
HIDDEN SOCKS FROM THE ECONOMIC CRISIS IN MACEDONIA DURING 2010

■ **Abstract:**

Macedonian managers are scared that the crisis will continue in 2010, giving new and much stronger economic socks. Most of them will be price oriented, coming from outside. People from the government are scared too, but they do not like to admit it. From one side this is good because they are the last which should show pessimism. They should be optimists because only then they will canalize and direct the economics ahead, which means that they will do all the necessary steps to help the real sector. But if this optimism is not real, than is not serious and detrimental. It is not allowing them to accept the fact that the economic crisis in Macedonia is not finished yet. Some numbers are predicting more complex period with higher budget deficit, lower consumption, bigger unemployment rate and significantly higher trade deficit. The beginning of 2010 is showing that company's profitability will be significantly low. It is obvious that the government anti-crisis actions do not gave the necessary results and there is an immediate need for completely new steps. There are some steps that immediately should be taken for better business climate in Macedonia. They should be oriented toward improvement of the company's liquidity and promoting investment activities with the same conditions for the domestic and international entities.

■ **Keywords:**

anti-crisis actions, business climate, company's liquidity, economic trends, investment activity

■ **INTRODUCTION**

With very pessimistic thoughts the managers in Macedonia finished 2009. Very sincerely they admit that are scared from the situation and that the crisis will continue and will be even stronger in 2010. In the Government are scared also, but they do not like to acknowledge. From one side this is good because they are the last one that should show pessimism. The prime minister and the other ministers should be optimists because only that way they will lead the economy, which means that they will do the necessary actions to help the real sector. But, if the optimism is not real, than it is not serious and realistic. It is not allowing them to open their eyes and see the real situation, which means publicly to admit something that is more than realistic, that the economic crisis in Macedonia is not finished yet.

The budget is the top priority of this Government. This budget must finance more than 100 000 public administration, social classes, retired people and even the Government campaigns. The main question here is-From where the money will come? Does the increased public spending can be financed by the lower income for the households and companies? Is it possible all the time to take, and never to give, and to help the private sector, as it is done in all the countries under this crisis? According to the ministry of finance, most probably during the second quarter of this year new Eurobond will be emitted, not to finance some infrastructure project, but mainly because of the lack of money in the budget.

It is sure that the electric energy will be expensive for more than 10%. The price of the

crude oil will have upward trend mainly because of the globally stronger economy. Both of them are included for about 50% in the overall expenses for the bigger industries in Macedonia, which in the same time are the biggest exporters and are making the biggest foreign exchange earnings.

Even though the necessary steps till now are not made, and the numbers form the first three months are showing bad condition of the Macedonian economy, we should expect that during 2010 the economic situation will be better than in 2009, but that the economic recovery will be slow and will take longer time than expected. This means that the economy officially is out of recession, but according to the best case scenario, the GDP increase will be not more than 2%. We can say that it will depend on the world economic recovery. We imported the recession. Now we should import the recovery also. But, as we were late with the import of the recession, it is obvious that the import of the recovery will be late also. Some pessimist scenarios are arguing that we haven't still seen the worst situation from the recession.

We still believe the Macedonian economy will recover from the crisis slowly, but surely. There are two main risks for the economic recovery. The first one is that the world economic recovery will fail to reach the expected increase between 1 and 2%. The second one is connected with the country's balance of payment, which should improve enough and to ensure lower interest rates, which is the main point in the economic growth.

Other types of risks in Macedonian economy are located in the labor market and financing sources, especially foreign investments. Although bigger usage of exported capacities is expected, the imported dependence and increased price of fixed costs will provoke bigger deficit in the current account. This will make bigger pressure on the foreign exchange market and denar's rate of exchange. This is guaranteeing stronger monetary policy, which main goal is stronger denar. Mainly the same situation as 2009.

■ **SOUTH EAST EUROPE**

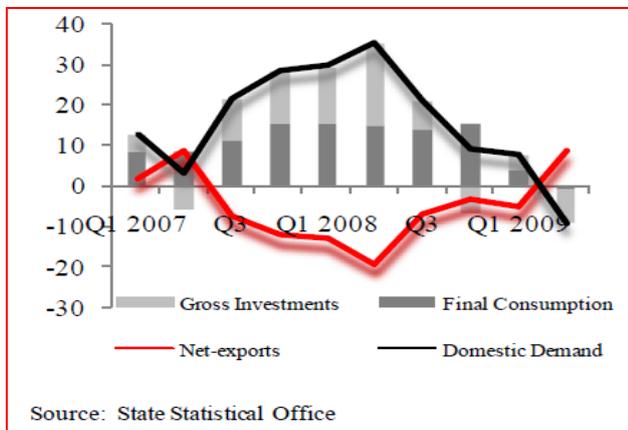
The crisis in the countries from Central and East Europe mainly entered via the channels of demand for their exporting products, decreasing the capital gains and significantly negative

expectations from their companies initiated from the crisis in the developed countries. Opposing to the good economic results in 2008, in 2009 this group of countries had decrease in the economic activity. The domestic demand was under the influence of the negative expectations: slowing the credit growth in the situation when the risk increase and the places for financing decrease, uncertainty about the future economic trends and absence of bigger investment decisions. Depending on the variation of the economies and the stability of their fundamentals, there is difference in the intensity and speed of entrance of the crisis, which will also make difference in the recovery from the crisis in those countries. Except Bulgaria and Croatia, the external debt of the other countries from this region has regular margins, which is one of the positive reasons why they should smoothly pass the crisis. Speaking separately, the biggest decrease in the economic activity is perceptible in Turkey, about 15% in the first quarter in 2009, but in the second the decrease was half in comparison to the first quarter. In this group of countries, Turkish economy has bigger chances for faster recovery, mainly because of the stabile banking system (in comparison to other regional countries), small external debt and diversified base for economic growth. On the other hand, the economic slowdown in Romania, which was 6% in the first and about 9% in the second quarter of 2009, does not give any signal for faster recovery, but longer anemic economic revitalization. This is coming mainly from the long period of low domestic demand, but also from the fact that the financial stability was not very bright point of Romanian economy even before the crisis. The inflation slowdown is noticeable in all the countries from South East Europe, mainly because of the lower pressure from the prices of imported products and the demand. But, in some countries like Turkey and Serbia, the inflation is gravitating around 7-8%, which is comparable to the nominal depreciation of their currencies.

■ **MACEDONIAN ECONOMY DURING 2009**
 ■ **AGGREGATE DEMAND**

A characteristic of the second quarter of 2009 is the faster decline of the domestic economy, but also the change in the direction of the domestic and net-export demand. Unlike the first quarter,

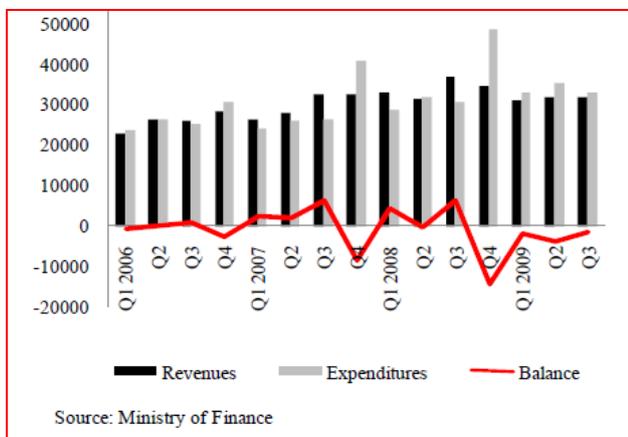
when the decline was a result of the lower exports as a consequence of the lower foreign demand, the main factor of decline in the second quarter was the reduced domestic demand, i.e. the lower private and investment consumption. Such structural changes indicate a process of adjustment of the behavior of the domestic entities, and they indicate that regaining of the confidence will be one of the factors for recovery from the crisis. On the other hand, the larger contraction of the domestic demand relative to that of the foreign demand spilled over in the imports, whose intensive decline is the reason behind the positive contribution of the net-export demand. This can be seen from the graph 1 presented below.



Graph 1: Domestic Demand and Net-exports

BUDGET AND PUBLIC CONSUMPTION

In circumstances of higher nominal growth in expenditures (10.7%), relative to the growth in the revenues (0.3%), in the second quarter of the year, the consolidated budget deficit went up to 0.9% of the projected GDP for 2009 (from 0.5% of the projected annual GDP in the first quarter).



Graph 2: Budget revenues and expenditures

The growth in budget revenues was entirely a result of the paid dividend of one company. On the contrary, the deteriorated economic condition continued to reflect also on the tax revenues, so that the VAT revenues registered a decline of 14.5%, as a consequence of the inhibited economic activity, while the revenues from the profit tax dropped by 70.4%, partially due to the deteriorated profitability of the companies, but partially also due to the tax relieves which came as part of the anti-crisis measures. On the other hand, the increase in budget expenditures is to a large extent a result of the higher current expenditures (11.2%), primarily of the growth in wages (16.3%) and pensions (10.8%), given the high rise both in the transfers to local authorities (22.3%) and other transfers (27%). Increase was registered also in the capital expenditures (6.5%), which stimulated the construction and investment activity in the economy.

EMPLOYMENT AND WAGES

Despite the annual contraction of the economic activity in the first two quarters of 2009, no changes in the trends were evident on the labor market in the following quarter. Thus, in the second quarter, the upward trend in the employment continued in this market segment, with simultaneous drop in the unemployment rate being registered. The lack of reaction on the labor market can be partially explained with several factors. First, the change in the phase of the economic cycle transferred on the labor market with certain delay. In most of the other economies, where the recession touched the bottom, the adjustment of the labor market already happened, whereas our economy expects the deepest drop to happen in 2010. Simultaneously, these economies characterized with more intensive fall in the economic activity relative to the drop in the Macedonian economy. Second, with most of the companies, the decrease in the level of facility utilization was followed with temporary termination of the engagement of the employees, as a consequence of the uncertainty about the character and the sustainability of the effects from the crisis. Simultaneously, the uncertainty on the crisis duration discouraged part of the employers to reduce the number of employees in this phase. These factors were still not enough to explain the improvement of the trends on the labor market,

manifested through the growth in the employment, which still can be explained mainly by the growth in the employees in the public administration. However, the fall in the domestic economy till the end of the year indicated to potential worsening in the conditions on the labor market in the area of the unemployment in the following period.

■ BALANCE OF PAYMENTS

In the first half of 2009 positive developments were registered on the current account. The effect from the drop in the export transferred on the import demand with more intensive dynamics, and it was intensified with the smaller pressures through the domestic demand as well, which resulted in annual narrowing in the trade deficit. Simultaneously, with the stabilization of the expectations of the domestic entities, the pressures on the domestic currency dropped as well, so since April the net inflows from private transfers registered upward trend. Opposite to this, the global financial crisis still restricts the foreign investors and creditors to make more considerable financial investments, so the annual fall in the net inflows continued in the capital and financial account. In July 2009, the trend of more intensive downward adjustment in the domestic demand relative to the foreign continued, thus narrowing the trade gap. Despite the positive trends, the risks about the recovery dynamics of the global economy and the re-stabilization of the global financial flows were still high. This created uncertainty about the possibility for the domestic economy to withdraw additional capital inflows, necessary for funding the gap in the current transactions.

■ INFLATION

The annual average inflation rate in the third quarter is negative of 1.4%, compared to the 0.6% price cut in the second quarter of 2009. Consequently, the cumulative price change shifted to the negative zone, and in the first three quarters of 2009, the average inflation rate equaled -0.4%. The price cut primarily reflects the high-base effects of the energy and food price component, and the decrease pressures of the import prices and the fall in the aggregate demand. The labor unit costs went up in the second quarter of 2009, as well, given the lower productivity and higher paid wages, but as the demand dropped, no larger inflationary

pressures are expected through this channel. The annual inflation rate projections indicate further decrease in the next period, due to the broadening of the negative output gap and the expectations for relatively stable prices of the global products.

■ GOVERNMENT ANTI-CRISIS ACTION

The governments of most of the countries came with anti-crisis actions to smoothly overtake the global financial and economic recession. The same was done in Macedonia from the state government. First group of these actions was brought in November 2008 with the fiscal stimulus of 330 million Euros for the domestic economy. The actions, according to the government, were mainly pointed to the companies who have problems with liquidity, but also to help the companies that were in a good condition during the recession. The second anti-crisis actions were brought as eight year program for infrastructure projects with total amount of 8 billion Euros. The idea on the short run was helping the building and construction sector which is directly influencing the economic development, and on the long run to improve the competitiveness of the domestic economy. April 2009 there are another, third, anti-crisis actions which cover 70 steps which can be grouped in 3 segments. The first one is rebalancing the budget, which include change of the asset and liability sides in accordance to the macroeconomic projections and situation on the market. The second one is direct help for the companies with credit lines. This should be especially pointed to the small and medium companies which are either working for the domestic market or are exporting to other foreign markets. And, the third segment is consisted of 54 other steps for support of the companies in the specific fields like faster customs procedures, lower transportation costs for companies and transporters etc.

■ ECONOMIC SITUATION IN 2010

It is obvious from the beginning of 2010 that company's profitability will be significantly low. All the steps that will be taken from them for the exit from the crisis will be unsuccessful if there aren't specific actions that will give them the opportunity to work normally. Here, the priority is given to the public sector, which should be of support for the private companies, not just for

their rigorous control. It is normal to work according to the obligations given from the laws, but not to produce norms in order to oblige companies to pay penalties. This process must come to an end. There are two steps that are against the interest of the companies and are showing why the government should stop with this process. First, the Custom officials do not accept the custom guarantees from the import companies, which are issued from the banks. This means that the companies that already had guarantees from the banks will have to additionally deliver funds from their cash flow in order to pay the current customs. This will have significant financial impact on the companies which have to wait from the Custom to return back that funds. Second, on every fifteenth of the month, when the return of VAT should happen, in fact nothing is happening. This means lack of funds for the production companies that should be invested in the current production. It is a big question for the production companies when the return of VAT will be, while in the meantime the state liquidity is contemporary improved.

It is obvious that the budget has a lack of funds to finance the basic obligations. The revenues from the penalties from private entities and companies will cover the shortage to some extent, after which there will be no sources for funds to cover the rest of the government spending. After this, we will be all victims of the forced obligations and penalties for the private companies, coming together with the late return of VAT. With the forced obligations and penalties for the private companies the government should collect 50 million Euros in 2010. Even this is not the biggest problem if the government spends the money for some capital investment, building new factories or highways. All that money are planned for paying the interest rate for the domestic bonds, but also for the Eurobond issued from the government. In fact, the government will finance the banks, domestic and international, with the money collected from the private companies and the real sector in Macedonia.

■ ACTIONS FOR BETTER BUSINESS CLIMATE IN 2010

There are some steps that immediately should be taken for better business climate in Macedonia. Here are some of them as proposals:

1. Promoting investment activities with the same conditions for the domestic and international entities.

With the intention to assemble as more as possible international investments, the Government brought new measures with the changing of the Law for Technological and Industrial Development Zones, with which there is a possibility for the Government to give support for the potential international investors. As one of the news in this law is 100% relief for the personal tax obligations for 10 years for the international companies that will invest in Macedonia, which previously was 50% relief for five years. This is surprising for the business community. One of the basic issues from the economic crisis was the importance of the domestic production in the real sector and the influence it has on the domestic supply. This reason is enough for the government to equalize the conditions for investing for the domestic and international investors.

It is fact that the international investments are key factor for intensified production without increase of the aggregate spending in the country, which on the short-run will decrease the trade deficit. It is also fact that production increase is in direct proportion with the technical and technological modernization and know-how, which faster will come with international direct investments. That is why there should be a big priority for the Government to intensify the international investments in Macedonia. But, the increase of the international investments should not decrease the importance of domestic investments. After all, all business subjects are equal in front of the law and should be equally important for the country.

2. Actions for improvement of the company's liquidity in Macedonia

As mentioned previously, the liquidity is among the biggest problems for the companies in Macedonia. Very big percentage from the companies has problems with the payment of receivables. This is resulting with everyday problems, accounts blocked, inability to compete for better credit lines etc. Some of the proposed actions are:

- *Insuring the short-term inquiries from the domestic buyers on the basis of sold products and services - There is a possibility for the domestic companies to insure the short-term*

inquiries from the international buyers after the export is done, but the business sector is trying to have the same condition regardless of the origin of the buyer. With this, the Bank for Support and Development (MBSD) will indicate new service and scan the domestic company which is the buyer for the products of services (same as the international company), after which will guarantee or not that the payment will be done after the specific period..

- *Realization of the compensation for the debt obligations between the private and the public sector - On the long run this will regulate the obligation between the private and the public sector that are lasting for years. For this, a new law that will regulate this type of obligations is needed. This law will regulate the subjects which will enter in this type of compensation, type of obligations, their level, way and time of realizations etc.*
- *Coordinative actions of different inspection officials - Initiation of new Coordinative Body for inspection officials, which main activity will be collecting the data for the companies from different officials and making a data base for the companies, which will shorten the time that inspection officials are spending in the companies.*

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