



Weekly Briefing

Macedonia Economy briefing:

Macedonia's economic slowdown in 2017- reasons and social impact

Anastas Vangeli


China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: Huang Ping

 1052 Budapest Petőfi Sándor utca 11.

 +36 1 5858 690

 office@china-cee.eu

 china-cee.eu

Macedonia's economic slowdown in 2017: reasons and social impact

Context

Macedonia is a transitional economy that never during its independence managed to maintain a high growth rate for an extended period of time. In the aftermath of the global financial crisis, it managed to achieve some economic growth above than the European average, and managed to consolidate relatively well. Yet, if one takes in account the size of the Macedonian economy, and the disparity compared to the EU, then this growth rate has not been sufficient. Macedonia, just like the other countries of the Western Balkans would need to consistently grow at a rate of above 6% per year, to be able to come at a respectable European level in a decade or two.

In 2016 and 2017, however, things even took a turn for the worse – Macedonia's economy growth slowed down to 2.4% in 2016, and then noticed only a small growth in Q1 of 2017, declined in Q2, and stagnated in Q3. Estimations about Q4 are moderately optimistic. Inflation has been rising, although not at an excessively high rate. Macedonia's growth in 2017 has been sustained mostly by exports as trade deficit has narrowed, of which significant part come from trade processing, as well as private consumption. However, this in itself has not been sufficient to stimulate higher growth. While Macedonia technically still not having fallen in a recession, in 2017 has become the slowest growing economy in the region of the Western Balkans (the average for the region is 2.6%, and the second-last is Serbia with 2.0%).

Why Macedonia's growth slowed down?

In the debates, there are several explanations for the economic slowdown in 2016 and contraction in 2017. For one, there is a wide consensus that the main impediment to growth has been the protracted political crisis and the uncertainty about the future of the country. Macedonia was not able to form a government

from December 2016 to June 2017, and in the meantime was on the brink of a serious deterioration of social stability. In this sense, for some analysts, the low growth rate is still a good outcome, given that there were conditions for far worse outcomes to happen too.

The political crisis has first and foremost taken a toll on the market sentiment and the ability of Macedonia to attract foreign direct investments – but has also led to withdrawal of some already invested capital too. While this is somewhat commonsensical in nature (the crisis simply increased the risks for investors), there is also another more specific point related to the actors in the political crisis themselves. The outgoing government of VMRO-DPMNE, marred by grand corruption allegations and under multiple investigations of the Special Prosecutors' Office, had completely neglected its day-to-day tasks, including the economic policy, and had directed all its efforts towards damage control. VMRO-DPMNE, although nominally a free market party, in parallel to their neoliberal reforms had adopted a neoprebendalist approach to economic development, while in the last two years had altogether greatly neglected their development projects. At the same time, according to the numerous reports on the corruption scandals that had caused the political crisis, high-ranking figures of VMRO-DPMNE who amassed huge fortunes through illicit and illegal activities, had re-diverted their funds through off-shore tax havens back to Macedonia (and in other countries as well, but that's beside the point). The laundered corruption profits were then counted as foreign capital coming in Macedonia. Once these officials were targeted by the SPO and ultimately fell from power in 2017, they withdrew some of their operations and assets in the country, contributing to the loss of investment.

Similarly, a significant part of the state-centric approach to development of VMRO-DPMNE relied on achieving growth through construction projects – including the infamous project Skopje 2014 to turn downtown Skopje into neoclassical-looking area. To be able to spend abundantly on other projects beyond Skopje 2014 and beyond the construction industry, VMRO-DPMNE

governments continuously borrowed money from the international commercial markets, raising the level of Macedonia's debt. In the realization of the projects, however, they contracted their cronies from the construction industry. In addition to symbolic politics and pumping the numbers, this also served for VMRO-DPMNE to channel money back into the party. Namely, a lot of the contracts signed were greatly inflated, and then the contractors (who made astonishing profits), would find a way (both covertly and openly) to make substantial donations to VMRO-DPMNE. One such donation has been the luxurious new party seat, the Palace Hristo Tatarchev – a donation worth several million of Euros by the construction industry tycoon Mincho Jordanov and his company Beton (who is said to have won 30 tenders of Skopje 2014). Such practices led to VMRO-DPMNE becoming the richest party in Europe (including all the EU countries), which has been quite a shocking development given the size of Macedonia and its economy in comparison to the rest of the continent – while pumping the GDP growth numbers.

The incoming government of SDSM once in power stopped a number of construction and other projects. The reasons were twofold. For one, SDSM has pledged to stop projects that were investigated for corruption, but also projects that were considered an outcome of bad policies. One such project was the highway Kichevo-Ohrid, financed by the Chinese ExIm Bank, and implemented in partnership with Sinohydro – a project that is investigated for corruption, and a project where there have been errors due to lack of diligence. Second, and more important, however, is SDSM's quasi-austerity approach that sought to stabilize and reduce the debt of the country. This measure in this sense was stopping unproductive costs, and therefore a lot of construction projects that are part of Skopje 2014 were stopped. These moves have divided the opinion of experts – while some say it is counter-productive since the stopping of construction essentially contributes to the slowing the economy, others say it is a necessary evil, and that soon the short-term negative effects of solving corruptive projects and balancing the budget deficit will be reversed.

Another related explanation is based on the assumption that simply VMRO-DPMNE for some time manipulated the numbers and was not paying back the internal debt, but also delayed reforms and failed at revenue collection. Once SDSM got in power, they had to (and still have to) address these questions, which required prolonged time. This is an assumption that implies that VMRO-DPMNE's economic performance was not sustainable and that were the reason for the slowing down of Macedonia's growth is a consequence of VMRO-DPMNE's general economic policies that, at least as much as it is a consequence of the protracted political crisis.

Partially related, but not completely determined by the political factors, is the explanation that even though trade deficit narrowed, account deficits widened. For one, this is a result of profit repatriation by foreign firms (while foreign investors get benefits and subsidies to set up production capacities in the country, they rarely re-invest the profit made, and moreover, often for some time they are exempted from taxes – which is again, a result of misguided FDI attraction policy). Remittances, which traditionally played a significant injection of cash coming from Macedonian economic migrants abroad, have been weakening due to the economic conditions in the global economy and due to changing social structure in Macedonia – Macedonian workers abroad are predominantly workers who are replaceable, who are vulnerable to the ongoing crises in advanced economies, and have non-scalable earnings and therefore less and less disposable income to spend on their families in Macedonia – at the same time, they also would rather help the rest of their family move abroad, rather than sustain it for a prolonged period of time – as now Macedonians want to move abroad not only because of economic reasons, but ever more often because of political reasons and because of the high pollution. Finally, Macedonian citizens, not trusting the institutions, also consider the denar (Macedonia's currency) a liability, and therefore often opt to have their savings in foreign currency such as Euro, which has a constraining effect on the domestic financial market.

Social impact

While one can argue that the economic slowdown in 2017 was not of dramatic proportions, its effects have been disproportionately felt by the majority Macedonia's population – ordinary people whose livelihoods on average worsened in 2017. One obvious indicator of this has been the constant increase of the costs of services as well as the price of food and essential goods. Salaries grow with the same pace as living costs. According to current research, only 16.8% of the population can satisfy their needs, the majority facing significant economic uncertainty. Macedonia has also developed a public finance system that is to a great extent extractive in nature, meaning that the government tends to create various regulations and implement them with the main goal of increasing the revenue by any means, without taking in account the effects on the citizens and the consequences on economic activity – therefore, it has often suffocated small businesses and endangered livelihoods of many with unreasonable, and selectively implemented measures. It has consistently tweaked the regulatory framework to optimize the access for foreign investors, while however, not undertaking sufficient measures to make sure that at least part of the profits investors make remain in the country, nor to protect labor rights or the environment. Macedonia has become, therefore, a country of cheap labor, and of landfills that import European toxic waste. Under the pretext of social measures, the government has also contributed to worsening the social and labor conditions. For instance, while introducing minimal wage, it has also mainstreamed the concept of normalized performance, meaning that now evaluation of labor costs are not tied to working hours, but rather to the output of the worker that is left to be arbitrarily defined by the employer. Finally, the inefficiency of the institutions has also contributed to worsening of the situation for the common people – for instance, after the introduction of the minimal wage, a number of employers have asked their employees earning minimal wage to return parts of their earnings in cash. All of this suggests that under the bleak

numbers of the Macedonian economy, a much darker reality of everyday life is hidden.