# Activation and Smart Safety Nets in FYR Macedonia: Constraints in Beneficiary Profile, Benefit Design, and Institutional Capacity

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This study is part of the Western Balkans Activation and Smart Safety Nets analytical and advisory services. It was completed by a World Bank team led by Boryana Gotcheva and Aylin Isik-Dikmelik, and including also Matteo Morgandi, Victoria Strokova, Tomas Damerau, Bojana Naceva, Zlatko Nikoloski, and Nikica Mojsoska-Blazevski.

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# Abbreviations

| | |
|---|---|
| AETR | Average Effective Tax Rate |
| ALMPs | Active Labor Market Programs |
| AW | Average Wage |
| BEEPS | Business Environment and Enterprise Performance Survey |
| CCT | Conditional Cash Transfer |
| EA | Employment Agency |
| EBRD | European Bank for Reconstruction and Development |
| ECA | Europe and Central Asia |
| EOs | Employment Offices |
| EU | European Union |
| EUR | Euro |
| FDI | Foreign Direct Investment |
| FYR Macedonia | Former Yugoslav Republic of Macedonia |
| GDP | Gross Domestic Product |
| HBS | Household Budget Survey |
| IAP | Individual Action Plan |
| IMF | International Monetary Fund |
| LCA | Latent Class Analysis |
| LFS | Labor Force Survey |
| LITS | Life in Transition Survey |
| LRSA | Last Resort Social Assistance |
| METR | Marginal Effective Tax Rate |
| MF | Ministry of Finance |
| MIS | Management Information System |
| MLSP | Ministry of Labor and Social Policy |
| MKD | Macedonian Denar (national currency) |
| MW | Minimum Wage |
| OECD | Organization for Economic Cooperation and Development |
| PEA | Private Employment Agency |
| PFA | Permanent Financial Assistance |
| PTR | Participation Tax Rate |
| PWPs | Public Work Programs |
| SA | Social Assistance |
| SFA | Social Financial Assistance |
| SSN | Social Safety Net |
| SWC | Social Work Center |
| TIMSS | Trends in International Mathematics and Science Study |
| TWA | Temporary Work Agency |
| USD | United States Dollar |
| VT | Vocational Training |

# 1. Introduction

**Most countries of the Western Balkans are gradually shifting from first to second generation social safety net (SSN) reforms.** As countries of the Western Balkans are moving up the income tree, there is a need and political will to finalize the first generation SSN reforms (such as reducing benefit fragmentation, improving targeting and coverage, and establishing unified registries) and to move toward a second generation of SSN reforms. The second-generation reforms entail creation of "smart" safety net programs that *inter alia* focus on decreasing dependency on welfare among those who are able to work and promoting their employability with a combination of incentive-based cash transfers and services. In other words, this process could be described as moving beyond "how to get the right people into safety net programs" and toward "how to 'activate' and help beneficiaries graduate from poverty and eventually dependence on transfers." In this context, activation is a combination of policy tools that supports and incentivizes job searching and job finding as a way to increase productive participation in society and self-sufficiency.

## 1.1 Motivation of the Note

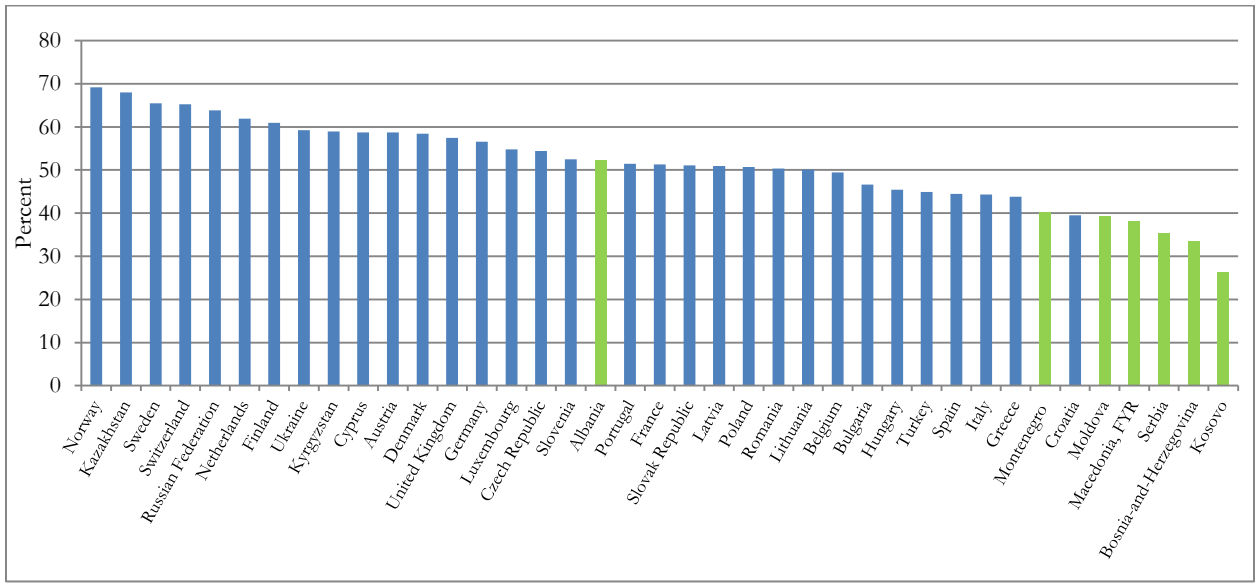
**The pressures to reform social assistance to promote activation are especially acute in the Former Yugoslav Republic of Macedonia and stem from high unemployment, a lower labor activity rate particularly among social assistance beneficiaries, and demographic challenges**. The employment rate in FYR Macedonia is among the lowest in Europe (figure 1). The labor force participation rate is modest at best (with only about half of the population aged 15+ active), but it is comparable to the labor force participation rates of the other countries in the region. In addition, FYR Macedonia is facing some serious demographic challenges: the share of the younger population is shrinking and it is lower than the shares of young population in the other countries of the region. This clearly will have an impact on the size of the future labor force and the contribution-based social protection system. Finally, all of these issues have been exacerbated by the impact of the global economic recession. Although FYR Macedonia was not significantly affected (ironically, because the crisis transmission mechanisms such as banking sector exposure and foreign direct investment inflows were rather weak or absent), the crisis recovery has been rather sluggish.[1] The unfavorable macroeconomic climate has had a significant effect on fiscal balance, which has been consistently worsening since the mid-2000s. All of this has given further impetus for embarking on a comprehensive second-generation social assistance program reform.

**In the aftermath of the economic and financial crisis, FYR Macedonia is introducing behavioral conditions for receiving social assistance in an effort to incentivize active behavior in the labor market and to promote building of human capital.** This note aims to

[1] The recovery has been further burdened by the Euro Area debt crisis.

inform about recent trends and developments in international activation practices and provide analytical underpinnings for informed decisions on reform options.

*Figure 1: Employment Rates in the Western Balkans and Other European Countries, 2011-2012*




*Sources:* ILO KILM online database; MONSTAT (for Montenegro); Kosovo LFS data 2009.

## 1.2 Objectives

**Although the activation policy reforms are fairly new (especially in the context of the transition countries), the extant knowledge from high-income countries offers invaluable lessons in providing good design of such reforms.** As evidenced by the ongoing research in the Organization for Economic Co-operation and Development (OECD) countries, a well-designed activation policy is based on good understanding of target clients' profile, and ultimately it encompasses assessment of benefit adequacy and rationale for receipt. Furthermore, as this country note argues, evidence from high-income countries (such as the United States) suggests that activation policy often reflects a trade-off between competing goals—for instance, financial incentives, work requirements, and time limits, on one hand, and low welfare use, increasing employment, and rising income, on the other. Although FYR Macedonia has made strides in pushing ahead with the second generation of reforms—for example, by introducing behavioral conditions and decreasing the benefit schedule of its last resort social assistance (LRSA) program, Social Financial Assistance (SFA)—significant gaps remain. This country note thus contributes to further understanding of the issue of activation in a few crucially important ways:

- It reveals the main characteristics of the social assistance beneficiaries compared with the general population and tries to assess to what extent beneficiaries can be activated and with which policies and measures.

- It pinpoints the challenges of possible activation policies (stemming from both institutional bottlenecks and disincentives inherent to policy design) while also offering (a) valuable examples from comparator countries and (b) relevant policy steps.

- It specifically analyzes the enabling conditions for activation in the context of FYR Macedonia by looking at the extant active labor market programs (ALMPs), their targeting and coverage, their cost-effectiveness, and, ultimately, their impact and relevance. Within this goal, it also assesses the work of the employment service offices and their ongoing cooperation with the Social Work Centers (SWC).

**Promoting activation policies should not be seen in a vacuum, but rather in the context of FYR Macedonia's desire to align its social protection system with those of the European Union (EU) member states.** Moreover, the activation policies closely correspond to the new strategic guidelines of the European Commission set in "Europe 2020: A European Strategy for Smart, Sustainable and Inclusive Growth" (EC 2010)—emphasizing the inclusive growth that would follow from modernizing and strengthening employment, education and training policies, and social protection systems. In the context of the Western Balkans, the Europe 2020 strategy calls for development and implementation of policies to support access to employment, education, and training for all those distant from the labor market and those who receive social welfare payments, as well as for increased awareness that the groups most distant from the labor market require specific and often more intensive assistance to achieve employability. FYR Macedonia's most recent efforts to improve the effectiveness of ALMPs should be seen as a step in this direction.

## 1.3 Scope of Work and Methodology

**While analyzing the extent of activation policies in FYR Macedonia, this note answers a few important questions.** Specifically, its aim is fourfold:

- *To profile social assistance recipients* in order to identify the segment that could be activated in the labor market. This section (Section 2) will encompass subsections on macro profiling and micro profiling, including latent class analysis as well as highlights of international best practices for activation of able-bodied and "activable" recipients of social assistance.[2]

- *To identify incentives and disincentives* in the SFA benefit design as well as financial work incentives and disincentives stemming from the interaction of benefit design with the tax system.

- *To assess the institutional readiness* for implementing cost-effective activation policies, including (a) the coordination between the agencies in charge of activation policies; (b) the capacity of employment services and Social Work Centers (SWCs); (c) the available mix of activation policies and ALMPs; and (d) ALMPs' financing.

[2] "Activable" recipients are those who could potentially be required to work in exchange for social assistance.

- *To devise policy steps* based on the understanding of the social assistance beneficiary profile, the incentives and disincentives in SFA design, and the institutional strengths and weaknesses.

**The findings in this note rely on both quantitative and qualitative analysis.** First, in identifying the "activable" recipients of social assistance, the note draws on administrative data to analyze the scope of social assistance in the country and its coverage and financing as well as on household budget survey (HBS) data to analyze the performance of the SFA, including targeting accuracy, coverage, and adequacy. Moreover, in addition to basic descriptive statistics, the note uses advanced econometric techniques—including latent class analysis to ascertain which segments of the social assistance recipients are truly "activable." A well-established methodology using the OECD tax-benefit model for FYR Macedonia was used to calculate indicators of financial work incentives. The analysis of the institutional capacity relied on (a) extensive desk reviews of legislative acts and internal instructions regulating institutional roles in design, implementation, financing, eligibility restrictions, and links to services and associated rights; and on (b) structured field interviews[3] with staff working at different levels of the design and implementation of employment and social welfare policies. Previous World Bank analytical work in the context of FYR Macedonia (as well as in the rest of the region) (World Bank 2011) provided further basis and background to this note, as did two extensive background papers on the overview of social assistance programs in FYR Macedonia (World Bank 2012a), and on institutional arrangements for activation (World Bank 2012b). Finally, a literature review concerning activation of able-bodied social assistance recipients provided comparative perspective (especially in the context of benchmarking) to the issue of activation.

**This rest of the note is organized as follows**. *Section 2* presents the profile of the social assistance beneficiaries in FYR Macedonia. *Section 3* provides an overview of the main social benefits in the country for which the work-able are eligible and, against this background, describes the work incentives and work disincentives connected with the benefit design and the design of the tax-benefit system. *Section 4* discusses the institutional setup for activation, focusing on the ongoing ALMPs and their financing, the capacity of the employment services and the social welfare institutions, and the coordination mechanisms between them. *Section 5* provides conclusions and policy recommendations that follow from the analysis.

[3] Field interviews were held with both the local offices of the Agency for Employment and the SWC in the cities of Kumanovo, Skopje and Veles.

# 2. Profiling of Social Assistance Beneficiaries in FYR Macedonia

This section is dedicated to a labor market profile of SSN beneficiaries that can shed light on the constraints to productive employment and on the appropriate activation policies. The first part provides the framework for understanding labor market outcomes and an operational definition of work-able—the manin clients of activation policies. Using HBS data the section identifies the share of SSN beneficiaries who can work compared with the general population in FYR Macedonia. The final part discusses the employment barriers and activation options for specific groups of SSN beneficiaries, identified with advanced cluster analysis techniques. The profiling reveals that SNN beneficiaries have worse labor market outcomes due to multiple barriers (limited education and work experience, higher caretaking duties etc.) but they constitute a small share of the overall work-able indicating the need for a broader perspective on activation. Identifying the characteristics/barriers to employment of all inactive/unemployed is crucial for tailoring the right mix of activation policies and services.

## 2.1 A Framework to Understand Labor Market Outcomes for Safety Net Beneficiaries

**Three main types of barriers could prevent SSN beneficiaries from participating in gainful employment: employability constraints, participation constraints, and benefit-related disincentives.** Many are the reasons that could explain nonparticipation in the labor force or prolonged unemployment spells among the working-age population—in particular among SSN beneficiaries. Figure 2 illustrates the organizing framework used in this study to analyze constraints to employment in a systematic manner:

- *Employability constraints.* People may be out of work because their existing level of human capital, such as their education, skills, or experience, does not meet the requirements of the labor market.

- *Participation constraints.* A person may be potentially work-able but facing nonmarket constraints to joining the labor force. These include, for instance, caretaking duties in the household, lack of transportation to the work place, or lack of information about job opportunities.

- *Benefit disincentives.* In addition to these two typologies of constraints—which apply to the entire labor force—the design of social assistance benefits (and their interaction with the tax system) may be an additional factor discouraging SSN beneficiaries (who would otherwise be working) from taking up employment.

*Figure 2: Analytical Framework of Constraints to Employment of Safety Net Beneficiaries*


**These barriers are interrelated.** The ultimate labor force participation outcome of each individual results from the combination of these factors, which are strongly interrelated but also particularly difficult to identify. In classical labor supply models (Heckman 1979; Blundell and MaCurdy 1999; Killingsworth and Heckman 1986), the expected market wage of an individual (which relates to employability) affects the decision to participate in the labor force. For individuals whose leisure time is particularly valuable, supplying labor to the market at a low wage may be prohibitive. For instance, this is the case for low-educated women with children, whose labor income may not be sufficient to compensate for the cost of performing time-consuming but essential household tasks, such as taking care of children. In addition, social transfers may reduce labor supply, not only because—like any other unearned income—they may reduce the valuation of work over leisure, but also because the design of benefits may constitute an effective tax on earnings, especially among workers with low wage potential.

**Only rigorous impact evaluations or natural experiments have been able to identify the effect played by some of these factors**. In the case of social transfers, the existing studies relate to OECD countries; overall, they do find some evidence that welfare programs create work disincentives, especially among women with children and low-income earners, driven by the design of tax and benefits (Gruber 1996; Moffitt 1992; Hoynes 1993; Blundell 2000). On the other hand, the emerging literature on SSNs and labor supply in developing countries (Skoufias and Di Maro 2006; Ardington, Case, and Hosegood 2007) fails to find significant work disincentives, possibly because the generosity, the design of benefits, and the labor market conditions all differ strongly from the OECD context (Charlot, Malherbet, and Ulus 2013). Where countries in the Western Balkans stand in this respect has not yet been proven empirically, and the profiling exercise presented in this chapter can be a first step to build such evidence. In addition, Section 3 will model theoretically the potential work disincentives arising from the design of tax and SSN systems in FYR Macedonia.

## 2.2 Labor Market Profile of Social Safety Net Beneficiaries

**The labor market profiling of SSN beneficiaries can shed light on the constraints to labor force participation and on the appropriate activation policies.** The first part of this section will provide an operational definition of work-able population—the main client of activation policies. Using HBS data, it will then illustrate the share of SSN beneficiaries who are work-able compared with the general population. The second part of the section will describe the work-able population and highlight, to the extent possible, the constraints to participating in productive employment that they may be facing. Finally, the section will present a synthetic profile of different groups of SSN beneficiaries, who share similar labor market challenges, through an advanced profiling technique (latent class analysis). (See box 1 for a discussion of the HBS data source in this note.)

***Box 1: Data Source: Macedonia Household Budget Survey (HBS) 2009***

The current analysis relies largely on HBS data. This is the only nationally representative dataset that enables identification of households that benefit from various social safety nets as part of their income. The HBS contains also several basic employment variables, which are used to identify the labor market profile of SSN beneficiaries. The HBS employment statistics, however, are not directly comparable with official data derived from the labor force survey (LFS), for two main reasons: First, the samples of the two surveys differ (one aiming at being representative of households in Macedonia, the other one aiming at being representative of the labor force). Second, the detection of unemployment, employment, and labor force participation is carried out using different questions in the two instruments.

**The detailed profile of SSN beneficiaries will then inform the design of activation policies that may help each subset of the population overcome barriers to employability and participation**. The findings of this section will be complemented by an analysis of the design of tax and benefit systems in FYR Macedonia in Section 3, which will explore whether beneficiaries may be facing disincentives in taking up employment deriving from the current social assistance design.

**More than half of the overall population in FYR Macedonia, and a similar share of the SSN beneficiary population, could be considered "work-able."** This report defines as SSN beneficiaries all those individuals living in a household that received income from any noncontributory program (see box 2). It also adopts a simple definition of the "work-able" population as individuals of working age (15–64) who are not in full-time education or training and who are not disabled (see box 2). The work-able concept is used to describe the population that could be potentially the target of activation policies if not working or if working in very low-quality jobs. Defined as such, 56 percent of the population in FYR Macedonia is work-able, and even the composition of SSN beneficiaries mirrors the national average, with 54 percent of them being of working age and neither disabled nor in education or training (figure 3). On the other hand, the distribution of the *non*-work-able members among SSN beneficiary households stands out for having a much larger share of children and a lower share of old people than the general population (figure 3).

*Box 2: Definitions of Work-Able and SSN Beneficiary*

***Work-able*** individuals include all those of working age who are neither disabled, nor in education, nor in training. Note that this definition does not question the ability to work of persons with disabilities, but rather acknowledges that this population may not be *expected* to seek or find employment as a condition to receive social assistance.

***SSN beneficiaries*** are defined as all individuals living in a household that benefits from any of the following noncontributory programs, according to the household survey:

—*Social assistance* (SA) is defined as the combination of all means-tested social assistance benefits, including SFA, Permanent Financial Assistance (PFA), and targeted disability benefits, with the exception of child allowances. SA in this case is defined narrowly as (a) LRSA (SFA and PFA in the case of FYR Macedonia), and (b) noncontributory disability benefits.

—*Child allowance* is the combination of means-tested child allowance benefits and one-off monetary assistance for newborn children and a parental allowance.

—*Scholarships* include scholarships for pupils and students as well as allowances for qualified workers.

—*War-related benefits* include personal, family, or disability allowances for war veterans, civilians handicapped during war, and participants in the war.

The SSN in FYR Macedonia does not include contributory benefits such as pensions or unemployment insurance. Section 3 provides a detailed description of some programs, while table B2.1 provides data on program coverage in 2009.

*Table B2.1: Share of Households Covered by the Safety Net in FYR Macedonia*

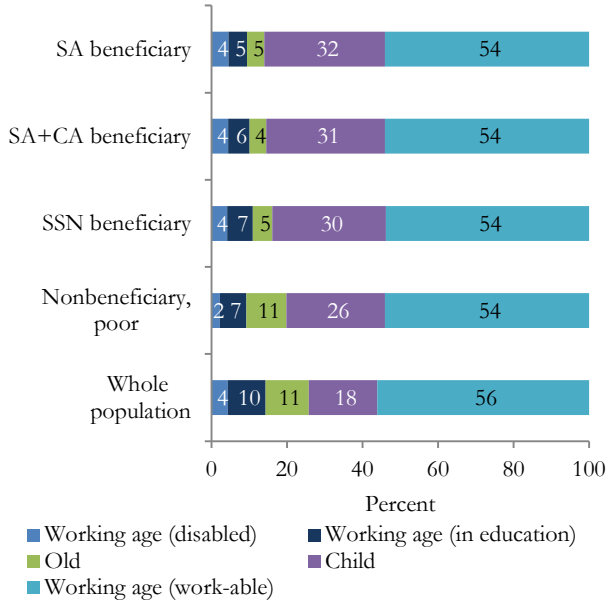
| | |
|---|---|
| Any social safety net | 6.9% |
| Last resort social assistance | 5.5% |
| Child allowance | 0.7% |
| War-related benefits | 0.4% |
| Scholarships | 0.3% |

*Source:* Calculations from FYR Macedonia HBS data 2009.

**Three-quarters of the work-able population participate in the labor force, and wage employees make up the bulk of the employed** (figure 4). More than 75 percent of the work-able population declared themselves to be either working or being unemployed, signaling an overall high activity rate among those who could be expected to work; and among those participating, most are employed. Unlike most other countries in the Western Balkans, the structure of employment in FYR Macedonia is highly skewed toward wage employment.[4]

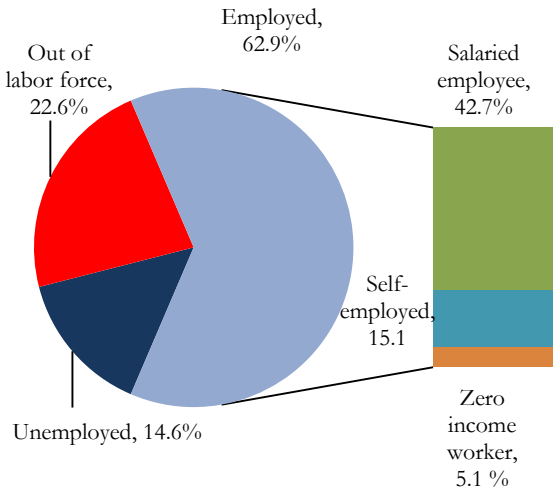
[4] However, participation and unemployment rates cannot be compared with official LFS-based statistics because the work-able group excludes many individuals who are disabled and in education (see box 1).

*Figure 3: Age Composition of SSN Beneficiaries Relative to General Population in FYR Macedonia, 2009*




*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. CA= child allowance.SSN = any social safety net (includes SA, CA, disability benefits, and scholarships). Poor = living in bottom quintile. "Work-able" includes all individuals of working age (15–64) who are neither disabled nor in education or training.

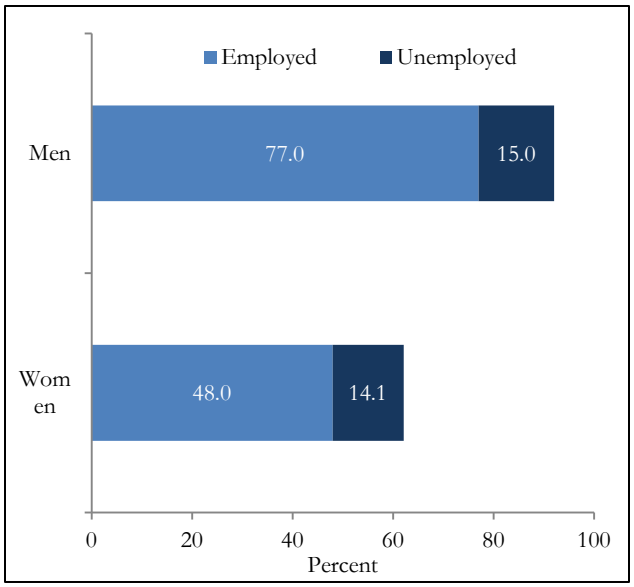
*Figure 4: Labor Market Characteristics of Work-Able Population in FYR Macedonia, 2009*




*Source:* FYR Macedonia HBS data 2009.
Note: "Work-able" includes all individuals of working age (15–64) who are neither disabled nor in education or training.

**There is a considerable gender and age gap in labor outcomes, with young people and women showing the highest disadvantage.** Participation rates among the work-able are clearly skewed by gender, at more than 90 percent among males and just above 60 percent among women (figure 5). Consequently, more than 80 percent of the inactive work-able population is constituted by women, while to some extent the opposite is true for the stocks of employed. Figures 6a and 6b also show that unemployment is evenly distributed by gender but skewed toward the young, who make up most of the unemployed.

*Figure 5: Labor Force Participation Rates of SSN Beneficiaries in FYR Macedonia, by Gender, 2009*



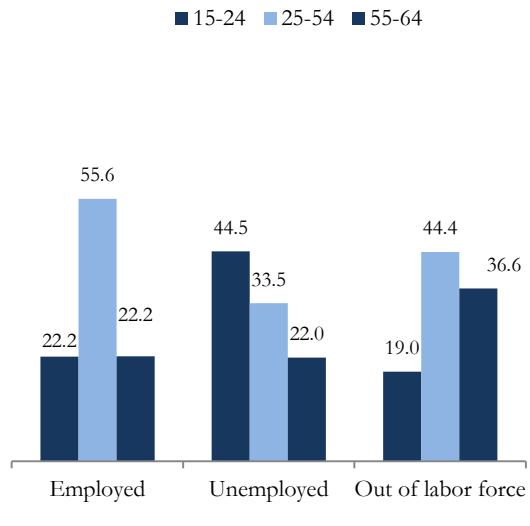

*Source: FYR Macedonia HBS data 2009.*
*Note: Calculation based on the work-able population (individuals of working age [15–64] who are neither disabled nor in education or training.*

*Figure 6: Gender and Age Composition of Employed, Unemployed, and Inactive in FYR Macedonia among work-able population, 2009*

**6.a By gender**


*Source:* FYR Macedonia HBS data 2009.

**6.b By age group**

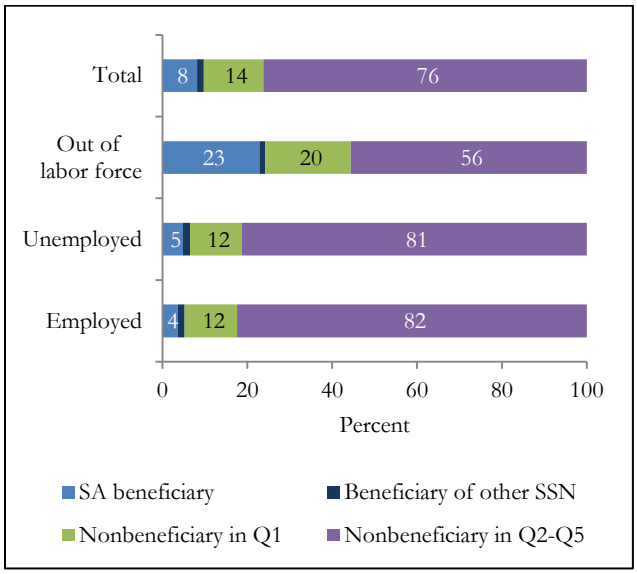



*Source:* FYR Macedonia HBS data 2009.

**Naturally, SSN beneficiaries represent only a fraction of the work-able population.** Figure 7 indicates that SSN beneficiaries represent only 10 percent of the work-able population, with this coverage rate being skewed toward those who are out of the labor force: 24 percent of the

inactive benefit from a safety net program, against only 6 percent of the employed and 7 percent of the unemployed respectively. It is also evident that fewer than half of the *poor* work-able individuals are actually benefiting from any safety net program. The safety net coverage implies that an activation agenda aiming uniquely at SSN beneficiaries would reach only a relatively small share of the work-able who are out of jobs.

***Figure 7: Safety Net Coverage of the Work-Able Population in FYR Macedonia, 2009***

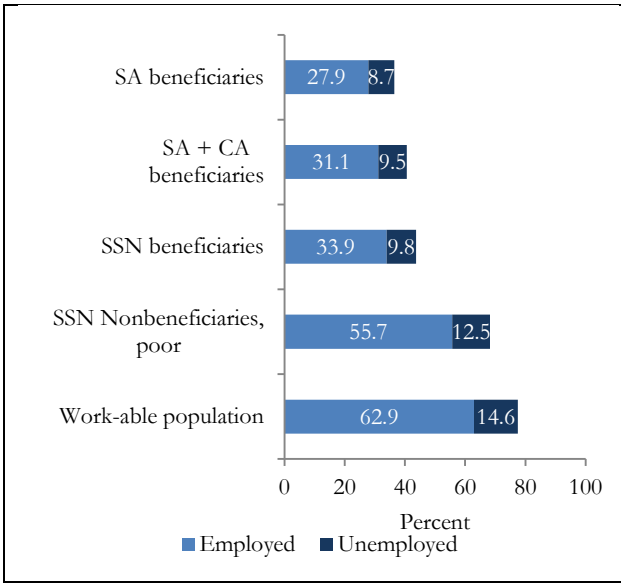



*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. "Other SSN" = other social safety nets (includes CA, disability benefits, and scholarships). Q = consumption quintile (1 = lowest, 5 = highest).

**However, the case for activation policies for this group is pronounced given their much higher likelihood to be out of jobs.** The employment profile of the SSN beneficiary population differs markedly from the general population. More specifically, among those who are work-able and SA beneficiaries, just above a third are in the labor force (figure 8). The SA beneficiary employment rate is also low at 28 percent, in contrast with 56 percent among poor nonbeneficiaries and 63 percent in the general work-able population. SSN beneficiaries are more strongly represented among those out of the labor force than among those who participate in the labor market. Their much higher labor market vulnerability, coupled with the potential fiscal implications of prolonged inactivity, justifies a specific analysis of the constraints and incentives faced by this group.

**Compared with the average population, employed SSN beneficiaries are in low-quality jobs.** Nearly 70 percent of SSN beneficiaries who work are either self-employed or unpaid family workers—a markedly higher share in those categories collectively than either the nonbeneficiary poor employed population or the general employed population, who are largely salaried employees (figure 9). In terms of job quality, high prevalence of self-employment is correlated with more casual work, and it is three times as likely among SA beneficiaries as among the nonbeneficiary poor population (figure 10).

*Figure 8: Employment and Unemployment Rates among the Work-Able Population in FYR Macedonia, 2009*

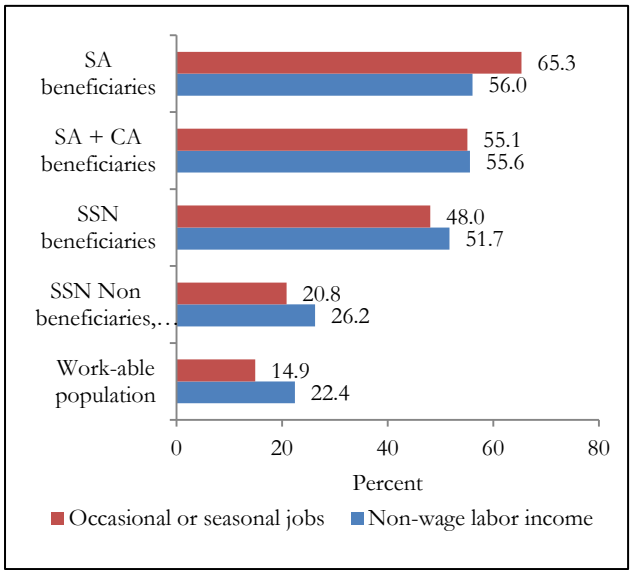



*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. CA = child allowance. SSN = any social safety net (includes SA, CA, disability benefits, and scholarships). "Work-able" includes all individuals of working age (15–64) who are neither disabled nor in education or training. "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

*Figure 9: Work Status of Employed Safety Net Beneficiaries in FYR Macedonia, 2009*


*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. CA = child allowance. SSN = any social safety net (includes SA, CA, disability benefits, and scholarships). "Work-able" refers to individuals of working age (15–64) who are neither disabled nor in education or training. "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

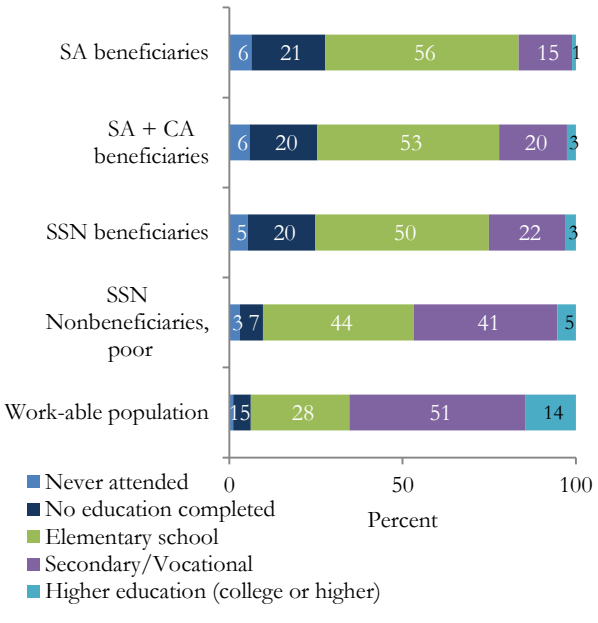
*Figure 10: Share of Employed in Precarious Working Conditions in FYR Macedonia, 2009*




*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. CA= child allowance. SSN = any social safety net (includes SA, CA, disability benefits, and scholarships). "Work-able" includes individuals of working age (15–64) who are neither disabled nor in education or training. "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

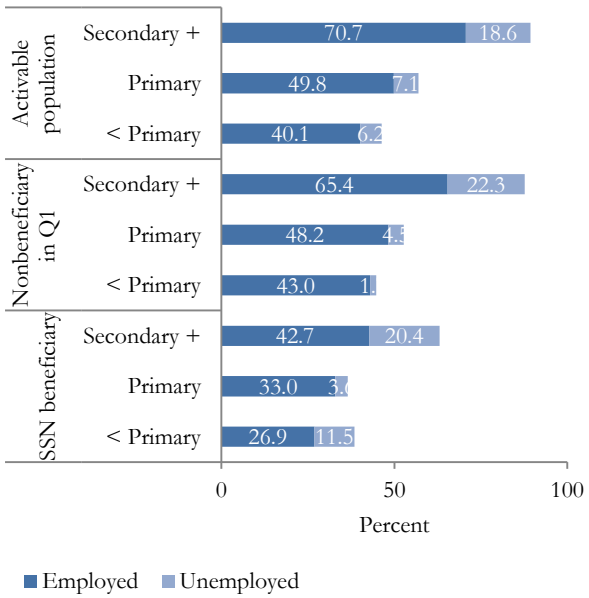
**The low employability and employment quality of SSN beneficiaries is in part explained by their generally low educational achievement.** One of the most striking gaps between the SSN population and nonbeneficiaries in the bottom income quintile in FYR Macedonia is in terms of education and skills. More than 80 percent of work-able SA beneficiaries achieved at most primary education, compared with about 32 percent among the general work-able population (figure 11) and 55 percent among the nonbeneficiary poor. A considerable share of beneficiaries (25 percent or more) does not have a primary education diploma. Understandably, lower levels of human capital also affect employment rates, even though figure 12 suggests that SSN beneficiaries are significantly less employed than their education would predict. For instance, preprimary-educated beneficiaries display low employment rates at about 27 percent, against 40 percent in the whole activable population, and 43 percent among the nonbeneficiary poor. Hence, unlike in other countries like Serbia, these findings suggest that in FYR Macedonia skill-related employability barriers only partially explain why beneficiaries are not employed.

*Figure 11: Education Distribution of Work-Able SSN Beneficiaries in FYR Macedonia, 2009*




*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. CA= child allowance. SSN = any social safety net (includes SA, CA, disability benefits, and scholarships). "Work-able" includes individuals of working age (15–64) who are neither disabled nor in education or training. "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

*Figure 12:: Employment and Labor Force Participation, by Education, in FYR Macedonia, 2009*



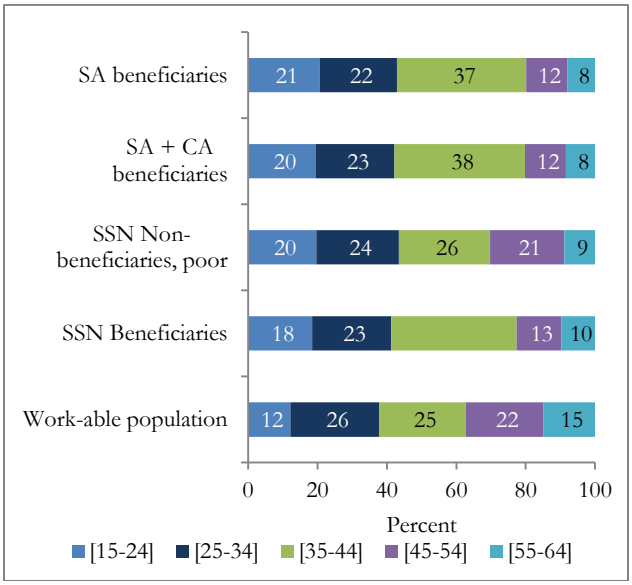

*Source:* FYR Macedonia HBS data 2009.
Note: SSN = social safety net. Q1 = poorest population quintile. The "activable" population refers to those who could be potentially required to work in exchange for social assistance.

**SSN beneficiaries include a larger share of young out-of-school individuals, who generally are among those at higher risk of unemployment.** In terms of age distribution, SA beneficiaries tend on average to include a greater share of young out-of-school individuals (21 percent compared

with 12 percent in the general population) (figure 13), as well as more mid-aged individuals (35–44) and fewer older people (55–64). Because this young group tends to comprise new labor market entrants with low working experience and few formal skills, the age composition of SSN beneficiaries also explains the lower employment rates of this group relative to the general population. In fact, survey data indicate that young people living in SSN beneficiary households are particularly likely to be in informal jobs, with the propensity to work informally decreasing only partially with age (figure 14). Youth in nonbeneficiary poor households are also likely to begin working in the informal economy, but after their mid-20s the informality rate tends to be quite similar to that of the general population.

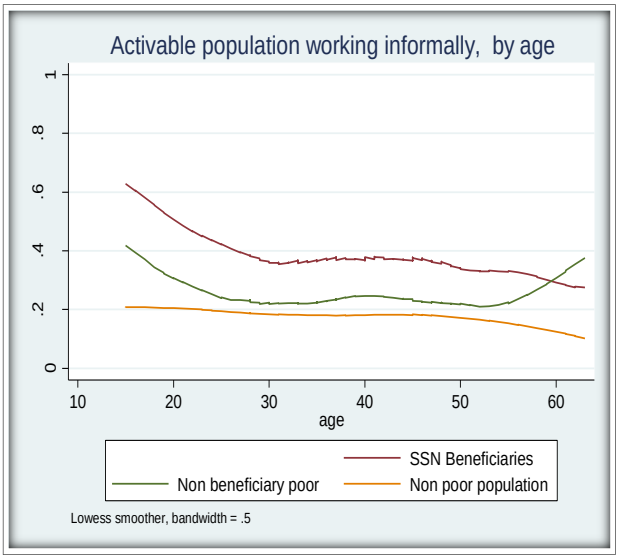
**On the other hand, younger individuals may be among the clients who could benefit the most from activation policies**. Those with sufficient basic education may be more likely to absorb and accept new training that can improve their employability potential. In addition, young people can display greater flexibility in changing their professional orientation or work location to meet labor demand.

***Figure 13: Age Distribution of Work-Able SSN Beneficiaries in FYR Macedonia, 2009***




*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. CA= child allowance. SSN = any social safety net (includes SA, CA, disability benefits, and scholarships). "Work-able" includes individuals of working age (15–64) who are neither disabled nor in education or training. "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

***Figure 14: Likelihood of Working Informally, by Age, in FYR Macedonia, 2009***




*Source:* FYR Macedonia HBS data 2009.
Note: SSN = social safety net (includes social assistance, child allowance, disability benefits, and scholarships). "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

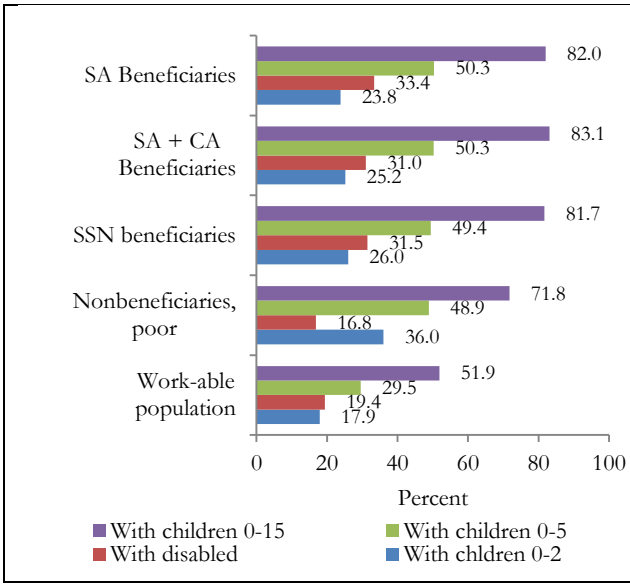
**In addition to human capital constraints, barriers at the household level prevent work-able individuals from realizing their labor market potential.** These barriers pertain largely to the environment where beneficiaries live and include caretaking duties for children or other people in

need of care, mobility constraints, or information constraints. However, data limitations allow us to examine only one such barrier: caretaking duties.

**Work-able SSN beneficiaries display greater caretaking duties than the work-ready population as a whole.** Figure 15 shows that 33 percent of work-able individuals receiving social assistance live with at least a person declaring to be disabled, compared with 19 percent among the general work-able population. Similarly, 26 percent of work-able SSN beneficiaries live with a child under 2 years of age, compared with 18 percent in the general population. Although it is difficult to identify exactly who in the family may be in charge of caretaking duties, the presence of family members in need of assistance correlates with lower employment rates in the case of women.

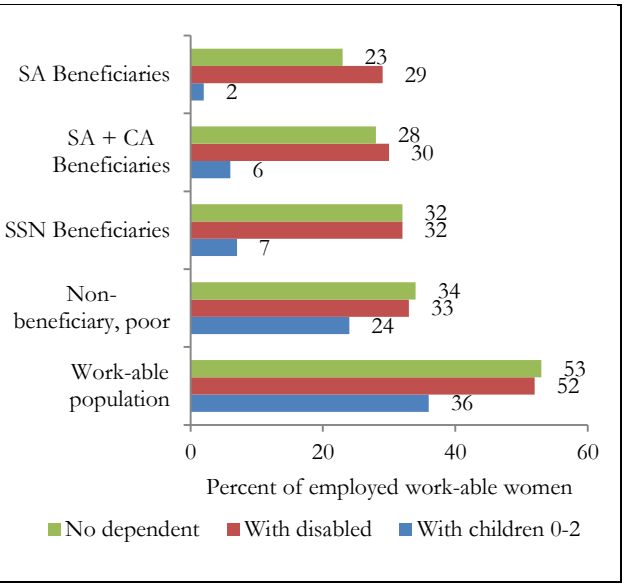
**Work-able women in SSN households with young children tend to work much less than non-SSN beneficiaries in similar conditions.** The available evidence indicates a pronounced correlation between the employment rates of work-able women and the presence of young children in SSN households (figure 16). For instance, the employment rate of work-able women living in SSN beneficiary households is 28 percent without babies or disabled people, but this rate drops to 6 percent in households with babies or young children (aged 0–5 years). Among the general work-able population as a whole, women living with babies also tend to have lower employment rates, but the difference does not appear to be as sharp. Interestingly, and unlike in other Western Balkan countries such as Kosovo or Serbia, the presence of people who declare to be disabled is not associated with lower employment rates. One reason may be that families with disabled members receive a specific allowance for caretaking costs (World Bank 2011), and this would suggest that providing assistance also for women currently in charge of children may effectively improve their participation rates. In fact, in the case of Serbia, where child care tends to be provided at a subsidized rate for low-income families, young children do not appear to have a significant effect on participation or employment rates of women benefiting from SSN programs; instead, those women actually tend to work as much as women living with a young child in the general population.

*Figure 15: Share of Work-Able Population Living with At Least One Person in Need of Care in FYR Macedonia, 2009*




*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. CA= child allowance. SSN = social safety net (includes SA, CA, disability benefits, andscholarships). "Work-able" includes individuals of working age (15–64) who are neither disabled nor in education or training. "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

*Figure 16: Employment Rate of Work-Able Women Living with a Person in Need of Care in FYR Macedonia, 2009*




*Source:* FYR Macedonia HBS data 2009.
Note: SA = social assistance. CA= child allowance. SSN = social safety net (includes SA, CA, disability benefits, and scholarships). "Work-able" includes individuals of working age (15–64) who are neither disabled nor in education or training. "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

## 2.3 Advanced Profiling of SSN Beneficiaries

**The following section will use latent class analysis (LCA) to classify SSN beneficiaries in homogenous groups exhibiting similar labor market challenges.** The profiling presented so far suggests that large heterogeneity exists among the safety net beneficiaries who can be considered work-able. Taking this into account, this section attempts to classify work-able beneficiaries in a number of homogenous groups using the statistical technique of LCA to match each group with specific policy approaches for activation. The exercise's heuristic potential is limited by the amount of information that the HBS provides on the labor market characteristics of beneficiaries. LCA relies on a number of "indicator variables" to capture different "symptoms" of an overall latent condition (in this case, the degree of distance from the labor market) and then groups together beneficiaries who exhibit similar responses into homogenous classes. In addition, the model includes "covariates" that describe the socio-demographic characteristics of the classes; statistically covariates also shape, to a lesser degree, the composition of latent classes. (Box 3 explains the methodology in detail.)

***Box 3: Profiling Beneficiaries through Latent Class Analysis***

Descriptive statistics enable an illustration of the heterogeneity of the SSN beneficiary population under a limited number of dimensions at a time; as such, it is challenging to *synthetically* describe individuals in the population according to their prevailing characteristics.

The main purpose of using LCA is to identify an organizing principle for a complex array of variables, and it is particularly useful to reach a classification of individuals. This latent variable model uses "categorical observed variables, representing characteristics, behaviors, symptoms, or the like as the basis for organizing people into two or more meaningful homogeneous subgroups" (Collins and Lanza 2010). Formally, LCA enables a characterization of a categorical latent (unobserved) variable, starting from an analysis of the relationships among several observed variables (named "indicators"), using a maximum likelihood estimation method. The estimation model used in this study also includes active covariates, which are "variables that may be used to describe or predict (rather than to define or measure) the latent classes and if active, to reduce classification error" (Vermunt and Magidson 2005).

Through LCA, individual observations are scored according to the likelihood of belonging to each of the computed latent classes, and then assigned into the class to which they have the highest posterior probability of belonging (modal assignment) given their observed characteristics. Statistics such as the Bayesian Indicator Criterion (BIC) are used to identify the most appropriate number of classes, that is, the model that has on average the highest likelihood of predicting class membership for all individuals in the given sample.

A fundamental assumption underlying LCA is that of local independence, which implies that each one of the chosen indicator variables should be related to the others uniquely through the latent class membership, and a random error. Advanced computational techniques allow detecting and in part controlling for, the correlation between the residuals of selected indicators, thus enabling the use of the available information to construct categories.

*Sources:* Collins and Lanza 2010; Vermunt and Magidson 2005.

**Based on their observable characteristics and employment status, work-able SSN beneficiaries could be categorized into 10 main classes.** Using the LCA technique, 10 groups of beneficiaries are identified. Figure 17 below illustrates their employment status, and table 1 shows their likelihood of being in the bottom income quintile. Table 2 shows their characteristics, including active covariates and statistics. It is important to note that the actual size of the groups varies considerably. The characteristics of each group can be summarized as follows:

1. *Poor inactive adult women (27 percent).* This large group comprises females, largely of mid age (35–44), with primary education, most of whom are poor (belonging to the poorest consumption quintile). Most (58 percent) live in households with babies or young children, and nearly all are SA beneficiaries (receiving SFA, PFA, or disability benefits).

2. *Nonpoor inactive individuals (15 percent).* The second-largest group includes men and women largely out of the labor force (or, in a minority, self-employed) who live above the bottom consumption quintile. This is the group most likely to receive war-related benefits (17 percent) and exhibit a very low propensity to have household income from labor.

3. *Poor mostly inactive mature men (14 percent).* This group comprises mid- or prime-aged men living in poor (belonging to the bottom consumption quintile) households. About two-thirds of them are not working, and a large share lives in households with young children (64 percent) and people with disabilities (46 percent).

4. *Nonpoor educated men (9 percent).* About 65 percent of the members of this class—constituted nearly wholly of men—are employees or self-employed. Their main characteristic is that they live in households with incomes above the bottom quintile, and they exhibit a good level of education (74 percent with secondary or more).

5. *Educated mostly jobless young women (8 percent).* This group exhibits a markedly higher education rate than most other beneficiaries; nevertheless it includes an equal share of poor and nonpoor young women, prevalently in the labor force (67 percent) but most of whom are unemployed. An important share of them benefits from child allowance and war-related benefits.

6. *Uneducated jobless youth (6 percent).* Comprising entirely young people with no primary education, this group is divided between inactive and unemployed individuals of both genders. In addition, this group exhibits a high likelihood of poverty, and more than half of them live in households with young babies.

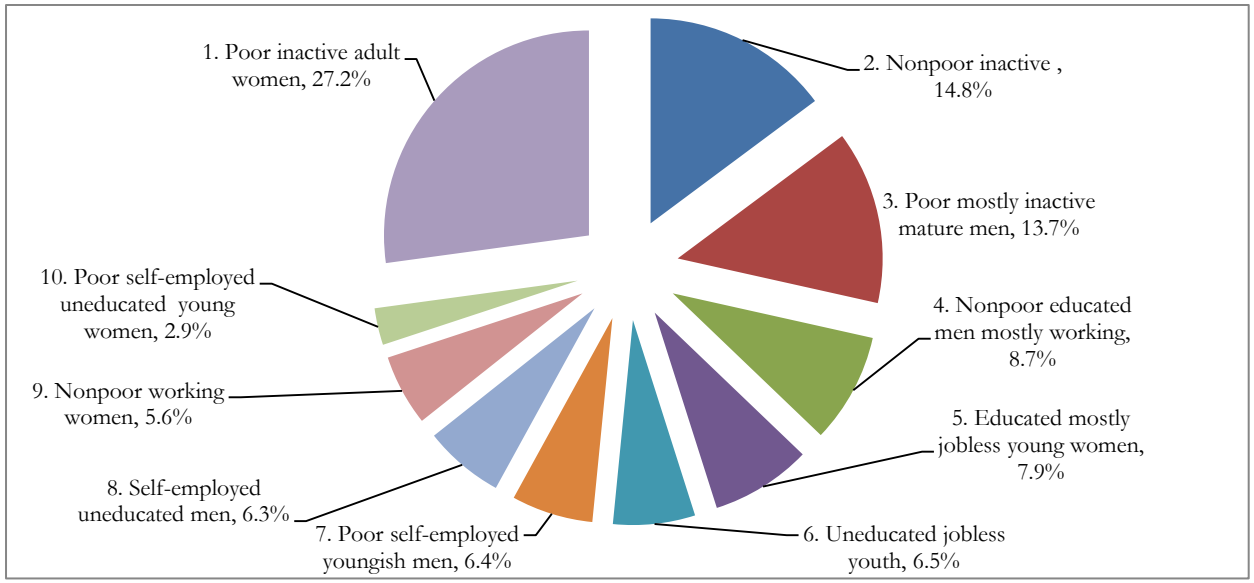
7. *Poor self-employed youngish men (6 percent).* This group comprises young- and mid-aged self-employed men who live in poor households. All are beneficiaries of social assistance.

8. *Self-employed uneducated men (6 percent).* Unlike the members of the previous class, this group of mostly self-employed male beneficiaries includes a large share of individuals who are not poor, in spite of being among the least educated of all classes considered.

9. *Nonpoor working women (6 percent).* Most of the women in this class are employees or, in a small part, self-employed. Sixty percent of them have at least secondary education, and all live in households above the bottom income quintile.

10. *Poor self-employed uneducated young women (3 percent).* This is a small homogenous class of young women, almost entirely with no formal education, who are self-employed, mostly in urban areas, but belong to the bottom income quintile.

*Figure 17: Classes of Work-Able Beneficiaries in FYR Macedonia, 2009*




*Source:* Authors based on HBS 2009.

Note: "Work-able" includes individuals of working age (15–64) who are neither disabled nor in education or training. "Poor" refers to individuals in the bottom 20th percentile of the total consumption distribution.

*Table 1: Labor Market Characteristics of the 10 Beneficiary Classes in FYR Macedonia (Indicators)*

| | 1. Poor inactive adult women | 2. Nonpoor inactive | 3. Poor mostly inactive mature men | 4. Nonpoor educated men mostly working | 5. Educated mostly jobless young women | 6. Uneducated jobless youth | 7. Poor self-employed youngish men | 8. Self-employed uneducated men | 9. Nonpoor working women | 10. Poor self-employed uneducated young women |
|---|---|---|---|---|---|---|---|---|---|---|
| Self-employed | **1%** | 23% | **0%** | **19%** | 0% | **1%** | **96%** | **75%** | 21% | **94%** |
| Employee | 1% | 0% | **30%** | **46%** | 22% | 0% | 0% | 0% | 68% | 0% |
| Unemployed | 0% | 0% | 6% | 27% | **45%** | **40%** | 0% | 2% | 3% | 3% |
| Inactive | **99%** | **77%** | **64%** | 8% | 32% | 59% | 4% | 23% | 7% | 2% |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| % in Q1 | 64% | 1% | 93% | 0% | 50% | 81% | 95% | 35% | 1% | 98% |

*Source:* Authors, based on HBS 2009

Note: Q1 = poorest quintile. "Poor" also refers to individuals in the bottom quintile of the total consumption distribution. "Inactive" = out of the labor force.

### *Table 2: Characteristics of 10 Beneficiary Classes in FYR Macedonia (Active Covariates and Statistics)*

| | | 1. Poor inactive adult women | 2. Nonpoor inactive | 3. Poor mostly inactive mature men | 4. Nonpoor educated men mostly working | 5. Educated mostly jobless young women | 6. Uneducated jobless youth | 7. Poor self-employed youngish men | 8. Self-employed uneducated men | 9. Nonpoor working women | 10. Poor self-employed uneducated young women |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Class size (% total)** | | 27% | 15% | 14% | 9% | 8% | 6% | 6% | 6% | 6% | 3% |
| **Active covariates** | Female | 100% | 37% | 0% | 13% | 79% | 34% | 0% | 0% | 85% | 99% |
| | Young (15–24) | 20% | 28% | 0% | 36% | 72% | 100% | 50% | 2% | 1% | 94% |
| | Adult (25-54) | 69% | 45% | 76% | 33% | 28% | 0% | 44% | 86% | 97% | 3% |
| | Old (55–64) | 11% | 28% | 24% | 30% | 0% | 0% | 6% | 12% | 2% | 3% |
| | Preprimary educ. | 25% | 21% | 10% | 0% | 1% | 99% | 1% | 60% | 11% | 87% |
| | Primary educ. | 71% | 46% | **81%** | 25% | 2% | 0% | 99% | 40% | 29% | 0% |
| | Secondary educ. | 4% | 33% | 9% | 74% | 97% | 1% | 0% | 0% | 60% | 12% |
| **HH statistics** | With baby 0–5 | **58%** | 30% | **64%** | 31% | **55%** | - | - | - | - | - |
| | With disabled | 28% | 31% | **43%** | 17% | 14% | - | - | - | - | - |
| | SA beneficiary | **95%** | 78% | **99%** | 33% | 69% | 100% | 97% | 89% | 43% | 100% |
| | War-related beneficiary | 1% | **17%** | 0% | 5% | 12% | - | - | - | - | - |
| | CA beneficiary | 4% | 5% | 2% | **39%** | 19% | - | - | - | - | - |
| | % income from labor[a] | 0.26 | 0 | **0.68** | **0.56** | 0.27 | - | - | - | - | - |
| | Urban | **49%** | **57%** | **33%** | **67%** | **77%** | 94% | 25% | 49% | 50% | 87% |

*Source:* Authors, based on HBS 2009

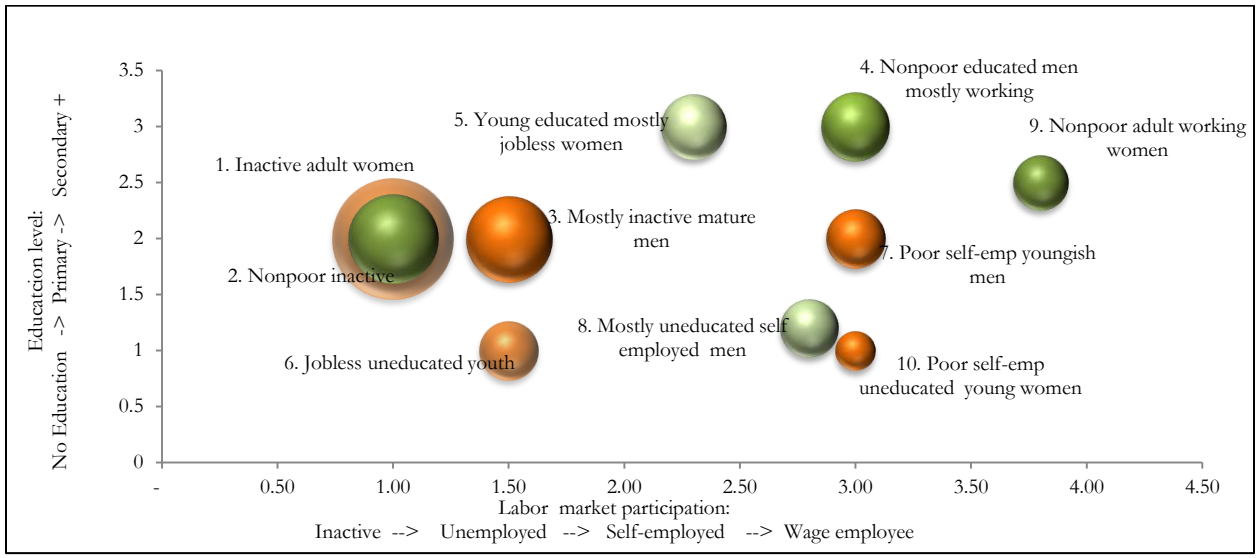
Note: Poor = living in a household belonging to the bottom consumption quintile. SA = social assistance. CA = child allowance. HH = household. - = statistics are not reported because of the small sample size.

a. Median household income from employment as a percentage of household consumption.

## 2.4 Implications of Profiling Results for Activation Policies

**The relationship between the employability barriers, poverty rates, and labor market participation rates of different classes of SSN beneficiaries are heterogeneous and specific to each group**. Figure 18 maps the relationship between education, labor market participation, and poverty among the different classes of beneficiaries. The graph shows that among beneficiary classes for a given level of education there is heterogeneity of employment outcomes and participation decisions; certainly the more-educated tend on average to be closer to the labor market, but among the low-educated a wide range of labor market and poverty outcomes is observed. In other words, this rather complex picture suggests that beneficiaries may be facing quite specific challenges in entering the labor market that the available data do not entirely capture.

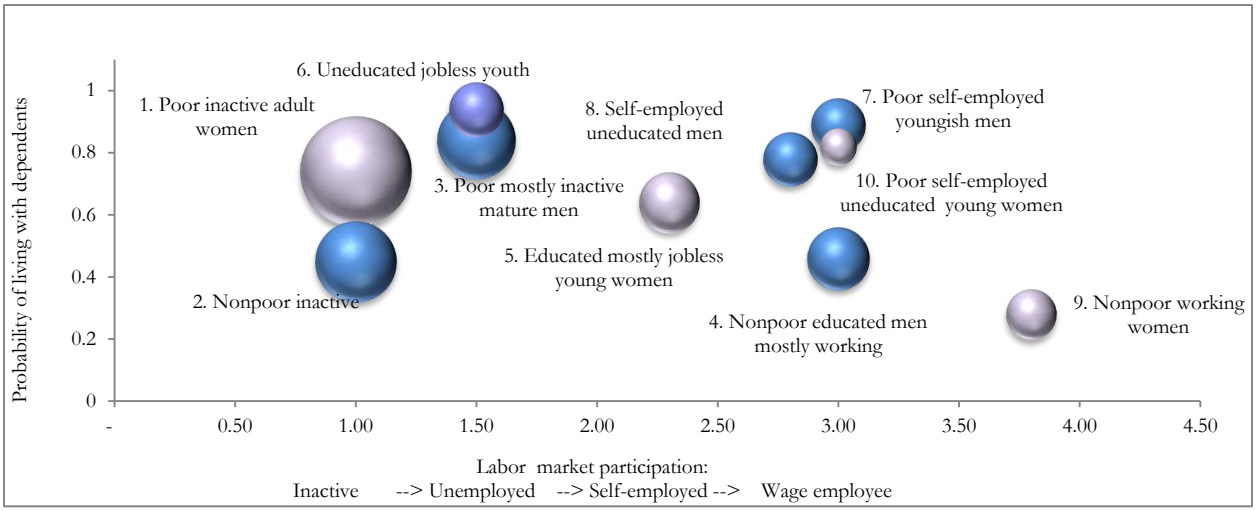
***Figure 18: Degree of Labor Market Attachment, Poverty, and Education Level among Work-Able SSN Beneficiary Clusters in FYR Macedonia, 2009***




Note: Size indicates the cluster's relative share within the total beneficiary population. Color indicates the extent to which beneficiary households are in the poorest consumption quintile (Q1): orange being all, green being none, and the lighter color being in between.

**Caretaking duties appear to be well distributed across classes of individuals with different employment outcomes**. Figure 19 plots on the horizontal axis the prevailing employment status of each class of beneficiaries and on the vertical axis the extent to which beneficiaries in each class live with individuals in need of caretaking (such as young children or persons with disabilities). Some groups exhibit a distinctly higher probability of living with dependents, such as *poor self-employed youngish men* (group 7), *uneducated jobless youth* (group 6), or *poor self-employed uneducated young women* (group 10). Assuming that caretaking duties are more likely to fall on women than on men, the graph reveals the heterogeneity in labor market outcomes even for groups with seemingly high burdens, such as *poor inactive adult women* (group 1) or *poor self-employed uneducated young women* (10).

*Figure 19: Likelihood of Living in a Household with Caretaking Duties Relative to Employment Outcomes among Work-Able Beneficiary Clusters in FYR Macedonia*




Note: Size indicates the cluster's relative share in the total beneficiary population. Pink gradient defines the concentration of women in the cluster; blue indicates the concentration of men. A dependent is defined as a disabled person or a young child aged 0–5.

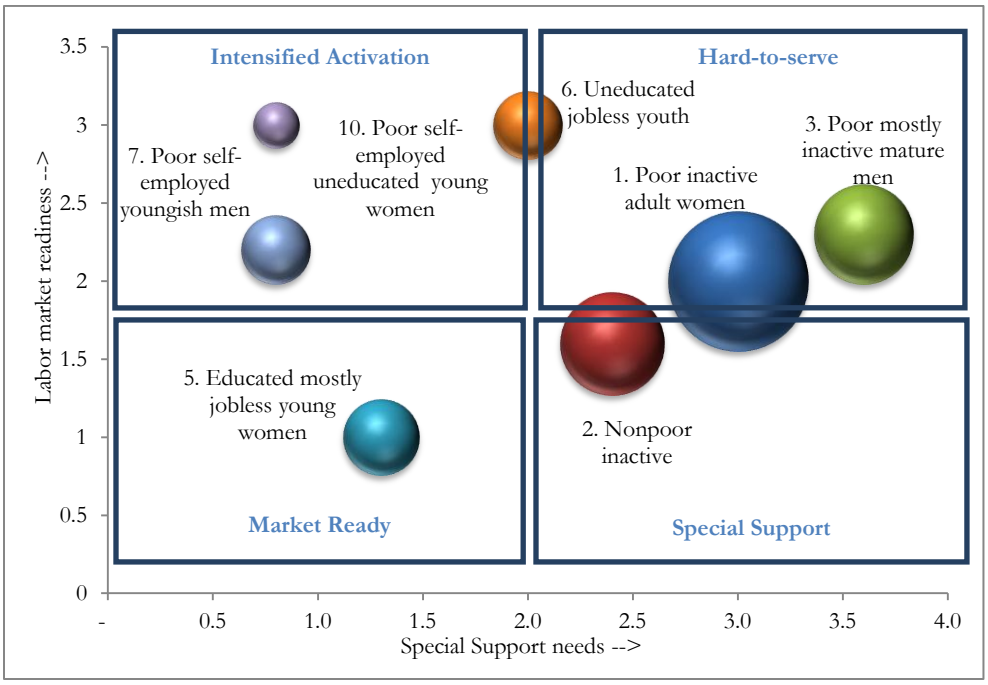
**The largest groups of beneficiaries are constituted by mid-aged or older individuals, while the unemployed are concentrated in clusters of young people.** Classes 1, 2, and 3—which, combined, represent about 55 percent of beneficiaries—portray different typologies of inactive individuals. Class 1, that of *poor inactive women*, is the largest, followed by *non-poor inactive* and by *poor mostly inactive mature men*. The two categories where unemployment is most prevalent mainly comprise young people: classes 5 and 6 are two complementary groups representing, respectively, the educated and uneducated young people out of work; these two groups stand out for being those where unemployment is more prevalent than inactivity.

**If the policy objective is to reduce long-term reliance on SSN benefits, activation policies will also need to target some of the beneficiaries who are currently working.** Figure 19 also shows that, among SSN beneficiaries, some of the groups that are most likely to be in poverty are employed; in particular, groups 7 and 10 are made up entirely of poor self-employed men and women who have either elementary or no education. Although they are working, these individuals are unable to lift themselves and their households out of poverty and therefore need interventions that improve their earning potential. For such working poor, usually employed in informal self-employment or agriculture, the avenue to improving productivity probably lies outside the realm of labor market interventions *stricto sensu* (World Bank, 2012d). This group does not particularly need incentives to work, but they probably would benefit most from policies that improve agricultural productivity or the productivity of their microbusiness (such as access to finance, business skills development, and infrastructure to connect them to markets if they live in remote areas). They can also benefit from policies that promote business start-up and from basic training for microbusiness start-up. Benefit design could be improved to provide incentives for human capital accumulation in the household and to reduce the incentives to work in the informal self-employed sector.

**On the other hand, nonpoor and working clients may not be a priority for activation measures and services.** Such clients could include those people in groups 4 (*nonpoor educated men*), 8 (*self-employed uneducated men*), and 9 (*nonpoor working women*) who are either not "working poor" or who are already employed and have at least a secondary level of education. These groups could also benefit from using intermediation services from private providers, or they could self-select into the skills training programs offered by employment services after priority groups are served. However, some of the beneficiaries in these classes receive categorical benefits, like war veterans' benefits, which are exempted from the income test for SA and provide access to health insurance coverage. A more encompassing and precise income test for SFA will lead to attrition of some of the members of these clusters, with subsequent redirecting of SSN spending to those whose incomes are the lowest.

**The activation of these heterogeneous classes of work-able beneficiaries will require a tailored mix of services and incentives.** Figure 20 presents a taxonomy of activation "packages" that may fit the needs of the different beneficiary clusters presented earlier. The four activation packages are distributed along the two axes representing the extent of "labor market readiness" (related to beneficiaries' human capital) (y-axis) and the need for "special support" to overcome participation barriers (x-axis). It is important to consider this as a first step toward a comprehensive exercise that matches profiling of beneficiaries with services, which would require a wider range of information, such as the range included in the administrative datasets.

*Figure 20: Matching Beneficiary Profiles and Activation Services in FYR Macedonia, by Client Group*




Note: This figure does not include groups 4, 8, and 9, which, as discussed earlier, are not considered a priority for activation. Size indicates the cluster's relative share in the total beneficiary population.

***Market-Ready* clients are those who can be more easily activated**. These clients normally do not require services other than those offered to facilitate intermediation with the labor market because their unemployment spells tend to be short, and engagement in ALMPs other than tools for job matching may not be cost-effective. The unemployed—especially the young and educated or the skilled unemployed with work experience—could belong to this group. In FYR Macedonia, these clients represent a relatively small a share of all work-ready SSN beneficiaries and include essentially the *educated mostly jobless young women*. To the extent that the labor market has open vacancies, cost-effective services to this client segment can range from access to information on vacancies to workshops on résumé preparation, interview skills, and job searching (Brown and Koettl 2012). Impact evaluations show that incentives or threats—such as the reduction of benefits in association with the duration of unemployment, or more stringent work search requirements where job search efforts are monitored—have been associated with reductions in unemployment duration (Cahuc and Lehmann 2000; see Fredriksson and Holmlund 2006 for a review of the evidence).[5]

***Intensified Activation* clients can benefit the most from interventions that build human capital.** SSN beneficiaries in this group include the individuals who, to become employable, need retraining in job-specific skills that the labor market requires. In the case of FYR Macedonia, this group could include *uneducated jobless youth* who did not complete any formal education but are, at least in part, actively looking for work. In addition, training can be considered most appropriate for those beneficiaries who have work experience but are at higher risk of becoming—or actually are—long-term unemployed; training has had little short-term effect on such groups, but it does have positive long-term effects on earnings and employability (Brown and Koettl 2012). Finally, enhancing human capital could be the most appropriate strategy to improve the conditions of individuals who are already employed in low-productivity jobs, such as those in groups 7 and 10 (*poor self-employed men and women*), and may require further skills to transition into wage employment. An essential element for the success of such training programs, whose discussion is beyond the scope of this study, rests in the quality and market relevance of the training offered, with on-the-job training being the most effective. Options for training design may be limited because important shares of the work-ready SSN beneficiaries in Macedonia have only primary or no education, with a limited capacity to absorb vocational training. Financial incentives built into the benefit formula and associated with participation to activation measures and into the activities offered for "market clients" is an appropriate mix to sustain this group's effort to find employment.

***Special Support* clients require intensified case management and a mix of services to improve their participation in the labor force.** They include individuals who could be potentially *market-ready* but may face barriers to joining the labor force related to caretaking duties, temporary health conditions, geographic barriers, lack of motivation, or actual disincentives to doing so. These clients may require intensive case management to identify the specific barriers they face and the potential solutions for activation, which often lie beyond the confines of the employment services. In this case, the main role and challenge of activation services is to ensure proper institutional

[5] The limitation of this research is that it tends to apply to unemployment insurance, where the link between individual behavior and benefit eligibility is stronger than in a household context.

coordination with the other service providers in the community, including facilitating clients' access to specific benefits (such as transport, housing, prioritization in child-care centers, and disability benefits for other family members). Because most of these clients are not part of the labor force, they will also benefit from a mix of incentives and job search assistance to build motivation and identify their labor market potential. In the case of FYR Macedonia, however, it appears that clients who are inactive and face such labor force participation constraints are also facing important employability barriers (in which case they fall in the "hard-to-serve" category). One exception could be the *nonpoor inactive* individuals, who display on average a good education level.

***Hard-to-Serve*** **clients include individuals who face high barriers both in terms of employability skills and in terms of ability to participate in the labor market**. This group is similar to the Special Support clients, but in addition suffers from lack of basic skills and work experience. The largest share of work-ready beneficiaries in FYR Macedonia probably belongs to this group. Individuals such as *poor inactive women*, *poor mostly inactive mature men*, and part of the *uneducated jobless youth* exhibit at most primary education, they do not participate in the labor force, and an important share of them live with dependents (which affects participation of female beneficiaries). As their naming implies, such beneficiaries may be considerably harder to activate and require, in any case, a longer process, which will include the intensive case management for Special Support clients, basic skills development activities, and the job search assistance discussed for Market-Ready clients.

**Statistical profiling of beneficiaries could further improve the targeting and cost-efficiency of activation measures and of social assistance itself.** In many OECD countries such as Australia, Denmark, Germany, or the United States, the profiling of beneficiaries of unemployment insurance or of LRSA is an exercise integrated into the regular business process of case management.[6] The main objective of "statistical profiling" is to improve the cost-efficiency and the effectiveness of activation services by reducing the "deadweight loss" associated with providing services to populations that would be likely to find a job without the need for intensified activation measures. The advanced analysis of administrative data and of the results of individual questionnaires that collect information on hard skills, behavioral skills, personal motivation, and constraints is used to predict the optimal timing and mix of activation measures based on past success rates for similar clients.

**Existing evaluations indicate the contribution of predictive models to targeting of activation services.** Statistical models have shown acceptable degrees of accuracy in predicting unemployment spells. A model for the United Kingdom could predict duration of unemployment in 70 percent of cases (Driskell 2005); similar rates were observed for Denmark and Sweden (Konle-Seidl 2011) and an even higher rate in Ireland (O'Connell et al. 2009). This information is used to evaluate the typology of customers who may benefit immediately from intensified activation services, and in some countries the profiling score also determines the eligibility criteria for programs, such as in the

[6] This section draws from the comprehensive assessment of statistical profiling in OECD countries conducted by Konle-Seidl (2011).

United States, or the budget allocated to each beneficiary as in Australia. On the other hand, in Germany the model is only one of the tools available to case workers (together with structured interviews and checklists to design a personalized action plan), and its predictions are not considered binding. In fact, in spite of their high predictive power, in several countries staff resistance has been a major reason for opposition to mainstreaming the approach.

**Statistical profiling can be particularly appropriate in countries where case management is still relatively underdeveloped.** This technique can be particularly useful in countries, such as those in the Western Balkans, where case managers have a high caseload, which is associated with poorer performance (Hainmueller et al. 2011), and where case management is still at the developmental stage. Especially because the practice of face-to-face case management is still not very institutionalized, staff resistance to statistical techniques may be lower.

**However, the HBS data can provide only an initial overview of the general beneficiary profiles in FYR Macedonia and of the policies that could benefit those groups**. Advanced profiling would require the analysis of administrative data, an improvement of the information collected at entry to also capture motivation, soft skills, and qualification frameworks that can appropriately identify skills shortages among employers.

# 3. Incentives and Disincentives in the SFA Design in FYR Macedonia

This section complements the labor market profiling of beneficiaries with an analysis of the design of FYR Macedonia's SFA program from the perspective of whether it contains inherent (dis)incentives for work. The sections starts with a brief description of the benefit's design, financing, and performance characteristics. Against this background, it identifies possible incentives and disincentives for work that are built into the design of the program, specifically in the eligibility criteria, benefit formula, required registration as unemployed, benefit generosity, and employment-related conditions to receive cash assistance. Furthermore, it looks at the interaction of these design features with the tax system in FYR Macedonia, which may ameliorate or exacerbate any disincentives embedded in the design of social assistance programs.

## 3.1 Main Benefits for the Work-Able

**FYR Macedonia has a comprehensive social protection system**. As in most European countries it has three building blocks: (a) contributory benefits, including pensions, disability insurance, and family benefits; (b) active labor market programs (ALMPs) and contribution-based unemployment benefits (passive labor market programs); and (c) social assistance benefits comprising LRSA, noncontributory disability benefits, family and child protection benefits, war veteran-related benefits, and social care services. The social protection system has two main instruments for protecting incomes and consumption of people who are able to work: the contributory unemployment benefit and the LRSA scheme—the SFA program.

**The unemployment benefit is the main labor market instrument that safeguards the unemployed.** A person would be registered as unemployed in the Employment Agency (EA) conditional upon fulfilling certain criteria: does not hold a job, is able and willing to work, is actively searching for a job, and is ready to accept a suitable job offered by the EA. The requirements for active job searching are considered to be met if the unemployed person uses at least one of the following actions: regular re-registration in the EA, attendance at interviews with employers arranged by the EA, or acceptance of a job offer or participation in ALMPs mediated by the EA. The registered unemployed who do not fulfill these criteria are deleted from the roster of unemployed for one year and lose the right to the unemployment benefit. The re-registration period is set at 30 days for unemployed persons receiving the unemployment benefit and 60 days for the others (World Bank 2012a).

**However, only about 9.1 percent of registered unemployed persons in FYR Macedonia receive unemployment benefits.**[7] Hence, the unemployment benefit plays only a marginal role as

[7] This may be partially due to the fact that the number of registered unemployed is much larger than the actual unemployed because free health insurance was linked to being registered unemployed until 2011, at which point it was delinked. Latest administrative numbers indicate a slightly higher coverage rate of about 20% due to the decrease in overall registered unemployed based on this de-linking.

an income generator or safety net during downturns. Such a low proportion reflects the labor market situation in a country where most of the unemployed either have no prior work experience or are long-term unemployed who had an unsuccessful job search and exhausted their eligibility. The eligibility conditions for the unemployment benefit restrict benefits to people who have a sufficient contribution record from work: at least 9 months of continuous work or 12 months with breaks in the last 18 months. Benefit duration has been downsized few times during the transition, and it is currently set to last for up to 18 months.[8]

**Given that the unemployment benefit provides only marginal and short-term income support, the SFA acts as the main social safety program.** The large incidence of long-term unemployment and relatively low duration of the unemployment benefit means that only a small share of the unemployed receives this benefit. Moreover, labor market entrants and the self-employed are not eligible for the benefit. Hence, SFA acts as a substitute for the unemployment benefit (for people with expired unemployment benefit eligibility and insufficient means) and as a complement (for those not eligible to have unemployment benefits). In other words, SFA can be regarded as a noncontributory assistance strand for the unemployed, ensuring that they have some guaranteed income and are protected against falling into further poverty. At the same time, however, the eligibility criteria for SFA are quite rigorous, and as a safety net it can capture only a small portion of those who are at the bottom of the income distribution.

**The SFA is a "classical" LRSA benefit granted based on income and asset test and additional binary (Yes/No) filters.** It is usually granted to units of assistance (families and households) even when their members are able to work but are unable to provide for themselves materially. The income threshold for SFA is differentiated by household size using equivalence scales. The maximum amount of the SFA benefit that a household might receive is MKD 5,515 (approximately €90). This amount is calculated for a five-member or larger household. The average monthly income of the household earned in the previous three months is considered, and it must be lower than the amount of the SFA for the respective household size. The actual benefit due is calculated as the difference between the income eligibility threshold for the respective unit of assistance and its own income; ergo it is reduced for any additional income or increased with lost income. The application includes submission of information to the SWC about the income, assets, property, family size and status, employment status, and so on of the applicant and persons jointly assessed with him or her (that is, other household members). The applicant has to provide official documents as a proof, although some documents are provided by the SWCs through data exchange with some institutions or through home visits. A finding that a person's or household's income is above the threshold level; discovery that person or family is asset-rich; refusal to accept a job, training, or public work; or failure to report any change in status leads to rejection of the application or refusal of an already assigned benefit (World Bank 2011).

[8] Republic of Macedonia (2012).

**In recent years the social protection programs have been the subject of several reforms, which has led to some improvement of the targeting and cost saving.** These reforms were implemented under the Social Protection Implementation Loan project of the World Bank, which among other things aimed to reduce fragmentation and streamline the benefits as well as to improve cost-effectiveness and targeting, including through enforcement of behavioral conditions. Under the project, a management information system (MIS) was established for cash benefits. The system is currently functional only for the SFA, but there are plans for its upgrade so as to include all cash transfers. The MIS now allows cross-checks of data across local SWCs, which has decreased the number of SFA users because of elimination of duplicative and faulty claims (World Bank 2012a).

**Reforms included the introduction of a conditional cash transfer program for secondary education.** In recent years, special attention has been given to increasing the educational attainment of the population across all age groups, with special attention given to children from disadvantaged family backgrounds. This effort is reflects the recognition of the importance of investment in human capital in reduction of intergenerational poverty/vulnerability. More specifically, education can mitigate the effect of a disadvantaged social background on a person's lifetime opportunities. In this respect, the government has introduced two programs: (a) CCTs as a top-up benefit for eligible SFA beneficiaries, conditioned on their children's mandatory secondary school enrollment and attendance;[9] and (b) an additional financial incentive for children without parents or parental care, conditional upon their participation in tertiary education.[10] In addition, recognizing the multiple barriers that the SFA beneficiaries and the youth face in productive employment (and the resulting high levels of inactivity) the Government recently introduced a conditional cash transfer program for subsidized employment of SFA recipients. Box 4 provides more details on the design of this program.

***Box 4: Conditional Cash Transfer Program for Subsidized Employment of SFA Beneficiaries.***

Recognizing that youth, who constitute a sizeable share of the SFA beneficiaries, are among the most disadvantaged in the labor market with high inactivity and unemployment rates, the Government of FYR Macedonia recently approved (in April 2013) a CCT program for subsidized employment of SFA beneficiaries. The objective of the program for subsidized employment is to ease the transition of the young SFA beneficiaries to the labor market by providing wage subsidies to companies that are willing to employ SFA beneficiaries, primarily from the 19-29 age group. Utilizing the fact that there are significantly more potential beneficiaries than the actual number who can benefit during the first year (6400 vs 165), an impact evaluation is built-into the program to measure the impact of the program. The main design features of the program are as follows:

[9] The CCT benefit level has been established at MKD 12,000 (slightly less than EUR200) per child per year, which is similar to the amount of child allowance per child. The two benefits exclude each other: the receipt of the child allowance makes the family or household ineligible for the CCT and vice versa. Schools regularly report school attendance to SWCs. This program was supported under the World Bank Conditional Cash Transfers Project.

[10] Those persons receive MKD 5,000 per month (set in 2011, Official Gazette No. 36/2011) which is increased to MKD 5,600 if regularly attending school. Each year, the amount is adjusted by the cost of living. The new type of financial assistance is set at MKD 18,000 per month if the person is enrolled in tertiary education (only public universities). If the person at the same time rents a social apartment, the amount of the benefit is reduced to MKD 9,000 (amendments to the Law, Official Gazette No. 36/2011) (World Bank 2012b).

**Target Group**: Members of households that are receiving SFA and are registered as active job seekers at the EA. Within the target group, priority will be given to the young SFA beneficiaries (defined as age 19-29) that are registered as active job seekers in the EA. The number of SFA beneficiaries 19-29 that are actively searching for work, is around 6400 individuals. The program intends to provide subsidies for 165 individuals in year one and around 800 individuals in year two and three.

**Benefit design:** Provide wage subsidies for the target group for a six-month period with the condition that the employer keeps the subsidized employees for additional six months. The intervention takes as the basis the current program for employment subsidies implemented by the EA of FYR Macedonia while making adjustments to address the specific needs of the target group.

**Employer selection criteria:** (i) Not lay off current employees to get subsidized employees under the CCT program; and (ii) Not having violated the contract with EA if previously received a subsidy from similar programs implemented by the EA.

**Beneficiary selection criteria:** (i) applicant must be an SFA beneficiary; and the applicant must be registered as active job seekers in EA

**Implementation steps and responsible institutions:** (i) Issuance of public calls for employers and SFA beneficiaries (EA); (ii) Assessment of applications for eligibility and identifying eligible SFA beneficiaries through data exchange (MLSP and EA); (iii) matching of the skills of applicants and the needs of employer (EA and MLSP); (iv) Provision of counseling/training to selected applicants for the interview/job (EA); and; (v) final selection of beneficiaries to be employed (Employer); (vi) Payment of the subsidy to employers (MLSP)

**Condition for beneficiaries:** Those that refuse to enroll (refuse to respond to the EA invitation, the invitation for the interview or refuse employment) or those that quit/fired at their own will/fault will be penalized by being excluded from the calculation of the SFA household size, for six months starting from the day of refusal or resignation

**Condition for employers:** The employer would have the obligation to retain in employment 100 percent of the program participants for additional 6 months after the expiry of the 6 months subsidized employment period.

**Benefit amount:** The level of the subsidy will be the gross wage of 14,000 MKD plus 3,000 MKD per employee per month to compensate the employer for training charges for a period of 6 months.

**Design incentive to participate in the program**: During the 12 month period of employment, the SFA household from which the beneficiary (SFA recipient) originates will not be deprived of SFA entitlements since the wage received under this program will not be counted in the household income for SFA eligibility. The beneficiary of the subsidized employment will be excluded from the calculation of the SFA household benefit during this 12 month period.

*Source*: CCT program for Subsidized Employment of SFA Recipients (MLSP 2013)

## 3.2 Spending and Performance Characteristics of the SFA Program

**Overall spending on social protection is slightly below 10 percent of gross domestic product (GDP), which ranks FYR Macedonia among the low spenders compared with the rest of the countries in the Eastern European and Central Asian region** (figure 21). The total spending on

social assistance (LRSA, child and family protection, noncontributory disability benefits, and war-related benefits) was slightly above 1 percent of GDP in 2011, which is below the average regional standard. Very few countries in Eastern Europe and Central Asia (only Azerbaijan, Bulgaria, and Latvia) spend less than FYR Macedonia on social assistance as a percentage of GDP. Moreover, in FYR Macedonia, half of this social assistance spending is allocated for the noncontributory and also categorical disability benefits (figure 21).

**The LRSA scheme—the SFA program—is average in size by regional standards**. Close to 0.3 percent of GDP is allocated for it in FYR Macedonia, while some countries spend significantly more: for example, Montenegro spends close to 0.5 percent of GDP, and Kosovo, up to 0.7 percent of GDP. There were about 35,450 SFA beneficiary families in 2012, down from 44,851 families in 2011. Spending on SFA was about MKD 1.1 billion in 2012, down from MKD 1.36 billion (or roughly USD 28.8 million) in 2011. The spending on SFA (as a percentage of GDP) has been declining since 2007 (details on spending are provided in annex 1).

**The performance[11] of the "broad" LRSA[12] in FYR Macedonia (in terms of coverage and targeting accuracy) is comparable to other such programs in the region.** The broad LRSA targeting accuracy used to be mediocre earlier in the 2000s, and elite capture (leakage of benefits to the richest quintile) was significant. The most recent HBS (2010) data[13] indicate a targeting accuracy comparable with similar programs in the region with 67 percent of the total benefits going to the poorest quintile, and very limited elite capture (slightly over 3 percent). However, the leakage to the nonpoor is over 30 percent, which is significant by regional standards. On average, the means-tested LRSA programs in Eastern Europe and Central Asia are characterized by high targeting accuracy[14]—with as much as 80–90 percent of the overall benefit transfer going to the poorest consumption quintile.

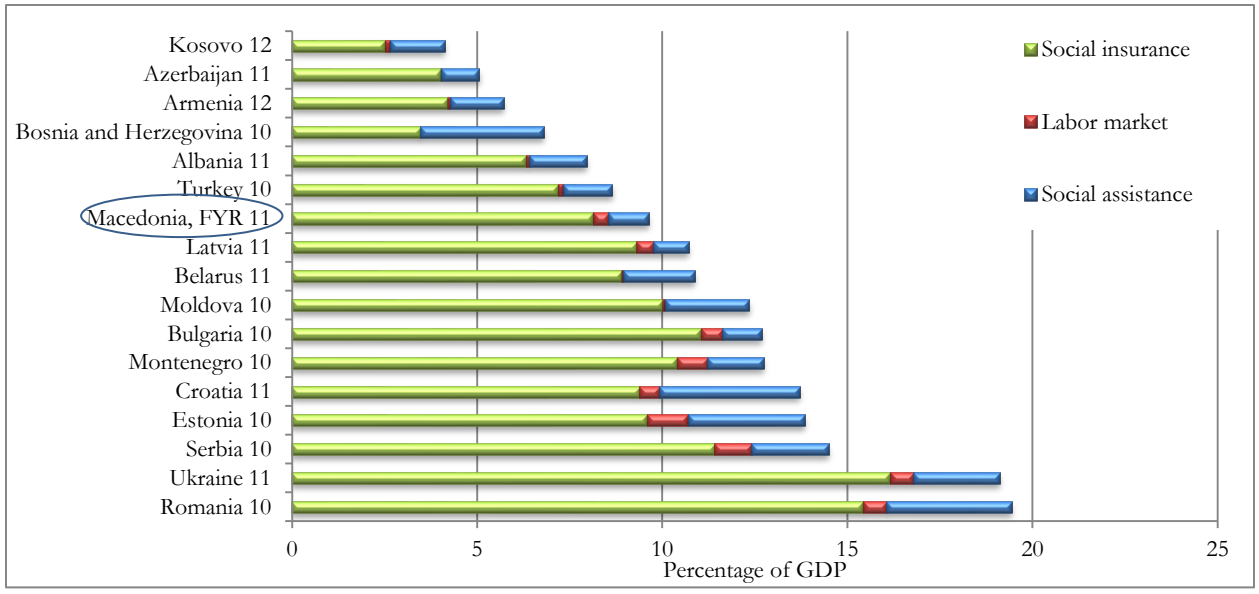
[11] We use household survey micro data to assess performance outcomes of social assistance in FYR Macedonia in terms of (a) *coverage* (percentage of the poorest quintile who receive benefits); (b) *targeting accuracy* (percentage of benefits going to the poorest quintile); and (c) *generosity (adequacy)* (average transfer amount as a fraction of average consumption for beneficiary households in poorest quintile and unit transfers as a fraction of minimum wage). We use standardized methodology to develop the performance indicators. Welfare is measured with a harmonized consumption aggregate, and individuals are ranked based on per capita consumption before cash transfer. Standardized software is used to compute indicators. For comparative purposes, those belonging to the quintile with the lowest consumption are defined as poor.

[12] The HBS data do not allow us to distinguish the performance of the SFA program separately. The performance information pertains to what we define as "broad" LRSA, which includes the SFA and small-scale, means-tested Permanent Financial Assistance (PFA) and noncontributory disability benefit.

[13] The performance numbers are obtained with the standard methodology using HBS 2010. However, there is a decrease in the overall sample size in 2010 (and an even bigger decrease in the sample reporting receipt of broad LRSA benefit) compared to previous years. Hence the observed increase in performance should be interpreted cautiously as issues with sampling may be driving some of these results.

[14] The main performance characteristics of the social assistance in FYR Macedonia are presented in annex 2.

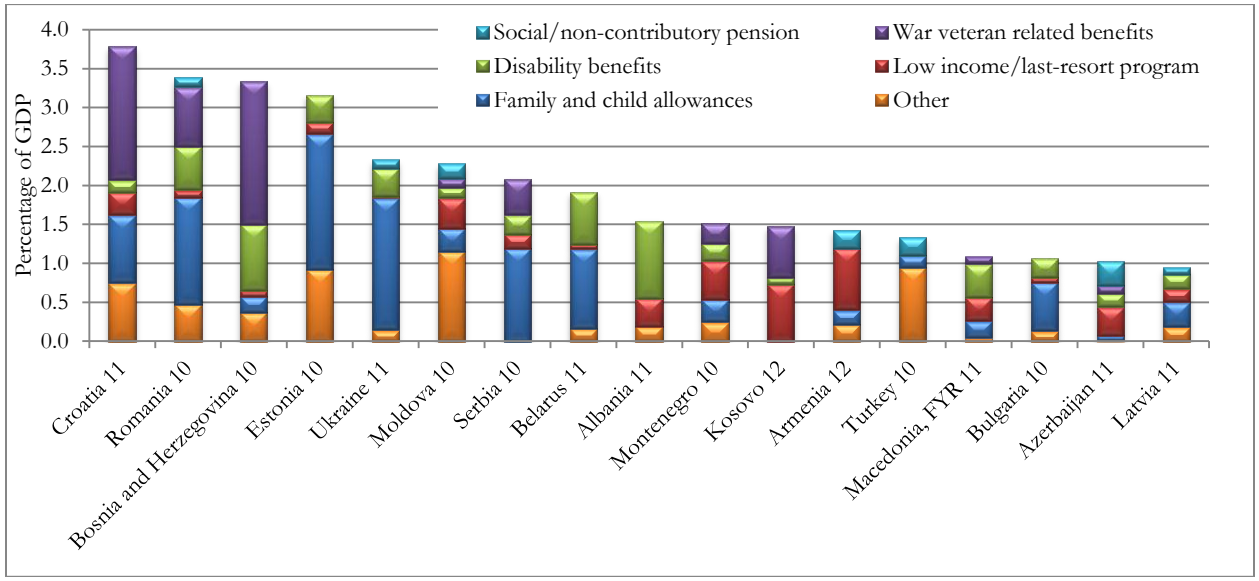
*Figure 21: Structure of Spending on Social Protection in FYR Macedonia and Selected Other Eastern European and Central Asian Countries, 2009–11*




*Source:* Eastern Europe and Central Asia Social Protection Database, World Bank.

*Note:* Country-specific data are for the year indicated following each country's name in the y-axis (most recent year for which data are available). Social insurance includes pension and disability programs based on social insurance contribution payments. Labor market programs include both passive (unemployment) benefits and ALMPs. Social assistance encompasses three main types of noncontributory benefits: last resort social assistance, family and child protection benefits, and noncontributory disability benefits. In some cases, including in the Western Balkan countries, social assistance includes region-specific war veteran-related benefits (World Bank 2011).

*Figure 22: Social Assistance Spending by Program Type in FYR Macedonia and Selected Other Eastern European and Central Asian Countries, 2009–11*




*Source:* Eastern Europe and Central Asia Social Protection Database, World Bank.
Note: Country-specific data are for the year indicated following each country's name in the x-axis (most recent year for which data are available). Social assistance encompasses four main types of noncontributory benefits: last resort social assistance, family and child protection benefits, noncontributory disability benefits, and war veteran-related benefits.

**A different picture emerges relative to broad LRSA coverage**. The coverage of the poorest quintile has been rather low, with only 25 percent of the poorest quintile covered by the broad LRSA in 2010[15], and coverage has declined (down from 30 percent of the poorest quintile in 2008). The coverage of the richest 20 percent of the population is negligible (under 1 percent, down from 4 percent in 2008). The estimates of coverage from HBS 2010 data indicate that the broad LRSA's coverage of the poorest quintile is relatively better compared with the coverage of other LRSA programs in Eastern Europe and Central Asia.[16] In all comparator countries, these programs have quite low coverage. Exceptions are the programs in Armenia and Kosovo, which by design are more encompassing than LRSA.

## 3.3 Incentives and Disincentives in SFA Benefit Design

**The SFA program's main objective is to provide minimum income and social integration of the most vulnerable and poor members of society. However, as do most means-tested social welfare programs, it raises concerns about the potential negative impact on labor supply as well as the development of long-run welfare dependency of beneficiaries**. The activation process relies on two complementary elements (Vidovic et al. 2011): One is a *demanding element*, which ensures that the relevant legal framework provides incentives to actively supply labor. The other is an *enabling element*, which provides tools for overcoming barriers to active labor supply. A simple analytical framework that summarizes these two "elements of activation"—adapted according to the SFA design and instruments for activation in FYR Macedonia—is presented in table 3. The benchmarking of SFA activation conditions to this framework reveals that the design of the program does not seem to induce active labor behavior among the benefit recipients.

*Table 3: The Two Elements of Activation*

| Demanding | Enabling |
|---|---|
| **1. Duration of benefit receipt**<br>• Lowering benefit rate with time or decreasing schedule (yes)<br>• Limitation of the benefit receipt duration (no)<br>**2. Availability criteria and sanctioning clauses**<br>• How restrictive is the definition of | 1. **Classical ALMPs**<br>• Job-related training schemes (yes)<br>• Employment incentives (yes)<br>• Start-up programs (yes)<br>• Public works programs (direct job creation) (yes)<br>**2. Soft ALMPs**<br>• Job search assistance (yes) |

[15] The performance numbers are obtained with the standard methodology using HBS 2010. However, there is a decrease in the overall sample size in 2010 (and an even bigger decrease in the sample reporting receipt of broad LRSA benefit) compared to previous years. Hence the observed increase in performance should be interpreted cautiously as issues with sampling may be driving some of these results.

[16] Note that "broad" LRSA includes SFA (which is the main LRSA) as well as means-tested PFA and the noncontributory disability program, hence the coverage is likely overestimated compared with other countries where only one program's coverage is included.

| | |
|---|---|
| suitable job offers (moderately)<br>• Punitive sanctions for noncompliance (exist but are not strictly enforced)<br>• Restrictive entry, reentry and exit conditions (restrictive, no legal guarantees for reentry in SFA after trying a job or participation in ALMPs)<br>**3. Individual activity requirements**<br>• Integration contracts (yes, individual action plans )<br>• Monitoring of individual job search effort (yes)<br>• Mandatory participation in ALMPs (yes) | • Counseling (yes)<br>**3. Financial incentives**<br>• Earning disregard clauses (no)<br>• Wage supplements granted in case of taking up low pay jobs (in-work benefits) (no)<br>• Earned-income disregards (no) |

*Source:* Vidovic, 2011, based on Eichhorst W. and Konle-Seidl R., IZA Discussion Paper No. 3905, 2008 and adjusted to SFA program characteristics.
Note: ALMP = active labor market program. SFA = Social Financial Assistance.

**Both the unemployment benefit and the SFA have work incentives embodied mainly as work requirements.** Moreover, work requirements and activation in a narrow sense are legislated and enforced because they are part of the program. If able-bodied, recipients of the transfers have to prove active job searching to exercise the right to SFA. That can be done through regular registration or re-registration in the EA, attendance at job interviews, responding to job referrals by the EA, participation in ALMPs, and so forth. Once per month, the EA provides data to SWCs on the job-search history of the SFA beneficiaries. The regularity of such data exchange varies by municipality or from case to case. The sanctions for not taking a job are not always strict or are not enforced. In particular, when an SFA recipient rejects a job offer, he or she loses the right to SFA, but that same right can be easily transferred to other household member. The legislation is somewhat more restrictive when an SFA beneficiary rejects participation in public work programs (PWPs) or seasonal work organized by a municipality or public enterprise (World Bank 2012b).

**Specific incentives for making the transition from social assistance to work are embedded in the declining schedule for receipt of SFA and legal guarantees for keeping SFA status while on PWPs** (World Bank 2011; World Bank 2012b). The SFA benefit declines with time to 50 percent of the initial amount after three consecutive years of receipt. SFA beneficiaries can be engaged in public works up to five days per month without losing the right of SFA. Although their PWP income is not disregarded, their reentry to the SFA program is easier. Not yet considered are

"advanced" and more powerful work incentives such as in-work benefits, earned income disregards, or higher income thresholds for exit from LRSA than the entry thresholds.[17]

**Work disincentives are either "generic" or program-specific.** *Generic disincentives* are pertinent to LRSA programs because of the use of income and asset tests for eligibility determination, and because of a benefit formula that defines the benefit due as difference and taxes away any additional income (NAO 2011). *Program-specific disincentives* stem from the individual design of each program, which eventually determines the generosity of the program and envisages specific incentives to graduate or (alternatively) incentives for staying on social assistance. International evidence suggests that large work disincentives are only found in programs for work-able households that are marked by two characteristics: (a) programs that are characterized by high generosity; and (b) programs that have a high marginal tax rate on earnings. The ongoing analysis also suggests that policy solutions exist to mitigate the concerns about work disincentives. More specifically, certain policies might work for promoting work and employability, on one hand, and for reducing dependency, on the other, especially in middle- and high-income countries. These programs usually revolve around a few subgroups of elements that, among others, encompass financial incentives, earning subsidies, time limits in programs, and work requirements. It is important to also note that some of these reform measures come with a cost. The extant policy research from high-income countries points also to a significant trade-off among policy goals. For example, the financial incentives might increase employment and income and decrease use of welfare. At the same time, however, work requirements might increase the use of the welfare and increase employment but decrease income. Finally, the time limits to these programs have a similar effect as the work requirements: they may increase the use of welfare and increase total employment but, at the same time, they might be associated with decrease in income (see, for instance, Jonassen 2013 or Decker 1997).

**The specific disincentives to work stemming from the SFA program's design and use appear significant.** There are several arguments in support of this statement.

**First, registration of SFA users as unemployed is not mandatory.** Those who are able-bodied and eligible for work can apply if they fulfill the eligibility criteria, which – unlike in other Western Balkan countries – do not include mandatory registration as unemployed. However, this is somewhat complicated by some ambiguity in the legislation. In particular, the Law on Social Protection sets the entitlement criteria so that a person who is able to work but lacking minimum resources ("materially not provided") is eligible for SFA. The Law on Social Protection does not explicitly refer to a person being unemployed, but it asks that a person be either unemployed (providing evidence from the EA of being a registered unemployed person) or prove that he or she has no work contract (again, this proof is provided by the EA). In the latter case, the SFA beneficiary does not have to be registered as unemployed and to actively seek for job. The absence of work contract should evidence lack of income from work. The implementation of this regulation varies. In some SWCs, SFA beneficiaries are asked to bring proof of registration as unemployed,

[17] Details on these types of incentives and other instruments to incentivize job searching and job taking are presented in annex 5.

whereas in others they are asked to bring proof of not having a work contract. The existing knowledge from the field suggests that there are pros and cons for both practices. On one hand, SFA users who do not search for a job actively or are unwilling to work and accept a job should not be asked to register as unemployed. On the other hand, if they are not registered as unemployed, they would not be entitled to participate in the ALMPs, and hence their activation would not be possible. With the recent commencement of data sharing between the EA and SWCs, the EA could activate some of the SFA beneficiaries through ALMPs (including public works, seasonal work or training) without an obligation of SFA beneficiaries to register with the EA (World Bank 2012b).

**Furthermore, although the income test for SFA eligibility is fairly rigorous, hard-to-verify incomes are not taken into consideration.** These incomes, among other types, include incomes obtained as a result of informal employment or in-kind benefits. In addition, some incomes are disregarded, although this is not the case for the incomes that are gained by participating in activation measures.[18]

**Third, from a legal point of view, the sanctions for not taking an offered job are not severe.** If an SFA user rejects a PWP or seasonal work organized by a municipality or public enterprise, the SFA benefit going to that unit of assistance would be decreased by the amount owned to that respective SFA user for the next 12 months (World Bank 2012a; Lehman 2010). Moreover, the sanctions depend on what type of work has been rejected. In particular, when an SFA recipient rejects a job offer made by the EA office, he or she loses the right to SFA. However, the right to SFA can be claimed by other member of the same unit of assistance. The penalty would be that the SFA going to it would be reduced by the amount of the SFA due to the non-complying member only (coefficient 0.37 – amount equal to 37 percent of the amount due to the first adult in the assistance unit), and for six months. The current legislation is more restrictive when an SFA beneficiary rejects a PWP or seasonal work organized by a municipality or public enterprise. Then the same rules apply but the non-complying member is excluded, ergo the amount of the benefit for the unit of assistance is reduced for 12 months.

**Fourth, the design of the SFA benefit creates further disincentives for work.** Given that SFA is means-tested, any formal earned income reduces the amount of the benefit. Just as in many other countries in the Eastern European and Central Asian region, FYR Macedonia's SFA program is designed in a way that each additional denar earned by a beneficiary is subtracted from the benefit amount. The benefit is calculated as a difference between a certain income threshold and net income of beneficiary families. As a result, below the threshold there is no financial incentive for a family to earn more income because it will be automatically reduced from the benefit they receive. This design thus has a 100 percent marginal effective tax rate. Such benefit design discourages a beneficiary's own efforts to earn and increase income as well as participation in PWPs or ALMPs offered by the EA. If an SFA beneficiary is engaged in public work or seasonal or temporary work organized by municipalities or public enterprises for more than five days per month (in which case they receive an allowance), the benefit is made "pending." It can be regained automatically afterward, but the

[18] Republic of Macedonia (2009).

income earned would be counted when calculating the benefit level (because the SFA is means-tested)[19]. Moreover, if the person earns higher income than the level of the benefit, the benefit would be withdrawn completely. In addition, if the seasonal work is provided by a private entity, the person might lose the right to SFA. Given that SFA is based on the average income level in the previous three months, that person might not be eligible for SFA at the end of the seasonal work. Hence, some SFA beneficiaries prefer to perform the seasonal work informally because the income test is performed only on formal income.

**The design of the SFA creates incentives to look for an informal job because returns from getting a formal job are rather low.** More specifically, some combination of income gained from informal employment and SFA could be higher than an income gained from formal employment (which, in turn, will be subject to taxation). This, in turn, could create further disincentives from entering the formal labor market. Informal workers need to give up a significant amount of their formal wage in order to formalize, which is equal to the social security contributions and any income taxes. In return, they get some social security entitlements (mainly, pension and health insurance) and some other benefits (such as employment protection), but the present value of these benefits might not be enough of an incentive for certain workers to take formal employment. These individuals could become "trapped" in unemployment or informal employment.

**Fifth, disincentives are likely further exacerbated by some additional rights or benefits given to the households that use social assistance.** For instance, these households (a) are entitled to cheap telephone and television packages (of about USD 2.5 per month); (b) have the right to financial reimbursement for energy bills; (c) would be granted personal computers from the government (the government recently announced this); and (d) receive some in-kind support from nongovernmental organizations. Social workers from the SWCs reported that by combining all types of social assistance benefits, a four-member household might get up to MKD 25,000 per month (plus the mentioned benefits). If the two parents (adults) from the household accept a job at minimum wage, they would earn a total of about MKD 16,500 and lose the other benefits. These calculations imply that disincentives are related to a small difference between wages in low-skilled jobs in an open labor market and the level of benefits that a family might draw from the unemployment and social assistance system. In other words, the opportunity cost of a formal job is high (World Bank 2012b). In addition, participating in SFA is a prerequisite for additional government transfers such as the secondary education CCT program and the recently introduced subsidized employment for SFA recipients CCT program, which may further provide additional benefits to a smaller group of SFA recipients. However, it is important to note that both these programs are designed to help the family in reducing their vulnerability and ultimately their dependence on transfers through education and employment opportunities. So both these programs have built-in incentives for moving from transfers to productive employment.

[19] The Government is in the process of approving/discussing a draft law which proposes that the SFA beneficiary status will be on-hold for those who take-up seasonal work up to 90 days in a given year. While the income earned will not be disregarded, SFA beneficiaries will not be removed from the program and can go back to the benefit once the seasonal employment is over.

## 3.4 Financial Disincentives Stemming from the Tax-Benefit System

**To further assess how the tax-benefit system in FYR Macedonia can affect work incentives, a tax-benefit model was used.** The model incorporates *legal rules* related to cash social assistance benefits, such as the SFA and child benefits, as well as income taxes and contributions. The tax-benefit model reflects the *combined* effect of taxation and benefit systems on the *net income* of individuals and other select types of households. Specifically, the "typical" household types available in the model are single, single parent with two children, one-earner couple without children, and one-earner couple with two children.[20] The results presented here are based on a tax-benefit model developed following OECD methodology for FYR Macedonia for the year 2012. For more details on the methodology, please see annex 3.

**There are unlikely to be significant financial work disincentives stemming from the unemployment insurance.** In line with the assessment above, unemployment insurance benefits in FYR Macedonia are unlikely to be a source of work disincentives as measured by the indicator of the "unemployment trap," that is, the implicit tax on returning to work for unemployed persons receiving the unemployment benefit. In FYR Macedonia, the average effective tax rate for moving from unemployment to work is lower than or comparable to other countries in the region and the OECD averages (annex 3, figure A3.1).

**There are implicit work disincentives in the LRSA program design.** As mentioned above, just as in many other countries in the Eastern European and Central Asian region, the SFA program is designed in a way that each additional denar earned by a beneficiary is subtracted from the benefit amount. The benefit is calculated as a difference between a certain income threshold and net income of beneficiary families. As a result, below the threshold there is no financial incentive for a family to earn more income because it will be automatically reduced from the benefit they receive. This design has a 100 percent marginal effective tax rate. As shown in figure 23,[21] the marginal effective tax rate is 100 percent for a one-earner family with two children up to about 15 percent of the average wage, when this family is no longer eligible for social assistance. Similarly, there is an increase in the marginal and average effective tax rates when a household loses eligibility for the child allowance (about 33 percent of the average wage for a one-earner couple with two children).

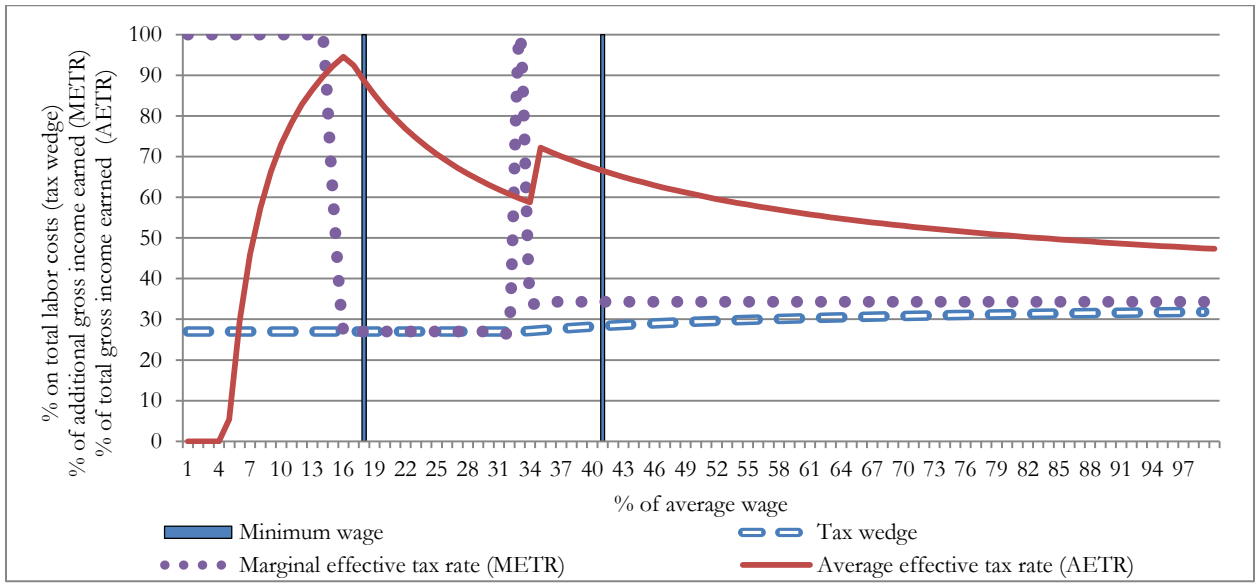
**However, social assistance is withdrawn at very low earnings levels; hence, these high marginal effective tax rates are unlikely to have a significant impact on employment decisions.** For a one-earner family with two children, social assistance is withdrawn at a level that is less than the full-time minimum wage. This is also the case for other household types. It is therefore unlikely that these high marginal effective tax rates have a significant impact on employment decisions, but, in theory, they could weaken incentives to take up part-time, temporary, or seasonal

[20] Children in the model are assumed to be of preschool and school age. Although the standard model also includes simulations for two-earner couples, they were not considered in the analysis here. Simulated earnings of two-earner couples in the model start at 67 percent of the average wage for the first adult. At this level, in most simulations, households are not eligible for social assistance.

[21] See annex 3 for additional figures for other household types.

employment at levels below the social assistance threshold. Disregarding such earnings partially or fully for the purposes of the social assistance income test could significantly improve attachment of SFA beneficiaries to the formal labor market. In the absence of such a possibility, beneficiaries are most likely to take such employment in the informal sector.

*Figure 23: Tax Wedge and Effective Tax Rates for a One-Earner Couple with Two children in FYR Macedonia (2012)*




*Source:* Calculations based on OECD tax-benefit model.
Note: The figure reflects the situation when the household earnings are related to working days in a week. The rise of earnings from 0 to 100 percent of the average wage is linked to the increase of working days from 0 to 5 (full-time).
The tax wedge is defined as the proportional difference between the costs of a worker to their employer (wage and social security contributions, i.e. the total labor cost) and the amount of net earnings that the worker receives (wages minus personal income tax and social security contributions, plus any available family benefits). The METR is defined as (1 – Δne/Δge) where Δne is equal to the change in net earnings, and Δge is the change in gross earnings experienced by the household, where the marginal change is 1 percent of the average wage. The AETR is defined as (1 – Δne/Δge) where Δne is equal to the change in net earnings, and Δge is the change in gross earnings experienced by the household, where the total change is from 0 to x percentage of the average wage (from 1 to 100 percent, as indicated on the x axis).

**Low benefit levels limit potential for "inactivity traps."** The average effective tax rates for taking low-paid jobs are quite moderate in FYR Macedonia—significantly below the EU10 and EU15 averages. Only for a one-earner couple with two children, the average effective tax rates to take a job for 67 percent of the average wage or less is somewhat higher than in other Western Balkan countries (except Serbia). Even in this situation, such a household stands to gain at least 40 percent more net income when a person takes such a job (see annex 3, figure A3.3). As a result, "inactivity traps" are not likely to present a significant problem in FYR Macedonia.

**However, incentives to take employment could be improved by lowering the tax burden on low wages.** Withdrawal of social assistance benefits only partially contributes to participation tax rates in FYR Macedonia. The combined burden of social security contributions and income taxes represents more than half of the effective tax on earnings (see annex 3, figure A3.4). This is

particularly driven by social security contributions in FYR Macedonia, which are paid at the same rate of 27 percent for those working part-time.[22] For those working full-time, however, there is a minimum floor for payment of social security contributions, which is set at 50 percent of the national average gross wage. In such cases, the tax wedge is very high at the full-time minimum wage level, equaling 34 percent of gross pay. This would not only prevent certain jobs from being viable but would also likely contribute to incentives to work informally.

**Finally, the macroeconomic climate also creates further disincentives to work among "activable" SFA recipients[23].** Although FYR Macedonia ranks relatively well in terms of business climate, constraints to employment exist at company level in many areas—from taxation to land access, public services, operation of the courts, and corruption. In the context of a large state, high tax rates (notably on labor), and other impediments to doing business, the entry of firms and entrepreneurship in FYR Macedonia face barriers. Indeed, the World Bank's *Doing Business* ranks FYR Macedonia as the fifth-easiest country in which to start a business. According to the *Doing Business* estimates, it takes an average of about two business days to start a business and costs about 1.9 percent of the average per capita income. However, such legal advancements do not fully translate into on-the-ground improvements. According to the EBRD and World Bank's Life in Transition Survey (LITS) (2010), only around 15 percent of the FYR Macedonian population has attempted to start a business. Of those, a bit over two-thirds have been successful. In addition, the skills of FYR Macedonian laborers are not up to par. Although lack of skills does not figure high on the list of barriers to employment highlighted by FYR Macedonian firms, some workers evidently do not have the necessary job skills. Table 4 pulls together information on educational indicators, including tertiary enrollment and test scores in mathematics and science as compiled by the Trends in International Mathematics and Science Study (TIMSS). Enrollment rates are lower than the regional average and are significantly below rates in Western Europe. Test scores—a good measure of educational outcomes—show that FYR Macedonia ranks relatively low among countries participating in the test. In mathematics and science, FYR Macedonia ranked 45th and 51st respectively out of 69 countries, and its test scores are significantly lower than those of the neighboring countries. To put this in a wider context, FYR Macedonia's 8th-grade mathematics score was 75–80 percent of the average attained by 8th-grade students in the leading countries such as Singapore and Japan, and it was at least 10 percent lower than that of most Western European countries.

[22] Social security funds accept a partial contribution based on part-time work, that is, contributions are calculated on a per-hour basis.

[23] These kinds of incentives and disincentives are only mentioned here to give a sense of demand and supply side complexity but are not the subject of more detailed analysis in this particular note.

*Table 4: Effectiveness of Government Education Spending in Western Balkan Countries, 2010*

| Country | Public expenditure per pupil, in % of GDP per capita, 2010 | Tertiary school enrollment rate,(% gross, 2010) | TIMMS 8th grade mathematics (score and rank relative to total number of participating countries, 2007) | TIMMS 8th grade science (score and rank relative to total number of participating countries,2007) |
|---|---|---|---|---|
| Bosnia and Herzegovina | | 37.16 | 456 (42/69) | 466 (44/69) |
| Albania | | 18.38 | .. | .. |
| Croatia | 24.0 | 54.13 | .. | .. |
| FYR Macedonia | 16.9 | 38.62 | 435 (45/69) | 449 (51/69) |
| Montenegro | | 47.64 | .. | .. |
| Serbia | 28.8 | 49.08 | 486 (29/69) | 470 (40/69) |

*Source*: World Development Indicators, UNESCO Institute for statistics. Note: ** Latest TIMMS data is for 2007

# 4. Institutional Setup for Activation

This section continues the review of elements that the activation process relies upon. The institutional problems with the activation policies stem from both the institutional setup and the current activation programs' design. This section of the note assesses the strengths and weaknesses of the institutional setup and constraints that have a bearing on the delivery of services for activation. As such, it is divided in two main parts: (a) one that analyzes issues regarding the institutional capacity, staffing, and organization of the EA and SWCs as well as the cooperation between them for activating the able-bodied recipients of income support; and (b) one that focuses on the challenges of the ongoing ALMPs.

## 4.1 Institutional Setup and Capacity

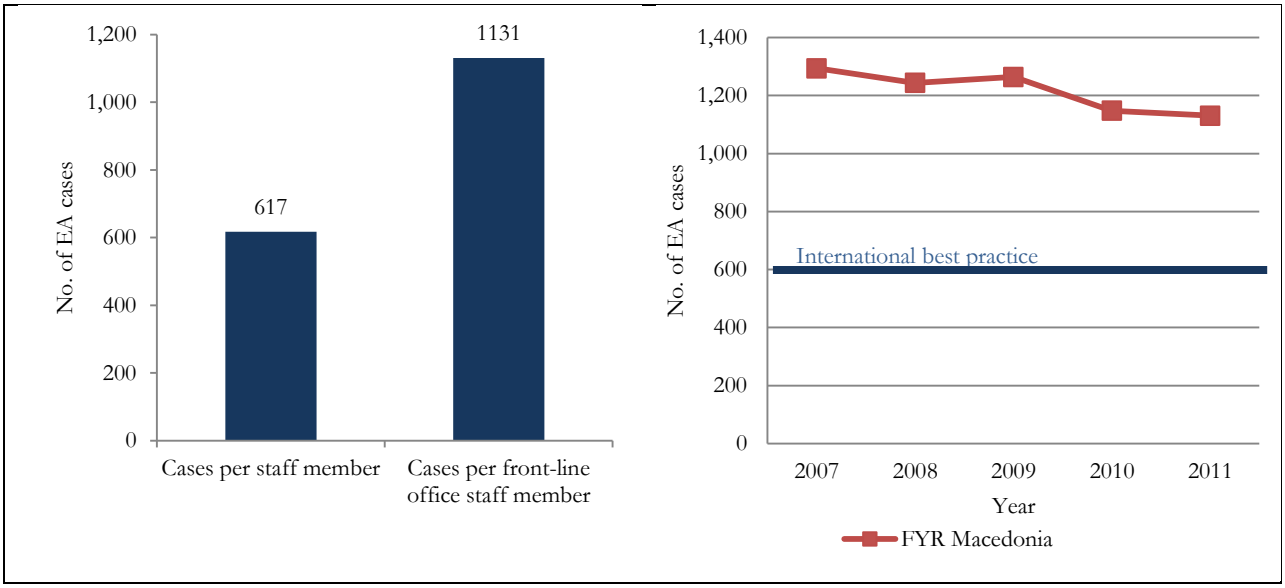
**FYR Macedonia has labor market institutions in place, but capacity for activation on a large scale is insufficient.** A few issues revolve around the work of the EA.

**First, EA local offices are understaffed, underfinanced, and overburdened with a relatively high caseload by international standards.** For example, data for 2011 show that there were 617 cases per staff member, coupled with 1,131 cases per front-line office staff member (figure 24). The latter ratio has been improving over the years (figure 25). Close to 80 percent of job seekers use the employment service as a job-search method, leading to a staff-to-unemployed ratio of 1 to 617, which is also high by international standards (Vidovic et al. 2011). Moreover, the caseload is uneven across the country, with the staff-to-unemployed ratio varying between 250 and 2,101 (see annex 4). Finally, although 55 percent of the staff is engaged in delivery of ALMPs, most of their time is spent on administrative work. Some of this administrative work is not typical for a public employment service, such as, for example, registration of new work contracts and termination of existing ones (World Bank 2012b). As a result, little attention is devoted to a client-oriented, individualized approach, especially for disadvantaged job seekers.[24] For instance, with the amendments to the Law on Employment and Insurance in Case of Unemployment, the EA has taken the responsibility for preparation of individual action plans for all unemployed. However, the latest data show that such plans have been prepared for only 1 percent of the registered unemployed (World Bank 2012a).

[24] Recently a quota for participation in activation measures by vulnerable groups was put in place (about 100 persons per each call). However the group is defined too broadly, including single parents, people with disabilities, ethnic minorities and others beyond SFA beneficiaries.

*Figure 24: Job Seekers per EA Staff Member in FYR Macedonia, 2011*

*Figure 25: Change in Caseload per Front-Line EA Staff Member in FYR Macedonia, 2011*




*Source:* EA administrative data.
Note: EA = Employment Agency.

**Second, the implementation of employment policies and ALMPs, the budgeting process, and the decision making are highly centralized.** Most of the employment strategies, national action plans for employment, and operational plans for ALMPs are decided at the central level with little or no input from the local EA offices. Moreover, in light of the generally underdeveloped system of monitoring and evaluating ALMPs, there is no evaluation of the effectiveness of the local employment centers. In a similar vein, costing for various labor market policies is conducted at the central level and is not differentiated across local centers. Furthermore, the budgeting procedure is centralized, and budget decisions are conducted by the Ministry of Labor and Social Policy (MLSP) with strong oversight by the Ministry of Finance on total yearly allocation from the state budget. The actual budget allocation is tied to the availability of funds within national multiannual fiscal strategy and yearly budgets. Local offices do not manage their own budgets, but all the payments are made from the central office. Although some flexibility within the budget lines is possible, it is, again, approved centrally, and it depends on the availability of funds in the national budget. Managers of EA offices reported that the organization of the EA has not been adapted to the increased focus on ALMPs. Most of the staff members have job descriptions that do not reflect their actual tasks, or their duties are dual. Moreover, managers argued that only a small proportion of the unemployed are interested in ALMPs and only a few come to visit job clubs on their own initiative.

**Third, there is limited capacity for client profiling and individualized interventions.** The main idea of profiling is to identify which services best fit the particular segment of the unemployed based on the demographic, skill, and education characteristics. Introduction of the profiling system and targeting the high-intensity employment services (such as individual counseling) could also

prove beneficial to those who are hardest to place (Konle-Seidl 2011). Among different countries' experiences with profiling models, some include only hard information in determining the profile of the unemployed worker (such as length of unemployment and formal qualifications), while others add the soft information (for instance, motivational aspects and social networks). However, the profiling of the SFA recipients is predicated on the caseload of the EA staff, which, as noted above, is heavy. [25]

**Fourth, local EA centers have no obligation to actively look for vacancies.** In other words, the local EA centers are not in a position to be "agents of employment." Experiences from other middle-income and advanced countries suggest that communication between EA staff and employers could bring numerous benefits while undertaking the activation policies. This can be done through introduction of "agents for employment," (job brokers who specialize in working with employers) but also by increasing the quality of EA services. For instance, the EA might also implement satisfaction surveys for employers (as well as for the unemployed persons). However, at present, none of this is implemented, mainly because local EA staffs are overburdened with other activities, leaving little time to focus on employers.

**Fifth, there is no legislative framework for outsourcing professional counseling and placement services.** The existing legislation favors using local EA offices for mediation purposes only. The country had no regulatory framework for outsourcing of the placement services. Private employment agencies (PEAs) and temporary work agencies (TWAs) perform their recruitment and selection independently, although they acquire information on job seekers from the EA (in addition to their own clients). There is no available information on whether private agencies focus on those easy-to-place clients. However, TWAs certainly work with hard-to-serve clients and disadvantaged job seekers because they usually provide low-educated workers for the available temporary (usually manual) jobs.

**Sixth, there is minimal cooperation between the institutional bodies that are in charge of social assistance and activation policies.** The interaction between the employment services and social assistance has been limited to file sharing, whereby the EA has been obliged to send, once per month, data on the registered unemployed to the SWCs. In reality, however, this data exchange occurs much less frequently, especially in the provincial offices. This situation will change as starting in mid-2012, more intensive data exchange is being introduced between the databases of the two agencies. As in some of the situations described above, this situation varies across the country, and cooperation seems to be better where local offices are co-placed in the same or close premises (World Bank 2012b). Apart from data sharing possibilities, the cooperation between the EOs and SWCs has been hampered by the high caseloads in many SWCs, leaving little room for casework that goes beyond the required minimum effort for verification of eligibility and benefit determination (box 5).

[25] Reorganization of the ESA with a service delivery approach was approved in February 2013 to improve effectiveness and increase capacity for more individualized interventions. The alignment of staffing with this reorganization is expected to start soon (as of end May 2013).

***Box 5: SWCs—Outreach, Capacity, and Caseload***

The SWCs function since the early 1960s as key public providers of professional social services and administrators of social assistance payments. Currently, there are 30 inter-municipal SWCs with 1,040 employees. The capital Skopje hosts 6 SWC offices of the SWCs with 258 employees. Despite the on-going decentralization in FYR Macedonia, the SWCs have not been transferred to the municipalities for management or financing; they continue to be de-concentrated program implementation bodies of MLSP.

There are professional criteria for social work, and since 2012 social workers are licensed in order to be able to practice their profession. They are required to have special education - completed university degree in social work and social policy. Other experts (pedagogues, psychologists, defectologists, lawyers) working in the SWCs must also have university degree in the respective field of expertise. Administrative workers have to have minimum secondary education. Currently close to 60 percent of the SWCs employees have university education, and close to 40 percent – higher and secondary education.

Casework load is high. The SWCs do not maintain data on all applicants (eligible and ineligible); data exist only for the eligible applicants, and hence we present only the number of active cases serviced per social worker. Total cases for all types of social assistance amounted to 394 per social worker in 2010. In reality, the number of active cases per social worker is higher because social workers in most cases work in parallel on administration of social benefits and on provision of social protection services, such as counseling. According to research by the Institute for Social Affairs in 2011 on the time social workers needed for administration of SFA, PFA, and financial reimbursement for care of other person, one social worker spends an average of 5.3 hours per day on SFA administration. Based on a total of 1,768 working hours in 2010 (excluding vacation, national holidays, and other nonworking days), one social worker might administer on average 333 cases per year. The average number of SFA cases per social worker in 2010 was 330, albeit with large variations among SWCs (for example, from 951 cases per worker in Tetovo to 44 cases in Rezen). A review of the business processes in 3 SWCs – in Skopje, Kumanovo and Veles, indicates that the SWC staff dedicates to SFA close to 20 percent of their working time (at average); and that 60 percent of this time is spent on administration.

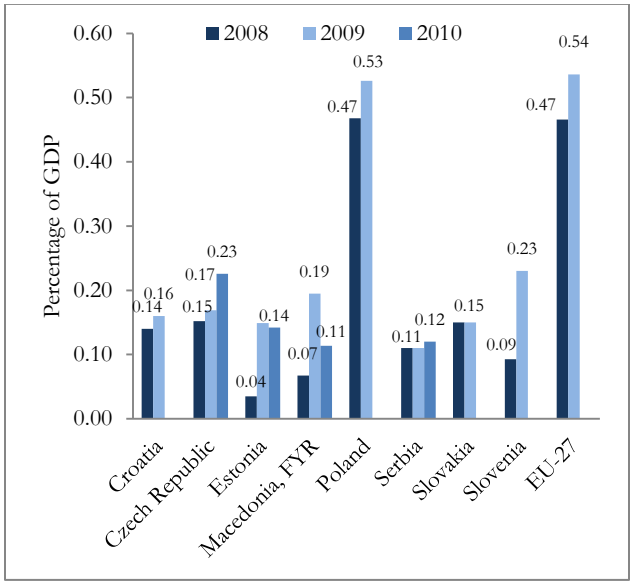
*Source:* World Bank 2012b.

**The cooperation between the EA offices and SWCs is also burdened by ambiguity in the law.** Although the instructions from the relevant ministry on the issue have changed a few times in the past, it is not clear whether the authorities prefer that SFA beneficiaries register as unemployed or simply prove that they do not hold a job. The former system has an advantage in that it would allow for interventions targeted to SFA beneficiaries and activity tests, but the drawback is an artificial increase in the number of registered unemployed to the extent that SFA beneficiaries are not active job seekers. In reality, there is no uniform system across various centers. Although SFA beneficiaries have to prove that they are not employed, some SWCs would ask the unemployed to register in the EA as unemployed (and bring proof of the unemployment status), while others might ask them to bring proof that they do not hold a job (the EA would also issue a notification that a person does not have a labor contract).

## 4.2 Active Labor Market Programs

**The main labor market activation policies consist of two main groups: labor market services and labor market measures.** Labor market services include information services, placement, counseling, preparation of individual action plans, job clubs, professional orientation, and so forth. Labor market measures include training, internships, and employment creation schemes (such as employment subsidies, self-employment programs, and public works). Although the spending on ALMPs has been consistently on an upward trend since 2007, it still remains low. Data for 2011, for example, show that spending on ALMPs amounted to only 0.1 percent of GDP (World Bank 2012b). Despite being low, this level of spending on labor market programs is comparable to the level of spending in the Western Balkan region and, in certain cases, comparable to the level of spending in some of the EU member states, such as Estonia or the Slovak Republic (figure 26). However, in this respect, FYR Macedonia lags behind the EU27, where the average expenditure on ALMPs amounted to 0.54 percent of GDP. In nominal per unemployed head terms, spending on ALMPs in FYR Macedonia is also very low. In 2011 FYR Macedonia spent less than 30 EUR per registered unemployed, where some of the new EU member states allocated much more (e.g. Romania allocated 49 EUR per registered unemployed, Bulgaria – 95 EUR per registered unemployed and Lithuania – 169 EUR per registered unemployed) (World Bank, 2012b).

*Figure 26: Spending on ALMPs in FYR Macedonia and Selected Comparator Countries, 2008–10*




*Source:* World Bank 2012b.
Note: ALMP = active labor market program. GDP = gross domestic product. EU = European Union.

**Although the ALMPs explicitly target a few subgroups of the general population, younger workers are overrepresented in these programs.** The ALMPs specifically target a few subgroups of the population: young workers (defined as workers until 27 years of age), unemployed workers with more than six months of unemployment (three months for women), elderly workers (aged 55–

64), orphans, women victims of family violence, Roma minority population, and workers with disabilities. In reality, however, young workers seem to be overrepresented in these programs (as reported by the MLSP and the EA). The relatively high share of young workers in subsidized employment reflects the preference of employers for younger workers. On the other hand, older workers and the less-educated ones seem to be less represented. In addition, current data show that there is significant allocation of funds for programs such as self-employment, business start-ups, and post-start-up support. Finally, in line with the National Strategy for the Roma, a few ALMPs specifically target this segment of the population.

**The profile of those who have successfully completed different types of ALMPs highlights distinct patterns in ALMP participation.** Figure 27, panel a, shows that *women* are overrepresented in training programs (the biggest of which involve training in foreign languages and in computer skills) as well as in training and retraining for improvement of existing qualification. Women are also overrepresented in "other" ALMPs, which include trainings for the skills needed by specific employers or industries (for example, the textile industry), internships, soft skills, and motivation building. *Men*, on the other hand, tend to take up more of the offered employers' subsidies, training for business start-ups, and training for self-employment. Figure 26, panel b, highlights that *young to mid-age registered unemployed* (28–49 years old) tend to participate in support measures for self-employment, while the highest share of *older registered unemployed* are benefiting from placements in subsidized jobs. *Young registered unemployed* most often take "other" ALMPs, some of which are specifically targeted to their age group. Figure 26, panel c, points out that the *unemployed with upper and postsecondary education* represent more than 60 percent of those who take up training, training for business start-up, support for self-employment, and subsidized employment. Registered *unemployed with primary or lower secondary education*—a group that largely corresponds to the profile of SFA beneficiaries—are a minority among the ALMP beneficiaries. Finally, as shown in figure 26, panel d, the *long-term unemployed* have relatively less preference for getting support for self-employment, business start-up, or for participation in training programs; however, they are overrepresented in "other" AMLPs, which include internships but also some targeted ALMPs for vulnerable groups on the labor market.

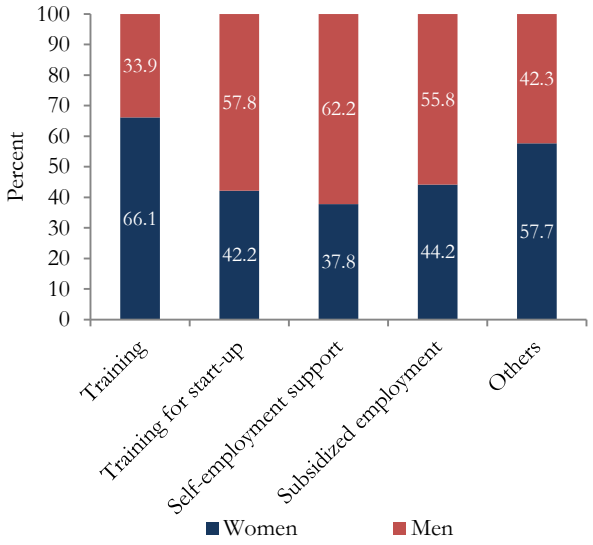
**A few quality constraints are connected with the ALMPs.** Some ALMPs have limited impact because of weak labor market and social welfare institutions and weak coordination between them. For instance, the main challenge with provision of labor market information and professional orientation is that neither the MLSP nor the EA have modern labor market forecasting that would provide information on medium-term developments in the labor market, including medium-term demand for certain types of workers. The EA implements an annual Skill Needs Analysis[26], but it has a short-term horizon (labor demand in the following 6–12 months) and some methodological issues. In addition, as evidenced in our analysis above, the regulatory framework for outsourcing is not fully developed. Moreover, non-state provision is allowed only for training services and for

[26] ESA plans to conduct next year's skills need assessment survey of firms in cooperation with the Statistical office to improve the quality and frequency of the information collected.

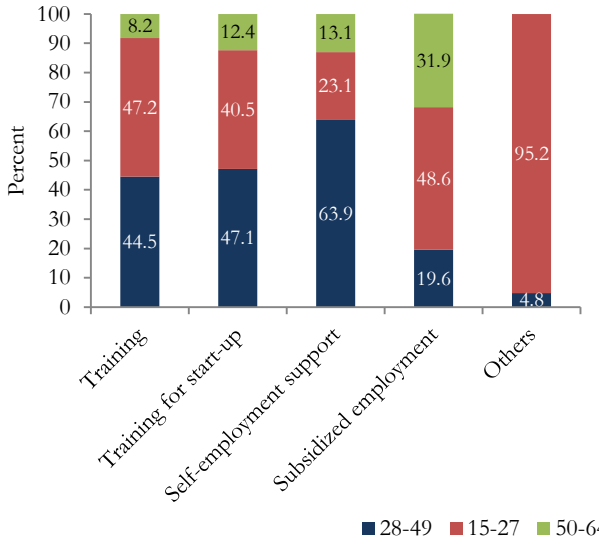
linking with temporary or seasonal jobs.[27] Finally, the employment services are the sole provider of mainstream job placement, mediation, and counseling services. As evidenced from the existing international evidence, this setup limits the capacity for serving the "difficult" clients who constitute the majority of SFA recipients (World Bank 2012b).

*Figure 26: Profiles of Participants in Selected Types of ALMPs in FYR Macedonia, 2011*[a]

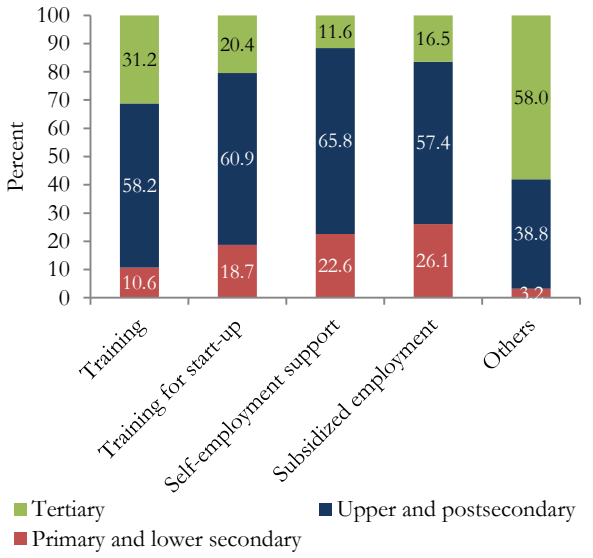
*a. By gender*



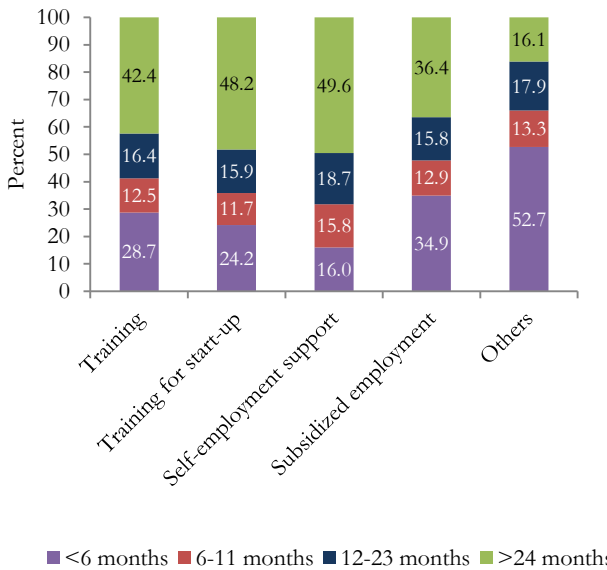

*b. By age group*




*c. By education level*




*d. By unemployment duration*[b]




*Source:* World Bank 2012b from MLSP and EA data.

[27] ESA faces challenges with outsourcing training to non-state providers as the market is underdeveloped with only a few accredited private training providers. The certification/accreditation requirements are reported to be burdensome and time-consuming which likely inhibit the growth of this market.

Note: ALMP = active job market program. Training includes "Training, retraining or additional training," "Training in job clubs (languages and IT)," "Pilot training of unemployed young people up to 29 years for textile industry," and "Training for occupations that are deficient in the labor market." Training for start-up refers to the program "Training in job clubs (program for starting a business)." Self-employment support includes "Support for additional employment in firms registered through self-employment grants in previous years" and "Program for formalization of business," Others includes the "Support program for Roma" and internship programs.
a. A participation in an ALMP is "successful" if the participant achieves the objective of the ALMP (for example, completing the training, preparing a business plan, and so forth).
b. Data for the duration of unemployment are for all participants, not just the successful ones.

**ALMPs are further constrained by the long-lasting unemployment periods of SFA beneficiaries.** It is evident that the existing ALMPs are not well positioned to target the able-bodied SFA recipients, who are either unemployed for long periods of time or are out of the labor force. For instance, one of the target groups for start-up business loans are the long-term unemployed. Out of the registered unemployed in FYR Macedonia, about 80 percent have been unemployed for more than one year, about half have been unemployed for more than three years, and 30 percent have been unemployed for more than eight years. It is, hence, questionable whether a person who lost attachment to the labor market for eight years and whose skills and knowledge have degraded would be able to start a business. Exceptions are cases where those unemployed are informally employed, but there is a special active program for formalization of businesses (World Bank 2012b).

**SFA beneficiaries rarely participate in ALMPs which makes their activation even more difficult.** Interviews with local SWCs have shown that SFA beneficiaries are rarely involved in active programs and even more rarely are they offered jobs. The CCT program for subsidized employment of SFA recipients is a significant step in the right direction to mitigate this (though it will only cover a small share of the unemployed SFA beneficiaries, but can be scaled up if found to be effective). SFA beneficiaries were involved on a larger scale in PWPs in 2009, when the government introduced the public works as part of the ALMPs. However, SFA beneficiaries do not have preferential treatment in placement on the labor market but instead are left to compete for jobs with the other registered unemployed (Lehman 2010; World Bank 2012b).

**Moreover, as argued above, most of the existing programs are biased toward the young and well educated, while, as the analysis above has shown, the current recipients of SFA are characterized by low education levels and long-term unemployment spell.** Given that workers with low levels of education are underrepresented in the ALMPs, it is questionable to what extent ALMPs are able to reach the "activable" SFA recipients. Until recently, explicit targeting of the SFA recipients has been impossible, mainly because of lack of cooperation between the EA and SWCs as well as lack of available data about the percentage of SFA recipients who are also registered as unemployed. However, there have been some improvements in recent years, and the authorities have been explicitly targeting the SFA recipients mainly by adding a few pilot programs in 2012. The first one would allow 100 registered unemployed who are SFA beneficiaries to engage in agriculture by receiving state agricultural land for use. They would be required to register as farmers. They would still receive social assistance (100 percent in the first year and 50 percent in the second year) and unemployment benefits (until exhaustion of the right), and the state would pay social contributions on their behalf (in the first two years). The second pilot, Program for Sustainable

Employment, combines a training program in defined deficient skills and a possibility for the trainees to subsequently start a business with a support from the EA. The third one is a socially beneficial municipal work program that would secure five months of employment in the municipality's social protection services to ensure greater communication and inclusion of the socially excluded unemployed (World Bank 2012b).

**In addition, there are significant problems with the cost-effectiveness of the existing ALMPs.** In other words, they are designed without strong evidence of cost-effectiveness and impact. For instance, most of the program impact evaluation has been fragmented, and assessment of impact through employment outcomes has been limited. The evaluation of active measures is conducted through employment outcomes of different programs or interventions. However, the evaluation results are not fully used for evidence-based policy making. Moreover, the cost-effectiveness of the interventions is not assessed.

**There is also weak enforcement of mutual obligation.** The job-search activity of the unemployed is not really tested because the legislation does not clearly state how the unemployed should prove their active search for a job. Timely registration with the EA is considered as sufficient proof. On the other hand, job search requirements are not enforced strictly. For example, the unemployed are not always sanctioned for lack of "active behavior" nor are they advised on how exactly to prove and document their job search efforts. In addition, job referrals and ALMP participation are used as work tests but only to a limited extent.

**The verification of job search activities currently is rather formal, with on-time re-registration considered as sufficient proof of an active job search.** Besides that, the current legislation sets the following forms of active job search: the unemployed applies to job vacancies; responds to referrals by the EA and other providers of measures; attends job interviews at the request of the employer, EA, or other provider of measures; participates in ALMPs; and so forth. ALMPs, in this case, are considered as a surrogate to work test in addition to their role of improving the employment prospects of unemployed (Duell et al. 2010). Currently, there are proposed changes to the requirements with a view to making them more stringent. However, this is still work in process. Finally, the problem with the superficial verification of job search is exacerbated by the fact that the punishment for not complying with requirements is weak. Approximately 35–50 percent (depending on the year) of those erased from the register return to it after the sanction period of 12 months. (This ratio is an approximation calculated as the number of persons previously deleted from the register who return to it in a certain month divided by the number of unemployed deleted from the register 12 months before).

# 5. Conclusions and Recommendations

**The profile of SA beneficiaries indicates that slightly more than half (54%) of the beneficiaries are work-able, but they are more likely to be out of jobs and have low quality jobs.** They are also less educated with a larger share of young out-of-school individuals, and face additional participation constraints such as higher caretaking duties. The SFA bears the generic disincentives to work, increase income and assets that are pertinent to means-tested guaranteed minimum income schemes in general. At the same time, some demanding conditions for activation have been already introduced. The labor market and social welfare institutions are still not creating conditions that enable activation, such as profiling of the job seekers to tailor interventions; enforcing mutual obligation in the efforts to increase employability and reduce other barriers to work; expanding the offer of activation options; or introduction of case management.

**Based on the analysis conducted above, it is evident that most of the recommendations in this area would consist mainly of two broad elements**:

- Improvement in the design of the social assistance benefits to decrease the disincentives to work
- Improvement in the institutional setup of the labor market and social protection institutions to better position them to answer the challenges of activating the able-bodied recipients who continue to depend on cash transfers

**There is still room for improvement in the design of the SFA program in FYR Macedonia.** The authorities have been making consistent efforts to incentivize exit from the SFA program with the declining level of the benefit over time and the recently approved subsidized employment CCT as well as investing in human capital of the vulnerable through the secondary education CCT program reduce intergenerational poverty/dependency. However, design of the SFA program can still be improved to facilitate better employment outcomes among the beneficiaries through *introduction of a more gradual labor income disregard* (that is, so the FSA benefit is not reduced 1:1 with the increase in earned income[28]). This would reduce the marginal effective tax rate on labor income and would likely create an incentive to look for a job in the formal sector. For instance the Government can consider time-bound in-work benefit schemes, as suggested by the review of international practices, or partial benefits whereby the registered unemployed would further receive unemployment benefits or SFA, by some discount, if they accept a short-term seasonal job organized or directed by the EA, municipalities, public enterprises, or public institutions (World Bank 2012c). The Government has taken steps in the right direction, and it is currently reconsidering the legislation on seasonal work to avoid demotivation to accept formal seasonal work.

**Incentives to take up employment can be further improved by lowering the tax burden on low wages.** Labor taxes on low-wage labor are relatively high in FYR Macedonia, which likely to

[28] This design principle is built-in for the subsidized employment CCT but this program will only cover a very small share of SFA beneficiaries while this principle can be applied more broadly to reduce disincentive effects.

contribute to incentives to work informally. Lowering or offsetting the high tax burden on low-paid or marginal (seasonal or temporary) employment can further strengthen incentives to take such jobs.

**Closer institutional cooperation between EAs and SWCs is needed for effective activation of vulnerable.** Improved coordination might ensure more efficient treatment of the unemployed with multiple barriers to employment and long-term detachment from the labor market, instead of leaving disadvantaged individuals to cope with the two separate systems. Improving the business processes in the SWCs to introduce case management will potentially allow differentiated approaches and more individualized work on each 'case' with the SFA beneficiaries; and their greater involvement in the provision of social care and employment services to address in parallel barriers to employability and participation barriers. Moreover, efforts need to be made to improve the communication between the EA and employers and to boost EAs services for them. One way to do this could be through introduction of "agents for employment" but also by increasing the quality of EA services, and providing targeted support to employers who hire difficult-to-employ EA 'clients'. The EA might also implement user satisfaction surveys for employers (as well as for the unemployed persons).

**Even before enhancing the institutional cooperation between the employment and social welfare agencies, the capacity and effectiveness of the EA work need to be strengthened.** First, there is scope for changes in the work organization of the EA centers, with introduction of profiling, which will increase the focus and time devoted to those hard-to-place workers. Second, there is also room for matching of staffing and resources with the specific labor market conditions, and for linking staff performance with results. Other countries use different benchmarks for budget allocations and staffing to local offices. Those might include the local unemployment rate; the number of registered job seekers; the frequency of interviews with job seekers; the meeting of performance targets (such as the average duration of unemployment benefit entitlement per unemployed or success in preventing exhaustion of unemployment benefits); the application of profiling tools, and so on (Duell et al. 2010; Konle-Seidl 2011). Third, significant improvement of quality and performance of activation measures for hard-to-employ cases can be achieved through the involvement of non-state providers of employment-related services. FYR Macedonia could also rely on the experience in some of the EU countries, such as the United Kingdom, that have long experience with outsourcing of employment services to private providers. Such experiences show that competition might increase cost-efficiency of the programs (Finn 2011). However, the empirical knowledge suggests that the results are not always conclusive. What needs to be considered when outsourcing services is that the right financial incentives are in place for private providers to place disadvantaged and very disadvantaged groups into either ALMPs or employment, along with the right performance monitoring mechanisms.

**There is a need for improvement of data flow across the institutions which have a role in activation.** In June 2012, the government proposed changes in the Law on Employment and Insurance in Case of Unemployment (in Parliamentary procedure), whereby cooperation with TWAs and PEAs would be more formalized. It is yet to be confirmed how the implementation of this law will proceed.

**The MLSP should further develop its capacity for labor market analysis[29].** This could be done in a few ways, thus also streamlining all available information (such as the Skill Needs Analysis, the Job Vacancy survey of the State Statistical Office, the LFS, administrative data on new employments by occupation, and so on) to provide better and more useful data for pupils, parents, and all labor market participants to make informed choices.

**In addition, the FYR Macedonia government may consider significant policy changes, such as advanced profiling, to improve the cost-effectiveness of the ALMPs.** First, increased competition is a prerequisite for increased cost-effectiveness of the programs. Second, expansion of private provision of wider job intermediation should be placed on the reform agenda. Finally, Advanced profiling of job seekers, including SFA beneficiaries, could be introduced in the near future to further improve the targeting and cost-efficiency of activation measures**.** Currently basic job-seeker profiling methodology is in the process of development and is pending enforcement. Statistical profiling, used in many OECD and EU countries, could be adopted to increase the targeting and cost-efficiency of activation measures. This will likely result in efficiency gains if target groups for ALMPs are streamlined and defined based on multiple employment barriers instead of on a single one.

**Social assistance beneficiaries are only a fraction of the inactive, and activation measures that only target them will not bring significant impact.** The detailed analysis of the profile of social assistance beneficiaries, unemployed and inactive in FYR Macedonia suggests that social assistance beneficiaries are only a small segment of all inactive. An activation agenda aiming uniquely at social assistance beneficiaries would reach only a relatively small share of the work-able who are out of jobs. However, analyzing the reasons for and barriers to activation of social assistance beneficiaries is important due to the increasing sensitivity associated with unconditional social transfers, and ineffective use of public funds, which could lead to welfare dependency, albeit for a small fraction of the inactive population.

**There is a much broader activation agenda than the one implied by a focus on addressing welfare dependency**. While the note is focused largely on developing incentive compatible safety net in FYR Macedonia and activation of social assistance beneficiaries, most of the inactive and/or unemployed "work-able" population is outside the beneficiary population. The note provides entry points for further analysis and policy dialogue on the importance of a broader activation agenda. The knowledge of the profile of inactive and unemployed, along with the interaction of the enabling and demanding elements of activation can be applied to reduce work disincentives for larger groups of inactive. As a next step the analysis and policy dialogue on activation measures should encompass other social programs. Under the current fiscal pressures, a careful consideration of the cost-effective ALMPs with the right mix of services will be needed to maximize employment impact.

[29] The Western Balkans Jobs task is actively engaged in the broad labor market analysis including examining labor demand through use of various data sources. It is expected that this engagement will strengthen the capacity in the Government for labor market analysis.

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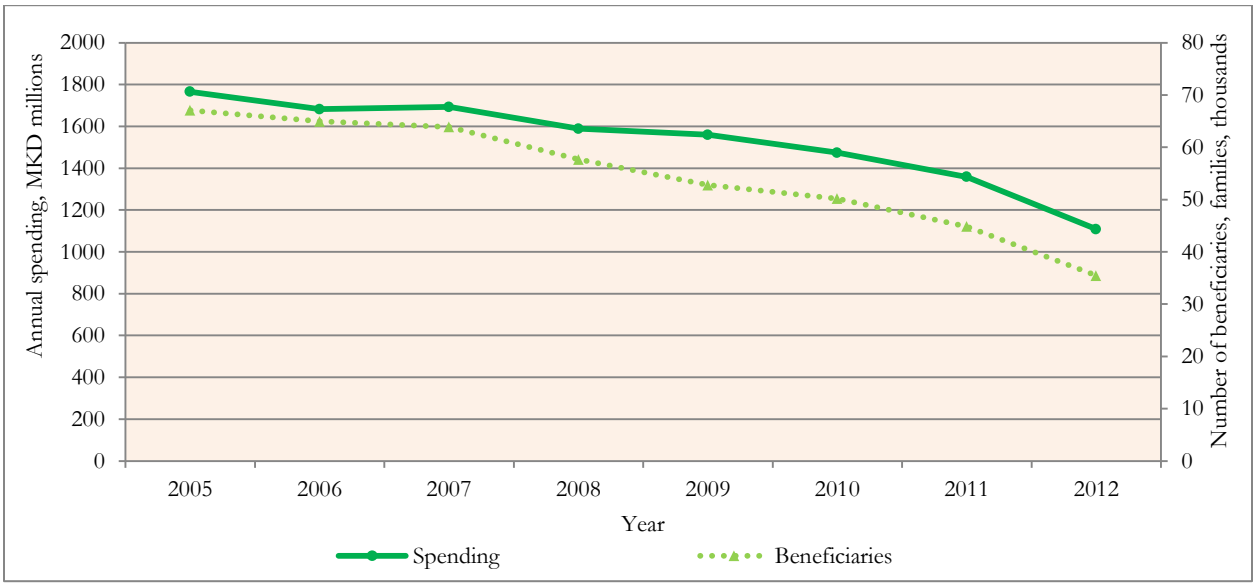
# Annex 1: Administrative data on Social Financial Assistance spending and beneficiary numbers

*Table A.1: Beneficiaries and Spending on Social Financial Assistance*




*Source*: ECA Social Protection Database

# Annex 2: Performance indicators for Last Resort Social Assistance programs

Indicators of performance of social assistance cash transfers include:

**a) Coverage**: What share of the population and each quintile receives the transfers?

**b) Targeting accuracy:** What share of social assistance transfers goes to each quintile? In other words, it indicates the transfer amount received by the group as a percent of total transfers received by the population.

**Coverage of Last Resort Social Assistance Programs**

*Figure A2.1: Coverage of the Poorest Quintile*

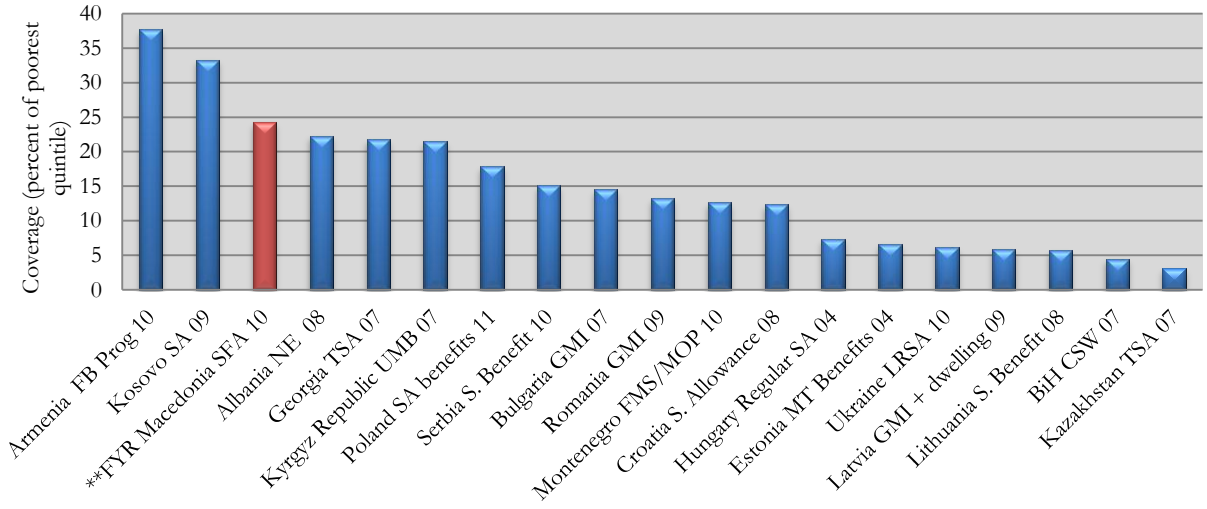
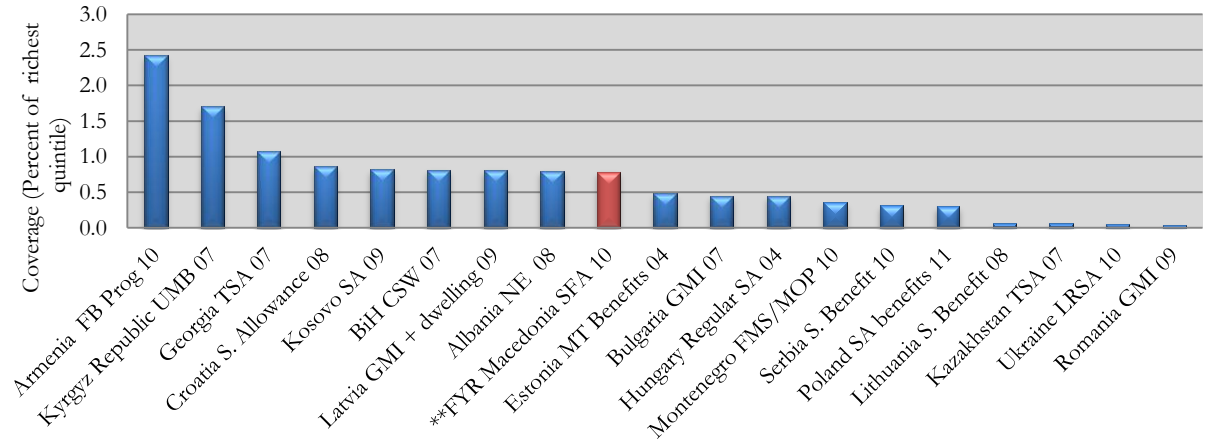



*Figure A2.2: Coverage of the Richest Quintile*



## Targeting Accuracy of Last Resort Social Assistance Programs

*Figure A2.3: Targeting Accuracy of the Poorest Quintile*

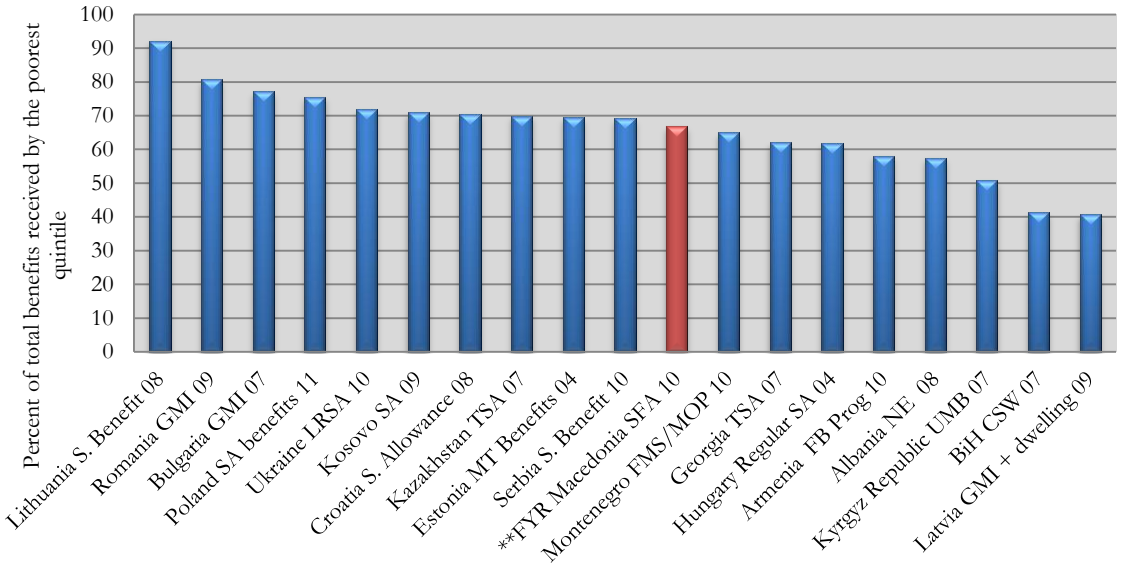
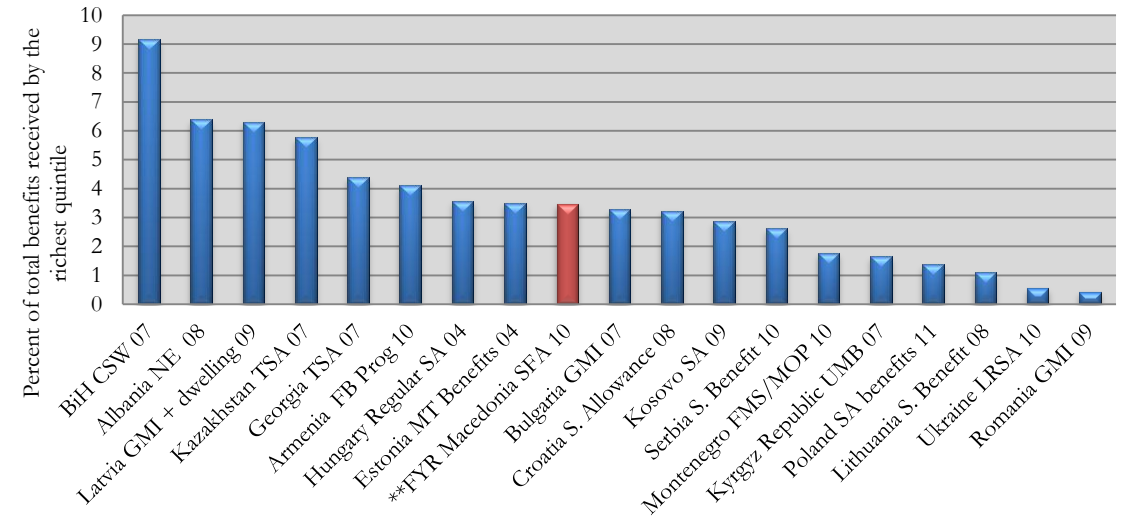



*Figure A2.4: Targeting Accuracy of the Richest Quintile*




** Performance indicators were generated in the context of analytical work supporting the Macedonia DPL program.

*Source*: Europe Central Asia Region Social Protection Database

Performance indicators are generated using a standardized methodology that includes the use of household surveys (HBS, LSMS, etc.) and harmonized consumption aggregates (developed by ECAPOV team). For the purpose of this analysis, individuals are ranked on the basis of per capita consumption before all social assistance cash transfers and then divided into five equally sized groups, representing 20 percent of the population ("quintiles") to form the bottom, second, third, fourth, and top quintile. A standardized software (ADePT) developed by the World Bank's Development Economics Research Group is used.

# Annex 3: Analysis of financial disincentives stemming from the tax-benefit system

## Introduction

**Possible adverse effects of taxes and social benefits on unemployment and inactivity levels present a widespread concern.** In FYR Macedonia, where unemployment and inactivity rates remain very high, it is of particular importance to assess whether the current design of social benefits and tax system could undermine financial incentives to work. This section employs a well-established methodology to calculate indicators of financial work incentives using the OECD tax-benefit model.[30]

**Adequacy of incomes of those out of work is also important to consider in designing policies aimed at increasing work incentives**. While lowering the level of social benefits could increase the gap between earnings and out-of-work benefits making work more desirable, it would do so at the cost of an increased risk of poverty for those families and individuals who are not working. The challenge is to design policies in a way that they promote labor market integration and return to self-sufficiency of those receiving social assistance benefits instead of merely cutting the level of benefits.

## Measures of financial work incentives and benefit adequacy

**To assess how the tax-benefit system in FYR Macedonia can affect work incentives a tax-benefit model was used.** The model incorporates *legal rules* related to cash social assistance benefits, such as the Social Financial Assistance (SFA), child benefits, as well as income taxes and contributions. The tax-benefit model reflects the ***combined*** effect of taxation and benefit systems on ***net income*** of individuals and other select types of households. Specifically, the "typical" household types available in the model are: single, single parent with two children, a one-earner couple without children and a one-earner couple with two children[31]. The results presented in this section are based on a tax-benefit model developed following OECD methodology for FYR Macedonia for the year 2012.

The main features of the tax-benefit system in FYR Macedonia include:

- **Income tax** – a flat income tax of 10 percent;
- **Social security contributions** – employee-paid social security contributions including minimum floor for payment of social security contributions;
- **Unemployment insurance** – contributory unemployment benefit;[32]

[30] See Carone G. et al (2004).

[31] Children in the model are assumed to be of pe- and school age. Albeit the standard model also includes simulations for two-earner couples, they were not considered in the analysis below. Simulated earnings of two earner couples in the model start at 67 percent of the average wage for the first adult. At this level, in most simulations, households are not eligible for social assistance.

[32] The unemployment benefit recipient is assumed to be 40 years old with a long and uninterrupted employment history.

- Social Financial Assistance **(SFA)** – means-tested last-resort social assistance program for low income households;
- **Child allowance** – means-tested social assistance program targeting families with children.

**An important outcome of the tax-benefit model is the estimate of the financial incentives to work for different household types.** Financial incentives to work are measured by the so called so called "unemployment trap", "inactivity trap", and "low-wage trap" (or "poverty trap"). The "trap" indicates that the change in disposable income when increasing work effort is small and, conversely, the work-disincentive effect of tax and benefit systems is large. The well-established definitions of these are the following[33]:

- The **unemployment trap** is the implicit tax on returning to work for unemployed persons receiving the unemployment benefit. It measures the part of the additional gross wage that is taxed away in the form of increased taxes and withdrawn benefits such as unemployment benefits, social assistance and housing benefits, when a person returns to work from unemployment.
- The **low-wage trap** is defined as the rate at which taxes are increased and benefits withdrawn as earnings rise due to an increase in working hours (or move into higher-paid employment). This kind of trap is most likely to occur at relatively low wage levels due to the fact that the withdrawal of social transfers (mainly social assistance and housing benefits, as well as any in-work benefits or tax credits), which are usually available only to persons with a low income, adds to the marginal rate of income taxes and social security contributions.
- The **inactivity trap** measures the part of additional gross wage that is taxed away in the case where an inactive person (not entitled to receive unemployment benefits but eligible for income-tested social assistance) takes up a job. In other words, this indicator measures the financial incentives to move from inactivity and social assistance to employment.

In this note we will focus mainly on the potential **inactivity traps** due to our focus on incentives for social safety net beneficiaries to take up employment. The OECD tax benefit model allows calculating the quantitative measures of these traps conceptualized and calculated as tax rates. The main types of tax rates are the following:

- **Marginal effective tax rates (METRs)** are used to consider the financial disincentive for an already employed individual to increase the number of hours they work. METRs show, at a given wage level, how much of an additional small amount of gross income (usually 1 percent of average wage) earned is "taxed away", either through income tax or social security contributions or as a result of withdrawal of social benefits[34]. They provide an indication of the extent of poverty traps in OECD countries.

[33] See http://ec.europa.eu/economy_finance/db_indicators/tax_benefits_indicators/index_en.htm
[34] Technically, the METR is defined as $(1 - \Delta ne/\Delta ge)$ where $\Delta ne$ is equal to the change in net earnings, and $\Delta ge$ is the change in gross earnings experienced by the household.

- **Average effective tax rates (AETRs)** or participation tax rates (PTRs) are used to assess the financial disincentive to move into work. These show how much of the gross income earned from moving into work from either unemployment or inactivity is "taxed" away in the form of lost social assistance or unemployment benefits, and taxation of in-work income (personal income tax plus employee social security contributions). As such, they provide an indication of the extent of unemployment and inactivity traps.

**The higher the METR, the lower the financial incentive for households to work additionally, which could reduce work efforts—at least, theoretically**. Empirical findings show that many individuals work despite high METRs, suggesting that other factors can play a role on whether an individual decides to work or not.[35] Hence, "incentives" do not automatically translate into "incentive effects", as employment levels, unemployment rates and total hours worked are not determined entirely by the size of benefits and extent of taxation. These can depend on the availability of suitable jobs, flexibility of the labor market and overall economic conditions. Additionally, a number of non-financial considerations can also play a role in the decision of whether and how many hours to work. Empirical studies have shown that financial incentives for some types of earnings changes are more relevant than other. For instance, a common result is that the incentive of whether or not to work at all (i.e., move from zero earnings to, say, the minimum wage) matter more than the incentives to work an additional hour for those who already have a job[36]. The majority of evidence on incentive effects of social benefits and taxes comes from OECD and other developed countries. The evidence in low- and middle-income countries is still lacking.

**One of the main limitations of the model is that full-take up is assumed.** Further, in order to calculate METR, some assumptions and simplifications have to be made. One of the most significant assumptions is that everyone who is legally eligible gets their full entitlements and that take-up is 100 percent. Empirically, this has been shown not to be the case. For example, Hernanz et al. (2004) find that in OECD countries, for which data is available, take-up rates of social assistance and housing programs span between 40 and 80 percent. In FYR Macedonia, coverage of unemployment and social assistance benefits is low and non-take up, i.e. those potentially eligible who do not receive the benefit, is estimated to be quite high (for example, among unemployed in the poorest quintile based on per capita consumption, 12 percent do not receive LRSA or any other social benefits – (figure 7)[37].

**Hence, the share of the population affected by high AETRs or METRs could be very small**. It is important to keep in mind that the population potentially facing high disincentives to work can be quite small – especially in countries with limited coverage of social safety nets.

[35] At least partially, this could be due to future benefits associated with contributing to the social insurance schemes, such as pensions. The future benefits arising from such contributions are not incorporated into the tax-benefit model, thus decreasing the value of work compared to non-working.
[36] For review of the existing literature please see OECD (2005); Immervoll and Pearson (2009).
[37] Among the reasons for non-take up could be the so called legal barriers, i.e. program rules which exclude certain groups of income-eligible beneficiaries based on ownership of certain assets or other program requirements, but research finds that a rather high share of income-poor households does not know that the LRSA program exists (17.6 percent) and for many of them the administrative procedures are very complicated (13.1 percent). See Matković, G. and M. Petrović (2012).

Nevertheless, important insights can be gained by looking into how the benefit design and taxes could contribute to work disincentives.

**The design and relative generosity of other social benefits could affect individual's labor market decisions**. On the other hand, other social benefits, which are not considered in the tax-benefit model calculations, could have an impact on the individual's work effort. For example, the design of maternity or parental leave benefits could in some cases impact labor market participation of women. Policies on early retirement or disability program rules could provide incentives for certain individuals to remove themselves from the labor force. The extent of work disincentives potentially stemming from these other programs is not considered below.

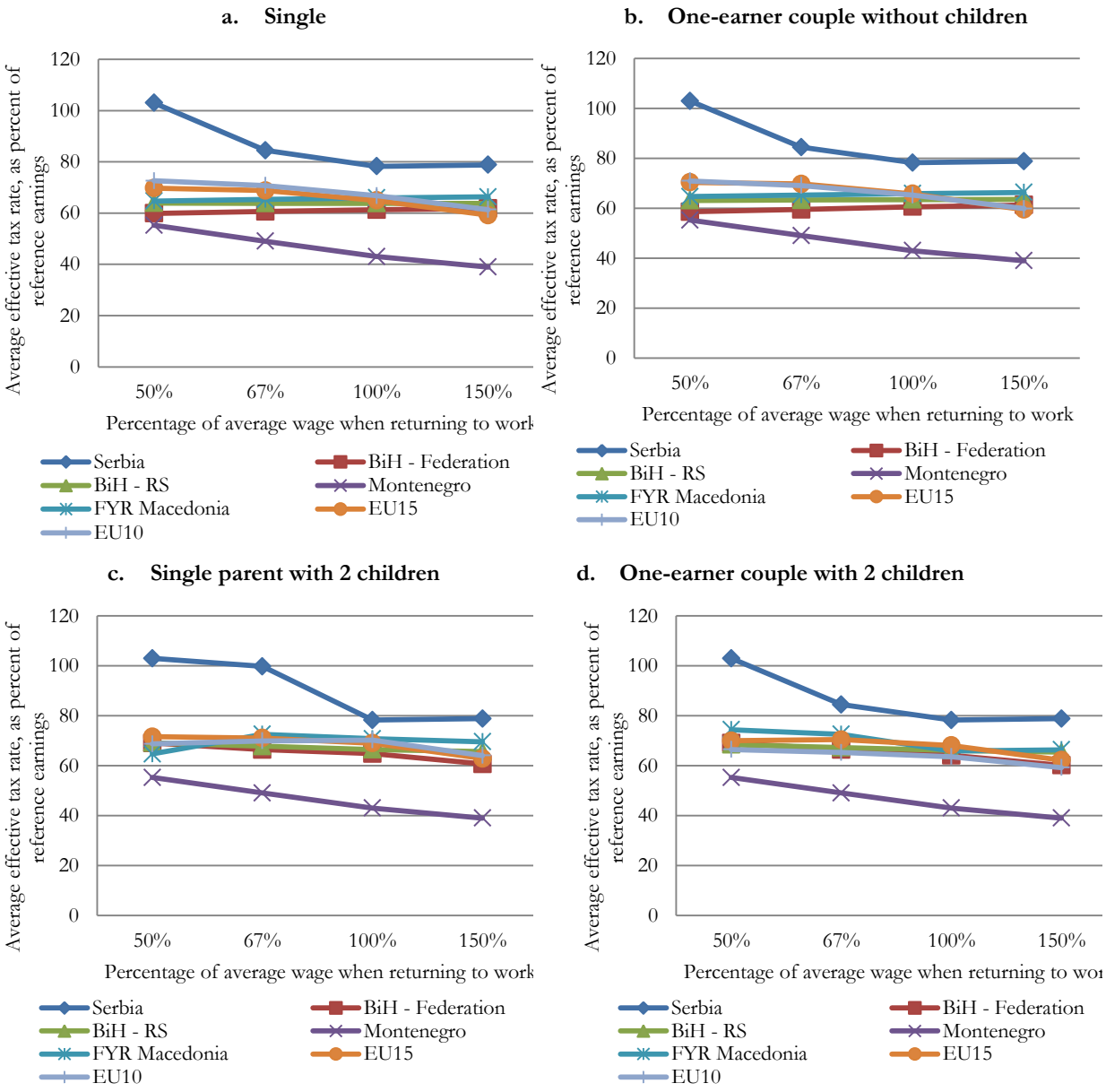
## Unemployment benefit, as currently designed, is unlikely to weaken incentives to seek or accept low-paid jobs

**Generosity and strict eligibility criteria of the unemployment benefit are not likely to create significant work disincentives.** In Macedonia, a contributory unemployment insurance program exists for those in the formal sector. Unemployment benefit amounts to 50 percent of the reference earnings,[38] but it cannot exceed 80 percent of the most recently published average net monthly wage in the country. There is no minimum unemployment benefit. Even for those with longer contribution history,[39] there unlikely to be weaker financial incentives to seek or accept low paid employment in Macedonia compared to EU10 and EU15, as well as other Western Balkans countries (figure A3.1), let alone for those with short or interrupted formal job spells. Additionally, any job search requirements imposed on unemployment benefit recipients are likely to improve incentives for moving from unemployment to work.

[38] The basis for calculation of unemployment benefit is the average net monthly wage of the insured worker during the last 24 months,

[39] The benefit duration ranges between 1 month for those who contributed for less than 18 months to 12 months to those who contributed for more than 25 years. Special provisions exist for those nearing official retirement age.

**Figure A3.1:** Unemployment trap (average effective tax rate for moving from unemployment to work at different wage levels as a share of average wage)




*Source:* OECD/EU Tax and benefits indicators database. Author's calculations based on OECD Tax and Benefit model for Western Balkans countries.

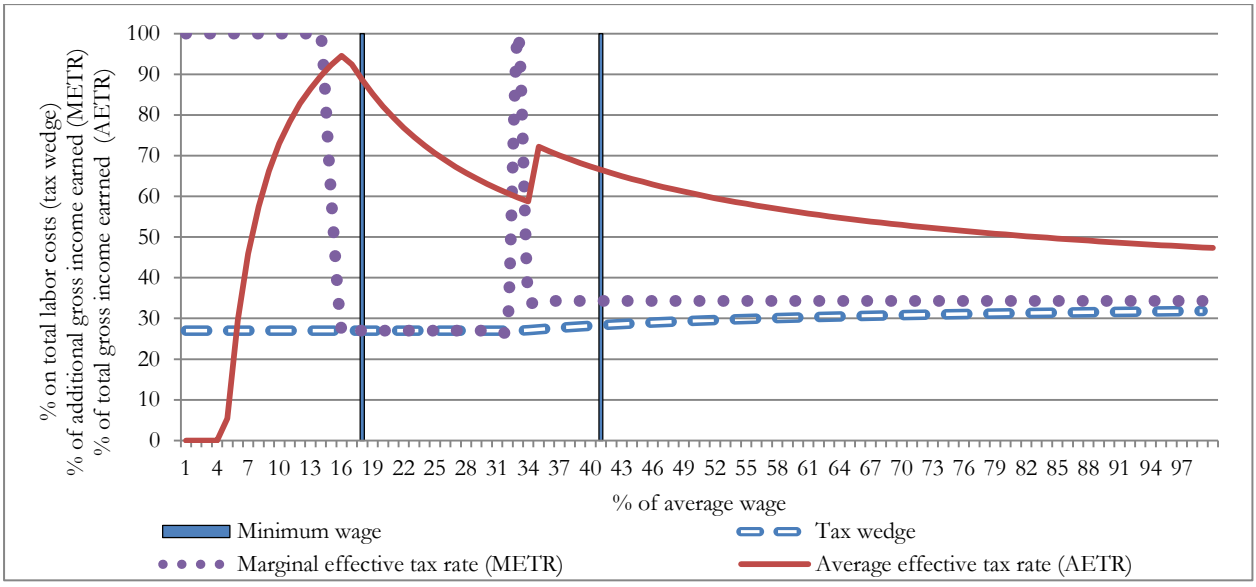
Note: EU10 data doesn't include Poland. EU10, EU15 are from 2011. Serbia, BiH - Federation, BiH - RS, Montenegro and FYR Macedonia data are from 2012. Initial phase of unemployment but following any waiting period. No social assistance "top-ups" are assumed to be available in either the in-work or out-of-work situations. Any income taxes payable on unemployment benefits are determined in relation to annualized benefit values (i.e. monthly values multiplied by 12) even if the maximum benefit duration is shorter than 12 months. See Annex A of the OECD series Benefits and Wages for details. For married couples the percentage of AW relates to one spouse only; the second spouse is registered as an unemployed with no earnings in a one-earner couple and to have full-time earnings equal to 67%. Children are aged 4 and 6 and neither childcare benefits nor childcare costs are considered.

## LRSA program's design can be improved

**There are implicit work disincentives in the last-resort social assistance program design.** Just as in many other countries in Europe and Central Asia region, the Financial Social Assistance program is designed in a way that each additional denar earned by a beneficiary is subtracted from the benefit amount. The benefit is calculated as a difference between a certain

income threshold and net income of beneficiary families. As a result, below the threshold there is no financial incentive for a family to earn more income, as it will be automatically reduced from the benefit they receive. This design has a 100 percent marginal effective tax rate. This is clearly illustrated in figure A3.2, which shows that marginal effective tax rate is 100 percent for a one-earner family with 2 children until about 15 percent of the average wage, when this family is no longer eligible for social assistance. Similarly, there is an increase in the marginal and average effective tax rates when a household loses eligibility for the child allowance (about 33 percent of the average wage for a one earner couple with 2 children).

*Figure A3.2: The tax wedge, the marginal effective tax rate (METR), and average effective tax rate (AETR) for a one earner couple with 2 children in Macedonia (2012)*




*Source:* Author's calculations based on OECD Tax and Benefit model.
Note: The figure is reflective of the situation when the household earnings are related to working days in a week. The rise of earnings from 0 to 100 percent of the average wage is linked to the increase of working days from 0 to 5 (full-time).

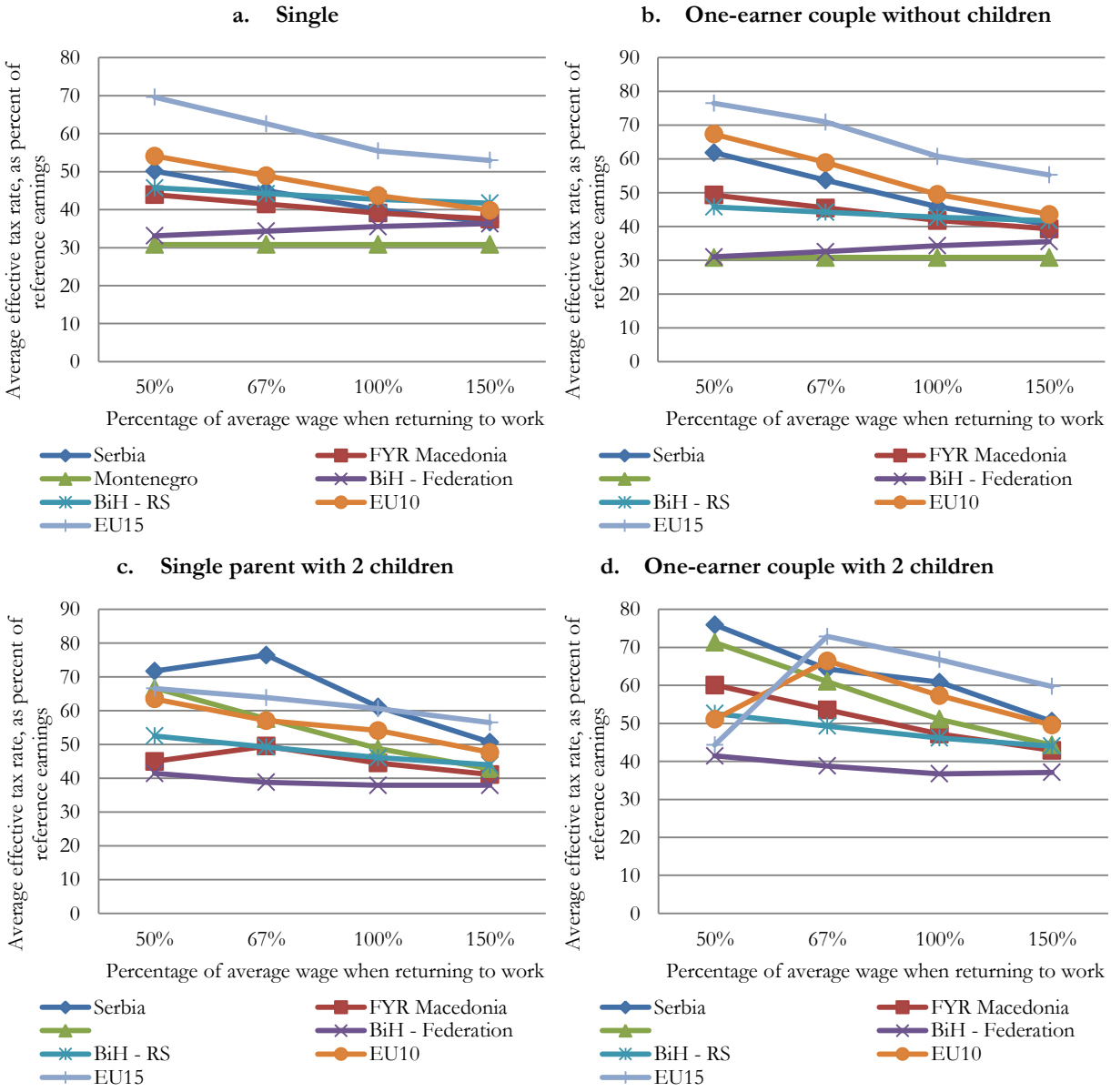
**However, social assistance is withdrawn at very low earnings levels; hence, these high marginal effective tax rates are unlikely to have a significant impact on employment decisions.** For one earner family with 2 children, social assistance is withdrawn at a level which is less than the full time minimum wage. This is also the case for other household types. It is therefore unlikely that these high marginal effective tax rates have a significant impact on employment decisions, however, in theory; they could weaken incentives to take up part-time, temporary or seasonal employment at levels below the social assistance threshold. Disregarding such earnings partially or fully for the purposes of social assistance income test could significantly improve attachment of SFA beneficiaries to formal labor market. In the absence of such possibility, they are most likely to take such employment in the informal sector.

## The extent of "inactivity traps" is limited in Macedonia

**Low benefit levels limit potential for "inactivity traps".** The average effective tax rates for taking up low-paid jobs are very moderate in Macedonia – significantly below the EU10 and EU15 averages. Only for one earner couple with 2 children the average effective tax rates to take up a job for 67 percent of the average wage or less is somewhat higher than in other Western

Balkan countries (except Serbia). Even in this situation such a household stands to gain at least 40 percent more net income when person takes such a job (figure A3.3). As a result, "inactivity traps" are not likely to present a significant problem in Macedonia.

*Figure A3.3: Inactivity trap (average effective tax rate for moving from inactivity to work at different wage levels as a share of average wage)*




*Source:* OECD/EU Tax and benefits indicators database. Author's calculations based on OECD Tax and Benefit model for Western Balkans countries.

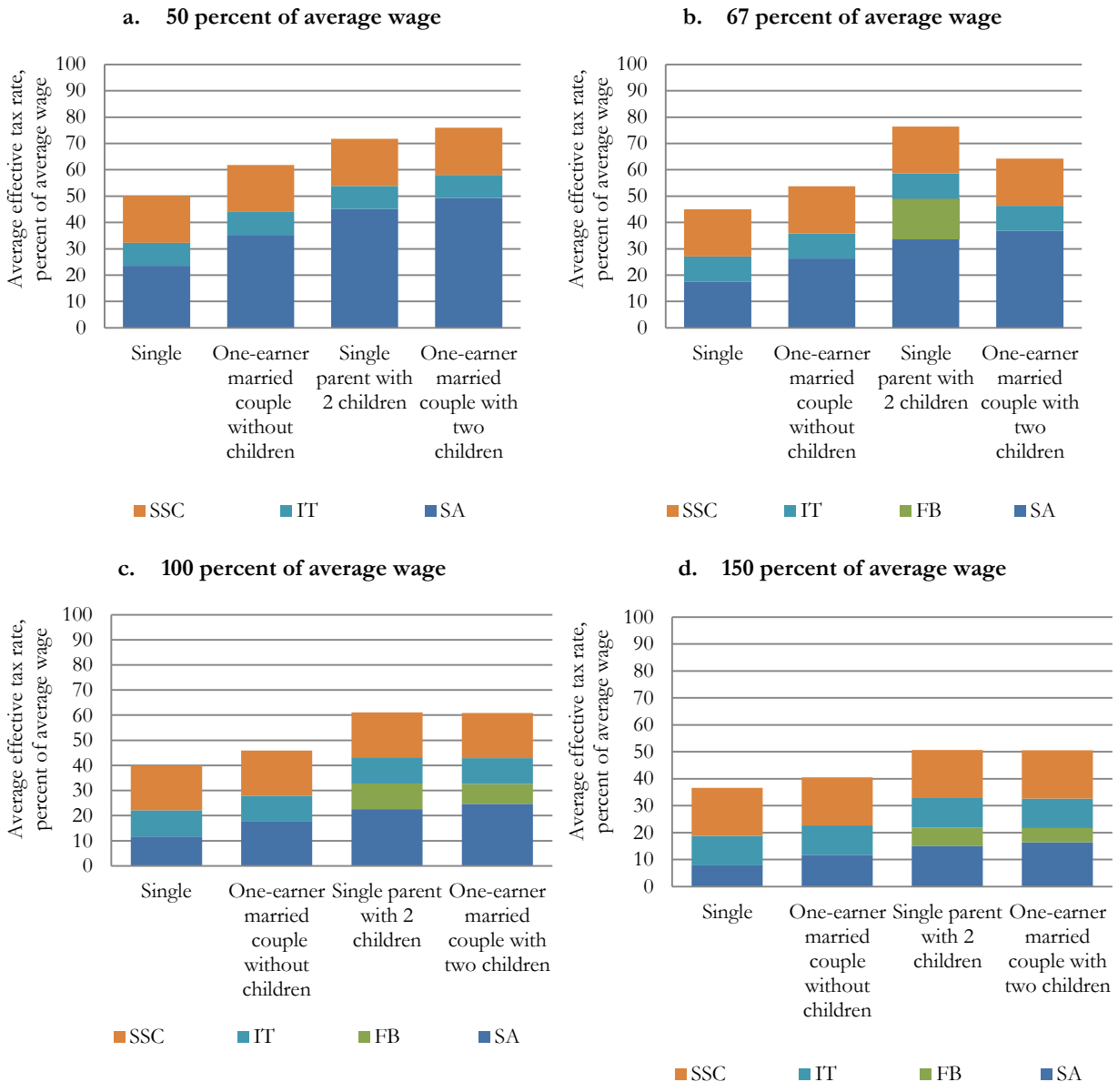
Note: EU10 data doesn't include Poland. EU10, EU15 are from 2011. Serbia, BiH - Federation, BiH - RS, Montenegro and FYR Macedonia data are from 2012.

## Reducing tax wedge for low wage earners, especially those working full-time, can increase financial gains from work

**However, incentives to take up employment could be improved via lowering tax burden on low wages.** Withdrawal of social assistance benefits only partially contributes to participation tax rates in Macedonia. The combined burden of social security contributions and income taxes represents more than half of the effective tax on earnings (figure A3.4). This is particularly driven by social security contributions in Macedonia, which are paid at the same rate of 27 percent for those working part-time[40]. For those working full-time, however, there is a minimum floor for payment of social security contributions, which is set at 50 percent of the national average gross wage. In such cases, the tax wedge is very high at the full-time minimum wage level, equaling 34 percent of gross pay. Not only this would prevent certain jobs from being viable, but also likely contributes to incentives to work informally.

[40] Social security funds accept a partial contribution based on part-time work, i.e. contributions are calculated per hour basis.

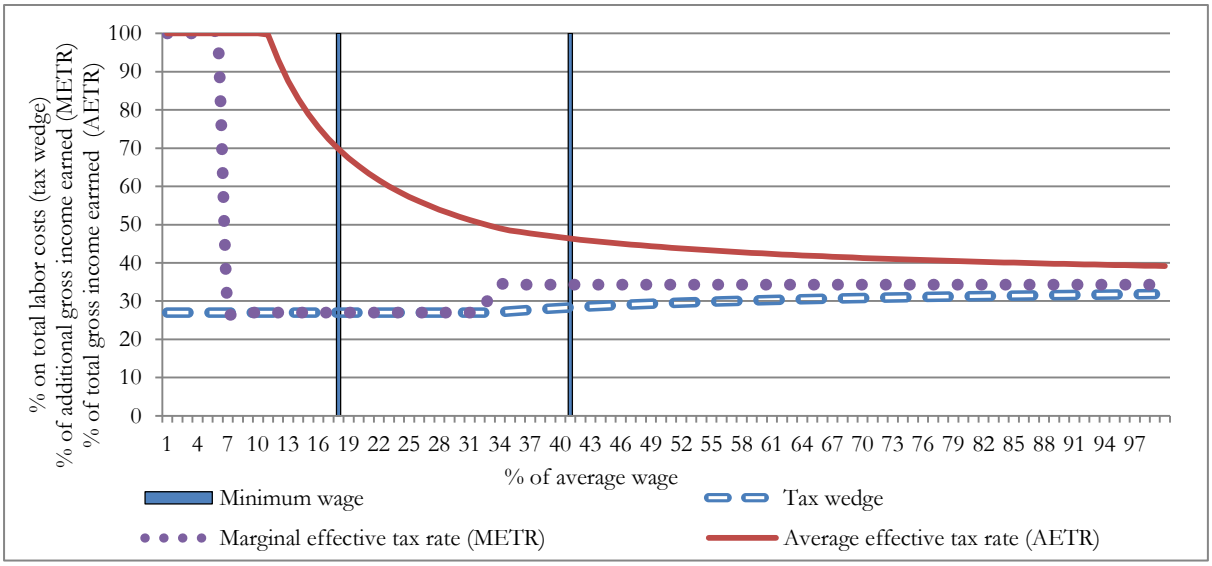
*Figure A3.4: Inactivity trap (average effective tax rate for moving from inactivity to work at different wage levels as a share of average wage)*




*Source:* Author's calculations based on OECD Tax and Benefit model for Western Balkans countries.
Note: FB: Family benefit (Child allowance), SA: Social assistance (SFA program), IT: Income tax, SSC: Employee-paid social security contributions. AW= Gross average wage.

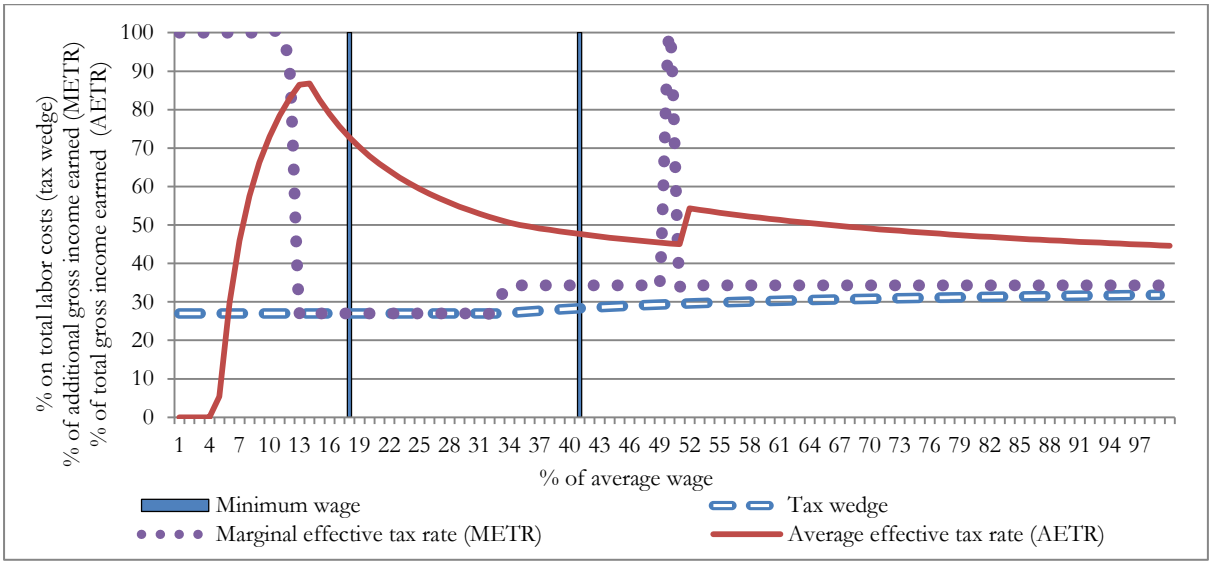
## Additional figures

*Figure A3.5: The tax wedge, the marginal effective tax rate (METR), and average effective tax rate (AETR) for a single person in Macedonia (2012)*



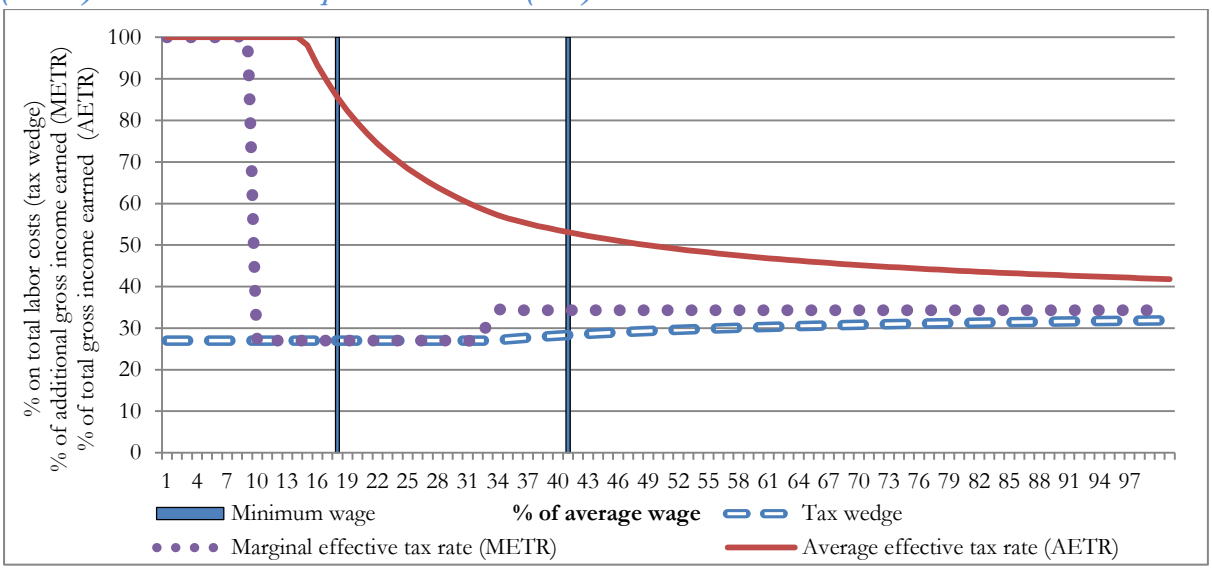

*Source:* Author's calculations based on OECD Tax and Benefit model.
Note: The figure is reflective of the situation when the household earnings are related to working days in a week. The rise of earnings from 0 to 100 percent of the average wage is linked to the increase of working days from 0 to 5 (full-time).

*Figure A3.6: The tax wedge, the marginal effective tax rate (METR), and average effective tax rate (AETR) for a single parent with 2 children in Macedonia (2012)*




*Source:* Author's calculations based on OECD Tax and Benefit model
Note: The figure is reflective of the situation when the household earnings are related to working days in a week. The rise of earnings from 0 to 100 percent of the average wage is linked to the increase of working days from 0 to 5 (full-time).

*Figure A3.7: The tax wedge, the marginal effective tax rate (METR), and average effective tax rate (AETR) for a one earner couple in Macedonia (2012)*




*Source:* Author's calculations based on OECD Tax and Benefit model

Note: The figure is reflective of the situation when the household earnings are related to working days in a week. The rise of earnings from 0 to 100 percent of the average wage is linked to the increase of working days from 0 to 5 (full-time).

# Annex 4: Staff and caseload by local EA office

*Table A4.1: Staff and caseload by local EA office*

| | Managers | ALMPs | Passive policies | Support staff | Total staff | Share of staff in ALMPs (%) | Share in passive (%) | Registered U | Total staff to U | ALMPs staff to U |
|---|---|---|---|---|---|---|---|---|---|---|
| Central Office | 12 | 19 | 17 | 6 | 54 | 35.2 | 31.5 | | | |
| Skopje | 1 | 50 | 29 | 11 | 91 | 54.9 | 31.9 | 63628 | 699 | 1273 |
| Bitola | 1 | 20 | 8 | 1 | 30 | 66.7 | 26.7 | 16423 | 547 | 821 |
| Veles | 1 | 11 | 5 | 1 | 18 | 61.1 | 27.8 | 13088 | 727 | 1190 |
| Kumanovo | 1 | 15 | 8 | 2 | 26 | 57.7 | 30.8 | 23111 | 889 | 1541 |
| Ohrid | 1 | 8 | 7 | 1 | 17 | 47.1 | 41.2 | 8878 | 522 | 1110 |
| Prilep | 1 | 16 | 6 | 1 | 24 | 66.7 | 25.0 | 18910 | 788 | 1182 |
| Strumica | 1 | 9 | 5 | / | 15 | 60.0 | 33.3 | 15574 | 1038 | 1730 |
| Tetovo | 1 | 15 | 5 | / | 21 | 71.4 | 23.8 | 24381 | 1161 | 1625 |
| Shtip | 1 | 8 | 3 | 2 | 14 | 57.1 | 21.4 | 5528 | 395 | 691 |
| Berovo | 1 | 3 | 3 | 2 | 9 | 33.3 | 33.3 | 3094 | 344 | 1031 |
| Valandovo | 1 | 2 | 2 | 1 | 6 | 33.3 | 33.3 | 1959 | 327 | 980 |
| Vinica | 1 | 5 | 2 | / | 8 | 62.5 | 25.0 | 2710 | 339 | 542 |
| Gevgelija | 1 | 4 | 2 | 1 | 8 | 50.0 | 25.0 | 3028 | 379 | 757 |
| Gostivar | 1 | 8 | 4 | 2 | 15 | 53.3 | 26.7 | 12781 | 852 | 1598 |
| Debar | 1 | 4 | 3 | / | 8 | 50.0 | 37.5 | 3827 | 478 | 957 |
| Delcevo | 1 | 8 | 4 | / | 13 | 61.5 | 30.8 | 4190 | 322 | 524 |
| Dem.Hisar | 1 | 4 | 2 | / | 7 | 57.1 | 28.6 | 1786 | 255 | 447 |
| Kavadarci | 1 | 6 | 4 | / | 11 | 54.5 | 36.4 | 7042 | 640 | 1174 |
| Kicevo | 1 | 7 | 4 | / | 12 | 58.3 | 33.3 | 7180 | 598 | 1026 |
| Kocani | 1 | 6 | 3 | 1 | 11 | 54.5 | 27.3 | 7980 | 725 | 1330 |
| Kratovo | 1 | 2 | 3 | / | 6 | 33.3 | 50.0 | 1942 | 324 | 971 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Kr. Palanka | 1 | 6 | 3 | 1 | 11 | 54.5 | 27.3 | 5515 | 501 | 919 |
| Krushevo | 1 | 4 | / | 1 | 6 | 66.7 | / | 1740 | 290 | 435 |
| Mak. Brod | 1 | 4 | 3 | / | 8 | 50.0 | 37.5 | 2235 | 279 | 559 |
| Negotino | 1 | 5 | 3 | / | 9 | 55.6 | 33.3 | 2793 | 310 | 559 |
| Probistip | 1 | 5 | 5 | / | 11 | 45.5 | 45.5 | 8878 | 807 | 1776 |
| Radovis | 1 | 5 | 3 | / | 9 | 55.6 | 33.3 | 18910 | 2101 | 3782 |
| Resen | 1 | 5 | 2 | / | 8 | 62.5 | 25.0 | 2605 | 326 | 521 |
| Sv. Nikole | 1 | 5 | 3 | / | 9 | 55.6 | 33.3 | 5309 | 590 | 1062 |
| Struga | 1 | 10 | 4 | 1 | 16 | 62.5 | 25.0 | 2496 | 156 | 250 |

*Source:* EO administrative data

# Annex 5: Behavioral Requirements and Benefit Sanctions in Selected EU and OECD Countries, and the Western Balkan Countries

*Table A5.1: Behavioral Requirements and Benefit Sanctions in Selected EU and OECD Countries, and the Western Balkan Countries*

| Country | Registration as unemployed | Job search requirements | Job acceptance and exceptions | Work and / or social integration requirements | Implications of refusal / sanctions | Other behavioral conditions |
|---|---|---|---|---|---|---|
| **Albania** | Required | No | Required | Yes | Denial of benefit | n.a. |
| **Australia** | Required | Yes, proof every two weeks | na | Yes | From 'warning' to 100% benefit withdrawal | Behavioral requirements can be extended to other family members |
| **Austria** | Required | Yes | 'Reasonable' work, exceptions related to age (men over 65; women over 60) | na | Denial of benefit | Cooperation with employment services |
| **Belgium** | Required | Demonstration of willingness to work, and evidence of job search | Obligation to accept 'suitable' job. Exceptions are possible for health reasons | Yes | Benefit (Integration income) can be denied to a person who is not willing to work | Participation in employment, social integration or individualized social integration project offered by the municipality |
| **Bosnia-i-Herzegovina** | Yes | No | No | Yes, focus made on social inclusion first, then labor activation | n.a. | n.a. |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Bulgaria** | Required for at least 9 months before claiming social assistance | To have not rejected any jobs offered or qualification courses offered by the Employment Offices | Exceptions for able-bodied with care respon-sibilities, health conditions, full-time students and pregnant women | Work - required | Denial of benefit to the person who have refused job or training, first refusal – 1 month; second – 1 year | Could be identified and included in the Individual Employment Plan |
| **Canada** | Required | Yes | Yes | Yes | Up to 100% withdrawal | Regular confirmation of circumstances; verification periods vary by provinces |
| **Czech Republic** | Recipients, unless employed, must register with the Labor Office as jobseekers | No specific independent job search requirement but willingness to work is basic condition for being treated as a person in material need | Accept any job, even short-term or less paid. Exclusions due to age, health status, disability or family situation (care responsibilities) | Yes | Participation is obligatory and is subject to verification. Refusal to participate results in exclusion form social assistance receipt | To actively look for a job, accept any employment, participate in active employment programs, public works, public service |
| **Denmark** | Required | Required for both spouses | Appropriate job | Work - required | Payment is suspended if the beneficiary or his/her partner refuses without sufficient reason to participate in activation measure or repeatedly fails to report on job search | Behavioral requirements are extended to other family members |
| **Estonia** | Required registration with the Estonian Unemployment Insurance Fund | Required | To be available for suitable work | Yes | Refusal to grant the benefit to those capable of work and aged between 18 and pensionable age, who | Fulfillment of other conditions and activities can be agreed in an individual job searching plan |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | are neither working nor studying and have repeatedly refused, without reason, training, or suitable work or have refused take up of social or employment services | |
| **Finland** | Required | Required | Required, suitable job | Work - required | 100% benefit withdrawal for 60 to 90 days | Action plans mandatory for certain groups; regular confirmation of circumstances |
| **France** | Required | Obligation to look for work | Suitable job | Work – required<br>SI - required | na | To take the necessary steps to generate one's own activity or to participate in integration activities |
| **FYR Macedonia** | Proof of no-work is required | no, only training and retraining | Required | Yes | Benefit suspension of 6-12 months claimant. Bigger for refusal to participate in public works than for not taking up active labor market measures | Monthly confirmation of circumstances |
| **Germany** | Required | Required for beneficiaries capable of working and persons living with them in a domestic unit | Take up of reasonable job Exemption for people with disability and those taking care for children under 3 years | Yes | From 10% to 100% withdrawal for 1.5 to 3 months | Specific conditions for (a) the basic security benefit - to take part in all work-oriented inclusion measures; to enter in integration agreement with the job center; (b) for occupational integration benefits; (c) for the starting allowance and loans for self-employed beneficiaries. Take up of services provided by the local authorities for the care of minor or disabled children and for home care of family members; debt counseling, psychological support and addiction counseling. Update of action plan every 6 months. |
| **Hungary** | Required for benefit for persons in active age / | Required | Suitable job | Work - required | The entitlement to the benefit is terminated if the person is deleted from the registry of | To cooperate with the public employment services; to participate in training programs, guidance, programs which help to prepare for work, etc. Proof of independent job search every 3 months |

| | | | | | | |
|---|---|---|---|---|---|---|
| | employment substituting benefit | | | | job seekers due to his/her own fault, if (s)he refuses a proper job, works, cannot prove that in the previous year (s)he pursued a gainful activity, or took part in training or labor market program for at least 30 days | |
| **Ireland** | Required | Jobseeker's Allowance recipients must be available for, capable of and genuinely seeking work | Required | Yes | 100% benefit withdrawal for weeks | All persons unemployed for 3 months must participate in the National Employment Action Plan aimed at assisting them to enter or re-enter the labor market. Confirmation of circumstances – every 4 weeks |
| **Japan** | Not required | Required | na | Work – no<br>SI - no | From warning to 100% withdrawal | Confirmation of circumstances every 4 weeks |
| **Kosovo** | Required | No | Required | Yes, participation in employment counseling, public works and other employment programs. | n.a. | Re-registration with unemployment office every 3 months. Re-application to benefit every 6 months. |
| **Latvia** | Required | Yes | Suitable job | Work – required<br>SI - required | Total amount of benefit is reduced by the part of the person who has refused | Beneficiaries are obliged to co-operate with social workers in order to overcome the situation through provision of information, personal attendance, participation in measures promoting employment, acceptance of medical examination, participation in medical and social rehabilitation |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Lithuania** | Required registration with the local office of Labor Exchange or another EU MS employment service | Required | Required | | Refusal of job offer, training, public duties or works supported by the Employment Fund may cause suspension of, or refusal to grant, social benefit | |
| **Montenegro** | Required | Required to access to services provided by Employment Agency | Not required by law | 'Soft' requirements to participate in activation-related activities, to take a job or training offer while still in unemployment. | From denial to participate in activation programs to denial of benefit. | Monthly confirmation of circumstances. There are no legal guarantees for re-entry into social assistance if the activation does not render self-sufficiency and independence. |
| **Nether-lands** | Required registration with the Institute for Employee Benefit Schemes | Required. The partners of unemployed should also look for work | Required acceptance of suitable employment | Yes | Cut or reduction of benefit in case of non-cooperation. Medical and social factors are taken into account, and childcare obligations | The parent is however obliged to attend training courses. If the children are aged 5 or older, cases are examined individually to determine the exemption from this obligation. If all attempts are unsuccessful, the social services will help to find work or training |
| **Poland** | Required | Required | Obliged to undertake offered work | Work – required<br>SI - required | Refusal to grant or withdrawal of social assistance benefit; reduction of integration allowance | Cooperation with social services; regular confirmation of circumstances; in certain cases proof of independent job search; individual plan |
| **Portugal** | Registration with job center is required | Required | Required, any offered job | Work – required<br>SI – required, with | Cancellation of registration with the job center | To obtain the benefit, the claimant must accept the obligations stemming from the integration contract. The obligations contained in the integration contract include: accept proposed jobs and vocational trainings; attend courses; participate in occupational programs or other |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | exceptions | | temporary programs stimulating labor market integration or meeting social, community or environmental needs; undertake professional counseling or training actions; take steps regarding prevention, treatment or rehabilitation of drug addiction and incentives to take up self-employment |
| **Romania** | Required | No | Acceptance of community work. Exemptions for non-prime age recipients, attending vocational training or professional or other activity | Work – required<br>One family member is obliged to work in the interest of the local authority | Failure to comply results in suspension of the Social Aid | |
| **Serbia** | Required | Required | Yes, suitable job. | Yes | Sanctions exist for recipients who refuse a job offer or to do not participate in activation measures, but they do not apply to work-unable family members. Sanctions are rarely applied. | Assistance is granted for 9 out of 12 months a year. Eligibility must be recertified every 12 months. |
| **Slovakia** | Registration with the Office of Labor, Social Affairs and Family is mandatory for activation allowance | Required for activation allowance | Suitable work | Taking suitable work, training or community work is optional for the beneficiary but obligatory for getting the activation allowance | The person receives only the basic benefit in material need | The take up of activation allowance is conditional on participation in training, municipal works or other suitable work |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Slovenia** | Required | Required | Required acceptance of any job after receiving Social Assistance for a certain time, i.e. 9 times in the last 12 months | | Refusal to grant the benefit or benefit withdrawal in case of voluntary termination of employment, refusal of job offer or refusal/ abandonment of ALMPs | |
| **Spain** | Required | Required | Yes, suitable job | Yes | 100% withdrawal from 4 weeks to indefinite | Confirmation of circumstances every 3 months and intensive interviews every 3 months |
| **Sweden** | Required | Required | Required | Yes | Sanctions exist, they vary by municipality | Social assistance is conditional to participation in ALMPs; also on intensive interviews, regular confirmation of circumstances, individual action plans |
| **United Kingdom** | Required | Required | Required – to be available for 'all work' | Yes | Termination of benefit from 2 weeks to 26 weeks | For Jobseekers' Allowance - must sign a Jobseekers' agreement detailing the type of work, hours and activities to be undertaken by the jobseeker in their search for work; initial intensive interview with quarterly follow ups, confirmation of circumstances every 2 weeks, proof of independent job search every 2 weeks. Requirements can be extended to other family members afer recognizing caring responsibility |
| **United States** | Required (for Food stamps) | Required (for Food stamps) | Required (for Food stamps) | Required (for Food stamps) | 100% withdrawal for minimum of 1 month | Confirmation of circumstances rules vary by state, proof of independent job search can be required, requirements are extended to other family members as well |

*Source:* Compiled by authors from European Commission (2012) and national legislation