The social consequences of the global economic crisis in the Western Balkans

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Effects of the global economic crisis for the Western Balkan countries (WBs)

[WBs: Albania, Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Montenegro, Serbia]

Issues

1. Macroeconomic effects of the crisis
2. Social impact of the crisis - key features of WBs labour markets
3. Some reasons why prospects are not bright
1. Effects of the crisis

The WB countries also severely hit by the global economic crisis (from last quarter of 2008), after years of rapid growth (2001-08)

- **2009**: Negative GDP growth rates in almost all countries (even -6% in Croatia)
  Exceptions: Albania, Kosovo → slowdown, growth rates half those in 2008

- **2010**: Recovery on its way, partly as a consequence of improving prospects in EU, but not in all countries
  Croatia: 2d year of recession

- **2011**: GDP growth rates substantially lower than in 2008 → around or less than 2%, in all countries except Kosovo
Real GDP growth (%) [EBRD, Oct. 2011]

→ 2011 growth still far below rates in 2008
Effects of the crisis

Transmission factors

- In late 2008, both WBs & CEE (10 new EU MS) were severely hit by two external shocks
  - Financial sector: reduced inflows of private capital inflows (FDI, foreign loans, remittances)
  - Real sector: sharp drop in export demand
- WBs were among the most vulnerable
  - Huge external imbalances $\rightarrow$ extremely high current account deficits (10-33%), covered by massive inflows of foreign capital (thus among the most exposed to the global credit crunch)
  - Banking systems $\rightarrow$ after privatization mostly foreign-owned, risk of capital withdrawals or reduced lending to local clients
  - Dependence on trade with EU $\rightarrow$ Though less than CEE, WBs also integrated with EU economy (60-80% of exp & imp), vulnerable to deteriorating conditions in EU + extremely unbalanced trade (huge foreign trade deficits)
Foreign direct investment (million US$)

→ Sharp fall after 2007 in most WB countries
Credit boom (2005-2007) was followed by much slower expansion/decline (Bosnia, Montenegro) in 2009-10
Workers’ remittances (million US$)

→ Reduced or stagnated after 2007 (exp. Serbia)
Merchandise exports (million US$)

→ Sharp drop in 2009
Effects of the crisis

**Effects of the global crisis dampened down by positive policy response**

- National governments: stimulus programs + measures by central banks to support enterprises and prevent withdrawal of deposits
- International: IMF support (Serbia, Bosnia), “Vienna initiative” to prevent capital withdrawals, EU funds (IPA, EIB), EBRD support

**Results**

- Along with gradual economic recovery, in 2010-11 all countries have seen a reduction in current account and trade deficits, in some countries thanks to adjustments of the exchange rate (depreciation) → fall in imports, increase in exports
- More balanced current account, but increase in foreign debt
2. Social impact of the global crisis

2009 recession

- Direct impact on the labour market → worsening of all indicators in most WB countries
  - Unemployment rate has increased, after a positive trend towards decline in the years preceding the crisis
  - Employment rates have declined
  - Further social differentiation, increasing poverty and inequality
- Reliable data on many indicators are not available
- Although the impact for now has not been so large (2009-2010), the situation was very unsatisfactory even before the global economic crisis [+ is likely to worsen]
Social impact

Key features of labour markets in WBs

- WB countries were badly hit by the phenomenon of “jobless” growth (similar to the CEE a decade earlier), but its proportions have been much worse (Croatia an exception)

- Persistence in time: in most WBs, high unemployment is a long-term problem, inherited from the 1990s (many reforms delayed, limited adjustments)

- Already in 2000: unemployment rates very high, esp. in Macedonia (45%), Bosnia and Herzegovina (almost 40%) and FR Yugoslavia (27%), for years no signs of improvement

- Today: unemployment remains a very serious problem in four of the seven WB countries (Serbia, Macedonia, Bosnia and Herzegovina, Kosovo)
Social impact

Comparing CEE and WB labour markets ➔ the situation far worse in the WBs

- Unemployment rates generally higher
- Long-term unemployment much higher
- Employment and participation rates are lower
- Informal economy more widespread
- Strong migration (“brain drain”): the most qualified workers left their homelands, emigrated to USA, Australia... may never come back
- “Brain waste”: high-skilled workers leaving for better paid jobs in private sector
Unemployment (LFS, % labour force)

→ After 2008 again increasing in most countries
Unemployment rates in 2010 were higher than in EU-27 & most NMS (esp. Ser, Mac, Bos, Kos)
Unemployment rates in NMS/WB in 2011 (preliminary, last available data)

NMS: reduced in 6 Cs    WBs: increase in at least 3
Long-term unemployment rates, 2008

Extremely high (compared to EU), from 5-36%
Employment rates, 2002-08 (LFS, %)
Low, until 2006 stagnating/declining (exc. Croatia)
Social impact

*What have been the main policy failures?*

- WB governments: a number of measures to create new jobs for workers being laid off through passive and (sometimes) active labour market policies, long-term employment strategies ...
- Measures to stimulate private sector development, to facilitate entry of new private firms, facilities for SMEs ... but policies were clearly not very effective
- Why is the situation on the labour market so much worse in most WB countries (in comparison with NMS)?
  - Structural weaknesses of the WB economies: a product of legacies of the 1990s, in combination with inadequate economic reforms/transition strategy flaws
Social impact

*Transition-related economic reforms*: Emphasis was placed on macroeconomic stabilization, liberalization and privatization

→ Enterprise restructuring and reallocation of labour was expected simply as a by-product of liberalization and privatization

- Many *microeconomic reforms* neglected: easing conditions for firm entry and exit, increasing competition, improving corporate governance → insufficient enterprise restructuring, slow growth of private sector, slow or no employment growth

- *Inadequate structural changes* favouring primarily the fast expansion of services, closely related to the structure of FDI (2/3 in services - banking, telecommunications, real estate...)

- FDI: mainly in non-tradable services (and not manufacturing), explains poor export performance → *Instead of export-led growth, WB countries have had service-led growth!"
Social impact

**Persistence of the informal economy (& high unemployment)**

- 1990s: wars and sanctions stimulated smuggling, illegal trade and the development of underground activities.
- Improvements after 2000, but still today a large portion of activities concentrated in informal sector: according to some estimates, informal activity highest in Albania (52% of household income), Kosovo (45%) and Macedonia (39%), but in Bosnian Federation, Serbia and Croatia: 18-19%.
- Reasons? *Inadequate tax system*
  - Social contributions: over 30% of gross wage in the Republika Srpska, Montenegro and Serbia, even higher in the Bosnian Federation (41.5%).
  - Very low in Kosovo (only 10%).
- *Weak rule of law*, despite various measures to formalize... → avoiding to pay taxes has become the main element of firms’ competitiveness.
- Insufficient changes in the *overall business environment*.
World Bank’s *Ease of Doing Business Ranks*

⇒ Only Macedonia highly ranked (22d out of 183)
Social impact

*Within the transition strategy*, social sector reforms not given sufficient attention (social costs of transition greatly underestimated)

- Reforms pushed in the direction of a particularly flexible labour market, with weak trade unions and scarce diffusion of collective bargaining (few exceptions)
- Inadequate systems of taxation (flat-tax rate)
- Emphasis on fiscal discipline has led to cuts in public expenditure → the welfare state considered a luxury that must be sacrificed for the sake of transformation

- *High popular dissatisfaction*: EBRD *Life in Transition* (2007): only 30% of respondents from transition region, on average, consider their households were better off than before 1989
3. Prospects and future challenges

Prospects not bright for several reasons

1. Forecasts of world output
   - World growth recently revised downwards → further global slowdown; in view of the eurozone crisis, will probably be revised further
   - Given the strong dependence of WBs on the EU economy, many issues are beyond control of WB governments
   - We may expect slow growth in the WBs over the next few years and further worsening of social sector indicators

2. Growth model based on fast trade & financial integration: much less successful in the WBs than in the CEE countries
Prospects and future challenges

1. Current forecasts of world output (UN)
   - After the economic recovery in 2010, world output growth has strongly decelerated in 2011-12
   - EU-27 growth has followed a similar trend, in 2012 growth forecast to be only 0.7% (0.4% in Eurozone)
   - A further deceleration of GDP growth is expected in Albania and Macedonia, or stagnation in Bosnia and Herzegovina and Serbia
   - Period of slow economic recovery
   - 2013: forecast of a 3% growth rate for the WBs
UN output growth forecasts for 2011-13

→ WBs: slow economic recovery
Future challenges

2. Growth model

- The global crisis has demonstrated the fragility of WBc, due to the model of credit-driven growth and resulting high dependence on foreign capital
- Key deficiency of WBs: limited restructuring of the real sector
- Over the next few years, despite remaining privatization opportunities, WBs cannot rely much on FDI
- Need to move away from reliance on easy finance, towards the development of domestic financial markets, stronger institutions, and more diversified production base – how?
Future challenges

- Considering some key features of the WB economies (low level of development, deindustrialization, high trade deficits), WBs need

  - **An industrial policy:** not to support national champions, but to encourage innovation, R&D, protect quality and technical standards, facilitate enterprise restructuring, strengthen the industrial base... But also promote investment in certain sectors

- **Quality of institutions** must be improved, in the first place of government institutions, in enforcing laws, collecting taxes, supervising the financial sector, implementing *active* labour market policies...

- Without stronger institutions, policies will remain ineffective
Future challenges

- **Strategies aligned with EU objectives**
  - Europe 2020: smart, sustainable and inclusive growth
    - R&D, skills, innovation, education
    - Energy and environment
    - Employment, social cohesion

- **Integrated approach**: Education & Innovation & Research together with employment policies (→ importance of human capital)

- Unemployment (also in WBs): mismatch between demand and supply of labour → education reforms crucial, but must be implemented in coordination with labour demand and employment policies

- **Employment policy**: Cannot be treated as exogenous to the core reform process, reduced to a supporting legislative labour market reform, but must involve various sectoral mutually coordinated policies (Arandarenko)