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**LESSONS FROM WORLD ECONOMIC CRISES: CLEANING, REMODELING AND  
HARMONIZING THE ECONOMY**

**ABSTRACT**

Every bigger economic crisis, as the current one, leaves behind a huge material damage to the world economy, and to separate national economies as well. However, every such crises reminds national authorities of the mistakes done in the past while creating and running macroeconomic policy and teaches them how they should overcome them in the upcoming period. That is the positive part of the crises: it should be understood as a good teacher who gives lessons based on which an ambient for a lasting and sustainable growth in future should be created.

From the current economic crises we've learned that it worked as a purgatory: the weak and fragile companies fell down; the more resistant ones took the chance and became even stronger; new companies emerged which create optimism and faith in an upcoming sustainable course towards the expansive path of the economic cycle.

The crisis reshapes the world economic map. Market forces are not in the same geographical borders as before. Spheres of interest are not the same as before. Competition on world markets gets new forms and players. The authorities of most of the countries became aware that they should remodel the domestic economy, if they wanted a better position in the incoming distribution of world markets.

Finally, the crisis showed that a stable economic growth may not be expected in future, either locally or globally, without appropriate harmonization of the basic instruments of macroeconomic policy: fiscal policy, monetary policy and foreign trade policy.

Has Republic of Macedonia learned those lessons? How can its economy shift into a lasting and sustainable economic growth in the upcoming period? The simple and, at the same time, very complex answer would be: by remodeling its economy!

**Key words:** crisis; lessons; growth; remodeling; harmonization.

**J.E.L. classification code:** E6 - Macroeconomic Policy, Macroeconomic Aspects of Public Finance, and General Outlook

## **Introduction**

The focus of this research will be on the response to the global economic crisis by selected South Eastern Europe countries such as: Albania, Bosnia, Macedonia, Serbia, Slovenia, Croatia, Bulgaria and Montenegro. Since these countries are considered as transition, mainly small and highly open economies, their economic growth model prior 2008, seemed manageable and sustainable. The formula they pursued for achieving higher economic growth was clear: increasing export, investing heavily into real estate and infrastructure plus implementing structural reforms in addition to promoting the countries as attractive foreign investment destinations, which should ultimately lead to a higher economic growth. But, these countries appeared ex ante more vulnerable when taking into consideration their reliance on foreign demand and capital inflows prior and during 2008, which were used to finance their growth. As global liquidity springs 'dried out', the SEE region's growth model appeared dramatically challenged, triggering fears that the shortage of external capital inflows could generate some

severe macroeconomic adjustment and jeopardize macroeconomic and financial stability. To a great extent, this poses question on whether these countries should continue to rely mostly on external demand and foreign capital, or a new approach is needed in order to finance their economic growth in future. The main finding of this research is that instead of experiencing external ‘push’ factors for economic growth by the Governments, a promotion of internal resources is needed in order to enable for “the catching up” process of these countries to continue.

The position assumed for this research is interpretative using qualitative methods of research. In order to ensure comparability among results, the proposed methodological design will be multiple-case study research on the selected SEE economies. Due to the personal interest of the author of this text, the case of Macedonian economy will be thoroughly analyzed. While doing so, following questions will be raised: Has Republic of Macedonia learned those lessons and how can its economy shift into a lasting and sustainable economic growth in the upcoming period? The answer of those questions will be the same again: Macedonia will have to remodel its economy.

## **I THE POSITIVE SIDE OF THE WORLD ECONOMIC CRISIS**

Usually, economic crises are valued as a negative economic form. Such is the case with the actual world economic crises. While evaluating it, analyses are being done on how big might be the final losses and how big might be their consequences for the upcoming developing trend of the world economy. While doing so, it is rarely estimated that the crises has some positive characteristics. They may be located in several fields.

### **a) Cleaning the economy: Economic Crisis as a purgatory**

It is understandable that the number of newly opened companies continually increases. Economic subjects try to realize their innovative qualities by modifying to business climate. Some succeed to better establish themselves in the national and world economy. However, others cannot make a qualitative and lasting business even in the best economic conditions, thus breaking the more intensive economic development. In the times of economic crisis, their

weakness is even more emphasized, which is why they have to give up the place for economic competition to the stronger and more qualitative economic subjects.

Thus, we can say that economic crisis acted as purgatory (14, 2011, p. 2): weak firms failed, strong firms remained and strengthened, and new, brave actors have appeared on the economic scene. It indicates the existence of latent powers and possibilities of the economy that should be used in the upcoming period for taking national economies to a more prosperous path of their post crisis development.

### **b) Crisis as a teacher**

The appearance and presence of economic crisis in any material or geographic range shows the weaknesses that are present in the economy and shows the carriers of economic policy which are the basic lessons that have to be learnt from economic crisis and to be taken into consideration in the creation of economic policy in the post crisis period. Whereupon, the economic crisis should be treated as any well-intentioned teacher, because it (1) shows us what are the main weaknesses of the existing economic growth model and (2) how we should create an ambient for a lasting and sustainable growth in the future.

Further analyses in this work will show that creators of economic policy in analyzed countries should seriously analyze and apply the lessons learnt from the world economic crisis.

## **II MAIN CHARACTERISTICS OF PRE CRISIS ECONOMIC GROWTH MODEL OF SELECTED SEE ECONOMIES**

### **1. Strong economic growth**

In the years that marked the shock which the economies of the analyzed countries were exposed to, after the breakdown of the previous socio-political system, they recorded negative or modest growth level. After that shock and especially after establishing institutional bases for a functional market economy which is a prerequisite for their future development and integration in EU market, economies of those countries started recording high levels of growth (see table 1).

**Table 1**  
**Rates of GDP Growth**

<b>Country/Year</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Albania</b>	5.8	5.4	5.9	7.7	<b>3.3</b>	3.5
<b>Bosnia</b>	4.0	6.1	6.1	5.7	<b>-3.1</b>	0.8
<b>Bulgaria</b>	6.4	6.5	6.4	6.2	<b>-5.5</b>	0.2
<b>Croatia</b>	4.2	4.7	5.5	2.4	<b>-5.8</b>	-1.4
<b>Macedonia</b>	4.4	5.0	6.1	5.0	-0.9	0.7
<b>Montenegro</b>	4.2	8.6	10.7	6.9	<b>-5.7</b>	1.1
<b>Serbia</b>	5.6	5.2	6.9	5.5	<b>-3.1</b>	1.8
<b>Slovenia</b>	4.5	5.9	6.9	3.7	<b>-8.1</b>	1.2

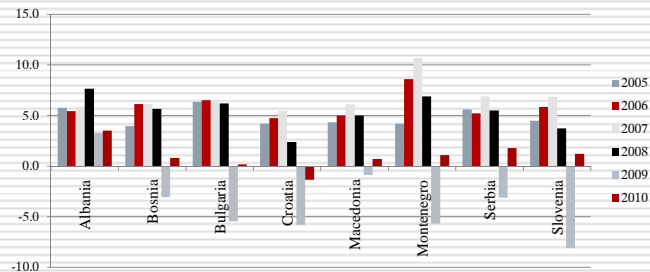
Source: IMF, World Economic Outlook Database, April 2011

In the years before the begging of the crisis (2005-2008) the economies of all analyzed countries recorded especially high growth development. Average annual growth of those economies was 5.7%. That is a higher growth rate compared to averagely realized growth of other emerging market regions, and also to the average growth rate of the economy of other EU member states.

It may be also be said that there were significant growth differences between individual countries which is a result of the chosen model of economic development and the positioning of certain economies in regional and world economy (see graph 1).

**Figure 1**

## Rates of GDP Growth



Source: IMF, World Economic Outlook Database, April 2011.

The trend of intensive economic growth in all analyzed countries was broken in 2009. Then all analyzed countries recorded negative growth rates, except Albania, where due to previously started intensive investment activities supported by a large inflow of direct foreign investments, the economy recorded a noticeable economic growth in 2009 and 2010.

Decrease of economy had a diverse intensity in different countries. The biggest fall was recorded in Slovenia, Croatia, Montenegro and Bulgaria, and the smallest in Macedonia.

Thus, the growth trend was broken in (2009) the time when almost all world economy entered in the zone of recession. That is a logical reason for such happenings. However, during that year, the main weaknesses on which previous model of economic growth of almost all analyzed countries was based, were recorded.

### 2. Basis for economic growth

What is the intensive economic growth of most countries before the beginning of economic crisis due to?

To a significant degree, external drivers accounted for this (1, 2011, p. 2). High growth was made possible with a distinctive growth model based on large capital flows (10, 2011, p. 8), which mainly came through foreign direct investment, credit inflows and private transfers.

### **a.Foreign direct investment**

In the pre-crisis period, all analyzed countries had recorded a high inflow of foreign direct investment (FDI's). That is logical, having in mind that all those countries were determined to become EU members, that's to say economic integration into EU. One of the conditions for fulfilling that aim is liberalization of capital inflows in the country from abroad, and especially from EU member states. Their determination to enter EU and NATO made them attractive for foreign investors who had decided to invest great amount of money and thus became one of the main promoters of economic growth of those countries. At the same time, depending on the size of the country, its business climate, its position towards the EU integration, the openness towards foreign countries, its infrastructure, monetary and fiscal freedom, protection of author's rights and so on, the amounts of FDI's differed greatly from country to country. Understandably (due to its joining to EU and NATO in the meantime) the highest absolute inflow of FDI's was recorded in Bulgaria, and afterwards Croatia which is the closest to joining EU (see table 2.)

### **Table 2**



## Foreign Direct Investments (USA \$)

Country/Year	2005	2006	2007	2008	2009	2010
Albania	264	325	662	988	979	1,205
Bosnia	613	766	2,077	1,064	501	68
Bulgaria	3,916	7,804	12,388	9,795	4,467	2,388
Croatia	1,825	3,468	5,023	6,140	2,605	641
Slovenia	577	648	1,514	1,924	(67)	897
Macedonia	97	424	699	587	248	296
Montenegro*	–	–	450	916	1,311	387
Serbia	1,441	4,286	2,004	2,995	1,920	1,157

Source: UNCTADstat

However, in 2009 a sudden decrease of FDI's inflow occurred at most of these countries. Thus dropped one of the most important sources of financing the growth on which was based the economic model of those countries in that time. The rapid decline of FDI's inflow may be determined as one of the more significant reasons for economic fall in those countries in 2009 and in Croatia in 2010 as well. This finding doesn't count for Albania where FDI's reached high amounts in 2009, which was one of the main reasons that Albania accomplished high rate of economic growth (3.3. to 3.5%) in 2009 and 2010 respectfully.

### b. Credit inflows

The lack of domestic financial capital for financing the projected economic growth more of the analyzed countries compensated by borrowing funds from abroad on credit basis. Credits were largely intermediated by subsidiaries of Western Europe banks in those countries due to (10, 2011, p. 9):

- Macroeconomic stability and structural reforms in selected countries;
- Reduced country risk;

- EU membership of some of the selected countries and prospects for EU membership of the other selected countries.

Besides that, the credit interest rates in euro-zone were lower than those in the analyzed countries. As the same time, their reduced country risk has resulted in an improved access to capital markets at very low prices.

Those reasons conditioned the indebtedness of certain countries to grow from year to year (see table 3). With exemption of Bulgaria, the level of their gross indebtedness in 2009 and 2010 was remarkably higher than the one recorded in the previous two-three years, which is understandable having in mind the decreased inflow of FDI's in most of them during those two years.

**Table 3**

<b>General Government Gross Debt (% of GDP)</b>						
<b>Country /Year</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Albania</b>	58.2	56.7	53.8	55.2	<b>60.2</b>	59.7
<b>Bosnia</b>	25.3	21.8	32.9	30.9	<b>35.4</b>	36.9
<b>Bulgaria</b>	29.4	23.4	18.6	15.5	<b>15.6</b>	18.0
<b>Croatia</b>	38.4	35.8	33.2	29.3	<b>35.4</b>	40.0
<b>Macedonia</b>	39.5	32.0	24.0	20.6	<b>23.9</b>	24.8
<b>Montenegro</b>	38.6	32.6	27.5	31.9	<b>40.7</b>	44.1
<b>Serbia</b>	56.3	43.0	35.2	33.4	<b>36.8</b>	44.0
<b>Slovenia</b>	27.0	26.7	23.4	22.5	<b>35.4</b>	37.2

Source: IMF, World Economic Outlook Database, April 2011

According to this, the development in those countries leaned on foreign credits. However, as a result of the emergent situation under the influence of the economic crisis, country risk of all countries in the region increased, and thereby the interest rates of foreign credits. That caused almost external imbalances at most of the selected countries and big vulnerability because of high proportion of foreign denominated debt.

At the same time, in the countries (Serbia) with a fluctuating course of national currency, the value of debt towards foreign countries calculated in domestic currency increased in circumstances when economy recorded low or negative growth rates, when profits of companies-debtors decreased, and wages of citizen-debtors remained the same or were reduced.

Thereby, the possibilities for new indebtedness abroad suddenly lowered down and worsened. It appeared that their future economic development could not lean on foreign credits as earlier.

### c. Private transfers

The third most important financial source of economic growth of selected countries were private transfers from abroad, especially worker's remittances. It is noticeable (see table 4) that in all selected countries (with exemption of Montenegro, which has a small number of citizen that work abroad) private transfers recorded high amounts and dynamics of growth during the pre-crisis period.

**Table 4**

## Private Transfers (in EUR million)

Country/YEAR	2005	2006	2007	2008	2009	2010
<b>Albania</b>	897	1,011	1,043	937	938	922
<b>Bosnia</b>	613	1,772	1,972	1,926	1,650	1,700
<b>Bulgaria</b>	818	670	681	861	956	1,547
<b>Croatia</b>	1,184	1,107	1,043	1,070	1,036	1,104
<b>Slovenia</b>	97	173	239	302	159	104
<b>Macedonia</b>	853	982	1,012	985	1,132	1,366
<b>Montenegro*</b>	–	–	59	73	85	114
<b>Serbia</b>	–	–	2,876	2,554	3,518	3,356

Source: National Banks

More importantly, those transfers were not only reduced but also increased in times when economic crisis reached its peak. That may be evaluated as illogical bearing in mind that due to economic crisis great number of workers abroad were fired or their wages were reduced. An objective explanation of that occurrence is the fact that part of those workers that were temporally fired returned back at their native countries and stayed there longer than their usual annual holidays. That was a reason for their bigger expenditure (transfer) of savings in their native country.

However, private transfers played a serious role in financing growth activities of selected countries in 2009 and 2010. On the contrary, those countries would have certainly recorded worse economic results than the ones realized. Private transfers played a serious role of amortizing external imbalances in most of those countries for achieving a remarkably lower rates of current account deficit (see table 5). That however showed the great dependence, uncertainty and high sensibility of those countries to the amount and dynamics of capital inflow of private transfers that should be taken into consideration while creating the future model of their economic development.

**Table 5**

## **Current account imbalances**

### **Current account balance (percent of GDP)**

<b>Country/Year</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Albania</b>	-6.1	-5.6	-10.4	-15.2	-14.0	-10.1
<b>Bosnia</b>	-17.2	-8.0	-10.7	-14.5	-6.9	-6.0
<b>Bulgaria</b>	-11.7	-17.6	-30.2	-23.3	-10.0	-0.8
<b>Croatia</b>	-5.5	-7.0	-7.6	-9.2	-5.5	-1.9
<b>Macedonia</b>	-2.6	-0.8	-6.5	-13.9	-6.4	-2.8
<b>Montenegro</b>	-8.5	-24.1	-39.5	-50.6	-30.3	-25.6
<b>Serbia</b>	-8.7	-10.2	-16.0	-21.1	-6.9	-7.1
<b>Slovenia</b>	-1.7	-2.5	-4.8	-6.7	-1.5	-1.2

Source: IMF, World Economic Outlook Database, April 2011

### **3. General conclusion: Countries with high external vulnerabilities**

The previous analysis showed the ways in which the pattern of growth in most of selected countries was unbalanced, allowing significant external and financial vulnerabilities to emerge. Capital inflows did not sufficiently feed into productive investment, and the competitiveness of economies was not upgraded to assure sustainable growth. There was an over-reliance on foreign savings to sustain consumption and residential investment (1, 2011, p. 5). It became obvious that yesterday's import-led, financial sector driven and debt fuelled transition trajectory of economic development in the region must be subject to a root and branch re-evaluation (3, 2011, p. 90).

Financial integration, including the prominent role of foreign-owned banks, was a crucial part of transition strategy of those countries. However, the associated high investment levels during times of growth did not help much to improve the competitiveness of the countries. Productive investment did not flow in those countries. Domestic reforms lagged in key areas for the business environment and for a healthy growth of the traded goods sector (1, 2011, p. 4). Indicators show that there was a big lagging performance in reforming the enterprise sector and in creating competitive domestic market conditions.

In general, the previous model of growth in those countries has shown significant domestic and external vulnerabilities (10, 2011, p. 18). Most of those countries became exposed to international capital flows, the channel through which the financial and economic crisis was transmitted to them. In new created economic world that convergence strategy seems not to be sustainable any more. It becomes obvious that new model for economic growth is needed.

### **III A NEED FOR REMODELING THE ECONOMY – INCREASING THE RESISTANCE TO EXTERNAL SHOCKS**

There is no doubt that the crisis has challenged the regional growth model, which relied on foreign financing of high levels of investment. But, previously mentioned policy and market weaknesses in the pre-crisis period now need to be addressed.

It becomes obviously that there is a need for shifting the pattern of growth towards one that is more labor intensive, more competitive in terms of productivity growth, and less

dependent on foreign savings. It is also clear that the previous model, relying on massive capital inflows, will not return in the short run, and probably not even in the medium or long term (16, 2011, p. 34). Having all that in mind we come to conclusion that selected countries, as well as many of others Central and East Europe countries need new economic model that will increase their resistance to external shocks.

In general, there are three broad areas where attention should be pointed out: changing the drivers of growth and its sources of financing; achieving greater risk mitigation through macroeconomic and financial policies; and exploring more effective cross-border linkages as a key dimension of a more prosperous future for the region (1, 2011, p. 6). In other words, there is a need these countries to promote internal resources as “push” factors:

### **1. Increase and reliance on domestic (national) savings**

As the pre-crisis growth model of relying heavily on massive capital inflows has proven to be unsustainable for selected countries (10, 2011, p. 29), they will have to figure out ways to develop local sources of finance (16, 2011, p. 34). That means national policy to be more directed towards increasing private and public savings. On one hand an improved business environment should increase potential returns and thus private savings ratio and it will stimulate the shift of investment towards tradable sector and export. On the other hand, a comprehensive fiscal consolidation will correct previously significantly deteriorated fiscal position and will increase the public savings. All of this will decrease the dependence of those countries from foreign savings and will gradually reduce their external imbalances.

### **2. Deleveraging the economy**

Increase domestic savings will cause selected countries to decrease their indebtedness at home and abroad. Consolidated fiscal policy, the expected increase of export of goods and services and decreased (limited) import of certain goods and services, due to their production by domestic companies, will diminish the need of the countries for further indebtedness on domestic and foreign markets. At the same time this will create conditions for the countries to more

intensively decrease their continual indebtedness which will release them from their interest burden and will increase their rating on international markets.

At the same time, the increase of savings will release private sector from long-term problems of insufficient liquidity and dependability on domestic and foreign credit institutions. The achieved excess of funds they may use for a gradual decrease of their debt towards their creditors. Of course, that should be done cautiously, because deleveraging of the household sector dampens consumption, while corporate deleveraging reduces investment and potential GDP.

At any case, gradual deleveraging will condition reducing the gross indebtedness of the countries and especially their public debt as a sign for the level of creditability of a certain country in the international context.

### **3. Greater reliance on domestic credit funding**

According to that, national policies in selected countries should have to stimulate greater reliance on domestic sources of credit funding. Banks in most of those countries will need to rebalance their business, with lending growth linked to deposit growth. National policies should have to discourage excessive leveraging what would contribute to mitigation of external vulnerabilities and make domestic financial system more resistant to external shocks (10, 2011, p. 31).

### **4. Diversification and increase of home produced goods and services**

Adjustments in external imbalances should have to be associated with deeper structural reforms in labor and product markets. Such reforms are essential to increase the capacity of those economies to compete with other emerging markets. Policies (17, 2011, p. 50) must be tailored toward competitiveness in the markets most likely to hold growth prospects in those countries. There is a need for structural reform for faster productivity growth. One priority is to integrate further in supply chains feeding demand in Western Europe and generally increasing penetration of Western European markets. But, as a safety valve, Schädler (2011) urges the need for a broadening of export bases in terms of products and markets outside EU.

The economies of analyzed countries can shift their pattern of growth to a more sustainable and balanced one if they sharply address business environment which can help promote the traded good sector.

### **5. Channeling foreign capital inflows in export sector**

The crisis has certainly highlighted the problems of export concentration and its potential to derail growth (17, 2011, p. 50).

If some of the analyzed countries are to continue to depend on large inflows from abroad, those inflows must be channeled mostly into export sector.

That may be effectively done by fiscal encouragements of foreign direct investments which production will be directed for export. For example, by giving beneficiaries for paying lower purchase prices for building land, lower communal taxes, giving so called investment premium, temporally exemption of personal income tax, profit tax, social taxes etc.

### **6. Harmonization (adjustments) in macroeconomic and financial policy**

Because of their close interdependence, it will be necessary in the upcoming period to harmonize the relations between the most important parts of macroeconomic policy (12, 2010, p. 29) in the direction of their coordinated action. That will eliminate the possibility of destabilizing the economy and create conditions for starting a process of lasting and sustainable (at least at medium term) economic growth of the country. While creating the new model of economic growth the selected countries should insist on harmonizing the measures of fiscal to the measures of monetary policy. It is especially important these two policies to be more proactive in managing capital inflows and particularly in their stimulating to be channeled into tradable sector and export.

Since monetary policy in most cases is given, the fiscal and supervisory policies should be seen as the main bulwarks containing overall levels of risk in the economy (1, 2011, p. 9). Realigning to fiscal-monetary policy mix to focus strategies for existing crisis-induced easing will require early and decisive fiscal tightening so that interest rates can remain low. If fiscal



policy is not more credible over the medium term, this could jeopardize growth prospects and increase volatility in money market.

Fiscal adjustment would be best supported by having a public debate on a viable fiscal rule, establishing such a rule, and then sticking to it (17, 2011, p. 50). Besides, a credible, multi-year planning of fiscal policy and fiscal discipline is needed (16, 2011, p. 34).

## **7. Cross-border linkages and regional cooperation**

To achieve pattern of growth towards productive investment and export require a deepening of cross-border linkages, and would benefit hugely from the development of a more integrated regional market (8, 2011, p. 69). It is particularly important regional cooperation among the private sector to be improved. There are signs of direct investment growing across borders – for example, from Serbia to Slovenia, Croatia to Serbia and Slovenia etc. But they are only emergent trends. Parallels can be drawn with the scope to achieve much stronger and more efficient networks in the region in the fields of energy, transportation or institutions, for example. Of course, there are lot of other areas – usage of IPA funds, for example, in which exchanges of experiences and cross-border initiatives in the selected countries could be explored.

## **IV REPUBLIC OF MACEDONIA AND THE WORLD ECONOMIC CRISIS**

### **1. Effects of the Global Economic Crisis**

Republic of Macedonia (RM) has an underdeveloped and shallow financial system which is dominated by commercial banks. It is practically non-integrated into the global financial markets. That weakness proved to be an advantage for the Macedonian economy. Finance developments in the world have not spilled over the banking system in Macedonia. It remained stable, well capitalized and with a small amount of so-called bad loans (non-performing loans). This means that the financial crisis passed RM.

However, the great openness of the economy towards foreign countries meant recession spillover of the crisis in Macedonia (15, 2011, p. 3). That was especially felt when its most

important foreign trade partners (Germany, Greece, Italy, Bulgaria, Serbia, etc.) entered the recession. The beginnings of the recession of the economy can be seen at the end of 2008. RM, officially entered the recession in January 2009. After two consecutive quarters in 2009 in which the economy experienced negative trends, in the third and fourth quarter of 2009 it recorded positive growth rates, which interrupted the recession of its economic cycle. In the bigger part of 2010 the Macedonian economy experienced a modest positive change, which caused modest, but positive economic result of 0.7 percent at the end of the year.

The rule (11, 2010, p. 97) according to which recession is followed by social crisis is confirmed in the case of RM. More intensive penetration of the economy in recession in mid-spring 2009 and its peak in midsummer of the same year resulted in intensified increase in the number of effectively unemployed individuals. That trend continued until the end of 2009 and during the first few months of 2010. However, as a result of four packages of anti-crisis measures previously brought by the Government, the number of unemployed did not increase at a pace witnessed in most European countries.

## **2. Lessons for Macedonian economy from the economic crisis**

Macedonia's entering the crisis and its gradual coming out of the crisis provoke a few deductions (14, 2011, p. 3) which the authorities need to take into consideration in the upcoming creation of the economic scene in Macedonia:

- a. The Macedonian economy is dependent on the performance of several countries (Germany, Serbia, Greece, Bulgaria, Italy...);
- b. The Macedonian economy is dependent on the performance of only few sectors: metal industry, textile industry, parts of agriculture, etc. This fact proved to be a widely restrictive factor for the future development of the economy;
- c. The Macedonian economy is heavily dependent on the movement of prices of its most important export and import products. The increase of the prices of the metals on the world stock markets at the beginning of 2010 extremely positively influenced the economic development of the major part of the economy in the second and third quarter of the year. On the other hand, the increase of the prices of the fuels and the agricultural and food products, which are basic for the

Macedonian economy, triggers rising of the input expenditures, which in turn decreases their competitiveness on the world markets;

d. The supply and the demand of domestic products and services on the domestic market are relatively small scale, which is a serious restrictive shortcoming in the development of the country.

### **3. A need for remodeling the economy**

The experiences (positive or negative) of the world economic crisis are used for remodeling the global economic map. For many countries in the world it is a sign of a necessary alteration of their own economic model, if they want to follow the new world trends.

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

The existing conditions and favorable actions in the economic and social area in the upcoming period indicate the necessity of introducing the so-called *holistic approach* (14, 2011, p.4.) in creating a future medium-term model for economic development.

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

In order to overcome the weaknesses the economy showed during the crisis, to protect itself against future crises and to provide conditions for achieving sustainable economic development, the activities of the economic policy makers and economic actors in the country (which should be dominated by Small and Medium Enterprises) in the next period should be directed towards diversification of production of goods and services offered at home, which could be offered to foreign markets as well. Actions should be aimed at encouraging existing and new companies to operate in the areas of services, agriculture, competing industries (particularly the manufacturing industry), etc. Of particular importance is the encouragement of innovation and not just in the

form of newly discovered products, but also in already existing goods and services. To achieve this goal, the following things are necessary (15, 2011, p. 4):

a. *Institutional support* for the new business ideas and business projects through:

- adjustment of legislation;
- elimination of legal restrictions wherever possible and necessary;
- fiscal support.

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

- Subsidizing domestic production of strategic goods and services as a replacement for the same or similar products which are now exported;
- Opening of purchasing/distributional centers for planning, buying, sorting, cooling, processing and distribution of agricultural and food products;
- Promotion of alternative sources of energy: building new national hydro power plants and small household hydro power plants and household water supply stations, construction of windmills; introduction and expansion of the gas network in the country and others. This will provide greater quantities of the most important input - energy, at a lower price than the current one. It will reduce production cost and increase competitiveness of domestic products in respect of import;
- Increasing the competitiveness of domestic goods and services;

c. *Promoting domestic investment through the deployment of domestic capital*, i.e. savings that businesses and citizens have in banks and at home. That capital should be forced to be engaged in the process of economic reproduction through:

- Investing in government bonds;
- Investments in agriculture and in construction of apartments, houses, business premises and others;

- Investing in projects that are offered concessionary and/or public-private partnership (building and maintaining schools, hospitals, government administrative buildings, roads, etc.);
- Construction of alternative energy sources: sewage treatment, construction of small hydropower plants (family HPPs in the villages and the weekend houses);
- Recycling paper, glass, plastic, etc.;
- Opening individual facilities for products which are already a great part of the Macedonian tradition, like wine, brandy, brine, cheese, honey, jam, juice, milk, margarine, butter, cream, ketchup, and raw materials and comparative advantages;
- Development of rural tourism: the construction of hotels, motels, vacation homes, swimming pools, saunas, fitness centers, etc.;
- Building homes for the elderly, kindergartens, entertainment parks, dispensaries, tennis courts, playgrounds, etc.

The population capital mobilization will increase the number of newly opened companies, payroll supply of goods and services, increase the number of employees, reduce import dependence and increase the country's GDP.

d. *Finishing the started activities for improving the educational process* that needs to overcome the problem of poor or low qualifications of the workforce;

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

f. *Encourage exports.* The increased volume of domestic goods and services would be primarily aimed to satisfy domestic needs, which will reduce the country's heavy dependence on imports of some or most of these goods. At the same time, the expected increased number of newly opened businesses and increased productivity will enhance their domestic and international competitiveness. This, in addition with synchronized action of the essential

macroeconomic policies will create conditions for increasing the production volume of goods and services for export.

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

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

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

#### **4. Expected results**

Newly established model of economic policy will result with multiple positive effects. Primarily, it will be manifested with the following indicators (15, 2011, p.8):

- Increase of the number of new SMSEs;
- Dynamic creation of new SME will increase the level of domestic investment by large amount and rates ever observed;
- Large number of the newly opened SME in following five-year period will be located in different branches of the industry. Their activity in the newly established environment will lead to an increase in industrial production. Fair is the assumption that in the upcoming five-year period, newly opened SME will contribute to the encouragement (increase) the average annual industrial production from a 8-10 per cent;
- The increased volume of investment by SME, supplemented by the expected increase in industrial production will subsequently contribute (in addition to the action of other

constituent elements) to increase the country's GDP from an average of 6-8 percent annually in the forthcoming five-year period. This will enable the gradual reduction of differences in the level of economic development compared to that in the EU. In fact, with such rates of growth of the economy, it is realistic to expect that Macedonia will reach the level of economic growth of EU in 25-30 years;

- A logical consequence of the increasing number of SME will be newly increased number of new employees;
- Applying the aforementioned incentives will increase the volume of production that SME will have earmarked for export. It will contribute to the total exports at the country level. At the same time, increase of the production of various goods and services will cause them to place a certain extent on the domestic market. This will increase domestic consumption of those goods and services with dual positive effect: a) an increase in GDP under the influence of increased domestic consumption, and b) reducing the consumption of the relevant goods and services provided by an importation from abroad, i.e. reduction of total imports of the country;
- Increased exports or reduced imports of goods and services will lead to a gradual reduction of the deficit the country's foreign trade. It will have a direct positive impact on increasing the domestic GDP, reducing the current account deficit within the balance of payments, increasing the state foreign currency reserves and sharply reduce and possibly eliminate entirely the need for borrowing by the country abroad. Further positive consequence of such changes will be reducing the public debt, especially international debt of the country;
- Newly created model will not disturb the macroeconomic stability as a condition for future long-term, permanent and sustainable economic growth. Inflation will move into the projected frames because they are an essential element of the proposed new Central Bank monetary strategy. Significantly increased foreign exchange inflows from abroad on the basis of increased exports and reduced imports of goods and services will be a guarantee for maintaining stability of the exchange rate and without the need for new credit borrowings of the country abroad. The increased inflow of funds in the Budget on one hand, and his rational and productive use on the other hand, conditioned the permanent budget deficit to shrink and move in modest sizes from 1 to 1.5 percent of

GDP. However, public debt and the international debt of the country will be reduced and will be significantly under the framework established by the Maastricht criteria.

## V CONCLUSIONS OF THE RESEARCH

The economic growth model of selected SEE economies during pre-global economic crisis was based mainly on foreign demand and capital inflows which created big external imbalances in those countries. It was main reason why those countries were exposed to big vulnerability of external shocks. The lessons learnt from economic crisis say there is a need for revising the pre - crisis economic growth model in the selected countries as they to be less vulnerable to external shocks (remodeling the economy). New economic model will enable their long lasting and more sustainable economic growth in future.

But, all those countries are members or candidates for becoming EU members. That means there is no room for application on entirely new economy growth model since those countries have to create economic model which has to be convergent to EU one. There must be different approach by individual countries in remodeling their economies. In the center of new model there should be pointed out: changing the drivers of growth and its sources of financing; achieving greater risk mitigation through macroeconomic and financial policies; and exploring more effective cross-border linkages.

The existing conditions and favorable actions in the economic and social area in Republic of Macedonia in the upcoming period indicate the necessity of introducing the so-called *holistic approach* in creating a future medium-term model for economic development. That means the focus should not be only on macroeconomic and financial policies but also on creating jobs and providing social protection.

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