

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



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***Social Consequences of the Economic Crisis in SEE***

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## Outline

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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



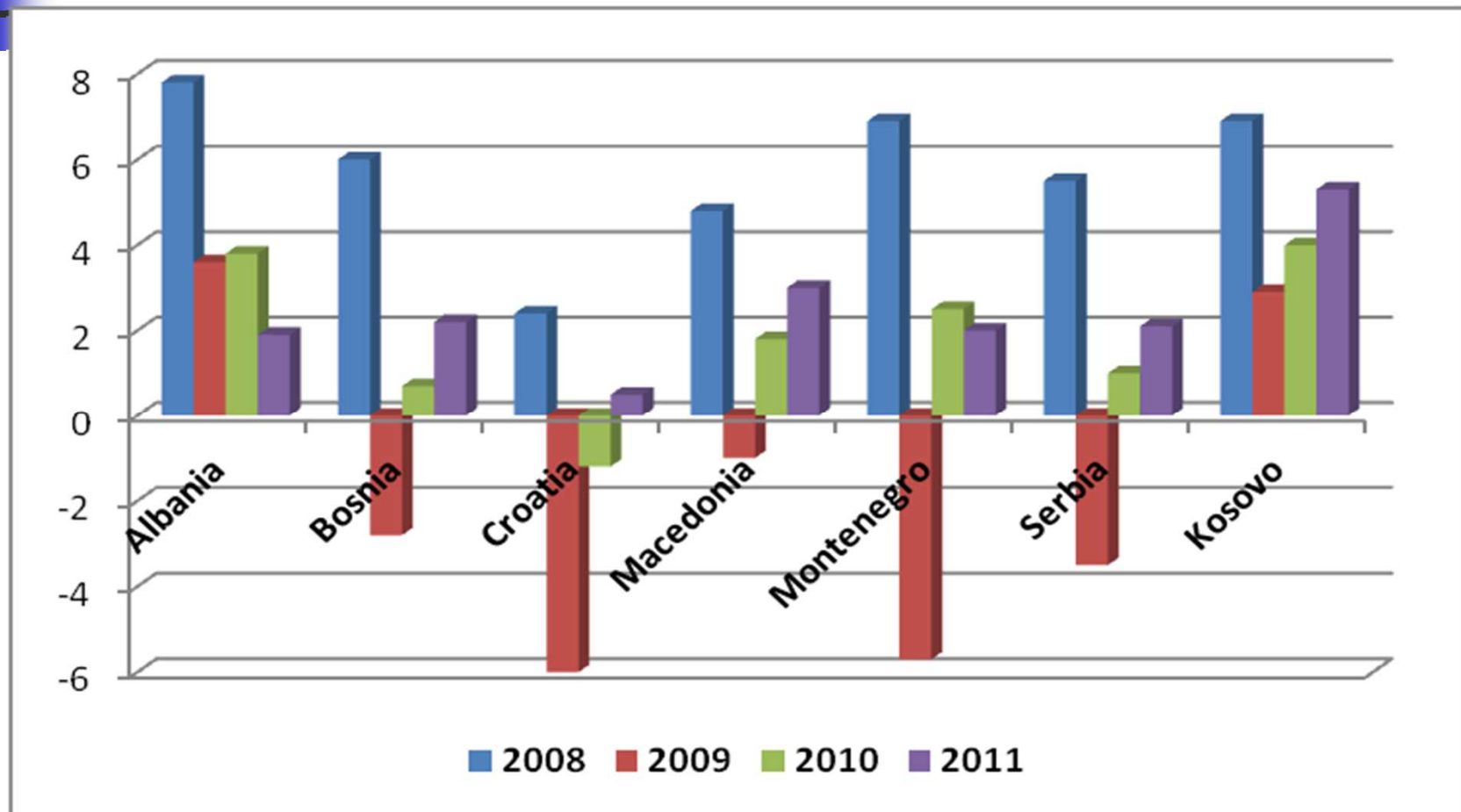
# 1. Effects of the crisis

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- 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





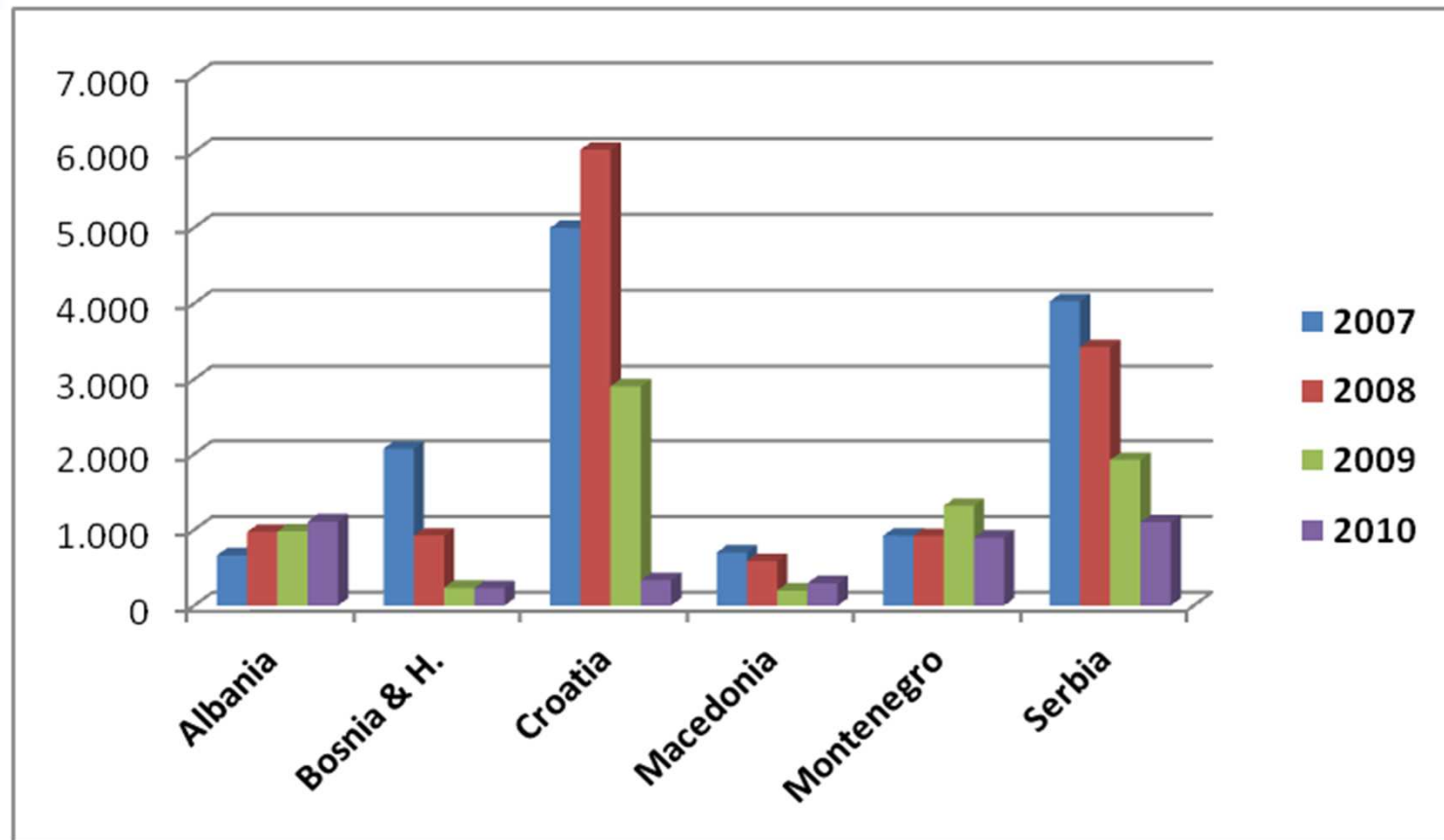
# Effects of the crisis

## *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 → 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 → after privatization mostly foreign-owned, risk of capital withdrawals or reduced lending to local clients
  - Dependence on trade with EU → 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)

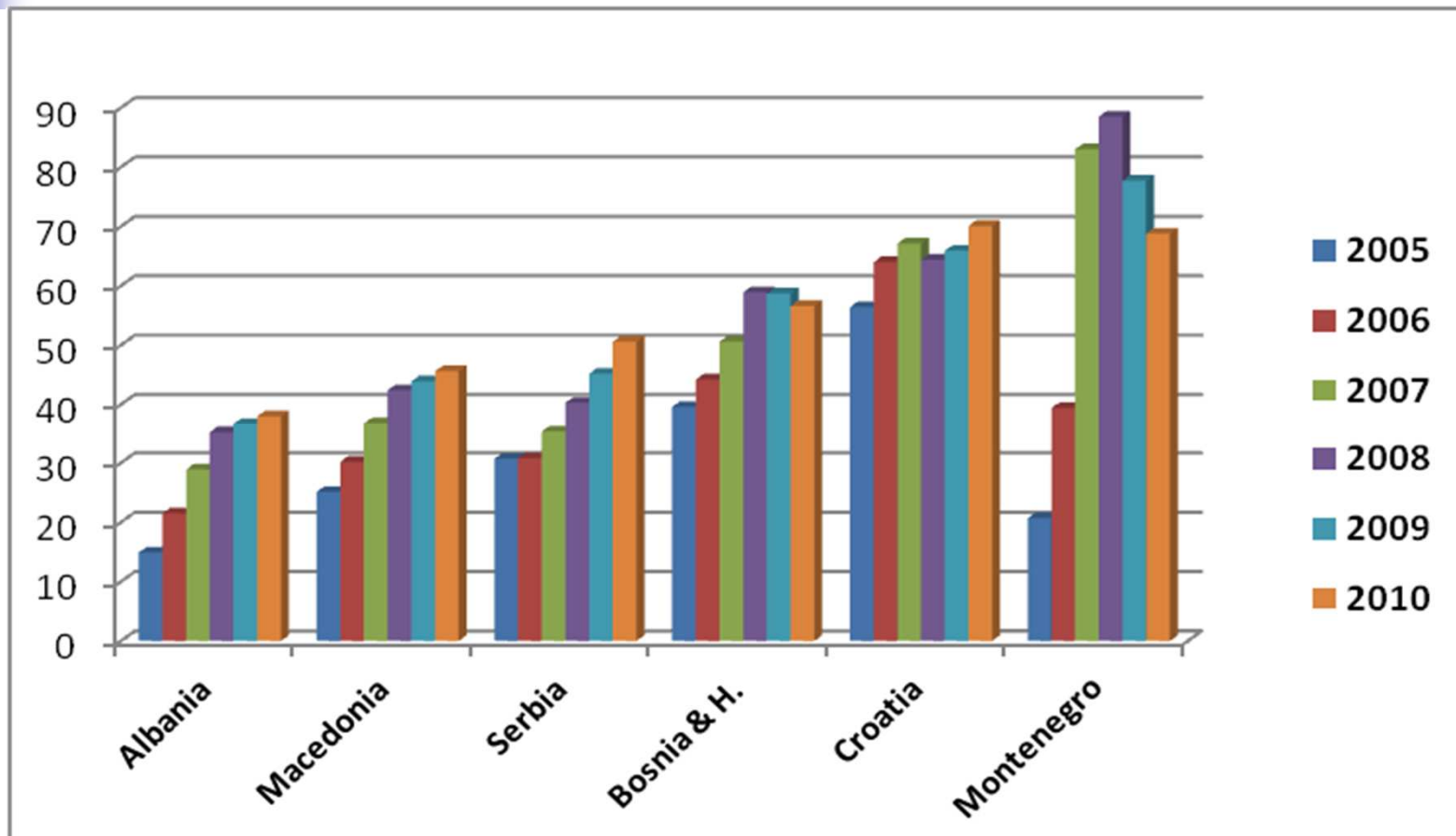
## Foreign direct investment (million US\$)

→ Sharp fall after 2007 in most WB countries



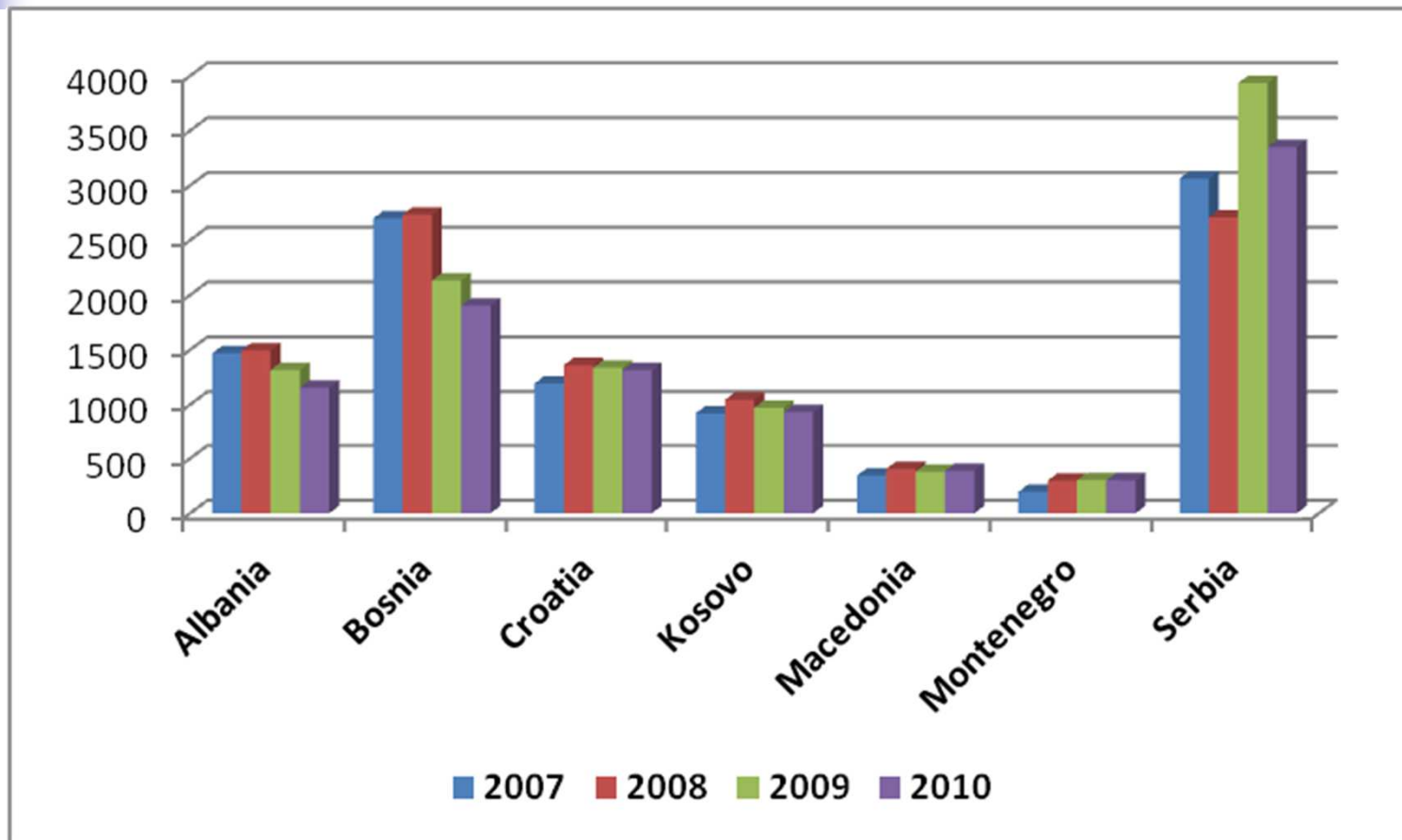
## Credit to private sector/GDP

→ Credit boom (2005-2007) was followed by much slower expansion/decline (Bosnia, Montenegro) in 2009-10



## Workers' remittances (million US\$)

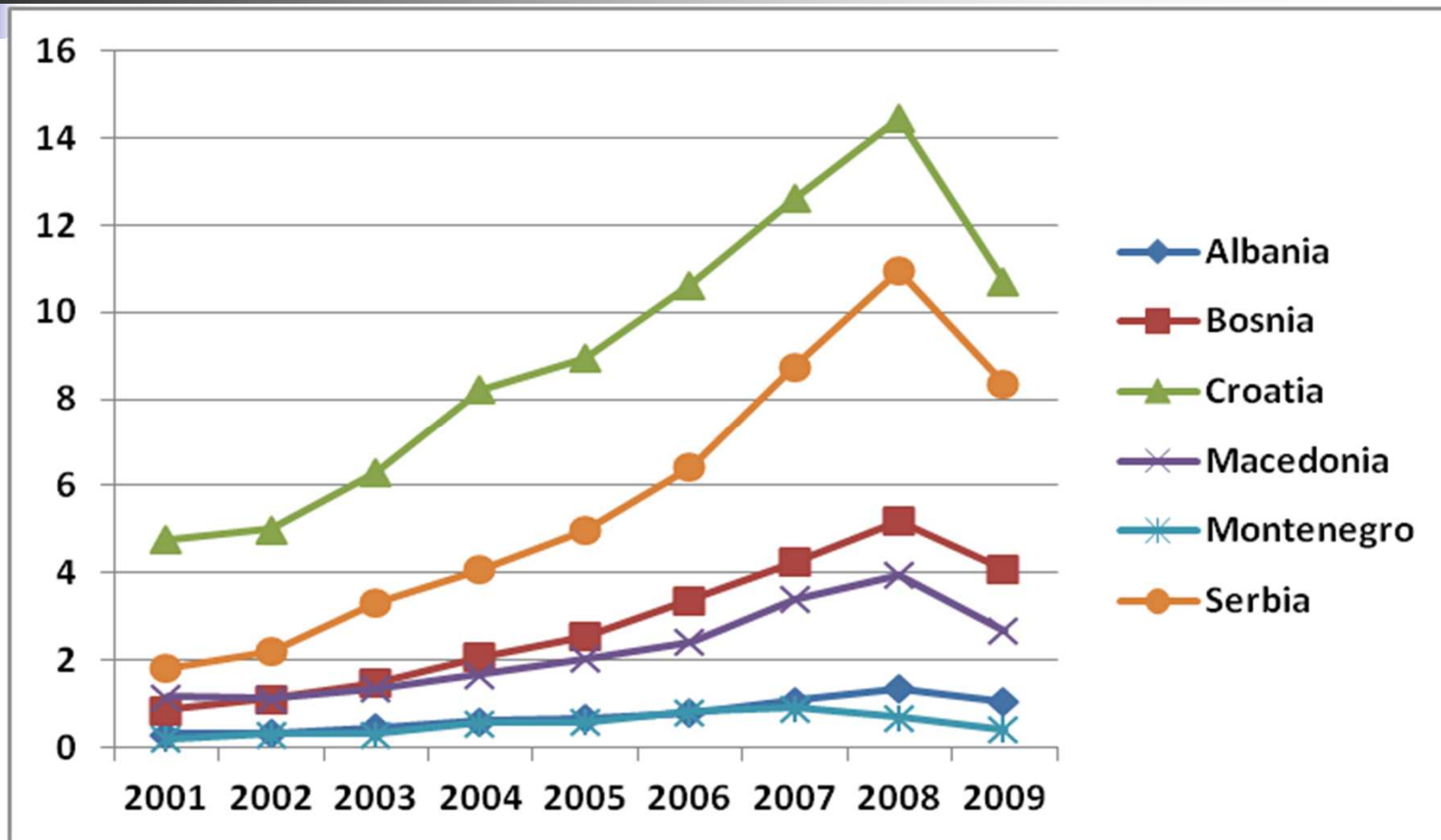
→ Reduced or stagnated after 2007 (exp. Serbia)





## Merchandise exports (million US\$)

→ Sharp drop in 2009





# Effects of the crisis

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## ***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

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### ***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

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### *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

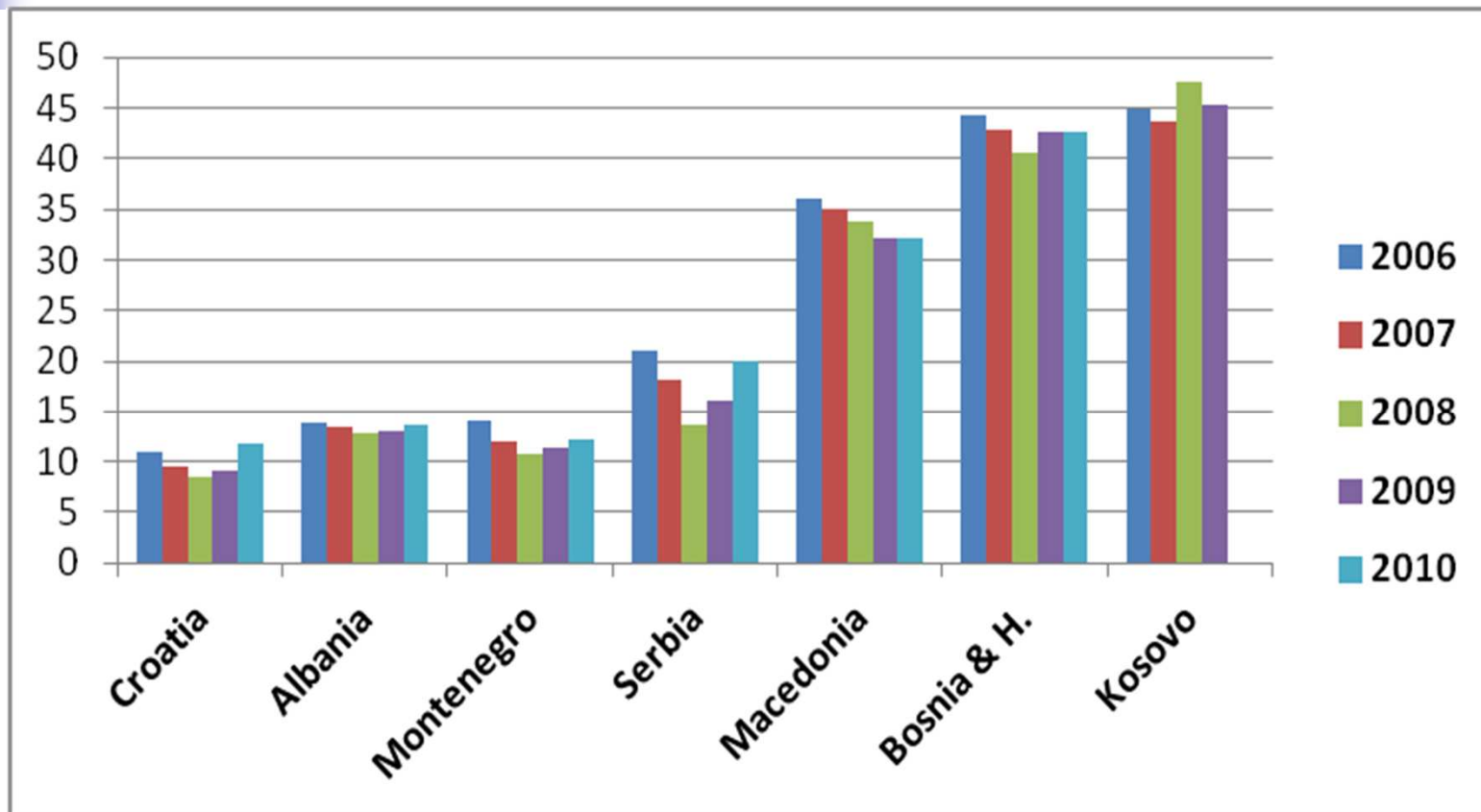
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***Comparing CEE and WB labour markets*** → the situation far worse in the WBs

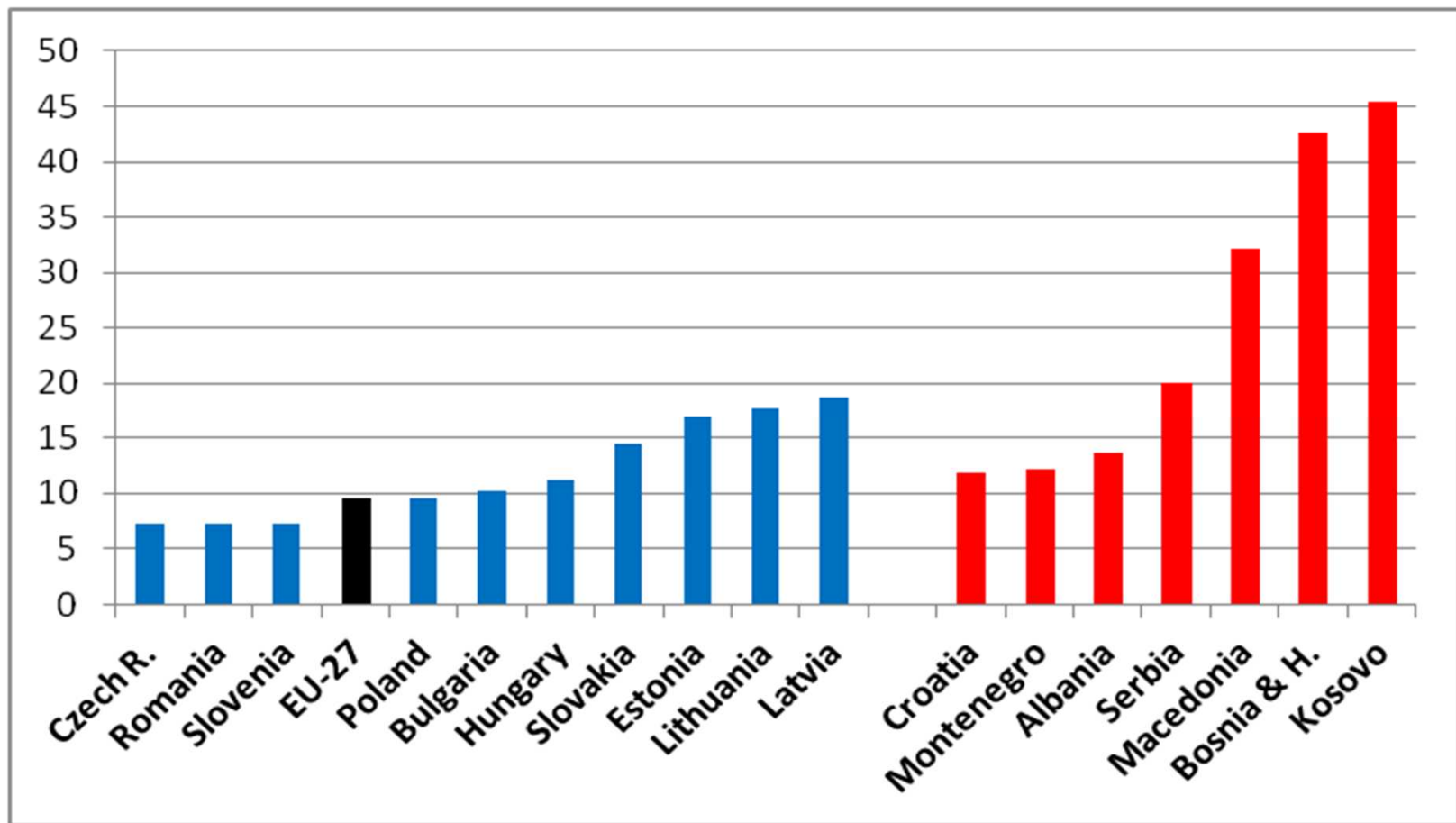
- Unemployment rates generally higher
- Long-term unemployment much higher
- Employment and participation rates are lower
- Informal economy more widespread
- Strong migration (“brain drain”): the most qualified workers left their homelands, emigrated to USA, Australia... may never come back
- “Brain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

## Unemployment (LFS, % labour force)

→ After 2008 again increasing in most countries



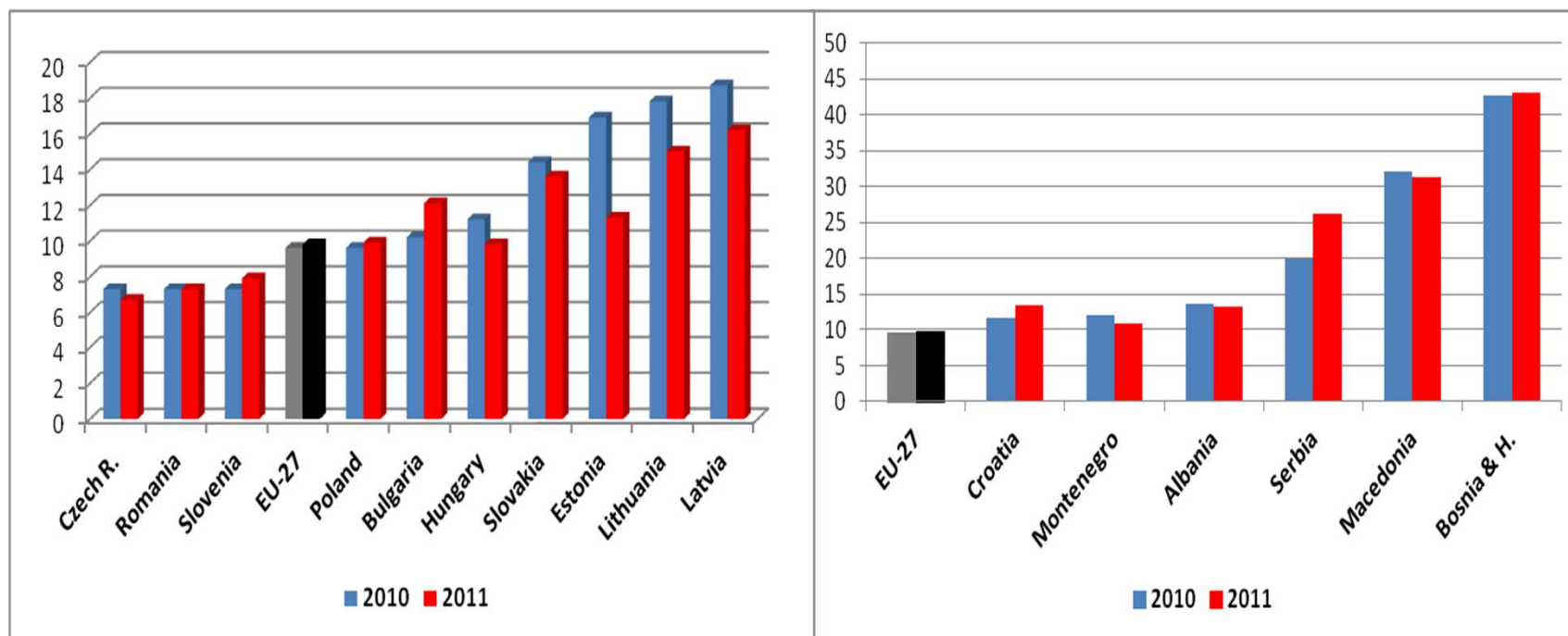
## Unemployment rates in 2010 → Higher than in EU-27 & most NMS (esp. Ser, Mac, Bos, Kos)



# Unemployment rates in NMS/WB in 2011 (preliminary, last available data)

NMS: reduced in 6 Cs

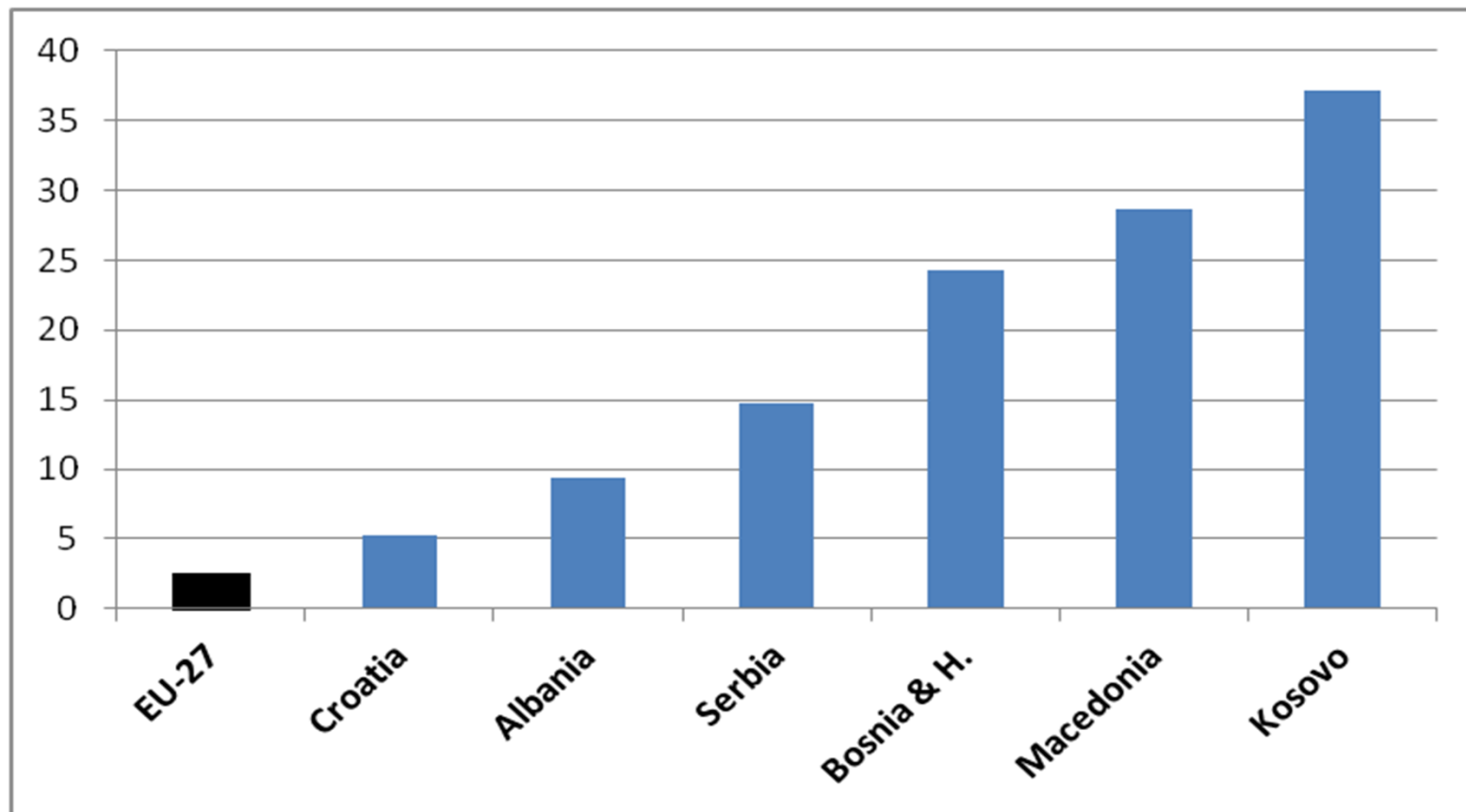
WBs: increase in at least 3





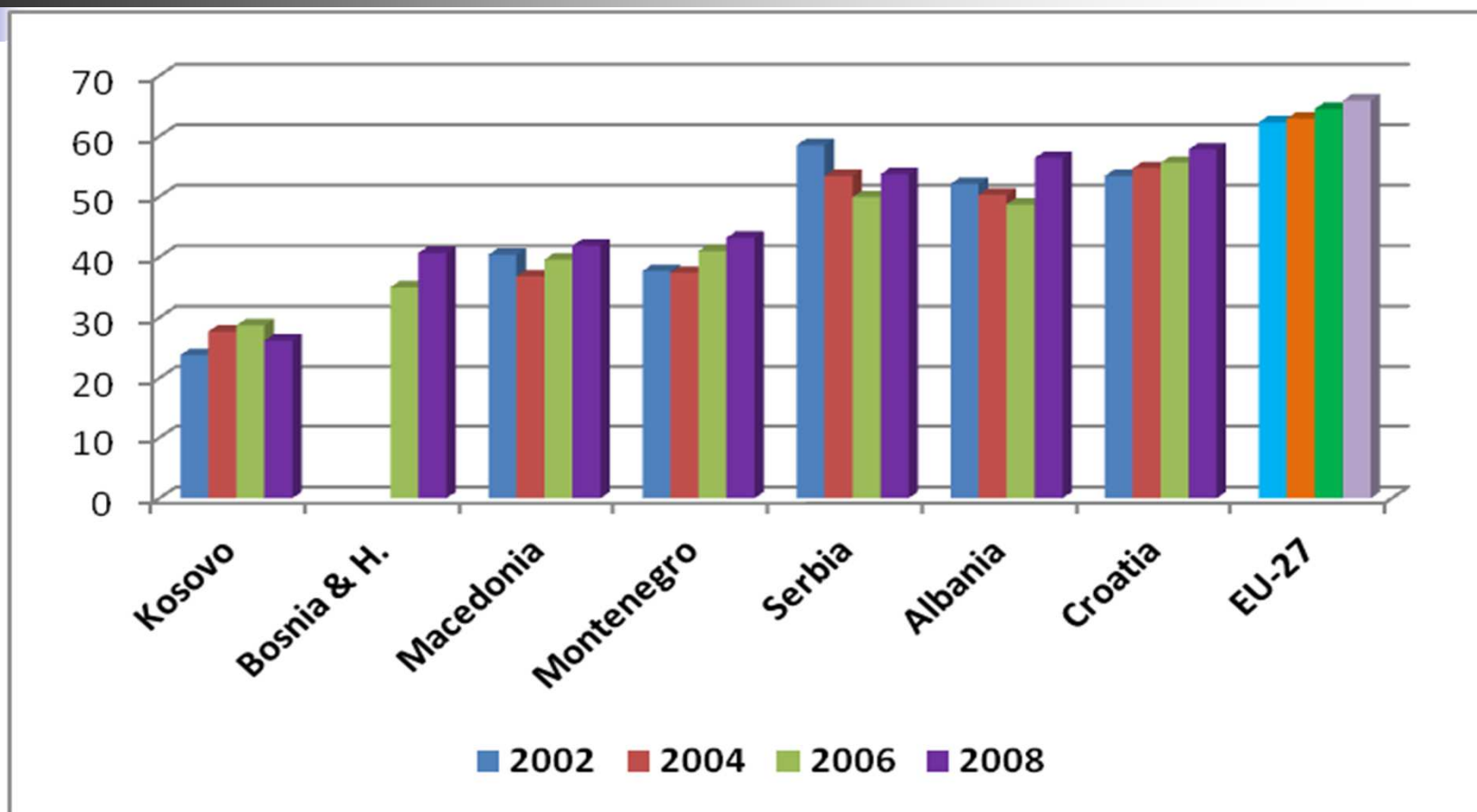
## Long-term unemployment rates, 2008

→ Extremely high (compared to EU), from 5-36%



## Employment rates, 2002-08 (LFS, %)

Low, until 2006 stagnating/declining (exc. Croatia)





## Social impact

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### ***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

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***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

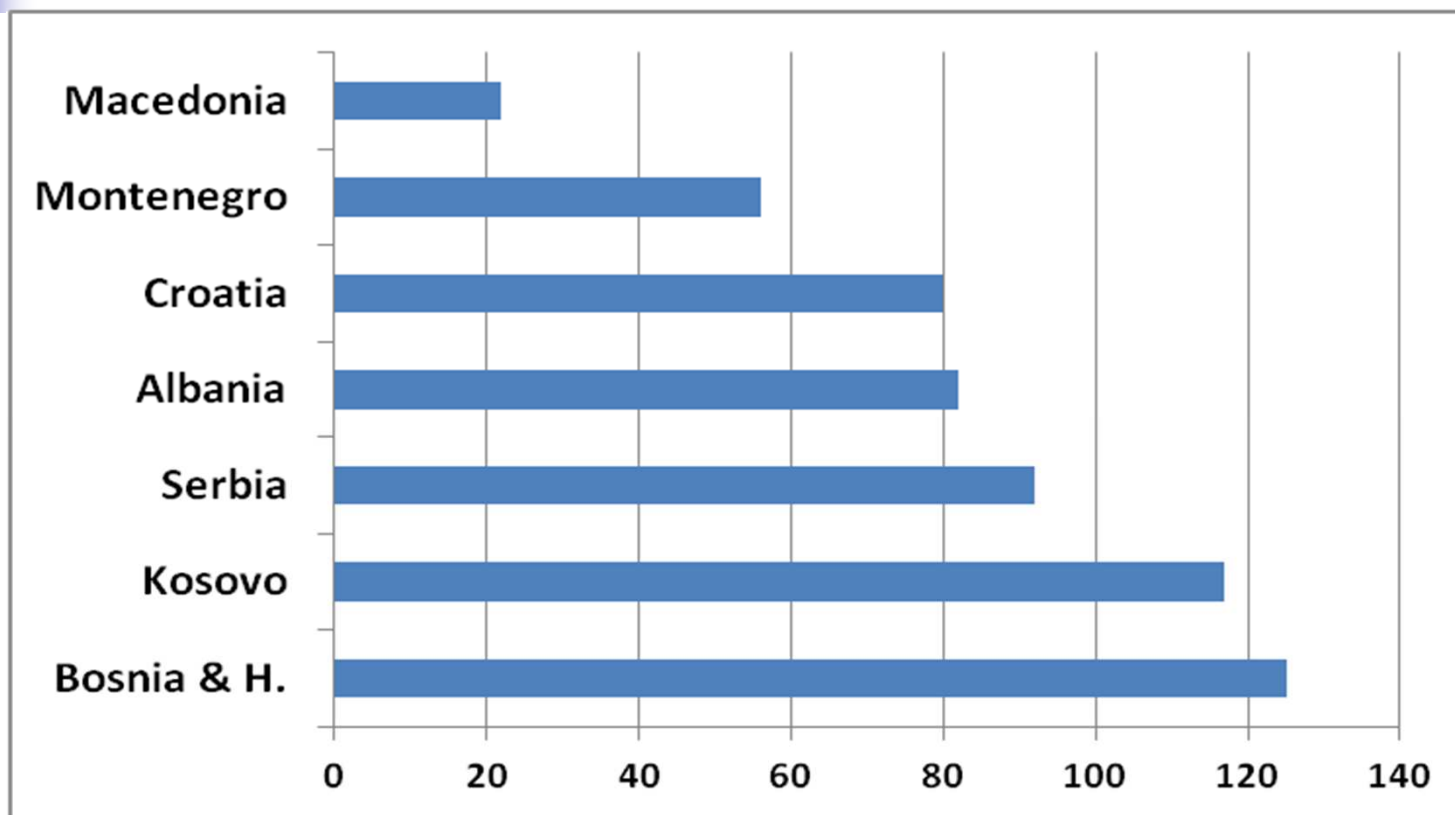
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## ***Persistence of the informal economy (& high unemployment)***

- 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

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***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

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***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

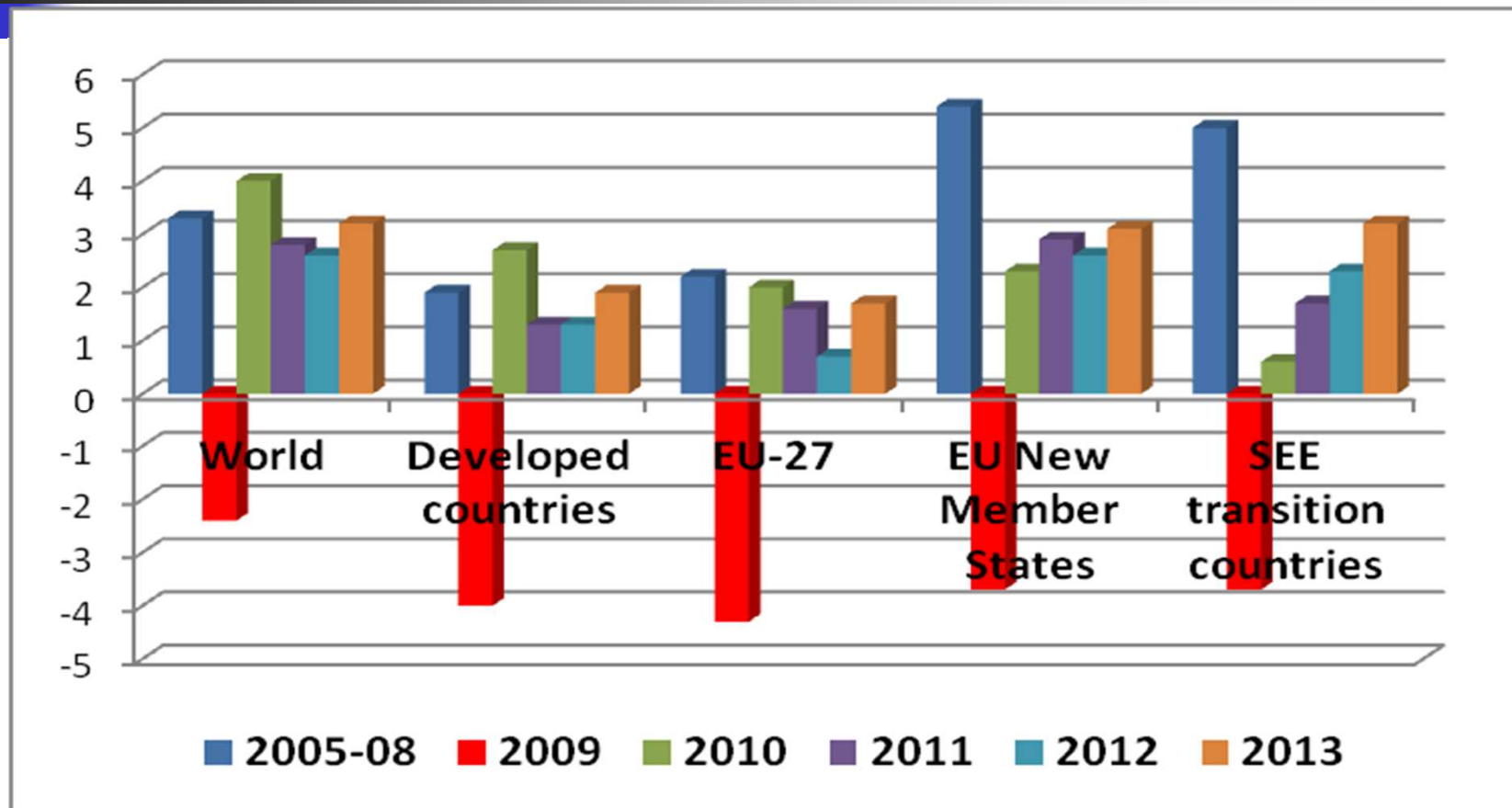
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## ***1. Current forecasts of world output (UN)***

- 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

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## ***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

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- 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

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- ***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)