

# **IMPACT OF RECESSION ON THE MACROECONOMIC VARIABLES IN REPUBLIC OF MACEDONIA**

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## **Abstract**

When it is spoken about the economic i.e. business cycles that could be met meet in the macroeconomics literature, then we think about the economy in the short run, i.e. economic fluctuations. Modern economies are subject to significant short-run variations in aggregate output and employment, so such fluctuations are periodic problem for economists and politicians. The understanding of the causes of aggregate fluctuations is the main goal of macroeconomics.

From economic theory it is known that the macroeconomic variables move simultaneously. This means, if the real GDP increases (expansion) in the national economy, then in the same time increases the employment, investment, standard of living. But if the real GDP declines (recession), then in the same time reduces the employment, investment, standard of living. So, the question is whether each of these macroeconomic variables moves simultaneously, i.e. whether they move with the same dynamics. The answer of this question is of course, no. The national economy is relatively more complex, and therefore its study is relatively difficult.

Based on scientific research, the aim of this paper is to see and analyze the economic policies that are focused towards taking measures in order to stabilize the national economy, i.e. improving the economic performance in the period of recession.

## **1. Recession as the phase of the business cycle and its impact on macroeconomic variables**

Recession as a phase of economic cycle is hard to predict because of the fact that each recession is distinguished by its dynamics, severity and duration. Having in mind that recession differs among them, the subject of this paper is an analysis of the main reasons for the emergence of economic recession. Business cycle is a major topic of interest in the macroeconomics, so that fluctuations in the business cycles growth and downs of global economic activity are felt in every economy. When there is growth in economic activity, then the prosperity will be felt by a greater number of economic entities, as well as firms, industries, employees, owners of capital and others. When there is a drop in economic activity, then the sector of companies faces with declines in manufacturing and other sectors of the economy with the declines in consumption. As a result of reduced production, the companies dismissed employees or reduced their hours and their wages. These negative trends affect on the reduction of standard of living and quality of life of people and increase the poverty rate, which certainly represent the most difficult problem for each country. Therefore, economists try to discover

the causes of these episodes (stages) of business cycles and make suggestions about what could be done through appropriate economic policies to mitigate such negative phenomena of recession. Recession should not be seen as phenomena from which there is no exit, but as a very serious symptom that indicates that the economy is diseased and we should take vigorous measures to its faster recovery. There are several theories explaining the reasons for the emergence of recession. According Keynesian Theory, the main reason for the occurrence of recession is reduced effective demand, i.e. demand of the sector of households and firms.<sup>1</sup>

$$E = C + I$$

The theory of real business cycles, as the main reason for the occurrence of recession cited reduced overall factors productivity. According the theory of real business cycles, reasons of reducing the overall factors productivity, as the main reason for the occurrence of a recession are the technological changes and the phenomena of labour hoarding.<sup>2</sup>

Monetary theory of the business cycles as the main reason for the occurrence of recession cited money supply. When the central bank leads restrictive monetary policy for a longer period, i.e. reduces the supply of money that causes a reduction of overall economic activity in the national economy and the emergence of a recession.<sup>3</sup>

Based on analysis of business cycles, especially the recession as the phase of the business cycle we may indicate some characteristics:<sup>4</sup>

- Recession accompanied by financial crises are unusually sharp and the revival (recovery) is typically slow;
- Synchronized, i.e. global crises are long and deep, and their recovery is generally slow.

As noted earlier, the recession has negative implications for real macroeconomic variables. The fall of the total economic activity means reducing of the aggregate output which means a reduction of employment in the national economy. When the country is in the phase of recession, the economy is far from the point of effective use of resources, i.e. e far from the optimal production and the natural rate of unemployment. But for us, more important is the impact of recession on the quality of life of people as the most significant economic goal.

## **2. Measures of economic policies in the terms of recession and stabilize the national economy**

To answer the question whether to take appropriate economic policies in the time of recession in order to stabilize the economy is controversial. Much of this controversy comes from the various economic thoughts in the

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<sup>1</sup> Effective demand is consists of demand of household sector C and the demand for capital goods of the sector of firms I.

<sup>2</sup> N.,Gregory Mankiw, Macroeconomics, fifth edition, Worth Publishers, 2003, pp.

<sup>3</sup> A., B. Abel and B.,S. Bernanke: Macroeconomics, 4<sup>th</sup> ed, Addison-Wesley

<sup>4</sup> Taki Fiti, Phenomenology of economic crises, Faculty of Economics - Skopje, 2009

macroeconomics between Classics and Keynesian economists. Representatives of the classical economic school, do not look great or any need for state intervention in terms of recession. According to them, the market itself will overcome such phenomena and the economy itself will come out of this situation. Otherwise, Keynesian economists say that, because the wages and prices adjust slowly, distortions in production or consumption may move economy away from its preferred level of production and employment for a longer period of time. According to the view of Keynesian, the state should intervene through measures of economic policy to alleviate the consequences of the occurrence of recession and the reduction of overall economic activity. As the most important macroeconomic policies that will reduce the negative effects that faced the economy in terms of the recession and its stabilization at the same time, stated *fiscal and monetary policy*. Based on the theory and practice, in a period of recession should be applied expansive macroeconomic policies. Essential is synchronization between measures of fiscal and monetary policy in the direction of increasing liquidity in the economy, decreasing interest rates, increasing investment and employment, increasing the income of economic entities and finally, in the direction of increasing demand, i.e. consumption as ultimate indicator of exit of economy from the phase of recession. If measures of monetary and fiscal policies are not sufficiently synchronized, then the economy will inevitably faced with a condition of i.e. prolonged recession (due to over-restrictive monetary and fiscal policy) or with the condition of excessive monetary stimulation of the economy, i.e. inflationary gap (due to over-loose monetary and fiscal policy).

### **Expansive fiscal policy**

In terms of recession it is necessary to increase public spending in order to stimulate the production, retention of jobs and creating new jobs. Discretion fiscal policy is largely supported by Keynesian economic school. Undertaking of economic measures, i.e. state intervention through fiscal policy in terms of a recession is necessary. According to Keynesian, the state should not be indifferent when market failure occurs, i.e. when the economy is far from desired level of economic activity. The consequences of the emergence of a recession are large: a reduction of production, reduction of employment, increasing the poverty, reducing the quality of life of people. All these negative deviations in the economy are enough reason for state through expansive fiscal policy (increased government spending or tax cuts) to alleviate this situation and to stabilize the economy.

### **Expansive monetary policy**

With the increase of money supply and reducing interest rates in the short run, monetary authorities can improve the deteriorated economic performance. We know that in term of the recession, the economy faced with the decline in total production and the decline in total consumption by all sectors of the economy. Classical dichotomy shows that there is a difference between nominal and real variables, i.e. the nominal variables, such as money can not affect on the real macroeconomic variables (production and

employment). In essence, monetary neutrality shows the same. The supply of money in the long run will not have an impact on real macroeconomic variables. But despite this, in terms of recession (decline in economic activity), the Central Bank should lead a policy of increasing the money supply, which in the short run will cause a reduction in interest rates and increased investment by companies and increasing consumption of household goods for those who are affected by the interest rate. This policy of the central bank in the long run can cause an increase in the rate of inflation and reduction of price stability in the national economy.

### **3. Recession in the Republic of Macedonia and economic policies for its overcome**

#### **Impact of the global economic crisis on the Macedonian economy**

As a result of mutual connection and dependence of economies, it is seldom some country to avoid the recession. In addition, a national economy could be affected by recession as a result of internal causes which may be of political, economic or social nature. For example, in the initial years of transition, as a result of the restructuring of the economy were closed a number of companies, and the number of unemployed increased dramatically, the Macedonian economy are often entered into the phase of recession. Also in 2001 the Macedonian economy entered deep into the phase of recession as a result of the former military conflict.

Realistically, the world financial crisis caused the economic crisis, but in Macedonia was vice versa, the economic crisis caused a financial crisis or crisis in the financial sector. One of the reasons is that the financial system of the Republic of Macedonia is largely integrated with the global financial system, i.e. global financial markets have a major impact on the Macedonian financial market. We know that the crisis first appeared in the financial market in the U.S.A, but today globalization, including integration of financial markets caused a rapid expansion of the crisis through a greater number of countries on global level. The fact that the developed countries are faced to stagnated rates of economic growth, causing adverse effects in less developed countries of Southeast Europe, especially countries from the Balkans.

In this process, the reduced consumption in Europe caused adverse effects on the real sector in Macedonia, because of decreased product distribution of Macedonian companies in the markets in Germany, France, Greece, Italy, Russia, Serbia. This is due to the connection and dependence of the economy of our country with the economies of these countries. The sooner these countries will go out from recession the sooner our economy will revive. We should emphasize that the negative consequences of this crisis, particularly felt in the metal processing industries, textile industry, and other activities related to foreign trade sector, i.e. companies that distribute their products in foreign markets.

Taking into account the previous analysis we can conclude that the negative indirect effects of the global economic crisis on the Macedonian economy is reflected on the export oriented industries and on reducing economic growth. Large exporting companies have begun to layoffs its

workers. So, Fenimak fired 200 workers, Makstil fired 180 workers, and large layoffs occurred in Skopje alloys and Mittal.<sup>5</sup> The fall in world prices of metals, decreased selling in foreign markets, high cost of electricity, were the reason for the decline of the steel industry which has significant involvement in the Macedonian industry and GDP. The textile industry is also faced to failure caused by the global crisis. This industry is important for Macedonian economy because it absorbs most of the employees. Reducing the distribution in the foreign markets caused a reduction in the production of textile products and a large number of layoffs in the industry.

Also, one of the key macroeconomic categories that should be subject to analysis is investments, especially foreign investment. Economic policies undertaken by the Government of the Republic of Macedonia before the global crisis were aimed at attracting foreign investors, which in the short run yield positive effects, but the biggest effects are expected in the years ahead. But the global financial crisis and the collapse of investment activities worldwide caused the cancellation of a number of foreign investments.

From previous analysis we can conclude that the global economic crisis hasn't avoided Macedonian economy. Many sectors were affected by the global crisis, so according the projections in 2009, Macedonia end with a negative rate of economic growth.<sup>6</sup> The economy saw a drop in the industrial production, decline in exports and increase the trade deficit, decline in investment and increase unemployment.

World Bank believes that the world recession will be deeper than expected and that the international economic crisis will leave large traces in underdeveloped and developing countries. To overcome the negative influences of the global crisis, these countries need \$ 700 billion. According to the World Bank, the international financial institutions are unable to provide the necessary means for overcoming the global economic crisis in developing countries. Particularly worrisome is the fact that these countries have not their own financial resources to overcome the effects of recession on the world economy. The global crisis requires global efforts to its overcome, tells World Bank President Robert Zoellick. It is necessary additional investment in social funds, in the infrastructure and in the small and medium enterprises in order to maintain employment and prevent social and political troubles.<sup>7</sup>

### **Economic measures to overcome recession**

Before we start with the economic measures undertaken by the Macedonian government in order to alleviate the negative effects of recession and creation of conditions for achieving positive economic growth rates we will quote the famous economist John Maynard Keynes who said, in terms of recession when the economy faces with decline in economic activity, the state should not be indifferent, on contrary it should take energetic measures and activities that will help to overcome the recession.

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<sup>5</sup> [www.finance.gov.mk](http://www.finance.gov.mk)

<sup>6</sup> [www.stat.gov.mk](http://www.stat.gov.mk)

<sup>7</sup> [www.worldbank.org](http://www.worldbank.org)

Most Member States of European Union have introduced comprehensive anti-crisis packages. Most of these schemes include the following elements:<sup>8</sup>

- direct support to enterprises, such as loans or guarantees to facilitate access to finance; in addition, public investment has also been undertaken to promote company sales, as have various fiscal measures, such as the lowering of social security contributions;
- instruments to foster consumer demand by supporting purchasing power, such as tax reductions or increases in the minimum wage;
- support of the labour market – for example, creating employment opportunities in the public sector and reducing employment taxes and
- support for the workers and citizens – for instance, financial support for families and compensation for income loss.

Despite initial announcements of the global economic crisis, during the 2008 Macedonian economy had continuous growth. Its real gross domestic product in that year rose 4.9 percent. However, in the last quarter of 2008 the effects of the global economic crisis began to feel in the Macedonian economy. It has already started to enter in the phase of recession and the economy faced with a serious problem of liquidity. To reduce this problem, the Government of Macedonia in late 2008 decided for those companies with impaired liquidity that have due but unpaid taxes, contributions and other public duties, to perform reprogramming of debts, with the possibility of write off of interest with these debts if the firms regularly and in the agreed deadlines pay the principal of those debts. Once completed the applications for registration of companies for acquiring such right, were registered 2.807 companies with debts in amount of 165 million euros in principal and 60 million euros as interest (it may write off January, if firms paid the principal). Moreover, in this package of anti-crisis measures was the conversion of debt into four state-owned enterprises in permanent debt of the state in order to increase their competitiveness and attractiveness for future sale. In addition, the National Bank of Macedonia increased the restrictive monetary policy, i.e. its raise rates at which banks separated their compulsory reserve in national and foreign currency deposits and increased its main interest rate (interest rate of treasury bills of the National Bank of the Republic of Macedonia) of 9 percent annually. Hence, banks increased their interest rates which led to increases in loans to banks, and thus reducing the liquidity of economic entities.

Rapid dynamics of the economic crisis caused financial implications in the Macedonian economy, which forced the Government of Macedonia in early 2009 to take the second set of anti-crisis measures. The most important measures in the package were free companies from the obligation to pay income tax on the amount of redistributed gains in investment and reduction of customs rates on raw materials for the textile industry, as well as import machinery and equipment metal industry, which was supposed to be a

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<sup>8</sup> Restructuring in recession – ERM Report 2009, European Foundation for the improvement of Living and Working Conditions

function of protection of these two central export industries from the recession that most manifests precisely in these two economic areas.<sup>9</sup>

Reinforcing of the recession movements in the economy and the growing of illiquidity of the companies, has caused the Government of Macedonia in April 2009 to adopt third package of anti-crisis measures (70 anti-crisis measures), to overcome the recession. They refer to three segments. The first segment refers to rebalance of the budget, which includes adjustments of income and expenditure in order to comply with the newly created circumstances (or revised macroeconomic assumptions for GDP growth of 1% and inflation rate of 1% in 2009). With the rebalance of the budget will provide significant savings of resources that would enable to maintain macroeconomic stability, including a sustainable deficit in the balance of payment and most importantly, a stable exchange rate of denars. The second segment includes a package of measures for direct credit support to enterprises through a EIB credit line in amount of 100 million euros for small and medium enterprises, including long-term investment loans, short term loans for working capital, subsidizing interest rates for companies and issuing guarantees and at least 50 -100 million euros to be provided by commercial banks from their own funds, as cofinancing.<sup>10</sup>

Therefore, a basic requirement for use of the support will be maintaining the existing number of employees by enterprise users, as a carrier of most of the employment in Macedonia. In this context, the Union of Trade Unions of Macedonia support government in its efforts to find solutions and measures in getting out of recession. The most important for the Union of Trade Unions of Macedonia is crisis can not be abused for the dismissal of workers, and to maintain the same level of wages. For successful implementation of these measures, as well as suggestions for others, it is necessary to maintain meeting of the Government of RM with the social partners. Economic crisis affects all three sides and it requires active and continuous dialogue between social partners, trade unions, employers and government. The third segment includes other measures to support businesses, including measures to facilitate the export of goods and cost reduction. The realization of this package will significant facilitate the operations of firms, it will increase their competitiveness and accelerate the flow of goods across the borders of our country.

In the same time with the anti-crisis measures, the Government of the Republic of Macedonia continues and strengthens the implementation of ambitious economic program of comprehensive structural reforms, i.e. reforms in the business environment in order to improve the entrance and exit from the market and creating free competition, strengthening the capacity of institutions, judicial reforms aimed at speeding up proceedings, reforms in the health system, labour market, education, public financial management and modernization of infrastructure. Estimation for 2010 show that the Macedonian economy still faces with serious difficulties, but despite this, in the second half of 2010 is expected to start positive rates of economic growth.

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<sup>9</sup> Customized according to a report from the monitoring and assessment of realization of the program activities of the Government of Macedonia in the period September 2008 - October 2009, Monitoring of leadership, Skopje 2009

<sup>10</sup> [www.vlada.mk](http://www.vlada.mk)

Government of the Republic of Macedonia together with the monetary authority should continue to take coordinated policies that will be focused towards economic prosperity in the future.

## **Conclusion**

The economic cycles are fluctuations in economic activity. The importance of the economic cycle, especially as the recession phase of the economic cycle is important because it affects real macroeconomic variables, such as, production, employment, the rate of economic growth, quality of life and standard of living. Economic policy makers are interested in the causes that determine recession, as well as appropriate economic policies that will be directed towards reducing the negative effects and consequences on the national economy resulting from the recession. Within this paper is elaborated theoretical approach to economic cycles and recession as its stage, as well as the impact of recession on national economy and on real macroeconomic variables. In the second part of this paper is analyzing the impact of the global economic crisis on the Macedonian economy, anti-recession measures undertaken by government to reduce or mitigate the adverse effects that were felt in the Macedonian economy with the emergence of the global economic crisis. At the end of this paper are given measures and recommendations of the authors in the direction of economic policies that can assist in overcoming the recession facing the Republic of Macedonia and policies that will enable achievement of economic growth in the future.

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