

ECONOMIC IMPACTS OF AN EARTHQUAKE DISASTER AND COVID-19 IN ALBANIA

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Abstract: *The earthquake, occurred on 26th November 2019, caused considerable material and financial damages. According to a document compiled by the Albanian Government with the support of several International Institutions, the earthquake affected directly and indirectly over 202,000 people, including 51 victims, 17,000 displaced and about 985 million Euros in damage, mainly to housing and educational infrastructure. Reconstruction under the same document will cost 1 billion 78 million Euros. As if that were not enough, the vast majority of the decline in economic activity during the post-earthquake period was “due to Covid-19 pandemic” of 2020. Therefore, the main aim of this study is to evaluate the long-term impacts of these two major events in the Albanian economy. The impacts of earthquake and pandemic damages are expected to have a resultant slowdown in the economic growth of Albania, caused mainly by unemployment, inflation and productivity decline in the main economic sectors. However, even if not stronger growth what will be needed in the future is the readiness to be reduced significantly unemployment and poverty. This will require progress on a number of priority reform areas, including ongoing reforms to Albania’s system of economic governance, which is more important than everything in this country. Loss compensation is the driving force of the post disaster recovery, and social productivity and sustainable economic development are the economic basis of compensation for disaster losses. To this end, economic development is the most effective way to compensate for disaster losses. At the end, the question that arises is: How will all this change the Albanian economy?*

Keywords: Earthquake, Pandemic, Recession, Albania.

JEL Classification Codes: E00, E01, E02, E60.

1. INTRODUCTION

Previous studies on the impact of natural disasters (including earthquakes) on the economy can be grouped into estimates of short-term impacts and long-term impacts. A typical way to detect this impact is to compare the ex post level of economic development to its level before a disaster. When examining country-level data, several studies have found that disasters have little to no effect in the long run, with wealthy countries which need short time to go in their long-term equilibrium, while poor countries, as well as small states show less resilience.

Long-term impacts of disasters are the main focus of this paper. In order to have a better view of this, we have to use some statistics and also the arguments using a simple before-and-after comparison of variables, including Gross Domestic Product (GDP), the growth rate,

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and inflation rate before and after disasters. According to the Government of Albania data, considerable damage is caused to the Albanian economy (around 6.4 % of GDP), while its effect persists for an extended period of time.

Still reeling from a devastating November 2019 earthquake, Albania is faced with two back-to-back shocks that are likely to cumulate into severe economic and social hardship for the country, as well as more restricted fiscal space, in the context of deteriorating global financial resources. (Hashorva, 2019). The shutdown of several public services first hit the marginalized and vulnerable groups, who already had difficulties in accessing such services and are less reachable by communication channels. With all schools nationwide closed, and although alternative online learning options were adopted, these closures of educational facilities had an impact on the quality of learning, especially on most of the vulnerable groups who lack connectivity and adequate equipment for online options. Furthermore, COVID-19 has radically changed the Albanian economic outlook. At the end of 2019 the economy was projected to grow at 3.5 per cent in 2020³, but now the real GDP is expected to contract by 5 per cent in 2020. The demand for goods and services, both in the domestic and foreign markets, has experienced a rapid decline. In April 2020, exports had decreased 44 per cent from April 2019, and imports by 37%.⁴ In this context, Albania has had to confront two consecutive crises in a short period of time. The expected COVID-19 related global economic downturn will compound the effects of the two shocks and will require that the government and development partners act quickly to soften their macroeconomic impacts on the country's economy and society.

In response to all these adverse effects, the Albanian Ministry of Finance and Economy developed a recovery and response plan, in order to help businesses (especially small ones) affected by the earthquake and followed by the pandemic. According to official sources, survival strategies and support measures for damaged businesses are taken by the Albanian Government to help citizens and companies during the significant economic impact of these successive fatalities. As a response to this challenge, Albanian government announced an updated economic stimulus package to support the economic recovery by focusing on budgetary, liquidity and policy measures in order to increase the capacity of its health system and provide relief to those citizens and sectors that are particularly impacted. More specifically, the government instituted a range of support measures that include: welfare benefits and other support to individuals (including sick pay, cash transfers, housing relief), protection for vulnerable people in households at risk of abuse, financial support / guarantees for businesses, and home education support. "In this respect, the Government has enacted a package of fiscal stimuli in the form of two sets of economic policy measures (on 21 March 2020, and 13 April 2020) consisting of budget spending, sovereign guarantees and tax deferrals. The fiscal packages amounting to about 2.8 per cent of GDP, also included a mixture of tax moratoriums, loan guarantees and wage subsidies for those businesses and individuals in dire economic distress. These fiscal measures have been adopted on top of the existing earthquake relief and recovery package included to the 2020 budget, totaling 1.2 per cent of the GDP".⁵

Regarding monetary policy and macroeconomic measures introduced, the Central Bank of Albania cut the interest rate to a record low of 0.5 per cent from 1.0 per cent, to support the economy and to alleviate the impact of the pandemic. It has also allowed borrowers affected by the pandemic to postpone their debt service payments. The exchange rate has remained stable after an initial depreciation and no measures regarding the exchange rate have been announced.

³ IMF Country Report No. 20/118 – April 2020.

⁴ INSTAT data on Imports – Exports (<http://www.instat.gov.al/en/>)

⁵ IMF Country Report No. 20/118 – April 2020.

However, it remains to be seen whether such temporary measures will be enough to mitigate the longer-term impacts of COVID-19 without additional structural measures.

2. ECONOMIC IMPACT OF EARTHQUAKE AND POLICY RESPONSES

According to the Albanian Government Report, the earthquake is estimated to have caused effects that are equivalent to 6.4% of GDP in damage and 1.1% of GDP in loss. Damages amount to 26.4% of gross fixed capital formation which indicates Albania's limited ability to achieve full restructuring within short - medium term. In terms of losses, the most damaged economic sectors were tourism and real estate, but significant damages was also caused to education, health, public infrastructure, manufacturing and trade, and also agriculture, as the report stated.

The Albanian economy was projected to grow by about 2.9% in 2019, and 3.5% in 2020 from a pre-earthquake baseline. But after the earthquake, there was a curb, showing that the economic growth for 2019 was 2.4%, 0.5 % less than forecast and 3.2 % for 2020, or 0.3 % less, the report stated. In nominal terms, GDP in 2020 was estimated to be lower by about Euro 98 million (ALL 12.06 billion).

The expert analysis also explains that the earthquake is also expected to bring further strains on public finances, where the fiscal deficit is estimated to be higher, just 0.7 % of GDP. Trade deficit and current account deficit (CAD) are also expected to worsen. CAD is expected to expand by about 0.2% of GDP, rising from an initial pre-earthquake forecast of 7.1% to 7.3% of GDP in 2020.

The analysis of damages and losses caused by the earthquake shows that tourism and real estate activities have been the most affected by the earthquake. Likewise, significant damage has been caused to education, health, manufacturing and commerce.

On the other hand, reconstruction and recovery efforts are expected to partially offset the negative effect on economic activity through a faster growth of the construction sector and to a lesser extent, of trade and professional activities. Also damages repair and reconstruction, according to the earthquake report, will probably lead to higher investment growth than previously anticipated. "If reconstruction and investment were to proceed faster with greater donor support, the decline in GDP could have been smaller. The earthquake is expected to have no significant impact on inflation given the current low inflation in Albania and its trading partners", the Albanian Government Report stated.

The share of real estate activities in the Albanian economy is 5% of GDP. The earthquake losses in real estate activities are due to disrupted rental activities and housing, owned by owners with disaster-damaged housing units. Total effects in losses are estimated at 696.3 million Euros (85.68 billion ALL).

The total needs for earthquake damages recovery are estimated at Euro 1 billion and 76 million (ALL 132.4 billion) in all sectors, for the 11 affected municipalities. Needs in the housing sector alone are Euro 802.86 million (ALL 98.8 billion), representing 75% of all needs. The recovery of the education sector will cost around Euro 95 million (ALL 11.7 billion) or about 9% of the total and the recovery for the infrastructure sector will be Euro 61 million (ALL 7.4 billion) or 6%. Within the infrastructure sector, over half of the recovery needs are in Energy and Government Buildings subsectors, with Euro 12.9 million (ALL 1.5 billion) and Euro 26.5 million (ALL 3.3 billion). In the manufacturing sector with 4.2% of all recovery needs, they are concentrated in the Business and Employment (Manufacturing and Trade) subsector with Euro 27.84 million (ALL 3.4 billion).

Albania managed to raise a significant amount of funding, in the form of aid and loans, at the International Donors Conference held in Brussels. The amount raised amounts to 1.15 billion Euros, exceeding the damages bill, which amount to almost Euro 1 billion.

According to the Bank of Albania, the three channels where the earthquake will adversely affect the economy are:

1. Damage to business premises, increased uncertainty and reorientation of costs towards repairing damages, are expected to materialize in slowing production in some sectors, including tourism;
2. Increasing uncertainty and reorienting costs towards repairing damages are expected to materialize in slowing consumption.
3. On the other hand, the rebuilding process is expected to give a positive upward effect, but this effect will be later in time compared to the negative shocks and not sufficiently strong enough to offset their effects.

A range of support measures aimed at protecting the population and businesses, as well as relevant guidelines for the implementation of legal changes are currently being finalized. In the business support package, the Ministry of Finance and Economy states that the plan of measures enables the damaged businesses to postpone the payment deadline on time, but they initially has to pay 20 % of them. Due to the situation, any fines for late filings will be removed and planned controls on damaged businesses will be delayed. According to official sources, such mitigation measures include: (1) recognizing in the balance sheet the damage to goods and buildings that have been destroyed or shut down as a result of the November 26 earthquake; (2) postponement of audits for damaged businesses, exemption from property tax for damaged businesses, postponement of liabilities, and recognition of expenses for employees, etc.

Specifically, the measures taken include:

- 1) Recognition in the balance sheet of damages in goods and materials;
- 2) Recognition in the balance sheet of damages in buildings;
- 3) Recognition in the balance sheet of any reconstruction expenses;
- 4) Extending the deadline for payment of tax liabilities declared in cases when there are insolvencies;
- 5) Removal of any penalties for late statements due to the situation;
- 6) Introduce previously planned controls on earthquake-affected entities;
- 7) Exemption from the payment of property tax for damaged businesses;
- 8) Priority payment of required refunds;
- 9) Recognition on the balance sheet of any expenses incurred in maintaining the workforce.

This plan of support measures is in addition to a series of fiscal facilities that are granted by the Albanian Government, in order to improve the current fiscal framework by providing more support to the entities affected by the earthquake, where the most important are:

- a) Exemption of construction of new houses from VAT;
- b) Tax Exemption for reconstruction processes;
- c) Increment of sponsorship level for natural disasters from 3%- 8% of pre-tax profit.

Reinsurance companies have changed their approach to the situation in Albania, following the November 26 devastating earthquake. This is reflected in the increase of reinsurance premiums for contracts signed in relation to the property insurance portfolio. Also, the reinsurance companies have been forced to compensate millions of Euros, mainly due to real estate damages that were in the portfolio of Albanian companies following last year's earthquakes.

It's not clear yet whether the increase of the reinsurance premium will be transferred to the initial property insurance premium applied by the insurance companies or not. Some of them are operating with old premiums due to reserves they had from previous years, while the rest are still pending.

There is currently an initiative to make property insurance by earthquake mandatory by law and there is a government draft about it; however the appropriate links have not been yet established to make it functional. The above draft envisions setting up a government agency, in order to manage the whole scheme.

3. COVID-19 ECONOMIC IMPLICATIONS AND POLICY RESPONSES

The outbreak of COVID-19 and measures to control its spread have severely affected economic performance in the second quarter of 2020 in all Western Balkan countries, according to the latest European Commission Report.

In Albania, the recession deepened to an economic contraction of 10.23% after an annual decline in output of 2.3% in annual terms in the first quarter, mainly driven by a sharp decline in exports as well as a contraction in investment, private and public consumption. For Albania, the report analyzes that the recession worsened the labor market in the second quarter, as employment shrank by 3.9% on an annual basis, reflecting the loss of 34,000 jobs.

The unemployment rate (15-64 years) increased by 0.6 percentage points on an annual basis to 12.5%, the same level as in early 2019. The worst hit was among young people, age group 15 to 29 years for whom the unemployment rate rose 1.4 percentage points to 21.4%. Despite the weak 0.4% increase in public wages and a sharp decline in all wage indices except construction, the average nominal wage recorded 1.7% quarterly increase in Q2 and 2.9% annual increase. As in the first quarter, economic output shrank in all sectors in the second, except real estate and agriculture.

The latter recorded in the first two quarters of 2020 the highest growth rates of the last three years. Services, which account for about 50% of GDP, suffered the most, driven by a 27% drop in output in the trade, transport and hospitality categories. Industrial production also fell, by 13.1%, driven by a decline in processing (-19.1% on an annual basis).

But the crisis created by the pandemic has been the strongest in terms of damage to fiscal accounts. According to the report, due to declining revenues and rising expenditures, public debt in the country jumped from 66.3% at the end of 2019, to an estimated level of 81.5% in the second quarter. According to a report from IMF, Albania offered the least fiscal measures in the 2020 budget in relation to GDP to cope with the consequences of the pandemic in the economy.

As shown in the figure below (Fig. 1), fiscal support (additional expenditures and deferral of tax payments) was about 1% of the country's GDP, the lowest among developing countries (the reddest part of the graph). Albania's fiscal measures have been dominated by the reallocation of budget expenditures.

The International Monetary Fund analyzed that governments in Europe applied unprecedented fiscal support that acted as major automatic stabilizers, keeping almost half of the decline under control. (Baldwin&Weder di Mauro, 2020). In developed European countries, fiscal measures averaged 6.2% of GDP, while in developing countries these measures were weaker, averaging 3.1% of GDP. In Albania they were even lower, accounting for only 1% of GDP. The IMF notes that in developing countries such as Albania aid packages were more limited due to space constraints from high public debt.

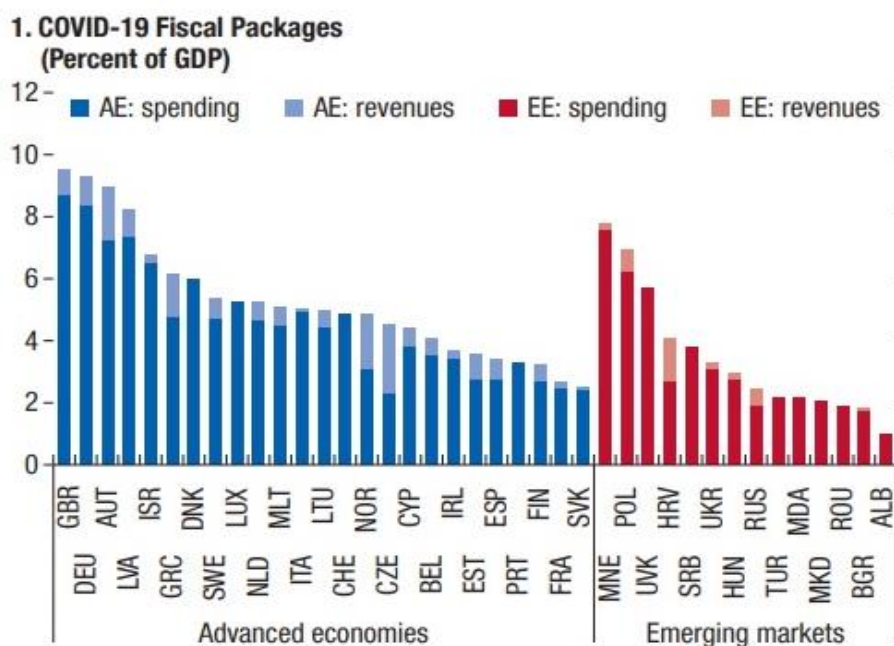


Figure. 1. Fiscal Policy support

Source: International Monetary Fund, Support Package against Covid-19 in Albania, the smallest one in Europe, 2020, <https://www.monitor.al/fmn-paketa-e-ndihmes-anti-covid-19-e-shqiperise-me-e-uleta-ne-europe/>

The closing of the economy increased costs and narrowed the income base, for banks. Microfinance faced the most sensitive consequences of the COVID-19 crisis compared to the banking system. (Gourinchas, 2020). The freezing of credit installments put some institutions in a liquidity test, in difficulty to cover operating costs and to support the continuation of lending activity (Guerrieri et al., 2020).

Although they work in the most difficult financial field, serving smaller, more informal and less financially educated clients, the representatives of the sector say that even the government does not understand much about the contribution of this sector to the economy.

The International Monetary Fund has called for increased revenue and a more transparent fiscal system, as well as for maintaining financial stability, as non-performing loans are expected to grow. Further progress is needed in the area of recreating room for maneuver with budget policy by reducing the fiscal deficit.

During 2021, according to the IMF, the authorities should limit non-priority expenditures, to create space for sufficient expenditures on pandemic-related health care and social protection of the most vulnerable groups, as well as to maintain a considerable level of liquidity as reserve.

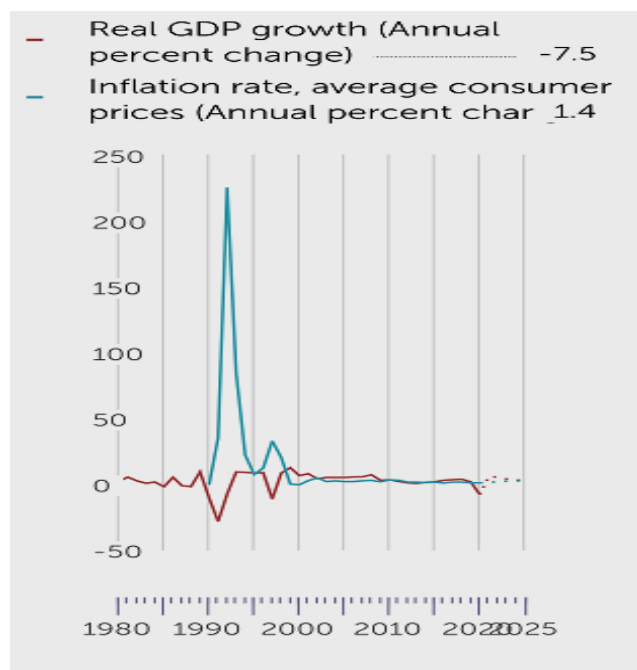


Figure 2. Real GDP growth, Inflation rate

Source: International Monetary Fund, Country Data Albania, October 2020, <https://www.imf.org/en/Countries/ALB>

4. CONCLUSIONS

It is concluded that the economic activity in Albania was badly affected by the earthquake, although the economic shock has not widespread and lasting effects on the economy, and it hasn't been reflected in medium and long-term development trends. The worst damage is caused by the pandemic. Deteriorating epidemiological situation in the country and possible restrictive measures may affect the improvement marked by the economy during the summer season after the strong decline, marked in the second quarter. The new measures to limit the pandemic negative impact are among the main risks faced by the recovery of the Albanian economy, according to a late statement by Bank of Albania.

The magnitude of the impact of the pandemic on the economy will largely depend on the extent and duration of possible measures to limit its spread. In addition to the impact of restrictive measures, risks to the economy also stem from the degree of impairment of production capacity, and the possibility of a slower recovery of domestic and foreign demand, as well as the emergence of difficulties in the monetary policy transmission mechanism, in the form of rising interest rates and financing costs of the private sector, in the form of slow growth in bank lending, or in the form of strong fluctuations in other financial market indicators.

At present, the baseline scenario of developments expected from Bank of Albania is built on the assumption of avoiding extreme measures to control the spread of a second wave of the pandemic and the gradual reduction of its consequences.

In this scenario, the Albanian economy is expected to record a significant decline for 2020 and relatively fast and steady growth rates in the future. Inflation is expected to stay close to current levels in the coming year, while the return of economic activity close to potential will create the conditions for the return of inflation to target within 2022.

In the context of low interest rates of loans, restrained liquidity pressures and stable exchange rates, the banking sector has welcomed and also satisfied their borrower's needs, by offering them a temporary deferral of loan installments payment and a possible debt restructuring process (a complete restructuring), thus sharing the financial burden of the crisis.

Banks have also continued lending to the economy, in response to private sector's financing needs. The amount of lending granted to the private sector increased by about 6%, in the third quarter of 2020; mostly secured business loans in Albanian currency (All). The persistence of this positive approach by the banking sector in Albania to support and stimulate economic growth by providing financing to firms, where the market is failing to do so, constitutes a necessary precondition for the recovery of the Albanian economy.

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