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# **ASPECTS OF THE LABOUR MARKET IN THE ALBANIAN TRANSITION A QUALITATIVE AND QUANTITATIVE APPROACH**

**Hasan Mytkollli**

Dep. of Statistics, Mathematics and Applied Informatics  
Faculty of Economics, University of Tirana, ALBANIA

**Stefan Qirici**

Dep. of Economics  
Faculty of Economics, University of Tirana, ALBANIA

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## **ABSTRACT**

In this paper, we study the new phenomenon for the Albanian society, unemployment. The inefficiency of the communist system brought the country into an economic and social collapse at the end of the 80's. This collapse caused an explosion of unemployment, which caught high quotes of more than one third of the labour force. We study the causes of such a burst and at the same time we carry out a statistical analysis of the problem using a two-sided strategy to prove for stationarity. We conclude that this phenomenon suffered from the strong form of the persistence-hysteresis.

## **KEYWORDS:**

ALBANIA, UNEMPLOYMENT, HYSTERESIS, UNIT ROOT

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## **1. UNEMPLOYMENT-A NEW AND COMPLEX PHENOMENON IN THE ALBANIAN SOCIETY**

In this study we are going to deal with some of the main features of unemployment in Albania during its transitional period. These problems, in a general frame, are similar to those in other ex-communist countries. However, due to the specific conditions of Albania there are many fluctuations of these features in the real ground of the Albanian economy.

First, we study labour relationships in Albania during the communist regime. This problem seemed to be quite alike with those in other ex-communist countries. The Albanian official data indicated quite a healthy economic picture before 1990. Unemployment and inflation were officially non-existent. The cardinal goal of its employment policy was to acquire full employment, whatever the cost. To achieve that, Albania pursued a strategy of a rapid industrial growth that was facilitated by largely assured markets and supplies, including credits and other financial subsidiaries by the ex-communist countries, especially from the USSR and China.

However, this kind of solution was more political, than an efficient and economic one. A total analysis of the labour market during this period (low productivity, rather equal wages, political administration and management, etc.) depicts that there was an inefficient usage

and allocation of labour force and other sources of production in this period. This analysis also clears up, the total falsity of the concept of the full employment policy in socialism.

In the 1980's, Albania came to a state of total isolation, which cut down credits and other aids from ex-communist countries and soon the economy seemed to slash down. A system of 80% awarding (1988) was used to all state-owned enterprises that did not work because of the failure of the raw materials. In reality, it was an effort to hide the bursting of unemployment and the impossibility of the survival of the communist economy. This caused a sharp rise of unpublished inflation and hidden unemployment.

The first signs of unemployment came about in the late 1980's, when many people (especially those with some form of schooling) were told to work in mines or in agriculture. These two sectors were overpopulated so they were unproductive and the flow of the labour force increased its burden on the total economy. Officially, these people were not treated as unemployed.

In this time a slight rise of the prices of some services and commodities was allowed, which was the first sign of the official acceptance of the inflation throughout all the 45 year history of the communist regime.

The end of 80's indicated the collapse of a centralized and planned economy and the emergence of political and economic changes. Albania began its transition from a more unfavorable starting position compared to Hungary, Czech Republic, Poland or other Eastern European countries and it was the last country entering the way of market economy. The collapse of the old system was accompanied by a drastic fall of GDP (respectively 10% in 1990, 29.9% in 1991, 10% in 1992). A great number of the state owned enterprises came out of functioning and some of them came to a close. At the same time the cooperative system in agriculture was destroyed and the state owned agricultural enterprises were only officially still alive. Between many other outcomes of this collapse, we can count two, which by our opinion have a great weight in the problem that we are dealing with: unemployment and inflation.

They appeared simultaneously in the reforming Albanian economy. By its character the unemployment of this period in Albania is above all a recessionary one. Soon, the other kind of classical unemployment came to the scene of the Albanian labour market, but it is difficult to point out their real numerical effects.

The new epoch in Albania started with the total change in ownership in agriculture (1991). The outcome of this reform was that, all the labour forces from cities and towns, that used to work in agriculture, became unemployed and contributed to the rise of the rate of unemployment.

Foreign goods substitute those being traditionally produced inside.

In 1992 the stabilization reform started in the Albanian economy. At the labour market, the system of 80% awarding was put off, many enterprises closed down, so the number of the unemployed people rose drastically. A huge migration of the labour force left the country and went to the neighboring countries.

The reasons for such a huge migration are so many, but we can point out some of them:

1. The difficult economic position of most Albanian families on the eve of the new economic system.
2. There was a great gap in the level of the wages in Albania and in neighboring EC-countries, such as Italy and Greece.
3. Albania was in a good geographic position, which favors an easy migration to Italy,

especially to Greece.

4. A large part of the people that were unemployed had no possibility to get a job in Albania because of the collapse of the economy. Furthermore, these people did not see any sign of a near improvement on the horizons of the employment affair.

This massive migration was one reason for the relatively low rate of unemployment in these years of transition in Albania (it is worthy to remember that the economy of the country in that time was rather paralyzed). After 1992 a system of 40 hours/week was going to be partly applied. At the same time the government allowed those persons who wanted to retire before they reached the age of retirement to get half a pension. The number of the pensioners in 1993 came to the quote of 313172 for the state owned sector and 157215 for the agriculture sector. The services were underevaluated in the socialist system. This was the reason for the boom in this sector in these three years of transition (1992-1995). All these above mentioned factors (passive actions in the labour market), created more possibility for employment relaxing in this manner the sharp problem of unemployment.

But, if we take under consideration that about 60% of the Albanian population is still living in the country, then we can expect continues flow from the country to the cities. The services sector is not able to withdraw all this flux and the huge investments are still a subject of rumors. These factors will cause a negative influence in the labour market for a long period.

The phenomenon of the double numbers of the rate of unemployment was crucial and needed to be cured (the rate of unemployment was 9% in 1991, it rose to 27% in 1992 and came to 22% in 1993, 18% in 1994 and 12% in 1995). The persistence of high unemployment and the relatively poor employment performance is a characteristic of this period of transition in Albania. The first step of the government in this aspect was the introduction of a system of compensation for those people that have no other financial sources to survive. Thus, for the first time in Albania were created the Ministry of Labour, Emigration and Social Protection and Labour Offices were created to support the Local Government.

The established state system of service related to employment and the introduction of passive and active measures against unemployment are new for Albania, but strategically similar to those applied in the other countries of Eastern and Central Europe during the period of transition. Anyway, if we consider the different starting points of the transition period, different ways following to carry out the economic reform, different economic positions in the starting of these reforms and finally specific factors occurring in each country, we will find different applications of these institutions in Albania and in other EEC-countries.

Widening of wage differentials, the emergence of persistent unemployment, point to greater flexibility in the labour market. The labour market is and will be in the future under the pressure of the changes in macroeconomic policy, changes in GDP and in capital markets.

As the process of economic reform and industrial restructuring continues, there will be further painful labour market adjustments. The mobility of the labour force by the geographic and professional point of view is still a serious problem for Albania. The economic conditions are still forcing people to leave the north-east of Albania, especially the rural zones and to move toward the most civilized and developed areas such as Tirana, Durres and other districts of the central and southern regions of the country. If we will bear in mind that these urban centers have their acute problems in employment, then it is clear that the stabilization of this problem will be postponed in a not quite near future.

Labour market policy is not an aim in itself and it can not be isolated from its macroeconomic

context. Therefore it is indispensable that the problems of the battle against unemployment must be examined closely with other macroeconomic problems. Complex policy measures are needed, when considering the structural distortions of the labour market.

Unfortunately, the recent decline in the rate of which people became unemployed has been accompanied by a relatively small percentage of the unemployed finding jobs. As a result, the average duration of unemployment has increased and a lot of people became long-run unemployed. Data from INSTAT indicates increase in the number of the long-run unemployed from 64 500 in '93 to 80 000 in '94 and 73 000 in '95. This situation could result in large losses of human capital, because of depreciation of skills, and difficulties in finding a new job.

From that situation emerged the necessity to introduce a new set of labour market policies, including a combination of passive and active measures. A general indicator of the present situation of unemployment and of the success of the applied policies is the rate of unemployment.

## **2. PERSISTENCE, HYSTERESIS AND INTEGRALITY OF THE RATE OF UNEMPLOYMENT**

The analysis of the rate of unemployment is quite related with the notions of the trend relating to consistency and integrality of time series. To have a general idea, we will present shortly, the core of these two concepts.

The trend stationary processes (TS) are those that can be presented by the following equation:

$$y_t = \alpha + \beta t + \varepsilon_t \quad 1$$

where  $\varepsilon_t$  is a white noise process.

On the other hand for the integral process (DS), we will consider only one process which can be presented by the following equation:

$$y_t = y_{t-1} + \varepsilon_t \quad 2$$

We can suppose that our study is concerned with a fixed time, let's say  $t=0$ . Allowing for an intercept,  $b$ . By subsequent substitutions in equation (2) for  $t=1, 2, \dots$  we can take a similar view of this equation to equation (1):

$$y_t = y_0 + \beta * t + \varepsilon_t \quad 3$$

$$\text{where } \varepsilon_t = \sum_{i=1}^t \varepsilon_i$$

Even though (1) and (3) look alike they have two essential differences:

1. The intercept term in (1) is a constant, where in (2) it is to be generated by a random walk. It reflects all the history of the process up to the starting time being under consideration.
2. The residuals of (1) are i.i.d., where those of (2) are correlated.

There are many tests, which can validate and prove consistency or inconsistency. The more commonly used tests are those which look for the existence of the unit root in time series being observed. Among them we can underline ADF and Philips - Perron tests.

Another way to judge for the TS or DS is using the KPSS test that has as null hypothesis the trend of consistency against the alternative hypotheses which states the existence of a unit root. As this test is not as common as the two above mentioned tests we are going to define it in more details. If we set  $\overline{\sigma^2}$  for the evaluation of the variance of the residuals of the equation (1) and  $\hat{\sigma}^2$  for the evaluation of the variance of the residuals of the equation (3), then this test makes only the comparison of these two variances:

$$\eta_t = \frac{\hat{\sigma}^2}{\overline{\sigma^2}} * \frac{1}{t^2}$$

The critical values are tabulated by its authors and can be found at Kwiatkowski and al... , (1992)

A number of studies have explored the problem of unemployment using one or another from the above mentioned tests. We are going to apply a double way strategy using both tests: augmented Dickey-Fuller and KPSS test.

The problem seemed to be related with the concept of persistence and hysteresis on time series. The way of incorporating the unemployment persistence on the Philips-curve model is to write the inflation equation as follows:

$$P_t = a_0 - a_1 u_t + a_2 u_{t-1} + W_t - Z_t \quad 4$$

From the traditional Philips curve model we know that :

$$P_t = A - R U_t - Z_t + P_t^e \quad 5$$

where  $u_t$  stands for the rate of unemployment,  $W_t$  stands for the wage,  $Z_t$  for the rate of the growth of GDP,  $P_t$  for the rate of inflation and  $P_t^e$  for the expected rate of inflation, all at time t.

If we allow for the persistence of the previous unemployment it will take the shape:

$$P_t = A - R U_t + I U_{t-1} - Z_t + P_t^e \quad 6$$

where  $I$  - inertia parameter of inflation.

$R$  - responsiveness parameter of inflation.

We know that in short run ,  $P_t = P_t^e$ , so we can write:

$$U_t = \left( \frac{A - Z_t}{R} \right) + \frac{I}{R} U_{t-1}$$

or:

$$U_t = U_0 + \rho U_{t-1}$$

Coefficient  $r=I/R$  is called the "total unemployment persistence coefficient".

In the case where  $I = R$  we have the drastic situation which is called hysteresis and has been studied in many issues such as Blanchard and Summers (1986 and again in 1987), Franc (1990), Nelson and Plosser (1982). Their conclusions are contradictory: some of their conclusions trend consistency in the rate of unemployment, others conclude the presence of hysteresis. Perron (1988) did not analyze the presence of unit root in the series of unemployment because of his belief that this kind of series could not be DS, Nelson and Plosser found that the unemployment rate series was the only one to reject the unit root hypothesis. Blanchard and Summers (1986, 1987) and Franz (1990) have treated the problem of hysteresis theoretically, where Mitchell (1993) has gotten support for the presence of hysteresis working with the series of the rate of unemployment from the OECD countries.

### **3. EMPIRICAL RESULTS.**

Data being used in this study are monthly and have been taken from INSTAT, Tirane. They cover the period of transition in Albania: 1993-1995.

We choose the two-way procedure to prove for TS or DS in the unemployment data for the Albanian economy. The first-way that has been used frequently in such situation is to look for unit root. We use the ADF test looking for  $d$  to be 1 in the following equation:

$$y_t = \alpha + \beta t + \delta y_{t-1} + \sum_{i=1}^p \rho_i \Delta y_{t-i} + \varepsilon_t$$

which allow for correlation on residuals.

Even from its autocorrelation function it looks that our series suffer from unit root. However, we run the ADF test whose results are reported in Table I and prove that we are in conditions of the presence of at least one unit root, which is good enough for the presence of the strong form of persistence-hysteresis.

The other way to be run out was the KPSS test. The statistical value-7.6694 is clearly far from the critical value-0.041. This is one more reason to believe that our conclusion derived from the ADF-test was quite correct and the rate of unemployment for Albania in transition suffers from hysteresis.

### **4. CONCLUSIONS**

In this paper we are trying to present a picture of unemployment in Albania during the transition period. First of all we study some of the factors that caused the total collapse of the old system, which are related with the bursting of unemployment in 1990. We conclude that this boom of unemployment is a direct result of the accumulations under the communist regime. The collapse in Albania in 1990 resulted, above all in a recessionary unemployment.

Economic reforms that started in 1992 gradually created the conditions for a better performance in the labor market. The rate of unemployment has gone down, but it is still in the level of double-numbers. A great role in this decline of unemployment was played by the service sector. Anyway, this sector is unable to attract the unemployed and those who will be unemployed. The absence of the investments in the main sectors, such as infrastructure and manufacturing is one of the main reasons for a high rate of unemployment.

New institutions were created to relax these hard phenomena for the Albanian economy, but

their performance still indicates a need for radical improvements in active and passive policies.

The statistical analysis calls for the presence of the strong persistence-hysteresis in the rate of unemployment, which is a sign on the open horizons for better macroeconomic policies from the new state institutions which care for unemployment's affairs.

**Table I.** Statistical reports of ADF and KPSS tests for the rate of unemployment in Albania: 1993-1995

	ADF-Test for the rate of unemployment				KPSS-test	
	D-F	ADF(1)	ADF(2)	ADF(3)	Statistical-value	Critical value-95%
Without trend	-0.504	-0,86	-1,66	-2,41	7,6694	0,041
With trend	-1,17	-1,68	-2,22	-2,81		

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