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EVALUATION NOTE

RAMIFICATIONS OF COVID-19 IN THE WESTERN BALKANS

Like many regions across the globe, the Western Balkans is struggling with the challenges of the COVID-19 pandemic. The region's most salient problems of prolonged political instability, economic stagnation, and emigration of its best and brightest, have worsened during the pandemic. Moving forward, the extent of the economic and social damage will be determined by two variables: the extent of political instability and the depth of the recession in the EU.

The problem of weak decision making

The extended duration of the pandemic requires coordinated political decisions in order to spearhead a systematic approach for managing debt and economic recovery. Protracted political instability has meant that the governments of the Western Balkans are weak and incapable of making sustainable economic decisions. State institutions will thus be unable to execute the necessary recovery measures. According to the assessment of the Economist Intelligence Unit, the likelihood of weak economies having to implement austerity measures for mitigating the pandemic crisis is much higher.² These measures require dedicated and politically unpopular decisions. The governments in the Western Balkan, however, are preoccupied with enacting popular political decisions geared at enabling political elites to remain in power, while making their electorates worse off.

¹ <https://www.tepav.org.tr/en/ekibimiz/s/1415/Zoran+Ivanov>

² Economist Intelligence Unit, What's Next for Global Growth and Oil Market, Webinar, 25 Aug 2020, <https://economist.zoom.us/rec/play/uMZ4dLivp203E4eVuASDBKJ4W9W8fKmshiRK8vpcyUa0V3YDMAbwMLdDa>

Macedonia

Macedonia has a volatile government after the recent elections, which makes its decision-making process anemic. The coalition of Social Democratic Union of Macedonia - SDSM won election by a very close margin, with only 2 MPs over opposition Internal Macedonian Revolutionary Organization – Democratic Party for Macedonian National Unity - VMRO-DPNE political party. To sustain a coalition in the government, they have changed its decision-making model. Before establishing a government, the Albanian political party DUI wanted the prime minister to be Albanian. The SDSM opposed their candidate, and after negotiations, both sides agreed on an arrangement in which their party leaders would make executive decisions together. This decision is against the tenets of Democracy, disabling checks and balances, and making state institutions passive and ineffective. Meanwhile, the economy is struggling.

The Macedonian economy is service based, providing 50 percent of the total employment in the country. According to the World Bank's reporting, GDP growth for 2020 is expected to be negative 3.2 percent. Macedonia has allocated 2 percent of the GDP to support salaries in business and households. Nevertheless, fiscal deficits may reach values comparable to those in the post-global financial crisis, up to 4.7 percent.³ Real GDP is forecast to decline by 4 percent in 2020 due to a fall in both domestic and external demand. Becoming a NATO member and opening the EU accession talks should accelerate the recovering process. Though, this opportunity is hindered by weak institutions.

Amplified by COVID-19, Macedonia will enter into a deep recession due to the weak government institutions and the novice alterations in the governing model. Skopje will have a difficult time managing the restructuring of the economy and repaying its debt to the IMF.

Bosnia and Herzegovina

For more than two decades Bosnia and Herzegovina has been an international protectorate. This has resulted in weak state institutions, high corruption and continuous political instability.⁴ The tripartite presidency? Model (whereby government positions are shared amongst the Bosnian, Croatian, and Serbian communities with quotas) does not leave room for effective decision making. The biggest weakness of building Bosnia as a functioning and stable state has been that the current Constitution was never meant to last this long.⁵ Internal political division between the Federation of Bosnia and Republika Srpska promoted by Miroslav Dodik's secessions aspiration is giving additional impediments to decision making. Bosnia and Herzegovina must prioritize spending requirements in order to limit their budget to only their urgent needs otherwise debt is set to exponentially increase.

Due to the pandemic crisis, the growth for 2020 is estimated to be negative 4.2 percent. The IMF has approved an emergency support package of 361 million US dollars.⁶ Besides a small

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³ <https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report>

⁴ <https://www.un.org/press/en/2020/sc14180.doc.htm>

⁵ <https://foreignpolicy.com/2018/03/21/bosnia-is-teetering-on-the-precipice-of-a-political-crisis-balkans-election-law-dodik/>

⁶ <https://www.imf.org/en/News/Articles/2020/04/20/pr20176-bosnia-and-herzegovina-imf-executive-board-approves-usd361-million-in-emergency-support>

upward trend of leveling imports to exports, Bosnia is still an import dependent economy. The labor market heavily relies on SMEs which represents about 99 percent of all enterprises. As such, this sector is the most vulnerable victim of the COVID-19 crisis because of its limited access to financing, small cash reserves and heavy credit dependency.

The complex governing model that produces a lack of coordination between the varying levels of government represents the biggest obstacle regarding the implementation of measures.⁷

Kosovo

After the latest election in October 2019, Kosovo is still struggling to maintain a government. They are the only country that has toppled the government in the middle of a pandemic crisis and replaced it with a caretaker government for the time being. The political competition is hampering the country's ability to manage two major issues. First, negotiating with Serbia over their official recognition and pressure from the US to find a faster solution. Second, managing the pandemic crisis. Furthermore, the measures to fight the pandemic are used to fulfill political grievances. Prime Minister Kurti opposed the President's decision to declare state of emergency across the country. And this political turmoil is reflecting itself on the economy.

Kosovo's economy is based on remittances sent by the diaspora, which represent 15 percent of the GDP.⁸ With a negative 11.3 percent shrinkage due to COVID-19 induced global economic slowdown, the country is expected to have the worst growth performance for 2020.⁹ The caretaker government has announced an emergency response package of about 2.8 percent of GDP to support affected citizens, businesses, and professions.¹⁰ An additional burden comes from the exceptional influence of EU monetary decisions, considering that the Euro is the country's official currency.

A remittance-based economy cannot provide sustainable solutions for recovery since it is dependent on the Kosovars diaspora and the EU. It will result with increasing unemployment and fiscal expenditure which will lead to increasing the budget deficit and debt burden.

Albania

Albania is struggling with heavy protesting due to accusations of organized crime and rigged voting from the current government of Edi Rama.¹¹ Establishing dialog for a functioning government is difficult because Albania has two major political parties. Political instability continues as the Socialists draw their power from a majority of seats in the Parliament and are making decision without consideration for the opposition, the pre-pandemic protests were fueled by the Democrats call for canceling local elections. As a result, the state's institutions are becoming weaker and legitimacy is further jeopardized. In such a complex political environment, it is expected that Albania will enter into a recession.

⁷ <https://emerging-europe.com/news/economic-problems-mount-for-bosnia-and-herzegovina-while-the-number-of-covid-19-cases-remains-low/>

⁸ <https://www.oecd.org/south-east-europe/COVID-19-Crisis-in-Kosovo.pdf>

⁹ <https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report>

¹⁰ <https://www.worldbank.org/en/news/press-release/2020/04/29/kosovo-economy-projected-to-contract-by-45-percent-in-2020-due-to-covid-19>

¹¹ <https://www.theguardian.com/world/2019/jun/10/edi-rama-albania-pm-escape-curse-of-history>

At the onset of the crisis, the government allocated a total of 45 billion Euro (2.8 percent of GDP) support packages which includes budget spending, sovereign guarantees and tax deferrals.¹² Tourism is the main sector of economy with over 25 percent of GDP generation¹³ and it is expected to experience a 20 to 35 percent fall in revenues this year.¹⁴ The Albanian economy is heavily relying on trade and investments from the EU. Almost 50 percent of exports are directed to Italy.¹⁵ Under such conditions, Albania will suffer more losses due to the limited demand of the market at the current moment.

Even though the EU, EC, and IMF is providing 424.2 million Euros of financial support,¹⁶ the high levels of corruption and political instability represent real obstacles for the successful implementation of funds.

Serbia

The protests against the government in Serbia is entering its second consecutive year. The civil unrest is motivated by rife corruption, media suppression, neoliberal policies and strong grip of the government by President Vucic.¹⁷ In the recent election of June 2020, Serbia Progressive party won 60 seats in the Parliament giving them absolute majority and paving a way for passing unanimous governmental decisions. The main opposition parties led by Dragan GJilas and Vuk Jeremik were demanding that Serbian citizens oppose Vucic and that the elections were illegitimate. Their accusations over the mismanagement of the pandemic by the government in order to present President Vucic as successful in controlling the crisis continues.¹⁸ The mismanagement of the crisis has a direct impact on the economy.

The Serbian economy is expected to shrink by 5.6 percent as results of the containment measures.¹⁹ Serbia is one the countries that has to heavily rely on FDI which is over 7 percent of the GDP. In the first half of the 2020, FDI began to decrease to 6.4 percent of GDP.²⁰ The EU countries of Germany and Italy are main investors in Serbia. Hence, investment is expected to shrink, especially from Italy since they are one of the weakest economies in the EU.

Montenegro

Montenegro is experiencing internal divisions and political pressure due to the animosity towards the regions longest ruling leader, President Molo Djukanovic, now for almost 30 years. The opposition parties are accusing President Milo Djukanovic, of presiding over poverty, a loss of human rights, freedom of media, and systematic corruption. On the other hand, President Djukanovic is denying accusations and blames the opposition for trying to destabilize the country while being backed by Russia and Serbia. Political turmoil does not allow dialog

¹² <https://www.oecd.org/south-east-europe/COVID-19-Crisis-in-Albania.pdf>

¹³ <https://pdfs.semanticscholar.org/3acf/25dd46e80b641aede69d96ed4b79f55390b0.pdf>

¹⁴ <https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report>

¹⁵ <https://www.oecd.org/south-east-europe/COVID-19-Crisis-in-Albania.pdf>

¹⁶ <https://www.oecd.org/south-east-europe/COVID-19-Crisis-in-Albania.pdf>

¹⁷ <https://www.aljazeera.com/indepth/opinion/protests-serbia-200718175749533.html>

¹⁸ <https://www.nytimes.com/2020/07/08/world/europe/serbia-protests-coronavirus.html>

¹⁹ <https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report>

²⁰ <https://www.ceicdata.com/en/indicator/serbia/foreign-direct-investment>

and consensus for making decision that would strengthen the economy as the pandemic crisis rages on.

It is expected that the country will instigate deep recession since Montenegro heavily relies on tourism, the most vulnerable sector during the pandemic. In total, the tourism sector makes up about 25 percent of GDP.²¹ Furthermore, remittances from the EU consists of about 11 percent of GDP.²² The major investors in Montenegro are Austria, Germany and Italy. Since EU is experiencing a drawn-out internal process of reorganizing and allocating financial support to its members, remittance is likely to diminish- especially from Italy. The government has made adjustments to their Investment and Development Fund (IDF) in order to cushion the immediate jolts from the pandemic.

Both sectors, relying on remittances from the EU and tourism, are subject to suspension of travel and social distancing measures because of the pandemic which will directly result in further increasing debt. Montenegro must carefully prioritize its spending without jeopardizing debt sustainability.

The Impact of the EU

EU countries are the main investors in the Western Balkans and they have also been severely affected by the pandemic crisis. Their recovery will have a direct impact on the recovery of the Western Balkans. Foreign investment in the region comes primarily from Austria with 50.7 percent, Germany with 23.9 percent, Greece with 28.5 percent, Italy with 22.1 percent, Netherlands with 9.1 percent, and Slovenia with 13.9 percent.²³

Some of the investments are coming from the United Kingdom, the United States, and the Russian Federation as well. Turkey's investments in the region are about 18.3%.²⁴ Western Balkan countries such as Albania, Montenegro, and Macedonia should expect serious challenges in keeping the investments continuing from Greece and Italy. These two southern EU countries are in weak shape and struggling to keep their own economies intact. Greece will struggle the most since tourism is one of the major industries, making up 21 percent of its GDP.²⁵ Athens is expecting almost 10 billion Euros of revenue losses from tourism in 2020. With these losses, it is highly unlikely to expect Greece to maintain the same intensity of investments in the region. Therefore, the governments of the Western Balkans need to prepare contingency plans for economic restructuring in the case of trickling down foreign investments and no expected emergence of new investments for a prolonged period.

²¹ EBRD (2020), Responding to the Coronavirus Crisis URL:

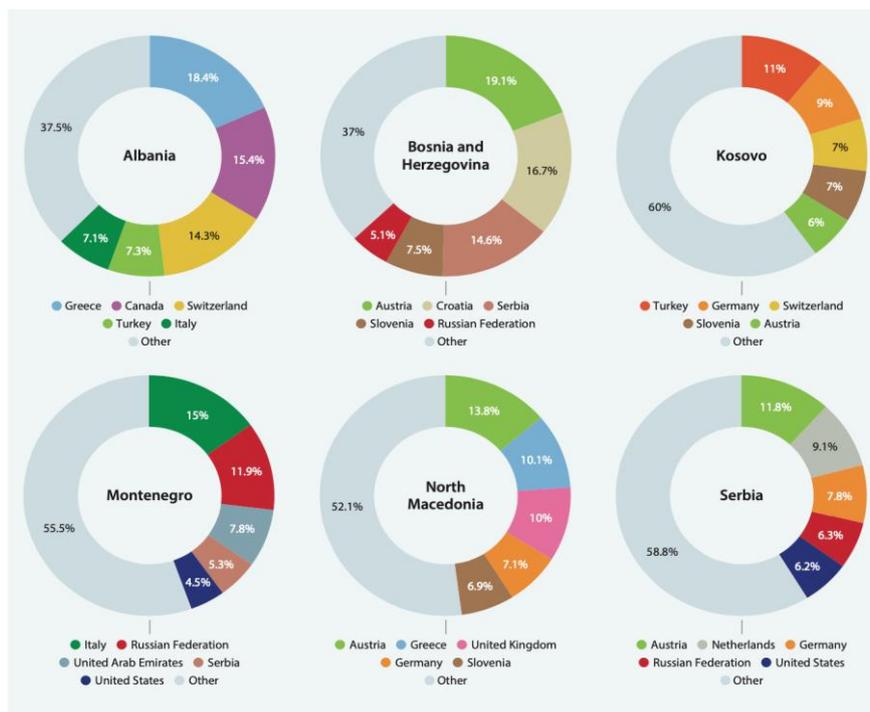
<https://www.ebrd.com/documents/admin/montenegro-coronavirus-policy-response-.pdf?blobnocache=true>

²² <https://www.oecd.org/south-east-europe/COVID-19-Crisis-in-Montenegro.pdf>

²³ Covid-19 crisis in the Western Balkan: Economic impact, policy responses, short-term sustainable solutions, OECD report 2020, <http://www.oecd.org/coronavirus/en/>

²⁴ <http://www.oecd.org/south-east-europe/COVID-19-Crisis-Response-Western-Balkans.pdf>

²⁵ <https://www.cnn.com/2020/04/28/coronavirus-hits-greece-tourism-with-more-people-at-risk-of-unemployment.html>



Note: Latest available data for Kosovo, 2015.
 Source: UNCTAD (2019), https://unctad.org/Sections/dite_dir/docs/WIR2019/WIR19_tab22.xlsx

Source: OECD report, <http://www.oecd.org/south-east-europe/COVID-19-Crisis-Response-Western-Balkans.pdf>

There has been a long internal struggle between EU members over economic solutions, share and participation. The tussle has increased since they cannot reach an agreement to cover the social and political costs of the economic crisis fueled by the pandemic.²⁶ According to some economic analyst, the EU’s Recovery Fund took too long to be approved and potentially will not be enough to mitigate the accumulated economic problems.²⁷ The EU has reach a point where it cannot sustain to further subsidize salaries and keep workers at home during a time of business closures. According to McKinsey & Company research, it is estimated that 59 million jobs are at risk of layoffs.²⁸ Internal struggle within EU to keep its economy intact and safeguard the Eurozone certainly does not help Western Balkan prosperity. It can bring back past voices of enlargement fatigue expressed by EU leaders towards the Western Balkans.

The possible way out

Governments in the Western Balkans did take immediate measures to alleviate the economic impact from the pandemic by providing subsidies or delaying payments. However, these are short-term solutions that are not sustainable in the long-term. Across the region, many companies are trying to restructure and exploit online opportunities. Their success is

²⁶ <https://www.project-syndicate.org/commentary/european-union-divisions-create-cohesion-by-kemal-dervi-2015-09>
²⁷ https://www.washingtonpost.com/business/technology/stimulus-package-breaks-new-ground-in-european-unity/2020/07/21/81310358-cb4e-11ea-99b0-8426e26d203b_story.html
²⁸ <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/safeguarding-europes-livelihoods-mitigating-the-employment-impact-of-covid-19#>

questionable since their economic model is rigid. Therefore, Western Balkan countries should have a systematic approach in restructuring their economic models to be able to face the challenges from limited investments, EU's changing economic policy, limited global supply chains, and equalization of imports with exports.

The governments must focus on medium-to-long term arrangements for economic development. Since the region is heavily dependent on imports, the main structural reforms should start boosting productivity. They can increase their capabilities to replace some of the interrupted global supply chains. To foster a positive business climate, they need to reinforce state institutions that protect the rule of law. They also need to immediately address education and vocational skills training to minimize skills mismatches. These challenges require initiating systematic approaches by stable governments that focus on securing a prosperous future, rather than political and nationalistic grievances.