

Economic Impact of the COVID-19 Pandemic on Western Balkan Countries

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ABSTRACT

The COVID-19 pandemic has caused major economic imbalances and impeded economic activity in all Western Balkan (WB) countries. This paper analyzes the strength of economic impact of the ongoing health crisis on key macroeconomic variables (GDP, public debt, fiscal balance, and unemployment) in the WB countries. In addition, the paper points out the main challenges that the economies of these countries will face in the years to come. The analysis has shown that the crisis slowed down the WB economies, but its intensity differed among the observed countries. The main economic challenges in the coming period relate to the further course and duration of the pandemic. Due to the great level of uncertainty, more detailed analysis of the crisis' impact on the economic potential will be possible only after the end of the pandemic.

Key words: COVID-19, GDP, Fiscal balance, Public debt, Unemployment, Western Balkans

JEL Classification: E60, F40, G01

INTRODUCTION

The global pandemic triggered by the contagious coronavirus outbreak represents an acute global health and economic shock. Unlike previous economic crises, this crisis is not caused by an economic factor, which makes it very difficult to compare to something similar from the past (Pavlović *et al.*, 2020, Erić *et al.*, 2021). The crisis caused by the COVID-19 pandemic differs significantly from previous recessions due to the fact that directly affects the real economy when it comes to both aggregate supply and demand (Carletti *et al.*, 2020). The initial decline of the aggregate supply due to disruption of the global production and supply chain as well as reduced labor engagement on one hand, and a drastic decline in aggregate demand due to imposed social distancing measures, declining employment, and reduced wages (Firano and Fatine, 2020) on other, led to a sudden and symmetrical shock to a large number of economies worldwide resulting in a dramatic slowdown of the global economic activity (IMF, 2020). Results of recent analysis indicate that "the COVID-19 pandemic has generated the worst world economic recession since the Great Depression" (Bortz *et al.*, 2020). According to data published by the International Monetary Fund, the global economy shrank by 3.3 percent last year (IMF, 2021).

The subject of this paper is the analysis of the impact of the COVID-19 pandemic on the countries of the Western Balkans (Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia). The COVID-19 pandemic has caused huge disruptions in the economic activity of the observed WB countries, which were already lagging behind in terms of economic conversions to

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Union (WB, 2021). The aim of this paper is to evaluate the economic impact of the crisis on key macroeconomic variables (*GDP, public debt, fiscal balance and unemployment*) in WB countries. In addition, the paper points out the main challenges that the economies of these countries will face in the years to come. Given that the COVID-19 pandemic is still present and that its future course is very unforeseen, authors believe that at this point of time it is still early to apply a quantitative approach in the analysis primarily due to the fact that implementation of such a model requires the inclusion of a large number of assumptions which at this point of time, unfortunately, cannot be fully comprehended. For this reason, in this paper authors opted for empirical analysis using a descriptive method when evaluating the impact of the COVID-19 pandemic on the economies of the WB countries. With that regard, the paper aims to answer the following questions:

- What are the economic effects of COVID-19 in WB countries?
- What are the main risks facing the WB economy?

The paper is divided into 5 parts. In addition to the introduction, Part 2 provides an overview of the scientific literature that analyzes the impact of the COVID-19 pandemic on the global economy. In Part 3, the impact of COVID-19 virus on basic macroeconomic variables in WB countries was analyzed using different data sources. Subsequently, Part 4 contains a discussion emphasizing the main challenges that the economies of the WB countries will face during the following years. Finally, Section 5 presents our conclusions.

LITERATURE REVIEW

The COVID-19 pandemic has resulted in unprecedented, unforeseen, and most abrupt economic downfall in modern economic history (*European Commission, 2021*). The ongoing health crisis has had devastating impacts on all aspects of the society, some of which are predicted to have high scope and long-term effects. By the end of April 2020, there were more than 3 million confirmed cases of the COVID-19 disease distributed among more than 180 world economies (*World Bank Group, 2020*). The lingering health crisis has profoundly affected aggregate supply and demand both on national, and global level (*Stanceva Gigov, 2020*). According to the OECD's March 2021 Economic Outlook (*OECD, 2021*) the global GDP expressed in real terms shrank by 3.4 percent in 2020 but is projected to rise by 5.6 and 4.0 percent in 2021 and 2022, respectively. It has been widely accepted that the COVID-19 pandemic has been overshadowing other developments while at the same time has accelerated existing trends (*Balkans in Europe Policy Advisory Group, 2020*).

The measures taken to suppress the spread of the contagious coronavirus have put the world into the state of "forced hibernation". The crisis has severely hit external demand, prices of export commodities, and flow of international remittances (*World Bank, 2020a*) on one hand, as well as financial outflows, FX rates, foreign reserves, and interest rates (*Hofmann et al., 2020*), on other. The pandemic's influence on global inflation and volatility of the financial instruments has already been profound (*Baker et al., 2020a*), but its overall economic effects are yet to be evaluated (*Zaremba et al. 2021*). With that regard, results of McKinsey's Global Survey imply that global sentiment remains high in January 2021, even though it has tempered since December 2020 (*McKinsey, 2021*). Furthermore, BNP Paribas' report indicates that major impacts of the COVID-19 pandemic on the global production and trade are expected to be: accelerated deglobalization, reduced scope of trade and level of foreign direct investments (FDI), as well as lower productivity (*BNP Paribas, 2020*). In domain of consumer behavior, new normal which will include structurally higher savings, less leisure travel, and greater remote working is foreseen to establish. Apart from that, increased burden of public debt is predicted to become one of the major legacies of the COVID-19 pandemic (*Morrón Salmeron and Garcia Arenas, 2021*).

In addition, sectoral impact of the COVID-19 crisis defers substantially from normal recessions (*European Commission, 2021*). The most affected sectors are contact-intensive services (*Lazić et al., 2021*). It is estimated that at the peak of the first wave in Q2 2020 economic activity in these

sectors was 25 percent lower compared to the pre-COVID-19 levels. Activities in pro-cyclical sectors (like industry and construction) are estimated to decrease somewhat modestly – 19 percent and 15 percent, respectively. Finally, remote-work intensive services with high-skilled employees such as ICT, finance, and real estate are estimated to contract less than 10 percent.

Furthermore, the regional and local impacts of the COVID-19 pandemic are highly heterogeneous. By November 2020, it became clear that the impacts of the global pandemic differ substantially not only across countries, but also across lower political and administrative divisions within the countries, both in terms of declared cases and related deaths (*OECD, 2020*). According to a brief study published by KPMG countries and regions across the globe are expected to experience divergent recovery paths which will mostly be influenced by their experience in mitigating the spread of the coronavirus, on the one hand, and the underlying socio-economic characteristics of each country or region, on the other (*KPMG, 2020*). It is also projected that more trade-exposed economies are going to take proportionally longer period to recover.

Finally, the countries with the lowest income were those affected the most. During the pandemic emerging market economies (EMEs) have faced the largest capital outflows (*BIS, 2020*) that were consequently followed by the negative spillovers of the economic downfalls in developed economies (*Bortz et al., 2020*). Moreover, less developed countries compared to developed ones have at their disposal less space to mitigate crisis' negative effects (*Aizenman et al., 2019*).

When it comes to Western Balkans, the region has registered the main waves of COVID-19 infections later than the vast majority of European Union countries. Nevertheless, contingency strategies were implemented at the same time and with equal force as in the rest of Europe (*EMCDDA, 2021*). By the end of October 2021 (Table 1), the total number of registered cases in the Western Balkans was 3,0 percent of the total number of cases registered in Europe, while the total number of deaths, the total number of people recovered, and the total number of active cases represented 2.6 percent, 2.9 percent, and 3.9 percent of the same categories recorded for Europe, respectively.

Table 1. The COVID-19 reported cases by October 28, 2021 – World, Europe, and Western Balkans

28-Oct-21	Total Cases	Deaths	Recovered	Active Cases	Mortality Ratio
World	246,165,934	4,994,011	223,052,026	18,119,897	2.03%
Europe	63,845,667	1,293,402	57,631,960	4,920,305	2.03%
Albania	183,873	2,902	173,443	7,528	1.58%
Bosnia and Herzegovina	252,083	11,477	192,218	48,388	4.55%
Montenegro	142,807	2,087	136,212	4,508	1.46%
North Macedonia	201,292	7,098	187,695	6,499	3.53%
Serbia	1,125,602	9,761	990,667	125,174	0.87%
Western Balkans	1,905,657	33,325	1,680,235	192,097	1.75%

Source: WHO Coronavirus (COVID-19) Dashboard, Retrieved from: worldometers.info, Accessed 10/28/2021

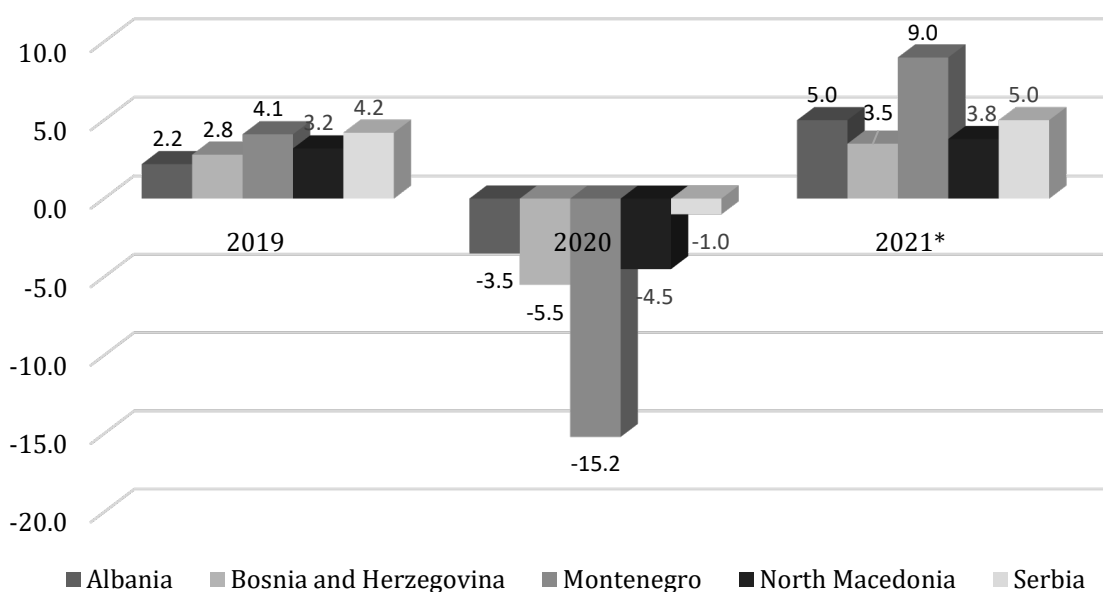
The region is expected to enter a recession whose magnitude will be mostly affected by the duration of the COVID-19 outbreak in developed European countries (*World Bank Group, 2020*). The current pandemic is expected to have lasting social, political, and economic repercussions in the Western Balkan countries (*CEP, 2020*). To make economic recovery sustainable over the medium term, some of the Western Balkan countries would have to implement higher-resilience-to-shocks mechanisms into their economic systems. At the same time, it is advisable that all of the

Western Balkan countries should continue to conduct structural reforms to boost productivity in the years to come (*World Bank Group, 2020*).

IMPACT OF COVID-19 CRISIS ON WB ECONOMY

The crisis caused by the COVID-19 pandemic has caused major economic disruptions and impeded economic activity in all WB countries. As the countries officially declared the epidemic, various epidemiological measures were imposed i.e., the ban on movement, social distancing, and suspension of certain activities, which resulted in the deterioration of almost all economic indicators. The extent to which these measures had an impact on individual countries depended primarily on the part of the economy that was affected by them and the time in which they were applied.

From the following graph, we can see that the COVID-19 crisis hit Montenegro the hardest, where the GDP decline in 2020 was 15.2%. The main reason for such a large decline is the high dependence of this country's economy on service activities, primarily tourism (*Ivanović et al., 2021*). Therefore, these macroeconomic shocks affected Montenegro to a greater extent compared to other countries (*IMF, 2020*). Other observed countries did relatively well in the crisis, primarily Serbia, which in 2020 recorded a decline in GDP of 1%. Common to all countries that recorded lower GDP in this crisis is the fact that the structures of their economies had a small share of service activities (*Prentice et al., 2021*).

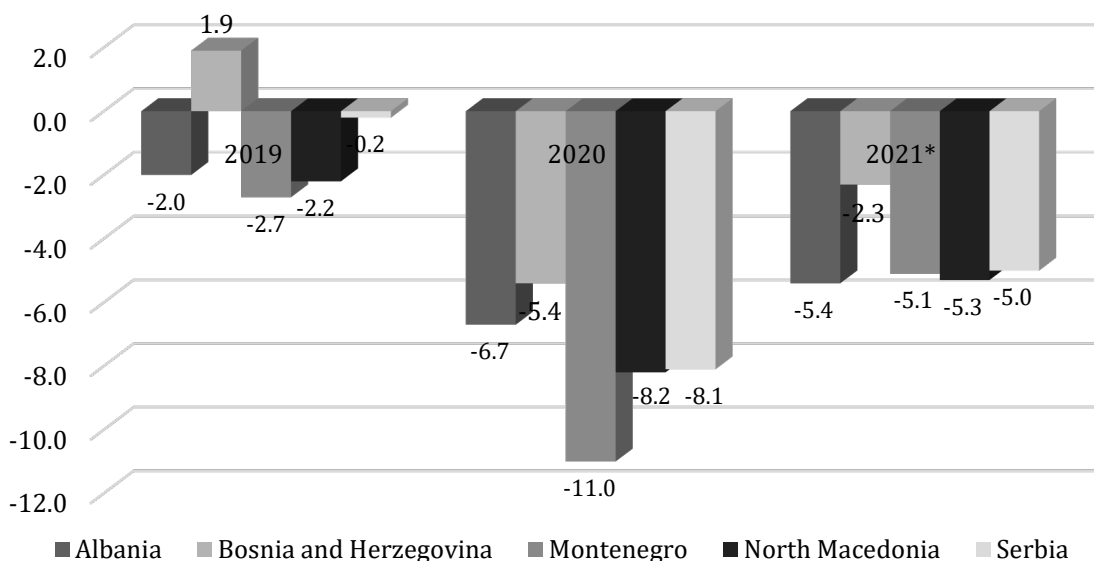


Graph 1. GDP growth in WB countries, 2019-2021*, %

Source: World bank

*Forecast

In response to the COVID-19 pandemic, the governments of the observed countries implemented strong monetary and fiscal support to limit the negative impact of the crisis on economic growth. Such support, together with a decline in the collection of fiscal revenues as a result of the economic activity slowdown, has led to an increase in the fiscal deficit and public debt in all observed countries. The largest fiscal deficits in 2020 were recorded in Montenegro (-11.0% of GDP), North Macedonia (-8.2% of GDP) and Serbia (-8.1% of GDP).

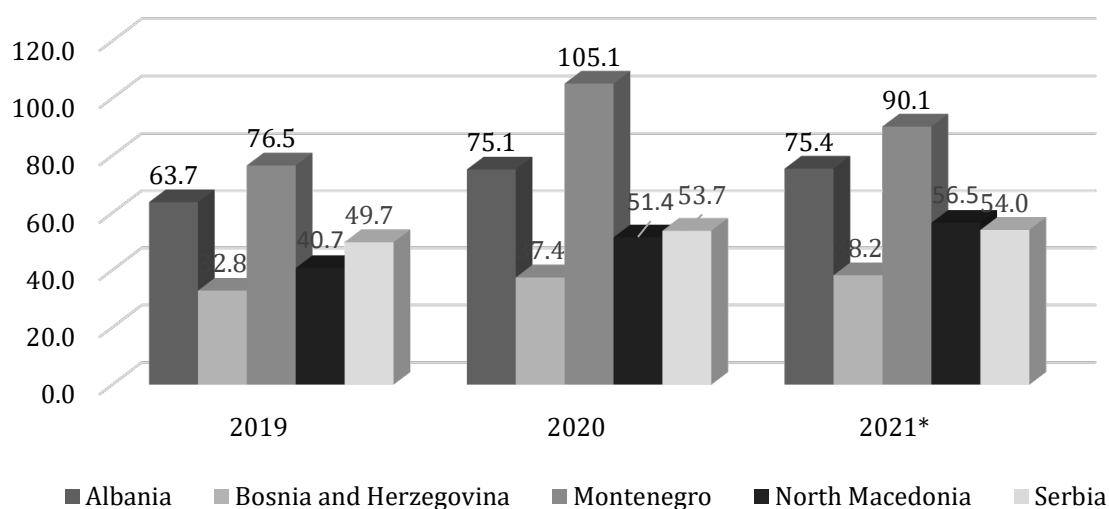


Graph 2. Fiscal balance in WB countries, 2019-2021*, % of GDP

Source: World bank

*Forecast

With the growth of the fiscal deficit, the need for falling into greater debt grew sharply as the COVID-19 disease spread. All observed WB countries in 2020 recorded an increase in the share of public debt in GDP. Montenegro (28.6%), Albania (11.4%) and North Macedonia (11.4%) recorded the highest growth of debt-to-GDP ratio. Considering the other WB countries, the share of public debt in GDP in Serbia increased by 4.0% while in Bosnia and Herzegovina grew by 4.6%. If we look at the debt-to-GDP ratio in relation to the set Maastricht criteria (60% of GDP), we can see that the level of debt in Bosnia and Herzegovina, North Macedonia and Serbia is below the prescribed level. On the other hand, in Montenegro, the debt-to-GDP ratio at the end of 2020 was 105.1%, which is an indicator of high risk. In the same period, Albania recorded a debt-to-GDP ratio of 75.1%.

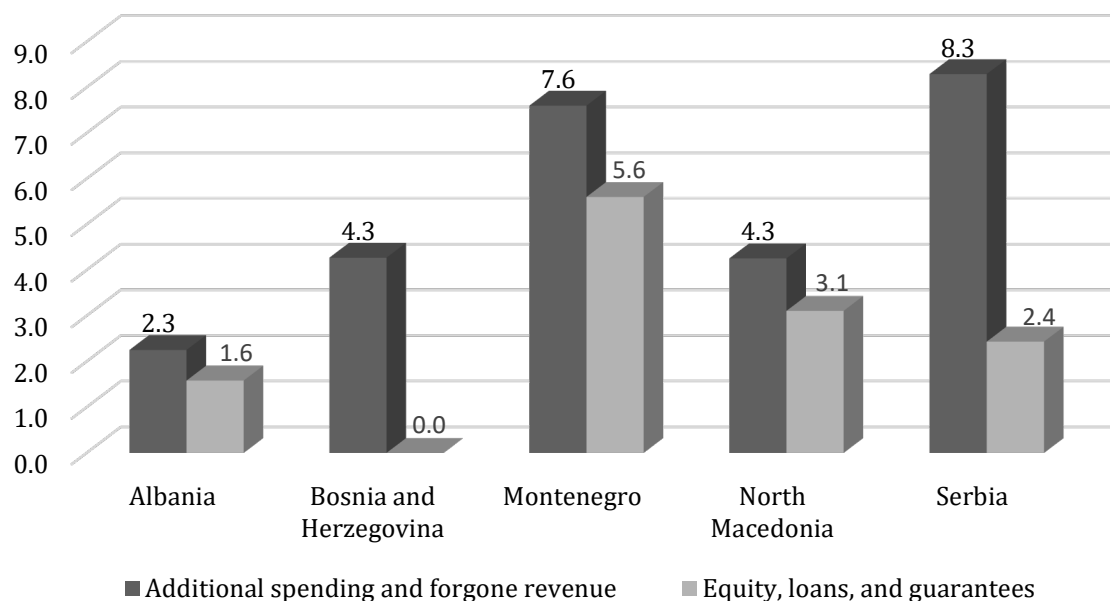


Graph 3. Public debt in WB countries, 2019-2021*, % of GDP

Source: World bank

*Forecast

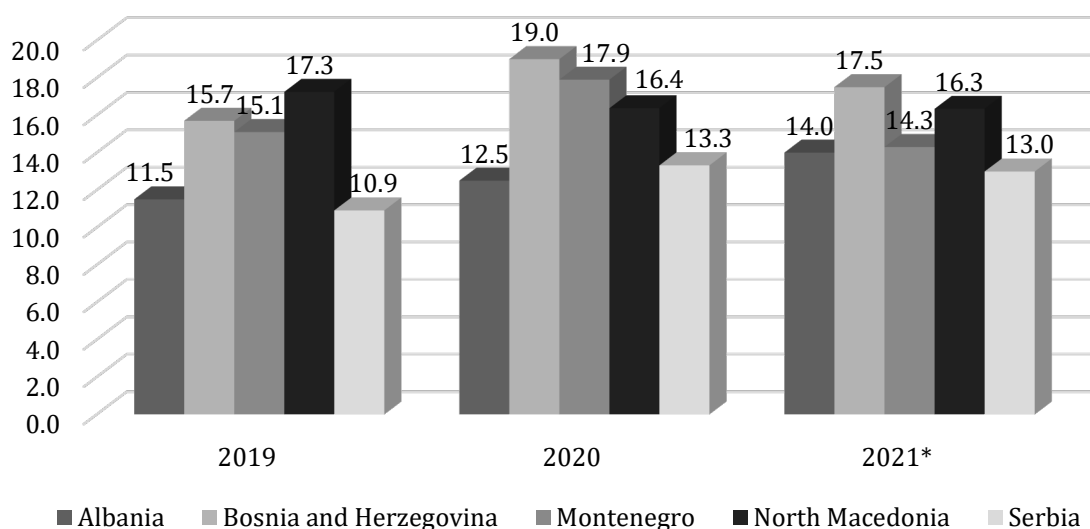
With the exception of Montenegro and Albania, we can conclude that public debt in the other observed WB countries is sustainable and far from the level that could lead to a crisis. However, one should keep in mind the fact that interest rates are currently at an all-time low and that their growth in the future could lead to problems in servicing debts.



Graph 4. Discretionary fiscal response to the COVID-19 crises in WB countries, cumulative spending in 2020 and the first four months of 2021.

Source: International Monetary Fund

Observed by country, different fiscal and monetary policy measures were taken. Their shaping was influenced primarily by the fiscal space that the governments of the countries had at their disposal and the possibilities of using monetary policy instruments. The economic assistance package in the WB countries consisted of a combination of short-term crisis mitigation measures, the provision of subsidized loans to firms, the introduction of tax reductions or deferrals or loan repayments, or the subsidization of wages for affected firms. In addition to these measures, trade ones were created with the aim of banning the export of medical equipment or food products (*WB, 2020, Pavlović et al., 2020, Đuričin and Beraha, 2020*). Regardless of the type of measures chosen, all WB countries exceeded their planned fiscal results and projected pre-pandemic public debt levels. Montenegro and Serbia were in the lead. The slowdown in economic activity also affected the labor market, as can be seen from the graph below.



Graph 5. Unemployment rate in WB countries, 2019-2020*, %

Source: International Monetary Fund, *Montenegro SEE – 6 Economic outlook*

*Forecast

Of the observed countries, only North Macedonia in 2020 recorded a decrease in the unemployment rate from 17.3% to 16.4%. All other WB countries had an increase in the unemployment rate in the observed period: Bosnia and Herzegovina (3.3%), Montenegro (2.8%), Serbia (2.4%) and Albania (1.0%). Unemployment rates indicate that the labor market has remained relatively stable given the severity of the crisis. Strong fiscal and monetary stimulus certainly contributed the most to this.

DISCUSSION

The economic measures taken to alleviate the crisis have stimulated economic growth, reduced unemployment, but also the growth of public and budget deficits in all observed WB countries. We can conclude that the measures have given a positive short-term result, but it should be borne in mind that the COVID-19 virus is still present and that from a macroeconomic point of view, these measures are not sustainable in the long run. Given the high degree of unpredictability about the further development of the pandemic, we believe that decision-makers in the observed WB countries should be very careful in choosing future measures, especially given the fact that now the scope for counter-cyclical fiscal policy in many countries is narrowed. Also, the measure of direct assistance to citizens and the economy through the provision of grants has proven to be quite ineffective in developed countries. In the United States, on average, less than 40% of transferred funds were spent, which means that the effects on aggregate demand were relatively small (*Coibion et al., and Baker et al., 2020b*).

The main challenges for the future growth and development of WB economies lie primarily in the duration of the COVID-19 pandemic. Although these trends show that the current effects of the pandemic are smaller than during the first wave (*IMF, 2021*), the situation is still very uncertain. In such circumstances, investors are still quite cautious, which may lead to a continued decrease in foreign capital inflows, especially foreign direct investment (FDI), on which WB countries are highly dependent (*Marijanović and Đukić, 2020*). During 2021, according to the UNCDTE, global capital flows decreased by 42%, while in the countries of Southeast Europe, to which the WB countries belong, the decline was 28% (*UNCDTE, 2021*). A drop in capital inflows would also have negative effects on interest rates, which would increase fiscal costs for WB

countries, especially those with a high debt-to-GDP ratio such as Montenegro and Albania, due to rising interest rates.

In addition to FDI, inflows from remittances are a very important factor for all WB countries (*Russell and Oruc, 2019*). A slowdown in economic activity in Western European countries, where most WB nationals are temporarily or permanently employed, would have a negative impact on the balance of payments and economic growth. Also, Western Europe countries are the largest trading partners for WB countries (*Bonomi and Uvalic, 2019*). A slowdown in growth in these countries would reduce the exports of the entire WB, which would have a negative impact on the dynamics of their economic growth.

Finally, the long-term sustainability of economic recovery requires the implementation of structural reforms aimed at boosting productivity growth. In order for the economies of the WB countries to be more resistant to external shocks, it is necessary to diversify their economic structure. Future diversification should be based on green technologies and smart specialization, which would achieve a synergetic effect with the current economic structure. In a broader context, it is a simultaneous attempt to respond to the challenges of the global COVID-19 pandemic by using various instruments to increase resource efficiency through sector-specific improvements (*Montresor and Quatraro, 2020, Santoalha and Boschma 2021*).

CONSLUSION

The crisis caused by the spread of the COVID-19 disease has had a strong impact on the economies of the WB countries. According to conducting analysis, COVID-19 crisis hit Montenegro the hardest, where the GDP decline in 2020 was 15.2%, while other observed countries did relatively well in the crisis, primarily Serbia, which in 2020 recorded a decline in GDP of 1%. Due to the simultaneous shock which occurred to both aggregate supply and demand, there was a drop in GDP and an increase in unemployment in all observed WB countries. Strong fiscal and monetary stimuli have mitigated these negative effects but also burdened public debt and the budget. Short-term measures to mitigate the negative effects of the crisis are very expensive and unsustainable in the long run. It would be economically justified to focus the new anti-crisis measures selectively on those economic activities that are most affected by the crisis.

Future recovery is unlikely to be equally quick and easy for all countries. The duration of the crisis will depend primarily on the further course of the pandemic. In addition, we see the slowdown in the inflow of foreign capital, especially FDI, as well as remittances from abroad, as the main challenges of the economic recovery. Also, the speed of the EU's recovery as our largest foreign trade partner will significantly affect the speed of the WB's recovery.

The conclusions and analyzes presented in this paper cannot be considered final given that the COVID-19 virus is rapidly spreading in all observed WB countries at the time of writing this paper (October 2021). Also, the final assessment of the economic consequences occurred due to the impact of the crisis will be possible only after the end of the pandemic.

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Article history:	Received: October 5, 2021
	Accepted: November 1, 2021