WORLD BANK GROUP

Migration and Brain Drain

Europe and Central Asia Economic Update

Office of the Chief Economist

Fall 2019

WORLD BANK **ECA ECONOMIC UPDATE** FALL 2019

Migration and Brain Drain

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1 2 3 4   22 21 20 19

ISBN (electronic): 978-1-4648-1506-5
DOI: 10.1596/978-1-4648-1506-5

Cover design: Lauren Kaley Johnson

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Acknowledgments

This Europe and Central Asia (ECA) Economic Update is a product of ECA's Office of the Chief Economist led by Asli Demirgüç-Kunt, in collaboration with the Macroeconomics, Trade and Investment and the Poverty and Inequality Global Practices.

In Part I, Chapter I was prepared by the Prospects Group in the Equitable Growth, Finance and Institutions Practice Group, comprising Carlos Arteta, Patrick Alexander Kirby, Julia R. R. Norfleet, Vasiliki Papagianni and Collette Mari Wheeler. Chapter I was closely coordinated with contributions from Part II authors. Chapter II was prepared by the ECA Chief Economist's team with contributions from the Development Research Group by a team made up of Çağlar Özden, Bingjie Hu, Michael Packard and Chuan Li. Inputs were provided by Harry Patrinos and his team in the Human Development Global Practice; and Ivan Torre and Michael Lokshin of the ECA Chief Economist's office. Useful comments were provided by Olga Emelyanova, Linda Van Gelder, Sebastian-A Molineus, Evgeniy Najdov, Fadia M. Saadah, Apurva Sanghi, Steven N. Schonberger, Andrea Fitri Woodhouse.

Part II was prepared by teams from the Macroeconomics, Trade and Investment Global Practice (led by Andrew Burns, Lalita M. Moorty, Sandeep Mahajan, and Gallina Andronova Vincelette) and the Poverty and Equity Global Practice (led by Salman Zaidi). These teams included the following staff: Azamat Agaidarov, Enrique Blanco Armas, Sarah Nankya Babirye, Reena Badiani-Magnusson, Olena Bogdan, Benoit Philippe Marcel Campagne, Cesar Cancho, Marie-Anne Chambonnier, Alexandru Cojocaru, Marcel Chistruga, Paul Corral, Pablo Facundo Cuevas, Donato De Rosa, Mariam Dolidze, Andrei Silviu Dospinescu, Bakyt Dubashov, Hasan Dudu, Olga Emelyanova, Samuel Freije-Rodriguez, Alan Fuchs, Josip Funda, Mismake D. Galatis, Anastasia Golovach, Claudia Gutierrez, Gohar Gyulumyan, Kiryl Haiduk, Sandra Hlivnjak, Saida Ismailakhunova, Ivailo Izvorski, Charl Jooste, Jonathan George Karver, Faruk Khan, Edith Kikoni, Milan Lakicevic, Leonardo Ramiro Lucchetti, Sanja Madzarevic-Sujster, Mikhail Matytsin, Kristina Cathrine Mercado, Rose Mungai, Evgenij Najdov, Metin Nebiler, Minh Cong Nguyen, Trang Van Nguyen, David Night, Desislava Enikova Nikolova, Ana Maria Oviedo, Catalin Pauna, Alisher Rajabov, Nadir Ramazanov, Monica Robayo, Paul Andres Corral Rodas, Natasha Rovo, Armineh Manookian Salmasi, Apurva Sanghi, Marc Tobias Schiffbauer, Gregor Schwerhoff, William Hutchins Seitz, Asli Senkal, Lazar Sestovic, Hilda Shijaku, Bojan Shimbov, Maryna Sidarenka, Sangjin Song, David Andrew Stephan, Thi Thanh Thanh Bui, Eskender Trushin, Michal Tulwin, Christoph Ungerer, Ekaterina Vostroknutova.

Sandra Gain and Barbara Karni provided the editorial support, and Michael Alwan typeset the report. Paul Anthony Clare, Carl Patrick Hanlon, Artem Kolesnikov, John Mackedon, Sona V. Panajyan and Kym Louise Smithies provided communications and outreach support. Ekaterina Ushakova oversaw the layout and production of the report.

Abbreviations

BoA	Bank of Albania
CAD	current account deficit
CBA	Central Bank of Armenia
CBR	Central Bank of Russia
CPI	Consumer Price Index
CRP	Centralized Remittance Platform
ECA	Europe and Central Asia
ECAPOV	ECAPOV (ECA Poverty) database of standardized household surveys
EEA	European Economic Area
EEC	Eurasian Economic Community
EMDEs	emerging markets and developing economies
EU	European Union
FDI	foreign direct investment
GCC	Gulf Cooperation Council
GDP	gross domestic product
HPP	hydropower plant
ICT	information and communications technology
IOM	International Organization for Migration
LCU	Local currency unit
LF	labor force
MIC	middle-income country
MIPEX	Migration Integration Policy Index
NBM	National Bank of Moldova
NBR	National Bank of Romania
NBT	National Bank of Tajikistan
NPL	non-performing loan
OECD	Organisation for Economic Co-operation and Development
pc	per capita
pp	percentage point
PPA	power purchasing agreement
PPG	public and publicly guaranteed
PPP	public-private partnership
PPP	purchasing power parity
RHS	right-hand side
SOE	state-owned enterprise

TSA	Targeted Social Assistance
USD	US dollar
VAT	value added tax
WAP	working-age population
y-o-y	year on year

Country Codes

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

Regional Classification Used in this Report

This report covers 47 countries referred to as Europe and Central Asia (ECA) countries. These are divided into 10 groups: Western Europe, Southern Europe, Central Europe and the Baltic Countries, Northern Europe, Western Balkans, South Caucasus, Central Asia, Russia, Turkey, and Eastern Europe.

TABLE E.1 Regional classification used in this report

<table>
<tr><th rowspan="4">Europe and Central Asia</th><th rowspan="2">European Union and Western Balkans</th><th colspan="4">European Union</th><th>Western Balkans</th></tr>
<tr><th>Western Europe</th><th>Southern Europe</th><th>Central Europe and the Baltic Countries</th><th>Northern Europe</th><th></th></tr>
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<tr><th>Eastern Europe and Central Asia</th><th>South Caucasus</th><th>Central Asia</th><th>Russian Federation</th><th>Turkey</th><th>Eastern Europe</th></tr>
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Moldova
Ukraine</td></tr>
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Executive Summary

Global growth continued to dampen in 2019, amid heightened policy uncertainty and deceleration of global investment and trade. Growth in the emerging and developing countries of Europe and Central Asia (ECA) is expected to slow to 1.8 percent in 2019 (down from 3.2 percent in 2018), a four-year low. This update summarizes the recent developments and outlook for the region. It also focuses on labor mobility, which can mitigate demographic trends and produce significant growth and poverty reduction benefits for the region.

Aggregate growth figures mask the diversity of performance across the region. Regional growth was hindered by marked weakness in Turkey, which suffered from substantial financial market stress, as well as sluggish activity in the Russian Federation amid oil production cuts. There was robust growth in other parts of the region, such as Central Europe and Central Asia, and the South Caucasus strengthened. Regional growth is expected to pick up in 2020–21, as Turkey recovers from its sharp growth slowdown and Russia strengthens. But there are significant downside risks to this outlook. Chief among them is a sharper than expected slowdown in the region's most important trading partner, the euro area, as well as the escalation of global policy uncertainty, particularly in relation to trade tensions and Brexit. In Central Asia and Eastern Europe, slowing activity in Russia could reduce remittances, which account for an important portion of income in countries including the Kyrgyz Republic, Moldova, Tajikistan, and Ukraine. Countries with large current account deficits, heavy reliance on capital flows, or sizable foreign currency–denominated debt—such as Turkey and Ukraine—may be subject to sudden shifts in investor sentiment. Sharp fluctuations in energy prices also represent a downside risk, particularly for the region's energy exporters, such as Azerbaijan, Kazakhstan, and Russia. And increased policy uncertainty could further undermine business and investor confidence in the region.

The region faces many long-run challenges to development, including the need to improve governance, complete the transition to competitive and inclusive markets, strengthen the environment for private investment and innovation, and mitigate and adapt to climate change. Worsening demographics, including a shrinking working-age population, add to these challenges. Migrants—who disproportionately tend to be of working age—ease demographic pressures by increasing the size of the labor force, raising productivity and boosting growth in the region. This update focuses on the design of policies on labor mobility to take advantage of the gains and address the costs of migration and presents the trends, determinants, and impacts of low- and high-skilled labor.

Migrants' share of the world population has barely changed over the past six decades, remaining remarkably stable at 2.5–3.5 percent. The aggregate share hides changing patterns, however, as immigration is increasingly concentrated in a handful of destination regions. For example, the share of immigrants in Western and Eastern Europe increased rapidly over the past four decades. Today, one of every three migrants in the world goes to Europe. Furthermore, although globally only one-third of migration takes place within regions, intraregional migration is especially high within ECA, with 80 percent of the region's emigrants choosing to move to other ECA countries.

This concentration has led to widespread opposition in high-income European countries, where migrants are often blamed for high unemployment and declining social services. There are also widespread concerns about brain drain in the migrant-sending countries of Eastern Europe, the Western Balkans, South Caucasus, and Central Asia.

Easing immigration restrictions is one of the most effective tools for ending poverty and reducing inequality across the globe. Opposition to migration is often strong, however, because the benefits tend to be longer term and diffused but the costs—displacement and unemployment—are immediate and concentrated among certain groups.

These short-term costs need to be addressed. Policy makers can assist workers in destination countries by designing programs to retrain them and adjusting education systems for young people, so that they are not competing with lower-skilled immigrants. Governments can provide relocation assistance for workers who need to change occupations, cities, or sectors of employment. Transitory welfare benefits and unemployment insurance payments can be components of such efforts. Replacing quota regimes with tax regimes would be a useful way to finance the required adjustment assistance by taxing the beneficiaries. Innovative policies may take the form of an additional income tax, a visa fee, or even a visa auction system. Such fee-based systems would allow employers to adjust more quickly to changes in labor markets and reduce the hostility toward immigrants.

All countries want to attract skilled labor to boost their innovation and productivity. For destination countries, creating a clear path to permanent residency or even citizenship is important in attracting skilled labor, because those countries tend to have permanent jobs that require significant employment-specific human capital investments. Because many skilled migrants move with their families, guarantees on residency and access to education and other public services are important. Investing in higher education is also critical, as the presence of good universities is key in drawing talent and ambition. Destination countries could even directly fund educational institutions in origin countries, an effort that would benefit both the destination and origin countries, as not all graduates of such schools would emigrate.

For origin countries that experience extended periods of loss of scarce human capital, emigration of skilled labor represents a serious concern. Such persistent patterns are often a symptom rather than the cause of the underlying problem. Improving governance quality and strengthening institutions in origin countries are long-term policies that can address the root causes of persistent emigration. Policies to retain skilled labor include promoting private sector and job creation, investing in higher education, and increasing opportunities for women in the economy. Greater connectivity is also an important aspect of increasing engagement with the diaspora; even if it facilitates emigration, emigrants who stay connected are more likely to invest and return.

Over time, skilled migration may increasingly involve shorter durations and circular paths, thanks to greater global integration, lower transportation and communication costs, and rising standards of living outside the traditional advanced economies. Increasing the potential benefits of remaining in countries of origin is more likely to deter outward migration than pursuing policies that restrict the benefits abroad.

PART

Economic Outlook and Long-term Challenges

1

Economic Outlook

Global Context

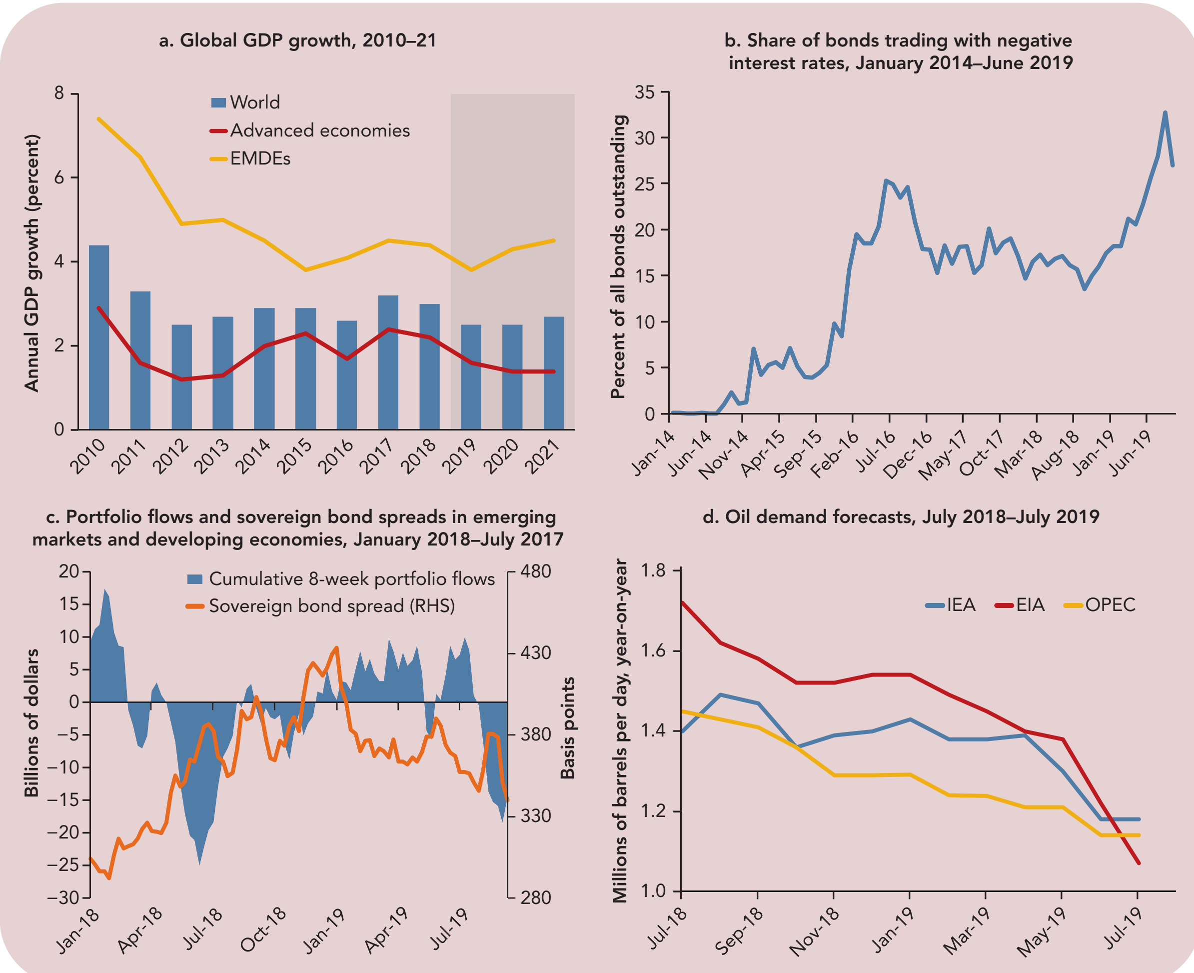
Global growth has continued to soften in 2019. It is projected to decelerate to 2.5 percent this year, amid weaker-than-expected trade and investment. Heightened policy uncertainty has been accompanied by a deceleration in global investment and a decline in confidence. Growth in emerging markets and developing economies (EMDEs) is expected to slow in 2019, as weakening global trade and persistent policy uncertainty in key economies are only partially offset by recent improvements in external financing conditions. Global growth is projected to stabilize, reaching 2.6 percent by 2021. This outlook is predicated on the absence of any major negative shocks, as well as a modest recovery in EMDEs that were previously affected by financial market pressure. Risks are firmly on the downside, partly reflecting the potential of destabilizing policy developments, including a further escalation of trade tensions between major economies, rising geopolitical frictions, renewed financial turmoil in EMDEs, and sharper-than-expected slowdowns in major economies. It is therefore urgent for EMDEs to reinforce policy buffers and build resilience to possible negative shocks.

Overall Trends

Global economic activity has continued to soften in 2019, with trade and manufacturing showing signs of weakness. Global industrial production was anemic in the first half of 2019, growing at less than half the rate observed in early 2018. A sustained deterioration in business confidence and the global manufacturing Purchasing Managers' Index suggests that industrial activity will remain subdued for the rest of 2019. Although the services sector was resilient earlier in the year, it has begun to slow in tandem with declining consumer confidence.

The weakening global environment is consistent with the deceleration in growth discussed in the June 2019 *Global Economic Prospects* report, which forecast that global growth would decline to 2.6 percent in 2019, its slowest pace since 2016 (figure 1.1, panel a; World Bank 2019b). But the realization of certain risks—including the re-escalation of trade tensions between major economies—has darkened the outlook since June. Market expectations of GDP growth have deteriorated, with average forecasts for global and EMDE growth continuing to edge downward. Under current working assumptions, more than half of all economies—including several major advanced economies and EMDEs—are expected

FIGURE 1.1 Global economic outlook



Source: Bloomberg; EIA; Institute of International Finance; IEA; J.P. Morgan; OPEC; World Bank.
Note: In panel a, the shaded area indicates forecasts. Data for 2018 are estimates. Aggregate growth rates are calculated using constant 2010 US dollar GDP weights. In panel b, the last observation is for September 2019, which includes data through September 18, 2019. Panel c shows the cumulative weekly flows since January 1, 2018. Equity flows include Brazil, India, Indonesia, the Philippines, Qatar, Sri Lanka, South Africa, Thailand, Turkey, and Vietnam. Debt flows include Hungary, India, Indonesia, Mexico, Poland, South Africa, Thailand, and Turkey. Sovereign spreads are measured by J.P. Morgan's Emerging Markets Bond Index. The last observation is for September 13, 2019. Panel d shows the level change. EIA = Energy Information Administration; EMDEs = emerging markets and developing economies; GDP = gross domestic product; IEA = International Energy Agency; OPEC = Organization of the Petroleum Exporting Countries.

to slow in 2019. Collectively, they account for about two-thirds of global GDP. As a result, global growth in both 2019 and 2020 is now projected to be slightly slower than previously projected.

Cyclical headwinds and persistent policy uncertainty continue to dampen global trade growth. The estimate for global trade growth in 2019 was revised downward by a full percentage point in June, to 2.6 percent, the weakest pace since the global financial crisis. Preliminary estimates incorporating more recent data suggest that projections of trade growth may be reduced even further. Growth in global goods trade and industrial activity weakened substantially over the course of 2019, and new export orders have been declining for more than a year, amid escalating trade tensions, most notably between the United States and China. By the end of 2019, tariffs will cover nearly all U.S. imports from China and more than two-thirds of Chinese imports from the United States. Trade policy uncertainty in the United States spiked this year, reaching levels not recorded since the early 1990s. Disputes involving other economies have also escalated, particularly between the United States and India and between Japan and the Republic of Korea. Since October 2018, the volume of trade affected by new import-restrictive measures introduced by the G20 has more than tripled relative to the 2012–18 average.

Amid signs of deterioration in the global growth outlook and subdued global inflation, major central banks have adopted more accommodative monetary policy stances. Long-term yields in advanced economies have declined sharply in anticipation of further monetary easing, with 10-year yields recently reaching a three-year low in the United States and an all-time low in Germany. As a result, the share of bonds yielding negative market interest rates has increased to its highest level since mid-2016, exceeding 25 percent globally and more than 50 percent in Europe and Japan (figure 1.1, panel b).

Although long-term yields in advanced economies have declined, capital outflows from EMDEs have resumed, and external financing conditions have tightened for some economies. Currency and equity price pressures have also returned, amid growing concerns over the global economy and trade policy uncertainty, but so far most losses have affected only the most vulnerable economies. Notwithstanding recent reversals related to geopolitical and trade policy concerns, aggregate EMDE sovereign bond spreads have fallen back to May 2018 levels, albeit with much variation across countries (figure 1.1, panel c). Amid lower global borrowing costs, debt in EMDEs has increased to historical highs. Moderating inflation has allowed some EMDE central banks to cut interest rates or put their tightening cycles on hold to support growth.

Oil prices rose in the first half of 2019, supported by supply constraints and production cuts. Concerns about slowing global growth, compounded by growing trade tensions, triggered a sharp fall in oil prices in early June and August, with the Brent crude oil price falling to as low as $56/barrel (bbl), down from $72/bbl in May. Supply concerns stemming from geopolitical tensions in the Middle East led to price spikes in July and again in September, after a strike on Saudi Arabia's oil infrastructure halved Saudi production capacity. As production was reportedly fully restored in late September, the impact is likely to be short-lived and not affect current oil price projections. However, the incident is a reminder of the volatility of energy prices in an environment of heightened geopolitical uncertainty, highlighting potential risks for oil exporters, including Azerbaijan, Kazakhstan, and the Russian Federation.

Weak oil demand and escalating trade tensions are expected to dampen oil prices (figure 1.1, panel d). In light of this expected dampening, the Organization of the Petroleum Exporting Countries (OPEC) and its partners, including Russia, agreed to extend their production cuts to March 2020. Oil prices were forecast to decline slightly from 2018 levels, but this forecast is predicated on a rebound in prices in the second half of 2019.

Supply bottlenecks for metals—including copper, nickel, lead, and zinc—supported prices in the first half of 2019. Although iron ore prices have continued to rise amid ongoing supply concerns, the prices of other base metals have since declined, partly reflecting the re-escalation of trade tensions in mid-2019. Overall, metals prices are expected to decline in 2019 and 2020, reflecting a weaker outlook for global metals demand. In contrast, agricultural prices, particularly prices for grains—which rose earlier in the year, on worries that poor weather for some major producers may reduce harvests—are expected to fall, as weather conditions improve.

Trends in Major Economies

The United States

The United States entered the longest period of sustained economic growth on record in 2019, overtaking the 1991–2001 expansion. Incoming data suggest that the expansion is likely to slow, as rising trade tariffs and policy uncertainty weigh on investment. Activity in the industrial sector has decelerated, but the labor market continues to make strong gains. Amid persistently low inflation and concerns about the prospect of a deceleration in U.S. activity, the Federal Reserve has adopted a more dovish stance, cutting rates by 25 basis points in both July and September. Working assumptions project growth to slow to 2.3 percent in 2019 and 1.6 percent in 2020, as the effects of earlier fiscal stimulus wane and recent tariff increases weigh on activity.

The euro area

Activity in the euro area has deteriorated markedly since 2018, particularly in the manufacturing sector, which has fallen into a pronounced contraction. While industrial production and international trade have shown the greatest weakness, consumer activity is starting to show signs of deterioration amid softening retail sales volumes and declining consumer expectations. On the back of growth concerns, the European Central Bank cut policy rates further and resumed quantitative easing. Growth in the euro area is expected to slow to 1.1 percent in 2019 and 2020, reflecting weakness in trade and domestic demand that will not be fully offset by more accommodative fiscal and monetary policy support.

The United Kingdom's exit from the European Union, originally scheduled for late March, was extended to October 31. Following Prime Minister Theresa

May's resignation, the Conservative Party elected Boris Johnson as prime minister. He has indicated that he will not seek further extensions to the scheduled exit, but he lost several key votes and his party's majority in Parliament, where many legislators are seeking to prevent the country from leaving without a deal. The exact form of Brexit remains unclear—the default option if no new agreement is reached is a potentially costly no-deal Brexit, with no transition agreement in place to smooth the introduction of border controls. A no-deal Brexit could disrupt activity in the short term and exacerbate financial stability risks in the United Kingdom and abroad. Uncertainty remains high, and recent data suggest that the economy is fragile. In the second quarter of 2019, activity contracted for the first time since 2012, and the manufacturing Purchasing Managers' Index and economic sentiment fell to their lowest levels since 2013.

China

Growth in China is projected to decelerate to 6.1 percent in 2019, slightly weaker than anticipated, as incoming data point to slowing activity. Trade flows and industrial production growth have weakened amid elevated policy uncertainty. Survey data point to subdued sentiment, especially in the manufacturing sector. Expectations of continued domestic policy support and more accommodative external financing conditions have helped support growth but may slow the

TABLE 1.1 Growth assumptions about the external environment

(Percent change from previous year)

	Real GDP (percent)						Percentage point differences from June 2019 projections		
Category	**2016**	**2017**	**2018e**	**2019f**	**2020f**	**2021f**	**2019f**	**2020f**	**2021f**
World	2.6	3.2	3.0	2.5	2.5	2.6	−0.1	−0.2	−0.2
Advanced economies	1.7	2.4	2.2	1.6	1.4	1.4	−0.1	−0.1	−0.1
United States	1.6	2.4	2.9	2.3	1.6	1.5	−0.2	−0.1	−0.1
Euro Area	1.9	2.4	1.9	1.1	1.1	1.2	−0.1	−0.3	−0.1
Japan	0.6	1.9	0.8	0.9	0.5	0.6	0.1	−0.2	0.0
Emerging market and developing economies (EMDEs)	4.1	4.5	4.3	3.7	4.2	4.4	−0.3	−0.4	−0.2
China	6.7	6.8	6.6	6.1	5.9	5.8	−0.1	−0.2	−0.2
World trade volume[a]	2.6	5.8	4.1	1.5	2.0	2.6	−1.1	−1.2	−0.6
Commodity prices[b]									
Oil price	−15.6	23.3	29.4	−3.4	−1.5	0.7	0.0	0.0	0.0
Non-energy commodity price index	−2.8	5.5	1.7	−2.1	−0.1	1.4	0.0	0.0	0.0

Source: World Bank.
Note: Aggregate growth rates are calculated using constant 2010 U.S. dollar GDP weights. World Bank assumptions are frequently updated based on new information. Consequently, the working assumptions presented here may differ from those in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given moment.
e = estimate; f = forecast.
a. World trade volume of goods and nonfactor services.
b. Oil is the simple average of Brent, Dubai, and West Texas Intermediate. The nonenergy index is made up of the weighted average of 39 commodities (7 metals, 5 fertilizers, and 27 agricultural commodities). For details, see http://www.worldbank.org/en/research/commodity-markets.
To download the data in this table, please visit www.worldbank.org/gep.

deleveraging process. Growth is projected to decelerate to 5.9 percent in 2020 and 5.8 percent by 2021, as mounting trade tariffs with the United States dampen growth.

Global Risks

Risks to global growth remain firmly on the downside. Confidence and investment could be dented by a sudden rise in policy uncertainty—triggered, for instance, by substantial new trade barriers between major economies or further escalation in geopolitical tensions. A further increase in trade tensions between the United States and China would result in significant economic losses for exporters of the targeted products and lead to cascading trade costs to other sectors. Although some countries could benefit from trade diversion in the short run, adverse effects from weakening growth and rising policy uncertainties involving the world's two largest economies would have predominantly negative repercussions (Freund and others 2018). Additional US tariff hikes, including in the automobile sector, could significantly disrupt tightly integrated value chains and raise average US tariffs substantially above those of most G20 countries (World Bank 2019b). A disorderly exit of the United Kingdom from the European Union would lead to a spike in uncertainty and further impede trade flows, and it could lead to dislocating shifts in financial markets. Further disruptions to the global energy supply—triggered, for instance, by rising geopolitical tensions in the Middle East—could also generate substantial volatility in commodity prices.

Any event that triggers a sudden weakening of financial market sentiment could spur sharp increases in risk premiums. The impact on the economy would be amplified by high and rising debt levels, corporate sector vulnerabilities, and increasing refinancing pressures in many EMDEs. The risk of a sharper-than-expected deceleration in major economies—such as the euro area, the United States, or China—would result in considerably weaker global and EMDE growth.

The probability of growth in 2020 being at least 1 percentage point below current projections is estimated at about 20 percent. Such a slowdown would be comparable to the 2001 global downturn. Meanwhile, climate change poses ever-growing risks to various EMDE regions, especially those with agricultural exporters or low-lying coastal regions.

Europe and Central Asia: Recent Developments and Outlook

Aggregate growth in EMDEs in Europe and Central Asia (ECA) is projected to decelerate to 1.8 percent in 2019, down from 3.2 percent in 2018. The sharp slowdown partly reflects substantial weakness in Turkey, following acute financial market stress last year, as well as sluggish activity in Russia amid cuts in oil production. Regional growth is projected to improve in 2020–21, as activity recovers in Turkey and firms up in Russia. Headline growth numbers mask substantial subregional variation, however, with Central Europe markedly decelerating and Central Asia delivering the strongest growth in the region. Key external risks to the region include spillovers from weaker-than-expected *activity in the euro area and escalation of global policy uncertainty, particularly in relation to trade tensions and Brexit. Renewed financial pressures in Turkey could also disrupt regional growth, while the possibility of sharp energy price declines represents a downside risk to the region's energy exporters.*

Recent Developments

Growth in the EMDEs in ECA is projected to decelerate markedly in 2019, to a four-year low of 1.8 percent, down from 3.2 percent in 2018. The growth profile reflects slowdowns in the region's two largest economies, Turkey and Russia, as well as in other economies that are grappling with continued weakness in trade and industrial activity in Europe (figure 1.2, panel a). Headline numbers mask diverging growth trends across the region, however. In Central Europe, continued government support has staved off spillovers from a slowing euro area, temporarily boosting growth in early 2019. In the Western Balkans, activity decelerated more than anticipated, despite robust private consumption growth.

TABLE 1.2 Europe and Central Asia growth assumptions summary

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

	Annual GDP growth (percent)						Percentage point differences from June 2019 projections		
Category	2016	2017	2018[e]	2019[f]	2020[f]	2021[f]	2019[f]	2020[f]	2021[f]
EMDE ECA, GDP[a]	1.9	4.1	3.2	1.8	2.7	3.0	0.2	0.0	0.1
EMDE ECA, GDP excl. Turkey	1.5	3.0	3.3	2.5	2.6	2.6	0.1	0.0	0.0
Commodity exporters[b]	0.7	2.1	2.6	1.7	2.2	2.4	−0.1	0.0	0.1
Commodity importers[c]	3.1	6.1	3.7	2.0	3.1	3.5	0.6	0.0	0.0
Central Europe and Baltic States[d]	3.3	5.0	4.6	4.0	3.3	3.1	0.4	0.1	0.1
Western Balkans[e]	3.2	2.6	3.9	3.2	3.6	3.8	−0.3	−0.2	−0.1
Eastern Europe[f]	0.9	2.6	3.3	2.8	3.0	3.3	0.4	0.3	0.3
South Caucasus[g]	−1.6	1.7	2.6	3.5	3.1	3.1	−0.2	−0.8	−1.1
Central Asia[h]	2.9	4.6	4.7	4.4	4.2	4.5	0.2	0.2	0.4
Russian Federation	0.3	1.6	2.3	1.0	1.7	1.8	−0.2	−0.1	0.0
Turkey	3.2	7.5	2.8	0.0	3.0	4.0	1.0	0.0	0.0
Poland	3.1	4.9	5.1	4.3	3.6	3.3	0.3	0.0	0.0

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. For additional information, see www.worldbank.org/gep. e = estimate; ECA = Europe and Central Asia; EMDE = emerging market and developing economy; f = forecast; GDP = gross domestic product.

a. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.

b. Includes Albania, Armenia, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Kosovo, the Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

c. Includes Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, Moldova, Montenegro, North Macedonia, Poland, Romania, Serbia, and Turkey.

d. Includes Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, 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, Turkmenistan, and Uzbekistan.

Sustained weakening in the volume of goods trade growth and new export orders continues in ECA, amid slowing manufacturing activity and investment. Softening external demand is likely to dampen export growth across the region, especially in economies with closer trade and financial linkages to the euro area, such as Central Europe (figure 1.2, panel b). Overall, regional gross domestic product (GDP) growth is expected to firm to 3 percent by 2021, assuming that the euro area and key commodity prices stabilize and Turkey's economy bottoms out in 2019.

Moderating inflation and generally lower global interest rates have provided some EMDEs in ECA with space for monetary policy room to support growth. Headline inflation in ECA has somewhat eased in tandem with energy prices, particularly among commodity importers. These factors have allowed some ECA economies (including Russia, Tajikistan, Turkey, and Ukraine) to offset weakening growth momentum by pausing or reversing the tightening cycle that was pursued in 2018. However, core inflation is beginning to pick up in some economies, especially economies with accelerating wages as a result of labor shortages and other rising capacity constraints, such as Hungary, Poland, and Romania (figure 1.2, panel c). For economies facing sustained weakening and spillovers from the slowdown of key trade partners, countercyclical fiscal stimulus would be appropriate if there is fiscal space. Careful consideration should be given to debt sustainability, however. In economies that are more constrained, policy makers could mobilize domestic resources and ensure that public expenditure is efficiently allocated.

The Russian Federation

Growth in Russia is projected to decelerate to 1.0 percent in 2019, down from a six-year high of 2.3 percent in 2018. The slowdown stems from multiple factors, which are compounded by the continuation of international economic sanctions. Weak investment and trade growth partly contributed to softer-than-expected GDP growth in early 2019. Industrial activity softened in the first half of 2019, as compliance with agreed upon oil production cuts with OPEC took effect. Contamination of major fuel lines to Europe has further disrupted energy production. Retail sales volumes also slowed with the onset of the value-added tax hike, and consumer confidence remained firmly negative. Tighter monetary policy at the beginning of the year also weighed on activity; the central bank later reversed course by cutting the key policy rate three times in mid-2019. As a non-OPEC partner, Russia agreed to extend current oil production cuts until March 2020. Further policy accommodation and planned public infrastructure projects should help buoy growth in 2020. Private investment remains tepid because of policy uncertainty and prospects for slowing potential growth over the longer term as demographic pressures increase and ongoing structural problems, such as the lack of competition, accumulate. Weaker-than-expected growth in Russia could potentially spill over to Central Europe, Eastern Europe, and the South Caucasus, all of which maintain close trade and financial linkages with it.

Turkey

Turkey entered a recession in the second half of 2018, after acute financial market pressures led to sharp declines in investment and consumption. The downturn was triggered by corporate fragility stemming from rising levels of debt, often denominated in foreign currency, and exacerbated by policy uncertainty. Investment weakness is expected to weigh on activity in Turkey in 2019. Flare-ups in financial market pressures highlight the fact that downside risks remain very high. Incoming data point to a slow recovery in Turkey, as industrial production growth and manufacturing activity remain soft amid heightened policy uncertainty. Private consumption has been dampened by elevated inflation and associated pressures on real incomes as well as rising unemployment. In mid-2019, the central bank sharply reversed monetary policy by cutting the policy rate 7.5 percentage points, to 16.5 percent, despite above-target inflation. Gradual improvement in domestic demand and net exports are expected to support growth over the forecast horizon, provided that fiscal and monetary policy avert further sharp declines in the lira and corporate debt restructurings help prevent serious damage to the financial system.

Central Europe and the Baltics

Growth in Central Europe and the Baltics is projected to slow to 4.0 percent in 2019, down from 4.6 percent in 2018. Robust growth in the first half of the year in Central Europe was supported by temporary factors, which helped offset waning activity in some economies in the Baltics. In Bulgaria, Croatia, Hungary, Poland, and Romania, strengthening private consumption—supported by rising real wages and government transfers—helped underpin disposable income and growth at the start of 2019. A boost in investment helped delivered robust growth and propel construction in Hungary and Romania. These trends are not expected to continue, however, as decelerating investment, weakness in external demand from key trading partners, and rising domestic capacity constraints will likely dampen growth prospects. The slowdown in the euro area has already begun to weigh on exports in Bulgaria, Hungary, and Romania. Fiscal stimulus, and the resulting boost to private consumption, will begin to fade in some of the subregion's largest economies (Hungary, Poland, Romania) by 2020–21. Shrinking working-age populations, partly reflecting emigration to Western Europe in recent years, limit growth prospects. Progress on structural reforms is key to support private investment growth over the medium term.

The Western Balkans

Growth in the Western Balkans is expected to slow to 3.2 percent in 2019, down from 3.9 percent in 2018. Activity decelerated in several economies, with marked weakness stemming from slowing investment (Kosovo), manufacturing (Serbia), and export growth (Albania). One-off factors related to weather and subsequent energy production dampened activity in Albania, while domestic demand softened in Montenegro.

Growth in the Western Balkans is projected to firm to 3.8 percent by 2021, assuming political instability and policy uncertainty remain contained. Rising fiscal liabilities in the subregion—in some cases due to large public sector wage increases or higher-than-expected costs for infrastructure projects—could reduce space for future countercyclical fiscal stimulus and weaken the business climate (Kosovo and Montenegro). Investment in existing infrastructure needs could boost growth in Kosovo, the Republic of North Macedonia, and Serbia, but the subregion faces rising external risks from weakness in key trading and financial partners in the euro area.

The South Caucasus

Growth in the South Caucasus is forecast to grow 3.5 percent in 2019, slowing to 3.1 percent by 2021. However, the recent escalation of tensions following Russia's imposition of sanctions on travel to Georgia has reduced tourism and could further dent activity and confidence in the region.

Activity in the South Caucasus has been supported by private consumption, with growth further boosted by an expansion in industrial activity, reflecting strong manufacturing growth and a recovery in mining production in Armenia. In Azerbaijan, the subregion's largest economy, activity is expected to be dampened by slowing private investment; the effects will be compounded by subdued oil prices and weak credit growth arising from fragilities in the financial sector. Longer-term growth depends on continuation of domestic reforms to enhance the business environment, as well as investment in education in order to boost human capital and reduce skills mismatches.

Eastern Europe and Central Asia

Growth in Eastern Europe and Central Asia is expected to stabilize over the forecast horizon, but it is subject to considerable policy uncertainty. Both subregions face a challenging external environment, as growth remains subdued in major trading partners, such as the euro area and Russia; Central Asia is also affected by developments in China. Industrial production growth has softened in Eastern Europe, reflecting weakness in manufacturing amid slowing export growth, particularly in Belarus. Activity in Ukraine was robust in early 2019, but it reflected temporary factors, including a bumper crop harvest.

In Central Asia, the cyclical recovery is expected to moderate following flattening oil production following agreed upon production cuts by Kazakhstan and lackluster growth in the nongold sectors in the Kyrgyz Republic. Activity in Kazakhstan—the largest economy in Central Asia—will be constrained by the waning effect of earlier fiscal stimulus; modest or slowing growth in key trading partners (Russia, China); and low productivity.

The pace of growth in Eastern Europe and Central Asia depends on successful implementation of structural reforms to improve the business environment, achieve debt sustainability, and restructure state-owned enterprises to improve competition (EBRD 2017; Funke, Isakova, and Ivanya 2017).

TABLE 1.3 Europe and Central Asia country growth assumptions

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

Country	Annual GDP growth (percent)						Percentage point differences from June 2019 projections		
	2016	2017	2018e	2019f	2020f	2021f	2019f	2020f	2021f
Albania	3.3	3.8	4.1	2.9	3.4	3.6	−0.8	−0.3	−0.2
Armenia	0.2	7.5	5.2	5.5	5.1	5.2	1.3	0.2	0.0
Azerbaijan	−3.1	−0.3	1.4	2.8	2.3	2.1	−0.5	−1.2	−1.6
Belarus	−2.5	2.5	3.0	1.5	1.3	1.2	−0.3	0.0	0.0
Bosnia and Herzegovina[a]	3.1	3.2	3.6	3.1	3.4	3.9	−0.3	−0.5	−0.1
Bulgaria	3.9	3.8	3.1	3.2	3.0	3.1	0.2	0.2	0.3
Croatia	3.5	2.9	2.6	2.9	2.6	2.4	0.4	0.1	0.0
Georgia	2.8	4.8	4.7	4.4	4.3	4.5	−0.2	−0.5	−0.5
Hungary	2.3	4.1	4.9	4.4	2.8	2.6	0.6	0.0	0.0
Kazakhstan	1.1	4.1	4.1	3.9	3.5	3.7	0.4	0.3	0.5
Kosovo	4.1	4.2	3.8	4.0	4.2	4.1	−0.4	−0.3	−0.4
Kyrgyz Republic	4.3	4.7	3.5	4.2	3.7	3.7	−0.1	−0.3	−0.4
Moldova	4.4	4.7	4.0	3.4	3.6	3.8	0.0	0.0	0.0
Montenegro	2.9	4.7	4.9	3.0	2.8	2.7	0.1	0.4	0.4
North Macedonia	2.8	0.2	2.7	3.1	3.2	3.3	0.2	0.0	−0.3
Poland	3.1	4.9	5.1	4.3	3.6	3.3	0.3	0.0	0.0
Romania	4.8	7.0	4.1	4.2	3.6	3.2	0.6	0.3	0.1
Russian Federation	0.3	1.6	2.3	1.0	1.7	1.8	−0.2	−0.1	0.0
Serbia	3.3	2.0	4.3	3.3	3.9	4.0	−0.2	−0.1	0.0
Tajikistan	6.9	7.6	7.3	6.2	5.5	5.0	0.2	−0.5	−1.0
Turkey	3.2	7.5	2.8	0.0	3.0	4.0	1.0	0.0	0.0
Turkmenistan	6.2	6.5	6.2	5.0	5.2	5.5	−0.6	0.1	0.6
Ukraine	2.4	2.5	3.3	3.4	3.7	4.2	0.7	0.3	0.4
Uzbekistan	6.1	4.5	5.1	5.5	5.7	6.0	0.2	0.2	0.0

Source: World Bank.
Note: GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars, unless indicated otherwise. World Bank assumptions are frequently updated based 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 significantly differ at any given moment in time. For additional information, see www.worldbank.org/gep.
e = estimate; f = forecast.
a. GDP growth rate at constant prices is based on the factor costs approach.

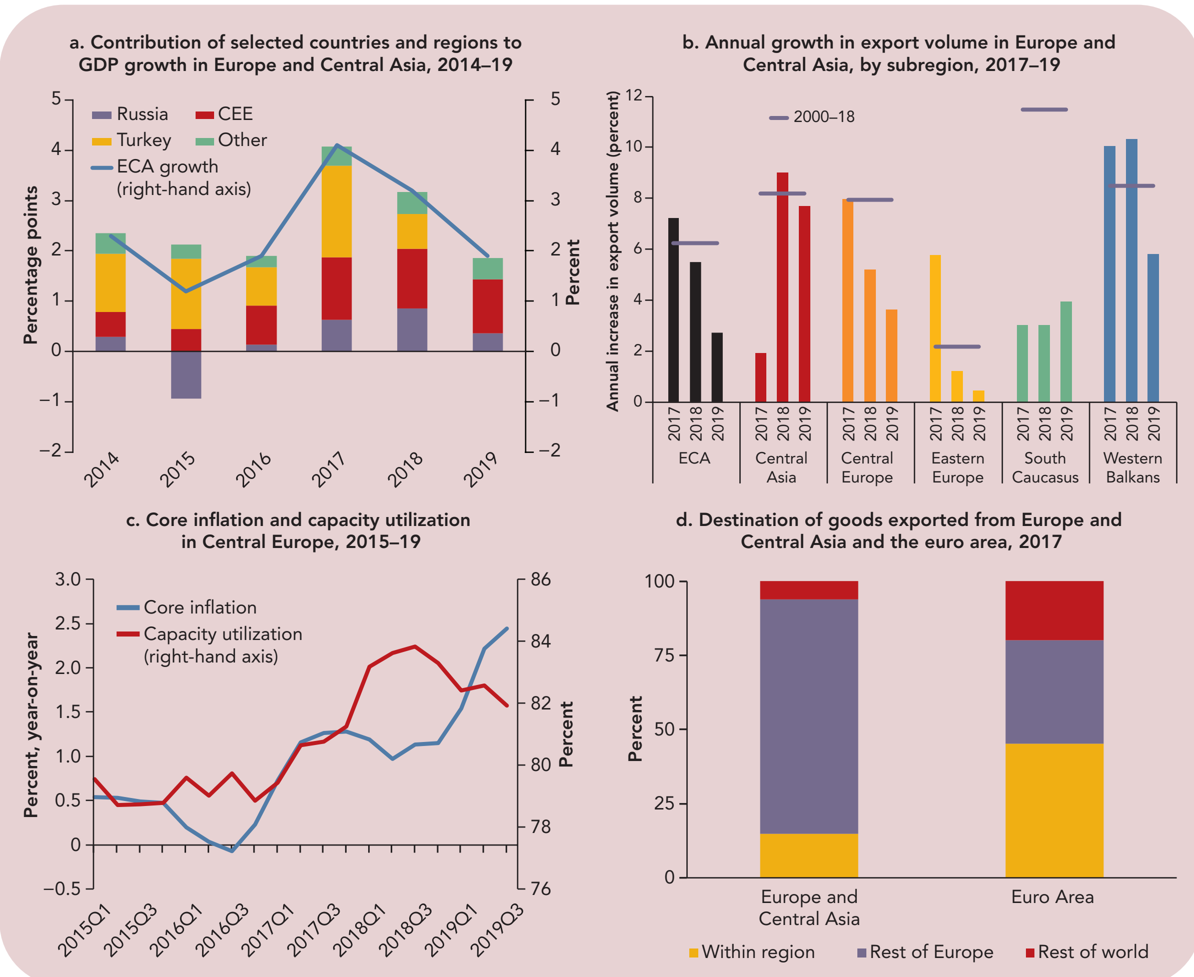
Risks to the Regional Outlook

The regional outlook remains subject to significant downside risks, despite recent easing in global financing conditions. A sharper-than-expected slowdown in the euro area—ECA's most important trading partner—could generate negative spillovers in economies with tightly linked trade and financial ties (figure 1.2, panel d). Modest activity in Russia could dent remittance inflows, which account for an important share of income in the Kyrgyz Republic, Moldova, Tajikistan, and Ukraine. Slowing growth in China—which continues to expand its role in trade in the region, particularly for metals exporters—could affect commodity exporters and economies in Central Asia through trade channels.

Financial stress in Turkey has had limited spillover to the other economies in the region, but it is a stark reminder of the risks associated with sudden shifts in investor sentiment. These risks can be magnified in economies in which imbalances persist, including economies with large current account deficits or heavy reliance on potentially volatile capital inflows, high external debt loads, or sizable foreign currency–denominated debt (Belarus, Croatia, Georgia, the Kyrgyz Republic, Moldova, Tajikistan, Ukraine). In Central Europe, fiscal stimulus–driven growth has also generated imbalances, with strong wage growth coupled with government transfers widening current account and fiscal deficits.

Rising policy uncertainty, particularly on the trade front, could undermine business and investor sentiment in the region. Further escalation of international trade restrictions or sanctions could have a negative impact on the region, especially given its openness to trade and capital flows. A disorderly exit from the

FIGURE 1.2 Recent developments, outlook, and risks in Europe and Central Asia



Sources: Haver Analytics; OECD; UNCTAD; World Bank.
Note: In panel a, aggregate growth rates are calculated using 2010 constant US dollar GDP weights. Data for 2019 are forecasts. CEE = Central and Eastern Europe. In panel c, core inflation is the median for the sample, and capacity utilization is calculated using constant 2010 US dollar GDP weights. The sample includes Hungary, Poland, and Romania. The last observation is for the third quarter of 2019. In panel d, shares are calculated from exports in millions of dollars.

European Union by the United Kingdom or a flare-up in trade relations between the United States and Europe, particularly with respect to auto tariffs, could adversely affect the ECA region. A spiraling of trade tensions between the United States and China could hurt some regional economies, particularly energy and metals exporters. A reversal of structural reforms remains a key risk in many economies, especially in Eastern Europe, Central Asia, and Turkey. Renewed conflict in the Syrian Arab Republic or Ukraine, as well as military disagreements with the North Atlantic Treaty Organization (NATO), could trigger new sanctions against Russia and Turkey.

Long-Term Challenges and Policies

Structural challenges are intensifying in the region, as worsening demographic trends—including the shrinking size of the working-age population—and weak productivity growth continue to weigh on prospects. Structural reforms to strengthen institutions and governance could help confront corruption, bolster the business climate, and spur investment growth. Investing in human capital and improving learning outcomes could help unleash untapped potential for growth. Improving access to reliable and affordable infrastructure, leveraging productivity-enhancing technologies, and buttressing institutional quality could help remove key bottlenecks to activity. Adapting to climate change will be critical for the region's agricultural producers and coastal areas; strengthening institutional capacity and enhancing agricultural productivity could help mitigate climate change risks. Chapter 2 of this update focuses on labor mobility, which can mitigate demographic trends, increase growth, and spur poverty reduction in the region.

Improving Governance

Structural reforms aimed at improving governance can lead to sizable productivity gains, particularly in countries that are farthest from best practices (Acemoglu, Johnson, and Robinson 2005; Cusolito and Maloney 2018). EMDE experience illustrates that major governance and business reforms in EMDEs were associated with higher growth rates in output, total factor productivity, and investment (Hodge and others 2011; Divanbeigi and Ramalho 2015; World Bank 2018b). Reform is particularly important given the region's fiscal constraints and large investment needs (World Bank 2019b). Countries across the region need to tackle weak public institutions and policies, in order to improve service delivery, promote stability, and manage economic resources sustainably.

Governance indicators, such as indicators of government effectiveness and regulatory quality, tend to be stronger in EMDEs in ECA than in other regions, but they continue to trail those of advanced economies and suffer from deficiencies in various aspects, notably corruption (figure 1.3, panel a) (Kaufmann, Kraay, and Mastruzzi 2010). Nearly 75 percent of ECA EMDEs fall below the global average for tackling corruption, including almost all of the countries of Central Europe, Eastern Europe, and the South Caucasus. Because progress in confronting perceived and actual corruption has been slow, the perception of corruption is higher than it is in other EMDEs (Transparency International 2019). Anticorruption campaigns, as well as a reduction in the number of regulations and tax complexity, have helped some economies tackle corruption (IMF 2019b). A promising development in the region has been new policy momentum to tackle corruption. Armenia, for example, announced an action plan to prevent and investigate corruption as well as campaigns to improve awareness and education.

Bolstering governance—including through control of corruption and rent-seeking, fair application of the rule of law, protection of property rights, and political stability—could boost innovation, increase financial access, improve the provision of public services, enhance infrastructure quality, and spur stronger investment growth (Berkowitz, Lin, and Ma 2015; Kornejew, Rentschler, and Hallegatte 2019; Rentschler and others 2019). Citizen engagement is an important element of building effective, accountable, and inclusive institutions that underlie good governance. When citizens can exercise their right to participate and access real-time information, they can become part of the solution by demanding necessary policy changes (World Bank 2016). Transparency, accountability, and citizen engagement are also key to building trust and establishing a strong social contract, which is critical to bringing societies together in striving to achieve their development goals. These issues and policy implications were discussed at length at an ECA Regional Governance conference held in Turkey June 11–12, 2019.

Completing the Transition to Competitive and Inclusive Markets

EMDEs in ECA face substantial long-term challenges to ensure sustained improvements in incomes and living standards amid rapid technological and demographic changes. Countries in the region are at different stages of transitioning to building competitive and inclusive markets. Across the board, however, there is a need to boost productivity growth and investment, which has fallen over the past decade. This decline has occurred despite large increases in debt, particularly in the corporate sector. Indebtedness is particularly high in Eastern Europe and Central Asia (Feyen and others 2017; World Bank 2019b). Worsening demographic trends have played an important role in these developments. Generating stronger potential growth will require measures to mitigate declining population size and free up untapped potential for growth and productive gains. Such policies include increasing the labor force participation of women, attracting and retaining labor, and investing in human capital.

ECA countries are at different stages of the demographic transition, but trends are worsening due to shrinking working-age populations. Higher-income economies in Central Europe are reaching an advanced stage of aging, with declining fertility and mortality; Turkey and to some extent Central Asia are at earlier stages of this transition (Bussolo, Koettl, and Sinnott 2015; World Bank 2018b). Growth in the size of the working-age population in the region has long lagged the average for EMDEs, as a result of sharp declines in fertility rates and significant migration to the European Union and Russia. One approach that could help counteract the problem would be to remove barriers to entry for female labor force participation—by improving access to parental leave and childcare, for example (Raute 2017; Thévenon and Solaz 2013). Implementing more flexible immigration policies could help relieve capacity constraints in the labor market by attracting foreign workers in an orderly way (Delogu, Docquier, and Machado 2014). Relaxing restrictions on cross-border movement of labor could produce significant gains, but there are costs as well as benefits to such labor mobility. Chapter 2 of this update focuses on labor mobility, presenting recent trends and discussing policy options to reap overall gains while recognizing and easing the short-run adjustment costs so that the long-run benefits are shared more evenly.

Inadequate investment in human capital has left parts of the workforce in some EMDEs in ECA poorly equipped with the skills required for the future and unprepared for rapid technological change (Flabbi and Gatti 2018). Boosting human capital investment—including in education and health—could help remove bottlenecks to productivity growth.

How education systems adapt to skills needs will be a key determinant of the productivity and distributional effects of technological change (Barro and Lee 2015). In some economies in ECA, learning and the acquisition of necessary skills are lower than expected given the level of school enrollment and the average years of schooling (Altinok, Angrist, and Patrinos 2018). The learning gap (the difference between years spent in schools and educational assessment outcomes) is wider than the global average in most Western Balkan economies as well as in some economies in Eastern Europe, Central Asia, and the South Caucasus. Some economies, including Georgia, have taken measures to reform the education sector and its funding (figure 1.3, panel b) (Kraay 2018). Education policy and training programs can be redesigned to adapt available skills to changing development needs and new technologies, which could boost growth and employment prospects (Hallward-Driemeier and Nayyar 2018; World Bank 2018b).

Strengthening the Environment for Private Investment and Innovation

A large body of literature suggests that state-owned enterprises tend to be less efficient than private sector firms (World Bank 1995). Privatization therefore presents an opportunity to raise economywide productivity in many countries across the region, especially if it is accompanied by improvements in management, corporate governance, and the business environment. Improving the business environment is a critical part of fostering private investment and job creation. Reforms that target simplifying tax and regulatory requirements and ensuring clarity and predictability for investors are an effective way to support private investment, attract foreign direct investment, and increase productivity. Strengthening the environment for business can also help reduce the likelihood of corruption, informality, and extreme poverty (Demenet, Razafindrakoto, and Roubaud 2016; Djankov, Georgieva, and Ramalho 2018; Lawless 2013; Paunov 2016).

Over the past decade, EMDEs in ECA made strides in improving their business environments. As a result, in many countries in Central and Eastern Europe, the Western Balkans, and the South Caucasus, business environment indexes are approaching the levels in advanced EU countries (figure 1.3, panel c) (World Bank 2018a). Challenges remain, however, including limited improvements in some indicators, which has muted the overall economic response. Notable challenges also remain in Central Asia, which continues to lag well behind countries elsewhere in the region, notwithstanding improvements in Kazakhstan and Uzbekistan (World Bank 2019a).

A key part of the business environment is a well-functioning financial system. Well-functioning financial systems contribute to growth and poverty alleviation by mobilizing and pooling resources, allocating capital to its most efficient uses, monitoring these investments after they have been made, and diversifying and managing risk. To be able to perform these functions, financial systems need to be deep, efficient, and stable. For all segments of the society to benefit from these services, they also need to be inclusive (World Bank 2019a).

There is great variation in financial inclusion in the region. Central Asia and the South Caucasus made the greatest advances in recent years, although they started from a very low base and still lag the rest of the region. Although nearly two-thirds of the adult population owned an account in 2017—up from less than half in 2011—significant challenges remain. Turkey suffers from significant gender gaps, for example, and income gaps are wide in Romania (Demirgüç-Kunt, Hu, and Klapper 2019).

Small and medium-size enterprises (SMEs) have the largest untapped potential for productivity catch-up with advanced economies, but their growth potential continues to be hindered by many factors, including insufficient access to finance (Ayyagari, Demirgüç-Kunt, and Maksimovic 2017; Cusolito, Safadi, and Taglioni 2017; Wang 2016). The largest gaps in financial inclusion for SMEs in ECA lie in Central Asia and the South Caucasus, where access to financial services is nearly as limited as it is in the Middle East and North Africa, South Asia, and Sub-Saharan Africa (IMF 2019a).

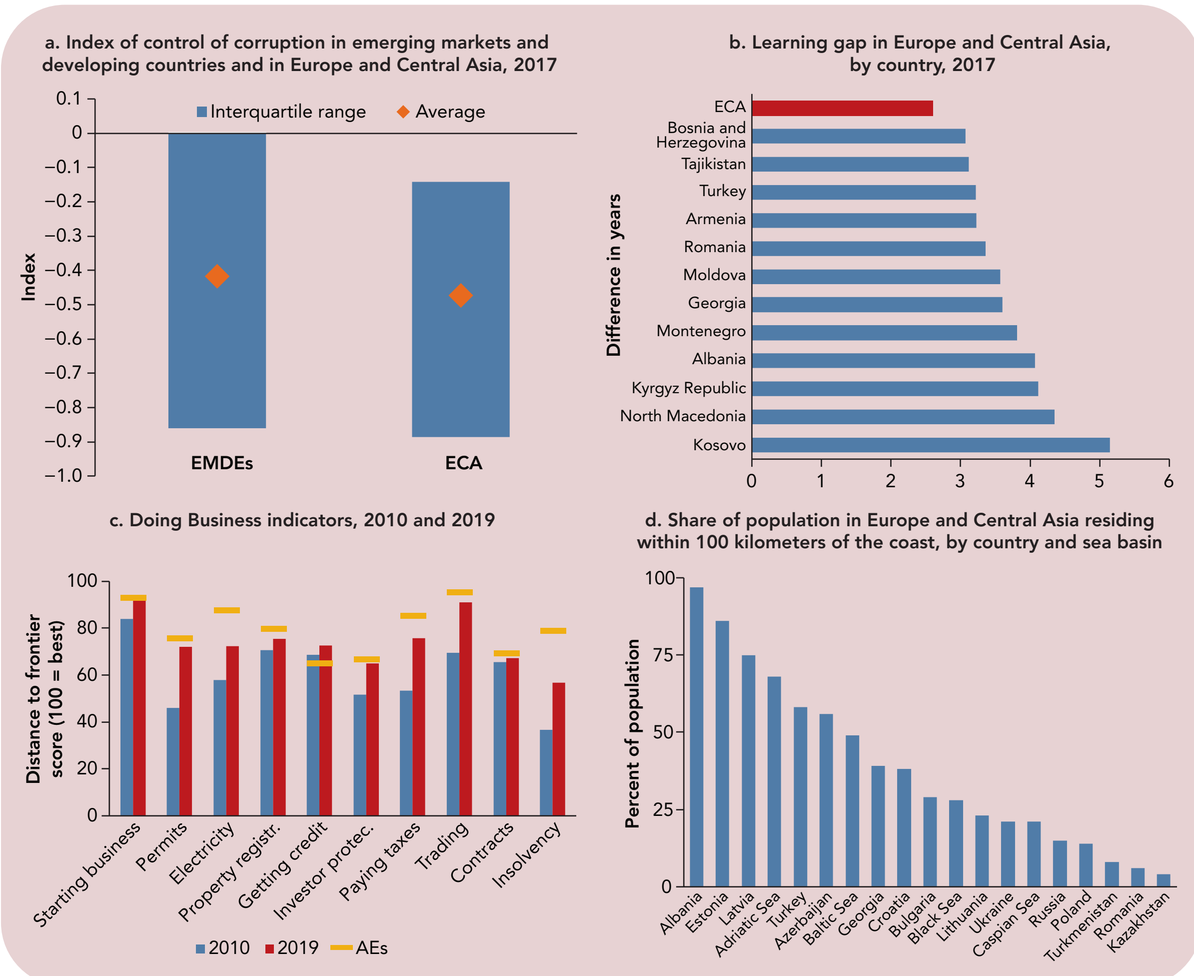
Policies that target more widespread adoption of digital technologies, including in the delivery of financial and public sector services, could bolster financial inclusion and boost productivity by helping spread innovation and improving private sector and government efficiency (Baldwin 2019). In economies with large informal sectors, widespread adoption of these digital technologies could help expand tax bases through the fiscalization of informal sector transactions (World Bank 2019b). Increasing SMEs' access to finance could help these firms increase their average size and reduce their reliance on retained earnings to fund investment, which in turn would support job creation and deter suboptimal capital spending (Ayyagari, Demirgüç-Kunt, and Maksimovic 2017; Ayyagari and others 2016).

Strengthening the environment for private investment also requires removing other key bottlenecks to economic activity and private sector development, such as inefficient connectivity and inadequate infrastructure. Improved connectivity can accelerate the absorption of technology and speed convergence with advanced economies (Gould 2018). Infrastructure spending needs remain large in ECA, particularly for transport and electricity. Appropriate land use planning and urbanization policies can substantially reduce the cost of meeting transport needs while minimizing carbon footprints (ITF 2018; Rozenberg and Fay 2019). The percentage of firms experiencing electrical outages is lower in ECA than in any other EMDE region, but losses for affected firms in Central Asia can exceed 9 percent of annual sales (Blimpo and Cosgrove-Davies 2019; IMF 2019c).

Mitigating and Adapting to Climate Change

Climate change is contributing to various risks for more exposed EMDE regions, including ECA, which contains many agricultural producers and coastal communities (IPCC 2018). The Eastern Europe and Central Asia subregions are vital for global food chains, exporting nearly a quarter of the world's wheat exports; most of these exports are from Russia, Ukraine, and Kazakhstan (Swinnen and others 2017). The adaptive capacity to mitigate climate change in ECA is undermined by inadequate infrastructure, weak institutions, and constrained financial resources—a serious problem in a region that relies heavily on agriculture and tourism.

FIGURE 1.3 Long-term economic challenges facing Europe and Central Asia



Sources: Kraay 2018; World Bank 2017.
Note: In panel a, the indicator reflects perceptions of the extent to which public power is exercised for private gain, including petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. The sample includes 150 EMDEs. In panel b, the learning gap is the difference between expected years of schooling and learning-adjusted years of schooling, as in Kraay (2018). Panel c shows the median ECA EMDE across the different indicators. The sample includes 22 ECA EMDEs and 33 advanced economies. The full names of the reform areas given on the x-axis are making it easier to start a business, deal with construction permits, get electricity, register property, get credit, protect minority investors, pay taxes, trade across borders, enforce contracts, and resolve insolvency.

Heavy reliance on agriculture leaves many ECA economies vulnerable to changes in rainfall patterns, rising temperatures, droughts, and floods. Soil quality is expected to deteriorate in response to higher temperatures and more frequent droughts, especially in Russia and Ukraine, which could threaten crop yields in the absence of adaptive measures (Dronin and Kirilenko 2011; Lioubimtseva, de Beurs, and Henebry 2013; Müller and others 2016; Teixeira and others 2013). These economies are particularly vulnerable because of their aridity, previous underinvestment in infrastructure, frequency of natural disasters, reliance on glaciers for water supply, and legacy of environmental mismanagement. Productivity-enhancing measures in the agriculture sector—including improved irrigation, better access to markets, effective use of fertilizers, and new technologies—could help maintain crop yields and food security (Leclère and others 2014; Müller and others 2011; Roudier and others 2011; World Bank forthcoming).

Coastal populations in ECA are exposed to climate change risks from sea level rise, storm surges, floods, and droughts. Within the ECA basins—the Adriatic Sea, Baltic Sea, Black Sea, and Caspian Sea—the average coastal population ranges from 20 percent (Caspian Sea) to nearly 70 percent of the population (figure 1.3, panel d) (World Bank 2017). A significant rise in sea level, erosion, and storm surges in the Black Sea are threatening ports, housing, arable land, and tourism sites along the coasts of Georgia, Russia, Turkey, and Ukraine (Frolov 2000; Karaca and Nicholls 2008). Boosting adaptive capacity through improvements in coastal management policies—such as zoning and planning, water resource management, use of new technologies, and flood control—will be critical to mitigate the risks climate change poses on coastal communities.

Improved institutions and policy buffers can enhance resilience to climate change, as they provide the resources needed to support victims of extreme events. Strengthening institutional capacity by moving closer to best practices in governance, government effectiveness, contract enforcement, control of corruption, and regulatory quality is critical to ensure that climate mitigation policy efforts are not hindered (Tol, Klein, and Nicholls 2008; World Bank 2017). Investment in climate-smart infrastructure, combined with appropriate land use planning, can help mitigate climate change risks. Effective social safety nets and productive inclusion programs, which act as a countercyclical buffer during economic downturns triggered by climate events, are needed to protect the most vulnerable.

Annex 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 (OECD) analytical housing price indicators, the IMF's Balance of Payments Statistics, and the IMF's International Financial Statistics.

Aggregations

Aggregate growth for the world and all subgroups of countries (such as regions and income groups) is calculated as the GDP–weighted average (at 2010 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 EMDEs, which are produced using macroeconometric models, accounting frameworks to ensure national account 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

Migration and Brain Drain in Europe and Central Asia

Global migration is composed of many different narratives with distinct causes, economic and social implications for all involved, and context-specific policy responses. Every migrant and refugee has a different story. A farm worker may be doing work no one else is willing to perform. A brain surgeon may be saving lives. A desperate young man may be pretending to be a refugee, because doing so may be the only path available to flee his country.

On the other side of the border, a middle-aged factory worker fears for her job, as a young immigrant is willing to work for half her wage. A teacher does not know how to teach when half the students in his class do not speak the native language.

In the origin country, patients at the local clinic worry their last doctor will also emigrate. The minister of education wonders why the ministry is spending so much money to subsidize the economies of rich countries as many of the university graduates emigrate, while the finance minister is grateful for the remittances they send but worried that these may not last.

Whether the issue is undocumented migration, brain drain, refugees, or temporary migration, the only certainty is that global migration is here to stay. Current problems show that policy makers cannot fight labor markets or the pull/push forces behind migration. These forces are too strong to overcome with simple restrictive policies. They need to be properly managed with innovative and economically sound policies.

Labor mobility can address many of the long-run challenges the Europe and Central Asia (ECA) region is facing, such as the burdens created by demographic pressures arising from population aging and low fertility rates. The main difficulty is designing policies that will enable the region to take advantage of the gains generated by labor mobility and address the costs of migration. The gains arise from more efficiently allocating labor across sectors and geographic areas, matching unmet demand in many occupations, and taking advantage of

agglomeration spillovers in high-skilled sectors. The costs result from the displacement and relocation of some workers in destination labor markets and the loss of scarce human capital (brain drain) in origin countries.

Emigration and immigration rates are high in ECA, especially within the region. The policy debate should focus on managing external and internal migration so that the region can more effectively transition to a competitive, inclusive, efficient, and integrated market.

This chapter examines migration in the region. The first section presents the trends, determinants, and impacts of low- and high-skilled labor in the region. The second section discusses policies for attracting both types of labor and dealing with the repercussions in both origin and destination countries. The last section summarizes the main conclusions.

The Nature of Migration

Patterns of Migration

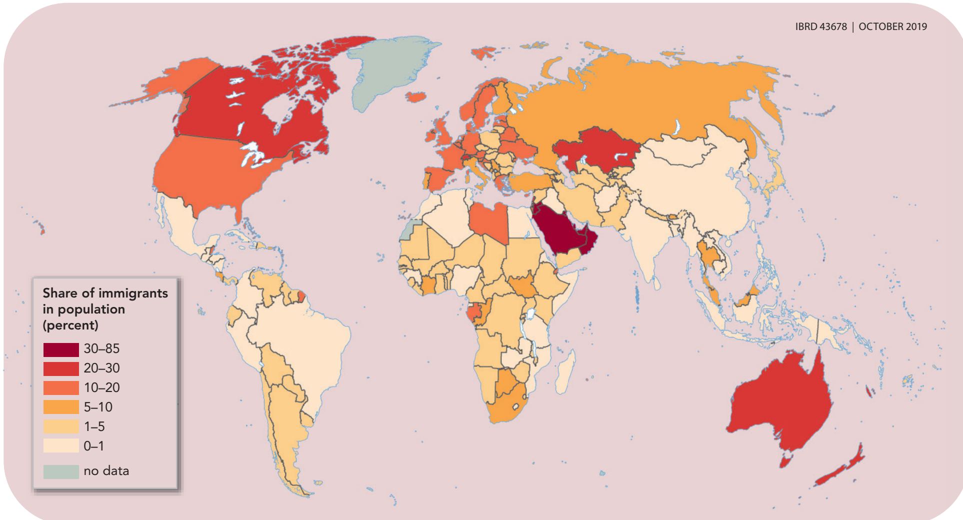
Opinion polls suggest that the world is facing its most severe migration crisis in recent history. Migration data, however, reveal a different picture. There were slightly more than 250 million international migrants in the world in 2017, the latest year for which comprehensive data exist. This figure represents an increase of more than 75 percent over the 140 million migrants in 1990 and a tripling of the number of migrants in 1960. The share of international migrants in the world population barely changed over the past six decades, however, remaining within the remarkably narrow range of 2.5–3.5 percent.

Beneath this overall stability lie several rapidly changing patterns that are the real causes of the anxiety over migration. The first is that immigrants are concentrated in a handful of destination regions, especially in high-income countries with ongoing labor shortages, high demand in certain sectors and occupations, and relatively liberal immigration policies. Two-thirds of the world's migrants live in North America, Western and Eastern Europe, and the oil-exporting Gulf Cooperation Council (GCC) countries in the Persian Gulf. The share of immigrants in Western European countries increased especially rapidly over the past four decades, rising from 18 to about 25 percent of the world migrant population. Former Soviet republics in Eastern Europe account for another 10 percent of the world's migrants, making Europe the destination region for more than one in three emigrants in the world (World Bank 2018).

Migration rates vary significantly both across and within countries. The highest immigrant-to-home population ratios are in the oil-exporting GCC countries, followed by Australia, Canada, and New Zealand, where immigrants make up about 20 percent of the population (map 2.1). In much of Western Europe and the United States, the share of immigrants is approaching 15 percent of the population, about four times the world average.

Globally, emigration is more evenly distributed than immigration (map 2.2). Within the ECA region, most sending countries are in Eastern Europe and Central Asia. Emigrants from Eastern Europe migrate to Western Europe, particularly to

MAP 2.1 Immigrant-to-population ratio, by country

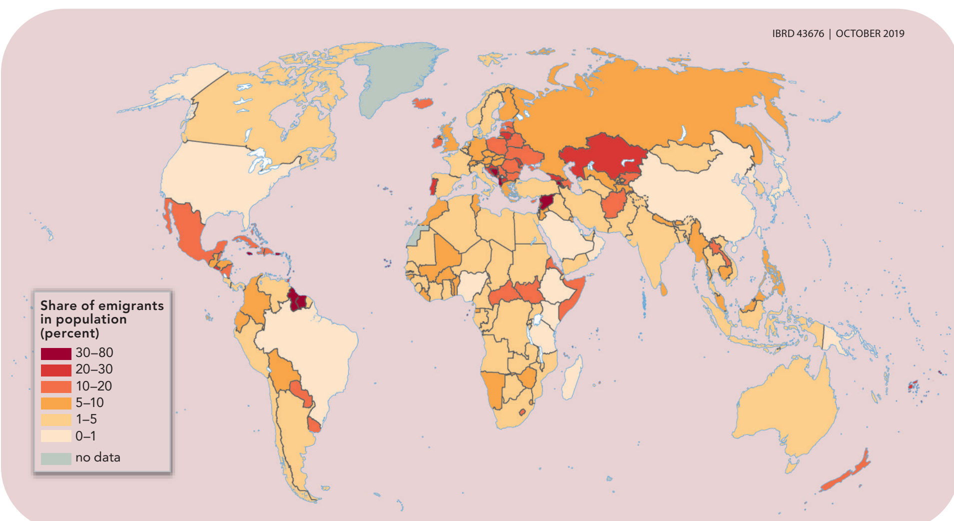


Source: UN DESA 2017, 2019.

countries that recently joined the European Union. Emigrants from Central Asia move to the Russian Federation, taking advantage of their historical, political, and economic ties.

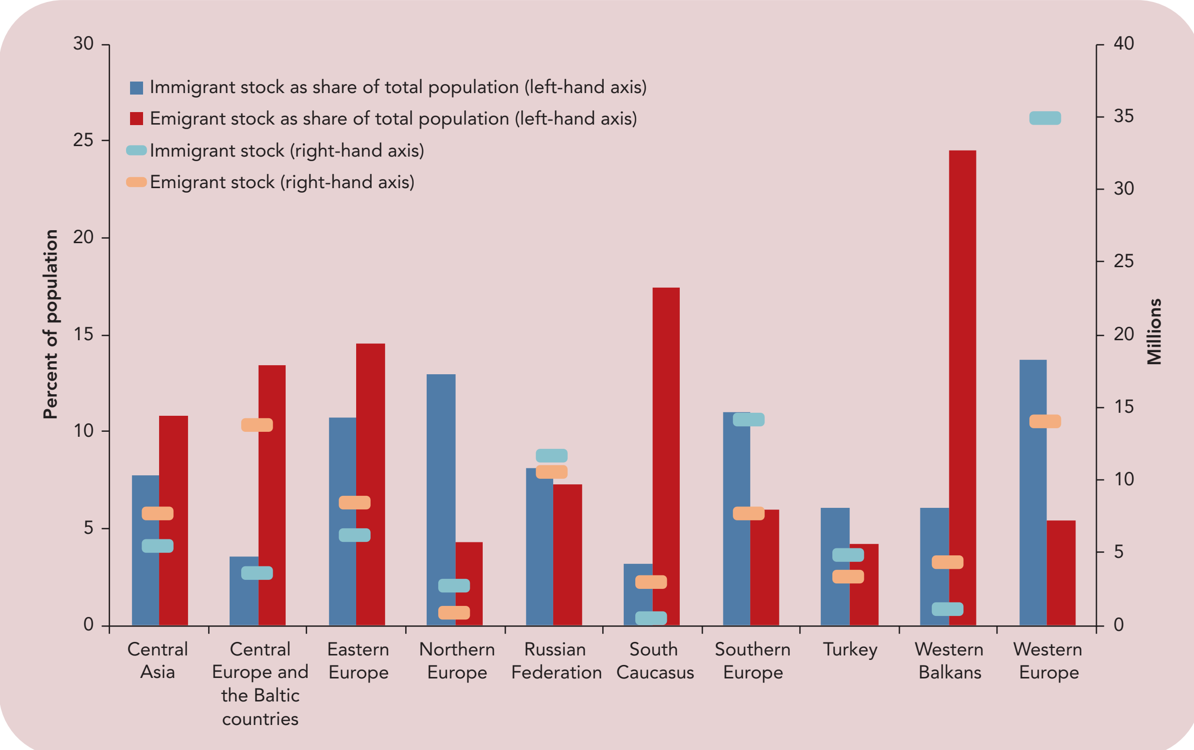
The number and share of migrants vary widely across ECA. The number of immigrants ranges from 520,000 in the South Caucasus countries (3 percent of the population) to about 35 million in Western Europe (14 percent of the population) (figure 2.1 and table 2.1). The number of emigrants from each region ranges from 900,000 in Northern Europe to 14 million in Western Europe. This wide range partially reflects differences in the population sizes of these regions, as the shares of emigrants in both regions are similar (4.3 and 5.4 percent).

MAP 2.2 Emigrant-to-population ratio, by country



Source: UN DESA 2017, 2019.

FIGURE 2.1 Share of population and number of international immigrants in Europe and Central Asia, by subregion, 2017



Source: UN DESA 2017; World Bank 2017.

A more appropriate metric is the share of immigrants in the total population. At the low end, it is 3.2 percent in the South Caucasus region, 3.7 percent in Central Europe and the Baltics, and 6.0 percent in the Western Balkans and Turkey. At the other extreme, the main destination regions are the high-income countries in Western, Northern, and Southern Europe, where the shares of immigrants are 13.7, 13.0, and 11.0 percent, respectively. Most of the migrants from the first group of regions moved to the countries in the latter group. The Western Balkans and the South Caucasus have the highest emigration rates, at 25 and 18 percent, respectively, followed by Eastern Europe (15 percent) and Central Europe and the Baltic countries (13 percent).

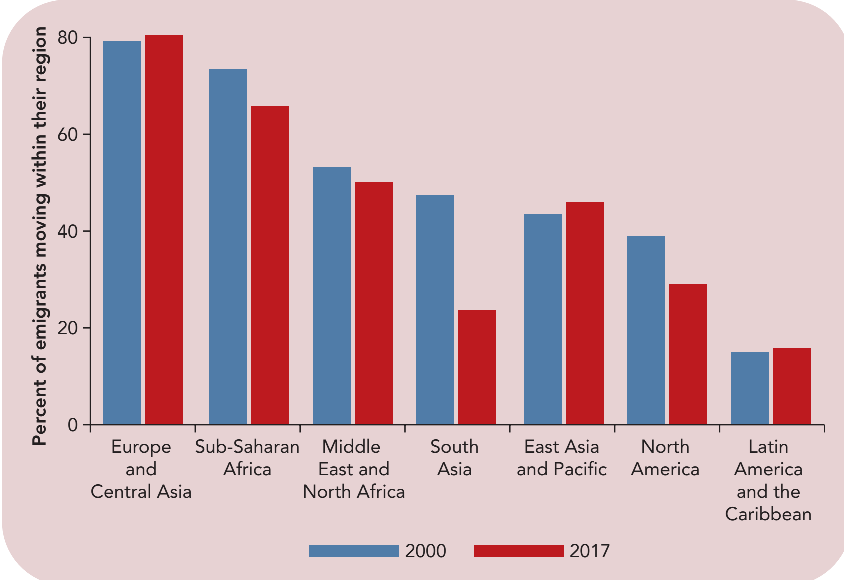
The next critical migration pattern is intraregional migration stocks, which account for about a third of global migration and an even larger share in ECA (figure 2.2). Despite the decline in transportation and communication costs, most migrants still prefer to move to neighboring or nearby countries. Physical proximity, linguistic and cultural similarities, and policy preferences granted by destination countries to their neighbors contribute to such patterns. Regional migration preferences—such as the free mobility granted to residents of member countries within the European Union—are especially important for the ECA region. As a result, about 80 percent of emigrants from the region move to other ECA countries. This share is significantly larger than in any other part of the world.

TABLE 2.1 Immigrant and emigrant stocks in Europe and Central Asia, by country (total and as percent of population), 2017

Subregion/country	Immigrant stock (millions)	Immigrant stock share of total population (percent)	Emigrant stock (millions)	Emigrant stock share of total population (percent)	Immigrant share from top five origin countries (percent)	Emigrant share to top five destination countries (percent)
Central Asia	5.4	7.6	7.7	10.9	92.7	92.5
Kazakhstan	3.6	19.8	4.1	22.5	93.5	95.8
Kyrgyz Republic	0.2	3.1	0.8	12.3	86.1	94.9
Tajikistan	0.3	3.1	0.6	6.5	97.0	95.6
Turkmenistan	0.2	3.3	0.2	4.2	92.9	92.7
Uzbekistan	1.1	3.4	2.0	6.2	97.1	90.5
Central Europe and the Baltic Countries	3.6	3.5	13.8	13.4	52.0	62.7
Bulgaria	0.2	2.1	1.3	18.2	46.6	73.5
Croatia	0.5	12.9	0.9	21.9	94.6	78.4
Czech Republic	0.4	4.1	1.0	9.0	74.5	85.8
Estonia	0.2	14.6	0.2	15.1	91.6	72.4
Hungary	0.5	5.0	0.6	6.5	73.0	67.4
Latvia	0.3	13.2	0.4	19.1	91.2	71.7
Lithuania	0.1	4.4	0.6	20.9	86.2	62.9
Poland	0.6	1.7	4.7	12.4	72.8	76.8
Romania	0.4	1.8	3.6	18.2	75.8	76.1
Slovak Republic	0.2	3.4	0.4	6.5	74.7	73.1
Slovenia	0.2	10.6	0.1	6.9	86.6	70.2
Eastern Europe	5.7	9.9	8.4	14.6	89.1	72.4
Belarus	1.1	11.4	1.5	15.7	93.3	82.3
Moldova	0.1	3.3	1.0	24.0	96.2	83.2
Ukraine	4.5	10.2	5.9	13.4	91.5	75.7
Northern Europe	2.5	11.9	0.9	4.3	26.0	57.3
Denmark	0.6	10.7	0.3	4.4	27.9	62.4
Finland	0.3	6.2	0.3	5.3	45.3	74.7
Sweden	1.6	16.1	0.3	3.5	34.3	59.3
Russian Federation	11.6	8.0	10.6	7.3	73.2	78.5
South Caucasus	0.6	3.5	3.0	17.5	89.1	81.8
Armenia	0.2	5.7	1.0	32.3	94.7	87.6
Azerbaijan	0.3	2.6	1.2	11.7	95.2	87.4
Georgia	0.1	1.9	0.8	20.9	91.7	82.1
Southern Europe	14.1	11.0	7.7	6.0	34.5	55.2
Cyprus	0.2	15.9	0.2	13.9	56.5	85.5
Greece	1.2	11.5	0.9	8.8	61.4	69.2
Italy	5.9	9.7	3.0	5.0	40.5	57.5
Malta	0.1	9.9	0.1	24.0	55.4	95.2
Portugal	0.9	8.3	2.2	21.7	60.7	65.4
Spain	5.9	12.7	1.3	2.8	41.2	57.0
Turkey	4.8	5.9	3.4	4.2	84.8	80.3
Western Balkans	1.1	6.1	4.4	24.5	92.1	53.8
Albania	0.1	1.6	1.1	39.8	98.8	93.5
Bosnia and Herzegovina	0.1	1.1	1.7	49.5	95.2	75.6
Kosovo	—	—	—	—	—	—
Republic of North Macedonia	0.1	6.2	0.5	25.7	97.2	77.0
Montenegro	0.1	11.2	0.1	21.9	76.1	72.9
Serbia	—	—	—	—	—	—
Western Europe	34.6	13.4	14.0	5.4	28.0	46.3
Austria	1.7	18.8	0.6	6.6	56.6	71.8
Belgium	1.2	10.3	0.6	4.9	54.4	61.2
France	7.9	12.1	1.9	2.9	49.4	45.3
Germany	12.0	14.6	4.2	5.1	52.3	45.1
Ireland	0.8	17.0	0.8	16.7	63.7	87.9
Luxembourg	0.3	44.5	0.1	10.5	74.9	77.5
Netherlands	2.0	11.8	1.0	5.9	41.7	59.4
United Kingdom	8.7	13.0	4.8	7.2	33.9	69.1

Source: UN DESA 2017, 2019; World Bank 2017.
Note: — Not available. Immigration and emigration data are not separately available for Serbia and Kosovo in UN DESA (2017), the main source for this table.

FIGURE 2.2 **Share of emigrants moving intraregionally, by world region, 2000 and 2017**



Source: UN DESA 2017.

Migration within ECA is concentrated within certain subregions, based on geographic proximity, economic similarity, and historical linkages (table 2.2). ECA is home to 86.8 million immigrants and sends about 74.5 million emigrants to other countries. Of the total number of migrants, almost 60 million are intra-ECA migrants, 26.9 million moved from outside ECA to ECA countries, and 14.6 million moved from ECA to outside ECA. The 26.9 million immigrants from outside ECA represent less than 3 percent of the approximately 900 million people in ECA. The net migration of 12.3 million people to ECA represents only about 1.3 percent of the region's total population.

High-income (mostly) EU member countries in Western, Southern, and Northern Europe receive the largest share of immigrants. Of the 54.3 million immigrants in these countries, more than half (31.3 million) come from other ECA countries; the rest come from other parts of the world. The most important sending areas are Sub-Saharan Africa, the Middle East and North Africa, and Latin America and the Caribbean. Non–EU member countries in Eastern Europe and the South Caucasus (mostly former republics of the Soviet Union) form the second-largest destination subregion, with 17.9 million migrants. Two-thirds of these migrants come from the same set of countries. A large share moved within the Soviet Union before its dissolution, becoming international migrants with the creation of new national borders. Others moved to neighboring countries because of their continuing economic, political, and cultural links.

Among sending regions, a similar degree of concentration exists for smaller and lower-income countries. Recent EU member countries in Central Europe and the Baltics form one of the most important source of migrants, with a total of 13.7 million emigrants. About 70 percent of these people moved to high-income EU member countries, taking advantage of the free labor mobility privileges granted as part of their EU membership. Central Asian countries also send many emigrants, especially as a proportion of their populations. Most of these migrants

TABLE 2.2 Migration within Europe and Central Asia, by subregion, 2017 (millions)

Origin region	Destination region						
	Western, Southern, and Northern Europe	EU member in Central Europe and the Baltics	Russian Federation, South Caucasus, and Eastern Europe (non-EU)	Central Asia	Western Balkans and Turkey	Rest of world	All destina-tions
Western, Southern, and Northern Europe	12.2	0.6	0.2	0.2	0.6	9.6	23.4
EU member in Central Europe and the Baltic countries	9.7	0.7	0.4	0.0	0.9	2.0	13.7
Russian Federation, South Caucasus, and Eastern Europe (non-EU)	3.0	1.3	11.5	4.4	0.1	1.7	22.0
Central Asia	1.3	0.0	5.6	0.5	0.0	0.2	7.6
Western Balkans and Turkey	5.2	0.7	0.0	0.0	0.7	1.1	7.8
Rest of world	23.0	0.3	0.2	0.0	3.4		
All origins	54.3	3.6	17.9	5.3	5.8		

Source: UN DESA 2017, 2019; World Bank 2017.

moved to Russia or other former Soviet republics. Many emigrants come from Turkey and the Western Balkan countries (Albania and the former Yugoslav republics), moving to high-income EU member countries such as Germany, Austria, and the Netherlands.

These flows slowed over the past decade, but the stock of migrants remains large. During this time, Turkey became a major destination country, as a result of the arrival of almost 4 million refugees fleeing the civil war in Syria. Their numbers are not fully reflected in table 2.2, as the UN Population Division's migration statistics exclude Syrian refugees worldwide (see annex 2A for issues related to migration data).

A small number of corridors shape world migration (World Bank 2018). Indeed, 300 of the more than 40,000 possible corridors account for more than 75 percent of the world's total migrant stock.

The same concentration holds within the ECA region (table 2.3). Migration within the former Soviet republics continues to dominate intra-ECA migration, with the Russia–Ukraine and Russia–Kazakhstan corridors accounting for the largest numbers of migrants. In addition, ethnic Germans migrate from Russia and Kazakhstan to Germany, taking advantage of German immigration laws and preferences granted to them. The main development since 2000 has been the emergence of the Poland–Germany and Romania–Italy corridors after the entry of Poland and Romania into the European Union.

Migration from a few origin countries dominates flows into most subregions (table 2.4). The top five origin countries account for more than half of all migrants in every subregion of ECA except the high-income countries of Western, Southern, and Northern Europe, where migrants come from a wider range of countries and the top five origins account for 26–35 percent of migrants. In Central Asia, for example, almost 93 percent of migrants come from just five countries.

TABLE 2.3 Largest migration corridors in Europe and Central Asia, 2000 and 2017 (millions of migrants)

2000			2017		
Origin region	**Destination**	**Stock**	**Origin region**	**Destination**	**Stock**
Russian Federation	Ukraine	3.7	Russian Federation	Ukraine	3.3
Ukraine	Russian Federation	3.5	Ukraine	Russian Federation	3.3
Kazakhstan	Russian Federation	2.6	Kazakhstan	Russian Federation	2.6
Russian Federation	Kazakhstan	2.0	Russian Federation	Kazakhstan	2.4
Turkey	Germany	1.6	Poland	Germany	1.9
Russian Federation	Uzbekistan	1.1	Turkey	Germany	1.7
Belarus	Russian Federation	0.9	Uzbekistan	Russian Federation	1.1
Uzbekistan	Russian Federation	0.9	Russian Federation	Germany	1.1
Russian Federation	Germany	0.9	Romania	Italy	1.0
Azerbaijan	Russian Federation	0.8	Kazakhstan	Germany	1.0

Source: UN DESA 2017, 2019; World Bank 2017.

TABLE 2.4 Concentration of immigration in Europe and Central Asia, by subregion (percent of total immigration), 2017

Subregion	Top origin country	Top 5 origin countries	Top 10 origin countries	Top 20 origin countries
Western Europe	9.1	28.0	44.8	62.9
Southern Europe	12.5	34.5	49.2	67.9
Northern Europe,	6.8	26.0	42.2	62.6
Central Europe, and the Baltic countries	14.1	52.0	70.4	86.6
Russian Federation	28.1	73.2	93.2	99.1
South Caucasus	31.6	89.1	97.0	99.7
Eastern Europe	70.4	89.1	96.5	99.4
Central Asia	69.4	92.7	97.3	99.8
Turkey	37.3	84.8	94.7	98.6
Western Balkans	68.3	92.1	94.6	97.8

Source: UN DESA 2017, 2019; World Bank 2017.

The same pattern is evident at the country level (see table 2.1). Except in a handful of high-income countries, such as Denmark, Norway, Sweden, and the United Kingdom, migrants from the top five origin countries constitute more than half of all immigrants in all ECA countries. This ratio reaches 90 percent in every Balkan country and former Soviet republic.

A similar degree of concentration is observed in the destination choices of emigrants from ECA (table 2.5). Most emigrants from all ECA countries except high-income countries in Western, Southern, and Northern Europe go to only a handful of destinations. Five destination countries receive two-thirds of all emigrants from recent EU member countries in Central Europe and the Baltics. The concentration of destinations is even stronger at the country level. As table 2.1 shows, more than 75 percent of the emigrants from most ECA countries go to five or fewer destinations.

Immigrants are also concentrated within destination countries. This concentration is most pronounced for high-skilled migration, which tends to concentrate in locations where productivity spillovers and agglomeration effects are highest (such as Silicon Valley for technology jobs or London for finance). In contrast, refugee flows tend to concentrate in the border regions of neighboring destination countries, at least initially, and then eventually in their largest urban areas (World Bank 2018). The rest of this chapter discusses the economic and political significance of this concentration of migration for origin and destination countries.

Determinants of Migration

Like the movement of goods, capital, and even technology across national borders, migration responds to a range of push and pull factors. Empirical evidence identifies several broad determinants of migration patterns.

Potential migrants weigh the economic, social, and other personal costs and benefits in deciding whether and where to move. They move from low-wage to high-wage locations and are attracted to labor markets with better current and future employment opportunities.

On the cost side, the most important determinants of mobility are physical and cultural distances. Physical distances impose high transportation costs and are the reason why most low-skilled migrants with tight budget constraints move

TABLE 2.5 Concentration of emigration in Europe and Central Asia, by subregion (percent of total emigration), 2017

Subregion	Top destination	Top 5 destinations	Top 10 destinations	Top 20 destinations
Western Europe	13.3	46.3	69.8	88.0
Southern Europe	18.3	55.2	78.6	93.1
Northern Europe	22.4	57.3	79.6	93.2
Central Europe, and the Baltic countries	27.2	62.7	77.8	92.5
Russian Federation	31.1	78.5	88.3	95.0
South Caucasus	59.3	81.8	91.0	97.3
Eastern Europe	51.6	72.4	86.2	96.4
Central Asia	64.8	92.5	96.6	98.9
Turkey	48.6	80.3	89.2	97.4
Western Balkans	13.6	53.8	82.0	97.5

Source: UN DESA 2017, 2019; World Bank 2017.

to neighboring countries or remain within the same region. Cultural adaptation and settlement are also costly, so existing personal and social networks shape migration flows. Networks of co-nationals help migrants find jobs, establish a new social life, and navigate legal hurdles. The policy environment—preferential treatment granted to certain groups of people; tight border controls; access to domestic health, welfare, and education programs—also makes a big difference. Entry into the European Union has been a critical determinant of the size and distribution of intra-ECA migration flows from Central European and the Baltic countries.

Many domestic policies and factors that are not directly linked to migration policies may also operate as "push" factors. People are more likely to emigrate if they lack access to proper public services, their political freedoms and rights are curtailed, or they feel under physical threat, even if there is no explicit civil conflict.

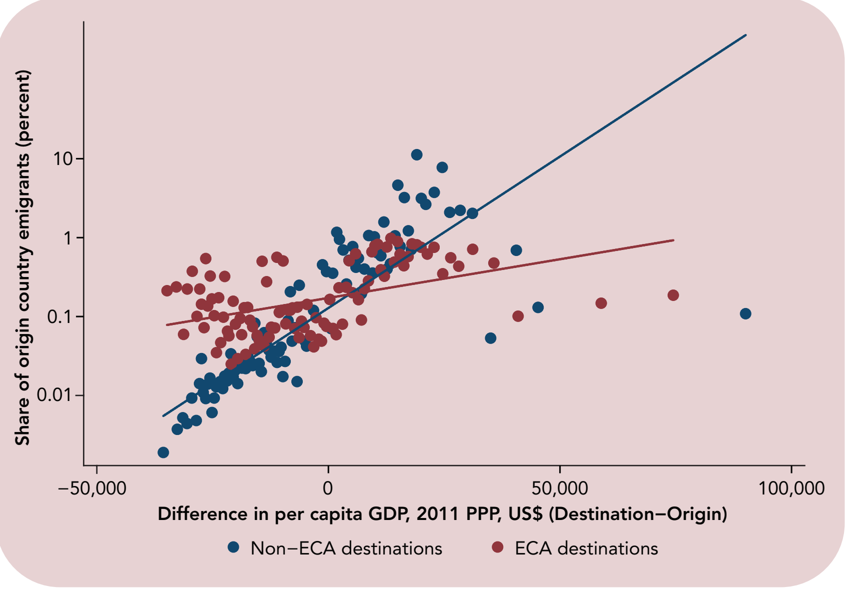
These factors also affect the education, skills, gender, and age composition of migrant flows. The skills composition is a critical determinant of the economic impact of migration in destination and origin countries. Economic factors explain the large variation in skills observed in different corridors. High-skilled migrants are disproportionately attracted to higher-income countries that have liberal and skill-selective immigration policies and higher returns to human capital. These migrants have an easier time overcoming physical distances, linguistic differences, and policy barriers, enabling them to move farther and to more diverse countries. The policy environment, the use of English as the official language, and the presence of liberal labor markets are some of the reasons why, for example, the United Kingdom attracts more high-skilled immigrants than most other countries in Europe and why the United States is home to one-third of all migrants with higher education.

Income and employment gaps

Income gaps are the most important determinants of bilateral migration flows (World Bank 2018; Gould 2018). Figure 2.3 reveals the strong correlation between income differences between pairs of countries and the share of emigrants from each source country in each destination country. The slope of the blue line suggests that a $2,000 increase in mean annual GDP per capita in the destination country is associated with a 10 percent increase in the likelihood that an emigrant chooses that destination. Migration between ECA countries is much less sensitive to income gaps; the same level of income gap leads to only a 4 percent increase in the likelihood of emigration. This difference indicates the importance of other factors, such as free labor mobility privileges within the European Union or historical and political bonds within ECA countries.

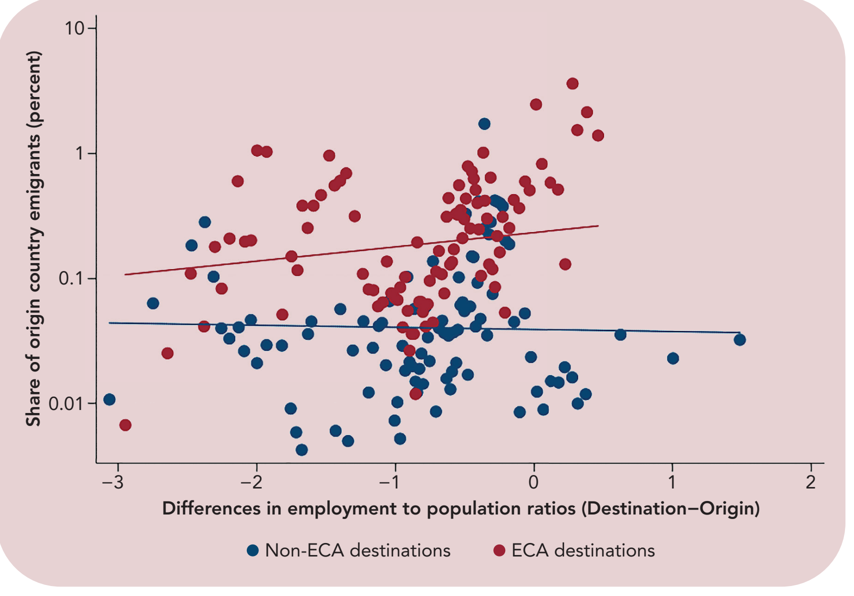
Income differentials tell only part of the story of the labor market–based motivations of migration. Differences in employment rates and opportunities across labor markets are also important (figure 2.4). Intra-ECA flows are sensitive to employment opportunities, as measured by employment-to-population ratios in destination countries.

FIGURE 2.3 Correlation between emigrant shares of origin countries in Europe and Central Asia and income differences between destination and origin countries, 2017



Source: UN DESA 2017. Employment data are from World Bank Open Data.
Note: Each point represents the mean of 100 equal-size groups of country-pairs.

FIGURE 2.4 Correlation between emigrant shares of origin countries in Europe and Central Asia and employment differences between destination and origin countries, 2017

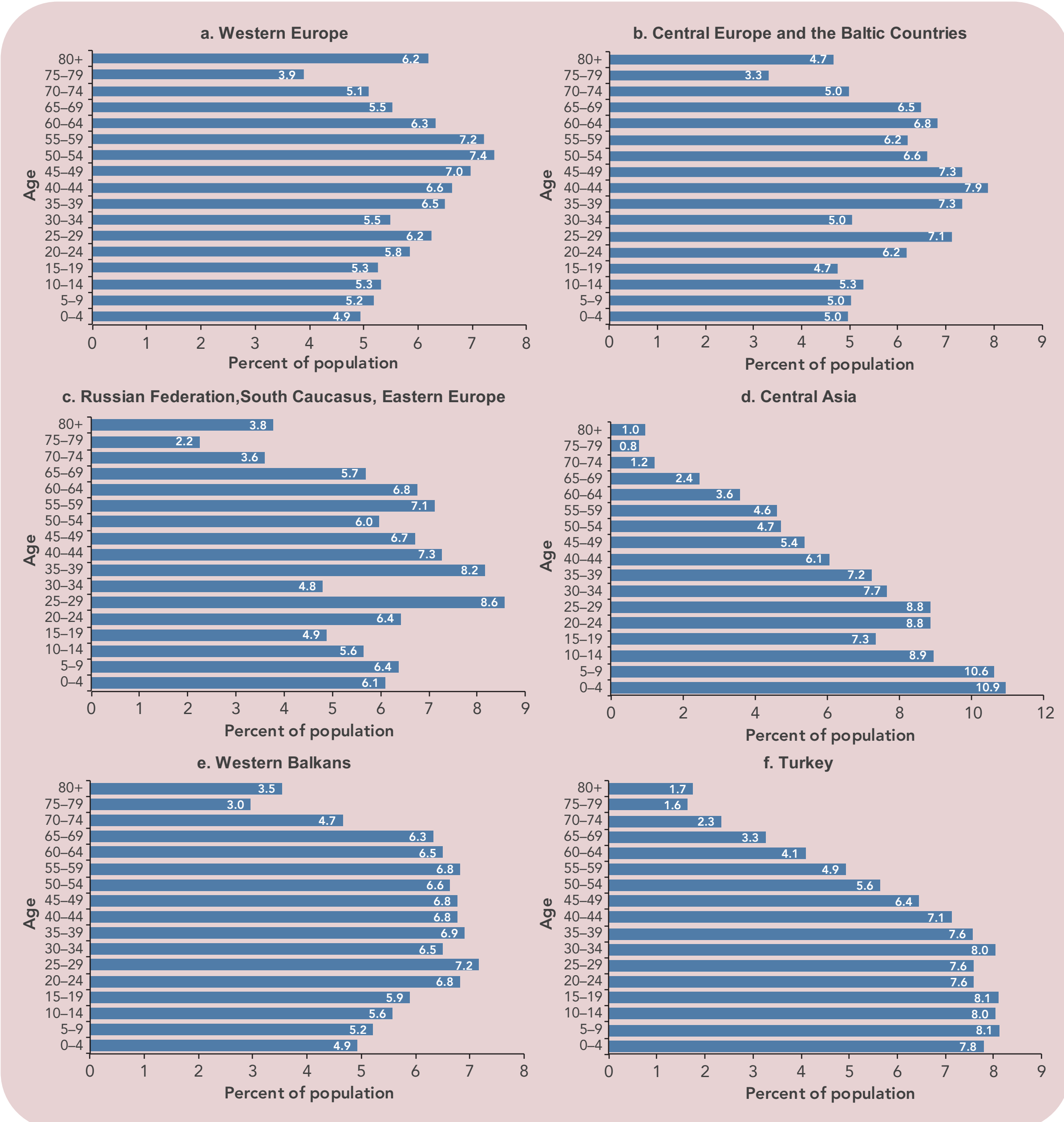


Source: UN DESA 2017. Employment data are from World Bank Open Data.
Note: Each point represents the mean of 100 equal-size groups of country-pairs.

Demographic factors

Demographic forces are the second most important factors in shaping global migration patterns. They are especially critical for Europe. Almost all countries in the ECA region are aging rapidly; the typical age pyramid has almost disappeared. People 35–55 make up the largest cohort in every subregion except

FIGURE 2.5 Projected age distribution of the population in Europe and Central Asia in 2020, by subregion



Source: UN DESA 2019.

Central Asia and Turkey (figure 2.5).[1] People are living longer, and the share of children in the population is shrinking rapidly, as fertility levels decline. As a result, there has been a rapid increase in the number of people in the population over 65 and a steep decline in the size of the labor force. The resulting demands

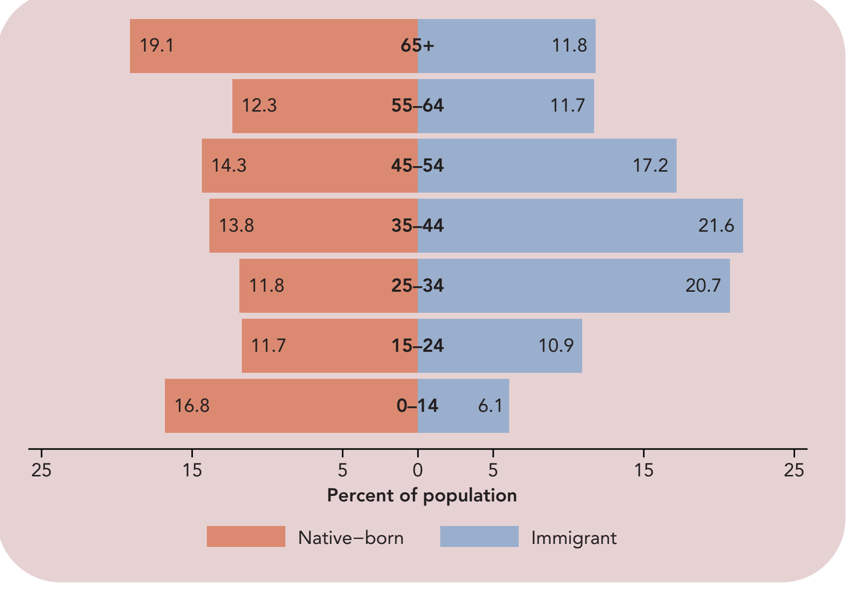
1. Even Central Asia and Turkey, which have a more traditional age structure, are just two decades behind in their demographic transition, with declining fertility rates and aging populations.

on the social welfare system are already a source of concern, and pressure on the public finance system will only increase.

The demographic composition of ECA countries and the resulting labor market dynamics will shape migration patterns in the next several decades. Migrants are disproportionately of working age, because employment is the main reason for migration. In the high-income Western, Southern, and Northern European destination countries with rapidly aging populations, migrants bolster the size of the working-age population and significantly increase the size of the labor force. Figure 2.6 presents the age distribution of immigrants and the (weighted) age distribution of the population in Western European destination countries. It shows that most immigrants are 25–54 and that destination country populations are significantly older.

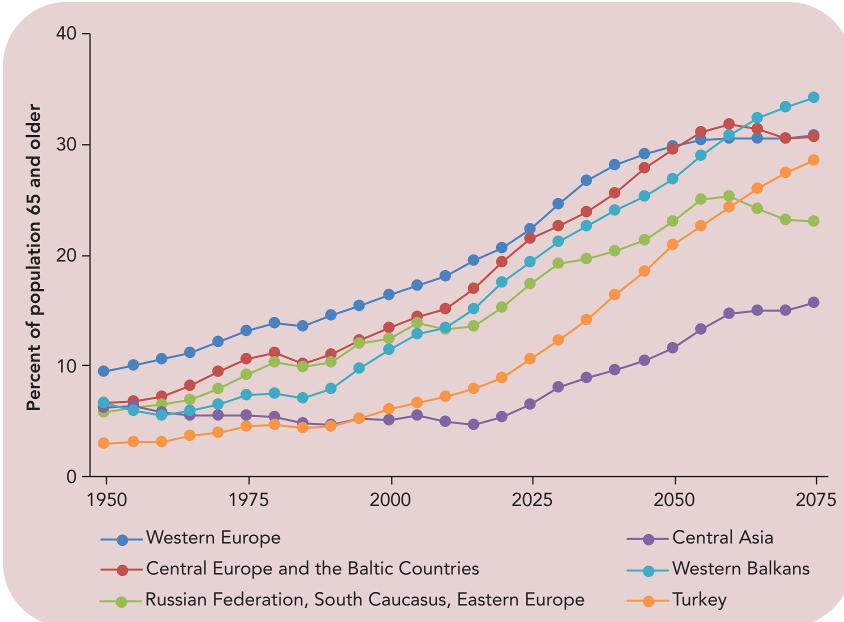
Current demographic profiles explain recent migration patterns. The rapid aging of the population in ECA countries that will occur over the next two generations is even more critical for policy making. Figure 2.7 presents the share of the population over 65, which is currently about 20 percent in Western, Northern, and Southern Europe; 17 percent in Central Europe and the Baltic countries; and 14 percent in other ECA subregions. These shares are lower in Turkey (8 percent) and Central Asia (5 percent). The share of people over 65 in most subregions of ECA is significantly higher than the world average of 7 percent—and the trend is even more important. According to the most recent projections by the UN Population Division, the share of people over 65 will reach 28 percent in Western Europe and 25 percent in Central and Eastern Europe by 2040. In Turkey it will reach almost 20 percent, and it will double to 10 percent in Central Asia. Within another generation—that is, by 2070—the share of people over 65 will stabilize at about 25–35 percent for the ECA region excluding Central Asia.

FIGURE 2.6 **Age distribution of immigrants and destination country population in Western Europe, 2017**



Source: OECD 2010; UN DESA 2019.

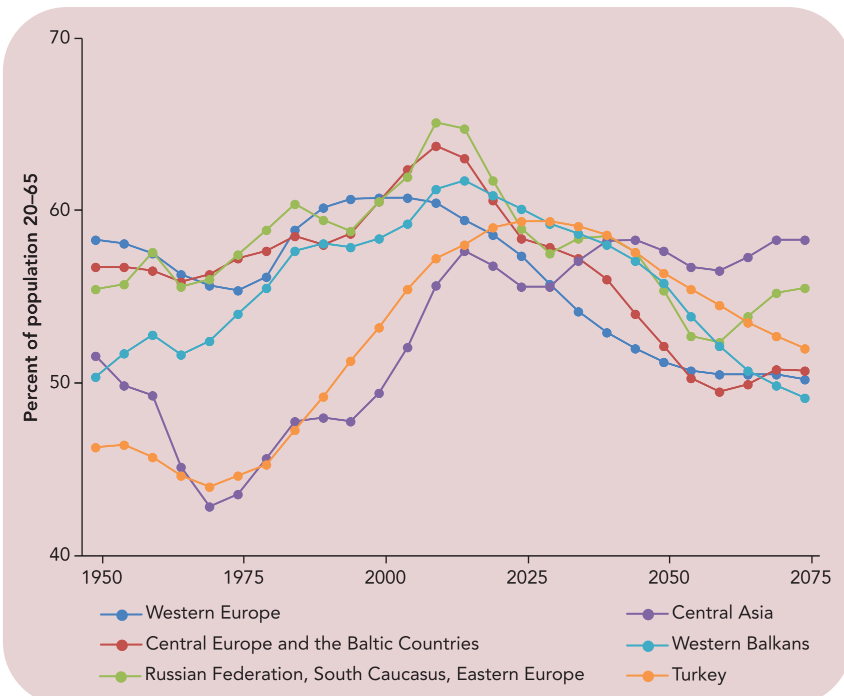
FIGURE 2.7 Actual and projected shares of population 65 and older in Europe and Central Asia, by subregion, 1950–2075



Source: UN DESA 2019.

The implications of rapid population aging for labor markets are severe. Although the share of people 20–65 in the population (a proxy for the size of the potential labor force) has been gradually increasing in most countries (figure 2.8), it has done so only because of the decline in the share of children. By 2020 the size of the labor force will peak in almost every country in the region, at about 60–65

FIGURE 2.8 Actual and projected shares of working-age population (20–65) in Europe and Central Asia, by subregion, 1950–2075



Source: UN DESA 2019.

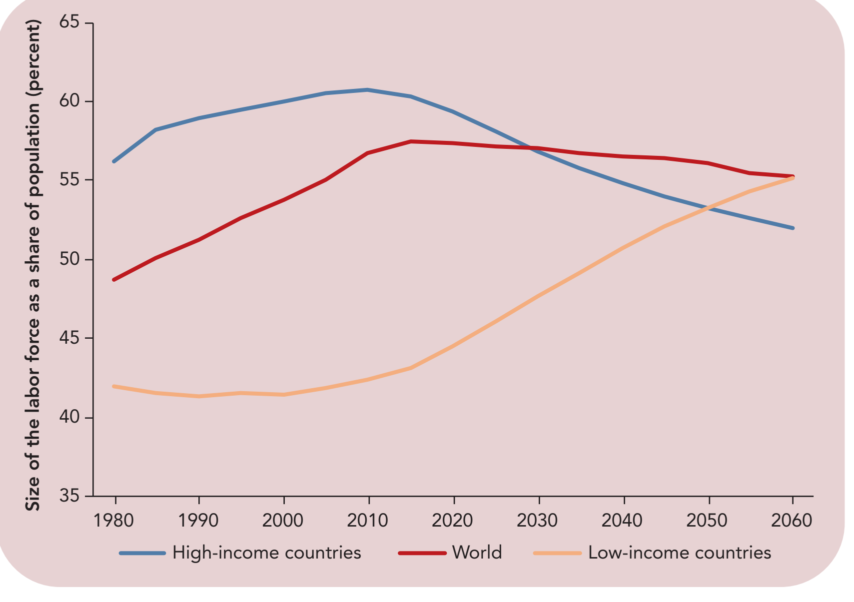
percent. As the population ages, the labor force will start to shrink, to 55–58 percent in 2040 and 50–55 percent in 2075. This decline will affect all aspects of the economy in every country in ECA.

In many regions of the world, such as the Americas and East Asia, demographic profiles and economic development levels vary widely across countries. This variation creates regional migration opportunities and helps narrow age distributions and income levels. For example, over the past two decades, the Mexico–United States corridor—the largest migration corridor in the world—has been fueled by the proportionately larger youth population in Mexico, which has faced underemployment. Similarly, the Philippines is the source country for many economic migrants to other countries in the region—such as Singapore and Malaysia—as well as oil-rich countries in the Middle East.

For the most part, this type of demographic variation does not exist in ECA, where origin and destination countries tend to be at similar points in their demographic transitions. There are no "young" countries in the region that can export working-age people to "older" countries.

The relative uniformity of the age distribution in ECA countries means that the future labor force will need to come from other parts of the world. Figure 2.9 presents the size of the working age population as a share of the total population in high-income OECD countries and low-income countries (mostly in Sub-Saharan Africa and South Asia). It shows that the size of the working-age population in high-income countries began its steady decline in 2010 and will continue to decline over the next five decades. In contrast, low-income countries have young populations, with declining fertility rates and few older people. As a result, their working-age populations will be rising steadily over the same period. This contrast will lead to a world population distribution with a surprisingly stable age distribution (the orange line in figure 2.9). To put it differently, the world has

FIGURE 2.9 Working-age population as a share of the total population in high-income countries, low-income countries, and the world, 1980–2060



Source: UN DESA 2019.

enough workers, but they are not necessarily in the right labor markets. Migration from low-income countries with younger populations to higher-income countries with aging populations does not solve the structural economic problems that both regions face. However, it does provide a window of opportunity—of about three decades—to address the issues surrounding aging and youth unemployment.

Impacts of Migration

Recent decades have seen dramatic changes in the global economic landscape thanks to rapid technological progress, increased international trade, and large-scale migration from poorer to wealthier countries. The resulting changes in patterns of employment and wage inequality have given rise to a highly politicized debate about the merits of globalization and open markets in which immigrants are often blamed for many of the economic problems in origin and destination countries. In destination countries, they are accused of causing unemployment and reducing wages. In origin countries, they are viewed as perpetrators of brain drain.

Benefits of migration for destination countries

A large body of literature has shown the many benefits of migration for destination countries, including higher productivity, innovation, growth, and poverty reduction and elimination of labor market shortages (Peri and Sparber 2009; National Academy of Sciences, Engineering, and Medicine 2017). Realization of these benefits requires that labor markets in destination countries have certain features. First, migrants with the appropriate human capital characteristics need to be selected, so that they can meet labor market demands. The initial level of migrants' human capital does not address all problems; their eventual contributions depend on the degree to which they continue to invest in country- and firm-specific skills and human capital, ranging from language acquisition to technical training to social norms.

Second, migrants need to have relatively secure legal rights, employment contracts, and possibly a clear pathway to permanent residency, depending on their occupation and sector. Only then will proper economic and social integration take place.

Third, the returns to investing in migrants' children and integration are high. Immigrant families can help destination countries address some of the demographic challenges they are facing, but only if proper education and social policies are implemented (World Bank 2018).

Short-term labor market impacts of migration

A vast body of literature examines the short-term labor market impacts of migration. This research has not yet reached a definitive consensus, but three stylized facts emerge from it.

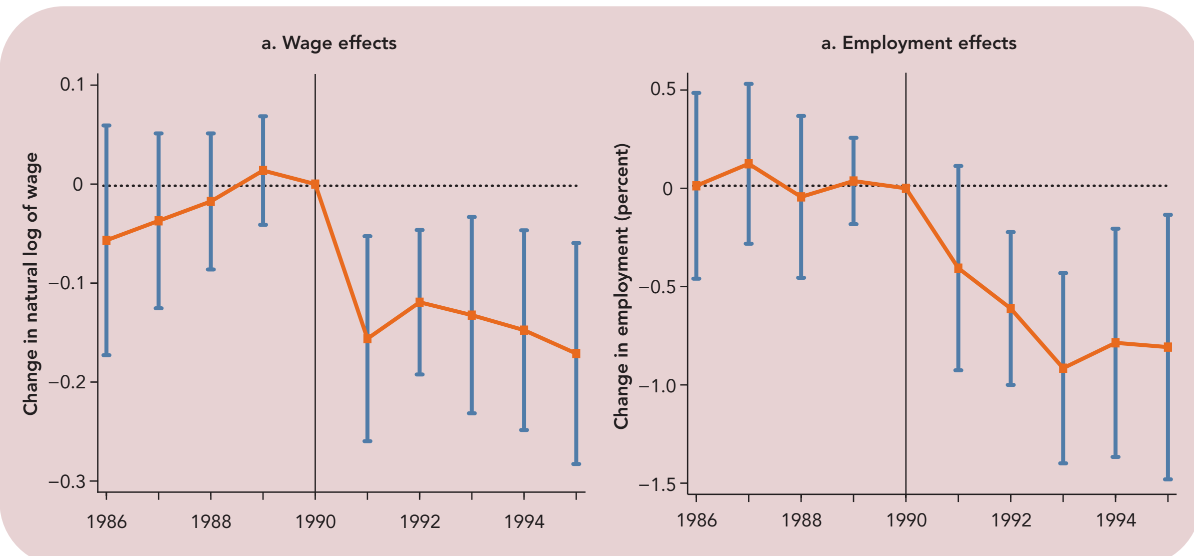
First, immigration results in large displacement effects in destination countries for the workers who most directly compete with the immigrant labor. They tend to be low-skilled and older workers who have few opportunities and are already struggling in the labor market. Second, workers who do not compete directly with immigrants frequently enjoy significant gains. These workers' skills tend to be complementary to those of the migrants, and the returns to their human capital increase with the arrival of migrants. Third, average wage effects tend to be small compared with the employment and displacement effects of immigration. Labor market flexibility and ease of movement across local labor markets within destination countries contribute to this outcome.

Overall, the benefits of migration tend to be longer term and diffused, whereas the costs—displacement, wage declines, loss of employment—are immediate and concentrated in certain groups of workers. This dichotomy is the source of the political opposition and anti-immigrant sentiments frequently observed in destination countries.

An insightful example of the impact on wages and displacement is the post-1989 policy that allowed Czech workers to seek employment, but not residency rights, in eligible German border municipalities (Dustmann, Schonberg, and Stuhler 2017). Figure 2.10 presents the differences in wages and employment rates in migrant-receiving border regions and comparable nonborder regions. By 1993, an inflow of Czech workers equivalent to 1 percent of the local employed labor stock led to about a 0.15 percent decrease in native wages. In contrast, there was an almost one-to-one (0.93 percent) decrease in local employment, as the German workers in these border regions moved to other parts of the country rather than stay and compete with migrant workers.

Short-run displacement effects as a result of the sudden inflow of migrants (such as refugees) provide evidence that conflicts with much of the literature on voluntary and economically motivated immigration, which typically finds small

FIGURE 2.10 Effect of inflow of Czech workers on German wages and employment, 1986–95



Source: Dustmann, Schönberg and Stuhler 2017.
Note: The orange lines indicate the effects of Czech workers on the natural log of wages (panel a) and employment (panel b). The blue bars indicate 95 percent confidence intervals. The vertical black lines indicate the year 1990, when the policy that allowed Czech workers into Germany was implemented.

average wage effects. The differences reflect the speed of adjustment in the destination labor markets. Sudden inflows of migrants can cause significant dislocation in certain geographic areas, sectors, and occupations over a short period in destination countries. The subsequent labor market adjustments (the movement of most workers to other areas or sectors) tend to be similarly large and rapid. As a result, the final wage effects in these local labor markets tend to be small.

The literature on voluntary and economic migration flows focuses on average and longer-term wage effects, rather than the relocation of workers. It concludes that immigration has little wage impact for most groups of workers. In most cases, the overall effect might even be positive, especially when long-term spillovers are considered. Even if relative wage effects are small, however, the dislocation of existing workers as a result of the arrival of immigrants can be costly, and it can explain some of the opposition toward immigration. In sum, immigration is likely to adversely affect certain groups of workers, although its overall wage effects are small.

The labor market impacts of refugees are similar to the impacts of economic migrants, although the push factors are different (box 2.1). Refugee flows arise from wars, conflict, and natural disasters. The sudden nature of these events leads to large and unpredictable numbers of refugees. In contrast, economically motivated migration tends to be slow and steady. The overall effects in destination countries are qualitatively similar, however, once the refugees adjust and enter the labor force.

The concentration of the impact of migration is important. Migration flows are concentrated in certain geographic areas, sectors, or occupations, as people respond to wage gaps and other push/pull factors. As labor moves across markets and migrant workers earn higher incomes, employers and consumers benefit. Strong economic forces and higher wage gaps attract more migrants, which leads to further economic gains for employers and consumers. At the same time, the concentration of migration leads to lower wages for and the displacement of some existing workers. The benefits of migration—to consumers, employers, and complementary labor inputs—tend to be longer term, and beneficiaries are less easily identifiable. In contrast, the costs—especially to the existing substitutable labor groups—are immediate, concentrated and easily identified. The political opposition and resulting clash become more striking if the overall economic prospects in the destination country become less promising, as has been the case in OECD countries since the great recession.

Comparing the impacts of migration on different labor groups has been one of the main research questions over the past two decades. In a study of the United Kingdom, Dustmann, Frattini, and Preston (2012) estimate the impact of overall immigration along the distribution of wages, implicitly assuming that workers with higher skills earn higher wages. They show an association between the location of measured effects and the location of immigrants in the native wage distribution. They then estimate the impact of immigration across the full wage distribution. Figure 2.11 shows that immigration decreases the wages of people at the bottom end of the wage distribution, who tend to be direct competitors of low-skilled immigrants, and increases the wage of people at the higher end of the wage distribution, who benefit from productivity spillovers.

BOX 2.1 How have refugees affected labor markets in Europe and Central Asia?

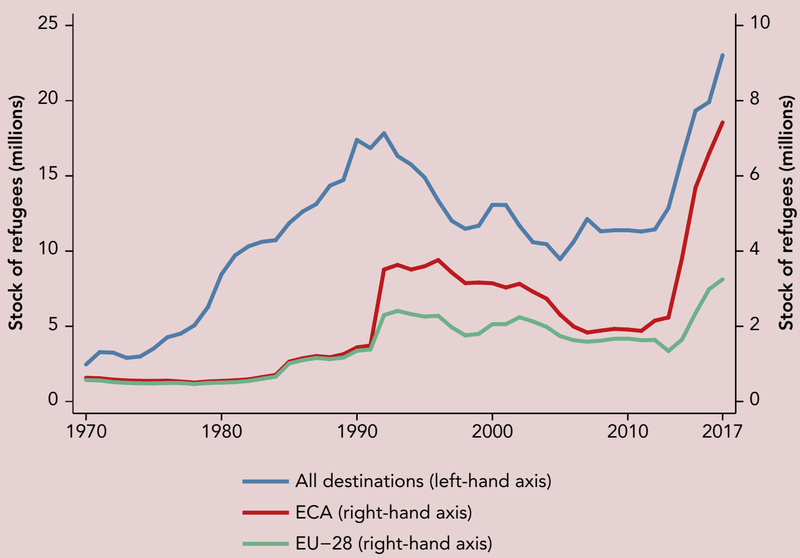
Refugee crises capture much of the attention in the debate on migration, to the extent that refugee crises and migration problems have become synonymous, even though economic migration and refugee flows exhibit distinct characteristics. Refugees make their choices under much more severely constrained conditions than most economic migrants, and their flows are unpredictable. Their motivations in choosing one destination over another are similar, however. As a result, their long-term economic impacts in destination labor markets are also similar.

Refugee flows tend to follow wars, civil conflicts, and natural disasters. The sudden nature of these events is reflected in the fluctuations in their numbers (box figure 2.1.1). Refugee stocks are currently at an all-time high, as a result of the Syrian civil war, which began in 2011, as well as the fleeing of millions of people from violence in Sudan, South Sudan, Somalia, Iraq, Afghanistan, and Myanmar. The spike in refugee stocks is reflected in ECA and EU countries. Turkey hosts nearly half of all Syrian refugees. Syrians who can travel farther go to Western and Northern Europe. As of 2015, Germany hosted more than 200,000 Syrians, the largest number among the EU-28 countries.

The recent spike in refugees follows a period of declining refugee stocks from a previous high that occurred in the early 1990s, when most refugees were a product of the first Gulf War, conflicts in Ethiopia and Mozambique, and the dissolution of Yugoslavia. Most of these refugees resided in neighboring countries. Apart from those in Yugoslavia, they did not have a large presence in Europe. The rise of the Yugoslavian refugee wave beginning in 1992 brought larger numbers of refugees to ECA and EU-28.

For both economic migrants and refugees, the costs and benefits of mobility are critical determinants of their migration decisions. Economic constraints and urgency are more binding for refugees, who, as a result, are more likely to end up in

BOX FIGURE 2.1.1 Stock of refugees in Europe and Central Asia, the EU-28, and globally, 1970–2017



Source: UNHCR Population Statistics Database 2019.

(Continued next page)

BOX 2.1 How have refugees affected labor markets in Europe and Central Asia? *(continued)*

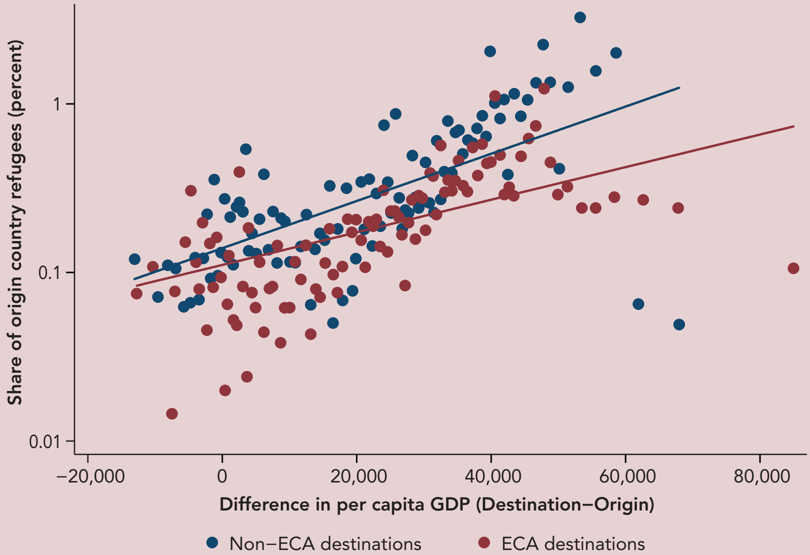
poorer, neighboring countries. In 2017, for example, nearly 70 percent of refugees resided in neighboring countries, compared with just under 40 percent for nonrefugee migrants (World Bank 2018). Most economic migrants can afford to wait for the best economic opportunities before they move.

When they are able to choose, refugees appear to favor higher-income countries. Box figure 2.1.2 shows the share of origin country's refugees in different destinations, by differences in per capita GDP. Despite the large share of refugees residing in neighboring countries, there is a clear, positive relationship between GDP and their choice of destination. Local opposition to refugees is partially motivated by this reason. Workers worry that increased competition for jobs will push down wages or displace them altogether.

These worries are not fully grounded in empirical evidence; there is little consensus among economists on the extent of the long-term effects of refugee inflows on labor markets. Looking at the arrival of refugees in four different settings, Borjas and Monras (2017) find that refugees "adversely affect the labor market opportunities of competing locals in the receiving countries, and often have a favorable impact on complementary workers." Their study does not fully address the possibility that destination country workers increase their human capital levels, change occupations or sectors, and benefit from immigration in the long run, however.

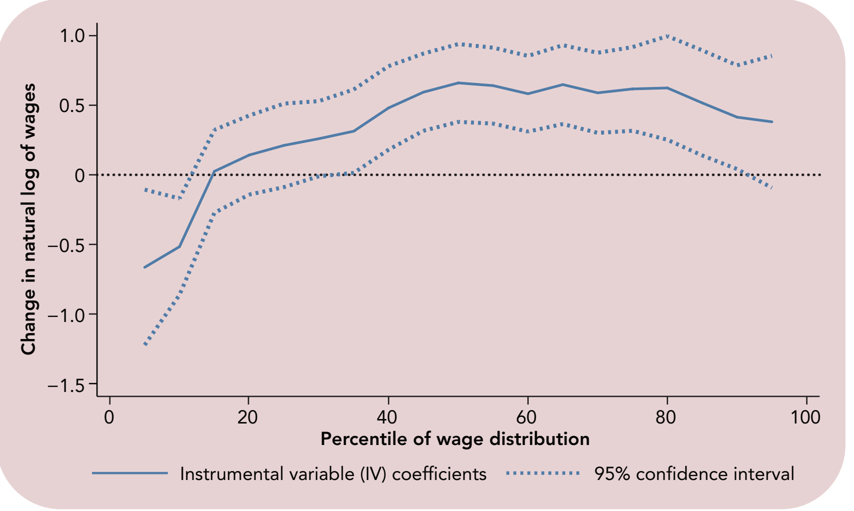
Using longitudinal data, Foged and Peri (2016) show that even native workers who are in direct competition with refugees can benefit from immigration. They find that inflows of refugees who work primarily in manual-intensive occupations push native workers away from those jobs into jobs that are more intensive in communication and cognitive skills. The move results in higher long-run wages, even for workers who appear very similar to refugees. Similar results have been found following the arrival of Syrian refugees in Turkey (Del Carpio and Wagner 2016) and Eastern Europeans in Austria (Packard 2019). The sudden arrival of refugees resulted in workers moving into formal employment in Turkey and white-collar jobs in Austria.

BOX FIGURE 2.1.2 Correlation between refugee destinations and differences in per capita GDP between the destination and origin country



Source: UNHCR Population Statistics Database 2019.

FIGURE 2.11 Effect of migration to the United Kingdom at different points of the wage distribution



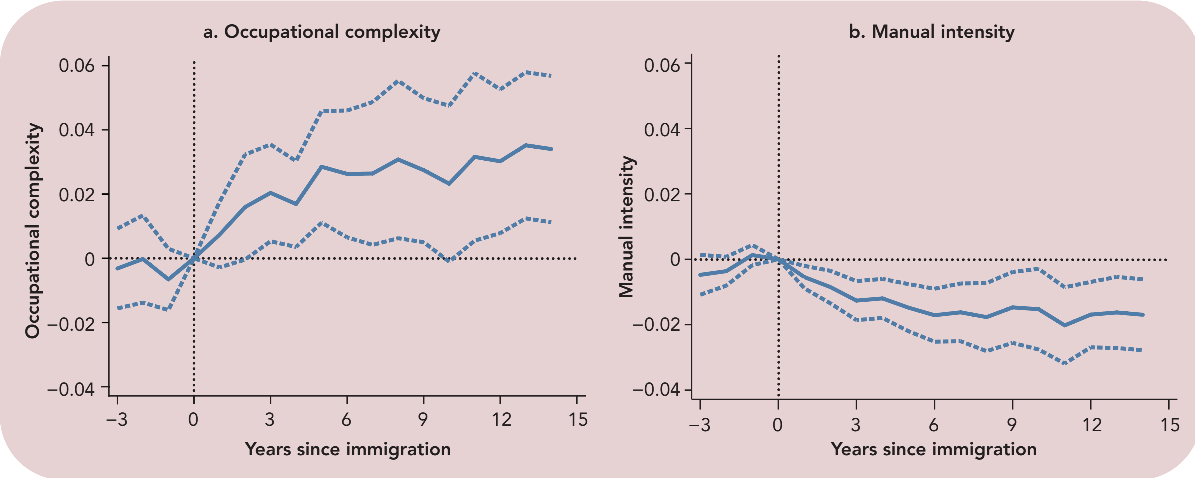
Source: Dustmann, Frattini, and Preston 2012.

Another significant impact of immigration is the sectoral and occupational relocation of existing workers. This job switching occurs because the arrival of migrants reduces wage levels in some regions or occupations, making them less attractive to existing workers. Peri and Sparber (2009) show that foreign-born workers specialize in occupations that require manual tasks, such as cleaning, cooking, and building, and that immigration causes existing workers to pursue jobs requiring more sophisticated and interactive tasks, such as coordinating, organizing, and communicating, presumably as a result of their comparative advantage in language skills and familiarity with the culture.

Figure 2.12 show the impact of refugees in Denmark on a measure of occupational complexity (panel a) and manual intensity (panel b) of the occupations in which Danish workers are engaged. The estimates show the difference in outcomes for less-skilled Danish workers in municipalities that are more and less exposed to refugees. An increase in the supply of low-skilled refugees pushes less-educated workers (especially the young) to pursue fewer manual-intensive occupations and more occupations with greater complexity. The occupational complexity of Danish workers increases and their manual intensity decreases in municipalities with larger number of refugee arrivals. The impact is remarkably stable over time, suggesting that these changes are permanent. A critical variable is the age of the workers. Younger workers with longer time horizons and presumably higher cognitive abilities relative to older workers are more likely to make these career switches.

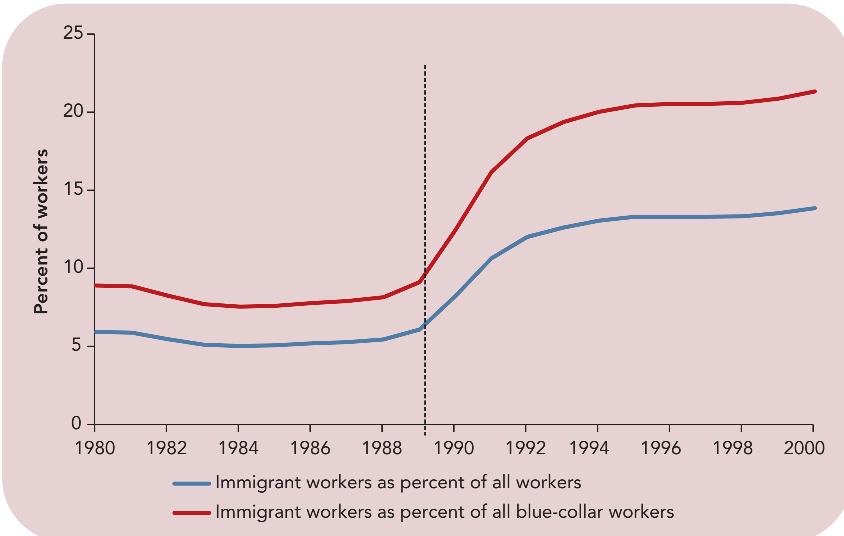
A similar pattern of sectoral relocation is observed in Austria, which experienced a large influx of migrant workers and refugees following the collapse of the Berlin Wall and the start of the civil war in Bosnia in 1989 (Packard 2019). Most of these workers—from Bosnia and Herzegovina, Croatia, the Czech Republic, Hungary, and the Slovak Republic—were relatively low skilled and sought blue-collar jobs (figure 2.13). Over time, the immigrant share of blue-collar workers increased faster than the overall labor market share, as more Austrian workers, especially young workers, entered white-collar jobs.

FIGURE 2.12 Impact of refugees on the occupational choices of Danish workers



Source: Foged and Peri 2016; data from the Danish Integrated Database for Labor Market Research.
Note: Values represent the results of difference-in-differences regressions controlling for industry-by-year, region-by-year, education-by-year, occupation-by-year, and municipality fixed effects. The solid lines indicate parameter estimates. The dashed lines indicate 95 percent confidence intervals.

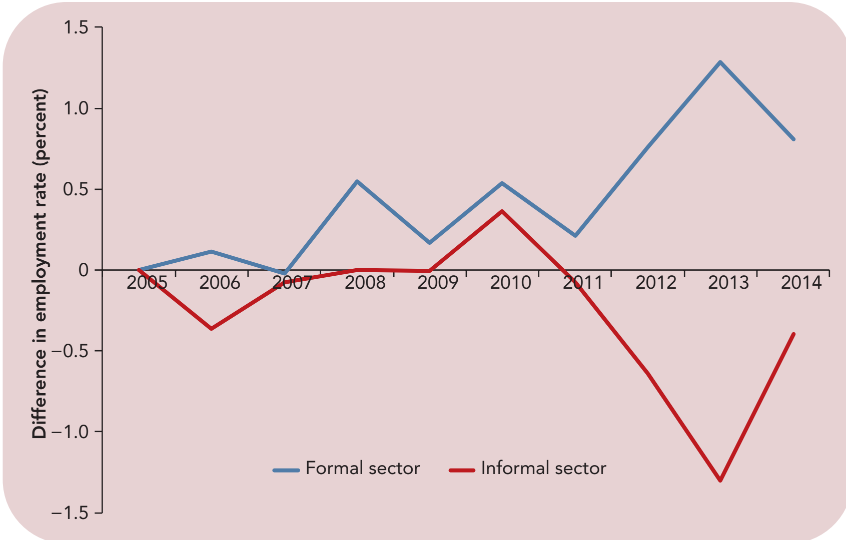
FIGURE 2.13 Effect of migration to Austria on blue-collar employment of native workers, 1980–2000



Source: Austrian Social Security Database.

The refugee crisis caused by the war in Syria had similar effects on Turkey (Ceritoglu and others 2017; Del Carpio and Wagner 2016). Because Turkey has not issued work permits to the vast majority of Syrian refugees, they are overwhelmingly employed in Turkey's already large informal sector. Refugees appear to have displaced workers from informal employment but increased the demand for younger Turkish men who have not completed high school. Figure 2.14 shows the difference in the share of the population employed in the formal and informal sector between Southern provinces with large number of refugees (treatment group) and the rest of the country (control group). Less-educated men and women experience net displacement from the labor market and, like workers in the informal sector, declining earning opportunities.

FIGURE 2.14 Effect of Syrian refugees on formal employment of Turkish workers, 2005–14



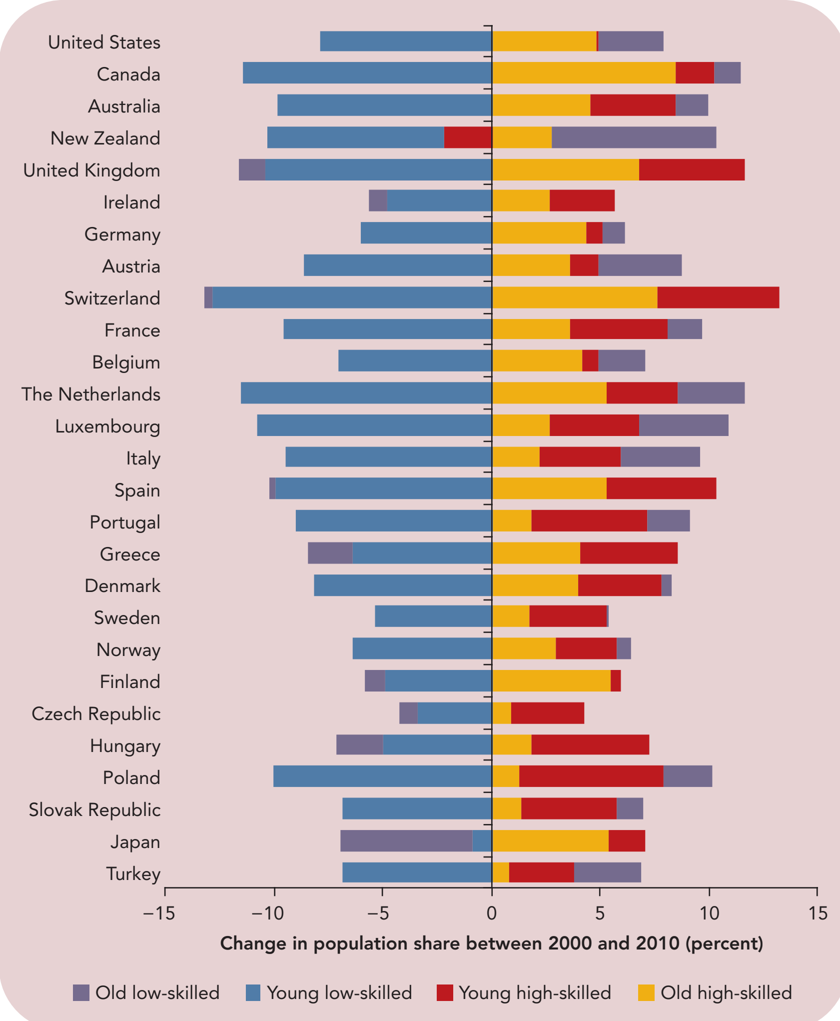
Source: Del Carpio and Wagner 2016.
Note: Y-axis shows difference in share of population employed in treatment and control regions.

Three forces—population aging, migration, and education—are shaping wage distributions in all countries, especially high-income countries in Europe. Population aging is a slow but powerful process that evokes great concern among policy makers. Immigration is blamed for the challenges faced by many low-skilled workers. Educational upgrading is viewed as the silver bullet that will solve all problems. An important question is how much each of these forces influences wages across different skill and age groups.

Docquier and others (2019) explore the labor market implications of the changes in the education and age structure of the population in the period between 2000 and 2010. Figure 2.15 shows the changes in the shares of four main groups in the working-age population: young low-skilled, young high-skilled, old low-skilled, and old high-skilled workers. (Workers are considered high skilled if they have higher education; they are considered young if they are 25–45.) The most striking feature is the decline across all countries in the share of young low-skilled workers, as a result of population aging and increased education levels. This decline is matched by increases in the shares of young and old skilled workers. There are some exceptions to this pattern, notably Japan, but the pattern holds in all high-income ECA countries.

Analysis by Docquier and others (2019) shows that changes in the age and skill structure of the workforce are the dominant factors explaining wage changes. In the absence of technological change that rewards higher skills, current trends of aging and increased education levels should favor young and low-skilled workers. However, strong skill-biased technological change that has taken place over the last two decades offsets these benefits for low-skilled workers and explains the increases in the skill premium observed in many countries (Autor, Katz, and Kearney 2008). This observation also confirms the importance of technological change as a key contributing factor to wage inequality over the past decades, including in EU countries with generous welfare programs.

FIGURE 2.15 Changes in population shares by age-education group in selected countries between 2000 and 2010



Source: OECD 2010; UN DESA 2019.

Policy Design

Migration policies span a range of areas, including the admission of migrants, migrant reunification with family members, access to local labor markets in destination countries, opportunities for migrants to obtain permanent residence and citizenship, and migrants' rights to political participation and access to social services. There are three paths of entry into a destination country, each corresponding to a different set of policies. The first path, legal migration, includes three categories. One is economic migration, which aims to address labor market needs. The other two are family reunification and humanitarian migration for refugees and other people in distress. The second path is undocumented migration, which occurs when people enter a country illegally or overstay their visas. It is also generally economically motivated. The third path is human trafficking or involuntary migration (box 2.2).

Most migrants move in response to economic incentives (World Bank 2018), even if the data on the type of their entry visa imply otherwise (many economic migrants enter under family unification or humanitarian assistance programs, because most formal labor market channels are restrictive). A fundamental challenge for immigration policy is that labor markets create powerful push and pull forces that lead to large-scale demand for migrant labor in many sectors and regions. In most instances, policies cannot withstand such pressure from labor markets. Restrictions on immigrant labor flows lead to the entry of large numbers of undocumented migrants, abuse of humanitarian or family unification–based policies, and distorted labor market outcomes, resulting in eventual political conflicts and cultural clashes.

Another important dimension of immigration policy is whether visas, especially employment-based visas, are temporary or permanent. In some ECA countries, a significant share of economic migrants are temporary migrants. In Russia, for example, 83 percent of migrants are admitted on a temporary basis;

BOX 2.2 Human trafficking: Ongoing analysis with a new data set

The International Labour Organization (ILO), the Walk Free Foundation, and the International Organization for Migration (IOM) estimate that more than 25 million people worldwide are in forced labor, many of them having been trafficked. Estimates from the United Nations Office on Drugs and Crime (2018) indicate that about 93 percent of identified victims had been trafficked to work as forced laborers, including sex workers. In 2016 ECA had the second-highest rate of forced labor (3.6 forced laborers per thousand inhabitants), behind only East Asia and Pacific (4.0 forced laborers per thousand inhabitants) (ILO, Walk Free Foundation, and IOM 2017).

Research on human trafficking has been limited to aggregated cross-country analysis or qualitative, community-level studies. Although there is agreement in the literature on some common features of trafficking—the fact, for instance, that it can occur in both institutionally weak and strong states—the lack of microdata has prevented researchers from assessing the supply and demand factors behind it.

The Victims of Human Trafficking database developed by the IOM contains more than 49,000 individual cases, with approximately 5,000 new cases added each year. The data suffer from several selection biases, as coverage is limited to countries where IOM has victim assistance operations, some types of trafficking cases are more likely to be identified (or referred) than others, and larger numbers may indicate more effective countertrafficking response rather than higher prevalence. Nevertheless, the database provides a unique source of detailed data on victims of trafficking that is international in scope and can yield initial insights into trafficking trends and patterns.

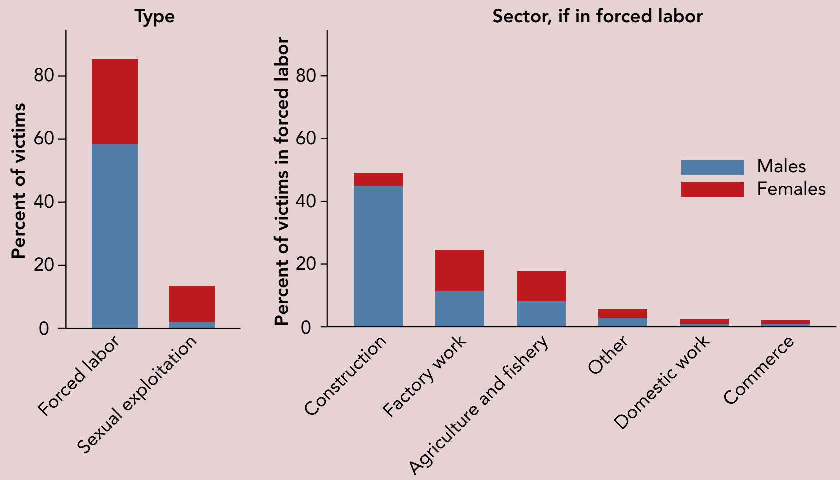
For 2014–18, the IOM data set includes more than 11,500 cases corresponding to victims exploited in ECA, mostly in former Soviet republics in which the IOM has an active presence. Focusing on the citizens of these countries, the data set includes about 10,800 victims, with almost the same number of females (50.4 percent) and males (49.6 percent). About 17 percent were children. Eighty-six percent of the victims were trafficked internationally, with Russia the most common target destination: 65 percent of citizens of former Soviet republics who were trafficked abroad were sent to Russia. Of the 20 percent who were trafficked outside the former Soviet Union, most were sent to EU countries.

(Continued next page)

BOX 2.2 Human trafficking: Ongoing analysis with a new data set *(continued)*

For a third of the cases, the dataset includes information on the type of exploitation (box figure 2.2.1). Sexual exploitation accounted for 14 percent of exploitation (89 percent of the victims were women) and forced labor accounted for 86 percent (32 percent of the victims were women). The most common sector for forced labor was construction (49 percent of victims in forced labor on whom information is available), followed by factory work (24 percent) and agriculture (17 percent). Future research by the World Bank, jointly with the IOM, will analyze this dataset to increase the understanding of the drivers behind human trafficking in the region and to design policies to prevent it.

BOX FIGURE 2.2.1 Type and sector of exploitation of victims of human trafficking from former Soviet republics, 2014–18



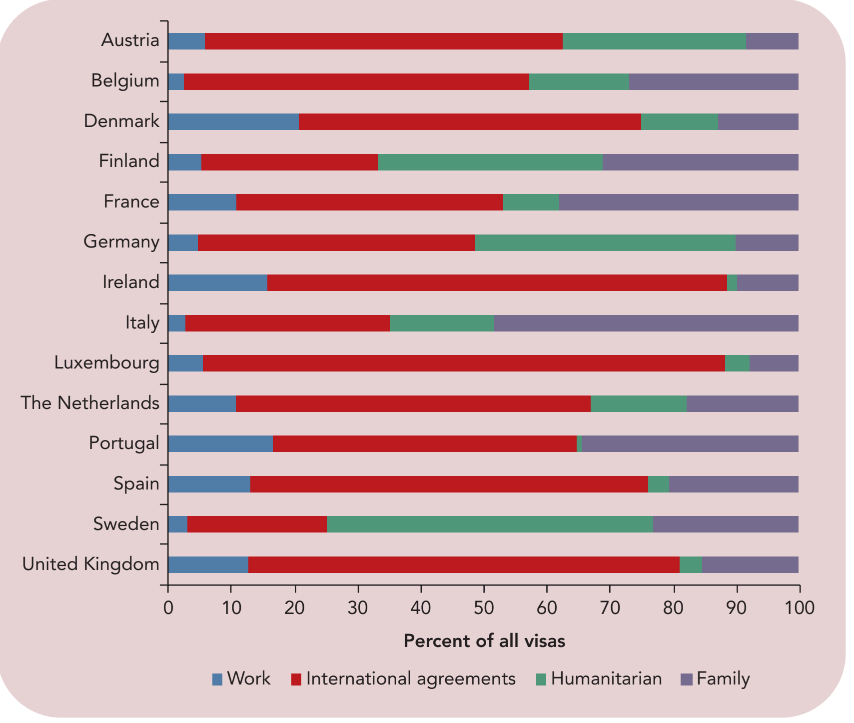
Source: World Bank calculations based on data from Victims of Human Trafficking dataset.
Note: In panel a, 1 percent of victims reported other types of exploitation (forced marriage, organ removal).

permanent work- and family-based migration are rare. In Finland about 50 percent of migrants are on temporary visas; in Germany and Switzerland, this share is over 40 percent; in the United Kingdom, it is 30 percent. It is possible that the permanent visa mix and temporary ratio (the share of temporary economic migration) interact with each other.[2] Sweden, for instance, has low numbers of permanent economic migrants but a moderate temporary ratio, partly as a result of the country's low levels of permanent economic migration and relatively large numbers of humanitarian visas. In contrast, Denmark and Norway have low temporary ratios and a large share of free-movement migrants from countries within the European Economic Area (EEA).

Figure 2.16 shows the visa mix in the main EU destination countries. In addition to the work/employment, family unification, and humanitarian categories,

2. Boucher and Gest (2018) define the visa mix as the distribution of immigrants entering a country under designated laws related to labor, family reunification, humanitarian refuge, or free movement. Family members entering destination countries on work visas are included as work-related migrants.

FIGURE 2.16 Visa mix for main destination countries in the European Union, by country, 2016



Source: OECD 2019.

it includes a fourth category: international agreements. This category covers people who enter under the free mobility provisions of the European Union (they do not require visas). Among permanent migrants in ECA, economic migration is more prevalent than other types of migration in the United Kingdom, Spain, and Italy (Boucher and Gest 2018). Among OECD countries, the work-based immigration share is high in Australia, Canada, and the United Kingdom. Immediate family members entering on work visas are also included in the work-based category of migrants, as policy makers usually treat work-based migrants and accompanying family visa holders together.

The figure shows the importance of the EU provisions for labor mobility within Europe, as "international agreements" represents the leading type of entry in most countries. Family unification is also important, representing more than 40 percent of all permanent admission permits issued in many countries, including France and Italy. The economic/work migration category represents less than 20 percent of permanent admissions in every country, averaging less than 10 percent, for two reasons. First, economic migrants from EU countries, especially in Eastern Europe, take advantage of their privileged status and do not use this category, which applies to non-EU citizens. Second, most EU countries do not have legal entry pathways for economic migrants, especially low-skilled workers, although there is significant demand for their labor. As a result, many economic migrants use the family unification channel or enter illegally.

Visa and immigration regimes vary widely across countries (box 2.3). Some countries, such as Belgium and Sweden, have just one main labor immigration program. In contrast, the United States has six different programs for admitting

BOX 2.3 Comparing countries' migration regimes using the Migration Integration Policy Index

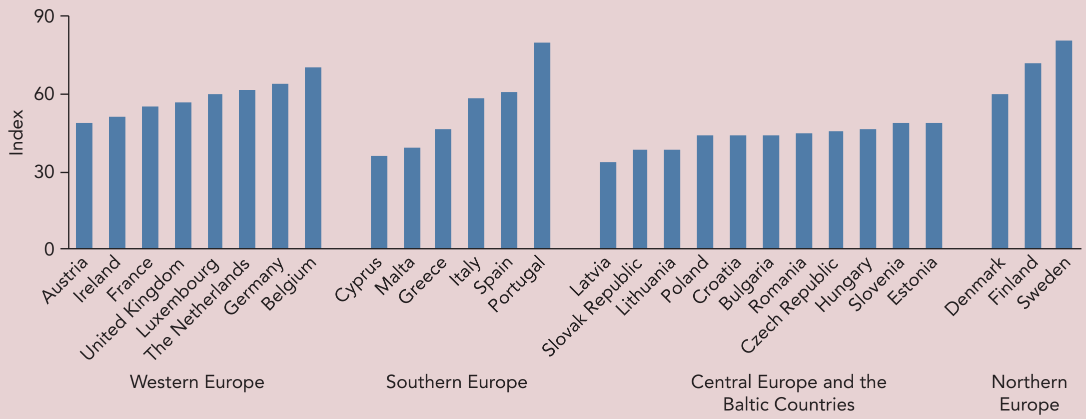
Migration policy regimes vary widely across countries. Governments admit migrants for different purposes and for different durations. They grant different residency rights, citizenship rights, and access to public services. Countries often implement different programs, seemingly for the same purposes or targeted migrant groups. Countries may also differ in their enforcement of migration policies. All of these differences make it almost impossible to compare the immigration regimes of different countries over time.

To address this challenge, academics from economics, political science, law, and sociology created the Migration Integration Policy Index (MIPEX), which measures policies to integrate migrants. The 2015 edition of the index (http://mipex.eu/) includes information on 38 countries, including all EU member states, Australia, Canada, Iceland, Japan, the Republic of Korea, New Zealand, Norway, Switzerland, Turkey, and the United States. It covers eight policy areas of integration: labor market mobility, education of children, political participation, family reunion, access to nationality, health, permanent residence, and antidiscrimination. It is based on 167 policy indicators that benchmark current laws and policies against the highest standards.

The MIPEX data show that migrants generally face greater obstacles in emerging market economies, where there are smaller numbers of immigrants and high levels of antiimmigrant sentiment (box figure 2.3.1). They tend to enjoy more equal rights and opportunities in wealthier, older, and larger destination countries, such as Western Europe (the EU15 average MIPEX score is 60/100) and traditional destinations such as Australia, Canada, New Zealand, and the United States (the MIPEX average is 67/100 for these countries).

In recent years, integration policies have improved moderately. Among the 38 MIPEX countries, 13 made improvements by reinforcing current programs (Portugal, the United States); improving procedures (France, Ireland, Japan, Switzerland, Turkey); or implementing EU law (Hungary, Italy, Lithuania, Romania). Ten countries passed major reforms. Denmark introduced several reforms to catch up with policies in the other Nordic countries, Germany, and international trends. There was

BOX FIGURE 2.3.1 The Migration Integration Policy Index (MIPEX) in Europe and Central Asia, by country



Source: Migrant Integration Policy Index 2015.

(Continued next page)

BOX 2.3 Comparing countries' migration regimes using the Migration Integration Policy Index *(continued)*

more targeted support in Austria and Germany, and Germany introduced dual nationality for second-generation migrants. The Czech Republic and Poland adopted EU-required antidiscrimination laws and domestic citizenship reforms.

Seven countries, including Greece, the Netherlands, and the United Kingdom, lost one point or more during 2010–2014. Greece reduced citizenship and voting rights. The Netherlands and the United Kingdom imposed residence restrictions and targeted support cuts.

Variations in MIPEX scores by policy area are in line with variations in overall scores. Family reunion policies are a major factor determining whether migrants reunite with their families. MIPEX data suggest that non-EU families are more likely to reunite in countries with inclusive family reunion policies, such as Spain and Portugal. Education and health services are slow to adapt to immigrants' needs. Migrants' basic access to health services depends on their legal status. Relative to other countries, traditional destination countries and some countries in Northern Europe offer more personalized, general, and targeted support that reaches more immigrants in need.

Opportunities for permanent residence vary widely across countries. Austria, Cyprus, and Greece restrict permanent residence and citizenship, which leads to large numbers of permanently temporary foreigners, who are legally precarious and socially excluded. Denmark, Italy, Switzerland, Estonia, and Latvia facilitate permanent residence but restrict citizenship. Permanent residents may be discriminated against. In Hungary, Spain, Japan, and the Republic of Korea, policies privilege some national or ethnic groups over others. Some countries in ECA, including Belgium, Portugal, and Sweden, provide opportunities that allow migrants to enjoy equal and secure rights that boost their integration.

migrant workers, and Canada and Australia each have four. Norway and Sweden have a single labor immigration program that is open to migrants of any skill level. In contrast, the United Kingdom has multiple labor immigration programs.[3]

One of the prominent themes of the migration literature is that immigration does not have a uniform impact across labor markets. The appropriate migration policies should therefore be tailored to the labor markets they are targeting. The rough distinction adopted here between migration policies for high-skilled and low-skilled workers is based on human capital and education levels.

Policies to Meet the Demand for Low-Skilled Workers

Economically motivated migration is not random: Workers move from labor markets where demand and wages are low to markets where they are higher. As education levels started to increase and the population started to age in OECD

3. There are five tiers of the UK labor immigration programs. Tier 1 admits "high-value migrants" from outside the EEA; it covers the entry of investors and exceptionally talented workers. Tier 2 admits medium- and high-skilled workers. Tier 3 was designed for low-skilled workers filling temporary labor shortages; it no longer exists, and the government never allocated any visas under it. Tier 4 is for students from outside the EEA who wish to study in the United Kingdom. Tier 5 provides temporary work visas. It covers creative, athletic, charity, religious, and young temporary workers.

countries (see figure 2.15), the demand for low-skilled workers surpassed the supply. Young, less educated immigrants from poorer countries on the periphery of OECD countries started to arrive to meet this excess demand.

Migration policies are designed to address many objectives in addition to meeting excess demand in labor markets (Boucher and Gest 2018). In many cases, these social and political objectives require restrictions on migration flows and conflict with the needs of the labor market, leading to market distortions as well as cultural, political, and social problems.

Evidence and comparison of different experiences show that it is almost impossible for governments to implement policies that stand against market forces. Instead, immigration policies should be designed with markets in mind.

One example of such a policy involves temporary migration schemes. When market demand exists—in sectors like agriculture, construction, and tourism, for example, where seasonal and short-term jobs are the norm—countries should consider creating temporary programs to meet shortages. Temporary migration programs for temporary jobs benefit migrants and destination countries' labor markets, employers, and consumers. Such programs discourage undocumented immigration by facilitating repeated circular migration.[4] Temporary migration policies work only in industries with low turnover costs and substantial seasonal fluctuations, however; they cannot be used to address labor shortages in industries that require higher skills or sector-specific human capital investments.

Relocating and compensating workers adversely affected by migration

Workers who compete directly with migrant labor often relocate to other sectors, occupations, or geographic regions. Younger workers tend to have more successful relocation experiences, eventually obtaining higher incomes and better jobs (World Bank 2018). Thanks to this adjustment in the labor markets, the overall wage effects of migration, especially at the national level, are generally small. However, dislocation costs to workers can be large and involve substantial financial and emotional burdens in the short-run. Policy should therefore support workers in their adjustment and relocation, especially if the workers are relatively low skilled and older, making relocation costlier. How should such policies be designed so that they help reduce these mostly transitory but potentially disruptive costs?

Transitory welfare benefits, unemployment insurance payments, and retraining programs are possible components of such assistance programs.[5] Education systems for young people should be modified so that they are not forced to compete with lower-skilled immigrants who are willing to accept low-paying and demanding jobs.

In principle, the beneficiaries of immigration—migrants, employers, and consumers of the products and services they produce—should be at least partially

4. Circular migration refers to the migration and return of people to their home countries, often multiple times, rather than one-time emigration.
5. The evidence on assistance mechanisms used to compensate workers dislocated by international trade or technological change is not encouraging.

responsible for the cost of such efforts. In practice, there are very few policies through which beneficiaries shoulder the costs of relocation. They include extra taxes or fees charged for work permits or requirement for firms to limit the number of migrant workers they employ. As a result, the people who pay the costs often oppose such programs, leading to economic inefficiency and political conflict. Box 2.4 describes possible ways to overcome such resistance.

BOX 2.4 Creating markets for work permits

Free mobility of labor across international borders yields overall efficiency gains—as well as losses for certain groups of existing workers. The challenge is to design policy measures to finance and compensate these workers for their losses, so that political resistance to migration is reduced.

Over the past decades, many prominent economists suggested market-based mechanisms that would address two problems: identifying who should be allowed to migrate and work in a country and determining how to extract some of the economic gains of migration to compensate the workers facing losses. Becker proposed that the US government sell visas to foreigners rather than establishing quotas (Becker 1992; Becker and Becker 1997; Becker and Lazear 2013). Foreign workers (or employers) with the highest potential income gains would submit the highest bids, and the government would raise revenues that would otherwise be captured by the migrants and their employers. Selling visas has also been suggested as a means of reducing human trafficking (Auriol and Mesnard 2016) or compensating native workers who lose out as a result of competition from migrants (Weinstein 2002). Zavodny (2015) proposes visa auctions to sell work permits. Recently, various cash-for-passport programs have emerged (Sumption and Hooper 2014).

These proposals do not eliminate an underlying market failure. Although there is excess demand for work permits, the supply side of the labor market is absent in this mechanism. An immigrant needs permission or a work permit to take up formal employment; the government is technically selling this permit to them. But the real owners of the permit are the citizens who own the implicit right-to-accept-work entitlement. A mechanism proposed by Lokshin and Ravallion (2019) compensates people who are willing to "sell" this right for a period of time. Their proposal allows working-age citizens to "rent out" their "right-to-accept-work" to foreign workers. The government would operate a web platform that connects citizens who want to auction their right to accept work and the foreigners who need a work permit. When a citizen decides to rent out his or her right to accept work, that right is temporarily transferred, in the form of a work permit, and the money is transferred to the person who relinquishes the right. This mechanism allows citizens who are most likely to face economic losses from migration to be directly compensated. The migrant worker who buys a work permit is then free to take up any job offer in the country. Once the contract term is completed, the permit is transferred back to the original owner.

Creating an anonymous and transparent market for work permits can reduce political opposition to migration, by helping internalize the main externalities generated (or at least perceived to be generated) by migrants in the host country. The host country enjoys several benefits from adopting this policy, as low-productivity workers with low wages would be replaced with higher-productivity migrant workers, raising GDP and tax revenues. The replaced workers are directly compensated, reducing the need for sophisticated and inefficient social assistance programs for them. The scheme can be designed to maintain the total number of jobs in the host country, so that migration does not lead to unemployment. The market for work permits can be seen as a social protection policy as well as an efficient policy for managing immigration. It would likely increase the acceptance of freer international migration.

Changing the mechanism through which migrants enter the labor market

One way to raise the funds from the beneficiaries of migration to finance relocation costs would be to change the mechanisms through which migrants enter a destination labor market by moving from quantitative restrictions to price mechanisms. Almost every destination country currently uses quotas to regulate formal and documented immigration flows. Governments decide on the number of immigrants with a given level of education, occupation, and sector category that will be allowed to work in their country.

The use of quotas creates several problems. First, bureaucrats, rather than employers or labor markets, make the assessment of how many immigrants should be allowed to enter. It is difficult to determine what type of migration most benefits a destination country, especially in the long run. Furthermore, the needs of the labor market may change rapidly over time. Second, quota-based systems are subject to rent-seeking activities and corruption, as firms try to sway government officials to issue quota permits to benefit their industries. Third, when quotas are set too low, the incentives for smuggling are great, creating large numbers of undocumented migrants. These migrants work in the informal labor market, outside the social protection system, generating negative externalities for the very low-skilled workers whom the government was trying to protect. Fourth, quotas do not generate revenue for the government. Instead, they benefit only those firms lucky enough to hire an immigrant (by obtaining an employment visa). The intermediary firms that handle the recruitment or the human smugglers who aid the undocumented migrant charge hefty fees for these services.

Replacing quota regimes with tax regimes to regulate immigration flows can be achieved via several different methods, including an additional income tax, a visa fee, and a visa auction system. A few countries, such as Malaysia and Singapore, impose levies on immigrants. The imposition of taxes, fees, or levies instead of quota restrictions has many clear benefits, although none of these policies has been properly evaluated. These mechanisms would provide the government with revenue to support workers who are struggling economically as a result of migration, particularly older and lower-skilled workers, who are less able to move to other jobs or sectors. Employers would also be able to respond more rapidly to economic fluctuations and hire extra workers when needed. In a quota regime, firms cannot expand production quickly, even if they are willing to pay for employment permits. Governments would be able to adjust the fees/taxes more quickly to respond to changes in the labor markets. Fee-based regimes might also reduce the cultural hostility to immigrants, who would provide the needed "tax" revenue and could no longer be accused of "free riding."

The global trade regime gradually replaced quotas with tariffs over multiple decades. It will take a similar period of time to implement and enforce such policies for immigration, but doing so is worth trying.

Policies to Meet the Demand for High-Skilled Workers

Many countries want to attract high-skilled migrants, because they generate productivity spillovers, fill skill gaps in labor markets, integrate more easily into the destination country, and do not impose a burden on social services. The main beneficiaries of high-skilled migration in the labor markets are workers with complementary skills working in sectors in which knowledge spillovers are prevalent.

Labor market patterns, outcomes, and policies for high-skilled workers vary substantially across countries. Four destination countries—the United States, the United Kingdom, Canada, and Australia—receive more than two-thirds of the world's high-skilled migrants. Many high-skilled workers from high-income Western European countries, including France and Germany, choose to leave Europe for these destinations for various reasons, including the synergies and productivity spillovers generated by the agglomeration of high-skilled workers.

Policies on high-skilled immigration need to be designed with these patterns and the underlying labor market characteristics in mind (Kerr and others 2016, 2017). Such policies are particularly relevant for European countries, which are both origin and destination countries for such migrants. A large portion of high-skilled migration in ECA is intraregional (box 2.5).

There are two basic approaches to policy design: demand driven and supply driven. The demand-driven approach is employer driven. Employers identify the skilled workers that will potentially be admitted into the country. The supply-driven approach is based on points that reflect the priorities of the country or merit-based screening of individual applicants for admission.

There are pros and cons to both approaches. Although the employer-driven approach makes the program more responsive to labor market policies, it ties the migrant to the sponsoring firm, at least for an initial period. In both approaches, setting the quotas can be difficult.

Demand-driven policies

The current trend is toward demand-driven features that emphasize the employability of the migrant. The basic premise of demand-driven selection policies is that incoming migrants should obtain a job in the destination country; the burden of selection is thus placed on labor markets and employers. It is implicitly assumed that if a migrant can obtain a job, he or she provides a net benefit and should be allowed to enter. Priority is given to migrants who will be immediately employed and contribute to the economy. Potential employers and current labor market conditions determine who can potentially migrate. Most temporary work permit programs, such as the United Kingdom's Tier 2 program and Ireland's work permit program, fall in this category. They require migrants to have a firm job offer before being admitted to the host country.

Another high-profile program is implemented in Germany, where applicants with a bachelor's degree are eligible to apply for a Blue Card, which allows them to reside and work in Germany.[6] Applicants must prove that they have secured

6. After a certain period of residence in Germany, such applicants can move to another EU member state and apply for the Blue Card for that country. For instance, if a non-EEA migrant had an EU Blue Card issued by Germany for 18 months, he or she has the right to move to Spain and apply for a Spanish EU Blue Card. See https://www.expatica.com/es/moving/visas/work-visas-103258/.

BOX 2.5 Labor migration programs and the Russian Federation

Much migration within ECA is intraregional. One important pathway is migration from former Eastern Bloc countries that joined the European Union, whose citizens obtained free access to the labor markets of high-income EU countries, such as Germany. Another is between former Soviet republics, where historical and economic links shape the patterns of migration. The migration policies of these countries deserve special attention, given the importance of these corridors.

Enlargement of the European Union

Eight Central and Eastern European countries (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia) joined the European Union in 2004. This was the single largest enlargement in terms of people and number of countries. They were followed by Bulgaria and Romania in 2007 and Croatia in 2013. With each accession prior to 2004, free movement of people was automatically applied to the new member countries. Due to the concerns of mass migration, some temporary restrictions were implemented in 2004. Several EU members, such as the Ireland, Sweden and United Kingdom granted immediate access to the new members while the rest imposed restrictions lasting between two and five years. By April 2008, the restrictions on the eight new members (which joined in 2004) had been dropped by all members except Germany and Austria, which removed them in 2011.

The impact of EU membership has been rather dramatic for these countries. For example, the number of Polish immigrants in other EU countries is estimated to be over 2 million people, mainly to the United Kingdom, followed by France and Germany. Even though the financial crisis of 2008 and the resulting labor market difficulties hampered emigration rates, the overall flows have stabilized around half a million people leaving Poland each year. Naturally, many of these people return after a several years but, currently, around 6 percent of the Polish population is living in the EU countries.

Russian Federation

Russia is a major destination for migrants from former Soviet republics. Labor migration within the Commonwealth of Independent States is regulated by several multilateral and bilateral agreements aimed at forming a common labor market. Russia has bilateral treaties with Armenia, the Kyrgyz Republic, Moldova, Tajikistan, Ukraine, and Uzbekistan. All treaty countries are obligated to recognize the education, work experience, entitlement to compensation for damages, and social security contributions of migrant workers.

Every year, the Russian government defines how many work permits can be issued and how they will be distributed among the constituent components of the Russian Federation, depending on the labor market situation and the opinions of labor unions. Quotas are divided by region, profession, and field of employment. Foreign workers are not allowed to change their employer for the duration of the labor contract and are not eligible for hire by another employer after the contract expires. If an individual does not obtain employment within 30 days of the issuance of the work permit, he or she must leave Russia.

Special rules were established in 2011 for citizens of Eurasian Economic Community (EEC) countries (Russia, Belarus, and Kazakhstan). Citizens of Belarus and Kazakhstan have the same employment rights as Russian citizens. They are therefore not required to apply for work permits for employment in Russia. More lenient rules for renewal of employment contracts apply to citizens from EEC countries.

an employment contract in Germany, in a field related to their qualifications, with a minimum annual salary of €48,000. Applicants who do not have a work contract can still move to Germany, but only for the purpose of searching for a job and only for six months. After securing an employment contract, the migrant can apply for an EU Blue Card.

A critical and complementary policy measure of demand-driven regimes involves labor market tests. These tests require employers to provide evidence that they could not find a current resident with the necessary qualifications to fill the job in question. In Ireland, for instance, employers are required to obtain a certificate from the public employment service to certify that they have advertised the vacancy and were unable to find local workers who met the job requirements.

Another example of a labor market test comes from Spain, where work permit applications are more likely to be approved if the job is listed as a "shortage occupation" or the vacancy has been advertised and there are no suitable candidates from Spain or other EU countries. Applicants with at least a bachelor's degree are eligible to apply for an EU Blue Card if they have a work contract or legally binding job offer that pays at least 1.5 times the average wage in Spain (1.2 times for shortage occupations).

Other demand-side policies include sectoral and occupational regulations, economic work permit fees, wage regulations, and trade union involvement. For example, almost all ECA countries require employers to pay migrants at least the minimum wage. The most restrictive policy is to require employers to comply with the wage and employment conditions stipulated in collective wage agreements. These restrictions are strongest in Norway and Sweden. In Sweden, before the immigration policy reform in 2008, any application for a work permit for non-EEA workers had to be approved by the relevant Swedish trade union, which thus had veto power over individual applications. In some other countries, such as Canada, unions do not have veto power but still have influence over work permit applications (Ruhs 2011). The United Kingdom has an intermediate policy on wage restrictions. It requires employers to pay migrants the average or prevailing wage in the relevant occupation and/or sector.

Supply-driven policies

Supply-driven policies evaluate potential migrants by their qualifications, without an explicit labor market test or employability. These policies generally take the form of a points-based evaluation, giving preference to applicants who possess more desirable labor market or social characteristics, such as youth, education, experience, or local language proficiency, or work in certain occupations.

Proponents of supply-driven policies argue that these regimes adopt a longer-term perspective on the economic needs of a country. Human capital and integration rather than the short-term needs of the labor market are at the heart of the selection process. Supply-driven policies also give workers more flexibility, as they are generally allowed to enter a country, search for a job while there, and obtain a better match, as opposed to trying to find employment while outside the country.

An example of this approach is the Austrian points system, the Rot-Weiß-Rot Karte (Red-White-Red Card system), which allows qualified workers from non-EEA countries and their family members to emigrate permanently to Austria. Qualified workers are very highly educated professionals or skilled workers in shortage occupations, such as engineering and health care. Workers in these categories are not required to prove German language skills before entering the country, although extra points are granted for German or English language skills.

Nationality plays a key role in determining the eligibility to work and reside in various European countries. Citizens from EU member states, Iceland, Liechtenstein, Norway, and Switzerland are allowed to work and live in all of these countries without applying for a residence or work permit. Germany does not require citizens of Australia, Canada, Israel, Japan, the Republic of Korea, New Zealand, and the United States to apply for a visa to enter the country. Citizens from these countries must register with the local authority for a residence and work permit before being employed, however. In effect, these rules work as a supply-driven selection mechanism.

Another policy measure that is commonly used in countries adopting supply-driven policies is skill requirements. For instance, under Germany's labor immigration program for admitting skilled migrant workers, residence permits are granted to professionals with a recognized degree or a German-equivalent foreign degree. Non-EEA graduates can request a residence permit for job-seeking purposes; it is valid for 18 months. Once applicants get a job contract, they become eligible for an EU Blue Card if the job is related to their qualifications. Non-EEA nationals who want to reside in Germany to get professional training are eligible to apply for a residence permit that allows them to live in Germany for up to one year for job-seeking purposes. When candidates obtain an employment contract, they become eligible for a work permit.

The most restrictive policies allow admission only for migrants with very specific skills. For example, Denmark's "positive list" immigration program defines a set of minimum qualifications for each profession, which range from a bachelor's degree to a master's degree, with some occupations, such as dentistry, requiring government authorization.

Some countries have hybrid programs with features of both approaches. Certain permanent labor immigration programs and temporary programs for high-skilled migrants do not strictly require a job offer. Denmark's Green Card Scheme and the United Kingdom's Tier 1 program are examples of points-based temporary labor migration policies that admit high-skilled migrants without job offers. Both programs allow migrants to look for jobs after being admitted on a temporary basis once they obtain enough points. Migrants can upgrade to permanent status after several years of employment; if they do not, they must leave the country.

Economic migrants in France are eligible to apply for a multiyear Talent Passport permit if they hold a high-skilled position in France. Foreign employees who are not eligible for the Talent Passport can still be granted access to the French labor market through a temporary residence permit, but their visa and residence permit applications may be rejected if their skill levels are not deemed high enough.

Elements of successful migration policies for high-skilled workers

Successful policies for high-skilled labor share several key elements. They create a clear path to permanent residency or citizenship. Residency and employment security are especially important for high-skilled migrants, because they tend to have permanent jobs that require them to make significant employment-specific human capital investments. The experiences of Australia, Canada, and the United States show the importance of the adoption and enforcement of such policies. Long-term guarantees on residency and access to education and other public services are especially important for high-skilled migrants, because many of them move with their families. High-skilled migrants also tend to be more sensitive to top tax rates and to be attracted to destinations with favorable tax treatment.

The quality of higher education in the destination country is also very important in attracting skilled labor. Many high-skilled migrants arrive at the destination country only with raw talent and ambition, rather than specialized human capital and experience; they enroll in higher education programs. Obtaining formal education provides an important entry point into labor markets for such individuals. The existence of universities—especially universities that focus on research and graduate training in technical and science-oriented fields—is thus an important draw.

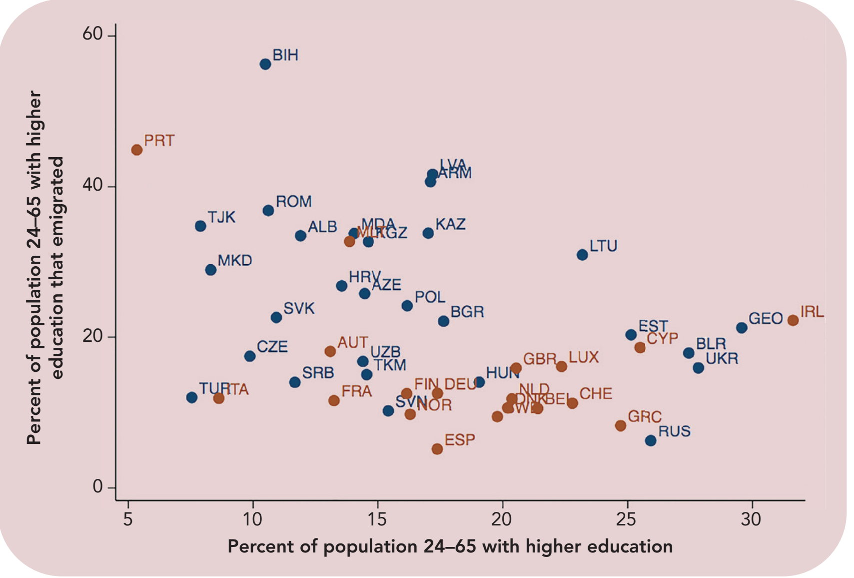
Another possible approach is to provide funding to educational institutions in origin countries (Clemens 2015). Brain drain is a key concern in many lower-income countries, especially in occupations and sectors that provide economywide externalities, such as health care and technical education. Migration of high-skilled workers from lower-income countries implies an implicit fiscal subsidy, as higher education is publicly funded through tax revenue in most countries.

If a high-income destination country like Germany were to fund higher education institutions in an origin country (for example, a medical school in Moldova), both countries would benefit. Germany would gain access to highly qualified professionals who are trained according to Germany's licensing and educational standards. Training might even be done in German, so that the migrants would arrive in Germany with the necessary language skills and be able to start work immediately. Moldova would be able to provide medical education at no fiscal cost. The two countries could set the enrollment capacity of the school greater than the number of graduates that Germany would accept. As a result, there would be a net gain in the stock of doctors for Moldova. Such a program might even be funded via the "immigration tariff revenues" discussed in box 2.4, completing the full circle in which migrants fund their own education and contribute to their origin country.

In response to destination countries' policies to attract more high-skilled migrants, origin countries are struggling to find ways to retain them. Departure of high-skilled workers leads to severe skill shortages in many critical sectors, such as healthcare. This problem is especially severe in smaller middle-income countries in ECA, whose high-skilled citizens face fewer restrictions and preferential access to work in high-income countries in the European Union.

Figure 2.17 plots the share of the population in the labor force (people 24–65) that has higher education against the share of the population with higher education that emigrated. It shows that with the exception of Malta and Portugal, higher-income countries have emigration rates below or about 20 percent. In contrast, many Eastern European countries have much higher high-skilled emigration rates.

FIGURE 2.17 Correlation between emigration rates among people with higher education and share of labor force with higher education in Europe and Central Asia



Source: OECD 2010; UN DESA 2019; World Bank 2017.
Note: Red dots indicate high-income countries in Western, Northern, and Southern Europe. Blue dots indicate countries in other subregions of Europe and Central Asia.

The emigration rates of high-skilled workers are high, especially in some of the lower-income countries in the Balkans and Eastern Europe. Among people with higher education, 55 percent in Bosnia and Herzegovina; more than 40 percent in Armenia and Latvia; and almost 40 percent in Albania, Kazakhstan, Moldova, North Macedonia, and Romania have emigrated. Countries with fewer high-skilled workers experience higher rates of emigration.

Various factors drive brain drain from these countries. In addition to higher wages, they include opportunities for professional advancement and training, better future for family members (such as educational opportunities for children), and better living and working conditions. The physical proximity and preferential access to the labor markets of the European Union as well as a massive diaspora reduce the costs of emigrating from many ECA countries.

Although the mobility of high-skilled professionals generates gains, extensive and sustained emigration is likely to have long-term negative effects on origin countries. Brain drain is often the symptom, not the cause, of an underperforming economy, however.

The cost of brain drain arises from the loss of productivity spillovers and important public services—such as health care and education—that workers with higher education would have generated in their own countries had they not emigrated (box 2.6). In many cases, governments find themselves without good policy options for reversing the tide.

Lower-income countries cannot influence pull factors originating in high-income countries, but they can diminish the strength of push factors. The first step is to increase the attractiveness of the home country, by increasing the competitiveness of wages and productivity in critical high-skilled occupations. Many high-skilled people work in the public sector. It is therefore important to improve meritocracy and reduce red tape and cronyism in public employment.

BOX 2.6 Migration of health care workers from the Western Balkans to the European Union

Shortages of health care workers are a critical challenge in many European countries. The World Health Organization estimates a global shortage of about 17.4 million health workers (WHO 2016). Recent estimates project that Germany will need 500,000 additional nurses by 2030 (GIZ 2019), and the demand for health care workers in the United Kingdom is projected to grow twice as rapidly as the population by 2035 (Buchan and others 2019).

Personnel shortages arise for several reasons, including an undersupply of medical and nursing school graduates, the high cost of labor as a national health expense for governments, and demographic change, as the working-age population in Europe continues to shrink and the population ages. As people live longer, noncommunicable diseases, such as cancer and strokes, are more common and require more complex, longer-term, and labor-intensive care.

The Western Balkans have been a net exporter of human resources. Fourteen percent of the population of Serbia and 48 percent of the population of Bosnia and Herzegovina has emigrated. Once these countries accede to the European Union, it will be even easier for their citizens to leave. Bulgaria, Croatia, and Romania report high levels of out-migration for all health workers, despite high vacancy rates in their domestic health sectors. Many health professionals leave for the European Union and Switzerland. In 2015 about 17 percent of physicians and 6 percent of nurses in OECD countries were foreign trained (OECD 2016). Higher salaries in higher-income countries, better working conditions, and professional development are among the main reasons health professionals migrate.

If well planned, recruiting health professionals from abroad can help address short- and medium-term fluctuations in demand and increase professionals' skill levels. Migration is often the only route for physicians and nurses to gain experience in centers of excellence or subspecialties. Twinning relationships between teaching hospitals and universities in different countries enhance research and education opportunities for students and professionals. Circular migration through bilateral agreements with destination countries allows returnees to bring back new skills and experience to the health sector in origin countries.

Challenges arise when international recruitment is not well coordinated and negatively affects medical education financing and health sector performance. Many health professionals who migrate to higher-income countries have benefited from government-financed higher education in their home countries. Investing in the training of health professionals who migrate may create additional pressure on the financing of the education and training systems in source countries and possibly undermine the quality of training. The fact that many health professionals migrate after receiving education at the expense of the source country may reduce source countries' incentives to invest in education. Selective international recruitment of specialist doctors or experienced nurses can also generate critical shortages in source countries and reduce the quality of service delivery.

The World Bank's health team in ECA has started to conduct analytical and advisory work on health workforce mobility. Core activities include country-based workshops with clients that are informed by background material, including a review of the international literature, country case studies, and short policy notes. These activities will examine the interaction between health care worker migration and education of health professionals, the health workforce, health sector performance, and the policy context. Findings will help inform bilateral and regional agreements to ensure fair recruitment practices while promoting mutually beneficial social and economic policies for medical education and health.

Private sector development and job creation need to complement public sector reforms. Private enterprises employ the majority of high-skilled professionals in most middle- and upper-middle-income countries (although public sector employment is important in critical occupations such as healthcare). Without private sector job creation, especially in knowledge-intensive sectors with productivity spillovers, high-skilled professionals will continue to emigrate. Foreign direct investment (FDI) could play an important role, by both increasing the employment of high-skilled workers and providing technology and capital. Policies to attract FDI in high-skilled intensive sectors should thus complement other policies to reduce brain drain.

Countries can also expand the coverage of higher education and increase its quality to compensate for the loss of human capital via emigration. Even though a frequently cited concern is that improvements in education levels will encourage even more emigration, leading to further losses, many countries follow this path. Investing in education also helps prevent students from going abroad in search of higher education, which makes it easier for them to settle abroad permanently. Box 2.7 provides examples of policies that ECA countries have adopted in response to high-skilled migration.

In most origin countries, higher education is publicly funded. Emigration of high-skilled workers therefore imposes a significant fiscal burden. As a result, a policy option that is often recommended is for governments to require emigrants to repay their country for their education. Such a policy would increase equity with respect to people who stay. Enforcement is difficult, however, especially once the emigrant leaves the country. Moreover, heavy-handed enforcement and legal measures may lead to detachment of the emigrant from the country, preventing the realization of diaspora externalities. Policies to tax emigrants need to be designed with care to avoid potential unintended effects.

Education policies need to be designed with emigration issues in mind, especially in smaller European countries, from which millions of people migrate, because of both mismatch and quality challenges in origin countries' labor markets. Long-term workforce planning is almost nonexistent, and coordination between education institutions and private sectors employers is limited. Smaller countries could focus on certain sectors and train the workforce needed to attain a critical mass, especially in sectors that have long-term viability and competitiveness. Specialization and agglomeration lead to increased productivity and higher wages, reducing incentives for emigration. Education systems should focus on training people for these sectors. Collaborative and coordinated efforts with educational institutions and firms from destination countries would increase the effectiveness of such policies. The legal and political structure of the European Union might support the implementation of such policies via the provision of financing through common internal funds.

Another policy initiative for origin countries is to improve labor market outcomes for women and reduce gender-based discrimination. High-skilled women make up the fastest-growing group of migrants. Between 2000 and 2017, the number of women with higher education that emigrated from non-OECD countries to OECD countries grew by 130 percent, and the number that emigrated from other OECD countries rose by 70 percent (figure 2.18). In contrast, the total

BOX 2.7 Policy responses to high-skilled migration in Europe and Central Asia

High-skilled migration in ECA increased rapidly over the past several decades. In Eastern Europe and the Balkans, regime change and the entry of many of these countries into the European Union opened the doors of Western Europe to many young professionals. As a result, emigration from Romania increased 287 percent between 1990 and 2017. High-skilled workers in Romania experienced the highest emigration rate, with 27 percent of the total stock of such workers living abroad in 2017. This process led to labor supply shortages, especially in science and technology fields. As of 2017, more than a third of the university-educated workforces of Albania, Bosnia and Herzegovina, and the Republic of North Macedonia was living abroad. The emigration rate is not uniform across occupations. In 2017 about 70 percent of people employed in North Macedonia's higher education system were planning to emigrate; 20 percent of them had already applied for jobs abroad.

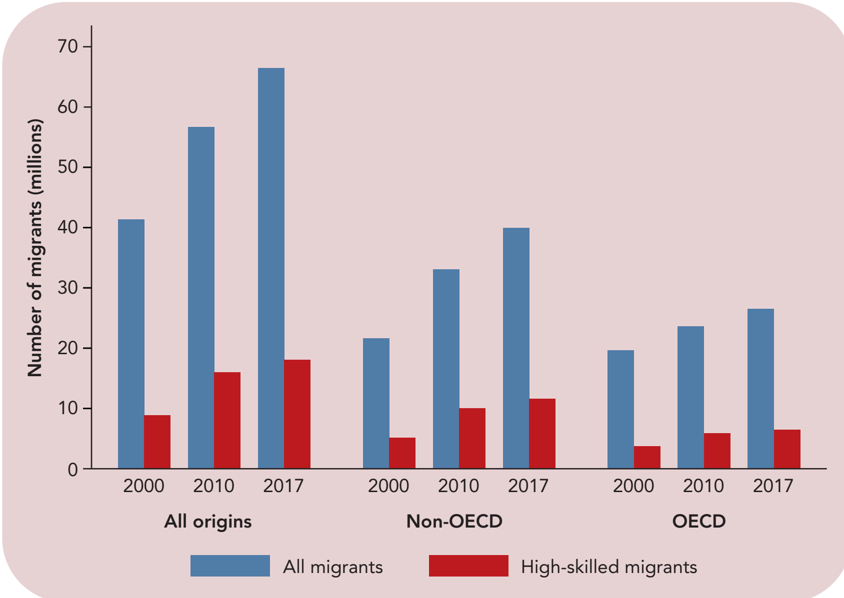
Some countries have improved the quality and reach of higher education to retain or expand their high-skilled labor forces. The World Bank's Moldova Higher Education Project aims to support interventions to improve the quality and labor market relevance of higher education institutions by providing incentives for the internationalization of programs to attract foreign students and researchers. A World Bank project in Ukraine intends to improve the quality and relevance of education, discouraging students and faculty/researchers from leaving the country.

In response, the government is planning to establish a Regional Scholarship and Career Development Center for the region of Slavnoia, Baranja and Srijem to boost investment in higher education through the introduction of scholarships for secondary vocational and university students. It will also set up a new permanent scholarship fund through partnerships with the private sector. The new center would also provide job training and career services. The scholarships are expected to increase enrollment.

Some countries hope to attract talented students from other countries, in addition to retaining their own. Kazakhstan implemented two programs for this purpose. The first established world-class universities, such as Nazarbayev University, founded in 2010. It serves the 5,000 most gifted and talented Kazakh students. The plan is to increase enrollment to 8,000 by 2025. Having access to higher-quality education allows graduates to contribute to the growth of the Kazakh economy, conduct research, and engage in entrepreneurial activities without leaving the country. The second program provides incentives for returning scholars. The Bolashak scholarships, for example, finance study abroad on the condition that students return to Kazakhstan and work in their field there for at least five years.

Some ECA countries are trying to reduce high-skilled migration by offering joint programs with foreign universities. These programs have the added benefit of attracting high-skilled labor from outside the country. For example, Uzbekistan has a partnership with Webster University, in the United States, which expanded to a location in Tashkent in early 2019 with a graduate program for teaching English that encourages foreign students to study in Uzbekistan. Attracting foreign students is also a key priority in Russia, where the 2025 strategy states that education services should be a key export and that high-skilled foreign students should be attracted to Russian universities.

FIGURE 2.18 Stock of female migrants to OECD countries, by skill group and origin, 2000–17



Source: World Bank calculations based on data from UN DESA 2017.

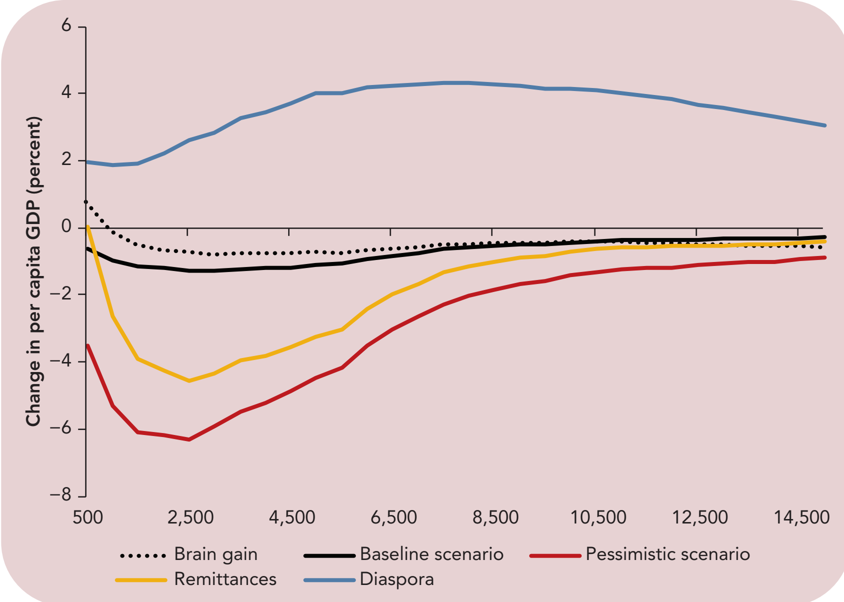
number of all female migrants increased by only 57 percent. Part of this rapid growth reflects increased enrollment of women in universities over the past three decades (Nejad and Young 2015). Another factor is the continuing discrimination against women in the labor market, especially in Eastern and Central Europe and Central Asia.

The evidence on the impact of high-skilled emigration on origin countries is inconclusive (Gibson and McKenzie 2011). Data constraints as well as the empirical difficulty of identifying the effects of skilled migration on economic indicators limit the ability to determine the true costs and benefits of high-skilled emigration for sending countries. Nevertheless, a sustained outflow of high-skilled professionals will have long-term negative effects for a small country with limited resources to fund public education. As figure 2.17 shows, many ECA countries in Central Europe, the Caucasus, and the Balkans fall into this category. There is an urgent need for more research on the extent and impact of high-skilled emigration for these countries. Given the regional nature of the skill flows, the policy dialogue needs to include the higher-income EU countries.

Until more detailed microdata become available on the size and distribution of high-skilled migration, one possible research venue involves macroeconomic analysis. Figure 2.19 illustrates the results of a calibration exercise in which the impact of skill-biased emigration is simulated in a macroeconomic model.

The critical determinant of the impact of high-skilled emigration is the extent of productivity spillovers that human capital generates across the economy. In the absence of such spillovers (the solid black line, representing the baseline scenario, in figure 2.19), brain drain has a relatively small impact: for most countries with income levels below $6,500, the loss is about 1 percent. In the presence of productivity spillovers (the solid red line), the impact can be large, about 6 percent, especially for countries with annual per capita income levels of about $2,500.

FIGURE 2.19 Simulated effect of high-skilled emigration under various assumptions



Source: Docquier 2017.

Remittances may partially offset this loss, reducing the loss to about 4 percent at the same income level.

A common response to brain drain is to restrict migration. However, evidence indicates that high-skilled workers are not necessarily productive in low-income countries, and their presence might not lead to externalities (Kerr and others 2017). A large part of what makes high-skilled workers productive in the destination labor market is the work environment and other complementary inputs. Restricting migration could also reduce the incentives for individuals to accumulate human capital.

What should the governments of source countries do? Recent research highlights at least two promising ways to take advantage of the global market for high-skilled workers and ideas (World Bank 2018). First, source countries should encourage return migration. Second, they should actively and extensively engage with their diasporas and maximize their externalities. Emigrants tend to stay actively engaged—socially and economically—with their home countries and communities. The most common economic engagement takes the form of remittances. Diaspora engagement programs also attempt to connect investors and entrepreneurs abroad with investment opportunities at home and foster the transfer of technology and knowledge from abroad. Communication, political engagement, professional activities, and consular services all serve to increase the connectivity of the diaspora to the origin country and community, in order to increase the transfer of knowledge, capital, and technology. If diaspora externalities can be realized, they may more than compensate for the losses from brain drain (the blue line in figure 2.19).

A large diaspora can generate significant economic benefits for origin countries in the ECA region (Gould 2018). Remittances are an important source of income, have a positive impact on long-term economic growth and poverty reduction, and improve access to capital markets. Diasporas are also a significant source of investment, export demand, and knowledge transfer for ECA economies (Gould 2018). By increasing their populations' exposure to the norms of competitive democratic countries, the growing share of migrants going to the United States and advanced European economies may have contributed to improving institutions in transition economies in ECA. Migration and remittances also provide more incentives and resources for people to increase the accumulation of human capital leading to "brain gain" (Contreras 2013).

Over time, skilled migration may involve shorter durations and circular paths (as opposed to one-way and long-duration experiences) as a result of greater global integration, lower transportation and communication costs, and rising standards of living outside traditional destination countries. High-skilled diaspora members often stay connected with their home countries, periodically going back home or even maintaining two-country residency. These emigrants are instrumental in channeling investments and promoting trade and knowledge transfers. The return of migrants to their home countries can support economic development, particularly when they bring capital and knowledge with them and the origin country provides the framework conditions to help them make use of their skills and investments (Gould 2018).

Rather than preventing emigration, some programs seek to encourage the return of successful emigrants. In Malaysia, for example, the Returning Expert Program provides tax incentives to successful emigrants who have lived abroad for at least five years to return to Malaysia. The program has increased return migration and roughly pays for itself, as return migrants pay taxes, albeit at lower rates than non-returnee taxpayers.

Conclusions

Migration has played a key role in economic and social development in ECA. Economic migration has helped meet labor market demand in destination countries and improved the welfare of the migrants. Maintaining supportive policies toward migration would contribute to prosperity in the region. Indeed, easing immigration restrictions is one of the most effective way to promote productivity and growth in the region. Supporting migration is often politically fraught, however, because the benefits of migration tend to be longer term and more diffused than the costs to the people in destination countries who are unemployed or displaced by migrants.

To reduce resistance to immigration, policies need to address these short-term distributional costs. They can include programs to retrain or relocate workers in destination countries and adjust education systems for young people, so that they are not competing with lower-skilled immigrants. Transitory welfare benefits and unemployment insurance payments can also be components of such programs. Replacing quota regimes with tax regimes would be a useful way to finance the required adjustment assistance, by taxing the beneficiaries and compensating the losers.

For origin countries that experience extended periods of loss of scarce human capital, emigration of skilled labor represents a serious concern. Persistent outmigration is often a symptom rather than the cause of underlying problems, however. To reduce potential brain drain, countries need to adopt policies that increase the potential benefits in the origin country rather than restrict migration. Improving governance quality and strengthening institutions in origin countries are long-term policies that can address the root causes of persistent emigration. Policies to retain skilled labor include promoting private sector development and job creation, investing in higher education, and providing greater job opportunities for women. Greater connectivity—through lower transportation and communication costs—is also important in engaging the diaspora in ways that maximize externalities such as the transfer of ideas, knowledge, technologies, trade, and FDI and encourage return migration. Thanks to greater global integration and technological advances that increase connectivity, skilled migration may increasingly involve shorter durations and circular paths, leading to gains for origin countries.

Annex 2A. Data on Migration

Bilateral migration databases are constructed using data gathered from multiple census rounds in multiple destination countries. They capture the total migrant stock or flow from a given origin country to a given destination, sometimes disaggregated by age, gender, education level, or labor market status. Such databases are limited by the number of destination countries available, making estimates of total migration difficult. Because the quality and frequency of data collection are correlated with a country's income level and size, the data from the OECD and other high-income destinations are much more complete than data from other parts of the world; most data gaps are in lower-income and smaller destination countries.

Data availability also depends on the level of disaggregation required. The United Nations' Global Migration Database—which disaggregates bilateral stocks only by gender—has collected data from at least one data source from more than 200 destination countries over many years. In contrast, the OECD Database on Immigrants in OECD and Non-OECD Countries (DIOC-E)—which collects bilateral migration data disaggregated by age, gender, education level, and labor market status—contains destination data for only 88 countries in the 2010 census round (33 of the 34 OECD member countries and 55 of the more than 180 non-OECD countries) (see Arslan and others 2015 for details). To account for the missing data, researchers often focus on migration into OECD countries in order not to bias the results.

Another way to address missing data is to estimate the size of missing corridors using econometric methods that incorporate historical patterns, country-pair characteristics, and patterns observed from other migration corridors. Three databases that use this approach to impute missing data are the United Nations' Global Migration Database, the World Bank's Global Bilateral Migration

Database (Ozden and others 2011), and the World Bank's High-Skilled Bilateral Migration Database (Artuc and others 2015).

Researchers use many different strategies to impute data. The quality of the estimates depends on the amount of data used and the model used to forecast migration stocks. These estimates provide researchers with a full matrix of migration corridors, allowing them to make statements about global migration patterns that would otherwise be impossible to make.

The complete global data in this report come from two sources. The first is Artuc and others (2015), who use the DIOC-E dataset to predict international migration stocks by education group and gender. These data are available only through 2010. To extend these data into 2015 and 2017, the report pulls from the full migration matrix provided by the United Nations' Global Migration Database, which is disaggregated by gender but not by education group. Country-pair and gender-specific education shares for 2010 data from Artuc and others (2015) are then applied to the 2015 and 2017 immigration stocks from the UN data.

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PART II

Selected Country Pages

ALBANIA

Table 1	2018
Population, million	2.9
GDP, current US$ billion	15.1
GDP per capita, current US$	5269
International poverty rate ($1.9)[a]	1.1
Lower middle-income poverty rate ($3.2)[a]	7.7
Upper middle-income poverty rate ($5.5)[a]	39.1
Gini index[a]	29.0
School enrollment, primary (% gross)[b]	110.1
Life expectancy at birth, years[b]	78.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2012), 2011 PPPs.
(b) Most recent WDI value (2017)

Growth is expected to slow to 2.9 percent in 2019, as lower rainfall slashed energy production. The labor market continued to improve but is showing signs of fatigue, and poverty is projected to stagnate. Contained spending and clearance of arrears helped bring public debt down, but off-balance risks are mounting. Over the medium term, growth is projected to accelerate to around 3.5 percent. Fiscal consolidation, improvements in public spending efficiency, and structural reforms remain critical to sustainable and equitable growth.

Recent developments

After an expansion of 4.1 percent in 2018, annual growth is projected to slow to 2.9 percent in 2019. A drastic decline in rainfall in the first half of the year cut hydroelectric power production in half and is estimated to lower GDP growth by a half-percentage-point. Despite growing political tensions, domestic demand expansion led growth in 2019. Net exports reduced growth by 0.4 percentage points (pp), as stagnant growth among trade partners limited traditional exports, while energy exports declined. Job creation, higher wages, and consumer credit continue to drive private consumption, which contributed 2.1 pp to GDP growth. Meanwhile, investment increased thanks to better credit conditions and government infrastructure spending, contributing 0.5 pp to GDP growth.

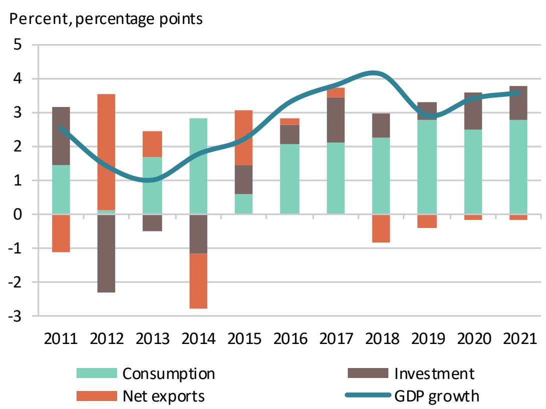
Employment continued to grow – albeit the growth slowdown brought a deceleration in job creation, while poverty has stagnated. Job creation growth fell from 3 percent in 2018 to 2.4 percent in the first half of 2019. While new jobs were created in services, employment in agriculture declined. Labor force participation rose by 2.3 percent in Q2 relative to the Q2 2018, with a remaining gap between male and female participation. Meanwhile, unemployment reached a record low of 11.5 percent in Q2 2019. Real wages increased by 3.3 percent on average, mostly in services (trade and transport, and tourism sectors). Poverty remains high, as about 34.6 percent of Albanians are estimated to live with under 5.5 dollars per day per capita (in 2011 PPP) in 2019.

Inflation declined compared to end-2018, reversing the trend of the recent past. Low imported inflation from Albania's trade partners and an appreciation of the lek were the key factors. The decline in inflation reflected the decline in food inflation. The average inflation rate is expected to close at 1.5 percent for 2019. The Bank of Albania (BoA) has maintained its policy rate at a record-low 1 percent since June 2018. Through the first half of 2019, the real effective exchange rate appreciated by 4.5 percent.

The banking sector is well capitalized and profitable. All banks exceeded the Basel III minimum capital-adequacy ratio of 18.5 percent in June 2019, while the liquidity ratio was adequate at 21 percent. The loan portfolio improved as the BoA continued to restructure the nonperforming loans of large borrowers. Nonperforming loans reached 11.2 percent of the total loan portfolio in June 2019. A new insolvency law was adopted in 2016, and the BoA is preparing a framework for out-of-court settlements to resolve large nonperforming loans. The monetary easing and improvements in the loan portfolio facilitated private sector credit growth: loans to the private sector grew by 6.8 percent in the first half of 2019, increasing private sector credit from 35.3 percent of GDP at the end of 2018 to 35.9 percent in 2019.

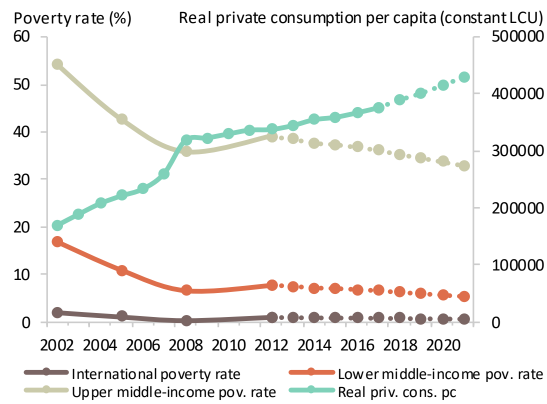
While Albania's fiscal position improved in 2019, risks from contingent liabilities and SOEs remain high. In 2019 fiscal revenue growth was limited by lower GDP

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



Sources: Instat and World Bank.

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



Source: World Bank. Notes: see table 2.

growth and, especially, by increased repayment of VAT-refund-arrears. The revenues-to-GDP ratio declined from 27.6 percent of GDP in 2018 to an estimated 27.3 percent in 2019. Personal income tax revenue and social security contributions rose slightly, supported by higher wages and efforts to reduce informality. Meanwhile, tighter controls on social transfers and subsidies curbed current spending. Due to lower than projected revenues, capital spending relative to GDP fell by 0.1 pp. The government has recently increased the use of public-private partnerships (PPPs) to finance infrastructure, healthcare, and education projects. Budgetary arrears (e.g., VAT refunds and local-government arrears) amounted to about 1.5 percent of GDP in 2018. The budget deficit is estimated to widen in 2019 to 2.2 percent of GDP, as the government reduces the stock of VAT arrears while the public debt, including guarantees and arrears, is estimated to decline to 68.4 percent of GDP in 2019. In August 2019, Moody's confirmed its long-term sovereign credit ratings for Albania at B+.

The energy shock and lower foreign demand have exposed country's external vulnerabilities. The current-account deficit is highly sensitive to commodity prices and rainfall conditions, as the latter largely determine energy production. Thus, the current account deficit is expected to widen from 6.7 percent of GDP in 2018 to 7 percent in 2019. Foreign direct investment is expected to remain unchanged as the large projects in energy and gas transmission end their investment phase. Foreign-exchange reserves have been stable since 2016 at over six months of goods' and services' imports. Large reserves reduce risks posed by the high level of external debt, which is projected to reach 65.7 percent of GDP in 2019.

Outlook

Growth is projected to accelerate slightly, to 3.4-3.6 percent by 2019-20, as labor income gains fuel private consumption. Slowdown in global growth will contain net exports. Investment will also contribute to growth, fueled by public projects and – assuming continued progress on structural reforms such as justice and the financial sector – private investment. Over the medium term, fiscal consolidation will continue as the government further reduces expenditures on the wage bill, goods and services, and transfers to social insurance beneficiaries and local governments. Gradual fiscal consolidation combined with continued economic growth should eventually lower the debt-to-GDP ratio to 60 percent of GDP beyond 2022.

Risks and challenges

The country's economic prospects are vulnerable to significant downside risks. Lower demand from foreign trade partners may constrain growth, worsen labor market conditions and increase poverty. Preserving macro-fiscal stability is crucial to support sustainable growth, which includes continued streamlining of expenditures, increasing tax revenues, and managing fiscal risks from PPPs and SOEs. Further, fostering inclusive growth requires creating better conditions for private sector development, including improving the business environment, increasing financial access, energy security, and human capital.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	3.3	3.8	4.1	2.9	3.4	3.6
Private Consumption	2.0	2.3	3.2	2.9	3.3	3.3
Government Consumption	4.8	2.9	-1.1	6.4	1.0	3.4
Gross Fixed Capital Investment	2.4	5.5	2.9	2.2	4.4	4.1
Exports, Goods and Services	11.5	13.0	2.9	1.8	4.3	4.3
Imports, Goods and Services	7.0	8.1	3.8	2.1	3.3	3.4
Real GDP growth, at constant factor prices	3.2	3.9	4.3	2.8	3.4	3.6
Agriculture	2.0	0.8	0.9	1.5	1.5	1.5
Industry	1.9	1.9	9.1	-1.2	1.5	1.7
Services	4.3	6.0	3.4	5.2	5.0	5.2
Inflation (Consumer Price Index)	1.3	2.0	2.1	1.5	2.7	2.9
Current Account Balance (% of GDP)	-7.6	-7.5	-6.7	-7.0	-6.4	-6.1
Net Foreign Direct Investment (% of GDP)	8.7	8.6	8.0	7.8	7.5	6.9
Fiscal Balance (% of GDP)	-2.2	-2.0	-1.8	-2.2	-2.0	-1.7
Debt (% of GDP)	73.3	71.9	69.7	68.4	66.6	64.3
Primary Balance (% of GDP)	0.3	0.0	0.4	0.0	0.2	0.4
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.9	0.8	0.8	0.7	0.7	0.6
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	6.8	6.6	6.3	6.0	5.8	5.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	36.9	36.2	35.3	34.6	33.8	33.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2002-LSMS, 2008-LSMS, and 2012-LSMS. Actual data: 2012. Nowcast: 2013-2018. Forecast are from 2019 to 2021.
(b) Projection using average elasticity (2002-2008) with pass-through = 1 based on private consumption per capita in constant LCU.

ARMENIA

Table 1	2018
Population, million	2.9
GDP, current US$ billion	12.4
GDP per capita, current US$	4238
International poverty rate ($1.9)[a]	1.4
Lower middle-income poverty rate ($3.2)[a]	12.3
Upper middle-income poverty rate ($5.5)[a]	50.0
Gini index[a]	33.6
School enrollment, primary (% gross)[b]	94.2
Life expectancy at birth, years[b]	74.8

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

Real GDP growth is estimated to have remained strong in 2019, at 5.5 percent, supported by private consumption. Growth will remain above 5 percent over the medium term supported by fiscal stimulus and higher private investment in response to a robust reform agenda. As the economy continues to grow, poverty rates will continue to fall. Challenges to the economic outlook include uncertainty in the global growth outlook as well as gaps in domestic infrastructure, connectivity, human capital, and Armenia's capacity to restructure its economy toward a path of sustainable export-led growth.

Recent developments

Following robust expansions in 2017 and 2018 (of 7.5 and 5.2 percent, respectively), annual economic growth remained robust in the first half of 2019, expanding by 6.8 percent. Growth was supported mainly by private consumption, fueled by rising real wages (up 3.5 percent) and consumer lending (up 40 percent), in contrast to 2018 when a substantial build-up of inventories (investment) accompanied growth.

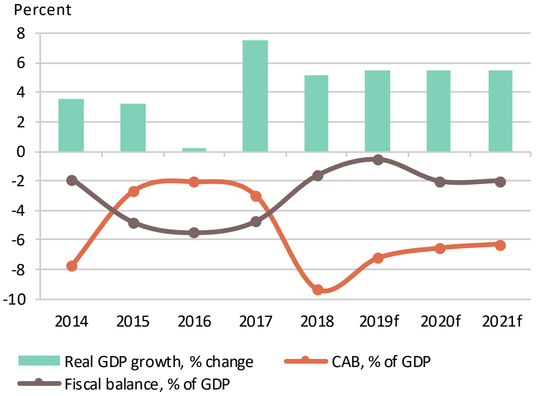
On the supply side, services (up 10 percent year on year) and manufacturing (up 7 percent) buoyed economic growth in the first half of 2019. Mining output expanded by 6 percent as the base effect of the closure of a large mine in early 2018 dissipated. Construction growth remained modest, at 4 percent year on year. Agricultural output fell by 7 percent year on year in the first half, extending a three-year contraction in sectoral output. Higher fishery output only partly offset declines in output of both horticulture and cattle-breeding. The decline reflects structural issues, which have contributed to a reduction in the harvested areas, but also a delayed 2019 harvest season.

With external and internal inflationary pressures low, and the exchange rate appreciating until recently, average annual inflation fell from 2.5 percent in 2018 to 1.8 percent in August 2019, below the Central Bank of Armenia's (CBA) target range (4 +/-1.5 percent). The increase reflected modest increases in food prices. In response, the CBA cut the refinancing rate by 25 basis points in September, (the second cut in 2019) to 5.5 percent to stimulate the gradual recovery of inflation.

The fiscal accounts over-performed in the first half of 2019, recording a surplus of 1.9 percent of GDP, in stark contrast to the budget projection of a deficit of 1.2 percent of GDP. The surplus was mainly owing to under-execution of expenditure, but also a 10-percent over-performance of tax revenue. Just 27 percent of the capital budget was executed during the period, while current spending underperformed by 10 percent. Government debt fell from 51.3 percent of GDP at end-2018 to below 48 percent in July 2019.

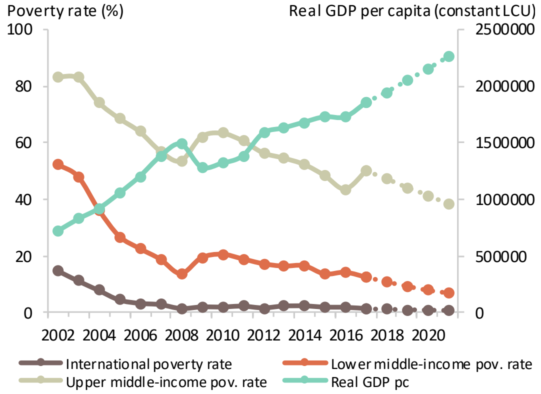
The current account balance deteriorated in the first quarter of 2019 as a slight widening of the trade deficit accompanied lower surpluses on the services and income accounts. Owing to slower growth in the Russian Federation and a weaker Russian ruble, remittance inflows declined by 3 percent year on year. Still-weak foreign direct investment was offset by other types of financial inflows, including deposits by non-residents and private sector borrowing. High-frequency data show a gradual recovery in goods exports and imports, following a contraction in early 2019. On the export side, the decline was due to lower exports of minerals. Owing to a strengthening of the Armenian dram the real effective exchange rate appreciated by 6 percent in the first half of 2019. Foreign reserves remained steady at $2.2 billion, providing 3.6 months of import cover.

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



Sources: National Statistics Service of Armenia; Central Bank of Armenia; World Bank staff projections.

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



Source: World Bank. Notes: see table 2.

Banking sector prudential indicators are sound—at end July the capital adequacy ratio stood at 17.3 percent, the overall ratio of non-performing loans was 5.5 percent, and liquidity in the banking system was high. While positive, profitability remains low with return on assets of just 1.4 percent. Credit expanded by 13 percent year on year in the first half of 2019, entirely due to an increase in dram denominated credits. Total deposits rose by 18 percent, mainly as a result of higher foreign currency deposits by non-residents.

Together with low inflation, the recent steady economic expansion has resulted in a reduction in poverty levels. The poverty rate, measured at the lower-middle-income poverty line of $3.2/day (PPP 2011), is estimated to have fallen to 10.8 percent in 2018, its lowest rate since 2010. The poverty rate fell sharply to 12.3 percent in 2017, from 14.1 percent in 2016.

Although real wages rose by 1.5 percent in 2018 (and are estimated to have risen again in 2019), the unemployment rate edged up in early 2019, to 21.9 percent (from 20.4 percent in 2018). The increase reverses a trend of declining unemployment since 2017 and could limit improvements in living conditions.

Outlook

Armenia's baseline scenario envisages further economic growth in 2019, with real GDP estimated to rise by 5.5 percent. Consumption will remain strong, supported by additional stimulus from higher government spending, as the authorities compensate for spending under-execution in the first half of the year. This will offset the weaker external environment. Continued structural reform and sound macroeconomic policy will keep inflation low and attract investment, supporting healthy GDP growth rates of over 5 percent over the medium term. As the economy continues to expand, labor income will rise. With sustained social transfers, poverty will maintain its decline, with the poverty rate dipping to around 7 percent by 2021.

The over-performance of tax revenue will contain the budget deficit in 2019, to 0.5 percent of GDP. The deficit will rise to 2 percent in the medium term, affected also by the fiscal cost emerging from lower direct tax rates effective 2020. Modest fiscal deficits will drive a reduction in the debt-to-GDP ratio, to around 50 percent in 2021. The current account deficit will narrow gradually, falling from 9.4 percent of GDP in 2018 to 6.3 percent in 2021, supported by higher goods exports and tourism.

Risks and challenges

The risks related to the global growth outlook remain firmly to the downside. Lower oil prices could negatively impact Russia, one of Armenia's main economic partners, which would affect exports, putting pressure on the exchange rate and inflation. Domestically, addressing the still-high poverty rate and low income over the medium term will require a concerted effort to restructure the economy toward a sustainable export-led growth path. Doing so will require an efficient government, better connectivity, reliable infrastructure, and investment in human capital. The strong commitment of the government to reduce corruption, improve the business environment, and make the country more attractive for investment provides an opportunity for a vibrant response from Armenia's private sector.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	0.2	7.5	5.2	5.5	5.1	5.2
Private Consumption	-1.1	12.4	4.8	7.7	5.3	5.8
Government Consumption	-2.4	-2.1	7.4	4.9	7.9	7.4
Gross Fixed Capital Investment	-11.4	9.7	4.5	3.3	4.6	4.3
Exports, Goods and Services	19.1	18.7	2.9	5.1	6.8	7.0
Imports, Goods and Services	7.6	24.6	12.8	4.2	6.7	7.2
Real GDP growth, at constant factor prices	0.6	7.3	4.9	5.5	5.1	5.2
Agriculture	-5.0	-5.1	-8.5	0.5	2.7	2.5
Industry	-0.3	9.0	4.4	4.1	5.4	5.8
Services	3.2	10.6	9.1	7.4	5.4	5.4
Inflation (Consumer Price Index)	-1.4	1.0	2.5	3.0	4.0	4.0
Current Account Balance (% of GDP)	-2.1	-3.0	-9.4	-7.2	-6.6	-6.3
Net Foreign Direct Investment (% of GDP)	2.5	1.9	2.0	2.3	2.5	2.8
Fiscal Balance (% of GDP)	-5.5	-4.8	-1.6	-0.5	-2.0	-2.0
Debt (% of GDP)	56.7	58.9	55.8	52.6	51.7	50.6
Primary Balance (% of GDP)	-3.6	-2.7	0.5	1.8	-0.2	-0.3
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.8	1.4	1.2	1.0	0.9	0.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	14.1	12.3	10.8	9.4	8.1	7.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	43.5	50.0	47.2	44.1	41.4	38.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-ILCS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU.

AZERBAIJAN

Table 1	2018
Population, million	9.9
GDP, current US$ billion	46.9
GDP per capita, current US$	4718
School enrollment, primary (% gross)[a]	103.3
Life expectancy at birth, years[a]	72.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2017).

Expanding natural gas production and steady growth in non-energy sectors supported Azerbaijan's economy in the first half of 2019. The trickling down of resource rents will improve living conditions, but will also increase risks given the volatile external environment. Over the medium term, economic growth is forecast to moderate as natural gas production peaks and other sectors grow at a moderate pace. With global risks elevated, it will be important to focus on structural reforms and strengthening the economy's resilience to external shocks.

Recent developments

Azerbaijan's economy grew at an annual pace of 2.4 percent in the first half of 2019, driven by a surge in both natural gas output and the non-energy sectors. Non-energy GDP rose by 3.2 percent year on year, spurred by strong performances in agriculture, manufacturing, and the services sectors, while the downturn in construction sector lingered. On the demand side, booming consumption reflected fiscal stimulus, rising real wages, and a recovery in household credit. Investment appears to have bottomed-out, although the investment rate remains low.

Favorable terms of trade in early 2019 sustained a high current account surplus of 15 percent of GDP in the first quarter of the year. However, the non-energy current account deficit widened to 25 percent of GDP. At the same time, the financial account recorded a small surplus (2 percent of GDP) despite negative net foreign direct investment. As a result, pressures on the exchange rate were modest, allowing the authorities to maintain the exchange rate at 1.7 manat per U.S. dollar. By mid-2019 foreign reserves held at the central bank totaled $5.9 billion, while State Oil Fund (SOFAZ) assets reached $42.5 billion (91 percent of GDP).

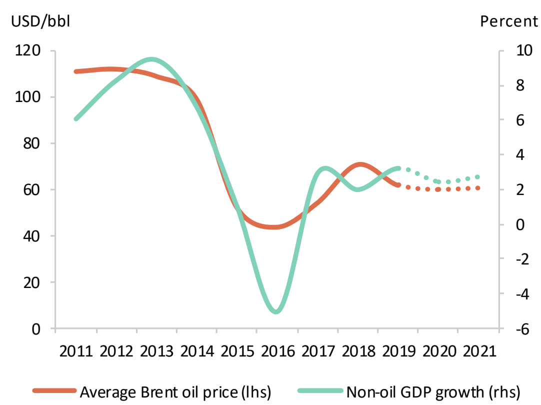
Although 12-month consumer price inflation edged up to 3.7 percent in July 2019, it remained comfortably within the central bank's target band of 2-6 percent, allowing the authorities to loosen monetary policy. The central bank cut its policy rate five times between January and July (from 9.75 percent to 8.25 percent) and scaled back liquidity absorption operations; however, a weak transmission mechanism and financial sector limited the response.

Banking sector indicators stabilized in the first half of 2019, with higher capital and fewer non-performing loans reported. The latter was the result of a foreign-currency loan bailout scheme introduced by the government in February. Banking sector profitability improved in 2018 on the back of the stable currency, but several banks reported losses while others were undercapitalized. Banks remain exposed to high credit and foreign exchange risks, with a continued short open currency position due to the high dollarization of deposits. Credit expanded by 10.7 percent in 2018, before easing to 3.6 percent in the first half of 2019; growth was mostly driven by consumer lending. In contrast, corporate lending contracted by 0.3 percent year on year in the first six months of 2019.

The government introduced fiscal stimulus measures in 2019. These measures include more generous personal income tax exemptions, increases to the minimum wage and pensions, higher salaries for public employees (between 20-40 percent), and the foreign-currency consumer loan bailout scheme. The cost of these measures is estimated at roughly 3 percent of GDP in 2019.

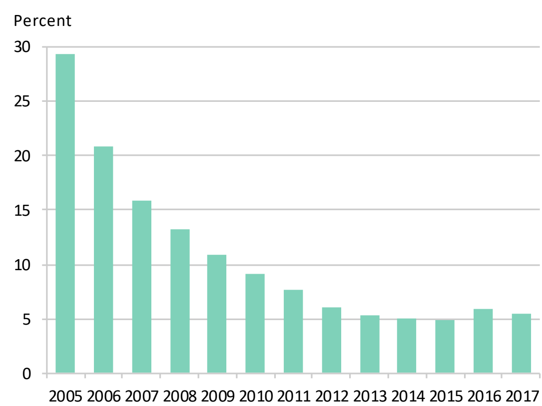
The official national poverty rate has hovered at 5-6 percent since 2012, falling from 5.9 to 5.4 percent between 2016 and 2017 despite economic contraction, a sharp rise in consumer prices, and declining real wages in those years. Owing to higher real

FIGURE 1 Azerbaijan / Non-oil GDP growth and oil price



Sources: State Statistical Committee and World Bank staff estimates.

FIGURE 2 Azerbaijan / Poverty headcount rate at the national poverty line



Source: State Statistical Committee. Note: The World Bank has not reviewed the official national poverty rates for 2013-17.

incomes and rising private consumption, the poverty rate is estimated to have declined further in 2018–19.

Outlook

Annual GDP growth is forecast to average 2.4 percent in 2019–21, as oil output moderates and natural gas production peaks in 2020. Fiscal stimulus will lift economic activity in 2019, but future growth in the non-energy sectors is projected to settle around 2.8 percent as inherent structural weaknesses persist. With domestic demand recovering gradually, inflation is expected to remain low, averaging 3.1 percent in 2019–21.

The surplus on the external account is likely to remain significant, assuming no major decline in oil prices. The current account surplus will average 6.5 percent of GDP through 2021, with a widening of the non-energy current account deficit, as higher domestic demand pushes up imports.

The fiscal accounts will remain in surplus despite the fiscal stimulus; however, the surplus is forecast to fall from 5.9 percent of GDP in 2018 to 4.4 percent of GDP in 2021. Additionally, the non-oil fiscal balance will widen.

With projections of moderate GDP growth and inflation, living standards are expected to continue to improve. However, vulnerability to poverty remains high, and a negative shock such as job loss, illness, or inflation, could push many people into poverty. A concerted effort is needed to promote shared prosperity and boost the incomes of the poorest 40 percent. Social policies could be better tailored to help those at the very bottom of the income distribution attain equal opportunities and capitalize on the benefits of Azerbaijan's growing economy.

Risks and challenges

Azerbaijan's hydrocarbons-dependent economy faces external risks, driven by deepening uncertainties, a deceleration in the global economy and high geopolitical tensions in the Middle East. Slower global growth could reduce demand for Azerbaijan's exports. Additionally, recent increased volatility in oil prices makes fiscal planning (and expansion) challenging, thereby increasing the risks of the recent fiscal stimulus.

Restoring compliance with a fiscal rule will be critical to strengthening economic resilience amid high commodity market volatility. Further efforts could be made to improve the transparency of the fiscal rule, strategic allocation of resources, public investment management, and public procurement system.

Slow progress on structural reforms represents another downside risk. Azerbaijan's recent economic growth has benefited from fiscal stimulus (which will only support growth temporarily). Structural reforms to improve the business environment and investment climate, reduce the state footprint in the economy, and tackle competition are necessary to increase the economy's productive capacity.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	-3.1	-0.3	1.4	2.8	2.3	2.1
Private Consumption	-2.8	2.7	2.8	3.8	4.0	3.6
Government Consumption	-8.1	1.8	3.3	12.0	11.4	2.7
Gross Fixed Capital Investment	-20.0	-5.2	-0.2	-0.4	-4.3	0.6
Exports, Goods and Services	-2.0	-1.0	1.0	2.5	2.4	1.5
Imports, Goods and Services	-10.0	0.2	2.5	4.5	4.6	2.3
Real GDP growth, at constant factor prices	-3.0	-0.5	1.4	2.7	2.3	2.1
Agriculture	2.6	4.2	4.6	4.2	4.4	4.5
Industry	-4.2	-3.5	-0.7	0.6	1.8	1.5
Services	-1.4	4.9	4.8	6.4	2.6	2.8
Inflation (Consumer Price Index)	12.4	12.9	1.9	2.8	3.2	3.3
Current Account Balance (% of GDP)	-3.6	4.1	11.4	8.5	6.2	5.0
Net Foreign Direct Investment (% of GDP)	3.2	2.8	2.4	2.3	2.2	2.1
Fiscal Balance (% of GDP)	-1.1	-1.4	5.9	4.8	4.5	4.4
Debt (% of GDP)	20.6	22.5	24.4	19.8	19.1	18.4
Primary Balance (% of GDP)	-0.7	-0.8	7.1	5.8	5.3	5.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

BELARUS

Table 1	2018
Population, million	9.5
GDP, current US$ billion	58.6
GDP per capita, current US$	6184
Upper middle-income poverty rate ($5.5)[a]	0.8
Gini index[a]	25.4
School enrollment, primary (% gross)[b]	101.6
Life expectancy at birth, years[b]	74.1

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

Worsening external conditions and longstanding structural weaknesses have led to a significant slowdown in economic growth in 2019. Output has stagnated in key sectors, marking the end of the 2017-2018 recovery. The room for fiscal and monetary stimulus is limited due to adverse consequences for macro-stability. Potential growth is likely to remain below two percent, unless major progress is made on structural reforms to improve productivity and competitiveness.

Recent developments

In the first half of 2019, economic growth slowed considerably to 0.9 percent y/y, from 4.5 percent in the first half of 2018. Declining exports put a drag on growth, as exports of goods fell by 4.1 percent y/y in nominal US$ over Jan-June 2019, with merchandize exports to EU countries down by 11.2 percent (in sharp contrast to the 30 percent increase in 2018), and exports to Russia down by 0.3 percent (compared to the 0.7 percent growth in 2018). On the supply side, output stagnated in both industry and agriculture, with the former growing by only 0.1 percent y/y, and the latter growing by 0.2 percent y/y in H1 2019. Weaknesses in the corporate sector translated to an almost twofold increase in the volumes of bad loans, mainly concentrated in two dominant state-owned banks. At the same time, domestic demand was supported by growth of wages and investments in real terms. While real wage grew by 7.6 percent y/y in the first half of 2019, real investments was up by 4.9 percent, driven by higher capital expenditure at the local level and increased private sector investments.

In H1 2019, growth of real consolidated government expenditures lagged behind growth of revenues (1.9 percent vs. 3.1 percent y/y), leading to a fiscal surplus of 4 percent of GDP, net of quasi-fiscal expenditures. Public debt pressures remain significant, with the ratio of direct and guaranteed debt of central and local authorities to GDP at 45.7 percent of GDP in 2018, and debt service payments close to 2 percent of GDP in 2018 and in H1 2019.

Inflation picked up slightly to 6 percent in July 2019, from 5.6 percent in December 2018, due to a scheduled increase in utility prices and a seasonal spike in food prices. As inflation accelerated due to these non-monetary factors, and M3 growth remained within the established ceiling, the National Bank has reduced its policy rate to a historic low of 9.5 percent p.a. from 10 percent, set in mid-2018.

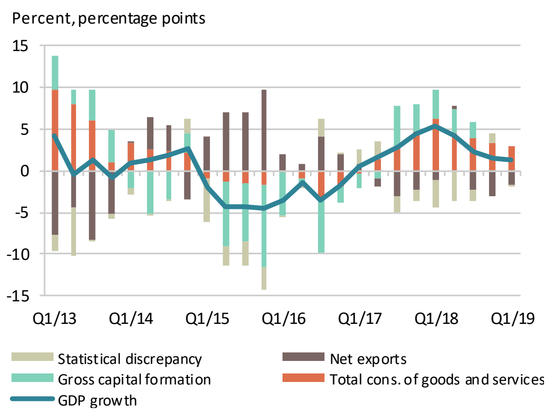
In the face of exports slowdown, exchange rate flexibility has been retained and additional forex market liberalization measures implemented. Between June 2018 and June 2019, the BYN/US$ depreciated only by 2.6 percent in nominal terms. Gross international reserves amounted to US$8.3 billion at the end of June 2019, covering two and a half months of goods and services imports.

The national poverty rate peaked at 5.9 percent in 2017. The economic recovery of 2017-18 contributed to a decline in 2018 to 5.6 percent and further in Q2 2019 to 5.1 percent, on account of steady growth of real wages and household incomes (8 percent y/y in 2018 and about 7 percent y/y throughout the first half of 2019).

Outlook

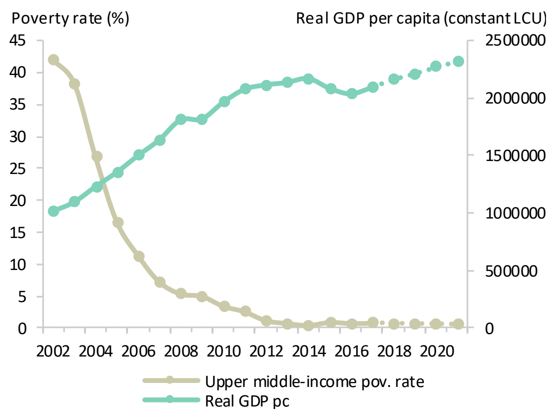
Economic growth is projected at 1.5 percent in 2019 due to the continued deterioration in terms of trade as well as longstanding structural rigidities in the economy. Even this modest outlook is

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



Sources: World Bank calculations based on Belstat data.

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



Source: World Bank. Notes: see table 2.

conditional upon partial compensation – at least of one half of the expected losses – from Russia's new energy taxation system, which would imply a loss of export duties on oil products and rise in input prices for oil refineries. With no compensation, growth can slow down even further, while additional foreign borrowing would be required to offset the loss of foreign exchange unless exports substantially grow. In this context, the room for demand stimulus is limited, with fiscal policy being affected by the burden of debt repayments and high levels of contingent liabilities related to state-owned enterprises (SOEs) and commercial banks. Monetary policy efficiency is weakened by high dollarization, with the foreign currency component of broad money still close to 60 percent. Exchange rate adjustment would also further impact the high share of foreign currency-denominated corporate (above 50 percent) and public (about 97 percent) debt.

Over the 2020-2021 period, the poverty headcount is projected to remain flat, on account of still positive, yet significantly weaker economic growth, and smaller increases in real wages, as well as steady labor market indicators, in particular higher unemployment rates among those with low levels of education.

Risks and challenges

Rising public debt, largely denominated in foreign currency, against the background of weakening exports, and uncertainties about negative spillovers from Russia's new energy taxation system and the terms of possible compensation, pose risks to medium-term economic growth. Also, recent wage increases, especially in the public sector for low-paid workers, may challenge macro-stability, if carried out continuously throughout 2019-20. The current export profile makes Belarus's economy vulnerable to external shocks, arising from commodity price fluctuations and periodic trade disputes between Belarus and Russia. While these disputes may well be resolved, Russia's reliance on import-substitution policies, especially in agricultural sector, along with intensified competition in manufacturing sector from Russian and global players, is a major challenge for Belarus's external competitiveness. In this context, one of the main challenges is to undertake the necessary structural reforms to strengthen competitiveness and accelerate export diversification. Improvements in the regulatory environment, supported by further ease of doing business, must be accompanied by operational restructuring of domestic businesses, especially of SOEs, as export success and diversification require moving into new markets with new products. Recent measures to stimulate private sector development could have limited effects, unless SOE restructuring is activated to allocate resources for more productive uses and to reduce fiscal risks. To cushion the impact of restructuring on vulnerable groups, social safety net needs to be enhanced by introducing unemployment assistance mechanisms and improved targeting of means-tested support.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	-2.5	2.5	3.0	1.5	1.3	1.2
Private Consumption	-3.2	4.7	8.3	3.5	2.5	1.8
Government Consumption	0.7	-1.4	-1.0	-0.5	-2.5	2.2
Gross Fixed Capital Investment	-14.1	3.7	2.0	1.4	-1.5	-8.7
Exports, Goods and Services	2.6	7.5	3.9	2.8	2.0	2.0
Imports, Goods and Services	-1.4	11.1	7.9	4.1	1.6	-0.9
Real GDP growth, at constant factor prices	-2.5	2.5	3.0	1.5	1.3	1.2
Agriculture	3.3	4.2	-3.4	1.5	3.5	3.0
Industry	-0.4	6.1	5.7	0.7	2.8	2.1
Services	-14.9	-14.7	-3.6	6.2	-9.6	-6.8
Inflation (Consumer Price Index)	11.8	6.0	5.6	5.8	5.0	4.5
Current Account Balance (% of GDP)	-3.5	-1.7	-0.5	-2.3	-1.1	-2.1
Net Foreign Direct Investment (% of GDP)	2.6	2.4	2.5	2.4	2.2	2.2
Fiscal Balance (% of GDP)	1.5	3.1	4.3	-1.4	0.5	0.4
Debt (% of GDP)	53.9	53.5	48.7	55.3	58.8	56.2
Primary Balance (% of GDP)	3.0	5.6	6.8	0.7	3.4	3.1
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	0.7	0.8	0.7	0.7	0.7	0.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-HHS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU.

BOSNIA AND HERZEGOVINA

Table 1	2018
Population, million	3.5
GDP, current US$ billion	20.6
GDP per capita, current US$	5870
Life expectancy at birth, years[a]	77.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2017).

Economic growth reached 3.6 percent in 2018. Growth is expected to slow in 2019, weighed down by weaker growth in Europe, and slow progress on the formation of a new government. Growth is expected to pick up in the medium-term, as the newly formed government implements structural reforms and progresses on EU accession. These developments would be important for poverty reduction.

Recent developments

Growth (at factor prices) reached 3.6 percent in 2018, an increase of 0.4 pp compared to 2017, driven by consumption (1.1pp increase) and net exports (0.5pp). On the production side, the main contributor to GDP growth in 2018 was services (2.6pp). Although the composition of growth will not change, regional and global trade developments have weakened external account dynamic in the first months of 2019 and are expected to offset Bosnia and Herzegovina (BiH) growth momentum.

Unemployment continued to decline but remains high having fallen from 18.4 percent in 2018 to 15.7 in 2019. This improvement was partly due to the rise in employment (from 34.3 percent in 2018 to 35.5 percent in 2019), with a decrease in the working-age population and rising inactivity playing an important role.

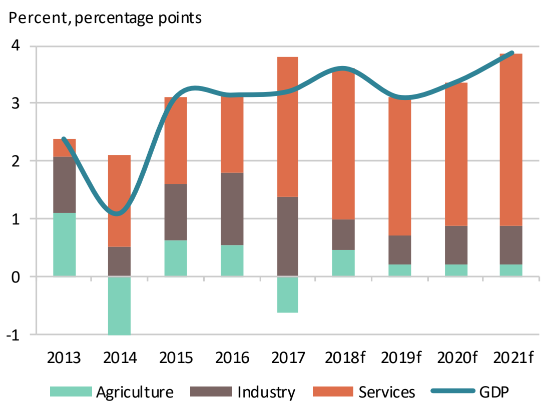
The consumer price index increased by 1.6 percent year-on-year (y-o-y) in December 2018 and continued on an upward trend in 2019, albeit at a slower pace. Inflation was driven by the recovery of global oil prices and metals, alongside the increased excise tax on oil. The biggest drivers of inflation were transport, tobacco and rental housing, negatively affecting households purchasing power.

In 2019, the fiscal balance is expected to turn to deficit due to higher current expenditure mainly in wages. In 2018, revenues rose due to stronger collection of indirect taxes while an expenditure increase is expected due to higher transfers (i.e. veteran benefits) and higher current expenditures on wages. Current sluggish capital spending reflects implementation delays due to lack of government formation in Federation of BiH and BiH Institutions. Public debt remains moderate at around 36 percent of GDP in 2018, consisting largely of concessional debt. However, without agreement on the Global Fiscal Framework there is currently no guidance on a common fiscal policy for BiH.

On the external side, the current account deficit (CAD) is expected to widen to 4.3 percent in 2019, on account of declining exports and a slower rise in imports. Exports have been weighed down by the slowdown in growth in the EU (a significant trading partner for BiH), weaker global prices of aluminum (a major export in BiH), and loss of markets for some commodities due to ongoing regional trade disputes, including the export of milk to Kosovo (one of BiHs main markets for milk), which slowed down as Kosovo imposed a 100% tariff on imports from BiH. Other components of the current account, such as services surplus, arising from transport, travel, construction, and remittances were almost unchanged and have been sufficient to finance a significant part of the trade deficit, together with other investment and FDI. The exchange rate is fixed to the EUR under the Currency Board Arrangement. In 2018, total external debt stood at 66 percent of GDP.

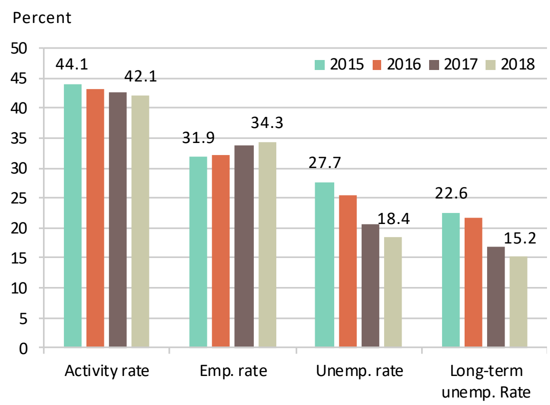
Poverty was estimated at 16 percent in 2015, the latest available poverty data using the national poverty line, very close to

FIGURE 1 Bosnia and Herzegovina / Real GDP growth and contributions to real GDP growth



Sources: BHAS, World Bank staff estimates.

FIGURE 2 Bosnia and Herzegovina / Labor market indicators, 2015-2018



Sources: LFS 2015-2018 report, World Bank staff calculations.

the 15 percent poverty rate estimated for 2011. Rural poverty (19 percent) was higher than urban poverty (12 percent). Across entities, poverty increased slightly in BiH from 15 to 17 percent, while it remained stable in RS at about 14 percent. Higher pensions and social assistance contributed to improve the welfare of the less well-off, while labor incomes had a small poverty-increasing effect. This effect may have shifted between 2015-2018, given the recent improvements in the labor market. Inequality remained constant at 33 Gini points between 2011 and 2015.

Outlook

Supported primarily by consumption and public investment, growth is projected to strengthen to 3.9 percent by 2021. BiH's commitment to gain candidate status from the EU is seen as a key anchor to advance the country's reform agenda. The CAD is expected to deteriorate from 4.3 percent of GDP in 2018 to 5.0 percent of GDP by 2021 as export growth remains moderate and imports grow due to robust consumption and implementation of infrastructure projects. Remittances are likely to remain stable, and, together with progress on reforms, will underpin a gradual pickup in consumption, which will remain a major driver of growth in medium term.

The much needed consolidation of expenditures will be delayed as the low formation of the government delays the needed fiscal framework setting upper limits of expenditures. Investment in energy, construction, and tourism will support job creation.

As poverty is strongly associated with unemployment and inactivity in BiH, for growth to translate into poverty reduction, improvements in labor market participation and employment will remain key, in particular in agriculture where most of the poor are employed. However, poverty is projected to decline slowly over the next couple of years as a result of high unemployment and flat real wages due to the substantial remaining slack in the labor market.

Risks and challenges

Achieving prudent, efficient, and effective fiscal policy, addressing persistent unemployment and continuing to safeguard the banking sector, will remain central to the BiH reform progress. Although external deficits continue to be moderate, on the fiscal side the tax burden is high, and public spending is inefficient, as evidenced by poorly-targeted benefits and the accumulation of arrears. Without continued implementation of structural reforms, it would be difficult to address rigidities in public employment, pensions, and SOEs.

The main domestic risk is the challenging political environment, which makes structural reforms difficult, especially in important network sectors, such as infrastructure, telecommunications, energy sector, and transport. It also increases risks to the economic outlook. EU accession process hinges on progress on the recently received EU opinion on reforms needed towards becoming a candidate country. Main external risk for BiH remains slow growth in Europe, linked to rising regional and global trade tensions.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	3.4	3.4	3.2	3.1	3.4	3.9
Private Consumption	2.2	1.5	1.4	3.2	3.2	3.3
Government Consumption	0.0	1.5	0.6	1.5	3.6	2.6
Gross Fixed Capital Investment	2.4	16.4	0.0	2.1	1.9	4.7
Exports, Goods and Services	9.3	11.8	5.9	1.1	1.5	3.0
Imports, Goods and Services	6.8	7.7	3.2	0.8	1.2	2.0
Real GDP growth, at constant factor prices	3.1	3.2	3.6	3.1	3.4	3.9
Agriculture	7.6	-8.1	6.8	2.9	2.9	2.9
Industry	4.7	5.2	1.9	1.9	2.5	2.6
Services	2.0	3.7	4.0	3.6	3.8	4.5
Inflation (Consumer Price Index)	-1.1	1.2	1.4	1.2	1.2	1.2
Current Account Balance (% of GDP)	-4.5	-4.5	-4.2	-4.3	-4.9	-5.0
Net Foreign Direct Investment (% of GDP)	1.6	2.0	2.2	2.8	3.0	3.1
Fiscal Balance (% of GDP)	2.6	2.6	2.2	-0.6	0.6	1.4
Debt (% of GDP)	42.5	37.3	36.3	34.3	35.9	35.6
Primary Balance (% of GDP)	3.4	3.3	3.5	0.3	1.9	2.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

BULGARIA

Table 1	2018
Population, million	7.0
GDP, current US$ billion	65.1
GDP per capita, current US$	9274
International poverty rate ($1.9)[a]	1.5
Lower middle-income poverty rate ($3.2)[a]	3.8
Upper middle-income poverty rate ($5.5)[a]	8.7
Gini index[a]	37.4
Life expectancy at birth, years[b]	74.8

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2014), 2011 PPPs.
(b) Most recent WDI value (2016)

After relatively strong readings in Q1 and Q2, GDP growth is expected to slow down in H2 2019 on worsened external conditions. The labor market remains buoyant with employment reaching an all-time high and nominal wages growing at double-digit rates. Backloading of certain expenses and unplanned military spending in H2 will most likely result in a small budget deficit for the full 2019. Risks to the outlook are primarily external but skewed to the downside.

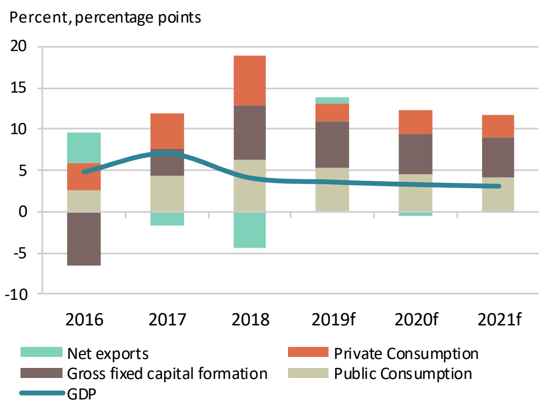
Recent developments

After posting higher-than-projected growth of 3.5 percent yoy in Q1 2019, GDP expansion slowed down to 3.3 percent in Q2. The slowdown was widely expected on the back of negative signals from the eurozone and particularly from Bulgaria's major markets – Germany and Italy. On the demand side, the deceleration in Q2 was due to slower growth of both exports and consumption. The latter contrasted both the substantial increase of fiscal expenditure and strong labor market data for H1. The employment rate reached a 16-year high of 54.7 percent, while the jobless rate fell to an ever-low of 4.2 percent in Q2 2019. Strong labor demand fed into rapid nominal wage growth, reaching 11-13 percent yoy in Jan-Jun, 2019. The 10 percent increase of the minimum wage and the 20 percent salary hike for public-school teachers in January contributed to this increase.

Higher inflation likely drove the slowdown of real consumption growth in H1. Average annual CPI inflation in Jan-Jul, 2019 reached 3.3 percent yoy, primarily on the back of rising fuel, food and regulated utility prices. Yet, inflation apparently supported fiscal performance. After posting a marginal surplus of 0.2 percent in 2018, the general government budget showed a surplus of 2.8 percent of the official GDP projection in Jan-Jul, 2019. Apart from inflation and the one-off effect of consolidating an energy sector fund into the general government, the surplus was due to traditional frontloading of revenues in H1, backloading of certain expenditures in H2, and conservative planning of tax collection. A budget revision was passed in July to accommodate unplanned expenditure for the acquisition of F-16 military aircraft from the USA. The purchase is part of Bulgaria's commitments as a NATO member and increases the central government deficit to 1.9 percent of GDP.

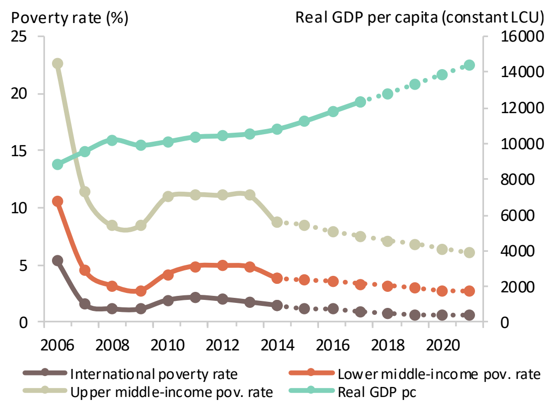
The external position remains good. In addition to growing CA surpluses since 2016, gross external debt has remained on a downward course after early 2015, reaching 57.5 percent of the projected GDP as of June 2019. Yet, FDI inflows stay far from their pre-2008 levels, totaling 3.2 percent of GDP in 2018. Strong labor market conditions, including decreasing unemployment rates among the uneducated, and high real wage growth among low-productivity sectors supported continued improvement in poverty reduction. Poverty is projected to have declined from 8.5 percent in 2015 to 7.1 percent in 2018 (at the U5.5 per day line). However, income inequality in Bulgaria has been increasing and is the highest in the EU, with the Gini coefficient reaching 39.6 in 2018. The coverage and adequacy of the social transfer system remains low. Unemployment has declined significantly but regional variations and unemployment among the unskilled remain high. Inactivity among certain groups of the population persists and many citizens – including the elderly, those living in rural areas, and the Roma – are excluded from economic opportunities.

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



Sources: World Bank, Bulgarian National Statistical Institute.

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



Source: World Bank. Notes: see table 2.

Outlook

Growth is expected to remain above the EU average in the medium run. Following a relatively strong first half of 2019, the Bulgarian economy is expected to slow down in H2 2019 and further in 2020. in tune with the worsened external environment and the toll it takes on export. Growth for the full 2019 is projected at 3.2 percent, with final consumption expected to act as growth driver in H2, while exports wane. Consumption will be supported by public sector wage and pension raises, as well as strong increase of employment and salaries in the real sector. Investment growth is likely to pick up in H2 as local elections approach in October and the military aircraft acquisition is accounted for. Going forward, investment remains largely dependent on EU funds, which are to pick up as the end of the current programme period approaches. The current account balance is projected to remain in positive territory in the medium term but shrink in 2019 against 2018, as exports of goods and services underperform in H2, not least due to a weaker summer tourist season. After deterioration of the fiscal balance in 2019 on unplanned expenditure, the fiscal position is expected to improve in 2020. Poverty reduction is expected to continue at a modest pace in the near term. Sustained improvements in employment and wages, as well as recent increases in pensions, should support real incomes and therefore further reductions in poverty. Poverty is projected to fall to 6.8 percent in 2019, as measured at $5.5 a day in 2011 PPP, to 6.4 percent in 2020, and further to 6.0 percent by 2021.

Risks and challenges

Risks to the outlook stem mostly from the external environment, including the ongoing global trade tensions. Since China already ranks as the country's second largest market outside the EU, the ongoing slowdown of the Chinese economy is having both direct and second-round effects on Bulgaria. The acceleration of credit growth, especially in the household segment, has also recently added to risks. The growth rates for banks' consumer and mortgage credits reached 19 percent and 14 percent yoy, respectively, in July, spurring concerns about the potential build-up of non-performing loans in the wake of a new downturn. So far, the share of non-performing loans remains on a downward trend, reaching 7.2 percent of outstanding credits and advances in June, but this could be easily reversed, as evidenced after the 2008 crisis. Bulgaria's ambition to join the Exchange Rate Mechanism II (ERM II) and the European Banking Union before end-2019 remains high on the government's agenda. A recently concluded asset quality review and stress tests of 6 Bulgarian banks by the ECB showed that two banks – First Investment Bank and Investbank - faced capital shortfalls under different scenarios. Given that, the possibility of postponing ERM II entry until the two banks raise their capital to the required thresholds, should not be ruled out. The S&P's rating agency has reiterated recently that as soon as the country enters ERM II, its sovereign rating is most likely to be upgraded. Despite low unemployment and the continued reduction of poverty, high income inequality undermines the inclusiveness of growth and the impact it may have on poverty.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	3.9	3.8	3.1	3.2	3.0	3.1
Private Consumption	3.4	4.3	6.0	2.2	2.9	2.7
Government Consumption	2.5	4.4	6.3	5.3	4.5	4.1
Gross Fixed Capital Investment	-6.6	3.2	6.5	5.6	4.8	4.9
Exports, Goods and Services	8.1	5.8	-0.8	4.2	3.7	3.5
Imports, Goods and Services	4.5	7.5	3.7	3.5	4.2	3.6
Real GDP growth, at constant factor prices	3.4	4.2	3.0	3.2	3.0	3.1
Agriculture	5.3	8.9	-1.1	-0.5	1.0	1.0
Industry	4.0	4.1	1.3	2.8	3.1	2.3
Services	3.1	3.9	4.0	3.7	3.1	3.6
Inflation (Consumer Price Index)	-0.8	2.1	2.8	3.1	2.5	2.3
Current Account Balance (% of GDP)	2.6	3.0	4.6	3.2	3.5	2.9
Net Foreign Direct Investment (% of GDP)	2.1	2.7	2.7	2.8	2.9	3.0
Fiscal Balance (% of GDP)	1.6	0.8	0.2	-0.9	-0.2	-0.7
Debt (% of GDP)	27.4	23.3	23.8	23.3	22.9	22.8
Primary Balance (% of GDP)	2.3	1.6	0.9	-0.1	0.5	0.0
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.2	1.0	0.8	0.7	0.6	0.6
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	3.6	3.3	3.2	2.9	2.7	2.7
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	7.9	7.5	7.1	6.8	6.4	6.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2014-EU-SILC. Actual data: 2014. Nowcast: 2015-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2014) with pass-through = 0.87 based on GDP per capita in constant LCU.

CROATIA

Table 1	2018
Population, million	4.1
GDP, current US$ billion	60.8
GDP per capita, current US$	14876
Lower middle-income poverty rate ($3.2)[a]	1.3
Upper middle-income poverty rate ($5.5)[a]	5.5
Gini index[a]	31.1
Life expectancy at birth, years[b]	77.8

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2017)

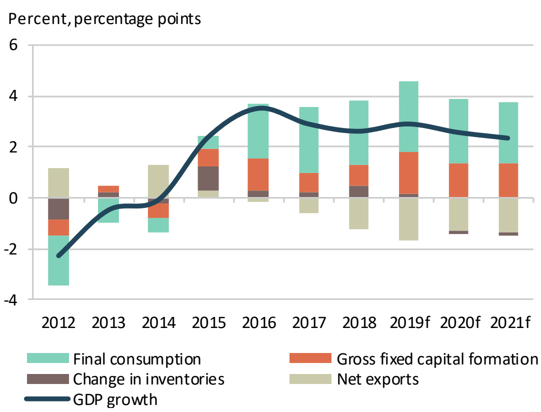
After a strong rise at the beginning of 2019, in the second quarter the Croatian economy lost momentum. By year-end, GDP growth is expected to accelerate to 2.9 percent, driven primarily by domestic demand. In the remaining forecast horizon, growth is set to moderate on the back of weakening external outlook and structural supply-side rigidities. Public finances are expected to remain sound, despite further tax reductions. The poverty rate is set to decline, albeit at a moderate rate, through 2021.

Recent developments

The Croatian economy started strongly in 2019 but lost momentum in the second quarter. Annual real GDP growth accelerated to 3.9 percent in the first quarter, the highest growth rate since 2007, and the increase was broad-based. After a dismal performance in the second half of 2018, export growth rebounded at the beginning of the year to 4.6 percent y-o-y on the back of goods export, while public and private investments soared recording an annual growth rate of 11.5 percent. Government consumption also strengthened, while household consumption growth edged-up to 4.4 percent y-o-y, from 3.9 percent in the last quarter of 2018. However, in the second quarter the economy lost momentum and annual growth decelerated to 2.4 percent. This mainly reflects the fall in export of goods related to an economic slowdown in Croatia's main trading partners and a deceleration of growth of household consumption. On the other hand, growth of export of services picked up and capital investment as well as government consumption remained robust. Meanwhile, employment continued to increase in the first half of 2019 at a similar pace as in 2018, and the growth was spread across most sectors, with the largest contribution coming from construction and services related to tourism. Registered unemployment continued to decline falling close to 8 percent (seasonally adjusted) in the second quarter of 2019. At the same time, wage growth moderated, but it remains high in certain sectors, especially in retail where labor shortages seem most severe. Inflation remained subdued, with average growth of consumer prices of 0.7 percent in the first six months of 2019. The current account balance deteriorated in the first quarter of 2019, driven by deterioration in the goods and services account, while workers' remittances continued to rise. The financial account of the balance of payments in the first quarter registered similar capital inflow as in the same period last year, but direct investments declined. At the same time, the downward trend of external debt reversed, mainly reflecting central bank's investment of international reserves, which do not affect the net external position. On the fiscal side, despite a rise of expenditures of around 10 percent and tangible reduction in the tax burden due to changes in VAT and PIT systems, in the first half of 2019 the general government balance remained stable compared to the same period last year. This mainly reflects buoyant tax collection and suggests that the outturn for the whole 2019 might be better than expected by the government. At the beginning of August, the government has presented additional tax cuts for 2020 in the amount of around 0.5 percent of GDP, which, with previously adopted reduction of the standard VAT rate, leads to a total tax relaxation in 2020 of around 0.9 percent of GDP.

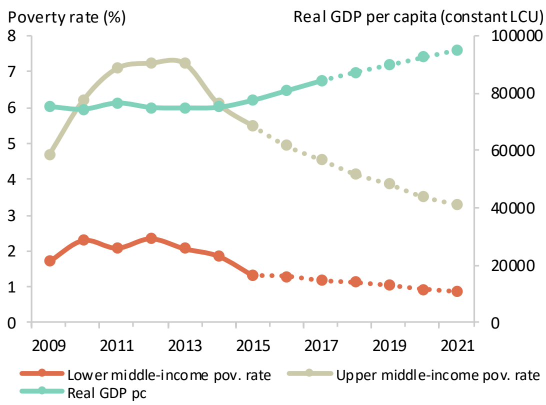
Pension and labor income have been important drivers of poverty reduction over the period 2013-2016. Therefore, positive labor market developments in more recent years, including strong real wage growth,

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



Source: World Bank.

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



Source: World Bank. Notes: see table 2.

decreasing unemployment rates among the uneducated, and a decline in the youth NEETs are expected to support growth of disposable income, particularly among the poor. Poverty incidence (measured at the US$5.5 at PPP 2011) is expected to have further declined from 5 percent in 2016 to 4.2 percent in 2018. Furthermore, recent Gini coefficient estimates suggest that inequality has been decreasing, reaching in 2018 its lowest level since 2009.

Outlook

Growth is expected to pick up slightly in 2019 to 2.9 percent. Household consumption will make the largest contribution to overall GDP growth, reflecting further growth in employment and wages but also rising household borrowing. A significant contribution could also come from investment activity both in the public and private sector, partly reflecting greater EU funds absorption. As a result of robust domestic demand import growth is projected to increase, while export growth might remain at the level recorded in 2018. This will lead to further deterioration of the trade balance and a rising negative contribution of net exports to growth. Over the next two years, growth is set to moderate to an average rate of 2.5 percent. Despite tail winds from tax cuts, household consumption growth is expected to slow down, as employment and wage growth gradually decelerate. Furthermore, after a marked increase in 2019, investment growth is set to moderate, both in the private and general government sector, while exports might also edge down on the back of a weak external outlook. Notwithstanding tax reductions, the general government budget is expected to remain close to balance in the forecast period, as revenues are expected to remain buoyant, while interest expenses could further diminish. Public debt could further decline to 64.6 percent of GDP by the end of 2021. Moderate economic growth should lead to steady income growth for the poor. Poverty, measured at the upper middle-income poverty line (US$ 5.5/day, 2011 PPP), is expected to continue its downward trend, but at a slower pace. Assuming that growth from 2019 onwards is equally distributed across all individuals, poverty would decrease from 4.2 percent in 2018 to 3.9 in 2019 and further to 3.3 percent by 2021.

Risks and challenges

Risks are skewed to the downside. Exports of goods are exposed to the risk of faster slowdown in external demand of Croatia's main trading partners. On the fiscal side, strong pressures for wage increases in the public sector and a possible increase in spending before the general elections scheduled for Autumn 2020 might negatively affect the general government balance and debt trajectory. Tackling the weak potential of the Croatian economy would require a broad structural reform agenda with the aim to increase low productivity by raising the quality and mobility of both human and physical capital. The latter would include addressing business environment constraints related to an inefficient public sector (both as a service provider and a regulator) and low labor market inclusiveness, as reflected in one of the lowest employment and participation rates in the EU and in the recent labor shortages. Decisive action on these fronts would lead to higher and more inclusive growth.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	3.5	2.9	2.6	2.9	2.6	2.4
Private Consumption	3.5	3.6	3.5	3.7	3.5	3.3
Government Consumption	0.7	2.7	2.9	3.5	2.7	2.3
Gross Fixed Capital Investment	6.5	3.8	4.1	8.3	6.4	6.3
Exports, Goods and Services	5.6	6.4	2.8	2.8	2.7	2.6
Imports, Goods and Services	6.2	8.1	5.5	6.3	5.3	5.1
Real GDP growth, at constant factor prices	3.5	2.1	2.1	2.9	2.6	2.4
Agriculture	7.3	-2.1	2.0	2.0	2.0	2.0
Industry	5.0	0.9	0.3	2.9	2.7	2.5
Services	2.8	2.8	2.8	3.0	2.6	2.3
Inflation (Consumer Price Index)	-1.0	1.0	1.5	0.9	1.0	1.4
Current Account Balance (% of GDP)	2.5	3.5	2.5	1.1	0.3	-0.8
Net Foreign Direct Investment (% of GDP)	4.3	2.6	1.4	2.2	2.2	2.4
Fiscal Balance (% of GDP)	-1.0	0.8	0.2	0.2	-0.2	0.0
Debt (% of GDP)	80.5	77.8	74.5	70.4	67.5	64.6
Primary Balance (% of GDP)	2.1	3.5	2.5	2.3	1.7	1.8
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	1.3	1.2	1.1	1.0	0.9	0.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	4.9	4.6	4.2	3.9	3.5	3.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on GDP per capita in constant LCU.

GEORGIA

Table 1	2018
Population, million	3.7
GDP, current US$ billion	15.7
GDP per capita, current US$	4226
International poverty rate ($1.9)[a]	5.0
Lower middle-income poverty rate ($3.2)[a]	16.3
Upper middle-income poverty rate ($5.5)[a]	43.6
Gini index[a]	37.9
School enrollment, primary (% gross)[b]	102.8
Life expectancy at birth, years[b]	73.4

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

Georgia's economy expanded by 4.7 percent in the first half of 2019, driven by strong exports and consumption. Growth is projected to slow to 4.4 percent for the full year as a ban on flights from the Russian Federation impacts tourism. Growth will moderate in 2020 as the external outlook weakens but is projected to recover in 2021, helping to improve living conditions. The national poverty rate decreased to 20.1 percent in 2018.

Recent developments

Real GDP growth accelerated in the first half of 2019, to 4.7 percent (reaching 5.1 percent year on year in July). Domestic demand was supported by higher consumption in the first half. Investment contracted as infrastructure projects were completed and FDI declined. Net exports improved considerably reflecting slowing imports and increased re-exports of used cars and copper ore. On the supply side, all sectors except for mining and electricity production contributed positively to growth. Construction sector output, which contracted during most of 2018 and early 2019, appears to have bottomed out. However, recent developments (a ban on flights from Russia imposed by the Russian authorities, the TBC Bank management case, and a reshuffling of the government) have weakened sentiment and will negatively affect growth.

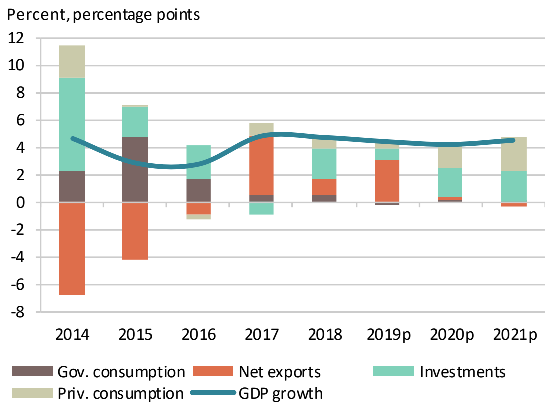
Poverty declined as economic growth created jobs. The unemployment rate fell to 12.7 percent in 2018, helping to lower the poverty rate, as measured at the national poverty line, to 20.1 percent. Rural poverty fell by 3.4 percentage points, while urban poverty fell by 0.6 percentage points. These trends continued in the first half of 2019 as the unemployment rate declined further, to 12 percent. While increased employment opportunities mostly benefited the country's urban population, the urban unemployment rate remains high (at 17 percent). Some of this improvement may be reversed as tourism is affected by the Russian flight ban and higher inflation affects purchasing power.

Annual inflation accelerated to 4.9 percent in July due to the weakening of the lari and higher tobacco excise taxes. In response, the authorities tightened the policy interest rate in early September by 50 basis points to 7 percent.

The current account deficit narrowed by half to 4.5 percent of GDP in the first half of the year. Goods exports increased by 12.4 percent year on year in the first seven months of 2019 while imports contracted by 4.7 percent. Money transfers (including remittances) rose by 7 percent. Tourism proceeds growth declined to 7.8 percent in January-July from 21 percent growth in 2018. With the financing requirement declining and healthy portfolio inflows, the central bank was able to accumulate reserves in the first half of the year despite a drop in FDI. However, sentiments have deteriorated markedly since, resulting in rising pressure on the exchange rate.

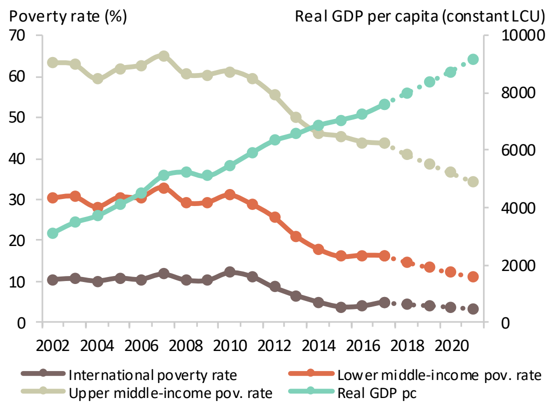
A faster outturn in government spending supported economic growth in the first half of 2019. Revenue growth of 10 percent year on year was outpaced by spending growth of 17 percent. Public investment rose by 32 percent year on year in the same period. As a result, the budget registered a deficit of 0.6 percent of annual GDP by end-July 2019, compared to a 0.5 percent surplus in the same period of last year. Public debt increased by 7.4 percent since the start of the year, reflecting the depreciation of the lari, the acceleration of capital spending (mostly foreign-financed) and efforts to develop the domestic debt market.

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



Sources: Geostat and World Bank staff estimates.

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



Source: World Bank. Notes: see table 2.

After moderating in early 2019, credit growth accelerated to 13.5 percent year on year in August, driven mainly by lari-denominated loans. Deposits were up by 8 percent year on year in August, mostly on account of lari deposits. Although prudential indicators are solid, the banking sector will remain sensitive to exchange rate depreciation on account of high levels of dollarization.

Outlook

Real GDP growth is projected to slow to 4.4 percent in 2019 as the ban on all flights between Russia and Georgia costs the economy around 0.6 percent of GDP. Stronger net exports, recovery in credit growth, and some fiscal stimulus will only partly offset this loss. Growth is projected to further slow in 2020, reflecting the full-year impact of lower arrivals from Russia, delays in several larger planned infrastructure projects, and easing credit growth as international financial markets tighten. This deceleration will be partly offset by a moderate expansion in government spending as well as rising tourist inflows from Turkey. Real GDP growth is expected to recover over the medium term as some of the constraints to growth dissipate. Although easing, economic growth will remain positive and generate more employment and other income-generating opportunities at the bottom of the income distribution. Increased social assistance spending may also help to reduce poverty, but the impact on fiscal sustainability will need to be considered carefully.

Risks and challenges

Substantial quasi-fiscal risks emanate from Georgia's state-owned enterprises (SOEs). The liabilities of the 57 SOEs classified as high- and medium-risk total 16.2 percent of GDP; additional risks stem from contingent liabilities generated by the government's 181 power purchasing agreements (PPAs) which provide state guarantees for the purchase of excess electricity from power generators. While PPAs present a fiscal risk, consumption growth trends suggest the need for additional power capacity. The government will review PPA decisions going forward to ensure compliance with the 2018 Law on Public-Private Partnerships (PPPs). The inclusion of liabilities from PPPs in public debt is also an important step.
Georgia is vulnerable to regional developments and the risks associated with a sharp decline in demand for exports of its goods and services or a reduction in remittance inflows. A fresh round of disturbances in Russia or Turkey could undermine Georgia's tourism and investment prospects, complicate access to financial markets, and negatively impact economic growth. At the same time, with its stable business environment, Georgia is well placed to attract investors from neighboring countries.
Despite some progress in 2018, rural poverty remains a challenge. Providing new job opportunities to workers currently employed in low-productivity agriculture—and supporting productivity increases in agricultural production—will be critical to reducing rural poverty.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	2.8	4.8	4.7	4.4	4.3	4.5
Private Consumption	-0.6	1.3	1.1	1.0	3.1	4.3
Government Consumption	6.5	2.0	2.0	-0.6	0.7	0.3
Gross Fixed Capital Investment	11.2	-4.4	8.3	2.6	7.1	7.5
Exports, Goods and Services	7.7	10.3	8.0	7.5	7.0	7.0
Imports, Goods and Services	6.3	0.9	4.2	1.2	5.2	6.2
Real GDP growth, at constant factor prices	3.1	4.7	4.7	4.4	4.3	4.5
Agriculture	0.3	-3.8	1.0	2.0	2.0	3.0
Industry	6.2	6.4	0.9	3.0	3.0	3.0
Services	2.4	5.1	6.4	5.1	4.9	5.1
Inflation (Consumer Price Index)	2.1	6.0	2.6	4.0	3.2	3.0
Current Account Balance (% of GDP)	-13.1	-8.8	-7.7	-6.0	-5.6	-5.8
Net Foreign Direct Investment (% of GDP)	9.8	10.9	8.9	6.5	5.8	7.1
Fiscal Balance (% of GDP)	-4.1	-3.2	-2.9	-2.9	-2.9	-2.5
Debt (% of GDP)	44.2	45.2	44.8	46.0	44.6	44.6
Primary Balance (% of GDP)	-2.9	-1.9	-1.5	-1.4	-1.5	-1.3
International poverty rate ($1.9 in 2011 PPP)[a,b]	3.9	5.0	4.5	4.2	3.8	3.3
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	16.4	16.3	14.8	13.5	12.3	11.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	44.0	43.6	40.9	38.7	36.5	34.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-HIS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2017) with pass-through = 0.87 based on GDP per capita in constant LCU.

KAZAKHSTAN

Table 1	2018
Population, million	18.3
GDP, current US$ billion	172.9
GDP per capita, current US$	9465
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]	8.5
Gini index[a]	27.5
School enrollment, primary (% gross)[b]	107.9
Life expectancy at birth, years[b]	73.0

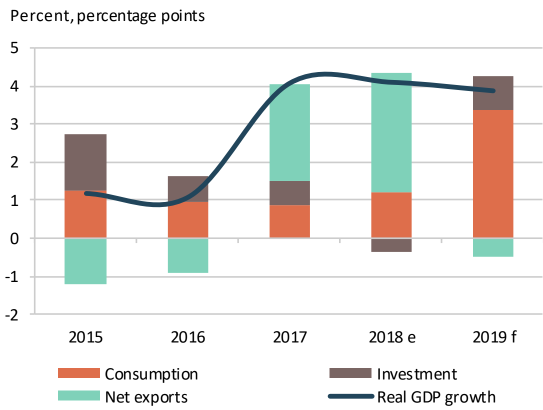
Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2017)

Real GDP expanded by 4.1 percent year on year in the first half of 2019 supported by strengthening domestic consumption and investment. Inflation has increased slightly, spurred by rising food prices. The poverty rate is projected to remain little changed. Consumer spending—backed by higher incomes due to real wage gains and expanded social benefits—is likely to sustain economic activity and support further modest poverty reduction. Faster improvements in living standards, however, will require renewed vigor in advancing structural reforms to reinvigorate productivity growth.

Recent developments

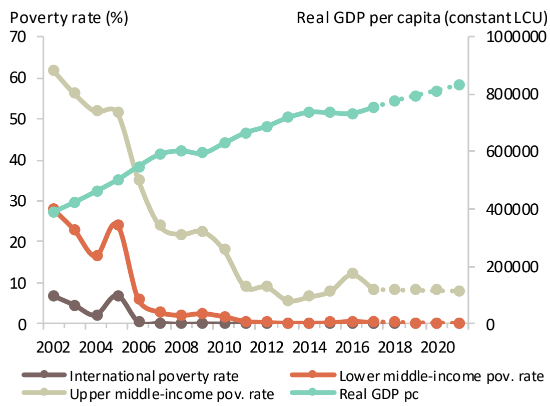
Real GDP grew by 4.1 percent in the first half of 2019, reflecting robust expansions in household and business spending. After providing a substantial addition to GDP in the last two years, the contribution of net exports faded on account of surging imports. Private consumption expanded by an estimated 5 percent in the first half of 2019, supported by higher wages and social benefits and increased bank lending. Investment increased by 3.4 percent. On the supply side, growth was mainly supported by non-tradable services while the contribution of mining remained moderate compared to previous years.
The current account deficit widened to 2.7 percent of GDP in January-June 2019 from 1.8 percent a year earlier, as higher domestic spending boosted imports and lower oil prices squeezed exports. Net inflows of foreign direct investment, mostly in the mining sector, fell to 4.4 percent of GDP from 5.6 percent a year earlier. With net capital inflows failing to offset the current account deficit, net international reserves declined to $27.7 billion by the end of June (down from $30.9 billion at end-2018). The weaker performance of the current account put pressure on the tenge, which fell to a historic low.
Higher revenues largely offset stepped-up spending to keep the deficit of the general government budget (excluding the NFRK, the national oil fund) at about 0.3 percent of GDP in the first half, little changed from a year earlier. Revenues increased on account of improved tax administration and a weaker tenge. In the second half—and for 2019 as a whole—fiscal policy is likely to be more expansionary because of increased social spending, higher wages for low-paid public sector workers, housing and debt relief for low-income earners, and infrastructure investment. Public debt is expected to fall to 19 percent of GDP (from 20.7 percent in 2018).
Although the government supported the banking sector through several bailouts, the industry remains fragile. The central bank plans to conduct an asset quality review of banks in late 2019. The officially-reported ratio of non-performing loans was 9.4 percent in June 2019. A contraction in corporate lending was more than offset by increased lending to households, partly reflecting the government's program of providing subsidized loans to households.
Twelve-month inflation increased to 5.4 percent in July from 4.8 percent in March 2018, owing in part to higher food price inflation and a recent uptick in import prices. The decline in inflation earlier in the year towards the middle of the 4-6 percent inflation target range led the central bank to cut its policy rate by 25 basis points to 9 percent in mid-April. After surging in 2016 following the tenge devaluation, inflation has been following a downward trend over the past three years.
A substantial increase in the minimum wage at the beginning of the year and a strengthening labor market resulted in a 7.4 percent increase in real wages in the first half of 2019. The unemployment rate declined slightly to 4.8 percent.

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



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

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



Source: World Bank. Notes: see table 2.

Poverty rates have yet to return to their previous lows following the 2014–16 decline in oil prices and the ensuing economic slowdown. However, in the context of rising wages and more generous social assistance, the poverty rate is estimated to have continued to fall to 8.5 percent in 2018 (using the $5.5/day international poverty line), marking the second consecutive year of poverty reduction.

Outlook

Economic activity is estimated to have slowed modestly in 2019 on account of softer exports (including hydrocarbons). Economic growth will likely slow further in 2020, reflecting the impact of stagnant oil production and sluggish demand in Kazakhstan's main trading partners, as well as the diminishing effect of the fiscal stimulus on domestic demand.

Household spending and investment will drive demand, although to a lesser extent than in previous years. On the supply side, growth is expected to be supported by non-tradable services. Weak manufacturing output, owing to lackluster foreign direct investment and the limited participation of domestic companies in global supply chains, will weigh on economic performance.

The draft state budget for 2020 envisages a deficit of 2.1 percent of GDP, relatively unchanged from the 2019 budget, before a steady decline in subsequent years. The budget includes additional spending on social assistance, infrastructure, and subsidies to small and medium enterprises. Increased spending will need to be offset by higher revenues. The authorities plan to start reducing the non-oil fiscal deficit in 2020, with a goal of reducing it to about 5.4 percent of GDP by 2022.

Lower oil prices and higher domestic demand for imports are expected to keep the current account in modest deficit over the medium term.

Inflation is likely to stabilize around its current level. However, rising domestic price pressures and potential tenge volatility may strengthen inflation expectations and fuel price increases. To help keep inflation within its target band and help effectively steer inflation expectations, the central bank plans to strengthen the interest-rate transmission channel further.

The policy actions to support socially vulnerable groups, along with solid job creation, are expected to help bring the poverty rate down to near 8 percent by 2021. A significant portion of the population will likely remain close to the poverty line, and any potential shocks to economic activity could reverse prior gains.

Risks and challenges

The economy's vulnerability to external shocks remains the major source of risk to medium-term GDP growth and poverty reduction. Growth could weaken significantly if the ongoing trade war between China and the United States intensifies; an intensification could trigger a substantial global economic slowdown (or recession), affecting manufacturing and goods trade dynamics, depressing global commodity prices, and reducing external demand for Kazakhstan's exports.

Economic prospects are under threat from domestic shocks and limited progress in advancing reforms to expand the economy's productive potential. The lack of a dynamic private sector, market capture by large SOEs, and banks that are not lending to medium- and small-sized corporates present high downside risks to the economy. Renewed vigor in advancing structural reforms, therefore, will be imperative to boosting productivity and attracting much-needed foreign investment in the non-oil economy.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	1.1	4.1	4.1	3.9	3.5	3.7
Private Consumption	1.2	1.5	5.3	4.9	4.4	4.5
Government Consumption	2.3	1.9	-14.0	8.6	2.9	3.1
Gross Fixed Capital Investment	3.0	4.0	4.6	3.3	3.6	4.2
Exports, Goods and Services	-4.5	6.4	11.5	0.8	1.0	1.5
Imports, Goods and Services	-2.0	-1.4	3.2	4.4	4.1	4.3
Real GDP growth, at constant factor prices	1.2	3.9	4.1	3.8	3.6	3.8
Agriculture	5.4	3.2	3.2	3.5	3.3	3.4
Industry	1.7	6.3	4.1	1.1	1.7	1.7
Services	0.5	2.5	4.2	5.5	4.8	5.1
Inflation (Consumer Price Index)	14.6	7.4	6.2	5.3	5.4	5.3
Current Account Balance (% of GDP)	-5.9	-3.1	0.0	-1.4	-1.1	-0.4
Net Foreign Direct Investment (% of GDP)	10.0	2.3	2.8	2.1	2.5	2.1
Fiscal Balance (% of GDP)	-5.5	-4.5	2.7	0.5	0.2	0.1
Debt (% of GDP)	19.6	20.1	20.7	19.0	18.9	19.2
Primary Balance (% of GDP)	-4.4	-3.6	3.6	1.5	1.1	0.9
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.0	0.0	0.0	0.0	0.0	0.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.7	0.4	0.4	0.3	0.3	0.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	12.2	8.6	8.5	8.4	8.3	8.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2011-HBS and 2017-HBS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.
(b) Projection using annualized elasticity (2011-2017) with pass-through = 1 based on GDP per capita in constant LCU.

KOSOVO

Table 1	2018
Population, million	1.8
GDP, current US$ billion	7.9
GDP per capita, current US$	4312
Life expectancy at birth, years[a]	71.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2017).

Growth is expected at 4 percent in 2019. The fiscal deficit should reach 2.9 percent of GDP, but in line with fiscal rules. The outlook is positive, with a projected growth rate of 4.2 percent for 2020-2021. Fiscal risks are rising due to uncertainty about the cost of the law on public salaries, which could reverse Kosovo's track record of prudent headline fiscal policy, if not properly regulated. To prevent this, employment and allowances could be contained through 2020 budget.

Recent developments

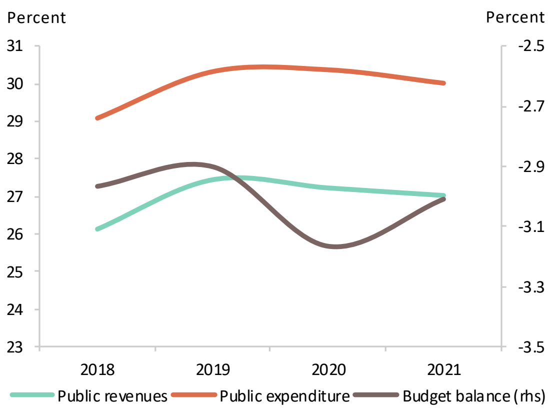
Growth reached 4.1 percent in Q1 2019 and is expected to remain at 4 percent by end 2019, driven by higher public and private consumption, strong services exports, and higher investment. Higher wages and social spending, remittances growth, and increasing credit to households are expected to continue to promote private consumption, which will add 2.7 percentage points (pp) to growth in 2019. The contribution of investment to growth will be limited at 1.1 pp, as the late approval of the budget law in 2019 delayed the execution of investment plans, and upcoming elections will likely postpone capital investment. Net exports will subtract 1.4 pp from real GDP growth, despite the strong growth in services exports. On the production side, services are expected to be the main engine of growth, followed by industry.

Consumer price inflation accelerated during the first part of the year but started to ease, reaching 2.7 percent y-o-y at end August 2019. The main drivers of price increases are food, followed by alcoholic drinks and tobacco. The increase in import prices contributed to the increase in consumer price inflation, with an average y-o-y increase of 4.5 percent in the first quarter. Tariffs imposed on imports from Serbia and Bosnia and Herzegovina might have contributed to the rise in consumer prices.

The budget was balanced at end August due to significant underspending of the capital budget, including projects financed by international financial institutions and privatization proceeds. Capital spending on infrastructure is expected to accelerate towards the end of the year financed by the privatization proceeds and the fiscal deficit will reach 2.9 percent by end 2019. Moreover, since amendments to the law that caps war veterans' benefit spending at 0.7 percent of GDP were not implemented in 2019, these benefits will exceed the amount budgeted. The overall fiscal balance according to the fiscal rule definition will be below the deficit ceiling of 2 percent of GDP, as it excludes PAK-financed (privatization proceeds) capital spending and investment clause. Public and publicly guaranteed debt is expected that 17.7 percent of GDP by end 2019.

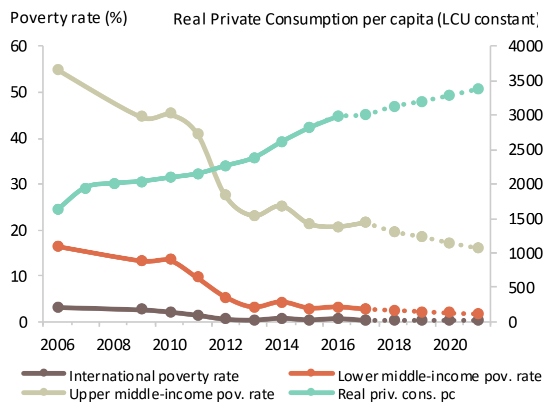
Net foreign direct investment (FDI) and remittances continue to finance the current account deficit (CAD), expected at 8.7 percent of GDP, due to under execution of the capital budget. Net FDI increased by 50 percent in the first half of 2019 compared to the same period last year. However, most FDI (83 percent) flows into in real estate and construction (12 percent) sectors. The main origin of FDI is Germany, Switzerland and the United States. Net remittances grew by 8.1 percent in the first half of 2019, compared to the same period last year. Goods exports increased by 10.5 percent up until July 2019, compared to the same period last year. While net service exports increased by 17.3 percent, mainly driven by travel by the Kosovo diaspora. At the same time, goods imports grew by 4.9 percent during the same period.

FIGURE 1 Kosovo / General government revenues, expenditures and balance



Sources: Ministry of finance and World Bank staff projections.

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



Source: World Bank. Notes: see table 2.

Labor force participation continues to be chronically low at 39.9 percent of the working age population (WAP) in Q2 2019. The employment rate has been largely constant since 2017, at 28-29 percent of the WAP, suggesting that robust growth is not translating into more jobs. Unemployment remains high at 25.3 percent of the labor force (LF) in Q2 2019 (the annual average was 29.5 percent in 2018), and its recent movements follow closely the evolution of LF participation rather than employment. Youth unemployment affects more than half of the active youth and fluctuates between 50-55 percent since 2012, with no significant downward trend.

The poverty rate (measured at US$ 5.5/day, 2011 PPP) decreased from 21.6 percent in 2017 to an estimated 19.6 percent in 2018. Analysis of poverty drivers between 2012-2017 suggests that higher earnings contributed the most to poverty reduction, since labor is the primary source of income for the poor. Rural areas saw greater progress. Despite weak employment gains, net job creation has favored low-skilled sectors benefitting relatively more workers at the bottom of the income distribution.

Outlook

Kosovo's economic growth is projected at 4.2 percent in the medium-term, driven mainly by public investment, services exports and consumption. Public investment will continue to be financed through privatization proceedings and IFI-financed infrastructure projects. Private investment should also pick up as private credit is stimulated by the partial credit guarantee fund for SMEs.

FDI inflows, including in the energy sector, and remittances are expected to continue to finance CAD.

The stagnation of the labor market indicators combined with cost of living pressures due to rising food prices and upward trend in urban inequality are likely to slow the pace of poverty reduction going forward.

Risks and challenges

The positive outlook is vulnerable to potential delays in the formation of the government, lower than projected IFI investment, and weaker growth in the EU. Moreover, the expansion of public investment as a driver of growth in 2019–2021 may suffer from capacity constraints in the implementation of the investment program.

Fiscal risks need to be contained. The law on public salaries, if not regulated through prudent secondary legislation and 2020 budget to control employment and allowances, could pose risks for macro-fiscal sustainability through higher fiscal deficits or can lead to a deterioration in the composition of public spending. As the law will only come into force at end 2019, the full impact will be felt in 2020. Higher wages in the public sector can also put pressure on private sector wages reducing export competitiveness. Additional fiscal risks might arise from untargeted social protection spending.

The slower pace of poverty reduction, high incidence and long duration of unemployment continue to be major challenges. The level of unemployment is particularly worrisome among the young and low-skilled workers, that tend to be over overrepresented among the poor.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	4.1	4.2	3.8	4.0	4.2	4.1
Private Consumption	6.6	1.8	4.8	3.2	3.4	3.6
Government Consumption	-6.3	-0.6	8.9	11.6	3.6	2.6
Gross Fixed Capital Investment	7.3	5.7	6.1	4.0	7.3	5.5
Exports, Goods and Services	2.4	16.8	3.8	4.2	4.4	5.5
Imports, Goods and Services	6.4	5.4	9.0	4.5	4.4	4.3
Inflation (Consumer Price Index)	0.3	1.5	1.1	2.8	1.8	1.5
Current Account Balance (% of GDP)	-7.9	-6.0	-8.2	-8.7	-8.3	-7.4
Net Foreign Direct Investment (% of GDP)	2.9	3.3	2.7	3.8	4.1	4.2
Fiscal Balance (% of GDP)	-1.4	-1.2	-3.0	-2.9	-3.2	-3.0
Debt (% of GDP)	14.0	15.5	16.3	17.1	17.2	18.8
Primary Balance (% of GDP)	-1.0	-0.9	-2.7	-2.5	-2.9	-2.7
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.6	0.2	0.2	0.2	0.2	0.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	3.1	2.6	2.4	2.2	1.9	1.8
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	20.7	21.6	19.6	18.5	17.1	15.9

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. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on private consumption per capita in constant LCU.

KYRGYZ REPUBLIC

Table 1	2018
Population, million	6.3
GDP, current US$ billion	8.1
GDP per capita, current US$	1287
International poverty rate ($1.9)[a]	1.5
Lower middle-income poverty rate ($3.2)[a]	19.6
Upper middle-income poverty rate ($5.5)[a]	66.4
Gini index[a]	27.3
School enrollment, primary (% gross)[b]	107.9
Life expectancy at birth, years[b]	71.2

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

Real GDP grew by almost 7 percent year on year in the first half of 2019, driven by a surge in gold production and exports and supported by monetary easing. The growth rate will ease to 4.2 percent for the year as a whole as gold output slows in the second half of 2019. Growth is projected to slow in 2020–21 as gold output contracts. The poverty rate will ease modestly. Risks to the outlook include a slowdown in regional growth—in part reflecting global trade tensions and weaker commodity demand—and failure to implement fiscal consolidation measures.

Recent developments

A surge in gold production boosted real GDP growth to 6.9 percent year on year in January-July 2019 (compared to a contraction of 0.1 percent in the year-earlier period). Gold production rose by 50 percent year on year in the first half, partly reflecting a low base of comparison (gold production contracted by 25.7 percent in the same period of 2018). Non-gold GDP growth was moderate at 3.1 percent driven by construction and the services sector. Investment and exports drove growth on the demand side. Growth was also supported by looser monetary policy in response to subdued inflation. Credit growth was buoyant, rising by 17 percent year on year in June 2019. Furthermore, financing from the Russian-Kyrgyz Development Fund, which provides support to the real sector, rose by 16 percent during the first half of the year.

Annual inflation stood at 0.9 percent in June 2019, up from 0.5 percent at end-2018, mainly driven by seasonal increases for vegetables and construction materials. With inflation running well below the central bank target range of 5-7 percent, the central bank cut its policy rate twice (in February and May) by 25 basis points to 4.25 percent.

The current account deficit shrank to 1.5 percent of GDP in the first quarter of 2019 from 6 percent a year earlier owing to higher exports and increased income and current transfers. Exports rose by nearly 15 percent mainly as a result of gold shipments abroad (which were up by 60 percent year on year). Imports contracted by almost 7 percent, driven by declines in imports of food and textile products. The deficit was mainly financed by foreign borrowing by companies and banks.

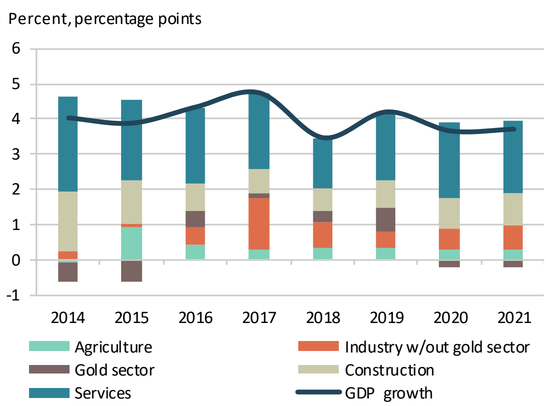
The budget deficit declined to 0.3 percent of GDP in January-July 2019 (from 1.4 percent a year earlier) as both current and capital spending fell as a percentage of GDP. Lower tax revenues reduced total revenues in spite of slightly higher non-tax revenues and grant support.

Central bank interventions have maintained the stability of the som against the U.S. dollar since November 2018. Since the beginning of 2019, the central bank has sold almost $87 million on a net basis (compared to net sales of $31.7 million a year earlier). The real effective exchange rate has depreciated slightly since the start of the year, mirroring the nominal effective exchange rate. Gross international reserves were broadly unchanged at $2.1 billion in July 2019, the equivalent of four months of goods and services imports.

Banking sector performance remains robust, with key prudential indicators well above their relevant benchmarks. The capital adequacy ratio stood at 23.6 percent at end-July 2019, almost twice the minimum regulatory requirement of 12 percent. However, banks remain vulnerable to interest rate and concentration risks.

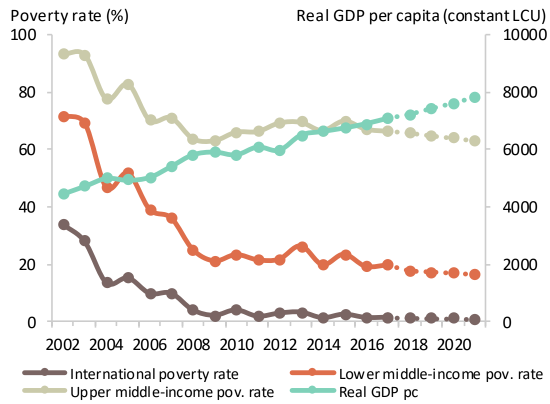
Higher real incomes are supporting household consumption. When combined with falling food prices, higher real incomes have positively affected the purchasing power of households at the

FIGURE 1 Kyrgyz Republic / Real GDP growth and contributions to real GDP growth



Sources: Kyrgyz authorities; World Bank staff calculations.

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



Source: World Bank. Notes: see table 2.

bottom of the income distribution. The poverty rate (measured at $3.2 per day in 2011 PPP terms) is estimated to have fallen from 19.6 percent in 2017 to 17.7 percent in 2018. Pensions and public social transfers are also believed to have supported consumption by the poor, but to a lesser extent owing to the limited reach of safety net programs and the modest transfer amounts.

Outlook

Full-year GDP growth is projected at 4.2 percent in 2019 as gold production growth slows in the second half (due to a high base effect). Non-gold GDP growth is projected at 3.9 percent. This scenario reflects recently-reduced GDP growth projections for the Russian Federation (to 1 percent from 1.4 percent). GDP growth in the Kyrgyz Republic will be supported by continued growth in remittance inflows, a looser monetary policy, and rising public investment. Unless the authorities pursue rigorous structural reforms that expand the economy's productive capacity, GDP growth is likely to slow to an average of 3.7 percent over the medium term as gold production declines.

Twelve-month inflation is projected to increase to 3 percent in 2019, fueled by an increase in teachers' wages and pension payments. Over the medium term, inflation will likely remain below the central bank's target range of 5-7 percent, assuming exchange rate stability and no major shocks to global food prices. While remittance inflows are expected to rise further, the current account deficit is projected to remain elevated at about 7 percent of GDP, reflecting structural constraints to exports and the significant import content of public investment.

The authorities are committed to reducing the fiscal deficit to 3 percent of GDP by 2020 and keeping it below 3 percent thereafter. In 2019–21, tax revenues are projected to rise, reflecting planned policy measures to expand the tax base by addressing constraints to private sector growth, reducing tax exemptions, and raising excise tax rates. Meanwhile, expenditures are projected to decline following efforts to streamline non-priority purchases, reduce the wage bill as a share of GDP, and strengthen public procurement.

Against this backdrop, modest progress is expected in poverty reduction and inequality in the near term, especially given the weak transmission between gold output growth and employment. The poverty rate is projected to fall only slightly to 17.3 percent in 2019 and 16.9 percent in 2020.

Risks and challenges

The Kyrgyz Republic's growth performance will remain vulnerable to developments in its major trading partners. A slowdown in Russia, as U.S. sanctions intensify, or in Kazakhstan, could negatively impact the baseline scenario through remittances and trade. Fluctuations in commodity prices could have a mixed impact on export receipts and the import bill. Unless accompanied by robust productivity growth, a sustained real effective appreciation of the som will lead to a deterioration of Kyrgyz competitiveness.

The adoption of Eurasian Economic Union standards by more local producers and the improvement in the business environment remain a significant challenge and a profound opportunity. Improving the Kyrgyz Republic's connectedness with economies in the region will be the foundation for stronger growth in exports, output, and jobs.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	4.3	4.7	3.5	4.2	3.7	3.7
Private Consumption	3.2	5.2	3.7	3.6	3.3	3.3
Government Consumption	1.5	1.3	-0.1	0.3	2.7	-1.0
Gross Fixed Capital Investment	7.9	9.2	3.5	9.8	6.6	7.6
Exports, Goods and Services	-3.8	6.1	-1.8	2.6	3.1	3.8
Imports, Goods and Services	-1.1	7.4	6.7	3.9	4.6	5.1
Real GDP growth, at constant factor prices	3.8	3.8	3.1	4.2	3.7	3.7
Agriculture	2.9	2.2	2.7	2.5	2.5	2.5
Industry	7.1	8.6	6.2	7.2	5.3	6.0
Services	3.3	3.3	2.1	4.2	3.9	3.7
Inflation (Consumer Price Index)	0.4	3.2	1.5	1.5	3.0	3.0
Current Account Balance (% of GDP)	-11.6	-6.8	-15.1	-8.3	-7.6	-6.9
Net Foreign Direct Investment (% of GDP)	8.5	-1.0	5.7	5.7	6.1	6.2
Fiscal Balance (% of GDP)	-6.3	-4.6	-1.6	-2.3	-3.0	-2.9
Debt (% of GDP)	59.1	58.8	56.0	56.3	55.8	55.5
Primary Balance (% of GDP)	-5.2	-3.5	-0.5	-1.2	-1.6	-1.2
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.4	1.5	1.4	1.2	1.1	1.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	19.1	19.6	17.7	17.3	16.9	16.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	67.2	66.4	65.8	65.0	64.2	63.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2011-KIHS and 2017-KIHS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.
(b) Projection using average elasticity (2011-2017) with pass-through = 0.7 based on GDP per capita in constant LCU.

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MOLDOVA

Table 1	2018
Population, million	3.5
GDP, current US$ billion	11.4
GDP per capita, current US$	3227
Lower middle-income poverty rate ($3.2)[a]	1.1
Upper middle-income poverty rate ($5.5)[a]	16.3
Gini index[a]	25.9
School enrollment, primary (% gross)[b]	91.3
Life expectancy at birth, years[b]	71.7

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

Despite strengthened growth in early 2019 due to election-related spending, growth is expected to moderate to 3.4 percent by year-end. After months of political instability, the new government managed to unlock external assistance to close the financing gap for orderly budget execution. Accelerating reforms to improve governance, maintain fiscal and financial sector stability and boost competitiveness remain a challenge for the current coalition government. A slow poverty decline starting in 2018 is expected to continue over the forecast period.

Recent developments

Moldova's GDP increased by 4.4 percent in Q1 2019. Robust increase in wages (14 percent yoy) and pensions, public investment and credit growth spurred private consumption and investment, together contributing 3.9 percentage points (pp) to overall growth. Due to the electoral cycle, public consumption added another 0.5 pp to growth. Net exports also contributed to growth (1 pp) due to robust agricultural exports. On the production side, retail and wholesale trade together with the construction sector were the most buoyant, contributing 1.2 and 0.9 pp respectively to growth. The remaining growth came from industry and ICT.

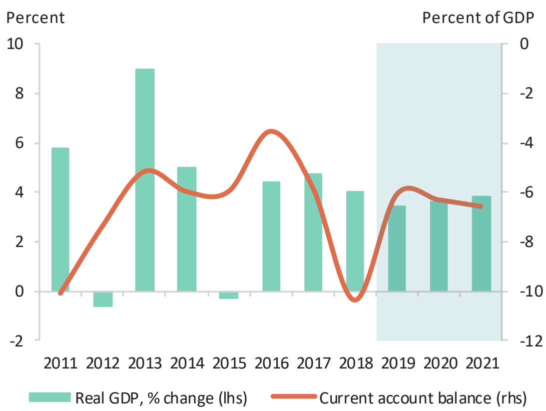
With higher food prices, inflationary pressures are on the rise. Supported by a weaker Leu and robust domestic demand, inflation grew by 4 percent in July 2019. The base rate was increased for the second time this year to 7.5 percent and the reserve requirement rate remains at a record high of 42.5 percent. Nonetheless, credit activity intensified increasing by 17.1 percent in Q2 2019, reducing the excessive liquidity in the system after the banking fraud. In June 2019, the National Bank of Moldova (NBM) completed the process of transferring the largest three banks to fit and proper shareholders.

Due to lower imports, the current account deficit (CAD) decreased by 0.6 percentage points to a still-high 10.1 percent of GDP in Q1 2019. Contrary to 2018, the CAD was mainly financed by the net sale of reserve assets by the NBM and by FDIs, which increased by 18 percent, amounting to 4.9 percent of GDP. By August 2019, foreign reserves decreased to USD2.9 billion (covering more than 5 months of imports), after reaching a record high of USD3.1 billion in November 2018. In March 2019, external debt decreased to 62.5 percent of GDP. Yet, from July the resumed external assistance will help rebuilt reserves and allow for orderly budget financing.

The labor market improved, with unemployment rate down to 3 percent in 2018, boosting activity and employment rates, particularly in rural areas. Strong agricultural performance was reflected in a higher pace of disposable income growth among farmers and agricultural sector workers. Disposable income growth in the bottom 2 quintiles outpaced that of higher income households, leading to a projected decline in poverty rates in 2018. Yet, low participation rate remains a challenge.

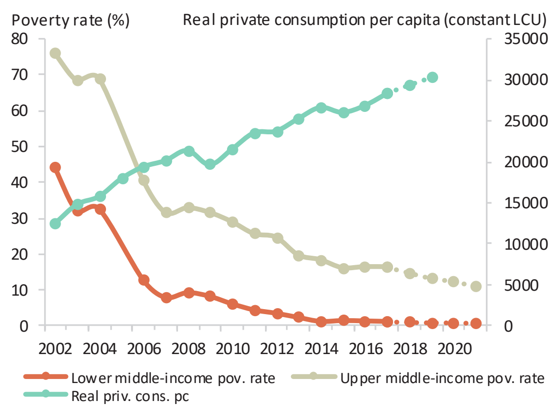
The fiscal deficit remained contained despite a pre-election spending spree. By July 2019, revenues increased by 6.6 percent yoy due to a rise in VAT (7.9 percent yoy) and social contributions (8.2 percent). Given the excessive increase in non-financial assets (37.1 percent), public sector wages and social spending (18.7 and 16.4 percent), expenditures increased by 16.9 percent, resulting in a 1-percent of GDP deficit. With lower external borrowing and resilient growth, the public and publicly guaranteed debt decreased to 27.8 percent by June 2019, from 30.5 percent of GDP in 2018.

FIGURE 1 Moldova / Actual and projected real GDP growth and current account balance



Sources: World Bank and national statistics.

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



Source: World Bank. Notes: see table 2.

Outlook

Faster credit growth, robust real wage growth and strong export performance will underpin growth in 2019. Yet, lower remittances, higher inflation and the dissipation of the fiscal stimuli introduced before elections will decelerate growth in 2019 to 3.4 percent. Over the medium term, economic growth is expected to average 3.6 percent. The recently adopted fiscal consolidation package resumed external assistance but will also lead to a growth slowdown. In the medium term, provided that the reform agenda will continue, consumer and business confidence, together with a continued normalization of financial conditions, will further support private consumption and investment. At the same time, the projected lower foreign demand, despite an expansion of activities in free economic zones, will also contribute to a growth slowdown, keeping the current account deficit below historical values.

The increase in food prices along with the expected adjustments in regulated prices, and the 2018 expansionary fiscal package (tax cuts and wage increases), built up inflationary pressures, likely pushing inflation out of the target corridor in the second half of 2019. In the medium term, on the back of moderate import prices, the inflation is expected to remain close to 5 percent inflation target. Poverty is projected to continue declining due to improving economic and labor market conditions, including continuing growth in disposable incomes.

Increases in social spending and wages, as well as lower tax revenues will widen the 2019 fiscal deficit to 2.7 percent of GDP, the new government's fiscal package is expected to stabilize revenues over the medium term, although the deficit will be higher than historical averages. This requires renewed attention to strengthening public finance management, tax collection, as well as spending efficiency review.

Risks and challenges

Despite the declared determination of the new ruling coalition, major effort and political will are needed to accelerate reforms. Fighting corruption, strengthening institutions and leveling the playfield for all market participants, including through the elimination of price controls, would unleash productivity, currently held back by weak performance of state-owned companies and barriers to market competition. The economy remains susceptible to weather and external shocks, while persistent emigration weakens the country's human capital.

In the medium term, the fiscal position may deteriorate due to structural inefficiencies in public spending and increasing burden from wages and social transfers. Deficit financing also constitutes a risk, as it heavily relies on external financial sources. The government may find it difficult and costlier to finance the planned spending on the local market, with the risk of crowding-out private sector credits. To reduce fiscal risks, further efforts are needed to stabilize the financial sector and address loss-making state-owned companies. While banking sector risks have subsided, the accelerated growth of non-bank credit organizations and insurance sector could yield to accumulation of systemic risks in the financial sector due to current weaknesses in the regulatory and supervisory framework.

Key long-term challenges to economic growth include population ageing, large emigration flows, and low productivity. Boosting productivity is the key solution for Moldova to achieve sustainable growth, create jobs, and further reduce poverty. This requires concerted actions to improve competitiveness and public sector efficiency.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	4.4	4.7	4.0	3.4	3.6	3.8
Private Consumption	2.9	5.3	3.8	2.1	2.8	3.5
Government Consumption	0.8	1.6	-0.1	0.9	0.1	0.2
Gross Fixed Capital Investment	1.0	11.3	14.0	8.7	7.6	8.3
Exports, Goods and Services	9.8	10.9	4.8	3.3	6.3	7.5
Imports, Goods and Services	2.8	11.0	8.9	3.1	5.1	6.7
Real GDP growth, at constant factor prices	5.0	4.2	4.1	3.4	3.6	3.8
Agriculture	18.4	8.6	1.9	1.2	2.1	2.4
Industry	0.7	3.8	8.1	5.2	5.3	5.4
Services	4.0	3.4	3.1	3.2	3.3	3.4
Inflation (Consumer Price Index)	6.4	6.6	3.8	4.7	4.5	5.0
Current Account Balance (% of GDP)	-3.5	-5.8	-10.4	-6.1	-6.3	-6.5
Net Foreign Direct Investment (% of GDP)	1.0	1.5	1.7	1.7	1.7	1.5
Fiscal Balance (% of GDP)	-1.6	-0.6	-0.8	-2.7	-2.1	-1.8
Debt (% of GDP)	36.9	32.7	30.1	30.4	30.8	31.0
Primary Balance (% of GDP)	-0.4	0.5	0.0	-1.7	-1.1	-0.8
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	1.3	1.1	0.9	0.7	0.7	0.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	16.4	16.3	14.7	13.2	12.3	11.0

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. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on private consumption per capita in constant LCU.

MONTENEGRO

Table 1	2018
Population, million	0.6
GDP, current US$ billion	5.5
GDP per capita, current US$	8761
Upper middle-income poverty rate ($5.5)[a]	4.8
Gini index[a]	31.9
School enrollment, primary (% gross)[b]	98.2
Life expectancy at birth, years[b]	77.3

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2014), 2011 PPPs.
(b) Most recent WDI value (2017)

Growth in 2018 reached 4.9 percent, a 10-year high. Growth is expected to moderate as large public investment cycle phases out. Labor market developments remain positive with rising employment, and poverty is estimated to continue declining. Fiscal consolidation reduced the budget deficit, but less than projected due to higher than planned current expenditures. Accelerating structural reforms and managing of public expenditures prudently are critical to sustain growth. Significant external and domestic risks surround the otherwise positive outlook.

Recent developments

After reaching 4.9 percent in 2018, its fastest rate in a decade, economic growth slowed down in the first quarter of 2019 because of weaker investment and industrial production. Supported by favorable labor market developments, increased lending, and booming tourism, private consumption led growth by adding 4.5 percentage points in the first quarter but delays in public projects weighed on total investment which added mere 0.2 percent points to growth. The slowdown in investment has reduced import growth which, however, still outpaced solid growth of exports. As a result, net exports subtracted 1 percentage point from growth in the first quarter. Recent economic activity indicators are mixed. Retail trade grew 5.3 percent y-o-y by June and tourists overnight stays were up by 12.5 percent y-o-y. At the same time, industrial production shrank by 12.2 percent y-o-y as unfavorable hydrological conditions early in the year hindered energy production. Manufacturing growth also declined by 3.5 percent y-o-y, led by a contraction in the manufacturing of metals and minerals. The strong recent construction growth decelerated somewhat to 12.3 percent y-o-y, the lowest since March 2016. Growth is projected to amount to 3 percent in 2019.

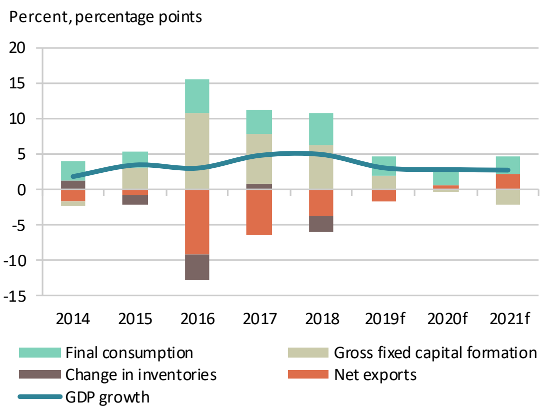
Inflation eased in the first half of 2019 to 0.5 percent, driven by declining clothing, transportation, alcohol, and tobacco prices. Supported by buoyant economic activity, employment has risen steadily since 2018, mostly in construction, tourism, and other services sectors. The survey-based unemployment rate declined to 14.3 percent in Q22019, down from 14.4 percent in Q12018. The youth unemployment rate fell from 23.9 to a historic low of 20.7 percent in the same period. Likewise, the survey-based participation and employment rates reached new record highs of 57.8 percent and 49.5 percent in Q22019, respectively.

Growth and labor market improvements reduced poverty (measured as consumption below the standardized middle-income-country poverty line of $5.5/day 2011PPP) from 8.7 percent in 2012 to an estimated 4.7 percent in 2018, despite potential negative short-term impacts of fiscal consolidation.

The financial sector has remained stable so far after the liquidation of two banks. Deposits declined somewhat by 2.7 percent y-o-y by June while credits grew by 0.6 percent y-o-y, driven by lending to households. The overall liquidity in the banking system remains stable, as reflected in a loan-to-deposit ratio of 90 percent. Continued credit growth helped to reduce non-performing loans to 5.3 percent of total loans in June.

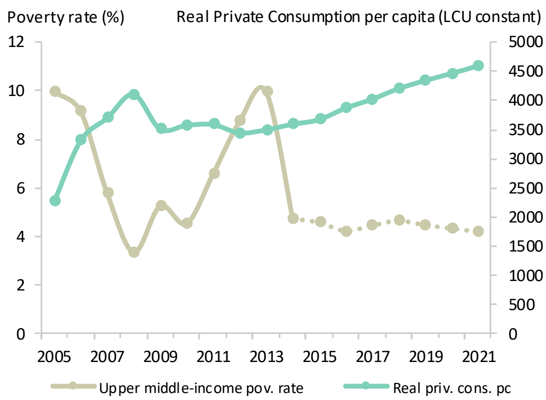
The current account deficit (CAD) remained around 17 percent of GDP y-o-y in June. Solid growth of exports was led by services, namely tourism and transportation, while merchandise exports stalled because of lower aluminum and electricity exports. The solid export growth has been outweighed by volume of imports growth, driven by electricity, minerals, and import of medical products. Income accounts moderated due to interest and dividends

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



Sources: MONSTAT, World Bank.

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



Source: World Bank. Notes: see table 2.

payments. Net FDI picked up to 8.3 percent of GDP, providing around half of the CAD financing, the rest being covered by net inflows of portfolio investment and loans.

Fiscal consolidation helped reduce the fiscal deficit from 5.7 percent in 2017 to 4.1 percent in 2018. The strong recent economic activity supported high revenue growth of 8 percent y-o-y by June 2019. Low capital budget execution, which was just below 50 percent, also helped to reduce the fiscal deficit. But higher-than-planned current spending because of delays in public administration and social sector reforms led to total expenditure growth of 3.7 percent. The high current spending delays the goal of balancing the budget.

Against the backdrop of the benign current financial market conditions, the government plans to issue Eurobonds in 2019 to service debt coming due in 2020 and to improve the government debt maturity profile. The Eurobond is projected to push public debt to 78.6 percent and public and publicly guaranteed debt to an estimated 83.3 percent in 2019.

Outlook

Falling business confidence and the overall uncertainty stemming from the external environment pose a risk to the otherwise positive outlook for the economy, which is expected to grow by an average of 2.8 percent over 2019-2021. The phasing out of an investment boom, which has driven growth in the past three years, is expected to continue to slow growth somewhat from 3 percent in 2019 to 2.8 and 2.7 percent in 2020 and 2021, respectively. The completion of large public infrastructure projects will also reduce current account imbalances and the fiscal deficit, which is expected to turn to surplus in 2021. As a result, public debt and public and publicly guaranteed debt are expected to decline to 62.3 percent and 66.6 percent of GDP in 2021, respectively. Private investment is expected to remain at a high level, mostly driven by the energy and tourism sectors. Consumption is expected to grow at around 3 percent annually by 2020, supported by positive labor market developments. Exports are expected to strengthen because of new energy and tourism capacities which may be (partially) offset by a faster slowdown in external demand from the EU.

Subject to improvements in private sector employment and earnings, poverty is expected to decline to an estimated 4.5 percent in 2019.

Risks and challenges

A stronger than considered overall global slowdown and the associated uncertainties would weigh on growth which could limit the scope for robust labor market and welfare improvements. On the other hand, the beginning of the construction of the remaining phases of the Bar-Boljare highway within the forecast period would support growth but, at the same time, may compromise the fiscal consolidation. A financing through PPPs, for example, can imply high contingent liabilities which would increase the level of public and publicly guaranteed debt relative to the projections. On the other hand, the realization of the airport concessions within the forecast period would result in additional, one-time revenues. Potential remaining vulnerabilities in the financial sector stemming from ailing second-tier banks can also bear downside economic risks. With uncertain global prospects and with limited fiscal space, it is an imperative for Montenegro to remain fully committed to fiscal consolidation, to improve governance, and to accelerate the implementation of structural reforms.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	2.9	4.7	4.9	3.0	2.8	2.7
Private Consumption	5.4	3.9	4.5	3.3	2.8	2.9
Government Consumption	0.8	-1.4	2.5	0.1	-0.2	-0.3
Gross Fixed Capital Investment	38.4	18.7	14.8	3.9	-0.8	-4.4
Exports, Goods and Services	5.9	1.8	9.5	4.3	3.9	4.0
Imports, Goods and Services	15.3	8.4	9.3	4.2	1.4	-0.1
Real GDP growth, at constant factor prices	3.0	4.8	4.9	3.0	2.8	2.7
Agriculture	3.9	-3.1	0.0	0.1	0.4	0.5
Industry	11.5	9.7	14.0	5.0	3.0	1.8
Services	0.6	4.4	2.7	2.7	3.1	3.3
Inflation (Consumer Price Index)	-0.3	2.4	2.6	1.0	1.6	1.8
Current Account Balance (% of GDP)	-16.2	-16.1	-17.2	-17.4	-15.3	-11.9
Net Foreign Direct Investment (% of GDP)	9.4	11.3	7.0	8.0	8.0	8.0
Fiscal Balance (% of GDP)	-2.8	-5.7	-4.1	-3.2	-1.0	1.5
Debt (% of GDP)	64.4	64.2	70.8	78.6	71.2	62.3
Primary Balance (% of GDP)	-0.7	-3.3	-1.9	-1.1	1.1	3.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	4.2	4.4	4.7	4.5	4.3	4.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2009-HBS and 2014-HBS. Actual data: 2014. Nowcast: 2015-2018. Forecast are from 2019 to 2021.
(b) Projection using point-to-point elasticity (2009-2014) with pass-through = 0.4 based on private consumption per capita in constant LCU, with estimated impact of fiscal consolidation.

NORTH MACEDONIA

Table 1	2018
Population, million	2.1
GDP, current US$ billion	12.7
GDP per capita, current US$	6079
International poverty rate ($1.9)[a]	5.3
Lower middle-income poverty rate ($3.2)[a]	9.8
Upper middle-income poverty rate ($5.5)[a]	23.2
Gini index[a]	35.6
Life expectancy at birth, years[b]	75.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2017).

Growth is firming up in 2019, expected to reach 3.1 percent, driven by rising investment and consumption. Unemployment fell to a historical low due to employment rise. Public debt and deficit are projected to widen in 2019, as current spending rose due to higher public sector wages, pensions and subsidies. Increasing wages beyond productivity is putting pressure on the cost competitiveness of the economy. Further reforms are needed to address the declining human capital, judiciary, declining productivity and rising migration.

Recent developments

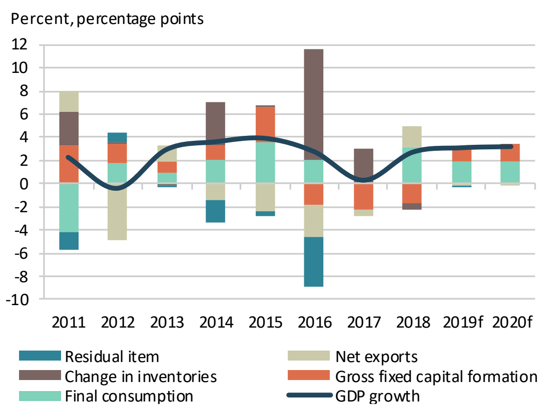
Economic growth strengthened in the first half of 2019 to 3.6 percent, its fastest rate since 2016. Wholesale and retail trade were the main driver of growth, accounting for 1.5 pp. Agriculture contributed 0.5 pp contributions, while industry contributed 0.4 pp despite a slowdown in manufacturing, evident in Q2 2019. Construction also added 0.1 pp, but this is expected to be temporary as surveys for the sector point to positive expectations from companies in terms of contracts, prices and employment. On the demand side, the main contributors to growth were investment as well as private consumption, the latter spurred by rising wages, pensions, and household lending. Net exports subtracted from growth, as rising exports did not compensate for the growing imports of capital and consumer goods. Growth for 2019 is expected to reach 3.1 percent, rising from 2.7 percent in 2018.

Employment growth accelerated to 5.2 percent y-o-y in H1 2019, compared to an average of 2.1 percent in 2018. Most of the new jobs created were in manufacturing, transport and storage, administrative services and entertainment. The employment rate improved to 47.4 percent–-up by 2.7 pp on an annual basis. Unemployment declined to a historic low of 17.7 percent in H1 2019. The real net wages increased by 2 percent y-o-y by end June 2019, partly reflecting the increases in the minimum wage in July 2018 and April 2019, as well as higher wages for public services introduced in early 2019. Using the US$5.5/day (2011 PPP) poverty line, poverty is projected to have fallen to below 21 percent in 2019, continuing a decreasing trend present since 2009. Using the $11/day (2005 PPP) line, the middle class increased from approximately 30 percent in 2009 to about 41 percent in 2015.

Monetary policy was further relaxed. In early 2019, the central bank lowered the key interest rate by 25 bps to a historic low of 2.25 percent, based on favorable developments in the foreign exchange market, moderate inflation, continued solid deposit growth, and a negative output gap. Consumer prices increased by 1.2 percent y-o-y, largely due to higher food prices. Credit continued its strong growth in 2019, helped by a rise in corporate lending. Overall, credit growth stood at 6.8 percent y-o-y in July 2019, with corporate credit growth at 4.3 percent, led by longer-term investment lending. Non-performing loans increased somewhat, but remained low at 5.4 percent, with corporate NPLs standing at 8.4 percent. Deposits continued increasing at 10.5 percent y-o-y.

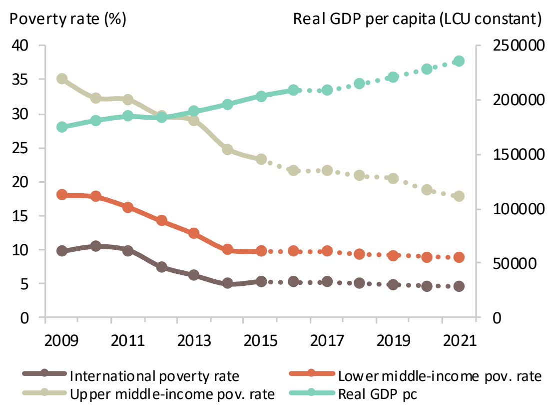
Despite rise in tax and contribution rates, fiscal deficit widened in 2019. Government revenues increased by 6.1 percent y-o-y in the first half of 2019, on the back of social contributions (higher rates introduced in January), personal income tax (higher rate introduced, exemptions reduced) and excises (increased tobacco and fuel excises). However, spending went up by 8.5 percent y-o-y due to rising pensions, wages, subsidies (including for social

FIGURE 1 North Macedonia / Real GDP growth and contributions to real GDP growth



Source: World Bank.

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



Source: World Bank. Notes: see table 2.

contribution payments to incentivize formalization of wages paid in cash, agriculture, and for a 15-percent paid VAT refund to citizens upon submission of tax receipts to strengthen tax compliance) and health spending. Capital spending, although rising, is still vastly under-executed. The revised 2019 deficit is projected at 2.5 percent of GDP, increasing from 1.1 percent in 2018 (with the Public Enterprise for State Roads deficit it is estimated at 2.7 percent of GDP). Public and publicly guaranteed (PPG) debt is expected to rise to 51 percent in 2019 from 48.5 percent in 2018, as the Government intensifies borrowing to meet its obligations and guaranteed debt also increases as public investments in roads accelerates.

External imbalance widened marginally in early 2019, with the current account deficit in H1 2019 at 1 percent of GDP (on a four quarter rolling bases). The continued solid export performance of FDI-related industries like automobiles and electrical machinery was supplemented by growth of exports in iron and steel, because of favorable terms of trade, as well as furniture and tobacco. However, rising imports, resulted in a slight increase of the goods trade deficit. FDIs in H1 2019 dropped as a result of repatriation of profits but are expected to rebound in H2 and to reach 3.2 percent of GDP for the full year. External debt is projected to rise to above 78 percent of GDP, also due to rise in public sector external debt.

Outlook

The macroeconomic outlook is moderately positive with annual average growth projected at 3.4 percent through 2021. Investment (including in the highway, and private investment in energy and tourism) will be the main driver of growth. It will be supported by exports and personal consumption as employment picks up further and wages continue to grow, propelled partly by a higher minimum wage that is expected to affect private sector employees. Moderate fiscal consolidation is expected, with public debt stabilizing over the medium term.

Poverty will likely continue decreasing given the expected real wage growth and the continuous improvement in the labor market. If growth is equally distributed across all Macedonians, the share of the population with an income below the US$5.5/day will likely decrease to 18 percent by 2021. The social assistance reform currently under implementation should favor poorer households.

Risks and challenges

While the Government introduced two programs to fight informality (estimated at 30-40 percent of GDP), the cost of these programs should not crowd out productive spending or lead to fiscal imbalances. While these programs have been accommodated within the 2019 planned deficit due to lower capital spending, for the medium term they should be offset with other spending or revenue measures.

While these measures are intended to tackle one of the key constrains of the economy, they are unlikely to address the issue if not accompanied by strengthening of the tax administration and inspection efficiency along with further improvements in public service delivery and the legal framework for businesses.

Despite the pre-election year, further reforms are needed to address the challenges of low and declining human capital, weak competition policy, judiciary, declining productivity and rising migration.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	2.8	0.2	2.7	3.1	3.2	3.3
Private Consumption	3.9	0.6	3.3	2.5	2.5	2.4
Government Consumption	-4.9	-2.5	6.2	1.0	0.8	0.6
Gross Fixed Capital Investment	-6.2	-8.7	-7.2	5.7	6.6	7.2
Exports, Goods and Services	9.1	8.1	15.3	8.0	8.0	8.2
Imports, Goods and Services	11.1	6.4	9.1	6.3	6.5	6.7
Real GDP growth, at constant factor prices	2.0	0.1	2.8	3.1	3.2	3.3
Agriculture	-0.4	-13.5	-5.0	1.8	1.5	1.5
Industry	-2.9	-1.0	2.2	5.5	5.9	6.4
Services	4.5	2.3	3.9	2.3	2.3	2.2
Inflation (Consumer Price Index)	-0.2	1.3	1.4	1.6	1.8	2.0
Current Account Balance (% of GDP)	-2.9	-0.8	-0.3	-0.7	-1.2	-1.0
Net Foreign Direct Investment (% of GDP)	3.3	1.8	5.8	3.2	3.7	4.0
Fiscal Balance (% of GDP)	-3.8	-3.5	-1.7	-2.7	-3.4	-2.7
Debt (% of GDP)	48.7	47.7	48.4	51.1	52.4	52.2
Primary Balance (% of GDP)	-2.6	-2.1	-0.5	-1.3	-2.1	-1.4
International poverty rate ($1.9 in 2011 PPP)[a,b]	5.2	5.2	5.0	4.8	4.6	4.4
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	9.7	9.7	9.3	9.2	8.9	8.7
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	21.6	21.6	20.8	20.5	18.9	17.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-SILC-C. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on GDP per capita in constant LCU.

POLAND

Table 1	2018
Population, million	38.0
GDP, current US$ billion	585.5
GDP per capita, current US$	15418
International poverty rate ($1.9)[a]	0.4
Lower middle-income poverty rate ($3.2)[a]	0.8
Upper middle-income poverty rate ($5.5)[a]	2.6
Gini index[a]	31.8
Life expectancy at birth, years[b]	77.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2016)

Poland's economy continued to perform strongly in 2018. Real GDP growth reached 5.1 percent in 2018, driven by domestic consumption and pick up in investment. The pace of growth is expected to subside in the coming years in the face of a tightening labor market and slowing growth in the rest of the EU. Labor shortages and expansionary fiscal policies are the main challenges to sustained growth in the medium-term.

Recent developments

Poland's GDP grew by 5.1 percent in 2018, driven primarily by expanding domestic consumption (4.5 percent growth) and high investments (8.7 percent increase). Private consumption was fueled by a strong labor market, increases in average salaries (by 5.3 percent) and social programs such as "Family 500+". Increased government investments substantially influenced by local elections held in 2018, higher absorption of EU funding and inflow of FDI have contributed to the acceleration of total investments. On the production side, industry (5.6 percent growth), transportation (9.3 percent), and construction (17.1 percent) were the key drivers of growth, while agriculture sector declined by 4.1 percent following the summer drought.

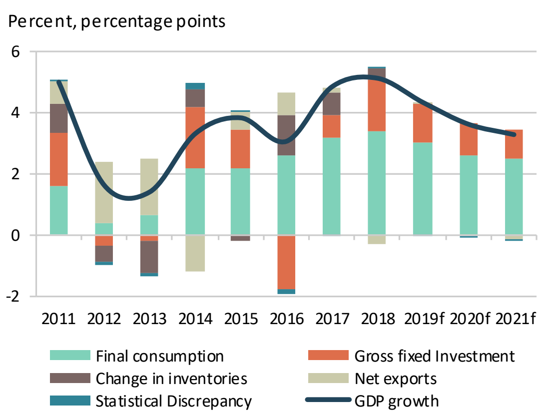
Despite growing public expenditures, the general government deficit for 2018 amounted to 0.4 percent of GDP, while Poland's debt-to-GDP ratio decreased to approximately 48.9 percent as budget revenues exceeded government projections. Despite high consumption growth, consumer prices rose by a modest 1.6 percent in 2018, thanks to low core inflation of 0.7 percent. The pass-through of higher energy prices to consumer prices was moderated by a government cap freezing electricity prices faced during 2019 at mid-2018 levels for households, micro and small enterprises among others.

Robust domestic demand caused imports to grow by 7.1 percent in 2018. As Poland's key trade partners experienced economic slowdown, exports increased by 6.3 percent in 2018 (compared to 9.5 percent in 2017), resulting in a small negative contribution of net exports to GDP growth. The current account balance returned to a deficit in 2018 as robust household consumption, higher investments, and a slightly depreciated Polish currency pushed up the volume and cost of imports.

The labor market has further tightened, partly due to strong labor demand, policies that have affected the supply of labor (lowered retirement age and "Family 500+" child benefits) and a decrease in the size of the working age population, linked to aging. This has contributed to a sharp decline in the economically active population (by approximately 0.35 million people since 2015) during a period of growing demand for labor. Despite rising employment rates and more foreign workers, labor shortages affect business activity, as the job vacancy ratio increased in the recent year by 0.2 pp to 1.2 percent.

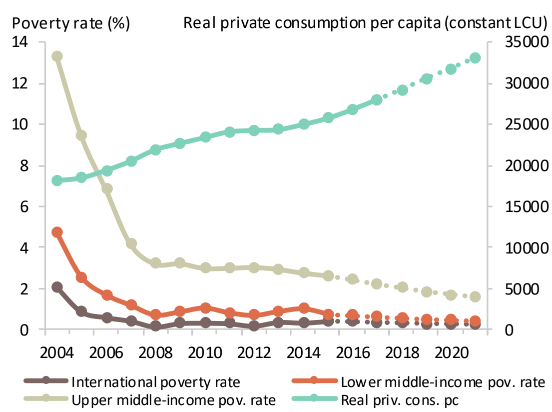
Median household incomes rose by 5.7 percent in 2017. Income gains were registered throughout the distribution, and faster growth at the bottom of the income distribution due to employment and wage gains contributed to a decline in the Gini Coefficient of inequality between 2016 and 2017. Household expenditures from 2018 however signal that growth among the bottom 10 percent dropped 2017-18. The poverty rate using the Upper Middle-Income Class line of $5.50 per day (2011 PPP) is estimated to have declined from 2.7 in 2015 to 2.0 percent in 2018.

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



Source: World Bank.

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



Source: World Bank. Notes: see table 2.

Outlook

Amid the economic slowdown in the EU, Poland's GDP growth may reach 4.3 percent in 2019, driven by persistently strong domestic consumption and higher-than-expected investments. Household consumption expenditures are set to continue growing, fueled by an expansion of Family 500+, additional pension payments, and a strong labor market. However, as the impact of new social programs on consumption is likely to be smaller than the initial effects of "Family 500+" due to growing prices (CPI reaching almost 3 percent in 2020), the contribution of private consumption to GDP growth is expected to fall in coming years. A stable banking sector, low interest rates and availability of EU funds are expected to support private investments and offset an anticipated post-election decline in growth of government investments.

Despite the uncertain economic perspectives of Germany and the UK (which together account for approximately a third of Poland's exports), Polish exports expanded by 4.9 percent in the first half of 2019 and are expected to result in a positive trade balance and a modest current account surplus. In the medium-term, economic growth is forecast to decelerate to 3.6 percent in 2020 and 3.3 percent in 2021. Nonetheless, rising real incomes are expected to lead to further declines in poverty: the $5.50/day 2011 PPP poverty rate is projected to decline to 1.9 percent in 2019 and to 1.6 percent by 2021.

Fiscal performance remains a challenge despite the sound budget position so far. In the short-term public expenditure is expected to increase significantly due to new policies introduced prior to the general elections in October 2019. The extended "Family 500+" program and the 13th month pension payment (announced to span over 2020) are expected to elevate the general government deficit to 1.6 percent of GDP in 2019. Due to additional budget revenues from restructuring of pension system (one-off proceeds over the next couple years), removing the cap on social security contributions, and from improved CIT and VAT collections, the deficit is likely to stabilize at 1.0 percent in 2020-21. Thanks to the economic expansion, general government gross debt is expected to move towards 47.5 percent of GDP between 2019-21.

Risks and challenges

The two main challenges ahead for Poland are a shortage of labor and expansionary measures encouraged by the political calendar.

The shortage of labor will eventually weigh heavily on potential GDP growth, and will be exacerbated by the early retirement of an increasing share of the workforce. Poland is at an advanced stage in its demographic transition: its working age population is already shrinking and is forecast to further decline in coming years. The simultaneous aging and shrinking of the workforce could negatively affect production capacity and investment. The problem may be amplified by the extension of the "Family 500+" program, which could result in more people withdrawing from the labor force.

A dense political calendar, with EU, presidential, and general elections taking place within a year, inspired a range of expansionary policies. Proposed measures increasing social benefits, lowering tax rates and inflating the cost of pension payments will put pressure on public finances. Due to the political cost of reversing these policies, they will weigh on Poland's fiscal position and may push the deficit towards the 3 percent EU threshold in the medium-term, once the provisional sources of funding dry up.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	3.1	4.9	5.1	4.3	3.6	3.3
Private Consumption	3.9	4.5	4.5	3.8	3.7	3.7
Government Consumption	1.9	2.9	4.7	4.6	2.5	2.1
Gross Fixed Capital Investment	-8.2	4.0	8.7	6.6	5.3	4.6
Exports, Goods and Services	8.8	9.5	6.3	4.5	4.3	3.8
Imports, Goods and Services	7.6	9.8	7.1	4.6	4.5	4.3
Real GDP growth, at constant factor prices	3.0	4.8	5.1	4.2	3.6	3.3
Agriculture	3.0	2.5	-4.1	3.2	2.3	1.8
Industry	3.9	2.5	5.6	5.9	4.0	3.4
Services	2.6	6.3	5.1	3.3	3.4	3.2
Inflation (Consumer Price Index)	-0.6	2.0	1.6	2.0	2.9	2.6
Current Account Balance (% of GDP)	-0.5	0.1	-0.6	0.3	0.2	0.2
Net Foreign Direct Investment (% of GDP)	0.9	1.2	1.9	1.4	1.2	1.2
Fiscal Balance (% of GDP)	-2.2	-1.5	-0.4	-1.6	-1.0	-1.0
Debt (% of GDP)	54.2	50.6	48.9	48.5	47.8	47.3
Primary Balance (% of GDP)	-0.5	0.0	1.0	-0.2	0.6	0.6
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.4	0.4	0.3	0.3	0.3	0.3
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.7	0.6	0.6	0.5	0.5	0.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	2.4	2.2	2.0	1.9	1.7	1.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2004-EU-SILC and 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using point-to-point elasticity (2004-2015) with pass-through = 1 based on private consumption per capita in constant LCU.

ROMANIA

Table 1	2018
Population, million	19.5
GDP, current US$ billion	239.6
GDP per capita, current US$	12307
International poverty rate ($1.9)[a]	5.7
Lower middle-income poverty rate ($3.2)[a]	13.3
Upper middle-income poverty rate ($5.5)[a]	25.6
Gini index[a]	35.9
Life expectancy at birth, years[b]	75.3

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2016)

Romania's growth was stronger than anticipated, at 4.7 percent in the first half of 2019. Economic activity was driven by private consumption, supported by an expansionary fiscal policy and a rebound in investment. The labor market has tightened, with unemployment reaching historic lows. Increases in wages and pensions contributed to continued poverty reduction. Risks to the economic growth outlook have risen and stem from weaker demand from major exports markets, a tightening labor market and the uncertainty of fiscal policy.

Recent developments

Romania's GDP grew at 4.7 percent in the first half of 2019, above the long-term potential. Private consumption remained the main driver of growth, up 6.1 percent yoy, supported by increases in public-sector wages, minimum wages and pensions, which boosted disposable incomes. Investment picked up at 12.4 percent yoy, owing to better than expected performance in construction, retail trade and services. Exports grew by 2.7 percent yoy reflecting weaker demand in the major export markets and a slowdown in industrial exports, while imports remained sturdy (up 6.4 percent) on the back of strong domestic demand. On the production side, ICT (up 9.9 percent yoy) and construction (up 14.9 percent yoy) were the main drivers of growth. Industry stagnated due to a slowdown in manufacturing and the deceleration in the dynamics of exports.

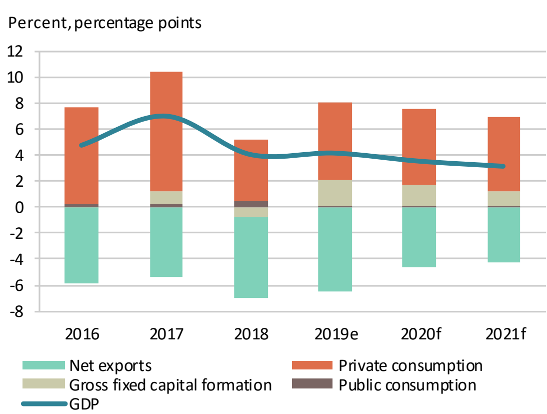
The execution of the budget posted a deficit of 1.9 percent of GDP as of June 2019. Compensation of employees was up by 23.4 percent yoy reflecting public wage increases and a 9 percent increase in the minimum wage in January 2019, while social assistance spending was up by 11.4 percent yoy due to increases in pensions. Revenue performance (up 14.4 percent yoy) reflects better VAT collection (up 12.6 percent yoy) and a rise in social security contributions (up 17.1 percent) due to a fast increase in gross wages and the transfer of the social contribution from employers to employees. The current account deficit widened to 2.4 percent of the projected GDP as of June 2019 reflecting consumption pressures. FDI inflows were up 30 percent yoy in the first half of 2019 amounting to 1.1 percent of the projected GDP.

Strong consumption and depreciation pressures on the currency pushed the annual inflation rate to 4.1 percent in June 2019, above the upper band of the National Bank of Romania (NBR). The NBR kept the monetary policy rate unchanged in 2019, at 2.5 percent, and focused on managing the liquidity in the financial sector. The dynamics of credit to the private sector decelerated slightly in the first half of 2019 to 6.7 yoy, reflecting a slowdown in the growth of domestic currency loans mainly to households.

The labor market benefited from the expansion of the economy, with unemployment at 3.8 percent in June 2019, a 27-year low and the real average wage increasing by 11.2 percent yoy. Nonetheless, the low employment rate at 65.7 percent, below the EU-28 average of 69.2 percent, coupled with high youth unemployment at 15.4 percent, as of Q1 2019, reflect persistent structural rigidities in the labor market.

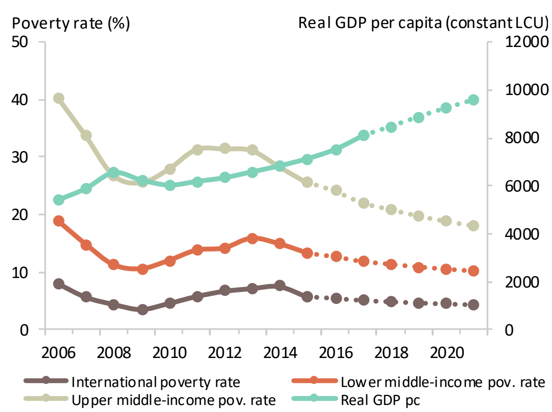
Real median household incomes increased by 20 percent yoy in 2017, partly linked to strong labor market conditions, rising average and minimum wages. Although strong growth was seen throughout the income distribution, inequality indicators increased slightly due to faster growth among the top 40 percent. The poverty rate corresponding to upper middle-income countries (using the $5.50/day 2011 PPP poverty line) is forecast to have declined between 2015 and 2018, from 25.6

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.

to 20.9 percent respectively, continuing the progress seen since 2012. Poverty continues to be substantially higher and concentrated in rural areas and among marginalized communities. While fiscal policy in 2019 supports redistribution, it raises headcount poverty rates since direct cash transfers to poor households are not large enough to compensate for their tax payments.

Outlook

Economic growth is expected to moderate over the medium term in line with long-term potential, as the available fiscal space shrinks and the labor market increasingly tightens. This tightening is likely to be most pronounced for tertiary educated workers, whose employment rates at 89.2 percent in Q1 2019 were twice those of workers with less than lower-secondary education. This is likely to put pressure on wage growth and to feed into rising inequality.

The fiscal measures promoted in recent years coupled with the political uncertainty in the context of a series of elections will make it unlikely that the government will be able to firmly contain imbalances. In 2019, we expect inflation to stay elevated and the external deficit to continue widening.

The government will have difficulties keeping the budget deficit within 3 percent of GDP over the medium term. The newly promoted pension law and the planned public wage increases will put endemic pressure on the consolidated budget deficit and reduce the available fiscal space for investment. The two measures would add around 0.8 percent of GDP to public expenditure in 2019, and 1.7 percent of GDP in 2020. The widening of the fiscal deficit would push public debt to 39.5 percent of GDP at end -2021, from 36.6 percent in 2018. Despite this, public debt remains one of the lowest in the EU.

Strong private consumption aided by the expansionary fiscal policy and continued growth in real wages, partly supported by minimum wage increases, should continue to boost real incomes and lead to further declines in poverty incidence. The $5.50/day 2011 PPP poverty rate is projected to decline to 19.8 percent in 2019 and to 18.1 percent in 2021.

Risks and challenges

The uncertainty of fiscal policy coupled with the tightening labor market – amplified by emigration - could generate significant domestic adverse effects on growth and investment. These would be exacerbated by the expected slowdown in growth in Romania's traditional export markets in the EU, mainly Germany and Italy. The partial decoupling dynamics of real wage and productivity could also contribute to weakening exports, putting supplementary upward pressures on the current account deficit. Renewed efforts are needed to improve labor participation and to tackle the high unemployment among the youth and the low-skilled, helping to ease supply side constraints and improve the sustainability of growth. Over the medium term, the focus of fiscal policy should be rebalanced from boosting consumption towards mobilizing investment, primarily from EU funds, to support a sustainable EU convergence path and social inclusion. Reforms in public administration and SOEs, increased regulatory predictability, as well as policies to address the large social and spatial disparities should be on the agenda of priorities of the government.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	4.8	7.0	4.1	4.2	3.6	3.2
Private Consumption	8.0	9.6	4.7	6.0	5.8	5.6
Government Consumption	4.6	4.6	9.9	2.6	2.5	2.4
Gross Fixed Capital Investment	0.0	3.3	-3.1	8.1	6.2	4.1
Exports, Goods and Services	16.1	9.7	5.4	2.9	3.7	3.7
Imports, Goods and Services	16.5	11.3	9.1	7.5	6.1	5.7
Real GDP growth, at constant factor prices	4.9	7.1	3.5	4.2	3.6	3.2
Agriculture	4.2	14.6	10.0	2.0	2.0	2.0
Industry	6.6	6.2	2.1	1.4	2.1	2.4
Services	4.0	6.8	3.5	6.1	4.6	3.8
Inflation (Consumer Price Index)	-1.5	1.3	4.6	4.1	3.6	3.1
Current Account Balance (% of GDP)	-2.1	-3.2	-4.4	-5.2	-5.4	-5.6
Net Foreign Direct Investment (% of GDP)	2.7	2.6	2.3	2.4	2.3	2.2
Fiscal Balance (% of GDP)	-2.4	-2.8	-3.0	-3.0	-3.6	-3.5
Debt (% of GDP)	38.9	36.9	36.6	38.5	39.1	39.5
Primary Balance (% of GDP)	-1.1	-1.6	-1.7	-1.7	-2.3	-2.1
International poverty rate ($1.9 in 2011 PPP)[a,b]	5.5	5.1	4.9	4.7	4.5	4.4
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	12.7	11.8	11.3	10.9	10.5	10.1
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	24.1	22.1	20.9	19.8	18.9	18.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2006-EU-SILC and 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using annualized elasticity (2006-2015) with pass-through = 0.7 based on GDP per capita in constant LCU.

RUSSIAN FEDERATION

Table 1	2018
Population, million	144.5
GDP, current US$ billion	1660.9
GNI per capita, US$ (Atlas method)	10230
International poverty rate ($1.9)[a]	0.0
Lower middle-income poverty rate ($3.2)[a]	0.3
Upper middle-income poverty rate ($5.5)[a]	2.7
Gini index[a]	37.7
Life expectancy at birth, years[b]	72.1

WDI, MPO, Rosstat, and Bank of Russia.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2017)

Real GDP growth slowed to 0.7 percent in the first half of 2019 due to weak domestic and external demand. The economy is forecast to grow at 1 percent in 2019 and 1.7 – 1.8 percent in 2020 – 2021. The poverty rate using the national definition declined by 0.6 percentage points to 12.6 percent in 2018, driven by a rebound of incomes at the bottom of the income distribution and a slight downward shift in real terms in the poverty line.

Recent developments

Real GDP growth decelerated to 0.7 percent year on year in the first half of 2019 owing to lackluster domestic and external demand. Economic sanctions continued to weigh on economic performance. Real disposable incomes fell by 1.3 percent year on year in the first six months of 2019 reflecting a hike in value added tax (VAT) rates in January 2019 and subsequent acceleration in inflation. A decline in public investment, partly related to slow set-up of the national projects, negatively affected total investment. Mineral resource extraction, financial services, and the transportation sector led growth, while trade and real estate acted as significant drags.

Softening external demand, lower prices for Russian exports, particularly in the second quarter, and oil contamination in the Druzhba pipeline drove a narrowing of the trade surplus in the first half of 2019. Declining imports—reflecting weak domestic demand—failed to offset falling export earnings. As a result, the current account surplus decreased to 5.8 percent of GDP in the first half of 2019 (from 6 percent in the same period of 2018). Renewed foreign investor interest in government bonds led to strong capital inflows in the government sector in the first half of 2019. Net capital outflows from the private sector almost doubled to $27.4 due to larger acquisition of net foreign assets by banks. Nonetheless, international reserves held by the Central Bank of Russia (CBR) rose to $517.1 billion as the CBR continued currency purchases within the fiscal rule framework. The real effective exchange rate appreciated by 0.5 percent in the first eight months of 2019.

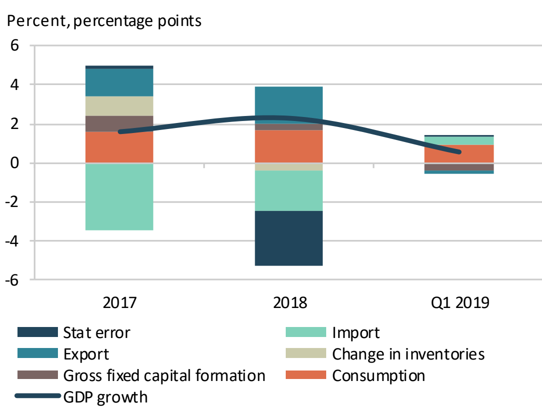
After peaking in March at 5.3 percent (fueled by the effects of the VAT rate increase), 12-month consumer price inflation has been declining and eased to 4.3 percent in August. As inflation pressures subsided amid weak domestic demand, the CBR cut the policy rate by 25 basis points in June, July, and September to 7 percent in annual terms.

Russia's banking sector has been relatively stable. The CBR has continued its clean-up of the sector by revoking the licenses of some smaller banks and focusing on the financial rehabilitation of large financial institutions. To address the risks of accelerated consumer lending growth, which peaked at 24 percent year on year in April, the CBR has adjusted risk weights on unsecured retail loans three times within the last year. All banks and microfinance organizations have been required to calculate the debt-to-income ratio on all consumer loans above RUB 10,000 ($150) since October.

In January-June 2019, the general government balance improved to a surplus of 5.2 percent of GDP (from 3.2 percent in the same period of 2018), supported by the VAT rate increase and lower spending.

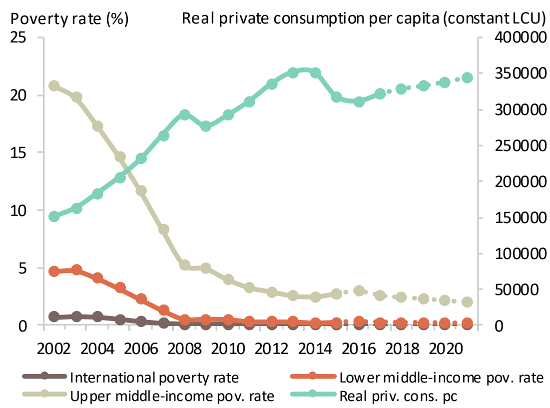
The unemployment rate fell to 4.7 percent in the first half of 2019 (from 4.9 percent in 2018), while real wages rose by 6.8 percent. Wage growth was highest in the public sector. Pensions increased by

FIGURE 1 Russian Federation / Real GDP growth and contributions to real GDP growth



Source: Rosstat.

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



Source: World Bank. Notes: see table 2.

0.8 percent in real terms. The average real disposable income was unchanged in 2018 compared to 2017, potentially implying that some unobserved components (such as informal incomes) contracted in real terms. Nevertheless, incomes at the bottom of the distribution grew slightly faster than at the top, supported by the increase in the minimum wage and new family benefits.

The poverty rate using the national definition (the share of the population with a monthly income per capita of less than RUB 10,088 in 2017) fell in 2018 by 0.6 percentage points, partly driven by a shift in the poverty line and partly by the rebound in incomes at the bottom of the distribution. However, in the first half of 2019 the poverty rate rose slightly (by 0.2 percentage points) as poverty lines were raised by 2 percent in real terms. World Bank estimates of the poverty rate using the upper-middle-income country line (the share of the population with per capita consumption of below $5.5/day in 2011 PPP, or RUB 4,351 per month in 2017) also suggest a decline, from 2.6 percent in 2017 to 2.4 percent in 2018. The poverty rate using the international poverty line of $1.9/day remained negligible, well below 1 percent.

Outlook

GDP growth, which is expected to accelerate in the second half of 2019 on the back of monetary easing and faster public spending on national projects, will reach 1 percent in 2019. Russia's medium prospects remain modest, at 1.7 and 1.8 percent in 2020 and 2021. Domestic demand, supported by the ongoing national projects, can be expected to drive growth in 2020–2021. Relatively comfortable oil prices will keep the general government budget in surplus in 2019–2021. Inflation is forecast to return to the CBR's target of 4 percent in 2020–21 as one-off effect of the VAT rate increase dissipates. Weaker global demand and rising import spending underpin the forecast of a narrower external surplus in 2020–21. The moderate poverty rate is expected to continue to decline through 2021.

Risks and challenges

External risks stem from the further deterioration of global growth prospects and the expansion of sanctions. The ongoing fast-paced expansion in household credit may pose a risk to financial stability in the event of a deterioration in the macroeconomic environment. Currently, consumer lending risks appear to be contained by a continued tightening in CBR regulation. Investment growth will be subject to the successful and efficient implementation of government infrastructure investment initiatives.

The liquid part of the National Welfare Fund will exceed 7 percent of GDP in 2020, creating an opportunity for the government to invest part of the Fund in domestic infrastructure projects. However, substantial domestic investments could make the economy more dependent on energy prices and heighten inflation risks. Demographic challenges, which weigh on Russia's growth potential, and the resulting tight labor market, pose medium-term inflation risks.

Although Russia has undertaken steps to improve its business environment, progress in enhancing competition conditions has been limited.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	0.3	1.6	2.3	1.0	1.7	1.8
Private Consumption	-1.9	3.3	2.3	1.2	1.6	1.6
Government Consumption	1.5	2.5	0.3	0.2	0.5	0.5
Gross Fixed Capital Investment	1.0	5.2	2.9	1.1	3.7	4.0
Exports, Goods and Services	3.2	5.0	5.5	0.0	2.1	2.3
Imports, Goods and Services	-3.6	17.4	2.7	-0.2	3.4	3.7
Real GDP growth, at constant factor prices	0.4	1.5	2.2	1.0	1.7	1.8
Agriculture	2.3	1.5	-2.0	0.7	1.4	1.4
Industry	2.2	0.8	2.9	1.0	1.4	1.6
Services	-0.6	1.9	2.2	1.0	1.9	1.9
Inflation (Consumer Price Index)	7.1	3.7	2.9	4.7	4.0	4.0
Current Account Balance (% of GDP)	1.9	2.1	6.8	5.0	4.2	3.6
Net Foreign Direct Investment (% of GDP)	0.8	-0.5	-1.4	-0.1	-0.5	-0.5
Fiscal Balance (% of GDP)[a]	-3.7	-1.5	2.9	1.5	1.1	1.1
Debt (% of GDP)	16.4	15.5	14.3	14.9	15.9	16.8
Primary Balance (% of GDP)[a]	-2.8	-0.6	3.8	2.3	2.0	2.0
International poverty rate ($1.9 in 2011 PPP)[b,c]	0.0	0.0	0.0	0.0	0.0	0.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[b,c]	0.3	0.3	0.2	0.2	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[b,c]	2.9	2.6	2.4	2.3	2.1	2.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Fiscal and Primary Balance refer to general government balances.
(b) Calculations based on ECAPOV harmonization, using 2015-HBS. Actual data: 2015. Nowcast: 2016 - 2018. Forecast are from 2019 to 2021.
(c) Projection using neutral distribution (2015) with pass-through = 0,87 based on private consumption per capita in constant LCU.

SERBIA

Table 1	2018
Population, million	7.0
GDP, current US$ billion	50.5
GDP per capita, current US$	7220
International poverty rate ($1.9)[a]	5.6
Lower middle-income poverty rate ($3.2)[a]	11.1
Upper middle-income poverty rate ($5.5)[a]	23.6
Gini index[a]	39.7
School enrollment, primary (% gross)[b]	100.3
Life expectancy at birth, years[b]	76.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2017).

Growth is projected to slow down from 4.3 percent in 2018 to 3.3 percent. Growth continues to bring improvements in labor market outcomes, with unemployment down to 10.3 percent in Q2 2019. Poverty is projected to have declined from 23.8 percent in 2014 to 19.8 percent in 2019. Over the medium-term, growth is expected to remain at 3-4 percent, although risks remain, including from policy reversals and delays in structural reforms.

Recent developments

Based on the latest estimates, year-on-year growth in the first and second quarter of 2019 reached 2.7 and 2.9 percent, respectively. Given this performance, the growth projection for 2019 has been revised downwards from 3.5 percent to 3.3 percent. As in the past, strong consumption and investment is not sufficient to compensate for an increasing negative contribution of net-exports to growth, with increasing consumption (both public and private) to a large extent matched by increased imports.

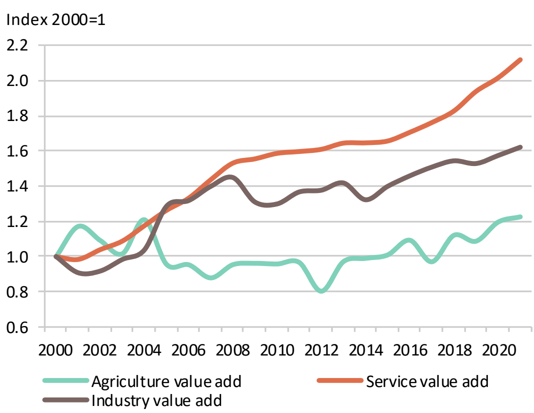
Looking at sectoral composition, performance of industry disappointed most: industrial output fell by 2 percent in the first half of the year, including a 2.8 percent decrease in manufacturing. This decline was broad based, with 17 out of 29 industrial sectors decreasing output. Based on early indicators, agriculture output is also projected to decline or stagnate in several key subsectors.

Growth has contributed to labor market improvements. The Q2 activity rate and employment rate among population aged 15 and above continued to increase in 2019, reaching 54.8 and 49.1 percent respectively. The employment rate remains lower among female workers and youth. Unemployment declined to an estimated 10.3 percent in the second quarter of 2019 (the unemployment rate for population aged 15-64 stood at 10.8 percent). In the first half of 2019, average wages increased by 9.9 percent in nominal terms (in real terms 7.2 percent). The private/public sector wage gap has narrowed, with private sector wages growing by 10.7 percent compared to 9.5 percent in the public sector. Thanks to these trends, combined with higher pensions, poverty (living on income under $5.5/day in 2011 PPP terms, the standardized middle-income-country poverty line) is estimated to have declined from 23.8 percent in 2014 to 19.8 percent in 2019.

The consolidated general government budget showed a surplus of 0.3 percent of GDP in the first half of 2019. Revenues increased by 7.6 percent in nominal terms, compared to the same period of 2018. This increase was led by VAT revenues, up by 8.9 percent in nominal terms thanks to higher collection from growing imports, and social security contributions, up by 8.1 percent, as the government withdraws fiscal adjustment measures and formal employment increases. Budgetary spending rose by 9.6 percent in nominal terms, corresponding to 1.7 percent of annual GDP, driven by social transfers (up by 6.6 percent), capital investments (up by 30.7 percent) and the wage bill (up by 8.3 percent).

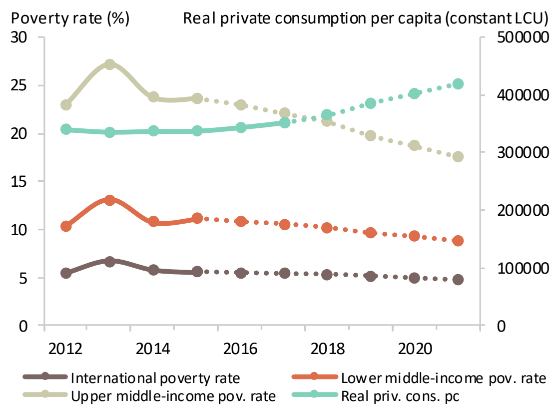
Inflation is on a declining path, after reaching a peak in April of 3.1 percent (y/y). Increasing food prices was the main driver of inflation in the first half of the year. Food prices index reached a peak in April of 6.1 percent (y/y), constraining households' purchasing power. With inflationary pressures low and a stab le inflation outlook, and in order to support growth, the NBS lowered its policy rate to 2.75 percent in July and to 2.5 percent

FIGURE 1 Serbia / Value added



Source: Statistics Office.

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



Source: World Bank. Notes: see table 2.

in August, the lowest level since the introduction of the targeted inflation policy. In 2019, the dinar continued to appreciate against the euro, by 0.4 percent in nominal terms.

External imbalances widened as evidenced by an increase in the CAD by 51 percent in the first half of the year, and now projected at 6.7 percent of GDP for 2019. FDI inflows remain strong – up 28 percent in the first half of the year. Total external debt reached EUR 27.1 billion in the first quarter, but continued to decline as a share of GDP, to 62.5 percent at end-March 2019. Public debt declined to 54 percent of GDP by end-June 2019.

Credit continues strong in 2019. Overall credit grew by 6.9 percent (y/y) through July, primarily because of the increase of loans to enterprises (up 10.3 percent, y/y). Loans to private businesses, SOEs and households were up by 8.4 percent, 32.8 percent and 9 percent respectively. A high proportion of household loans continue to be short-term "cash" loans to individuals. Gross nonperforming loans (NPLs) declined considerably, to reach 5.2 percent in June 2019.

Outlook

The economy is expected to continue to grow at around 3-4 percent over the medium-term. The ongoing political divisions in the society will likely to increase with the upcoming elections in the spring 2020. Investment and consumption will be the main drivers of growth. Consumption will increase as wages and employment are expected to continue to grow. The rising consumption will continue to push up imports, widening the CAD.

The medium-term growth projections crucially depend on the pace of structural reforms and political developments. Most importantly, Serbia needs to work further on removing bottlenecks to growth (among others, inefficiencies in SOEs, constraints to both foreign and domestic investment, the regulatory framework for the financial sector, taxation and trade facilitation). Acceleration of the EU accession process is important not only from the point of view of strengthening institutions but also as a signaling device to attract investment. Finally, short- to medium-term growth prospects may be affected by lead times for the election campaign and formation of the government.

With economic growth and improvements in the labor market, poverty is expected to continue its gradual decline. Poverty, measured as income below the standardized $5.5/day 2011 PPP line is estimated to fall to around 18.7 percent by 2020.

Risks and challenges

Risks are associated with the pace of reforms (particularly in the public sector), progress on EU accession, and internal political developments. Regional disputes, and relatively slow progress with the EU accession process affect investment sentiment and therefore delays realization of investment projects in infrastructure and other sectors. Despite recent labor market improvements, participation rates remain low and limit the scope for robust welfare improvements.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	3.3	2.0	4.3	3.3	3.9	4.0
Private Consumption	1.3	1.9	3.3	5.3	4.6	3.8
Government Consumption	1.3	3.3	3.6	3.8	0.6	1.5
Gross Fixed Capital Investment	5.4	7.3	9.2	7.9	15.9	5.9
Exports, Goods and Services	11.9	8.2	8.9	4.0	3.8	8.7
Imports, Goods and Services	6.7	11.1	11.1	8.3	7.2	7.3
Real GDP growth, at constant factor prices	3.7	2.1	4.3	3.3	3.9	4.0
Agriculture	8.3	-11.2	15.6	3.8	3.0	3.0
Industry	4.1	3.3	2.8	4.6	3.5	3.5
Services	2.9	3.2	3.8	2.6	4.2	4.4
Inflation (Consumer Price Index)	1.1	3.1	2.0	2.2	1.9	2.5
Current Account Balance (% of GDP)	-3.3	-6.3	-5.2	-6.7	-7.9	-7.7
Net Foreign Direct Investment (% of GDP)	3.5	4.4	3.9	6.2	6.0	5.7
Fiscal Balance (% of GDP)	-1.2	1.1	0.6	-0.4	-0.5	-0.5
Debt (% of GDP)	68.9	58.7	55.7	52.1	49.4	46.5
Primary Balance (% of GDP)	1.7	3.6	2.7	1.2	1.0	1.1
International poverty rate ($1.9 in 2011 PPP)[a,b]	5.5	5.4	5.3	5.1	4.9	4.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	10.8	10.6	10.2	9.6	9.3	8.8
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	23.0	22.1	21.2	19.8	18.7	17.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on private consumption per capita in constant LCU.

TAJIKISTAN

Table 1	2018
Population, million	9.1
GDP, current US$ billion	7.5
GDP per capita, current US$	826
International poverty rate ($1.9)[a]	4.8
Lower middle-income poverty rate ($3.2)[a]	20.3
Upper middle-income poverty rate ($5.5)[a]	54.2
Gini index[a]	34.0
School enrollment, primary (% gross)[b]	98.8
Life expectancy at birth, years[b]	71.2

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2017)

Tajikistan's economy continued registering strong across-the-board growth during the first half of 2019. The poverty rate, based on the national poverty line, fell from 29.5 percent in 2017 to 27.4 percent in 2018, reflecting a recovery in remittance inflows and rising wages. Growth is expected to soften in the medium-term reflecting the projected fall in metal prices and the slowdown of the Russian economy. While public investments will continue to remain high, the slow pace of reform pose downside risks.

Recent developments

Real GDP growth remained buoyant at 7.5 percent in the first half of 2019, compared to 7.3 percent in 2018, supported by robust expansion in industry (12.5 percent), agriculture (11 percent), and services (9 percent). On the demand side, growth was driven by net exports and public investment. Private consumption was muted on account of stagnant remittance inflows during the first half of the year.

The current account deficit remained steady at 5 percent of GDP in January-July. Public purchases of construction materials from abroad for large infrastructure projects boosted import spending on machinery and construction materials. At the same time, surging export earnings from precious metals and increased electricity exports helped to narrow the trade deficit to 30 percent of GDP in the first half of 2019 (from 32 percent of GDP in the same period of 2018). Tajikistan's export basket is small and concentrated in metallic minerals, raising its vulnerability to fluctuations in international commodity prices. Chinese investment in the mining sector helped lift foreign direct investment (FDI) from 0.9 percent of GDP in 2017 to 2.6 percent in 2018.

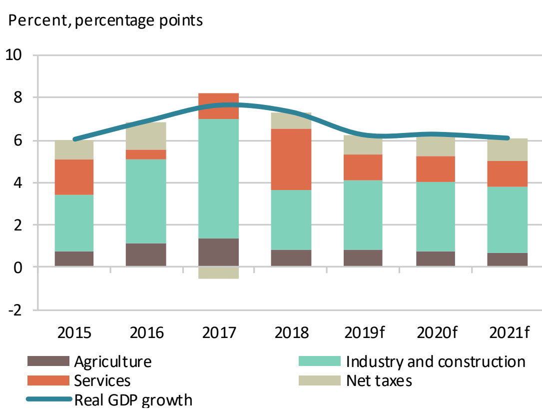
The Tajik authorities reduced the budget deficit to 2.8 percent of GDP in 2018, reflecting fiscal consolidation efforts. Preliminary data for the first seven months of 2019 suggest that the authorities broadly adhered to the consolidation path by containing the fiscal deficit to around 3 percent of GDP. However, while safeguarding investments in the energy sector, the authorities have delayed important decisions on social spending, namely the long-awaited rollout of the Targeted Social Assistance (TSA) program and the 10 percent increase of the TSA budget. Investments in the Rogun Hydropower Plant (HPP) continue to account for the largest share of public investment in 2019; the authorities launched the second of six turbines in September.

After subsiding to 5.4 percent in 2018, reflecting one-off effects from the introduction of low-price Uzbek imports, consumer price inflation surged to 8.7 percent in the first half of 2019, mostly driven by food price increases in April-May. Full-year inflation is expected to exceed the central bank's target band of 5-9 percent; this will also reflect the pass-through effect of the 2.7 percent depreciation of the somoni in August and the 15 percent electricity tariff increase in September.

With the intention to leveraging the large inflows of foreign exchange received through private transfers, the National Bank of Tajikistan (NBT) plans to launch a Centralized Remittance Platform (CRP). However, there are concerns that this platform may divert some remittances from official to unofficial channels and end up on the "black" market for foreign exchange.

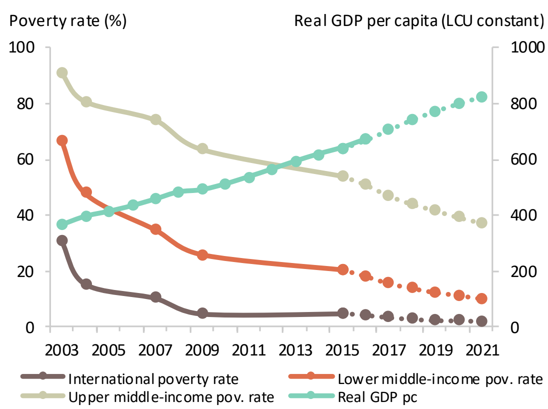
Except for two problem banks, the financial sector has continued its recovery from the 2016 banking crisis, demonstrating an improvement in the quality of the credit portfolio. The share of non-performing loans declined to 27 percent in June (from 30 percent in 2018), while the capital adequacy ratio rose to 23 percent (from 22 percent in December 2018 and 17 percent in 2016). In addition, the profitability of the banking sector

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



Sources: TajStat; World Bank staff estimates.

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



Source: World Bank. Notes: see table 2.

has continued to improve, and the level of dollarization has declined. The NBT has successfully advanced reforms of banking supervision and the deposit insurance scheme.

The pace of poverty reduction has accelerated since the second half of 2017. The poverty rate, using the country's official poverty line, fell to 27.4 percent in 2018, reflecting a recovery in remittance inflows. Rural poverty fell markedly, from 36.1 percent in 2014 to 33.2 percent in 2017, and further to 30.2 percent in 2018, reflecting rising household consumption. Urban poverty also declined, though to a lesser extent, falling from 24 percent in 2015–16 to 21.5 percent in 2017–18. Extreme poverty fell steadily from 18 percent in 2013 to 12 percent in 2018.

Outlook

Tajikistan's medium-term growth outlook is expected to moderate reflecting the projected slowdown in China and the Russian Federation, and volatility in international prices for major export commodities (aluminum, gold, and cotton). GDP growth is likely to be supported by large public investment in the run-up to Tajikistan's commemoration in 2021 of 30 years of independence. In addition, the expected deepening of regional cooperation, connectivity, and trade should also help to sustain high rates of GDP growth. Remittances are expected to support private consumption despite the current uncertainties surrounding the CRP. Fiscal pressures are expected to remain high; however, the country's high risk of debt distress suggests that it will likely adhere to fiscal consolidation throughout the medium term to restore macroeconomic stability. The long-awaited resolution of problem banks, once completed, would help lead to a gradual pickup in private credit and investment. The central bank's declared move to an inflation-targeting regime would help strengthen the monetary policy framework and macroeconomic stability.

The current account is expected to remain in deficit at around 4 percent of GDP owing to continued strong demand for capital-intensive imports for the construction of large public investment projects. FDI inflows are forecast to remain modest, mirroring the significant shortcomings of Tajikistan's business environment.

Risks and challenges

Domestic and external risk factors weigh on Tajikistan's economic growth prospects. Governance challenges in public enterprises—including in key sectors of the economy—present high quasi-fiscal risks and threaten the sustainability of public finances. Delays in implementing much-needed structural reforms to improve the business environment will continue to hinder private sector development. Tajikistan's limited fiscal space and weak policy buffers expose its economy to potential shocks. An escalation of global trade tensions, or economic slowdown in the region's large economies, would negatively impact inflows of FDI and remittances.

The construction of the Rogun HPP financed from budget proceeds could present a serious risk to fiscal sustainability and crowd out social spending. However, there are indications that the authorities consider financing from private sources and improve fiscal management by initiating tax reforms and strengthening power utilities and the financial sector.

A potential three-year program with the IMF, if successfully negotiated, would suggest an upside risk to the outlook.

Extreme poverty is likely to decline further if the TSA program is expanded to compensate for the utility tariff increases.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	6.9	7.6	7.3	6.2	5.5	5.0
Private Consumption	6.4	0.0	7.2	6.6	5.3	4.8
Government Consumption	3.9	2.5	3.8	3.7	3.9	3.9
Gross Fixed Capital Investment	20.3	20.3	8.9	10.8	11.2	11.5
Exports, Goods and Services	0.0	0.0	2.2	2.7	2.7	3.2
Imports, Goods and Services	0.0	0.0	3.5	3.7	4.2	4.0
Real GDP growth, at constant factor prices	6.8	9.8	7.6	6.2	5.5	5.0
Agriculture	5.2	6.8	4.0	3.3	2.9	2.7
Industry	16.2	20.5	10.4	8.7	8.0	7.7
Services	1.1	2.9	7.0	5.4	4.5	3.6
Inflation (Consumer Price Index)	6.0	7.3	3.9	8.0	6.8	6.0
Current Account Balance (% of GDP)	-5.2	2.1	-5.3	-5.0	-4.1	-4.0
Net Foreign Direct Investment (% of GDP)	3.4	-0.2	3.4	2.3	2.3	2.3
Fiscal Balance (% of GDP)	-9.0	-6.0	-2.8	-2.8	-2.5	-2.1
Debt (% of GDP)	42.0	50.3	47.9	45.9	43.3	41.8
Primary Balance (% of GDP)	-8.3	-5.5	-1.6	-1.8	-1.7	-1.2
International poverty rate ($1.9 in 2011 PPP)[a,b]	4.2	3.4	2.8	2.3	2.3	2.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	18.0	15.5	13.9	12.4	11.4	10.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	51.0	47.1	44.0	41.7	39.2	37.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-HSITAFIEN. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2015) with pass-through = 1 based on GDP per capita in constant LCU.

TURKEY

Table 1	2018
Population, million	81.4
GDP, current US$ billion	773.7
GDP per capita, current US$	9505
Upper middle-income poverty rate ($5.5)[a]	9.9
Gini index[a]	41.9
Life expectancy at birth, years[b]	76.0

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2017)

The Turkish economy is gradually adjusting from the external shock of August 2018. Economic recovery and deleveraging have progressed steadily in 2019 despite market instability late in the first quarter and early in the third quarter. Inflation is easing from elevated levels and unemployment is high, putting upward pressure on poverty rates. GDP is projected to record zero percent growth in 2019 before a gradual medium-term recovery. Restoring investor confidence through the implementation of a robust economic program will be essential for a sustained recovery.

Recent developments

After ending 2018 with two successive quarters of seasonally-adjusted negative growth, the economy grew in both the first and second quarter of 2019. Credit growth and fiscal stimulus in the first quarter spurred an expansion of private and public consumption growth. Investment, on the other hand, contracted for the fourth consecutive quarter. Although GDP expanded by 0.8 percent in the first half of 2019 compared to the second half of 2018, on a year-on-year basis growth remained negative—GDP contracted by 2 percent year on year in the first half of 2019.

The current account deficit has narrowed steadily; in June, the current account recorded a surplus on a 12-month rolling basis for the first time since 2002. In real terms, exports rose by 8.6 percent year on year in the first half, while real imports fell by 23 percent.

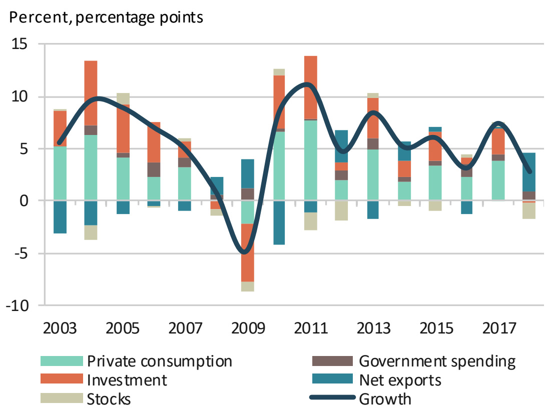
The government pursued an expansionary fiscal policy in the first half of 2019, resulting in a 50 percent year-on-year widening of the fiscal deficit in nominal terms. The main drivers of the wider deficit were an acceleration in public transfers and weaker revenue mobilization linked to declining economic activity. Central government net borrowing more than doubled, with a notable increase in external borrowing.

The financial sector continued to deleverage in the first half of 2019. External loan liabilities of banks fell by 10 percent year on year through July; the stock of foreign currency loans to the corporate sector fell by a similar amount. Domestic credit has remained flat as the banking sector focuses on improving its balance sheet and borrowing costs remain elevated. While the official non-performing loan (NPL) ratio remains low (4.5 percent in 2019 Q2), corporate leverage and economic slowdown have raised concerns over asset quality.

Twelve-month inflation has declined from a peak of 25 percent in late 2018 to an average of 18.2 percent in the first eight months of 2019, reflecting the improved stability of the Turkish lira. However, monthly inflation remains high, averaging 1 percent. Additionally, policy rates have fallen sharply (by 750 basis points so far in 2019), and recent consumption tax hikes may slow downward pressure on inflation.

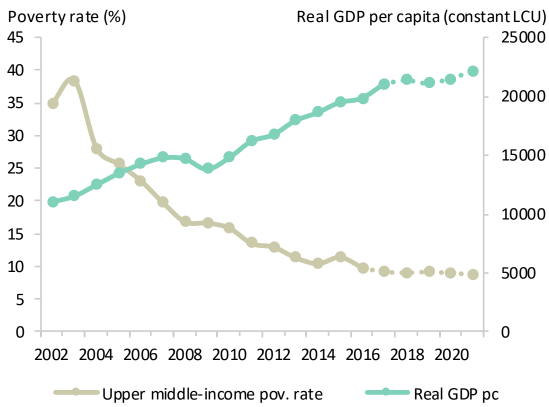
The slowdown in the economy has driven a spike in unemployment. Turkey's economy lost around 770,000 jobs in the 12 months between June 2018 and June 2019. The seasonally-adjusted unemployment rate increased from 10.9 percent to 13.9 percent during this period, leaving 4.5 million people unemployed (up from 3.5 million a year earlier); the non-agricultural unemployment rate rose to 16.2 percent from 12.9 percent. The highest job losses were in the agriculture and construction sectors, where low-income households comprise most of the workforce. Similarly, youth unemployment rose sharply to 25.8 percent from 20.2 percent a year earlier. Moreover, real wages dropped for all income groups. These trends are putting upward pressure on the incidence of poverty, which

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.

has remained steady at around 9 percent for the last three years.

Outlook

Leading indicators suggest that the economy continued its recovery in the third quarter. Manufacturing capacity utilization is nearing long-term averages, retail sales are on a moderately increasing trend, and real sector indicators (confidence, purchasing managers index) have recovered to their levels from a year ago. The economy is projected to record zero percent growth in 2019 before rebounding to 3 percent and 4 percent in 2020 and 2021, respectively.

Nominal credit growth is projected to accelerate—however, given asset quality concerns and debt overhang, economic recovery is unlikely to be fueled by rapid credit expansion. Turkey is expected to record a moderate current account deficit in 2019 as import demand begins to recover in the second half of the year. The general government fiscal deficit is expected to peak in 2019 with high countercyclical expenditure.

Poverty is expected to increase in 2019. The total number of poor is forecast to rise from 7.35 million people in 2018 to 7.53 million in 2020. Although the government increased the minimum wage by 26 percent in January 2019, unemployed and informal workers will remain particularly exposed to falling into poverty. Stronger social safety nets may be required in the medium term to protect vulnerable households from recent income and price shocks.

Risks and challenges

The outlook for the global economy and financial markets is uncertain. Further volatility in and bearish sentiment on emerging markets is likely to hit Turkey particularly hard, given its high external financing requirement and uncertain outlook. Geopolitical developments also pose a risk to Turkey, most notably the potential imposition of sanctions by the United States.

Addressing high levels of unemployment is central to Turkey's push for poverty reduction. Unemployment continues to climb in sectors where low-income households are employed, resulting in income loss and rising vulnerability. Inflation, which remains high despite a slight decrease in prices pressures, disproportionately impacts low-income households. The continuation of adverse trends in the medium term would increase poverty and put some of the poverty reduction gains of the last decade at risk.

External buffers have eroded over the last year; rebuilding them would afford greater confidence in Turkey's capacity to absorb future shocks. Gross international reserves have recovered to $100 billion, but this is still below the prudential level recommended by the IMF; reserves net of short-term drains (both pre-determined and contingent) have fallen sharply from $50 billion in January to $30 billion in July.

Turkish banks have remained resilient since the lira depreciation of August 2018. Banks have adequate liquid foreign exchange to cover their short-term liabilities. Banks are well-capitalized, and the capital adequacy ratio is above 17 percent. However, the banking sector remains exposed to deteriorating asset quality and the risk of further currency fluctuations. The regulator has asked lenders to reclassify $8.1 billion in bad loans by the end of 2019, which would raise the NPL ratio to an estimated 6.3 percent. A significant share of loans (12 percent) is under close monitoring. The Turkish banking system's profitability will also suffer from reduced business volumes and higher funding and hedging costs.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	3.2	7.5	2.8	0.0	3.0	4.0
Private Consumption	3.7	6.2	0.0	1.0	2.2	3.3
Government Consumption	9.5	5.0	6.6	3.0	2.6	1.8
Gross Fixed Capital Investment	2.2	8.2	-0.6	-11.5	6.5	9.5
Exports, Goods and Services	-1.9	12.0	7.8	7.2	4.0	4.5
Imports, Goods and Services	3.7	10.3	-7.8	-9.1	6.5	9.0
Real GDP growth, at constant factor prices	3.1	7.9	3.1	0.0	3.0	4.0
Agriculture	-2.6	4.9	1.9	2.3	2.0	2.0
Industry	4.6	9.2	0.4	-3.0	3.5	4.0
Services	3.2	7.6	4.6	1.2	2.9	4.2
Inflation (Consumer Price Index, on average)	7.8	11.1	16.3	16.5	11.0	9.0
Current Account Balance (% of GDP)	-3.8	-5.6	-3.5	-0.8	-3.1	-3.8
Net Foreign Direct Investment (% of GDP)	1.3	1.0	1.2	0.9	1.1	1.1
Fiscal Balance (% of GDP)	-1.4	-1.8	-2.4	-2.9	-2.1	-1.7
Debt (% of GDP)	28.3	28.2	30.2	32.1	32.5	32.4
Primary Balance (% of GDP)	0.6	0.1	-0.2	0.6	0.4	0.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	9.9	9.2	9.0	9.1	9.0	8.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2011-HICES, 2017-, and 2016-HICES. Actual data: 2016. Nowcast: 2017-2018. Forecast are from 2019 to 2021.
(b) Projection using point-to-point elasticity (2011-2017) with pass-through = 1 based on GDP per capita in constant LCU.

TURKMENISTAN

Table 1	2018
Population, million[a]	5.8
GDP, current US$ billion	40.8
GDP per capita, current US$[a]	7065
School enrollment, primary (% gross)[b]	88.4
Life expectancy at birth, years[c]	67.8

Source: IMF, WDI, Macro Poverty Outlook, and official data.
Notes:
(a) estimations.
(b) Most recent WDI value (2014).
(c) Most recent WDI value (2016).

Growth weakened, inflation accelerated, and pressures on the national currency increased in 2018, reflecting the adjustment of the Turkmen economy to declining hydrocarbon revenues in 2016-17. A reduction of public investment helped to improve the fiscal and external balances in 2018. The public sector-driven and hydrocarbon-dominated economic structure assumes a recovery in public investment and an expansion of gas exports to sustain growth. The slow pace of reforms presents a downside risk; cuts in budget subsidies may negatively affect welfare.

Recent developments

The availability and quality of statistical data are major concerns in Turkmenistan; the following analysis should be viewed with that caution.

Real GDP growth weakened slightly in 2018, slowing to 6.2 percent from 6.5 percent in 2017, reflecting a decline in the non-hydrocarbon economy. Net exports positively contributed to economic growth, but this was more than offset by weakened domestic demand, reflecting a decline of public investment (to 22 percent of GDP in 2018 from an average of 30 percent in 2014-17). Following the government's decision to discontinue the free provision of water, natural gas, electricity, and salt, the authorities eliminated budget subsidies for utilities, which also negatively impacted domestic demand.

Average annual inflation rose sharply in 2018, to 13.2 percent (up from 8 percent in 2017). In addition to eliminating budget subsidies, the authorities adjusted utility tariffs (gasoline prices rose by 50 percent) and increased public salaries, pensions, and other social transfers by 10 percent. Reduced consumer imports, owing to currency shortages, also stoked price pressures. However, greater administrative price controls and state procurement and imports of basic consumer staples—which boosted food supply—helped to contain food price inflation during the second half of the year.

The government's fiscal consolidation efforts nearly resulted in a balanced budget in 2018 (compared with a deficit of 2.8 percent of GDP in 2017). Revenue was bolstered by higher hydrocarbon proceeds, while public spending was reduced by 17.6 percent on account of sharp cuts to public investment and subsidies. External borrowing to finance large investment projects is estimated to have increased the public external debt to 25.4 percent of GDP in 2018 (from 21.8 percent of GDP in 2015).

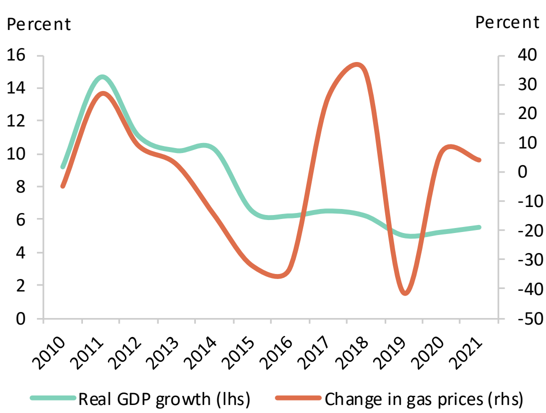
Turkmenistan's external position reversed in 2018; the current account recorded a surplus of 5.7 percent of GDP from a deficit of 10.3 percent of GDP in 2017. Higher prices and export volumes of natural gas were the main drivers of this reversal. Meanwhile, continued import substitution efforts combined with lower demand for imported construction materials resulted in 47.8 percent reduction in imports. However, once tight foreign exchange controls are eased, and the deficit of foreign exchange is eliminated, the external position may again revert. The official exchange rate of the Turkmen manat to the U.S. dollar is still set at 3.5 manat/US$, despite significant pressures.

Foreign investment continued to decline in 2018 owing to challenges in the foreign exchange market, the dominance of inefficient state-owned enterprises (SOEs), and a challenging business environment.

The authorities continued their directed lending and easy credit policies in 2018, although credit growth slowed slightly. The loan portfolio continues to be allocated mostly to SOEs at concessional financing terms by the central bank.

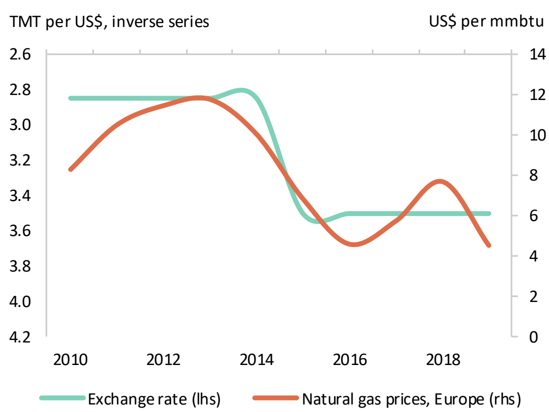
Turkmenistan does not release official statistics on living standards, and little is known about the country's labor market or the prevalence of poverty. Nonetheless, the gradual reduction of welfare subsidies—

FIGURE 1 Turkmenistan / Real GDP growth and natural gas prices



Source: State Committee of Statistics of Turkmenistan.

FIGURE 2 Turkmenistan / Exchange rate and natural gas prices



Source: Central Bank of Turkmenistan.

which the population has enjoyed since shortly after independence—is expected to have negatively affected living standards. International migration drives substantial poverty reduction in neighboring economies but is restricted from Turkmenistan, and remittance flows remain much lower than elsewhere in Central Asia.

Outlook

Turkmenistan's weak economic outlook reflects the projected fall in the natural gas price and softening global demand for energy resources. The global economy, including China and Russia, is expected to slow down in 2019-20. Although in July 2019 Turkmenistan and the Russian Federation signed a 5-year contract for resuming natural gas supply, the agreed volumes will be significantly lower than used to be the case until three years ago. Policies aimed at fostering private sector development and economic diversification should be prioritized to promote non-hydrocarbon sectors and contribute to inclusive growth.

Inflationary and exchange rate pressures are expected to remain as hydrocarbon earnings decline. The authorities are likely to adhere to the exchange rate peg. Considerations to adjust the national currency will largely depend on the evolution of public sector foreign liabilities.

Turkmenistan's external position is expected to deteriorate in 2019-20 but then benefit from the expected expansion of natural gas exports. Also, the industrial output is expected to respond to the government's export promotion and import-substitution policies. However, ongoing challenges associated with expatriating profits will discourage strong FDI inflows.

The government will seek fiscal consolidation in the medium term to rebuild depleted policy buffers. However, the expansion of public investment in strategic infrastructure using off-budgetary funds cannot be ruled out.

Although ending free access to water, gas, and electricity may result in a deterioration in living standards for the poor, such measures underscore the government's commitment to improving the finances of Turkmenistan's utilities and reducing state budget liabilities. The agriculture sector—which employs most of the labor force—is expected to benefit from increased government procurement prices for wheat and cotton, which were raised by 100 percent and 50 percent, respectively, in January 2019.

Risks and challenges

External and domestic risks to the economy will remain elevated. A decline in hydrocarbons prices would significantly reduce economic growth prospects. Other external risks include the escalation of trade tensions or the tightening of global liquidity, which could result in a sudden deceleration in economic growth in Turkmenistan's trade partners.

Domestically, risks include slow progress on the implementation of policies that support economic diversification and private sector development. Liberalizing business regulations and easing foreign exchange controls will be necessary to improve investor confidence. Long-term socio-economic sustainability will require a shift toward investment in human capital. Turkmenistan's restrictions on internal mobility are the strictest in Central Asia, resulting in the exclusion of rural residents from more diverse urban labor markets and the relative prosperity of higher-income areas, in particular the capital, Ashgabat.

Utility tariff increases will impact the welfare of households over the medium term. Therefore, the social consequences of the reform should be considered, and a distributional analysis performed, together with mitigating measures to protect vulnerable households through a well-targeted social protection mechanism. Although Turkmenistan has a social protection system in place, a performance assessment is needed to evaluate the targeting accuracy, and implications on the Sustainable Development Goals.

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

	2016	2017	2018	2019 e	2020f	2021 f
Real GDP growth, at constant market prices	6.2	6.5	6.2	5.0	5.2	5.5
Inflation (consumer price index, period average)	3.6	8.0	13.2	13.4	13.0	8.0
Current account balance (% of GDP)	-20.2	-10.3	5.7	-2.0	-2.3	-4.0
Financial and capital account (% of GDP)	5.9	6.1	3.6	4.2	4.5	4.5
of which: net foreign direct investment (% of GDP)	5.4	4.0	3.7	3.0	2.9	2.6
Fiscal balance (% of GDP)	-2.4	-2.8	-0.2	-2.2	-1.5	-0.8
Total Public debt (% of GDP)	24.1	28.8	29.1	30.4	29.5	29.9

Source: National authorities, International Monetary Fund and World Bank
Notes: e = estimate, f = forecast.

UKRAINE

Table 1	2018
Population, million	44.5
GDP, current US$ billion	124.6
GDP per capita, current US$	2799
International poverty rate ($1.9)[a]	0.1
Lower middle-income poverty rate ($3.2)[a]	0.5
Upper middle-income poverty rate ($5.5)[a]	6.4
Gini index[a]	25.0
Life expectancy at birth, years[b]	71.8

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2017).

GDP growth was solid at 3.5 percent in 1H2019 due to a good harvest and growth in consumption supported by remittances, consumer lending, and social transfers during the elections. At the same time, investment remained weak due to structural bottlenecks and high interest rates. Ukraine faces macroeconomic vulnerabilities from current expenditure pressures and formidable financing needs to repay public debt in 2019-2021. The growth outlook depends on delivering on the ambitious reform agenda of the new government and mobilizing adequate financing.

Recent developments

In 1H2019 GDP grew by 3.5 percent (compared to 3.3 percent in 2018). The solid growth was driven by a strong agricultural harvest, and sectors dependent on domestic demand—including services (domestic trade, transport, and the financial sector) and construction. Household consumption continued to grow rapidly in 1H2019, supported by (i) one-off social transfers during the election cycle; (ii) continued strong remittances from labor migration to EU countries; and (iii) a resumption of consumer lending. At the same time, manufacturing and investment growth remained weak, with the level of fixed investment (only 20 percent of GDP) insufficient for sustainable growth. Investment was limited by (i) low FDI of just 0.6 percent of FY GDP in 1H2019, (ii) high interest rates and structural weaknesses in the financial sector (little progress has been made in resolving non-performing loans so far) and (iii) market distortions from the absence of an agricultural land market, an anticompetitive environment, and large number of SOEs.

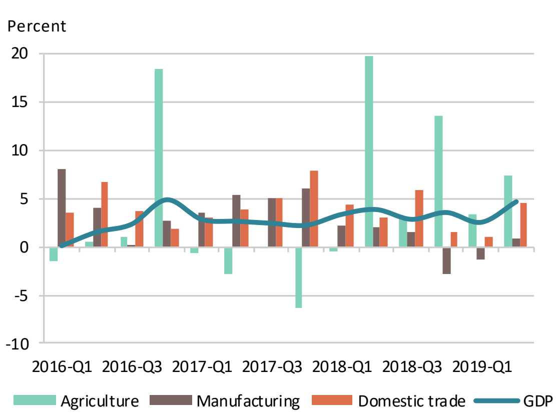
Higher consumption helped reduce poverty. Real wages continued to grow in 2019 due to economic growth and continued outward labor migration. As a result, poverty (consumption per capita below 5.5 USD/day in 2011 PPP) declined to 3.5 percent in 2018 from 4.9 percent in 2017 and 6.4 percent in 2016.

Strong domestic demand, together with real exchange rate appreciation (by 13.2 percent in 2018), contributed to a pick-up in imports and a widening of the current account deficit to 3.3 percent of GDP in 2018 (vs 1.9 percent in 2017). Remittances reached 9 percent of GDP in 2018. In 1H2019, Ukraine's terms of trade improved due to higher iron ore and wheat prices, with exports growing 6 percent YoY. Imports, however, continued to grow faster at 8.6 percent YoY, driven by intermediate goods. The merchandise trade deficit grew by 13 percent YoY in 1H2019, but growth in the surplus of services trade and primary incomes (mostly remittances) brought the current account deficit down to just $0.2bn, one third of that in 1H2018.

Tight monetary policy, together with official borrowings helped stabilize the exchange rate and boost international reserves to US$20.8 billion at end-2018 (equivalent of 3.5 months of imports). Inflationary pressures have declined in 2019, with the CPI stabilizing at 9 percent, the National bank reduced the policy rate to 16.5 percent by September 2019. As election related uncertainties have subsided, foreign portfolio flows into local currency government bonds have increased markedly by US$3 billion, attracted by high rates. As a result, Ukraine's international reserves grew to US$21.8 billion in August 2019, while the exchange rate has appreciated to UAH25/$1 (vs UAH27.4/$1 average in 2018).

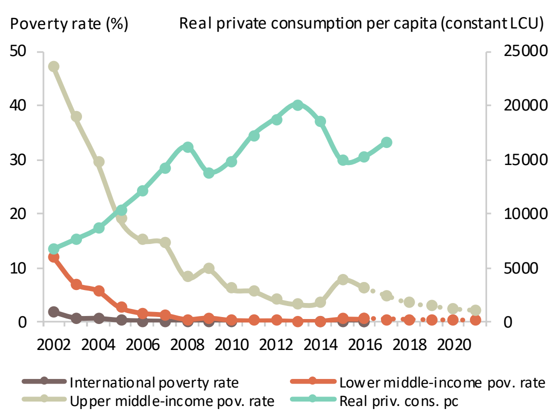
The fiscal deficit was contained at 2.1 percent of GDP in 2018 (compared to 2.3 percent in 2017), with the primary balance at 1.2 percent, which helped reduce PPG debt to 63 percent of GDP in 2018. At the

FIGURE 1 Ukraine / GDP growth by sectors



Source: UKRSTAT.

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



Source: World Bank. Notes: see table 2.

same time, the public wage bill grew to 11 percent of GDP in 2018 (vs. 9 percent in 2016) due to a significant hike in minimum wages and additional sectoral top-ups, while social assistance spending remained high at 4 percent of GDP. In 2019, pressures on the wage bill are easing due to a more prudent increase in the minimum wage, while improved targeting of the housing utility subsidy (HUS) is helping to reduce expenditures on social programs to 3.5 percent of GDP. Revenue performance in 1H2019 was affected by the shortfall of VAT on imported goods and other external trade related proceeds due to appreciation of the hryvnia, although this was offset by overperformance of other revenue sources due to higher than expected GDP growth.

Outlook

The growth outlook going forward depends critically on accelerating the reform momentum address the bottlenecks to investment and productivity. Given the strong performance in 1H2019, growth is projected to stay at 3.3 percent in 2019. Going forward, if the new government is able to deliver on its ambitious reform goals, growth can increase to 4 percent by 2021. This will require progress in the following areas: (i) reviving sound bank lending to the enterprise sector by completing the reform of state-owned banks; (ii) attracting private investment into tradable sectors by establishing a transparent market for agricultural land, demonopolizing key sectors and strengthening antimonopoly policy and enforcement, privatizing state-owned enterprises, and tackling corruption; and (iii) safeguarding macroeconomic stability by addressing current expenditure pressures, securing adequate financing, further reducing inflation, and rebuilding international reserves. If reforms do not progress and adequate financing is not mobilized, growth could fall below 2 percent as investor confidence deteriorates, macroeconomic vulnerabilities intensity, and financing difficulties force a compression in domestic demand.

Ukraine will need to safeguard macroeconomic stability and manage fiscal risks. The key to safeguarding fiscal sustainability going forward is to address current expenditure pressures and keep the fiscal deficit below 2.5 percent GDP to ensure the sustainable debt reduction. This will require (i) avoiding any additional hikes in wages in education and health that are not linked to productivity growth in these sectors, (ii) resisting populist pressures to tinker with the newly established pension indexation, (iii) further targeting social assistance programs.

If the necessary reforms are undertaken, the poverty rate is expected to decline further in the medium term. As public spending is constrained, labor income will become the most important driver of income growth for the bottom 40 percent. Some rebound in the real sector, including wage growth in the private sector will support disposable incomes and help the poverty rate to gradually decline.

Risks and challenges

Ukraine faces formidable financing needs in the next three years, which will require mobilizing sizable international financing. Ukraine needs about $11 billion per year (8 percent of GDP per year) to repay public debt and finance the fiscal deficit in 2019, 2020, and 2021. To raise the necessary financing, it is critical to maintain the reform momentum and fiscal discipline, while continuing cooperation with development partners.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	2.4	2.5	3.3	3.4	3.7	4.2
Private Consumption	1.8	8.4	8.9	6.7	4.5	4.0
Government Consumption	0.0	3.3	0.1	-0.5	0.1	0.1
Gross Fixed Capital Investment	20.1	18.4	14.3	10.5	11.3	12.1
Exports, Goods and Services	-1.6	3.6	-1.6	-1.0	2.2	2.6
Imports, Goods and Services	8.4	12.8	3.2	7.2	6.0	5.0
Real GDP growth, at constant factor prices	2.4	2.6	3.3	3.4	3.6	4.3
Agriculture	6.0	-2.5	7.8	3.0	3.5	4.5
Industry	3.3	2.1	2.0	2.0	3.0	4.0
Services	1.4	3.7	3.0	3.9	3.8	4.4
Inflation (Consumer Price Index)	13.9	13.7	9.5	6.8	6.0	5.4
Current Account Balance (% of GDP)	-3.7	-2.1	-3.2	-3.5	-3.8	-4.3
Net Foreign Direct Investment (% of GDP)	0.2	2.1	1.9	2.2	2.2	2.3
Fiscal Balance (% of GDP)	-2.3	-2.3	-2.0	-2.2	-2.1	-1.9
Debt (% of GDP)	80.9	71.9	60.9	53.0	54.6	55.3
Primary Balance (% of GDP)	2.0	1.5	1.9	2.2	2.0	2.7
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.1	..	..	..	..	..
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.5	0.4	0.3	0.2	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	6.4	4.9	3.5	2.9	2.3	2.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2016-HLCS. Actual data: 2016. Nowcast: 2017-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2016) with pass-through = 0.87 based on private consumption per capita in constant LCU.

UZBEKISTAN

Table 1	2018
Population, million	32.3
GDP, current US$ billion	49.8
GDP per capita, current US$	1540
School enrollment, primary (% gross)[a]	103.1
Life expectancy at birth, years[a]	71.4

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2017).

Economic growth accelerated in the first half of 2019 due to increased investment in infrastructure and industry. Despite projected weaker conditions in its main trading partners, Uzbekistan's medium-term economic outlook remains favorable as broad-based reforms continue to improve the environment for new and high-potential growth sectors. Steady economic growth and buoyant remittance inflows are expected to contribute to a modest reduction in the poverty rate.

Recent developments

In the first half of 2019, real GDP growth increased to 5.8 percent (from 4.9 percent in the year-earlier period) supported by a surge in investment growth financed by substantial increases in directed lending to state-owned enterprises (SOEs). Industry, agriculture, and services all experienced faster growth in the first half of 2019 compared with a year earlier.

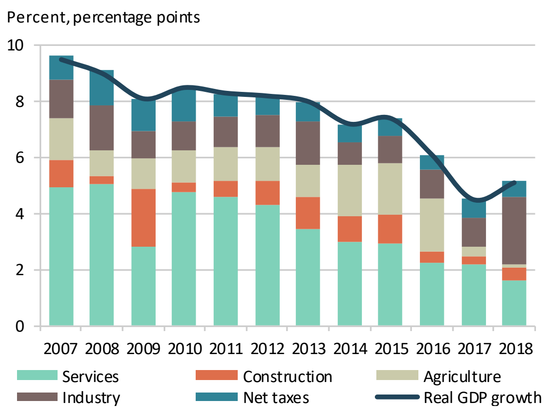
Annual consumer price inflation eased to 13.6 percent in June 2019 (from 17.7 percent in June 2018) reflecting a slowdown in the growth of both food and non-food prices. Slower inflation and stronger remittance inflows (up 13 percent year on year) supported an expansion of private consumption in the first half of 2019.

The current account deficit, which fell to an estimated 6.6 percent of GDP in the first half of 2019 (from 8.4 percent in the year-earlier period), was financed by a drawdown of reserves and borrowing abroad. Import spending rose sharply in the first half of 2019 (up 32 percent year on year) driven by large capital imports by SOEs and new investment projects in infrastructure, industry, and housing. Export earnings growth (up 27 percent year on year) was fueled by higher exports of gold (up 35 percent year on year), food (36 percent), and natural gas and cotton (33 percent each). Large transfers resulted in a capital account surplus of $135 million in the first quarter of 2019. Owing to higher repatriation of investments under production-sharing agreements with international investors, net inflows of foreign direct investment (FDI) contracted sharply. The negative balance on the financial account reflected the rapid growth of portfolio investment, foreign loans, and trade credits and advances.

The Central Bank of Uzbekistan (CBU) has kept its policy rate on hold at 16 percent since September 2018 (when it was raised from 14 percent). However, the interest rate transmission mechanism continues to be distorted by significant state-directed lending at subsidized interest rates. Directed lending contributed to a 52.8 percent year-on-year spike in credit growth in the first half of 2019 (on the back of a 50.8 percent increase in 2018). Currency depreciation in Uzbekistan's main trading partners (Russia, China, and Kazakhstan) and increased domestic demand for U.S. dollars led to a som depreciation of 8.8 percent against the U.S. dollar in August 2019 (compared to a 2 percent depreciation in the first half of 2019). The exchange rate has remained stable since the end of August, supported by a recent decision by the CBU to allow the som to float more freely in response to market conditions.

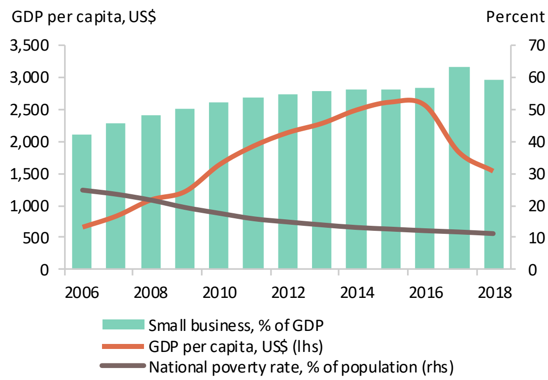
Government revenue collection has remained strong despite cuts to direct tax rates in January 2019. Nevertheless, expansions in public investment, government lending to SOEs, and reform-related social spending schemes increased the overall budget deficit from 2.3 percent of GDP in the first half of 2018 to estimated 3 percent of GDP in the first half of 2019.

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



Source: Uzbekistan official statistics.

FIGURE 2 Uzbekistan / Poverty, GDP per capita, and small business development



Source: Uzbekistan official statistics. Due to a 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. Both the national poverty line and welfare aggregate exclude non-food items.

In August 2019, the capital adequacy ratio of the banking system was 14.9 percent, down from 16.5 percent a year earlier. While the capital adequacy and liquidity buffers remain above regulatory minimum levels, both have been depleted over the last year owing to high bank credit growth, which increased vulnerability to shocks.

Stronger economic growth resulted in a decline in the official poverty rate from 11.9 percent in 2017 to 11.4 percent in 2018, though it is measured using non-standard methods. Producing internationally comparable poverty rates is challenging due to limitations in PPP conversion factor data for Uzbekistan, but World Bank data sources suggest the poverty rate at the LMIC line was approximately 9.6 percent in 2018. The official unemployment rate was 9.1 percent in the first half of 2019 (down from 9.3 percent rate in the same period of 2018), including 16.8 percent among youth (16-25 years old) and 12.7 percent among women. According to the official labor force survey, the number of workers employed in the informal sector declined for the first time since independence, falling by 1.1 percentage points to 58.2 percent of total employment in the first half of 2019. Since September 2018, income growth among the bottom 40 percent has been driven by increased remittance inflows and a 30 percent nominal increase in social protection payments. Minimum wages, salaries, pensions, and allowances were increased by 10 percent on August 1, 2019. Public works and employment programs were expanded in 2018 and the first half of 2019.

Outlook

GDP growth is expected to remain at around 5.6 percent in 2019–20 before increasing to 6 percent in 2021 as market reforms open new sources of export-led growth, address production bottlenecks, and ease regulatory constraints. Annual inflation is forecast to increase by about one percentage point in 2019 following increases in energy prices in August 2019 (18.8 percent for natural gas, 18 percent for electricity, and 12.5 percent for gasoline). Inflationary pressures are likely to persist in 2019–20, due to further price reforms and wage increases, but should decline over the medium term.

The current account deficit is expected to moderate from its 2018 peak but remain at 5-6 percent of GDP in 2020–21 on account of sustained heavy machinery and equipment imports. The shortfall is expected to be financed by a gradual increase in FDI and sustained donor inflows. Foreign exchange reserves stood at $27.7 billion in August 2019 (the equivalent of 12.4 months of import cover); external buffers will remain comfortable over the medium term. Gross external debt is expected to decline slightly by 2020 to about 34 percent of GDP.

Risks and challenges

The prospect of turbulent global economic conditions is the main risk to Uzbekistan's economic outlook. The country is especially vulnerable because its main trading partners face particularly heightened external risks. These risks are mitigated by a comfortable level of foreign exchange reserves and low external public debt. Domestic risks emanate from the high rate of credit growth that continues to undermine the transmission of monetary policy and heighten the potential for financial sector instability. The complexity of the next phase of structural reforms to tackle difficult issues such as SOEs, the banking sector, agriculture, and land reforms also heighten domestic risks.

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

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	6.1	4.5	5.1	5.5	5.7	6.0
Private Consumption	1.4	1.3	3.8	5.2	5.3	5.4
Government Consumption	2.4	1.9	3.7	5.9	6.2	6.6
Gross Fixed Capital Investment	4.5	19.7	18.1	21.4	15.4	9.7
Exports, Goods and Services	7.9	1.3	10.7	8.2	3.5	4.5
Imports, Goods and Services	-2.2	17.2	26.8	28.1	15.9	9.6
Real GDP growth, at constant factor prices	6.1	4.5	5.1	5.5	5.7	6.0
Agriculture	6.2	1.2	0.3	2.7	3.2	3.4
Industry	5.9	5.4	10.5	6.4	6.5	6.7
Services	6.2	6.1	5.4	6.6	6.6	7.0
Inflation (Private Consumption Deflator)	8.8	13.9	17.5	15.8	14.1	11.0
Current Account Balance (% of GDP)	0.3	2.5	-7.1	-6.4	-5.5	-4.8
Fiscal Balance (% of GDP)	-0.5	-1.9	-2.1	-2.6	-2.1	-1.8
Debt (% of GDP)	8.6	20.2	20.6	24.0	25.5	25.4
Primary Balance (% of GDP)	-0.4	-1.8	-1.7	-2.2	-1.6	-1.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

WORLD BANK **ECA ECONOMIC UPDATE** FALL 2019

Migration and Brain Drain

The share of immigrants in Western and Eastern Europe has increased rapidly over the past four decades. Today, one of every three immigrants in the world goes to Europe. Furthermore, although globally only one-third of migration takes place within regions, intraregional migration is especially high within Europe and Central Asia, with 80 percent of the region's emigrants choosing to move to other countries in the region. In high-income destination countries, migrants are often blamed for high unemployment and declining social services. There are also widespread concerns about brain drain in the migrant sending countries of Eastern Europe, the Western Balkans, South Caucasus, and Central Asia. This update focuses on the design of policies on labor mobility and presents the trends, determinants, and impacts of low- and high-skilled labor.

ISBN (electronic): 978-1-4648-1506-5

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