WORLD BANK GROUP

Competition and Firm Recovery Post-COVID-19

Europe and Central Asia Economic Update

Office of the Chief Economist

Fall 2021

WORLD BANK **ECA ECONOMIC UPDATE** FALL 2021

Competition and Firm Recovery Post-COVID-19

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Contents

Boxes

Figures

Tables

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Abbreviations

Belstat	National Statistical Committee of the Republic of Belarus
BHAS	Agency for Statistics of Bosnia and Herzegovina
BiH	Bosnia and Herzegovina
bn	billion
bp	basis point
BPS	Business Pulse Survey
BTI	Bertelsmann Stiftung Transformation Index
CA	Central Asia
CE	Central Europe
CAB	Current Account Balance
CAD	Current Account Deficit
CBA	Central Bank of Azerbaijan
CBA	Central Bank of Armenia
CBR	Central Bank of Russia
CE	Central Europe
CEFTA	Central European Free Trade Agreement
COVAX	COVID-19 Vaccines Global Access
CPI	Consumer Price Index
CROSTAT	Croatian Bureau of Statistics
DSSI	Debt Service Suspension Initiative
EAP	East Asia and the Pacific
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ECAPOV	ECAPOV (ECA Poverty) database of standardized household surveys
ECB	European Central Bank
ECDC	European Centre for Disease Prevention and Control
EE	Eastern Europe
EEA	European Environmental Agency
EFSD	European Fund for Sustainable Development
EMDEs	emerging markets and developing economies
EPLex	Employment Protection Legislation index
ES	Enterprise Survey
EU	European Union
EU-SILK	European Union Statistics on Income and Living Conditions
FDI	foreign direct investment
FX	foreign exchange
GCI	Global Competitiveness Index
GDP	gross domestic product
GHG	greenhouse gas emissions
HARPEX	Harper Petersen Charter Rates Index
H1	first half
IEA	International Energy Agency
IFI	International Financial Institution
ILO	International Labour Organization
IMF	International Monetary Fund
INSTAT	Institute of Statistics (Albania)

IOSCO	International Organization of Securities Commissions
IPCC	Intergovernmental Panel on Climate Change
ITU	International Telecommunication Union
KIHS	Kyrgyz Integrated Household Survey
lhs	left-hand side
LICs	low-income countries
MONSTAT	Statistical Office of Montenegro
$mtCO_2e$	million tons carbon dioxide equvialent
Q1	first quarter
NBG	National Bank of Georgia
NBK	National Bank of Kazakhstan
NBR	National Bank of Romania
NBS	National Bank of Serbia
NBT	National Bank of Tajikistan
NPL	non-performing loan
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PCE	personal consumption expenditure
PMI	Purchasing Managers' Index
PMR	product market regulations
pp	percentage point
PPP	purchasing power parity
q/q	quarter over quarter
rhs	right-hand side
saar	seasonally adjusted annual rate
SCC	South Caucasus
SDR	Special Drawing Rights
SILC	Statistics on Income and Living Conditions
SMEs	small and medium-size enterprises
SOE	state-owned enterprise
SOFAZ	State Oil Fund of the Republic of Azerbaijan
TajStat	Agency on Statistics of Tajikistan
TFP	total factor productivity
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNECE	United Nations Economic Commission for Europe
UNESCO	United Nations Educational, Scientific, and Cultural Organization
UNICEF	United Nations Children's Fund
UNWTO	United Nations World Tourism Organization
USD	US dollars
VAT	value added tax
VFDI	Vivid Economics and Finance for Diversity Initiative
WBK	Western Balkans
WDI	World Development Indicators
WEF	World Economic Forum
WTO	World Trade Organization
y/y	year-over-year

Country Codes

Albania	ALB	Latvia	LVA
Armenia	ARM	Lithuania	LTU
Austria	AUT	Luxembourg	LUX
Azerbaijan	AZE	Malta	MLT
Belarus	BLR	Moldova	MDA
Belgium	BEL	Montenegro	MNE
Bosnia and Herzegovina	BIH	Netherlands	NLD
Bulgaria	BGR	Norway	NOR
Croatia	HRV	Poland	POL
Cyprus	CYP	Portugal	PRT
Czech Republic	CZE	Republic of North Macedonia	MKD
Denmark	DNK	Romania	ROU
Estonia	EST	Russian Federation	RUS
Finland	FIN	Serbia	SRB
France	FRA	Slovak Republic	SVK
Georgia	GEO	Slovenia	SVN
Germany	DEU	Spain	ESP
Greece	GRC	Sweden	SWE
Hungary	HUN	Switzerland	CHE
Iceland	ISL	Tajikistan	TJK
Ireland	IRL	Turkey	TUR
Italy	ITA	Turkmenistan	TKM
Kazakhstan	KAZ	Ukraine	UKR
Kosovo	XKX	United Kingdom	GBR
Kyrgyz Republic	KGZ	Uzbekistan	UZB

Regional Classification Used in this Report

This report covers 50 countries referred to as Europe and Central Asia (ECA) countries. These are divided into 10 groups: Central Asia, Central Europe and the Baltic Countries, Eastern Europe, Northern Europe, South Caucasus, Southern Europe, Western Balkans, Western Europe, Russia, and Turkey.

TABLE E.1 Regional classification used in this report

Central Asia	Central Europe and Baltic Countries	Eastern Europe	Northern Europe
Kazakhstan	Bulgaria	Belarus	Denmark
Kyrgyz Republic	Croatia	Moldova	Finland
Tajikistan	Czech Republic	Ukraine	Iceland
Turkmenistan	Estonia		Norway
Uzbekistan	Hungary		Sweden
	Latvia		
	Lithuania		
	Poland		
	Romania		
	Slovak Republic		
	Slovenia		

South Caucasus	Southern Europe	Western Balkans	Western Europe
Armenia	Cyprus	Albania	Austria
Azerbaijan	Greece	Bosnia and Herzegovina	Belgium
Georgia	Italy	Kosovo	France
	Malta	Republic of North Macedonia	Germany
	Portugal	Montenegro	Ireland
	Spain	Serbia	Luxembourg
			Netherlands
			Switzerland
			United Kingdom

	Russian Federation	Turkey	

Executive Summary

After nearly two years since COVID-19 first gripped the world, the ongoing pandemic continues to shape the path of the global economy. Economic activity in the emerging and developing countries of Europe and Central Asia (ECA) is expected to grow 5.5 percent in 2021, higher than initially projected due to a stronger-than-anticipated recovery in external demand in the first half of the year, as well as strengthening domestic demand due to vaccinations and support packages. The boost to exports, however, is already fading due to the ongoing global and regional spread of more contagious COVID-19 variants, which has also dampened the recovery in domestic demand. In the global context, this update summarizes recent developments and presents the outlook for the region. It also focuses on competition, which is key to robust recovery after the pandemic, as well as for sustainable, long-term economic growth.

The pace of recovery in 2022 is forecast to be 3.4 percent, as external demand and commodity prices further stabilize, global growth plateaus, and macroeconomic policy support is withdrawn. The outlook remains highly uncertain given the continuation of the pandemic, unequal vaccine access, and vaccine hesitancy. The regional recovery has been accompanied by a rapid acceleration in inflation and remains vulnerable to financial stress, which could be triggered by an abrupt tightening of external financing conditions or a sharp rise in policy uncertainty and geopolitical tensions.

Although global economic activity is recovering and output in ECA is expected to grow in 2021, containing COVID-19 remains a challenge in the region. At the onset of the pandemic, the rapid spread of the disease and movement restrictions and lockdowns that were imposed to contain the virus led to sudden supply and demand shocks, which manifested in declines in output and productivity.

This ECA Economic Update assesses the impact of COVID-19 on firms in the region, with a focus on the role of competition during the crisis and recovery. The focus is on competition because it is associated with dynamism, incentivizes firms to innovate, and motivates more efficient firms to enter and grow, while facilitating the exit of less efficient ones. As economies start to recover from the COVID-19 crisis, it will be important to ensure that a competitive business environment is in place that supports the reallocation of resources from less productive to more productive firms, that is, the process of "creative destruction."

The COVID-19 pandemic has heightened concerns about limited competition and its potential consequences for economic growth. Smaller firms may find it more difficult to adopt new technologies or business models, are less likely to receive government support, and, as a result, are more likely to exit. In this case, concentration and the dominance of large firms may increase, potentially further limiting competition, just when it is most needed to promote recovery. Perception-based and regulatory indicators suggest that most countries in ECA can improve the institutional framework and enforcement of laws for a strong competition environment, particularly in Central Asia and the South Caucasus.

Analysis using firm-level survey data for the emerging and developing countries in the region shows that COVID-19 had a profound and heterogeneous impact on firms. On average, in the first round of the survey, conducted between May and November 2020, firms in the region reported a 24 percent drop in monthly sales and a 10 percent decline in the number of full-time employees, compared with the previous year. By the second round of the survey, which was conducted between November 2020 and May 2021, one in four firms reported anticipating falling into arrears on outstanding liabilities in the next six months. Smaller and younger firms were hit harder by the COVID-19 crisis. By the second round of the survey, smaller, younger, and female-run businesses had not yet seen their sales improve since the initial drop.

Crises can be devastating for many firms, but they often have a silver lining, playing a cleansing role. Evidence presented in the report is consistent with this, showing that economic activity in ECA appears to have been reallocated toward more productive firms during the COVID-19 crisis, particularly in countries with more competitive markets. Firms with high pre-crisis labor productivity experienced significantly smaller drops in sales and employment than firms with low pre-crisis labor productivity. More productive firms were also more likely to adapt to the crisis by increasing online activity and remote work. Whether the reallocation of economic activity toward more productive firms is long-lasting will depend on whether more productive firms will grow and less productive firms ultimately exit.

Importantly, in countries with more competitive markets and stronger policies that protect competition, the reallocation toward more productive firms was even greater. Similarly, in countries with a larger share of employment in the public sector and higher public ownership of banks, the reallocation from lower productivity to higher productivity firms was weaker, consistent with lower competition and dynamism being associated with a greater role of the state.

Finally, many governments in ECA implemented broad policy support schemes that could promptly address the initial economic fallout from the COVID-19 crisis and provide immediate relief to protect firms and workers from the worst effects. The reach of government support varied widely across countries, but on average half the firms reported having received some government support in response to the economic fallout of the pandemic. Overall, government support was more likely to go to less productive firms, larger firms were more likely than smaller firms to receive support in the form of payment deferrals and fiscal relief, and support measures were given to firms regardless of the level of their pre-crisis innovation.

Since the broad support measures implemented at the beginning of the COVID-19 crisis appear to have gone to less viable firms irrespective of their pre-crisis innovation, they may have lasting negative consequences for competition and growth. As economies enter the economic recovery phase, it will be important for policy makers in all countries to phase out broad policy support measures as soon as appropriate and focus on fostering a competitive business environment. Such an environment is key to a strong recovery, resilience to future crises, and sustainable, long-term economic growth.

PART

The Economic Outlook and Long-term Challenges

1

COVID-19: In It for the Long Haul?

Global Context

After nearly two years since COVID-19 first gripped the world, the ongoing pandemic continues to shape the path for the global economy. Although a cyclical recovery has been underway in many economies since the initial collapse in activity in 2020Q2, the pace of the recovery is not envisioned to be sufficient to return global output to its pre-pandemic projection by 2022. Moreover, the strength of the recovery continues to diverge. In major economies, substantial fiscal support and widespread vaccination has helped bolster the rebound in domestic demand; while for many emerging markets and developing economies (EMDEs), the spread of more transmissible COVID-19 variants has prompted renewed mobility restrictions amid uneven vaccine access and deployment. Obstacles from the pandemic, combined with the continued withdrawal of macroeconomic support, are offsetting some of the benefits of firming external demand and elevated commodity prices for EMDEs. Risks to the global outlook remain tilted to the downside, reflecting a protracted pandemic. The risk of an abrupt tightening of global financing conditions also looms given above-target inflation in major economies. Growth-enhancing policy reforms are critical to set the recovery on a green, resilient, and inclusive development path.

COVID-19 Pandemic and Overall Trends

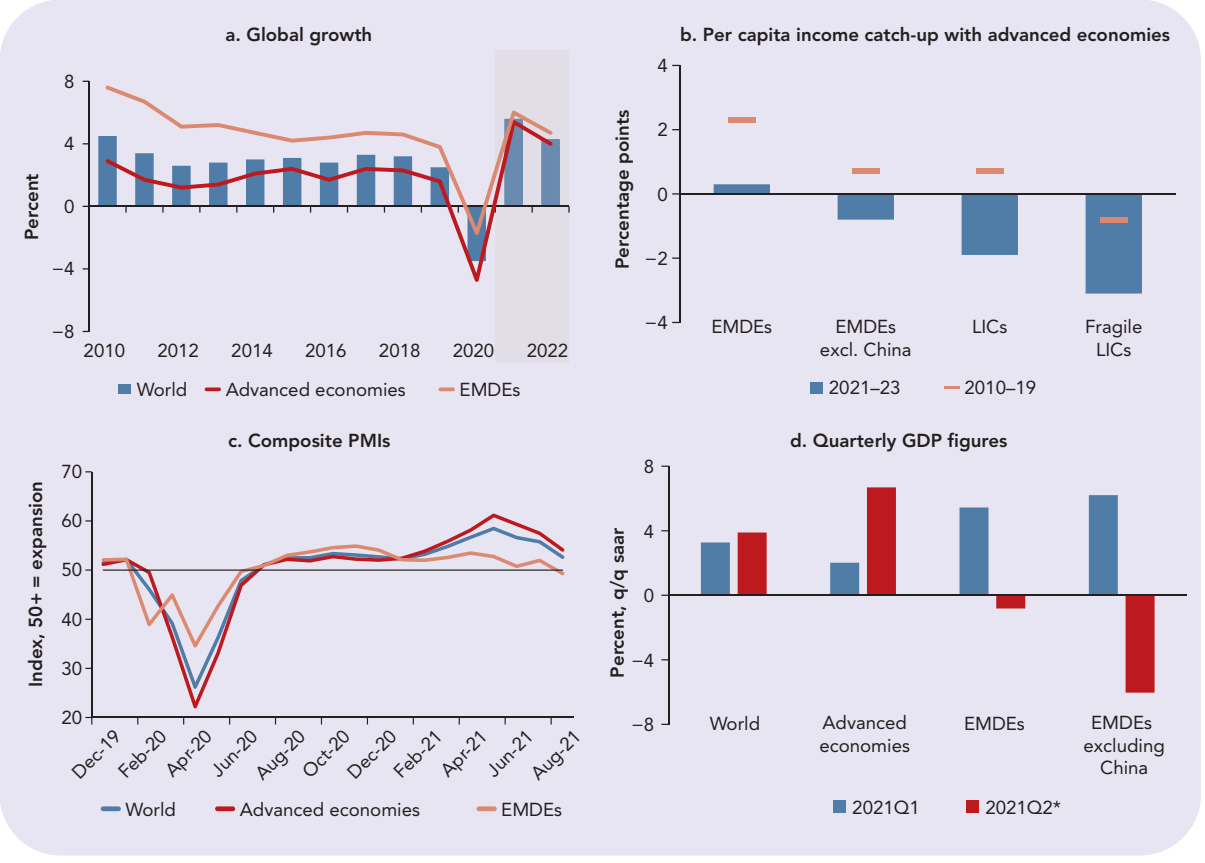
After the COVID-19 pandemic triggered an estimated 3.4 percent contraction in 2020, global economic activity has rebounded but remains well below pre-pandemic projections. The baseline forecast, as reported in the June 2021 edition of *Global Economic Prospects*, envisioned that the global economy would expand 5.6 percent in 2021 (figure 1.1, panel a) (World Bank 2021a). This projected pace of recovery, however, largely reflected strong rebounds in some major economies, partly owing to substantial fiscal support. Despite firming external demand and elevated commodity prices, growth in many EMDEs had been expected to be dampened by severe COVID-19 outbreaks amid limited vaccine access and the partial removal of macroeconomic policy support. The global recovery had then

been forecast to continue into 2022, with global growth moderating to 4.3 percent—a pace insufficient to bring output levels in line with pre-pandemic projections.

The pandemic's devastating effects on per capita income growth, poverty, and inequality will reverberate for a protracted period. Per capita income losses incurred in 2020 will not be fully unwound by 2022 in a majority of EMDEs, including a handful in Europe and Central Asia (ECA). Additionally, the per capita income catch-up with advanced economies has slowed and even reversed in some cases (figure 1.1, panel b). By end-2021, about 100 million people are expected to fall back into extreme poverty. The pandemic has also exacerbated inequality as it has disproportionately affected vulnerable groups—including women, school-age children, and informal and unskilled workers.

Global activity, while robust, likely plateaued in the first half of 2021, with incoming economic data pointing to a loss of momentum amid the ongoing effects of the Delta variant. The subsequent rise in global new COVID-19 cases has

FIGURE 1.1 Global economic activity

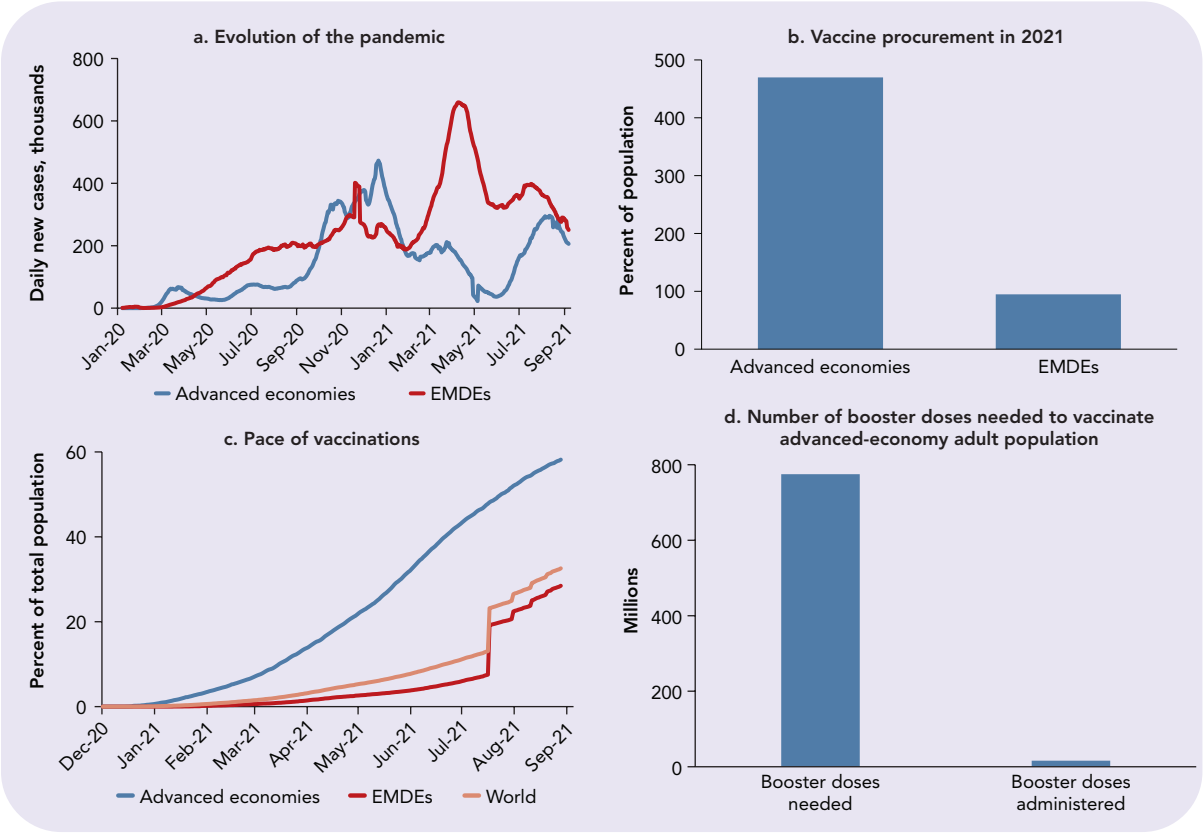


Sources: Haver Analytics; World Bank.
Note: EMDEs = emerging markets and developing economies; GDP = gross domestic product; LICs = low-income countries; PMI = Purchasing Managers' Index; q/q = quarter over quarter; saar = seasonally adjusted annual rate.
a. The shaded area indicates forecasts. Data for 2020 are estimates. Aggregate growth rates are calculated using GDP weights at average 2010–19 prices and market exchange rates.
b. Relative per capita income growth is computed as the difference in per capita GDP growth between respective EMDE groups and advanced economies.
c. PMI readings above (below) 50 indicate expansion (contraction). The last observation is August 2021.
d. Data for 2021Q2 are preliminary and reflect a limited sample of 33 EMDEs and 35 advanced economies due to data availability.

corresponded to a steep fall in confidence, with the global Sentix investor confidence index nearly halving in 2021Q3 from a three-year high. After expanding at a fast clip in the first half of 2021, the global composite Purchasing Managers' Index (PMI) eased in the third quarter, as resurgences of new COVID-19 cases dampened services activity, especially in EMDEs (figure 1.1, panel c). Similarly, the expansion in the manufacturing PMI edged down slightly, as new export orders were constrained by global supply bottlenecks and renewed softness in some large EMDEs amid pandemic-related disruptions.

As a result of renewed COVID-19 surges, many countries' recoveries have faltered (figure 1.1, panel d). This slowdown has been most evident in countries with severe COVID-19 outbreaks; in EMDEs, this has been compounded by low vaccination rates, partly owing to highly unequal vaccine access (figure 1.2, panels a and b). Although about 45 percent of the global population has received at least one vaccine dose, the rate falls to only about 2 percent of the population in

FIGURE 1.2 COVID-19 trends

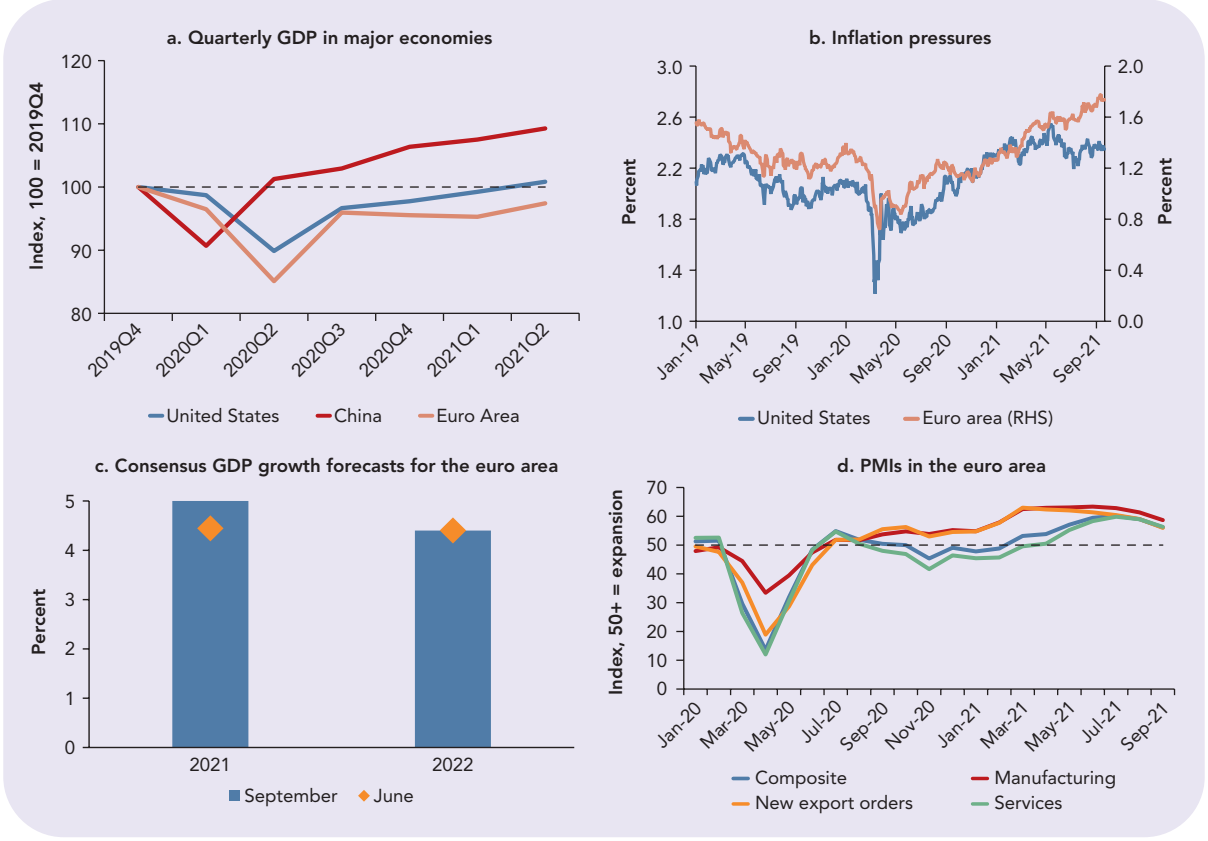


Sources: Duke Global Health Innovation Center 2021; Fitch Solutions; Haver Analytics; Our World in Data (database); United Nations; World Bank.
Note: EMDEs = emerging markets and developing economies.
a. The figure shows the seven-day moving average of daily new COVID-19 cases. The last observation is September 27, 2021. The sample consists of 36 advanced economies and 149 EMDEs.
b. The figure shows the share of confirmed vaccine doses purchased as a share of total population. The sample includes 16 advanced economies and 67 EMDEs. Data are as of September 27, 2021.
c. Figure shows percent of population fully vaccinated, which is defined as receiving a single-dose vaccine or both doses of a two-dose vaccine. Data for China added on August 12 and August 26. The last observation is September 23, 2021.
d. The last observation is September 2, 2021.

low-income countries, reflecting substantial procurement and logistical challenges (figure 1.2, panel c). This trend is likely to be sustained, with the COVID-19 Vaccines Global Access (COVAX) facility recently lowering its supply forecast for vaccines by around 30 percent in the near term (Gavi 2021). This comes on the heels of many advanced economies considering providing booster vaccines to their populations (figure 1.2, panel d).

After the U.S. economy contracted 3.4 percent in 2020, substantial fiscal support and reopening efforts helped underpin a robust recovery. Although gross domestic product (GDP) growth rose slightly to 6.6 percent (quarter over quarter (q/q), seasonally adjusted annual rate (saar)) in 2021Q2 from 6.3 percent in 2021Q1, it fell short of market expectations of an 8.5 percent increase. Nevertheless, the overall strength of the recovery lifted output above its pre-pandemic level by 2021Q2 (figure 1.3, panel a). A sharp resurgence of new COVID-19 cases, however, has clouded the outlook for the second half of 2021. Inflationary pressures have increased, with headline and core personal consumption expenditure (PCE) inflation far exceeding the Federal Reserve's target of 2 percent; however,

FIGURE 1.3 Major economies



Sources: Bloomberg; Consensus Economics; Haver Analytics; World Bank.
Note: GDP = gross domestic product; PMI = Purchasing Managers' Index.
a. The last observation is 2021Q2.
b. The last observation is September 21, 2021.
c. The figure shows the average forecast for the months indicated from Consensus Economics.
d. The last observation is September 2021.

many Fed officials view the recent increase as largely transitory (figure 1.3, panel b). Fed officials now expect three interest rate increases by the end of 2023—up from two in June—and to start gradually tapering asset purchases by the end of 2021.

In the euro area, output contracted about 6.5 percent in 2020 and remained roughly 2.5 percent below its 2019Q4 level by 2021Q2. Following two consecutive quarters of contraction, GDP growth in the euro area bounced back in 2021Q2, expanding 9.2 percent (q/q, saar), prompting an improvement in private sector forecasts for 2021 growth (figure 1.3, panel c). The rebound had been boosted by firming services activity following the relaxation of mobility restrictions and an accelerated vaccine rollout. Although incoming composite PMI data indicate that activity in the euro area continued to be strong in the third quarter, mounting supply and shipping bottlenecks have weighed on manufacturing production (figure 1.3, panel d). These record-high backlogs, combined with the rise in energy prices, have also contributed to the increase in prices, with inflation reaching a 13-year high of 3.4 percent in September.[1]

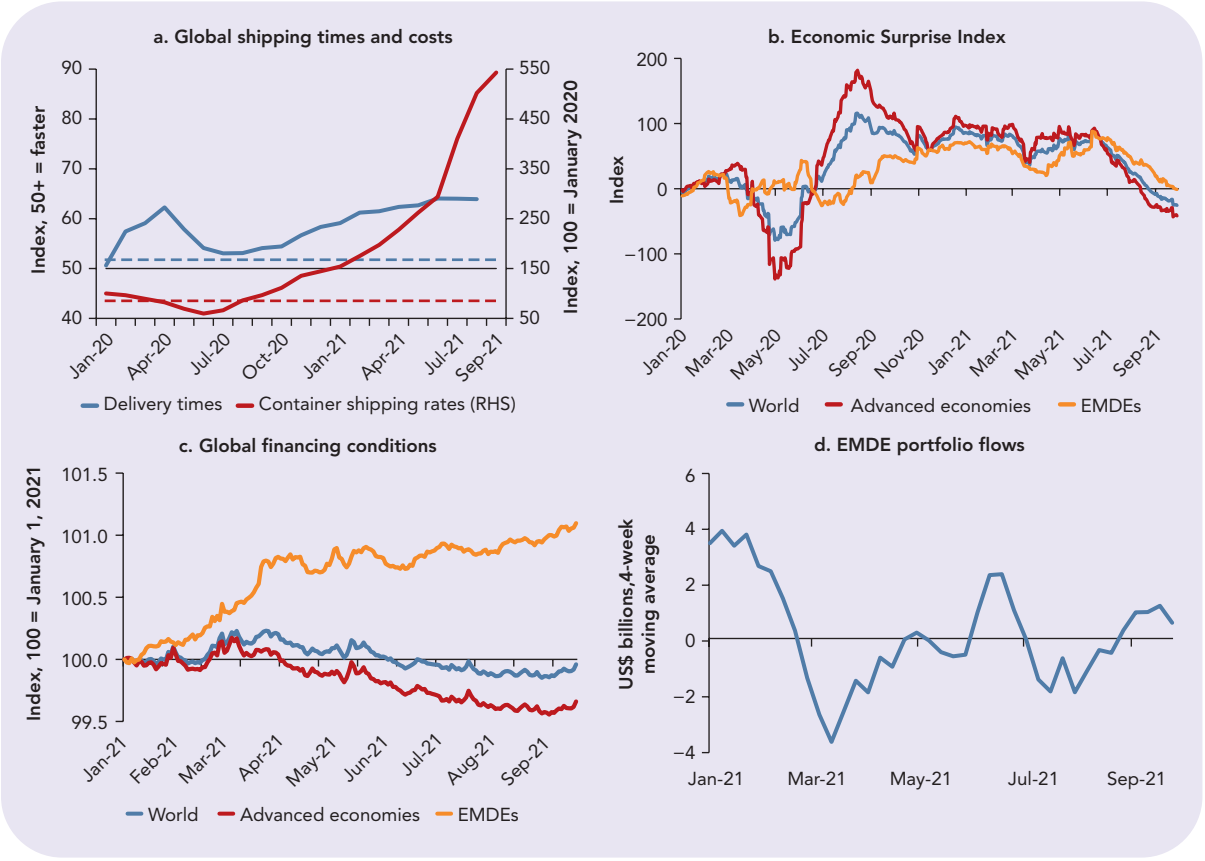
Incoming data point to a continued recovery in China, albeit at a more modest pace, owing to COVID-19 outbreaks and further regulatory tightening. GDP growth slowed to a still strong 7.9 percent (year over year) in 2021Q2. High-frequency indicators suggest that activity continued to moderate in 2021Q3 due to a resurgence of COVID-19, with the expansion in the official manufacturing and non-manufacturing PMIs declining while retail sales growth missed market expectations and slowed sharply. About 75 percent of the population in China had been vaccinated with at least one dose by the end of September. Broader pandemic restrictions, however, remain in place in response to an increased number of localized COVID-19 outbreaks.

After contracting 8.3 percent in 2020, global trade growth started to rebound shortly after its 2020Q2 trough, with goods trade volumes surpassing pre-pandemic levels by November 2020. By 2021Q2, global goods trade growth slowed sharply to about a third of its pace in the previous quarter and continued to lose momentum in July. Survey data point to further softening moving forward, with the manufacturing PMI for new export orders slipping in 2021Q3 amid substantial supply bottlenecks and strains in global value chains. Ongoing shipping delays and shortages of raw material resulted in record-high backlogs (figure 1.4, panel a). Meanwhile, services trade continues to be dampened by sustained weakness in tourism, which is expected to be muted for some time owing to lingering mobility restrictions and reluctance to travel while the virus is not completely under control (UNWTO 2021).

Although global financing conditions continue to be generally benign, they have diverged across advanced economies and EMDEs, and economic data have surprised on the downside (figure 1.4, panel b). In advanced economies, financing conditions remain broadly accommodative. However, pockets of short-lived market volatility have emerged at times over concerns about the strength of the

1. The European Central Bank (ECB) shifted its monetary policy strategy in July, raising its inflation target to 2 percent—compared with its previous target of close to just below 2 percent—and affirming it would tolerate moderately higher, transitory inflation. Nevertheless, the ECB recently announced plans to start slowing its pandemic emergency bond purchases.

FIGURE 1.4 Global trade and financial indicators



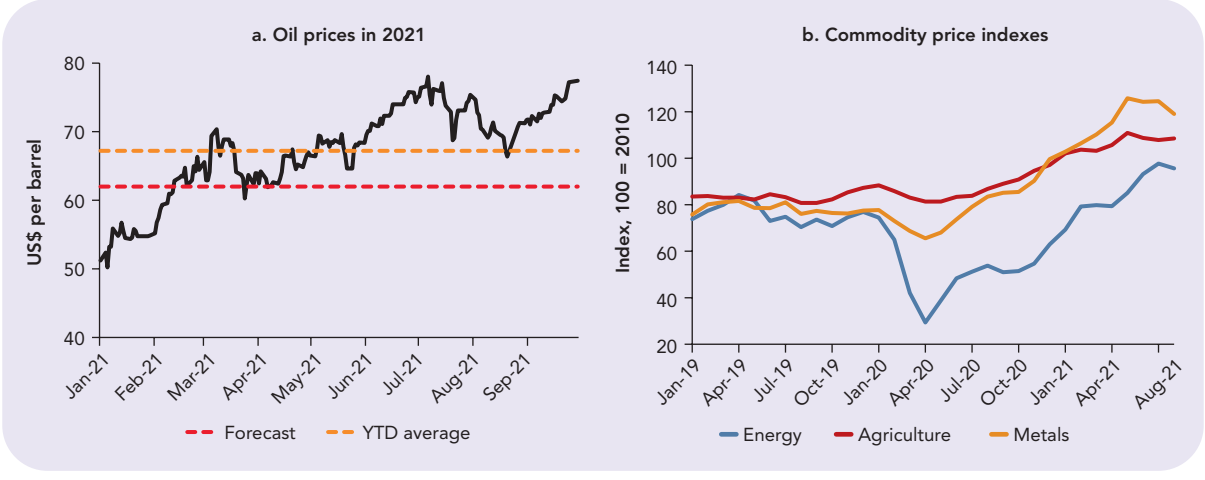
Sources: Bloomberg; harperpetersen.com; Haver Analytics; Institute of International Finance; World Bank.
Note: EMDEs = emerging markets and developing economies; GDP = gross domestic product; PMI = Purchasing Managers' Index.
a. The figure shows the global manufacturing suppliers' delivery times PMI and the HARPER PETERSEN Charter Rates Index (HARPEX) for container shipping rates. PMI data are inverted by subtracting data from 100; therefore, increasing (decreasing) PMI data indicate faster (slower) delivery times. Container shipping rates are monthly averages of weekly data and reflect price developments on the charter market for container ships. Dashed lines indicate long-term averages over January 1998 to December 2019 for delivery times and February 2018 to December 2019 for container shipping rates. The last observation is August 2021 for delivery times and September 24, 2021, for container shipping rates.
b. The figure shows Citi's Economic Surprise Index, which measures the degree to which economic data are beating or missing expectations. The last observation is September 28, 2021.
c. Based on Goldman Sachs country-specific financial conditions indexes, which track borrowing costs, exchange rates, and equity valuations. GDP-weighted aggregates are calculated using 2021 GDP measured at average 2010–19 prices and market exchange rates. The sample includes 10 advanced economies, the euro area, and 14 EMDEs (excluding China). A reading above 100 indicates tightening of financial conditions. The last observation is September 17, 2021.
d. The figure shows the four-week moving average of weekly portfolio flows. The sample includes 16 EMDEs, including China. The last observation is September 24, 2021.

global recovery and the pace of tapering in advanced economies. Equity valuations remain at historically high levels in advanced economies despite spreads on corporate borrowers having inched up somewhat. Meanwhile, 10-year U.S. Treasury yields fell below 1.3 percent in July—the first time since February—and hovered around that rate throughout most of 2021Q3 amid signs of moderating activity and concerns over the ongoing effects of the Delta variant. U.S. yields rose again in late September following the Federal Reserve's announcement of its plans to unwind asset purchases later this year and prospects of an additional rate hike, bringing the total anticipated increases to three by the end of 2023.

In EMDEs, financing conditions have tightened further since June (figure 1.4, panel c). Despite falling U.S. interest rates and robust EMDE bond issuance, EMDE credit spreads widened in July and remain elevated, reflecting policy rate hikes in some EMDEs. Pandemic setbacks and country-specific risks have also continued to push up borrowing costs and weaken domestic currencies in several countries. After a modest uptick in EMDE portfolio inflows at the end of 2021Q2, portfolio outflows resumed in July and August on expectations of sooner than anticipated policy normalization in the United States. Although portfolio flows to EMDEs picked up in September, they continued to be sensitive to broader declines in risk sentiment (figure 1.4, panel d). Underlying vulnerabilities are growing, including rising debt levels and weakening bank balance sheets, especially as COVID-19 relief measures expire.

Commodity prices saw a sharp rise in the first half of 2021, with many now plateauing well above their pre-pandemic levels. Oil prices rallied markedly in 2021, averaging $67/barrel so far—well above the average price previously expected for 2021 as a whole (figure 1.5, panel a) (World Bank 2021a). More recently, oil prices have been somewhat volatile, with Brent crude oil briefly spiking to more than $80/barrel in late September—this follows after a period of easing prices amid the spread of the Delta variant, which triggered concerns of weakening demand, especially in China. As envisioned in June, oil prices are likely to remain elevated and then stabilize alongside the global recovery in 2022. Meanwhile, the June forecasts expected metals prices to be 36 percent higher in 2021 on average relative to last year owing to the global recovery, before falling back in 2022 as some supply constraints ease. Agricultural prices have also seen a substantial rise, particularly those of food commodities, with prices previously projected to rise by 16 percent in 2021 before stabilizing in 2022 (figure 1.5, panel b).

FIGURE 1.5 Commodity markets



Sources: Bloomberg; Haver Analytics; World Bank; World Trade Organization.
a. The figure shows Brent crude oil prices. The dashed red line indicates the 2021 forecast barrel price, $62, and the dashed orange line indicates the year-to-date (YTD) average, $67. The last observation is September 29, 2021.
b. The last observation is August 2021.

Global Risks

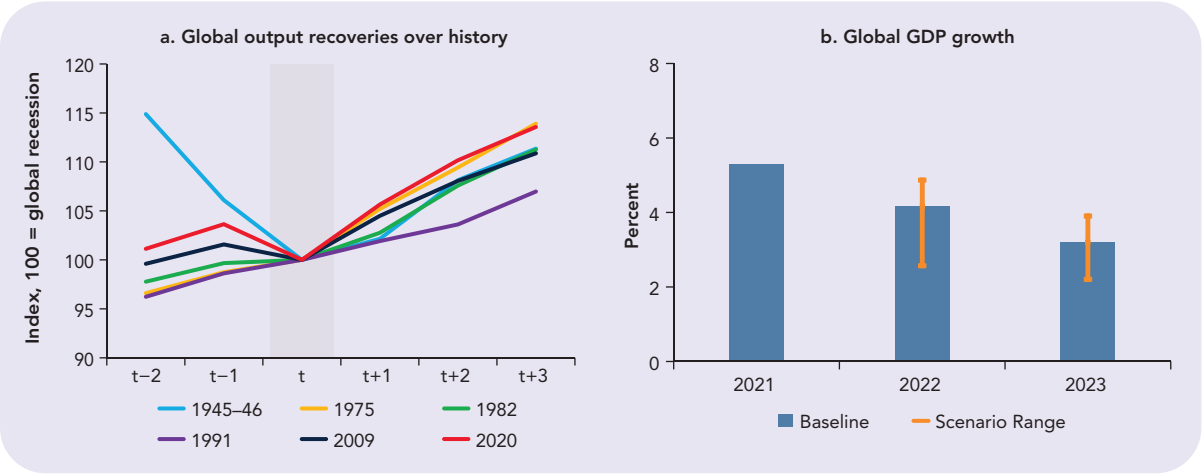
The global growth projections in June expected a rebound of 5.6 percent in 2021—the strongest post-recession pace in 80 years—and then to moderate to 4.3 percent in 2022 (figure 1.6, panel a).[2] Despite this relatively robust baseline, the outlook continues to be subject to key downside risks, particularly in the context of the pandemic. In a downside scenario of a protracted pandemic, global growth over the next two years would falter to a pace similar to the anemic recovery that followed the global financial crisis (figure 1.6, panel b). A lingering pandemic could further exacerbate the unevenness of the recovery, as limited vaccine access in poorer countries would continue to hinder widespread vaccination.

The continued outbreak of COVID-19—especially in light of the emergence of new variants that are more virulent and resistant to vaccines—has cast a long shadow over the strength of the global recovery. In particular, global growth could falter if the ongoing effects of the Delta variant continue to disrupt activity. Recent developments in East Asia and the Pacific (EAP) highlight the importance of this risk. In EAP, low vaccination rates combined with the more transmissible Delta variant contributed to severe COVID-19 outbreaks and dented activity. As a result, Consensus survey data point to downgrades to near-term growth forecasts. A further deterioration in growth outcomes in EAP could weaken the external outlook for other EMDEs, including those in ECA that rely on industrial commodity exports or have deep trade linkages with EAP. Disruptions from the pandemic have also contributed to existing supply bottlenecks, which, if sustained, could slow the recovery in global trade and put further upward pressure on prices (box 1.1).

The risk of financial market stress also remains pronounced, especially following last year's rapid buildup of government and corporate debt. This followed on the heels of a decade of rapidly accumulating debt after the global financial crisis (Kose et al. 2020). In an environment of elevated debt, financial stress could be triggered by a number of shocks that unexpectedly increase borrowing costs (Rogoff 2021a). A sudden increase in interest rates could stem from a rise in risk aversion, inflation, or expectations of faster monetary tightening. In some countries, there is a risk that the recent acceleration in inflation due to commodity price increases and currency depreciation could de-anchor inflation expectations. For EMDEs that have borrowed heavily in foreign currency, that have substantial upcoming redemptions that need to be rolled over, or that have limited foreign exchange reserves, a sustained pick-up in inflation could drive further depreciation, exacerbating currency mismatches. This could result in significant outflows of the volatile portfolio flows that are often used to finance current account deficits (Ha et al. forthcoming). These pressures could be compounded by monetary policy normalization in some major advanced economies, which could trigger a sudden tightening in global financing conditions (Arteta et al. 2015; Kose et al. 2017).

2. The June baseline outlook was predicated on the assumption that widespread vaccination would allow advanced economies to achieve effective containment of the pandemic by the end of 2021, while it was assumed that many major EMDEs would have substantially reduced local transmission rates.

FIGURE 1.6 Global risks



Sources: Bolt et al. 2018; Guénette and Yamazaki 2021; Kose, Sugawara, and Terrones 2020; Oxford Economics; World Bank.
a. Data for 2021–23 used in the "2020" episode are forecasts. The lines show global recession episodes. Multiple years are used when a global recession lasted for more than one year.
b. Blue bars show baseline gross domestic product (GDP) growth from the *Global Economic Prospects* June 2021 database. Orange whiskers indicate the scenario ranges from Oxford Global Economic Model simulations compared with the baseline scenario, as described in Guénette and Yamazaki (2021).

Europe and Central Asia: Recent Developments and Outlook

Economic activity in EMDEs in ECA is expected to grow 5.5 percent in 2021. This is considerably higher than initially projected due to a stronger-than-anticipated recovery in domestic demand, especially in the region's largest economies. The improvement has also reflected robust external demand, which has benefited regional export growth and helped support higher commodity prices. This boost, however, is now fading due to the ongoing global and regional spread of more contagious COVID-19 variants. The cyclical recovery in ECA is forecast to ease to 3.4 percent in 2022, as domestic demand stabilizes, global growth plateaus, and commodity prices edge down. The outlook for 2022 is weaker than previously anticipated, owing to a faster-than-expected removal of macroeconomic support. The outlook remains highly uncertain given the continuation of the pandemic, especially in the context of low vaccination. The regional recovery remains vulnerable to financial stress, which could be triggered by an abrupt tightening of external financing conditions or a sharp rise in policy uncertainty and geopolitical tensions.

Recent Developments

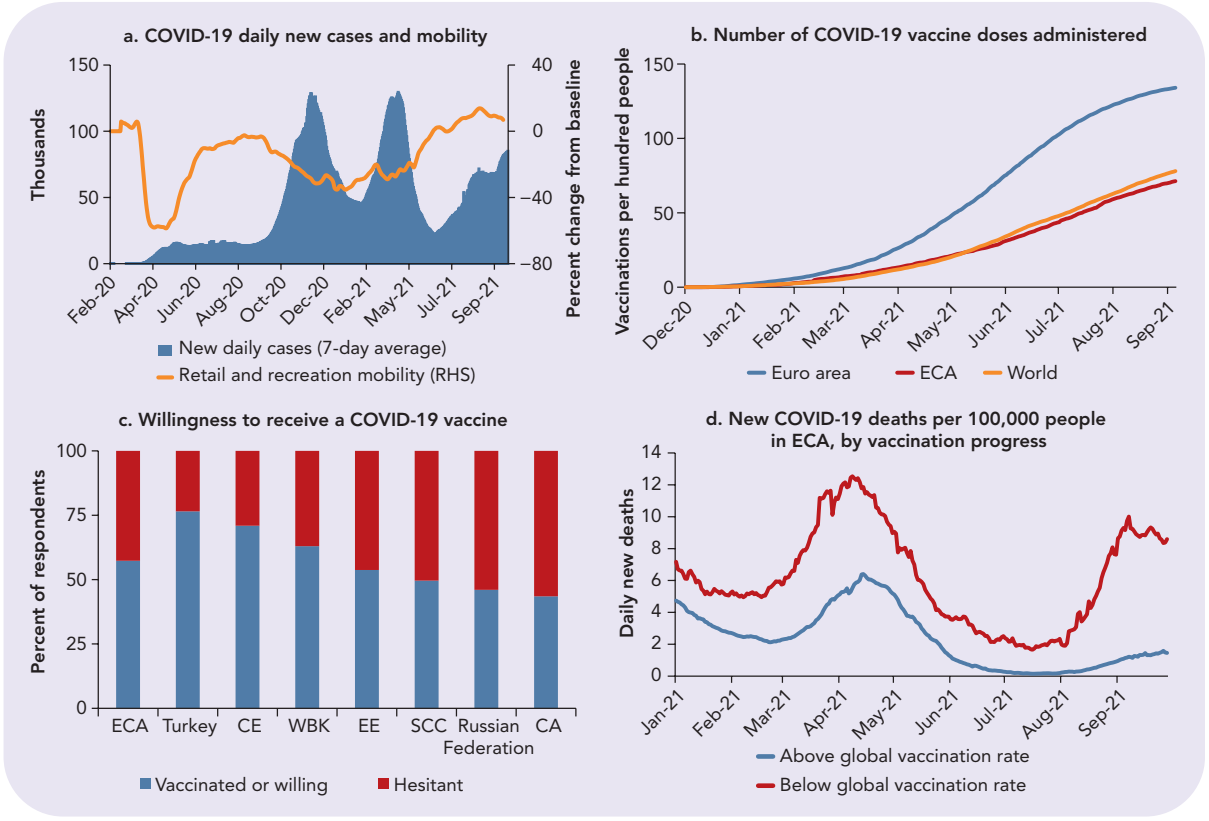
The COVID-19 pandemic continues to shape the economic outlook for EMDEs in ECA after more than 18 months since the first case was detected in the region.[3] Since then, COVID-19 has infected more than 28 million people in the region, making ECA the second hardest hit EMDE region in per capita terms. The region

3. In this section, ECA refers to the 23 EMDEs in ECA for which the World Bank forecasts GDP growth.

has faced several resurgences of the virus this year, with daily new COVID-19 cases and deaths starting to increase once again in early June (figure 1.7, panel a). Five ECA countries—Bosnia and Herzegovina, Bulgaria, Hungary, Montenegro, and North Macedonia—are among the 10 EMDEs with the highest per capita numbers of deaths from COVID-19. Although there are vast differences across ECA, roughly 70 COVID-19 vaccine doses per 100 people have been administered in the region—lower than the global average of almost 80 doses per 100 people (figure 1.7, panel b).

By the end of September, the share of people fully vaccinated was above the global average in five ECA countries (Azerbaijan, Croatia, Hungary, Poland, and Turkey), while the rest of the region lagged. Although the pace has accelerated

FIGURE 1.7 Recent COVID-19 trends in ECA

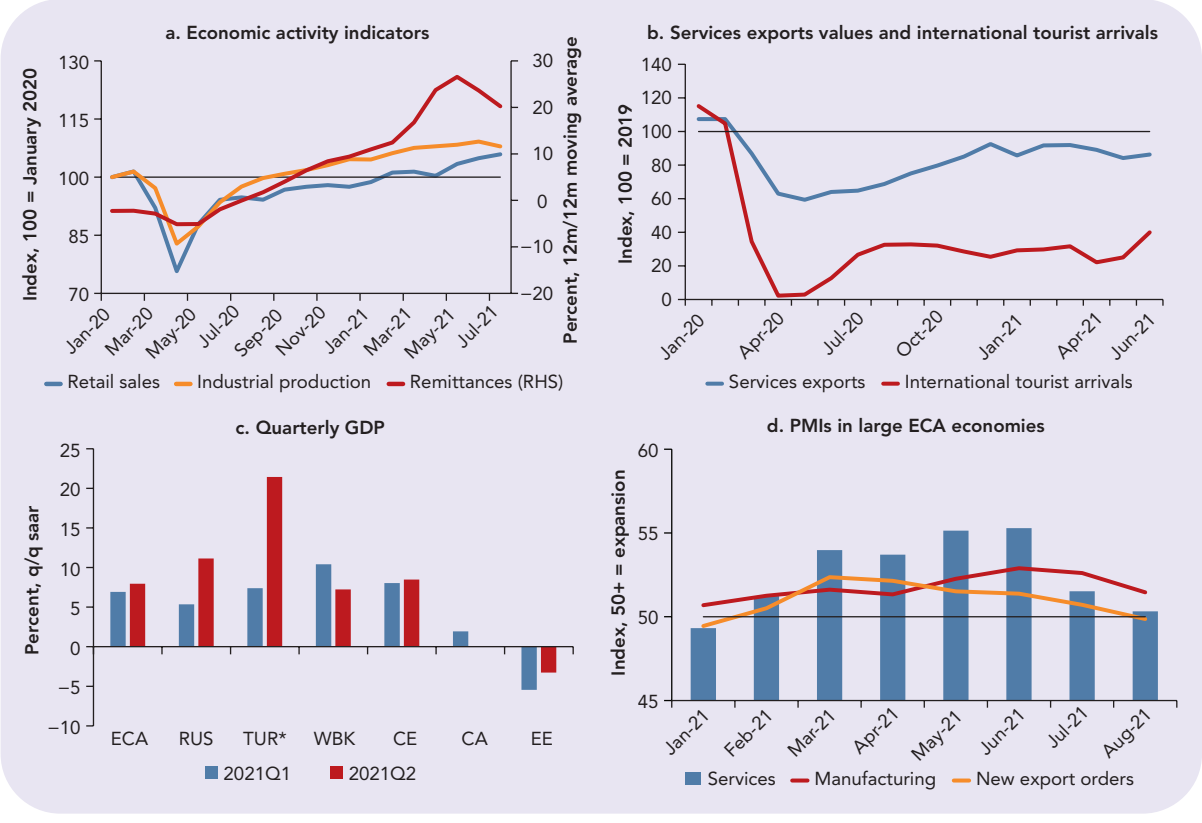


Sources: Fan et al. (2021); Johns Hopkins University; Our World in Data; World Bank.
Note: CA = Central Asia; CE = Central Europe; ECA = Europe and Central Asia; EE = Eastern Europe; SCC = South Caucasus; WBK = Western Balkans.
a.–b. The figures show seven-day moving averages.
a. Retail and mobility data refer to mobility and trends for places like restaurants, cafes, shopping centers, theme parks, museums, libraries, and movie theaters. The baseline for mobility is the median value, for the corresponding day of the week, during January 3 to February 6, 2020. The orange line indicates the baseline for retail mobility. Aggregates are calculated as the sum for daily cases and the average for mobility. The sample includes 19 and 23 ECA economies for mobility and COVID-19 cases, respectively. Last observation is September 28, 2021 for new daily cases and September 21, 2021 for mobility data.
b. Last observation is September 23, 2021.
c. Survey results are based on 236,000 interviews conducted in 18 countries during April 1-30, 2021. The bars indicate the share of the population receiving at least one vaccine dose and responses to a vaccine acceptance question. Responses to the vaccine acceptance question are weighted to reflect the share of population who have not yet received a vaccine. Survey respondents are asked, "If a vaccine to prevent COVID-19 were offered to you today, would you choose to get vaccinated?" Aggregates are calculated using population weights.
d. The figure shows seven-day moving averages of daily new COVID-19 deaths per 100,000 people for ECA countries above and below the global vaccination rate, which is almost 80 vaccinations per 100 people. The sample includes 23 ECA countries. The last observation is September 28, 2021.

more recently, the number of vaccine doses was about half or lower than the global rate in a third of the region's economies, partly owing to high vaccine reluctance (figure 1.7, panel c). In many ECA countries with low vaccination rates, the increase in new COVID-19 deaths in the third quarter was particularly pronounced (figure 1.7, panel d).

After output in ECA fell a modest 2.1 percent in 2020, a supportive external environment helped the regional recovery gain traction in early 2021. Stronger-than-expected rebounds in the euro area and the Russian Federation in the first half of 2021 benefited economic activity in ECA, boosting ECA goods export volumes and remittance inflows into the region (figure 1.8, panel a) (World Bank 2021a). The recovery in services exports in ECA continued to trail that of manufactured goods, reflecting subdued international tourism (figure 1.8, panel b). Meanwhile, industrial activity in many of the region's oil and metals exporters (Central Asia, South Caucasus, and Russia) was lifted by elevated commodity

FIGURE 1.8 Recent economic developments in ECA



Sources: Haver Analytics; World Bank; World Trade Organization.
Note: ECA = Europe and Central Asia; GDP = gross domestic product; PMI = Purchasing Managers' Index.
a. Retail sales volume is seasonally adjusted. The last observation is July 2021. The sample for retail sales includes nine ECA countries. The sample for remittances includes six ECA countries.
b. The figure is indexed to equal 100 for the same month in 2019. The sample includes 11 and 12 ECA economies for services exports and tourist arrivals, respectively. The last observation is June 2021.
c. CA = Central Asia; CE = Central Europe; ECA = Europe and Central Asia; EE = Eastern Europe; RUS = Russian Federation; SCC = South Caucasus; TUR = Turkey; WBK = Western Balkans. Data are reported as the quarter-on-quarter seasonally adjusted annual rate, except for Turkey, which is year-on-year due to data volatility.
d. PMI readings above (below) 50 indicate expansion (contraction). The last observation is August 2021.

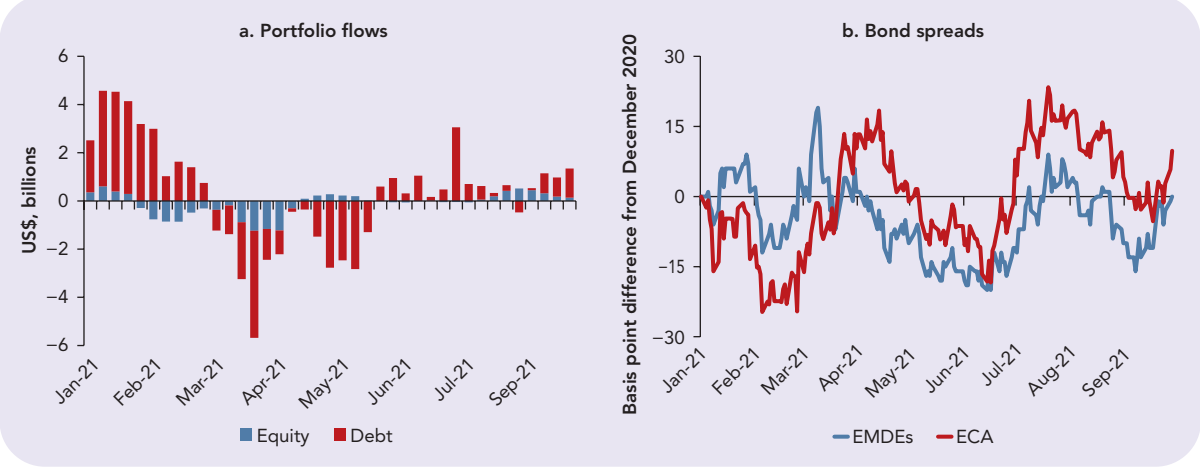
prices, owing to an earlier recovery in China and improving demand from the rest of the world.

Aggregate domestic demand gradually firmed in ECA in the first half of 2021, as earlier reopening efforts underpinned an uptick in services activity and retail sales. Nevertheless, the domestic recovery continued to be partly held back by protracted weakness in investment, as elevated policy uncertainty and mounting geopolitical tensions weighed on investor sentiment in many regional economies (Central Asia, Eastern Europe, South Caucasus, and Russia). Moreover, the recovery was highly uneven in the first half of 2021—a trend that could continue given varying vaccination progress (figure 1.8, panel c).

The ongoing recovery appears to be decelerating in the second half of 2021, as many ECA countries grapple with the continued effects of the Delta variant. Following a deterioration in pandemic trends in mid-2021, the services and manufacturing PMIs have eased in some large regional economies (figure 1.8, panel d). New export orders have slipped back into contraction amid ongoing supply bottlenecks and softening external demand. Consumer confidence has also waned in the third quarter, as the combination of Delta and rising inflation weighs on household sentiment.

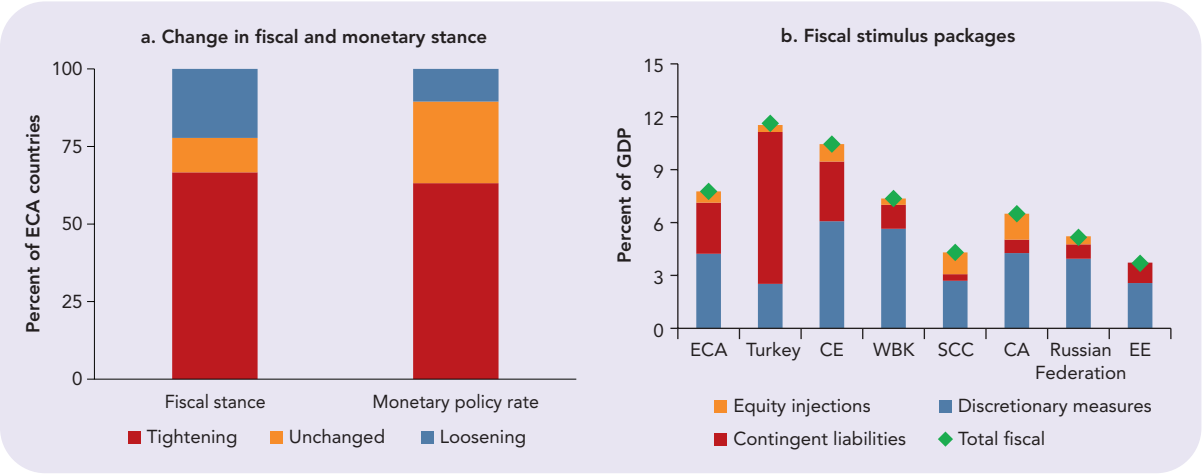
External financing conditions in ECA have tightened at a somewhat faster pace relative to the EMDE aggregate in 2021. The region experienced significant portfolio outflows in 2021Q2 amid weakening investor sentiment, but inflows have gradually resumed in 2021Q3, albeit at a much more modest pace than in early 2021 (figure 1.9, panel a). Emerging Market Bond Index spreads have widened further in many ECA economies—particularly in those with elevated domestic political and geopolitical tensions, policy uncertainty, or external financing pressures—which has further exacerbated currency depreciation (Belarus, Turkey, and Ukraine) (figure 1.9, panel b). After the region faced a severe collapse in foreign direct

FIGURE 1.9 Portfolio and FDI flows in ECA



Sources: Institute of International Finance; J.P. Morgan; World Bank.
Note: ECA = Europe and Central Asia; EMDEs = emerging markets and developing economies; FDI = foreign direct investment.
a. The figure shows weekly data. The last observation is September 24, 2021.
b. The figure shows bond spreads represented by the J.P. Morgan Emerging Market Bond Index. Aggregates are calculated as simple averages. The sample includes 11 EMDEs for ECA. The last observation is September 28, 2021.

FIGURE 1.10 Macroeconomic Policy in ECA



Sources: International Monetary Fund; World Bank.
Note: CA = Central Asia; CE = Central Europe; ECA = Europe and Central Asia; EE = Eastern Europe; GDP = gross domestic product; SCC = South Caucasus; WBK = Western Balkans.
a. The figure shows the share of countries with a positive (loosening fiscal stance), negative (tightening fiscal stance), and unchanged fiscal impulse in 2021 using +/- 0.5 percentage point of potential GDP threshold, and the shares of countries that experienced a policy rate hike (tightening monetary policy rate) and cut (loosening monetary policy rate). Fiscal impulse is defined as the negative change in the cyclically-adjusted primary balance from the previous year. Monetary policy stance shows whether countries have had net policy rate hikes/cuts this year. The sample includes 10 ECA countries for fiscal balance and 19 ECA countries for monetary policy rate. The monetary policy rate data are through September 2021.
b. The data are through June 2021.

investment last year, inflows to some economies have remained subdued, especially in large oil exporters owing to anemic extractive investment (UNCTAD 2021).

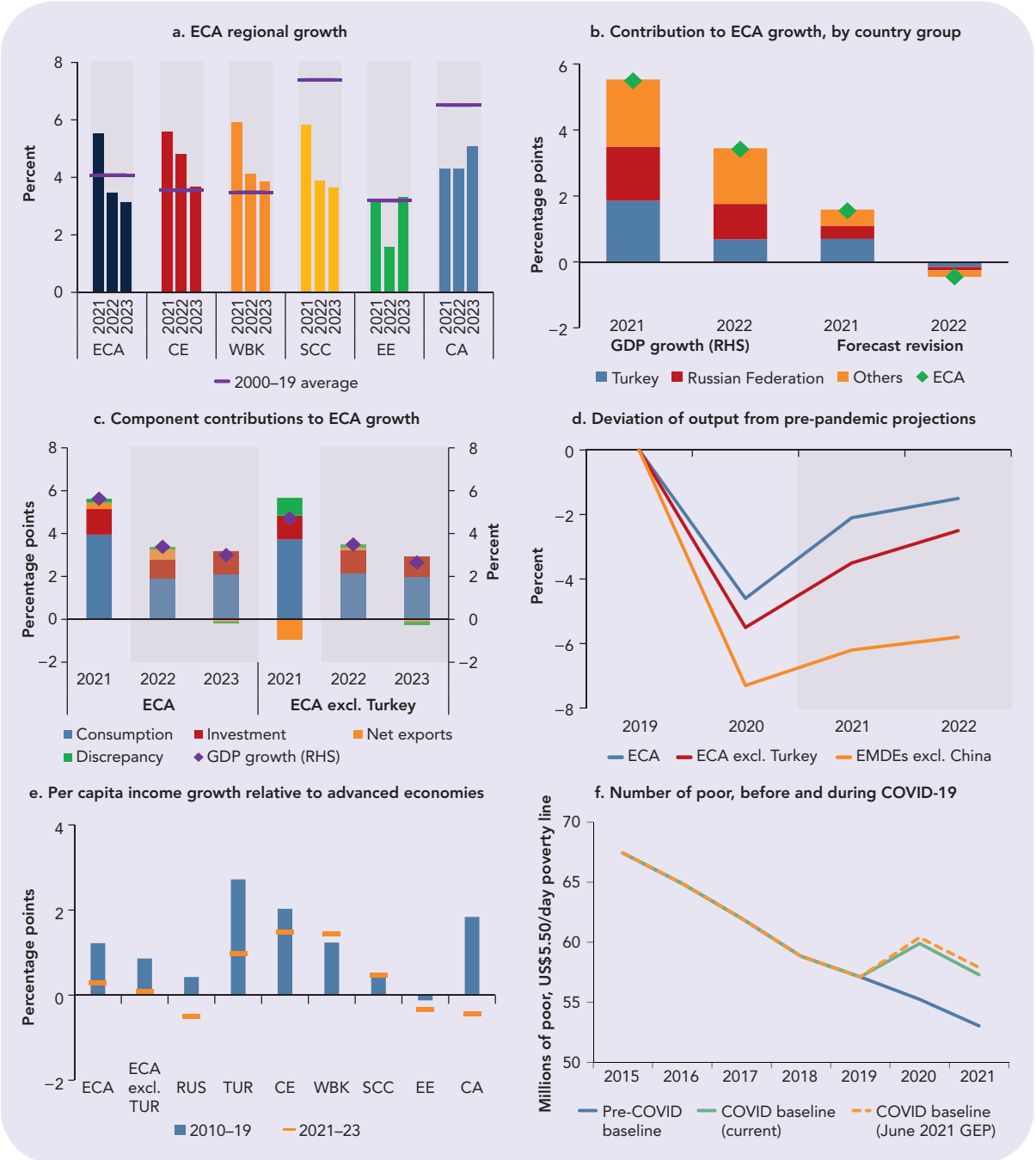
Earlier currency depreciations, combined with supply-side constraints, have put further upward pressure on prices and prompted policy interest rate hikes in more than half of the region's economies thus far in 2021 (box 1.1; figure 1.10, panel a). Although the banking sector has adequate liquidity and buffers in many ECA economies, increases in nonperforming and distressed loans are expected as countries continue to phase out regulatory relief and moratoriums on credit obligations.

Large fiscal support packages delivered in 2020—equivalent, on average, to 7.5 percent of GDP—are expected to be partially unwound this year (figure 1.10, panel b). A handful of regional economies, however, have announced additional fiscal support measures in 2021 to confront continued disruptions from the pandemic (Kazakhstan, North Macedonia, and Russia). In all, the fiscal response to the pandemic, together with last year's contraction in output, is expected to leave median public debt at 54 percent of GDP by end-2022—nearly 15 percentage points higher than in 2019.

Regional Outlook

ECA's economy is expected to expand 5.5 percent in 2021—insufficient to return output to its pre-pandemic projection (figure 1.11, panel a; table 1.1). Nevertheless, the outlook for 2021 is considerably stronger than previously envisioned, reflecting a release of pent-up demand in the region's largest economies (figure

FIGURE 1.11 ECA outlook



Sources: World Bank.
Note: Aggregates are calculated using real weights at average 2010–19 prices and market exchange rates. CAC = Central Asia; CE = Central Europe; ECA = Europe and Central Asia; EE = Eastern Europe; GDP = gross domestic product; GEP = *Global Economic Prospects*; RUS = Russian Federation; SCC = South Caucasus; TUR = Turkey; WBK = Western Balkans.
a.-c. The values are forecasts.
a.c.d. Shaded areas indicate forecasts.
c. The sample includes 14 ECA countries for which GDP component data are available.
d. The figure shows the percent deviation between the levels of the January 2020 baseline World Bank projections and current projections.
e. Relative per capita income growth is computed as the difference in per capita GDP growth between respective groups and advanced economies.

TABLE 1.1 Europe and Central Asia growth forecast summary

(real GDP growth at market prices in percent, unless indicated otherwise)

	2019	2020	2021[f]	2022[f]	2023[f]	Percentage point differences from June 2021 projections 2021[f]	2022[f]	2023[f]
EMDE ECA, GDP[a]	**2.7**	**−2.1**	**5.5**	**3.4**	**3.1**	**1.6**	**−0.5**	**−0.4**
EMDE ECA, GDP excl. Turkey	3.1	−3.1	4.7	3.6	2.9	1.0	−0.1	−0.3
Commodity exporters[b]	2.5	−2.9	4.3	3.1	2.4	1.0	−0.3	−0.4
Commodity importers[c]	2.8	−1.3	6.8	3.8	3.8	2.2	−0.6	−0.4
Central Europe[d]	4.4	−3.6	5.6	4.8	3.7	1.1	0.3	−0.2
Western Balkans[e]	3.7	−3.2	5.9	4.1	3.8	1.5	0.4	0.0
Eastern Europe[f]	2.7	−3.2	3.1	1.6	3.3	1.2	−1.2	0.7
South Caucasus[g]	3.8	−5.2	5.8	3.9	3.6	2.2	−0.3	−0.4
Central Asia[h]	4.9	−1.4	4.3	4.3	5.1	0.6	0.0	0.0
Russian Federation	2.0	−3.0	4.3	2.8	1.8	1.1	−0.4	−0.5
Turkey	0.9	1.8	8.5	3.0	4.0	3.5	−1.5	−0.5
Poland	4.7	−2.7	4.5	4.7	3.4	0.7	0.2	−0.5

Source: World Bank.
Note: World Bank assumptions are frequently updated based on new information and changing (global) circumstances. Consequently, the working assumptions presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given moment. Due to lack of reliable data of adequate quality, the World Bank is currently not publishing economic output, income, or growth data for Turkmenistan, and Turkmenistan is excluded from cross-country macroeconomic aggregates.
e = estimate; ECA = Europe and Central Asia; EMDE = emerging market and developing economy; f = forecast; GDP = gross domestic product.
a. GDP and expenditure components are measured in average 2010–19 prices and market exchange rates.
b. Includes Armenia, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Kosovo, the Russian Federation, Tajikistan, Ukraine, and Uzbekistan.
c. Includes Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, Moldova, Montenegro, North Macedonia, Poland, Romania, Serbia, and Turkey.
d. Includes Bulgaria, Croatia, Hungary, Poland, and Romania.
e. Includes Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.
f. Includes Belarus, Moldova, and Ukraine.
g. Includes Armenia, Azerbaijan, and Georgia.
h. Includes Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan.

1.11, panel b). The improvement is broad-based, with growth in 2021 upwardly revised in about 90 percent of ECA's economies on the back of strengthening domestic demand. Positive spillovers from firming activity in the euro area and higher commodity prices in the first half of this year have also bolstered ECA's recovery, particularly in exports.

The cyclical recovery in ECA is forecast to ease to 3.4 percent in 2022, as domestic demand stabilizes. The earlier boost from external demand is also expected to fade alongside plateauing global growth and easing commodity prices. The near-term outlook has deteriorated, partly reflecting a faster removal of macroeconomic support than envisioned, especially in some large ECA economies. Nevertheless, the continued relaxation of OPEC+ production cuts should help buoy activity in the region's oil exporters. The regional forecast is also predicated on a gradual recovery in investment, particularly in those economies benefiting from sizable EU spillovers and funds (Central Europe and the Western Balkans) (figure 1.11, panel c).

The strength of the earlier recovery has helped limit the amount of scarring from the pandemic in ECA relative to other EMDEs (figure 1.11, panel d). Nonetheless, per capita GDP is projected to remain about 1.5 percent below its pre-pandemic projection in 2022. As a result, the pace of per capita income growth catch-up with advanced economies is anticipated to slow over the next three

BOX 1.1 Inflationary pressures in ECA: transitory or persistent?

Prior to the pandemic, inflation in most economies in Europe and Central Asia (ECA) remained within or below central bank target ranges and inflation expectations were well-anchored. Aggregate ECA inflation had decelerated leading up to the pandemic alongside easing economic growth and moderating energy prices. In parts of the region, however, underlying inflationary pressures were building to varying degrees (Central Europe and Turkey). In some cases, this reflected rising capacity constraints, which were becoming binding amid the combination of positive output gaps and accommodative fiscal policy. In other ECA economies, confidence shocks triggered financial market turbulence and currency depreciation, which contributed to a surge in inflation.

At the onset of the pandemic, inflation in ECA initially remained relatively stable, reflecting diverging country trends—most notably a rise in inflation in Turkey and a slowdown in the Russian Federation. Since the start of 2021, however, rising inflationary pressures have prompted many central banks in emerging markets and developing economies (EMDEs)—including in ECA—to respond with policy rate hikes despite output gaps remaining negative. Moreover, price pressures have built alongside the recovery in output, with rising capacity constraints and global commodity prices contributing to the uptick in inflation.

Against this backdrop, this box examines regional inflation trends and monetary policy responses by asking the following questions:

- What are the recent developments and drivers in regional inflation?
- What are the near-term prospects for regional inflation?
- What are the policy implications of higher inflation for regional monetary authorities?

Recent inflation developments and drivers in ECA. The global collapse in demand and subsequent plunge in oil prices from the pandemic exerted downward pressure on global inflation throughout most of 2020 (World Bank 2021a; Ha et al. 2021). Regional inflation in ECA also shifted lower in 2020, as the large negative demand shock from COVID-19 more than offset pandemic-related supply shocks that increased inflation, including lockdowns and mobility restrictions.[a] These trends and drivers, however, varied widely across the region in 2020. In Turkey, inflation rose due to positive demand and supply shocks, with a rapid expansion of credit buoying demand. Meanwhile, in some oil exporters and Central European economies, inflationary pressures increased on the back of tight supply conditions, which were only partly offset by subdued demand. In contrast, inflation in Russia collapsed alongside demand—in tandem with global trends. In all, the pandemic-induced recession prompted many central banks across the region to cut policy interest rates—in some cases, to record-low rates (Russia).

Price pressures began to build at the start of 2021, as the regional recovery gained traction alongside a robust rebound in demand.[b] Ongoing supply constraints also contributed to the rise in headline and core inflation. In all, ECA inflation accelerated to a 12.5-year high in August 2021, reaching 9.1 percent and outpacing EMDE inflation by 5.1 percentage points (figure B.1.1.1, panel a). These trends are broad-based across the region—of the 17 ECA central banks with inflation targets, more than half reported headline inflation above the upper bound of the target band in 2021.

The pick-up in headline inflation has partly reflected the region's exposure to global spillovers amid tight global financial and commodity market linkages. For about a quarter of ECA's economies, the surge in inflation directly mirrored developments in the euro area due to their exchange rate arrangement with the euro.[c] Many countries in the region experienced a sharp acceleration in food prices due to several idiosyncratic factors, including drought, low crop yields, and export bans in

(Continued next page)

BOX 1.1 (continued)

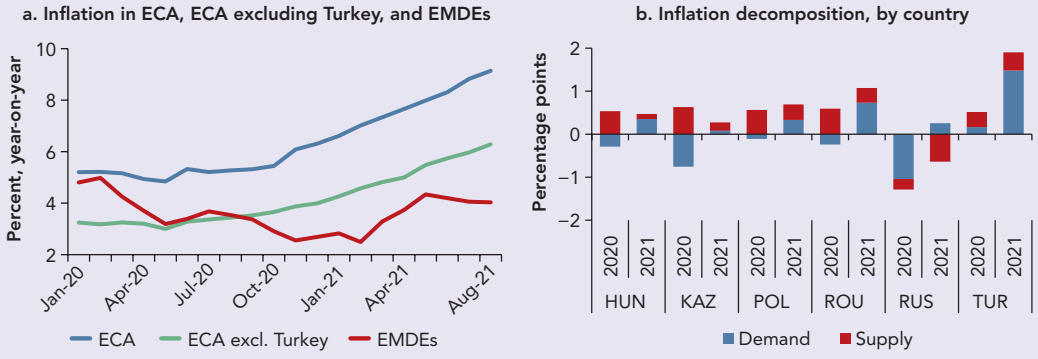
some cases. For the region's oil importers, the global rebound in oil prices has also led to transitory increases in headline inflation. Earlier currency depreciation passed through to inflation, which has been exacerbated by sustained portfolio outflows.

In response to rising inflationary pressures, ECA central banks have begun removing monetary policy accommodation in 2021 at a pace faster than other EMDEs. Since the start of 2021, policy rates have increased in more than half of ECA's economies—nearly double the broader EMDE group.[d] In about a quarter of the region, euroization (Kosovo and Montenegro), as well as currency boards (Bulgaria and Bosnia and Herzegovina) or managed currency arrangements (Croatia and North Macedonia), prevent these economies from having active monetary policy.

Near-term inflation prospects in ECA. Although price pressures were initially thought to be transitory, they are not expected to subside until late 2022 in some of the region's largest economies (CBR 2021; World Bank 2021a). Contributing to inflation in the near term are the dissipating effects of the earlier negative demand shock, the base effects from higher energy prices, as well as the rapid acceleration of food prices—the latter of which has led to a de-anchoring of consumer price inflation in some ECA countries (figure B.1.1.1, panel b). Conversely, the continued effects of the Delta variant of COVID-19 could ease global demand, thus leading to less binding supply constraints. Nevertheless, inflation forecasts—much like those for gross domestic product (GDP) growth—remain highly uncertain due to the protracted nature of the pandemic and idiosyncratic factors, including ongoing global supply and agricultural chain disruptions.

Despite decelerating economic momentum, underlying core inflation continues to rise in ECA amid binding capacity constraints, which has coincided with upward pressures on wages. Rising capacity constraints have partly reflected ongoing,

FIGURE B1.1.1 Inflation trends and decomposition in ECA



Sources: Haver Analytics; World Bank.
Note: ECA = Europe and Central Asia; GDP = gross domestic product; HUN = Hungary; KAZ = Kazakhstan; POL = Poland; RUS = Russian Federation; TUR = Turkey.
a. Aggregate headline inflation is calculated using real 2019 GDP weights at average 2010–19 prices and market exchange rates. The sample includes 71 EMDEs and 20 ECA economies. Last observation is August 2021.
b. Based on a sign restricted Bayesian VAR models for Hungary, Kazakhstan, Poland, Romania, Russia, and Turkey. See Annex for details. Supply and demand shocks are four-quarter moving averages of the quarter-on-quarter shocks from the models. There are other shocks that drive outcomes in inflation and that are excluded from the figures. Shocks are as a deviation from a model-determined constant. Outcomes for 2021 based on forecast from 2021Q3.

(Continued next page)

BOX 1.1 (continued)

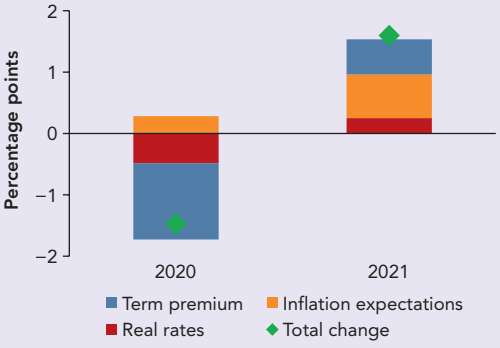
persistent global supply bottlenecks, to which ECA is particularly exposed as a result of the region's deep integration in global and European value chains. Global value chains and the availability of intermediate goods have been hit by widespread COVID-19 outbreaks at large factories and shipping ports, particularly in East Asia and the Pacific, where curtailed operations have generated backlogs of vessels, which could take several weeks to clear. Companies have experienced a sharp rise in freight rates and localized shortages of shipping containers—the latter of which have reached record-high prices globally.

Compounding these supply bottlenecks is the incomplete rotation from manufactured goods to the low-trade-intensity domestic service sector, as the ongoing effects of the Delta variant dampen services activity and continue to put pressure on an already overheated manufacturing sector. Although firms have increased their use of digital technologies and diversified suppliers and production sites to increase resilience and mitigate logistical problems, these efforts have not been sufficient to ease binding constraints (Saurav et al. 2020). As a result, the composite Purchasing Managers' Index input and output price indexes have accelerated this year in EMDEs, including in ECA, but the increase appears to be moderating alongside plateauing global GDP and trade growth.

Implications of high inflation for macroeconomic policy in ECA. Although central banks in ECA were among the first in EMDEs to respond to rising inflation with policy rate hikes in the first half of 2021, the acceleration in inflation outpaced the increase in policy rates. Moreover, these policy rate hikes generally had weaker transmission since inflationary pressures were partly driven by external factors, such as accelerating food prices.[e]

Monetary policy rates have further tightened in the second half of 2021 despite the still negative output gaps, as concerns over de-anchoring inflation expectations persist in the region. As a result, several economies in the region are transitioning to a more restrictive monetary policy stance, which will present a drag on economic growth going forward. Rising inflationary pressures, combined with normalizing term premiums and rising Emerging Market Bond Index sovereign bond spreads, are starting to put upward pressure on government financing costs, which could increase rollover risks in economies with high short-term external debt levels (figure B1.1.2).

FIGURE B1.1.2 Decomposition of change in ECA government bond yields



Sources: Andrle et al. 2015; Botha et al. 20917; Ruch 2021; World Bank.
Note: ECA = Europe and Central Asia. Based on estimates from a multivariate filter model of Ruch (2021) extended using the expectations hypothesis as in Andrle et al. (2015) and Botha et al. (2017). Actual data up to 2021Q3 and forecasts thereafter.

a. A negative supply shock lowers output growth but raises inflation, whereas a negative demand shock lowers both output and inflation. A negative supply shock occurs when the production of a good (or service) is disrupted. This could be caused by drought, labor strikes or shortages, and mobility restrictions and lockdowns in the context of COVID-19. Negative demand shocks arise from the loss of income and, in the context of COVID-19, increased precautionary behavior, which lead to a decrease in the consumption of goods and services.
b. The uptick in inflation has been pronounced even in ECA subregions where the economic recovery is not yet fully entrenched (Eastern Europe).
c. Following above-target inflation, the European Central Bank announced plans for gradually unwinding its pandemic bond purchasing program.
d. Armenia, Belarus, Georgia, Hungary, Kazakhstan, the Kyrgyz Republic, Moldova, the Russian Federation, Tajikistan, Turkey, and Ukraine.
e. Nevertheless, these monetary policy actions likely helped buoy investor confidence, which is critical in ECA given elevated policy uncertainty and geopolitical tensions.

years in ECA, but the deceleration varies across the region (figure 1.11, panel e). Weak growth prospects amid lingering structural issues and elevated geopolitical tensions are projected to reverse per capita income catch-up in Eastern Europe and Central Asia—home to some of ECA's poorest—setting development goals further from reach. In contrast, the pace of catch-up is anticipated to accelerate in the Western Balkans—the only ECA subregion projected to do so—on the back of solid investment and reform progress.

Despite a robust cyclical recovery, the pandemic is estimated to have reversed earlier gains in poverty reduction. By the end of this year, COVID-19 will likely have pushed an additional 4.3 million people under the $5.50 a day poverty line in ECA (figure 1.11, panel f).[4] Although this figure is about a third smaller compared with previous forecasts, it suggests that the recovery is not complete or inclusive, with household incomes continuing to be dampened by job losses and a reduction in working hours, the removal of policy support, and high inflation, particularly for food items (box 1.1) (ILO 2021).

Trends in Europe and Central Asia: Major Economies and Subregions

Russian Federation

Following a sharp spike caused by the Delta variant in mid-2021, daily new COVID-19 cases somewhat stabilized in 2021Q3, albeit at high levels. Moreover, new COVID-19 deaths continue to hover near record-high daily rates, while the excess mortality rate has surged relative to the pre-pandemic baseline. Despite Russia being among the first in the world to start inoculating its population—owing to the early development of domestically produced vaccines, including Sputnik V—vaccination rates trail ECA and the world, with about a third of the population fully vaccinated. Stubbornly high vaccine reluctance continues to impede inoculation, with over 50 percent of surveyed respondents indicating that they are not ready to get vaccinated against COVID-19 (Levada-Center 2021).

Following the relaxation of various COVID-19 restrictions, activity is estimated to have returned to its 2019 level by mid-2021, with GDP growing at its fastest pace in 2021Q2 since 2000. The rebound has since moderated, however, with various PMI indicators falling back into contraction amid waning external demand and disruptions from the pandemic. Macroeconomic policy support has also started to unwind in 2021. After cutting the policy rate to a record low 4.25 percent in 2020, the Central Bank of Russia has raised it five times thus far in 2021, to 6.75 percent, to tackle above-target inflation. The Central Bank of Russia has indicated that it will continue to tighten monetary policy as consumer surveys point to de-anchoring inflation expectations following sustained currency depreciation and sharp food price increases.

Output in Russia is projected to grow 4.3 percent in 2021, as the economy is supported by an earlier rebound in domestic demand and elevated energy prices. The forecast for 2021 growth has been revised up substantially, partly reflecting a stronger-than-expected upturn in both domestic and external demand in the

4. For upper-middle-income countries, the $5.50 a day poverty line is most commonly used.

TABLE 1.2 Europe and Central Asia country growth forecasts

(real GDP growth at market prices in percent, unless indicated otherwise)

						Percentage point differences from June 2021 projections		
	2019	2020	2021[f]	2022[f]	2023[f]	2021[e]	2022[f]	2023[f]
Albania	2.1	−4.0	7.2	3.8	3.7	2.8	0.1	0.0
Armenia	7.6	−7.4	6.1	4.8	5.4	2.7	0.5	0.1
Azerbaijan	2.5	−4.3	5.0	3.1	2.7	2.2	−0.8	−0.7
Belarus	1.4	−0.9	1.2	−2.8	2.3	3.4	−4.7	1.1
Bosnia and Herzegovina	3.3	−3.2	4.0	3.0	3.2	1.2	−0.5	−0.5
Bulgaria	3.7	−4.2	3.7	3.8	3.6	1.1	0.5	0.2
Croatia	2.9	−8.0	7.6	6.0	4.2	2.1	−0.2	−1.5
Georgia	5.0	−6.2	8.0	5.5	5.0	2.0	0.5	0.0
Hungary	4.6	−5.0	7.3	5.0	4.3	1.3	0.3	0.0
Kazakhstan	4.5	−2.5	3.5	3.7	4.8	0.3	0.0	0.0
Kosovo	4.8	−5.3	7.1	4.1	4.4	3.1	−0.4	0.3
Kyrgyz Republic	4.6	−8.6	2.3	4.7	4.3	−1.5	0.4	−0.2
Moldova	3.7	−7.0	6.8	3.9	4.4	3.0	0.2	0.6
Montenegro	4.1	−15.3	10.8	5.6	4.8	3.7	1.1	1.3
North Macedonia	3.2	−4.5	4.6	3.7	3.4	1.0	0.2	0.0
Poland	4.7	−2.7	4.5	4.7	3.4	0.7	0.2	−0.5
Romania	4.1	−3.9	7.3	4.8	3.9	1.3	0.3	0.0
Russian Federation	2.0	−3.0	4.3	2.8	1.8	1.1	−0.4	−0.5
Serbia	4.2	−1.0	6.0	4.5	4.0	1.0	0.8	0.1
Tajikistan	7.4	4.5	6.0	5.0	5.0	0.7	−0.6	−1.0
Turkey	0.9	1.8	8.5	3.0	4.0	3.5	−1.5	−0.5
Ukraine	3.2	−4.0	3.8	3.5	3.7	0.0	0.4	0.6
Uzbekistan	5.7	1.7	6.2	5.6	5.8	1.4	0.1	0.0

Source: World Bank.
Note: World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time. Due to lack of reliable data of adequate quality, the World Bank is currently not publishing economic output, income, or growth data for Turkmenistan, and Turkmenistan is excluded from cross-country macroeconomic aggregates.
e = estimate; f = forecast.
a. Data are based on GDP measured in average 2010-19 prices and market exchange rates, unless indicated otherwise.

first half of 2021 (table 1.2). The improved outlook also reflects additional, albeit modest, fiscal support. The recovery is then expected to moderate to a still solid 2.8 percent in 2022, as demand stabilizes and industrial commodity prices edge down. The outlook is also predicated on a gradual easing of OPEC+ oil production constraints and the eventual return to the fiscal rule. The escalation of geopolitical tensions, including additional U.S. sanctions imposed in 2021, low vaccination rates, and increases in the policy rate from record lows are weighing on the growth outlook.

Turkey

Shortly after emerging from a sharp resurgence of COVID-19 that peaked in April 2021, Turkey entered another wave of the virus in July, driven by the spread

of the Delta variant. Daily new COVID-19 cases started to accelerate again in September, while deaths remain elevated. After months of slow vaccination progress, the pace quickened in July. As of late September, about two-thirds of the population had received at least one dose of a COVID-19 vaccine—among the highest in the region.

Turkey's economy was one of the few to avoid a contraction last year, partly owing to substantial credit expansion. Growth strengthened further in the first half of 2021, as the deployment of vaccines permitted relaxing COVID-19 restrictions, supporting robust services activity and retail sales. Activity was also fueled by a sharp rebound in industrial production and goods exports to the euro area as external demand firmed. Meanwhile, new export orders have remained solid in the third quarter. Tourist arrivals have firmed somewhat although international tourism remains depressed relative to pre-pandemic levels. And Turkey's inclusion on travel red lists amid high COVID-19 cases is likely to weigh on international arrivals in the second half of the year. The country also suffered from floods and wildfires this summer, which caused a devastating loss of life and impacted many popular tourist areas on the coast.

Growth is projected to accelerate to an eight-year high in 2021, reaching 8.5 percent, with export growth surging in tandem with firming external demand, particularly from the euro area. The expansion is set to ease to 3 percent in 2022—slower than previously projected, as the drag on domestic demand from tight financial conditions more than offsets the sustained boost from net exports. Going forward, the outlook assumes that activity will moderate, with growth supported by domestic demand as the contribution from net exports fades.

On the back of a strong cyclical recovery, employment has returned to pre-crisis levels, although not to the same extent for younger people and for those informally employed. At the same time, a combination of a weak lira and rising international commodity prices has raised headline inflation to nearly 20 percent, with producers facing roughly twice as high price increases. Inflationary pressures could continue to build in the near term following the policy rate cut in September 2021, which was largely unexpected by the market and triggered the lira to plunge to a new historical low against the U.S. dollar. The economy remains vulnerable to abrupt shifts in investor sentiment, which could trigger financial market pressures and sudden stops in capital flows, especially given the ongoing challenges related to high inflation and policy uncertainty.

Central Europe

New COVID-19 cases in Central Europe fell dramatically in 2021Q2, tumbling from their April peak of 24,000 cases per day to 1,000 cases per day. Moreover, widespread deployment of vaccines in several economies likely contributed to the decline in the number of infected patients hospitalized. Since then, pandemic trends have diverged in Central Europe, with new COVID-19 cases and hospitalizations remaining low and stable in highly vaccinated countries (Hungary and Poland), while a fourth-wave resurgence is underway in Bulgaria and Romania—the two EU countries with the lowest vaccination rates, reflecting high vaccine hesitancy.

Output in Central Europe rebounded in the first half of 2021, with activity surpassing its pre-pandemic level by the second quarter in every economy except Bulgaria. The expansion was partly driven by a recovery in domestic demand, as loosening pandemic restrictions unleashed pent-up demand, particularly for services, and fueled a pick-up in private consumption. Despite supply bottlenecks, new export orders expanded and industrial production growth surged to record highs in the first half of 2021, owing to solid demand from the euro area. Industrial activity has since stabilized in tandem with moderating global goods trade growth. Above-target inflation has prompted some central banks to begin removing policy accommodation, with Hungary increasing the policy rate from 0.6 to 1.65 percent in 2021.

Growth in Central Europe is projected to rebound to 5.6 percent in 2021, supported by an earlier recovery in trade amid improvement in euro area activity. Despite increases in COVID-19 cases due to the spread of the Delta variant in some parts of the subregion, the potential drag on growth is likely to remain more limited relative to previous waves, as policy makers opt for more targeted restrictions rather than full lockdowns. Growth in Central Europe is forecast to moderate to 4.8 percent in 2022, as activity is buoyed by firming domestic demand while the recovery in the euro area stabilizes. The sizable EU fund packages for member states, totaling EUR 1.21 trillion—including for all Central European economies—should help bolster investment. The boost, however, could be tempered by low absorption of the funds due to challenges relating to administrative capacity and governance.

Western Balkans

The economies in the Western Balkans were among those most impacted by the spread of the Delta variant in 2021Q3, with the number of new COVID-19 cases approaching or surpassing previous peaks while new deaths continued to increase. Vaccination rates lag the world in Albania, Bosnia and Herzegovina, and Kosovo, as general reluctance hinders vaccination progress. The deterioration in pandemic trends in the Western Balkans has prompted travel advisories and bans, as well as renewed restrictions and vaccine mandates in some cases.

As COVID-19 restrictions eased, growth in the Western Balkans remained solid in the first half of 2021, with output reaching its 2019Q4 level by the second quarter. The recovery was fueled by strong export growth on the back of firming external demand, especially from the euro area, and a gradual improvement in tourist arrivals. Strengthening domestic demand also supported activity, particularly in Serbia, as restrictions on the economy were lifted. Retail sales and mobility data also increased, pointing to rising services activity. Ongoing accommodative policy measures, including cash payments (North Macedonia and Serbia), continued to support robust household consumption. Early indicators, however, point to moderating momentum in the second half of 2021, as external demand eases and new COVID-19 variants trigger an increase in cases and deaths, particularly in economies with low vaccination rates.

Growth in the Western Balkans is expected to rebound to 5.9 percent in 2021—the fastest pace among the ECA subregions amid strong export performance. The

recovery is projected to moderate to 4.1 percent in 2022, as the earlier external boost fades and growth becomes more balanced. The outlook also assumes that consumer and business confidence is gradually restored, and that political instability eases. Medium-term growth in Albania and North Macedonia should be boosted by accelerating structural reforms in preparation for EU membership, provided negotiations surrounding the accession process are not further delayed (Rovo 2020). The subregion is also expected to benefit from the European Union's recently adopted Economic and Investment Plan, which will mobilize funding to support competitiveness and inclusive growth, as well as the green and digital transition.

South Caucasus

The South Caucasus saw an increase in new COVID-19 cases in 2021Q3, with cases rising well beyond previous peak levels in Azerbaijan and Georgia. Although new COVID-19 cases have started to fall or stabilize in the South Caucasus toward the start of 2021Q4, deaths remain elevated. In a bid to stem the rise in new cases, Azerbaijan and Georgia re-imposed selected restrictions, while Azerbaijan has implemented public and workplace requirements to show proof of COVID-19 vaccination. Workplace vaccination and testing requirements are also expected to take effect at the start of the fourth quarter this year in Armenia.

The three economies saw a solid improvement in activity in the year through July, particularly for the service sectors. The rebound in Armenia was supported by a robust pick-up in domestic demand, as well as strong export performance amid firming external demand for oil and metals. Although international tourist arrivals to the South Caucasus have improved somewhat from the troughs experienced in 2020, they remain about 75 and 60 percent below pre-pandemic levels in Georgia and Armenia, respectively. Inflationary pressures, driven in part by an acceleration in food prices, as well as elevated uncertainty, may weigh on the recovery of private consumption in the rest of the year.

Among the ECA subregions, the South Caucasus suffered the sharpest collapse in output last year, contracting more than 5 percent, as the impact of COVID-19 was exacerbated by armed conflict between Armenia and Azerbaijan. Output is projected to rebound sharply in 2021, expanding 5.8 percent, with activity boosted by the recovery in consumption and a strong pick-up in exports. In Azerbaijan, growth is expected to be further supported by energy production aided by an increase in OPEC+ production quotas.

The recovery is projected to edge down to 3.9 percent in 2022, as macroeconomic support continues to be removed. The current forecast is predicated on political stability and reduction of geopolitical tensions, limited further rounds of pandemic-related restrictions supported by progress on COVID-19 vaccination, and a recovery in tourism alongside improving consumer and business confidence. Nevertheless, the recovery in the South Caucasus remains constrained, owing to heightened domestic political tensions and stability risks, as well as tighter monetary policy.

Eastern Europe

Vaccination rates in Eastern Europe rank toward the bottom of the ECA subregions, where a general reluctance has facilitated low uptake of available supplies. That said, the pace of vaccination picked up in 2021Q3, particularly in Ukraine. As the Delta variant gained a stronghold in Europe, new COVID-19 cases have continued to trend upward in all three Eastern European economies toward the start of the fourth quarter. In response, Ukraine subsequently extended its state of emergency through October 1 to allow local authorities to continue enacting COVID-19 restrictions and introduced antigen testing as part of border controls.

Much like other ECA subregions, economic activity in Eastern Europe was buoyed by improving external demand in early 2021, which helped underpin a robust rebound in industrial production and partly offset the drag from macroeconomic tightening. In Ukraine—the subregion's largest economy—services activity benefited from a temporary easing of COVID-19 restrictions. Rising wages boosted household incomes in Ukraine and Moldova, which helped buoy private consumption. Above-target and accelerating inflation, especially in Ukraine, triggered policy rate hikes in all three economies in 2021.

Growth in Eastern Europe in the near term is projected to be the weakest among the ECA subregions, rising only to 3.1 percent in 2021 before nearly halving to 1.6 percent in 2022. Near-term activity is expected to be dampened by slowing growth in exports and private consumption in some economies, but a gradual improvement in domestic demand should help lift growth by 2023. Nevertheless, the outlook, particularly for private investment, remains clouded by ongoing geopolitical and domestic political tensions in Ukraine and Belarus, with the latter facing newly imposed sectoral economic sanctions. Longer-term growth prospects are also constrained by continued challenges related to slow reform momentum, which has hindered competition and private sector development.

Central Asia

New COVID-19 cases and deaths in Central Asia soared to all-time highs in 2021 as low vaccination rates left large portions of the population vulnerable to the highly contagious Delta variant. Vaccination requirements and renewed restrictions, which were implemented at the start of 2021Q3, limited operational hours and capacity in some countries. Since then, some mobility restrictions have been eased, as increased vaccine access has helped accelerate vaccination.

Improving domestic demand helped lift economic activity in Central Asia, as a gradual reopening of economies bolstered retail sales. In Kazakhstan—Central Asia's largest economy—the pick-up in private consumption was also boosted by additional fiscal support. Firming external demand has also boosted export performance for many goods. Nevertheless, the recovery is incomplete—oil exports remain below pre-pandemic volumes and foreign direct investment inflows continue to be subdued amid weak extractive investment. In the Kyrgyz Republic, weaker-than-expected gold production weighed on the recovery.

In Central Asia, growth is forecast to recover to 4.3 percent in both 2021 and 2022—well below historical averages amid ongoing pandemic challenges.

Nevertheless, firming investment should help support activity over the forecast horizon. In Uzbekistan, growth should continue to benefit from the implementation of an ambitious reform agenda, which progressed throughout the pandemic despite formidable headwinds. Higher inflation prompted increases in key policy interest rates in Kazakhstan, the Kyrgyz Republic, and Tajikistan.

The medium- to longer-term outlook in Central Asia could be dampened by stability concerns in neighboring countries, including Afghanistan amid heightened security risks and uncertainty regarding the influx of migrant refugees. The outlook also faces challenges due to rising policy uncertainty, particularly in the Kyrgyz Republic, following political tensions and social unrest. Political tensions have also increased within Central Asia amid conflict over a border dispute between the Kyrgyz Republic and Tajikistan.

Risks to the Regional Outlook

Risks to the regional outlook remain tilted to the downside, reflecting the ongoing effects of the protracted pandemic. Despite the pandemic's persistence, its economic impact in recent resurgences appears to be smaller than the initial wave. Nevertheless, COVID-19 outbreaks are likely to continue to weigh on the recovery amid low vaccination rates. Absent clear and consistent communication to strengthen public trust, inoculations will be hindered by vaccine hesitancy in some ECA countries. The continued circulation of the virus in these places means that countries risk repeatedly cycling between making progress in reducing COVID-19 caseloads and relaxing restrictions, followed by the reemergence of the virus, triggering new lockdowns and renewed declines in activity.

The risk of financial stress also looms over the region's outlook. Financial stress could be triggered by a number of negative shocks, including a sharp rise in risk aversion or expectations of a faster tapering and removal of monetary policy accommodation in major economies. Both the United States and the euro area face above-target inflation, which could prompt sudden policy rate hikes and, in turn, generate a disorderly tightening of global financing conditions. As a result, the ability of ECA countries to service debt would be more challenging, especially given the sharp uptick in debt last year to confront the pandemic. A rapid deterioration in global financial conditions could derail the global and regional recovery over the forecast horizon (CBR 2021). Given tight global financial linkages and the earlier drawdown of buffers from the pandemic, ECA's economy is vulnerable to shocks emanating from the euro area in particular. The recent European Central Bank announcement on reducing the pace of its pandemic emergency purchase program led to some market volatility in ECA, particularly in Central Europe and the Western Balkans, but equity prices have since recouped those losses.

Even absent global financial stress, a worsening of the pandemic, alongside elevated policy uncertainty, could further exacerbate the decline in portfolio inflows and reignite currency depreciation and reserve losses in the region. As a result, external financing pressures could build, particularly in countries with a large share of foreign currency–denominated debt. The recovery in regional activity has been accompanied by a rapid acceleration of inflation. Rising price

pressures have further constrained the capacity of some central banks to buffer the impact of additional negative external shocks, with more than one-half of the region's economies forced to raise policy rates in 2021. Meanwhile, global supply disruptions and shipping bottlenecks have also exerted upward pressure on prices in ECA. In an environment of sustained, above-target inflation, a sharper erosion of investor sentiment could abruptly tighten financing conditions and lead to cascading defaults and rising nonperforming loans. Corporate balance sheet pressures have continued to rise as authorities unwind liquidity support and regulatory forbearance, putting strain on the banking sector.

A slower-than-expected recovery in the euro area, ECA's largest trading partner, could generate negative spillovers in economies with tightly linked trade and financial ties (Elekdag, Muir, and Wu 2015; World Bank 2016). Moderating growth in China could be propagated through trade and commodity price channels to Central Asia, as well as metals exporters in the ECA region, which are increasingly reliant on China as an export destination. The region's energy exporters—Azerbaijan, Kazakhstan, and Russia—remain vulnerable to large swings in global commodity prices, particularly when accompanied by heightened volatility (van Eyden et al. 2019).

The possibility of intensifying geopolitical tensions is also a downside risk in ECA, and could be accompanied by additional sanctions and financial market pressures. The region could be destabilized by an escalation of conflict in Ukraine or between the Kyrgyz Republic and Tajikistan, elevated stability risks following armed conflict between Armenia and Azerbaijan, and security challenges in neighboring Afghanistan—the latter of which could generate a disorderly influx of migrant refugees into ECA. The effects of sectoral economic sanctions on Belarus's economy or additional political pressures in the Kyrgyz Republic could weaken the outlook in Eastern Europe and Central Asia. Disagreements between the European Union and other major economies could also lead to additional sanctions that could have spillover effects on some ECA countries. A further rise in policy uncertainty, particularly in some of the region's large economies, could also undermine the recovery if it triggers financial stress.

Long-Term Challenges and Policies

The long-term outlook for EMDEs in ECA will likely be dampened by the pandemic's lasting legacies. Productivity growth had been projected to lose momentum even before the COVID-19 crisis, and this trend is likely to be exacerbated by the scarring effects of the pandemic. Entrenching a green, resilient, and inclusive development path will require measures that rekindle productivity growth, while also addressing the scars from the pandemic and challenges of climate change. A comprehensive approach to reinvigorate productivity growth includes policies that facilitate technological adoption and innovation among firms, promote competition in a growth-friendly macroeconomic and institutional environment, and bolster investment in physical and human capital—all while protecting vulnerable groups. In addition, investments in green infrastructure can help achieve development goals and improve resilience to climate change.

Reinvigorating Firm Productivity Growth

The pandemic is expected to exacerbate the slowdown in productivity growth that had already been projected over the next decade (Dieppe 2020; World Bank 2021a). Even in the decade prior to the pandemic, EMDEs in ECA were among the countries that suffered the steepest deceleration in labor productivity growth—with a large share of the slowdown accounted for by total factor productivity (TFP) (World Bank 2021b). Firm productivity in EMDEs in ECA had been low relative to advanced economies and may have been impaired by COVID-19 through disruptions to organizational effectiveness, increased transaction costs, and reduced dynamism, even if some firms have taken the opportunity to increase technological adoption (di Mauro and Syverson 2020; Apedo-Amah et al. 2020). Absent reforms to counter the scarring effects of COVID-19, the pandemic has likely further diminished prospects for catch-up over the next decade. Measures that address longstanding challenges and cement the foundation for sustainable growth can be implemented to align private sector incentives with broader policy reforms, including those that facilitate technological adoption and innovation, promote competition, and strengthen institutions.

Facilitating technological adoption and innovation. Accelerating the digital transformation could support higher productivity and output in EMDEs in ECA, while also strengthening economic resilience in times of crisis (Hallward-Driemeir et al. 2020; ITU 2020). Throughout the pandemic, over 50 percent of small and medium-size enterprises (SMEs) surveyed by the Organisation for Economic Co-operation and Development (OECD) have increased the use of digital tools to ensure business continuity in the wake of reduced mobility (OECD 2021a). Preliminary evidence also suggests that innovation and digitalization may have helped promote firm survival during the pandemic (Muzi et al. 2021).

Although ECA fairs well relative to other EMDE regions on digital connectivity, weak investment has led to large infrastructure gaps in telecommunications in the region, limiting the capacity for further regional integration (IMF 2014). Moreover, outdated technologies, lagging innovation, misallocation of labor to inefficient sectors, and market rigidities have weighed on productivity and contributed to dispersion in TFP across countries and firms (Araujo, Vostroknutova, and Wacker 2017; Bahar 2018; Syverson 2011; Hallward-Driemeir et al. 2020). While the number of individuals using the internet in countries in Central Europe is on par with the rest of the European Union, several of ECA's poorest EMDEs are below the global average, which will hinder their ability to close the distance to the TFP frontier (UN 2020; Burunciuc 2021). The digital divide also extends to firms, with SMEs trailing larger companies in digital connectivity and adoption, particularly in high-speed broadband and e-commerce tools, which makes narrowing productivity gaps with larger companies even more challenging for SMEs (Hallward-Driemeir et al. 2020; OECD 2021a).

For many ECA countries, improving the digital infrastructure and expanding access to high-quality digital connectivity will require boosting investment in communications infrastructure (Hallward-Driemeir et al. 2020). Liberalized telecommunications, coupled with regulatory independence and efficient taxation of digital services, can catalyze private sector investment that lowers the cost of

access and increases internet adoption and access to digital services, with significant spillovers to the rest of the economy (Arezki et al. 2021; Rodriguez-Castelan et al. 2021). Public investment can also play a role in supporting the digital transformation for firms by reducing cost barriers and accelerating the uptake of digital adoption, particularly for finance-constrained SMEs.

Promoting competition in a growth-friendly macroeconomic and institutional environment. Reforms that strengthen institutions and foster favorable business climates are critical in ECA to promote competition and sustainable growth—especially given the state's large and expanding footprint (EBRD 2020; World Bank 2021b). Even prior to the pandemic, the region's slowing reform momentum—and in some cases backsliding—meant that private investment and firm productivity continued to be hampered by weak institutions and governance (World Bank 2018, 2020). Pervasive corruption and crime, weak administrative capacity, regulatory obstacles, and informality remain formidable constraints on the ability of private firms to operate, invest, innovate, and close the productivity gap with high-income countries (Cusolito and Maloney 2018). In over 40 percent of ECA's EMDEs, at least a quarter of the firms surveyed identified corruption as a major constraint to business (Enterprise Surveys; Albania, Bosnia and Herzegovina, Bulgaria, Kosovo, Kyrgyz Republic, Moldova, Poland, Romania, Turkey, and Ukraine). Past major reform initiatives to improve the business climate or governance have been followed by significantly higher TFP growth in the near term and investment growth in the medium term, including in EMDEs in ECA (World Bank 2021a, 2021b). These reforms can be complemented by efforts that improve accountability, including enhancing data transparency and security, which can strengthen institutions and ensure the efficient allocation of resources (Islam and Lederman 2020; World Bank 2021b).

Firm productivity has also been held back by poorly regulated markets through adverse incentives and the lack of creative destruction (Goldberg et al. 2010). Private sector shortcomings, including insufficient competition and elevated market concentration, have also weighed on TFP in the region (EBRD 2018). This is why competition is the feature topic of this economic update. Part 2 of this report illustrates the competition landscape in ECA before COVID-19, explores the impact of the pandemic on firms in different competition environments, and investigates government support initiatives and which firms received them. Removing business climate distortions and restrictions on competition—including nontransparent investment regulations, cumbersome tax compliance rules, and differing treatment for state-owned enterprises—as well as better targeting of policy support measures are among the policy reforms that could help bolster productivity and support viable firms in the region.

Healing the Pandemic's Scars and Bolstering an Inclusive Recovery

COVID-19 has cost millions of lives and jobs globally, reversed progress in poverty reduction, and is likely to impart harmful health and economic legacies in its wake. The accumulated scars on human capital will be slow to heal, while the pace of accumulation of physical capital is likely to remain subdued for a

prolonged period (World Bank 2021a). Even prior to the pandemic, all the fundamental drivers of growth—investment, productivity growth, improvements in education and health, and working-age population growth—had been expected to decelerate over the coming decade in ECA. However, the pandemic has likely exacerbated this slowdown and its negative effects will be acutely felt by the most vulnerable—the poor, women, children, as well as youth, migrant, and informal workers (Dieppe 2020; World Bank 2021b).

The pandemic has also eroded earlier gains in human capital through its impact on health outcomes, school closures, and prolonged spells of unemployment. Beyond its direct effects on morbidity and mortality, the pandemic has also delayed essential primary health services and increased food insecurity, which could lead to higher maternal and early childhood deaths (Roberton et al. 2020). These effects are also likely to weigh on longer-term productivity, as malnutrition early in life can permanently impair learning abilities. To address these challenges and prevent the entrenchment of economic insecurity, a comprehensive set of macroeconomic policies is needed to help buttress an inclusive recovery, including measures to reverse scarring and protect the vulnerable (World Bank 2020).

Nurturing the labor market recovery and protecting workers. The COVID-19 recession triggered a sharp yet uneven collapse in employment across sectors. The impact would have been worse absent far-reaching fiscal support, including job protection schemes and targeted cash transfers to vulnerable households. Despite this support, ECA workers—especially those who are part-time, temporary, young, or unskilled—have suffered considerable income losses and declines in working hours. Moreover, these losses are likely to be sustained in ECA, as the recovery in employment is anticipated to lag the other EMDE regions (ILO 2021). In all, total working hours in ECA are expected to remain 2 percent below 2019 levels by 2022, with an additional 2 million projected to be unemployed in 2022 relative to 2019 and another 1 million estimated to leave the labor force amid discouragement (ILO 2021). As a result of widespread job losses, an overwhelming majority of the respondents surveyed by the OECD indicated their concerns over social and economic insecurity over the next few years (OECD 2021b). These effects are expected to ripple well beyond the next few years, with households that reported a job loss concerned about lacking the necessary skills and knowledge to secure a well-paid job in the next decade.

Policy action needs to underpin an inclusive recovery in employment and limit the damage to human capital originating from long spells of unemployment or disengagement. Where appropriate, policy can help accelerate a reallocation of labor across sectors. Measures that facilitate the employment of displaced workers—notably female and young workers—are critical given that many of the occupations in the hardest hit sectors were already highly susceptible to automation (Albanesi and Kim 2021; Hallward-Driemeier and Nayyar 2018; OECD 2021c). Active labor market policies—such as providing employment services, entrepreneurship support, and worker retraining programs—can be pursued to encourage employment in sectors experiencing higher growth (Card, Kluve, and Weber 2018; OECD 2021b; Schmillen 2020; Trebilcock 2014). Coupled with income support programs geared toward vulnerable populations, such as targeted

cash transfers, active labor market policies can facilitate the movement of labor across sectors and enhance employment prospects for more vulnerable populations to ensure a balanced, inclusive recovery (Escudero and Liepermann 2020; OECD 2021c).

Tackling educational losses and investing in the future. Education for ECA schoolchildren—particularly those from vulnerable households—has been disrupted as partial and full school closures continue to interrupt learning continuity, which could worsen learning outcomes (World Bank 2021a, 2020). This, combined with the deskilling associated with prolonged unemployment, could lead to sizable future earnings losses.[5] While learning outcomes had improved prior to the pandemic, those gains were not equitable—pointing to the need for structural reforms not only to tackle educational losses from COVID-19, but also to ensure an inclusive recovery (OECD and UNICEF 2021).

Investing in education is needed to mitigate the disruptions to human capital brought about by the pandemic, including learning losses and youth disengagement. About 60 percent of low- and lower-middle-income countries—including those in ECA—have cut their public education budgets since the onset of the crisis, reversing a decade-long trend of increased funding (UNESCO 2021). Education budgets can be bolstered with additional financing deployed to incentivize attendance and educational attainment, improve school facilities, and reform incentive structures for teachers, which can also increase the efficiency of existing education spending (Hui, La-Bhus, and Baoping 2019; World Bank 2021cd). Investment in learning infrastructure leads to improved educational outcomes and higher incomes in the long term (Akresh, Halim, and Kleemans 2021).

In ECA, transforming the education system could also help the region become more resilient to crises. Measures that adapt instruction in a new hybrid educational setting, identify struggling students, and streamline the curriculum to target foundational skills can help ensure learning continuity for all students (Saadah 2021). Moreover, governments can facilitate access to existing free and open-source education technologies in a way that favors the inclusion of disadvantaged groups (Burns et al. 2019; UNESCO 2020). Efforts to foster equitable internet access for distance learning can help avoid the widening of the digital divide across income levels.

Ensuring a Sustainable Recovery and Protecting the Future by Boosting Green Investment

Climate change poses substantial downside risks to the longer-term health and economic landscape. As a result of the pandemic, these challenges are magnified in the context of narrower macroeconomic policy space and rising budgetary pressures (Rogoff 2021b). Nevertheless, the cost of inaction is higher—on the current trajectory, economic damage from climate change alone could shave about 10 percent off global economic output by 2050 relative to a scenario without

5. See Azevedo et al. (2021); Bundervoet, Davalos, and Garcia (2021); UNESCO (2021); and UNICEF (2021) for a discussion of the impact of COVID-19 on education. See Azevedo et al. (2020) and Fasih, Patrinos, and Shafiq (2020) for a discussion of the impact of COVID-19 on future labor earnings through its disruptions to education and employment.

climate change (Swiss Re 2021). The true cost, however, extends well beyond the economy: as many as one in eight deaths in Europe were attributed to pollution in 2012—the most recent year of analysis available (EEA 2020).

Climate change is anticipated to have a particularly large impact on Europe, including on EMDEs in ECA, with temperatures projected to rise across the continent at a pace faster than the global average regardless of the global warming scenario (IPCC 2021). The frequency of droughts is anticipated to increase, which will decrease production and yields in many of ECA's large agricultural exporters. The expected rise in sea levels will leave ECA's coastal populations vulnerable to flooding and land erosion. Thus, the need for structural transformation is pressing, especially given that half the world's 20 most carbon-intensive economies are located within the broader ECA region (Bjerde 2021).

Despite slow progress over the past few decades, the recent materialization of climate change risks—including weather-related disasters—has highlighted the urgency of accelerating decarbonization efforts. Countries that represent over two-thirds of global emissions and GDP have committed to achieving net zero emissions by 2050 or 2060 (IEA 2021; Pisani-Ferry 2021). The menu of policy proposals is wide ranging and includes carbon taxes, regulatory standards, investments in green energy, and reductions in fossil fuel subsidies—the latter of which accounted for about 1.5 to nearly 7.5 percent of GDP in 2019 for some ECA economies (IEA 2021; Wheeler et al. 2020). The European Commission recently announced plans to cut emissions by an additional 15 percentage points than initially legislated in 2018, aiming to reduce levels by 55 percent of the 1990 baseline by 2030 (European Commission 2021). A minimum carbon tax is envisioned at the national level, but the revamped framework also includes a broadening of the cap-and-trade scheme and additional environmental standards, all of which are anticipated to transform the energy, transportation, housing, manufacturing, agriculture, and service sectors (European Commission 2021; Pisani-Ferry 2021).

One of the key policy challenges of decarbonization will be to manage nonnegligible transition costs to ensure a sustainable and inclusive recovery. The transition is likely to change the composition of GDP, as resources are directed toward sizable investment needs and away from consumption. Equity issues must be considered in this respect. Although investment gaps can be partly funded by carbon taxes, these taxes tend to be regressive. Moreover, stricter environmental regulations are likely to burden poorer households more than others. As a result of these costs, additional government transfers to vulnerable households may be warranted and put further pressure on public balance sheets (Pisani-Ferry 2021). In light of these costs and equity considerations, attracting private investment is essential to realizing ambitious green investment goals. This requires a supportive domestic environment, with reduced risks, strong competition, and measures to promote capital flows. Providing an effective regulatory environment, while enforcing environmental standards, is paramount for this endeavor (Ambec et al. 2011).

Transition costs also include those related to labor market adjustments as countries move away from fossil fuel intensive sectors, which will likely require sizable re- and up-skilling of workers, particularly in Central European countries

due to high levels of employment in coal-related sectors (Pisani-Ferry 2021; World Bank 2021d). In all, the impact of transition on 2030 EU GDP is estimated to range from -0.7 to 0.55 percent under various policy scenarios—highlighting the need for the appropriate mechanisms to estimate the economic impact to ensure better growth outcomes (European Commission 2020).

Despite these challenges, economies in Europe are leveraging pandemic-related support packages to ensure a greener, more sustainable recovery. In addition to the European Union's Multiannual Financial Framework and Next Generation EU Funds, which includes sizable transfers to ECA's Central European economies, the region has implemented or accelerated measures to boost energy-efficient housing and sustainable transportation, both of which are substantial sources of carbon emissions in ECA (Bjerde 2021). To benefit fully from positive spillovers from these funding arrangements and deliver on the European Green Deal, ECA economies could put in place measures that help increase the absorption of these funds, including those that bolster technical and administrative capacity (World Bank 2021d).

Annex 1.1 Data and Forecast Conventions

The macroeconomic forecasts presented in this report are the result of an iterative process involving staff from the World Bank Prospects Group in the Equitable Growth, Finance, and Institutions Vice-Presidency; country teams; regional and country offices; and the Europe and Central Asia Chief Economist's Office. This process incorporates data, macroeconometric models, and judgment.

Data

The data used to prepare the country forecasts come from a variety of sources. National income accounts, balance of payments, and fiscal data are from Haver Analytics; the World Bank's World Development Indicators; and the International Monetary Fund's (IMF's) World Economic Outlook, Balance of Payments Statistics, and International Financial Statistics. Population data and forecasts are from the United Nations' World Population Prospects. Country and lending group classifications are from the World Bank. In-house databases include commodity prices, data on previous forecast vintages, and country classifications. Other internal databases include high-frequency indicators—such as industrial production, consumer price indexes, housing prices, exchange rates, exports, imports, and stock market indexes—based on data from Bloomberg, Haver Analytics, the Organisation for Economic Co-operation and Development's analytical housing price indicators, the IMF's Balance of Payments Statistics, and the IMF's International Financial Statistics. Aggregate growth for the world and all subgroups of countries (such as regions and income groups) is calculated as the gross domestic product–weighted average (in average 2010–19 prices) of country-specific growth rates. Income groups are defined as in the World Bank's classification of country groups.

Forecast Process

The process starts with initial assumptions about advanced economy growth and commodity price forecasts. These assumptions are used as conditions for the first set of growth forecasts for emerging markets and developing economies, which are produced using macroeconometric models, accounting frameworks to ensure national accounts identities and global consistency, estimates of spillovers from major economies, and high-frequency indicators. These forecasts are then evaluated to ensure consistency of treatment across similar economies. This process is followed by extensive discussions with World Bank country teams, which conduct continuous macroeconomic monitoring and dialogue with country authorities. Throughout the forecasting process, staff use macroeconometric models that allow the combination of judgment and consistency with model-based insights.

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2

Competition and Firm Recovery Post-COVID-19

Economies around the world have been hit hard by the COVID-19 pandemic. In 2020, global economic activity contracted because of the pandemic, resulting in the deepest economic recession since World War II (World Bank 2020a). Although global economic activity is recovering and output in Europe and Central Asia (ECA) is expected to grow in 2021, containing COVID-19 remains a challenge in the region. Indeed, ECA is among the emerging market and developing economy regions with the highest case and death rates per capita (World Bank 2021b). At the onset of the pandemic, the rapid spread of the disease and movement restrictions and lockdowns imposed to contain the virus led to sudden supply and demand shocks, which manifested themselves in declines in output and productivity (Demirgüç-Kunt, Lokshin, and Torre 2021). Widespread uncertainty among businesses and concerns about the risks of increasing financial sector distress limiting firms' access to credit have compounded these supply and demand shocks.

How did firms fare? This *ECA Economic Update* builds on the World Bank's ongoing work with the Enterprise Surveys (ES) COVID-19 Follow-Up Surveys and Business Pulse Surveys (BPS) to assess the impact of COVID-19 on firms in the region, with a focus on the role of competition during the crisis and recovery. Previous work has provided insights into the short-term impacts of the COVID-19 crisis on businesses around the world (Apedo-Amah and others 2020; Karalashvili and Viganola 2021) and has examined the reach, targeting, and effectiveness of government policy measures to support firms during the COVID-19 crisis (Cirera and others 2021; World Bank 2021c). The focus of this chapter is on the role of competition because it is key to sustainable, long-term economic growth. A more competitive business environment is associated with greater dynamism and is likely to contribute to growth through three main channels: (a) by incentivizing firms to innovate and become more efficient (*productive efficiency*); (b) by shifting resources toward more efficient firms (*allocative*

efficiency); and (c) by forcing less efficient firms to exit while more efficient ones grow and new ones enter (*market contestability/creative destruction*).[1]

Evidence suggests that in a regulatory environment characterized by pro-competitive product market regulations, economies generally experience higher productivity growth and do a better job of reallocating resources toward more productive firms (Arnold, Nicoletti, and Scarpetta 2011). Countries with a lower regulatory burden for entry also see more firm entry and higher productivity and investment in the economy, thanks to increased competition from new firms (Motta, Oviedo, and Santini 2010). Evidence from the European Union suggests that countries with a sound business and regulatory environment are more resilient to negative output shocks and suffer smaller output losses than countries with weaker business and regulatory environments (Sondermann 2018).

As economies start to recover from the COVID-19 crisis, it will be important to ensure that a competitive business environment is in place that supports the reallocation of resources from less productive to more productive firms—a process Schumpeter (1942) referred to as "creative destruction." Competition has been identified as an important source of creative destruction (Caballero 2008).

The COVID-19 pandemic has heightened concerns about limited competition and its potential consequences for economic growth. The rise of dominant firms—so-called "star" or "superstar" firms—and their market power was a subject of debate among policy makers years before the pandemic (box 2.1). Evidence suggests that a more competitive environment promotes entrepreneurship and produces more star firms and that in advanced economies, the market power of such firms has been increasing since the 1980s. There is a debate, however, over whether firms are becoming larger and more dominant because changes in the economic environment—including globalization and scale-biased technological change related to advances in information and communications technology—result in larger, more efficient firms securing increasingly larger market shares or because of anti-competitive behavior and declining competition caused by weakened antitrust enforcement and regulations (Autor and others 2020; Gutierrez and Philippon 2018; Akcigit and others 2021; Diez, Leigh, and Tambunlertchai 2018; IMF 2019). A critical concern for policy makers is to ensure that markets remain contestable and that even in concentrated markets, entrants with new ideas and technologies are able to challenge incumbent firms. Lack of competition and a less favorable business environment are often cited as key factors explaining why Europe generates few global stars and European corporations have fallen behind in recent decades (The Economist 2021). Others argue that weaker antitrust enforcement relative to the European Union explains why market power has risen more in the United States (Gutiérrez and Philippon 2018). In emerging economies, including in ECA, observed increases in corporate market power have been much more limited, possibly because of the weaker starting level in the competitive environment and dynamism that made it less likely for star firms to emerge (IMF 2019).[2]

1. See Dauda (2020) for a review of the literature.
2. Iootty, Pop, and Pena (2020) explore the drivers of market power trends in Romania and the implications for competition and economic growth there.

BOX 2.1 Star firms and competition

An extensive body of literature has established that both institutions and the Schumpeterian process of "creative destruction" matter for economic development and growth (see Acemoglu and Robinson 2012 and Aghion and Howitt 1992). The consensus emerging from this work is that policies fostering competition are important for economic growth.

Recent academic literature in finance and economics points to the growing importance of superstar firms in the United States (Autor and others 2020; Hall 2018; Van Reenen 2018; and De Loecker, Eeckhout, and Unger 2020) and worldwide (Andrews and others 2015). Freund and Pierola (2015) and Gaubert and Itskhoki (2020) show that "granular" forces (exports driven by large individual firms) explain the trade pattern of countries. A few dominant firms can shape the landscape of national economies; competition policies that affect individual firms may therefore have aggregate consequences.

Ayyagari, Demirgüç-Kunt, and Maksimovic (2020) document the incidence of star firms—which they define as firms in the top 10 percent globally in return on invested capital—across industries and countries. They find that star firms are more likely to occur in high-income countries and industries that rely on high intangible capital. There is greater churn in the population of star firms in high-income countries, reinforcing the importance of good institutions and creative destruction for star firms. A good competitive environment—as measured by competition-enhancing product market regulation, low state ownership of the banking sector, and easier entry regulations—is associated with the rise of star firms.

In an earlier paper, Ayyagari, Demirgüç-Kunt, and Maksimovic (2019) point out that star firms are associated with greater intangible capital investment and are thus most likely to have their profits mismeasured, because traditional accounting standards do not capitalize research and development, brand capital, or other forms of organizational capital. Even after allowing for the mismeasurement of intangible capital, the joint existence of high profits and markups is not sufficient evidence of star firms being detrimental to consumer welfare. Star firms have higher innovation output and more economically important patents than non-stars. At every level of markup, they have higher output and investment than non-stars. Several other studies highlight the role of intangible capital in contributing to increasing concentration and market power in industries and the overall economy (see Crouzet and Eberly 2019; Autor and others 2020; and Bessen 2017).

Keller and Yeaple (2020) find that the most productive firms, which charge the highest markups, tend to be attracted to the most competitive markets. Less competitive firms, which charge lower markups, tend to be attracted to less competitive countries.

Together, this body of research suggests that (a) the rise of star firms is reflective of good business environments and institutions that encourage creative destruction and investment in innovation and (b) star firms are more innovative and efficient than non-star firms.

There may be legitimate concerns that a few dominant firms are able to keep out competition by engaging in mergers and acquisitions, with long-ranging impacts on the incentives to innovate, as Cunningham, Ederer, and Ma (2021); Akcigit and others (2021); and Kamepalli, Rajan, and Zingales (2021) discuss. The critical concern for policy makers should thus be not only to control the exercise of market power by these few firms but to ensure that markets remain contestable and that entrants with new technologies are able to challenge the current market leaders.

The pandemic may be exacerbating concerns about competition (Akcigit and others 2021). If smaller firms find it more difficult to adapt new technologies or business models; are less likely to receive government support; and, as a result, are more likely to exit, concentration and the dominance of large firms may increase, potentially further limiting competition, just when it is most needed to promote recovery.

This chapter addresses the following questions: How did COVID-19 affect firms' growth, employment and technological adaptation? Did the impact vary by firm characteristics such as size, age, sector, or gender of top manager? Is there any evidence of creative destruction so far, with resources allocated to firms that are more productive? Did firms in countries with a stronger pre-COVID-19 competition environment see more or less creative destruction? What forms of government support did firms receive to help them weather the pandemic? Which firms received government support, and what are the implications for competition and recovery?

The analysis yields four main results:

1. On average, the pre-COVID-19 competitive environment–-measured by various indicators—is stronger in higher-income emerging and developing countries in the region. In countries with a more competitive environment, firms had higher pre-crisis labor productivity, as measured by sales per worker in 2019.
2. COVID-19 had a profound and heterogenous impact on firms in the region. On average, in the first survey round, conducted between May and November 2020**,** firms in the region reported a drop in monthly sales of 24 percent and a 10 percent decline in the number of full-time employees with respect to the previous year. By round 2, conducted between November 2020 and May 2021, one in four firms reported that they expected to fall into arrears on outstanding liabilities in the next six months. Smaller and younger firms were hit harder by the COVID-19 crisis. By the second round of the survey, smaller, younger, and female-run businesses had not yet seen their sales improve since the initial drop.
3. Economic activity in ECA appears to have been reallocated toward more productive firms during the COVID-19 crisis, particularly in countries with more competitive markets. Firms with high pre-crisis labor productivity experienced smaller drops in sales and employment than firms with low pre-crisis labor productivity. More productive firms were also more likely to adapt to the crisis by increasing online activity and remote work. Whether the reallocation of economic activity toward more productive firms is long-lasting will depend on whether more productive firms grow and less productive firms ultimately exit.
4. Many governments in ECA implemented broad policy support schemes to promptly address the initial economic fall-out from the COVID-19 crisis and provide immediate relief to protect firms and workers from its worst effects. The reach of government support measures varied widely across countries, but on average half of firms reported having received some government support in response to the economic fall-out of the pandemic. Overall, government support was more likely to go to less productive firms, larger firms were more likely than smaller firms to receive support in the form payment deferrals and fiscal relief, and support measures were given to firms regardless of the level of their pre-crisis innovation.

The chapter is organized as follows. The first section describes the competition landscape in ECA before COVID-19. The next section shows how COVID-19

affected firms in the region. The section "Reallocation from Less Productive to More Productive Firms" focuses on whether firms that were more productive before COVID-19 weathered the pandemic better and explores how the competition environment affected the process of resource allocation from less productive to more productive firms during the crisis. The section "Government Support Measures" describes government policy support measures enacted to help firms weather the crisis. It identifies which firms received this support and the implications for competition and recovery. The following section discusses the policy implications of the findings for a strong recovery and resilience to future crisis. The last section summarizes the chapter's main results.

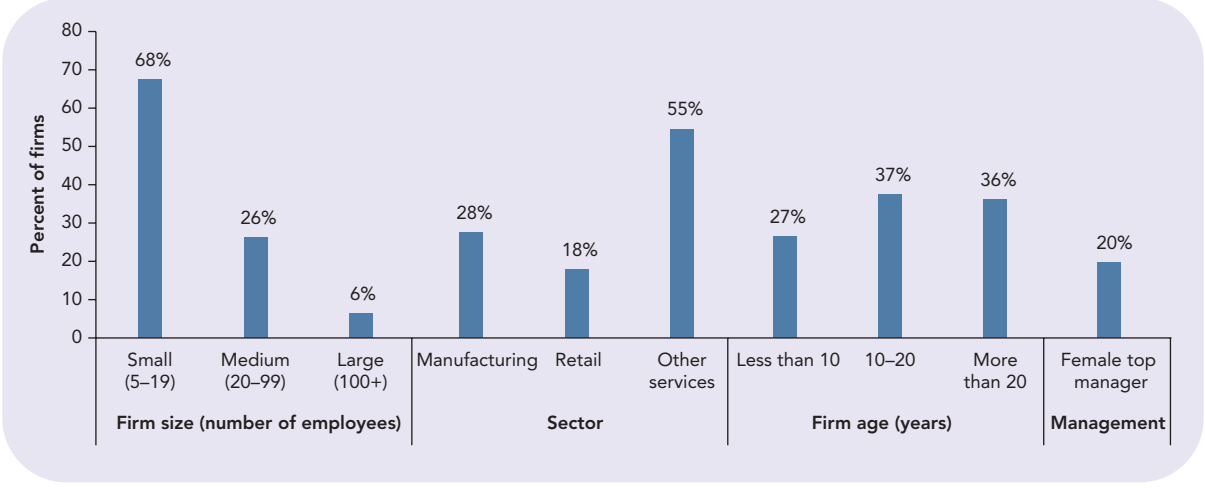
The Private Sector Landscape before COVID-19

Firm Characteristics

World Bank Enterprise Surveys provide nationally representative insights into the private sector landscape in ECA (see annex 2.1 for details on data and methodology). Data from the latest round of surveys in the region, collected primarily in 2019, show that on average two-thirds of firms are small (5–19 employees), a quarter are medium-size (20–99 employees), and less than a tenth are large (100 or more employees) (figure 2.1). Firms in retail and other services account for 72 percent of firms, with the remaining share in manufacturing. About 27 percent of firms were less than 10 years old; the remaining firms were about equally split between having been established 10–20 years earlier and 20 or more years earlier. Twenty percent of firms reported having a female top manager.

Firm characteristics vary across countries (table 2.1). In most countries, more than 60 percent of firms are small. Armenia, Azerbaijan, Belarus, and Bosnia and Herzegovina are the only countries in the region in which the share of large firms

FIGURE 2.1 Characteristics of firms in Europe and Central Asia



Source: Authors' calculations based on data from latest Enterprise Surveys available (for most countries, 2019) for 29 countries in ECA.
Note: Firm-level responses were aggregated to the country level using weights and then (simple) averaged across countries.

TABLE 2.1 Characteristics of firms in Europe and Central Asia (percent of total)

	Firm size (number of employees)			Sector			Firm age (years)			
Region or country	Small (5–19)	Medium (20–99)	Large (100+)	Manufac-turing	Retail	Other services	Less than 10	10–20	More than 20	Female top manager
ECA	68	26	6	28	18	55	27	37	36	20
Central Asia	66	28	6	33	18	50	43	39	18	20
Kazakhstan	76	20	4	17	20	62	52	38	11	26
Kyrgyz Republic	56	35	9	37	22	41	22	43	36	33
Tajikistan	63	31	6	41	14	45	48	39	13	7
Uzbekistan	70	26	4	35	13	51	50	35	15	12
Central Europe and Baltic countries	72	23	5	26	20	54	20	33	47	24
Bulgaria	68	28	4	27	22	51	26	44	29	29
Croatia	66	27	7	25	41	35	21	16	63	27
Czech Republic	73	23	5	28	12	60	16	30	53	16
Estonia	72	25	4	26	10	64	24	33	43	22
Hungary	67	28	5	24	22	54	15	37	48	22
Latvia	69	27	3	24	21	55	15	31	54	33
Lithuania	76	20	4	21	24	55	26	34	40	31
Poland	87	11	2	22	18	60	23	35	42	28
Romania	71	24	5	27	23	51	19	34	47	17
Slovak Republic	71	20	9	30	20	49	17	45	38	23
Slovenia	72	23	5	32	10	58	19	23	57	19

(continued next page)

TABLE 2.1 *(continued)*

Region or country	Firm size (number of employees)			Sector			Firm age (years)			Female top manager
	Small (5–19)	Medium (20–99)	Large (100+)	Manufac-turing	Retail	Other services	Less than 10	10–20	More than 20	
Eastern Europe	63	28	9	30	17	53	21	43	36	19
Belarus	62	28	10	28	18	54	31	38	31	21
Moldova	69	24	7	27	22	51	19	43	38	19
Ukraine	58	33	8	35	10	55	14	48	38	18
Russian Federation	74	22	5	16	12	72	42	48	10	24
South Caucasus	57	30	12	19	25	56	38	40	23	17
Armenia	60	26	13	21	28	51	34	36	30	19
Azerbaijan	55	31	15	16	25	59	25	51	24	17
Georgia	57	34	8	21	22	57	54	32	13	17
Turkey	72	25	4	31	16	53	24	40	35	4
Western Balkans	66	28	6	31	12	57	22	38	39	15
Albania	68	26	6	26	17	58	40	37	23	18
Bosnia and Herzegovina	54	36	11	36	17	47	14	33	53	17
Kosovo	73	23	4	40	0	60	28	47	25	3
Montenegro	69	26	5	23	0	77	18	41	41	15
North Macedonia	70	25	5	30	28	42	16	36	47	21
Serbia	62	31	6	33	11	56	17	36	47	18

Source: Authors' calculations based on data from latest Enterprise Surveys available (for most countries, 2019).
Notes: Firm-level responses were aggregated to the country-level using weights. ECA and subregional averages are simple country averages.

exceeds 10 percent. In Central Europe and the Baltics, Eastern Europe, and the Western Balkans, almost 40 percent or more of firms are at least 20 years old. The Russian Federation and countries in Central Asia and the South Caucasus show greater dynamism. In Kazakhstan, Tajikistan, Uzbekistan, and Georgia, for example, about half or more than half of firms are less than 10 years old—twice the ECA average.

On average, there are few differences in the distribution of sectors, but some countries stand out. In Kosovo, the Kyrgyz Republic, and Tajikistan, the share of firms in the manufacturing sector is above average (at about 40 percent); in Azerbaijan, Kazakhstan, and the Russian Federation, it is below average (at about 16 percent).

The share of firms with female top managers is about 20–25 percent for most of the region. It is smaller in Kosovo and Turkey (less than 5 percent) and larger in the Kyrgyz Republic, Lithuania, and Latvia (more than 30 percent).

Competition Environment

The competition environment is characterized by four measures. The first two come from the 2020 Bertelsmann Stiftung Transformation Index (BTI), which surveys political and economic transformation around the world based on expert opinion. Two subcomponents of the BTI provide information on the competition environment in 2019: market organization and competition policy. The first measure captures the extent to which the fundamentals of market-based competition have been developed, with a maximum score (10) indicating that "market competition is consistently defined and implemented both macroeconomically and microeconomically. There are state-guaranteed rules for market competition with equal opportunities for all market participants. The informal sector is very small." The minimum score (1) indicates that "market competition is present only in small segments of the economy and its institutional framework is rudimentary. Rules for market participants are unreliable and frequently set arbitrarily. The informal sector is large." The second measure captures the extent to which safeguards exist to protect competition and are enforced, with the maximum score (10) indicating that "comprehensive competition laws to prevent monopolistic structures and conduct exist and are strictly enforced." A score of 1 indicates that "no legal or political measures are taken to prevent monopolistic structures and conduct."

Although BTI scores are based on perceptions, they are highly correlated with indicators from the OECD's Product Market Regulation database, which is based on encoding laws and regulations and provides a de jure assessment of the competitive environment (it does not reflect the extent or manner in which the laws and regulations are enforced) (box 2.2).

The average score for ECA is 7 for both competition measures, with significant variation across countries (table 2.2). A score of 7 corresponds to an assessment that "market competition has a strong institutional framework, but the rules for market competition are not consistent or always uniform for all market participants. The informal sector is small" and "competition laws to prevent monopolistic structures and conduct exist, but are enforced inconsistently." The average

BOX 2.2 Measuring the competitive environment

The competitive environment of an economy can be defined and measured in various ways. Three datasets provide indicators of the competitive environment across countries:

- **OECD Product Market Regulation (PMR) indicators** are based on a questionnaire containing more than 1,400 questions on economywide and industry-specific regulatory provisions. They are available for 35 OECD and 11 non-OECD countries. The economywide indicator PMR 2018 is constructed by aggregating numerical values assigned to each question. It is the simple average of two high-level aggregate indicators: Distortions Induced by State Involvement and Barriers to Domestic and Foreign Entry. Scores range from 0 to 6, with lower values indicating a more competition-friendly regulatory environment. The most recent scores reflect the situation in each country on January 1, 2018 for most countries (for some it is January 1, 2019).
- **The Bertelsmann Stiftung Transformation Index (BTI)** is a perception-based measure of the quality of democracy, the market economy, and governance in 137 developing countries and transition economies based on detailed country assessments produced in cooperation with experts from leading universities and think tanks in more than 120 countries. Two subcomponents—market organization and competition policy—provide information on the competition environment in a country. Scores range from 1 to 10, with higher values indicating a more competitive, market-based economy. The 2020 scores reflect the situation in each country at the beginning of 2019.
- **The World Economic Forum's Global Competitiveness Index (GCI)** measures national competitiveness, defined broadly as the set of institutions, policies, and factors that determine the level of productivity in a country, ranging from the macroeconomic environment to health and primary education. The index is available for 137 countries. The 2019 dataset includes three subcomponents relevant to the competitive environment based on the World Economic Forum's Executive Opinion Survey based on almost 13,000 interviews with business executives: the distortive effect of taxes and subsidies on competition, the extent of market dominance, and competition in services. The three subcomponents are also aggregated into a domestic market competition score. The values of the subcomponents range from 1 to 7; the aggregate score ranges from 0 to 100, with higher values indicating a more competitive environment. The 2019 measures are based on interviews conducted in 2018 and 2019.

PMR indicators provide a de jure assessment of the competitive environment; they do not reflect the extent and manner in which these laws and regulations are enforced. The BTI subcomponents, in contrast, provide a de facto assessment of the competitive environment that is based on detailed expert assessments that reflect both the relevant laws and regulations and the (perceived) extent and manner in which they are enforced. The GCI measures similarly provide a de facto assessment based on an opinion survey of business executives. The measures from the three datasets are highly correlated in many cases.

This chapter uses the two BTI subcomponents on market organization and competition policy to capture the competitive environment because the BTI dataset has the most complete coverage of the ECA countries used in the analysis. The BTI measures also allow for more nuance between countries by using a wider score range than the other two datasets.

TABLE 2.2 Market organization, competition policy, public sector employment, and share of public banks in Europe and Central Asia

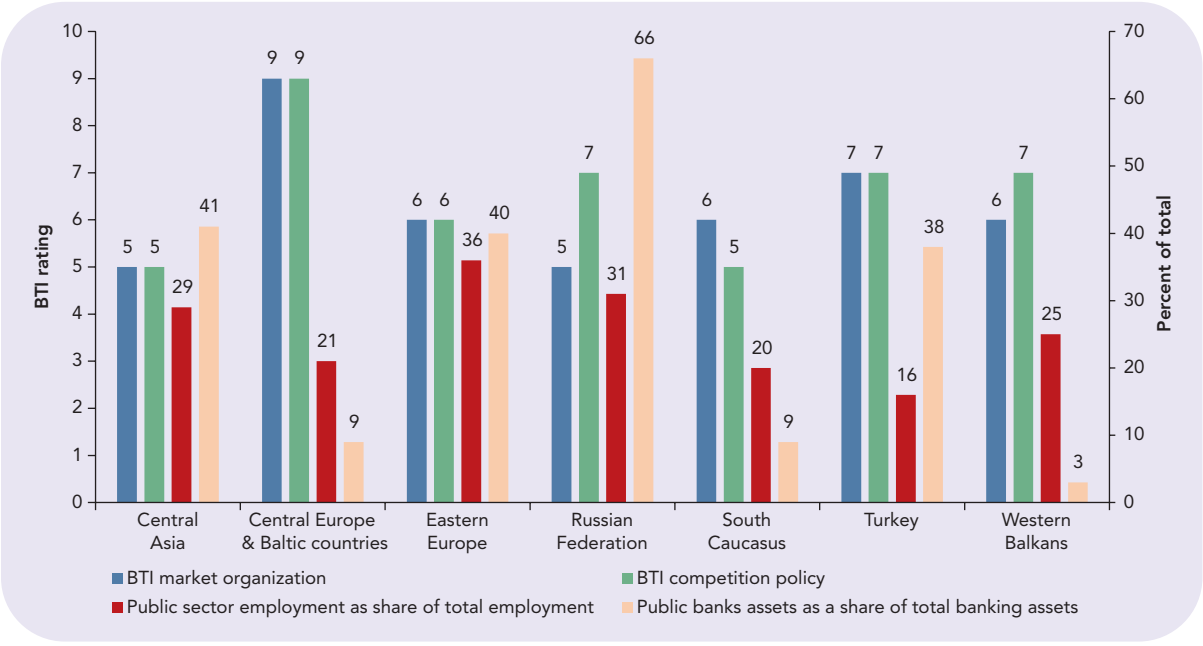
Region or country	BTI market organization	BTI competition policy	Public sector employment share	Public banks share
ECA	7	7	24	18
Central Asia	5	5	29	41
Kazakhstan	6	5	37	0
Kyrgyz Republic	5	6	21	38
Tajikistan	4	3	28	.
Uzbekistan	3	4	28	84
Central Europe and Baltic countries	9	9	21	9
Bulgaria	8	8	17	3
Croatia	8	10	21	6
Czech Republic	10	10	20	2
Estonia	10	10	22	0
Hungary	7	7	26	7
Latvia	8	10	23	0
Lithuania	9	10	22	0
Poland	9	10	20	41
Romania	8	8	14	8
Slovak Republic	9	9	21	1
Slovenia	10	10	23	31
Eastern Europe	6	6	36	40
Belarus	4	6	39	64
Moldova	6	6	30	0
Ukraine	7	7	39	55
Russian Federation	5	7	31	66
South Caucasus	6	5	20	9
Armenia	6	5	22	0
Azerbaijan	4	4	23	28
Georgia	7	6	14	0
Turkey	7	7	16	38
Western Balkans	6	7	25	3
Albania	7	8	20	0
Bosnia and Herzegovina	5	7	30	3
Kosovo	5	6	31	0
Montenegro	7	8	26	0
North Macedonia	7	8	23	0
Serbia	7	7	19	16

Source: Transformation Index of the Bertelsmann Stiftung (2020); Worldwide Bureaucracy Indicators (World Bank 2020b) and local sources where Worldwide Bureaucracy Indicators were not available or outdated (Armenia, Azerbaijan, Belarus, the Kyrgyz Republic, Montenegro, North Macedonia, the Russian Federation, Tajikistan, and Turkey); and Anginer, Demirgüç-Kunt, and Mare (2020).

scores for the region are higher than the average for upper-middle-income countries of 5 for market organization and 6 for competition policy.

Central Europe and the Baltics is the subregion with the highest average scores (figure 2.2). The Czech Republic, Estonia, and Slovenia all achieve the maximum score of 10 for both BTI measures. Croatia, Latvia, Lithuania, and Poland all achieve scores of 10 for the competition policy measure. The competitive

FIGURE 2.2 Market organization, competition policy, public sector employment, and share of public banks in Europe and Central Asia, by subregion



Source: Transformation Index of the Bertelsmann Stiftung (2020); Worldwide Bureaucracy Indicators (World Bank 2020b) and local sources where Worldwide Bureaucracy Indicators not available or outdated (Armenia, Azerbaijan, Belarus, the Kyrgyz Republic, Montenegro, North Macedonia, the Russian Federation, Tajikistan, and Turkey); and Anginer, Demirgüç-Kunt, and Mare (2020).
Note: Subregional averages based on 29 countries in ECA.

environment is least developed in Central Asia, with an average score of 5 for both competition measures, with an especially weak competitive environment reported in Tajikistan and Uzbekistan. In the South Caucasus, Azerbaijan scores poorly on the competitive environment and Belarus scores poorly on market organization. Turkey is at the regional average. Market organization in the Russian Federation lags the regional average.

The next two measures that may be associated with the level of competition are proxies for the size and influence of the state in the economy. Countries in which the state plays a relatively large and influential role in the economy may have weaker competition environments. The first proxy is the share of public sector employees in total employment. This share averages 24 percent in ECA and ranges from 16 percent in Turkey to 36 percent in Eastern Europe. Variations in the share are also large within some subregions. In Central Europe and the Baltics, for example, the share ranges from 14 percent in Romania to 26 percent in Hungary.

The second proxy is the share of public banks in total banking sector assets (where a public bank is a commercial bank in which the state has more than a 50 percent ownership stake). A large body of literature suggests that public banks may be subject to government influence and that their existence may distort credit allocation, introducing inefficiencies (World Bank 2012). The 18 percent average for the region masks wide variation across countries. The share is as high as 84 percent in Uzbekistan, followed by 66 percent in Russia, and 64 percent in Belarus, but 0 in 11 of the 29 countries in the sample.

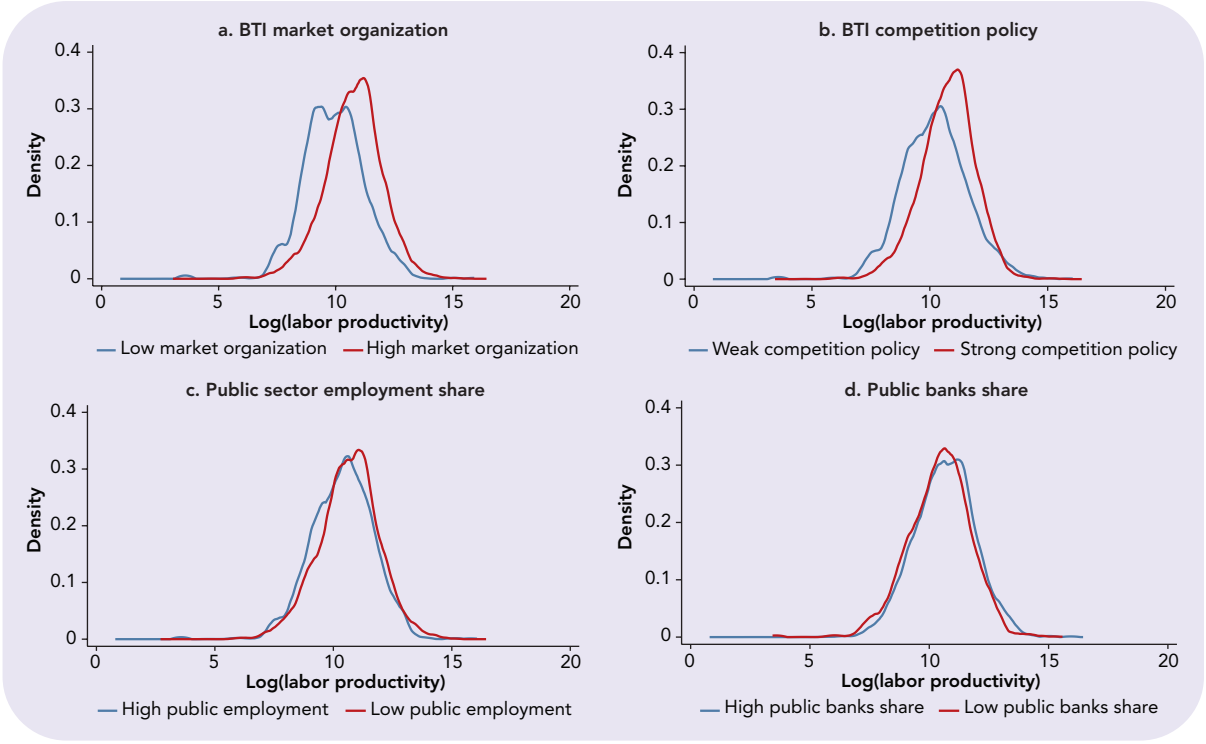
Labor Productivity and the Competitive Environment

Productivity is key to economic growth. At the firm level, it captures how efficiently a firm converts inputs into outputs.

A firm's productivity can be measured in different ways. Given the data limitations of Enterprise Surveys, productivity measured by straightforward factor ratios such as labor productivity provides a simple but much more robust estimate of productivity than measures of total factor productivity (World Bank 2021a).

Firms in countries with a more competitive environment tend to be more productive (figure 2.3). This relationship is especially clear when the competitive environment is captured by the BTI market organization or BTI competition policy score. When measuring the competitive environment in terms of the public sector employment share or public banks' asset share, the difference is not significant. (This analysis does not control for confounding factors, such as differences in the sectoral distribution of firms within countries, which is further explored in the section Reallocation from Less Productive to More Productive Firms.)

FIGURE 2.3 Labor productivity distributions in Europe and Central Asia



Source: Authors' calculations based on latest Enterprise Surveys (for most countries, 2019) for 29 countries in ECA; Transformation Index of the Bertelsmann Stiftung (2020); Worldwide Bureaucracy Indicators (World Bank 2020b) and local sources where Worldwide Bureaucracy Indicators were not available or outdated (Armenia, Azerbaijan, Belarus, the Kyrgyz Republic, Montenegro, North Macedonia, the Russian Federation, Tajikistan, and Turkey); and Anginer, Demirgüç-Kunt, and Mare (2020).
Note: Figure plots the distributions of log(labor productivity) across firms, using scaled survey weights, so that each country has equal weight. Low and high indicators are relative to median values, which were 6 for BTI market organization, 7 for BTI competition policy, 22.3 for the public sector employment share, and 2.6 for public banks' share of banking assets. BTI market organization is based on responses to the question "To what level have the fundamentals of market-based competition developed?" BTI competition policy is based on the question "To what extent do safeguards exist to protect competition, and to what extent are they enforced?"

How Did Firms Weather the COVID-19 Crisis?

During the COVID-19 crisis, the World Bank conducted ES COVID-19 Follow-Up Surveys around the world, covering 23 countries in ECA (see annex 2.1 for details). Data for the first survey round were collected between May and November 2020. Data for the second round were collected between November 2020 and May 2021. Only 13 of 23 countries participated in both survey rounds.

The surveys ask firms about changes in performance measures, relative to 12 months earlier or since the start of the COVID-19 crisis. The sampling frame for the ES COVID-19 Follow-Up Surveys includes all firms that replied to the most recent pre-COVID-19 Enterprise Surveys, making it possible to link performance during the COVID-19 crisis back to firm characteristics collected through that survey. [3]

During the first follow-up survey round, firms reported an average drop in monthly sales of 24 percent compared with one year earlier; these figures ranged from 7 percent in Latvia to 57 percent in Moldova (table 2.3).[4] The average drop in sales was considerably smaller than in other regions. Apedo-Amah and others (2020) analyze data from 51 countries, including ECA. They report an average drop in sales of 49 percent across countries. In ECA, the average drop in sales reported during the second survey round (23 percent) was similar to that in the first survey round, suggesting that firms faced sustained revenue losses (table 2.3).

The decline in the number of permanent full-time workers (10 percent in round 1 and 13 percent in round 2) was more muted than the drop in sales (see table 2.3), a pattern that is also observed in the global data. Firms adjusted their workforces proportionally less than their drop in sales in part because they relied on other mechanisms to adjust output and labor costs, including granting leave, reducing hours, and lowering wages (Apedo-Amah and others 2020). The widespread use of wage subsidies in ECA likely also played a role in limiting layoffs, as discussed later in the chapter.

Table 2.3 does not report firm exit rates, because the percentage of firms that closed permanently during the COVID-19 pandemic was relatively low in ECA. Muzi and others (2021) report an average annualized exit rate of 1.9 percent across countries in ECA—a far lower rate than the 6.2 percent across other countries. The relatively low exit rates in ECA may partly reflect the government assistance they received (see later in this chapter). Although most firms in ECA have not exited the market, there are signs of serious financial distress. In the round 2 survey, 26 percent of firms reported that they anticipated falling into arrears on outstanding liabilities in the next six months, with the figures ranging from 11 percent in Kazakhstan to 69 percent in Lithuania.

3. The tables and figures in this section present performance measures by survey round using all firms available in each survey round. The findings are similar when restricting the sample to firms that participated in both survey rounds.

4. The figures in table 2.3 are constructed using survey weights, which are relative to the stratified distribution of establishments in the country (by sector and firms size group). They do thus not necessarily correspond to changes at the macro level. For example, the drop in sales in table 2.3 may be larger than the drop in GDP, because large firms are weighted based on their often small share of the firm size distribution in table 2.3 but tend to contribute a larger share to GDP.

TABLE 2.3 Impact of COVID-19 crisis on firms in Europe and Central Asia (percent of firms, except where otherwise indicated)

	Percentage change in monthly sales relative to one year earlier		Percentage change in number of permanent full-time workers since December 2019		Reduced number of permanent full-time workers since December 2019		Anticipate falling into arrears on outstanding liabilities in the next 6 months		Started or increased online business activity		Started or increased remote work arrangements for workforce	
Region or country	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2
ECA	–24	–23	–10	–13	28	36	30	26	21	29	29	36
Central Asia												
Kazakhstan		–21		–12		25		11		34		44
Uzbekistan[a]	–10		–11		24		18		50		18	
Central Europe and Baltic countries	72	23	5	26	20	54	20	33	47	24		
Bulgaria	–24	–23	–7	–5	21	36	22	22	9	17	10	16
Croatia	–17	–19	–3	–2	12	20	29	21	13	15	24	23
Czech Republic	–15	–24	–7	–8	19	32	15	14	23	25	36	50
Estonia	–13	–14	–7	–12	33	42	16	20	21	33	25	39
Hungary	–15	–14	–4	–6	20	21	26	16	11	15	27	27
Latvia	–7	–27	–13	–64	66	66	10	40	14	39	30	28
Lithuania	–17	–32	–7	–13	37	45	84	69	25	31	30	48
Poland	–19	–17	–5	–5	22	28	17	27	17	34	20	35
Romania	–18	–14	–9	–11	31	46	57	36	13	21	20	29
Slovak Republic	–14	–26	–7	–10	29	37	32	32	12	26	29	39
Slovenia	–18	–15	–8	–4	33	41	25	22	16	25	32	40

(continued next page)

TABLE 2.3 *(continued)*

Region or country	Percentage change in monthly sales relative to one year earlier		Percentage change in number of permanent full-time workers since December 2019		Reduced number of permanent full-time workers since December 2019		Anticipate falling into arrears on outstanding liabilities in the next 6 months		Started or increased online business activity		Started or increased remote work arrangements for workforce	
	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2
Eastern Europe												
Belarus	–19		–4		26		18		32		40	
Moldova	–57	–29	–20	–17	14	38	56	38	32	40	36	45
Russian Federation	–28				18		15		53		55	
South Caucasus												
Armenia		–24		–18		37		17		40		41
Azerbaijan		–41		–20		28		23		63		70
Georgia	–47	–29	–37	–18	26	31	28	35	27	36	45	52
Turkey[a]	–31	–23	–1	3	11	21	27	21	47	41	34	22
Western Balkans												
Albania	–52		–15		28		39		18		14	
Bosnia and Herzegovina		–16		–8		44		16		8		24
Kosovo[a]	–49		–3		12		44		27		8	
Montenegro		–30		–11		32		26		19		6
North Macedonia	–31		–12		36		26		24		14	
Serbia		–17		–2		23		14		24		21

Source: Authors' calculations based on ES COVID-19 Follow-Up Surveys and Business Pulse Survey.
Note: ECA averages are based on data from the ES COVID-19 Follow-Up Surveys. Firm-level responses from the ES COVID-19 Follow-Up Surveys are aggregated to the country-level using weights and then (simple) averaged across countries. BPS data for Kosovo and Turkey on percentage change in number of workers includes both full-time and part-time workers and for Kosovo, Turkey, and Uzbekistan the percentage change is relative to a baseline in 2020, not December 2019. BPS data for started or increased remote work arrangements for workforce are based on a survey question on share of workers currently working remotely from home.
a. Results are from BPS data, which are not directly comparable to data in the ES COVID-19 Follow-Up Surveys, as the BPS sampled a different, nonrepresentative sample of firms.

To respond to the crisis, 29 percent of firms started or increased online business activity, and 36 percent started or increased remote work arrangements (table 2.3). These changes show initiative to adapt to the economic environment, but they may provide limited help with weathering the crisis, as among firms that made these changes, the average percentage of online sales was just 8 percent and the average share of the workforce working remotely was just 7 percent.

Most firms use digital technologies for marketing and sales purposes, with fewer firms introducing production planning and supply chain management tools. Box 2.3 presents data on adoption of digital technology by business function.

Which Firms Were Hit Harder by the COVID-19 Crisis?

In other regions, the COVID-19 crisis hit smaller firms harder than larger firms (see De Nicola and others 2021 on East Asia and Pacific and Brucal, Grover, and Reyes Ortega 2021 on South Asia). This pattern is also evident in ECA (figure 2.4). Small firms experienced larger drops in sales than large firms. They also reported larger percentage drops in employment, although these numbers may be skewed, as firm size is defined in terms of number of employees. For firms with fewer employees, any lost job translates into a bigger percentage change. Small firms

BOX 2.3 Firms' adoption of digital technology during the COVID-19 crisis

Movement restrictions associated with the COVID-19 crisis increased firms' use of digital technology. For example, digital platforms facilitated online ordering and home delivery in sectors that typically relied on intense face-to-face interactions with consumers, including food services and retail (Hallward-Driemeier and others 2020). The increased digitalization may lead to lasting productivity gains (Apedo-Amah and others 2020), but adoption has not been even across types of technology and firm size.

Among firms in eight ECA countries that increased their use of digital technology, most did so for marketing and sales purposes, followed by payments methods and service delivery, business administration, and production planning and supply chain management (figure B2.3.1).

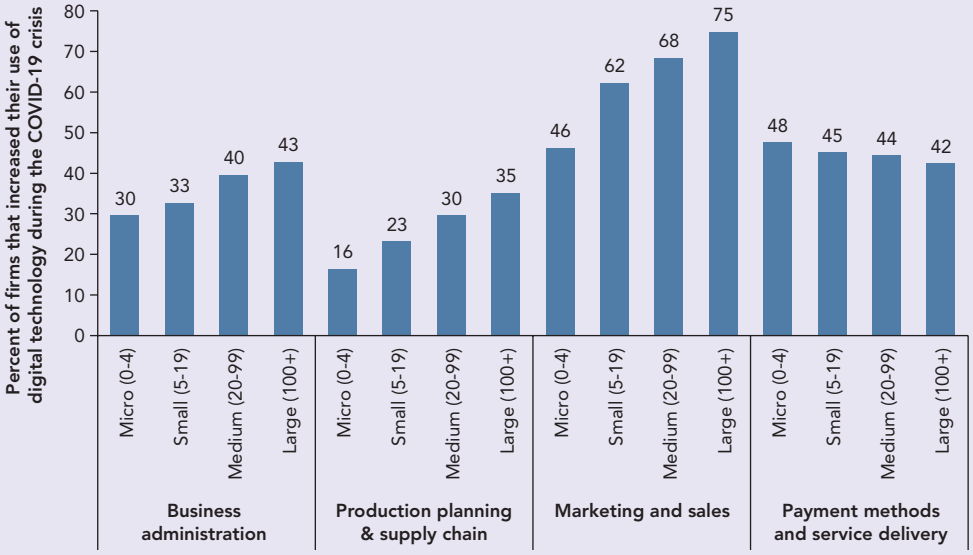
Larger firms were more likely than smaller firms to adopt digital technology for all business functions, except payment methods and service delivery. Digital technology for payment methods and service delivery may be easier to adopt for smaller firms because it does not involve large investments and fixed costs, making it less reliant on economies of scale and access to finance. In contrast, increased use of digital technology in production and supply chain management typically requires significant financial investment, managerial capacity, and complementary skills, so it is not surprising that large firms were more likely to adopt these technologies.

Overall, these patterns suggest that firms used digital technologies to boost sales and facilitate payments to deal with the logistical challenged posed by the COVID-19 crisis. However, fewer firms, particularly small firms, used the crisis as an opportunity to introduce digital technology for production planning and supply chain management.

(Continued next page)

BOX 2.3 (continued)

FIGURE B2.3.1 Increase in use of digital technologies by firms in Europe and Central Asia, by function and firm size



Source: Business Pulse Surveys for eight ECA countries (Bulgaria, Kosovo, the Kyrgyz Republic, Poland, Romania, Tajikistan, Turkey, and Uzbekistan).
Note: The figure includes only firms that reported increasing their use of digital technology during the COVID-19 crisis. Firm size is defined in terms of the number of employees.

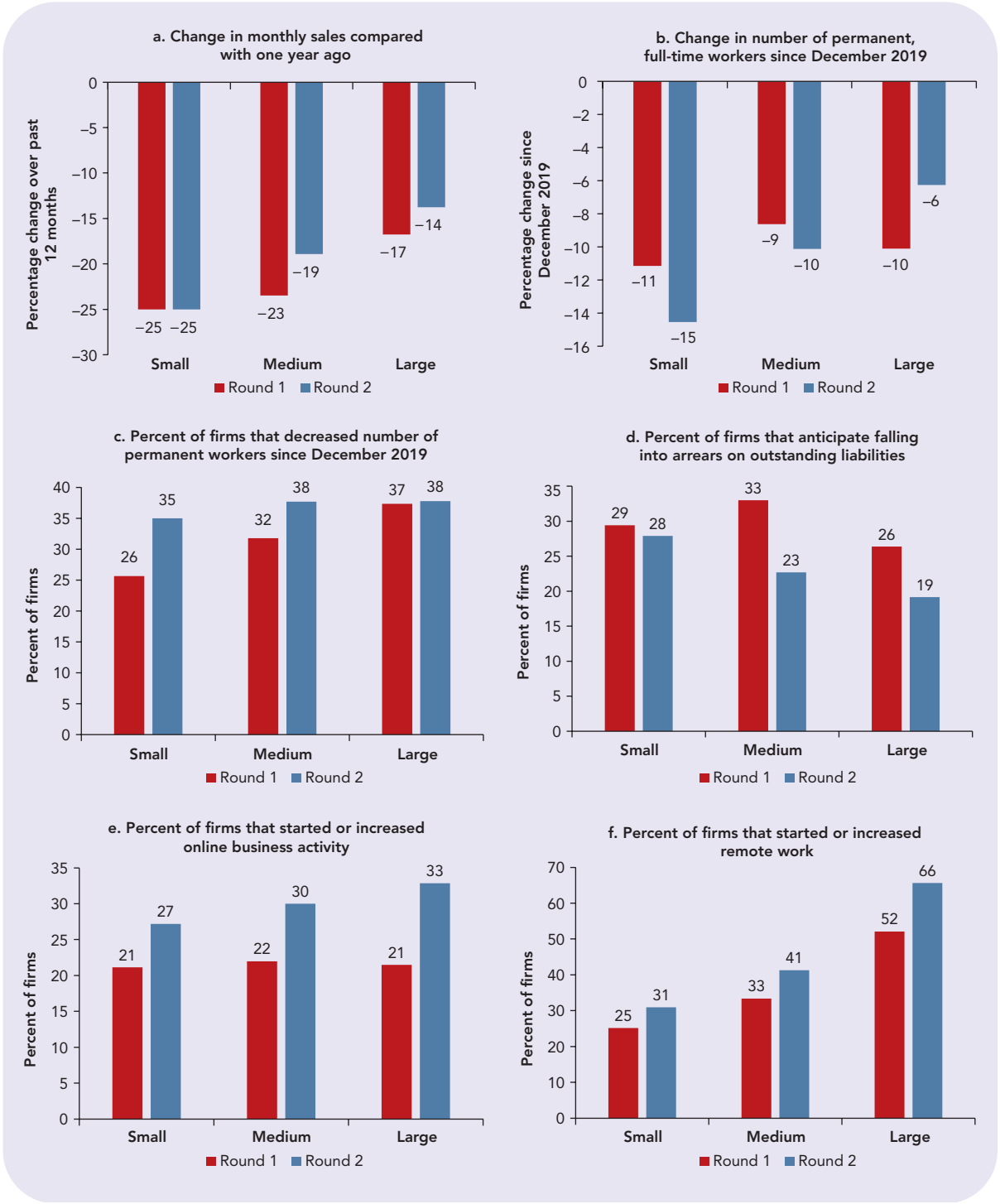
were slightly less likely to reduce the number of permanent workers than large firms. They appear to face greater difficulties recovering from the crisis, however. In the second ES COVID-19 Follow-Up Survey round, 28 percent of small firms expected to fall into arrears on outstanding liabilities (compared with 29 percent in round 1); among large firms, the figure dropped to 19 percent (from 26 percent in round 1). Small firms were only half as likely to have increased remote work as large firms, possibly because large firms are more likely to have specialized administrative staff that perform tasks that can be done from home.

Firms in the retail sector reported smaller drops in sales and employment than firms in the manufacturing or services sector in round 1 (figure 2.5). However, although sales recovered somewhat in the manufacturing sector and stayed about the same in the services sector between round 1 and 2, they dropped in the retail sector. In round 2, firms in all sectors reported similar expectations of falling into arrears.

The youngest firms experienced the largest drops in sales and employment (figure 2.6). They were also most likely to expect to fall into arrears. They were more likely than older firms to adapt to the crisis by increasing their online business activity.

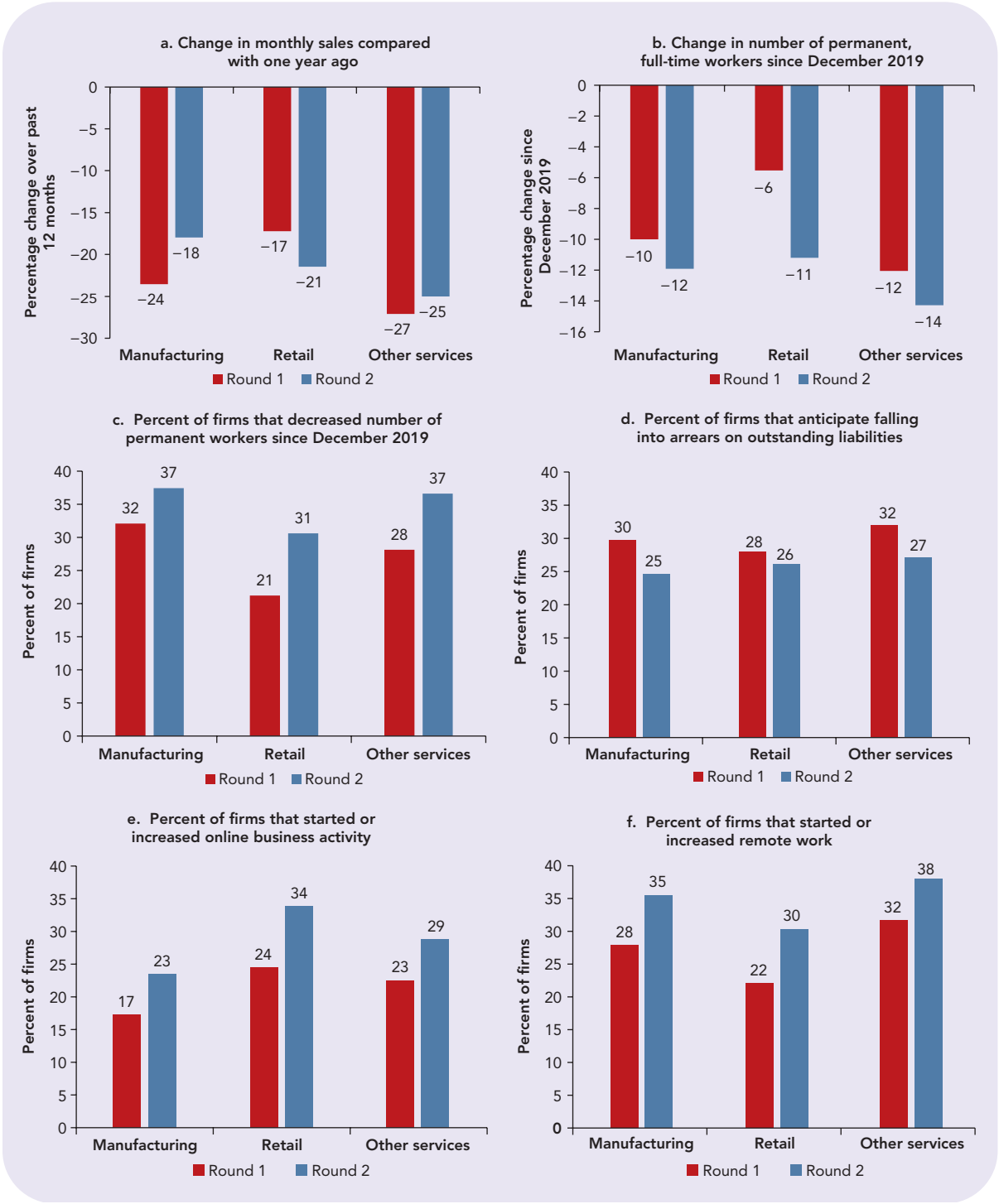
Firms with male and female top managers experienced similar initial drops in sales (24 percent) (figure 2.7). However, female-run businesses had greater difficulty recovering from the crisis. Among firms with female top managers, the

FIGURE 2.4 Changes by firms in Europe and Central Asia during the COVID-19 crisis, by firm size



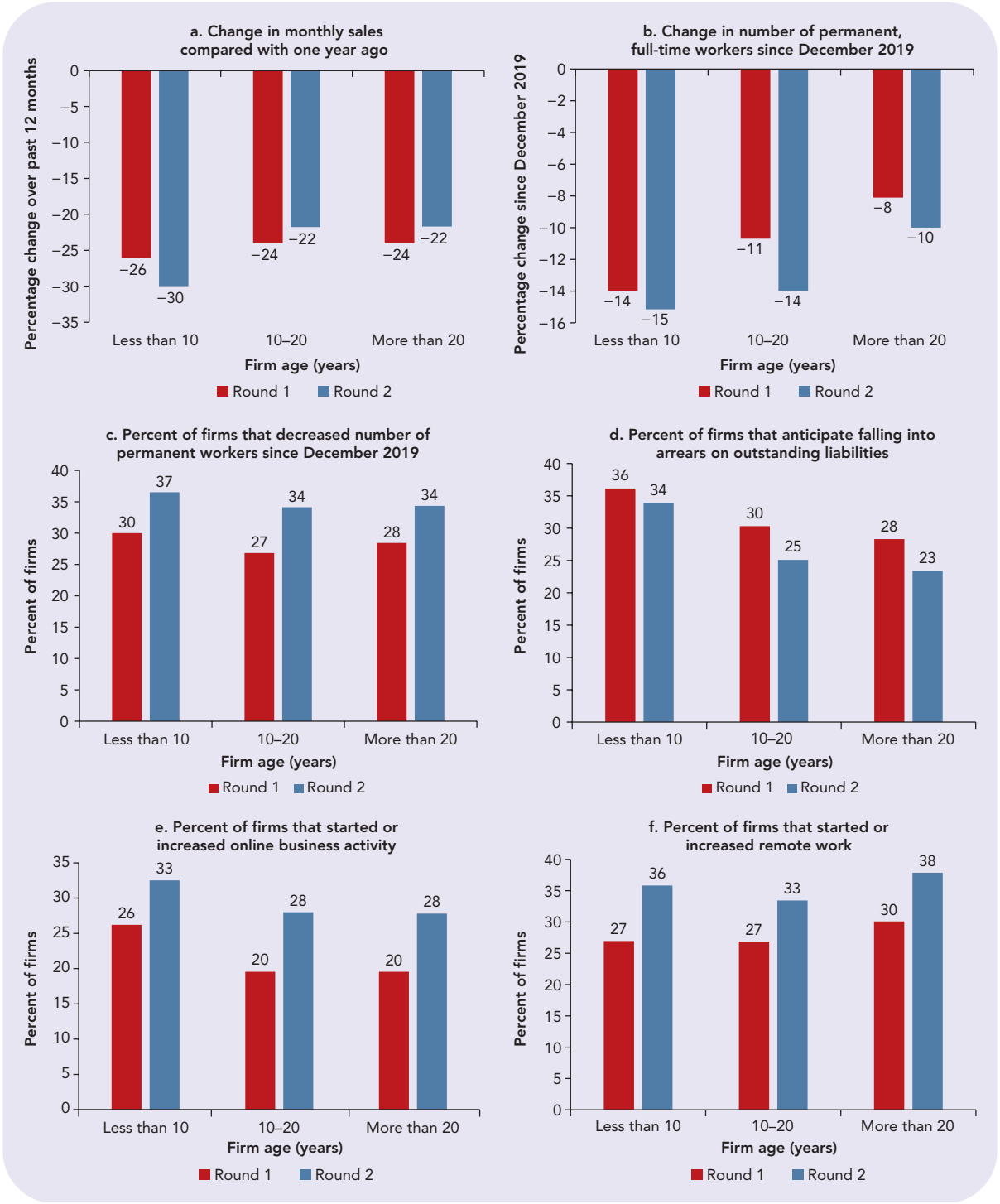
Sources: Authors' calculations based on ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA.
Note: Firm size is defined in terms of the number of employees. Small firms have 5–19, medium-size firms have 20–99, and large firms have 100 or more. Firm-level responses were aggregated to the country-firm size level using weights and then (simple) averaged across countries. Round 1 refers to surveys conducted in 17 countries in ECA between May and November 2020. Round 2 refers to surveys conducted in 19 countries in ECA between November 2020 and May 2021. The countries included in the two rounds differ.

FIGURE 2.5 Changes by firms in Europe and Central Asia during the COVID-19 crisis, by sector



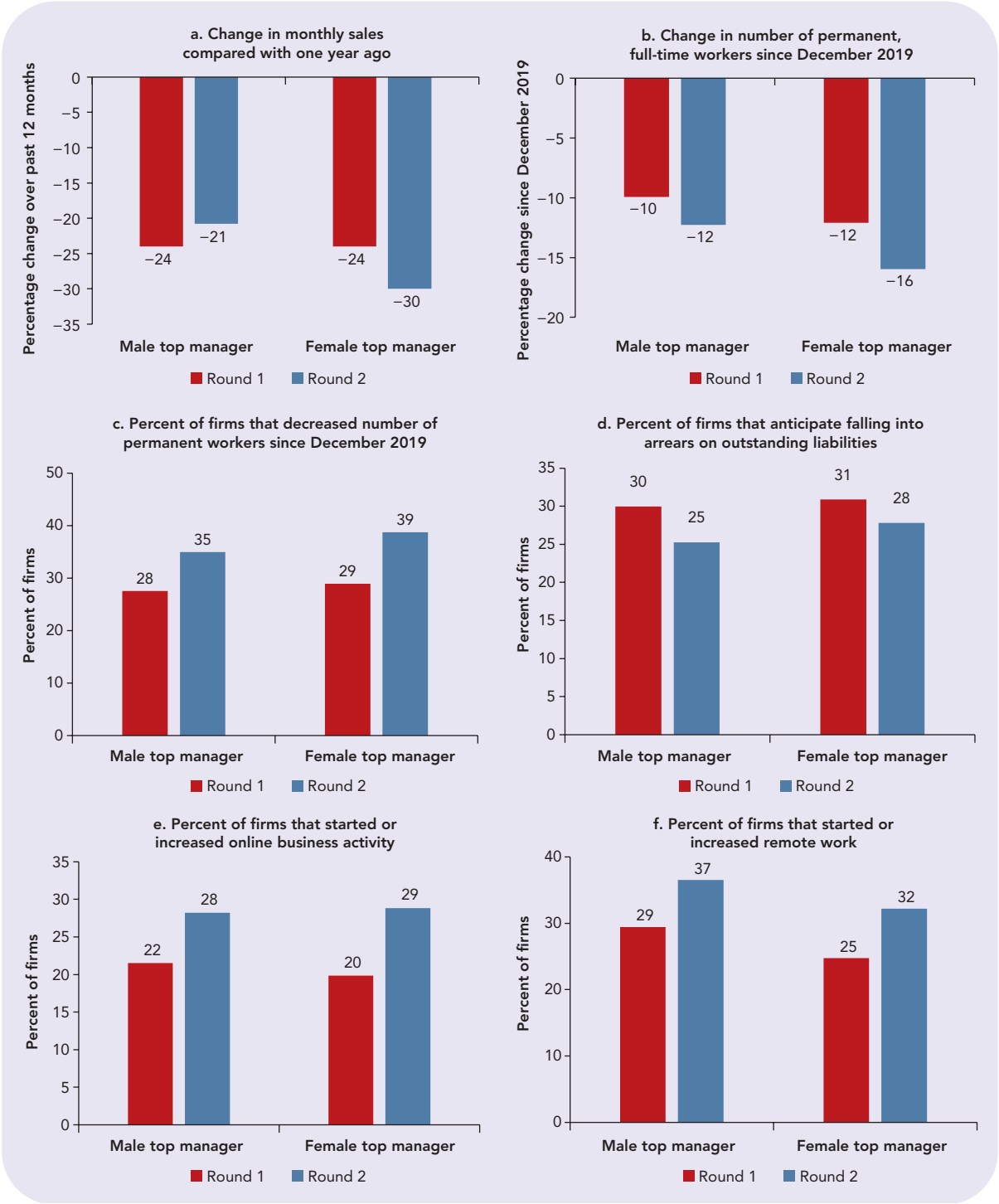
Sources: Authors' calculations based on ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA.
Note: Firm-level responses were aggregated to the country-firm size level using weights and then (simple) averaged across countries. Round 1 refers to surveys conducted in 17 countries in ECA between May and November 2020. Round 2 refers to surveys conducted in 19 countries in ECA between November 2020 and May 2021. The countries included in the two rounds differ.

FIGURE 2.6 Changes by firms in Europe and Central Asia during the COVID-19 crisis, by firm age



Sources: Authors' calculations based on ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA.
Note: Firm-level responses were aggregated to the country-firm size level using weights and then (simple) averaged across countries. Round 1 refers to surveys conducted in 17 countries in ECA between May and November 2020. Round 2 refers to surveys conducted in 19 countries in ECA between November 2020 and May 2021. The countries included in the two rounds differ. `

FIGURE 2.7 Changes by firms in Europe and Central Asia during the COVID-19 crisis, by gender of top manager



Sources: Authors' calculations based on ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA.
Note: Firm-level responses were aggregated to the country-firm size level using weights and then (simple) averaged across countries. Round 1 refers to surveys conducted in 17 countries in ECA between May and November 2020. Round 2 refers to surveys conducted in 19 countries in ECA between November 2020 and May 2021. The countries included in the two rounds differ.

drop in sales increased to 30 percent in the second survey round. In contrast, it dropped to 21 percent in firms with male top managers. Female-run businesses were also slightly more likely to anticipate falling into arrears than male-run businesses (28 percent versus 25 percent).

Overall, smaller and younger firms were hit harder by the COVID-19 crisis than larger and older firms. Smaller, younger, and female-run businesses did not see their sales improve after the initial drop. These businesses are the ones most likely to anticipate falling into arrears; insolvencies may be more common in these types of firms.

Reallocation from Less Productive to More Productive Firms

Economic crises can be devastating for many firms, but they may also have a silver lining. Crises can play a cleansing role, by speeding up the reallocation of economic activity from less productive to more productive firms, leading to greater productivity and economic growth in the longer run. Schumpeter called this reallocation process "creative destruction" (Schumpeter 1942), arguing that "depressions are not simply evils, which we might attempt to suppress, but—perhaps undesirable—forms of something which has to be done, namely, adjustment to previous economic change" (Schumpeter 1934, 16).

Creative destruction occurs in part because, in an economic downturn, less productive firms that use outdated technology can more easily become unprofitable and get pushed out of the market than firms that innovated (Caballero and Hammour 1994). It is not obvious whether this pattern of creative destruction will emerge from the COVID-19 crisis or whether the crisis will instead result in widespread destruction (Bosio and others 2020; De Nicola and others 2021). This crisis is unusual in that it imposed multiple large shocks on most firms, including supply, demand, uncertainty, and financial shocks (World Bank 2021c). One way firms have responded has been to rely increasingly on information technology, which may amplify preexisting patterns of technology adoption and innovation.

The evidence in this section suggests that economic activity in ECA was reallocated toward more productive firms during the crisis, consistent with creative destruction. Tables 2.4–2.7 examine the relationship between firms' pre-crisis labor productivity (measured as sales per worker in 2019) and firm performance during the crisis, controlling for the following firm characteristics: size, age, gender of the top manager, location of main market, and sector. The analysis also includes interaction terms between labor productivity and country-level measures of competition, to examine whether the relationship between labor productivity and firm performance during the crisis varied with market competition. The country-level measures of competition are de-meaned, so that a value of zero corresponds to the average value of competition across countries. The coefficients on labor productivity in tables 2.4–2.7 thus represent the relationship between productivity and firm performance for a country with the average value of competition. These coefficients show that firms with high pre-crisis labor

productivity experienced smaller drops in sales and employment than firms with low pre-crisis labor productivity. More productive firms were also more likely to adapt to the crisis by increasing online activity and remote work.

The magnitudes of the coefficients on labor productivity in tables 2.4–2.7 reveal that firms in the 10th percentile of the pre-crisis labor productivity distribution experienced a 12-percentage point larger drop in sales and a 9-percentage point larger drop in employment than firms in the 90th percentile. These firms were also 14 percentage points less likely to have increased remote work than firms in the 90th percentile. Firms in the 10th percentile of the pre-crisis labor productivity distribution were 11 percentage points more likely to anticipate falling into arrears than firms in the 90th percentile.

Confirmed exit rates in ECA were low during the COVID-19 crisis (annualized 1.9 percent on average). However, a measure of assumed exit that includes both confirmed closures and firms that could not be reached for the follow-up survey is about three times higher (box 2.4). Analysis by Muzi and others (2021) using this assumed upper-bound exit measure suggests that less productive firms were more likely to exit during the COVID-19 crisis.

These results suggest that economic activity in ECA was reallocated toward more productive firms during the COVID-19 crisis. This reallocation may increase if more of the least productive firms become insolvent and exit. However,

BOX 2.4 Productivity and firm exit during the COVID-19 crisis

Is the economic crisis induced by the COVID-19 pandemic "cleansing" out unproductive firms, in line with the creative destruction process postulated by Schumpeter (1939)? Or is the crisis displacing productive firms, undermining long-run productivity growth?

Muzi and others (2021) use World Bank Enterprise Surveys from 2019 and 2020 along with the follow-up surveys conducted since the outbreak of the pandemic to assess the effect of COVID-19 on business closures.

The authors created two measures of exit: (a) a conservative measure, consisting only of confirmed permanently closed businesses, and (b) a measure of assumed exit that also includes firms that could not be reached during fieldwork. The average annualized exit rate in the ECA region was 1.9 percent for the first measure and 6.8 percent for the second. Exit rates vary significantly across countries. Confirmed exits ranged from 0.07 percent in Slovenia to 5.3 percent in Bulgaria. Assumed exit rates ranged from 0.4 percent in Montenegro to 14.3 percent in Romania.

Assumed exit rates were regressed on pre-COVID-19 labor productivity (measured as sales per worker), while controlling for several firm characteristics. The results of this global analysis point to a Schumpeterian cleansing process in which less productive firms were more likely to permanently shut down than other firms.

Replicating the regressions for 20 ECA countries leads to consistent results with the global analysis (table B2.4.1). The coefficient on sales per worker implies that moving from the 10th percentile of labor productivity to the 90th percentile is associated with a 4.2 percentage point drop in the likelihood of exiting. Firms that survived the COVID-19 crisis also tended to be older. Before the COVID-19 crisis, survivors were less likely to spend time dealing with regulations, more likely to have their own website, and more likely to innovate.

(Continued next page)

BOX 2.4 (continued)

TABLE B2.4.1 Correlation between firm exit and labor productivity

	Permanent exit (assumed measure)				
Sales per worker (log)	–0.019*** (0.005)	–0.017*** (0.005)	–0.018*** (0.005)	–0.016*** (0.005)	–0.016*** (0.005)
Age of firm (log)		–0.032*** (0.009)	–0.031*** (0.010)	–0.030*** (0.010)	–0.031*** (0.010)
Senior management spent time on dealing with regulations (yes = 1, no = 0)			0.029* (0.014)	0.034** (0.014)	0.034** (0.014)
Has its own website (yes = 1, no = 0				–0.033*** (0.015)	–0.030*** (0.014)
Introduced product innovation (yes = 1, no = 0)				–0.029** (0.015)	–0.033*** (0.013)
Number of observations	9,570	9,477	8,017	7,967	7,844

Source: Based on Muzi and others (2021).
Note: The table shows logistic regressions. Coefficients are marginal effects. Regressions include sector and country fixed effects as well as firm characteristics (not reported in the table for brevity). Huber-White robust standard errors are in parenthesis and clustered at the sampling region and sector level. Sample size varies because of nonresponse.
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

This analysis provides evidence of a higher likelihood of exit among less productive firms more than a year after the start of the pandemic. Much remains to be learned about the recovery process. As more data become available, issues such as growth and job creation in surviving firms and the characteristics of new entrants should be explored.

the destruction of jobs will have a silver lining only if it is followed by increased job creation in more productive firms during the recovery (Caballero and Hammour 2005). An appropriate competition environment and regulation may facilitate both exit and job creation.

The Role of Competition

Competition is an important source of creative destruction (Caballero 2008). When markets are competitive, resources are allocated to the most efficient, most innovative firms, which can adapt to change, rather than to entrenched, connected firms. The competition environment also affects the pace of reallocation during a crisis. Evidence from the United States suggests that firms respond more sluggishly to reallocation shocks now than they did decades ago and that regulatory barriers to business entry and expansion are important reasons for the increased sluggishness (Barrero, Bloom, and Davis 2020).

The importance of competition has been evident during the COVID-19 crisis. The coefficients on the interaction terms in tables 2.4 and 2.5 show how the relationship between labor productivity and firm performance depends on market competition. For example, the positive coefficient on "Log(labor productivity)*BTI market organization" in the first column of table 2.4 indicates that the relationship between labor productivity and the drop in sales was stronger in countries with greater competition. Overall, the coefficients on the interaction terms in tables 2.4 and 2.5 suggest that in ECA countries with more competitive markets and stronger policies that protect competition, there was more reallocation of economic activity from less productive to more productive firms. A robustness check using 14 countries for which the PMR index is available shows similar results. The results are also robust to controlling for country-sector fixed effects instead of separate country and sector fixed effects.

TABLE 2.4 Correlation between firm performance, labor productivity, and BTI market organization in Europe and Central Asia

	Percentage change in sales	Percentage change in employment	Decreased employment	Anticipate falling into arrears	Increased online activity	Increased remote work
Log(labor productivity)	3.998***	2.908***	–3.016***	–3.474***	1.487*	4.413***
	(0.527)	(0.909)	(0.891)	(0.797)	(0.824)	(1.354)
Log(labor productivity) * BTI market organization	0.831**	0.087	–1.699***	–1.217***	0.094	1.274*
	(0.376)	(0.505)	(0.446)	(0.385)	(0.393)	(0.677)
Log(number of employees)	3.001***	2.151***	2.877**	–1.638***	1.373	6.799***
	(0.646)	(0.784)	(1.135)	(0.557)	(0.938)	(1.057)
Log(firm age)	0.688	1.533	–1.940	–3.648	–2.032**	0.290
	(1.626)	(1.513)	(1.765)	(2.226)	(1.036)	(1.710)
Top manager female dummy	–7.314***	–3.951*	3.781*	1.635	1.180	0.352
	(1.966)	(2.071)	(2.286)	(2.532)	(3.528)	(2.111)
National market dummy	5.005***	3.812***	–2.424	0.817	7.971***	12.082***
	(1.295)	(1.412)	(1.988)	(2.295)	(2.188)	(1.976)
International market dummy	3.469	2.331	1.630	–5.241*	1.912	9.850***
	(2.511)	(1.878)	(3.040)	(2.770)	(2.631)	(3.361)
Constant	–75.213***	–56.888***	70.656***	82.568***	3.244	–42.545***
	(5.933)	(9.439)	(9.894)	(10.600)	(8.797)	(13.804)
R^2	0.136	0.116	0.069	0.111	0.085	0.167
Number of observations	7,982	6,962	7,976	7,620	8,303	8,210

Source: Authors' calculations based on most recent ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA and Transformation Index of the Bertelsmann Stiftung (2020).
Note: Regressions include sector and country fixed effects. BTI market organization is based on responses to the question "To what level have the fundamentals of market-based competition developed?" Change in employment is not available for the Russian Federation. BTI market organization is centered on its mean to facilitate interpretation of the coefficients. Standard errors are clustered at the country level.
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

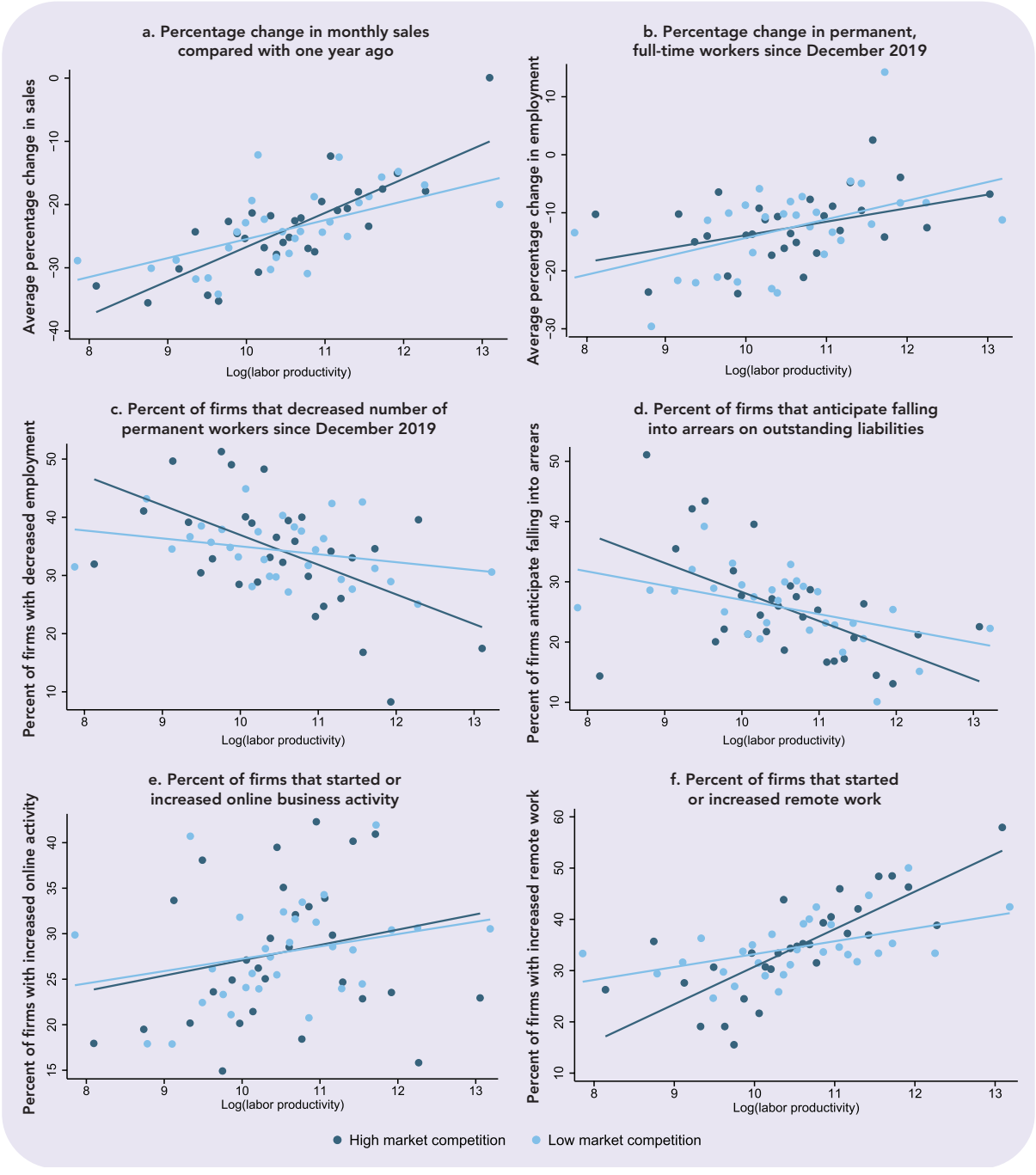
TABLE 2.5 Correlation between firm performance, labor productivity, and BTI competition policy in Europe and Central Asia

	Percentage change in sales	Percentage change in employment	Decreased employment	Anticipate falling into arrears	Increased online activity	Increased remote work
Log(labor productivity)	3.973***	2.890***	–3.052***	–3.621***	1.436*	4.577***
	(0.618)	(1.041)	(1.011)	(0.794)	(0.783)	(1.146)
Log(labor productivity) * BTI competition policy	0.522	–0.031	–1.266**	–1.174***	–0.076	1.319
	(0.396)	(0.614)	(0.642)	(0.426)	(0.423)	(0.912)
Log(number of employees)	3.001***	2.159***	2.893**	–1.611***	1.381	6.765***
	(0.645)	(0.797)	(1.126)	(0.570)	(0.935)	(1.042)
Log(firm age)	0.632	1.546	–1.794	–3.513	–2.011**	0.093
	(1.641)	(1.544)	(1.765)	(2.224)	(1.021)	(1.708)
Top manager female dummy	–7.390***	–3.962*	3.915*	1.723	1.169	0.247
	(1.979)	(2.068)	(2.312)	(2.529)	(3.522)	(2.109)
National market dummy	4.984***	3.831***	–2.354	0.973	8.002***	11.925***
	(1.291)	(1.381)	(1.958)	(2.270)	(2.209)	(1.926)
International market dummy	3.552	2.352	1.476	–5.260*	1.949	9.881***
	(2.515)	(1.889)	(3.040)	(2.731)	(2.629)	(3.390)
Constant	–74.696***	–56.451***	70.459***	84.025***	3.942	–44.245***
	(6.469)	(10.442)	(12.151)	(10.696)	(8.395)	(12.124)
R^2	0.135	0.116	0.068	0.112	0.085	0.168
Number of observations	7,982	6,962	7,976	7,620	8,303	8,210

Source: Authors' calculations based on most recent ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA and Transformation Index of the Bertelsmann Stiftung (2020).
Note: Regressions include sector and country fixed effects. BTI competition policy is based on the question "To what extent do safeguards exist to protect competition, and to what extent are they enforced?" Change in employment is not available for the Russian Federation. BTI competition policy is centered on its mean to facilitate interpretation of the coefficients. Standard errors are clustered at the country level.
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Figure 2.8 illustrates the findings from table 2.4. In countries with high competition, the relationship between labor productivity and firm performance during the crisis is steeper than in countries with low competition. In countries with high competition, firms at the 10th percentile of the pre-crisis labor productivity distribution experienced a 17-percentage point larger drop in sales than firms at the 90th percentile; this difference is only 10 percentage points in countries with low competition. Similarly, in countries with high competition, firms in the 10th percentile of the labor productivity distribution were 15 percentage points more likely to decrease employment and 16 percentage points more likely to anticipate falling into arrears than firms in the 90th percentile. The corresponding differences in countries with low competition were 5 and 7 percentage points, respectively. In countries with high competition, the lowest productivity firms were 22 percentage points less likely to have increased remote work than the highest productivity firms; this difference was only 9 percentage points in countries with low competition.

FIGURE 2.8 Firm performance, labor productivity, and BTI market organization index in Europe and Central Asia



Sources: Authors' calculations based on most recent ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA and Transformation Index of the Bertelsmann Stiftung (2020).
Note: Low or high market competition is defined as having a BTI market organization rating below or above the median across countries. BTI market organization is based on responses to the question "To what level have the fundamentals of market-based competition developed?" The figure shows average values in 30 percentiles of Log(labor productivity)—that is, the average of the y-value plotted against the average productivity in a bin/percentile range of productivity. The plots control for number of employees; firm age; gender of the top manager; location of the main market (local, national, or international); sector; and country fixed effects—that is, both the y- and x- variables are residuals (with the mean added back in). The lines are estimated using the underlying data, not binned data. These estimations are equivalent to running the regressions in table 2.4, but with high/low competition dummies (two interaction terms with productivity) instead of a continuous variable interaction term.

Public sector employment and ownership can also affect competition. Labor markets may be less competitive and dynamic when the share of public sector employment is high. Using the share of public employment as a proxy for competition reveals that a larger share of employment in the public sector was associated with reduced reallocation from lower productivity to higher productivity firms during the COVID-19 crisis (table 2.6). Public ownership of banks can limit dynamism in the economy by leading to less efficient allocation of credit. The coefficients on the interaction terms in table 2.7 suggest that reallocation from lower productivity to higher productivity firms during the COVID-19 crisis was lower in countries in which a larger share of banking sector assets was government-owned.

In a related analysis, Torres and Tran (2021) examine reallocation of employment across high- and low- productivity firms during the COVID-19 crisis. They find that this reallocation was greater in countries with less restrictive employment protection and more pro-competitive regulations (box 2.5).

TABLE 2.6 Correlation between firm performance, labor productivity, and public sector employment share in Europe and Central Asia

	Percentage change in sales	Percentage change in employment	Decreased employment	Anticipate falling into arrears	Increased online activity	Increased remote work
Log(labor productivity)	3.860***	2.895***	–2.700***	–3.280***	1.492*	4.338***
	(0.572)	(0.855)	(0.974)	(0.810)	(0.823)	(1.086)
Log(labor productivity) * Public employment share	–0.130**	0.071	0.174**	0.154	–0.049	–0.428**
	(0.060)	(0.047)	(0.080)	(0.097)	(0.093)	(0.205)
Log(number of employees)	3.014***	2.170***	2.815**	–1.668***	1.368	6.776***
	(0.652)	(0.786)	(1.141)	(0.560)	(0.936)	(1.063)
Log(firm age)	0.749	1.541	–2.031	–3.752*	–2.024*	0.393
	(1.632)	(1.480)	(1.775)	(2.243)	(1.038)	(1.697)
Top manager female dummy	–7.386***	–3.982*	3.916*	1.713	1.187	0.367
	(1.997)	(2.064)	(2.304)	(2.543)	(3.523)	(2.109)
National market dummy	5.093***	3.854***	–2.592	0.752	7.959***	12.045***
	(1.317)	(1.408)	(2.033)	(2.305)	(2.186)	(2.037)
International market dummy	3.586	2.377	1.356	–5.395**	1.905	9.887***
	(2.525)	(1.856)	(3.050)	(2.745)	(2.629)	(3.406)
Constant	–72.825***	–56.330***	65.276***	78.971***	3.326	–40.201***
	(6.450)	(8.099)	(9.983)	(10.867)	(8.613)	(11.825)
R^2	0.135	0.116	0.066	0.110	0.085	0.170
Number of observations	7,982	6,962	7,976	7,620	8,303	8,210

Source: Authors' calculations based on most recent ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA; Worldwide Bureaucracy Indicators (World Bank 2020b); and local sources where Worldwide Bureaucracy Indicators were not available or outdated (Armenia, Azerbaijan, Belarus, the Kyrgyz Republic, Montenegro, North Macedonia, the Russian Federation, Tajikistan, and Turkey).
Note: Regressions include sector and country fixed effects. Change in employment is not available for the Russian Federation. Public sector employment share is centered on its mean to facilitate interpretation of the coefficients. Standard errors are clustered at the country level.
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

TABLE 2.7 Correlation between firm performance, labor productivity, and public bank share in Europe and Central Asia

	Percentage change in sales	Percentage change in employment	Decreased employment	Anticipate falling into arrears	Increased online activity	Increased remote work
Log(labor productivity)	3.776***	2.761***	–2.580***	–3.143***	1.462*	4.067***
	(0.560)	(0.768)	(0.967)	(0.863)	(0.836)	(1.556)
Log(labor productivity) * Public banks share	–0.047***	–0.030	0.054**	0.056**	–0.002	–0.024
	(0.016)	(0.027)	(0.027)	(0.025)	(0.025)	(0.046)
Log(number of employees)	3.035***	2.153***	2.789**	–1.689***	1.376	6.850***
	(0.650)	(0.780)	(1.152)	(0.547)	(0.943)	(1.081)
Log(firm age)	0.734	1.520	–2.027	–3.729*	–2.026*	0.373
	(1.631)	(1.511)	(1.755)	(2.247)	(1.041)	(1.724)
Top manager female dummy	–7.396***	–3.947*	3.939*	1.747	1.172	0.242
	(1.993)	(2.069)	(2.303)	(2.543)	(3.516)	(2.110)
National market dummy	5.132***	3.840***	–2.657	0.697	7.983***	12.258***
	(1.337)	(1.435)	(2.039)	(2.312)	(2.182)	(2.036)
International market dummy	3.628	2.363	1.297	–5.434**	1.932	10.118***
	(2.541)	(1.867)	(3.026)	(2.751)	(2.614)	(3.367)
Constant	–72.164***	–56.025***	64.223***	78.085***	3.583	–37.961**
	(5.977)	(7.749)	(9.089)	(11.623)	(8.832)	(16.078)
R^2	0.135	0.116	0.066	0.110	0.085	0.165
Number of observations	7,982	6,962	7,976	7,620	8,303	8,210

Source: Authors' calculations based on most recent ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA and Anginer, Demirgüç-Kunt, and Mare (2020).
Note: Regressions include sector and country fixed effects. Change in employment is not available for the Russian Federation. Public banks share is centered on its mean to facilitate interpretation of the coefficients. Standard errors are clustered at the country level.
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

BOX 2.5 Employment reallocation and market regulation

In a recent paper, Torres and Tran (2021) use global data from the BPS and the ES COVID-19 Follow-Up Surveys to explore resource reallocation during the COVID-19 crisis. Results for 17 ECA countries suggest that on average, jobs are being reallocated toward more productive firms but that cross-country heterogeneity in the region is significant.

Torres and Tran (2021) examine whether the extent of productivity-enhancing reallocation as a result of the COVID-19 pandemic depends on a country's labor market regulations and competition policies. Employment changes are often subject to significant adjustment costs (Davis and Haltiwanger 1999). A country's regulatory environment can directly alter these adjustment costs by affecting the ease of hiring or firing workers. Lower entry, exit barriers, and other policies that improve competition can increase firms' incentives to adjust.

The analysis uses the Employment Protection Legislation index (EPLex) of the International Labor Organization (ILO) to measure labor regulation. This index codifies the content of legislation governing the termination of employment in the private sector, including substantive and procedural

(Continued next page)

BOX 2.5 (continued)

requirements for workers' dismissals and rules related to severance pay and redress (Aleksynska and Eberlein 2016). A higher value represents a higher level of de jure employment protection.

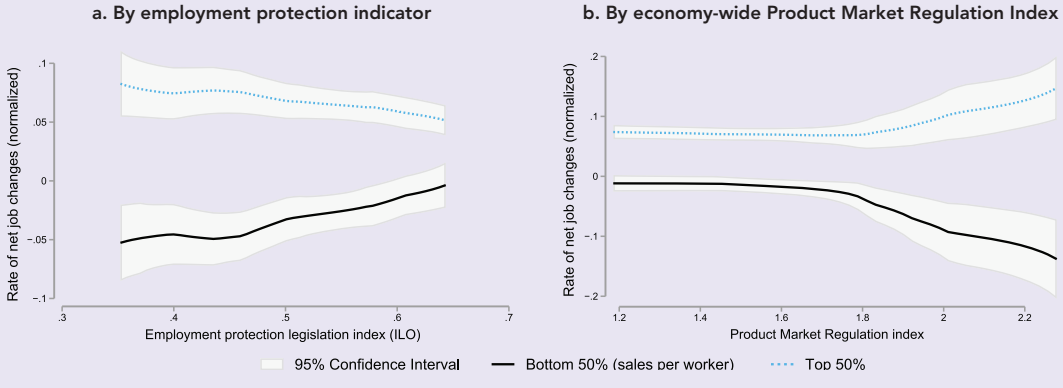
Competition policies are assessed by the OECD's economy-wide indicator of product market regulations (PMR). The PMR index measures the regulatory barriers to firm entry and competition in two areas: distortions induced by state involvement in the economy and barriers to entry and expansion faced by domestic and foreign firms (Vitale and others 2020). A higher score reflects a more pro-competitive de jure regulatory framework.

The results show that in countries with less restrictive employment protection and more pro-competitive regulations, there was more reallocation of employment from low- to high-productivity firms (figure B2.5.1). Higher-productivity firms (top 50 percent) experienced smaller drops in employment during the COVID-19 crisis than lower-productivity firms (bottom 50 percent).[a] Where labor regulations were more stringent, low-productivity firms shed fewer jobs and high-productivity firms added slightly fewer jobs (panel a); a more pro-competitive environment was associated with greater increases in employment in high productivity firms and greater decreases in employment in low productivity firms (panel b).

These findings suggest that policies that reduce labor adjustment costs and foster market competition can support productivity growth following the pandemic. Lowering labor adjustment costs will not necessarily imply lowering employment protection, as it can be complemented with active labor market measures that help improve workers' skills, incentivize hiring, and increase worker's mobility. Pro-competition reforms may include both enacting new policies and improving the implementation of existing policies to reduce the cost of entry, expansion, and exits (by, for example, reducing administrative costs from licensing and permits and reforming the insolvency framework).

a. Employment change in figure B2.5.1 is relative to its average, which was negative in most countries, indicating that job reallocation was driven mostly by greater job destruction in low-productivity firms, not more job creation in high-productivity firms. Although this reallocation may increase average productivity, it may reduce total economic output and overall welfare, as Bloom and others (2020) note.

FIGURE B2.5.1 Normalized employment change by labor productivity and policy indicators



Source: Analysis based on Torres and Tran (2021) using BPS and ES COVID-19 Follow-Up Surveys, as well as ILO's Employment Protection Legislation index and the OECD's economy-wide indicator of Product Market Regulations, for 11 countries in ECA (panel a) and 15 countries in ECA (panel b).
Note: Graphs show local polynomials of normalized firm-level rate of net job changes on the EPLex and PMR indexes for two groups: high- and low-productivity firms (below and above country-sector median sales per worker at baseline). Bandwidth chosen for the local polynomials is 20 percent of the range of the independent variable. The analysis uses panel data only. Net job change is defined as the net change of employment between the pre-pandemic baseline (December 2019) and the latest firm survey (which occurred between October 2020 and March 2021) as a share of the average employment in the two time periods. Employment change is normalized by obtaining residuals from regressing firm-level net job change on country, sector, size fixed effects and mobility from the first and second surveys. Firm's labor productivity is proxied using sales per worker, both measured at the baseline (Dec 2019), and normalized as deviations from country means.

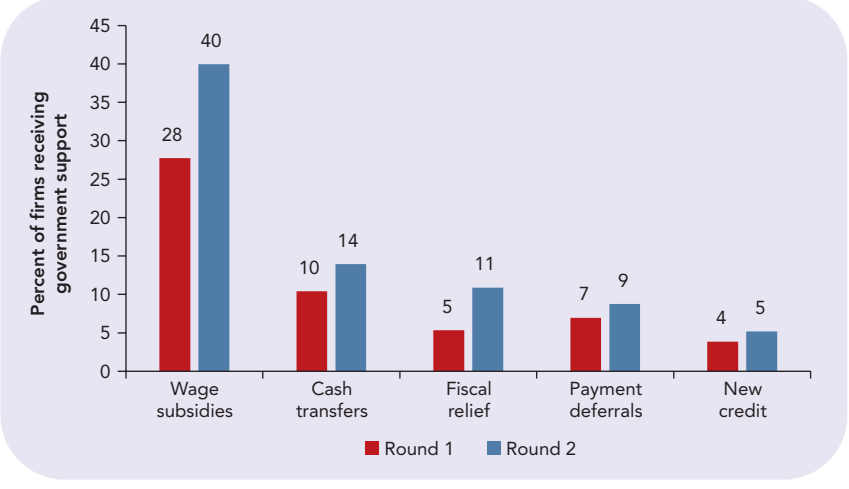
Government Support Measures

In response to the economic impact of the pandemic, governments around the world provided support to both households and firms. Support to firms was provided in order to prevent mass insolvency and bankruptcy of viable firms facing financial distress and related knock-on effects for the financial sector, to prevent losses of jobs and firm-specific intangible capital, and to reduce the friction costs of firms temporarily exiting the market (World Bank 2021c). In response to the pandemic, governments in 132 countries enacted almost 1,500 measures to support small and medium-size enterprises (SMEs), according to the World Bank's SME-Support Measure Dashboard.[5] Countries in ECA enacted 430 government support measures for SMEs.[6]

Across all 132 countries, the five most common types of measures were new credit (28 percent of measures), fiscal relief (23 percent), payment deferrals (17 percent), wage subsidies (10 percent), and reduced regulation (7 percent). In ECA, wage subsidies had a higher prevalence and cash transfers were among the top five measures; reduced regulation was not. The top measures were new credit (26 percent), fiscal relief (20 percent), wage subsidies (17 percent), payment deferrals (12 percent), and cash grants (7 percent).

The World Banks's ES COVID-19 Follow-Up Surveys provide information on the percentage of firms in ECA that received a specific type of measure (figure 2.9). The measure reaching by far the largest number of firms was wage subsidies, with 40 percent of firms in the second survey round receiving such

FIGURE 2.9 Government support measures in Europe and Central Asia, by type



Source: Authors' calculations based on ES COVID-19 Follow-Up Surveys for 23 countries in ECA.
Note: Firm-level responses were aggregated to the country-level using weights and then (simple) averaged across countries.

5. Governments also targeted measures at large firms (in the air transport and tourism sectors, for example). The World Bank's Tracker of Subsidies and State Aid to mitigate COVID-19 Effects records these measures (https://dataviz.worldbank.org/authoring/AID-COVID19/Overview). Data from this tracker are not reported here because the classification into types of measures does not clearly align with that of the measures recorded in the World Banks's ES COVID-19 Follow-Up Surveys.
6. See https://dataviz.worldbank.org/authoring/SME-COVID19/Overview.

subsidies. The second-most wide-reaching measure were cash transfers, followed by fiscal relief and payment deferrals. Although new credit was the most commonly used measure, according to the World Bank's SME-Support Measure Dashboard, it reached only 5 percent of firms.

In ECA, 37 percent of firms in the first ES COVID-19 Follow-Up Survey round and 50 percent in the second round reported receiving government support (table 2.8). These figures are higher than in other regions. Using data for 60 countries, Cirera and others (2021) find that only about 25 percent of surveyed firms received any type of government support during the first stage of the COVID-19 crisis (through August 2020). By January 2021, 33 percent of firms globally had received some type of public support (World Bank 2021c).

The reach of government support measures varied widely across countries in ECA (see table 2.8). The lowest percentage of firms receiving government support was 5 percent (in Moldova); the highest percentage was 86 percent (in Serbia). On average, firms received 1.6 different support measures, ranging from 1.0 in Moldova to 2.8 in Poland.

Preliminary evidence suggests that government support measures helped firms weather the crisis and decreased SME failure rates (Albagli, Fernández, and Huneeus 2021; Cespedes and others 2021; Cirera and others 2021; Gourinchas and others 2021). This evidence of positive effects is encouraging, but it is also important to assess the nature and distribution of government support. At the start of the COVID-19 crisis, the large economic shocks required quick action, making it difficult to target government support. It is thus useful to examine the distribution of support measures to assess whether they may hamper competition and slow the recovery process.

Which Firms Received Government Support?

A cursory analysis does not show big differences in the way government support was allocated across firms (figure 2.10). The percentage of firms receiving any support measure does not vary much by firm size, sector, age, or gender of the top manager.

However, a more in-depth analysis that simultaneously controls for different firm characteristics reveals interesting patterns. The regressions in table 2.9 estimate the probability of receiving different types of government assistance as a function of firms' labor productivity, size, age, gender of the top manager, pre-crisis innovation, and location of the main market, while controlling for the sector of operation. Positive coefficients indicate a greater likelihood of receiving government assistance.

Four main findings emerge from this analysis. First, more productive firms were less likely to receive any type of government support. Firms in the 10th percentile of the pre-crisis labor productivity distribution were 6 percentage points more likely to receive government support than firms in the 90th percentile.

Second, larger firms were more likely than smaller firms to receive payment deferrals and fiscal relief. This result is in line with that of Cirera and others

TABLE 2.8 Types of government support received in Europe and Central Asia (percent of firms, except where otherwise indicated)

	Received government support		Type of government support received										Average number of types of government support received among firms that received government support	
			Cash transfer		Payment deferrals		New credit		Fiscal relief		Wage subsidies			
Region or country	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2
ECA	37	50	10	14	7	9	4	5	5	11	28	40	1.5	1.6
Central Asia														
Kazakhstan		10		1		1		2		8		0		1.3
Uzbekistan[a]	38		5		21		3		14		1		1.2	
Central Europe and Baltic countries	72	23	5	26	20	54	20	33	47	24				
Bulgaria	16	30	14	29	1	3	0	1	0	4	10	22	1.6	1.9
Croatia	61	63	9	12	7	8	4	5	18	18	54	59	1.5	1.6
Czech Republic	62	58	42	30	7	7	3	2	4	4	20	39	1.2	1.4
Estonia	43	46	0	0	11	11	1	1	5	4	41	44	1.4	1.4
Hungary	22	26	1	2	0	3	1	1	1	1	21	23	1.1	1.3
Latvia	4	25	0	3	0	1	0	3	1	9	1	18	1.2	1.4
Lithuania	64	70	43	41	8	12	8	7	0	3	52	60	2.0	2.0
Poland	63	67	39	49	18	26	12	18	24	33	32	41	2.2	2.8
Romania	44	48	2	7	11	13	7	10	7	11	38	39	1.5	1.7
Slovak Republic	51	59	10	21	4	6	5	6	3	4	44	54	1.3	1.5
Slovenia	68	70	2	5	7	4	3	5	9	8	66	64	1.3	1.4

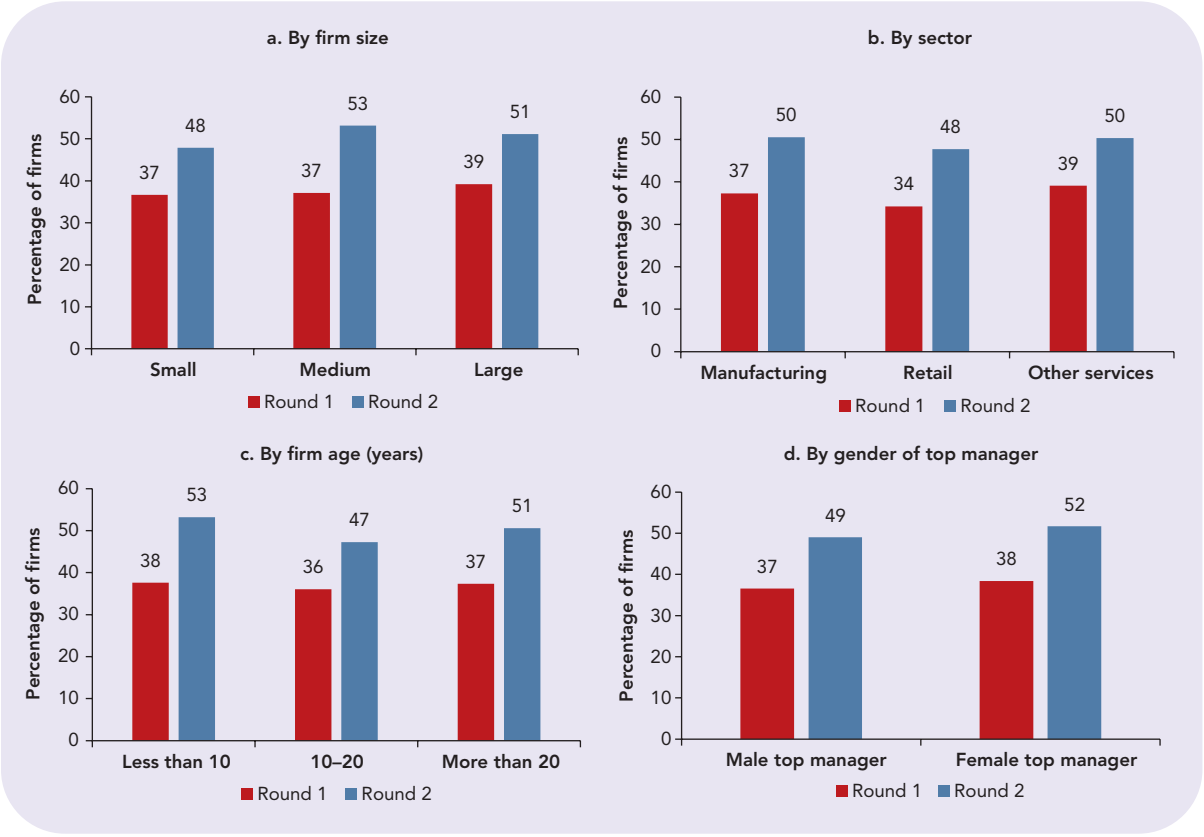
(continued next page)

TABLE 2.8 *(continued)*

Region or country	Received government support		Type of government support received: Cash transfer		Payment deferrals		New credit		Fiscal relief		Wage subsidies		Average number of types of government support received among firms that received government support	
	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2	Round 1	Round 2
Eastern Europe														
Belarus	5		0		3		0		1		1		1.1	
Moldova	1	5	0	1	0	1	0	0	1	2	0	2	1.0	1.0
Russian Federation	9		2		5		2		7		2		2.0	
South Caucasus														
Armenia		66		29		5		17		6		49		1.6
Azerbaijan		64		12		6		5		13		47		1.4
Georgia	33	48	3	5	17	20	1	2	8	25	12	17	1.3	1.5
Turkey[a]	41	49	5	1	6	6	14	19	9	11	28	29	1.6	1.4
Western Balkans														
Albania	44		5		9		8		3		40		1.5	
Bosnia and Herzegovina	70		5		9		1		3		63		1.2	
Kosovo[a]		47		10		6		0		1		43		1.3
Montenegro		57		1		8		2		15		55		1.4
North Macedonia	40		4		9		12		0		39		1.6	
Serbia		86		8		26		11		38		81		1.9

Source: Authors' calculations based on ES COVID-19 Follow-Up Surveys and Business Pulse Survey.
Note: ECA averages are based on data from ES COVID-19 Follow-Up Surveys. Firm-level responses from the ES COVID-19 Follow-Up Surveys were aggregated to the country-level using weights and then (simple) averaged across countries.
a. Results are from BPS data, which are not directly comparable to data in the ES COVID-19 Follow-Up Surveys, as the BPS sampled a different, nonrepresentative sample of firms.

FIGURE 2.10 **Percentage of firms in Europe and Central Asia that reported receiving government assistance, by firm size, sector, age, and gender of top manager**



Source: Authors' calculations based on ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA.
Note: Firm size is defined in terms of the number of employees. Small firms have 5–19, medium-size firms have 20–99, and large firms have 100 or more. Firm-level responses were aggregated to the country-firm group level using weights and then (simple) averaged across countries.

(2021), who find that, across 60 countries, support was more limited for smaller firms than larger firms. This finding could indicate that support was more likely to go to politically connected firms, which tend to be much larger than firms that are not politically connected. Before COVID-19, politically connected firms were more likely to receive subsidies (Francis, Hussain, and Schiffbauer 2018).

Third, firms with a female top manager were 5 percentage points more likely to receive government support than firms with a male top manager. This difference is driven by wage subsidies. Firms with a female top manger were less likely to receive new credit than firms with a male top manager.

Fourth, pre-crisis innovation is not correlated with receiving any type of government support.

All four findings are similar in two robustness checks: (a) controlling for country-sector fixed effects instead of separate country and sector fixed effects, and (b) controlling for change in sales or in employment. The second robustness check shows that firms with larger drops in sales were more likely to receive government support, but for a given change in sales or employment, firms with lower labor productivity were still more likely to receive support.

TABLE 2.9 Correlation between probability of receiving government assistance and firm characteristics in Europe and Central Asia

	Any type	Cash transfers	Payment deferrals	New credit	Fiscal relief	Wage subsidies
Log(labor productivity)	–1.944**	–1.266**	–0.353	0.357	–0.469	–2.263***
	(0.856)	(0.564)	(0.400)	(0.444)	(0.401)	(0.806)
Log(number of employees)	1.301	–0.530	1.390***	–0.134	1.596**	2.024
	(1.400)	(0.413)	(0.452)	(0.368)	(0.658)	(1.263)
Log(firm age)	–0.461	–0.806	–1.225	0.121	–1.288*	–1.017
	(1.686)	(0.968)	(0.990)	(0.588)	(0.767)	(2.020)
Top manager female dummy	4.824**	2.091	0.127	–1.271*	1.583	5.615**
	(2.442)	(1.915)	(1.544)	(0.687)	(2.018)	(2.514)
Innovated during 2017–19	0.493	0.276	–0.653	1.174	0.338	0.795
	(1.889)	(0.781)	(1.276)	(0.943)	(1.295)	(1.629)
National market dummy	–0.903	–1.360*	0.046	2.216***	0.732	–1.304
	(1.866)	(0.787)	(0.844)	(0.619)	(1.601)	(2.063)
International market dummy	1.149	0.211	0.167	1.909	1.527	–4.352*
	(2.614)	(1.708)	(2.062)	(1.418)	(3.027)	(2.346)
Constant	65.032***	27.795***	10.000***	–0.365	9.812*	61.088***
	(13.402)	(6.395)	(3.633)	(5.605)	(5.933)	(13.012)
R^2	0.213	0.170	0.055	0.052	0.132	0.223
Number of observations	8,207	8,176	8,171	8,166	8,164	8,191

Source: Authors' calculations based on most recent ES COVID-19 Follow-Up Surveys and Enterprise Surveys for 23 countries in ECA.
Note: Regressions include sector and country fixed effects. Standard errors are clustered at the country level.
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Taken together, these findings suggest that the broad support governments provided disproportionately went to less productive firms, irrespective of their pre-crisis innovativeness. Previous work has documented that firms that did not experience large declines in sales during the crisis benefitted from government support measures while firms that experienced large declines in sales did not (Cirera and others 2021). Not supporting firms with the largest declines in sales may be consistent with creative destruction, where less productive firms get pushed out of the market during a crisis while more productive and innovative firms recover and eventually thrive again. The results in table 2.9 are not consistent with creative destruction: Governments were more likely to support less productive firms, and support measures were given to firms regardless of their pre-crisis level of innovation. Less productive firms that stay in the market with the help of government support can stifle innovation and productivity growth in the recovery phase and beyond. The provision of more support to large firms can also increase industry concentration and market power. The following section discusses how government policy can counteract these trends and rebolster competition during the recovery.

Policy Implications

Government policy measures aimed at supporting firms through the economic fall-out of the pandemic have in many cases provided immediate relief to protect firms and workers from the worst effects of the crisis. In times of extraordinary circumstances—such as the COVID-19 pandemic—general policy measures and even some flexibility in allowing exemptions to competition law and policies may be appropriate (Akcigit and others 2021; Pop and Amador, 2020). Such exceptions may include easing restrictions regarding state aid to business that would otherwise go bankrupt. Although such measures weaken competition under normal circumstances, they can be appropriate if temporary to avoid a larger economic fall-out. They should be designed to minimize the disruptive effects they can have on competition.[7] Competition authorities can also potentially help mitigate anticompetitive effects of any such measures by providing guidance and closely monitoring the market. As countries emerge from the pandemic, however, it will be important to balance protection with the necessary reallocation among firms and sectors that is usual in the aftermath of major shocks (Blanchard, Philippon, and Pisani-Ferry 2020).

Government policy measures aimed at supporting firms through the economic fall-out of the pandemic have also reignited concerns about propping up so-called "zombie firms"—firms that are unprofitable but remain in operation only because of cheap credit and debt forbearance (ECB 2021). Zombie firms may reduce economy-wide productivity by crowding out resources for new, more productive firms. In the wake of the global financial crisis, low interest rates and weak insolvency frameworks contributed to a significant increase in the share of zombie firms in a number of European countries (Acharya and others 2020). Even before the outbreak of COVID-19, that share was larger than it was before the global financial crisis; government support measures enacted in response to the pandemic may have further increased the share.

As economies enter the economic recovery phase, it will be important for policy makers in all countries to phase out policy support measures and focus on fostering a competitive business environment that is key to a strong recovery, resilience to future crises, and sustainable long-term economic growth. The findings presented in this chapter support the policy priorities outlined in World Bank (2021c) and include the following:

- **Better targeting government policy support measures.** Many governments implemented broad policy support schemes to promptly address the immediate economic fall-out from the COVID-19 crisis. A cursory analysis of government support measures in the region suggests that there were no large differences in the type of firms that received assistance based on firm characteristics. A more careful analysis, however, suggests that more support appears to have gone to less productive firms. As conditions improve and economies enter the recovery phase, broad, indiscriminate policy support measures should be phased out as soon as

7. Pop and Amador (2020) provide an overview of the "Dos and Don'ts for State Aid Design."

appropriate. Although some policy support may continue to be necessary, it will be important to target remaining support better to viable, productive firms, in order to avoid propping up zombie firms and ensure that limited fiscal resources are deployed efficiently, to firms that will contribute to long-term economic growth. The World Bank is working across the region to improve the targeting of government support, and on-going projects in Turkey, Georgia, Romania, and the Kyrgyz Republic are good examples.

- **Ensuring that policy support measures do not lock in market structures with lower competitive pressures.** All support measures should be designed in a way that minimizes the risks of distorting market incentives or crowding out market players. Transparency and accountability of government support schemes can mitigate the risks of providing preferential access to support schemes to certain types of firms, including state-owned enterprises (SOEs) or large firms, and creating an unlevel playing field. Large firms in the region were more likely than smaller firms to receive aid in the form of payment deferrals and fiscal relief. Although there may be good reasons for this, transparency and accountability are key. Governments should also take this opportunity to review the economic rationale of SOEs and consider whether government support to them is the best use of limited resources, especially if these enterprises had structural viability issues even before the crisis. The authorities should also actively monitor all forms of government interventions and propose adjustments to policies that safeguard contestability and competition. Indeed, countries should not only ensure that they avoid locking in market structures with lower competitive pressures, they should also enhance their competition policy in support of the post-pandemic economic recovery phase. Toward this end, the World Bank has been providing technical assistance on assessing the effect of state aid on market outcomes (Romania), strengthening competition policy design (Moldova and Uzbekistan), and reducing the role of state induced distortions to competition (Kazakhstan).

- **Undertaking policy reforms to enable improved firm exit by strengthening insolvency and resolution frameworks.** Strengthening insolvency and resolution frameworks, including legal frameworks for corporate and debt restructuring, and out-of-court conciliatory measures are crucial to ensuring that uncompetitive firms are restructured or exit. As a result of the COVID-19 crisis, many firms will need to restructure their debt; others will have to be promptly resolved to prevent an increase in the number of zombie firms, which can lower economywide productivity by crowding out resources for more productive or new firms. The World Bank is engaged with authorities on reforms in this area in some countries in the region, including in Bulgaria, Estonia, and Poland.

- **Undertaking policy reforms to enable improved firm entry and growth.** Countries can improve the competitiveness of their business environment by lowering regulatory costs to business, accelerating digitizing

government-to-business services, and strengthening institutions to enhance policy certainty. More broadly, countries need to realign policy and regulatory environments to facilitate the reallocation of resources toward long-run economic transformation, job creation, and inclusion, which is an important focus of World Bank operations across the region. Ongoing operations in North Macedonia, Moldova, Romania, Serbia, and Turkey are examples of projects intended to help firm entry, exit, innovation, and competition.

- **Ensuring that the financial sector has the capacity to provide liquidity as needed and remains healthy.** A strong financial sector is a vital part of a competitive business environment. It may provide funding for new firms to enter and productive firms to invest in innovation and adaptation to change. Regulatory and supervisory incentives should be considered, where relevant, to foster early action on non-performing loans (NPLs) and promote effective corporate debt restructuring. The World Bank has multiple engagements across the region on financial sector health. A good example is its joint work with the International Finance Corporation (IFC) in Kazakhstan, where a diagnostic report on NPLs and stakeholder engagements aim to identify impediments to and opportunities for the development of the distressed asset market, including market-based options to address the long-standing issue of high NPLs.

Conclusion

The COVID-19 pandemic had a profound and heterogenous impact on firms in ECA. On average, firms surveyed in the first survey round, conducted between May and November 2020, reported a drop in monthly sales of 24 percent and a 10 percent decrease in full-time employees compared with one year earlier. By round 2 of the survey, conducted between November 2020 and May 2021, one in four firms reported anticipating falling into arrears on outstanding liabilities in the next six months. Smaller and younger firms were hit harder by the COVID-19 crisis than other firms.

A competitive business environment in which resources are allocated to the most efficient, most innovative firms is key for sustainable, long-term economic growth. Before COVID-19, firms' labor productivity was higher in countries with more competitive environments. During the COVID-19 crisis, economic activity appears to have been reallocated toward more productive firms, especially in countries with more competitive markets. More productive firms were also more likely to adapt to the crisis by increasing online activity and remote work. Whether the reallocation of economic activity toward more productive firms is long-lasting will depend on whether more productive firms grow and less productive firms ultimately exit.

Many governments implemented broad policy support schemes to promptly address the initial economic fall-out from the COVID-19 crisis and provide immediate relief to protect firms and workers from the worst effects. This support may not have gone to the most viable or innovative firms.

As economies enter the economic recovery phase, it will be important for policy makers in all countries to phase out policy support measures as soon as appropriate and focus on fostering a competitive business environment. Such an environment is key to a strong recovery; resilience to future crises; and sustainable, long-term economic growth.

Annex 2.1 Data and Methodology

World Bank Enterprise Surveys provide nationally representative insights into the private sector landscape in ECA. Data for formal (registered) firms with 5 or more employees from the latest round of surveys were collected primarily in 2019 in the region (table A2.1.1). More information on Enterprise Surveys is available at https://www.enterprisesurveys.org/en/methodology.

TABLE A2.1.1 Completion dates of survey fieldwork for World Bank Enterprise Surveys and Business Pulse Surveys

Country	ES Baseline	ES COVID-19 round 1	ES COVID-19 round 2
Albania	May 2019	June 2020	—
Armenia	December 2020	April 2021	—
Azerbaijan	December 2019	May 2021	—
Belarus	April 2019	August 2020	—
Bosnia and Herzegovina	September 2019	March 2021	—
Bulgaria	March 2020	September 2020	December 2020
Croatia	November 2019	September 2020	January 2021
Czech Republic	March 2020	October 2020	February 2021
Estonia	January 2020	November 2020	February 2021
Georgia	January 2020	June 2020	November 2020
Hungary	March 2020	September 2020	February 2021
Kazakhstan	October 2019	March 2021	—
Kyrgyz Republic	December 2019	—	—
Latvia	January 2020	November 2020	February 2021
Lithuania	January 2020	October 2020	February 2021
Moldova	November 2019	May 2020	November 2020
Montenegro	July 2019	February 2021	—
North Macedonia	October 2019	November 2020	—
Poland	December 2019	August 2020	December 2020
Romania	June 2020	September 2020	December 2020
Russian Federation	July 2019	June 2020	—
Serbia	October 2019	February 2021	—
Slovak Republic	March 2020	October 2020	February 2021
Slovenia	November 2019	August 2020	December 2020
Tajikistan	August 2019	—	—
Ukraine	December 2019	—	—
	ES Baseline	**BPS COVID-19 round 1**	**BPS COVID-19 round 2**
Kosovo	December 2019	July 2020	—
Uzbekistan	August 2019	September 2020	—
Turkey	December 2019	July 2020	March 2021

Note: — Not available.

The World Bank has conducted Enterprise Surveys COVID-19 Follow-Up Surveys around the world, including in ECA (table A2.1.2). Data for a first survey round were typically collected between May and November 2020; data for the second survey round were collected between November 2020 and May 2021 (table A2.1.1). In some countries with only one round of data collection so far, the first survey round was not collected until data collection for the second round was already underway in countries with two rounds. For analysis purposes, survey rounds for these countries are assigned by date of fieldwork completion (see tables 2.3 and 2.8).

Additional rounds of ES COVID-19 Follow-Up Surveys are continuously released. This chapter uses up to the first two rounds of data available as of the cut-off date of June 28, 2021. As it focuses on emerging markets and developing countries, it does not include data for countries in Southern Europe in the

TABLE A2.1.2 **Availability Enterprise Survey COVID-19 data in Europe and Central Asia, by subregion**

Central Asia	Central Europe and Baltic countries	Eastern Europe	Northern Europe
Kazakhstan	**Bulgaria**	**Belarus**	Denmark
Kyrgyz Republic	**Croatia**	**Moldova**	Finland
Tajikistan	**Czech Republic**	Ukraine	Iceland
Turkmenistan	**Estonia**		Norway
Uzbekistan	**Hungary**		Sweden
	Latvia		
	Lithuania		
	Poland		
	Romania		
	Slovak Republic		
	Slovenia		
South Caucasus	**Southern Europe**	**Western Balkans**	**Western Europe**
Armenia	**Cyprus**	**Albania**	Austria
Azerbaijan	**Greece**	**Bosnia and Herzegovina**	Belgium
Georgia	**Italy**	Kosovo	France
	Malta	**Rep. of North Macedonia**	Germany
	Portugal	**Montenegro**	Ireland
	Spain	**Serbia**	Luxembourg
			Netherlands
			Switzerland
			United Kingdom
Russian Federation	**Turkey**		
Russian Federation	Turkey		

Note: As of June 28, 2021, countries in bold had conducted at least one round of the ES COVID-19 Follow-Up Surveys data. Countries shaded in gray had conducted two rounds. Data from Southern Europe are available but not used in the analysis of the chapter. For Kosovo, Turkey, and Uzbekistan (shaded in light red), only BPS data are available.

analysis. The sampling frame for the ES COVID-19 Follow-Up Surveys includes all firms that replied to the latest pre-COVID-19 Enterprise Surveys, making it possible to link performance during the COVID-19 pandemic back to firm characteristics collected through the Enterprise Surveys. More information on ES COVID-19 Follow-Up Surveys is available at https://www.enterprisesurveys.org/en/covid-19.

In addition to the ES COVID-19 Follow-Up Surveys, the World Bank also conducts Business Pulse Surveys (BPS), using a similar but not identical questionnaire as the ES COVID-19 Follow-Up Surveys. BPS do not use the Enterprise Surveys sampling frame and as a result cannot be linked with the pre-COVID Enterprise Surveys. In ECA, BPS data as of the cut-off date of June 28, 2021, were available for six countries: Bulgaria, Poland, and Romania (also covered by ES COVID-19 Follow-Up Surveys) and Kosovo, Turkey, and Uzbekistan. For the three countries for which no ES COVID-19 Follow-Up Surveys data are available, BPS data are reported instead in tables 2.3 and 2.8. To make the data more comparable with ES COVID-19 Follow-Up Surveys, only firms with five or more employees are included in any calculations. More information on Business Pulse Surveys is available at https://www.worldbank.org/en/data/interactive/2021/01/19/covid-19-business-pulse-survey-dashboard.

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PART II

Selected Country Pages

ALBANIA

Table 1	2020
Population, million	2.8
GDP, current US$ billion	14.9
GDP per capita, current US$	5321.4
Upper middle-income poverty rate ($5.5)[a]	33.8
Gini index[a]	33.2
School enrollment, primary (% gross)[b]	104.8
Life expectancy at birth, years[b]	78.6
Total GHG Emissions (mtCO2e)	9.8

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2019).

The economic recovery in 2021 is stronger than anticipated, as travel, construction, and extractives bounced back following robust international demand. Private investment, consumption, and public spending have led growth. Macroeconomic policies have supported the recovery, although higher public spending has lifted the debt-to-GDP ratio for the second year. Employment and labor force participation have yet to recover, but rising incomes should lead to a modest fall in poverty. Uncertainty remains high as daily Covid-19 cases are increasing again.

Key conditions and challenges

In 2020, the pandemic hit Albania's economy hard. GDP fell by 4 percent, and the government incurred additional public debt to mitigate the economic losses through increased spending.

Activity has rebounded in 2021 and GDP is projected to increase by 7.2 percent, as restrictions are lifted and construction activity resumes, including the reconstruction following the 2019 earthquake.

However, economic prospects remain uncertain as daily cases have started increasing again. Further, by August 2021, the vaccination rate stood at around 20 percent only. If reinstated, new containment measures would delay the recovery of activity and employment, especially in services and manufacturing.

The government successfully met its financing needs by issuing Eurobonds in 2020 and plans to repeat this in 2021. To allow public debt to increase further in 2021, the government temporarily suspended the fiscal rule of a declining debt-to-GDP.[1] Still, the country's buffers remain low in case of a new pandemic wave. In the absence of fiscal consolidation, refinancing risks could arise if external financial market demand reverses and interest rates increase.

The structural conditions for sustained growth are still weak. Although growth averaged a healthy 3.3 percent in 2015-2019, stagnant productivity, a firm landscape dominated by Small and Medium Enterprises that employ low-skilled, low-wage labor, limited access to finance, burdensome logistics, and poor market integration discourage private investment. In addition, low public revenue mobilization at only 26.3 percent of GDP hinders much-needed investment in public infrastructure and human capital.

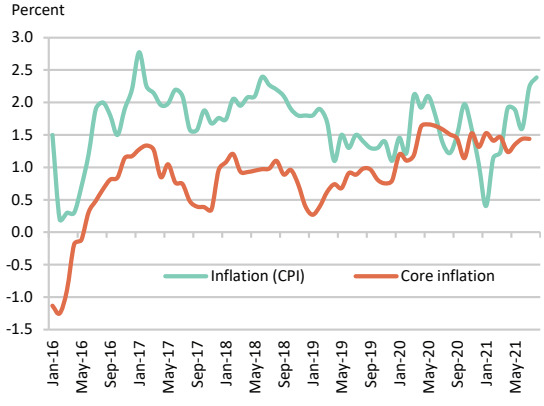
Recent developments

The Albanian economy has shown encouraging signs of recovery in 2021. Higher consumer confidence, external demand, and policy stimulus supported growth. Construction led GDP growth in the first quarter of 2021 and is expected to remain strong, thanks to reconstruction and new infrastructure projects. Strong external demand and favorable hydrologic conditions have boosted extractives and energy production and tourism exports.

Meanwhile, inflationary pressure is building up. Food and oil prices pushed average inflation to 1.8 percent in Q2, from 0.9 percent in Q1. While core inflation remains stable at 1.4, upward pressure could intensify with the expansion of demand and monetary and fiscal stimulus.

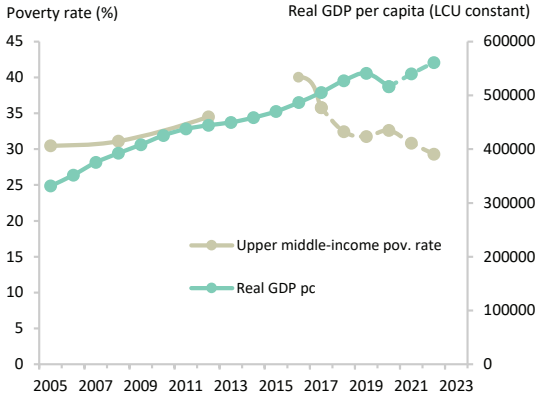
The labor market has not recovered yet. Labor force participation in Q2 2021 continues to be below Q2 2019. There is still a deficit of about 35 thousand jobs relative to Q2 2019. Unemployment started to decline slightly in Q2, especially for workers under 30. Formal real wages rose by 2.9 percent, partially because of an increase in

FIGURE 1 Albania / Headline inflation and core inflation



Sources: INSTAT and World Bank.

FIGURE 2 Albania / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

the minimum wage. Notwithstanding the labor market underperformance, the poverty rate (at USD 5.5 per day) is projected to fall in 2021 by 1.8 percentage points relative to 2020. Although the extent of the poverty increase in 2020 is not confirmed, projections suggest that by end-2021 the poverty rate could be 0.9 percentage points below its 2019 estimated value. However, this assumes employment recovers to long-term trends and food prices remain stable.

Higher fiscal revenue collection and new debt allowed the government to increase infrastructure spending. Fiscal consolidation and the achievement of a positive primary balance was postponed to 2024.

Outlook

The Albanian economy has shown encouraging The strong projected GDP growth rebound in 2021 is subject to a smooth vaccination rollout, no further lockdowns, and continued recovery in services, led by tourism, and construction. If labor participation and employment pick up again, poverty could continue to decline; in an optimistic scenario it could fall to 30 percent by 2022.

In the years following, private consumption is projected to return as the primary driver of GDP growth. Private investment could provide further support to growth if business climate reforms are implemented. Meanwhile, the current account deficit is expected to expand to 9.4 percent of GDP, as high infrastructure investment demand brings imports' growth to 29 percent in 2021. With exports bouncing back, the current account deficit should gradually shrink to 7.0 percent by 2023. Service exports, including tourism and fast-expanding business-process operations should narrow the trade deficit over the medium term.

Strong GDP growth is expected to help increase public revenues to 27.4 percent of GDP in 2022-2025. However, beyond 2021, spending will likely be constrained by limited fiscal space, as public debt is projected to increase to 78.6 percent of GDP in 2021, before declining gradually over the medium term. Fiscal space could further deteriorate in a downside growth scenario and if the tax base is further eroded. In this case, the government may need to cut capital spending to prevent an increase of the debt-to-GDP ratio. Moreover, with more reliance on external financing, exchange rate, interest rate, and refinancing risks remain elevated. A key medium-term reform priority is the need to boost revenue collection and achieve fiscal consolidation, while allowing for significant growth-enhancing spending.

1/ The fiscal rule includes an escape clause in the case of an emergency, which applied in 2020.

TABLE 2 Albania / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	4.0	2.1	-4.0	7.2	3.8	3.7
Private Consumption	3.2	3.2	-2.4	3.1	3.2	3.2
Government Consumption	0.7	2.9	1.6	12.9	-3.7	3.2
Gross Fixed Capital Investment	2.3	-3.7	-2.0	13.3	-1.7	2.1
Exports, Goods and Services	4.0	2.6	-25.6	25.4	12.8	6.4
Imports, Goods and Services	2.4	2.3	-19.9	16.3	3.7	3.7
Real GDP growth, at constant factor prices	4.1	2.4	-3.4	7.2	3.8	3.7
Agriculture	1.2	0.6	0.3	1.5	1.5	1.5
Industry	9.9	0.9	-3.5	10.8	5.0	5.0
Services	2.6	3.8	-4.7	7.7	4.0	3.8
Inflation (Consumer Price Index)	2.1	1.4	2.2	2.6	2.9	2.8
Current Account Balance (% of GDP)	-6.8	-7.9	-8.8	-9.4	-8.1	-7.0
Net Foreign Direct Investment (% of GDP)	8.0	7.5	6.8	6.6	7.4	7.0
Fiscal Balance (% of GDP)	-1.7	-1.9	-6.8	-6.7	-2.8	-3.0
Debt (% of GDP)	69.5	67.4	77.2	78.6	76.7	74.9
Primary Balance (% of GDP)	0.5	0.1	-4.7	-4.6	-0.7	-0.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	32.4	31.8	32.6	30.8	29.3	
GHG emissions growth (mtCO2e)	-2.2	1.3	-1.6	3.2	1.0	0.9
Energy related GHG emissions (% of total)	46.8	47.3	46.8	47.6	46.9	45.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.
(a) Calculations based on SILC 2017-2019.Actual data: 2017. Nowcast: 2018-2020. Forecast are from 2021to 2022.
(b) Projection for 2021using sectoral GDP growth with pass-through =1for agriculture and services and 0.7 for industry.

ARMENIA

Table 1	2020
Population, million	2.9
GDP, current US$ billion	12.6
GDP per capita, current US$	4344.8
International poverty rate ($19)[a]	1.1
Lower middle-income poverty rate ($3.2)[a]	9.8
Upper middle-income poverty rate ($5.5)[a]	44.0
Gini index[a]	29.9
School enrollment, primary (% gross)[b]	91.8
Life expectancy at birth, years[b]	75.1
Total GHG Emissions (mtCO2e)	9.1

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2019), 2011 PPPs.
(b) Most recent WDI value (2019).

Due to the twin shocks of the pandemic and the conflict with Azerbaijan, Armenia's economy contracted sharply in 2020, which inflicted a significant welfare loss. The economic recovery in 2021 has been faster than anticipated, and the economy is likely to return to pre-COVID output levels by mid-2022. The slow pace of vaccinations, rising COVID-19 cases, and geopolitical fragility present important risks to the outlook.

Key conditions and challenges

Armenia's economy expanded rapidly between 2017 and 2019, with an annual GDP growth rate averaging 6.8 percent. An effective fiscal rule, an active inflation-targeting regime, and sound financial-sector oversight helped establish a track record of macroeconomic stability. The business environment gradually improved, with gains in market liberalization and pro-competition reform following the political realignment of 2018.

However, in 2020 the twin shocks of the pandemic and the military confrontation with Azerbaijan derailed the economy. GDP fell by 7.4 percent, one of the sharpest contractions in the region, and poverty rates rose sharply, especially in urban areas.

Emergency spending packages and limited tax breaks provided as part of the fiscal response to the pandemic, coupled with declining revenues, pushed public debt to 67 percent of GDP in 2020. However, the debt composition remains favorable. The current-account deficit narrowed in 2020, while increased borrowing kept reserves adequate. The banking sector is well capitalized, albeit with low profitability, though the impact of the 2020 shocks may yet unfold.

The 2020 conflict was followed by a period of heightened political uncertainty, but snap elections held in June 2021 have helped stabilize the situation. A tense geopolitical context, combined with unaddressed structural issues, continues to prevent the country from reaching its full potential.

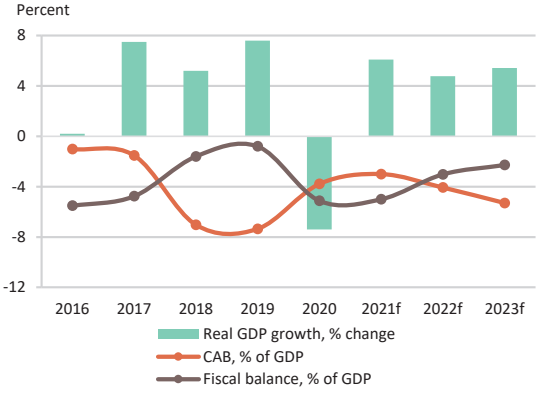
Recent developments

The economy expanded by 4.9 percent, year-on-year (y/y) in the first half (H1) of 2021, faster than anticipated, reflecting also the base effect of a contraction in H1 2020. Services led the recovery, benefiting from limited pandemic-related restrictions in 2021, while agricultural and industrial growth were more modest. Rebounding private consumption supported by greater mobility, recovering employment rates, and increased investment drove growth on the demand side. The unemployment rate fell by 2.7 percentage points y/y in the first quarter of 2021, albeit from a historically high base of around 20 percent.

Inflation has picked up to 8.8 percent y/y in August, its highest level since 2013 and well above the 5.5 percent upper bound of the Central Bank of Armenia's (CBA) inflation target range. High international food and energy prices and the pass-through effect of a more volatile exchange rate intensified inflationary pressures. In response, the CBA increased the policy rate by 300 basis points since end-2020 to 7.25 percent in mid-September 2021.

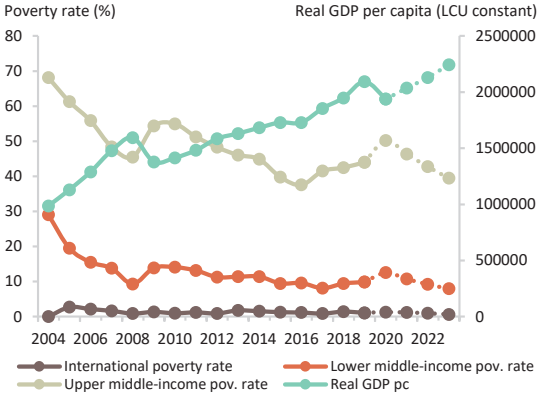
Fiscal revenues exceeded budgeted levels by 13 percent in H1 2021, as growth exceeded expectation, while expenditures were executed almost as planned. The budget deficit narrowed to 1.1 percent of

FIGURE 1 Armenia / GDP growth, fiscal and current account balances



Sources: Statistical Committee of the Republic of Armenia, Central Bank of Armenia and World Bank staff projections.

FIGURE 2 Armenia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

projected annual GDP in H1 2021, below the 2.6 percent deficit anticipated in the original budget.

The current-account balance continued to improve in H1 2021, y/y. Exports of goods recovered faster than imports in nominal terms (up 23 and 8 percent, respectively), as rising global copper prices added to the slow growth of export volumes. Rising tourist arrivals and the recovery of remittances improved the services and income balances, while FDI inflows expanded from a low base in 2020. An improving current-account balance and the issuance of a US$750 million Eurobond in February 2021 boosted international reserves to seven months of import coverage. Political uncertainty increased pressure on the Armenian dram in early 2021, but the exchange rate has stabilized since July.

After declining from March to July of 2021, daily COVID-19 infections have begun rising again, though as of mid- September reported infections remained below last two peak levels. The pace of vaccinations has been slow, hindered by vaccine hesitancy, and only 6.6 percent of the adult population was fully vaccinated by September 26th.

Outlook

Following a faster-than-expected recovery in H1, the projected GDP growth rate for 2021 has been revised to 6.1 percent, up from 3.4 percent in April 2021. In the absence of renewed lockdowns or serious domestic or regional instability, the economy is expected to return to pre-COVID output levels by mid-2022.

Private consumption will continue to drive the recovery as rising employment rates, wage levels, and remittance inflows bolster household incomes. Private investment growth is expected to accelerate, while fiscal consolidation may slow the growth of public investment. The government's medium-term expenditure framework anticipates a narrowing of the deficit from 5.1 percent of GDP in 2020 to around 2 percent in 2023, contributing to a decline in the public debt-to-GDP ratio from 67.4 percent at end-2020 to 63.4 percent in 2023.

While output is projected to rebound rapidly, the more gradual recovery of the labor market will attenuate the impact of renewed growth on poverty and inequality. Increased generosity of support measures and improved program targeting could help minimize the long-term impact of the economic shocks of 2020 on economic opportunity, household vulnerability, and gender parity.

The average inflation rate is forecast to remain above the CBA's target band in 2021, but it should converge with the 4 percent target in the medium term as monetary policy anchors inflationary expectations. Elevated inflation rates will adversely affect distributional equity and household welfare.

The current-account deficit is projected to narrow in 2021 and then widen over the medium term as imports fully recover. FDI inflows are expected to increase but will remain low.

Risks to the outlook are balanced. The key downside risks are limited progress in COVID-19 vaccinations, rising COVID-19 cases, geopolitical tensions, and a delayed recovery among major trading partners. On the upside, greater political certainty may enable renewed progress on the implementation of structural reforms while accelerating public investment.

TABLE 2 **Armenia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	5.2	7.6	-7.4	6.1	4.8	5.4
Private Consumption	4.9	11.5	-13.8	6.0	5.9	6.4
Government Consumption	-3.0	12.9	15.2	4.1	-3.9	2.7
Gross Fixed Capital Investment	4.8	4.4	-8.6	6.2	8.1	8.2
Exports, Goods and Services	5.0	16.0	-32.4	6.5	10.2	12.5
Imports, Goods and Services	13.3	11.6	-31.7	5.6	9.5	12.8
Real GDP growth, at constant factor prices	4.9	7.7	-7.1	6.1	4.8	5.4
Agriculture	-6.9	-5.8	-4.1	6.4	4.0	3.9
Industry	3.7	10.5	-3.0	3.5	4.1	5.1
Services	9.0	9.7	-9.8	7.4	5.3	5.9
Inflation (Consumer Price Index)	2.5	1.4	1.2	6.3	4.2	4.0
Current Account Balance (% of GDP)	-7.0	-7.4	-3.8	-3.0	-4.1	-5.3
Net Foreign Direct Investment (% of GDP)	2.1	1.7	0.6	1.7	2.3	2.6
Fiscal Balance (% of GDP)	-1.6	-0.8	-5.1	-5.0	-3.0	-2.3
Debt (% of GDP)	55.7	53.7	67.4	66.9	65.8	63.4
Primary Balance (% of GDP)	0.7	1.6	-2.4	-2.5	-1.1	-0.3
International poverty rate ($1.9 in 2011 PPP)[a,b,c]	1.4	1.1	1.3	1.2	1.0	0.6
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b,]	9.4	9.8	12.5	10.7	9.2	7.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b,]	42.5	44.0	50.2	46.4	42.8	39.5
GHG emissions growth (mtCO2e)	0.8	5.1	-7.6	5.3	4.5	4.8
Energy related GHG emissions (% of total)	59.7	61.1	60.2	60.9	61.3	62.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2019-ILCS.Actual data: 2019. Nowcast: 2020. Forecast are from 2021to 2023.

(b) Projection using neutral distribution (2019) with pass-through = 0.87 based on GDP per capita in constant LCU.

(c) The poverty rates for 2019 are not strictly comparable with 2018 due to revisions on the ILCS starting in 2019.

AZERBAIJAN

Table 1	2020
Population, million	10.1
GDP, current US$ billion	42.6
GDP per capita, current US$	4217.8
School enrollment, primary (%gross)[a]	97.9
Life expectancy at birth, years[a]	73.0
Total GHG Emissions (mtCO2e)	73.2

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent WDI value (2019).

After contracting in 2020, Azerbaijan's economy has rebounded strongly in 2021, with recovery in the nonoil/gas sectors combined with rising hydrocarbon production and prices. While the pandemic's evolution remains uncertain, solid progress on vaccinations and significant financial buffers are expected to help the economy reach pre-pandemic levels by end-2021, and support households to recover from the crisis. Structural weaknesses need to be addressed to sustain future growth.

Key conditions and challenges

Azerbaijan is an upper-middle-income country in the South Caucasus. Its over-reliance on hydrocarbon products as a major source of export and fiscal revenues remains its major vulnerability, especially given the declining oil production, the perpetual volatility of commodities markets, and the global transition away from fossil fuels.

Azerbaijan was hit hard by the COVID-19 pandemic, but substantial reserve buffers and low public debt levels have helped the country weather the ensuing economic crisis. Nevertheless, the pandemic has adversely impacted employment, wages, and poverty rates.

Over the medium and longer term, underlying structural weaknesses including an undiversified asset mix, heavy state economic footprint, institutional rigidities, an uneven private sector playing field, stagnating human capital indicators, and weak financial markets threaten Azerbaijan's continued growth. In 2021, the government presented its 2030 national development vision which aspires to address the country's structural challenges.

Regional geopolitical tensions eased following the signing of a ceasefire agreement between Azerbaijan and Armenia in November 2020. Although the security situation remains fragile, reconstruction efforts are underway, and the authorities approved a program to rebuild damaged infrastructure and restart socioeconomic development in the conflict-afflicted areas.

Recent developments

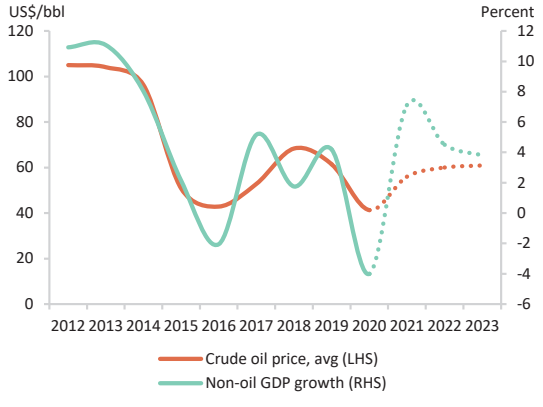
The COVID-19 pandemic continues to affect Azerbaijan. In the spring, the government's mitigation efforts shifted from strict mobility restrictions to vaccinations, and by mid-September about 63 percent of the adult population had received at least one vaccine dose. The authorities also began requiring COVID-19 passports to enter public spaces starting on September 1st.

Economic conditions improved after the lockdown was lifted in May and OPEC+ started gradually relaxing its oil-production quotas, and the overall economic growth rate reached 3.6 percent, year on year (y/y), in the first eight months of 2021. The nonoil/gas sector led the recovery, expanding by 5.7 percent over the period.

On the demand side, public and private investment remained weak, contracting by 10.1 percent y/y during January-August 2021, while the release of pent-up consumer demand coupled with counter-cyclical fiscal spending supported consumption growth. Net exports also increased significantly, as high global energy prices, recovering oil production, and expanding gas production more than offset a rise in imports.

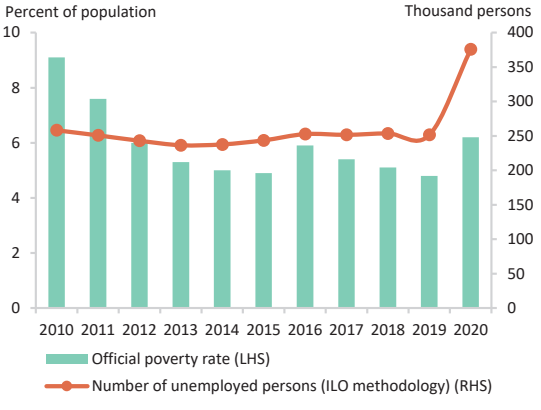
Rebounding domestic demand, rising global commodity prices, and increased administrative prices boosted consumer price inflation to 4.8 percent y/y in the first

FIGURE 1 Azerbaijan / Nonoil GDP growth and oil price



Sources: State Statistical Committee of Azerbaijan and World Bank staff estimates.

FIGURE 2 Azerbaijan / Official poverty rate and unemployment



Source: State Statistical Committee of Azerbaijan.
Note: The World Bank has not reviewed the official poverty rates for 2013–20.

eight months of 2021, prompting an increase in the policy rate.

Favorable terms of trade pushed the current-account balance from a 0.5 percent of GDP deficit at end-2020 to an 8 percent surplus in the first half of 2021. While financial-account outflows continued, CBA reserves were stable at US$6.5 billion, and the assets of the State Oil Fund (SOFAZ) rose by 2 percent y/y to US$44.1 billion (104 percent of GDP) in the first half of 2021. Easing currency pressure since March 2020 helped the CBA maintain the exchange rate at 1.7 Azerbaijani manat per U.S. dollar.

The consolidated budget balance posted a surplus of 7.1 percent of GDP in the first seven months of 2021, as the economic recovery increased fiscal revenue, while some crisis-response measures expired and budget execution slowed.

According to official data, the pandemic contributed to a sharp rise in unemployment, and between March 2020 and March 2021, the number of unemployed workers increased by 115,200. The official poverty rate also increased from 4.8 percent in 2019 to 6.2 percent in 2020, indicating that the government's response effort did not fully counter the pandemic's impact on poverty.

Outlook

The GDP growth rate is projected to rise to 5.0 percent in 2021, reflecting a strong recovery in both the energy and nonenergy sectors. This forecast assumes that the pandemic will remain controlled, and vaccination will continue at its current pace. Nonoil/gas GDP growth is projected to reach 7.1 percent in 2021, due to a low base effect, rebounding service-sector activity and robust growth in agriculture and nonenergy manufacturing. Output is expected to reach pre-pandemic levels by end-2021.

The annual GDP growth rate is projected to moderate to an average of 2.9 percent during 2022-23. The nonenergy sectors are expected to drive growth, supported by rising public investment, including post-conflict reconstruction. Energy-sector growth is projected to stabilize in line with predetermined OPEC+ quotas and anticipated expansion of natural gas production by end-2023, which will also increase energy-related greenhouse gas emissions and slow overall decline in emissions.

Following a marked rebound in 2021, consumption growth is expected to slow over the medium term amid declining fiscal spending. Investment is forecast to remain subdued amid lingering COVID-19 related uncertainty and persistent structural weaknesses.

Rapid increase in prices for imported food and nonfood items and recovering domestic demand is projected to boost inflation to 5.5 percent in 2021, close to the upper bound of the CBA target range. External inflationary pressures are expected to remain elevated in 2022 and moderate thereafter.

A significant external-account surplus is projected to persist through 2023, supported by elevated hydrocarbon prices and rising natural gas exports. Imports are estimated to increase gradually as demand recovers.

The fiscal balance is forecast to remain in surplus until end-2021 and to average 4.6 percent of GDP over the medium term, supported by favorable energy prices, increased revenue collection due to resurgent economic activity, and stable spending anchored by a new fiscal rule targeting the nonoil/gas primary balance that is expected to take effect in 2022.

TABLE 2 Azerbaijan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	1.5	2.5	-4.3	5.0	3.1	2.7
Private Consumption	3.0	4.2	-5.1	5.0	4.7	4.3
Government Consumption	1.5	7.9	4.8	4.8	4.4	3.0
Gross Fixed Capital Investment	-0.2	-2.4	-7.1	-5.0	2.5	1.0
Exports, Goods and Services	1.0	1.5	-8.1	5.6	1.8	1.9
Imports, Goods and Services	1.5	2.2	-10.5	2.5	2.7	2.8
Real GDP growth, at constant factor prices	1.5	2.5	-4.4	5.0	3.1	2.7
Agriculture	4.6	7.3	1.9	4.5	3.2	3.2
Industry	-0.7	0.4	-5.2	2.7	1.1	1.1
Services	5.1	5.1	-4.4	9.0	6.2	5.0
Inflation (Consumer Price Index)	2.3	2.7	2.8	5.5	4.5	4.1
Current Account Balance (% of GDP)	12.8	9.1	-0.5	6.9	6.4	4.5
Net Foreign Direct Investment (% of GDP)	-1.7	-2.9	-1.5	-0.5	-0.6	-0.6
Fiscal Balance (% of GDP)	5.6	9.0	-6.5	5.0	4.3	4.4
Debt (% of GDP)	18.9	18.8	18.4	17.6	17.9	17.5
Primary Balance (% of GDP)	6.8	9.7	-5.7	5.7	4.8	4.8
GHG emissions growth (mtCO2e)	-0.3	-1.6	-5.1	0.0	-0.7	-0.8
Energy related GHG emissions (% of total)	39.9	41.1	41.1	42.8	43.9	45.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

BELARUS

Table 1	2020
Population, million	9.4
GDP, current US$ billion	61.6
GDP per capita, current US$	6553.2
Lower middle-income poverty rate ($3.2)[a]	0.0
Upper middle-income poverty rate ($5.5)[a]	0.2
Gini index[a]	25.3
School enrollment, primary (% gross)[b]	100.5
Life expectancy at birth, years[b]	74.2
Total GHG Emissions (mtCO2e)	68.8

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2019), 2011 PPPs.
(b) WDI for School enrollment (2018); Life expectancy (2019).

During the first half of 2021, the surge in commodity prices and boost in external demand helped to offset weaknesses in domestic consumption and investment, while rising deficit spending provided additional support to growth. The outlook for 2021-2023 is shaped by the impact of EU sectoral economic sanctions, while the scope for fiscal stimulus is determined by available financing options. Poverty rates have declined as real incomes continued to rise, but further improvements of household welfare depend on medium-term growth.

Key conditions and challenges

External factors continue to shape Belarus's growth trajectory, as the drastic improvement in external demand and commodity price surge of 2021 helped to temporarily overcome the 2020 pandemic-induced recession. Domestically, GDP growth has been supported by the absence of broad-based lockdown measures, coupled with subsidized lending in 2020 (at about 1.6 percent of GDP) and fiscal spending at a cost of a widening deficit in 2021. Going forward, the room for fiscal stimulus will largely depend on refinancing opportunities due to sizeable public debt payments (US$2.4 bn in 2022 and US$3.3 bn in 2023). Issuing bonds in the Russian markets is one of the options, as access to the EU financial markets is restricted by sanctions.

The major challenge is to adjust to sectoral economic sanctions targeting Belarus's commodity exports. Manufacturing production chains could be affected, too, as the foreign producers of components might restrict their supplies, making Belarusian manufacturers search for second-best substitutes.

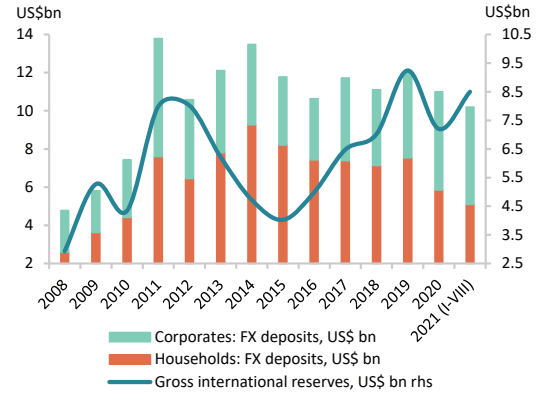
As structural economic deficiencies remain unaddressed, the medium-term recovery becomes dependent on the dynamics of the external environment. While enterprises remain cautiously optimistic, households display higher inflation expectations and continue to withdraw FX holdings from the banking system. In this context, reducing economic uncertainty and sending positive signals to economic agents are critical, along with maintaining prudent monetary and fiscal policies.

Recent developments

In January-June 2021, real GDP grew 3.3 percent y/y (vs. 1.8 percent decline in H1 2020) on the back of an exceptionally strong improvement in external demand and higher export prices. Over January-June 2021, merchandise trade revenues grew by 37.6 percent y/y in nominal US$ terms helping to narrow the goods trade deficit. This was offset by services export growth (by 17.6 percent y/y), especially of transportation and ICT, which contributed to a goods and services surplus and a stable BYN/US$ nominal exchange rate. Stronger exports led the 70.1 percent y/y increase in revenues from foreign trade taxes, while indirect tax revenues, such as VAT and excises, have also held up due to higher intermediate and consumption imports and increased VAT rates for selected goods. However, general government spending (28.1 percent of GDP) exceeded revenues (27.1 percent), resulting in a fiscal deficit of 1.4 percent of GDP.

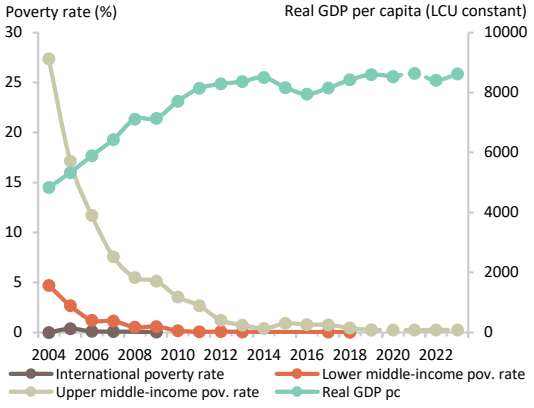
The National Bank kept money supply under control, with annual average broad money volume growth remaining below the annual nominal target of 7-10 percent. Nevertheless, since Q2 2021, consumer price inflation accelerated to

FIGURE 1 Belarus / FX Reserves and FX holdings



Source: National Bank.

FIGURE 2 Belarus / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

9.9 percent y/y in June 2021, double the annual target, due to an increase in administratively regulated prices, imposition of VAT for selected medicines, and imported inflation.

An outflow of household foreign currency deposits, which started in July 2020, continued during the first half of 2021. By July 1, 2021, the total volume of deposits shrank by 10 percent y/y, driven mainly by the reduction of household deposits (27 percent y/y), being partially offset by increased foreign currency holding by corporates (18 percent y/y). External public debt repayment pressures have been alleviated by refinancing from Russia and spending of reserves, which decreased by US$528.5 million over January-March 2021. Gross foreign reserves have since partially recovered by US$469.3 million in April-June and then boosted by the IMF SDR allocation in August, reaching US$8.5 bn, which is equivalent to 2.5 months of goods and services imports.

Outlook

While the surge in commodity prices and boost in external demand helped to offset weaknesses in domestic consumption and investment, the pace of recovery remains weak. A solid 32.7 percent increase in goods and services exports y/y in January-June 2021 follows the 14 percent decline during the same period of 2020. Measured against the first half of 2019, export volumes were just 10 percent higher. Under these circumstances, once the base effects due to the recession in 2020 have passed and sectoral sanctions will gradually take a toll, year on year growth is likely to stall in the second half of 2021, leaving full-year real GDP growth to reach 1.2 percent y/y.

As sectoral sanctions introduced by the EU are expected to hit commodity export revenues harder in 2022, real GDP is projected to decline by 2.8 percent y/y. While the impact on the current account would be cushioned by reduced imports, the restrictions introduced on access to the EU financial markets could negatively affect the financial account. Also, sanctions are likely to increase transaction costs not only for exporters, but also for companies operating in the domestic market.

Continued household welfare growth will depend on the extent to which economic growth can be maintained in a challenging external environment with constrained fiscal space.

TABLE 2 **Belarus** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	3.1	1.4	-0.9	1.2	-2.8	2.3
Private Consumption	7.9	5.1	-1.4	-1.0	-1.8	2.1
Government Consumption	-0.4	0.4	-1.1	-0.4	-0.8	1.1
Gross Fixed Capital Investment	4.4	6.2	-6.8	-2.8	-9.8	1.6
Exports, Goods and Services	3.8	1.0	-3.2	3.6	-3.7	4.2
Imports, Goods and Services	7.3	5.2	-7.9	7.4	-5.3	3.6
Real GDP growth, at constant factor prices	3.2	1.5	-0.9	1.2	-2.8	2.3
Agriculture	-3.4	3.0	4.9	-4.8	2.3	1.2
Industry	5.2	1.4	-0.7	5.7	-4.2	3.4
Services	2.9	1.3	-2.0	-1.1	-2.5	1.6
Inflation (Consumer Price Index)	4.9	4.7	7.4	10.5	7.1	5.7
Current Account Balance (% of GDP)	0.0	-1.8	-0.4	-0.9	-3.0	-2.6
Net Foreign Direct Investment (% of GDP)	2.4	2.0	1.0	1.0	1.0	1.0
Fiscal Balance (% of GDP)	4.0	2.5	-1.7	-2.9	-1.9	-1.4
Debt (% of GDP)	42.5	37.5	41.1	45.8	48.8	49.9
Primary Balance (% of GDP)	5.9	4.3	0.0	-0.9	0.3	0.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	0.4	0.2	0.2	0.2	0.2	0.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2019-HHS. Actual data: 2019. Nowcast: 2020. Forecast are from 2021to 2023.
(b) Projection using neutral distribution (2019) with pass-through = 0.7 based on GDP per capita in constant LCU.

BOSNIA AND HERZEGOVINA

Table 1	2020
Population, million	3.3
GDP, current US$ billion	19.6
GDP per capita, current US$	5939.4
Life expectancy at birth, years[a]	77.4
Total GHG Emissions (mtCO2e)	23.9

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent WDI value (2019).

Real GDP is expected to expand 4 percent in 2021 after contracting 3.2 percent last year, while headline inflation is set to remain below 1 percent. After the rebound following the COVID-19 crisis, growth should stabilize around 3 percent over the medium-term. Addressing the political deadlock would allow the implementation of delayed structural reforms that are also part of EU accession priorities. The latter would help address persistent high unemployment, which worsened during the pandemic, and is key to reducing poverty.

Key conditions and challenges

BiH has signed the Stabilization and Association Agreement with the EU and is a potential EU candidate country. Macroeconomic stability was maintained over the last decade facilitated by the currency board peg to the euro, which, together with the EU membership prospects, remains a critical economic anchor. Despite real income growing roughly over 3 percent per annum since 2015, per capita GDP continues to hover around one-third of the EU27 average. This income gap is significantly larger compared to other peers in the Western Balkans. With continued low investment rates and an economy driven by private consumption, achieving a more pronounced convergence toward the EU27 average will be challenging. While a full recovery to the 2019 real income level is expected in 2021, BiH is unlikely to catch up with the pre-pandemic growth trajectory, unless political bottlenecks are resolved (Graph 1).

Fiscal surpluses ranged between 2 and 3 percent of GDP over the past six years prior to the pandemic, which in turn helped rein in the current account deficits averaging below 4 percent since 2015. The external shortfall was largely financed by net FDI inflows, mainly into the foreign-owned banking sector, which remained stable during the pandemic.

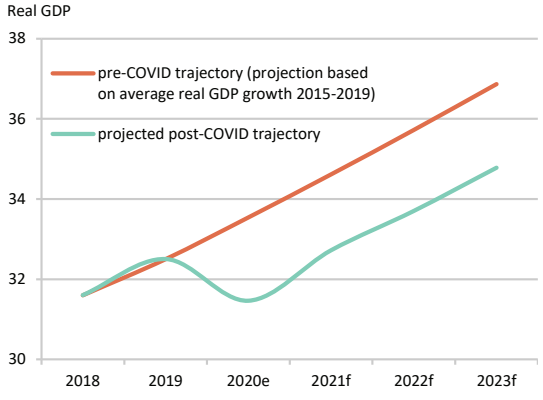
Steady, albeit low, economic growth has not translated into more and better jobs, with a large share of the workforce active in the informal sector. Hence, poverty rates do not seem to have improved, according to the latest official data from 2015.

Implementation of much needed structural reforms is sluggish due to political deadlock, pressures from frequent elections, corruption that pervades all levels of society, and a complex governing structure characterized by fragmentation of responsibilities between the two entities and Cantons. The pandemic has further highlighted shortages in institutional effectiveness resulting in the slow release of fiscal support to households and businesses, which has weighed on economic activity.

Recent developments

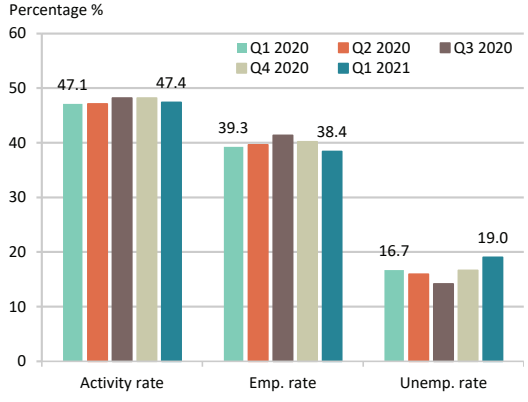
Real GDP contracted 3.2 percent in 2020, much less than previous official estimates of 4.3 percent suggested as manufacturing, wholesale and retail trade declined less than initially estimated. Moreover, driven by a surge in exports and robust private consumption, real GDP growth turned positive in the first quarter of 2021 (year-on-year) at an estimated rate of 1.5 percent. An acceleration in manufacturing translated into a surge in exports to neighboring CEFTA countries, whereas the increase in private consumption resulted from pent-up demand as well as higher lending to households, and the impact of delivery apps connecting consumers to goods. Stronger household and government consumption have driven inflation to 0.4 percent during the period

FIGURE 1 Bosnia and Herzegovina / Real income, in bill KM



Sources: BiH Agency for Statistics (BHAS), World Bank staff estimates.

FIGURE 2 Bosnia and Herzegovina / Labor market indicators, 2020-2021



Sources: LFS 2020 - 2021 report, World Bank staff calculations.

January-July in 2021 compared to the same period last year, which followed about twelve months of deflationary pressures that started in April 2020.

The pandemic caused significant damage to the labor market. As Covid-19 cases remained high and some restrictions continued, the employment rate (15+) decreased to about 38 percent in the first quarter of 2021, while the unemployment rate (15+) increased to 19 percent. (Graph 2). Meanwhile, a slump in tax revenues and higher spending led to an estimated fiscal deficit of 1.8 percent of GDP in 2020, after a surplus of 1.8 percent of GDP in 2019. Higher public wages, and additional spending on goods and services as well as social benefits were aimed at countering the effects of the pandemic.

The sharp rise in exports narrowed significantly the traditionally large merchandise deficit, and as a result the current account deficit declined to 1.2 percent of GDP in the first quarter of 2021 compared to a 3.2 percent deficit during the same period last year. In 2020, the external shortfall improved marginally to 3.3 percent of GDP due to a larger drop in merchandise imports than exports as investments and household consumption fell. The resulting loss of jobs and earnings due to Covid-19, especially in the informal economy, have negatively affected household welfare in 2020.

Outlook

Real GDP is projected to grow 4 percent in 2021 and decelerate to around 3 percent over the medium term. The rebound will in part depend on how successful the authorities are in accelerating the share of the vaccinated adult population, which currently stands at 27.2 percent. As the impact of the pandemic subsides, the Socio-Economic Program, fulfilling priorities for EU accession, is expected to gain needed attention. Announced investments in energy and infrastructure are envisaged to lead the recovery phase together with a further pick up in private consumption fueled by remittances, tightening labor market, and domestic lending. Safeguarding the banking sector remains key as the full impact of loan repayment moratoria is yet to be assessed. Despite stronger private consumption, external balances are set to improve on the back of robust growth in exports. While revenues are set to recover gradually, the fiscal deficit is expected to return to surplus only in 2023. The planned investment push in energy, infrastructure, and tourism should support job creation after the crisis. With limited access to international markets, the authorities will continue relying on support from IFI.

As the economy recovers in 2021, improvements in labor market participation and employment will remain key for growth to translate into poverty reduction. Finally, addressing bottlenecks causing persistent long-term unemployment and EU accession priorities remain important challenges on the country's development path and road to EU membership.

Two main risks dominate the outlook: first, a prolonged adverse impact of the pandemic domestically and abroad could translate into slower growth rates over the medium term and the corresponding deterioration of jobs and household incomes; and second, the political deadlock could adversely affect the implementation of the adopted socio-economic program needed to address the development challenges.

TABLE 2 Bosnia and Herzegovina / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	3.2	3.3	-3.2	4.0	3.0	3.2
Private Consumption	2.4	2.8	-4.5	4.5	3.0	3.2
Government Consumption	0.9	2.6	0.5	6.1	3.0	3.0
Gross Fixed Capital Investment	6.8	5.1	-21.0	-16.4	-4.9	7.2
Exports, Goods and Services	5.9	-0.3	-8.5	28.0	9.0	7.0
Imports, Goods and Services	3.2	0.2	-13.4	17.0	6.0	7.0
Real GDP growth, at constant factor prices	3.7	2.8	-3.2	4.0	3.0	3.2
Agriculture	9.1	2.9	-1.5	3.4	3.0	2.9
Industry	3.8	1.9	-3.0	2.0	2.6	3.2
Services	3.2	3.1	-3.5	4.9	3.2	3.2
Inflation (Consumer Price Index)	1.4	1.2	-0.5	0.7	0.7	0.8
Current Account Balance (% of GDP)	-3.7	-3.1	-3.3	-2.0	-0.6	-1.2
Net Foreign Direct Investment (% of GDP)	2.2	2.9	2.0	3.4	3.6	3.4
Fiscal Balance (% of GDP)	2.5	1.9	-1.8	-3.1	-0.9	0.4
Debt (% of GDP)	36.4	34.4	40.1	38.9	38.4	38.0
Primary Balance (% of GDP)	3.8	2.8	-0.5	-1.8	0.0	1.3
GHG emissions growth (mtCO2e)	-1.0	-1.0	-5.1	4.0	2.8	3.0
Energy related GHG emissions (% of total)	87.6	87.2	87.1	87.0	86.9	86.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

BULGARIA

Table 1	2020
Population, million	6.9
GDP, current US$ billion	67.9
GDP per capita, current US$	9840.6
International poverty rate ($ 1.9)[a]	0.9
Lower middle-income poverty rate ($ 3.2)[a]	2.2
Upper middle-income poverty rate ($ 5.5)[a]	6.9
Gini index[a]	41.3
School enrollment, primary (% gross)[b]	87.4
Life expectancy at birth, years[b]	74.9
Total GHG Emissions (mtCO2e)	13.0

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2018), 2011 PPPs.
(b) WDI for School enrollment (2018); Life expectancy (2019).

Bulgaria has embarked on a stronger-than -expected recovery, with growth projected at 3.7 percent in 2021. Yet, despite robust budget revenues, fiscal consolidation is likely to be postponed to 2022 due to continuation of support measures. Going forward, an ongoing political crisis suggests reform slack and slim chances of tapping EU Resilience and Recovery Facility before 2022. Also, slow inoculation rates imply that pandemic-related risks will remain high. In line with labor market improvements, poverty is expected to fall in 2021-2022.

Key conditions and challenges

Bulgaria remains the poorest and the most unequal country in the EU. Yet, as a result of the relatively milder impact of the pandemic on its economy in 2020, real incomes continued to converge to the EU average, reaching 55 percent of the average GDP per capita in PPP terms. Nevertheless, poverty kept edging up, reaching 23.8 percent in 2019 using the at-risk-of-poverty concept, with the trend expected to persist in 2020 due to the impact of COVID-19. This, together with Bulgaria historically registering the highest rates of inequality in the EU (40 percent) point to limited redistribution and ineffective social policies. Amidst rapid aging and population decline, convergence to the EU core can speed up only if the productivity gap shrinks markedly, while governance and institutional weaknesses are addressed decisively. Since late 2020, however, the country has been in a political crisis and has been unable to form a regular government despite two rounds of early elections. Although the caretaker government has taken steps to combat corruption and address some long-standing governance issues, deeper structural reforms will require a regular government with a parliamentary majority.

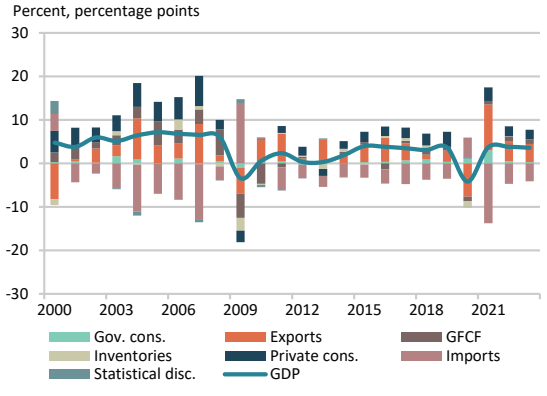
The pandemic has aggravated weaknesses in a number of public domains - with the most pronounced being in health care and education - and resulted in a moderate deterioration in the fiscal stance. Going forward, the authorities would need to engage in fiscal consolidation, including the challenging withdrawal of support measures, as soon as the recovery gains momentum. The planned conversion of some temporary social measures, such as pension supplements, into permanent support indicates the difficulty in unwinding anti-crisis measures. Over the longer run, the country's key development challenges remain its weak productivity, wide inequalities of income and opportunities, state capture by private interests, and a costly transition out of carbon dependency.

Recent developments

Following a contraction of 4.2 percent in 2020, economic recovery gained momentum in Q2/2021 with GDP growth going into positive territory at 9.6% yoy. The key growth drivers included a 20.3 percent rise in exports and a notable increase in domestic demand and investment growth. As imports have been recovering at a faster pace than export, the CA balance moved in the red in H1 and is likely to stay there in the medium run, shrinking to -3.4 percent of GDP in 2023.

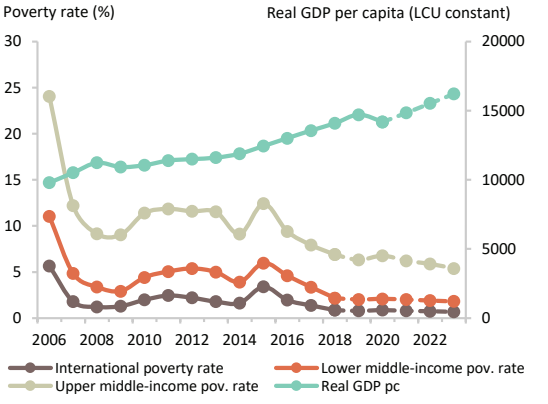
Inflation edged up to 3.0 percent yoy in July, due primarily to the fuel price spike. Yet, household incomes have been growing faster in H1 – by 7.7 percent yoy, due mostly to a significant increase in pension income. This suggests a real increase of incomes this year, which will become more pronounced going forward, because

FIGURE 1 Bulgaria / Contribution to GDP growth, percentage points



Sources: World Bank, Bulgarian National Statistical Institute.

FIGURE 2 Bulgaria / Actual and projected poverty rates (left-hand scale), and GDP per capita in constant LCU (right-hand scale)



Source: World Bank. Notes: see Table 2.

of base effects. The labor market showed first signs of improvement only in Q2/2021 when unemployment declined to 5.6 percent. The banking sector remains stable with non-performing loans at 6.7 percent as of end-June 2021 against 8.1 percent a year ago.

The fiscal stance loosened notably in 2020 due to the economic downturn and the government's support measures. The deficit reached 3 percent of GDP in 2020 and is projected to widen further in 2021.

Poverty is anticipated to decline from 6.8 percent in 2020 to 6.2 percent in 2021 using the upper middle income US$5.50 PPP poverty line. The decline is largely attributable to improvement in household finances stemming from a rebound in the labor market, as evidenced by fewer reports of work stoppages, reduced hours and income, as well as continued government support in the form of wage subsidies and pension supplements. Despite improvements, poorer households continue to report higher levels of economic distress as the longevity of the crisis strains already limited economic resources.

Outlook

Economic growth is expected to rebound to 3.7 percent in 2021 but recovery to pre-crisis levels is likely to happen in 2022. In the short term, the biggest risk to the outlook is the slow pace of COVID vaccination – the slowest in the EU to date. With some 20 percent of the adult population vaccinated with at least one dose (and 18 percent fully vaccinated) as of mid-Aug compared with 75% with at least one dose in the EU, Bulgaria faces high risk of another peak of infections in early autumn, which may end up in new restrictions depending on the capacity of hospitals to handle the new wave.

Potential restrictions would also weigh heavily on an already stretched budget and may lead to further overshooting of the deficit above 4 percent of GDP. Even if budget revenues in 2021 are expected to exceed the plan due to improved economic growth forecasts for the year, some temporary anti-crisis policies are likely to be converted in permanent spending measures, putting off fiscal consolidation. Current government plans foresee that absorption of the Recovery and Resilience Facility (RRF) envelope for Bulgaria will start in 2021, boosting budget revenue by 1.3 percent of GDP. Yet, as the national RRF plan has not yet been approved, this scenario seems increasingly unlikely.

Another key risk in the short term is political instability. The country is heading towards another round of early elections in the autumn following snap elections in April and July 2021, which failed to produce a ruling majority.

Poverty is projected to decline further in 2022 to 5.9% as Bulgaria continues its economic recovery. However, this could be tempered by the slow pace of vaccination, restrained consumer spending in anticipation of worsening finances and the unwinding of government support.

TABLE 2 Bulgaria / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	3.1	3.7	-4.2	3.7	3.8	3.6
Private Consumption	4.4	5.5	0.2	4.7	3.4	3.2
Government Consumption	5.4	2.0	7.5	16.7	2.3	1.5
Gross Fixed Capital Investment	5.4	4.5	-5.1	4.3	6.3	5.5
Exports, Goods and Services	1.7	3.9	-11.3	16.8	6.4	5.8
Imports, Goods and Services	5.7	5.2	-6.6	20.5	6.0	5.1
Real GDP growth, at constant factor prices	3.5	3.3	-4.3	3.7	3.8	3.6
Agriculture	-2.0	4.1	-5.3	3.4	1.0	0.5
Industry	-1.1	-0.5	-4.6	4.5	4.0	3.9
Services	5.8	4.6	-4.1	3.4	3.9	3.7
Inflation (Consumer Price Index)	2.8	3.1	1.7	3.2	3.3	3.4
Current Account Balance (% of GDP)	0.9	1.8	-0.7	-3.9	-3.7	-3.4
Net Foreign Direct Investment (% of GDP)	-1.3	-1.9	-3.2	-1.7	-1.8	-1.9
Fiscal Balance (% of GDP)	0.1	-1.0	-3.0	-3.5	-2.9	-2.2
Debt (% of GDP)	22.3	20.2	25.0	28.2	29.6	30.0
Primary Balance (% of GDP)	0.8	-0.4	-2.5	-3.2	-2.6	-1.8
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.9	0.8	0.9	0.8	0.7	0.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	2.2	2.0	2.1	2.0	1.9	1.8
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	6.9	6.3	6.8	6.2	5.9	5.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2018-EU-SILC. Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021to 2023.
(b) Projection using neutral distribution (2018) with pass-through = 0.87 based on GDP per capita in constant LCU.

CROATIA

Table 1	2020
Population, million	4.0
GDP, current US$ billion	56.2
GDP per capita, current US$	14050.0
International poverty rate ($1.9)[a]	0.5
Lower middle-income poverty rate ($3.2)[a]	0.8
Upper middle-income poverty rate ($5.5)[a]	2.4
Gini index[a]	29.8
School enrollment, primary (% gross)[b]	94.6
Life expectancy at birth, years[b]	78.4
Total GHG Emissions (mtCO2e)	16.5

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2018), 2011 PPPs.
(b) WDI for School enrollment (2018); Life expectancy (2019).

In the first half of 2021, Croatia's economy continued to recover from the deepest recession in the country's history. Abundant EU funds and an improved global outlook are expected to provide a strong boost to growth over the medium term, with output expanding by 7.6 percent in 2021. However, risks related to the pandemic remain and public debt is projected to remain elevated. The poverty rate is estimated to fall to 2.2 percent in 2021 and continue its downward trend.

Key conditions and challenges

Croatia has been hit hard by the COVID-19 pandemic in 2020 and has also suffered from two earthquakes. However, stronger than expected recovery is under way, reflecting robust foreign demand for domestic goods and services, particularly hospitality services, dynamic private investment and increased consumption supported by a strong labor market. The country is likely to return to its pre-crisis level of output in 2022. Nevertheless, at 64.1 percent of the EU27 GDP per capita in 2020 (in PPP), Croatia remains one of the least developed countries in the EU. Raising Croatia's economic growth over the medium term will crucially depend on the government's willingness and capacity to undertake structural reforms to boost productivity including the business environment, public administration, education system and judiciary. Against this backdrop, the EU structural and investment funds as well as the new facilities represent a unique opportunity for the country to accelerate income convergence with the rest of the EU. In July this year, European Commission (EC) endorsed Croatia's Recovery and Resilience Plan (NRRP) worth around 12 percent of 2019 GDP. Disbursement of EU grants from this facility is linked to the implementation of important reforms aimed at addressing the country's long-standing structural issues.

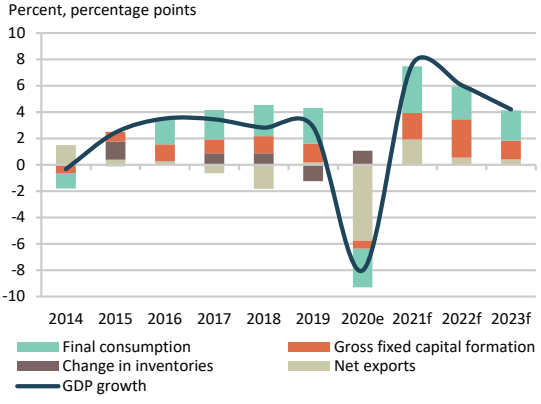
In addition, the economic outlook in the short run continues to depend on the course of the pandemic. While by the summer months the number of new cases had been strongly reduced partly due to social distancing restrictions, the reopening of the economy, inflow of foreign tourists and a still rather low share of fully vaccinated population could result in a surge in new infections by the yearend. This in turn could require further fiscal support, putting additional strain on public finances which are already stretched, if some social distancing measures were to be introduced.

Recent developments

Croatia's economy continued to recover in the first half of 2021, which together with a deep recession last year resulted in strong real annual GDP growth (7.5%) in this period. All components of aggregate demand positively contributed to recovery, reflecting less stringent social distancing restrictions, higher external demand, and improved labor market conditions. On the supply side, the services sector significantly strengthened albeit from a relatively low level, while manufacturing and construction, which already by the end of 2020 reached pre-crisis levels, continued to expand.

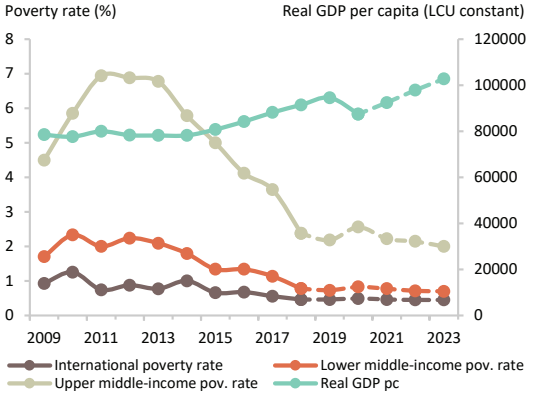
In line with improving economic conditions, employment increased compared to the first half of 2020, while the administrative unemployment rate declined to 7.5 percent in June 2021. At the same time,

FIGURE 1 Croatia / Contributions to annual GDP growth



Sources: CROSTAT, World Bank.

FIGURE 2 Croatia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

annual growth of nominal net wages accelerated, in part due to reduction of PIT from January 2021. However, rising inflation rate that has reached 2.8 percent in July 2021, has dampened the effects on real disposable income of households. The financial sector remains stable but risks to the real estate market need to be monitored.

The current account deficit remained broadly unchanged in the first quarter of 2021, compared to the same period last year (EUR 1.4bn).

On the fiscal front, in the first half of 2021, the budgetary central government deficit narrowed, following a strong increase in tax revenues, but remained elevated. Public debt at the end of May 2021 stood at 86.4 percent of GDP.

The recent Rapid Assessment Survey shows household income declines were less widespread than they were in the first wave of the pandemic as temporarily inactive workers returned to work and labor income partially recovered. As of June 2021, 19 percent of Croatian households reported a decline in income, marking a slight improvement from 2020. The share of the Croatian population living on less than $5.5 a day at 2011 revised PPP prices is estimated to have declined from 2.6 percent in 2020 to 2.2 percent in 2021.

Outlook

For the whole of 2021, Croatia is projected to achieve a robust economic rebound and real GDP is set to grow by 7.6 percent, after a fall of 8 percent in 2020. Under the assumption that a broadly favorable epidemiological situation continues in the future and social distancing measures remain relaxed, strong and broad-based growth is expected to continue over the 2022-2023 period with real GDP surpassing its pre-crisis level in 2022. Exports of goods and services are projected to provide the largest positive contribution to growth, following continued recovery of tourism and a favorable external outlook. Investments are also set to markedly increase which, however, depends upon the realization of an ambitious government investment program related to earthquake reconstruction and implementation of the NRRP. In such an environment, employment is projected to further increase while the unemployment rate is expected to fall below 6 percent. As a result, personal consumption will remain robust, increasing at an average rate of around 3.4 percent over the forecast horizon. Pick-up in inflation in 2021 is expected to be transitory as global supply bottlenecks and commodity price increases ease. The current account balance is projected to return to surplus (estimated at 2.4 percent of GDP in 2023), following improvements in the trade balance. The increase in tax revenues, following an increase in economic activity and discontinuation of the COVID-19 fiscal support measures, is projected to reduce the general deficit below 2 percent of GDP and bring public debt to below 77 percent of GDP by 2023.

Strong economic growth in 2021 is expected to reduce poverty to the pre-crisis level of 2.2 percent and decline further to 1.9 percent by 2023. However, the pandemic still disproportionately affects low-wage workers and women. Work stoppage compounded by a low rate of savings suggest a longer recovery process for these vulnerable population groups compared to others.

TABLE 2 Croatia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	2.8	2.9	-8.0	7.6	6.0	4.2
Private Consumption	3.3	3.5	-6.2	5.0	3.5	3.3
Government Consumption	2.3	3.4	3.4	2.5	2.3	2.3
Gross Fixed Capital Investment	6.5	7.1	-2.9	9.1	13.0	6.0
Exports, Goods and Services	3.7	6.8	-25.0	28.6	12.1	6.4
Imports, Goods and Services	7.5	6.3	-13.8	20.4	10.0	5.2
Real GDP growth, at constant factor prices	2.6	2.5	-6.3	7.6	6.0	4.2
Agriculture	6.2	1.2	3.7	4.5	3.5	3.5
Industry	1.4	2.3	-1.3	6.8	5.1	2.9
Services	2.8	2.7	-8.6	8.0	6.5	4.7
Inflation (Consumer Price Index)	1.5	0.8	0.2	2.3	1.5	1.7
Current Account Balance (% of GDP)	1.8	3.0	-0.4	1.6	2.0	2.4
Net Foreign Direct Investment (% of GDP)	1.6	6.3	1.6	1.6	1.6	1.6
Fiscal Balance (% of GDP)	0.2	0.3	-7.4	-3.4	-2.0	-1.6
Debt (% of GDP)	74.3	72.8	88.7	83.6	79.5	76.6
Primary Balance (% of GDP)	2.5	2.5	-5.4	-1.7	-0.5	-0.3
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.5	0.5	0.5	0.5	0.4	0.4
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.8	0.7	0.8	0.7	0.7	0.7
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	2.4	2.2	2.6	2.2	2.0	1.9
GHG emissions growth (mtCO2e)	-4.4	-0.8	-8.6	7.3	5.8	4.3
Energy related GHG emissions (% of total)	87.2	86.9	86.1	87.0	87.1	87.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2018-EU-SILC. Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021to 2023.

(b) Projection using neutral distribution (2018) with pass-through = 0.87 based on GDP per capita in constant LCU.

GEORGIA

Table 1	2020
Population, million	3.7
GDP, current US$ billion	15.9
GDP per capita, current US$	4297.3
International poverty rate ($1.9)[a]	4.2
Lower middle-income poverty rate ($3.2)[a]	17.0
Upper middle-income poverty rate ($5.5)[a]	46.6
Gini index[a]	34.5
School enrollment, primary (% gross)[b]	99.3
Life expectancy at birth, years[b]	73.8
Total GHG Emissions (mtCO2e)	15.9

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2020), 2011 PPPs.
(b) Most recent WDI value (2019).

The COVID-19 pandemic hit Georgia hard in 2020. While a robust recovery is underway, rising inflation and the persistence of the pandemic could exacerbate weak labor market outcomes. Supported by adequate macroeconomic policies and recovery among major trading partners, continued economic expansion should return poverty rates to pre-crisis levels by 2022. Key downside risks include slow progress on vaccinations, potential reintroduction of pandemic-related mobility restriction and renewed political tensions.

Key conditions and challenges

Georgia's economy expanded rapidly during the pre-COVID period, growing at a robust annual average rate of 5 percent from 2005 to 2019. Rapid growth contributed to halving of the national poverty rate between 2007 and 2019. Responsible macro policies, intensifying global integration, sound public investments, an attractive business environment, improving governance, and rising public spending underpinned the progress.

However, years of sustained growth had only a limited impact on quality job creation, and many Georgians continue to rely on low-productivity employment, especially in agriculture and the informal sector. Export volumes have increased, but exports remain unsophisticated, and firms face low growth and survival rates. These outcomes indicate an incomplete structural transformation and an economic divide between regions. Education outcomes remain poor, and workers are generally not equipped with the skills demanded by employers. Domestic political tensions are also a concern for the private sector.

The COVID-19 pandemic reversed some of Georgia's gains. After the country achieved early success in containing the spread of the disease, infections surged in late 2020, and by the summer of 2021 Georgia had one of the world's highest infection rates per capita. Economic output fell, contracting by 6.2 percent in 2020 as mobility restrictions were implemented and tourist arrivals collapsed.

This meant that, despite a robust fiscal response estimated at 7.5 percent of GDP, close to the ECA regional average, the poverty rate at the international upper-middle-income poverty line (US$5.50 per capita per day, 2011 PPP) increased from 42 percent in 2019 to an estimated 46.6 percent in 2020.

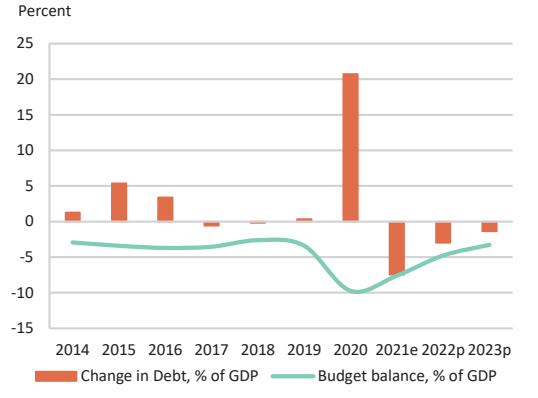
Recent developments

The Georgian economy grew faster than expected in H1 2021, with output expanding by 12.7 percent year-on-year (y/y) as pandemic-related restrictions were gradually eased. Economic acceleration—evident from rising mobility, trade volumes, tax collection, credit growth, and tourism revenues—returned GDP to pre-COVID levels. However, the labor market has been slow to recover. The unemployment rate remained high at 22.0 percent in H1 2021 as compared to 18.3 percent in H1 2020 and 17.3 percent in 2019.

Repeated waves of new COVID-19 infections threaten Georgia's recovery. The number of reported cases per capita was once again among the highest in the world with recovered cases reaching 15.5 percent of the population. Vaccination coverage rose but only 26 percent of the adult population was fully vaccinated as of mid-September.

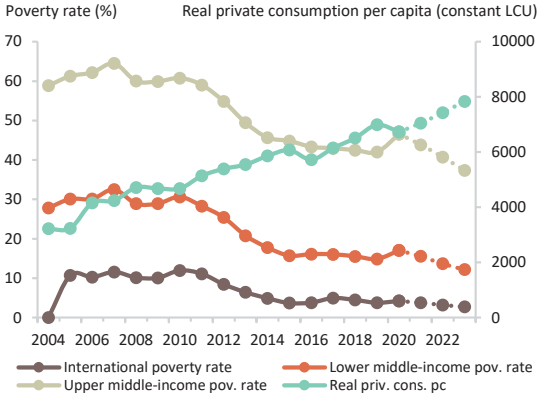
Driven by rising global food and oil prices and pass-through from the earlier depreciation of the lari, the inflation rate spiked

FIGURE 1 Georgia / Budget balance and change in debt



Sources: Ministry of Finance of Georgia and staff calculations.

FIGURE 2 Georgia / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see Table 2.

to 12.8 percent y/y in August, its highest level in over ten years. In response, the central bank increased its policy rate by a cumulative 200 basis points since March 2021 to 10 percent.

The current account deficit remained high at 11 percent of GDP in Q1 2021, as weak services exports, particularly from tourism, were only partially offset by strong remittances and an improved goods trade balance. FDI and portfolio investment covered 23 percent of the current account deficit, while public borrowing covered the rest and enabled accumulation of international reserves. The latter remained adequate at US$4.1 billion as of end-August 2021, covering over four months of goods and services imports.

The banking sector remained profitable, and the share of nonperforming loans (more than 90 days overdue) was low at 2.4 percent.

The fiscal deficit widened by 27 percent y/y in the first seven months of 2021, as rising public expenditures—including additional COVID-19 response measures—offset a 15 percent y/y increase in revenues. By end-July, the fiscal deficit had reached about 4 percent of annual GDP out of planned 7.6 percent, while public debt fell to 53 percent of GDP from 62 percent as of end-2020.

Outlook

Georgia's GDP growth rate for 2021 is now projected at 8 percent, up from 6 percent in April. In the baseline scenario, output surpasses its 2019 level in 2021. This estimate assumes that some COVID-19-related restrictions will remain in effect for the rest of the year.

Over the medium term, GDP growth is expected to return to its potential rate of about 5.0-5.5 percent as the fiscal stimulus winds down, monetary policy normalizes, and tourism recovers. The baseline projection assumes no major new COVID-19-related restrictions in a context of rising vaccination rates. As growth recovers, and real wages and transfers increase, the poverty rate is expected to decline and reach pre-crisis levels by 2022.

The fiscal deficit is expected to remain elevated at around 7.6 percent of GDP in 2021 before gradually declining as revenues recover and emergency spending subsides. The deficit is projected to narrow to about 3 percent of GDP by 2023 in line with the fiscal rule.

Inflation is forecast to remain above the central bank's 3 percent target in 2021 and 2022 but should converge with the target over the medium term by end-2023 as transitory pressures subside, and monetary policy actions anchor inflationary expectations.

As service exports recover and rebounding economic activity causes imports to rise, the current-account deficit is expected to narrow to 10 percent of GDP in 2021 and continue shrinking over the medium term. Recovering FDI and sustained support from international financial institutions are expected to cover Georgia's external financing needs and help maintain a comfortable reserve cushion.

Delayed vaccinations, new mobility restrictions, and prolonged political tensions are the key downside risks to Georgia's outlook. These risks could slow the recovery and inhibit progress on poverty reduction and job creation.

TABLE 2 **Georgia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	4.8	5.0	-6.2	8.0	5.5	5.0
Private Consumption	5.8	7.2	-4.0	4.5	5.0	5.2
Government Consumption	1.6	5.7	11.8	2.3	-2.4	-1.3
Gross Fixed Capital Investment	1.9	-0.1	-6.2	0.5	8.7	4.4
Exports, Goods and Services	10.1	9.8	-31.1	38.5	10.0	9.7
Imports, Goods and Services	10.3	6.6	-19.2	18.0	7.3	7.1
Real GDP growth, at constant factor prices	5.2	5.1	-5.9	7.6	5.6	5.0
Agriculture	13.8	-0.6	3.6	4.0	2.0	2.6
Industry	0.2	2.7	-2.8	12.0	6.0	4.0
Services	5.8	6.4	-7.7	6.8	5.9	5.6
Inflation (Consumer Price Index)	2.6	5.0	5.3	9.0	6.0	3.8
Current Account Balance (% of GDP)	-6.8	-5.5	-12.5	-10.2	-8.8	-8.7
Net Foreign Direct Investment (% of GDP)	5.3	5.9	4.3	3.3	6.0	5.5
Fiscal Balance (% of GDP)	-2.6	-3.4	-9.7	-7.6	-4.8	-3.3
Debt (% of GDP)	41.4	41.8	62.5	55.0	52.0	50.6
Primary Balance (% of GDP)	-1.4	-2.2	-8.2	-5.6	-3.3	-1.8
International poverty rate ($1.9 in 2011 PPP)[a,b]	4.5	3.8	4.2	3.8	3.2	2.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	15.5	14.9	17.0	15.5	13.7	12.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	42.5	42.0	46.6	43.8	40.7	37.4
GHG emissions growth (mtCO2e)	-1.7	-2.5	-3.4	7.4	3.3	2.6
Energy related GHG emissions (% of total)	52.4	50.8	50.6	51.7	52.5	52.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2020-Actual data: 2020. Nowcast: 2021 Forecast are from 2021to 2023.
(b) Projection using neutral distribution (2020) with pass-through = 0.87 based on private consumption per capita in constant LCU.

KAZAKHSTAN

Table 1	2020
Population, million	18.8
GDP, current US$ billion	171.2
GDP per capita, current US$	9106.4
Upper middle-income poverty rate ($5.5)[a]	4.6
Gini index[a]	27.8
School enrollment, primary (% gross)[b]	104.4
Life expectancy at birth, years[b]	73.2
Total GHG Emissions (mtCO2e)	272.1

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2018), 2011 PPPs.
(b) Most recent WDI value (2019).

GDP grew by 2.3 percent in 1H2021 supported by household consumption, reduced COVID-19 restrictions, and supportive fiscal measures. Higher food prices and release of pent-up demand raised inflation. The poverty rate is expected to fall in 2021 but remains above the pre-pandemic level. The economy is projected to recover further as restrictions ease and aggregate demand improves. The recovery pace remains vulnerable to the pandemic and external demand for hydrocarbons.

Key conditions and challenges

Since independence in 1991, Kazakhstan has experienced rapid growth, fueled by reforms and FDI into extractive industries, which reduced poverty and transformed the country into an upper middle-income economy. Real GDP per capita increased by more than 80 percent, as the country currently accounts for nearly two -thirds of Central Asia's GDP with a quarter of the population.

However, weak productivity growth is slowing down GDP growth and gains in living standards. Over-dependence on hydrocarbons and limited diversification pose significant development challenges.

Containing the pandemic, including by accelerating vaccination, is the key short-term priority. The second priority is improving competitiveness and attracting investment in the non-extractive sectors. The third priority is launching a transition to a low-carbon economy, supported by energy pricing, regulatory reforms, and public investments that facilitate the mitigation and adaption to climate change.

Recent developments

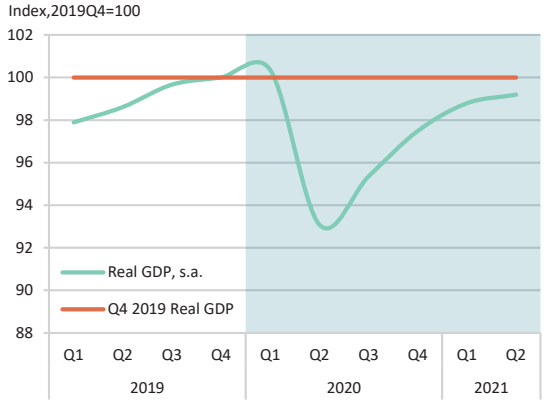
The economy is bouncing back from its pandemic-driven decline in 2020. GDP expanded by a 0.4 percent q-o-q (seasonally adjusted) in 2021 Q2, following a 1.3 percent growth in Q1. Real GDP in Q2 of 2021 was still 0.8 percent below the pre-crisis level.

Consumer demand supported by reduced COVID-19 restrictions and continued fiscal and credit support to households and enterprises have been the key drivers of GDP dynamics. Solid growth in retail trade by 7.6 percent suggests a strong rebound in household consumption in January–June. But investment has remained weak and contracted by 1.8 percent in 1H2021, mainly due to weak FDI inflow. Reopening the economy increases activity in service sectors while growth in housing and infrastructure projects is supporting construction and manufacturing.

A sizable outflow of profits from FDI-linked projects and a pickup in imports led to a 2.2 percent of GDP deficit of the current account in 1H2021. The National Bank of Kazakhstan (NBK) reserves in August reached $36.8 billion due to the $1.6 billion new SDR allocation. The tenge depreciated slightly through April but subsequently recovered some of its losses as oil prices rose.

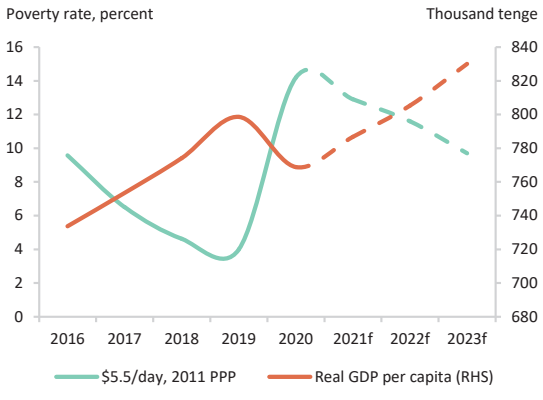
The fiscal policy remained supportive in 1H2021. In April, the government adopted a supplementary budget with an additional US$3.0 billion (1.7 percent of GDP) support package for COVID-19 measures and economic recovery. The authorities included an additional transfer from the Oil Fund in the package and financed the deficit by increased borrowing. As a result of higher spending, the deficit increased to 3.5 percent of GDP in 1H2021 compared with 2.8 percent in

FIGURE 1 Kazakhstan / Movement in real GDP



Sources: Statistical Office of Kazakhstan and World Bank staff estimates.

FIGURE 2 Kazakhstan / Poverty rates and real GDP per capita



Source: World Bank staff estimates.

1H2020. The government debt rose to 25.2 percent of GDP.

The yearly inflation rose to 8.7 percent in August 2021, up from a 7.5 percent in December. A surge in global food prices, logistical disruptions, and pent-up demand contributed to the rising prices across the board. The government set price caps on some staple food products and introduced export quotas on grain. The NBK tightened monetary policy and increased a policy rate by 0.25 p.p. to 9.5 percent in September.

The banking sector is weathering the COVID-19 crisis. In June 2021, banks recorded return to assets of 3.5 percent and maintained minimum capital adequacy requirements. The authorities continue the reform and revoked licenses of two small banks. Nevertheless, pre-existing vulnerabilities and risks coming from higher NPLs because of the COVID-19 crisis call for vigilance.

Employment level recovered, and real wages increased in Q2 2021. Although the rate of temporary leave among low-wage workers is still high compared to other income groups, it showed a declining trend. As a result, the poverty rate is expected to fall to 13 per-cent in 2021.

Outlook

Economic activity is projected to recover to its pre-pandemic level by end-2021, with growth of 3.2–3.7 percent in 2021 and 3.7 percent in 2022. Growth will be supported by the resumption of domestic activity, a supportive fiscal stance, and the rollout of vaccines. Improving growth prospects in foreign markets will buoy external demand for commodities.

Household consumption growth will continue, aided by an income rebound. Recovery in exports and improved prospects for FDI in the mining sector, which along with planned housing and infrastructure projects, is expected to restore investment growth.

Fiscal policy will remain supportive over the medium term. The budget will continue to prioritize spending on social assistance, education, human capital, infrastructure, and support to SMEs. Government debt is projected to increase further through 2023 as the authorities withdraw the fiscal support to the economy only gradually.

Inflation will remain above the target range of 4–6 percent in 2021 and is expected to decline gradually in following years, as the effect of the pandemic-linked temporary factors wanes. However, the rising cost of intermediate goods, real wage growth, and an expansionary fiscal stance with significant direct lending provisions can keep inflation high.

With only a third of the population fully vaccinated by end-August, the vaccine rollout remains a prime concern. Without higher coverage, COVID-19 will continue to threaten the recovery. Increasing prices and elevated levels of absence from work could delay the reduction in poverty. Volatile oil prices and uncertainty over the scale of global demand for hydrocarbons are other risks that could weaken export and pressure exchange rate. The recent increase in housing prices also makes homeownership less affordable and a steady rise in mortgage lending along with lifting of forbearance measures could expose the banking sector to higher NPLs in the event of future shocks. Moreover, with the heavily reliant on hydrocarbons, the country faces challenges arising from the emissions reduction and low-carbon transition.

TABLE 2 Kazakhstan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	4.1	4.5	-2.5	3.5	3.7	4.8
Private Consumption	6.1	6.1	-3.8	7.0	6.0	5.0
Government Consumption	-14.1	15.5	12.8	0.5	0.7	0.8
Gross Fixed Capital Investment	5.4	13.8	-0.3	0.0	3.6	3.7
Exports, Goods and Services	9.6	2.0	-12.1	-0.2	1.9	8.0
Imports, Goods and Services	6.6	14.9	-10.7	5.9	5.6	4.9
Real GDP growth, at constant factor prices	4.1	4.5	-2.5	3.6	3.8	5.0
Agriculture	3.8	-0.1	5.6	3.2	3.3	3.2
Industry	4.4	4.1	-0.4	3.3	3.6	6.5
Services	3.9	5.2	-4.5	3.8	4.0	4.2
Inflation (Consumer Price Index)	6.2	5.3	6.8	8.0	6.2	5.2
Current Account Balance (% of GDP)	-0.1	-4.0	-3.7	-2.7	-1.4	-0.4
Net Foreign Direct Investment (% of GDP)	2.7	3.1	3.4	3.4	3.3	3.3
Fiscal Balance (% of GDP)	-1.0	-1.3	-3.3	-3.0	-2.6	-2.3
Debt (% of GDP)	19.9	19.6	24.8	26.9	28.8	29.9
Primary Balance (% of GDP)	-0.1	-0.3	-2.2	-1.6	-1.3	-1.0
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	4.6	4.0	14.2	13.0	11.6	9.8
GHG emissions growth (mtCO2e)	-3.3	5.3	-4.7	5.4	1.1	2.8
Energy related GHG emissions (% of total)	79.8	81.3	81.4	80.5	80.4	79.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2018-HBS.Actual data: 2018. Nowcast: 2019. Simulated results for 2020. Forecast from 2021to 2023.

(b) Projection using neutral distribution (2018) with pass-through = 0.87 based on GDP per capita in constant LCU.

KOSOVO

Table 1	2020
Population, million	1.8
GDP, current US$ billion	7.7
GDP per capita, current US$	4277.8
Upper middle-income poverty rate ($5.5)[a]	24.4
Gini index[a]	29.0
Life expectancy at birth, years[b]	72.5

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2019).

Kosovo's economy is recovering rapidly, but risks to the outlook remain high as the country continues to grapple with the pandemic. Economic activity in 2021 is expected to expand by 7.1 percent against a rebound in diaspora visits, fiscal support measures, and higher consumer lending. Growth is projected to remain above 4 percent over the medium term. Maintaining the accelerated rate of vaccinations is a priority in the near term. In the medium term, Kosovo needs to transition to a more productivity-oriented growth model.

Key conditions and challenges

Kosovo grew at an average of 4.6 percent between 2014 and 2019. The economy contracted by 5.3 percent in 2020, but high informality likely conceals the full economic and social impact of the pandemic. Formal employment weathered the impact of the pandemic, but low labor force participation, especially for women, continues to be among Kosovo's key constraints. Poverty is expected to decrease in 2021 (about 2 percentage points) to 21 percent, reverting back to its 2019 level.[1]

Growth returned to positive territory during the fourth quarter of 2020 and gained momentum during the first half of 2021. Kosovo faced a new wave of infections in late August 2021. However, vaccinations picked up in April 2021, exceeding 1.2 million doses administered by September 2021.

Kosovo's growth model is largely consumption-based, with a significant reliance on diaspora financing. The trade deficit remains high, although merchandise exports started to pick up during the pandemic. Private investment added to growth in recent years, but was mostly concentrated in trade and construction industries, with limited productivity spillovers. Poor education and health outcomes limit the contribution of human capital to inclusive growth.

Given the rise of new virus variants and vaccination trends, both in Kosovo and globally, the pandemic risks remain elevated. Accelerated vaccination is the key priority in the near term. In the medium term, there is a pressing need to focus policies on tackling constraints to higher productivity growth and investing in human capital.

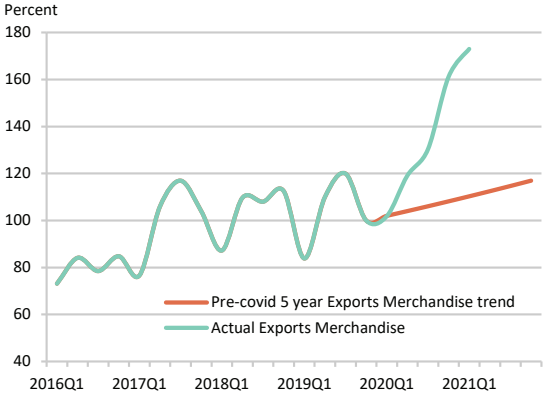
Recent developments

Growth gained momentum during the first quarter of 2021, reaching 5.6 percent. Economic activity is estimated to expand by 7.1 percent in 2021, with exports and private consumption expected to provide the highest contribution to growth.

Services exports exceeded 2019 levels by June 2021, and by year-end are estimated to exceed 2019 levels by 9.5 percent. The rebound in diaspora visits continues to fuel Kosovo's service exports and informal remittances. Merchandise exports have also been on the rise. Limited containment and fiscal support measures, and strong credit growth have bolstered private consumption.

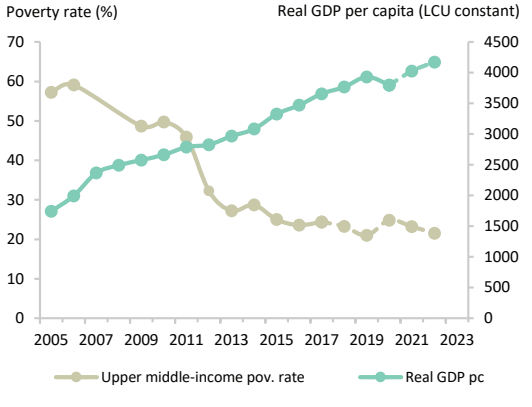
Although the information on the overall labor market is not complete due to a large share of informal jobs, there are significant gains in formal employment. The average number of active pension contributors increased by 13.6 percent during the second quarter of the year; representing about 40 thousand new formal jobs compared to the same period of both 2020 and 2019. During the second quarter of 2021, the number of registered jobseekers also dropped by more

FIGURE 1 Kosovo / Index of merchandise exports in USD, 2019Q4=100



Sources: Kosovo agency of statistics and World Bank staff calculations.

FIGURE 2 Kosovo / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

than 30 percent compared to the same period of 2020.

Consumer price inflation, driven primarily by higher import prices, is expected to reach an annual average of 3.5 percent in 2021. Import prices are expected to accelerate, with the most pronounced increase on commodity imports. Should food prices increase above overall consumer prices, their impact on the poor and vulnerable could be significant.

Growth in exports is expected to outpace the rebound in imports. however, as imports grow from a higher base current account deficit is projected to reach 8.5 percent of GDP in 2021, up from 7 percent in 2020.

Public revenues will increase by almost 24 percent y-o-y in 2021, thanks to an increase in firm turnover and the rebound in imports, but also higher inflation and tax debt collection. Public expenditure is expected to decrease by 3 percent compared to 2020, driven mainly by public investment underspending. As a result, the fiscal deficit by year-end will be below 1 percent of GDP. PPG debt is expected to increase from 22.2 percent of GDP in 2020 to 23.8 percent in 2021, mainly driven by higher domestic debt.

The financial sector is experiencing strong credit and deposit growth. Capital adequacy remained above regulatory requirements while non-performing loans hovered between 2.5 and 2.7 percent from January to July 2021.

Outlook

Growth is expected to ease in 2022, but will remain above 4 percent in the medium term, contingent on the global course of the pandemic and its successful management. Thus, poverty is also projected to decline. Exports are expected to increase at a slower pace. Investment is expected to pick up, driven by accelerated public investment, restored business confidence and a deceleration of inflation, hence providing a higher contribution to growth alongside consumption. However, investment is expected to continue being focused mainly on construction activities. The current account balance is projected to marginally deteriorate, driven by higher import demand.

Public expenditure growth is projected to accelerate in the medium term, leading to higher fiscal deficits, fueled by an acceleration in public investment spending, but also increased current expenditure driven by the implementation of the Economic Revival Plan. As a result, fiscal deficit levels are expected to increase from 2021 reaching an average of 2 percent of GDP for the medium term, with PPG debt as a share of GDP rising from 23.2 percent in 2021 to 27.8 percent by end-2023.

Given that projections hinge on the assumption of limited economic activity restrictions in the medium term, the pandemic risks to the outlook continue to remain high for Kosovo. Prevalence of international travel restrictions from diaspora hosting countries during 2022 could weigh on growth and the fiscal position. In the medium-term, credible fiscal reforms should be implemented through rationalizing current expenditures and tax exemptions to provide fiscal space for developmental needs and to avoid faster accumulation of debt.

1/ Poverty is measured as the percentage of the population living with under $5.5 per capita per day (2011 PPP USD).

TABLE 2 **Kosovo** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	3.4	4.8	-5.3	7.1	4.1	4.4
Private Consumption	4.4	5.6	2.5	6.6	2.3	2.4
Government Consumption	7.0	10.1	2.1	-3.2	6.6	5.5
Gross Fixed Capital Investment	5.4	2.9	-7.6	6.4	7.7	7.6
Exports, Goods and Services	9.1	7.6	-29.1	63.0	7.5	6.5
Imports, Goods and Services	10.9	4.5	-6.0	25.2	5.5	4.5
Inflation (Consumer Price Index)	1.0	2.7	0.2	3.5	1.8	1.6
Current Account Balance (% of GDP)	-7.6	-5.6	-7.0	-8.5	-9.6	-9.2
Net Foreign Direct Investment (% of GDP)	3.4	-2.7	-4.1	3.8	4.1	4.5
Fiscal Balance (% of GDP)	-2.9	-2.9	-7.6	-0.9	-2.0	-2.1
Debt (% of GDP)	16.4	17.0	22.0	22.7	25.9	27.6
Primary Balance (% of GDP)	-2.6	-2.6	-7.1	-0.4	-1.5	-1.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	23.2	20.9	23.4	20.9	18.9	17.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-HBS.Actual data: 2017. Nowcast: 2018-2020. Forecast are from 2021to 2023.
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU.

KYRGYZ REPUBLIC

Table 1	2020
Population, million	6.6
GDP, current US$ billion	7.7
GDP per capita, current US$	1166.7
International poverty rate ($ 19)[a]	0.6
Lower middle-income poverty rate ($3.2)[a]	9.7
Upper middle-income poverty rate ($5.5)[a]	52.6
Gini index[a]	29.7
School enrollment, primary (% gross)[b]	106.0
Life expectancy at birth, years[b]	71.6
Total GHG Emissions (mtCO2e)	15.4

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2019), 2011 PPPs.
(b) Most recent WDI value (2019).

Real GDP contracted by 0.7 percent in January–August 2021 due to a fall in gold production. 2021 GDP should expand by 2.3 percent, driven continued growth of the non-gold economy in the remainder of the year. Inflation has increased sharply and should remain elevated in 2021–22. Strong revenue performance led to fiscal surplus in January–July 2021, but the budget should fall back into a deficit by year-end.

Key conditions and challenges

The economy remains heavily dependent on gold production (about 10 percent of GDP and 40 percent of exports), remittances (25 percent of GDP), and foreign aid. Economic and structural reforms lost momentum, and businesses are facing significant uncertainty because of the continuing COVID-19 pandemic and political uncertainty triggered by the protests after the parliamentary elections in October 2020. The ongoing revision of legislation after the adoption of the new Constitution in April 2021 and afresh parliamentary elections in November 2021 are adding uncertainty. Security threats arising from potential border conflicts and a regional tension due to developments in Afghanistan are also causing concerns.

Strong and sustainable economic growth requires institutional strengthening and policies to develop the private sector, spur international trade, and encourage fiscally sustainable energy production. Constraints to private investment and growth include the large infrastructure gap, weak rule of law and governance, poor business environment, and onerous regulations. The energy sector's financial weaknesses—stemming from the below-cost recovery tariffs- and failure to meet WTO and Eurasian Economic Union standards and technical regulations further limit the growth potential.

Recent developments

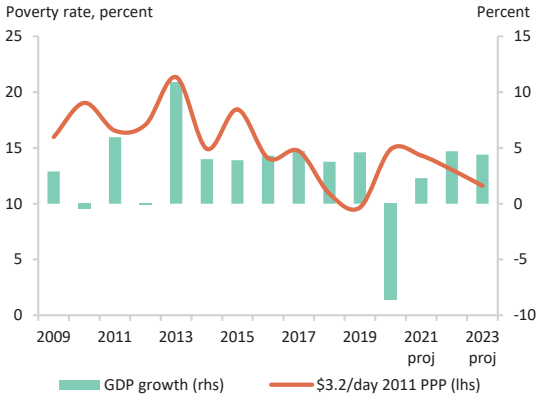
Real GDP contracted by 0.7 percent in January–August 2021, year-on-year, following a significant decline by 8.6 percent in 2020, as a result of a fall in gold production (-29 percent) while the non-gold economy is recovering (3.6 percent). The non-gold economy has been supported by increased remittance inflows and trade revival.

Twelve-month inflation rose to 14 percent in July, up from 9.7 percent in December 2020, driven by larger increases in prices for imported food and fuel, as well as a rising demand for goods and services owing to higher remittances. The trade deficit is estimated to have significantly widened to 41 percent of GDP in January–June 2021 from 18 percent a year ago. This reflects a decline in exports (9 percent in US dollars) mainly due to a fall in gold exports and strong growth in imports (41 percent in US dollars). Gross official reserves remained adequate at 6.2 months of imports at end-June.

In response to rising inflation, the central bank increased its policy rate three times by a cumulative increase of 250 basis points to 7.5 percent since the start of the year. Credit to the economy growth was strong (12.2 percent). The foreign exchange market has stabilized after central bank interventions in the first quarter.

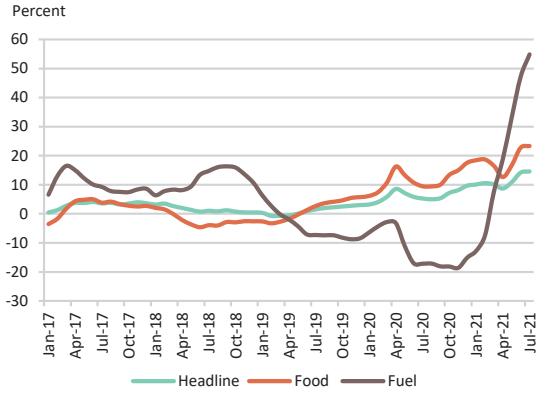
The budget surplus amounted to 1.4 percent of GDP in January–July 2021, owing to higher revenues and lower expenditures as a share of GDP. Revenues increased to 37.7 percent of GDP from 32.3 percent a year ago, thanks to tax and non-tax revenues.

FIGURE 1 **Kyrgyz Republic** / GDP growth and poverty rate



Sources: Kyrgyz authorities and World Bank staff estimates.

FIGURE 2 **Kyrgyz Republic** / Headline, food and fuel inflation



Source: Kyrgyz authorities.

Improved tax performance reflects increased tax revenues from imported goods—VAT on imports, customs duties and excises on imports—as well as taxes from mining companies owing to higher gold prices. Non-tax revenues increased thanks to the central bank profit transfers and a higher amount of receipts from public paid services. Expenditures declined to 36.3 percent of GDP from 38.8 percent a year ago, as wage bill, transfers and subsidies, and pensions fell as a share of GDP. Public debt declined to 66.4 percent of GDP from 68.1 percent at the end of December 2020.

The combined health and economic shocks of 2020 drove up poverty and diminished social welfare. A significant share of the population became poor or vulnerable due to lower incomes, higher food prices, or job losses. The poverty rate is estimated to have increased to 14.3 percent in 2020 from 9.7 percent in 2019 (US$3.2 a day, 2011 PPP).

Outlook

The economy is expected to grow by 2.3 percent in 2021, assuming a continued expansion in the non-gold economy in the remainder of the year. Growth is forecast to increase to 4.7 percent in 2022 and slow to 4.4 in 2023, reflecting gold production growth while non-gold economy stabilizes at its potential level. This scenario assumes a reduction of new COVID-19 cases as vaccines are deployed and political stability is maintained.

Inflation is projected to rise to 10.6 percent in December 2021 from 9.7 percent a year ago, driven by food and fuel prices. It is projected to moderate to the central bank's target range of 5–7 percent by 2023.

The current account deficit is projected at 6.1 percent in 2021, reflecting a recovery of imports and a decline in gold exports. As the latter picks up, the deficit is expected to narrow slightly in 2022–23.

While the budget ran a surplus in January–July, a deficit of 1.8 percent of GDP is projected in 2021 as a whole, reflecting planned increases in social assistance and pensions in October 2021. The deficit is expected to widen to 3.1 percent of GDP in 2022 because of the full year affect of these increases. Assuming expansion of the tax base, rolling back pandemic-related expenditures, streamlining nonpriority purchases, and reducing the wage bill as a share of GDP, the deficit is expected to narrow to 2.7 percent of GDP in 2023.

The poverty rate should remain little changed in 2021–22 as households continue to face price increases, health issues, and other pandemic impacts. In spite of planned spending increases for the social sector, they remain insufficient to support poor and vulnerable groups.

TABLE 2 **Kyrgyz Republic** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	3.8	4.6	-8.6	2.3	4.7	4.3
Private Consumption	5.0	0.8	-11.4	4.4	5.0	3.5
Government Consumption	1.3	0.5	1.3	1.9	1.7	0.3
Gross Fixed Capital Investment	6.9	7.1	-23.3	11.2	9.3	11.9
Exports, Goods and Services	-2.7	16.2	-18.5	-5.8	7.1	8.0
Imports, Goods and Services	7.4	6.1	-24.0	11.1	9.5	9.3
Real GDP growth, at constant factor prices	3.1	3.6	-8.6	2.2	4.7	4.3
Agriculture	2.6	2.5	1.1	0.0	2.2	2.5
Industry	5.1	6.6	-7.5	-2.8	8.4	8.7
Services	2.8	3.2	-17.0	6.8	5.5	4.0
Inflation (Consumer Price Index)	1.5	1.1	6.3	12.0	7.3	5.3
Current Account Balance (% of GDP)	-12.1	-12.1	4.5	-6.1	-5.8	-5.6
Net Foreign Direct Investment (% of GDP)	0.5	3.8	-7.5	0.7	1.0	2.0
Fiscal Balance (% of GDP)	-1.6	-0.5	-4.2	-1.8	-3.1	-2.7
Debt (% of GDP)	54.7	51.6	68.1	66.2	64.8	63.2
Primary Balance (% of GDP)	-0.5	0.5	-3.0	-0.2	-1.4	-1.1
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.6	0.6	1.1	0.9	0.8	0.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	10.9	9.7	14.3	13.8	12.6	11.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	54.8	52.6	60.7	60.0	57.6	55.5
GHG emissions growth (mtCO2e)	14.5	8.8	-4.7	2.4	5.2	5.8
Energy related GHG emissions (% of total)	74.3	75.4	74.7	73.6	74.0	74.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2019-KIHS.Actual data: 2019. Nowcast: 2020. Forecast are from 2021to 2023.
(b) Projection using neutral distribution (2019) with pass-through = 0.87 based on GDP per capita in constant LCU.

MOLDOVA

Table 1	2020
Population, million	2.7
GDP, current US$ billion	11.9
GDP per capita, current US$	4407.4
International poverty rate ($ 19)[a]	0.0
Lower middle-income poverty rate ($ 3.2)[a]	0.9
Upper middle-income poverty rate ($ 5.5)[a]	12.8
Gini index[a]	25.7
School enrollment, primary (% gross)[b]	89.5
Life expectancy at birth, years[b]	71.9
Total GHG Emissions (mtCO2e)	12.8

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2018), 2011 PPPs.
(b) Most recent WDI value (2019).

Moldova is recovering swiftly, growth is expected to be above potential in the medium term. Short- and medium-term forecast is under the assumptions of the containment of the COVID-19 pandemic, implementation of a broad-based reforms program, and sustained fiscal support. In case of a resumption of the pandemic, the authorities should first and foremost focus on the health sector to manage the pandemic while striking a balance between long term reforms and mitigation measures.

Key conditions and challenges

Despite a solid economic performance in the past two decades, Moldova has fallen short of its aspiration to achieve faster convergence towards EU income levels. The economic model continues to be reliant on remittances-induced consumption, with an associated low productivity growth resulted from the persistence of deep structural and governance weaknesses, a significant state enterprises footprint, low competition, uneven playing field, and taxes distortions. The bank fraud of 2014 uncovered deep weaknesses in the financial sector. In addition, the economy is highly vulnerable to external shocks. While extreme weather events and the propagation of economic and financial crisis from the main trading partners have been a traditional risk for a small open economy like Moldova, the COVID-19 pandemic has recently raised concerns also about the health system.

Persistent inequality of opportunity continues to limit the ability of low-income households to access public services, reducing their resilience to shocks and cementing low intergenerational mobility. The contraction in 2020 resulted in an increase in poverty from 25.2% in 2019 to 26.8% in 2020 (based on the national poverty line), marking the second consecutive year in which poverty increased. Though poverty rates increased more in urban than in rural areas, rural areas remain much poorer with a poverty rate of 35.3% in 2020 (vs 14% in urban areas).

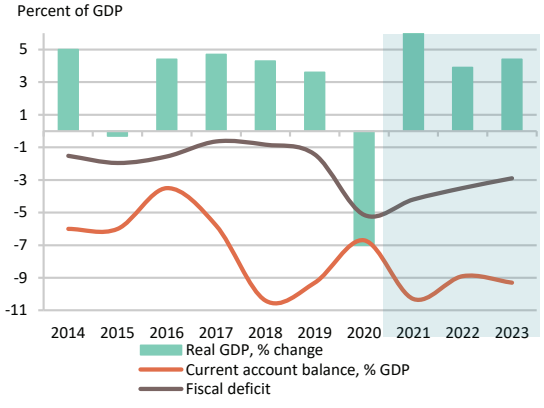
Against this background, the newly elected government is expected to implement an ambitious structural reforms program to improve competitiveness (justice reforms and strengthening the rule of law corruption together with actions towards rent seeking schemes, the regulatory environment, and the state footprint), while sustaining economic recovery with a stronger fiscal impulse. Striking the balance between cyclical and structural problems and ensuring fiscal sustainability will be an essential aspect be considered when designing short - and medium-term policy response.

Recent developments

The economic activity is expected to bounce back by 6.8 percent in 2021. A strong increase in wages, remittances and social transfers contributed to a robust increase in private consumption. Investments registered a 20 percentage increase on the back of favorable monetary conditions. Strong domestic demand and restocking after the lockdown led to significant drag on growth from net exports. All sectors of the economy signaled positive developments after a sharp contraction last year. However, agricultural sector was still is with a negative territory in the first half of the year due to heavy rains.

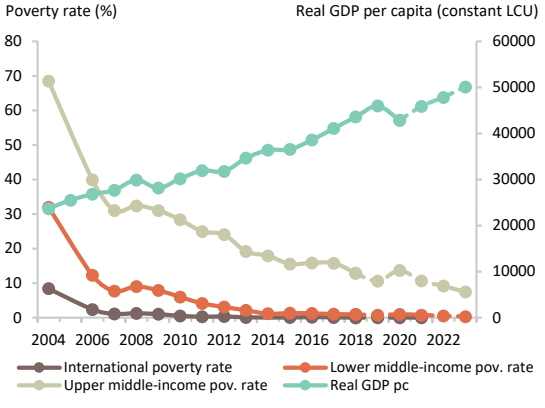
Higher prices on food products due to bad harvest, and increase in global energy prices, along with a strong domestic demand has increase inflationary pressure, forcing

FIGURE 1 Moldova / Projected macroeconomic indicators



Source: Author's calculations based on national statistics.

FIGURE 2 Moldova / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

the central bank to tighten the monetary stance by 100 basis points to 3.75 percent in July after almost 10 months of a record low rate. External position deteriorated as imports expanded quickly while exports remained latent despite terms of trade improvements. As a result, the current account deficit reached almost 13 percent of GDP as compared to 8.2 percent to the first quarter of 2020, financed primarily by cash and deposits in foreign currency. External debt moderated decreasing by 2.1 percentage points to 68 percent of GDP.

In the first seven months of 2021, health (+51 percent, y/y) and social protection (+14.5 percent, y/y) were the main drivers of spending increase (+ 16.4 percent, y/y). Spending on non-financial assets increased by 25 percent despite lower execution of capital investments. Revenue collection rebounded strongly (+20.5 percent, y/y) after the relaxation of restrictive measures. The fiscal deficit reached 2.8 percent of forecasted GDP and was mainly financed through domestic market. Public and publicly guaranteed debt increased by 8 percentage points of GDP to 35.2 percent of GDP.

In line with the economic rebound, Q2 of 2021 saw recovery in the labor market, with an increase in both employed population (1.9 percent in Q2 y/y) and in real wages (+11.8 percent), which aided household finances. Despite the general improvement in employment, certain vulnerable groups continued to experience the impacts of the crisis in the form of reduced work hours, involuntary part-time and remote work, and work stoppages, with disproportionate impacts on women. Recovery in the main trading partners led to strong remittance inflows which helped stabilize household consumption. However, rising food inflation is cause for concern among poorer households.

Outlook

Under the assumptions of a successful containment of the pandemic, a broad-based reforms program by the new government, and sustained fiscal impulse to the economy supported by development partners, growth is expected to continue in the medium term above potential. Consumer and investment confidence and all sectors are expected to register a strong growth, but their 2019 level will only be reached after 2022. Strong domestic demand and higher global energy prices are expected to propel current account deficit. Inflation is expected to fluctuate in the upper bound of the corridor in the second half of 2021, breach the corridor in 2022, and stabilize to 5 percent in 2023.

Fiscal deficit in the medium term is expected to remain higher than in pre-Covid -19 period with the 2022 Budget to reflect the promised increase in minimum pensions and new external resources from IMF, the EU and other development partners. As a result, public debt is expected to increase further, while remaining relatively low by international standards. Vulnerability from natural disasters is expected to remain high with the risk of derailing the fragile recovery and shifting government attention from long term reform to mitigation efforts.

In line with the recovery in the labor market and strong remittance receipts, poverty is expected to decrease from 13.7 percent in 2020 to 10.6 percent in 2021 as measured by the upper middle income US$5.50 PPP poverty line. Looking further forward, under the assumption of continued improvement in the labor market and strong remittance inflows, poverty is anticipated to continue to fall further to 9.2 percent in 2022. Downside risks to an inclusive recovery include the slow pace of vaccination, the possibility of the reintroduction of containment measures, the possibility of adverse climate events, and rising food inflation .

TABLE 2 **Moldova** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	4.3	3.7	-7.0	6.8	3.9	4.4
Private Consumption	4.5	3.2	-5.9	9.6	3.7	4.5
Government Consumption	-0.2	-0.5	-0.2	9.1	1.0	2.5
Gross Fixed Capital Investment	14.5	12.9	-1.7	13.7	7.3	8.9
Exports, Goods and Services	7.2	7.3	-15.5	6.3	7.6	7.5
Imports, Goods and Services	9.7	6.7	-8.9	16.1	6.3	7.6
Real GDP growth, at constant factor prices	4.4	4.0	-7.2	7.3	4.0	4.5
Agriculture	2.6	-2.3	-26.4	18.7	5.0	7.0
Industry	8.3	7.1	-4.3	5.6	4.8	5.4
Services	3.3	4.2	-4.1	6.0	3.4	3.6
Inflation (Consumer Price Index)	3.1	4.7	4.1	4.4	5.0	5.0
Current Account Balance (% of GDP)	-10.4	-9.4	-6.7	-10.3	-8.9	-9.3
Net Foreign Direct Investment (% of GDP)	2.4	4.5	1.3	3.4	3.6	3.4
Fiscal Balance (% of GDP)	-0.8	-1.4	-5.1	-4.2	-3.5	-2.9
Debt (% of GDP)	30.1	27.4	33.5	35.2	36.0	39.7
Primary Balance (% of GDP)	0.0	-0.7	-4.3	-3.4	-2.7	-2.2
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.0	0.0	0.0	0.0		
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.9	0.7	1.0	0.7	0.5	0.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	12.8	10.6	13.7	10.6	9.2	7.5
GHG emissions growth (mtCO2e)	3.7	3.6	-6.9	6.8	3.8	4.2
Energy related GHG emissions (% of total)	61.5	62.6	64.6	67.4	68.6	69.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2018-HBS.Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021to 2023.
(b) Projection using neutral distribution (2018) with pass-through = 0.87 based on GDP per capita in constant LCU.

MONTENEGRO

Table 1	2020
Population, million	0.6
GDP, current US$ billion	4.8
GDP per capita, current US$	8000.0
Upper middle-income poverty rate ($5.5)[a]	16.0
Gini index[a]	38.8
School enrollment, primary (% gross)[b]	100.6
Life expectancy at birth, years[b]	76.9
Total GHG Emissions (mtCO2e)	3.4

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2019).

After the deep 2020 recession, Montenegro's economy is recovering faster than anticipated with a projected double-digit growth rate in 2021. Vaccination, health protocols, and open borders have helped revive tourism. However, unemployment remains high as the recovery has not ignited the labor market yet, which limits the pace of resumed poverty reduction. The large Eurobond issuance in December 2020 has relieved financing pressures in 2021, along with a reduced fiscal deficit. Still, careful fiscal management remains critical as uncertainties loom.

Key conditions and challenges

Montenegro's small, open, and tourism-dependent economy was hit very hard by the pandemic and it suffered the largest contraction in Europe of -15.3 percent in 2020, reversing several years of poverty reduction. The crisis has revealed and further exacerbated Montenegro's structural weaknesses.

Over the five years prior to the crisis, growth averaged 4 percent, driven by large public investments and strong growth in consumption. Over two-thirds of Montenegro's jobs are in services, which account for over 70 percent of value added. The current account balance shows a large structural deficit and averaged 15 percent of GDP over 2015-19, largely financed by net FDI and external debt. Montenegro's net international investment position at negative 170 percent of GDP is amongst the largest in the world. Due to weaker adherence to fiscal plans and debt-financed highway construction, public debt has doubled since independence and peaked at 105 percent of GDP in 2020. Montenegro aspires to join the EU, but significant rule of law challenges have slowed progress towards this goal and reflect a key development constraint.

With progress in vaccination and the lifting of restrictions, GDP is estimated to bounce back by 10.8 percent in 2021. Growth is stronger than previously estimated due to a swifter tourism recovery—tourism revenues are projected to rebound to 75 percent of their 2019 levels. Tourism will continue to drive the recovery but ta gradual transition towards greener tourism will be critical for sustainable and inclusive development.

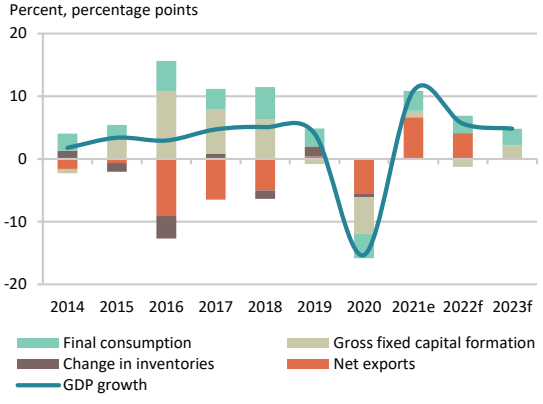
The political landscape is complex, reflected in high political polarization, which slows the reform process. The government has committed to accelerating reforms, strengthening the rule of law, and fighting corruption. These, coupled with strong fiscal and debt management and independent and accountable state institutions, would enable more inclusive, private sector-led growth and efficient service delivery to citizens.

Recent developments

The peak tourism season has been stronger than anticipated, with July tourist overnight stays reaching 90 percent of their 2019 level. Tourism has in turn supported retail trade, which, by June, strengthened by 6 percent, while electricity generation boosted industrial production by 10 percent.

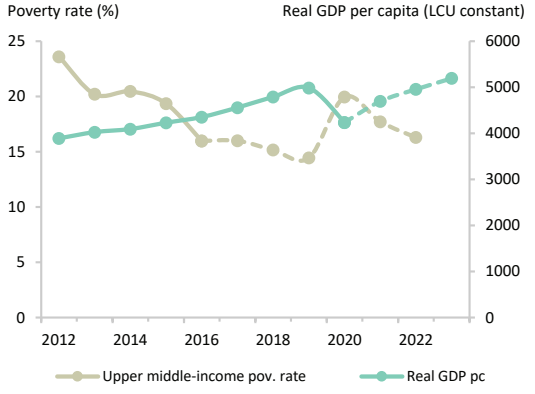
Nevertheless, administrative data show a persistent decline in employment that reached a record low in June. Registered unemployed rose from 41,890 in June 2020 to 55,703 in June 2021, with over 60 percent of newly registered being women. Poverty (income below $5.5/day in 2011PPP) is projected to decline slowly to 17.7 percent in 2021 but remain higher than its 2019 level.

FIGURE 1 Montenegro / Contributions to annual GDP growth



Sources: MONSTAT, World Bank.

FIGURE 2 Montenegro / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

Stronger demand and higher oil prices have pushed up inflation, which by August averaged 1.7 percent y-o-y.

The financial sector has remained resilient thus far, with both outstanding loans and deposits reaching record highs in July. The June average capital adequacy ratio was at 19.2 percent, while non-performing loans increased to 6.3 percent of total loans from 5.6 percent in June last year. However, the full impact of the pandemic will be clearer once the loan moratoria expire.

By June, growth of exports outpaced that of imports, as tourism strengthened, while investment stalled. Net income accounts further reduced the current account deficit, which was largely financed by reserves and net FDI, although the latter declined. In July, international reserves covered 7.7 months of merchandise imports.

Higher revenues and fiscal discipline have helped reduce the fiscal deficit which is projected to decline from 11 percent in 2020 to 4 percent in 2021. By July, central government revenues increased by 11 percent, supported by robust VAT collection, while expenditures declined by 4.5 percent, driven by under-execution of capital spending and lower spending on goods and services. After the Eurobond repayment in March, public debt is expected to decline to 90 percent of GDP in 2021.

Outlook

Assuming a full recovery in tourism in 2022 and 2023, growth is projected to remain strong at 5.6 and 4.8 percent, respectively. Investments are expected to level off in 2022 as the highway construction is finalized by end-2021. The government has announced stronger public capital spending starting in 2022, which would further boost medium-term growth. However, public investment management challenges should be addressed in order to ensure stronger economic effects. The projections do not assume that the remaining sections of the highway will start by 2023, as fiscal space is limited. The fiscal balance is expected to turn into surplus in 2023, on account of contained expenditures and stronger revenues due to the economic recovery. Running a sustained primary fiscal surplus in the medium term will be critical for debt reduction. Public debt is expected to decline to 77 percent of GDP in 2022 and further to 70 percent in 2023, as about €500 million of debt is due for repayment in 2022-2023.

Given the expected full recovery of tourism, the poverty outlook depends on how fast job creation will pick up, especially for low-skill workers. The poverty rate is projected to continue its decline in 2022.

The outlook is surrounded with multiple risks. A new wave of infections in Europe could slow down Montenegro's economic recovery. Moreover, inflationary pressures in the US and the EU may accelerate monetary tightening which could translate into more expensive external financing. Domestic risks stem from vaccination hesitancy, whilst possible new restriction measures could delay the recovery. Political polarization remains high. In contrast, acceleration of structural reforms and a firm commitment to careful fiscal and debt management would reduce investment uncertainty and improve the growth outlook.

TABLE 2 **Montenegro** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	5.1	4.1	-15.3	10.8	5.6	4.8
Private Consumption	4.6	3.1	-4.6	3.5	3.2	2.9
Government Consumption	6.3	1.0	0.8	-0.9	-0.6	0.5
Gross Fixed Capital Investment	14.7	-1.7	-12.0	2.2	-2.9	5.5
Exports, Goods and Services	6.9	5.4	-47.5	66.8	14.5	6.8
Imports, Goods and Services	9.2	2.4	-19.8	16.3	2.9	3.8
Real GDP growth, at constant factor prices	6.0	4.2	-14.4	10.8	5.6	4.8
Agriculture	3.3	-2.2	1.1	0.5	1.0	1.0
Industry	15.3	5.6	-12.0	8.0	3.0	5.0
Services	3.5	4.5	-16.9	13.3	7.1	5.2
Inflation (Consumer Price Index)	2.6	0.4	-0.3	1.9	1.6	1.2
Current Account Balance (% of GDP)	-17.0	-14.3	-26.1	-15.2	-11.2	-9.5
Net Foreign Direct Investment (% of GDP)	6.9	6.2	11.2	7.8	7.4	7.4
Fiscal Balance (% of GDP)	-4.6	-3.0	-11.0	-4.0	-0.9	1.1
Debt (% of GDP)	70.1	76.5	105.3	87.7	77.0	69.9
Primary Balance (% of GDP)	-2.4	-0.8	-8.3	-1.6	1.4	3.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	15.2	14.5	20.0	17.7	16.3	
GHG emissions growth (mtCO2e)	7.5	2.9	-12.8	8.6	0.7	0.7
Energy related GHG emissions (% of total)	68.8	70.6	70.1	75.8	77.5	78.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2012-SILC-C, 2015-SILC-C, and 2016-SILC-C Actual data: 2016. Nowcast: 2017-2020. Forecast are from 2021to 2023.
(b) Projection using point-to-point elasticity (2012-2015) with pass-through = 0.7 based on GDP per capita in constant LCU and simulations of Covid-19 impacts, with lower passt

NORTH MACEDONIA

Table 1	2020
Population, million	2.1
GDP, current US$ billion	12.3
GDP per capita, current US$	5857.1
Upper middle-income poverty rate ($5.5)[a]	17.9
Gini index[a]	33.0
School enrollment, primary (% gross)[b]	98.2
Life expectancy at birth, years[b]	75.8
Total GHG Emissions (mtCO2e)	9.6

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2018), 2011 PPPs.
(b) WDI for School enrollment (2018); Life expectancy (2019).

A robust recovery is underway despite a prolonged adverse pandemic impact. Continued government support measures helped mitigate the impact on households and firms but are further increasing public debt—now above 62 percent of GDP. As the recovery takes hold, carefully balancing the withdrawal of fiscal support to restore public finance sustainability with structural and institutional reforms is key. The central bank will also need to find the right balance between supporting domestic demand and responding to rising inflationary pressures.

Key conditions and challenges

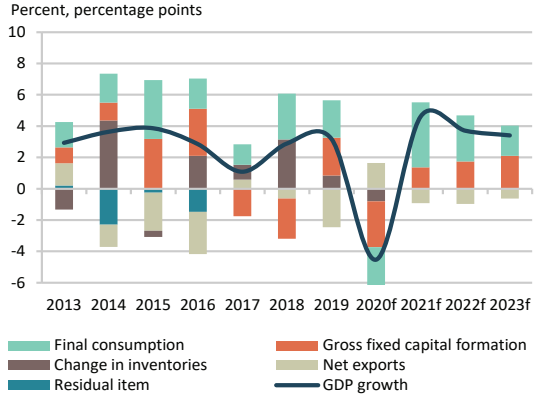
After a decade of a relative macroeconomic stability, accompanied by rising trade integration, especially in GVCs, an improved business environment and inflows of foreign direct investment, North Macedonia was hit hard by the COVID-19 pandemic. Output contracted by 4.5 percent in 2020, and the excess death rate remains one of the highest in Europe.

Poverty rate declined steadily from 35.8 percent in 2009 to a projected 16.9 percent in 2019, (based on the upper middle income class poverty line of $5.5/day in 2011 PPP). However, the COVID-19 crisis reversed recent progress in poverty reduction; it is estimated that poverty increased between 1 and 4 percentage points in 2020. Support measures introduced by the government (including subsidies and social security contributions to private firms and cash benefits and vouchers for vulnerable people) helped alleviate the impact of the pandemic on poverty. The economy resumed growth in 2021 helped by robust external demand and unlocked private consumption. Yet, while outlook for the near term remains positive, continued containment measures, a slow vaccine rollout, and unresolved structural bottlenecks pose challenges. Weak human capital development, and a low labor participation rate, have led to underutilized labor resources amidst demographic decline. Further, state involvement in the market through direct ownership, tax exemptions, and subsidies remains high. While this helps protect employment in the near term, it also derails fiscal sustainability. Countercyclical fiscal policies put in place to mitigate the impact of COVID-19, will need to be gradually withdrawn to address these sustainability concerns. Improving public investment management to help implement the government's Growth Acceleration Plan that eyes energy, environment, and transport investments, will be critical to avoid further fiscal sustainability concerns. Finally, further delays in the EU accession negotiations may lead to delays in efforts to improve governance, as well as anti-corruption reforms that are critical to unlocking the country's long-term growth potential.

Recent developments

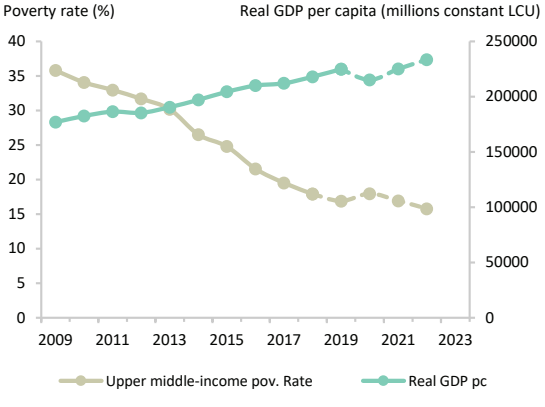
After declining in the first quarter by 1.9 percent, domestic output surged double-digit in Q2. As a result, growth in the first half of the year turned positive at 5.2 percent. Private consumption picked up, investment surged, while government consumption after dropping early in the year, resumed growth in Q2. Exports and imports increased as well, with the latter growing faster thereby worsening the trade balance. On the production side, growth was observed in nearly all sectors, given the low base effect, with the fastest recovery occurring in trade, transport and tourism, manufacturing, and ICT. Construction

FIGURE 1 North Macedonia / Contributions to annual GDP growth



Sources: North Macedonia State Statistics Office and World Bank staff calculations.

FIGURE 2 North Macedonia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Note: see Table 2.

surprisingly declined in Q2.

The activity rate slowly picked up from its low in summer 2020, driven by an increase in male participation. The unemployment rate decreased to 15.9 percent by 0.2 pp since Q4 2020, while the employment rate increased by 0.5 pp, with women contributing to the rise as they moved from unemployment to service sector jobs. In June 2021 the government tightened labor restrictions by adopting changes to trade and labor laws that increase the hourly pay for Sundays and holiday work and reduce the number of working Sundays in the trade sector. In addition to these regulatory changes, wage pressures continued to rise, with the largest increases being in sectors that were most affected by the pandemic-related restrictions, such as transportation, food and accommodation, and other services, and which observed a resumed labor flight abroad.

The inflation rate reached 3.6 percent in August 2021—the highest growth rate since July 2013. The increase was primarily driven by energy and food prices. Cumulatively, inflation grew by 2.7 percent by August 2021 broadly within the central bank targets. Credit growth remains solid, providing support to both households and firms. The non-performing loans ratio, currently at 3.4 percent, might see an upward correction, as loan moratoriums are being phased out. However, the capital adequacy ratio remained high at 16.8 percent, as is the banking sector liquidity ratio that stood at 23 percent in Q1, with minimal adjustments since the start of the pandemic. Fiscal deficit almost halved in the first half of the year but is set to rise by yearend. Revenue growth was robust on the back of VAT collections. Expenditures have increased at a slower pace given more targeted COVID-support, and despite an uplift in capital spending. Public and publicly guaranteed debt increased to 64.4 percent of GDP in H1 given the new Eurobond issuance amid a retained sovereign issuer default rating of BB- with a stable outlook.

Outlook

Economic growth is expected to rebound to 4.6 percent in 2021 returning to the pre-pandemic output level by year-end. The baseline scenario is built on the assumptions that the pace of immunization continues, there are no further lockdowns in 2021, consumer and investor confidence remain high, and external demand continues to be supportive. Growth is expected to continue in 2022 as the economy gradually starts to stabilize. Poverty is projected to resume its decline modestly as expected economic growth rebounds in 2021.

Fiscal deficit is expected to very gradually decline, following the latest plans of the government to ramp up capital spending. Over the medium term, public and publicly guaranteed debt will remain on the rising path reaching 65 percent of GDP by 2023. As the recovery takes hold, the authorities will need to boost tax compliance, restructure and reprioritize spending, address long-term bottlenecks and enhance efficiency of the management of public finances. To boost potential growth, the country needs to redirect its attention to structural and institutional reforms, that can unlock growth by addressing legacies in state-owned companies and network infrastructure, investing in the human capital of the population, strengthening the accountability and independence of public institutions, as well as commitment to the rule of law, and promoting private sector innovation and competitiveness. Efforts to boost potential output through structural reforms will need to take place in the context of region-wide efforts to accelerate the low-carbon transition and reduce greenhouse gas emissions.

TABLE 2 **North Macedonia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	2.9	3.2	-4.5	4.6	3.7	3.4
Private Consumption	3.7	3.4	-5.1	5.0	3.8	2.6
Government Consumption	1.5	-0.8	10.1	3.6	1.2	0.3
Gross Fixed Capital Investment	-8.9	9.5	-10.8	5.4	6.8	8.0
Exports, Goods and Services	12.8	7.2	-10.9	8.0	7.2	7.3
Imports, Goods and Services	10.2	8.3	-9.9	7.0	6.5	6.2
Real GDP growth, at constant factor prices	3.9	3.2	-3.7	4.6	3.7	3.4
Agriculture	8.6	0.6	1.7	2.7	2.5	2.0
Industry	0.2	4.6	-6.8	5.7	5.0	4.5
Services	4.9	2.9	-3.2	4.4	3.4	3.1
Inflation (Consumer Price Index)	1.4	0.8	1.2	2.4	2.0	1.8
Current Account Balance (% of GDP)	-0.1	-3.3	-3.5	-3.6	-3.0	-2.0
Net Foreign Direct Investment (% of GDP)	5.6	3.2	1.9	2.5	2.6	2.7
Fiscal Balance (% of GDP)	-1.1	-2.2	-8.3	-5.8	-4.9	-4.0
Debt (% of GDP)	48.4	49.4	60.2	62.7	64.7	65.5
Primary Balance (% of GDP)	0.1	-1.0	-7.0	-4.3	-3.5	-2.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	17.9	16.9	18.0	16.9	15.8	
GHG emissions growth (mtCO2e)	-4.6	-0.5	-8.4	5.0	0.5	-0.2
Energy related GHG emissions (% of total)	67.9	67.9	66.0	67.3	67.3	67.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2018-SILC-C. Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021.
(b) Projections based on sectoral GDP growth at constant LCU.

POLAND

Table 1	2020
Population, million	38.0
GDP, current US$ billion	596.0
GDP per capita, current US$	15684.2
International poverty rate ($ 19)[a]	0.4
Lower middle-income poverty rate ($3.2)[a]	0.5
Upper middle-income poverty rate ($5.5)[a]	1.2
Gini index[a]	30.3
School enrollment, primary (% gross)[b]	96.9
Life expectancy at birth, years[b]	77.9
Total GHG Emissions (mtCO2e)	315.8

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2018), 2011 PPPs.
(b) WDI for School enrollment (2018); Life expectancy (2019).

The Polish economy has recovered swiftly from the COVID-19 recession, with output recovering to pre-crisis levels by Q2 2021. The well-diversified economy and large economic and fiscal package facilitated the strong rebound and cushioned household impacts. With output expected to exceed potential GDP in 2021, a gradual withdrawal of the fiscal and monetary stimulus would help rebalance growth and rebuild fiscal space. A fourth COVID-19 wave is emerging, and a short-term challenge is sustaining the robust economic recovery.

Key conditions and challenges

The well-diversified Polish economy has proven to be one of the most resilient in the EU, with a 2.7 percent contraction in GDP in 2020, the first output contraction since 1991.

A sound macroeconomic framework, effective absorption of EU investment funds, a sound financial sector, and better access to long-term credit supported inclusive growth and poverty reduction. Real wage growth and a range of demographically targeted social programs ("Family 500+", "13th pension") fueled robust consumption growth until early 2020. With an improving business environment, Poland integrated well into regional value chains (RVCs). Higher private investment, an improved innovation ecosystem, and further upgrading of RVCs are needed to boost productivity and growth.

The unprecedented policy response to mitigate the impacts of the COVID crisis has narrowed available fiscal space and the key challenge is rebuilding this buffer once the recovery is on solid footing.

The full economic and social impact of COVID-19 remains uncertain as new variants emerge.

Spending efficiency is needed to rebuild fiscal buffers, accommodate higher spending on health, and the green transition, and to prepare for the growing fiscal burden arising from aging.

Over the medium term, a key challenge is a tightening labor supply made more acute by the aging population. Achieving decarbonization commitments is another challenge. Strengthening institutions is needed for sustained and inclusive growth and for narrowing regional disparities.

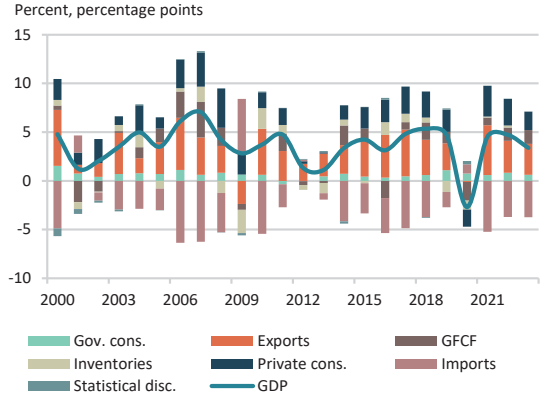
Recent developments

The economic recovery from the COVID-19 crisis was swifter than expected, with output expanding by 5 percent in the first half of 2021. The well diversified economy, exceptional fiscal stimulus and accommodative monetary policy helped contain the impact of the crisis.

Labor market, industrial production, and exports performed well, particularly following the relaxation of restrictions at the end of April 2021. GDP expanded by 2.1 percent in the second quarter, on a seasonally adjusted basis. Industrial output rebounded by nearly 16 percent year-on-year in the first half of the year, with manufacturing up by 18 percent. The transport sector expanded by 12 percent. Yet the recovery in sectors heavily affected by the pandemic (construction, accommodation and catering, and creative) is lagging.

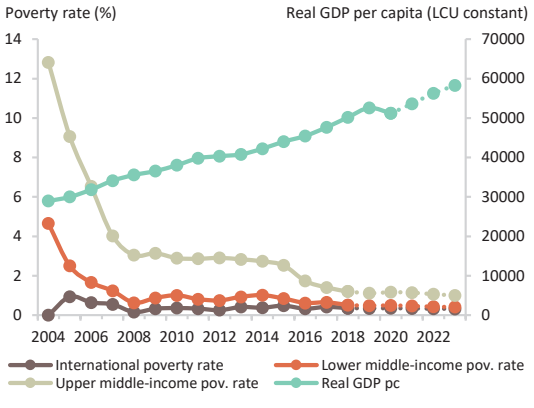
Pent-up demand, strong income growth in the context of the labor market recovery, and family support measures fueled a 6.3 percent growth in household consumption in the first semester, with a strong demand for durable goods. Investment recovery is lagging, however. Stronger export demand from EU supported the

FIGURE 1 Poland / Contributions to annual GDP growth



Sources: GUS and World Bank.

FIGURE 2 Poland / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

recovery in the industrial sector and exports. Exports rose 16 percent in the first half of 2021, year-on-year. Imports also rebounded strongly, however, translating into a negative contribution to growth of net exports.

Inflation has surged to 5.5 percent in August, a 20-year record, fueled by a spike in fuel prices, supply chain bottlenecks, pent-up demand and the large stimulus. Higher core inflation, strong domestic demand, and higher producer prices will put pressure on prices.

Household income and employment impacts of the pandemic were mitigated through multiple support measures and demographically targeted transfers. These measures included wage subsidies and support to domestic enterprises in the form of non-returnable transfers, loans, tax reliefs and deferrals. The unemployment rate was contained, and it retreated to 5.8 percent by July 2021, as the economy started to recover. Rapid assessments show that household income declines and work stoppages were more widespread and pronounced in the first pandemic wave but have moderated in subsequent waves. Work stoppages had a more pronounced impact on lower-wage workers and those with non-standard contracts, who were also less covered by protective policies. National extreme poverty increased and there was a notable rise in income inequality, reflecting the unequal labor market impacts.

The current account surplus narrowed to 1.9 percent of GDP in the first half of 2021, from 3.5 percent of GDP in 2020, as primary income outflows increased.

The fiscal stimulus and the recession caused the fiscal deficit to widen to 7 percent of GDP in 2020, from 0.7 percent in 2019.

Financial sector capital adequacy ratios remain adequate.

Outlook

Economic growth is expected to remain above potential in 2022, with output expanding by more than 4.5 percent and a widening of the output gap. A leveling of demand in the euro area will slow export growth, while improved confidence and investment execution, including through the National Recovery and Resilience Plan (NRRP), will support growth. Domestic demand will be supported by the proposed "Polish Deal", a new socio-economic program for 2021-30. The program calls for new PIT relief that will strengthen the progressivity of the PIT, increased spending on health care to 6 percent of GDP by 2023, as well as a large infrastructure and local public investment program, among others. The outlook incorporates the uncertainty arising from the new COVID-19 strains.

The crisis has put a financial strain on poor working households that are more vulnerable to reductions in hours worked and job loss. The share of the population at risk of poverty is expected to remain elevated through 2022.

Strong import demand, higher import prices, and higher primary income outflows are expected to reduce the current account surplus to below 2 percent of GDP in 2021.

To fund its NRRP Poland requested €23.9 billion in grants and €12.1 billion of preferential loans under the "Next Generation EU", which is yet to be approved. The NRRP would be implemented by 2023, with disbursements finalized by 2026.

The fiscal deficit is expected to narrow in 2021 by close to 2 percentage points, due to lower central government deficit. A gradual consolidation is expected over the 2022-2023 period, as economic growth accelerates, and the fiscal stimulus is withdrawn.

TABLE 2 **Poland** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	5.4	4.7	-2.7	4.5	4.7	3.4
Private Consumption	4.5	3.9	-3.1	5.5	4.7	3.3
Government Consumption	3.5	6.5	4.4	3.2	4.5	3.5
Gross Fixed Capital Investment	9.4	6.1	-9.6	4.2	7.3	7.4
Exports, Goods and Services	6.9	5.2	-0.2	9.4	5.7	5.5
Imports, Goods and Services	7.4	3.0	-1.9	10.3	6.9	6.8
Real GDP growth, at constant factor prices	5.3	4.6	-2.8	4.5	4.8	3.3
Agriculture	-9.1	-0.8	-3.0	4.0	1.0	1.0
Industry	7.0	2.1	-1.0	6.1	3.7	3.3
Services	5.0	6.1	-3.7	3.7	5.4	3.4
Inflation (Consumer Price Index)	1.6	2.3	3.4	4.2	3.6	3.1
Current Account Balance (% of GDP)	-1.3	0.5	3.5	2.1	1.6	0.9
Net Foreign Direct Investment (% of GDP)	-2.6	-1.6	-1.4	-1.2	-1.0	-1.0
Fiscal Balance (% of GDP)	-0.2	-0.7	-7.0	-5.1	-3.2	-3.0
Debt (% of GDP)	48.8	45.6	57.5	57.6	56.5	56.1
Primary Balance (% of GDP)	1.2	0.7	-5.7	-4.0	-2.0	-1.8
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.4	0.3	0.4	0.3	0.3	0.3
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.5	0.5	0.5	0.5	0.4	0.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	1.2	1.1	1.2	1.2	1.1	1.0
GHG emissions growth (mtCO2e)	-0.1	-3.5	-8.3	3.0	0.5	-0.4
Energy related GHG emissions (% of total)	87.5	87.2	86.9	87.4	87.6	87.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2007-EU-SILC and 2018-EU-SILC. Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021to 2023.
(b) Projection using point-to-point elasticity (2007-2018) with pass-through = 1based on GDP per capita in constant LCU.

ROMANIA

Table 1	2020
Population, million	19.2
GDP, current US$ billion	249.0
GDP per capita, current US$	12968.8
International poverty rate ($ 19)[a]	2.6
Lower middle-income poverty rate ($3.2)[a]	5.3
Upper middle-income poverty rate ($5.5)[a]	11.0
Gini index[a]	35.9
School enrollment, primary (% gross)[b]	87.3
Life expectancy at birth, years[b]	75.5
Total GHG Emissions (mtCO2e)	75.5

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2018), 2011 PPPs.
(b) WDI for School enrollment (2018); Life expectancy (2019).

Amidst relaxed containment measures and increased business and consumer confidence, economic recovery gathered momentum with real GDP growing by 6.5 percent in H1, 2021. The economy is projected to expand by 7.3 percent this year, amongst the highest in the EU, with output returning to pre-pandemic levels. However, the fiscal deficit will remain elevated in 2021, at around 7.4 percent of GDP. Poverty is expected to have declined to 11 percent in 2021.

Key conditions and challenges

Romania had a short-lived stint as a high-income country in 2020 (WB Atlas classification) following post-GFC growth averaging 5 percent per year. The pandemic-triggered crisis, however, pulled the country back into the upper-middle-income group. In the medium to long term, Romania needs to address its structural constraints, including persistent twin deficits, high inequalities, and weak growth fundamentals stemming from low productivity, labor quality issues, mainly due to shortcomings in the quality and inclusiveness of education and skills shortages, and labor quantity issues. Growth potential is further hindered by the shallow financial sector, limiting the availability of long-term finance.

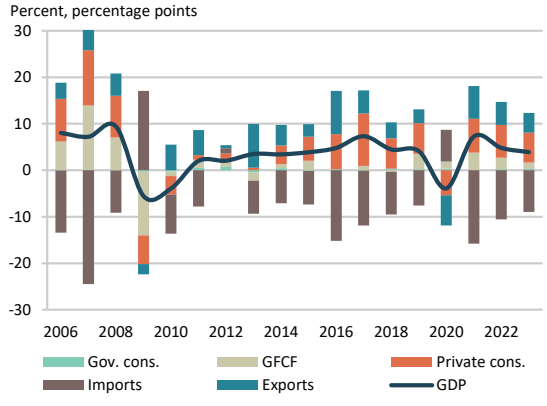
The Government provided one of the lowest fiscal stimuli in the EU to mitigate the impact of COVID-19, reflecting the limited fiscal space. In the first COVID wave, poor and vulnerable households were less supported by the fiscal response measures, which extended more directly to those in formal employment. Subsequent government programs for daily wage and seasonal workers extended protection to typically more vulnerable segments. As a result of these measures together with a robust economic rebound, the share of Romanian population living on less than $5.5 a day at 2011 revised PPP prices is estimated to have declined from 11.6 percent in 2020 to 11 percent in 2021.

The key challenge in the short term is to contain the COVID-19 crisis and limit its health, economic and social impacts. Romania is lagging in vaccination, with about 28 percent of the population having received at least one dose as of early September, which may jeopardize recovery. Increased inflationary pressures will trigger a more hawkish stance from the National Bank of Romania. Once recovery is firmly established, fiscal consolidation will be critical to avoid sharp increases in debt levels. Given Romania's limited fiscal space, maximal absorption of the EU Multiannual Financial Framework and Next Generation EU (NGEU) funds will be crucial for a sustainable recovery.

Recent developments

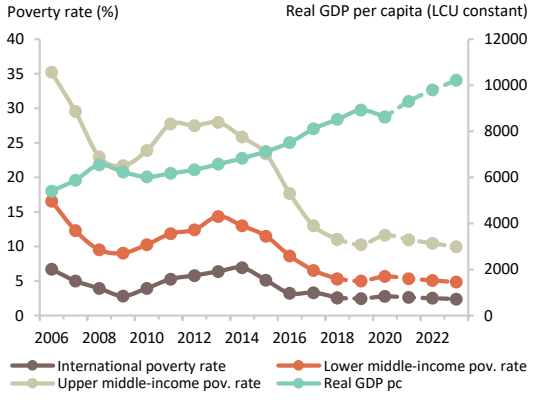
The Romanian economy grew by 6.5 percent in H1, 2021 on the back of better-than-expected Q2 performance at 13.0 percent yoy. Private consumption recovered strongly in H1, 2021 (up 5.2 percent yoy) led by robust demand for durable and household goods. Increased business and consumer confidence also supported higher investment (up 11.9 percent yoy). However, higher prices of raw materials could temper investment growth over the short to medium term. The trade deficit marginally decreased as both exports (up 16.8 percent yoy), and imports (up 20 percent yoy) recovered, benefiting from the gradual reopening of the EU economies and the low base effect. On the supply side, growth was led by industry (up 10.4 percent yoy), as

FIGURE 1 Romania / Real GDP growth and contributions to real GDP growth



Source: World Bank

FIGURE 2 Romania / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

new industrial orders recovered strongly, signaling continued output expansion. The ICT sector (up 14.1 percent yoy) benefited from increased remote work needs. Strong economic recovery and labor supply constraints reduced unemployment to 5.2 percent in June from as high as 5.9 percent in January 2021. Labor shortages coupled with higher inflation expectations led to wage increases, with nominal net wages up by 7.4 percent yoy in June 2021. The National Bank of Romania kept the policy interest rate unchanged at 1.25 percent in August, signaling a more hawkish stance. Further cuts are unlikely this year, given recent inflationary pressures as the annual inflation rate accelerated to 5 percent in July 2021.

Results from the recent round of the Rapid Household Assessment show a lessening impact of the crisis on Romanian households as temporarily inactive workers returned to work and household income partially recovered. Poverty is anticipated to have declined to 11 percent in 2021 yet remains above the pre-crisis level. In March, 14 percent of Romanian households reported a reduction in income compared to 31 percent during the first wave of the pandemic. The persistent impacts of the pandemic on household income, despite an overall recovery in employment, mean that some vulnerable population segments, in particular lower-earning workers and those on non-standard contracts, continued to bear the brunt of the crisis.

The fiscal deficit reduced to 3 percent of GDP in H1 of 2021, 1.3 percentage points lower than in the same period of last year. Tax facilities and exceptional expenditures allocated to combat the effects of the COVID-19 pandemic totaled 8.1 billion Ron (1.2 percent of GDP in H1 2021). Higher revenues (up 20.6 percent yoy) on the back of strong economic recovery offset the 9.8 percent yoy increase in expenditure, but fiscal pressures remain significant.

Outlook

The economy is projected to rebound at 7.3 percent in 2021 on the back of the recovery in domestic demand, and growth will settle around potential (4 percent) over the medium term. The strength of the recovery will depend on tackling the low vaccination rate, which reflects high vaccine hesitancy, the evolution of the Delta variant, and the policy response to the health crisis. Romania's capacity to absorb the EU funds will be critical to a sustainable recovery process. In a scenario of 100% absorption of the Resilience and Recovery funds, Romania's real GDP growth will, on average, rise by one percentage point per year between 2021 and 2026. Private and public investment will benefit from the phasing in of projects financed by EU funds. Exports are set to recover, aided by the gradual recovery of global trade. As growth recovers, inflationary and current account deficit pressures are expected to strengthen, requiring an appropriate policy response.

The fiscal deficit will remain high in 2021, at around 7.4 percent of GDP, but risks are tilted to the upside as the recent budget revision increased the planned expenditures by 1.6 percent of projected GDP while being overly optimistic as to revenue increases. Renewed attention should be given to fiscal consolidation to avoid an unsustainable increase in public debt over the medium term.

An economic rebound is expected to gradually reduce poverty. Poverty is projected to decline to 10 percent by 2023. However, the triple hit in income in 2020 – the persistent pandemic, a prolonged drought, and declining remittance incomes – could mean a longer recovery process for vulnerable population segments compared to others in the coming years.

TABLE 2 **Romania** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	4.5	4.1	-3.9	7.3	4.8	3.9
Private Consumption	6.5	6.4	-5.1	7.0	6.8	6.1
Government Consumption	6.8	5.0	6.5	1.1	4.2	5.1
Gross Fixed Capital Investment	-1.1	13.0	5.6	12.5	7.8	4.2
Exports, Goods and Services	5.3	4.6	-10.0	11.6	7.8	6.5
Imports, Goods and Services	8.6	6.8	-6.0	14.2	8.9	7.3
Real GDP growth, at constant factor prices	3.9	4.0	-3.3	7.3	4.8	3.9
Agriculture	9.4	-5.0	-16.2	3.2	4.2	2.9
Industry	4.3	-0.6	-9.3	9.7	4.3	4.1
Services	3.2	7.6	0.9	6.5	5.1	3.9
Inflation (Consumer Price Index)	4.6	3.8	2.6	4.5	3.7	3.2
Current Account Balance (% of GDP)	-5.3	-4.7	-5.0	-6.1	-6.2	-6.4
Net Foreign Direct Investment (% of GDP)	2.3	2.3	0.9	2.7	2.6	2.6
Fiscal Balance (% of GDP)	-2.9	-4.4	-9.2	-7.4	-6.2	-4.7
Debt (% of GDP)	34.7	35.2	47.3	51.2	54.7	57.6
Primary Balance (% of GDP)	-1.8	-3.2	-7.8	-5.9	-4.3	-2.9
International poverty rate ($1.9 in 2011 PPP)[a,b]	2.6	2.5	2.8	2.6	2.5	2.4
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	5.3	5.0	5.7	5.4	5.1	4.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	11.0	10.3	11.6	11.0	10.5	10.0
GHG emissions growth (mtCO2e)	0.5	2.2	-14.2	4.3	2.6	1.4
Energy related GHG emissions (% of total)	84.7	85.9	87.5	87.4	87.5	87.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2007-EU-SILC, 2017-EU-SILC, 2018-EU-SILC Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021to 2023.
(b) Projection is based on elasticities calibrated on 2007-2018 growth periods and rapid assessment data,
allowing for elasticities to vary between periods of contraction, recovery and expansion.

RUSSIAN FEDERATION

Table 1	2020
Population, million	144.1
GDP, current US$ billion	1486.9
GNI per capita, US$ (Atlas method)	10690.0
International poverty rate ($1.9)[a]	0.0
Lower middle-income poverty rate ($3.2)[a]	0.4
Upper middle-income poverty rate ($5.5)[a]	3.7
Gini index[b]	37.5
School enrollment, primary (% gross)[b]	104.7
Life expectancy at birth, years[c]	73.1

Sources: WDI, MPO, Rosstat.
(a) Most recent value (2018), 2011 PPPs.
(b) Most recent WDI value (2018).
(c) Most recent WDI value (2019).

Russia's economic recovery is set to exceed expectations this year. Rising commodity prices and buoyant external and domestic demand has boosted the projected GDP growth rate to 4.3 percent. However, persistent structural constraints are expected to slow growth in 2022 and 2023. Ably navigating the global low-carbon transition will be key to Russia's outlook in future years and will call for important public policy choices and economic diversification.

Key conditions and challenges

Significant macro-fiscal stabilization efforts undertaken by the government before the COVID-19 pandemic have underpinned Russia's ability to effectively respond to pandemic's adverse social and economic impacts. After providing substantial countercyclical fiscal stimulus and accommodative monetary policy to support the recovery, the authorities are now moving to phase out the stimulus and normalize Russia's policy frameworks. However, the negative effects of the pandemic on growth potential—including those stemming from learning losses, ongoing restrictions on certain service activities, and diminished migrant inflows—will require continued policy attention.

Russia's potential growth rate has been trending downward since the global financial crisis. Faster growth will hinge on the success of efforts to promote economic diversification, reduce the state's economic footprint, level the playing field for the private sector, and improve economic governance— especially as it pertains to state-owned enterprises. Moreover, the carbon intensity of domestic economic activity is about twice the world average, and Russia continues to rely heavily on earnings from fossil-fuel exports. In 2021, Russia announced its interest in stepping up international cooperation on climate change, and in June 2021 a new regulation on greenhouse gases was approved. However, a low-carbon transition will pose significant challenges for the Russian economy unless the government takes preemptive steps to facilitate people centered low-carbon growth.

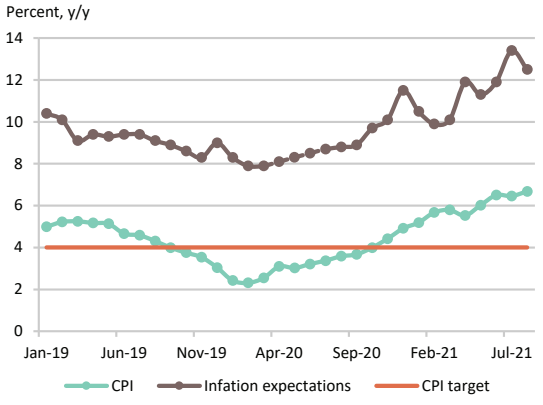
Recent developments

Russia's GDP grew strongly, by 10.5 percent year-on-year, in the second quarter of 2021, with GDP topping its pre-pandemic level. Relatively high commodity prices and external demand combined with a robust recovery in domestic demand as labor markets strengthened, credit growth was robust, and elements of social support were continued, built growth momentum this year.

Russia's third wave of COVID-19 infections peaked in mid-July, but the incidence of new cases remains elevated, and the number of new deaths related to COVID-19 is close to its peak. Vaccination rates are rising, but the share of the population that is fully vaccinated remains below both the world average and the levels of comparator countries.

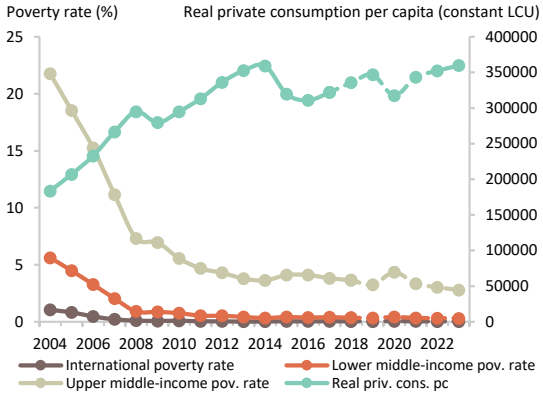
Crude oil extraction continues to be constrained by the OPEC+ production agreement and is not expected to return to pre-pandemic levels before May 2022. Government support programs have buoyed the construction industry, retail trade was supported by the economic recovery and new credit. High-frequency indicators for the third quarter show growth moderating as the output gap narrows. The Russian banking sector has successfully

FIGURE 1 Russian Federation / Consumer price index and inflation expectations



Sources: Rosstat and Bank of Russia.
Note: In April – July 2020, due to the self-isolation measures introduced by the government in connection with the spread of Covid-19 infection regular surveys of the population in the format of personal interviews were suspended.

FIGURE 2 Russian Federation / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see Table 2.

weathered the COVID-19 crisis. The banking sector's key credit-risk and performance indicators have remained largely stable since the beginning of the pandemic, with an overall capital-adequacy ratio of 12.4 percent (as of August 1, 2021).

In the first half of 2021, the general government registered a surplus of 2.4 percent of GDP compared to a deficit of 1.8 percent deficit in the first half of 2020. With the removal of emergency support measures primary expenditures dropped by 3.8 percentage points of GDP while economic rebound and higher commodities prices boosted receipts from oil/gas-sector taxes and VAT.

Rebounding domestic demand in a context of persistent supply bottlenecks and elevated global commodity prices pushed the annual inflation rate to a five-year high of 6.7 percent in August, and inflationary expectations are also elevated. These developments prompted the central bank to increase interest rate by a cumulative 250 basis points to 6.75 percent by September 2021.

The labor market has been steadily improving since August 2020, and the unemployment rate fell to 4.5 percent in July 2021, close to its pre-pandemic level. The official poverty rate reached 14.4 percent in the first quarter of 2021, as the impact of the pandemic endured while emergency safety-net measures were phased out. This rate is not strictly comparable to the previous series because of changes in methodology adopted by ROSSTAT in December 2020. In the second quarter, it fell to 13.1 percent, driven by improvements in the labor market and new support for low-income households with children.

Outlook

The GDP growth rate is expected to reach 4.3 in 2021 before declining to 2.8 percent in 2022. With the output gap closing in 2021, growth is expected to moderate toward its trend level and reach 1.8 percent in 2023. A continued global economic recovery, relatively high oil prices, and an improved COVID situation are expected to help consolidate the incipient recovery of domestic demand. A gradual easing of OPEC+ restrictions by end-September 2022 will boost the oil sector's output, while less-stringent COVID measures will benefit several services subsectors. Meanwhile, improved business confidence and high profits for resource-oriented companies will accelerate investment growth. Moderate pressure on bank capitalization is expected in the medium term, as the share of restructured loans is high at 13 percent of all loans. However, following the withdrawal of forbearance in July, asset-quality problems have now largely materialized and are adequately covered by reserves. Rising interest rates, recent changes to the subsidized mortgage-lending program, and new macro-prudential measures are expected to help slow the rapid growth of retail lending (22 percent, year-on-year), which has been driven by mortgages and unsecured loans.

The poverty rate at the upper-middle-income poverty line of US$5.5 per day is expected to decline in 2021 as the economy rebounds, but it is projected to remain above pre-pandemic levels until 2022.

Downside risks have intensified. With low vaccination rates, the evolution of the pandemic remains the primary source of immediate risk. New sanctions and an abrupt tightening of global financing conditions could also worsen Russia's outlook.

TABLE 2 **Russian Federation** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	2.8	2.0	-3.0	4.3	2.8	1.8
Private Consumption	4.3	3.2	-8.6	7.8	2.5	2.0
Government Consumption	1.3	2.4	4.0	-0.9	-1.0	1.0
Gross Fixed Capital Investment	0.6	1.5	-4.3	4.2	3.6	3.2
Exports, Goods and Services	5.0	1.4	-4.3	5.3	4.9	3.0
Imports, Goods and Services	2.7	3.4	-12.0	15.9	4.2	3.7
Real GDP growth, at constant factor prices	2.8	2.0	-2.7	4.3	2.8	1.8
Agriculture	1.7	3.5	0.2	1.1	1.8	1.8
Industry	2.9	1.5	-3.2	4.2	3.6	2.2
Services	2.8	2.2	-2.6	4.6	2.5	1.7
Inflation (Consumer Price Index)	2.9	4.5	3.4	6.2	4.8	4.0
Current Account Balance (% of GDP)	7.0	3.9	2.4	5.5	4.6	2.7
Net Foreign Direct Investment (% of GDP)	-1.4	0.6	-0.2	-1.1	-0.7	-0.5
Fiscal Balance (% of GDP)[a]	2.9	1.9	-4.0	-0.2	1.5	1.1
Debt (% of GDP)	14.6	14.7	20.4	21.1	21.2	21.4
Primary Balance (% of GDP)[a]	3.8	2.7	-3.2	0.6	2.4	2.0
International poverty rate ($1.9 in 2011 PPP)[b,c]	0.0	0.0	0.1	0.0	0.0	0.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[b,c]	0.4	0.3	0.4	0.3	0.3	0.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[b,c]	3.7	3.2	4.3	3.3	3.0	2.8
GHG emissions growth (mtCO2e)	5.4	2.4	-6.5	2.7	3.1	1.3
Energy related GHG emissions (% of total)	95.2	91.6	92.7	91.8	90.4	89.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

(a) Fiscal and Primary Balance refer to general government balances.

(b) Calculations based on ECAPOV harmonization, using 2018-HBS.Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021to 2023.

(c) Projection using neutral distribution (2018) with pass-through = 0.87 based on private consumption per capita in constant LCU.

SERBIA

Table 1	2020
Population, million	6.9
GDP, current US$ billion	53.0
GDP per capita, current US$	7681.2
Upper middle-income poverty rate ($5.5)[a]	19.8
Gini index[a]	37.2
School enrollment, primary (% gross)[b]	99.6
Life expectancy at birth, years[b]	75.7

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2019).

The Serbian economy is recovering well from the impact of COVID-19 pandemic that led to a mild recession of -1 percent in 2020 and poverty incidence remains close to its 2019 value at 17.1 percent. Growth will rebound in 2021 to an estimated 6 percent, and to stabilize around 4 percent over the medium term, but this is critically dependent on the recovery of the world economy, the ability to contain COVID-19 and the pace and depth of key structural reforms.

Key conditions and challenges

The focus of the Government of Serbia in 2020 was on supporting the economy to recover from the impact of the COVID-19 pandemic. The Serbian government approved a robust fiscal stimulus program – amounting to nearly 13 percent of GDP – at the outset of the pandemic. The program comprised direct budgetary measures (tax deferrals and higher spending) and guarantees, corresponding to 8 percent of GDP and 4.8 percent of GDP respectively. Thanks to the timely deployment of the program, the economy experienced only a mild recession (of -1 percent) in 2020. The impact of the program, however, came at considerable fiscal cost. The fiscal deficit reached 8.1 percent of GDP in 2020 and public debt increased to 58.2 percent of GDP.

The rate of economic growth averaged 1.9 percent annually in the decade prior to the pandemic and had started to increase just before the onset of COVID-19, with growth averaging 4.4 percent in 2018-19. Consumption was the main driver of growth while investment remained low, hovering around 19 percent of GDP during 2010-19.

Over the medium term the Serbian economy is expected to return to the pre-pandemic growth levels. However, Serbia still faces challenges that limit its potential growth both in the short and medium to long terms. Most importantly, Serbia needs to further remove bottlenecks for private sector investment. These include a deteriorating governance environment, lack of infrastructure and an unreformed education sector, which creates skills mismatches in the labor market. With limited space for future stimulus packages, structural reforms are needed to bring the economy back to sustained growth, boost jobs and incomes and strengthen resilience to shocks.

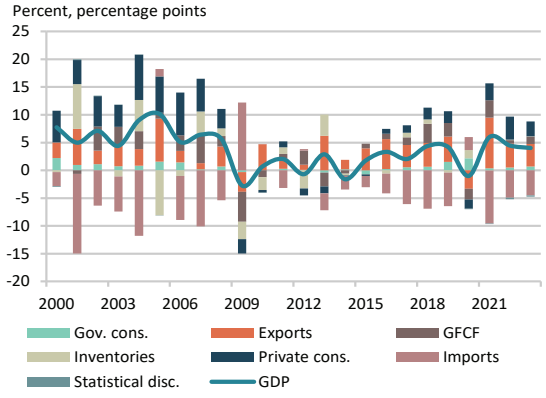
Recent developments

The Serbian economy started to show signs of recovery in the first half of 2021. After three consecutive quarters of decline (Q2-Q4 2020), the economy grew 1.8 percent y/y in Q1. Growth accelerated in Q2 and is estimated at 13.7 percent, well above expectations. As a result, projected growth for 2021 has been revised upwards from 5 to 6 percent.

The fast increase in exports underpinned the recovery in 2021: the contribution to growth of net exports was 5.2 percentage points in Q1. Exports increased across the board, with raw materials having the most significant impact; while consumption and investment contributed negatively to growth (-1.4 and -2.1 percentage points respectively) in Q1. During the second quarter, however, the drivers of growth changed with consumption having the main impact on GDP growth.

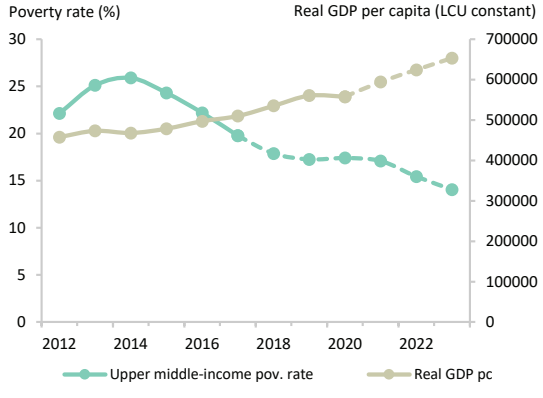
The wage subsidy and cash transfers to citizens in 2020 helped to avert a spike in poverty. Due to the support package,

FIGURE 1 **Serbia** / Real GDP growth and contributions to real GDP growth



Source: World Bank staff calculations

FIGURE 2 **Serbia** / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

limited labor market impacts, and growth in agriculture, poverty (defined as income under $5.5/day in revised 2011 PPP) is estimated to have only slightly increased from 17.3 percent in 2019 to 17.4 percent in 2020.

Despite an economic rebound, the labor market recovery has been sluggish. The Q1 and Q2 employment rates of 46.3 and 48.3 percent are down from 49.7 percent in Q4 2020 and lower than those in 2019, as measured by the Labor Force Survey. The unemployment rate increased from 9.9 percent in Q4 2020 to 12.8 and 11.1 percent in Q1 and Q2 2021. In the formal sector, average net salaries and wages increased by 6.2 percent in real terms in January - June 2021 compared to 2020.

The fiscal deficit increased significantly in 2020 to 8.1 percent of GDP. It is projected to decline to 6.9 percent of GDP in 2021, despite the continuation of an expansionary fiscal stance in 2021. Public debt is projected to increase to 60.3 percent by end-2021.

Inflation has been on the rise since April 2021 and reached a peak of 4.3 percent in August, with adverse effects on households' purchasing power. It is expected that by year-end inflation will stay at around 3 percent y/y. The dinar has remained broadly stable against the euro at around 117.6 RSD/EUR. The banking sector's performance remains robust even after the phasing out of two rounds of debt moratoria introduced in 2020 as part of the COVID-19 response measures. NPLs stood at 3.6 percent as of June 2021. The current account deficit decreased significantly – from 6.9 percent of GDP in 2019 to 4.3 percent in 2020, primarily due to improved primary income balance – and reached 0.9 percent of GDP in the first half of 2021 which is likely to result in the CAD falling to below the originally projected 5 percent of GDP.

Outlook

The economic recovery is expected to continue in the second half of the year, with growth expected to reach 6 percent for 2021. A package of measures to support citizens and the economy – worth around 4.5 percent of GDP – will support growth. Over the medium term, growth is expected to be around 4 percent, driven mainly by consumption while investment will recover only slowly, with possible adverse repercussions on employment and wages. This medium-term outlook crucially depends on the recovery of the world economy, the ability to contain COVID-19, the pace and depth of structural reforms and political developments.

Among immediate priorities for action, lowering the cost of doing business and improving the quality of infrastructure figure prominently. In the medium to long term, challenges include managing an ageing population and climate change. An aging and shrinking population will leave Serbia with a smaller labor force. Labor shortages, combined with skills mismatches, could significantly hurt the competitiveness of the Serbian economy. In addition, more frequent and severe droughts and floods can adversely impact agriculture and food production and will increase the cost of maintaining infrastructure.

The pace of labor market recovery will be critical for resumed poverty reduction. Poor and vulnerable households, who tend to depend more on self-employment and less secure jobs, may take longer to regain their income levels. Labor market challenges could also exacerbate the ongoing brain-drain. With the lag in labor market improvements in early 2021, poverty is projected to remain close to its 2019 level, at 17.1 percent.

TABLE 2 Serbia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	4.4	4.2	-1.0	6.0	4.5	4.0
Private Consumption	3.1	3.1	-2.5	4.6	6.3	4.0
Government Consumption	3.7	8.7	11.8	1.9	2.5	3.5
Gross Fixed Capital Investment	17.8	11.2	-8.2	14.5	2.6	5.8
Exports, Goods and Services	8.3	8.5	-5.9	17.1	7.4	6.7
Imports, Goods and Services	11.6	9.5	-3.5	14.7	7.0	6.2
Real GDP growth, at constant factor prices	4.5	4.2	-1.0	6.0	4.5	4.0
Agriculture	15.2	0.0	4.2	-0.5	1.0	1.0
Industry	2.8	0.2	0.0	5.2	4.4	4.5
Services	4.1	6.8	-2.1	7.2	4.9	4.2
Inflation (Consumer Price Index)	2.0	2.2	1.6	2.5	2.8	2.6
Current Account Balance (% of GDP)	-5.2	-6.9	-4.4	-5.0	-5.0	-4.9
Net Foreign Direct Investment (% of GDP)	3.8	6.3	4.8	4.9	5.5	5.2
Fiscal Balance (% of GDP)	0.6	-0.2	-8.1	-6.9	-3.0	-1.8
Debt (% of GDP)	55.6	52.9	58.2	60.3	58.9	56.1
Primary Balance (% of GDP)	2.7	1.4	-7.1	-5.7	-0.9	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	17.9	17.3	17.4	17.1	15.4	14.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2013-EU-SILC and 2017-EU-SILC Actual data: 2017. Nowcast: 2018-2020. Forecast are from 2021to 2023.
(b) Projection using point-to-point elasticity (2013-2017) with pass-through = 0.7 based on GDP per capita in constant LCU, and lower pass through in 2021reflecting the lag in labor market improvements.

TAJIKISTAN

Table 1	2020
Population, million	9.5
GDP, current US$ billion	8.2
GDP per capita, current US$	863.2
International poverty rate ($1.9)[a]	4.1
Lower middle-income poverty rate ($3.2)[a]	17.8
Upper middle-income poverty rate ($5.5)[a]	50.5
Gini index[a]	34.0
School enrollment, primary (% gross)[b]	100.9
Life expectancy at birth, years[b]	71.1
Total GHG Emissions (mtCO2e)	16.9

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2015), 2011 PPPs.
(b) WDI for School enrollment (2017); Life expectancy (2019).

Tajikistan's economy rebounded strongly from the 2020 pandemic, supported by solid exports of gold, strengthening remittances, and investment inflows. While the overall poverty rate has been falling, climbing inflation exacerbated food insecurity among the most vulnerable. Over the medium term, GDP growth at around 5 percent a year is expected to reduce the poverty rate further; however, downside risks prevail.

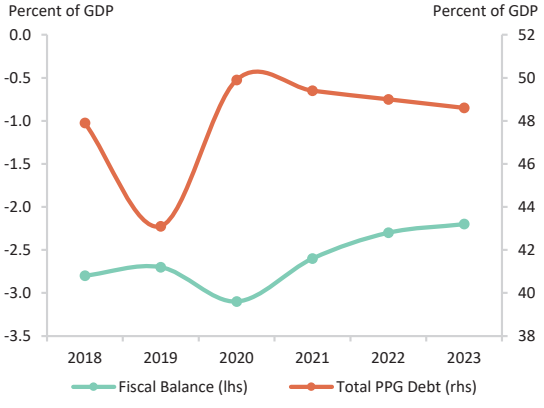
Key conditions and challenges

Tajikistan's robust economic growth in the past 10 years translated into significant poverty alleviation. The officially reported real GDP growth averaged 6.9 percent per year during 2011–20, benefiting from solid remittance inflows and externally financed public investments. During the pandemic, in 2020, the Tajik economy showed resilience by registering a growth rate of 4.5 percent. However, despite the strong economic performance, Tajikistan still struggles to eliminate food insecurity and overcome domestic structural bottlenecks to create jobs. This primarily concerns an environment unconducive to private investment, inefficient governance of the state-owned enterprises (SOE), imprudent management of public finances, and weak institutional capacity. Most SOEs are loss-making, and the government regularly bails them out by clearing their arrears to suppliers and creditors and writing off tax obligations. Unbalanced prioritization of budgetary spending, mainly due to the energy sector crowds out investments for human capital development and creates substantial pressure on the state budget by pushing the public debt level to the verge of sustainability. Generous tax exemptions on one side and onerous revenue mobilization efforts on the other side have washed away the level playing field for healthy competition for the private sector. Moreover, the business environment has been suffering from weak institutional capacity to protect property rights and enforce contracts and the rule of law.

Recent developments

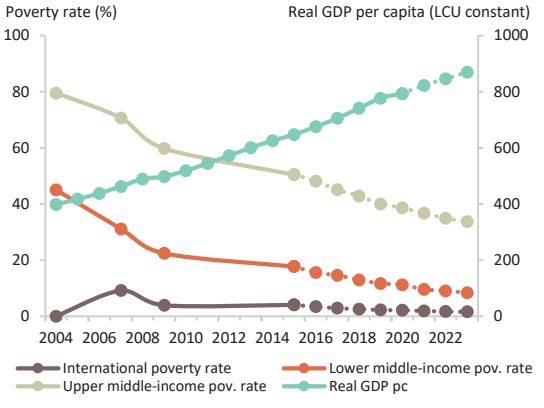
After the economic slowdown in 2020, Tajikistan's GDP grew at an annual rate of 8.7 percent in the first half of 2021. The continued sharp increase in the export of precious metals and a pickup in private investment and consumption supported this solid economic rebound. The resumption of air traffic with Russia allowed migrants to resume traveling abroad and restore the inflow of remittances. The share of households with at least one migrant abroad reached 40 percent in August 2021, compared with 34 percent a year earlier. Driven by large increases in gold exports, Tajikistan's current account surplus increased to 6.2 percent of GDP in the first quarter of 2021 from 4.1 percent in 2020. The export of precious metals attained a new height, $709 million, followed by the export of minerals and textiles. Higher remittance inflows, a stable exchange rate, and the release of pent-up demand strengthened consumer and capital goods imports. Foreign investments rose by about 35 percent (y/y) in the first eight months of 2021, primarily because of strong Chinese interest in the mining industry. In mid-2021, the central bank's net foreign assets stood at about seven months of import cover.

FIGURE 1 Tajikistan / Fiscal balance and total public and publicly guaranteed (PPG) debt



Sources: Ministry of Finance, World Bank staff estimates.

FIGURE 2 Tajikistan / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

Following expansionary fiscal policy in 2020, the government pursued budgetary consolidation during 2021. The fiscal deficit amounted to 1.5 percent of GDP compared with 3.1 percent a year earlier. External donor support in infrastructure projects financed the budgetary gap. At about 50 percent of GDP, Tajikistan's public debt remains at high risk of debt distress. The country did not extend its participation in the 2021 Debt Service Suspension Initiative after suspending $42.8 million of debt service in 2020.

To combat rising inflation, the authorities gradually increased the policy rate from 10.75 percent at the end of last year to 13 percent by August 2021. Due to rising fuel and food prices, the 12-month inflation stood at 9.4 percent in August 2021—above the central bank's medium-term inflation target of 6 percent (+/-2). Solid economic activity improved the financial sector's overall performance, with the share of overdue loans in the total lending portfolio declining to 15.5 percent by mid-2021 from 23.8 percent in 2020. Some improvement in asset quality is also attributed to the liquidation of two insolvent banks with relatively higher shares in bad loans.

Despite a strong economic rebound, the share of households reporting reduced food consumption increased to 33 percent in August 2021 compared with 28 percent a year earlier. A sharp increase in consumer prices coupled with falling household wage incomes increased food insecurity, particularly for vulnerable households without remittance income. The government plans to further enhance its support to the most vulnerable, starting in the fourth quarter of this year, by providing additional emergency transfers to women-headed families with children and those with disabilities.

Outlook

The economic outlook hinges on the pace of the vaccination rollout and the resiliency of the global economy. The government expects new deliveries of vaccines in the remainder of 2021 and next year through donations and self-procurement. Real GDP is projected at 6.0 percent in 2021 and moderate in the medium term. Remittances and foreign investment are projected to rise, reflecting a better growth outlook in Russia and China. Commodity and food prices will exert upward price pressure. Poverty is projected to fall in 2021, thanks to economic recovery and improvements in household income.

The fiscal deficit is projected to narrow to about 2–2.5 percent of GDP in the medium term. The most pressure on the state budget is likely to come from COVID-19-related spending on healthcare, social protection, and development projects in infrastructure, particularly energy and transport.

There are substantial risks to the outlook. Growth prospects are affected by possible new flareups of COVID-19, the precarious situation in neighboring Afghanistan, and the unresolved border dispute with the Kyrgyz Republic. Top domestic challenges include inefficient SOEs, insufficient development of the private sector, and weak institutional capacity. The newly developed tax code is expected to establish a better dialogue between the state and the private sector in the medium term.

TABLE 2 Tajikistan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	7.6	7.4	4.5	6.0	5.0	5.0
Private Consumption	7.2	7.1	-4.4	2.8	4.0	3.8
Government Consumption	3.8	3.5	0.4	4.2	2.7	3.0
Gross Fixed Capital Investment	7.9	-6.4	-6.6	9.4	6.0	7.6
Exports, Goods and Services	2.2	3.5	9.6	9.3	3.4	3.6
Imports, Goods and Services	3.3	2.2	-2.8	7.5	2.7	2.9
Real GDP growth, at constant factor prices	7.8	8.7	4.3	5.8	5.0	5.0
Agriculture	4.0	7.1	8.8	5.6	5.5	5.0
Industry	11.8	13.6	9.7	9.5	7.0	6.5
Services	6.3	4.9	-4.0	1.4	2.2	3.1
Inflation (Consumer Price Index)	3.9	8.0	8.6	7.8	7.0	6.5
Current Account Balance (% of GDP)	-5.0	-2.2	4.1	1.9	1.1	-0.4
Net Foreign Direct Investment (% of GDP)	3.3	2.3	0.4	1.8	2.1	2.3
Fiscal Balance (% of GDP)	-2.7	-2.7	-3.1	-2.6	-2.3	-2.2
Debt (% of GDP)	46.8	43.1	49.9	49.4	49.0	48.6
Primary Balance (% of GDP)	-1.6	-1.7	-2.2	-1.4	-0.7	-0.5
International poverty rate ($1.9 in 2011 PPP)[a,b]	2.6	2.3	2.2	2.0	1.8	1.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	13.0	11.7	11.3	9.6	9.1	8.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	42.9	40.1	38.7	36.7	35.0	33.7
GHG emissions growth (mtCO2e)	7.3	7.2	4.4	5.4	5.2	5.2
Energy related GHG emissions (% of total)	45.6	46.0	44.5	45.1	45.3	45.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2015-HSITAFIEN. Actual data: 2015. Nowcast: 2016-2020. Forecast are from 2021to 2023.

(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on GDP per capita in constant LCU.

TURKEY

Table 1	2020
Population, million	83.4
GDP, current US$ billion	720.0
GDP per capita, current US$	8633.1
Upper middle-income poverty rate ($5.5)[a]	10.2
Gini index[a]	41.9
School enrollment, primary (% gross)[b]	94.9
Life expectancy at birth, years[b]	77.7
Total GHG Emissions (mtCO2e)	489.1

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2019), 2011 PPPs.
(b) WDI for School enrollment (2018); Life expectancy (2019).

Turkey's economic growth was the second highest among G-20 countries in 2021Q2, driven by strong domestic and external demand, and effective control of COVID-19. GDP is expected to grow by 8.5 percent in 2021 but regaining monetary policy credibility and containing inflation will be the major challenges. Poverty is projected to decline following sharp increases in 2019-2020, and further poverty reduction hinges on ensuring an inclusive recovery with adequate support for vulnerable groups.

Key conditions and challenges

Turkey enjoyed high growth rates between 2002-17, which propelled the country to the higher reaches of upper-middle-income status. But productivity growth has slowed, as reform momentum waned over the last decade, and efforts have turned to supporting growth with credit booms and demand stimulus, exacerbating internal and external vulnerabilities. High private sector debt, persistent current account deficits, high inflation, and high unemployment, have been exacerbated by macro-financial instability since August 2018. Turkey entered the pandemic with lower buffers than its peers.

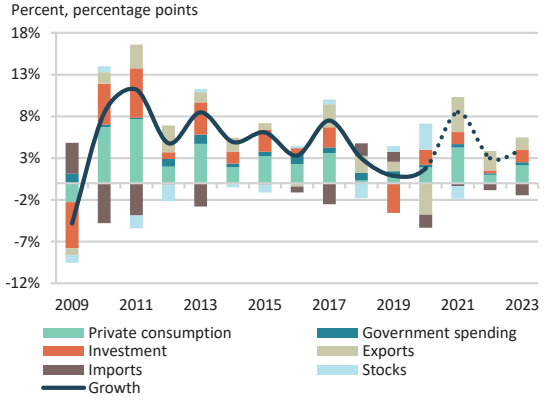
The government's economic policy response to COVID-19 was swift but focused on loose monetary policy and rapid credit expansion. Turkey's economy was one of the few in the G20 and OECD to experience positive growth in 2020. A favorable base effect, an easing of restrictions permitted by accelerated vaccinations, and supportive external demand led to double digit GDP growth in 2021H1, returning the economy and employment to pre-crisis levels. But inflation has risen to nearly 20 percent, while external financing needs have remained elevated and met largely through short-term portfolio flows. Going forward, efforts to rebuild policy credibility and macro stability coupled with reforms focused on labor, product, and financial markets and on strengthening the way institutions work are needed to attract foreign investment and revive productivity growth. Moreover, the high energy and carbon intensity of the economy makes it vulnerable to global and regional decarbonization policies.

Recent developments

Turkey's economy grew by 21.7 percent in 2021Q2 – the second highest among G-20 countries. Good progress in expanding vaccination coverage allowed pandemic-related restrictions to be relaxed in May, supporting a recovery in domestic demand. Private investment and consumption of durables, and increasingly services, have been major contributors to growth, despite the persistently high cost of borrowing and easing of fiscal support. Exports were buoyed by a strong recovery in external demand, currency depreciation, and an opportunity for Turkey to gain market share in the EU as Asian exporters grappled with rising logistic costs and global supply chain constraints.

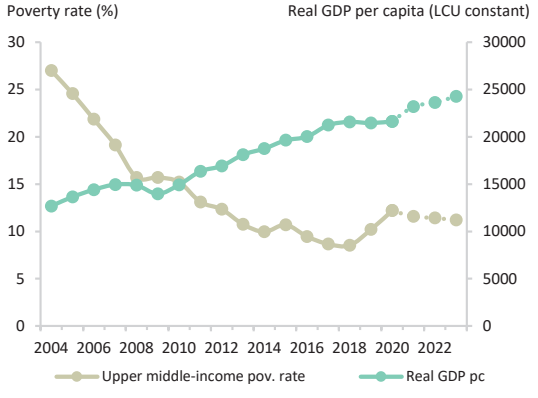
Yet, inflation continued to rise with the weakening of the Lira, rising international commodity prices and demand-side pressures. In August, consumer price inflation reached 19.3 percent and food prices soared by 29 percent whilst producer price inflation rose 45.5 percent. Despite this, the Central Bank reduced the policy rate to 18 percent, resulting in negative real interest rates, and raising policy uncertainty among investors already conscious of frequent

FIGURE 1 Turkey / Real GDP growth and contributions to real GDP growth



Sources: Turkstat and World Bank staff calculations.

FIGURE 2 Turkey / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

changes of central bank governor. Following a credit push in 2020 through public banks, credit growth declined from 30.9 percent at the end of 2020 to 9.3 percent in August in annualized FX-adjusted terms. As forbearance measures are still in place, NPLs are still low at 3.7 percent.

Despite a rising interest burden and elevated Covid-related expenditures, the central government fiscal deficit declined to 1.6 percent of GDP in H1 2021, thanks to strong tax revenue growth driven by buoyant domestic demand. On the other hand, general government debt stock rose from 32.7 percent in 2019 to 39.8 percent in 2020.

The 12-month rolling current account deficit narrowed to 3.9 percent of GDP as exports recovered sharply and gold imports declined. This, combined with new swap deals and the global IMF SDR expansion, supported an increase in gross FX reserves to $122 billion in September. However, reserves net of short-term drains remains negative at -$21.1 billion.

Supported by economic growth, nearly 3 million jobs were generated in January-July 2021, returning employment to pre-crisis levels. Nevertheless, despite new entrants, labor force participation remains low, at 52.1 percent.

Turkey has successfully vaccinated nearly 54 million people (86.5 percent of the eligible population) with their first dose. However, a recent surge in provinces with low vaccination rates has led to daily cases and deaths of close to 20.000 and 250 respectively.

Outlook

While the growth momentum is expected to wane in 2021H2, the economy is still expected to grow by 8.5 percent in 2021 before returning to a path of 3 percent and 4 percent in 2022 and 2023. These baseline projections assume no further COVID-19 restrictions in Turkey or its major export markets or excessive flareups in macro-financial conditions.

Inflation is forecasted to stay high but gradually decline from 17.7 percent in 2021 to 15 percent and 13 percent in 2022 and 2023. As tourism and exports recover, the current account deficit is expected to narrow to 3 percent of GDP in 2021. The general government deficit is projected to decline to 3.4 percent in 2023 as temporary tax reductions and COVID-19 related transfers are reined in.

External risks are balanced, with the upside of a quicker-than-expected recovery in global demand being netted out by potential global financial market disruptions caused by future tightening expectations and supply chain constraints. The continuation of loose monetary policy could further weaken investor confidence, heighten market volatility, and threaten macro-financial stability in the upcoming period. The banking sector remains highly capitalized and with adequate foreign exchange buffers. However, expected removal of forbearance measures are likely to put pressure on banks' balance sheets.

Simulation analysis of the pandemic impacts suggests that Turkey had 1.6 million more poor people in 2020 than 2019, reaching the highest poverty rate since 2012. Swift early government action, including household support measures prevented worse outcomes. However, some job and income protection measures expired as of July 2021 and rising COVID-19 cases may require additional support to protect vulnerable households. The strong rebound in economic growth, the labor market and household incomes are expected to reduce the poverty rate from 12.2 percent in 2020 to 11.6 percent in 2021. Further poverty reduction hinges on ensuring an inclusive recovery with adequate support for vulnerable groups.

TABLE 2 Turkey / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	3.0	0.9	1.8	8.5	3.0	4.0
Private Consumption	0.6	1.5	3.2	7.2	1.7	3.7
Government Consumption	6.5	4.1	2.2	2.8	1.4	2.5
Gross Fixed Capital Investment	-0.2	-12.4	7.2	5.5	1.3	6.0
Exports, Goods and Services	8.8	4.6	-14.8	19.7	10.0	6.0
Imports, Goods and Services	-6.2	-5.4	7.6	1.5	4.0	7.0
Real GDP growth, at constant factor prices	3.3	1.0	1.1	8.5	3.0	4.0
Agriculture	2.1	3.3	5.9	2.8	1.4	2.0
Industry	0.5	-2.9	1.0	13.5	3.0	3.7
Services	4.8	2.7	0.6	6.9	3.2	4.4
Inflation (Consumer Price Index)	16.3	15.2	12.3	17.7	15.0	13.0
Current Account Balance (% of GDP)	-2.8	0.9	-5.2	-3.0	-2.4	-3.1
Net Foreign Direct Investment (% of GDP)	1.2	0.8	0.6	0.6	0.8	0.9
Fiscal Balance (% of GDP)	-2.4	-3.0	-3.9	-4.0	-3.8	-3.4
Debt (% of GDP)	30.2	32.7	39.8	38.2	38.0	37.3
Primary Balance (% of GDP)	-0.2	-0.5	-1.1	-0.9	-0.6	-0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	8.5	10.2	12.2	11.6	11.4	11.2
GHG emissions growth (mtCO2e)	0.0	0.9	2.3	8.7	2.2	3.3
Energy related GHG emissions (% of total)	80.2	79.8	79.4	80.0	79.7	79.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2011-HICES and 2019-HICES. Actual data: 2019. Nowcast: 2021. Forecast are from 2021to 2023.
(b) Projection using point-to-point elasticity (2011-2019) with pass-through = 1based on GDP per capita in constant LCU.

UKRAINE

Table 1	2020
Population, million	44.0
GDP, current US$ billion	140.9
GDP per capita, current US$	3202.3
International poverty rate ($ 19)[a]	0.0
Lower middle-income poverty rate ($ 3.2)[a]	0.2
Upper middle-income poverty rate ($ 5.5)[a]	2.5
Gini index[a]	26.6
School enrollment, primary (% gross)[b]	99.0
Life expectancy at birth, years[b]	71.8
Total GHG Emissions (mtCO2e)	232.0

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2019), 2011 PPPs.
(b) WDI for School enrollment (2014); Life expectancy (2019).

A slow recovery from the COVID-19 shock is underway, supported by high commodity prices and rising government spending. Above-target inflation and rising fiscal spending pressures require continued prudent monetary and fiscal policy. The outlook hinges upon global economic and financing conditions, and implementation of critical reforms to reduce the state's economic footprint and ease investment bottlenecks. COVID-related poverty impacts were relatively muted thanks to pensions and wage growth; the poverty rate is expected to decrease to 1.6 percent in 2023.

Key conditions and challenges

Benefiting from reforms implemented following the 2014-16 crisis, Ukraine's economy has shown greater resilience to the COVID-19 outbreak than initially anticipated. COVID-response measures adopted by the Government have also been somewhat effective in cushioning the poor from the shock, while Ukraine's financial sector has entered the COVID-19 crisis stronger and more resilient than any previous crisis.

However, COVID-19 has exacerbated existing socio-economic challenges and partially set back some gains made since 2014/15. The growth recovery also remains weak, underpinned by low investment-to-GDP ratios, an export structure heavily dependent on commodities and significant institutional challenges that have dragged on economy-wide productivity and investment. The poverty rate, based on the national poverty line, marginally increased in 2020 following four years of steady decline. The labor market recovery that started in 2017 was upended, with employment declining by over 660,000 in 2020 and the unemployment rate hitting 9.9 percent – higher than during the 2014/15 crisis.

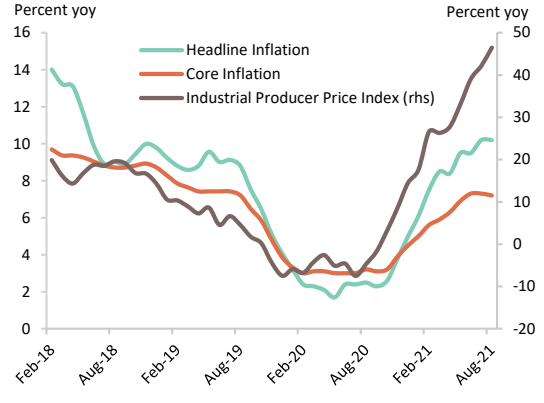
A broad-based recovery requires completing key reforms to stimulate private sector-led growth and inclusive job creation, by addressing structural bottlenecks to investment while safeguarding macroeconomic sustainability. The implementation of reforms in land markets, banking, demonopolization and concession projects should improve the environment for private investment, but major challenges remain with respect to weak rule of law and institutions. The direct participation of the state in the economy (via some 3,500 SOEs many of which are poorly managed) is excessive and restricts the role of market forces, and SOE reforms need to be accelerated. Judicial reform is in the early stages and timely implementation of recent laws adopted will be critical. Finally, rebalancing fiscal spending towards investment, and tax reforms to ease competition distortions that undermine investment, can also support capital deepening and accelerate growth .

Recent developments

Following a 4 percent contraction in 2020, the recovery during the first half of 2021 has been hampered by supply-side constraints and a second wave of infections. Base effects and a partial recovery in the industrial and services sector lifted GDP growth to 5.4 percent y/y in Q2 2021 (vs -2.2 percent in Q1); however, on a sequential basis, the economy contracted by 0.8 percent (sa qoq) in Q2. The labor market also deteriorated in Q1, with unemployment rising to 10.9 percent. High frequency retail and industrial production indicators, however, point to strengthening domestic demand; a record harvest is also anticipated in the H2 2021.

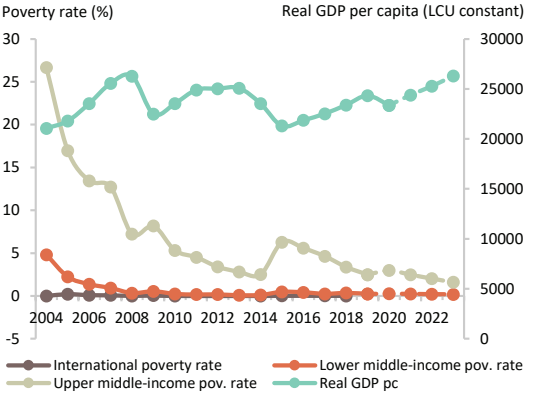
After steadily accelerating over the past

FIGURE 1 **Ukraine** / Consumer and producer price indices



Source: State Statistics Service of Ukraine.

FIGURE 2 **Ukraine** / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

year, headline inflation remained flat at 10.2 percent y/y in August, double the inflation target of 5 percent. Base effects, food inflation, and gas price adjustments have been major drivers while expansionary wage policies, notably a 27 percent increase in minimum wages, have also played a role. However, inflation momentum has begun to ease owing to weakening base effects, a strengthening currency and a proactive tightening of policy rates (by 250bp since April to 8.5 percent) by the central bank which also terminated anti-crisis monetary tools in September.

Helped by strong external demand, favorable terms of trade and rising wages, fiscal revenues have performed better than anticipated, with consolidated revenues in H12021 rising by almost 16 percent y/y. However, expenditures grew faster, by 17.4 percent y/y, driven by rising goods and services and public wage expenditures, while capital expenditures fell 8.2 percent. On a general government basis, the deficit was twice (1.4 percent of GDP) the size of the consolidated deficit (0.6 percent) in Q1 and has been financed by costly short-term domestic and Eurobond issuances.

The current account surplus reached a record $5.2bn in 2020 and has since remained positive (although narrowing) due to strong services net exports and higher global commodity prices. Already ample at nearly $29 bn (4 months of imports), reserves have been further supplemented by the $2.7bn IMF SDR allocation in August. Ukraine has successfully retained access to market financing despite volatility in global markets.

Outlook

Activity should continue recovering in H2 2021, helped by better harvests, strengthening consumer demand, and a supportive external environment. Growth is projected at 3.8 percent in 2021 underpinned by positive base effects in agriculture, and relative to last year's economic contraction. The forecast takes into account the possibility of further temporary lockdowns and additional tightening by the central bank to anchor inflation expectations.

Inflation is expected to moderate to the target rate in H2 2022 supported by monetary tightening and as base effects and supply shocks fade. The 2021 budget deficit (including arrears to the private sector and recapitalization requirements) is estimated at 5 percent of GDP. Together with 9.1 percent of GDP debt amortization this will increase total fiscal financing needs to 14.1 percent of GDP (vs 15.2 percent of GDP in 2020) that are expected to be met through domestic and international borrowing. Coupled with rising public wage expenditures (expected to reach over 11 percent of GDP in 2021), medium term spending pressures are increasing and continued prudent fiscal policy is needed to safeguard fiscal sustainability. Downside risks stem from an uncertain global economic and financing environment amidst an ongoing pandemic and flagging of domestic reform efforts.

The poverty rate based on the US$5.5 a day threshold is expected to decrease to 2 percent in 2022 and 1.6 percent by 2023, though the outlook is uncertain given rising COVID-19 cases both domestic and abroad and the slow vaccination pace. Accelerating critical reforms will be key to support the recovery and create more and better jobs.

TABLE 2 **Ukraine** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	3.3	3.2	-4.0	3.8	3.5	3.7
Private Consumption	8.9	11.9	1.6	4.6	4.5	3.5
Government Consumption	0.1	-5.0	-3.0	1.5	0.0	0.0
Gross Fixed Capital Investment	14.3	15.0	-24.4	10.4	8.4	7.5
Exports, Goods and Services	-1.6	6.7	-5.6	3.4	2.0	4.4
Imports, Goods and Services	3.2	6.3	-9.6	7.5	5.7	4.8
Real GDP growth, at constant factor prices	3.3	3.4	-4.0	3.9	3.4	3.7
Agriculture	7.8	1.3	-11.5	5.0	4.5	5.0
Industry	2.0	-2.0	-4.0	2.0	3.0	4.5
Services	3.0	5.7	-2.7	4.3	3.4	3.2
Inflation (Consumer Price Index)	9.8	4.1	4.8	9.5	6.0	5.0
Current Account Balance (% of GDP)	-3.2	-0.9	4.1	1.5	-0.2	-0.7
Net Foreign Direct Investment (% of GDP)	1.9	2.1	2.1	2.2	2.2	4.9
Fiscal Balance (% of GDP)	-2.0	-2.0	-6.0	-5.0	-3.5	-2.5
Debt (% of GDP)	60.6	50.4	60.6	59.3	58.1	56.8
Primary Balance (% of GDP)	1.4	1.1	-2.4	-0.9	0.2	1.4
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.4	0.2	0.3	0.2	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	3.4	2.5	3.0	2.5	2.0	1.6
GHG emissions growth (mtCO2e)	4.2	-2.8	-9.0	2.9	2.7	3.1
Energy related GHG emissions (% of total)	69.9	70.0	69.5	70.1	70.7	71.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2019-HLCS.Actual data: 2019. Nowcast: 2020. Forecast are from 2021to 2023.

(b) Projection using neutral distribution (2019) with pass-through = 0.87 based on GDP per capita in constant LCU.

UZBEKISTAN

Table 1	2020
Population, million	34.2
GDP, current US$ billion	59.9
GDP per capita, current US$	1751.5
School enrollment, primary (% gross)[a]	102.2
Life expectancy at birth, years[a]	71.7
Total GHG Emissions (mtCO2e)	237.4

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent WDI value (2019).

Economic growth is expected to rebound in 2021 as Uzbekistan strengthens its pandemic management. Health and social assistance costs have continued elevating the fiscal deficit. These pressures are mitigated by greater fiscal discipline and strong external buffers. The outlook for growth is favorable but contingent on improving global economic conditions and progress with structural reforms to increase private sector growth, reduce state dominance in the economy, and increase economic inclusion.

Key conditions and challenges

Reforms are beginning to address structural constraints such as absent factor markets and the state's economic dominance. These reforms will create more room for competition and business growth and help create more jobs and incomes that help accelerate Uzbekistan's market transition.

Job and income displacement from COVID-19 has amplified the importance of inclusion. About 9 percent of citizens live below the World Bank's lower-middle-income poverty line ($3.2 a day, PPP 2011 adjusted); many more live close to this line. The national poverty level (based on minimum food intake) increased to 11.5 percent in 2020 from 11 percent in 2019. Expanded social assistance has provided some relief to Uzbekistan's affected households, as has the swift recovery in employment following the economy's reopening. Uzbekistan's rebounding economy will support a return to poverty reduction in 2021.

Over the medium-term, in addition to growth, faster poverty reduction will require stronger safety nets, labor market conditions, and health and education services.

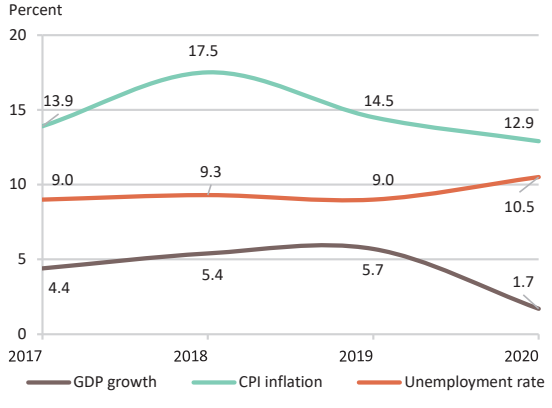
Recent developments

GDP growth increased to 6.2 percent in H1 2021 after slowing to 1.7 percent in 2020. Strong industrial and services growth tempered weaker agricultural production. Robust increases in household incomes and domestic investment, and the continuation of anti-crisis spending and tax relief measures, also contributed to this year's strong growth.

A decision to reduce gold export volumes led to a wider current account deficit of 10 percent of GDP in H1 2021 (from 7.3 percent in H1 2020). Exports of other goods, however, such as copper, textiles, fertilizers, food, and machinery, recovered from weaker trading partner demand in 2020. Total exports increased by 12.3 percent year-on-year. Imports grew by 14.3 percent in H1 2021 due to higher private consumption and a rebound in demand for capital goods. This led to a wider trade balance deficit of 18.8 percent of GDP in H1 2021 from 16.2 percent in H1 2020. Sustained inflows of personal remittances (8.7 percent of GDP in H1 2021) helped offset the negative trade balance.

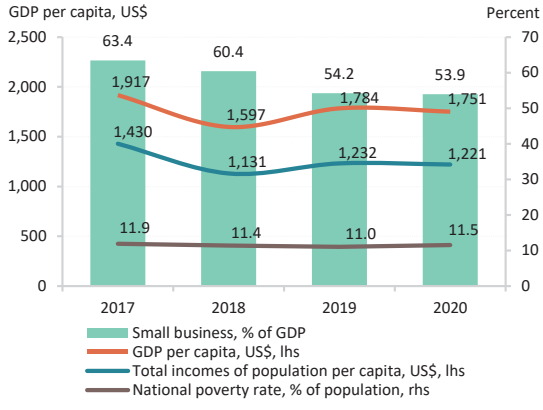
The fiscal deficit was within budget at 5.4 percent of GDP in H1 2021. Lower policy-based lending and higher tax revenues from a rebounding economy offset higher budget spending on social support, health, and public infrastructure. Though the deficit was financed through an increase in public debt, robust nominal GDP growth contributed to a slightly lower ratio of public debt to GDP of 38.5 percent of GDP in 1H 2021, compared with 38.9 percent at end-2020. The Government remains on track with its 2021 debt ceiling of $5.5 billion. Official reserves reached $34.1 billion in July 2021, an increase of $1.8 billion compared with July 2020.

FIGURE 1 Uzbekistan / GDP growth, inflation, unemployment



Source: Uzbekistan official statistics.

FIGURE 2 Uzbekistan / Poverty, GDP per capita, and small business development



Source: Uzbekistan official statistics. Due to the lack of data access, the Bank cannot validate the official figures. Note: The national poverty line is based on a minimum food consumption norm of 2,100 calories per person per day that exclude non-food items.

Inflation has continued to trend lower, reaching 11 percent in June 2021 (compared with 14.7 percent in June 2020), but remained in double digits due to high food prices. Given an uncertain inflationary outlook, the central bank has left its reference interest rate unchanged since September 2020 at 14 percent. Credit growth in June 2021 slowed to 24 percent from 34 percent in June 2020, and 52 percent in 2019. This reflected weaker demand from higher real lending rates and a reduction in government-subsidized lending. The banking sector's capital adequacy ratio fell to 17.4 percent in June 2021 from 18.5 percent in January 2021 and 20.8 percent in June 2020. This was partly due to a rise in nonperforming loans due to COVID-19, which increased to 4.6 percent in June 2021 from 2.2 percent in June 2020. Nevertheless, Uzbekistan's financial system remains sufficiently capitalized to absorb potential credit shocks. From August 1, 2021, to further reduce financial sector risks and dollarization, commercial banks will face increased reserve requirements on foreign currency bank deposits in banks from 14 to 18 percent.

Alongside a recovering economy, the unemployment rate declined to 10.2 percent in H1 2021 from 13.2 percent in H1 2020 and 10.5 percent at end-2020. The unemployment rate has not yet returned to pre-pandemic levels (of about 9 percent) and remains disproportionately high for women and youth.

Outlook

Growth is projected to accelerate to 6.2 percent in 2021. However, this forecast remains subject to uncertainties about the continued impact of further COVID-19 waves on global and domestic economic conditions. A recovery of investment, trade, and remittances will support the economic growth and reduce unemployment and poverty in 2021. Growth is projected to remain strong at 5.6 percent in 2022 as the pace of vaccinations accelerates and global disruptions ease further. The current account deficit is projected to be 5.9 percent of GDP in 2021 as capital imports for investment projects recover and as gold exports fall from record levels in 2020. Foreign direct investment is expected to remain subdued in 2021 and partially recover in 2022. The continued expansion of social assistance and public investments to improve rural infrastructure, and vaccination costs, will continue to elevate public spending in 2021. This will be partially offset by higher tax, mining, and privatization revenues, leading to a projected overall fiscal deficit of 5.5 percent of GDP in 2021. Increased public debt will finance this deficit, and public debt is projected to reach 40.6 percent of GDP by end-2021. COVID-19 uncertainties and a forthcoming VAT rates reduction in 2023, are likely to contribute to a higher medium-term fiscal deficit. A robust economic recovery, the gradual withdrawal of anti-crisis measures, and tax administration reforms to widen the tax base are projected to help consolidate public finances and stabilize debt at about 42 percent of GDP by end-2023.

TABLE 2 **Uzbekistan** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	5.4	5.7	1.7	6.2	5.6	5.8
Private Consumption	3.8	5.3	-1.2	4.1	5.3	5.5
Government Consumption	3.8	5.7	2.0	9.5	5.7	3.7
Gross Fixed Capital Investment	18.0	7.6	2.8	8.3	8.4	8.8
Exports, Goods and Services	10.7	16.2	-20.0	10.4	17.4	15.5
Imports, Goods and Services	26.8	19.5	-21.0	11.6	20.7	17.9
Real GDP growth, at constant factor prices	5.4	5.7	1.7	6.2	5.6	5.8
Agriculture	0.3	3.1	3.0	1.9	2.9	3.1
Industry	11.5	8.9	2.5	6.8	4.7	5.0
Services	5.2	5.2	0.4	8.6	7.8	7.9
Inflation (Consumer Price Index)	17.5	14.5	12.9	10.9	10.5	8.5
Current Account Balance (% of GDP)	-7.1	-5.6	-5.0	-5.9	-5.3	-5.1
Fiscal Balance (% of GDP)	-2.1	-3.8	-4.3	-5.5	-4.4	-3.7
Debt (% of GDP)	20.3	29.3	36.4	40.6	42.5	42.2
Primary Balance (% of GDP)	-1.7	-3.3	-3.8	-5.1	-4.0	-3.4
GHG emissions growth (mtCO2e)	0.3	1.9	0.4	3.4	3.1	3.2
Energy related GHG emissions (% of total)	46.6	46.4	45.8	46.7	47.6	48.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.

WORLD BANK **ECA ECONOMIC UPDATE** Fall 2021

Competition and Firm Recovery Post-COVID-19

Although global economic activity is recovering and output in Europe and Central Asia (ECA) is expected to grow in 2021, containing COVID-19 remains a challenge in the region. Enterprise Surveys data for the emerging and developing countries in the region show that COVID-19 had a profound and heterogeneous impact on firms. Smaller and younger businesses were hit harder and smaller, younger, and female-run businesses had greater difficulty recovering. But the crisis also played a cleansing role and economic activity in ECA appears to have been reallocated toward more productive firms during the crisis, particularly in countries with more competitive markets. Firms with high pre-crisis labor productivity experienced significantly smaller drops in sales and employment than firms with low pre-crisis labor productivity and were also more likely to adapt to the crisis by increasing online activity and remote work.

Many governments in ECA implemented broad policy support schemes to address the initial economic fallout from the crisis. Overall, this government support was more likely to go to less productive and larger firms, regardless of the level of their pre-crisis innovation. As economies enter the economic recovery phase, it will be important for policy makers in all countries to phase out broad policy support measures as soon as appropriate and focus on fostering a competitive business environment, which is key to a strong recovery, resilience to future crises, and sustainable, long-term economic growth.

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