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South East Europe Regular Economic Report No.5

Special Topic:

**FIRST INSIGHTS**

into Promoting

**SHARED  
PROSPERITY**

in South East Europe



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EUROPE AND CENTRAL ASIA REGION

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# **First Insights into Promoting Shared Prosperity in South East Europe**

April 2014



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Washington, D.C.

## **Acknowledgments**

The Regular Economic Report (RER) covers economic development, prospects, policies, and policy topics in six South Eastern European countries (SEE6): Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, and Serbia. The report is produced twice a year by staff economists at the World Bank Europe and Central Asia Region Poverty Reduction and Economic Management Department (ECA PREM). The authors of this SEE6 RER Special Topic are María E. Dávalos and Lidia Ceriani.

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## Introduction

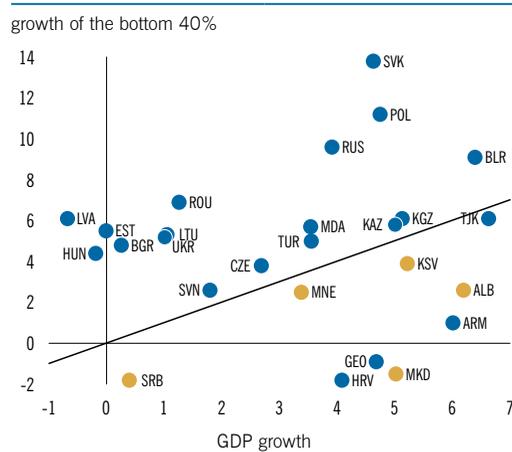
**Long-term economic growth is the key driver for increasing the economic well-being of the population, but the pattern and the incidence of growth also matter.**

Economic growth narrowly based on certain enclave sectors or benefitting small groups is neither socially stable nor sustainable. Along these lines, the World Bank recently revised its institutional strategy, establishing two goals, namely: (i) ending extreme global poverty—the traditional goal of the institution—by reducing the percentage of people living on less than \$1.25 a day globally to 3 percent by 2030, and (ii) promoting shared prosperity by fostering income growth of the bottom 40 percent of the population. Furthermore, as an overarching condition, the World Bank aims to achieve those goals in a way that is environmentally, economically and socially sustainable to ensure that welfare of the population is not increased at the expense of future generations or specific groups in society.

**The World Bank’s goal of shared prosperity—measured as the income or consumption growth of the bottom 40 percent—depends on whether economic growth is benefiting the less well-off.** The indicator is a relative measure in that it is a moving target, in contrast to the goal of eliminating absolute poverty. It is similar to the EU indicator of relative monetary poverty and it is relevant to countries across all income levels and over time, including the six countries of South East Europe known as the SEE6: Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro and Serbia. The indicator, although not

perfect, can provide SEE6 Governments and development partners with a measure to assess whether economic growth is broad-based and sustainable.

**Figure 1.** GDP growth and growth of the bottom 40 percent, 2005–2010 (circa)



Source: Bussolo and Lopez-Calva (2014).

Note: Growth is calculated for the period 2005–2010 circa.

**Achieving the new goal of shared prosperity requires not only sustained and strong economic growth in SEE6 countries, but also a policy agenda to ensure that the less well-off are able to contribute to the growth process.** Evidence across countries shows a strong and positive association between average income growth and the income growth of the bottom 40 percent (see Box 2 for a review of recent literature). Increasing average economic growth is, however, not sufficient. Figure 1, for instance, shows that GDP growth in SEE6 countries in the second half of the 2000s translated into a less than proportional increase in welfare of the bottom 40 percent. Therefore,

### Box 1. Data for shared prosperity in SEE6

The unavailability (to the Bank and to the broader research community), comparability and quality of microdata are concerns in SEE6. To the extent that they affect the main data sources typically used for the analysis of poverty and shared prosperity (household budget surveys, labor force surveys), these issues limit the analysis and lessons that can be drawn regarding living standards, growth, poverty and inclusion. For this note, the analysis uses the latest available data in SEE6 countries, which in some cases (Bosnia and Herzegovina, FYR Macedonia) date to the pre-crisis period. The countries' transition towards the adoption of the Survey of Income and Living Conditions (SILC) as a tool to monitor living standards, in line with the *acquis communautaire*, also poses issues in terms of breaks in the series. Finally, concerns for personal privacy under the *acquis* often limit data accessibility, even though the experience of some EU Member States shows that this does not need to be the case.

The data situation by country is the following:

**Albania:** Albania's analysis is based on Living Standards Measurement Surveys (LSMS) produced by the Albanian Institute of Statistics (INSTAT). They were conducted in 2002, 2005, 2008 and 2012, all with donor funding. The latest two sets of data (2008 and 2012) are publicly available on the INSTAT website, while the previous ones, collected with WB funding, are available on the LSMS website. Moving forward, the main constraint for monitoring both poverty and shared prosperity in Albania lies, as in the past, in the frequency of the surveys and availability of donor funding. Access to other surveys, namely the Household Budget Survey and Labor Force Survey, has been thus far limited.

**Bosnia and Herzegovina:** the Household Budget Surveys (HBS) are conducted by the three statistical agencies in the country: BHAS, the Agency for Statistics of Bosnia and Herzegovina; RSI, the Republika Srpska Institute of Statistics and FOS, the Federal Office of Statistics. HBS's have been conducted in 2004, 2007 and, in a pioneering extended format aimed at capturing the main SILC indicators, in 2011. These surveys have all been externally funded and failure to mobilize complementary national funds delayed implementation of the EHBS in 2010. Concerns remain regarding the ability of the country to conduct regular HBS's, even though there are plans for the introduction of SILC with IPA funds. Data are not publicly available and access is typically regulated through Memoranda of Understanding that limit how the data can be used.

**Kosovo:** The Kosovo poverty and shared prosperity analysis is based on the Household Budget Surveys conducted annually by the Kosovo Agency of Statistics since 2003. The latest available data refer to the year 2011. The main concern about the Kosovo HBS data is comparability over time. The HBS data for 2009 to 2011 are comparable, but comparability with other years is compromised by changes (largely improvements) in the survey instrument and sampling frame. A secondary concern is the limited access by others to the HBS data. Although KAS is very cooperative in sharing HBS data with the World Bank, its access policies for other organizations and local researchers are very restrictive, which limits the range of analysis conducted.

**FYR Macedonia:** FYR Macedonia data come from the Household Budget Surveys conducted annually by the Republic of Macedonia State Statistical Office since 1996. Since 2010, FYR

Macedonia has also produced Surveys on Income and Living Condition (SILC), in line with EU countries. Official poverty numbers are now being calculated with the SILCs using an income-based relative poverty measure, which break the series of the traditional welfare measures based on the HBS. There are several data challenges for FYR Macedonia. HBS data concerns for rounds after 2008 limit the analysis to up to that year. For the SILC, microdata access was granted on-site at the Statistics Office to the World Bank, but the available rounds of 2010 and 2011 do not allow for the calculation of the shared prosperity indicator given the still short series.

**Montenegro:** Montenegro's analysis is based on Household Surveys conducted by the Institute for Strategic Studies and Prognoses in years 2002, 2003 and 2004 and on the Household Budget Survey, harmonized with international standards and recommendations of EUROSTAT and with the UN. It has been conducted annually since 2005 by MONSTAT, the Statistical office of Montenegro. The latest available survey is 2011. At this time there are no pressing concerns with respect to the Montenegro HBS.

**Serbia:** Since 2007, poverty in Serbia has been monitored through data from the Household Budget Surveys conducted annually by the Statistical Office. The latest published poverty figures are from 2010, even though data have been collected regularly ever since. Different quality concerns have been raised. Issues with the small sample size, which leads to difficulties in drawing significant trends with the data, are planned to be addressed in 2015. In 2013, the Statistical Office has conducted the first round of the SILC survey with support from the World Bank and IPA funding. A second round is planned for 2014. The SILC has now become the official data source for poverty figures, though their nature is such that they are not comparable to the pre-2010 data.

Given these data limitations, initial and final years for computing consumption growth rates are not consistent across all countries. The main periods and surveys considered for each country are: Albania (LSMS 2008–2012), Bosnia and Herzegovina (HBS 2007), Kosovo (HBS 2006–2011), FYR Macedonia (HBS 2003–2008), Montenegro (HBS 2006–2011) and Serbia (HBS 2007–2010). The different data sources have been harmonized and standardized by the World Bank Europe and Central Asia Team for Statistical Development.

Finally, data on some aspects relevant to understand and monitor shared prosperity do not exist or are not accessible across countries. These include data on ethnicity (in some cases available but not shared), on land ownership and/or registration and on social capital. A more detailed country-by-country analysis of data gaps is necessary.

beyond an agenda that promotes overall economic growth, policies need to focus on influencing the ability of those at the bottom to contribute to the economic growth process by enhancing their capacity to generate income. Policies should promote sound macroeconomic management as well as sustainable, efficient and equitable fiscal policy; strengthen institutions and the provision of public goods and services;

ensure efficient risk management both at the household and country levels and enable well-functioning markets, including labor markets.

**This paper presents first insights into shared prosperity in SEE6 countries.** First, it looks at the incidence of growth in SEE6 in the context of the Europe and Central Asia region to determine whether economic growth

## Box 2. Literature review: Economic growth and the twin goals

The literature on inclusive growth has established an empirical constant: economic growth is good for the poor in the sense that their income growth closely follows that of average income. This literature builds on a widely cited research by Dollar and Kraay (2002). Using a cross-country regression analysis for a sample of 92 countries over 1950–1999, they indeed find that the relationship between the growth of income of the poor and the growth of mean income is one-to-one, holding across regions, time periods, income levels and growth rates.

Having become the standard methodology for the measurement of the poverty elasticity of growth, Dollar et al. (2013) recently updated it for the 1967–2011 period. The definition of poor earners was widened to include those in the bottom 40 percent of the income distribution, in addition to those in the bottom 20 percent. The results remained consistent with the original findings: growth is good for the poor and their income increases relatively close to mean income, both for the bottom 20 percent and the bottom 40.

In an interesting nuance to this line of research, Campos-Vazquez et al. (2013) recently found that growth was also good for the very rich. Following the same specifications of Dollar and Kraay (2002) and Dollar et al. (2013), they measured the elasticity of growth, not only at the bottom of the income distribution but at the top. Using panel data from the World Top Incomes database, they found that the top 10 percent of the income distribution grew in proportion to that of the whole population. The income of the top one percent grew even more than the average income.

Building on this literature, Lara-Ibarra and Lopez-Calva (2013) conducted an exercise to estimate the elasticity along the income distribution in the Europe and Central Asia region, taking a broad view in terms of growth and the incidence of growth. Using data from comparable household surveys for ECA countries between 1992 and 2009, they concluded that growth in ECA appeared to be on average slightly regressive. Growth did have an effect on poverty, although less than proportional to the growth of mean income, and seemed to be less beneficial for poorer individuals than for richer ones. While the elasticity at the bottom was lower than one in all specifications, it was above one at the top. Their results were consistent with the overall analysis of Milanovic and Ersado (2008), who looked at a similar period and found that growth tended to benefit more individuals in the upper tail of the distribution. The results are, however, more consistent with Dollar and Kraay (2002) and Dollar et al. (2013) when the period is restricted to 2002–2010. This preliminary exercise highlights two issues: first, the importance of looking at the incidence of growth throughout the whole distribution, and second, the sensitivity of the results to different periods of growth.

has benefited all segments of society in these countries in recent years. Second, it presents a framework, which is being adopted by the World Bank's Europe and Central Asia region, to analyze the bottom 40 percent's capacity to generate income—and thus contribute to, and benefit from, growth—and what variables influence that capacity over time. Finally, the

note provides broad guidance on policy areas of relevance for SEE6 to promote shared prosperity. Beyond this paper, further country-specific work is required to have a more comprehensive picture of the constraints that the bottom 40 percent face and the specific policies of relevance in each country to boost income growth for this group. Some of these

knowledge gaps are discussed in the paper. The analysis is limited by the availability of microdata (Box 1) and thus covers different periods by country, depending on each one's most recent data available. Unless otherwise noted, periods refer to: Albania (2008–2012), Bosnia and Herzegovina (2007), Kosovo (2006–2011), FYR Macedonia (2003–2008), Montenegro (2006–2011) and Serbia (2007–2010).

# Patterns of Shared Prosperity in SEE6

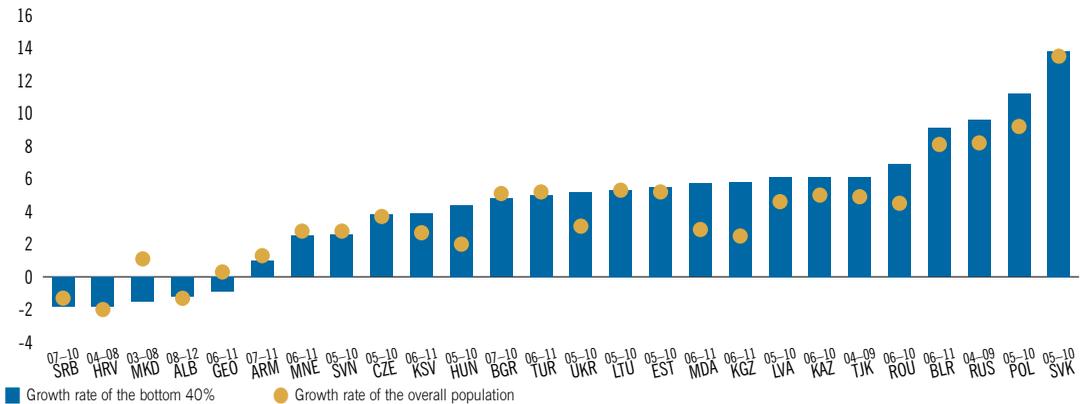
The Europe and Central Asia region has a positive record of promoting shared prosperity. Figure 2 shows that in most countries in the region, the welfare of the bottom 40 percent grew at high annual rates: the average growth rate of their income was around 4.5 percent in the periods analyzed.

It is also evident, however, that there is large heterogeneity in performance across countries, with growth rates for the less well-off reaching over 10 percent in some countries, as in Poland and Slovak Republic, while others, such as Croatia, Serbia and FYR Macedonia, had negative growth rates.

**Figure 2.** Shared prosperity indicators for Europe and Central Asia and for SEE6, annualized

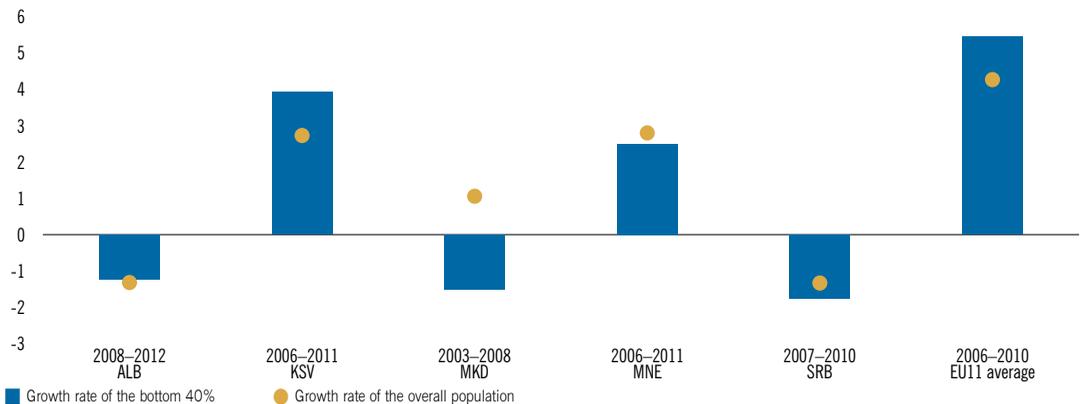
### A. Europe and Central Asia

Periods used for World Bank indicator monitoring, following corporate data criteria, in percent



### B. SEE6

Periods used for World Bank indicator monitoring, following corporate data criteria, in percent



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11 countries.

Note: EU11 growth rates are the arithmetic mean of the growth rates for the bottom 40 percent and the population as a whole in all EU11 countries for the period 2006-2010. Bosnia and Herzegovina is excluded given that the data is more than five years old, the cutoff for shared prosperity analysis by World Bank corporate criteria.

**SEE6 experiences with consumption<sup>1</sup> growth of the bottom 40 percent vary but, on average, the region is among the worst performers in Europe and Central Asia.**

In Kosovo and Montenegro, growth did benefit the less well-off over the periods considered; indeed, in Kosovo, consumption growth of this group was higher than that of the whole population (Figure 2). In contrast, the economic crisis worsened the living standards of all socio-economic groups in Albania and Serbia. In the case of FYR Macedonia, with data limited to the pre-crisis period, the well-being of the less well-off slightly deteriorated up to 2008, even if mean consumption growth was weak but still positive. To benchmark SEE6's performance, the EU11 countries, on average, fared better as a region in promoting inclusive growth, with higher overall growth and higher increases in the well-being of the bottom 40 percent of their population (Figure 2).<sup>2</sup>

**The global economic crisis affected the performance of several SEE6 countries in promoting shared prosperity.**

For some countries, additional data are available that allow for a separate shared prosperity assessment of the pre-crisis period. In some cases, notably Serbia, the performance is strikingly different before and after the crisis. From 2005 to 2008, Serbia was the region's best performer, with the less well-off segments of the population seeing their income grow by 11 percent while overall consumption rose 6.4 percent. The sharp contraction experienced during the crisis, which resulted also in rises in unemployment

from 18 percent (2007) to 22.4 percent (2012), led to decreases in overall welfare, including that of the bottom 40 percent. Albania and Montenegro also present different patterns of shared prosperity before and after the crisis, with a more positive performance before.

**SEE6 countries' recent performance on shared prosperity is related to the distribution of economic growth across consumption groups.**

Growth incidence curves, depicting the consumption growth rate for each percentile of the population using the most recent data periods in each country, show that Kosovo and FYR Macedonia are examples of divergent patterns (Figure 3). In Kosovo, in the period from 2006 to 2011, the growth rate of the bottom 40 percent of the population was consistently above average. In FYR Macedonia between 2003 and 2008, in turn, overall consumption growth was weak. However, while households at the top had positive growth rates, consumption declined for those in the bottom of the distribution. In Serbia, all groups experienced a decline in well-being based on the most recent data, again showing a very different and contrasting picture from the pre-crisis path of the country.

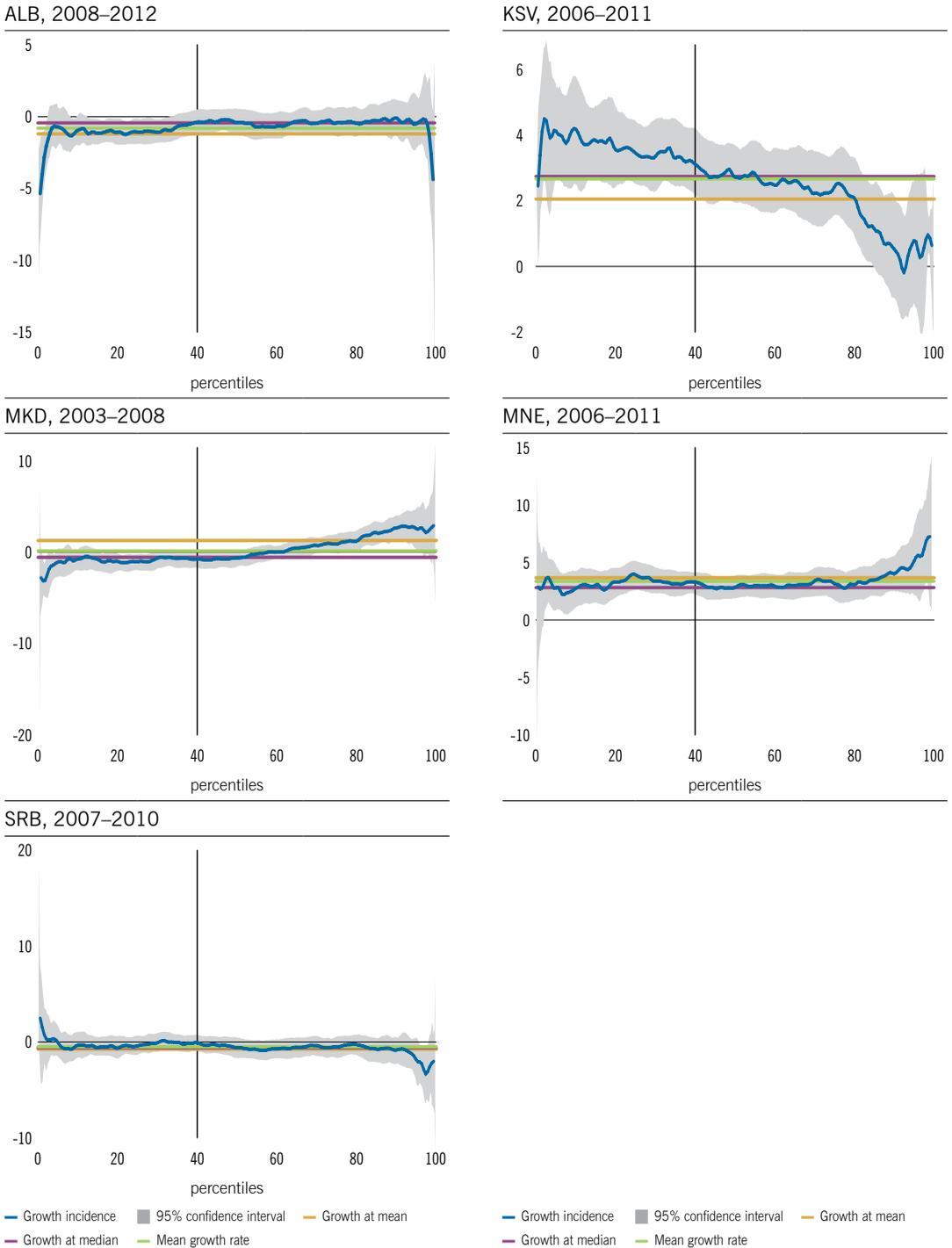
**SEE6's performance on shared prosperity influenced their level of poverty and inequality.**

Over the periods considered, the SEE6 countries with positive growth for the bottom 40 percent saw poverty fall. Countries also fared differently in terms of inequality (see Figure 4). While in Serbia, Montenegro and FYR Macedonia, inequality increased over the periods analyzed, in Albania and Kosovo it fell. The majority of the EU11 countries had higher—or at least equal—growth rates for those in the bottom 40 percent compared to

1 Similar to poverty estimations for SEE6 and consistent with data availability, the note uses consumption-based welfare measures.

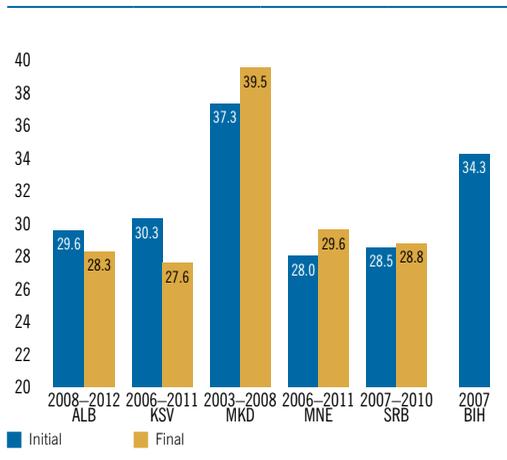
2 EU11 includes Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

**Figure 3. Growth incidence curves, periods as indicated, annualized growth**



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD).

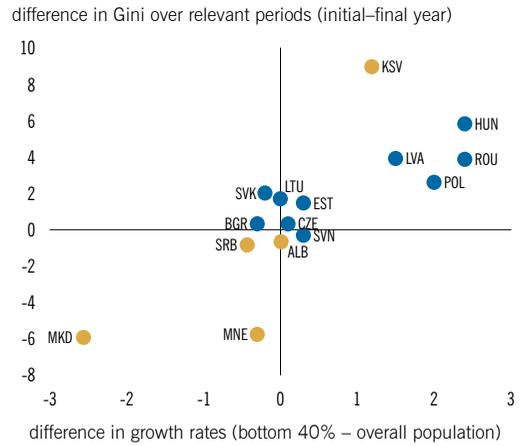
**Figure 4.** Gini index, years as indicated



Source: World Bank staff estimates based on the ECAPOV harmonized dataset.

Note: Each bar refers to each year in the period considered.

**Figure 5.** Inequality changes and consumption growth gap (bottom 40 percent vs. mean)



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2008–2012), Kosovo (2006–2011), FYR Macedonia (2003–2008), Montenegro (2006–2011), Serbia (2007–2010), EU11 (2006–2010).

the top 60 percent, and they saw their level of inequality decrease over time (Figure 5).<sup>3</sup>

3 As discussed in Bussolo and Lopez-Calva (2014), the performance of the bottom 40 is related to the overall level of growth, the incidence of growth along the income distribution and the initial share of income held by the bottom 40—inversely related to the level of inequality.

## Drivers of Shared Prosperity: An Assets-Based Framework

**Shared prosperity depends on the long-term productive capacity of the household—allowing households to boost their income over time—and it is both about economic growth and its incidence.** To understand the drivers of shared prosperity, this note adopts the World Bank’s shared prosperity framework for Europe and Central Asia<sup>4</sup>, which relies on an assets-based approach that focuses on the long-term income-generating capacity of households. As depicted in Table 1, households’ productive capacity, and thus contribution to economic growth, depends on several elements: (i) *the stock of assets* owned by each individual in the household; (ii) the *intensity of use* of those assets to produce income; (iii) *prices/returns to assets*, and (iv) *transfers* from public or private sources. Some of these elements and their distribution, such as household members’ education level, are not easily altered in the

short-run, but changes in their distribution in the medium and long-term will drive both growth and its incidence. An economy with lower human capital for the bottom 40 percent, for instance, will face a cap in its growth potential. However, macroeconomic variables will affect the household’s ability to generate income, particularly in the short-run. These include external/global conditions like the global economic crisis of 2009, prices of commodities, changes in the fiscal structure and capacity of the country, as well as sectoral patterns of economic growth and how they influence, for example, demand for labor with certain skills.

**An economic crisis can lead to adjustments in hourly wages and/or in employment, and to public responses to the shock (or lack thereof) that can affect households’ income.**

**Table 1.** What determines the medium and long-term productive capacity of the household?

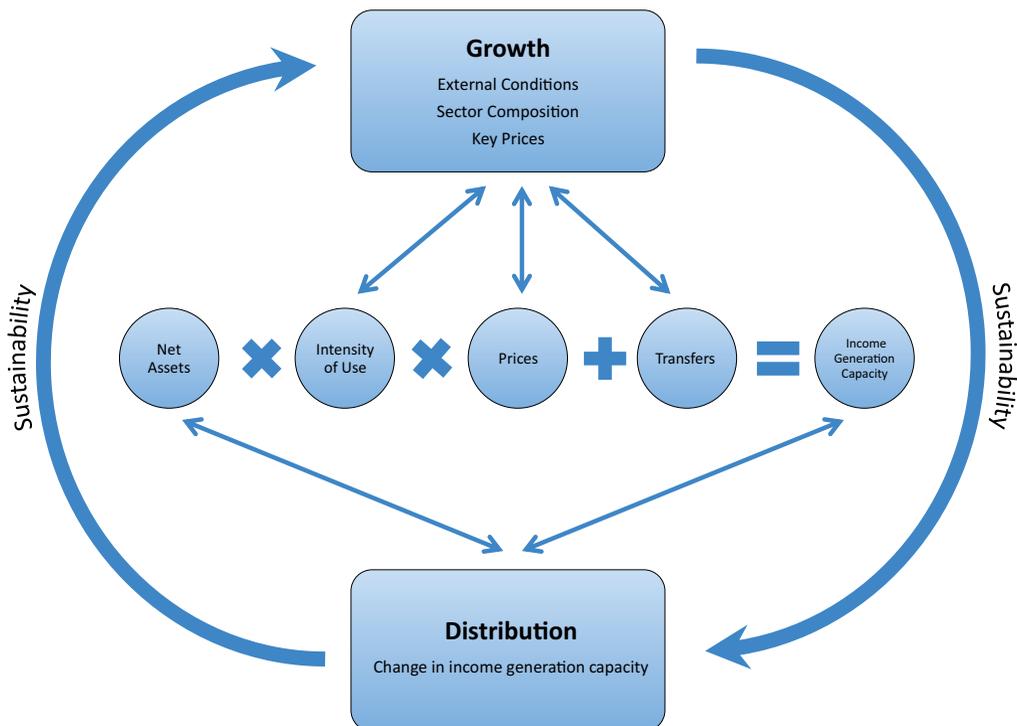
	<b>Assets</b> → stock of assets owned by the household, including human capital, physical assets, financial assets, natural capital and social capital.
	<b>Intensity of use</b> → use of assets to produce income, including education and health used for employment and entrepreneurship as a way to generate labor income, and use of land as a productive input.
	<b>Prices</b> → returns to assets, including hourly earnings and interest rates.
	<b>Transfers</b> → from public or private sources, including social assistance and remittances.

<sup>4</sup> Bussolo and Lopez-Calva (2014).

In fact, countries like Albania and Serbia that experienced negative growth for the bottom 40 percent in the recent period (Figure 2) also experienced a decline in the employment rate during those years (-1.6 percentage points in Albania and -3.1 percentage points in Serbia). Similarly, in Montenegro, the stark difference between its pre- and post-crisis performance is in line with an increase in the employment rate prior to the crisis (from 36 to 44 percent between 2005 and 2008), and a drop during the crisis times (from 44 to 39 percent from 2008 to 2011).<sup>5</sup>

**Figure 6 brings the framework together, emphasizing how the income-generating capacity of households is affected by both these macroeconomic level variables that affect growth and by changes in the distribution of the stock, use and returns to assets in the household.** Furthermore, transfers—public and private—are also a component of a household’s income and they can play an important role in lifting households out of poverty and protecting them from shocks. It is important to determine, however, whether they are or not a sustainable source of income growth for the bottom 40 percent over the medium and long-terms.

**Figure 6.** Assets based approach: decomposing the income-generating capacity of households



Source: Bussolo and Lopez-Calva (2014).

<sup>5</sup> Employment to population ratio for individuals 15 years and older (World Development Indicators).

**Beyond considerations of timing of policies, with a bigger role for macroeconomic variables in the short-run, the question of potential short-term vs. long-term trade-offs between policies also arises.** The framework proposes that policies should be guided by a dynamic long-term view in which enhancing the productive capacity of the bottom 40 percent will have a positive impact on both economic growth and equity. Given this long-term view of a policy agenda aimed at promoting shared prosperity, it is key to account for the economic, social and environmental sustainability of the policies to achieve the goal.

**The proposed framework can guide the thinking on shared prosperity, but can also be relevant for poverty reduction.** First, it is important to note that there are key differences between the two goals and their respective indicators. Promoting the income growth of the bottom 40 percent is a relative concept and relevant to all countries across income levels; furthermore, it does not target specific households over time but whoever is placed in the bottom 40 percent in each time period (anonymous indicator). Poverty reduction, in turn, is an absolute concept meaning that poverty can be eliminated by targeting and pushing above the poverty line a specific set of the population: the poor. Despite these differences, both reducing poverty and boosting shared prosperity aim at increasing households' income so the framework can guide the thinking on both goals.

## Understanding the Income-Generating Capacity of Households in SEE6

**Having a detailed understanding of the capacity of households in the bottom 40 percent to accumulate, use and receive returns from their assets in SEE6 can inform policymakers on how to increase their ability to benefit from and contribute to the economic growth process.** This section provides first insights on how the bottom 40 percent has fared in SEE6 along the four dimensions of the framework. The analysis in this first note on shared prosperity in SEE6 focuses relatively more on the determinants of labor income, given that it constitutes the most important source of income for households and the more sustainable path to producing income and contributing to growth. The section uses the most recent available data from 2012 in Albania, 2007 in Bosnia and Herzegovina, 2011 in Kosovo, 2008 in FYR Macedonia, 2011 in Montenegro, 2010 in Serbia and 2010 in EU11.<sup>6</sup> It complements this with findings from alternative sources.

**Findings underline some common patterns across countries that sketch a portrait of households in the bottom 40 percent and can help guide policy actions.** Findings from the following analysis show that: (i) they have fewer assets, including lower education levels, savings and land; (ii) they use their fewer assets in lower intensity, including lower labor market

engagement; (iii) they receive lower returns, through lower wages; and (iv) they rely heavily on public and private transfers. For the latter, in SEE6 and in many countries in Europe and Central Asia, households in the top 60 percent also rely heavily on non-market income, raising questions over the fiscal sustainability of public transfers in particular. Moreover, the bottom 40 percent is more vulnerable to shocks, putting at risk their opportunities to accumulate assets and increase their productive capacity.

**Further work should focus more closely on understanding the impact of macroeconomic level variables on the various dimensions** (e.g. sectoral composition of economic growth) and on digging deeper into each of these dimensions through country-specific analyses. Additional diagnostics are also needed in terms of the fiscal, social and environmental sustainability of efforts and progress towards the goals.

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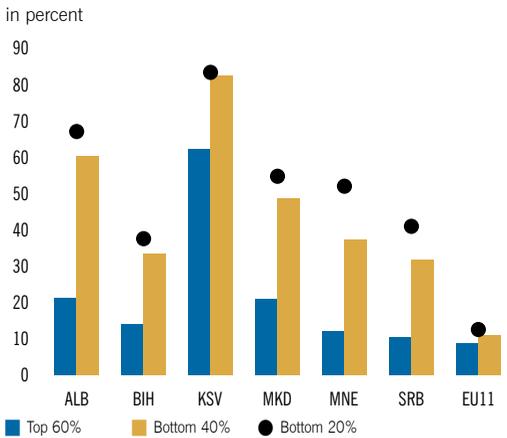
### Assets

**The bottom 40 percent counts on relatively few working-age household members to provide for larger households.** Less well-off households are larger and have more dependents, especially children (Figure 7 and Figure 8). This pattern is consistent across the SEE6 countries, and contrasts with that

<sup>6</sup> EU11 estimates are obtained from EU-SILC 2011 cross-sectional dataset. The bottom 40 percent and upper 60 percent in the EU11 are defined on the distribution of per adult equivalent disposable household income. Data from the 2011 wave refers to 2010 incomes.

of the well-off, who have smaller households, fewer children and a relatively higher share of members over 65 years old (Figure 9). Regression analysis (Table A1) indeed points

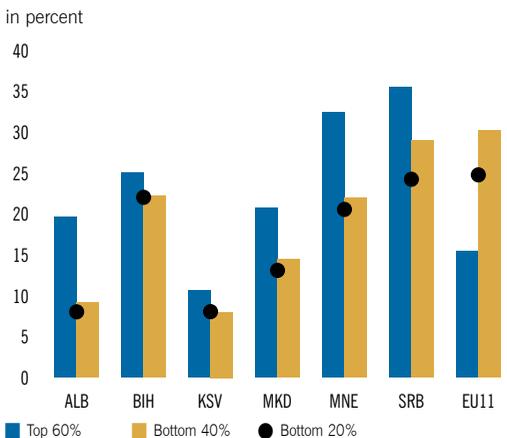
**Figure 7. Share of households with five or more members**



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), EU11 (2010).

**Figure 9. Share of elderly (65 years old or more) in the household**

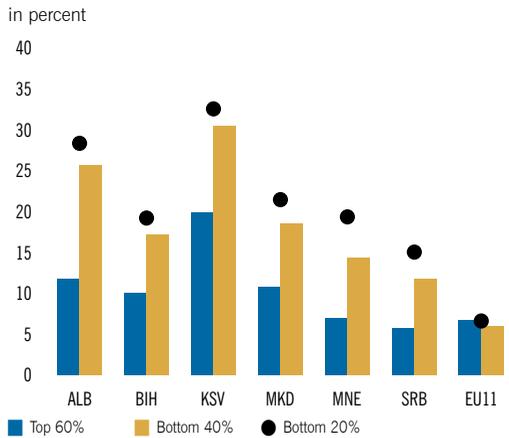


Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), EU11 (2010).

to an increased probability of being in the bottom 40 percent for larger households and households with more children.<sup>7</sup>

**Figure 8. Share of children (less than 15 years old) in the household**



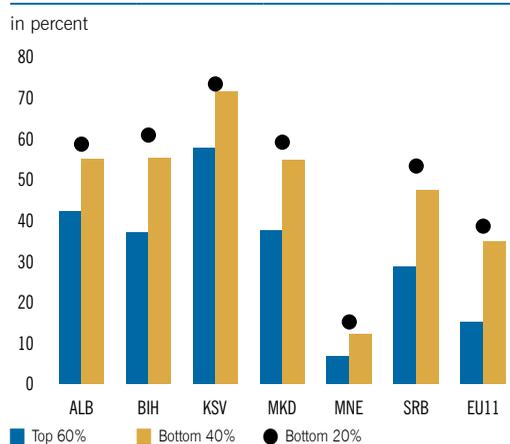
Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), EU11 (2010).

**Individuals in the bottom 40 percent have lower levels of educational achievement.**

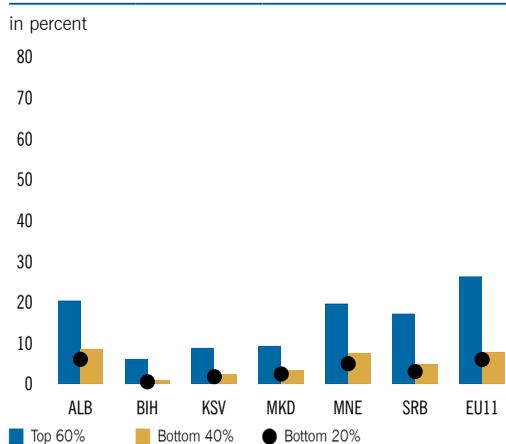
Individuals 15 and older in the poorest two quintiles of the consumption distribution are more likely to have no education or incomplete primary education, and are less likely to have attained tertiary education (Figure 10 and Figure 11). For instance, in Serbia and Albania the share of individuals with incomplete 5–12 grades is nearly 20 percentage points higher for the bottom 40 percent than for individuals in the top 60 percent. This gap is even more pronounced for the poorest quintile.

<sup>7</sup> The highest probability associated with being in the bottom 40 percent for large households is in Albania (at 29 percentage points). A probability of 32 percentage points or higher in Albania, Bosnia and Herzegovina and Serbia is associated with a higher share of children in the household.

**Figure 10.** Share of individuals (aged 15+) with at most primary education

Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), EU11 (2010).

**Figure 11.** Share of individuals (aged 15+) with tertiary education

Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

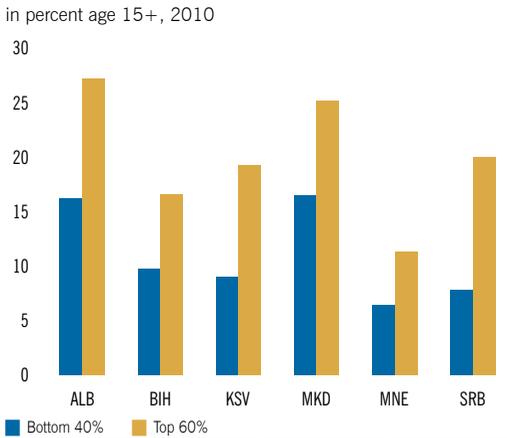
Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), EU11 (2010).

Conversely, across countries, the share of individuals with tertiary education is lower in the bottom of the distribution than at the top. Individuals in rural areas have significantly lower educational attainment than their urban counterparts and in the rural bottom 40 percent, even more so. Simple regression analysis shows that having tertiary education is associated with a reduced probability of belonging to the bottom 40 percent by, for example, 19 percentage points in Montenegro, 21 percentage points in Serbia and 24 percentage points in Bosnia and Herzegovina, compared to those with secondary education (Table A1). However, beyond educational attainment, it would be important to assess whether the bottom 40 percent is at a disadvantage on other types of skills, such as socio-emotional skills, increasingly demanded by employers in SEE6, but also key for achieving successful entrepreneurial and managerial undertakings. Ongoing data collection efforts in FYR Macedonia and Serbia—using the Skills Toward

Employment and Productivity (STEP) skills measurement study—will shed light on this issue.

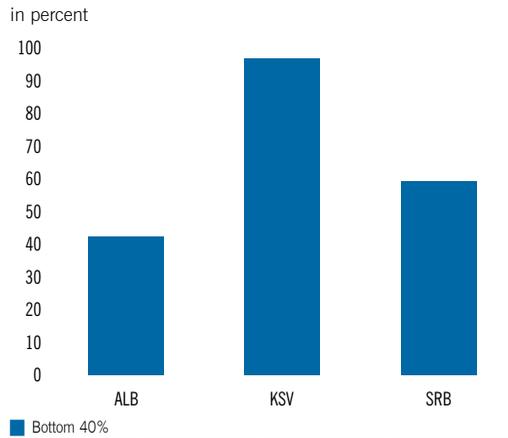
**Beyond counting on fewer working-age members and having a lower stock of human capital, the bottom 40 percent is less likely to have accumulated other assets.** For instance, in terms of financial assets, a lower share of individuals in the bottom 40 percent saved money in the past year, compared to those in the top 60 percent (Figure 12). The gap across households in the two groups is particularly large in Albania, Kosovo and Serbia. For land as a productive asset, the bottom 40 percent in Albania and Serbia, for instance, count on smaller plots of land relative to those of the top 60 percent (Figure 13). Furthermore, across SEE6 countries, some groups are systematically excluded from land ownership: women, for instance, are significantly underrepresented as land owners compared to men.

**Figure 12. Financial assets: Saved any money in the past year, income, bottom 40% and top 60%**



Source: World Bank Findex database.

**Figure 13. Average dimension arable land of bottom 40 percent, as a share of average dimension arable land of top 60 percent**



Source: World bank Staff estimates on the harmonized ECAPOV dataset and LSMS 2012 for Albania, HBS 2011 for Kosovo, HBS 2010 for Serbia.

**Box 3. Social capital as an asset: the case of Albania**

Social capital refers to the institutions, relationships, and norms that shape the quality and quantity of a society’s social interactions. Social capital provides households with access to networks that could facilitate access to jobs, to credit, and to a cushion from asset depletion in the face of shocks Thanks to an ad-hoc module in the Albania 2012 LSMS, social capital can be included in the list of assets to study for comprehending shared prosperity.

Results suggest that individuals in the bottom 40 percent have less social capital than those in the top 60 percent. These households have fewer networks: only 8 percent of individuals in the bottom 40 percent declare to participate at least in one association (among a list of 19 groups ranging from trade unions to neighborhood associations and religious, cultural and political groups), as opposed to 16 percent of individuals in the top 60 percent. When asked if they would contribute in time or money to a community project that has benefits for many others in the village/neighborhood but not directly for themselves, only 35 percent of individuals in the bottom 40 percent would contribute money, as opposed to 46 percent in the top 60 percent. Only 10 percent in the bottom 40 percent would contribute time, as opposed to 18 percent in the top 60 percent. And fewer individuals in the bottom 40 percent have participated in any communal activities than in the top 60 percent (6 percent as opposed 8 percent). The perception of neighborhood safety is weaker for individuals in the bottom 40 percent: only 5 percent feel very safe from crime and violence staying alone at home as opposed to 12 percent of individuals in the top 60 percent. It is important to note, however, that access to networks are not always conducive to better economic opportunities, particularly for socially excluded groups as in the case of some ethnic minorities, if the networks are limited to their kin.



## Intensity of use of assets

**Overall, SEE6 countries face important labor market challenges with low labor force participation, particularly of women, and high unemployment rates in several countries.** Labor income is the main source of income for most households, making labor markets the main engine for shared prosperity. As such, it is critical to understand the labor market engagement of those in the bottom 40 percent—capturing the dimension of intensity of use of human capital as a productive asset—as well as the barriers they face to accessing more and better jobs. This subsection focuses particularly on the differences between socio-economic groups in terms of employment, unemployment and inactivity rates.

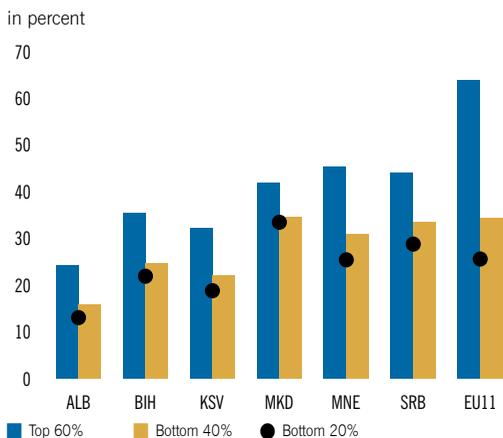
**The share of employed adults among those of working age is lower for the less well-**

**off in every country.** Among employees, in particular, there are large differences between the first two consumption quintiles and the top three in SEE6 countries (Figure 14), and these disparities are larger in EU11 countries. In terms of self-employment, patterns between socio-economic groups vary by country, with a higher share of self-employed in the bottom 40 percent in Montenegro and Serbia, as well as in EU11 countries, possibly capturing informal small businesses and own-account workers (Figure 15). In Montenegro, in particular, being self-employed as opposed to an employee increases the probability of being in the bottom 40 percent by 14 percentage points.

**Household dependency on employed members is high for the bottom 40 percent.**

On average in SEE6, each employed household member has to provide for five other persons in the bottom 40 percent, as opposed to three in the top 60 percent (see Figure 16). This difference is higher in Kosovo, where for

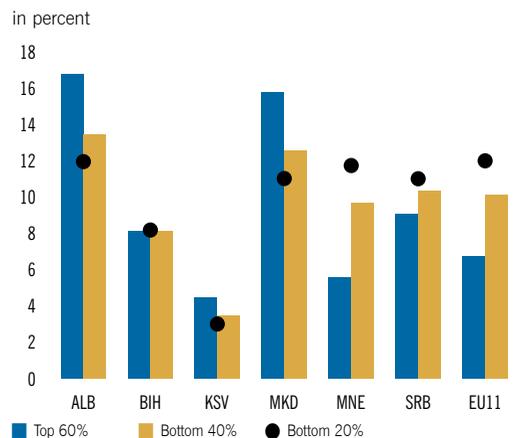
**Figure 14.** Share of employees (age 15–64) in the working age population



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Notes: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

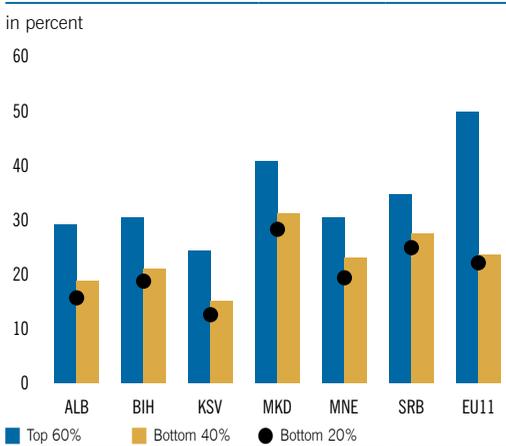
**Figure 15.** Share of self-employed (age 15–64) in the working age population



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Notes: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

**Figure 16.** Share of employed household members (age 15–64) among all household members



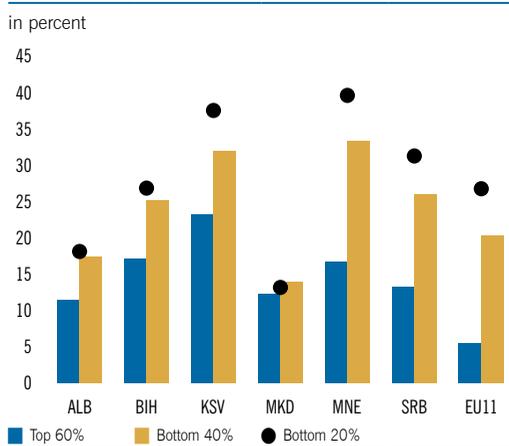
Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Notes: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

each employed household member there are 4 additional dependent members in the bottom 40 percent than in the top 60 percent. The gap is on average larger in EU11 countries than in SEE6. This pattern is the result of both a higher child dependency ratio (as previously discussed) and lower employment rates for working-age individuals at the bottom of the distribution. A high rate of dependency on employed household members means that the earnings of a few people need to provide for many more in the household, but also that the household is highly vulnerable to job loss, illnesses or other shocks affecting income earners.

**Individuals in the bottom 40 percent are more likely to be unemployed than the rest of the population** (Figure 17). This pattern is also observed in EU11 countries. Not surprisingly, being unemployed as opposed to a wage earner is associated with a significant and positive probability of being in the bottom 40 percent for all six countries, with the highest

**Figure 17.** Share of unemployed individuals (age 15–64) in the working-age population



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

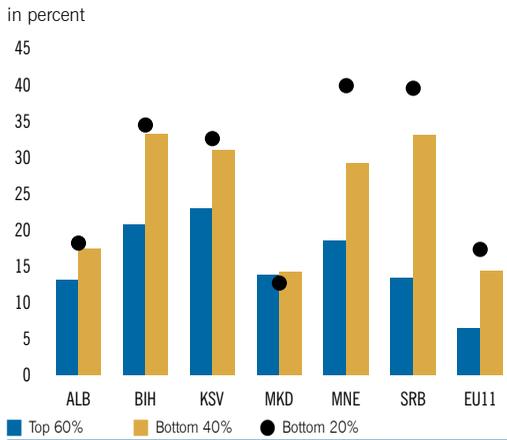
Notes: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

probability in Serbia at 23 percentage points (Table A1).

**Among the youngest and the oldest parts of the population, the share of unemployed in the bottom 40 percent is high in the majority of countries, and even higher for the poorest.** In SEE6, the share of unemployed youth and older adults in their respective age groups is higher for the bottom 40 percent than for the rest of the population (Figure 18 and Figure 19). Differences are exacerbated in the comparison between the poorest quintile and those at the top.

**Inactivity rates are also higher for those in the bottom 40 percent, except in Montenegro and in Serbia** (Figure 20), where a high share of retirees (among those of working age) in the top 60 percent explains the counter-trend (see Figure 21). The inactivity rate is as high as 50 percent in Albania and reaches 57 percent for the first quintile. On the other end of the

**Figure 18.** Share of unemployed in the younger working-age population (ages 15–24)

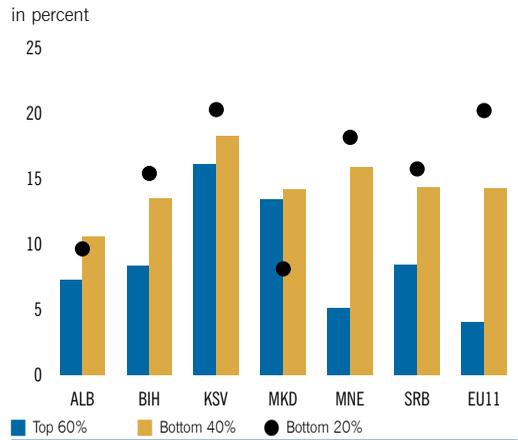


Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

scale, there is Montenegro, where inactivity levels are lower than the EU11 average. Furthermore, the presence of more people out of the labor force who are neither studying nor retired is associated with a high and significant probability of being in the bottom

**Figure 19.** Share of unemployed in the older working-age population (ages 55–64)

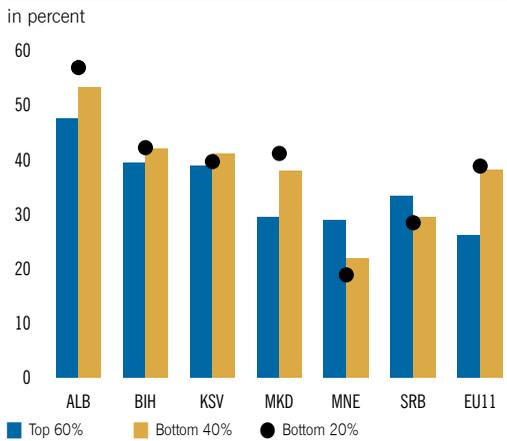


Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

40 percent in all countries except Montenegro, particularly in Serbia (11 percentage points higher) and Albania (7 percentage points higher). Focusing on retirees only, the share of retirees in the working-age population group is lower in the bottom 40 percent than in the top

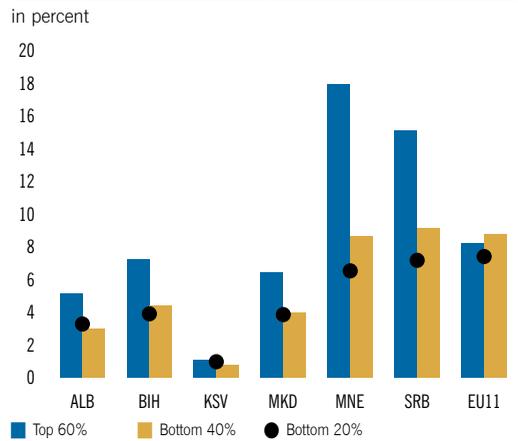
**Figure 20.** Inactivity rates (age 15–64)



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

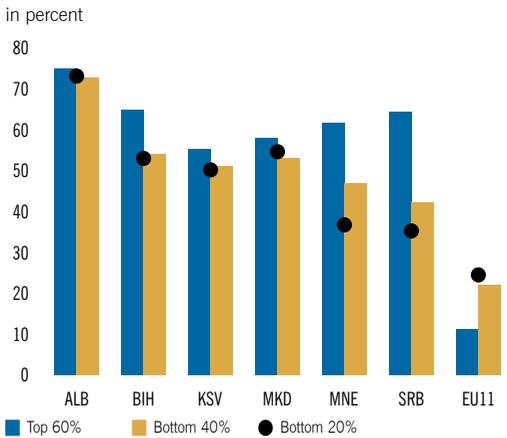
**Figure 21.** Share of retirees (age 15–64)



Source: World Bank Staff estimates based on the harmonized ECAPOV dataset, and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

**Figure 22.** Inactivity rates among the younger working-age population (ages 15–24)



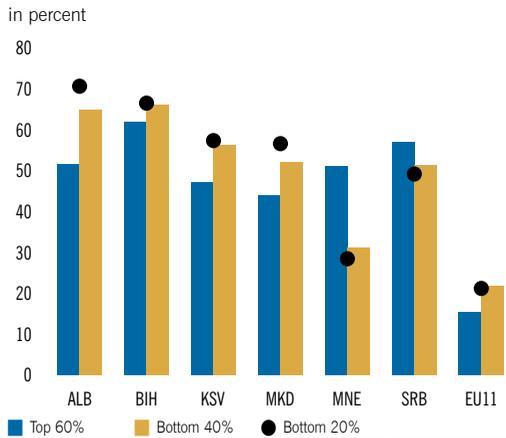
Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

60 percent (Figure 21) and is particularly high in Montenegro and Serbia.

**Average inactivity rates are higher within the young cohort (age 15–24) and mature adult cohort (55–64) than for the whole working-**

**Figure 23.** Inactivity rates among the older working-age population (ages 55–64)

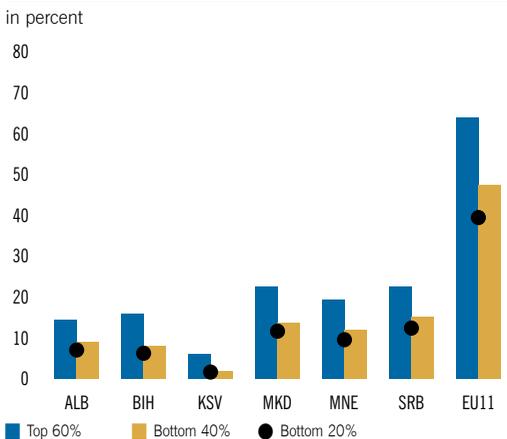


Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

**age population** (Figure 22 and Figure 23). In Albania, the share of youth aged 15–24 that is inactive is over 70 percent for all socio-economic groups. All SEE6 countries show rates of inactivity for the younger and the older working age cohorts that are double or triple

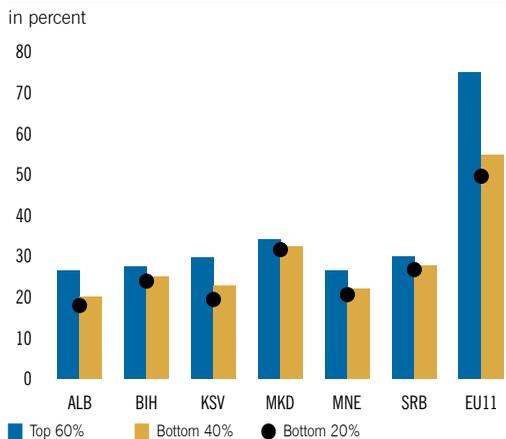
**Figure 24.** Share of Employed Women (15–64)



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

**Figure 25.** Share of Employed Men (15–64)



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EU-SILC for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010).

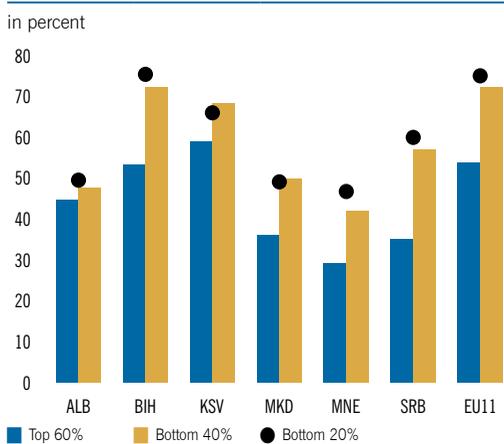
the shares registered in the EU11 as average. These high rates of inactivity among younger and older workers likely reflect barriers and disincentives to work for these groups (World Bank 2013).

**Gender gaps in labor markets exist between and within socio-economic groups.** For instance, the employment rate for men in the bottom 40 percent in FYR Macedonia is 32 percent, while it is 14 percent for women in the same group but 23 percent for women in the top 60 percent (see Figure 24 and Figure 25).

**This overrepresentation in rural areas likely limits the opportunities of those in the bottom 40 percent to accumulate assets through, for example, suggesting differences in economic opportunities across socio-economic groups.** The bottom 40 percent is more concentrated in rural areas than in urban areas. In Serbia, for instance, nearly three in

every five individuals in the bottom 40 percent of the population live in rural areas compared to two in every five people in the better-off households (Figure 26). The same pattern is observed in EU11 countries. The probability of belonging to the bottom 40 percent increases by around 9 percentage points for rural households in Serbia and Montenegro (Table A1), and it is positive and significant in all countries except Albania. This overrepresentation in rural areas likely limits the opportunities of those in the bottom 40 percent to accumulate assets through lower access to tertiary education institutions and to use these assets to produce market income, given the lower dynamism of rural labor markets. Barriers to low internal mobility in SEE6 countries reinforce these differences. The evidence for SEE6 shows that relatively few individuals move from one region to the other in the same country, suggesting that people in rural areas also have less access to opportunities in leading regions, which tend to be urban.

**Figure 26.** Share of individuals living in rural area



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD), and EUSilc for EU11.

Note: The periods covered for each country are as follows: Albania (2012), Bosnia and Herzegovina (2007), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), EU11 (2010).

**Limited evidence points to lower intensity of use of other assets by the bottom 40 percent.**

For financial assets, for instance, the bottom 40 percent are less likely to put their savings in a financial institution than the top 60 percent. Of those who saved money in the past year in Bosnia and Herzegovina, for example, 32 percent of the bottom 40 percent did so in a financial institution, compared to 51 percent of the top 60 percent.<sup>8</sup> Using land as an asset—as collateral, for example—would require for the property to be registered. Evidence from Serbia suggests that small and medium-sized enterprises often use land/real estate as collateral to access credit. Additional data are, however,

<sup>8</sup> World Bank Findex database.

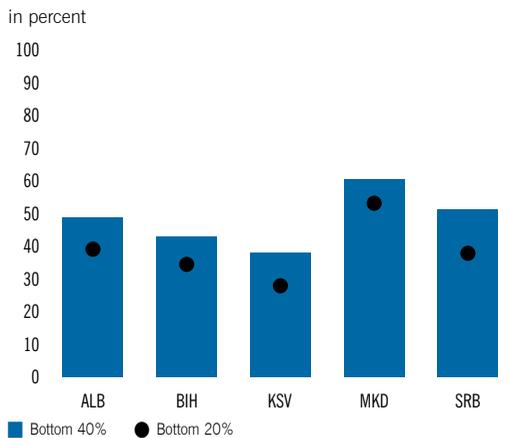
required to determine whether land registration in SEE6 is less accessible to some population groups, such as those in the bottom 40 percent. Existing evidence suggests that women are significantly less likely to be registered as owners than men. Focusing on natural capital, higher intensity of use to generate income, however, can lead to environmentally unsustainable practices. Ongoing efforts in Albania through a World Bank-supported Environmental Services Project aim to harness the power of access to natural assets and their sustainable intensive utilization, also providing conditional transfers to poorer households for improving land management practices.

## Returns to assets

**The bottom 40 percent has lower average wages than the top 60 percent.** The ratio between the average wage in the bottom 40 percent and the average wage for employees in the top 60 percent is as low as 38 percent in Kosovo, and lower than 50 percent in Albania and Bosnia and Herzegovina (Figure 27). These differences can be attributed to many factors, including lower levels of education and hence of returns, more limited access to productive jobs, lower access to capital and a disadvantageous labor taxation structure, among others. The following paragraphs discuss some of these factors.

**Given the bottom 40 percent's lower levels of education, returns from tertiary education—although high in SEE6—are out of reach**

**Figure 27. Average wage in the bottom 20 and 40 percent, as shares of top 60 percent average wage**

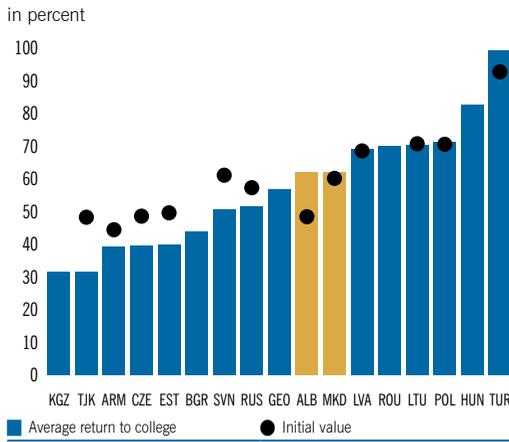


Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD).

Note: The periods covered for each country are as follows: Albania (2012), Kosovo (2011), FYR Macedonia (2008), Montenegro (2011), Serbia (2010), Bosnia and Herzegovina (2007), EU11 (2010). Wage refers to employees' income from labor with the exception of MKD where it generally refers to income from labor.

**for most of them.** The earnings premium for workers with tertiary education—relative to workers with secondary education and similar observed characteristics—remains high in countries like Albania and FYR Macedonia and has actually increased in Albania during the 2000s even with the expansion in tertiary education (Figure 28). As discussed above, however, the share of individuals with tertiary education is lower for the bottom 40 percent than it is for the top 60 percent. This means that these higher returns are not accessible to the bottom 40 percent given their lower stock of human capital. For youth in the bottom 40 percent, the opportunity cost (foregone earnings) and direct costs (tuition-related) of investing in higher education, and factors like less access to information on labor market prospects, limit their opportunities to benefit from those higher returns (World Bank, 2013). Some population groups, such as women, systematically face lower returns to education

**Figure 28.** Evolution of average wage premiums for tertiary education in the 2000s, salaried workers, age 25–64

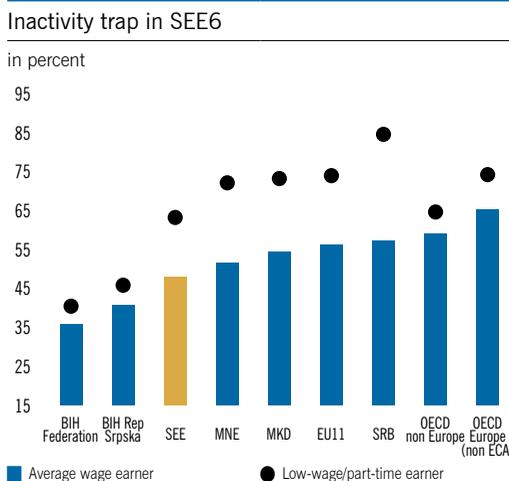


Source: World Bank (2013).

than men. The gender wage gap for individuals with similar observed characteristics is estimated at around 19 percent in Albania and FYR Macedonia, 16 percent in Montenegro and 11 percent in Serbia.<sup>9</sup>

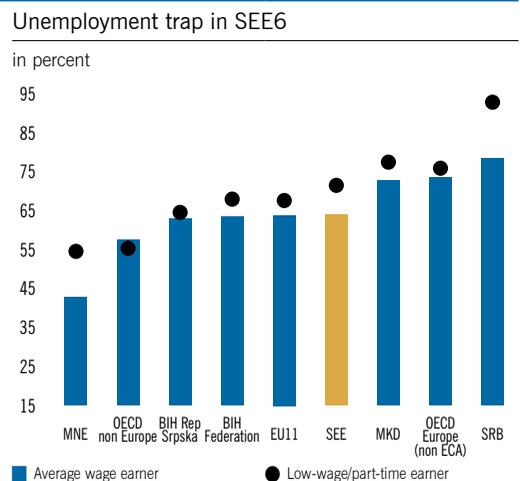
Furthermore, low wage earners—among which the bottom 40 percent is overrepresented—face high disincentives to work from labor taxation and social protection. Taking a formal job is often not worthwhile in SEE6 countries from a combination of labor taxation and lost social assistance or unemployment benefits (World Bank, 2013). On average in these countries, average earners that forego unemployment benefits to take a formal job face (implicit) tax rates reaching up to 78 percent in Serbia (Figure 29); this is the so-called “unemployment trap”. The same arises for individuals receiving social assistance as they move from inactivity into formal employment (“inactivity trap”). Even if unemployment benefits and social assistance are not very generous in most countries, their design can result in disincentives to work: for example, benefits are often withdrawn abruptly when people start to work formally, benefits are

**Figure 29.** Average effective tax rate 2009: income tax plus lost benefits as a percentage of gross labor income



Source: World Bank (2013), based on OECD Tax and Benefit Model.

Note: Calculations are based on one-earner couples with two children. They measure the share of gross income of the accepted formal job—including in-work benefits—that is taxed away through personal income tax, social security contributions, and lost benefits (for the inactivity trap it refers to social assistance, family, and housing benefits; for the unemployment trap it refers to unemployment benefits, family, and housing benefits). Children are assumed to be ages 4 and 6. The data for Montenegro is from 2011. Low-wage earner refers to those earning 50 percent of the average wage.



<sup>9</sup> Data from World Bank (2013) and FREN (2013).

tied to eligibility criteria that prohibits work (one-off filters) or benefits are tied to additional services and benefits that are lost as well when working formally.

**Disincentives are more pronounced for low-wage earners than for average-wage earners** (World Bank, 2013). Figure 29 shows that the cost of moving out of social assistance in the Western Balkans is higher for low-wage earners, and thus likely more onerous for the bottom 40 percent. This is particularly so in FYR Macedonia, Montenegro and Serbia with tax rates above 70 percent for low-wage earners: in other words, taking a formal job increases a household's total income by a mere 30 percent of the low-wage earner potential new salary. In FYR Macedonia and Serbia, for example, the structure of social contributions disproportionately penalizes low-wage earners making it costly for them to join the formal labor market (World Bank, 2013). Similarly, moving out of the unemployment trap is often not worth it for low-wage earners, given the structure of taxes and unemployment benefits.

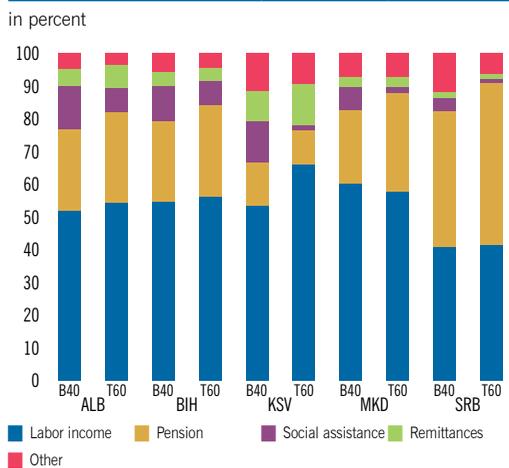
**Further analysis needs to explore the returns to other assets.** Although wages capture most of the market returns for households, more in-depth, country-specific work should shed light on returns to other assets.

## Transfers

**The share of public transfers in household income, particularly pensions, is high in**

**the region.** Public transfers in SEE6 account for a higher share of household income, even if labor remains the main source of household income. Although data sources on income are imperfect, Figure 30 shows that around 60 percent of household income comes from labor market income. This is low compared to, for example, the average in Latin American countries of around 70 percent. In turn, income from pensions accounts for a high share of households' income, both for the bottom 40 percent and top 60 percent, particularly in Serbia. Social assistance benefits, as expected, account for a larger share of income for those in the bottom 40 percent.

**Figure 30.** Share of income by source, as a percent of total household income



Source: World Bank Staff estimates on the harmonized ECAPOV dataset and LSMS 2012 for Albania, HBS 2007 for Bosnia and Herzegovina, HBS 2011 for Kosovo, HBS 2008 for FYR Macedonia HBS 2010 for Serbia.

**Public transfers provide a necessary source of income for many households, protecting them from poverty and vulnerability.** For some households, income from social assistance, for example, represents a much-needed lifeline to keep them out of poverty. Coverage of social assistance for those in the bottom 20 percent,

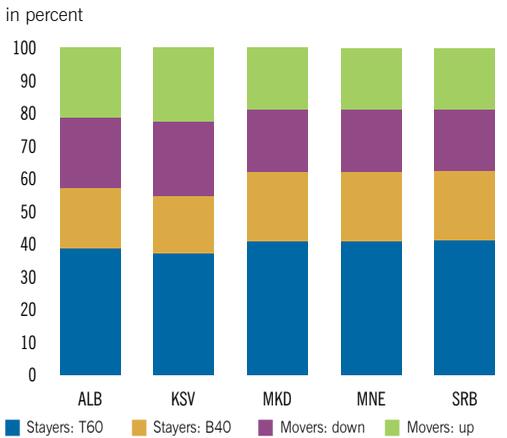
however, remains low across all countries. As public transfers do not always have a role in strengthening the capacity of the household to generate market income, and can, in some cases, be fiscally unsustainable, it is essential to ensure that these transfers are well-targeted, cover those in need, do not discourage work and have a role in strengthening the long-term capacity of the household to generate market income. As seen in Figure 29, there is room for improvement in this area, as the design of social protection in some SEE6 countries can actually provide disincentives to formal employment.

**Private transfers are also a source of income for households in SEE6.** Evidence shows that remittances account for a non-negligible share of GDP in SEE6 countries, particularly Albania, Bosnia and Herzegovina and Kosovo, at 8, 11 and 16 percent of GDP respectively (WDI, 2012). Limited available data on remittances at the household level suggests, however, that in some of these countries with the highest share of households receiving remittances, there is a relatively lower share of households in the bottom 40 percent receiving them. For Albania, in 2012, 25 percent of households in the bottom 40 percent received remittances, compared to 40 percent for the top 60 percent. In Kosovo, these figures are around 14 and 18 percent, respectively. Still, remittances income represents around 9 percent of total household income for the bottom 40 percent. Furthermore, income-based data for 2011 in FYR Macedonia shows that private transfers account for only a small share of total household income at 3 percent for the bottom 40 percent, even if that share is lower for the top 60 percent of households.

**In sum, this initial analysis of the income-generating capacity of the bottom 40 percent shows that this group is relatively unprepared to contribute to and benefit from economic growth.** Its members have larger households to provide for and can count on fewer assets to do so. They have lower intensity of use of their assets, particularly of their human capital endowments through lower labor market attachment: they are more likely to be unemployed or inactive, which limits their capacity to earn labor income, and they receive lower returns from employment.

**Beyond this limited income-generating capacity, the bottom 40 percent is more vulnerable to setbacks given that they can count on fewer assets to cope with shocks.** For these households—who have a lower stock of assets, use them less intensively and get lower returns from them—shocks can have long-lasting effects through, for example, asset depletion. A 2010 survey (LiTs 2010) asked all households about their mechanisms to cope with the global economic crisis: nearly 50 percent of households in FYR Macedonia and Serbia reported reducing consumption of staple foods and more than one quarter stated that they had to delay utilities payment (World Bank 2012). The bottom 40 percent are very likely overrepresented in this group as they, again, count on fewer assets—including social capital—or other coping mechanisms to protect themselves. Their vulnerability can be exacerbated by fewer coping mechanisms, given their more limited access to credit and private transfers. As a result, households in the bottom 40 percent are more likely to suffer large income changes across years. In fact, among those in the bottom 40 percent in SEE6, consumption fluctuations reveal

**Figure 31.** Economic mobility between the bottom 40 percent and the top 60 percent

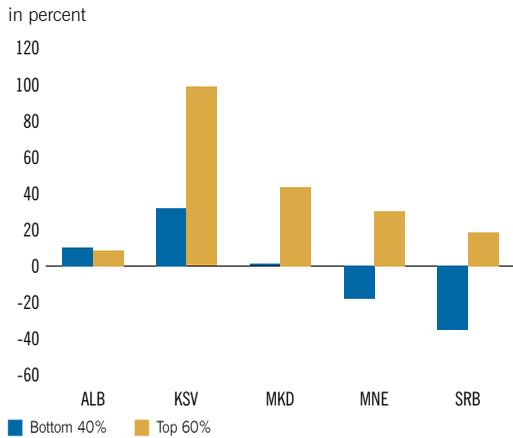


Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD).

Notes: Economic mobility estimates are based on the upper bound of synthetic panel methods (Dang et al. 2011) over the available initial and final year for each country. Explanatory variables include year of birth cohort, number of children, education of the head of household, rural/urban and regional dummies, and different interactions between these variables and means at the regional level. The sample is restricted to head of households 25–55 years of age. The periods covered for each country are as follows: Albania (2008–2012), Kosovo (2006–2011), FYR Macedonia (2003–2008), Montenegro (2006–2011) and Serbia (2007–2010).

particularly high vulnerability. In all countries except in Albania and Kosovo, those in the bottom 40 percent, on average, experienced net losses in consumption levels over the period considered (Figure 32); those in the top three quintiles, although affected also by volatility, had net gains. Vulnerability in SEE6 seems to affect, however, all groups: evidence shows high flows in and out the top 60 percent and bottom 40 percent (Figure 31). In Albania, for example, 19 percent of households moved from the top 60 percent to the bottom 40 percent, and vice versa. This picture of high churning is not exclusive to SEE6 countries but is also observed in EU11 countries.<sup>10</sup> Overall, high vulnerability to setbacks will affect the ability of individuals to accumulate, use and

**Figure 32.** Net change in yearly consumption per capita (2005\$ PPP) within each group, weighted average



Source: World Bank Staff estimates based on ECAPOV Harmonization (ECATSD).

Notes: Economic mobility estimates are based on the upper bound of synthetic panel methods (Dang et al. 2011) over the available initial and final year for each country. Explanatory variables include year of birth cohort, number of children, education of the head of household, rural/urban and regional dummies, and different interactions between these variables and means at the regional level. The sample is restricted to head of households 25–55 years of age. The periods covered for each country are as follows: Albania (2008–2012), Kosovo (2006–2011), FYR Macedonia (2003–2008), Montenegro (2006–2011) and Serbia (2007–2010).

receive returns to their assets either from lack of certainty about the future or from limited capacity to weather shocks.

10 Data for Hungary, Czech Republic, Poland, Bulgaria and Romania.

## What Can SEE6 Governments do? Policy Areas to Promote Shared Prosperity

**Achieving poverty reduction and shared prosperity in SEE6 requires cross-sectoral policy actions to reignite rapid and sustained economic growth and enhance the ability of the less well-off to participate in the growth process.** Incorporating the assets-based framework into the policy agenda can provide a clearer pathway to shared prosperity for policymakers. Specifically, policies can be designed or evaluated through their impact on building assets for the less well-off, increasing the intensity of use or returns, and their impact on non-market income. Five policy areas are identified that could be explored through the lens of the framework and its dimensions:

1. **Macroeconomic management:** macroeconomic stability and prudent monetary and fiscal policies reduce vulnerability, allow for the accumulation of assets and reduce distortions in relative prices and returns to assets. This includes, for instance, effective debt management and avoiding inflationary environments and exchange-rate volatility.
2. **Fiscal policies:** fiscal policies, through taxes and spending, can influence the various elements determining income from market and non-market sources, but they also have the potential to affect people's behaviors in the medium and long-terms regarding their asset accumulation and their use. For instance, the tax structure can be more burdensome for low-wage earners, as previously discussed, introducing disincentives to work and for firms to hire them. Public transfers also play an important role in households' income offering the necessary protection, but in some cases affecting people's behavior such as job search efforts.
3. **Institutional capacity for efficacy in quality service delivery** at different government levels: improving service delivery enhances productivity but also promotes equality of opportunities. The provision of quality education and health services, for instance, can promote the accumulation of human capital assets. Moreover, transport and energy investments can promote the use of assets through, for example, increased connectivity to markets and providing higher returns to land and financial assets.
4. **Effective instruments and systems for risk management:** this policy area aims at mitigating the impact of shocks on households' income and on their capacity to generate income. Shocks, such as job losses, can not only reduce household income, they can also deplete assets, particularly for large households that rely on very few sources of income and earners, such as those in the bottom 40 percent. Depleting their already limited assets can have devastating permanent effects on the ability of these households to recover from shocks.

5. **Capacity to enable well-functioning markets and a favorable business environment:** well-functioning markets allow for assets to be put to their most productive use. Exclusion from markets, such as labor markets, prevents households from accumulating assets and/or using them more intensively and efficiently. Acting through this policy area can promote, for example, more productive labor market engagement for the bottom 40 percent by removing barriers and disincentives to work and greater opportunities for entrepreneurship through increased access to credit and improved regulations that ease the entry and exit of firms.

**The following matrix (Table 2) illustrates the framework with policy examples of relevance to SEE6 for boosting shared prosperity.** More diagnostic work is undoubtedly needed for a comprehensive analysis of policy areas and options as well as trade-offs between policies.

**In SEE6, one policy area of relevance on the fiscal side relates to making labor taxation and social protection systems more compatible with work.** This entails addressing the disincentives to work from both the labor taxation and the social protection fronts. Adjusting tax rates to reflect differences in hours worked and household structure can avoid penalizing low-wage earners. Disincentives for low-wage earners were found in FYR Macedonia and Serbia, for example, in their artificially high social contribution rates for low-wage earners, through the “reference wages” used for the calculation of these social contributions. As for social protection systems, rethinking their design could eliminate disincentives to work

arising from eligibility criteria that discourages work and from the abrupt withdrawal of benefits as a person takes on a formal job. In Albania, for example, eligibility conditions for their main social assistance program are being reformed to eliminate exclusionary filters related to household employment. FYR Macedonia has implemented income disregards in social assistance to make it easier to combine work and receiving social assistance by making the removal of benefits gradual instead of abrupt.

**Furthermore, on service delivery, a policy agenda should aim at increasing access to quality education and making education and training systems more closely linked to labor market needs.** As briefly presented in the matrix, this entails putting place in policies to help the less well-off build human capital by ensuring access to quality education and ensure that the skills provided to students lead them to jobs. This could require a greater involvement of the private sector in the design of programs and curricula. Furthermore, education and training systems need to provide these individuals not only with the basic cognitive and technical skills, but also with such socio-emotional skills as self-discipline, ability to work in teams and persistence that are increasingly valued by employers today.

**The proposed shared prosperity framework can, as mentioned, also guide the thinking on reducing poverty; however, policy recommendations for achieving each goal will vary.** In other words, the policy emphasis for each goal will likely be on different elements of the framework. For instance, the available stock of assets of the poor to produce market income—e.g. human capital, land, savings—can be so limited in some cases that they would

**Table 2.** Policy examples relevant to SEE6 countries, and how they could impact the productive capacity of the households in each dimension

Policy examples	 Assets	 Intensity of use	 Returns/Prices	 Transfers	+ Sustainability
<b>The policy example can impact the productive capacity of the household by, for instance:</b>					
<b>Macroeconomic fundamentals:</b> Policies to strengthen public financial management	Promoting investments in asset accumulation (e.g., investments in education, purchase of land, savings) by providing certainty to economic actors	Promoting better use of assets (e.g., land, financial assets) by providing certainty to economic actors	Avoiding crowding out of private sector investment and increases in interest rates that can limit access to credit	Improving the predictability of fiscal policy and thus limiting ad hoc fiscal adjustments often at the expense of social policies and programs  Opening fiscal space to strengthen social programs targeted at the poor	Promoting fiscal sustainability from more efficient debt management
<b>Fiscal systems:</b> Policies to make labor taxation and social protection systems more compatible with work	Strengthening the role of social protection systems in building human capital for children and adults <sup>11</sup>	Removing disincentives to work from labor taxation and social protection systems, thus increasing the intensity of use of human capital through greater labor market engagement	Removing disincentives to work (and to hire workers) by making labor taxation more progressive to avoid penalizing low-wage earners through lowers returns to work	Improving coverage, targeting and eligibility criteria of social protection to offer protection to vulnerable groups without discouraging work	Increasing the effective use of public resources to contribute to fiscal sustainability
<b>Institutional capacity/service delivery:</b> Policies to increase access to quality education and market-driven education and training systems	Increasing the stock of human capital, particularly education	Increasing employability by ensuring education and training systems provide market-relevant skills	Increasing opportunities for higher returns (from higher educational achievement)	Reducing long-term vulnerability and reliance on public transfers from higher human capital and stronger links to labor markets	Providing access to services for systematically excluded groups such as the Roma to contribute to social sustainability

(continued)

be much more reliant on public transfers to cover their basic needs. For the bottom 40 percent, a broader group, a bigger emphasis might be placed on removing barriers to employment

and entrepreneurship, for example, to increase the intensity of use of their current stock of assets, and to provide adequate public transfers allowing for smooth and efficient labor market transitions.

<sup>11</sup> The conditional cash transfer program in FYR Macedonia, for example, successfully reached less well-off households by increasing secondary school enrolment among children (15–18 years old) in households receiving social assistance, by 6.5 percentage points.

(Table 2 continued)

Policy examples	 Assets	 Intensity of use	 Returns/Prices	 Transfers	+ Sustainability
<b>The policy example can impact the productive capacity of the household by, for instance:</b>					
<p><b>Risk management:</b></p> <p>Policies to strengthen the role and flexibility of social protection systems in reducing households' vulnerability during shocks (systemic and household shocks)</p>	<p>Protecting households during shocks—such as climatic shocks or main-earner job loss—to avoid depletion of assets (e.g., from cutting investments in education and health, selling physical assets or consuming financial assets)</p>	<p>Fostering more efficient labor market transitions by providing workers with a financial cushion to make better employment decisions and move to better jobs</p>	<p>Promoting more risk-taking given adequate and portable protection to, for instance, allow the unemployed to actively search for jobs outside their place of residence and in leading regions, potentially increasing returns to education</p>	<p>Providing necessary public transfers to compensate for short-term losses in market income</p>	<p>Allowing for fiscally sustainable responses to shocks</p> <p>Promoting the sustainability of welfare gains by avoiding downfalls and setbacks</p>
<p><b>Well-functioning markets/business environment:</b></p> <p>Policies to improve the land/real estate markets, including strengthening and enforcing property rights and contracts</p>	<p>Increasing access to land as a productive asset through privatization of state-owned land, for example</p> <p>Increasing access to other assets by facilitating the use of land as collateral</p>	<p>Promoting a more effective use of land as a productive asset through the provision of property rights</p>	<p>Enabling a more vibrant land market and avoiding distortions to land prices</p>	<p>Providing fiscal space from improved property tax collection to strengthen social programs targeted at the poor</p>	<p>Promoting a more effective and sustainable use of land as a productive asset</p>

## Conclusions

**Promoting shared prosperity in SEE6 countries requires policies at the macroeconomic and microeconomic levels that enhance the long-term productive capacity of the bottom 40 percent.** This will, at the same time, increase their ability to benefit from growth and economic opportunities, but also increase the growth potential of the country. Today, the bottom 40 percent of the population in SEE6 has a lower ability to participate in the growth process: they have more disadvantageous demographics, lower levels of human capital and access to other assets, lower participation in and returns from the labor market and are more vulnerable than the rest of the population. Given the significant jobs challenge in SEE6 countries, it is particularly important to create an enabling environment for job creation, promote well-functioning and inclusive labor markets and increase access to jobs for the bottom 40 percent.

**A shared prosperity lens helps debunk two commonly accepted, though only apparent, dichotomies.** The first dichotomy is between macro and microeconomic approaches to income growth at the bottom of the distribution. Indeed, the framework integrates both the macroeconomic and microeconomic elements, explaining how the macro variables affect income growth differentially along the income distribution—for example, through relative prices and the composition of growth—but also how the distribution of assets at the bottom will determine the capacity of each group to contribute to overall

growth. The second false dichotomy is between growth and redistribution. As explained above, growth and distribution are jointly determined. More importantly, redistribution policies that increase the productive capacity of the bottom 40 percent—via, for example, provision of education and health or investments in connectivity—will pay off by enhancing the overall growth potential of the economy. Equity-efficiency trade-offs can then be overcome. A recent review of the evidence has shown that the trade-off between fiscal redistribution and growth cannot be empirically validated (Ostry et al., 2014).

**Data limitations prevent a more comprehensive analysis.** A combination of data issues—including concerns over quality, limitations in data access and lack of data for certain dimensions—represent an obstacle to understanding the challenges and putting together a policy agenda. An agenda on data quality, access and frequency should be at the top of the priority list, as it would allow monitoring progress, identifying gaps and informing policymaking.

**Further diagnostic work—for which more and better data is needed—is required in each country to better understand and act upon the binding constraints to inclusive growth in SEE6.** In-depth country analyses will contribute to identifying the key constraints to maximizing the income growth of the bottom 40 percent in each country. Furthermore, it will help better understand the interactions between

macroeconomic and microeconomic variables and how they affect the income-generating capacity of the bottom 40 percent. Finally, it will provide policymakers in the region and development partners with evidence to inform and support a policy agenda on increasing welfare gains for their whole populations in SEE6.

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**Table A1.** Logistic regression with correlates of being in the bottom 40 percent (individuals ages 15–64), marginal effects

	ALB–2012	BIH–2007	KSV–2011	MKD–2008	MNE–2011	SRB–2010
Age	-0.008***	0.003	-0.002	0.011***	-0.016*	0
	-0.002	-0.002	-0.003	-0.003	-0.007	-0.004
Age squared	0.000*	-0.000*	0	-0.000***	0.000*	0
	0	0	0	0	0	0
Female Household Head	0.040**	0.012	0.022	0.034*	0.044	-0.004
	-0.015	-0.012	-0.022	-0.016	-0.03	-0.014
Rural Settlement	-0.047***	0.084***	0.043***	0.061***	0.092***	0.090***
	-0.008	-0.008	-0.011	-0.011	-0.024	-0.012
HH has 5 members or more	0.291***	0.194***	0.202***	0.193***	0.215***	0.194***
	-0.008	-0.009	-0.013	-0.011	-0.024	-0.013
Share of children in the HH	0.375***	0.299***	0.487***	0.162***	0.188**	0.317***
	-0.023	-0.025	-0.033	-0.03	-0.069	-0.04
Share of elderly in the HH	-0.008	0.175***	0.048	-0.158***	0.15	0.093*
	-0.034	-0.03	-0.058	-0.042	-0.078	-0.037
<i>Labor Force Status</i>						
Employed (omitted variable)						
Self-Employed	-0.047***	0.003	-0.014	-0.070***	0.136**	0.02
	-0.014	-0.016	-0.029	-0.014	-0.047	-0.021
Unemployed	0.147***	0.134***	0.151***	0.117***	0.205***	0.232***
	-0.015	-0.012	-0.017	-0.016	-0.03	-0.017
Retired	-0.012	0.004	0.051	0.021	-0.078	-0.013
	-0.025	-0.021	-0.063	-0.027	-0.041	-0.023
Student	-0.067***	-0.089***	0.025		-0.03	-0.094***
	-0.017	-0.017	-0.024		-0.047	-0.024
Inactive	0.068***	0.033*	0.034*	0.048***	0.231	0.112***
	-0.012	-0.013	-0.017	-0.014	-0.166	-0.023
<i>Education</i>						
No Education (<1–4 years)						
	-0.108	0.241***	0.231***	0.264***		0.278***
	-0.105	-0.017	-0.042	-0.047		-0.061
Incomplete 5–12						
	0.079***	0.156***	0.097***	0.118***	0.076	0.147***
	-0.009	-0.011	-0.013	-0.011	-0.097	-0.014
Secondary (omitted variable)						
Tertiary	-0.137***	-0.241***	-0.155***	-0.138***	-0.188***	-0.209***
	-0.01	-0.016	-0.021	-0.017	-0.026	-0.015
N	17,361	16,399	8,395	11,049	2,270	8,696

Source: World Bank staff estimates based on ECAPOV Harmonization (ECATSD).











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