

COVID-19 CRISIS – EUROZONE AND WESTERN BALKANS POLICIES' RESPONSES

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ABSTRACT

The COVID-19 crisis represents a unique global threat in recent history that affects social and economic dynamics of different countries and regions. The aim of the paper is to provide an overview of economic policies' reactions to present crisis in the Eurozone and Western Balkans region. The paper tends to answer the question whether proposed policies' actions provide adequate risk mitigating tools for the current crisis.

Keywords: COVID-19, Economic policies' responses, Eurozone, Western Balkans

1. INTRODUCTION

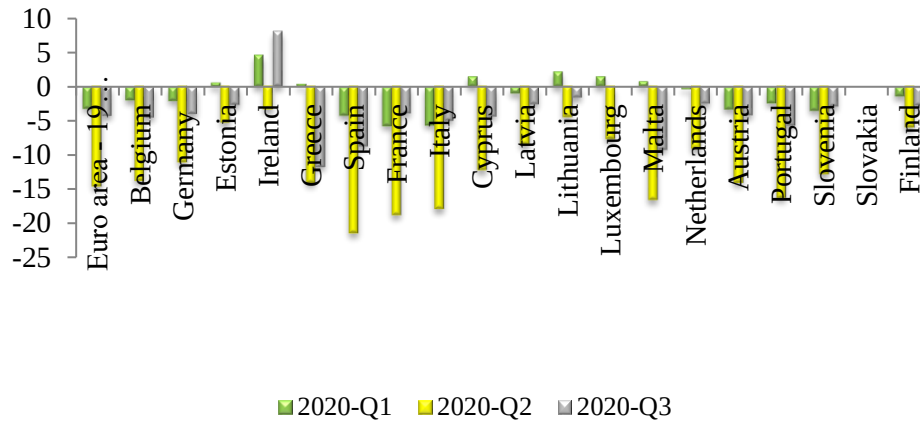
The ongoing social and economic crisis, triggered by the COVID-19 pandemic, represents an unprecedented threat in recent history for the Europe and the world. It affects social dynamics and economic activity of different countries and regions. The economic systems are slowing down. The COVID-19 crisis tests again the boundaries of the European currency union and challenges the EU accessing states. Corona crisis has its own unique characteristics. Its catastrophic potential is high while the external shock is said to be symmetric since it affects different economies and EU countries in a similar manner. This paper tries to answer whether proposed and implemented monetary and fiscal actions in the EU and Western Balkans represent viable risk mitigating tools for the present crisis. It is devoted to the analysis of already taken and potential anti-crisis policies' measures oriented to mitigate Corona crisis economic impact in analyzed countries. The paper is organized as follows – analysis begins with recent monetary decisions of the European Central Bank (ECB). It further focuses on the fiscal and economic strategies employed. Finally, the paper presents Western Balkans EU members and accessing countries' (with a special focus on Serbia) efforts to mitigate Corona crisis consequences.

2. EUROZONE INITIAL ECONOMIC POLICIES' RESPONSES TO COVID-19 CRISIS OUTBREAK

The challenges European economies are currently facing are specific as severe. They are caused by a symmetrical external shock. This type of crisis could potentially reduce the gap between the core and periphery member states of the Eurozone. Global financial crisis 2007-2008 and debt crisis in Eurozone 2010-2012 brought to light significant imbalances that Member States were facing for a long period. It appears that the ongoing COVID-19 crisis represents even a bigger challenge for the whole Union. The economic shock in the present crisis is severe and it is a fiscal rather than monetary challenge. As such it strikes the central weakness of the Eurozone – the absence of the fiscal union. The Corona crisis hits all Member States of the Economic and Monetary Union but also the whole Europe. The policy reactions to this pandemic are so far predominantly national. Thus, even in the presence of the symmetric shock the Eurozone responds asymmetrically. The substantial variety in policy responses is amplified by differences in initial conditions.

The longer the crisis lasts, the more visible these differences may become. Figure 1 presents the GDP volumes percentage changes during 2020 for Eurozone Member States indicating significant fall of economic activity during the year, in particular the second quarter.

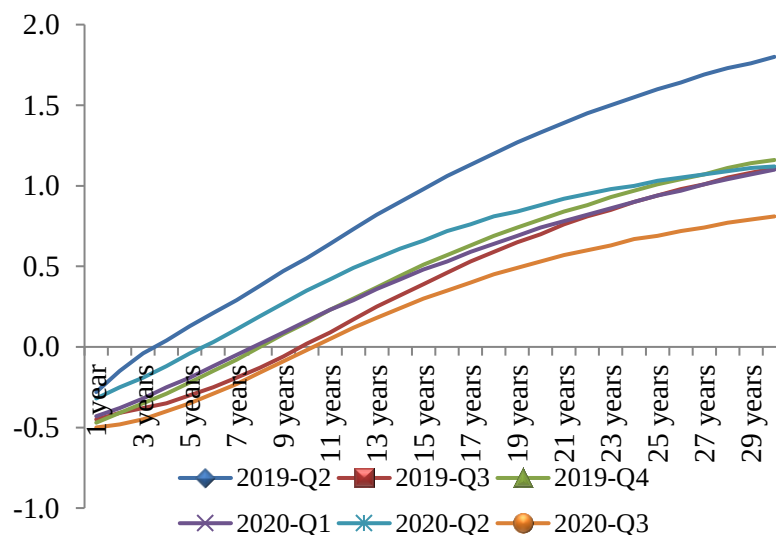
Figure 1: GDP volume changes for Eurozone member states during 2020, in %



* Growth rates with respect to the same quarter of the previous year are calculated from calendar and seasonally adjusted figures.
(Source: Authors' presentation based on the Eurostat data)

Often delayed responses of the national governments during previous crises have imposed significant economic costs to their countries. Similar scenario happened at the beginning of the present crisis. Then, once the ECB announced a new programme of asset purchases to stabilise European markets, the markets started to calm and bond spreads narrowed [Tooze and Schularick, 2020]. The spot rate yield curve of the Euro area shifted downwards.

Figure 2: Spot rate yield curve – Euro area*, in %



* Euro area - All euro area central government bonds
(Source: Authors' presentation based on the Eurostat data)

What becomes obvious from previous crises and the present one is that Eurozone needs a joint fiscal response to Corona crisis in addition to monetary policy measures. The in detail analysis is presented in continuation.

2.1. The ECB Anti-crisis Measures

The ECB liquidity provisions come in the form of targeted and non-targeted programmes. Monetary authority decision of March 12, 2020 announced additional longer-term refinancing operations to be conducted as prompt liquidity support to Eurozone financial system. The changes in the terms of targeted longer-term refinancing operations - TLTRO III (more favourable interest rate during the period from June 2020 to June 2021 and increase in the maximum amount that counterparties are entitled to borrow) were followed by a large expansion in the central bank funding. In the June 2020 banks bid for a total of €1,308 billion in TLTRO funds, which is the largest amount to date under any single lending operation. In relation to non-targeted programmes, the ECB announced in April 2020 a series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) to ensure sufficient liquidity and smooth money market conditions as response to the crisis [Hutchinson and Mee, 2020]. On March 18, 2020 the ECB introduced a new temporary asset purchase program of private and public sector securities in order to preserve monetary policy transmission mechanism. This Pandemic Emergency Purchase Programme (PEPP) initially based on the amount of €750 billion, was planned to be conducted until the end of 2020 and to include all the asset categories eligible under the existing asset purchase programmes [ECB, 2020]. The PEPP objective and means fall within the ECB's monetary policy mandate. Regarding prohibition of monetary financing defined in Article 123 of the Treaty on the Functioning of the European Union (TFEU) [Article 123], the European System of Central Banks (ESCB) does not have authority to purchase government bonds on secondary markets under conditions which would mean that its action has an effect equivalent to that of a direct purchase of government bonds from the public authorities and bodies of the Member States. The ECB should not purchase government bonds in primary markets either that would mean that it would effectively issue money to finance Member States' budget deficits during the crisis. The grant of financial assistance to the Member States does not fall within monetary policy. Member States are still obliged to conduct sound budgetary policies. The Governing Council of the ECB decided on June 4, 2020 to increase the size of the PEPP by €600 billion to €1,350 billion and to extend the purchase horizon until at least the end of June 2021. In addition, it decided to set up a new Eurosystem repo facility for non-euro area central banks (EUREP) providing precautionary euro repo lines to non-euro area central banks. EUREP complements the ECB's bilateral swap and repo lines which provide liquidity to non-euro area central banks. New bilateral repo lines with Romania, Serbia and Albania were announced during the review period [Forsyth and Lizarazo, 2020].

2.2. The Coordination of Fiscal Policy Responses within the Stability and Growth Pact (SGP)

Within the SGP framework fiscal reaction to COVID-19 crisis was firstly conducted in decentralised manner. Each Member State was using direct and indirect measures for their declining economies. However, the Eurogroup has offered platform for coordinated action and fiscal stimulus as reaction to crisis. In their public statements during March 2020 Ministers of Finance in EU have stressed out the need for coordinated policy actions. On March 16, 2020 the Eurogroup held discussion with non-Euro Area Members on necessary respond to human and economic crisis caused by Corona virus. The Eurogroup is committed to effectively address challenges, to restore confidence and support economic recovery. Exceptional circumstances require employment of all instruments necessary to limit the socio-economic consequences of the COVID-19 outbreak. Thus, Eurogroup has agreed a first set of national and European measures and set a framework for further actions to support economic recovery. Primary estimates of the European Commission have shown that the total necessary fiscal support will be very high.

Fiscal measures decided for economy reach 1% of the GDP, on average, for 2020 in addition to the impact of automatic stabilisers. Planned liquidity facilities consisting of public guarantee schemes and deferred tax payments are estimated on the level of at least 10% of the GDP. These figures could, however, be much higher till the end of the pandemic period. The following set of measures was announced to protect economies: national measures, coordinated efforts at the European level and measures to support the economic recovery [European Council, 16 March 2020]. European Commission has set up several temporary frameworks and significantly relaxed EU rules on state aid or competition law to support measures undertaken on the national level. On March 23, 2020 EU ministers of finance provided statement on the Stability and Growth Pact in light of the COVID-19 crisis. They see the importance of the coordinated policy response to limit the duration and the scope of the shock, protect economy and keep sustainability of public finances in the medium term. Ministers of Finance of the Member States agreed with the previously stated assessment of the European Commission that the conditions for the use of the general escape clause of the EU fiscal framework – a severe economic downturn in the euro area or the Union as a whole – are fulfilled. Member States remain obliged by the EU's fiscal rulebook, but they may depart from their 'normal' fiscal trajectory for the purposes of crisis management. The clause represents the most far-reaching form of flexibility under the SGP, and its activation is as significant as it is unprecedented [Dermine and Markakis, 2020, p. 3]. The use of this, so called, escape clause is ensuring the flexibility to undertake all necessary measures to support health systems, civil protection systems and economies, including further discretionary stimulus and coordinated action that should be timely, temporary and targeted by Member States. The goal is to address challenges, restore confidence and support fast recovery [European Council, 23 March 2020]. However, although EU seems to be very flexible in the ongoing situation, the long-lasting problem of economic and public finance divergence among Member States is still present. Notable is the difference in the capacity to support their economies [Tooze and Schularick, 2020]. Since the crisis is affecting all EU Member States, a significant increase in public debt levels in all EU countries seems inevitable. However, there is considerable divergence in available space that each country has in deficit spending [Heinemann, 2020, p. 2]. The past and present divergence is the reason why Europe requires a collective fiscal response at Eurozone level. Two options are proposed: relying on the European Stability Mechanism and/or issuing joint debt instruments.

2.3. The Latest Policy Actions

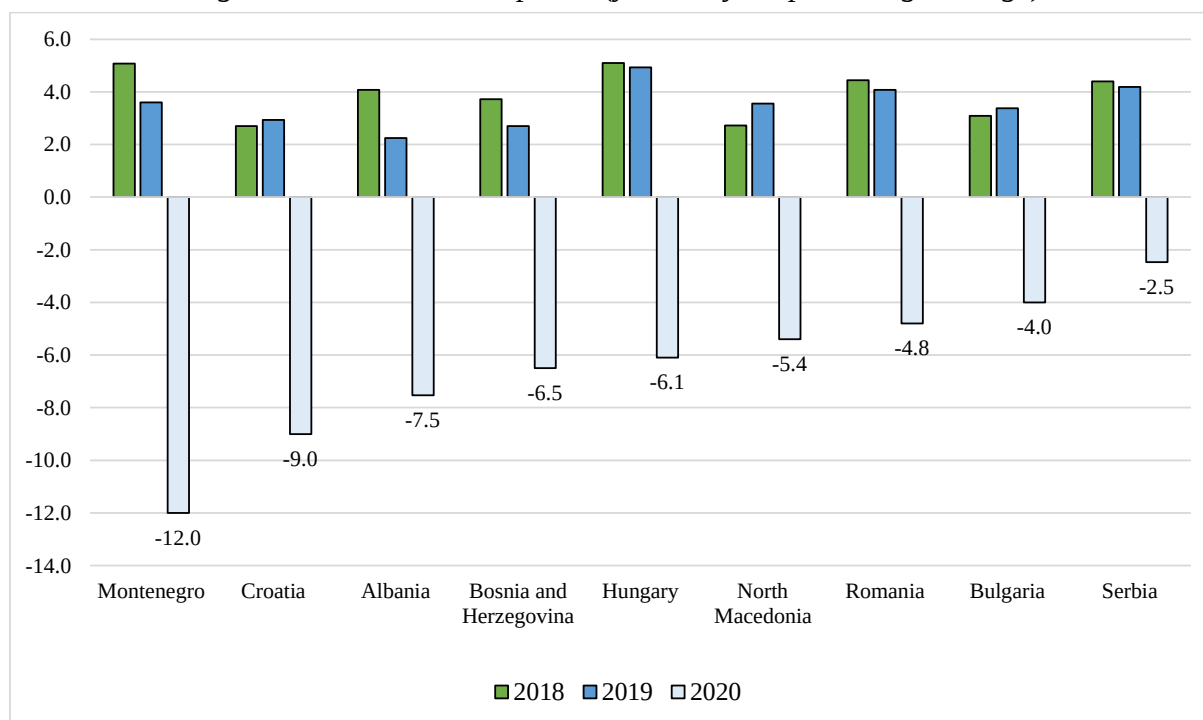
European Union leaders agreed in July 2020 on a €1.8 trillion spending package oriented at economic downturn in EU. They ultimately agreed on a €750 billion recovery plan. Of that, €390 billion is to be offered in grants and the rest in the form of loans. Additionally, the agreement was made on a seven year EU budget of over €1 trillion in the period 2021-2027 [Norman, 2020]. Despite long-standing opposition to joint debt issuance from the core Eurozone members, on October 20, 2020 the EU raised €17 billion from the sale of 10 and 20-year social bonds for its SURE unemployment scheme. It presented the first stage of the EU's plan to fund two support programmes for Member States that will channel funding to the countries hardest hit by the pandemic and consequent economic losses. The plan is to issue €100 billion of bonds under the SURE programme [European Commission, 25 November 2020]. These issuances bring EU closer than ever to debt mutualisation.

3. CORONA CRISIS CONSEQUENCES ON WESTERN BALKANS EU COUNTRIES AND CANDIDATE COUNTRIES

Western Balkans countries that are already EU members or are candidates for membership, put important effort to mitigate Corona crisis consequences. As the entire world, these countries recorded recession in 2020 as a result of COVID-19 pandemic.

The containment measures and external shocks have significantly influenced economic activity in those countries. This European region expects year on year negative economic growth of around 5% in 2020¹. These countries have responded with containment measures in the spring, easing of measures over the summer and re-introduction of stricter measures at the end of 2020 (similar to those seen in the spring), following the trend of the number of COVID-19 infections. With that, after Q2 2020 – when many countries in the world introduced severe containment measures that led to a sudden stop of many economic activities due to lockdowns – a mild economic recovery ensued in Q3, but in Q4 a more severe pandemic will consequently lead to significant drop of economic activity in the region.

Figure 3: GDP, constant prices (year-on-year percentage change)



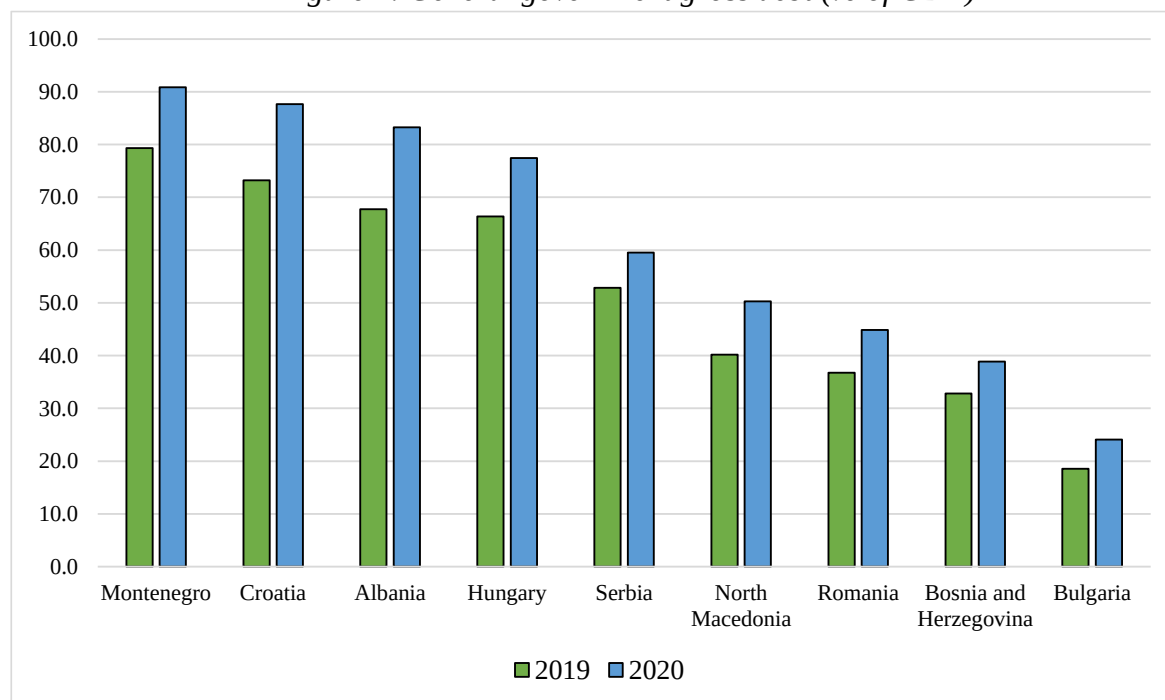
(Source: IMF, World Economic Outlook Database, October 2020)

Before pandemic outbreak, countries in the region were expected to achieve a solid growth between 2.5 and 4% (IMF World Economic outlook for Western Balkans countries from October 2019), continuing previously recorded favourable trend. Due to new circumstances, countries in the region fell into recession, while World Economic outlook (WEO) from October 2020 has anticipated that drop in GDP in this European region for that year would be between 2.5% and 12% (Figure 3). Thus, according to data, the highest drop is expected in countries that are substantial tourist destinations due to lower tourism activities: Montenegro (12%), Croatia (9%) and Albania (7.5%). On the other hand, among observed countries, the lowest drop is projected for Bulgaria (4%) and Serbia (2.5%)². Also, according to data [IMF WEO, October 2020] all selected countries have positive projected GDP growth rate in 2021, even though those projections should only be considered as a framework due to the fact that 2021 is (still) full of unknowns. It is expected that after pronounced drop in 2020, all these countries will have higher economic activity by 4-6% in 2021 compared to 2020. During 2020, as a result of the health crisis, Serbia recorded a moderate GDP drop (even though IMF WEO estimate was 2.5%,

¹ Authors' calculation, weighted average (by population) of annual negative GDP growth based on IMF WEO and Statistical Office of the Republic of Serbia (SORS) estimate.

² According to SORS estimated GDP drop in Serbia is 1,1% in 2020.

the drop was actually 1.1%, according to the newest estimate of the Statistical Office of the Republic of Serbia). This yearly data, as well as quarterly data for 2020 show that GDP drop in Serbia was smaller than that recorded in most European countries. Such result is achieved primarily due to the specific structure of Serbian economy which, unlike other European countries, has greater participation of industries producing existential goods and other products that were less affected by the drop in demand during the crisis (agriculture, food, tobacco and chemical industry) [QM62, July–September 2020, p. 14], as well as smaller service sector and less dependence on tourism. Smaller yearly drop is partly a consequence of Serbia entering the crisis with a higher economic growth rate compared to other countries, that is, in Q1 it logged a significant year on year GDP growth above 5%. Nevertheless, Serbia also recorded significant drop in industries highly affected by the crisis (tourism, traffic, automotive industry). In the Western Balkans region, the main cause for the initial GDP drop in Q2 2020 was the drop of domestic and foreign demand, as well as disruptions in supply chains. In 2020, recorded drop in the Western Balkans region was pronounced in private consumption, remittances inflow, foreign trade, industrial production, public and private investments, business activity of SMEs and self-employed. Private consumption in the years before the pandemic outbreak was the chief determinant of GDP growth in the region, but it fell considerably during the pandemic. Despite higher government spending, fall in private consumption led to drop in overall consumption in the countries of the region, which will be the main reason for negative growth in majority of these countries [World Bank, 2020, pp. 4-5]. Considerable drop in economic activity influenced the job market in the countries of Western Balkans. Most affected were small and medium enterprises (SMEs) and informal businesses. By April 2020, all countries of Western Balkans launched programs aimed at supporting job preservation. Despite that, all those countries recorded unemployment growth. Countries in the region focused on health protection measures, tax relief, guarantee schemes, subsidized credit lines and social assistance measures, but have also secured partial or full compensation for wage costs aimed at job preservation. Measures taken were generous and timely, but their scope differed greatly among countries. In the focus of these measures were different companies – from those whose closure was ordered by the government (BiH), over those that recorded drop of income of at least 30 percent (North Macedonia) to all SMEs and self-employed (Serbia). Depending on fiscal capability of a country, subsidies for employed ranged from 120 to 260 euros. Measures weren't exclusively aimed at certain sectors, but some of the countries in the region had more favourable terms for tourism, hospitality and transport companies (Montenegro, Albania, North Macedonia). Also, in Montenegro new employment was ensured by income subsidies. Since the official goal was prevention of layoffs, those in North Macedonia that received support had to keep their employees for two additional months, while in Serbia companies that let go more than 10 percent of workforce weren't eligible for support [World Bank, 2020, pp. 10-11]. Countries' governments responded with economic recovery packages that lead to increase in fiscal deficit as well as public debt, which will be one of the long-term consequences of COVID crisis. As a result of the pandemic, in 2020 fiscal deficit grew in all countries of Western Balkans. In 2019, unweighted average of the fiscal deficit level for candidate countries was 1.4% of GDP, while in 2020 it is expected to grow to 8% of GDP [World Bank, 2020, p. 19]. Figure 4 shows that the public debt was higher in 2020 compared to 2019 in all observed countries. Based on IMF data, public debt is the highest in Montenegro, Croatia and Albania – countries that recorded the highest growth during 2020 (12, 14 and 16 pp of GDP, respectively). According to data, level of public debt in Montenegro, Croatia and Albania will be above 80% of GDP. On the other hand, the smallest growth in 2020 was recorded in countries that have comparatively lower level of public debt in GDP – BiH (6 pp of GDP) and Bulgaria (5 pp of GDP).

Figure 4: General government gross debt (% of GDP)

(Source: IMF, World Economic Outlook Database, October 2020)

Considerable growth of fiscal imbalance is noted in Serbia, since that country recorded the best result in 2019 and in 2020 it launched a sizeable aid package that, subsequently, led to high public spending and fiscal deficit. Estimates are that fiscal deficit in 2020 amounts to 8% of GDP, higher than initially planned (0.5% of GDP). That points to a strong response to the pandemic crisis in terms of fiscal policy in Serbia. Very high fiscal deficit in 2020 on one side and drop in GDP on the other led to growth of public debt in Serbia in 2020, estimated to reach almost 60% of GDP, after 53% in 2019. Set of anti-crisis measures in Serbia consisted of wage subsidies, deferral of tax liabilities and approval of guaranteed loans. The first package consisted of the early liquidity loosening measures undertaken by the Serbia's National Bank. These measures were followed by government's support package and revised budget in April 2020 [Aspen Institute, 2020, p. 97]. The aid package in Serbia was similar in structure to other countries in the region, but more generous in scope. The program could have been more selective, because e.g. the state granted one-time assistance (of 100 euros) to all adult citizens, which is not the most efficient solution from the aspect of long-term economic growth and redistribution of income to vulnerable groups, and it significantly affected the growth of public expenditures and deficit. The newly adopted government package of economic measures from February 2021 aimed at helping citizens and the economy is worth 249 billion dinars. Combined with previous aid packages, it amounts to 953 billion dinars or approximately eight billion euros³. The new set of measures will include direct assistance to entrepreneurs, micro, small, medium and large companies, support to the hospitality sector, hotels, travel agencies, passenger and road transport sector. Also, this new package of measures includes one-time financial assistance to citizens and extension of the guarantee scheme aimed at maintaining private sector liquidity. When it comes to the further course of the pandemic, the effect on the economies of the region and the forecast of economic trends in 2021 has a lot of unknowns. The effects of the pandemic in the region are already severe, but still, Western Balkans governments will have to deal with many effects of the pandemic in the future: political,

³ <https://www.srbija.gov.rs/vest/en/167619/new-package-of-assistance-to-economy-citizens-adopted.php>

economic, and social consequences in general, and growth of fiscal deficit and public debt in particular. During the next period of the coronavirus pandemic, economic support packages will continue to be relevant throughout the region in order to limit layoffs and insolvency and increase household income. Given their significant costs, governments should direct public spending to the most affected segments of the economy. The governments in the region could use these immediate challenges imposed by the pandemic as an opportunity to review structural constraints and steer their economies towards a successful recovery as well as sustainable growth in the future. The pace of Serbia's recovery will be determined by further course of the epidemic and the pace of recovery of European economies. It is certain that further recovery of Serbia will be influenced by the political will and public administration's capacity to implement differentiated and targeted support measures for the affected and endangered segments of Serbian economy.

4. CONCLUSION

The COVID-19 crisis represents an unprecedented global treat in recent history that strongly affects different countries and regions. The aim of this paper was to provide a critical overview of economic policies' responses to the ongoing crisis in the Eurozone and Western Balkans. The analysis began with Eurozone initial responses and recent monetary decisions of the ECB. In the further focus were relevant fiscal and economic strategies. The effects of the pandemic in Western Balkans countries are already severe, but economic support packages will continue to be relevant in order to limit negative effects of the pandemic on labor market, businesses and households. In the next period, the region countries will have to deal with many effects of the pandemic, especially rising fiscal deficit and public debt. Political, economic, and social consequences could be huge, therefore countries should focus on achieving successful recovery and sustainable growth in the future.

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