

# Black Sea and Central Asia

PROMOTING WORK AND WELL-BEING

*An OECD Development Centre Economic Outlook*



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ARMENIA  
AZERBAIDJAN  
BULGARIA  
GEORGIA  
GREECE  
KAZAKHSTAN  
KYRGYZ REPUBLIC  
MOLDOVA  
ROMANIA  
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TAJIKISTAN  
TURKEY  
TURKMENISTAN  
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# **Black Sea and Central Asia**

PROMOTING WORK AND WELL-BEING



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# FOREWORD

This book is a product of the Development Centre's work on monitoring and analysis of regional performance set out in the Centre's 2007–2008 Programme of Work. It is one of three regional outlooks; the others are the *African Economic Outlook* and the *Latin American Economic Outlook*. The objective of this book is to promote the systematic monitoring and evaluation of economic performance and underlying policies in the Black Sea and Central Asian regions, in order to facilitate evidence-based policy dialogue amongst the countries of these regions, as well as to facilitate dialogue and exchange of good practices between them and the members of the OECD.

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Reports were drafted by Tamaz Asatiani and Michael Tokmazishvili (Center for Social and Economic Research, Tbilisi), Mher Baghramyian (Armenian International Policy Research Group, Yerevan), Jamshed Kuddusov (Resource Information Advisory Centre on Labour, Dushanbe), Roman Mogilevsky (Center for Social and Economic Research, Bishkek), Veronika Movchan (Institute for Economic Research and Policy Consulting, Kiev), Kosovka Ognjenovic (ESPI Institute, Belgrade), Ziyodullo Parpiev (Center for Economic Research, Tashkent), Rasim Ramazanov (Research Centre for Development and International Collaboration, Baku), Galina Selari (Center for Strategic Studies and Reforms, Chisinau) and Valentina Vasile (Institute of National Economy of the Romanian Academy, Bucharest).

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# PREFACE

## Preface

*Black Sea and Central Asia: Work and Well-being*, an OECD Development Centre Economic Outlook is an assessment of economic performance and underlying social policies in the Black Sea and Central Asian regions.

The *Outlook* provides cross-country comparative analysis of recent economic developments and of the regions' growing involvement in the global economy. Indeed, the two are intimately linked and it therefore is entirely logical that we should have chosen work and well-being as a central theme of this book.

Work and well being are central not only to the construction of economic development but to its very conception. The work programme of the OECD Development Centre seeks to address two sets of overlapping interests: *i*) development policies and peer learning; and *ii*) the monitoring and analysis of regional performance. Hence this Outlook examines development policies from a comparative point of view in order to enhance peer learning within the two regions concerned. It also includes a chapter on what OECD countries have done; not to preach, but to share experience and learning. The book draws on the expertise available in the OECD as a whole, but most particularly on work within the Development Centre on the informal sector and on social institutions in developing countries.

A special feature of this *Outlook* was the creation of a network of local partners who provided substantial inputs into the report and contributed to policy dialogue and dissemination activities. Research groups in Albania, Armenia, Azerbaijan, Georgia, Kazakhstan, Moldova, the Kyrgyz Republic, Romania, Serbia, Tajikistan and Uzbekistan prepared background papers, discussed at workshop meetings in Almaty and Tbilisi. The project, thus, aims to have a modest capacity building role in the Black Sea region and Central Asia, which we hope will contribute to continued high-quality monitoring and analysis of economic developments.

The outcome of the programme that led to this book will be felt in the coming years as the policies we have identified and discussed are refined and implemented in the countries themselves, under the guidance of a growing body of local analytical expertise. The theme of work and well-being is one that will have implications and echoes in other parts of the developing world and in the emerging economies; there is much for them to learn from the experiences and policies described here.

Javier Santiso,

OECD Chief Development Economist and  
Director, OECD Development Centre  
Paris  
May 2008



# ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
BSEC	Organization of the Black Sea Economic Cooperation
CAREC	Central Asia Regional Economic Cooperation
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
DAC	Development Assistance Committee of the OECD
DIFD	Department for International Development (United Kingdom)
EBRD	European Bank for Reconstruction and Development
ECE	United Nations Economic Commission for Europe
ECO	Economic Cooperation Organization
EITI	Extractive Industry Transparency Initiative
ESCAP	United Nations Economic and Social Commission for Asia and the Pacific
EU	European Union
EurAsEc	EurAsian Economic Community
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome
IDA	International Development Association (of the World Bank)
ILO	International Labour Organization
IMF	International Monetary Fund
IOM	International Organization for Migration
KILM	Key Indicators of the Labour Market (ILO database)
LLM	Low- and Lower-Middle-income countries
MFN	Most-Favoured Nation
NAFTA	North American Free Trade Area
NGOs	Non-Governmental Organisations
ODA	Official Development Assistance
PPP	Purchasing Power Parity
SCO	Shanghai Cooperation Organisation
SITC	Standard International Trade Classification

UMH	Upper-Middle- and High-income countries
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund (originally known as the United Nations International Children's Emergency Fund)
UNODC	United Nations Office on Drugs and Crime
USAID	United States Agency for International Development
WHO	World Health Organization
WITS	World Integrated Trade Solution (software developed by the World Bank, in close collaboration with UNCTAD, giving access to the major trade and tariffs data compilations).
WTO	World Trade Organization

# INTRO DUCTION

## Introduction

The *Black Sea and Central Asia Economic Outlook* provides an overview of recent economic developments in the 17 countries in the Organization of the Black Sea Economic Cooperation (BSEC) and in Central Asia (CA). The 12 BSEC countries include Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Serbia, Turkey and Ukraine; the five Central Asian countries are Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan. The BSEC-CA countries form a region that is connected geographically; its central location in the Eurasian landmass makes it a pivotal region in terms of economics and geopolitics. Yet there is no single source that brings together data and analysis of the region on a regular basis. This regional *Outlook* seeks to fill this gap.

The emphasis of the *BSEC-CA Economic Outlook* is on the formerly centrally planned economies. Turkey and Greece feature primarily as benchmarks, rather than being included in the analytical sections. Even among the formerly centrally planned economies, there are substantial differences in size, living standards and human capital, as well as in the nature of their market-based economic systems. The years since the turn of the century have been characterised by economic growth, with especially high growth rates in the energy exporters (Azerbaijan, Kazakhstan, Russia and Turkmenistan). This has focused attention on the Black and Caspian Sea area as never before; the *Outlook* is a response to this growing interest. At the same time, the not-so-distant past continues to cast a heavy pall over the growing economies.

The legacy of a decade of wrenching change during the 1990s remains so important that this *Outlook* is devoted to work and well-being; a theme that draws on perceptions shaped during the transition from central planning and examination of the changes in income and employment as well as qualitative measures of well-being. The transition was associated with declining output, increased inequality and the emergence of widespread and unaccustomed poverty. The shock of transition to a market-based economy was, in many cases, exacerbated by political change, notably the dissolution of the Soviet Union in 1991 and the gradual and more violent disintegration of Yugoslavia; several BSEC-CA countries experienced civil or inter-state warfare and secession, which added to the traumas of transition.

Today, all of the BSEC-CA countries have open economies, although the extent to which they are integrated into global capital and labour markets varies. The impact of the economic shock during transition was exacerbated by entry into the global economy, which was a particularly dramatic change for some of the previously more isolated economies. The long-term benefits from participation in the global division of labour are not at issue here, rather the issue is how the short-term adjustment was made extreme by the discipline of the global market and the uncertainty about where the comparative advantage of the BSEC-CA countries would eventually lie. There is a sharp contrast between the transition in the BSEC-CA countries and the transition experiences in China and Viet Nam, where agricultural reform and specialisation in labour-intensive manufactures were obvious and successful.

Income alone fails to capture the full extent of changes in well-being under such far-reaching economic and social change. The provision of basic needs, including shelter, heating, education and health care, deteriorated for many people. Job placement upon completion of education, and security once employed, were no longer guaranteed as they had been in the era of central

planning. Initial high expectations gave way to widespread disillusionment. Public institutions were poorly equipped to address the new economic conditions and increased uncertainty. The 1990s were characterised by macroeconomic instability, including hyperinflation in 1992-93 in the Soviet successor states and episodes of high inflation in other transition economies. Privatisation of state enterprises and other property was in many cases inefficient, non-transparent and unfair. Market-supporting institutions – such as an effective legal system for the protection of property rights or a financial system, which could serve the needs of private enterprises – took time to construct.

Building upon sustained economic growth in more recent years, in some cases among the highest in the world, the region is now in a position to make more proactive policies (general and specific) designed to tackle the remaining economic malaise, the insufficient provision of satisfying work and the promotion of well-being. These issues are featured in Part II of the 2008 *Outlook*, which looks at the factors that have affected work and well-being and analyses the links between the reformed economies' integration into the global economy and their ability to generate work and promote well-being.

While economic growth is important and in the long term expanding the demand for labour is crucial, in the short term, government policies can help to match job seekers with employment opportunities and to provide insurance against the economic consequences of job loss. All of the transition economies have been slow to adopt labour market policies, which were understandably seen as being of second-order importance during the initial shift from central planning to a market-based economy. In the early 21st century, this is changing; approaches range from the *laissez faire* market-facilitating approach of Georgia to more paternalistic or *dirigiste* approaches in newly wealthy energy exporters such as Azerbaijan.

Yet, as governments strive to introduce institutions appropriate to work and well-being in market-based economies, they do not start with a clean slate. The policy environment has emerged from a centralised past, sometimes with more or less appropriate foreign elements superimposed. The way forward must take into account this legacy and, even more importantly, the coping mechanisms introduced during the transition. As old sources of economic security disappeared and governments failed to provide adequate security during the 1990s, households adapted in various ways, including urban to rural migration as urban enterprises shrank, rural to urban migration as collective farms were broken up, retreat into the extended family and other traditional community organisations, entering the unofficial economy, criminality and temporary or permanent emigration.

In the 21st century, as economic growth picked up the coping mechanisms became less necessary, and more normal patterns of employment and migration emerged. However, as in OECD countries, work and well-being call for institutional arrangements to facilitate desirable market-driven outcomes. Part II of the *Outlook* is intended to help countries to improve the policy environment for promoting work and well-being. Although there are variations, the similarity of backgrounds in BSEC-CA countries suggests a potential for learning from one another's experiences, whether by adopting and adapting policies that have worked well for others in the region, or by heeding less positive experiences where plausible policy innovations had negative consequences.



# PART ONE

## Recent Economic Development in the Black Sea and Central Asia Regions

### INTRODUCTION TO PART I

The economies of the BSEC-CA region, and especially the 11 that were republics of the former Soviet Union, have experienced rapid growth in the first years of the 21st century. This is in welcome contrast to the 1990s, when the formerly centrally planned economies of Europe and the Commonwealth of Independent States (CIS) underperformed in most regions of the world, experiencing an output collapse that far exceeded expectations. During the period 2001-06, the simple average growth rate of the 11 CIS countries was around 8 per cent per year, which compares favourably even with the high performing Asian economies. Part of this impressive performance is recovery from a deep trough, and some countries have benefited from large terms of trade gains, but it also reflects substantial improvement in macroeconomic policies.

Many of the countries' governments are running fiscal surpluses and, where the public budget is in deficit, the magnitude is small. Only Albania and the Kyrgyz Republic had deficits greater than 3 per cent of gross domestic product (GDP) in 2006, and these were being reduced from much higher percentages a few years earlier.

Inflation rates are also much reduced from the high rates of the 1990s, although the record is mixed. In 2006, Albania, the Kyrgyz Republic, Armenia and Greece all had consumer price inflation in the 2 to 4 per cent per year range. Romania, Bulgaria, Azerbaijan, Turkmenistan, Kazakhstan, Ukraine, Georgia, Turkey and Russia had higher single-digit inflation. Tajikistan, Moldova and Uzbekistan all had double-digit inflation; Uzbekistan's inflation appears to be higher, estimated at almost 20 per cent by the International Monetary Fund (IMF), although government estimates would place it even below the 10-13 per cent range of the other two countries in this group.

All of the countries have open economies. Greece, at 28 per cent, has the lowest merchandise trade-to-GDP ratio. Bulgaria and Tajikistan have the highest merchandise trade-to-GDP ratios. The countries' external positions, however, vary considerably, depending in large part on terms of trade changes, which have favoured energy exporters since the late 1990s and have had a more volatile impact on cotton, aluminium and gold exporters.

The first part of the *BSEC-CA Economic Outlook* reviews and analyses recent economic developments in the Black Sea and Central Asian countries. Chapter One focuses on macroeconomic policies and their external position indicators. This is followed by a regional overview of trade, investment and labour flows.

Although the analysis covers all 17 BSEC-CA countries, there is less emphasis on Greece and Turkey for which the OECD regularly produces *Economic Outlooks* and on Russia and Ukraine which have been the subject of recent OECD *Outlooks*.



# CHAPTER ONE

## Macroeconomic Performance and External Position

In recognition of the heterogeneity of the BSEC-CA countries, the macroeconomic survey considers them in three groups. The Organization of the Black Sea Economic Cooperation is divided into low- and lower-middle income (LLM) countries (Albania, Armenia, Azerbaijan, Georgia, Moldova and Ukraine) and upper-middle- and high-income (UMH) countries (Bulgaria, Greece, Romania, Russia, Serbia and Turkey). The third group consists of the Central Asian (CA) countries (Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan). For each group, basic demographic data, key macroeconomic variables, fiscal and monetary indicators and data on the external position are presented.

### LOW- AND LOWER-MIDDLE-INCOME BSEC COUNTRIES

In 2007, population in the LLM-BSEC region was 69.3 million; just over 1 per cent of the world's total population. Two-thirds live in Ukraine, which is the largest country in the sub-group. Azerbaijan has 8.6 million people while none of the other countries in the group (Albania, Armenia, Georgia and Moldova) has more than 5 million inhabitants. The population, however, has been shrinking over the last decade due to emigration and declining fertility. Fertility rates fell considerably in all LLM-BSEC countries over the last 15 years, with the sharpest declines taking place in Albania and Moldova. In addition, death rates increased in most countries. Consequently, total population in the group fell by 6.63 per cent between 1995 and 2005; in 2000 it was 72 million and in 1995 over 74 million. Since the turn of the century, only Azerbaijan and Albania have displayed consistently positive population growth.

The region's total output amounted to an estimated USD 194 billion in current prices in 2007, or 0.36 per cent of world GDP. Ukraine is the largest economy with a GDP that exceeded USD 130 billion in 2007. The smallest economies in terms of aggregate production are Moldova and Armenia. In terms of GDP per capita, the highest figure is that of Albania with just over USD 1 500 in 2005 (measured in constant 2000 prices); in contrast the figure for high-income OECD countries was USD 29 251. Measuring per capita income in purchasing power parity (PPP) terms, as in Table 1.1, provides a better assessment of living standards; Ukraine is at the top with USD 8 624 in 2007, followed by Azerbaijan, Albania and Armenia. The poorest country in the region is Moldova with just over USD 3 000 per inhabitant in 2007.

**Table 1.1. LLM-BSEC: Key Macroeconomic Variables, 1995-2007**

	GDP (current prices, USD billion)		Real GDP growth (per cent)		GDP per capita, PPP (USD)		Population (million)
	1995	2007e	2006	2007e	1995	2007e	2007
Albania	2.7	10.8	5	6	2 636	6 197	3.2
Armenia	1.3	7.8	13.4	11.1	1 418	5 769	3.5
Azerbaijan	2.4	31.1	31	29.3	1 764	8 521	8.6
Georgia	1.9	9.6	9.4	11	1 287	4 176	4.4
Moldova	1.4	4.0	4	5	1 650	3 090	3.4
Ukraine	37.0	131.2	12.1	2.6	3 999	8 624	46.4

Note: e data for 2007 are estimates.

Source: IMF *World Economic Outlook 2007*, October (on-line database accessed on 28 February 2008).

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Low- and lower-middle-income BSEC countries have seen consistently positive growth rates in the first few years of the 21st century. In 2007, the region's real GDP grew by a weighted average of 10.6 per cent, a figure that is projected to slow down to 9.2 per cent in 2008. In the period 2001-06, the region grew, on average, by 8.5 per cent per year; whereas between 1995 and 2000 the region's activity had remained stagnant (cumulative real growth was 0.3 per cent in that 5-year period). The highest growth rates are in Azerbaijan, which grew by 29 per cent in real terms in 2007, on the back of booming oil prices and an increasing volume of oil production. Armenia has also maintained double-digit growth since 2002 (11 per cent in 2007), while Georgia grew by around 11 per cent in 2007. Growth rates have been lower in Albania, Moldova and Ukraine, but they are typically above 5 per cent.

Growth rates have fluctuated in recent years, partly reflecting various domestic and external shocks and the differing degrees of resilience that the economies in the region have displayed. For example, rising energy prices and a Russian ban on Moldovan wine exports can explain the deceleration of the Moldovan economy in 2006; Ukraine, on the other hand, saw its growth pick up significantly in 2006, despite rapidly rising prices for its energy imports.

The share of agriculture in GDP has fallen steadily over the last decade; state support to the sector has faded in the transition period and productivity in the agricultural sector has failed to keep up with overall labour productivity due to low investment. The composition of GDP has gradually shifted towards industry (especially in the countries of the southern Caucasus) and services (especially in Moldova). Nevertheless, by OECD standards, these economies are generally characterised by an underdeveloped tertiary sector and a higher reliance on agriculture.

Government expenditure and revenue have both been rising as a share of GDP over the last five to six years in LLM-BSEC countries. General government revenue rose from 11.1 per cent to 28.3 per cent of GDP in Georgia between 2001 and 2007, while the share of expenditure in GDP more than doubled in the same period. Ukraine and Moldova have the largest share of government in GDP, while Armenia has the smallest share (Table 1.2).

Despite generally expansionary fiscal policies, governments have largely managed to improve their fiscal position. Albania's deficit has fallen considerably since the turn of the century, although at 3.9 per cent of GDP in 2007 it is still the highest in the group. Moldova has the smallest deficit, 0.5 per cent of GDP in 2007 after recording three consecutive years in fiscal surplus between 2003 and 2005, while Azerbaijan's general government accounts moved into positive territory in recent years. Narrowing deficits are primarily the outcome of strong revenue growth, which has outpaced the growth of expenditure in most cases; tax collection has notably improved, although tax evasion remains a significant constraint in all countries. Revenue from direct and indirect taxes makes up between 80 and 90 per cent of total revenue, with the exception of Azerbaijan, which also relies heavily on oil fund revenue.

**Table 1.2. LLM-BSEC: Fiscal Indicators, 2001-07**

	Size of general government (total revenue plus expenditure as per cent of GDP)			General government fiscal balance (per cent of GDP)		
	2001	2006	2007e	2001	2006	2007e
Albania	55.3	55.2	55.7	-7.9	-3.9	-3.9
Armenia	37.9	34.3	38.1	-3.8	-2.7	-3.0
Azerbaijan	37.3	58.6	59.4	-0.4	0.1	2.2
Georgia	23.8	55.5	57.9	-1.6	-3.0	-1.3
Moldova	58.4	81.3	84.5	-0.3	-0.3	-0.5
Ukraine	67.9	81.7	..	-0.9	-2.3	..

Note: e denotes data for 2007 are estimates.

Source: IMF staff country reports (various years) and IMF *World Economic Outlook 2007*, October (on-line database accessed on 28 February 2008).

StatLink  <http://dx.doi.org/10.1787/343635602055>

Inflation rates have been volatile in recent years, which is a sign of relatively ineffective monetary policies. Albania stands out in that it maintains an explicit inflation targeting regime and has managed to keep inflation within the targeted bounds of 2 to 4 per cent since 2003 (Table 1.3). Increasing inflationary pressures since mid-2006, mainly due to increased import prices, led the central bank to increase its policy interest rate by 25 basis points in July to 5.25 per cent and then by another 25 basis points in November. Moldova's central bank tightened monetary policy in 2006 in order to restrain inflation, and increases in the policy interest rate were accompanied by sterilisation operations that reduced the money supply; after a deceleration in inflation in early 2007, the government eased its policy, letting the policy rate drop by 100 basis points to 13.5 per cent in April. Inflation increased in 2006 in Georgia, Armenia and Azerbaijan, and monetary authorities tightened their monetary policies in response: Azerbaijan's central bank raised its refinancing rate in 2006 and early 2007 by a cumulative 3 per cent, and the central bank of Armenia raised its refinancing rate in 2006. Ukraine's monetary policy has instead focused on currency stability, to the extent that the national currency is *de facto* pegged to the US dollar. Inflation eased in Ukraine in 2006 but picked up again in 2007 as the effects of rapidly rising energy prices were passed on to consumers.

Inflationary pressures are increasing in a number of LLM-BSEC countries. The main drivers are high import prices, particularly energy, and increasing consumer demand boosted by remittances. For Azerbaijan, the IMF estimates expect the consumer price index (CPI) to increase by over 20 per cent in 2007, mainly as a result of high oil revenue leading to an inflow of foreign currency and an increase in consumption. The regulated price of bread is especially sensitive, as the government ponders how to deal with increased prices of wheat imports from Russia and Kazakhstan.

Despite widening current account deficits (excluding Azerbaijan) and relatively high rates of inflation, national currencies in the region have generally appreciated in nominal terms against the dollar and the euro in recent years. The currencies that appreciated the most since 2001 have been the Albanian Lek and the Armenian Dram. Reasons behind this trend are the strong remittance inflows, in addition to foreign currency purchases by the central banks; the total stock of foreign exchange reserves in the LLM-BSEC countries almost doubled between 2005 and 2007 to just under USD 43 billion.

**Table 1.3. LLM-BSEC: Monetary Indicators, 2001-07**

	Consumer price inflation (per cent, year average)			Nominal exchange rate (local currency/USD, year average)		
	2001	2006	2007e	2001	2006	2007
Albania	3.1	2.4	2.5	143.5	98.1	90.9
Armenia	3.1	2.9	3.7	555	416	342
Azerbaijan	1.5	8.4	21.1	0.9	0.9	0.9
Georgia	4.7	9.2	8.5	2.1	1.8	1.7
Moldova	9.8	12.7	11.2	12.9	13.1	12.1
Ukraine	12.0	9.1	11.5	5.4	5.1	5.1
	Money growth rate (per cent change in M2, on previous year)			Foreign exchange reserves (excl. gold), USD million		
	2005	2006	2007e	2005	2006	2007e
Albania	14.1	16.0	7.1	1 404	1 769	2 130
Armenia	27.8	32.9	34.2	669	1 072	1 657
Azerbaijan	23.2	86.9	55.4	1 178	2 500	4 273
Georgia	26.5	39.7	46.1	479	931	1 363
Moldova	34.4	23.5	31.1	597	775	1 334
Ukraine	53.9	34.3	39.4	18 988	21 845	31 785

Note: e denotes data for 2007 are estimates.

Source: IMF International Financial Statistics (February 2008).

StatLink  <http://dx.doi.org/10.1787/343731282023>

All the countries in the region are open to international trade. A simple measure of openness (merchandise and service exports and imports over GDP) reveals that Moldova, Azerbaijan and Ukraine are the most engaged in international trade in relative terms, while Armenia and Albania are the least "open" economies in the region (Table 1.4).

Azerbaijan recorded a trade surplus of USD 7.7 billion in 2006, or 39 per cent of its GDP; oil and oil products accounted for USD 12 billion out of total exports of USD 13 billion. All the other countries have a merchandise trade deficit. Although export activity has recently been on the rise, the trade deficits widened in 2005 and 2006 due to unfavourable developments in their terms of trade and a growing demand for imports. Moldova's trade deficit reached 47.4 per cent of its GDP in 2006, the highest among LLM-BSEC countries. Ukraine's trade balance moved into a deficit in 2005, and estimates for 2006 indicate a widening of the deficit, partly owing to rising prices paid for Russian gas imports and despite increased demand for the country's exports and rising steel prices (the main exported commodity). The widening of the trade deficit has contributed towards deterioration in the current account of all countries, except Azerbaijan, in 2005 and 2006. Nevertheless, the current account is more balanced in all countries than the merchandise trade balance, mainly due to the impact of remittances and of trade in services. Net current transfers, which include worker's remittances or, to be precise, remittances of migrants who are considered as permanent residents in their host countries, are strongly positive and increasing. Net income inflows, consisting of investment income and remittances of non-resident workers, are positive in all countries except Azerbaijan, and are a significant source of income for Moldova.

The increasing integration into the world economy manifests itself in the increasing flows, not only of trade and income, but also of direct investment. For the group as a whole, direct investment flows from abroad soared from USD 1.46 billion in 2001 to USD 7.3 billion in 2006, growing on average by 30 per cent (compound rate) every year, and peaking at USD 10.7 billion in 2005. The growth of foreign direct investment (FDI) has been particularly strong in Ukraine, Georgia and Moldova. On the other hand, direct investment from LLM-BSEC countries into other

economies has been low and sluggish; in Moldova and Armenia, it is practically non-existent, whereas in Georgia a net disinvestment took place in 2005 and 2006. As a result, the financial account was positive in most countries in 2005 and 2006. Azerbaijan is partly an exception to those general trends; it is the only country with strong FDI outflows, and the only one to move swiftly into a deficit in its financial account in 2006, due to a net withdrawal of foreign investment in 2006, not least in the oil sector.

**Table 1.4. LLM-BSEC: External Position Indicators, 2006**

	Openness (merchandise and service trade/GDP)	Trade balance (goods)	Current account balance	FDI inflows	FDI inflows change over previous year	Financial account balance
	% of GDP			(USD million)	(%)	(USD million)
Albania	74	-23	-7	325	24	523
Armenia	59	-14	-1	343	33	391
Azerbaijan	111	39	16	-219	-113	-1 265
Georgia	90	-26	-16	1 026	128	1 362
Moldova	139	-47	-12	222	-3	294
Ukraine	97	-5	-2	5 604	-41	4 085

Source: IMF *International Financial Statistics* (February 2008) and IMF *World Economic Outlook 2007*, October (on-line database accessed on 28 February 2008).

StatLink  <http://dx.doi.org/10.1787/343786137653>

## UPPER-MIDDLE- AND HIGH-INCOME BSEC COUNTRIES

Total population in the upper-middle- and high-income BSEC countries was 264 million in 2007, or 4 per cent of the world's total. The two largest countries, Russia and Turkey, together make up more than four-fifths of the group's population, and largely determine its dynamics. The constant declines in Russia's population over the last 15 years have been more than offset by an increase in that of Turkey by about 25 per cent over the same period. The other transition countries (Bulgaria, Romania and Serbia) also have negative population growth rates, mainly because of falling fertility and rising death rates in the 1990s and net emigration. For these countries as a whole, population was slightly higher in 2006 than in 2000.

Following the turbulent period of the 1990s, with the various crises and the transitional recession that hit all the countries except the two OECD countries, Greece and Turkey, growth has been strong in the UMH-BSEC countries since the turn of the century (Table 1.5). All UMH-BSEC countries have experienced uninterrupted positive GDP growth since 2000, with the exception of Turkey, which suffered an economic crisis in 2001; it has since recovered to achieve strong growth rates, attributable to successful policy reforms and strong investment inflows. Bulgaria and Romania are among the fastest growing countries in the 27 countries of the European Union (EU-27), benefiting from structural reforms, sound macroeconomic policies and EU membership. Greece's growth performance has also been solid, owing to large productivity gains, product and financial market reforms, the 2004 Olympic Games and an increasing role in regional trade. The Russian economy is growing rapidly, boosted by increasing external and domestic consumption demand. Serbia has also managed to maintain high growth rates despite recent political instability. On average, the UMH-BSEC group has been growing by 5.5 per cent

annually from 2001-06. In 2007, the region's real GDP grew by a weighted average of 6 per cent, a figure that is projected to slow down to 5.8 per cent in 2008.

The combined GDP of the UMH-BSEC countries was USD 2 300 billion in 2007. This corresponds to 4.3 per cent of world GDP, as compared to 2.11 per cent in 2001. Russia is by far the largest economy in the group, accounting for over half of its total product. The two smallest economies are Bulgaria and Serbia. In per capita terms, Greece is the highest income country in the BSEC-CA region with an estimated 2007 GDP per capita of USD 35 167 at PPP. Russia has the next highest average living standard with per capita GDP of USD 13 432, or about 40 per cent that of Greece. Romania, Bulgaria and Turkey all have per capita GDP at PPP of USD 9-10 000, and Serbia's is USD 7 265.

**Table 1.5. UMH-BSEC: Key Macroeconomic Variables, 1995-2007**

	GDP (current prices, USD billion)		Real GDP growth (per cent)		GDP per capita, PPP (USD)		Population (million)
	1995	2007e	2006	2007e	1995	2007e	2007e
Bulgaria	13.1	39	6.1	6.0	5 494	10 973	7.6
Greece	148	356	4.3	3.9	1 4156	35 167	11.1
Romania	35.5	159	7.7	6.3	5 717	11 079	21.6
Russia	313.5	1 224	6.7	7.0	5 947	13 432	142.1
Serbia	..	41	5.7	6.0	..	7 265	7.5
Turkey	166.4	482	6.1	5.0	5 494	9 816	73.6

Note: e denotes data for 2007 are estimates.

Source: IMF International Financial Statistics (February 2008).

StatLink  <http://dx.doi.org/10.1787/343787507035>

Compared to other BSEC-CA countries, production in the UMH-BSEC countries is oriented towards services and relies much less on agriculture. The OECD member countries, Greece and Turkey, have the largest tertiary sectors (around 75 per cent and 65 per cent of GDP respectively), while Russia's economy is skewed towards industry, which includes oil and natural gas production. Nevertheless, agriculture is still quite significant in Serbia, accounting for 13 per cent of GDP and close to 20 per cent of total employment, even though it is the service sector that drives economic growth.

All countries in the group have displayed good fiscal performance in recent years, thereby improving their fiscal positions (Table 1.6). Russia's general government fiscal surplus rose from under 1 per cent to 8.1 per cent of GDP between 2002 and 2005, as energy prices remained at high levels. Increased oil revenue has also financed high expenditure. Bulgaria was the only other country to run a fiscal surplus in 2007 (3.5 per cent of GDP); in contrast to Russia, Bulgaria has improved its fiscal position by means of a tight spending policy and increasing tax revenue. Turkey's fiscal performance since 2001 has been impressive; the government brought the deficit down to less than 1 per cent of GDP in 2005 and 2006. Large primary surpluses have been achieved, with taxes (mainly indirect taxes such as social security contributions and the value-added tax) being the largest source of revenue growth. Higher spending in 2007 resulted in a deterioration of the fiscal balance, which is estimated to remain at slightly more than 2 per cent. In June 2007, Greece officially exited the European Union's Excessive Deficit Procedure, under which it had been placed in June 2004, as it successfully reduced its general government deficit to less than 3 per cent of GDP (2.1 per cent in 2006). Factors that contributed to the deficit reduction include the fall in capital expenditure following the Olympic Games of 2004, a reduction in debt-service payments as a share of GDP and an increase in revenues. Romania has also reduced its general government deficit, from 3.2 per cent of GDP in 2001 to 0.8 per cent in 2005; however, a fiscal loosening in 2006 with both revenue and



expenditure (particularly public-sector wages and capital expenditure) rising significantly saw the deficit rise to 1.7 per cent of GDP. Preliminary estimates for 2007 place the deficit below 1 per cent. The Serbian government had largely achieved its target of a balanced budget in 2004 and 2005. However, extraordinary expenses in 2006 (pension arrears and public wages) and higher public investment led to a fiscal deficit of 1.5 per cent of GDP. Projections for 2007 set the deficit at 1 per cent of GDP.

**Table 1.6. UMH-BSEC: Fiscal Indicators, 2001-06**

	Size of general government (total revenue plus expenditure as per cent of GDP)			General government fiscal balance (per cent of GDP)		
	2001	2006	2007e	2001	2006	2007e
Bulgaria	75.2	74.5	77.1	-0.9	3.5	3.5
Greece	76.9	71.5	71.3	-3.9	-2.1	-2.0
Romania	65.3	64.1	69.0	-3.2	-1.7	-0.9
Russia	78.8	71.0	68.0	2.7	8.4	4.9
Serbia	..	82.4	84.0	..	-1.5	-1.0
Turkey	71.7	60.1	60.2	-14.5	-0.7	-2.3

Note: e denotes data for 2007 are estimates. Data for Turkey refer to the central government overall balance as defined by the national authorities and refer to 2002.

Source: IMF *World Economic Outlook 2007*, October (on-line database accessed on 28 February 2008) and latest IMF staff country reports.

StatLink  <http://dx.doi.org/10.1787/343805577117>

Recent monetary developments follow a pattern of currency appreciation against the US dollar (Table 1.7). This is alongside a background of strong import growth and a widening external payments imbalance as well as relatively high rates of inflation, which are nevertheless on a generally downward trajectory. For instance, Serbia has been successful in curbing inflation over the last 5 years, bringing it down from 91.8 per cent in 2001 to 12.7 per cent in 2006; a further decrease to 6.4 per cent in 2007 is projected. Romania has also drastically reduced inflation since 2000. These declines in inflation highlight the successful tight monetary policy of the two countries, oriented towards inflation targeting. Turkey has also achieved an impressive reduction in its inflation rates since 2000, although they remain close to double-digit figures despite relatively tight monetary policy and high interest rates. The figure is similar in Russia, which was 8.1 per cent in 2007, down by 3 per cent from 2005 despite strong demand and currency inflows. The lowest and least volatile rates of inflation are observed in the euro area economy of Greece, with the European Central Bank keeping a tight monetary stance since 2005.

**Table 1.7. UMH-BSEC: Monetary Indicators, 2001-07**

	Consumer price inflation (per cent, year average)			Nominal exchange rate (local currency/USD, year average)		
	2001	2006	2007e	2001	2006	2007
Bulgaria	7.5	7.3	8.2	2.2	1.6	1.4
Greece	3.7	3.3	3	1.1	0.8	0.7
Romania	34.5	6.6	4.3	2.9	2.8	2.4
Russia	21.5	9.7	8.1	29.2	27.2	25.6
Serbia	91.8	12.7	6.4	66.9	67.2	59.8
Turkey	54.2	9.6	8.2	1.2	1.4	1.3

	Money growth rate (per cent change in M2, on previous year)			Foreign exchange reserves (excl. gold) USD million		
	2005	2006	2007e	2005	2006	2007e
Bulgaria	24.5	27.6	19.8	8 041	10 943	16 478
Greece	euro area			506	566	631
Romania	20.2	36.2	..	19 872	28 066	36 983
Russia	36.3	40.5	33.1	175 891	295 568	464 379
Serbia	42.1	38.3	38.4	5 628	11 648	13 179
Turkey	24.0	25.7	17.5	50 579	60 892	73 384

Note: e denotes data for 2007 are estimates.

Source: IMF, *International Financial Statistics* 2008 (February).

StatLink  <http://dx.doi.org/10.1787/343826427408>

The international balance of payments of the economies in the UMH-BSEC countries has generally deteriorated over the last few years (Table 1.8). With the exception of Russia, all countries are running a current account deficit, which has widened significantly in recent years. In 2006, Bulgaria's current account deficit reached 15.9 per cent of GDP; in Serbia it was 11.4 per cent and in Romania 10.5 per cent. These high figures highlight the increasing exposure of many of the economies to international shocks and crises. The main culprits behind the current account deficit are, in all cases, a deep deficit in merchandise trade, associated with low competitiveness and sluggish export growth; rising import prices, particularly for energy; and high import demand. Bulgaria, for example, saw its trade deficit double between 2001 and 2006 and exceed 20 per cent of GDP. The same increasing trend is observed in Greece, Romania and Turkey, which ran merchandise trade deficits of between 10-15 per cent of their respective GDPs in 2006. Unlike the other countries in this grouping, Russia is facing a favourable international context and its terms of trade gains have allowed it to maintain a strong surplus in its balance of payments.

**Table 1.8. UMH-BSEC: External Position Indicators, 2006**

	Openness (total trade/ GDP)	Trade balance (goods)	Current account balance	FDI inflows	FDI inflows change over previous year	Financial account balance
	per cent of GDP			(USD million)	(per cent)	(USD million)
Bulgaria	146.3	-21.6	-15.9	5 172	22	6 816
Greece	44.4	-14.3	-9.6	5 401	721	25 661
Romania	76.8	-12.2	-10.5	11 393	76	18 899
Russia	55.3	14.1	9.6	28 732	125	11 682
Serbia	73.4	-19.5	-11.4	4 387	183	8 518
Turkey	64.6	-10.0	-7.9	20 125	105	38 077

Note: Trade includes import and exports of goods and services, as reported in the Balance of Payments statistics.

Source: IMF *International Financial Statistics*, February 2008, and IMF Staff Country report for Serbia.

StatLink  <http://dx.doi.org/10.1787/343870678778>

Trade as a share of GDP is particularly high in the case of Bulgaria and low in the case of Greece. Although the values of the index are generally lower than in other BSEC-CA groups, it must be noted that the structure of trade is different too, as the higher-income countries engage in a significant amount of trade in services. In the case of Greece, exports of services make up more than 60 per cent of total trade and the surplus from trade in services is as high as 6.3 per cent of GDP. Turkey also enjoys a substantial surplus from trade in services. Russia, however, is a net importer of services, which is typical of the CIS countries.

## CENTRAL ASIA

Central Asia is home to a population of almost 59 million people. The most populous countries are Uzbekistan (26.8 million) and Kazakhstan (15.1 million). High fertility rates and rising living standards have contributed to positive population growth rates for all five Central Asian countries in the 2000s. In particular, fertility rates of around 2.5 births per woman in Central Asia are much higher than in the BSEC countries, while death rates are considerably lower. The total population of the region thus increased by more than 3 million between 2000 and 2007, with Turkmenistan and Uzbekistan recording the strongest population growth rates in this period.

The region's total GDP amounted to USD 121 billion in 2006 and USD 148.7 billion in 2007 (Table 1.9). However, the IMF estimates for Turkmenistan rely on the overvalued official exchange rate; using the estimated market rate lowers Turkmenistan's 2006 GDP by about USD 10 billion. The largest economy in Central Asia is that of Kazakhstan, which accounts for almost two-thirds of the region's total product. The Kyrgyz Republic and Tajikistan have the smallest economies with a GDP of about USD 3.5 billion each in 2007.

In the period 2001-06, the economies of Central Asia grew significantly: the average weighted annual growth rate for that period was 9 per cent (excluding Turkmenistan). Growth in the Kyrgyz Republic has not only been lower on average than in the other countries (3.8 per cent in 2001-05), but also much more volatile; for instance, real GDP shrank by 0.2 per cent in 2005 due to political unrest and a fall in gold production, before picking up again in 2006. Kazakhstan, on the other hand, has posted the highest growth rates. Finally, the IMF estimates for Turkmenistan indicate a slight slowdown in growth in 2005 and 2006, while nevertheless remaining at 9 per cent. Regional growth slightly decelerated in 2007 reaching 8.6 per cent; it is forecasted to attain 7.7 per cent in 2008, mainly because of a deceleration in Kazakhstan's growth.


Tajikistan, and to a lesser extent the Kyrgyz Republic and Uzbekistan, are among the poorest countries worldwide in terms of per capita income, even after adjustments for purchasing power have been taken into account. Despite a general improvement in absolute terms, the poorest countries have seen their per capita incomes worsen relative to the regional average between 1995 and 2007. In Uzbekistan, the per capita income at PPP terms was 50 per cent of the regional average in 2007, against 70 per cent in 1995. For the Kyrgyz Republic, it went from 60 per cent in 1995 to 40 per cent in 2007, while in Tajikistan it remained about one-third of the regional average.

**Table 1.9. Central Asia: Key Macroeconomic Variables, 1995-07**

	GDP (current prices, USD billion)		Real GDP growth (per cent)		GDP per capita, PPP (USD)		Population (million)
	1995	2007 e	2006	2007 e	1995	2007 e	2007e
Kazakhstan	16.6	95.5	10.7	8.7	3 556	10 658	15.1
Kyrgyz Rep.	1.5	3.5	2.7	7.5	1 171	2 315	5.3
Tajikistan	0.6	3.4	7.0	7.5	668	1 637	6.4
Turkmenistan	5.9	26.2	9.0	..	3 098	9 483	5.2
Uzbekistan	10.2	20.2	7.3	8.8	1 277	2 541	26.8

Note: e denotes data for 2007 are estimates.

Source: IMF *World Economic Outlook 2007*, October (on-line database accessed on 28 February 2008).

StatLink  <http://dx.doi.org/10.1787/343871670652>

Compared to that of advanced industrialised economies, the structure of production in the countries of Central Asia is skewed either towards agriculture, as in the Kyrgyz Republic (33 per cent of GDP in 2006) and Uzbekistan (28 per cent of GDP), or towards industry in the oil and gas economies of Kazakhstan and Turkmenistan. The share of the service sector in GDP is generally quite low, and exceeds 50 per cent only in Kazakhstan.

As Table 1.10 shows, general government revenue and spending in Central Asian countries has been stable as a share of GDP since 2000. Only the Kyrgyz Republic has substantially increased both revenue and expenditure relative to total product. Uzbekistan has the largest government sector relative to GDP and Tajikistan the smallest. There are no reliable public finance data for Turkmenistan.

Overall, governments in the region conduct prudent fiscal policies and have actively sought to maintain fiscal discipline and improve their fiscal position. Kazakhstan's general government account recorded a surplus equal to 7.4 per cent of GDP in 2006, reflecting rapid oil and non-oil revenue expansion. Tajikistan's fiscal accounts swung into a modest surplus in 2006, when tax revenue collection was better than expected, despite significant tax arrears by state-owned enterprises in the aluminium and energy sector, partly due to the strong import growth, which boosted revenue from value-added tax. Uzbekistan's general government budget has been practically balanced in recent years, and this continued in 2006, as tax revenue rose to compensate for higher public sector expenditure. According to official Turkmenistan data, the budget was balanced in 2006, whereas in 2005 the general government accounts posted a surplus of 0.9 per cent of GDP; however, the situation is complicated by many non-transparent off-budget accounts. In the Kyrgyz Republic, the general government deficit has been falling since 2002; strong revenue performance brought it down to 2.3 per cent of GDP in 2006, which is nevertheless still the highest among Central Asian republics.

**Table 1.10. Central Asia: Fiscal Indicators, 2001-06**

	Size of general government (total revenue plus expenditure as per cent of GDP)			General government fiscal balance (per cent of GDP)		
	2001	2006	2007e	2001	2006	2007e
Kazakhstan	48.6	47.9	51.0	2.7	7.4	4.3
Kyrgyz Rep.	46.3	55.4	..	-5.5	-2.3	..
Tajikistan	35.9	35.4	..	-2.5	0.4	..
Uzbekistan	..	61.7	60.1	..	0.01	-0.6

Note: e denotes data for 2007 are estimates. Data for Tajikistan refer to 2002.

Source: IMF *World Economic Outlook* 2007, October (on-line database accessed on 28 February 2008) and latest IMF staff country reports.

StatLink  <http://dx.doi.org/10.1787/344003588370>

Inflation is on the rise in most countries in Central Asia (Table 1.11), and the evolution of changes in the consumer price index since the turn of the century has been U-shaped. Some factors driving this recent trend are high energy prices, growing domestic demand due to strong remittance inflows, a gradual increase in liquidity (partly because of rising foreign currency inflows and the rapid accumulation of foreign exchange reserves in most countries in 2006) and, in the cases of Kazakhstan and the Kyrgyz Republic, a nominal depreciation of their currencies. In 2006, consumer price inflation ranged from 5.6 per cent in the Kyrgyz Republic to 14.2 per cent in Uzbekistan (although official Uzbekistan data report a rate of inflation below 10 per cent). Preliminary 2007 data and projections provide a mixed picture, with inflation accelerating in Tajikistan and the Kyrgyz Republic, slightly decelerating in Uzbekistan and stabilising in Kazakhstan. Keeping inflation at low levels is a priority for central banks in the region, which generally follow tight monetary policies; in 2006, Tajikistan's central bank gradually raised its

policy interest rate by 3.5 percentage points, and in Kazakhstan, it was raised by 1 percentage point. Nevertheless, the ability of monetary authorities in the region to control inflation has often proved limited, as the transmission mechanisms are weak due to underdeveloped banking and financial sectors. Accumulation of foreign reserves has strengthened in all countries, almost doubling since 2005, reaching USD 23 billion in 2007.

**Table 1.11. Central Asia: Monetary Indicators, 2004-06**


	Consumer price inflation (per cent, year average)			Nominal exchange rate (local currency/USD, year average)		
	2001	2006	2007e	2001	2006	2007
Kazakhstan	8.4	8.6	8.6	147	126	123
Kyrgyz Rep.	6.9	5.6	7	48	40	37
Tajikistan	38.6	10.1	11.4	3.3	2.4	3.4
Turkmenistan	11.6	8.2	7	10 098 (5 200)	10 882 (5 200)	..
Uzbekistan	27.3	14.2	12	646	1 220	..

	Money growth rate (per cent change in M2, on previous year)			Foreign exchange reserves (excl. gold) USD million		
	2005	2006	2007 e	2005	2006	2007 e
Kazakhstan	26.3	78.1	21.8	6 084	17 751	15 540
Kyrgyz Rep.	10.0	51.5	..	570	764	1107
Tajikistan	25.9	59.7	15.1	168	175	207
Turkmenistan	..	..	..	3 442	5 425	..
Uzbekistan	..	..	..	2 895	4 665	6 104

Note: e denotes estimates; Inflation data for 2007 are estimates. Data for exchange rate in Turkmenistan refer to 2002. Data refer to the estimated market rate, while the official exchange rate is reported in parenthesis.

Source: IMF *International Financial Statistics* (February 2008) and EBRD (2007) for Uzbekistan.

StatLink  <http://dx.doi.org/10.1787/344034004043>

The three largest Central Asian economies — Kazakhstan, Uzbekistan and Turkmenistan — enjoy substantial surpluses in their merchandise trade (Table 1.12). Kazakhstan's surplus was 18 per cent of GDP in 2006, mainly due to high oil prices and despite rapidly growing imports. Turkmenistan's surplus stems predominantly from exports of oil and natural gas, and to a lesser extent cotton. Uzbekistan's export revenue comes primarily from cotton, gold and natural gas, with the international prices of the latter two on the rise. Uzbekistan's trade surplus was 12 per cent of GDP in 2006. On the other hand, the merchandise trade balance of the two poorest countries in Central Asia, the Kyrgyz Republic and Tajikistan, is negative. High energy and other import prices, combined with a fall in gold export volumes, led to the widening of the Kyrgyz trade deficit to an estimated 35 per cent of GDP in 2006. Tajikistan benefited from high world aluminium prices, which prevented its trade balance from deteriorating significantly.

Trade in services is relatively limited in Central Asia. In 2006, its total value in the four countries for which there are available data (that is, excluding Turkmenistan) was USD 14.5 billion; during the same year, total merchandise trade was USD 78.2 billion (USD 88 billion including Turkmenistan). All the countries are net purchasers of foreign services, especially Kazakhstan, which imports large amounts of construction, financial and oil sector services.

The income account is also negative in all four aforementioned countries, reflecting earnings of foreign investors. Kazakhstan is the only Central Asian country to report significant volumes as well as movements in its income account, with both credits and debits rising sharply in

recent years. This is due to the high levels of foreign direct investment compared to the other countries of the region.

There has been a strong increase in net current transfers in recent years in Uzbekistan, Tajikistan and the Kyrgyz Republic. Part of this increase is attributable to remittance inflows, as all of these are net emigration countries. Uzbekistan saw its net current transfers rise from USD 318 million to USD 1.14 billion between 2003 and 2006. The comparable figures for the Kyrgyz Republic were USD 93 and USD 634 million. Net current transfers are negative for Kazakhstan, which is now a net immigration country.

Kazakhstan and Tajikistan both have a largely balanced current account, while Uzbekistan had a current account surplus of 18.8 per cent of GDP in 2006. In contrast, the Kyrgyz Republic runs a deep and widening current account deficit, 9.3 per cent of GDP in 2005 and 16.8 per cent in 2006. Turkmenistan's large merchandise surplus leads to a surplus in the current account as well, given the country's limited engagement in international transactions. Estimates for 2006, using the official exchange rate, place the current account surplus at 5.9 per cent of GDP.

**Table 1.12. Central Asia: External Position Indicators, 2006**

	<b>Openness</b> (total trade/ GDP)	<b>Trade balance</b> (goods)	<b>Current account balance</b>	<b>FDI inflows</b>	<b>FDI inflows change over previous year</b>	<b>Financial account balance</b>
	per cent of GDP		USD million	per cent		USD million
Kazakhstan	92	18	-2.2	6 143	211	15 296
Kyrgyz Rep.	120	-35	-16.8	107	151	694
Tajikistan	142	-16	-0.8	339	522	276
Turkmenistan	..	9	5.9	731	75	..
Uzbekistan	63	12	18.8	195	122	..

Source: IMF *International Financial Statistics* (February 2008) and EBRD (2007) for Uzbekistan and Turkmenistan.

StatLink  <http://dx.doi.org/10.1787/344057117856>

# CHAPTER TWO

## Integration into the Global Economy

One of the striking features of the BSEC-CA countries is their integration into the global economy. The openness to trade was evident from the trade/GDP ratios reported in Chapter One.

Chapter Two analyses the countries' external economic relations more deeply, in terms of trade, financial flows and labour migration.

### TRADE

Table 2.1 shows the bilateral trade flows (exports plus imports) among the BSEC-CA countries in the period 2001-06 as a share of each country's total trade. The focus of the following trade flow analysis is on trade among the BSEC-CA countries, but mention is also made of trade with the European Union, China and the developing world. For most of the BSEC-CA countries, the European Union is the main trade partner, and for the six non-CIS countries, the European Union accounts for over half of all trade. Ukraine, Moldova and Georgia mostly export to and import from developing countries; the reverse is true of Albania and Serbia.

For most countries in the BSEC-CA region, Russia is the main regional trading partner, accounting, for example, for 34 per cent of Ukrainian imports and 33 per cent of Moldovan exports. The exceptions are Albania (main intra-regional trading partner Greece), Romania (main intra-regional trading partner Turkey) and Serbia (main intra-regional trading partner Bulgaria). For most of the BSEC countries, the second largest trading partner in the region is Turkey, whose significance is particularly high for Georgia, Bulgaria, Albania and Azerbaijan. Serbian exports and imports in the region are relatively concentrated in the Balkan region. Greek and Turkish trade within the BSEC region accounts for a very small part of their total trade, particularly if one excludes Russia. Moldova conducts around 48 per cent of its total trade with three countries, namely Russia, Ukraine and Romania. Bulgaria conducts a considerable proportion of its trade within the BSEC region, particularly with Russia, Turkey and Greece. Romania's degree of regional integration is lower, despite substantial exports to Turkey and imports from Russia. In the south Caucasus, there are significant trade flows between Georgia and Azerbaijan, equal to almost 9 per cent of total trade of the former, and to a lesser extent between Georgia and Armenia. Besides Russia and Turkey, Ukraine is also an important trade partner for these countries. Overall, the countries with the highest degree of regional integration (share of intra-BSEC trade to total trade) are Moldova and Georgia, while the largest economies (Russia, Turkey and Greece) are the ones that display the lowest degrees of regional trade integration.

**Table 2.1. Direction of Trade in BSEC-CA Region, average 2001-06**

	ALB	ARM	AZE	BGR	GEO	GRC	KAZ	KGZ	MDA	ROM	RUS	SER	TJK	TUR	TKM	UKR	UZB	CHN	DEV	EU
ALB	-	n.a.	0.0	2.1	0.1	17.5	n.a.	n.a.	0.1	0.6	2.2	1.5	n.a.	6.0	n.a.	2.0	n.a.	3.2	25.8	76.0
ARM	0	-	0.0	1.9	2.7	1.1	0.3	0.0	0.1	1.8	15.2	0.0	0.0	1.9	3.9	4.4	0.2	2.1	56.7	36.0
AZE	0	0	-	0.8	2.6	0.9	2.0	0.0	0.0	0.9	10.4	n.a.	0.7	6.3	4.2	2.3	0.7	2.5	48.7	49.3
BGR	0.2	0.1	0.1	-	0.4	7.0	0.6	0.0	0.1	3.3	9.8	1.6	0.1	7.5	0.0	2.4	0.0	2.5	44.6	57.4
GEO	0.0	2.6	8.5	2.7	-	0.8	0.9	0.0	0.1	1.0	14.9	0.1	0.1	13.2	4.6	7.2	0.3	1.7	67.3	30.4
GRC	0.7	0.0	0.1	2.4	0.1	-	0.5	0.0	0.0	1.6	5.6	0.4	0.0	2.8	0.0	0.5	0.1	3.0	38.9	59.2
KAZ	n.a.	0.0	0.5	0.3	0.1	0.6	-	0.9	0.2	1.7	24.1	0.0	0.4	2.1	0.3	2.6	1.2	12.1	62.4	33.4
KGZ	n.a.	0.2	0.2	0.0	0.0	0.0	12.3	-	0.1	0.1	18.2	0.0	0.9	3.5	0.2	1.2	3.9	31.6	86.9	7.9
MDA	0.0	0.1	0.1	1.2	0.1	0.6	2.1	0.1	-	9.7	21.7	0.1	0.0	2.9	0.1	16.4	0.1	1.3	69.5	43.7
ROM	0.0	0.0	0.2	1.5	0.1	1.8	1.4	0.0	0.6	-	4.7	0.6	0.0	5.1	0.2	1.2	0.0	4.0	36.3	68.5
RUS	0.0	0.1	0.3	0.6	0.1	0.7	3.1	0.2	0.3	0.8	-	0.0	0.1	3.5	0.1	6.2	0.6	6.3	48.3	53.8
SER	0.6	n.a.	n.a.	5.9	0.1	3.8	0.0	0.0	0.0	4.6	0.8	-	n.a.	4.0	n.a.	n.a.	n.a.	2.9	31.8	79.8
TJK	n.a.	0.0	4.1	0.1	0.1	0.7	7.2	1.1	0.0	1.1	16.1	n.a.	-	8.3	2.8	4.1	11.7	4.8	75.5	24.7
TUR	0.1	0.0	0.4	1.2	0.3	1.1	0.5	0.1	0.1	1.9	7.4	0.2	0.1	-	0.2	1.7	0.2	3.5	41.2	50.7
TKM	n.a.	0.9	3.9	0.1	1.5	0.2	1.2	0.1	0.1	1.2	6.1	n.a.	0.7	5.9	-	31.4	1.1	1.8	79.9	16.5
UKR	0.1	0.1	0.4	0.9	0.3	0.4	1.5	0.0	1.1	1.0	27.6	n.a.	0.1	3.7	4.1	-	0.5	3.6	73.1	34.2
UZB	n.a.	0.1	0.9	0.1	0.1	0.5	6.3	1.5	0.1	0.4	23.9	n.a.	3.9	5.3	1.2	4.7	-	8.0	76.8	22.2

Note: Figures are row's trade with column as a per cent of row's total trade. n.a. indicates that data for the specific pair of countries are not available in the IMF database.

Source: IMF Direction of Trade Statistics CD-ROM.  
 StatLink  <http://dx.doi.org/10.1787/344065842321>



Trade with Russia makes up a very large share of total trade of Central Asian countries. Kazakhstan buys 38 per cent of its imports from Russia, while that figure is 25 per cent for Uzbekistan, 21 per cent for Tajikistan and 19 per cent for both Tajikistan and the Kyrgyz Republic. Exports to Russia also represent very large shares of total exports, although slightly smaller than in the case of imports. The notable exception is Turkmenistan, which receives 13 per cent of its imports from Russia and directs only 1.5 per cent of its exports to Russia, although much of its gas exports transit through the Russian pipeline system. Excluding Russia, trade flows between the BSEC countries and Central Asia are limited and, in some cases, practically non-existent, although the pattern varies significantly; Azerbaijan is, for instance, a considerable trade partner for Tajikistan and Turkmenistan, and Turkey accounts for a substantial share of total trade of all Central Asian republics, especially Tajikistan, Turkmenistan and Uzbekistan. Finally, Ukraine is the main destination of Turkmenistan exports, receiving 45 per cent of their total value, much of it natural gas. For other primary products, notably oil and cotton, it should be noted that reported bilateral trade may be a misleading guide to final destination; contracts are concluded at cotton exchanges in England or Switzerland and oil contracts may be signed anywhere, without the exporting country knowing, or caring, where the cotton or oil ends up.

The importance and intensity of trade relations within Central Asia display significant variations. Kazakhstan appears to be in the centre of these relations, providing almost 13 per cent of the imports of the Kyrgyz Republic and 12 per cent of the imports of Tajikistan, while absorbing 11 per cent of Kyrgyz and almost 6 per cent of Uzbek exports. At the same time, however, intra-regional trade accounts for a negligible share of Kazakhstan's total trade. There are substantial trade flows between Uzbekistan and Tajikistan, running in both directions; 11.7 per cent of Tajikistan's total trade is with Uzbekistan. The Kyrgyz Republic engages in some trade with Uzbekistan and Tajikistan, mainly exporting to these countries, while Turkmenistan has very limited ties with the four Central Asian countries. Tajikistan exhibits the highest degree of regional trade integration with 22.8 per cent of its total trade taking place within the Central Asian region; the respective values are also quite high for the Kyrgyz Republic and Uzbekistan, especially taking into account the fact that the region comprises only five countries, and excludes Russia.

All five Central Asian nations conduct the majority of their trade with developing, rather than developed, countries. Especially on the side of imports, the share of trade with developing countries to total trade is never below 70 per cent, and reaches 91 per cent in the case of Tajikistan. In accordance with these numbers, trade with the European Union is very limited, especially when one compares it with the respective shares in the BSEC region discussed earlier. Kazakhstan is, relatively, the most open to European Union trade, while the Kyrgyz Republic lies at the opposite end with less than 8 per cent of its total trade taking place with EU countries.

Trade with China represents between 1.3 per cent and 6.3 per cent of total trade for all the countries in the BSEC region, with imports being of slightly higher importance than exports. The countries that import the most from China (always as part of their total trade) are Russia, Romania and Turkey, whereas on the side of exports China represents a significant market only for Russia. For the Central Asian countries, apart from Turkmenistan, the second most important trade partner in the wider region (after Russia) is China. The Kyrgyz Republic imports a striking 40 per cent of its total trade from China (some of which is sold on to consumers in Uzbekistan) and Kazakhstan 14 per cent. These two countries, followed by Uzbekistan and to a lesser extent Tajikistan, conduct a substantial share of their total trade with China.

Turning now to trade specialisation analysis, Table 2.2 reports the Balassa index of export specialisation for the BSEC-CA countries in the period 2001-06. This index measures the extent to which a country specialises in each of the ten broad product groups in the Standard International Trade Classification (SITC). A value above unity indicates that an economy is relatively specialised in the exports of a particular group of products, and a value below unity indicates that an economy is relatively less specialised in the exports of a particular group. A high index value does not necessarily mean that the group accounts for a large part of the country's total exports; the index measures export specialisation relative to the rest of the world,

and not absolute specialisation. Given the high level of aggregation of the trade data used, these indices suggest macro export patterns, and do not reveal the comparative advantages in specific products.

The general pattern is that the BSEC-CA countries are relatively specialised in exports of agricultural products and raw materials. The Balassa index generally shows higher values for product groups 0-4. On the other hand, the BSEC-CA countries are least specialised in chemical products (SITC 5) and machinery (SITC 7), which require a higher level of technological intensity: the values of the Balassa index are very low for those products, and only in one group (SITC 5 for Greece) are they above one.

On a country level, the specialisation of the four energy exporters (Azerbaijan, Kazakhstan, Russia and Turkmenistan) lies clearly in oil and natural gas. Moldova, Georgia and Armenia specialise in beverages and tobacco. Serbia, Greece and Ukraine specialise in foodstuffs, mostly oils in the case of the latter two countries. Uzbekistan and Tajikistan have strong specialisation in inedible crude materials (SITC 2), attributable to exports of cotton and aluminium respectively, and the Kyrgyz Republic in gold exports (included in SITC 9).

**Table 2.2. Export Specialisation (Balassa) Index, average 2001-06**

SITC group	0	1	2	3	4	5	6	7	8	9
Country										
ALB	0.7	1.9	3.4	0.3	0.1	0.1	1.0	0.1	5.3	0.0
ARM	0.5	10.7	3.5	0.3	0.3	0.0	3.9	0.1	0.9	1.6
AZE	0.6	0.8	0.9	8.8	2.3	0.2	0.2	0.1	0.0	0.1
BGR	1.3	2.5	1.9	0.9	0.7	0.7	1.8	0.3	2.1	1.5
GEO	2.5	18.8	7.4	0.4	0.1	0.7	0.8	0.5	0.2	1.3
GRC	2.8	4.6	1.8	1.0	6.4	1.2	1.5	0.3	1.3	0.6
KAZ	0.6	0.2	2.1	6.9	0.1	0.2	1.4	0.0	0.0	0.3
KGZ	1.5	3.5	3.6	1.4	0.0	0.2	0.7	0.2	0.5	10.5
MDA	3.7	33.3	2.8	0.1	8.7	0.1	0.6	0.2	1.9	0.0
ROM	0.4	0.2	1.8	0.9	0.6	0.5	1.4	0.6	2.7	0.1
RUS	0.3	0.2	1.4	5.3	0.2	0.4	1.1	0.1	0.1	5.1
SER	3.2	1.5	1.5	0.3	2.3	0.9	2.6	0.3	1.3	0.1
TAJ *	1.5	0.2	7.6	0.1	0.0	0.1	4.4	0.0	0.2	0.1
TUR	1.5	1.1	0.5	0.2	1.2	0.3	1.8	0.6	1.9	3.8
TKM *	0.0	0.0	0.9	9.3	0.0	0.1	0.2	0.1	0.1	0.1
UKR	1.5	1.2	2.4	1.0	5.2	0.8	3.1	0.4	0.4	0.3
UZB *	1.9	0.6	10.0	1.5	0.2	0.6	1.4	0.2	0.1	1.7

Notes: \* indicates the use of mirror trade data for the calculation of the index.

SITC (revision 3) groups: 0 = food and live animals; 1 = beverages and tobacco; 2 = crude materials, inedible, except fuels; 3 = mineral fuels, lubricants and related materials; 4 = animal and vegetable oils, fats and waxes; 5 = chemical and related products; 6 = manufactured goods classified chiefly by material; 7 = machinery and transport equipment; 8 = miscellaneous manufactured articles; 9 = commodities and transactions not classified elsewhere.

Source: calculations based on UN COMTRADE database (accessed through <http://wits.worldbank.org>).

StatLink  <http://dx.doi.org/10.1787/344068432667>

The potential for trade competition in the BSEC-CA region is another factor that affects, and can highlight, integration into the global economy. The coefficients of export conformity (shown in Annex Table 1) are a measure of similarity in the exporting structure between countries. The higher the value of the coefficient between two countries, the more similar their export structures; a coefficient of 1.0 corresponds to a perfect match, and values close to 0.5 already indicate a very strong similarity in export structures between two countries. These values can be translated into a measure of potential export competition with countries that specialise in the same mix of exported products representing a threat to each other. The coefficients have been calculated for the BSEC-CA countries; China and India have also been included to give an idea about the role they can play and their potential impact on trade in the region. However, because these coefficients are calculated at the one-digit SITC level, they present very rough indicators of opportunities and threats.

Potential export competition is particularly strong in the Balkan region, with all the relevant coefficients being among the highest observed in Annex Table 1. The highest degrees of similarity are observed between Bulgaria and Romania, and between Greece and Turkey. Russia, on the other hand, does not seem to pose a serious threat to the exports of Greece and Turkey, and only a very moderate one to those of Bulgaria and Romania. Bulgaria, Romania, Serbia and Ukraine all have similar export structures and are therefore potential competitors and the same is true of Serbia and Greece, while Albania and Moldova do not exhibit strong similarities with any other countries, with the possible exceptions of Romania and Bulgaria respectively.

Armenian and Georgian exports exhibit some degree of conformity with each other, but not when one compares them to exports of third countries. Azerbaijan, in contrast, has very high conformity coefficients with Kazakhstan (0.61) and Russia (0.44), and very low ones in all other cases; this is due to the relative specialisation of these countries in oil and gas exports, as can be seen from their Balassa indices for these products (SITC 3). Russia and Kazakhstan share similar export structures with only one-third country in the sample, Azerbaijan. The Kyrgyz Republic has a distinctly different export structure to every other country, mainly due to its heavy reliance on gold exports, which are classified under a different product category (SITC 9) than exports of other extractive industries.

Annex Table 2 presents the coefficients of export-import conformity, for the same sample of countries and using the same methodology. These coefficients are a measure of similarity between one country's export structure (the row in the table) and another country's import structure (the column in table); in other words, it is a measure of the extent to which one country represents an opportunity for others to export to it. The figures reveal that the import structure of the region is well suited to exports from Greece and Turkey, with coefficients ranging between 0.33-0.35 and 0.51-0.54. This is true for the whole of the BSEC region, including the Caucasus, as well as for the Central Asian countries. Bulgaria and Romania also have high coefficients for their exports, which means that the BSEC-CA region represents a significant opportunity for their exports. Apart from these four high-income BSEC countries, the region seems to be quite favourable to exports from Ukraine and Serbia. This is not always true for Russia, whose export structure is relatively similar to the import structures of the high-income countries of the BSEC, Ukraine and Serbia, but not to those of the other countries under examination. The values of the coefficient are always low for Albania. The same is generally true in the case of Moldova, which sees Albania and Russia as its best export opportunities. As far as the countries of the south Caucasus are concerned, they do not have those export structures that would encourage them to engage more heavily in intra-regional trade. Armenia's exports, notably, do not display a coefficient higher than 0.15 with any other country in the region. Finally, the results are also discouraging for the Central Asian countries: none of the countries in the region can be considered an obvious opportunity for Kazakhstan or the Kyrgyz Republic to expand their exports.

Rapid economic growth in China and in India has raised concerns about whether they are a competitive threat to producers in the BSEC-CA region, while more optimistic commentators point to the increasing demand from China and India as a source of large potential benefits for countries owing to an increase in their exports. The values of the coefficients of conformity,

shown in Annex Table 2, suggest that both fears and hopes could be overblown at the export-import aggregate level. The caveat that the tables are constructed at a high level of aggregation should, however, be borne in mind; given the sizes of the Chinese and Indian economies relative to most BSEC-CA economies, there may be both threats and opportunities for specific producers.

## FINANCIAL FLOWS

External financing, including capital inflows (both equity and debt flows), workers' remittances and official development assistance (ODA) compensates for low saving rates in many of the BSEC-CA countries. The region has seen a significant increase in private capital inflows over the last few years, but still lags behind other emerging economies. Figure 2.1 and Figure 2.2 show that investment flows have been unevenly distributed with a few countries in the BSEC-CA region (Greece, Russia and Turkey in BSEC and Kazakhstan in Central Asia) accounting for the bulk of investment. Foreign investment in natural resource-based industries is also relevant. Remittances also play an important role, although their contribution to external financing and GDP varies considerably across countries. ODA played an important role in supporting the transition to market economies in many countries and remains a significant source of financing for the lower income ones.

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In 2006, total external financing to the BSEC-CA region as a whole amounted to USD 304 billion, or 14 per cent of the 17 countries combined GDP (Table 2.3). In particular, capital inflows reached a record high of USD 275.7 billion. This represented a 30 per cent increase over the previous year, while ODA and workers' remittances remained at about the same level of 2005. Such growth in capital inflows was mainly due to a strong increase in foreign direct investment (FDI), which almost doubled between 2005 and 2006. Portfolio inflows slightly declined, while "other flows", which include financial derivatives and other investment liabilities (currency transactions, deposits, loans and trade credits), continued their strong rise, although at a slower pace than in 2005 (they rose by 22 per cent in 2006, against 130 per cent in 2005). On average, private flows to the BSEC-CA region have grown at a compound rate of 32 per cent per year since 1995. The strongest growth took place over the last five years, with an average annual increase of 45 per cent between 2002 and 2006.

This aggregate picture needs qualifications as there are important differences between the BSEC and CA regions, as well as within them. The BSEC countries accounted for the bulk of capital inflows, receiving USD 241 billion, or 90 per cent of overall inflows in the BSEC-CA region – a figure that mirrors their share in the GDP of the region as a whole (95 per cent). The overall performance of the BSEC region is influenced heavily by the three largest economies: Greece, Russia and Turkey (Figure 2.3). In terms of flows, "other investment liabilities" accounted for the largest share, although the importance of FDI has increased dramatically since 2002. The nine other BSEC members only received 26 per cent of total capital inflows in 2006, mainly as FDI, while portfolio flows and other capital flows played a less important role for these countries. The degree of openness to capital inflows – as measured by their share in a country's GDP – is highest in Bulgaria, Serbia and Ukraine, while in Albania, Russia and Armenia they account for less than 10 per cent of GDP. Both workers' remittances and ODA remained relatively stable over the last ten years.

In 2006, remittances reached USD 22 billion for the whole region, while ODA only represented USD 3.4 billion. Remittances were extremely high as a percentage of GDP in three countries, Moldova (36 per cent), Tajikistan (36 per cent) and Kyrgyzstan (27 per cent), and moderately high in Albania (15 per cent), Armenia (18 per cent), and Serbia and Montenegro (14 per cent) in 2006 (World Bank, 2008). In Georgia and Romania, remittances amount to some 6 per cent of GDP (World Bank, 2008).

The five Central Asian Republics attracted USD 34.3 billion in capital inflows in 2006, a threefold increase from 2005. The extraordinary capital inflows into Kazakhstan, where FDI tripled from that of 2005, and other capital flows jumped from 8.4 to 26.7 billion, largely explain the regional pattern (Table 2.3). Over 1995-2006, Kazakhstan received, on average, USD 6.5 billion per year, while the other four Central Asian countries together received only USD 960 million per year. The capital inflows represented some 27 per cent of the region's GDP in 2006, but this picture masks a high heterogeneity amongst the four republics: the high share in Kazakhstan's GDP offsets the very low level in the other countries where capital inflows account for between 1 and 2 per cent of GDP. For Kazakhstan, Kyrgyzstan and for Tajikistan, data on worker's remittances have only been available since 2002 and should therefore be interpreted with extreme care. In 2006, remittances amounted to USD 1.5 billion (or 1.8 per cent of the three countries combined GDP), although this figure is likely to underestimate reality, given the high level of informal remittances in the region. Tajikistan was the largest recipient, both in absolute (USD 1.02 billion) and relative terms (36 per cent of GDP). ODA amounted to about USD 900 million.

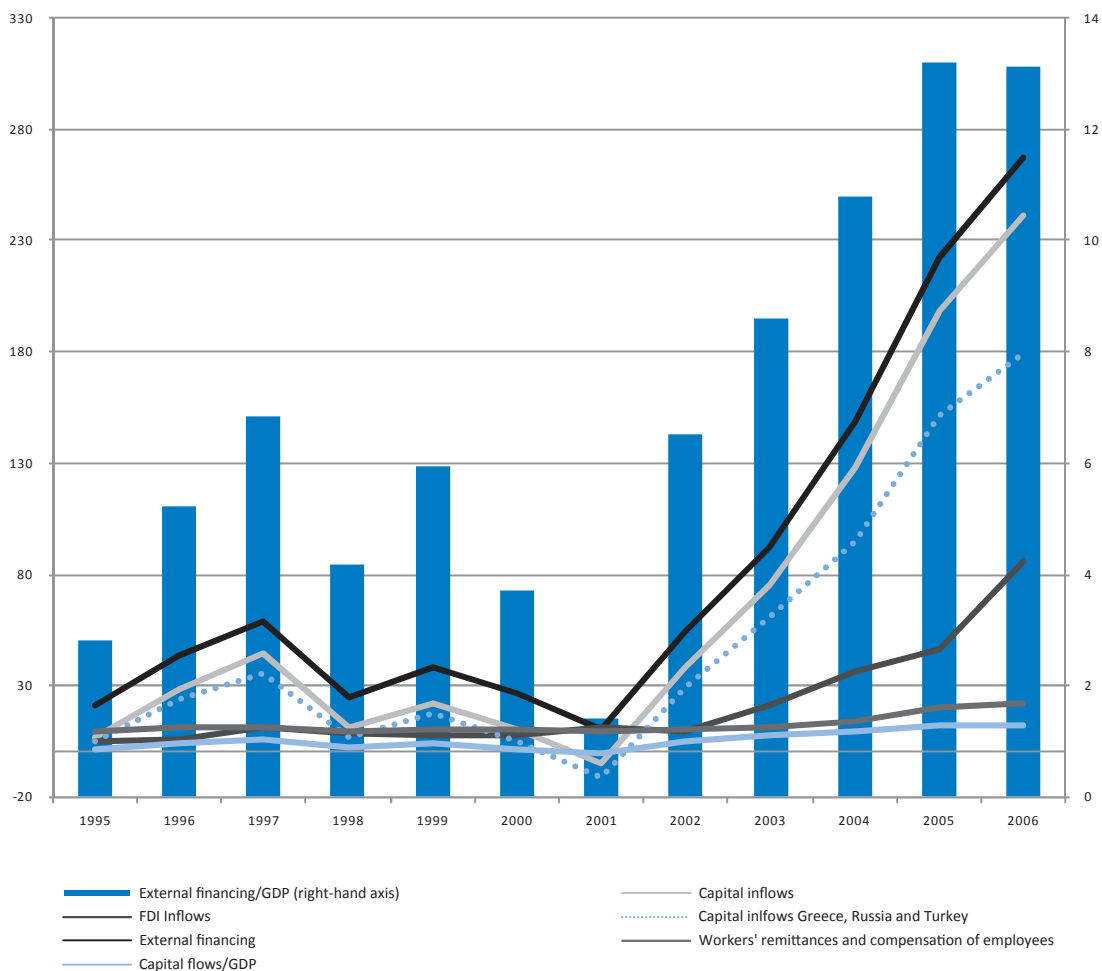
The year 2006 saw a dramatic surge in FDI to the BSEC-CA region, reaching USD 90 billion (Figure 2.3). Inflows rose in almost all countries, driven by several factors. FDI to UMH-BSEC countries more than doubled in 2006 when it reached USD 76 billion. The main drivers were the forthcoming accession of Bulgaria and Romania to the European Union, the continuation of the privatisation process and new opportunities in extractive industries, especially in Russia. Greece and Turkey recorded their highest-ever FDI inflows, owing to large takeover deals in the financial sector and telecommunication sector (OECD, 2007a). On the other hand, the LLM-BSEC group of countries attracted less FDI in 2006 than in 2005. The increased FDI to Albania, Armenia, Moldova and especially Georgia (registering a 140 per cent increase) were not sufficient to offset the reduced inflows to Ukraine and the strong decline in Azerbaijan, where major FDI-funded projects reached their concluding phase, resulting in a negative inflow of USD 600 million. FDI to Central Asia rose strongly in every country, but especially so in Kyrgyzstan and Tajikistan, although from very low levels. Investment was mainly driven by new projects in extractive industries and related infrastructure.

In fact, FDI has been on the rise since the early 2000s. Cumulated inflows over 2002-06 amounted to USD 221 billion, against only USD 57 billion over the previous five years (see Table 2.4). Russia, Romania and Turkey alone accounted together for 60 per cent of that figure. On average, Russia received more than USD 13 billion in FDI per year over this period, followed by Turkey (USD 7 billion) and Romania (USD 5.5 billion). The inflows of FDI are more evenly spread amongst the BSEC countries (with only Albania, Armenia, Georgia and Moldova receiving about 1 per cent of the regional investment each), while the distribution is extremely skewed in Central Asia, where Kazakhstan accounted for 80 per cent of the inflows over 2002-06.

Despite such a remarkable growth, the BSEC-CA region remains relatively small in the global geography of FDI, accounting for less than 5 per cent of global inflows over 2002-06. Over the last five years, the BSEC LLM countries combined attracted about the same amount of direct investment as the Czech Republic, while the whole of Central Asia received slightly less than Hungary.

The contribution of FDI to national fixed capital formation has also increased substantially over the last ten years. Over 2002-06, the unweighted average ratio of FDI inflows to gross investment was 29 per cent in the BSEC region, against 25.4 over 1997-2001. For Central Asia, the ratio was 31.4 against 19 per cent in the previous five years. The importance of foreign investment in capital accumulation varies considerably across countries (Figure 2.4), as does the ratio of FDI inward stock to GDP. The latter ranges from a low of 8 per cent in Uzbekistan to a high of about 66 per cent in Azerbaijan and Bulgaria.

**Figure 2.1. External Financing in BSEC (1995-2006), USD billion, per cent of GDP**

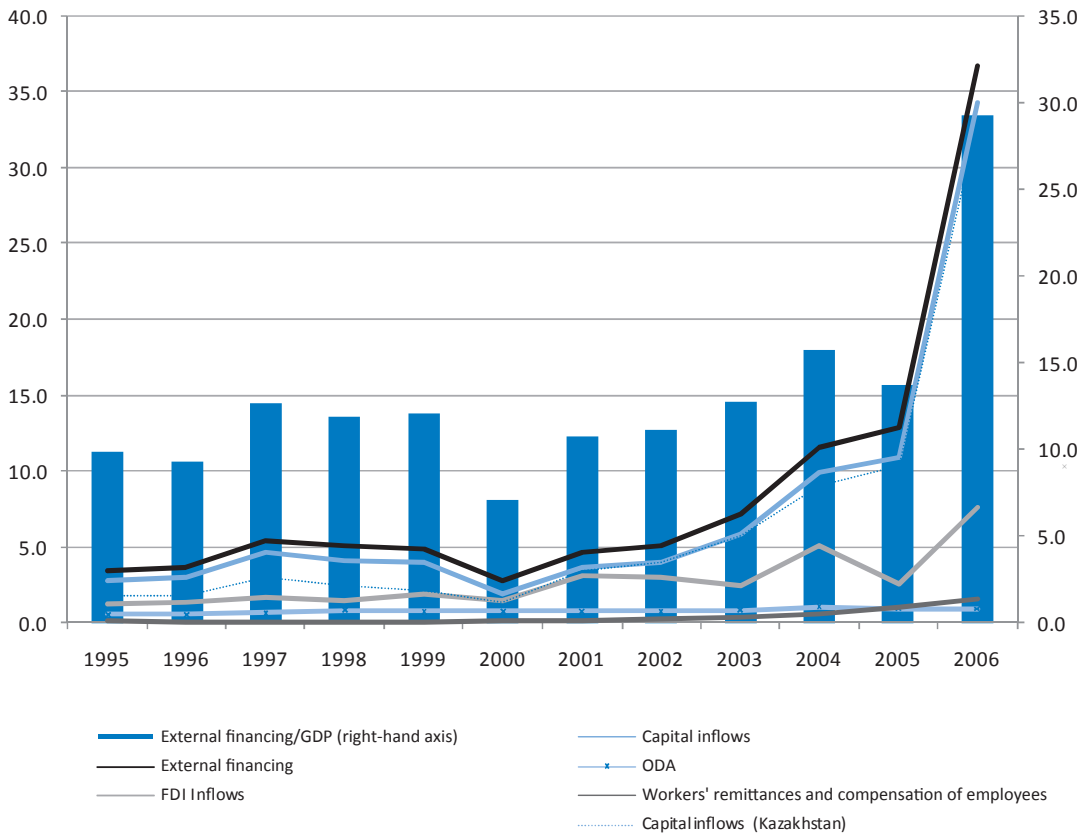


Notes: Data on capital flows and remittances are not available for Greece for 1998. ODA data include assistance from all bilateral and multilateral donors.

Source: IMF International Financial Statistics 2007 (on-line database, accessed 28 February 2008); World Bank, Global Development Finance 2007 (on-line database accessed 28 February 2008) for data on capital portfolio (equity and debt) flows to Serbia, Uzbekistan, Turkmenistan; and OECD Development Assistance Committee International Development Statistics (on-line database accessed on 28 February 2008).

StatLink <http://dx.doi.org/10.1787/343446070240>

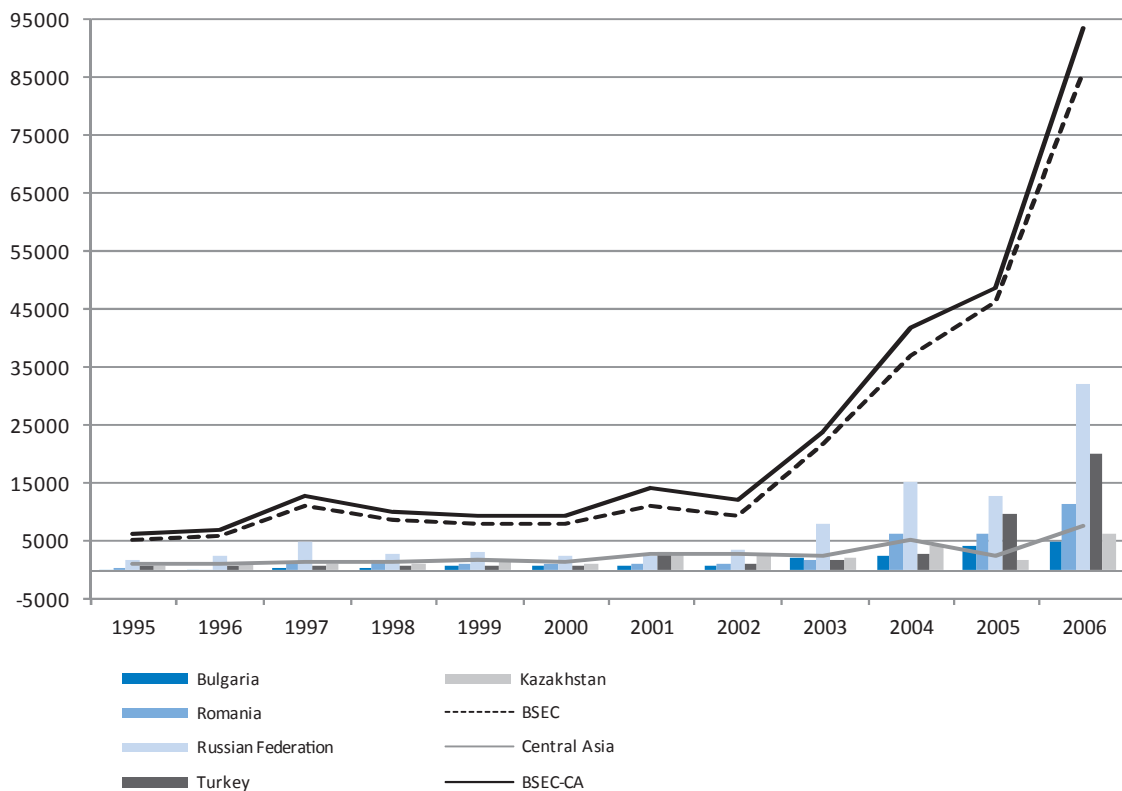
**Figure 2.2. External Financing in Central Asia (1995-2006), USD billion, per cent of GDP**




Source: see Figure 2.4.

StatLink  <http://dx.doi.org/10.1787/343465838861>

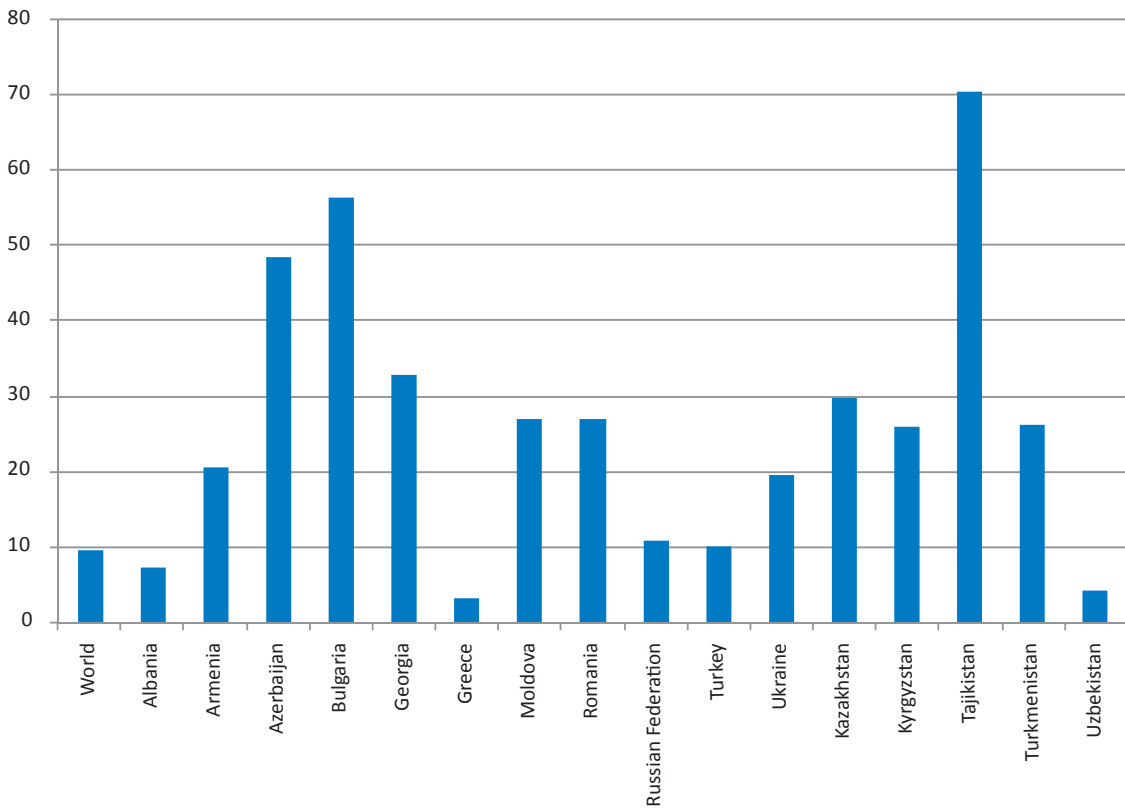
**Figure 2.3. FDI Inflows to the BSEC-CA Region (1995-2006, USD million)**



Source: UNCTAD World Investment Report 2007 (on-line database accessed 28 February 2008 at <http://stats.unctad.org>).  
 StatLink  <http://dx.doi.org/10.1787/343484740233>



**Figure 2.4. Inward FDI Stock as Percentage Share of Gross Fixed Capital Formation (average 2002-06, per cent)**



Note: Data for Serbia not available.

Source: UNCTAD *World Investment Report 2007* (on-line database accessed 28 February 2008 at <http://stats.unctad.org>).

StatLink  <http://dx.doi.org/10.1787/343551107755>

Data on FDI by country of origin are notably of poor quality and not reliable. Based on information provided by central banks, the United Nations Conference on Trade and Development (UNCTAD) has a matrix of FDI by source country covering the period 1993-2003. However, not only do these data stop in 2003, they are only available for Armenia, Azerbaijan, Bulgaria, Kazakhstan, Kyrgyzstan, Moldova and Russia. Nevertheless, the data show that Europe and the United States are the largest foreign investors in the region. In the early-2000s, China emerged as a major investor in Central Asia.

In terms of sectoral composition, FDI in the countries of the south Caucasus and Central Asia has been driven by the availability of oil and gas. The region around the Caspian Sea has one of the richest endowments of oil and especially natural gas in the world. Estimates of the region's crude oil reserves vary widely, from a low of 17 to a high of 49 billion barrels. Regional oil production, which reached 2.3 million barrels per day in 2006, was largely driven by Kazakhstan (63 per cent of oil production), followed by Azerbaijan (21 per cent), Turkmenistan (10 per cent) and Uzbekistan (6 per cent). The natural gas potential is even more significant, with reserves estimated at 232 trillion cubic feet, placing the region fourth after Russia, Iran and Qatar. The strategic geographic location of this region is also a driver of FDI, particularly as transit routes for pipelines. Construction of the USD 3.7 billion Baku-Tbilisi-Ceyhan oil pipeline (started in 2003 and completed in 2005) and of the USD 1 billion south Caucasus gas pipeline (Baku-Tbilisi-Erzurum) have been amongst the largest FDI projects in the region. Most of Kazakhstan's FDI has been in the extraction and transport of oil and gas from the Caspian region oil fields (Tengiz, Karachaganak and Kashagan), although Kazakhstan has also attracted considerable

FDI in mining, power, telecommunications and other public utilities sectors, as well as in the banking sector (for example, the acquisition of the ATF Bank by Unicredit in 2007).

In contrast to this mainly “resource seeking” FDI in the Caucasus and Central Asia, other host countries have a more diversified picture, with both “efficiency seeking” and “market seeking” FDI in manufacturing and services (mainly telecommunications and banking). Russia’s inward FDI ranges from natural resources to manufacturing (e.g. Coca Cola’s USD 501 million investments in food and beverages), construction and services. Romania and Ukraine registered FDI surges in 2005, associated to the on-going privatisation processes. In Romania, the new annual FDI record was mainly related to the privatisation of the Romanian Commercial Bank (bought by Austria’s Erste Bank). The sale of the Kryvorizhstal iron and steel factory (bought by Mittal steel for USD 4.8 billion) and of Aval Bank (bought by Raiffeisen International for USD 1 billion) led an over fourfold increase in FDI to Bulgaria.

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A new dynamism in the region’s multinational corporations (MNCs) contributed to escalations in outward FDI, with increases of 40 per cent between 2005 and 2006, reaching USD 24 billion. Russia, Greece and Turkey have emerged as significant sources of outward FDI. Their cumulative outward FDI reached USD 69 billion over 2002-05, with Russia responsible for 78 per cent of the total, followed by Greece with 10 per cent, Turkey with 5 per cent and Azerbaijan with 6 per cent (Table 2.5). Giant natural resource exploitation and energy companies are driving the expansion of Russian MNCs, while other important multinational enterprises are active in mining, metals and metal products (e.g. nickel and aluminium). While some of these companies are establishing themselves as global competitors, most outward Russian FDI remains regional, with BSEC-CA countries as the main destination. Russian companies are also major concerns in the regional mobile telecom market. Oil prices and competition for resources in 2005 and 2006 prompted Russian MNCs to maintain high levels of FDI abroad; for example, Lukoil acquired Canadian-based oil company Nelson Resources, and RusAl became a joint-venture refinery partner in Australia, while the electricity company, Unified Energy Systems, won a privatisation bid for power stations in Bulgaria.

Greek outward FDI surged from the early 2000s to reach USD 4.2 billion in 2007. Greece’s outward FDI concentrates in the BSEC region and includes large investments in Bulgaria and Romania, mainly in telecommunications, construction, information technology, the plastic industry, distribution and banking. In 2006, Greece was the fourth largest foreign investor in Bulgaria after the United Kingdom, Netherlands and Austria, with investments over EUR 280 million, while in Romania it ranked ninth. Significant Greek FDI is also taking place in Albania.

Turkish MNCs invested some USD 900 million abroad in 2006, slightly less than in 2005. National data suggest that Turkey’s outward investments are concentrated in the European Union with 63 per cent of total cumulated outward FDI over 1997-2004 going to the EU-25. The BSEC countries received 22 per cent of this cumulative investment, and Central Asia received 8 per cent. Turkish companies investing abroad are mostly active in finance (37 per cent of total outward FDI), manufacturing (22 per cent) and energy (20 per cent). Turkish outward FDI within the BSEC-CA region is dominated by energy (70 per cent), manufacturing (14 per cent) and finance (8 per cent). The internationalisation of the Turkish economy is mainly driven by large conglomerates in manufacturing, especially of consumer durables, retail, banking, and food and beverages. There are, however, some small- and medium-sized enterprises, especially in the textile sector, investing in neighbouring countries. Azerbaijan is the first destination of Turkish investment within the BSEC-CA region due to huge investments in the energy and construction sector. Kazakhstan also received an important share of Turkish FDI, concentrated in the energy sector. Russia has emerged as an increasingly important FDI destination over the last few years.

Finally, most of the Azerbaijani outflow – which rose from USD 1 million in 2000 to over USD 1 billion in 2004 and 2005 – was related to the construction of the Baku-Tbilisi-Ceyhan pipeline in which the State Oil Company of Azerbaijan has a 25 per cent share.

Official development assistance (ODA) represents an important source of financing for many of the BSEC-CA countries. While ODA to the whole BSEC-CA region remained stable over the

2000-04 period, averaging USD 6.4 billion per year, with BSEC countries receiving the bulk of the assistance, over 85 per cent of the total went to only four countries, namely Russia, Serbia, Romania and Bulgaria (Table 2.6). Multilateral donors accounted for one-third of total disbursed ODA over this period, while EU countries were the main bilateral donors (Table 2.6). The removal in 2005 of Bulgaria, Romania and Russia from the OECD Development Assistance Committee (DAC) list of ODA recipient countries makes regional comparisons within BSEC more problematic after 2004. Over the following two years, donors disbursed USD 6.6 billion to the nine ODA-eligible BSEC countries, with Serbia getting 40 per cent of the total, followed by Ukraine (13 per cent), Georgia and Albania (10 per cent each). ODA to Central Asia amounted to USD 1.8 billion over the biennium; it was more evenly spread amongst countries than in the BSEC region. While Turkmenistan accounted for only 3 per cent of the total, the other four republics received between 17 and 31 per cent of the total. Over 2000-04, ODA represented, on average, 0.6 per cent of the aggregate BSEC regional GDP (including ODA-eligible countries only), while this figure was 4.4 per cent in Central Asia. The relative importance of ODA is stronger for the lower-income BSEC-CA countries. Aid amounted to over 10 per cent of GNI in countries such as Armenia, the Kyrgyz Republic, Serbia and Tajikistan, although this figure has generally decreased by 4 to 5 per cent for the two BSEC countries (i.e. Armenia and Serbia) in 2005 and 2006.

While Turkey received on average USD 300 million in ODA over 2002-06 (mainly from the European Commission), this inflow represented less than 0.15 per cent of the country's GDP. Moreover, Turkey has emerged as an important aid donor, providing some USD 714 million of ODA in 2006, corresponding to 0.18 per cent of the gross national income. This represented an increase of 12.2 per cent in real terms over 2005. Approximately half of Turkey's ODA went to the Caucasus and Central Asia and some 15 per cent to the Balkans and Eastern Europe. Similarly, Russia is graduating from an aid-receiving country to an aid-giving country. Official government figures estimate Russian ODA in 2005 and 2006 at about USD 100 million.

**Table 2.3. External Financing (1996-2006, USD billion)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
BSEC-CA												
External financing	23.9	47.0	63.7	29.3	42.4	29.2	14.7	59.6	98.9	160.0	235.2	304.0
Capital inflows	10.1	31.5	49.5	15.8	26.2	12.5	-1.0	42.0	81.3	138.2	209.1	275.7
FDI Inflows	6.5	7.4	13.0	10.2	9.8	9.6	14.4	12.4	24.2	42.1	48.9	93.7
Other capital flows	3.0	16.3	12.5	4.6	6.7	4.6	-19.9	12.1	31.8	46.5	106.4	129.9
Portfolio Investment (equity and debt)	0.5	7.8	24.0	1.0	9.7	-1.7	4.5	17.6	25.3	49.6	53.8	52.2
ODA	4.1	3.9	3.0	3.9	5.8	6.0	5.9	7.0	6.2	6.9	4.2	4.3
Workers' remittances and compensation of employees	9.7	11.6	11.2	9.6	10.3	10.7	9.7	10.5	11.4	14.9	21.9	24.0
Capital flows/GDP	1.3	3.6	5.5	2.0	3.9	1.7	-0.1	4.8	7.2	9.5	11.8	12.8
Remittances/GDP	1.3	1.3	1.2	1.2	1.5	1.4	1.3	1.2	1.0	1.0	1.2	1.1
BSEC												
External financing	20.4	43.3	58.3	24.3	37.5	26.4	10.0	54.5	91.7	148.4	222.4	267
Capital inflows	7.3	28.4	44.8	11.6	22.2	10.6	-4.7	38.0	75.4	128.3	198.2	241
FDI Inflows	5.3	6.0	11.3	8.8	7.9	8.1	11.3	9.4	21.8	36.9	46.3	86.0
Other capital flows	2.0	15.6	11.0	3.1	6.0	4.5	-20.5	10.4	28.3	42.3	99.0	107.4
Portfolio Investment (equity and debt)	0.0	6.8	22.5	-0.2	8.3	-2.0	4.5	18.2	25.3	49.0	52.8	48.0
ODA	3.5	3.4	2.4	3.1	5.1	5.3	5.2	6.3	5.3	5.8	3.2	3.4
Workers' remittances and compensation of employees	9.6	11.5	11.1	9.5	10.2	10.5	9.6	10.2	11.0	14.3	21.0	22.4
Capital flows/GDP	1.0	3.4	5.2	1.6	3.5	1.5	-0.7	4.5	7.1	9.3	11.8	11.9
Remittances/GDP	1.3	1.4	1.3	1.3	1.6	1.5	1.3	1.2	1.0	1.0	1.2	1.1
CA												
External financing	3.4	3.7	5.4	5.1	4.9	2.8	4.6	5.1	7.1	11.6	12.9	36.8
Capital inflows	2.8	3.1	4.7	4.2	4.0	1.9	3.7	4.0	5.9	9.9	11.0	34.3
FDI Inflows	1.3	1.4	1.7	1.5	1.9	1.5	3.1	3.0	2.5	5.1	2.6	7.6
Other capital flows	1.0	0.7	1.5	1.5	0.7	0.1	0.6	1.7	3.5	4.2	7.4	22.5
Portfolio Investment (equity and debt)	0.5	1.0	1.5	1.2	1.4	0.3	0.0	-0.7	-0.1	0.6	1.0	4.2
Capital inflows to Kazakhstan	1.8	1.8	3.0	2.5	2.1	1.4	3.5	4.0	5.7	9.0	10.3	33.0
ODA	0.5	0.6	0.6	0.8	0.8	0.7	0.7	0.8	0.8	1.1	0.9	0.9
Workers' remittances and compensation of employees	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.3	0.4	0.6	1.0	1.5
Capital flows/GDP	8.0	7.6	11.1	9.8	10.0	4.9	8.6	8.8	10.6	13.5	11.7	27.4
Remittances/GDP	0.6	0.4	0.3	0.4	0.5	0.7	0.8	1.2	1.1	1.3	1.6	1.8

Note: data for workers' remittances and compensation of employees are not available for Uzbekistan over the whole period, and for Tajikistan before 2002. The ratio to GDP has been calculated accordingly.

Source: see Figure 2.4.  
StatLink  <http://dx.doi.org/10.1787/344085634547>

**Table 2.4. Cumulated FDI Inflows (five-year periods, 1997-2001 and 2002-06)**

	1997-2001			2002-06		
	Sum of FDI inflows (USD million)	Share in region's FDI (per cent)	Average annual flow (USD million)	Sum of FDI inflows (USD million)	Share in region's FDI (per cent)	Average annual flow (USD million)
Albania	484	1.0	97	1 253	0.6	251
Armenia	569	1.2	114	1 052	0.5	210
Azerbaijan	2 604	5.5	521	9 233	4.6	1 847
Bulgaria	3 748	7.9	750	15 553	7.8	3 111
Georgia	859	1.8	172	2 532	1.3	506
Greece	4 315	9.1	863	9 397	4.7	1 879
Moldova	423	0.9	85	728	0.4	146
Romania	6 488	13.8	1 298	27 751	14.0	5 550
Russian Federation	16 398	34.8	3 280	68 361	34.4	13 672
Serbia and Montenegro	1 180	2.5	236	10 205	5.1	2 041
Turkey	6 862	14.5	1 372	35 695	18.0	7 139
Ukraine	3 249	6.9	650	16 843	8.5	3 369
<b>BSEC</b>	<b>47 178</b>	<b>100.0</b>	<b>9 436</b>	<b>198 603</b>	<b>100.0</b>	<b>39 721</b>
Kazakhstan	8 062	84.2	1 612	16 960	81.7	3 392
Kyrgyzstan	239	2.5	48	450	2.2	90
Tajikistan	88	0.9	18	761	3.7	152
Turkmenistan	596	6.2	119	2 005	9.7	401
Uzbekistan	586	6.1	117	574	2.8	115
<b>Central Asia</b>	<b>9 571</b>	<b>100.0</b>	<b>1 914</b>	<b>20 751</b>	<b>100.0</b>	<b>4 150</b>
<b>BSEC-CA</b>	<b>103 928</b>	<b>100.0</b>	<b>20 786</b>	<b>417 957</b>		<b>83 591</b>
World	4 541 374	100.00	908 275	4 179 864	100	835 973
BSEC	47 178	1.04	198 603		4.8	
BSEC 9	19 604	0.43	85 150		2.0	
Central Asia	9 571	0.21	20 751		0.5	

Note: Data for Serbia alone are available only starting in 2004. For the purpose of comparison between the two periods, data for Serbia and Montenegro are used in this table and in text.

Source: UNCTAD World Investment Report 2007 (on-line database accessed 28 February 2008 at [stats.unctad.org](http://stats.unctad.org)).

StatLink  <http://dx.doi.org/10.1787/344153115857>

**Table 2.5. Outward FDI from the BSEC-CA Region, 1995-2005 (USD million)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Albania	12	10	10	1	7	6	0	-	-	14	4	11
Armenia	-	-	0	-	2	-1	0	1	0	2	7	3
Azerbaijan	-	4	0	0	-	1	12	326	933	1 205	1 221	705
Bulgaria	-8	-29	-2	0	17	3	8	29	27	-217	308	156
Georgia	-	-	-	1	1	-0	-0	4	4	10	-89	-18
Greece	42	-25	156	-276	552	2 137	616	655	412	1 029	1 451	4 167
Moldova	1	1	0	-1	0	0	0	0	0	3	-0	-1
Romania	2	0	-9	-9	16	-13	-16	17	39	70	-30	38
Russian Federation	606	923	3 184	1 270	2 208	3 177	2 533	3 533	9 727	13 782	12 763	17 979
Serbia	-	-	-	-	-	-	-	-	-	-	58	112
Turkey	113	110	251	367	645	870	497	175	499	859	1 078	934
Ukraine	10	-5	42	-4	7	1	23	-5	13	4	275	-133
Kazakhstan	-	-	1	8	4	4	-26	426	-121	-1 279	-146	-412
Kyrgyzstan	-	-	-	23	6	5	6	0	0	44	0	0
Tajikistan	-	-	-	-	-	-	-	-	-	-	-	-
Turkmenistan	-	-	-	-	-	-	-	-	-	-	-	-
Uzbekistan	-	-	-	-	-	-	-	-	-	-	-	-

Source: UNCTAD World Investment Report 2007 (on-line database accessed 28 February 2008 at [stats.unctad.org](http://stats.unctad.org)).  
 StatLink  <http://dx.doi.org/10.1787/344153116300>

**Table 2.6. Net ODA Disbursement to the BSEC-CA Region, all donors (USD million)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Albania	180	226	166	269	488	317	270	308	349	299	319	321
Armenia	218	292	166	194	209	216	198	293	249	254	193	213
Azerbaijan	119	96	184	120	169	139	232	349	301	176	225	206
Bulgaria	113	180	220	239	271	311	346	327	420	620	..	..
Georgia	209	309	242	209	245	169	300	313	226	314	309	361
Moldova	66	36	65	40	107	123	122	142	118	120	191	228
Romania	298	231	219	367	387	432	648	419	601	914	..	..
Russian Federation	1 611	1 281	793	1 078	1 946	1 561	1 108	1 296	1 252	1 322	..	..
Serbia and Montenegro	95	70	97	108	676	1 134	1 306	1 930	1 318	1 170	1 136	1 586
Turkey	313	245	7	29	11	327	169	410	165	286	459	570
Ukraine	319	398	268	465	569	541	519	483	323	358	396	484
BSEC Total	3 540	3 365	2 427	3 117	5 078	5 270	5 217	6 270	5 320	5 832	3 227	3 968
Kazakhstan	65	124	140	223	175	189	148	188	270	268	225	172
Kyrgyz Republic	285	230	240	240	283	215	189	186	200	261	268	311
Tajikistan	65	103	86	161	123	124	169	168	148	243	251	240
Turkmenistan	28	24	12	24	24	31	72	41	27	37	29	26
Uzbekistan	84	88	140	158	155	186	153	189	195	246	169	149
CA Total	526	569	618	805	760	744	731	772	839	1054	943	897
BSEC-CA	4 066	3 934	3 045	3 922	5 838	6 015	5 948	7 042	6 160	6 887	4 171	4 866

Note: Bulgaria and Romania were removed from the DAC list of ODA-eligible countries in 2005.

Source: OECD DAC *International Development Statistics* (on-line database accessed at [www.oecd.org/dac/stats](http://www.oecd.org/dac/stats) on 28 February 2008).  
 StatLink  <http://dx.doi.org/10.1787/344175783167>

## MIGRATION

The collapse of central planning and especially the dissolution of the Soviet Union brought about social as well as economic changes; one of these was the increased freedom to move. This was followed by large-scale migration. Much of the migration in the early 1990s was driven by political disruption (e.g. wars in the Balkans, the Caucasus and Tajikistan) or motivated by cultural factors; the latter includes the pull of consanguinity (e.g. the prospect of citizenship in Germany or Israel), and the push of feeling out of place in the new independent states (e.g. the movement of many ethnic Russians to the Russian Federation). In Kazakhstan and Ukraine, emigration was on such a scale that despite natural increase the population is still less than it was in 1990. The permanent migrants often incorporated high levels of human capital so that this represented a substantial brain drain.

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Since the late 1990s, however, the largest migration flows have been driven by the search for temporary employment. For the CIS countries the main pole of attraction has been Russia and to a lesser extent Kazakhstan as these countries' economies have boomed, while for the western BSEC-CA countries the European Union has been the main destination. There are, however, many variations on these broader themes, as analysed in Chapter Five.

Migration data are notoriously difficult to compile. However, according to a recently constructed World Bank database on bilateral migrant stocks, as of the early 2000s, the Europe and Central Asia region (as defined by the World Bank and roughly coterminous with the BSEC-CA region) was the world's largest region of emigration with 25.9 per cent of the world's migrants by origin. As a destination region for migrants, it was, with 18.6 per cent of the world's total, only marginally behind the United States (19.7 per cent) and the EU-15 plus the European Free Trade Association region (19.1 per cent). According to the International Organization for Migration (IOM), Russia was host to the second largest number of international migrants in 2005 (12.1 million), superseded only by the United States (38.4 million) (IOM, 2006). Notably, Germany hosts the third largest number of migrants (10.1 million), but perhaps most surprisingly, Ukraine hosts the fourth largest number with 6.8 million migrants. Europe, as a whole, however, hosts the largest number of international migrants, estimated at 64 million in 2005 – 11 million more than Asia and 21 million more than North America in the same year (UN DESA, 2005).

Immigration and emigration data presented are estimates, in part because of conceptual differences in the reporting of permanent and temporary migrants, but also because of data collection difficulties. This is especially true for emigrants, which are the group of greatest interest in most BSEC-CA countries (see Box 5.4 on Moldova). The situation is complicated by the irregular status of many migrants; estimates of the number of irregular migrants within the CIS region vary from 5 to 15 million, of whom most are in Russia, with about a million in Kazakhstan and 0.2 million in Ukraine. Especially in Russia and Ukraine, there are large numbers of transit migrants from Africa or South Asia whose ultimate destination is Western Europe, but they have been stranded en route due to tight control of EU borders.

The net external migration data, shown in Table 2.7, suggest that the magnitudes of migrants have fallen from the high levels of the 1990s. This may be misleading for several reasons, apart from the inherent unreliability of the data. The shift from permanent migration, based partially on non-economic motives, to temporary migration, primarily for economic reasons, makes it likely that the gap between reported and actual flows is larger in the 2000s. Moreover, within some of the BSEC-CA countries there is simultaneous immigration and emigration; for example, Russia is estimated to have two to three million workers abroad, which likely represents a brain drain of skilled workers. Ukrainian workers travel to Poland where some sectors have labour shortages because Polish workers have migrated temporarily or permanently to other parts of the European Union, while workers from the poorer CIS countries work in Ukraine; a pattern similar to Poland's may be emerging in Bulgaria and Romania. With this more complex network of labour movements, gross migration flows may have increased while net flows diminished.



Even allowing for these caveats, the data in Table 2.7 appear to underestimate the magnitude of international migration in the BSEC-CA region. Alternative estimates are country-specific and unsuited for inclusion in a comparative table because of the differing methodologies used by each country. For example, some of the major countries of origin, such as Moldova, consistently report larger numbers than those noted in Table 2.7. Methods of counting legal immigrants, such as national censuses do not include illegal immigrants. Including data on temporary migrants is also problematic and difficult to measure accurately. As an example to highlight this phenomenon, consider the differences in the following reported figures: The 2002 Russian census recorded 90 000 Tajiks legally residing in Russia, while the Russian Federal Migration Service reports 600 000-800 000 illegal Tajik immigrants. Yet, the IOM (2006) estimates that, in 2003, over 632 000 Tajiks (18 per cent of the adult population) were economic migrants, and about 1 million people in Tajikistan lived in households whose main income source was remittances; 84 per cent of Tajik labour migrants were in Russia, 5 per cent in Uzbekistan, 3 per cent in the Kyrgyz Republic and 1 per cent in Kazakhstan. This then would suggest that there are nearly 531 000 Tajik in Russia – a figure that only includes “labour migrants”. Hence, there are likely many more migrants, across migrant categories, and thus greater impacts on sending and receiving countries than those discussed herein.

Migration in the BSEC-CA countries can be divided into three types: internal labour migration, mainly from economically depressed regions and rural areas to cities; external labour migration, including cross-border migration within the region and outflows from BSEC-CA countries; and in-coming labour migration from neighbouring countries.

Enabled by laws on internal migration, which guarantee freedom of movement and residence, and prompted by unemployment, low standards of living and poverty, internal migration, including of the seasonal variety, has been a viable option for citizens unable or unwilling to migrate outside their home countries. The large scale of internal migration of mostly able-bodied young people not only reduces the labour capacity of depressed regions, but also exerts additional pressure on labour markets and social infrastructures in receiving cities and regions.

External labour migration has also occurred as a response to limited labour markets in home countries. In some BSEC-CA countries, external labour migration started as a coping mechanism during the transition period, but it has continued as a key income-generation strategy. For example, in Tajikistan, where political instability, low wages and limited employment opportunities served as catalysts for migration processes that started in 1992, after 15 years of consistent external migration, the phenomenon today affects the overwhelming majority of families, as recognised by the government in its employment policy (Kuddusov, 2004). According to a 2003 study in Tajikistan, 26.4 per cent of all households had one or several labour migrants abroad (Olimova and Bosc, 2003). The IOM estimates that nearly 10 per cent of the population of the Kyrgyz Republic are labour migrants abroad (IOM, 2006). In the Caucasus, external migration seems to have stabilised but is still high by international standards. Because of the absence of a visa regime within the CIS, an accurate calculation of the number of migrants, however, is impossible, and estimates vary widely. External migration is also a feature of the European BSEC-CA countries. A survey conducted by the National Academy of Science of Ukraine (2004) estimated that 10.2 per cent of Ukrainian households had experienced temporary external labour migration by 2004. In Serbia, emigration of highly educated people began in the 1980s and accelerated significantly due to political and economic factors in the 1990s; external migration rates increased from 3.5 per cent of the total population in 1991 to 5.3 per cent in 2002 (Statistical Office of the Republic of Serbia, 2006).

The third type of labour migration in the BSEC-CA region relates to a relatively new phenomenon of in-coming flows to countries originally considered to be sending communities. The reverse process when citizens of other countries arrive in BSEC-CA countries in search of jobs is still a small phenomenon, but may have potential impacts for the labour market as it increases competition between immigrants and local citizens, especially in construction and trade. Although numbers are unavailable, the incoming flow of Chinese labourers, engaged in construction work on infrastructure – which the Chinese government is supporting as part of its development assistance – and in trade, is likely to be the most important change in demographic features of this region.

## DESTINATIONS

As noted earlier, several of the BSECA countries are among the top ten sending and receiving countries for migrants worldwide with Russia (2nd), Ukraine (4th) and Kazakhstan (9th) in the top ten receiving countries (Mansoor and Quillin, 2007).

Migration flows in Eastern Europe and Central Asia tend to move in a largely bipolar pattern, though this trend does not explain all flows. Much of the emigration in western BSEC-CA countries is directed toward Western Europe, while much emigration from the CIS countries remains within the CIS. The most popular destination for labour migrants from the former Soviet countries remains the Russian Federation. Over 96 per cent of migrants from Tajikistan and 65 per cent from Georgia, for example, head to Russia.

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Although the majority of migrants from the poorer CIS countries travel to the middle-income CIS countries, many are also beginning to move west, in search of higher earnings, toward the European Union and Turkey. Ninety per cent of labour migrants from Armenia work in the CIS countries, including Russia, Ukraine and Kazakhstan; the remaining 10 per cent work in the European Union (mainly France), the United States and Canada. While rural, poor migrants in Moldova tend to go to Russia and CIS countries, residents from Chisinau and other large towns prefer to move to Western Europe. The main destinations of Ukrainian outward migration are other CIS countries, especially Russia. The stream of migration between Russia and Ukraine could be explained by the close personal links between the populations of the two countries. In the first years of independence (until 1999), migration to Russia consisted mainly of resettlement after the collapse of the Soviet Union. Other flows of temporary labour migration in Ukraine are directed towards the European Union.

A number of CIS migrants may spend short or long periods in central and Eastern European countries or Turkey in the hope of moving to Western Europe. The number of undocumented migrants from BSEC-CA countries in Western Europe and the CIS is believed to be large but, by definition, is difficult to quantify. Germany is the most important destination country outside of the BSEC-CA countries for migrants from the region, while the United Kingdom is becoming a destination for migrants from the EU member countries of the BSEC-CA regions who do not yet have legal access to many of the other EU-15 labour markets.

**Table 2.7. Net External Migration, 1990, 1995 and 2000-05**

	1990		1995		2000		2001		2002		2003		2004		2005	
	#	share	#	share	#	share	#	share	#	share	#	share	#	share	#	share
Albania	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Armenia	40.8	1 152	-7.8	-207	-11.2	-295	-10.3	-272	-9.2	-287	-7.6	-237	-7.7	-240	-7.8	-243
Azerbaijan	70.5	982	-9.8	-128	-5.6	-69	-4.7	-58	-3.1	-38	-1.3	-15	-0.4	-5	-0.9	-11
Bulgaria	-87.6	-1 005	-50.5	-601	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Georgia*	-13.2	-243	-127.2	-2 687	-35.2	-797	-31.2	-711	-29.1	-668	-28.6	-661	-26.9	-625	n.a.	n.a.
Greece	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Kazakhstan	-92.6	-567	-238.5	-1 508	-108.3	-728	-88.2	-593	-62.0	-417	-5.6	-38	2.8	19	22.7	150
Kyrgyz Rep.	-41.9	-955	-18.9	-415	-22.5	-461	-26.6	-540	-27.8	-560	-16.7	-334	-19.3	-382	-27.0	-527
Moldova	-16.8	-385	4.2	97	-6.4	-175	-3.7	-102	-3.7	-102	-4.5	-124	-3.6	-101	-3.6	-101
Romania	-96.9	-418	-21.2	-94	-3.7	-17	0.4	2	-1.6	-7	-7.4	-34	-10.1	-47	-7.2	-33
Russia	268.5	1825	519.5	350	213.6	146	72.3	50	77.9	54	35.1	24	39.4	27	107.4	75
Serbia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Turkey	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tajikistan	-59.0	-1 113	-39.8	-703	-12.8	-207	-11.2	-178	-10.5	-163	-8.8	-133	-6.8	-101	-6.2	-90
Turkmenistan	-8.5	-227	-13.4	-300	-9.5	-194	-9.0	-182	-8.6	-170	-15.7	-307	-9.2	-178	n.a.	n.a.
Ukraine	-139.3	-270	-94.8	-185	-46.6	-95	-43.0	-88	-33.8	-70	-24.2	-51	-7.6	-16	4.6	10
Uzbekistan	-120.7	-591	-83.3	-367	-57.1	-232	-72.4	-290	-79.1	-313	-88.1	-345	-88.8	-343	-97.8	-374

Notes: # = immigrants minus emigrants in thousands; share = number of migrants (net) per 100 000 mid-year population. n.a. = not available. Georgia data for 1992-2004 exclude Abkhazia and Tskhinvali; net migration numbers are revised on the basis of 2002 population census.

Source: TRANSMONEE 2007 database (2007), UNICEF IRC at: [www.unicef-irc.org/databases/](http://www.unicef-irc.org/databases/), StatLink  <http://dx.doi.org/10.1787/344247678226>

**Annex Table 1. Coefficients of Export Conformity, average 2001-05**

	GR	ROM	RUS	TUR	ALB	SER	MOL	UKR	ARM	AZE	GEO	KAZ	KGZ	TAJ	UZB	TKM	CHN	IND
Bulgaria	0.50	0.59	0.33	0.49	0.36	0.52	0.36	0.44	0.23	0.14	0.20	0.24	0.24	0.10	0.22	0.12	0.43	0.46
Greece		0.41	0.27	0.51	0.25	0.46	0.32	0.38	0.21	0.19	0.20	0.13	0.28	0.20	0.22	0.17	0.38	0.46
Romania			0.26	0.48	0.41	0.48	0.28	0.43	0.17	0.15	0.19	0.15	0.22	0.11	0.13	0.10	0.46	0.42
Russia				0.18	0.11	0.23	0.10	0.34	0.12	0.44	0.17	0.47	0.15	0.07	0.20	0.24	0.16	0.24
Turkey					0.33	0.42	0.33	0.35	0.18	0.12	0.18	0.10	0.23	0.15	0.24	0.09	0.44	0.47
Albania						0.27	0.26	0.21	0.18	0.06	0.18	0.10	0.15	0.08	0.07	0.05	0.30	0.26
Serbia							0.32	0.42	0.22	0.10	0.23	0.18	0.22	0.18	0.18	0.07	0.38	0.39
Moldova								0.24	0.22	0.07	0.28	0.07	0.18	0.13	0.13	0.04	0.25	0.28
Ukraine									0.18	0.14	0.25	0.25	0.22	0.09	0.14	0.10	0.28	0.36
Armenia										0.04	0.36	0.14	0.19	0.10	0.16	0.03	0.17	0.32
Azerbaijan											0.11	0.61	0.12	0.06	0.09	0.15	0.07	0.16
Georgia												0.18	0.22	0.11	0.18	0.06	0.13	0.16
Kazakhstan													0.12	0.05	0.19	0.10	0.10	0.14
Kyrgyz Rep														0.15	0.26	0.11	0.18	0.23
Tajikistan															0.38	0.08	0.10	0.13
Uzbekistan																0.22	0.13	0.18
Turkmenistan																	0.07	0.14

StatLink  <http://dx.doi.org/10.1787/344252812812>

**Annex Table 2. Coefficients of Export-Import Conformity, average 2001-05**

	BUL	GR	ROM	RUS	TUR	ALB	SER	MOL	UKR	ARM	AZE	GEO	KAZ	KGZ	TAJ	UZB	TKM	CHN	IND
Bulgaria		0.45	0.40	0.44	0.45	0.49	0.45	0.43	0.36	0.37	0.35	0.38	0.38	0.40	0.38	0.36	0.33	0.34	0.29
Greece	0.45		0.42	0.48	0.41	0.53	0.46	0.52	0.39	0.43	0.38	0.47	0.40	0.47	0.41	0.38	0.35	0.33	0.28
Romania	0.38	0.43		0.35	0.40	0.46	0.42	0.38	0.32	0.32	0.37	0.35	0.39	0.36	0.38	0.39	0.34	0.33	0.29
Russia	0.37	0.33	0.28		0.38	0.21	0.35	0.32	0.47	0.29	0.27	0.28	0.27	0.31	0.23	0.20	0.15	0.27	0.48
Turkey	0.49	0.45	0.46	0.42		0.51	0.44	0.43	0.37	0.33	0.38	0.39	0.43	0.37	0.37	0.38	0.39	0.28	0.24
Albania	0.19	0.21	0.21	0.18	0.15		0.20	0.19	0.16	0.16	0.16	0.16	0.18	0.19	0.19	0.17	0.15	0.14	0.12
Serbia	0.39	0.44	0.42	0.41	0.38	0.48		0.41	0.35	0.36	0.36	0.40	0.40	0.41	0.40	0.43	0.35	0.32	0.27
Moldova	0.21	0.25	0.20	0.26	0.17	0.31	0.24		0.18	0.23	0.22	0.23	0.21	0.24	0.24	0.22	0.20	0.14	0.12
Ukraine	0.36	0.39	0.37	0.39	0.39	0.40	0.42	0.36		0.37	0.40	0.41	0.45	0.38	0.37	0.39	0.33	0.33	0.31
Armenia	0.17	0.17	0.14	0.15	0.17	0.19	0.17	0.16	0.14		0.14	0.14	0.13	0.15	0.14	0.15	0.12	0.14	0.26
Azerbaijan	0.10	0.24	0.15	0.13	0.19	0.14	0.21	0.17	0.25	0.17		0.19	0.16	0.22	0.17	0.09	0.10	0.15	0.36
Georgia	0.18	0.22	0.19	0.23	0.23	0.23	0.24	0.21	0.20	0.23	0.23		0.24	0.24	0.25	0.26	0.27	0.18	0.22
Kazakhstan	0.14	0.22	0.21	0.13	0.25	0.12	0.21	0.13	0.31	0.15	0.16	0.14		0.16	0.16	0.13	0.07	0.21	0.41
Kyrgyz Rep	0.20	0.21	0.20	0.22	0.24	0.28	0.24	0.28	0.19	0.24	0.19	0.23	0.22		0.22	0.18	0.17	0.17	0.25
Tajikistan	0.11	0.10	0.11	0.10	0.11	0.13	0.11	0.09	0.08	0.09	0.06	0.06	0.07	0.07		0.08	0.06	0.09	0.07
Uzbekistan	0.20	0.21	0.21	0.17	0.22	0.19	0.23	0.23	0.27	0.24	0.23	0.20	0.19	0.19	0.13		0.11	0.14	0.18
Turkmenistan	0.08	0.12	0.13	0.05	0.13	0.10	0.16	0.21	0.25	0.19	0.14	0.18	0.13	0.19	0.13	0.06		0.10	0.10

Note: Coefficients for Tajikistan, Uzbekistan and Turkmenistan have been computed on the basis of mirror data.

Sources: Intracen and WITS.  
StatLink  <http://dx.doi.org/10.1787/344307182114>

## DATA SOURCES FOR PART I

### Key Macroeconomic Variables

GDP data (in current prices, per capita PPP, real growth), inflation, population: From IMF *World Economic Outlook* database.

Structure of the economy (GDP by production sector and by expenditure type): World Bank *World Development Indicators*.

Fiscal accounts: From IMF Country reports ([www.imf.org/external/country/index.htm](http://www.imf.org/external/country/index.htm)).

Except for 1995 data (in country pages), which are taken from the European Bank for Reconstruction and Development (EBRD) *Transition Report* (for the transition countries).

(Note: Data structure differs for Turkey, which gives primary expenses and revenue, and then overall balance. The lack of data on total revenue/expenses leads to smaller estimates of the size of government.)

### External Position

Balance of payments: From IMF *International Financial Statistics (IFS)*.

*Notes:*

*Georgia:* IFS data typically start at 1997, so for 1995 trade and current account EBRD data are used.

*Uzbekistan:* No IFS data. Balance of payments data for 2002-06 are from IMF country papers; 1995 trade, current account and forex data are from the EBRD.

*Azerbaijan:* IFS data typically start at 2002.

*Tajikistan:* 1995 trade, current account and forex data are also from the EBRD since they are not available from IFS.

*Turkmenistan:* No IFS data; export/import data and forex data are from EBRD up to 2005, and EIU estimates for 2006. Current account balance is available from the IMF *World Economic Outlook* database but this is not included in Table 1.12, since it is not really comparable with EBRD data (see comments below). As in the case of Uzbekistan, Georgia and Tajikistan, 1995 trade, current account and forex data are from the EBRD. Data on the general government fiscal balance are from the EBRD. All other data (inflation, structure, growth, GDP, social) are from the same sources as for the other countries.

*Serbia:* Almost all 1995 data are missing, even for GDP. Sometimes there is ambiguity as to whether Montenegro is included. Serbia is not included in IFS (although some data can be found in the online database); balance of payments data are therefore from country reports. Social indicators include Montenegro.

World Bank *Global Development Finance* has net FDI inflow data up to 2005.

Net ODA Disbursements are from OECD.stat (DAC data); available until 2005.

External debt data are from World Bank *Global Development Finance* (except for Greece which is not in the *Global Development Finance* database).

Exchange rates, forex reserves are from IMF *International Financial Statistics*.

Migration data are from TransMONEE 2007 database (2007), UNICEF IRC, Florence. Available at: [www.unicef-irc.org/databases/](http://www.unicef-irc.org/databases/)

## Social Indicators

Poverty, inequality and life expectancy are from World Bank *World Development Indicators*. Literacy rates from United Nations Development Programme *Human Development Indicators*.

## Foreign Investment

UNCTAD *World Investment Report*

Private capital flows (source WB *Global Development Finance* and IMF *International Financial Statistics*): Private capital flows include both equity and debt flows. Equity inflows include FDI and portfolio equity. Portfolio equity flows are the sum of country funds, depository receipts (US or global), and direct purchases of shares by foreign investors. Debt flows include private non-guaranteed (PNG) as well as public and publicly guaranteed (PPG) debt from private creditors. PNG debt is an external obligation of a private debtor that is not guaranteed for repayment by a public entity. PPG from private creditors include bonds that are either publicly issued or privately placed; commercial bank loans from private banks and other private financial institutions; and other private credits from manufacturers, exporters, and other suppliers of goods, and bank credits covered by a guarantee of an export credit agency. Net flows (or net lending or net disbursements) are disbursements minus principal repayments.





# PART TWO

## Work and Well-being: Policy Challenges in the Global Environment

### INTRODUCTION TO PART II

Despite sustained economic growth, in some cases among the highest in the world in recent years, the BSEC-CA region suffers from a pervasive malaise. Part II of this *Economic Outlook* analyses the links between the reformed economies' integration into the global economy and their ability to generate work and promote well-being. The focus is on the former centrally planned economies, with Turkey, Greece and other OECD countries providing a basis for comparison.

Following the end of central planning, privatisation and restructuring led to huge declines in employment in state-owned enterprises during the 1990s, while the non-state sector was slow to generate adequate employment opportunities. The impact of unemployment on well-being was exacerbated by the loss of access to social services associated with the state enterprise. Recorded unemployment was often low, as there was little incentive to register formally as unemployed; moreover, many people were underemployed. Asset stripping or selling personal or household items supported consumption when employment earnings could not. Privatisation contributed to increases in economic inequality as people's share of redistributed state assets varied widely. The market economy also gave differential rewards to human capital; some skills increased in value, while other skills – particularly those valued in the centrally planned economy – became worthless. Widening regional inequality indicates that in many countries, viable national labour markets have failed to develop. Gender income inequality has also increased in some countries, although the picture is complex as some women (e.g. those with university degrees or skills in demand, such as languages or computing) may be better off in a market economy than they were in the planned economy.

Throughout the region, the transition from central planning was associated with an opening up to the global economy. Globalisation provided new opportunities for trade and for some people to migrate. At the same time, however, exposure to the global economy imposed a harsh discipline on producers.

Governments struggled to soften the blow by propping up enterprises, subsidising consumption and maintaining social safety nets. The challenge was, however, huge. Policy makers were unfamiliar with market-based economies. Public budgets shrank as old sources of revenue – primarily turnover taxes on state enterprises – atrophied and new forms took time to establish and administer efficiently. Public expenditure patterns adjusted slowly as some groups were better able to protect their interests than others. As taxes were established and collected, they sometimes posed disincentives for new enterprise formation or drove economic activity into the informal sector. The old universal social benefits could only be funded at low levels, but attempts to replace them by targeted benefits opened avenues for corruption or involved a complexity that overwhelmed the capacity of state agencies.

These outcomes are not obvious from the improvements in the overall macroeconomic situations of the BSEC-CA countries presented in Part I. Clearly then, the rapid economic growth and far improved fiscal situations of all of the BSEC-CA governments, as well as the declines in inflation and increases in foreign direct investment have not yet translated into a general overall

improvement of work and well-being. The legacy of coping patterns established during the 1990s remains evident. The slower expansion of job markets and the relatively slow creation of appropriate, supportive well-functioning social institutions means that the situation of work and well-being within many of the BSEC-CA countries has not improved at the same pace as the macroeconomic situation. Chapter Three provides evidence more specific to the observed outcomes with respect to work and well-being. Chapter Four analyses why these outcomes occurred, and how they are related to the countries' integration into the global economy. The focus in Chapter Four is primarily on the reaction of producers to the external shocks of transition and integration into the global economy. Although employment declined by less than output during the transitional recession, firms were, to varying degrees, exposed to competitive pressures which led to job losses. Job creation lagged behind job destruction, often reflecting a poor business environment. These trends and phenomena still characterise most BSEC-CA countries.

A feature of the transition to market-based economies was people's ability to find coping mechanisms as old sources of economic security disappeared. The variety of coping mechanisms is explored in Chapter Five.

The temporal sequencing was of course more complex in reality, but globalisation did force firms into making decisions faster than their governments might have liked. Households were, from the start, resourceful in adopting coping mechanisms, but they went through a learning process with short-term responses initially dominant before seeking more forward-looking responses to the realities of market-based economies; overall, it is the latter that are more durable and more significant in setting the parameters for future policy choices. Policy responses to problems of work and well-being in the 1990s were often slow and reactive, and only since the turn of the century, have there been concerted efforts to introduce appropriate policies in this area; the policy responses are described and analysed in Chapter Six.

The final chapter brings together some lessons from past policy formation, in order to assess future policy options in the area of work and well-being. The policy environment has emerged from a centralised past, sometimes with more or less appropriate foreign elements superimposed. The way forward must take into account this legacy and the coping mechanisms introduced during the transition.

# CHAPTER THREE

## Work and Well-being: The Observed Outcomes

The end of central planning was widely welcomed in Eastern Europe and, to a lesser extent, in the Soviet Union where it became entwined with the dissolution of the Union. A common expectation was that, after a brief transition, the economies would provide the higher living standards evident in Western Europe and parts of East and Southeast Asia. In practice, the optimism was misplaced as, unlike the experience of China and Viet Nam, which had experienced enhanced growth after their reforms of 1978-79 and 1986, the European and CIS transition economies experienced a sharp recession. The proximate cause was the decline of output from existing enterprises and the slow process of job creation in restructured and new enterprises.

The change in well-being during the transition from central planning is difficult to measure. Well-being is not captured in national income statistics, and even less in the conceptually fraught GDP measures of countries undergoing major structural change. Well-being measures include both objective and subjective indicators. Objective indicators are those such as income, employment, life expectancy, infant mortality, disease incidence and other directly measurable information on social outcomes. Subjective indicators may include data on subjective attitudes and evaluations of health, security and freedom, as well as indirect measures of life satisfaction and happiness. For low and middle-income countries, income and well-being are highly correlated. Studies of pro-poor growth, both from the BSEC-CA region and elsewhere, show that jobs and employment are the keys to transforming GDP growth into more equitably distributed income. Yet, pro-poor growth is not achieved simply with overall increases in employment, available jobs or GDP. The poor must be the targets of job creation and employment schemes. Work is an important element of subjective life satisfaction, and poverty and unemployment are a frequent cause of unhappiness, stress and poor health.

This chapter sets the stage for Part II by analysing the observed outcomes in important dimensions of work and well-being. The transitional recession and the emergence of inequality and poverty, on a scale and conspicuousness unknown in the era of central planning, affected well-being. The first section of Chapter Three reports this evidence and the extent to which inequality and poverty have been reduced during the first few years of the 21st century. Lack of employment was an important element of diminished well-being, and one cause of the continuing malaise in the region is the phenomenon of jobless growth in some countries. One response to the end of central planning was the growth of the informal economy; another response was migration, both of which have important implications for work and well-being. In the long term, the region's future prospects depend upon the maintenance and creation of human and social capital.

## INCOME, INEQUALITY AND POVERTY

That average living standards dropped in all of the BSEC-CA transition economies in the 1990s is incontrovertible, although there are severe measurement problems in comparing consumption bundles in the centrally planned economy with those in the market-based economies which included goods and services previously unavailable (Pomfret, 2003). Declining living standards were driven by falling real incomes as GDP collapsed.

What should have been expected, because a market economy relies on price signals to allocate labour, capital and other inputs, but was poorly anticipated, was increased income inequality. Milanovic (1998) documented this for the 1990s in a World Bank published study. Although there are difficulties in obtaining consistent data and measures of inequality, Milanovic's work shows such large increases in summary statistics like Gini coefficients that there can be no doubt of the pattern. Wealth inequality increased more than income inequality, especially in countries where the privatisation process was associated with unequal access to the most valuable state assets, but this is much more difficult to document.

Since the turn of the century, income inequality measures have become more stable, although they show substantial variation across countries. Some of this variation may reflect differences in the design of household surveys rather than true inequality differences. The World Bank data reported in Table 3.1 attempt to identify measurement issues and make estimates that are more consistent indicators of the distribution of consumption. (Because income measures may be more distorted by under-reporting, expenditure measures are usually considered a better guide to permanent income and of well-being in low- and middle-income countries.) The Gini coefficients are low in comparison to most low- and middle-income countries, yet all BSEC-CA countries' Gini coefficients are within the 28-44 per cent range (cf. 2nd column). Apart from Turkey, the greatest inequality is in the oil and gas exporters (Russia, Turkmenistan, Azerbaijan and, to a lesser extent, Kazakhstan).

**Table 3.1. Inequality**

	Share of lowest 20 per cent in total consumption or income	Gini coefficient	Alternative estimate of Gini coefficient
Albania (2004)	8.2	31.1	28.1 (2002)
Armenia (2003)	8.5	33.8	54.3
Azerbaijan (2001)	7.4	36.5	50.8 (2002)
Bulgaria (2003)	8.7	29.2	32.2
Georgia (2003)	5.6	40.4	46.6 (2002)
Greece (2000)	6.7	34.3	33
Kazakhstan (2003)	7.4	33.9	35.9
Kyrgyz Republic (2003)	8.9	30.3	47.8
Moldova (2003)	7.8	33.2	41.1
Romania (2003)	8.1	31	35.5
Russia(2002)	6.1	39.9	49.1
Serbia (2003)	8.3	30	28.1 (2001)
Tajikistan ((2003)	7.9	32.6	32.5
Turkey (2003)	5.3	43.6	45
Turkmenistan (1998)	6.1	40.8	26.5 (1999)
Ukraine (2003)	9.2	28.1	40.8
Uzbekistan (2003)	7.2	36.8	48.1 (2001)

Notes: The year refers to the survey year. All calculations (except Greece which uses income) are based on expenditure Gini coefficients measure, on a scale from 0 to 100, the extent to which a distribution lies between complete equality (e.g. all households receive the same income) and complete inequality (e.g. one household receives all the income).

Source: *World Development Indicators*, World Bank, April 2007, Table 2.7.

StatLink  <http://dx.doi.org/10.1787/344326278656>

With declining average incomes and rising inequality during the early 1990s, poverty rates increased. The increase was especially severe in the Central Asian countries and Azerbaijan, which had been the poorest of the Soviet republics. The Kyrgyz Republic and Tajikistan had the largest changes in both poverty and inequality. Using a common measuring rod of USD 120 per month at PPP, Milanovic assembled comparative poverty headcount figures, and found that from 1993-95 the Kyrgyz Republic had the highest poverty rate of any Eastern European or former Soviet economy. Taking four Central Asian countries as a group (i.e. excluding Tajikistan whose civil war only wound down after the 1997 ceasefire), the poverty rate increased from 15 per cent of the population in 1987-98 to 66 per cent in 1993-95, representing an increase from 6.5 million to 30.7 million people.

Poverty rates declined after the mid-1990s as countries emerged from the nadir of the transitional recession, but according to the World Bank's headline poverty measures (Table 3.2), based on PPP exchange rates (or "international dollars"), they still remain high in the Caucasus countries and Tajikistan. Apart from in Tajikistan and Georgia there is little extreme poverty, falling below the dollar-a-day measure, but severe poverty (incomes between one and two international dollars a day) affects between one-tenth and one-third of the population in almost all of the countries. The two-dollars-a-day measure is not high, especially in countries with harsh climates, which require extra expenditures on warm clothing and heating (see Box 3.1 "How much would two-dollars-a-day buy?"). The levels of severe poverty in Azerbaijan, Armenia and Georgia reported in Table 3.2 are consistent with the domestic evaluation that about one-half of the population in each of these countries is living below national poverty lines.

**Table 3.2. Poverty**

	Population below the national poverty line (per cent)		Population below international poverty lines (per cent)		
	Rural	Urban	Survey year	Expenditure below USD 2 a day	Expenditure below USD 1 a day
Albania	25.4 (2002)		2004	10	< 2
	29.6	19.8			
Armenia	50.9 (2001)		2003	31.1	< 2
	48.7	51.9			
Azerbaijan	49.6 (2001)		2001	33.4	3.7
	42	55			
Bulgaria	12.8 (2001)		2003	6.1	< 2
	n.a.	n.a.			
Georgia	54.5 (2003)		2003	25.3	6.5
	52.7	56.2			
Greece	n.a.				n.a.
Kazakhstan	34.6 (1996)		2003	16	< 2
	39.0	30.0			
Kyrgyzstan	47.6 (2001)		2003	21.4	< 2
	51.0	41.2			
Moldova	48.5 (2002)		2003	20.8	< 2
	67.2	42.6			
Romania	21.5 (1994)		2003	12.9	< 2

	Population below the national poverty line (per cent)		Population below international poverty lines (per cent)		
	Rural	Urban	Survey year	Expenditure below USD 2 a day	Expenditure below USD 1 a day
	27.9	20.4			
Russia	30.9 (1994)		2002	12.1	< 2
	n.a.	n.a.			
Serbia	n.a.			n.a.	
Tajikistan	n.a.		2003	42.8	7.4
Turkey	27.0 (2002)		2003	18.7	3.4
	34.5	22.0			
Turkmenistan	n.a.			n.a.	
Ukraine	19.5 (2003)		2003	4.9	< 2
	28.4	n.a.			
Uzbekistan	27.5 (2000)		2003	< 2	< 2
	30.5	22.5			

Note: Year of the survey used in brackets. Data on the breakdown of poverty differences between rural and urban residents is more fragmentary, with only pre-2000 estimates for three countries and no estimates for four others, but there is still a striking pattern observed in Table 3.2. Urban poverty exceeds rural poverty in all three Caucasus countries. Elsewhere, rural poverty exceeds urban poverty, and the rural poverty rate is in some cases over 50 per cent higher than the urban poverty rate.

Source: *World Development Indicators*, World Bank, April 2007; Table 2.6.

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### Box 3.1. How Much Would Two Dollars a Day Buy?

At 2000 PPP, the food expenditure necessary to meet basic caloric requirements with the cheapest products available varies, but the average is USD 1.18 per day (the extreme values in the CIS in the early 2000s were USD 1.15 in Tajikistan and USD 1.22 in Kazakhstan); this is for a meagre food basket consisting mainly of wheat, beans, milk and oil. Consuming 150kWh of electricity a month, enough for three light bulbs plus basic appliances, would cost 7-17 cents per day and heating another 17-42 cents per day, on average, through the year.

This means that people living below the USD 2 per day poverty line have to spend three-fifths or more of their income on the most basic food and energy needs, leaving only two-fifths of income for clothing, transport, housing, education, health, social activities or any minimal luxuries. Warm clothing is essential in some countries and families with children have greater and more frequent replacement costs; in some Balkan and CIS countries there are complex reciprocal arrangements to economise on children's clothing. Transport costs are a necessary expenditure item needed to maintain access to the labour markets, school or other training facilities, and for maintaining social networks.

## EMPLOYMENT

The institutional set-up in the early transition years meant that many people who lost their jobs did not register as unemployed; hence, the reduction in the number employed is a better guide to the changes than the number counted as unemployed. Even the “employed” category may be misleading, as many workers were underemployed in agriculture or petty trading and many people retained the status of “employed” even though their wages were in arrears. By the end of the 1990s, these anomalies were becoming less salient, but care still needs to be taken in comparing unemployment rates.

Table 3.3 indicates the number of people employed in each year from 1995 to 2005. In the longer established market economies of Greece and Turkey, employment increased more or less continuously over the decade. In Serbia and in Tajikistan, the dramatic declines in employment during the second half of the 1990s are related to conflict situations. The other countries have a mixed record. The energy exporters (Azerbaijan, Kazakhstan and Russia) experienced a strong growth in employment after oil prices began to rise in 1998-99. Some countries (Albania, Armenia, Moldova, Romania and Ukraine) have experienced more or less continuous decline in employment. Finally, the Kyrgyz Republic experienced continuous employment growth (perhaps partly as recovery from the severe collapse in 1991-94), and Bulgaria reversed the decline in employment in 2001 and experienced strong growth in jobs thereafter. In Table 3.3 Turkmenistan and Uzbekistan show continuous employment growth but the data only cover 1995-99; conservative reforms in these two countries delayed the job destruction process, although the pattern may also reflect poor statistics.

**Table 3.3. Employment (thousand people, 1995-2005)**

	Albania	Armenia	Azerbaijan	Bulgaria	Georgia	Greece	Kazakhstan	Kyrgyzstan	Moldova	Romania	Russia	Serbia	Tajikistan	Turkey	Turkmenistan	Ukraine	Uzbekistan
<b>1995</b>	1 138	1 476	3 613	3 282 2 984	3 824	3 824	6 552	1 642	11 152	66 441	3 947	1 853	19 893	1 759	2 3725	8158	
<b>1996</b>	1 116	1 436	3 687	3 286 3 066	3 872	3 872	6 519	1 652	10 936	65 950	3 949	1 731	20 388	1 780	2 4125	8561	
<b>1997</b>	1 107	1 372 740	3 694	3 157	3 854	3 854	6 472	1 689	11 050	64 639	3 822	1 143	20 362	1 816	2 2598	8680	
<b>1998</b>	1 085	1 337	3 702	3 153	4 024	4 024	6 128	1 705	10 845	63 812	3 892		20 872	1 839	2 2349	8800	
<b>1999</b>	1 065	1 298	3 703	3 088	4 040	4 040	6 105	1 764	10 776	58 464	3 325		21 413	1 908	2 2998	8885	
<b>2000</b>	1 068	1 278	3 705	2 980	4 098	4 098	6 201	1 768	10 764	62 945	3 324		21 581		1 9948		
<b>2001</b>	1 063	1 265	3 715	2 968	4 103	4 103		1 787	10 697	64 710	3 320		21 524		2 1016		
<i>1 042*</i>				2 752		6 699				65 123					1 9972		
<b>2002</b>	920	1 106	3 727	2 979	4 190	4 190		1 807	9 234	65 650	3 221		21 354		2 1379		
				2 801			6 709	1 850		66 659					2 0091		
<b>2003</b>	926	1 108	3 747	3 167	4 287	4 287		1 837	9 223	66 432	3 130		21 147		2 1449		
927				2 834			6 985	1 931							2 0163		
<b>2004</b>	931	1 082	3 809	3 236	4 331	4 331		1 880	9 158				21 791				
931				2 922			7 182	1 991		67 275					2 0296		
<b>2005</b>	931	1 098	3 850	3 276	4 382	4 382		1 932	9 147				22 046				
				2 980						68 169					2 0680		

Notes: Figures in italics are "Labour Force Survey" data; \* ILO "Population Census" estimate.

Source: Key Indicators of the Labour Market (KILM) database, International Labour Office (on-line database accessed on 15 December 2007 at: [www.ilo.org/public/english/employment/strat/kilm](http://www.ilo.org/public/english/employment/strat/kilm))

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In the unemployment data presented in Table 3.4, gender differences are noticeable in 12 countries where unemployment is higher among females; in five it is higher among males, while Turkey and Russia show no significant gender difference. However, the ratio of female to male labour force activity rates has not declined in any of the countries in the region (Paci, 2002). Other features of the employment picture, which are more country specific, are the position of minorities and the geographical distribution of unemployment. For a short discussion on gender inequalities in the BSEC-CA region, see Box 3.2.

### Box 3.2. The Socialist Woman? Gender Inequalities in BSEC-CA Countries

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As a result of state policies to maximise labour and production, and to bring “the socialist woman” into the public sphere, the labour participation of women in planned economies was particularly high. Employed women had many benefits, including access to social services such as kindergartens and nurseries, child-minding and medical aid services, which were partially supported through state subsidies, but mainly through the social funds of large enterprises. They also worked in both traditional and non-traditional female jobs. As with women throughout the world, the so-called “dual burden” or “second shift”, which places responsibility for social reproduction and domestic tasks mainly on women’s shoulders, characterises women’s lives in the BSEC-CA countries both before and after the transition. Balancing home and paid work is a burden, and more so when the paid work is physically demanding, as it is in some of the non-traditional sectors, such as heavy industry.

In Soviet-era Russia, protective legislation to remove women from jobs with possible detrimental health effects and night shift work was put in place to improve the reproductive capacities of women, but the legislation was elastic: overlooked in times of economic demand and then reinstated when demand decreased (Illic, 1995). Policies such as this do not address equality, but highlight the labour/reproduction priorities of the Soviet state, which disadvantaged women while subordinating them to the status of reproductive vehicles. The notion that the “socialist woman” had greater equality must be looked at critically, to avoid both historical romanticism and erroneous conclusions about changes in their status.

Creating policies that promote job equality and equal rights, while challenging behaviour and attitudes about gender and family, are all needed to remove barriers to gender equality. A UNDP study in Azerbaijan found that it is the latter, traditional attitudes and deeply rooted cultural norms, held by both males and females about gender roles, which are the greatest barriers (Ahmedova, 2007). This has not changed significantly since the era of central planning. Recent studies debunk the myth that gender equality privileged the socialist woman or that gender pay gaps were not the norm (Bridger and Pinnick, 1996; Paci and Reilly, 2004).

A labour-market study, entitled “Gender Effects on Labor Market Outcomes in Russia: 1985-2001” (Gerber and Perelli-Harris, 2007), using seven,167 employment histories spanning 1985-2001 collected in the Survey of Stratification and Migration Dynamics in Russia (SMDR) found that:

...the transition has been neither uniformly harmful, nor uniformly beneficial to women relative to men. The pre-transition period was marked by considerable female disadvantage in exposure to layoff, opportunities for employment (re-)entry, and, among those without college education, access to jobs outside of one’s current firm. In the course of market transition, the first two of these disadvantages declined and reversed. On the other hand, while women gained greater access to jobs as the transition progressed, the gender gap in the quality of those new jobs has widened. Even as the labor market has opened up to women in terms of opportunities for employment, it has become more segmented on the lines of gender in ways that increase women’s economic disadvantages.

Paci and Reilly (2004), in a World Bank report that looked at the transition economies of Europe and Central Asia, entitled, “Does economic liberalization reduce gender inequality in the labour market”, found that the “gender pay gap has either remained stable or has actually contracted over the transitional decade”.

Nevertheless, a gender gap and gender inequality persist. Some explanations for this are traditional or ubiquitous in that they explain these phenomena in most countries of the world, where others are unique and localised to the formerly centrally planned economies of the BSEC-CA region. Traditional explanations of gender inequality in the labour market note that they are the result of persistent horizontal segregation, where women's participation remains concentrated in sectors traditionally viewed as "woman's work", for example those in the care professions (teaching, nursing, homecare) and in the lower levels of the tertiary sector. In addition, vertical segregation, where women and men work in the same area, but stay on different levels of the hierarchy remains a challenge in most BSEC-CA countries. Localised inequality grew with the decline of the public sector, among other things. The public sector employed many women in the era of central planning; female job loss accompanied the decline of this sector over the transition years. In general, women in the region do not possess the necessary financial resources, skills and education that allow them to compete in the highly skilled areas of the formal private sector. However, those women who had a university education often gained the most from the move to a market economy, especially when their degree was in a field of high demand. By contrast, men who had graduated from Soviet-era vocational training often found that their skills were not valued in the market economy.

Reforms of agricultural enterprises and their privatisation occurred without women's participation; in Central Asia and the Caucasus land was distributed to heads of households, usually men. Most women did not have the resources or the skills that enabled them to become landowners of agricultural properties. Lack of representation in the structures of power also disadvantaged women during the privatisation process.

The growing informal private sector, especially in the unorganised markets of wholesale and real trade, personal services, catering and tourism, has had a number of advantages that has facilitated the participation of women. The fact that the informal sector can be more flexible than the formal sector aids women's entry or re-entry into the workforce. The negative aspects of work in the informal economy (as discussed elsewhere in this book) may not, however, outweigh the benefits of paid labour over the long term.

The process of privatisation in the BSEC-CA countries, in general, did not benefit women. Throughout the formerly centrally planned economies wage gaps and gender inequality persist. While gender equality, in general, can be improved through adequate legal frameworks and institutional capacity, the greatest gains may be in the introduction of programmes and policies that directly address the causal reasons, including traditional belief systems and attitudes. Gender equality must be institutionalised.

*Sources:* drawn from Ahmedova, 2007; Bridger and Pinnick, 1996; Gerber and Perelli-Harris, 2007; Illic, 1995; Paci and Reilly, 2004; other data and information compiled from country background papers also listed in references.

Table 3.4 presents unemployment rates as reported by the World Bank and the International Labour Organization (ILO). There are questions of comparability across BSEC-CA countries, and especially for the CIS countries the number found to be unemployed in surveys is substantially greater than the number reported in official statistics (see Box 3.3 on Ukraine). In Azerbaijan, the State Statistical Office undertook a labour market survey in 2003, which indicated that 404 670 people were unemployed; at that time official unemployment stood at 54 365, or 1.4 per cent of the economically active population.

**Table 3.4. Unemployment as a Percentage of Labour Force: by gender, age and education level (2000-05)**

	Albania	Armenia	Azerbaijan	Bulgaria	Georgia	Greece	Kazakhstan	Kyrgyzstan	Moldova	Romania	Russia	Serbia	Tajikistan	Turkey	Ukraine
Total Unemployment (2000-2005)*	15.2	n.a.	n.a.	12.1	12.6	10.2	8.4	12.5	8.1	8	7.9	15.2	n.a.	10.3	8.6
By gender															
Male unemployment, as % of male labour force	13.2	n.a.	n.a.	12.5	13.4	6.4	7	11.2	10	9	7.8	14.4	n.a.	10.3	8.9
Female unemployment, as % of female labour force	18.3	n.a.	n.a.	11.5	11.8	15.9	9.8	14.3	6.3	6.9	8	16.4	n.a.	10.3	8.3
By level of education**	2002	2004	2004	2004	2004	2002	2003	2002	2004	2004	1999		1997	2004	2004
Primary	56.4	5.2	4.6	37.8	5.8	34.2	7.9	13.7	n.a.	26	16.8	n.a.	10.6	53.5	13.5
Secondary	38.4	81.5	31.4	50.9	57.6	50	53.2	67.8	n.a.	66.9	41.6	n.a.	83.2	29.2	54.3
Tertiary	3.4	13.3	64.1	11.4	36.5	15.1	38.9	18.5	n.a.	5.4	41.6	n.a.	6.3	12.7	32.2

Note: no data available for Turkmenistan and Uzbekistan.

Source: \* World Development Indicators, World Bank 2007; \*\* Key Indicators of the Labour Market (KILM) database, International Labour Office. (on-line database accessed on 15 December 2007 at: [www.ilo.org/public/english/employment/strat/kilm/](http://www.ilo.org/public/english/employment/strat/kilm/)).

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### Box 3.3. Official Data and Survey Evidence on Unemployment in Ukraine

The Ukrainian Longitudinal Monitoring Survey (ULMS) found unemployment rates of 17.3 per cent in 2003 and 14.2 per cent in 2004, which indicate higher levels of unemployment than the 8.6 per cent reported in Table 3.4. Although gender differences were small (as in Table 3.4) the ULMS revealed large differences by age group and location. Among 15-24 year-olds the unemployment rate was 29.1 per cent in 2003 and 23.5 per cent in 2004.

Unemployment was much higher in rural areas than in towns and in the centre/north (17.6 per cent) and west (15.8 per cent) than in Kyiv (3.2 per cent). The incidence of long-term unemployment is high, with 47.8 per cent of those unemployed in 2004 having been out of work for over a year, but this percentage is declining from a peak of 70.2 per cent in 2001.

Source: Ukrainian Longitudinal Monitoring Survey, 2004.

Although there are data limitations, the unemployment data indicate that the majority of the BSEC-CA countries are not creating sufficient jobs to meet the demand for work and that there is a problem of matching those wanting to work with jobs. In all of the countries, there are concerns about the duration of unemployment, and the potential for creating a pool of people who have been outside the workforce for so long that they risk being considered “unemployable”. In the early transition period, this concern was particularly associated with older workers, and led to measures such as lowering the pension age, but today it is more often associated with concerns about youth unemployment. This has a social dimension, as unemployed and dissatisfied youths can become a major source of social and political disruption.

## INFORMALITY

\*Shoeshine workers in Tbilisi, street vendors in Baku, unlicensed taxi drivers supplementing their formal incomes in Moscow are all part of the phenomenon called informal employment. Examples can be found in almost every city within the BSEC-CA region. Informal employment can take many different forms, and hence it comes as no surprise that defining and measuring it is a difficult task surrounded by a great deal of controversy. In practice, there is no single internationally accepted and operational definition or indicator of informal employment, and a variety of definitions and indicators is used (Parleviet *et al.*, 2008a).

“Informal”, “undeclared” or “underground” employment is “employment which falls mainly outside the scope of taxation, social insurance and other regulations” (OECD, 2004). Given this situation, where the incidence of informality is high, many workers fall outside the reach of labour market and social-protection policies. Weak or absent social protection and reduced career perspectives for the informal worker are two of four major concerns associated with informal employment. The other two being unfair wage competition with both formal sector workers and employers, and potential rewarding of tax evasion.

The International Labour Organization (ILO), the main international body providing official definitions of the informal sector and informal employment, first defined informal work in 1993 in terms of production units: informality in this sense refers to whether a firm is formal or not. This definition includes self-employment. Then, employment in the informal sector refers to: “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” (ILO, 2002).

As this definition omitted important segments of informal employment, the ILO expanded the definition to include informal workers outside of informal enterprises. In this broader understanding, informal employment is defined as the “total number of informal jobs, whether carried out in formal sector enterprises, informal sector enterprises, or households”. Informal jobs are outside the regulatory framework because they are not subject to labour legislation, social protection, taxes or employment benefits. Various dimensions determine whether a job is

informal or formal, ranging from registration with social protection schemes, to compliance with labour or tax law. Based on this definition, several types of workers are identified: own-account workers and employers of informal firms, contributing family workers, informal employees (of formal and informal firms) and members of informal producers' co-operatives.

Irrespective of definition, it is important to keep in mind that informal employment is heterogeneous and refers to many different types of workers and activities. The diversity of the sector is also apparent when one looks at the phenomenon of multiple job holding. For some people an informal job is the only source of income, while others combine a formal job or formal business with a small informal business or informal wage work. While it is well established that multiple job holding of this kind is widespread, it is hard to establish the extent of the phenomenon as household and labour force surveys often do not capture the existence of several jobs. ILO (2002) provides data for a limited number of countries in 1998-2001 indicating whether informal work is performed as the main or as a secondary activity. In some BSEC-CA countries, a large share of people is engaged in informal employment in addition to their formal job, as high as 22.5 per cent in Lithuania and 20.3 per cent in Russia, while in Georgia and the Kyrgyz Republic informal employment is the main employment for over 95 per cent of those holding informal jobs. The overlap between formal and informal activities is even more pronounced if we take the household or the family as the unit of analysis. Many families decide on the division of labour within the household based on expected returns and often choose a smart combination of informal and formal work along with other forms of income-generating and risk-management activities (e.g. migration).

To do more justice to the multidimensionality of the phenomenon, informal employment is sometimes also presented as a continuum. An ILO report (ILO, 2004) presents such a continuum of informality along five dimensions: regularity status, contract status, workplace status, employment protection status and social protection status. The use of a continuum of informality brings out the limitations of the standard zero/one way of measuring informality. In many cases the majority of people are found somewhere between formal and informal employment, hence important information would be lost if a dichotomous measure was used.

In reality, there is no single definition that is preferred over another one. Different definitions of informal employment may refer to very different groups of people. Therefore, when comparisons are made across different definitions, the differences have to be taken into account. Even if the percentages of informality are similar, it should be remembered that they can refer to very different groups of people, between which the overlap is far from perfect.

In practice, the choice of definition and measurement method is strongly driven by data availability. The most common way to measure the size of informal employment is through household surveys. As a result, survey questions can dictate the definition used by researchers. In addition, selection of an informal employment indicator is driven by the goals of the researcher or policy maker involved. While some people are mainly interested in precarious, unprotected work, others are more interested to know whether people engage in black or unregistered activities. While there is often overlap of the various definitions, this is not always the case.

The definitions, concept and measures of informal employment are relevant to the diverse situation of informal employment in BSEC-CA countries. As the centrally planned economy disappeared, many people worked on a barter basis, engaged in informal jobs, or in combinations of formal and informal employment. Even as countries established institutions appropriate for a market-based economy, the shadow economy continued to flourish as people avoided onerous regulations or taxes. Table 3.5 reports estimates the share of the informal economy as a percentage of gross national product (GNP), where the informal economy is defined as unregistered activities (Schneider, 2004). Although this table does not indicate the share of people engaged in the informal economy, the number of people employed in unregistered activities is closely linked to the share of the informal sector in GNP. Furthermore, it is important to note that involvement in the informal economy is not necessarily the same as informal employment (e.g. illegal activities). Nonetheless, the table offers some interesting information about the informal economy in BSEC-CA countries up until 2003.

**Table 3.5. The Informal Economy (per cent of GNP)**

	1999-2000	2002-03
Albania	33.4	35.3
Armenia	46.3	49.1
Azerbaijan	60.6	61.3
Bulgaria	36.9	38.3
Georgia	67.3	68.0
Greece	28.7	28.2
Kazakhstan	43.2	45.2
Kyrgyzstan	39.8	41.2
Moldova	45.1	49.4
Romania	34.4	37.4
Russia	46.1	48.7
Serbia*	36.4	39.1
Tajikistan	n.a.	n.a.
Turkey	32.1	34.3
Turkmenistan	n.a.	n.a.
Ukraine	52.2	54.7
Uzbekistan	34.1	37.2

Notes: \* Data for Serbia represent all of Serbia and Montenegro; n.a.: not available.

The figures are estimated through indirect methods based on physical inputs (e.g. electricity use), currency demand or a model approach combining several factors. See Schneider (2002) for a more thorough presentation. A more critical account of the use of these methods can be found in Breusch (2005).

Source: Schneider (2004).

StatLink  <http://dx.doi.org/10.1787/344575611472>

Table 3.5 reveals a large range of the informal sector's GNP percentage, from two-thirds of GNP in Georgia to less than two-fifths in Greece, Turkey, Albania, Uzbekistan, Romania and Bulgaria. In general, there is a negative relationship between the level of per capita GNP and the share of the informal sector; out of Schneider's global estimates Africa and Central and South America have the highest average shares and the OECD countries the lowest average, but there is substantial variation around this pattern. Within the BSEC-CA region, the Caucasus countries, Ukraine, Moldova and Russia have the biggest shadow economies, but they do not have the lowest incomes. A striking feature of Table 3.5 is that for all countries, except Greece, the GNP share of the shadow economy increased between 1999 and 2003. This was despite the generally rapid growth in the region, and suggests that informality is not just a response to the lack of formal job opportunities and poverty, but has become an intrinsic feature of the region's economies.

The general absence of statistical data on wages in the informal sector does not allow an in-depth analysis of this important economic indicator at the national or regional average level for BSEC-CA countries. In all parts of the region, a wide range of published estimates of employment and output in the informal sector exists. For Armenia, the 2003 *Poverty Reduction Strategy Paper* estimated employment in the informal sector in the range of 30-38 per cent of total employment, but according to the 2006 Social Snapshot and Poverty (National Statistical Service of Republic of Armenia and World Bank, 2007), informal-sector employment accounted for 60 per cent in 1998-99 and 59 per cent of employment in 2004. In Tajikistan, while official statistics showed that the shadow economy produced 25 per cent of GDP, independent experts evaluated the shadow economy at around 82 per cent of GDP in 2003 (Olimov, 2007). Official statistics in Serbia estimated the non-observed economy (i.e. underground, informal, illegal and

other activities omitted due to deficiencies in the basic data collection programme as well as statistical measuring and coverage problems) at 14.6 per cent of GDP in 2003, while independent researchers estimated that 30.6 per cent of the employed were engaged in the grey economy (Bogićević *et al.*, 2003). In Ukraine, the shadow economy increased dramatically from around 14 per cent of official GDP in 1991 to above 70 per cent in 1997 (Borodyuk and Turchinov, 1999); these estimates are, however, disputed and Melota and Gregory (2001), for example, estimate the share of the shadow economy to official GDP at only 32 per cent in 1999. These extremely wide ranges illustrate the approximate nature of any attempt to measure a sector that is hard to define, but a major phenomenon.

That the informal sector, despite the challenge of its measurement, has been a very significant one both for national and household economies in the region is not disputable. The question is whether the informal sector is growing or whether it is in decline, as the formal sector is reorganising itself as an attractive source of employment after the reforms have taken root. Some countries have recorded a growth in informality in the 2000s, while other estimates show a decline. In Uzbekistan, according to Ministry of Labour and Social Protection estimates, informal sector employment exceeded formal sector employment for the first time in 2004, and 56 per cent of all employed were engaged in the informal sector by the end of 2006. In Ukraine, Ministry of Economy estimates show a gradual reduction of the shadow economy, which in 2000 constituted 35 per cent of total value added but, by the end of 2005, was 23 per cent; this level was maintained in 2006. However, the State Statistical Committee reports a trend that does not correlate with these figures, showing the informal sector growing from 14.8 per cent of total employment in 2000 to 22.3 per cent in 2006. The informal sector accounts for just over 37 per cent of Romania's GNP in 2003, as shown in Table 3.5, which marks a slight increase from 2000.

Notably, all of the figures on informal employment and the share of the informal economy within standard economic indicators highlight the heterogeneity of the informal sector and the key role that informal employment often plays as survival strategy. Perhaps, most importantly, they highlight the need for appropriate policies designed to provide ways of extending social protection and improving working conditions for those engaged in the informal sector while simultaneously increasing employment opportunities in the formal sector.

## DEMOGRAPHY AND HEALTH

Many BSEC-CA countries experienced declines in life expectancy during the early and mid-1990s (Cornia and Panicià, 2000). In Azerbaijan, Kazakhstan, Russia, Tajikistan, Ukraine and Uzbekistan life expectancy declined for men and women (with the exception of Kazakhstan for women) from 1992-2008 (see Table 3.6, especially percentage of change). In several countries there is a 10-year differential from Greek life expectancy in 2008 – Azerbaijan, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan – which is close to the high-income OECD countries' average. The lowest life expectancies for the region can be found in Russia, Tajikistan and Uzbekistan, which are lower than the world average. With some notable exceptions, from 1992-2008 there has been an improvement in BSEC-CA countries' average life expectancies (see Table 3.6).

**Table 3.6. BSEC-CA Life Expectancy – Males and Females (1992 and 2008)**

Global rank (2008)*	Country/region	Life expectancy (2008 estimates)			Life expectancy (1992)*		Percentage change 1992-2008	
		Total population	Male	Female	Male	Female	% change male	% change female
25	Greece	79.52	76.98	82.21	75	81	2.57	1.47
51	Albania	77.78	75.12	80.71	71	78	5.48	3.36
65	Georgia	76.51	73.21	80.26	67	75	8.48	6.55
78	Serbia	75.29	72.7	78.09	70	75	3.71	3.96
105	Turkey	73.14	70.67	75.73	68	72	3.78	4.93
108	Bulgaria	72.83	69.22	76.66	69	76	0.32	0.86
115	Armenia	72.4	68.79	76.55	68	74	1.15	3.33
118	Romania	72.18	68.69	75.89	68	74	1.00	2.49
134	Moldova	70.5	66.81	74.41	64	71	4.21	4.58
144	Kyrgyzstan	69.12	65.12	73.33	62	71	4.79	3.18
146	Turkmenistan	68.6	65.53	71.82	59	66	9.96	8.10
148	Ukraine	68.06	62.24	74.24	65	75	-4.43	-1.02
150	Kazakhstan	67.55	62.24	73.16	63	72	-1.22	1.59
156	Azerbaijan	66.31	62.2	71	65	73	-4.50	-2.82
159	Russia	65.94	59.19	73.1	63	74	-6.44	-1.23
163	Uzbekistan	65.38	61.95	68.99	64	70	-3.31	-1.46
165	Tajikistan	64.97	61.95	68.15	64	70	-3.31	-2.71
127.5	Avg. BSEC-CA	70.95	67.21	74.96	66.18	73.35	1.54	2.14
42	EU	78.51	75.39	81.82	n.a.	n.a.		
157	World	66.12	64.18	68.2	61	65	4.95	4.69

Notes: \*global rank based on life expectancy total population; 1992 is the first year *World Factbook* data available for new successor states.

Sources: CIA World Factbook 2008 ([www.cia.gov/library/publications/the-world-factbook/](http://www.cia.gov/library/publications/the-world-factbook/)); CIA World Factbook 1992 ([www.umsl.edu/services/govdocs/wofact92/index.html](http://www.umsl.edu/services/govdocs/wofact92/index.html)).

StatLink  <http://dx.doi.org/10.1787/344582411782>



The age structure of the BSEC-CA region, as of 2008, when viewed graphically (see Figure 3.1) is similar to that of OECD countries in the 15-64 age group – the working age population. Differences, however, become noticeable in both the number of young and old in the region, with higher percentages of population in the 0-14 age group and lower percentages in the over 65 age group than the more developed economies of the OECD and Europe. This will present two challenges for many countries in the region, as discussed later in the *Outlook*: creating jobs for the next generation and supporting the large numbers of elderly as the current working age population retires. With likely improvements in life expectancy, already noticeable in several countries, due to the improvements in prosperity over the past decade, supporting the elderly population will become a priority policy area. Table 3.7 provides population data by sex and age structure for all BSEC-CA countries.

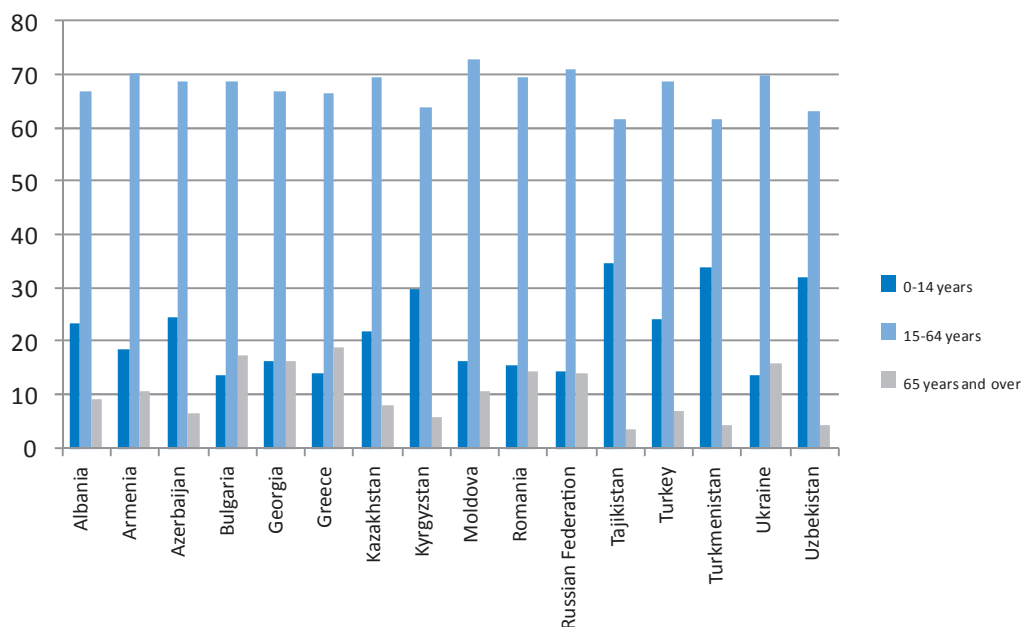
**Table 3.7. Population Structure BSEC-CA (2008 estimates)**

Country	Age structure						Age group % population		
	0-14 years		15-64 years		65 years and over		0-14 years	15-64 years	65 years and over
	male	female	male	female	male	female			
Albania	447 126	406 757	1 239 819	1 180 720	160 241	185 115	23.6	66.9	9.5
Armenia	296 401	259 594	975 438	1 111 989	128 398	196 766	18.7	70.3	11
Azerbaijan	1 061 318	947 607	2 753 277	2 855 406	208 293	351 816	24.6	68.6	6.8
Bulgaria	514 238	489 608	2 449 812	2 532 845	520 962	755 210	13.8	68.6	17.6
Georgia	402 961	352 735	1 496 802	1 610 725	307 795	459 823	16.3	67.1	16.6
Greece	789 137	742 469	3 568 101	3 575 572	898 337	1 149 200	14.3	66.6	19.1
Kazakhstan	1 734 622	1 659 723	5 219 983	5 463 468	443 483	819 254	22.1	69.6	8.2
Kyrgyzstan	817 369	784 782	1 681 440	1 748 222	127 263	197 793	29.9	64	6.1
Moldova	361 000	341 785	1 528 080	1 622 620	174 448	1 622 620	16.3	72.9	10.9
Romania	1 778 864	1 687 659	7 718 125	7 791 102	1 337 915	1 933 197	15.6	69.7	14.7
Russian Federation	10 577 858	10 033 254	48 187 807	52 045 102	6 162 400	13 695 673	14.6	71.2	14.1
Serbia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tajikistan	1 270 289	1 226 954	2 203 720	2 244 660	113 156	153 105	34.6	61.7	3.7
Turkey	8 937 515	8 608 375	25 030 793	24 253 312	2 307 236	2 755 576	24.4	68.6	7
Turkmenistan	902 811	868 428	1 577 187	1 607 353	97 480	126 312	34.2	61.5	4.3
Ukraine	3 277 905	3 106 012	15 443 818	16 767 931	2 489 235	4 909 386	13.9	70	16.1
Uzbekistan	4 618 815	4 445 571	8 851 738	9 042 647	538 699	770 970	32.1	63.3	4.6

Note: Serbia not available.

Source: CIA World Factbook 2008 ([www.cia.gov/library/publications/the-world-factbook/](http://www.cia.gov/library/publications/the-world-factbook/)).

StatLink  <http://dx.doi.org/10.1787/344642524747>

**Figure 3.1. BSEC-CA Age Structure (2008 estimate)**

Notes: Serbia not available.

Source: CIA World Factbook 2008 ([www.cia.gov/library/publications/the-world-factbook/](http://www.cia.gov/library/publications/the-world-factbook/)).  
StatLink  <http://dx.doi.org/10.1787/343560266002>

Standard indicators of health and health services, such as fertility, crude death rates or infant mortality (Table 3.8), show a sharp deterioration in many BSEC-CA countries, especially those in the CIS, during the 1990s, from which there has still been only a partial recovery. A recent UNICEF working paper by Menichini and Marnie (2007) notes that although infant mortality rates seem to have fallen dramatically in Eastern Europe, in Central Asia and the Caucasus the data are unreliable due to variable definitions of “live births” and infant mortality may still remain high. Relatively high death rates from pneumonia suggest that health-care systems are unable to provide vaccines, antibiotics or bridge the isolation of poorer rural areas. Respiratory deaths in Kyrgyzstan are particularly high in the region, both as a death rate per 100 000 and as an age-standardised death rate per 100 000; however, in absolute terms, Russia, Ukraine and Turkey reveal high numbers of total deaths from respiratory causes. Significantly, Georgia and Albania have the lowest rates of respiratory-related deaths in both absolute and relative terms (see Table 3.9). Hygiene appears to be another significant determinant of death rates for a handful of countries. Tuberculosis is responsible for three times the loss of life in Kazakhstan and Turkmenistan compared with other BSEC-CA countries.

**Table 3.8. Vitality and Health Indicators: Total Fertility Rate, Crude Death Rate and Infant Mortality Rate**

	1990			1995			2000			2001			2002			2003			2004			2005		
	TF	CM	IM	TF	CM	IM	TF	CM	IM	TF	CM	IM	TF	CM	IM	TF	CM	IM	TF	CM	IM	TF	CM	IM
Albania	3.03	5.6	28.3	2.60	5.5	30.0	2.10	5.1	12.1	4.9	11.4	2.10	5.3	10.4	2.05	5.8	8.4	1.80	5.7	7.8	1.60	5.5	7.6	
Armenia	2.62	6.2	18.5	1.63	6.6	14.2	1.11	6.3	15.6	6.3	15.4	1.21	8.0	14.0	1.35	8.1	12.0	1.38	8.0	11.5	1.37	8.2	12.3	
Azerbaijan	2.77	6.0	23.0	2.29	6.6	23.3	2.00	5.8	12.8	5.6	12.5	1.84	5.7	12.8	1.91	6.0	12.8	2.05	6.0	9.8	2.33	6.2	9.3	
Bulgaria	1.81	12.5	14.8	1.23	13.6	14.8	1.27	14.1	13.3	14.0	14.4	1.21	14.3	13.3	1.23	14.3	12.3	1.29	14.2	11.6	1.31	14.6	10.4	
Georgia	2.15	9.3	20.7	1.54	10.4	28.2	1.46	10.7	22.6	10.5	22.9	1.42	10.7	23.8	1.37	10.6	24.8	1.44	11.3	23.8	n.a.	n.a.	19.7	
Kazakhstan	2.76	7.9	26.3	2.22	10.7	27.0	1.85	10.1	18.8	10.0	19.1	1.88	10.1	17.0	2.03	10.4	15.7	2.21	10.1	14.5	2.22	10.4	15.2	
Kyrgyz Rep.	3.60	7.0	30.0	3.10	8.1	28.1	2.40	7.0	22.6	6.6	21.7	2.50	7.1	21.2	2.50	7.2	20.9	2.60	6.9	25.7	2.50	7.2	29.7	
Moldova	2.39	9.7	19.0	1.76	12.2	21.2	1.30	11.3	18.3	11.0	16.3	1.20	11.6	14.7	1.20	11.9	14.4	1.30	11.6	12.2	1.20	12.4	12.4	
Romania	1.84	10.6	26.9	1.34	12.0	21.2	1.30	11.4	18.6	11.6	18.4	1.25	12.4	17.3	1.27	12.3	16.7	1.29	11.9	16.8	1.32	12.1	15.0	
Russia	1.89	11.2	17.4	1.34	14.9	18.1	1.19	15.2	15.3	15.4	14.7	1.29	16.1	13.3	1.32	16.4	12.4	1.34	16.0	11.6	1.29	16.1	11.0	
Serbia	2.08	9.3	22.8	1.88	10.2	16.8	1.64	11.1	13.3	10.6	13.1	n.a.	10.2	10.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	
Tajikistan	5.09	6.2	40.7	4.38	6.0	44.0	3.68	4.3	43.9	4.1	43.2	n.a.	4.2	43.8	n.a.	4.1	43.6	n.a.	4.0	n.a.	n.a.	4.2	n.a.	
Turkmenistan	4.20	6.9	45.2	3.50	7.0	42.2	2.90	5.3	21.4	5.2	20.1	2.60	5.4	17.7	2.60	5.3	16.4	2.60	5.2	14.1	n.a.	n.a.	n.a.	
Ukraine	1.90	12.2	12.8	1.40	15.5	14.4	1.10	15.4	11.9	15.5	11.3	1.10	15.7	10.3	1.20	16.1	9.6	1.20	16.1	9.5	1.20	16.7	10.0	
Uzbekistan	4.07	6.1	34.6	3.59	6.4	26.0	2.58	5.5	18.9	5.3	18.3	2.52	5.4	16.7	2.36	5.3	16.4	2.46	5.0	15.4	2.36	5.4	14.9	

Notes: TF: live births per woman aged 15-49, CM: deaths per 1 000 population, IM: infant deaths per 1 000 live births.

Source: TransMONEE 2007 Database, Innocenti Research Centre, UNICEF (available at [www.unicef-irc.org/databases](http://www.unicef-irc.org/databases)).  
StatLink <http://dx.doi.org/10.1787/344651534584>

**Table 3.9. Respiratory Deaths in BSEC-CA Countries (2002)**

Country	Total # of Deaths	Death rate per 100 000	Age-standardised death rate per 100 000
Albania	275	8	13
Azerbaijan	1 025	12	17
Armenia	782	25	25
Bulgaria	1 117	14	8
Georgia	172	3	2
Greece	1 783	16	7
Kazakhstan	5 217	33	37
Kyrgyzstan	2 872	56	80
Republic of Moldova	1 670	39	35
Romania	5 742	25	17
Russian Federation	34 538	23	16
Top of Form Serbia and Montenegro* Bottom of Form	2 730	25	17 Bottom of Form
Tajikistan	1 027	16	28
Turkey	18 220	25	40
Turkmenistan	384	8	14
Ukraine	25 304	51	31
Uzbekistan	3 400	13	23 Bottom of Form

Note: \*data for Serbia alone is not available.

Source: WHO Global Infobase: Country Comparison ([www.who.int/infobase](http://www.who.int/infobase)).

StatLink  <http://dx.doi.org/10.1787/344662664443>

Table 3.10 presents the death rates in the 17 countries of the BSEC-CA region using the World Health Organization (WHO) category of “all causes” and includes deaths from non-communicable and communicable diseases, cardiovascular and respiratory diseases, as well as injuries, maternal, perinatal and nutritional conditions. Figure 3.2 shows the age-standardised death rate per 100 000 people in the region. This graphically highlights the extreme range of male-to-female ratios, but also stark differences between Greece (one of the benchmark countries of this book) and those of the rest of the region, including Turkey (the other benchmark country), which falls in the mid-range. However, when the age standardisation is removed, and mortality is looked at by crude death rate per 100 000 (Figure 3.3 and Table 3.10), Greece is exactly in the mid-range with the 9<sup>th</sup> highest death rate per 100 000 in the region, and Turkey has the lowest. Notably, Russia has the highest crude death rate in the region, followed closely by Ukraine, both of which are two and a half times that of Turkey’s.

**Table 3.10. Total Mortality (Deaths) in the BSEC-CA Countries – (all causes, 2002)**

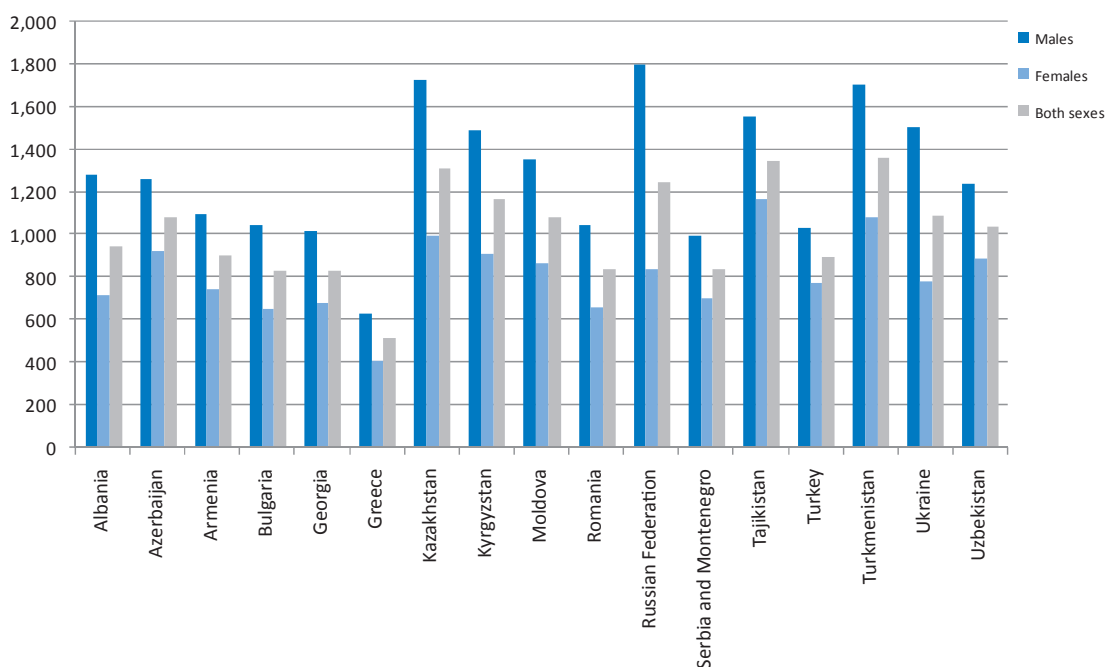
Country	Males			Females			Both sexes		
	Total no. of deaths	Death rate per 100 000	Age-standardised death rate per 100 000	Total no. of deaths	Death rate per 100 000	Age-standardised death rate per 100 000	Total no. of deaths	Death rate per 100 000	Age-standardised death rate per 100 000
Albania	12 819	798	1 286	9 277	604	714	22 096	703	947
Azerbaijan	33 507	828	1 261	30 705	722	924	64 212	773	1 084
Armenia	13 780	923	1 094	12 367	783	748	26 148	851	905
Bulgaria	57 077	1 476	1 046	49 670	1 211	652	106 747	1 340	831
Georgia	28 581	1 156	1 015	32 767	1 211	680	61 348	1 184	833
Greece	59 013	1 091	628	54 967	988	411	113 981	1 039	514
Kazakhstan	97 755	1 315	1 726	86 322	1 074	999	184 078	1 190	1 315
Kyrgyzstan	24 463	984	1 488	20 792	805	912	45 255	893	1 166
Republic of Moldova	24 543	1 201	1 358	23 663	1 062	869	48 206	1 128	1 079
Romania	138 167	1 263	1 048	120 507	1 052	661	258 674	1 155	838
Russian Federation	1 286 035	1 908	1 797	1 119 686	1 459	837	2 405 721	1 669	1 244
Serbia and Montenegro*	63 391	1 209	994	57 556	1 087	704	120 948	1 148	839
Tajikistan	28 092	910	1 553	26 193	842	1 168	54 286	876	1 346
Turkey	237 491	670	1 029	199 428	571	775	436 920	621	895
Turkmenistan	23 125	974	1 703	18 608	768	1 086	41 734	870	1 359
Ukraine	391 177	1 723	1 505	391 815	1 495	784	782 993	1 601	1 089
Uzbekistan	87 899	688	1 237	83 612	646	891	171 511	667	1 043

Notes: \*data for Serbia alone is not available; The age-standardised mortality rate is a weighted average of the age-specific mortality rates per 100 000 persons, where the weights are the proportions of persons in the corresponding age groups of the WHO standard population.

Source: WHO Global Infobase: Country Comparison ([www.who.int/infobase](http://www.who.int/infobase)).

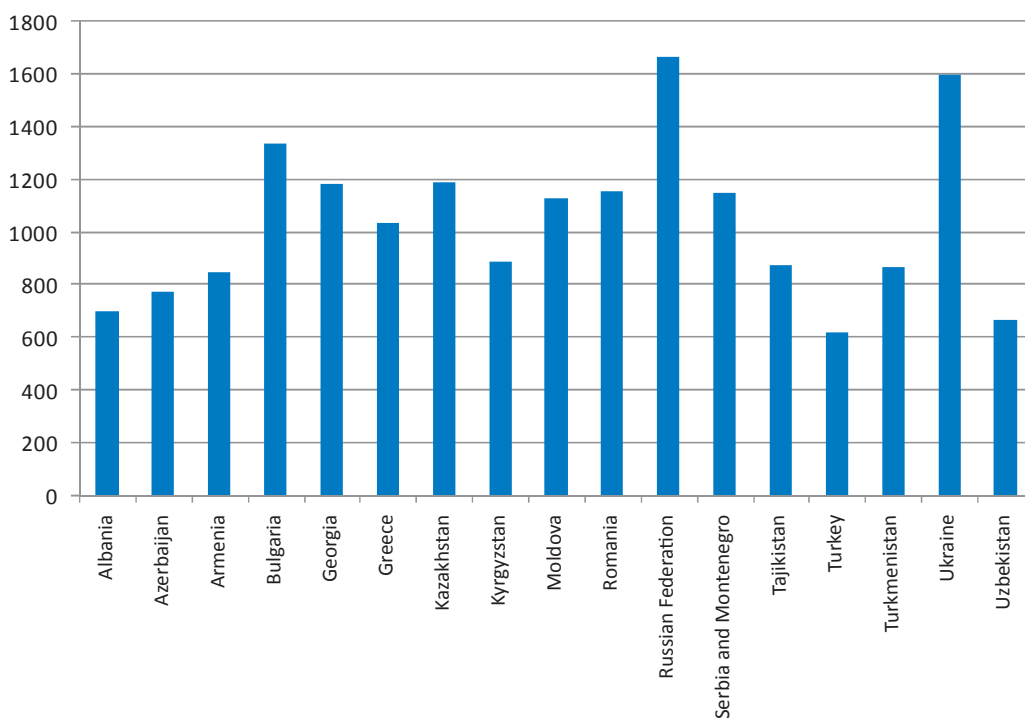
StatLink  <http://dx.doi.org/10.1787/344670386730>

**Figure 3.2. BSEC-CA – Age Standardised Death Rate per 100 000 (all causes, 2002)**



Source: WHO Global Infobase: Country Comparison ([www.who.int/infobase](http://www.who.int/infobase)).  
 StatLink  <http://dx.doi.org/10.1787/343571808183>

**Figure 3.3. BSEC-CA – Crude Death Rate per 100 000 (all causes, 2002)**



Source: WHO Global Infobase: Country Comparison ([www.who.int/infobase](http://www.who.int/infobase)).  
 StatLink  <http://dx.doi.org/10.1787/343572204173>

A few of the BSEC-CA countries face other health challenges, in particular HIV/AIDS, although HIV/AIDS incidence in the region is still comparatively low when set against global incidence rates. However, in Ukraine, and to a lesser degree in Russia and Moldova, the incidence rate is rising. The United Nations Programme on HIV/AIDS (UNAIDS) noted that "Ukraine has the most severe AIDS epidemic in Europe with an adult prevalence of 1.46 per cent " (UNAIDS, 2007). The incidence rates have risen throughout the first years of this century in the Ukraine, with a HIV/AIDS related death toll for 2006 of 24 216. There has also been a change in the population affected, with more women and children among the 2006 cases reported. The UNAIDS estimates that, in 2005, 377 000 adults and children lived with HIV/AIDS in Ukraine. Although officially registered cases totalled 370 000, UNAIDS estimates there were 940 000 people living with HIV/AIDS in Russia in 2006, making Russia's incidence the highest in the BSEC-CA region. The adult prevalence rate of 1.1 per cent is, however, lower than that of Ukraine. Moldova is the third country in the region with a notable adult prevalence rate, 1.1 per cent , with 29 000 people reported to be living with HIV/AIDS. While the prevalence is low in all other countries of the region, there are still concerns, particularly as epidemics occur most among vulnerable sectors of the population. Moreover, the fast growing epidemics in Ukraine, Russia and Moldova, combined with the challenges and outcomes of globalisation, put the entire region at risk (UNAIDS, 2007).

In Central Asia, while the overall prevalence rate is low, the annual reported diagnosis of HIV is rising with steady increases noted since 2000 (UNAIDS, 2007). "In Uzbekistan, which now has the largest epidemic in Central Asia, the number of newly reported HIV diagnoses rose exponentially between 1999 and 2003, from 28 to 1836. Since then, the number of newly reported HIV infections has grown at a slower pace, and reached 2205 in 2006" (UNAIDS, 2007: 7). The HIV epidemic is concentrated largely among injecting drug users and those who engage in male-with-male and male-with-female unsafe sex with non-regular partners, including sex-trade workers. Growth of the sex-trade industry is one of the other primary causes of the increasing incidence of HIV infections in the region. The high levels of injecting drug use in parts of Central Asia mean that the epidemic is likely to continue to grow. Though harm-reduction programmes (e.g. needle-exchange projects, education and information media), are found to be effective in slowing HIV growth rates, there are only a few such pilot programmes available in Central Asia and Eastern Europe and these have only been recently introduced. They are neither sufficiently widespread nor comprehensive enough (targeting only needle/syringe exchange) to slow the trend as programmes in Western Europe have done (UNAIDS, 2007).

Alcohol consumption is another cause of life loss in the region, especially in Moldova and Russia which have a comparatively high incidence of liver cirrhosis (digestive disease) and alcohol use disorders (neuro-psychiatric conditions). The WHO (2004) reports that, in 2002, Russia lost over 8 300 people to alcohol disorders. In Moldova, almost one person per thousand died from cirrhosis of the liver. Costs from injuries are particularly high in Russia, Ukraine and Kazakhstan, where cases of intentionally self-inflicted injuries are four times more common than in other BSEC-CA countries, and explain, on average, over 2.5 per cent of those countries' deaths. Overall, the working age population has been affected by increased incidence of accidental or violent death along with suicide and HIV/AIDS related deaths, although these impacts tend to be country specific.

The declines in life expectancy and health reinforce the picture of reduced well-being during the past decade despite improvements in GDP for many of the BSEC-CA countries. In recent years, there has been some reversal of the negative health trends, but in some cases, indicators such as life expectancy or infant mortality rates are low for the countries' income levels and by their historical standards.

Overall, total expenditure on health is low in BSEC-CA countries. Health expenditure, on average, as a percentage of GDP in 2004 was almost one-third less than the average in high-income OECD countries. There is, however, significant variability in health expenditure levels across the BSEC-CA region, with Serbia and Azerbaijan spending a larger share of GDP than high-income OECD countries, but a majority of countries (Armenia, Georgia, Kazakhstan, the Kyrgyz Republic, Romania, Russia, Tajikistan, Turkey, Turkmenistan and Uzbekistan,) allocate smaller budget shares to health than the BSEC-CA average. Yet, BSEC-CA countries score relatively well on average in terms of physician availabilities, which are generally equivalent to the high-income OECD rates of availability, despite lower rates in Albania and Turkey.

## HUMAN CAPITAL

The BSEC-CA economies rank more highly by composite indicators than their relatively low per capita income levels might suggest. For example, the UNDP Human Development Index, which takes into account indicators of health and education, including life expectancy at birth, adult literacy rate, and combined gross enrolment ratio for primary, secondary and tertiary schools, as well as GDP per capita (among other indicators) ranks all of the BSEC-CA countries within the high or medium human development scale (Table 3.11). Apart from Turkey, where adult literacy was 87.4 per cent in 2005, literacy levels in the region were all over 96 per cent. In some BSEC-CA countries, however, there are signs that literacy rates may decline. For example, in Albania, primary school attendance declined to approximately half of primary age children attending school in 2005. Attendance in primary schools also dropped substantially in Turkmenistan and, to a lesser extent, in Moldova and Ukraine.

**Table 3.11. Human Development Index and Other Human Capital Indicators.**

Country	Human development index (HDI)	Human development index (HDI)	Life expectancy at birth	Adult literacy rate	Combined gross enrolment ratio for primary, secondary & tertiary education	GDP per capita	Public expenditure on education	
	(global rank)	(value)	(years)	(% aged 15 and above)	(%)	(PPP USD)	(% of GDP)	
	2005	2005	1995-05	2005	2005	2005	1991	2002-05
Greece	24	0.926	78.9	96.0	99.0	23 381	2.3	4.3
Bulgaria	53	0.824	72.7	98.2	81.5	9 032	5.4	4.2
Romania	60	0.813	71.9	97.3	76.8	9 060	3.5	3.4
Russia	67	0.802	65.0	99.4	88.9	10 845	3.6	3.6
Albania	68	0.801	76.2	98.7	68.6	5 316	n.a.	2.9
Kazakhstan	73	0.794	65.9	99.5	93.8	7 857	3.9	2.3
Ukraine	76	0.788	67.7	99.4	86.5	6 848	6.2	6.4
Armenia	83	0.775	71.7	99.4	70.8	4 945	n.a.	3.2
Turkey	84	0.775	71.4	87.4	68.7	8 407	2.4	3.7
Georgia	96	0.754	70.7	100.0	76.3	3 365	n.a.	2.9
Azerbaijan	98	0.746	67.1	98.8	67.1	5 016	7.7	2.5
Turkmenistan	109	0.713	62.6	98.8	n.a.	3 838	3.9	n.a.
Moldova	111	0.708	68.4	99.1	69.7	2 100	5.3	4.3
Uzbekistan	113	0.702	66.8	n.a.	73.8	2 063	9.4	n.a.
Kyrgyzstan	116	0.696	65.0	98.7	77.7	1 927	6	4.4
Tajikistan	122	0.673	66.3	99.5	70.8	1 356	9.1	3.5
Average	84.6	0.768	69.3	98.0	78.0	6 585	5.3	3.7
Median	83.5	0.775	68.1	98.8	76.3	5 166	5.3	3.6

Notes: Data for Serbia not reported.

Source: UNDP (2008), Human Development Report 2007/2008, (Human Development Indicators).

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In a 1998 regional monitoring report, *Education for All?*, UNICEF highlighted the increase in disparities in the quantity and quality of education provided to children in Eastern Europe and the CIS during the 1990s (UNICEF, 1998). This was evident within countries – with children from ethnic minorities, war-torn areas, and poorer, rural families suffering disproportionately – and also between countries – with education systems in the Caucasus and Central Asia suffering more than those in Eastern Europe. Among the most worrying changes found in the study were the declines in enrolment and attendance in less-developed areas, and the increased selectivity and provision of better-funded schools for the children of the more affluent. Widening disparities threaten the past achievement of universal literacy. Also, the report noted that although education had a stronger positive effect on earnings in post-Communist economies, many young people faced unemployment upon completing full-time education and parents began to doubt the value of leaving their children in school, especially as the costs of schooling (textbooks, meals, clothing, and so forth) increased.

In the follow-up report, *Education for some more than others?*, UNICEF (2007) concluded that the situation continues to deteriorate in many BSEC-CA countries, and the inequality between access to education for rich and poor children is widening across the region. In terms of the Millennium Development Goals, Georgia, the Kyrgyz Republic, Moldova, Romania, Tajikistan and Ukraine (and perhaps Azerbaijan, Serbia and Turkey) are identified as countries failing to achieve universal completion of primary education, while Tajikistan and Turkey fail to eliminate gender disparities in primary and secondary education. Despite official commitment to education reform and ratification of the UN Convention on the Rights of the Child, change within schools has been hampered by deteriorating material conditions, scepticism among teachers and reform fatigue; reforms on paper are negated in fact by lack of heating, desks and chairs, textbooks and other necessities, while teachers often remain underpaid. Pre-school enrolment rates have recovered from their 1990s trough in some BSEC-CA transition economies, but they remain low in Albania, Serbia, the Caucasus and Central Asia. Although access to basic education (in most BSEC-CA countries starting at age seven) is unrelated to family income, pre-school education is not available to all and is a strong determinant of a child's performance in elementary school and beyond. By upper-secondary school, enrolment rates of poorer children are much lower than those of children from richer families, and the disadvantaged are more strongly represented in the still-unreformed vocational schools; this also has a spatial dimension as upper-secondary enrolment rates are, in all countries except Armenia and Tajikistan, higher in the cities than in small towns or rural areas.

The economic growth and strengthened fiscal positions reported in Part I should have had a positive impact on education. However, public expenditure on education was on average 3.7 per cent of GDP for BSEC-CA countries in 2005, a decrease of 1.6 per cent compared to 1991 expenditures of 5.3 per cent (See Table 3.11). A further comparison puts the BSEC-CA average at 1.9 per cent lower than the 5.6 per cent spent in high-income OECD countries. Yet, primary level pupil-to-teacher ratios in BSEC-CA countries are quite close to those of high-income OECD countries, with some exceptions (e.g. the Kyrgyz Republic and Ukraine have higher pupil-to-teacher ratios). The demographic trends, with the proportion of the population under 18 declining in every BSEC-CA country since the 1990s, should loosen the budget constraint in the early 21st century. Coping mechanisms, however, such as cutbacks in expenditure (e.g. on children's clothing), increased use of child labour (whether in legal or illegal paid activities) and migration by one or both parents are associated with reduced school attendance.

One of the most striking educational developments has been the expansion of higher education since the mid-1990s in some of the BSEC-CA transition economies and in Turkey. All of these countries had higher education enrolment rates below 30 per cent in the early 1990s, but by 2004, enrolment rates exceeded 40 per cent in Kazakhstan, Russia and Ukraine, and 30 per cent in Bulgaria, Georgia, the Kyrgyz Republic and Turkey. At the same time, however, higher education enrolment rates in some countries remained low in 2004: Albania 19 per cent, Tajikistan 14 per cent, Azerbaijan 13 per cent, Uzbekistan 8 per cent and Turkmenistan 3 per cent. Private provision of higher education has become important in some countries; the private share is over 25 per cent in Armenia, Georgia and Romania, and over 15 per cent in Azerbaijan, Bulgaria, Moldova and Russia. Private secondary vocational schools have also

become important in some cities, but the data are even more incomplete than for private tertiary institutions (see Chapter Six for more information on vocational school provision and programmes in the BSEC-CA countries).

Productive skills and technological knowledge influence people's ability to obtain employment and their wage levels. It is important to distinguish between types of human capital. Human capital includes general-purpose skills, mid-level technical skills, lower-level vocational or job-specific skills and high-level professional skills. University education was especially important in the 1990s, while some inherited skills (e.g. operating specific Soviet-era equipment) became valueless. Analysis of labour market outcomes in the 1990s found weak relationships between education levels and earnings, apart from those with tertiary education.

Recent evidence suggests that earnings are better explained by the standard human capital model, which relates earnings to education *and* demographic variables such as age and gender, but there is still a large unexplained component (Anderson and Pomfret, 2003, on Central Asia; Bruck *et al.*, 2008, on Ukraine). This should provide an incentive for people to invest in human capital accumulation, but in the short-term there may be a principal-agent problem as parents see benefits from having their children work or help in the home, while poverty and inadequate access to public assistance or financial markets may mean that families cannot afford to send their children to school. At the economy-wide level, long-term well-being in all countries is associated with increases in human capital. People with higher education and skills have the ability to earn more; they also have lower unemployment rates, better employment and may be better able to take advantage of geographical mobility. In sum, better-educated workers tend to have better working lives.

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Many of the outcomes described in this chapter have affected the level of human capital and the potential for accumulation of human capital. During the 1990s, many transition countries encouraged early retirement as a response to falling demand for labour, which reduced unemployment but shifted the burden to already overstretched pension budgets. Moreover, the human capital of the older workers was prematurely lost to the economy. More recently, governments have reversed this policy, encouraging older workers to remain in the workforce so that their human capital is still put to economically productive use. The migration flows described in Chapter Two have three potential effects on human capital: causing a potential brain drain in sending countries, contributing to the possibility of acquiring human capital while working abroad and returning with this capital, and improving human capital in receiving countries.

The relationship between work and well-being and human capital is complex and two-way. Prosperity is the best means to improve health and human capital, but improvements in human capital are the surest way to promote prosperity and long-term growth.

## SUBJECTIVE MEASURES OF WELL-BEING

The objective evidence presented, whether economic measures such as GDP per capita or the incidence of poverty or social indicators such as health or education measures, suggest that the BSEC-CA countries in transition from central planning to market-based economies went through a traumatic experience in the decade and a half after 1990. This evidence, however, does not include subjective data and perceptions of well-being. What did people really think about their situation? To capture this, other measures are needed.

An alternative approach is to ask people how happy they are. Such surveys have many obvious problems, especially when the results are interpreted across countries. Nevertheless, subjective indicators, including surveys, are increasingly used in economic and social analysis as a triangulation method (i.e. a useful cross-check) to augment analyses and conclusions drawn from standard objective data.

In Table 3.12, the results of a question posed in World Values Surveys: "Taking all things together, would you say you are happy?" are depicted. The data cover 13 BSEC-CA countries; four of the Central Asian countries are not included. The survey years vary with the most recent being 2003, and the sample sizes are not large. In the countries with multiple survey years (see Table 3.12), there is year-to-year variation and any general patterns cannot be ascertained, particularly because the survey respondents are not the same across survey years. In other words, this is not one longitudinal study but separate studies with the same questions given in other years to different participants. Nevertheless, the results indicate a general sense of being happy rather than unhappy: in every country except Bulgaria the most common response to the question is "quite happy". Ukraine is the only country for which a majority in all surveys say they are not happy, and in four other countries, a majority surveyed report being unhappy in one survey year and the majority surveyed in another year report being happy. In eight of the 13 countries surveyed, the majority in all surveys report being "happy" rather than "not happy".

**Table 3.12. Are People Happy?**

Country	Year	Taking all things together, would you say you are				Number of responses
		Very Happy	Quite Happy	Not very happy	Not at all happy	
Albania	2002	10	49	31	10	993
Armenia	1997	6	51	36	8	1 929
Azerbaijan	1997	11	67	21	1	1 964
Bulgaria	1990	7	31	50	12	963
Bulgaria	1997	9	48	34	9	1 039
Bulgaria	1999	8	38	42	13	997
Georgia	1996	12	54	29	5	1 999
Greece	1999	19	57	21	3	1 098
Kyrgyz Rep	2003	20	65	15	1	1 035
Moldova	1996	4	40	48	8	973
Moldova	2002	6	45	45	4	979
Romania	1993	6	55	33	5	1 102
Romania	1998	5	52	36	7	1 219
Romania	1999	4	44	41	12	1 127
Russia	1990	6	46	44	4	1 770
Russia	1995	6	45	41	8	2 002
Russia	1999	6	43	41	10	2 432
Serbia	1996	14	57	25	5	1 266
Serbia	2001	12	63	21	4	1 177
Turkey	1990	29	52	16	3	1 026
Turkey	1996	51	37	10	2	1 904
Turkey	2001a	21	38	23	18	1 205
Turkey	2001b	35	43	14	9	3 398
Ukraine	1996	5	43	43	9	2 675
Ukraine	1999	6	42	42	10	1 143

Source: European and World Values Surveys Four-wave integrated Data File, 1981-2004, 2006. The European Values Study Foundation and World Values Survey Association (downloaded from [www.worldvaluessurvey.org/](http://www.worldvaluessurvey.org/) on 5 August 2007).

StatLink  <http://dx.doi.org/10.1787/344704860356>

The overall positive tone from the World Values Surveys is in stark contrast to the general picture of doom drawn for all of these countries during the years when the surveys were undertaken. The World Poll undertaken by Gallup also reveals levels of happiness higher than might be expected from the literature on BSEC-CA countries, apart from that people in the Caucasus countries report greater unhappiness than their income levels might suggest (Deaton, 2007). A 2006 joint World Bank and European Bank for Reconstruction and Development (EBRD) survey found less positive responses, despite the improved economic performance of the last decade, which Guriev and Zhuravskaya (2007) ascribe to sample bias; the nouveaux riches are under-represented in the samples from BSEC-CA countries. The main causes of dissatisfaction in this last survey were deterioration in public goods provision, increased macroeconomic volatility and mismatch of human capital to jobs.

## CONCLUSIONS

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After dramatic declines in output and income and unprecedented increases in inequality and poverty during the 1990s, the BSEC-CA transition economies began to enjoy better economic conditions in the 2000s. The improvement is reflected in many objective and subjective indicators. However, in most countries labour market development lagged. Employment creation has been slower than output growth, although precise evaluation is hampered by measurement problems, in part due to the high level of informality. Yet, happiness, as one measure of well-being, does not appear to have declined in the long-term. Well-being then must be looked at across diverse variables and situations, in macro- and micro-scales and through objective and subjective lenses.

# CHAPTER FOUR

## Labour Market Outcomes and the Global Policy Environment

The previous chapter looked at some of the structural changes that have affected work and well-being negatively in the BSEC-CA countries since the transition from centrally planned to market-based economies. This chapter considers why this happened. The proximate cause is the temporal gap between job destruction and job creation during the transition from central planning, a process which took far longer than many anticipated at the start of the 1990s. Job destruction and creation during the transitional recession are analysed in the first section of this chapter.

The timing of the end of central planning, which coincided with increased globalisation meant that the external environment has been especially important. In part, this is because more and more countries, including large emerging economies like China, Brazil and India, have become more involved in the international division of labour, offering greater potential gains from trade but also greater competitive pressures. Primarily though, most of the BSEC-CA countries rely on OECD countries for their export markets, capital inflows and technology transfer. While participation in the global economy offers many potential benefits, it also exacerbates job insecurity and volatility. The second section of this chapter examines firms' responses to the simultaneous transition from central planning to market-based economies and integration into the global economy.

The third section considers the role of OECD countries' policies in helping or hindering the BSEC-CA countries from benefiting from globalisation. Finally, the connections between globalisation and the functioning of the labour market are reviewed from a policy perspective. The chapter concludes with an inventory of the appropriate domestic framework for establishing a labour market where people can benefit from globalisation while having some security against the vicissitudes and uncertainties inherent in an open economy.

### THE TRANSITIONAL RECESSION

A universal feature of the transition economies of Europe and the former Soviet Union was that a sharp drop in output followed the end of central planning. Many enterprises were unprofitable once prices were liberalised and state subsidies reduced, while some firms, which may have been viable, could not survive the breakdown of supply and marketing channels. Lack of financial services exacerbated these developments as many companies had limited access to credit to stabilise their cash flow or to take advantage of profitable opportunities. The expectation that redundant labour would be guided by price signals to superior alternative employment was inadequately fulfilled in the short- to medium-term, and for many years job destruction exceeded job creation.

The pattern is illustrated by the rate of job destruction and job creation in Ukraine. The number of people losing jobs exceeded the number being hired throughout the 1990s and early 2000s; the gap only began to narrow significantly in 2003-04. In 2005, the largest negative gap between job creation and job destruction continued to be in the agriculture and fishery sectors, with job

creation exceeding job destruction only in service sectors such as finance and wholesale and retail trade. Throughout the transition, turnover was lowest in the public sectors, including the health and education sectors.

The gap between separation and recruitment underlies the widespread decline in aggregate employment reported in the previous chapter. Nevertheless, employment in state enterprises often declined slowly and wage differentials continued to favour workers in state enterprises. Some enterprises continued to receive state subsidies and, even when the subsidies ceased, many enterprises were slow to accept that soft budget constraints had hardened. Despite payment in kind, arrears in paying wages or enforced unpaid leave, workers often hung on to their positions in the hope that the enterprise would survive, or as a fallback option while they worked in the informal sector.

The simplest models of unemployment during the transition, originally developed by Olivier Blanchard (1997), focus on the gap between job destruction and job creation. The extent of job destruction varied depending on the policy environment. Countries adopting more rapid and complete price liberalisation and stabilisation experienced deeper short-term recessions. Rapid privatisation and restructuring were also associated with greater short-term job losses. These patterns were exacerbated by political shocks such as internal- or intra-state conflicts. The rate of job creation is more difficult to explain. Rapidly reforming Eastern European countries such as Poland were successful in generating employment in new enterprises by the late 1990s, but other rapid reformers experienced less new enterprise creation. The negative investment environment arose from the costs of opening and operating businesses and the high risks arising from policy unpredictability, unreliable infrastructure, insecure property rights and weak contract enforcement. Potential entrepreneurs had limited access to finance and, in the absence of secure property rights, had little confidence in the benefits of risk taking. The most dynamic sectors were those that included small-scale trading and other unofficial activities within them, but these could not generate sufficient employment to match the large decline in employment in the formal sector. The difficulty of establishing a market-based economy with a good business environment and which functions well in new job creation is the major reason why the transition has been such a drawn-out process. It also explains why transition to a market-based economy was easier in countries with a relatively recent memory of a functioning market economy, such as the Eastern European countries, than in the CIS; the Central Asian countries were especially disadvantaged insofar as they never had a market economy, not even the kind of market economy that operated in other CIS countries before 1917. Still today, as shown by Gianella and Thompson (2007) for Ukraine, impediments to firm exit and entry are due to excessive and ill-administered regulation of product, as well as labour markets that inhibit both job destruction and job creation, reducing economic growth.

The insufficient rates of job creation highlight the need to increase both the demand for labour and the adaptability of labour markets. In countries where employment protection legislation is stringent but enforcement weak, duality has often resulted: a sheltered formal sector in which wages exceed productivity and labour receives many benefits coexists with an informal sector in which workers' rights are limited or non-existent. The key to long-term improvement in work and well-being is aggregate productivity increases, which must come from breaking such duality so that the established formal sector is not sheltered from the consequences of low productivity, and the growing informal sector operates in a framework more conducive to increasing productivity. Liberalising the law and promoting compliance with core worker rights will improve labour market flexibility. However, for most of the BSEC-CA transition economies, there was little policy change during the 1990s, and the CIS countries were only beginning to formulate labour market policies in the first decade of the 21st century.

## OPENING UP THE ECONOMY AND FIRMS' RESPONSES

The transition from central planning was accompanied by integration into the global economy. All of the BSEC-CA countries have high trade-GDP ratios. Even those governments which lagged in reform and maintained tight economic control relied on primary product exports to generate income (e.g. Turkmenistan) or on imports to fill some essential domestic needs (e.g. energy importers). Three of the BSEC-CA countries (Greece, Romania and Turkey) were signatories to the General Agreement on Tariffs and Trade (GATT) and hence became charter members of the World Trade Organization (WTO) in 1995. With the exception of Turkmenistan, the remaining countries have applied for WTO membership. Bulgaria, the Kyrgyz Republic, Georgia, Albania, Moldova, Armenia and Ukraine have completed the negotiations; the other applicants are at various stages in the process (Table 4.1).

The gains from trade are well known and the costs of autarchy are high, but rapid opening of national economies exacerbated the transitional recession. Governments wishing to slow the pace of job destruction were frustrated by their inability to shield domestic producers from huge changes in relevant prices, which led to downsizing or closures. This especially affected workers in firms most exposed to import competition who were ill prepared to navigate labour markets characterised by intensive restructuring, rising skill requirements and employers who were increasingly sensitive to labour costs. Some skills were in high demand in the new environment, but much of the vocational training in the planned economy became valueless.

The increased vulnerability of workers due to the impact of globalisation is a universal feature. It has been observed in OECD countries (see OECD *Employment Outlook*, 2007) and in developing countries, but it is likely to be most extreme in countries undergoing rapid reform and structural change and this is nowhere more true than in Eastern Europe and the former Soviet Union after 1989. There is strong evidence from cross-country studies of Eastern European transition economies that firms more intensively involved in foreign trade shed labour more aggressively. Firms involved in exporting were slow to create new jobs, but when successful, employment gradually expanded. Other formerly centrally planned economies such as China and Viet Nam faced many similar problems, but the structural change was simpler; their comparative advantage was in labour-intensive activities, and the restructuring of agriculture from communes to household plots and the creation of small- and medium-sized labour-intensive manufacturing activities were relatively straightforward and job-creating. The comparative advantage of BSEC-CA countries, whose economies had been distorted by decades of artificial prices, was far from clear.

The volatility of economies exposed to the global economy is also driven by external shocks. Many of the BSEC-CA countries are highly exposed to world price shocks either because they are dependent on a small number of primary product exports or because they rely on imported oil and gas for their energy needs. Especially within the CIS countries, a widening division between energy exporters and energy importers has emerged as oil prices climbed from less than USD 10 per barrel in 1998 to over USD 100 in 2008. The rapid rise in wheat prices in 2007-08 helped farmers in Kazakhstan or Ukraine, but in many countries, it caused distress for poor people facing increased bread prices. Individual countries are also exposed to fluctuating commodity prices (e.g. the southern Central Asian countries rely heavily on earnings from cotton exports). There have also been large shocks to sub-groups of countries, due to political instability in south-eastern Europe and the Caucasus or the 1998 Russian crisis in the CIS. In relations with Russia, still the major market for the CIS countries, small trading nations have been vulnerable to political decisions such as the 2006 ban on wine imports from Moldova or restrictions on trade with Georgia after the 2003 Rose Revolution and with Ukraine after the 2004 Orange Revolution. Home-grown volatility can be magnified by integration into global markets, especially financial markets, as illustrated by Kazakhstan's banking problems, which emerged in 2007, as an asset bubble was exacerbated by banks' foreign borrowing and became problematic when foreign loans became due but the banks' assets were tied up in long-term loans (e.g. for real estate).

## OECD COUNTRIES' POLICIES

The response of the OECD countries came on two levels: through multilateral institutions and through national policies. In the early 1990s, policy makers in North America, Western Europe and Japan were distracted by regional or domestic policy issues and were largely willing to allow the IMF and World Bank to take the lead in economic relations with the economies in transition. Debates over the policy advice from those institutions continue and have been extensively discussed. The multilateral institutions also provided training for economic policy makers. Regional development banks became involved, although with some delay as the EBRD was established and some of the CIS countries joined the Asian Development Bank (ADB). Various UN agencies, especially the United Nations Development Programme (UNDP) and the regional commissions, the United Nations Economic Commission for Europe (ECE) and the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), also provided training and forums for policy co-ordination.

National policies often responded to *ad hoc* forces rather than making a coherent response by considering the wider array of issues and circumstances. For example, the German constitution enabled hundreds of thousands of people in Kazakhstan (with German heritage) to emigrate, which involved a huge brain drain and disrupted many economic activities. The United States advocated open markets but, in response to the Armenian lobby, refused most-favoured nation (MFN) treatment to Azerbaijan, and potential energy investors in Central Asia or the Caucasus were discouraged by US legislation prohibiting dealings with Iran, which was a natural export route. In the immediate aftermath of the unforeseen collapse of Communism and the dissolution of the Soviet Union, short-term political considerations, such as the decommissioning of the nuclear arsenal in new independent states, were often dominant. Members of the European Union were especially concerned with the situation in Central and Eastern Europe, but from a perspective of maintaining political stability and assessing applications for EU accession. Relations with Russia also focused on short-term stability rather than longer-term considerations.

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By the turn of the century, there was little excuse for policy inconsistencies (see Box 4.1 on the role of coherent policies). Moreover, the increase in energy prices focused interest on the Caspian basin as a major potential source of oil and natural gas. This became intertwined with broader geopolitical considerations as competing regional organisations pulled Central Asian attention to the north, south and east. The long-standing economic connection with Russia, which had weakened during the 1990s, was strengthened with the establishment of the Eurasian Economic Community (EurAsEc). Connections with southern neighbours Iran, Pakistan and Turkey are formalised in the Economic Cooperation Organization (ECO). China's economic growth and adoption in 1999 of a "Go West" (*xibu dakaiifa*) policy has its counterpart in the Shanghai Cooperation Organisation (SCO). The region has also assumed a higher profile since 2001 with ongoing military interventions in Afghanistan and Iraq.

### Box 4.1. The Role of Coherent Policies

The OECD countries have typically looked to official development assistance to promote economic growth and poverty reduction in low- and middle-income economies. Increasingly, however, policy makers recognise that aid is not enough, particularly to meet international goals and commitments such as the Millennium Development Goals. Moreover, other policy decisions taken in OECD countries – governing trade, investment, migration, security and other policy domains – can get in the way of aid doing its job. A growing awareness of the complicated interactions of policy decisions taken in OECD countries has led to calls for greater policy coherence for development.



Some of the most glaring examples of policy incoherence occur at the intersection of trade and aid policies. Aid policy promotes productive restructuring (often export-oriented) in developing economies, while trade policies pursued by OECD countries (including domestic subsidies that distort trade) can sometimes present obstacles to developing-country exports. Aid and migration policies can be likewise incoherent. To the extent that OECD-country migration policies deliberately target skilled developing-country nationals (e.g. nurses, doctors, teachers, engineers), these policies are inconsistent with foreign aid policies that seek to build capacity in the health and education sectors of the migrants' home countries.

Policy makers can exploit policy interactions more conscientiously. Such interactions come in two forms: complements, if increases in one policy tend to lead to increases in another, such as where foreign aid builds infrastructure that increases trade flows; and substitutes, if higher values of one can reduce the need for the second (e.g. if increased trade flows, via export-led growth, reduce the need for development assistance).

If older conceptions of policy interactions tended to see policies as substitutes, the newer perspective is that policies are complementary. In the short to medium term, aid is more often a complement to other flows, though in the long term it might be a substitute. The relationship of trade policy to migration is a good example. Over time, increased trade volumes will encourage developing countries to specialise in the production of goods that use labour intensively and thus reduce the incentives to emigration through job creation. In the short to medium term, however, job creation in an expanding export sector might be associated with strong emigration, for a number of reasons (Dayton-Johnson and Katseli, 2006). In this latter case, trade and migration are complements.

If policies are complementary, then the question facing decision makers is not which policies to choose, but how to combine them to achieve the desired results most effectively. An example is aid for trade. Some aid spending seeks to bolster developing economies' export potential, in three broad categories: helping countries negotiate, reform and prepare for closer integration in the multilateral trading system; building trade-related infrastructure, including transport and storage, communications and energy; and seeking to enhance competitiveness, for example by providing aid for the development of banking and financial services, and for upgrading skills in the primary sector, in manufacturing and in services. An OECD study in support of the Doha round of trade negotiations reported that in 2004, assistance to the broader aid-for-trade agenda included USD 2.5 billion for trade-related technical assistance and capacity building, USD 12.9 billion to build infrastructure and USD 7.3 billion to promote productive capacities, for a total of nearly USD 23 billion – over 24 per cent of total ODA, excluding debt relief (OECD, 2005a).

Policies that are more coherent call for new institutional arrangements – arrangements that facilitate information sharing, negotiation and consensus building across government ministries and agencies (e.g. the development co-operation and foreign trade ministries). The form such arrangements will take will necessarily vary from one country to another, though the varied experiences of the OECD member countries already offer many possible models.

*Source: OECD (2005a); Dayton-Johnson and Katseli (2006); Dayton-Johnson and Fukasaku (2008).*

## Trade

In the trade area, a consensus has emerged in the BSEC-CA countries on the desirability of WTO accession, and only Turkmenistan among the non-members has not applied (Table 4.1). Primarily, this concerns recognition of the desirability of conforming to a single set of rules as the basis for international trade law. WTO accession negotiations progressed smoothly for smaller BSEC-CA countries; Bulgaria joined the WTO in 1995, the Kyrgyz Republic in 1998, Georgia and Albania in 2000, Moldova in 2001 and Armenia in 2003. There has been closer and more critical involvement by the OECD countries in the accession negotiations of larger economies such as Kazakhstan, Ukraine and, especially, Russia; in Russia's case the Working Party has met an extraordinary 30 times, and still has not agreed on a final report. Ukraine concluded 14 years of negotiations to join the WTO in early 2008 with membership beginning in July 2008. Kazakhstan negotiations have been in progress since 1996.

The OECD countries' willingness to resort to special protection in response to demands from domestic pressure groups has been less consistent. The most notable examples are antidumping findings. Some OECD members continue to use constructed values for prices in non-market economies and have been slow to remove this designation from some BSEC-CA countries even after their WTO accession. This has been deleterious to work prospects in the exporting countries whether it prevents old factories from exploiting their depreciated capital by selling steel at low prices or whether it prevents start-up enterprises from increasing their scale.

Sector-specific trade restrictions have been harmful. Moldova has had limited success in exploiting its comparative advantage in wine and other agricultural products because of restricted access to EU markets. The concentration of Ukraine's exports in iron and steel, an industry subject to strong protectionist pressures and use of anti-dumping duties in many OECD countries, has also led to difficulties.

Domestic policies in OECD countries affect BSEC-CA countries' export prospects. The large cotton-farming subsidies in the United States and the European Union depress world prices, causing substantial losses to the Central Asian countries and Azerbaijan. Direct assistance to cotton growers amounted to USD 2.3 billion in the United States and USD 0.8 billion in the European Union in the 2001-02 season. These subsidies raised producer prices above the world price by 91 per cent in the United States, by 144 per cent in Greece and by 184 per cent in Spain, while the domestic supply response to these artificially high prices lowers world prices, thus producers in non-subsidised countries have substantially lower earnings than their subsidised counterparts. A World Bank study (Baffes, 2004) estimates that removal of the US and EU subsidies would increase world prices by as much as 12.6 per cent, which coincides with other recent studies where estimates range from 10 to 11.5 per cent. Higher world cotton prices would tend to increase GDP and producer revenues in the cotton-producing countries, Uzbekistan, Tajikistan and Turkmenistan.

Energy prices, although more clearly market-driven, are also influenced by OECD countries' domestic policies. As with all commodity prices, shifts in world prices create losers as well as winners, but the differentiation is especially stark between energy-rich and energy-poor CIS countries. The oil boom has dramatically changed the geopolitical situation; Russia has become more assertive on global and regional stages, and Kazakhstan has become economically dominant in Central Asia and an important investor in the Caucasus. Competition over energy supplies and pipeline routes has also undermined the consistency of OECD countries' relations with energy producers and transit countries.

## Migration

The emigration patterns described in Chapter Two are strongly affected by OECD countries' policies towards immigration and temporary work permits. The selectivity of the rich countries' immigration schemes ensures that most permanent emigration from BSEC-CA countries involves brain drain. Even temporary migration towards high-income countries may be biased towards skilled labour, although in this case, there may be skill acquisition, which benefits the returning migrant's home country.

One indirect effect of EU labour market policy has been migration diversion. As eight Eastern European countries joined the European Union in 2004 and obtained open entry to some EU members' labour markets, there was a rapid response highlighted by, for example, the quarter of a million young Poles obtaining temporary work in Ireland. The ensuing labour shortages in the Polish economy created opportunities for Ukrainians, Moldovans and other BSEC-CA citizens to obtain temporary or informal work in Poland. According to Ukrainian embassy reports, in 2005 there were about 300 000 Ukrainians working in Poland and 200 000 in both the Czech Republic and in Italy; no other country attracted over 150 000 Ukrainian workers. Similar migration diversion appears to be following Bulgaria and Romania's 2007 EU accession. This progress may be long lasting as freedom of intra-EU labour movement is subject to a lengthy transition period in the accession treaties.

Sector-specific temporary work permits in Western Europe have become important for many citizens of non-EU BSEC-CA countries. An example of such labour demand is in personal care, especially as native populations age, traditions of familial care for the aged decline and availability of native labour willing to work in the lower end of the care sector diminishes. For female migrants from Moldova, for example, working in the care sector in Italy has become the single-most important opportunity abroad, and it has the benefits of formality and being in an economy where the developed financial sector facilitates efficient transfer of remittances to Moldova.

## Foreign Investment

Foreign investment is a potentially important conduit for technology transfer as well as capital. In some Eastern European countries (and especially in China), FDI played a critical role in introducing modern management and marketing techniques into formerly planned economies. The process has been slower in the BSEC-CA transition economies, in large part because of the unattractive business environment described in the first section of this chapter. Investment flows can, however, also be facilitated by policies in the investor's home country such as risk insurance.

More controversial have been OECD countries' policies affecting their corporations' behaviour abroad. Some of these measures, such as the global reach of the US Foreign Corrupt Practices Act or of sanctions against Iran, are seen by some in the region as unacceptable extraterritoriality. The Extractive Industries Transparency Initiative (EITI), announced at the World Summit on Sustainable Development in Johannesburg, September 2002, takes a more collaborative approach to increasing transparency over payments by companies to governments and government-linked entities, as well as transparency over revenues by those host-country governments. Some BSEC-CA countries have taken the lead in supporting this initiative. Azerbaijan announced its decision to pilot EITI implementation in June 2003. Kazakhstan joined the countries taking part in the EITI in September 2005.

A 2001 OECD report on corporate responsibility documents a generally improving record of corporate responsibility (OECD, 2001a). Nevertheless, there are still concerns about whether some high-profile foreign investors recognise the standards of transparency and good corporate citizenship that they would observe in their home country. For example, information about deadly cyanide spills from the Kumtor goldmine in the Kyrgyz Republic were covered up and inadequate compensation paid, but whether that was the fault of the Canadian operator of the mine or of Kyrgyz officials remains unclear.

## Aid

The largest aid flows measured by the OECD Development Assistance Committee (DAC) in 2006 were to Serbia, Turkey and Ukraine (Table 2.6). The European Union is the largest DAC donor to Serbia, Turkey and Albania. The United States is the largest bilateral DAC donor to Armenia, Azerbaijan, Georgia, Tajikistan and Ukraine, although none of these countries rank among the top ten recipients of US aid. Japan is the largest DAC donor to Kazakhstan and Uzbekistan, although neither ranks among the top ten recipients of Japanese aid. Turkey is the largest donor to the Kyrgyz Republic and Turkmenistan.

These patterns of EU focus on the Balkans, US focus on the Caucasus and Ukraine and Turkish focus on Turkic-speaking countries reflect the strong role of geopolitical and cultural considerations. The secondary role of developmental need is reflected in the average per capita aid flows to the eight lower-middle income countries (USD 53.50) being greater than the average going to the four low-income countries (USD 35.25). Among the low-income countries military aid, which is not included in ODA figures, was probably more important in US assistance to Uzbekistan (until the closure of the US military base in late 2005) and to the Kyrgyz Republic.

Some of the countries receive substantial assistance from non-DAC donors too. In particular, Russia, with a historically important stake in the CIS countries, provides assistance there. China has become very active in providing infrastructure in Central Asia, and to a lesser extent, Iran is involved in infrastructure projects in the Caucasus and Central Asia. These emerging patterns of geopolitical competition have contributed to raising OECD countries' awareness of the Caucasus and Central Asia.

The United Nations and other international organisations are active in the Caucasus and Central Asia. The international financial institutions were especially significant during the 1990s, when Russia played a less active role and other countries' direct involvement was minor. The Kyrgyz Republic, in particular, became a "poster child" for the World Bank and IMF reform agenda with relatively easy access to concessional loans; but concessional loans have to be repaid and, by the late 1990s, the country's external debt to GDP ratio exceeded 100 per cent and it had to seek debt relief in 2001. The role of the international financial institutions has been relatively more limited since then, and only for Tajikistan did multilateral agencies account for over half of DAC aid flows in 2005. Multilateral agencies remain heavily involved in providing technical assistance and supporting regional co-operation, as for example in the Central Asian Regional Economic Cooperation (CAREC) programme, supported by the Asian Development Bank, the IMF, the Islamic Development Bank, the UNDP and the World Bank.

## CONCLUSIONS: GLOBALISATION AND THE FUNCTIONING OF THE LABOUR MARKET

The shift to market-oriented economies has been disappointing for many people in the BSEC-CA region. There can, however, be little doubt that central planning was discredited and that North Korean-style autarchy is a poor option. The challenge is to balance the potential gains from open trade and investment with the costs of volatility and job insecurity.

The OECD *Employment Outlook* notes that:

The impacts of globalisation on labour markets are manageable, but international economic integration increases the urgency of enacting pro-growth and pro-employment policies which also ensure that political support for open trade and investment will not be eroded by excessively high levels of insecurity or inequality (OECD, 2007d: 142).

This statement applies to all open economies, but it is especially relevant to transition economies, which are experiencing huge structural change as well as coming to terms with unaccustomed levels of poverty and inequality. The appropriate policy responses should include trade deepening, policies to enhance labour market mobility, employment-oriented social policies, and political support via a well-informed discussion of the benefits and costs of globalisation. These are further discussed in the last chapter of the *Outlook*.

Trade, work and well-being are inextricably interconnected in an open economy. High poverty rates, lack of suitable employment and emigration of unskilled labour in the poorer BSEC-CA countries all reflect restrictions, geographical and artificial, on trade. If the costs of international trade were not prohibitively high due to poor infrastructure, weak institutions and lack of efficient transit regimes, then countries could exploit comparative advantages by exporting labour-intensive goods; trade would boost the returns to labour and provide a counter-incentive to migration.

**Table 4.1. WTO Status**

Albania	Joined WTO 2000	
Armenia	Joined WTO 2003	
Azerbaijan	Applied 1997	Working Party has met four times 2002-06; bilateral negotiations under way.
Bulgaria	Joined WTO 1996	
Georgia	Joined WTO 2000	
Greece	Joined WTO 1995 (charter member)	
Kazakhstan	Applied 1996	Draft Working Party Report May 2005, revised September 2006
Kyrgyz Republic	Joined WTO 1998	
Moldova	Joined WTO 2001	
Romania	Joined WTO 1995 (charter member)	
Russia	Applied 1993	Draft Working Party Report March 2002, revised October 2004
Serbia	Applied 2004	Working Party has met four times 2005-07; bilateral negotiations under way
Tajikistan	Applied 2001	Factual Summary April 2005, revised May 2006
Turkey	Joined WTO 1995 (charter member)	
Turkmenistan	Not applied	
Ukraine	Joined WTO 2008	Draft Working Party Report March 2004, revised April 2007, Report accepted February 2008
Uzbekistan	Applied 1994	Working Party has met three times 2002-05; bilateral negotiations under way.

*Notes:* After an application is lodged, a Working Party is established. After bilateral negotiations, the Working Party produces an agreed Factual Summary of the applicant's trade policies. Following further bilateral negotiations between the applicant and WTO members concerned about particular trade policies or other barriers to trade, the Working Party draws up a Report, which is the basis for formal accession. After the WTO General Council accepts the Report, the applicant has five months to ratify the agreement, which takes effect 30 days later.

*Source:* Up-to-date membership information is provided on the WTO website at [www.wto.org](http://www.wto.org).

StatLink  <http://dx.doi.org/10.1787/344746208568>



# CHAPTER

## Households' Responses and Coping Mechanisms

# FIVE

As discussed in the previous chapter, the malfunctioning of labour market institutions and the limited ability of firms to respond to shocks in the initial years of transition led to the need for households to adopt coping strategies to mitigate the effects of income variability. This was especially true where formal financial institutions that offer insurance services were poorly developed. The continuation of many of these strategies in the recovery period today provides both opportunities and challenges for the implementation of government policies.

Coping mechanisms are defined as arrangements arising between individuals and communities on a personalised basis, rather than through markets or states. They include both *ex post* coping mechanisms, adopted once events resulting in income losses have already occurred, such as in the aftermath of labour cutbacks, as well as *ex ante* strategies in anticipation of risks. Households that lack insurance absorb negative income shocks by using accumulated precautionary savings and reducing household expenditures. When downturns are small, the reductions may be in terms of downgrades in the quality and quantity of foodstuffs. However, when shocks are larger, households may undertake more drastic actions, such as drawing down savings and selling physical assets, which can be effective in the short term, but at the cost of future well-being. In anticipation of risks, households could make conservative production choices in agriculture, adopting less risky crop varieties, or engage in wage labour in the public sector rather than in riskier entrepreneurial activities. These choices are also not without cost, since they may mean forgoing higher average returns in order to secure a steady income. The negative outcomes of coping mechanisms can be avoided if households are able to use financial services or public institutions to maintain consumption levels in the face of income shortfalls.

The 1990s were a traumatic decade for most of the population. Reduced output, massive layoffs and hyperinflation during the first decade after the end of central planning and the dissolution of the Soviet Union, analysed in the previous chapter in terms of the economic impact on firms, were also a shock to the well-being of households and individuals. For many households, transition from state socialism to market economies brought hopes of new institutions and prosperity. However, as state revenues and capabilities shrank, former entitlements to state provisions in cash and in kind were no longer available, and the new market economy ended previous assumptions of job security. The initial reform years brought more goods and civil liberties, but also drastic drops in incomes, the erosion of state protection and rising insecurity and inequality in income distribution.

With reductions in public interventions and in the absence of proper credit and insurance markets, households in the BSEC-CA transition economies learned to develop sophisticated and often simultaneous (*ex ante*) risk reduction and (*ex post*) coping strategies. Within the socialist planned economies, the labour force was not exposed to the risks of economic insecurity and layoffs and did not need to develop strategies of risk avoidance. The workplace was highly secure and the majority of workers, who were employed in state and collective enterprises, continued in the same place during most if not all of their working life. With restructuring, came the need to cope with layoffs, and adapt to new risks inherent in the opening up of the planned economies: competition with the private sector and the resulting bankruptcy of enterprises.

Among the many coping and risk-reduction mechanisms adopted by households of the BSEC-CA region in response to decreases in income from wages and salaries, this chapter will discuss the most common and important ones, which have long-term policy implications. Coping mechanisms are discussed in terms of relying on family and community support. Household responses to retrenched labour market opportunities, which have longer-term consequences, are then discussed in terms of engagement in informality and migration, the evidence for which was provided in earlier chapters. The chapter will then examine the consequences of these strategies on various socio-economic groups in the region.

In the initial years of political and economic turmoil, households had been unprepared to deal with economic shocks. Those living in planned economies had been used to an all-providing system that guaranteed jobs and basic goods. With hyperinflation and the collapse of banking systems in many countries, the value of savings eroded overnight, and with enterprise restructuring, jobs were lost abruptly. The immediate and temporary response was panic, when households relied on desperate measures to make ends meet. As shocks subsided, households and individuals began taking advantage of new opportunities within the private sector, including in the informal market, as well as from the opening up of borders, for migration. If they had been once considered as strictly coping mechanisms to deal with downturns, informality and migration, given that they continue today even in countries that have seen considerable economic growth and political stability, need to be considered as phenomena with long-term policy consequences. Public policies need to recognise coping mechanisms, mitigate those with negative risks and build upon the creativity and resilience displayed through them.

## SHORT-TERM COPING MECHANISMS TO DEAL WITH IMMEDIATE SHOCKS

### Family and Community Support

In the BSEC-CA countries where societies are based on tight informal family links, social and family relations form a significant part of the social capital of individuals. Such relationships allow members to use connections to borrow money, obtain jobs or make other business connections. These networks and relationships had an especially important cushioning effect when the social safety nets in the region proved insufficient.

Central Asian households, in particular, benefited from the strong cultural tradition of obligatory mutual aid among relatives, where a wide range of relatives is involved in provision of assistance, be it in cash, in kind or in labour. Reliance on family members has not only been particular to the large extended households of Central Asia, but also among Slavic societies where household units are generally much smaller. In Ukraine for example, the increase in family support as an important coping mechanism during the economic transformation is confirmed by the 2001 census data. The share of the population that relied on other people's support as a main source of income increased by 21 per cent between 1989 and 2001, when it reached almost one-third of the total population. The importance of support from other people was more important among the urban population (32.6 per cent in 2001) than among the rural population (28.5 per cent), which could be explained by the considerable involvement of the rural population in subsistence agriculture that increased tenfold between 1989 and 2001 (Statistical Committee of Ukraine, 2004).

Beyond extended families, households sought assistance to address common needs in the form of community mobilisation, often reviving the tradition of *hasher* – collective voluntary labour to render assistance in the form of physical work to neighbours – which is widespread in parts of the Kyrgyz Republic, Uzbekistan and Tajikistan (Tashbayeva and Earl, 2003). Throughout the region, as the state contracted, local communities and collectives proved to be efficient agents capable of taking over functions and delivering services that were previously the responsibilities



of the state. A World Bank study showed, for example, that village credit associations in the region continued to function even during the major financial crisis of the mid-1990s; water-users associations flourished, and governments were increasingly transferring irrigation management entirely to village-based federations (World Bank, 2002). In Uzbekistan, the government revived the traditional local organisations known as *mahallas* as an institution for targeted delivery of social assistance (see Box 5.1).

In the absence of savings accounts and formal credit-granting institutions, informal rotating savings and credit associations among rural communities, extended households and friends played a key role in the BSEC-CA countries. States, donors and non-governmental organisations (NGOs) drew on the experience of informal rotating savings and credit associations to establish and develop local community organisations in the form of self-help groups and credit unions. By 2004, about 2 per cent of the Kyrgyz population was involved in micro-credit schemes, and in 2006, the 1 250 self-help groups and 305 credit unions had a total of 21 900 clients (Government of the Kyrgyz Republic, 2005). Micro-credit and savings schemes were pursued at the policy level as an important tool for poverty eradication.

Throughout the region, mutual-aid groups, credit unions, associations (e.g. water users, homeowners), agricultural co-operatives and other organisations became forms of social mobilisation aimed at providing access to financial and physical resources, creation of jobs, as well as maintenance of social infrastructure facilities. However, while social mobilisation conducted at small scales helped improve well-being at the individual level, it could hardly replace the state in the creation of durable jobs. For example, as a survey of local implementation of the National Poverty Reduction Strategy conducted in 2004 in the Kyrgyz Republic showed, the active participation of the population in the area of social mobilisation depended on their levels of poverty, lack of alternative sources of agricultural incomes and on the extent of limited access to infrastructure services. Communities did not participate directly in the rehabilitation of local infrastructure facilities, and actual social mobilisation did not depend on participation or non-participation in poverty reduction programmes. Mutual-aid groups and credit unions improved the well-being of their members by intensifying entrepreneurial activities, but only local governments had a positive impact on the creation of new jobs (UNDP, 2006b).

At the same time, the transition process led to the reduction of the mutual aid system and social networks that had been built around public goods. Kuehnast and Dudwick (2004) show that reform of institutions brought changes to the form of mutual support schemes, especially those used to secure jobs and access to proper education and public services. This was associated with the breakdown of formal and informal links related to work after privatisation and the restructuring of enterprises (Kuehnast and Dudwick 2004). The use of social networks was increasingly limited to borrowing cash rather than obtaining jobs or education opportunities. In research on the coping strategies of households and individuals in Serbia between 2000 and 2002, Babović and Cvejić (2002) found that, as the transition reforms deepened, social capital became weaker; the sense of reciprocity, the use of relatives and friends for employment opportunities, access to medical institutions and help to enrol children in schools all weakened, while borrowing money from relatives or friends had become common practice, as one-third of their sample representatives recognised.

**Box 5.1. Mahallas in Uzbekistan**

In Uzbekistan, a major novelty was the decentralisation of social security payments through local organisations known as *mahallas*. In late 1994, coinciding with the removal of general food subsidies, about 12 000 *mahallas* were set up to assist families in need.

The *mahallas* receive their funding almost entirely from the central government budget, although the amounts were initially small, around 0.4 per cent of GDP, in 1995 and 1996. The rules established for *mahallas* include guidelines and a considerable degree of formality about what must be taken into account and what procedures must be followed in awarding assistance, and yet there is also considerable discretionary power insofar as there is no obligation for the *mahalla* to make or not make an award in any particular case. Based on a 1995 household survey, Coudouel and Marnie (1999) found that the *mahalla* scheme delivered benefits more frequently to less well-off households than to better-off households, but they also found that the scheme, as it operated in 1995, was not transparent and failed to achieve horizontal equity (i.e. equal treatment for households in equal circumstances). The amounts of benefits paid were not related to observed measures of household well-being or even to some obvious target indicators such as family income or children's nutritional status. Although the assistance given by *mahallas* favoured children, female-headed households and the unemployed, it also (even when other variables are controlled for) favoured ethnic Central Asian households.

In 1997, 11 per cent of all households in Uzbekistan were receiving assistance through *mahallas*. The *mahallas'* functions were then extended as providers of child benefits, previously universal for all children under the age of 16. Child benefits involved more substantial amounts than the social assistance programme, with 2.6 per cent of GDP spent on child benefits during the first half of 1997. Eligibility for child benefits is more narrowly set out than for social assistance, focusing on family per capita income. Thus, *mahallas* became more specifically involved in means testing of their member households, which may have been intended to reduce the discretionary element in order to improve horizontal equity, but it also enhanced the incorporation of *mahallas* into the state apparatus. A staff member of the local labour office was attached to each *mahalla* to help with the paperwork involved in the more formal process of claiming child benefits. Since 1997, the chair and secretarial positions of a *mahalla* are both salaried positions, paid by the state. Candidates for a *mahalla* chairperson must be approved by local government offices.

The biggest threat to sustainability is the fragility of the legitimisation of traditional institutions such as the *mahallas* when the economy is becoming ever more market-based. As they are absorbed into the centralised state apparatus, the *mahallas* lose the legitimacy conferred by tradition and are likely to be challenged as an effective instrument for targeting social assistance.

*Source:* Based on Coudouel and Marnie, 1999; and updated information provided by the Centre for Economic Research, Tashkent.

## LONGER-TERM HOUSEHOLD RESPONSES: INFORMALITY AND MIGRATION

If relying on family and community members were strategies adopted by BSEC-CA households to deal with the immediate impact of economic shock, they nevertheless could not be sustained. In order to prepare for the future and as a direct experience of the 1990s, households also adopted a number of more durable strategies to compensate for loss of income through formal employment. These included engaging in informality to substitute income loss or add to formal wages, and migration.

### Informality

As discussed in Chapter Three, there is ample evidence to conclude that informality today represents a significant activity of the population of a wide range of countries, at different stages

of transition from planned to market economies. With no private income from employment and with the erosion of social security, people in the transition economies resorted to informal, low-skilled, precarious activities to generate income. This included changing of professions where it was possible, and engaging in new types of work for which they may not have had the corresponding specialisation. Increase in domestic demands in consumption and services, coupled with the supply of unemployed and underemployed in the state sector, led to the mushrooming of informal private shops, informal kiosks, private use of cars for taxi services, home production of clothes by women and so forth.

Chapter Three offers estimates of the size of the informal economy in the BSEC-CA countries. There are three explanations concerning the dominance of informality as a coping mechanism in the region (Bernabè, 2002).

The first explanation looks at informality as a set of survival strategies, or active coping mechanisms that enabled households to weather the abrupt economic changes. In this view, engagement in the shadow economy in the BSEC-CA countries most hit by economic hardship, at least in the initial transition period of the 1990s, was not a response to opportunities, but a response borne of desperation for subsistence. However, some authors have argued that informality does not constitute a social safety net for the poorest strata of the population, but provides additional security only for those who are already well placed or have initial capital. Lokshin and Yemtsov (2001), for example, argue that households with human capital are more likely to use active coping strategies (such as secondary work, cultivation of gardens, renting of apartments) rather than the more passive strategies (such as cutting back on consumption and expenditures) of households with less capital. Active coping strategies provide better chances to withstand economic shocks.

The second explanation recognises informality as a legacy of practices of the incentive structure of the second economy of the Soviet Union and Eastern Europe. The Soviet period had already witnessed a parallel, private, unregistered and untaxed part of the economy, referred to as the "second economy" (Grossman, 1977). This second economy constituted both activities that were illegal, or legal but that met with ideological disapproval (i.e. they were private not state activities). While the official Soviet economy provided basic standards of living, the second economy complemented it by providing for a better lifestyle for the population engaged in second economy activities. Corruption was also a phenomenon of the second economy in the Soviet period and included daily petty bribing of authorities, particularly of law-enforcement officials; gift giving to supervisors; purchase of lucrative official positions; and *blat*, the use of personal influence to obtain favours to which individuals or firms were legally entitled (Grossman, 1982). The persistence of such practices as *blat*, left-hand work, manipulation of official business transactions to earn additional earnings, or pocketing of fees from services are seen as evidence of today's informal economy being the continuation of the second economy. Feige (1997) argues that formal policies fail in the former Soviet Union when they are based on the incentive structure of formal institutions, given that the dominant incentive structure is that of informal institutions, which are a result of the Soviet system of non-compliance.

The third explanation considers the phenomenon as an outcome of tax evasion and unrecorded GDP that sprung from the opportunities that excessive regulation created during the initial years of re-organisation of the post-planning economies. The main reason why firms and individuals hid their earnings was the high tax rates and regulatory activities of the state. Informality was a reaction to the high tax burden, onerous regulation and inefficient tax collection, as well as to the non-existence or inadequate supply of public goods, such as enforcement of contracts and police protection (Friedman *et al.*, 1999; Schneider and Klinglmaier, 2004).

For the BSEC-CA countries, especially those that underwent structural transformation in the 1990s, engagement in the informal private sector was a combination of these three factors, but was most often as a direct result of decreased opportunities, low salaries and wage arrears in the public sector (see Box 5.2, which presents some of the characteristics of informality in the region). As Chapter Four argued, employment layoffs at the privatised or re-structured enterprises, as well as privatisation and (re)distribution of land, led to sectoral changes in

employment. Unemployed industrial workers sought employment opportunities in trade and agriculture. According to a 1994-95 survey of 232 enterprises in five oblasts of the Kyrgyz Republic, every second person employed in industrial enterprises in 1991 had lost his or her job by 1995 (Evans-Clock and Samorodov, 2000).

The informal sector in the BSEC-CA countries is, at the same time, an important source of livelihoods, the cause of further public deficits and, a dynamic sector that developed in reaction to excessive regulation, corruption and red tape (Bernabè, 2002). For the countries in transition, its mere existence, real but invisible to national accounts, has been one of the reasons that the collapse in living standards in the CIS did not lead to a destabilising social explosion.

### Box 5.2. Some Characteristics of Informality in the BSEC-CA Countries

Employment in the informal sector is mainly in labour-intensive sectors such as agriculture or construction, and in low-skilled occupations such as retail trade, catering and domestic services. Informal employment is more rural than urban. In Ukraine, typical in the region, the grey economy is smaller in urban areas (38 per cent) than in rural areas (62 per cent).

In rural areas, informally employed individuals engage mostly in agriculture on private (subsidiary) plots and family farms, such as in the Kyrgyz Republic, where it is a risk-mitigation strategy. Among the Eastern European countries and in the Caucasus, the biggest share of informal employment in urban areas is concentrated in the construction and service industries, with both industries providing many people, particularly from rural areas, opportunities for temporary employment. In Central Asia, the informally-employed individuals in urban areas mostly work for their relatives in small family-owned businesses or are self-employed.

- A number of those employed in the formal state sector, simultaneously work in the informal sector.
- The majority of private sector employment is informal.
- Informal employment is associated with lower educational attainment. In Ukraine, for example, 48 per cent of those employed in the grey economy had the lowest level of educational attainment.
- More females than males work in the informal sector.
- Those employed in the informal economy tend to remain there. In Ukraine, the probability of remaining in the informal sector is around 63 per cent, followed by 15 per cent probability of entering into formal employment and 11 per cent probability of exiting the labour force. Formally employed individuals are almost equally likely to enter informal employment and unemployment (around 3 per cent probability), and it is more likely (7 per cent probability) that formally employed will exit the labour force altogether.

Source: Compiled from background country reports, Bernabè, 2002, Childress *et al.*, 2003; and World Bank, 2006a;

For the BSEC-CA countries, there is a difference between *informality for subsistence* carried out by households for meeting basic needs, the *underground sector* where activities are deliberately concealed from public authorities to avoid payment of taxes, social security contributions and administration procedures, and the *illegal sector* which consists of activities that generate goods and services whose production and distribution is illegal or is carried out by unauthorised producers. Distinguishing between them is important because they raise different policy imperatives.

Informality for subsistence consists mostly of petty trade, cross-border "suitcase trade", unofficial taxi services, street trading and subsistence agriculture. The single-most important informal sector activity for coping with economic adversity in Ukraine, as a consistent example of most of the BSEC-CA transition countries, was the cultivation of a personal plot of land to grow

vegetables and possibly to support livestock (World Bank, 1996). The growing of crops was important not only for rural households, but particularly for the urban population as it provided cheap fruits and vegetables, improved consumption and allowed for savings for purchases of manufactured products. In rural areas, or for urban dwellers with plots in their home villages, agriculture continues to represent a coping mechanism, even though profitability and productivity is low in this sector. Besides subsistence agriculture, most informal employment is concentrated in construction and services. In the higher-income BSEC-CA countries, however, there is a noticeable reduction in informal employment in services (trade, repair, hotels and restaurants) and a growth in construction, because of the current construction boom in the region, which is attracting many temporary workers.

The second type of informal employment in the region occurs in the underground informal market, characterised by tax evasion, hidden employment and insecurity for workers. The underground informal market comprises unregistered economic activities in all spheres of the economy. The heavy burden of taxes has caused its growth.

The third type of informal activities in the region is in the black economy, which consists of goods and services that are either produced and/or distributed illegally. This substantial illegal economy is highly organised and consists of criminal activities revolving around trafficking, of either drugs or people. Drugs are becoming a major part of the informal local economy in different parts of the region. Starting in the late 1990s, Central Asia has become the main drug trafficking route for the Western and Eastern European markets, transporting not only drugs from Afghanistan, but also increasingly from other parts of Asia, including China and Southeast Asia (UNDP, 2005). With high levels of poverty, young people have been increasingly lured to the world of drug trafficking, particularly in the Balkans and in Central Asia. A combination of vast potential earnings and dire socio-economic conditions provide fertile conditions for the drug trade. For traffickers, a single successful deal can amount to the equivalent of several years' wages. Although criminal cartels represent the demand side that contributed to the growth of illegal activities in the region, in particular smuggling of migrants and trafficking in women and children, a considerable supply side was also made available by the lack of economic opportunities for an increasing number of children and women involved in the sex industry. According to the United Nations Economic Commission for Europe (UNECE, 2004), "up to 80 per cent of the women and girls trafficked from Central, Eastern European and CIS countries to Western Europe are destined for the sex services market". The report notes, "the Republic of Moldova, the Russian Federation and Ukraine have become the main supplying countries since the mid-1990s. Recently, they have been joined by Albania, Lithuania, Romania and Central Asian countries". Table 5.1 highlights the main sending and receiving countries of women trafficked from various parts of the BSEC-CA region.

**Table 5.1. Trafficking in Women: Sending and Receiving Countries (1989-2000)**

Major sending countries	Main receiving countries	Estimated number of trafficked women
Albania	(of whom 30% are under 18) Italy, the United Kingdom	over 8 000
Kazakhstan	United Arab Emirates	5 000
Kyrgyzstan (northern part)	Middle East, Turkey, Europe	4 000
Kyrgyzstan (southern part)	United Arab Emirates	5 000
Lithuania	The Balkans, Germany, Austria, the United Kingdom	several thousands/ year
Moldova	The Balkans, Austria, Germany, Greece	50 – 100 000

Russia	50 countries throughout the world, including Germany, Italy, Greece, Switzerland, Austria, Bosnia, Herzegovina, Serbia, Israel, Turkey and the United States	500 000 – 1 000 000
Ukraine	Germany, Italy, Greece, Switzerland, Netherlands, Bosnia, Herzegovina, Serbia, Bulgaria, Switzerland, Israel, Turkey, Canada and the United States	400 000

Source: drawn from "Economic Roots of Trafficking in the UNECE Region", (UNECE, 2004) at [www.unece.org/press/pr2004/04gen\\_n03e.htm](http://www.unece.org/press/pr2004/04gen_n03e.htm).

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## Implications of Informality for BSEC-CA Households and Economies

Informality can be both positive (taking advantage of new opportunities) and negative (engaging in illegal or grey markets, where job security is very low and vulnerability high). Informality has proven to be a sustained, important and coveted coping mechanism for some of the hardest hit populations of BSEC-CA countries. It can be argued that the growth of informality is a positive phenomenon, as it is a sign of the efficiency, flexibility and adaptability of the labour market. At the same time, however, the growth of the informal sector has negative implications, particularly the increase in precarious, unprotected employment, which can contribute to vulnerability among the population (Bernabè, 2002; Dennis, 1996). Among the different negative implications, the following characteristics can be observed in the BSEC-CA countries.

Although the informal labour market is an important source of employment, it is typically associated with greater insecurity, reduced transparency and exclusion from government social programmes. The main risk for workers engaged in the informal sector arises from its inherent insecure nature. Employment in the informal sector is mostly casual and based on kinship or personal and social relations rather than on contractual arrangements. Workers employed in the informal sector have no right to the social benefits based on social insurance like unemployment benefits, health insurance, pension and disability insurance. Additionally, given that the informal sector principally engages low-skilled workers, there is a risk that their skills stay under-developed, further locking informal workers to low wages. Thus, those employed in the informal sector live in conditions of economic insecurity, their work is based on oral agreement with employers and new workers can easily replace them. Long working days, lack of vacations, insecure employment conditions as well as absence of social protection against illness and disability are widespread for those employed in the informal sectors in the BSEC-CA region, as in elsewhere. Despite its disadvantages, however, for the majority of the population, the most important characteristic of informality is the nature of payment, which is fast and often in cash.

Informality cannot be equated necessarily with poverty reduction in the region. The agricultural sector accounted for most informal employment, but informal activity in agriculture has not contributed to reducing poverty in the region, given the low productivity and returns. Although the growth of informal industry and informal services has been relatively large in BSEC-CA countries, these activities have contributed very little to the overall informal employment growth, due to their low share in informal employment. Not all informal workers are poor, however, as running informal enterprises often requires initial capital expenditures and, those that are successful may have reasonable or even substantial earnings. Nevertheless, the growth of the informal sector has not proven to be a sustainable poverty eradication strategy in the region. On the one hand, the large informal economy has proven mostly lucrative for those with access to key assets to command substantially higher earnings than formal sector activities, creating a large inequality gap. On the other hand, this large informal economy has reduced government revenues that could have been used to improve services and social assistance for the poor (World Bank, 2004).

The informal economy has had implications for the national economies of the region. Tax evasion reduces public revenues and hampers efforts to provide social security and invest in public

goods. This in turn can contribute to the informalisation of payments for services such as health and education (Bernabè, 2002). Illegal and criminal activities undermine the legal system and could create political and legal instability. When individuals and firms make a decision whether to pay taxes fully or to hide operations and underpay taxes, the shadow economy has negative effects on economic growth by attracting resources which otherwise would be employed in the formal economy.

Despite a variety of conclusions about causes and consequences of the informal economy, the low quality of economic institutions, weak legal environments, over-regulation and corruption stimulate its growth in the region and encourage firms and individuals to underpay taxes. It is however, not clear whether informality is the cause of economic crisis and poverty or a solution to the problem. It has nevertheless proven to be an important source of income and social security in the absence of formal social protection in transition countries.

## Internal Migration, Emigration and Remittances

Labour migration as an income generating activity, like engagement in the informal sector, has not abated in parts of the BSEC-CA region. Part I of the *Outlook* analysed the existence of this phenomenon within the global context. In this chapter, the subject is reviewed from the lens of individuals and households willing to engage in migration, either as a coping mechanism in response to economic crisis, or for taking advantage of opening up of borders for more lucrative jobs abroad.

Emigration provided opportunities for members of households to escape unemployment and poverty and gain the necessary means for subsistence consumption, and for some, investment in housing and education. Similar to informality, however, the phenomenon can be viewed as bane or boon. On the one hand, migration as a coping mechanism is a sign of regional inequalities, lack of opportunities, low salaries and the rising cost of living, which local economies cannot absorb. On the other hand, it is a manifestation of opportunities created by the integration of the BSEC-CA countries into globalisation.

Labour migration in the BSEC-CA countries can be explained by the basic push-and-pull model: economic conditions, demographic pressures and unemployment ("push factors") in the sending countries work in co-ordination with higher wages, demand for labour and family reunification ("pull factors") in the receiving countries (Mansoor and Quillin, 2007). During the initial transition years, population movements were mostly related to refugees fleeing civil wars and trans-border conflicts and diasporas returning to their ethnic homelands after the creation of new independent republics. As countries recovered from the initial years of transition, widening disparities in GDP per capita drove migrants from lower-income to higher-income countries. Beginning around the turn of the century, market opportunities and integration into the global economy provided a pull factor for labour migration, and today migration flows in the BSEC-CA region consist mainly of labour migrants motivated by economic opportunities.

Labour migration as a coping mechanism in the BSEC-CA region is caused by economic inequality. A 2007 study in Uzbekistan showed, for example, that the main factor behind labour migration to neighbouring countries was the growing per capita income difference between Uzbekistan on the one hand, and Russia and Kazakhstan on the other (CER Uzbekistan, 2007a). In Moldova, migration decisions are influenced by the dramatic reduction of the public sector's provision of primary social services (education, health, housing), as well as patriarchal attitudes and discrimination against women (see Box 5.3 for more on migration in Moldova). A survey in Moldova conducted for an IMF study (Cuc *et al.*, 2005: 20), revealed a spectrum of migration motives. Among respondents, the most commonly cited primary causes for deciding to migrate were to obtain current consumption items such as "foodstuffs, clothes, utilities and household commodities (44 per cent); home investment including cars, house or apartment and repairs (19 per cent); special expenditure items such as education, tuitions and health (11 per cent); loan repayment (21 per cent); and only a minor share noted investment in business, for example for the purchase of land, agricultural equipment, minibus, animals (1 per cent), as

primary motivation." A World Bank study by Mansoor and Quillin (2007: 75) on migration and remittances concludes 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 Europe and Central Asia (ECA) region seem largely to be a response to poorly functioning labour markets, insufficient productive capital, the low quality of life in a number of migration sending countries, and a rising demand for unskilled labour for the nontraded services sector in the labour-importing economies in the European Union and Commonwealth of Independent States.

These results confirm the general picture that lack of work prompts most migrants to leave in order to cover the subsistence costs of daily living.

### Box 5.3. How Many Moldovan Emigrant Workers?

Moldova's National Bureau of Statistics estimates a rapid increase in emigration from 234 000 in 2002 to 290 000 in 2003, 345-357 000 in 2004 and 394.5 000 in 2005. However, an independent study conducted in October-November 2004, noted in an IMF publication, concluded that 399 000 Moldovans were currently working abroad, and an additional 172 000 had recently worked abroad and were intending to do so again; the total of 571 000 is a large share in a national population of 3.6 million (Cuc *et al.*, 2005). The discrepancy highlights the importance of the timing of any survey (especially for seasonal migration) and also of definitions: does emigration in 2004 include only those working abroad at year's end or all who migrated during the year, and does the latter lead to double-counting if the same worker made repeated trips?

Migration has a gender dimension as more men than women migrate from Moldova to Russia and Ukraine and to Germany and Portugal, whereas women migrate mainly to Italy, Spain, Greece, Cyprus and Turkey. The 2004 survey showed female migrants spending longer abroad than men did, partly due to the higher transactions costs of moving to the European Union rather than to CIS countries. Although male migrants earn more than females in each destination, on average, migrant women earn more than migrant men do. For example, a large share of the male migrants work in the construction sector in Russia, with an average monthly wage of USD 370, while many female migrant labourers work in the social or domestic sectors in Italy, where they earn, on average, USD 879 per month.

Source: Drawn from Cuc *et al.*, 2005.

### Profile of Labour Migrants

Migrants from Central Asia mostly come from traditionally large poverty-stricken households. The vast majority of labour migrants come from rural areas, from agricultural regions, as well as from small- and medium-sized towns hardest hit by de-industrialisation and restructuring. Most external labour migrants from the region are involved in construction, agriculture (harvesting) and in trade and services (See Box 5.4 for a discussion on migration patterns with the Kyrgyz Republic provided as an example). The overwhelming majority of labour migrants are married males and, in most cases, the migrant is either the head, or the son, of the household. Since the beginning of 2000, employment in domestic work (nurses, cleaners, cooks) started to play an important role in the structure of migrant activities, leading to more females in the labour flows from Ukraine and Moldova (Levtsun, 2005). From the European parts of the BSEC-CA region, migration is dominated by young and well-educated migrants of both sexes, and the vast majority of migrants in all the BSEC-CA countries are between the ages of 20 and 40. In Moldova, where gender disaggregated information was available, there are relatively more males in the youngest age brackets (below age 30) and more females in the 31-50 age category (Cuc *et al.*, 2005). The large-scale outflow of individuals of reproductive age may alter the long-term demographic profile in the region.



The majority of labour migrants from Central Asia are low-skilled workers. In Tajikistan for example, 53.3 per cent of migrants surveyed had basic, incomplete secondary or secondary education (Olimova and Bosc, 2003). Lack of professional training, low levels of technical education, poor knowledge of Russian and absence of legal knowledge and unfamiliarity with basic elements of labour relations complicate the employment possibilities of Central Asian migrants in Russia. As a result, they engage in low-qualified, poorly paid work.

In the European parts of the BSEC-CA region, external migration is associated with brain drain. In Serbia, for example, where initial external migration after World War II to European countries consisted mainly of a low-skilled labour force in demand in Western European countries, after the 1990s, the structure of the migrating labour force changed to include specialists. According to a study by Vuković (2005), the majority of Serbian migrants have education in electrical engineering, physics, mathematics, chemistry and medicine. Migration of specialists can have a negative impact on the demographic, economic and social development of sending countries.

#### **Box 5.4. Changing Migration Patterns in the Kyrgyz Republic**

In the Soviet Union, internal mobility was strictly controlled and emigration almost impossible. After the dissolution of the Soviet Union there was a large-scale emigration from the Kyrgyz Republic of people who could obtain non-Soviet passports (mainly ethnic Germans) and people who felt uncomfortable in an independent country where Kyrgyz was the state language (the proportion of Russians in the population fell from 21.5 per cent in 1989 to 12.5 per cent in 1999 and less than 10 per cent by 2005). There was also a substantial but poorly documented urban-rural migration as the newly unemployed retreated into a subsistence lifestyle in their family village.

After the mid-1990s, new patterns of migration became dominant. Permanent migration to Russia continues (16 000 in 2004 and 25.5 000 in 2005), but is dominated by temporary migrants (estimated between 200 000 and 500 000 by the International Organization for Migration) mostly leaving southern Kyrgyzstan for industrial regions of Russia or agricultural employment in Kazakhstan. Many are unskilled labourers, but there are concerns about a brain drain of doctors and teachers going to Russia and of semi-skilled tobacco pickers to Kazakhstan. There are few obstacles to Kyrgyz migrant workers going to Russia or Kazakhstan, although in 2005 flows were disrupted when 340 000 Kyrgyz citizens were unable to obtain their passports. The migrants have limited civil rights, but they are pushed by the lack of employment opportunities in rural areas of southern Kyrgyzstan and their remittances are important for their families; estimates of the value of remittances in 2006 are around USD 500 million, or over a quarter of the GDP. Attempts to improve the status of migrants (e.g. an agreement between the Kyrgyz government and Russian employers in Penza, Krasnoyarsk district) may encourage more permanent migration, as the workers gain civil rights and Russia focuses on the problems associated with an aging workforce.

Internal migration has become significant, as the capital city, Bishkek, and the surrounding region (Chui oblast) have enjoyed greater economic prosperity than other parts of the country. Official data report 351.4 000 inter-regional migrants in the years 1999-2005; almost three-quarters of these went to Bishkek or Chui, with most of the rest attracted from Batken, the poorest oblast, to the main city of the south, Osh. The internal migrants often have poor living conditions and lack of access to social services. The host population is concerned with social and health problems associated with marginalised residents. Internal migration may also be fuelling the post-2005 increase in Kyrgyz-Uzbek and Kyrgyz-Dungan inter-ethnic tension.

Despite the poverty in the southern regions, they have been attractive destinations for migrants from Uzbekistan and Tajikistan where work conditions are even worse. There are more than a dozen illegal labour markets on the Kyrgyz-Uzbek border, despite tightening of controls by the Uzbekistan authorities. There is also a sizable inflow of Chinese migrants, 10 000 of whom were officially registered (early 2007). Many of the Chinese are small traders working in the two huge bazaars in Bishkek and near Osh.

*Source:* Drawn from Pomfret, 2006 and CER Kyrgyzstan, 2007.

## Remittances

Migrants' remittances, as a portion of gross domestic product, are large by world standards in many countries of the region and continue to play an important role in the household revenues. Remittances provide many poor families with an additional social safety net while relieving fiscal pressure on governments for social spending on the unemployed and poor. For many net emigration countries in the BSEC-CA region, household income and national output are tied to the incomes of migrants living and working abroad.

According a report published by the World Bank, in 2004 officially recorded remittances to Eastern Europe and Central Asia totalled over USD 19 billion (rising to over USD 22 billion by 2006, according to the World Bank *Migration and Remittances Factbook 2008*, as noted in Chapter Two), amounting to 8 per cent of the global total for remittances and over 12 per cent of remittances received by developing countries (Mansoor and Quillin, 2007). The European Union and the resource-rich CIS are the main sources of remittances, with the "European Union accounting for three-quarters of the total and the rich CIS countries for 10 per cent" (Mansoor and Quillin, 2007: 60).

For many countries, remittances are the second most important source of external financing after foreign direct investment, and in poorer countries of the region, second to exports. They represent an important source of foreign exchange for several countries and a significant contribution to the GDP. According to one study, the amount of remittances sent home through official money wiring channels in Uzbekistan increased sixfold between 2002 and 2006, reaching the equivalent of 21.4 per cent of exports or 8.2 per cent of GDP in 2006 (CER Uzbekistan, 2007a).

Remittances can play an essential role in the reduction of poverty in the poorest regions. The income levels of families with migrants are estimated to be generally higher than in families without migrant members. Household budget surveys indicate that remittances constitute over 20 per cent of the expenditure of households in the poorest quintile (Mansoor and Quillin, 2007). For many of households in the poorest countries in the BSEC-CA region, they are the largest source of outside income. As the majority of those who left constitute the core labour resource of households, families are heavily dependent on the labour of their relatives abroad. In Armenia for example, in 2004 the consumption of households with a migrant worker was, on average, 11 per cent higher than in those without a migrant. Even in better off economies such as Serbia, remittances constitute 2 per cent of total household incomes.

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Even though remittances support families' budgets, as noted earlier, the majority of recipients spend their remittances on consumption rather than on education and investments (Mansoor and Quillin, 2007). Overall, labour migrant remittances have not become a major source of investment in the economies of poorer BSEC-CA countries. Information on Moldova provides an example of using remittance monies for consumption rather than productive and employment-generating investments; Moldovan migrants and their families spend half of their remittances on daily consumption, and much of these goods are imported, about 20 per cent is invested in durable products, while investments in existing businesses or as start-up capital are limited to 7 per cent of total remittances assets (Cuc *et al.*, 2005). Remittances are also principally used for personal consumption in households of the better-off economies such as Serbia, although there are diverging patterns of use between rural and urban households. Research conducted in 2007 among Serbian temporary workers in Switzerland showed that remittances received by rural households were mainly used to cover costs of living, while those received by urban households were mostly used as a financial safety net instead of supporting living costs and were invested in housing or in small- and medium-sized businesses when they were not saved. Labour migrants from Belgrade, who were in general more educated, tended to send remittances less frequently than their rural counterparts (Petree and Baruah, 2006).

## Impact of Labour Migration for BSEC-CA Households and Economies

Inevitably, with such complex international migration patterns, evaluation of the significance for well-being is difficult. Migration creates both challenges and opportunities for sending and receiving countries. Migration can allow migrants to learn new skills and can facilitate cross-border trade and investment linkages. As argued above, for households in regions where employment is scarce, having a household member working abroad can provide a lifeline. For post-conflict societies such as Tajikistan, foreign labour migration can also be considered a factor of political stability, alleviating extreme poverty, which could spark social grievances feeding renewed political tension. Labour-importing CIS economies and the European Union rely on migrant labour from the region to fill deficits in the labour force and to maintain rates of economic growth and standards of living (Mansoor and Quillin, 2007). For host communities of external migration, namely in the Russian Federation, labour migrants are filling a deficit in the labour force.

Negative aspects of migration abound, however. In receiving communities, migrants may overburden the existing physical and social infrastructure, and could create social friction. Temporary immigrants almost invariably lack the rights and protection of domestic labour, and some groups are exploited through poor working conditions, long hours of work and lower pay levels than domestic workers. Occupational hazards, lack of legal status and social protection, and ethnic intolerance are the challenges commonly faced by migrants in host countries. Migrants without work permits or registration status are particularly vulnerable, often deprived of proper legal protection and access to basic social services. They face problems finding employment and decent living arrangements and, those who are employed often receive poor wages and work irregular hours. Working abroad can also expose migrants to risks of abuse or trafficking, particularly those that work abroad illegally and do not have recourse to legal channels. When migration occurs through smuggling channels or the trafficking of women and children, it falls under the triple rubric of illegal migration, informality and criminality, a combination that increases the vulnerability and marginalisation of migrants in the host country.

For sending countries, large-scale migration can deprive the economy of needed skills. The outflow of highly qualified specialists leads to a brain drain of skilled workers and qualified professionals. The emigration of skilled workers is especially problematic in low-income countries of the BSEC-CA region where specialists, such as teachers and doctors are already in shortage and in high demand. The continuation of the brain drain could have long-term implications for the future labour force and have a negative effect on the region's long-term economic growth. Another growing indirect impact of migration is increasing inequality in sending communities. Households that have no access to the option of emigration are lagging behind those that increase their income level via remittances. Moreover, migration raises expectations, and often frustrations, among a growing stratum of the population who compares its economic situation with specific reference groups (see Box 5.5 for a discussion on possible gains for sending/home countries).

Improvements in the overall quality of life in sending countries have the potential to reduce out-migration rates, induce migrants in the diasporas to return home, and provide incentives for migrants to use the human and financial capital, including remittances, accumulated abroad at home (Mansoor and Quillin, 2007). Further studies are required in all BSEC-CA countries to examine the developmental outcomes of migration, in terms of the negative impact on families, on the education system, on specific sectors of the labour market and general well-being beyond income gains.

**Box 5.5. The Migration Cycle: What Gains for Migrants' Home Countries?**

Few dimensions of globalisation are as capable of stirring passionate debate as the international mobility of workers. While the magnitude of people's mobility has not risen in proportional terms – the share of the world's population that lives outside their country of birth was 3 per cent in 2005, versus about 2.5 per cent in 1960 – the share of the foreign-born population in OECD countries has risen more dramatically. Moreover, the magnitude of migration from low- and middle-income countries to high-income countries has risen in importance. Attention to the opportunities and risks of the global mobility system has tended to focus on the consequences for migrant-receiving countries, particularly in the OECD, and for the migrants themselves. What, though, are the effects of international migration on economic and social progress in the migrant-sending countries (which include many of the countries in the Black Sea and Central Asian regions)?

Emigration can affect growth and poverty reduction through three channels: changes in the labour supply, changes in productivity induced by migration, and through the effects of migrants' remittances. The net benefit at a point in time is the sum of these three effects. A review of different sending countries' experiences clearly demonstrates that the net effect can be positive, but the effects vary across countries and over time. Indeed, most migrant-sending countries pass through several stages of a migration cycle:

- During the *exit* stage, wages may rise and unemployment or underemployment may fall; if labour markets are tight, output may fall. Productivity also falls, particularly in the case of skilled emigration.
- During the *adjustment* stage, the home economy starts adapting to emigration, whether through higher labour-force participation rates, (among women and children, for example) or through economic restructuring (e.g. mechanisation of agriculture), or through increased human-capital investment in other sectors, including human capital accumulation. Indeed, the possibility of migration might encourage those left behind to start investing in skills required to leave the country and seek improved prospects abroad (e.g. training to be a nurse). However, massive emigration of skilled employed labour may turn out to be detrimental to the economy and the social fabric if it negatively affects social-service delivery or leaves the home country without a critical mass of human capital and with no prospects of replenishing the stock.
- Although reunification of emigrants' families in the destination country may continue at this stage, at some point the *consolidation* stage begins and international labour flows tend to stabilise. Given a reasonably good policy environment, economic activity improves as migrants' remittances increase and the benefits of economic restructuring and human capital accumulation are realised. Remittances first increase consumption, especially of food and other basic needs. They are also frequently used to finance improvements in housing and living conditions as well as education expenses for children. Output tends to increase and poverty to fall.
- During the *networking* stage, migrants become better integrated into the destination country and often form networks across transnational communities. As time passes, migrants exploit their knowledge of markets in both countries and become good trade and investment intermediaries. Migrants continue to send growth-fuelling remittances, but at a declining rate, especially if they have been joined by their family members. Human capital accumulation, spurred in part by remittance flows and the improved incentives provided by the possibility of emigration, has in the meantime contributed to skill formation in the countries of origin. All of these phenomena boost productivity in the sending countries.
- By the *return* stage, emigration has contributed to development, skill formation and increased growth. As a result, the home country begins to experience labour shortages, especially in low-skill jobs in selected local markets. These vacancies may be filled by domestic migration and by inflows of labour from neighbouring countries. Repatriation of older emigrants coincides with immigration of unskilled labour to increase labour supply; remittances tend to decline.

The framework above does not apply equally to all countries and experiences. Some stages might be skipped or never reached in a given migration experience, and the stages' duration may differ from one country to another. The benefits and costs of international migration, and therefore the appropriate policy response to it, depend critically upon where a country finds itself in this cycle at a given point in time. Evidence shows that policies can influence migration flows to bring greater gains for sending and receiving countries alike, if migration flows (at all skill levels) are framed within partnerships between sending and receiving countries, if host countries successfully integrate migrants into their economies and societies, and if migration and development policies harness the energies of diaspora networks, commercial banks and other businesses.

*Source: drawn from Dayton-Johnson et al., 2007; Katseli et al., 2006a; Katseli et al., 2006b; OECD, 2007b.*

## Prospects

For the poorer countries of BSEC-CA region, migration, once considered a coping mechanism, is now sustained as an income-generating opportunity and is not abating in countries like Moldova and Tajikistan. Labour migration is likely to gain in importance in view of the aging of populations in Europe and some parts of the former Soviet Union, so that, while economic factors will continue to be important drivers of migration, demographic patterns will play an increasingly important role in the future. Migration flows that are generated in the short term may be unsustainable in a decade owing to the medium-term population dynamics in the European countries of the BSEC-CA region. The decline in the working-age population will create a demand for workers that can only be sourced from abroad. The more prosperous European Union countries and middle-income CIS countries may be able to obtain some of these workers from the rest of the European and BSEC-CA region, but for the region as a whole, demand will have to be met from elsewhere, probably from Africa and Asia (Mansoor and Quillin, 2007).

Despite fears of increasing the brain drain and possible unsustainable demographic changes, migration is accepted as a win-win solution in a number of Central Asian countries. In the Kyrgyz Republic, for example, migration is recognised by the state as a positive source of remittances, which contribute to poverty reduction. Russian and Kazakh officials neither prevent an inflow of unskilled Kyrgyz workers to large cities and villages, nor of specialists, teachers and doctors to towns.

State policies regulating labour migration and programmes that target support for labour migration as a coping mechanism are now in the process of design or implementation in a number of countries. Although the phenomenon of migration of an active population in search of work abroad began in 1993–94 in Tajikistan, the state only started forming its policy of regulating labour migration in 2000 and specific programmes did not begin until 2002. Lack of adequate financial support and the absence of quantitative benchmarks that could measure progress – for example, on the number of citizens of Tajikistan prepared for foreign labour migration in accordance with professional and qualification requirements of the market of Russia – have hindered policy and programme formation.

Inter-regional and intra-regional migration will most likely continue in the future, particularly if it remains a viable solution to future low-skill labour shortages. Return migration and repatriation of existing migrants may lead to significant changes to the social and demographic fabric in receiving and sending countries (for example, deportation or administrative repatriation from Russia, for example, could lead to deterioration of the social situation in countries such as Tajikistan). It is therefore imperative for the countries of BSEC-CA region to draw up comprehensive migration policies and laws, and to enter into regional and bilateral agreements with other countries.

One of the main problems for Central Asian migrants remains the legalisation of labour migrants in Russia. Inter-governmental agreements have been ratified between Tajikistan, Russia, and Kazakhstan on labour migration stipulating legalisation by selection principles (i.e. employment will be granted only to professionally prepared persons) but they are not sufficient. There is also no existing regional agreement on labour migration between Russia and Central Asian countries as a whole.

## VULNERABLE GROUPS AND COPING MECHANISMS

The adoption of specific household coping mechanisms has different impacts on different socio-economic groups. They can induce changes in gender roles within households and societies. They also have implications for spatial inequalities, notably widening the rural-urban divide, and on enhancing ethnic division. As different socio-economic groups adopt different coping mechanisms, these actions could affect the opportunities available to vulnerable and marginalised groups, such as the elderly and children.

### Changing Gender Roles

Men and women in the BSEC-CA region have adopted different coping mechanisms related to opportunities opened or closed to them. The direct consequences of these differences, as well as indirect consequences of migration, include changes in the gender division of labour and in the overall role of women within households and societies.

Traditional gender roles, as well as the gender division of labour and gender relations within BSEC-CA households, changed as a result of increased poverty, unemployment and migration patterns brought on by the economic transition. Women in newly impoverished traditional households entered the wage-earning economy. War and migration by male heads of households increased the domestic responsibilities of the women that stayed behind, as well as their need to enter the formal or informal wage sectors. Women took on added responsibilities when their partners migrated for work, although these new responsibilities did not significantly transform their status in households or societies.

On the one hand, women have shown flexibility in adapting to changes in the labour market by engaging in the informal sector, increasing their share of the care economy, and becoming increasingly the *de facto* if not *de jure* bread-winners in households. On the other hand, this change has happened within traditional and patriarchal societies, which have not come to terms with the image of women as primary wage earners. At the societal level, this collective attitude leads to the under-valuing of the importance of social reproductive labour and, at the household level, it could lead to derangements in gender relations affecting the well-being of households and individuals within them, especially in rural areas.

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The stress of transition also took a significant toll on the psyche of men. The loss of jobs has been painful for men, unaccustomed as they have been to combining productive and social reproductive labour at home, and given the patriarchal societies of most BSEC-CA countries where men are expected to be wage earners and decision makers. Where there were wars, such as in the Caucasus, Tajikistan and in the territorial region of what was once Yugoslavia during the 1990s, political turmoil added to the stress of high and growing unemployment and survival. In other transition countries, the diminished authority of men who were no longer able to provide for their households led to increased suffering, marginalisation and risky behaviour, including depression, suicide, drugs, alcohol, and criminal activities. Male unemployment, combined with activism among women, diminished the authority of unemployed men both inside and outside the household and contributed to the increasing levels of depression and alcohol consumption in the CIS. Increased dependence on alcohol among men has often led to higher levels of domestic violence, divorces and disruptions of family structures. Transition stress is associated with the decrease in male life expectancy in some BSEC-CA countries; in Russia, life expectancy among men reached critical levels at 58.9 years in 2005, down from 63.8 years in 1990. At the same time, the gap between men and women's life expectancy has increased, a trend that will most likely have implications for the labour market in the future with the current state of pensions and female employment in the third age.

Socio-economic changes during the 1990s also had a negative influence on family units. Divorce rates increased in the 1990s after a decrease in the 1980s, leading to an increasing number of female-headed households. According to the National Statistics Committee of the Kyrgyz

Republic, for example, the highest divorce rates (a ratio of 24.6 per cent divorces to registered marriages) were registered between 1996 and 1999 when the country was undergoing its most difficult economic period.

## The Widening Gaps Between Urban and Rural Households

As rural enterprises closed or privatised during the transition period, they transferred their social assets to municipalities that were unable to maintain them. As a result, the social and physical infrastructure in rural areas deteriorated, contributing to a widening gap between urban and rural households and the isolation of cash-poor, rural populations. While poverty is acute in small towns, the majority of the poor live in rural areas. This is also where most extreme poverty is to be found as income from agriculture is low.

Poverty in small towns is linked to the pattern of industrialisation during the central planning period, in which a few medium-large industries were established in each town, which resulted in a highly undiversified economic structure at the regional level. With market liberalisation, these mono-industries showed limited ability to compete, not least because of lack of investment for restructuring.

Migration from rural to urban areas aside, there are several factors that explain the widening of the gap between urban and rural populations. Physical and social infrastructure has deteriorated in rural areas at the expense of the growth of cities. Throughout the region, urban populations have access to better quality social services, transportation that is more dependable, better utilities and telephone services and greater economic opportunities. At the same time, rural regions have been seriously neglected. In the Kyrgyz Republic, for example, more than a half the villages have unpaved roads, damaged irrigation and drinking water supply systems and low telephone-service coverage. The quality of educational and health sectors in villages has dropped to a greater extent than in cities, while preschool educational institutions have all but disappeared from villages. Rural schools and health facilities now lack teachers and doctors.

The rural population is more likely to be unemployed than the urban one. In rural areas, there has been a sharp deficiency of jobs: the closing of village social institutions has increased unemployment. At the same time, women in rural areas are in less demand for paid work, given their lower levels of education, coupled with the nature of physical work often required in rural areas. The populations of the small towns are also more vulnerable than rural populations in the region, given that the latter can, to some extent, sustain their food consumption through subsistence agriculture.

Wages in agriculture are the lowest in the national economies. The high volatility of people going in and out of poverty and extreme poverty in rural areas is often directly related to the unpredictability of income from agriculture. Poor harvests, tightening international competition and substandard health and environmental standards in the agrarian economies of Central Asia, southern CIS and southeast Europe all contribute to the poor income in rural households.

The rural population has the largest involvement in informal sector activities, and thus lower social protection. In the agrarian countries of Central Asia, the main source of income for households comes from informal work in agriculture. Rural poverty is strongly related to the size of land available to households. A severe structural issue is the consequence of the land reforms, which divided agricultural land into many small plots of one to two hectares of land per family. Non-agricultural households situated in rural areas have a high risk of poverty incidence and those without land are not only poorer, but also more vulnerable. Subsistence farming provides a strong safety net in coping with poverty in rural areas.

Rural populations have fewer opportunities for non-agricultural rural employment. In most transition economies, many of the skilled agricultural workers who were employed on state farms during the Soviet era are nearing retirement age. Few young people can see a future in living off the land. While the agricultural sector plays an important role in employment in

Central Asia and Moldova, jobs were lost in agriculture during the period of transition, leading to migration from rural areas.

Throughout the BSEC-CA region, the main coping mechanism of urban households is through additional jobs in the informal or service sector or subsistence gardening, while the main coping strategy of the rural households is in-kind production and lower consumption. In rural areas, households have been compelled to adopt bartering due to lack of cash, and agriculture has become the main livelihood strategy and is often the only major source of income. The major livelihood strategy for rural households is crop production, with little opportunities for diversifying income outside agriculture.

As a consequence of diverse coping mechanisms and opportunities, increased rural-urban migration is creating more stress on urban areas, further increases in rural poverty and reducing local tax bases. With poverty eradication strategies having a greater impact on urban areas than on rural communities, the gap remains and is growing. The fact that most of the rural population of the BSEC-CA countries formally or informally work in the agricultural sector represents a significant challenge for rural development policy. Increasing rural unemployment will lead to further social and economic problems that will need to be addressed by policy makers.

## Ethnic Relations and Patterns of Marginalisation

Competition for reduced resources as a result of unemployment, and the adoption of coping mechanisms can divide societies along minority/majority lines.

One of the largest minorities within the BSEC-CA region who have suffered from the transition of the 1990s are the Roma, residing in Romania, Moldova, Serbia and elsewhere. Socially and economically isolated under socialism, the continuation of discrimination of the Roma population in the local economies of the countries in which they reside has resulted in poor integration (Ringold, 2000). As enterprises downsized, the Roma were among the first to be laid off, and with the privatisation of land based on the principle of restitution, those who formerly worked in collective agriculture have no access to land (Ringold, 2000). Many now reside in ghettos on the periphery of rural or urban settlements, and have little access to municipal services. In Ukraine, in 2003, 38 per cent of Roma were economically active and 26 per cent were employed; out of these, only 21 per cent had regular jobs, mostly in agriculture, construction and services, with the remaining engaged in occasional, seasonal or odd job, mostly in the shadow economy. However, discrimination does not occur in a vacuum, cultural and economic factors converge. According to a study for the World Bank, by Dena Ringold, entitled, *Roma and the Transition in Eastern and Central Europe: Trends and Challenges*:

Cultural factors affect access and interactions with social service providers. Because of language barriers and low education levels, Roma may have difficulty communicating with teachers, understanding health professionals, and maneuvering through local government offices to access social assistance. Poor communication and negative stereotypes of both Roma and non-Roma breed mistrust and reinforce preconceptions on both sides. Related to this, the overall absence of Roma personnel involved in policy design and public services means that there are few individuals who can bridge cultures (Ringold, 2000: viii).

The stereotypical image of the Roma in central Europe is that of beggars who rely on social assistance and do not seek jobs actively. Yet, the reality is the discrimination that the Roma continue to face. According to Human Rights Watch (2006), "the Roma in Ukraine continue to suffer frequent police abuse, despite repeated appeals by Romani organisations to the police, prosecutors, and the Ombudsperson calling for effective investigations and punishments. In a positive development, the Parliament's Human Rights Committee held its first ever hearing on 'The Situation of the Romani People,' on April 12, 2005". Another source of the poverty of the Roma, besides high unemployment rates, and another cause and consequence of lack of integration, is their very poor educational background. The 2002 Census data in Serbia showed that 62 per cent of Roma had not completed primary school, and only 0.3 per cent of



Roma have university education. Discrimination and a general lack of skills means they are, additionally, the most likely to remain unemployed. In recent years, however, with the plight of the Roma communities receiving much attention from the European Union, EU-accession countries have implemented a number of measures to improve their human rights record, and access to improved health, education and employment opportunities.

Besides the Roma, majority-minority tensions over resources and jobs plague relations of at least three other categories in the BSEC-CA countries, most of which are multi-national countries.

The oldest category of excluded groups consist of Russians in the countries of the former Soviet Union. Originally settled in the former socialist republics to carry out Soviet industrialisation projects, many returned to their original homeland, Russia, as independence swept through the region. Laws on state languages, which were, adopted beginning in 1989 in most of the Central Asian republics, resulted in loss of competitiveness of the Russians in the state administration, management and education fields. This resulted in the intensification of external migration processes, when about three million Russians left the region, taking with them technical and industrial skills. They also faced, and caused, significant resettlement problems in an economically depressed Russia in the early 1990s.

The second category consists of ethnic groups who were forced to repatriate into communities during the Soviet era but were unable to adapt. One example is the Crimean Tatars, who were deported during the Soviet era to Central Asia but returned to Ukraine in the post-independence period, without being able to acquire the citizenship necessary to take part in the division of land in Crimea. By 2003, 60 per cent of Crimean Tatars did not have regular jobs and suffered discrimination in the labour market based on their non-nationality (Shanghina, 2004). Members of other non-titular ethnic groups and minorities continue to face discrimination related to employment. Migration, whether by force or free will, has created multi-ethnic countries, and what can be observed in some countries is the segregation of the labour market according to different nationalities. The language laws implemented in government jobs today in Central Asia, for example, mean that the private and informal sectors are more open to diversity by nationality than the public one. Consequently, informal rules allowed different ethnic groups to gain access to informal spheres of influence in different sectors of political and economic life. For instance, in the Kyrgyz Republic, the Kyrgyz dominate in governmental and law enforcement bodies, while Uzbeks are influential in trade in the southern regions, the Uigur are successfully trading with China, and the Dungan are very successful in agriculture.

The third category of ethnic groups facing minority discrimination consists of migrants in search of more fertile lands. Migration can be viewed as one of the main causes for potential social conflicts of ethnic or regional natures. The absence of mechanisms available to both employees and employers to legalise employment conditions for the period of seasonal work may give rise to social conflicts that might be aggravated by ethnic component. For instance, such labour migration related conflicts could arise in villages in the Ferghana Valley, where many citizens of Uzbekistan are employed on a daily basis by Kyrgyz citizens (Public Fund "For International Tolerance" 2006). The occasional conflicts between different ethnic groups in Central Asia have more often to do with economic competition over resources such as land and water than a manifestation of inter-ethnic or religious intolerance. They often flare up when members of one ethnic group, often the newly arrived ones, seems to have succeeded more in the local economy than the titular nationality. Such has been the case of the 2005 clashes between the Kyrgyz and Dungan in the village of Iskra in the Kyrgyz Republic over the distribution of irrigation water and the perceptions of wealth from the informal economy among the Dungan. In April 2006, similar clashes erupted between Dungan employers and Kyrgyz job seekers at an informal labour exchange in Jety-Oguz rayon of Issyk-Kul oblast (EurasiaNet, 16 February 2006. Available at [www.eurasianet.org/departments/civilsociety/articles/eav021606.shtml](http://www.eurasianet.org/departments/civilsociety/articles/eav021606.shtml).)

## The Marginalisation of Pensioners: The Invisible Citizens

The elderly population is often more vulnerable than younger populations, in part due to the weakening of non-formal intergenerational social security systems in the face of increased migration and the splintering of households.

The economic behaviour of the elderly also changed in response to the economic restructuring of the 1990s. The coping mechanisms they generally engaged in to maintain welfare were late retirement, multiple job holding, home production, private transfers, borrowing and even migration (moving in with family, creating an extended household). The very elderly, notably in the European BSEC-CA countries, which lacked the support of extended families, had to cut back sharply on their consumption of utilities, food and medical treatment, particularly when a pension was their only source of cash income. Consequently, poverty has risen among the elderly, as has social seclusion of pensioners who live in isolation, ashamed to seek the help or the company of others. Even where pensioners are paid benefits on a regular basis, the purchase of medicine and payment for medical and public utilities can only be achieved at the expense of reducing food and other consumption expenditures.

As a sign of an active coping mechanism, the employment level is relatively high among elderly persons not only in the European parts of the BSEC-CA region, but also in Central Asia and the Caucasus, especially in agriculture in rural areas. The low level of pension benefits is an incentive to continue labour activities or to look for additional earnings. Low pension earnings and the loss of savings after the collapse of financial institutions also forced many people above working age to stay in the labour force in other parts of the BSEC-CA region. In Ukraine, 15-20 per cent of individuals aged 60 or above remain in the labour force; in 2005, working pensioners accounted for 15.5 per cent of total employees, mostly engaged in sectors such as education, health care and provision of communal services – sectors where enterprises are mostly publicly owned and have lower than average wages, and thus cannot attract younger workers.

The welfare of the some of the elderly depends on relatives capable of providing them with financial support. Yet, even though government pensions are highly inadequate, economic hardship in many of the poorer and post-transition BSEC-CA countries means that offspring are not able to support their aged parents. In Serbia, Satarić and Rašević (2007) showed that the elderly very rarely used social protection services; only 0.28 per cent of those older than 65 years use help and care in the household and only 180 persons lived in apartments provided by the social safety net.

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Living with the extended families is a survival mechanism in more traditional societies of the Caucasus and Central Asia. Three generations living together is typical in most of Central Asia and the Caucasus, but also in other parts of the BSEC-CA countries where the younger generation taking care of their old is considered a duty. An urban pensioner that receives only a pension for all expenditures and that does not have any other support from family transfers, falls into the category of the extremely poor. The incidence of poverty among pensioners varies between rural and urban areas; while rural pensioners face a lower than average risk of poverty, as they often can count also on a plot of land, the opposite is true in the cities where the pensioners that take part-time work are less numerous.

In countries where the almost universal outreach of the state pension inherited from the socialist era survived the fiscal collapse of the first decade of transition, the risk of poverty and extreme poverty was lower among those over 60 years of age than on average. The future maintenance of such system is questioned in the region, forcing governments to introduce other measures such as compulsory pension insurance systems.

Whatever the outcome of the alternative pension and social security systems, both the welfare of the elderly and their economic contribution is a serious point on the agenda of the BSEC-CA countries. By 2020, it is estimated that the number of pensioners globally will reach that of working citizens. This trend is also evident in the European and Caucasian countries of the BSEC-CA. Serbian society is rapidly ageing and in several decades, it will become one of the oldest societies in the world. The rapidly aging population will have dire consequences for the economies and induce labour force shortages in the future.

## The Alienation of Children and Youth

Unemployment, disparagement of social status, reduction of income and consequently, reduction in consumption, migration and the insecurity of informal jobs among men and women in the BSEC-CA countries has not only affected those directly involved, but also their children. In addition, children and young people often have been directly affected by the collapse of social services, and reduced opportunities, all of which threaten their ability to survive, participate and compete in society.

In Central Asia, where around half the population is under 30, children are growing up with poorer prospects than those of their parents when they were young. They have high rates of illiteracy, unemployment, poor health and drug use and are more likely to be victims or perpetrators of violence. Few regions have seen such sharp declines in the welfare of their youth, and the combination of declining living standards with a demographic bulge brings increased risks of political instability and conflict. As noted in Chapter Three, Central Asian countries inherited widespread literacy and relatively high educational standards, but the education system saw a considerable decline in the 1990s, with the underpayment of teachers and the breakdown of basic school facilities. Economic hardships meant that children were encouraged to leave school to work informally. Most young people with limited schooling end up as casual labourers or engaging in subsistence agriculture.

For the CIS countries, this has given rise to the "quiet problem" of poverty among children and youth. The profile of poor children throughout the CIS countries is similar and consists of children of primary school age from large families, especially in the rural areas and economically undeveloped regions of countries. In the Kyrgyz Republic, for example, according to a household survey, nearly 55 per cent of children were poor, and among these, the number of rural children was almost 30 per cent greater than in urban areas. The inability of parents to take care of their children has also led to an increase in the number of children in institutional infant homes, which for example increased by 50 per cent in Ukraine between 1989 and 2005, and the number of orphans registered in state assistance programmes, which increased threefold from 2001 to 2005. Even in the European parts of the BSEC-CA region, the prolonged period of economic recession and social uncertainty negatively affected children.

Many youth in the region have dealt with the growing dissatisfaction about opportunities at home through increased migration. According to the International Crisis Group (2003), two-thirds of young people say they want to leave Central Asia, and many have already migrated, exposing themselves to additional risks as illegal labour migrants. The extended family has also been weakened by large-scale emigration and rising divorces. By the mid-1990s, one out of four children in the urban areas of Central Asia lived in single-parent households (International Crisis Group, 2003). Children growing up in single-parent (usually female-headed) households face a higher risk of being poor.

Child labour has also been on the increase in a number of BSEC-CA countries. In urban areas, children are mainly employed in the service (e.g. public catering enterprises, restaurants, local markets) and trade sectors. In rural areas, child labourers most often work in agricultural production processing plants, textile workshops and family farms. In rural areas of Central Asia, children are entrusted with grazing livestock, collecting firewood, bringing water for household needs, taking care of smaller children, washing clothes and dishes, as well as selling milk products, fruits and vegetables in the market. They are also often hired to deliver goods to markets, load and unload cargoes, trade in small items from stands, peddle in streets and markets, gather bottles and aluminium and wash cars. The ILO estimates that 16.5 per cent of children aged 6 to 14 are involved in some kind of informal economic activity in Uzbekistan. The proportion of working children in rural areas was twice as high as that in urban areas. The majority of child labour in rural areas took place in agricultural production, in particular, in cotton harvesting. Qualitative studies show that most child workers are employed in small enterprises of the informal sector, where they are usually paid less than adults and where working hours and wages are set arbitrarily. Even in Serbia, 4 per cent of children aged 5-14 years are involved

in child labour; they consist mostly of children from rural areas, from poor families and Roma children, who are involved in unpaid work, including for their households (UNICEF, 2007b).

A 2006 study on child labour in the context of land reforms in Georgia found that an increase in landholdings as an outcome of the land reform can, in the presence of market imperfections, lead to an increase in child labour because the increased demand for labour on the family farm was stronger than the wealth effect generated by the land reform (Kimhi, 2007). The results were, however, more relevant for boys than girls, and for smaller families, as larger households were able to meet the increased demand for farm labour without the need for additional child labour. The study concluded that smaller, thus poorer, households tended to sacrifice the future well-being of their male children in order to satisfy current needs. Thus, the land reforms may lead to long-term higher rural inequality.

Migration is another important feature leading to child labour in the region. Children who accompany migrant parents to urban centres may engage in informal labour activities rather than attend schools. Older children may remain at home, alone or with responsibility for younger siblings, when parents migrate to another region or country in search of work. This trend could lead to the establishment of “a generation without parents” in countries such as Moldova and Tajikistan, where migration is most acute. There is a considerably higher risk that children of absent migrant parents drop out of school, leave home and end up on the street engaged in criminality or sex-trade work. Many of these children and youth also have a risk of becoming the victims of traffickers.

## CONCLUSIONS

The existence of private and non-formal coping mechanisms available to households to address economic risks needs to be recognised properly for policies to target adequately vulnerability among populations. A number of these mechanisms are beneficial in terms of generating not only income for the short term, but also savings and assets, while others can be costly and limited in effectiveness and short-term benefits can carry high long-term costs.

Public policy can help reduce vulnerability by encouraging flexible, private coping mechanisms, while discouraging those that are fragile or that hinder economic and social mobility. Only by building up from an understanding of actions already taken by households and communities can public policies maximise their effectiveness and minimise displacing existing mechanisms that work. They therefore need to build on, complement and extend informal and private institutions. The most effective policies will combine both transfer systems that are sensitive to existing mechanisms and new institutions for providing insurance and credit and for generating savings. Private sector and non-governmental organisations could also play an important complementary role in the policy-making process.

# CHAPTER

# SIX

## Policy Responses

Economic policy making in the BSEC-CA transition economies during the 1990s was dominated by the fundamentals of creating a market-based economy. There were substantial differences in the extent and speed of price liberalisation, monetary stabilisation and enterprise restructuring, characterised at the time by polemics over shock therapy versus gradualism. The variations were, in practice, however, more complex. The crucial importance of institutions was not well recognised and everywhere institutional reform was slow.

The Soviet model of universal access to education and health care, social protection (including generous pay-as-you-go pension schemes), social assistance for those with special needs, such as the disabled or orphans; and numerous untargeted subsidies such as transport, housing and utilities was retained in principle. Budget constraints, however, led to delayed payment or reduced real value of pensions and other redistributive payments, as well as to poor implementation of public services provision. Governments responded to increasing inequality and poverty with *ad hoc* measures to protect the most vulnerable (or most vocal) sufferers. Since unemployment was not officially acknowledged in the planned economies, there was no provision for unemployment insurance in the first years of the transition economies.

With the completion of the transition, governments paid more attention to designing policies relevant to work and well-being in a market-based economy. Labour markets require legislation to define minimal working conditions and to protect workers from unfair dismissal, as well as other institutional arrangements such as unemployment insurance, which can help individuals to manage risk and to provide support during periods between employment. Beyond that, several governments have adopted active labour market policies (ALMPs) to match people without work to jobs, to increase the probability of finding work, and in some cases to target particular segments of the population such as youths, females or ethnic groups.

For the EU accession countries and would-be members, the common social agenda of the European Union provides a clear framework. At the 2000 Lisbon summit, six key objectives were adopted, specifically EU countries are to:

- promote employment and employability through active labour market measures to help those with difficulties in entering the labour market;
- ensure adequate social protection, including minimum income schemes;
- increase access of those most at risk of social exclusion to decent housing, quality health care and lifelong learning opportunities;
- prevent early exit from formal education and facilitate the transition from school to work;
- eliminate poverty and social exclusion among children to combat intergenerational inheritance of poverty; and
- increase labour market participation of immigrants and ethnic minorities to the same level as the majority population.

The list represents high aspirations, which are imperfectly met even in the best-run economies.

Elsewhere in the BSEC-CA region, approaches to labour market and other social policies have been diverse. ALMPs can improve the labour market outcomes of targeted participants, especially with enabling macroeconomic conditions and business environments, but ALMPs are only part of a broader set of policies to promote employment and cannot be considered as a substitute for job creation by private firms (World Bank, 2005a; OECD, 2006). Although satisfying work is a key contributor to most people's well-being, disadvantaged groups outside the workforce may also require social assistance. Since the turn of the century, BSEC-CA countries have become much more successful in targeting employment and social assistance policies, but these activities are still in their infancy and BSEC-CA countries have had varying priorities and implementation records over the brief time that they have been adopted. Thus, this chapter assesses public response to promote work and well-being through labour market policies. These policies are undergoing profound changes in all countries, as a result of two shocks: the full transition to market-based economies and the further integration of these economies into the global economy. At this stage of ongoing creation and implementation, though, complete information about the size, structure and composition of the policies is lacking. For the resulting programmes that have been implemented, there is minimal evidence of monitoring and evaluation to analyse thoroughly their impact. Despite their nascence in some countries of the BSEC-CA region, this chapter, nevertheless, attempts to shed more light on these policies, complementing the evidence and analysis of the previous chapters in Part II of the *Outlook*. Since the BSEC-CA countries are, for the most part, at a relatively early stage of implementation, they may find useful lessons in the experience of the OECD countries, which is discussed in Chapter Seven.

The first two sections of this chapter distinguish between passive and active labour market policies, the former setting the labour market environment, while the latter are delivered to individual employers and workers or target specific groups, occupations or sectors. The next two sections examine policies to improve redistribution either by the state or by the private sector. Finally, the chapter briefly reviews other policies directly affecting work and well-being and international co-operation on labour migration.

## THE LABOUR MARKET ENVIRONMENT

An effective labour market environment requires the creation of sufficient jobs to meet the available labour supply, plus institutions to match demand and supply. Initial concern in many BSEC-CA countries focused on the demand side, because the constraints in the transition economies arose from the collapse of jobs in the old state enterprises. The top priority was to identify new areas of comparative advantage and to reduce the obstacles to enterprise restructuring and new enterprise creation. However, the high levels of open and disguised unemployment and the failure to create national labour markets indicate that there are also major problems in matching demand and supply in the labour market.

**116** All of the BSEC-CA countries have ratified the relevant ILO Conventions and Recommendations (see Box 6.1). Within the broad goal of governments, employers and employees co-operating to promote full, productive and freely chosen employment, specific conventions make a variety of requests of ILO members. These requests include such things as provision of a public employment service; placing emphasis on the importance of providing vocational training and guidance; defining the role, functions and organisation of labour administration; managing services to enable disabled persons to retain and advance in their employment; and addressing the provision of income support in the case of unemployment. These conventions, however, are, often expressed in general terms and therefore, implementation varies considerably.

### Box 6.1. ILO Conventions and Recommendations

The international labour standard is the ILO Convention 122 on Employment Policy, adopted in 1964 and reaffirmed by the Copenhagen 1995 World Summit for Social Development. The convention urges governments to formulate and implement, in close collaboration with employers and workers, an active policy promoting full, productive and freely chosen employment. The general principles of an active employment policy are elaborated further in ILO Recommendation No. 122. These closely related instruments make explicit reference to other ILO Conventions, especially the Employment Service Convention No. 88, Human Resources Convention No. 142, Labour Administration Convention No. 150, Vocational Rehabilitation and Employment (Disabled Persons) Convention No. 159 and Employment Promotion and Protection against Unemployment Convention No. 168. Convention No. 88 requests ILO members to run a public employment service. Convention No. 142 and the related Recommendation No. 150 emphasise the importance of providing vocational training and guidance. Convention No. 150 defines the role, functions and organisation of labour administration. Convention No. 159 deals specifically with services to enable disabled persons to retain and advance in their employment. Convention No. 168 deals mainly with the provision of income support in the case of unemployment.

Source: drawn from the ILO website "International Labour Standards", available at [www.ilo.org/global/What\\_we\\_do/InternationalLabourStandards/lang--en/index.htm](http://www.ilo.org/global/What_we_do/InternationalLabourStandards/lang--en/index.htm)

Workers' right to choose their employment and bans on forced labour are often constitutionally guaranteed. Legislation on humane work conditions, minimum wages and protection against unfair dismissal are universal in BSEC-CA countries. Other legislation on working hours, vacations, maternity leave and so forth is country-specific, but typically strong on paper and weaker in implementation. These measures contribute to the cost of employing labour and should therefore involve a cost-benefit analysis of the extent to which workers should be protected; minimum wages set too high, for example, may help those already with low-paid jobs but opponents of minimum wage laws note that it can also discourage employment of young and unskilled workers. Trade unions exist and have a legal role, but in many countries they are holdovers from the Communist era and ineffective in the market-based economies. A general, and desirable, trend is that countries are, over time, acceding to an increased number of ILO Conventions, although again there may be a gap between the aspirations of a convention's drafters and the workplace reality.

Employment protection legislation varies from country to country. The variations are greater in how the legislation is implemented than in the legislation itself. The common pattern is that legislation is stringent, apart from in Georgia where hiring and firing have been made much easier since 2003, but implementation is weak. Extensive informality undermines employment protection policies in most BSEC-CA countries<sup>1</sup>.

After the end of central planning, governments established minimum wage levels either by presidential decree or by legislation, but their purchasing power was rapidly eroded by inflation during the first half of the 1990s (see Box 6.2 "Minimum wages in the Caucasus"). Since the mid-1990s, minimum wages affect few in the workforce, although some countries use them as a benchmark for pensions and other social payments. Even in the countries where reform has been more gradual, where minimum wages rates have greater impact, there has been erosion of their real value. In Uzbekistan, for example, the minimum wage, which was 13-14 per cent of the average wage in 2000-03, failed to keep pace with wages, and by 2006 was equal to less than 9 per cent of the average wage (CER Uzbekistan, 2007b). In Azerbaijan, the minimum wage was increased by presidential decree to 5.5 manat per month in 2001 and to 12 manat in January 2003 and then by further increases at intervals of a year or less to 50 manat (USD 57) in February 2007 (SIGMA, 2007). The World Bank's 2006 *Serbia Labor Market Assessment* report concluded that the minimum wage had no significant impact on employment when minimum wages are set too low, as in Serbia where they are just under 40 per cent of the average wage (World Bank, 2006b).

## Box 6.2. Minimum Wages in the Caucasus

In the three Caucasus countries minimum wages in 2000 were 28 per cent of the average wage in Georgia, 24 per cent in Armenia and less than 10 per cent in Azerbaijan. Over the next half-decade, the three countries took divergent approaches to labour market policies: Georgia adopted a hands-off approach after the 2003 revolution, Azerbaijan took a more proactive stance as the economy boomed and concerns about inequality increased, and Armenia's policy approach remained fairly stable. This is reflected in the minimum wage rates, which, as a percentage of the average wage, have remained more or less constant in Armenia (25 per cent in 2005), fell in Georgia (to 10 per cent in 2005) and were increased in Azerbaijan (to over 30 per cent in 2005).

Source: AIPRG, 2007; SIGMA, 2007; CER Uzbekistan, 2007b.

Payroll taxes have been an important contributor to high labour costs. In Uzbekistan, the various payroll taxes amounted to 37 per cent in 2002, although after that they were reduced to 25 per cent in 2006 and 24 per cent in 2007 (CER Uzbekistan, 2007b), which is still significantly higher than the OECD average. Payroll taxes increase non-wage costs for employers, which can make it possible for non-wage costs to become a larger share of total labour costs. High payroll taxes provide an incentive for adopting inappropriately capital-intensive techniques, and encourage informality where the savings may be shared between employer and employee.

Other passive labour market policies, such as unemployment insurance or social transfers are designed to mitigate short-term financial needs of the unemployed, but they address none of the greater social security objectives epitomised by the EU social agenda noted earlier. Well-designed unemployment insurance programmes can, nevertheless, provide workers with income lost due to frictional unemployment associated with the business cycle or structural change. In most of the transitional BSEC-CA countries, unemployment benefits are earnings related and subject to floors and ceilings. A recent World Bank study estimates that, during the late 1990s, unemployment benefits were equal to 0.1-0.3 per cent of the GDP in CIS countries, compared to 1.4 and 1.7 per cent of GDP in south-east Europe and central Eastern Europe, respectively (World Bank, 2005a). These figures, although estimates, suggest a wide variation across countries in terms of resources allocated to passive labour market policies and their coverage.

The take-up rate of unemployment benefits is very low in some countries. In Moldova, for example, in 2005 only 2 966 people received unemployment benefits even though the number registered as unemployed was almost 60 000 (CSSR, 2007). Such a low take-up rate (less than 5 per cent) suggests there are higher costs in claiming benefits than receiving them and/or that the benefits are extremely low. Low monetary amounts of unemployment benefits are the result of the low take-up rate in the Kyrgyz Republic, where only 10 per cent of the registered unemployed receive the unemployment benefit of 250 som (USD 7) per month (CER Kyrgyzstan, 2007). There are also unusual distinctions and rules that define eligibility for unemployment benefits that deserve scrutiny. In other CIS countries, the number of registered unemployed is smaller than expected because those who own land (i.e. most of the rural population since the land reforms of the 1990s) cannot register, even if their plot of land is too small to produce a subsistence crop.

The current low coverage and onerous qualification rules of unemployment insurance programmes make them inadequate in many countries of the region. Because much of the unemployment is of the long-term nature, it may be that the types of unemployment insurance programmes that are typical in the OECD countries are considered an inefficient or premature use of resources. Similarly, measures such as severance payments, which are widespread in market economies, are minimal. Although it is impossible to provide universal passive labour market programmes and harder to enforce policy rules and regulations in economies where informal employment remains considerable and widespread, they are necessary to encourage a healthy, secure formal sector.

The widespread existence of the informal economy reduces the effectiveness of labour market policies, which are intended to be universal. Its existence undermines governments' abilities to



raise revenue and provide services. For these reasons, some states are attempting to reduce informality by promoting formality and/or strengthening enforcement of regulations. Measures to encourage informal businesses to become formal include both incentives (e.g. reducing the tax and social security payments and bureaucratic rules that encourage evasion) and disincentives (e.g. tighter auditing and bans on cash transactions). Turkey's recent programme, highlighted in Box 6.3, provides examples of incentives to reduce informality of businesses by easing tax burdens and simplifying procedures for tax remittances.

### Box 6.3. Efforts to Reduce Informality in Turkey

The efforts in Turkey to reduce informality began in 2006 when corporate tax rates reduced from 33 to 20 per cent. This measure was adopted in conformity with the OECD recommendations.

In June 2007, the Turkish Minister of Finance announced a plan to reduce the size of the unregistered economy by 2 per cent per year. Incentives to formalise include the removal of tax exemptions and a reduction in the number of bureaucratic transactions. In 2008, a more effective auditing system will be introduced and all employers will be obliged to deposit workers' pay into bank accounts. The income tax system will also be streamlined, and social security payments by registered employers will be reduced by 5 per cent in 2008, which may cost the government about TRY 4 billion. The launching date of this initiative has yet to be announced, however.

The announcement also noted measures to reduce the cash economy, which could also help to curb informality, though its overall impact on informality is hard to predict. The estimated level of informal employment today is almost 50 per cent of total employment in Turkey.

Another initiative to reduce informality is the reduction of the value added tax (VAT) rates. The VAT rates for the tourism, textile and service sectors were decreased from 18 to 8 per cent in 2008. In order to simplify bureaucracy and streamline tax declaration, all tax centres have been computerised. Around 80 per cent of declarations for corporate, income, VAT and excise taxes have been transmitted electronically. Moreover, tax payments can be made electronically as well. The website of the Income Directorate of the National Tax Administration ([www.gib.gov.tr](http://www.gib.gov.tr)) provides taxpayers with online services and easy access to administrative information.

*Source:* Information provided by the Turkish Ministry of Finance.

## ACTIVE LABOUR MARKET POLICIES

Since the turn of the century there has been a shift of emphasis in the BSEC-CA transition economies from passive labour market policies to active labour market policies (ALMPs), which consist of social expenditures (other than formal education) aimed at improving the beneficiaries' prospect of finding gainful employment or otherwise increasing their earnings capacity. ALMPs are intended to reduce structural unemployment and boost economic activity rates by facilitating the matching of workers to jobs and keeping the unemployed in contact with the labour market, while improving their skills (Lehmann, 1995; OECD, 1993 and 2005*b*). In other words, they have three functions: to increase the quality of labour supply, to increase the demand for labour or to improve the matching of workers to jobs, all of which emphasise economic goals. Non-economic goals are those such as capitalising on possible social benefits derived through participation in productive employment.

For many BSEC-CA countries, especially the lower-income ones, these policies are quite new and minimally target specific segments of the workforce. For instance, age-specific and gender-specific programmes to promote youth or female employment have been introduced only very recently, and mainly consist of vocational training and wage subsidies (Stavreska, 2007). Detailed information on the specific programmes implemented by each country and the resources allocated

for their realisation is absent or scattered. It is sometimes difficult to ascertain to what extent programmes approved on paper have been implemented. It is practically impossible to assess their impact, given the absence of regular monitoring and proper evaluation.

ALMPs include spending on public employment services and administration, vocational guidance and training, public works, microfinance and counselling services for potential entrepreneurs, special programmes for youths in transition from school to work and special programmes for the disabled. All BSEC-CA countries implement some of these measures, though wide variations can be observed in their scope, resources and integration with other labour market policies. In some countries the employment programme involved a tripartite dialogue between government, employers and employees, but this was sometimes thwarted by the lack of a unified employers' organisation (e.g. in the Kyrgyz Republic) or ineffective trade unions, which are weak and unrepresentative in many CIS countries. The poorer countries have also had problems funding ALMPs and the amounts devoted to such programmes may be tiny (e.g. 18 million lei in Moldova in 2006, which was 0.04 per cent of GDP). On a positive note, several countries are trying to design their ALMPs in a more efficient fashion, as part of comprehensive employment strategies. For instance, the 2006 Armenian law on employment ("Employment and Social Protection Law in Case of Unemployment") establishes and provides funds for both passive and active labour market measures, including a vocational training component to promote skills upgrading and facilitate the reinsertion of unemployed people and vulnerable groups in the labour market.

Faced with mounting youth unemployment and low female employment rates, many governments in the region have recently stepped up their efforts to tackle these problems. For instance, Azerbaijan has approved a National Action Plan on Youth Employment inviting several youth non-governmental organisations to provide inputs into the development of the Action Plan. In Moldova, the number of people receiving professional guidance increased from 23 000 in 2003 to 28 000 in 2006. In 2006, about 62 per cent of the participants were women and over 70 per cent were young unemployed between the age of 16 and 29 years old (CSSR, 2007).

Public employment centres (PECs) providing job mediation services exist in all BSEC-CA countries, though their organisational structure, scope of their activities and actual policy implementation vary considerably across countries. The task of PECs range from organising a labour market information system, implementing public works, conducting training programmes and the administration of unemployment benefits to job mediation/placement. PECs affiliated to a relevant ministry are often the primary public labour market institutions responsible for implementing labour market policy through public services. The funding structure of PECs is also diverse in the region. Some countries such as Kyrgyzstan and Georgia are financing their PECs from their general budget, while others are funding from different sources; for example, Tajikistan and Azerbaijan have their own separate fund (Hansen *et al.*, 2005). Armenia has a combined financing scheme (i.e. a separate fund and general budget). In Kazakhstan, local administrations finance their local PECs.

Significant differences exist in the efficiency of PECs among BSEC-CA countries. The background country papers prepared for this *Outlook* indicate that most transition economies have been unable to implement job mediation services effectively. This can be attributed to inefficient organisational structures, lack of financial and human resources and inadequate co-operation with employers. In Moldova, the number of vacancies announced by employers went up from about 40 000 in 2000 to 47.5 000 in 2006, a rise associated with a decline in the job-placement rate. Such a mismatch can be explained by a lack of information channels between employers with job openings and the unemployed and, more importantly, an absence of appropriate counselling for job seekers (O'Leary *et al.*, 2001). In several countries, PECs and their local offices have yet to be fully computerised and networked with other relevant agencies, as information technologies are underutilised in these countries. The absence of comprehensive and reliable data on labour market conditions creates an impediment to designing and implementing efficient policies. The burden of high formality sometimes may bring about serious disincentives to job mediation programmes. Contacts with job seekers and payment of benefits can be excessively complex and bureaucratic; for instance, some countries require job seekers to report to the labour office two to three times per month even if no suitable vacancies are available.

Certain countries have established decentralised decision-making processes, delegating certain functions and responsibilities to local offices from central PECs. This is the case, for instance, with the training components of PECs in Armenia and Ukraine (ETF, 2007a; ETF, 2007h). Others, however, still function under a heavily centralised decision making structure, which is less than optimal for the delivery of ALMPs for they can require extensive situational knowledge. Moreover, overall programme assessments or evaluations are rarely conducted by governments on their own initiatives, unless they are required by technical assistance programmes. This hinders critical analysis and appropriate policy recommendations.

Private employment agencies and other actors, such as universities, are starting to play a more active role in job mediation in the region. In Kyrgyzstan, for example, career fairs are regularly organised in the framework of the Youth Placement Service Programme. Monthly events are organised to bring young unemployed in contact with potential employers. In 2005, more than 5 000 people attended such events, of which more 85 per cent successfully found jobs (CER Kyrgyzstan, 2007). In Armenia, universities have taken a more proactive role in establishing student placement structures and career centres (AIPRG, 2007).

All BSEC-CA countries have put in place technical and vocational education and training (TVET) programmes, though many are limited in size, scope and geographical reach<sup>2</sup>. In general, TVET programmes have two principal components. One concerns training unemployed youth, as they constitute a major share of the jobless in most BSEC and CA countries. Employers usually prefer older workers, as they argue that young people are lacking experience and discipline. In this respect, TVET programmes may play an important role in providing essential skills for a proper job. Another component of TVET programmes is retraining offered to workers to help them acquire skills to maintain jobs or facilitate subsequent redeployment.

In the BSEC-CA region, training or retraining is usually offered freely to those registered as unemployed, but as discussed previously in the *Outlook*, the registered numbers of those unemployed does not reflect the actual number of unemployed people and thus, a large segment of the population cannot access the programmes. Where information on public resources allocated to ALMPs is available, TVET often accounts for the largest share; for example, it accounts for 38 per cent of total ALMP expenditure in Armenia (AIPRG, 2007). This stands in sharp contrast with Georgia, which has a very limited TVET programme, mainly driven by international organisations.

However, participation rates are generally low, and effectiveness of these programmes in terms of the employment outcomes is not well known. According to the European Training Foundation, enrolment rates in TVET schools (as a percentage of students in secondary education) in selected BSEC countries vary considerably, but are, with the exception of Serbia, generally below the EU average<sup>3</sup>. In most countries, there has not been an evaluation, or procedures for doing so, to assess the number of participants that have secured regular, permanent and stable employment following participation in TVET programmes.

The reform of educational policies in general, and TVET more specifically, is a compelling priority in many BSEC-CA countries, including the higher income ones<sup>4</sup>, as their increasing integration into the global economy is likely to set in motion structural adjustment and reallocation of resources across sectors. Most governments have adopted action plans for improving the effectiveness of their TVET programmes, often with support from international organisations such as the UNDP and the European Training Foundation. The establishment of regional training centres, more responsive to local needs, and the decentralisation of planning and implementation responsibilities is foreseen in most reform strategies, but is only slowly taking place. A number of TVET centres are established and run with the help of international organisations such as the Baku Regional Vocational Training Centre, which began in May 2007 (see Box 6.4).

**Box 6.4. Regional Vocational Training Centre in Baku, Azerbaijan**

The Regional Vocational Training Centre in Baku was established jointly by the Ministry of Labour and Social Protection of Population (MLSPP) and the UNDP. Its objectives, to promote the “development of the social protection system”, and to implement the selected activities of the “National Employment Strategy” will provide the job seekers and unemployed (the unemployed must be registered in the Employment Offices of MLSPP) with vocational and skills training. Situated in Darnagul district, it offers training programmes to the applicants from Baku, Sumgayit and Absheron and other regions close to Baku. The Centre contributes to the development of those skills that are in most demand on the labour market, according to local businesses, which will make use of the certified specialists of the Centre in the future. The Ministry announced that the Centre would be able to train around 1 000-1 200 specialists a year.

The ILO assisted the Ministry in developing training materials for the Centre for a number of specialties such as turning, carpentry, welding and dressmaking. The training programmes comply with ILO standards and were approved by the Ministry of Education. The ILO also trained the instructors at the Centre. The Centre plans to offer computer and English language courses in the near future.

Source: Adapted from web page of UNDP Azerbaijan Office ([www.un-az.org/undp/news/2007/15-5-2007/15-5-2007.php](http://www.un-az.org/undp/news/2007/15-5-2007/15-5-2007.php))

Recent EU member countries of the BSEC have allocated increasing resources to TVET, as part of their efforts to facilitate adjustment of their labour force and meet the goals of the action and development plan of the European Union, set out in the Lisbon Agenda in 2000. For instance, Romania has expanded the budget allocations to TVET over the last few years and substantially increased the number of people receiving training<sup>5</sup>. The country’s 2005 strategy for continuous vocational training seeks to improve the regulatory framework (a flexible approach to the Labour Code, consistent regulations on initial and continuous vocational training) and strengthen the implementing capacity of the institutions involved. TVET programmes are freely available to the unemployed as well as to those who are entitled by law, such as those working in rural areas and having an income lower than the minimum wage. Participants receive certain benefits, including training materials, free medical services and payment for transportation. Financial incentives are provided to employers that organise training courses to foster lifelong learning<sup>6</sup>. Despite this emphasis, TVET accounted for only about 9 per cent of expenditures on active employment measures in 2006, while job subsidies accounted for over 50 per cent and the rate of re-employment after retraining or vocational conversion was reportedly low (Vasile, 2007).

Reform has gained momentum in lower-income countries too, also in conjunction with the preparation of the EU European Neighbourhood Policy Action Plans. In Armenia, the government endorsed, in 2005, a TVET Modernisation Priorities Paper and Action Plan that set out six priority areas (ETF, 2007a): *i*) introducing competency-based TVET standards; *ii*) modernising quality-monitoring mechanisms; *iii*) creating technical support and quality-assurance infrastructures; *iv*) improving cost efficiency and educational outcomes; *v*) optimising TVET financing; and *vi*) building a national capacity for implementing and monitoring the TVET modernisation process. In a similar vein, Azerbaijan has recently adopted a National Employment Strategy, which attempts to better integrate labour market requirements into the educational system, and strengthen and rationalise TVET programmes (Government of Azerbaijan, 2005 and 2007; ETF, 2007b). The strategy includes a National Action Plan on Employment, which incorporates a specific component on youth employment. In 2005, Georgia, adopted a reform strategy for its TVET programme, with a lifelong learning perspective based on the European education system and in accordance with the Bologna process, which aims to create a European Higher Education Area by 2010 (ETF, 2007c). The UNDP has launched a joint project with the Ministry of Education and Science to assess skill shortages and support modernisation of the TVET programme there.

In Moldova, participation in traditional and centralised TVET programmes has been declining in recent years, and the government is establishing regional training centres and devolving

responsibilities to relevant stakeholders (ETF, 2007e). As a result, half of traditional TVET schools have closed and have been replaced by “Labour Clubs” (*Clubul Muncii*), which are a local alternative model for providing the unemployed with professional guidance and physiological assistance as well as training.

The Serbian government adopted the National Employment Strategy (2005-10) in compliance with three objectives of the 2000 Lisbon Strategy: full employment, quality of work and productivity, and social cohesion and inclusion in the labour market (Ognjenović, 2007). In this framework, several initiatives have been launched to modernise the education and training system, with aims to develop a national qualifications system, establish quality assurance mechanisms and modernise curricula. A recent assessment of the TVET system in Serbia, however, suggests that major problems persist in the adult education and training system, while the overall TVET system lacks flexibility to adapt to changing market conditions and social needs (ETF, 2007f).

Education and training reform is still in its infancy in the smaller Central Asian countries, whose infrastructure has been seriously damaged during the transition period (ETF, 2007d; ETF, 2007g). In the Kyrgyz Republic, the Public Employment Agency organises annual TVET programmes. So far, 5 000 unemployed have participated in TVET programmes, with youth accounting for 75 per cent of attendance, mostly from rural areas (CER Kyrgyzstan, 2007). However, the early outcome of the country’s TVET programmes reveals several shortcomings, such as insufficient information on job offers, lack of flexibility in the training courses and financial shortages. The reform of TVET programmes has also been slow in Tajikistan, partly because the government initially prioritised reforming the general educational system. More recently, the government approved a National Action Reform Plan for the Initial Vocational Education and Training System in 2006, encompassing the content and organisation of educational and training processes, the qualification structure and TVET system management, and quality control (ETF, 2007g).

Wage subsidies, often supplemented by social insurance, and public works, are other examples of ALMPs found in the BSEC-CA region. Wage subsidies are paid to an employer for a certain period on condition that the employer will hire a registered job seeker (usually from a vulnerable group). If subsidised employment is combined with training, as in the case of internships for youth seeking first-time employment, the subsidy may also cover training costs. A recent example from Ukraine is the programme initiated in 2006 by the State Employment Office to subsidise wages and social insurance costs of a jobless person for one year if an employer ensures at least two years of employment for the individual and provided that the individual has been registered as unemployed for more than six months.

Evidence on the employment effect of wage-subsidy schemes is mixed. Although they can enhance labour demand for disadvantaged groups, they can also result in deadweight losses for the economy and can have unforeseen impacts, such as subsidised workers replacing unsubsidised ones or employers hiring subsidised workers and then laying them off once the subsidy period ends (Betcherman *et al.*, 2004; OECD, 2003; Gupta and Larsen, 2007). Despite such effects, wage-subsidy schemes for target groups can be successful. A recent World Bank inventory of youth employment programmes found that the wage-subsidies programmes for youth employment in Bulgaria, Romania and Kyrgyzstan had positive employment results, especially in introducing the young unskilled into the labour market (Stavreska, 2007). This inventory suggests that short-term programmes have more impact on employment and that women and individuals with lower educational qualifications tend to benefit the most (Stavreska, 2007).

Public works schemes to create temporary jobs are another type of ALMP. Municipal authorities or other governmental institutions, but also private firms, usually, create such programmes. They are directed to the maintenance (in some countries construction or upgrading) of infrastructure, cleaning of public areas and similar activities beneficial to the community. Funding from the public employment service may cover wages, social insurance and operational costs; costs may also be shared by project organisers (the formula differs by country and by project). Participants are usually registered job seekers, but in some countries, they may be employed persons on administrative leave or short-time work assignments, students or pensioners.

Transition countries of the BSEC-CA region experiencing long-term unemployment are inclined to engage in broad-based public works programmes to alleviate poverty among the jobless, and to help them remain in contact with the labour market. Public works schemes are widespread in Armenia, the Kyrgyz Republic, Moldova, Russia, Serbia, Turkey and Ukraine. In 2004, 29 per cent of the registered job seekers participated in public works programmes in the Kyrgyz Republic, 11 per cent in Armenia and 3.5 per cent in Azerbaijan (Hansen *et al.*, 2005). Local public authorities in Moldova initiate Remunerated Public Works to meet the interests of local communities. Each participant receives a monthly allowance allocated from the Unemployment Fund, which is equivalent to 30 per cent of the average salary of the previous year (CSSR, 2007). In Tajikistan, unemployed youths engaged in public works represent nearly half of all participants (RIACL, 2007).

While public works can act as counter-cyclical income support programmes, their impact on the prospect of finding regular jobs appears to be very limited, especially if they are not associated to training (O'Leary *et al.*, 2001; Stavreska, 2007). The "Beautiful Serbia" programme, implemented in 2004 and 2005 by the Serbian Ministry of Labour, Employment and Social Affairs, with the support from the UNDP and international donors, combines training and temporary employment (Ognjenović, 2007). The programme, modelled on the "Beautiful Bulgaria" initiative, offers vocational training in construction skills and promotes temporary jobs in the construction sector for long-term unemployed people registered in the National Employment Service. It gives priority to the most vulnerable groups (refugees, internally displaced people and the Roma). The training programme had a low dropout rate, and approximately half of the unemployed who found a temporary job in refurbishment projects financed by the programme participated in the vocational training segment (Bonin and Rinne, 2006).

Self-employment promotion includes grants (usually equal to the job seeker's total unemployment benefit), preferential loans, payment of interest on commercial credits or provision of credit warranty, business training, assistance in designing a business plan and other related aspects of entrepreneurship. Registered job seekers qualify for this type of assistance but some countries have launched pilot projects enabling the public employment service to support business training before layoff to facilitate immediate business start-up. The grant or loan must be repaid if the business plan is not pursued, but if self-employment continues successfully, part of the loan may be forgiven.

In some of the countries running general self-employment promotion programmes, new businesses launched in regions with high unemployment may get additional support from the public employment services if they create new jobs for registered unemployed persons. In Georgia, for instance, firms that create new jobs are eligible for investment subsidies. In Armenia, a new programme has been initiated to provide eligible registered unemployed with a subsidy for paying state duties and fees in setting up their own business. In addition to the new programme, TVET programmes for running business and developing entrepreneurial skills are provided.

More generally, microfinance programmes often have job creation as one of their goals. For instance, the State Committee for Migration and Employment of Kyrgyzstan launched a micro-credit programme and KGS 20 million (USD 500 000) was extended to 1 800 unemployed in 2005. The Public Employment Services, in collaboration with international organisations, has set up a business incubator system to help increase survival rates of innovative start-up companies.

Several measures may promote the professional and geographical mobility of unemployed persons within a national economy. Relocation measures cover the costs of moving to a new place of residence where a suitable job is available. Housing assistance may temporarily subsidise accommodation for seasonal workers or relocated workers. The public employment service may also subsidise commuting costs either alone or through cost-share initiatives with a municipality or employer. These measures feature prominently in the Greek set of labour market interventions, as set in the 2004 National Action Plan for Employment and restated in the National Reform Programme for Growth and Jobs 2005-08 (see Box 6.5).

### Box 6.5. Promoting Geographic and Professional Mobility in Greece

While the Greek government attaches importance to job security in both permanent and temporary contracts, some recent initiatives have been launched to promote occupational and geographic mobility and foster employment. The support of professional and geographic mobility is considered to be contributing to the reduction of regional inequalities and the more efficient operation of the job market in general. Some measures include:

- promotion of part-time jobs in the public sector and local government (more than 200 000 part-time job contracts were concluded in 2005);
- legislation regarding working time was rearranged to establish further flexibility and promote competition;
- encouragement of private employment offices and temporary employment companies to increase the number of temporary workers;
- promotion of lifelong learning initiatives;
- promotion of young entrepreneurship through the Subsidy Programme of New Free Lance Professionals; and
- establishment of a Special Social Solidarity Fund to provide increased incomes and social protection to long-term unemployed people and those made redundant through company restructuring.

In order to enhance geographic mobility and to prevent the depopulation of the countryside, the Greek Manpower Employment Organisation (OAED) provides a range of subsidies (such as rent subsidies) and incentives for employers who hire unemployed people who move from their residence for limited duration employment; it also covers transportation expenses for the shifting personnel. Incentives for geographic mobility are also provided within the Subsidy Programme of New Free Lance Professionals for young unemployed people in large urban centres who will "return to the region" in order to start their business activity.

*Source:* Information provided by the Greek Ministry of Labour and Social Protection, General Directorate of Labour, Directorate of Employment and OAED ([www.oaed.gr](http://www.oaed.gr)).

In sum, many BSEC-CA countries have adopted, or are in the process of adopting, a range of active labour market policies similar to those pursued in OECD countries. Within the OECD countries, there exists a body of evidence on what works (e.g. well-designed job mediation services) and what has a poor record of accomplishment (e.g. public works projects that are not associated with training). This topic is discussed further in the next chapter.

## PUBLIC REDISTRIBUTION: TARGETING SOCIAL ASSISTANCE AND PROMOTING EMPLOYMENT

One of the positive features of the centrally planned economies was their universal provision of health, education and social services. Although a substantial number of families, especially in Azerbaijan and Central Asia, were classified as "under-provisioned" (i.e. living on or below 75 roubles per capita per month), this status was cushioned by the state's provision of basic needs. With the end of central planning and the collapse of government revenues (exacerbated for CIS countries by the dissolution of the Soviet Union and the end of inter-republic transfers), governments in the transition economies quickly ran into budget constraints.

One example of the difficulty of continuing universal provision of social services was the situation concerning the elderly. The Soviet pension scheme related payments to the minimum wage and had wide coverage. During the early- and mid-1990s, many transition economies actually eased eligibility before the normal age of 60 for males and 55 for females in order to cushion increased unemployment and other economic pressures, although the prevalence of payments arrears makes it difficult to assess the net impact. In Kazakhstan in the mid-1990s, for example,

half of those receiving pensions were below the normal retirement age. One consequence was severe budget pressure as pensions came to account for a huge share of GDP — over 10 per cent in Uzbekistan, for example — and over half of all social protection spending everywhere. Budgetary pressure contributed to the need for reform; hence major pension reforms have been introduced, most notably in Kazakhstan in 1997.

Another problematic area was the use of subsidies for basic goods and services. These were dropped by most transition countries by the mid 1990s, although Turkmenistan maintained free provision of gas, electricity, water and salt for residential use. Such untargeted social assistance is costly, inefficient and inequitable as richer households, who have more electric appliances and are more likely to have indoor toilets, benefit most from free electricity and water.

Poverty analyses indicate very clear patterns of winners and losers from the transition to market-based economies (e.g. Anderson and Pomfret, 2003). The elderly were not especially hard-hit during the 1990s, when the main determinants of changes in household expenditure were family size, education levels and location. Households with several children were hurt not just by lack of transfer payments but also by the decline in services provided for children, especially kindergartens and basic health care. Many people saw the value of their skills or experience eroded with the onset of market-based economies and increasing integration into the global market, while demand grew for those with other human capital assets, especially a high general-purpose education or specific skills such as in information technology or English language competency. Location has also become a major determinant of poverty, not just in rural-urban differences. There are also major regional differences, which have widened; the poverty gap between residents of a capital or largest city and other parts of a country is widening. In other words, there are large regional inequalities both between and within countries.

The ability to identify groups of winners or losers indicates the need for a targeted approach to public redistribution. In practice, many of the BSEC-CA countries have already redesigned their social protection programmes to target the poor. In Azerbaijan, Bulgaria, Georgia and Romania, for example, social protection programmes covered practically all of the poor by 2003. Elsewhere coverage was lower, but in all except Tajikistan, over half of the poor received some form of social transfer. The share of social assistance going to the poor, however, remains well below 100 per cent although it has been rising as targeting measures improve (e.g. in Kazakhstan the share of social assistance going to the poor was 6 per cent in 1998 and 56 per cent in 2003, in Georgia the share of extreme poor receiving social assistance was 20 per cent before the introduction of a new targeting system in 2006). Despite improved coverage, lack of resources greatly undermines the ability of public social assistance systems to address the needs of an expanding population requiring assistance. Dependency on public and private social transfers is increasing; yet, "state social assistance is limited, and most unemployed individuals receive no social or humanitarian assistance and do not even know where to apply for it" (World Bank, 2005b: 79).

The World Bank has identified some well-targeted programmes as being among the best in the world: specifically, Armenia's Family Poverty Benefit, the Kyrgyz Unified Monthly Benefit, Albania's *Ndihme Ekonomika*, and the Guaranteed Minimum Income in Bulgaria and in Romania (World Bank, 2005c). The recent reform of social assistance in Georgia highlights the challenges involved in planning and implementing a cost-efficient and transparent system for targeting social expenses (Box 6.6).



### Box 6.6. Better Targeting of Social Assistance in Georgia

The previous system provided three types of transfers (a cash transfer, health vouchers and electricity subsidies) to five eligible categories of citizens: disabled individuals, disabled children, orphans, single, non-working pensioners and multi-children families. That system was considered ineffective in providing support to those in real need: the poor. About one quarter of total social assistance spending was provided to people who were not poor. Moreover, only 20 per cent of those living below the line of extreme poverty received some kind of support, leaving a large share of those in need without any assistance.

With support from the World Bank, the Georgian government, in 2005, created a new targeting system, based on a more accurate assessment of individual household income and wealth, and reducing the number of programmes. The Social Assistance and Employment State Agency was created to run the programme. The new targeting system is designed to:

- maximise the coverage of the poor receiving social assistance;
- minimise leakages to non-poor;
- improve transparency and objectivity (minimise the subjective components in the assessment and distribution of social assistance);
- advance cost-efficiency in collection of more accurate data on household welfare; and
- ensure flexibility to allow adjustment of coverage and type of support.

In 2006, the Georgian government approved a new system of social assistance aimed at improving its poverty alleviation efforts by better targeting recipients. The new system required the creation and management of a detailed database of socially vulnerable families, based on multidimensional characteristics of vulnerability.

The building block of the new system is a large household survey that collects information on economic characteristics, and then enters the data into a unified database (household information registry), which allows for comparisons against the eligibility criteria for the various support programmes.

The system uses a measure of household welfare based on consumption and expenditures, adjusted for household size and composition. This measure is an aggregate of measurable characteristics, such as income (wages, pension and public transfers), ownership of consumer durables, and living conditions (e.g. access to electricity, water, size of house). This objective measure is accompanied by a subjective assessment based on an interview about the well-being of the household. The system also includes a monitoring procedure, with random checks of 10 per cent of all questionnaires, cross-checks with other databases and dedicated monitoring surveys to assess the efficiency of the targeting mechanism.

The database of socially vulnerable families now constitutes the basis for implementing various social assistance programmes, such as cash transfers, health-care vouchers, electricity subsidies as well as other social programmes. According to government data, the new system has dramatically improved targeting, increasing the share of extreme poor that receive social assistance threefold.

*Source:* Interview with the Director of the Social Assistance and Employment State Agency, Tbilisi, 3 September 2007; and Lokshin, 2007.

Specific measures may be required in some countries for especially disadvantaged groups such as the Roma, who often lack documentation to benefit from social assistance programmes, and internal displaced persons (IDPs), who often suffer from loss of social capital as the most dynamic group members leave the community.

Effective social protection systems should contribute to future prosperity and well-being. Child benefits facilitate keeping children in school and contribute to human capital formation. Unemployment insurance helps households and individuals to better manage risk. More generally, social protection leaves lifetime career choices less exposed to short-term risk, encourages beneficial risk-taking and hence more flexible labour markets.

More generally, social assistance systems have the potential not only to provide insurance for the unemployed and for poor and vulnerable segments of the population, but also to promote

the (re-)integration of those receiving welfare benefits into the labour market. The promotion of employment integration has become a central feature of social policy in OECD governments for tackling poverty and social exclusion. So-called “employment-oriented social policies” or “active social policy” can help to reconcile workers’ economic security with efficient mobility and tackle social exclusion<sup>7</sup>. Welfare benefits can be combined with mutual obligations, which increase re-employment opportunities while mitigating work disincentive effects. The underlying rationale for an employment-oriented social policy is that social protection systems can alleviate poverty, but they are insufficient for tackling social exclusion unless they promote labour market integration (OECD, 2005*b*). As discussed in the next chapter, well-designed and targeted social protection — especially when closely co-ordinated with labour market policies — is not a burden on entrepreneurship and employment creation, but rather a critical instrument for more competitive and cohesive societies.

Meanwhile, the financing of social assistance remains a serious problem in many BSEC-CA countries. On the one hand, governments must be careful in designing financing schemes that do not produce unintended effects on optimal functioning of the labour market, for instance by excessively increasing the tax wedge between the cost of labour and workers’ net earnings. On the other hand, financing of social assistance through pension contributions risks jeopardising the financial sustainability of pension systems and can create serious inter-generational equity problems. As discussed in World Bank (2007), despite relatively young populations in most BSEC-CA countries, high unemployment and informal employment result in low contributions to the pension system. Therefore, the high ratios of beneficiaries to contributors are a source of major concern for the region. Today’s contributors might find themselves without pension benefits when they retire. Pension reform is an urgent priority in most countries of the region and it will necessarily have important implications for the overall social protection system.

## PRIVATE REDISTRIBUTION: FACILITATING INTRA-FAMILY OR COMMUNITY SUPPORT

As detailed in the previous chapter, an important coping mechanism has been private redistribution. During the 1990s, this occurred primarily within the extended family or the community. Increasingly in the 21st century, it has been in the form of workers’ remittances. In countries where remittances have become a major source of support for poor families (especially Moldova and Tajikistan, but also for many families in other countries) governments have promoted secure and low-cost means of transferring remittances. In Moldova, a deposit insurance scheme, introduced in 2004, increased trust in placing savings in banks and confidence in formal channels for remittances. Fierce competition among the 16 or so providers of this service to migrant workers, which encouraged use of their services as commissions dropped to between 1.5 and 3 per cent, was the main driver of using formal channels, however. The use of formal channels also depends on host-country institutions; about half of all formal transfers to Moldova are from migrant workers in Italy, where well-established formal channels exist, while migrant workers in the CIS, which has minimal formal channels, are more likely to use informal channels such as transport workers (e.g. train conductors or minibus drivers).

Public policies that develop, complement and extend informal and private institutions can help reduce vulnerability by encouraging flexible, private coping mechanisms, while discouraging those that are fragile or that hinder economic and social mobility. The most effective policies combine transfer systems that are sensitive to both existing mechanisms and new institutions for providing insurance and credit and for generating savings. New institutions to help vulnerable households manage risk include microfinance programmes, which have started all over the BSEC-CA region, often under the tutelage of international organisations. Savings banks and micro-insurance schemes have also been introduced, but not as widely as in South Asia. These programmes can help households to increase their incomes and savings, a key to self-insurance, as well as providing extra cash to help households cope with consumption shocks. Loans can

help households start new businesses that provide income diversification, although when the focus of microfinance projects is mainly on their efficiency, such as repayment within rigid schedules instead of longer-term empowerment, they could add to vulnerability.

## OTHER DOMESTIC POLICIES

This chapter has focused on labour market policies, but almost any economic policy — and many other policies — will have an impact on work and well-being. Macroeconomic, trade and other pro-development policies are crucially important in creating an environment of growing demand for labour, as well as providing access to consumer goods. Tax reforms affect the incentive to work, as well as decisions about whether to work in the formal or informal sector. Simplification of the tax code, as in Ukraine in 1999, has encouraged formalisation of labour markets and small businesses. Pension reforms, social insurance and social assistance allow individuals to mitigate risks and effectively supplement private coping mechanisms by allowing the state to reduce the impact of a negative income shock or persistent low income.

Financial-sector reform is related to work and well-being in several ways. Lack of access to capital has been a significant constraint on start-up enterprises or on the expansion of private enterprises. Financial reform tended to lag in all transition economies, and trust in the financial system was damaged by financial crises. The situation has improved over the last decade, as financial regulation has improved and other reforms shifted demand for financial services. Pension reforms, by changing from pay-as-you-go to contributory schemes in Kazakhstan and the Kyrgyz Republic, increased demand for financial assets. With the expansion of labour migration and the growing importance of remittances, financial reform has also been connected to the channels through which remittances are sent, as noted above. Formality is desirable because formal transfers are deposits in the financial system that can be mobilised for lending for productive investment, apart from the benefit to migrants and their families of more efficient means of transferring remittances,.

Evidence from the European Union, and especially from the Eastern European countries, which acceded in 2004, suggest that labour market institutions play a relatively minor role, compared to other policies and the broader economic environment, in explaining labour market outcomes. High taxes and strict employment protection depress the labour activity rate, while active labour market policies reduce unemployment (Fialová and Schneider, 2007). Eastern European countries' policies have been converging rapidly towards EU norms, and the BSEC-CA pattern is of convergence in a similar direction, albeit at a variable, and generally far slower, pace.

## INTERNATIONAL CO-OPERATION ON LABOUR MIGRATION

As highlighted in previous chapters, inward and outward migration has become a major issue for all countries in the BSEC-CA region, with sizeable effects on labour market dynamics. Within the BSEC-CA region, there are two major circles of migration flows, one directed to Western Europe and the other to the richer CIS countries. Each circle involves international co-operation.

For the EU member states and adjacent countries, the EU regime on migration is critical. Thus, Poland's EU accession in 2004 and the opportunity for Polish workers to move freely to work in booming economies such as Ireland created a demand for migrant labour from lower-wage countries east of Poland. The accession of Bulgaria and Romania in 2007, albeit with transitional restrictions on labour mobility, is having a similar knock-on effect to countries further east.

For countries in the CIS, the opaque legal situation of the 1990s is becoming more transparent in the 2000s as relative economic stability is achieved and the economic benefits of orderly labour

migration are recognised. Before 1992, CIS citizens lived in a common economic space but with strict regulation of internal movement. With the end of central planning and the dissolution of the Soviet Union, almost non-existent border controls and psychological pressures to find a home where people felt ethnically or linguistically comfortable led to large-scale unregulated migration. The 1992 Bishkek Treaty provided the legal framework for visa-free travel within the CIS. In the second half of the 1990s, border management became more rigorous, and as the new nations established stronger notions of citizenship and national identity, the rights of foreign workers within the CIS were often minimal. In some cases, visa requirements were introduced; Turkmenistan withdrew from the Bishkek Treaty and Uzbekistan suspended its operation. Most importantly, Russia rescinded the Bishkek Treaty in 2000.

The 2000 Eurasian Economic Community treaty provided free movement among EurAsEc members. This was implemented by a 2005 agreement on visa free trips among Kazakhstan, the Kyrgyz Republic, Russia, Tajikistan and Belarus. Uzbekistan acceded to EurAsEc at the end of 2005, but this did not prevent the introduction in 2007 of visa requirements for entry into Uzbekistan by citizens of Tajikistan. There are also bilateral agreements to facilitate the movement of people engaged in border trade or of seasonal farm workers. However, the intra-CIS visa situation remains uncertain and changes at short notice are not uncommon. Introduction of more complex documentation rules (such as the migration cards required in Ukraine and Russia) or plans to require biometric passports also inhibit migration, especially from poorer countries. Recognition of the costs of exploitation of unregulated migrants in provoking illegality, social tensions and epidemiological risks has stimulated action by governments and NGOs to protect the migrants' human rights and to penalise unscrupulous employers.

The re-integration of returning migrants into the domestic labour market is becoming a high priority for many countries in the region, as large numbers of emigrants fail to find satisfactory jobs in the destination countries or, in the case of illegal migrants, they are sent back to their country of origin. Several donor-funded projects, often implemented by the IOM, provide re-integration assistance to returning nationals in the BSEC-CA regions, especially in Southern Caucasus. Re-integration assistance is also considered an important instrument to reduce illegal migration. Yet, illegal migrants that are sent back to their country of origin often end up re-emigrating to the same or other countries because they do not find satisfactory earning opportunities at home.

In this respect, an IOM-led initiative in Georgia is unique, as it provides job counselling not only to returning migrants, but also to potential migrants (Box 6.7). Given the lack of job mediation assistance in Georgia, this pilot Centre is also becoming a useful reference for job seekers in general.

### Box 6.7. IOM Job Counselling and Referral Centre in Georgia

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In 2007, with support from the Czech Republic Development Cooperation Programme and the International Polish Aid Programme, the IOM established a Job Counselling and Referral Centre in Tbilisi. The Centre assists both returning migrants and potential migrants, referred through the IOM's Migration Resource Centres, by providing professional orientation assistance and information on existing retraining and employment opportunities. The Centre also conducts labour market surveys to identify the skills required by employers and available training opportunities to match those skills. As of September 2007, surveys had been conducted in four sectors. The project envisages a number of capacity building activities, such as personnel training and methodology provision to the staff of the professional education system of the Ministry of Education and Science.

The Tbilisi Centre is a pilot that should be replicated in other regions in Georgia with high unemployment pressures. In the pilot phase, the Centre will serve at least 50 beneficiaries in searching for or enhancing their job opportunities.

Source: Interview with IOM resident representative (September 2007) and [www.iom.ge](http://www.iom.ge)

## NOTES

1. Detailed information on national labour, social security and related human rights legislations is provided by the ILO's International Labour Standards Department NATLEX database that can be accessed at [www.ilo.org/dyn/natlex/](http://www.ilo.org/dyn/natlex/).
2. See also O'Leary *et al.* (2001) and the European Training Foundation country plans provided in the References for detailed information on TVET programmes in the BSEC and CA countries.
3. According to this study, enrolment rates are extremely low in Albania (15 per cent) and Moldova (22 per cent), while they are comparable to the EU average (64 per cent) in Montenegro (69 per cent), Romania (64 per cent) and Bulgaria (55 per cent). They are higher in Serbia (75 per cent).
4. For instance, in Turkey, despite the emphasis on TVET contained in the national development plans since the 1970s, which envisioned a large vocational and technical component in the secondary school system, general education has been more favoured than TVET programmes and secondary TVET schools are perceived as not providing essential skills for students.
5. It is estimated that in 2006 between four and 5 per cent of the active population received some form of training (Vasile, 2007). The National Strategy regarding Labour Force Employment 2005-10 set a target for 2010 of about 7 per cent of the active population to pursue training courses. Although this is below the 2010 Lisbon Strategy target (12.5 per cent), it represents a large increase with respect to the recent past. In 2005, only 1.5 per cent of the active population was enrolled in training programmes, a marginal increase over 2001 (1.4 per cent).
6. Based on information provided by the Romanian Ministry of Labour, Social Solidarity and Family.
7. While an employment-based social-benefit system awards rights on the basis of an employment record, an employment-oriented system promotes employment opportunities, particularly for those who would otherwise be dependent on benefits. See "Towards an Employment-centred Social Policy", editorial in OECD (1998) for a discussion and "Extending Opportunities: How Active Social Policy can Benefit us All" (OECD, 2005b).



## Conclusions and Policy Recommendations

# CHAPTER SEVEN

The countries of the BSEC-CA region have experienced dramatic economic and social changes over the last two decades. Apart from Greece, Turkey and the workers' self-managed economy of Serbia, they had centrally planned economies 20 years ago. The transition to a market-based economy was accompanied by declining average incomes and widening inequality, both inter- and intra-regionally. The disruption was exacerbated by armed conflicts or secession in much of south-eastern Europe and the CIS. In the 21st century, the economic situation has improved substantially as the main elements of the transition have been completed and economic growth has resumed, in some cases at a very fast rate. Much, however, remains to be done in terms of establishing market-based economies that promote prosperity and economic security. In no area has this been clearer than with respect to work and well-being.

### GLOBALISATION AND POLICY CHOICES

The integration of more countries into the global trading system and the rapid expansion of international production networks are generating more and more opportunities for new specialisations in production – as well as undermining old specialisations. The opportunities for participating in global or regional trade depend critically on actions to reduce the costs by cutting red tape and other unnecessary burdens. For workers to benefit from globalisation, business must seize these opportunities, which means policies that will facilitate innovation and business formation are crucial. As the global economy becomes ever more complex, however, it is more and more difficult to predict where comparative advantage will lie and what policies will work so that all may share the benefits. The OECD countries have a litany of failed attempts to “pick winners”; these experiences can encourage policy makers in emerging market economies to do better through heeding the mistakes and investigating the successes for possible replication. This is especially important in countries whose senior policy makers were trained in the centrally planned economy.

One of the most difficult balancing acts for governments is to foster an open and well-informed public discussion of the benefits and costs of globalisation. All too often, it is easy to see foreign governments, companies or migrant workers as scapegoats for domestic problems. This has been especially harmful in countries whose populations were raised on stories of the evils of capitalism and of multinational corporations, and where popular understanding of the indirect effects of market forces is limited. Promoting independent policy-oriented research on economic issues is one way to improve the debate. OECD countries can also contribute by not conforming to the stereotypes that foster discontent with the international system.

The benefits of economic prosperity must be widely shared to create the best domestic environment for promoting work and well-being. Thus, in crucial respects, those formerly centrally planned economies that prioritise the establishment of well-functioning market-based economies with sound macroeconomic policies and growth-friendly institutions are on the right track. To varying degrees, this remains unfinished business throughout the region; hence, the priorities need to be maintained, bolstered where necessary and fully adopted by those countries that have not yet done so. However, as this *Outlook* has highlighted, despite sustained

economic growth in most of the countries since the turn of the century, many people remain unemployed or without satisfactory and satisfying employment, and there is still nostalgia for pre-reform security.

Although economic growth and the accompanying demand for labour are central to any economic development strategy, creating institutions to match workers and jobs, improving human capital assets and providing for those temporarily or permanently unable to work are crucial policy tasks still facing governments in the region. Much can be learned from the experience of other countries, including OECD members such as Greece or Turkey. However, no policy makers are operating in a vacuum. In particular, the coping mechanisms adopted during the 1990s – with national variations – throughout the region have become embedded in the economic environment. Unwillingness to trust the state's ability to provide a social safety net and other services, the extensive informality, in part to avoid taxes and regulations, criminality and distrust, and large-scale emigration are all elements of the environment created in the years since the collapse of central planning. Only by building up from an understanding of actions already taken by households and communities can public policies maximise their effectiveness and minimise displacing existing mechanisms.

## SUSTAINING REFORMS FOR BETTER JOB CREATION

A meaningful policy strategy for creating more and better jobs and reducing unemployment must tackle both the supply side and the demand side of the labour market. Hence, governments must ensure that macroeconomic and structural policies are conducive to promoting strong employment growth. Macroeconomic stability, as reflected in low inflation and sound budget balances, can boost job creation through lower real interest rates and smaller fluctuations in economic activity, as well as increase investors' confidence by stabilising inflation expectations. Evidence from OECD countries suggests that reform in labour and product markets plays an important role in stimulating productivity growth and sustaining job creation (OECD, 2006<sup>1</sup>). Regulatory reform and in particular the easing of barriers to the entry and growth of new firms, including through FDI and foreign trade, had a strong impact on labour market performance in OECD countries. World Bank (2005a) shows that a wide range of structural policies improving the ease of doing business can facilitate the ability of enterprises to adjust to market changes and enhance job opportunities in Eastern Europe and Central Asia. As highlighted in the first Part of this book, BSEC-CA countries are heterogeneous in terms of their size, resource endowments and macroeconomic performance. Macroeconomic stability, open markets and efficient governments are common recommendations for promoting growth and job creations, but each country faces specific challenges related to its specific structural characteristics. Oil- and gas-rich countries, such as Azerbaijan, Russia, Kazakhstan, Turkmenistan and Uzbekistan, enjoy buoyant foreign exchange revenues thanks to booming commodity prices and strong GDP growth. These countries face the challenge of diversifying their sources of growth and managing large capital inflows. The resource boom is both an opportunity and a challenge for employment creation. Export revenues and capital inflows must be carefully managed to avoid perverse effects on inflation and exchange rate appreciation affecting the competitiveness of the tradable, non-extractive sector. Transparency in the amount and allocation of commodity-related revenues is fundamental to avoid rent-seeking behaviour. Governments should not use such revenues as an excuse for delaying much needed restructuring, especially in the state-owned sector.

**134** Non-resource rich countries face different, but still delicate challenges. Several BSEC-CA countries have seen large shares of their populations migrate. They include Albania, Armenia, Kyrgyzstan, Moldova, Serbia and Tajikistan. Emigration can relieve some pressure on unemployment and underemployment in domestic labour markets. Migrants furthermore provide sizeable remittances to finance needed consumption and investment back home. However, emigration can also contribute to depleting the stock of skilled people – teachers, doctors, engineers – who might otherwise contribute to the development of their home countries. These countries thus face a double challenge. In order to maximise the development impact of remittances, they must



promote financial-market intermediation and work to lower transfer costs. To mitigate the effects of the brain drain, they must create more opportunities and incentives for potential migrants to remain at home, to return home if they have already emigrated, or to be more engaged in their home countries' development even if they do not return (e.g. via remittances, investment, knowledge transfer, networking).

Countries with more diversified economies, such as Bulgaria, Romania and Ukraine, have fared quite well over the recent years, especially in attracting FDI, which has contributed to job creation in both manufacturing and service sectors. Improvements in their fundamentals and the prospects of EU accession for Bulgaria and Romania played an important role. However, informality and unemployment remain high. Sustaining the recent economic performance will require implementation of structural reforms and improvements in legal and regulatory frameworks.

The EU accession process has created a strong momentum in Bulgaria and Romania to pursue structural reforms in recent years. Recent studies conducted at the World Bank applying the OECD methodology to benchmark regulatory reform in product markets suggest that both countries have made significant steps forward. Romania has rapidly approved several reforms in the area of product market regulation, but implementation and enforcement seem to lag behind schedule (Fay *et al.*, 2007a)<sup>2</sup>. Bulgaria also made progress, especially in terms of regulation concerning international trade and FDI. However, the country has much room for improvement in terms of state control of the economy and barriers to entrepreneurship (Fay *et al.*, 2007b). For both countries, the challenge is to sustain the reform momentum, to favour entrepreneurship and improve efficiency in regulated service sectors, which can have significant impact on total factor productivity, growth and job creation.

As far as Ukraine is concerned, the 2007 OECD *Economic Assessment* (OECD, 2007c) highlights some major challenges for accelerating growth and job creation. It has experienced an impressive recovery since the early 2000s. Sustaining such a growth path will require raising private investment considerably and facilitating a profound modernisation of the industrial sector. The OECD study finds that barriers to growth remain significant. In particular, poor framework conditions for business constitute a major obstacle to increasing the level and efficiency of investment, while barriers to firms' entry and exit are still substantial. The implementation of competition-friendly regulatory reforms will require a government-wide strategy and better co-ordination.

## ACTIVE LABOUR MARKET POLICIES

Well-targeted active labour market policies (ALMPs) can be an effective instrument to tackle structural unemployment and improving the employment prospects of poorly qualified job seekers, disadvantaged workers and the long-term unemployed (OECD, 2005c). Therefore, activation programmes can help achieve both economic and equity objectives, by promoting greater equality of opportunities in the labour market. However, these policies may entail significant costs; hence, their effectiveness must be carefully assessed.

Within the region, a wide range of ALMPs is being pursued in recent years, although in most countries, and especially in lower income ones, ALMPs are still in their infancy. Information is scattered in terms of their scope, the resources allocated and the number of beneficiaries. Evaluations of results on the employability of beneficiaries are very rare, as monitoring and evaluation are not conducted on a regular basis and, more often, not conducted at all. This problem is not limited to the BSEC-CA region, as lack of proper evaluation is observed in many countries with far more developed ALMPs. Given the high incidence of informal or undeclared employment in many BSEC-CA countries, ALMPs that target mainly registered unemployed, as do most of them in the region, are likely to miss out a significant share of the labour force. Programme design should pay due attention to ensuring broader coverage, including in the

informal sector. Improving the reach of job-mediation services could decrease the incentive for the unemployed to seek job opportunities abroad. Decentralising the design and implementation of TVET programmes by region or by industry can also be an important source of dynamism, creativity and initiative that is highly responsive to local demand and changing local needs. By mobilising all stakeholders (enterprises, local leaders, employers, workers, training providers, educators, academics and associations), it can help to exploit fully the community's private and public training resources and make the whole system more demand-driven (ILO, 1999).

Judging from the experience of the OECD countries, the focus should be on well-designed job mediation services and investment in human capital; public works projects are less likely to have a lasting impact. One of the most serious problems that BSEC-CA countries face is that their human capital may be deteriorating as children fail to complete secondary school, and school and university systems have been allowed to atrophy. The top priority should be to provide educational opportunities and basic healthcare so that all children complete secondary school, or at a very minimum primary school. Policies that provide vocational training and counselling to match unemployed workers with job vacancies can also help, although the design of the training schemes is critical. In particular, training programmes must clearly target participants and establish strong links with employers to include an on-the-job component (Martin and Grubb, 2001). More generally, policies to promote employability should be based on an accurate assessment of the job seeker's individual needs. Wage subsidies aimed at reducing labour costs can also be used to enhance labour demand for disadvantaged groups (e.g. unskilled workers or workers with disabilities). However, their effectiveness hinges upon close targeting and complementary training for beneficiaries. In addition, interventions that support employment in the private sector lead to better integration into the world of work than direct job creation in the public sector does (OECD, 2003).

The long experience of OECD countries with respect to ALMPs can provide useful insights for the BSEC-CA countries as they move towards adopting a broader range of policy instruments to enhance the job opportunities of their populations. Available programme evaluations, mainly referring to higher-income countries, point to several ingredients that contribute to make these programmes more effective (Martin and Grubb, 2001; OECD, 1993 and 2005; Carcillo and Grubb, 2006). Six main lessons can be drawn from these comparative studies:

- Programmes with precise targeting seem to yield better results than broadly targeted programmes, since they often involve a more careful assessment of the beneficiaries' specific needs.
- Job-search assistance strategies have a large impact in terms of subsequent job prospects of the unemployed and their cost is relatively low.
- Long-term programmes, such as vocational training, tend to achieve positive results, but only after some years and usually involve higher costs. Evidence for other long-term programmes, such as job-creation ones, is less clear-cut.
- Mixed strategies that combine job search and participation in training and other long-term programmes seem to be most promising. At the same time, governments should avoid setting up an unmanageable panoply of programmes, which can be difficult to administer and may confuse the firms and unemployed that they aim to support.
- ALMPs should be designed and managed in tandem with passive labour market policies. Unemployment and other welfare benefits can exert a significant impact on wage setting and on the motivations of the unemployed to seek new job opportunities. Therefore, to maximise impacts, the agencies in charge of job placement, benefit payments and participation in active programmes should work in close co-ordination. For instance, significant evidence suggests that job-search assistance should be a mandatory component of the unemployment benefits system.

Programme design should include a regular monitoring and evaluation component aimed at measuring the impact on individuals' employment and earning outcomes over a relevant time span after their participation in the programme. Evaluations can be costly, but can significantly contribute to improve policies.

In sum, ALMPs can be effective instruments in the overall strategy to promote employment. At the same time, they cannot solve all labour market problems, and their impact is greatest where labour markets function well (OECD, 2003). The design of ALMPs should be carefully co-ordinated with passive labour market and social policies to minimise possible distortions and ensure they all contribute to increasing employment rates.

## EMPLOYMENT-ORIENTED SOCIAL POLICIES AND TARGETED ASSISTANCE

One of the strengths of the Communist system was the universal provision of benefits, but this is an unsustainable legacy in a market-based economy. In an effort to make social assistance more effective and equitable, all of the transition economies have moved towards targeting of social assistance, and some of the BSEC-CA countries have been relatively successful, e.g. Armenia, the Kyrgyz Republic, Bulgaria and Romania, and more recently Georgia. Unemployment benefits are common in the BSEC-CA countries, but their coverage is limited and eligibility is conditional, usually on having an employment or contribution record. As documented in Chapter Three, many countries in the BSEC-CA region are confronted with declining employment rates, as a large share of their working-age population remains outside the labour force or seeks income opportunities in the informal sector. In all of the countries, there are concerns about the duration of unemployment, and the growing share of youth unemployment. This situation calls for well-targeted active policies to increase the employability of job seekers.

Meanwhile, the experience of several OECD countries suggests that an employment-oriented or active social policy that aims to promote integration of the beneficiaries into the labour market can be effective in tackling social exclusion and poverty. Comprehensive social insurance benefits can contribute to raising participation rates in the labour force, particularly of women and disadvantaged groups, and help job seekers withstand the consequences of layoffs and structural adjustment, while also having potentially significant effects on productivity (OECD, 2001*b* and 2005*b*). However, where poorly designed, welfare transfers can create distortions in the labour market, reduce incentives to actively seek employment and become unsustainable.

Unemployment benefits are a good example of such a trade-off. Such benefits can play an important insurance role to cushion income and consumption losses following layoffs and allow the unemployed more time to find a better job. The design and administration of these insurance schemes is crucial, as loose unemployment benefits systems can create distortions and reduce the job-search intensity of the unemployed. This is especially the case when entitlements are of long or indefinite duration and not combined with work availability conditions and measures for activation. However, the risks associated to the provision of unemployment benefits can be minimised when these benefits are co-ordinated with other labour market policies and programmes, such as ALMPs (OECD, 2006).

Early retirement schemes can mitigate the cost of enterprise restructuring for workers close to retirement age. However, these schemes have proven to be very costly. The priority should be to favour re-insertion of redundant workers into the labour market through re-training programmes and targeted social assistance. Finally, pension reform can also help the elderly to retire with a reasonable living standard, without imposing too heavy a burden on the current working generation. This is one of the most difficult reform areas owing to its widespread macro-economic, social and equity implications. Governments face trade-offs between the need to increase minimum pensions and the imperative to avoid a deterioration of the fiscal position of the pension fund. To address the current situation in the region, it is important to stress that more sustainable and equitable pension systems require: *i*) better alignment of benefits to contributions; *ii*) broadening of the pool of contributors; and *iii*) separation between the pension and social protection systems.

Vulnerable sectors of the population should have access to protection through targeted social assistance programmes, but these should be financed through the budget, and not through the pension system. As suggested above, activation policies and employment-oriented social policies can contribute to expanding the range of contributors by promoting formalisation and higher employment rates, as well as increasing workers' productivity. Since social insurance is generally covered through taxes on labour, reduced unemployment and increased employment would raise funding for social assistance programmes.

Governments should also be very careful in designing non-distortionary tax instruments to finance social assistance, ensuring that they do not excessively increase the tax wedge between total labour costs and the net workers' earnings<sup>3</sup>. The negative employment effects of the tax wedge appear to be especially strong for low-paid employment, notably in the presence of a binding minimum wage. Making funding systems more progressive may help alleviate the adverse employment effect of the tax wedge (OECD, 2007d).

## PROMOTING FORMALISATION

Another precondition for effective labour market (and other) policies is to encourage formalisation. All workers should be covered by workers' rights legislation. In many BSEC-CA countries, labour market policies define employers' and employees' rights and obligations, but there is a gap between legislation and enforcement, which means that the laws fail to benefit everybody. The key is to encourage formality by showing that benefits accrue to both employers and employees without incurring unreasonable and unnecessary costs.

International evidence indicates that better enforcement of labour market legislation and policies may increase demand for formal-sector employment and reduce informality, although unemployment may increase temporarily as workers seek formal employment. The Labour Inspection Unit created in Armenia in 2006 is a promising example of how to achieve reasonable compliance rates. Nevertheless, poor governance can lead to corrupt enforcement. Turkey's 2007-08 programme to increase formalisation illustrates the range of measures that can be promoted to discourage informality and increase formality (see Chapter Six).

High levels of informal employment can be a serious obstacle to effective implementation of social and labour market policies, since a large share of workers is *de facto* outside the reach of those policies. The design of social policies and labour-market programmes should consider this reality. These policies should be reviewed regularly to improve their effectiveness as informal activities are regularised. Well-designed employment-protection legislation can contribute to efficient labour reallocation, if it does not defend activities that have become uncompetitive. For example, moderate advance-notice requirements and severance pay can be structured to avoid penalising voluntary mobility. Unemployment insurance can help workers to mitigate risk, although such programmes presume that unemployment is frictional or short-term rather than the long-term unemployment that is prevalent in many of the BSEC-CA countries. Relative wages must be able to adjust to changing market conditions. Reforms in other areas, such as housing and transport, can facilitate labour mobility.

Regularising informal activity requires a multi-pronged strategy, relying on policy instruments that are adapted to the characteristics of the national economy and of its informal sector, as well as to the specific aspects of informal employment that are to be tackled. There is no "one-size fits all" remedy. Meanwhile, the experience of OECD countries points to some important ingredients of such a strategy for reducing the negative consequences of informality (OECD, 2004).

The first ingredient of such a strategy has to do with effective governance. Governments should promote effective legal frameworks for transactions in the formal sector, ensure adequate pay for civil servants and strengthen the administrative capacity of central governments, especially of the tax administration services. Second, authorities should seek a balance between the need of labour regulation and the possible unintended effects on tax compliance and informal

employment. The objective should be to devise better-quality employment regulation that promotes tax-collection but with low-compliance costs. Enforcement measures should be complemented by appropriate and cost-effective economic incentives for the declaration of work. Third, tax administrations should move towards a taxation of profits that is based on a value-added system to provide an incentive to business owners to maximise declared wages and salaries. Fourth, policies must be realistic. Effective implementation requires a careful assessment of informality and of its causes; results are unlikely to materialise overnight, but achievements can be jeopardised if policy implementation is inconsistent, provides mixed signals and fails to change agents' expectations and behaviours.

Meanwhile, any attempt to promote formalisation should acknowledge that many people working informally have no other choice and often move in and out from the shadow economy or even combine formal and informal jobs. Stigmatising informality and tax evasion can do little for the workers and entrepreneurs engaged in informality. Those in the informal sector are unlikely to "emerge" and firmly join the formal sector overnight. Policies need to encourage the rights to decent employment for everyone. Efforts to promote formalisation should be accompanied by policy measures to minimise the worst consequences of informality, to broaden access to social and employment protection, and to exploit the use of informal insurance mechanisms as a social safety net. Informality can be a source of flexibility, especially for micro and small enterprises. Informality, can, however, become a serious impediment to growth for the most successful ones. As they grow larger, enterprises will need the legal and regulatory infrastructure that only the formal sector can offer. An efficient government and a business-friendly regulatory environment is then a major incentive for formalisation.

## MIGRATION, REMITTANCES AND MIGRANT WORKERS' RIGHTS

Throughout the BSEC-CA countries, policies that promote the rights of migrant workers and aid the channelling of remittances are required. Addressing the rights of migrant workers can improve relations between the host community and migrants, and can increase migrants' representation in the formal labour market. Policies should facilitate the secure and low-cost transfer of remittances, preferably encouraging their passage through the formal financial system, and encourage investment in productive enterprises.

Co-operation between source, transit and destination countries should be enhanced in order to achieve orderly migration within the region and from the region, as well as to promote the development potential of migration. The selectivity of some receiving countries' immigration schemes causes a brain drain in certain BSEC-CA countries. Policies and measures to combat brain drain in BSEC-CA countries should be explored. Such policies include circular migration schemes, which encourage "brain circulation" and can potentially reverse the trend to "brain gain". Countries of destination might make an important contribution to promoting the migration-development nexus by undertaking co-financing initiatives for micro projects of returned migrants.

Women and girls can constitute a vulnerable sub-group of migrants, often confined to less well paid, and less desirable, gender-defined jobs. Trauma caused by trafficking and exploitation as well as separation from children and families needs to be addressed. Home and receiving countries need to adopt policies (jointly and at national level) that address issues of discrimination and exploitation of migrant women and girls. Specific provisions should be made for the victims of trafficking and organised crime in close co-operation between all stakeholders.

Children and youth constitute another vulnerable group of migrants. Policies should be adopted by countries of origin and destination with a view to protecting minors and youth directly or indirectly affected by the migratory process.

## INVESTMENT IN STATISTICS

The data collected in this book highlights the mixed standards of statistical collection in the region. Definitions vary and collection standards are inconsistent. In many countries, especially newly independent states, creation of an effective national statistical office was understandably a low priority. However, good data are essential for evidence-based policy decisions.

A related issue is the need to regularise the definition and application of the notion of unemployment. Definitions which exclude, for example, landowners, however impoverished, or those in the informal sector from being defined or registered as “unemployed” hinder their access to social programmes targeted only to those officially unemployed. Policies that widen the access to active labour market policies such as vocational training schemes or subsidised employment will enhance human capital and improve access to the formal labour market.

The quality of data and statistical capacities vary greatly across the BSEC-CA countries. Even in countries where statistical information is collected on a regular basis and in accordance with internationally agreed standards, problems of access to data and co-ordination among government agencies are observed. Migration statistics are a case in point. Lack of co-ordination between relevant national agencies is part of the problem. Better co-operation between sending and receiving countries is also needed.

Targeted support from international organisations and donors to strengthen data collection and dissemination remains very important. The Statistical Office of the European Communities (Eurostat), the ILO, the IOM and the UNECE are implementing capacity development programmes in several BSEC-CA countries in the field of labour and social indicators<sup>4</sup>. These efforts should be developed further and could benefit from advances being made in the OECD Global Project on “Measuring the Progress of Societies”, in which the OECD is working with other international organisations and partners to develop a new approach to measuring how societies are changing by using high quality, reliable statistics to assess progress in a range of areas affecting citizens’ quality of life<sup>5</sup>. This is a global effort to find better measurements of progress that consider the multidimensional features of societal well-being.

## CONCLUSIONS

Despite their specific features, the countries of the BSEC-CA region face many common challenges in promoting work and well-being for their populations. Addressing these challenges will require sustaining regulatory reform and sound macroeconomic policies, while improving the design of labour market and social policies. As this *BSEC-CA Economic Outlook* has highlighted, there are successful reform experiences across the two regions. Strengthened regional co-operation within each region can contribute to building a larger and more efficient market and create new growth opportunities. Regional co-operation can also promote a continuous exchange of experiences and mutual learning on policy reform, to allow each country to cope with the opportunities and adjustment challenges that open markets create.

## NOTES

1. The OECD has developed a range of indicators of product market regulation at both the economy-wide and sectoral levels. All of these indicators measure the extent to which policy settings promote or inhibit competition in areas of the product market where competition is viable. The methodology and country specific information are available data at [www.oecd.org/eco/pmr](http://www.oecd.org/eco/pmr).
2. Pauna *et al.* (2007) note that “interviews with business associations suggest a significant gap between officially adopted policies, on the one hand, and implementation and enforcement, on the other. ... The lack of a greater effort in terms of implementation and enforcement would substantially reduce the impact of the policies adopted in recent years that could hurt the competitiveness of the Romanian economy in the longer run”.
3. The extent to which a higher tax wedge has an impact on employment depends crucially on three factors: *i*) the “progressivity” of funding systems; *ii*) the link between what is paid and expected benefits; and *iii*) how labour taxation affects wage claims and replacement incomes (see OECD, 2007).
4. For instance, the ILO has contributed to the development or redesign of labour force surveys in several countries, including Azerbaijan, Georgia, Moldova, Turkey and Ukraine, and the design of informal sector surveys in Georgia and Turkey. In co-operation with OSCE, IOM and ILO, UNECE is leading a capacity-building programme on Improving International Labour and Environment-Related Migration Statistics in member countries of the UN Special Programme for Economies of Central Asia (SPECA) with a special emphasis on population, health and the non-observed economy.
5. Information on the project and relevant documents, including the Istanbul Declaration of the OECD “World Forum on Statistics, Knowledge and Policy,” held in Istanbul on 27-30 June 2007, can be found at [www.oecd.org/oecdworldforum](http://www.oecd.org/oecdworldforum).





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# Black Sea and Central Asia

## PROMOTING WORK AND WELL-BEING

The Black Sea and Central Asian regions are fascinating because of their political, cultural and economic diversity. With the exception of OECD members Greece and Turkey, all the countries in this region are emerging from transition from the centrally-planned economies of the Soviet era into market-based societies. This transition has created opportunities for development, but has also introduced new problems and fresh challenges for governments and society. Issues such as migration, gender relations, social protection, job creation and ethnic relations need to be tackled, and ways to consolidate development, while not excluding sectors of society, need to be found.

This book addresses some of these challenges. It analyses the opportunities and conditions of employment throughout the Black Sea region and Central Asia. It examines how different countries deal with social issues affecting well-being. It presents, thus, both a country-based view and a whole-region analysis that will be useful for policy makers and civil society in responding to the challenges ahead.

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