Comment: Joblessness Threatens EU Ambitions

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Region risks missing out on Europe unless it tackles soaring unemployment.

Chronic unemployment in many Western Balkan countries is undermining stability and the goal of European Union membership. Having a functioning market economy is a pre-condition for accession, but joblessness rates of 44 per cent in Kosovo, 42 per cent in Bosnia and Hercegovina and 37 per cent in FYR Macedonia in 2004 show that this condition has not yet been met.

Even allowing for the likelihood that many of the unemployed have work in the grey economy, these rates are extremely high.

As a comparison, the formerly socialist countries of Central and Eastern European which joined the EU last year had much lower unemployment rates at a similar stage. In 1996 when, as in the Western Balkan countries now, some five to six years had elapsed since the start of transition, unemployment in Slovakia was 13 per cent, 14 per cent in Slovenia and 11 per cent in Poland.

Does this therefore mean that changes are needed in the model for economic transition and development in the Western Balkans?

It is obviously worth asking why unemployment rates are so much higher, despite economic growth in the region. Recent wars have not helped and, while the sharp effects on GDP are past, their legacy inevitably affects confidence. This helps account for low domestic, and comparatively low levels of foreign direct investment, FDI, in the region. This matters because investment drives growth and influences job creation. Indeed, the latter is not yet high enough to absorb those who lose their jobs or provide work for young people looking for a job for the first time.

But are there other factors at work that impede investment, growth and job creation in the Western Balkans? One constraint is likely to be the prevalence of high wage rates compared to those in competitor countries since wages, along with productivity rates, determine competitiveness.

Salary levels are a sensitive subject and nobody wants to argue for people to become poorer. But, on the other hand, a disparity between productivity and pay cannot be sustained. Comparatively high wage rates will dissuade foreign investors, diverting FDI to countries with lower employment costs. And, over time, lower FDI will tend to compound the problem by weakening productivity growth.

Wage rates will thus be one FDI-influencing factor amongst others in a period when Western Balkan countries are competing for FDI with the new EU member states.

So why are wages inflexible despite high unemployment and poorer economic performance? One possible explanation is high expectations because of the comparative ease of getting work in neighbouring, richer countries – which leads to an unwillingness to accept the low wages on offer at home. Alternatively, as some studies have shown, it may be due to strong employment legislation which protects those in work through complex and costly dismissal requirements.

Studies in Croatia suggest that employment protection legislation there, which is amongst the strongest in Europe, is a key constraint on job creation and hiring and that job creation is slowed down by labour costs associated with protected workers being able to outpace growth in productivity with their wage demands.

Overall, such legislation seems to have the reverse of the intended effect and does not prevent high unemployment, since lighter employment protection (as in the UK, Ireland and the USA) is associated with much lower rates of joblessness.

Weakening employment protection could therefore be one route to encouraging firms to create new jobs in the knowledge that, if they have to restructure their workforces, they can dismiss employees without unduly high costs and/or having to go through unduly complex and time-consuming procedures.

Making it easier to employ people on temporary contracts, which do not attract the same level of protection as regular posts, also helps and could ease the higher rates of unemployment amongst young people and women since they have a higher tendency to seek temporary jobs.

Growth in the number of new firms is essential to job creation. Drawing on the experience of Bulgaria, Lithuania and Poland, business start-ups might create about 30 per cent of new jobs.

Research shows that the Western Balkan countries remain comparatively difficult places to do business, although there have been some marked recent improvements.

It appears that partial or slow implementation of key reforms has contributed to the economic underperformance that underpins the unemployment crisis in the region – and inflexible wages are a symptom. Tackling unemployment will therefore require the acceleration of liberalisation measures.

That said, there are still aspects of unemployment in the Western Balkans which are not well understood. For example, it is generally felt that the informal economy is a bad thing which should be progressively phased-out.

But, if subsistence and semi-subsistence agriculture constitutes a significant share of the informal economy then the opposite may be true. In other words, improving agricultural productivity and incomes would provide an improved safety net and income source for the unemployed in a sector where informality is likely to persist for some time to come.

Similarly the reasons for high rates of long-term, female and youth unemployment along with effective productivity rates are not well known and require further investigation before a tailored policy response can be determined with confidence.

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