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EUROPEAN FUNDS FOR THE BULGARIAN AND ROMANIAN AGRICULTURE – WHAT IS IT ENOUGH FOR?

After the accession of Bulgaria and Romania on 1 January 2007 the EU increased by the size of Germany. The population of European Union increased by 30 million inhabitants. There is now an additional agricultural area of 16.8 million hectares, of which 11.5 millions are arable. Almost 83% of the new agricultural area belongs to Romania. Both countries use more than 50% of their total area in agriculture, which is much higher compared to the average of the EU-15 (40.6%) and the EU-27 (44%). 4.66 million farms joined the EU in the beginning of this year.

THE AGRICULTURAL SECTOR IN THE NEW MEMBER STATES

In Bulgaria, the agricultural sector plays a much more important role in the economy, than in the EU-15 countries, but also compared to the ten member states joining the EU in 2004. The contribution of agriculture to GDP is still above 15% (2% in the EU-15). Agriculture has an even bigger share in employment (26.2%), which is 21.9 percentage points higher compared to the average of EU-15. Bulgaria has a positive agricultural trade balance. Similarly to other former communist countries, during the transition period, the total value of agricultural production declined until 1996, reaching about 62% of the 1990 level. Between 1996 and 1999 agricultural production stabilized, or even increased up to 67% of the 1990 level. However, this positive period lasted only until 2000, when the production dropped again to the 1996 level. Both crop production and livestock production has fallen heavily since 1990, but livestock production still dominates over crop production. The average size of farms is 4.7 hectares, because almost 95% of farms are personal holdings producing for themselves, but not for the market. The most important agricultural products (based on their share of the value of agricultural output) are pork (around 16%), vegetables (14%), milk (12%) and cereals (wheat and maize – 12%).

Romania is in a similar position than Bulgaria. Agriculture contributed to 11.4% of GDP, and the share of agricultural employment in total employment is even higher than in Bulgaria, reaching 42.8%. It means that 30.9% of agricultural employment in the EU-27 takes place in Romania. Concerning agricultural trade, the country is in a worse situation than Bulgaria, as the increasing trend of agricultural exports before 1997 stopped, and export of agricultural products stagnated, while agricultural imports more than doubled during the last ten years. Agricultural output was stable, as it decreased only by 3.5 percentage points during the transition period. On the contrary to Bulgaria, crop production dominates over livestock production, having a share of around 50% in agricultural output. The average farm size amounts to only 2.67 hectares, as almost 40% of holdings cultivate an area smaller than 1 hectare, producing for own consumption. Besides cereals (16%) milk products (14%) are the most characteristic output of the sector.

Adding the agricultural output of the two new member states, they produce 6% of grain, 11% of oilseed, 3% of beef and poultry, and 1% of pork of the European Union's production.

EUROPEAN FUNDS IN THE COMING FINANCING PERIOD (2007 – 2013)

Concerning direct payments, the two new members have inherited the negotiation results of the 10 new members joining to the EU 3 years ago. Concerning direct payments, Bulgaria and

Romania will gradually phase in between 2007 and 2016. Direct payments will start at 25%, increasing by yearly 10%, until reaching 100% of old member states in 2016, three years later, compared to NMS-10. Bulgaria and Romania have also the possibility to top up EU direct payments to 55% in 2007, 60% in 2008, and 65% in 2009. From 2010, the top up can be maximally 30 percentage points above the applicable phasing in level.

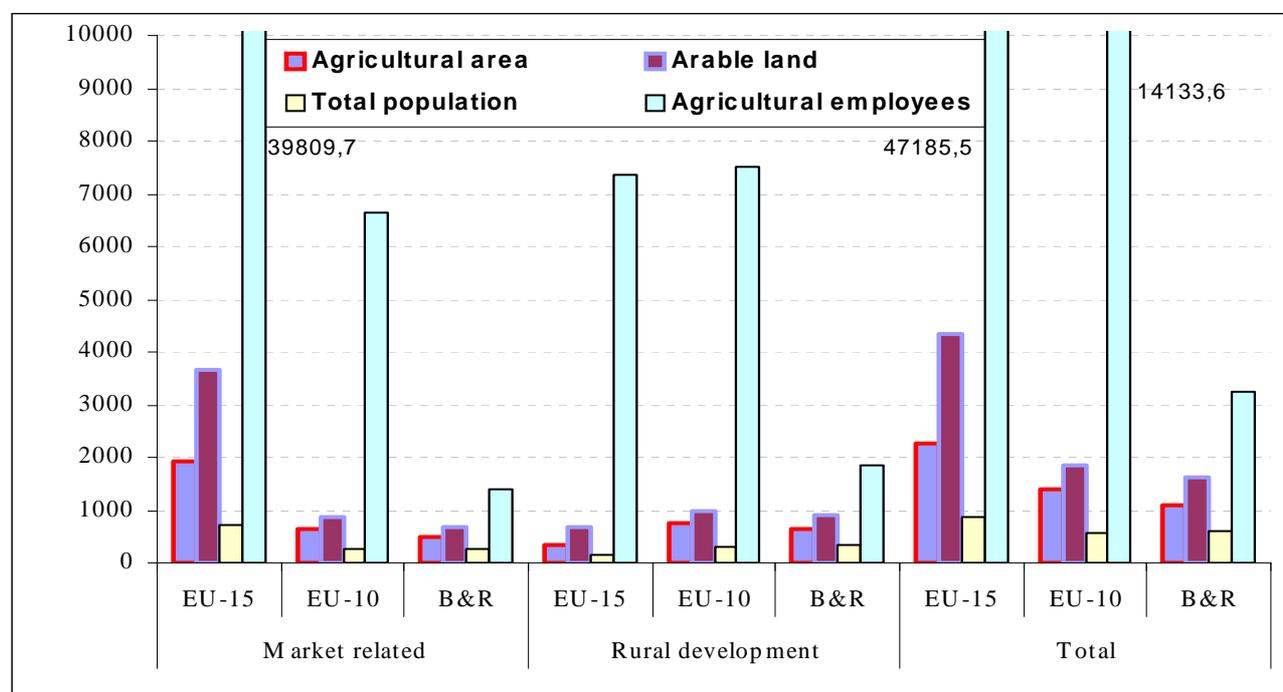
TABLE 1. CAP RESOURCES FOR BULGARIA AND ROMANIA IN THE FINANCING PERIOD 2007-2013 (MILLIONS OF EUROS)

	2007	2008	2009	2010	2011	2012	2013
Market related expenditure*	380	976	1075	1170	1261	1459	1648
Rural development							
Bulgaria	244	337	437	399	398	397	395
Romania	742	1023	1319	1236	1234	1235	1233

Sources: European Commission; *Bulgaria and Romania

Concerning rural development funds, the two countries receive EUR 10.6 billion in the coming seven years, which is in case of Romania (EUR 8 billion) the fourth largest rural development subsidy for a member state. The tendency of rural development subsidies is the same as in the case of NMS-10, it is relatively stable, while the amount of direct payments will increase in this financing period. The relative change in the proportion of rural development subsidies in total subsidies aims to reach an equal share of rural development funds in each member state by 2013. Based on the absolute numbers the two new members seem to have equal positions compared to NMS-10.

CHART 1. RELATIVE EUROPEAN SUBSIDIES IN THE TWO NEW MEMBER STATES, 2007-2013



Source: European Commission and own calculations

However, having a look at subsidies (for the period 2007-2013) per 1 hectare agricultural area, per 1 hectare arable land, per capita and per agricultural employee, the situation is quite disappointing for the new members (Chart 1.). In case of market related expenditure, Bulgaria

and Romania are only slightly behind NMS-10, as they receive 72% and 79% of the subsidies per one hectare agricultural area and one hectare arable land respectively. Comparing market related expenditure divided by total population, the two countries receive even a bit more, than the countries of the previous enlargement. The gap between EU-15 and Bulgaria and Romania is extraordinary big, as Bulgarian and Romanian farmers are eligible only for a fraction of direct payments granted to EU-15 farmers. Concerning rural development funds, the gap between NMS-10 and the two new member states is smaller, (15 and 6 percentage points per one hectare agricultural area and one hectare arable land) and receive more than EU-15 countries.

WHAT IS IT ENOUGH FOR?

The answer to this question should be based on the last aspect of relative EU subsidies, subsidies per agricultural employee. As in Bulgaria more than a quarter of the population and in Romania almost half of the population is employed in agriculture, European subsidies are lagging behind concerning this aspect. Total agricultural subsidies per agricultural employee amounts to EUR 3262,8 in the two new member states, which is only 6.9% of the EU-15 average and 23% of NMS-10 average.

The subsidies planned for the period of 2007-2013 are significant, comparing to the income situation of Bulgaria and Romania. But it will not be enough to modernize the whole agricultural sector of these countries, because of the huge rural population. Thus, the Bulgarian and Romanian government has to decide, whether those farms having an area smaller than one hectare and producing for their own consumption, or for having a small, but additional income source, should be treated as targets of the agricultural policy or as targets of social policy. In case funds from the CAP will be sent on farms, being able to become competitive, European subsidies could boost the modernization of the agricultural sector, which could close the gap to the EU-15 in a few decades. Without a focusing, consequent agricultural and rural development strategy, the sector and rural areas will remain far away from the dream of becoming as viable as EU-15 countrysides.

KOSOVO - DIVIDED AND ECONOMICALLY BACKWARD

Although Kosovo's future is still uncertain, by reviewing the developments of international politics, an independent Kosovo can be expected. Moreover, in most aspects the province is already de facto independent. Albanians in the province would not accept any other solution than full independence, while Serb politicians have just the opposite opinion.¹ No doubt that there would be potential danger as a consequence of independence, but it must be emphasised that recently 16 000 troops are deployed in the province and leading Serbian or other countries' politicians are not threatening with the possibility of military actions. The international community, the countries of the region (and Europe in a wider sense), the Security Council are all politically divided in the question of Kosovo, influenced by their own minority issues, and political and economic interests. Let us now assume that sooner or later Kosovo will gain its independence, and take a view at the province's economy, its potentials and give some relevant background information.

BASIC INFORMATION ABOUT THE INSTITUTIONAL SYSTEM

Different scenarios and plans emerged since 1999, but the future status and structure of Kosovo is still uncertain. The delay of the final status of the province sets back economic development and increases the tension among the ethnic groups.² Riots and protests already took place, so security remains a substantial issue and will need to be supported by international forces in the future as well.

Step by step Kosovo is becoming a functioning state, with its own central bank, ministries, local governments, etc. Institutions have been gradually built up and partly the power has been shifted to the local people, but the main power remains at the United Nations Interim Administration Mission in Kosovo (UNMIK). Kosovo is administered by the UNMIK, which is headed by the Special Representative of the Secretary-General for Kosovo. Recently four pillars guide the implementation of UNMIK's mandate:

- Pillar I: Police and Justice (led by the UN)
- Pillar II: Civil Administration (led by the UN)
- Pillar III: Democratization and Institution Building (led by the OSCE)
- Pillar IV: Reconstruction and Economic Development (led by the EU)

Even if Kosovo will gain its so called independence, it won't be sovereign in full sense, since in some form the international community will support and supervise the state institutions (like for example in Bosnia-Herzegovina), and the number of deployed troops will be cut only gradually, depending on the state of security. According to the "Ahtisaari plan", an EU mission would replace the UN's, and it would have significant power over Kosovo's government.

¹ Serbia's Ministry of Foreign Affairs has the following view about Kosovo's potential independence: "Advocating a compromise, consensual solution to the future status of Kosovo-Metohija, the National Assembly of the Republic of Serbia emphasises that imposed independence of the province will have unforeseeable negative consequences. Such an outcome will have far-reaching consequences on the stability of the region, impede the European perspective of the entire Western Balkans and present an extremely dangerous precedent for resolving minority issues and territorial disputes throughout Europe and the world." (http://www.mfa.gov.yu/Facts/resolution_kim_aht_e.html)

² According to the UN, Kosovo's population is approximately 1.9 million, around 90% Albanian, 6% Serb, 2% Muslim Slavs, 2% others (Roma, Turks, etc.).

Kosovo's leading politicians have already stated that their goal is integration into the EU, thus EU standards are being taken over and the province is part of the Stabilisation and Association Process (SAP).

... AND ABOUT THE ECONOMY

In Kosovo the typical transition and post-war symptoms are still present, with its unrestructured or closed companies, outdated technology, etc. The province has the lowest GDP level in the region, GDP per capita is only around EUR 1 100, and although in 2004 GDP growth was recorded, the economy can be characterised by stagnation. (See Table 2. for macroeconomic indicators.) Moreover, Kosovo shows the macroeconomic problems that can be considered typical for South-Eastern Europe, namely the trade deficit and the unemployment. As a consequence of the basic problems, unemployment is pervasive. Although data are unreliable, unemployment is estimated to range between 35 and 50%, without taking into consideration the grey economy, and youth unemployment is probably even higher.

As a result of the fact that production in Kosovo is lacking, and small-scale trade and family businesses dominate (mainly in the trade sector), trade balance performs very high deficit, and exports only cover around 6% of the imports. Exports of Kosovo are around EUR 30 million. Bilateral Free Trade Agreements are being negotiated by the UNMIK and a regional free trade zone is starting to develop, but until Kosovo does not produce goods for the international market, mainly this may only cause the decrease of customs revenues (the general tariff rate is recently 10%, while for exports it is 0%). Trade deficit is partly compensated by the diaspora's remittances and foreign aid. The large group of non-residents also supports the economy with their consumption, which is over EUR 100 million. On the other hand we must note that the amount of remittances, aid and the number of foreign employees has been declining, signalling further economic difficulties in the future.

All these facts hint that Kosovo is aid dependent. Kosovo received and receives financial support from various international institutions. Also the IMF supported the province, although special circumstances were needed, due to the fact that Kosovo is not a member of the IMF, since officially it is not recognised as a country. According to the UN, the cost of reconstruction and recovery between 1999 and 2003 was approximately USD 2.34 billion, while the contribution from the international community between 1999 and 2004 reached EUR 2.76 billion. 35% of the aid was donated by the EU and 13.5% by the USA. Donor commitments for 2006 reached EUR 169 million, while in the previous year it amounted to EUR 241 million. In 2006, EBRD lended EUR 17 million and EIB EUR 20 million in order to support the development of Pristina International Airport and of the financial sector.

Inflation can be considered low. As far as the monetary issues and the financial sector is concerned, after the war institutes like the IMF had to face the fact that there was a lack of financial infrastructure with no central bank or other banks. Step by step the financial sector, the regulatory and supervisory framework is being built out, and the Banking and Payments Authority of Kosovo (BPK) gradually shifted into a de facto central bank and has been transformed in September 2006 into the Central Banking Authority of Kosovo (CBAK), handling all the regular functions. CBAK regulates and supervises six banks and eight insurance companies, pension funds, micro finance institutions, etc. Kosovo uses euro as its currency. The banking sector is growing in all terms. For example the use of credit cards is increasing, but Kosovo is still quite much cash-oriented.

TABLE 2. MACROECONOMIC INDICATORS OF KOSOVO, 2002-2005

	2002	2003	2004	2005
Real GDP growth (%)	-2.9	-1.4	3.7	-0.5
Inflation (%)	3.6	1.6	-1.6	1.9
M2/GDP (%)	41.0	42.6	44.9	47.6
Bank assets/GDP (%)	19.3	24.0	31.8	39.2
Deposits of the private sector (% of GDP)	16.7	20.5	20.1	34.1
Credit to private sector (% of GDP)	3.5	9.6	14.9	20.9
Foreign aid inflow (millions of euros)	215.98	169.75	100.56	n.a.

Source: BPK, IMF, MEF, RIMS

Among the main problems that enterprises and potential investors must face is the poor infrastructure and a very problematic energy supply system. The educational system also needs to be improved, because there is lack of skilled workforce. Corruption is widespread. Unfortunately landmines are still scattered over Kosovo, including the agricultural and industrial areas. A small and relatively poor market may also be a disadvantage, even if we can speak of a so called pan-Albanian market with 6 million consumers. It is important to note that until the status of the province is uncertain, there will be a lack of investments.

OPPORTUNITIES AND SUSTAINABILITY

A key issue is the sustainability of Kosovo, which can be supported by certain opportunities. The province inherited mines and factories from ex-Yugoslavia, but in many cases these are closed or inefficient, thus large financial investments are needed to help these companies function again. The former Socially Owned Enterprises (SOEs) have already started to be privatised by the Kosovo Trust Agency (KTA), and the first success stories appeared. These SOEs range from mining, wineries, construction companies, glass production factories, warehouses, etc. Kosovo is trying to attract investors by business friendly environment, which is incorporated by one of the lowest tax rates in the region. VAT rate is 15%, but 0% for certain agricultural goods and personal income tax rate is between 0 and 20%.

Certain opportunities ought to be named. In case the infrastructure will be further developed, the province can function as a major crossroad in the region. Kosovo has very good attributes for the agricultural sector, which gave around one third of the GDP in 1995. The province has abundance of raw materials and natural resources. For example large amount of lignite reserves that can be exploited in surface mines, but Kosovo has zinc, lead, copper, nickel, etc. as well. Electric power, mining, metallurgy, construction materials, agriculture are named as priority fields, and recently tourism is also starting to gain attention.

Further institutional development is needed, although due to the activity of the international institutes, the background of a functioning state and a market economy is being laid down. At certain sectors a broad regional integration may underpin development. It goes without saying that the financial assistance of international donors will remain inevitable in the near future, but aid dependency ought to be altered by foreign investments. However, as noted before, many problems and hazards are present that gradually must be eliminated or handled.

THE INSTRUMENT FOR PRE-ACCESSION ASSISTANCE (IPA)

The beginning of 2007 meant automatically the end and termination of the three financial instruments for pre-accession process, namely PHARE, ISPA and SAPARD; of the Turkish pre-accession assistance and of the CARDS, which was inspired to support the Western Balkan countries in the process of the accession towards the European Union.

Tasks and responsibilities they included are implemented into the new, contracted and common IPA (Instrument for Pre-Accession Assistance), which came into force on 1st January, 2007, and extends on the candidate countries (Croatia, Macedonia and Turkey) and on the potential candidate countries (Albania, Bosnia-Herzegovina, Montenegro, Serbia including Kosovo) for the period 2007-2013. According to EC representatives, the goal is to modernise pre-accession assistance and place it in a single framework and single regulation, but the IPA instrument is also meant to 'rationalise and simplify procedures and improve coherence and co-ordination of the activities undertaken'.

To summarize the IPA's main objectives, they are to support "*institution-building and the rule of law, human rights, including the fundamental freedoms, minority rights, gender equality and non-discrimination, both administrative and economic reforms, economic and social development, reconciliation and reconstruction, and regional and cross-border cooperation.*"

The Instrument for Pre-Accession Assistance makes up of five main components, from which the last three is available only for the candidate countries. Their main objective is the preparation of the introduction of essential "handling" structures and the familiarization of structure of the structural funds. The elements are the followings:

1. Transition Assistance and Institution Building. It relates to assistance and activities in the areas of the institutional development, investments in harmonisation with the European legislation, building administrative and judiciary capacity as well as other measures not covered by the remaining components.
2. Regional and Cross-Border Cooperation
3. Regional Development, which is designed to prepare the countries for the implementation of the Community's cohesion policy, and for the European Regional Development Fund and the Cohesion Fund
4. Human Resources Development, which element regards preparation for cohesion policy and the European Social Fund
5. Rural Development, which is concerned with preparation for the common agricultural policy and related policies and for the European Agricultural Fund for Rural Development (EAFRD).

The main explanation of the separation of components according to the status of certain countries is coming from difference of economies' and governments' preparedness for accession. With using the assistance of the last three elements the candidate countries is preparing for full implementation of the *acquis communautaire* of the European Union at the time of accession, while the potential countries are under the pressure to adopt by degrees the Community *acquis*. But the separation does not mean that the potential countries cannot access to arrangements provided to candidate countries. They can use Community funds for

Regional Development, Human Resources and Rural Development as well, but only 'within the framework of the first two components' and in decentralised way.

Initially, the EC had projected EUR 14 billion for the region in the framework of IPA, but the adoption of the EU 2007-2013 budget made it clear that the amount cannot be higher than about EUR 11 billion for the next seven years.

'Divided by years and per capita, that amounts to 13 euros annually. The countries in the Central and East Europe that joined the EU in 2004 received 27 euros per capita annually', the daily Dnevnik said, citing Istvan Szent-Ivanyi, a European MP from Hungary. According to the present conception about the volume of the assistance the European Union (especially the European Parliament) may increase the amount to the level to 20 Euros per capita in the future. The next table shows the Pre-Accession Assistance envelopes for 2007-2009 in Euro million:

**TABLE 3. PRE-ACCESSION ASSISTANCE ENVELOPES FOR 2007-2009
(IN EURO MILLION)**

	2006	2007	2008	2009
Croatia	140	138.5	146	151.2
Macedonia	43.6	59.5	70.2	81.8
Turkey	500	497.2	538.7	566.4
Albania	45.5	61	70.7	81.2
Bosnia and Herzegovina	51	62.1	74.8	89.1
Montenegro	59.3	31.4	32.6	33.3
Serbia	19.5	186.7	190.9	194.8
Kosovo	167	63.3	64.7	66.1
TOTAL	1024.1	1099.7	1188.6	1263.9

Source: SEERECOM

The implementation of IPA's measures and assistance is anchored through annual and multi-annual programmes. All programmes are compiled to answer the documents with multi-annual plans, which means, that the Commission has presented the main objectives and priorities for each countries in a three-year strategy document.

The European Parliament has the right to initiate the suspension of the assistances by the Commission, or vica versa (set them back), if it is justified by the 'behaviour'" of the beneficiary country.

The main objective of the European Union regarding the South East European countries is to help in the fields of peace, stability, prosperity and freedom. For the last decade, the EU has been at the forefront of efforts to make this aim a reality.

The continuation of the enlargement process is the historical task and responsibility of the European Union. The role of IPA is in this procedure to ensure assistance for the candidate and potential candidate countries to achieve the terms of the accession. It is a further responsibility to associate to these objectives adequate budget funds. The plan of the EU's budget was not liberal to the IPA, but the concerned are confident that the supervision in 2008/2009 will give a chance to the correction.

STABILISING LABOUR MARKET IN BULGARIA

Positive trends of 2005 continued in the Bulgarian labor market in the previous year. Employment increased by 61.7 thousand during this period resulting in higher activity rate. The unemployment rate decreased by 1.2 percentage points to 8.9% and long-term unemployment showed a decreasing trend as well.

TENDENCIES OF EMPLOYMENT AND UNEMPLOYMENT

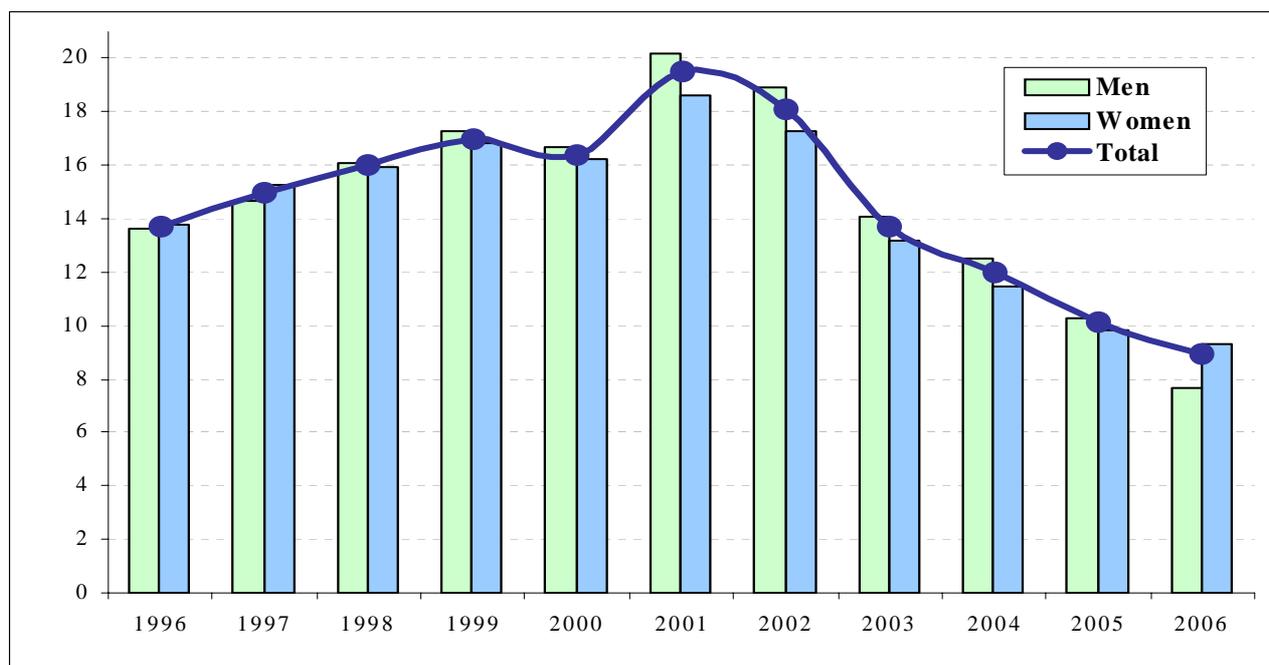
After the shock of the transition period Bulgaria seems to be on the way of recovery concerning employment and unemployment. Unfavorable external conditions combined with the low speed of restructuring and privatization led to a decrease of 37.7% in employment between 1989 and 1999. The lowest employment was reached in 2001 (2702 thousand) and since then employment increased at a slow pace. Employment of the third quarter of 2006 meant a 3.3% growth compared to the same period of the previous year and being the second highest after the initial employment level (4366 thousand) of 1989. The employment situation of men and women is quite similar, however, employment of women grew by 4.4% which is 1.9 percentage points higher compared to the growth of the number of male employees.

The sectoral changes of employment followed the restructuring of the economy, however this process was rather slow. The only sector experiencing a decline (also) in the number of employees was the secondary sector, as the share of industry from total employment decreased by 18.5 percentage points to 26.2% between 1989 and 1999. Thanks to faster economic growth the share of the secondary sector increased to 34.6% by the end of 2005 and remained at that level in the last year as well. The share of agriculture in total employment experienced an 8 percentage point increase in the first ten years after the change of regime. Since then the proportion of the primary sector in employment is stagnating. The tertiary sector remained underrepresented compared to the average of the EU, as it reached 47% by 1999 and grew only by three percentage points until the third quarter of 2006.

Large scale unemployment (over 20%) was an unknown problem before the transition. Huge number of unemployed meant high social expenditure for the budget, which had to make restrictions on the entitlement to receive unemployment benefit. The unemployment rate reached its peak in 1993 (21.4%) and has been stagnating since then. 2003 can be considered as a turning point. Strong economic growth facilitated not only employment but contributed to a significant decrease of the unemployment rate as it fell by 4.4 percentage points. In the first quarter of 2006 the proportion of unemployed has become a one digit number for the first time since 1989. The dynamic decrease of unemployment seems to continue as the rate dropped by 0.9 percentage points between the first and third quarter of the previous year.

Interestingly female unemployment has been lower in the last eight years before 2006. The reason for the higher number of male unemployed is the continuing privatization process and job reduction in sectors where male employment prevails (mining, chemicals, some manufacturing branches). There were more women among unemployed in the beginning of the transition period when industries such as textiles, food, clothing or tobacco faced privatization.

CHART 2. UNEMPLOYMENT RATE IN BULGARIA 1996-2006



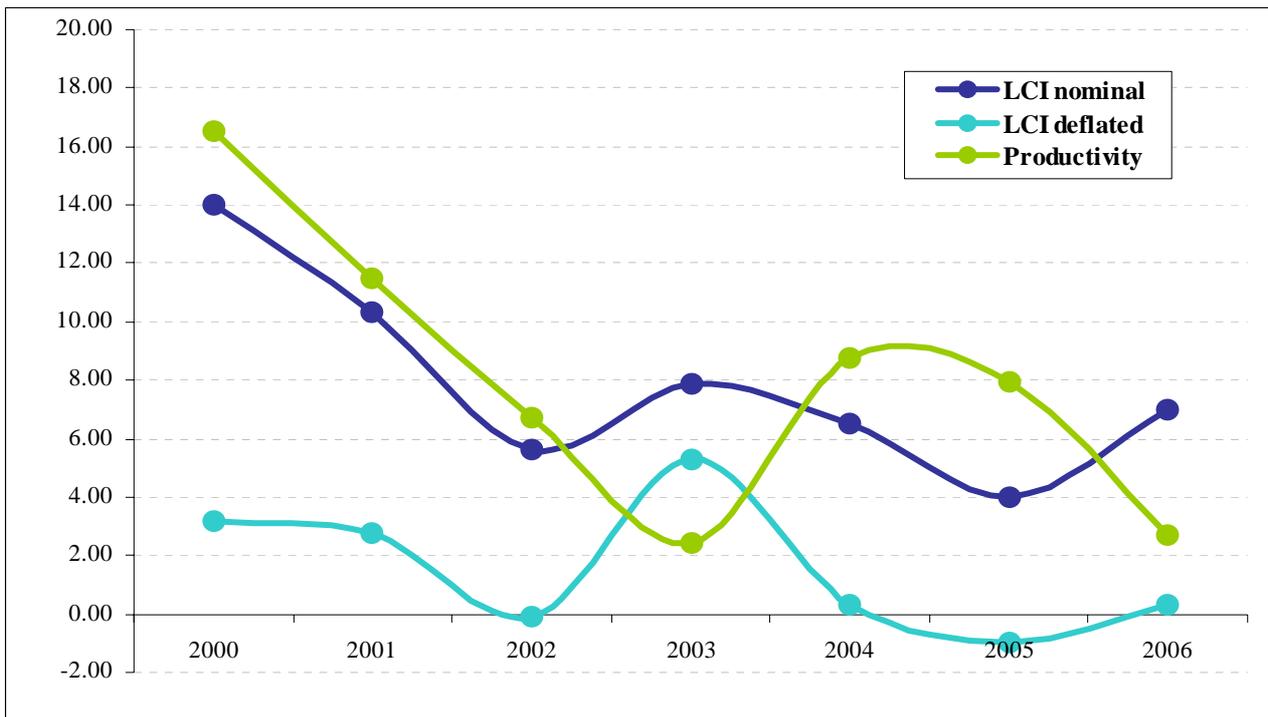
Source: Eurostat

Long-term and youth unemployment are still the biggest problem in the Bulgarian labor market. 56.4% of unemployed did not have a job for more than a year in the third quarter of 2006, which is a 5.5 percentage point decrease compared to the same period of 2005. Although long term unemployment is on a backward trend, it will remain a serious problem in the coming years. Youth unemployment has been significantly higher than adult's unemployment. 35.5% of people aged 15-24 were unemployed in 2002. The situation of this age group eased by the third quarter of 2006 since youth unemployment dropped to 19.4%. Although youth unemployment declined significantly in the last 4 years, the rate is still twice the rate of total unemployment.

WAGES AND LABOR COST

Changes in real wages depended mainly on inflation in the first ten years of the transition period. The increase of nominal wages were a kind of compensation for inflation, thus it was not fully determined by labor demand and supply. Because of inflation peaks, real wages decreased by more than 17% in 1991, 1994, and between 1996 and 1997. Declining wages meant reducing labor costs, which decelerated the adjustment of companies to economic conditions, maintaining a bad employment structure. Real wages have been growing since 1998. Positive economic tendencies appeared in wages as well, as the annual growth of real wages reached 10% in 2005 and 2006.

CHART 3. LABOUR COST AND PRODUCTIVITY 2000-2006



Source: Bulgarian National Statistical Institute

Labor productivity is relatively low, amounting to EUR 6541 (GDP/employee), which is only 33.8% of the EU25 average. In the previous year productivity of the Bulgarian labor force grew by 3%. Average labor cost was approximately EUR 3000 less than GDP per employee in 2000. Comparing productivity growth with labor cost index, the deflated labor cost index remained below the growth rate of productivity since 2000, except for one year. Thus, labor has been getting relatively cheaper. Additionally, the large proportion of shadow economy in Bulgaria helps to keep labor costs low.

EXPECTATION

Because of the slow transition process and the long recession period, passive and active labor market policy had only limited possibilities to compensate the negative effects of negative economic processes. The passive labor market policy became more and more restrictive concerning criteria for benefit entitlement. Thanks to buoyant economic growth, conditions are now favorable for active labor market policy measures such as job creation schemes, self-employment promotion, job creation in regions with high unemployment rate, programs for increasing labor force mobility, training and retraining, special programs for youth, early retirement, public work etc. With the help of these measures the Bulgarian government could benefit more from the favorable economic conditions and facilitate the structural changes on the labor market. In case of continuing economic growth and a successful labor market policy activity rate could reach the EU average 70% and unemployment could be rolled back to 5% in the coming 4-5 years.