

# **Activation and Smart Safety Nets in Serbia: 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 Damerou, Marijana Jasarevic, Marina Petrovic, and Gabriela Stoyanova-Rozenova.

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## Abbreviations

AETR	Average Effective Tax Rate
ALMPs	Active Labor Market Programs
AW	Average Wage
BIC	Bayesian Indicator Criterion
CA	Child Allowance
CSW	Center for Social Work
ECA	Europe and Central Asia
EOs	Employment Offices
EU	European Union
EUR	Euro
FSA	Financial Social Assistance
GDP	Gross Domestic Product
HBS	Household Budget Survey
IDPs	Internally Displaced Persons
IEP	Individual Employment Plan
ILO	International Labor Organization
IOM	International Organization for Migration
LCA	Latent Class Analysis
LFS	Labor Force Survey
LRSA	Last Resort Social Assistance
LSMS	Living Standards Measurement Survey
METR	Marginal Effective Tax Rate
MF	Ministry of Finance
MIS	Management Information System
MLSP	Ministry of Labor and Social Policy
MLESP	Ministry of Labor, Employment and Social Policy
MOP	Materijalno Obezbedenje Porodice
MW	Minimum Wage
NES	National Employment Service
OECD	Organization for Economic Cooperation and Development
PTR	Participation Tax Rate
PWD	People with Disability
PWPs	Public Work Programs
RSD	Serbian Dinar (national currency)
SSN	Social Safety Net
TVET	Technical Vocational Education and Training
UNDP	United Nations Development Program
UNICEF	United Nations Children's Fund
VT	Vocational Training

# 1. Introduction

## 1.1 Motivation of the Note

**Worsening of the economic environment and the associated decline in budget revenue puts pressure on government expenditure, while at the same time the need for effective social protection increases.** Unemployment in the Western Balkans increased significantly after the onset of the 2007–09 global economic crisis because of contracting external and domestic demand. Serbia was not an exception from the general trend of deteriorating labor market conditions in the region, and unemployment increased from 14 percent in 2008 to 23.9 percent in 2012.<sup>1</sup> Long-term unemployment, which was 10 percent in 2008 (Arandarenko 2012), soared to 17.5 percent,<sup>2</sup> implying that an increasing number of households have suffered sustained loss of income in recent years. These developments increased the pressure on the social safety net against the background of reduced budget resources, thus prompting a reassessment of social expenditure policy and a reform of different social programs to increase their flexibility as crisis response instruments, their proactivity, and their incentive compatibility.

**The last resort social assistance program (LRSA) is only one element in an array of income supporting measures in Serbia, and it is relatively small in size, coverage, and generosity.** Currently it represents about 0.25 percent of the country's gross domestic product (GDP) and covers about 3.3 percent of its population (according to administrative data), including both workable and unable-to-work adults, as well as children. The average transfer per person under the program is about 20 percent of the minimum wage, and it contributes one-third (34 percent) of the consumption of those in the poorest quintile, according to the latest household budget survey (HBS) 2010 data. Relative to total social assistance expenditure, the last resort program represents less than 10 percent (World Bank 2012). In the aftermath of the 2007–09 crisis Serbia overhauled its LRSA program: *Materijalno Obezbedenje Porodice* (MOP). The overhaul entailed replacement of the MOP program with a new LRSA scheme—the *Financial Social Assistance* (FSA) program—whose design involves, for the first time in Serbia, positive incentives for activation of able-to-work beneficiaries.<sup>3</sup>

**Despite the reform, certain features of the FSA program in Serbia raise concerns that it may still encourage inactivity of recipients or employment in the informal sector.** Although the program is relatively well targeted to poor households,<sup>4</sup> there are concerns, as in many Organization for Economic Co-operation and Development (OECD) countries recently, that it creates "welfare dependency" and "work disincentives" among recipients. This effect is commonly attributed to income support programs. It could lead not only to higher inactivity among the members of the recipient household but also to social exclusion. Furthermore, from a dynamic perspective, long-

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<sup>1</sup> Statistical Office of Republic of Serbia, Labor Force Survey (LFS), unemployed aged 15 years or more, 2012

<sup>2</sup> Statistical Office of Republic of Serbia, LFS, unemployed aged 15 years or more, 2012

<sup>3</sup> Activation uses policy tools to support and incentivize beneficiaries' job searching and job finding as a way to increase productive participation in society and self-sufficiency.

<sup>4</sup> Data on targeting accuracy are provided in annex 2 and World Bank 2011.



term reliance on social benefits increases the probability of passing on this model to future generations, with the corresponding negative implications for labor market participation. The relatively high share of the informal sector in Serbia, estimated at about 30 percent of GDP (Koettl 2011), is another source of concern because it provides opportunities for misuse of the existing LRSA program through employment in the informal economy. In light of these issues, there is growing demand for the "smart safety nets" that allow for greater flexibility of benefits and contain features that stimulate proactive behavior while maintaining effective protection for the poor and vulnerable members of society.

## 1.2 Objectives

**The main objective of this note is to enhance the understanding of the LRSA program in Serbia and its impact on labor supply with a view to facilitating a shift toward a "smart safety net."** Such a shift would reduce the "welfare dependency" by removing potential work disincentives built into the income support programs. The analysis aims to achieve three broad goals:

- ***Identify the inactive recipients*** of social assistance, their socioeconomic and demographic characteristics, and specific barriers to active labor supply. This would provide a basis to better serve the LRSA recipients by addressing some of the challenges they face in the labor market and designing active labor market programs (ALMPs) and measures that target specific groups of inactive recipients.
- ***Improve policy makers' awareness*** of how certain design features of social assistance programs create incentives or disincentives for benefit recipients to accept employment in the formal or informal sectors or to remain inactive. Policy makers should also understand the extent to which the social welfare and labor market institutions are prepared for designing and implementing activation programs and measures for those who can work and support themselves.
- ***Stimulate discussions among stakeholders*** about the prioritization of different social programs, their cost, and their impact and efficiency in achieving their goals.

## 1.3 Scope of Work and Methodology

**The note attempts to identify areas where policy actions could influence the labor market activity of recipients of financial assistance.** The first such area concerns the employability barriers stemming from the recipients' social, demographic, and economic characteristics. A second area comprises the legislative framework that can shape the labor supply decisions of LRSA recipients through creation of work incentives or disincentives. A third area relates to the institutional arrangements that support the implementation of the social assistance program. The methodology used in the analysis is largely based on statistical methods, including latent class analysis to classify the beneficiaries in homogeneous groups exhibiting similar labor market

characteristics. Review of the existing literature and findings of other studies in this area as well as analysis of the legislation related to the social assistance programs complement the beneficiary profile to give an additional perspective of the features of the system. In this regard, the OECD tax-benefit model enables an estimation of the marginal and average effective tax rates that social assistance recipients face when accepting employment or increasing work effort. Estimates of such tax rates could be indicative of potential trade-offs between (formal) employment and inactivity. Finally, the institutional analysis and benefit design analysis benefited from detailed study of the business processes in the offices of the national employment service (NES) and centers for social work (CSW) in Belgrade, Pancevo and Kovin, and in-depth interviews with policy makers, academics, social workers and employment officers.

**The rest of the note is organized as follows.** *Section 2* provides an in-depth analysis of the specific characteristics of the work-able population, including beneficiaries of FSA and other safety net programs that could be relevant to their activity in the labor market. *Section 3* examines the FSA design to reveal underlying disincentives that potentially affect the labor-supply decisions of able-to-work recipients with the aim of improving their employability by addressing these remaining issues. *Section 4* lists a number of institutional and capacity constraints to better enforcement of the existing policies and measures for activation. *Section 5* provides a summary of the main analytical findings and recommendations on how to go forward with the activation of those who are at risk of welfare dependency.

## 2. Profile of Safety Net Beneficiaries in Serbia

This section is dedicated to a labor market profile of social safety net (SSN) beneficiaries that can shed light on constraints to productive employment and on appropriate activation policies. The first part provides the framework for understanding the labor market outcomes of SSN beneficiaries and an operational definition of work-able—the main clients of activation policies. Using HBS data and data from the stand-alone survey of LRSA beneficiaries (MOP/FSA Beneficiaries Survey), the section identifies the share of SSN beneficiaries who can work compared with the general population in Serbia. Next, the analysis focuses on the work-able SSN population and highlights, to the extent possible, the constraints on productive employment participation that it may be facing. The last part is dedicated to a detailed profile of LRSA beneficiaries using advanced analytical tool – latent class analysis. The profiling reveals that SSN beneficiaries have worse labor market outcomes due to multiple barriers (less education and work experience, or higher care taking duties), but they are only a small share of the overall work-able (ranging from 2 to 11 percent), and activation should be broader. Identifying the characteristics of all inactive /unemployed is crucial for tailoring the right mix of activation policies/services to them.

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

**Three main types of barriers could prevent social assistance beneficiaries from participating in gainful employment: employability constraints, participation constraints, and benefit-related disincentives.**<sup>5</sup> Many are the reasons that could explain nonparticipation in the labor force or prolonged unemployment spells among the working-age population—in particular among social safety net<sup>6</sup> beneficiaries. Figure 1 illustrates the organizing framework used in this study to analyze constraints to employment in a systematic manner:

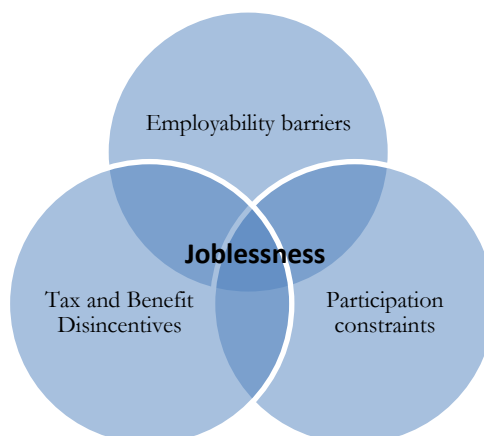
- ***Employability constraints.*** People may be out of work because their existing level of human capital, such as their education, skills, or experience, does not meet the requirements of the labor market.
- ***Participation constraints.*** A person may be potentially work-able but facing nonmarket 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 the two preceding types 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 social assistance beneficiaries (who would otherwise be working) from taking up employment.

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<sup>5</sup> The note focuses only on labor supply-related issues, while of course labor market outcomes depend also on the labor demand and how jobs are intermediated. Labor demand and overall labor market conditions are to be analyzed more in depth in a forthcoming World Bank analytical work on jobs in the Western Balkans.

<sup>6</sup> The note uses the terms “social safety net” and “social assistance” synonymously. LRSA is a narrower concept; it is part of the SSN/SA. FSA is Serbia’s LRSA program.

*Figure 1: 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 effects of 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 low-income earners and women, 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 2008; 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 section can be a first step to build such evidence.

**The labor market profiling of SSN beneficiaries can shed light on the constraints to productive employment and inform the design of appropriate activation policies.** The next part of this section will put the SSN beneficiary population into perspective by illustrating its characteristics with respect to the general population. Then, the section will describe in detail who

are the work-able among the group of SSN beneficiaries, what is their employment situation, and what are the possible constraints they face to participating in productive employment. Finally, the section will present an advanced profile of the different typologies of SSN beneficiaries, grouped according to their labor market challenges based on a specialized 2011 survey of Serbia's FSA beneficiaries (see box 1 for a discussion of data sources in this note). The findings of this section will be complemented by an analysis of the design of tax and benefit systems in Serbia in Section 3, which will explore whether beneficiaries may be facing disincentives in taking up employment that derive from the current social assistance design.

#### *Box 1: Data Sources*

##### ***Household Budget Survey (HBS) 2010***

**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 also contains 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) 2010, for two main reasons: First, the samples of the two surveys differ (one aiming at being representative of households in Serbia, the other one aiming at being representative of the labor force). Second, the detection of unemployment, employment, and labor force participation is carried out very differently in the two instruments.

##### ***Serbia MOP/FSA Beneficiaries Survey 2011***

The latent class analysis uses the MOP/FSA Beneficiaries Survey. This specialized survey was carried out in July 2011 by the Statistical Office of Serbia on a representative sample of households that are beneficiaries of the Serbia's LRSA program, MOP/FSA, covering a total of about 2,400 individuals. The survey collected demographic information on household members; asked an ample set of questions related to employment, job searching, and transfers; and posed specific questions on the use of employment services and social care services offered by the Centers for Social Work (CSWs).

## **2.2 Main Characteristics of Safety Net Beneficiaries Relative to General Population**

**Most SSN beneficiaries can be expected to work, and this mirrors the situation in the general population in Serbia.** This report defines as SSN beneficiaries all those individuals living in a household that benefits from a social assistance program (see box 2). In addition, the report adopts a simple operational definition of the “able to work” population, defined as individuals of working age who are outside full-time education or training and who are not incapacitated from working for health reasons. This is the population that potentially is “activable”—for example, potentially required to work in exchange for social assistance. Using these definitions, about 53 percent of SSN beneficiaries in Serbia are work-able. Although this rate is only slightly lower than the national average, figure 2 below suggests that SSN beneficiary households stand out for having a much larger share of members who may require special care, including children and people with disabilities (PWDs).

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

**Work-able** includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training. Note that this definition does not question the ability to work of PWDs, but rather acknowledges that this population may not be expected to seek or find employment as a condition to receive social assistance. In the HBS data, disabled persons are self-identified through a question on the reasons for being out of the labor force.

**SSN beneficiaries** are defined as all individuals living in a household benefiting from any of the following noncontributory programs implemented by the CSWs and municipal social welfare departments in Serbia:

#### a. Targeted (means-tested) noncontributory programs

*Financial Social Assistance (FSA) is Serbia's LRSA program*, last redesigned with the Social Welfare Law of April 2011. The LRSA program has existed since 2004 and was previously known as MOP (*Materijalno Obezbedenje Porodice* or Material Family Support). This is an income support program for the units of assistance (families or households) that meet certain eligibility criteria related to income levels, asset ownership, and employment status of the able-bodied members. The amount of the benefit is determined as the difference between an administratively preset income threshold for a unit of assistance of specific size (from one to six members, using explicit equivalence scales) and the actual income of the respective unit of assistance (household or family). The eligibility thresholds and maximum benefit levels are updated twice a year with consumer price growth. The program is financed by the central budget and designed by the MLSP, while eligibility verification, certification, and payments are administered by the Centers for Social Work (CSWs), which are de-concentrated bodies of the MLSP. Eligibility is verified each year and whenever changes in circumstances occur. The CSWs are responsible for complementing documentary verification with mandatory home visits (World Bank 2011).

*The Child Allowance (CA) Program* is intended to support the income of poor households with children. As in the LRSA, eligibility is determined by asset tests. However, the benefit is fixed and does not vary with the level of income. The income threshold increases with the size (number of children) of the household. Children are also required to attend school. Each child is entitled to the allowance until he or she reaches 19 years of age (or 26 years if disabled). Households must reapply annually. The child allowance is administered by the municipal social welfare departments.

#### b. Categorical Noncontributory Programs

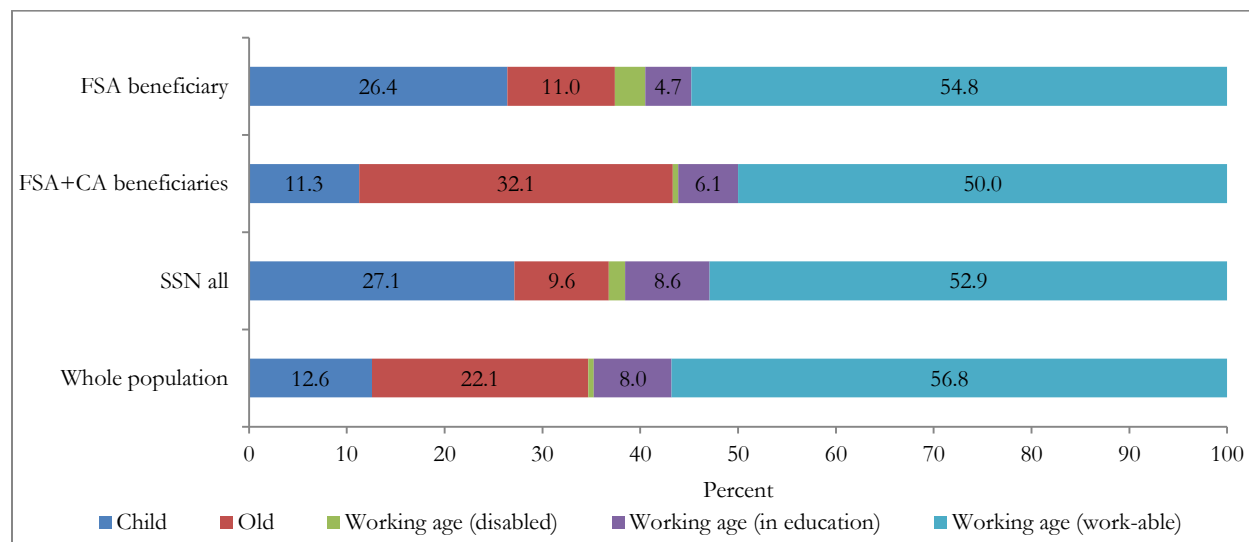
*The maternity leave allowance (wage compensation during maternity leave)* compensates mothers for lost wage earnings during maternity leave. The eligibility is based on employment in the formal sector or self-employment. The benefit is based on the net wage in the 12 months prior to the maternity leave and the length of employment service. If a mother has been employed for more than 6 months, her compensation equals 100 percent of her net wage; if employed 3 to 6 months, 60 percent; and if employed less than 3 months, 30 percent. In addition, the maximum monthly compensation is 'capped' at five average monthly wages for the country. The benefit period is up to one year for up to the second child, and two years for up to the fourth child. The benefit is paid by the employer, who is then reimbursed by the MLSP.

*The birth grant* is paid in one installment for the first child and in monthly installments for the second, third, and fourth children. The amount of the benefit depends on the order of the child. To be eligible for the grant, the mother has to be entitled to health care insurance. The birth grant, similarly to other child and family protection benefits, is administered by the municipalities – the municipal social welfare departments.

*Disability benefits* include a personal disability benefit and a caregiver's allowance (allowance for provision of care by other person). These benefits are extended to persons who have a disability from birth or childhood, or adults who have no social insurance against the risk of disability. The noncontributory disability benefits are designed by the MLSP and administered by the CSWs.

*War veterans' benefits* comprise various forms of income support to war veterans, survivors, civilian victims of war, and their families. The benefits include wage compensation for working veterans, cash compensation for disabled war veterans, a caregiver's allowance, and survivor's benefits. The veterans' benefits are designed and administered by a dedicated department in the MLSP.

*Figure 2: Age Composition of SSN Beneficiaries Relative to General Population in Serbia, 2010*



*Source:* Calculations from Serbia HBS data 2010.

*Note:* SSN = social safety net. LRSA = last resort social assistance.

**Because of the high rate of individuals who are out of work in Serbia, safety net beneficiaries represent a very small share of the population potentially in need of activation policies.** Both the demographic structure and the current labor market performance contribute to an overall low employment rate in Serbia (Koettl 2011). In terms of demographics, Serbia has a high dependency ratio, with only 65 percent of the population being of working age (15–64), according to HBS data. In addition, a salient characteristic of the labor market in Serbia is the low share of working-age individuals who are employed. In fact, the HBS data suggest that about 37 percent of all work-able individuals in Serbia were either unemployed or inactive in 2010<sup>7</sup> (figure 3). Hence, out-of-work people constitute a large group who could benefit from activation policies, even those who are not SSN recipients.

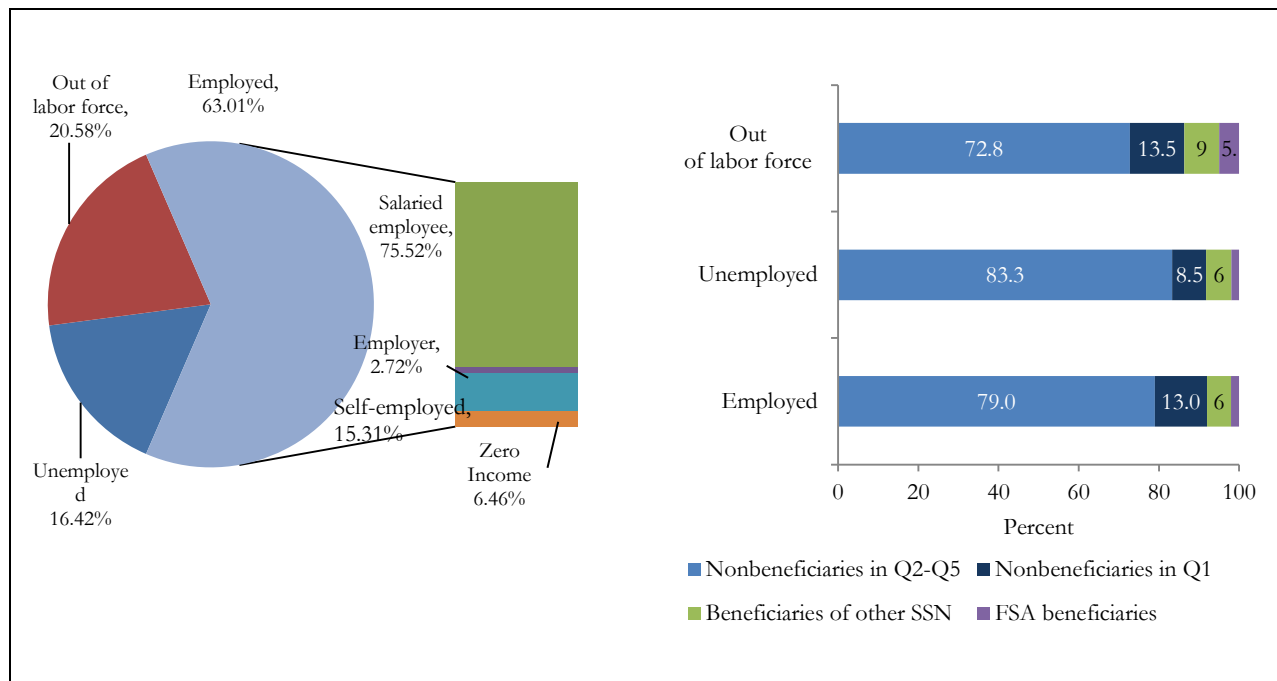
**If activation policies were to focus only on the work-able SSN beneficiaries, the effect of these policies on the labor market—and even on the working poor—would be rather limited.** In fact, only 14 percent of the work-able who are out of the labor force and 8 percent of those who are unemployed are covered by any safety net in Serbia (figure 4). Moreover, among both

<sup>7</sup> This rate is significantly lower than what shown by LFS of the same year. Data from the most recent LFS, for instance, suggest that only 44 percent of the working-age population was employed in 2011. Such a difference is attributable to the fact that the LFS's classification of "work-able" population disregards those who cannot be expected to work, although statistical discrepancies may also exist between the LFS and HBS data (see box 1).

unemployed and inactive individuals, the number of work-able poor who do not receive a safety net exceeds the number of those who do.

*Figure 3: Labor Market Status of Work-Able Population in Serbia, 2010*

*Figure 4: Social Safety Net Coverage of Work-Able Population in Serbia, 2010*



*Source:* Calculations from Serbia HBS data 2010.

*Source:* Calculations from Serbia HBS data 2010.

*Note:* HBS = household budget survey. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

*Note:* HBS = household budget survey. Q = consumption quintile (1 is lowest; 5 is highest). SSN = social safety net. LRSA = last resort social assistance. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

### 2.3 Labor Market Outcomes for Safety Net Beneficiaries Who Are Work-Able

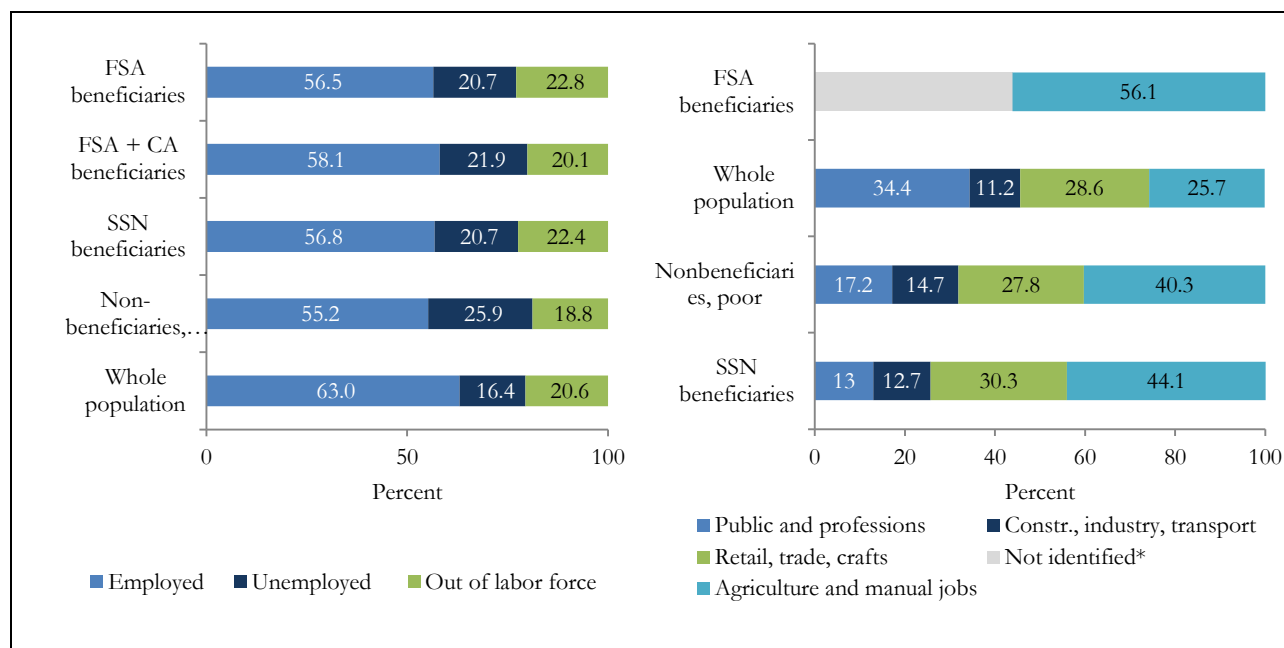
**Within the work-able population, SSN beneficiary households stand out for their particularly low employment rates.** The employment profile of the SSN beneficiary population differs markedly from that of the general population. Among those who are work-able, just above half appear to be working (figure 5, panel a). Unsurprisingly, those who work are mostly in low-paying jobs, which are, of course, correlated with the status of being beneficiaries (figure 5, panel b).



Figure 5: Employment Rates and Sectors of Work-Able SSN Beneficiaries in Serbia, 2010

a. Employment Status

b. Employment Sectors\*



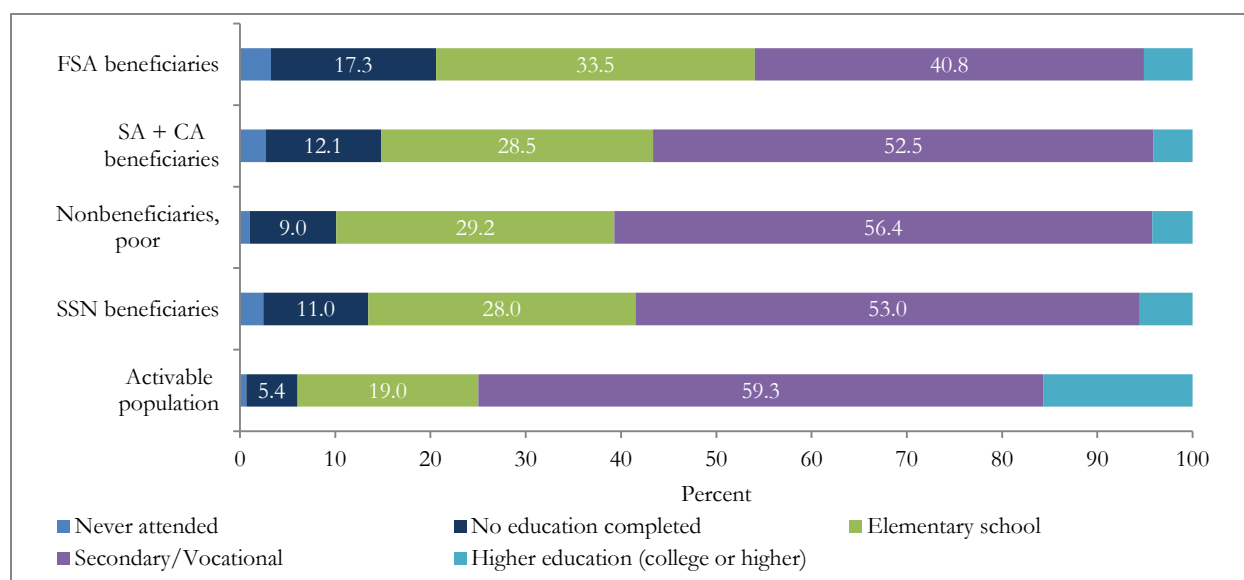
Source: Calculations from Serbia HBS data 2010.

Note: HBS = household budget survey. FSA = Financial Social Assistance. CA = Child Allowance. SSN = social safety net. “Poor” refers to individuals in the bottom 20th percentile of the total consumption distribution. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

\* Because of the sample size, conclusions cannot be drawn about the sectors other than “Agriculture and manual jobs.”

**Human capital levels explain, in part, the particularly low employment rates of SSN beneficiaries.** On average, the work-able SSN beneficiaries tend to be less educated than the nonbeneficiary poor and the general population (figure 6). Interestingly, human capital appears to be a more important predictor of employment status than whether one benefits from a safety net (figure 7). For instance, primary-educated FSA beneficiaries display low employment rates, at 50 percent, but this rate is only few percentage points away from that of the whole population. On the other hand, FSA beneficiaries with secondary education or above have employment rates of 60 percent, markedly higher, and again this rate is comparable to the one for the average population (66 percent). Hence employability barriers may be particularly important in explaining the low employment outcomes observed among SSN beneficiaries.

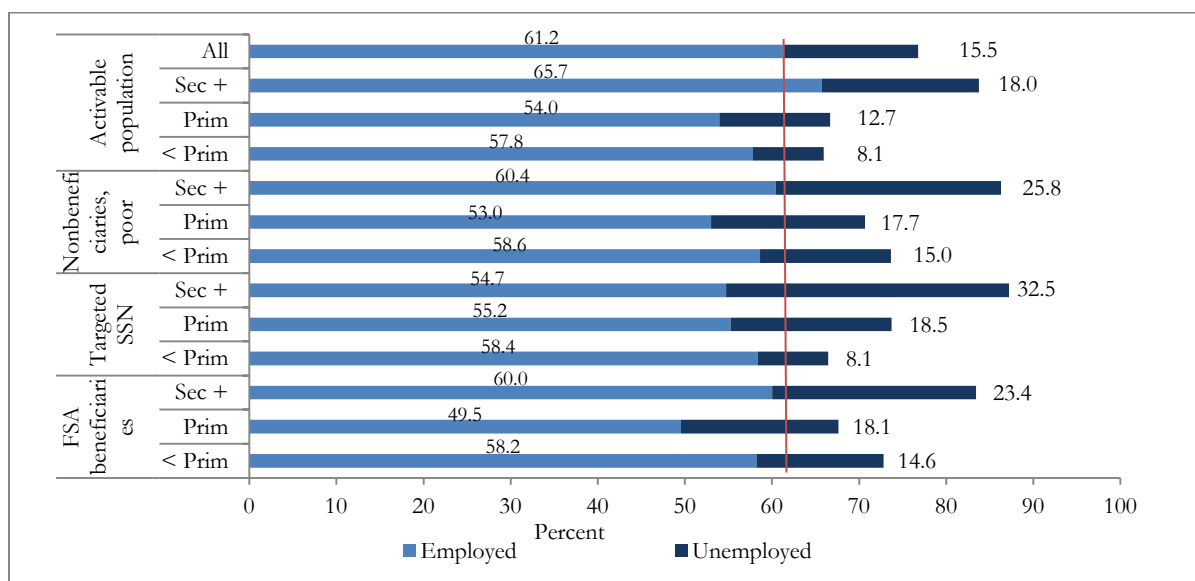
Figure 6: Education Distribution of SSN Beneficiaries in Serbia, 2010



Source: Calculations from Serbia HBS data 2010.

Note: LRSA = last resort social assistance. SA = social assistance. CA = child allowance. SSN = social safety net. “Poor” refers to individuals in the bottom 20th percentile of the total consumption distribution. “Activable” refers to individuals who could be required to work in exchange for social assistance.

Figure 7: Employment Status of SSN Beneficiaries in Serbia, by Education Level, 2010



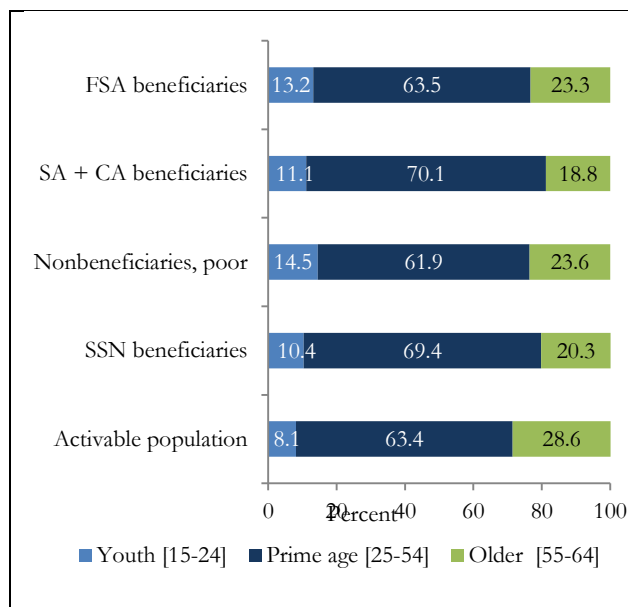
Source: Calculations from Serbia HBS data 2010

Note: SSN = social safety net. Q1 = lowest consumption quintile. FSA = Financial Social Assistance. “Activable” refers to individuals who could be required to work in exchange for social assistance.

**SSN beneficiaries are, on average, slightly younger than the general population; younger beneficiaries who are out of work have limited relevant work experience to build on.** In terms

of age distribution, SSN beneficiaries on average tend to include a greater share of young out-of-school individuals than the total activable population (figure 8). Because younger individuals tend to be new labor market entrants with lower experience (as shown in figure 9), the age composition may also explain their lower employment rates compared with the general population. Even among those with work experience, the MOP/FSA Beneficiaries Survey data also indicate that younger job seekers tend to have had more temporary and seasonal jobs than the older beneficiaries (figure 11), and they are more likely to have developed this work experience in the informal economy (figure 10).

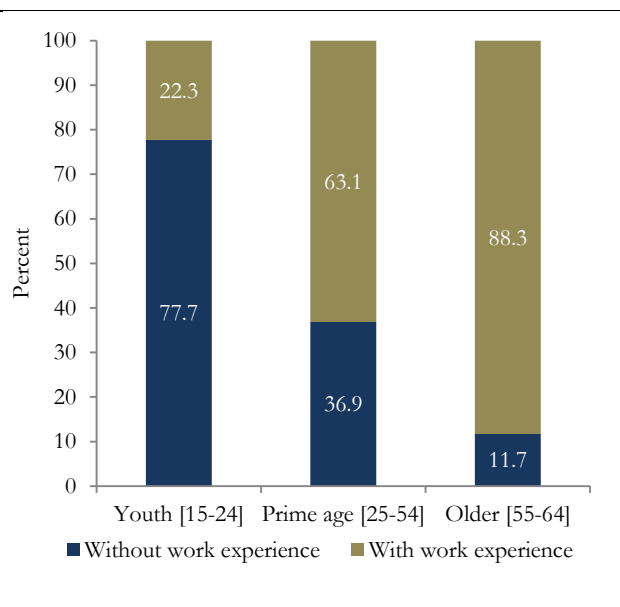
*Figure 8: Age Distribution of Work-Able SSN Beneficiaries in Serbia, by Age Group, 2010*



*Source:* Calculations from Serbia HBS data 2010.

*Note:* SSN = social safety net. LRSA = last resort social assistance. SA = social assistance. CA = Child Allowance. “Poor” refers to individuals in the bottom 20th percentile of the total consumption distribution. “Activable” refers to individuals who could be required to work in exchange for social assistance. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

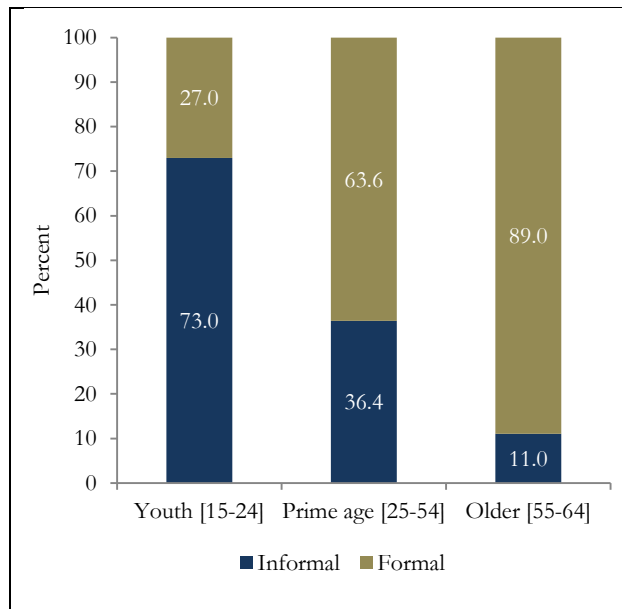
*Figure 9: Work Experience of SSN Beneficiaries in Serbia, by Age Group, 2011*



*Source:* Calculations from 2011 MOP/FSA Beneficiaries Survey.

*Note:* SSN = social safety net.

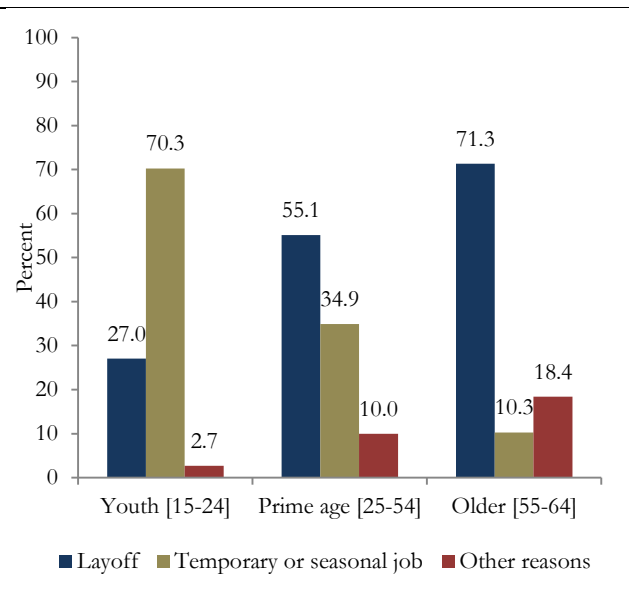
*Figure 10: Formal Status of Previous Job among FSA Beneficiaries in Serbia, 2011*



*Source:* Calculations from 2011 MOP/FSA Beneficiaries Survey.

*Note:* FSA = Financial Social Assistance. Calculations are for unemployed or inactive work-able population. An “informal” job is one without a written employment contract. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

*Figure 11: Reasons for Terminating Previous Job among FSA Beneficiaries in Serbia, 2011*



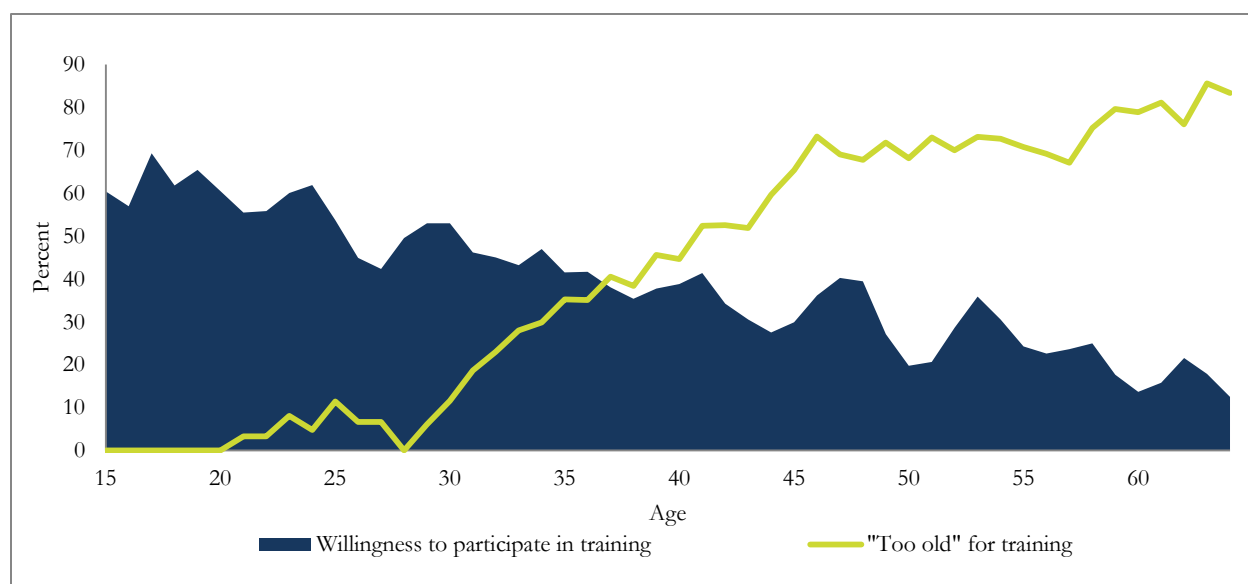
*Source:* Calculations from 2011 MOP/FSA Beneficiaries Survey.

*Note:* Statistics calculated for those with work experience within the unemployed or inactive work-able population. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

**On the other hand, younger individuals may also be more receptive to activation policies.** Those with sufficient basic education may be more likely to absorb and accept new training that can improve their employability. And they can display greater flexibility in changing their professional orientation or work location to meet labor demand. The MOP/FSA Beneficiaries Survey data suggest, for instance, that the willingness to retrain into a new profession drops steadily as age increases, with more than 50 percent of out-of-work individuals older than 45 reporting that they do not want to take new training because of their age<sup>8</sup> (figure 12).

<sup>8</sup> Authors’ elaboration based on MOP/FSA Beneficiaries Survey of July 2011.

Figure 12: Openness to Job Training among Work-Able FSA Beneficiaries in Serbia, 2011



Source: Calculations from MOP/FSA Beneficiaries Survey 2011.

Note: Statistics calculated using moving average over a window of 3 for the work-able population. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

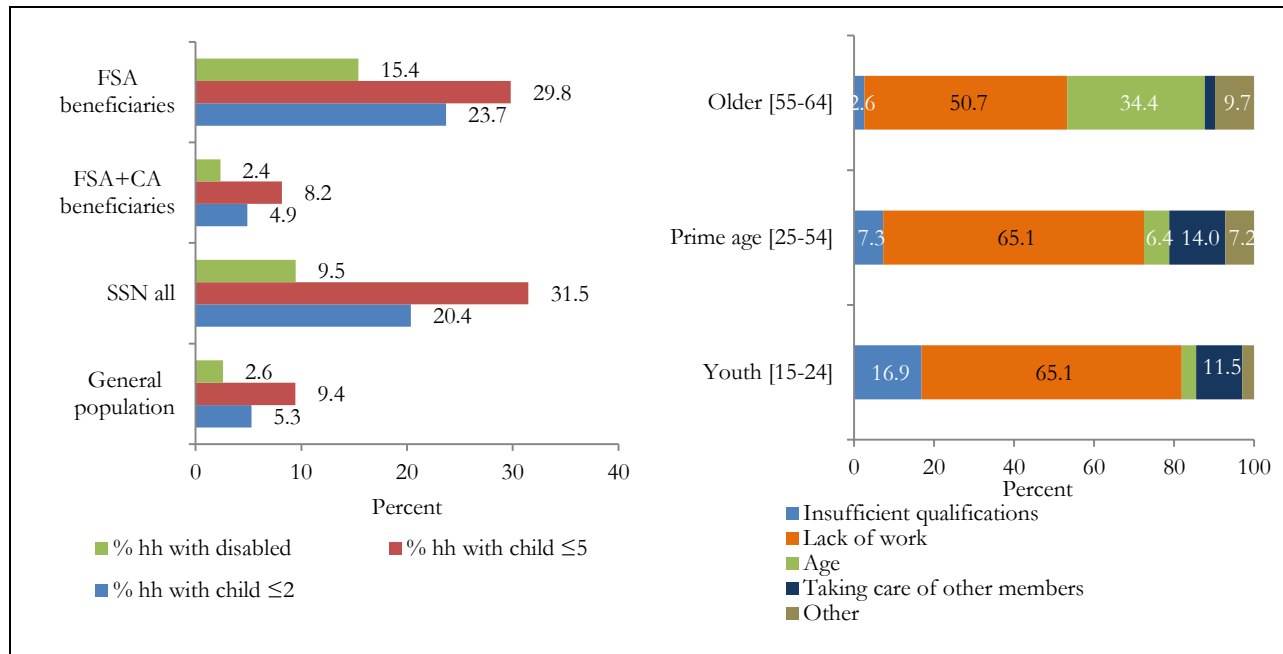
**A second set of barriers relates to all the household and community-level conditions that prevent work-able SSN beneficiaries from realizing their labor market potential.** These barriers pertain largely to the environment where beneficiaries live, and they include caretaking duties for children or people in need of care, mobility constraints, or information constraints. Data limitations allow us to examine only one such barrier: caretaking duties. However, it is important to note that, according the MOP/FSA Beneficiaries Survey, most beneficiaries report that the main barriers lie either in the depressed labor market or in their lack of skills—that is, the barriers relate to their employability rather than to their household condition. An obstacle to working commonly reported by older but not yet retired workers relates to the challenges of “age,” which would deserve greater research to be illustrated concretely.

**Households receiving social assistance display much greater caretaking duties than households in the general population.** 29 percent of households receiving FSA have at least a child under 5, and 24 percent have at least a child under 2, compared with only 9 percent and 5 percent, respectively, in the general population. The presence of disabled people is also markedly different, with 15 percent of FSA beneficiary households having at least one person declaring to be disabled, compared with only 3 percent in the population (figure 13). The MOP/FSA Beneficiaries Survey corroborates the idea that caretaking duties can be an important impediment to working for some groups of beneficiaries. Caretaking duties are reported as the most significant obstacle to finding work among 15 percent of FSA beneficiaries aged 25–54, with this rate being slightly lower for younger age groups (figure 14). To explore this further, information on the composition of

households can be used to understand how the presence of family members in need of assistance correlates with employment, particularly among women.

*Figure 13: Share of Serbian Households with Disabled Members and Young Children, by SSN Beneficiary Status, 2011*

*Figure 14: Self-Reported Most Significant Obstacle in Finding a Job among FSA Beneficiaries*



Source: MOP/FSA Beneficiaries Survey 2011

Source: MOP/FSA Beneficiaries Survey 2011

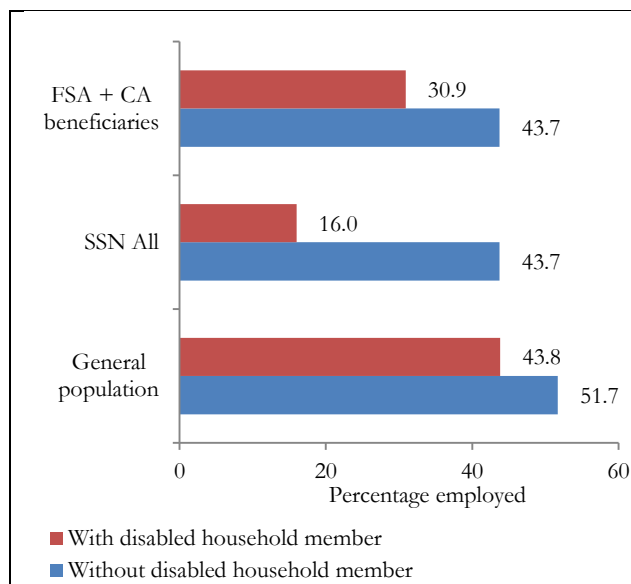
Note: SSN = social safety net. LRSA = last resort social assistance. hh = households.

**Caretaking duties appear to affect employment rates of work-able women in households that include a person with a disability, while the effect of young children on female employment is unclear.** The available evidence displays a clear correlation between the employment rates of work-able women and the presence of PWDs in beneficiary households (Figure 15). On the other hand, Figure 16 suggests that, in the case of SSN beneficiaries, women of fertile age (17–45) who are living in households with young children (aged 2 or younger) are equally likely to work as women in households without young children.

**In households with children, women have higher employment rates, potentially because of an increased need for income.** When work-able SSN beneficiary women of all ages were considered (not shown in the figures), the results suggest higher employment rates among women living in households with young children than among women who do not. The lack of a distinct correlation between the presence of young children and women’s employment rates is robust to different specifications, including the exclusion of households with older individuals who could act as caretakers or households with more than one adult woman of any age, or the inclusion of

households with children up to the age of 5. Such counterintuitive results could be explained by the higher need among SSN beneficiaries to earn an income to support their dependents compared with other women in the population. However, even in this case, more qualitative research is needed to understand how caretaking duties are performed in SSN households with young children.

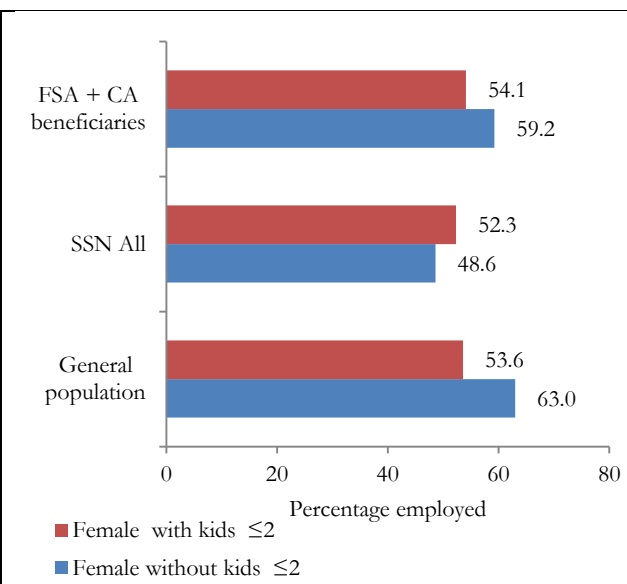
*Figure 15: Employment Rates of Work-Able Women in Households with and without PWDs in Serbia, by SSN Beneficiary Status, 2010*



Source: Serbia HBS data 2010.

Note: SSN = social safety net. PWDs = people with disabilities. Sample comprises all women of working age who are not disabled or in education.

*Figure 16: Employment Rates of Work-Able Women Aged 17–45 Years in Households with Children in Serbia, by SSN Beneficiary Status, 2010*



Source: Serbia HBS data 2010.

Note: SSN = social safety net. Sample comprises all women aged 17–45 years who are not disabled or in education.

## 2.4 Advanced Profiling of Last Resort Social Assistance Beneficiaries

**Latent class analysis allows classification of 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 latent class analysis (LCA) to match each group with specific policy approaches for activation. The exercise uses the MOP/FSA Beneficiaries Survey 2011, which has richer information on FSA beneficiaries than the HBS, despite a more limited sample. 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 group together beneficiaries who exhibit similar patterns in 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*

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. Our estimations also include 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).

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 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 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. In practice, however, it is possible that indicator variables are also correlated with each other *ex ante*. Advanced computational techniques are now allowing detecting, and in part controlling, for the correlation between indicator residuals, thus enabling the full use of the available information.

*Source:* Collins and Lanza 2010; Vermunt and Magidson 2005

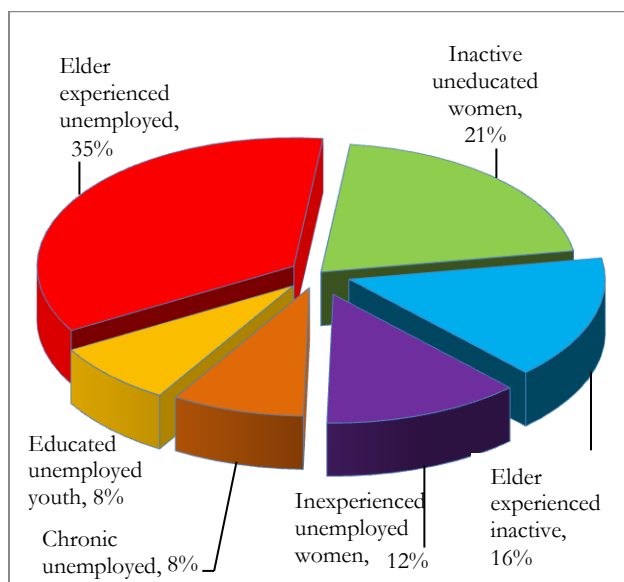
**The analysis suggests that work-able FSA beneficiaries who are not employed could be categorized into six main groups** (figure 17) and table 1 show, respectively, the values of indicator and covariate variables that define each group of beneficiaries. The characteristics of each group can be summarized as follows:

- ***Elder experienced unemployed (35 percent)***. This large group of FSA beneficiaries comprises adult or prime-age individuals who have work experience, a prevalently good education level (secondary or tertiary), and a discrete willingness to accept more training to find more employment. Most members of this class are long-term unemployed (looking for work for more than 18 months), and even among the minority who are out of the labor force, most declared themselves to be discouraged unemployed.
- ***Inactive uneducated women (21 percent)***. The second largest group of FSA beneficiaries includes young and middle-aged women who are out of the labor force and who have very low levels of education (a third of them do have any diploma). Few of these women worked in the past, and nearly half report not being interested in working. This is also the group with the highest likelihood of not reporting to work because of caretaking duties.
- ***Elder experienced inactive (16 percent)***. With mixed education and gender composition, this group is characterized mainly by individuals who have worked in the past but are currently out of the labor force because of discouragement. This group has the highest average age (47 years old) and reports low openness to retraining for a new job. Nearly a third of the group members report being unable to work because of caretaking duties.



- ***Inexperienced unemployed women*** (12 percent). This group is composed almost entirely of young and middle-aged women who are inexperienced, unemployed (mostly so for a long time), and largely with very low educational attainment (69 percent with primary education or less). Unlike the inactive uneducated women, members of this group do not appear to be constrained by caretaking needs but rather have a general employability constraint related to skills.
- ***Chronic unemployed*** (8 percent). A class of long-term unemployed includes rather young individuals, most of them males, with limited work experience but characterized by high willingness to accept more training.
- ***Educated unemployed youth*** (8 percent). This category is composed almost exclusively of young people who have recently joined the labor market and are short-term unemployed. The large majority is willing to accept more training, and the few who report to be inactive could be categorized largely as discouraged unemployed.

*Figure 17: Size Distribution of Work-Able, Unemployed and Inactive FSA Beneficiary Classes in Serbia, 2011*



*Source:* Calculations from MOP/FSA Beneficiaries Survey 2011.

*Note:* FSA = Financial Social Assistance. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

*Table 1: Characteristics of Work-Able but Out-of-Work FSA Beneficiary Groups in Serbia, 2011 (Indicators, Covariates, and Statistics)*

		Elder experienced unemployed	Inactive uneducated women	Elder experienced inactive	Inexperienced unemployed women	Chronic unemployed	Educated unemployed youth
Class size		35%	21%	16%	12%	8%	8%
Indicators	Worked before	100%	19%	95%	24%	20%	21%
	Willing to retrain	54%	23%	5%	45%	66%	73%
	Inactive	22%	100%	100%	16%	0%	19%
	Long-term unemployed	66%	0%	0%	63%	99%	6%
	Short-term unemployed	12%	0%	0%	21%	0%	75%
Active covariates	Uneducated	6%	31%	21%	31%	20%	6%
	Elementary education	34%	54%	36%	38%	37%	21%
	Secondary+ education	61%	16%	43%	31%	43%	73%
	Young (15–29)	4%	41%	8%	26%	39%	92%
	Adult (30–54)	54%	52%	45%	59%	61%	4%
	Prime age (55–64)	42%	7%	47%	15%	0%	4%
	Female	41%	82%	34%	92%	28%	26%
	Caretaker	0%	33%	32%	0%	0%	0%
Statistics	Married	62%	65%	64%	48%	55%	9%
	Discouraged inactive (% of total)	20%	56%	78%	8%	0%	14%
	Willing inactive (% of total)	2%	44%	22%	8%	0%	5%
	Mean age	46.0	32.0	47.0	36.0	31.0	23.0

*Source:* Calculations from MOP/FSA Beneficiaries Survey 2011.

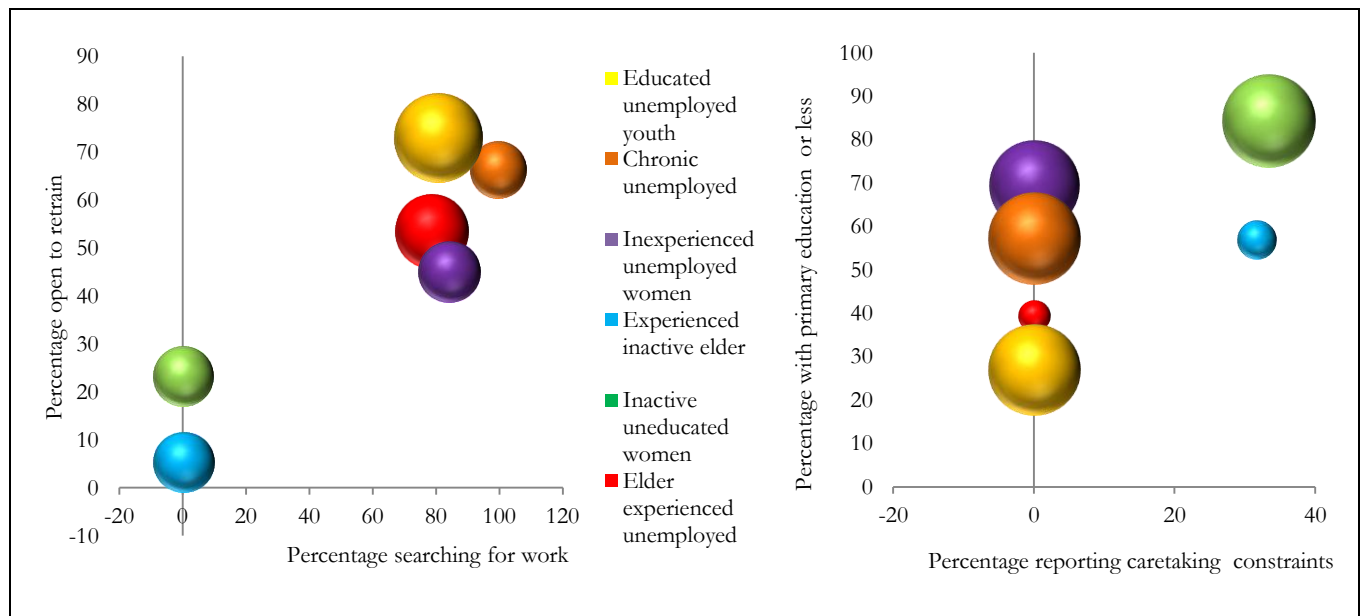
*Note:* FSA = Financial Social Assistance. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training.

**Those groups that exhibit the greatest “distance” from the labor markets are also those with the highest employability challenges.** Figure 18 and figure 19, respectively, plot proxies of the potential “effort” to join the labor market (in terms of job search, use of the employment services, and willingness to take training to become more employable) and proxies of constraints to employment (in terms of skills, experience, and caretaking duties). Interestingly, two groups—

namely, inactive uneducated women and elder experienced inactive—exhibit both high constraints and lower openness to search for work and learn new skills. A third group that may be particularly difficult to activate are the inexperienced unemployed women, who seem to be strongly constrained in terms of education and work experience and also make relatively low use of employment services and are relatively closed to training. In an opposite situation stand the two groups of the elder experienced unemployed and the educated unemployed youth, who score high on education and rather high in their efforts to enter the labor force.

*Figure 18: Labor Market Insertion Efforts among Work-Able, Out-of-Work FSA Beneficiary Groups in Serbia, 2011*

*Figure 19: Labor Market Constraints of Work-Able, Out-of-Work FSA Beneficiary Groups in Serbia, 2011*



*Source:* Calculations from MOP/FSA Beneficiaries Survey 2011.

Note: FSA = Financial Social Assistance. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training. Negative values of both axes are only introduced for graphing purposes.

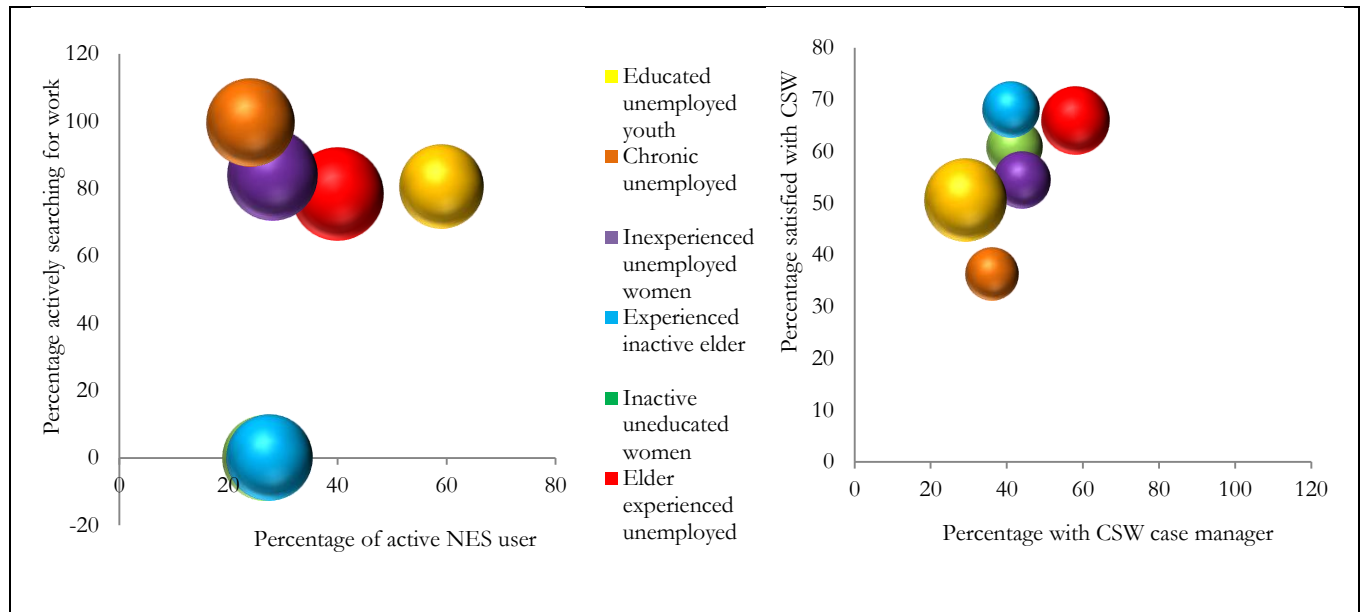
*Source:* Calculations from MOP/FSA Beneficiaries Survey 2011.

Note: FSA = Financial Social Assistance. “Work-able” includes all individuals of working age (15–64) who are neither disabled, nor in education, nor in training. Negative values of both axes are only introduced for graphing purposes.

**With the exception of the educated unemployed youth, only a minority of individuals in each group rely on employment services to find work.** The survey of MOP/FSA beneficiaries captured the extent to which individuals visited the employment services for reasons *other than* being formally registered as unemployed, which is a requirement to receive the FSA benefit. Figure 20 suggests that fewer than half of the beneficiaries use the National Employment Service (NES) to find a job, with the exception of the educated unemployed youth. In addition, the two groups that stood out in terms of high employability constraints (the chronic unemployed and inexperienced unemployed women) are also those that show very low propensity to use employment services in spite of actively looking for work.

Figure 20: Use of National Employment Service by Out-of-Work FSA Beneficiaries in Serbia, 2011

Figure 21: Coverage and Perceptions of CSW Case Management by Out-of-Work FSA Beneficiaries in Serbia, 2011



Source: Calculations from MOP/FSA Beneficiaries Survey 2011.

Note: Size indicates % registered in the National Employment Service (NES). FSA = Financial Social Assistance. Categories are all of work-able individuals, meaning those of working age (15–64) neither disabled, nor in education, nor in training. Negative values of Y-axis are only introduced for graphing purposes.

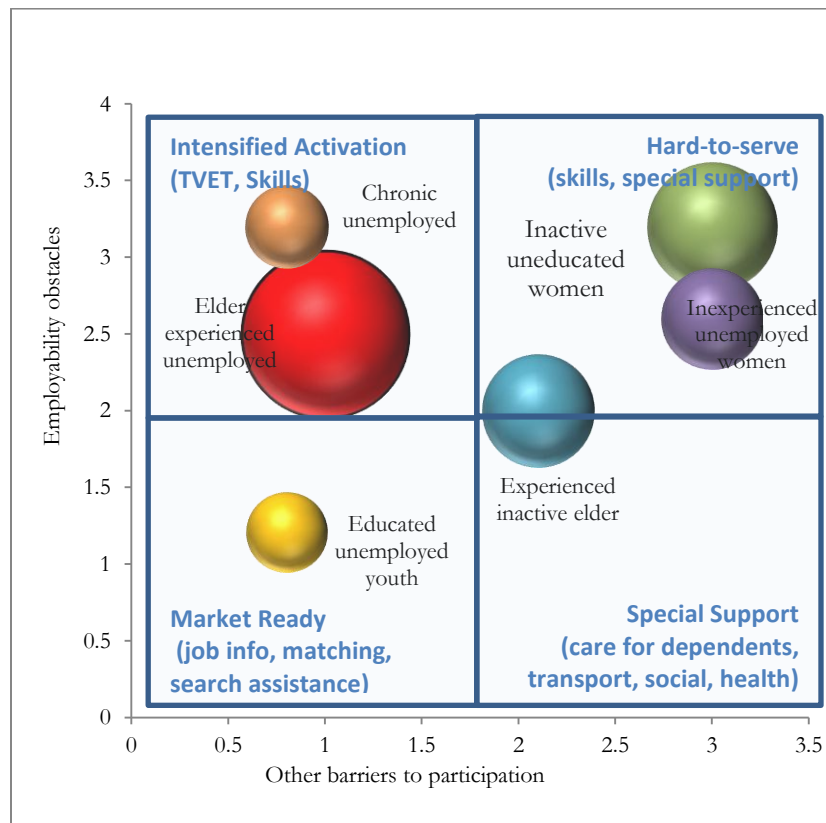
Source: Calculations from MOP/FSA Beneficiaries Survey 2011.

Note: Size indicates % of FSA beneficiaries. FSA = Financial Social Assistance. CSW = Center for Social Work. Categories are all of work-able individuals, meaning those of working age (15–64) who are neither disabled, nor in education, nor in training.

**A significant share of work-able FSA beneficiaries does not have a case manager.** The MOP/FSA Beneficiaries Survey also captures the extent to which FSA beneficiaries have case managers at the CSWs (figure 21). Groups that tend to benefit the most from case management generally consist of older people, possibly suggesting that case management involves services directed particularly to such people while groups that benefit less from case management include younger people such as the groups of chronic unemployed and the educated unemployed youth. Some groups, however, may need greater case management than they currently receive, especially among the hard to serve, such as the inactive uneducated women, or the elder inexperienced inactive.

**The activation of different classes of beneficiaries will require a tailored mix of services.** Figure 22 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 constraints related to employability (y-axis) and “other barriers” to entering employment (x-axis). It is important to consider this taxonomy 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 22: Matching FSA Beneficiary Profiles and Activation Services in Serbia, by Client Group*



*Note:* Size indicates % of out-of-work beneficiaries in each labeled client group. FSA = Financial Social Assistance. TVET = technical vocational education and training. “Activation” is a set of policy tools to

support and incentivize beneficiaries' job searching and job finding as a way to increase productive participation in society and self-sufficiency.

**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. In Serbia, this group includes the *educated unemployed youth*, who are among the most active users of the NES, although their coverage rate (60 percent) remains below potential. Services to this client segment can range from access to information on vacancies to workshops on résumé preparation, interview skills, and job searching. Impact evaluations show that incentives or threats have been associated with reductions in unemployment duration (Cahuc and Lehmann 2000; Fredriksson and Holmlund 2006). These include, for example, reduction of benefits in association with the duration of unemployment or more stringent work search requirements where job search efforts are monitored.

**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 again, require retraining in job-specific skills that the labor market requires. This could be the most appropriate strategy to activate the large group of *elder experienced unemployed*, who have, on average, a good educational foundation that allows them to absorb more specific training, as well as prior work experience, but were laid off and never found employment thereafter. A second group that would benefit from a similar mix of policies but with more elementary skills training includes the *chronic unemployed*. Because individuals in both groups are long-term unemployed but declared to be searching for work and willing to attend training, financial incentives built into the benefit formula and associated with participation in activation measures and in the activities offered for “market clients” are an appropriate mix of incentives to sustain their effort. An essential element for the success of this strategy, which is beyond the scope of this study, rests in the quality and market relevance of the vocational training offered.

**Special Support clients require intensified case management and a mix of services to improve their participation in the labor market.** This group includes individuals in the cluster of the *elder experienced inactive*, who face a number of other barriers to joining the labor force related to caretaking duties, temporary health conditions, geographic barriers to joining markets, and potentially also little personal motivation. These clients require intensive case management to identify the specific barriers they face and the potential solutions for each person's 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 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.

Finally, **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. For instance, the *inactive uneducated women* cluster exhibits very low education levels, high caretaking duties, and no prior attachment to the labor market. Also the *inexperienced unemployed women* cluster, while showing higher motivation to join the labor force and having lower caretaking duties, may be considered as a borderline case of Hard-to-Serve and Intensified Activation clients in light of their poor education and lack of prior work experience. These groups of beneficiaries may be considerably harder to activate, and they require, in any case, a longer process, which will include both the intensive case management for *Special Support* clients and basic skills-development activities, especially “soft skills” training, that can improve their capacity to seek, find, and retain work.

**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 last resort social assistance is an exercise integrated into the regular business process of case management.<sup>9</sup> 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), and similar rates were observed for Denmark and Sweden (Konle-Seidl 2011), and even higher 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 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

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<sup>9</sup> This section draws from the comprehensive assessment of statistical profiling in OECD countries conducted by Konle-Seidl (2011).

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.

**The available data for Serbia can provide however only an initial overview of the general beneficiary profiles and the policies that those beneficiary clusters may benefit from.**

Advanced profiling would require the analysis of administrative data, an improvement of the information collected at entry to also capture soft skills, and potentially the use of a classification system of skills that matches the one used to define skills shortages cited by employers.



### 3. Design Limitations, Work Incentives, and Disincentives in the Last Resort Social Assistance Program in Serbia

This section looks into the regulatory aspects of the FSA with a view to highlighting specific features that could influence the individual decision to supply labor in the first place and subsequently the choice of employment in the formal or informal sector. Given the fiscal constraints that Serbia faces, attention needs to be turned to the elements of the system that shape the work incentives of social assistance beneficiaries. The analysis reveals that improvements to FSA design are necessary (but not sufficient) to improve the labor supply of its able bodied recipients. Thee FSA design contains built-in disincentives (rather than incentives) stemming from the means test and benefit formula mainly. The FSA is not very generous unless eligibility brings a package of other benefits and rights with it. FSA design could be improved to incentivize transition to work through income disregards, in-work benefits etc. but this will not be sufficient alone. High labor taxes on low-paid labor also need to be addressed as a source of potential work disincentives, as well as other barriers to work as identified with the profiling.

#### 3.1 Design Overview, Financing, and Performance of the Financial Social Assistance Program in Serbia

**The FSA in Serbia is a universal program financed by the central budget that provides cash benefits to low-income families.** The last resort social assistance program in Serbia, the FSA, is centrally designed and financed by the government budget. It has national coverage, provides equal treatment to all citizens, and targets the chronic poor relatively well. Coverage, however, is low. Still, there are concerns about the high level of exclusion of transient poor households and poor households that do not pass the exclusionary assets test. The number of FSA recipients has increased recently as a result of the economic crisis, and the duration of benefit reliance is likely to be prolonged. As of November 2012, nearly 240,000 individuals (3.3 percent of the population<sup>10</sup>) were reported to receive FSA. Relative to December 2011, the number of recipients increased by more than 11 percent, while the direct budgetary expenditure under the program increased by almost 13 percent. Direct budget expenditure on FSA represented 0.25 percent of GDP in 2011.

**Eligibility for FSA is conditioned on a set of income criteria and asset filters.** The amount of the benefit is determined as the difference between a predetermined income threshold and the income of the supported household on a monthly basis. The social assistance threshold for each household is calculated using equivalence scales. In addition to the income criterion, there are filters—such as size of the claimant’s dwelling, land ownership, possession of bank accounts and other assets, as well as required unemployment registration—that further limit the access to the program.

**The LRSA program was thoroughly revamped in 2011 with the adoption of the new Social Welfare Law.** The objectives of the reform were manifold: to expand the coverage and benefit

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<sup>10</sup> Census data 2011

adequacy; to regulate the provision of social care services and link it to cash assistance (case management); and to introduce behavioral conditions and incentives for activation of able-to-work LRSA beneficiaries. Activation is defined as 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. Box 4 further discusses the reform.

**Box 4: Main Changes in the LRSA with the Law on Social Welfare (April 2011)**

In the late 2000s, the LRSA program is Serbia medium-term structural reforms to make the system more cost-effective and accessible by the poor while keeping it accurately targeted. With the enactment of the new law, the former LRSA program—MOP (*Materijalno Obezbedenje Porodic*, Material Family Support)—was replaced by the FSA program. The FSA has several new features compared with MOP:

- The FSA benefit levels are determined according to an equivalence scale that is aligned to the modified OECD scale (1 for the first adult, 0.5 for the second and each additional adult, and 0.3 for each child). This measure has resulted in increase of the benefit amount paid to multi-member households/families (of more than 3 members) thus eliminating the overestimation of the economies of scales from sharing assets and expenditures in one household, as well as the bias of the MOP towards small units of recipients. The scale is implicit, the maximum amounts due are set as nominal amounts. Unlike the MOP scale, this one differentiates the scales of economies when family/household members are adults or children.
- Benefit indexation is mandatory twice a year with the growth of consumer prices. The legal framework (both the present and the former social assistance legislation) require the LRSA program eligibility threshold to be indexed to the cost-of-living, or consumer price index. The Law on Social Protection and Provision of Social Safety to Citizens which was in force from 2004 to April 11, 2011 envisaged monthly indexation, while the newly adopted Social Protection Law provides for benefit increase and purchasing power protection by indexation to consumer price growth every six months.
- The benefit level is higher for certain vulnerable as households without work-able members and single parent families with children—for them, the new law provides for a 20 percent benefit increase.
- The maximum number of eligible household members was raised from five to six.
- The land ownership threshold was increased from 0.5 hectare to 1 hectare for households with members who are unable to work, and left at 0.5 hectare for families with able bodied members.
- The definition of individuals “not capable to work” was changed to include college and university students, pregnant women, and those providing care to disabled family members.

These amendments were geared towards expansion of coverage and improving benefit adequacy. Both numbers of FSA recipients and spending on social assistance increased significantly after the introduction of the FSA which can be partially attributed to the new elements in benefit design.

The law also introduces the concept of activation of those who are able to work and overcoming the long-term dependence on social benefits is embedded in the Social Welfare Act. It is expected to eliminate the existing disincentives for participating in public works, training and other activation measures; to encourage the efforts on behalf of the employment services in helping benefit recipients overcome the obstacles to entering into paid work; and to also encourage benefit recipients to actively search for paid work and to invest in better employability. These policies was supported with active labor market programs targeted to recipients of non-contributory social assistance included in the National Employment Action Plans for 2011 and 2012.

The new law also emphasizes activation of FSA recipients through education, training, employment, and community-based work. For the first time, the Law on Social Welfare prescribes that an individual who is able to work has the right, as well as the obligation, to participate in activities leading to his or her inclusion in society.

The new law makes it possible for the CSWs or NES to sign agreements with beneficiaries for their activation (individual employment plans).

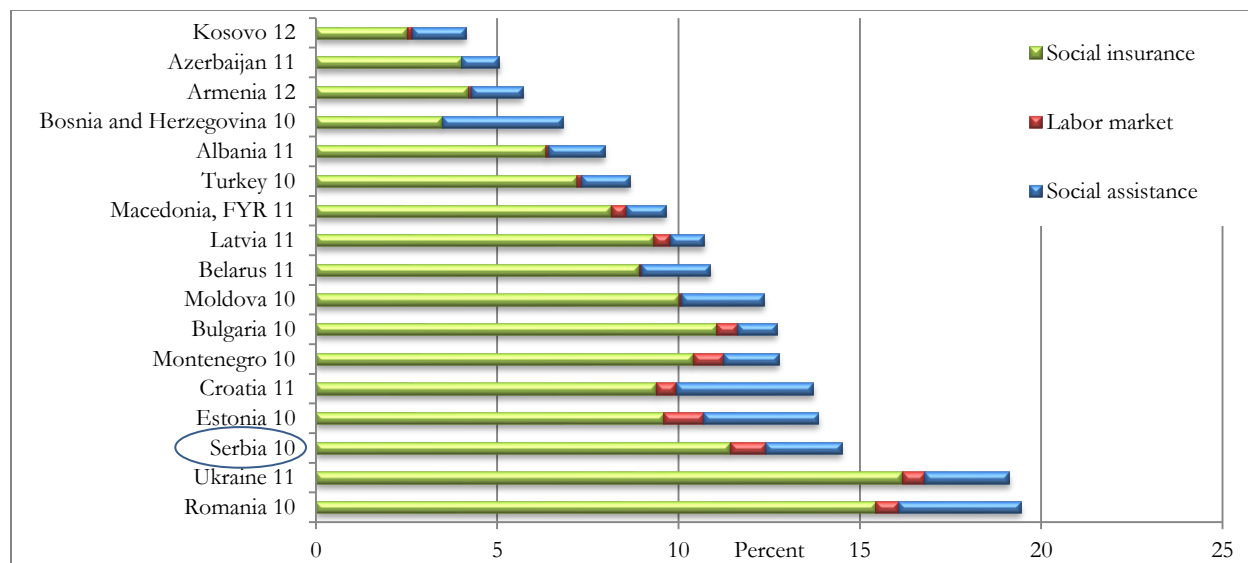
The FSA design – for the first time in the Western Balkan countries - envisages disregard of certain incomes from activation measures, such as stypends, travel costs and per diems received when participating in training, along with more flexible resumption of beneficiary status after participation in activation measures.

Finally, the Law regulates in a detailed manner social care services which will boost their development and work towards limiting social and care-giving related barriers to labor market participation.

*Source:* Social Welfare Law, Republic of Serbia, 2011.

**The FSA program should be viewed in the context of other related programs for support to those in need.** An important element of the safety net for families with children in Serbia, which is closely related to the FSA, is the monthly child allowance (CA) program. It also represents an income-tested benefit for which the income threshold is only about 7 percent higher than the one for FSA.<sup>11</sup> However, when determining the minimum income for CA benefit eligibility, no equivalence scales are used and, as a result, the threshold levels for FSA and the CA vary considerably depending on the structure of the household. Finally, FSA is an element of the overall social protection system of Serbia which (by regional standards in Eastern Europe and Central Asia) includes a large system of pensions and other social insurance-based benefits accounting for around 12 percent of GDP, expenditure on unemployment benefits and ALMPs, and noncontributory social assistance (figure 23).

*Figure 23: Structure of Spending on Social Protection in Serbia and Other Selected Eastern European and Central Asian Countries, 2009–11*



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

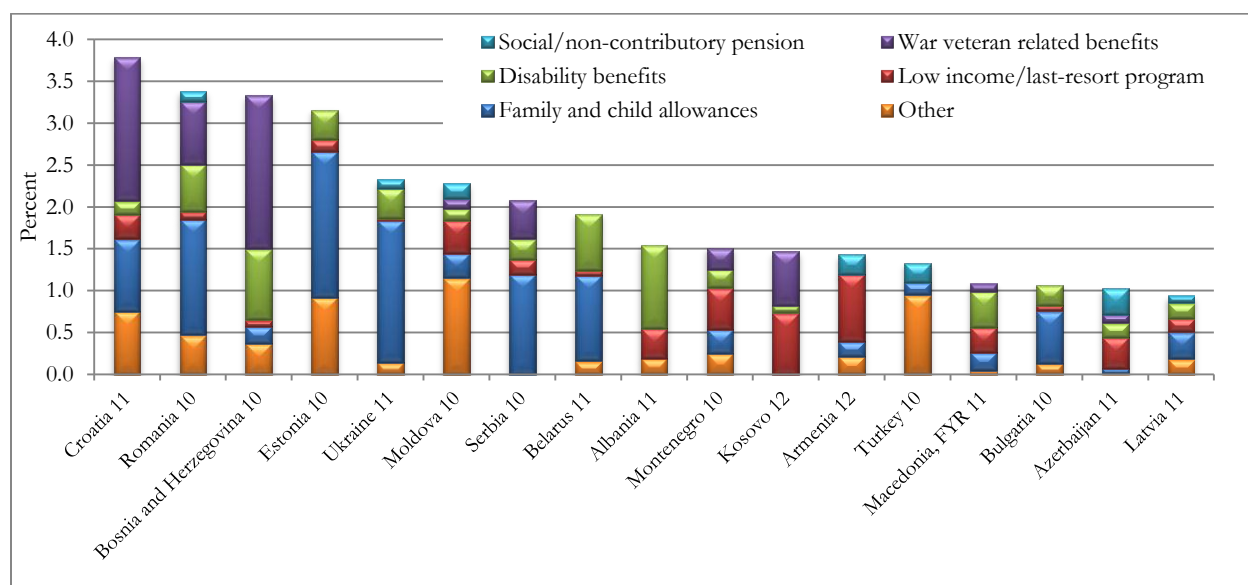
*Note:* Social insurance includes pension and disability programs based on social insurance contribution payments. Labor market programs include both passive (unemployment) benefits and active labor market programs (ALMPs). Social

<sup>11</sup> Republic of Serbia, Ministry of Labor, Employment and Social Policy website (accessed October 2012).

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.

**Although Serbia’s spending on FSA is small by regional standards, its overall spending on noncontributory social programs is above the average in Eastern Europe and Central Asia** when measured as percentage of GDP (figure 24). Spending on all social assistance (including child and family benefits, noncontributory disability benefits, war veteran benefits, and LRSA) in Serbia accounts for 2.1 percent of GDP, which is higher than the average for Eastern Europe and Central Asia (1.9 percent of GDP). Until 2010, high spending on wage compensation during maternity leave was the main reason for boosting overall social assistance spending. At the end of 2010, however, the formula for calculation of this benefit was changed to ensure a tighter link between the employment and contribution record, and the actual wage of the beneficiary mother, on one hand, and her compensation during maternity leave, on the other, as well as to limit the previously existing possibilities for “inflating” the reference wage. As a result, in 2011 the cost of the wage compensation during maternity program was contained relative to 2010 despite a notable increase in the number of claimants. The spending on FSA accounts for 0.25 percent of GDP, which is below the regional standards. Some countries in Eastern Europe and Central Asia spend up to 0.5 percent of GDP, or even 0.7 percent of GDP, on similar programs. At the same time, it is worth noting that the spending on FSA in Serbia increased after the enactment of the new Social Welfare Law, which, as already mentioned, was desired and deliberately sought. The increase is mostly due to the equivalence scales that provide a higher income eligibility threshold for larger families as well as to the provisions that led to increasing the coverage and generosity of FSA, especially for current claimants.

*Figure 24: Social Assistance Spending in Serbia and Selected Eastern European and Central Asian Countries, 2009–11*



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

Note: 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.

The targeting performance<sup>12</sup> of FSA was close to the Eastern European and Central Asian average before the legal and design changes that were introduced with the reform of April 2011. Evidence suggests that the targeting accuracy of Serbia's LRSA was close to the Eastern European and Central Asian average, which is overall quite high. The poorest quintile received close to 70 percent of the LRSA benefits in 2010, and the leakage to the richest quintile was low. The good targeting accuracy is mostly due to the rigorous income test coupled with binary exclusion filters, including possession of movable assets and real estate.

**However, although Serbia's LRSA program accurately identifies the most vulnerable groups, it does not provide sufficient coverage.** In 2010, it reached only 15 percent of the poorest population quintile. The same reasons that underline the good targeting accuracy—strict eligibility rules—explain the low coverage. The coverage is also dependent on the outreach efforts to identify eligible poor (which are not very strong in Serbia) and on the administrative burden related to attaining and maintaining eligibility, which is significant. One of the main objectives of the reform of 2011 was to increase coverage. As part of the 2011 social assistance and social services reform, coverage was increased within larger families which were already covered with the program and indexation rules were introduced to allow expansion of coverage in parallel with the increase in consumer prices. Annex 2 provides details on the Serbia LRSA targeting accuracy and coverage relative to other Eastern European and Central Asian countries for which data are available.

### 3.2 Design Limitations, Work Incentives, and Disincentives

**Certain design characteristics of the guaranteed minimum income schemes have built-in work incentives and disincentives.** The FSA program's main objective is to provide minimum income and social integration of the most vulnerable and poor members of society. 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 types of complementary elements (Vidovic et al. 2011): *demanding elements* (conditions for receiving benefits), to ensure that the relevant legal framework provides incentives to actively supply labor, and *enabling elements* to lower the barriers to active labor supply. A simple analytical framework that summarizes these two “elements of activation”—adapted according to the FSA design and instruments for activation in Serbia—is presented in table 2. The benchmarking of activation conditions in Serbia to this framework reveals that the design of the program does not seem to induce active labor behavior among the benefit recipients.

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<sup>12</sup> We use household survey micro data to assess performance outcomes of the social welfare benefits 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 the 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.

*Table 2: The Two Elements of Activation*

Demanding	Enabling
<p><b>1. Duration of benefit receipt</b></p> <ul style="list-style-type: none"> <li>• Lowering benefit rate with time or decreasing schedule (not available in Serbia; benefit is not time bound)</li> <li>• Limitation of the benefit receipt duration (up to 9 months in a calendar year for households where most members are able to work)</li> </ul> <p><b>2. Availability criteria and sanctioning clauses</b></p> <ul style="list-style-type: none"> <li>• How restrictive is the definition of suitable job offers (moderately restrictive)</li> <li>• Punitive sanctions for noncompliance (exist but are not strictly enforced)</li> <li>• Restrictive entry, reentry, and exit conditions (restrictive, no legal guarantees for reentry to FSA after trying a job or participation in ALMPs)</li> </ul> <p><b>3. Individual activity requirements</b></p> <ul style="list-style-type: none"> <li>• Integration contracts (IEPs for some of the FSA recipients)</li> <li>• Monitoring of individual job search effort (superficial for FSA recipients; exchange of information between EOs and CSWs is limited and ad hoc)</li> <li>• Mandatory participation in ALMPs (yes)</li> </ul>	<p><b>1. Classical ALMPs</b></p> <ul style="list-style-type: none"> <li>• Job-related training schemes (yes)<sup>a</sup></li> <li>• Employment incentives (yes)<sup>a</sup></li> <li>• Start-up programs (yes)<sup>a</sup></li> <li>• PWP (direct job creation) (yes)<sup>a</sup></li> </ul> <p><b>2. Soft ALMPs</b></p> <ul style="list-style-type: none"> <li>• Job search assistance (yes)<sup>a</sup></li> <li>• Counseling (yes)<sup>a</sup></li> </ul> <p><b>3. Financial incentives</b></p> <ul style="list-style-type: none"> <li>• Earning disregard clauses (no)</li> <li>• Wage supplements granted in case of taking up low-paying jobs (in-work benefits) (no)</li> <li>• Disregards exist for certain incomes related to taking up ALMPs, such as stipends during training, per diem, and travel costs to training or public works venue</li> </ul>

*Source:* Vidovic et al. 2011, based on Eichhorst W. and Konle-Seidl R., IZA Discussion Paper No. 3905, 2008 and adjusted to FSA program characteristics.

*Note:* ALMP = active labor market program. FSA = Financial Social Assistance. IEP = individual employment plan. EO = employment office. CSW = Center for Social Work. PWP = public works program.

a. Elements that exist but are limited in scope and cannot cover a meaningful share of FSA recipients.

### **3.2.1 Work Incentives**

**A number of elements of the LRSA program in Serbia are conducive to more active labor supply by social welfare beneficiaries.** These include a relatively low benefit level, a requirement to register in the NES, limited support during a calendar year, and procedures for entry and reentry into the system, among others. In some of these areas there is room for further improvement to strengthen their positive impact on labor market participation.

**The level of the monetary social benefit is considered to be low.** The benefit level is one of the key parameters of social assistance programs. It has to be generous enough to provide the needed support to poor families. However, a very generous benefit may create job-search disincentives among recipients. The level of benefits received under the FSA program in Serbia is considered to be low. Relative to the post-transfer consumption of a recipient household in the poorest quintile, the benefit represented 34 percent in 2010. The average LRSA transfer per family member<sup>13</sup> as a share of the net minimum wage in 2009 and 2010 was about 41 percent (World Bank 2012). After the 2011 reform of the LRSA program and based on the 2011 MOP/FSA Beneficiaries Survey, about 82 percent of the surveyed individuals estimate that the FSA benefit covers one-third or less of their needs (World Bank 2012). Even after taking into account the centralized determination of the income threshold for FSA eligibility and possible differences regarding generosity of the benefits at the regional level, the level of benefits still seems low. For example, the share of recipients in urban areas who perceive that the FSA benefit covers one-third or less of their needs is 85 percent, while in nonurban areas this share is 78 percent.

**Registration in the NES is likely to encourage labor participation of social assistance participants by providing more opportunities for training and access to ALMPs, among other benefits.** Family members who are out of a job but able to work are required to register as unemployed with the NES to be eligible for FSA. This eligibility criterion is seen as evidence that the individual is actively searching for a job, is available to start working, and is not currently employed. The NES registration is likely to have a positive effect on the labor market participation of those able-to-work FSA recipients because it includes them in the system of services for unemployed and ensures access to programs and measures, some of which are specifically targeted at the hard-to-place, long-term unemployed.

**Enforcement of the benefit reduction in case of noncompliance with NES requirements, however, is weak.** Although an explicit penalty exists<sup>14</sup> for refusing to participate in training programs or for turning down a job offer, the enforcement appears to be weak. Anecdotal evidence suggests that it is possible to avoid participation in ALMPs or public works by negotiating with the provider of the service without losing access to FSA. This is due to the lack of communication between the CSW worker, NES, and the provider of the service. In addition, there does not seem to be a clear rule for calculating the reduced benefit that is to cover only the unable-to-work members.

**Limiting the period for receiving social benefits creates strong incentives for more active labor participation.** One of the features of the FSA program in Serbia is the strictly enforced restriction allowing up to nine months of welfare benefit in one calendar year. This restriction applies to households where most of the members are able to work, and it creates incentives for accepting a short-term job or participation in ALMPs or public works. The legislation seems flexible with respect to the timing of the restriction, as there are no stipulations about specific time frames

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<sup>13</sup> Based on beneficiary households only

<sup>14</sup> If an FSA recipient refuses to participate in a program, training, and so forth or turns down a job offer, there will be a reduction in the benefit for the family and only unable-to-work members will continue to receive the benefit.

during the calendar year, but the CSWs apply it in an inflexible way: they provide FSA for nine consecutive months and then stop it for three consecutive months. Although this feature of FSA would be expected to stimulate labor supply, its scope is limited to work-able recipients in single families and families where work-able recipients are the majority. The effect is also limited because of the rigidity of implementation, which does not allow flexibility for partial use of the three-month period without FSA whenever opportunities for work emerge. Collecting and keeping up-to-date information on the beneficiaries would be useful for monitoring and analysis of the profiles of families affected by this regulation with a view to further adjusting the latter if needed.

**Entry and reentry into the eligibility system for FSA in Serbia can discourage the demand for benefits but can also have a negative impact on accepting short-term employment.** The procedures for entry into the system for financial support could have a significant impact on the behavior of potential applicants. The efforts needed and potential costs of collecting the necessary documents, together with possible multiple visits to CSW and NES branch offices, the scrutiny of conditions by social workers through a home visit, and other requirements can adversely affect the demand for social assistance. In the case of Serbia, a relatively long list of documents must be presented and verified before entry in the system is granted (World Bank 2011). Once verification is completed and the applicant is approved, eligibility for FSA must be recertified every 12 months based on the income during the preceding three months.<sup>15</sup> Recipients are required to report any change in the structure of the household, assets, and income within 15 days.

**Immediate access to social assistance after short-term formal employment provides an incentive for active labor supply.** Because eligibility is based on the income during the three months preceding the application, the regulation exempts from consideration earnings from formal employment when the earnings were terminated by no fault of the employee (World Bank 2011). This provision ensures an immediate access to the FSA after short-term formal employment or participation in public works, thus providing an incentive for FSA recipients to actively supply labor. However, because the household is subjected to the entire eligibility procedure again, its members may be reluctant to undertake low-paid, very-short term (for example, one to three months) employment.

**The disregards of certain incomes that have been earned while taking part in activation measures create incentives for participation.** This means that certain incomes from PWP, training and re-qualification programs are not counted as incomes when eligibility for FSA is assessed. The effect of income disregards is reinforced by easing the formalities for reentry into FSA after finishing participation in activation measures. The same effect results from the provision of financial support for participation in training and skill development (such as stipends, per diem, and travel costs) and exempting that financial support when determining family income eligibility for FSA. The participation of FSA recipients in measures and programs that provide training, additional education, vocational training, and so forth is an important part of the activation process, job search support, and eventually job retention. Direct financial incentives, income disregards, and legal

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<sup>15</sup> Law on Social Welfare, Art. 96



guarantees for reentry into FSA can increase the share of FSA recipients who would be ready to take up training and skills development measures.

**Eligibility for FSA in Serbia is not “packaged” with many other social assistance payments.**

Packaging or ‘passporting’ is a benefit design approach where the eligibility for one benefit automatically leads to eligibility for other benefits, services or rights. In the case of Serbia, the main case of ‘passporting’ relates to eligibility for health insurance coverage, which is a right associated with FSA eligibility and can be lost if an individual works part-time. Other social assistance payments include the CA, the caregiver allowance, and the parental allowance, which are not conditioned on FSA eligibility. About 43 percent of the FSA recipients receive other forms of financial support (World Bank 2012; Petrovic 2011). The largest overlap with other social programs is with the CA program (93 percent), while 5 percent of the FSA recipients also receive caregiver assistance. Child care for FSA recipients is free of charge, but with the increase of income, the family is required to cover a progressively higher share of the cost. Therefore, even if a participant leaves the FSA system, he or she can still be eligible for these benefits, and they do not by themselves discourage labor supply. The exception, as previously mentioned, relates to the health insurance contributions. Health care is free for FSA recipients and also for people registered with the NES as unemployed and with income that is below a specified threshold. However, an individual who is not unemployed (for example, has a part-time job) and has earnings above the threshold for FSA eligibility will have to pay the minimum health insurance contribution, which is calculated on a base that could be higher than his or her income. Hence, it is likely that the minimum health insurance contribution would have a negative impact on accepting a part-time job or working in the formal sector of the economy. Another exception with potential disincentives for FSA recipients’ labor supply might be emerging with the new energy benefit (discount of electricity and gas consumption), which has been introduced with a decree as of March 21, 2013.<sup>16</sup> Currently FSA recipients are eligible for an electricity subsidy that is low in terms of generosity and has low acceptance. The new benefit—as designed—could potentially overlap with the receipt of FSA and the monthly CA,<sup>17</sup> thus increasing the overall “package” of benefits and rights that FSA beneficiaries have access to. The further decisions on this benefit should be cognizant of the above-stated possible work disincentives, along with the increase in administrative cost for the implementation of yet another (third) means-tested benefit and the fragmentation of social assistance.

### ***3.2.2 Work Disincentives***

**Some of the features of the FSA program in Serbia do not promote active labor participation of work-able participants.** These features could result in participants being better off staying in the program than accepting low-paid formal employment.

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<sup>16</sup> A new Council of Ministers’ Decree on Vulnerable Energy Consumers, pursuant to the provisions referred to in Article 149 of the Law on Energy (“Official Gazette of the Republic of Serbia,” No. 57/11, 80/11 – correction, 93/12 and 124/12) and Article 42 item 1 of the Law on Government (“Official Gazette of the Republic of Serbia,” No. 55/05, 71/05 – correction, 101/07, 65/08, 16/11, 68/12 and 72/12).

<sup>17</sup> The means test for the energy benefit is not yet elaborated in detail, and it is not clear whether it will disregard incomes from other benefits, including means-tested ones

**Fixed income thresholds for eligibility for free services can increase the reservation wage of social assistance beneficiaries.** An important feature of LRSA programs that is often considered to negatively affect labor supply is the existence of a fixed income threshold above which the family loses the entire benefit. In the case of Serbia, among the benefits affected are free child care, a utility bill subsidy, soup kitchen benefits (mostly provided at the municipal level), and free health insurance under certain conditions. Eligibility for benefits based on a fixed income threshold creates a kink in the household’s budget constraint that could increase the level of the reservation wage for FSA-supported, work-capable recipients. At the same time, as outlined before, most FSA recipients have little or no education, implying that they will most likely be offered low-paid jobs. An extensive overview of the financial disincentives against moving from FSA to employment is provided in box 4 and in the technical annex to this note.

**Although the average level of the FSA benefit is low, for certain recipient households it can come close to the net minimum wage.** One of the major disincentives built into the LRSA programs in general is the proportional reduction in the benefit for each unit of earned income. A participant will prefer not to exert effort (that is, participate in the labor market) if he or she will receive the same amount of money from social assistance. Table 3 shows the average ratio of the FSA benefit to the net minimum wage depending on the family composition. Assuming that no other factors are influencing the decision to participate in the FSA program except maximizing the disposable income in the family, one may conclude that members who are able to work in families where the benefit level comes close to the net minimum wage are more likely to stay at home than to accept a formal job that pays the minimum wage.<sup>18</sup> The disincentive against accepting a part-time job in the formal sector would be even stronger, particularly in light of the high minimum contribution floor for social security (see Koetl 2011). In the extreme and rare case of a family without other income and with six unemployed adults (no children under 18 years), the FSA transfer would be 25 percent higher than the net minimum wage. Box 5 provides further details on the financial disincentives against moving from FSA to employment.

*Table 3: Average FSA Transfer as Share of Net Minimum Wage in Serbia, by Family Structure, 2012*

No. of family members	Ave. transfer per person (%)	Ave. transfer per family (%)
1	37%	37%
2	23%	47%
3	18%	55%
4	16%	<b>63%</b>
5	14%	<b>72%</b>
6	14%	<b>83%</b>
<b>Total Average</b>	<b>20%</b>	<b>51%</b>

*Source:* Ministry of Labor and Social Policy (MLSP) and calculations<sup>1</sup> from MLSP FSA data (<http://www.minrzs.gov.rs/socijalna-davanja-visina.ph>); data for October 2012.

*Note:* Net minimum wage based on 22 working days. Net minimum wage as of October 2012 is RSD 115 per hour.

<sup>18</sup> This assumes that starting a job implies the additional costs of transportation, clothing, and so on.

**This design feature of the FSA program, coupled with the very low level of the benefit for large families, is likely to encourage employment in the informal sector.** A possible measure to address the issue is to expand the scope of disregarded income for the eligibility test by including formal employment income and using a diminishing scale for gradual exit from FSA benefits. This would increase the minimum income threshold for families where one or more members work in the formal sector. Furthermore, if such a measure enhances active labor supply, this would lead to program savings in the long run. Detailed fiscal impact analysis based on the distribution of families below and above the current income threshold would be important in this regard.

**The CSW worker's discretion in making the income assessment can deter current benefit recipients from exiting the system.** The procedure for determining eligibility for FSA includes assessment by the social worker. The latter is responsible for identifying possible foregone opportunities for earnings, confirming the number of family members, checking for informal employment, and so forth. Because a structured evaluation process is lacking, the CSW worker has some discretion in assessing certain elements of the family income when applying the income eligibility criteria. This can potentially lead to denial of FSA to a current recipient if, in the future, another CSW worker comes up with a different estimate. Therefore, once approved, some of the recipients may feel reluctant to exit the system because of fears about future reentry. In this regard, a comprehensive and well-structured procedure for income assessment by the CSW worker needs to be developed and implemented.

*Box 5: Financial Disincentives against Moving from FSA to Work*

**Measures of Financial Work Incentives and Benefit Adequacy**

**To assess how the tax-benefit system in Serbia can affect work incentives, a tax-benefit model was used.** The model incorporates *legal rules* related to cash social assistance benefits. 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, one-earner couple without children, and one-earner couple with two children. The results presented in this section are based on a tax-benefit model developed following *OECD methodology* for Serbia for the year 2012.

**An important outcome of the tax-benefit model is the estimate of the financial incentives to work for different household types.** This note focuses mainly on the potential *inactivity traps* due to disincentives for social safety net beneficiaries to take up employment. The “trap” indicates that the change in disposable income when increasing work effort is small and, conversely, that the work-disincentive effect of the tax and benefit systems is large. The OECD tax-benefit model allows calculation of 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 that he or she works. METRs show, at a given wage level, how much of an additional small amount of gross income earned (usually 1 percent of the average wage) is “taxed away,” either through income tax, social security contributions, or as a result of withdrawal of social benefits.
- *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).

### ***How an LRSA Program's Design Can Be Improved***

**There are implicit work disincentives in LRSA programs' design.** Just as in many other countries in the Eastern European and Central Asian region, Serbia's FSA program is designed in a way that each additional dinar earned by a beneficiary is subtracted from the benefit amount. The benefit is calculated as a difference between a certain income threshold and the 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 METR. This is clearly illustrated in figure B4.1, which shows that the METR is 100 percent for a one-earner family with two children up to about 30 percent of the average wage, when this family is no longer eligible for social assistance. Similarly, there is an increase in the METR and AETR when a household loses eligibility for the Child Allowance (about 68 percent of the average wage for a one-earner couple with two children).

### ***Lower Employment Incentives in Some Households, Particularly Those with Children***

**There is a potential for the "inactivity trap" for families with children.** Compared with other countries in the Western Balkans and also with the EU15 and EU10 averages, indicators of the "inactivity trap" are not significantly different in Serbia except among families with children. The AETRs for moving from inactivity to lower-paid jobs (those at 50 or 67 percent of average wage) are somewhat on the higher end for households consisting of single parents and two children in Serbia and one-earner couples with two children. Specifically, if a single parent with two children takes a job at 50 percent of the average wage, he or she would lose about 70 percent of the hard-earned income through a combination of taxes, contributions, and benefit withdrawals. For families where one spouse is inactive and there are two children, a job earning 67 percent of the average wage taken by the other spouse would only bring in about 35 percent of additional net income.

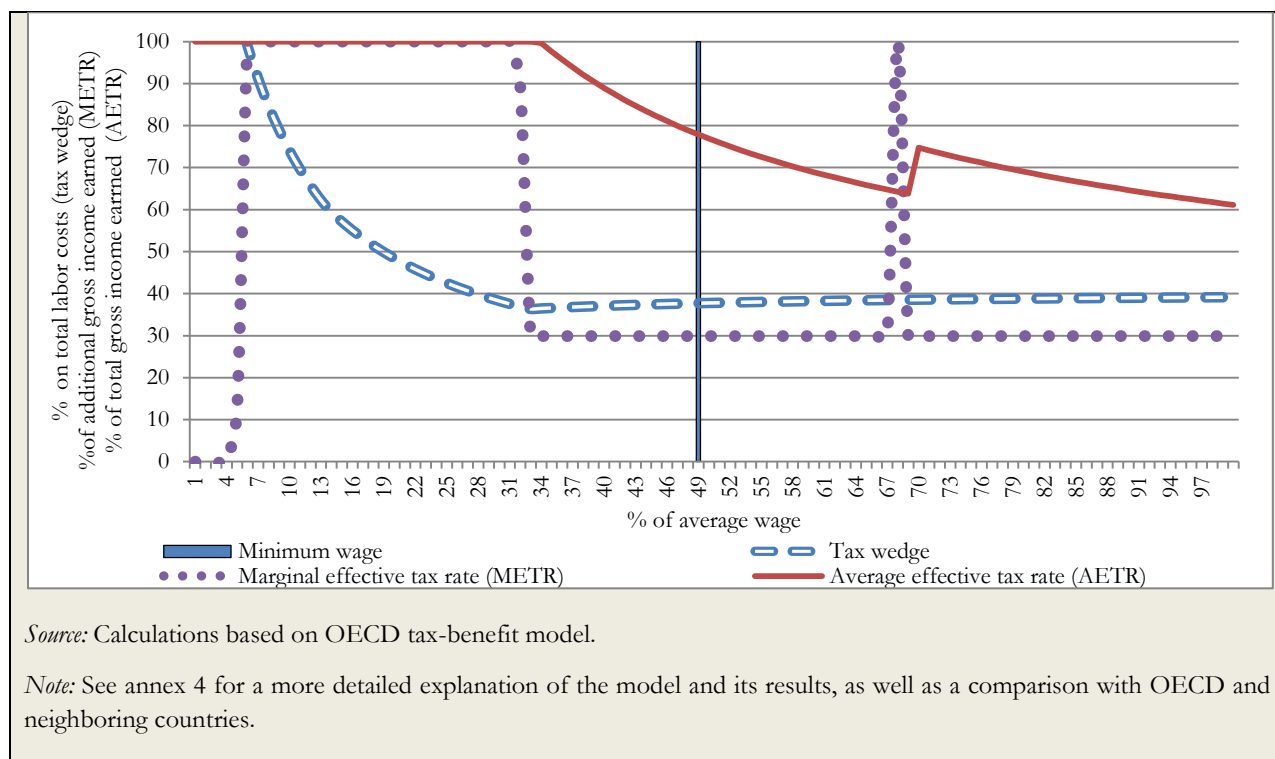
### ***High Labor Taxes for Low-Wage Earners in Serbia***

**Labor taxes in Serbia are average for higher-wage earners but very high for low-paid jobs.** A comparison with OECD and neighboring countries shows that the tax wedge on labor at lower wage levels in Serbia is one of the highest, at 36.7 percent. The reason for the high tax wedge is the minimum social security contributions that employees and employers are mandated to pay. The minimum base for calculation of social security contributions equals 35 percent of average salary in Serbia in the previous quarter. Therefore, if an employee's monthly gross salary is below this threshold, social security contributions are calculated on this threshold. *This means that, in particular, low-paid part-time jobs with few hours worked per week have a relatively higher burden of payroll taxes.* In some extreme cases (such as someone working five hours per week at the minimum wage), it would simply not pay off to have a job because of the high value of the social security contributions due. Not only would this prevent certain jobs from being viable, but it also likely contributes to incentives to work informally (Koettl 2011).

### ***"Inactivity Traps" from High Labor Taxes on Low-Paid Jobs***

**Social security contributions and income taxes contribute significantly to potential inactivity traps.** Withdrawal of social assistance benefits only partially contributes to high PTRs in Serbia. While at lower wage levels, withdrawal of social assistance constitutes a large share of the implicit tax on earnings, the combined burden of social security contributions and income taxes contributes a non-negligible amount to the tax on earnings. This combined burden ranges between 26.6 percent and 28.8 percent for households with earnings in the range of 50–150 percent of the average wage.

*Figure B5.1: Tax Wedge, METR, and AETR for a One-Earner Couple with Two Children in Serbia, 2012*



**Replacing the existing binary asset tests with hybrid tests could be more appropriate given the need to enhance labor market participation.** Eligibility for FSA is means-tested and hence includes asset tests. However, in Serbia, the asset tests are binary (Yes/No), and each of them can lead to denial of access to the system. Binary eligibility criteria may not only lead to exclusion of a poor family due to failure to pass one of the filters but may also impede active job searching. For example, the requirement that the value of movable assets (such as a car) should not exceed the amount of the benefit for six months potentially creates a disincentive to work because it deprives the family members of a means of transportation that could affect their labor participation. In addition, the evaluation process appears flawed because the threshold for movable assets is defined as up to six times "the amount of cash social assistance that would be determined"<sup>19</sup> for the owner of the asset. This not only implies different criteria for eligibility but also creates room for discretion in estimating the value of the property and its importance for "basic subsistence needs." Possible improvement in this regard could include development of a structured process for evaluation of income and assets by the CSW worker and introduction of some flexibility in the criteria (for example, a hybrid test) to reduce the discretion and ensure equality of treatment across families.

**Evidence for Serbia suggests that a large share of social benefits recipients have relied on the system for prolonged periods of time.** Open-ended benefits are usually viewed as contributing to the development of welfare dependency because the lack of a lifetime limit adversely affects individual labor supply. In Serbia, social workers report that about 90 percent of the current

<sup>19</sup> Law on Social Welfare, Law on Social Welfare, Art. 83, Paragraph 1, item 3.

work-able FSA recipients reapply regularly and have stayed in the program for more than five years (World Bank 2011). At the same time, according to the MOP/FSA Beneficiaries Survey, the average duration of FSA participation is 4.4 years, with about 6 percent of the recipients being in the program for more than 10 years and 19 percent for more than 5 years (World Bank 2012). One possible explanation of the large discrepancy between the survey results is that the latter survey was conducted in the summer, when finding a seasonal job is relatively easier and many work-able recipients may be temporarily out of the system because of the requirement for three months without FSA. Also, with the unfolding of the recent economic crisis, the number of FSA recipients in Serbia has increased significantly as more new families have entered the system in the past two to three years (Government of the Republic of Serbia 2011b.) Last, in April 2011, the new Law on Social Welfare was adopted, which among other things expanded the coverage of the system, increasing further the number of beneficiaries. Although it is difficult to estimate precisely the share of welfare recipients who have been in the system for a long time, there are indications that it is relatively large.

**The size of the informal sector in a country has a bearing on the performance of its social assistance programs.** A large informal sector weighs on both the scope and the efficiency of the social system through loss of budget revenue and misallocation of benefits. In Serbia, the estimates of the size of the informal economy vary; the 2012 Labor Force Survey (LFS 2012) indicates that about 390,000 people were working informally, representing 17.5% of the total employed (aged 15+) implying relatively high levels of informal employment. Because social assistance eligibility is based mostly on administrative data collection, it most likely fails to capture informal sector employment or remittances. This creates a strong incentive among FSA recipients to hide employment in the informal sector.

**The main factors that make employment in the informal sectors attractive include the proportional reduction in the FSA benefit for each dinar earned, the high tax wedge, and the low benefit level.** An important stimulus for a social assistance recipient to take an informal sector job is the one-to-one decrease of the social benefit for each dinar earned and the high tax wedge for low-income earners in Serbia (see the technical annex). This is specifically pronounced in the case of part-time jobs, which are common for individuals with low or no education. Another relevant factor is the level of the FSA benefit. To make a living, many FSA recipients need to earn additional income. However, a clear distinction should be made between "inactive" recipients and those who actually work in the informal sector. Although the latter present a problem for the FSA system regarding its scope and efficiency, moving such individuals to formal employment would require an approach different from activation. To minimize informal employment, in addition to the structured ALMPs specifically designed for FSA participants, daily visits to the labor office with frequently changing hours can be introduced. Such an approach has been implemented in Sweden, and the program evaluation shows that it had a noticeable effect on the activity of welfare recipients, reducing the welfare participation and increasing employment (Dahlberg, Johansson, and Mörk 2008). The evaluation also found no significant effect on the disposable income of welfare receivers.

## 4. Institutional Setup for Activation

This section continues the review of elements that the activation process relies upon. After analyzing the role of the "demanding" element—which, as covered in the previous section, ensures that the relevant legal framework provides incentives to actively supply labor—now the emphasis is on the "enabling" element, which provides tools for overcoming barriers to active labor supply. This section assesses the strengths and weaknesses of the institutional setup and constraints that have a bearing on the delivery of services for activation, focusing specifically on issues like (a) weak coordination and communication between the NES and CSW, including limited the referral processes; (b) institutional capacity constraints for activating those who are detached from the labor market, including virtual absence of case management; (c) available mix of ALMPs but limited scope of participation of FSA beneficiaries in them; (d) financing constraints.

### 4.1 Coordination between Employment Services and Centers for Social Work

**The activation of FSA recipients results from the combined efforts of the CSWs and NES local offices.** Currently the coordination is limited to the CSWs' requirement for mandatory registration as unemployed: individuals who are considered capable of working<sup>20</sup> but do not work while claiming FSA should register as unemployed. This is the only mechanism for connecting able-bodied FSA recipients with the employment services. Unemployment registration entails an obligation to participate in the programs assigned by the NES office to receive FSA. Failure to do so would result in ineligibility for FSA benefits. Therefore, the effective enforcement of the existing legal framework and the successful implementation of all demanding and enabling elements of activation would depend to a great extent on the coordination and cooperation between the NES (including its local offices) and CSWs.

**The exchange of information between the CSWs and the NES (and its offices) in Serbia is uneven, and as a result the regulations concerning active labor supply by the unemployed who receive FSA and the sanctions for noncompliance are not properly enforced.** Although both institutions have established information systems, they are not interconnected. There is no information regarding either the unemployed receiving FSA or the share of registered unemployed among those receiving FSA benefits. Furthermore, the information exchange refers only to the (un)employment status of FSA recipients. Official channels do not seem to exist for the exchange of information on their job search efforts and on whether they have taken or refused offered training or participation in ALMPs. Often this kind of information exchange between the NES and CSWs is of an ad hoc nature and based on personal contact. As a result, the tracking of the readiness to work of FSA recipients who are also clients of the NES is very difficult.

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<sup>20</sup> Pensioners, persons with high degree of disability, caregivers, pregnant women or parents under care leave, and students (under 26 years of age) are not considered capable of working according to the Law on Social Welfare.

**Apart from the information exchange, the coordination between the CSWs and employment services is very limited, and opportunities for synergies from joint services provision are being missed.** The 2011 MOP/FSA Beneficiaries Survey concludes that referrals between social and employment services cover a negligible share of recipients, with referrals from social and employment services to formal education being slightly more common. The incidence of referrals from the employment service (NES) to social transfers and service (CSWs) and *vice versa* is low—3 percent and 0.5 percent, respectively. At the same time, the share of those referred to formal education by the CSWs, NES, and other institutions is 4 percent. Interestingly, a much smaller share of FSA recipients is referred to training programs (2.7 percent) and mostly individuals in the 30–49 age group (3.2 percent). Young people are not involved in referrals because many are still in education. However, the data confirm that youth outside the formal education system appears to be rather neglected. These findings indicate a clear need for improved cooperation and an enhanced referral system.

**The employment offices offer in general a wide range of support services for job seekers; however, the services that specifically target clients who are hard-to-serve because of their multiple barriers to work and subsequent long-term detachment from the labor market are still limited.** The National Employment Strategy 2011–20 recognizes FSA recipients as disadvantaged job seekers, but no ALMPs or other measures specifically aim to reduce their barriers to employment (Government of the Republic of Serbia 2011a). Instead, the scope of services offered to the registered unemployed in general is also available to work-able unemployed FSA recipients (World Bank 2012), and each type of ALMP or measure is supposed to have a “quota” for FSA recipients. A step forward is made with the National Employment Action Plan for 2012, which singles out FSA recipients as a specific group (for the second subsequent year). The plan calls for strengthening the cooperation between CSWs and the NES and for broader participation of FSA beneficiaries in ALMPs. In addition, measures for other groups at risk on the labor market such as the long-term unemployed (those unemployed for 12 months or more), persons with no or with low education, ethnic minorities, and youth have been expanded to include FSA recipients as well. The plan sets indicators for monitoring the progress toward increased labor market inclusion of FSA beneficiaries, namely (a) the number and characteristics of social assistance beneficiaries participating in ALMPs, by type of measure; (b) the share of social assistance recipients participating in ALMPs over the total number of ALMP participants; and (c) the number and characteristics of social assistance beneficiaries employed six months after participation in an ALMP, by type of measure. The CSWs and NES are designated as the implementing agencies or responsible parties, while the financing will be ensured from the Republic of Serbia’s budget.

**The profiling of those who register with the employment offices exists, but it is very simple and not always able to predict the job-search behavior of the profiled or the motivation behind their registration as unemployed.** The procedures for each job seeker who chooses to register at the labor office include status verification and a vocational guidance interview. After going through the registration process (by front-line administrative registration staff), the job seeker is referred to the deciding officer for the verification of the unemployment status. Each job seeker is



then entitled to a vocational guidance interview (within the initial 90 days) and a group session. During the guidance interview, the client's background, educational and work history, job expectations, and other relevant information are discussed and entered into the unified information system. The client is then profiled into one of three categories: (a) clients who are easily employable in the open labor market and are offered basic mediation services; (b) clients who are employable but who need intensive support (eligible for subsidized employment); and (c) clients who are employable but who need intensive support (eligible for comprehensive support for reintegration into the labor market). This type of client profiling is rather basic, and there is little guidance with regard to the identification of potentially "activable" FSA recipients (such as those required to work in exchange for social assistance). Improved client profiling and detailed rules for action in different cases are essential for ensuring better-quality service to social assistance recipients. Profiling would help to develop a customized approach to serving the clients, and standardized procedures would alleviate the workload and speed up the staff's work. Specific guidelines on how to identify and work with FSA recipients with potential for activation could be beneficial.

**A more meaningful role should be ascribed to the individual employment plans (IEPs).** The profiling process finishes with agreement to an IEP, which is then revised every six months. However, among the registered unemployed recipients of social assistance, fewer than half are actually looking for a job (World Bank 2012). This fact shows a loophole in the formal process of confirming unemployment status because the change in attitude is not detected when the unemployed person visits the labor office for the regular review. The abovementioned problems are likely to be related to the relatively long period for individual plan reassessment as well as the lack of formal criteria for demonstrating job search efforts and availability to start to work.

**The CSWs are not properly addressing the barriers to employability stemming from household and community problems.** An active job search is demonstrated by readiness of the registered unemployed to participate in an ALMP and to start work. However, certain conditions, such as caretaking duties, health problems, or other family reasons often impede active labor supply. According to the MOP/FSA Beneficiaries Survey, among those who were registered as unemployed, about 43 percent responded that they were not actually looking for a job because of illness or disability, 19 percent claimed inactivity due to caretaking duties for children or PWDs, and 13 percent claimed inactivity for other personal or family reasons. It is difficult to rationalize such a result given that FSA recipients who are registered as unemployed are supposed to be capable of working, which excludes caretaking duties or disability. This points to the need for more in-depth work within the CSWs to uncover the real barriers to employment and to address them as much as possible.

**The coordination problem is exacerbated by the fact that during economic downturns the frequency of interactions between unemployed and NES decreases.** The level of overall economic activity has a significant impact on the outcome of the activation measures. In a worsening economic environment associated with an increase in the number of unemployed and constant or declining administrative staff, the frequency of unemployment interventions is likely to

decrease. Consequently, an overloaded administration is not able to properly check the individual eligibility for benefits (Grubb 2009), thus extending the periods of reliance on social assistance. In addition, the demand for labor contracts not only creates inactivity by discouraging job searches but also has negative fiscal implications that further constrain the financing of the activation policies.

**A solution considered by many developed countries is to integrate the provision of cash support, social care, and employment services in order to approach the multiple barriers to employment holistically in the context of a stagnant labor market.** In the 2000s, and especially in the aftermath of the global financial crisis, many middle- and high-income countries moved toward integration of cash support, social care, and employment services and adjusted the institutional setup for integrated service delivery. Examples of different levels of coordination and institutional integration include the reformed employment services in Germany, the co-located employment services and social assistance offices in the Slovak Republic, and the Jobcentre Plus agency in the United Kingdom. In recognition of the need for a holistic approach to addressing the barriers to work, the Government of Serbia embarked on piloting an integrated service delivery model that entailed strengthening cooperation between the CSWs, the NES, general and vocational education, and other institutions, and setting a common objective for their efforts. Details on the pilot project in Serbia are provided in box 6.

*Box 5: Pilot Project on Integrated Service Delivery in Serbia*

A pilot project on integrated service delivery was carried out in 2009-11, under the Joint Program for Promotion of Youth Employment and Management of Migration, financed by the Government of Spain through the Millennium Development Goals Achievement Fund and implemented by four UN agencies: the International Labour Office (ILO), the International Organization for Migration (IOM), the United Nations Development Program (UNDP), and the United Nations Children's Fund (UNICEF). The target audience of the pilot integrated service delivery model were young (15–30 years old) LRSA beneficiaries in five municipalities.

The project activities included (a) development and testing of a new referral mechanism between the CSWs and NES branch offices, where the cooperation between the various systems offering services to the joint clients was defined by the “*Partnership Agreements*” signed between the CSWs and NES in the participating pilot sites; and (b) training of social workers in how to activate young social assistance beneficiaries with no or very limited work experience and on how to motivate them for labor market participation.

According to the final evaluation of the pilot, 242 young men and women (*long-term unemployed beneficiaries of different social services but mostly FSA recipients, many belonging to Roma population groups*) received targeted employment and social services (Taylor 2012). Altogether, 138 women and 104 men were referred between the CSWs and NES branch offices. Among them, 56 were Roma, 8 were PWDs, 6 were internally displaced persons, and 108 were long-term unemployed. Ninety-eight successfully completed training, 24 interrupted training (11 reasonably and 13 unreasonably), and 85 received on-the-job training. Nineteen percent stayed in employment six months after the completion of the program. At the time of project evaluation (February 2012), 120 treated young people were still participating in on-the-job training programs.

*Source:* World Bank, 2012

## 4.2 Institutional Capacity Constraints

Another set of constraints to the smooth functioning of the activation for FSA recipients arises from the weak institutional capacity of the systems for social assistance and public employment services. Some of the key impediments to a more effective process of encouraging social assistance beneficiaries to actively supply labor include the following:

- ***High client-staff ratio in CSWs and in NES and lack of obligation or incentives to cooperate.*** The ratio of clients to staff in the cash transfer units of CSWs ranges between 200 and 250 recipient households per staff member. Because the staff deals with a broad range of issues pertaining to social assistance, the share of the actual time spent with FSA recipients in total annual working time is estimated at about 15 percent (World Bank 2012). In addition, a large share of the staff is not trained to work with hard-to-place individuals, and there is no structured approach for the different profiles of FSA recipients. Staff motivation is another potential source of inefficiencies because there is no reward for exerting more effort to activate social assistance recipients. As noted above, the cooperation between local CSWs and NES offices is largely on an ad hoc basis. The situation is similar in the NES, where the client-to-staff ratio is very large, ranging from 700 to 3,000 clients per counselor (World Bank 2012; Kavanagh 2010).
- ***Centralized and rigid decision making.*** The existing planning system does not provide enough room for tailoring approaches to specific regional needs, and the available information is not sufficient for a detailed analysis of the characteristics of FSA recipients by region. It is therefore difficult to design specific programs and measures in both the social assistance and employment services sectors. Some degree of decentralization of the decision-making process could help better address the specific problems that certain regions may have. However, for decentralization to be successful, it needs to be based on a careful analysis of the characteristics of the FSA recipients by region. A system for continuing observation and adjustment should be in place as well.
- ***Weak incentives for the CSW staffs to provide better client service.*** The low level of cooperation between the CSWs and NES not only makes it difficult to arrange an adequate follow-up of the registered unemployed FSA recipients but also precludes analysis of the performance of specific measures and practices. Furthermore, the lack of information that would enable the tracing of social assistance beneficiaries hampers the design of a system of staff incentives based on their performance.
- ***Limited scope for case management at the CSWs.*** The existing case management practice within CSWs, which provide a holistic approach to the systems surrounding the client and face multiple problems, does not include FSA recipients who are able to work but whose only problem is insufficiency of financial resources. However, the abovementioned problems of registered unemployed recipients of social assistance, which prevent them from actively looking for jobs, imply that more people need support than the currently covered FSA recipients. Expansion of the scope of case management eligibility will reveal possible employability barriers

(for example, chronic disease that prevents accepting a certain type of job or participation in specific public works; or caretaker duty for an ill person, a senior, or a child who cannot be transferred to a public institution). Based on a case-by-case review, many of these barriers to employability could be removed.

### 4.3 Active Labor Market Programs

**The participation rate of FSA recipients in NES ALMPs is very low.** In general, the social assistance recipients make up only a very small fraction of ALMP participants in Serbia (see table 4). However, the participation rate increased somewhat in 2011, and the trend is likely to continue because "fostering opportunities for hard-to-place individuals and achieving greater social inclusion of vulnerable groups" is on the list of main objectives of the National Employment Action Plan for 2012.

*Table 4: Shares of Participating FSA Recipients among ALMP Participants in Serbia, 2009–11*

ALMP type	2009	2011
Career guidance and counseling	0.47%	2.66%
Active job search	0.28%	0.99%
Job fairs	0.28%	1.60%
Trainings	0.41%	4.16%
Professional training and education	-	0.16%
Self-employment subsidy	-	0.55%
Subsidies for equipping and opening new jobs	-	0.49%
Public works	-	2.63%

*Source:* Administrative data of the National Employment Service, Republic of Serbia, June 2012.

*Note:* FSA = Financial Social Assistance. ALMP = active labor market program.

**Although the effect on employment appears encouraging, few approaches are tailored for FSA beneficiaries in the ALMPs.** Positive examples include public works and the abovementioned integrated service delivery program (box 6) for the young unemployed. ALMPs are promising tools for improving the employability of the FSA recipients, despite the lack of officially completed evaluations. The 2011 MOP/FSA Beneficiaries Survey shows that 6.8 percent of FSA recipients employed in public works found a job after completion of the project versus the 1.4 percent for all public works employees estimated in 2007 (Petrovic 2011). Furthermore, 26.7 percent of those employed in public works responded that they would prefer to work and receive a salary equal to the amount of the social benefit, compared with only 6.2 percent of all FSA recipients (Petrovic 2011). Regarding the integrated service delivery pilot program, preliminary data suggest that about 20 percent of the participants retained work six months after the program completion, but a more structured evaluation of this program is yet to be done.

**FSA recipients need to receive priority for ALMP participation.** As mentioned no ALMPs currently are specifically designed and targeted to FSA recipients. This is contrary to the experience of most European countries, where the target group of ALMPs consists mostly, if not only, of recipients of unemployment benefits or participants in social assistance programs (Vidovic et al. 2011); nor does there seem to be adequate prioritization when selecting ALMP participants. The typical profile of FSA recipients (low-educated, low-skilled, long-term unemployed) implies that these individuals need to be included in programs that target structural unemployment, including job-related training schemes, employer incentives, and PWPs. Currently, as shown in table 5, the biggest share of FSA recipients among all ALMP participants is in training (4.1 percent), followed by career guidance and counseling and public works with 2.7 percent and 2.6 percent, respectively. Also, as shown in figure 25, a relatively small share of ALMPs matched the profile of FSA recipients. It is important to note that although many agree that giving ALMP priority to FSA recipients is beneficial for their transition to employment, some hold the view that this actually does not improve their prospects to find a job. This is so because ALMP participation that would increase the skills and education of the long-term unemployed would eventually put them into competition with a larger pool of better-educated and possibly short-term unemployed, thus rendering the ALMP ineffective (Kavanagh 2010).<sup>21</sup> The authorities would need to decide which approach is better suited for the current situation in Serbia and to realign the targeting of the ALMPs if necessary. The current National Employment Action Plan for 2012 clearly states that ALMPs will be directed primarily to “hard-to-employ” individuals, including FSA recipients.

#### 4.4 Financing Constraints

**Serbia spends very little on ALMPs, as acknowledged in the National Employment Strategy 2011–2020.** The strategy emphasized the large discrepancy in the funds allocated to passive and active labor market policies—favoring passive ones despite changes in the *law on employment and unemployment insurance* that have opened some fiscal space to increasing ALMP funding, which used to be only 0.17 percent of GDP in 2011<sup>22</sup>. The strategy acknowledges that investing larger amounts in active measures would help mitigate the impact of the economic crisis on the labor market, especially by providing constant support to the most vulnerable groups of the population who are most adversely affected by the crisis and will benefit least from economic recovery. The strategy sets as an objective to increase funding for active measures to 0.4 percent of GDP by 2013 and subsequently to stabilize spending at 0.5 percent of GDP by 2020. In parallel, the strategy introduces monitoring mechanisms and calls for rigorous evaluation of existing ALMPs as well as for more efficient targeting of hard-to-place individuals and vulnerable groups.

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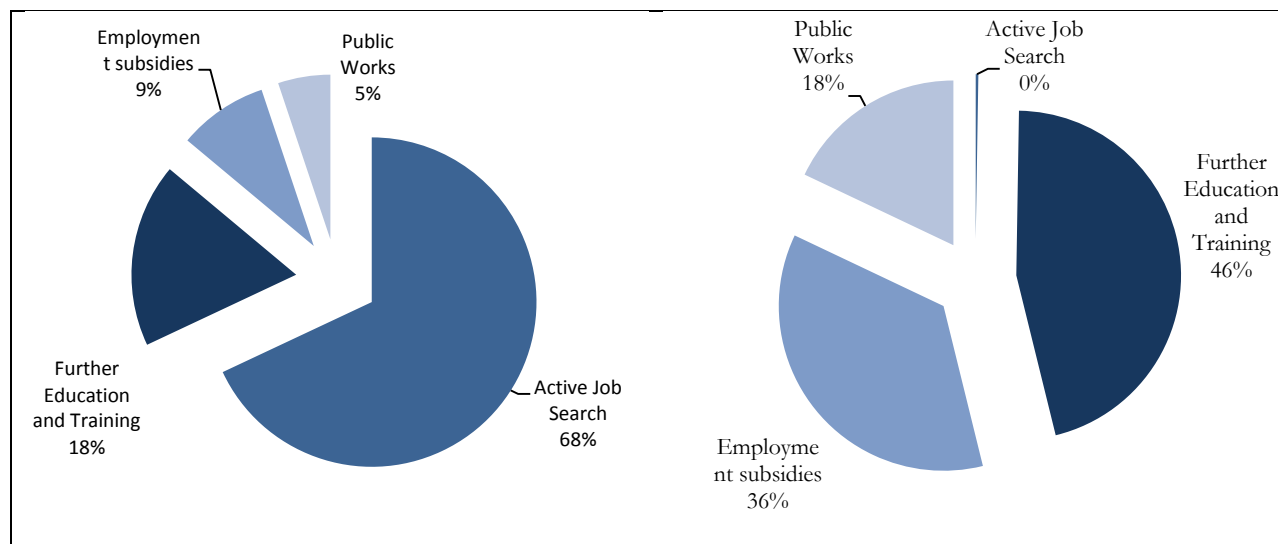
<sup>21</sup> Kavanagh (2010, 38) contends that about 200,000 unemployed people are receiving the LRSA benefit and “have little current interest in becoming active in the labor market.”

<sup>22</sup> In 2011 funds from unemployment contributions were also used to finance Active Labor Market Programs.

Figure 2: Share of Participants in ALMPs and Expenditures for ALMPs in Serbia, 2011

a. ALMP Participation

b. ALMP Expenditures



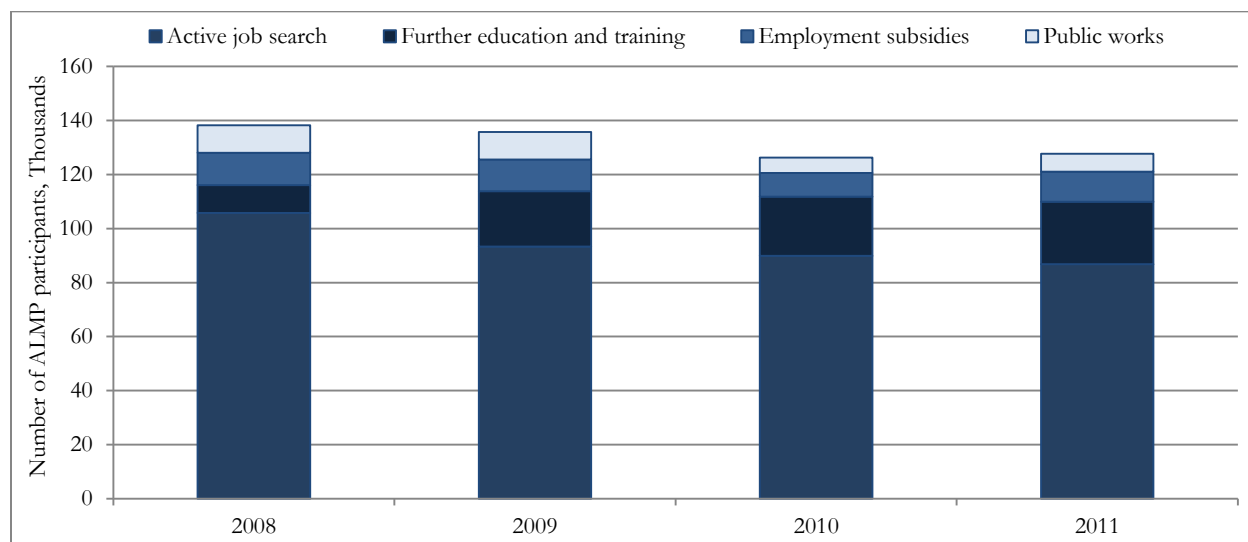
Source: Ministry of Economy and Regional Development, June 2012 cited in World Bank 2012

Note: ALMPs = active labor market programs.

**ALMP expenditure as a share of GDP in Serbia is low relative to most European countries.**

During the recent crisis, this share was maintained at the level of 0.12 percent, and – as mentioned above – increased to 0.17 percent of GDP in 2011. Strong fiscal constraints do not allow further expansion of the program and make it difficult to improve the client-staff ratio. However, better tracking of ALMP participants (figure 26) after they complete the project appears feasible and can help in rebalancing the programs.

Figure 3: Number of ALMP Participants, by Type, in Serbia, 2008–11



Source: Ministry of Economy and Regional Development, June 2012 (World Bank 2012).

Note: ALMP = active labor market program.

## 5. Conclusions and Policy Recommendations

**There is a much broader activation agenda in Serbia than the one implied by a focus on addressing welfare dependency.** While the note is focused largely on developing incentive compatible safety net in Serbia and activation of FSA beneficiaries, most of the inactive and/or unemployed "work-able" population is outside the beneficiary population. The note provides entry points for acknowledgement of the importance of a broader activation agenda, and launching of activation policies with a higher labor market impact because of their targeting to groups of inactive which are broader than the social assistance beneficiaries. 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

**FSA claimants, despite being a small fraction of the inactive, can also benefit from activation measures.** The detailed analysis of the profile of social assistance beneficiaries, unemployed and inactive in Serbia suggests that FSA claimants are only a small segment of all inactive, and their activation will hardly have a significant impact on labor supply.

- Understanding the reasons for and barriers to activation of social assistance beneficiaries is however important in order to assess their specific employability and labor market participation barriers and to tailor the interventions which would help them become active.
- Despite the challenges, support for FSA beneficiaries' activation 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.
- FSA beneficiaries' activation requires – even more than in the case of other population groups, a holistic approach that combines tailored to their labor market barriers supporting employment and social services with an enabling tax and benefit environment.

**The detailed analysis of the FSA program in Serbia suggests that its recipients could be affected by work disincentives which are built in its design.** There is room for improvements in the FSA design, as well as in its implementation arrangements, which can come into effect quickly and will bring meaningful effects:

- ***Regarding the program design, one option would be to introduce gradual labor income disregard.*** That is, the FSA benefit is not reduced one-to-one with the earned income, or a higher exit-threshold income is set for families whose work-able members do actually work. This would reduce the marginal tax rate on labor income and would likely create an incentive to look for a job in the formal sector. Also, well-defined rules and procedures for evaluation of family income and assets would minimize *subjectivity in eligibility assessment*.
- ***These system design changes could be complemented by strengthened coordination between the NES and CSWs, such as linking their information systems to facilitate the***

**exchange of information.** Enforcement of the *active labor search requirement* should be improved by scheduling more frequent visits to the employment offices and more careful evaluation of the job search efforts. In addition, information exchange regarding the participation of FSA recipients in programs and training will provide a base for *better client service by CSW staff*.

- **The profiles of FSA recipients who are capable of working and identification of barriers to their employability could be used to develop ALMPs that specifically target FSA recipients.** Most of the policy measures discussed in this note would require additional resources, but the long-run benefit from their implementation in terms of the efficiency gains and the sustained labor-supply increase would likely outweigh the short-term cost.

**Improvements to social assistance design are necessary, but not sufficient.** Social assistance benefit design can be improved to provide more financial incentives to work, but that would be insufficient unless high labor taxes on low-paid labor are addressed as another source of potential work disincentives. Other programs, including unemployment insurance, could create conditions whereby certain population groups face lowered financial gain from (additional) work. Additionally, introducing financial incentives to work would not guarantee increased employment unless other barriers to work are addressed, including lack of skills, unavailability of support services, or weak labor demand. In addition, to maximize the effect on employment, the measures should extend to the personal income tax regime and social and health insurance systems because some of their elements also influence the active supply of labor by FSA recipients.

**When addressing the barriers to inactivity, it is important to make a clear distinction between genuinely inactive FSA recipients and those who work in the informal sector.** To improve the efficiency and limit the misuse of the FSA system, steps should be taken to reduce informal sector employment through improved procedures for verification of income and work availability, including more frequent staff visits and meetings with the FSA recipients.

**Last but not least, adequate institutional setup is crucial for activation.** The supporting activation institutions exist and function but face challenges such as capacity and funding constraints and lack of coordination across institutions. The client staff ratios in the PES are high, the referrals to employment services by the CSWs are very limited, while most beneficiaries do not have a case manager. The recent legal amendments eliminate disincentives from participation in training and PWP. In order to be effective however, employment-related behavioral conditions need to be fully enforced, complied with and consistently monitored. This will require elaborating secondary legislation and strengthening the capacity of the enforcing institutions.

**Labor demand is an important factor for activation and employment.** All activation measures discussed above are related to the supply side of the labor market. However, labor demand plays a key role in the process as well. Reduced demand for labor not only creates inactivity by discouraging job searching but also has negative fiscal implications, thereby limiting the scope for response because of constraints on financing of the activation policies.



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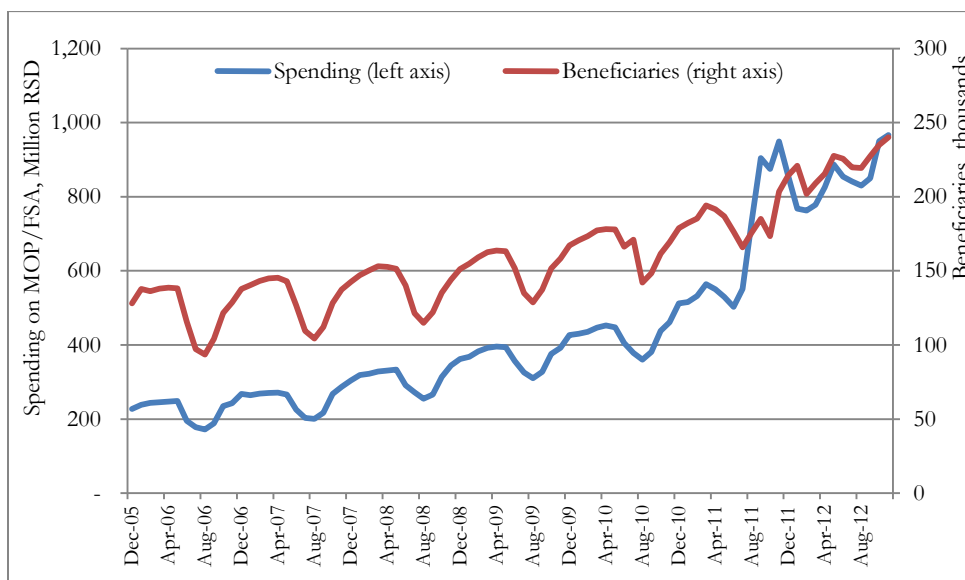
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## Annex 1: Spending and number of beneficiaries of Financial Social Assistance, 2005-2012

*Figure A1:4 Spending and Number of Beneficiaries on Materijalno Obezbedenje Porodice - Financial Social Assistance*



Source: Europe Central Asia Region Social Protection Database

## Annex 2: Coverage and Targeting Accuracy of Last Resort Social Assistance in Serbia and Selected ECA Countries

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.

Figure A2.1: Coverage of the Poorest Quintile

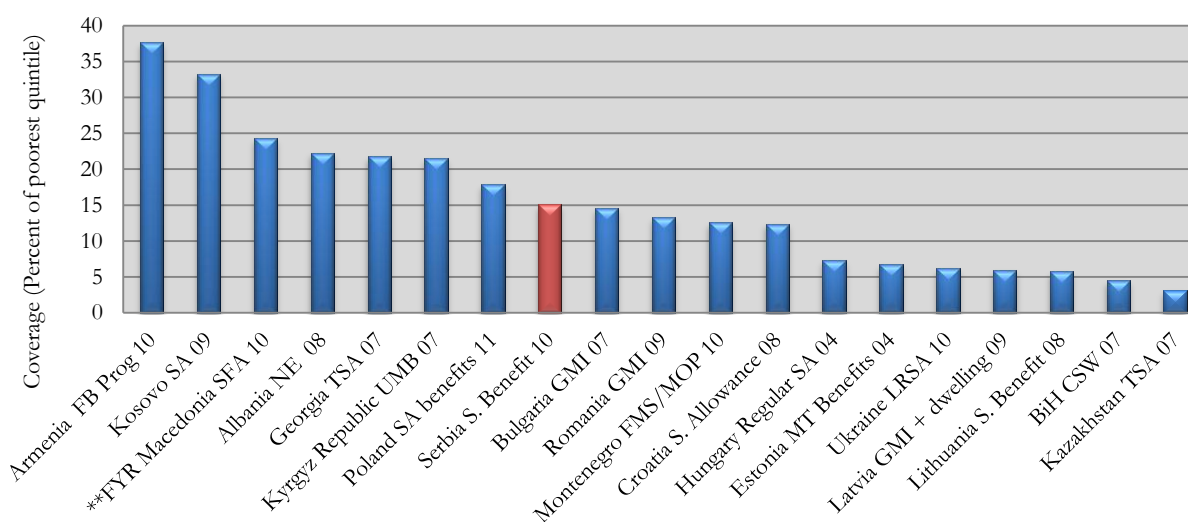
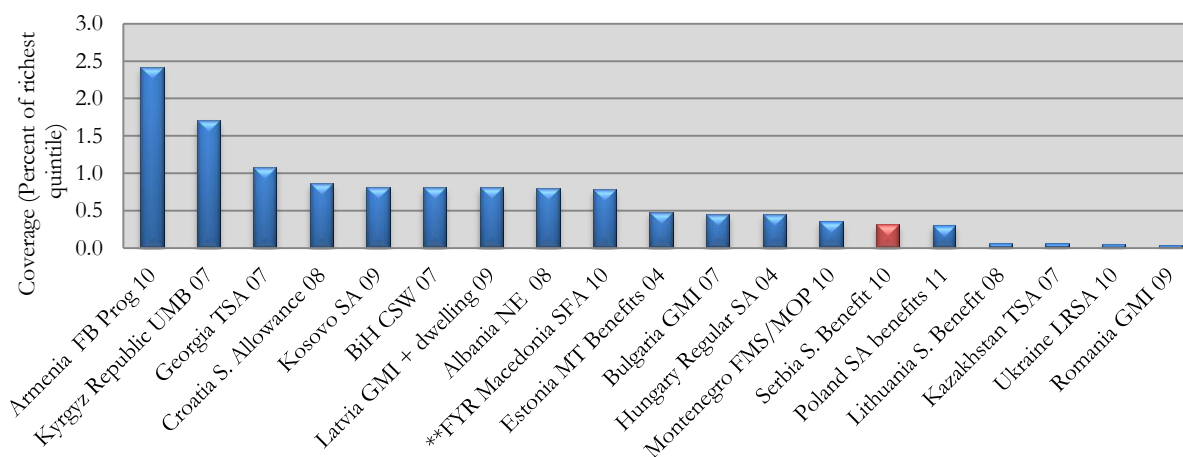


Figure A2.2: Coverage of the Richest Quintile



## Targeting Accuracy of Last Resort Social Assistance Programs

Figure A2.3: Targeting Accuracy of the Poorest Quintile

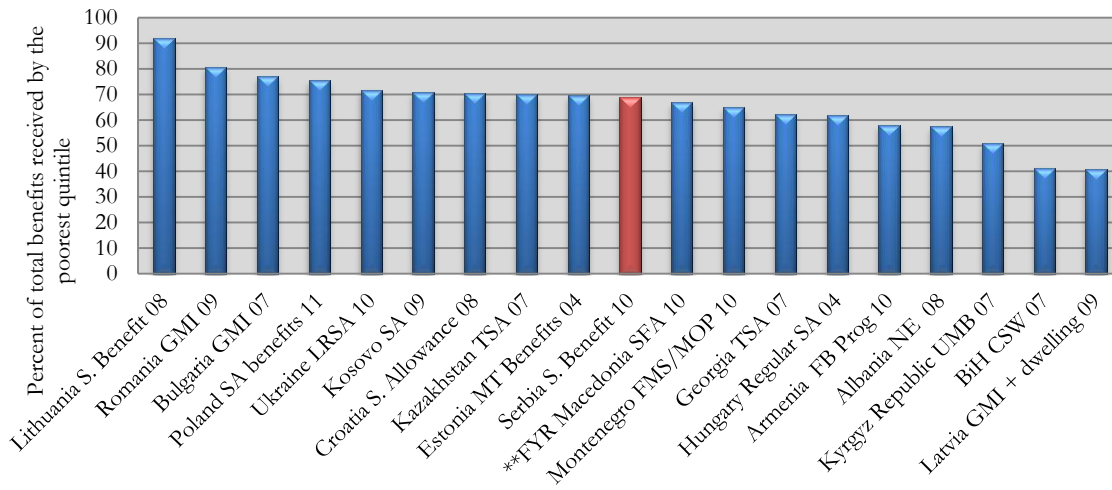
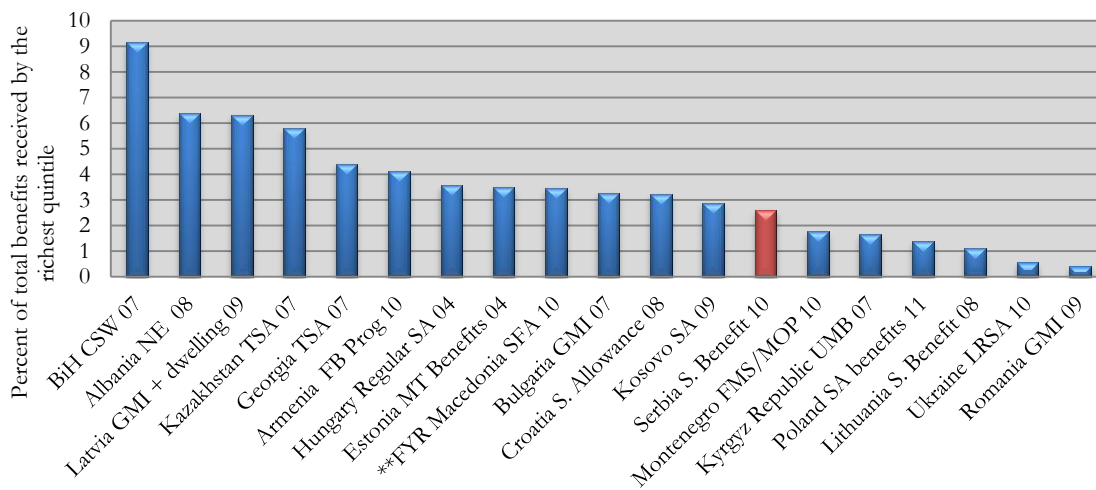


Figure A2.4: Targeting Accuracy of the Richest Quintile



\*\* 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: Behavioral Requirements and Benefit Sanctions in Selected EU and OECD Countries, and the Western Balkan Countries

*Table A3.1: 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
<b>Albania</b>	Required	No	Required	Yes	Denial of benefit	n.a.
<b>Australia</b>	Required	Yes, proof every two weeks	na	Yes	From ‘warning’ to 100% benefit withdrawal	Behavioral requirements can be extended to other family members
<b>Austria</b>	Required	Yes	‘Reasonable’ work, exceptions related to age (men over 65; women over 60)	na	Denial of benefit	Cooperation with employment services
<b>Belgium</b>	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



<b>Bosnia-i-Herzegovina</b>	Yes	No	No	Yes, focus made on social inclusion first, then labor activation	n.a.	n.a.
<b>Bulgaria</b>	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 responsibilities, 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
<b>Canada</b>	Required	Yes	Yes	Yes	Up to 100% withdrawal	Regular confirmation of circumstances; verification periods vary by provinces
<b>Czech Republic</b>	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 from social assistance receipt	To actively look for a job, accept any employment, participate in active employment programs, public works, public service
<b>Denmark</b>	Required	Required for both spouses	Appropriate job	Work - required	Payment is suspended if the beneficiary or his/her partner	Behavioral requirements are extended to other family members

					refuses without sufficient reason to participate in activation measure or repeatedly fails to report on job search	
<b>Estonia</b>	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 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	Fulfillment of other conditions and activities can be agreed in an individual job searching plan
<b>Finland</b>	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
<b>France</b>	Required	Obligation to look for work	Suitable job	Work – required SI - required	na	To take the necessary steps to generate one’s own activity or to participate in integration activities
<b>FYR Macedonia</b>	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	Monthly confirmation of circumstances

					public works than for not taking up active labor market measures	
<b>Germany</b>	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.
<b>Hungary</b>	Required for persons in active age / employment substituting benefit	Required	Suitable job	Work - required	The entitlement to the benefit is terminated if the person is deleted from the registry of 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	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

<b>Ireland</b>	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
<b>Japan</b>	Not required	Required	na	Work – no SI - no	From warning to 100% withdrawal	Confirmation of circumstances every 4 weeks
<b>Kosovo</b>	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.
<b>Latvia</b>	Required	Yes	Suitable job	Work – required 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
<b>Lithuania</b>	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	

<b>Montenegro</b>	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.
<b>Netherlands</b>	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
<b>Poland</b>	Required	Required	Obligated to undertake offered work	Work – required 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
<b>Portugal</b>	Registration with job center is required	Required	Required, any offered job	Work – required SI – required, with exceptions	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 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

<b>Romania</b>	Required	No	Acceptance of community work. Exemptions for non-prime age recipients, attending vocational training or professional or other activity	Work – required One family member is obliged to work in the interest of the local authority	Failure to comply results in suspension of the Social Aid	
<b>Serbia</b>	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.
<b>Slovakia</b>	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

<b>Slovenia</b>	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	
<b>Spain</b>	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
<b>Sweden</b>	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
<b>United Kingdom</b>	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 after recognizing caring responsibility
<b>United States</b>	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

## Annex 4: Financial Disincentives for Individuals 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 Serbia, 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.<sup>23</sup>

**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 Serbia can affect work incentives a tax-benefit model was used.** The model incorporates *legal rules* related to cash social assistance benefits, such as the Financial Social Assistance (FSA), 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<sup>24</sup>. The results presented in this section are based on a tax-benefit model developed following OECD methodology for Serbia for the year 2012.

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<sup>23</sup> See Carone G. et al (2004).

<sup>24</sup> Children in the model are assumed to be of pre- 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.



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

- **Income tax** – a flat income tax of 12 percent including surtaxes for high income and non-taxable minima;
- **Social security contributions** – employee- and employer-paid social security contributions including minimum and maximum contribution amounts;
- **Unemployment insurance** – contributory unemployment benefit;<sup>25</sup>
- **Financial Social Assistance (FSA)**<sup>26</sup> – 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<sup>27</sup>:

- 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:

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<sup>25</sup> The unemployment benefit recipient is assumed to be 40 years old with a long and uninterrupted employment history.

<sup>26</sup> Previously known as the Family Material Support (MOP) now Financial Social Assistance (FSA).

<sup>27</sup> See [http://ec.europa.eu/economy\\_finance/db\\_indicators/tax\\_benefits\\_indicators/index\\_en.htm](http://ec.europa.eu/economy_finance/db_indicators/tax_benefits_indicators/index_en.htm)

- **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<sup>28</sup>. They provide an indication of the extent of poverty traps in OECD countries.
- **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.<sup>29</sup> 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.<sup>30</sup> 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 Serbia, 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

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<sup>28</sup> 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.

<sup>29</sup> 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.

<sup>30</sup> For review of the existing literature please see OECD (2005); Immervoll and Pearson (2009).

on per capita consumption, 8.5 percent do not receive LRSA or any other social benefits (see Figure 4)<sup>31</sup>.

**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. 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.

### **Labor taxes for low-wage earners are particularly high in Serbia**

**Labor taxes in Serbia are average for higher wage earners, but very high for low-paid jobs. A comparison with OECD and neighboring countries shows that the tax wedge on labor at 67 percent of average wage is average in Serbia (see figure 1).** However, at low wages the tax wedge is significantly higher compared to other countries. For instance, for a single with no children who earns 33 percent of average wage, there were only four countries with higher labor taxes than Serbia in 2009 (see Table A), while for a one-earner couple with two children, only three countries charged higher taxes than Serbia (see Table B) (Koettl, 2011).

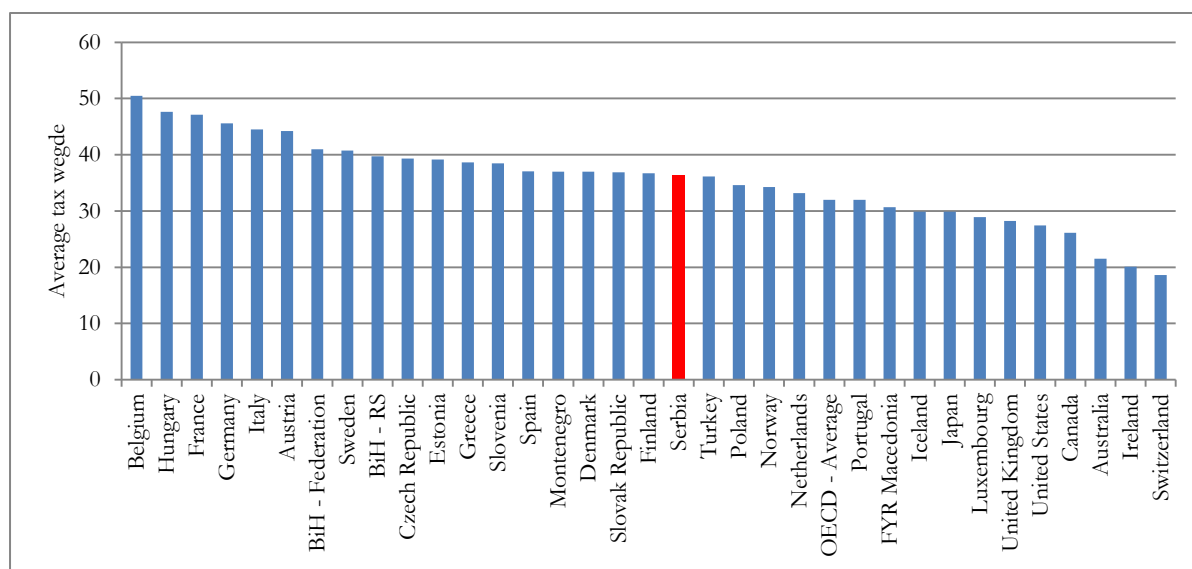
**The reasons for the high tax wedge at lower wage levels in Serbia are the minimum social security contributions that employees and employers are mandated to pay.** Minimum base for calculation of social security contributions equals 35 percent of average salary in Serbia, paid out in previous quarter (published by the Statistical Bureau of the Republic of Serbia). According to the official information, minimum base for calculation of (monthly) social security contributions in Serbia, in July 2012 was RSD 18,946.<sup>32</sup> Therefore, if employee’s monthly gross salary is below this threshold, social security contributions are calculated on this threshold. The minimum social security contribution is not adjusted for hours actually worked, so those working part-time are subject to it.

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<sup>31</sup> 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).

<sup>32</sup> For comparison, the gross full-time minimum wage is estimated at RSD 27,534 in July 2012.

Figure TA.1: Tax wedge for a single with no children at 33 percent of average wage for select countries



Source: Koettl (2011).

**This means that, in particular, low-paid part-time jobs with few hours worked per week—have a relatively higher burden of payroll taxes.** In some extreme cases (like someone working 5 hours per week at the minimum wage), it would simply not pay off to have a job due to the high value of social security contributions to be collected. Not only this would prevent certain jobs from being viable, but also likely contributes to incentives to work informally (Koettl, 2011).

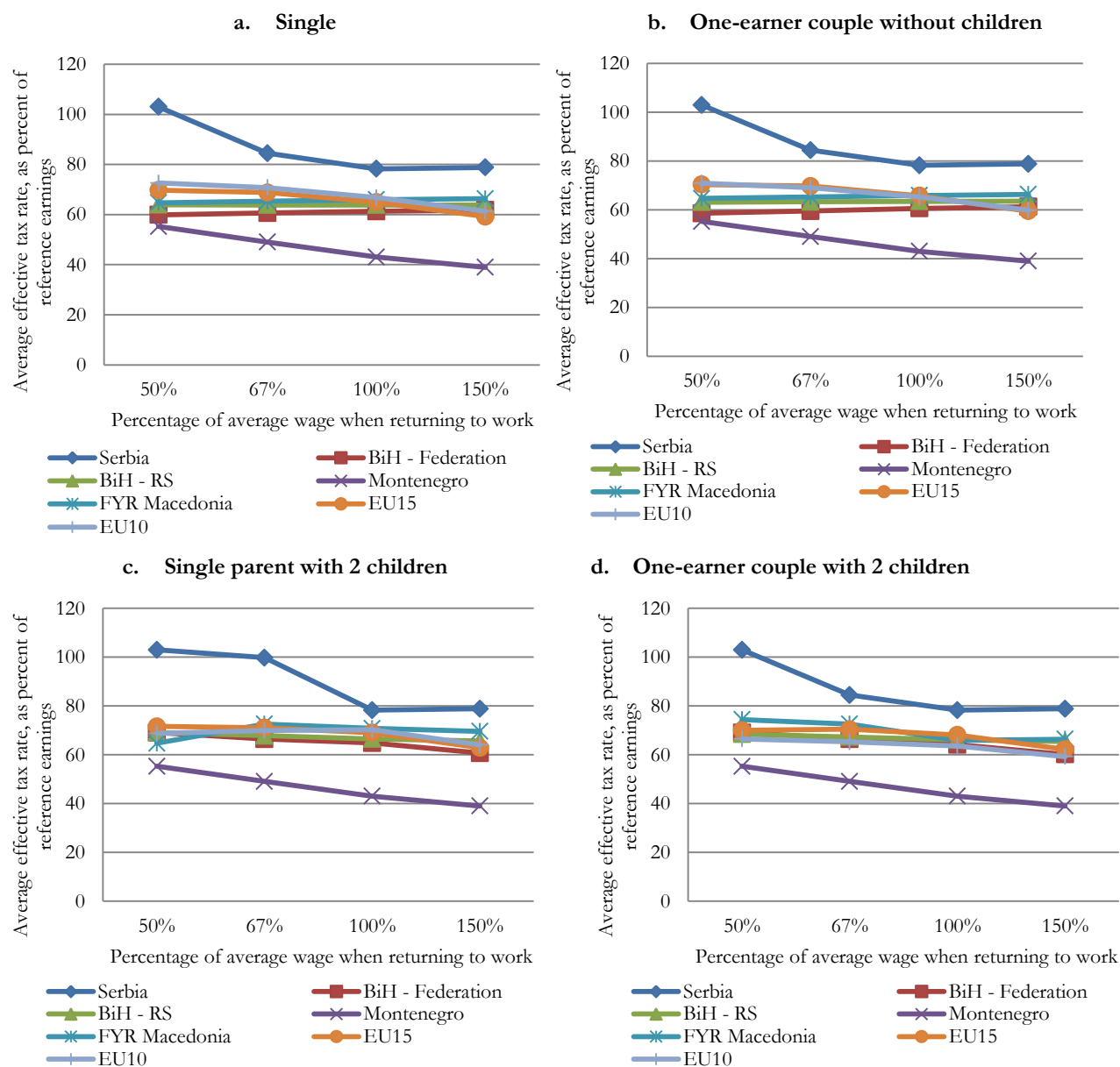
### Some unemployment benefit recipients could face weaker incentives to seek or accept low-paid jobs

**For certain groups of the unemployed, there could be weaker financial incentives to accept lower paid jobs while receiving the unemployment benefit.** In Serbia, a contributory unemployment insurance program exists for those in the formal sector. Unemployment benefit amounts to 50 percent of the reference earnings,<sup>33</sup> but it cannot exceed 160 percent of minimum gross salary. Neither can it be lower than 80 percent the gross minimum wage prevailing in the month when the unemployment benefit is being paid. For those with longer contribution history,<sup>34</sup> there could be weaker financial incentives to seek or accept low paid employment in Serbia compared to other Western Balkans countries (figure TA.2). This would be less the case, however, for those with shorter contribution histories, as benefit duration is much shorter. Additionally, any job search requirements imposed on unemployment benefit recipients are likely to improve incentives for moving from unemployment to work.

<sup>33</sup> The reference earnings correspond to the average gross salary of the employee, over the last 6 months preceding the month in which his employment is terminated.

<sup>34</sup> The benefit duration ranges between 3 months for those who contributed for less than 5 years to 12 months to those who contributed for more than 25 years.

Figure TA.2: Unemployment trap (average effective tax rate for moving from unemployment to work at different wage levels as a share of average wage)



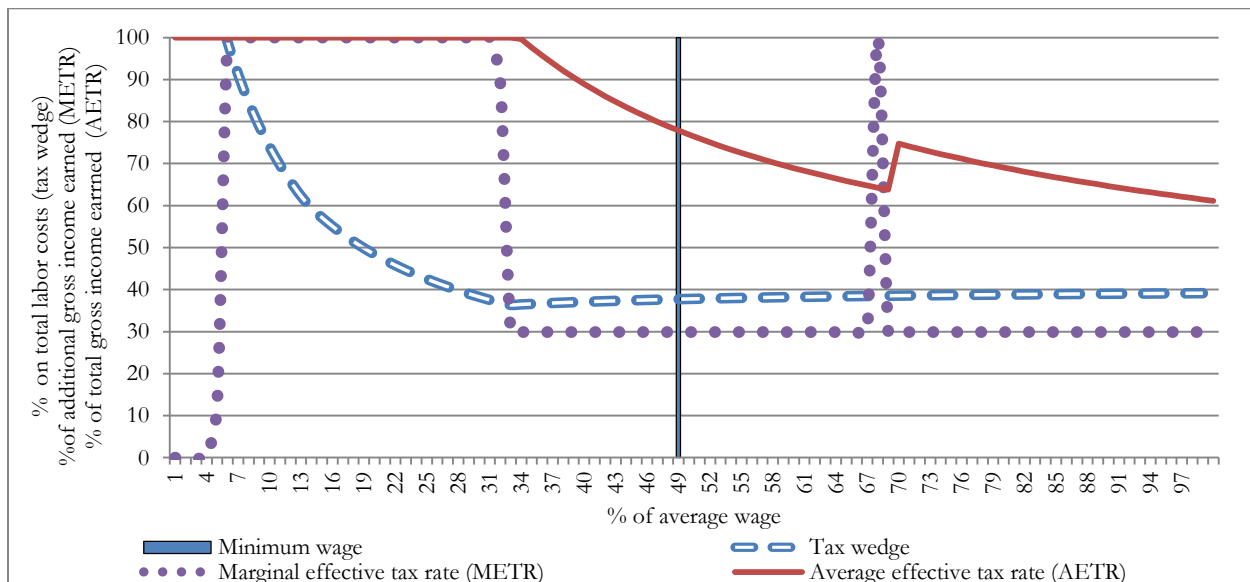
Note: EU10 data doesn't include Poland. EU10, EU15 are from 2011. Serbia, BiH - Federation, BiH - RS, Montenegro and FYR Macedonia data are from 2012. Initial phase of unemployment but following any waiting period. No social assistance "top-ups" are assumed to be available in either the in-work or out-of-work situations. Any income taxes payable on unemployment benefits are determined in relation to annualised 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.

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

## 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 Monetary Social Assistance program is designed in a way that each additional dinar 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 TA.3<sup>35</sup>, which shows that marginal effective tax rate is 100 percent for a one-earner family with 2 children until about 30 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 68 percent of the average wage for a one earner couple with 2 children).

*Figure TA.3: The tax wedge, the marginal effective tax rate (METR), and average effective tax rate (AETR) for a one earner couple with 2 children in Serbia (2012)*



Source: Author’s calculations based on OECD Tax and Benefit model.

**Social assistance is withdrawn at very low earnings levels; hence, the extent to which low-wage earners may be affected by the “low-wage trap” is very limited.** While theoretically low-wage trap exists whenever marginal effective tax rates are high, in practice, it depends on availability of jobs at such low earnings levels. 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. As mentioned previously, formal part-time low-paid jobs are also not viable in

<sup>35</sup> See additional figures for other household types at the end of the annex.

Serbia due to the mandatory minimum social security contributions. As a result, currently, it is unlikely that the extent of low-wage trap is high.

### **High labor taxes on low-paid jobs contribute significantly to potential “inactivity traps”**

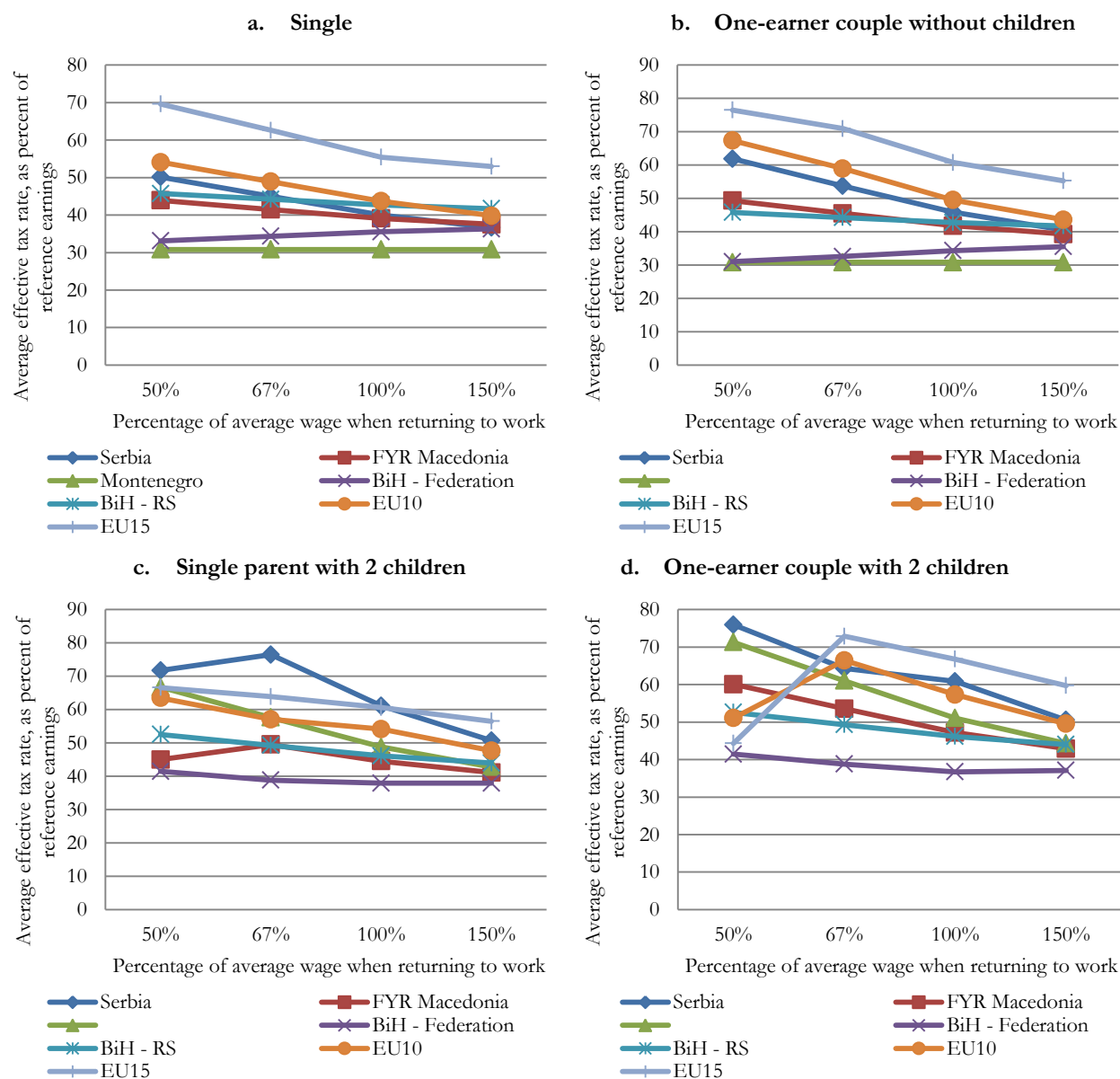
**There is, however, a potential for the “inactivity trap” for families with children.** Compared to other countries in Western Balkans and also to the EU15<sup>36</sup> and EU10<sup>37</sup> averages, indicators of the “inactivity trap” are not significantly different in Serbia, with the exception of families with children. The average effective tax rates for moving from inactivity to lower-paid jobs (those at 50 or 67 percent of average wage) are somewhat on the higher side for households consisting of single parents and 2 children in Serbia and or one-earner couple with 2 children. Specifically, if a single person with 2 children takes a job at 50 percent of the average wage, he or she would lose about 70 percent of the hard-earned income through a combination of taxes, contributions and benefit withdrawals. For families where one spouse is inactive and there are 2 children, a job paid at 67 percent of the average wage taken up by another spouse would only bring in about 35 percent of additional net income (figure TA.4).

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<sup>36</sup> The EU15 is comprised of the following 15 countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and United Kingdom.

<sup>37</sup> The EU10 is comprised of the following 10 countries: Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia, and the Slovak Republic.

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



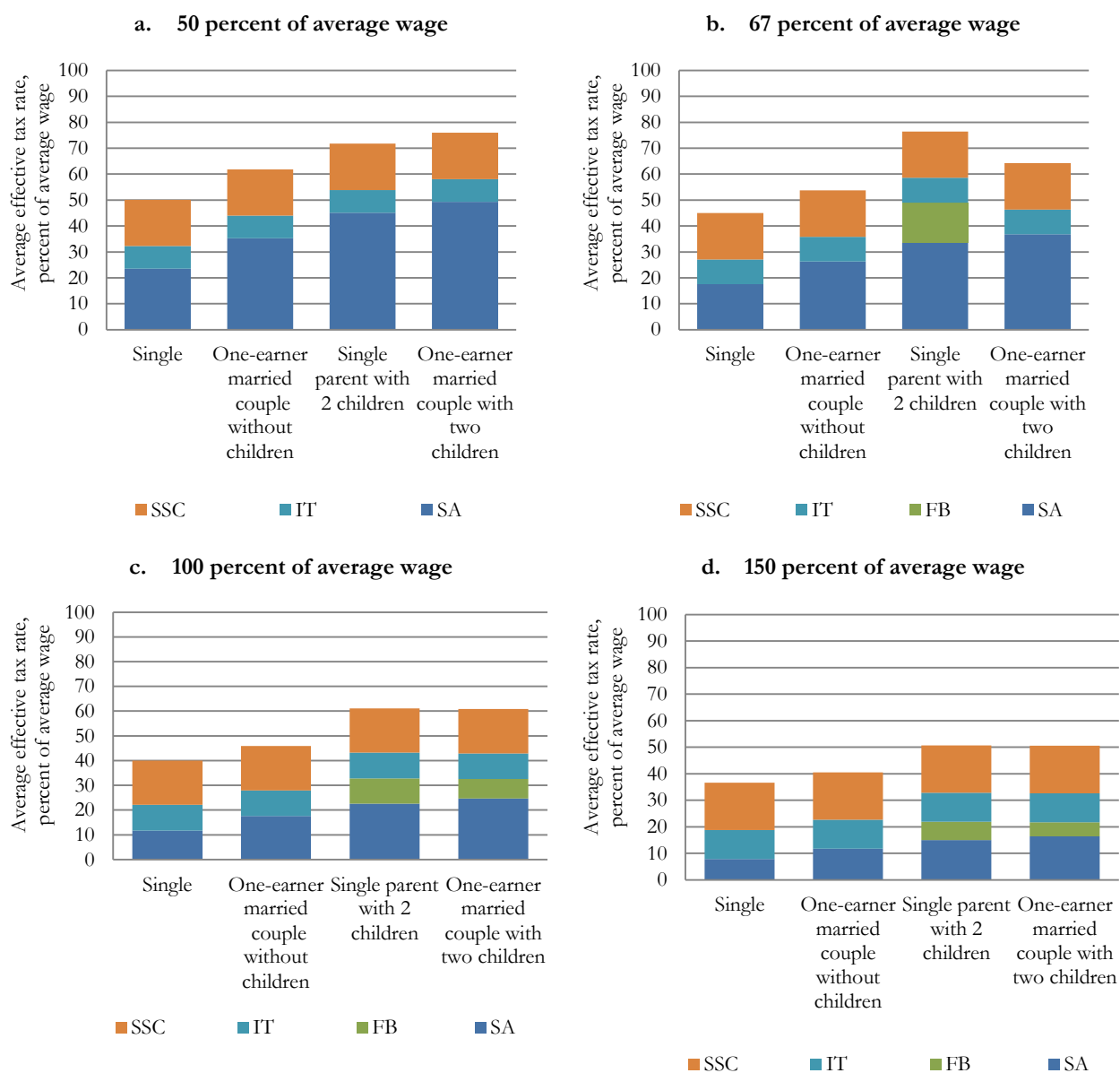
Note: EU10 data doesn't include Poland. EU10, EU15 are from 2011. Serbia, BiH - Federation, BiH - RS, Montenegro and FYR Macedonia data are from 2012.

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

**Social security contributions and income taxes contribute significantly to such potential inactivity traps.** Withdrawal of social assistance benefits only partially contributes to high participation tax rates in Serbia. While at lower wage levels, withdrawal of social assistance comprises a large share of the implicit tax on earnings, the combined burden of social security contributions and income taxes contributes a non-negligible amount to the tax on earnings (figure TA.5). This combined burden ranges between 26.6 and 28.8 percent for households with earnings in the range of 50-150 percent of the average wage.



Figure TA.5: Inactivity trap (average effective tax rate for moving from inactivity to work at different wage levels as a share of average wage)



Note: FB: Family benefit (Child allowance), SA: Social assistance (FSA program), IT: Income tax, SSC: Employee-paid social security contributions. AW= Gross average wage.

Source: Author's calculations based on OECD Tax and Benefit model for Western Balkans countries.

## Additional tables and figures to technical annex

Table TA.1: The tax wedge for singles with no children at various levels of average wage for select countries (2008, unless otherwise indicated)

	Tax wedge at 33 percent of average wage <sup>1</sup>	Tax wedge at 50 percent of average wage <sup>1</sup>	Tax wedge at 100 percent of average wage <sup>1</sup>	Progressivity (percentage point change between 33 and 100 percent level)
Sweden	41.8%	44.6%	47.9%	6.1%
Hungary	39.5%	43.4%	54.1%	14.6%
Romania	37.9%	39.9%	42.4%	4.5%
Bosnia – Federation <sup>2</sup>	37.8%	39.5%	41.8%	3.9%
<b>Serbia<sup>2</sup></b>	<b>36.7%</b>	<b>38.0%</b>	<b>39.3%</b>	<b>2.6%</b>
Germany	36.3%	43.0%	51.5%	15.2%
Belgium	36.0%	48.5%	55.7%	19.7%
Lithuania	36.0%	38.9%	41.6%	5.6%
Finland	35.5%	38.0%	44.9%	9.4%
Czech Republic	35.2%	36.8%	43.5%	8.3%
Bulgaria	35.1%	35.1%	35.1%	0.0%
Poland	35.0%	37.4%	39.6%	4.6%
Latvia	34.7%	38.2%	41.6%	6.9%
Greece	34.4%	34.4%	41.5%	7.1%
Estonia	34.0%	36.8%	39.5%	5.6%
Austria	33.5%	39.8%	48.5%	15.0%
Slovenia	32.9%	35.0%	42.9%	10.0%
France	32.5%	35.0%	49.3%	16.8%
Netherlands	32.1%	37.5%	45.1%	13.0%
Italy	31.5%	36.7%	45.8%	14.3%
Slovak Republic	31.4%	33.2%	38.8%	7.4%
Bosnia - Republika Srpska <sup>2</sup>	31.1%	32.8%	34.5%	3.4%
Macedonia <sup>2</sup>	28.5%	30.9%	33.2%	4.8%
Portugal	28.1%	30.3%	37.3%	9.2%
Spain	28.0%	29.3%	38.0%	9.9%
Norway	27.5%	31.1%	37.5%	10.0%
Japan	26.0%	27.3%	29.5%	3.5%
United States	22.6%	25.7%	30.1%	7.5%
United Kingdom	19.9%	26.6%	32.8%	12.9%
Switzerland	15.9%	26.9%	31.7%	15.8%
Ireland	7.8%	14.0%	27.0%	19.2%

Notes: 1. The tax wedge is defined as the share of income tax and social security contributions by employers and employees over total labor costs. The numbers presented in this table refer to a single earner with no children who receives average wage and works 33 or 50 percent part-time or full-time. Alternatively, in most—but not all—countries this can be interpreted also as the tax wedge of a single earner with no children, working full-time, but receiving 33, 50, or 100 percent of average wage. In the latter case, working full time at 33 percent of average wage might be below the legal minimum wage.

2. Values refer to 2009.

Source: Koettl, J. (2011)

*Table TA.2: The tax wedge for a one-earner couple with two children at various levels of average wage for select countries (2008, unless otherwise indicated)*

	Tax wedge at 33 percent of average wage <sup>1</sup>	Tax wedge at 50 percent of average wage <sup>1</sup>	Tax wedge at 100 percent of average wage <sup>1</sup>	Progressivity (percentage point change between 33 and 100 percent level)
Sweden	41.8%	44.6%	47.9%	6.1%
Hungary	39.5%	43.4%	54.1%	14.6%
Bosnia - Federation <sup>2</sup>	37.8%	37.8%	37.9%	0.1%
<b>Serbia<sup>2</sup></b>	<b>36.7%</b>	<b>38.0%</b>	<b>39.3%</b>	<b>2.6%</b>
Finland	35.5%	38.0%	44.9%	9.4%
Bulgaria	35.1%	35.1%	35.1%	0.0%
Greece	34.4%	34.4%	39.8%	5.4%
Lithuania	34.4%	37.8%	41.1%	6.7%
Poland	33.7%	33.7%	33.7%	0.0%
Germany	33.4%	33.4%	42.8%	9.4%
Romania	32.9%	35.3%	40.9%	7.9%
Slovenia	32.9%	32.9%	35.8%	2.9%
France	32.5%	34.1%	45.1%	12.7%
Italy	31.5%	31.5%	40.2%	8.7%
Slovak Republic	31.4%	31.4%	33.2%	1.8%
Bosnia - Republika Srpska <sup>2</sup>	30.6%	30.6%	33.0%	2.4%
Macedonia <sup>2</sup>	28.5%	30.9%	33.2%	4.8%
Portugal	28.1%	28.1%	31.0%	2.9%
Spain	28.0%	28.0%	32.0%	4.0%
Estonia	26.9%	26.9%	31.3%	4.4%
Latvia	26.7%	26.7%	34.5%	7.8%
Netherlands	26.4%	33.4%	43.1%	16.7%
Belgium	23.6%	35.7%	47.0%	23.4%
Japan	22.6%	22.5%	26.1%	3.6%
Austria	22.0%	32.3%	44.7%	22.7%
Norway	20.9%	26.8%	35.3%	14.4%
United Kingdom	19.9%	26.6%	32.8%	12.9%
Czech Republic	17.7%	23.7%	31.0%	13.3%
United States	14.9%	11.9%	17.9%	2.9%
Switzerland	12.6%	15.2%	32.9%	20.3%
Ireland	7.8%	12.2%	18.5%	10.6%

*Notes:*

1. The tax wedge is defined as the share of income tax and social security contributions by employers and employees over total labor costs. The numbers presented in this table refer to a one-earner couple with two children who receives average wage and works 33 or 50 percent part-time or full-time. Alternatively, in most—but not all—countries this can be interpreted also as the tax wedge of a one-earner couple with two children, working full-time, but receiving 33, 50, or 100 percent of average wage. In the latter case, working full time at 33 percent of average wage might be below the legal minimum wage.

2. Values refer to 2009.

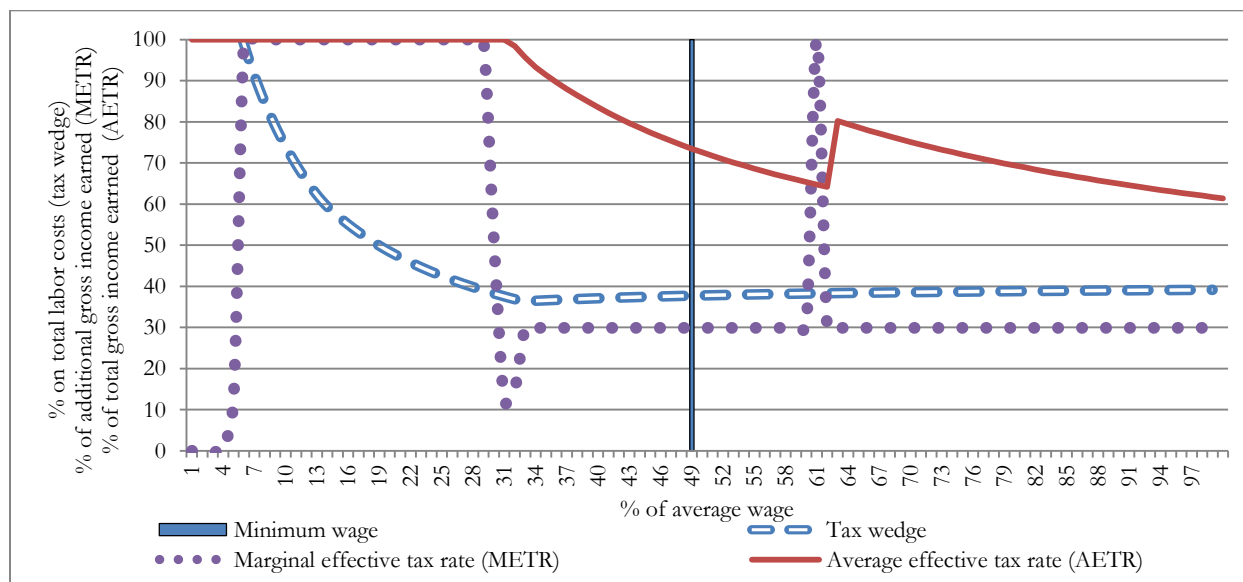
Source: Koettl, J. (2011)

Table TA.3: The tax wedge, the marginal effective tax rate (METR), and average effective tax rate (AETR) for a single person in Serbia (2012)



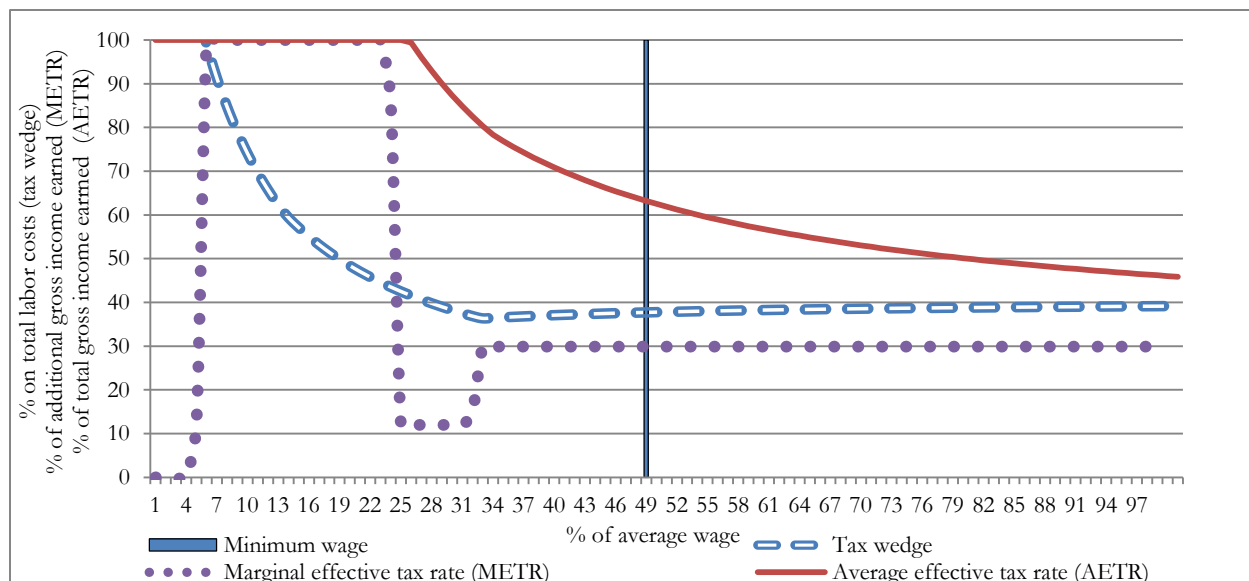
Source: Author's calculations based on OECD Tax and Benefit model.

Table TA.4: The tax wedge, the marginal effective tax rate (METR), and average effective tax rate (AETR) for a single parent with 2 children in Serbia (2012)



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

Table TA.5: The tax wedge, the marginal effective tax rate (METR), and average effective tax rate (AETR) for a one earner couple in Serbia (2012)



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