Macedonian economy before and after the global economic crises

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MACEDONIAN ECONOMY BEFORE AND AFTER THE GLOBAL ECONOMIC CRISES

ABSTRACT

During the last twenty years Macedonian economy experienced numerous internal and external shocks from economic and political nature. Current world economic crisis is the last shock. However, the economy always showed latent power and possibilities of getting out of such shocks. It was a sign that it can generate higher and sustainable rates of growth.

The experiences and lessons taken from the global economic crisis should serve as a basis for changing the current model with a new one in order the economy of the country to catch a connection with the intense changes that are expected to occur in the coming period. It is expected that creating new economic model in Republic of Macedonia will result in multiple positive effects that primarily manifested in the increasing number of newly small and medium enterprises, domestic investments, industrial production, GDP, number of new employees and total exports as well as in reduction of the trade deficit in maintaining macroeconomic stability of the country.

The achievements of the Republic of Macedonia with the new development model will largely depend on the realization of risks and threats to which it is or will be exposed in the short run and in the medium run, and in relation to the developments in the global and especially in European economy in future, as well as the international political status of Macedonia in relation to its membership in NATO and EU.

K**EY WORDS:** Shocks; Crisis; Macroeconomic indicators; Growth; Remodeling; Risks; Threats.

JEL CLASSIFICATION CODES:
E6 - Macroeconomic Policy, Macroeconomic aspects of Public Finance, and General Outlook

1. Introduction

On April 26, 1992, RM introduced its own currency – the Macedonian denar (MKD) and the country's monetary independence from the former Yugoslavia was declared. Through the construction of its own monetary institution, RM began the process of its economic transition. The process was neither easy nor short-lived, especially because of the strong exposure to the external and internal shock influences that impeded reaching lasting and sustainable growth rates. However, it always showed latent power and possibilities of getting out of crisis. It was a sign that it can generate higher and sustainable rates of growth.

Despite the objectivity of the numerous shocks, RM can not accomplish more intensive economic growth by sticking to the economic model that is primarily based on expected foreign loans and investment from abroad. The current economic crisis has uncovered a number of weaknesses of previously shaped economic model and imposed the need for modification. The need that Macedonia, like most other Balkan countries, should remodel its economy, which basically means restructuring and diversification, is becoming more obvious.

2. Shocks

After proclaiming monetary independence in 1992, the Macedonian economy repeatedly experienced extremely strong shocks (Nenovski, Orleans, 2011). In fact, it is a miracle how it managed to successfully fight the shocks and keep the qualities of its perspective and prosperous economy in both, the medium and the long term.

It all began with the disintegration of former Yugoslavia. Leaving the Yugoslav company, to which the Macedonian economy was tied with an umbilical cord, meant a few year wandering and seeking a position on the unscrupulous world economic scene. It was difficult, but still a period which was enthusiastically overcome. However, the wars on the territories of former Yugoslavia followed. Fortunately, they avoided Macedonia, but it lost most of the markets where it had previously placed its products. Winning new markets in the overcrowded world economic space was difficult, at times almost an unmanageable problem for Macedonian companies.

But as the popular Macedonian proverb says, " there is worse than the bad ", the United Nations in 1993-1994 introduced economic and political sanctions against Yugoslavia (Serbia and Montenegro) for its war on the territory of the Republic of Croatia and Bosnia and Herzegovina. In such conditions, not only products of Macedonian enterprises could not be sold in markets of their traditionally biggest economic partner, but these companies had to transport their goods through alternative and indirect routes because passage through Yugoslavia was banned. It was a new shock, loss of markets, increased transportation costs, increasing losses of the Macedonian companies.

These affairs were immediately followed by an additional, equally strong shock. Greece tried to solve the dispute about the name of the Macedonian state by introducing an embargo (1994-1995) for the import of Macedonian products from Greece and for transport of the products through Greek territory. The Macedonian economy was put into devastating sandwich: the sanctions in the north, embargo in the south. In the west, the basically undeveloped Albania (especially it's infrastructure). Fortunately, the road transportation of Macedonian products through neighboring Bulgaria was available, which at that time turned into the only window to the world of RM. However, increased transport costs of Macedonian products made them more expensive in emerging markets, and imported products became more expensive on the domestic market.

And when one thought that the shock economy came to an end, the so-called Kosovo crisis came along. RM, which has 2 million inhabitants, accepted 360,000 Kosovo refugees whose residence spent huge amounts of the country's funds. The Yugoslav market (including Kosovo) was again closed for the Macedonian companies. The political risk brought the foreign investors further away from RM. Economic indicators noted the fast-moving downward trends. The Macedonian economy was facing a complete collapse.

However, there was a twist. Just a few months after the Kosovo crisis, the economy confirmed its toughness and embarked on its prosperous journey. In 2000 it recorded its best results, almost identical to the ones realized before (1989/1990) the disintegration of Yugoslavia.

Then another shock, again. The most devastating one. The territory of the Republic of Macedonia was enduring a "war" whose character has not been clarified yet. Besides the hundreds of lost lives, a part of the economy was destroyed and huge amounts of funds irreversibly consumed. Instead for developing purposes, hundreds of millions of German marks from the state budget and from the state reserves were used to buy tanks, guns, military choppers, fighter planes, bombs, guns, bullets, grenades and similar inhumane assets. The Yugoslav markets, and Kosovo in particular, were again blocked for Macedonian companies. Investments in the economy declined dramatically. The economy suffered severe consequences of the bizarre war.

However, the Macedonian economy proved its durability and latent power. In the years that followed it recorded accelerating rates of growth. And, when it was expected that Macedonia was finally able to maintain sustainable rates of economic growth, the last shock occurred in its fifteen year transition period: the global economic crisis happened. Its effects and the solutions within the RM will be discussed later in this text.

3. Macroeconomic fulfillments

Exposure to numerous shocks raises the logical question: whether and how successful the economy was in facing the problems of transition and whether it succeeded in establishing a foundation for further movement along the path of its prosperous development? Perhaps it sounds less illogical if taken into consideration the previously stated problems which the economy was facing, but the answer to that question, in general, is positive (Nenovski, Orleans, 2011). The following facts confirm it best.

a) Macroeconomic stability

All international institutions and organizations support and welcome the maintenance of the macroeconomic stability in Macedonia, despite the numerous temptations to which it was exposed in the past transition period. If we exclude the first 3-4 years of that period, when understandably there were no basic conditions for establishing and maintaining macroeconomic stability, in the entire subsequent period it was consistently maintained even during the strongest action of the world economic crisis.

Thus, in the period after 1995 in the RM low inflation rate was accomplished, with its average size of between 2 and 3 per cent. The average, partly, was disturbed by the actions of the global economic crisis due to which in 2009 deflation of 0.7 percent was accomplished.

Since 1995 fixed ("pegged") exchange rate of the MKD has been implemented. Its value, initially, was tied to the value of DM (Deutschmark), and after the introduction of the euro in 1999, its value has been tied to the value of the European common currency. This means that the whole past period in RM a fixed exchange rate of the domestic currency has been implemented. Such a regime was not changed or even abandoned under the influence of the global economic crisis.

Finally, the authorities of the State have shown maturity in maintaining the necessary budget discipline. It confirms the fact that the average budget deficit in the past 15-year period ranges between 2 to 2.5 percent of GDP, which is significantly below the criterion established by the Maastricht agreement (budget deficit up to 3 percent of GDP in a state).

b) Low-debt country

The low and controlled budget deficit has conditioned for the state to move into reasonable frames that placed the RM in the group of low-debt countries. The maximum amount of its public debt was reached in the middle of the first decade of this century and was about 40 percent of the GDP of the country. In subsequent years it has come to its abrupt decrease after early repayment of a substantial part of the external debt of the state. Today, the public debt of RM is about 33 percent of its GDP, which is almost half the limit set by the Treaty of Maastricht (the country's public debt not exceeding 60 percent of its GDP).

c) GDP

Because of numerous shocks and other limiting factors, GDP of RM in the past years experienced a variety of sizes and trends. According to statistical indicators, in 2005-2006 GDP reached the level of before the period of proclamation of political and economic independence. In the following years a period of intense and sustained economic growth began. In 2005 GDP grew by 4.1 percent, in 2006 by 3.9 per cent, in 2007 by 5.9 percent, and in 2008 by 4.8 percent. Because of the strength of the effects of the global economic crisis and the entrance of the Macedonian economy in the zone of recession in 2009, it had a negative growth rate of 0.9 percent. Fortunately, recession impacts were short-lived, as economic conditions and the RM in 2010 again reported positive, although modest growth of 0,7 percent. This creates the basis for the expectation that the GDP of the Republic of Macedonia in 2011 could increase by an additional 3.5 to 4 percent annually. During the first quarter of 2011 GDP growth of 5,1% was recorded.

Of course, the realized rates of economic growth can not be classified as satisfactory in terms of strengthening the base and the fitness of the domestic economy and in terms of raising the living standards of the population. The fact indicates that the average GPA per capita of the RM in 2008 was about 3,000 U.S. dollars.

d) External balances

Macedonia is a small country (2 million inhabitants), whose economy by 80 percent is open abroad, and is integrated into the global economy. Its foreign trade accounts for 120 percent of the annual GDP of the country.

RM is a member of the World Trade Organization (WTO). It causes the dynamic adjustment of its foreign-trade rules to the rules of the WTO. That and the implementation of the Stabilization and Association Agreement of the RM with the EU in 2001 imposed a reduction or elimination of over 90 percent of customs and border restrictions on exports and imports of goods and services in relations with the EU.

RM is a member of CEFTA, which is the vanguard of its gradual accession to the EU family. However, the data confirms that the effects of the membership in CEFTA are wearing out more and more and that two thirds of the economy trade with the EU, with a tendency to further increase that figure. That fact indicates that the most important foreign trade partners of the Republic of Macedonia are Germany, Greece, Italy, Bulgaria and Serbia and Russia after them, while the greatest foreign investors in Macedonia are companies from Austria, Greece and Hungary.

Macedonian firms export metals, steel, textiles, agricultural and pharmaceutical products and processed oil the most, while energy, automobiles, raw materials and foodstuffs are imported.

Long time ago (while it was still part of former Yugoslavia), Macedonia had the characteristics of import-dependent country. That was the reason for regularly high trade deficit, which in the last five years amounted to an average annual 23.56 per cent of GDP. Moreover, the coverage of imports by exports was about 60 percent.

Most of the trade deficit is covered by high inflows of funds based on private transfers, dominated by worker remittances from abroad. They allow the current account deficit of balance of payments of RM to be bearable (average of 5.04 percent over the past five years).

Due to the above-mentioned reasons, foreign direct investments register modest annual sizes (between 1 and 2 percent of GDP). On the other hand, foreign exchange reserves have a permanent tendency of growth and extend to five - a monthly value of imports of goods and services from abroad.

e) Unemployment

The biggest socio-economic problem which Macedonia has been facing for a long time now is high unemployment. It, in large part, is inherited from the time when Macedonia was part of former Yugoslavia. Meanwhile, its number was increasing as a result of numerous structural changes in the economy for its adaptation to emerging situations and changes in the socio-political system of the country.

In the last five years the unemployment rate was: 37.3 percent in 2005, 36 percent in 2006, 34.9 percent in 2007, 33.8 percent in 2009, 32.3 per cent in 2009 and 30,9 percent in 2010. In analyzing the rate and structure of unemployment, however, one should bear in mind the fact that a large number of officially unemployed are working in the informal sector, i.e. the so-called "gray" economy, which in Macedonia is estimated to account for about 40 percent of the GDP of the country.

4. RM and the global economic crisis

Large and long-term economic crises comprise of several parts. First, there is a *financial crisis*, which after a while turns into a crisis on the real sector (*recession*), which inevitably results in a *social crisis* (reduced wages, increased number of unemployed, etc.). At the end (very rarely) there may be a *political crisis.*

How has the global economic crises been manifested in the Republic of Macedonia?

a) Effects of the crisis

RM has an underdeveloped and shallow financial system. It is dominated by commercial banks. Due to several reasons, above all due to restrictive clauses of the EU Stabilization and Association Agreement, they are generally poorly integrated in the global financial markets. That weakness has proved an advantage for the Macedonian economy. Finance developments in the world have not spilled over the banking system in Macedonia. It remained stable, well capitalized and with a small amount of so-called bad loans (non-performing loans). This means that the financial crisis passed RM.

However, the extensive foreign openness of the economy meant spill over of the recession part of the crisis in Macedonia. This was especially felt immediately after the recession of its most important foreign trade partners (Germany, Greece, Italy, Bulgaria, Serbia ...). The beginnings of the recession of Macedonian economy can be traced at the end of 2008. RM officially entered a recession in January 2009. After two consecutive quarters in 2009 in which the economy experienced negative amounts, the third and fourth quarter of 2009 recorded positive growth rates, which interrupted the recession part of its economic cycle. In most of 2010 Macedonian economy experienced a modest positive change, which caused a modest, but positive result of 0,7 percent at the end of the year.

The rule according to which after a recession there is a social crisis phase (increase in the unemployment rate), only partly confirmed to be true in RM. More intensive penetration of the economy in recession in mid-spring 2009 and its peak in midsummer of the same year resulted in intensified increase in the number of effectively unemployed individuals. That trend continued until the end of 2009 and during the first few months of 2010. By the end of July 2010 the unemployment rate reached 33,5%, which was 1,2 percentage points higher than the unemployment indicated at the end of 2009. However, in the second half of 2010 the unemployment rate started to decrease and by the end of the year it dropped down to 30,9%. The main reasons for the modest and rapid repair of the forms of social crisis in RM are located mainly in:

- the effects of the previously applied four packages of anti-crisis measures by the Government;
- slight decrease in the economy in 2009, which was compensated for by its growth in 2010;
- appearance (establishment) of 5-6,000 new firms (small and medium sized) which engaged an a substantial part of the labor force in Macedonia.

Generally, it can be concluded (Nenovski, Smilkovski, Poposki, 2011) that the economy was significantly less injured by the global economic crisis in comparison to most other European countries. This can be assessed as the greatest advantage of the Republic of Macedonia in the post-crisis period and the period of a new redistribution of world goods and services markets.

b) Lessons from the crisis

Macedonia's entering the crisis and its gradual coming out of the crisis provoke a few deductions (Nenovski, Ravda, 2011) which the authorities need to take into consideration in the upcoming creation of the economic scene in Macedonia:

- Macedonia's economic accomplishments depend heavily on the economies of its most important trade partners; in other words, depending on the dynamics of the current demand of those economies, the Macedonian economy alternates between positive and negative fluctuations;

- The areas in which the Macedonian economy is dependent are: metal industry, textile industry, parts of agriculture, etc. This fact proved to be a widely restrictive factor for the future development of the economy;

- Macedonia is also excessively dependent on the prices of its primary export and import products. The increase of the prices of the metals on the world stock markets at the beginning of 2010 extremely positively influenced the economic development of the major part of the economy in the second and third quarter of the year. On the other hand, the increase of the prices of the fuels and the agricultural and food products, which are basic for the Macedonian economy, triggers rising of the input expenditures, which in turn decreases their competitiveness on the world markets.

- The supply and the demand of domestic products and services on the domestic market are relatively small scale, which is a serious restrictive shortcoming in the development of the country;

- The economic crisis assumed the role of a purgatory: the weak companies disappeared, but the strong ones remained standing even stronger than before, while also new brave economic entities appeared.

5. A need for remodeling of the economy

Not only in Macedonia, but also in other states of the West Balkans, the economic crisis showed that the post crisis period would require changing of the current economic development model for protection against future similar crises, and also for provision of conditions for permanent and sustainable economic development.

The economic achievements before the crisis and the effects of the crisis itself refer to the needs of providing new economic development model, the so called *holistic approach (*Nenovski, Smilkovski, Poposki, 2011*)*. It generally means directing the focus not only to the macroeconomic and financial policy, but also to creating new employment possibilities and social protection. For realization of this approach, adequate reconstruction of the economy is required, which mainly includes activities to encourage the development of small and medium-sized enterprises (SME), increasing the production and diversifying the offer of goods and services on the domestic and foreign markets and instigating innovations, not only as newly developed products but also as innovations in the already existent goods and services. To achieve this goal, the following things are necessary:

- Institutional support for the new business ideas and business projects through adjustment of legislation, elimination of legal restrictions wherever possible and necessary and adequate fiscal support;

- Increase of the supply and demand of domestic products, which will lower the dependence of the national economy on the world current happenings and the import of final products by: subsidizing domestic production of strategic goods and services as a replacement for the same or similar products which are now imported; opening of purchasing/distributional centers for planning, buying, sorting, cooling, processing and distribution of agricultural and food products; promotion of alternative sources of energy; increasing the competitiveness of domestic goods and services as a condition for promotion of their export through the mentioned cheaper alternative sources of energy, subsidizing part of the cost of strategic goods and services and those that are found to have a comparative advantage over the same or similar products in neighboring countries and/or other foreign trade partners of the country; increasing competitiveness of the domestic goods and services as a prerequisite for their export;

- instigation of domestic investments is needed, which can be executed through employing the domestic capital – the savings which the companies and citizens have at home or in the banks. The result will be increase of new companies and diversity in the supply of goods and services, as well as rise of the number of newly employed;

- continuance of the already initiated activities for improvement of the educational process, which will help fighting the long lasting problem of insufficient and unqualified work force;

- increase in the infrastructure (roads, railways, gasification, electrification, energy supply and others), together with reconstruction of the economy (using the Polish model);

- harmonizing both most important macroeconomic policies: 1) Fiscal policy: reduction of the budgetary deficit to 1-1.5% of the GDP and reorganization of the structure of Macedonia's budget regarding reduction of current expenses and increase of the capital investments; 2) Monetary policy: maintaining stability of the prices; careful reflation of the economy; gradual replacement of the monetary strategy of a fixed exchange rate with the strategy of targeting of the inflation; improvement of the conditions for access of the economic subjects to financial means.

Newly established model of economic policy will result with multiple positive effects. Primarily, it will be manifested with the following indicators:

- Increase of the number of new SME's. In ambient that offers great opportunities for action in various spheres of economy, the easiest and the most adaptable are SME's. This fact will determine the increasing number of newly SME's in the next coming years (55.000 newly established SME's in the next five years);
- Dynamic creation of new SME's will increase the level of domestic investment by large amount and rates ever observed;
- Large number of the newly opened SME's in following five-year period will be located in different branches of the industry. Their activity in the newly established environment will lead to an increase in industrial production. Fair is the assumption that in the upcoming five-year period, newly opened SME's will contribute to the encouragement (increase) the average annual industrial production from a 8-10 per cent;
- The increased volume of investment by SME's, supplemented by the expected increase in industrial production will subsequently contribute (in addition to the action of other constituent elements) to increase the country's GDP from an average of 6-8 percent annually in the forthcoming five-year period. This will enable the gradual reduction of differences in the level of economic development compared to that in the EU. In fact, with such rates of growth of the economy, it is realistic to expect that Macedonia will reach the level of economic growth of EU in 25-30 years;
- A logical consequence of the increasing number of SME's will be newly increased number of new employees. Assuming every newly opened SME's employ an average of 4 persons, the total number of new employees in SME in the next five years would be 220,000 people. The number of unemployed would gradually decreased so that the end of 2015 the unemployment rate would amount to about 12-15 percent from the current 30.9 per cent;
- Applying the aforementioned incentives will increase the volume of production that SME's will have earmarked for export. It will contribute to the total exports at the country level. At the same time, increase of the production of various goods and services will cause them to place a certain extent on the domestic market. This will increase domestic consumption of those goods and services with dual positive effect: a) an increase in GDP under the influence of increased domestic consumption, and b)

- reducing the consumption of the relevant goods and services provided by an importation from abroad, i.e. reduction of total imports of the country. Cumulative effect of such movements in the foreign trade sector would gradually reduce the difference between exports and imports, increasing the coverage of imports with exports from the current 60 to around 80 percent;
- Increased exports or reduced imports of goods and services will lead to a gradual reduction of the deficit the country's foreign trade. It will have a direct positive impact on increasing the domestic GDP, reducing the current account deficit within the balance of payments, increasing the state foreign currency reserves and sharply reduce and possibly eliminate entirely the need for borrowing by the country abroad. Further positive consequence of such changes will be reducing the public debt, especially international debt of the country;
- Newly created model will not disturb the macroeconomic stability as a condition for future long-term, permanent and sustainable economic growth. Inflation will move into the projected frames because they are an essential element of the proposed new Central Bank monetary strategy. Significantly increased foreign exchange inflows from abroad on the basis of increased exports and reduced imports of goods and services will be a guarantee for maintaining stability of the exchange rate and without the need for new credit borrowings of the country abroad. The increased inflow of funds in the Budget on one hand, and his rational and productive use of the other hand, conditional permanent budget deficit to shrink and move in modest sizes from 1 to 1.5 percent of GDP. However, public debt and the international debt of the country will be reduced and will be significantly under the framework established by the Maastricht criteria.

6. Risks and threats

Creation and effective implementation of new suggested model for development of the economy in the next period, to a large extent, will depend on the (non) realization of a greater number of risks and threats (Nenovski, Smilkovski, Poposki, 2011). The volume and quality of performance of the economy of the Republic, to a great extent, will depend on:

a) further development of the global economic crisis, whose prolonged action has ramifications throughout 2011;

b) the movement of prices of energy and agro-food products on world markets. The beginning of 2011 shows the rapidly increasing pace because of several reasons: political (crisis in the north of Africa), climate (drought in some parts of the world) and social-economic (increase the standard of much of the world's population and their demand);

c) the strength and speed with which authorities in many countries will face rising inflation, as imported, is reflected on the economy of the Republic of Macedonia;

d) the effects of (un)resolving the financial crisis in Greece, Ireland and Portugal, of its possible further expansion in Spain, Italy, Belgium and the announcement of its occurrence in other EU member states;

e) The fate of the Euro, caused by (un)resolving the crisis in financial aforementioned member states of the EMU;

f) The speed of resolving foreign political status of the RM, i.e. its membership in the EU and NATO, taking into account this problem about the veto that Greece puts on Macedonia's membership in these international structures, which is the result of the existing problem on international recognition of the constitutional name of Macedonia.

7. Conclusions

Current world economic crisis is the last shock for the Macedonian economy because of its almost complete openness. The crisis was especially present in the economic sector and activity that are export oriented, such as metal and textile industries, a significant part of agriculture, petroleum derivatives, etc.

Experiences and lessons from the economic crisis should serve as a basis for changing the current one with new model for the country's economy in order to catch a connection to the intense changes that are expected to occur in the next period in the global economy. Creating new (holistic) economic model in Republic of Macedonia has multidimensional direction. Among them are dominant: a) Completion of initiated and undertaken new activities to improving business climate in the country, b) Economic restructuring, c) Increasing of domestic production, d) Harmonizing effects of macroeconomic instruments.

Newly established economic model is expected to result in multiple positive effects that are primarily manifested in achieving lasting, sustainable and significantly higher rates of economic growth and reducing the high rate of unemployment in the country; increasing the number of new employees and total exports as well as reduction of the trade deficit in maintaining macroeconomic stability in the country. It primarily will be accomplished by opening new small and medium enterprises, by encouraging and increasing domestic investment, reducing excessive dependence on imported products, encouraging consumption of domestic products and by encouraging the export of Macedonian products.

Achievements of the Republic of Macedonia with the new development model largely will depend on the realization of risks and threats to which it is or will be exposed to on short and medium term. Dominant position and role have the performances of the World and especially European economy in future, as well as the international political status of Macedonia (NATO and EU).

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