

Remodeling of the Macedonian Economy

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The Macedonian economy gets out relatively little hurt by the global economic crisis not facing with financial crisis, the recession was short-lived, and social crisis emerged in modest sizes. However, the global crisis revealed the major weaknesses of the economic model which was implemented. It turned out that the Macedonian economy is very dependent on the performance of only a few sectors and movements on the prices of its most important export and import products, and that the scope of supply and demand for domestic goods and services is small. These lectures from the economic crisis posed by the need to create a new model for country economic development in the future. The application of historical, statistical, analytical and comparative method shows that Macedonia should exercise other holistic approach in the remodeling of their economy. This means that, besides keeping macroeconomic and financial policy in the future the Macedonian government should act more vigorously in the direction of creating new jobs and provide greater social security. The economic model that we propose in this paper recommends it be done by encouraging small and medium enterprises, diversification of production, encouraging domestic investments, developing human capital, improving infrastructure, encouraging exports and harmonization the macroeconomic instruments. The application of this model will result in increasing investments, industrial production and exports, increasing the competitiveness of domestic products, reducing the trade deficit and maintaining the macroeconomic stability. The general conclusion of the paper is that application of the proposed economic model should lead to realization of two most important goals: achieving lasting, sustainable and significantly higher rates of economic growth and reducing the high rate of unemployment in the country.

Keywords: shocks, economic crisis, economic model, harmonization, risks

Introduction

The transition of the economy of the Republic of Macedonia (RM) started in 1992 after its monetary independence from former Yugoslavia. During that period, it was exposed to numerous internal and external

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shocks that impeded reaching lasting and sustainable rates of growth. 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.

Although, the analyses confirm that despite the objectivity of the numerous shocks, RM cannot 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.

Shocks

After proclaiming monetary independence in 1992, the Macedonian economy repeatedly experienced extremely strong shocks (Nenovski, 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 SFRY. Then the wars on the territory of former Yugoslavia happened. These shocks caused the Republic of Macedonia (RM) to lose most of the markets where it had previously placed its products.

In 1993-1994, the United Nations imposed economic and political sanctions against Yugoslavia (Serbia and Montenegro) for its war on the territory of the Republic of Croatia and Bosnia and Herzegovina. The border of Macedonia with Yugoslavia was blocked for all transport and economic activities. Another additional powerful shock followed: the dispute about the name of the Macedonian state with Greece. Greece tried to solve it by introducing an embargo (January, 1994) for import and export of Macedonian products in that country and for transport of Macedonian products through its territory. The Macedonian economy was placed into a devastating position: sanctions in the north and embargo in the south. In the west, there was the undeveloped Albania (in general sense, and especially infrastructurally). Fortunately, the transportation road of Macedonian products through neighboring Bulgaria remained open, which at that time turned into the only window to the world for Macedonia. However, increased transportation costs of Macedonian products made them more expensive in emerging markets which were just about to be won, and imported products became more expensive on the domestic market.

In 1999 the Kosovo crisis has happened. 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.

Once again, a devastating shock happened. In 2001, 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 16-year transition period: the global economic crisis happened. Its effects and the solutions within the RM will be discussed later in this text.

Effects of Global Economic Crisis

RM has an underdeveloped and shallow financial system. It is practically non-integrated into the global financial markets. That weakness proved to be an advantage for the Macedonian economy, because the financial crisis practically missed RM.

However, the great openness of the economy towards foreign countries meant recession spillover of the crisis in Macedonia. That was especially felt when its most important foreign trade partners (Germany, Greece, Italy, Bulgaria, Serbia, etc.) entered the recession. The beginnings of the recession of the economy can be seen at the end of 2008. RM officially entered the recession in January 2009. After two consecutive quarters in 2009 in which the economy experienced negative trends, in the third and fourth quarter of 2009 it recorded positive growth rates, which interrupted the recession of its economic cycle. In the bigger part of 2010, the Macedonian economy experienced a modest positive change, which caused modest, but positive economic result of 0.7 percent at the end of the year (IMF, 2011).

The rule (Nenovski, 2010) 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. 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 5,000-6,000 new firms (small and medium sized) which engaged a substantial part of the labor force in Macedonia.

It can generally be concluded that the economy was significantly less injured by the devastating actions of the global economic crisis, compared to most of the other European countries. It can be labeled as the greatest advantage on RM's entering in post-crisis period and in implementing its international integration aspirations.

Lessons From the Economic Crisis

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

(1) The Macedonian economy is dependent on the performance of only few sectors: metal industry, textile industry, parts of agriculture, etc.. This fact proved to be a widely restrictive factor for the future development of the economy;

(2) The Macedonian economy is heavily dependent on the movement of prices of its most important 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;

(3) 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;

(4) The economic crisis acted as purgatory: weak firms failed, strong firms remained and strengthened, and new, brave actors have appeared on the economic scene. It indicates the existence of latent powers and possibilities of the economy that should be used in the upcoming period.

Remodeling of the Economy

According to several indicators, the global world economic crisis is at its end. A period of expansive trend of the global economy is currently beginning. Moreover, the experiences (positive or negative) of that crisis are used for remodeling the global economic map. For many countries in the world, it is a sign of a necessary alteration of their own economic model, if they want to follow the new world trends.

Republic of Macedonia is one of those countries. New modeling is necessary for the Macedonian economy, not only because of the impact and effects of the crisis, but also because of the need for establishing a basis for the more dynamic, durable and sustainable future development.

Creating a new economic model for RM includes acting in different areas, among which the dominant ones are:

- (1) Completion of started actions and taking new actions to improve the business climate in the country;
- (2) Restructuring of the economy;
- (3) Increasing domestic production;
- (4) Harmonizing the effects of macroeconomic instruments.

Restructuring the Economy

The existing conditions and favorable actions in the economic and social area in the upcoming period indicate the necessity of introducing the so-called “holistic approach” (Nenovski, 2011) in creating a future medium-term model for economic development.

Basically, that means the focus should not be only on macroeconomic and financial policies but also on creating jobs and providing social protection. However, for the realization of such an approach, an appropriate restructuring of the economy is necessary (Anastasakis & Watson, 2011), which mainly includes activities to encourage the development of small/medium-sized enterprises (SME), increasing the production and diversifying the offer of goods and services on the domestic and foreign markets.

Increase and Diversification of Domestic Production

In order to overcome the weaknesses the economy showed during the crisis, to protect itself against future crises and to provide conditions for achieving sustainable economic development, the activities of the economic policy makers and economic actors in the country (which should be dominated by SME) in the next period should be directed towards diversification of production of goods and services offered at home, which could be offered to foreign markets as well. Actions should be aimed at encouraging existing and new companies to operate in the areas of services, agriculture, competing industries (particularly the manufacturing industry), etc.. Of particular

importance is the encouragement of innovation and not just in the form of newly discovered products, but also in already existing goods and services. To achieve this goal, the following things are necessary:

(1) Institutional support for the new business ideas and business projects through:

- Adjustment of legislation;
- Elimination of legal restrictions wherever possible and necessary;
- Fiscal support in order to reduce or even eliminate customs duties and other taxes on imports of intermediate goods and services; reduction of tax rates and/or providing subsidies for products that will be defined as strategic (agricultural, livestock, processing, etc.); increase of the funds of the national budget to support SMEs.

(2) Increase of the supply and consumption of domestic products, which will make the economy less dependent on the world affairs and the import of finished products with the following actions:

- Subsidizing domestic production of strategic goods and services as a replacement for the same or similar products which are now exported, such as agricultural products (wheat, fodder, sugar, oil, oil plants, sugar, sugar plants), wood products, textile products, leather products;

- Opening of purchasing/distributional centers for planning, buying, sorting, cooling, processing and distribution of agricultural and food products. This will prevent the occasional occurrence of chaos in the purchase of those products from the fields;

- Promotion of alternative sources of energy: Building new national hydro power plants and small household hydro power plants and household water supply stations, construction of windmills; introduction and expansion of the gas network in the country and others. This will provide greater quantities of the most important input-energy, at a lower price than the current one. It will reduce production cost and increase competitiveness of domestic products in respect of import;

- Increasing the competitiveness of domestic goods and services (Schadler, 2011) 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.

(3) Promoting domestic investment through the deployment of domestic capital (Sanfey, 2011), i.e., savings that businesses and citizens have in banks and at home. Currently, the savings of the Macedonian people in banks is about 2.1 billion Euros and the accounts of companies count approximately 900 million Euros. Here should also be mentioned the assets of population that are kept in their home safes, which are estimated at about 1.2 billion Euros. That capital should be forced to be engaged in the process of economic reproduction through:

- Investing in government bonds in MKD (Macedonian denars) and/or foreign currencies. With this action the state would collect money to finance their activities, which will have a multiplying effect on the economy and the companies will increase their own income;

- Investments in agriculture. The state is expected to sell agricultural land cheap or grant it for free to interested persons, which would benefit individuals in running their own small family businesses—farms for growing various vegetables, fruits, grapes, tobacco, silk, grains, etc.;

- Investment in construction of apartments, houses, business premises and other;

- Investment in livestock: cattle, fish, poultry and others;

- Investing in projects that are offered concessionary and/or public-private partnership (building and

maintaining schools, hospitals, government administrative buildings, roads, etc.);

- Construction of alternative energy sources: sewage treatment, construction of small hydropower plants (family HPPs in the villages and the weekend houses);

- Recycling paper, glass, plastic, etc.;

- Opening individual facilities for products which are already a great part of the Macedonian tradition, like wine, brandy, brine, cheese, honey, jam, juice, milk, margarine, butter, cream, ketchup, and raw materials and comparative advantages;

- Development of rural tourism: the construction of hotels, motels, vacation homes, swimming pools, saunas, fitness centers, etc.;

- Building homes for the elderly, kindergartens, entertainment parks, dispensaries, tennis courts, playgrounds, etc..

Results of the population capital mobilization would be increase the number of newly opened companies, payoff supply of goods and services, increase the number of employees, reduce import dependence and increase the country's GDP.

(4) Finishing the started activities for improving the educational process needs to overcome the problem of poor or low qualifications of the workforce. The present educational structure of the labor force has to be changed. According to official data of the relevant institutions, almost 80% of about 324,000 unemployed people are actually persons with low level education, unskilled, semi-skilled, skilled or qualified people. Despite their majority, there are some profiles that are insufficient in the economy: water supply workers, electricity workers, textile workers and others. The part of unemployed population with high school degree accounts for about 14 percent. The remaining 6 percent of the unemployed population have a university degree. However, within this percentage there are still insufficient profiles like experts, technicians or various types of financial managers, or occupations for which there is great demand on the domestic and foreign market. Accordingly, responsible institutions (Ministry of Education and its agencies, the Ministry of Labor and Social Policy, universities, donors and other institutions) should focus their attention to the increasing quality of the workforce as a factor of increased competitiveness of domestic goods and services to domestic and foreign markets.

(5) Strengthening the infrastructure in the country. The use of budget capital investments, foreign direct investment and the activation of various forms of concessionary and public-private partnership should encourage the construction of new, and finalization and reconstruction of existing infrastructure facilities (roads, railways, gasification, electrification, energy facilities, etc.). It should be done before or simultaneously with the economy reconstruction (using the Polish model), in order to avoid a situation of having a solid infrastructure, but undeveloped economy (like the Greek economy), something that on medium and long term could have adverse effects on the economy.

(6) Encourage exports. The increased volume of domestic goods and services would be primarily aimed to satisfy domestic needs, which will reduce the country's heavy dependence on imports of some or most of these goods. At the same time, the expected increased number of newly opened businesses and increased productivity will enhance their domestic and international competitiveness. This, in addition with synchronized action of the essential macroeconomic policies will create conditions for increasing the production volume of goods and services for export. That should change the current picture of the country where two thirds of the current export

level of goods and services are achieved by firms established with foreign capital, and only a third of it is supplied by domestic firms.

Furthermore, such an approach will change the current unfavorable structure of export dominated only by few types of products (textile, metals, some agricultural products processed for oil, etc.) The number of goods and services intended for export will increase, and this will reduce the current dependence of the dominant Macedonian export products on the conjuncture movements of world markets on which they are placed.

Goods for which the economy has some competitive advantages (heavy goods, textile, manufacturing industry, agriculture, tourism, service provider, etc.) should be encouraged with government concessions, stability of the taxes and stability of the prices of input elements in their production, deployment of domestic capital for investment purposes, and other measures.

Harmonization of Macro-economic Instruments

Because of their close interdependence, it will be necessary in the upcoming period to harmonize the relations between the most important parts of macroeconomic policy (Nenovski, 2010) in the direction of their coordinated action. That will eliminate the possibility of destabilizing the economy and create conditions for starting a process of lasting and sustainable (at least at medium term) economic growth of the country.

Fiscal policy. As a condition for effectively establishing the new model for economic development, fiscal policy should be reorganized because of, primarily, restructuring and rebalancing of the budget. It has to do with:

- Limiting the budget deficit to up to 1.5 percent of GDP. These conditions will reduce the public/government debt, increasing national savings and the level of investment in the country;
- Changing the structure of expenditure in the budget such as reducing non-productive (social) transfers and the costs of unproductive goods and services, forcing the capital investments;
- Budget revenue and expenditure compliance. It should be done without introducing additional fiscal duties for the economy, reducing or eliminating tariffs on imports of raw materials, machinery and spare parts intended for production for export, reducing the non-tax revenue and other measures with similar effect;
- Budget deficit has to be less financed by selling treasury bills and/or by issuing Eurobonds. If necessary, its coverage can be done by issuing domestic bonds with maturity of at least five years.

Monetary policy. Monetary policy should be in full compliance (harmony) with reorganized fiscal policy. It requires:

- Gradually reflationing of the economy (controlled increasing of the liquidity of the economy without jeopardizing macroeconomic stability);
- Determining the actual surplus of money in the economy that has to be sterilized (withdrawn from circulation) through the instruments of monetary policy. This will eliminate or drastically reduce the effect of “crowding out”—crowding out the funds from the real banking sector;
- Harmonization of referent interest rate of the Central Bank with the benchmark interest rate of the European Central Bank;
- Gradually changing monetary strategy (replacement strategy, the de facto fixed exchange rate with the strategy of limiting inflation);
- Accelerating the use of funds from IPA and IPARD funds;

- Increasing the capital of the Macedonian Bank for Development (MBDP) and giving it the right directions for crediting the enterprises;

- Increasing the amount of MBDP guarantees for loans used by SME to finance activities at home and abroad;
- Relaxation of loans approved by MBDP in the following guidelines:

(a) The deadline for return of credits to move between 5 and 10 years depending on the purposes for which they are used and the amounts of appropriations;

(b) The interest rate has to be 0.5 percentage points higher than the interest rate at which MBDP or RM borrowed funds from abroad, but it should not be higher than the benchmark interest rate in the Republic (now 4%). If the interest rate of foreign loans is higher than the benchmark interest rate in RM, then the difference should be subsidized by the state.

Foreign-trade policy. The main directions of action in the foreign trade operations in the forthcoming period should encourage the import of intermediate goods, which take role in production of domestic goods and services, gradually replacing the import of domestic goods and services and encouraging the export of goods and services. The existing structure of imported final products for personal consumption has a high share. This part of imports does not stimulate the domestic economy and, in fact, it finances the foreign economy (demand). Despite the final, the import has to be directed to intermediate goods and services (raw materials, intermediate goods, etc.) that directly participate in creating new products for domestic consumption and export. Therefore, there is a need for changing the structure of the import by:

- Providing incentives (subsidies) for domestic production of identical or similar goods and services like imported ones;

- Diversification of domestic production in the manner described above in this strategy;

- Establishing antidumping actions for final goods and services imported from abroad and subsidized by their foreign authorities;

- Reinforcement of phytosanitary and environmental control of imported goods and services, as well as quality standards of goods and services imported from abroad;

- Allowing no limits, even introducing appropriate customs exemptions for imports of intermediate goods and services that will reflect the increase in domestic production and the supply of custom goods and services to domestic and foreign markets, etc..

Simultaneously, the authorities should encourage the export of goods and services by:

- Realization of new suggested model for economic growth;

- Measures that were mentioned above in this text;

- Subsidized incentives on selective basis (for goods and services whose production volume exceeds the absorption power of the domestic market, products whose production has a relative comparative advantage, etc.).

Such a combination of the proposed measures will result in reduced imports of final goods and services, increased production of goods and services, decreased outflow and increased inflow of foreign exchange, relaxation of fiscal and monetary policy and growth in total GDP of the country.

Expected Results

Newly established model of economic policy will result with multiple positive effects, primarily, it will be

manifested with the following indicators (AMCC, 2011):

- Increase of the number of new SMSEs. In an ambient that offers great opportunities for action in various spheres of economy, the easiest and the most adaptable are SME. This fact will determine the number of newly SME in the next five years to increase an average of 11,000 SME annually. Of course, for various reasons, in that period some SME will be closed. However, at the end of 2015 in Macedonia there will be about 100,000 SME, that will be more than 40,000 SME at the end of 2010;

- Dynamic creation of new SME will increase the level of domestic investment by large amount and rates ever observed. If we assume that each newly opened SME will start working with an initial capital of 10,000 Euros and if their capital increases with the expected rate of 20 percent a year, then the additional amount of domestic investment made by SME at the end of 2015 would be about 1.4 billion Euros, i.e., an average year investment level is approximately 280 million Euros. This average annual amount has not been achieved either by an influx of foreign direct investment in the period after passing all the political and economic independence of RM. That fact confirms the conclusion that the competent institutions should pay attention to stimulating the domestic equivalent, even at a higher level than the foreign direct investment;

- Large number of the newly opened SME 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 will contribute to the encouragement (increase) the average annual industrial production from a 8-10 percent;

- The increased volume of investment by SME, 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 will be newly increased number of new employees. Assuming every newly opened SME employs 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 percent;

- Applying the aforementioned incentives will increase the volume of production that SME 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 of 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.

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. The volume and quality of performance of the economy of the Republic, to a great extent, will depend on (Nenovski, 2011):

(1) Further development of the global economic crisis, whose prolonged action has ramifications throughout 2011;

(2) 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);

(3) 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;

(4) 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;

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

(6) 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.

Conclusion

Creating the proposed new economic model in the RM should lead to realization of two important goals: achieving lasting, sustainable and significantly higher rates of economic growth and reducing the high rate of unemployment 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.

Of course, achieving those goals and effects will be far from easy given the numerous risks, threats and restrictions to which economy will be exposed in the 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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