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The Global Financial Crisis and its Socio-economic Effects in Macedonia – the Social-democratic Response to the Crisis

By
Joonas Rahkola, Dragan Tevdovski, Marija Stambolieva



**THE GLOBAL FINANCIAL CRISIS AND ITS
SOCIO-ECONOMIC EFFECTS IN MACEDONIA –
THE SOCIAL-DEMOCRATIC RESPONSE TO THE CRISIS**

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Summary

The paper analyses the economic and social effects of the current crisis. The text first describes the reasons behind the global crisis and its consequences and then focuses on the effects in the Republic of Macedonia. It analyses the capability of the Macedonian socio-economic system and its institutions to cope with the crisis. By giving a comparative

overview of the crisis that the Scandinavian countries experienced in the 90ties and their recovery through the use of social-democratic policies, the paper tries to offer policy options for the Macedonian case. The authors conclude by giving recommendations for future policy actions.

The economic downfall that we are facing now globally is going to have a significant impact on the global economic order. The failure of the politics that relied on free markets and believed on the ability of the markets to regulate themselves will alter both economic thinking and mainstream economic policies. In the first part of the paper we will first recapitulate the background of the crisis and then give a glance to actions that policy makers need to take in order to overcome the crisis and return to the path of socially and economically sustainable growth. Particular attention will be given to social democratic aspects of the post-crisis policies.

The end of the neoliberal era

The roots of this crisis lie in the neoliberal era of economic deregulation and free markets. The neoliberal dominance began in the 1980s first in the UK and the US after Margaret Thatcher and Ronald Reagan came into power. Then neoliberal policies spread quickly basically to all market economy countries. During that era markets were deregulated around the world, this was the case especially with financial markets. Economic policies around the world were based on the belief that free markets are always efficient and they produce economically best outcomes. The role of government in the economy was reduced in nearly all countries with market economy.

Many still view the neoliberal period as a success, but the economic and especially social consequences of the neoliberal politics were not really that impressive: the global economic growth was significantly lower in the years 1980-2000 compared for example to the Keynesian era from 1950s to 1970s. Also the fruits of the economic growth were distributed unequally during the neoliberal era: income inequalities grew significantly both within and between countries.

Now the neoliberal era is drawing to a close. It seems that the neoliberal, free-market-orientated policies seeded their own seeds of downfall. The developments we have seen both in the financial markets and in the real economy during the last two years show that the ultimate free-market policies did not work and that they brought the global economic

system almost to a collapse. Greed and short-term seeking of profits did not serve the interests of societies in the end. Markets were not able to work out on their own and regulate themselves.

In the financial markets perverse incentives encouraged hazardous short-term risk-taking. The Financial sector innovated more and more complex and non-transparent instruments. Basic problem was that financial markets were treated as they would have been like any other sector of production, not as a mean of allocating finance in real economic activities. This created a bubble especially in the prices of asset-backed securities. The expected return on those securities was unsustainable high, which in turn biased the allocation of financial capital towards these instruments instead of the healthy investments in the real economy.

Without sufficient financial regulation, the biased micro-level incentives created a systemic risk that was not taken into account in the decision-making process of the actors in the financial markets. Finally this systemic risk realized during the years 2007-2008. The problems escalated right after the collapse of Lehman Brothers in September 2008. The whole global financial system faced a serious risk of a total collapse, but now it seems that the worst systemic threat for the existence of the financial system has been averted. The acute re-structuring and the trillion dollar bail-outs for the banks have stabilized the financial markets at least for a while. However, everyone seems to agree that the global financial architecture needs fundamental reform in order to avoid the realization of the systemic risks in the future. These acute actions that have rescued the financial markets from immediate collapse are surely not enough.

The almost-collapse of the financial markets was followed by a severe global slump in the real economy. The malfunction of the financial markets launched the downturn in the real economy, but the main fundamental factors behind the slump lie in the global macroeconomic imbalances. The aggregate debt of the private sector had grown significantly during the last thirty years especially in the US, which was consuming more it could have afforded. The US savings

rate (roughly income minus consumption) was close to zero for many years before 2009, which is an unsustainable situation in the long run.

The over-consumption of the US was possible because of the huge current account surpluses of China, oil-exporting countries, some high-income countries (mainly in Northern Europe) and some emerging economies (that had current account surpluses as a result of restrictive foreign currency reserve requirements of the IMF). Capital flows from these countries ended up mainly in the US, financing their deficits. Globally the US economy acted as a “consumer of last resort”. It was only a question of time when these imbalances would end up in the downfall of the global economy. As a result we are now facing a restructuring of the whole global economic order.

We need strong international policies

The crisis requires coordinated policy responses on many dimensions on both international level as well as national levels. Ensuring the proper functioning of the financial markets in the future is an essential policy question that policy makers have to solve, but alone it is not enough.

As economy is globalized, also governance has to become more global compared to the current situation. Now policies, especially economic policies, are too often tied to national context. Achieving truly global political rule over economy requires the strengthening of global economic institutions (like IMF or World Bank) and re-defining their objectives. Right steps towards closer international co-operation and coordination in economic policy have also been taken (like the G20 summit in London in April), but their results have however been rather modest this far.

Now the crisis has spread into real economy globally. The next phase is global employment crisis that has already realized in many countries. The main driving force behind this is the sharply reduced global total demand. The most urgently needed global macroeconomic action is thus an increase in public consumption and investments. Since the private sector is

stagnated, the governments (or other public bodies) are the only actors that can take this responsibility. The US has increased their public expenditure significantly, and other countries (especially EU) should follow their policies.

The financial sector as such is and will be an integral and vital part of the economy. In the building of the new financial architecture we should be careful of not throwing the baby away with the bathwater: markets still have their advantages. The question is how to use these advantages in a socially sustainable way. Financial architecture needs to be restructured so that finance markets serve their purpose: allocating financial capital in real economic activities in an efficient manner. The interests of the financial sector must be aligned with the interests of the whole society. For example, new standards of transparency and disclosure are vital for efficiently operating financial markets. All actors in the financial markets should be regulated and monitored more effectively.

A basic problem behind the current financial regulation is that regulatory frameworks have been mainly national whereas finance markets have been global for a long time. National regulations have not been able to deal efficiently enough with internationally operating financial institutions. So the actions in improving the regulation have to be truly global. For example the combat against tax evasion and tax havens can succeed only if the actions are globally coordinated.

In the longer run both global financial regulation and global macroeconomic policy is needed. Economic globalization has clearly its advantages and its drawbacks are best resolved when economic policies work globally. Unfortunately, protectionist and nationalist voices are raising their heads currently in many countries. Retreating from economic globalization is not the right response to this crisis; it would only be harmful for global economic development and in the end also for those nations sticking to that kind of policies. We need global policies first in order to overcome this crisis and second in creating economically and socially more sustainable global economic development in the future.

The social-democratic point of view

What has been the role of social democrats during this turmoil and after that? While many right-wing politicians are returning to state capitalist and even protectionist ideas, left wing seems to be unable to work in any relevant manner. That is difficult since all mainstream social democratic parties haven't done any politics outside the neoliberal setting during the last decades. There haven't been alternative plans for the neoliberal agenda, so it is difficult now to move fast enough.

From social democratic point of view response to the crisis must be in line with the basic values of equality and social justice. Markets should be seen as a device that serves the interests of the whole society. In cases where markets don't achieve this, we should be confident enough to intervene in the markets in order to improve their functioning from the social point of view. Clearly a new balance between the markets and the state is needed: it is now clear that in the future governments will have a bigger role as regulators but also as independent economic players.

International examples have shown that in terms of economic efficiency and economic growth, the size of the governments is not the most fundamental factor. Instead of the pure size of the government, more essential question is that what does the public sector do and how it does it. We can identify many successful combinations of government and market: Anglo-Saxon countries have relied on markets and their public sectors are rather small, whereas for example in Northern Europe the public sectors are much bigger and the reliance on markets is smaller. In economic terms both groups of countries have succeeded well during the last decades. The difference is in social outcomes: Northern European societies are socially equal with small income and other social differences.

It seems that the more we want to incorporate social aspects in the political decision making process, we end up with a bigger public sector. During the neoliberal era a big public sector and high taxation were seen rather as obstacles to economic growth. The growth-promoting aspects of those were almost totally ignored.

Real-world examples have however shown that the neoliberal style reasoning is not consistent with what is really happening. Large welfare states and private markets can be combined in a way that enhances both social equality and economic efficiency.

Social democratic policies are based on understanding the interdependencies between social and economical developments. Economy cannot be treated as a mean of itself or as an entity that is separate from the rest of the society. All economic policies and their consequences should thus be seen in a wider social context. For example, when we assess economic growth, just looking at the absolute GDP growth rate is never enough. Social aspects of the growth, such as income inequality or the environmental impacts of the growth need careful consideration as well. From this point of view, the support of those most affected by the crisis should be at the heart of post-crisis policies.

The most urgent challenge is to manage the consequences of the massive job layoffs and quickly rising unemployment. If not managed properly, the rising unemployment will cause human suffering and political and social instability. Unemployment insurance schemes help to stabilize the income of the unemployed and prevent them from falling to absolute poverty. The main aim of employment policy should however be the creation of new jobs. Ensuring sufficient total demand by efficient use of public investments and consumption is essential. Full employment has to be restored as the most important aim of economic policy. It is also the best way of combating against income inequality, poverty and social exclusion.

The consequences of the global recession will be particularly harmful in developing countries. The number of people in absolute poverty will inevitably rise significantly. Deteriorating economic conditions that are not managed in socially sustainable way will cause difficult social and political consequences. Therefore, global solidarity must be an important aspect of the response to the crisis. Especially rich countries should not concentrate only on helping just themselves. Rising economic nationalism is a threat that needs to be averted.

I. THE ECONOMIC CRISIS OF FINLAND IN THE 1990S

In the beginning of the 1990s Finland faced a serious economic collapse. The background of the crisis was very similar with the crisis we are now facing globally: the overshooting of deregulated financial markets created a basis for a wide economic turmoil. In Finland this turmoil was particularly severe because bad economic policies and the collapse of the Soviet Union also had a harmful impact on the economy of the country. However, the recovery from the depression was also very fast. At least partly the fast recovery was based on determined growth policy. The policies resulted in fast economic growth, but now the downsides of those policies are becoming more and more visible as well.

The background: bad banking, bad policy, bad luck

The roots of the crisis lie in the liberalization of the finance markets that took place in Finland in the 1980s. Until the beginning of the 1980s the financial markets were heavily regulated: capital flows and interest rates were regulated by the central bank, the exchange rate of the Finnish currency (Mark) was fixed and governed by the central bank and the overall economic policy was centralized. In the middle of the 1980s the capital markets were almost totally liberalized during only a couple of years.

The liberalization created a credit boom. The debt policy of the banking sector was extremely loose: they kept giving credits to companies and individuals without really investigating the sensible usage of that money. During the time of strict regulation individuals and companies were used to take credit whenever it was possible to get it, and they did not change their behaviour in the new economic environment. This loose banking policy resulted in an asset price bubble as well as inefficient investments in the private sector. The debt/GDP ratio rose to record levels. The economy of the country was overheated. So basically what happened in Finland in the late 1980s was very similar to

that development we have seen in the US 15 years later.

During the time of the quick credit expansion the exchange rate of the Finnish currency Mark was fixed in an overvalued level. This together with lower international interest rates encouraged private actors to take debt in foreign currencies since they believed in the sustainability of the exchange rate.

The new economic environment with free capital markets was a new situation also for the policy makers and they were not able to react to the credit boom and overheating in a proper manner. Only few politicians and experts understood the economic problems and structures behind the overheating of the economy; most of them were feeling rather comfort with the record high GDP numbers (Finnish GDP/capita reached the world top 5 in 1989). The loose fiscal policy in the end of the 1980s was only boosting the imbalanced situation. The monetary policy reaction wasn't any better. The only real attempt to hold back the overheating economy was the re-valuating of the Mark in 1989, which happened a way too late. On the other hand it encouraged the private actors to take more debt in foreign currencies.

The Finnish economy was export driven already in the 1980s. The biggest trade partner was the Soviet Union. The trade with the Soviet Union accounted for about 25 % of the total Finnish export. Trade with the Soviet Union began to contract sharply in 1989 and it ended almost totally after the collapse of the Soviet system in 1991.

The collapse

The price competitiveness of the Finnish industry deteriorated in the late 1980s as a result of the overvaluation of the Finnish Mark. This together with a European downturn and the collapse of the Soviet Union brought the Finnish export industries to almost a standstill. Private investments fell sharply. The burst of the asset price bubble created a debt-deflation-circle that halted also the private consumption.

As a result the GDP fell by almost 15 % in 1991-1993. At the same time the unemployment rate rose from 3 % in 1990 to 18 % in 1994. The banking sector ended up in crisis and was rescued only by the huge capital injections from the government.

Economic policy during the recession: comparison with Sweden

During the first years the hands of the monetary policy were tied on defending the overvalued fixed exchange rate of the Finnish Mark: the central bank was forced to keep the interest rates at a high level in order to prevent capital outflows. High interest rates in turn sharpened the economic downfall. In the end of 1991 the central bank was forced to devaluate the Mark, which only worsened the situation of those who had debt in foreign currency terms. Finally the central bank wasn't able to guarantee the fixed exchange rate and the Mark became a floating currency. On the other hand this enabled lower interest rate that was crucial for the looming recovery.

The quickly rising unemployment and sharply declining economy created a big deficit in the public sector. The public budget deficit was highest in 1993, when it was 8 % of GDP. As a result the government started massive expenditure cuts and tax increases, which reduced the total demand in the economy and was thus making the recession even worse. After the recession there has been a wide consensus that the government's expenditure cuts during the most severe recession made it only worse and the balancing of the public budget should have begun some two or three years later.

It is interesting to compare the Finnish policy reaction to the Swedish one: Sweden also experienced a similar recession, although it was not as deep as in Finland. Sweden began the balancing of the budget later than Finland and Sweden had bigger public deficits for a longer time. This difference in economic policy was one factor behind the fact that the recession never was as deep in Sweden as it was in Finland: the Finnish policy of balancing the public budget as quickly as possible reduced the total demand in Finland during the most

severe recession, making the recession even worse.

At the same time Sweden relied more on Keynesian active fiscal stimulus with apparently good results. In Sweden the unemployment never rose even close to the Finnish levels. On the other hand the public debt rose in Sweden much more than it did in Finland, but after the recession the public debt has not been a major problem in either country. It is often stated that Sweden chose the road of higher public debt and Finland chose the road of higher unemployment. Socially the Finnish way was much more harmful: through higher unemployment the burden of the recession was much more unequally distributed in Finland.

From the Social Democratic point of view the differences in the social consequences of the recession are of a particular interest. First, as a result of more active fiscal policy the unemployment rate never rose in Sweden as high as it rose in Finland. Second, Finland was balancing the public finances by massive expenditure cuts in public services and in income transfers. Taxes were also increased. When Sweden began its budget balancing later than Finland, it relied more on tax increases leaving the welfare state arrangements more or less untouched. As a result, the poorest and the worse-off citizens were hit more severely by the consequences of the recession in Finland than in Sweden. By Scandinavian standards social exclusion became a major political problem in Finland. This phenomenon is still visible: the social inequalities remained bigger in Finland also after the recession.

The post-recession policies and their drawbacks

Finnish fiscal policy was pro-cyclical during the most severe recession. Instead of active fiscal stimulus, economic policy aiming at recovery and growth was based on long-term growth-promoting structural policy. In this sense Finnish economic policy after the recession can be seen as neoliberal, in which the focus of the policy was on long-term structural issues and short-term fiscal activism was not used.

The post-recession policies were based on a wide national consensus of the direction of the politics. All major political parties as well as other social partners (like trade unions, industry confederations) were committed to formulating the policies and adhered to them. Overcoming the economic crisis was seen as a national challenge that required strong and equal contribution of all members of the society. Minor conflicts of interests between different parties were set aside, and all parties were together trying to find the solutions that could help the country out of recession. For example, in 1995-2003 the government consisted of five parties across the political spectrum: from the ex-communist Left union to the right wing National coalition party, together with the Social democrats, the Greens and the Swedish people's party. Of course the policies faced also criticism, especially from the social point of view: it is often stated that the poorest and worst-off citizens didn't get as much attention as they would have needed and the fruits of the post-recession economic growth were unequally distributed.

Growth and recovery strategy after the recession was based on export-led growth. The devaluations of the Finnish Mark in 1991 and 1992 increased the competitiveness of export industries. Policies aiming at improving technological development were promoted forcefully. Productivity in industry, especially in technology industry, grew rapidly, adding to the improvement of the competitiveness. As a result, economic growth was rapid in the end of the 1990s and the beginning of 2000s. Share of exports grew steadily, reaching some 40 % of the GDP in the end of 1990s. The current account surplus was almost 10 % of GDP in the beginning of 2000s.

Massive tax cuts were one part of the economic policy strategy. The overall tax rate has been declining steadily, from almost 50 % of GDP in 1995 to current 42 % of GDP. As in a standard neoliberal thinking, tax cuts were seen as a prerequisite for growth and economic

dynamics. Later research has shown that the contribution of the tax cuts to growth has probably been very limited. This observation has also affected the direction of the current tax policy: now policy makers seem to share the view that we have seen the bottom in the level of taxation and the direction of the tax rate will be upwards in the future. In this sense it seems that the neoliberal agenda of the economic policy is changing also in Finland.

The massive tax cuts in the 1990s and 2000s meant on the other hand that the resources for developing the welfare state were limited. The level of social services and income transfers didn't develop as quickly as the rest of the economy. As a result, income disparities have grown rapidly after 1995. The growing social inequalities and the more and more difficult state of the welfare services became to receive wider attention in 2000s. Commonly shared opinion is now that the welfare state needs more resources in order to again achieve the level of the other Nordic countries. During the current global recession that constraints the public finances as well, that task will be very challenging.

In terms of economic growth the export-led strategy worked extremely well after the recession. However, the current global downturn has shown the downsides of the high dependence in export industries. The domestic economy of Finland and especially its finance sector and public sector were very strong before the current global crisis. At first it was thought that Finland could remain rather untouched by the global turmoil. Of course, this was a way too optimistic view, given that almost 40 % of the Finnish GDP is exported, and the export industries are producing mainly investment goods. The rapid reduction in the global total demand we have seen lately is very visible now in the Finnish economy as well: exports have declined quickly, which have caused a recession in previously very strong economy.

II. The effects of the current crisis in Republic of Macedonia

1. The economic effects

Macedonian economy felt the first effects of the global financial and economic crisis in the second half of 2008. The global crisis affected the economy via three main channels: lower trade volumes, lower foreign direct investments (FDI) inflows and lower inflows from remittances. The industrial production contracted by 10,8% in the first quarter of 2009 compared to the previous year. As a result, the rate of unemployment increases. The country is facing severe recessionary pressures and significant risk ahead. The main risk for macroeconomic stability of the country is current account deficit. Both the current account deficit size (12,7% of GDP in 2008, high for Macedonia and now comparable with vulnerable countries in the region) and its rate of deterioration are significant (current account deficit was 0,9% of GDP in 2006). The main contribution for this increase came from the trade account. In addition, private transfers no longer cover substantial part of the trade deficit. Accordingly, the need for external financing remains high. On the same time, there is increased inclination for foreign currency, which made strong pressure on the foreign exchange market.

Fiscal and monetary policies of the country are not coordinated. The Government response to the crisis is very slow. The fiscal policy forces strong public spending, which have crowding out effect for the business sector. There is shortage of investments in road and energy infrastructure as well as human capital related

investments (education and health). The monetary policy is strongly committed to maintain the current informal peg to the euro and macroeconomic stability of the country. The monetary conditions are continually tightened. As result it is become much heavier for Macedonian companies, not only to enter into the investment activities, but also to finance their current activities.

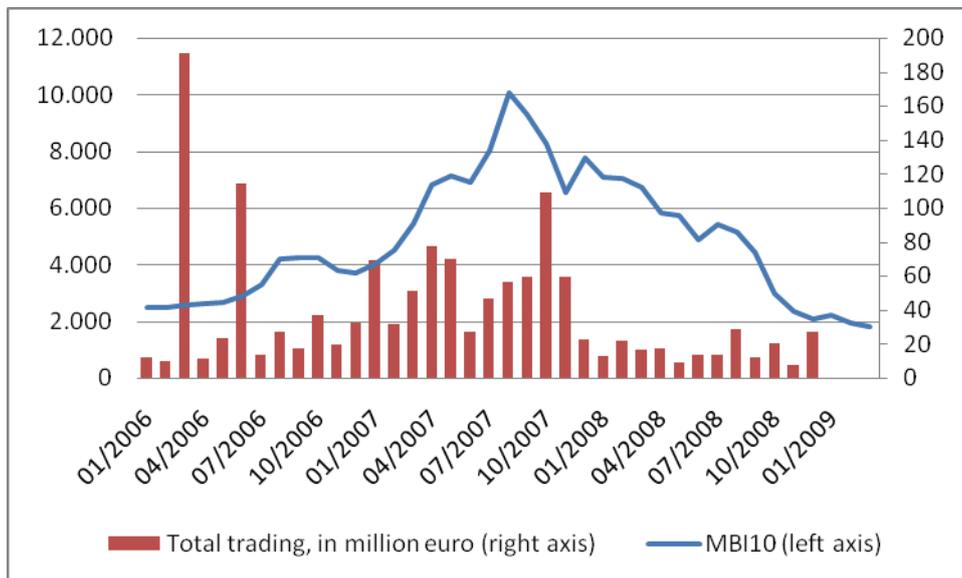
In this part of the paper we analyze the effects of the crisis on the both financial and real sector of Macedonian economy. At the end we comment the policy responses.

The financial sector: stable banks and bear market

The Macedonian financial system is dominantly based on the role of banking sector as a financial intermediary. On the other hand, in the last few years, the capital market became attractive as an investment opportunity for the domestic, as well as the foreign investors (Arsov, 2008). We analyze the effects of the global crisis on these two segments of the financial system.

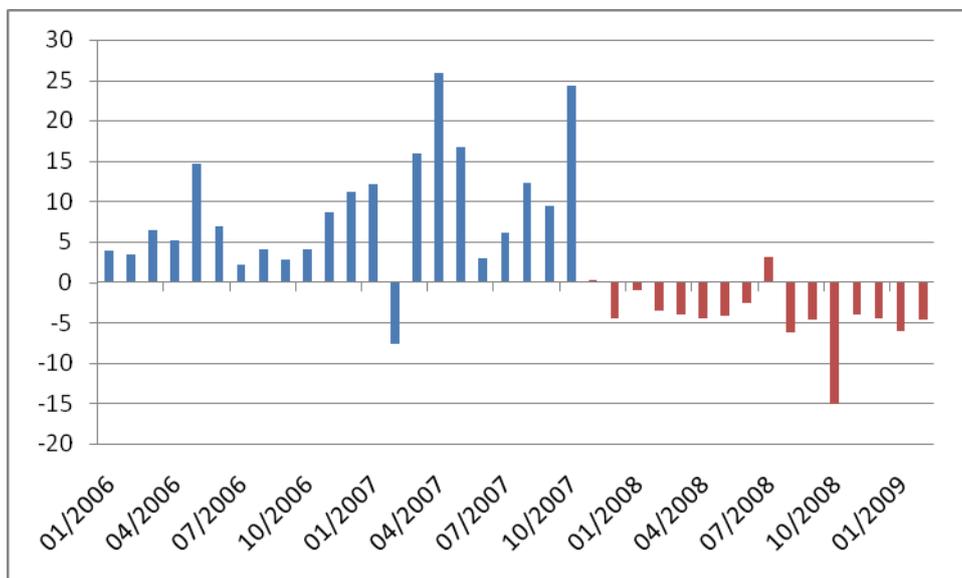
The most of the Macedonian banks are in dominant foreign ownership. The banking sector itself consists of 18 banks. The 11 banks were in dominant foreign ownership at the end of 2007, while 3 other banks having being acquired by foreign banks in 2008. Also, at the end of 2008, the foreign capital participates with 74,3% in the total equity capital of the Macedonian banks (5,2% more than the 2007) and the assets owned by the banks under dominant foreign ownership represent 92,7% of the total assets in this sector (6,8% more than the 2007).

Figure 1: **MBI10 and total trading on the Macedonian stock exchange,**
January 2006 – March 2009



Source: Macedonian Stock Exchange.

Figure 2: **Net foreign portfolio investments,** in million euro, January 2006 – February 2009



Source: National Bank of the Republic of Macedonia.

Fortunately, the banking sector has remained stable. The main reasons for the resistance of the Macedonian banks are: (1) The banks maintain a rather conservative structure of their operations, with savings deposits as a

major source of funds and loans as the major item in their investment portfolio (Arsov, 2008). The coefficient credits/deposits is 92,8% in 2008 (14,9% higher than 2007), which is significantly lower than 135% from the

developed countries. (2) The credit penetration of the Macedonian banks is 42,9% of GDP at the end of 2008 (6,9% higher than 2007). In comparison, the credit penetration is 132% of GDP in the developed countries (Petkovski 2008). (3) The banking system is well capitalized. The coefficient of the capital adequacy was 15% at the end of September 2008, which is almost two times higher than minimum of 8%. Macedonian banks had 6% higher capitalization than commercial banks and 3,5% higher capitalization than investment banks in the developed countries (Bisev, 2008). (4) The financial crisis most hardly stroked international investment banks. The Macedonian banks in their portfolios didn't have financial derivatives from the international markets. So they weren't directly exposed to the global financial crisis.

In the financial sector, the effects of the crisis are most visible on the Macedonian stock market. The Macedonian stock market has experienced a sharp decline in both prices and trading volumes (Filipovski, 2008). The line on the figure 1 presents the significant downward trend of the Macedonian stock exchange index (MBI10), which started in September 2007. MBI10 is reduced for 81,91% in the period from September 2007 to March 2009. Also, the bars on the figure 1 presents that total trading volume (classical trading and block transactions) on the stock market is reduced in 2008. The total trading volume in 2008 is 202 million euro and it is significantly lower than 2007 (681 million euro) and 2006 (506 million euro).

There are three main factors for this bear market: (1) Macedonian stock market has been to a large extent dependant on the liquidity provided by the foreign portfolio investments (Filipovski, 2008). During the period of bull market (January 2006 – August 2007), the average monthly net foreign portfolio investments is 7,89 million euro. In contrary, because of the global crisis, there is continual outflow of foreign portfolio investments in the period from November 2007 till now (Figure 2). The average monthly net foreign portfolio investment is -4,22 million euro in 2008. (2) The activity of domestic investors is significant

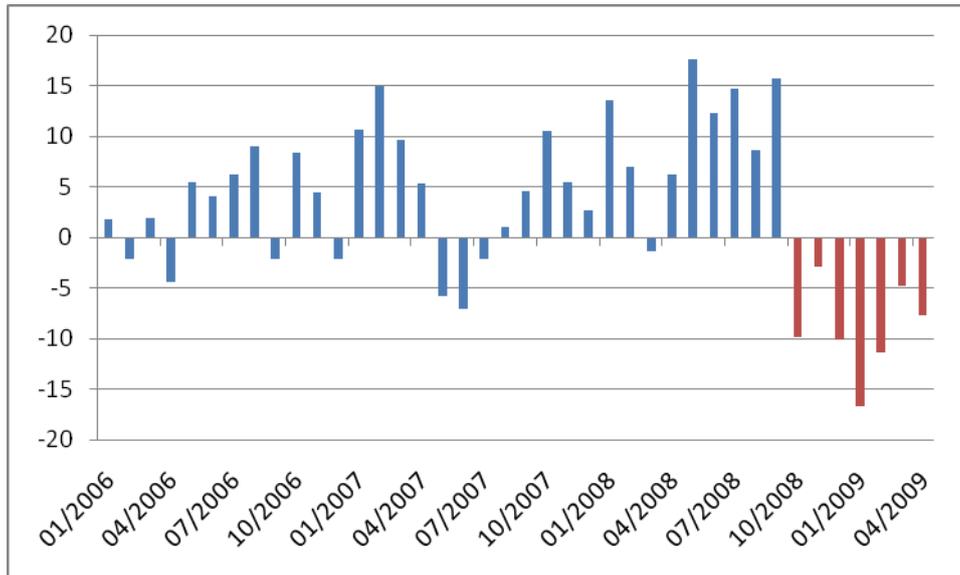
proportion of the overall market activity. The policy of strengthening the credit conditions lower the available capital for investment in the stock market. (3) The investors did not react on the Government anti-crisis measures. Their expectations for the Macedonian economy became pessimistic. Also, the investors' expectations were influenced by the political failure of the April 2008 NATO Summit.

The real sector: lower economic activity

Macedonia has small and open economy. The external trade scope is 20% higher than GDP (for the year 2008). The effects on real sector are transferred through the reduced demand for exports goods. The export creates 44% of GDP (year 2008). Domestic companies started to adjust their plans to the substantially lower outlook on demand by reducing their output already in the second half of 2008. Economic activity decelerated sharply in the fourth quarter of 2008, mainly as a result of weak investment, while private and public consumption remained strong. Real GDP growth slowed to 2,1% in the last quarter, compared to 5,7% during the first three quarters of 2008. Gross fixed capital formation dropped by 33%, while private consumption rose by 11% and public consumption by 23%.

Industrial production, which accounts for some 20% of GDP, contracted sharply in the last quarter of 2008 (by 7,6%), figure 3. In the first quarter of 2009 the contraction of industrial production is much stronger (by 10,8%). All industrial sectors lowered its output. The biggest industrial sector, manufacturing decreased by 12,1% in the first quarter. Main subsectors for this strong declination of the manufacturing are: manufacture of basic metals (declination by 61,2% in the first quarter), manufacture of wearing apparel, dressing and dyeing (by 23,7%), manufacture of textiles (by 27,9%), and manufacture of wood and of products of wood and cork (by 23,5). The two other industrial sectors, mining and quarrying, and electricity, gas and water supply contracted by 12,6% and 1,6%, respectively.

Figure 3: **Growth rates of production volume index, January 2006 – April 2009**

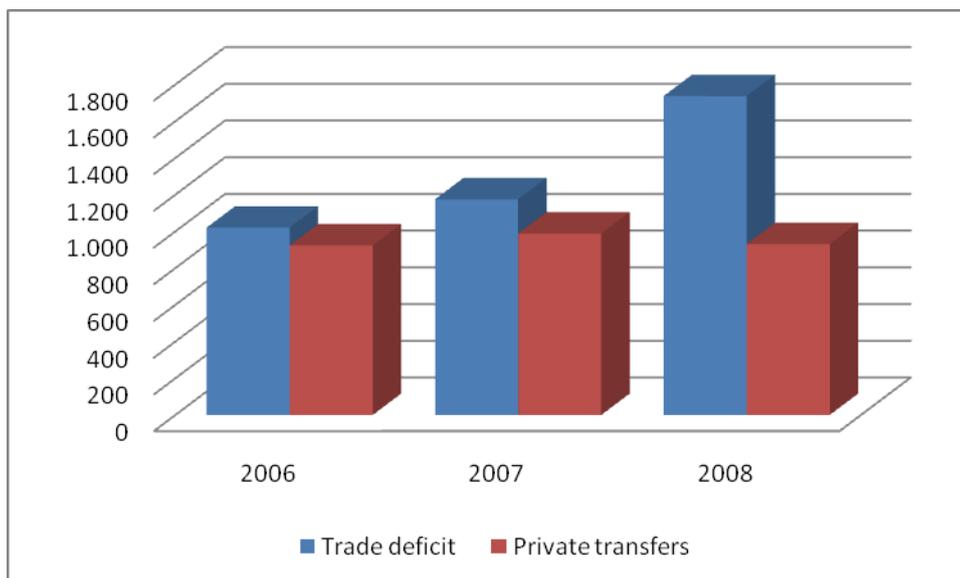


Source: State Statistical Office of the Republic of Macedonia.

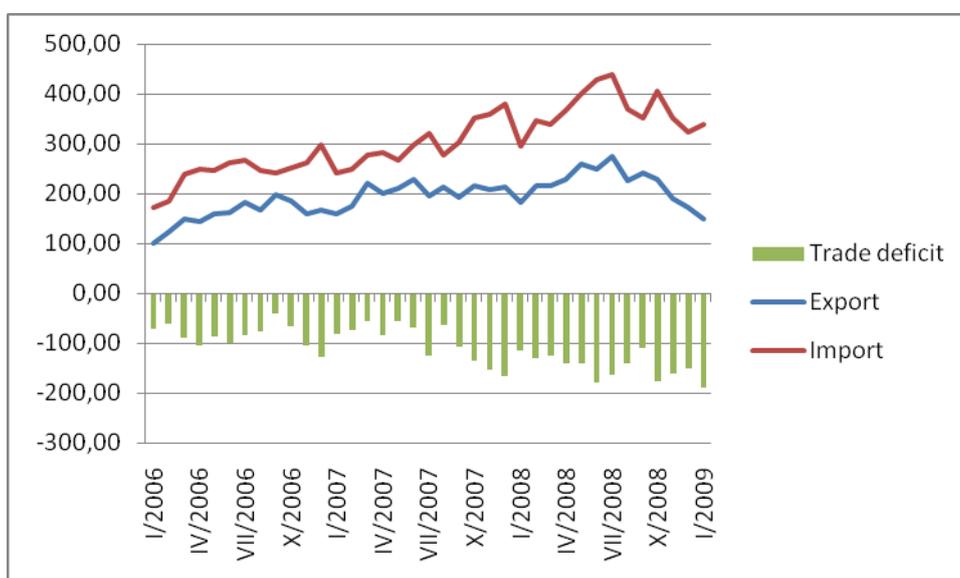
Declination of the economic activity leads to further worsening the unemployment. The number of employees in industry is decreased by 4,4% in the first quarter of 2009 in comparison with the same quarter of previous year. In addition, the total number of unemployed is increased by 7915 persons in March 2009 in comparison to December 2008.

The main risk for macroeconomic stability of the country is current account deficit. The current account deficit size is significantly increased in 2008. It is 851,16 million euro or 12,7% of GDP in 2008). As comparison, it was

44,92 million euro or 0,9% of GDP in 2006. In 2006, Macedonian current account deficit was smallest in the region. Now, the current account deficit is comparable with vulnerable countries in the region. The main contribution for this increase came from the trade account. As the figure 4 suggest, the trade deficit increased from 858,48 million euro in 2006 to 1.736,67 million euro in 2008. Average contribution for the trade deficit of a month during 2006 is 85 million euro. In contrary, average contribution for the trade deficit of a month during 2008 is 144 million euro (figure 5).

Figure 4: **Private transfers as proportion of trade deficit**, in million euro, 2006 – 2008

Source: National Bank of the Republic of Macedonia.

Figure 5: **Import, export and trade deficit**, in million euro, January 2006 – January 2009

Source: National Bank of the Republic of Macedonia.

The situation is even worse in the first quarter of 2009. The decreasing of import in the first quarter of 2009 in comparison with the same quarter of 2008 is 27,8%, and the decreasing of export in the first quarter of 2009 is much stronger (43,3%). It leads to the conclusion that

the average contribution for the trade deficit of a month during first months of a 2009 is higher than those of 2008.

In addition, private transfers no longer cover substantial part of the trade deficit. The private

transfers had upward trend in the years till 2008. In the 2008 they decreased by 57 million euro (from 988 million euro in 2007). The coverage of the trade deficit with the private transfers was 90,46% in 2006. The coverage of the trade deficit with the private transfers is 53,60% in 2008. The private transfers are even smaller in the first months of 2009. For example, in the January 2009 they are decreased by 13% in comparison with the January 2008.

Accordingly, the need for external financing remains high. But, the foreign direct investments (FDI) are smaller in 2008 than in 2007. The FDI are 422,02 million euro in 2008, and they were 506,85 million euro in 2007. The FDI in January and February 2009 are 33,33% smaller than the same month in 2008.

At the same time, the psychological pressures are increased. They are manifested through deceleration of the growth of the deposits at the banks and increased inclination for foreign currencies, which made strong pressure on the foreign exchange market.

The Government and National Bank of the Republic of Macedonia, at first, gave the unreal predictions for the growth of the Macedonian economy in 2009. Government predicted 5,5% growth of the real GDP. The National Bank predicted 3,5% growth of the real GDP. Both institutions lowered its predictions during the 2009. The International Monetary Fund (IMF) and Wien Economic Institute predict that the growth of the real GDP will be -2% in the 2009.

State statistical office of the Republic of Macedonia will publish the data for the GDP in the first quarter of 2009 on the 25th June 2009 and the data for the GDP in the second quarter of 2009 in September 2009. So, the Government could officially announce that Macedonia is in the recession in 2009 almost at the end of the year. The State statistical office must be prompter in publishing of data.

The Policy responses: from denial via panic to ad hoc-ism

The government response to the effects of the crisis was not adequate. Several months were

wasted before the government accepted the existence of crisis. The first ten anti-crisis measures did not have any success. The main goal of the most of the measures was improvement of the collection of taxes and social contributions. Government activities have been dominated by preparations of the local and presidential elections, which took place on 22nd of March and 5th of April 2009.

The 2009 budget was projected as the Macedonian economy will not be affected by the crisis in 2009. The unrealistic assumption of the budget (economic growth of 5,5% in 2009), together with slowdown of economic activity due to impact of the global crisis led to substantial revenue gaps for the first months of the 2009. The tax revenues were 10% lower than projected in the first quarter of the 2009. As a result, public sector accounts registered a deficit of about 0,4% of GDP in the first quarter.

Altogether, this translates into a need for a rebalancing of 2009 budget. In April 2009, Government proposed rebalanced budget together with a package of anti-crisis measures. The rebalanced budget is based on the optimistic assumption that the growth of economy will be 1% in 2009. Despite the fact that the rebalanced budget is cut for 162 million euro, the fiscal policy remains expansionary, with the goal to compensate for the fall of the private consumption. The projected budget deficit with the rebalance is again 2,8% of GDP. This significant budget deficit could lead to further increasing of the current account deficit having in mind that Macedonian economy is import dependent. The rebalanced budget is lacking of investments in road and energy infrastructure, which should be stimulus for the country's economy.

The biggest problem with the Government package of anti-crisis measures is **the time**. The Macedonian business sector could not felt the effects of the most important anti-crisis measures (favorable credits, from the European Investment Bank credit line) before September 2009. So the Macedonian economy will be without adequate stimulus almost one year. This situation can be compared with the

injured man who has an intensive bleeding, but the doctor decides to help him very late.

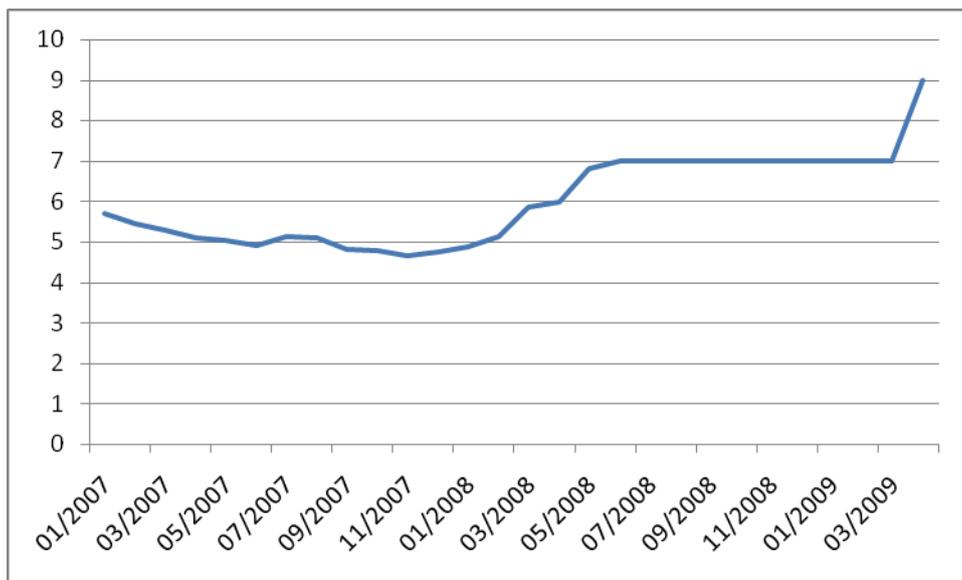
Now, the government is increasingly confronted with liquidity bottlenecks and financing constraints. With declining revenues and tight international and domestic credit market, the country fiscal space is severely limited. The Government plans to issue euro bond. But, the problem is the high interest rate of the bond. It must be noted that Standard & Poor's and Fitch already downgraded the country's sovereign rating outlook from stable to negative. It means that the credit conditions for Macedonia will be tighter and the interest rates will be higher.

In the current situation an arrangement with IMF is necessary to maintain the macroeconomic stability of the country. This arrangement, on the one hand will have much better interest rate than the euro bond or possible credits from commercial banks, and on the other will introduce macroeconomic control of the country from IMF. The Government excludes this possibility now. But, if the trend of the worsening current account deficit continues the Government will be forced to make such arrangement, but then the

Government's negotiation position will be significantly lowered.

The National bank continues to be strongly committed to maintain the current informal peg to the euro. Monetary policy is response to expansionary fiscal policy and reduced external financing. Monetary conditions are continually tightened during the last months. Interest rates of the treasury bills were increased for 30 base points at the beginning of 2008. In February 2008 they were again increased for 85 base points and reached 6%. In June 2008, interest rates of the treasury bills were increased for third time, and were put on 7%. They were unchanged until April 2009. In March 2009, Ministry of finance, confronted with liquidity problems, started to issue for the first time the state bills with the duration period of 28 days (same as the treasury bills of the National bank). The interest rate of these state bills was 1,9% higher than interest rate of the National bank's treasury bills. This action had strong implication and further increased the interest rate of the treasury bills for 2%, and they reached 9% in April 2009. The figure 6 shows that now the interest rate of the treasury bills is highest in the observed period.

Figure 6: Interest rates of the treasury bills, January 2007 – April 2009



Source: National Bank of the Republic of Macedonia.

The interest rates of the money market and interest rates of the commercial banks continually follow the interest rate of the National Bank. As a result, it's becoming much harder for Macedonian companies to enter in investments. The investment activity of Macedonian business sector is significantly lowered. The credit activity of the commercial banks is slowdown. For example, the average monthly growth rate of the credit activity is 1,51%, 0,51%, and 0,26% in February, March and April 2009, respectively. For additional comparison, the same rate for April 2008 is 3,87%.

During recent months, the National Bank had to intervene more frequently than in the past months to maintain the stability of the exchange rate to the euro. Foreign exchange reserves decline more than half billion euro since the third quarter of 2008, thus reaching 1.184 billion euro in May 2009. It could be expected that the foreign exchange reserves will fall bellows 3 months of imports during the summer 2009.

As a result the question for possible devaluation is open. The devaluation will have positive and negative effects for Macedonian economy. The main positive effects will be: (1) the trend of the decrease of foreign exchange reserves will stop, because there will not be a need for their use in the defense of the denar; (2) the import will be discouraged; and (3) it should help to export industries by improving their price-competitiveness. The main negative effects will be: (1) devaluation will raise the prices of imported goods, and in import dependent country as Macedonia, it will stimulate inflation; (2) expenditures of many companies which are import dependent will increase; (3) the standard of living will be lowered; and (4) devaluation could have negative impact on the capability of the individuals and companies to return their credits to the banks (most of the credits are with the foreign currency clause), which could have also negative effect on the bank liquidity. If these effects are put in scale, it is obvious that the devaluation, especially in the time of global crisis, will have destroyable effect for the economy in the short run.

2. The social effects

Ever since it was manifestly triggered by the burst of the housing bubble in the United States in 2008, the global financial crisis is unravelling its devastating effects firstly over the financial markets and indirectly over the world's economies, causing recession. It is often said that this crisis is the biggest the world has seen ever since the Great Depression in the 1930ies. According to the causes and the type of the effects, there are similarities between this crisis and the one around 80 years ago. It could be therefore useful to compare solutions, especially having in mind that the steps undertaken after the Great Depression have already been historically tested, although there are those who are inclined to be sustained from making parallels, such as Nobel Prize Winners Paul Krugman and Robert Solow (Spiegel 18/09).

The governments of the leading world's economies have been meeting in order to coordinate actions and propose mutual solutions for financial and economic recovery, the result of which are the *European Economic Recovery Plan* from 26 November 2008 and the *G20 Global Plan for Recovery and Reform* from 2 April 2009. These packages and other ones proposed on national level are focused mostly on the restoration of the financial system and the economy and pay little attention to the individual people, affected by the crisis. Following a decision of the Obama administration to inject public money into the banking system in the United States, bonuses were distributed among managers of failing banks. This crisis has brought to the surface systematic problems which have existed for decades, or as the European Social NGOs put it: "We were in a crisis before the financial crisis exploded. A crisis of continuing massive poverty, growing social inequalities and climate change..." (Social Platform 2008, 1). It has become more obvious that the domination of the neo-liberal ideology, promoting deregulation of markets, has had negative repercussions over the majority of people all over the world, except for a smaller number of individuals who profited from the system as it is. Therefore, "bailing out banks is definitely not enough should we want meaningful and

effective recovery plan...". It should in no way be left out that **the crisis also has a human dimension**. It has not only financial and economic, but also social consequences with long-lasting impact, such as loss of jobs, increased poverty, loss of homes...all of which affect the lives of people in their current form.

In this part, the paper will look into the social effects of the crisis, over the individuals and the Macedonian society as a whole, it will explore the capability of the state to deal with the new social challenges and it will search for possibilities to alleviate the conditions that the crisis has created and to offer exit-alternatives. Some of the existing measures will be taken into consideration and further analysis, focusing on the measures proposed by the Government of Republic of Macedonia.

Main social problems

During the entire transitional period, the **unemployment** rate in Macedonia was kept at a high level. Ever since the break-up of Yugoslavia, where the unemployment rate from 1980 to 1990 was between 21,4% and 23,9% (Stambolieva/Tevdovski/Spasov 2008, 16), the unemployment rate in Macedonia has been kept relatively stable at a little over 30% (in 1996 it was 31,9% and in 2007: 34,9%)². The last data from the State Statistical Office³ is the one from the last quarter of 2008, when the unemployment rate was measured at 33%. This unemployment rate was followed also by a relatively low employment rate (in 1996 it was 37,4% and in 2007: 36,2%). It was as late as 2006 that the GDP reached the level it had in 1990 and although there had been modest productivity growth of 10% over the whole transitional period, it was not accompanied with the employment growth (ILO 2008, 6). The

size of the informal economy is rather high throughout the whole period: from 34,1% of GDP in 1999/00 to 38,3% in 2006/07 (Schneider 2009, 6) and thus absorbs a relatively high proportion of the labour force. Although it is mostly those working in the informal economy which are subjects to precarious working conditions, the employed in the formal economy are only slightly better off, with exception of some sectors, such as the services sector, especially the financial services. According to the World Bank, 20% of the poor in the country are working poor (ILO 2008, 24). It has been estimated that around 20.000 workers, mostly from the industry sector, have lost their jobs as result of the crisis and new lay-offs are being announced (Federation of Trade Unions 2009, 3). This means that the already high number of unemployed individuals will grow in the up-coming period, which will put extra pressure on the welfare state as well as contribute to further increase of social inequality and poverty in the country.

Following the high percent of unemployment, the drastic decline in the economic performance in the 90ties, which took almost 2 decades to reach the level before the transition, the size of the informal economy, there is a high percent of **poverty** in Macedonia, which has been continuously increasing. In 1996 approximately 20% of the population was poor and in 2007 this number was 29,4% (Source: State Statistical Office). Thus, the slow economic recovery of the country has been socially unjust, as the economy has experienced some growth with no effect on creating jobs or on poverty alleviation. What is more, the data shows that despite the growth in GDP, there has been poverty increase. The current financial crisis will only make matters worse.

The Macedonian social security system

Through public spending, the state could correct the social inequalities. This could be done in various ways, such as social insurance, welfare transfers, active labour market policies, public investments in infrastructure, education and others.

² The State Statistical Office of Republic of Macedonia started applying the Labour Force Survey methodology in 1996, according to the ILO recommendations.

³ For the purpose of this paper, the official data on the labour market and poverty which will be used is the one obtained from the State Statistical Office. However, it should be mentioned that there is data inconsistency provided by different state institutions (for example the data provided by the Employment Service Agency, which reports a higher number of registered unemployed persons, excluding the people who register only for receiving health insurance).

The social security system foresees **unemployment benefit** for those that lose their jobs. This benefit is given one month to an unemployed person that has had contribution paid continuously at least 9 months or 12 months with interruptions for the last 18 months⁴. The maximum duration is 12 months of unemployment benefit to persons that have been working over 25 years. With this change, the conditions for receiving unemployment benefit have been made even stricter (before 2006 the minimum duration of unemployment benefit was 3 months and the maximum 18 months). Also, the way it is formulated, the right to unemployment benefits excludes new market entrants, long-term unemployed as well as persons whose contributions haven't been regularly paid. These categories could apply for social assistance. There are also special categories of workers that have been made redundant and bankruptcy workers, who receive unemployment benefits, but also here, the accessibility to the right to the benefit has become stricter. The number of people receiving unemployment benefit has constantly been decreasing over the years: from 41.375 in December 2001 to 23.565 in December 2008 (Source: Employment Service Agency).

The high percent of unemployment puts pressure over the **pension system** and results in low pension coverage. In 2002 the pension system in Macedonia was reformed and following the recommendations of the World Bank, mandatory fully funded pension insurance for market entrants after January 2003 was introduced. The introduction of the three-pillar pension scheme caused a deficit in the Pension and Disability Fund, or of the first pay-as-you-go pillar, which is covered by transfers from the state budget. This deficit has been increasing and is predicted to further increase in the upcoming years (IMF 2009, 15). On the other hand, the costs for operation of the private funds managing the second pillar are rather high (6,9%) and will affect future pensions. In 2008 the Government implemented a one-off increase of the amount of the pensions (10-20% depending on the level of pensions).

The **health-care system** provides for wide-based coverage of the population and the basic benefit package is comprehensive. Health-care is delivered through a system of health-care institutions, which are relatively evenly distributed in the country. However, the health-system is one of the spheres, which seem most confusing, primarily because of the fact that according to its organization and the public finances spent the system should provide for universal health-care, however in practice this is difficult to achieve. For example, the patients contribute a quite significant proportion to health-care costs through out-of-pocket payments in the form of co-payments, unofficial payments or payments for services that are listed in the statutory package but are not available unless the patient agrees to buy them. The out-of-pocket payments are estimated to amount to 25% of the total health-care expenditure (European Commission 2007, 148). According to one pooling conducted in 2006 the bad quality of the services and bad conditions in the institutions, as well as the corruption are among the most frequently emphasized problems, followed by shortage of drugs from the positive list, insufficient organization and efficiency of the services provided in the state owned health sector. Some of the respondents have mentioned the bad management and low salaries in the health sector, as well as insufficient information of the providers and patients, as equally important problems which leads toward bad impressions about the system (European Commission 2007, 156).

Additional burden to the social security system, especially the part relying on the contributions is the fact that there are cases where the employer hasn't paid the contributions either temporarily, with delays or it has been an on-going process of evasion of social contribution payments. These people, therefore, neither qualify for unemployment benefit or social assistance nor are protected by the social insurance system, since they have no health insurance, nor could they in the future claim pensions' rights. This is a problem for these individuals, because it keeps them socially excluded, but also for the society and the state, as it deteriorates the welfare base and creates additional social wounds. With the introduction of the new way of payment of the gross salary

⁴ Law amending the Law on Employment and Unemployment Insurance (Official Gazette 50/06)

as of 2009, the number of employees who haven't received salary has decreased: 2,8% in January 2009 compared to 7,5% in December 2008 (Source: State Statistical Office), however the problem of former debt remains open. No systematic data on state level exists that would follow and analyse this issue.

The system of **social protection** is part of the organized activity of the state for prevention and mitigation of the basic social risks to an individual, family or group of citizens. It includes social prevention, institutional care, non-institutional care and social assistance. It is difficult to assess how inclusive the system is for the vulnerable groups, since the legal framework enumerates the exact categories of persons or groups that have the right to social benefit. The administrative capacity of the Social Work Centres is considered a weak point and it is unclear if the mean-test is correctly implemented in order to properly target the benefits (see also MLSP 2008, 53). The amount of the financial social benefits is very low and does not cover the needs of the people living in poverty. The latest trends are deinstitutionalization and decentralization. The deinstitutionalization means refocusing the state's involvement in the provision of social protection and widening the non-institutional care, for which purpose cooperation with non-governmental organizations is being strengthened. However, the participation of these actors in the drafting and coordinating the social inclusion policies is limited. The decentralization, which involves the transfer of competences from central to local level, is facing major problems (Commission of the European Communities 2008b, 52).

The crisis has found its way into the pores of the Macedonian society, which is primarily visible through the shutting down of companies and loss of jobs. As described before, the social security system is very weak and incapable to protect the excluded and vulnerable people. In such a constellation of circumstances there is the question:

What could be done against the effects of the crisis?

At the end of 2008 the Macedonian Government came up with the first proposals to handle the crisis. The proposed measures consisted of writing-off companies' liabilities for social contributions and taxes as well as reduction of taxes. These measures were immediately criticized for their ineffectiveness. The business community was criticizing these measures for their discriminatory treatment of the subjects on the market. Furthermore these measures contributed to the acceptance and stimulation of social injustice, as they basically mean legal rehabilitation of the companies which have not paid the social contributions for their employees or their tax obligations towards the state, thus contributing to impoverishment of the workers and weakening of the anyway fragile social system.

Another package of measures was announced by the Government in April 2009. This package of measures came after it became more than obvious that the planned Budget for 2009 will not be able to be implemented. These measures focus on revision of the Budget for 2009, credit support for small and middle-sized enterprises through the credit line of the European Investment Bank and measures for alleviation of the administrative burden of export-oriented enterprises. Some of the suggestions given by the chambers of commerce were taken into consideration when drafting these proposals, however that was not the case with the suggested measures by the Federation of the Trade Unions. This is also a result of the fact that the social dialogue in the country is practically inexistent.

During times of crisis states tend to increase the amount of money into the economy and arrange targeted public spending. This was the case in the 30ties when the US president Roosevelt introduced the so called "New Deal"⁵. This is the case with the current crisis when the leading world's economies take action in the direction of budgetary expansion with focus especially on the areas of protecting

⁵ The main measures of the New Deal included public investments in infrastructure, increase of workers' rights

employment, promoting entrepreneurship, investment in infrastructure, energy and research (Commission of the European Communities 2008a). This is in line with the Keynesian⁶ argument for public spending as a vehicle for recovery. It seems that the world once again stands before alternative ways to go, whose choice will decide upon the future of whole generations. The main dilemma, which governments are confronted with, is as basic as **what kind of society we want for the future**. Once finding an answer for this question it would be easier to propose appropriate measures out of the crisis. Losing the human dimension out of sight during the neo-liberal era has been one of the major driving forces for the current financial and socio-economic collapse. Another question is if the neo-liberal era has ended or is being slowly abandoned and if there's now the readiness to build different kind of economies and societies.

As for the Republic of Macedonia, this kind of vision as to where the country should be headed seems to be lacking. The measures which are being proposed by the Macedonian government against the effects of the crisis are confusing. On one hand the government projects an extensive budget, which stays relatively extensive even after its revision, in comparison to the expected decline in the GDP, but on the other, it is not clear what the priorities of the public expenditures are. Unlike other states as the ones abovementioned, the Macedonian government does not allocate the public expenditure into stimulation of the economy and fostering employment, investment in energy, infrastructure and research, but rather plans to spend it on building monuments, churches and on keeping a wide public administration. The investment in

such short-term and non-productive expenses does not stimulate the economic performance nor helps the society.

The social-security system is already weak, primarily due to weak economic base, but also due to socially unjust priorities in its shaping. Although the public expenditure has increased especially over the last two years, the share of the social expenditure in the overall budget has been decreasing (as can be seen from the table below). This is relatively low compared to social-protection expenditure in other countries, members of the EU. The EU27 was 26,9% of GDP in 2006 (Source: EUROSTAT). The only states which had lower percentage of social expenditure in 2006 were the Baltic states and Bulgaria and Romania, which have more or less the same percentage as Macedonia⁷.

⁶ Keynes was a British economist (1883-1946), who questioned the sufficiency of the self-regulation of markets. His proposals for stimulation of the demand through public spending marked the period after the 1930ies crisis. However, during the 70ties the Keynesianism is considered to have experienced a crisis of its own. States' debts which occurred for the sake of financing the public spending were not returned during the time of economic growth, which contributed to further increase of the state deficits. Another problem was the appearance of Stagflation (Inflation due to the increased wages and Stagnation of economic growth due to the oil crisis). This is what made way for the neo-liberals on the world stage, promoting deregulation of markets, which is believed to have lead to the current crisis.

⁷ Estonia 12,4%, Lithuania 13,2%, Latvia 12,2%, Bulgaria 15% and Romania 14%.

Table 1: Social expenditures by type as % of General Government Expenditures:

	1996	2000	2006	2007	2008
Old-age and survivors (pensions)	24.5	24.5	24.0	24.0	23.8
Employment and unemployment ¹	3.1	2.3	2.2	1.4	1.2
Health	15.4	15.0	15.0	13.7	13.6
- health (including disability)	15.7	15.2	15.2	13.8	13.6
Social assistance (benefits)	4.1	4.3	3.5	3.4	2.8
- family benefits and measures	n.a.	n.a.	2.7	2.3	2.0
- other social benefits	n.a.	n.a.	0.8	1.1	0.8
Total social expenditures in % of GGR	47.4	46.3	44.9	42.6	41.8
Total social expenditures in % of GDP	17.6	15.8	15.4	14.1	14.6

1) including administrative costs of the Employment Service Agency

Source: ILO 2008, p.39, complemented with data obtained from the Ministry of Finance for 2007 and 2008.

Therefore, it would be of crucial importance that at a time of crisis the state undertakes **extraordinary measures** to alleviate the burden

off the society and prevent further social exclusion. For this purpose we propose two main types of

Recommendations:

- 1) **Targeting the fiscal policy towards sustaining and creating jobs.** In the time of recession the state should allocate its resources towards keeping a favourable investment climate and keeping the people included in the labour market. With decline in GDP, this can be secured through borrowing money, either from international organizations or private entities, which on the other hand increases the public deficit. This is why this money should be spent wisely and plans to restore fiscal discipline should be devised. One way of achieving it is by cutting down budget costs which are expensive but non-productive, such as employment in the public administration and building of cultural or religious objects. In order to have an effect the priorities of the state fiscal policy should be:
 - *Public expenditure in infrastructure and energy* – these investments will secure and create jobs at a moment of crisis, as well as make way for potential future investments, once the economic situation has restored;
 - *Access to credits* – for the enterprises and the population. The Macedonian government has already proposed this measure for a number of small and middle-sized enterprises, through the credit line of the European Investment Bank, however on one hand its implementation is late and on the other it's not enough and should be expanded, especially to the labour-intensive branches, as well as complemented with provision of environment for favourable credits for the population in order to stimulate the demand. This can be achieved by proper combination of the fiscal and monetary policy and through better coordination among the public actors, especially the Ministry of Finance and the National Bank;
 - *Wage subsidies* – the government should consider this measure in order to reduce the job losses. This measure could especially help those which are more likely to be first affected by the crisis, such as low-qualified workers, workers on a limited time contract, old workers or new labour market entrants, especially the young people...and prevent their further exclusion.

- 2) **Strengthening the social-protection schemes.** At a time of crisis, the social security becomes more of a burden for the state. However, it is important that during such tough times there is no backtracking on social investments, as it may have deteriorating effects on the long run. The social expenditures should not be affected and what is more, they should be increased and used effectively to prevent further impoverishment of the population.
 - *Special unemployment benefit arrangements* – more flexibility in the strict unemployment benefit scheme should be introduced, thus providing extra space for the people who will have lost their jobs during the crisis and preventing exclusion;
 - *Active labour market policies* – with more people leaving the labour market, focus on these measures should be sustained in order to achieve re-integration. Full implementation of the envisaged operational plan for 2009 should be secured, but also monitoring and reporting should be provided for, in order to measure the impact of the proposed plans and strategies, as well as to obtain information on how to combine or better utilize these policies;
 - *Decent income* – the state should take extra care for the category of people who will be left without jobs as well as the ones already leaving on the margins of the society. The active labour market policies are a good measure, but are not enough to stop waste of human resources. Infrastructure should be understood as a broader term and therefore public expenditure in social infrastructure should be strengthened. By providing people

with income support, demand is being stimulated, and by providing adequate access to quality services in housing, health, education, training, people are offered better chances for later labour market- and social inclusion;

- *Sustainable financing of the pension- and health-care system* – ensuring sustainability of the pensions and health-care protection for the population is crucial during a crisis, especially for a system with already existing loopholes in its funding. The three pillar system may be put at risk, connected to decline in asset values of the private funds under the second pillar, which are exposed more to financial rather than labour market risks. However, unlike other countries (for example Croatia), this risk is smaller for Macedonia, primarily due to the fact that there are no workers which will retire under this scheme during the up-coming years. Still, having in mind the abovementioned problems with financing of the system, during the crisis, special financing measures should be undertaken in order to secure sufficient minimum old-age and health-care protection. Further privatization of the health-care should not be considered a solution, as it may leave a lot of people without proper health-protection;
- *Introduction of progressive personal taxation* – the shift from the flat-tax rate will lift the burden from people with lower income and enable fair redistribution in society. We propose a tax policy which will oppose and limit the growing inequalities in society, stop the tendency of poverty (gap) increase especially in time of crisis and promote a vision for a fair and just future;
- *Social dialogue* – the social partners should be made part of the decision-making process and their opinion should be taken into consideration. So far the Macedonian government has partly relied on the opinion of the chamber of commerce, but not of the trade unions. In times of crisis it is important that consensus is sought for among all stakeholders, including those which express criticism towards some proposals coming from the government. Short-term conflicts of interests between the different social partners should be left aside. That kind of a social dialogue also strengthens political stability in the longer run, which is a prerequisite for further economic development. In the end the short-term conflicts of interests in domestic policies are usually rather small issues compared to the fundamental questions behind the development and success of the country.

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