

WHAT IS THE OPTIMAL LEVEL OF LABOUR MARKET FLEXIBILITY IN MACEDONIA

A comparative analyses of the legislation and institutions governing Macedonian labour market with those of other economies, both transition and developed, can yield some interesting and surprising findings which should guide policymakers in determining measures for boosting employment

The growing interest about the characteristics and functioning of the labour market in Macedonia is due to a high and persistent unemployment rates during transition, which are more than 30% according to ILO definition. It is often argued that the lack of flexibility and/or failure of the labour market institutions to adjust to new economic environment are at fault for high unemployment rates. A comparative analyses of the legislation and institutions governing Macedonian labour market with those of other economies, both transition and developed, can yield some interesting and surprising findings which should guide policymakers in determining measures for boosting employment/reducing unemployment.

Is unemployment rate above 30 percent in Macedonia sensible?

It is very difficult to conduct an analysis of the Macedonian labour market because of the data constraint and vagueness. Two official data sources for unemployment are Labour Force Surveys (LFSs) conducted on annual basis and National Employment Bureau (NEB) which

covers registered unemployment. While there is considerable overlap between the two sets of numbers in almost all transition economies, there are few countries in which the numbers obtained from LFSs based on self-reports are larger than the registered numbers (Cazes and Nesporova, 2001). On the contrary, registered unemployment in Macedonia is by far higher than the LFS's unemployment (Table 1).

Table 1

Country	Registered	LFS
Azerbaijan	1,1%	19,4%
Estonia	4,4%	10,0%
Georgia	2,6%	10,0%
Russia	3,4%	9,2%
Macedonia	37,5% ¹	30,5%

Source: http://eurochild.gla.ac.uk/dev_web/Documents/monee/Download.htm. Data for Macedonia are from State Statistical Office and the National Bureau for Employment.

Note: data refer to 1996. For Macedonia data are for 2001.

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1) ratio of the number of registered unemployed to the sum of the LFS employed (aged 15 and more) and registered unemployed

*) The views expressed are those of the author and do not necessarily represent those of the Ministry of Finance



The likely reason for such discrepancy is different incentive to register as unemployed based on the availability and eligibility of benefits. In particular, a greater incentive in Macedonia relative to other countries to register with the NEB as unemployed rests on the entitlement to social insurance benefits on the basis of being unemployed. Namely, NEB pays pension contributions for all registered unemployed that receive unemployment insurance benefits (cash payment). In addition, all registered unemployed persons are entitled to health insurance if they cannot acquire it on some other basis, for example through other member of the household. Consequently, workers engaged in the grey economy and part of the inactive population register with the NEB which yields an unrealistic picture about the size of the unemployment in Macedonia. There is a great need for change in the appropriate laws in order to improve labour statistics and to switch the role and resources of the NEB from benefit administration to more active policies.

In particular, a greater incentive in Macedonia relative to other countries to register with the NEB as unemployed rests on the entitlement to social insurance benefits on the basis of being unemployed

A study of the labour markets in 22 east European countries carried out by the Interuniversity Consortium for Political and Social Research (ICPSR) in the period of 1990-1997 gives many comparative statistics (see Blanchflower, 2001). It shows that Macedonian citizens have 7.4% higher probability of being unemployed than the average CEE citizen. Only Bulgarian citizens are in worse position (12.1% higher probability of being unemployed) whereas Albanians are by 6.6% more likely to be unemployed than the CEE citizens as a whole. However, we have to point out that Macedonia was one of the few countries (if not alone) with open unemployment during the communist system. For illustration, unemployment rate in Macedonia in 1980 was equal to 21.5% and 22.1% in 1989, compared with the official zero open unemployment in the rest of the ex-Yugoslav Republics and other communist countries.

In most of the CEE countries males experience lower probability of being unemployed compared to females (Table 2). In Macedonia, males are on average 2.7% less likely to be unemployed than females. Similarly, equation results in Table 2 show that higher educated workers have on average 8.8% lower probability of being unemployed relative to less (no) educated workers. However, there is no separate data on the size of the returns to schooling and experience which would have shown the relevance of education and experience acquired in the previous communist system for the new, market oriented, economy.

Table 2 Probit unemployment equations by country

	Male	Higer education no education	Number of observations	Years
Bulgaria	-.023*	-.215*	3683	1990-1997
Czech Rep.	-.003*	-.021*	5588	1990-1997
Estonia	-.012*	-.107*	4583	1991-1996
Hungary	-.078*	-.133*	3713	1990,1992-1997
Latvia	-.010	-.136*	4005	1991,1992,1994-1997
Lithuania	.004	-.088*	3829	1991,1992,1994-1997
Russia	-.025*	-.090*	3570	1992-1996
Romania	-.002	-.100*	4466	1992-1997
Albania	-.034*	-.169	3396	1992-1996
Armenia	-.026*	-.074*	2943	1992-1996
Slovakia	-.004	-.119*	3184	1992-1996
Macedonia	-.027*	-.088*	3221	1992-1997
Slovenia	-.017	-.110*	3005	1992-1996
Ukraine	-.016*	-.115*	3686	1992-1996
Belarus	-.004	-.023	3580	1992-1996

Source: Blanchflower (2001), Table V, pp. 372.

*) implies significance at 5% level

Although ILO unemployment is much lower than registered unemployment, it is still too high and persistent over long period, and is much higher than in other transition economies. In addition, presented comparison suggests that Macedonian citizens are more likely to be unemployed than their counterparts in other CEE countries, meaning that even if we allow for lower data accuracy unemployment is severe problem in Macedonia.

Regarding high LFS unemployment rate, it might be that LFSs do not capture employment in the grey eco-

nomy although that is intended in the ILO definition on unemployment. This can be supported by the World Bank (World Bank, 2003) calculations for unemployment in Macedonia based on LFSs and Household Budget Surveys (HBSs). According to data from HBS, unemployment rate in 2000 equals 23% which is by 9.2 percentage points lower than LFS unemployment rate.

If further adjustments are made to this number for family farms, unpaid family workers and unreported self-employment, unemployment rate reduces even to 10%, implying that despite the lack of formal market jobs people are engaging in some other economic activities.

We proceed by examining three separate labour market issues which are often revealed in the public debate without being supported by the robust analysis.

I. Strictness of the employment protection legislation (EPL)

Labour legislation strictness is often blamed as a main cause for high unemployment in Macedonia. The case for employment protection is based on worker welfare, implicit contracts, the positive impact of stable employment relationship on human capital investment, and the social costs of dismissals and macro-economic stability.

The main argument against employment protection is that it limits firms' behaviour by increasing labour costs which can reduce total employment. The net impact of these effects varies with size of firms, type of activity and economic conditions.

Cazes (2002) finds that EPL has little or no effect on overall unemployment, but stricter EPL increases unemployment duration. However, stricter EPL tends to negatively affect employment and labour market participation rates. Table 3 presents comparison of the

degree of labour legislation strictness in some of the transition economies.

Table 3 Employment protection legislation in late 1990s

	<i>Regular Employment Index</i>	<i>Temporary Employment Index</i>	<i>Collective Dismissals Index</i>	<i>EPL Strictness Index</i>
<i>Bulgaria</i>	1,4	3,8	3,6	-
<i>Czech Rep.</i>	2,8	0,5	4,3	2,1
<i>Estonia</i>	3,1	1,4	4,1	2,6
<i>Hungary</i>	2,1	0,6	3,4	1,7
<i>Poland</i>	2,2	1,0	3,9	2,0
<i>Slovak Rep.</i>	2,6	1,4	4,4	2,4
<i>Slovenia</i>	2,9	0,6	4,9	2,3
<i>Macedonia</i>	3,9	5,0	4,2	4,4
<i>Macedonia</i>²	2,1	4,4	4,0	3,2
<i>CEEC average</i>	2,7	1,2	4,1	2,4
<i>EU average</i>	2,4	2,1	3,2	2,4
<i>OECD average</i>	2,0	1,7	2,9	2,0

Source: Riboud, Sanchez-Paramo and Silva-Jauregui, 2002. World Bank estimates for Macedonia.

Note: Index ranges between 0-6, with 6 indicating most restrictive legislation.

The above table illustrates that despite the reduction of the overall employment protection index in Macedonia during 1990s and again in 2003, scores are still high and above the average in the Central and Eastern European countries (CEECs). Regarding regular employment legislation which regulates the rules for hiring and firing procedures for permanent workers, notification procedures and severance payments, there was a substantial reduction in the strictness during transition. After the recent law amendments Macedonia has now even less strict legislation on regular employment than the CEEC average.

On the contrary, law amendments did not produce a significant decline in the temporary employment index, which is well above the indexes in all other countries, both transition and developed economies. Temporary

2) After amendments of the legislation in 2003

employment legislation establishes the rules for fixed-term contracts, possibility for their renewal, maximum duration and the functioning of the temporary work agencies. Temporary employment is an important source of labour market flexibilisation and includes workers on fixed-term contracts, agency workers, seasonal workers and those in other forms of irregular employment (mainly so-called civil-law contracts). Information on temporary employment is very scarce and may not be fully reliable because of difficulty of detecting the use of civil-law contracts. In some countries there is a legal ban on the use of temporary contracts for certain occupations (e.g. Russia), or for graduates from secondary vocational schools and universities and apprentices or young people below 18 (e.g. the Czech Republic). Despite the popular perception that temporary employment in CEECs has substantially increased during transition, as employers prefer to have more freedom in deciding whether to lay-off workers, the share of temporary to total employment is rather low in almost all transition economies (Cazes and Nesporova, 2001). It ranges between 3 to 6.9% in Ukraine, Estonia, Hungary, Poland and Russia, with the exception Slovenia with relatively high proportion of temporary employment (11% in 1999), although it remains below the 15% average in the EU. Some other estimates for fixed-term contracts in Hungary point out that they account for about 16% of total employment.

Equation results show that higher educated workers have on average 8.8% lower probability of being unemployed relative to less (no) educated workers

Macedonia seems to be an outlier in this group with the share of temporary employment in total employment of 13.2% in 1998, 10.2% in 2000 and 17.7 % in 2002. We cannot be sure about the data reliability for Macedonia since data are from LFSs (counted for population aged 15-64) meaning that the coverage of civil-law contracts solely depends on the self-perception and self-report of workers with such

contracts. While recent amendments of the Labour Code in Macedonia allow for greater use of fixed-term contracts (up to three years) without limits to their number or duration, legislation on temporary work agencies does not exist which explains a very high score of the temporary employment strictness. Interesting information is that, on average, EU and OECD countries have stricter legislation governing temporary employment than CEEC average.

Collective dismissals index captures the definition of collective dismissals, additional notification requirements and possible delays. Macedonian index of co-



llective dismissals is reduced by recent law amendments and is one percentage point lower than CEEC average but is much higher than developed economies' indexes.

There are different views in the economic literature regarding the impact of labour legislation on economic performance. Svejnar (2002), for example, applies a regression analysis for the actual data in transition economies in order to investigate the impact of different labour market institutions and policies on economic performance, measured by GDP growth. By running a simple bivariate regression instead of multivariate one which can explain the joint influence of those factors on the economic growth, Svejnar finds that employment protection (flexibility) has a modest impact on GDP growth. However, to draw stronger conclusion from his analysis there is a need to consider also wages' flexibility, geographical and occupational flexibility, etc.

Comparative analysis of the EPL in Macedonia and other transition economies provides a valuable information for the policymakers for the need and direction of further labour law' amendments. An important issue to be considered and regulated (since there is no regulation) are temporary work agencies (TWAs). Besides the total of 3 articles in the Law for employment and insurance in the case of unemployment (articles 27, 28 and 29) which regulate private placement agencies, there is no legal framework for establishment and operation of the TWAs. Second issue that has to be addressed is the regulation on part-time employment which adds to the labour market flexibility. Namely, the floor set for social contributions, 65% of the average monthly net wage for full-time job, creates disincentive for the use of part-time employment because it increases employers' costs for part-timers.

II. Analysis of the labour market flows

Most of the analyses of the Macedonian labour market refer to the stock of unemployed/employed persons which can yield misleading inferences about the labour market dynamics. By contrast, analysis of the relative size of inflows and outflows provides deeper insight into the operation of the labour market and the factors underlining the high unemployment. Although we recognize constrains in terms of data availability and reliability to analyse the flows, we discuss this issue with comparing flows in the Macedonian labour market and in some of the transition economies for which data are available.

While data calculations are not identical for all countries included, Table 4 shows that Macedonian labour market is relatively dynamic. In addition, it reveals that the persistency of the high unemployment in Ma-

Table 4: Unemployment inflows and outflows

		1994	1995	1996
Czech Rep.	Annual average inflow rate ³	0,6	0,6	0,6
	Annual average outflow rate ²	21,3	21,3	19,3
Hungary	Annual average inflow rate	1,1	1,0	1,3
	Annual average outflow rate	9,1	7,9	9,4
Poland	Annual average inflow rate	1,2	1,3	1,2
	Annual average outflow rate	6,2	8,0	8,2
Slovenia	Annual average inflow rate	6,7	8,4	9,0
	Annual average outflow rate	9,8	6,9	9,7
Macedonia	Annual average inflow rate ⁵		10,6	13,0
	Annual average outflow rate ⁶		14,7	9,2

Source: Terrel (1999) and European Training Foundation (1999). Author's own calculations for Macedonia.

cedonia is due to high inflows and not because of low outflows. High inflows in unemployment may result from high inflow of first-time labour market entrants (school-leavers), workers that lost jobs, inflow from inactivity to activity or from other source of incentive for registration, without any change in demographics or activity.

The classic method for measuring the effects of demographic changes is to compute a Perry-weighted unemployment rate (Perry, 1970; Ball and Mankiw, 2002) which is a weighted average of unemployment

Macedonian employers allocate the smallest amount of the total costs for 'wages and salaries', or about 61.3%. Employers' social contributions contribute with 28.8% in total labour costs for Macedonian workers, with the contribution's share being higher only in Hungary and Romania

rates for different demographic groups with fixed weights. Consequently, in order to investigate whether high inflows into unemployment are result of high inflow of school-leavers, i.e. high natural increase of the

1) Average annual rates of the number flowing into unemployment divided by the number employed and multiplied by 100.

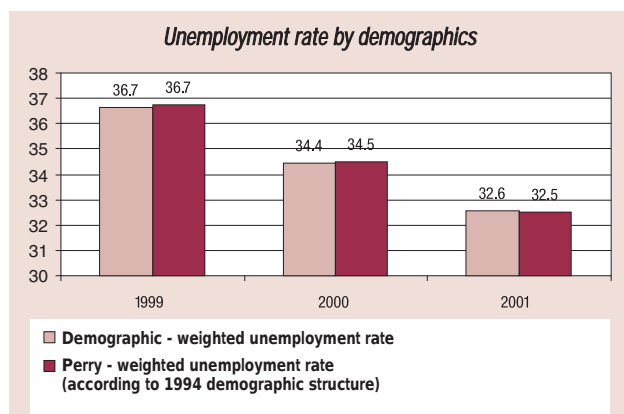
2) Average annual rates of the number flowing out of unemployment divided by the number unemployed and multiplied by 100.

3) New registered unemployed divided by the number of employed from the LFSs and multiplied by 100. Data refer to 2001 and 2002.

4) Employments from the registered unemployed in the NEB divided by the number of registered unemployed and multiplied by 100. Data refer to 2001 and 2002.

population, we have computed the 'Perry-weighted' unemployment rate for Macedonia. A time series for Perry weighted unemployment shows what would have happened to the unemployment rate given the evolution of each group's unemployment if the sizes of groups did not change.

Figure 1



Source: Author's own calculations on the basis of LFSs and 1994 Census of population.

Figure 1 demonstrates that the unemployment rates would have been almost the same if there were no changes in the demographic structure of the population. Hence, we conclude that high inflows into unemployment cannot be explained by a changing demographic structure. Also, there were no massive lay-offs as a result of restructuring in Macedonia compared with other transition countries (World Bank, 2003). Furthermore, data from LFSs show that participation rate is much stable ranging between 59 and 62% meaning that there is no increased inflow into unemployment from inactivity. Consequently, we have to consider some other factors which may contribute to high inflows and very high unemployment.

The most sticking factor, already mentioned, is the administration of social insurance benefits (e.g. health insurance) through NEB. Part of the school-leavers that engage in the grey economy as their first economic activity and part of the inactive population register as unemployed and hence, even without any demographic change or increase in participation rate, regis-

tered unemployment rises. In addition, high LFS unemployment rate may be explained by the failure of the LFSs to capture informal employment as most of the respondents perceive only regular employment, and not fixed-term, part-time contracts or civil-law contracts as employment.

There are two important recommendations for policy-makers that arise from the above analysis. Firstly, the government should strongly market to the public the advantages of doing a formal sector' activity such as access to the commercial buyers in the formal sector of the economy, access to credit lines, legal protection of workers and possibility to operate on the foreign exchange market, which are not so obvious for some employers. Secondly, the government has to take an action to detect and convert civil-law contracts into working contracts, not necessarily in contracts on indefinite time but at least in fixed-term or part-time contracts.

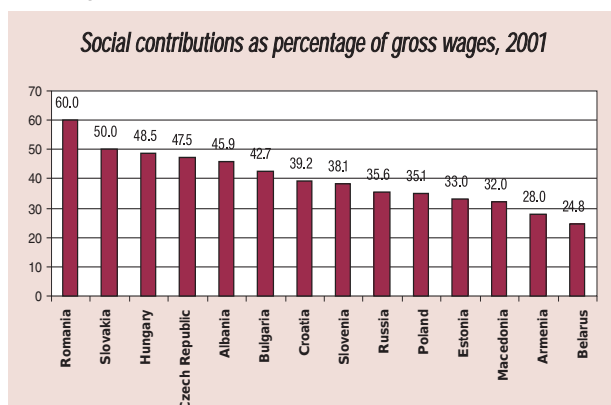
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III. Labour costs

Much of the public debate over employer's labour costs concentrates on the size of the social contributions measured by their share into gross wage. By comparing this measure of the burden imposed on employers by social contributions they pay for workers, Figure 2 shows that Macedonia is among countries with lower share of social contributions in the gross wage.

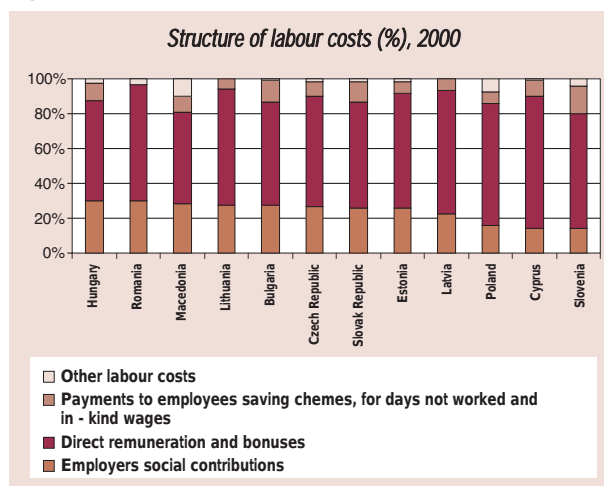
However, what matters from the employers' standpoint is not gross wage and its structure, but labour costs.

Figure 2



Source: World Bank

Figure 3



Source: Eurostat

This is somewhat broader category that in addition to wages and social contributions includes bonuses, payments for days not worked, in-kind wages, payments to employees saving schemes, employers imputed social contributions, etc. By comparing the structure of the labour costs, i.e. the share of employers' social contributions, the picture is rather different (Figure 3).

As Figure 3 shows, in all countries the largest share of total costs is accounted for by 'wages and salaries' which comprises of 'direct wages and salaries' plus 'payments to employers saving schemes, for days not worked, and in-kind wages'. The largest share occurs in Cyprus (85%) and Slovenia (81%), and the lowest in Hungary and Romania (both 67%). Macedonian employers allocate the smallest amount of the total costs

for 'wages and salaries', or about 61.3%. Because of the differences in the methodology¹, this share can increase to 71.3%, which is still lower than that in other CEECs except Hungary and Romania. Employers' social contributions contribute with 28.8% in total labour costs for Macedonian workers, with the contribution's share being higher only in Hungary and Romania.

By contrast, the share of social contribution in employers' expenditures for labour is lowest in Slovenia and Cyprus and equals 14.2 and 14.4%, respectively. It follows that Macedonian workers are in worse position than their colleagues in other transition economies since they receive the lowest part of employers' labour costs as direct remuneration and bonuses.

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7) In most of the countries employers' costs for the nutrition of workers are in the form of canteens and vouchers which is part of 'salaries in-kind', while in Macedonia they are in the form of cash payments to employees and are included in 'other labour costs'.