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COVID-19 AND THE IMPACT ON THEECONOMY

Opportunities for economic recovery and transformation

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Content

Introduction: What kind of crisis are we facing?

The phrase "It is an economic tsunami" is being widely used to describe the state of the economy and international financial markets by all analysts and experts in the world economy. The Coronavirus is pushing economies towards economic recession, at a time when all parameters and trends were in positive trend. As the pandemic situation worsens, everyone finds it difficult to decide which conversations are more frightening, the conversations with epidemiologists or the conversations with economists and company executives. Social distancing is turning into economic distancing. People are facing restriction to going to shops, theaters, cinemas, museums, bars, restaurants and workplaces. To prevent the spread of the COVID-19 pandemic, we are inevitably heading towards economic recession, and more likely, if it lasts, even towards economic depression, to the extent we have not seen in the modern economy.

There is no analogous situation in modern times. There is agreement among experts that the "economic pain" will go through several waves: The first wave is the "unplanned stop", so almost all economic activities throughout the country stop suddenly. A few weeks ago, people went to work, ate at restaurants, paid for their services, booked trips and vacations, planned car purchases, were considering buying a new home, held trainings, and conferences. Now, almost everything is put on halt. People have found shelter and security in their homes and are passive. In the second wave, when everything is halted, people can gradually lose their jobs. In the third wave, all those who may be out of work or those at risk of losing their jobs will be panic, not because of the pandemic, but the anxiety about the future. No one will buy new car, new house, or plan a vacation this summer. Although much of the restrictions imposed to prevent the spread of the COVID-19 pandemic will be phased out, consumer reluctance will slow economic growth for a much longer time after the end of the COVID-19 pandemic. In the fourth wave, businesses that have planned investments will give up any new investment, whether in new production lines, new product development, or investments in new workspaces and thus a significant economic growth engine will be paralyzed.

Leading economists are proposing "heavy artillery" to fight the economic catastrophe that could be caused by the COVID-19 pandemic. Governments need to reduce the chances of bankruptcy of individuals and enterprises, ensure that people continue to spend, even if they are not working, and increase public investment and investment in health systems.

Kenneth Rogoff, Professor of Economics and Public Policy at Harvard University, in an article published on the Project Syndicate platform underscores the fact that uncertainty about the actions and behavior of people and policymakers in the coming weeks and months is as great as scientific uncertainty in relation to Coronavirus. According to Rogoff, "until there is a better sense of when and how the COVID-19 public-health crisis will be resolved, economists cannot even begin to predict the end of the recession that is now underway. Still, there is every reason to anticipate that this downturn will be far deeper and longer than that of 2008.

According to Ricardo Hausmann, Professor at the John F. Kennedy School of Government at Harvard, "Macroeconomists initially thought that the COVID-19 pandemic would shake aggregate demand and that this should be combated with policies that increase consumption. But they soon realized that, unlike the global financial crisis of 2008, which collapsed the aggregate demand, the COVID-19 pandemic is first and foremost a shake-up of aggregate supply." So even if people want to consume, go to the theater, go out to restaurants, travel, this will be impossible, as everything has to be closed or there will be measures that make the operation of many impossible

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businesses. According to Hausmann, this situation is unbearable, especially for developing countries. These countries depend on raw material exports, tourism, remittances and are all expected to collapse this year. This will affect purchase power in these countries and Governments will face problems with budget revenues.

In the report on the world economy, published in the second week of April, the International Monetary Fund characterizes the economic crisis caused by the COVID-19 pandemic, as a crisis that we have never seen before and therefore has great uncertainty regarding its impact on people's lives. Most countries in the world are simultaneously facing health crisis, financial crisis and a drastic drop in the price of raw materials, including oil. According to International Monetary Fund projections, the global economy will contract by -3%, which is a decrease of 6.3 percentage points, compared to the January 2020 projections. This decline is expected to cause the most negative recession we have seen since the "Great Depression" crisis and way worse than the 2008 global financial crisis.

At the same time, the World Trade Organization (WTO) has found that global trade is on the verge of collapse, similar to that of 1930, during the Great Depression. According to the WTO, recovery will be faster if countries keep markets open, do not put up barriers and act together. The WTO estimates that world trade will contract by 13% to 32%, depending on the duration of the COVID-19 pandemic and the duration of the restrictive measures that have been put in place to prevent the pandemic from spreading.

What kind of policies does the economy need?

The modern economy is a complex structure of many interconnected parties: governments, workers, enterprises, suppliers, consumers, banks and other financial institutions, etc. Everyone is someone's employee, someone's consumer, someone's lender. A sudden halt creates a chain reaction, which can be justified on an individual level, but will be followed by catastrophic collective damage. The self-isolated consumer, faced with uncertainty about the future, continually reduces purchases. This makes it impossible for enterprises to generate revenue and they are forced to reduce costs, while also reducing the number of jobs, to avoid total disaster. Banks, in order to maintain stability and prevent increasing exposure, in relation to non-performing loans, reduce lending, further obscuring the outlook for the non-financial sector. Panic and declining confidence are another layer in the problem with many unknowns. Even without isolation and social distancing measures, recession would be expected. Because panic and uncertainties and lack of confidence will lead to reduction in consumption and investment.

Like the health system, the economic system must have "intensive care, beds and ventilators" to deal with the crisis. In an economic system this role is played by central banks with monetary policy and governments with fiscal measures. One thing is clear: with no economic policy, recession cannot be prevented. The recession is happening, but hopefully it will be short term. In this case, the main policy objective should be to target all channels that may lead towards deepening of the problem, taking swift and timely action. The time aspect of implementing the measures is more important. Measures must be implemented effectively throughout the duration of closure, restrictions and social distancing. Comprehensive and stable measures must be taken. There is little risk if we do much to stabilize the economy, and risk is if we do little.

In 2008 there was a question, "How fast can the economy recover?" In 2020, at the time of the COVID-19 pandemic, we are faced with two conflicting questions. First, how to stop fatalities from Coronavirus? Second, how do we ensure that the economy recover once we return to normalcy? No book, no theory, no practice, has taught us the answer to both questions contemporaneously. But what is known so far, based on China's practice, solving only the public health problem, i.e. putting the virus under control, can help and accelerate economic recovery.

Policies are needed that make money distribution now and efficiently into the pockets of families. We must also acknowledge the fact that this is not enough. According to Paul Krugman, a regular columnist at the New York Times and winner of the Nobel Prize in Economics, "in typical recessions, the priority of monetary and fiscal policy is to get people back to work as soon as possible. "But this is a natural disaster and the role of the government is to help families prevent economic disaster." Ivan Krastev from the European Council on Foreign Relations in his view on the possible effects of the COVID-19 pandemic, says that this pandemic will force the idea of the return of the "big government", through economy incentives interventions.

The basic calculations are that one month with a production capacity of 50% and another two months with a production capacity of no more than 25%, will lead to a decrease of up to 10% of annual output in an economy.

According to Mike Konczal, a researcher at the Roosevelt Institute, there are five elements to slowing the recession and limiting potential negative impacts:

a) Help people directly by providing cash;

b) Support for workers to ensure care for them;

c) Support businesses and municipalities with fiscal and monetary policy measures;

d) Prevent the collapse of businesses, by providing liquidity tools, including the possibility for the government to be the final consumer, for a part of the stock of their products, provided that companies do not lay off workers

e) For industries/sectors that may go bankrupt, create incentive mechanisms that make their recovery possible, through a clear corporate and financial governance framework, including limiting dividends and bonuses.

The basic calculations are that one month with a production capacity of 50% and another two months with a production capacity of no more than 25%, will lead to a decrease of up to 10% of annual output in an economy. Based on this, emergency measures, incentive measures and recovery measures in the economy should be calculated. Economy incentives should in principle match the expected drop in economy output, with monetary and fiscal policy measures.

How deep is crisis in Kosovo?

The Kosovo report of the International Monetary Fund, published in early April, states that the COVID-19 pandemic has hit the economy of Kosovo hard. According to the International Monetary Fund, Kosovo's economy will shrink by 5%. Prior to the outbreak of the COVID-19 pandemic, the International Monetary Fund projected economic growth of 3.5%. According to the International Monetary Fund projections, the outbreak of the pandemic will affect the tourism sector by 20%, mainly because of travel restrictions affecting regular visits from diaspora. The International Monetary Fund predicts a 19% drop in exports as a result of falling global demand and a 10% drop in remittances due to the negative effects of the COVID-19 pandemic in the countries of origin of remittances. Decrease in Foreign Direct Investment and other financial revenues are also expected. The World Bank, in its October 2020 report, also predicts economic hardship for all countries in the region, including Kosovo and all countries affected by COVID-19. According to the World Bank, Kosovo's economy is expected to shrink by 8.8% as a result of the crisis caused by the Covid-19 pandemic.

According to the latest World Bank report on Kosovo, published in October this year, "Despite the easing of austerity measures in June 2020, the economy continues to decline, as the COVID-19 shock is negatively affecting diaspora-driven export services, investment and private consumption. Economy of Kosovo is expected to shrink by 8.8 in 2020."

Other credible research also shows very negative impacts of the COVID-19 pandemic on Kosovo's economy. To measure the impact of restrictive measures against the spread of the COVID-19 pandemic in the private sector, five organizations representing business interests conducted a joint survey. According to this survey, respectively data processed and analyzed by Recura Financials, 95% of surveyed companies assess the crisis caused by COVID-19 as negative. 60% of surveyed enterprises believe that the COVID-19 pandemic endangers their survival, while 30% of surveyed enterprises stated that they have reduced the number of employees.

Even in the latest research of the Kosovo Chamber of Commerce, which measures every 4 months the business climate and business confidence in the most relevant sectors of the economy, the second quarter of 2020 shows a poor state of business in the country. About 80% of businesses have estimated that they have an unsatisfactory business situation. Compared to the previous quarter, the situation in this quarter has deteriorated even more, the percentage of businesses that assess the current unsatisfactory situation is higher by 47 percentage points.

The confidence indicator also dropped significantly compared to the previous quarter (about 37.3 percentage points). The declining confidence was mainly driven by the negative statements of key economic sectors in the country. ***The confidence indicator in this quarter is -44.7, and the most negative value ever recorded since 2013 when this indicator began to be measured.***

What will the future bring?

In an interview with National Public Radio (USA), Historian YUVAL NOAH HARARI talks about Transformed Post-Pandemic World: "There are experiments everywhere. Universities just moved all its courses online, which it thought of doing for years but never did anything. And now we have this huge experiment. What happens when hundreds of millions of people start working from home, instead of going to the factory? So all these are basically social experiments on a massive scale that will change the world. Technology will help us adapt to the extreme we have now. Physical mobility may be reduced by moving a good portion of our activities to Cyberspace. Schools, offices, universities, workspaces, are likely to change permanently and much faster than previously thought and designed.

There is a consensus among analysts and experts in various fields that after the end of the COVID-19 pandemic, "nothing will be the same". There will be a "new normalcy", with many changes in lifestyle and way of doing business. Changes in customer behavior, online learning and working are expected, you have been given a big boost, social distancing will coexist for a long time with us, while businesses will take care that the sources of production and supply are as close as possible to the operation site. Moving production as close as possible to the operation site will push manufacturing companies to make larger investments in automation, artificial intelligence, digitization of processes and organize work in "physical shifts", with workers who must necessarily be physically present during the production process and with "virtual shifts" with workers and experts related to the production process, who may drive the production process, or give advice and opinion on the processes, but may do it virtually and remotely.

Changes are also expected in the flow of trade and the organization of production and supply chains. The impact of the COVID-19 pandemic on trade flows is evident. The economic contraction has reduced the demand for imports and has led to collapse of many developments in trade. On the policy side, supply disruptions, as well as shortages of medical supplies and equipment, have placed the focus on the security of production and supply networks. What will happen when the emergency situation moves to public health? Voters, businesses and governments will greatly reassess expectations and the risk tolerance zone in relation to different parts of the economy.

From 1980 to 2007, "globalization" accelerated trade exchanges and raised livelihood. The rapid gains in communication and information technologies, in addition to innovations, have significantly reduced barriers to the movement of goods, services, people, knowledge, ideas and cultures. At the same time, many governments, as a result of planned economic policy failures and protectionism, moved rapidly towards opening up economies and free trade, based on the rules of the GATT (General Agreement on Trade and Tariffs) and later within the framework and rules of the World Trade Organization. Regional trade agreements, including: The European Single Market, NAFTA, ASEAN, and dozens of bilateral trade agreements, have contributed to the simplification of trade between countries, increasing specialization, within production and supply networks. This approach yielded results. The share of trade in global output increased from 13% in 1989 to 28% in 2007.

This bright period in global trade and economy began to change in 2008, following the global financial crisis. Since then we have had many disagreements between countries, problems in new initiatives for trade facilitation and liberalization, problems in reform within the European Union, Britain's exit from the European Union, stagnation in transatlantic trade relations, as well as between Asian countries, countries of the Pacific and the United States of America. In 2017, a decade after the "peak in trade", the share of trade in global output fell to 22%. If at one time trade liberalization was seen as a "good deal", now the global downturn, the aftermath of

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the financial crisis and growing populism are making many countries to view trade liberalization with skepticism.

Production networks are continuing to adapt, with or without a local or global policy agenda. Emerging markets are no longer just consumers, but have also become producers. Final products have a pronounced component of innovation and knowledge, while production methods are becoming more sophisticated. Value chains on a regional basis are performing much better than value chains based on large global systems, and trade in services has begun to exceed the value of trade in goods.

What will happen to the global production and supply chain once the risk of the COVID-19 pandemic is lifted? It must first be expected that the supply chain will become more adaptable, more flexible, and develop depending on the circumstances. Secondly, companies will reassess supply patterns by moving away from single-source supplies, while governments and health institutions will reassess stocks and supply sources for medical devices and supplies, changing the assessment of what is considered safe and adequate supply.

What have been the policies of the institutions of the Republic so far in managing the economic consequences caused by the pandemic?

To address the negative consequences of the COVID-19 pandemic in Kosovo's economy, the Government of Kosovo initially approved an emergency package, worth 179 million Euros. The cost of Government emergency measures is about 2.5% of GDP and these measures focus on transfers to Small and Medium Enterprises, as well as most affected enterprises in various sectors; upgrades to social schemes by adding extra payments for one month; additional budget for the Ministry of Health; deferral of tax returns and payments, including corporate income tax, personal income tax and value added tax. At the same time, the Central Bank of Kosovo has decided to suspend loan payments initially until April 30, 2020, with the possibility of extension for another month. Based on the evaluations of businesses in the research conducted by five business organizations, businesses have assessed the measures taken by the institutions of the countries as insufficient. The above research, conducted by five business organizations, shows that only 6% of respondents estimate that the measures have greatly alleviated the difficulties of doing business, compared to a similar percentage of those who estimate that the measures do not alleviate the difficulties at all.

During July (2020) the Government approved the Economic Recovery Program, allocating 365 million Euros to support businesses in creating and maintaining jobs, as well as to promote aggregate demand. The Economic Recovery Program includes measures to facilitate access to finance for businesses, additional subsidies for farmers, various tax incentives, wage subsidies for workers, and the opportunity for citizens to withdraw 10% of their accumulated contributions to the Kosovo Pension Savings Trust.

Conclusions and Recommendations: How can the economy in Kosovo recover and transform?

The common threat we face should unite us all along with some of the key powers that humanity has, solidarity, courage, creativity and freedom of thought. we also need to put these powers into effect on our path to economic recovery and transformation. Crises also provide a good opportunity for change, adaptation and launching of new energies for a more comprehensive transformation. In an article published a few weeks ago, together with the Director of the American Chamber of Commerce in Kosovo, Arian Zeka and entrepreneur Visar Ramajli, we argued that "Kosovo missed two opportunities to create proper models of economic development - in 1999 when it was liberated from occupation and in 2008 after the declaration of independence. Despite continuous positive growth over the years, the sources of this growth were completely unstable. First time in the last two decades, Kosovo has a unique new chance to make a difference. The recovery package should be based on several important pillars: (1) The National Economic Transformation Pact shall include all decision-makers in the country, the private sector and the financial sector. The aim of the pact should be to set long-term, medium-term and short-term priorities for economic development of the country, through policies, instruments and measures that put the private sector in its deserved position - a generator of economic growth. All priorities, policies, instruments and measures must meet three basic requirements: Be in full compliance with the rules of the market economy; be based on 'cost-benefit' data and analysis, as well as be budgeted, including the identification of funding sources, where international financial institutions and the donor community also play an inalienable role. (2) The core of economic transformation should be the new development model, based on a strategy that enables a gradual removal of dependence on unstable sources of economic growth, including public investment and remittances, and the latter should be replaced by direct investment from the diaspora. The new development model should focus on sectors that have competitive capabilities, with high potential for export and integration into regional and global supply chains. To strengthen these competitive sectors, foreign investment should be encouraged. Promoting investment opportunities should focus on international companies that aim to stabilize the supply chain and maintain competitiveness, following their possible departure from Asian countries. (3) The new development model also means a change in the mindset of doing business. The paradigm of this model cannot be imagined without the digital aspect. Therefore, sectors with competitive potential and ancillary services to these sectors need to undergo a holistic process of digital transformation. Restrictions on economic activity as a result of the COVID-19 pandemic have raised the need for digital transformation of businesses in a new dimension. All industries need to take advantage of the opportunities provided by digitization, both to increase competitive advantages and to survive difficulties such as those posed by the pandemic. However, for greater success, digitization must integrate both governance and public services, but also education and health care. (4) A new development model requires finance and human capital. The country's budget and existing financial resources are insufficient to launch a new cycle of country development. Therefore we need to advance the existing instruments of the financial system, to increase capital in the market, through the creation of investment funds, which can accumulate funds from citizens, businesses, diaspora, financial institutions, etc. Private investment funds would finance the growth of our enterprises in international markets, the increase of production capacities and projects of strategic importance. As far as human capital is concerned, a complete transformation of the education system is needed which should reflect the features and behaviors of the new generations, but also the real needs of the labor market and the priorities of the National Economic Transformation Pact. Foreign direct investments would play a key role, both in terms of financial capital and in terms of knowledge transfer."

In the short- and medium-term Recovery Policies, in addition to those adopted in the Economic Recovery Program, should focus on providing confidence to businesses and consumers and on the uninterrupted circulation of money in the market.

To achieve this goal the following institutional actions are recommended:

1) Investments in the health system to address the health of citizens and keep the virus under control

2) Focus on digitization of administration and reduction of bureaucracy. Funds to companies for digitization of their business processes and expand of business activities through e-commerce

3) Program to support the integration of Kosovan companies in global supply chains

4) Special financial program to support and promote the tourism and gastronomy sector, two of the sectors most affected by the pandemic

5) Create tax and legal facilities for the construction sector, a sector that may be affected by the crisis, in the coming months, as a result of cash flow problems of companies active in this sector, including the reduction of construction taxes and the creation of legal basis for temporary cadastral registration of buildings under construction

6) Promote aggregate demand by promoting purchases in certain periods (for example 0% VAT on weekend purchases)

7) Create financial instruments for financing the transition to energy, towards more sustainable and efficient energy supply solutions, for businesses and households

Economic recovery and transformation will depend on a number of factors, including the likelihood of a new pandemic outbreak, the duration of the pandemic and its impact on consumer and business confidence, but also on the ability of businesses to adapt to "new normalcy". The government must be proactive in providing adequate support to citizens and businesses, but also flexible at the same time to adapt to any new circumstances that may arise.

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