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LABOUR MARKETS AND EMPLOYABILITY

TRENDS AND CHALLENGES IN ARMENIA, AZERBAIJAN, BELARUS, GEORGIA, REPUBLIC OF MOLDOVA AND UKRAINE

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TRENDS AND CHALLENGES IN ARMENIA, AZERBAIJAN, BELARUS, GEORGIA, REPUBLIC OF MOLDOVA AND UKRAINE

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PREFACE

The European Union (EU) has established a policy framework called the European Neighbourhood Policy (ENP) to reinforce relations with its neighbours by means of greater political, security, economic and cultural cooperation and participation in various EU programmes and activities. The ENP provides for enhanced preferential trade relations and supports the prospect of a stake in the EU's internal market in return for legislative and regulatory approximation. It covers, among other priorities, enhanced dialogue and cooperation regarding social dimensions, including socioeconomic development, employment, social policy and structural reforms (European Commission, 2004). The EU encourages its neighbours to reduce poverty, create employment, promote core labour standards and social dialogue, improve working conditions and enhance the effectiveness of social safety systems through the promotion of decent work (European Commission, 2006b).

Significant internal developments within the EU include the recent launch of Europe 2020 (the successor to the Lisbon Strategy) with its integrated guidelines for growth and jobs, active participation in the Bologna (higher education) and Copenhagen (vocational training) Processes, and the European Qualifications Framework (EQF). Finally, a new policy initiative entitled New Skills for New Jobs aims to build better bridges between education and work and ensure a better match between skills and labour market needs through regular assessments of future skill and job requirements (European Commission, 2008a). Although all these were developed with the EU member states in mind, they increasingly have external implications for cooperation with neighbouring states. The Bologna and Copenhagen processes, for example, could act as voluntary cooperation frameworks for improving quality, transparency and the recognition of qualifications in the education and training systems of partner countries[1].

Through the ancient Silk Road and now the modern oil pipelines, the Black Sea has been and continues to be at the crossroads of trade and migration routes. This important cultural, political and economic triangle connects Europe, Central Asia and the Middle East. It moved ideologically closer to Europe after the dissolution of the Union of Soviet Socialist Republics (USSR). With the accession of Bulgaria and Romania to the EU in 2007, the Black Sea has become as much of a European border as the Mediterranean and Baltic Seas. The past 15 years have witnessed a great number of regional initiatives aimed at bringing together the countries in the Black Sea region. In 2007 the EU made an effort to streamline these initiatives, within the general framework of the ENP, through a complementary regional Black Sea Synergy cooperation initiative (European Commission, 2007a) for this distinct geographical area, which is rich in natural resources and an important hub for energy and transport flows, and which represents an expanding market and great development potential[2].

Finally, an EC Communication and the official launch of the Eastern Partnership (EaP) in May 2009 established the EU's commitment to its Eastern neighbours: to provide a regional framework that complements different bilateral relations and strengthens European support for the countries included in the Eastern Partnership – Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova[3] and Ukraine (European Commission, 2008b, 2008c). This framework envisages a more comprehensive institution-building programme, a comprehensive free trade area, and mobility and security pacts, with special emphasis on support mechanisms for economic and social development.

In line with these developments and the pressing employment challenges facing the six Eastern neighbours, the European Training Foundation (ETF) initiated its Black Sea Labour Market Review project based on the implementation of country reviews in Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine, to be followed by a comparative regional study aimed at analysing the trends and challenges of labour markets and the employability of human capital. The overall objective was to improve labour market analysis and forecasting for evidence-based policies in reviewing human capital development systems in the light of new skills for new jobs. Other specific objectives were to raise awareness and exchange experiences among key stakeholders (particularly labour and education ministries) and among the countries, and to provide technical support to the European Commission.

The end of the Soviet era and the transitional crises of the early 1990s produced a rapid deterioration in living standards and increasing political instability in the six Eastern partner countries. The first decade of transition was generally characterised by the destruction of infrastructures; a sharp decline in industrial and agricultural outputs, real income, consumption and capital investment; and widespread poverty. A decade of painful transition was followed by a recovery

1 While the Bologna process is about creating a European Higher Education Area through comparable undergraduate and postgraduate degrees organised within a three-cycle structure, the Copenhagen process is a voluntary cooperation framework for vocational education and training through a single framework for transparency, quality assurance, a credit transfer system and validation of non-formal learning. All Eastern partner countries (except Belarus) are part of the Bologna process, while the Copenhagen process is open only to candidate countries.

2 According to the European Commission's communication COM(2007) 160, the Black Sea region includes Bulgaria, Romania, Greece and Moldova in the west, Ukraine and Russia in the north, Georgia, Armenia and Azerbaijan in the east and Turkey in the south. Although Armenia, Azerbaijan, Moldova and Greece do not literally border the Black Sea, history, proximity and close ties make them natural regional actors.

3 Hereinafter 'Moldova'.

period (starting around the early 2000s) marked by real economic growth, increasing integration into the world economy and some progress in reducing poverty. However, despite the significant economic growth that was recorded prior to the recent economic crisis, all six countries have been weak in creating decent jobs, and have experienced a significant contraction of employment. The decline in industry and the increase in labour redundancies have led to the growth of an informal economy, and most newly created jobs are poor-quality and poorly paid service jobs. The weight of subsistence agriculture and small-scale self-employment in the economy has increased, as these represent coping strategies for poor people.

In these circumstances, public investment in human capital has decreased, despite the fact that the training needs of individuals and enterprises have changed. The quality of the education systems has also deteriorated considerably. In addition to the problems relating to redundant industries/workers and the restructuring of economies, new graduates from the education system face significant obstacles in their transition from school to (decent) work. Many people have migrated to the economically attractive centres in their countries (rural to urban, mostly to capital cities) or abroad to seek better wages and higher standards of living. Consequently, remittances have become a significant income source for many households.

This publication includes seven stand-alone chapters, each focusing on a specific theme from a cross-country perspective. Each chapter opens with a short summary and ends with concluding remarks. Readers can thus choose to read the chapters according to their interests. Overall, the chapters analyse key labour market trends and challenges and the employability of human capital in the six countries included in the Eastern Partnership, while also reflecting country-specific details. Despite the focus on the six Eastern partners, some comparative data from immediate neighbours is included in the analysis for benchmarking purposes (e.g. Russia, Poland, Romania, Bulgaria, Turkey and the EU-27 for such issues as foreign trade, cross-border relations and migration flows).

Chapter 1 starts with an overview of the general socioeconomic context and macroeconomic developments in the six Eastern partner countries in terms of output, fiscal and monetary indicators, foreign trade and foreign direct investment (FDI). Poverty issues are also discussed, along with international benchmarking performance according to several human development indicators. Special attention is paid to the impact of the current global economic and financial crisis on these economies. Uneven growth performance across the countries is explained by differences in initial conditions, varying natural resource endowments, the regional conflicts affecting some of the countries, different stances towards the EU and Russia, and different approaches to adopting and implementing structural reforms. All these differences have contributed to divergent transitional paths within the group, with countries at different stages of economic transition and with varying achievements.

Chapter 2 reviews the main transitional reforms implemented by the countries, namely, the economic, legal and institutional changes that deeply affect the structure of labour markets and employment conditions. The economic reforms, which were launched in all of the countries with the privatisation of state-owned entities (mostly the mass privatisation of enterprises), were followed by land distribution (except in Belarus) that resulted in significant fragmentation of ownership. Thus, private subsistence agriculture replaced the collective ownership of *kolkhozy* from the Soviet era. As a result, a significant proportion of the population are classified as self-employed and rely on subsistence agriculture, even though it is not economically viable. Although all countries do have institutional, political and legislative frameworks, such frameworks are not always sufficiently effective.

Chapter 3 opens with a discussion of key demographic trends and challenges and goes on to discuss the availability and comparability of labour market data. The first part explains the demographic transformation of the Eastern partners, which is characterised by negative natural population growth as a result of low birth rates (except in Azerbaijan), ageing populations and emigration. Interestingly, the falling birth rates, which are linked to economic and social changes, have been accompanied by rising mortality rates. This is a departure from the patterns usually witnessed in Western industrialised countries. The second part of the chapter reviews the reliability and comparability of labour market data, which is crucial for a sound analysis of labour markets. Since a well-functioning labour market information system (LMIS) is essential for developing evidence-based labour market policies, data sources are assessed in terms of factors such as their existence, periodicity, national comparability over time and international comparability.

Chapter 4 gives a comprehensive overview of the main labour market trends and challenges in the six Eastern partner countries, including a discussion of the impact of transitional reforms on employment and wage adjustments. Activity and employment rates have declined as a result of the competition that has replaced the full-employment policy of the Soviet era. Unemployment has emerged as a new concept and wage differentials have increased significantly as a result of a closer alignment of wages with productivity. High levels of self-employment and the prevalence of subsistence agriculture indicate the lack of secure and decently paid jobs in the Eastern economies. Labour market restructuring has produced many losers, but a question remains regarding the ongoing inability to create jobs even after many years of socially costly transformations.

Chapter 5 deals with the employment policy framework through an assessment of strategies, legislation and institutions. Employment support has been an important objective in all the countries, given the high levels of job

destruction during the period of transition. Starting from the labour market rigidity of the Soviet era, each country has taken a different path towards flexibilisation. At the two extremes, Georgia opted for a liberal labour market policy, while Belarus opted for greater protection for employees. All the countries have introduced passive and active measures for addressing (un)employment issues; however, most of the funds are spent on passive measures (unemployment benefits) covering a small proportion of those who are unemployed. Active policies include measures for job creation (public works and employment subsidies), employability (training), and job counselling and job search; however, the impact of such measures is rarely evaluated. A better balance is needed between labour market flexibility that avoids segmentation, and employment and income security.

Chapter 6 focuses on labour emigration trends, which are significant phenomena affecting all the labour markets. These countries are both sending and transit countries to varying degrees, with outflows to the Commonwealth of Independent States (CIS)[4] region and the EU. Emigrants typically have relatively high formal education levels (though quality remains an issue), include a considerable proportion of females and are diverse in terms of age groups. The type of jobs they hold abroad are poorly paid positions mainly in labour-intensive sectors requiring few skills (construction, agriculture, hotels and catering and domestic services). Although emigration is a solution to the limited availability of jobs at home, and the remittances do help to reduce economic hardship, it worsens demographic imbalance and reduces human capital. Whether migration is viewed as a blight or a benefit, given the sheer size of outflows the better management of labour migration is a valuable policy option, with mutual benefits for the Eastern partners and the destination countries (mainly the EU and Russia).

Chapter 7 reviews developments in the quality of human resources and the role of the education and training systems in ensuring appropriate skills for employability, social cohesion and economic development. Despite the relatively high educational levels of the population (a legacy of the Soviet era), transition-related problems threaten the availability of relevant skills for future socioeconomic development: the underfunding of education systems, a lack of consistency and sustained modernisation efforts, and reduced adult training opportunities can create skill gaps that represent obstacles for future enterprise development and the employability of individuals. Early school leaving and the entry to the labour market of young people without qualifications are other potential problems. Since the mid 2000s countries have demonstrated a renewed interest in developing vocational education and training (VET) as a valid educational pathway to the labour market, but adult training requires particular attention given the ageing population and the pace of economic restructuring in all countries.

This publication ends with a summary of the conclusions and recommendations identified in each of the chapters. It must be emphasised that the ETF team carried out an extensive stock-taking exercise between 2008 and 2009; this included comprehensive desk research and data collection in each country and the production of country reports as background papers. This publication – drafted in 2009/10 – is the outcome of the cross-country analysis that draws heavily on the corresponding ETF Country Reports produced within the Black Sea Labour Market Reviews, as well as on other available international and national sources, including national statistics offices[5]. The ETF would like to acknowledge and gratefully thank the authors and other contributors from the six Eastern partners, who provided invaluable help and cooperation regarding data collection and information verification and validation of the country analyses for each country:

- Moldova Country Report (2009a): Prepared by a local think tank, the Expert-Grup (mainly Ana Popa, Alex Oprunenco and Valeriu Prohniþchi), with valuable input and cooperation from the Moldovan Ministry of Labour, Social Protection and the Family (then the Ministry of Economy and Trade) and the National Bureau of Statistics.
- Ukraine Country Report (2009b): Prepared by a local company, BEST LLC (mainly Olga Kupets, Nataliya Leshchenko, Elena Osinkina, Svetlana Taran and Vladislav Komarov), with valuable input and cooperation from the Ukraine State Statistics Committee, the Public Employment Service and the Ministry of Labour and Social Security.
- Armenia Country Report (2010a): Prepared by a local company, AVAG Solutions Ltd (mainly Vahram Avanesyan, Armen Yeghiazaryan, Nairuhi Jrbashyan, Vardan Baghadasrayan and Melik Gasparyan), with valuable input and cooperation from the National Statistical Service, State Employment Service and the Ministry of Labour and Social Issues.
- Georgia Country Report (2010d): Prepared by an ETF expert, Eduarda Castel-Branco, on the basis of significant input and close cooperation from Tsiuri Antadze (International Organization for Migration in Tbilisi), the Ministry of Economic Development, the Ministry of Labour, Health and Social Affairs and the National Statistics Office of Georgia.
- Azerbaijan Country Report (2010b): Prepared by the Scientific Research and Training Centre on Labour and Social Problems of the Ministry of Labour and Social Protection of the Population (with Masuma Mamedova as team leader), with close cooperation and support from the State Statistical Committee.

4 The CIS was formed by Russia, Belarus and Ukraine through the signing of a Creation Agreement in 1991 on the dissolution of Soviet Union and the creation of CIS as a successor entity to the USSR. In 1993 another agreement, the 'CIS Charter', was signed in order to formalise the countries' membership. Currently nine official members have signed and ratified both agreements, namely Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan and Uzbekistan. Turkmenistan is an unofficial associate member and Ukraine is not officially a member, though it is participating de facto in the system. Note that Georgia left the CIS in 2008 after the South Ossetian war and no longer has any link with the CIS. Using the EBRD classification, Mongolia is included in the CIS group in Figure 1.1.

5 Many of the tables and figures are based on data from national statistics offices as follows: Armenia: www.armstat.am/en/; Azerbaijan: www.azstat.org/statinfo/consumermarket/en/; Belarus: www.belstat.gov.by/homep/en/about/about.php; Georgia: www.statistics.ge/main.php?pform=62&plang=1; Moldova: www.statistica.md/category.php?l=ro&idc=336&; Ukraine: www.ukrstat.gov.ua/.

- Belarus Country Report (2010c): Prepared by a local expert, Svetlana Matskevich, with the contribution of invaluable comments and cooperation from the Scientific Research Institute for Labour (Svetlana Shevchenko as director), the Ministry of Labour and Social Protection and the National Statistical Committee.

Note that in the text, tables and figures below, comparative information drawn from most or all six of the ETF Country Reports is indicated generically as 'ETF Country Reports'. Otherwise, individual ETF Country Reports are cited in the normal way.

The preliminary findings of this regional analysis were presented and discussed at an Experts' Meeting held in Turin on 12–13 October 2009 as part of the quality enhancement review built into the study. The ETF would like to thank all experts and international organisations, including the European Commission, for their contributions to these discussions. The draft report was also peer-reviewed by ETF experts (Gabriela Platon and Arne Baumann) and three other external experts from the ETF Editorial Board, whose comments provided valuable guidance in the final writing stages. The final publication was presented and disseminated at the joint European Commission–ETF Regional Conference on 'Trends and Challenges of Labour Markets and Employability of Human Capital in the Six Eastern Partners', in Odessa (Ukraine) on 20–21 October 2010, an event attended by representatives of all the Eastern partners as well as the European Commission and EU Member States.

Finally, the publication was edited by Ummuhan Bardak (ETF) and includes contributions from Jesús Alquézar Sabadie (European Commission DG Research), Ummuhan Bardak (ETF), Anastasia Fetsi (ETF) and Dr Constantin Zaman (Paris Université de Paris 12 and Zaman Consultants). The publication could not have been produced without the high-quality project assistance provided by Cristiana Burzio and the statistical support provided by Debora Gatelli, who are warmly thanked for their invaluable contributions.

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EXECUTIVE SUMMARY

This publication presents a cross-country overview of labour market trends and challenges and the employability of human capital in the six Eastern partners – Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine – during two decades of turbulent transition. These six countries, all of which are transitional economies[6] with a common Soviet heritage, have experienced enormous social, economic and political changes, leading each to take a different pathway towards a free market economy and democracy. The end of the Soviet era and the transitional crises of the early 1990s resulted in a rapid deterioration in living standards and growing political instability in all the countries of the former USSR. The first decade of transition was generally characterised by the destruction of infrastructure; a sharp decline in industrial output, agricultural output, real incomes, consumption and capital investment; and widespread poverty. The countries also faced tangible challenges to their vital national interests, including regional conflicts and civil wars in Georgia (Abkhazia and South Ossetia), Moldova (Transnistria) and Armenia and Azerbaijan (Nagorno-Karabakh).

For most of the Eastern partners, the second decade of transition was a period of stabilisation and recovery. However, some continued to experience political changes that ultimately resulted in more reform-minded and Western-leaning administrations, such as the 2003 Rose Revolution in Georgia and the 2004–05 Orange Revolution in Ukraine, and the pro-European shift in Moldova's foreign policy orientation. The increasingly assertive foreign policy of Russia in the region, which provoked periodic gas disputes with Ukraine (and the EU countries) and involved trade sanctions against Georgia and Moldova, were other factors that absorbed enormous amounts of resources in the countries. Despite the continuing impact of the Russian economy on all the countries, Georgia, Moldova and Ukraine have developed aspirations for a closer relationship with the EU, while Armenia, Azerbaijan and Belarus have their own vision for development and better relations with Russia.

This analysis focuses mainly on developments in the Eastern partner countries during the past decade; however, since the study was completed only recently, there is only partial coverage of the impact of the 2009 global financial crisis. The objective of the study is to enhance labour market analysis and forecasting in the Eastern partners and to support evidence-based policy making in employment, education and training in terms of new skills for new jobs. Although the focus is broadly regional, there is full recognition of the fact that the Eastern partners are very different in terms of their economies, economic restructuring policies and opportunities for future socioeconomic development. Belarus and Ukraine have opted for gradual transition to a market economy and protection of their predominantly industrial economies, whereas Armenia, Georgia and Moldova have implemented rapid deindustrialisation and deep transformations. Azerbaijan, meanwhile, has relied largely on its natural resources to support economic development and has not yet managed to diversify its economy.

MAIN ECONOMIC DEVELOPMENTS

Following the first decade of transition, which was marked by steep falls in economic output, the Eastern partners started to recover from the mid 1990s and the early 2000s, with average annual real gross domestic product (GDP) growth rates for the region that were well above 5% until the 2009 global economic crisis. Growth was particularly impressive in Armenia, Azerbaijan and Belarus (above the CIS average), with all three managing to recover their 1989 GDP by the end of this period. Growth, however, was less impressive in Moldova, Georgia and Ukraine (below the CIS average), with GDP reaching only 55%, 65% and 75%, respectively, of the 1989 GDP level. Hence, the first three countries experienced a relatively less dramatic recession than the latter three, which lost up to two-thirds of the GDP levels recorded before independence. The recent global crisis has negatively affected economic growth in the region, with growth contracting again in 2009. The impact has been particularly strong in Armenia (-14.4%) and Ukraine (-15.1%) and, to a lesser degree, in Moldova (-6.5%) and Georgia (-4.0%). The Belarusian economy recorded zero growth, while Azerbaijan's economy continued to grow (9.3%). Several factors contributed to these differences in economic performance.

Firstly, despite the shared heritage of a Soviet-type economy, initial conditions were different in all the countries. While Armenia, Azerbaijan, Georgia and Moldova started transition with a per capita gross national income (GNI) below USD 3 000 (expressed in terms of purchasing power parity (PPP) at international prices), Belarus and Ukraine were at practically the same level of development as Bulgaria and Romania (with per capita levels above USD 5 000). By 2010, however, Belarus had the highest per capita GDP (expressed in PPP), at around USD 13 000, followed by Azerbaijan (USD 10 100) and Ukraine (USD 6 700), while the lowest per capita GDP figures were for Armenia (USD 5 000), Georgia (USD 4 900) and Moldova (USD 2 800). As already mentioned, economic structures and natural resource endowments were different at the beginning of transition: Belarus and Ukraine had important industrial sectors; agriculture was more significant in Armenia, Azerbaijan, Georgia and Moldova; and Azerbaijan had oil and gas resources.

6 The term 'transitional economy' is widely used for all the former USSR and communist bloc countries that have switched from a centrally planned economy to a free-market economy. All six Eastern partner countries are former members of the USSR and are directly or loosely connected with the CIS.

The second factor affecting economic performance was the speed and intensity of the implementation of structural market reforms. The sudden disruption of traditional economic links with the USSR created enormous pressures on these countries to reorient their economic ties with the world. Initial differences were further accentuated over the transition period, and the six Eastern partners now have different-sized economies and very distinct institutional characteristics. In the first decade of transition, Moldova and Georgia made very modest progress in structural reforms, while Armenia and Azerbaijan succeeded in catching up economically with Ukraine, which experienced a reform process that was characterised by intermittent periods of acceleration and deceleration. Belarus was the outlier in this context, as state control over the economy remained significant.

The third factor affecting growth patterns was the disruptive political events that amplified the initial effects of recession, namely the regional conflicts and civil wars in Armenia, Azerbaijan, Georgia and Moldova. These political crises absorbed enormous amounts of resources that could have been used for economic and social development.

Yet another factor affecting growth in the Eastern partner countries was post-independence economic relations with Russia. Countries such as Georgia and Moldova, whose relations with Moscow remain tense, have not benefited from growth spill-over within the region as much as Belarus (which is highly dependent on the Russian economy), Ukraine (whose food-processing industry boomed after a decade of decline as a result of increased Russian demand) and Armenia (which has good economic relations with Moscow).

The main determinants of transitional growth were also different in the six countries. Growth in Azerbaijan was primarily driven by the booming export-oriented oil and gas sector, and in Georgia and Armenia by growing domestic demand that was largely financed by loans and transfers from abroad. In Belarus, the growth recorded after 2000 was largely driven by an increase in exports to the Russian market. Growth in Ukraine was very much helped by booming world prices for its main exports (steel and minerals) and increased real household incomes stimulating consumption. In all the Eastern partner countries, the services sector has contributed most to economic recovery and GDP growth, while the contribution of agriculture has declined significantly. Industrial output in all the countries fell victim to the abrupt opening up to international markets, but was also negatively affected by reforms resulting in price liberalisation, the abolition of subsidies, privatisation and restructuring.

The high economic growth in the second decade of transition led to a significant increase in foreign trade. With the Eastern partners increasingly opening up their economies to the world, particularly high growth levels were recorded for exports, which were largely redirected from intra-CIS to EU-oriented trade. Overall, Ukraine was the best export performer, while Moldova lagged behind the rest of the group. Armenian and Moldovan exports have higher penetration in EU markets, though most of their products have low added value. Although trade among the six countries themselves is extremely limited, increased integration in the global economy, together with existing regional ties to the CIS, proved to be beneficial as long as the world economy was performing well. However, external exposure to international shocks was also enhanced. Remittances stimulated domestic consumption and (implicitly) growth, but were an additional factor that boosted the external vulnerability of these economies.

TRANSITIONAL REFORMS AND SOCIAL DEVELOPMENTS

The above differences have contributed to quite divergent transitional paths in the six countries. Economic reform was launched with the mass privatisation of state enterprises. Land was in effect privatised through egalitarian distribution to rural residents (except in Belarus). Both enterprise privatisation and land distribution have had a profound impact on the structure of the labour markets and employment conditions. To give one example, land distribution resulted in substantial fragmentation of ownership, resulting in a large number of small farms producing for self-consumption. A significant share of the population have survived through this subsistence form of agriculture and are classified as self-employed in the statistics. Structural reforms were biased towards economic liberalisation (foreign trade and prices), with far more modest achievements in institutional reforms. Governments gave higher priority to macroeconomic stability policies than to measures that would directly support the business sector and job creation. Indeed, the creation of a growth-conducive business environment remains a major challenge. All the countries currently possess the institutional, political and legislative framework necessary for a market economy, although the effectiveness of this framework is still variable, and remains limited.

The transition period has had an enormous impact on the social development of these countries, and in particular has led to an increased in poverty levels as a result of the limited access to social services, which were traditionally provided by the state in the Soviet era. The recession brought a dramatic fall in real wages (for example, Armenian wages in 1995 were 5% of their 1989 level) and this has forced people to look for alternative means of survival, whether in the informal sector, in subsistence agriculture or through emigration. Improved economic performance since 2000 has been translated into better living conditions, but the reduction in poverty has been accompanied by growing inequalities in terms of access to employment and education, and by regional disparities in development, large income differences between urban and rural areas, and evident social polarisation. In 2007 the proportion of the population at or below the minimum subsistence level was around 18% in Belarus, 23% in Georgia, 25% in Armenia, 26% in Moldova and 29% in Ukraine. The recent global economic crisis, which

has undermined some of the gains of recent years, has exacerbated the level of vulnerability to poverty.

According to the 2008 United Nations Development Programme (UNDP) Human Development Index (HDI), the countries show diversity in terms of their human development levels. Belarus and Ukraine have the highest rankings (placed 67th and 76th); Armenia is in an intermediate position (83rd), followed by Georgia and Azerbaijan (96th and 97th); finally, Moldova lags behind the rest of the group (111th). The rankings of all these countries have been negatively affected by their low per capita GDP and life expectancy (both significantly lower than in the Central and Eastern European and Baltic (CEEB) countries). Literacy rates, on the other hand, are particularly high in the region, with Georgia ranking first in the world. Human capital is therefore the most important asset of these countries.

DEMOGRAPHIC DEVELOPMENTS

The Eastern partners vary greatly in terms of population. In 2008, Ukraine had 46.2 million inhabitants, Azerbaijan and Belarus had 8.6 and 9.6 million inhabitants respectively, while Armenia, Moldova and Georgia barely reached 3–4 million inhabitants each. Most of these countries are relatively small compared with neighbours such as Russia and Turkey, and also with Poland and Romania. Despite their different sizes, they face similar demographic challenges: their populations are shrinking and ageing as a result of low birth rates, increasing mortality rates and emigration. In 2008 the population growth rate was negative in all the countries except Azerbaijan (1.1%) and Armenia (0.2%). Fertility rates (average number of children per woman) also reflect this trend, which is close to the EU-27 average of 1.5, with slightly higher rates in Armenia and Azerbaijan. By 2020, Belarus, Georgia, Moldova and Ukraine will have lower populations than they have today, and while this is not yet the case for Armenia and Azerbaijan, similar trends appear likely in the longer term.

Unique to the Eastern partners are their growing mortality rates (mainly among adult males), even during economic boom periods. This is a result not only of deficiencies in their healthcare systems, but also of diseases linked with unhealthy lifestyles (exhausting work days and alcohol abuse), social illnesses (tuberculosis and AIDS), violent deaths (accidents, murders and suicides), poor living conditions, psychosocial stress, local conflicts and even the long-term effects of the Chernobyl disaster. Substantial emigration outflows have further aggravated the demographic problems of these countries. This will have serious consequences for labour markets, and for education, healthcare and pension systems, placing in doubt the future fiscal sustainability of the countries and the availability of human resources for long-term economic development.

Although labour productivity can help to neutralise negative demographic effects, other appropriate measures would include the following:

- promoting healthier lifestyles, since the high mortality rates are partly a result of unhealthy habits (e.g. alcohol abuse);
- reducing poverty in order to improve health and, indirectly, demographic indicators;
- making healthcare accessible and affordable for all;
- promoting birth rates with supportive social policies.

However, implementing effective policies aimed at increasing the birth rate is very difficult. Benefits have been introduced in several EU countries and in Ukraine, for example, without success. Nevertheless, in the Scandinavian countries there are positive models that closely link family and social policies, promote equality in relation to gender roles in family and childcare responsibilities, provide accessible and affordable childcare, and encourage reconciliation of work and family life for both sexes.

LABOUR MARKET DEVELOPMENTS

Labour markets in the Eastern partner countries have undergone a turbulent transition period marked by low levels of economic activity, high unemployment and underemployment rates, and frequent changes in the employment status of individuals. The end of Soviet-era full employment led to declining participation rates, the emergence of unemployment as a new concept and increasing wage differentials in all of these countries (albeit to a lesser extent in Belarus). Meanwhile, the size of the working-age population as a proportion of the total population increased during the transition period as a result of the baby boom of the 1970s and 1980s. In 2008 the 15–64 age group accounted for around 70% of the population as a whole in all these countries (67% in the EU-27). This growth trend is expected to continue for several more years in all the countries concerned, coinciding with the ageing of the population and a slight feminisation of the labour force.

Activity and employment rates have generally been modest in all six countries. The lowest economic activity rate is in Moldova (49% in 2008), and this is partly explained by the high number of labour emigrants who are classified as inactive in Moldovan statistics. Based on ILO data, activity rates are somewhat higher in Armenia, Azerbaijan and Georgia (around 64–65% in 2008) and rather modest in Belarus and Ukraine (60%). A specific feature of the region is that the female activity rate is high in all countries, and is comparable with that of males, although at a slightly lower level. Youth participation rates are low, partly as a result of high levels of enrolment in university education. However, although these activity rates are comparable with those in the EU, they are significantly distorted by the large contribution of rural self-employment and the high level of informal activities.

Employment rates are generally low, and male employment rates are higher than female employment rates. In 2008, Armenia (38.1%) and Moldova (44.7%) had the lowest employment rates and Azerbaijan had the highest (60.0%), with the remaining countries (Belarus, Georgia and Ukraine) in intermediate positions. Over the

whole period 1995–2008, only Armenia and Azerbaijan recorded a net increase in their employment rates; Moldova experienced the largest fall in employment, and moderate reductions were recorded for Georgia and Ukraine. Azerbaijan's employment rate is closest to the EU-27 average, although its figures include very high levels of informal employment. In all six countries, two-thirds of employed people have secondary education, while the proportion of people with primary or lower education is extremely low. The number of university graduates has increased tremendously, though paradoxically there appears to be a significant skill mismatch, particularly in Ukraine.

Changes in employment rates have not necessarily been reflected in unemployment rates; interestingly, both rates show a declining trend in all the countries except Georgia. In 2008 the highest unemployment rate was in Armenia (28.0%), followed by Georgia (13.3%), Azerbaijan (6.5%) and Ukraine (6.4%). Unemployment in Moldova (4.0%) and Belarus (1.0%, based on registered unemployed, rather than the labour force survey (LFS)) is very low. Economic growth has contributed less to the reduction in unemployment than has emigration. Moldova, with the highest emigration rate in the region, recorded the steepest fall. Low rates are also explained by the inclusion of small landowners as self-employed workers in the total employment rate. Unemployment is inversely correlated with age: younger age groups are affected to a greater extent than mature age groups. The youth unemployment rate is particularly high in Armenia (48% in 2001) and Georgia (31% in 2007) and is around 15% in Azerbaijan, Moldova and Ukraine. In Armenia, women have been harder hit by unemployment than have men (40% female unemployment against 28% total unemployment), whereas the opposite is true for Azerbaijan, Georgia, Moldova and Ukraine.

An important characteristic of the employment structure in terms of employment status is the low proportion of wage employment in most of the Eastern partner countries. In 2007, wage employment as a share of total employment was only 33.7% in Georgia, 41.8% in Azerbaijan, 49.7% in Armenia and 66.7% in Moldova. Only Ukraine, with 80.7% wage employment in 2007, is in any way comparable with the EU-27 average of 87.7%. The proportion of the employment structure represented by wage employment decreased between 2000 and 2007 in Armenia, Georgia and Ukraine, although there was a slight increase in Moldova. Self-employment therefore has a very high incidence in these countries: 58.2% of Azeris and 50.3% of Armenians are self-employed, as are 31.0% of Moldovans and 19.0% of Ukrainians. The most extreme case, however, is Georgia, where self-employment and family workers together account for 63.3% of total employment. Such high levels of self-employment indicate the great fragility of these labour markets, and are mostly the outcome of limited wage employment opportunities. They reflect a survival strategy for people forced to take up small-scale own-account informal activities or subsistence agriculture on small plots of land.

Labour market vulnerability is also evident in the sectoral structure of employment in certain Eastern partner countries where the proportion of agricultural employment is still high. Agriculture plays a key role in absorbing employment in Georgia (53.4%), Armenia (46.0%), Azerbaijan (39.0%) and, to some extent, in Moldova (32.8%, although this is decreasing rapidly). However, agricultural value added to GDP is extremely low in all these countries (to a lesser extent in Armenia), indicating low productivity and possibly high poverty levels. The country with the lowest agricultural employment rate is Belarus (11.8%), followed by Ukraine (16.7%). Industry is still an important employer in Belarus (28.4%) and Ukraine (23.9%), particularly for males. Industrial employment in the rest of these countries is much lower, at around 10–15%. All the countries except Georgia have a high employment rate for the services sector, with most being above 50% of employment, and almost 60% in the case of Ukraine.

At the sectoral level, the Eastern partners have maintained – and even expanded – labour-intensive activities that have relatively low added value and that require low qualification levels. Employment restructuring has taken place mostly at the inter-sectoral level, i.e. across economic sectors and between public and private sectors. In the case of shifts between economic sectors, two types can be distinguished: between agricultural and non-agricultural sectors, and within non-agricultural sectors. The shift from the public to the private sector was much greater in the first decade of transition as a result of mass privatisation and land distribution. High levels of informality were the result of several factors: the reduction of public formal employment, largely supported by privatisation and subsequent restructuring; land reform resulting in self-employment activities; an oversupply of labour as a result of closures that enabled employers to enter into informal and semi-formal arrangements; an erosion in incomes that forced many people to look for alternative income sources; and the cost-cutting strategies of enterprises. The ultimate outcome is that a significant proportion of the labour market now functions under low-productivity and low-wage conditions.

The labour markets in the region are heterogeneous and heavily localised as a result of varying speeds of reform, unequal investment activities, geographical patterns of demand for goods and services and other factors favouring regional disparities. The labour markets have a dual nature in various respects: formal versus informal, with most of those who are self-employed belonging to the informal sector; and rural versus urban, with higher rural rates of participation and informality because of subsistence agriculture. Although national definitions vary greatly, in 2007 informal employment was estimated to be 66% in Azerbaijan, 50% in Armenia, 33% in Moldova, 26% in Georgia, 23% in Ukraine and 10% (officially) in Belarus. Large employment discrepancies exist across regions and also between the larger cities and the rest of the country, with job opportunities largely concentrated in the larger urban centres. These regional discrepancies persist as a consequence of low levels of inter-regional labour

mobility, which in turn are the result of deficiencies in the transport infrastructure, a shortage of housing and significant regional differences in property prices.

Real wages underwent an initial dramatic decline in all six economies, followed by recovery after 2000 in most of the countries. During transition, the wage differential widened, but was partially offset by the introduction of a minimum wage in some countries. Overall economic liberalisation brought about a process of wage deregulation (except in Belarus) that led to inequalities in the distribution of earnings. After an initial drop in GDP per employee, several years of growth after 2000 brought a rapid increase in real wages, to the point where they overwhelmed productivity increases. Productivity improvements translated almost exclusively into better wages for insiders, since enhanced economic performance failed to create more jobs. All the countries therefore experienced a trend reversal in the evolution of productivity.

Within the context of the highly vulnerable employment situation described above, it is obvious that more and better jobs offering decent working conditions need to be created. However the business environment in these countries, particularly for small and medium-sized enterprises (SMEs), is not always conducive to the creation of decent jobs. Many impediments to business remain, including numerous formalities and procedures required in the course of operating a business, and the lengthy amount of time required to deal with those formalities. International benchmarks indicate an insufficient restructuring of government institutions, bureaucratic structures within those institutions, corruption, and, in some cases, a lack of competent personnel. Consequently, the dynamics of job destruction and creation, aimed at a better reallocation and skills readjustment of the workforce, have been weak. Labour market restructuring has resulted in many losers, and some questions remain after two decades of reforms: why have the transformations not been less costly in social terms, and why, after so many years, has the lack of employment opportunities pushed so many people to emigrate while a significant proportion of those who have stayed live in poverty? There is no clear answer to this dilemma; what is certain for the Eastern partners is that the process of transition has not yet led to the creation of enough decent jobs.

LABOUR MARKET MONITORING AND DATA ISSUES

When analysing labour markets, the reliability and comparability of data is crucial. A well-functioning LMIS is an important institutional factor that is essential to enable the development of evidence-based labour market policies. The six Eastern partners have undergone a statistical transition in which statistical tools such as censuses, LFSs, household budget surveys (HBSs), establishment surveys and administrative registers were improved. An assessment of existing data based on factors such as periodicity, national comparability over time and international comparability shows that most of them have been able to develop labour-related statistical resources that are, in the case of Moldova and Ukraine, comparable with EU standards. Belarus is an exception, as it does not conduct any LFSs, and the other countries are at different levels of development. Despite positive developments, methodological problems persist in Azerbaijan and Armenia, making comparisons over time very problematic. These countries also have problems regarding access to micro-data and the timely dissemination of results, as LFSs are carried out and results disseminated on a yearly basis only. Georgia, Moldova and Ukraine, on the other hand, conduct such surveys quarterly or even monthly.

Transparency and timely dissemination of data (including micro-datasets) both need to be improved. Hard-copy publication is the main dissemination method, with websites being used to present only a limited picture of the surveys. Access to datasets is generally restricted, reducing the possibilities of developing independent research capacities and skills. Meta-data is underdeveloped, and it is difficult to obtain accurate and up-to-date information on methodologies and definitions so as to be able to assess the weaknesses and limitations of the statistics in use. Another area for improvement is the development of comparable methodologies and definitions regarding the informal economy. This is a crucial issue in analysing labour markets in the Eastern partner countries, given the size of their informal sectors. Furthermore, a cultural change is needed within public authorities and all stakeholders, who need to understand the essential role of reliable and transparent statistics in the good management of public affairs, as a catalyst for analysis and public debate and from the perspective of international credibility.

EMPLOYMENT POLICIES

Employment support has been an important objective in all six countries, given the high levels of job destruction experienced from the beginning of transition. Actions to support employment have been focused in three main areas. The first is labour market regulation, with the aim of reducing the rigidity inherited from the Soviet era and facilitating labour turnover from less productive to more productive sectors. All the Eastern partners have revised their labour legislation, and a brief overview of labour codes confirms that the six countries have taken different pathways, from more rigid (Belarus, Moldova and Ukraine) to relatively flexible (Armenia, Azerbaijan and Georgia) approaches. Georgia has the most liberal labour market policy, while Belarus, Moldova and Ukraine have opted to protect employees in jobs, even at the expense of underemployment and rigidities in labour turnover. Legal provisions are not always respected in practice, however, even in countries where labour legislation is supposed to be quite flexible, implying further flexibilisation in labour market functioning.

The second area is the formulation of employment policies; these were overly ambitious, given that they were not accompanied by specific action plans or

adequate financing. All the countries (except Georgia) have introduced labour market policies aimed at addressing the impact of unemployment. However, in 2008 public spending on active and passive measures was much lower than the EU-27 average (1.6% of GDP), despite higher unemployment levels in the Eastern partner countries. This spending was around 0.1% of GDP in Armenia, Azerbaijan and Ukraine, 0.09% in Belarus and a mere 0.05% in Moldova (the figure for Georgia is not known). Most countries have increased spending on labour market measures, with the exception of Belarus, where spending decreased from 0.15% of GDP in 2006 to 0.09% in 2008. Georgia has suspended all labour market measures since the abolition of the public employment service (PES) in 2007; the limited 'cheap-credit' and social assistance programmes for the poor were also suspended in 2009 in response to the economic crisis.

All the countries except Georgia have unemployment insurance systems in place and most labour market funds are used for unemployment benefits. However, a large number of unemployed people receive no income, since the strict eligibility criteria restrict access to only a small number of formal workers, and the amount of benefits is too low to be considered an adequate measure of income security. In 2008, only 1% of unemployed people in Azerbaijan, 4% in Armenia and 7% in Moldova received cash benefits. Spending on active labour market measures to enhance the employability of unemployed people is even lower. Of total public spending on labour market policies, only 15% is spent on active measures in Azerbaijan, 30% in Ukraine, 40% in Armenia, 44% in Moldova and 90% in Belarus.

The menu of active labour market measures is quite rich in most of the Eastern partner countries (except in Georgia, where they are not in operation). Job-creation measures (specific public works and employer subsidies for the recruitment of specific population groups) are the most common measures and absorb most of the budgets, although employability measures (such as training) and job-search facilitation (including job clubs and job fairs) are also common. The problem is that the reach of these measures is quite limited given the funds available. No impact evaluation has been made regarding the effectiveness of active labour market measures, but it is thought that neither the design nor the mix of measures fits the nature of unemployment in the countries. Training measures in countries where evaluations are available (Moldova and Ukraine) seem to have positive outcomes in terms of work placement. Nonetheless, for the reasons mentioned above, the overall impact of employment policies on employment enhancement has been insignificant.

The third area is the improvement of the capacity of labour market institutions. Ministries of labour in all the countries are rather weak within the overall cabinet, and their financial and human resources are limited. However, differences exist between the countries, with Ukraine leading in terms of capacities. The role of social partners needs to be strengthened in the process. The PESs that exist in all the countries (except Georgia) have brokerage, job search and counselling functions, and they implement active and passive labour market measures, including the administration of unemployment benefits. The largest such structure exists in Ukraine, with a relatively low caseload of 179 clients per front-office member of staff (this figure is often below 100 in the EU countries). Ukraine also has a special internet portal called Trud (*trud* means labour), which provides online services to job seekers and employers. Other countries have smaller PES structures, with 405 staff in total in Armenia, 577 in Azerbaijan, 249 in Moldova and 1 060 in Belarus. Georgia has not had a PES in the traditional sense since 2007. Outside the larger cities, PES offices are, in general, insufficiently equipped and staffed, and are hampered by bureaucracy and passivity in promoting employment and by limited coverage of the unemployed population.

Using the EU concept of flexicurity – with its four components of flexible contracts, modern social protection systems, effective active labour market measures and comprehensive lifelong learning – as an underlying principle for the design of labour market policies, the six countries can be roughly positioned in one of four quadrants defined by a flexibility axis and a security axis. All the labour markets can be placed in the 'less secure' left half of the horizontal security axis; as for the vertical flexibility axis, Georgia, Azerbaijan and Armenia belong in the 'more flexible' top quadrant, whereas Ukraine, Moldova and Belarus belong in the 'less flexible' bottom quadrant. It is clear that all the countries need to achieve a better balance between income and employment security and labour market flexibility that avoids labour market segmentation, leads to a better allocation of human resources and does not encourage informality. In other words, flexibility must be combined with the provision of decent work and well-functioning social safety nets.

Another gap in the employment policies of these countries is their weak focus on job creation through the development of a friendly business environment. To date, governments have been much more concerned with limiting job destruction than with creating new jobs. The development of a business-friendly environment requires a behavioural change towards service orientation and transparency on the part of administrations and policy makers. In the current globalised economy it is essential to attract investors both at home and abroad, and credibility is a pillar underpinning investment attractiveness and, ultimately, positive expectations. Credibility refers to clear and straightforward administrative procedures, an absence of corruption, and transparent and stable state policies, all of which enable investors to devise long-term strategies.

Overall, there is much scope for improvement of employment policies through the following:

- striking the right balance between job-creation measures (including the improvement of the business environment) and supply-side measures (i.e. labour market measures);

- strengthening the institutional setting for policy development by enhancing the capacity of labour ministries, ensuring greater involvement on the part of social partners and creating synergies and linkages with other policy areas for policy coherence;
- strengthening the role of PESs in the implementation of labour market measures, and enhancing their capacity to identify jobs and match skills to jobs;
- developing the appropriate instruments for labour market monitoring and the evaluation of the effectiveness of policy measures.

LABOUR EMIGRATION

Another sign of the existence of dysfunctional labour markets is the fact that the region is the source of substantial labour outflows, which have a profound impact on domestic labour markets, human capital stocks and demographics. These outflows are mainly directed towards the CIS and EU countries. Indeed, three-quarters of movements are intra-regional (CIS), with Russia alone receiving more than half of all migrants from the Eastern partners. Moldova and Ukraine have outflows in two main directions, with Russian speakers in the eastern parts of Moldova and Ukraine going to Russia and people from the western parts migrating mainly to Europe. Some cross-border movements also occur in the Ukrainian–Polish and Moldovan–Romanian border regions. According to the World Bank database, of the six Eastern partners, Ukraine had the highest total number of emigrants abroad (6.56 million in 2010), followed by Belarus (1.77 million), Azerbaijan (1.43 million), Georgia (1.05 million), Armenia (870 200) and Moldova (770 300). When emigrants are expressed as percentages of the total population, however, the countries with the highest population losses are Armenia (28.2%), Georgia (25.1%) and Moldova (21.5%), followed by Belarus (18.6%), Azerbaijan (16.0%) and Ukraine (14.4%).

Different socioeconomic, ethnic and political factors played a role in the earlier migratory flows of the period 1990–2000, including refugees fleeing civil wars, trans-border conflicts and diasporas returning to ethnic homelands[7]. Thereafter, migration became a coping mechanism in the face of a rapid deterioration in living standards, and widespread poverty. Migrant outflows since the early 2000s have increasingly been motivated by work factors, and have become an important income-generating activity, given the limited jobs and low wages, insufficient capital and lower quality of life in poorly functioning home labour markets. Labour emigrants typically have relatively high formal education levels (although quality remains an issue), include a considerable proportion of females and are from diverse age groups. The types of job held abroad are mostly low-paid positions, mainly in labour-intensive sectors with low skill requirements, such as construction, agriculture, hotels and catering and domestic services (house cleaning, childcare and care of the elderly).

Emigration profoundly affects the domestic labour markets in the sending countries in a number of closely related ways. Occurring against a background of low fertility rates (except in Azerbaijan) and higher than average mortality rates (adult males), emigration exacerbates the demographic imbalances. However, it also helps countries to cope with continuing economic hardship, limited job opportunities and unemployment in the region. One obvious benefit is the contribution of remittances to reducing poverty: the amount of remittances received in 2007 was highest in Armenia (USD 1.273 billion) and Moldova (USD 1.200 billion), followed by Azerbaijan (USD 993 million) and Ukraine (USD 944 million). Remittances have increased dramatically in all six countries since 2000, although there was a drop in 2009 as a result of the economic crisis (with recovery in 2010). In 2006 the contribution of remittances to GDP was most significant in Moldova (36.2%) and Armenia (18.3%).

The temporary and seasonal nature of most migratory flows is another feature of migration in the region. Temporary migration is feasible, mainly because of geographical proximity, easy travel connections and visa-free entry to the CIS countries. Gender and age seem to be linked to the destinations and employment sectors that are chosen. Most middle-aged men emigrate to Russia, Germany and Portugal to work in construction, whereas younger women emigrate mainly to Italy, Spain, Greece, Cyprus and Turkey to work in domestic jobs such as cleaners and carers. A significant proportion of emigrants of both sexes are young (aged 20–40 years) and well educated in most of the Eastern partner countries. In countries such as Moldova and Ukraine, emigration is to some extent associated with brain drain. There are signs that many migrants work in low-skilled or unskilled jobs (below and outside their expertise) abroad, irrespective of their level of education. Thus, education and skills acquired at home are often irrelevant and, indeed, are likely to be lost – for migrants and both host and home countries – making the migration process inefficient for all sides.

As a result of increasing labour outflows, the countries' governments have recently started a migration dialogue with destination countries in the CIS and the EU. This type of dialogue is fundamental for the management, coordination and effective implementation of migration. The EU's recent signing of Mobility Partnerships with Moldova in 2008 and with Georgia in 2009 is an important step forward in this cooperation (with Armenia apparently next in line). Although it is too early to make any evaluation, this initiative has the potential to lay the groundwork for a comprehensive migration management dialogue between the Eastern partners and EU countries. The ETF, by contributing to the policy debate on skills recognition and transparency of professional qualifications (including both certified and non-certified skills), is involved in this process. Mobility partnerships explicitly deal with labour mobility and return migration as a circular process, but also bring very diverse areas of cooperation

7 Examples of population movements in the region include the outflow of 2 million ethnic Germans, 1.5 million Jews and 1.1 million Poles; the significant numbers of ethnic Russians living outside Russia (26 million); and the movement of 0.9–1 million people from Armenia, around 2 million from Azerbaijan and 1.9 million from Georgia as a result of the ethnic and political tensions in Nagorno-Karabakh, South Ossetia, Abkhazia and Chechnya.

(such as illegality, border controls and refugees) under the umbrella of migration management.

Whether it is viewed as a curse or benefit, migration is a reality in the region. Given the sheer size of outflows, better management of labour migration is a valuable policy option that offers mutual benefits for the Eastern partners and destination countries. Many studies have already highlighted the ongoing need for migrant labour within the EU (and Russia). A 'win–win–win' situation may be possible for all stakeholders involved in the migration process if a virtuous circle is created that benefits all the parties through the better management of labour migration and the skills-matching dimension. In fact, skills matching between migrant workers and jobs abroad is crucial to efficient labour mobility. In this context, comprehensive cooperation mechanisms are needed in order to reduce exploitation and skills waste and to ensure better skills matching in destination countries. The six countries also need to work more effectively on proactively encouraging expatriates to return home and become entrepreneurs, by creating conducive environments for more productive use of migrants' skills, knowledge and savings.

HUMAN CAPITAL DEVELOPMENT

At the start of the transition process the Eastern partner countries had high levels of human capital by international standards. Zero illiteracy levels were inherited from the Soviet era and the vast majority of the population had medium skill levels that enabled them to access employment. Despite the differing national classifications of education levels and the hugely varying figures available, a breakdown of the labour force by educational level shows that on average, two-thirds of the labour force have secondary education (lower and upper) and one-fifth have tertiary education, with small numbers of people having primary education or lower. Moreover, there is no gender difference in educational levels. This clearly represents a comparative advantage in relation to other countries at the same level of economic development, and can be a key pillar for sustainable future economic growth and competitiveness.

Despite the economic hardships for both governments and households during transition, access to free and compulsory primary education remained high, according to the gross enrolment rates (GERs). Post-compulsory education at the upper secondary level suffered more in the initial stage of transition, but improved slightly after 2000. In 2008, the GER at the upper secondary level was high in Azerbaijan (116% [national estimate]) and Ukraine (91%), followed by Georgia (90%) and Moldova (83%). The rate was relatively low in Armenia (75%) and Belarus (72%), indicating vulnerability and possible unequal access to education for some children. Participation patterns in upper secondary education have been changing in favour of general secondary education, and the importance of VET at secondary level has decreased since the beginning of transition in all Eastern partner countries. Today, the combined VET enrolment rate (upper secondary and post-secondary non-tertiary VET) accounts for one-third of total enrolment (ISCED 3+4) in Belarus, Moldova and Ukraine, while it is one-quarter in Armenia and almost one-fifth in Azerbaijan. Armenia has a relatively lower VET enrolment (one-quarter), while Georgia has a very small VET component (5.5%).

Tertiary education has experienced the greatest changes in its enrolment rates during transition in all the countries except Azerbaijan. In 2008 the GER in tertiary education was particularly high (and comparable with the EU-27) in Ukraine (79%) and Belarus (73%); the rate was 40% in Moldova, 34% in Georgia (affected by the accreditation process for higher education institutions), 34% in Armenia and 16% in Azerbaijan (where access to university is restricted by difficult exams because of the small number of places available). The increases in participation in tertiary education were mainly a result of female participation in all six countries, which exceeds that of males. Much of the increase in participation was funded by households, with private higher education and fee-paying public education on the increase. For example, in Armenia and Georgia more than 20% and 21%, respectively, of enrolment in tertiary education is in private institutions. In Moldova more than 75% of students pay fees in either public or private institutions.

Education yields returns in all the countries, with people with higher education and VET qualifications generally having higher employment rates. More education is compensated for by higher salaries, as demonstrated by the rates of return on education. The return on an extra year of education (for those in wage employment) is 9.0% in Georgia and 9.5% in Moldova. Only Ukraine (among the Eastern partners for which data are available) had a relatively low rate of return on an extra year of schooling (5.0%) in the early 2000s, although this increased to 8.6% according to calculations based on data from the 2006 HBS. However, holders of different levels and types of diplomas still face problems in entering the labour market and using their skills. Although this is partly a problem of the aggregate demand for labour, the existence of a skill mismatch is often proposed as an explanation.

Overall, there is no strong evidence that a lack of human capital is impeding the progress of these countries on the path towards technologically advanced, knowledge-based, competitive economies. Yet exposure to risk will eventually develop if these countries fail to address the current problems in their education and training systems and ensure the development of relevant skills to allow enterprises to function. Although there is no specific monitoring of the demand for skills in any of the Eastern partner countries, there is some evidence that the lack of skills is starting to become a significant obstacle to the further development of businesses. The experiences of advanced transition economies demonstrate that a lack of skills becomes more apparent as economic restructuring advances.

The countries may lose their competitive advantage regarding human capital, given that this has deteriorated as a result of a number of factors: the poor quality of the

education system, which has failed to adapt quickly to the social and economic changes brought about by transition and to keep up with developments at the international level; a lack of funding for education at a time of serious economic contraction; and the limited number of high-skilled job opportunities available during transition, which could have maintained and would have eventually enhanced existing skills. The results of the European Bank for Reconstruction and Development (EBRD) and World Bank 2009 Business Environment and Enterprise Performance Survey (BEEPS) point to the existence of skill mismatches in these labour markets: 55% of Belarusian and 43% of Ukrainian and Moldovan enterprises consider the lack of skills to represent a problem for the performance and development of their enterprises; the percentages are lower, but still significant, for Georgia (27%), Armenia (24%) and Azerbaijan (12%). Moreover, comparison of the results of the 2005 and 2009 BEEPSs reveals a deteriorating trend in terms of enterprises being able to recruit workers with specific skills, in all these countries except Georgia.

The education and training systems in the Eastern partner countries face the following specific challenges:

- ensuring access to education and training opportunities for all young people, which requires reducing the number of early school leavers in rural areas and ensuring the provision of skills for gainful employment (employability);
- increasing the quality of education across the board, while also ensuring its relevance to labour market skill needs;
- addressing the skill needs of the adult population in view of the ageing population profile and further economic restructuring.

The current situation in the teaching profession in the region is unlikely to assist with improving the system, since salaries are very low (even lower than the average national wage or the lowest public wage in some cases). It is important to make the teaching profession attractive to younger generations.

VET has an important role to play in skill-formation processes in all six countries as it can improve a country's capacity for technology absorption and diffusion, and enhance individual employability. A renewed interest in VET is broadly evident, following a decade of neglect during which it lost its credibility and attractiveness as a result of the closure of large enterprises (the main users of VET skills) and a rapid deterioration in its relevance to emerging skill requirements. Since the mid 2000s, all the Eastern partners have acted to modernise their VET systems from a lifelong learning perspective, tackling issues such as governance, institutions and curricula. Sustained efforts are now needed to reinforce employer involvement in the design and delivery of education and training provision; strengthen the capacity of professional institutions to modernise methodologies for training delivery; strengthen the capacity of training providers to introduce flexible demand-driven training courses that cater for the needs of different learners; make efficient use of the limited funds available; and develop qualifications and qualification frameworks that are transparent and relevant to the labour market. More systematic efforts need to be directed at supporting training provision and at providing incentives to adults to participate in training.

1. SOCIOECONOMIC CONTEXT AND MAIN MACROECONOMIC DEVELOPMENTS

Dr Constantin Zaman

This chapter describes the main macroeconomic trends in the six Eastern partner countries in terms of output, fiscal and monetary indicators, foreign trade and FDI over two decades of transition following the collapse of the USSR in 1991. Poverty and human development issues are also included in the discussion, with special attention being paid to the impact of the current global economic and financial crisis, which has hit most of the countries especially hard (Armenia and Ukraine in particular, but also Georgia and Moldova); real GDP rates in 2009 were negative almost everywhere in the region except Azerbaijan.

Growth performance has varied across the six countries since the collapse of the USSR, but overall, the Eastern partners have recorded impressive levels of economic growth. The first decade of transition (1990–2000) was painful, with a dramatic fall in output, high unemployment and an increase in poverty and inequality. Recovery started in the second decade (the early 2000s to 2009), with real GDP growing well above an average rate of 5%. Uneven growth patterns are explained by differences in initial conditions, different economic structures, varying national resource endowments, regional conflicts affecting some of the countries, different stances towards the EU and Russia and varying approaches to the adoption and implementation of structural reforms. Overall, Armenia, Azerbaijan and Belarus have been good performers, with average rates of real GDP growth above the rate recorded by the CIS, while Ukraine, Georgia and Moldova have performed more modestly, with growth rates below the CIS average. The former group have succeeded in recovering their 1989 GDP levels and have experienced a relatively less dramatic recession than the latter group, which have lost up to two-thirds of the GDP recorded before independence, and have still not fully recovered their 1989 GDP levels.

All these differences have contributed to divergent transitional pathways within the group. The six partners are therefore at different stages of economic transition and, consequently, their achievements vary significantly in terms of the objectives set at the beginning of the transformation process. Progress has been made in all the countries, with Belarus the slowest in terms of implementing structural reforms. Nonetheless, there are major differences in terms of economic performance between the six Eastern partners and the Central and Eastern European members of the EU, which have benefited much more from EU support to redress their economies. Moreover, the prospect of EU membership has represented a challenge, but is also a rewarding perspective that has motivated those countries to accelerate their reform processes.

Improved economic performance has translated into better living conditions since 2000, compared to the first decade of transition. However, the reduction in poverty rates has been accompanied by growing inequalities in terms of employment opportunities and access to education, and regional disparities in terms of development, large income differences between urban and rural areas and a clear polarisation of society. Uneven opportunities have forced vulnerable groups within the population to look for alternative means of survival, whether in the informal sector, in subsistence agriculture or through emigration. The recent global economic crisis, which has hit most of the Eastern partners particularly hard, has exacerbated the vulnerability of these groups in the population, since the governments have not been able to set up adequate social safety nets to protect them.

1.1 GROSS DOMESTIC PRODUCT: TRANSITIONAL DEVELOPMENTS

Following the collapse of the USSR in 1991, the six Eastern partners underwent two decades of significant transition. The 1990s were characterised by a painful transition, with a dramatic fall in output, high rates of unemployment or underemployment, and increased poverty and inequality. Recovery commenced in the mid 1990s/early 2000s, with real GDP growth well above 5% on average (**TABLE 1.1**). This trend was shared with the CIS and Mongolia, whose economic performance after 2000 has on average been better than in the CEEB countries[8] and in the South-Eastern European (SEE) countries[9] (**FIGURE 1.1**). However, exceptional growth started from a significantly lower base in the Eastern partner countries compared with the CEEB countries. Furthermore, the recent financial and economic crisis has hit most of the Eastern partners particularly hard (see Section 1.2 below).

8 Three Baltic countries (Estonia, Latvia and Lithuania) and Hungary, Poland, Czech Republic, Slovakia and Slovenia.

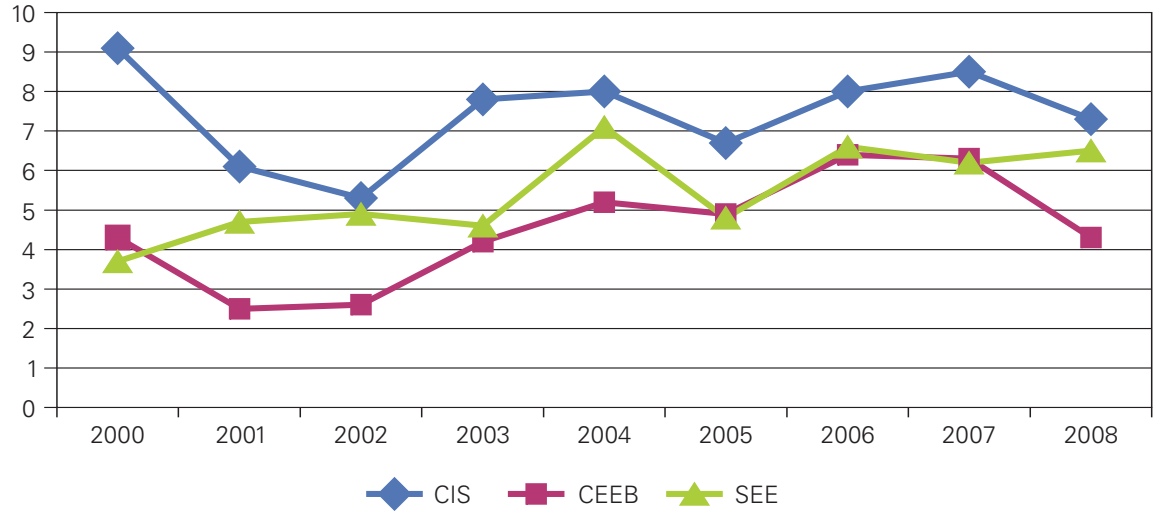
9 Bulgaria, Romania, Croatia, Albania, Serbia, Montenegro, Bosnia-Herzegovina and the former Yugoslav Republic of Macedonia.

TABLE 1.1 REAL GDP GROWTH RATES, 2000–10 (%)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010*
Armenia	5.9	9.6	13.1	14	10.5	13.9	13.3	13.7	6.8	-14.4	1.2*
Azerbaijan	11.1	9.9	10.6	11.2	10.2	26.4	34.5	19.2	11.6	9.3	7.3*
Belarus	5.8	4.7	5.0	7.0	11.4	9.4	10	8.2	10.0	0.2	1.8*
Georgia	1.8	4.8	5.4	11.0	5.8	9.6	9.3	12.4	2.1	-4.0	2.0*
Moldova	2.1	6.1	7.8	6.6	7.4	7.5	4.7	2.9	7.2	-6.5	0*
Ukraine	5.9	9.2	5.2	9.6	12.1	2.7	7.3	7.3	2.1	-15.1	2.6*
Average CIS	9.1	6.1	5.3	7.8	8.0	6.7	8.0	8.5	5.5	-6.6*	
Average CEEB	4.3	2.5	2.6	4.2	5.2	4.9	6.4	6.3	3.3	-3.6*	
Average SEE	3.7	4.7	4.9	4.6	7.1	4.8	6.6	6.2	6.5	-6.2*	
Bulgaria	5.4	4.1	4.9	4.5	5.7	5.5	6.3	6.2	6.0	-5.0	-2.5*
Poland	1.3	1.3	3.6	5.2	3.3	6.0	6.7	6.8	5.0	1.7	2.1*
Romania	2.1	5.7	5.1	5.2	8.4	4.1	7.7	6.0	7.3	-7.1	0.4*
Russia	10.0	5.1	4.7	7.3	7.2	6.4	7.7	8.1	5.6	-7.9	1.5*
Turkey	7.4	-7.5	7.9	5.8	8.9	7.4	6.9	4.5	1.3	-4.7	3.7*

*Source: World Bank World Development Indicators (WDI); ETF Country Reports; *IMF estimations: IMF (2010c).*

FIGURE 1.1 REAL GDP GROWTH RATES, 2000–08 (%)



Source: EBRD (2008).

The Eastern partners started to recover from the mid 1990s and/or early 2000s onwards, with average regional real GDP growth of well above 5% per year. Growth was particularly impressive in Armenia, Azerbaijan and Belarus (above the CIS average) up until the 2009 global economic crisis, with all three of these countries recovering their 1989 GDP levels. However, the growth performance of Moldova, Georgia and Ukraine was less impressive (below the CIS average), and they have not yet recovered their 1989 GDP levels (55%, 65% and 75% respectively). As a result, by 2010 Belarus had the highest per capita GDP (expressed in PPP), at USD 13 000, followed by Azerbaijan (USD 10 100) and Ukraine (USD 6 700), whereas the lowest per capita GDP figures were for Armenia (USD 5 000), Georgia (USD 4 900) and Moldova (USD 2 800).

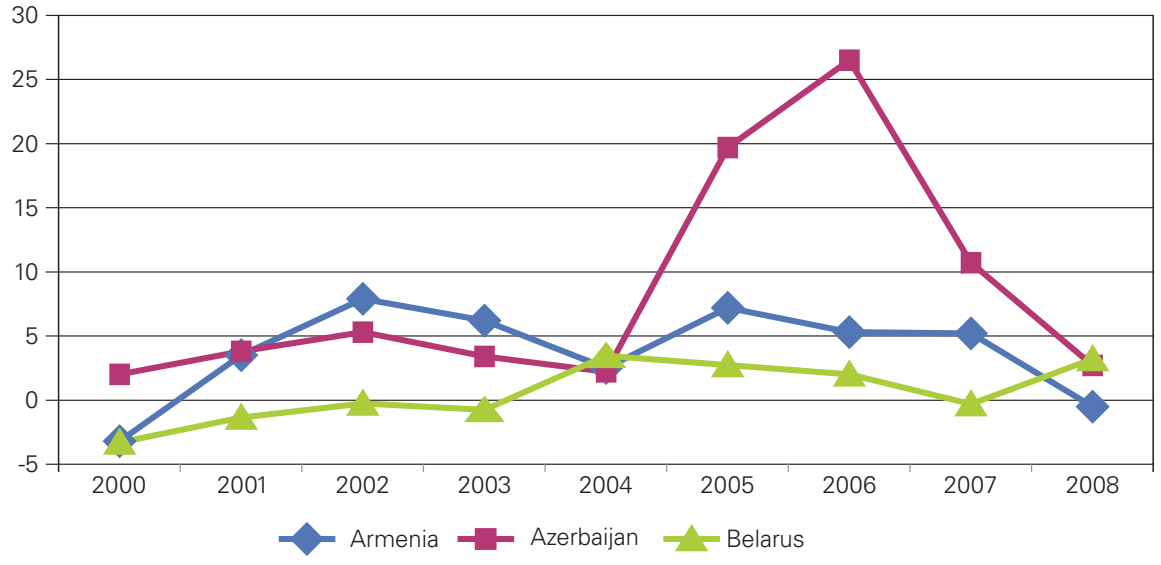
Table 1.1 shows how the recent global crisis has negatively affected economic growth, with most economies contracting again in 2009. The impact was particularly strong in Armenia (-14.4%) and Ukraine (-15.1%), but there was also quite an impact in Moldova (-6.5%) and Georgia (-4.0%), while Azerbaijan continued to grow (9.3%) and Belarus recorded zero growth. Certain economic sectors (e.g. construction) were hit particularly hard. Estimates for 2010 indicate a relative recovery, but the growth rates are still far lower than previous rates recorded, except in Azerbaijan.

Before the crisis, performance varied within the selected group of countries. For the period 2000–08, if we calculate the growth differential (Δg_i) between the effective rate (g_i) recorded by a particular country and the CIS average (g_{CIS}) as $\Delta g_i = g_i - g_{CIS}$, we can distinguish two types of performer:

1. good performers: Armenia, Azerbaijan and Belarus; the average rate of real GDP growth was above the rate recorded by the CIS group (**FIGURE 1.2**);
2. modest performers: Georgia, Moldova and Ukraine; the average rate of real GDP growth was below the rate recorded by the CIS group (**FIGURE 1.3**).

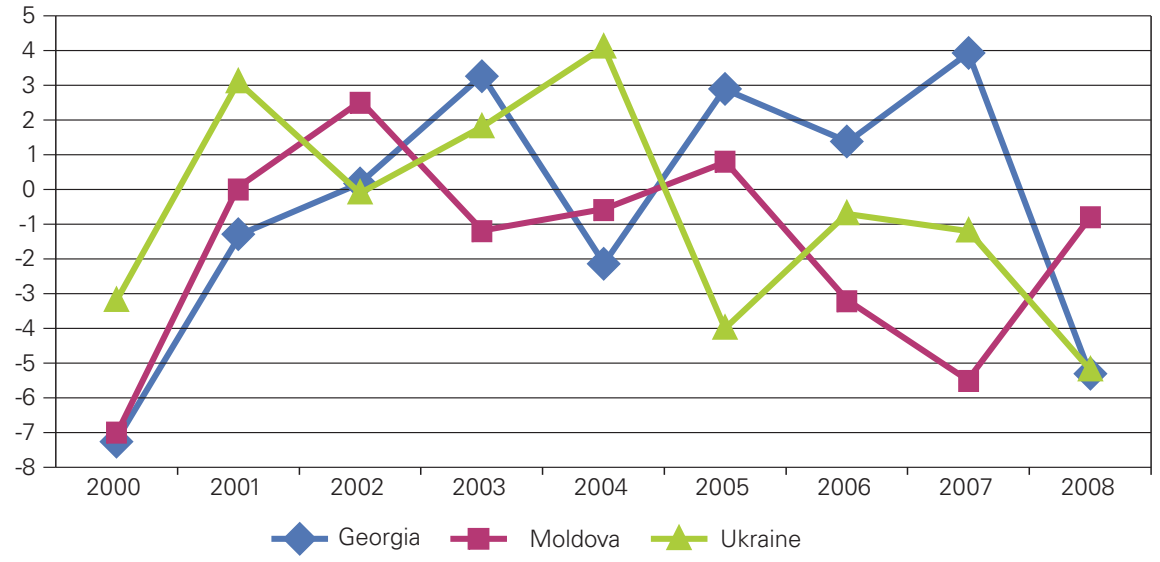
As previously mentioned, countries in the first group experienced a relatively less dramatic recession (as measured by lowest GDP after independence, as shown in **TABLE 1.2**) and succeeded in recovering their 1989 GDP levels. The countries in the second group lost up to two-thirds of the level of GDP that was recorded before independence.

FIGURE 1.2 GDP GROWTH DIFFERENTIAL 2000–08 – GOOD PERFORMERS



Source: Author, based on EBRD (2008).

FIGURE 1.3 GDP GROWTH DIFFERENTIAL 2000–08 – MODEST PERFORMERS



Source: Author, based on EBRD (2008).

TABLE 1.2 SELECTED TRANSITIONAL GDP VARIABLES

Country	Lowest GDP after independence		Real GDP[2] ratio 2007:1989	Year real 1989-level GDP recovered
	Year	% 1990 GDP[1]		
Armenia	1993	53.2	1.4	2004
Azerbaijan[3]	1995	42.7	1.6	2005
Belarus	1999	69.9	1.45	2003
Georgia	1994	32.5	0.63	Not recovered
Moldova	1999	32.6	0.54	Not recovered
Ukraine	1999	38.4	0.72	Not recovered
Bulgaria	1994	46.8	1.13	2006
Romania	1992	65.5	1.2	2004
Russia	1999	37.9	1.02	2007

Source: EBRD (2008).
Note: 1. GDP in current international prices in USD; 2. Current international prices expressed as PPP in USD; 3. Data only available since 1993 for Azerbaijan.

Several factors contributed to these differences in economic performance. Firstly, despite the shared heritage of a Soviet-type economy, initial conditions varied in the countries. While Armenia, Azerbaijan and Moldova started transition with a GNI per capita (expressed in PPP at international prices) below USD 3 000, Belarus and Ukraine had practically the same level of development as Bulgaria and Romania (GNI per capita of USD 5 080 and USD 5 710 respectively, according to the World Bank World Development Indicators (WDI). The six countries also differed in terms of their natural resource endowments, and this had a significant bearing on their attractiveness to investors. Equally importantly, the quality of human capital varied between countries, despite the fact that it was based on the same Soviet education system. The initial differences were accentuated over the transition period, and the six Eastern partners are now widely disparate countries, with economies that differ in size and institutional characteristics. To some extent the post-independence divergence among these countries has been determined by the evolution of their EU foreign policies. While Georgia, Moldova and Ukraine aspire to a closer relationship with the EU, Armenia, Azerbaijan and

Belarus have their own vision regarding economic development and integration prospects. These varying visions have led to the development of different policies in the EU and Russia. The former has built a neighbourhood policy and EaP framework as instruments to assist the region, while Russia, which has its own integration blueprints, aims to economically reintegrate post-Soviet territories.

Secondly, increasing economic divergence was linked to the speed and intensity of the implementation of market reform. In the first decade of transition, Moldova and Georgia made very modest progress in this respect. Armenia and Azerbaijan succeeded in catching up economically with Ukraine, which experienced a reform process characterised by intermittent periods of acceleration and deceleration. Belarus was the exception in this context, as few structural reforms were implemented and state control over the economy is still significant.

Thirdly, the effects of the initial recession experienced by all the countries in the early transition years were amplified by disruptive political events (regional conflicts and civil wars) in Armenia, Azerbaijan, Georgia and Moldova, and these absorbed enormous resources that could have been used to finance economic restructuring. The conflicts also led to an unstable environment, which hindered FDI and cross-border trade flows.

Fourthly, all the countries were fully integrated within the Soviet Union area in their common communist past. Independence brought about a sudden disruption in traditional economic links, which created enormous difficulties in terms of reorienting economic ties with the world. Consequently, economic relations with Russia have followed differing paths, depending on each country's vision of its future in relation to Europe. Russia has always maintained its position as key economic player in the region; in addition, its oil and gas resources have made most of its neighbours highly dependent on Russian supply. As a result of their tense relations with Moscow, countries such as Georgia and Moldova have not benefited from growth spill-over within the region as much as Belarus (which is highly dependent on the Russian economy), Ukraine (which saw its food-processing industry boom after a decade of decline, thanks to increased demand from Russia) and Armenia (which maintains very good economic relations with Moscow).

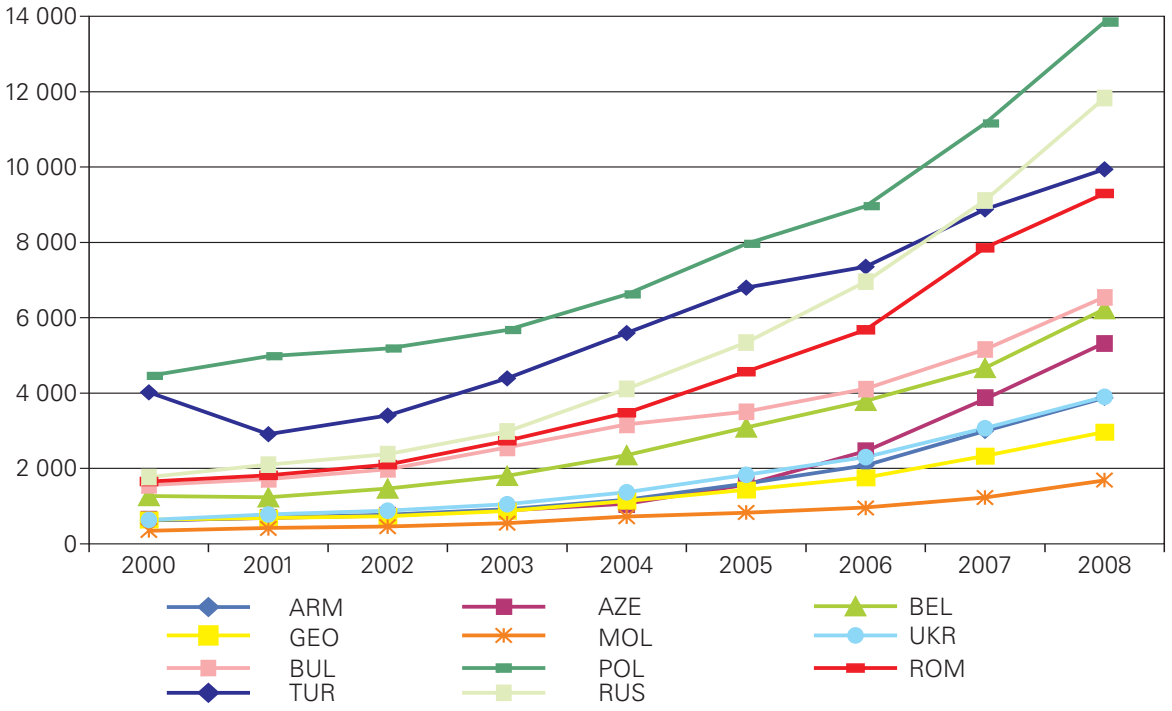
The final factor explaining the growing economic divergence among these countries and with the CEEB group is their progress in implementing structural reforms. The EBRD stressed the link between progress with reforms and subsequent economic growth, with market-sustaining reforms having the highest impact on growth (EBRD, 2004). Compared with the CEEB group, countries in the CIS started the process of restructuring their economies, institutions and legal frameworks with a delay of several years. The exception was Armenia, where reforms were started earlier and much more decisively than in the other countries in the region. The reason for this was that Armenia experienced the hardest post-independence economic shock, marked by hyperinflation, high budget deficits and the near collapse of industry. The country was therefore forced to implement rapid and dramatic structural reforms, including price and trade liberalisation, and land and enterprise privatisation. As a result, economic recovery started as early as 1994 and continued uninterrupted until 2008, with an average annual growth rate of 8.8% during this period. Other countries delayed embarking on structural reforms, and merely developed a minimum threshold of macroeconomic stabilisation, liberalisation and institutional restructuring (Havrylshyn, 2008).

In per capita terms, GDP followed a similar pattern, with more accelerated growth in Armenia and Azerbaijan (**FIGURE 1.4**), particularly in more recent years. It is interesting to note that GDP increased faster in per capita terms than in volume terms. This was mainly the consequence of emigration and declining population numbers; on average, Ukraine (followed by Armenia and Belarus) recorded the highest differential between GDP per capita and GDP volume.

The main determinants of transitional growth differed in the six countries. Growth in Azerbaijan was driven primarily by the booming export-oriented oil and gas sector, while increasing domestic demand, largely financed by loans and transfers from abroad, fuelled growth in Georgia and Armenia. Transfers originated from the diaspora, from official assistance or from remittances from Armenians and Georgians working abroad, particularly in Russia. Growth in Ukraine was very much boosted by booming world prices for metals (its main export), as well as by a surge in Russian import demand for Ukrainian products. In recent years, growth has been driven mainly by strong private consumption – resulting from increases in household real income and consumer credit – and intensified investment demand, a consequence of ongoing industry modernisation and a construction boom.

In Belarus, growth recorded since 2000 has been largely driven by an increase in exports to Russian markets. However, this remarkable improvement in the terms of trade has been accompanied by only a small improvement in competitiveness. The economy is largely dominated by the public sector and state intervention, and the level of bureaucracy is particularly high: senior managers in Belarusian companies spent twice as much time dealing with government regulations as their counterparts in Eastern Europe or Central Asia (World Bank, 2008b). Export performance responds to the economic privilege awarded by Moscow in exchange for the country's pro-Russian political orientation. However, overall economic performance, which has led the country to have the highest per capita income within the group, is also the result of improvements in labour productivity and efficiency in energy consumption by the dominant industrial sector. Together with services, industry is the major driver of growth in Belarus. Consequently, the country is practically the only Eastern partner whose exports are dominated by manufactured commodities; the other countries rely heavily on exports of natural resources, raw materials and goods with low added value.

FIGURE 1.4 GDP PER CAPITA, 2000–08 (USD)



Source: World Bank World Development Indicators.

In all the Eastern partner countries the services sector has contributed most to economic recovery and GDP growth. Construction[10] has been particularly important for Armenian growth, benefiting from both FDI and remittances, and posting growth rates of around 30% over the past few years. In Georgia, the share of GDP represented by services reached 54.0% in 2007, while in Moldova the contribution of services to GDP increased from 28.7% in 2005 to 51.0% in 2007. Between 2000 and 2006 the Georgian economy was essentially driven by the construction boom, with the sector achieving an annual growth rate of 46.6% in 2003; even in 2007, it was the most dynamic economic activity in Georgia. A lower contribution to GDP for construction was recorded for Ukraine, where the proportion increased from 4.0% in 2001 to 4.3% in 2006; in fact, in 2005 the sector had a negative impact on GDP growth. In Moldova the construction sector recorded the deepest downturn and the most severe job losses in the recession period: in 2000, output was only 36.0% of the 1994 level. A rapid recovery was recorded after 2003, but the contribution of construction to employment growth was much less impressive than its performance in terms of output (ETF Country Reports).

As the ETF Country Reports show, the contribution of agriculture to GDP has declined significantly in all six countries. In Georgia, agriculture contributed only 18% to GDP in 2007, compared with 29% in 1999. Between 2001 and 2006 Ukrainian agriculture lost 7.7 percentage points as a share of GDP. In Moldova, whose economy is very much dependent on this sector, agricultural output in 2007 reached only 67% of the levels recorded in 1994 and 1997; consequently, the sector's contribution to GDP fell from 29% in 2005 to only 13% in 2007. In most of these countries, however, the declining trend cannot be interpreted accurately because land privatisation resulted in a large number of small farms that essentially produce for self-consumption. Agricultural production may actually be as high as at the beginning of transition; however, since subsistence agriculture has increased tremendously in traditionally agrarian countries such as Moldova and Georgia, a significant portion of agricultural output may simply go unrecorded.

The industrial sector in all six countries was hit particularly hard by the economic recession of transition, with output falling victim not only to the abrupt opening up to international markets but also to inherent reforms that introduced price liberalisation, a hardening of budget constraints, privatisation and restructuring. Industry suffered disproportionally from the dismantling of the USSR, with Georgia (by 1995), Azerbaijan (by 1997) and Armenia and Ukraine (by 1993) losing 80%, 70% and 50%, respectively, of industrial output. Despite rapid industrial recovery from the late 1990s, only Ukraine, Belarus and Azerbaijan have so far managed to fully restore their previous levels of industrial output, and in Azerbaijan this has largely been as a result of the development of oil fields. In 2008 industrial added value in Armenia (including energy) represented only 87% of the 1990 level. In Moldova, the industrial sector (mainly based on food processing) entered a new period of

10 The statistical definitions of the services sector differ between countries, and precise calculation of the contribution of this sector to GDP is therefore impossible. In Armenia, for example, construction is considered a service by most of the statistical sources, and services in Moldova include a component (social services to citizens) that would not be part of this sector under the standard definition.

recession in 2006, after only a few years of growth; as a consequence, industry's share of GDP fell from 25% to 15% between 2005 and 2007 (EBRD, 2008).

Hence, the sectoral dynamics of GDP growth are different in the six countries, but have also varied over time within particular countries, reflecting the policy options for development implemented by the various governments. In Armenia, for example, the main drivers of growth between 1999 and 2003 were the industrial and construction sectors (accounting for 60.6% of the GDP increase), while the share of agriculture and services accounted for only 30.5% (compared with 53.8% in the period 1994–98). However, between 2004 and 2008, services and construction were the leading sectors in the economy, with an accumulated contribution of 72.2% to GDP growth. The share of industry in GDP declined from almost 27% to only 4.6% between 1999 and 2003 (ETF, 2009a).

Although these sectoral adjustments reflect the flexibility of economic policies, they also reveal that decision makers do not have a very clear perspective regarding long-term economic development. Relying essentially on specific sectors to boost growth for relatively short periods is not always an appropriate strategy. In addition to the fact that agriculture is highly dependent on climatic conditions, the construction sector has a serious development disadvantage in that it is mostly concentrated in urban areas to the detriment of rural areas; this has resulted in increasing regional disparities in terms of economic development. Although the services sector is generally the most important engine of growth in developed countries, the services sectors of Eastern partner countries are characterised by the development of low-value-added activities. These activities need to become increasingly sophisticated; stimulating the growth of information and communications technology (ICT) services is one such example.

The GDP ownership structure also varies in the six countries (EBRD, 2008). In Belarus the private sector accounts for the lowest share of GDP (30% in 2008 compared to 25% in 2002). Armenia, Azerbaijan and Georgia have the lowest public sector presence in the economy (accounting for 25% of total GDP produced), this being comparable to the situation in CEEB countries. The state sector remained constant in Ukraine (65% of GDP) over the period 2002–08, while in Moldova the contribution of public firms to GDP declined by ten percentage points in the same period, falling to 35% in 2008. Between 2002 and 2007, gross capital formation (GCF)[11] made the highest contribution to GDP growth (**TABLE 1.3**); the sole exception was Georgia, where

TABLE 1.3 GDP GROWTH CONTRIBUTORS, 2002–07 (%)

Country		2002	2003	2004	2005	2006	2007
Armenia	Private consumption	10.3	11.5	16.3	7.6	13.3	16.1
	Public consumption	2.5	21.9	17	21.9	13.3	24.2
	Gross capital formation	38.1	30	21.9	46.8	41.2	21.3
Azerbaijan	Private consumption	13.1	6.0	6.9	6.3	18.9	3.8
	Public consumption	0.5	11.1	4.6	1.9	16.9	27
	Gross capital formation	64.8	72.6	13	-0.5	15.2	3.5
Belarus	Private consumption	11.4	7.4	9.6	15	14.6	11.3
	Public consumption	0.3	0.3	-0.2	0.6	0.2	0.5
	Gross capital formation	6.7	20.6	19.9	19.5	26.5	15.1
Georgia	Private consumption	3.4	3.2	7.6	0.1	29.1	9.8
	Public consumption	5.7	4.1	64.2	27.2	-3.6	7.8
	Gross capital formation	-5.2	20.9	9.0	12	-0.4	14.8
Moldova	Private consumption	5.9	18.5	6.2	10.1	7	3.5
	Public consumption	31.4	3.2	-16.2	6.3	5.3	17.4
	Gross capital formation	1.1	13.5	10.5	11	15.1	16.7
Ukraine	Private consumption	9.5	11.5	13.1	16.6	15.9	17.1
	Public consumption	-6.7	6.9	1.8	2.7	2.7	2.8
	Gross capital formation	3.4	22.5	20.5	3.9	21.2	24.8

Source: EBRD (2008).

11 Gross capital formation is measured by the total value of the gross fixed capital formation, changes in inventories and acquisitions less disposals of valuables for a unit or sector.

public consumption contributed most to GDP growth. Armenia and Ukraine recorded, on average, the highest growth rates for private consumption. The contribution of public consumption was particularly low in Ukraine and Belarus: this is surprising for Belarus as the state sector still plays a preponderant role in the economy.

1.2 SHORT-TERM GROWTH: THE IMPACT OF THE GLOBAL CRISIS

After years of impressive growth and remarkable progress in implementing reforms, the Eastern partners are currently facing great uncertainty regarding their growth prospects for the coming years. The economic integration into the global context that has been achieved since 2000, together with the strong regional integration that already existed, proved to be beneficial as long as the world economy was performing well. A negative aspect of integration is that it has proportionally raised the exposure of the domestic economies to international shocks. Most of the Eastern partners benefited from demand-driven growth, which was, in turn, fuelled by considerable capital inflows that were largely dominated by remittances. The flow of remittances obviously depends on the economic performance of the migrant's destination country, with any economic downturn in that country inducing a proportional fall in remittances. Remittances stimulate domestic consumption and, implicitly, growth, but they also increase the external vulnerability of economies. Moreover, if a significant share of foreign money is used to buy imported goods, external vulnerability is further accentuated by the deterioration in the current account. In the event of international turmoil, as has occurred in the current financial and economic crisis, any small and relatively open economy is directly affected.

The initial optimism that the impact of the financial crisis would possibly be limited only to developed economies was unrealistic. The view that emerging countries would not suffer because their financial sectors are weakly integrated into the world system was also erroneous (Zaman, 2008). The decreased market value of financial institutions and credit rationing have led to a dramatic fall in stock markets and in consumer and business confidence. This has induced a large decrease in demand and output, with most advanced countries and the majority of emerging economies showing negative growth (Blanchard, 2009). The first signs of economic difficulties were already evident by mid 2008, when the Russian–Georgian conflict, combined with the fall in oil prices, quickly triggered considerable capital flight from all six countries; this was in spite of the fact that the military conflict was geographically limited and that five of the six Eastern partners have no oil resources. Furthermore, certain sectors of the economy – construction in particular – showed immediate signs of contraction. The first and most heavily affected country was Ukraine, where the crisis was amplified by currency depreciation; by the end of October 2008 the country was forced to ask the International Monetary Fund (IMF) for urgent financial support.

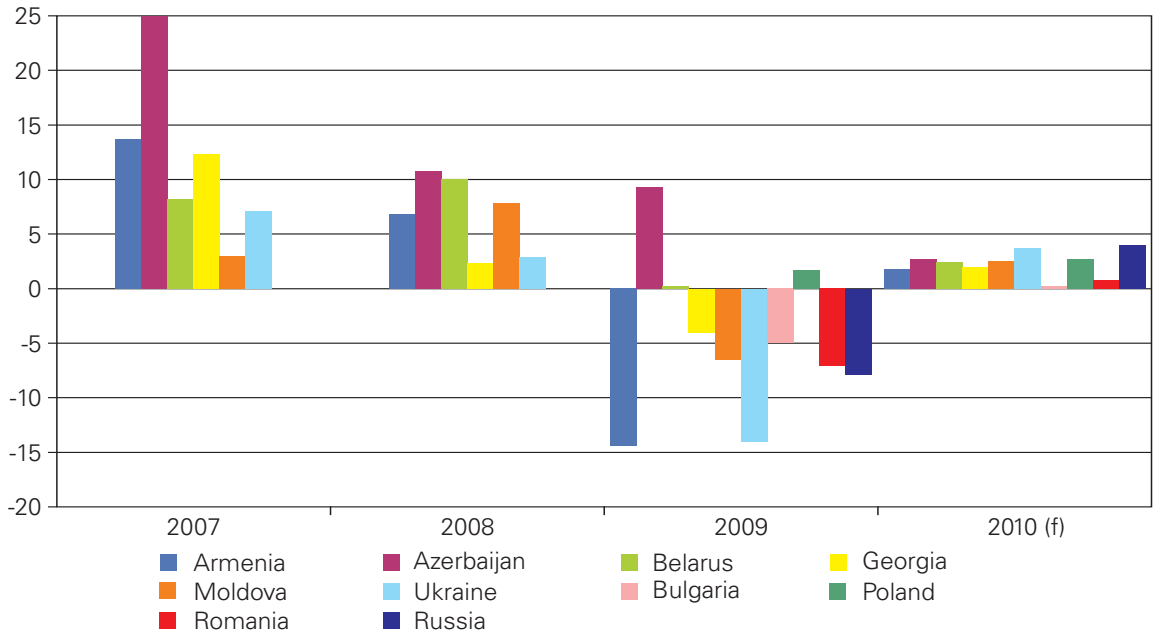
Equally significant have been the internal imbalances of recent years, which have amplified in most of the countries in the region. Despite the exceptional levels of growth in the Eastern partner countries – which have induced excessive optimism regarding their economic potential – structural reforms have not been completed, and this has left these countries with inadequate adjustment mechanisms to cope with the negative effects of the global crisis. The unprecedented turbulence experienced by the world financial system has led the global economy to slow down considerably since 2008, with most developed countries entering recession. The IMF (2009a, 2009c, 2009d, 2010c) is pessimistic in its prognosis for the coming years: world output declined by 1.1–1.3% in 2009[12], while the recovery expected in 2010 will only be possible if strong policies are urgently adopted. In April 2010 the IMF reported a 6.6% drop in GDP in the CIS countries for 2009 (-3.5% excluding Russia). With the exception of Azerbaijan, and to a much lesser extent Belarus, all the countries faced a sharp reduction in economic output, in particular Armenia and Ukraine (**FIGURE 1.5**).

Although a return to positive growth is foreseen for 2010, this is expected to be relatively modest and far below the impressive performance that was achieved prior to the crisis. The economic slowdown will therefore persist for several years, with severe social and labour market consequences for some countries, particularly the energy importers. Within this category of countries, the crisis will be accompanied by worsening living standards (IMF, 2009a, 2009c, 2009d, 2010c) as a consequence of a sharp fall in remittances.

Armenia has been hit particularly hard by the global economic crisis, which has drained capital inflows and sharply slowed down exports and inward remittances. In addition to the decline in real GDP growth, unemployment has risen and corporate sector distress has increased considerably. The resulting downward pressure on the exchange rate was initially resisted by the authorities, with a rapid and unsustainable loss of international reserves in late 2008 and early 2009. In response to these events, Armenia introduced a strong set of policies, but deteriorating economic conditions – with sharply falling fiscal revenues and a widening external gap – eventually forced the government to request IMF aid. This helped with the return to a floating exchange rate, with the Armenian dram (AMD) stabilising after an initial depreciation of 20% (IMF, 2009b). Despite macro-framework stabilisation, the short-term outlook continues to be difficult, and important challenges remain. The significant economic downturn in Russia and other trading partners will continue to have a negative impact on remittances and exports. Although sound and well capitalised, the banking sector is still at risk from economic contraction, which affects credit risk; this is already reflected in the

12 See www.imf.org/external/pubs/ft/weo/2009/02/pdf/tables.pdf for the Statistical Appendix of the IMF World Economic Outlook.

FIGURE 1.5 IMF GDP GROWTH ESTIMATES, 2007–10



Source: IMF (2010c).
Note: 2010 (f), data is forecasted for 2010.

increase in non-performing loans. Despite considerable international reserves, balance of payments pressures will persist for some time.

Azerbaijan and Belarus are the two countries in the group that have been least affected by the global crisis. Azerbaijan has been very modestly hit by the economic crisis, as a result of its limited integration into the global financial system. Consequently, it was the only Eastern partner that recorded positive growth in real GDP (9.3%) in 2009. In Belarus, GDP fell by just 0.2% in 2009, possibly as a result of the adoption of a package of adjustment policies with the support of the IMF in response to the crisis. Despite a substantial decline in exports, economic contraction has been modest, as the exchange rate adjustment has helped to reduce external vulnerabilities; meanwhile, a tight fiscal policy promoted by the authorities has offset revenue shortfalls with major spending cuts. At the same time, interest rate policy has been redesigned to keep market rates high in real terms (IMF, 2010a, 2010d).

Georgia's economy has been hit hard by the crisis. The economic downturn has proved to be deeper than expected, with sharp falls in FDI, remittances and exports, which in turn have led to a significant reduction in employment and income levels. With a monetary policy impaired by high dollarisation, the authorities' response has been to rely mainly on fiscal stimuli and a steady reduction in the budget deficit. In parallel, interest rates have been reduced and ample liquidity injected into the banking sector; however, these measures have not led to a resumption of bank lending, owing to balance sheet weaknesses and high credit risk. Large repayment obligations in 2013 forced the government to request an extension to the initial arrangement (IMF, 2010b).

Moldova experienced a 9% fall in real GDP in 2009. Weak demand from trading partners has led to a severe downturn in exports and remittances, while FDI has fallen sharply. Deflationary pressures have emerged, with 12-month inflation registering -2.3% in September 2009. Poverty and unemployment levels have increased significantly. Great political uncertainty makes the macro-stabilisation programme recently agreed with the IMF highly unpredictable in terms of outcome (IMF, 2010e).

Ukraine negotiated a USD 16.4 billion loan from the IMF in 2008 to cope with the impact of the crisis, which has created an extremely difficult economic situation (another one followed in July 2010). A sizeable part of this loan has been used to ensure the timely payment of wages and pensions by the government. However, the government's stabilisation programme is affected by serious disagreement among the authorities on how to proceed. Policies in some areas, including an expansionary 2010 budget, threaten the expected success of the programme, as they would fuel inflation and unemployment. In addition, although in October 2009 the parliament passed a law on social standards that would cost up to 7% of GDP, the government was strongly against the law because of the commitment to the IMF conditions, and its implementation is still not clear (IMF, 2010f).

1.3 INFLATION TRENDS

Satisfactory economic performance in terms of growth has not always been accompanied by suitable policies for combating inflation. After a period (2002–06) of relatively moderate price increases (below 10% on average for all the CIS countries), inflation started to increase in 2007 (**TABLE 1.4**). For the first time since the Russian crisis, inflationary pressures again threaten the macroeconomic stability of the region. In fact, since 1998 the price index for the six Eastern partner countries has been higher than the average inflation recorded by the whole pool of transitional economies and much higher than the rates recorded on average within the CEEB group (**FIGURE 1.6**). However, this is mainly a result of the outlier position of Belarus, which recorded single-digit inflation for the first time only in 2006. If Belarus is excluded from the group, the average rate for the remaining five countries was only 8.94% for the period 2000–08, i.e. six percentage points below the group average when Belarus is included.

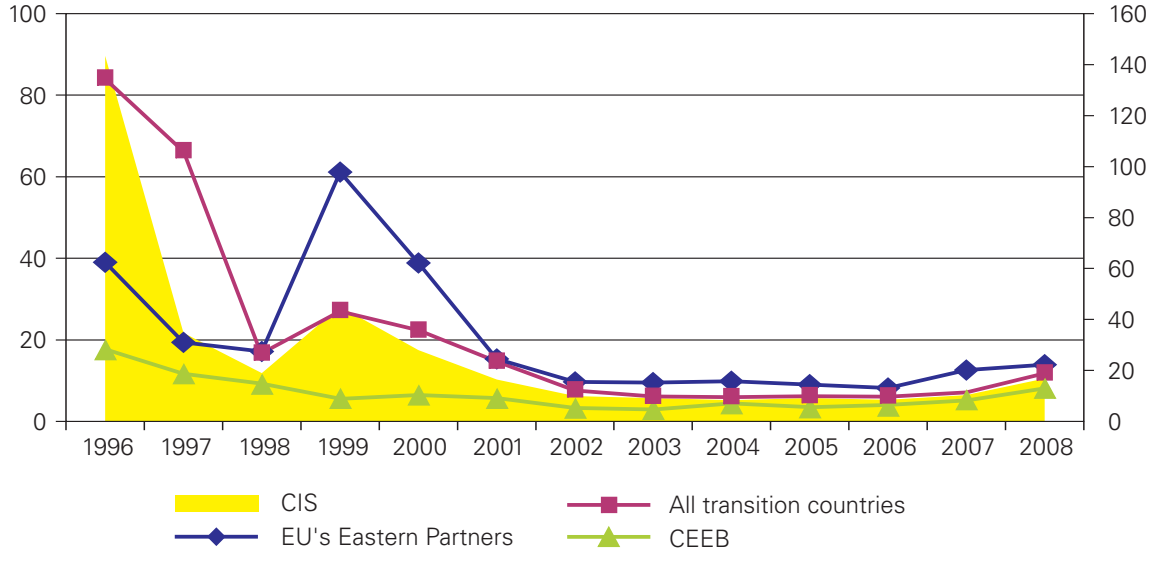
In terms of individual performance (with Belarus excluded from this calculation), Armenia and Georgia recorded the lowest average rates of inflation since 2000, while Moldova and Ukraine recorded the highest. Azerbaijan is very close to the group mean. Low inflation rates have been possible because of significant productivity growth and high rates of investment; increased globalisation has also reduced import prices. In parallel, increasing unemployment in the first decade of transition has led to labour abundance and therefore low-wage pressures on the labour market. Nevertheless, after several years of accelerated growth – largely stimulated by high capital inflows and rapid credit expansion – in 2007 the economies of Eastern partner countries started to face serious capacity constraints. The dramatic fall in output in the first decade of transition generated significant underutilisation of productive capacities in the economy, which persisted throughout the recovery period. However, since 2000 output expansion increased capacity utilisation to the point where potential GDP approached effective output. Beyond this point, for the same demand level,

TABLE 1.4 CONSUMER PRICE INDEX INFLATION, 1996–2008 (% YEARLY AVERAGE)

Country	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	18.7	14.0	8.7	0.7	-0.8	3.1	1.1	4.7	7.0	0.6	2.9	6.6	9.0
Azerbaijan	19.7	3.5	-0.8	-8.5	1.8	1.5	2.8	2.2	6.7	9.6	8.3	19.7	20.2
Belarus	52.7	63.9	72.9	293.7	168.6	61.1	42.5	28.4	18.1	10.3	7.0	8.4	14.9
Georgia	39.4	7.1	3.6	19.2	4.1	4.6	5.7	4.9	5.7	8.4	9.2	11	5.5
Moldova	23.5	11.8	7.7	39.3	31.1	9.6	5.2	11.6	12.5	12.0	12.8	13.1	9.0
Ukraine	80.0	15.9	10.6	22.7	28.2	12.0	0.8	5.2	9.0	13.5	9.1	12.8	25.2

Source: EBRD (2008); ETF Country Reports; State Statistical Committee of Azerbaijan; Georgian Ministry of Foreign Affairs.

FIGURE 1.6 INFLATION RATES IN TRANSITION COUNTRIES (%)



Source: EBRD (2008).

productive capacity became constrained and the output price consequently started to increase, leading to greater inflationary pressures.

One important factor that has contributed to considerable differences among the countries with respect to inflation-reduction performance is the exchange rate. Countries that had adopted a floating regime (Armenia and Georgia) found it much easier to keep inflation down than countries where managed float or pegged exchange regimes were in place (Azerbaijan, Belarus, Moldova and Ukraine). The rise in food prices since mid 2007 has contributed significantly to a reversal in the inflation trend, since the weight of food items in the consumer price index (CPI) ranges between 40% and 60% in CIS countries (compared with only 20% on average in the CEEB countries (for a detailed analysis, see EBRD, 2008)). Inflationary pressures appeared earlier in most of Eastern partner economies as a result of the faster increase in wages than in labour productivity. The wage-productivity gap started to be visible after 2005, particularly in booming sectors such as construction and financial services, where the demand for labour was higher than the available supply. In Ukraine, for example, the accumulated growth of wages between 2005 and 2007 was almost 3.8 times higher than the accumulated productivity increase (ETF, 2008c); in Belarus and Moldova, the values were 2.8 and 1.8 respectively. The wage-productivity gap resulted in rising unit labour costs that put significant pressure on marginal profits and, ultimately, on market prices, especially in sectors where competition was still insufficient.

Under these circumstances, fiscal responses to rising inflation have not always been appropriate; in some countries, the response has even been pro-cyclical. This inadequate policy was determined by the over-optimism of the respective governments, which wrongly considered the inflationary trend to be a temporary phenomenon that would not seriously affect wage expectations in the labour market. At the same time, the credit turmoil that started in mid 2007 has noticeably limited policy makers' room for manoeuvre.

1.4 FOREIGN ECONOMIC RELATIONS

The high level of economic growth of recent years in all the CIS countries has translated into a significant increase in the region's contribution to world trade. Between 2003 and 2007, CIS trade volume increased by more than 70%, from USD 526.5 billion to USD 898.7 billion (Astrov and Havlik, 2008), as a result of the growing integration of CIS economies, both regionally and internationally. In line with these trends, the Eastern partners have increasingly opened up their economies to foreign trade, either through multilateral trading systems and increased regional cooperation or as part of domestic reform programmes. In exchange, trade and globalisation have brought enormous benefits to the domestic economies because open trading in a global context is beneficial for specialisation and enables more efficient production. At the same time, efficiency – supported by the spread of knowledge and new technologies – is synonymous with increased productivity and, therefore, with better wages and a wider range of choices for consumers.

Between 2003 and 2007 the level of foreign trade among the six Eastern partners increased considerably. Exports recorded particularly high growth (**TABLE 1.5**), with the total volume in 2007 higher than that in 2003 by 131.3%. Imports also increased, leading to exceptionally high trade

TABLE 1.5 EXPORT AND IMPORT GROWTH, 2004–08 (% PREVIOUS YEAR)

Country	2004	2005	2006	2007	2008
			Exports		
Armenia	3.85	34.72	1.15	16.97	24.01
Azerbaijan	39.57	20.24	46.58	-4.92	
Belarus	38.49	16.01	23.50	23.01	35.54
Georgia	40.20	33.79	8.17	31.64	21.53
Moldova	24.72	10.77	-3.64	27.59	18.61
Ukraine	39.00	6.30	13.70	27.20	-34.90
			Imports		
Armenia	19.51	33.39	21.64	49.11	-6.60
Azerbaijan	33.88	19.78	25.06	8.46	
Belarus	42.68	1.32	33.77	28.37	37.60
Georgia	61.72	34.91	47.70	41.80	16.17
Moldova	26.11	29.62	17.49	36.99	32.78
Ukraine	26.90	25.80	24.80	34.50	40.50

Source: National statistics offices.

turnover in the region. Between 2003 and 2008, Ukraine had the best export performance (an average increase of 29.25%), while Moldova lagged behind the rest of the group (an average increase of 15.61%). For the same period, import growth was highest in Georgia (an annual average of 40.46%) and lowest in Azerbaijan (an annual average of 21.8%). This favourable trade performance was the result of increased productivity (and therefore competitiveness) in the domestic economies, accelerated integration at the regional and international levels, the removal of trade barriers, the opening up to foreign investment and foreign capital, the preferential treatment accorded by the EU or Russia to some countries, and favourable international prices for the raw materials, metals, oil and similar commodities exported in large quantities by these countries.

Foreign trade is basically dependent on the international competitiveness of a domestic economy. It is generally agreed that countries exporting more tend to grow faster and, consequently, improve further their terms of trade with the rest of the world. The relationship between export growth and domestic economic growth could be expressed by the evolution of the current account balance, which includes – as well as the trade balance – net factor incomes and net transfers from abroad. Within the six Eastern partner countries, the current account balance clearly improved in those countries that have experienced fast, sustainable growth since 2000. Armenia is the best example in this respect: its current account deficit as a share of GDP declined from 14.6% in 2000 to 1.8% in 2006 (**TABLE 1.6**), although this positive trend has reversed since 2006. With the exception of Azerbaijan, all the Eastern partners witnessed a worsening of this indicator in 2007 and 2008.

Economic growth and improved terms of trade through exports are therefore interconnected, since the expansion of GDP is normally accompanied by increased productivity, competitiveness and efficiency. All these elements improve the comparative advantage of a country in the regional and international contexts. The geographical distribution of foreign trade gives an indication of the markets in which a country is able to compete. In the case of the six Eastern partners, a large proportion of their foreign trade is carried out within the CIS region (**FIGURE 1.7**). In 2007 two-thirds of Belarus's originated in the CIS in 2007, while more than 46% of the country's total exports were shipped there. The region is therefore economically integrated with Russia, though the six countries are not integrated with one another (OECD, 2008). Most of the foreign trade within the CIS area is carried out on the basis of regional agreements that are not always very strict in terms of quality and safety norms.

The trade performance of a country can be analysed in terms of its capacity to expand foreign economic exchanges towards the developed world. In this respect, trade with EU member states is a good indicator. Armenia and Moldova have the highest rates of penetration in EU markets, with almost half of their exports going to Europe (**FIGURE 1.8**). The two countries, together with Georgia, are in fact the longest-standing World Trade Organisation (WTO) members in the group. Georgia, Moldova and Armenia joined in 2001, 2002 and 2003 respectively, and Ukraine joined in 2008; Belarus and Azerbaijan are still negotiating membership. WTO membership offers certain exporting facilities to new members, but this benefit alone cannot much improve the terms of trade. Being a WTO member offers the possibility of better geographical diversification of exports, but has no effect on product diversification.

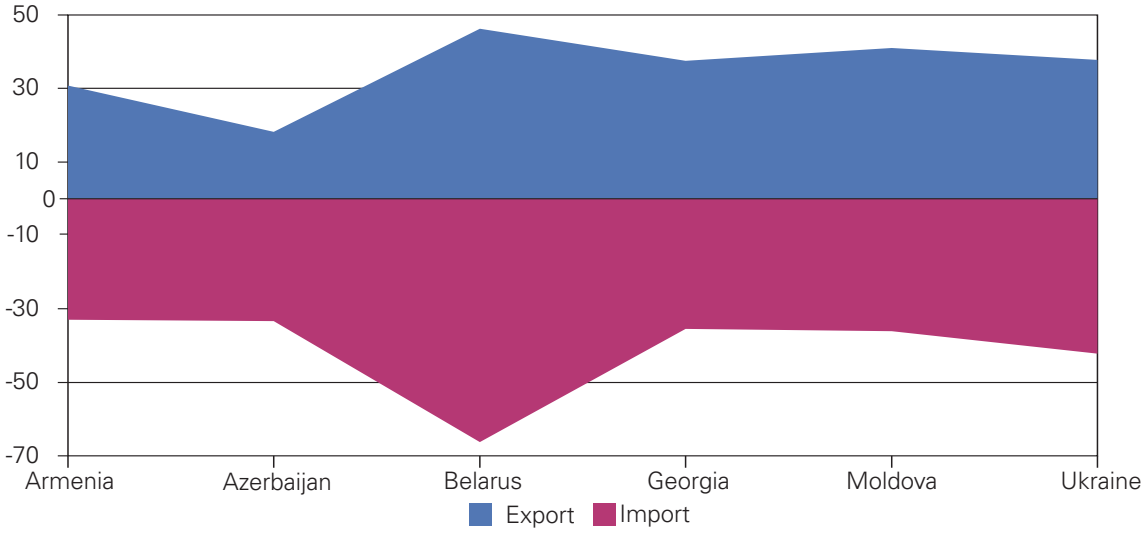
What a country exports essentially reflects its degree of economic diversification. Comparative advantage is acquired through trade specialisation. Product diversification reveals the capacity of the economy to adjust rapidly and efficiently to changing patterns in international demand. Foreign trade is more competitive when the balance between specialisation and diversification is optimised. Specialisation brings a comparative advantage (in terms of natural, physical and human capital resources); diversification allows enough flexibility to adjust economic output so that the quality of exported goods improves (enhanced competitiveness) as a permanent shift occurs into new products (innovation). Although geographical diversification of CIS exports over

TABLE 1.6 CURRENT ACCOUNT BALANCE, 2000–08 (% GDP)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008*
Armenia	-14.6	-9.4	-6.2	-6.7	-4.5	-3.9	-1.8	-6.4	-12.5
Azerbaijan	-3.5	-0.9	-12.3	-27.8	-29.8	1.3	17.7	28.8	35.5
Belarus	-3.2	-3.3	-2.2	-2.4	-5.2	1.4	-3.9	-6.7	-8.4
Georgia	-4.4	-6.5	-5.8	-7.4	-8.3	-9.8	-13.7	-19.7	-22.7
Moldova	-7.6	-1.7	-4.0	-6.6	-2.2	-8.1	-11.7	-15.2	-16.7
Ukraine	4.7	3.7	7.5	5.8	10.5	2.9	-1.5	-4.1	-7.2

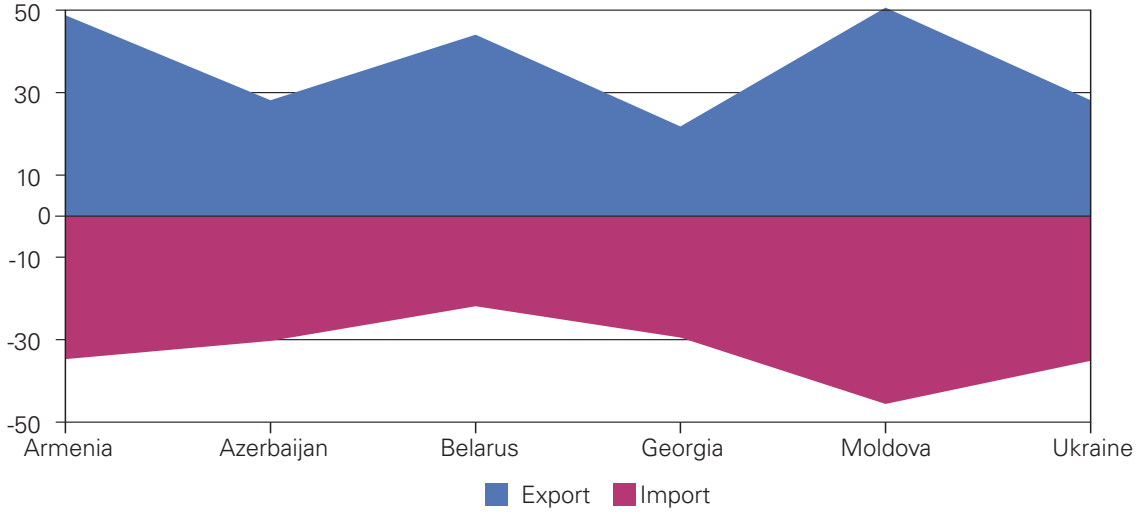
Source: EBRD (2008).
*Note: *Figures for 2008 are estimates.*

FIGURE 1.7 TRADE WITH CIS COUNTRIES, 2007 (% TOTAL)



Source: National statistics offices.

FIGURE 1.8 TRADE WITH EU COUNTRIES, 2007 (% TOTAL)

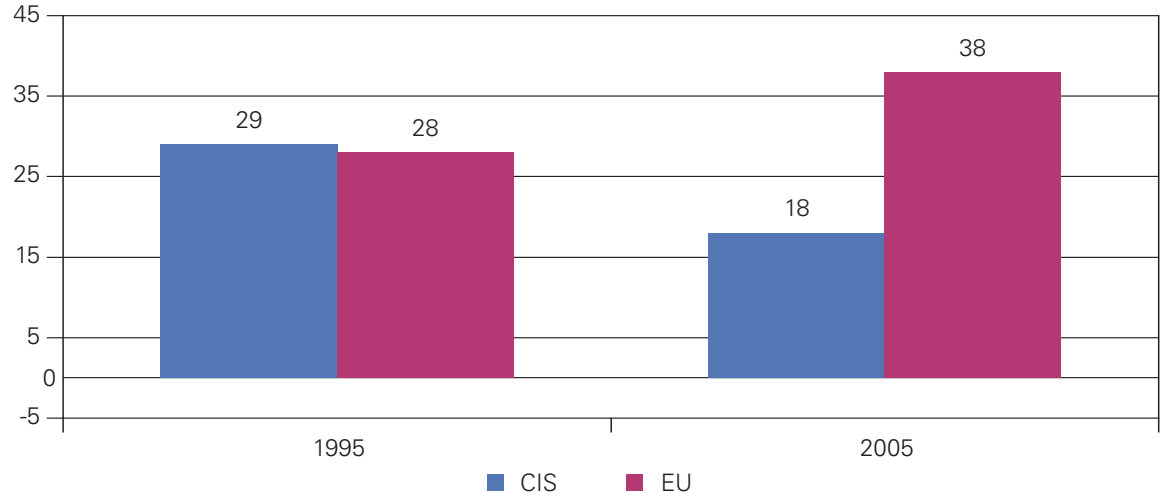


Source: National statistics offices.

the past decade has changed, with a clear shift from intra-CIS trade towards EU-oriented exports (**FIGURE 1.9**), product diversification has not mirrored this trend. CIS exports to the EU are predominantly raw materials and low-value-added commodities, mainly oil and gas. CIS economies have thus become increasingly reliant on non-manufactured or minimally manufactured exports in response to the sharp increase in international prices for these commodities.

National statistical sources indicate that the six Eastern partners did not noticeably change the commodity structure of their exports during the period of high economic growth. Crude petroleum, diesel fuel and motor oil were the main exports from Azerbaijan in both 2003 and 2008. More than 45% of Ukrainian exports in 2007 were represented by iron and steel products and minerals, and the same products accounted for around 48% in 2004. Moldova, which has trade that is heavily based on agricultural goods, exported the same products in 2007 as it did in 2000: beverages, vegetables, raw tobacco and seeds. Iron and steel, beverages, spirits and vinegar are the most important commodities currently exported by Georgia, while almost half of Armenia's exports are metals and mineral products. Around 57% of Belarusian exports are mineral products, rubber and chemicals.

FIGURE 1.9 GEOGRAPHICAL REORIENTATION OF CIS EXPORTS (%)



Source: National statistics offices.

In conclusion, exports by the six Eastern partners – and the whole CIS region – outside the former Soviet area consist of commodities involving a relatively low level of manufacturing and consequently incorporating little added value. However, industry is important in Ukraine and Belarus, with manufacturing sectors that contribute significantly to GDP. Nevertheless, their export of machinery, equipment and technical appliances is almost exclusively intra-regional or directed to less developed markets. This is because manufactured goods produced in the CIS region are generally of poor quality and lack sophistication.

It follows that the Eastern partners specialised in exports in two directions during the period of fast economic growth:

- raw materials and fuels, mostly for the EU and developed markets;
- technologically more sophisticated and higher-value goods, destined for regional CIS markets.

The high level of intra-regional exchange of manufactured goods could be also explained by the traditional and historical relationships that existed between these countries during their Soviet past, when economic isolation forced them to trade essentially among themselves. However, this only partly explains the current geographical structure of exports, given the economic openness of some of the countries and their accession to the WTO. The essential factor explaining this dual foreign trade pattern may be the non-emergence of new manufacturing industries since independence. As a result, poor quality, a lack of sophistication and, consequently, a lack of competitiveness have rendered products from Eastern partner countries incapable of penetrating developed world markets.

Since 1995 only Belarus and Ukraine have recorded any progress with respect to export sophistication (EBRD, 2008). Nevertheless, this progress is still insufficient to allow them to become candidates for exporting machinery to EU markets. Moreover, even in the case of these two countries, the increase in export sophistication is not necessarily a result of any improvement in the export basket. The index of sophistication is based on per capita GDP, to which it is inversely related; consequently, if the increase in GDP per capita is less than the GDP growth rate (as is the case in Ukraine), product sophistication increases. Moldova, Georgia and Armenia have lower export sophistication than their economies are capable of; Azerbaijan is also within the group of countries with low export sophistication, but its position is explained by the fact that its economy is dominated by the production of oil, which has practically no degree of sophistication.

In parallel, the CEEB countries have succeeded in considerably upgrading their export structure over the transition period, and this has enhanced the export sophistication of their products. The CIS group, and in particular the subgroup of six Eastern partners, lags far behind in this respect, and this may generate a vicious circle of uncompetitive exports: because their manufactured commodities are internationally uncompetitive, the Eastern partners redirect them towards regional markets in the CIS area, but by producing less sophisticated goods for less demanding clients, no real pressure is exerted on national economies to diversify and innovate, and hence, only CIS markets will buy such commodities.

The reason that manufactured exports are not sufficiently competitive lies in the inability of the six Eastern partners to transform their production structure and therefore enhance their comparative advantage through the accumulation of factors of production resulting from economic growth. Transitional reforms were supposed to induce structural changes in the economy that would stimulate economic growth and fuel

the accumulation of factors of production (physical and human capital). When this cycle does not function properly, the economy may still grow, but certain internal disequilibria will develop. In the Eastern partner countries, inadequate trade policies have arisen from what was originally perceived as an economic advantage: rising world prices for oil and raw materials. In addition to the non-renewable nature of these commodities, the high level of natural resource exports has become an economic disadvantage as the global crisis starts to gnaw at the real economy. The fall in world prices for raw materials and oil has now exactly the opposite effect: the value of exports is falling sharply, capital inflows sometimes become capital outflows and the balance of payment deteriorates rapidly.

In recent years, however, most governments have come to acknowledge this drawback and have invested significant efforts in changing their economic structure and diversifying activities. Azerbaijan, for example, is currently considering a major strategy to prepare a post-oil future, based on reorienting the economy towards new sectors and activities. Economic diversification is conditional on innovation regarding existing products (upgrading tradable goods) and shifting to new commodities that enter the nomenclature of domestic production. However, according to the EBRD (2008), only Armenia and Ukraine can significantly benefit from innovation and from improving the quality of their products. Moldova, highly specialised as it is in agricultural exports, has less scope for upgrading existing commodities, so the only way it can improve its terms of trade is to shift to new types of products. Azerbaijan is in the worst position in this respect, as it has few opportunities to move to new products and very limited possibilities for upgrading an economy that is highly dependent on oil production; it therefore needs to consider very seriously what type of post-oil economy can be envisaged.

Appendix 1.1 at the end of this chapter summarises the main features of Eastern countries' trade, in terms of the main import and export partners (both within and outside the CIS region) and the main products traded. Not surprisingly, Russia is the major CIS trade partner for all the counties, in terms of both imports and exports, with the exception of Georgia (the statistics correspond only to the post-conflict period). Belarus is by far the most trade-dependent on Russia (81.7% of exports and almost 92% of imports). As already noted by the Organisation for Economic Cooperation and Development (OECD), trade between the six countries is very limited (OECD, 2008). Taking the top three trade partners for each country, it can be observed that exports are generally more concentrated than imports, i.e. the share of the top three trading countries is higher for exports than for imports. As an example, for Azerbaijan, 35.5% of imports are from Russia, United Kingdom and Turkey, and 51.2% of exports are to Italy, Turkey and Israel.

Such trade concentration, particularly of exports, has certain advantages, but it also increases economic dependence on only a few markets. In a fragile geopolitical context such as the one that exists in the region, this considerably increases external vulnerability and could cause serious damage to the domestic economy. The Russian ban on Moldovan agricultural imports is a relevant example. The gas conflict between Ukraine and Russia was also the result of trade dependence. Russia, as a major trade player in the region, has a relatively important monopoly over some of the products exported (mainly oil and gas), and uses this power not necessarily to set export prices above the competitive level, but rather as a political and economic constraint; this ensures even greater economic dependence on Russia. Russia also enjoys a certain degree of monopsony power for certain goods imported from the region. When Moldovan wine was banned, the economy was affected precisely because of Russia's monopsony power. As a positive aspect of this incident, Moldova was forced to look for new export markets; although success has been minimal to date, the country has no other choice for the future.

National statistical sources indicate that the negative effect of the global crisis on foreign trade performance in the six Eastern partner countries is already significant. Exports are generally the most affected; for example, in the first quarter of 2009, Armenia exported just over half (52.7%) of what it had sold abroad in the first quarter of 2008, while Georgian exports declined by almost two-thirds. Industrial production in Ukraine and Belarus – an important exporting sector for these economies – fell drastically in the first quarter of 2009 compared to the same period in 2008: by 68% in Ukraine and around 90% in Belarus. In general, exports declined more than imports and this fuelled the trade deficit. The exception was Moldova, where exports fell less than imports.

1.5 FOREIGN DIRECT INVESTMENT

During the first decade of transition, the main determinant of FDI in CIS countries was the abundance of natural resources. For many years the extraction of mineral resources, the construction of pipelines for oil transportation, and large-scale privatisations in the energy sector represented the main sectors of interest for foreign investors. As an example, during the first decade of transition, between 75% and 82% of FDI in Azerbaijan was in the oil and gas industry; in Georgia, the vast majority of FDI inflows until 2006 were related to the construction of an oil pipeline (Kudina and Jakubiak, 2008). According to the United Nations Conference on Trade and Development (UNCTAD), in the coming years, natural resources will continue to represent the main attraction for foreign investors in the CIS region (UNCTAD, 2008). The second important factor behind investment in CIS countries – and in particular in the six Eastern partners – has been the market-seeking behaviour of investors, a motivation that has gained in importance only since 2000, when structural reforms started to be implemented and economic growth accelerated. Foreign interest began to focus on economic sectors and activities such as telecommunications and banking that were accessible and potentially highly profitable.

The empirical evidence (UNCTAD, 2008) shows that foreign investors investing in the CIS region did not necessarily look for efficiency in production, which was the main investment motivation in the CEEB and SEE countries. Resource-seeking and market-seeking behaviours are characteristic for relatively risky investments. Production efficiency is taken into consideration only when the investment climate is sufficiently stable, safe and favourable for investors, thus encouraging a longer-term view of the return on investment. When high return rates can be obtained over a short period of time, this implies that the conditions for attracting foreign investors for efficiency reasons (given the low labour cost in these countries) are as yet unfulfilled. Various studies show that the main impediments to long-term, efficiency-motivated investment are related to excessive bureaucracy, corruption and political and legal uncertainty (see, for example, Kudina and Jakubiak, 2008).

TABLE 1.7 shows that in per capita terms, over the entire transition period, each Eastern partner succeeded in attracting more FDI than the CIS average. The best performer was Georgia, which had FDI per capita that was 2.52 times higher than the CIS average. The share of FDI in GDP was likewise highest in Georgia (15.1%), and much higher than the CIS average (4.5%). Nevertheless, compared to the CEEB countries, the performance in attracting FDI was very modest: in per capita terms, the total net inflow of FDI in Georgia between 1989 and 2007 represented less than 30% of the CEEB average (**FIGURE 1.10**)[13].

Some of the Eastern partner economies are very dependent on FDI inflows. Between 2000 and 2006 in Moldova, for example, more than one-third of total investment (in a consumption-driven economy) came from abroad. Other countries (e.g. Belarus) depend very little on FDI. It is evident that a relatively high inflow of foreign investment over a specific period of time may significantly reduce FDI dependence. The total accumulated stock of investment in a country is therefore an indication of its FDI dependence/independence: the higher the stock, the less dependent the economy should be. Another indicator of the degree of FDI dependence is the share of net foreign investment inflows in total GCF: the higher this share, the more FDI-dependent the country.

In **TABLE 1.8** this share is given for the first decade of transition (the 1990s, when major transformations took place) and for four recent years. Azerbaijan represents a particular case in the sample: it recorded the highest share of FDI in GCF between 1990 and 2000, when major investments were made in the oil sector. After 2006, the indicator changed sign – most probably because GCF has completely changed its nature in recent years. The indicator was practically constant in Armenia until 2005 and increased thereafter, mirroring to some degree the level recorded by Poland. This shows a certain stability in the Armenian economy, which increasingly attracts sufficient foreign investment for development.

From 2007, Belarus, which for many years had not been seen as an attractive destination for FDI, experienced a major increase in foreign investment as a result of improvements in its business environment: the government eliminated the golden share rule, thereby largely opening the door to private investors, particularly from abroad. Georgia is another particular case within the group: foreign investment is mostly related to the construction of the oil pipeline, and consequently the share of FDI in fixed capital is exceptionally high. Ukraine, with one of the lowest FDI shares until 2000, has in recent years become very dependent on foreign investment; this was the result of accelerated structural reforms after 2000 and particularly of the privatisation of

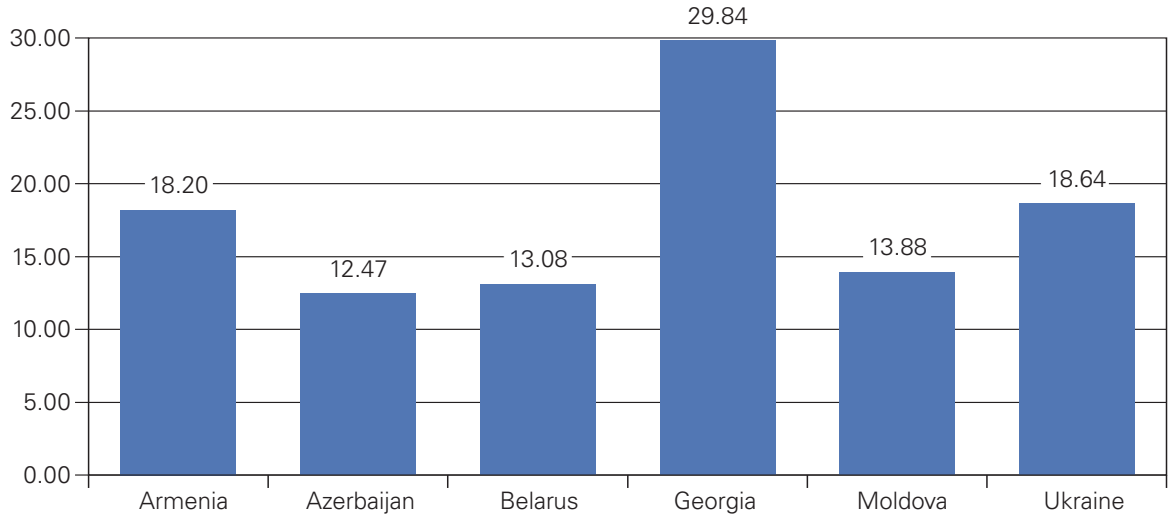
TABLE 1.7 NET FDI INFLOWS

Country	Accumulated 1989–2007 (million USD)	Per capita (USD)		Share of GDP (% 2007)
		Accumulated 1989-2007	2007	
Armenia	2 117	658	141	4.8
Azerbaijan	3 784	451	-619	-16.6
Belarus	4 564	473	183	4.0
Georgia	4 877	1 079	340	15.1
Moldova	1 724	502	129	10.1
Ukraine	31 070	674	200	6.5
Average CEEB	NA	3 616	481	3.7
Average SEE	NA	2 294	560	10.6
Average CIS	NA	428	87	4.5

Source: EBRD (2008).

13 It should be mentioned that this whole analysis is based on net inflows of FDI, which means that outward investment has been deducted. Some of the countries (Azerbaijan amongst the Eastern partners, but also Russia in the CIS and most of the CEEB countries) have recently become net investors. The data should therefore be interpreted with care.

FIGURE 1.10 COUNTRY SHARE OF CEEB AVERAGE FDI (%)



Source: EBRD (2008).

state-owned companies, which attracted investors. Over the whole transitional period, Moldova has remained highly dependent on FDI, since domestic investment in the economy has remained very modest.

In most Eastern partner countries the major investor is Russia: for example, in 2008 Russian investments represented half of Armenian FDI. Germany and France are also investors in Armenia, together with the USA. The UK, USA and Norway have been the dominant investors in Azerbaijan since 2000. Given their common history prior to the formation of the USSR, Romania and Moldova have very good economic relations; as a consequence, Romanian companies are among the most active investors in the Moldovan economy. FDI composition by main investor country is inconclusive for the purpose of analysis for two main reasons.

1. A country may have been a major investor in a particular year or for a few consecutive years, but almost never for the whole duration of transition. In Azerbaijan, for example, the British oil company BP made a huge investment in 2005, which placed the UK as the top foreign investor with one-third of total FDI. However, before and after that one-off investment, the UK was not among the top foreign investors in Azerbaijan.
2. Some of the large investor countries are in reality offshore investors. Thus, the Virgin Islands accounted for about 10% of FDI in Armenia between 2003 and 2006, and Cyprus (home to many Russian offshore firms) represented about 20% of FDI in Ukraine in 2007.

TABLE 1.8 NET FDI SHARE OF GCF, 1990–2000 AND 2005–08 (%)

Country	1990-2000	2005	2006	2007	2008
Armenia	14.8	15.9	20.1	19.8	24.2
Azerbaijan	35.9	8.4	-20.9	-64.1	-5.9
Belarus	3.5	3.8	3.2	12.5	10.9
Georgia	17.5	30.2	60.9	64.0	52.9
Moldova	15.7	31.9	30.3	33.7	33.0
Ukraine	3.6	39.7	21.6	23.5	19.7
CIS average	3.0	4.0	7.9	7.1	9.1
Poland	13.8	12.6	16	19.5	11.3
Romania	9.3	29.6	34.9	19	21.4
Russia	1.1	0.1	3.6	2.4	5.0

Source: UNCTAD Country Factsheets www.unctad.org/Templates/Page.asp?intItemID=2441&lang=1

With regard to the composition of FDI by sector of activity, the resource-seeking behaviour of foreign investors prevailed during the first decade of transition. Minerals, metal ores (in Armenia), oil and gas (in Azerbaijan) and other raw materials formed the bulk of foreign investment in Eastern partner countries. The transport and distribution of electricity was also an attractive sector for FDI (in Georgia, for example). In the tertiary sector, foreigners were particularly attracted by telecommunications, transport, banking and financial intermediation. The sectoral structure of FDI is marked by a similar pattern to geographical composition, with large investment being made at one or several points in time, rather than continuously. Mining and quarrying in Armenia, for example, recorded major investments in 1998, but three years later, FDI was 41 times lower because no additional investment was needed after 1999.

Rather than use geographical or sectoral composition to assess FDI performance, it is preferable to analyse the ranking of selected countries according to the United Nations (UN) Inward FDI Performance and FDI Potential Indexes (**TABLE 1.9**). The FDI Performance Index shows the attractiveness of investment in a particular country in terms of return. The best investment opportunities are in the countries ranked at the top of the list (Georgia and Bulgaria, for example). A country may lose its position over time and slide down the ranking for two reasons:

1. the increase in FDI stock diminishes the rate of return on investment, at least in the short term;
2. other countries become more attractive for investors because they have improved their business climates.

Of the Eastern partner countries, Azerbaijan was ranked 140 in 2007, probably because most of the highly profitable opportunities had disappeared by that time, but also because the decline in oil prices froze investment projects. Belarus, Georgia and Moldova seemed more attractive for foreign investors in 2007 compared to the previous year. Ukraine held a relatively stable position, while Armenia offered fewer investment opportunities because of investment saturation, which reduced the expected year-on-year rate of return.

The FDI Potential Index has a dynamic interpretation as it shows the latent investment opportunities of a country if the political, legal or institutional environment was to improve. The countries ranked higher are seen to have a higher investment potential. Of the six Eastern partners, Ukraine and Belarus have the best investment potential, but the business environment is currently not sufficiently friendly for investors (political instability or state control of the economy). Investment in Georgia continues, for the time being, to be profitable, but once the oil pipeline is fully functional, there will be nothing in particular to attract foreigners to invest in the country. It is interesting to compare the two indexes by calculating the difference between the rankings expressing future FDI potential and current FDI performance (**FIGURE 1.11**). A positive sign means that a country has exhausted most of its potential, while a negative one shows that a country (Belarus and Azerbaijan in this case) offer higher investment opportunities for the future.

It should be mentioned that the investment climate in each country greatly influences the estimated investment potential. Ukraine, for example, where the government has stalled the privatisation process, probably has a lower investment potential than it should have. Political instability is likely to be the major impediment to investment, followed by administrative bureaucracy, corruption and inappropriate business conditions. In spite of the impressive improvement in the business and investment environment in Georgia, the lack of a strategic approach to economic diversification makes foreign investors sceptical about the future of the

TABLE 1.9 INWARD FDI PERFORMANCE AND POTENTIAL INDEX RANKINGS, 2006 AND 2007

Country	Inward FDI performance		Inward FDI potential	
	2006	2007	2006	2007
Armenia	29	39	72	73
Azerbaijan	14	140	67	64
Belarus	125	95	50	48
Georgia	15	9	94	102
Moldova	27	19	83	79
Ukraine	37	35	48	44
Romania	21	32	74	69
Bulgaria	3	2	60	59
Poland	51	60	44	43

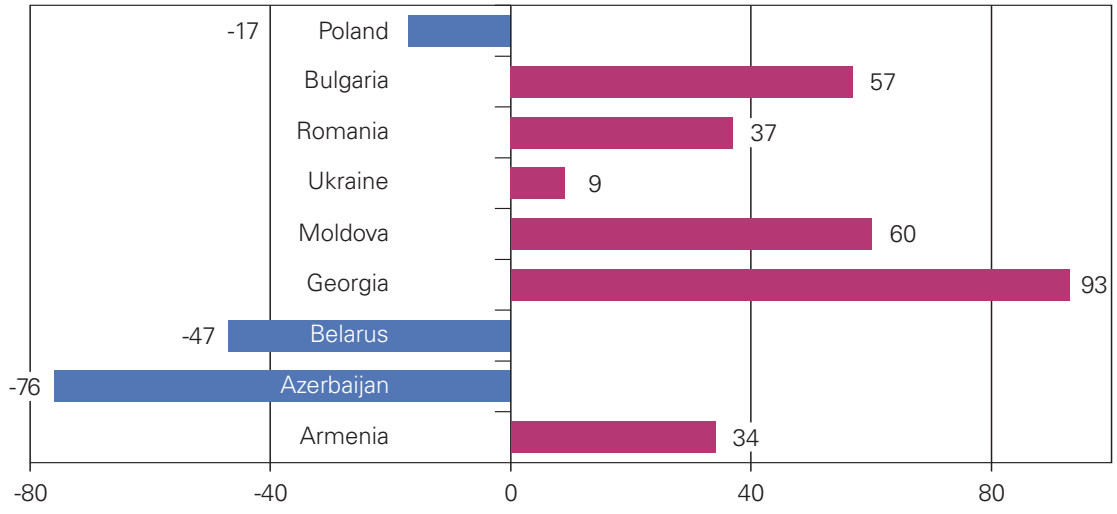
Source: UNCTAD Country Factsheets www.unctad.org/Templates/Page.asp?intItemID=3198&lang=1

country. In addition to all these impediments, the current financial crisis has completely changed foreign investment behaviour, priorities and prospects in the region.

1.6 POVERTY AND HUMAN DEVELOPMENT

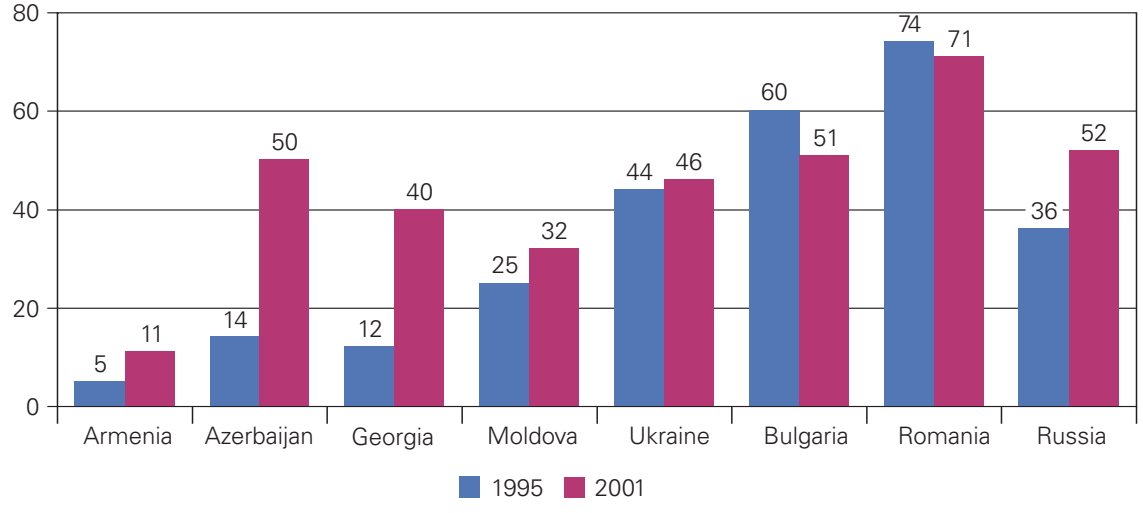
The dramatic economic decline in the first decade of transition translated into a sharp deterioration in living standards in all six Eastern partner countries. To a greater extent than in the CEEB countries, transition was marked by a pronounced dismantling of the role of the state, especially when it came to social networks (Astrov and Havlik, 2008). The contraction in output and the related increase in poverty were much greater and of longer duration than initially expected, particularly for countries that are relatively poor in natural resources (World Bank, 2005; IMF, 2002). The economic recession caused a dramatic fall in real wages, and this was much more severe than in the CEEB countries (**FIGURE 1.12**). In Armenia, for example, the real wage in 1995 represented only 5% of the 1989 level and, although this increased to 11% six years later, it was still the lowest in the group.

Figure 1.11 FDI Potential versus FDI Performance, 2007



Source: Author, based on UNCTAD (2008).
Note: A positive sign indicates the degree to which a country has exhausted its FDI potential, expressed as the difference between the rankings of each country with respect to inward FDI potential and inward FDI performance.

FIGURE 1.12 REAL WAGE INDEX, 1995 AND 2001 (1989=100)



Source: Simai (2006).

Poverty patterns in the six Eastern partner countries are very similar to those for the whole CIS region. An analysis of poverty should take into account three major transitional phases:

1. the period until the mid 1990s, when poverty increased tremendously and reached alarmingly high rates in some of the countries;
2. the economic recovery period, when poverty started to decline as a result of increases in disposable incomes and the reinforcement of social safety nets put in place by governments;
3. the current phase, when the global crisis is expected to relegate significant numbers of people to poverty and vulnerability, and therefore erase much of the progress achieved in the early 2000s; anti-poverty policy measures are now much more critical than at the beginning of transition.

During the first years of transition, poverty increased significantly and a sizeable portion of the population entered absolute poverty. Social safety nets deteriorated greatly, mainly because of the limited resources available for poverty reduction in the state budgets. Estimates based on national poverty lines[14] suggest that in most Eastern partner countries, more than half the population were living in poverty by 1999 (**TABLE 1.10**). Income inequality had also increased sharply, with the Gini coefficient doubling from 0.2–0.3 in 1990 to 0.4–0.6 in 1999. This increase in poverty was mainly attributable to the collapse in output and to inflation, which eroded a large part of population's income and savings. These two major factors affected various population sectors in different ways: the hardest hit were groups with limited earning potential and those typified by a high level of dependency (retired persons, individuals with disabilities, orphans and unemployed people) and also persons internally displaced by military conflicts.

During the second phase of economic recovery, all the countries experienced a reversal in the trend towards poverty. Broadly speaking, the period started at the end of the Russian crisis (1998–99) and ended in mid 2008. Economic growth and rising wages (helped by improved labour productivity) were the main driving forces behind the decline in poverty, together with a reinforced social safety net. Rising public transfers, combined with higher coverage and better targeted social assistance programmes, helped to reduce poverty. Social spending increased strongly in real terms, although in reality most transferred resources were used to raise pensions. Poverty was also reduced by increasing remittances from abroad, which in some countries amounted to as much as 20% of GDP. Nevertheless, the overall reduction in poverty (at the national level) was accompanied by a series of adverse factors that mark the current specific characteristics of poverty patterns in the region.

Firstly, the share of working poor (in a broad sense, i.e. defined according to employment status of the household head) remains unusually high, representing two-thirds of poor individuals (World Bank, 2005); this is not the case in CEEB countries, where poverty is mostly related to unemployment. In the CIS region as a whole and in the Eastern partner countries in particular, employment is not necessarily a guarantee against poverty. Moreover, the risk of poverty for people employed in agriculture is higher than for those working in the industry and services sectors.

Secondly, progress in reducing poverty has been greater in larger urban areas, particularly in capital cities, than in the countryside and small towns. The gap between urban and rural populations has increased enormously in some countries (Georgia, Moldova and Azerbaijan); growth is mostly concentrated around the capital, while the rest of the country is almost completely excluded from growth opportunities.

TABLE 1.10 POPULATION LIVING IN POVERTY (%)

Country	According to national poverty line			Less than USD 2 daily per person	
	1988	1999	2000-2007*	1999	2000-2006*
Armenia	18.0	55.0	50.9	44.0	43.4
Azerbaijan	33.0	NA	49.6	24.0	< 2.0
Belarus	NA	41.9[1]	18.5	NA	< 2.0
Georgia	16.0	60.0	54.5	19.0	30.4
Moldova	13.0	80.0	48.5	55.0	28.9
Ukraine	NA	27.8	27.1	80.2[2]	29.3[2,3]

Source: IMF (2002); World Bank (2005); UNDP Human Development Reports: http://hdr.undp.org/en/statistics/; Istomina (2006); ETF Country Reports.
*Note: *Most recent data available; 1. Figure for 2000; 2. Subsistence minimum; 3. Figure for 2007.*

14 The national poverty line is defined as the minimum level of income deemed necessary to achieve an adequate standard of living in a given country. In Ukraine, the poverty line is defined in relative terms as 75% of the median level of total expenditures/income.

The third element is the social polarisation that has created a well-defined profile for poor people. Whereas the initial recession hit the population indiscriminately, economic recovery led to social stratification characterised by a clear demarcation between rich and poor segments of the population and a well-defined typology of poor categories. Although poverty declined overall, it became more concentrated among specific groups, namely those who lack the education, skills and mobility necessary to take advantage of new opportunities. Even if high economic growth continues, it will take a long time to reduce poverty in these population segments.

Poverty indicators differ significantly between countries. Moreover, within the same country the methodology for estimating the poverty rate may change over time. This was the case in Georgia in 2004, when a 'reconsideration' of the cost of living reduced poverty rates by 40%. It is therefore important to use a common measure that indicates the position of each country in the regional and international contexts. A comparable indicator in this sense is the Human Poverty Index (HPI), developed by the UNDP. In contrast to the economic poverty discussed above, the HPI incorporates other more qualitative elements that focus on human potential to escape poverty (through easy access to education, healthcare and other social infrastructure elements). As can be observed in **TABLE 1.11**, on the basis of the HPI, the Eastern partners are in a better position compared to their ranking when economic poverty alone is considered. Even within this group, countries are ranked differently according to the HPI and according to national poverty rate rankings. Armenia, for example, is top of the group and ranked 12th in the world, four places higher than Belarus, although its rate of economic poverty is almost three times higher.

In the regional context, transitional poverty has particularly affected two categories of people: agricultural workers and small farmers in rural areas, and the unemployed in urban localities, particularly small towns. The dismantling of USSR cooperatives and land privatisation have created a large number of small farms that lack basic technologies and are therefore economically inefficient. In urban areas, privatisation and the subsequent restructuring of state companies has resulted in redundant labour and, consequently, increased unemployment. No viable alternatives were offered to compensate for the corresponding loss in incomes, and so two different survival strategies were developed: subsistence agriculture in rural areas, and participation in small-scale informal activities in towns. When these strategies proved to be insufficient for survival, an alternative solution was sought: better-paid jobs abroad.

Subsistence agriculture is still the only activity for most of the rural population in Moldova, Georgia and Armenia. Moreover, in Belarus, which is an industrialised country, subsistence agriculture is also practised in towns and small cities, where a section of the population supplements its income by selling products cultivated on small plots around summer houses. For rural populations, the income originating from subsistence agriculture is relatively important: without this source of income, rural poverty would be double the current rate (Istomina, 2006).

The informal sector represents the only survival option for jobless individuals when employment opportunities are rare. Unemployment benefits exist in all the Eastern partner countries, but they are either insufficient or limited in duration. Most informal workers are in marginalised and labour-intensive sectors such as agriculture, construction, the retail trade, catering and domestic services. Informal wages are low, job insecurity is high and no social protection is offered by employers. However, this is the only option available to some people. Although measures of informal employment are not very reliable, it seems that undeclared work is particularly important in Azerbaijan (66% of employment), while in Armenia it represents between 40% and 45 % of employment (ETF Country Reports).

TABLE 1.11 HUMAN POVERTY INDEX RANKINGS, 2008

Country	Rank	(%)
Armenia	12	3.7
Azerbaijan	50	10.7
Belarus	16	4.3
Georgia	18	5.7
Moldova	22	5.9
Ukraine	21	5.8
Romania	20	5.6
Turkey	40	8.3
Russia	32	7.4

Source: UNDP Statistics on HPI: http://hdr.undp.org/en/statistics/indices/hpi/

At the country level, Armenia significantly reduced poverty between 2004 and 2007, with poverty incidence declining from 34.6% to 25.0% and extreme poverty decreasing from 6.4% to 3.8%. Economic growth was the most important factor in reducing poverty: over the period, an increase of one percentage point in GDP translated into a 0.6 percentage point reduction in poverty. Since this elasticity is much higher in urban than in rural areas, the decline in poverty was accompanied by an increase in regional inequalities (ETF, 2010a).

In Azerbaijan – the richest country in the group and one of the fastest-growing economies in the world – empirical evidence suggests that poverty is still widespread because the current system of social protection does not cover a significant proportion of the poor, while social transfers are too small to lift households out of poverty. Between 2003 and 2007, poverty was practically halved (Roman, 2008), yet poverty remains a major challenge for a country where abundant oil reserves have boosted the national revenues to exceptionally high levels.

Belarus has succeeded in reducing poverty to a level that is far below that of the other transitional countries: less than 1% of the population is living in extreme poverty (defined as a personal disposable income level of less than USD 2 per day). This achievement is mainly the result of large-scale social expenditure (accounting for half the state budget between 1995 and 2005, equivalent to 13–14% of GDP), which includes a wide range of subsidies as well as measures such as administered prices and other forms of state intervention. Social security programmes, accounting for 12–13% of total budget expenditure (one of the highest rates among the transition economies), cover 95% of the population. However, a significant number of people fall into the low-income category, while the proportion of those living on less than the minimum subsistence income reached almost 18% of the population in 2007. The social groups most likely to be at risk of poverty are people living in rural areas and small towns, unemployed individuals, people with disabilities, single-parent families, and children (20.4% of all children under 18 years were living below the poverty line in 2005). Moreover, the share of working poor remains unusually high in the country (ETF, 2010c).

Living standards in Georgia have improved in many respects since 2003: poverty rates declined from more than 50% in 2003 to 23% in 2007 (although there are some doubts as to the quality of the statistics, because of a recent change in methodology). Currently, poverty continues to be deeply entrenched in rural areas, which account for 60% of the total poor. The main determinants of poverty are unemployment and insufficient income from employment, as wages amount to only 25–27% of household incomes. Employment has therefore played only a minor role in poverty reduction (ETF, 2010d).

Moldova continues to be the poorest country in Europe in terms of GDP per capita. More than 30% of its population lived in poverty in 2006, though the rate declined to 25.8% in 2007. Poverty is highly concentrated in rural areas and small towns, where the rates are almost double those of the larger cities. Poverty indicators in rural areas started to deteriorate in 2005 and were further exacerbated by a drought in 2007 and floods in 2008. A particular feature of Moldova, as indicated by recent studies, is that poverty in small towns is actually more severe than that in rural localities. While subsistence agriculture represents a coping strategy in the countryside, the lack of decent employment opportunities in small towns fuels poverty. A large majority of those living in poverty have formal jobs, though employment income often falls below the poverty line (ETF, 2009a).

In Ukraine, 27.3% of the population in 2007 were in relative poverty. There has been a net reduction in both absolute and relative poverty since 2002, largely stimulated by economic growth but also by government efforts to build an appropriate safety net (for the working population, elderly people, individuals with disabilities, and large families) consisting of generous increases in wages, pensions and social transfers. It is interesting to note that social transfers were reduced thereafter, and Ukrainian social assistance is considered inadequate in terms of targeting beneficiaries. In contrast to the situation in other Eastern partner countries, poverty in Ukraine has declined across all regions and industries. Poverty currently affects, in particular, large households, less-educated people and unemployed individuals (especially long-term jobless persons). Despite a significant reduction in poverty, inequality has slightly increased over the period, with a relatively constant Gini coefficient. Wealthy households have benefited more from economic growth than their worse-off counterparts. Around 28% of the population currently lives in poverty, which is essentially a rural phenomenon: 40% of the rural population is poor and lacking in basic social services (ETF, 2009b).

In summary, poverty has declined over the past decade in all six countries; progress has been made, albeit less than expected. This trend has recently started to be overshadowed, however, by growing vulnerability and poverty. The World Bank (2009b, 2009c) has already announced that one in three individuals who escaped poverty in the past decade will fall back into vulnerability and poverty by the end of 2010 as a result of the financial and economic crisis. The reduction in remittances is likely to affect most of the partner countries, and unemployment-related poverty could occur as a consequence of the contraction in activities in many sectors, particularly construction. In most countries there is no accurate estimate of the impact of the crisis on poverty. For Armenia, however, the World Bank has been more precise, announcing that the crisis will push 172 000 people below the poverty line. By the end of 2010, Armenia will therefore have 906 000 poor people, of whom 297 000 will be extremely poor. Most of the reduction in poverty, which took more than a decade to achieve, will therefore be eroded in the space of around two years.

With regard to international human development benchmarks, there is a certain heterogeneity among the

six Eastern partners. The measure most frequently used to rank countries is the HDI. According to this indicator, three groups of countries can be distinguished in the sample: Belarus and Ukraine (placed 67th and 76th, and thus comparable to Romania); Armenia is in an intermediate position (83rd), followed by Georgia and Azerbaijan (96th and 97th); finally, Moldova lags behind the rest of the group (111th) (**TABLE 1.12**). All the countries are heavily penalised in this ranking by two components of the index:

1. their per capita GDP, which is lower than the average level recorded for the CEEB countries;
2. their life expectancy, which is also lower than that recorded for most reference countries.

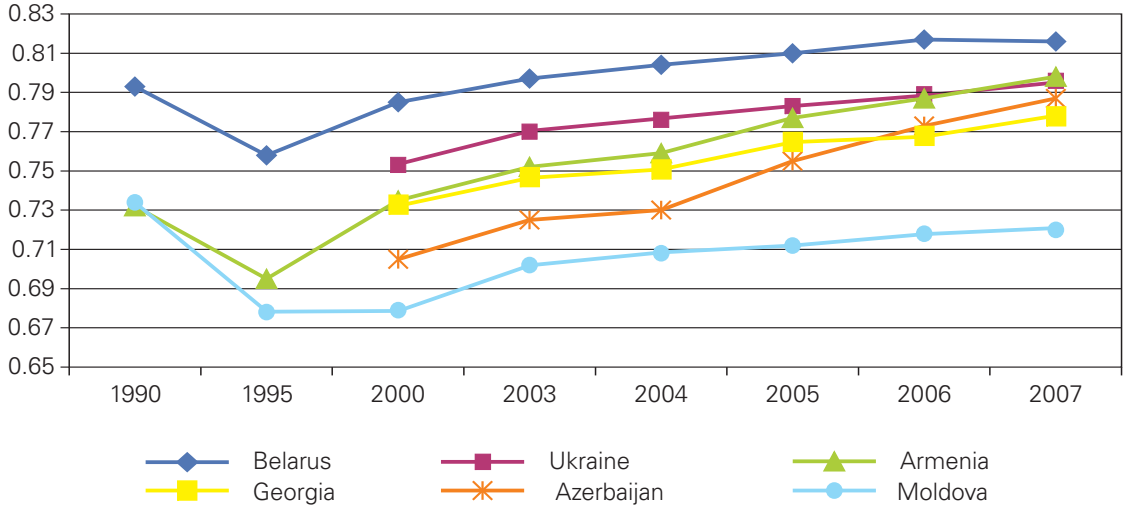
The literacy rate, on the other hand, is particularly high in the region, with Georgia ranked first in the world. Human capital is therefore the most important asset of these countries. The HDI started to improve significantly after 2000 in all the countries (**FIGURE 1.13**), but this improvement was almost exclusively determined by economic growth, which raised GDP per capita. Equally important was the strong appreciation of domestic currencies against the US dollar, which has contributed noticeably to the increase in per capita GDP and therefore in the HDI.

TABLE 1.12 HUMAN DEVELOPMENT INDEX AND SELECTED VARIABLE RANKINGS, 2008

Country	HDI		Life expectancy		Adult literacy		Enrolment		Per capita GDP	
	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank
Armenia	0.775	83	71.7	80	99.4	12	70.8	96	4945	103
Azerbaijan	0.758	97	67.3	114	99.3	14	66.2	121	6172	94
Belarus	0.817	67	68.8	108	99.7	5	89.5	31	9737	72
Georgia	0.754	96	70.7	95	100.0	1	76.3	72	3365	119
Moldova	0.708	111	68.4	107	99.1	13	69.7	102	2100	135
Ukraine	0.788	76	67.7	110	99.4	11	86.5	39	6848	85
Bulgaria	0.824	53	72.7	66	98.2	22	81.5	53	9032	64
Poland	0.870	37	75.2	46	99.3	39	87.2	38	13847	48
Romania	0.813	60	71.9	76	97.3	26	76.8	70	9060	63
Russia	0.802	67	65.0	119	99.4	10	88.9	31	10845	58
Turkey	0.775	84	71.4	85	87.4	69	68.7	108	8407	66

Source: UNDP HDI: http://hdr.undp.org/en/statistics/

FIGURE 1.13 HUMAN DEVELOPMENT INDEX TRENDS



Source: UNDP HDI: http://hdr.undp.org/en/statistics/

Another important element in country classification at the international level is freedom. Three main indexes are usually calculated by specialist institutions:

1. the Economic Freedom Index (EFI), developed by the Economic Freedom Network for 141 countries;
2. the Freedom Index (FI), published regularly by Freedom House;
3. the Index of Economic Freedom (IEF), calculated by Heritage Foundation for 184 countries.

The FI is relatively narrow in terms of evaluating freedom status as it only uses three categories: free, partly free and not free. The other two indicators provide a more interesting analysis, since they reflect economic freedom in each country. As can be observed in **TABLE 1.13**, rankings differ according to which index is used. The gap comes from methodological differences, with one using more variables for measurement than the others.

However, it is rather surprising that some countries (Moldova and Ukraine) are ranked higher by the IEF than by the EFI, while the opposite is the case for other countries. The Corruption Perceptions Index, which is related to some extent to the freedom indexes, at least in its political dimension, does not appear to be very favourable for the Eastern partners, which are all ranked below most CEEB countries (**TABLE 1.14**). Georgia is by far the best performer of the group, while Belarus and Azerbaijan, with the most corruption, are on a comparable level with Russia.

Another international comparison indicator is gender inequality. Two indexes are calculated by the UNDP in this area, the Gender-related Development Index (GDI) and the Gender Empowerment Measure (GEM). The GDI is a gender split of the HDI variables (life expectancy, illiteracy rate, etc.), while the GEM focuses on political participation and decision making, economic participation and decision making, and power over economic resources by gender. A third gender inequality indicator, calculated by the World Economic Forum (WEF) is the Gender Gap Index (GGI) (WEF, 2007). The GGI indicator is more comprehensive than the UNDP indicators, as it combines four variables: economic participation and opportunity, educational attainment, health and survival, and political empowerment. **TABLE 1.15** shows values and rankings for the Eastern partners for the three indicators.

With regard to the two UNDP indexes, it is interesting to note that all six countries are ranked higher according to the GDI than the GEM, with the exception of Moldova, for which the situation is the opposite, as a result of the strong feminisation of public administration in that country. The highest gap between the GDI and GEM is in Ukraine, followed by Armenia. All the Eastern partners are ranked relatively higher according to the GGI, in particular Moldova and Belarus.

1.7 CONCLUDING REMARKS

Following a decade of painful transition, the Eastern partners started to recover rapidly in the 2000s, with real GDP growing well above an average of 5%. This performance varied between countries. The better performers (Armenia, Azerbaijan and Belarus) had an

TABLE 1.13 FREEDOM INDEXES

Country	EFI[1]		FI[2]			IEF[3]	
	Value	Rank	PR	CL	Status	Value	Rank
Armenia	6.83	67	5	4	PF	69.9	31
Azerbaijan	5.73	118	6	5	NF	58.0	99
Belarus	NA	NA	7	6	NF	45.0	167
Georgia	7.29	39	4	4	PF	69.8	32
Moldova	6.51	78	3	4	PF	54.9	120
Ukraine	5.64	121	3	2	F	48.8	152
Bulgaria	6.82	68	1	2	F	64.6	56
Poland	6.78	69	1	1	F	60.3	82
Romania	6.66	74	2	2	F	63.2	65
Russia	6.12	101	6	5	NF	50.8	146
Turkey	6.35	90	3	3	PF	61.6	75

Source: 1. Gwartney and Lawson, 2008. 2. Freedom House, 2008. 3. Heritage Foundation, 2009.
Note: EFI, Economic Freedom Index; FI, Freedom Index; IEF, (Heritage) Index of Economic Freedom; PR, political rights; CL, civil liberties.

TABLE 1.14 CORRUPTION PERCEPTIONS INDEX, 2008

Country	Value	Rank
Armenia	2.9	109
Azerbaijan	1.9	158
Belarus	2.0	151
Georgia	3.9	67
Moldova	2.9	109
Ukraine	2.5	134
Bulgaria	3.6	72
Poland	4.6	58
Romania	3.8	70
Russia	2.1	147
Turkey	4.6	58

Source: Transparency International (2008).

TABLE 1.15 GENDER GAP INDEXES

Country	GDI (2006)[1]		GEM (2006)[2]		GGI (2007)[3]	
	Value	Rank	Value	Rank	Value (%)	Rank
Armenia	0.773	83	0.405	95	66.5	77
Azerbaijan	0.755	81	0.434	88	67.8	59
Belarus	0.816	60	NA	NA	71.1	23
Georgia	NA	93	0.399	96	66.6	67
Moldova	0.715	97	0.552	63	71.7	21
Ukraine	0.783	70	0.453	86	67.9	57
Bulgaria	0.832	51	0.605	44	70.8	25
Poland	0.825	54	0.618	39	67.6	60
Romania	0.872	37	0.500	80	68.7	45
Russia	0.805	62	0.544	65	68.6	47
Turkey	0.780	72	0.371	101	57.7	121

Source: 1 and 2. UNDP Statistics on GDI and GEM: http://hdr.undp.org/en/statistics/indices/gdi_gem/; 3. WEF statistics on GGI: www.weforum.org/en/initiatives/gcp/Gender%20Gap/index.htm

average rate of real GDP growth above the rate recorded by the CIS group, whereas growth in the more modest performers (Georgia, Moldova and Ukraine) was below the CIS average. The better performers succeeded in recovering their 1989 GDP levels and experienced a relatively less dramatic recession compared to the modest performers, who lost up to two-thirds of the GDP they had recorded before independence. Several factors contributed to the differences in economic performance.

1. Despite their shared heritage of Soviet-type economies, initial conditions differed in the six countries.
2. The speed and intensity of market reform implementation differed in the six countries. During the first decade of transition, Moldova and Georgia made very modest progress in this respect. Armenia and Azerbaijan succeeded in catching up economically with Ukraine, which experienced a reform process characterised by periods of intermittent acceleration and deceleration. Belarus was the outlier, as it was slower to adopt structural reforms aimed at developing a market economy.
3. The effects of the initial recession were amplified by disruptive political events (regional conflicts and civil wars) in Armenia, Azerbaijan, Georgia and Moldova. These episodes absorbed enormous resources that could have been used to finance economic and social development.
4. Post-independence economic relations with Russia followed different paths, depending on each country's vision of its future in relation to Europe and Russia. Countries such as Georgia and Moldova (which have tense relations with Moscow) did not benefit as much from growth spill-over within the region as Belarus (which was highly dependent on the Russian economy), Ukraine (which saw its food-processing industry booming after a decade of decline thanks to increased Russian demand) and Armenia (which maintains good economic relations with Moscow).
5. The main determinants of transitional growth varied in the six countries. Growth in Azerbaijan was driven primarily by the booming export-oriented oil and gas sector. In Georgia and Armenia growth was fuelled by increasing domestic demand, largely financed by loans and transfers from abroad. In Belarus, growth recorded after 2000 was largely driven by an increase in exports to Russian markets. Growth in Ukraine was very much helped by booming world prices for its main exports and by increased real household incomes that stimulated consumption.
6. The ownership structure of GDP also varied among the six countries. Belarus had the smallest private sector share and Armenia, Azerbaijan and Georgia the largest private sector presence. The state sector has remained at around two-thirds of GDP in Ukraine, but has declined to one-third in Moldova.

In all the Eastern partner countries, the services sector has contributed most to economic recovery and GDP growth. During the period 2000–07 the most significant growth in services was recorded in Moldova and Ukraine, followed by Georgia and Belarus. The contribution of agriculture to GDP declined significantly in all the countries over the same period, with higher decreases in Moldova and Georgia, followed by Ukraine and Azerbaijan. However, this must be interpreted with care, as subsistence agriculture increased dramatically following land privatisation in the traditionally agrarian countries (Moldova and Georgia) and a significant proportion of agricultural output from the large number of family plots may simply be unrecorded.

In all six countries the economic recession at the outset of transition hit the industrial sector particularly hard, with output falling victim to the abrupt opening up to international markets, and also to inherent reforms that brought price liberalisation, the abolition of subsidies, privatisation and restructuring. Industry suffered disproportionally from the dismantling of the Soviet system; as a result, significant industrial output was lost during the first decade in Georgia (80%), Azerbaijan (70%), Armenia (50%) and Ukraine (50%). Rapid industrial recovery was subsequently experienced in Belarus and Ukraine (which managed to restore their previous levels of industrial output) and in Azerbaijan (as a result of the development of its oil industry). In 2008 Armenia had almost managed to restore its previous industrial output level, but Moldova and Georgia have industry sectors that represent a diminished proportion of GDP, and in which there have been no signs of recovery to date.

These sectoral adjustments reflect the divergent economic conditions and the different policies followed in the six Eastern partner countries, which are currently facing great uncertainty regarding growth for the coming years. Initial optimism regarding the limited impact of the financial crisis proved to be unrealistic. The impact of the crisis has been particularly great in Armenia and Ukraine, but also in Georgia and Moldova; real GDP rates since 2009 have been negative in all the countries except Azerbaijan. The high levels of economic integration in the global context that have been achieved since 2000, and the strong regional integration that already existed, proved to be beneficial while the world economy performed well, but integration proportionally increased external exposure to international shocks. Most of the countries have benefited from demand-driven growth, fuelled in turn by considerable capital inflows that are largely dominated by remittances. Remittances stimulated domestic consumption and, indirectly, growth, but also increased the external vulnerability of the receiving economies.

The positive economic performance in terms of growth has not always been accompanied by suitable policies to combat inflation. Following a period (2002–06) of relatively moderate price increases, inflation started to increase in 2007. Since 1998, the price index for the Eastern partners has always been above the average inflation recorded by the transitional economies as a whole. In terms of individual performance, Armenia and Georgia recorded the lowest average rates of inflation since 2000, and Moldova and Ukraine the highest. Low inflation rates were the result of significant productivity growth, high rates of investment and increased globalisation. In parallel, high unemployment during the first decade of transition led to labour abundance in the economy and therefore to low-wage pressures in the labour market.

The high level of economic growth in recent years has translated into a significant increase in the region's contribution to world trade. The Eastern partners have increasingly opened up their economies to foreign trade,

and export growth has been particularly high. Imports have also increased, leading to exceptionally high trade turnover in the region. Ukraine had the highest export performance, while Moldova lagged behind the rest of the group. The positive trade performance was the result of several factors: increased productivity (and therefore competitiveness); accelerated integration at the regional and international levels; the removal of trade barriers; an opening up to foreign investment and foreign capital; the preferential treatment accorded by the EU and Russia to some countries; and favourable international prices for raw materials, metals and oil. It should be noted, however, that trade between the six countries is very limited.

Although CIS exports have become significantly more diverse geographically, with a clear shift from intra-CIS trade towards EU-oriented exports, product diversification has not followed this trend. During the first decade of transition, the main determinant of FDI was the abundance of natural resources: Azerbaijan with oil and gas, and Georgia with the construction of an oil pipeline. An important motivation for investing in Eastern partner countries was the market-seeking behaviour of investors, which gained in importance only after 2000, once structural reforms started to be implemented and economic growth accelerated. In per capita terms, all the Eastern partners, and Georgia in particular, succeeded in attracting FDI that was above the CIS average.

The dramatic economic decline in the first decade of transition translated into a sharp deterioration in living standards and widespread poverty. Among the six Eastern partners – and to a greater extent than in the CEEB countries – transition was marked by a pronounced dismantling of the role of the state, especially in relation to social networks. Output contraction and the associated spread of poverty were much greater and of longer duration than initially expected, particularly in countries that are relatively poor in natural resources. The economic recession brought a dramatic fall in real wages that was much more severe than in the CEEB countries.

The share of working poor remains remarkably high, and the risk of poverty is higher for people employed in agriculture than for those working in the industry and services sectors. Although poverty declined overall, the progress was achieved mainly in large urban areas, particularly the capital cities, and not in rural areas and small towns. The urban–rural divide has increased enormously in some countries (Georgia, Moldova and Azerbaijan), with growth mostly concentrated around each capital city, leaving the rest of the country excluded from growth opportunities. While the initial recession hit all populations without discrimination, economic recovery led to social stratification characterised by a clear gap between the rich and poor segments of the population (social polarisation); this resulted in a well-defined typology of the poor (i.e. those who lack the education, skills and mobility to take advantage of new opportunities).

In terms of international benchmarks, there is a certain degree of heterogeneity among the six partners. According to the HDI, we can distinguish between three groups of countries: Belarus and Ukraine with higher HDI scores; Armenia in an intermediate position; and Azerbaijan, Georgia and Moldova with lower HDI scores. The rankings of all these countries are heavily affected by their low per capita GDP and life expectancy, both of which are significantly lower than those in the CEEB countries.

APPENDIX 1.1 FOREIGN TRADE STRUCTURE IN THE SIX EASTERN PARTNER COUNTRIES

	Main trading partners				Main CIS partners				Main traded goods			
	Exports		Imports		Exports		Imports		Exports		Imports	
	Country	%	Country	%	Country	%	Country	%	Goods	%	Goods	%
Armenia	*Average 2004–07*				*2007*					*Average 2004–07*		
	Russia	13.2	Russia	15.3	Russia	56.7	Russia	66.8	Precious stones and metals	29.7	Miscellaneous goods	32.7
	Germany	14.2	Ukraine	7.0	Georgia	24.7	Ukraine	22.3	Non-precious metals and articles thereof	29.4	Precious stones and metals	16.1
	Netherlands	10.9	Germany	6.8	Ukraine	13.0	Georgia	4.3	Mineral products	13.1	Mineral products	14.5
Azerbaijan	*Average 2003–07*				*Average 2003–07*					*Average 2003–07*		
	Italy	35.1	Russia	18.1	Russia	39.0	Russia	51.4	Mineral products	82.2	Machinery and mechanical appliances	30.0
	Turkey	8.7	UK	9.2	Georgia	29.3	Ukraine	17.3	Vegetable products	2.9	Vehicles, aircraft, vessels and associated transport equipment	12.3
	Israel	7.4	Turkey	8.2	Turkmenistan	11.5	Turkmenistan	12.7	Vehicles, aircraft, vessels and associated transport equipment	2.7	Non-precious metals and articles thereof	14.4
Belarus	*2008*				*Average 2000–08*					*2008*		
	Russia	31.5	Russia	60.6	Russia	81.7	Russia	91.7	Mineral products	37.9	Mineral products	36.4
	Netherlands	16.7	Germany	6.9	Ukraine	12.7	Ukraine	7.0	Chemical products and rubber	18.9	Machinery, equipment and vehicles	24.3
	Ukraine	8.6	Ukraine	5.4	Kazakhstan	2.1	Moldova	0.5	Machinery, equipment and vehicles	18.7	Ferrous and non-ferrous metals and articles thereof	12.3
Georgia	*Q1 2009*				*Q1 2009*					*Q1 2009*		
	Turkey	16.5	Turkey	21.2	Azerbaijan	41.0	Ukraine	31.3	Iron and steel	14.0	Mineral fuels and products of their distillation, bituminous substances and waxes	16.0
	Azerbaijan	15.3	Ukraine	9.1	Armenia	24.0	Azerbaijan	30.2	Beverages, spirits and vinegar	11.7	Vehicles other than railway or tramway rolling-stock and parts thereof	10.3
	Canada	11.2	Azerbaijan	8.8	Ukraine	19.8	Russia	26.7	Pearls, precious or semi-precious stones and articles thereof	11.3	Other products	9.4
Moldova	*Average 2003–07*				*Average 2003–07*					*Average 2003–07*		
	Russia	28.3	Ukraine	20.0	Russia	61.9	Ukraine	51.4	Animal or vegetable fats and oils	12.1	Mineral products	21.4
	Romania	12.4	Russia	13.7	Ukraine	19.6	Russia	35.6	Prepared foodstuffs, beverages, spirits and tobacco	20.6	Instruments and apparatuses, clocks and watches and musical instruments	14.8
	Italy	11.6	Romania	11.1	Belarus	12.2	Belarus	9.0	Plastic, rubber and articles thereof	20.6	Metallic products and articles thereof	9.1
Ukraine	*2008*				*Average 2006-2008*					*2008*		
	Russia	29.0	Russia	22.7	Russia	67.3	Russia	63.0	Base metals and preparations thereof	41.2	Mineral products	29.7
	Germany	10.7	Germany	8.4	Belarus	8.9	Turkmenistan	16.9	Mineral products	10.5	Machines, equipment, instrumentation, electrical and technical equipment, audio, video and TV equipment	15.6
	Turkmenistan	8.4	Turkmenistan	6.6	Kazakhstan	7.4	Kazakhstan	7.2	Machines, equipment, instrumentation, electrical and technical equipment, audio, video and TV equipment	9.5	Ground, air and water transport facilities	14.1

Source: ETF Country Reports, and national statistical offices – Armenia: www.armstat.am/en/; Azerbaijan: www.azstat.org/statinfo/consumermarket/en/xten_11.shtml; Belarus: www.belstat.gov.by/homep/en/about/about.php; Georgia: www.statistics.ge/main.php?pform=62&plang=1; Moldova: www.statistica.md/category.php?l=ro&idc=336&; Ukraine: www.ukrstat.gov.ua/.

2. MAIN TRANSITIONAL REFORMS

Dr Constantin Zaman

This chapter reviews the main transitional reforms (economic, legal and institutional) implemented by the six Eastern partners that have deeply affected the labour market structure and employment conditions over the two decades of transformation. These reforms have significantly changed the rules of the game in the social, political and economic life of the countries and of individuals. Economic reform commenced in all the countries with the privatisation of state enterprises, mass privatisation programmes that were implemented with varying degrees of success. The speed of privatisation has been different across the six countries and, consequently, the results in terms of improved efficiency in privatised entities vary significantly.

Land privatisation was implemented exclusively through distribution in the Eastern partner countries (with the exception of Belarus, where the land is still in state hands), in contrast to the CEEB countries, where land was restored to its former owners. Land distribution led to a significant fragmentation of ownership, with a large number of small farms producing for self-consumption. Private subsistence agriculture has therefore replaced the collective *kolhoz* ownership system of the Soviet era.

A significant share of the population now makes a living from this subsistence form of agriculture. From a statistical point of view, the fact that this sector of the population is automatically classified as self-employed greatly exaggerates the employment figures for rural areas. Most farmers cultivate small plots of lands using rudimentary techniques, and are unable to obtain credit to invest in production. Produce commercialisation is minimal, and so farmers are deprived of a decent income.

In all six Eastern partner countries, structural reforms are biased towards economic liberalisation (foreign trade and prices in particular), while achievements in other fields are rather modest. Consequently, most of the countries are still facing fundamental reform challenges. One important area that requires reform is the business environment, which continues to be a hindrance for private enterprises, despite specific improvements in the past few years. The higher priority given to macroeconomic policies is aimed at preserving economic stability.

Economic reforms have suffered most from political, institutional and legal setbacks and inconsistencies. Although all Eastern partners possess the necessary institutional, political and legislative framework required by a market economy, this framework is not always sufficiently effective. Institutional and economic reforms are not sufficiently interlinked, political, administrative, legal, institutional and economic changes have not always been harmonised, and the various domains of transitional change have been approached separately and sometimes inconsistently.

2.1 CHARACTERISTICS OF THE SOVIET ECONOMY

According to Havrylyshyn and Wolf (1999), transition in a broad sense implies:

- liberalising economic activity, prices and market operations and reallocating resources to their most efficient use;
- developing indirect, market-oriented instruments for macroeconomic stabilisation;
- achieving effective enterprise management and economic efficiency through privatisation;
- establishing an institutional and legal framework to secure property rights, the rule of law and transparent market entry regulations.

Thus a transitional economy is one that is undergoing a switch from a centrally planned economy to a free market. As the process has been applied most fervently in the former USSR and communist bloc countries, the term is widely identified with those countries, including the six Eastern partner countries.

The Soviet economy, based on state ownership, was centrally planned according to five-year plans that transformed the USSR from a mainly agrarian society into one of the most important manufacturing economies in the world. This performance was achieved by giving priority to heavy industry and capital goods to the detriment of consumption commodities. The planning mechanism was based on quantitative objectives to which the corresponding inputs were allocated. In addition, prices for all goods were administratively set according to criteria that had little bearing on demand or the scarcity of resources. Consequently, certain goods were underproduced and in short supply, while others were in excess supply and had to be stored. The importance of an economic sector or commodity was decided by the central planner, never by the market.

The agricultural sector was organised around highly mechanised collective and state farms, and the USSR became the world leader in cereals production and one of the main producers of cotton, potatoes and flax. The ad hoc setting of quantities and prices induced major dysfunctions in the economy. In the absence of a proper financial mechanism, increasing inter-enterprise arrears forced most companies to use barter as a clearing

system, in most cases outside the economic plan. The inflexibility of the central administration mechanism, which generated bureaucracy and excessive control at all levels of the economy, forced President Gorbachev to initiate a set of reforms in 1985. The relaxation of economic conditions revitalised growth, but also called for more reforms, with the ultimate result that the Soviet system was eventually abandoned.

In the labour domain, the allocation of labour resources had to be consistent with planned priorities. In the absence of market mechanisms, labour hoarding became a generalised phenomenon since unemployment was criminalised. This generated very high participation rates, especially for women, but also very low mobility of labour as a result of strict controls over individuals' movements. Wages were set at the central level, through a mechanism of grades, qualifications, education and seniority and on the basis of small variations between the lowest and highest levels and across occupational groups. Wages, which were relatively low compared to those in Western countries, were supplemented with a diverse package of non-wage benefits, most of them provided by enterprises. In addition, healthcare, education and childcare facilities were provided free by the state.

2.2 TRANSITIONAL ECONOMIC REFORMS

Each of the Eastern partner countries has followed a different path in terms of the speed, intensity and sequencing of the transitional reform process. Consequently, after two decades of transformation, success in implementing reforms varies significantly among the six countries. Theoretically, economic reforms aimed at introducing market rules exert a positive influence on long-term and sustainable growth (Pelipas and Chubrik, 2008). Privatisation, restructuring, liberalisation, macroeconomic stability, institutional changes and the legal improvement of business conditions are the key elements of transitional transformations.

2.2.1 ENTERPRISE PRIVATISATION

The countries in transition used a wide variety of methods to privatise their state-owned enterprises (Estrin, 2006), with each one using its own strategy to sell off public companies. This variation is explained by the fact that the political, economic and institutional legacies of each country differed, narrowing the options available to policy makers. Moreover, neither the policy makers nor their advisers from international organisations had any experience in corporate restructuring on this scale. Different forms of privatisation therefore brought different results and benefits. In general, the group of CEEB countries used slightly different privatisation procedures from the CIS group, in which mass privatisation was the primary method. This choice involved most of the population and was considered politically preferable so as to achieve the declared objectives of social justice and equality.

The most frequently used method of privatisation in the Eastern partner countries was the management and employee buyout (MEBO)[15], which was predominantly used for SMEs in Ukraine, Moldova and Georgia. Although easily implemented, the method does not sufficiently improve corporate governance and has an insignificant impact on economic growth. As insider ownership was also used in mass privatisation programmes, this would explain why performance has been more modest in the CIS than in the CEEB region: there is evidence (Frydman et al., 1997) that privatisation to foreign investors and private domestic outsiders improved the performance of privatised companies. The difference in performance between the CEEB and CIS countries was also a result of the poor institutional and business environment in which privatisation took place in the CIS, as the process was not accompanied by sufficient legal and institutional transformations.

In Armenia the first programme for privatising industrial companies was adopted in 1994, along with the establishment of a voucher scheme. Large-scale privatisation began in April 1995 and advanced at a rapid pace until the end of 1998, when the voucher scheme was terminated[16]. From 1999 the process slowed down, as the focus shifted from voucher to cash privatisation. Currently, the process is practically complete, including for sectors that were initially considered to be strategic. Most small enterprises were sold through the MEBO method and the majority of medium-sized enterprises through the voucher scheme. Large firms were converted into joint-stock companies, with 20% of shares distributed free to employees and the rest opened up to public subscription. The privatisation of large companies was a rather slow process, as managers put up a certain amount of resistance (ETF, 2010a).

Azerbaijan's mass privatisation process began only in 1995: 15% of small companies were distributed to their employees and the rest were auctioned for cash. The second step was taken in 1997, when voucher privatisation was adopted for medium and large enterprises. This was supposed to conclude by 2000, but the government had to extend the period because the process had started to slow down significantly after 1998. The reason for this sluggish pace was the insufficiency of structural reforms, poor infrastructure and a poorly developed financial system, which reduced the appetite of potential buyers. In 2000, the government adopted a second privatisation programme, based on case-by-case sales, through MEBO, auctions, tenders and liquidation (EBRD, 2008).

15 Apart from the MEBO, other variants are the management buyout, when the buyout group consists of the top managers of the company (no workers can participate) and the employment buyout or workers' buyout, when the buyout is sponsored by the workers (managers are not allowed to participate). In the economic literature, the MEBO is referred to most frequently, as the term covers all three variants.

16 Many transitional countries from Central and Eastern Europe (Bulgaria, Poland, Romania and also Russia) used the voucher method. Under this privatisation scheme, all adult citizens are given a number of vouchers representing potential shares in state-owned companies. The vouchers (also called coupons) allow people to invest in public companies that are open for privatisation, usually through specially created investment funds.

Privatisation in Belarus (called 'denationalisation') was carried out in three stages. The first very short stage (1991–92) consisted of the transfer of ownership of 19 commercial companies and 42 public utilities to private hands. The second stage, also very brief (1992–93), introduced a voucher system and prepared the legal groundwork for the bulk of privatisation (two-thirds of existing enterprises). The programme adopted in 1993 for this purpose was very ambitious and aimed at completing privatisation by 1999. In reality, progress was slower than expected; consequently, the third stage of the process, initiated in 1995, reconsidered the privatisation strategy; new legislation was passed and a new programme was launched (ETF, 2010c). The introduction of the golden share principle and the adoption of a legal provision stipulating presidential approval for any sale above USD 80 000 blocked the process in Belarus almost completely (EBRD, 2008). The golden share rule was introduced with the aim of guaranteeing state security, public health and respect for constitutional rights. In reality, the measure was adopted to maintain state control over joint-stock companies, as was confirmed by the 2003 government decision to extend the golden share system to fully privatised companies. As a result, several enterprises were renationalised in 2004 and 2005, bringing the share of privatised large companies to only 30% by 2006. In this environment it is not surprising that in 2005 investors acquired only 4 small companies of the 223 offered for sale. This poor performance forced the government to abolish the golden share principle, initially only in the banking sector in 2006 and then completely in March 2008.

In Georgia the privatisation process began in 1992. The main methods used to sell state assets were tenders, auctions and direct sales. Corruption and lack of transparency characterised the process under President Shevardnadze, who issued a Presidential decree in 1997 allowing for privatisation transactions at discretionary price levels set by individual decisions taken by government officials. In these circumstances, 90% of public assets intended for privatisation were already sold before the Rose Revolution. A new privatisation programme launched in 2004 was supposed to be completed in 18 months, on the basis that very little remained to be sold. However, the process was slowed down by political debate on whether strategic assets (e.g. the gas pipeline) should be sold. The new privatisation programme has also received some criticism regarding transparency (ETF, 2010d).

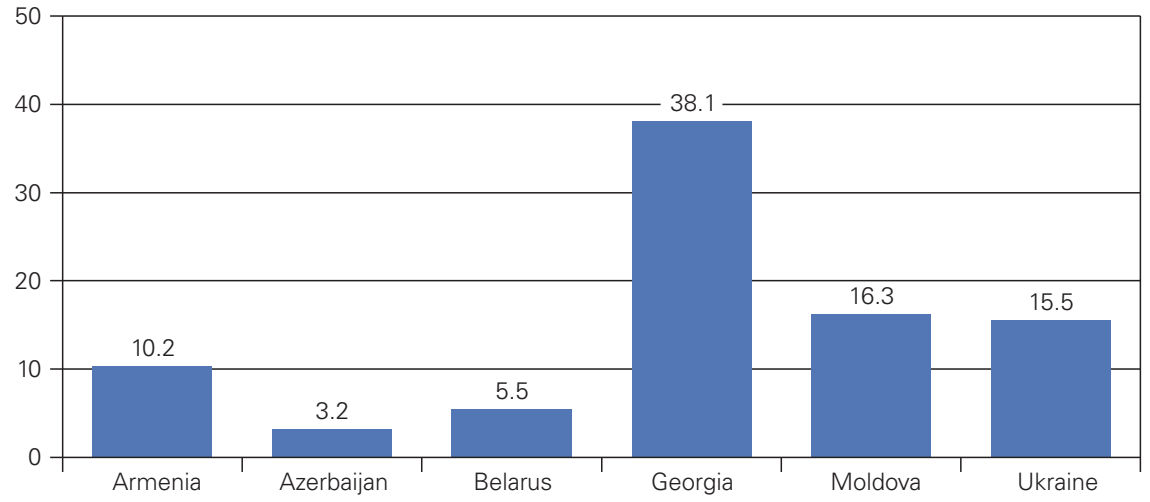
Moldova started the privatisation process in 1993 using a voucher system that offered employees the opportunity to buy up to 30% of their companies, including the state agricultural farms. Mass privatisation, which was completed by 1995, had two particular features. Firstly, Moldovans were allowed to buy state-owned dwellings in exchange for vouchers; as a result, 51% of apartments were privatised through this method. A second feature was that up to 50% of ownership in food-processing companies was transferred to suppliers (state farms). Cash privatisation, mostly undertaken through investment funds, encountered serious difficulties, as most of the industrial enterprises were located in separatist Transnistria. In addition, after 1995 the privatisation policy became uncertain, with major privatisations cancelled in the telecommunications and tobacco sectors. The return of communists to power further complicated the situation. New legal provisions were introduced in 2007, aimed at encouraging EU investors from neighbouring Romania to buy Moldovan assets. The initiative proved to be successful. Moldova now has one of the highest privatisation levels and FDI in its post-independence history (ETF, 2009a).

Privatisation in Ukraine was carried out in several steps (ETF, 2009b). The first stage took place in the period 1992–94 and involved small-scale privatisation, typically implemented through the leasing and subsequent purchase of assets using the MEBO method. Between 1995 and 1997 a mass privatisation programme distributed vouchers exchangeable for shares to citizens. Large-scale cash privatisation started in 1997 with the transformation of state enterprises into joint-stock companies. A special privatisation programme was adopted in 2000, the aim being to facilitate the strategic privatisation of large companies, utilities, infrastructure facilities and technological complexes. Although this had a promising start, the enormous vested interests in these sectors fuelled corruption and a lack of transparency. Privatisation therefore entered a crisis period and has been practically at a standstill since 2003.

Given this heterogeneity of policy approaches in the six countries, it is hardly surprising to see different performance levels, expressed as the share of privatisation proceeds in GDP (**FIGURE 2.1**). Georgia was by far the best performer of the group, with more than 38% of revenues collected from privatisation over the period 2002–08. More than half of total proceeds in Belarus were obtained in 2007, after the golden share rule was abolished in the banking sector in 2006. Privatisation of state-owned companies has led to a higher private sector contribution to GDP and employment (**TABLE 2.1**). In general, the fact that this contribution represented a higher proportion of GDP than of employment is explained by the large numbers of self-employed people in agriculture, particularly in subsistence farming, which plays a key role in some of these countries.

Privatisation performance can also be represented by the two EBRD indexes: large-scale and small-scale privatisation (**TABLE 2.2**). Overall, the countries performed better in small-scale than in large-scale privatisation. An exception is Georgia, which has considerably improved its performance since 2007 in both indexes. Belarus, Azerbaijan and Ukraine show the poorest performance in large-scale privatisation, followed closely by Moldova.

FIGURE 2.1 ACCUMULATED PRIVATISATION REVENUES, 2002–08 (% GDP)



Source: EBRD (2008).

TABLE 2.1 PRIVATE SECTOR SHARE OF GDP AND EMPLOYMENT (%)

Country	Private sector							
	As share of GDP				As share of employment			
	1991	1995	2002	2008	1991	1995	2002	2008
Armenia	NA	45	70	75	29	49	74	NA
Azerbaijan	NA	25	60	75	NA	43	68	67
Belarus	7	15	25	30	2	7	NA	NA
Georgia	27	30	65	75	25	NA	77	80
Moldova	NA	30	50	65	36	NA	NA	NA
Ukraine	8	45	65	65	NA	NA	36	NA
Bulgaria	17	50	75	75	10	41	81	NA
Poland	45	60	75	75	51	61	72	72*
Romania	24	45	65	70	34	51	75	68*
Russia	10	55	70	65	5	NA	NA	NA

Sources: EBRD (2008); Estrin (2006).
*Note: *Data for 2007.*

2.2.2 LAND PRIVATISATION

While land was restored to former owners in the CEEB countries, in the CIS, where the long history of collectivised agriculture made restitution virtually impossible, the land was in effect privatised through a system of egalitarian distribution to rural residents (**TABLE 2.3**). Prior to that, private ownership was legalised by transforming collective farms into corporate farms, the shares of which were then distributed to workers.

With the exception of Belarus, where practically no reforms have been implemented in this direction, the Eastern partners started land distribution relatively early. Armenia was the fastest reformer, with most of the land distributed in 1991 and 1992 (90% of total). By the end

TABLE 2.2 EBRD PRIVATISATION INDEXES

Country	2002		2003		2004		2005		2006		2007		2008	
	SS	LS	SS	LS	SS	LS	SS	LS	SS	LS	SS	LS	SS	LS
Armenia	3.7	3.3	3.7	3.3	4.0	3.3	4.0	3.7	4.0	3.7	4.0	3.7	4.0	3.7
Azerbaijan	3.7	2.0	3.7	2.0	3.7	2.0	3.7	2.0	3.7	2.0	3.7	2.0	3.7	2.0
Belarus	2.0	1.0	2.3	1.0	2.3	1.0	2.3	1.0	2.3	1.0	2.3	1.0	2.3	1.8
Georgia	4.0	3.3	4.0	3.3	4.0	3.3	4.0	3.7	4.0	3.7	4.0	4.0	4.0	4.0
Moldova	3.7	3.0	3.7	3.0	3.7	3.0	3.7	3.0	3.7	3.0	3.7	3.0	4.0	3.0
Ukraine	3.7	2.0	4.0	2.0	4.0	2.0	4.0	2.0	4.0	2.0	4.0	2.0	4.0	2.0

Source: EBRD (2008).
Note: SS, small-scale; LS, large-scale.

TABLE 2.3 EXTENT OF LAND REFORM AND STRATEGIES

Country	Extent of land privatisation	Land privatisation strategy
Armenia	All	Distribution
Azerbaijan	All	Distribution
Belarus	Household plots only	None
Georgia	All	Distribution
Moldova	All	Distribution
Ukraine	All	Distribution
Bulgaria	All	Restitution
Romania	All	Restitution + distribution
Russia	All	Distribution

Source: Sedik and Lerman (2008).

of 1992, over 300 000 new farms had been created in Armenia, and in 1998 around 99% of agricultural output was produced by private farmers (Giovarelli and Bledsoe, 2001). Between 1992 and 1998, Georgia distributed around 60% of agricultural arable land for subsistence farming and the rest remained under state ownership for leasing.

In Azerbaijan, most land privatisation (90%) took place between 1996 and 2000. Land privatisation in Moldova and Ukraine was carried out differently: the two countries converted land shares into titles for land parcels or actual land parcels at the end of the 1990s. The process took longer in Ukraine, and private ownership by law was introduced only in 2001, when a new land code was adopted.

Some specific features existed in each country. In Armenia and Moldova, the land area distributed was proportional to household size. In addition, Armenia used a lottery system to determine the specific location of family parcels in villages, and a symbolic payment was made in exchange for the land received. In Ukraine, the land was distributed to rural residents for farming purposes, but people from urban areas also received small plots for summer houses. Land transactions are currently permitted in all the countries except Belarus. Specific restrictions exist for foreigners who want to buy land in Ukraine, while in Azerbaijan and Moldova foreigners are forbidden to buy land.

2.2.3 STRUCTURAL REFORMS

The implementation of structural reforms is the most important transitional step in terms of sustainable economic growth. In the current context of globalisation and economic openness, structural reforms are essential if countries are to increase the resilience of their national economies to changes taking place in the world economy; in other words, making structural adjustments is equivalent to a permanent fine-tuning that ensures convergence with the international context.

In all the transition countries the implementation of structural reforms has been the most difficult aspect of transformation. Besides their complexity, structural reforms have the particular feature that their benefits are only visible in the medium and long term, yet the social costs are immediate. Hence, some of these measures are unpopular (price liberalisation, for example) and may produce social unrest. In many transitional countries, therefore, the most painful structural changes have been postponed, or implemented very slowly. Apart from population uneasiness, governments have also been afraid of structural reforms because, if not properly implemented, they could undermine macroeconomic stability. The classic example in this respect was liberalisation of foreign trade, which led to serious external imbalances in all the transitional countries.

EBRD (2008) indexes were used to analyse Eastern partner countries in terms of their progress in implementing structural reforms (**TABLE 2.4**). These indexes provide information on enterprise restructuring, liberalisation of prices and trade, emergence of competition in the economy, development of the banking sector and financial institutions, and the improvement of infrastructures. Such indexes must be used with care as the methodologies are questionable, either because they are based mainly or partly on opinion surveys, or because of the quality of the data used to elaborate the composite index (see Chapter 3). Nevertheless, they strongly influence policy makers and the mass media, as they are broad indicators of the extent of structural reforms.

TABLE 2.4 EBRD STRUCTURAL REFORM INDEXES, 2002–08

Country	Index	2002	2003	2004	2005	2006	2007	2008
Armenia	Enterprise reform	2.3	2.3	2.3	2.3	2.3	2.3	2.3
	Price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
	Trade liberalisation	4.0	4.3	4.3	4.3	4.3	4.3	4.3
	Competition	2.0	2.0	2.0	2.3	2.3	2.3	2.3
	Banking reform	2.3	2.3	2.3	2.7	2.7	2.7	2.7
	Financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.3
	Infrastructure reform	2.3	2.3	2.3	2.3	2.3	2.3	2.7
Azerbaijan	Enterprise reform	1.7	2.0	2.0	2.0	2.0	2.0	2.0
	Price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
	Trade liberalisation	3.7	3.7	3.7	4.0	4.0	4.0	4.0
	Competition	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Banking reform	2.3	2.3	2.3	2.3	2.3	2.3	2.3
	Financial institutions	1.7	1.7	1.7	1.7	1.7	1.7	1.7
	Infrastructure reform	1.7	1.7	2.0	2.0	2.0	2.0	2.0
Belarus	Enterprise reform	1.0	1.0	1.0	1.0	1.0	1.0	1.7
	Price liberalisation	2.7	2.7	2.7	2.7	2.7	2.7	2.7
	Trade liberalisation	2.3	2.3	2.3	2.3	2.3	2.3	2.3
	Competition	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Banking reform	1.7	1.7	1.7	1.7	1.7	2.0	2.0
	Financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Infrastructure reform	1.3	1.3	1.3	1.3	1.3	1.3	1.3

Country	Index	2002	2003	2004	2005	2006	2007	2008
Georgia	Enterprise reform	2.0	2.0	2.0	2.3	2.3	2.3	2.3
	Price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
	Trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
	Competition	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Banking reform	2.3	2.3	2.7	2.7	2.7	2.7	2.7
	Financial institutions	1.7	1.7	1.7	1.7	1.7	1.7	1.7
	Infrastructure reform	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Moldova	Enterprise reform	2.0	1.7	1.7	2.0	2.0	2.0	2.0
	Price liberalisation	3.7	3.7	3.7	4.0	4.0	4.0	4.0
	Trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
	Competition	2.0	2.0	2.0	2.0	2.0	2.3	2.3
	Banking reform	2.3	2.3	2.7	2.7	2.7	3.0	3.0
	Financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Infrastructure reform	2.3	2.0	2.0	2.3	2.3	2.3	2.3
Ukraine	Enterprise reform	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
	Trade liberalisation	3.3	3.3	3.3	3.7	3.7	3.7	4.3
	Competition	2.3	2.3	2.3	2.3	2.3	2.3	2.3
	Banking reform	2.3	2.3	2.3	2.7	3.0	3.0	3.0
	Financial institutions	2.0	2.0	2.3	2.3	2.3	2.7	2.7
	Infrastructure reform	2.0	2.0	2.0	2.0	2.0	2.3	2.3

Source: EBRD (2008).

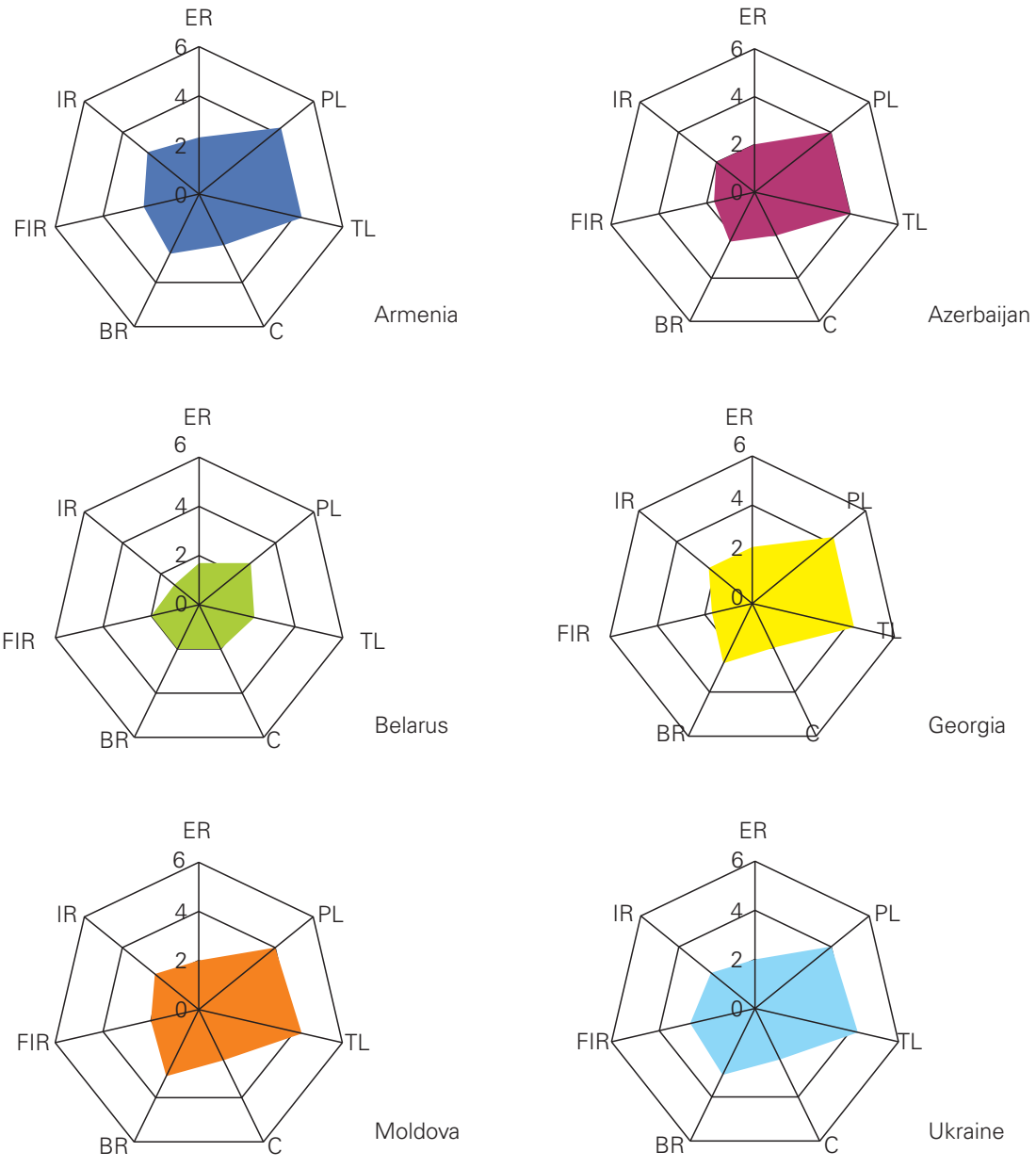
The country that has made most progress in implementing structural reforms is Armenia; at the other extreme, Belarus has achieved very little. Ukraine had made considerable progress by 2009, while Azerbaijan has practically stagnated since 2005 in all areas. All the countries have advanced most with price and foreign trade liberalisation, with the highest scores in these areas for the period as a whole. In contrast, the poorest performance was recorded in reforming the financial (non-banking) sector and infrastructures. Enterprise reform has also been inadequate, and this has direct consequences for competition in these economies.

In order to better visualise the current status of structural change in each country, a structural reform heptagon has been constructed (**FIGURE 2.2**); this is similar to the EBRD graphic representation of the quality of the regulatory framework in the telecommunications sector (EBRD, 2008). The heptagon is constructed from the seven EBRD indexes: enterprise reform, price liberalisation, trade liberalisation, competition, banking reform, financial institutions reform and infrastructure reform.

This representation clearly shows that structural reforms in all six countries are biased towards economic liberalisation (foreign trade and prices), while achievements in the other fields are rather modest. It is also possible to calculate an aggregated indicator that shows the overall progress of each country in implementing structural transformations over the whole period 2002–08. The indicator is constructed by adding up the seven index values for each year and then expressing this sum as a percentage of the maximum value of the aggregated structural reform indicator. Since the highest level of any index is 5, it follows that the maximum value of the aggregated index is 35. The percentages of this maximum that were recorded for each country are represented in **FIGURE 2.3**.

It can be observed that, of the six countries, Armenia obtained the highest aggregated score in 2008 in terms of the implementation of structural transformation. At this early stage of transition, Armenia had managed to liberalise prices and foreign trade. The large majority of small and medium-sized state-owned enterprises have now been privatised. The business environment and governance improved noticeably after 2000. By 2007, Armenia had the best system for registering property and licensing of the whole CIS group. However, its economic vulnerabilities are still considerable. Dependence on remittances and capital flows grew in recent years against

FIGURE 2.2 STRUCTURAL REFORM HEPTAGONS, 2008

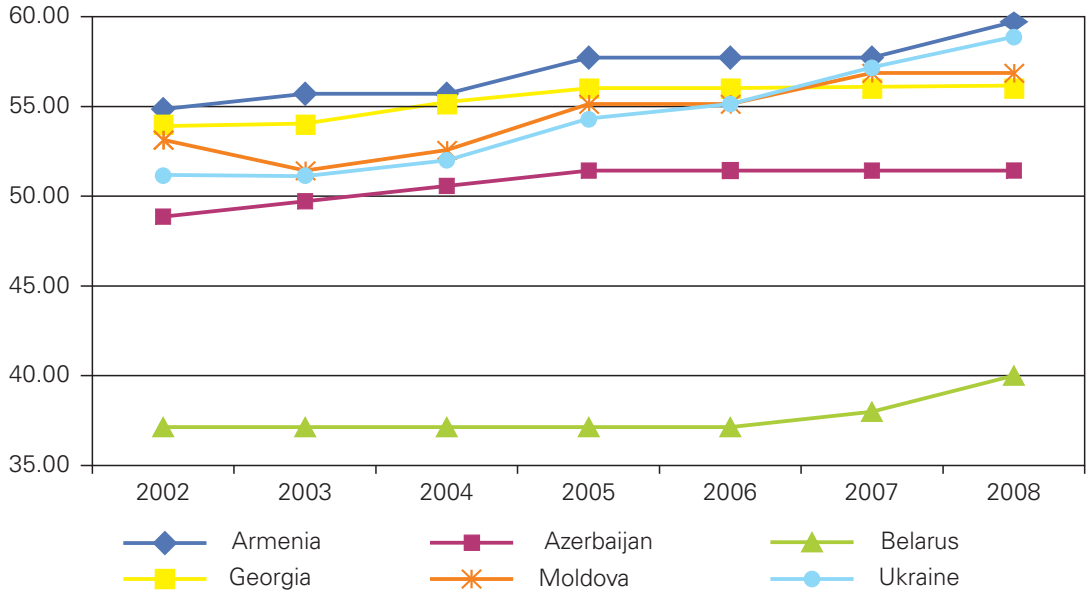


Source: Author, based on EBRD (2008).
Note: ER, enterprise reform; PL, price liberalisation; TL, trade liberalisation; C, competition; BR, banking reform; FIR, financial institution reform; IR, infrastructure reform.

a background of a slowdown in tradable sector growth in general, and exports in particular. Trade and current account deficits have considerably widened since 2007. Competition is still insufficient, despite recent improvements in the regulatory framework. Tax and customs administration is relatively weak, while corruption remains a problem.

Ukraine has made some progress at the structural level, particularly in further liberalising trade and improving the situation of financial institutions. These achievements place the country in second place according to the aggregated structural index depicted in Figure 2.3. WTO accession in 2008 significantly helped the country to improve its EBRD scoring. Ukraine's progress in structural reform has been modest but continuous since 2000. Some progress has recently been recorded in improving the business environment, particularly through simplification of the tax regime for SMEs and the modernisation of customs administration. However, weaknesses remain with respect to enterprise restructuring, governance, competition policy, the non-banking financial sector and infrastructure reform. The tax regime continues to be complicated and

FIGURE 2.3 AGGREGATED INDEX OF STRUCTURAL REFORMS*



Source: Author, based on EBRD (2008).
*Note: *The aggregated index is constructed by adding up the seven index values for each year and expressing this total as a percentage of the maximum value of the aggregated structural reform indicator. In order to make relatively small differences between better performers and the progress in each of them over the period 'detectable', the axis was compressed from the standard 0–100% to 35–60%. The figure represents the value of the index as a percentage of the maximum of 35. This means that if a country records an index of, say, 21, the percentage of this value (21) of the maximum (35) is 21*100/35 = 60%.*

burdensome, the regulatory framework is insufficiently stimulatory for the private sector, and the enforcement of property rights is relatively weak.

Moldova is ranked third in the classification with respect to progress in implementing structural reforms. Economic performance and stability have improved since 2000, the result of structural reforms launched after 2000 to stimulate growth and enhance the social protection system, including some tentative efforts to reform the pension system and privatise electricity distribution. More recently, significant efforts have been made to reduce administrative and regulatory barriers in the economy. All these achievements have been possible as a result of the massive inflow of remittances, which fuelled domestic consumption and the remonetisation of the financial sector, while allowing the government to boost budget expenditures. In 2008 Moldova further liberalised trade with the EU by introducing the Autonomous Trade Preference regime, which gives its goods free access to European markets. Some recent legislative amendments have contributed to the improvement of the business environment, particularly for SMEs. Although competition has improved since 2007, weaknesses persist.

After the Rose Revolution in 2003, Georgia become the champion of the region in implementing structural reforms, which were centred on anti-corruption, accountability and transparency of government institutions and the development of a competitive private sector. Consequently, the business environment improved, making Georgia one of top reformers in the World Bank's Doing Business Report ranking: the country climbed to 15th place in 2009 from 112th place four years previously. Nevertheless, the 2008 conflict with Russia and the global economic crisis have resulted in a number of significant shocks to growth and stability, including a deterioration in investor and consumer confidence and a contraction of liquidity in the banking system. The government responded to these shocks with a good macroeconomic policy mix, aimed at maintaining stability, in the form of a global financial sector competitiveness programme. Improving the external competitiveness of the private sector remains particularly important in terms of generating sustained growth. Decisive measures are necessary to strengthen the non-banking financial sector, which remains underdeveloped.

For five of the six countries (no data is available for Belarus), the WEF (**TABLE 2.5**) confirms that progress in improving competitiveness has been relatively slow. Only Azerbaijan has achieved a level comparable with that of Poland, while the other Eastern partner countries remain below the level of countries such as Bulgaria, Romania, Turkey and Russia. None of the six Eastern partner countries have been able to take full advantage of their potential and especially of their abundant human capital. Apprehension about the possible adverse effects of reforms has prevailed in most of these countries, and has made governments hesitant to implement competitiveness-enhancing policies. Indeed, the ranking of countries such as Moldova and Ukraine has worsened since 2007–08.

TABLE 2.5 COMPETITIVENESS RANKINGS, 2007–10

Country	2007-2008	2008-2009		2009-2010	
	Rank	Rank	Score	Rank	Score
Armenia	93	97	3.73	87	3.71
Azerbaijan	66	69	4.10	51	4.30
Belarus	NA	NA	NA	NA	NA
Georgia	90	90	3.86	90	3.81
Moldova	97	95	3.75	NA	NA
Ukraine	73	72	4.09	82	3.95
Bulgaria	79	76	4.03	76	4.02
Poland	51	53	4.28	46	4.33
Romania	74	68	4.10	64	4.11
Russia	58	51	4.31	63	4.15
Turkey	53	63	4.15	61	4.16

Source: WEF Global Competitiveness Reports 2007–08, 2008–09 and 2009–10: www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%

According to the EBRD (2008), Azerbaijan showed no noticeable progress in implementing structural reforms from 2005, despite its excellent rating in the 2009 Doing Business Report, which named Azerbaijan as the top reformer of the year. This performance is attributable to a substantial improvement in business registration, protection of investor rights, property registration and tax administration. The stabilisation programme started in 1995, when the government decided to embark on a programme to accelerate structural reforms. These reforms included strengthening governance in the banking sector, enhancing transparency in the utility sectors, enacting a modern tax code and ensuring more transparent budget execution and accounting. Despite these achievements, the public sector, which mainly comprises large enterprises, lacks transparency in its operations. The non-banking financial sector is not well developed.

Belarus lags behind the rest of the group in terms of implementing structural reforms, having only started serious reforms in 2006. The economy is still dominated by the state sector, a large proportion of public enterprises produce losses, wage and tax arrears have reached considerable levels, and inflation is high. The quasi-fiscal deficit is significant, as the soft budget constraint of public bodies persists. The business environment is not supportive, despite some recent policy measures aimed at strengthening the private sector (in particular the abolition of the golden share principle). Recently adopted market mechanisms are limited to certain activities (forestry and the timber industry) or companies (SMEs). These improvements are not sufficient to stimulate investor appetites, given the barriers resulting from excessive regulation.

Most countries still face fundamental reform challenges. One important area is the business environment, which remains a hindrance for private enterprise despite some improvements in the past few years. The 2009 Doing Business Report ranking (**TABLE 2.6**) shows that the greatest progress has been achieved in registering property. Dealing with fiscal administration in relation to paying taxes remains the most problematic issue in these economies, and obtaining construction permits seems equally difficult. However, a major difference with the CEEB countries relates to obtaining credit, which is much easier in the latter. What is striking in this classification is the fact that all countries record enormous ranking differences between the best and the worst positions. Even in Georgia, which is the most advanced of the group, there are 108 positions between its best performance (registering property) and worst performance (paying taxes). These gaps between extremes are the consequence of a fragmented approach to carrying out the reforms necessary to improve the business environment. A reform package for enhancing the business environment comprises several elements that need to be treated in an integrated manner. However, the governments of these countries have preferred to concentrate on a single policy at a time, leaving the others to be dealt with at a later date.

TABLE 2.6 DOING BUSINESS REPORT RANKINGS, 2009

Country	Overall rank	Highest rank	Lowest rank
Armenia	44	5: registering property	150: paying taxes
Azerbaijan	33	9: registering property	174: trading across borders
Belarus	85	14: enforcing contracts	181: paying taxes
Georgia	15	2: registering property	110: paying taxes
Moldova	103	50: registering property	158: dealing with construction permits
Ukraine	145	28: obtaining credit	179: dealing with construction permits
Bulgaria	45	5: obtaining credit	117: dealing with construction permits
Poland	76	28: obtaining credit	158: dealing with construction permits
Romania	47	12: obtaining credit	146: paying taxes
Russia	120	18: enforcing contracts	180: dealing with construction permits
Turkey	59	27: enforcing contracts	138: employing workers

Source: World Bank's Doing Business Index: www.doingbusiness.org/

Consequently, the business environment is still insufficiently friendly in these economies because the various strongly interlinked components have evolved separately. All the components are important, and should be improved simultaneously. It is difficult to comprehend why it should take a business 958 hours to pay taxes in Armenia but 1 188 hours to pay taxes in Belarus, or why the cost of obtaining a construction permit in Ukraine is 19 times higher than the average income per capita, and that obtaining such a permit takes 471 days. In Azerbaijan (the top reformer according to the 2009 Doing Business Report) the cost of cross-border trading is three times higher than the OECD average, while the time needed for importing/exporting is five times higher.

Survey data gathered by various international institutions indicate that the business climate in the six Eastern partner countries is less favourable than that in the CEEB countries as a result of corruption, tax administration inefficiency, complex regulations that are implemented on a discretionary basis, complicated customs and trade procedures, insufficient property rights protection and macroeconomic instability. In 2008, Coface @rating (www.trading-safely.com) awarded Armenia a B rating for the quality of its business climate, while Belarus was given the worst rating (D); all the other countries in the group scored C (for comparison purposes, in the same year Bulgaria, Romania and Turkey scored A4 and Poland A3). One possible explanation for this gap comes from insufficient economic restructuring at the company level in Eastern partner countries, which have maintained a relatively poor level of corporate governance. Competition is also weak, with public enterprises receiving preferential treatment in some countries (Belarus and Ukraine in particular, but also Azerbaijan). This argument is supported by the EBRD (2009) scores received by the six countries for governance and enterprise restructuring (**TABLE 2.7**): Armenia, Georgia and Ukraine scored higher than the others, but their score was still very modest (2+) compared, for example, to Poland (4–). Ukraine improved its score (from 2 to 2+) between 2008 and 2009. The countries also scored poorly for competition, with a maximum of 2+ achieved by Armenia, Moldova and Ukraine within the group.

Poor corporate governance[17], combined with insufficient competition in the economy, has a negative impact on factor productivity, and consequently on the profitability of enterprises. The standard production function of firms, with two factors of production (capital and labour), becomes less significant in transitional economies where a third factor (governance) is sometimes more important than the other two. If governance is weak, total factor productivity is below its potential and the production

17 Corporate governance refers to the set of policies, legal instruments, institutions and related elements (relationships among stakeholders) that influence directly or indirectly the way a corporation (company) is directed, administered and controlled. The concept of corporate governance implies that the principal stakeholders are represented by shareholders of the company and its managerial structures (including the board of directors); other stakeholders are employees, customers, creditors (banks and bond holders), suppliers and regulators. Good governance implies appropriate accountability of responsible individuals in the organisation through specific mechanisms. Corporate governance has a major impact on economic efficiency and, therefore, on shareholder welfare.

TABLE 2.7 SELECTED EBRD SCORES, 2009

Country	Governance and enterprise restructuring	Competition policy
Armenia	2 +	2.3
Azerbaijan	2	2
Belarus	2 –	2
Georgia	2 +	2
Moldova	2	2.3
Ukraine	2+ î	2.3
Bulgaria	3-	3
Poland	4-	3+
Romania	3-	3-
Russia	2+	2+

Source: EBRD (2009).
Note: î indicates countries that improved position with respect to the previous year.

function is remote from the production possibility frontier. In other words, firms produce sub-optimally; if productivity is expressed for labour alone, the six countries achieve less than 20% of the US productivity level (the benchmark used in EBRD (2009) international comparisons).

The improvement in corporate governance and competition (which stimulate productivity and therefore economic growth) is conditional on the existence of a good institutional framework in which competition is sufficiently strong. According to the EBRD (2009), there has been no improvement in the competition-related institutional framework in Azerbaijan, Belarus, Georgia and Ukraine since 2002, or in Armenia since 2005. Despite its excellent ranking in the World Bank's 2009 Doing Business Report, Georgia is still far from having a sufficiently attractive business environment. Its progress has come principally from a noticeable reduction in the number of procedures necessary to start a business and register property. Nevertheless, winding up a business remains very problematic, paying taxes is extremely difficult and trading across borders is complicated.

A second explanation for the differences between the six Eastern partners and the CEEB countries relates to the former's limited access to financing. Development of the banking sector has been slower in this part of the world, and the process was seriously shaken by the 1998–99 Russian crisis. Moreover, non-banking financial institutions are less developed than those of the CEEB countries. Azerbaijan and Belarus have the least reformed banking sectors of the six countries (**TABLE 2.8**). Moreover, no progress has been made in the financial sectors in Georgia and Azerbaijan since 2002. Finally, the Eastern partner governments have given higher priority to macroeconomic policies aimed at preserving economic stability than to measures that are directly related to the business sector. This policy approach, deriving from the belief that reforms at the macro level are sufficient to ignite microeconomic changes, is largely justified by the huge difficulties faced by the governments at the very beginning of transition. For example, in contrast to the situation in the CEEB countries, the newly independent states from the CIS region had to introduce their own currency and create a central bank, which was no easy task.

In recent years, macroeconomic policies have concentrated on reducing the imbalances that accumulated in the past and on stabilising the macroeconomic environment. In the fiscal sector, budget execution has been prudent in all six countries since 2000 (**TABLE 2.9**); as a result, the deficit is low to moderate (except in Georgia, where the government balance deteriorated after 2005). This performance is mainly the result of improved tax collection, together with efficient management of public expenditure. In some countries the proceeds from privatisation have also contributed to revenues, while in Azerbaijan the oil sector has been crucial in ensuring the very healthy public finances of the country. A particular feature of Armenia is that the country used fiscal policy as an effective demand-management tool: the government achieved an impressive fiscal adjustment between 1999 and 2004, with the underlying deficit cut from 8% to less than 2% of GDP. This fiscal adjustment contributed to a significant improvement in macroeconomic stability and to double-digit growth. The improvement in public finances translated in almost all the countries to a

TABLE 2.8 BANKING AND FINANCIAL SECTOR PERFORMANCE, 2002–08

Country	2002		2003		2004		2005		2006		2007		2008	
	B	F	B	F	B	F	B	F	B	F	B	F	B	F
Armenia	2.3	2.0	2.3	2.0	2.3	2.0	2.7	2.0	2.7	2.0	2.7	2.0	2.7	2.3
Azerbaijan	2.3	1.7	2.3	1.7	2.3	1.7	2.3	1.7	2.3	1.7	2.3	1.7	2.3	1.7
Belarus	1.7	2.0	1.7	2.0	1.7	2.0	1.7	2.0	1.7	2.0	2.0	2.0	2.0	2.0
Georgia	2.3	1.7	2.3	1.7	2.7	1.7	2.7	1.7	2.7	1.7	2.7	1.7	2.7	1.7
Moldova	2.3	2.0	2.3	2.0	2.7	2.0	2.7	2.0	2.7	2.0	3.0	2.0	3.0	2.0
Ukraine	2.3	2.0	2.3	2.0	2.3	2.3	2.7	2.3	3.0	2.3	3.0	2.7	3.0	2.7
Bulgaria	3.3	2.3	3.3	2.3	3.7	2.3	3.7	2.3	3.7	2.7	3.7	2.7	3.7	3.0
Poland	3.3	3.7	3.3	3.7	3.3	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Romania	2.7	2.0	2.7	2.3	3.0	2.3	3.0	2.3	3.0	2.3	3.3	2.7	3.3	3.0
Russia	2.0	2.3	2.0	2.7	2.0	2.7	2.3	2.7	2.7	3.0	2.7	3.0	2.7	3.0

Source: EBRD (2008).
Note: B, banking sector; F, finance sector.

TABLE 2.9 BUDGET DEFICITS, 2000–08 (% GDP)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008*
Armenia	-6.4	-3.8	-0.4	-1.1	-1.8	-2.6	-2.8	-2.3	-1.4
Azerbaijan	-0.6	-0.4	-0.5	-0.8	1.0	2.6	-0.2	2.4	25.5
Belarus	-0.1	-1.9	-2.1	-1.7	0	-0.7	1.4	0.4	1.4
Georgia	-4.0	-1.9	-2.0	-2.5	2.3	-1.5	-3.0	-4.2	-6.4
Moldova	-1.8	-0.3	-2.2	1.0	0.4	1.5	-0.3	-0.3	-1.0
Ukraine	-1.1	-0.9	0.1	-0.7	-4.4	-2.3	-1.3	-2.0	-3.2
Bulgaria	-0.5	0.9	0.1	-0.9	2.2	1.9	3.3	3.5	3.0
Poland	-3	-5.1	-5	-6.3	-5.7	-4.3	-3.9	-1.9	-3.9
Romania	-4.6	-2.1	-2	-1.5	-1.2	-0.8	-1.6	-3.1	-4.9
Russia	1.9	3	0.9	1.3	4.5	8.1	8.4	6	4.8
Turkey	-8.0	-12.1	-11.4	-8.8	-5.4	-1.3	-0.8	-1.7	-1.9

Source: EBRD (2009).
*Note: *Data for 2008 is estimated.*

strengthening of their external position by reducing the amount of foreign debt (**TABLE 2.10**). Ukraine is the exception: it practically doubled its GDP share of external debt between 2002 and 2007. Moldova has an exceptionally high stock of external debt, but only around one-third of the total is governmental debt.

In the monetary sector, the main achievement was the full liberalisation of the interest rate regime and full convertibility of the current account. The exception is Belarus, where liberalisation has been limited in both areas. Most of the countries adopted a 12% capital adequacy ratio for the financial sector, with the exception

of Ukraine (10%) and Belarus (8%). Most of the exchange rate regimes are of the managed float type, with two exceptions: Belarus, where the central bank adopted a crawling peg to the USD, and Armenia, which officially has a floating exchange rate. The (overvalued) Belarus exchange rate came under pressure towards the end of 2008, forcing the authorities to intervene to slow down depreciation. This intervention reduced official reserves by more than 30% in less than four months. In Armenia, although the official regime is a floating one, the central bank in effect used a fixed exchange rate policy as a means of strengthening investor confidence. However, this policy translated into an increasing misalignment of the exchange rate and, consequently, into an accumulation of depreciation pressures. The monetary authorities were therefore obliged to sell an important share of hard currency reserves, the value of which fell by more than 40% between December 2008 and the end of February 2009. In addition, the central bank recently decided to return to a flexible exchange rate (managed float) and to intervene in the market only in the case of excessive volatility.

The banking and financial sectors are currently under mounting stress in all six Eastern partner countries, as the financial and economic crisis has hit the CIS economies hard (IMF 2009c, 2009d, 2010c). These economies have been badly hit by three major shocks:

- the global financial turmoil, which considerably limited access to external funding;
- the fall in demand from developed economies for CIS products;
- the related decline in commodity prices, notably for energy.

The largest direct impact of the crisis was an abrupt reversal of foreign funding to banking systems. Prior to the crisis, only Azerbaijan did not need to rely on external funding in order to sustain domestic borrowing. When the crisis struck, both non-financial companies and commercial banks found it very difficult to renew funding from investors who preferred safer assets. In addition, households began to switch from domestic to foreign-currency-denominated assets. Belarus and Ukraine have been particularly affected in this respect and are likely to have limited access to external financing over the next two years. Another major problem has been the rapid depreciation of domestic currencies, which raised the debt burden on non-financial firms that had borrowed in foreign currency. The share of domestic bank credit represented by foreign-currency-denominated credit widened to around 30% in Belarus, 50% in Ukraine and 70% in Georgia. In these three cases, when the exchange rate depreciates, foreign currency obligations will not be met without significant reductions in investment and employment in the real economy.

In the short term, the situation of the financial and banking sectors depends on the policies adopted by national authorities, which, in turn, depend on two basic elements: the effective capital adequacy ratio and the proportion of non-performing loans. The ratio of net worth capital to total assets is sufficiently high in all countries and comparable to those in Bulgaria and Romania (**TABLE 2.11**), where the banking sector is more developed.

TABLE 2.10 TOTAL EXTERNAL DEBT, 2002–08 (% GDP)

Country	2002	2003	2004	2005	2006	2007	2008
Armenia	43.2	63.7	52.2	38.0	32.0	17.5	17.9*
Azerbaijan	41.7	37.7	40.2	32.8	23.2	18.6*	NA
Belarus	22.7	23.4	21.3	17.1	18.4	28.0	25.3
Georgia	54.7	49.0	39.2	33.3	25.7	30.7	35.6
Moldova	109.2	97.2	73.0	69.6	74.0	75.1*	NA
Ukraine	30.1	47.5	47.3	46.0	50.6	59.9	NA
Bulgaria	56.3	48.1	40.1	31.3	24.6	19.8	16.8
Poland	44.3	50.5	52.3	47.5	47.8	44.8	47.1
Romania	25.9	23.5	39.0	39.2	44.0	50.4	49.0
Russia	44.1	43.1	36.2	33.7	31.4	36.0	28.6
Turkey**	37.5	32.1	21.9	17.4	13.4	6.5	4.0

Source: EBRD (2008); IMF Country Information: www.imf.org/external/country/index.htm
*Note: *Preliminary figures; **Data for Turkey given as share of gross national product.*

The proportion of non-performing loans is equally acceptable (**TABLE 2.12**), except in Azerbaijan. Nonetheless, banks in the Eastern partner countries remain relatively vulnerable to liquidity problems, reflecting the fragile state of public confidence in the banking system. The banking sector is still small, with a relatively low share of deposits in GDP (lower than the proportion of USD cash in circulation). These two elements – insufficient confidence and reduced size – prevented banks from attracting a local deposit base during the period of high economic growth.

2.3 INSTITUTIONAL AND LEGAL REFORMS DURING TRANSITION

Institutions are important for sustained growth. Various studies on this issue (Bassanini et al., 2001; Eicher and Garcia-Penalosa, 2006; Acemoglu and Robinson, 2008) have concluded that economic reforms – mostly liberalisation and stabilisation – were the most important determinants of economic recovery in the first phase of transition, whereas the sustainability of post-recovery growth depended essentially on institutional development. Moreover, some empirical studies

TABLE 2.11 YEAR-END RATIO OF CAPITAL (NET WORTH) TO ASSETS, 2004–08 (%)

Country*	2004	2005	2006	2007	2008
Armenia (12%)	17.8	21.5	22.9	22.5	27.5
Azerbaijan (12%)	19.9	20.7	18.7	19.9	NA
Belarus (8%)	19.0	19.0	17.3	15.5	17.1
Georgia (12%)	NA	17.5	20.6	16.0	13.9
Moldova (12%)	NA	NA	NA	29.3	32.2
Ukraine (10%)	12.9	11.8	11.7	11.7	NA
Bulgaria (12%)	16.6	15.3	14.5	13.9	14.9
Romania (8%)	NA	NA	NA	13.8	12.3

Source: IMF Country Information: www.imf.org/external/country/index.htm
*Note: *The numbers in brackets refer to the minimum capital adequacy ratio.*

TABLE 2.12 NON-PERFORMING LOANS AS A PROPORTION OF TOTAL LOANS, 2002–08 (%)

Country	2002	2003	2004	2005	2006	2007	2008
Armenia	4.9	4.9	2.1	2.1	2.6	2.5	4.4*
Azerbaijan	19.7	14.6	14.5	14.9	12.0	8.1	NA
Belarus	10.2	5.8	4.7	3.4	2.9	2.0	0.7*
Georgia	7.9	7.5	6.2	3.8	2.5	2.6	12.8*
Moldova	7.6	6.4	6.9	5.3	4.4	3.7	3.2*
Ukraine	4.5	3.4	3.2	2.2	1.7	1.3	NA
Bulgaria	5.6	4.4	3.7	3.8	3.2	2.5	2.4
Poland	24.7	25.1	17.4	11.6	7.7	5.4	NA
Romania	2.3	1.5	1.7	1.7	1.8	3.0	NA

Source: EBRD (2008); IMF Country Information: www.imf.org/external/country/index.htm
*Note: *Year end.*

(Schweickert, 2008) have concluded that EU cooperation with the CIS region (in particular, the ENP cooperation agreements) has contributed to institution building and the quality of governance in those countries. A certain degree of Europeanisation and institutional convergence towards EU standards can be observed in some of the CIS countries in recent years, particularly in Ukraine, Georgia and Azerbaijan. EU policies towards these countries can therefore be considered as a catalyst for institutional convergence, if not a main driver.

All six Eastern partners currently possess the institutional, political and legislative framework appropriate for a market economy and a democratic society. How effective these elements are in reality is another matter. The most popular measure of political, institutional and legal efficiency is the World Bank Institute (WBI) set of governance indicators, published periodically for practically all countries in the world. The best indicator is the government effectiveness measure, which evaluates the efficiency of institutions: none of the six partners recorded a positive value for 2007 (**TABLE 2.13**), which indicates the existence of functional problems. The worst government effectiveness score was for Belarus, while Armenia and Ukraine faced the greatest difficulties in controlling corruption. Georgia had real problems with political stability and Moldova with the effectiveness of its government. The six Eastern partners are therefore lagging behind the more advanced transitional countries from the CEEB region. Sweden is included in Table 2.13 as a benchmark advanced democracy for comparison.

With regard to the legislative environment, two indicators are used to evaluate the quality of the legal framework:

- regulatory quality, which reflects the appropriateness of legal provisions;
- rule of law, which expresses the extent to which legal provisions are respected in practice.

In almost all the countries a certain discrepancy exists between the suitability of law and the rectitude of its implementation: the smaller the gap, the better the democratic and institutional system. It can be observed (**FIGURE 2.4**) that the greatest discrepancy exists in Armenia and Georgia, the gap being as high as those in Bulgaria and Romania and higher than that in Russia. Belarus is a special case where law enforcement is strong as a result of its specific political regime. In Sweden, as in Belarus, the rule of law is very well respected, but for different reasons: the good functioning of democracy and related institutions of the state.

For comparative purposes, the Bertelsmann Transformation Index (BTI) classifies countries according to two main criteria:

- the status of democracy and the market economy;
- overall institutional management.

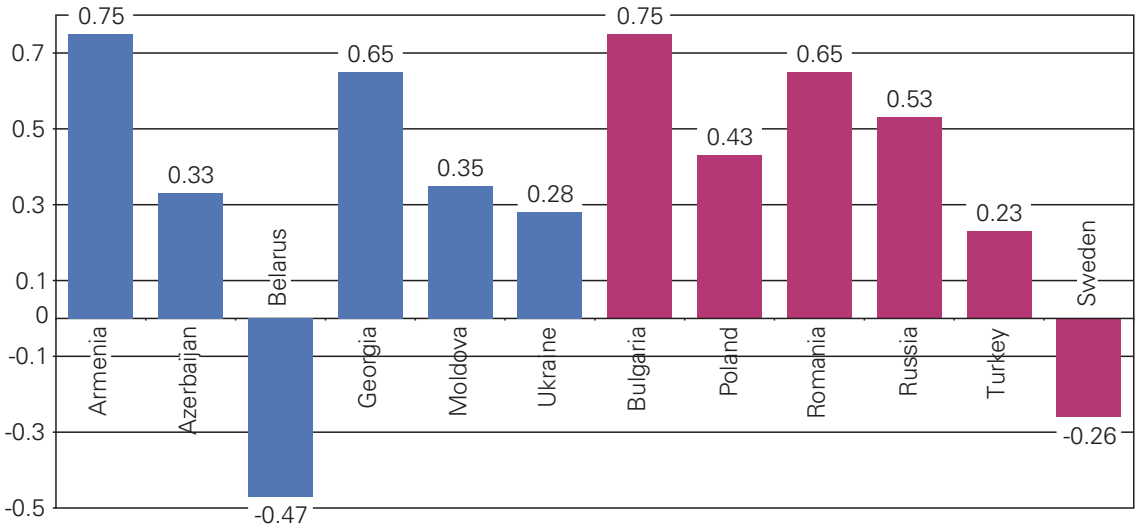
Azerbaijan and Belarus recorded a low index in terms both of democratic and market aspects and effective governance through institutions (**TABLE 2.14**). For the existing conditions (overall status), only Georgia performed better in terms of institutional management: this is expressed by a higher value for the management index than for the overall index. Moldova had the greatest difference between the two components: governance is rather poor although democracy is advanced and market rules are present in the economy.

TABLE 2.13 WBI GOVERNANCE INDICATORS, 2007

Country	VA	PS	GE	RQ	RL	CC
Armenia	-0.59	-0.01	-0.31	0.24	-0.51	-0.68
Azerbaijan	-1.13	-0.69	-0.65	-0.50	-0.83	-1.04
Belarus	-1.80	0.20	-1.26	-1.56	-1.09	-0.88
Georgia	-0.19	-0.70	-0.13	0.21	-0.44	-0.38
Moldova	-0.38	-0.22	-0.83	-0.31	-0.66	-0.68
Ukraine	-0.09	0.16	-0.60	-0.42	-0.70	-0.73
Bulgaria	0.65	0.42	0.10	0.61	-0.14	-0.22
Poland	0.81	0.58	0.38	0.71	0.28	0.14
Romania	0.47	0.19	-0.09	0.48	-0.17	-0.19
Russia	-1.01	-0.75	-0.40	-0.44	-0.97	-0.92
Turkey	-0.19	-0.78	0.24	0.23	0.00	0.04
Sweden	1.47	1.24	2.08	1.64	1.90	2.37

Source: Kaufmann et al. (2008).
Note: VA, voice and accountability; PS, political stability; GE, government effectiveness; RQ, regulatory quality; RL, rule of law; CC, control of corruption.

FIGURE 2.4 REGULATORY QUALITY VERSUS RULE OF LAW, 2007



Source: Kaufmann et al. (2008).
Note: This diagram shows the difference between the appropriateness of legal provisions and the extent to which legal provisions are respected in practice.

TABLE 2.14 BERTELSMANN TRANSFORMATION INDEX, 2008

Country	Overall status				Management		
	Ranking	Index	Democracy	Market economy	Ranking	Index	Management performance
Armenia	41	6.41	6.00	6.82	56	5.14	5.90
Azerbaijan	87	4.51	3.80	5.21	99	3.83	4.28
Belarus	89	4.47	3.93	5.00	110	2.89	3.28
Georgia	38	6.60	6.85	6.36	23	6.36	7.05
Ukraine	35	6.93	7.35	6.50	55	5.21	6.00
Moldova	60	5.93	6.85	5.00	87	4.48	4.93
Bulgaria	15	8.44	8.70	8.18	13	6.73	7.97
Poland	11	8.76	8.80	8.71	53	5.27	6.45
Romania	17	8.31	8.55	8.07	22	6.49	7.62
Russia	59	5.94	5.35	6.54	98	3.84	4.40
Slovenia	2	9.49	9.70	9.29	12	6.83	8.53
Turkey	32	7.17	7.05	7.29	24	6.33	7.28

Source: Bertelsmann Foundation: www.bertelsmann-transformation-index.de/11.0.html?&L=1

Transition in Armenia has been marked by a daunting set of economic, political and social challenges. The country was forced to quickly find and forge its own economic and political institutions in a difficult initial stage of transition. Changes aimed at moving towards a market economy were introduced in the early 1990s, with the successful implementation of macro-stabilisation policies. However, democratic changes have been hindered by a regional conflict with Azerbaijan that delayed the imperatives of institution building. With the elections in 1998, a gradual downward trend abated. Despite some gains in political reform in recent years, participatory democracy remains fragile because of the closed nature of the political system and weak political institutions. The rule of law is weakened by poor governance and the predominance of individuals over institutions. Despite a well-developed administrative system, efficiency is negatively affected by political influence and a lack of transparency. The rights to property and its acquisition are adequately defined and soundly defended. Armenia is consistently rated as one of the most open economies in the CIS region and is credited with having positive trade and investment policies, with no restrictions on capital.

Shortly after Azerbaijan gained its independence, all power was concentrated in the hands of the president and his ruling apparatus. Independent political and civic organisations are allowed to form, but they experience occasional difficulties with the authorities. The Nagorno-Karabakh conflict with Armenia further complicated the democratic process. Azerbaijan's leadership does not face any opposition in executing the tasks required for transformation, but tends to seek to achieve reforms almost exclusively in the economic field. Even there, problems exist regarding partial reforms of the judicial system and state administration. Huge oil revenues enabled the strategic goal of macroeconomic stabilisation to be achieved, while also serving the interests of the main political actors. The collapse of the large enterprises that dominated the Soviet era has been offset by the development of an SME sector, mainly in trade and services. Market competition has been given an institutional framework, but the economic environment is still characterised by inadequate judicial and political settings, an underdeveloped infrastructure and a lack of access to capital. Rights to private property and its acquisition are formally well defined; however, implementation procedures are arbitrary and lengthy.

In Belarus, independence has not led to major changes in the system, and institutional reforms have been carried out slowly. Presidential power has dominated the country's development and has largely isolated it from the West. The initial conditions for adopting a market economy were favourable, but in 1995 the president halted the trend towards liberalisation and privatisation in favour of a reform model similar to that of China and Vietnam. This choice of a 'social market' economy restricted liberalisation to a minimum number of key economic sectors and increased state control. As a result, the macroeconomic reforms have moved forward slowly. The legal and financial conditions for an active civil society are not supportive for non-governmental organisations (NGOs) and foreign assistance. Market competition operates under a weak institutional framework, with pervasive state involvement in the economy. The private sector and entrepreneurship are discouraged, profit taxes remain high, price and wage controls are widespread, and a large proportion of industry is still in state hands. While numerous laws have been enacted that should theoretically improve the enforcing of contracts and property rights, their implementation is problematic. Consequently, only modest structural reforms have been achieved since 1995.

Georgia has undergone a turbulent transition towards the consolidation of democracy and a market economy. Although President Shevardnadze succeeded in restoring public order, he was unable to sufficiently consolidate Georgia's institutions. Within a frequently changing political environment, clientelist networks developed based on competing personal interests, while pluralism was confined to intra-elite competition inside the ruling party. As the gap between a legal fiction and corrupt practices increased, presidential authority waned and authoritarian measures provoked the Rose Revolution in 2003. The new elite rapidly curbed corruption and streamlined an inefficient administration. Despite these impressive achievements, however, certain deficits remain, especially in the legislative sphere. With respect to institutional consolidation, the results achieved since the Rose Revolution have been rather mixed. Undisputed efficiency gains – in terms of curbing corruption, improving the implementation of political decisions by the administration and overcoming internal frictions between different institutions – have been somewhat constrained by setbacks in terms of ensuring a proper functioning of the system of checks and balances.

In the economic domain, Georgia has implemented a wide range of structural reforms that have led to a significant improvement in the business climate, ranging from the simplification of the tax regime to measures dealing with the registration of property. The legalisation of formerly unregistered activities has been very much facilitated by a liberal policy of issuing licences. Fiscal policy is probably the most outstanding success. Prudent anti-corruption measures, the adoption of a simplified tax code, decisive steps to combat smuggling and significant progress in enhancing the efficiency of tax and customs administration have contributed to a remarkable increase in budget revenues. At the same time, institutional safeguards, such as the introduction of a single treasury account, have prepared the ground for a more transparent and rational execution of the budget.

Transition in Moldova has been marked by continuous friction between two political factions: one supporting reunification with Romania and the other in favour of a separate Moldovan nation. These controversies absorbed all political energies until 1994 and, consequently, no major economic reform was initiated before this. By the time reform considerations became a priority, the window of opportunity for transformations was gone. As a result, the electorate penalised the democratic ruling coalition by electing the Communist

Party and reconfirming it in power in 2009. The return of the communists implied the end of reform prospects, and the economy has been increasingly reduced to obsolete public industrial enterprises. Most families rely on remittances from migrants to survive, and the state's power to manage economic processes is hindered by irregular flows of labour and capital, as well as by state capture of the most profitable economic activities by the political elite.

The 2005 reform of the judiciary represented a substantial improvement, but certain deficiencies (particularly corruption) mean that public trust in the courts is very low. A national anti-corruption strategy was adopted in 2005; it was well received by Transparency International, which labelled Moldova the least corrupt CIS country in 2006. Nevertheless, most of the attention has concentrated on petty corruption, while high-profile political corruption has been ignored. The overall performance of administrative institutions is hampered by vested interests and a lack of resources. Although the vertical centralisation of power reinstituted by the communists was halted in 2006 with the launch of a decentralisation initiative, the institutional framework remains weak and is unable to support market competition and related reforms. The communist government is not very committed to reform, while bureaucratic inefficiencies, coupled with the vested interests of the political elite, have tended to undermine reform agendas. Private property is formally safeguarded and state intervention is no longer a major concern.

The initial transitional reforms in Ukraine were launched by the old *nomenklatura* elite, which shaped the new institutional framework in such a way that Soviet institutional legacies were translated into the corresponding forms of state building. Most former *apparatchik* members kept their positions in the state administration and the economy, with personal networks overriding legal rules. The situation improved after 1996, when the newly adopted constitution limited presidential power, although the head of state continued to influence government decisions and often even vetoed laws. Presidential decrees, which were used frequently until 2004, extensively circumvented the legislature and the executive. Consequently, state authority weakened, leading to increasing state capture and opposition to structural reforms.

After 2004 the political system changed significantly and democracy was consolidated. However, new institutional blockades and power struggles have emerged, and these hamper the pace of reforms. The public administration currently functions at all levels with varying degrees of effectiveness. There remains a lack of transparency in certain areas, and loopholes and institutional frictions persist, since there is insufficient delineation between some of the competencies of the president, cabinet and parliament. Market elements have been adopted at a slow pace in the economy, though the essential elements of free market competition are in place. However, inconsistent legislation, anti-competitive practices and corruption are slowing down progress. Extensive direct and indirect state subsidies and the dominance of financial industrial groups result in unequal treatment of market participants and distort the allocation of resources. With regard to the regulatory framework, progress has been made in reducing entry barriers for small companies, but the rules of the game are not consistently enforced. In response to past failures and mistakes, the political leadership formulates ambitious reform programmes, while policy frequently remains fixed in the same routines of the past.

Institutional and economic reforms are therefore interlinked and induce high levels of synergy when optimally combined. This has rarely been the case, however, in the Eastern partner countries, where political, administrative, legal, institutional and economic changes have not always been harmonised. The various domains of transitional change have been approached separately and sometimes inconsistently. Economic reforms have suffered most from political, institutional and legal setbacks and inconsistencies. Current achievements in adopting a market economy are therefore very much related to past political developments, progress in restructuring institutions and the attainment of a proper legislative framework.

It is possible to carry out a global evaluation of these reform areas in terms of economic freedom by analysing the components of the EFI (**TABLE 2.15**). The quality of regulation is the most problematic aspect for Armenia and Moldova, and the situation is similar in Russia. Georgia is seriously penalised by the inefficiency of its legal structures. Government (political aspects) is particularly cumbersome in Ukraine and Azerbaijan, as it is in Bulgaria, Poland and Romania. Similarly, the Heritage Foundation's IEF is based on ten different components that capture political, legal and institutional aspects of economic freedom (see Appendix 2.1 at the end of this chapter). The evaluation by the IEF is slightly different from that by the EFI, but such differences do not necessarily imply that the evaluations are contradictory; rather, different weights are attached to particular elements of the assessment.

2.4 CONCLUDING REMARKS

The main transitional reforms – economic, legal and institutional – implemented by the six Eastern partner countries over almost two decades have been reviewed in this chapter. These reforms have significantly changed the rules of the game in the social, political and economic lives of the countries and of individuals, and have also had a far-reaching impact on the structure of the labour market, the employment situation and human capital development. Economic reform commenced in all the countries with the privatisation of state-owned companies. Enterprise privatisation took various forms, but the most common approach was mass privatisation programmes, which were implemented with varying degrees of success. The speed of privatisation varied across the six countries and, consequently, results expressed in terms of improved efficiency in privatised entities have varied significantly.

The most frequently used method of privatisation in the Eastern partners was MEBO, which was predominant in

TABLE 2.15 ECONOMIC FREEDOM INDEX STRUCTURAL COMPOSITION, 2008

Country	Government size		Legal structure and security of property rights		Access to sound money		Freedom to trade internationally		Regulation of credit, labour and business	
	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank
Armenia	6.26	76	5.56	75	9.43	22	6.53	86	6.37	87
Azerbaijan	3.64	135	5.67	69	7.10	99	6.38	93	5.86	110
Belarus	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Georgia	7.42	29	4.95	91	9.07	41	7.44	31	7.55	23
Moldova	6.84	54	5.72	68	6.97	104	6.79	73	6.24	93
Ukraine	4.06	130	5.25	82	6.60	117	6.38	92	5.92	109
Bulgaria	4.95	113	5.61	72	8.76	55	7.64	22	7.11	48
Poland	5.34	103	5.83	62	9.54	9	6.84	69	6.36	88
Romania	5.54	97	5.51	76	8.69	59	7.12	56	6.45	79
Russia	5.64	96	5.73	67	7.46	90	6.00	110	5.79	114
Turkey	7.82	17	6.29	57	5.42	136	6.77	76	5.47	122

Source: Gwartney and Lawson (2008).

the case of SMEs in Ukraine, Moldova and Georgia. Given the heterogeneity of policy approaches, the outcome of the process – expressed as the proportion of GDP represented by the proceeds of privatisation – differs among the six countries. Georgia is the best performer in the group, while more than half of total proceeds in Belarus were obtained in 2007, following the abolition of the golden share rule in the banking sector in 2006. While land in the CEEB countries was restored to former owners, in the CIS (including the Eastern partners), where the long history of collectivised agriculture made restitution virtually impossible, the land was in effect privatised through egalitarian distribution to rural residents (except in Belarus). This resulted in the significant fragmentation of land ownership and in the creation of many smallholdings, with subsistence farmers and their families classified as self-employed persons.

In all six countries, structural reforms are biased towards economic liberalisation (foreign trade and prices), while achievements in other fields are rather modest. Consequently, most of the countries in the region still face reform challenges. The most important challenge concerns the business environment, which remains a hindrance for private enterprise, despite recent improvements. The transitional governments of the Eastern partner countries have given higher priority to macroeconomic policies aimed at preserving economic stability than to measures directly related to the business sector. This policy approach, deriving from the belief that reforms at the macro level are sufficient to ignite microeconomic changes, is largely justified by the huge difficulties the governments faced at the very beginning of transition. In contrast to the CEEB countries, countries in the CIS had to introduce their own currencies and create a central bank, which was not an easy task.

All six Eastern partners currently possess the institutional, political and legislative framework typical of a market economy and a democratic society. The effectiveness of these elements in reality is another matter. Economic reforms have suffered most from political, institutional and legal setbacks and inconsistencies. Institutional and economic reforms are interlinked, and lead to a high degree of synergy when optimally combined. This has rarely been the case in the Eastern partner countries, where political, administrative, legal, institutional and economic changes have not always been harmonised. The various domains of transitional changes have been approached separately and sometimes inconsistently.

APPENDIX 2.1 INDEX OF ECONOMIC FREEDOM BY COMPONENT, 2008

Country	Business freedom		Trade freedom		Fiscal freedom		Government size		Monetary freedom		Investment freedom		Financial freedom		Property rights		Freedom from corruption		Labour freedom	
	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank
Armenia	83.7	25	86.4	15	90.0	20	89.7	24	77.8	67	70	21/46	70	20/36	35	90/93	30	100/106	66.3	68
Azerbaijan	74.6	54	78.4	79	79.7	70	77.5	68	66.3	160	30	126/163	40	106/134	25	142/150	21	152/163	87.0	10
Belarus	63.7	94	67.2	131	79.4	73	30.9	160	66.8	158	20	164/171	10	173/178	20	151/163	21	152/163	70.8	50
Georgia	86.6	21	80.6	68	86.8	30	74.6	82	70.9	132	70	21/46	60	37/70	35	90/93	34	81/84	99.4	2
Moldova	70.1	67	81.6	57	85.3	38	51.3	136	67.6	152	30	126/163	50	71/105	40	76/89	28	113/119	45.1	151
Ukraine	40.5	161	84.0	46	77.0	85	39.0	151	68.1	149	30	126/163	40	106/134	30	94/141	27	120/124	52.4	121
Bulgaria	73.5	59	85.8	20	86.2	34	58.7	123	72.8	117	60	47/63	60	37/70	30	94/141	41	65/67	78.4	35
Poland	53.7	140	85.8	34	69.0	126	42.2	148	80.8	29	60	47/63	60	37/70	50	50/75	42	62/64	59.8	97
Romania	74.9	51	85.8	35	87.0	29	70.0	93	75.0	94	60	47/63	50	71/105	35	90/93	37	71/72	57.1	109
Russia	54.0	138	60.8	152	78.9	76	70.6	91	65.5	164	30	126/163	40	106/134	25	142/150	23	145/148	60.0	92
Turkey	69.9	70	86.6	14	73.2	106	83.4	50	71.1	129	50	64/98	50	71/105	50	50/75	41	65/67	40.3	166

Source: Heritage Foundation (2009).

3. DEMOGRAPHIC TRENDS AND LABOUR MARKET DATA

Jesús Alquézar Sabadie

The first part of this chapter discusses key demographic trends and challenges, and the second covers the availability and comparability of labour market data. The first section explains how the demographic transformation of the Eastern partners is characterised by negative natural population growth (as a result of low birth rates and high mortality) and emigration. The consequent ageing population impacts on the labour market, education, healthcare and pension systems. Azerbaijan is a partial exception, with positive population growth. The decreasing birth rates are linked to economic and social changes, and to new patterns of reproduction and family models. The Eastern partners (including Russia) are characterised by the unique feature of increasing mortality rates, even during periods of economic recovery. This situation is the result of a combination of deficient healthcare systems, diseases linked to unhealthy lifestyles (such as alcohol abuse and exhaustion from overwork), 'social illnesses' (tuberculosis, HIV/AIDS), violent death (accidents, murders and suicides), deteriorating living conditions, psychosocial stress, local conflict and the long-term effects of the Chernobyl disaster. Substantial emigration flows further deplete the picture.

It may be argued that demographic decline can alleviate the labour market situation by reducing demand-side pressure. However, the long-term impact is unpredictable and is more dependent on the national capacity for creating sustainable economic growth and jobs, the quality of the workforce, migration policies, and the evolution of activity rates than on reduced demand. The demographic challenge also poses a threat to the maintenance of healthcare, pension and education systems. International institutions such as the World Bank recommend reforms, which are intended to create sustainable pension systems and increased labour productivity. Extensive informal employment in the region means that real dependency rates (i.e. the number of beneficiaries as a percentage of the number of contributors) remain high, with limited public resources available to finance health, pension and education services.

The second part of the chapter analyses the availability and comparability of labour-market-related data across the six countries to provide a sound analysis of labour markets. The 'statistical transition' in the Eastern partners has not been as visible as other transitions. The old national statistical systems were designed to collect information on centralised, public and planned economies through the widespread use of registers, and the economic shift from planned to market models has required a change in statistical culture among administrators and policy makers. Data is no longer used for planning and control, but instead provides the basis for the design, monitoring and evaluation of evidence-based policies. This represents an enormous cultural change that requires new administration and decision-making skills and also a political leap forward towards transparency and open public debate. This section reviews existing statistical resources for labour market analysis such as censuses, LFSs, HBSs, establishment surveys, national accounts and administrative registers, and goes on to assess their reliability on the basis of criteria such as the quality of sources, periodicity, national comparability over time and international comparability.

Each country is at a different stage of development regarding its LMIS: data from Moldova and Ukraine are comparable to EU standards, whereas the system in Belarus is practically unchanged since Soviet times (no LFS has been conducted in the country to date). Armenia, Azerbaijan and Georgia fall between, having developed statistical instruments to some extent, but with some problems still to be resolved. Some of these problems are of a technical nature: different retirement ages between countries (with the implied bias for data analysis), seasonality, sub-national representativeness and consistency of methodologies over time. Other more complex issues include measurement of the informal sector, given its prevalence in the region. Data collection tools also need to be harmonised in order to ensure their comparability, and greater transparency of statistics is required (especially in the dissemination of datasets and meta-data to a wider public). The core problem continues to be insufficient resourcing in the face of increasing demands on statistical services from national and international institutions and researchers. Investments in ICT and human resources, including training and participation in international conferences, are not sufficient to meet these increasing demands.

3.1 KEY DEMOGRAPHIC TRENDS

The Eastern partners are demographically diverse. As can be seen in **TABLE 3.1**, Ukraine had 46.2 million inhabitants in 2008, while Armenia, Moldova and Georgia had between 3 and 4 million; the population sizes of Azerbaijan (8.6 million) and Belarus (9.6 million) fell between the two. Most of these are small nations, especially in comparison with neighbours such as Russia (142 million), Turkey (73 million), or even Poland (38.1 million) and Romania (21.5 million). Despite the differences in their sizes, the countries face similar demographic challenges: their populations are both shrinking and ageing in what has been dubbed the 'third transition'[18] (Chawla et al., 2007). Only Azerbaijan escapes this trend, as a country that currently has a slight positive natural population growth (although with a decreasing trend).

The concept of 'demographic transition' generally refers to a situation in which both mortality rates and birth rates are in decline. This implies a change in demographic patterns, moving from a situation characterised by high birth rates and mortality rates to low levels of both. During this process, the population grows because the death rate reduces faster than the birth rate. Demographic transition is a symptom of gradual development in any given country where improvements in the healthcare system, better food supplies and an enhanced quality of life account for the bulk of the reduction in the death rate, while the increased education and empowerment of women, urbanisation and access to contraception lead to shrinking birth rates. This process has occurred in most developed countries in the past, and the trend continues in most developing countries today.

The six Eastern partners fall broadly into this pattern, but all except Azerbaijan present the atypical characteristics of falling birth rates and increased mortality. Emigration adds to these negative natural factors as another common trend in most of the six countries. This section attempts to explain the causes behind this demographic challenge and discusses the potential consequences and issues relating to population decline, in particular with regard to the labour market and the healthcare, pension and education systems.

Demographic decline is often attributed to the crisis provoked by the collapse of the USSR, and evidence has been presented to support this view in Central and Eastern European (CEE) countries (Spéder et al., 2002). However, the link was not so obvious in the Eastern partner countries. Close analysis of trends in population growth between 1980 and 2008 (Appendix 3.1 at the end of this chapter) shows that the population growth rates of the six countries started to decline in the 1980s and reached negative values in most countries in the early 1990s, following independence. Similar trends can be seen in Russia and other transition countries such as Poland and Romania (Appendix 3.2 at the end of this chapter). From the late 1990s in Armenia and Georgia

TABLE 3.1 TOTAL POPULATION TRENDS, 1985–2008, AND VARIATION, 1990–2008

Country	1985	1990	1995	2000	2005	2008	Absolute variation 1990–2008	% variation 1990–2008
Armenia	3 339 147	3 544 695	3 223 169	3 075 811	3 064 925	3 077 087	-467 608	-13.2
Azerbaijan	6 669 000	7 159 000	7 685 000	8 048 535	8 391 850	8 680 100	1 521 100	21.2
Belarus	9 975 000	10 189 000	10 194 000	10 005 000	9 775 591	9 680 850	-508 150	-5.0
Georgia	5 287 002	5 459 999	5 068 901	4 744 750	4 464 543	4 307 011	-1 152 988	-21.1
Moldova*	4 214 996	4 363 950	4 338 750	4 100 257	3 759 329	3 633 369	-730 581	-16.7
Ukraine	50 917 000	51 892 000	51 512 299	49 175 848	47 105 150	46 258 200	-5 633 800	-10.9
Russia	143 858 000	148 292 000	148 141 000	146 303 000	143 150 000	141 950 000	-6 342 000	-4.3
Turkey	51 288 815	56 086 184	61 206 099	66 459 578	71 169 037	73 914 260	17 828 076	31.8
Bulgaria	8 941 000	8 718 000	8 400 000	8 060 000	7 740 000	7 623 395	-1 094 605	-12.6
Poland	37 203 000	38 118 800	38 587 600	38 453 757	38 165 450	38 125 759	6 959	0.0
Romania	22 725 000	23 207 000	22 681 000	22 443 000	21 634 350	21 513 622	-1 693 378	-7.3

Source: World Bank World Development Indicators.
*Note: *Moldova includes Transnistria.*

18 The first two transitions were political and economic change.

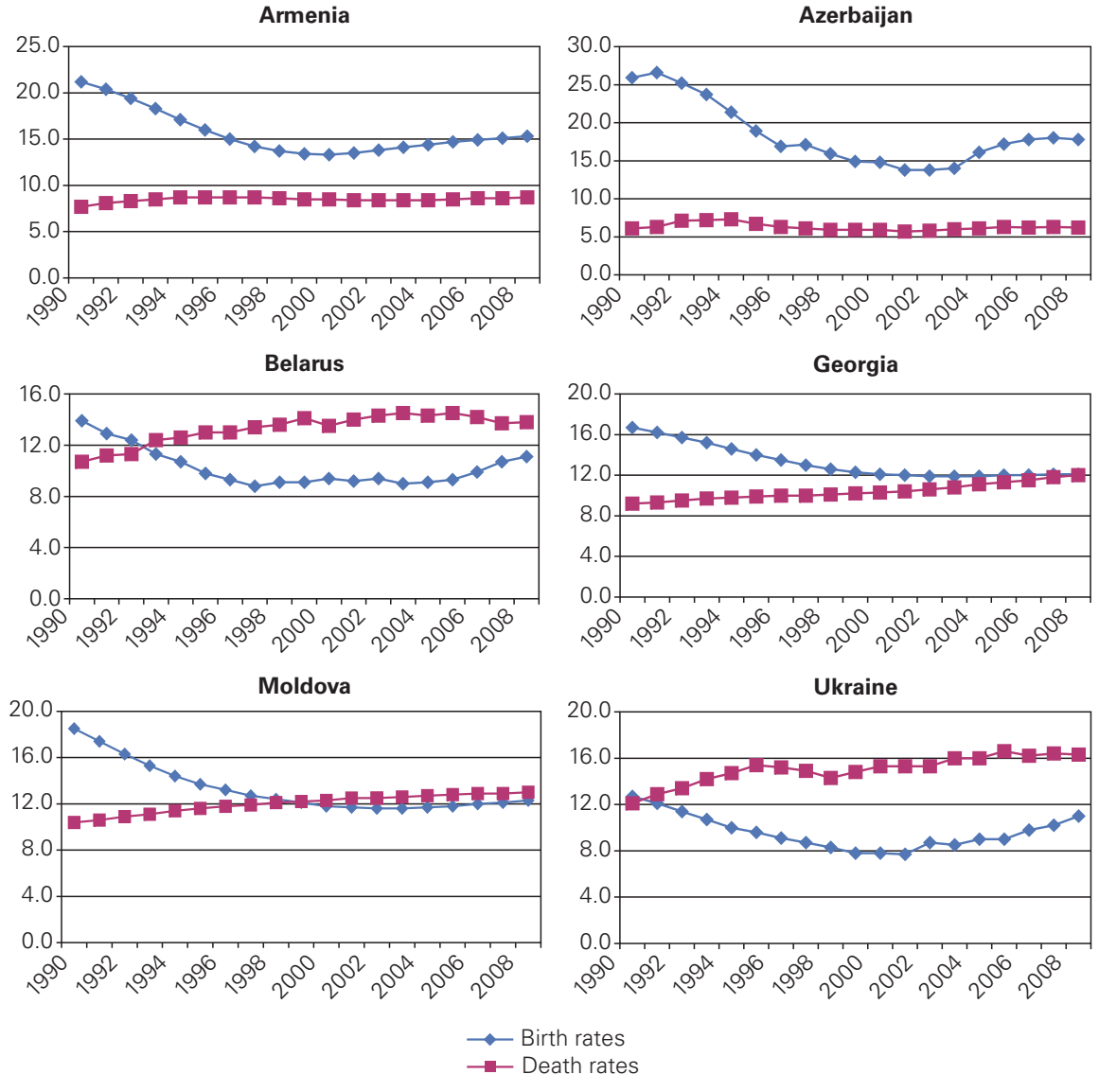
and from the early 2000s in Belarus, Moldova and Ukraine, population growth followed a slight positive trend (with the rate of population decline becoming lower) but in all countries except Armenia, the population growth rate remained negative until 2009. This trend may be associated with improving living conditions or with other factors such as the fact that the large population cohorts born during the 1970s and 1980s are reaching the age of fertility.

3.1.1 NATURAL POPULATION GROWTH AND POPULATION PROJECTIONS

Detailed analysis of mortality and birth rates is needed in order to understand population evolution. As explained above, most of the Eastern partners have low birth rates and high mortality rates (see **FIGURE 3.1**). Birth rates are largely similar to the 10.9‰ of the EU-27 (Eurostat[19]) in 2008, at 11.1‰ in Belarus, 12.1‰ in Georgia, 12.3‰ in Moldova and 11.0‰ in Ukraine. Armenia and Azerbaijan are the only countries of the region that show natural population growth. Their birth rates for 2008 are 15.3‰ and 17.8‰ respectively, with the latter on a par with Turkey (18.8‰), although both with a tendency to decrease. All of these countries have experienced a dramatic decline in their birth rates that started well before the 1990s, but the intensity of the trend increased during the painful early periods of transition.

The decrease in birth rates is mainly due to economic and social changes that have led to new reproductive patterns and a new family model. The new model is characterised by an increased social and economic role for women, later

FIGURE 3.1 TRENDS IN BIRTH AND DEATH RATES, 1990–2008



Source: WB WDI.

19 Available at www.ec.europa.eu/eurostat.

first marriage, a higher incidence of divorce and a higher number of children born outside the marriage, later parenthood and fewer children per woman. Fertility rates in this region are comparable to those of most EU members at below 1.8 children per woman in 2008 (World Bank WDI; Marcu (2009)), except in Azerbaijan. Another contributory factor is the difficulties faced by young people in accessing labour markets, leading them to postpone the decision to have children. These trends are common to most CEE and CIS countries (Philipov and Dorbritz, 2003; Spéder et al., 2002; ETF Country Reports) and are not vastly different from family patterns in the EU member states.

The economic crisis that followed the collapse of the USSR further reduced fertility and birth rates. A reversal in this declining trend has occurred since 2002–03 in some of the Eastern partner countries. This is clearly the case in Armenia, Azerbaijan, Ukraine and, to lesser extent, Belarus. There are various factors that could explain this change in the pattern. Firstly, people born during the baby boom of the 1970s and 1980s, which was promoted by active population policies implemented in the Soviet Union, reached childbearing age during the 2000s. Secondly, a number of potential births from the 1990s were postponed until the 'better times' of the 2000s, with the improving economic situation, better standards of living and increasing adaptation to the new political, economic and social environment. Finally, pro-natal policies and child benefits were implemented in countries such as Ukraine in order to address the demographic challenge (Kurilo et al. (2007) cited in ETF (2009b, p. 15). The effect of such measures, however, would appear to be negligible, and will hardly be sustainable by the time the new generation born in 1990s reaches childbearing age, given that demographers consider pro-birth transfers to be ineffective if they are not accompanied by social and family measures such as public care facilities (Chawla et al., 2007).

Special explanation is needed for the particular case of Azerbaijan, the country with the highest birth rate and natural population growth in the region. Some possible explanations of the phenomenon could be the following.

- An exceptionally high infant mortality rate (see **TABLE 3.2**) indicates an early (pre-modern) phase of demographic transition that sustains higher birth rates in the country.
- Strong family ties and in-family support in Azerbaijan may provide an additional incentive for having larger families.
- The continuing importance the agricultural population in Azerbaijan may contribute to the desirability of a larger family, as the agricultural and household tasks they traditionally undertake produce net flows of wealth to the older generations (Caldwell, 1976).
- The high and sustained economic growth of the past decade as a result of oil production may have given the population a sense of optimism for the future that encourages them to have more children.

Some of these explanations may also apply to Armenia, although the natural growth rate there is not as high.

Mortality rates for the Eastern partners are challenging, since they have followed an increasing trend since the early 1990s (Figure 3.1). In 2008 mortality rates were 6.2‰ in Azerbaijan, 8.7‰ in Armenia, 12‰ in Georgia, 13‰ in Moldova, 13.8‰ in Belarus and 16.3‰ in Ukraine (WB WDI). The EU average was 9.7‰ in 2006,

TABLE 3.2 TRENDS IN INFANT MORTALITY AND LIFE EXPECTANCY AT BIRTH, 1985–2007

Country	Infant mortality*						Life expectancy at birth (years)					
	1985	1990	1995	2000	2005	2007	1985	1990	1995	2000	2005	2007
Armenia	54.1	48.1	41.7	31.9	24.4	21.9	69.2	68.5	69.6	70.8	71.5	71.7
Azerbaijan	81	77.9	74.9	57.6	39.9	34.4	69.5	65.8	66.0	66.5	67.1	67.4
Belarus	21	20.1	18.5	15.4	12.8	11.9	71.0	70.8	68.5	68.5	68.9	68.9
Georgia	47.1	40.6	35.1	30.7	28	26.9	69.8	70.2	70.3	70.3	70.6	70.8
Moldova	36.7	30.4	25.1	20.8	17.1	15.9	66.4	67.3	66.8	67.3	68.3	68.7
Ukraine	20.5	18.4	17.9	16.6	14.7	14	70.0	70.1	67.1	67.9	68.0	68.2
Russia	25	22.9	22.9	20.4	14.8	12.8	67.9	68.9	65.2	65.3	65.5	67.6
Turkey	83	67	52	37.5	26	21.4	63.4	66	67.8	70.4	71.3	71.7
Poland	17.9	19.3	13.6	8.1	6.3	5.8	70.5	70.9	71.9	73.7	75	75.1
Romania	26	26.9	21.2	18.7	14.7	12.6	69.7	69.7	69.5	71.1	71.7	72.6
EU-27	NA	NA	NA	5.9	4.9	4.7**	NA	NA	NA	NA	78.5	78.9*

Source: WB WDI; Eurostat for the EU average.
*Note: *Infant mortality is measured in the number of infants dying before reaching the age of one year, per 1 000 live births; **2006 data.*

compared with 14.5‰ and 11.8‰ in Bulgaria and Romania respectively (Eurostat[20]). The exceptional feature of the Eastern partners and Russia is the increasing mortality trend that has persisted even during economic recovery (King et al., 2006). Some potential explanations of the increasing mortality rate are summarised below:

- diseases linked to unhealthy habits, such as excessively tiring working days or alcohol abuse and the related cardiovascular and respiratory problems, and the 'social diseases' of tuberculosis, HIV/AIDS and other infectious diseases, which are listed in the literature, together with violent death by accident, murder or even suicide (Brainerd, 2001; King et al., 2006; Libanova et al., 2008);
- deterioration in living conditions, which is a factor intimately linked with unhealthy lifestyle elements; in particular, existing poverty is seen as a catalyst for a number of diseases and health problems;
- the collapse of the healthcare system;
- psychosocial stress as a result of widespread and deep change, such as the mass privatisation linked to neoliberal transition (King et al., 2006), economic decline (Brainerd, 2001) or even the 'humiliating [Cold War] defeat with all the consequences of a "post-war" situation, including inflation, anomie and social polarization' (Field, 1995);
- local conflicts and/or political instability – such as the Nagorno-Karabakh conflict between Armenia and Azerbaijan; Moldova and its secessionist Transnistria region; the Abkhazian and South Ossetia conflicts in Georgia and the Russian invasion in 2008 – have a direct or indirect effect on mortality; for instance, the Nagorno-Karabakh military conflict is estimated to have directly resulted in a total of 18 500 deaths, plus more than one million displaced persons (International Crisis Group, 2005), while at a secondary level, the ensuing political and economic instability has led to deterioration in living conditions with forced internal migration, an insecure environment, a lack of economic synergies and reduced income, among other elements; finally, and very importantly, military expenditure in the region is growing[21], sapping funds that could have been used to improve the healthcare and education systems;
- the long-term effects of the Chernobyl disaster in Ukraine and Belarus and the consequent impact on labour market performance; recent evidence has shown that 'the Chernobyl accident carries a long-lasting legacy for many residents of the Ukraine, notably because of its effect on the perception of their health' (Lehmann and Wadsworth, 2009, p. 16);
- ageing population: logically, populations with negative population growth (including all the Eastern partners except Azerbaijan and Armenia) are becoming older and more likely to have higher natural death rates: this explains the relatively low death rates in Armenia and Azerbaijan (two countries with relatively young populations).

The notion of the collapse of the healthcare system also deserves some comment. Eberstadt (1981) and Field (1995) argue that the Soviet healthcare system did not experience a sudden collapse, but that despite the achievements of the past, the Soviet healthcare system had been in a long period of crisis since the late 1960s, partly as a result of the massive diversion of resources from civilian to military purposes. Analysis of trends in infant mortality and life expectancy supports this thesis (Table 3.2). Infant mortality, a proxy of the quality and extent of healthcare systems, is relatively high in the Eastern partner countries; this is especially the case in Azerbaijan, where it reached 34.4 per 1 000 live births in 2007, twice the rates of Russia and Belarus, and more than seven times the EU average. The decreased quality of healthcare systems is coupled with recent problems in the accessibility of medical care. Personal health costs have increased and informal methods of payment have become widespread. In Georgia, a survey showed that following a shift to a decentralised, market-driven healthcare system, 19% of households had to borrow money or sell personal property in order to access medical care, and 16% were unable to pay for the drugs prescribed (Xu et al., 2003).

Analysis of life expectancy at birth can provide more insight into the situation of the Eastern partners: life expectancy levels have not yet recovered to their 1985 levels in Azerbaijan, Belarus and Ukraine, despite improvements since the mid 1990s. In Armenia, Georgia and Moldova, life expectancy has steadily increased over the past two decades. In 2001, survey-based evidence for Armenia, Belarus, Georgia, Moldova, Ukraine and Russia (among other CIS countries) showed that the principle of universal access to care did not always apply. Significant numbers of respondents reported they were unable to access medical services, mainly because of a lack of money, except in Belarus and Russia. Payments, in the form of money, gifts or both, were particularly common in countries such as Georgia and Armenia (Balabanova et al., 2004).

It is also important to stress the gender gap in life expectancy and adult mortality (**TABLE 3.3**). Female life expectancy is a decade longer than that for males in countries such as Belarus, Ukraine or Russia, and male adult mortality is more than twice the female rate. These differences between male and female figures are often attributed to the fact that men are traditionally involved in more dangerous and physically demanding work (heavy industry and mining), combined with night-shift working, while women tend to work in social services or light industry. This pattern is compounded by health problems and the unhealthy habits of men, particularly alcohol abuse and its consequences (Dragazde, 1994). A study based on adult survey data in Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia and Ukraine in 2001 showed that around 23% of men and 2% of women were defined as heavy episodic drinkers (Pomerleau et al., 2008).

20 Available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database

21 The Georgian military budget rose from USD 60 million to USD 769 million between 2004 and 2008. In Azerbaijan, military investment increased from USD 81 million to USD 376 million in the same period. See Mkrtchyan (2009, p. 33).

TABLE 3.3 GENDER GAP IN LIFE EXPECTANCY AT BIRTH AND ADULT MORTALITY, 2007

Country	Life expectancy at birth (years)		Adult mortality rate (‰)	
	Males	Females	Males	Females
Armenia	70.1	76.7	168.6	81.1
Azerbaijan	67.6	72.3	185	112.1
Belarus	64.5	76.2	330.1	115.2
Georgia	68.1	75	199.8	78.9
Moldova	64.5	72.1	287	129.3
Ukraine	62.5	74.2	384.6*	142.5*
Russia	61.4	73.9	429.4*	158.2*
Turkey	69.4	74.2	153.1	86
Bulgaria	69.5	76.7	213	90.6
Poland	71	79.8	209.1*	79.7
Romania	69.7	76.9	200.5	85
EU-27	75.8*	82.1*	NA	NA

Source: WB, WDI; Eurostat for EU average.
*Note: *2006 data.*

The current financial and economic crisis will not have a positive effect on healthcare systems. Fewer resources will be available, while the expected increases in poverty will create more need and greater costs. Analysis of the main causes of illness and disease shows that preventive measures to modify negative habits could be more cost-effective in countering increasing mortality in the short term and could, by extension, help meet the demographic challenge that is common to all the Eastern partners except Azerbaijan.

National and international institutions (UN, 2009) have produced detailed population projections showing that the consequences of the demographic challenge will become even more evident in the future, and that policies must be implemented now in order to reduce the impact. Appendix 3.3 at the end of this chapter presents population projections for selected age groups to 2050: 0–14 (under the legal working age); 15–24 (student age); 25–54 (main working age group); 55–64 (close to retirement or already in the 'young pensioner' bracket); and 65 years and over ('pensioner', according to ILO standards). It shows that the youngest age groups represent a smaller proportion of the total population, while the oldest ones will increase their share in all six Eastern partner countries including Azerbaijan. In 2050, retired people aged 65 and over will make up around one-quarter of the population in Georgia, Moldova, Ukraine and Belarus, while more than 40% of the population will be aged 55 or over (46% in Moldova). Around 62% of the population in the Eastern partner countries will be of working age (15–64).

3.1.2 POPULATION MOVEMENTS AND MIGRATION

The prosperous regions and cities of the Eastern partner countries are expected to become attractive destinations for people from rural areas, as has been the case in other parts of the world, especially where the distribution and quality of transport, education and healthcare infrastructure is unbalanced. Surprisingly, internal migration within the six countries is not high. The ratio of rural to urban population changed little between 1985 and 2008, except in Belarus, where the rural population reduced by 30.6%. Indeed, in 2008 the rural population was still substantial in Armenia (36%), Azerbaijan (48%), Georgia (47%) and Moldova (58%), with even a slight increase on the figure for 1985 (**TABLE 3.4**).

This unexpected trend can be explained by two of the effects of economic transition. Firstly, a high number of low-productivity industrial jobs were lost in industrial centres, leading to the depopulation of those areas. Secondly, many people were allocated small plots of land following the privatisation of state land, and many urban employees who lost their jobs moved to work in subsistence agriculture as self-employed farmers (Chapter 2). Moreover, a certain level of resources is required even for internal migration. High urban living costs, especially for accommodation, may hamper internal mobility for rural inhabitants who are on a low income. There is a certain degree of seasonal internal migration, but this is not reflected in the statistics (ETF Country Reports).

TABLE 3.4 TRENDS IN THE PROPORTION OF RURAL POPULATION, 1985–2008 (%)

Country	1985	1990	1995	2000	2005	2008
Armenia	32.9	32.5	33.7	34.9	35.9	36.1
Azerbaijan	46.5	46.3	47.8	48.8	48.5	48.1
Belarus	38.2	34.0	32.1	30.1	27.8	26.5
Georgia	46.1	44.9	46.1	47.3	47.5	47.3
Moldova	55.8	53.2	53.7	55.4	57.4	58.2
Ukraine	35.3	33.2	33.0	32.9	32.2	32
Russia	28.0	26.6	26.6	26.6	27.1	27.2
Turkey	47.6	40.8	37.9	35.3	32.7	31.3
Bulgaria	35.4	33.6	32.2	31.1	29.8	28.9
Poland	40.1	38.7	38.5	38.3	38.5	38.7
Romania	50.4	46.8	46.0	46.5	46.3	45.8

Source: WB WDI.

The topic of international migration is discussed extensively in Chapter 6. However, it must be mentioned here as one of the factors that has negatively affect population growth in the Eastern partner countries. Indeed, the tendency to lose population (generally young and working-age individuals) is common to all countries of the region, despite the fact that migration statistics need careful consideration in view of the issues of reliability and comparability explained in Chapter 6. **TABLE 3.5** shows that 'net migration'[22] during the reference period is particularly significant for countries such as Armenia, Georgia and Moldova, given the fact that the total population of each of these countries is below 5 million. Statistics from national sources and the World Bank indicate that only Ukraine has been a net receiving country since 2005 (encouraged by repatriation processes,

TABLE 3.5 NET MIGRATION ('000)

Country	2000	2005
Armenia	-225.0	-100.0
Azerbaijan	-127.5	-100.0
Belarus	0	20.0
Georgia	-390.0	-309.0
Moldova	-252.0	-220.0
Ukraine	-547.0	-172.8
Russia	2 208.2	964.0
Turkey	14.4	-70.8
Bulgaria	-103.6	-41.3
Poland	-300.0	-200.0
Romania	-350.0	-270.0

Source: WB WDI, based on UN Population Division, World Population Prospects.

22 Net migration is defined as the net total of migrants during the period, that is, the total number of immigrants less the annual number of emigrants, including both citizens and non-citizens. The data are five-year estimates.

increasing economic activity and rising living standards), although many young Ukrainians still continue to seek better opportunities abroad. Net receiver status was also reported recently by national sources in Armenia and Azerbaijan[23], even though nationals continue to leave these countries.

Labour emigration leads directly to a more acute demographic imbalance and a reduction in the number of young potentially active people. However, the consequences are not as negative as they would initially appear to be, because of the reduced pressure on labour markets offering limited and low-paid jobs (Chapter 6). The region is also characterised by various latent conflicts that periodically explode into active aggression. This type of instability provokes involuntary population movements that can create internally displaced persons, refugees or asylum seekers[24]. These displaced people swell the numbers of the 'traditional' internal labour migrants.

3.1.3 EFFECTS OF THE DEMOGRAPHIC CHALLENGE

The first consequence of the combination of low fertility, increasing mortality and emigration is that most of the Eastern partners are experiencing a process of depopulation. Table 3.1 shows that between 1990 and 2008: Georgia lost more than one million inhabitants (21.1% of its population); Moldova lost around 700 000 (or 16.7% of its 1990 population); Armenia almost half a million (13.2%); Ukraine more than five million (10.9%); and Belarus around half a million (5.0%). Only Azerbaijan escaped the severe depopulation pattern, with a population increase of 21.2%. This tendency towards depopulation is also prevalent in Bulgaria and, to a lesser extent, Romania. Despite its low fertility rate (1.41 children per woman in 2007, according to the World Bank's WDI), Russia has lost only 4.3% of its population since 1990, probably because natural population losses have been offset by net migration inflow.

The second obvious consequence is an ageing population profile. In fact, ageing rates among the Eastern partners are lower than or close to the EU average (**TABLE 3.6**). However, there are two distinct dimensions to the data for the region: while in Belarus, Georgia and especially Ukraine the proportions of the population who are aged 60+ are close to those of EU new members, the percentages in Armenia, Azerbaijan and Moldova are far lower than the EU average. These figures illustrate the fact that these countries have younger populations – indeed, the figures for Azerbaijan are even lower than those for Turkey.

TABLE 3.6 POPULATION AGED 60+ AND 50–59, 2007 (%)

Country	60 years and over (%)	50–59 years (%)
Armenia	13.1	10.8
Azerbaijan	8.8	8.7
Belarus	18.1	13.2
Georgia	17.8	11.7
Moldova	13.2	12.1
Ukraine	20.3	13.7
Russia	17.2	14.3
Turkey	9.5	NA
Bulgaria	23.3	NA
Poland	17.6	NA
Romania	19.4	NA
EU-27	22.1	NA

Source: National statistics offices and Eurostat (for Turkey, Bulgaria, Poland, Romania, and EU-27 average).

23 In Azerbaijan in 2007, according to the Ministry of Labour. This was the case in Armenia in 2005 and 2006, according to the National Statistical Service, External Departure and Arrival Statistics.

24 According to IOM (2008a), in 2006 Armenia accounted for 113 000 refugees, while Azerbaijan had more than 2 000, and Ukraine and Georgia 2 275 and 1 373 respectively. These data do not take into account internal migration due to the conflicts, which represented more than 1 000 000 displaced during the Nagorno-Karabakh military confrontation. During the 2008 summer conflict between Georgian, Russian and South Ossetian forces, at least 192 000 people were uprooted from their homes (UN News Centre, 2009).

However, this favourable comparison with EU figures does not mean that the ageing population profile presents less of a challenge for the region. Firstly, EU figures are not necessarily a good benchmark to use, and this particular issue has been recognised as a crucial challenge in various EU documents (European Commission, 2006a). Moreover, early retirement ages in the Eastern partner countries (62 years for men and 57 for women in Azerbaijan[25] and Moldova; 60 for men and 55 for women in Belarus and Ukraine) complicate the picture, as they are all below EU levels for 2007 (European Commission, 2010b)[26]. In Armenia the retirement age has been increased to 63 (men) and 60.5 years (women) and the intention is for both groups to work to 63 by 2011; Georgia has the highest retirement ages in the region at 65 years for men and 60 for women. There is currently a heated discussion about increasing retirement ages in the Eastern partner countries. For instance, in Ukraine it is proposed to gradually increase the retirement age for women to 60. However, in most of these countries, general and profession-specific regulations mean that many people can retire earlier (Chawla et al., 2007). While there is some evidence of certain groups working after they officially retire (Chapter 4), early retirement adds to the impact of ageing on the labour market and pension systems, as there are fewer active people and more pensioners.

Forecasts indicate that the situation will worsen in the future. For instance, in Georgia (Tsuladze et al., 2003) and Ukraine[27] one-third of the population will be aged 60 or over by 2050, while the figure will be 36.6%[28] for Moldova and 27.7%[29] for Armenia. Although exact forecasts differ according to the source and methodology (UN, 2009), the ageing population phenomenon is likely to increase over time in all countries. Indeed, some projections for Azerbaijan, the only country of the region with continued natural demographic growth, indicate that it too will experience the problems of an ageing population in the coming decades (Mamedova, 2004).

A third consequence of the demographic challenge is the slight feminisation of societies in the region as a result of higher male mortality and migration rates. This also implies the feminisation of the working-age population, which UN projections show will continue into the future. The exception again is Azerbaijan, where the ratio between men and women will become almost balanced in 2015. The pace of feminisation is greater in Armenia, Belarus and Moldova, and all have rates approaching that of Ukraine, where females account for more than 53% of the working-age population. However, by 2015 the gender ratio will become more balanced in the younger age groups (15–34) in Armenia, Azerbaijan and Georgia. This feminisation phenomenon would have been problematic if female activity rates had been low, but women represent an increasing proportion of the labour force in all countries (Chapter 4).

Implications of the demographic challenge for the labour markets

It is a generally accepted tenet that population decline has negative effects on the labour market because it means there is a smaller labour force available (the 'reserve army' concept). This is true in full-employment economies where there is high economic growth, where a shortage of workers leads to higher salaries, even above productivity levels, and thus higher costs and a decrease in competitiveness. But these are not the conditions in the Eastern partner countries. Indeed, the demographic challenge does not always pose a problem for the labour markets in these countries. It can be argued that population decline may even produce an alleviating effect, reducing supply-side pressures on labour markets that are not efficient and dynamic enough to provide decent jobs for all active citizens, as demonstrated by the high levels of migration outflows and informality.

FIGURE 3.2 shows the evolution of the working-age population since 1990. The standardised 15–64 age group has been used as a reference, even though it does not always correspond to actual working ages because of the lower retirement ages in most Eastern partner countries. The proportion of the population represented by the working-age population has grown steadily in all Eastern partner countries except during the first years of transition. Although the increase was not strong (with a maximum of 12.4% in Moldova), the upward trend is sufficient to disprove the hypothesis that demographic decline had an alleviating effect on the labour market to 2008. This apparent paradox (increasing working-age population coupled with declining demography) can be easily explained by the fact that the group of people born during the baby boom of the 1970s and 1980s entered the 15–64 age group during this period.

However, this trend is not set to continue into the future. **FIGURE 3.3** shows a completely opposite trend in the proportion of the population accounted for by the 0–14 age group, with this section of the population declining by around one-third in all countries between 1990 and 2008. Hence, the demographic alleviating effect on the labour market could perhaps have a temporary effect on the situation in the future.

25 In Azerbaijan the parliament is considering amending the Law on Pensions in order to increase the retirement age to 63 for men and 60 for women in 2016.

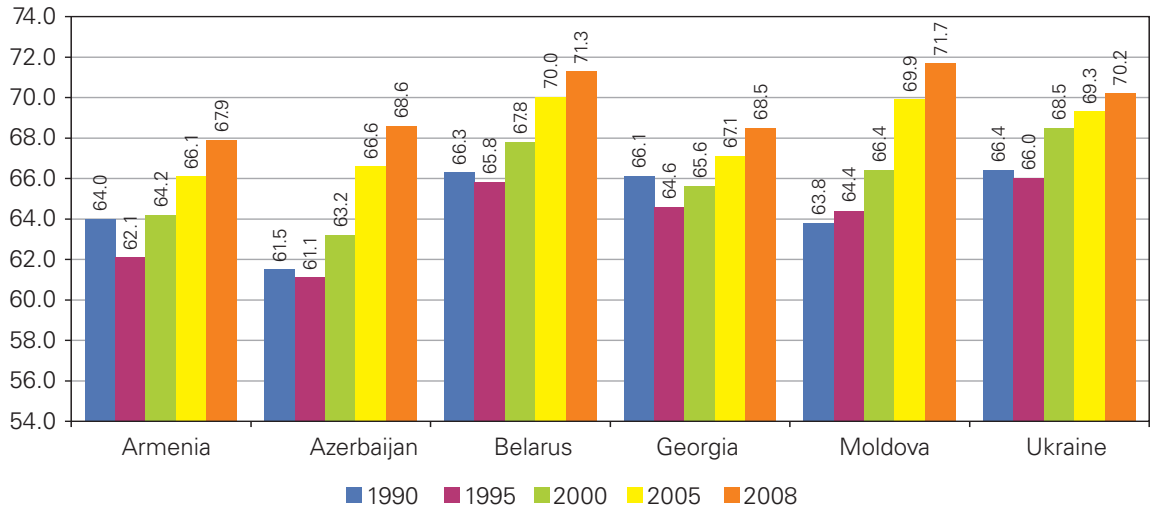
26 In 2007 EU levels were below 65 years in most countries (67 in Denmark). During the current period of economic crisis, several EU countries have discussed the need to increase retirement ages or have even implemented such changes: in Germany, the retirement age will gradually increase to 67 between 2012 and 2025, while in the UK it will increase to 68 years. See also the European Commission Green Paper *Towards adequate, sustainable and safe European pension systems* SEC 210/830.

27 Projections of the Institute of Demography and Social Studies of the National Academy of Sciences of Ukraine (www.idss.org.ua).

28 World Bank Population Projections.

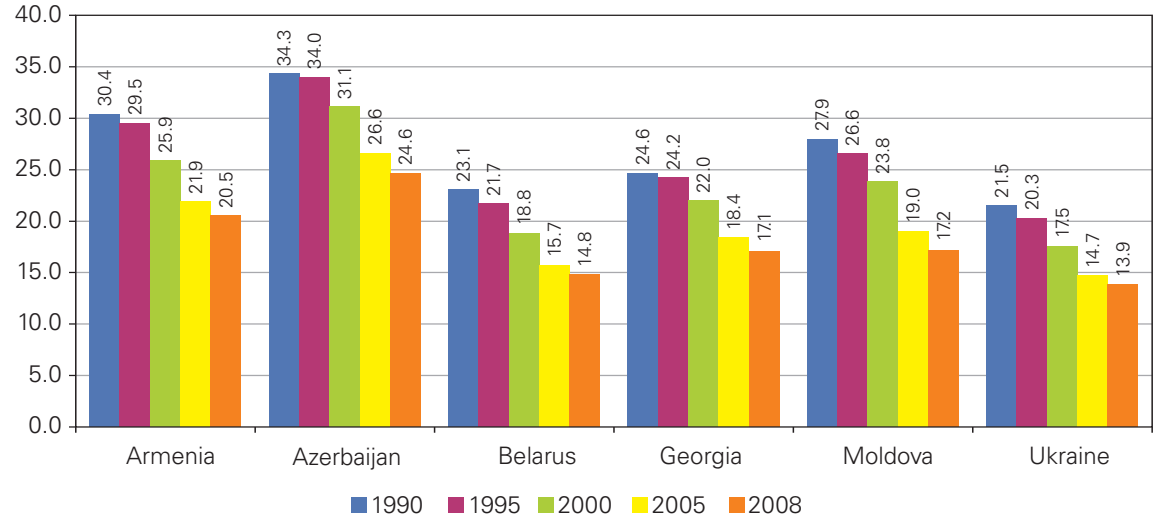
29 Extended version of the Sustainable Development Programme Population Projections Scenario, see ETF (2010a).

FIGURE 3.2 EVOLUTION OF WORKING-AGE POPULATION (15–64), 1990–2008 (% POPULATION)



Source: WB WDI.

FIGURE 3.3 EVOLUTION OF THE 0–14 AGE GROUP, 1990–2008 (% POPULATION)



Source: WB WDI.

Depopulation could also be a real issue in the long term, especially for countries that are losing high proportions of their inhabitants. These countries may have insufficient numbers of workers in the labour force to maintain growth, and may need to 'import' workers, as less than two-thirds of their populations will be of working age (15–64) by 2050. Given that school-life duration is increasing (see Appendix 3.4 at the end of this chapter), with increased participation in tertiary education, a more realistic view of the working-age population would take in a smaller section of the population, aged 24–64; such a group would represent only 50–55% of the total population in the Eastern partner countries.

The impact of a declining population on the labour market depends on a combination of factors. First, its effect is linked to the capacity of each country to create economic growth and therefore jobs. Elements such as the quality of the workforce, migration policies and changes in activity rates also play key roles. In some of the Eastern partner countries, employers complain about the difficulties they encounter in filling vacancies. Skills shortages are combined with high youth unemployment rates, low employment rates, informality and emigration (Chapters 4, 6 and 7).

Under these conditions, the relevance of the demographic challenge becomes secondary to the

difficulties facing the education and training system in providing the labour force with the skills required by the market. Skills shortages represent a challenge for economic efficiency, competitiveness and growth, and thus for job creation and improved activity rates. Such complexities currently render the future effects of demographic decline on the labour market unpredictable, although some potential scenarios can be drawn up on the basis of several factors, as discussed below.

Implications of ageing populations for the education, healthcare and pension systems

Another critical effect of the demographic challenge concerns the sustainability of healthcare, pension and education systems. When considering this element, the first assessment indicator used is the dependency ratio[30], a figure that reflects the contribution of age structure to variations in economic dependency. This measures age composition rather than economic dependency (Hobbs, 2004), calculating the ratio of the theoretically inactive population to the potentially active population on the basis of age. This indicator again underestimates the 'real' dependency ratio of the Eastern partners where statutory retirement ages are below 65. Despite this important caveat, **TABLE 3.7** shows that the figures for the Eastern partners are similar to those for some new EU member states. The situation is more complex in Georgia, which has a dependency ratio similar to the EU average.

On the basis of these figures alone, the EU and Eastern partners appear to be confronted by similar age-related challenges. However, each nation faces different preconditions, and each is armed with different tools for dealing with demographic change. The effects of an ageing population are generally analysed from three founding assumptions:

i) an ageing population increases expenditure in the healthcare system;
ii) an ageing population increases costs in the pension system;
iii) an ageing population decreases educational expenditure.

However, in-depth analysis of the labour market is required to establish whether or not these assumptions are true. In the simple model proposed here, the labour market is viewed as the main source of public revenue (providing taxes to be redistributed to healthcare, pensions and education systems) and citizens (who may pay part or all of cost for education and healthcare services). This means that a country with high unemployment and low activity rates, and high informal employment would be able to access fewer resources for financing such policies, whereas a labour market with high formal employment rates would have greater revenue for funding education, healthcare and pensions[31]. A brief impact analysis of an ageing population is given for each assumption.

TABLE 3.7 DEPENDENCY RATIOS, 2007 (%)

Country	Dependency ratio, %
Armenia	43.9
Azerbaijan	43.2
Belarus	41.0
Georgia	47.8
Moldova	39.2*
Ukraine	43.5
Russia	39.7
Turkey	59.6
Bulgaria	44.3
Poland	41.3
Romania	43.4
EU-27	48.6

Source: National statistics offices; Eurostat (for Turkey, Bulgaria, Poland, Romania, and EU-27 average); ILO (for Belarus).
*Note: *Data for 2006.*

30 Population aged 0–14 and 65+, divided by population aged 15–64. In other words, the (theoretically) inactive population, divided by the potentially active population on the basis of age.

31 Of course, the reality is more complex. An oil-producing country such as Azerbaijan can accumulate enormous resources from a single source of income, but this sector may not necessarily employ a large proportion of the population. There are also critical cultural and ideological factors that affect the value placed on health, care of the elderly and education by governments and populations. The resources (public or private) allocated to such services depend enormously on dominant cultural values.

Assumption 1 – 'increased health expenditure': It is generally accepted that older people require more healthcare services and long-term care, and that they represent increasing costs to the healthcare system. In the Eastern partner countries, where there are high adult mortality rates as a result of unhealthy lifestyles, it is reasonable to expect that the elderly will have a worse health status, leading to a greater demand for expenditure. However, this hypothesis has been challenged by World Bank experts, who argue that 'ageing explains a minor part of increased health expenditure' (Chawla et al., 2007) and that public health expenditure is far more dependent on technological innovations, GDP per capita, quality of services and other socioeconomic factors. They conclude that any increase in healthcare costs will be mainly unrelated to ageing (Chawla et al., 2007).

Nonetheless, there is no doubt that long-term care of the elderly will represent higher costs for ageing countries. Even potential policies to encourage informal care models[32] (a cheaper option for the public budget) could have serious implications on productivity and the underutilisation of skills. In such models, highly experienced workers are obliged to leave their jobs and the labour market in order to care for parents or other relatives. As these workers are generally women, the process has deep gender implications, and such a change would lead to extensive skill losses for an efficient economy. It may be concluded from the above that this hypothesis holds, even if this is more the result of the impact of long-term care than the direct effects of ageing on the healthcare system.

Assumption 2 – 'increasing pension costs': The former USSR countries inherited public, almost universal 'pay-as-you-go' systems, in which current employees contributed to current pensions through their taxes and in which there were early retirement ages. Indeed, a significant percentage of the population were permitted to retire even before the legal retirement ages, because there were special regimes for certain groups of workers (miners and those in other heavy professions), and disability-based pensions were widespread. Most CEE and CIS countries and international organisations considered that pension system reform should have been implemented from the beginning of the transition period (Svejnar, 1996). Maintaining such systems through the demographic challenge has had negative effects on transition: pensions consumed resources that were needed to establish new political, social and economic infrastructures; the tax burden of public expenditure encouraged the informal labour sector; and macroeconomic stabilisation policies consisting of reduced public expenditure and public debt became inefficient (Fox, 1998).

The reforms (World Bank, 1994, cited by Fox, 1998) that were launched or promoted, particularly by the World Bank, consisted of:

i) an increased retirement age;
ii) reduced indexation provisions;
iii) lower average benefits;
iv) reserve funds allocated to individual accounts;
v) optional private pension systems[33].

Some CEE and CIS countries started to implement these 'multi-pillar' pension system reforms, but only Latvia actually introduced radical changes. In countries such as Georgia, meanwhile, there have been four main attempts at deep reform of the pension system, with no real implementation taking place. The most recent reform process was blocked by political fragmentation (confrontation between parliamentary support for the EU-backed reform approach and defence of World Bank principles by the government) combined with the effects of the conflict with Russia in August 2008 (Gugushvili, 2009). In Moldova, a 'third pillar' (individual voluntary savings invested in pension funds) was introduced in the social security system, but take-up was poor.

The example of Latvia has been cited often in the literature as a paradigm of successful pension system reform[34], but the initial optimism has been undermined by the current financial and economic crisis in the country, where public finances are close to collapse. This Baltic example shows that the much-promoted pension reforms and cutbacks are no guarantee against insolvency in the medium or long term where there is demographic decline (Chawla et al., 2007). An independent evaluation of World Bank pension policy reform stated that this contributed to pension sustainability in many CEE countries, but 'too often the Bank has not addressed sufficiently the primary goal of a pension system to reduce poverty and provide adequate retirement income […] it has also focused insufficient attention on the income of the aged' (Independent Evaluation Group, 2006, p. 55). Indeed, secondary objectives of the multi-pillar strategy, such as developing capital markets and savings, have remained unfulfilled, as the national economic and financial structures are weak. This is also the case in both Russia and Ukraine, where the OECD (2008, p. 112) states there is 'marginalisation of pensioners whose welfare depends on relatives capable of providing them with financial support'.

Assumption 3 – 'decreased educational expenditure': This considers that an ageing population implies a decline in the number of young people, which would lead to a reduction in participation in education and, consequently, to decreased education expenditure. In reality, this has not been the case in any of the six Eastern partner countries. Total enrolment (primary to tertiary) began to

32 See the recommendations presented by Chawla et al. (2007, pp. 33–4).

33 For a critique of these policy principles, see Barr (2001). The potential effect of increasing retirement ages in countries where male life expectancy does not reach 69 years must also be considered (Table 3.4).

34 See Fox (1998) or the 2003 EU assessment: 'Pension reform has succeeded in ensuring a sustainable pension system in Latvia, to a certain extent differentiated according to the amount of social insurance contributions paid by the individual, and in line with the available financial resources', available at: http://ec.europa.eu/employment_social/news/2003/jan/abstract_latvia_en.pdf. A concise and clear explanation of the system is available at: www.oecd.org/dataoecd/44/60/40212550.pdf, while a detailed analysis can be found in Vanovska (2006, pp. 143–265).

decrease only recently, since 2000 in Armenia, Belarus, Georgia and Ukraine, and since 1995 in Moldova. The demographic effect has been partly reduced by a slight increase in school-life expectancy, following a brief decline in the early 1990s. Nevertheless, the school-life expectancy levels of the 1980s have not been recovered in Azerbaijan, Georgia and Moldova (Appendix 3.4 at the end of this chapter).

Appendix 3.4 also shows that public expenditure on education has not been linked with trends in enrolment. In Armenia, Azerbaijan and Georgia, dramatic expenditure cuts occurred in the 1990s (as a percentage of GDP and also, in the case of the first two of these countries, in proportion to total public expenditure). Belarus is the only country of the six to show a constant increase in public expenditure on education as a percentage of GDP, but not in relation to total government expenditure. These data do not include private costs of education for students in private institutions or fee-paying students at public ones (Chapter 7). Chawla et al. (2007, p. 224) mention that the CIS countries (including the Eastern partners) inherited 'first-world education systems and third-world levels of income and budgetary support' from the USSR. Indeed, Soviet education systems were conceived for planned economies and needed radical reform for adaptation to the needs of market economies. Access to higher education was formerly restricted and controlled, while transition allowed students to choose their own path; this was a change that resulted in increasing numbers of post-secondary students.

Thus, it seems unlikely that the ageing of populations will necessarily lead to lower spending on education. If we consider the examples of Poland, Romania or even Russia, higher levels of participation in tertiary education may also be expected in the Eastern partner countries, at least partially compensating for the demographic decline. Indeed, the quality of education appears to present a challenge in all countries, and more resources will be required to undertake the necessary reforms. The data presented in Appendix 3.4 are also useful for analysing possible effects of the current economic and financial crisis. In the 1990s, school-life expectancy declined following the collapse of the Soviet Union and the subsequent crisis, only to increase again with economic recovery. Something similar may be expected now and in the coming years.

3.2 LABOUR MARKET STATISTICAL RESOURCES

Most countries started to introduce a new statistical system alongside the transition to a market economy, institutional reforms, social and political changes and other new initiatives undertaken following the collapse of the USSR. This element of the reform process is less well known than other transitions (political, economic, labour market) but is no less important, in particular since it represents a basis for the sound and thorough analysis of labour markets. Analysis of the statistical sources (as part of the LMIS) will display the strengths and weaknesses of the systems for evidence-based policy development and provide opportunities for the improvement of labour-market-related statistics and their consequent analyses.

Policy makers and the international community that supported reform were aware that the statistical tools in place at the beginning of the transition in CEE countries were not adequate for monitoring the policies being implemented nor for guaranteeing follow-up (Zecchini, 1997). The problem of statistics in transition countries is two-pronged: technical shortcomings exist, and statistical classifications are in need of updating to fit the new realities. The former system in this region was designed to collect information on centralised, public and planned economies characterised by the extensive use of registers and accountability, meaning that a radical new statistical culture was needed for market economies that were free of heavy state control.

- A whole new book-keeping system had to be implemented in the many private companies to replace the previous model, which was based on central plans managed by a few large public firms that meticulously collected the data under state control. Privatisation and the creation of new enterprises required far less detailed and more flexible book-keeping, particularly in SMEs. Thus, the system needed to allow for the aggregation of multiple data, and to allow for this data to be supplemented with estimates (Zecchini, 1997).
- The use of employment and unemployment registers in particular became redundant. The new flexibility in the labour market, and other economic areas no longer under strict state control, called for survey techniques that would provide estimates for essential indicators such as unemployment and activity rates.
- The former statistical system was organisation-based. Individuals were not taken into account, except as participants in productive activities, and this is still the case in Belarus (ETF, 2010c).
- Change was also needed in the use of statistics by authorities. This needed to be oriented towards the market economy, providing a tool to analyse and understand new situations in order to design, implement, monitor and evaluate policies, rather than simply to plan and control. This shift required new skills for administrators and policy makers.

The Eastern partners have not remained immune to these trends. Indeed, they represent excellent examples of different 'statistical transitions'. In Moldova and Ukraine, data collection is broadly comparable with EU standards, while in Belarus the statistical system has remained practically unchanged since the fall of the USSR. Between these extremes lie Azerbaijan, where reforms are ongoing, and Armenia, where the comparability of data over time continues to raise problems. Georgia has not yet reached the level of development of Moldova or Ukraine, but it is another example of positive development with the publication of comprehensive statistics. The speed and depth of reform in the national statistical systems is not necessarily linked with the speed and depth of economic reforms. In Ukraine, for instance,

economic transition has been a slow process, yet a complete statistical system that is adapted to the new economic requirements has been implemented.

The statistics used for this publication are based on a combination of national and international sources. The ETF developed a template and a guide to help local experts compile the main indicators for demography, economic trends, labour market and human capital, including use of a time series. These form the main national sources, in combination with the qualitative information provided in the ETF Country Reports. The following international sources and databases were used to provide additional data:

- the United Nations Population Division (UNPD), the most comprehensive source of information on world populations and population movements for the period 1960–2005[35];
- ILO Laborsta[36], which provides detailed hard data on the labour market;
- UNESCO Institute for Statistics (UIS)[37] for literacy and education statistics;
- the EBRD[38] on macroeconomic indicators, covering aspects such as output, finances, prices and wages, trade, privatisation;
- UNDP HDI[39], a composite indicator based on measures of achievements in life expectancy, adult literacy, enrolment rates and GDP per capita (PPP);
- Eurostat[40], which is mainly used for comparison and benchmarking with the EU;
- World Bank databases (WDI and migration)[41], compiling a wide range of statistics (economic, financial, labour market, education, migration);
- migration profiles prepared by the International Organization for Migration (IOM)[42].

These sources, together with others that are quoted occasionally in this report (IMF, UNCTAD), represent a core of hard data that is generally harmonised with composite indicators included. Other data that are used, such as the World Bank's Doing Business[43] or the WEF Global Competitiveness Index (GCI)[44], are based on surveys that measure perceptions of the business sector. These sources are therefore more subjective, as the interviewees are not necessarily experts on the topics they are discussing. The Bertelsmann Foundation Transformation Index (BTI)[45] is based on expert assessment, while other indices, such as the Economic Freedom Network EFI and the Heritage Foundation IEF, are built by combining data from several sources, including the above-mentioned perception surveys.

Statistics are an essential tool in the creation of evidence-based policies. This is particularly true in times of crisis or reform, when policies need to be monitored and sometimes reoriented. They are also crucial for national and international investors, who need to make their decisions on the basis of the most recent, complete, transparent and accurate information possible. Good statistics are of fundamental importance in pluralistic cultures, providing as they do a catalyst for public debate and public participation. It is precisely for this reason that governments sometimes attempt to hide or even manipulate statistics in order to avoid open discussion and criticism. Finally, reliable and transparent statistics facilitate and encourage good quality social and economic research. Access to statistics allows for the type of independent analysis that is important for the promotion of reform, public debate and the development of new policy. The following are the key statistical resources for an LMIS in any country.

- **Population censuses** provide the main source of information on demography and population issues, and the basic information for survey samples that are relevant to labour market analysis, such as LFSs and household surveys.
- **Labour force surveys (LFSs)** provide the main source of information on the labour market. They provide more detailed and reliable information on activity, employment and unemployment than administrative records. They sometimes include modules on specific job-related topics, such as school-to-work transition and migration.
- **Household budget surveys (HBSs)** complement the LFSs. They are generally based on similar or even the same methodologies. Their comparability to LFSs increases the added value of both surveys, providing more complete information. LFSs tend to focus on the labour market, while HBSs provide more information on family budget and household living conditions. HBSs are also known as household expenditure or household consumption surveys.
- **Establishment surveys** cover companies rather than individuals, but they also collect information on employees (number, salaries, working status, training provided). These surveys are generally compulsory exercises for all or most enterprises, effectively forming a census of companies.
- **(Reliable) administrative sources** are accurate registers of the number of employed and unemployed individuals, and are generally compiled by the PES. They are useful because their data are close to the real figures and they provide the

35 www.un.org/esa/population/unpop.htm

36 http://laborsta.ilo.org

37 www.uis.unesco.org

38 www.ebrd.com/country/sector/econo/stats/index.htm

39 http://hdr.undp.org/en/statistics/

40 http://epp.eurostat.ec.europa.eu

41 http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20535285~menuPK:1192694~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html; and Migration and Remittances Factbook 2008: www.worldbank.org/prospects/migrationandremittances

42 http://publications.iom.int/bookstore/index.php?main_page=index&cPath=41_42&sort=20a&page=1

43 www.doingbusiness.org/

44 www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm

45 www.bertelsmann-transformation-index.de/en/bti/

opportunity to cross-check with statistics coming from other reliable sources such as LFSs. Even when data from registers are not completely in line with other sources, they can operate as a form of early warning system to monitor current trends in the labour market. This function is further augmented by the fact that administrative sources may include information on education, training and active labour market policies (ALMPs) from the relevant ministries.

- **National accounts** are necessary for studying macroeconomic trends, and provide basic complementary information for analysis of the labour market.
- **Other sources:** Ad hoc field surveys are conducted by both national institutions and international bodies, both public and private. These produce specific surveys on issues such as transition from school to work, gender, informal jobs and migration, and are accompanied by periodic publications on such areas as the economic environment (Doing Business, Business Environment and BEEPS), governance (EBRD), competitiveness (WEF and International Institute for Management Development (IMD)) and perceived corruption, on the basis of perception surveys or composite indicators that can provide greater understanding of the labour market context.

This section will analyse the main statistical resources that are available for the purposes of representing the labour markets in the Eastern partner countries. Comparability of data is a key issue in the cross-country character of this report: the discrepancies between data from various countries are highlighted, and must be borne in mind throughout this publication. The following parameters are considered in analysing the quality and pertinence of statistical sources relating to the labour markets:

i) existence or non-existence of each type of source in each country;
ii) periodicity: the period of time between one study and the next must be sufficient to show societal or economic changes and aid understanding of these;
iii) transparency of statistics: all data (including micro-datasets) and methodologies must be publicly accessible;
iv) comparability over time: methodologies and data must be consistent from one edition of the survey to the next;
v) international comparability: methodologies, definitions, and thus, results, must be comparable between one country and another;
vi) reliability: data (and their providers) must be credible and must represent a true picture of the reality.

3.2.1 STATISTICAL SOURCES

All of the Eastern partners except Belarus have transformed and developed complete statistical systems for analysing their labour market, in line with international standards and recommendations (ILO, IMF Special Data Dissemination Standards, EU, World Bank, OECD, United Nations Economic Commission for Europe), with the technical and financial support of international organisations or donors playing an important role in the process. For instance, a Sampling Unit was added to the Moldovan National Bureau of Statistics in 2003 with the help of the UK Department for International Development, which also provided training for bureau staff. In Armenia and Azerbaijan, the first country-wide Labour Force Units were designed and implemented in 1999 and 2003 respectively, with the financial and methodological assistance of UNDP and ILO. The EU Tacis programme provided funding for the 2004 and 2008 LFSs in Armenia. Transition countries find it difficult to make such initiatives sustainable. The cost of an LFS in the region is not enormous, but the challenge lies in creating and maintaining the necessary national infrastructure (ICT tools, skilled human resources) for the implementation of regular high-quality surveys and registers.

In other cases, international donors have directly funded and designed pilot studies in conjunction with local institutes or research companies. Some good examples of this include: the ETF's *Youth Transition from Education to Work Survey* in Ukraine in 2007 (ETF, 2008b) and its surveys on migration in Moldova (ETF, 2007b) and Ukraine (ETF, 2008a); IOM and IMF in Moldova (CBS-AXA, 2005); the Asian Development Bank (ADB) studies on remittances in Armenia and Azerbaijan[46], and those of the EBRD in Azerbaijan, Georgia and Moldova[47]; and the *Ukrainian Longitudinal Monitoring Survey* by the Kiev International Institute of Sociology on behalf of a consortium lead by the German Institute for the Study of Labour (IZA)[48].

National statistical systems have therefore evolved to different levels of development. Appendix 3.5 at the end of this chapter provides an overview of available statistical sources regarding the labour markets in each of the Eastern partner countries. These include population censuses, LFSs (citing coverage, periodicity, samples), HBS and/or living standards surveys, and others (establishment surveys or wage surveys). While the Ukrainian and Moldovan (de Vries, 2007) systems may be considered 'nearly fully compliant with EU requirements', despite some persistent problems, the statistical system in Belarus has remained practically unchanged since Soviet times, with only slight alterations to definitions and collaboration with the IMF. In between these two extremes lie Armenia, Azerbaijan and Georgia with their new statistical systems, but with a range of individual problems. An overall assessment of the labour-market-related statistical resources in Eastern partners identifies the following problems.

i) Data do not always cover the entire territory because of conflicts (Transnistria in Moldova, Abkhazia and Tskhinvali in Georgia, Nagorno-Karabakh in Azerbaijan) or ecological disasters (Chernobyl in

46 This was produced as part of the project *Remittances and Poverty in Central Asia and South Caucasus.*

47 www.ebrd.com/country/sector/etc/survey.htm

48 www.iza.org/en/webcontent/research/ra5?noAutoMenu=true&print=true

Ukraine, with environmental effects that extend beyond the borders).

ii) There is poor transparency of data in countries such as Azerbaijan, where LFS and HBS results are initially disseminated to a limited number of government agencies before being released to the general public one year later. There is only limited internet access to data in all of these countries, and paper publication predominates.

iii) Meta-data[49] is a neglected area, and it can be difficult to obtain accurate and detailed information and assessment of elements such as methodologies and definitions. This is a significant challenge for all users, from state agencies to independent researchers, as it provides opportunities for the misinterpretation or even manipulation of statistics. It prevents users from assessing the reliability and comparability of data, and generally blocks transparency. A good example of complete and detailed meta-data can be seen in the Eurostat meta-data server, RAMON[50]. Such a model could be used in the partner countries, even if this were in a less ambitious or well-developed form, to cover the current lack of a framework.

iv) There is a lack of collaboration, or poor cooperation, between statistical services and independent researchers. Access to raw datasets is generally restricted, blocking further analysis of data and the development of statistical research skills.

v) There are wide inconsistencies between labour statistics from registers and those from surveys; this is largely the result of the poor incentives for unemployed people to register and the expansion of the informal job sector. Other elements that feed inconsistency include weak collaboration between national employment services, ministries and statistical institutes (OECD, 2008), inconsistent definitions, and outdated infrastructures (ICT systems). Indeed, even within some countries, such as Moldova, the LFS, census and HBS use different definitions, building in inconsistencies and making it impossible to cross-check results.

vi) Representativeness at regional or sub-regional level is still in the process of improvement, as can be seen in the 2007 LFS in Armenia or the 2008 edition in Georgia.

vii) Population census intervals are too long. Censuses provide the basic information for designing the sample of surveys such as the LFS and HBS. Given the speed of demographic change, particularly in terms of migration outflows, estimates made on the basis of old population censuses may be highly inaccurate. This creates an implicit sampling error that is difficult to evaluate correctly and that is accentuated when a census is completed during a period of crisis or instability.

viii) Comparability of the LFS over time remains problematic, particularly in Armenia. Results vary hugely between one edition and the next, bringing the reliability of the studies into question. This is mainly the outcome of substantial methodological changes, including alterations to sample sizes, and the timing and duration of fieldwork.

ix) Insufficient resourcing is an underlying issue. Demands on statistical services are increasing, both from national and international institutions and from researchers. There is insufficient investment in ICT and human resources (training and attendance at international conferences) to meet the increasing demand. International donors and assistance continue to play an important role in some of the countries.

Belarus deserves special mention, as the transition model here is based on state control of the economy, with few real moves towards market principles. Given this situation, little has been done to reform the statistical system. No LFS has been implemented in Belarus, and labour market information is largely based on registers. This means that no reliable information is available on unregistered unemployment or links between the labour market, economy and education. Even the HBS (a long-standing tradition in former Soviet republics) is based on outdated concepts and provides limited access to data. The classifications used are not fully compliant with international standards. This leads to situations in which estimates still have to be used, despite the official adoption of certain benchmarks: for example, International Standard Classification of Occupations (ISCO)-88 is officially applicable in Belarus, but it does not correspond exactly to national practices.

However, since 2004 Belarus has collaborated with the IMF on the Special Data Dissemination Standards (IMF, 2005), and there is a trend towards introducing new classifications in accordance with European models. The *Belarus Standard Industrial Classification of all Economic Activities* is being adjusted to fit the categories of the *Standard Industrial Classification of All Economic Activities* (NACE-ISIC Rev.4)[51]. It is difficult to know how Belarus's statistical system will evolve in the future, as the current system is still based on the principles of the nation's post-Soviet ideology (Olenski and Tamashevich, 2007)[52].

3.2.2 COMPARABILITY OF STATISTICAL SYSTEMS: KEY ISSUES

This first overview is summarised in Appendix 3.5, but a complementary in-depth analysis of the comparability of LFSs in the Eastern partner countries will contribute greatly to the interpretation of the data. LFSs are the first and most important sources of labour market analyses in all countries, and five of the six Eastern partners (all except Belarus) conduct these surveys in a reasonably regular manner. However, before using these figures to make comparisons across the six countries, and

49 Meta-data explains how the statistics are collected, the methodologies and definitions used. This information is essential in order to understand and interpret the data, to assess representativity and comparability, and generally to determine how to use and manage the data.

50 http://ec.europa.eu/eurostat/ramon/

51 Decree No 1129 of 12 October 2005 and Decree No 65 of 28 December 2006.

52 The paper focuses more on the analysis of macro-economic indicators.

between the EU and the Eastern partners, it is necessary to take a closer look at the issues of comparability and the tenets of sound labour market analysis. Hence, the following section will assess existing LFSs in terms of the following criteria:

i) comparability of definitions (the problem of informal jobs);
ii) working-age criteria;
iii) other relevant issues (seasonality).

Comparability of LFS definitions: the problem of informal jobs

All of the statistical services in the Eastern partner countries state that they follow ILO definitions when calculating key labour market statistics. The basic reference is the *Resolution concerning statistics of the economically active population, employment, unemployment and underemployment,* adopted by the 15th International Conference of Labour Statisticians (ICLS) in January 1993[53] (for a comparison, see Appendix 3.6 on the detailed ILO definitions). These recommendations provide national statistical services with a degree of freedom in interpreting and adapting the system. For example, there is no concrete indication of parameters for definitions of terms such as 'usually active' or 'currently active'. Where 'employment' is defined more specifically, and the 'one hour' criterion is used, the country is free to choose between an hour in 'either one week or one day' as a measure of the brief 'reference period', and the ILO recognises that 'national definitions [of unemployment] used vary from one country to another as regards […] criteria for seeking work, treatment of persons temporarily laid off and of persons seeking work for the first time'[54].

Access to meta-data is problematic in the Eastern partner countries, and it is not easy to obtain concrete information on definitions, methodologies and their application.

This section provides a description of some of the similarities and differences between definitions, but the subject merits further exploration. However, reference periods in the Eastern partner countries are not at issue, since an employed person is defined as an individual who works 'one hour in one week' in almost all of the countries, and the period of job seeking used to define unemployment is a standard four weeks. Belarus is the exception, as 'the economically active population includes the employed and unemployed registered in the state employment services bodies' (ETF, 2010c), and no figures other than those registered are available.

In Moldova, definitions were changed in 2006 to take into account the 'seasonal work' that is common to all agrarian economies. Off-season employees with a seasonal job who know that they will start working in that job within the next six months, and who are being paid while they wait for the work season, are considered to be employed. Off-season seasonal workers who do not meet these conditions, and self-employed seasonal workers who have found work and are ready to start work, are considered to be unemployed.

The basic definitions used in the Eastern partner countries are generally comparable, except for those used in Belarus. However, the extent of the informal employment sector (see Chapter 4) presents a challenge for the statistical definitions. An international definition of 'informal employment' was included in the UN Statistics Division 1993 System of National Accounts, following the 15th ICLS. This initial definition was an attempt to measure the contribution of informal jobs to GDP, but was criticised for taking an 'enterprise-based' instead of a 'labour' approach (ILO, 2000). Thus, the 17th ICLS held in 2003 endorsed a more comprehensive definition, taking into account jobs in both formal and informal enterprises, as well as those carried out in households. These definitions, as reported by Hussmanns (2004, pp. 5–7) are set out in the box below.

53 www.ilo.org/public/english/bureau/stat/download/res/ecacpop.pdf

54 http://laborsta.ilo.org/applv8/data/c3e.html. 'The one hour criterion in the definition of employment is to cover all types of employment that may exist in a given country, including short-term work, casual labour, stand-by work and other types of irregular employment.' (Hussmanns et al., 1990)

Employment in the informal sector comprises all jobs in informal sector enterprises, or all persons who, during a given reference period, were employed in at least one informal sector enterprise, irrespective of their status in employment and whether it was their main or a secondary job (15th ICLS).

Informal employment comprises (17th ICLS):

- *Own-account workers and employers employed in their own informal sector enterprises*. The employment situation of own-account workers and employers can hardly be separated from the type of enterprise that they own. The informal nature of their jobs thus follows directly from the characteristics of the enterprise.
- *Contributing family workers*, irrespective of whether they work in formal or informal sector enterprises. The informal nature of their jobs is due to the fact that contributing family workers usually do not have explicit, written contracts of employment, and that usually their employment is not subject to labour legislation, social security regulations, collective agreements, etc.
- *Employees holding informal jobs*, whether employed by formal sector enterprises, informal sector enterprises, or as paid domestic workers by households. […] Employees are considered to have informal jobs if their employment relationship is, in law or in practice, not subject to national labour legislation, income taxation, social protection or entitlement to certain employment benefits (advance notice of dismissal, severance pay, paid annual or sick leave, etc.) for reasons such as: non-declaration of the jobs or the employees; casual jobs or jobs of a limited short duration; jobs with hours of work or wages below a specified threshold (e.g. for social security contributions); employment by unincorporated enterprises or by persons in households; jobs where the employee's place of work is outside the premises of the employer's enterprise (e.g. outworkers without employment contract); or jobs for which labour regulations are not applied, not enforced, or not complied with for any other reason.
- *Members of informal producers' cooperatives*. The informal nature of their jobs follows directly from the characteristics of the cooperative of which they are members.
- *Own-account workers engaged in the production of goods exclusively for own final use by their household* (such as subsistence farming or do-it-yourself construction of own dwellings), if considered employed according to the 13th ICLS definition of employment.

Georgia and Moldova were two of the countries that tested this framework before it was internationally accepted. The most relevant section of employment under this definition covers those jobs that are not subject to any national labour legislation or social protection. This extensive category covers multiple situations for which operational criteria must be defined by each country. The problem of measurement is generally twofold:

i) definitions must allow informal workers to be considered as 'employed';
ii) such informal workers must be distinguished from formal workers in order to evaluate the extent of informal employment in the economy.

Subsistence agriculture provides a good example of this element. People involved in agriculture for their own consumption are generally counted under identical definitions and criteria as workers in other (formal) economic activities, but this has not always been the case in all countries. Up until 2004 in Ukraine, individuals had to work a minimum of 30 hours a week in subsistence agriculture for profit or family gain before they were classed as being employed. According to ILO, paid and unpaid family workers in Georgia still have to work for at least 12 hours during any reference week before they are considered as employed, and those cultivating their own family plots for their own consumption are classified as inactive[55].

The practice of counting subsistence agriculture as an economic activity is sometimes criticised for artificially increasing the number of self-employed individuals and thus reducing unemployment rates. This is particularly the case in the Eastern partner countries, where a significant proportion of the population are engaged in a 'self-survival strategy'. Statistics from Azerbaijan, for example, show employment ratios comparable to or higher than the EU average[56], but formal employment represents around one-third of the total, and most informal activity is in agriculture. This definition, however, does not run contrary to ILO standards, and counting subsistence agriculture in other ways may introduce other forms of bias. This is particularly the case in relation to gender, since many unpaid family workers are women. All of the Eastern partners except Belarus, and Georgia to a lesser extent, have opted for similar statistical methods that make regional comparability possible, although the informal aspect of subsistence agriculture has a huge impact on the extent to which parallels can be drawn with other countries, as was explained above for Azerbaijan.

Measuring informal jobs as a proportion of the labour market raises a further set of questions, although the answers can generally be provided through a specific module or a set of questions in the LFS or the HBS, as has been seen in Moldova (ILO, 2005), Georgia and Ukraine (Hussmanns, 2003). The questions may cover:

55 See Georgia Survey Methodology at: www.ilo.org/dyn/lfsurvey/lfsurvey.list?p_lang=en&p_listall=Y

56 66.1% in Azerbaijan versus 65.4% in the EU in 2007. LFS, State Statistical Committee and Eurostat (www.ec.europa.eu/eurostat).

- type of employment contract or agreement (written or oral);
- employer's payment of social contributions for the employee;
- paid annual leave, sick leave and maternity leave;
- arbitrary dismissal without advance notice;
- employee's access to benefits and compensation specified in the labour legislation following dismissal.

Estimates differ according to the source used (LFS, HBS or others), the exact questions formulated and how the data are analysed depending on the criteria used. Attempts have been made to harmonise the collection of data on the informal sector, such as that driven by the ADB in Armenia. The ADB model follows a two-step strategy: the expanded LFS identifies Household Unincorporated Enterprises with some Market production (HUEMs), and these are then surveyed in the second phase[57]. As yet, this strategy has not been shared with the other countries.

Another issue concerns jobs that are in effect informal. Workers can theoretically be employed in formal conditions, but with rights (social protection or employment benefits) that cannot be claimed in practice. This is more common in times of economic crisis, when workers are obliged to accept work under any conditions. The definitions of the 17th ICLS cover such types of employment as much as they do the strictly formal ones (Hussmanns, 2004), but they can be notoriously difficult to measure and compare in practice. The statistical definitions of 'employed', 'unemployed' and 'inactive' are reasonably similar across the Eastern partner countries, but this harmonisation is lacking when it comes to estimating the number of informal jobs. The relatively high employment rates are therefore linked to the extremely high incidence of informal jobs and self-employment in agriculture, rather than to labour market efficiency. It can be argued that job creation is a positive process even if the openings are in the informal sector, but informality is in fact more often a synonym for low productivity and a lack of social protection and rights.

LFS and working-age criteria

Legal retirement ages in the Eastern partner countries vary from one country to another, and between genders. They are currently set as follows:

- Armenia: 63 for men and 60.5 for women;
- Azerbaijan: 62 for men and 57 for women;
- Belarus: 60 for men and 55 for women;
- Georgia: 65 for men and 60 for women;
- Moldova: 62 for men and 57 for women;
- Ukraine: 60 for men and 55 for women.

These retirement ages are lower than the ILO standard (65 years old). The impact of early retirement ages on the labour market and the healthcare, pension and education systems is discussed in the first part of this chapter, while the current section will concentrate on the impact of these varying standards on the cross-country comparability of labour market statistics. There is some evidence to show that a portion of the retirement-age population continue to work, but the large majority are expected to stop working (see Chapter 4).

The bias caused by the varying retirement ages must be taken into account when comparing relevant indicators such as activity, employment and unemployment rates. This is particularly the case in the detailed analysis of the older populations. Another age-related bias is implicit in the reference ages of LFS interviewees, for although they are generally fixed at the 15–70 or 15+ years, Armenia has chosen to set the lower limit at 16. Fortunately, this difference does not have a great impact, since it is only one year's difference in a single country.

Other relevant issues: seasonality and the limitations of administrative data sources

The seasonality of the LFS is an issue that has traditionally been raised for Armenia, as explained above. A bias is also introduced when comparing statistics between countries such as Armenia that conduct a 'one-shot' main survey (LFS or HBS) with those that collect quarterly data. In countries where seasonal jobs and seasonal migration are widespread, bias is introduced depending on the timing of the survey in the working year. Definitions also need to be updated, particularly in changing environments and in the evolving statistical systems of transition countries. Definitions must be adapted carefully to the new contexts and new needs in order to reduce bias. Some degree of bias may be unavoidable, but the impact on comparability over time can sometimes be significant. Each country, and Armenia in particular, must develop a long, complete and unbiased time series.

Administrative sources (i.e. registers) are not the most reliable sources for labour market analysis in the Eastern partner countries because of the low rate of registration among the jobless population. Unemployed individuals have little trust in the effectiveness of the PES. Moreover, there are few incentives to register, since registration can be costly in terms of the distances involved and the length of the formalities. The same lack of confidence is apparent among enterprises, with employers rarely relying on the employment services to fill their vacancies. Reliable statistics from registers could be useful in providing early warnings on labour market trends, but this does not currently happen. Such statistics can also serve as important indicators to measure the efficiency and effectiveness of the PES, and reliable statistics need to be developed from these registers.

3.3 CONCLUDING REMARKS

The first part of this chapter focused on the key demographic trends and challenges, while the second concentrated on the availability and comparability of labour market data. Demographic trends in the Eastern partner countries are characterised by negative natural population growth as a result of low birth rates, continuing high mortality rates, ageing populations and emigration.

57 For more details on the Armenia Informal Sector Survey see: www.adb.org/Statistics/reta-6430-Development.asp

Azerbaijan is the only obvious exception, with positive population growth, though on a declining trend. The demographic challenge here is different from that in the EU, since its causes are low birth rates coupled with increasing mortality and negative migration flows. Poverty, high-risk behaviours – particularly among adult males – and inadequate healthcare systems with increasing private costs (including 'under-the-table' payments) do not help to reduce mortality rates. Forecasts indicate a worsening situation over the coming decades, with potential impact of demographic decline on the fiscal sustainability of countries, and particularly on the funding of healthcare, education and pension systems.

Measures that would be most effective in addressing the demographic challenges include:

i) the promotion of healthier lifestyles in order to combat the high mortality rates that are partly the result of unhealthy habits (e.g. alcohol abuse, overwork), coupled with the introduction of campaigns against infectious diseases such as tuberculosis and HIV/AIDS;
ii) the reduction of poverty as a means to improve health and, consequently, demographic indicators;
iii) the provision of accessible and affordable healthcare for all;
iv) the provision of benefits for children through supportive social policies.

Meanwhile, it is recognised that there are difficulties in effectively introducing policies to increase birth rates, and benefits have been introduced in several EU countries and Ukraine without success. The Scandinavian countries provide a good model to be followed here, with family policies traditionally linked to supportive social policies, including greater equality in gender roles in terms of family and childcare responsibilities, accessible and affordable childcare and kindergartens, and the reconciliation of work and family life for both sexes.

Some authors and international institutions argue that the negative demographic effects of the former Soviet Union can be neutralised through increases in labour productivity (Chawla et al., 2007). There is certainly room for productivity to be enhanced in the Eastern partner countries, though the extensive influence of the informal sector in these labour markets must be addressed before any success is ultimately achieved. According to national statistical estimates, two-thirds of all jobs in Azerbaijan are in the informal sector, while in Moldova and Ukraine the rate stands at around one-third. Informal workers do not contribute to social security and education systems; this makes 'real' dependency rates (the number of beneficiaries as a percentage of the number of contributors) particularly high and reduces the amount of public resources available to finance healthcare, pensions, education and other public services. This lack of available funding makes it extremely difficult for these countries to fund the reforms and the changes in the infrastructure that are needed in order to improve the situation. Informality and the resulting low level of productivity is therefore one of the major issues facing the labour markets in the Eastern partner countries, even when the focus of the discussion is on demography and its consequences.

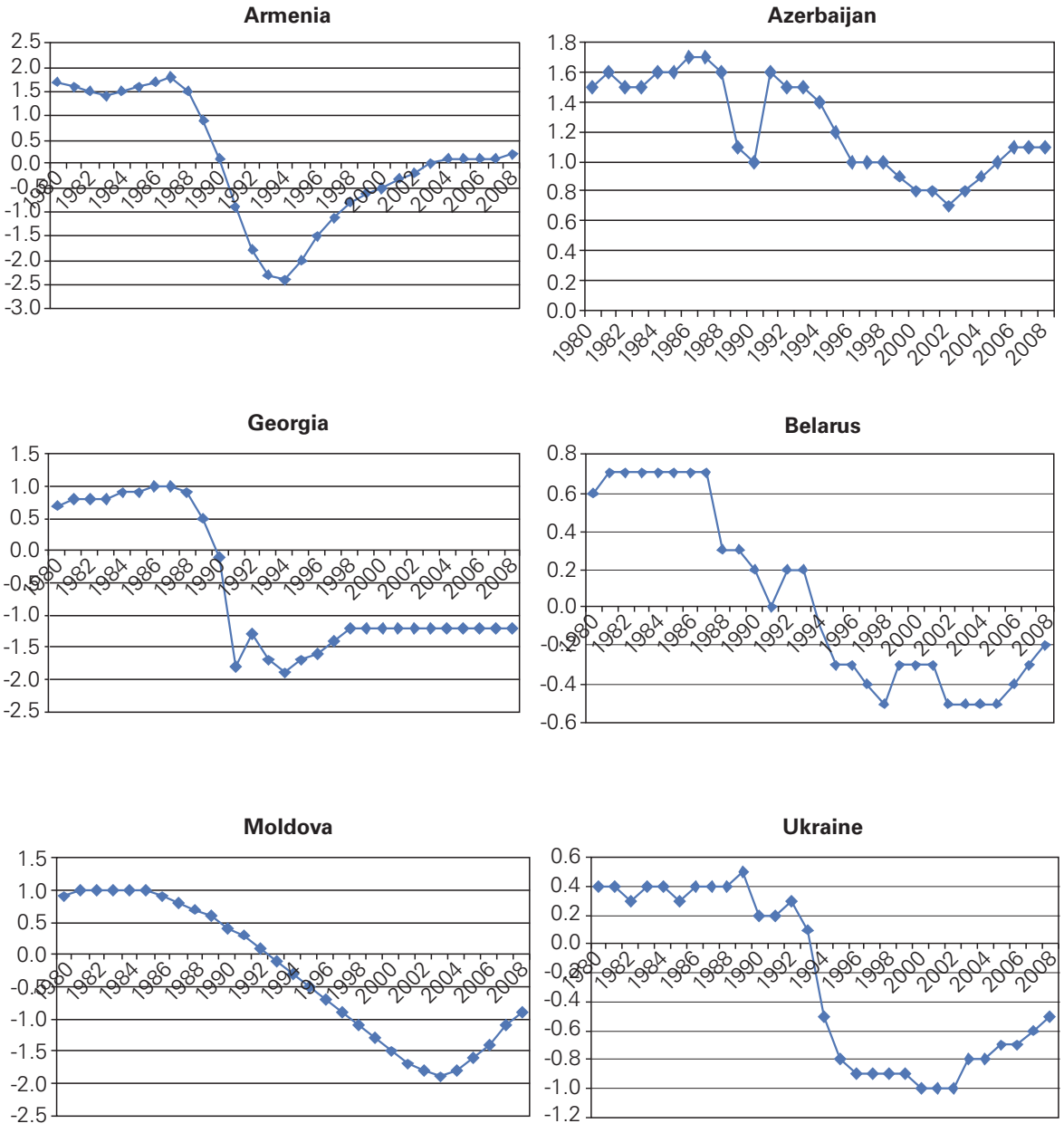
The second part of the chapter examined the transformation of statistical systems in the Eastern partner countries, where an almost complete set of labour-market-related data has been developed and is in some cases comparable with EU standards (Moldova, Ukraine). Belarus is the main exception, with no LFS yet established, in a country whose system and economy are based on almost Soviet-era principles. Armenia, Azerbaijan and Georgia fall between these two camps, with different degrees of improved statistical instruments, albeit with specific problems. In Azerbaijan and Armenia, for example, methodological problems persist, rendering the comparability of data across years problematic, even within each country, despite other positive developments. In these two countries, the LFS is only completed and disseminated on a yearly basis, while Georgia, Moldova and Ukraine conduct such surveys quarterly or even monthly.

International collaboration with institutions such as the EU, ILO, World Bank and IMF has led to the implementation of statistical systems that are adapted to the needs of the market economy. However, some problems remain, these generally relating to the lack of financial resources and skilled professionals. Technical decisions on sampling and methodology are sometimes made on the basis of the resources available rather than the optimal system, leading to second-best options being chosen. It must be stressed that labour statistics also suffer from the lack of a modern policy approach: the shift from planned, centralised economies to market principles implies the need for a new statistical culture among administrators and policy makers. The focus of data should no longer be on planning and control, but on the design, monitoring and evaluation of evidence-based policies. Such a change in perspective represents an enormous cultural change, requiring new administrative and decision-making skills, but also a great political move forward towards transparency and public debate.

Transparency and the timely dissemination of all results (including micro-datasets) is another area for potential improvement. Hard-copy publication remains the most widespread means of dissemination, while websites tend to present only a limited picture of survey outcomes. Access to datasets is generally highly restricted, reducing opportunities for developing independent research capacities and skills. Last but by no means least, meta-data is a seriously underdeveloped field. Hence, it can be very difficult to obtain accurate and up-to-date information on the details of methodologies and definitions, and thus to assess the weaknesses and limitations of the statistics in use. Another area that is ripe for improvement is the development of comparable methodologies and definitions for the informal economy (OECD, 2008). This issue is crucial for detailed analysis of the labour markets in the Eastern partner countries, in view of their extensive informal sectors.

This chapter concludes that there are still some serious issues outstanding, despite the many achievements of most of the Eastern partners in adapting their statistical systems to EU standards, in close collaboration with international institutions. Cultural exchange must be promoted between public authorities, administrators and stakeholders, who should be encouraged to understand the essential role of reliable and transparent statistics in the good management of public affairs and as catalyst for public debate and international credibility (in particular with regard to potential investors). Increased transparency in data and meta-data is not prohibitively expensive nowadays, given the ease of access to ICT; international institutions such as the EU could provide technical advice and examples of good practice, acting as a catalyst in improving labour-market-related statistics. Intra-regional coordination is needed in order to develop common approaches to data collection and analysis on the informal sector, while staff from national statistical services must be encouraged to attend international conferences and training to increase their skills and promote networking among regional experts dealing with similar problems.

APPENDIX 3.1 TRENDS IN POPULATION GROWTH IN THE SIX EASTERN PARTNERS, 1980–2008



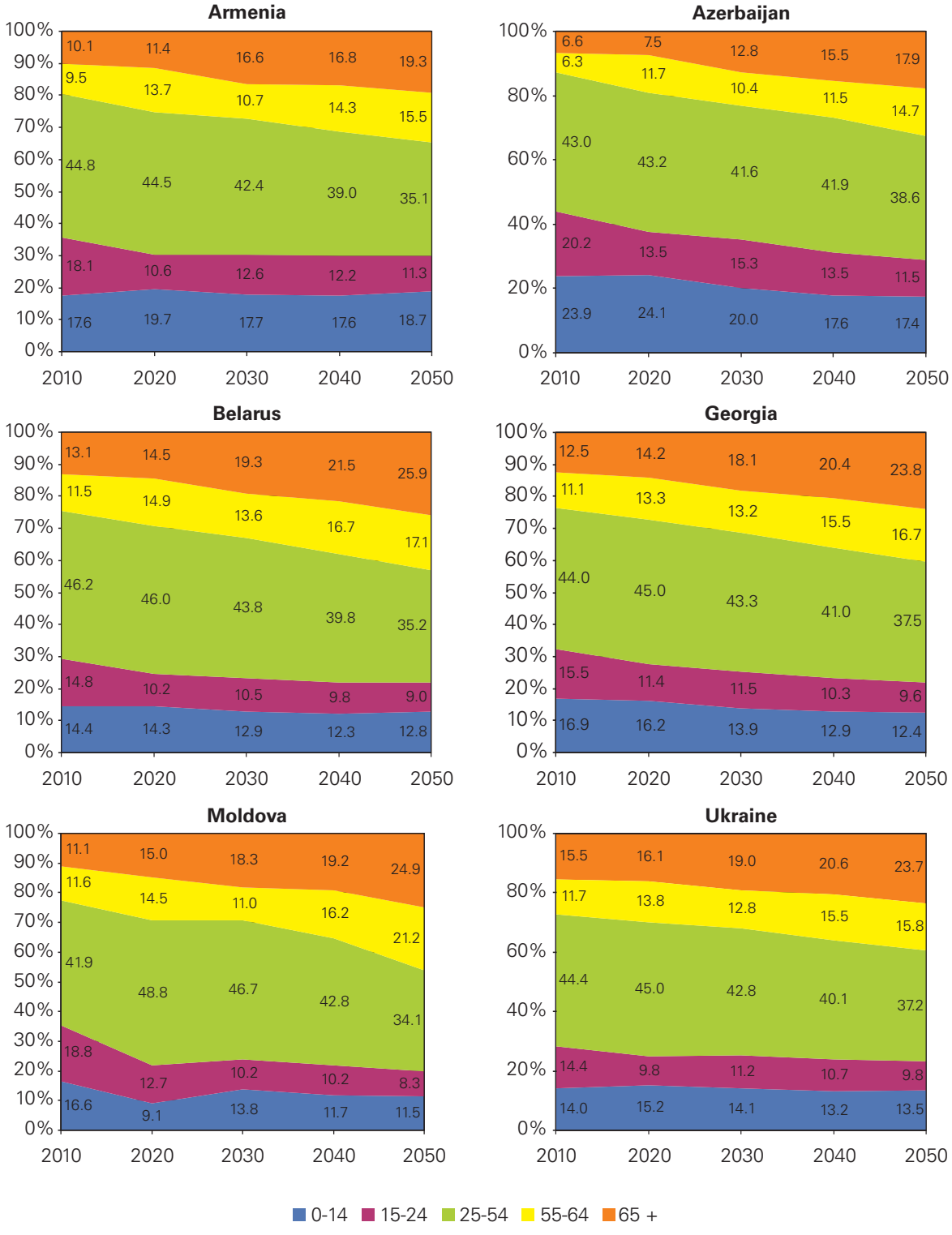
Source: WB WDI at: http://data.worldbank.org/data-catalog/world-development-indicators/.

APPENDIX 3.2 TRENDS IN ANNUAL POPULATION GROWTH IN THE SIX EASTERN PARTNERS AND NEIGHBOURING COUNTRIES, 1980–2008 (%)

Country	1980	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	1.7	1.6	1.7	1.0	1.5	0.9	0.1	-0.9	-1.8	-2.3	-2.4	-2.1	-1.6	-1.2	-0.8	-0.6	-0.5	-0.3	-0.2	0.0	0.1	0.1	0.1	0.1	0.2
Azerbaijan	1.5	1.6	1.6	1.7	1.6	1.1	1.0	1.6	1.5	1.5	1.4	1.2	1.0	1.0	1.0	0.9	0.8	0.8	0.7	0.8	0.9	1.0	1.1	1.1	1.1
Belarus	0.6	0.7	0.7	0.7	0.3	0.3	0.2	0.0	0.2	0.2	-0.1	-0.3	-0.3	-0.4	-0.5	-0.3	-0.3	-0.3	-0.5	-0.5	-0.5	-0.5	-0.4	-0.3	-0.2
Georgia	0.7	0.9	1.0	1.0	0.9	0.5	-0.1	0.8	-1.3	-1.7	-1.9	-1.7	-1.5	-1.4	-1.3	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
Moldova	0.9	1.0	0.9	0.8	0.7	0.6	0.4	0.3	0.1	-0.1	-0.3	-0.5	-0.7	-0.9	-1.1	-1.3	-1.5	-1.7	-1.8	-1.9	-1.8	-1.6	-1.4	-1.1	-0.9
Ukraine	0.4	0.3	0.4	0.4	0.4	0.5	0.2	0.2	0.3	0.1	-0.5	-0.8	-0.9	-0.9	-0.9	-0.9	-1.0	-1.0	-1.0	-0.8	-0.8	-0.7	-0.7	-0.6	-0.5
Bulgaria	0.4	0.2	0.2	0.2	0.1	-1.2	-1.8	-1.0	-1.1	-0.8	-0.4	-0.4	-0.5	-0.5	-0.7	-0.6	-1.8	-1.9	-0.5	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5
Polan d	0.9	0.8	0.7	0.6	0.5	0.3	0.4	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.0	0.0	-0.5	-0.5	0.0	-0.1	-0.1	0.0	-0.1	-0.1	0.0
Romania	0.7	0.4	0.4	0.5	0.5	0.4	0.2	-0.1	-1.7	-0.1	-0.1	-0.2	-0.3	-0.2	-0.2	-0.2	-0.1	-1.4	-1.5	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2
Russia	0.7	0.8	0.7	0.7	0.6	0.6	0.4	0.2	0.0	-0.1	-0.1	-0.1	-0.3	-0.3	-0.3	-0.4	0.0	-0.2	-0.4	-0.5	-0.5	-0.5	-0.5	-0.3	-0.1
Turkey	2.2	2.0	1.9	1.8	1.8	1.7	1.7	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.6	1.5	1.5	1.4	1.4	1.3	1.3	1.3	1.3	1.2

Source: WB WDI at: http://data.worldbank.org/data-catalog/world-development-indicators/.

APPENDIX 3.3 POPULATION PROJECTIONS FOR THE SIX EASTERN PARTNERS, 2007–50



Source: Armenia: Extended version of Sustainable Development Programme population projections scenario prepared by AVAG Solutions Ltd.; Azerbaijan: Population Division of the Department of Economic and Social Affairs of the UN Secretariat, World Population Prospects: The 2008 Revision, at: http://esa.un.org/unpp; Belarus: Wold Bank Population Projections; Georgia: Tsuladze et al. (2003); Moldova: World Bank Population Projections; Ukraine: Institute of Demography and Social Studies (medium scenario presented: www.idss.org.ua).

APPENDIX 3.4 TRENDS IN SCHOOL ENROLMENT, SCHOOL-LIFE EXPECTANCY AND EDUCATION EXPENDITURE

		Enrolment (thousands)		School-life expectancy (years)				Public expenditure on education	
Country	Academic year	Post-secondary	Total: primary to tertiary	Primary to secondary		Primary to tertiary		% of GDP	% of total government expenditure
		MF	MF	MF	F	MF	F		
	(1)	(2)	(3)	(4)	(5)	(8)	(7)	(8)	(9)
Armenia	2005	117	608	9.1	9.2	11.0	11.5	NA	NA
	2000	91	678	9.3	NA	11.0	NA	3.2	NA
	1995	40	616	12.1	5.6	NA	NA	2.0	10.3
	1990	66	NA	NA	NA	NA	NA	7.0	20.5
Azerbaijan	2005	203	1 841	9.5	9.4	10.8	10.6	2.3	19.6
	2000	157	1 802	9.0	9.1	10.1	10.1	3.9	23.8
	1995	121	1 606	10.7	11.2	11.6	12.0	3.5	17.5
	1990	161	1 532	13.9	6.3	15.0	NA	7.7	23.5
	1985	182	1 600	15.1	6.6	16.3	7.8	NA	26.7
	1980	186	1 668	14.7	6.5	15.9	7.5	NA	NA
Belarus	2005	642	1 951	10.4	10.4	14.4	14.7	6.0	11.3
	2000	547	2 148	10.5	10.5	14.0	14.2	6.0	NA
	1995	293	1 954	10.1	10.2	12.1	12.4	5.5	17.1
	1990	340	1 919	10.4	NA	12.8	NA	4.8	19.3
	1980	335	1 852	11.9	5.0	13.8	7.0	NA	NA
Georgia	2005	201	856	9.8	9.8	12.5	12.7	2.5	8.8
	2000	167	909	9.5	9.5	11.9	11.9	2.2	11.7
	1995	168	897	8.5	8.3	10.7	10.8	7.7	6.9
	1990	148	NA	10.5	10.4	12.4	12.4	NA	NA
	1985	NA	NA	13.1	12.3	NA	NA	NA	NA
	1980	141	1 150	13.2	12.1	14.7	13.7	NA	NA
Moldova	2005	130	709	10.1	10.2	12.0	12.5	7.2	19.4
	2000	104	770	9.7	9.8	11.4	11.7	4.5	16.8
	1995	101	865	12.0	12.1	13.4	13.7	9.0	22.9
	1990	108	863	12.6	12.9	14.3	NA	5.5	17.2
	1985	114	832	12.6	12.8	14.2	NA	NA	NA
	1980	110	786	12.1	12.1	13.6	NA	NA	NA

Ukraine	2005	2 793	8 781	10.5	NA	14.2	NA	6.1	18.9
	2000	1 991	9 274	10.2	10.2	12.9	13.1	4.2	14.7
	1995	1 533	NA	12.5	12.7	14.5	15.0	7.1	15.7
	1990	1 610	8 993	10.1	NA	12.4	NA	5.1	19.7
	1985	1 690	8 771	12.0	NA	14.3	NA	5.2	21.2
	1980	1 684	8 682	11.6	NA	NA	NA	5.6	24.5
Russia	2005	9 209	26 950	9.9	9.8	13.5	14.0	3.8	12.9
	2000	NA	NA	NA	NA	NA	NA	2.9	10.6
	1995	4 458	NA	NA	NA	NA	NA	3.9	9.6
	1990	5 200	26 422	14.1	14.1	16.7	17.1	3.5	NA
	1985	5 500	25 200	14.1	NA	16.7	NA	NA	NA
	1980	5 700	24 700	13.8	13.9	16.2	16.6	NA	NA
Turkey	2005	9 209	26 950	9.9	9.8	13.5	14.0	3.8	12.9
	2000	1 588	NA	NA	NA	NA	NA	3.5	NA
	1995	1 174	12 366	8.2	7.3	9.1	8.0	2.3	14.7
	1990	686	11 155	7.6	7.8	8.2	8.2	2.2	NA
	1985	417	9 700	7.3	7.5	7.7	7.7	1.8	NA
	1980	280	8 124	7.7	6.6	8.0	6.8	2.3	10.5
Bulgaria	2005	241	1 217	11.3	11.1	13.4	13.4	4.5	6.2
	2000	268	1 357	10.6	10.5	12.9	13.2	3.5	NA
	1995	250	1 441	11.0	10.4	13.1	13.1	3.8	7.0
	1990	158	1 547	13.7	7.5	15.0	8.9	5.2	NA
	1985	104	1 512	14.2	8.3	15.0	9.2	NA	NA
	1980	108	1 405	13.3	7.7	14.2	8.7	NA	NA
Poland	2005	2 190	8 359	11.8	11.8	15.2	15.8	5.5	12.7
	2000	1 767	9 074	12.0	11.9	14.7	15.1	5.0	12.7
	1995	747	8 386	12.7	11.2	14.1	12.8	4.4	16.4
	1990	506	7 477	12.2	11.0	13.2	12.2	5.2	14.6
	1985	457	6 682	12.2	NA	13.1	NA	4.8	12.2
	1980	610	6 438	11.9	NA	12.9	NA	NA	NA
Romania	2005	787	3 847	11.2	11.2	13.5	13.9	3.5	8.6
	2000	547	3 962	10.5	10.5	12.0	12.2	2.9	NA
	1995	370	3 958	9.9	10.0	10.9	10.9	3.6	10.5
	1990	165	4 709	14.0	13.9	14.5	14.3	2.8	7.3
	1985	166	NA	NA	NA	NA	NA	NA	7.5
	1980	193	NA	NA	NA	NA	NA	NA	6.7

Source: UIS: www.uis.unesco.org.
Note: Post-secondary education classified according to ISCED. For years 1970–95 post-secondary includes ISCED-76 levels 5, 6 and 7. For 1998 and following years, post-secondary in this table includes ISCED-97 levels 4, 5 and 6.

Country	Population census	LFS	HBS	Others
Armenia	■ Last one conducted in 2001, previous one in 1989 (under USSR). Next scheduled in 2011. ■ Includes data on demographic characteristics of de jure population: education; employment, economic activity; ethnic structure of the population; migration; number and structure of households; and housing conditions.	■ Conducted by the National Statistical Service for the first time in 1996. ■ Between 1999 and 2007, implemented jointly with the Integrated Survey of Living Standards (ISLS) using the same household samples. ■ In 2007, increased representativity (by region (marz)) and absolute data published for the first time. ■ In 2008, again representative at national level and by rural/urban breakdown. ■ Disseminated yearly. ■ Data on employment, unemployment, hidden employment, earnings, including by educational level, working status, sector, etc. ■ Comparability and consistency of data over time is a serious problem: different sample sizes; high seasonality for some particular years; different duration periods; and in some cases, changes in methodology.	**Integrated Survey of Living Standards (ISLS):** ■ Annually since 2001 (previously, 1996 and 1998/1999). ■ Main topics: household roster; migration; housing conditions; occupation; education; agriculture; self-employment; monetary and commodity flows between households; health and healthcare; savings and loans; self-assessment of well-being; social capital and service delivery; social assistance; and activities of households for own use.	**Establishment survey:** ■ Based on a combination of census (large and medium-sized public and private enterprises, private entrepreneurs) and sampling (small and micro private enterprises) techniques. ■ Monthly, quarterly and yearly, with increasing level of detail. ■ Information on number of employees; earnings; labour turnover; type of ownership by branch of economic activity; cost of labour (earnings, social benefits, training, etc.).
Azerbaijan	■ Completed in 1999 and in April 2009. ■ Includes questions on ethnic structure; mother tongue; literacy and education; main causes of infant, child and maternal mortality; migration; and participation in the labour force and unemployment.	■ Conducted by the State Statistics Committee in 2003 and 2006, and quarterly since 2007. ■ Between 2003 and 2006, specific labour-related surveys based on ILO standards carried out (part-time employment in 2004, child labour in 2005, transition from education to work in 2005 and child and female labour in 2006). Results were used to estimate labour market indicators. ■ Occupied territories around Nagorno-Karabakh are not covered. ■ Dissemination limited. Quarterly data provided for a limited number of public agencies only, and to general public annually, with a one-year delay. The latest available labour market statistical yearbook (2009) refers to the 2008 LFS results.	■ Current HBS methodology since 2000, sampling enhanced in 2006. ■ Quarterly. ■ Main topics: household size; household income and its sources; consumption of households; assets, housing and access to public utilities; economic activity; role of agricultural goods in assets and living standards of households; education. ■ Main data available annually, with a delay of one year; detailed data, with a delay of two years. **Other relevant non-periodic survey:** *Household Survey on Remittances and Poverty* (2007), by ADB.	**Wage Survey:** ■ Conducted annually since 1996, based on survey on establishments. ■ Information on wage rates and working hours in different industries by different occupations and positions. Thus, enables analysis on return to positions, industries and working time. ■ Agriculture, fisheries, public administration, production and distribution of public utilities not covered. ■ The survey results are available annually.
Belarus	■ Completed in 1999 and October 2009. ■ Information available on active and inactive population, including employment and unemployment.	■ No LFS survey carried out. All labour-market-related statistics are calculated on the basis of the administrative registers.	■ Since 1995 with current methodology. ■ Conducted yearly. ■ Data on household income and expenditure are published.	■ All labour-market-related statistics are based on registers.
Georgia	■ Last in 2002, previous in 1989. Next edition planned for 2010. ■ Includes questions on economic activity.	■ Conducted quarterly by the State Department of Statistics since 1996. ■ Disseminated quarterly and six monthly in greater detail. ■ Abkhazia and Tskhinvali regions are excluded. ■ Include data on income and expenditure, consumption structure and standard of living. ■ Expanded questionnaires in 1998 and 1999, with more detailed information on job-seeking methods and unemployment duration. ■ Sample size will increase from 2008 (almost doubling) to enhance representativity.	**Income, consumption or household expenditure survey:** ■ Conducted quarterly in 10 regions of Georgia (city of Tbilisi, Kakheti, Shida Kartli, Mtkheta-Mtianeti, Kvemo Kartli, Imereti, including Racha-Lechkhumi and Svaneti, Samegrelo, Guria, Samtkhe-Javakheti and Ajara). ■ Information on household income and expenditure; economic activity; employment and unemployment of household members; ownership of assets; education; sources of income.	**Establishment survey:** ■ Based on census methodology for large-scale enterprises and on sample survey of medium-sized and micro enterprises. ■ Annually. ■ Information on enterprise size, number of employees and labour costs.

Country	Population census	LFS	HBS	Others
Moldova	■ Last in 2004. ■ Includes questions on economic situation; seeking work (all unemployed and economically inactive persons in the age group 15–64 years); economic activity and location of job; occupation and employment status. ■ Different labour market definitions from LFS /ILO. Only consistent labour market information published (active population by gender and district).	■ Conducted by the National Bureau of Statistics since 1999. ■ New sample frame since 2006, in line with ILO recommendations. ■ Disseminated quarterly and yearly. ■ Transnistria region not covered. ■ Yearly ad hoc modules: transition from school to work in 2009, labour force migration in 2008, work organisation and working-time arrangements in 2007, youth in the labour market in 2003–06.	■ Since 1997 with current methodology. ■ Since 2006, same sample design than LFS, with a smaller size. ■ Questionnaire redesigned in 2006 in order to make labour statistics more comparable with LFS. ■ Data on household income and consumption, as well as non-monetary indicators covering education, health, employment, housing, ownership of assets, and self-assessments regarding living conditions. ■ No dissemination of estimates.	**Establishment survey:** ■ Based on compulsory reporting by employers (public and private with 20 or more employees). ■ Monthly, quarterly and yearly, with increasing level of detail. ■ Dissemination of information on number of employees and job creation/destruction; earnings and labour costs; working conditions and accidents at work; professional background and training; and unemployment and job placement for unemployed people.
Ukraine	■ Last in 2001. Previous under USSR (1989). Next in 2011. ■ Demographic and socioeconomic data on population numbers; nationalities; languages; family composition; distribution by age; gender; citizenship; education; means of subsistence; occupation; social status; migratory activity.	■ Conducted by the Ukraine State Statistics Committee since 1995, in line with ILO and EU standards. ■ In 1995–98 the LFS was conducted yearly, in 1999-2003 quarterly, and from 2004 monthly.	**Household Living Standards Survey:** ■ Since 1999 with current methodology, quarterly. ■ Chernobyl Zone of Alienation not covered. ■ Data on living standards of households; income structure; expenditure and cash resources; consumption patterns; household structure; presence of children. ■ Specific modules on: expenditure on repairing or constructing housing and subsidiary buildings; presence of durable goods in the household; health status of household members and the availability of healthcare services and self-identification of the level of income sufficiency. **Ukrainian Longitudinal Monitoring Survey:** ■ Household panel established to monitor the changing behaviour of workers during Ukraine's economic transition, by Kiev International Institute of Sociology (KIIS) on behalf of an international consortium led by IZA. ■ First wave in 2003, second in 2004 and third in 2007.	**Establishment survey:** ■ Based on compulsory reporting by employers (50 or more employees and a minimum turnover, among other conditions). ■ Monthly, quarterly, half-yearly, yearly and two-yearly, with increasing level of detail. ■ Information on extent of wage employment; average wages; amount and incidence of wage arrears; underemployment (both involuntary and voluntary); efficiency of the working time use; on-the-job training; extent of the collective bargaining process; and the structure of the stock of employees according to qualitative characteristics. ■ Not disseminated to researchers and other interested parties (confidentiality of data).

Source: Armenia: ETF (2010a) and National Statistical Service website (www.armstat.am); Azerbaijan: ETF (2010b) and State Statistics Committee website (www.azstat.org); Belarus: ETF (2010c) and National Statistics Committee website (http://belstat.gov.by); Georgia: ETF (2010d), ILO Laborsta database (http://laborsta.ilo.org) and www.statistics.ge; Moldova: ETF (2009a) and www.statistica.md; Ukraine: ETF (2009b) and www.ukrstat.gov.ua.

APPENDIX 3.6 ILO DEFINITIONS: ECONOMIC ACTIVITY, EMPLOYMENT AND UNEMPLOYMENT

Economically active population

This comprises all persons of either sex who furnish the supply of labour for the production of goods and services during a specified time reference period. According to the 1993 version of the System of National Accounts, production includes all individual or collective goods or services that are supplied to units other than their producers, or intended to be so supplied, including the production of goods or services used up in the process of producing such goods or services; the production of all goods that are retained by their producers for their own final use; the production of housing services by owner-occupiers and of domestic and personal services produced by employing paid domestic staff.

Two useful measures of the economically active population are the usually active population, measured in relation to a long reference period such as a year, and the currently active population, or, equivalently, the labour force measured in relation to a short reference period, such as one day or one week.

Employed population

This comprises all persons above a specific age who during a specified brief period, either one week or one day, were in the following categories:

(a) paid employment:

(a1) at work: persons who during the reference period performed some work for wage or salary, in cash or in kind;

(a2) with a job but not at work: persons who, having already worked in their present job, were temporarily not at work during the reference period and had a formal attachment to their job.
This formal job attachment should be determined in the light of national circumstances, according to one or more of the following criteria: (i) the continued receipt of wage or salary; (ii) an assurance of return to work following the end of the contingency, or an agreement as to the date of return; (iii) the elapsed duration of absence from the job which, wherever relevant, may be that duration for which workers can receive compensation benefits without obligations to accept other jobs.

(b) self-employment:

(b1) 'at work': persons who during the reference period performed some work for profit or family gain, in cash or in kind;

(b2) with an enterprise but not at work: persons with an enterprise, which may be a business enterprise, a farm or a service undertaking, who were temporarily not at work during the reference period for any specific reason.

For operational purposes, the notion of 'some work' may be interpreted as work for at least one hour.

(…)

Unpaid family workers at work should be considered as in self-employment irrespective of the number of hours worked during the reference period. Countries which, for specific reasons, prefer to set a minimum time criterion for the inclusion of unpaid family workers among the employed should identify and separately classify those who worked less than the prescribed time.

Persons engaged in the production of economic goods and services for own and household consumption should be considered to be in self-employment if such production comprises an important contribution to the total consumption of the household.

Unemployed

This comprises all persons above a specified age who during the reference period were:

(a) without work, i.e. were not in paid employment or self-employment, (…);

(b) currently available for work, i.e. were available for paid employment or self-employment during the reference period; and

(c) seeking work, i.e. had taken specific steps in a specified reference period to seek paid employment or self-employment. The specific steps may include registration at a public or private employment exchange; application to employers; checking at worksites, farms, factory gates, markets or other assembly places; placing or answering newspaper advertisements; seeking assistance of friends or relatives; looking for land, buildings, machinery or equipment to establish own enterprise; arranging for financial resources; applying for permits and licences, etc.

(2) in situations where the conventional means of seeking work are of limited relevance, where the labour market is largely unorganised or of limited scope, where labour absorption is, at the time, inadequate, or where the labour force is largely self-employed, the standard definition of unemployment given in subparagraph (1) above may be applied by relaxing the criterion of seeking work.

In the application of the criterion of current availability for work, especially in situations covered by [the previous] subparagraph, appropriate tests should be developed to suit national circumstances. Such tests may be based on notions such as present desire for work and previous work experience, willingness to take up work for wage or salary on locally prevailing terms, or readiness to undertake self-employment activity given the necessary resources and facilities.

Notwithstanding the criterion of seeking work embodied in the standard definition of unemployment, persons without work and currently available for work who had made arrangements to take up paid employment or undertake self-employment activity at a date subsequent to the reference period should be considered as unemployed.

Source: http://laborsta.ilo.org/definition_E.html

4. LABOUR MARKET TRENDS AND CHALLENGES

Dr Constantin Zaman

This chapter reviews the main labour market trends and challenges facing the six Eastern partners and assesses the impact of the transitional reforms that have taken place since independence. These reforms led to important adjustments in terms of both employment and wages. First of all, participation rates declined as a consequence of the ageing of populations and the early-retirement schemes, but also because labour market competition replaced the full-employment policy of the Soviet period. Unemployment emerged as a new concept and wage differentials increased significantly as a result of a different valuation system for jobs and occupations. Within this changing policy context, the chapter analyses the main transitional trends for the working-age population, labour force and employment, recent trends in and characteristics of unemployment, and specific sectoral and regional features – in particular, the extensive vulnerability in the structure of employment and the sectoral distribution of employment – and the relationship between education and employability.

Particular attention is given to the employment adjustment that occurred in these countries at two levels: (1) the inter-sectoral level, with employment shifting from economically less viable sectors to those responding better to competition, globalisation and modernisation and leading, therefore, to a change in the economic structure; and (2) the intra-sectoral level (skills adjustment), with employment shifting within the same sector of activity, but from old to new types of jobs requiring different qualifications associated with technological restructuring. Thus, job destruction and job-creation mechanisms are reviewed on the basis of the limited information available, with particular attention paid to informality, the business environment and the role of SMEs.

The Eastern partners have comparable labour participation rates to those in EU countries, while employment rates are considerably lower (particularly in Armenia and Moldova). An overview of employment status and the sectoral structure of employment indicates great vulnerability, given that the proportion of wage employment is low. Self-employment in agriculture contributes disproportionately to the level of these indicators. Only one-third of employed people in Georgia receive a wage; the other two-thirds are either self-employed (mostly on their own account) or family workers. Azerbaijan and Armenia also have very high levels of self-employment (more than half of total employment), while the proportion in Moldova is one-third. Only Ukraine is broadly comparable with the EU in this regard. The sectoral structure of employment also indicates the insufficiency of secure and decently paid jobs in these economies, where the proportion of the economy represented by agricultural employment is disproportionately high: Georgia (more than half), Azerbaijan and Armenia (close to half) and Moldova (one-third). Value added to GDP is quite low in Georgia, Azerbaijan and Moldova, indicating low productivity and possibly poverty. Industry is still an important employer in Belarus and Ukraine, while the services sector is more important in Belarus, Ukraine and Moldova.

The labour markets in the Eastern partner countries remain heterogeneous and heavily localised as a result of the varying speed of reforms across the regions, unequal investment activities, geographical patterns of demand for goods and services, and other factors resulting in regional disparities. They are also segmented and dual in many respects: between the formal and informal sectors, between rural and urban areas, between the sexes and between the public and private sectors. Widespread informality is stimulated by factors such as the reduction in public formal employment, the abundant labour supply, the erosion of incomes over the transition period, and the cost-cutting strategies used by enterprises in order to compete. This means that a significant proportion of the labour market is functioning in low-productivity and low-wage conditions.

Within the context of a high level of vulnerable employment, it is obvious that more and better jobs offering decent working conditions need to be created in all the Eastern partner countries. However, the current business environment is not always conducive to decent job creation, particularly for SMEs. Many institutional and legal impediments to doing business remain, including bureaucracy and complex procedures in operating businesses, and the length of time required to deal with bureaucracy. Consequently, job-creation mechanisms have been weak. Labour market restructuring has produced winners and losers. However, after two decades of reforms, questions remain: why have the transformations not been less costly in social terms, and why has the lack of employment opportunities pushed so many people to emigrate, while a significant proportion of those who stayed are living in poverty? There are no clear and universal answers; what is clear for these countries is that the process of transition has failed to create enough decent jobs to date.

4.1 TRANSITIONAL LABOUR MARKETS AND THEIR CHARACTERISTICS

Labour market policies are an essential element in the process of economic transformation as a prerequisite for achieving productivity increases and, consequently, better wages for employees. They also contribute to the sustainability of the overall reform process by alleviating the costs associated with labour reallocation. In reforming their labour markets, the Eastern partners have been confronted with the choice of two approaches. One is that the rigidities inherited from the Soviet era should be removed to allow increased flexibility (the liberal view); this has largely been the view taken by Georgia and, to a lesser extent, Azerbaijan. The other is that too much flexibility in the labour market leads to inequalities, poverty and social exclusion (the essentially European view). The choice is not to opt for either one or the other, but, given the specific economic context of a country, to strike the right balance between flexibility and security. Since an economy is a complex system in which the labour market represents just one of many interacting components (monetary sector, fiscal domain, foreign trade sector, real economy, etc.), successful policies in the labour area are conditional on a well-integrated package of economic, institutional, legal and social policies.

Market elements have developed differently in the CIS compared to the CEEB countries, and hence, certain differences exist between them with respect to the transitional evolution of their labour markets (Dutz et al., 2001). However, there are also a number of similarities. In both cases, communist labour institutions excluded any market mechanism from the process of allocating labour resources. Central planning priorities, combined with the criminalisation of inactivity and of private activities, generated very high participation rates, particularly in heavy industries where the level of labour hoarding became substantial. Labour regulations also limited to a large extent the inter-regional mobility of the workforce. A second similarity between the two groups of countries was the rapid shrinkage in the labour force and the declining participation rates in the early years of transition, provoked by a sharp decline in labour demand and demographic trends in the CEEB and Eastern partner countries.

One major difference was that the labour adjustment mechanisms used in the early years of transition to deal with massive overemployment by industrial enterprises produced more unemployment in the CEEB countries, but a less dramatic decline in real wages. In order to compensate for the transitional shock, this group of countries put in place relatively generous social safety nets. In contrast, most Eastern partners opted to preserve employment, and this produced a more significant decline in real wage levels. However, transformation of the labour market has advanced more slowly than in the CEEB countries. Consequently, high levels of hidden unemployment and underemployment persist, while real wages are below the rates recorded in the CEEB. In addition, labour relations and institutions are less efficient, and social protection is not sufficiently developed. The difference reflects the decision of the CEEB policy makers to introduce hard budget constraints for enterprises and force rapid restructuring of labour markets. This option led to accelerated growth in the private sector and to a faster improvement of efficiency in state-owned and privatised companies. The resulting increase in unemployment was largely offset by a faster increase in labour productivity, which in turn stimulated income growth for employees.

A second difference between the two groups refers to the geographical proximity of the CEEB countries to the EU, which has enabled significantly higher levels of worker mobility and offered better employment opportunities than in most of the CIS countries (Pavlova and Rohozynsky, 2005). Moreover, the prospect of accession to the EU, and the entry requirements for this, pushed the CEEB countries to adopt the European labour market model and, implicitly, the EU social model, with greater social protection of workers and unemployed individuals. Whereas in the CIS countries the proportion of GDP allocated to unemployment insurance, social assistance and sickness benefits has been less than 1% on average, CEEB governments have allocated between 2% and 5% of GDP for these purposes. The CIS countries have preferred a higher replacement ratio of social benefits relative to social security payments. On average, the CEEB labour markets are therefore considered to be more rigid than those in the CIS (Pavlova and Rohozynsky, 2005). To some extent the deregulation of their labour markets by most CIS economies compensated for their insufficiently friendly investment and business climates. For example, hiring and firing is easier in Georgia and Azerbaijan than in Eastern Europe.

Several additional aspects should be emphasised when analysing the labour markets in these countries. The first relates to participation rates, which are comparable with those in the EU. As explained in Chapter 3, this similarity is distorted by the lower retirement ages in the Eastern partner countries and high levels of subsistence agriculture. Another aspect relates to the heterogeneity of the internal labour markets, which are heavily localised as a result of the varying speed of reforms across the regions, variations in investment activities, geographical patterns of demand for goods and services, and other factors that have led to regional disparities. Moreover, specific territories and zones can often be identified within the regional markets in terms of urban–rural labour markets, but also in terms of the characteristics of the workforce. As a consequence, the demand for labour and the participation rate (labour supply) has been uneven across regions. In general, the demand for labour has always been less than the supply, leading to persistent unemployment.

As a specific transitional phenomenon of the Eastern partners, the boom in university graduates entering the labour market increased supply pressures and led to the overqualification of the labour force. This is a complex issue, since the excess supply of overqualified labour coexists with a significant unmet demand for skilled workers and competent professionals. There is therefore an obvious skill mismatch in terms of the level and type of qualifications in these economies: an excess supply of qualifications that

are not required by the market and a demand for skills that are not sufficiently supplied by the education system. Furthermore, some graduates do not have any real skills because of the poor quality of the education system. Therefore, a paradox can be observed in labour markets: the number of graduates with tertiary education has increased, but a portion of the workforce is quickly losing its skills, and existing skills are becoming obsolete (World Bank, 2007, 2009f). This is particularly true for VET and technical graduates, who are more likely to become unemployed as a result of poor links between employers, job seekers and the system of education and vocational training.

As discussed in Chapter 7, labour market demand and supply is not only a quantitative issue, expressed in terms of the number of people who offer their skills versus the number of vacancies, but also a matter of structural unemployment caused by a skill mismatch. The skill mismatch seems to be more significant at higher levels of education. In particular, this would explain why the participation rate for unskilled and poorly educated individuals is higher than for other categories: jobs requiring few qualifications are more in demand in an economy where labour productivity and product sophistication are low. The relatively low demand for skilled labour is also a result of an insufficiently friendly business climate that discourages investment in labour-saving technologies, which would require better-qualified personnel. In addition, organisational and managerial capacity at enterprise level is still poor, as most of the managers in these firms are graduates of an education system that is not sufficiently synchronised with the challenges of profiling and reprofiling employees according to market needs. All this leads ultimately to structural unemployment.

The labour markets in the six countries are characterised by multidimensional duality, the most striking being that between the formal and informal sectors. The estimates for all six countries indicate that a significant proportion of jobs are informal. The majority of undeclared workers are in marginalised economic activities and labour-intensive sectors such as agriculture, construction, the retail trade, catering and domestic service. Self-employment accounts for the bulk of employment in the informal sector, especially in subsistence agriculture. The level of informality in the six countries is similar to that in other CIS economies, but slightly different from that in the CEEB countries. Although the unofficial sector deprives workers of most of their legal rights, it represents a coping strategy for those willing to work for wages in more flexible conditions.

Another duality in the labour markets is the one between rural and urban areas. Although the rural participation rate is higher than the urban rate, this may not reflect the real situation. Rural areas may have better employment rates and lower levels of unemployment, but the jobs are mostly low paid and highly seasonal, and involve poorly skilled workers. Self-employment in (often subsistence) agriculture, which is prevalent in rural localities, is an indication of poverty and the lack of dynamism of labour markets.

A certain degree of gender duality also exists, as the family model involving the male breadwinner still persists as a social value. At the macro level, gender duality translates into vertical and horizontal gender segregation. Vertical segregation is evident from the proportion of men and women in top professional positions (senior government officials and managers in private companies): the proportion of women is lower than that of men. Horizontal segregation is indicated by the high concentration of female labour in sectors that pay less than the average wage, including social services (healthcare and education) and the textile industry.

4.2 WORKING-AGE POPULATION: RECENT TRENDS AND FUTURE CHALLENGES

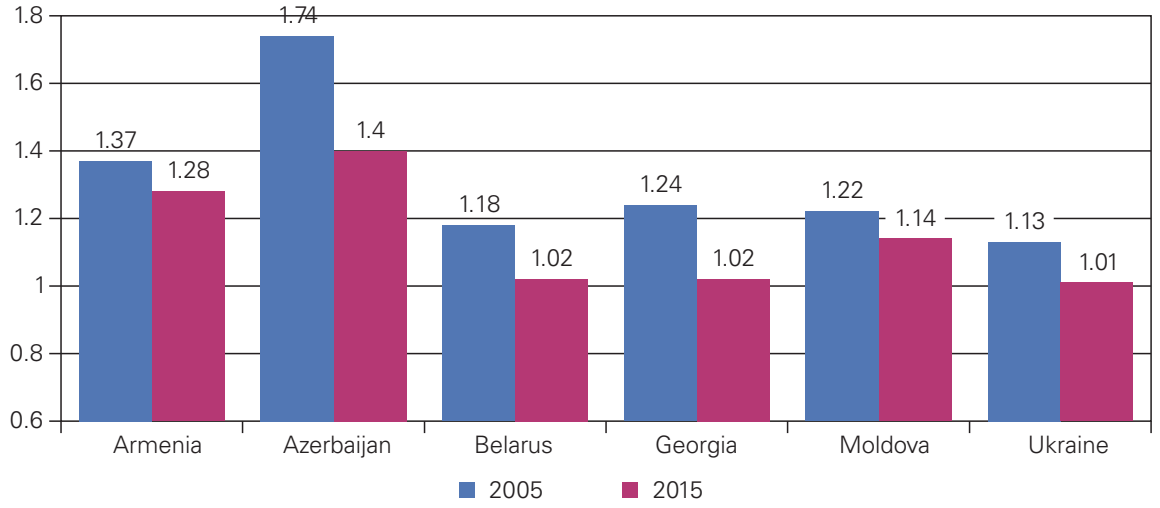
The main characteristics of the working-age population in the Eastern partner countries are mostly determined by demographic changes. As already explained in Chapter 3, the most important feature is the ageing population profile, a trend similar to that observed in the EU. The slightly higher percentage of females in the population is another notable aspect (this is also the case in other transition countries). Ukraine, for instance, has one of the lowest male–female population ratios in the world (85.8% in 2005), and this ratio is expected to increase further. For comparison, the male–female ratio in the EU-27 is 95.4%[58].

During the transition period as a whole, the working-age population as a proportion of the total population increased as a result of pre-independence demographics, specifically, the baby boom of the 1970s and 1980s. As shown in Chapter 3 (Figure 3.2), between 1990 and 2008 the proportion of the population represented by the working-age population increased from 63.8% to 71.7% in Moldova, from 61.5% to 68.6% in Azerbaijan and from 66.3% to 71.3% in Belarus. Similarly, though less dramatically, the working-age population increased in Armenia (from 64% to 67.9%), Ukraine (from 66.4% to 70.2%) and Georgia (from 66.1% to 68.5%). For comparison purposes, the equivalent figure for the EU-27 is 67%. This growth trend is expected to continue in all these countries for some years.

In the long run the population profile is expected to age faster in Belarus, Georgia and Ukraine. **FIGURE 4.1** shows the ratio between two parts of the age spectrum: the 15–39 and 40–64 age groups. It thus represents the ratio between young and the mature (i.e. close to retirement) generations. Ageing becomes a real concern when the intergenerational ratio approaches or surpasses unity. In the case of Belarus, Georgia and Ukraine, this ratio will be very close to unity in 2015. Azerbaijan will still have a relatively higher proportion of young rather than mature working-age people, but its working-age population profile is ageing more rapidly.

58 UN Social Indicators, available at http://unstats.un.org/unsd/demographic/products/socind/population.htm

FIGURE 4.1 INTERGENERATIONAL RATIO*, 2005 AND 2015



Source: Author, based on UN (2008).
*Note: *The ratio between the young (15–39 years) and mature (40–64 years) generations.*

4.2.1 LABOUR MARKET PARTICIPATION

Labour market participation has undergone a turbulent transition, with periods of low economic activity levels, and high unemployment and underemployment rates. A large number of individuals have experienced frequent changes in their status, passing between employment, unemployment and inactivity. Taking the 15–64 age category as the typical age range for labour force participation, three distinct development pathways are evident in the Eastern partner countries (see **TABLE 4.1**).

1. A continuous decline in the participation rate. This is the case for Moldova, where the total rate in 2007 (51%) was almost 19 percentage points below the 1995 level (69%). A similar declining tendency was recorded in Poland, Romania and Turkey.
2. A continuous increase in participation rates. This was the case for Armenia and Azerbaijan (from 66% in 1995 to 70–71% in 2007 for both). These two countries followed a similar trend to that in the European continent.
3. An initial decline in participation rates, followed by increasing trends since 2000. This trend was evident in Georgia and Ukraine (around 67% for both in 2007) and mirrored the developments in Russia.

Belarus does not fit any of the three categories, as it has had relatively stable and high participation rates (70% in 2007) over the whole period, a result of the employment preservation policies of the government. Stable participation rates are synonymous with few reforms being made to adjust the labour market to the requirements of a competitive economy and a high level

TABLE 4.1 LABOUR FORCE PARTICIPATION RATES FOR TOTAL POPULATION AND WOMEN, 1995, 2000 AND 2005–07 (% CORRESPONDING AGE GROUP)

Country	1995		2000		2005		2006		2007	
	Total	F	Total	F	Total	F	Total	F	Total	F
Armenia	66.7	61.0	67.5	62.6	69.3	64.6	69.1	64.4	70.0	65.2
Azerbaijan	66.7	61.0	69.4	64.2	70.3	65.7	69.5	65.1	71.2	66.5
Belarus	73.4	68.9	69.9	66.3	70.7	67.6	70.6	67.6	70.3	67.0
Georgia	67.3	59.6	66.3	57.4	67.2	58.8	67.6	59.2	67.6	58.8
Moldova	69.9	65.4	61.8	59.0	53.5	53.2	53.8	53.3	51.1	51.1
Ukraine	72.2	69.0	67.0	62.5	66.7	61.9	66.8	62.0	67.8	63.7

Source: ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240
Note: Active population aged 15–64 years; F, female.

of overemployment by large public enterprises. Moreover, Belarus does not conduct LFSs, and because measurement is exclusively based on labour registers, comparisons are difficult.

The increasing participation rates in Armenia and Azerbaijan have different causes. Armenia implemented radical reforms in the first years following independence, thus preparing the ground for a rapid restructuring of the labour market. Consequently, when growth was resumed after 1995, economic activities attracted an increasing number of individuals. In Azerbaijan the increased participation rate is probably the result of the high spill-over effects from the oil sector on other economic activities, particularly services and construction, and of the increase in self-employment activities of small landowners and their family members. The increasing proportion of the working-age population in all the countries could be another factor affecting participation rates.

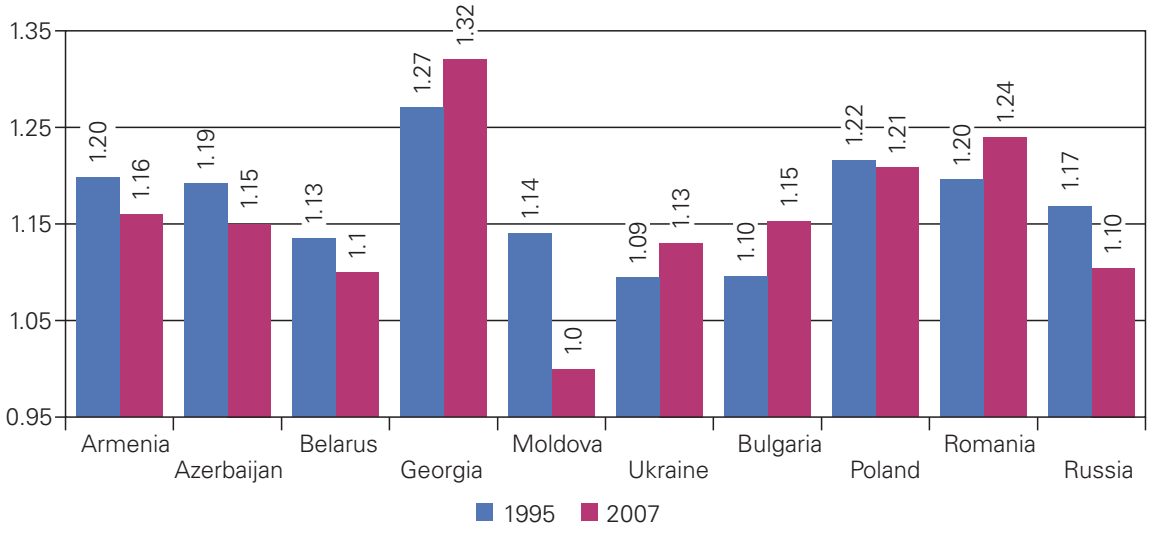
In Georgia and Ukraine, where participation rates declined until 2000 but started to improve thereafter, the implementation of economic reforms has been slower. Consequently, during the first decade of transformations job and business opportunities were insufficient to attract more people to the labour market. The post-2000 increase in participation rates in Georgia was affected by the inclusion of all landowners and their families in the 'self-employed' category. There were two main reasons for the declining participation rates in Moldova: insufficient restructuring of firms, and the social inefficiency of economic reforms. These led to a significant abandonment of the labour market by a large part of the working-age population, many of whom preferred to emigrate or take up small-scale informal activities.

As a result, most Eastern partners have participation rates that are comparable with those of the EU-27. However, the fact that informal employment and self-employment rates are particularly high among these countries explains these high rates. An exception is Moldova, where the labour participation rate is very low, partly as a consequence of the large-scale emigration of workers who were recorded as inactive. Withdrawal from the labour market, which started in the mid 1990s, affected employees from the public sector in particular. Two outflow channels from employment in state enterprises can be identified. The first is the privatisation and restructuring of public companies, which freed up excess labour inherited from the Soviet era. The second concerns companies that remain under state ownership: as a result of inefficiencies in production and marketing, wages, which were already very low, were paid with long delays and unpaid leave became common. Under these circumstances, many people turned to small-scale informal activities or started to look for work abroad.

Another important characteristic of labour market participation in the Eastern partners, and one that is common to the whole former communist bloc, is the high rate of female participation. Compared to Bulgaria and Romania – where the rate of female participation has declined considerably over the transition period – the rate remains comparable with that in the EU in some of the Eastern partner countries. Moreover, since the male–female labour force participation ratio has decreased in Armenia, Azerbaijan, Belarus and Moldova (**FIGURE 4.2**), women have become more prevalent in the labour market.

This trend is explained by the high proportion of active females in the working-age population, since large numbers of men left the labour market when they were affected by restructuring, mainly in the industrial sectors. There has also been a higher proportion of male emigrants. In Armenia, higher female participation within

FIGURE 4.2 MALE–FEMALE LABOUR FORCE PARTICIPATION RATIO, 1995 AND 2007



Source: Author, based on ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240
Note: 15+ age group.

the 25–34 age category has been confirmed (4.5 percentage points above male participation in 1995). It has also been confirmed in Moldova, where male participation rates have been below female rates by more than five percentage points since 2005. The ratio between males and females increased in Georgia and Ukraine, where the domestic role of women seems to be acquiring importance; more attractive early-retirement schemes for women in these two countries may also explain this trend.

The labour participation rate remains low among young people (15–24 years old) in all the Eastern partner countries (see Appendix 4.1 at the end of this chapter for detailed information on age groups). This is possibly explained by higher enrolment rates in tertiary education for this age group, which are related to labour market entry difficulties and emigration trends. In 2007 in Georgia, for example, only 32.3% of those within the 15–24 age cohort participated in the labour market. In the case of Georgia and Moldova, the youth participation rate is less than half the total, and can be explained by greater participation in education in Georgia and Moldova, with emigration an added factor in the latter country. Youth female participation rates are even lower than the average for their age group. Higher attendance in education is a likely explanation, but discouragement as a result of unequal opportunities in the labour market could be another reason.

With regard to participation among people aged 65+, there is great heterogeneity among the six countries (Appendix 4.1). Belarus has the lowest (and declining) participation rates for both males and females. This is largely explained by relatively generous pensions granted to retired people; Belarus has the highest ratio between the average pension and the average wage of the six countries (40%, compared with 20% in Armenia). At the other extreme, 45.9% of Georgians belonging to the 65+ age cohort remained active in 2007, a rate that reached almost 50% in 1995. This high activity rate essentially reflects activity in agriculture, as the official statistical methodology considers all farmers and their adult family members to be self-employed (ETF, 2010d).

Armenia and Azerbaijan exhibit similar trends and have almost the same participation rates for this age category. In 1995 they both recorded a participation rate of 14.5%, which declined steadily and then stabilised at just below 10%. The main reasons that people work after retirement are the low pension levels and high levels of agricultural employment in both countries, combined with the inefficiency of social assistance in the case of Azerbaijan (World Bank, 2009a). In Moldova and Ukraine, participation rates increased significantly after 2000. In 2005 the rate had doubled in Moldova compared to the 1995 rate, while in Ukraine it was 3.4 times higher than in 2000. Low pension-replacement rates resulting in high levels of poverty among the elderly are among the main reasons for their economic activity, both in Moldova and in Ukraine.

In all the countries, most of the labour force has completed secondary education (**TABLE 4.2**)[59]. Although participation rates are generally proportional to educational attainment, the proportion of less well-educated persons has recently increased, particularly in Ukraine, Moldova and Georgia. Low levels of education among participants prevail in rural areas, where more employment opportunities are available for unqualified persons. In Ukraine, between 2004 and 2007 participation rates increased from 17.1% to 21.3% for individuals lacking even basic secondary education; the highest increases occurred in rural areas (from 24.2% to 30.3%) and among women (from 16.5% to 21.3%). These trends have been shaped by the expansion of subsistence agriculture, a sector in which little education is required. A particular feature of Ukraine is that educational attainment is higher and is increasing faster for women than for men: the female labour force is therefore better educated than the male labour force. Between 2004 and 2007, the share of persons with higher education in the labour market increased by 1.3

TABLE 4.2 EDUCATIONAL ATTAINMENT OF LABOUR MARKET PARTICIPANTS, 2007 (% TOTAL, MALE, FEMALE)

Country	ISCED 0–1			ISCED 2–4			ISCED 5–6		
	T	M	F	T	M	F	T	M	F
Armenia	2.9	2.4	3.4	72.2	77.7	74.5	20.9	19.9	22.1
Azerbaijan	3.6	3.0	4.3	74.1	72.1	76.2	22.3	24.9	19.5
Belarus	0	NA	NA	76.8	NA	NA	23.2	NA	NA
Georgia	2.2	1.8	2.6	67.6	68.6	66.6	30.0	29.3	30.6
Moldova	18.3	NA	18.0	61.9	NA	60.3	19.8	NA	21.7
Ukraine	0.8	0.6	0.9	74.9	77.3	72.4	24.3	22.1	26.7

Source: ETF Country Reports; Azerbaijan State Statistical Committee; Moldova National Bureau of Statistics.
Note: T, total; M, male; F, female; ISCED, International Standard Classification of Education.

59 National definitions, particularly for secondary education, vary between countries, and this could affect the comparability of data.

percentage points; out of this increase, 70% was accounted for by women (ETF, 2009b; see Chapter 7 for a more detailed discussion).

4.2.2 REASONS FOR NON-PARTICIPATION

Participation depends on various factors: individual decisions to prolong studies in the case of young people; housekeeping and childcare responsibilities in the case of women; discouragement as a result of a lack of job opportunities and very low wages; and disabilities that impede a person from performing an activity, or that discourage them from entering the labour market. Most discouraged workers either enter the unregistered (informal) sector or join the flow of emigrants. In all six countries, education has become an important factor in inactivity among young people, as higher education seems to be positively correlated with the probability of obtaining a relatively well-paid job. To illustrate this, in Armenia the share of inactive individuals who preferred to continue their education rose from 9.4% in 2001 to 22.0% in 2007. However, suitable statistical information is not available for all the countries and, when available, it is based on surveys whose accuracy is sometimes questionable.

If retirement is excluded as a reason from the analysis, the second most important factor in non-participation is women's preference for childcare and housekeeping (**TABLE 4.3**). This is particularly important in Armenia; no information in relation to this exists for Belarus. The withdrawal of women from the labour market to take up domestic tasks is a consequence of the prevailing mentality that men should be the family breadwinners. This way of thinking, which causes women to postpone their entry into the labour market, reduces their future chances of finding employment because of a lack of experience and employment record; consequently, a considerable proportion of the human capital accumulated through education is lost. More women than men become discouraged, at least in Armenia, the only country for which such information exists.

TABLE 4.3 MAIN REASONS FOR LABOUR MARKET NON-PARTICIPATION, 2007 (% TOTAL)

		Armenia[1]	Azerbaijan[2]	Belarus	Georgia	Moldova[3]	Ukraine
Education	**T**	22.0	30.0			22.9	27.2
	F	17.9	24.5		9.6		
	M	31.9	35.9		10.6		
Retirement	**T**	42.0	53.0			33.2	49.5
	F	38.4	58.5		15.1		
	M	50.7	45.8		8.3		
Disability	**T**		7.0				
	F		5.8				
	M		9.1				
Housekeeping	**T**	21.2	7.0			7.0	17.0
	F	29.2	9.6		15.0		
	M	1.4	6.4		0.0		
Discouragement	**T**	9.6				1.6	2.8
	F	10.0					
	M	7.2					
Emigration	**T**					20.7	
Other reasons	**T**	5.2	4.0			14.6	3.5
	F	4.4	1.9				
	M	7.2	6.4				

Source: ETF Country Reports; Azerbaijan State Statistical Committee; Georgian Statistical Office.
Note: 1. Inactivity owing to disability is included in the retirement category; 2. 'Other reasons' refers to poor persons receiving social assistance; 3. 'Other reasons' includes non-participation as a result of disability; T, total; M, male; F, female.

Discouragement in general is an important factor in non-participation in some countries. Although this element seems to be of limited importance in the case of Moldova, in reality there are many discouraged workers. Emigration represents the second factor (after education) responsible for inactivity in Moldova. Most of those who migrate are discouraged workers who look for employment outside their country because they believe that there is no chance of finding a decent job at home. In Ukraine, the number of discouraged workers decreased by half between 2004 and 2007 as a result of the increased job opportunities brought by economic growth and a more efficient social safety net. In Armenia, on the other hand, this category as a proportion of the total number of inactive persons increased by 2.1 percentage points between 2001 and 2007[60]. Discouragement in Armenia occurs predominantly among young persons as a result of a lack of job opportunities.

Another factor behind non-participation is disability. In all six countries, people with disabilities belong to groups whose job opportunities on the open labour market are considerably restricted by two elements: their lower than average level of education, and the limited progress in implementing specific mechanisms to integrate them into the labour market. The first of these is linked to inappropriate government policies for the educational and social integration of people with disabilities. This situation is inherited from the communism system, in which people with disabilities were educated and employed in establishments created especially for them. This practice induced social isolation from mainstream vocational and professional life. After the fall of communism, these special establishments were closed down; as a consequence, individuals with disabilities are currently forced to compete for jobs with the other job seekers. To illustrate this, in Armenia the employment rate for those with disabilities is more than three times lower than the average.

Non-participation rates vary according to sex, age, geographical location and education level. Women mainly withdraw from the labour market for domestic reasons, while the continuation of education is more frequently a motive for men. Differences according to age are evident: inactivity among younger age groups is mostly determined by education and/or domestic reasons and by retirement for older groups. In Azerbaijan, 31.3% of inactive men are aged between 15 and 19 years and 10.0% are aged between 20 and 24 years; meanwhile, 19.4% of inactive women are in the 15–19 age group (ETF, 2010b). In addition to the factors mentioned above (education, childcare and housekeeping), discouraged workers represent a significant share of the young persons who are outside the labour market.

In the countries for which statistical information is available in the ETF Country Reports, non-participation is more of an urban than a rural phenomenon. In Azerbaijan, urban inactivity represented 34.9% in 2007, compared to 29.9% for rural areas. In the same year, male urban non-participation was 31.9%, while male rural inactivity was 26.4%; the proportion of inactive women in urban areas was 37.7%, compared to 33.2% for rural areas. A similar situation exists in Armenia (World Bank, 2007), Georgia and Moldova. This particular feature is primarily a matter of statistical classification: the lower rural rates of inactivity are largely due to the predominance of household self-employment in agriculture. In Azerbaijan and Georgia, landowners and their adult family members are not considered to be economically inactive.

4.3 EMPLOYMENT AND UNEMPLOYMENT: FEATURES AND TRENDS

Employment and unemployment represent the most relevant measures of the way the labour market functions, but also of the overall economic, institutional and legal policy framework. When the labour market is subject to imbalances and disequilibria, it generates voluntary and involuntary unemployment. Voluntary unemployment occurs when a job opportunity offered to a person does not match his/her expectations in terms of such factors as wages, working conditions and location. Involuntary unemployment is a consequence of a skill mismatch or an insufficient number of jobs in the economy relative to the number of people who are willing to work. In the Eastern partner countries, most unemployment is involuntary, though in recent years voluntary unemployment seems to have gained importance, particularly among highly educated people looking for better-paid jobs.

As already mentioned in Chapter 3, the statistical information available is not sufficiently comparable to enable a complete analysis of employment and unemployment trends to be carried out. Even within the same country, data is sometimes inconsistent, as a result of large differences between various sources of information. In Armenia, for example, employment statistics collected through labour force and establishment surveys vary significantly (e.g. almost ten percentage points for employment in the agricultural sector in 2007). Moreover, recent data is not comparable with past data because of methodological changes. Belarus performs no LFSs at all, making any kind of comparison of its data difficult. The use of ILO data eliminates some of these inconsistencies (see Appendix 4.2 at the end of this chapter for a detailed depiction of the employment structure), although its database too is based on national sources.

The same statistical problem appears in the case of unemployment: some countries (e.g. Belarus) define unemployment in national terms as the number of persons registered with employment offices. Since many jobless people in Belarus do not register because of the long and complicated formalities and a lack of trust in the capacity of these institutions to help them find a

60 This increase may in reality be due to methodological differences: the figure for 2001 is from the population census, while the figure for 2007 is from the LFS (ETF, 2010a).

job, this definition produces extremely low rates of unemployment (0.8% in 2008, while ETF Country Report estimates (2010c) are around 7%). Most of those whose entitlement period for receiving unemployment benefits has expired do not reregister and are therefore excluded from the registered labour market. For comparison purposes, Appendix 4.3 at the end of this chapter summarises data for two unemployment rates (national and ILO-defined) for Armenia and Azerbaijan.

TABLE 4.4 shows relatively high activity rates in Armenia, Georgia and Azerbaijan in 2008 (65.6%, 63.7%, and 63.4% respectively), and more modest rates in Belarus and Ukraine (59.8% and 58.0% respectively). In Moldova the rate has declined drastically, falling to 49.1% in 2008, partly as a result of the high number of labour emigrants classified as inactive in national statistics. It must be emphasised that the reference age group used for labour market indicators in this region is 15+, while the EU-27 data refers to the 15–64 age group. This creates inherent differences between figures. Hugely varying statutory and actual retirement ages in each country further distort the picture. All countries have a retirement age of less than 65 years, but the activity rate of people aged 65+ is generally quite high.

Employment rates are generally low, and male employment rates are always higher than female employment rates. In 2008 Armenia (38.1%) and Moldova (44.7%) had the lowest employment rates, while Azerbaijan (60.0%) had the highest. Employment rates were modest in Belarus (52.3%), Georgia (54.3%) and Ukraine (53.5%). Only Armenia and Azerbaijan recorded a net increase in employment rates throughout the 1995–2008 period, while Moldova experienced a large fall in employment, and Georgia and Ukraine recorded a moderate reduction. Youth employment rates are lower than average in most of the countries; they are significantly lower than in the EU, except in Belarus, where the rate is similar. However, youth employment in Belarus declined by 11.4 percentage points between 1995 and 2007; more women than men were affected by this trend, as female employment dropped by 12.8 percentage points. In fact, only Armenia and Azerbaijan recorded an overall increase in employment rates in this age category (4.2 and 3 percentage points respectively); female employment increased more in the case of Azerbaijan. The most dramatic decline in youth employment was recorded in Moldova, where the rate fell 15.4 percentage points in total, with female employment more affected than male employment.

As discussed in Chapter 1, until 2007 labour demand increased slightly in Ukraine, where economic growth created a relatively high number of jobs for those in the younger age groups, particularly men. A similar situation was recorded in Armenia and Azerbaijan. At the other extreme, the greatest job destruction occurred in

TABLE 4.4 KEY LABOUR MARKET INDICATORS, 2008 (REFERENCE AGE 15+)

Countries	Total activity rate (%)	Female activity rate (%)	Total employment rate(%)	Female employment rate (%)	Total unemployment rate (%)	Female unemployment rate (%)	Youth unemployment rate %
Armenia	65.6	59.0	38.1	32.1	28 (*)	NA	NA
Azerbaijan	63.4	60.6	60.0	55.9	6.5 (1)	5.3 (1)	14.0
Belarus	59.8	54.5	52.3	47.0	1 (**)	N.A.	NA
Georgia	63.7	55.4	54.3	47.2	13.3 (2007)	12.6 (2007)	31.5 (2007)
Moldova	49.1	46.8	44.7	43.7	4.0	3.4	14.5 (2007)
Ukraine	58.0	51.8	53.5	48.3	6.4	6.0 (2007)	14.9 (2005)
Bulgaria	55.6	49.4	46.3	41.0	5.7	5.8	12.7
Poland	54.6	46.8	48.2	41.3	7.1	8.0	17.3
Romania	54.6	46.9	48.1	42.5	5.8	4.7	18.6
Russia	62.8	57.1	56.7	51.3	6.1 (2007)	5.8 (2007)	14.5 (2007)
Turkey	47.9	25.1	42.3	21.7	9.4	9.4	18.1
EU-27 (15-64)	70.9	63.9	65.9	59.1	7.0	7.5	15.3 (2007)

Source: ILO-KILM (15 + years for all countries except EU-27); Eurostat for EU-27.
*Note: *National data for 2007 from ETF (2010a); **Only registered unemployment for Belarus; 1. Reference ages for Azerbaijan: 15–61, 2007 data.*

Moldova. In Belarus, although economic growth was strong and employment was high (including among the 15–24 age group, which had the highest rate), the employment rate has declined in recent years as a consequence of the economic reforms adopted after 2005 to restructure and privatise state enterprises (ETF Country Reports).

The evolution of unemployment rates does not necessarily directly reflect the evolution of employment rates, but interestingly, both rates show a declining trend in all the countries except Georgia (see Appendices 4.2 and 4.3). As can be seen in Table 4.4, in 2008 the highest unemployment rate was recorded in Armenia (28.0% in 2007), followed by Georgia (13.3%), Azerbaijan (6.5%) and Ukraine (6.4%); it was 4.0% in Moldova and 1.0% in Belarus, where the rate is based on registered unemployment (no LFSs are carried out). Economic growth contributed less to the reduction of unemployment than emigration in some countries such as Moldova, where the unemployment rate recorded the steepest fall. The unemployment rate is inversely correlated with age: young age groups are much more strongly affected than mature groups. The youth unemployment rate is particularly high in Armenia (48% in 2001) and Georgia (31% in 2007) and is around 15% in Azerbaijan, Moldova and Ukraine. In all cases, the high incidence of unemployment among young people is largely explained by a lack of work experience and relatively high reservation wages.

Women have been harder hit by unemployment than men in Armenia (40% female unemployment against 29% total unemployment). The opposite situation exists in Azerbaijan, Georgia, Moldova and Ukraine. In Azerbaijan, male unemployment is 3 percentage points higher than female unemployment because of higher male participation rates in the labour market. In Moldova, female self-employment (particularly in agriculture) is noticeably higher than male self-employment; however, the liquidation of enterprises during the first decade of transition essentially affected the sectors that traditionally employed men (industry). Female unemployment in Ukraine is lower because women are generally employed in more secure jobs in public administration and because sectors dominated by women are expanding faster than other sectors.

One important issue is long-term unemployment (12 months or more), which has a high incidence in all the Eastern partner countries, despite some positive trends in recent years. This indicates a stagnant unemployment pool, with little entry/exit turnover. Almost 40% of unemployed people in Armenia had been unemployed for more than one year in 2006, with women 16 percentage points above men. In Georgia, two-thirds of unemployed people had been out of work for at least one year in 2007 and, of these, more than 50% had been unemployed for 2–3 years. The risk of long-term unemployment increases with age in Moldova, where the average duration of unemployment in 2007 was 19 months, but 35 months for those above 50 years of age. In fact, 20.9% of unemployed people had been without a job for two years. Over the period 2001–07, the incidence of long-term unemployment in Belarus declined overall from 11.9% to 10.3%, falling, in particular, among rural inhabitants. The same declining trend occurred in Ukraine, where the proportion of long-term unemployment went from 54.8% in 2001 to 23.0% in 2007. Consequently, the average job-search period declined from 10 to 6 months over the period. However, the real challenge in Ukraine is that university graduates have a higher incidence of long-term unemployment than people with lower education levels (e.g. in 2005 the rate was 33.4% for university graduates, 29.6% for high school graduates and 11.3% for individuals with primary education or lower) (ETF Country Reports).

Another issue is hidden unemployment, as there are large differences between self-declared unemployment and the data that is based on registration with employment offices. Rough estimates for Armenia indicate that only one-quarter of those who are actually unemployed are registered. If we include those who cannot be accorded unemployment status because they have not worked for at least one year (mainly young graduates entering the labour market for the first time), hidden unemployment represents almost 80% of all jobless persons. Very little information exists in Belarus with regard to unregistered unemployment; the country report (ETF, 2010c) indicates that it is less than one-third of the officially recorded figure. Men make up a higher proportion (around 67%) than women of the pool of unregistered unemployed; less well-educated persons also predominate (69.1% with incomplete, basic or secondary education). Although it has not been fully confirmed by empirical research, it appears that in most of the Eastern partner countries, a large proportion of unregistered unemployed people voluntarily left their jobs, while those who register were laid off.

Although the proportion of unemployed people in the labour force is not very different from that in the enlarged EU (except in Armenia)[61], the Eastern partners differ from the EU in the social protection given to unemployed individuals. In the EU, jobless individuals receive better unemployment benefits, more diverse assistance in terms of training, and extensive counselling and professional reorientation. In the Eastern partner countries, unemployment and poverty are very much synchronised. The cause of unemployment is also different: in these countries the main reason is the liquidation, bankruptcy or privatisation of enterprises. Moreover, only a small proportion of unemployed people start their own businesses; most job seekers try to find salaried work. A certain traditionalism prevails here, inherited from the Soviet era, according to which able-bodied persons should work for a wage; the entrepreneurial spirit is less developed because of the risks involved and sometimes the use of fraudulent practices. Although the type of job is not necessarily important for those seeking remunerated activity, wage decency represents a major criterion for accepting a job.

61 The large proportion of informal employment in the Eastern partner countries explains to a large extent why the two groups of countries are similar in this respect. National definitions are also very different from ILO definitions.

During their unemployment period, jobless individuals combine job seeking with survival through casual earnings, mainly in the informal sector. Around two-thirds of unemployed people in Belarus are involved in some irregular and unrecorded activity and the rest are family-dependent. In 2007, 41% of jobless Ukrainians used the services of employment offices; these were generally from groups that were less competitive in the labour market (women, rural inhabitants and less well-educated persons). Men preferred other search channels, with personal contacts used by the most (43.8% in 2007); job advertisement and direct contact with the employers accounted for another 24.4% of unemployed males looking for a job.

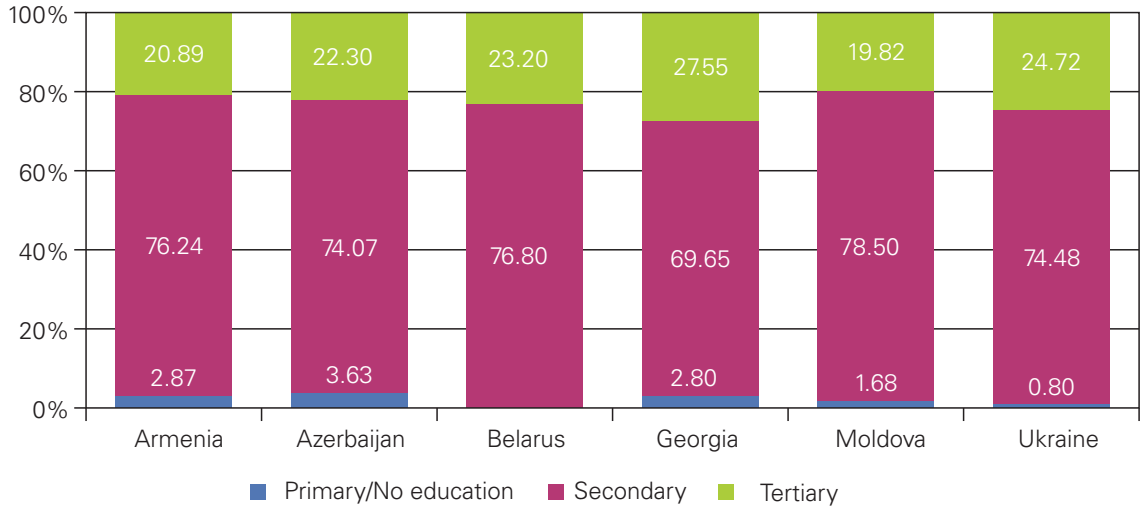
4.3.1 THE EDUCATIONAL LEVEL OF THE EMPLOYED POPULATION

Educational level represents the most important conditionality of labour supply, and individuals look for jobs that best fit best the human capital they have accumulated in the course of their education. As will be discussed extensively in Chapter 7, the probability of finding a job is closely correlated with educational level, and the expected wage rate also depends on educational attainment. Education pays even if individuals do not have sufficient specific human capital: thus more education – even if it is of a general rather than a specialist nature – offers higher returns in the labour market. Given this fact, and although there has traditionally been an appetite for learning in a region with highly educated populations from the Soviet era, the demand for education, especially for tertiary degrees, has increased significantly in all the countries. This increasing demand is also stimulated by another important factor: employment uncertainty.

Under the communist regime all graduates were automatically given a job; however, in the current circumstances, a degree is not necessarily any guarantee of employment. Furthermore, the jobs available in a market economy are much more diverse than they were during the communist era. Wages between the private and public sectors may differ noticeably, and working conditions are not the same in the capital city and in small provincial towns. Nevertheless, as a result of labour market competition – which was completely unknown in the Soviet era – good wages and appropriate working conditions are always associated with a certain risk of losing a job and its intrinsic privileges. Hence, competition increases the risk of not finding the expected job after graduation, and of losing a job once employed. More and better education is the most appropriate strategy to reduce this risk. This explains why, on average, almost one person in four had a tertiary degree in 2007, with Georgia leading the way in this respect (**FIGURE 4.3**). The proportion of women with university degrees is higher than that of men with the same level of education. For traditional reasons, Azerbaijan is the only exception in the group in terms of gender differences.

The proportion of people with primary or no education is very low, in terms of both employment and the labour force. However, the demand for unqualified workers belonging to this category is relatively high in Moldova and Ukraine. In both cases, the demand for female unskilled labour is on the whole greater than that for males. Georgia also has a demand for individuals with little education. Only in the Armenian economy is the unskilled labour force in less demand than workers with other levels of education. The possible explanation for this lies in the nature of economic activities. In Georgia and Moldova, for example, the largest proportion of employment is concentrated in low-qualified activities (agriculture, construction and small services) that offer very low wages. Consequently, a large proportion of unqualified people have migrated to Russia and Europe, where labour demand in those sectors is also high, but the wage rate is much higher than at home.

FIGURE 4.3 EMPLOYMENT BY EDUCATIONAL LEVEL, 2007 (%)



Source: ETF Country Reports.
Note: Primary, ISCED 1 and no education; Secondary, ISCED 2–4; Tertiary, ISCED 5–6. ISCED, International Standard Classification of Education.

In Ukraine, the construction and services sectors have expanded rapidly in recent years, demanding more labour than is available on the market. It appears that domestic services, which almost exclusively require people with little education (mostly women), may be responsible for this demand. Armenia is the only country where the economy demands workers with a higher level education than is available. This could be the result of a reorientation of the economy towards more complex activities that require higher levels of human capital. As already pointed out, the Armenian economy has created more jobs for the younger age groups in the labour force; this dynamism in restructuring the labour market could bias demand towards more innovative activities requiring better-educated people.

With respect to unemployment and educational levels, most unemployed young people have secondary general education. For example in Azerbaijan, the share of unemployed young people with secondary general education was 66% in 2007 (62% males and 72% females). Compared to a national average of 6.5%, the unemployment rates among tertiary and upper post-secondary graduates were 5.1% and 5.2% respectively. The unemployment rates for primary and lower secondary graduates were slightly higher. Ukraine reported an average rate of unemployment of 6.4% in 2007; for tertiary graduates this rate was 4.8%, while for people with primary or no education the corresponding rate was 0.6% (see Chapter 7 for further discussion on this point).

4.3.2 PART-TIME WORK AND MULTIPLE JOB HOLDING

Part-time employment or underemployment may be available as an alternative to unemployment. In some specific situations when demand is higher than supply, the opposite mechanism – that of multiple job holding – may come into play. While part-time work is mostly demand driven, holding more than one job is essentially a personal choice on the supply side. Underemployment is generally synonymous with a reduction in the number of hours worked, and may take several forms:

- a contractual agreement between employer and employee stipulating a work duration that is less than the legal one;
- periodic unpaid leave (also known as technical unemployment), which is used by employers to cope with disruptions in demand for their output;
- seasonal employment, which is frequent in agriculture and construction;
- occasional work, when employers need workers for short periods of time but not on a regular basis.

Part-time employment is less common in the Eastern partner countries than in the new EU member states, indicating less labour market flexibility and limited opportunities for combining work with studies or domestic obligations. However, underemployment was widespread during the transitional period in all the countries. As a rule, state enterprises frequently used unpaid leave as a method of maintaining employment while reducing the cost of overemployment. Moldova (in the first decade of transition) and Belarus (until recently) are examples in this regard. The private sector has also used other forms of underemployment, such as seasonality in agriculture and construction, and occasional employment in small businesses. The extent to which underemployment is used as a method of increasing labour market flexibility depends inversely on growth performance in the economy. In all countries for which statistical information is available, economic growth has been accompanied by a corresponding decrease in underemployment. It should be emphasised, however, that data on part-time work and underemployment is not always comparable between countries owing to the different definitions and statistical sources used (e.g. establishment surveys in Belarus and Ukraine, LFSs in Armenia and Georgia).

Two opposite trends can be observed in the Eastern partner countries with respect to underemployment and part-time work. The first is an increase in the number of underemployed people; in Moldova, underemployment reached 8% of total employment in the period 2005–07 (twice the level of the 2002–04 period). The same trend occurred in Georgia, where women as a proportion of underemployment increased from 50% to 60% between 2003 and 2006. In both countries, underemployment is mainly rural: 74% of the total in Moldova and 76% in Georgia. The second trend, relating to unpaid leave, is a declining one: in Ukraine, for example, the number of individuals taking unpaid leave as a proportion of total employment decreased from 21.5% in 1994 to only 1.1% in 2007. In parallel, the proportion of involuntary part-time employment declined from 6.4% to 4.4% (mainly in industry, which represented 54.3% of the total in 2007). This positive trend is the result of legislative changes that restrict the excessive use of unpaid leave and part-time employment (ETF 2009a, 2009b, 2010d).

The incidence of involuntary part-time work is also declining in Belarus; between 1998 and 2004, part-time workers as a proportion of total employment decreased from 4.0% to 3.2%. In the same period, the incidence of unpaid leave diminished from 4.7% to only 2.4% of total employment. However, this trend is mainly the result of declining participation rates; people preferred to abandon the domestic labour market and look for better-paid jobs in Russia, with which Belarus has a border. Indeed, the decrease in the incidence of both part-time work and unpaid leave is of the same magnitude as the decline in labour force participation rates. The estimates show that the real number of Belarusians working in the Moscow region (mostly in construction) was 60 times higher than that shown in the official figures (ETF, 2010c).

In Armenia, temporary, seasonal and occasional employment is mostly a feature of male employment (the rate of male temporary employment is double the female rate). Permanent (and therefore relatively secure) employment is preponderantly female. A particular feature is that the rate of occasional work increased by 3.1 percentage points between 2001 and 2006 (4.8

percentage points for men), reaching 4.3% of total employment (6.4% for men). This shows increasing polarisation in the labour market, with low-skilled, poor individuals trapped in casual, poorly paid and mostly informal activities. When combined with other forms of underemployment (especially part-time work), the number of people hired for shorter than the legally prescribed duration has increased since 2001. Overall, underemployment was 5.4 percentage points higher in 2006. Women appear to be more affected than men by underemployment in Georgia (60% of the total in 2006). A specific characteristic of Georgia is that underemployment affects those with higher levels of education to a greater extent (41.8% of total underemployment in 2006). Younger generations (age cohorts below 36 years) accounted for 51.6% of total underemployment in 2006. Most Georgian underemployment occurs in the education sector (30.0% of total underemployment in 2006), although this may be largely voluntary.

A declining trend in relation to multiple job holding can be observed in Belarus: the proportion of total employment represented by individuals having some form of additional work fell from 21.1% to 5.1% between 2000 and 2005. Secondary employment is common to both sexes, but is more frequent among young people and workers with higher levels of education. In Armenia in 2006, overtime for men occurred mainly in services (36.6%), agriculture (18.7%) and construction (23.9%), while women worked additional hours in agriculture (44.6%) and services (32.6%). Multiple job holding is not a major issue in the Armenian economy, as most people with an additional job are seasonal (non-wage) workers in agriculture. This is supported by the fact that an extension in working time has not translated into an increase in multiple job holding; in fact, the proportion of total employment represented by individuals holding additional jobs decreased from 4.6% to 3.2% between 2001 and 2006. Around 70% of those holding an additional job made this choice because the income from their main job was insufficient for their daily needs. The largest share of those holding multiple jobs is represented by non-waged workers (81.3% in 2006). Around 60% of additional jobs holders are men, and multiple job holding is most common in agriculture.

4.4 EMPLOYMENT STATUS AND THE SECTORAL EMPLOYMENT STRUCTURE

The most significant characteristics of employment in the Eastern partner countries relate to employment status and the sectoral structure of employment. An important sign of vulnerability is that in most of these countries, salaried workers represent a relatively low proportion of total employment. As can be observed in **TABLE 4.5**, in 2007 the proportion of total employment represented by salaried workers was 33.7% in Georgia, 41.8% in Azerbaijan, 49.7% in Armenia and 66.7% in Moldova. Only Ukraine, with 80.7% waged employment, was broadly comparable with the EU-27 average (87.7%) in 2007. No information is available for Belarus in this respect. The proportion of waged employment decreased from 2000 to 2007 in Armenia, Georgia and Ukraine (for which information was available); while Moldova experienced a slight increase.

This means that there is a higher incidence of self-employment (and family workers in the case of Georgia) in these countries. In fact, 58.2% of Azeris and 50.3% of Armenians work for themselves, compared with 31.0% in Moldova and 19.0% in Ukraine. Only one-third of employed people (33.7%) receive a wage in Georgia; the others are either self-employed (34.9%) or classified as family workers (28.4%), a category that is not very different from that of self-employment. Thus, self-employment and family workers in Georgia together account for 63.3% of total employment, indicating the huge fragility of the country's labour market (for more detailed data, see Appendix 4.4 at the end of this chapter).

On the basis of the limited information available it can be stated that employment status is not always a personal choice, and this is particularly the case for self-employed people in subsistence agriculture. As discussed in Chapter 2, land privatisation in all these countries (except Belarus) led to a fragmentation of ownership structures, creating too many small plots of land. Since other employment opportunities were limited, survival for the population meant that many people had to go back to subsistence agriculture, where they are almost automatically classified as self-employed in the national statistics. Thus, employment status is essentially an issue of access rather than preference. The large majority of people working on their own or involved in unpaid family activities do not have the opportunity to change their employment status. The status to which most people aspire is probably waged employment, yet this is still not available to many individuals, particularly in Georgia.

The sectoral structure of employment also confirms this fragility in Armenia, Azerbaijan, Georgia and Moldova, where the share of agricultural employment is still high. As can be observed in **TABLE 4.6**, agriculture plays a key role in absorbing employment in Georgia (53.4% of total employment), Armenia (46.0%), Azerbaijan (39.0%) and, to some extent, Moldova (32.8%), although the importance of this role is fast diminishing. However, the corresponding value added to GDP is extremely low in Georgia, Azerbaijan and Moldova and, to a lesser extent, Armenia, indicating very low productivity and possibly high poverty levels. The lowest level of agricultural employment is in Belarus (11.8% of total employment), followed by Ukraine (16.7%). On the other hand, industry is still an important employer in Belarus (28.4%) and Ukraine (23.9%), particularly for the male labour force. Industrial employment is at a much lower level in the remaining countries in the group, mainly around 10–15%. Finally, in all the countries except Georgia and Armenia the services sector represents a large proportion of employment, mostly around 50% of total employment and reaching almost 60% in the case of Ukraine.

TABLE 4.5 EMPLOYMENT STATUS, 2000 AND 2007 (% TOTAL EMPLOYMENT)

Country	Status	2000			2007		
		Total	Male	Female	Total	Male	Female
Armenia	**Salaried workers**	52.8			49.7		
	Self-employment*	47.2			50.3		
	Family workers						
Azerbaijan	**Salaried workers**				41.8	50.7	32.7
	Self-employment*				58.2	49.2	67.3
	Family workers						
Georgia	**Salaried workers**	37.2	37.5	36.9	33.7		
	Self-employment*	32.5	39.0	25.8	34.9		
	Family workers	29.5	22.7	36.7	28.4		
Moldova	**Salaried workers**	62.8	63.7	61.9	66.7	63.7	69.7
	Self-employment*	30.0	30.8	29.3	31.0	35.0	27.0
	Family workers	7.2	5.5	8.8	2.3	1.3	3.4
Ukraine	**Salaried workers**	89.9	90.6	89.2	80.7	81.8	79.5
	Self-employment*	9.0	8.6	9.3	18.9	17.7	20.2
	Family workers	1.1	0.8	1.5	0.4	0.4	0.4
EU-27 average	**Salaried workers**				87.7		
	Self-employment*	15.8**			10.5		
	Family workers				1.8		

Source: ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240; Eurostat: http://epp.eurostat.ec.europa.eu/; OECD: http://stats.oecd.org/Index.aspx?DataSetCode=CSP2010
*Note: *Self-employment includes own-account workers, cooperatives and a very small number of employers (only 5.0% of employment in Azerbaijan, 1.1% in Georgia and 0.9% in Moldova); **Data for EU-15.*

TABLE 4.6 MAIN ECONOMIC SECTORS BY THEIR VALUE ADDED TO GDP AND THEIR EMPLOYMENT SHARE, 2007 (% TOTAL)

Countries	AGRICULTURE		INDUSTRY[1]		SERVICES	
	GDP share	Employment share	GDP share	Employment share	GDP share	Employment share
Armenia	20.3	46.2[2]	43.9	15.6[2]	35.8	38.2[2]
Azerbaijan	7.0	38.7	68.5	12.8	24.5	48.4
Belarus	8.7	11.8[3]	42.1	36.7[3]	49.1	51.5[3]
Georgia	10.7	53.4	24.3	10.4	65.0	36.0
Moldova	12.0	32.8	14.8	18.7	73.2	48.4
Ukraine	7.5	16.7	36.7	23.9	55.8	59.4

Source: WB WDI: http://data.worldbank.org/data-catalog/world-development-indicators/
Notes: 1. Construction is included in industry; 2. Reference year for Armenia is 2006; 3. ETF Country Report for Belarus (2010c) (industry (28.4%) and construction (8.3%), which together make up 36.7%).

However, it should be noted that as a result of the differences in national definitions, the demarcation between the three economic sectors is not always very clear. Services, for example, include mostly construction, public administration and other social services, increasing the sector's contribution to employment. Armenia poses a specific problem in this respect, since the two statistical sources (the LFSs and establishment surveys) give entirely different proportions for the same years. Thus, the data should be approached with caution, and more elaboration is needed for these reasons. Appendix 4.5 at the end of this chapter presents a more detailed overview of the sectoral allocation of employment by gender, enabling comparisons over time to be made in these countries.

Moldova's economy is largely dependent on agriculture, yet the proportion of employment represented by this sector is lower than one would expect, while industry is relatively well represented. In reality, a considerable part of industrial activity is related to the food industry and, therefore, to agriculture. Employment in agriculture is low in Belarus, as low as 2% according to some sources (ETF, 2010c). There are still a significant number of state agricultural organisations in Belarus, and if the individuals involved in these organisations are not classified as being in agricultural employment, this could explain why agriculture represents such a low proportion of employment. There is insufficient information available to allow more detailed explanations to be provided regarding this particular feature.

It should be emphasised that employment in agriculture is not easily analysed, as the vast majority of people involved in this sector in most of the Eastern partner countries are self-employed and carry out subsistence-type activities. In Georgia, Moldova and Azerbaijan, at least, agriculture can hardly be considered an economic sector in the sense intended in developed countries. The preponderance of subsistence farming on small plots of land has made this activity a buffer for employment lost during the restructuring of industrial enterprises and collective farms. Agriculture still represents a survival activity for around half of the population in these three countries. Only Armenia, as a result of early and rapid land privatisation, seems to have gained some efficiency in agricultural activities.

The high level of agricultural employment is the direct consequence of the land privatisation already completed in five of the countries, and still pending in Belarus (see Chapter 2). The contribution of agriculture to employment is directly proportional to progress in transferring ownership to private hands. This reform was essential for dealing with the large cohorts of employees who became jobless after the restructuring of industrial public enterprises and state-owned farms. The necessity of ownership reform in agriculture is incontestable, but the change in land titles has not been adequate to ensure the proper development of the sector, nor to increase efficiency and productivity and, therefore, ensure a decent standard of living. In none of these countries was ownership reform followed up by additional measures to improve the conditions of farmers in terms of production, distribution and technical endowment. Farmers lack a basic infrastructure in some countries (Azerbaijan), technology (in all) and other facilities such as an adequate irrigation network. Investment in agriculture remains minimal. In most cases the land has been excessively fragmented into small plots, which makes production inefficient. Vertical integration between agriculture and food processing collapsed everywhere except in Belarus. All these elements have undermined any form of entrepreneurial initiative.

Consequently, employment in agriculture initially jumped to high levels when survival was a top priority for most people. The subsequent economic recovery was essentially urban; rural populations benefited very little from the recovery, if at all. As a result, the initial boom in agricultural employment commenced a downward trend as people started to look for other opportunities to earn a living, whether in services, in small informal activities (particularly construction) or outside the country. An illustrative example is provided by Moldova where, in 1999, agriculture accounted for half of total employment; less than a decade later, this share was only around 33%. Not surprisingly, the proportion of the total population represented by the 15–24 age cohort had declined by 77% during that period.

With the exception of Georgia and Moldova, employment in industry has largely remained constant in the Eastern partner countries since 2005. However, significant changes in terms of gender took place in Azerbaijan, where male employment increased between 2005 and 2007 by 6.2 percentage points, in contrast with a decline of almost 5 percentage points in female employment. In Georgia and Moldova, where industrial employment increased slightly, male employment rates have risen much faster than female rates. As would be expected, industry is a predominantly masculine domain and has become even more so in recent years: in 2007, 5.6 times more men than women were employed by this sector in Azerbaijan, and in Moldova the female employment rate was half the male rate (ETF 2009a, 2010b, 2010d).

In the services sector the most important changes were recorded in Moldova and Ukraine, where the overall employment rate gained 5.1 and 3.0 percentage points, respectively, between 2005 and 2007. In Armenia, Azerbaijan and Belarus, employment remained almost constant. The share of services in total employment is particularly high in Belarus and Ukraine, which may be the consequence of differences in statistical classifications. In all six countries, the services sector is mostly a female activity, employing on average 26.6% more women than men[62]. This trend was accentuated in 2007: in Moldova the ratio of men to women declined from 0.786 in 2006 to 0.683 in 2007. It seems, therefore, that some countries have experienced a certain sectoral substitution of female employment in the past few years: men have left agriculture and services for industry (in Azerbaijan and Georgia), while women have left agriculture for services (in Moldova).

62 The average is calculated for the five countries for which information is broken down by gender.

Like agriculture, the services sector represents an important buffer for employment. Both sectors are characterised by labour-intensive activities; their share of employment is significantly higher than their proportion of value added and GDP. Industry is the only sector in which GDP growth is higher than employment growth, given its technology-intensive nature. An exception is Moldova, where the opposite situation exists: the contribution of industry to employment is higher than its contribution to value added, as industry is dominated by the food industry, which adds relatively little value.

A more detailed analysis of employment by sector reveals that the sectors that were most dynamic in other transitional countries (financial intermediation, property, hotels and restaurants) developed more slowly in the Eastern partners countries (**TABLE 4.7**). There was little change in the contribution to employment of these sectors, which are supposed to be private and to absorb the workforce at an accelerated pace. In most of the countries, almost the same economic structure was found in both 2000 and 2007. Economic growth did not bring about a major inter-sectoral mutation, despite privatisation and the emergence of new businesses. The Eastern partners have therefore remained rather traditionalist in terms of diversifying their economic activities, while new sectors have had difficulty in expanding. The figures, however, are not always comparable owing to national differences in the way economic activities are defined by sector. In addition, lack of accuracy in the data is a problem, particularly in Armenia, where employment in construction declined between 2002 and 2007 in the establishment survey, but doubled in the same period according to LFS data. As the value added by construction was 4.5 times higher in 2007, the latter seems to be the more reliable source.

Overall, the economies of the six countries have maintained, and even expanded, labour-intensive activities that have relatively low added value and do not require high qualification levels. This is not necessarily a problem, as long as the situation changes in the near future. The gearing of an economy towards more labour-intensive sectors is in part due to an instinct for self-preservation: the massive layoffs caused by the transition, combined with a lack of the resources to build corresponding safety nets, forced a large number of people to look for ways to survive in an adverse economic environment that is characterised by limited

TABLE 4.7 STRUCTURE OF EMPLOYMENT BY ECONOMIC SECTOR (%)

	Armenia		Azerbaijan[1]		Belarus		Georgia		Moldova		Ukraine
	2002	2007	1999	2007	1999	2007	2002	2007	1998	2007	2006
Agriculture, forestry and fisheries	45.26	46.02	42.3[1]	38.90	17.0	11.8	53.8	53.4	45.7	32.8	17.62
Mining and quarrying			1.07	1.10			0.3	0.3			
Industry	12.93[2]	12.25[2]	4.88[4]	4.90[4]	29.4	28.4	4.6[6]	4.9[6]	11.0	12.7	19.47[7]
Construction	3.26	2.82	4.18	5.60	7.1	8.3	1.9	4.2	3.5	6.1	4.76
Water, gas and electricity			1.05	1.00			1.4	1.1			
Trade and repair	9.00[3]	10.39[3]	15.57	16.30			11.7	9.9	12.7[3]	15.9[3]	21.24[3]
Hotels and restaurants			0.26	0.60			0.8	1.1			
Transport and communications	3.63	4.32	4.55	5.10			4.3	4.2	4.7	5.5	6.89
Financial services	0.47	0.81	0.41	0.40			0.4	1.0			1.38
Real estate services	2.73	2.39	2.67	3.00			1.1	2.0			5.03
Public administration and defence	2.15	3.44	7.03	6.80			5.9	3.8	17.5[8]	20.0[8]	4.99
Education	13.69	9.19	8.09	8.50			7.1	7.3			8.15
Health and social services	6.05	4.56	4.54	4.50			3.4	3.5			6.54
Other	0.81	3.81	3.40	3.30	46.3[5]	51.5[5]	3.2	3.5	4.9	7.0	3.92[9]

Source: ETF Country Reports.
Notes: 1. Both formal and informal employment; 2. Includes mining and quarrying, and water, gas and electricity; 3. Includes hotels and restaurants; 4. Only manufacturing, includes oil processing; 5. Includes all services; 6. Only manufacturing; 7. Includes education, health, social services; 8. Only manufacturing, includes mining and quarrying; 9. Municipal and individual services.

employment opportunities and a drastic reduction in earnings. They therefore started and maintained small-scale activities and, since capital was inaccessible to most of them, labour became the essential factor of production.

4.4.1 THE INTER-SECTORAL REALLOCATION OF EMPLOYMENT

Most employment restructuring took place at the inter-sectoral level: across economic sectors, and between the public and private sectors. In the first case, shifts occurred between agricultural and non-agricultural sectors, and also within the non-agriculture sectors. Over the transition period, the level of employment declined continuously in specific activities and sectors, with no subsequent recovery. The shift from the public to the private sector was much more significant during the first decade of transition, when land privatisation and mass privatisation programmes were implemented.

Between 1990 and 2007, total employment in Armenia declined by almost 47%. The increase of agricultural employment determined an overall increase in the workforce of almost 75%, while non-agricultural employment contracted by 125% in the same period. Only trade and financial intermediation (the latter a new economic sector) experienced an increase in employment. In 2007, industry employed 3.6 times fewer people than in 1990, and construction 6 times fewer. It should be noted, however, that the real decline in construction was less dramatic, since this sector is known to use a large number of informal workers. In fact, the effective decrease over the period is estimated to be 50%. A major shift occurred in Armenia from the non-agriculture to agriculture sectors in the early years of transition, followed by an inter-sectoral shift across non-agricultural sectors.

In spite of the dominance of the private sector in Armenia's economy today, the public–private transfer of employment has not been very dramatic in reality. Land privatisation at the outset of transition immediately boosted private employment, and the subsequent mass privatisation process in the rest of the economy added a further substantial share to the sector. Consequently, within around five years of independence, the share of the private sector in Armenian employment had already reached more than 60%. But the true emergence of the private sector occurred much more slowly: once the main privatisations had been completed, the sector's contribution to the economy represented an increase of around eight percentage points between 2000 and 2007. The so-called de novo private sector represented 47% of Armenian GDP and 30% of employment in 1999. This clearly reveals higher productivity in new businesses as compared to privatised firms – up to eight times higher, according to certain estimates.

Over the whole period of transition, the number of jobs lost in the public sector in Armenia was never entirely replaced by newly created jobs in private enterprises. This was the case even during periods of high economic growth: between 2002 and 2007, the ratio between the number of jobs created and those destroyed was only 0.93. Therefore, high GDP growth rates did not contribute to employment expansion in the Armenian economy. Significant net job-creation rates were recorded in trade and public administration, where newly created jobs represented 86% and 82%, respectively, of total job turnover. The highest rates of net job destruction were in education (100% of turnover), healthcare (44.0%) and industry (43.6%).

In Azerbaijan, an analysis of the mechanism of job creation–destruction is affected by two factors: the unclear distinction between formal and informal employment, and the influence of the state, which intervenes in the economy to create new jobs through a special government programme aimed at stimulating regional employment. Between 1999 and 2007, only the services sector was a net creator of jobs (221 600), while a total of 236 300 jobs were lost in industry, agriculture and construction. However, it appears that the informal sector was very active in creating new jobs; over the same period, the three sectors that officially cut employment in reality created more than 650 000 (informal) jobs. These figures should be interpreted with caution because the definitional borderline between formal and informal employment is not very clear in Azerbaijan. Moreover, there is no information on job turnover, which would enable the mechanism to be better understood. During the period 2000–07 in the industrial sector, most jobs were lost in light industry, machinery and electrical equipment, while metallurgy created almost 60% of the new industrial jobs.

At a more disaggregated level, net job losses occurred in property and transportation in Azerbaijan during the period 1999–2007. This is in contrast to the typical trend in other transitional countries, in which these two activities expanded rather rapidly. The only possible explanation is that employment in Azerbaijan shifted from the formal to the informal sector. However, it is not clear whether this reallocation took place within the same activity, or whether certain sectors were better suited to developing informality and therefore attracted workers from other domains. It is thus impossible to say whether the shift from formality to informality was sectoral or inter-sectoral. If the official statistics are reliable, then the shift in agriculture was simply from formal to informal activities, as the number of jobs lost in formal activities was practically the same as the number of jobs that were created in informal activities. In construction and industry, some formal workers became informal, while the rest migrated to the services sector. However, in the services sector there was a clear trend towards formalisation that was contrary to the overall trend. Given the lack of specific reasons for such a large-scale move towards formal employment in services, the statistics do not look sufficiently reliable; trade seems to be destroying the largest number of informal jobs, while creating a significantly higher number of formal jobs.

63 The ETF Country Reports corresponding to the six Eastern partners were heavily drawn upon as the key information sources for this section (see ETF 2009a, 2009b, 2010a, 2010b, 2010c, 2010d).

Between 1999 and 2007 the private sector in Belarus was a net creator of jobs, while the public sector destroyed several times more jobs than it created. Nevertheless, the definition of private activities in Belarus is ambiguous. The services sector represented the main source of job creation between 1999 and 2003, with the construction sector recording the highest rate of job creation since 2000. Employment has been lost on an ongoing basis in agriculture, but in particular between 1999 and 2003. Since 2005, the services sector has become a net destroyer of jobs. Trade was the top job creator within the services sector over the whole period 1999–2007, while the largest number of jobs were lost in the transport and communications sector over the same period.

In Georgia the sectoral structure of employment did not change significantly between 2002 and 2007. Overall employment shrank by 7.3%; public administration lost the highest number of jobs (almost 41.0%), followed by electricity, gas and water (31.5%). Surprisingly, the trade sector lost 21.6% of jobs over the period. The property sector recorded the highest rate of net job creation (69.7%), followed by financial intermediation (25.4%). At enterprise level, more than half the companies have expanded their business and increased the number of employees since 2005.

Moldova recorded the most significant inter-sectoral reallocation of employment of all six countries. Considered to be a traditional agricultural country for a long time, Moldova has succeeded in reducing agriculture's significance in both employment and GDP over the past decade. During the same period, industry gained economic importance. However, construction remained the most buoyant sector in terms of creating jobs. Trade also contributed to net job creation in the economy, but to a lesser extent. Construction and trade absorbed a significant part of the employment that was liberated from agriculture. The banking system also contributed significantly to job creation. Labour reallocation across sectors followed the standard development paradigm observed in market economies: employment shifted from agriculture to services. A specific aspect of job creation in Moldova related to the type of ownership of the companies that created new jobs. While domestically owned private enterprises recorded a net rate of job loss between 2003 and 2006, ranging from 3.9% to 5.0%, foreign-owned firms were net creators of jobs over the same period, at rates varying from 2.9% to 4.2%. In fact, the size of foreign companies increased within that time interval from 132 to 148 workers on average, while the size of domestically owned firms fell from 130 to 111 employees on average.

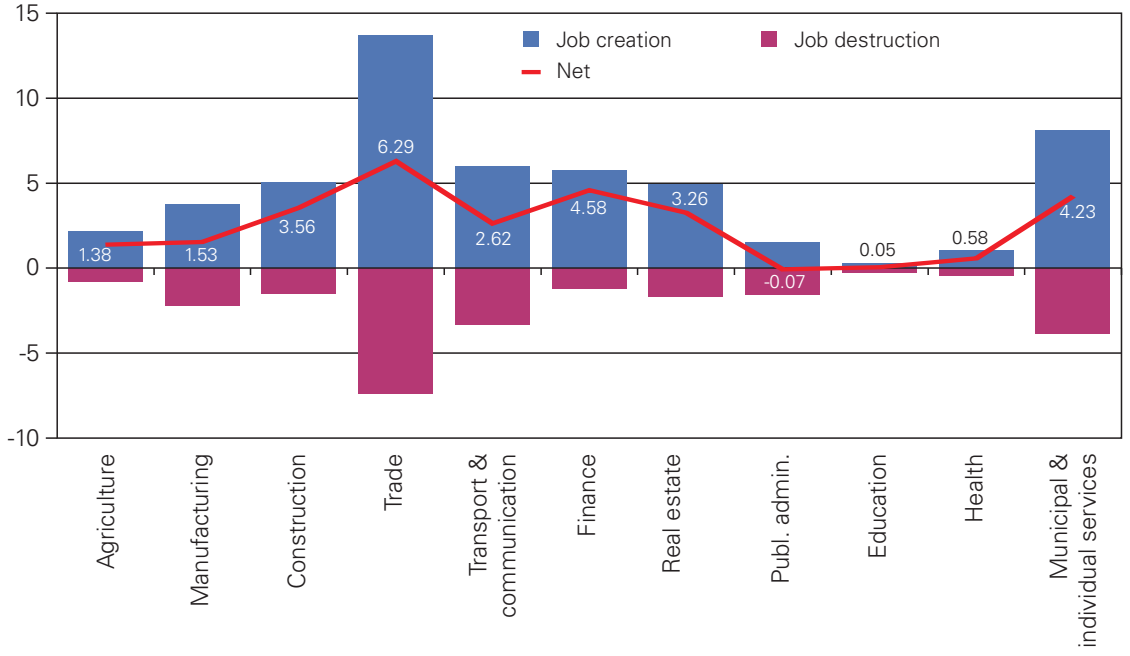
Ukraine has experienced a slower pace of job creation than other countries in the region. Although the process of employment reallocation has accelerated since 2002, net job creation in 2007 represented only 2.8%. Most job reallocation occurred within sectors rather than between sectors, signifying that the process was essentially determined by the expansion or contraction of enterprise size in employment terms. In this context, small enterprises had higher rates of job creation than medium and large companies. However, larger firms cut fewer jobs than smaller ones and thus recorded higher employment gains. The Ukrainian companies that conducted more trade with the EU were net job creators, while those trading with the CIS had higher job destruction rates than average.

As can be observed in **FIGURE 4.4**, the trade, financial intermediation, and transport and communications sectors were the major sources of net employment growth in the Ukrainian economy. The proportion of total job turnover that they accounted for exceeded the proportion of employment they represented. Little job reallocation took place in public administration, agriculture and social services (education and healthcare). Municipal and individual services, together with trade, recorded the highest employment turnover in the economy. In all sectors except public administration, the number of jobs created in 2006 was higher than the number of jobs destroyed. Most of the jobs created were for skilled manual workers (53% of all newly created jobs in 2007), which suggests that the demand for this category of workers was relatively high in the economy. This is also confirmed by the type of job vacancies registered with the Ukrainian PES in 2007: 47.4% of vacancies were for skilled manual workers. This indicates that the Ukrainian labour market was looking for more or less the same type of skills that were lost to a large extent during the liquidation and privatisation of industrial enterprises. The fact that the demand for such workers exceeded supply leads to the conclusion that the VET system may not be well adapted to market needs.

Another important feature that appears to be present in other Eastern partner countries was that most new jobs (around 60%) between 2000 and 2007 were created in the informal sector. Overall, the types of skills required for the jobs created in the economy differed significantly from the qualifications required for the jobs that were destroyed. In other words, the mechanism of job creation–destruction operating in the Ukrainian economy was also readjusting the skills structure of the workforce. Although there is no empirical evidence in other countries in this respect, it is likely that the same adjustment mechanism operated in all six economies. Thus the process of job creation–destruction had two main roles in restructuring employment.

1. **Inter-sectoral adjustment.** These were employment shifts from economically less viable sectors to those that were responding better to the challenges of competition, globalisation and modernisation. This process helped to change the economic structure and possibly assisted with economic diversification by reorienting activities towards more productive sectors. The demand for labour in this case indicates the number of people needed in a specific activity. In declining sectors, this demand was below the existing supply, generating unemployment and relatively low wages; in expanding sectors, labour demand exceeded supply, which explains why wage rates were higher than the national average in these cases.

FIGURE 4.4 JOB REALLOCATION IN UKRAINE BY ECONOMIC SECTOR, 2006 (%)



Source: Author, based on ETF (2009b).

2. **Intra-sectoral skills adjustment.** These were employment shifts within the same sector of activity, with new jobs requiring different types of qualifications. This mechanism changes the employment structure with respect to skills, and thus represents the most important signal from the labour market to the education system. Intra-sectoral adjustment is generally associated with technological restructuring: modern physical capital replaces obsolete technologies and requires slightly different types of skill. Labour demand in this case indicates the type of qualification required by the market; when demand differs from supply, the sector (and the economy) is confronted with a skill mismatch. The box below describes the special case of Ukraine regarding its skill mismatch.

THE IMPLICATIONS OF SKILL MISMATCHES: THE UKRAINIAN CASE

While common patterns can be identified across all the Eastern partner countries with respect to inter-sectoral adjustment, it appears that the skill mismatch is particularly significant in Ukraine, where the skills premium is still modest compared to other countries (World Bank, 2009f). For 20% of Ukrainian firms, the non-availability of skilled workers represents a major obstacle to operations and growth. This percentage is higher than in any other transition economy. The lack of skills is perceived by employers as being more problematic than corruption or the difficulty of obtaining credit. Moreover, it takes significantly more time to fill a job vacancy in Ukraine than in most other transition economies, particularly for skilled manual workers. The economy is therefore suffering from skills shortages coinciding with unemployment. In other words, many unemployed people cannot find a job because they lack the skills required by firms.

Higher demand for certain skills (highly qualified workers) coexists with insufficient demand for other types of skills (mainly less qualified labour). This skill mismatch affects economic performance and company growth, reducing the level of job creation while increasing structural unemployment. A particular feature of the country is that the high demand for VET skills has not raised the relative wage rate, which remains low. This contradicts the basic rule of a market economy, which is that an increase in demand for a particular occupational group pushes the wages for this group up, thereby restoring labour market equilibrium. Wage increases for a particular category of labour represent an important market signal, as they induce a reorientation in the demand for education relating to those skills. This mechanism does not function correctly in Ukraine, resulting in a shortage of skilled workers.

4.4.2 PUBLIC AND PRIVATE SHARE OF EMPLOYMENT

With the exception of Belarus, all the countries have dominant private sectors, in terms of both GDP and employment. In general, the decline in public employment after 2000 was slower than it was during the first decade of transition when the main privatisations were implemented. Between 2002 and 2007, private employment gained only six percentage points in Armenia and around two in Georgia. During the same period, the proportion of total employment represented by the private sector remained constant in Moldova (60%) and even declined in Azerbaijan (by half a percentage point).

A public–private comparison of employment is not very conclusive for the analysis, since the figures corresponding to private employment include workers in agriculture (essentially self-employed in most of the countries), much of which is subsistence agriculture. In Azerbaijan, for example, 31.3% of total employment in 2007 was concentrated in household agricultural farms, with female employment accounting for 38.3% of the total. Family farms represented the activity employing the highest number of people in Azerbaijan. Non-agricultural employment is therefore a more appropriate measure of employment performance. Such information is not available for Georgia and Ukraine. Within the remaining four countries, the lowest share of non-agricultural employment was recorded in Azerbaijan and Moldova: of the total number of people working in the private sector, agriculture employed 53.6% in Azerbaijan and 45.8% in Moldova.

Belarus and Ukraine have made little progress in expanding the private sector's contribution to total employment. Belarus has been very slow in terms of reducing the role of the state in the economy through privatisation, while private initiative through entrepreneurship has not been actively stimulated. Official statistics are not fully reliable, as until recently the state was able to control even privatised companies through the golden share principle. The distinction between private and public is therefore very ambiguous in many respects, including in employment. In Ukraine the slow expansion of the private sector in terms of employment is the result of a lengthy and bureaucratic process of privatisation, combined with a persistently unfriendly business environment for the development of private businesses.

The dynamics of private employment should be considered from two angles: public–private substitution, which takes place during ownership transfer (privatisation), and the development of new private activities (de novo private sector). In all countries, the first component is still prevalent, but certain activities – mostly construction and services – have gained more weight in recent years in terms of employment creation. In fact, a more appropriate measure of private sector performance in terms of employment would be net job creation by the de novo private sector. The privatisation process does not create employment; it simply changes the nature of ownership and, consequently, the statistical classification of workers. Moreover, privatisation has always been accompanied by technological change, which significantly reduces the workforce. The proper mechanism of analysis would examine:

i) the number of jobs destroyed by the public sector during privatisation and restructuring;
ii) the number of jobs created by the de novo private sector;
iii) the net rate of employment absorption of the private sector (the difference between first and second indicators).

If the difference is positive, the emerging private sector has the capacity to assimilate workers laid off by the public sector (given relatively low inflows of newcomers to the labour market). Unfortunately, such statistical information is either not available or only partially available in most countries.

4.4.3 REGIONAL DISPARITIES IN TERMS OF EMPLOYMENT

Employment adjustment across the three major sectors – industry, agriculture and services – has been significantly affected by the regional disparities that exist in practically all the Eastern partner countries. These regional differences are the result of a variety of factors, one of the most important being a high degree of heterogeneity in the labour markets. Certain areas have been particularly affected by the closure of large industrial complexes inherited from the Soviet era, leading to mass unemployment. At the same time, transitional reforms have been implemented unevenly, and investment has been distributed unequally across regions. Consequently, labour markets are heavily localised and possess specific characteristics.

There is a regional disparity between rural and urban employment, with rural rates higher than urban rates in some countries (Azerbaijan, Georgia and Moldova). Clearly, this is the result of large-scale agricultural self-employment. In Georgia, for example, the rural employment rate in 2007 accounted for 70.0% of the rural population, compared with a figure of only 40.4% in urban areas. Another regional difference exists between the largest cities and the rest of the country, with employment opportunities concentrated mainly in large urban centres. In Armenia the differences in employment rates by *marz* (province) can be as high as double. The coastal region of Azerbaijan is economically much more developed than the rest of the country, leading to large differences in employment rates (ETF, 2009a, 2010a, 2010b, 2010d).

Regional differences are also significant in relation to unemployment. Rural areas fare better than urban areas; owning land is equivalent to self-employment, so landowners are automatically excluded from the

unemployment pool. Significant discrepancies exist between the largest cities, where job opportunities are more numerous, and small towns, where the probability of finding work is much lower. In Belarus, according to the national statistics, unemployment in Minsk is only half the national average and several times below the rate recorded in the Grodno region. On the other hand, large cities could be recording much higher rates of unemployment because the apparent existence of job opportunities attracts many people from the rest of the country. One example of this is the fact that the unemployment rate in Tbilisi was almost double the average for Georgia in 2007. Differences are also significant at the level of administrative regions. In Armenia in 2007 there was a gap of 25 percentage points between the two regions with the lowest and highest unemployment rates; in Moldova, the unemployment rate in Chişinău was double that of the southern regions (ETF, 2009a, 2010a, 2010c, 2010d).

Regional disparities persist (and in some cases are increasing) because inter-regional labour mobility, including commuting, is restricted by deficiencies in the transport infrastructure, a shortage of accommodation and significant regional differences in property prices, and also by the fact that VET has not been properly adapted to local needs. VET policy in all Eastern partner countries is coordinated at the central level, through programmes and strategies that fail to pay sufficient attention to regional characteristics.

4.5 THE INFORMAL SECTOR

Undeclared activities[64] represent a considerable proportion of Eastern partner economies, although there are significant differences in terms of definitions of informality that make comparisons rather difficult. Together with emigration and subsistence agriculture, informality has represented an important coping strategy for a significant number of poor people. In general, individuals turn to the informal sector either because they are attracted to it or because they are forced to do so. People are attracted to informal employment because of the weakness of the state, poor law enforcement, and corruption. Individuals may be forced to choose informal employment because of excessive bureaucracy, high taxation, cumbersome legislation, uncertainty, an unfriendly business environment and a lack of employment opportunities in the formal market. Informality is the result of both these factors, although one tends to prevail over the other. More specifically, the following factors are responsible for increasing informality in the Eastern partner countries.

1. There has been a reduction in public formal employment, both in administration and in enterprises, that has largely been nurtured by privatisation and subsequent restructuring.
2. The land reform and the removal of direct and indirect state subsidies to collective and state farms caused them to be gradually dismantled, and consequently destroyed a large number of formal jobs, which have now been transformed into self-employment-type activities, mainly in subsistence agriculture.
3. The bargaining power of employers over employees increased in the first decade of transition when unemployment became endemic, poverty widespread, and employment opportunities very rare. The abundance of labour in the market allowed employers to set their own rules of the game. Cost minimisation of labour inputs became the major competition strategy for private firms, and this was easier to put into practice under informal or semi-formal arrangements, which enabled employers to avoid paying social security obligations, and avoid high tax rates and the regulatory burden of the official economy.
4. There has been a rapid erosion of real wages, pensions and other forms of income, as well as of accumulated savings. This situation forced many people to look for unofficial opportunities to earn additional income, and often the only alternative was the informal sector.
5. Productivity in certain activities has been low, since some companies cannot compete in the market if they pay, in addition to wages, the corresponding social contributions. The same cost-cutting strategy described above is therefore applicable to this case, which is possible only in informal conditions.
6. Workers often prefer higher informal salaries without social coverage in the present, than lower (official) wages and the prospect of a modest pension in the future. Moreover, the low level of social benefits (pensions and healthcare) reduces the potential loss implied by being informal.

TABLE 4.8 below gives estimates of the size of the informal sector in all six countries. Although estimates are rarely accurate, several common characteristics can be identified. The first relates to the employment status of those involved in undeclared activities: most are self-employed, but there is empirical evidence (Bernabè, 2008) of growing informality among salaried workers undertaking temporary, occasional and seasonal private jobs. Bernabè (2002) concludes that in Georgia in 1999, up to 70% of salaried employment was informal. A second characteristic is that women, young people, less well-educated persons and those living in poor households are most likely to work in the informal sector. Thirdly, the sectors in which informality predominates are agriculture, trade and construction.

64 In our analysis, informal (undeclared) activities relate exclusively to that part of the economic sphere that is not reported and therefore is officially unrecorded. Criminal activities (smuggling, drug trafficking, etc) are not taken into consideration. It should be mentioned that the definition of informality is quite diverse in the literature. The World Bank (www.worldbank.org/depweb/english/modules/glossary.html) describes the informal economy as 'the exchange of goods and services not accurately recorded in government figures and accounting; the informal economy, which is generally untaxed, commonly includes goods and services including day care, tutoring and black market exchanges'. The definition of the informal economy given in the MacGraw Hill Online Learning Centre (http://highered.mcgraw-hill.com/sites/0070294267/student_view0/glossary_e-l.html) is 'small-scale family businesses in temporary locations outside the control of normal regulatory agencies', and that given in the Business Dictionary (www.businessdictionary.com/definition/informal-economy.htm) is 'a system of trade or economic exchange used outside state-controlled or money-based transactions' and including 'barter of goods and services, mutual self-help, odd jobs, street trading, and other such direct sale activities. Income generated by the informal economy is usually not recorded for taxation purposes, and is often unavailable for inclusion in gross domestic product (GDP) computations'.

TABLE 4.8 INFORMAL SECTOR: SIZE AND FEATURES

Country	Date	Size and features
Armenia	2002-2007	Undeclared work: 23–25% of non-agricultural employment. Agriculture: 98%; total economy: 50%.
Azerbaijan	2007	66% of employment, but the definition is broader; manufacturing: 44%; 75% of 15–24 year-olds.
Belarus*	2007	33% of employment; 28–43% of GDP; the official figure is around 10%.
Georgia	1999	Up to 70% of salaried workers are informally employed (Bernabè, 2002).
	2007	26% of employment; 60% of informal workers have higher education.
Moldova	2007	One-third of employment, mostly in agriculture (46%); 11% of informal work in formal firms, but legislation allows for non-declaration of small activities (trade).
Ukraine	2002	36% of GDP; 17% of employment.
	2007	32% of GDP; 22% of employment (71% in agriculture). Frequent underdeclaration of wages.

Source: ETF Country Reports.
*Note: *The official figure for Belarus was provided by the Ministry of Labour and Social Protection to ETF staff during a mission to Minsk on 3–7 February 2010.*

Given the large share of subsistence farming, the analysis should focus on the presence of informality in non-agricultural activities, where informality takes two major forms, irrespective of the employment status of those involved: undeclared workers and non-registered employees. In general, the first type predominates; in Armenia over the period 2002–07, undeclared work represented around two-thirds of the non-agricultural sector, involving 23–25% of non-agricultural employment. Informality in agriculture accounts for 98% of employment in the sector; if agriculture is included, half of the country's employment is informal (ETF, 2010a). The figures for informal employment are based on statistical information from surveys, but data accuracy is sometimes too poor to allow robust conclusions to be drawn regarding the dynamics of informality. According to the 2007 Armenian LFS, the share of informal employment in 2007 was lower than in 2002 by more than 5 percentage points, while the disaggregated data show that informality in construction, transport and trade increased noticeably in 2007. In construction, 74.4% of employment is informal; trade is in second position, with 50.6% of informal employment, followed by industry with 21.3%, where, surprisingly, women are highly represented (26.9%).

The issue of employment informality in Azerbaijan has specific features: according to the national definition, all persons outside the formal system of state regulation are considered to belong to the informal system. This means that self-employed individuals, family workers and those working on their own are officially informal. Consequently, 66% of total employment in the economy is informal according to official statistics. Informal activities have therefore created more jobs over the transitional period than the formal sector, particularly in agriculture, where 97% of activity is informal. Moreover, informal activities are growth-resistant: despite exceptionally high rates of GDP increase, the extent of informal employment has remained practically constant (67% in 2000 and 66% in 2007). Therefore, economic growth does not formalise underground activities in the economy because the business environment is not sufficiently attractive and credit is difficult to obtain.

Another important characteristic of informality in Azerbaijan is the structure of non-agricultural employment that is not officially recorded. In the fishery sector, 81% of employment is informal, which is more than double the 1999 level. The highest increase in informality has been recorded in manufacturing, which accounted for 44% of undeclared employment in 2007 (6% in 1999). As in all other countries in the group, the construction sector is mostly informal, with 69% of jobs not officially recorded. Informality is also high in trade and transportation. All these figures are of dubious accuracy, so the real situation may be different, with unrecorded employment actually being much lower. The official statistics give high rates of informality in the public administration, defence and social protection sectors. At the same time, the water, gas and electricity distribution sectors record only formal employment. This is a consequence of either improper classification of economic activities or the poor quality of surveys.

Involvement in informal activities is inversely correlated with age in Azerbaijan: the 15–25 age group has the highest proportion of people involved in undeclared work (79% of the total), while the 51–57 age group has the lowest proportion (54%). Following retirement, involvement in informal activities increases again with age. It seems that lack of work experience represents a

major determinant in accepting undeclared jobs. Men are generally more willing than women to accept informal jobs. As would be expected, rural areas have the highest level of informal employment (85% in 2005), while in large cities the proportion is only 40%. Education plays an important role in Azeri informality: 91% of people with primary education are employed in the informal sector compared to only 18% of individuals with higher education (data for 2005). There are significant regional disparities with respect to informality: the region most affected is Nagorno-Karabakh and, with the exception of Baku, all the other regions record high rates of informal activities, particularly those with a large proportion of agricultural activities.

In Belarus informality has country-specific features as a result of two contradictory government policies. The first was aimed at maintaining high employment rates in the economy, and led to an unofficial shortening of working time and reductions in real wages. Consequently, people were obliged to look for alternative sources of income in the grey economy. The second policy approach originated in the government's desire to control the economy, including undeclared activities. This has multiplied the number of inspections and controls intended to combat informality. In line with this approach, all private entrepreneurs had to reregister their activities in 2008. Within these limitations, individuals have developed a latent type of informality, one in which formal employment has been preserved to a large extent, but in which many employees have tried to find a parallel way of supplementing their income. Rough estimates suggest that around one-third of the population is involved in such activities, mostly in small-scale businesses, farming and home-based activities. The estimates vary significantly because no accurate statistical information is available.

In Georgia, the contribution of the informal sector seems to be underestimated. According to the most recent sources (UNDP, 2008), around 26% of employment is informal, mostly in trade, construction and agriculture. Women are more represented in non-recorded employment (55.7%) than men. The highest proportion is recorded for the 41–50 age group. Surprisingly, more than 60% of informal employees have higher education. Only 54.7% of surveyed businesses are formally recorded, while 15.1% underreport their activity; this means that the share of informal employment should actually be higher than the findings of surveys. This is confirmed by the relatively low share of informality recorded for construction (32%), a sector that is usually more marked by informality.

Officially, one-third of Moldovan employment is informal, and this is concentrated mainly in subsistence agriculture. In rural areas informality represents 45.7% of employment, compared with only 18.9% in urban areas. The figure for urban areas corresponds practically to non-agricultural informal employment. In 2007 around one-third of those involved in unrecorded activities (almost 11% of total employment) were actually working in formally registered enterprises. A particular feature of Moldovan legislation is that it allows for financial non-declaration of certain small-scale activities, especially in the trade sector, and this significantly adds to the weight of informality in the economy. Non-agricultural informality is therefore predominantly undeclared work performed in formal concerns and enterprises, particularly by less well-educated people and women. Another feature of Moldova is that for tax purposes companies report a total wage bill that is higher than the CIS average, although the workforce levels reported for the same tax purposes are practically the same in Moldova and the CIS. Wage-bill reporting is therefore higher than workforce reporting.

Ukraine is another example of a country in which there has been a higher level of job creation in undeclared activities than in the formal sector. Expressed as a proportion of effectively produced GDP, the informal sector in Ukraine declined from 36% in 2002 to 32% in 2007. However, the number of informal employees as a proportion of the total number of employees increased from 14.8% to 22.3% between 2000 and 2007. As in most of the other countries, agriculture is a major employer of informal workers (around 71% over the period 2000–07), followed by trade (11.0% in 2007 compared to 15.9% in 2000). Although the contribution of construction to informality increased between 2000 and 2007, it remains relatively low (8.3% at the end of the period). Non-agricultural informality is therefore limited in Ukraine. However, 28.8% of undeclared employment relates to salaried workers. A particular aspect here is that the underdeclaration of wages in formal enterprises (including public companies) is fairly frequent, with a portion of effective wages made as 'envelope payments'. Many formal employees (public sector included) also perform a large variety of secondary (informal) jobs to supplement their official income (ETF, 2009b).

The highest proportion of informal workers in Ukraine is in the 40–49 age group (20.5% of the total in 2007), although young workers (aged 15–24 years) are almost as well represented in the sector (17.1%). The lowest rate of participation in undeclared work corresponds to the 25–39 age cohort. There are more older women than men entering the informal sector, especially those aged over 50 years; the opposite is the case for young people, with men predominating up to 49 years of age. Rural informality is particularly high in the case of young (15–24 years) and retired (60–70 years) persons. The ratio of informal to formal employment is disproportionately high in the case of individuals with lower levels of education (7.84 for primary/no education, 1.15 for lower secondary graduates, 0.30 for secondary graduates and 0.07 for university graduates). Less-educated women are more frequently involved in informal activities than men. As expected, most of those with less education participate in the rural informal sector.

4.6 WAGES, PRODUCTIVITY AND LABOUR COSTS

The equilibrium wage in an economy is determined by labour supply and demand. As long as supply exceeds demand, as has been the case for all the Eastern partners,

the wage rate remains low. Another element influencing the wage level is labour productivity, which is also low in these countries. The profit goals of firms in a competitive environment introduced by market rules determine that employers look for production methods that reduce their labour costs. Since labour costs depends proportionally on employment and the wage rate, profit maximisation objectives induce either employment shrinkage or a reduction in wage rates. The first option has generated high rates of unemployment in countries such as Armenia. Wage adjustment has led to declining incomes and living standards. The two mechanisms are normally temporary; when transitional reforms start to bring results, economic expansion creates more jobs while restructuring improves labour productivity. The opposite process starts to work in an economy when labour demand and productivity increase, stimulating wage increases, particularly in new sectors (such as financial services, banking and property).

As a rule, the private sector (and especially newly created firms) is faster than the public sector at improving economic performance and therefore increasing wages. Consequently, the success of transitional reforms can be judged by the speed at which wages recover their initial level, as well as by the wage differential between the private and public sectors. This mechanism is clearly influenced by the wage and employment policies of each government, which can be stimulatory or inhibitory. The transitional dynamics of real wages in all six countries experienced two major phases, an initial period of rapid decline resulting from output collapse, followed by a recovery period. All the Eastern partners went through the first phase; however, recovery is still not complete in all of them and, in some cases, the average wage is still below the pre-independence level.

An important issue in these countries is the significant reduction in salaried employment. As already mentioned, self-employment in various forms has become predominant in most of the countries. Self-employment offers an income that is not always sufficient or regular. Non-salaried work is therefore associated with a high level of uncertainty regarding revenues. Another issue relates to the increase in the wage differential between the lowest and highest levels. In some countries this has been partly offset by the introduction of a minimum wage. Although this measure has undeniably contributed to a certain level of income security for poorly paid workers, it has also imposed a certain degree of wage rigidity. The increasing wage differential resulted from structural changes in the economy, which induced changes in the relative demand for different categories of jobs and generated wage premiums for workers in jobs that did not exist during the Soviet era. At the same time, overall economic liberalisation induced a process of wage deregulation that in turn brought about inequality in earnings. The growing wage differences express relative alignment with productivity differentials.

In the case of Armenia, the first wage-related transitional phase culminated in an unprecedented decline in real salaries, which in 1994 were only 7% in real terms of the 1990 level (World Bank, 2007). Among the CIS countries, only Azerbaijan and Turkmenistan experienced such a dramatic fall. During the early 1990s, wages represented the main instrument of labour market adjustment, together with hidden unemployment, unpaid leave and reductions in working hours. After 1995 wages started to increase, indicating the beginning of the recovery phase; nevertheless, by 2004 they had only achieved 35% of their 1990 level. Wage increases were the result of increased productivity in the economy, although the former increased more slowly than the latter. The increase in wages was also accompanied by a reduction in wage inequality: the ratio of the average wage to the minimum wage declined from 13.60 to only 4.04 between 1997 and 2006 (World Bank, 2007). This ratio is closer to that in the CEEB countries than to that in the CIS, where inequalities are greater. However, the incidence of poorly paid workers is relatively significant in Armenia, where around one-quarter of employees earn less than two-thirds of the median wage.

Regional disparities in wages are quite high. In Yerevan, the capital of Armenia, the average wage is almost double that in the lowest paid regions. The discrepancies are caused by differences in human capital and job characteristics. Across sectors, pay in more modern activities, such as financial intermediation, is several times higher than the average. In general the private sector pays higher wages: on average, the non-state sector offered wages that were 1.4 times higher than those in the public sector in 2004. The wage level is proportional to educational attainment. Moreover, the salaries of well-educated and highly skilled individuals have increased faster than those of people with lower educational levels. The private sector offers a higher premium to workers with secondary education, while the public sector offers premiums only to university graduates. In spite of their higher educational attainment (on average), women are less paid than men in both the private and public sector, although the gap in the public sector (18%) is narrower than in the private one (32%). The gender gap is close to the average for the entire CIS.

Unit labour cost follows the same pattern as wages. This captures the change in the nominal wage as a result of changes in labour productivity: if the nominal wage and productivity increase at the same rate, the unit labour cost remains moderate. This means that the comparative advantage of a relatively low labour cost in attracting foreign investment is not affected. After 2000, Armenia initially recorded a slight improvement in its unit labour cost in the non-agriculture sector. However, this was due mainly to exchange rate undervaluation, as demonstrated by the reverse trend since 2004, when exchange rate policy was reviewed, leading to an appreciation of the national currency. This appreciation induced a rapid and significant increase of almost 40% in USD-denominated wages, and this increased the unit labour cost. Another specific factor is the declining competitiveness of agriculture. Although the sector performs better than it did in the Soviet era, its unit labour cost is higher than in other sectors (World Bank, 2007). This has widened the productivity gap between agriculture and other economic sectors: in 2004, average productivity in agriculture was

only 37% of productivity in the non-agricultural sector. At the same time, labour income from agriculture accounted for 55% of the wage income earned in the other sectors. This is the consequence of giving less attention to public investment in agriculture than to other activities.

Oil revenues have been beneficial to Azerbaijan, but have had the effect of relaxing the overall approach to policies that would have contributed to improved productivity and competitiveness in the rest of the economy. After an initial erosion in income caused by a fall in output, since 1995 wages have increased faster than productivity. Between 1995 and 2007 the unit labour cost in the non-oil sector increased 1.8 times more than productivity. If the unit labour cost represented 14.2% of the output value in 1995, in 2007 it represented 51.2%. As a consequence, over the period 2000–07 labour productivity increased by 27%, while the unit labour cost increased by 145%. Enormous differences exist between the oil sector and the rest of the economy in terms of the output value per employee. In fact, the oil production sector represented 64% of GDP in 2008, even though the sector's share of total employment was only 1%.

In Belarus, wages are still set by the state and the dynamics are very much influenced by major political events: presidential elections and referendums, for example, have been preceded by increases in the wage level. Between 1996 and 2005 the real wage rate increase was double the GDP growth rate and higher than the increase in productivity. However, there are inconsistencies in these official figures, as the wage bill as a proportion of GDP over the same period increased by only 5.5 percentage points. This inconsistency may come from the fact that wages are deflated by the CPI and productivity is deflated by the GDP deflator (ETF, 2010c). Sectoral differences exist in wage levels, with higher salaries paid in ICT activities (up to 143% of the average wage) and financial services (157% of the average wage). In contrast, agricultural workers are paid less than 62% of the average wage. However, discrepancies in pay do not seem as significant as they are in other countries in the region: managerial positions are remunerated at no more than 158% of the average wage. As in most Eastern partner countries, social services (education and healthcare) jobs are underpaid, with wage rates at the level of the average industrial wage and slightly below the average construction wage.

Real wages have also increased in Georgia, particularly since 2002. What is notable in this case is that the increase since 2006 has been partly due to the decline in employment. Hence, the labour market has undergone a largely quantitative adjustment that, for the same wage fund, has allowed for wage increases. As in other transitional countries, financial intermediation pays salaries that are several times higher than the average. Wages have more than tripled in the mining sector. Particularly low salaries persist for jobs in agriculture, hotels and restaurants, healthcare and education. A specific feature is that the average salary in education is the lowest in the whole economy, even lower than in agriculture, at only 54.4% of the average in 2007 (ETF, 2010d). If expressed in terms of value added per employee, productivity declined between 2005 and 2007 in agriculture and, even more significantly, in construction. According to official statistics, mining and quarrying doubled their productivity over the same period, while productivity in public administration in 2007 was 3.7 times higher than in 2005.

In Moldova, with the exception of agriculture, the wage differential has narrowed. In 2007 wages in financial intermediation were 2.2 times higher than the average wage. Social services and public administration salaries fell largely below the average, with education sector pay at 65.5% of the average in 2007. Over time, wages have declined in most sectors, except in construction and social services. The lowest increase occurred in financial services, where monthly earnings in 2007 represented only 40% of the 1999 level, while healthcare recorded the most significant increase in 2007, with a wage level 1.34 times that of 1999 (ETF, 2009a). There is therefore a clear wage convergence across sectors in the Moldovan non-agricultural economy.

The in-kind payment of wages, which was a common practice before 2000, has greatly reduced in Moldova. Gender differences in wages are significant in all sectors. Overall, women receive on average only 68.1% of the male wage. The largest difference exists in public administration, where women receive 61% of the male salary. In property and financial services the wage differential is lower[65] (86.1% and 85.6%, respectively). A similar situation exists in the education sector, where female employment is remunerated at 86.1% of the male salary. On average, labour productivity has increased at a slower pace than the wage rate. Between 1998 and 2001 the economy experienced a positive productivity wage differential, mainly as a result of the decline in real wages. However, after 2001 the wage rate increased sharply and eventually outstripped productivity growth. Construction represents the main sector driving productivity increases after 2000; agriculture, meanwhile, recorded a sharp decline in productivity. These developments have influenced the unit labour cost, which has increased significantly since 2000.

Wage–productivity trends in the Ukraine have followed a similar pattern. Wage rates are very similar for people with no education, primary education and basic secondary education. University graduates are much better paid, especially those in the younger age groups (15–34): their wage is twice that of individuals with only primary education. However, the return on education (expressed in terms of earnings) is lower than in the other countries in the region; one additional year of studies brings only a 5% increase in wages, whereas in Russia the same increment in education brings a 10% increase in wages (ETF, 2009b). Wage arrears in Ukraine still a frequent occurrence and are on an upward trend: delayed pay had increased from UAH 669 to 1 737 million in 2008.

In brief, two distinct trends are evident in wage–productivity dynamics in the Eastern partner

65 In the fisheries sector, women's pay is 1.07 times higher than that of men because women work in higher-paid administration work.

countries over the whole period of transition. The first stage, lasting until 2004, was characterised by real wage growth lower than real GDP growth per employee. This period is therefore characterised by significant productivity gains, especially since 1999. The opposite trend can be observed after 2004, when real wage growth began to erode productivity increases. Moreover, public sector wages have increased faster than private sector wages. In all the countries, labour productivity followed a similar pattern during transition. As shown in **FIGURE 4.5**, the initial drop in GDP per employee was followed by recovery starting in 1994–95. After several years of growth, the rapid increase in real wages since 2000 overwhelmed the increase in productivity.

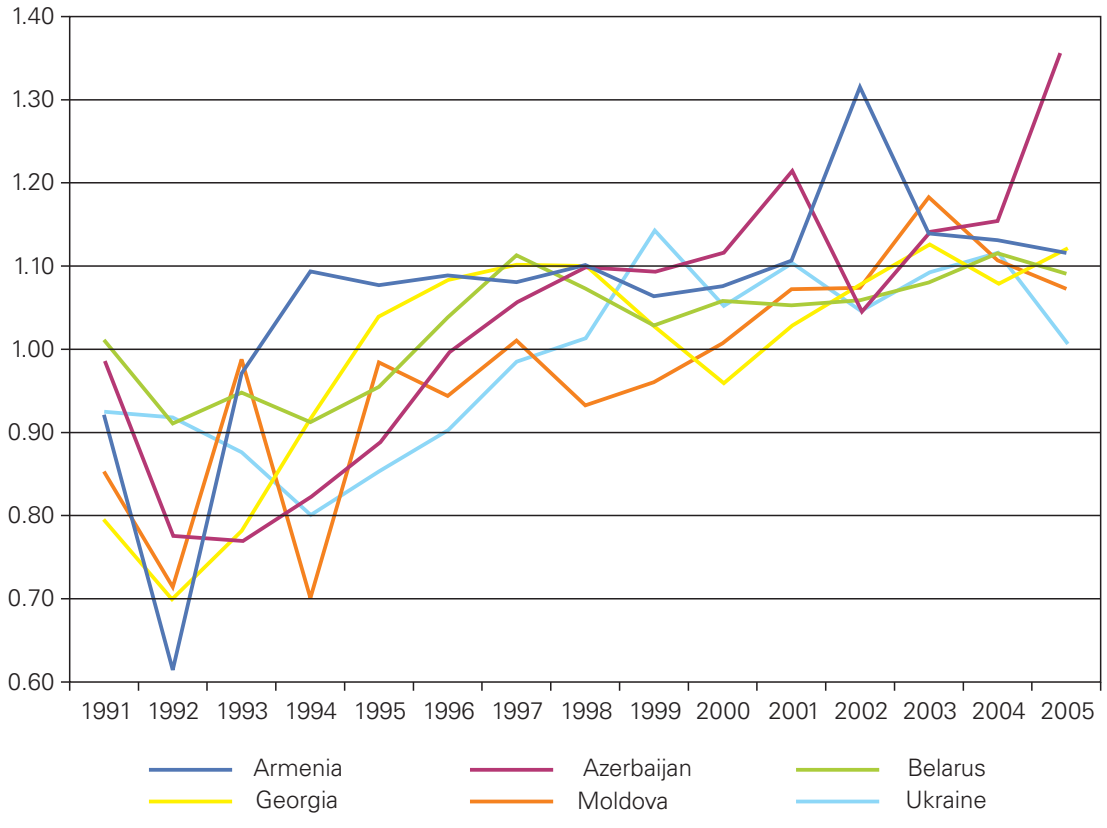
In fact, productivity improvements were translated almost exclusively into better wages for insiders, since enhanced economic performance has not increased employment. As long as wages grew faster than productivity, the unit labour cost rose more rapidly than improvements in economic competitiveness. Therefore, all the countries sooner or later experienced a reversal in the evolution of productivity. For comparative purposes, **FIGURE 4.6** represents the productivity changes over the same period of time in some of the new EU member states and Russia. It can be observed that productivity in the European countries is somehow cyclical, which means that productivity growth and wage increases are more synchronised than in the Eastern partners and Russia.

4.7 JOB CREATION AND THE QUALITY OF THE BUSINESS ENVIRONMENT

The above characteristics of the labour markets have their roots in the overall transition process in the Eastern partner countries. As explained in Chapter 2, the implementation of economic, legal and institutional reforms has produced systemic changes that are essential for the proper functioning of a market economy. The labour market and its components have been deeply affected by these changes, which have recalibrated the rules, values and relationships among participants in the labour market. Transformations have been more painful in this domain because they affected the jobs and income security of employees. Competition, which was unknown in Soviet era, has created tensions in marketplace relationships, but has also brought efficiency and higher productivity. The fall in employment has removed workers from the market but helped to improve wage levels for insiders. The liquidation of hundreds of companies produced mass unemployment, but new, more competitive and more efficient businesses have started to operate in the economies.

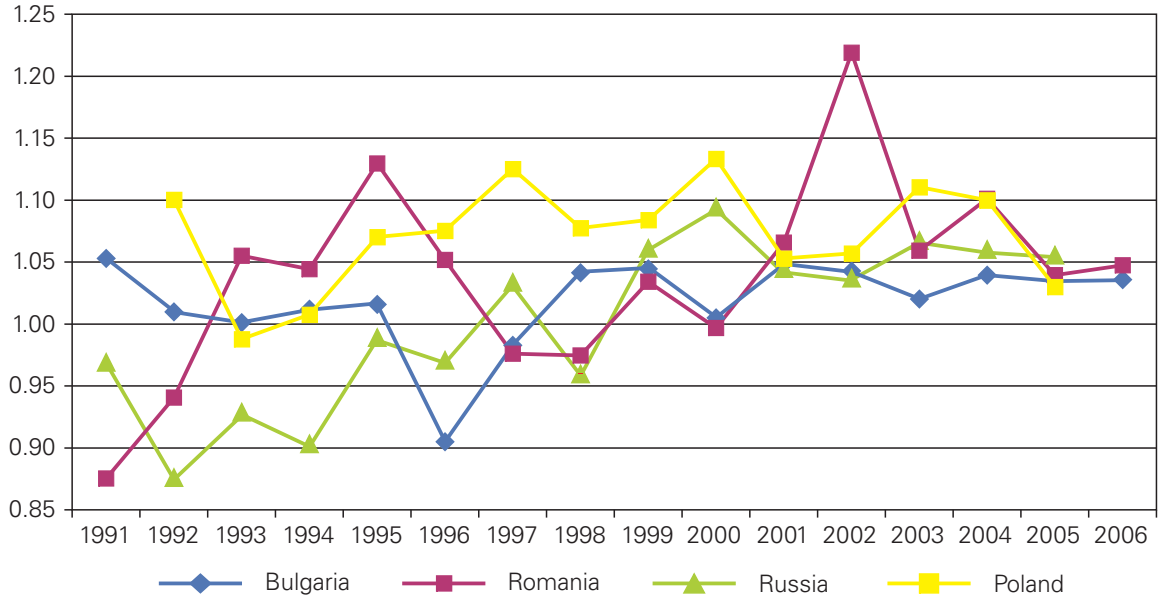
Thus, labour market restructuring has produced both winners and losers. After two decades of reforms, some

FIGURE 4.5 LABOUR PRODUCTIVITY GROWTH IN EASTERN PARTNER COUNTRIES, 1991–2005 (GDP/EMPLOYEE)



Source: Author, based on ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240.
Note: Calculated from index (GDP per person engaged, 1990=100) as the ratio of index in one year to this index in the previous year.

FIGURE 4.6 LABOUR PRODUCTIVITY GROWTH IN SELECTED TRANSITIONAL COUNTRIES, 1991–2006 (GDP/EMPLOYEE)



Source: Author, based on ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240
Note: Calculated from index (GDP per person engaged, 1990=100) as the ratio of index in one year to this index in the previous year.

questions remain unanswered. Why have the transformations been socially so costly? Why has the lack of employment opportunities pushed so many people to emigrate? And why is it that so many of those who have stayed are living in poverty? There are no clear and universal answers; what is clear is that transition has been unable to create enough jobs in the Eastern partner countries. Many factors could explain this situation. The first one, which has already been mentioned previously, is the nature of the economic activities that have developed since independence. Most of these activities have low added value and are labour intensive: such activities include agriculture, various types of services, and the food industry. Since labour productivity is low, wages cannot be increased to decent levels. The economic orientation towards labour-intensive activities was a suitable strategy for absorbing labour that was laid off after the liquidation of non-viable public enterprises. However, this should have been a transitional phase, aimed at economic diversification and enhancing the sophistication of products. The expansion of labour-intensive activities cannot last forever because there is a saturation limit in the market above which employment cannot increase. This saturation limit has already been reached in these economies, yet a second phase of diversification and product sophistication has not followed.

Hence, there is a time gap between the two phases of labour market evolution. The insufficiency of technologies at the enterprise level, combined with the state's unclear economic role, has delayed the final (but most important) phase of transition: economic modernisation. The Eastern partner economies lack the necessary dynamism and aggressiveness to ensure competitiveness gains. Most private businesses are still clustered in small-scale activities and their principal aim is to survive in an economic environment where credit is rare and expensive, support from the state is minimal (where it does not actually hinder) and access to external markets is problematic.

Productivity, competitiveness, efficiency, job creation and better wages are the usual ambitions for policy makers and individuals. All these elements are present in the economy when the business environment is appropriate – and therefore stimulatory – for the development of new and existing activities. In many countries the SME sector (composed of companies employing up to 50 workers) represents the major engine of the economy, employing, in Europe, around two-thirds of the labour force and contributing the same proportion to GDP. In the case of transitional countries, the development of this sector is an essential catalyst for private initiative, innovation and competitiveness. The rate of job creation is highest in SMEs, which are therefore major absorbers of employment. The sector is dynamic and flexible, and proves to be a net job creator even during economic recession. SMEs are, on average, more innovative than large enterprises, and respond better and faster to technological change and market trends.

Data on SMEs are available for only three of the six Eastern partners: Georgia, Moldova and Ukraine (**TABLE 4.9**). However, most characteristics will be broadly similar for most of the other countries. Job creation in small enterprises has increased significantly since 2002, though to a lesser extent in Ukraine. In Moldova, for example, growth in employment in the SME sector ranged from 10.0% to 14.6% in 2003 and 2006, respectively; conversely, employment in medium-sized and large firms declined by 3.1% and 4.8%, respectively. Moreover, average employment in medium-sized

TABLE 4.9 SHARE OF SMALL, MEDIUM AND LARGE ENTERPRISES, 2007 AND 2009 (%)

	Georgia		Moldova		Ukraine	
			2007			
	Turnover	Employment	Number	Employment	Number	Employment
Small	5.32	15.7	79.83	21.51	85.1	19.1
Medium	9.17	26.2	16.92	36.80	14.7	46.7
Large	85.51	58.1	3.25	41.69	0.2	34.2
			2009*			
	Turnover	Employment	Number	Employment	Number	Employment
Small	6.64	15.5	97.8	58.7	93.7	25.2
Medium	7.76	20.3			5.8	34.8
Large	85.60	64.2	2.2	41.3	0.5	40.0

Source: National statistics offices.
*Note: *Fourth quarter for Georgia.*

enterprises decreased from 112 to 102 workers over the same period; a more significant decline was observed in large companies, where employment shrank from 556 to 479 workers on average. Ukraine was an exception to this rule: more than 50% of jobs were created in large firms, an unusual pattern that reflects the structure of the economy, which is still dominated by a few large enterprises. Trends were similar in 2007 and 2009.

A favourable business environment is crucial for stimulating the creation of new businesses and the growth of established firms – and therefore for job creation. While there has been some improvement in the business environment in recent years in all the Eastern partner economies, business establishment and growth are still hindered by such factors as excessive formalities, difficulties in accessing credit, burdensome state intervention, high taxation, uncertainty and unfriendly regulations. Two methodological approaches were used in order to analyse the evolution of the business environment in these countries over the period 2002–08. The EBRD–World Bank BEEPSs provide information on the situation in 2005 compared to that in 2002, and the World Bank's Doing Business Index shows the situation in 2008.

According to the BEEPS results (**TABLE 4.10**), macroeconomic instability and uncertainty regarding the regulatory framework were the main weakness in all the countries except Azerbaijan. The cost of, and access to, capital for financing business was equally problematic in all six countries, except in Azerbaijan, where access to finance is easier, though costly. The difficulties were common to all the CIS countries. This was also the case for taxation, which is considered to be high in all the CIS economies, and tax administration, which is burdensome in the whole region except Belarus and Georgia.

Compared to the previous survey conducted in 2002, the situation improved most in Belarus, where the 2005 indicators showed an improvement in 15 areas; the situation worsened only with respect to land leasing. The situation deteriorated most in Azerbaijan: the country recorded higher scores in 2005 than in 2002 for ten different indicators.

The most important barrier to good business operation in Armenia was access to finance: around 70% of new investment had to be funded from internal resources. Unofficial payments to deal with custom formalities increased more than six-fold over the period 2002–05, confirming an upward trend in corruption (in 2005, bribes represented around 1.2% of annual sales). Bribes were also used in Azerbaijan, mainly to deal with taxes and tax collection. Corruption was therefore reported as the main problem when doing business in the country. Although 'mafia'-type practices do not represent a problem in Azerbaijan, security payments by firms to those involved in organised crime are four times higher than the average for the CIS countries.

The cost of labour was considered to be the major impediment to business functioning in Belarus, in addition to excessive inspections and controls of various types. In Georgia, uncertainty about government regulatory policies was reported as the key obstacle by around 70% of businesses. Organised crime was also ranked among the major impediments to carrying out an activity. The number of firms complaining about inadequate worker skills had increased noticeably in 2005 compared to 2002. Moldova was the only country in the group for which entrepreneurs reported infrastructure problems as an important obstacle to business, with telecommunications and transport as the most problematic sectors. The country also had

TABLE 4.10 BUSINESS ENVIRONMENT AND ENTERPRISE PERFORMANCE, 2006

	ARM	AZE	BEL	GEO	MOL	UKR	CIS
Contract violation	▶	▶	▼	▲	▼	▼	
Anti-competitive practices of others	▶	▲	▼	▲	▲	▶	
Organised crime/mafia	▲	▲	▼	▼	▼	▼	
Street crime and disorder	▲	▲	▼	▼	▼	▼	
Corruption	▲	▲	▼	▼	▼	▼	
Functioning of judiciary	▶	▶	▼	▶	▲	▶	
Macroeconomic instability	▶	▼	▼	▼	▼	▼	
Uncertainty of regulatory policies	▼	▼	▼	▶	▼	▼	
Worker skills	▶	▼	▶	▲	▲	▲	
Labour regulations	▲	▶	▼	▶	▲	▶	
Licensing and permits	▲	▲	▼	▼	▼	▼	
Customs/trade regulations	▼	▲	▼	▼	▲	▼	
Tax administration	▶	▲	▼	▼	▼	▼	
Tax rates	▼	▲	▼	▼	▶	▲	
Land leasing	▲	▲	▲	▲	▶	▲	
Access to land	▲	▶	▶	▲	▶	▲	
Transportation	▼	▶	▼	▲	▶	▶	
Electricity	▼	▼	▼	▶	▲	▼	
Telecommunications	▼	▼	▼	▶	▲	▼	
Cost of financing	▲	▲	▼	▼	▼	▲	
Access to financing	▶	▼	▶	▶	▶	▼	

Source: Author, based on EBRD-World Bank BEEPSs: www.ebrd.com/pages/research/analysis/surveys/beeps.shtml or www.enterprisesurveys.org/
Note: 1. Colours: green, no major difficulties; yellow, average level of difficulties; red, great difficulties; 2. Arrows (indicating change from 2002 to 2005): ▲, difficulties increased; ▼, difficulties decreased; ▶, same level of difficulties.

difficulties in the area of licensing businesses, excessive inspections and controls, paying taxes, dealing with corruption and organised crime. The tax rate represented the most important impediment for businesses for 70% of Ukrainian entrepreneurs. Lack of worker skills was cited as the next most important difficulty for enterprises; in addition, the losses incurred by companies because of strikes were 4.7 times above the level recorded for the CIS countries. Financing the expansion of a business through new investment was equally problematic, with around 70% of capital coming from businesses' own sources.

Compared with the conclusions of BEEPS 2005, significant progress was recorded in the 2008 World Bank's Doing Business rankings for Azerbaijan and Georgia, which were considered the best performers in the region (**TABLE 4.11**). Belarus had also climbed an impressive number of positions since the previous survey, but – with Moldova and Ukraine – remains one of the countries in which doing business is relatively difficult. The performance of Georgia and Azerbaijan has been uneven in terms of the various elements, as not all indicators progressed at the same rate. In Georgia, for instance, opening a business is as easy as in most developed countries, but closing one down is very complicated. Trading across borders in Azerbaijan is extremely difficult, and dealing with construction permits is almost prohibitive for businesses. The Doing Business classification should therefore be interpreted with a certain degree of caution.

TABLE 4.11 DOING BUSINESS REPORT RANKINGS, 2008 AND 2009

		Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Overall	**2009**	**44**	**33**	**85**	**15**	**103**	**145**
	2008	**41**	**97**	**115**	**21**	**92**	**144**
Starting a business	**2009**	66	13	97	4	89	128
	2008	49	66	121	10	85	113
Dealing with construction permits	**2009**	42	155	65	10	158	179
	2008	73	160	93	11	154	175
Employing workers	**2009**	54	15	49	5	119	100
	2008	52	67	48	5	118	103
Registering property	**2009**	5	9	14	2	50	140
	2008	2	63	95	8	47	142
Obtaining credit	**2009**	28	12	109	28	84	28
	2008	25	125	126	61	79	61
Protecting investors	**2009**	88	18	104	38	104	142
	2008	84	110	101	33	101	141
Paying taxes	**2009**	150	102	181	110	123	180
	2008	147	143	181	106	123	180
Cross-border trading	**2009**	143	174	134	81	135	131
	2008	131	176	142	68	125	121
Enforcing contracts	**2009**	61	26	14	43	17	49
	2008	63	27	15	43	16	48
Winding up a business	**2009**	47	81	71	92	88	143
	2008	47	78	72	108	85	143

Source: World Bank's Doing Business Index: www.doingbusiness.org/

The most cumbersome aspects of doing business – which were common to all six countries – relate to difficulties in trading across borders and paying taxes. In the case of the first, the time needed for importing and exporting is excessively long (five times longer in Armenia, Azerbaijan, Moldova and Ukraine and twice as long in Belarus, compared to OECD countries). The cost per unit imported or exported is also above the OECD average in Georgia (1.5 times) and Azerbaijan (3 times). This means that foreign investors and entrepreneurs who want to trade with the outside world face serious obstacles.

Paying taxes is equally difficult in these countries. The major problem comes from the excessively high number of taxes levied: this is nine times higher in Belarus than in the OECD, seven times higher in Ukraine, four times higher in Armenia and Moldova, and double the number in the OECD in Azerbaijan and Georgia. The time spent dealing with tax payments is also lengthy: 6 times longer than in the OECD in Belarus, 4 times longer in Ukraine and 4.5 times longer in Armenia. In addition, profit and other taxes in Belarus are 2.4 and 18 times greater, respectively, than OECD taxes. In all six countries these two elements (trading and tax payment) are mainly obstructed by state bureaucracy, with time and number of procedures the most significant barriers to doing business. With the exception of Azerbaijan and Georgia, the protection of investors is also insufficient. Difficulties with respect to liability for self-dealing (bringing a

manager to court in the event of damages caused to the company) exist in Armenia, Belarus and Moldova, while the transparency of transactions is five times lower in Ukraine than in the OECD countries.

Winding up a business is relatively easy in Armenia compared to the other five countries. In Ukraine, however, the cost of liquidating a company is five times higher than in the OECD; in addition, only 9.1 cents per USD can be recovered after closure. The recovery rate is also low in the other four countries: compared to a 68.6% rate in the OECD, only 22.0% can be recovered in Belarus, 27.9% in Georgia, 28.6% in Moldova and 30.1% in Azerbaijan. The time needed to close a business is more than 4 years longer in Belarus and 1.6 years longer in Georgia than in the OECD. Dealing with construction permits is particularly problematic in Azerbaijan, Moldova and Ukraine, where the number of necessary formalities is twice as high as in the OECD, while the cost (expressed as a percentage of per capita income) is almost ten times higher in Azerbaijan and around three times higher in Ukraine and Moldova. In addition, in Ukraine the process of registering property is lengthy (93 days, compared to 30.3 days in the OECD).

Hiring workers is 1.8 times more difficult in Ukraine and 1.5 times more difficult in Moldova than in the OECD. Firing workers is also problematic in Belarus and Moldova, where the corresponding index is 1.5 times worse than in the OECD countries. In order to start a business in Ukraine, an entrepreneur needs to complete twice as many formalities, spend twice as many days and disburse nine times more capital as the minimum requirement to start operating, compared to OECD countries. All these indicate that the difficulties with which businesses are confronted in the Eastern partner countries are more of an institutional and legal nature, rather than economic; except in Belarus, where the profit tax is high, doing business in this region is not costly. However, impediments stem from there being too many formalities and procedures required for operating a business and the lengthy time required to deal with those formalities. The situation may be the result of insufficient restructuring of institutions, bureaucracy, corruption and, in some cases, the lack of competent staff.

Since the publication of the Doing Business Report, some improvements have been made. In Belarus, for example, the government adopted several measures at the end of 2008 and the beginning of 2009 that were aimed at liberalising and improving the business framework. Largely imposed by the deterioration of the economic situation as a consequence of the financial crisis, these measures simplify procedures for creating new enterprises. Access to credit has also been improved. However, other barriers remain in the economy, some of which were not covered by the Doing Business Report: these include frequently changing legislation, excessive inspections and controls, high taxes and complex tax procedures, and customs restrictions. The most cumbersome restrictions on doing business in Belarus remain state control over most prices and state interference in the economy in general. Although a Presidential decree was issued in February 2009 to eliminate price registration procedures for new products and services, the control over price setting effectively remains, as enterprises are still obliged to provide unnecessary documents in order to obtain approval of their proposed prices.

It should be noted that the methodological accuracy of the Doing Business Report is sometimes contested, and alternative assessments by other institutions often lead to different conclusions. At the same time, its indicators reflect a part of the economic reality, while other aspects not considered by the World Bank are at least as important as the Doing Business Report indicators. Various other surveys conducted among business people show a slightly different picture. A survey conducted in Ukraine in 2008 reveals that entrepreneurs are discontented with political instability, corruption, taxes and other governmental regulations. Corruption is also cited by Transparency International as the most perverse element affecting the business climate, together with bureaucracy. Another conclusive example is Azerbaijan, ranked 33rd of 182 countries according to the Doing Business Report indicators; if the 2007–11 Economic Intelligence Unit business environment ranking is used, the country is ranked 72nd out of 82 countries, with the worst scores recorded in the fields of access to finance and inappropriate policy towards private enterprises and competition.

4.8 CONCLUDING REMARKS

Labour markets in the Eastern partner countries have undergone a turbulent transition, with periods of low economic activity, high unemployment and underemployment, and frequent changes in the employment status of individuals. Yet reforms have been essential in the process of economic transformations to achieve productivity increases and, consequently, better wages for employees. Over the transition period, the working-age population as a proportion of the total population has increased significantly as a result of the baby boom of the 1970s and 1980s (almost 70% of the population in all these countries). At the same time, all the countries are experiencing an ageing process (except Azerbaijan) that will accelerate in the coming years. The increasing percentage of females in both the working-age population and the labour force is another growing trend.

Labour force participation rates have been increasing in Armenia and Azerbaijan, and participation rates have started to increase modestly in Georgia and Ukraine after an initial decline up until 2000. In contrast, this rate has declined drastically in Moldova, and this is partly explained by the fact that high numbers of labour emigrants are classified as inactive in the national statistics. Belarus, on the other hand, shows relatively stable and high participation rates as a result of the employment preservation policies of the government. Female labour force participation is high in all the countries and comparable with that for males, although at a slightly lower level. Youth participation, on the other hand, is lower, and this is mainly explained by the high enrolment rates in university education. However, the relative

comparability of the participation rates of the Eastern partner countries with those in the EU is superficial, since they are significantly distorted by the large proportion of rural self-employment and a high level of informal activities.

Employment rates are generally low, especially in Armenia and Moldova. Azerbaijan is the country closest to the EU-27 average in this respect, although the figures include a very high level of informal employment. Over the whole period 1995–2008, only Armenia and Azerbaijan recorded a net increase in employment rates; Moldova experienced the largest fall in employment, and moderate reductions were recorded by Georgia and Ukraine. All male employment rates are higher than female employment rates. The evolution of unemployment rates does not necessarily directly reflect the evolution of employment rates; interestingly, both record a declining trend. The highest unemployment rate was in Armenia, followed by Georgia, while the rate in Belarus was less than 1% (based on registered unemployment only). Economic growth has contributed little to declining unemployment rates in some countries such as Moldova, where the principal factor was labour emigration. Low unemployment rates are also explained by the inclusion of small landowners as self-employed workers in the total employment rates.

An important characteristic of employment structure by status is the low proportion of salaried work in most Eastern partner countries. In Georgia, for example, only one-third of employed people receive a wage; the others are either self-employed or are classified as family workers. Azerbaijan and Armenia also have very high self-employment rates, at more than half of total employment, whereas the equivalent rate for Moldova is one-third of the total. Only Ukraine (with 80.7% wage employment) is broadly comparable with the EU-27 average (87.7%). This is mainly a result of the limited opportunities for wage employment and of the deliberate survival strategies of individuals who take up small-scale informal activities as self-employed workers, or perform subsistence agriculture in small plots of land as households. Both these groups are recorded as working self-employed in the national statistics.

The sectoral structure of employment also confirms the vulnerability of the employed population, a high proportion of which is accounted for by agricultural employment: in Georgia it is more than half, in Azerbaijan and Armenia close to half, and Moldova one-third. However, the added value of agriculture to GDP is quite low in Georgia, Azerbaijan and Moldova, indicating low productivity and possibly poverty. On the other hand, industry is still an important employer in Belarus and Ukraine, while it is much lower in the rest of the group. Belarus, Ukraine and Moldova record particularly high rates of employment in the services sector, unlike Georgia. In all the countries, most employed people have secondary education, and the proportion of people with primary or no education is extremely low. The number of university graduates has increased dramatically, though paradoxically, skill mismatches persist, particularly in Ukraine.

The labour markets are heterogeneous and heavily localised as a result of the varying speed of reforms across the region, unequal investment activities, geographical patterns of demand for goods and services and other factors that have led to regional disparities. There are various dualities: between the formal and informal sectors (with most of the self-employed occurring in the informal sector) and between rural and urban areas (with rural rates of participation higher than urban rates owing to the prevalence of subsistence agriculture). Serious disparities exist across regions and also between the large cities and the other areas of these countries, with employment opportunities largely concentrated in large urban centres. These regional differences persist because inter-regional labour mobility, including commuting, is restricted by a deficient transport infrastructure, a shortage of accommodation, and significant regional differences in property prices.

At the sectoral level, the Eastern partners have maintained and even expanded relatively low-value-added, labour-intensive activities that do not require high levels of qualification. Employment restructuring took place mostly at the inter-sectoral level: across economic sectors and between public and private sectors. In the first case, the shift between the agricultural and non-agricultural sectors can be distinguished, as can reallocations within the non-agriculture sectors. The shift from the public to the private sector was much more significant during the first decade of transition as a result of land privatisation and mass privatisation. High levels of informality were fuelled by the reduction of public formal employment, and largely nurtured by factors including privatisation and subsequent restructuring; land reform that resulted in an increase in self-employment activities; the abundance of labour in the market as a result of closures, which allowed employers to use informal or semi-formal arrangements; the erosion of incomes, which forced many people to seek other opportunities to earn additional income; and the cost-cutting strategies of enterprises. This has meant that a significant proportion of the labour market functions under low-productivity and low-wage conditions.

The evolution of real wages has gone through two major phases: an initial period of rapid decline resulting from output collapse, and a subsequent period of recovery. All the Eastern partners went through the first phase, but the second phase – recovery – remains incomplete; in some cases, the average wage is still below the pre-independence level. During transition, wage differentials widened, but this situation was partially offset by the introduction of a minimum wage in some countries. Overall, economic liberalisation induced a process of wage deregulation (except in Belarus), leading to inequality in the dispersion of earnings. Economic growth after 2000 brought a rapid increase in real wages that overwhelmed the increase in productivity. Productivity improvements translated almost exclusively into better wages for insiders, since the enhancement of economic performance has not increased the employment level. All the countries have therefore experienced a trend reversal in the evolution of

productivity. Public wages have increased faster than private sector wages.

Within the context of the highly vulnerable employment conditions described above, it is obvious that more and better jobs need to be created (offering decent working conditions) in all the Eastern partner countries. However, the existing business environment is not always conducive to decent job creation, particularly as regards SME growth. Many institutional and legal impediments to doing business remain, such as complex formalities and procedures required in the process of operating a business, and the length of time required to deal with such formalities. This situation is the result of insufficient restructuring of government institutions, bureaucratic structures within those institutions, corruption and, in some cases, a lack of competent personnel. Consequently, the process of job creation and destruction, aimed at readjusting the skill structure of the workforce, has been weak. Labour market restructuring has produced both winners and losers. Two questions remain after two decades of reforms: Why have the transformations not been less costly in social terms? And why, after so many years, has the lack of employment opportunities pushed many people to emigrate while a significant proportion of those who stay are living in poverty? There are no clear and universal answers to these dilemmas; what is clear for the Eastern partners is that to date, the transition process has failed to create sufficient decent jobs in their economies.

APPENDIX 4.1 ACTIVITY RATES BY AGE AND SEX, 1995, 2000 AND 2005–07 (% TOTAL POPULATION OF CORRESPONDING AGE AND SEX)

	1995			2000			2005			2006			2007		
Age group	**T**	**M**	**F**	**T**	**M**	**F**	**T**	**M**	**F**	**T**	**M**	**F**	**T**	**M**	**F**
ARMENIA															
15–24	44.9	49.9	40.1	46.3	50.7	42.2	45.3	49.4	41.3	44.5	48.5	40.5	46.9	50.7	43.1
25–34	80.9	87.8	74.8	82.4	89.6	76.1	84.1	91.6	77.8	84.2	91.7	78.0	85.0	92.3	78.9
35–54	82.8	86.6	79.5	84.5	88.7	81.0	86.2	90.9	82.5	86.3	91.1	82.6	86.8	91.7	83.0
55–64	40.2	55.4	27.1	33.2	46.8	22.4	39.6	58.3	25.5	41.0	60.0	26.7	40.7	60.2	26.1
65+	14.5	19.4	11.2	13.1	17.8	9.9	10.0	14.2	7.2	9.4	13.5	6.7	9.0	12.4	6.8
Total 15–64	**66.7**	**73.1**	**61.0**	**67.5**	**73.2**	**62.6**	**69.3**	**74.9**	**64.6**	**69.1**	**74.7**	**64.4**	**70.0**	**75.7**	**65.2**
Total 15+	**60.5**	**67.6**	**54.4**	**60.1**	**66.5**	**54.9**	**60.2**	**66.6**	**55.0**	**60.1**	**66.6**	**54.9**	**61.0**	**67.5**	**55.7**
AZERBAIJAN															
15–24	46.3	51.4	41.1	46.8	51.0	42.5	43.8	47.8	39.7	40.6	44.4	36.7	44.7	48.7	40.7
25–34	80.5	72.7	61.0	82.8	89.9	76.6	84.7	91.8	78.4	84.8	91.8	78.4	86.0	92.9	79.6
35–54	82.5	87.5	74.3	85.6	89.5	82.0	87.4	91.5	83.7	87.7	91.7	84.1	88.2	92.5	84.4
55–64	40.0	86.3	79.0	35.6	50.4	23.1	38.8	55.3	24.8	41.4	57.7	27.5	41.7	59.3	26.7
65+	14.5	54.9	27.0	12.8	17.4	9.6	9.5	13.6	6.8	8.4	12.2	5.9	7.6	10.3	5.9
Total 15–64	**66.7**	**72.7**	**61.0**	**69.4**	**74.9**	**64.2**	**70.3**	**75.2**	**65.7**	**69.5**	**74.2**	**65.1**	**71.2**	**76.2**	**66.5**
Total 15+	**62.8**	**69.5**	**56.7**	**64.6**	**70.7**	**59.0**	**64.5**	**70.2**	**59.3**	**63.7**	**69.2**	**58.7**	**65.2**	**70.9**	**60.0**
BELARUS															
15–24	49.0	51.2	46.8	44.4	48.1	40.6	41.7	44.5	38.7	41.0	43.5	38.3	42.2	45.1	39.1
25–34	91.9	94.1	89.9	86.8	88.9	84.6	86.8	88.9	84.8	86.8	88.8	84.7	86.2	88.2	84.1
35–54	92.4	93.1	91.8	88.9	88.9	88.9	89.1	89.0	89.1	89.1	88.9	89.2	88.5	88.9	88.2
55–64	37.6	57.0	22.8	29.7	45.9	17.5	36.7	54.5	23.0	37.8	55.3	24.3	36.3	53.6	22.9
65+	4.2	7.6	2.6	2.7	5.1	1.5	2.2	4.3	1.2	2.1	4.1	1.1	2.0	3.8	1.2
Total 15–64	**73.4**	**78.2**	**68.9**	**69.9**	**73.8**	**66.3**	**70.7**	**74.0**	**67.6**	**70.6**	**73.8**	**67.6**	**70.3**	**73.9**	**67.0**
Total 15+	**62.4**	**70.3**	**55.7**	**58.8**	**65.6**	**53.0**	**59.0**	**65.6**	**53.5**	**59.1**	**65.5**	**53.6**	**59.0**	**65.7**	**53.3**
GEORGIA															
15–24	33.6	38.6	28.5	35.8	43.7	28.1	32.5	40.3	24.6	32.7	40.5	24.8	32.3	41.2	23.1
25–34	73.0	86.0	60.7	71.0	84.9	57.5	73.6	88.0	60.3	74.1	88.4	60.8	74.6	89.3	61.0
35–54	81.0	89.3	73.4	80.1	88.6	72.5	82.6	91.9	74.5	83.1	92.2	75.0	82.3	91.8	74.1

55–64	75.3	84.8	67.2	69.7	82.5	59.2	74.1	83.6	66.4	74.1	83.7	66.3	76.7	87.1	68.4
65+	49.9	59.7	44.2	49.4	60.2	42.7	47.2	54.8	42.3	45.9	53.8	40.9	47.1	55.3	41.9
Total 15–64	**67.3**	**75.7**	**59.6**	**66.3**	**76.1**	**57.4**	**67.2**	**76.6**	**58.8**	**67.6**	**76.8**	**59.2**	**67.6**	**77.4**	**58.8**
Total 15+	**64.8**	**73.8**	**56.9**	**63.7**	**74.0**	**54.7**	**63.7**	**73.3**	**55.5**	**63.8**	**73.4**	**55.5**	**64.1**	**74.1**	**55.4**
MOLDOVA															
15–24	42.7	44.1	41.3	31.0	32.5	29.4	21.4	22.6	20.1	22.0	23.3	20.7	20.4	21.6	19.0
25–34	87.2	90.2	84.3	75.5	77.1	73.8	49.8	47.2	52.5	50.0	47.5	52.6	48.8	45.6	52.1
35–54	88.0	90.9	85.4	80.6	82.4	79.1	77.8	77.7	77.8	78.2	78.3	78.1	73.4	73.3	73.4
55–64	41.4	61.5	25.7	45.4	60.9	33.8	57.4	69.6	48.0	57.5	70.0	47.8	56.7	65.9	49.6
65+	8.5	13.0	5.9	12.3	16.8	9.7	16.9	20.8	14.6	16.6	20.5	14.3	18.4	21.9	16.4
Total 15–64	**69.9**	**74.6**	**65.4**	**61.8**	**64.8**	**59.0**	**53.5**	**53.9**	**53.2**	**53.8**	**54.4**	**53.3**	**51.1**	**51.1**	**51.1**
Total 15+	**62.1**	**68.5**	**56.6**	**55.3**	**59.8**	**51.4**	**48.5**	**50.3**	**46.9**	**48.7**	**50.7**	**46.9**	**46.6**	**48.0**	**45.4**
UKRAINE															
15–24	45.2	44.5	46.0	40.4	43.3	37.5	40.6	45.1	35.8	40.0	44.5	35.4	39.3	43.6	34.9
25–34	84.2	86.9	81.5	85.8	90.3	81.4	82.2	88.9	75.4	82.1	88.9	75.3	83.2	89.3	77.1
35–54	90.8	91.3	90.3	85.4	87.9	83.1	82.5	85.0	80.3	82.5	85.0	80.3	83.6	86.8	80.8
55–64	50.2	66.3	37.6	35.4	48.1	25.9	40.5	52.5	31.7	41.4	53.4	32.7	44.0	49.6	40.0
65+	12.2	17.2	9.8	5.6	7.9	4.5	19.2	22.7	17.3	18.5	22.0	16.6	17.0	19.5	15.7
Total 15–64	**72.2**	**75.5**	**69.0**	**67.0**	**71.9**	**62.5**	**66.7**	**72.0**	**61.9**	**66.8**	**72.0**	**62.0**	**67.8**	**72.2**	**63.7**
Total 15+	**61.9**	**68.5**	**56.5**	**56.6**	**64.0**	**50.5**	**57.8**	**65.0**	**51.7**	**57.7**	**64.9**	**51.7**	**58.3**	**64.8**	**52.8**
OTHER															
Bulgaria: 15–64	65.7	68.7	62.7	58.7	63.2	54.3	62.4	67.3	57.5	65.0	69.5	60.5	62.6	67.1	58.2
Poland: 15–64	66.4	72.9	60.0	64.7	70.5	59.0	63.9	70.1	57.7	63.3	70.0	56.7	63.0	69.0	57.1
Romania: 15–64	72.7	79.2	66.2	68.9	75.8	62.0	62.5	69.6	55.4	63.8	70.9	56.8	61.1	67.7	54.6
Russia: 15–64	70.9	76.6	65.6	69.3	74.1	64.7	71.0	74.9	67.3	70.8	74.6	67.3	72.4	76.1	68.9
Turkey: 15–64	57.4	81.5	32.7	52.8	77.1	27.9	51.6	76.1	26.5	51.3	75.3	26.6	50.4	74.2	26.0
EU-15: 15–64				69.3	78.5	60.1	71.2	79.0	63.4	71.8	79.3	64.3	72.1	79.4	64.7
Europe: 15–64				67.1	77.8	56.3	68.1	78.0	58.2	68.3	78.0	58.7	68.6	78.1	59.2

Source: ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240.
Note: T, total; M, male; F, female.

APPENDIX 4.2 EMPLOYMENT RATES BY AGE AND SEX, 1995, 2000 AND 2005–07 (% TOTAL POPULATION OF CORRESPONDING AGE AND SEX)

		1995			2000			2005			2006			2007		
Countries	**Age group**	**T**	**M**	**F**	**T**	**M**	**F**	**T**	**M**	**F**	**T**	**M**	**F**	**T**	**M**	**F**
Armenia	15–24	21.4	27.8	15.4	22.9	28.2	17.9	24.1	29.6	18.6	23.8	29.5	18.1	25.6	31.9	19.4
	Total 15+	37.1	44.2	31.0	37.8	44.5	32.2	39.5	46.4	33.8	39.4	46.4	33.7	40.1	47.4	34.2
Azerbaijan	15–24	36.2	40.4	31.9	37.1	40.8	33.5	36.8	40.4	33.1	35.2	38.7	31.7	39.2	42.8	35.5
	Total 15+	55.4	61.1	50.1	57.4	62.7	52.6	59.0	64.1	54.4	59.3	64.3	54.8	60.9	66.2	56.2
Belarus	15–24	38.2	40.0	36.3	30.3	33.8	26.6	26.5	27.6	25.3	26.3	29.5	23.1	26.8	30.1	23.5
	Total 15+	55.7	62.5	50.0	48.7	58.1	39.9	48.5	56.0	41.5	48.2	55.6	41.2	48.6	55.9	41.7
Georgia	15–24	23.0	27.8	18.2	28.4	34.4	22.4	23.4	29.6	17.1	23.0	29.5	16.5	22.3	29.8	14.7
	Total 15+	56.0	63.5	49.5	56.8	65.8	49.0	54.9	62.4	48.4	55.1	62.8	48.5	55.6	63.8	48.5
Moldova	15–24	32.8	33.1	32.6	24.9	25.6	24.1	17.4	18.3	16.4	18.2	19.0	17.4	17.4	18.4	16.3
	Total 15+	55.6	60.0	51.7	50.6	53.8	47.9	44.9	45.9	44.1	45.1	46.2	44.2	44.3	45.0	43.6
Ukraine	15–24	40.2	39.4	41.0	31.5	33.6	29.4	34.5	38.2	30.6	34.6	38.3	30.7	34.3	38.0	30.3
	Total 15+	58.4	64.6	53.4	50.1	56.3	44.9	53.6	60.1	48.2	53.8	60.3	48.3	54.4	60.4	49.4
Bulgaria	15–24	27.4	25.8	29.1	27.4	25.8	29.1	23.6	26.1	20.9	25.7	28.3	23.0	25.5	28.6	22.2
	Total 15+	45.6	48.9	42.5	45.6	48.9	42.5	45.4	50.6	40.5	47.8	53.3	42.8	47.3	52.8	42.1
Poland	15–24	27.0	31.1	22.6	23.9	26.7	20.9	20.3	23.0	17.5	24.3	27.4	21.2	25.7	28.8	22.5
	Total 15+	50.7	58.4	43.7	47.0	54.3	40.4	45.0	52.1	38.5	46.6	54.2	39.7	48.7	55.8	42.1
Romania	15–24	42.3	48.6	35.7	36.3	40.8	31.6	25.5	29.3	21.5	24.6	28.2	20.7	24.0	27.0	21.0
	Total 15+	61.8	68.8	55.3	58.9	65.3	52.9	50.2	57.0	44.0	51.1	57.6	45.0	49.5	55.6	43.8
Russia	15–24	36.8	39.4	34.2	33.0	37.3	28.7	32.7	36.0	29.4	31.6	34.4	28.7	33.3	36.3	30.2
	Total 15+	56.1	63.9	49.6	54.5	61.3	48.7	56.9	63.2	51.7	56.8	62.8	51.8	58.8	64.8	53.8
Turkey	15–24	42.3	54.3	29.7	37.9	50.7	24.6	32.6	44.5	20.3	32.3	44.4	19.9	30.6	41.1	19.7
	Total 15+	50.8	72.3	28.9	47.2	69.1	25.0	43.7	65.0	22.3	43.5	64.6	22.3	42.8	63.6	21.9
EU-15	15–24	38.3			40.7			39.9			40.2					
	Total 15+				63.4	72.8	54.1	65.4	73.0	57.8	66.2	73.6	58.8	67.0	74.2	59.7
EU-27	15–24															
	Total 15+				62.2	70.8	53.7	63.6	70.8	56.3	64.5	71.7	57.3	65.4	72.5	58.3

Source: ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240; Eurostat: http://epp.eurostat.ec.europa.eu/; OECD: http://stats.oecd.org/Index.aspx?DataSetCode=CSP2010.
Note: T, total; M, male; F, female.

APPENDIX 4.3 UNEMPLOYMENT RATES, 2000–08 (%)

	Armenia		Azerbaijan		Belarus	Georgia	Moldova	Ukraine	Bulgaria	Russia	Poland	Romania	Turkey	EU-15	EU-27
	Registered unemployed	ILO	Registered unemployed	ILO	Registered unemployed	ILO									
2000	11.7	NA	1.2	NA	2.1	10.3	8.5	11.6	16.9	10.6	16.1	7.1	6.5	7.7	8.7
2001	10.4	38.4	1.0	NA	2.3	11.1	7.3	10.9	19.8	9.0	18.3	6.6	8.4	7.2	8.5
2002	10.8	35.3	1.4	NA	3.0	12.6	6.8	9.6	17.8	7.9	19.9	8.4	10.3	7.6	8.9
2003	10.1	31.2	1.4	9.7	3.1	11.5	7.9	9.1	13.7	8.2	19.7	7.0	10.5	7.9	9.0
2004	9.6	31.6	1.3	8.4	1.9	12.6	8.1	8.6	12.0	7.8	19.0	8.0	10.3	8.1	9.0
2005	8.2	31.2	1.6	7.6	1.5	13.8	7.3	7.2	10.1	7.2	17.8	7.1	10.3	8.1	8.9
2006	7.4	27.8	1.3	6.8	1.2	13.6	7.4	6.8	9.0	7.2	13.9	7.3	9.9	7.7	8.2
2007	7.0	28.4	NA	6.5	1.0	13.3	5.1	6.4	6.9	6.1	9.6	6.4	10.0	7.0	7.1
2008	6.3	NA	NA	NA	0.8	NA	4.0	6.4	5.7	6.1	7.1	5.8	9.4	NA	7.0

Source: ETF Country Reports; ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240.
Note: ILO, International Labour Organization.

APPENDIX 4.4 EMPLOYMENT STRUCTURE BY STATUS, 2000 AND 2005–07 (% TOTAL EMPLOYMENT)

			2000			2005			2006			2007		
			T	M	F	T	M	F	T	M	F	T	M	F
ARM	**SW**		52.8			48.2			48.8			49.7		
	SE		47.2			46.3			46.8			50.3		
	FW					5.5	5.8	5.1	4.4	3.4	5.9			
AZE	**SW**					33.8	33.8	33.8	41.0	47.5	33.8	41.8	50.7	32.7
	SE	Employer				3.3	3.3	3.3	2.2	3.4	0.8	5.0	8.7	1.3
		Own account				45.8	45.8	45.8	56.5	48.9	65.1	53.2	40.5	66.0
		Cooperatives				0.4	0.4	0.4	0.3	0.3	0.3	0.0	0.0	0.0
	FW					16.8	16.8	16.8	0.0	0.0	0.0	0.0	0.0	0.0
BEL	**SW**													
	SE													
	FW													
GEO	**SW**		37.2	37.5	36.9	34.4	34.3	34.5	34.6			33.7		
	SE	Employer	1.5	2.6	0.4	1.1	1.6	0.4	0.8			1.1		
		Own account	30.4	35.4	25.1	35.7	44.7	25.8	35.8			33.8		
		Cooperatives	0.6	1.0	0.3	0.0	0.0	0.0	0.0			0.0		
	FW		29.5	22.7	36.7	28.5	19.0	39.0	28.7			28.4		
	NC		0.8	0.9	0.7	0.3	0.3	0.3	0.1			0.0		
MOL	**SW**		62.8	63.7	61.9	63.0	61.8	64.1	67.0	65.2	68.8	66.7	63.7	69.7
	SE	Employer	0.5	0.9	0.2	0.7	1.1	0.3	1.0	1.4	0.5	0.9	1.1	0.7
		Own account	29.3	29.6	29.0	35.2	36.3	34.2	29.0	31.7	26.4	30.1	33.9	26.3
		Cooperatives	0.2	0.3	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
	FW		7.2	5.5	8.8	1.1	0.8	1.4	2.9	1.6	4.3	2.3	1.3	3.4

		2000			2005			2006			2007		
		T	M	F	T	M	F	T	M	F	T	M	F
UKR	**SW**	89.9	90.6	89.2	81.8	82.9	80.6	81.0	81.9	80.0	80.7	81.8	79.5
	SE	9.0	8.6	9.3	17.7	16.6	18.9	18.6	17.6	19.7	18.9	17.7	20.2
	FW	1.1	0.8	1.5	0.5	0.5	0.5	0.4	0.5	0.3	0.4	0.4	0.4
BUL	**SW**				85.8	83.1	88.8	86.9	84.1	89.9	87.6	84.9	90.6
	SE				12.5	15.7	8.8	11.9	15.1	8.2	11.2	14.3	7.8
	FW				1.5	0.9	2.2	1.3	0.8	1.8	1.2	0.7	1.6
POL	**SW**	72.6	70.5	75.2	74.2	72.1	76.9	75.6	73.4	78.2	76.5	74.5	79.1
	SE	22.4	25.9	18.2	20.5	24.1	16.1	19.9	23.4	15.5	19.2	22.7	14.9
	FW	5.0	3.6	6.6	5.3	3.8	7.0	4.5	3.2	6.2	4.2	2.8	6.0
R0M	**SW**	56.1	58.2	53.7	64.7	64.4	65.2	66.2	65.5	67.1	66.3	66.0	66.6
	SE	24.6	31.2	17.0	21.4	27.8	13.5	20.6	27.0	13.0	21.1	27.5	13.5
	FW	19.3	10.6	29.3	13.8	7.8	21.2	13.1	7.4	19.9	12.6	6.5	19.9
RUS	**SW**	89.9	89.5	90.3	92.2	91.7	92.7	92.4	91.8	93.1	92.7	92.0	93.3
	SE	9.9	10.3	9.6	7.7	8.1	7.2	7.5	8.1	6.8	7.2	7.9	6.6
	FW	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
EU	**SW**										87.7b		
	SE	15.8a			15.6a			14.2a			10.5b		
	FW										1.8b		

Source: ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240; Eurostat: http://epp.eurostat.ec.europa.eu/; OECD: http://stats.oecd.org/Index.aspx?DataSetCode=CSP2010
Note: T, total; M, male; F, female; SW, salaried workers; SE, self-employed; FW, family workers; NC, not classified; a, EU-15; b, EU-27.

APPENDIX 4.5 EMPLOYMENT STRUCTURE BY ECONOMIC SECTOR, 2005–07 (% TOTAL EMPLOYMENT)

	2005									2006									2007								
	Industry			Agriculture			Services			Industry			Agriculture			Services			Industry			Agriculture			Services		
	T	M	F	T	M	F	T	M	F	T	M	F	T	M	F	T	M	F	T	M	F	T	M	F	T	M	F
ARM	15.9	21.1	9.8	46.2	46.1	46.4	37.8	32.8	43.8	15.6	20.8	9.5	46.2	46.3	46.1	38.2	32.9	44.5	20.5	30.0	8.6	31.6	26.1	38.5	47.9	43.9	52.9
AZE	12.1	15.2	8.7	39.3	41.1	37.4	48.6	43.7	54.0	12.4	19.8	9.0	39.5	36.2	36.7	47.9	43.7	54.3	12.6	21.4	3.8	38.6	35. 2	42.0	48.8	43.5	54.2
BEL	24.7	35.1	11.3	2.0	2.4	1.5	72.6	61.9	86.4	24.7	35.6	10.8	2.0	2.5	1. 3	72.8	61.3	87.4									
GEO	9.3	13.7	4.4	54.3	51.7	57.2	36.2	34.2	38.4	9.0	13.7	3.9	55.3	53.4	57.4	3 5.5	32.8	38.5	10.4	16.5	3.7	53.4	50.5	56.6	36.0	32.9	39.4
MOL	16.0	20.9	11.5	40.6	41.1	40.3	43.3	37.9	48.2	18.2	24.0	12.4	33.6	35.3	31.9	48.1	40.7	55.6	18.7	25.2	12.4	32.8	35.5	30.1	4 8.4	39.3	57.5
UKR	24.2			19.4			56.4			24.2			17.6			58.2			23.9			16.7			59.4		
BUL	34.2	38.9	28.9	8.9	10.7	6 .8	56.8	50.3	64.2	34.5	40.1	28.1	8.1	9.8	6.1	57.4	50.0	65.8	35.5	41.6	28.5	7.5	9.2	5.7	57.0	4 9.2	65.8
POL	29.2	39.0	17.1	17.4	18.0	16.7	53.4	43.0	66.2	30.0	40.1	17.5	15.8	16.4	15.0	54. 2	43.5	67.5	30.7	41.2	17.9	14.7	15.2	14.2	54.5	43.6	67.9
ROM	30.3	34.9	24.8	32.1	31.4	33.0	3 7.5	33.6	42.2	30.6	35.1	25.3	30.5	29.7	31.4	38.8	35.1	43.3	31.4	37.0	24.7	29.5	28.2	31.0	39 .1	34.7	44.3
RUS	29.8	38.1	21.2	10.2	12.3	8.0	60.0	49.6	70.7	29.3	37.9	20.7	10.0	12.1	7.8	60 .7	50.0	71.6	29.2	38.0	20.2	9.0	11.0	6.9	61.8	51.0	72.9
TUR	24.7	28.1	15.0	29.5	21.7	51.6	45 .8	50.2	33.3	25.4	29.1	15.0	27.3	19.8	48.5	47.3	51.1	36.5	25.5	22.3	14.8	26.4	19.1	47.3	48. 0	51.6	37.9
EU15	23.9	33.7	11.6	3.7	4.5	2.7	72.5	61.8	85.8	23.6	33.6	11.3	3.5	4.4	2.5	72.8	62. 0	86.2	23.5	33.6	11.1	3.4	4.2	2.5	73.0	62.2	86.4
EU27	25.2	34.7	13.4	6.3	7.1	5.3	68.5	58.2	81. 3	25.1	34.8	13.2	5.9	6.7	5.0	68.9	58.5	81.8	25.1	35.0	13.1	5.7	6.5	4.8	69.1	58.5	82.1

Source: ILO Key Indicators of the Labour Market: www.ilo.org/empelm/what/lang—en/WCMS_114240; Eurostat: http://epp.eurostat.ec.europa.eu/; OECD: http://stats.oecd.org/Index.aspx?DataSetCode=CSP2010; ETF (2009a).
Note: T, total; M, male; F, female. The construction sector is included in services.

5. EMPLOYMENT FRAMEWORK: POLICIES, LEGISLATION AND INSTITUTIONS

Dr Constantin Zaman and Anastasia Fetsi

This chapter describes how the institutional, legal and policy framework has evolved with regard to the labour market domain. Employment support has been an important policy area in all Eastern partner countries, in view of the high levels of job destruction and subsequent high unemployment rates experienced since the beginning of the transition process. A variety of policy documents with ambitious targets and objectives have been elaborated, aimed at stimulating employability and reducing unemployment, decreasing informality, increasing wages and enhancing productivity by promoting higher-value-added activities. These objectives have been only partially achieved because (1) the measures envisaged very often lack concreteness in implementation; (2) strategic documents duplicate and overlap with one another; and (3) financial envelopes for the implementation of the policies have been small.

Although all the countries except Georgia have introduced both passive and active measures to address (un)employment issues, most of the available funds have been spent on passive labour market measures (unemployment benefit) that cover only a small of percentage of unemployed people and offered only a low level of benefits. The menu of ALMPs is quite rich in most Eastern partner countries, with job-creation measures (specific public works and employer subsidies for the recruitment of specific population groups) absorbing most budgets; employability measures (training) are also applied quite widely. No evaluation has been made on the effectiveness of ALMPs. However, there are suggestions that neither the design nor the mix of measures fit the nature of unemployment in the countries. Training measures implemented in Moldova and Ukraine seem to have better outcomes in terms of work placement.

Eastern partners have faced the challenge of reducing the labour market rigidity of the Soviet era in order to encourage labour turnover and mobility from less productive to more productive jobs. However, developments in the different countries followed different pathways. Georgia, at one extreme of the labour market flexibilisation spectrum, opted for a liberal labour market policy, as did Armenia and Azerbaijan to a lesser degree. Belarus, Moldova and Ukraine, at the other extreme, opted for protecting employees in jobs, even at the expense of underemployment and labour turnover rigidities. It is clear that all the Eastern partners need to work on a better balance between security (in terms of employability and income security) and labour market flexibility that (1) avoids labour market segmentation; (2) leads to a better allocation of human resources; and (3) does not encourage the creation of informality.

In all six countries except Georgia, the main institutions in charge of labour market and employment issues at the central level are the labour ministries, which elaborate, implement and monitor national labour policy. They also typically have competencies for labour legislation, employment policy, social protection, wage policy and employment service administration. However, they are institutionally weak in designing, implementing, monitoring and evaluating effective policies. At the territorial level, the PESs implement brokerage functions by matching jobs with job seekers. Except for those located in capital and large cities, PES offices are generally insufficiently equipped and staffed, are affected by bureaucracy and passivity in promoting employment, and have limited population coverage (local offices are always situated in the main town of the region). Their institutional capacity needs to be improved in terms of financial and human resources.

Labour legislation is governed by labour codes, often complemented by additional acts that establish in law, for example, the status of trade unions, the remuneration system for specific categories of workers (public employees), the minimum wage, and labour inspection mechanisms. However, the effective application of legal provisions is not always respected in practice. Trade unions exist in all the countries, though to different extents and with varying degrees of influence. In Azerbaijan and Belarus they merely follow the official political line, while in Ukraine they perpetuate the Soviet tradition to a large extent. They are much less important in the private sector and are mainly concentrated in the remaining state enterprises and in the public sector. In order for more effective employment policy to be implemented, there is a need in all the countries for better involvement of social partners (both employers and trade unions).

5.1 EMPLOYMENT POLICIES AND LEGAL FRAMEWORK

Employment support has been an important policy area in all the Eastern partner countries, in view of the high levels of job destruction and subsequent high unemployment rates experienced since the beginning of the transition process. A variety of policy documents have been elaborated, including specific multi-annual employment or labour market strategies; more general socioeconomic government strategies and/or programmes that include employment promotion elements; and poverty-reduction strategies in which employment creation through economic growth represents a priority.

Employment policy is also an obligation for countries that have signed ILO conventions (**TABLE 5.1**). ILO Convention 122 on Employment Policy and ILO Convention 88 on Establishing Employment Services urge the governments of ratifying countries, in close collaboration with social partners, to formulate and implement an active policy promoting full, productive and freely chosen employment. To achieve these employment goals, countries are required, within the framework of a coordinated economic and social policy, to set up appropriate measures and to take the necessary steps for their application, including the launching of special labour market programmes in their support.

The general principles of an active employment policy are elaborated further in ILO Recommendation 122/1964, which takes into account the various possible causes of unemployment and suggests a wide range of policies to tackle them. Policies promoting economic growth, investment and job creation play a crucial role. In addition to economic measures, emphasis is placed on the following:

1. actions that regulate labour market functioning (labour laws and relevant by-laws and collective agreements);
2. policies and programmes aimed at enhancing the employability of job seekers (both unemployed and underemployed) and matching them to available jobs;
3. appropriate income support, mainly through unemployment benefits, to help unemployed and underemployed persons and their dependants meet their basic needs.

5.1.1 MAIN EMPLOYMENT POLICY DEVELOPMENTS

TABLE 5.2 summarises the main elements of employment policy as they have evolved over the transitional period. In Armenia, the first strategic document outlining the main government priorities in the labour market area was elaborated in 2003: this was the Poverty Reduction Strategy Paper. The main objectives of this document were employment enhancement and unemployment reduction, with a specific focus on structural unemployment. In 2005 the Employment Law that eventually became the Law on Employment and Social Protection for the Unemployed introduced Annual Employment Programmes in line with the overall development objectives of the country (ETF, 2010a).

The 2008 Sustainable Development Programme, which is an update of the Poverty Reduction Strategy Paper, integrated employment policy into the overall policy framework. The time horizon of the programme was extended to 2021 in order to incorporate long-term employment and labour market priorities. During the first years of transition, employment policy concentrated mostly on passive labour market measures, consisting, in theory, of providing unemployment benefits and/or temporary cash assistance for those who had lost their jobs in the process of restructuring. In practice, the majority of resources for labour market programmes allocated until 2000 (70–80%) went to passive measures. ALMP funding started to increase thereafter, but the largest share of expenditure dedicated to active measures has been consumed by training programmes and public works, the effectiveness of which has been rather low.

TABLE 5.1 ILO CONVENTIONS 122 AND 88: RATIFICATION DATES

Country	Convention 122	Convention 88
Armenia	29/07/1994	Not ratified
Azerbaijan	19/05/1992	11/03/1993
Belarus	26/02/1968	06/11/1956
Georgia	22/06/1993	11/09/2002
Moldova	12/08/1996	12/08/1996
Ukraine	19/06/1968	Not ratified

Source: ILOLEX: www.ilo.org/ilolex/english/convdisp1.htm

TABLE 5.2 MAIN EMPLOYMENT POLICY DEVELOPMENTS DURING TRANSITION

Country	First employment policy initiative	Main strategic employment policy documents	Adoption of labour code
Armenia	1991: Employment Law (revised 1996) 2005: Law on Employment and Social Protection for the Unemployed	2003: Poverty Reduction Strategy Paper (Sustainable Development Programme from 2008) 2005: Annual Employment Programmes 2007–11: Decent Work Country Programme with ILO	A new Labour Code in 2004
Azerbaijan	1991: Employment Law 2001: Employment Law and the related Presidential Decree to implement the law	2003: Poverty Reduction and Economic Development Programme 2001: Medium-term Economic and Social Development Programme 2006: National Employment Strategy (NES) 2006–2015 2007: Action Plan for Implementation of NES 2007–10 2008: State Programme for Sustainable Development and Poverty Reduction 2006–09: Decent Work Country Programme with ILO	1999
Belarus	1996: Presidential Decree on Basic Directions of Socioeconomic Development	2001: Programme for Belarus Socioeconomic Development 2004: Long-term Development Strategy 2006: Employment Law	1999 (revised in 2007)
Georgia	1991: Employment Law (revised 2001, abolished 2006)	2008: Georgia Without Poverty 2008: Cheap-credit programme	A new Labour Code in 2006
Moldova	1991: Employment Law 2003: Law on Labour Force Employment and Social Protection of the Unemployed	1994: State Programme for Labour Force Employment 2002: Strategy for Labour Force Employment 2007: National Strategy for Labour Employment Policy 2008–11: Decent Work Country Programme with ILO (following on from the one for 2006–07)	A new Labour Code in 2003
Ukraine	1991: Employment Law	1991–92, 1993, 1994, 1997–2000, 2001–04, 2005: respective National Employment Programmes 1998, 1999, 2000, 2002, 2004, 2007: respective National Action Plans for Employment 2006–07: Decent Work Country Programme with ILO 2008–10: New Decent Work Country Programme	1971 (amended many times 1991–2010)

Source: Author, based on ETF Country Reports and data from the Azerbaijan Ministry of Labour and Social Protection.

Azerbaijan has the most diversified policy framework in the employment domain, though not necessarily the most efficient. Until 2006 the Poverty Reduction and Economic Development Programme for the period 2003–05 represented the key document for implementing policies in the field. Between 2004 and 2008 the Programme for Socioeconomic Development of Regions complemented the government's Poverty Reduction and Economic Development Programme. Both documents stipulate the use of ALMPs to boost employment. The Medium-term Economic and Social Development Programme is another policy instrument that updates the employment situation in the economy every year and tries to reconcile economic growth and employment objectives.

This programme also defines employment policy priorities for the medium term, on the basis of two additional documents: the National Employment Strategy, elaborated for the period 2006–15, and the Action Plan for Implementation of the Employment Strategy, which covers the period 2007–10. It seems that employment policy in Azerbaijan is based on a national employment strategy that sets objectives and a social development programme that tries to correlate employment goals with economic development objectives. In order to link the medium-term development objectives with long-term employment goals, the government elaborated a corresponding plan for implementing the strategy. In addition, the State Programme for Sustainable Development and Poverty Reduction was elaborated in 2008, covering the period until 2015.

In Belarus the major policy implemented by the government in the field of employment has been wage control in the economy. The 1996 Presidential Decree on Basic Directions of Socioeconomic Development for 1996–2000, which became law in 1998, stressed the importance of controlling wages in the economy as the sole policy for maintaining employment. Another Presidential decree from July 2001 introduced the concept of state personnel selection in Belarus. This document represents some progress, as it stipulates the creation of a system of training and effective use of the labour force, and the development of personnel potential. A long-term development strategy was adopted in 2004, setting priorities for the period up to 2020. Like the previous documents, the strategy mentions wage control as a major policy measure for employment promotion (ETF, 2010c).

The 1991 Georgian Employment Law introduced for the first time the notion of unemployment; its revised version from 2001 changed the institutional framework in the field, but was abolished five years later. The Georgian Agency for Social Assistance and Employment was created in 2005 with the aim of formulating and applying employment policy. However, it concentrated almost exclusively on social protection and was therefore restructured in 2007 when its responsibilities were reduced only to social assistance, with employment policy formulation passing to the Ministry for Economic Development. Currently, the main strategic document dealing with employment promotion issues is the 2008–12 Georgia Without Poverty Programme, inspired by a poverty reduction and economic growth strategy that was initiated in 2000 but took several years to be adopted. The document insists on various social programmes being implemented on a large scale. The objectives are overambitious and are likely to be only partly achieved, and over a longer timescale than foreseen in the strategy. Previously implemented programmes focusing on training for unemployed individuals have consumed significant financial resources without bringing the expected results (ETF, 2010d).

In Moldova the 1994 State Programme for Labour Force Employment introduced social protection for workers who lost their jobs as a result of economic reforms. The Strategy for Labour Force Employment adopted in 2002 accepted the ILO definition of unemployment, together with other standardised labour market indicators. The main directions for policy intervention in the field were defined in the National Strategy for Labour Employment Policy (2007–15), which details annual plans for implementation; the first plan was adopted for 2008 and contains 90 specific actions grouped into 27 objectives and covering 11 policy directions. The document was developed in line with the revised European Employment Strategy, the EU–Moldova Action Plan and the UN Millennium Development Goals (ETF, 2009a).

Ukraine's employment strategy is formalised in a National Employment Programme. The most recent such programme was elaborated for 2005; thereafter, a government regulation issued in 2006 replaced the National Employment Programme. The employment objectives of this regulation were translated into a National Action Plan for Employment (2007–08), in which detailed actions are listed to achieve the objectives (ETF, 2009b).

As a result of the employment challenges existing in these countries, Azerbaijan, Armenia, Moldova and Ukraine have signed Decent Work Country Programmes (DWCPs)[66] with the ILO. DWCPs have been the main vehicle for the delivery of ILO support to these four countries in promoting decent work within national development strategies. Belarus and Georgia do not have such programmes. Both these countries have been criticised at various sessions of the International Labour Conferences at the initiative of their trade unions, for different reasons (Georgia for its 2006 Labour Code, which is considered too liberal, and Belarus for its policies on the independent trade union activities).

As one of the first examples in the region, the DWCP for Azerbaijan referred to the period 2006–09 and included the following priorities:

- improving employment policies (especially for young people);
- creating decent jobs;

66 The ILO concept of 'decent work' is defined as promoting opportunities for women and men to obtain decent and productive work in conditions of freedom, equity, security and human dignity. Thus decent work for all is made an objective of the ILO as well as national policies who signed these programmes. The four decent work country programmes are available at: www.ilo.org/public/english/bureau/program/dwcp/countries/index.htm

- strengthening social dialogue;
- advancing the implementation of international labour standards.

The country planned to renew its DWCP for the period 2010–13, the priorities for this being the creation of efficient mechanisms for labour market regulation and social dialogue, improved quality of workplaces, and the social integration of vulnerable groups; these priorities are largely formulated at the Sub-regional Conference on Decent Work Priorities and Anti-crisis Response.

The DWCP for Armenia referred to the period 2007–11 and included the following priorities:

- improving employment policies through the development of national employment policies;
- increasing the employability of marginalised groups;
- reforming employment-related legislation;
- strengthening social partnership;
- improving social protection, especially within the occupational health and safety system.

The DWCP for Moldova referred to the period 2008–11 period and included three priorities:

- strengthening the capacity of government institutions and the social partners to improve the governance of the labour market;
- improving the design, monitoring and evaluation of employment policy, through more effective labour administration as well as measures targeting workers in the informal economy and those exposed to migration;
- improving the effectiveness of social protection, with a special focus on vulnerable groups.

This is a continuation of the previous DWCP for Moldova (2006–07), which is considered to have been relatively successful.

The DWCP for Ukraine referred to the period 2006–07 and included three priorities:

deepening the democratisation process through strengthening social partners and social dialogue;

- promoting more and better employment opportunities for men and women;
- achieving a closer alignment with EU standards.

A new DWCP was subsequently signed for the period 2008–10 between Ukraine and the ILO.

The implementation of these programmes has been completed in some cases, and is still continuing in others. However, their actual impact on the real employment rates and/or quality of jobs is not so straightforward. Despite the lack of specific impact assessment studies, one independent evaluation of the ILO's country programme to Ukraine (2000–06)[67] provides some clues: the programmes influence thinking and actions relating to attitudes and policy changes among the stakeholders, and improve capacity building and infrastructure development at policy level; however, the decent work agenda could be more clearly outlined and advocated at multiple organisational levels, and better monitored and evaluated. Projects are fragmented and detached from larger policy frameworks, risking their sustainability, while unpredictable political changes impose constraints on the results.

5.1.2 AN ASSESSMENT OF EMPLOYMENT POLICIES

Irrespective of the type of document that establishes employment policies, the objectives and expected outcomes of these policies are similar in all the countries:

- to enhance employability and reduce unemployment;
- to improve participation rates in order to deal with demographic challenges;
- to reduce the size of the informal sector;
- to improve wage policies;
- to move towards higher-value-added activities in the economy;
- to reduce regional disparities in employment opportunities.

Although employment objectives are clearly set, the documents that are supposed to offer guidance for the achievement of these objectives lack specificity with respect to the effective actions to be taken. The common feature of all these strategies is that they set overambitious objectives that are above the capacity of the governments in terms of resources and of being achievable within a reasonable time period. As an example, the Georgia Without Poverty programme envisages, among other reforms, the transformation of the country into an international financial centre, but many doubts have been raised regarding the achievement of this goal[68]. In the same context, a Ukrainian action plan envisaged the creation of almost one million jobs per year (ETF, 2009b); this objective was not very realistic for the Ukrainian economy, even if all existing restrictions in the economy and the labour market were to be eliminated.

The second important inconsistency in these employment strategies relates to the measures envisaged to achieve the goals. Although in some countries (Azerbaijan, for example) employment promotion strategies have been accompanied by subsequent action plans for their implementation, the complementary documents and the basic strategies fail to describe concrete steps and actions to be implemented in order to achieve the proposed objectives. What the strategies describe as actions are, in fact, subsequent objectives, political wishful thinking or simply administrative measures. A relevant example is the Ukrainian National Employment Plan (2007–08), which was conceived as a plan of concrete actions for achieving equally concrete objectives.

67 For the full report, see www.ilo.org/public/english/bureau/program/download/pdf/ukraine2000.pdf

68 See, for example, www.eurasianet.org/departments/insight/articles/eav020608c.shtml and www.messenger.com.ge/issues/1508_december_18_2007/1508_edit.html .

The third problematic issue in employment policy design is the duplication of objectives between various documents. The coexistence of poverty reduction strategies, socioeconomic development plans, employment programmes and other government strategic documents has created overlapping objectives, unclear institutional delimitation of responsibilities and, ultimately, uncertainty about the final outcome. This is because all these policy documents are not sufficiently interlinked; instead of being complementary, they either duplicate or substitute for one another to a large extent. At the same time, the institutions in charge of implementing these strategies do not coordinate, and there is even a certain rivalry in some cases (Feldmann, 2005). A particular case in this regard is Belarus, where public intervention in the economy leaves little room for decision making on the part of enterprises, which are bound by strict wage policies fixed by the government. Without strong employers, the main goal is to maintain the existing high-employment policy. As a result, actions are mainly oriented to administrative controls and inspections of employers (Tomashevski, 2008).

Another important aspect of the elaboration and implementation of employment policy in the Eastern partner countries is related to financing. Apart from the fact that the objectives envisaged are too ambitious, given the ambiguity of the action plans that are supposed to lead to specific outcomes, the strategies do not detail the costs of the measures or the sources of finance for their implementation. Employment policy, as spelled out in the strategic documents, is not linked with the public finance framework of the countries. The clearest example of this is Azerbaijan, where the medium-term employment strategy coexists with a medium-term budget programme, with the latter the main legal and economic tool through which the government allocates resources for the execution of its overall policy. However, the two strategies are not correlated and many inconsistencies exist between them.

Employment policy implementation is also deficient in the areas of monitoring and evaluation. None of these programmes and action plans has been properly evaluated. When a programme does not bring results, another strategic document is elaborated, one that is even more ambitious and declarative than its predecessor. Unfortunately, the content, structure and approach remain essentially the same, with only the title of the documents changing. These deficiencies in elaborating and implementing employment policy can be explained by two main factors:

1. The governments have weak institutional capacities in terms of policy development and, in particular, policy implementation. Weak institutional capacity leads to strategic inconsistencies between various policy roadmaps elaborated by a government within the components of an employment strategy (a more detailed analysis of the institutional framework is presented in Section 5.4 below).
2. The focus of employment policies has been on dealing with job destruction rather than with job creation. Employment preservation has been given more importance than facilitating job turnover (labour mobility) and new job creation.

5.2 MAIN LABOUR MARKET INTERVENTIONS: ACTIVE VERSUS PASSIVE MEASURES

As already mentioned, the funds invested in the highly ambitious employment policies of the six countries have been limited. As demonstrated in **TABLE 5.3**, public spending on active and passive labour market measures was much lower than the EU average – despite the much higher unemployment levels of the Eastern partners – at around 0.1% of GDP in most countries (information for Georgia unknown) and even lower in Moldova (0.05%), compared to the EU-27 average of 1.6%. Most countries experienced an increase in spending on labour market measures, except Belarus, where there was a decrease from 0.15% of GDP in 2006 to 0.09% in 2008 (European Commission, 2009a, 2009b, 2009c). Moreover, Georgia has also suspended all labour market measures since 2007, and the limited programmes to provide inexpensive credit and social assistance to poor families were suspended in 2009 owing to the economic crisis.

TABLE 5.3 SPENDING ON LABOUR MARKET POLICIES, 2008

	Armenia	Azerbaijan	Belarus*	Georgia	Moldova	Ukraine	EU-27*
Total spending on labour market policies (passive and active), % of GDP	0.1 (2007)	0.1	0.09	NA	0.05	0.1	1.6
Spending on ALMPs, % of total spending on labour market policies	40	15	90	NA	44	30	Approx.30 (0.45% of GDP)

Source: ETF Country Reports; EC (2009a, 2009b, 2009c); Eurostat (for EU-27): http://epp.eurostat.ec.europa.eu/portal/page/portal/product_details/dataset?p_product_code=TPS00076
*Note: *Belarusian Ministry of Labour and Social Protection (meeting with ETF staff).*

5.2.1 ACTIVE LABOUR MARKET POLICIES

All Eastern partners (except Georgia) have introduced a broad range of ALMP programmes including the following:

- measures to enhance the employability of unemployed individuals and job seekers in general, such as training, retraining and job clubs;
- job-creation measures, such as employer subsidies, public works and new business start-ups;
- programmes and services for matching job seekers to jobs, such as job counselling and guidance, job-search assistance and job fairs.

The funds dedicated to these measures have been very limited, considering the extent of unemployment. In Armenia, spending on ALMPs represented only 0.04% of GDP between 2001 and 2008, against the EU-27 average of 0.45%. Most of the funds were allocated to subsidising employment through public works (57% in 2007). In Azerbaijan, 15% of all labour market funds in 2008 were used for active measures. In 2007 job seekers benefited most from job fairs (around 44 000 people) and placement services (around 2 500 people), while training and public works measures benefited smaller numbers of people: 2 623 and 1 832 people, respectively (Feiler, 2009). In Belarus most funds for ALMPs were allocated to public works and training, while the number of unemployed people who benefited from (small) grants for business start-ups was very small (2 500 people).

Georgia is the only Eastern partner that does not implement any ALMPs for job seekers. The underfunded training programmes that were provided in the country until 2006 were cancelled because of their low level of effectiveness. An ALMP aimed at job creation, launched in 2008 by the Ministry of Economic Development, supported access to financing for business projects under favourable lending conditions. It benefited around 30 000 people in starting up businesses oriented to exports, agriculture, tourism and crafts. Although the programme was in high demand, it was suspended in 2009 because of the economic crisis.

In Moldova, the entire package of labour market policies is financed by an unemployment fund. ALMPs absorb 43.5% of total spending on labour market policies. Most spending on ALMPs is directed at VET and public works (59% and 22%, respectively, of total spending in 2007) (ETF, 2009a). Ukraine spent the highest amount on ALMPs: 0.10% of GDP in 2007, after a peak of 0.15% in 2004 (ETF, 2009b). Most of the funds for ALMPs are for job-creation programmes, and in particular, employer subsidies and training. The number of people taking part in training programmes in 2007 was 229 400, double that of 1998, and representing 9.5% of the total number of jobless people registered with the employment offices.

Training and retraining programmes provided in all the countries except Georgia focus on a variety of target groups (long-term unemployed individuals, displaced workers, and young people, often with particular focus on school dropouts); however, no evidence is available on whether there is a clear identification with labour market needs. Moreover, training programmes are often organised in large cities, while the needs are often elsewhere (World Bank, 2007; SIDA, 2004). However, more countries are making efforts to improve the labour market relevance of their programmes. For example, Belarus and Ukraine are trying to bring training programmes closer to the demand for skills by organising them at the request of employers or by involving employers in programme design and delivery. Moldova and Ukraine have already started reporting the improved effectiveness of their training programmes. In Ukraine training programmes had a placement rate of 72.6% in 2007 (95.0% in certain regions of the country) (ETF Country Reports).

Job counselling and job-search assistance is provided by PESs, but the quality of these services is often low owing to overload and the limited capacity of counsellors. Armenia and Azerbaijan report major problems in this respect. In other countries, for example Moldova, such programmes appear to be more successful; around 122% of persons registered with the PESs applied for job counselling (some of the applicants registered several times). More than 2 500 individuals found a job through job fairs, which makes this type of assistance one of the most efficient policy tools together with public works programmes (ETF Country Reports). In Georgia, this service is mostly provided through private agencies, which limits the coverage and access for those who are in most need in the labour market.

Job-creation programmes are also offered in the majority of the countries. One approach consists of granting subsidies to employers to hire new workers or to keep employees who might otherwise be laid off for business reasons. These can take the form of direct wage subsidies (for either the employer or the worker) or social security payment offsets. These types of subsidies are always targeted to a particular category of worker or employer. Another approach involves direct job reinsertion into the public or non-profit sector through public works or related programmes. The government funds used for these programmes typically cover compensation costs for hiring previously unemployed workers, usually on a temporary basis. Public works programmes are usually organised in the case of massive layoffs when state enterprises are closed down, particularly in mono-industrial zones (e.g. mining regions in Ukraine). The employment is temporary and therefore has a social protection function (in Ukraine, employment through public works programmes is for a maximum of two months). Some countries record public works separately from employment subsidies, although public works are in effect subsidised employment.

A third type of programme concerns unemployed workers who are offered financial support to start their own enterprises. This can involve offering micro-financing for start-ups (Azerbaijan), allowing unemployment benefits to continue when claimants start their own business, offering lump-sum grants (Ukraine) and providing business support services. In Moldova, private firms creating new

jobs and employing unemployed individuals are offered lower interest loans (ETF Country Reports).

However, job creation should not be limited to unemployed persons; in fact, experience demonstrates that a focus on poor families and unemployed individuals is not effective in stimulating economic growth and hence creating decent jobs. Micro-credit schemes targeted at the jobless poor serve only as a survival tool, and very rarely do the beneficiaries of such support become real entrepreneurs. Job-creation policies should concentrate on expanding existing enterprises and on creating new businesses capable of generating salaried employment.

Although ALMPs are not evaluated in any of the countries, it appears that their effectiveness in improving the supply side of the labour market or in creating jobs is not significant. After the 2009 economic crisis, with increased number of potential clients, the funds dedicated to ALMPs were further reduced (spending per person), and only a small number of job seekers have access to them. There are also problems with their content design.

5.2.2 PASSIVE LABOUR MARKET POLICIES

Among the passive policies, the provision of unemployment benefits is the main social protection tool for temporarily compensating the loss of income through unemployment. Half of Ukraine's unemployment fund was spent on the payment of unemployment benefits in 2007 (2.4 times more than the resources allocated for ALMP programmes). Benefits are granted for a fixed period of time and their amount is correlated with previous work experience. In Moldova, for example, unemployed persons receive between 50% of the average wage for six months for less than five years' experience, and 60% of the average wage for 12 months for more than ten years of service. In Azerbaijan, all unemployed persons receive 70% of their previous salary, calculated over the previous 12 months, for a maximum period of 6 months annually. Eligibility is conditional on a minimum of six months of activity over the previous year.

Unemployment benefits are generally higher than the minimum wage, but less than the cost of living. In Moldova in 2007, benefits represented 1.41 times the minimum wage but only 51.3% of the standard cost of living. In Azerbaijan, benefits are also higher than the minimum wage but below the income corresponding to the poverty line. In Belarus, unemployment benefit is so low that unemployed people are not motivated to register. The unemployment benefits in the Eastern partner countries represent essential support for those who have lost their jobs, but their levels are so low that they do not really offer income security during periods of joblessness (ETF Country Reports).

Moreover, the support is only temporary and its coverage is limited, since there are strict eligibility conditions. In Armenia only 4% of unemployed individuals receive unemployment benefit; in Azerbaijan, less than 1% of jobless people received unemployment compensation in 2007, which is equivalent to around 5% of the total registered unemployed. In Moldova, 10.2% of those registered as unemployed and 7.4% of all unemployed individuals receive unemployment benefits. In 2006 the Georgian government decided to completely eliminate the system of unemployment benefits and replace it with a social assistance programme addressing poor families in general. Households with unemployed members are eligible for financial support through this programme (ETF Country Reports).

In some countries, unemployment benefits are supplemented by other forms of social assistance, but their contribution to personal income is modest. Dismissal compensation is paid in the case of mass unemployment generated by the closure of state enterprises; in Azerbaijan, this is equivalent to one average wage plus some additional benefits that depend on job tenure (ETF, 2010b). In summary, labour market measures, both active and passive, are not sufficient to protect workers from the risks posed by labour markets in continuous change or to enhance employability and ensure sufficient financial resources during periods of unemployment.

5.3 ADDRESSING LABOUR MARKET (IN)FLEXIBILITY

Labour legislation, which is necessary for the regulation of employer–employee relations, is intended to reconcile the long tradition of protection of the weaker party (i.e. workers, who are inherently unequal in the labour relationship) with recent concerns for economic development and employment creation through more adaptable enterprises. Discussion is still ongoing in the literature on finding an optimal balance between equity and efficiency in industrial relations. However, there is evidence that in some situations labour legislation may be counterproductive as a result of the excessive protection it accords to employees, and that it is ultimately harmful for both workers and employers. At the beginning of transition, all the CIS countries provided for severance payments for redundant workers, strong roles for labour unions (most of them successors of Soviet unions) in hiring and firing procedures, high social security and other labour taxes, and complicated firing procedures. As the observance of these regulations was not profitable for employers, the unintended consequences have been, typically, widespread avoidance of labour market regulations (often with the consent of workers), increasing informality and large wage arrears.

From the starting point of Soviet tradition, in which wage employment for life was the norm, and was the right of every citizen, all Eastern partner countries entered the transition process with strict labour market regulations that protected workers' rights to keep their jobs. However, this became incompatible with the intense job destruction that occurred during transition. Labour

market flexibilisation has gradually become a major issue, facilitating labour turnover and the shift of workers from less productive to more productive jobs. Different countries followed different policy options. Georgia, at one end of the spectrum of labour market flexibilisation, opted for a liberal labour market policy, as did Armenia and Azerbaijan, while at the other end of the spectrum, Belarus, and to a lesser extent Moldova and Ukraine, opted for protecting employees even at the cost of worker underemployment and rigidities in labour turnover.

Labour legislation in the Eastern partner countries is generally governed by labour codes, which are generally complemented by employment laws. In addition, the labour codes are complemented by additional acts that legalise such elements as the status of trade unions, the remuneration system of specific categories of workers (public employees, for example), the minimum wage, and the mechanisms of labour inspection. Appendix 5.1 at the end of this chapter gives a brief description of the main provisions of the labour codes in the six countries. A brief overview confirms the different paths taken by the six countries, from more rigid codes (Belarus, Moldova and Ukraine) towards relatively more flexible codes (Armenia, Azerbaijan and Georgia).

The Armenian labour code (2004) has not created major obstacles for business. However, although the quality of its laws is relatively good, enforcement of legislation is weak: this gives sufficient flexibility to employers to deal with employment issues, but affects workers' rights and working conditions. This was confirmed by a survey conducted in 2007 by Armenia's statistical service to assess the opinion of firms and specialists regarding labour legislation. This survey concluded that the legal provisions of the labour code are satisfactory (53% of respondents), although some improvements are necessary with respect to contractual issues. Of those interviewed, 43% considered that labour inspections are helpful for companies and workers in ensuring the implementation of legal provisions. Weak law enforcement, nonetheless, is due to difficulties in applying the provisions of various laws, especially the contractual clauses specified by the labour code (ETF, 2010a).

Labour legislation in Azerbaijan (1999) includes relatively stricter contractual clauses for employers than for workers, such as the prohibition of a probationary period when recruitment is based on competitive selection, restrictions on using fixed-term contracts, lengthy fixed-term contracts (five years) and relatively complicated formalities for dismissing workers (in some situations, the employer has the obligation to look for alternative employment for a worker whose contract is terminated). Very little information exists about law enforcement in the labour area in Azerbaijan. Anecdotal evidence suggests that non-compliance with the labour legislation is quite common. The use of fixed-term contracts and unpaid overtime are the most frequent practices, these being largely caused by the strictness of the law for workers with indefinite contracts. In fact, the labour code defines professions and occupations that are permanent in nature, and employers are obliged to propose only indefinite type of contracts for this kind of job.

The Georgian labour code (2006) was adopted as a policy response to high unemployment and a large informal economy. It represents the most liberal approach within the group, with most restrictions on the duration of fixed-term contracts, hiring rules and overtime hours being eliminated. The approval of trade unions for dismissing a worker was also eliminated, and dismissal rules, which under the previous legislation had been highly complex, were replaced by a very simple separation mechanism. All these elements substantially increased labour market flexibility and placed Georgia among the most liberal group of countries in terms of labour legislation. As the labour code also substantially reduced social contributions (from 31% to 20%), most of the informal jobs already existing in the market were formalised; however, the impact on net job creation is not clear. As already mentioned, the labour code is among the most liberal in the world; Georgia was ranked first in the world in the Heritage Foundation's labour freedom indicator and sixth in the 2009 Doing Business Index indicator for employing workers. To what extent this has facilitated the creation of employment is, however, debatable.

According to the International Trade Union Confederation (ITUC), the highly deregulatory framework introduced by the Georgian code undermines the fundamental rights of workers and does not contribute to job creation, thus leading to rising poverty in the country (ITUC, 2008). The main problem is that it is not combined with employment security (i.e. measures that increase employability and facilitate job and skills matching) and income security (i.e. unemployment benefits). Furthermore, trade unions lost a considerable share of membership (20 000 members in less than two years) following the adoption of the new labour code, since trade union activists can easily lose their jobs (e.g. as with Poti seaport). There is no definitive conclusion regarding the controversies surrounding the excessive liberalism of the Georgian labour code, which considerably reduces worker protection. There has been no assessment or evaluation regarding the impact of the code on labour mobility and/or the risks of losing jobs as a result of permissive dismissal rules. According to national statistics, unemployment declined within a year of the code being adopted, but increased in 2008 to higher levels than before its adoption, probably as a result of the economic crisis.

FIGURE 5.1 shows a ranking of the labour codes of the six countries along a continuum (rigid to flexible). The Belarusian labour code (1999, revised 2007) is the most rigid, and the 2007 revision did not bring any major improvements; the most significant innovations refer to the conditions for dismissing the management of companies and the introduction of greater flexibility in working time. The new version of the labour code was intended to be more liberal, while maintaining a certain balance between employer and employee rights and obligations. Nevertheless, it has not brought sufficient flexibility and dynamism to the Belarusian labour market. For example, employment contracts remain excessively inflexible for both employers and employees, even in the case of fixed-term contracts. In spite of strict administrative controls and regular inspections, anecdotal evidence suggests that the labour legislation is not fully

FIGURE 5.1 LABOUR CODES: FROM RIGIDITY TO FLEXIBILITY

enforced in practice, and some rights are not respected (Tomashevski, 2008).

Moldova adopted a completely new labour code in 2003 (effective from 1.10.2003), one that is not a revision or amendment of the old Soviet labour laws. The dismissal conditions are rather complicated, as the law forces an employer to re-employ workers who announced their intention to leave the company but change their mind within a period of two weeks. Dismissal is prohibited when the worker is on maternity or medical leave, or on holiday. Approval from trade unions is necessary when the employer wants to dismiss one of their members. The notice period before dismissal is excessively long – up to three months in some cases. Underperformance is not considered a reason for dismissal. The Moldovan labour legislation is therefore considered too restrictive by employers; the number of companies complaining about the severity of the labour code was three times higher in 2005 than in 2002, which shows that there has been no actual relaxation of regulations.

In fact, Moldova is considered to have a very unfriendly labour regulatory framework among the CIS countries. Trade unions are involved in wage and employment decisions and are thus able to influence the overall legal environment in the labour field. Being so restrictive, the labour legislation is often circumvented. Law enforcement fails the most in respecting contractual provisions and the legal working time, and there is widespread underreporting of wages. Dismissing workers is by far the most significant limitation, yet employers do succeed in dismissing unnecessary staff; in 2007, 25% more workers were fired than were hired. Certain legal provisions do not apply in private companies (the approval of trade unions for firing a worker, for example, since trade union membership is very low in the private sector) and dismissing workers is therefore simpler (ETF, 2009a).

Ukraine is the only country that still uses a version of the Soviet labour code (1971, with numerous revisions between 1991 and 2010); it has fragmented and unsystematic labour legislation, the provisions of which are often contradictory. Apart from the labour code, 11 different laws are in force, all of them directly related to employment and labour issues. Ministerial and Presidential decrees are often used as additional regulatory tools to add to the already cumbersome legislation. The labour code draws a distinction between labour agreements and labour contracts. The agreement is very rigid, while the contract offers the possibility of mutual agreement on specific terms and conditions. However, the law stipulates that contracts are applicable only to senior management positions, and this considerably limits their use.

In general, hiring is not restricted in Ukraine, whereas firing is subject to much more control, with employers having limited possibilities to dismiss a worker. Certain categories of employees cannot be fired at all. The dismissal of union members is conditional on approval from trade unions. In all cases, a dismissed worker should be offered an alternative job in the same enterprise if a vacancy exists. Severance payments are paid by the employer in most cases. The use of a Soviet labour code, although amended, is not entirely appropriate for a market economy as it distorts the legislative framework of the labour market. Consequently, irregularities and non-compliance are frequent occurrences, leading to various forms of informal or quasi-employment. Excessive regulation increases the procedural cost of employment, which adds to the already high non-wage cost of the workforce. The Ukrainian labour market is therefore among the least flexible of those in the CIS countries.

In summary, the Eastern partners base their labour legislation on the labour code. All the countries have elaborated new labour codes that are more appropriate to the rules of a market economy, except Ukraine, where an amended version of the Soviet labour code is still in use. In all cases, the fundamental principles regarding employment and workers' rights are guaranteed by the constitution, with the labour code based on these constitutional rights. The six codes are similar in terms of general provisions (contractual rules, working time, remuneration, etc.), though they differ with respect to the degree of protection granted to employees.

Legislation can contribute to labour market segmentation, namely between the state and private sectors. In most countries, public workers have some privileges (better wages, numerous non-wage benefits, job security, etc.) that make public employment attractive. For example, in 2009 an 8% wage increase was planned for the Armenian public sector, compared with only a 3% rise in the private sector[69].

69 See www.panarmenian.net/news/eng/?nid=28708.

The differentiation between the public and private sectors in terms of employment privileges is often discriminatory, since public sector employment is partially regulated by civil service laws, while the labour code is elaborated mainly for the private sector. A special law on public service employment exists even in very liberal Georgia, and there is a separate law on remunerating state employees in Ukraine. Thus, a certain elitism exists for state employees, particularly those working in public administration, but the difference between the public and private sectors derives not only from different laws, but also from differences in implementation practice (compliance versus non-compliance).

Wage mechanisms, as established by the labour legislation, differ between two groups of countries. In Belarus and Ukraine the legislation establishes a relatively generous wage system, with many additional benefits obligatory for private companies; moreover, Belarus maintains the Soviet practice of imposing social obligations on private companies (e.g. the provision of kindergartens). Armenia, Georgia and Moldova, on the other hand, have a simpler wage-setting mechanism, which considerably reduces labour costs at company level. Falling between these two groups, the legislation in Azerbaijan is less generous than in Belarus and Ukraine, but is extremely generous in specific situations and for specific professional groups (e.g. workers who are simultaneously completing their studies benefit from a different system of paid leaves, job protection, etc.).

5.3.1 ASSESSING LABOUR MARKETS FROM A FLEXICURITY PERSPECTIVE

As can be seen from the previous section, protectionist labour codes exist in Belarus, Moldova and Ukraine, in contrast with the very liberal code in Georgia and the relatively moderate codes in Armenia and Azerbaijan. Although in all these countries hiring rules are not restrictive, firing is complicated in countries with highly protective codes. However, this legal protection does not always guarantee workers' rights; on the contrary, the more protectionist labour legislation may end up providing less protection (Pavlova and Rohozynski, 2005). This is because more restrictive legislation may lower the chance of enforcement and create labour market segmentation between those who hold jobs (the insiders) and those who do not have access to jobs (the outsiders), who remain trapped in precarious low-quality work. What is important for workers' rights is not absolute job security, but a legal framework that is enforceable in practice and creates reasonable labour mobility so that resources are better allocated, with options for employment security and, in the case of unemployment, income security.

Excessively protectionist legislation can impede job creation, as has been confirmed by various studies in OECD countries and some transitional economies, where unemployment is positively correlated with the degree of legislation restrictiveness (Edwards et al., 2003; Dickens et al., 2005). As mentioned previously, the Eastern partners have been much more concerned with preventing job destruction than with job creation; by complicating dismissal mechanisms to limit job destruction, the governments have produced a fall in job creation. Employers avoid formally hiring workers, even if hiring is relatively easy; they prefer to either circumvent the law when it comes to contractual obligations or use informal mechanisms in their relations with workers.

Nonetheless, when analysing the most recent Doing Business Report indicators, the difficulty of employing workers does not appear to be too significant in the six countries (see **TABLE 5.4**). Apart from Moldova and Ukraine, all the countries of the group record better indexes of employment rigidity than the CEEB transitional countries, and better even than the OECD average. Azerbaijan and Georgia are by far the most flexible countries in this respect. However, at a disaggregated level, the situation is quite different. In principle, labour market regulation should be balanced in terms of both hiring and firing workers; in the OECD countries, the two indexes record practically the same value.

When this is not the case, it is generally preferable to have a lower firing than hiring index because this will keep job turnover relatively high. Among the Eastern partner countries, hiring is easier than firing in Azerbaijan and Belarus, which means that the labour legislation in the two countries tends to be protective of workers, although the overall framework is sufficiently flexible. A similar situation exists in Poland and Russia. In contrast, Armenia and Ukraine are more rigid in terms of hiring than in terms of firing, mainly because of complicated contractual aspects. In Moldova, the two elements are relatively well balanced, with rather complicated hiring and firing procedures, while Georgia has an optimal legislative framework with no restrictions on employing people.

Overall, firing difficulty is not very different from other transitional countries and is less costly than in the OECD group, as confirmed by the 'firing cost' indicator. Only Moldova has more costly dismissals than the rest of the transitional countries and the OECD. The 'rigidity of hours' index is not very relevant for the analysis, especially as this measure is highly contested from a methodological point of view. Table 5.4 does not show an overly negative picture for most countries, but this positive performance should be regarded with caution, as the methodology used in the Doing Business Report is increasingly contested by specialists.

In assessing the overall situation in the six countries, the EU concept of flexicurity can also be used as an underlying principle in the design of labour market policies. Flexicurity has four components: flexible contractual arrangements, modern social protection systems, effective ALMPs, and comprehensive lifelong learning strategies (European Commission, 2007b). The concept of flexicurity shifts the focus from labour market flexibilisation and deregulation towards a balanced approach that addresses the needs of both enterprises/employers and workers. In this sense, and as the name indicates, it reconciles the apparently opposing objectives of flexibility and security (more of one implies less of the other) while emphasising their

complementarities. Flexicurity requires an integrated approach to enhancing flexibility and security rather than ad hoc measures/actions that promote one or the other, probably at the expense of both.

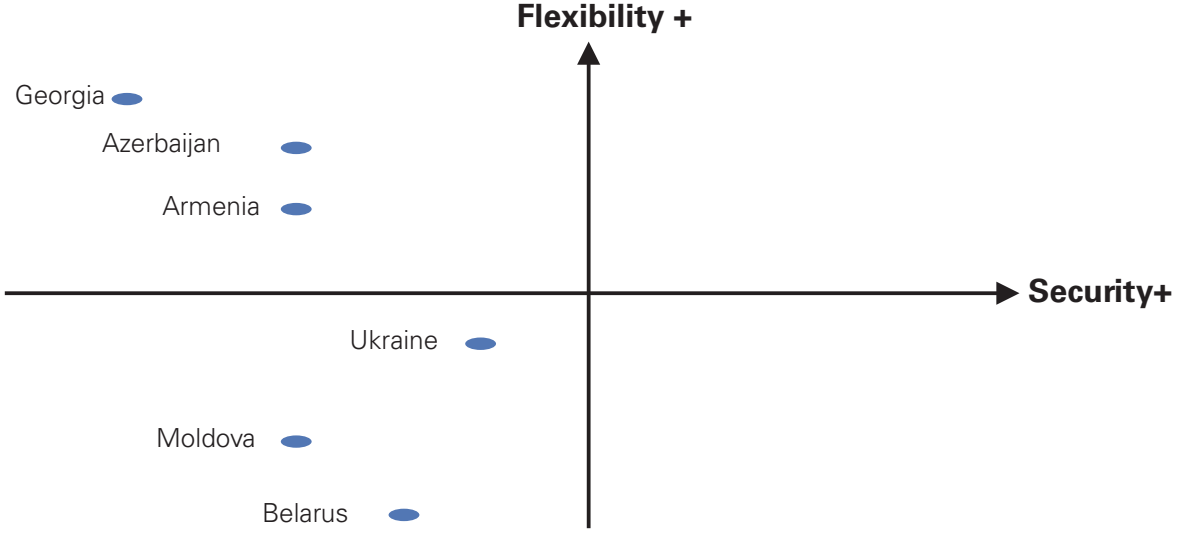
Taking into account the key features of the labour market systems in the six Eastern partner countries from the viewpoint of the four components of flexicurity, **FIGURE 5.2** positions the six labour markets along flexibility and security axes in a very simplistic way. All the six countries can be placed on the less secure left-hand half of the horizontal security axis; some countries (Georgia, Azerbaijan and Armenia) are in the more flexible top half and others (Ukraine, Moldova and Belarus) are in the less flexible bottom half of the vertical flexibility axis. Note that this preliminary flexicurity assessment on the basis of existing information requires more sophisticated analyses for a proper and more professional assessment.

TABLE 5.4 DIFFICULTY IN EMPLOYING WORKERS, 2009

Country	Rigidity of employment index	Difficulty in hiring index	Rigidity of hours index	Difficulty in firing index	Firing cost (weeks of salary)
Armenia	31	33	40	20	13
Azerbaijan	3	0	0	10	22
Belarus	27	0	40	40	22
Georgia	7	0	20	0	4
Moldova	41	44	40	40	37
Ukraine	45	44	60	30	13
Bulgaria	29	17	60	10	9
Poland	37	11	60	40	13
Romania	62	67	80	40	8
Russia	44	33	60	40	17
Turkey	39	44	40	30	95
OECD average	31.4	25.7	42.2	26.3	25.8

Source: World Bank's Doing Business Index: www.doingbusiness.org/

FIGURE 5.2 POSITIONING OF LABOUR MARKETS FROM A FLEXICURITY PERSPECTIVE



5.4 THE EMPLOYMENT INSTITUTIONAL FRAMEWORK

Good governance in general, and good labour governance in particular, plays an important role in countries that undertake far-reaching economic and social reforms. Both the pace and sustainability of policy decision making in the area of labour and social affairs may decisively influence the whole reform process. The effectiveness of economic reforms depends on the quality of supporting institutions within and outside the government. Empirical research suggests that the quality of institutions can support economic growth, and that labour reforms in general, and the reform of labour institutions in particular, allow for better employment matching. The labour market is a social institution and represents one of the most important factors for economic growth, since such growth is mainly determined by labour productivity. Recent studies show that the greatest source of long-term growth seems to be found in the 'black box' where institutions and economic public policies play the most important roles.

In all six Eastern partner countries the main institution in charge of labour market and employment issues at the central level is a labour ministry, which also has social attributions, usually social protection. Georgia is unusual in this respect, as the ministry also includes the healthcare portfolio. Labour ministries (except in Georgia) are at the centre of elaborating, implementing and monitoring national labour and social policy. They also have competencies for labour legislation, employment policy, social protection, wage policy and PES administration. The traditional functions of the labour ministries include labour protection, employment, industrial relations and cooperation with employer and worker organisations. The labour ministries are also responsible for promoting equality of opportunity in employment, training and skills upgrading, and managing labour migration, since these issues have become increasingly important in recent years. In some countries, labour inspection competencies are also covered by the labour ministries.

The role of labour administration is to elaborate, implement, control and evaluate national labour policy, which is not generally limited to employment and social policy. Ideally, labour administration should be included as part of a coordinated national economic and social policy. In the Eastern partner countries the necessary inter-ministerial cooperation is mainly based on government programmes and strategies. Governmental institutions very often compete with one another for funds and programmes, leaving little room for cooperation.

In policy development and implementation, the ministries are also responsible for ensuring social partner involvement in policy making. Although consultation with employer and worker organisations is widespread in Eastern partner countries, not all of them have an effective national tripartite council. There is a wide variety of bodies for consultation, cooperation and negotiation, and their composition varies widely. For example, Armenia only has a regional committee for employment assistance, while in Azerbaijan the tripartite dialogue takes place under the supervision of a Commission on Conclusion of the General Collective Agreement, through a tripartite national committee established by the labour law.

Trade unions are important stakeholders in the labour market. They are present in all the countries, but to differing extents and with variable levels of influence. In Azerbaijan and Belarus they mainly follow the official political line, while in Ukraine they perpetuate the Soviet tradition to a large extent. They are much less important in the private sector in the other three countries (Armenia, Georgia and Moldova), as they are mainly concentrated in the remaining state enterprises and in the public sector.

The labour force is highly unionised in Ukraine, with 75% of salaried workers being members of a union. The collective bargaining power of workers is significant: in 2006, 82.7% of employees were covered by collective bargaining agreements. Coverage is much higher in state-owned enterprises (up to 98.9%) and in the industrial sector (93.1%) than in private companies and the services sector. However, in contrast with other transitional countries, in the new activities that emerged during transition, collective bargaining has relatively high coverage (e.g. 51.6% in financial intermediation and 52.4% in trade) (ETF, 2009b). In the CEEB countries, such rates are not achieved even in large industrial firms or public institutions.

Another particular feature of Ukraine is that more than 90% of union members belong to the legal successors of the former Soviet trade unions. Nevertheless, at enterprise level, unions are very weak in defending workers' interests; as successors of Soviet trade unions, they limit their activity to the provision of social services and recreational and cultural programmes. Worker unionisation in Ukraine is therefore more a matter of a tradition inherited from the Soviet era rather than of an association to defend workers' rights. Unions are more powerful at the national level, where their role in wage setting is important.

In all cases, trade unions are relatively weak, irrespective of their size and level of involvement; they generally collude with governments against the employers in negotiating wages and employment rules and conditions. Tripartite social dialogue is therefore distorted, with entrepreneurs perceived by both the state and the unions to be undesirable capitalists who should be forced to pay their workers more and to grant more favourable contractual conditions to employees. This view, which is reminiscent of the communist mentality, is understandable in both cases: on the part of the trade unions, because they try to obtain as many privileges as possible for their workers; and on the part of the government, because the mass of workers is politically transformed into a mass of voters.

5.4.1 THE SPECIFIC ROLE OF THE PUBLIC EMPLOYMENT SERVICES

The implementation of employment policies is delegated to the PESs in the Eastern partner countries. The PES is the successor of Soviet employment, training and career guidance bureaus. The change of their status and roles does not necessarily mean that these offices have became more efficient in carrying out the new activities. Except in the capital and large cities, the PES offices are, in general, insufficiently equipped and staffed, and are affected by bureaucracy and passivity in promoting employment measures and in paying benefits. Their population coverage is limited, since most local PES offices are situated in the main town of the region. The Soviet legacy and the corresponding attitude to clients still influence these offices, and this is reflected in the relatively small number of people who use their services.

In general, the PESs have territorial structures and undertake brokerage functions, matching jobs with job seekers and implementing labour market policies (both active and passive measures). Currently, the main functions in all countries relate to the collection, analysis and dissemination of information on the labour market (job vacancies and registration of job seekers), the provision of professional counselling and guidance, placement services for jobs and training programmes, the granting of financial support to unemployed individuals, and the implementation of other specific measures.

Appendix 5.2 at the end of this chapter gives a summary of key data on the PESs in the six Eastern partner countries for 2008. Ukraine has the largest PES structure, with 15 700 staff and a relatively low caseload of 179 clients per member of front-office staff (usually below 100 in the EU countries). It also uses a common technology for the services delivered, with a special internet portal called Trud (*trud* means labour) that provides job seekers and employers with information on vacancies and available personnel. All the other countries have smaller structures, with 405 staff in total in Armenia, 577 in Azerbaijan, 249 in Moldova and 1 060 in Belarus. Georgia has not even had a PES structure in the traditional sense since the abolition of the employment section of the State Agency for Social Protection and Employment in 2007. The PESs in Armenia, Azerbaijan, Moldova and Ukraine are members of the World Association of Public Employment Services (WAPES). Except in Georgia, the PESs have responsibilities for active and passive labour market policies, including the administration of unemployment benefits.

In Armenia the State Employment Service Agency has one regional and several local employment offices in each territorial administrative unit (*marz*). Despite recent improvements in their functioning, the technical capacity of territorial offices is still underdeveloped, and the human capacity to implement employment policy is insufficient. Staffing varies between regions, with some regions recording 679 job seekers per PES employee, in contrast with a national average of 264 (ETF, 2010a). A survey conducted by the Swedish International Development Cooperation Agency (SIDA) in 2004 among the directors of regional centres concluded that the main factors hindering operations are poor technical endowment (a relatively large number of offices do not have computerised records), the low level of wages and inadequate means of communication (SIDA, 2004).

In Azerbaijan the General Employment Department fulfils the PES function. It has an extensive network of regional and local employment centres (83, including 11 in Baku). However, the offices are too poorly equipped to be able to provide quality employment services to the population. There was a substantial decrease in staffing at the beginning of the 2000s, from 1 500 to 500 workers, although staff numbers recovered thereafter to reach 577. The situation is similar in that other countries; in addition, the resources allocated are much below needs, and the insufficiency of resources is worse at the regional level than in the capital cities.

Between 2000 and 2004, Georgia made substantial cutbacks (50%) in the number of PES staff (SIDA, 2004). In 2005, the PES integrated with other social services and became the Agency for Social Assistance and Employment; its functions were mainly related to social assistance, and by 2007 it only retained this one function. Today there is practically no PES in Georgia.

In Belarus in 2003 a Presidential decree transformed the PES into the Department of Employment Services to the Population, attached to the Ministry of Labour and Social Protection, with regional and city structures covering the whole country. The reform also entailed a reduction in staff by one-third (from 1 600 to 1 060).

According to a SIDA assessment (SIDA, 2004), the National Agency for Employment in Moldova is characterised by a passive approach to the registration of unemployed people, and administration of their benefits. Only occasional training initiatives have been undertaken, the result of a 'let the clients come to us' approach. Severe fiscal constraints limit the organisation's ability to pursue a much more active and service-oriented role, but in many respects the deficiencies are the result of an attitude problem. Many active measures can be implemented without requiring additional resources.

Overall, PESs in the Eastern partner countries face important constraints on the successful fulfilment of their role. They are understaffed, and have low levels of resources and staff capacity to deal effectively with unemployed people, and to be of service to employers. This is demonstrated by the low rate of registration among jobless individuals and the small number of vacancies filled by companies using PES support (on which little information is available in the ETF Country Reports). As can be seen in **TABLE 5.5**, there is a considerable difference between the total number of people unemployed (as calculated in LFSs) and the number of those who are registered unemployed according to the PES registers. Unemployed individuals do not register either because they do not trust the effectiveness of employment service offices to help them to find a job, or because the cost of registration is high in terms of formalities and travel to the cities where the offices are located.

TABLE 5.5 PUBLIC EMPLOYMENT SERVICES AND REGISTERED UNEMPLOYMENT, 2008

	ARM	AZE	BEL	GEO	MOL	UKR
Unemployment (%) (LFS data except Belarus)	29.0	6.5	(0.8)	13.3	4.0	6.4
Number of unemployed (LFS data except Belarus)	NA	285 000	1 657 000	NA	NA	1 425 100
Registered unemployed, PES	25% of the unemployed	47 301	335 000	NA	79 200(2009)	596 000
Unemployment cash benefit recipients	NA	4 350	111 000	NA	NA	652 000
Unemployed receiving cash benefits (%)	4.0	1.0	NA	NA	7.4	77.2

Source: ETF Country Reports; Feiler, 2009 (for Azerbaijan); SIDA, 2004.

In fact, public employment registers and services are very important for a well-functioning LMIS, which is essential for developing evidence-based labour market policies. A comprehensive LMIS would include information-collection instruments, including LFSs, enterprise surveys and PES registers; it would also be able to call on strong analytical capacities (the administration or delegated bodies such as universities and public or private research centres) for the exploitation of this information. Moreover, an evaluation culture in respect of employment policies and in particular with regard to the effectiveness of ALMPs would provide guidelines for further realignment of ALMP design and mix, with more efficient use of limited financial resources. As explained in Chapter 3, the LMISs in the Eastern partner countries are partially developed and exploited, but the existing information, which could be used for effective targeting of beneficiaries and the monitoring and evaluation of ALMP measures, is not always available and accessible to the public. Thus, there is no regular mechanism for evaluating the impact of ALMPs or for performing skills-demand analyses for the short and medium term.

Finally, the role of private employment agencies in labour market management is rapidly expanding in transitional countries, although there is often confusion in the roles of PESs as opposed to private employment services. In the case of PESs, the government is the funder and usually the direct provider of free services, including a labour exchange, job placement service, labour market information and programmes. Private employment agencies are businesses that rely on customers paying privately, and the government's only role is to regulate them as businesses. In this role, a government needs to determine whether or not private agencies can operate as businesses and, if so, in what conditions. Among the Eastern partners, private recruitment agencies are operational and quite active only in Georgia, with recruitment carried out exclusively through private structures[70].

5.5 CONCLUDING REMARKS

Employment policy has evolved over the transitional period on the basis of various strategies, plans and programmes, all of them having as their main objectives increasing employability, reducing unemployment, improving participation rates, reducing informality, improving wages, enhancing productivity, promoting higher-value-added activities in the economy and reducing regional disparities in employment opportunities. Excessively ambitious, these objectives have been only partially achieved, since the measures envisaged lack concreteness in implementation, and no monitoring and impact evaluation studies are performed. At the same time, various strategic documents have often duplicated and overlapped with one another because institutional cooperation has been weak.

Insufficient resources have been allocated to labour market policies, particularly in view of the ambitious objectives listed in the national strategies. Out of already limited funding for overall labour market policies (including passive measures), an even more negligible share has been allocated to active measures. As a result, the impact of these policies on employment growth has been insignificant. Several initiatives to stimulate job creation have been adopted, but outcomes remain modest. Leaving aside the insufficiently friendly business environment, the governments of the Eastern partner countries have been much more concerned with limiting job destruction than with helping to create new jobs or to support labour mobility.

Labour legislation is generally governed by labour codes, complemented by employment laws. The codes have been supplemented by additional acts that establish in law such elements as the status of trade unions, the remuneration system for specific categories of workers (e.g. public employees), the minimum wage, and labour

70 Currently two such facilities are commonly used: Jobs.ge (www.jobs.ge/) and the Job Counselling and Referral Centre (www.jcrc.ge/?lang=en). Since its creation in 2007, the latter has received 878 applicants, 183 of whom have been sent for interviews with employers and 115 hired on a contractual basis (ETF, 2010d).

inspection mechanisms. However, the effective application of legal provisions is not always respected in practice; this is mostly because of the overly restrictive conditions imposed by the labour codes. Nonetheless, the most recent Doing Business Report indicators do not suggest that difficulties in employing workers are significant in the six countries. Trade unions are present in all the countries, though to different extents and with varying levels of influence. They are much less important in the private sector, and are concentrated in the remaining state enterprises and in the public sector. Both trade unions and employers' associations need to be considered as real partners in the design, implementation, monitoring and evaluation of labour market and employment policies.

Eastern partners have faced the challenge of reducing the labour market rigidity of the Soviet era so as to encourage labour turnover and mobility from less productive to more productive jobs. However, developments in the different countries have followed different pathways. For example, an analysis of the labour codes in the six countries shows that, at one extreme of the spectrum of labour market flexibilisation, Georgia, and to a lesser degree Armenia and Azerbaijan, opted for a liberal labour market policy, while at the other extreme Belarus, Moldova and Ukraine opted for protecting employees in jobs at the expense of underemployment and labour turnover rigidities.

When the EU concept of flexicurity is broadly applied to the labour markets of the six countries, it is possible to position all the countries in the 'less secure' half of the security axis; as for the flexibility axis, some countries (Georgia, Azerbaijan and Armenia) belong in the 'more flexible' quadrant, whereas others (Ukraine, Moldova and Belarus) belong in the 'less flexible' quadrant. It is clear that all the countries need to work – through active and passive labour market measures – on achieving a better balance between security (in terms both of employability and income) and labour market flexibility that (1) avoids labour market segmentation; (2) leads to the better allocation of human resources; and (3) does not encourage informality. This requires an integrated policy approach that enhances both flexibility and security, rather than ad hoc measures that are aimed at one or the other, probably at the expense of both.

Institutionally, the labour ministries are responsible for elaborating, implementing and monitoring national labour policy. They also have competencies for labour legislation, employment policy, social protection, wage policy and employment service administration. However, they are generally weak institutions within the overall cabinet, with limited financial and human resources. Coordination and cooperation with other policies and institutions (economy, social policy, etc.) is rather insignificant. At the territorial level, the PESs perform brokerage functions to match jobs with job seekers. The largest PES structure exists in Ukraine, with a relatively low caseload and a special internet portal providing services to job seekers and employers on vacancies and personnel. All the other countries have smaller structures, except for Georgia, which does not have a PES in the traditional sense.

PES offices, except for those located in the capital and large cities, are generally insufficiently equipped and staffed, and are affected by bureaucracy and passivity in promoting employment. Thus, a relatively a small proportion of people use their services. In fact, public employment registers and services are very important for a well-functioning LMIS, which, in turn, is essential to developing evidence-based labour market policies. Although all the countries except Georgia produce administrative records on registered unemployment and vacancies, this information, which could be used for effective targeting of beneficiaries and the monitoring and evaluation of ALMPs, is not always available and accessible to the public. Thus, mechanisms need to be established to ensure that better use is made of public employment registers and to implement impact evaluation of ALMPs and skills-demand analyses with employers.

APPENDIX 5.1 LABOUR CODE: MAIN PROVISIONS

Country	Year	Main provisions	Specificities	Supplementary legislation
Armenia	2004	a) Contractual employer–employee relations b) Remuneration and compensation c) Standard working timetable d) Minimum age for employment e) Rules for employee association and representation f) Rules for striking g) Dispute settlement	a) Standard working week: 40 hours b) Minimum age of employment: 16 c) Standard maternity leave: 70 + 70 days d) Labour contracts: - Fixed-term (FT) - Indefinite term (IT) Restrictions on using FT for 'permanent' tasks; the term 'permanent' is not clearly defined by law	Constitution (1995) Trade Unions Law (2000) Civil Service Law (2001) Minimum Wage Law (2004) Law on Employment of Population and Social Protection in case of Unemployment (2005)
Azerbaijan	1999	a) Contractual employer–employee relations b) Wage setting c) Standard working timetable d) Working conditions e) Minimum age of employment	a) Minimum age of employment: 15 b) Labour contracts: - Fixed-term (FT): up to 5 years - Indefinite term (IT) Restrictions on using FT for 'permanent' tasks; the term 'permanent' is not clearly defined by law c) Legal definition of decent job d) Annual paid leave: 21 days e) Standard maternity leave: 70 + 56 days	Constitution (1995) Employment Law (2001) Civil Service Law Minimum Wage Law
Belarus	1999 (revised 2007)	a) Main principles for hiring and firing b) Rules for anti-discriminatory practices c) Paid leave conditions, including special cases d) Working conditions, including special provisions for women	a) Employment agreements for two years; agreements are general (national level), by branch, and at territorial level b) Labour contracts: - Fixed-term (FT): up to 5 years - Indefinite term (IT) c) Standard maternity leave: 70 + 56 days	Constitution Presidential decrees Employment Law
Georgia	2006	a) Contractual relations b) Worker rights c) Remuneration conditions d) Safety rules e) Dispute settlement	a) Minimum age of employment: 16 b) Restrictions on part-time and overtime work c) Annual paid leave: 24 days d) Standard maternity leave: 140 days	Public Service Law

Country	Year	Main provisions	Specificities	Supplementary legislation
Moldova	2003	a) Contractual conditions (collective and individual) b) Working conditions and safety rules c) Worker association and striking rules d) Remuneration rules and minimum wage e) Vocational training rules f) Rules for overtime, part-time and seasonal work g) Working rules for special categories (religious, diplomats, military, farmers, artists) h) Dispute settlement	a) Labour contracts: - Individual - Collective b) Standard working week: 40 hours c) Annual paid leave: 28 days d) Standard maternity leave: 70 + 56 days	Government decisions setting minimum wage
Ukraine	1971 (amended 1991–2010)	a) Conditions for agreements and contracts b) Remuneration rules c) Rules for overtime, part-time and seasonal work d) Dispute settlement	a) Standard working week: 40 hours b) Annual paid leave: 24 days c) Standard maternity leave: 70 + 56 days	Work Safety Law Employment Law Remuneration Law Trade Unions Law Ministerial/Presidential decrees

Source: Author, based on ETF Country Reports and ILOLEX: www.ilo.org/ilolex/english/convdisp1.htm.

APPENDIX 5.2 KEY PUBLIC EMPLOYMENT SERVICE DATA, 2008

Country	PES name and website	Number of staff (staff directly working with client)	Number of regional and local offices	Caseload (clients per front-office staff)	Administration of unemployment benefits	Responsible for ALMPs
Armenia	State Employment Service Agency (Ministry of Labour and Social Issues) http://employment.am/en/index.html	405 (368)	1 central office; 51 regional/territorial offices	264 (2007)	Yes (60% of minimum wage, max. 12-month payment)	Yes
Azerbaijan1	General Employment Department (Ministry of Labour and Social Protection of Population) www.ses.gov.az/view.php?lang=az&menu=0	577 (Not available)	1 central office: 83 regional/territorial offices	Not available	Yes (higher than minimum wage)	Yes
Belarus2	Department of Employment Services to the Population (Ministry of Labour and Social Protection)	1 060 (Not available)	1 central office; 130 local offices in 7 regions (including Minsk)	Not available	Yes	Yes
Georgia3	No PES, but limited authority of State Agency for Social Protection and Employment (Ministry of Labour, Health and Social Affairs)	Not applicable	Not applicable	Not applicable	No benefits	No ALMP
Moldova4	National Employment Agency – Agentia Nationala Pentru Ocuparea Fortei de Munca (Ministry of Labour, Social Protection and Family) http://en.anofm.md/	249 (213)	1 national agency; 35 territorial employment agencies	372 (2007)	Yes (higher than minimum wage)	Yes
Ukraine5	State Employment Service of Ukraine (Ministry of Labour and Social Policy) www.dcz.gov.ua/control/en/index and www.trud.gov.ua	15 754 (14 166)	1 national agency: 27 regional centres; 645 centres in total in the whole territory	179 (2007)	Yes (80% of minimum wage)	Yes

Source: ETF Country Reports; national statistics offices; PES websites of those countries; WAPES (www.wapes.org), of which Armenia, Azerbaijan, Moldova and Ukraine's PES are members (Belarus and Georgia are not WAPES members).

Notes: (1) The information is taken from Feiler (2009). (2) Most of this information was obtained from EC (2009a) and the Belarusian Ministry of Labour and Social Protection to ETF staff during a mission on 3–7 February 2010 to Minsk. (3) Georgia reorganised its PES and integrated it into the State Agency for Social Protection and Employment in 2005, but the employment element was abolished in 2007. Since then it has not had a PES in the traditional sense. There are very few staff dealing with labour market issues in the Ministry of Labour, Health and Social Affairs and no specific labour market policies are implemented. Instead, the Ministry of Economic Development has some authority on limited training and inexpensive credit programmes under the Poverty Reduction Strategy. The unemployment benefit system was replaced in 2006 with a social assistance programme addressing poor families in general. Thus, currently there is no spending on active or passive labour market measures. (4) Moldovan ministries were restructured in late 2009 following the general elections, and responsibilities for labour market policy were shifted from the Ministry of Economy and Trade to the Ministry of Labour, Social Protection and the Family. (5) The Ukraine PES has unified internet–intranet technology for staff, job seekers and employers. A special internet portal called Trud provides services to job seekers and employers on vacancies and available personnel (see www.dcz.gov.ua/file/link/173177/file/broshura.doc).

6. LABOUR MIGRATION TRENDS AND CHALLENGES

Ummuhan Bardak

This chapter focuses on labour migration trends in the six Eastern partner countries within a larger regional system, since it is an important phenomenon that has an impact on domestic labour markets. An overview of emigration and immigration stocks in the six countries is provided, including discussion of regional migratory routes with neighbouring countries; the key socioeconomic, political and ethnic motivations for migration; and details of region-specific features shaped by the Soviet era. It must be noted, however, that the quantity and quality of data on migrant numbers is extremely variable across the region owing to difficulties in statistical data collection; varied definitions of 'migrant' according to residency, nationality or country of birth and 'migration' as permanent, temporary or short-term population movements; confusion in data on migrant stocks and flows; and different numbers of regular and irregular migrants.

A quick overview shows that the Eastern partners are both sending and transit countries to different degrees, and most labour emigration takes place towards the CIS region (with Russia as the major destination) and EU countries. Once considered as a temporary coping mechanism against acute poverty, migration has now become a regular income-generating activity as a result of the fact that there are still limited jobs available, low wages in poorly functioning labour markets, insufficiency of capital and a lower quality of life. The chapter identifies those characteristics that are most typical of labour emigrants from the region: relatively higher levels of formal education (though quality remains an issue); a significant proportion of female migrants; diverse age groups; employment abroad mainly in labour-intensive, low-skilled and low-paid sectors such as construction, agriculture, hotels, catering and domestic services (house cleaning, home care for children or the elderly); and temporary flows as a result of a considerable degree of seasonal and irregular employment.

Understanding the impact of emigration on the supply and demand side of labour markets in the Eastern partner countries is a complex issue, and it is probably too early for an overall assessment to be made, given the relatively recent development of widespread emigration. Most countries are in a situation where the number of labour migrants and the volume of remittances have grown steadily and where there is no indication of a reverse trend as yet. This process is taking place against a background of depopulation, a critical decline in fertility rates (except in Azerbaijan) and higher than average mortality rates for adult males. Although the process significantly alleviates economic hardship, eases the competition for limited jobs and contributes to political stability in the region, it also worsens the demographic imbalance, reduces labour supply and contributes to the phenomenon of brain drain. One visible outcome is the increasing levels of remittances, which are particularly important for the economies of Moldova and Armenia.

Finally, the chapter provides an overview of policy responses and institutions dealing with labour emigration in the Eastern partner countries, efforts that have been stepped up recently in response to the growing numbers of emigrants. The signing of a mobility partnership between the EU and Moldova in 2008 marked an important moment for the region, with Georgia and Armenia following suit. The mobility partnership deals explicitly with labour mobility and return migration on the basis of circularity, but also unites various different areas of cooperation including border control, visa facilitation, remittances, legal labour migration schemes and voluntary return, compelling various institutions to cooperate on migration management. Whether migration is viewed as a curse or a blessing, the sheer scale of migration outflows indicates that better labour migration management may be a valuable policy option that will provide mutual benefits for the Eastern partners and the destination countries of the EU and Russia.

6.1 MIGRANTS AND MIGRATION: INTRODUCTION AND DEFINITIONS

Migration had been virtually impossible in the Eastern partner countries during their years behind the Iron Curtain from the early 1950s to the late 1980s. Although several population movements did occur in the history of USSR for various reasons (for example, the 1917 revolution, the two World Wars, and forced population movements under Stalinism), both internal mobility and emigration were strictly controlled (Uzagalieva & Chojnicki, 2008). The collapse of the socialist system and the transitional crises of the early 1990s resulted in a rapid deterioration in living standards and increasing political instability in the countries of the Former Soviet Union (FSU). This generated strong waves of migration that dramatically increased the number of migrants in the world with the sudden release of thousands of new workers onto international labour markets.

Increased freedom of movement was one of the key social and economic changes that followed the dissolution of the Soviet Union, and it led to large-scale migration. The first migration waves of the early 1990s were motivated by economic, political, ethno-cultural and religious factors in FSU countries. Most of this migration was driven by political disruption (such as wars in the Caucasus) or cultural factors (such as the 'pull of consanguinity', the prospect of citizenship in Germany or Israel for certain groups), or feeling ethnically compelled to leave the new independent states (the movement of many ethnic Russians to Russia). A brain-drain effect ensued in the region, as many permanent migrants were at the high end of the human capital spectrum (OECD, 2008).

Since the late 1990s, however, the largest migration flows have been driven by the search for temporary employment, and economically motivated labour migration has continued at an unprecedented intensity and scale over the past decade. This has gradually come to form an important opportunity factor in the socioeconomic system of the region that also poses several challenges to societies. For most countries of the CIS the main pole of attraction has been Russia, which experienced an economic boom following the 1998 crisis, while the main destination of migrants in some more westerly FSU countries has been the EU. There are, however, many variations in these trends: while migration flows tend to move in two main directions (either west or east), different flows do occur, with migrants spending periods of varying length in CEE countries or Turkey in the hope of moving to Western Europe at a later date.

It is important to remember that reliable and comparable international migration data are difficult to find. Data are often absent, outdated or lacking in cross-country comparability. The huge social, political and economic transformations of the Eastern partners over the past 20 years and their recent history of mass migration has made the reporting of migrant numbers very difficult. For example, the number of reported Ukrainian emigrants abroad ranges from 0.7 million to 7 million in existing studies, while the reported number of Moldovan emigrants ranges from 280 000 to 705 000. There are several general and region-specific reasons for these differences, but the lack of consistency and conformity in national and international definitions of 'migrant' and 'migration' are responsible for most of the inconsistencies. 'Migrant' can be defined by residency, country of birth or nationality.

Furthermore, duration of stay is often unspecified in migration data, and thus only a vague picture can be provided by analysis of the permanent or temporary migration or short-term stay. UN Recommendations on Statistics of International Migration (UN, 1998) have not yet led to the creation of unified definitions and duration thresholds, a situation that results in incomparable statistical outcomes[71]. Another source of ongoing misunderstanding lies in the confusion of data on migrant stock with that on migrant flow. Migrant stock indicates the total number of migrants present in a given location at a specific point in time, while migrant flow measures the number of migrants who have arrived at or departed from a certain location within a specific period of time. The methodological inconsistencies are further complicated by the fact that statistical data collection systems are unable to capture details of irregular and illegal migrants, a section of the population estimated in figures that vary by several millions depending on the source.

Finally, the dissolution of Soviet Union in 1991 posed a region-specific challenge to the measurement of migration: vast numbers of statistical emigrants or immigrants were created overnight on the basis of population history and ethnic structure in the region, even though many of these individuals never actually moved from their place of residence. Moreover, migration today is far more complex than a simple process of 'sending' or 'receiving', as these countries simultaneously send and receive people, replacing emigrants seeking better opportunities in other countries with immigrants from poorer areas of the world. This process provides a partial explanation of paradoxes such as that of Ukraine, where there is high emigration coupled with substantial immigration (Appendix 6.1 at the end of this chapter).

Given the aforementioned limitations of the accuracy and comparability of migration figures in the region, the primary source of migration data for this chapter is the World Bank's Migration and Remittances Factbook (2008c, 2010a) (based on UNPD statistics) and a report for the World Bank by Ratha and Shaw (2007). The UNPD database[72] provides the most comprehensive source of information on international migrant stock for the period 1960–2005; in this context, migrants are defined as persons who move to a country other than that of their usual residence for a period of at least a year, such that the destination country effectively becomes their new country of usual residence. The chapter also uses some national data and qualitative information on labour migration from ETF Country Reports and IOM Country Profiles (IOM, 2008a–i) to complement the international data. However, OECD data is not used here, since only immigrants who are legally resident in OECD countries are counted, giving an incomplete picture by excluding the entire CIS area, which receives many emigrants from the Eastern partner

71 According to the Recommendations on Statistics of International Migration by the United Nations, 'long-term migrants' are those persons who move to a country other than that of their usual residence for a period of at least a year, so that the country of destination effectively becomes their new country of usual residence. 'Short-term migrants' are those persons who move to a country other than that of their usual residence for a period of at least three months but less than a year, except in cases where the movement to that country is for purposes of recreation, holiday, visits to friends and relatives, business, medical treatment or religious pilgrimage. The duration threshold to identify migrants varies between countries (for example, international students who study in the receiving country for more than a year would be considered as migrants under the UN system). The International Migration Outlook (OECD, 2006) made a first attempt to classify migrants by their 'reasons for movement' and to harmonise statistics among OECD countries.

72 For more detailed information on the methodology used to estimate migrant stock by the UNPD, see http://esa.un.org/migration/index.asp?panel=4

countries[73]. In conclusion, the emigration and immigration data presented here must be regarded as estimates and indications rather than statistically accurate figures.

6.2 MOTIVATIONS FOR MIGRATION AND SPECIFIC REGIONAL CHARACTERISTICS

Traditional migration theories focus on the relationship between migration trends and various labour market and other variables. Important labour market variables include wage and unemployment rates, while other factors include geography, institutional and legal aspects, quality of life, population composition and ethnicity, diaspora and family ties. Patzwaldt (2004) argues that socioeconomic, ethnic and political factors have played the most important role in the first migratory flows from and within the CIS, and believes that these 'ethno-political incentives' will combine with economic and demographic elements to determine the direction, pattern and size of future migration flows.

During the initial transition years, population movements were mostly related to refugees fleeing civil wars and trans-border conflicts, and diaspora returning to their ethnic homelands following the creation of new independent states. This was followed by a rapid deterioration of living standards and increasing political instability, during which poverty became a widespread phenomenon in most countries, with the poor economic prospects serving as push factor (OECD, 2008). As countries recovered from the initial years of transition, widening disparities in per capita GDP (and economic inequality) drove migrants from lower-income to higher-income countries. By the early 2000s, market opportunities and integration into the global economy were providing pull factors for labour migration. The demand for cheap labour in the international markets and constraints in domestic labour markets represent structural reasons for migration in the region.

Migration and poverty intertwine in the Southern Caucasus in both conflict-induced and labour migration. Pervasive and deep-seated poverty has motivated large-scale outflows in search of means of support for individuals and their families, with the bulk of emigrants going to Russia. According to Black et al. (2007), Moldova, the poorest country in the region, lost more than 60% of its per capita GDP following independence, and around 80% of the population were living below the poverty line by 1999. Ukraine suffered from hyperinflation in the initial period following transition, and around 15.5 million people (31.7% of the population) were living in poverty in 2001. Factors that contribute to poverty in the region include location (rural or urban area, and economic region), the number of (adult) working household members and their educational levels, and the number of children and non-working pensioners in the household.

Strong labour demand in Russia has been a driving force behind labour immigration from the neighbouring CIS countries over the past decade. Migrant workers and petty traders poured into booming areas such as Moscow and St Petersburg, mainly attracted by growing income opportunities and solvent demand (Patzwaldt, 2004). The movement coincided with a demographic decline in Russia (with projections of decline by a further 10 million by 2025) and unequal population distribution across the regions. Internal youth migration from rural areas to the central and southern parts of the country intensified in the 1990s and has resulted in the depopulation of economically and geopolitically important regions such as Siberia and the Far East. These economic and demographic aspects of migration flows into Russia were further supported by other facilitating factors: geographical proximity, prevalent ties from the Soviet era (Russian language, similar education and work legacies), and most importantly the inherited and still largely extant visa-free regime of the CIS region and its improved travel network[74]. The 'thinner borders' between Russia and other CIS countries thus contributed to continual flows of labour from weaker to stronger economies within the region.

Another region-specific factor was the creation of significant foreign-born populations following the breakup of the Soviet Union; these were more a result of the changed geopolitical status of countries than of actual international migration. The general trend of labour migration therefore overlaps heavily with ethno-political developments in the region. Historical relationships between Ukraine and other CIS countries, for example, make it difficult to differentiate between labour migration and other forms of population movement. Furthermore, the newly formed CIS states aimed to attract ethnic core groups living outside their new boundaries and to remove non-titular ethnic groups. It was such a process that led some of the Russian-speaking population of the former non-Russian Soviet Republics – whose total number amounted to as many as 26 million – to migrate back to Russia in the first decade following the collapse.

These ethnically driven migrants were also influenced by employment prospects, and as the Russian-speaking population had clustered in occupational fields such as medicine, education and engineering, the repatriation of the well-educated Russian-speaking population caused a brain drain. This contributed to further economic and social deterioration and increasing regional disparities, a process which then contributed to increased migration of non-Russians to Russia[75]. The initial Russian policy of

73 For more information, see OECD (2009). The OECD data are taken from the individual contributions of national correspondents appointed by the OECD Secretariat with the approval of member states (the Continuous Reporting System on Migration-SOPEMI). The information gathered includes total immigrant population and immigrant labour force flows and stocks, together with data on acquisition of nationality, mainly derived from population registers and residence and/or work permits.

74 The *1992 Bishkek Treaty* provided the legal framework for visa-free travel within the CIS. In the second half of the 1990s, however, border management became more rigorous, and the new nations established stronger notions of citizenship and national identity, including a category of 'foreign workers' with minimal rights. Visa requirements were introduced in some cases. For example, Russia withdrew the Bishkek Treaty in 2000 and differentiated its visa policy, introducing a visa for Georgian citizens. The intra-CIS visa situation therefore remains ambiguous and sensitive to political developments (i.e. the introduction of more complex documentation rules for migrants by Ukraine and Russia) (OECD, 2008).

75 This is the case for most of the Central Asian republics.

actively encouraging the remigration of Russians from former Soviet republics has therefore inadvertently set in motion the unwanted migration of low-skilled and low-paid migrant workers of non-Russian origin (Patzwaldt, 2004). Migrants have formed informal networks that serve as reliable channels for information and transport, unhindered by visa regimes.

A similar migration route following ethnic, cultural and/or linguistic lines can be seen with the Russian-speaking populations of eastern Ukraine (including a large number of Russians in Crimea) and Eastern Moldova (Transnistria)[76] who tend to seek work in Russia, whereas populations in the western regions of these countries use their geographical and linguistic proximity to move west in search of employment. In some locations, markets and historically founded political interests may work together, as is the case in the Ukrainian–Polish border regions, where cultural and ethnic proximity facilitates trans-border movements between Poland and Ukraine. The Polish border region itself lags behind in general economic development and has been largely dependent on trade with Ukraine that has created job opportunities for Poles and Ukrainians alike (Patzwaldt, 2004).

Another unique example of migration (or rather, population movement) is the outflow of Jews, ethnic Germans and Poles from the region. When the first migration wave in the FSU countries started in the early 1990s, half of all emigrants were ethnic Jews (almost all of whom were welcomed by Israel or moved to the USA where they had strong diaspora networks) and more than one-third were ethnic Germans (who were welcomed by Germany). In fact, Uzagalieva and Chojnicki (2008) attribute the emigration of 2 million ethnic Germans, 1.5 million Jews, and 1.1 million Poles from the region to these 'politically powerful bridgeheads'. The situation for these groups is reasonably comparable to that of the ethnic Russians living outside Russia mentioned above.

Similar economic, political and ethno-cultural factors are relevant in migration from the Caucasus region. The issue is further complicated by various ethnic and political tensions and conflicts that have become a push factor for emigrants in the three Caucasus countries. These include: the situation between Azerbaijan and Armenia in and around Nagorno-Karabakh[77]; the conflict between Chechens and Ingushis in the Northern Caucasus; and escalation of the conflict between Georgia and Russia over the Georgian breakaway regions of South Ossetia and Abkhazia[78] which culminated in war in 2008. In the period 1988–2005, 0.9–1 million people permanently left Armenia, while around 2 million left Azerbaijan and 1.9 million emigrated from Georgia (Uzagalieva & Chojnicki, 2008).

The discussion above suggests that migration pressure in the Eastern partner countries and other CIS countries is likely to continue because of diverging demographic, economic and political situations combined with various ethnic factors. Migration, once considered a temporary coping mechanism for relatively poorer countries, has now become a regular form of income generation. In view of the ageing populations of Europe and significant sections of the FSU, current migration flows may become unsustainable within a decade owing to the medium-term population dynamics of sender countries (Russia alone will need considerable immigration to replace its shrinking labour force). Demographic patterns will thus play an increasingly important role alongside economic factors in the future.

6.3 EMIGRATION STOCKS FROM THE SIX EASTERN PARTNERS

Migration is a significant phenomenon in all six Eastern partner countries to varying degrees, with flows both ways (emigration and immigration) in all cases. For all these nations this is a relatively recent phenomenon that mainly started following the dissolution of the Soviet Union and the transitional difficulties of the early 1990s. There were some historically significant episodes of emigration prior to this in the early 20th century that should not be forgotten, including the large movement of Armenians to the USA and Ukrainians to Canada. There were also other voluntary or compulsory population movements under the socialist regime, such as Ukrainians and Crimean Tatars to Central Asia, many of which paved the way for recent immigration flows.

Appendix 6.1 at the end of the chapter lists emigration and immigration stocks and main destination and origin countries for the six Eastern partners. As can be seen in the first emigration column, Ukraine has the highest total number of emigrants abroad of all six countries, with a total emigrant stock of 6.56 million in 2010. There is a relatively large gap between these figures and those for Belarus (1.778 million), Azerbaijan (1.432 million), Georgia (1.057 million), Armenia (870 200) and Moldova (770 300) (World Bank, 2010a). When these numbers are listed by percentage of total population, however, the countries with the highest population loss are Armenia (28.2%),

76 Transnistria is a Moldovan region east of the Dniester River that has been considered a 'frozen conflict' area since the disintegration of the Soviet Union. Its population is composed of Moldovans, Ukrainians and Russians. Although internationally Transnistria is part of Moldova, in reality its authorities do not exercise any power there.

77 Nagorno-Karabakh is a disputed enclave region of Azerbaijan that is, in effect, independent, and where an armed conflict took place from February 1988 to May 1994 between Azerbaijani and ethnic Armenian forces. Many ethnic Azeris and Armenians became internally displaced persons and/or refugees as a result of the fighting, after which the ethnic Armenians took control of the region and occupied the surrounding land beyond, creating a buffer zone linking Karabakh and Armenia. Azerbaijan has not exercised power over most of the region since 1991, and the conflict has been frozen since the Russian-brokered ceasefire was signed in May 1994. Peace talks between Armenia and Azerbaijan have been held ever since, and these are mediated by the OSCE Minsk Group (USA, France and Russia as co-chairs).

78 Abkhazia and South Ossetia are two disputed regions in the north part of Georgia which have, in effect, had independence since Georgia 's independence from the Soviet Union in 1991. They both fought against Tbilisi in the early 1990s, eventually dissolving central government control and carving out enclaves where they set up authorities, and running their own affairs with Russian support; however, they are not recognised internationally. The tension between Georgia and Russia over the two breakaway regions culminated in a war in August 2008, during which more than 127 000 people fled their homes, according to UN estimates, adding to the more than 220 000 people already displaced by the same conflict in the early 1990s.

79 The information and numbers in this section were collected from the World Bank Factbook (2008c, 2010a), IOM (2008a) and country profiles (IOM, 2008b-i) as well as ETF Country Reports.

Georgia (25.1%) and Moldova (21.5%), followed by Belarus (18.6%), Azerbaijan (16.0%) and Ukraine (14.4%).

Ukraine ranks fifth in terms of emigration stocks amongst all developing countries[80] while the figures for labour emigrants range from 0.7 to 7 million depending on the source. The main destination countries cited are Russia, Poland, the USA, Kazakhstan, Israel, Canada, Germany, Moldova, Belarus, Italy, the Czech Republic and Spain; however, Russia accounts for around 90% of Ukrainians living abroad. According to a 2006 IOM analysis (2008i), recent labour outflows have been directed towards Germany (9.0%), Canada (6.1%), the USA (5.9%) and Russia (5.5%); the Visegrád group of Poland, the Czech Republic, Hungary, and Slovakia also attracted a large share of recent migrants. A nationwide sociological survey showed that 15.7% of Ukrainian families have one or more members with experience of temporary labour migration. The Ukrainian Ministry of Labour and Social Policy estimated the number of labour migrants to be around 3 million where these were counted as the number of working-age people who disappeared from the national labour market (ETF, 2009b).

Despite Belarus being second in terms of absolute numbers, there is very little information on emigration from the country. While the absolute majority emigrated to Russia and Ukraine, smaller numbers also moved to Poland, Lithuania, Kazakhstan, the USA, Israel, Germany, Latvia and Estonia. The ETF Country Report (ETF, 2010c) classifies destination countries into the categories of 'near' (FSU countries) and 'distant' (non-FSU), and concludes that a significant majority of emigrants (80%) left for near countries, mainly for reasons of family unification, military resettlement, and political and economic difficulties in various regions, including the Chernobyl disaster. The number of Belarusians emigrating to work in Russia is estimated at 255 000 (5% of the labour force). Emigration flows in the direction of the EU are insignificant, even in terms of short trips.

Emigrants from Azerbaijan went mainly to Russia, Ukraine, Israel, Armenia, Kazakhstan, Germany, the USA, Turkey, Georgia and Turkmenistan. Estimates from the IOM (2008c) range from 300 000 Azeri labour migrants to a possible total of 2 million emigrants abroad. Official State Statistics reveal that more than 440 000 have people left the country since 1990 and that outflows have stabilised since 2001 with the higher levels of economic growth. An estimated 220 000 Azeri emigrants work in Russia (three-quarters of all labour migrants from Azerbaijan), while Ukraine is the second most important destination for Azeri workers (5%), followed by Turkey (3%), Kazakhstan (2%), Germany (1%), and Iran (1%). According to the Russian State Registry Office the number of Azeri citizens living in Moscow alone in May 2003 stood at 1.15 million, a figure representing 8.1% of the total population of the Russian capital (IOM, 2008c). Most of these Azeris left their home country because of the socioeconomic difficulties of the early post-independence years.

Georgia is primarily a sending country, with a significant part of the outflow directed to Russia, most of this being irregular in character. Estimates range from 200 000 to 1 million legal and undocumented migrants from Georgia, while the 2002 census indicated a loss of population of almost 20% owing to emigration since 1989 (IOM, 2008d). The main destination countries are Russia (63%), Ukraine (9%), Greece (6%), Armenia (5%), Israel (2%), Germany, the USA, Cyprus, Turkey, Latvia and Spain. According to the IOM (2003), there are some gender differences, with female emigrants tending to go towards Greece (70% of total migrants), Germany (69%) and the USA (55%), while the proportion of female labour migrants in the Russian labour market remains relatively small (14.8% of all labour migrants). Russia attracts mostly middle-aged male workers from Georgia.

In Armenia, the past two decades have also been characterised by emigration flows, albeit with a declining trend. The main destination countries were Russia, the USA, Ukraine, Azerbaijan, Georgia, Germany, Israel, Greece, Spain, Belarus and France. In fact, 60% of all emigrants went to Russia, 10% to the USA, 9% to Ukraine, 2% to Georgia and 2% to Germany (IOM, 2008b). Around three-quarters have settled in FSU countries (mainly in Russia), and 15% in various European countries. A national survey gives 6% of the resident population as emigrants, these mainly being in Russia (76.4%), the EU (9.8%) and the USA (4.8%). More than 60% of emigrants are men of working and reproductive age (20–44 years) and with, on average, educational levels that significantly exceed the national average. Emigration to Russia and Ukraine is mainly temporary in the pursuit of seasonal work, while migration to Europe and the USA is primarily for permanent residence, with emigrants being accompanied by their families.

Although relatively lower in absolute numbers, emigration from Moldova as a social phenomenon has expanded massively to involve a critical proportion of the population in a manner that shapes the social setting and the psychological mindset of the population. According to the IOM (2008e), labour emigration especially started to peak in the late 1990s following a severe economic crisis. By 2010, the outflows of migrants had multiplied and labour migration became the main component of Moldovan emigration (from less than 100 000 in 1999 to more than 770 000 in 2010). According to the National Statistical Bureau, in 2006 approximately one-quarter of the economically active population of Moldova, some 345 000 workers, was located abroad. The majority of Moldovan migrants (59%) are in Russia and most are men employed in the construction sector. Italy is also a significant destination for Moldovan migrants (approximately 17%) as are Portugal and Spain to a lesser extent. Other target countries include Ukraine, Romania, the USA, Israel, Germany, Kazakhstan, Greece and Turkey.

It is important to stress that the outflows are not yet decreasing, although a certain degree of stability has been achieved. According to an ETF survey from 2007 (ETF, 2008a), 26.7% of Ukrainians aged 18–40 were seriously

80 According to the World Bank Factbook (2008c), the top 10 emigration countries in the developing world are Mexico, Russia, India, China, Ukraine , Bangladesh, Turkey, Kazakhstan, Philippines and Pakistan.

considering leaving the country to live and work abroad. This figure is significant even though it is much lower than the equivalent for Moldovans (54%), especially in view of the fact that half of these potential migrants describe themselves as able to finance their move abroad in terms of getting a passport, visa and the relevant information (ETF, 2007b). Mansoor and Quillin (2007) focused on the economic and demographic factors and found that net outflows from the CIS countries to the EU and Russia would total 13.5 million and 5.4 million people respectively for the 2000 to 2050 period. Thus, the more prosperous EU countries and middle-income CIS (Russia) will still attract these workers, and inter-regional and intra-regional migration is likely to continue into the future if this remains a viable solution to future low-skilled labour shortages.

6.4 IMMIGRATION STOCKS WITHIN THE SIX EASTERN PARTNERS

As can be seen from the listings in Appendix 6.1, all of the six Eastern partners are also receiving countries that are destinations for thousands of immigrants, for a variety of reasons. Ukraine has the highest total number of immigrants of all these countries, with a total stock of 5.25 million in 2010, followed by Belarus (1.09 million), Moldova (408 300), Armenia (324 200), Azerbaijan (263 900), and Georgia (167 300). When these numbers are shown as a percentage of the total population, however, the countries with the highest population gains are Ukraine (11.6%), Belarus (11.4%) and Moldova (11.4%), followed by Armenia (10.5%), Georgia (4.0%) and Azerbaijan (3.0%) (World Bank, 2010a).

Ukraine ranks fifth in the world in terms of immigrant stocks[82], 4.7 million of whom have come from Russia. It is a destination country for immigrants from the FSU, including a significant number of repatriated ethnic Ukrainians and Crimean Tatars formerly deported under Stalin. The main countries of origin are Russia, Belarus, Kazakhstan, Uzbekistan, Moldova, Azerbaijan, Georgia, Armenia, Tajikistan and Kyrgyzstan. Smaller numbers of immigrants come from China, Jordan, India, Vietnam and Iran. The IOM (2008i) gives a total number of 213 749 foreigners[83] in Ukraine in 2006, including 2 822 foreigners with official work permits and 1 004 religious workers, while another 248 200 persons of Crimean Tatar nationality were registered in the 2001 census. Immigrants from the FSU enjoy relatively easy integration as many of them speak Russian, which is similar to Ukrainian, and benefit from extensive family or diaspora ties. The integration of migrants from other countries is more complicated, and Vietnamese, Iranian, Arabian, Chinese, Turkish, Indian and Pakistani diasporas have been developing, mainly consisting of those working in trade or as private entrepreneurs (60.8%) rather than as hired workers (15.3%), with an unemployment rate of 23.9%.

Immigration flows to the other five countries have been less well researched. Belarus is reported to be a destination for migrants from Russia, Poland, Ukraine, Armenia, Lithuania, Azerbaijan, Germany, Moldova, Georgia and Latvia. According to the ETF Country Report (ETF, 2010c), most of the immigrants are former inhabitants of Belarus who are returning from previous emigration periods. Almost 95% of the immigrants are Belarusians, Russians, Poles, and Ukrainians, nationalities with an established presence in Belarus; 91% of the immigrants come from Russia, Ukraine and Kazakhstan and 37% are more than 50 years old. There are around 5 000 Russian labour immigrants in the country, while some refugees from Afghanistan, Nigeria and Georgia work in the informal sector.

Current immigration flows to Moldova are insignificant in terms of regular migration, while the immigrant stock is reported to be over 400 000 people. The main countries of origin are Ukraine, Russia, Bulgaria, Romania, Belarus, Turkey and Azerbaijan. According to the IOM (2008b) and World Bank (2010a), Armenia is reported to host over 300 000 immigrants, mainly from Azerbaijan, Georgia, Russia, Iran, Syria, Ukraine, Turkey, Greece, Uzbekistan and Lebanon. Most of these are ethnic Armenian repatriates and/or asylum seekers and refugees.

Immigrant stocks in Georgia are mainly from Russia (65% of all immigrants), Armenia (11%), Azerbaijan (5%), Ukraine (4%), Turkey (4%), Germany, Pakistan, the USA and Greece. According to the IOM Country Profile (2008d) the recent conflicts in Abkhazia and South Ossetia have left Georgia with serious border-management issues in these two regions, and without full control of the territories. The conflict has resulted in the internal displacement of approximately 250 000 people within Georgia since the early 1990s. The overwhelming majority were ethnic Georgians from Abkhazia. Around 100 000 internally displaced persons (IDPs) have returned to their homes, but the issue of the remaining IDP population has not been addressed. Tbilisi has the second largest IDP population (29.6%) after the Samegrelo-Zemo Svaneti region (46.4%), most of them housed in temporary shelters. Other pending issues are the return or repatriation of the Meskhetian Turks who were forcefully displaced from Georgia to Uzbekistan, Kyrgyzstan and Kazakhstan in 1944, and the resettlement or local integration of approximately 1 370 Chechen refugees from neighbouring Chechnya.

The recent economic revival of Azerbaijan as a result of the oil and gas revenue and high annual GDP growth has created favourable conditions attracting many Azeri expatriates and foreigners to the country. The World Bank (2010a) puts the immigrant stock of Azerbaijan at almost 264 000 people, mainly from Russia, Armenia,

81 The information and numbers in this section were taken from the World Bank Factbook (2008c, 2010a), IOM (2008a) and country profiles (2008b-i), as well as ETF Country Reports.

82 According to the World Bank Factbook (2008c), the top 10 immigration countries in the developing world are Russia, Ukraine, India, Pakistan, Kazakhstan, Côte d'Ivoire, Jordan, Iran, West Bank and Gaza, Ghana. Ukraine (together with Russia as the key regional actor) hence stands as the most significant destination for migrants.

83 'Foreigners' refers to the number of foreign nationals living in Ukraine as registered by the Ukrainian Ministry of Interior.

Georgia, and Ukraine. The IOM (2008c) also lists Turkey, India, Iran, Pakistan, Turkmenistan, Uzbekistan, Kazakhstan and the UK as other source countries. In 2005, 20 986 foreigners were issued temporary registration cards and 980 foreigners were granted permanent residence. Since 2001, the Ministry of Labour and Social Protection of the Population has been issuing individual permits for employment in Azerbaijan, and to date these have been granted to 8 485 foreigners. However, unofficial sources give figures of around 60 000 for the number of labour migrants in Azerbaijan. Foreign nationals are mainly employed in the oil sector, but also in construction, transportation, service industries and the finance and insurance sectors.

Another important motive for immigration to Azerbaijan is the conflict in and around Nagorno-Karabakh that led to the displacement of approximately 1.5 million people. According to the IOM (2008c, p. 36), the Azeri Ministry of Foreign Affairs reported that 989 586 refugees, IDPs and asylum seekers were residing in Azerbaijan in 2008. These included 250 000 Azeris deported from Armenia, 50 000 Meskhetian Turks deported from Central Asia, and up to 700 000 IDPs. This number does not include the flow of ethnic Azeris from Georgia (an estimated 300 000 ethnic Azeris have left Georgia in the past decade, although the 2002 Georgian census recorded the presence of nearly 285 000 ethnic Azeris), some 8 000 ethnic Chechens with Russian citizenship, 7 500 Afghan citizens and 3 000 Iranians who were also resident.

6.5 REGIONAL MIGRATION SYSTEM AND MIGRATORY ROUTES

As discussed in previous sections, an intra-regional migration system exists where there are strong links between some neighbours. Russia, Poland, Romania, Bulgaria and Turkey have also been included in the analysis as they are immediate neighbours of the six Eastern partners. Russia holds a special place in the region since it is the second most important destination and origin country in the world[85] and it hosts 12.27 million immigrants (8.7% of the total population), mainly from Ukraine, Kazakhstan, Belarus, Uzbekistan, Azerbaijan, Georgia, Armenia, Kyrgyzstan, Tajikistan, Moldova, Turkmenistan and Latvia (World Bank, 2010a). Thus it is a principal destination for the six Eastern partners, receiving immigrants in the following numbers (IOM, 2008g): Ukraine (3.56 million), Belarus (936 000), Azerbaijan (846 000), Georgia (629 000), Armenia (481 000) and Moldova (278 000). A large amount of irregular immigration to Russia is also estimated to occur, reported to involved 12–15 million immigrants visiting Russia every year for seasonal work.

As shown in Appendix 6.2 at the end of this chapter, Russia is also an emigration country; it has sent 11.05 million people abroad (7.9% of the total population). Key destination countries for Russian emigrants are Ukraine (3.61 million), Kazakhstan, Belarus, Israel, the USA, Uzbekistan, Latvia, Germany, Moldova and Tajikistan. According to Uzagalieva and Chojnicki (2008), during the period 1990–2005 around 4.8 million people emigrated from Russia. The majority of these people left for other FSU states (78.0%), including Ukraine (33.9%), Kazakhstan (13.6%), Belarus (8.1%) and Uzbekistan (3.8%). Among other countries, Germany (16.1%) and Israel (5.5%) are the largest receivers of emigrants. For the same period, Russia received approximately 8.7 million immigrants, mostly from Kazakhstan (27.2%), Ukraine (23.2%), Uzbekistan (11.1%), the Caucasus (14.3%) and other CIS countries (19.7%) (IOM, 2008g).

Turkey is a close neighbour with a stock of 4.26 million emigrants abroad (5.6% of the total population), but its outflows are mainly directed towards Western Europe. Key destination countries are Germany, France, Netherlands, Austria, USA, Bulgaria, Belgium, Saudi Arabia, Britain and Switzerland. There are also a few Turkish emigrants in Azerbaijan (15 000), Georgia (2 000), Moldova (2 000) and Ukraine (2 250). On the other hand, Turkey hosts 1.41 million immigrants (1.9% of the total population) mainly from Bulgaria, Germany, Greece, Macedonia, Netherlands, Romania, Russia, Britain, Azerbaijan and France[86]. It also receives a low but stable number of immigrants from the three Eastern partners; 17 707 from Azerbaijan and similar numbers from Moldova and the western regions of Georgia (Ajara, Guria and Kvemo Kartli, inhabited by ethnic Azeris) (IOM, 2003, 2008h). Turkey has been a principal transit route for emigrants from Georgia and Azerbaijan since these countries' independence, mainly because of the easy access and visa-free travel arrangements With the enlargement of the EU, central and eastern Europe has also gradually become a leading destination for the Eastern partners. Poland is an important neighbour with a stock of 3.10 million emigrants abroad (8.2% of the total population) and its outflows are directed towards Germany, Britain, USA, Belarus, Canada, France, Israel, Italy, Ireland, Spain and Austria. It is also a destination country for 827 500 immigrants (2.2% of the total population), mainly from Ukraine, Belarus, Germany, Lithuania, Russia, France, USA, Czech Republic, Austria and Kazakhstan. Bulgaria is also a net sender country with 1.20 million emigrants abroad (16.0% of the total population). The main destinations for Bulgarian emigrants are Turkey, Spain, Germany, Greece, Italy, Moldova, Britain, USA, Romania and Canada. The country has recently experienced the remigration of 107 200 thousand immigrants (1.4%) as a result of the return of Bulgarian citizens of ethnic Turkish origin who were forced to leave during the mid 1980s.

84 The information and numbers in this section were taken from the World Bank Factbook (2008c, 2010a), IOM (2008a) and country profiles (2008 b-i) as well as ETF Country Reports.

85 According to the World Bank Factbook (2008c), the top emigration countries in the world are USA, Russia, Germany, Ukraine, France, Saudi Arabia, Canada, India, UK, Spain and Australia, while the top immigration countries are Mexico, Russia, India, China, Ukraine, Bangladesh, Turkey, the UK, Germany and Kazakhstan. Therefore, Russia ranks second in the world in terms of both emigrants and immigrants (while Ukraine is the fifth destination and fourth sender).

86 Immigration to Turkey from the Balkan countries includes mostly Turkish-speaking populations (ethnic Turks and/or Muslims), who have been present historically from Ottoman times.

Romania is another leading regional actor, with a stock of 2.76 million emigrants abroad (13.1% of the total population); its flows are mainly directed towards Western Europe. Key destination countries include Italy, Spain, Hungary, Israel, USA, Germany, Canada, Austria, France, UK and Greece. There are very few Romanians in the Eastern partner countries, but Romania is host to 132 800 immigrants (0.6% of the total population), mainly from Moldova, Bulgaria, Ukraine, Russia, Syria, Hungary, Greece and Turkey. This number is believed to exclude those Moldovans naturalised under a special Romanian law to facilitate citizenship for certain groups of Moldovans[87]. According to the IOM Country Profile (2008f), the number of Moldovans (around 22 000) exceeds that of other immigrant nationalities owing to the obvious factors of the shared border, language and ethno-cultural ties.

It should be noted that the direction of labour migration from the six countries has been changing slightly over the past 10 years. For example, labour migration towards Turkey from Georgia, Azerbaijan and Moldova was more significant during the initial years of the economic crisis owing to the relatively cheap and easy travel options, while access to other countries was limited. However, the low level of economic development compared to other European countries and the correspondingly low remuneration of labour slowed the pace of this emigration. A similar process occurred in the case of Russia, which received more Russian-speaking immigrants in the early 1990s. These initial ethnic flows have stabilised and have gradually been replaced by movements of native citizens from neighbouring countries who move for economic reasons. The vast natural resources of Russia have generated labour demand that is not easily met within the national population because of the negative demographic situation and the significant labour migration of qualified Russians to Europe and USA (the annual population decline amounted to 1 million in recent years) (IOM, 2003, 2008g).

However, increasing political tensions between Russia and Eastern partners such as Georgia and Moldova and the irregular nature of most migration flows have been creating barriers. In 2000, for example, the Russian government introduced a visa regime for Georgian nationals, while other CIS countries continued to enjoy visa-free movement. In 2006 many Georgians living in Russia were expelled for violations of immigration law, allegedly in response to the detention of four Russian military officers by the Georgian authorities on charges of espionage in September 2006. In addition, young migrants whose mother tongue is significantly different from Russian (Armenian, Azeri, Georgian and Moldovan) increasingly find it difficult to secure employment requiring higher education, despite their territorial proximity and the fact that they share similar social environments, cultural and social values, and systems with Russia. The language barrier is becoming a serious impediment for young potential migrants, as these younger generations no longer learn the Russian language sufficiently well to operate professionally as engineers, teachers or economists in Russia.

Finally, the recent global financial and economic crisis has had a somewhat negative impact on the capacity of host countries to take new migrants. According to the World Bank[88], the pace of new migration is slowing, but there is little evidence of large-scale return migration. New data show that existing migrants are unwilling to return home, as the employment situation there is even worse, and re-entry to the host country has become harder with tighter border controls imposed. The impact of a worsening employment outlook in Russia has been particularly severe for Moldova and the countries of Central Asia, which receive a large share of remittances from Russia. It is clear that rising unemployment in large labour markets such as Russia and the EU is of serious concern to prospective migrant workers from the region as job losses may continue for some time in host countries.

6.6 LABOUR EMIGRATION FROM THE EASTERN PARTNERS

As previously discussed, labour emigration has certainly increased and its pattern changed between the early 1990s and late noughties in the Eastern partner countries. This can be explained by the basic push-and-pull model: economic conditions, demographic pressures and unemployment (push factors) in the sending countries work in coordination with higher wages, demand for labour and family/ethnic repatriation (pull factors) in the receiving countries. For the CIS, Mansoor and Quillin (2007, p. 75) conclude that 'despite the great variation in the migration patterns across the region and the extremely complex combination of microeconomic and social motivations for migration, similar motivations seem to underpin the decisions to migrate throughout the region. The most recent labour flows [in the] region seem largely to be a response to poorly functioning labour markets, insufficient productive capital, the low quality of life in […] sending countries, and a rising demand for unskilled labour for the non-traded services sector in the labour-importing economies in the EU and the CIS'[89].

87 According to the EurActiv news (17 August 2010), Romania granted citizenship to 17 000 Moldovans during the course of 2010, while in April 2009 it was reported that 1 million requests by Moldovan nationals for Romanian citizenship were waiting in the Romanian Embassy in Chişinău (EurActiv 15 April 2009). Among the EU newcomers, Romania, Bulgaria and Hungary have a practice of granting citizenship to nationals of neighbouring countries under simplified procedures. Romania grants citizenship to Moldovans from the areas that were part of Romania before being annexed by the Soviet Union in World War II. Bulgaria grants citizenship to nationals of Macedonia who claim their Bulgarian origin, while Hungary recently passed a law making it easier for ethnic Hungarians living abroad to obtain Hungarian citizenship.

88 See recent news on the website: www.worldbank.org/prospects/migrationandremittances.

89 It should be emphasised that not all the labour-importing economies of the EU demand unskilled or low-skilled labour. Unlike the situation in some recent receiving countries of the EU, such as Italy, Spain and Portugal, forecasts in some other countries, such as Germany, show the need for more medium and high-skilled migrants. See, for example Bonin, H. et al. (2007), Zukunft von Bildung und Arbeit: Perspektiven von Arbeitskräftebedarf und -angebot bis 2020, Gutachten im Auftrag des Bundesministeriums für Bildung und Forschung, Bonn.

If size of the economy and per capita GDP is taken as a baseline for the comparison of national wealth for the Eastern partners and their neighbours (**TABLE 6.1**), the economic standing of the countries can be roughly correlated with migration routes. Outflows to the EU and OECD countries appear to occur where poverty, limited numbers of jobs, and low wages serve as push factors, while higher wages and welfare levels in destination countries create pull factors. In 2002, the majority of labour migrants from Ukraine went to Russia (1 million) followed by the other countries of Eastern Europe such as Poland (300 000) and the Czech Republic (200 000), and by Italy (200 000) and Portugal (150 000) in Western Europe, a region that is becoming increasingly attractive because of higher remuneration levels and better working conditions (IOM, 2008a). Thus, migration to CIS countries tends to be needs-driven (eased by visa-free access), while migration to non-CIS countries is more likely to be opportunity-driven.

6.6.1 LABOUR EMIGRANTS: PROFILES AND SKILLS MATCHING

Although migrants represent the whole range of educational levels, migrant workers from the Eastern partners tend to have relatively higher education levels than those from other developing countries. The quality of this education may be in question, but the medium-to-high level is a quite distinct feature. Despite this, most migrants abroad work in jobs that are low-skilled, unskilled or outside their expertise in low-paid, labour-intensive sectors. They are mostly employed in the construction, agriculture (harvesting), hotel and catering sectors, as well as domestic services (cleaning and home care). The distribution of foreign workers by type of economic activity in Russia shows construction as the main activity in both 2005 and 2006, followed by trade and services. In Romania, most migrant workers are involved in trade and service jobs (47%) and in industry and mining (28%). Similar patterns of economic activity are reported by the emigrants themselves, with construction the main occupation of Moldovan (46%) and Ukrainian (42%) emigrants abroad, followed by agriculture and services (domestic and care) (IOM, 2008a).

TABLE 6.1 AMOUNT AND WORLD RANKING OF GDP (PPP) AND PER CAPITA GDP (PPP) FOR THE EASTERN PARTNERS AND NEIGHBOURS, 2008 (USD)

Country	World rank	GDP (PPP) 2008 (USD million)	GDP per capita 2008 (PPP, USD)	World rank
Russia	6	2 288 447	16 139	42
Turkey	15	1 028 897	12 920	51
Poland	19	671 927	17 625	39
Ukraine	**32**	**336 355**	**7 271**	**83**
Romania	39	302 566	14 064	49
Kazakhstan	55	177 354	11 314	62
Belarus	**59**	**118 695**	**12 261**	**57**
Bulgaria	64	94 476	12 394	56
Azerbaijan	**72**	**76 072**	**8 765**	**70**
Uzbekistan	73	72 547	2 656	118
Turkmenistan	94	33 389	6 641	86
Georgia	**109**	**21 370**	**4 897**	**95**
Armenia	**117**	**18 678**	**6 070**	**88**
Tajikistan	129	13 027	1 906	131
Kyrgyzstan	134	11 549	2 177	126
Moldova	**136**	**10 628**	**2 925**	**114**

Source: World Bank: http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf
Note: Per capita values are obtained by dividing the PPP GDP data by population data; 2008 GDP and per capita GDP in nominal numbers are relatively low and therefore the rankings of the countries change in relative terms.

The labour market structure in destination countries creates labour demand in the less regulated sectors where there is less competition from the domestic labour force. Limited regular and legal migration channels and high seasonality may also contribute to the type of work undertaken. Recent regularisation programmes have revealed that there are many Ukrainian 'temporary workers' in Italy (117 000), Spain (over 80 000), Portugal (around 65 000) and Greece (over 30 000). Their occupational status varies in these countries, depending on the needs of the local labour markets. On average, 70% of migrant workers are male and 30% are female, and most are in the 20–49 age group; more of them come from rural than urban backgrounds, and almost all have medium levels of education (vocational training or secondary education). While high unemployment was the main reason for migration a decade ago, this has recently been replaced by the search for better income because of insufficient wages, indicating that having a job no longer prevents migration.

According to the IOM (2008i), the State Statistics Committee of Ukraine reported that almost 90% of female emigrants to Italy were employed in domestic work in 2001, while other females worked mostly in processing industries. In Poland, employment in agriculture prevails (66.7% of female migrants), while more than one-third of female migrants are employed in the retail trade in Russia. Although construction is the main sector of employment for male migrants in all destination countries, a large proportion of them are employed in transport in Russia (11.1%), while more than one-quarter of male migrants in Poland are employed in agriculture. The principal factors behind Moldovan emigration are low income, high unemployment and widespread poverty. Push factors appear relatively more important to Moldovans, although the low cost of travel to CIS countries is a key pull factor given the geographical proximity and visa-free travel. The main sectors of employment abroad for Moldovan migrants are: construction (51.6%), transport (10.8%), housekeeping and care (7.8%), trade (11.6%), services (21.4%), industry and mining (5.5%) and agriculture (3.9%) (IOM, 2008e).

Labour emigrants from Belarus mainly work in Russia (90%), with some in Ukraine. In some border cities a section of the population consider seasonal and part-time work in Russia to be their basic source of income. Inhabitants of other frontier towns work in neighbouring EU countries (Lithuania and Poland), although many part-time migrants returned to the country following the economic crisis. Most labour emigrants work in the building trade and people of varying social status and education invariably work in construction. Another common occupation is trade or the purchase and transportation of small consignments of goods, otherwise known as the 'shuttle trade'. Up to 60% of labour migrants are men, mainly 40–49 years old; 45–50% of migrants have higher education (ETF, 2010c). There is also a growing number of students who study in Lithuania where there is a Belarusian exile university, and in Poland where many universities reserve places for Belarusian students.

Armenian workers (predominantly males) mainly emigrate to Russia and Ukraine for seasonal work. A household survey showed that two-thirds of Armenian labour migrants work in construction, with around one-sixth of that number being employed in trade and services, which together account for 21–22% of migrant households (IOM, 2008b). Seasonal migration (people temporarily working mostly in construction in the FSU countries) occurs mainly during the spring, summer and autumn. The push factor for these movements is mainly the lack of job opportunities in Armenia, especially in rural areas and small towns.

According to the ADB study on migration and remittances (Rustamov, 2008), the majority of Azeri emigrants are prime-age, educated male workers. Almost 72% of labour emigrants have secondary education, while 26.1% have tertiary education (Bachelor's degree or higher). Although Azeri emigrants work abroad in many diverse professions and specialisms, most of them work as individual entrepreneurs (and self-employed) or employed workers in trade, construction and services sectors. One-quarter of emigrants are regular seasonal workers (IOM, 2008c).

According to the IOM (2003), a high level of education and professional qualification is a feature of Georgian labour emigrants who have limited prospects on the domestic labour market, despite the high educational levels of the general population. Many highly educated individuals are therefore unemployed at home, and are also better able to establish contacts and adapt to new environments abroad. Over 44% of Georgian emigrants have a university degree, while the proportion of emigrants with incomplete higher education is also high (10%). The proportion of specialists with upper secondary education and above is 67%. Since most of these emigrants do not work in their specific field of expertise abroad, their potential is effectively unused or lost. For example, most female emigrants are employed in the services sector as nurses (33.1%), nannies (9.2%), waitresses (4.8%), cleaners (9.2%) and salespeople (5.5%), regardless of their education level or field of study (IOM, 2008d).

It should be noted that while male migrants outnumber female migrants in absolute terms, outflows from the Eastern partners include a significant number of females who move abroad for work (in particular from Moldova and Ukraine) and not only in pursuit of family unification, as was the case in some traditional sending countries (Casas and Garson, 2005). The so-called feminisation of recent migration flows during the 1990s included 'migration for employment' ranking equally with 'family migration' amongst females. In 2004, for example, women represented 56% of recent arrivals in Austria, 86% of all immigrants to Spain during the past decade, 74% in Italy and 58% in Greece; most were seeking work in domestic services, healthcare and the social services, as well as hotels and restaurants. According to Chaloff (2005), female immigrant workers in domestic care in Italy are mostly Romanian, Ukrainian, Moldovan, Albanian, Polish and Filipino.

Gender and age seem to be linked to destination and sectors of work abroad. Middle-aged men tend to emigrate to Russia, Germany and Portugal to work in construction, while younger women tend to emigrate mainly to Italy, Spain, Greece, Cyprus and Turkey to perform domestic work as cleaners and carers. Since the early 2000s, work in domestic employment as nurses, cleaners, carers and cooks has become an important type of migrant labour; as a result there are a higher number of females in labour outflows from Moldova, Ukraine and Georgia. The 2004 survey showed that Moldovan female migrants spend longer abroad than men, partly as a result of the higher transaction costs of moving to the EU rather than CIS countries. Although male migrants earn more than females in the same destination, migrant women in the EU earn more than migrant men in Russia; while male migrants in the construction sector in Russia earn average monthly wage of USD 370, many female migrant labourers in the social or domestic sectors in Italy earn USD 879 per month (OECD, 2008).

A comparison of migrant outflows to east and west reveals certain trends: a higher number of middle-aged men go to Russia, while younger people (also attracted by the Western lifestyles and values) and women move to Western Europe. Less-educated migrants tend to to east to destinations such as Russia, rather than west to the EU and USA (ETF, 2007b, 2008a, 2008b). This trend can be observed in all the Eastern partner countries, where there is also significant low-skilled migration to the EU. Those who plan to go to the EU have lower expectations of being able to use their skills abroad, with a common pattern of skills waste. Thus, education and skills acquired at home seem irrelevant and are probably lost, both for the migrants themselves and for host and home countries, rendering the migration process less efficient for all parties involved (Alquézar Sabadie et al., 2010).

6.6.2 LABOUR EMIGRATION: TEMPORARY NATURE AND IRREGULARITY

The temporary nature of most labour migration (including seasonality) and the extensive irregularity of outflows is another notable feature in the region. The nature of jobs offered in destination countries is mostly seasonal and/or temporary in the key sectors of construction, agriculture and domestic labour. Heavy industries rarely employ migrants, and labour agreements with receiving countries are no longer common practice. Intra-regional movement is also aided by geographical proximity, easy travel connections and visa-free entry to Russia from many neighbouring countries, making temporary and/or seasonal migration a feasible option and contributing to a certain level of circularity. Conversely, migration is a politically sensitive issue in many destination countries, leading to more restrictive policies where there are only limited regular or legal migration channels. This situation could result in greater irregularity and rates of deportation, leading to temporary movements and the potential exploitation of some migrants through poor working conditions.

Moldova has been a prominent example of just such temporary labour migration during the past decade. Many of its labour emigrants (52%) engage in seasonal work, mostly in CIS countries. While visa-free entry and easy travel to Russia makes seasonal and/or circular migration feasible, those who choose to migrate to the EU, especially Italy, Portugal and Germany, tend to leave for extended periods and are most likely to settle abroad owing to the risks and high costs involved in frequent illegal travel. Thus, the extent of irregular border crossings is rather low in the visa-free CIS countries, but working without authorisation in Russia and Ukraine is quite widespread, resulting in many labour migrants having irregular status. There is also a high degree of irregularity in the EU, and research indicates that one in four migrants travel to the EU illegally. In general, 40% of migrants to both CIS and EU countries engage in irregular employment and live without proper documentation (IOM, 2008e).

Emigration patterns are therefore also affected by the immigration policies of receiving countries and work sectors. Selective immigration schemes result in a greater brain-drain effect with permanent emigration, and even temporary migration to high-income countries may be biased towards skilled labour (OECD, 2008). Another indirect effect of EU labour market policy has been migration diversion following the Eastern enlargement in 2004 and 2007. As the new members obtained open entry to some EU labour markets (and limited access to others over long transitional periods), a rapid effect was observed, with half a million young Poles obtaining temporary work in the UK and Ireland. The ensuing labour shortages in the Polish economy created opportunities for Ukrainians, Moldovans and others to obtain temporary or informal work in Poland.

The six Eastern partners are relatively new sending countries with poorly developed migrant networks abroad (except for the historical Armenian diaspora). In fact, an ETF study (Alquézar Sabadie et al., 2010) shows a significant difference between new and old emigration countries regarding migration patterns and informal networks abroad. In the case of old emigration countries, the networks with established communities abroad helped newly arrived migrants to find more suitable jobs, while recent labour emigrants from new sending countries tended to work in unskilled jobs despite their higher qualifications. ETF surveys on returnees from Ukraine and Moldova (2007b, 2008a) indicate significant 'brain waste', in particular for Moldovans and women. More than 60% of highly educated returning migrants from these countries worked abroad as unskilled workers. Where there are more recent histories of migration, networks abroad are not yet well-established, though they are already important in the decision to migrate and in the choice of destination.

6.7 THE IMPACT OF EMIGRATION ON THE EASTERN PARTNERS

Emigration can profoundly affect both the supply and demand sides of domestic labour markets in sending countries through a variety of closely intertwined elements[90]. Various facets of emigration (the prospect of migration, the actual migration of domestic workers, and their eventual return) and the issue of remittances are key factors requiring assessment. On the supply side of the labour market, emigration decreases a country's labour resources, possibly leading to a lower unemployment rate. It can indirectly influence the behaviour of the economically active population at home, mainly in terms of the incentive to actively look for a job. The prospect of migration may affect the participation rate or the reserve wage of domestic workers through the transfer of remittances.

On the demand side of the labour market, emigration exerts an indirect influence on the sector structure of labour demand as a result of the changes it induces in prevailing patterns of household consumption and investment, and the choice of entrepreneurial models made by domestic firms. Migration can influence the sector composition of labour demand by reshaping consumption patterns. It stimulates the demand for the communication and financial services required to maintain strong ties with migrant communities abroad. The uneven sector impact of migration is reinforced by the probable inflationary effects of remittances that tend to channel resources and labour towards the non-traded sector. This includes construction, and a property boom is a common feature in those countries that have undergone intense migration waves. Consumption patterns are also exposed to cultural influence imported from destination countries, with returnees forming a channel for the transmission of such influences.

Consequently, both growth and poverty are affected by changes in labour supply and demand, productivity and the interaction with remittances in sending countries. Many inconclusive views of the impact of emigration on domestic labour markets have been presented, ranging from expectations of a positive impact through the reduction of unemployment, to concerns over the loss of relevant skills that could hinder or retard economic development. However, these are open to constant change given the complexity of the effects of migration on the labour market, with differing degrees of relevance depending on the timing and the country involved. The net benefit at any point in time is the sum of all effects. A review of different experiences demonstrates that the net effect can be either positive or negative, and can vary across countries and over time. As summarised in the OECD report (2008, p. 106), sending countries pass through five stages of a 'migration cycle' (exit, adjustment, consolidation, networking and return), each of which has different impacts[91].

With their relatively recent history of emigration, the Eastern partners are still in the early phases of the migration cycle, making any impact assessment difficult. Indeed, most of them are in a situation where the number of labour migrants and the volume of remittances have grown steadily, with no indication of a reverse trend as yet (exit and adjustment stages). With the exception of small-scale surveys in some countries, there has been very little research on the impact of migration in the Eastern partner countries. For those particular Eastern partners where migration as a social phenomenon has expanded massively to affect a critical size of the population, such as Moldova, this raises difficult questions as to how the economies and societies will deal with the impact on the social setting and psychological mindset of the populations.

However, the net migration data provided by the OECD (2008) indicate a gradual decrease of emigrants from the high levels of the 1990s. **TABLE 6.2** shows the gradual decline of net migration, although the overall balance is still negative. Only Ukraine has experienced a positive balance recently, probably underestimating the real size of outflows. This trend is also confirmed by World Bank's data in which the net migration rate appears to be positive only in Ukraine (gaining population) and is negative in the other five countries (indicating an overall loss of population). The figures in the table must be treated with caution because there has been a shift from permanent migration partly based on non-economic motives to temporary migration primarily for economic reasons. The gap between reported and actual flows is probably larger in the 2000s. When compared with recent flow data provided by national authorities, other countries appear to have experienced a small positive rate and Ukraine a small negative rate (ETF Country Reports). As they experience simultaneous immigration and emigration in a more complex network of labour movements, gross migration flows may have increased while net flows have diminished.

As in most post-communist European countries, labour migration from the Eastern partners occurs against a background of depopulation, a critical decline of fertility rates (except in Azerbaijan) and higher than average mortality rates (especially among adult males). It therefore contributes to a worsening demographic imbalance and labour force decline in the region. The large-scale outflow of individuals of reproductive age may also impact on the long-term demographic profile, potentially hampering the future labour market and economic recovery prospects of the countries (see Chapter 3). In the meantime, labour migration also

90 For a useful discussion of the literature on the impact of emigration on the domestic labour market of sending countries, see Martin (2009).

91 These are (i) exit stage: wages in domestic markets may rise as labour force decreases; unemployment or underemployment may fall if labour markets are tight; output may fall; (ii) adjustment stage: domestic economy adapts to emigration (e.g. higher labour force participation or economic restructuring, increased human capital investment and accumulation); (iii) consolidation stage: migrant flows tend to stabilise, and if a good policy environment exists economic activity improves with migrants' remittances, economic restructuring and increased human capital accumulation; (iv) networking stage: migrants become better integrated into the destination country, often form networks across transnational communities and become good trade and investment intermediaries; and (v) return stage: if emigration contributes to skill formation and increased growth, the sending country starts to experience labour shortages, especially in low-skilled jobs, to be filled by domestic migrants or inflows from neighbouring countries.

TABLE 6.2 NET MIGRATION FROM THE EASTERN PARTNERS, 1990, 1995, 2000 AND 2005

Country	1990		1995		2000		2005	
	*	share	*	share	*	share	*	Share
Armenia	40.8	1 152	-7.8	-207	-11.2	-295	-7.8	-243
Azerbaijan	70.5	982	-9.8	-128	-5.6	-69	-0.9	-11
Georgia	-13.2	-243	-127.2	-2 687	-35.2	-797	NA	NA
Moldova	-16.8	-385	4.2	97	-6.4	-175	-3.6	-101
Ukraine	-139.3	-270	-94.8	-185	-46.6	-95	4.6	10

Source: Adapted from a table in OECD (2008, p. 49); on the basis of the TransMONEE 2007 database and UNICEF IRC.
*Note: *Immigrants minus emigrants in thousands; share = number of migrants (net) per 100 000 mid-year population.*

significantly alleviates the situation of economic hardship and limited jobs in the region. Many poor households in regions where employment is scarce have been provided with a lifeline and political stability factor through having a household member working abroad. For the OECD (2008), labour migration is an income-generating activity, and, like engagement in the informal sector, it has provided opportunities for household members to escape unemployment and poverty and gain the necessary means for subsistence consumption and sometimes for investment in housing and education.

Migrants' remittances are often viewed positively as they provide poor families with an additional social safety net while relieving fiscal pressure on governments for social spending on the unemployed and the poor. They are certainly an important source of external financing and foreign exchange for countries, and can play an essential role in poverty reduction in the poorest regions. HBSs indicate that in some Eastern partner countries remittances constitute over 20% of the household expenditure in the poorest quintile, and the largest source of external income. In countries such as Moldova and Armenia, household income and national output are tied to the incomes of migrants living and working abroad. However, when remittances lead to an appreciation in real exchange rates and affect production sector composition with resources shifted from traded to non-traded sectors, the situation may come to resemble that of 'Dutch disease', where windfall revenues, mainly in oil-producing countries, inflate exchange rates and reduce the competitiveness of the manufacturing sector. An overview of remittances in each of the Eastern partners will be given in the next section.

In countries such as Moldova and Ukraine, emigration is associated partly with brain drain. Young people in the western regions prefer to go to central and Western Europe, while people aged over 35 in the eastern regions prefer to work in CIS countries. Although the skills of migrants range across all levels, a considerable number of emigrants of both sexes are young (between the ages of 20 and 40) and well educated. In Ukraine, for example, the educational level of migrants is medium to high (with an average 11.3 years of schooling) and there is anecdotal evidence of a shortage of qualified workers in some sectors of construction in both Moldova and Ukraine. It is not clear whether this is a direct result of migration. The World Bank Factbook (2010a) gives the emigration rate in 2000 of those with tertiary education as 8.8% from Armenia, 3.5% from Ukraine, 3.4% from Moldova, 3.2% from Belarus, 2.0% from Azerbaijan and 1.6% from Georgia[92]. These quality outflows may have a negative impact on long-term economic growth in the region. Since most migrants with higher education or professional skills do not work in their specific field of expertise abroad, their potential is effectively unused or lost (brain waste) (Alquézar Sabadie et al., 2010).

The largely temporary nature of labour migration (including seasonality) and wide irregularity of outflows from the region result in complex labour movements and a high number of returnees of various types. According to the ETF survey findings in Moldova and Ukraine (2007b, 2008a), the most important reasons for return were the completion of a work contract or seasonal work, or family-related reasons. However, 51% of Moldovan returnees and 30% of Ukrainian returnees planned to migrate again, many because their migration project was interrupted or was not yet finished. Given the key sectors of migrant work abroad, the impact of these circulatory movements on domestic markets is not yet clear. One possible indirect impact can be seen in the increasing inequality between households in sending communities, where households with no access to emigration are falling behind those with increased income from remittances. Remittances do not directly provide governments with additional revenue as they are not taxable income. This reduces the leverage of governments in fighting poverty through coordinated state programmes, as remittances account for an ever-increasing share of GDP. Migration also has a strong negative effect in terms of broken families, particularly in the case of female migrants and with respect to the issue of abandoned children, both of

92 The emigration rate of tertiary-educated individuals is defined as the stock of emigrants with at least tertiary education as a proportion of the total number of people with tertiary education in the country. Tertiary education refers to more than secondary education (more than high school or 13 years of education). See Appendix 6.1.

which are causes of great concern and frustration in these countries.

Finally, the issue of established diaspora communities from the Eastern partners is rather difficult to assess. Given the relatively short history of migration from most of these countries (except for the early emigration of Armenians and Ukrainians at the beginning of the 20th century), the small and recent emigrant communities from countries such as Moldova and Georgia can hardly be described as a 'diaspora' when compared to the established Israeli or Armenian diasporas. There is a definite difference between new and old emigration countries in terms of their established diaspora abroad. According to the IOM Country Profiles (2008b–i), there are large communities of Ukrainians established in several regions of the world that maintain strong links with their home country (many diaspora organisations exist in Canada and there is a more recent diaspora in Poland). The Azeri diaspora abroad is a post-Soviet concept that is still in the process of development, but there are some quite affluent Azeri diaspora communities, mainly in Russia, Turkey and the USA.

Armenia holds a special position in the discussion of diasporas, as the modern Armenian diaspora began to form in the second half of the 19th century when Armenians from the Ottoman Empire began to migrate to the USA, a process that intensified in the early 20th century with the establishment of major diaspora centres in North America, Europe and the Middle East. The country has a population of 3.2 million, while estimates of the diaspora range from 6 million to more than 7 million. Many Armenians are settled in Russia, USA, Canada, other CIS countries and, to a lesser extent, Western Europe. According to Panossian (2003) the total Armenian diaspora in 2003 was: Russia (2 million, 28.8% of all emigrants), the US (1 million, 13.3%), Georgia (320 000, 4.4%), France (300 000, 4.2%), Ukraine (150 000, 2.1%), Iran (100 000, 1.4%), Lebanon (100 000, 1.4%), Syria (70 000, 1%), Azerbaijan (70 000, 1%). The diaspora link with Armenia is strong, with active participation in the political and economic life of the homeland through actions such as charitable causes, lobbying during elections and recognition of the Armenian massacre.

6.7.1 INCREASING REMITTANCES AND THEIR IMPACT ON THE EASTERN PARTNERS

'Remittances' are defined as the sum of a worker's income, the compensation provided to employees and migrants' personal transfers, while 'workers' remittances' are defined as current transfers by migrants considered resident in the destination country. As previously discussed, workers' remittances allow recipient households to escape from poverty and employ resources from other income for productive investments. However, such investments are unlikely to be made in any economy where the basic preconditions for them are not already in place. This clearly demonstrates how the job-creation effect of migration is highly dependent on the prevailing economic and institutional environment in the home country. The distrust of migrants in domestic financial systems clearly hinders the direct productive use of remittances.

It is also important to stress that estimates of national incomes from remittances vary greatly according to whether the source is national or international, and which methodology is used to calculate the total. In most cases the totals provided only include the sums sent through easily accountable formal channels such as banks and post offices, giving an incomplete picture. A recent World Bank survey of 28 European and Central Asian countries showed that 41% of migrant workers on average transfer money through informal channels, bypassing banking institutions (Mansoor and Quillin, 2007). This comprises cash transfer via the drivers of various forms of transport, acquaintances or friends, and well-organised courier services. Thus it is extremely difficult to quantify unofficial remittances with precision. According to the World Bank, only two countries (Moldova and Russia) attempt to capture remittances sent through informal channels within the balance of payments, while the remaining countries record mostly registered remittances. It is therefore no surprise that Moldova has the highest official rate of remittances per GDP of all the Eastern partners.

TABLE 6.3 shows the amount of remittances in 2000 and 2007 and the share of GDP (in 2006) for the six Eastern partners, and comparative figures for five of their neighbours. According to the World Bank Factbook (2008c), the amount of remittances received in 2007 was highest in Armenia (USD 1.273 billion), Moldova (USD 1.2 billion), Azerbaijan (USD 993 million) and Ukraine (USD 944 million), followed by Georgia (USD 533 million) and Belarus (USD 334 million). Remittances increased in all six countries between 2000 and 2007, but they increased tremendously in some countries: 28-fold in Ukraine, 17-fold in Azerbaijan and 14-fold in Armenia. This means increases with an annualised growth rate of 62% in Ukraine, 50% in Azerbaijan, 47% in Armenia and 31% in Moldova.

The remittances are also shown as a share of GDP, which provides a slightly different picture as they constitute the highest share of GDP in Moldova (36.2%) and Armenia (18.3%), followed by 6.4% of GDP in Georgia, 4.0% of GDP in Azerbaijan, 0.9% in Belarus and 0.8% in Ukraine. Therefore remittances are actually more important to the Moldovan and Armenian economies than to the others. Indeed, Moldova is the third-largest recipient of remittances in the world in terms of share of GDP after Tajikistan (46%) and Tonga (39%)[93]. The

93 According to the World Bank Factbook (2008c), the top 10 remittance recipients in 2008 were India (USD 52.0 billion), China (USD 40.6 billion), Mexico (USD 26.3 billion), Philippines (USD 18.6 billion), Poland (USD 10.7 billion), Nigeria (USD 10.0 billion), Egypt (USD 9.5 billion), Romania (USD 9.4 billion), Bangladesh (USD 9.0 billion), Vietnam (USD 7.2 billion), Pakistan (USD 6.1 billion), Indonesia (USD 6.0 billion) and Morocco (USD 5.7 billion). In contrast with these absolute amounts, the top recipients in terms of the share of remittances in GDP in 2007 include many smaller economies: Tajikistan (46% of GDP), Tonga (39%), Moldova (36%), Lesotho (28%), Guyana (26%), Lebanon (24%), Samoa (23%), Jordan (22%), Honduras (21%) and Kyrgyzstan (19%).

TABLE 6.3 TOTAL REMITTANCES, 2000 AND 2007, AND AS A SHARE OF GDP, 2006

Country	Remittances in 2000	Remittances in 2007	Share of GDP (%), 2006
Armenia	USD 87 million	USD 1.273 billion, ↑ *14-fold increase*	18.3
Azerbaijan	USD 57 million	USD 993 million, ↑ *17-fold increase*	4.0 (9.0% non-oil)
Belarus	USD 139 million	USD 334 million, ↑ *2.4-fold increase*	0.9
Georgia	USD 274 million	USD 533 million, ↑ *1.9-fold increase*	6.4
Moldova	USD 179 million	USD 1.200 billion, ↑ *6.7-fold increase*	36.2
Ukraine	USD 33 million	USD 944 million, ↑ *28-fold increase*	0.8
Neighbouring countries for comparison			
Bulgaria	USD 58 million	USD 1.854 billion, ↑ *31-fold increase*	5.4
Poland	USD 1.726 billion	USD 5.000 billion, ↑ *2.8-fold increase*	1.3
Romania	USD 96 million	USD 6.800 billion, ↑ *70-fold increase*	5.5
Russia	USD 1.275 billion	USD 4.000 billion, ↑ 3-fold increase	0.3
Turkey	USD 4.560 billion	USD 1.200 billion, ↓ *3.8-fold decrease*	0.3

Source: World Bank (2008c): www.worldbank.org/prospects/migrationandremittances

increasing role of remittances in the economic development of the six Eastern partners is thus obvious, as these nations received a joint total of USD 5.277 billion in 2007. This amount reflects only the officially recorded transfers, and the actual amount, including unrecorded flows through formal and informal channels, is believed to be much larger. The two main sources of remittances for the Eastern partners are the EU countries and Russia.

For many Moldovan households, remittances have become one of the most important sources of income. Their volume has continuously increased since the late 1990s, reaching USD 1.316 billion in 2010 (updated in World Bank (2010a)). They have amounted to over 50% of the country's trade deficit since the late 1990s and are worth more than 30% of national exports (IOM, 2008d). Thus, remittances have been one of the main drivers of economic growth since 2002, although with certain negative effects on inflation. However, the majority of remittances are spent on consumption rather than productive and employment-generating investments in Moldova, with households spending half of their remittances on daily consumption of largely imported goods. Around 20% is invested in durable products; investments in existing businesses or start-ups are limited to 7% of total remittance assets (OECD, 2008).

The findings of the CBS-AXA survey (2005) in Moldova suggest that remittances contribute to poverty reduction. In 2006, poverty incidence had fallen to around 20% for migrant households and to 32% for non-migrant households. Furthermore, 40% of the Moldovan population live in households that receive remittances, and remittances fund more than half of current expenditure in around 60% of all remittance-recipient households (ETF 2007b, 2009a). They also increase asset ownership for the recipients, relieving the financial constraints of the household and offering investment opportunities. It is estimated that the recent property boom has been partly triggered by remittances. Consumption, property, education and healthcare are the main expenditure items of the recipients, and young people in migrant households are more likely to enrol in undergraduate and graduate studies than their counterparts in non-migrant households.

Remittances from the diaspora are also crucial for the Armenian economy, making up 18.3% of its GDP in 2006. According to the Central Bank of Armenia, remittances are double the size of the national budget, and they keep many families above the poverty line. In 2004 consumption in households with a migrant worker was on average 11% higher than those without a migrant (Mansoor and Quillin, 2007). Remittances have had a particular impact on the construction sector, which has been the leading sector of the economy in recent years. Most of the remittances sent to Armenia come from Russia (70%), and correlate strongly with Russia's growth in GDP. They are a key component in financing the external imbalance that has enabled Armenia to run large deficits with the world and maintain decent living standards. Remittances make a positive impact on GDP growth, high gross domestic savings and poverty reduction. Although the driving forces behind recent Armenian growth are debated, the country's recent performance is largely attributed to private transfers sent by emigrants (in addition to the construction boom and increased exports) (IOM, 2008b).

Remittances to Georgia increased to USD 824 million in 2010 (updated in World Bank, 2010a). Between 2004 and 2007 Russia was the source of 60% of the country's remittances on average[94]. Most remittances are spent on everyday consumption and healthcare. According to the IOM (2008d), a study of emigration from the Tianeti Region showed that 71% of emigrant households received remittances. Most of the remittances received are spent on basic consumption as a result of the high levels of poverty in the region. During a period of extreme tension in Russian–Georgian relations, Russia imposed a transport, visa and mail blockade and deported many Georgian citizens. This increased official remittance flows significantly as the communication blockade made it very difficult for Georgian migrants to transfer money through informal channels, thus forcing them to use the banking services.

More than half of Georgian households consider remittances to be a major source of income for family subsistence, while 40% view them as just one of the key sources (Kakulia, 2007). Households in which remittances are a primary source of income tend to spend these on basic consumption, meaning that their impact on economic growth is limited to the multiplier effect of an increase in consumer demand. In this regard, Georgia bears more resemblance to the Moldovan pattern than that of Armenia. Kakulia (2007) argues that the proportion of remittances used as savings in the Armenian pattern is higher owing to the fact that the calculation in Armenia includes the 'old diaspora', where those sending the remittances are neither Armenian citizens nor migrant workers. Their transfers are less regular in nature but constitute a larger volume than transfers from migrant workers, providing more opportunity for saving.

Total remittances in Azerbaijan have risen to USD 1.472 billion in 2010 (updated in World Bank (2010a)), while national sources give estimates of up to USD 1.2 billion and 9% of non-oil GDP. The study carried out by the ADB in 2007 shows that remittances are sent home mainly by migrants working in Germany, Russia, Kazakhstan, Iran and Ukraine. The absolute majority of these come from Russia (83%), indicating the importance of the country for Azeri households. Some 77% of remittances sent to Azerbaijan are used for basic household expenses (food, housing, clothing, utilities and healthcare services) and less than 0.5% for business investment. The greatest part of the money is used by households to compensate for low income. According to Rustamov (2008), in contrast with their weak effect on investment, remittances have positive effect on levels of poverty and inequality, since when they are not included in household income, poverty incidence among remittance-receiving households rises from 4.1% to 33.1% and extreme poverty rises from 0.0% to 13.1% (the Gini coefficient also increases from 0.18 to 0.35). Remittances also contribute indirectly to political and economic stability in Azerbaijan.

Remittances in Ukraine totalled USD 5.289 billion in 2010 (World Bank, 2010a), though their share of GDP is relatively low. This amount has recently been updated to reflect the large proportion of remittances transferred through unofficial channels. Estimates by the Institute for Demography and Social Studies of the National Academy of Sciences give a figure of USD 7.2 billion, or 8.5% of GDP. Remittances benefit recipient families and stimulate the Ukrainian economy, which until the recent economic crisis was experiencing reduced unemployment, increased aggregate demand and growing market size. The Ukrainian Parliament Commissioner for Human Rights has stated: 'The money migrant workers make abroad exceeds by a dozen times the average wages of Ukrainian citizens and offers ample opportunities for building houses, buying cars, durable goods, products of the light and food industries, and financing education of children in prestigious educational establishments[95].'

Finally, World Bank data show that remittance flows to developing countries were USD 307 billion in 2009, less than the USD 325 billion in 2008 as a result of the global financial crisis. In 2010 remittances recovered their 2008 level and flows are expected to reach USD 346 billion in 2011 and USD 374 billion by 2012. Europe and Central Asia have experienced a decline as a result of the worsening employment outlook in Russia, which is an important source of remittances in the region. The Economist Intelligence Unit[96] reported a 29% decrease of remittances in Moldova in the first quarter of 2009, while net income from worker remittances fell 21% in the first quarter in Georgia. This has hit domestic economies, especially depressing retail sales and undermining construction activities in the countries.

6.8 POLICY RESPONSES TO LABOUR EMIGRATION

Despite the huge size of outflows and the massive impact of the migration phenomenon on people's lives, migration has been a low priority in the public and political spheres of the Eastern partners. Political, social and economic transition compelled governments to focus on macroeconomic stability and privatisation, the consolidation of political institutions and establishment of new borders. Indeed, these countries had no migration policy prior to the 1990s, as under the socialist systems movement was restricted by central job and housing allocation and internal residence permit requirements that only allowed individuals to move informally. The countries therefore lacked a legal framework for emigration and immigration issues, along with the institutional capacities and a coherent political strategy for labour emigration (IOM, 2008a).

Public attention on the topic of labour emigration slowly increased in the early 2000s as labour emigrants

94 In 2006 most remittances sent electronically to Georgia were from Russia (USD 364 642), USA (USD 59 497), Greece (USD 16 401), Turkey (USD 13 929), Spain (USD 11 348), and Ukraine (USD 11 146) (Kakulia, 2007).

95 This is cited in ETF (2009b), with reference to www.ombudsman.kiev.ua/S_Report1/gl1_4.htm.

96 See Economist Intelligence Unit, *Economist* magazine, 26 June 2009.

increased in number and became more visible. Given the importance of intra-regional migration, most CIS countries have demonstrated a desire to participate in the migration dialogue in recent years. Dialogue with Russia as the key receiving country in the region is of particular importance. Much work remains to be completed on the coordination and harmonisation of policies, regulation of labour migration and the rights of workers, and measures to counter irregular migration and human trafficking. In fact, all of the Eastern partners have made bilateral and/or multilateral labour cooperation agreements with Russia and other CIS countries since the early 1990s, but the current status and implementation outcomes of these are not clear. The Workers Trade Union for Enterprises Using Foreign Labour was established as a public organisation in Russia to lobby for migrant workers and their rights at state level.

However, the repeated temporary movements of emigrants interrupted by the end of contracts or forced returns represent a challenge for a traditional policy approach based on established communities abroad where the key issues are matters such as pension coverage and portability, and the residence rights of migrants. Donor involvement has supported the production of a number of policy documents in Moldova, though its migration policy is too recent to have been fully implemented in practice. A strategic approach to migration has been developed, but implementation is not clear. The Moldovan Ministry of Labour, Social Protection and the Family[97] is responsible for labour market and employment policy as well as labour emigration. The country has signed bilateral labour cooperation agreements with Russia (1993), Ukraine (1994), Belarus (1994), Greece (2004), Korea (2004), Azerbaijan (2005), Italy (2006), and Portugal and Spain (still in progress), but it is unclear whether these are all operational (ETF, 2007b).

Moldova was the first country to sign a Mobility Partnership with the EU on 5 June 2008 (European Commission, 2008d, 2007c). This agreement brought together for the first time the many diverse areas of cooperation, including: migration management systems (illegal migration, asylum, border control and document security); visa facilitation; legal labour migration schemes and information channels for potential migrants; pre-departure training; flows of remittances; voluntary return; diaspora; and social protection for migrants. The multi-disciplinary nature of this agreement has forced different ministries in the Moldovan government to cooperate in the field of migration management. It was the first agreement of this type to be signed by the EU with a non-member country (the one with Cape Verde was signed in parallel), with another signed with Georgia in November 2009[98] and one in the pipeline for Armenia. Moldova (like Russia) also signed readmission and visa-facilitation agreements with the EU in 2009; under these agreements it receives easier visa application procedures for special groups of people in return for accepting illegal migrants back to the country.

The Georgian Ministry of Labour, Health and Social Affairs has some competencies for labour migration, although labour migration issues receive very little attention from the government (except IDPs, under the Ministry of Refugees and Accommodation)[99]. The State Agency for Social Subsidies and Pensions, which is under the supervision of the ministry, has been allocated some tasks relating to labour migration, but little has been done so far. The EU–Georgia Mobility Partnership led to more integrated and active policy in the field: the State Migration Commission was established in October 2010 to develop recommendations for a migration policy under the Ministry of Justice whose Civil Registry Agency is in charge of the secretariat function.

In Armenia the Ministry of Labour and Social Issues Department of Labour and Employment deals with issues relating to labour migration. The ministry has a database of organisations, vacancies and unemployed people and is therefore able to implement a unified policy[100]. It conducts labour market analysis and organises training for people who are willing to work abroad, subsequently sending them to countries where there is a high demand for workers. This ministry is also expected to be responsible for issuing work permits for foreigners.

Since 2006, Azerbaijan has made many efforts to improve the formulation and implementation of migration policy. It has adopted a State Program on Migration (2006–08), has established a State Migration Service responsible for registering immigrants that includes a State Committee to deal with the issue of Refugees and IDPs as a matter of urgency, and has improved regulations for issuing work permits to foreigners (IOM, 2008c). The policy also highlights the need to address the employment and social problems of young Azeri emigrants abroad, but this has low priority, given the high number of IDPs and refugees in the country. According to the Azerbaijan Ministry of Labour and Social Protection of the Population, national priorities also include responsibilities relating to labour migration, but very little has actually been done so far to manage labour migration.

Ukraine seems to have an ambivalent position on migration and a mostly negative attitude towards labour migration. The Ministry of Labour and Social Policy (in cooperation with the State Committee for Nationalities and Religion) has responsibilities for labour migration[101], including the design and implementation of state migration policy, the issuing of licences to agencies mediating employment abroad, and the preparation and

97 See the website at: www.anofm.md/ro/ for more information. According to the Law on Migration No 1518-XV of 6 December 2002, which stipulates the basic rules of emigration and immigration in Moldova, and recent Law on Labor Migration (No 180-XVI of 10 July 2008), the mandate of the Ministry and its National Employment Agency includes issues relating to both emigration and immigration. This agency is in charge of implementing labour migration and other employment policies. It is responsible for placing Moldovan migrants abroad when bilateral labour agreements between Moldova and other countries are signed. It is also responsible for the work permits of foreigners who come to work in Moldova (ETF, 2007b, 2009a).

98 See the news on signing a Joint Declaration on 30 November 2009, available at: www.eumonitor.net/news/archive/141192.

99 For more information on IDPs and diaspora see: www.mra.gov.ge and www.diaspora.gov.ge.

100 See the ministry website: www.mss.am.

101 See the ministry website at: www.mlsp.gov.ua/control/en/index (IOM, 2008i).

implementation of international agreements in the field. Indeed, the country has signed bilateral agreements on labour cooperation with Armenia, Azerbaijan, Belarus, Bulgaria, the Czech Republic, Estonia, Italy, Libya, Lithuania, Latvia, Moldova, Poland, Portugal, Russia, Spain, Slovakia and Vietnam (ETF, 2008a). As in Moldova, however, it is unclear whether these agreements are operational. Ukraine also signed readmission and visa-facilitation agreements with the EU in 2008, under which the EU provides easy visa access for special groups of people (students, business people, journalists, scientists, government employees) in return for Ukraine accepting the return of illegal migrants originally from the country or those transited through it. The country also agreed to open migrant centres with the support of the EU.

In summary, labour emigration is a fact in the region, whether it is viewed as a curse or blessing. As was recently highlighted by the UNDP (2009), migration can expand human choices in terms of income, accessing services and participation, although the opportunities available vary from those who are best equipped to those with limited skills and assets. Given the sheer size of outflows, better migration management can offer a valuable policy option with mutual benefits for the Eastern partners and destination countries (EU and Russia). In fact, all recent studies into the future skill needs of the EU labour markets (Cedefop, 2010) indicate potential difficulties in skills matching and a continuing need for migrant workers at all qualification levels. A 'win–win–win' situation for sending and receiving countries and migrants is possible under certain conditions if a virtuous circle is created for the benefit of all. The Eastern partners need to better equip potential migrants with the right skills, proactively encourage expatriates to return and become entrepreneurs, and create conducive environments for the more productive use of their skills, knowledge and savings at home.

Faced with an ageing population, possible labour and skills shortages and the need to compete for high-skilled migrants with countries such as the USA, Canada and Australia, the EU has become more receptive to the idea of legally recruiting labour migrants. The EU mobility partnership is the main strategic, comprehensive and long-term cooperation framework for migration management of the EU, with non-EU countries keeping the balance between the three areas of promoting mobility and legal migration, optimising the link between migration and development, and preventing and combating illegal immigration (European Commission, 2007c). As the first example of its kind, the EU Mobility Partnership with Moldova deals explicitly with labour mobility and return migration, including the notion of circularity. The process of skills matching between migrant workers and jobs abroad has become a key element in achieving efficient labour mobility by reducing elements such as the asymmetric information on skills and the lack of formal signalling. Within this context, the development of tools that can provide transparency for migrants' skills and facilitate the recognition of their qualifications[102] is becoming important for both the EU and Eastern partners.

Given the massive emigration rates, this is an opportunity for the Eastern partners to create a 'win–win–win' situation through better management of labour migration. The ETF is involved in the EU–Moldova Mobility Partnership, and is contributing to policy debate on the transparency of skills and qualifications. The central idea behind the move is to improve the transparency of professional qualifications, involving both certified and non-certified skills learned at school and on the job, in the three dimensions of employer requirements; the content of the Moldovan qualification system; and the role of return migrants in the development of the Moldovan labour market with their new skills acquired abroad. The ultimate intention is to improve available information on the supply and demand of skills in Moldova in order to improve matching both in the domestic labour market and in relation to migration to the EU (European Commission, 2008d).

The EU recently adopted the Stockholm Programme (2010–14), which proposes flexible immigration policies for long-term EU economic development, and increased coherence between migration policies and other policy areas such as development policy and policies for trade, employment, healthcare and education at the European level. EU efforts to promote mobility and better labour matching are linked to its efforts to develop decent and productive work and improved livelihood options in non-EU countries. The Europe 2020 strategy and the recent New Skills for New Jobs (European Commission, 2010) refer to the use of migration potential in the EU by taking into account future global competition for talent and possible labour shortages in some occupations. They propose the effective management of migrant human capital, not only by recognising and improving skills, but also by managing labour inflows according to skills needs, and encouraging entrepreneurship.

Although developments such as the Bologna and Copenhagen processes, the EQF, New Skills for New Jobs and the Europe 2020 strategy are intended for the EU member states, they could have an external dimension in line with increasing temporary and/or circular migration flows between the EU and its neighbours (Bardak, 2010). The EQF, for example, could serve as a reference point for making qualifications portable by linking national qualification systems to the EQF. The Bologna (higher education) and Copenhagen (vocational training) processes could provide voluntary cooperation frameworks for improving quality, transparency and the recognition of qualifications in the education and training systems of partner countries. The relevance and applicability of these European tools can be explored for the EU neighbours and taken forward for the skills-matching dimension of migration management.

102 Unlike the term 'skill', 'qualification' refers to a formal assessment and validation process in which a competent body determines that an individual has achieved learning outcomes to given standards and/or possesses the necessary competence to do a job in a specific area of work. It is an official recognition of the value of learning outcomes (mostly obtained in the form of a certificate, diploma or degree) in the labour market and in education and training. See Cedefop (2008); Terminology of European Education and Training Policy, Luxembourg.

6.9 CONCLUDING REMARKS

This chapter has focused on labour migration in the six Eastern partner countries and has presented an overview of the key trends and challenges relating to human capital stocks and domestic labour markets. The large differences in migrant numbers are due to the difficulties of statistical data collection (legal versus illegal migration), different definitions of 'migrant' (by residency, nationality, or country of birth) and 'migration' (permanent, temporary or short-term stay), and confusion between migrant stocks and flows data. The Eastern partners are both sending and transit countries to varying degrees, with outflows directed mainly to the CIS region (with Russia as the main destination) and EU countries. According to the World Bank Factbook (2008c, 2010a), Ukraine had the highest total number of emigrants abroad of all the six countries in 2010, followed by Belarus, Azerbaijan, Georgia, Armenia and Moldova. When these numbers are shown as a percentage of the total population, however, the countries with the highest population losses are Armenia, Georgia and Moldova.

Socioeconomic, ethnic and political factors played an important role in the initial migratory flows of the 1990s and 2000s in the region (including refugees fleeing civil wars and trans-border conflicts, and diaspora returning to their ethnic homelands). This was followed by a rapid deterioration of living standards and increasing political instability, with poverty becoming a widespread phenomenon in most countries and poor economic prospects serving as push factors. Once considered a temporary coping mechanism against acute poverty, labour emigration has now become a regular income-generating opportunity that is widely viewed as a type of job in the region owing to the limited number of jobs, the low wages in the poorly functioning labour markets, insufficient capital and the lower quality of life. Since the early 2000s the outflows have been increasingly driven by employment motives, with workers from the Caucasus finding employment in wealthier Russia. Russia also forms an important draw for Moldovan and Ukrainian workers, especially from the eastern provinces.

The typical characteristics of labour emigrants from the region include relatively higher formal education levels (though quality remains an issue), a considerable proportion of females, diverse age groups, and jobs abroad mainly in labour-intensive sectors with low skill requirements and low pay, such as construction, agriculture, hotels and catering and domestic services (cleaning and homecare). The temporary nature of many flows is another feature that is mainly due to the fact that geographical proximity, easy travel connections and the visa-free entry to CIS countries makes temporary migration a feasible option. This may be further encouraged by the type of labour demand in less regulated sectors where there is less competition from domestic labour forces, higher seasonality and access to limited regular or legal migration channels. Gender and age seem to be linked to destination and sectors of work abroad. More middle-aged men emigrate to Russia, Germany and Portugal to work in construction, whereas younger women emigrate mainly to Italy, Spain, Greece, Cyprus and Turkey to perform domestic work as cleaners and carers.

Emigration profoundly affects both the supply and the demand side of labour markets in sending countries through a variety of closely interlinked factors. With only a relatively recent history of emigration, the Eastern partners are still in the early phases of the migration cycle and this makes impact assessment difficult. Indeed, most of these countries are in a situation where the number of labour migrants and the volume of remittances have grown steadily, with no indication of any reverse trend as yet. In some particular Eastern partner countries such as Moldova, migration has expanded massively to affect a critical proportion of the population, and questions are being raised as to how the economy and society will deal with the consequences.

As in most post-communist European countries, labour emigration from the Eastern partners occurs against a background of depopulation, a critical decline of fertility rates (except in Azerbaijan) and higher than average mortality rates (especially among adult males). This process worsens the demographic imbalance, although it significantly alleviates economic hardships, the limited number of jobs, and unemployment in the region. Indeed, the amount of remittances received has increased tremendously in all the countries since 2000, with the high GDP shares in Moldova and Armenia showing the importance of this element to these economies. However, in countries such as Moldova and Ukraine emigration is partially associated with the phenomenon of brain drain. Although the skill levels of migrants cover a wide range, the proportion of young (between the ages of 20 and 40), well-educated emigrants of both sexes is considerable in most of the Eastern partner countries.

As a result of increasing migration outflows, the governments of the Eastern partners recently participated in migration dialogue with some destination countries in the CIS and EU. Dialogue with both Russia and the EU as destinations seems essential for the coordination and harmonisation of policies, the regulation of labour migration and workers' rights, and the prevention of illegal migration. However, the repeated temporary movements of emigrants and restrictive immigration policies challenge the objectives of the sending countries (pension coverage and portability, residency rights of migrants). The EU initiative of signing a Mobility Partnership with Moldova in 2008 was a pioneering cooperation initiative in migration management that was followed by a similar agreement with Georgia in 2009. A further agreement is planned with Armenia in the near future. Although it is still too early to evaluate its impact, this initiative has the potential to provide a basis for a comprehensive migration management dialogue between the Eastern partners and EU countries. The ETF is involved in this process, and is contributing to policy debate on the issue of skills recognition and labour market matching by promoting recognition of skills and qualifications.

The mobility partnership deals explicitly with labour mobility and return migration with the notion of circularity,

but also brings together many diverse areas of cooperation including border control, visa facilitation, biometric passports, flows of remittances, legal labour migration schemes, pre-departure training, and voluntary return and reintegration; this compels different countries and ministries to cooperate in the field of labour mobility and migration management. The process of skills matching between migrant workers and jobs abroad is key to efficient labour mobility within this context, and the development of tools that give transparency to migrants' skills and facilitate the recognition of their qualifications is becoming an important issue for both the EU and the Eastern partners.

In conclusion, migration is a reality in the region, whether it is viewed as curse or blessing. Given the sheer size of outflows, better management of labour migration may offer a valuable policy option, with mutual benefits for the Eastern partners and destination countries. A 'win–win–win' situation may be possible for all stakeholders involved in the migration process if a 'virtuous circle' is created for the benefit of all through better management of labour migration and its skills-matching dimension. In this context, the acknowledgement of certificates from abroad is crucial for both sides in order to reduce the loss of human capital. Such a move would reduce the exploitation and skills waste of migrants, while destination countries would be able to recruit exactly the workers they need. The Eastern partners also need to work better to proactively encourage the return of expatriates who can become entrepreneurs, and to create conducive environments for the more productive use of their skills, knowledge and savings at home.

APPENDIX 6.1 MIGRATION STOCKS AND MAIN DESTINATION AND ORIGIN COUNTRIES IN THE SIX EASTERN PARTNERS, 2010 (OR 2008 FOR **)

Country	Emigrant stocks	Main destination countries**	Immigrant stocks	Main countries of origin**	Net migration
Armenia	870 200; 28.2% of total population.Emigration of tertiary educated: 8.8%*	Russia (485 460), USA (76 364), Ukraine (69 134), Azerbaijan, Georgia (20 314), Germany (16 663), Israel (14 939), Turkmenistan (7 807), Greece (7 788), Spain (6 836), Belarus (6 634), France (6 373), others (86 346)	324 200; 10.5% of total population	Azerbaijan (119 353), Georgia (54 996), Russia (23 941), Iran (13 173), Syria (4 401), Ukraine, Turkey, Greece, Lebanon and Uzbekistan	Net sender(-)
Azerbaijan	1 432 600; 16.0% of total population.Emigration of tertiary educated: 2.0%*	Russia (1+ million), Armenia, Ukraine, Israel, Kazakhstan, Germany, Turkey, USA, Georgia, Turkmenistan	263 900; 3.0% of total population	Russia, Armenia, Ukraine, Georgia, Turkey, India, Iran, Pakistan, Turkmenistan, Uzbekistan, Kazakhstan, UK	Net sender(-)
Belarus	1 778 900; 18.6% of total population.Emigration of tertiary educated: 3.2%*	Russia, Ukraine, Poland, Lithuania, Kazakhstan, USA, Israel, Germany, Latvia, Estonia	1 090 400; 11.4% of total population	Russia, Poland, Ukraine, Armenia, Lithuania, Azerbaijan, Germany, Moldova, Georgia, Latvia	Net sender(-)
Georgia	1 057 700; 25.1% of total population.Emigration of tertiary educated: 1.6%*	Russia (634 372), Armenia (94 111), Greece (62 174), Ukraine (54 996), Israel (23 557), Germany (17 127), USA (12 480), Cyprus (10 162), Turkey (6 868), Latvia (5 155), Spain (3 665), others (99 930)	167 300; 4.0% of total population	Russia (125 714), Armenia (20 314), Azerbaijan (8 939), Ukraine (8 513), Turkey (7 094), Germany (1 916), Pakistan (1 892), USA (1 821), Greece (1 561), Bulgaria, (1 372), Israel	Net sender(-)
Moldova	770 300; 21.5% of total population, approx. 25% of labour force.Emigration of tertiary educated: 3.4%*	Russia (279 909), Ukraine (218 830), Romania (39 292), USA (22 811), Israel (19 243), Germany (16 430), Kazakhstan (7 875), Italy (6 927), Greece (5 511), Spain (5 010), Latvia (4 498), Portugal (3 564), Belarus (2 778), Canada (2 655), Turkey (2 461), others (66 230)	408 300; 11.4% of total population	Ukraine, Russia, Bulgaria, Romania, Belarus, Azerbaijan, Turkey	Net sender(-)
Ukraine	6 563 100; 14.4% of total population, a total of 508 000 in the EU (Eurostat).Emigration of tertiary educated: 3.5%*	Russia (1–2 million), Canada (1 million), USA(900 000), Moldova (660 000), Kazakhstan (550 000), Poland (300 000), Belarus (237 000), Italy (200 000), Czech Republic (200 000), Israel, Germany, Portugal (150 000), Spain (100 000), Slovakia (60 000), Turkey (35 000)	5 257 500;11.6% of total population	Russia, Belarus, Moldova, Kazakhstan, Uzbekistan, Azerbaijan, Georgia Armenia, Tajikistan, Kyrgyzstan.Small numbers from others: China, Jordan, India, Iran, Vietnam, Korea, Turkey	Net receiver(+)

Source: World Bank (2008c, 2010a); data on immigration and emigration taken from UNPD (2005) and Ratha and Shaw (2007); data on emigration rate of tertiary educated taken from Docquier and Marfouk (2004).
*Note: *The rate refers to 2000; **The numbers for each country given in these columns refer to year 2008 and are mainly from the IOM (2008b-i) Country Profiles on Azerbaijan, Armenia, Georgia, Moldova and Ukraine.*

APPENDIX 6.2 MIGRATION STOCKS AND MAIN DESTINATION AND ORIGIN COUNTRIES IN FIVE NEIGHBOURING COUNTRIES, 2010 (OR 2008 FOR **)

Country	Emigrant stocks	Main destination countries**	Immigrant stocks	Main countries of origin**	Net migration
Bulgaria	1 200 600; 16.0% of total population. Emigration of tertiary educated: 6.6%*	Turkey, Spain, Germany, Moldova, USA, Greece, Romania, Italy, Israel, Canada, UK	107 200; 1.4% of total population	Turkey	Net sender (-)
Poland	3 102 600; 8.2% of total population. Emigration of tertiary educated: 14.1%*	Germany, UK, USA, Belarus, Canada, France, Israel, Italy, Ireland, Spain, Austria	827 500; 2.2% of total population	Ukraine, Belarus, Germany, Lithuania, Russia, France, USA, Czech Republic, Austria, Kazakhstan	Net sender (-)
Romania	2 769 400; 13.1% of total population. Emigration of tertiary educated: 11.8%*	Israel (125 160), Hungary (155 148), USA (154 018), Spain (130 771), Italy (125 160), Germany (122 398), Canada (65 553), Austria (48 041), France (27 414), UK, Greece (23 025), Australia (12 897), Sweden (12 798), Czech Republic (12 089), others (143 607)	132 800; 0.6% of total population	Moldova, Bulgaria, Ukraine, Russia, Syria, Hungary, Greece, Turkey, Italy, Germany	Net sender (-)
Russia	11 055 600; 7.9% of total population. Emigration of tertiary educated: 1.5%*	Ukraine (3 613 240), Kazakhstan, Belarus, Israel, USA, Uzbekistan, Latvia, Germany (662 000), Tajikistan, Moldova, Estonia	12 270 400; 8.7% of total population	Ukraine (3 560), Kazakhstan (2 585), Belarus (936), Uzbekistan (918), Azerbaijan (846), Georgia (629), Armenia (481), Kyrgyzstan (464), Tajikistan (383), Moldova (278), Turkmenistan (175), Latvia (103), others (466)	Net receiver (+)
Turkey	4 261 600; 5.6% of total population. Emigration of tertiary educated: 4.6%*	Germany (2 706 232), France (197 819), Netherlands (184 424), Austria (153 836), USA (100 325), Saudi Arabia (95 752), Bulgaria (95 248), Greece (66 402), Switzerland (61 861), UK (60 110), Belgium (46 324), Israel (41 162), Sweden (35 338), Denmark (32 472), Kazakhstan	1 410 900; 1.9% of total population	Bulgaria (507 172), Germany (288 528), Kosovo*** (118 581), Greece (62 463), former Yugoslav Republic of Macedonia (33 242), Netherlands (23 019), Romania (21 873), Russia (20 944), UK (19 983), Azerbaijan (17 707), France (16 928), Austria (15 121)	Net sender (-)

Source: World Bank (2008c, 2010a); data on immigration and emigration taken from UNPD (2005) and Ratha and Shaw (2007); data on emigration rate of tertiary educated taken from Docquier and Marfouk (2004).
*Note: *The rate refers to 2000; **The numbers for each country given in these columns refer to year 2008 and are mainly from the IOM (2008b-i) Country Profiles on Romania, Russia and Turkey; ***Under UNSCR 1244/1999.*

7. HUMAN CAPITAL DEVELOPMENT TRENDS AND CHALLENGES

Anastasia Fetsi

This chapter deals with developments in the quality of human resources in the six Eastern partner countries and the role of the education and training systems in ensuring that appropriate skills are provided for employability, social cohesion and economic development.

It reveals an improvement in the educational attainment levels of the population during transition in almost all Eastern partner countries; but it also recognises that this improvement does not necessarily ensure that the skills of the labour force are relevant to the future socioeconomic development of the countries. Underfunding and a lack of consistency and sustained effort in the modernisation of the education system have created a discrepancy between the supply and demand for skills and established openings for possible skill gaps in the future. Such gaps would act as serious obstacles to the economic development of the countries and the employability of individuals.

Ensuring access to basic education for all has been one of the main considerations for all countries, but some have been more successful than others in this regard. The issue of early school leaving and the entry of unqualified young people into the labour market remains an issue throughout the region, particularly in rural areas, although the extent of the problem varies across the countries.

VET for young people and adults has an important role to play in all countries at this stage of development, and this area needs to be modernised and adapted to emerging skill needs. This section of the education system has experienced a long period of neglect, but since the mid 2000s the Eastern partners have demonstrated renewed interest in making VET a valid educational pathway towards the labour market and further education. Sustained and well-planned efforts are still required to increase the quality of VET and its relevance to the labour market and the needs of individuals. Aspects such as the development of appropriate institutional settings to bring the world of education closer to the world of work, improvement in the training infrastructure and the development of qualifications that have market value are still in their early stages. The field of adult training in particular needs to be seriously reviewed and addressed in view of the ageing population in all countries and the pace of economic restructuring.

7.1 DEVELOPMENTS IN HUMAN CAPITAL

The Eastern partners enjoyed high levels of human capital at the beginning of the transition process. Illiteracy levels were extremely low by international standards (close to zero) and the vast majority of the population had already achieved a level of education that permitted access to employment. Skill enhancement opportunities for adults were provided by enterprises for their own staff, and by public training institutions, which offered a series of training courses of varying content and duration.

The economic transition had a significant impact on human capital formation in all countries. The fall in economic output during the first years of transition and the subsequent growth in unemployment reduced the amount of public funding available for investment in education, and the skills of individuals depreciated through joblessness, underemployment and subsistence activities in the agricultural and non-agricultural sectors. At the same time, economic restructuring created a demand for new skills that is expected to grow in the future as the countries reposition themselves in the global economic context. The question arises of what the Eastern partners can do to preserve and enhance the potential of their human capital and increase the employability of all population groups in order to contribute to economic development and social cohesion.

This chapter will provide a closer examination of:

- developments in human capital and its use in the six Eastern partner countries since 2000;
- opportunities for access to education and training among young people and adults;
- policy responses and investment in education and training systems.

The concluding remarks will identify current and future challenges for policy action in the education and training systems. The problem of statistics in the transition countries has already been explored in this report, but this chapter presented particular difficulties in terms of finding comparable information on the condition of human capital in the Eastern partner countries (both within the group of countries and beyond) owing to the lack of appropriate available data and the widely varying national definitions of educational types and levels.

7.1.1 EDUCATIONAL ATTAINMENT LEVELS

This section uses the ISCED[103], and for the purpose of analysis the educational levels of population are grouped as low (ISCED 0–2), medium/intermediate (ISCED 3–4) and high (ISCED 5–6), unless otherwise specified. There has been a general improvement in the educational attainment levels in all six countries over the past 10 years, but the patterns of improvement are different in each country.

Armenia has experienced an impressive reduction in the percentage of the population with a low level of education (ISCED level 0–2), from 19% in 2001 to 8% in 2007, and there is a growing group of people with intermediate-level qualifications (71% of 25–64-year-olds had completed secondary education in 2007). Meanwhile, the percentage of the population achieving higher education remained modest in relation to comparable countries, although the rate has increased throughout the transition period (21% of 25–64-year-olds in 2007)[104].

Azerbaijan also saw an increase in the percentage of the economically active population achieving intermediate-level qualifications, up from 72% in 2003 to 76% in 2008, and there was a modest increase in the percentage of the economically active population with higher education from 19% to 21% over the same period[105].

The 1999 population census in Belarus showed that 27.5% of the population aged over 15 years had basic education or less, 58.3% had secondary education (either general education or vocational education) and 14.2% had higher education. No recent data on the educational attainment levels of the population have been provided by the National Statistical Office, but given the participation rates reported for education and training it can be assumed that the educational attainment levels of the population have increased during the past decade (ETF, 2010c).

Georgia still has around 15% of its population with low or no qualifications, but the proportion of those with higher level qualifications increased to 25% in 2007 and the majority of the population maintained their level of intermediate qualifications (59%). The number of those holding a degree in a VET field has fallen to 20% (ETF, 2010d).

Moldova has made the least progress in reducing the percentage of the population with low or no qualifications: a constant 30% of the population left the education system with only basic education in both 1999 and 2007. At the same time, the percentage of the population who had intermediate-level qualifications (ISCED 3) decreased from 48% to 43%, with a parallel increase to 26% for those with higher education (ETF, 2009a).

According to LFS data for the period 2004–07, Ukraine reduced the proportion of its population (aged 25 or over) with low qualifications from 18% to 14%, increased the proportion of those with intermediate qualifications from 61% to 64%, and slightly increased the proportion of those with higher education from 20.6% to 21.4% (24.3% for the age group 15–70) (ETF, 2009b).

It is worth noting that the proportion of the population with low educational attainment in all the Eastern partner countries except Moldova is lower than that of some new member states (Bulgaria and Romania), and in some cases even lower than the EU-25 average. However, it is higher than that of the advanced transition economies of Central Europe such as the Czech Republic and Hungary. At the same time, the more highly educated younger generations are boosting overall levels of highly qualified people. Despite this, the proportion of highly educated people in most Eastern partner countries (with the exception of Ukraine) remains below that of the Central European countries and the EU-25 average.

The improvement of educational attainment levels has been primarily due to the increased participation of young people and females in higher education. Rural–urban disparities still persist in terms of level of education (in particular in Moldova) as a result of the internal migration of better-educated people to urban areas with better employment opportunities, and the relative lack of educational opportunities in rural areas in terms of both quality and quantity.

7.1.2 LOOKING BEYOND EDUCATIONAL ATTAINMENT LEVELS

Examining the educational attainment levels of the population provides only a partial picture of the quality of human capital. This approach describes the structure of qualifications among the population, but does not provide details of the knowledge and workplace skills of these qualified people. An increase in the educational or qualification levels of the population does not necessarily lead to a linear improvement in the human capital of the country concerned if the employment opportunities available do not offer individuals opportunities to use their skills and knowledge, and upgrade, enhance and adapt these; and if the quality of the education and training provision for both youth and adults is not continuously adapted to the changing economic needs of the country. It is entirely possible that both of the above conditions apply in the six Eastern partner countries.

On the first count, the reduction in economic output and the process of deindustrialisation during the first years of transition in the Eastern partner countries led to job losses and subsequent high levels of unemployment (as in Armenia), and underemployment and hidden

103 ISCED was designed by UNESCO and approved at its General Conference in 1997 to serve as an instrument suitable for assembling, compiling and presenting educational statistics, both within individual countries and internationally. According to ISCED-97 classification, the educational levels are broadly defined as follows: **Level 0:** Pre-primary education; **Level 1:** Primary education or first stage of basic education; **Level 2:** Lower secondary or second stage of basic education; **Level 3:** (Upper) secondary education; **Level 4:** Post-secondary non-tertiary education; **Level 5:** First stage of tertiary education (not leading directly to an advanced research qualification); and **Level 6:** Second stage of tertiary education (leading to an advanced research qualification, e.g. PhD.).

104 Data from the 2001 population census and LFS 2007 presented in the ETF Country Report (ETF, 2010a, p. 36).

105 Data from the survey of economic activity in the population of Azerbaijan, reported in ETF (2010b).

unemployment in countries that opted to avoid high levels of unemployment (such as Ukraine). Agriculture, particularly subsistence agriculture, increased in importance in terms of employment and acted as a buffer against joblessness, as did non-agricultural informal activities in petty trade, personal services and similar areas. All of the above factors have led to the deskilling of the section of the labour force whose mainly 'industrial' skills were no longer needed while they lacked the opportunity or desire to update their skills for the new economic context.

In terms of the second aspect, the quality of education and training provision is reported to have deteriorated across the board in both absolute and relative terms. The type of education on offer has not changed, but the quality is not as high as it was previously, as a result of underinvestment in updated teaching, learning materials and infrastructure. Education and training has not changed sufficiently to adapt to the new socioeconomic needs that are a consequence of reduced budgets and underinvestment in the modernisation of curricula and teaching and learning processes. As a result, the type of skills and knowledge reflected by qualifications are not necessarily those in demand in the labour market. These issues will be explored further in the following sections of this chapter.

7.1.3 THE USE OF HUMAN CAPITAL IN THE ECONOMY, AND RETURNS ON EDUCATION

As was discussed in Chapter 4 on labour market trends, the economic restructuring of transition has not yet led to the creation of large numbers of jobs in higher-value-added sectors. The destruction of jobs in the public sector has not yet been balanced by a corresponding increase in jobs created in the private sector (which is generally supposed to have higher productivity). Industry has lost its relative importance in employment almost everywhere (with the exception of Belarus, where the economic restructuring process has been delayed). The proportion of total employment represented by industry in the Eastern partner countries (with the exception of Belarus and Ukraine, where industry is in urgent need of productivity increases) is lower than in other transition countries (Russia, Bulgaria and Poland) and also in comparison to countries in the EU. Moreover, much of the industrial production is concentrated on the extraction of raw materials and fuel, while manufactured products are at a rather low level of sophistication compared with international standards (although both Belarus and Ukraine have made some progress in this regard).

The substantial increase in the service sector's share of total employment has been mainly in low-value-added sectors such as trade, repairs and personal services. Some higher-value-added sectors such as business, finance and telecommunications have also seen an increase in the share of employment in the service sector, though this has not occurred as rapidly as in advanced transition economies and the number of jobs created has been relatively small. Agriculture is still providing a buffer for the lack of employment opportunities in other sectors and currently accounts for between one-third and one-half of employment (except for Belarus and Ukraine). Overall job reallocation during transition has so far not moved strongly towards highly skilled jobs.

Despite the slow pace of creation of higher-value-added jobs, education seems to yield returns in the six Eastern partner countries. **TABLE 7.1** shows that people with higher education in the Eastern partner countries have generally higher employment rates, followed by those with vocational qualifications. However, trends in the various countries have followed different patterns. In the period 2005–08, employment rates in Armenia increased for all educational groups, though to a greater extent for those with a high level of attainment, while in Ukraine employment rates remained quite stable. Georgia has experienced a reduction in employment rates among highly educated people.

TABLE 7.1 EMPLOYMENT RATES BY EDUCATIONAL LEVEL (%)

Country	2005			2008		
	Low ISCED 0–2	Medium ISCED 3–4	High ISCED 5–6	Low ISCED 0–2	Medium ISCED 3–4	High ISCED 3–4
Armenia*	28	General: 42.8 Vocational: 52.2	ISCED 5: 40.9 ISCED 6: 60.5	35.8	General: 52.7 Vocational: 61.7	ISCED 5: 57.7 ISCED 6: 89.7
Georgia	39.5	General: 55.2 Primary vocational: 66.1 Secondary vocational: 61.8	59.4	35.4	General: 52.9 Primary vocational: 68.8 Secondary vocational: 57.7	55.4
Ukraine**	34***	60.8	73.4	35***	60.8	74.2

Source: National Labour Force Surveys.
*Note: *ISCED level 5 includes middle vocational, incomplete tertiary and tertiary education; **Data refer to 2004 and 2007; ISCED 5–6 includes complete higher and basic higher education; ISCED 3–4 includes incomplete higher and complete secondary general education; *** ISCED 2 only.*

A higher level of education is also generally rewarded by higher salaries, as demonstrated by the rates of return on education. The return on an extra year of education for those in waged employment is 9.0% for Georgia and 9.5% in Moldova, levels that are comparable with that for Hungary, and higher than that for Poland, both of which are advanced transition economies. Among the Eastern partners for which data are available, only Ukraine had a relatively low rate of return on an extra year of schooling (5.0%) in the mid 2000s, possibly as a result of wage compression policies, but the level had increased to 8.6% in recent calculations based on 2006 HBS data (ETF, 2009b).

Finally, education reduces the risk of exposure to poverty. In Azerbaijan an analysis of HBS data shows that in 2003 poverty incidence was lower in homes where the education level of the head of household was higher, with 28.0% of households headed by those with higher education in poverty compared with 38.3% of those with only secondary education and 45.0% of those with lower than secondary education. In Moldova, the rate of poverty is only 0.5% for higher-educated people, while it stands at 28.0% for those with secondary education and 41% for those with primary and no education (ETF, 2009a:51). In Georgia (World Bank, 2008b, in ETF, 2010d) poverty incidence among the highly educated was 12.1%, with higher rates of 21.7% among VET graduates, 29.0% among general secondary graduates and 31.8% among the less-educated individuals.

Despite the positive correlation between level of education and labour market outcomes, education does not guarantee labour market integration. The better labour market prospects that education offers to individuals do not mean that education protects these individuals against labour market risks. In Armenia and Georgia, for example, more than one-fifth of highly educated people were unemployed (**TABLE 7.2**). Neither does it mean that the economy is making full use of the investment in education. In Azerbaijan, for example, 70% of higher education graduates worked in the public sector. If we exclude unemployed people, less than 25% of the remaining higher education graduates actually used their skills in the higher-productivity private sector. In Georgia, meanwhile, 9.1% of highly educated people were underemployed (ETF 2010a, 2010b, 2010d).

The data on unemployment rates by educational attainment level in Table 7.2 show that Moldova and Ukraine made better use of their highly educated people over time than other countries. However, there is some evidence that individuals with medium and high levels of education in those two countries are not in jobs that correspond to their level of education. For example, in 2007 an ETF survey of young people in Ukraine (ETF, 2008b) showed that university graduates did quite well in terms of finding a job in six months (74%), followed by secondary vocational graduates (52%), while secondary general graduates performed poorly (38%). However, 49% of university graduates were in jobs that require a lower qualification level. The quality of jobs available to young people was generally poor, with low pay, low qualifications and little training. These findings strongly suggest that only low-quality jobs are available to young people in Ukraine. The percentage of university graduates

TABLE 7.2 UNEMPLOYMENT RATES BY EDUCATIONAL LEVEL (%)

Country	Reference year: from 2001 to 2005			Latest year available: 2007 or 2008		
	Low ISCED 0–2	Medium ISCED 3–4	High ISCED 5–6	Low ISCED 0–2	Medium ISCED 3–4	High ISCED 5–6
Armenia* 2005 and 2008	37.6	General: 31.8 Vocational: 35.4	ISCED 5: 25.0	29.8	General: 30.8 Vocational: 31.3	ISCED 5: 28.1
Azerbaijan 2003 and 2007	7.4	General: 3.7 Vocational: 7.0	5.1	11.3	7.0	4.4
Georgia 2005 and 2008	8.5	General: 11.3 Primary vocational: 12.4 Secondary vocational: 15.5	20.1	9.8	General: 14.5 Primary vocational: 11.2 Secondary vocational: 17.4	22.2
Moldova 2001 and 2007	7.1	10.8	7.8	6.2	5.2	5.1
Ukraine 2004 and 2007**	10.0***	9.7	4.8	5.9***	7.1	4.8

Source: National Labour Force Surveys.
*Note: *ISCED level 5 includes middle vocational, incomplete tertiary and tertiary education; **ISCED 5–6 includes complete higher and basic higher education; ISCED 3–4 includes incomplete higher and complete secondary general education; ***ISCED 2 only.*

in lower-skilled jobs is higher than the 30% found in advanced transition countries such as Poland or Slovakia, or in the UK. Around 40% of college graduates and 40% of secondary vocational education graduates were also in jobs that require a lower qualification level.

In Moldova the 2008 Survey on Inter-Sectorial Mobility and Transition from school to work (SLMT) for 18–34-year-olds found that despite the easy access to employment, 80% of graduates from post-secondary non-tertiary education and 28% of graduates from higher education did not find a job in their field of specialisation. Graduates of business, law and social sciences were among those who had most difficulties in finding a job in their field of specialisation, followed by those in the engineering industry and construction (ETF, 2009a). These observations may lead to the conclusion that the better labour market outcomes for better-educated people are not exclusively due to the mobilisation of their higher skills for higher-skill jobs but also to a 'crowding-out' effect on less-educated people. The extent of this phenomenon is difficult to measure with the information currently available, but there is no doubt that the use of human capital is less effective for both the individual and society, the larger the number of unused skills registered.

Although no transition survey is available for Belarus, a distribution system was introduced in that country through an appointments board for graduates of state-run educational institutions. This system gives these graduates an advantage over graduates of private educational institutions in finding a job. Under the regulation on the placement of graduates of educational establishments, specified by the Resolution of the Council of Ministers of Belarus from 10 December 2007 No 1702[106], young experts are appointed to state enterprises, where they are expected to work for two years. In 2007, 21 703 of the 30 349 state-funded graduates from state-run higher education institutions were appointed, as were 20 825 of the 25 446 state-funded graduates from specialised secondary and technical education schools (ETF, 2010c).

7.1.4 SKILL MISMATCH – A SUPPLY-SIDE EXPLANATION FOR UNEMPLOYMENT AND UNDEREMPLOYMENT

There has been an improvement in educational attainment levels in the Eastern partner countries that has led to better labour market outcomes for those with higher levels of education. However, individuals with various levels and types of qualification still encounter difficulties in joining the labour market and putting their skills to use. Although this is partly a problem of aggregate demand for labour, the existence of a serious skill mismatch is often proposed as an alternative explanation.

Skill mismatch can be approached from two perspectives. Firstly, it is quantitatively related to matching the number of people with certain qualifications to the number of jobs available for those with the corresponding qualifications. This matching can relate to the level of qualifications (low, middle and higher) or to the occupational qualification profiles (doctor, secretary, plumber, etc.). If the number of people who hold certain qualifications is lower than the available jobs requiring those qualifications, this is referred to as a skills shortage. If the number of people who hold certain qualifications is higher than the available jobs requiring those qualifications, this is a skills oversupply. An oversupply of those with high levels of education would be referred to in the specific case of matching lower-level jobs. Quantitative matching in centralised economies was pursued through manpower-planning mechanisms that considered the short- and medium-term economic demand for skills and projections of future skill needs, and then adapted educational and training provision to fill those needs. In market economies, matching takes place through information on demand for qualifications that then influence the choices made by individuals as to the type of studies they undertake and their choice of training providers, depending on the programmes on offer. The matching is reflected in the wages paid, which has therefore come to form an important labour market mechanism.

The second perspective is qualitative: examining the quality of skills held by those who are qualified, and the type of skills required for different jobs in the labour market. Divergences between the two criteria are known as skill gaps. Skill gaps appear in periods of economic restructuring when the new jobs created require different types of skill to those destroyed, before the education and training system has been sufficiently updated to match the pace of change. In this situation, even when people hold the correct qualification for an occupation, they may not necessarily have the skills needed to effectively perform the job and satisfy employer expectations. Rapid technological and economic change makes it difficult to predict what types of skill will be needed in the near and more distant future, and what kinds of new jobs will appear.

The data available are insufficient for a detailed analysis of skill mismatches in the labour markets of the Eastern partners, but it is possible to make an approximate assessment of quantitative mismatch in terms of qualification levels by using a rough indicator that calculates the difference between the proportion of qualification holders who are in employment to the share who are unemployed (Bartlett, 2007).

The results of **TABLE 7.3** show that, as a general trend, higher education graduates are in excess demand in all countries (apart from Georgia), but this demand for higher education graduates is decreasing over time (apart from in Belarus, where graduate access to employment is assured by law). Graduates of secondary education are in excess supply in Armenia, Belarus and Ukraine, but this excess supply is also decreasing over time. Moldova presents an interesting case as the relative position of secondary education graduates changed between 2000 and 2007, with there being an excess demand in more recent years.

106 See the website of the Belarusian Helsinki Committee: www.belhelcom.org/?q=en/node/3056

TABLE 7.3 EXCESS SUPPLY OF LABOUR BY EDUCATIONAL LEVEL (%)

	Employed	Unemployed	Excess supply	Employed	Unemployed	Excess supply
ARMENIA*		**2001**			**2007**	
Low (ISCED 0–2)	14.0	13.6	-0.4	11.3	9.2	-2.2
Medium (ISCED 3–4)	62.7	71.3	8.6	67.8	73.8	6.0
High (ISCED 5–6)	23.3	15.1	-8.2	20.9	17.1	-3.8
AZERBAIJAN**		**2003**			**2006**	
Primary and lower	1.1	0.6	-0.5	1.7	0.6	-1.1
General secondary	58.6	77.5	18.9	64.5	71.9	7.4
Vocational (primary+secondary)	20.1	12.9	-7.2	15.4	13.3	-2.1
Higher (complete and incomplete)	20.2	9.3	-10.9	18.3	14.4	-3.9
BELARUS		**2000**			**2007**	
Low (ISCED 0–2)	8.2	11.0	2.8	5.2	11.6	6.4
Medium (ISCED 3–4)	72.9	80.1	7.2	71.6	78.5	6.9
High (ISCED 5–6)	18.8	8.8	-10.0	23.2	9.9	-13.3
GEORGIA***		**2005**			**2007**	
Primary	3.8	0.3	-3.4	2.6	0.2	-2.4
Basic	7.6	4.4	-3.2	7.7	4.9	-2.8
General secondary	40.0	31.8	-8.2	40.0	31.8	-8.2
VET primary	9.5	8.4	-1.1	6.3	3.9	-2.5
VET secondary	13.8	15.8	2.0	15.6	16.9	1.3
Higher	25.0	39.2	14.2	27.6	42.4	14.8
MOLDOVA		**2000**			**2007**	
Low (ISCED 0–2)	24.1	15.0	-9.1	18.1	20.5	2.4
Medium (ISCED 3–4)	63.9	75.0	11.1	62.0	60.6	-1.5
High (ISCED 5–6)	11.9	10.0	-1.9	19.8	18.9	-0.9
UKRAINE		**2004**			**2007**	
Low (ISCED 0–2)	11.8	8.6	-3.1	9.9	8.5	-1.3
Medium (ISCED 3–4)	64.2	79.1	14.9	65.4	73.2	7.8
High (ISCED 5–6)	24.0	12.2	-11.7	24.7	18.2	-6.5

Source: LFS except Belarus (administrative data; for the calculation methodology of excess supply of labour, see Bartlett, 2007).
*Note: *National Statistical Service of Armenia (Census 2001); **LFS 2003 and 2006 Reports (ETF calculation, in Castel-Branco, 2008); ***Department for Statistics, in ETF (2010d); in Armenia ISCED level 5 includes middle vocational, incomplete tertiary and tertiary education; in Ukraine ISCED 5–6 includes complete higher and basic higher education, and ISCED 3–4 includes incomplete higher and complete secondary general education.*

It is not clear, however, whether this is due to migration or to an increased demand for those skills in the economy.

The medium-level qualification category includes secondary general education graduates, graduates from primary VET and graduates from secondary VET[107], a selection of individuals with various types of skill and different labour market perspectives. Azerbaijan and Georgia have data available by sub-category that show mixed results reflecting the characteristics of the job offer. Azerbaijan has a strong excess supply of general education graduates, while in Georgia there is excess demand.

The data in this table should be interpreted with caution as they do not take into account substitution effects among qualification holders and the crowding-out effect on people with medium qualifications by those with higher qualifications. Neither do they take into account the quality of jobs that people hold. For instance, people with low and no qualifications appear to hold a relatively 'good' position in the labour market, but in fact the severity of their poverty pushes them into subsistence activities in the agricultural and non-agricultural sectors, as they cannot afford to remain unemployed for any period of time.

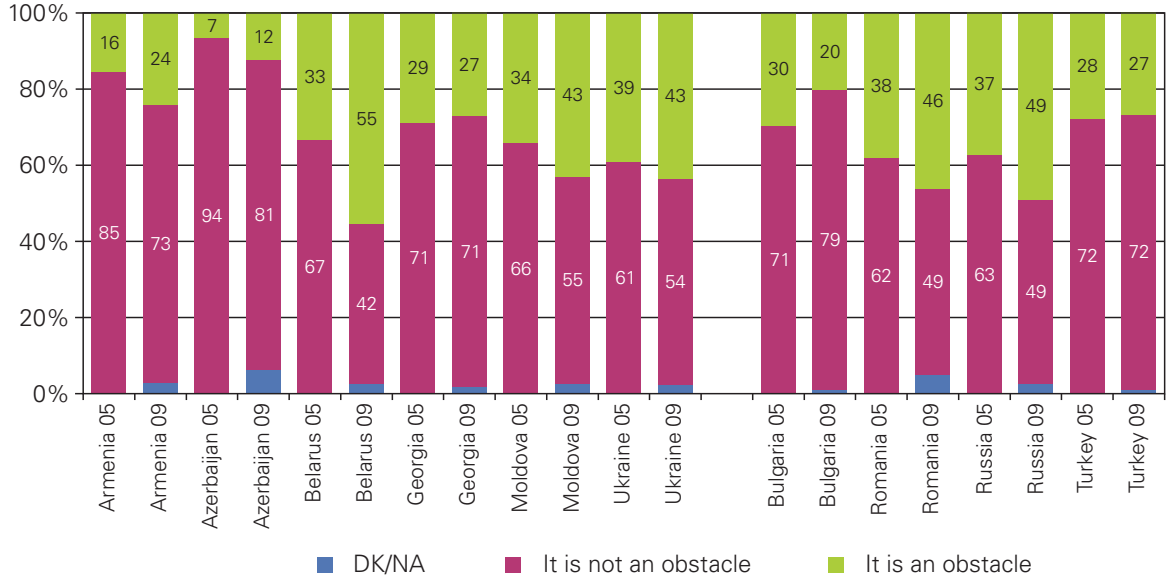
The EBRD–World Bank BEEPSs provide other evidence on the existence of skill mismatch in the labour markets of the Eastern partners. Despite high levels of unemployment in the Eastern partner countries, the results of these surveys show that 55% of Belarusian and 43% of Ukrainian and Moldovan enterprises consider the skills shortage to present a problem for the performance and development of their enterprise. The percentages are lower for Armenia (24%), Azerbaijan (12%) and Georgia (27%), but are still significant. Moreover, a comparison of the results of the 2005 and 2009 surveys demonstrate an upward trend of enterprises in search of skills in all of the Eastern partner countries except Georgia (**FIGURE 7.1**).

A more detailed analysis of the skill mismatch in Ukraine by the World Bank (2009f) demonstrates that there is a strong shift in the demand for labour from the unskilled manual (25% of newly created jobs) and non-manual (20% of newly created jobs) sectors to skilled manual labour (50% of newly created jobs are for craft workers and machine operators). The structure of labour demand combined with the skill structure among unemployed people creates an excess supply of manual and non-manual lower skills and an excess demand for higher skills, both manual and non-manual (World Bank, 2009f, p. 39). Belarus also reports a shortage of blue-collar workers (European Commission, 2009a), with an unfulfilled demand measured in terms of vacancies for such workers.

7.2 ACCESS TO EDUCATION AND TRAINING

Despite the economic hardship for both governments and households during transition, the Eastern partners managed to maintain relatively high levels of participation in free and compulsory basic education in comparison with other countries with similar GDP per capita. However, Belarus, Moldova, and in recent years Ukraine, lag behind the EU average. Besides, some negative

FIGURE 7.1 ENTERPRISES DECLARING WORKERS' SKILLS AND EDUCATION TO BE AN OBSTACLE TO THEIR DEVELOPMENT (%)



Source: BEEPS–ERBD: www.enterprisesurveys.org/ or www.ebrd.com/pages/research/analysis/surveys/beeps.shtml

107 For an explanation of the terms 'primary' and 'secondary' VET see p. 193.

trends can be noted in countries such as Moldova as participation rates in primary education have been declining in terms of GERs since at least 2000 (**TABLE 7.4**). These developments may reflect unequal access to education among vulnerable children, mainly in rural areas.

Post-compulsory education at upper secondary level suffered more heavily during the initial stage of the transition process, but since 2000 participation in this level of education has followed an upward trend in Belarus, Georgia and Moldova (**TABLE 7.5**). In Armenia and Azerbaijan the situation is stable, while there has been a decrease in Ukraine. Overall participation in upper secondary education (as measured by GERs) is lower than in the EU-25 in all of the Eastern partner countries, but it is still higher here than in Turkey and in some other comparator countries.

Female participation rates have generally been higher than those of males in Armenia, Belarus and Moldova, while in the other countries they are below those of young boys (see **TABLE 7.6**).

There has been a relative reduction in participation in VET since the beginning of transition in all Eastern partner countries, and today VET accounts for less than one-quarter to one-third of total enrolment in secondary and post-secondary non-tertiary education (**TABLE 7.7**). These negative developments in VET participation were the natural outcome of a VET system that had become less relevant to the changing economic basis of the countries during the transition process. All the Eastern partners report a reduction in the number of schools providing VET, and a slow pace of updating the qualifications offered by VET institutions and their content. The greatest decline occurred in primary (or initial) VET, which had never been viewed as particularly attractive because it was traditionally open to low achievers. It traditionally prepared young people for repetitive manual jobs in large enterprises, and with the closure or downsizing of those enterprises it lost its credibility altogether. Governments chose to reduce the role of this type of education through school closures and mergers rather than to transform it to cater effectively for the needs of transition. Secondary VET has also experienced a fall in participation, but to a much lesser degree, as this remained the only alternative for those who either did not have the means or desire to pursue their studies into higher education, or used this as an alternative pathway to higher levels of education. These trends created a vacuum in education provision in which there was a lack of sufficient training opportunities in medium-level skills.

However, VET participation has been gradually increasing since the start of the 2000s in Moldova and Ukraine, and to a lesser extend in Armenia, while it continues to fall in Belarus and Georgia (Table 7.7). In all cases participation in VET remains lower than in other transition economies such as Bulgaria, Romania, Russia, the Central European countries (such as Czech Republic and Hungary) and the EU average.

TABLE 7.4 GROSS ENROLMENT RATE IN PRIMARY EDUCATION – TOTAL, 2000–08 (%)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	99	102	96	96	97	97	100	108	105
Azerbaijan (1)	99	101	102	102	106	111	114	116	116
Belarus	112	111	108	98	96	95	96	97	99
Georgia	97	95	93	94	97	97	100	105	107
Moldova (1)	101	101	101	101	101	98	97	94	94
Ukraine	109	115	121	96	96	108	102	100	98
Bulgaria	106	106	104	105	104	102	100	101	101
Romania	103	100	99	100	105	105	105	105	100
Russia	106	106	112	117	NA	94	97	97	97
Turkey	98	99	99	96	96	96	97	98	99
EU-25 (2)	104	103	103	103	102	102	102	102	NA

Source: UIS.
Note: 1. national estimates; 2. Eurostat.

TABLE 7.5 GROSS ENROLMENT RATE IN UPPER SECONDARY EDUCATION – TOTAL, 2000–08 (%)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	81	79	70	74	76	75	81	83	75
Azerbaijan(1)	70	63	58	76	76	71	68	71	116
Belarus	66	62	63	62	68	70	71	72	72
Georgia	64	64	63	63	63	65	73	89	90
Moldova (1)	58	60	65	69	76	79	82	84	83
Ukraine	100	101	102	105	94	94	94	93	91
Bulgaria	100	103	106	85	89	90	90	91	90
Romania	69	72	74	76	76	77	77	79	84
Russia	NA	NA	NA	99	96	93	90	87	84
Turkey	56	69	78	83	76	69	74	76	72
EU-25 (2)	104	105	106	107	104	104	104	104	NA

Source: UIS.
Note: 1. national estimates; 2. Eurostat.

TABLE 7.6 GROSS ENROLMENT RATE IN UPPER SECONDARY EDUCATION – FEMALE, 2000–08 (%)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	NA	88 (1)	79	79	79	79	85	88	80
Azerbaijan (1)	69	60	56	73	74	70	66	68	NA
Belarus	73	69	70	69	74	76	77	79	NA
Georgia	61	62	63	62	63	64	73 (1)	87 (1)	88
Moldova (1)	61	62	68	73	81	85	87	90	88
Ukraine	101	99 (1)	103	105	92 (1)	92 (1)	91 (1)	92 (1)	88 (1)
Bulgaria	102	105	108	86	89	89	89	90	89
Romania	70	73	76	78	78	78	78	79	83
Russia	NA	NA	NA	98	94	91	88	84	80
Turkey	44	53	59	63	61	60	65	67	66
EU-25 (2)	104	105	106	107	104	104	104	103	NA

Source: UIS.
Note: 1. national estimates; 2. Eurostat.

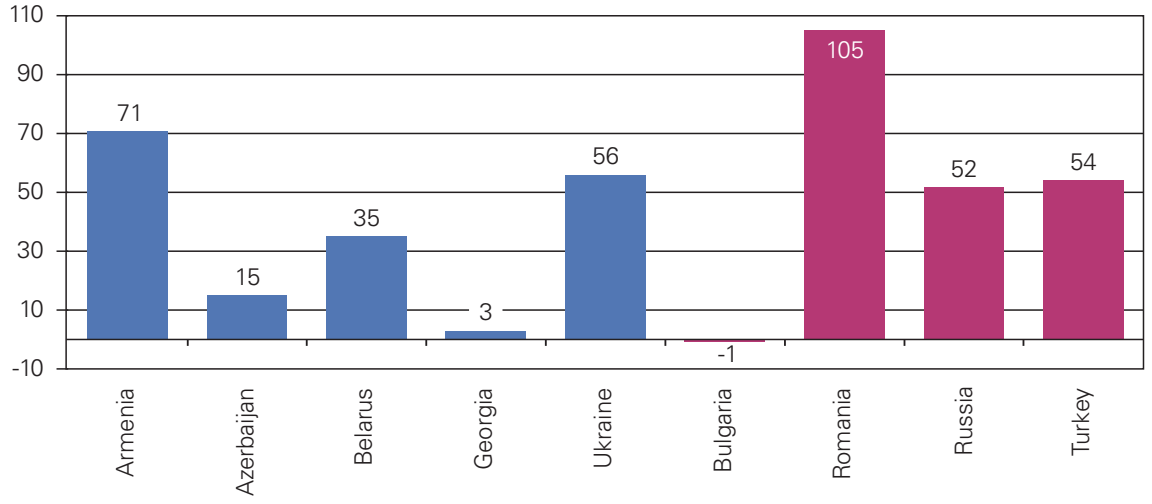
TABLE 7.7 ENROLMENT IN PRIMARY AND SECONDARY VET AT ISCED 3–4 LEVELS, 2000–08 (% TOTAL ENROLMENT IN ISCED 3–4)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	22	21	23	24	26	25	24	25	NA
Azerbaijan (1)	20	NA	NA	17	17	18	18	17	18
Belarus	40	41	40	40	37	35	35	36	NA
Georgia (2)	37	36	33	30	28	27	24	22	6 (2)
Moldova	28	26	24	22	27	30	33	33	36
Ukraine	31	30	30	29	32	33	34	34	35
Bulgaria	57	56	56	55	56	55	54	53	52
Romania	66	67	67	66	67	67	66	66	66
Russia	NA	NA	NA	43	44	45	47	48	49
Turkey	49	40	39	38	44	38	38	39	40
EU-27	NA	NA	NA	NA	NA	NA	NA	NA	50

Source: ETF calculations based on UIS; Azerbaijan: ETF estimates on the basis of data of the State Statistical Committee of the Republic of Azerbaijan; EU-27: Eurostat.
Note: 1. Includes participation in grades 10–12 of general education, vocational schools, vocational lyceums and secondary professional education in colleges; if secondary professional colleges were excluded the percentage would be 6% in 2008; 2. The large difference between 2007 and 2008 in Georgia is due to a reclassification of participation of higher professional education from ISCED level 4 to ISCED level 5B.

The Eastern partners entered the new millennium with a deficit in participation in tertiary education in comparison with other European countries, but the rates and the current number of students have been steadily increasing since then (**TABLE 7.8** and **FIGURE 7.2**). Azerbaijan and Georgia (since 2005) are exceptions to the pattern, with continued limited provision at tertiary level. In Azerbaijan the number of places available at universities is insufficient to cover demand, and access to higher education is channelled through a highly competitive procedure with demanding entry examinations. In 2006 the number of people who applied to the universities was almost three times the number of available places. In Georgia a process for the accreditation of higher education institutions was initiated in 2004, following a period of substantial increased enrolment in higher education that had threatened the quality of provision. This had an immediate impact on enrolment, which fell dramatically (Table 7.8). Despite the increased participation in tertiary education, only Belarus and Ukraine have GERs that match the levels of Bulgaria, Romania, other EU countries and Russia.

FIGURE 7.2 CHANGE IN ENROLMENT IN TERTIARY EDUCATION, 2000–07 (%)



Source: Calculations based on UIS.

THE STRUCTURE OF VET IN THE EASTERN PARTNER COUNTRIES

Provision of VET at secondary level has changed in recent years but it has generally followed the legacy of the USSR. The Eastern partners structure their vocational education into two levels:

- primary (or preliminary) VET, also known as 'vocational education' (at ISCED 3 upper secondary level), which delivers either a vocational qualification traditionally provided through attendance at a professional technical school (PTU), or a vocational qualification and a secondary general education certificate traditionally provided in a professional secondary school (Lyceum);
- secondary (or middle specialised) VET, also known as 'specialised vocational education' (mostly at ISCED 4 post-secondary non-tertiary level), traditionally provided in professional colleges and technical secondary schools (Technicums).

Armenia

Preliminary professional or craft training (primary VET), 1–3 years after basic education or high school in vocational schools (first merged with others, then abolished, then offered as a low level in middle professional schools before being re-established in 2005).

Middle professional VET, 2–5 years after basic education or high school in college or middle professional school.

Azerbaijan

Vocational education provided in vocational schools lasting for 1–2 years after basic education.

Vocational education provided in vocational lyceums lasting for 3 years after basic education and providing access to higher education national examinations.

Secondary professional education in colleges lasting for 4 years after basic education, or 3 years after the end of general secondary education.

Belarus

Vocational training, 1–3 years after basic or secondary general education provided in vocational schools.

Secondary specialised education, 1.5–4 years after basic or secondary general education provided in specialised schools, colleges, supreme professional schools, professional colleges, supreme colleges.

Georgia

Initial VET (apprenticeship), 2 years after compulsory education for those who do not continue to secondary general education, provided in vocational training centres.

Higher VET, higher professional education provided in licensed higher education institutions.

Introduction of vocational training courses in secondary vocational education.

Moldova

Secondary VET, provided after 9 years of compulsory schooling or after the end of secondary general education in polyvalent and trade schools in programmes of 1–3 years' duration.

Secondary professional education after the end of secondary general education in colleges, of a 2–4 year duration in colleges.

Ukraine

The first level of vocational education (offering preparation for simple technological operations) and the second level of vocational education (offering preparation for medium-complexity technological operations) start at the age of 15 and aim to train skilled workers. Courses are offered in vocational schools and also provide a certificate of completion of secondary general education.

The third level of vocational education produces high-level skills for technologically sophisticated, knowledge-intensive occupations, and trains specialist junior professionals. Courses are provided in technical schools and colleges, which are considered higher education institutions.

TABLE 7.8 GROSS ENROLMENT RATE IN TERTIARY EDUCATION, 2000–08 (%)

TOTAL	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	24	25	26	25	26	28	32	34	NA
Azerbaijan	16	16	16	15	15	15	15	15	16
Belarus	53	56	58	60	62	64	66	69	73
Georgia	38	39	41	42	41	46	38	37	34
Moldova	NA	NA	NA	NA	NA	NA	NA	NA	40
Ukraine	49	52	57	61	65	69	73	76	79
Bulgaria	44	43	40	41	41	44	46	50	50
Romania	24	28	32	36	40	45	52	58	58
Russia	NA	NA	NA	65	69	71	72	75	75
Turkey	23	23	24	28	29	31	35	36	37
FEMALE	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Armenia	25	26	28	26	29	31	34	37	NA
Azerbaijan	13	14	14	14	14	14	15	14	14
Belarus	61	64	67	70	72	74	76	80	86
Georgia	37	38	41	41	42	47	41	39	37
Moldova	37	36	37	38	39	43	46	48	47
Ukraine	52	57	62	67	71	76	81	85	88
Bulgaria	52	49	44	44	44	47	50	55	55
Romania	25	31	35	40	45	50	59	67	67
Russia	NA	NA	NA	75	80	82	83	86	86
Turkey	19	19	20	24	24	26	30	31	32

Source: UIS.

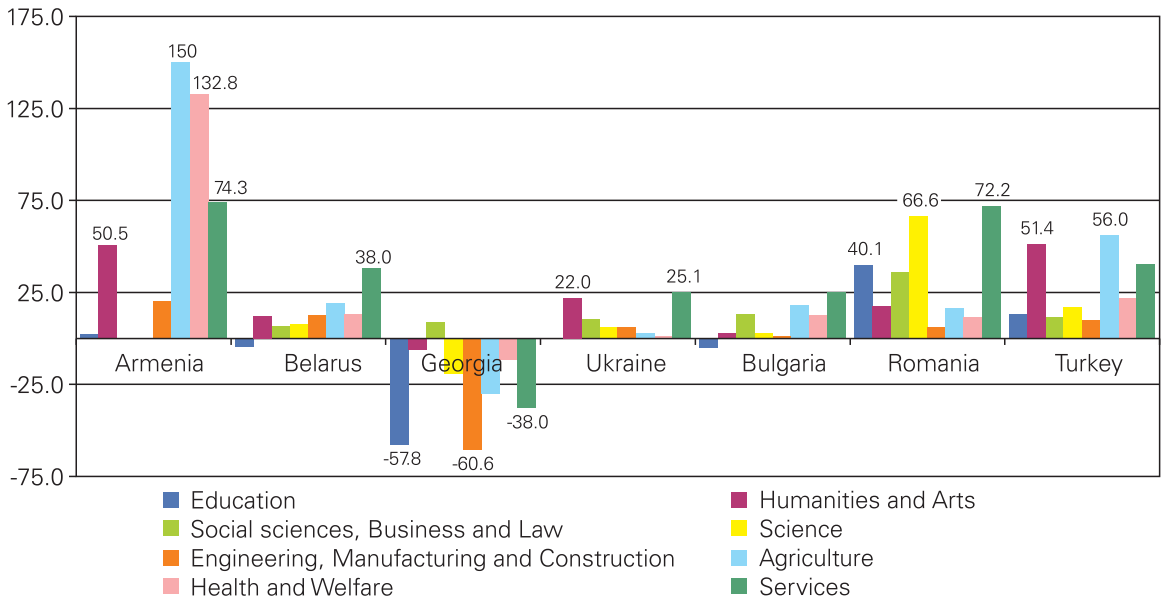
The increase in participation in tertiary education was mainly due to increased female participation, which exceeded that of males in all countries. Much of the increase in participation was funded by households rather than governments, as there was a rise in private higher education and fee-paying public education in a number of countries. More than 20% of enrolment in tertiary education in Armenia was in private institutions (World Bank, 2008a), while the level reached 21% in Georgia in the 2007–08 academic year (ETF, 2010d). In Belarus 15% of participants in higher education are in private institutions and around 55% are in fee-paying public education (European Commission, 2009a). In Moldova more than 75% of students pay fees in the many public or few private institutions. In Azerbaijan and Ukraine, private higher education remains marginal, as state provision has absorbed the increasing demand.

The vast majority of enrolment is in academic higher education (ISCED level 5A); enrolment in practical-oriented higher education (ISCED level 5B) in 2008 stood at 19.7% in Azerbaijan 27.0% in Belarus, 15.5% in Georgia, 12.0% in Moldova, and 15.5% in Ukraine in 2008, and has been decreasing since the early 2000s (UIS database).

Increased enrolment in different fields of study has varied across countries, but it is worth noting that science, engineering, manufacturing and construction experienced the lowest increases, or even decreases, in comparison with other fields of study (**FIGURE 7.3**)[108]. This may be linked to the development of private tertiary education, which normally focuses on the 'soft' fields that require a lower level of investment, or to the feminisation of tertiary education, as girls tend to opt for the softer fields.

108 It is interesting to note that these are the qualifications most in demand in the EU, and they take a prominent role in the EU Agenda on New Skills for New Jobs.

FIGURE 7.3 CHANGE IN ENROLMENT IN TERTIARY EDUCATION BY FIELD OF STUDY, 2000–07 (%)



Source: Calculations based on UIS.

7.2.1 SKILL POLARISATION AMONG YOUNG PEOPLE

Despite positive developments in participation in secondary and higher education, there is a growing polarisation in the skills held by young people in most of the countries. One aspect of this is the relatively low participation rates in basic education compared with EU standards, and the fact that these are decreasing in some countries. This observation implies that one section of the younger population (generally those from low socioeconomic backgrounds) is being left unskilled and poorly educated. This deprives countries of precious human resources and increases the risk of marginalisation for a section of the population.

Another aspect is that low levels of participation in VET mean that only a small proportion of secondary education graduates have the skills they need to compete in the labour market. For example, in Georgia in 2007–08, 40% of those who completed secondary education went on to study in higher education, and 8% entered secondary VET. The remaining school leavers (52%) were presented with no opportunities for developing skills for employment (ETF, 2007a).

The problems facing young graduates from general secondary education are documented by transition surveys from school to work in some countries. In Azerbaijan the State Statistical Committee survey of 15–29-year-olds in 2005 showed that the majority of unemployed young people (57.1%) were graduates of general secondary education, the next highest group being those with only basic education, and higher education graduates came last with only 10.0% unemployment (ETF, 2010b; Matsumoto & Elder, 2010). In Ukraine, which has retained substantially higher levels of participation in vocational education at secondary level than the other Eastern partners, the results of the ETF 2007 survey on transition from school to work showed the most problematic category of school leavers to be those with secondary general education (ETF, 2008b). Although this can partly be explained by the fact that many individuals will be waiting for a year before retrying for university, there are also many such graduates with limited labour market-related training who wait for more than two years to find a worthwhile job.

Meanwhile, reduced investment in the development of a VET system creates a gap in new middle-level skills for the economy among the younger age groups, as young people are entering the labour market either with no skills or with the higher skills of tertiary education. It is worth noting that the advanced transition economies of Central Europe all have increased higher-skill levels among the younger cohorts while maintaining relatively high levels of VET enrolment, indicating that they have neither neglected nor underestimated the importance of medium-level skills.

7.2.2 QUALITY IN EDUCATION – A CHALLENGE

The reduction of public funding for education has had a great impact on the quality of education offered at all levels of the education system. At the basic education level the international Trends in International Mathematics and Science Study (TIMSS), which measures student achievement in mathematics and science, shows that

Moldovan and Armenian children in grade 4 score close to the international average in mathematics, but lag behind children in Russia and other FSU countries (Kazakhstan, Latvia and Lithuania) (**TABLE 7.9**). However, by grade 8 there is a deterioration of achievement when compared with the international average, which demonstrates deficits in the quality of the education process[109]. Standard deviations below the international benchmark of 100 demonstrate that the Eastern partners ensure a more equal distribution of learning achievement across the student population, although generally not to the same extent as Russia and other CIS and central European countries.

An analysis of the results of the Progress in International Reading Literacy Study (PIRLS) of student achievement in literacy in Georgia and Moldova (**TABLE 7.10**) demonstrates that children in those countries lag behind their peers in Russia and the Baltic countries, but do better than children in Romania.

Azerbaijan is the only country which participated in the OECD Programme for International Student Assessment (PISA), in 2006 and 2009; it performed poorly, ranking 64th out of 65 participating countries in 2009.

At secondary level the quality problems are mainly, though not exclusively, confined to VET, where there has been only marginal improvement of curricula in response to new socioeconomic needs. The curricula and qualifications provided by the current VET systems are recognised as obsolete in the countries themselves in all analyses of the VET strategies developed during the 2000s. Links between the education sector and companies within the economy were destroyed during transition and have never really been re-established, presenting an obstacle to quality improvement and the relevance of vocational education. However, there is widespread growing recognition of the need to move faster on improving the quality of VET at secondary level.

At tertiary level, quality problems are linked to underfunding that leaves institutions unable to deal with the rapid increases in enrolment and slows the modernisation of education programmes and fields of study. There has been a significant increase in the ratio of students to teachers in state universities in almost all of the Eastern partner countries. It is reported that there is widespread corruption in the form of gifts and bribes for preferential treatment at this level of education. This is viewed as a parameter of low quality that shifts the

TABLE 7.9 TIMSS – AVERAGE SCORES IN MATHEMATICS AND SCIENCE, 2007

Countries	Mathematics				Science			
	Grade 4		Grade 8		Grade 4		Grade 8	
	Average score	Standard deviation	Average score	Standard deviation	Average score	Standard deviation	Average score	Standard deviation
Armenia	500	90	499	85	484	119	488	101
Georgia	438	88	410	96	418	85	421	83
Moldova	504	87	460	81	496	85	472	74
Ukraine	469	84	462	89	474	83	485	84
TIMSS scale average	**500**	**100**	**500**	**100**	**500**	**100**	**500**	**100**
Bulgaria	NA	NA	464	102	NA	NA	470	103
Czech Republic	486	71	504	74	515	76	539	71
Hungary	510	91	517	85	536	85	539	77
Kazakhstan	549	84	NA	NA	533	74	NA	NA
Latvia	537	72	NA	NA	542	67	NA	NA
Lithuania	530	76	506	80	514	65	519	78
Romania	NA	NA	461	100	NA	NA	462	88
Russia	544	83	512	83	546	81	530	78
Turkey	NA	NA	432	109	NA	NA	454	92

Source: TIMSS: http://timss.bc.edu/

109 Every 40 points in the TIMSS scores corresponds to a year of study and this can be used to assess the degree of divergence from the international average. For example, the average score in mathematics at grade 8 of 462 in Ukraine means that students are experiencing a delay in the learning process that can be quantified at around 11 months of study.

TABLE 7.10 PIRLS READING ACHIEVEMENT (GRADE 4), 2006

Countries	Average score	Standard deviation
Georgia	471	75
Moldova	500	69
PIRLS scale average	**500**	**100**
Latvia	541	63
Lithuania	537	57
Romania	489	91
Russia	565	69

Source: PIRLS: http://timss.bc.edu/

focus of attention from the educational process and student achievement to personal gain. Private higher education institutions also seem to operate at low levels of quality (Ukraine, Georgia and Moldova), as poor infrastructure and low salaries prevent them from attracting the best professionals. All of the EU Eastern partners (except Belarus) have subscribed to the Bologna process, which has been a major driver of quality enhancement in tertiary education through the establishment of accreditation procedures and mechanisms. However, the outcomes of the process are yet to be seen.

Low teachers' salaries are often cited as a reason for low quality levels in education, preventing the system from attracting and retaining good professionals and reducing teacher motivation to deliver a better education. Moreover, low teachers' salaries are also an indication of the low status of education within societies, which is itself partly an outcome of the low quality of provision. Evidence from the ETF Country Reports demonstrates that the average wage in the education sector in Azerbaijan is around 40% of the national average wage, while in Moldova it is 25% and in Ukraine 78% (or 70% of the average wage in industry). In Armenia, teachers' salaries are lower than teachers' pensions (World Bank, 2008a), and although starting salaries for teachers have been increasing, the average teachers' salary remains extremely low. Low teachers' salaries seem to be less of a problem in Belarus.

Student-to-teacher ratios are not reported to present any problems that would impede educational process. In fact, student-to-teacher ratios at secondary level are lower than the EU or OECD average (Appendix 7.2), and are set to become even lower given the negative demographic trends in these countries.

Other problems linked to the quality of education relate to school infrastructure, particularly in rural areas where countries with small education budgets are unable to adequately repair and maintain school buildings. The situation seems to be particularly serious in Georgia where, according to the World Bank poverty assessment report (2009b), more than 50% of schools are in need of repair. The slow pace of modernisation in the curriculum and teaching and learning materials are also issues of concern.

7.2.3 ADULT ACCESS TO EDUCATION AND TRAINING

Economic restructuring increased the need for adult retraining in order to enhance, upgrade or modify skills and increase employability in the new economic context. Adult training can be provided by enterprises for their employees; ministries of labour for unemployed individuals as part of active labour market measures (generally in cooperation with the PES); and by private providers for individuals. Although no systematically collected data are available, anecdotal evidence suggests that adult training has taken place in all countries, though with reduced coverage and quality.

Enterprises in the Eastern partner countries have traditionally taken an active role in training employees, but the economic uncertainty of the transition period decreased their involvement. However, it seems that there has been revived interest from enterprises during recent years as economic restructuring has advanced. In Azerbaijan there was a 32% increase in employee participating in training within enterprises during the period 2003–08 (ETF, 2010b), while in Moldova employee training in enterprises has increased eightfold in recent years (ETF, 2009a) and private sector investment has doubled in the past 10 years (ETF, 2010g). In Ukraine the larger foreign companies have been actively creating training centres for employee education: 50 such centres have been established in recent years (ETF, 2011).

However, the percentage of enterprises providing training to their employees is still limited, as can be seen in the BEEPS data for the Eastern partners (**FIGURE 7.4**). This percentage remains lower than in other transition economies such as Poland and Russia. While the larger companies are providing employee training, SMEs are lagging behind, particularly in the traditional sectors of economic activity.

Training for unemployed people is provided in all Eastern partner countries except Georgia as part of their ALMPs. Different types of programmes are available for skill upgrading, retraining for new occupations and skill enhancement. Training is organised by the PESs and is provided in various types of institutions, including vocational schools, regional training centres, higher educational institutions, certified training centres linked to enterprises, NGOs and private providers, some of which are enterprises. Funds for ALMPs overall, and for training in particular, are still restricted and only a limited number of unemployed individuals have access to any training. There are also issues relating to the relevance and effectiveness of the training provided, given that subsequent labour market outcomes are not evaluated. Countries such as Belarus have tried to increase the labour market relevance of the training provided by asking for half of the places offered to be filled in accordance with enterprise requests for the trainees they need (European Commission, 2009a).

Private provision of adult training is mainly focused on computer literacy, foreign languages and management training. This form of private provision has limited coverage that is concentrated mainly in major cities and is only accessible to those who can afford to pay for it (Gartenschlaeger, 2009).

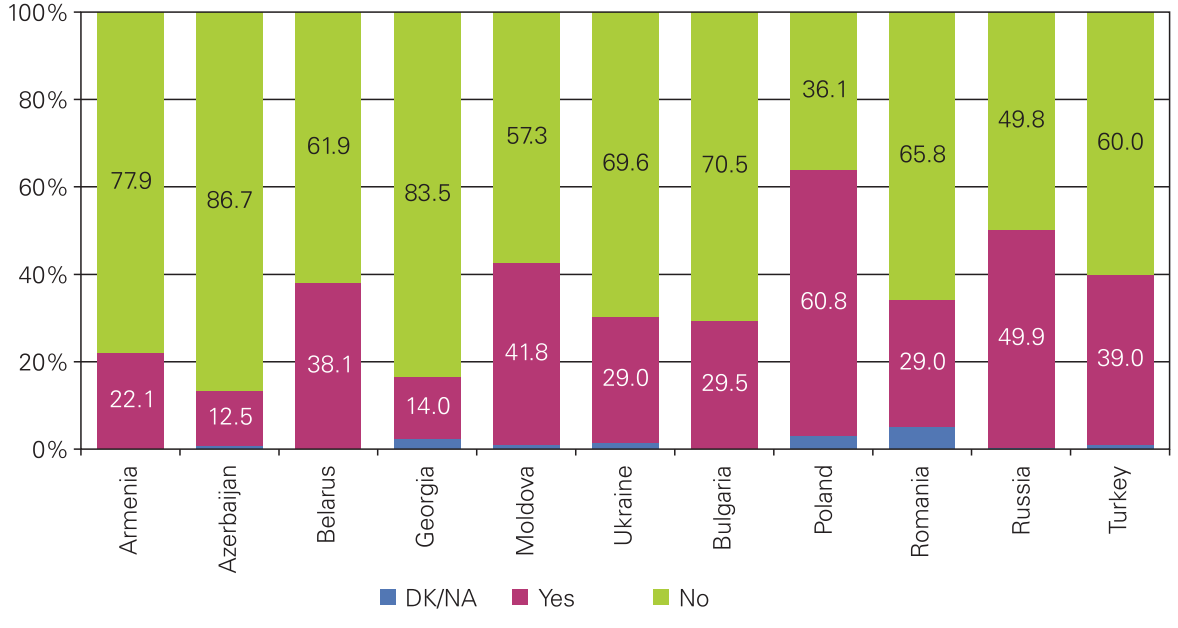
Overall, adult training provision is not yet well developed in the region, although efforts have been made to extend it with donor assistance. The German Adult Education Association (DVV International) established two multi-profile community centres for adult education in Georgia with EU funding and German assistance, and similar centres are planned for Armenia and Azerbaijan (Gartenschlaeger, 2009). In addition, Armenia and Georgia have started to build multi-purpose training centres to provide training for both young people and adults, with EU assistance. Finally, higher education institutions are providing training programmes for the adult population on a fee-paying basis.

7.3 POLICY RESPONSES AND INVESTMENT IN EDUCATION

Since the early 2000s, social and economic strategies have placed education and training high on the agenda of the Eastern partners as vehicles for poverty alleviation and social inclusion, and economic competitiveness and development. The education sector is a priority in both the Poverty Reduction Strategy Paper approved by the Government of Armenia in 2003 and the 2008 Sustainable Development Programme (with particular emphasis on activation measures). In Azerbaijan, both the Poverty Reduction Strategy (2003) and the Employment Strategy (2005) consider modernisation of the education system to be a priority, and education modernisation became a key priority for the Government of Georgia following the 2003 Rose Revolution.

In Moldova the importance of human resource development is highlighted in the National Development

FIGURE 7.4 TRAINING PROGRAMMES FOR PERMANENT FULL-TIME EMPLOYEES, 2007 (%)



Source: BEEPS–EBRD: www.enterprisesurveys.org/ or www.ebrd.com/pages/research/analysis/surveys/beeps.shtml.

Strategy 2008–11 as one of the five priorities for future socioeconomic development. At the same time, the Moldovan National Employment Strategy 2007–15 states as one of its objectives the enhancement of human capacity through training and retraining and the improvement of human mobility. The document Rethink Moldova: Priorities for Medium Term Development (Government of Moldova, 2010) includes human capital development as one of the few key medium-term priorities.

The main objectives of education policies have been access to education, the quality and efficiency of education, and the relevance of education to the emerging needs of both the labour market and learners. More recently, importance has been given to adult education and training and the promotion of education and training within a lifelong learning perspective.

These education policies have not yet led to any substantial modernisation of the education and training system in response to the new socioeconomic challenges. The review of education legislation and the development of policies to address emerging social and economic challenges began early in the transition process, but implementation has been fragmented and discontinuous or slow. This is due to political changes, reduced funding for modernisation or the poor capacity of institutions to proceed with reforms. The priority in most countries has been to maintain or enhance access to basic and general education while modernising curricula and funding mechanisms. Armenia made notable achievements with increased school autonomy and per capita funding mechanisms in secondary education (World Bank, 2008a), and new curricula were introduced for foreign languages and ICT in Belarus (ETF, 2010c).

All of the countries have piloted curriculum revision, teacher training and the introduction of new teaching and learning techniques through donor projects, though further work will be needed to improve the quality of basic and general education and to reduce disparities in the quality of schools between urban and rural areas. Progress has also been made in the subsector of higher education, driven mainly by participation in the Bologna process and efforts to integrate higher education systems into the European Higher Education Area.

7.3.1 INCREASED MOMENTUM IN VOCATIONAL EDUCATION AND TRAINING

VET was a neglected area in the early transition process and most countries focused on either maintaining previous programmes or rationalising VET school networks through closures and mergers in order to improve efficiency. However, since the mid 2000s VET has been gaining new momentum. All of the Eastern partner countries have started reviewing legislative and institutional frameworks for VET and are making efforts to modernise curricula and qualifications.

In 2003 Armenia endorsed the Strategy of Preliminary (Craftsmanship) and Middle Professional Education and Training, which led to a new VET Law in 2005. The VET Modernisation Priorities paper 2005–08 and the Revised Action Plan for VET modernisation 2008–10 provided for follow-up actions, and an important step was taken towards better system governance with the establishment of a tripartite VET National Council. This entity will drive reform of the VET system, and the National Centre for the Development of VET was established as an instrument to implement Council decisions from 2008. Moreover, in 2009 a memorandum of cooperation was signed among social partners, including the Ministry of Education, Union of Employers and Chamber of Commerce in an effort to improve educational standards, delivery and assessment in VET.

In 2007 Azerbaijan approved the State Programme on the Development of Vocational Education 2007–12, which aimed to modernise VET provision and move it closer to labour market needs. The modernisation of the VET system was reiterated in the new Framework Law on Education (2009). The Department for Vocational Education under the Ministry of Education established a Centre for the Development of VET and a Centre for Staff Retraining. A new Centre for Vocational Standards Development and a Centre for Assessment and Certification have also been established with World Bank assistance.

Belarus is expressing new interest in VET with a view to addressing the shortage of blue-collar workers. The priorities for VET modernisation are specified in the Programme for Secondary VET Development 2006–10, which includes issues of access and relevance in terms of VET content, and improvement of the institutional, material and human infrastructure (Borisova and Kuusela, 2009). Although no new laws or policy papers have been prepared for VET, vocational schools are expected to increase enrolment by 50%, and government funds for VET are increasing (European Commission, 2009a). At the same time, efforts have been made to update curricula in response to emerging labour market needs.

In Georgia reform of the VET sector started in the period 2005–07 with the adoption of a new legal basis and investment in the public VET infrastructure so as to increase the relevance of, access to and coherence of the VET system. A new VET Strategy 2009–12 has been developed for a more competitive labour force and approximation to the European Educational space. The three main objectives of the new strategy are:

i) increased access and support to professional development throughout life;
ii) quality and relevance;
iii) participatory governance, management and financing.

In Moldova the policy and legal framework of educational modernisation is based on the National Programme for the Modernisation of the Education System (2005–10), approved by the president and the government in 2005. Quality, relevance and efficiency of provision have been

the main considerations in the overall modernisation of the education system, including VET.

Ukraine has produced a series of documents on the modernisation of its VET system, including a Presidential decree of 2004 on additional measures for the improvement of vocational education in Ukraine, a Government decree (2007) on an Action Plan to meet the needs of the labour market in skilled workers, and another Government decree (2009) on management issues of public vocational-technical education institutions that are within the remit of the Ministry of Education and Science. The country has undertaken partial modernisation of curricula and has adopted a methodology for the generation of new educational standards. Employers are particularly active in enhancing the quality and relevance of VET through the development of a national qualifications framework (NQF). A new concept is being formulated for the development of VET in Ukraine up to 2020, addressing VET issues in the European and global context (ETF, 2010e).

The main objectives of these legislative and institutional steps have been to enhance the attractiveness of vocational education as a valid alternative pathway towards the labour market and to increase its relevance to the emerging skill needs of the economy. To that end, progress has been made with employer involvement in developing new occupational standards in all countries, with support from the EU, World Bank and bilateral assistance projects. All of the Eastern partners have also initiated discussions on the development of an NQF to ensure transparency, quality and relevance to labour market needs, and are looking to provide skill-upgrading opportunities for learners. Progress is at varying stages across the countries. In Armenia, Azerbaijan and Ukraine the conceptualisation of NQF has been completed and these countries are now in the design phase, while Belarus, Georgia and Moldova are still working on conceptualisation (ETF, 2010e).

Adult training is a recognised priority in all Eastern partner countries, but is still lacking the modernised policy frameworks and regulatory bases needed to create the enabling environments necessary for employers, training providers and individuals to participate in training. However, some efforts have been made in Armenia and Georgia to increase access to training through vocational schools in multifunctional training centres, and Moldova is also considering this possibility.

Overall, there has been intense activity in recent years in terms of rethinking and reshaping the VET system. However, many challenges still remain if these countries are to achieve high-quality, sufficient and flexible VET provision in terms of system governance; system financing; institutional capacities to implement reforms and new approaches in teaching and learning; and capacities for monitoring labour market developments and anticipating future skills requirements. Moldova and Belarus are hampered in relation to governance by highly centralised systems that prevent training providers from adapting to local needs, while Armenia, Georgia and Moldova will need massive amounts of funding to counteract years of system underfunding. Many countries are challenged by the shortcomings of their weak statistical systems, and social partnership is underdeveloped throughout the region, with the possible exceptions of Armenia and Ukraine.

7.3.2 PUBLIC INVESTMENT IN EDUCATION IN THE EASTERN PARTNERS

Public investment in education decreased substantially in Armenia, Azerbaijan, Georgia and Moldova during the period of economic growth in the 2000s (**TABLE 7.11**) and remained low by EU standards. Only Moldova managed to substantially increase the proportion of GDP spent on education and take it above the EU average during the later 2000s. However, given the small size of the Moldovan economy, this increase in investment in education is not sufficient to cater effectively for the younger age groups. Ukraine and Belarus were the only two countries who maintained their education budgets at EU-comparable levels, outperforming Bulgaria, Romania, Turkey and Russia.

General secondary education absorbs the largest proportion of public education spending. Expenditure on primary and secondary VET has been reduced in relative terms to a minimal level of funding that clearly demonstrates underinvestment in this type of education. Armenia increased the percentage of the education budget allocated to general education from 72.4% in 2001 to 79.7% in 2007, despite declining enrolments as a result of demographic change. The resources allocated to initial VET declined from 1.7% of the education budget to 0.8% in the mid 2000s, but increased again to 1.7% by 2007, while public funding for secondary or medium-level VET reduced from 3.8% in 2001 to 2.6% in 2007 (World Bank, 2008a).

According to data from the ETF Country Report (2010b), in 2009 Azerbaijan allocated 56.7% of public education funds to secondary general education, 4.7% to VET and 10.6% to higher education. In the same year, the proportion of GDP allocated to the public budget for education was increased to 3.1%. Belarus allocated 46.0% to general education, 6.7% to vocational training and 6.6% to specialised education in 2006 (ETF, 2010c). In Georgia in 2007, only 3.2% of the total education budget was allocated to VET, compared with 76.6% to general education (ETF, 2010d, p. 32).

Moreover, increasing enrolment in tertiary education has not been accompanied by an increase in the proportion of the total education expenditure allocated on tertiary education. In fact, evidence from countries for which data are available demonstrates a decrease in the relative availability of public funds for this level of education. The share allocated to tertiary education is far below the OECD average of 20% in Armenia, Azerbaijan and Georgia, while it is at comparable levels in Belarus, Moldova and Ukraine (**TABLE 7.12**).

TABLE 7.11 PUBLIC EXPENDITURE IN EDUCATION, 2000–08 (% GDP)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	2.8	2.5	2.1	2.1	2.5	2.7	2.7	3.0	NA
Azerbaijan	3.9	3.5	3.2	3.3	NA	2.3	2.0	1.7	1.9
Belarus	6.0	NA	NA	5.8	5.7	5.9	6.1	5.2	NA
Georgia	2.2	2.1	2.2	2.1	2.9	2.5	3.0	2.7	2.9
Moldova	4.5	4.8	5.5	5.4	6.8	7.2	7.5	8.3	8.2
Ukraine	4.2	4.7	5.4	5.6	5.3	6.1	6.2	5.3	NA
Bulgaria	NA	3.5	3.6	4.2	2.5	4.5	4.2	NA	NA
Romania	2.9	3.3	3.5	3.4	3.3	3.5	NA	NA	NA
Russia	2.9	3.1	3.8	3.7	3.5	3.8	3.9	NA	NA
Turkey	3.5	3.7	3.6	3.7	4.0	NA	NA	NA	NA
EU-27	4.68	4.99	5.1	5.14	5.06	5.04	5.05	NA	NA

Source: UIS.

TABLE 7.12 PUBLIC EXPENDITURE ON TERTIARY EDUCATION (% TOTAL EXPENDITURE ON EDUCATION)

Country and year	% of total education expenditure
Armenia* 2007	8.0–9.0
Azerbaijan 2009	10.6
Belarus 2007	20.0
Georgia 2008	11.6
Moldova 2008	18.6
Ukraine 2007	28.8
Bulgaria 2006	17.3
Romania 2005	23.3
Russia 2006	21.9
Turkey 2004	27.9
OECD 2007	20.0

Source: UIS.
*Note: *World Bank (2008a) (reported as data from the Ministry of Education).*

7.3.3 INCREASING PRIVATE FUNDS TO EDUCATION

Reduced education budgets in a number of Eastern partner countries (such as Armenia and Moldova) have obliged governments to discontinue the provision of free public education at post-compulsory level. Free places in post-secondary education are limited in number and are filled on a competitive basis. At the same time, governments have explored options for providing fee-paying places in public and private institutions in the education market. Consequently, the number of private institutions at secondary and post-secondary level and the number of fee-paying students in public and private institutions have been increasing in recent years. However, private education constitutes a small part of provision in Azerbaijan, Belarus and Ukraine, although the payment of fees in public institutions is common in all.

This implies that low levels of state investment in education have been counterbalanced by the private efforts of households to educate their children, which, in turn, shows that there is a high social demand for education in the Eastern partner countries. In Armenia, annual tuition fees for VET in 2006 ranged from USD 136 to USD 819, and for higher education from USD 519 to USD 2 185. This represents an especially heavy burden for lower-income families, given the low level of wages and GDP per capita in the country. In 2005 private expenditure on fees, books, transportation and private tutoring in education represented 1.9% of GDP, a figure substantially higher than the 2004 OECD average of 0.7% (World Bank, 2008a).

According to the ETF Country Reports, expenditure on education as a proportion of total cash consumption of households was roughly estimated at 4% in Georgia in 2007. In Moldova, a 2007 study by the Institute for Public Policy demonstrated that 17% of total household expenditure was spent on pre-university education, comprising formal payments for school fees, books and accommodation; informal payments for additional individual or group private tuition; and bribes. Even in Ukraine, where there is guaranteed public education for the population, out-of-pocket payments for higher education are estimated at 0.75% of GDP, while a conservative estimate for pre-university education payments gives a figure of around 0.7–0.8% of GDP (World Bank, 2009e).

Inequality in the education system has increased in line with the reliance on private funding for education, with lower socioeconomic groups unable to fund their children's education, particularly in rural areas. This situation is exacerbated by the practice of private tutoring and gifts or bribes for preferential treatment in all countries. Private tutoring is widely viewed as a strategy used by teachers to increase their income rather than a practice designed to fulfil a real need.

7.4 CONCLUDING REMARKS

The high level of human capital enjoyed by Eastern partners at the beginning of the transition process has deteriorated, despite noted improvements in the educational attainment levels of their populations. The reasons for this are linked to education systems that are unable to adapt quickly to the social and economic changes of transition and keep abreast of international developments; the lack of funding for education at a time of serious economic contraction; and the limited numbers of high-skilled job opportunities that could maintain and eventually enhance existing skills.

There is no evidence to show that the lack of human capital has impeded the countries in taking the path towards technologically advanced, knowledge-based and competitive economies. However, this represents a very real risk for the future if countries do not address the current problems in their education and training systems and ensure the provision of the skills needed by their enterprises. Although there is no specific monitoring of the demand for skills in any of the Eastern partner countries, there is some evidence that the lack of skills is becoming an important obstacle to the further development of businesses in all of them. Experience of advanced transition economies (Rutkowski, 2007) demonstrates that the lack of skills becomes more apparent as the economic restructuring advances.

Almost all countries still have universal coverage of basic education, but there are signs that a large and in some countries increasing proportion of young people is leaving the education system without a qualification relevant to the labour market.

This is particularly the case for two groups of young people. The first group consists of those young people who leave the education system early, i.e. during or at the end of basic education. Their numbers are relatively high in Moldova and Georgia and appear to be increasing in countries with high rates of participation in basic education, such as Ukraine. Given that early school leavers tend to come from low socioeconomic backgrounds, these young people are at high risk of entering a vicious circle of undereducation, reduced access to gainful employment, and poverty, that will only increase socioeconomic inequality. Rural areas in particular are still suffering from low-quality educational provision and reduced access to education and training.

The second group of young people who leave the education system without relevant qualifications for employment are general education graduates. Secondary general education has accounted for most of the enrolment in secondary education for a number of years. An increasing number of general education graduates are continuing into higher education (particularly in Belarus and Ukraine), but a large percentage of them are leaving the education system unprepared for the labour market. This is especially true in the Caucasus, where higher education opportunities are relatively limited.

The VET system has been under strong pressure during the transition period as a result of the closure or downsizing of the large enterprises that were traditionally the main receivers of its graduates. During the first 15 years of the transition process, governments did little to modernise this sector of the education system and make it more relevant to the emerging new labour market requirements. Curricula gradually became obsolete and the infrastructure deteriorated. A number of countries such as Armenia, Georgia and Moldova proceeded with the widespread closure of vocational schools. VET became unattractive and decreased substantially in most countries, except in Belarus and Ukraine, as the qualifications offered were not relevant to the labour market, and the number of training places was falling as a result of school closures. Participation in VET in all Eastern partner countries today remains lower than the EU average, and is lower than in the advanced transition economies of Central Europe, such as the Czech Republic and Hungary.

Higher education is the only remaining valid education pathway, and young people now follow this in ever-increasing numbers. The extent to which this is an efficient solution for both individuals and societies is debatable, as the level of investment is high on both sides. While the evidence shows that a higher education degree improves labour market outcomes and yields returns to those who find a job, there is no assurance that the skills developed in the education process will actually be applied in employment, given the substitution and crowding-out effects of higher-qualified over lower-qualified individuals. Neither does it protect the individual from labour market risks, given the high unemployment rates of higher education graduates in countries such as Armenia and Georgia. Moreover, public investment in higher education has remained low in relation to the increasing level of enrolment over recent years, and this has had a serious negative impact on quality. The limited amount of modernisation that has taken place in this sector has mainly been driven by the Bologna process.

In the medium and longer term, the lack of quality vocational education for medium-level skills that facilitate technological absorption may lead to bottlenecks in further economic development. The EBRD transition report (2008, p. 57) points out that investment in higher education and research is growth-enhancing for countries that are closer to the technological frontier, while investment in primary and secondary education is growth-enhancing for countries that are further from the technological frontier. The Eastern partners broadly fall into the second of these categories, though their distance from the frontier varies. This statement does not imply that investment in higher education is unnecessary, but rather that this investment should be better targeted to growth-enhancing fields of study and should strive for quality rather than for an increase in the numbers of students.

Finally, the ageing population in the countries of the region, the ongoing restructuring process and the reported deficiencies of the education and training system in terms of relevance to emerging economic skill requirements create an increased need for adult training opportunities. Efforts made so far in skill enhancement for the adult population remain limited and inadequate in terms of ensuring both access and quality. More systematic efforts are needed to support provision and to provide incentives for adult participation in training.

Policy documents in all the Eastern partner countries have recognised education and training as an important area for policy action since the beginning of transition, but while they are aware of its potential impact in reducing poverty and supporting economic development, the translation of policy intentions into specific actions has been sporadic and slow. More efforts need to be made to bring education and training closer to the emerging social and economic needs of the countries through a better understanding of the demand for skills and the adaptation of education and training provision to match this demand and increase the employability of all population groups.

Since the mid 2000s all of the Eastern partners have demonstrated a renewed interest in VET and have launched actions to modernise the sector from a lifelong learning perspective, tackling issues of system governance, qualifications frameworks and the subsequent content of education and training programmes. Efforts have been made to reinforce employer involvement in the design and delivery of education and training provision. In countries where economic activity is more vibrant, such as Ukraine, and Azerbaijan to some extent, many large and international enterprises have been proactive in providing training to compensate for the deficiencies of the education system. The process of developing qualification frameworks embarked upon by most Eastern partners offers more opportunities for stronger involvement on the part of social partners in VET, thus bringing skill demand and supply closer in a transparent manner. At the same time, efforts have been made to strengthen the capacity of professional institutions to modernise training delivery methodologies, mainly through donor projects, although the impact of these efforts at system level remains limited.

APPENDIX 7.1 CHANGE IN ENROLMENT IN TERTIARY EDUCATION BY FIELD OF STUDY, 2005–08 (%)

	2005-08	2005-07	2005-07	2005-07	2005-08	2005-07	2005-07
	Belarus	Bulgaria	Romania	Turkey	Ukraine	Armenia	Georgia
Education	-4.7	-5.2	40.1	13.2	0.2	2.6	-57.8
Humanities and arts	11.9	2.7	17.6	51.4	22.0	50.5	-5.9
Social sciences, business and law	6.5	13.2	36.1	11.6	10.7	-0.1	9.2
Science	7.9	3.0	66.6	16.8	6.0		-19.4
Engineering, manufacturing and construction	12.7	1.1	6.0	10.0	6.0	20.2	-60.6
Agriculture	19.2	18.2	16.4	56.0	2.9	150.0	-30.1
Health and welfare	13.3	12.9	11.3	21.9	1.2	132.8	-11.7
Services	38.0	25.2	72.2	40.2	25.1	74.3	-38.0

Source: Calculations based on UIS.

APPENDIX 7.2 PUPIL–TEACHER RATIO, 2004–08

Country		2004	2005	2006	2007	2008
Armenia	Primary	20.26	21.20	21.24	19.31	NA
	Secondary	7.91	8.65	8.31	7.77	7.42
Azerbaijan	Primary	14.27	13.45	12.51	11.63	11.30
	Secondary	8.54	8.39	8.14	7.82	NA
Belarus	Primary	15.44	16.04	16.02	15.97	15.16
	Secondary	9.24	8.93	8.53	8.10	NA
Georgia	Primary	14.50	NA	NA	NA	8.68
	Secondary	9.15	NA	NA	NA	7.46
Moldova	Primary	19.22	17.95	17.05	16.25	15.86
	Secondary	12.98	12.76	12.40	12.10	11.43
Ukraine	Primary	18.60	18.70	17.12	16.34	15.82
	Secondary	12.32	11.58	11.18	10.57	NA
Bulgaria	Primary	16.75	16.23	15.71	15.94	NA
	Secondary	12.23	11.98	11.74	11.55	NA
Romania	Primary	17.48	16.99	16.81	16.54	NA
	Secondary	13.67	12.93	12.84	12.70	NA
Russia	Primary	NA	16.75	17.15	17.12	NA
	Secondary	10.26	9.52	8.99	8.63	NA

Source: UIS.

CONCLUSIONS AND RECOMMENDATIONS

This document provides an overview of the factors that have shaped labour market trends and challenges and the employability of human capital in the six Eastern partner countries since the beginning of 2000. The objective was to improve labour market analysis and forecasting in these countries and to support them in reviewing their education and vocational training systems in the light of the new skills for new jobs perspective. Although this report has a regional focus, it also recognises that the individual Eastern partners vary widely in terms of their economic basis, their economic restructuring policies and the opportunities they have for future socioeconomic development. While Belarus and Ukraine have opted for a slow and gradual transition to a market economy and attempted to protect their industrial economic basis, Armenia, Georgia and Moldova have undertaken rapid deindustrialisation and profound transformation of their economies, and Azerbaijan has moved towards a reliance on income from natural resources, but has yet to diversify its economy.

Main economic developments

The Eastern partners started to recover rapidly after an initial decade of transition that was marked by steep decreases in economic output. From 2000 real GDP grew at well above 5% in the region until 2009, when GDP growth almost everywhere became negative again as a result of the global financial and economic crisis. The impact of the 2009 crisis was particularly strong in most of the Eastern partner countries (Armenia and Ukraine in particular, followed by Georgia and Moldova), with negative real GDP rates except in Azerbaijan (positive growth) and Belarus (zero growth). Prior to 2009, economic growth in Armenia, Azerbaijan and Belarus was above the CIS average, and these countries succeeded in recovering their 1989 GDP levels, while Georgia, Moldova and Ukraine have grown at below the average CIS rates. The former group have experienced less dramatic recessions during the transition process than the latter group, which lost up to two-thirds of their pre-independence GDP levels.

Several factors have contributed to the differences in economic performance. Firstly, the initial conditions were different in each country, despite their shared Soviet-style economic heritage. Secondly, the speed and intensity of the implementation of market reforms has not been the same in all nations. Moldova and Georgia made very modest progress in this respect during the first decade of transition, while Armenia and Azerbaijan caught up economically with Ukraine, which experienced a pattern of reform in which periods of acceleration were followed by deceleration. Belarus has remained an outsider in this context, as the country has been slow to adopt any structural reforms and there is still significant state control over the economy.

Thirdly, some countries saw the effects of initial recession amplified by disruptive political events (regional conflicts and civil wars in Armenia, Azerbaijan, Georgia and Moldova), and these absorbed an enormous amount of resources that could have been used for economic and social development. Fourthly, post-independence economic relations with Russia also affected growth patterns in the Eastern partner countries, and states such as Georgia and Moldova did not benefit from growth spill-over within the region owing to their tense relationship with Moscow. Belarus maintained a high level of dependence on the Russian economy, Ukraine saw its food-processing industry boom after a decade of decline as a result of increased Russian demand, and Armenia has also remained on very good economic terms with Moscow.

The main determinants of transitional growth also vary among the six countries. Growth in Azerbaijan has been driven primarily by the booming export-oriented oil and gas sector, while growth in Georgia and Armenia has been powered by increasing domestic demand largely financed by loans and transfers from abroad. In Belarus the growth recorded since 2000 has been largely driven by increased exports to Russian markets, while growth in Ukraine was boosted greatly by booming world prices for its main exports (iron, steel and minerals) and an increase in real household incomes that stimulated consumption. The services sector in all Eastern partner countries has contributed the most to economic recovery and GDP growth, while the contribution of agriculture has declined significantly. Industrial output fell victim to the abrupt opening up to international markets of all of the countries, but the sector also suffered through inherent reforms that brought price liberalisation, abolition of subsidies, privatisation and restructuring.

The high level of economic growth in recent years has been translated into a significant increase in the region's contribution to world trade. The Eastern partners have increasingly opened up their economies to foreign trade, and exports recorded particularly high growth until 2009. Imports have also increased, leading to an exceptionally high trade turnover in the region. Ukraine had the highest export performance, while Moldova lagged behind the rest of the group. Although trade among the six countries themselves is extremely limited, increased economic integration into the global context after 2000, together with the long-established regional links with the CIS, proved beneficial while the world economy performed well. One disadvantage was that integration proportionally increased the exposure of domestic economies to

external international shocks. Remittances have stimulated domestic consumption and have had an implicit impact on growth, but have also increased the external vulnerability of the economy.

The first signs of economic difficulties were already present by mid 2008, and certain sectors of the economy contracted significantly in 2009. The countries currently face great uncertainty regarding the growth prospects for coming years. The differences described above have contributed to quite divergent transitional paths within the group of Eastern partners. Each country has chosen a different path towards social and economic development, and each of the six partners is therefore at a different stage of economic transition.

Transitional reforms and social developments

The economic reforms that started in all countries with the mass privatisation of state-owned resources and land was in effect executed through egalitarian distribution to rural residents (except in Belarus). It is important to understand that transitional reforms such as privatisation and land distribution have had a profound impact on the structure of labour markets and employment conditions. The structural reforms in all six countries were biased towards economic liberalisation (foreign trade and prices), while achievements in other fields were rather modest (particularly in relation to institutional reform). Institutional and economic reforms are interlinked, and can induce high levels of synergy when optimally combined. This has rarely been the case in the Eastern partner countries, where political, administrative, legal, institutional and economic changes have not always been in harmony.

The governments placed a higher priority on macroeconomic stability policies than on measures to directly support the business sector; thus, the growth-conducive business environment necessary for job creation has still not been achieved. All countries currently possess the institutional, political and legislative framework appropriate to a market economy, but the effectiveness of this framework is still limited. Furthermore, the transition to a market economy has been weak in creating value-added products and jobs. Although educational choices have naturally evolved towards higher education, companies have remained at a low-value-added stage of production. This can be identified as an important possible cause of skill mismatch, and if this is the case it may imply the need for entrepreneurship education throughout the entire system, not merely for economics and business students.

The transition period had an important impact on social development in these countries, with an increase in poverty rates and more limited access to the social services that were traditionally provided by the state. Improved economic performance since 2000 translated into better living conditions for the population compared with those in the first decade of transition, but the reduction in poverty rates was accompanied by increasing inequalities in terms of employment opportunities and access to education; regional disparities in terms of development; large income differences between urban and rural areas; and a clear polarisation of societies. The uneven opportunities forced vulnerable groups within the population to seek alternative methods of survival in the informal sector, in subsistence agriculture or through emigration. The recent global economic crisis, which hit most of the Eastern partners with particular severity, exacerbated the vulnerability of these sections of population, as governments were not always able to establish social safety nets that were sufficiently strong to protect them.

Demographic developments

The Eastern partners face similar demographic problems to those of EU countries. An analysis of their key demographic trends indicates a challenge characterised by negative natural population growth as a result of low birth rates, ageing populations and emigration (except for Azerbaijan). Interestingly, the decrease in birth rates linked to economic and social changes was accompanied by increasing mortality rates, even during the economic recovery; this is a trend that is at variance with those in the EU. Forecasts indicate a worsening situation in the coming decades. The effects of the demographic decline are expected to have a serious impact on the fiscal sustainability of countries, as well as on the availability of the valuable human resources needed for sustainable economic development. Some argue that the negative demographic effects can be neutralised through the labour productivity increase that is certainly needed. However, the extent of informality in the labour markets presents a challenge in this respect. As informal workers do not contribute to social security and education systems, this inflates 'real' dependency rates (i.e. the number of beneficiaries as a percentage of the number of contributors) and reduces the amount of public resources available for financing healthcare, pensions, education and other public services.

The most effective measures that could be implemented to address the demographic challenges include:

- the promotion of healthier lifestyles (as high mortality rates are partly due to unhealthy habits such as alcohol abuse and overwork) and policies to counter infectious illnesses such as tuberculosis and HIV/AIDS;
- poverty reduction as a blanket approach, to improve health and therefore the demographic indicators;
- the provision of accessible and affordable healthcare for all;
- the provision of benefits for children coupled with supportive social policies.

However, the implementation of effective policies to increase birth rates is known to be difficult, and this type of benefit has been introduced in several EU countries and Ukraine in the past, to no avail. The Scandinavian countries could provide examples of good practice here, as their family policies are traditionally linked with supportive social policies that include more equal gender roles in family and childcare responsibilities, accessible

and affordable childcare, and the reconciliation of work and family life for both sexes.

Labour market trends and challenges

Labour markets in the Eastern partner countries have survived a turbulent transition, with periods of low economic activity, high unemployment or underemployment, and frequent changes in the employment status of individuals. These changes, however, have been essential to the economic transformation process in order to achieve increased productivity and better wages for employees. The share of working-age population is currently increasing, but is simultaneously undergoing a process of ageing and slight feminisation that is set to continue in the coming years.

The labour force participation rate has been increasing in Armenia and Azerbaijan throughout the entire period, and the participation rate started to increase modestly in Georgia and Ukraine following an initial decline up to 2000. In contrast, in Moldova it has declined dramatically, partly owing to the high number of labour emigrants classified as inactive in the country's statistics. Belarus, on the other hand, shows relatively stable and high participation rates as a result of government employment preservation policies. Female labour force participation is high in all countries and is comparable with the rate for males, although at a slightly lower level. Youth participation, on the other hand, is lower, which is partly explained by high enrolment rates in university education. However, while the participation rates in the Eastern partner countries initially appear relatively comparable with EU rates, the similarity is in fact superficial, as the figures are significantly distorted by the large contribution of rural self-employment and informal activities.

Employment rates in the region are generally low, especially in Armenia and Moldova; Azerbaijan comes closest to the EU-27 average, although the figures include very high levels of informal employment. Over the period 1995–2008 as a whole, only Armenia and Azerbaijan recorded a net increase in employment rates, while Moldova experienced the largest fall in employment and Georgia and Ukraine recorded a moderate reduction. Male employment rates are always higher than female employment rates. The evolution of unemployment is not necessarily balanced by developments in employment, and interestingly, both unemployment and employment rates show a declining trend. Armenia had the highest unemployment rate, followed by Georgia, while the rate in Belarus was lower than 1% (exclusively on the basis of PES registers). It seems that economic growth has contributed less to the reduction in unemployment than labour emigration in most countries. Low rates can also be explained by the fact that small landowners are listed as self-employed in the total employment rates.

An important characteristic of the employment structure by status is the low proportion of salaried jobs in most Eastern partner countries. In Georgia, for example, only one-third of those who are employed receive a wage, while the others are either self-employed (mostly on their own account) or work with their family. Azerbaijan and Armenia also have very high self-employment rates (more than half of total employment), while in Moldova this accounts for one-third of the total. Only Ukraine has figures on the proportion of wage employment that are comparable with the EU-27 average. This is mostly as a result of limited employment opportunities in wage employment, and survival strategies in which people have set up small, self-run, informal activities or have resorted to subsistence agriculture on small plots of land as households. The latter categories are recorded as 'working self-employed' in statistics.

The sectoral structure of employment also confirms the vulnerability of the employed population, as the share of total employment in agriculture is seen to be high: in Georgia, more than half of total employment, in Azerbaijan and Armenia close to half, and in Moldova one-third. Furthermore, the added value to GDP of agriculture is quite low in Georgia, Azerbaijan and Moldova, indicating low productivity and possible poverty. Meanwhile, industry is still an important employer in Belarus and Ukraine, while it ranks much lower in the other countries in the group. Belarus, Ukraine and Moldova recorded particularly high rates of employment in the services sector, while in Georgia this rate is low. The great majority of employed people in all countries have secondary education, and the proportion of people with only primary education or less is low. Meanwhile, the number of university graduates has increased immensely, but the somewhat paradoxical, skill mismatch is significant, particularly in Ukraine.

The labour markets are heterogeneous and heavily localised as a result of the varying speed of reforms across the region, unequal investment activities, geographical patterns of demand for goods and services, and other factors that have led to regional disparities. They are peppered with dualities in many respects: formal versus informal sectors, with most of self-employed belonging to the informal sector; and rural versus urban, with rural participation rates more favourable than urban ones, owing to high rates of involvement in subsistence agriculture. Serious disparities exist between regions, and between major cities and the hinterlands, with most employment opportunities concentrated in the large urban centres. These regional disparities persist because inter-regional labour mobility, including commuting, is restricted by deficiencies in the transport infrastructure, a shortage of accommodation and significant regional differences in property prices.

At sectoral level, the Eastern partners have maintained and even expanded labour-intensive activities with relatively low value added that do not require high levels of qualification. Employment restructuring has taken place mostly at inter-sectoral level, both across economic sectors and between public and private sectors. Moves across economic sectors can be distinguished in the shifts between agriculture and non-agriculture, and in reallocations within the non-agriculture sectors. Employment declined continuously in certain activities over the period of transition, with no subsequent recovery. The shift from the public to the private sector was much more significant during the first decade of

transition as a result of the mass privatisation of state enterprises and land. High levels of informality were fuelled by:

- the reduction in public employment, largely nurtured by privatisation and subsequent restructuring;
- land reform that resulted in self-employment-style activities;
- an overabundance of labour force availability on the market as a result of closures, allowing employers to exploit informal or semi-formal arrangements;
- erosion of incomes that forced many people to seek alternative opportunities for additional income;
- cost-cutting strategies by enterprises.

This has resulted in a significant proportion of the labour market operating in low-productivity and low-wage conditions.

The evolution of real wages experienced two major phases, an initial period of rapid decline as a result of output collapse, followed by a recovery period. All of the Eastern partners went through the first phase, but not all have completed the recovery. In some cases the average wage is still below its pre-independence level. The wage differential widened through transition, but this was partly balanced by the introduction of a minimum wage in some countries. Overall, economic liberalisation induced a process of wage deregulation (except in Belarus), leading to inequality in the distribution of earnings. Following an initial fall in GDP per employee, some recovery was seen from 1994–95 in some countries. Several years of growth brought a rapid increase in real wages after 2000 that outstripped the increase in productivity. This productivity improvement translated almost exclusively into better wages for insiders, as the enhancement of economic performance has not increased employment levels. All the countries therefore experienced a trend reversal in the evolution of productivity, and public wages have increased faster than wages in the private sector.

Within the context of highly vulnerable employment explained above, it is obvious that more and better jobs offering decent working conditions need to be created in all Eastern partner countries. However, the existing business environment is not always conducive to the creation of decent jobs, particularly for the growth of SMEs. Many institutional and legal impediments against businesses remain, including the high levels of formalities and procedures required in the process of operating a business and the length of time required to deal with these. When comparisons are drawn with international benchmarks, this situation can be seen to be the result of insufficient restructuring of government institutions, bureaucratic structures within those institutions, corruption and, in some cases, staff incompetence. Consequently, the dynamics of job destruction and creation processes have been weak in terms of achieving a more efficient reallocation and readjustment of labour. Thus, labour market restructuring has produced many losers. After two decades of reform it is important to ask why the transformations have not been less costly in social terms, and why the shortage of employment opportunities has persisted for so many years, forcing people either to emigrate or to risk living in poverty. There is no clear and universal answer to this dilemma, but it is clear that for the Eastern partners the process of transition has not yet led to the creation of enough decent jobs in their economies.

Labour market monitoring and data

The reliability and comparability of labour market data is crucial when analysing labour market trends and challenges. A well-functioning LMIS is an important institutional aspect of labour markets and is essential for developing evidence-based labour market policies. The six Eastern partners have all undergone a 'statistical transition', developing or improving key available statistical tools: censuses, LFS, HBS, establishment surveys and administrative registers. An assessment of existing data based on factors such as periodicity, national comparability over time and international comparability shows that most of the countries have been able to develop a fairly comprehensive set of labour-related statistical resources, in some cases comparable with EU standards (Moldova and Ukraine). Belarus is the exception, since it has no LFS as yet. Other countries in the group are at different stages of development. In Azerbaijan and Armenia, methodological problems persist, despite some positive developments, making the comparability of data across time highly problematic. They also have problems regarding access to the micro-data and the timely dissemination of results, as the LFS is completed and disseminated only on a yearly basis, while Georgia, Moldova and Ukraine conduct such surveys quarterly or even monthly.

Transparency and the timely dissemination of all results (including micro-datasets) are areas that offer room for improvement. Hard-copy publication remains the dominant form of dissemination, while websites are used in order to present a limited picture of survey outcomes. Access to datasets is generally restricted, reducing opportunities for the development of independent research capacities and skills. Meta-data is an underdeveloped field; it is very difficult to obtain accurate and up-to-date information on the methodologies and definitions used, and thus to assess the weaknesses and limitations of the statistics. Another area for improvement is the development of comparable methodologies and definitions for the informal economy, both at national and regional level. This is a crucial issue in the analysis of labour markets in the Eastern partner countries because of the large extent of informality. Furthermore, a cultural shift is needed within the public authorities, administrations and stakeholders, to make them fully aware of the essential role of reliable and transparent statistics for the good management of public affairs, as a catalyst for analysis and public debate, and to increase international credibility.

Employment policies

Employment support has been an important objective in all the Eastern partner countries, given the high levels of job destruction and subsequent high unemployment

experienced from the beginning of transition. Actions to support employment have been focused on the three main fields, labour market regulation, employment policies and improved labour market institutions.

There was a need for changes in labour market regulation in order to reduce the labour market rigidity that was inherited from the Soviet era and to facilitate labour turnover from less productive to more productive jobs. All of the Eastern partners have revised and developed their labour legislation, though the extent to which they have introduced greater labour market flexibility varies from country to country. For example, analysis of the labour codes in the six countries shows that Georgia has taken the most extreme line on flexibilisation, opting for a liberal labour market policy, followed by Armenia and Azerbaijan. Meanwhile, Belarus, Moldova and Ukraine have placed themselves at the other end of the spectrum, opting to protect employees in jobs, even when this has resulted in underemployment and rigidities in labour turnover. However, the effective application of legal provisions is not always respected in practice, even in countries where labour legislation is supposed to be quite flexible. This implies that further flexibilisation of labour market functioning occurs in practice beyond the legislation.

The second field covers the formulation of ambitious employment policies. However, these were not accompanied by specific action plans, or were not allocated adequate financial resources to achieve their objectives. All of the countries (except Georgia) have introduced passive and active measures to address the impact of unemployment. Most of the funding is dedicated to passive labour market measures, otherwise known as unemployment benefits. This option does not, however, imply income security for a large number of unemployed people, as there are strict eligibility criteria, and the level of the benefit is too low to really be considered a measure that provides income security during spells of unemployment.

The funding for ALMPs is too low to cover the employability needs of all unemployed individuals, though the menu of ALMPs is relatively rich in most of the Eastern partner countries, except in Georgia, where they do not exist. Job-creation measures are the most common measures, generally taking the form of employment in public works or the provision of subsidies to employers for the recruitment of specific population groups, and these absorb most of the budgets. However, employability measures such as training and job-search facilitation, including job clubs and job fairs, are also common. The problem is that the reach of such measures is quite limited owing to the restricted amount of funding available. No impact evaluation has been made on the effectiveness of ALMPs, but there is a view that the design and mix of measures do not always fit the nature of unemployment in the specific countries. Training measures that were follow up with evaluations in Moldova and Ukraine seem to have had good work placement outcomes. Overall though, the impact of employment policies on labour markets has been insignificant for the reasons mentioned.

The third field concerns the improvement of policy making and implementation in labour market institutions. The ministries of labour in all the countries are rather weak institutions within the overall cabinet, and their financial and human resources are limited. However, there are differences between the countries, with Ukraine leading in terms of capacities. Moreover, further efforts are needed to develop the involvement of social partners in policy formulation. Finally, the PESs, which exist in all countries except Georgia, undertake brokerage functions, matching jobs with job seekers and implementing labour market measures. PES offices outside the major cities are generally insufficiently equipped and understaffed, being hampered by bureaucracy, their passive attitude to promoting employment and their limited coverage of populations. The largest and best-equipped PES structure is in Ukraine, where there is a relatively lower caseload, and where a special internet portal provides services to help job seekers to find vacancies and employers to find staff. All the other countries have smaller PES structures except for Georgia, which has no PES in the traditional sense.

It is evident that all the Eastern partners must work on all three fields of action in order to achieve a better balance between labour market flexibility and security. Using the EU concept of flexicurity, policies must avoid labour market segmentation, provide a better allocation of human resources, and discourage expansion of the informal sector, while offering security in terms of employability and income. Flexibility must be combined with decent work and the type of social safety nets that do not appear to be functioning well at the moment.

Another gap in employment policies in the Eastern partner countries is the weak focus on job creation through the development of a business-friendly environment. Up until now, governments have been far more concerned with limiting job destruction than with helping to create new jobs. The development of a business-friendly environment would imply profound behavioural changes among administrations and policy makers, and a move towards service orientation and transparency. In the current globalised economy, it is essential to attract investors from both within the countries and abroad in order to guarantee success. Credibility and positive expectations form the pillars of this type of attractiveness to investors. In order to achieve credibility, countries must offer straightforward administrative procedures, avoid all corruption, and provide clear and stable state policy guidelines that enable investors to establish long-term strategies.

Overall, there is scope for improvement of employment policies through:

- achieving the appropriate balance between job-creation measures, including improvement of the business environment, and supply-side initiatives such as labour market measures;
- strengthening the institutional setting for policy development by enhancing the capacity of ministries of labour, ensuring greater involvement on the part of

social partners, and creating synergies and links with other policy areas for policy coherence;
- strengthening the role of the PESs in the implementation of labour market measures, and enhancing their capacity to identify jobs and match skills to jobs;
- developing the appropriate instruments for labour market monitoring and evaluation of the effectiveness of policy measures.

Labour emigration

Another important sign that the labour markets are dysfunctional can be seen in the substantial level of labour emigration, mainly to the CIS region (Russia being the major destination) and EU countries. This is an important phenomenon for the region, and has a profound impact on demography, domestic labour markets and human capital stocks and flows. According to the World Bank's Migration and Remittances Factbook, Ukraine has the highest total number of emigrants abroad of all the six countries. When the numbers are shown as a percentage of total population, however, the countries with the highest population losses are Armenia, Georgia and Moldova. Socioeconomic, ethnic and political factors played important roles in the first migratory flows from the 1990s to the 2000s (including refugees fleeing civil wars, trans-border conflicts, and diaspora returning to ethnic homelands). Early in 2000, these factors were replaced by economic ones as a result of the rapid deterioration of living standards, poverty, limited jobs and low wages in the poorly functioning labour markets, and the insufficient availability of capital.

Migrant outflows since the early 2000s have increasingly been directed towards the search for regular work. The typical characteristics of labour emigrants include relatively high formal educational levels (though quality remains an issue), a considerable proportion of females, diverse age groups, and employment abroad mainly in labour-intensive sectors with low skill requirements and low pay, such as construction, agriculture, hotels and catering and domestic services (house cleaning and home care). The temporary nature of many flows is another feature, and is mainly due to geographical proximity, easy travel connections and the visa-free entry to CIS countries that make temporary migration a feasible option. Gender and age seem to be linked to destination and sectors of work abroad. More middle-aged men emigrate to Russia, Germany and Portugal to work in construction, whereas younger women emigrate mainly to Italy, Spain, Greece, Cyprus and Turkey to perform domestic work in jobs such as cleaner and carer.

Emigration profoundly affects domestic labour markets in the sending countries through a variety of closely intertwined channels. Labour emigration occurs against a background of depopulation, a critical decline of fertility rates (except in Azerbaijan) and higher than average mortality rates amongst adult males. It accentuates the demographic imbalance while contributing significantly to the alleviation of increasing economic hardships, limited jobs and unemployment in the region. One obvious contribution can be seen in the increasing remittances that are particularly important in the Moldovan and Armenian economies. In some of the countries, such as Moldova and Ukraine, emigration is partially associated with brain drain and brain waste. Young people and those from the western regions prefer to migrate to central and Western Europe, whereas people aged 35+ and those from the eastern regions prefer to work in CIS countries. Although the skill levels of migrants are spread across all levels, the proportion of young (between the ages of 20 and 40) and well-educated emigrants of both sexes is considerable in most of the Eastern partners.

As a result of the increasing migration outflows, the governments of the Eastern partner countries recently participated in migration dialogue with some destination countries in the CIS and EU. This dialogue is fundamental for the coordination and harmonisation of migration management policies for the countries of the region. The EU's signing of a Mobility Partnership with Moldova in 2008 marked an important initial step in this cooperation process. This move was followed by a further agreement with Georgia in 2009, with another being planned for Armenia in the near future. Although it is too early to make any evaluation, this process offers a potential basis for comprehensive migration management dialogue between the Eastern partners and EU countries. The mobility partnership deals explicitly with labour mobility and return migration within the notion of circularity, but also brings together various diverse areas of cooperation under migration management. Within this context, the process of skills matching between migrant workers and jobs abroad is key to efficient labour mobility.

Whether it is viewed as curse or a blessing, migration is a reality in the region. Given the sheer size of outflows, better management of labour migration is a valuable policy option that will provide mutual benefits for the Eastern partners and destination countries. Many studies already exist indicating the continual need for migrant labour within the EU. A 'win–win–win' situation may be possible for all stakeholders involved in the migration process if a virtuous circle is created for the benefit of all through better management of labour migration and its skills-matching dimension. In this context, comprehensive cooperation mechanisms are crucial both for reducing the exploitation and skills waste of migrants and for providing better skills matching for migrant workers in destination countries. The Eastern partners also need to work better to proactively encourage the return of expatriates to become entrepreneurs, and to create conducive environments for the more productive use of their skills, knowledge and savings at home.

Human capital development

The Eastern partners enjoyed high levels of human capital in the early transition process, inheriting illiteracy levels of close to zero from the Soviet era, with the vast majority of the population educated to a level that would permit access to employment. This clearly offered them a comparative advantage that could act as a key pillar of sustainable economic growth in relation to other

countries at equal levels of economic development. However, there are signs that the Eastern partners may lose this comparative advantage by allowing their human capital to deteriorate as a result of:

- the inadequate quality of an education system unable to adapt quickly to the social and economic changes of transition and to keep abreast of developments at international level;
- a lack of funding for education in a time of serious economic contraction;
- limited numbers of high-skill job opportunities during transition that would maintain and eventually enhance existing skills.

There is no evidence that the lack of human capital has prevented the countries from taking the path towards technologically advanced, knowledge-based and competitive economies. However, this risk will eventually become apparent if countries do not address the current problems of their education and training systems and ensure provision of the skills needed for enterprises to operate. Although no specific monitoring of the demand for skills is taking place in any of the Eastern partner countries, there is some evidence that the lack of skills is starting to become an important obstacle to further business development. Experience of advanced transition economies demonstrates that the lack of skills becomes more apparent as economic restructuring advances.

The specific challenges facing the education and training systems in the Eastern partners are to:

- ensure access to education and training opportunities for all young people, implying the reduction of early school leaving as well as the provision of skills for gainful employment (employability);
- improve the quality of education across the board, including its relevance to labour market skills needs;
- address the skill needs of the adult population in view of the ageing society and further economic restructuring.

The current situation in the teaching profession in the region is not conducive to improvement in the system, as teachers are paid very low salaries, usually lower than the average national wage (even the lowest public wage in some cases). It is important that the teaching profession be made more attractive to the younger generations.

The role of VET is of great importance in the skill-formation processes of all the Eastern partners, since it can enhance the capacity of the countries in terms of technology absorption and diffusion, and increase employability. Over a decade of neglect, the sector had lost its credibility and attractiveness as a result of the closure of large enterprises (the main users of the skills it produced) and the rapid deterioration of its relevance to emerging labour market skill requirements. However, renewed interest is being shown by governments almost everywhere. Since the mid 2000s, all of the Eastern partners have launched initiatives to modernise their VET systems from a lifelong learning perspective, tackling issues of system governance, institutions and the content of education and training programmes. Sustained efforts are now needed to:

- reinforce employer involvement in the design and delivery of education and training provision;
- strengthen the capacity of professional institutions to modernise the methodologies for training delivery;
- strengthen the capacity of training providers to introduce flexible demand-driven training courses that cater for the needs of different learners;
- use the small amount of funding that countries have available in an efficient way;
- develop qualifications and qualification frameworks that are transparent and relevant for the labour market.

Efforts towards the skill enhancement of the adult population so far remain limited and inadequate in terms of ensuring both access and quality. More systematic efforts must be made to support provision and provide incentives for adults to participate in training. Education and training must be moved closer to the emerging social and economic needs of the countries through a better understanding of the demand for skills, and the adaptation of education and training provision to match this demand and increase the employability of all population groups.

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
ALMP	Active labour market policy
AMD	Armenian dram, national currency of Armenia
BEEPS	Business Environment and Enterprise Performance Survey
BTI	Bertelsmann Transformation Index
CBS-AXA	Centre for Sociological Investigations and Marketing in Moldova
Cedefop	European Centre for the Development of Vocational Training
CEE	Central and Eastern Europe
CEEB	Central and Eastern European and Baltic (countries)
CIS	Commonwealth of Independent States
CPI	Consumer price index
DG	Directorate General
DVV	German Adult Education Association
DWCP	Decent Work Country Programme (ILO)
EaP	Eastern Partnership
EBRD	European Bank for Reconstruction and Development
EFI	Economic Freedom Index (Economic Freedom Network)
ENP	European Neighbourhood Policy
EQF	European Qualifications Framework
ETF	European Training Foundation
EU	European Union
FDI	Foreign direct investment
FI	Freedom Index (Freedom House)
FSU	Former Soviet Union
GCF	Gross capital formation
GCI	Global Competitiveness Index (WEF)
GDI	Gender-related Development Index (UNDP)
GDP	Gross domestic product
GEM	Gender Empowerment Measure (UNDP)

GER	Gross enrolment rate
GGI	Gender Gap Index (WEF)
GNI	Gross national income
HBS	Household budget survey
HDI	Human Development Index (UNDP)
HPI	Human Poverty Index (UNDP)
HUEMs	Household Unincorporated Enterprises with some Market production
ICLS	International Conference of Labour Statisticians (ILO)
ICT	Information and communication technologies
IDP	Internally displaced person
IEF	Index of Economic Freedom (Heritage Foundation)
ILO	International Labour Organization
IMF	International Monetary Fund
IOM	International Organization for Migration
ISCED	International Standard Classification of Education
ISCO	International Standard Classification of Occupations
ITUC	International Trade Unions Confederation
IZA	German Institute for the Study of Labour
KILM	Key Indicators of the Labour Market (ILO)
LFS	Labour force survey
LMIS	Labour market information system
MEBO	Management and employee buy out
NACE	Nomenclature of Economic Activities
NGO	Non-governmental organisation
OECD	Organisation for Economic Cooperation and Development
PES	Public employment service
PIRLS	Progress in International Reading Literacy Study
PISA	Programme for International Student Assessment (OECD)
PPP	Purchasing power parity
PTU	Professional technical school
SEE	South-Eastern European (countries)
SIDA	Swedish International Development Cooperation Agency

SLMT	Survey on Inter-Sectorial Mobility and Transition from school to work (Moldova)
SME	Small and medium-sized enterprise
Tacis	Technical Aid to the Commonwealth of Independent States
TIMMS	Trends in International Mathematics and Science Study
UAH	Ukrainian hryvnia, the national currency of Ukraine
UIS	UNESCO Institute for Statistics
UK	United Kingdom
ULC	Unit labour cost
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNESCO	United Nations Educational Scientific and Cultural Organization
UNPD	United Nations Population Division
USA	United States of America
USD	United States dollar
USSR	Union of Soviet Socialist Republics
VET	Vocational education and training
WAPES	World Association of Public Employment Services
WBI	World Bank Institute
WDI	World Development Indicators (World Bank)
WEF	World Economic Forum
WTO	World Trade Organization

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