



Macedonia has a stable market economy?

By Marjan Nikolov, MSc

As transition took place in our country and many others, the focus went from emphasis on macroeconomic factors to microeconomic ones. Once macroeconomic stability was achieved, it became clear that the major challenges for achieving growth and social stability are microeconomic in character. After a decade or so, we can summarize some general and specific aspects of the transitional countries and their experiences.

This article is an attempt to explain the socioeconomic and institutional failure of Macedonian transition through a theoretical model that is based on micro theory assumptions. It explains the main inhibitors of economic growth and the main point is that all forces in the country are focused on rather redistribution of wealth instead on its growth.

The environment of the Macedonian transitional economy

Macedonia has survived the first wave of transition. In the past 12 years, it has taken steps to liberalize prices, open markets, and successfully control inflation. At the same time, it has largely finished the process of privatization. At first sight, there is a stable market economy in Macedonia, but the growth of the economy is almost of the “L” type, which may bode ill for optimistic as to development of a healthy economy in the longer term. The average annual rate of real GDP growth during 1995-2003, which reflects the potential growth rate of the economy, was roughly 2%. This growth rate is significantly below what Macedonia should be able to achieve given its level of development, and it is far below the rate of 5-6% that will bring about long-run convergence with European countries. Growth accounting analysis also has shown that the most important reason for this poor performance is a very low rate of investment in both physical and human capital.

The question is why, even after a decade, we are not on the right path. The answer might be found in looking at the theory of the institutional and new political economy. These economic disciplines assume that the behavior of the economic agents perform in a rather static fashion. The more erratic behavior is a reason for uncertainty and risk. In order to decrease the uncertainty and the risk we need rules. These rules must be defined, structured, implemented and controlled by the institutions. The institutions should be the catalysts of economic growth. They should provide incentives for the economic agents to use innovative initiatives for activities that lead toward higher productivity. With the growth of productivity the overall economic growth could be achieved.

Unfortunately, in Macedonia the institutions are providing incentives only for actions of redistribution of the existing resources and goods and do not give incentives for their growth and separate creation and development, once redistributed. In addition, there are key scarce resources that are needed to support this development and we will define three types, as further discussed below.

First types of resources are the capital goods. These goods are actually the physical capital that was subject to privatization. These capital goods were just transferred from unclear ownership to private ownership without supporting processes of privatization that enable the ultimate acquirer to use the goods and achieve positive results and improve firm performance. Thus, in these companies there is still lack in goodwill and corporate governance and trust in the sense of corporate actors being able to carry out business activities together without always having to fear violations of important formal and informal contracts. In Macedonia the economies of scale that we had in the existing companies and that was built over time (maybe on the path of the Rostow's model) was abruptly destroyed and fragmented in the name of the small and medium enterprises. Although new non-state owners now exist, under investment in physical capital will continue to be a major problem until we strengthen:

1. Corporate governance (something that we have started to talk about in the last year),
2. Competitive financial institutions (that still can not make difference between firstly the uncertainty, which is passive market entry where the "protection" and hedge is to do nothing and secondly the risk, which is more sophisticated phase where you can manage and estimate the probability of any event) that should carry the development of the capital market,
3. Management for the new era (it is not enough to change the title from director to manager), and
4. Marketing and create and win new markets and products (something that we have even not yet started).

The lack of the attributes from 1 to 4 in the new non-state owned entities almost certainly ensured the early and continuing failure of these entities.

Other general type of resources (liquid assets, rights, licenses, contracts etc) is subject to redistribution through formal and informal groups and processes. Here I refer to rights that can be owned through a procedure that involves discretion of the institutions in terms of honoring those rights. Part of the problem is the highly centralized and concentrated institutions that have not really kept up with the necessity and pace of the changes.

The third type, with the smallest fraction in the financial resources compared to other two types of resources, has been subject to redistribution through the general budget through social programs directly into the poor part of the Macedonian citizenry. This third type together with bribes, wage payments to unproductive workers and rent seeking are keeping the equilibrium stable.

Redistribution instead of growth

While the institutions did not succeed in redirecting the resources toward prolonged consumption and green field investments, they have taken active role in the redistribution of the resources at stake in Macedonia. Even after more than a decade, there is no investment in physical capital, human capital and social capital, all of which are critical as determinants of growth. Up until the present day, all of the agents are focusing on redistribution of what already exists, rather than what the ultimate effect of redistributing that item might be. In such an environment most of the redistributed resources are subject to question, because donating property rights alone does not lead to productivity increasing and growth. If there are no real or potential returns on these assets, the economic agents who receive them cannot exploit them. If there is insufficient attention paid to the need for considering potential return on investment (rather than the investment itself) those who question the legality of the property right will only challenge the process in the belief that that resource can sometimes in the future be of value to them (the dispossessed') even though they do not have slightest idea when and how to use the resource. That is why the workers are striking at almost all of the now private companies. They fail to understand that a non-viable asset is not a real asset, and those in charge of privatization have misled them by failing to educate them as to the realities of today's market economy.

The institutions itself are biased, and all-too-often uninformed because of the high monitoring costs, as well as being too personally committed to the redistribution and thus, they cannot answer these challenges with any real credibility. Because of that, these institutions are providing opportunities for formal and informal groups to compete with them. Under such conditions, the conflicts are getting more intense among the political-economic groups. These groups that are now involved in specific disagreements are becoming more and more polarized. The other political-economic groups are tending to join in this polarization because neither are strong enough to resist the political and economic gravity nor have strategy to act independently. The institutions that should be concerned with the welfare of the population as a whole and achieving economic efficiency and growth are instead captured by political interest groups, which claim this situation to be a natural outcome of democracy.

Assumptions of the model

Why is this happening? In this analysis we have four assumptions for this discouraging results of the Macedonian model of transition.

First we assume that each rational economic agent is estimating the marginal cost and the marginal benefit of its action.

Second assumption, all categories of economic agents seek to maximize their own individual welfare and will do what is necessary under existing rules and institutions to achieve that.

Third assumption, the institutions in Macedonia since after independence are not strong, they are obsolete and not compatible with the new environment. While they also

were forced politically to be part of the redistribution scheme, most involved never bought into the rationale therefore.

Fourth assumption, there is no competent and directed public debate.

In this model there are three types of economic agents in accordance with the resources breakdown from above. The fourth actors are the institutions.

The mechanisms of the model

The economic agents are undertaking actions each day. Each action has its marginal cost and may yield a marginal benefit. Part of the actions are beyond what the rules of law are prescribing and that should be protected by the institutions. The lack of strong institutions that could, by the judicious application of financial sanctions for failure to adhere to legal requirements, make the marginal cost for the agents higher means there is opportunity for undertaking criminal and corruptive actions. The missed penalty is actually equal the value of the rent seeking.

The lack of competent and potent public institutions only enhance and encourage such a behavior. Simply, in such a relationship there exist a stable equilibrium where the competing formal and informal groups are very successful and efficient. All three types of owners of resources have optimized their utility functions in this equilibrium and there is no control variable that can initiate growth. Thus, there exist a stable economy that leads toward low growth rates (if any), no green investment, further political and economic fragmentation and enhancing the conflicts of any type.

The institutions itself are facing the competition from the formal and informal groups and increased costs for monitoring and enforcement of the laws and this might give false picture that it is more efficient to operate like that, but this is only true in short run. In this environment we cannot balance the trade off of efficiency in long run with providing the services with lower costs that can deal with and compete the informal and formal groups that devastates the institutions.

In long run this stability leads toward sharp confrontations among the most conflicted groups of any type. The rational investors are foreseen the lack of protection of the property rights and that makes the long run contracts more expensive. In middle run, in order to calm the conflicts there could be undertaken campaign measures, but without a strategy to improve the environment and the lack of systematic approach and strategy, will be seen by the rational economic agents as a losing proposition. The campaign measures are limited to that what the institutions should do anyway as a part of the job description. Thus, the rational economic agents foresee that their marginal costs are higher during the campaign and thus may limit those costs by engineering a decrease in the scope of their activities. They are decreasing the economic activity in consumption, production, even the institutions itself are slowing the dynamics of their work in order not to make mistakes because they all know that this is not systematic but campaign approach and thus, are waiting for the campaign to end so that they can all get back to the old way of doing things with lower marginal costs.

In this model there is only one stable equilibrium where the economic agents are short sighted and cannot see that the model ends abruptly and without gain to most of them.

The public that should help in decreasing the monitoring costs and to help in delivering more perfect and symmetric information is biased and part of the redistribution scheme. That only helps the informal groups in competing the institutions.

These costs are breaking the neoclassical theory of perfect markets, do not allow long run contracts entry and building social capital as determinants of growth. Even if there is someone interested in long run contracts entry in Macedonia, the system does not seem able to protect and enforce the property rights, or to provide more perfect and symmetrical information, and thus, is increasing his/her cost of transaction and monitoring. Simply, the net present value of inflow are not high enough to outweigh the discounted outflows in their cost estimation developed in connection with possible long run entry into the Macedonian marketplace.

Possible way out

One possible way out is in the changes of the relative prices among the informal and formal owners of the resources that we have categorized above.

With the changes in the relative prices, the negotiation power of the agents will shift and will destabilize the equilibrium. This might be an opportunity for reforms toward innovations and institutions that can lead toward growth and productivity increase. Still, the success will depend from the external factors like moves to EU accession and consequent application of EU sanctioned methodologies, but the activities of internal agents that would like to reestablish their utility functions will also affect these outcomes. Another consequence of the model is that Macedonian policymakers have little or no incentives to take measures to improve institutions.

A more active involvement of the EU with west Balkan countries should be focused precisely on institutional strengthening, and this involvement is so far inadequate to the challenges faced. The reformed institutions should decrease the costs of the imperfect markets and provide cheaper and better symmetric information for the economic agents so that the transaction costs and monitoring costs can be on a level that can compensate each agent up to the moment of their preferences and Pareto optimality.

What remains are the following questions:

- Are there multiply equilibriums in this socio economic model and how stable they are?
- Are they on the stable path of growth and what is the limit of tolerance of the society without growth that in Macedonian is being tested as never before? and finally,
- What will be that shock that the system can sustain so that the Macedonia continues on the growth path?

Literature

1. W. W. Rostow, "The stages of economic growth"
2. R. Barro, X. S. Martin, "Economic Growth"
3. D. C. North, "Institutions, institutional change and economic performance"
4. E. Bomhoff, "Monetary Uncertainty"

5. R. Putnam, R. Leonardi, R. Nanetti, "Making Democracy Work"
6. M. Paldam and G. Svendsen, "Is Social Capital and Effective Smoke Condenser?"
7. D. Rodrik, A. Subramanian and F. Trebbi, "Institutions Rule: The Primacy of Institutions over Integration and Geography in Economic Development"
8. M. Raiser, C. Haerpfer, T. Nowotny and C. Wallace, "Social Capital in transition: a first look at the evidence"
9. M. Raiser, "Trust in transition"
10. J. Hellman, G. Jones, D. Kaufmann, M. Schankerman, "Measuring governance and state capture: the role of bureaucrats and firms in shaping the business environment"
11. C. Grootaert, T. Bastelaer, "Understanding and Measuring Social Capital"
12. H. Soto, "The Mystery of Capital"
13. V. Tanzi, "Corruption around the world"
14. J. Stiglitz, "Globalization and its discontents"
15. J. Zalduendo, "Enterprise restructuring and transition: Evidence from the FYROM"
16. R. Dur, B. Peletier, O. Swank, "The effect of fiscal rules on public investment if budget deficits are politically motivated"
17. T. Kuhn, "The structure of scientific revolutions"
18. P. Blustein, "The Chastening"
19. B. Roberts, "Growth accounting analysis in Macedonia for the period 1997-2001"