western Balkans*, eds. Caterina Ruggeri Laderchi and Sara Savastano (New York, NY: Springer, 2013), pp. 221–244.

³⁴ See, for instance, ILO, *World Social Protection Report 2014/15* (Geneva: ILO, 2014), p. 36.

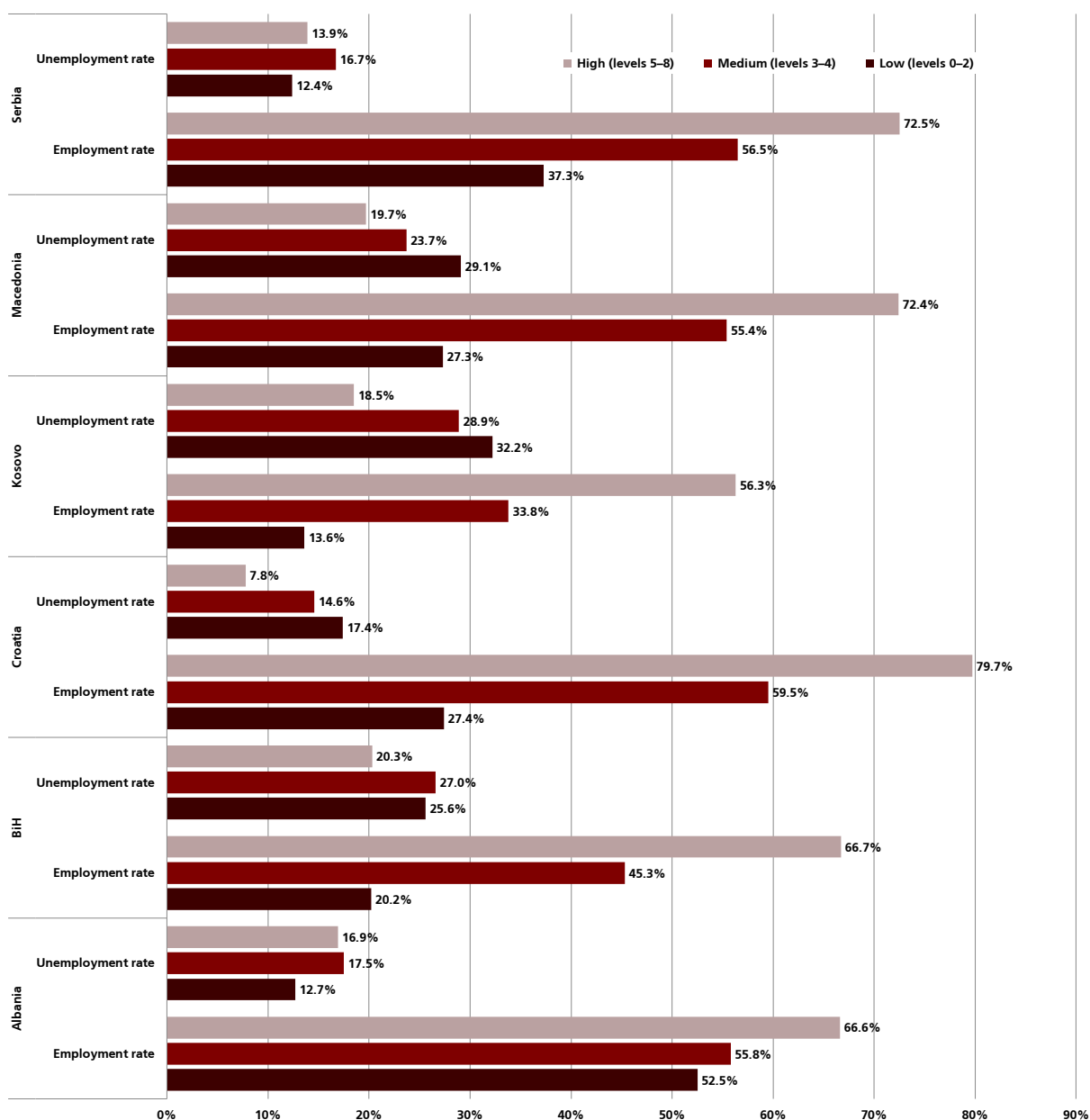
³⁵ E.g. UNDP, *Regional Human Development Report 2016*, pp. 52–53; European Commission, *Social Protection and Social Inclusion in the Western Balkans: A Synthesis Report* (Brussels: European Commission 2009).

³⁶ World Bank, *The Atlas of Social Protection Indicators of Resilience and Equity Database* (<http://datatopics.worldbank.org/aspire/>).

IV. REDUCED EDUCATIONAL OPPORTUNITY INCREASES INEQUALITY

A lack of access to quality education poses a serious threat to equality of opportunity and outcome in the SEE region. Persons with lower educational attainment are more often at risk of poverty or social exclusion, as are children of parents with lower educational attainment.³⁷ Higher levels of completed education have a positive bearing on one's position in the labor market in the region (Figure 8). Better-educated workers tend to have a higher income and are at a lower risk of in-work poverty.

Figure 8: Employment and unemployment rates by level of education, 2016, annual average



Source: SEE Jobs Gateway

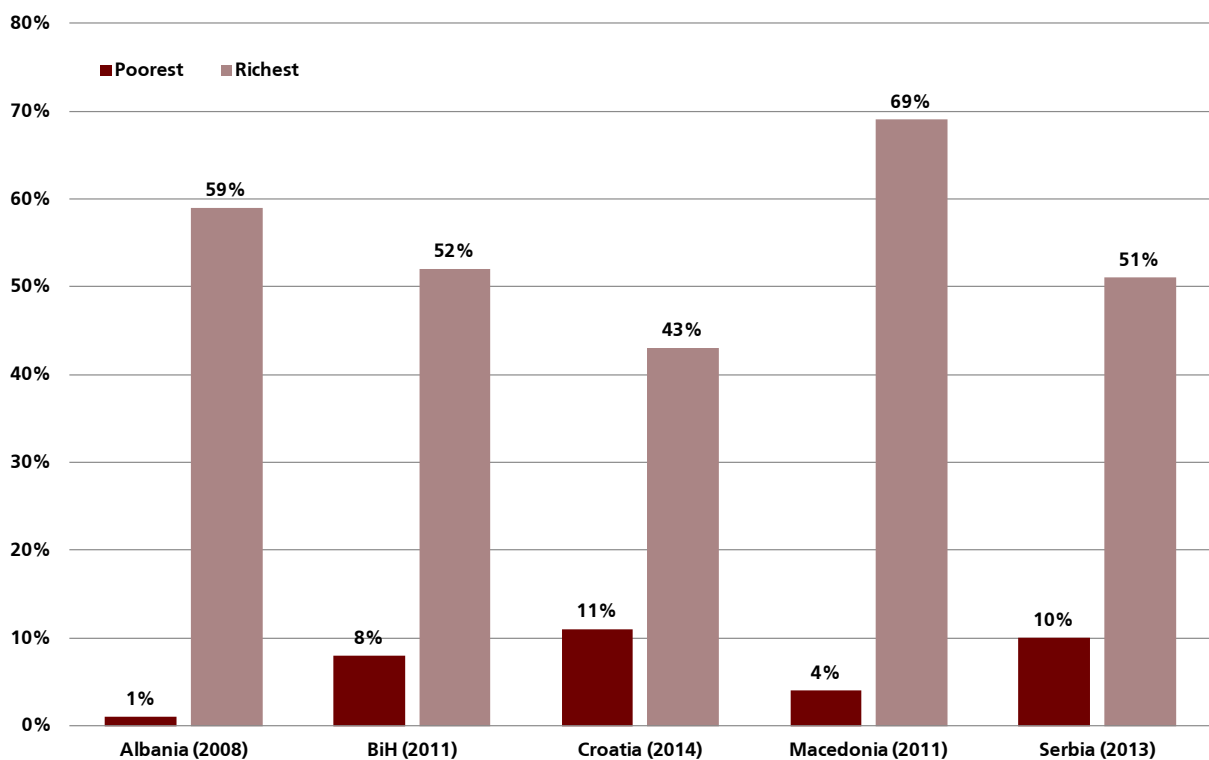
³⁷ Pertains to Serbia, Macedonia and Croatia. Data for Albania, BiH and Kosovo show that poverty is more common among households where individuals or household heads have completed primary education or less. World Bank, Agency for Statistics of BiH, FBiH Institute for Statistics and RS Institute for Statistics, *Braving the Storm: Poverty and Inequality in Bosnia and Herzegovina 2007–2011* (Washington, D.C.: World Bank, 2015); World Bank and Kosovo Agency of Statistics, *Consumption poverty in the Republic of Kosovo 2012–2015*, p. 8; World Bank, *An Update on Poverty and Inequality in Albania: 9 Stylized Facts*, May 2015, p. 16; 37.

Primary and secondary education in the region is principally free, while tertiary education is in most cases provided by public higher education institutions, free of charge or at a low fee; a vast majority of students attend public universities.³⁸ Gross school enrolment ratios are generally on par with EU28 countries, except for pre-primary and tertiary levels.³⁹ However, general enrolment and completion rates cloak important inequalities in opportunity: for instance, persons with higher completed levels of education tend to live in urban areas or come from richer families (Figure 9).

In comparison to the general population, levels of educational attainment are lower for Roma, which affects their employment prospects.⁴⁰ Although women's enrolment rates in post-secondary education are higher than those of men in the region, women tend to be clustered in specific programs, leading to sectoral segregation. Persons with disabilities also frequently face a risk of exclusion from education, may be separated into special programs, or attend programs geared towards certain professions.⁴¹

Moreover, poor quality of education in the region may lead to the social exclusion of young people. Poor quality is indicated by the high portion of 15-year-old students who scored below Level 2 proficiency on the OECD's Program for International Student Assessment (PISA) exam, which denotes basic ability. In Kosovo, Macedonia and Albania, a majority of students appear to be lacking access to education that would allow them to reach a baseline level of skills, while students in Croatia and Serbia also perform below the OECD average. As a result, young people may be in a disadvantaged position in comparison to other cohorts of the population, as reflected in their difficult labor market position. Education systems where a significant portion of students have not mastered basic skills are considered to be insufficiently inclusive.⁴²

Figure 9: Tertiary education completion rates by level of student wealth, at least 2 years of education



Source: World Inequality Database on Education⁴³

³⁸ Koczan, "Being Poor, Feeling Poorer," p.10. William Bartlett et al., *From University to Employment: Higher Education Provision and Labour Market Needs in the Western Balkans – Synthesis Report* (Luxembourg: Publications Office of the European Union, 2016), p. 17.

³⁹ UNESCO Institute for Statistics (uis.unesco.org).

⁴⁰ Based on UNDP, World Bank and European Commission Regional Roma survey (2011).

⁴¹ UNDP, *Regional Human Development Report*, p. 48; p. 72.

⁴² OECD, *PISA 2015 Results (Volume 1): Excellence and equity in education* (Geneva: OECD, 2016), p. 205.

⁴³ World Inequality Database on Education (www.education-inequalities.org), various surveys. Tertiary completion rates for 25–29.

V. SOCIOECONOMIC REFORMS FAIL TO TACKLE INEQUALITY

In light of EU accession requirements, prospective candidate and candidate countries from the region have adopted economic reform programs (ERPs); candidate countries have also adopted employment and social reform programs (ESRPs).⁴⁴ The former outline a variety of measures designed to enhance economic prospects, while the latter focus on social protection, development of human capital and skills and employment policy. However, envisaged reforms do not sufficiently tackle economic inequality.

Although SEE labor markets face extraordinary problems, policy responses to date are considered weak and insufficiently effective. Public expenditure on active labor market policies (ALMP) is well below the EU average in most countries, their coverage is low and targeting considered to be ineffective, failing to reach those hardest to employ.⁴⁵ A dominant policy response of SEE governments has been to amend labor laws to increase the flexibility of working conditions, despite previous evidence showing that employment protection legislation (EPL) in the region was, comparatively speaking, not particularly stringent in the first place and that its enforcement was weak.⁴⁶ Moreover, the presumed significant impact of flexible EPL on reducing unemployment and increasing employment has not been supported by empirical evidence,⁴⁷ including the region.⁴⁸ Flexibilization policies are seen to promote the creation of part-time and non-standard work, which widens gaps in the wage distribution,⁴⁹ increases employment insecurity for temporary workers, while decreasing their career prospects and training opportunities. In line with the tendency to deregulate working conditions, the region has also faced a continuous deterioration of trade unions and collective bargaining mechanisms,⁵⁰ despite the numerous positive effects of union organization on wage levels, working conditions and increased productivity, and of wage coordination mechanisms on reducing unemployment and wage dispersion.⁵¹

In annual ERPs, measures in the labor market realm are mostly supply-side oriented, relating to greater investment in ALMPs, and a decrease in the regulatory burden on businesses and entrepreneurs.⁵² In recent years, more attention is being paid to specific employment measures targeting vulnerable and hard-to-employ groups. However, substantial investment in childcare is not foreseen, and neither is the formulation of work and family reconciliation policies. Competitiveness-oriented reforms depart from the EU's policy of active inclusion,⁵³ which foresees that employment measures are complemented with adequate income support, that in-work poverty is challenged, or that going back to work is facilitated through access to quality care and other services. With very few exceptions, strengthening social dialogue and collective bargaining mechanisms is mostly left out of governments' strategic priorities. Labor market reform courses in the region generally seem to imply that an efficiency vs. equity trade-off is inevitable, and that the efficiency course is preferred for better labor market performance.

Social policy responses have by and large been marked by retrenchment during the course of the transition. Recommendations to cut down on categorical benefits and to make benefits conditional on means and income tests have continuously been promoted in the region by international financial institutions and espoused by governments as a way to reduce poverty,⁵⁴ albeit "with little impact" to that end.⁵⁵

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⁴⁴ The government of Croatia's national reform program (NRP) is prepared as part of the European semester.

⁴⁵ Can Alkan, Statistical Bulletin No. 6 (Yenimahalle-Ankara: CPESSEC, 2016). Amar Numanović, *Weak Labour Markets, Weak Policy Responses: Active Labour Market Policies in Albania, BiH and Macedonia* (Sarajevo: Analitika – Center for Social Research, 2016).

⁴⁶ For instance, Sandrine Cazes and Alena Nesporova, "Combining flexibility and security for employment and decent work in the Western Balkans," *South-East Europe Review 2* (2006), pp. 15–16.

⁴⁷ For a detailed overview of research in this area, see OECD, *Employment Outlook 2013* (Paris: OECD, 2013).

⁴⁸ E. g. see Cazes and Nesporova, "Combining flexibility and security," p. 19.

⁴⁹ OECD, *Divided We Stand*, p. 32. OECD, *In it Together*, p. 31.

⁵⁰ For instance, see the FES annual reviews of labor relations and social dialogue in SEE.

⁵¹ For an overview, OECD, *Divided We Stand*, p. 31. See also: David Card, Thomas Lemieux and W. Craig Riddell, "Unionization and Wage Inequality: A Comparative Study of the U.S, the U.K., and Canada," NBER Working Paper No. 9473, 2003.

⁵² Pertains to the 2018 and 2017 Economic Reform Programs of the governments of Albania, BiH, Kosovo, Macedonia and Serbia and the government of Croatia's 2017 National Reform Program.

⁵³ See, for instance, European Commission, "Active Inclusion," Employment, Social Affairs & Inclusion, 2018.

⁵⁴ World Bank, *Social Safety Nets in the Western Balkans: Design, Implementation, and Performance* (Washington, D.C.: World Bank, 2011); William Bartlett, "The Political Economy of Accession: Forming Economically Viable Member States," *The EU and Member State Building: European Foreign Policy in the Western Balkans*, eds. Soeren Keil and Zeynep Arkan (London & New York: Routledge, 2014), pp. 209–232.

⁵⁵ William Bartlett, "The Political Economy of Welfare Reform in the Western Balkans," *Poverty and Exclusion in the Western Balkans*, eds. Caterina Ruggeri Laderchi and Sara Savastano (New York, NY: Springer, 2013), pp. 253–254.

Notwithstanding their importance in reducing inequality and poverty in the region, broadening the scope of social protection systems generally does not appear to be a priority for governments in the region. National ERPs suggest that most governments plan to keep constant or decrease expenditure on social protection. As a result of fiscal consolidation efforts, countries are planning interventions that mostly focus on making social programs more cost-effective, and which target, *inter alia*, pension systems and social welfare benefits. While there is certainly ample reason to question the social contract behind some expenditure schemes – such as very high transfers for war veterans in BiH – further targeting of social assistance ought to be considered in a critical light, given international empirical evidence showing that increased concentration of benefits (as opposed to more universalistic schemes) increases inequality and poverty, and may lead to further deterioration of social welfare.⁵⁶ In countries that have high unemployment, low activity of the workforce and weak safety nets, enhancing, rather than further diminishing social protection appears to be a more intuitive path to take.

Despite the abundant empirical evidence that points to a significant link between higher progressivity of taxes and lower income inequality, progressivity is, with some exceptions, generally low in the region, while the tax burden on the lowest salaries remains high. In their ERPs, SEE governments are primarily concerned with the fiscal and business effects of current or planned tax policies, and foreseen reforms address issues such as the efficiency of tax collection or the lowering of the tax wedge as to reduce labor costs for employers and stimulate formal employment. Despite their potentially positive effect in terms of creating incentives for employment, reducing high inactivity rates and curbing inequality, especially among low-wage workers, specific measures such as in-work benefits to make work pay, or combinations of various types of tax allowances or social security contribution credits targeting families and other categories of workers who may be at a risk of in-work poverty are generally not foreseen.

An articulated priority for most governments from the region is to reduce the skills mismatch between the labor market and education, with reforms mainly focusing on improvements to vocational education and training systems. Although there has been “little investment in upgrading education systems”⁵⁷ in the region in the past decades, current reform programs suggest that spending on education will be kept constant or decrease. With very few exceptions, reform programs do not devote enough attention to the expansion of early childhood education schemes, despite a general underinvestment in early childhood education across the region. Moreover, making education more inclusive by removing obstacles in accessing education for a number of groups, such as Roma, persons with disabilities, children and young adults from poor and rural households, is generally not an articulated policy priority.⁵⁸

Many of the principles that are inherent to the Europe 2020 strategy and other important documents, such as active inclusion or social investment, are generally absent from reform documents. While governments aim to increase economic growth through measures that are seen to be conducive to improving competitiveness and attracting foreign direct investments, there is a general absence of policy debate on ‘predistribution’ as a means to decrease economic inequality through market mechanisms, by ensuring, for instance, efficient collective bargaining mechanisms, adequate legal protection of workers or basic social security in case of unemployment.⁵⁹ In most SEE countries, policies implemented in the name of efficiency have, in fact, had unfavorable effects on the very mechanisms that could lead to more equitable outcomes.

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⁵⁶ Walter Korpi and Joakim Palme, “The Paradox of Redistribution and Strategies of Equality: Welfare State Institutions, Inequality and Poverty in the Western Countries,” Luxembourg Income Study (LIS) Working Paper Series No. 174, p. 4.

⁵⁷ Mihail Arandarenko and Will Bartlett (eds.), *Labour Market and Skills in the Western Balkans* (Belgrade: FREN, 2012). p. 4.

⁵⁸ Exceptions include Serbia’s and Macedonia’s ESRPs; some inclusion measures are also articulated in Albania’s 2017 ERP.

⁵⁹ E.g. *The Predistribution Agenda*, eds. Claudia Chwalisz and Patrick Diamond (London: I.B. Tauris, 2015).

CONCLUSION AND RECOMMENDATIONS

SEE countries face a host of challenges in the process of democratization and economic transition. The region is characterized by slow economic growth and poor labor market performance, usually attributed to factors such as low competitiveness and adverse business environments, inadequate education systems and weak employment policies. Institutional inefficiencies and ‘systemic’ corruption⁶⁰ have led to a deterioration of trust in political institutions. They have also made their imprint on the extent to which resources have been redistributed – or captured and funneled towards the needs of specific interest groups. Corruption and poor governance have contributed to governments’ inability to generate policy response that could serve as “equalizing mechanisms”⁶¹ in the face of inequality. Although the roots of the problem of inequality are multifaceted, there appear to be sufficient indications that inequality in the region has not risen because of higher rewards to innovation, entrepreneurship or skills, as in a number of advanced economies, but because of widespread corruption, state capture and policy failures.

More than ever, the culprits of inequality need to be regarded with a sense of urgency because of numerous threats that may further increase gaps in prosperity. Due to a poor socioeconomic situation, joblessness, a corrosion of public services and security concerns, countries across the region are experiencing substantial emigration trends and a loss of human capital, which will have a detrimental effect on their economies. While emigration may alleviate the pressure on countries’ social welfare systems and curb inequality and poverty at home thanks to remittances from abroad, such effects may only be felt in the short run, as the exodus of predominantly young and educated people will have a detrimental effect on SEE economies. In fact, “the loss of qualified workers and the shortage of skills may have adversely affected competitiveness, growth and economic convergence.”⁶² An ageing population will place a growing burden on the countries’ already weak social safety nets. Like other regions of the world, SEE may increasingly be affected by the trend of ‘hollowing out’ of labor markets, whereby the share of employment in high- and low-skilled occupations may rise, while the share of middle-skilled employment – where the bulk of employment in SEE lies – may go down.⁶³

New thinking and a broad discussion surrounding socioeconomic reform is needed in light of the region’s EU integration. The EU’s new Enlargement Strategy for the Western Balkans, which stresses the importance of a “new reinforced social dimension,” may offer momentum to that end. The strategy envisages the Commission’s support for employment and social reforms, including investment in education and health and a closer alignment of countries’ ERPs with the European semester.⁶⁴ However, for a truly reinforced social dimension, principles inherent to the recently proclaimed European Pillar of Social Rights⁶⁵ should be actively promoted by the Commission in the region. These principles do not only pertain to access to training, life-long learning and active labor market policies, which the EU is providing considerable support for in the region, but also to quality jobs, income support, minimum wages, robust social dialogue and collective bargaining mechanisms, and a range of social services and benefits. In other words, the values inherent to the European Pillar of Social Rights and other important documents in the social realm should not be endorsed on a selective basis through the EU’s political, financial and technical support to enlargement. Residents of the region should not only be able to benefit from enhanced job prospects, but from secure, decent employment, adequate income and quality public services that would allow them to partake in society in a meaningful manner.

Given inequality’s multidimensional nature, piecemeal reforms or interventions will not suffice; rather, combined responses in the realms of education, employment, taxation and social policy are needed to ensure that the root causes of economic inequality are appropriately addressed. Provided the differences in the types of socioeconomic and political challenges that countries in the region face, they will inevitably espouse heterogeneous approaches to curb inequality. While by no means an exhaustive list, some policy responses that have been recognized and promoted in the labor market, social protection, taxation and education realms are suggested as common points of departure and provided below.

60 Velina Lilyanova, “Anti-corruption efforts in the Western Balkans,” April 2017, Briefing, European Parliamentary Research Service.

61 Atkinson, *Inequality: What can be done?* p. 2.

62 World Bank and wiiw, *Western Balkans Labor Market Trends 2018* (Washington, D.C.: World Bank Group and wiiw, 2018), p. 2.

63 World Bank, *Digital Dividends: World Development Report 2016* (Washington, D.C.: World Bank Group, 2016), pp. 21–22.

64 European Commission, “A Credible Enlargement Perspective for and enhanced EU Engagement with The Western Balkans,” 6 February, 2018, Brussels, p. 13.

65 The European Pillar of Social Rights was proclaimed by the European Parliament, the Council of the European Union and the European Commission in November of 2017. For more, see: European Union, *The European Pillar of Social Rights* (Luxembourg, The Publications Office of the EU, 2017).

Labor Market

- › Strengthening social dialogue and collective bargaining mechanisms as a means to ensure more equitable earnings, workers' improved representation in corporate governance, greater labor market security and a better quality of jobs.
- › Extending income security through greater coverage and generosity of unemployment benefits and the introduction of unemployment assistance schemes for those without social insurance coverage in the event of unemployment.
- › Improving the design, coverage and targeting of a mix of active labor market policies – not limited to training schemes and employment subsidies – as to enhance the employability of women, youth, persons with disabilities, ethnic minorities, and persons with low levels of educational attainment.
- › Strengthening the capacities of employment services, as to ensure more effective support in the event of unemployment. Better integration of employment and social services may foster the inclusion of vulnerable groups in labor markets.

Taxes and Social Benefits

- › Increasing the progressivity of personal income tax and reducing the overall tax burden on low-wage earners, as to encourage their transition to (formal) employment.
- › Introducing a mix of schemes that would “make work pay,” not limited to in-work benefits, tax credits or wage subsidies, as to encourage the employment of various categories of earners and to protect them against in-work poverty.
- › Stepping up efforts to combat tax avoidance and tax evasion, as to protect the tax base and increase tax revenues available for investment in the economy, and the financing of social transfers and important public services.
- › Expanding coverage and increasing the generosity of social transfers to protect individuals against various social risks. Considering general expansion of social protection towards more universal entitlements.
- › Promoting deinstitutionalization and further expansion of various types of social services, with an emphasis on access to services and quality assurance in service provision.
- › Designing and implementing more effective family and work reconciliation policies, not limited to the introduction of paternity leave in countries where such policy has not been adopted and expanding access to affordable, quality childcare.

Education

- › Greater investment in early childhood education in order to foster personal development and encourage greater equality of opportunity, especially for children from low-income families.
- › Introducing comprehensive measures to increase access to all levels of education, and especially tertiary education, for various excluded groups, such as students with disabilities, the Roma, residents of rural areas or children and young adults living in poverty. These may include scholarships or subsidized room and board, and for students with disabilities, greater focus on removing physical obstacles in accessing education.
- › Improving quality of education through measures such as teacher education and training, quality assurance, and students' access to appropriate learning resources. Modernizing curricula, expanding vocational education and improving the practical orientation of secondary and university-level education as to ensure better matching between education and labor markets.

The Friedrich-Ebert-Stiftung in Southeast Europe

After more than two decades of engagement in southeastern Europe, the FES appreciates that the challenges and problems still facing this region can best be resolved through a shared regional framework. Our commitment to advancing our core interests in democratic consolidation, social and economic justice and peace through regional cooperation, has since 2015 been strengthened by establishing an infrastructure to coordinate the FES' regional work out of Sarajevo, Bosnia and Herzegovina: the Regional Dialogue Southeast Europe (Dialogue SOE).

Dialogue SOE provides analysis of shared challenges in the region and develops suitable regional programs and activities in close cooperation with the twelve FES country offices across Southeast Europe. Furthermore, we integrate our regional work into joint initiatives with our colleagues in Berlin and Brussels. We aim to inform and be informed by the efforts of both local and international organizations in order to further our work in southeastern Europe as effectively as possible.

Our regional initiatives are advanced through three broad working lines:

- Social Democratic Politics and Values
- Social and Economic Justice
- Progressive Peace Policy

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