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*The Social Impact of the Global Economic Crisis
in the Western Balkans with a focus on the
Republic of Macedonia*

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European Institute
London School of Economics and Political Science

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Abstract

This paper studies the social impact of the global economic crisis on the countries of the Western Balkans, with a focus on the Republic of Macedonia. Although almost all countries of the region have been severely hit by the economic crisis in 2009 some, such as Macedonia, that were less integrated into the global economy were apparently less affected initially. The paper sets out the broad impact of the crisis on the region’s economic growth, and identifies the transmission mechanisms of the crisis, through contractions of export demand, falling remittance flows, bank credit, and sharply reduced flows of foreign direct investment. The international and domestic policy responses to the crisis are outlined. Finally the social impact of the crisis is examined in terms of the effects on unemployment and pension provision. The results of a household survey carried out in Macedonia in summer 2009 are used to identify the effects of the crisis on socio-economic conditions, poverty, income inequality, and ethnic tensions. The analysis shows that the social effects of the crisis have been far worse than implied by the official macroeconomic data. The paper concludes that the social impact of the global crisis in the region has been severe, and that its impact may worsen in the coming months and years with potentially serious consequences for regional stability. In the case of Macedonia, speedy progress with Euro-Atlantic integration may mitigate these risks.

Keywords

global economic crisis, household survey, political stability, Western Balkans, Republic of Macedonia

1 Introduction

The countries of the Western Balkans, as elsewhere throughout Eastern Europe, have been severely affected by the recession - more so than most other regions around the world (Mitra et al., 2009). While some countries within the region have been very deeply affected, others appear to have been relatively lightly touched by the crisis, while one, Albania, is among a handful of transition countries that have apparently not experienced negative economic growth. The effects of crisis have been transmitted mainly through a decrease in demand from the EU core countries to the peripheral countries. Variability in exposure to demand for tradable goods and migrant labour, and inflows of foreign investment and remittances, has been the main cause of the differential impact of the economic crisis in the region. The social impact has been equally variable across countries, and has followed partly the nature of the transmission mechanism, and partly followed more general factors related to structural features of the economies and the domestic and international policy responses to the crisis, as well as previous policies towards the social sector carried out during the transition process.

Social protection systems are relatively weak in the Western Balkans compared to those in the EU, and consequently, people in the region are more vulnerable to economic downturns. Over the last twenty years, poverty and social insecurity has led to political instability, and has undermined progress towards European integration. Low levels of public expenditure, designed to keep budget deficits within Maastricht and IMF targets, has largely undermined attempts to provide effective public services. The World Bank has initiated poverty reduction strategies in the poorest countries aimed at better targeting of social protection programmes towards the poor, but this has been difficult to achieve in countries where the administrative capacity is weak. Social sector reforms have therefore been directed towards marketisation, and in some countries this has been achieved through partial privatization of the pension system, one of the largest absorbers of public expenditure. Reforms to health systems have involved varying degrees of decentralization and privatization. Housing reforms carried out at the beginning of the 1990s in many countries have led to a dearth of public sector housing and growing housing problems. The region also still suffers from a large population of refugees which fled their homes during the wars of the 1990s. Donor agencies have been very active in the field of social policy in response to these problems, but they have offered conflicting advice which has led to inconsistencies in the provision of ser-

vices. Many donors have advocated a welfare mix involving an important role for NGOs in the provision of social services, but the NGO sector is in its infancy and does not have the capacity to play a leading role.

Institutional reforms in the region have been the outcome of a policy process which involved a political struggle between pro-reform and anti-reform coalitions (Bartlett 2008). According to Hellman (1998), winners from reform are the most dangerous opponents of reform progress. This is because, in partially reformed economies, new elites have established monopoly positions that provide opportunities for rent-seeking. Consequently, they aim to prevent further reforms that would undermine their privileges. Ethnic conflict is seen as a strategy by which the anti-reform coalitions have been able to mobilize the population against reform, and maintain their privileges built up during the transition. The current crisis also presents opportunities for the elites to reinforce and consolidate their positions of privilege, by mobilising the population for austerity measures which they themselves are in a position to avoid, thus leading to further increased inequality. In mobilising for austerity, we may ask whether ethnic mobilisation remains a useful strategy given the countervailing attractions of EU integration, which require elites to desist from fomenting ethnic rivalry and to engage in more normal processes of political mobilisation.

The second section of the paper provides an overview of the effects of the crisis in the region; the third section considers the effects of external transmission through trade, remittances, credit contraction, and falling inflows of FDI; the fourth section considers social impacts of the crisis; and the final section concludes with some observations on the implications for political stability.

2 The global economic crisis: impact on the Western Balkans

The sharpness of the contraction is underlined by opinion surveys carried out in September 2009. More than a third of respondents in all the countries involved considered that the economic crisis was having an extremely negative effect on their country's economy, rising up to over one half in Montenegro, Bosnia and Serbia and two thirds of respondents in Croatia.

Data on real GDP shows a similar pattern of effects. Table 2 on page 7 shows the Ecofin estimates for 2009 and the EBRD projections for 2010. Al-

	No impact	Somewhat negative	Extremely negative
Croatia	5	26	61
Serbia	8	32	55
Bosnia	5	36	52
Montenegro	3	32	52
Macedonia	7	36	48
Kosovo	10	38	44
Albania	11	41	37

Table 1: to what extent do you consider that the current economic and financial crisis has a negative effect on your country's economy (% of respondents?)

Source: Gallup Balkan Monitor 2009, survey carried out September 2009

	2007	2008	2009	Average growth 2008-09
Albania	6.0	8.0	3.0	5.5
Macedonia	5.8	5.5	-2.0	1.8
Montenegro	10.7	6.9	-4.1	1.4
Bosnia	6.0	5.4	-3.1	1.2
Serbia	6.9	5.5	-4.0	0.8
Croatia	5.5	2.4	-5.8	-1.7
Kosovo	5.0	5.4	n/a	n/a

Table 2 Real GDP growth rates (%)

Source: Ecofin 2009 Q4; and EBRD online data

bania has weathered the crisis relatively well, and is expected positive rates of growth throughout the crisis. Real GDP in Macedonia fell by 2%, in Bosnia by 3%, in Montenegro and Serbia by 4% and in Croatia by nearly 6%. Croatia was the only country to have average negative growth over the two year period from 2008-09. It should be emphasised that these data are estimates, and may well underestimate the real impact of the crisis.

In the period from 2000-08, the countries of the region experienced rapid growth fuelled by external borrowing, inflows of easy credit from foreign-owned banks, and inflows of foreign direct investment. The effects of the crisis were initially greater in those countries which relied most on external inflows to support rapid growth (Prica and Uvalic, 2009). Due to the collapse in export demand, industrial production fell even faster than GDP. By October 2009, compared to the same month in 2008, industrial production had fallen by 38% in Montenegro, 9.8% in Macedonia, -8.5% in Croatia, and 6.6% in Serbia (EC 2009).

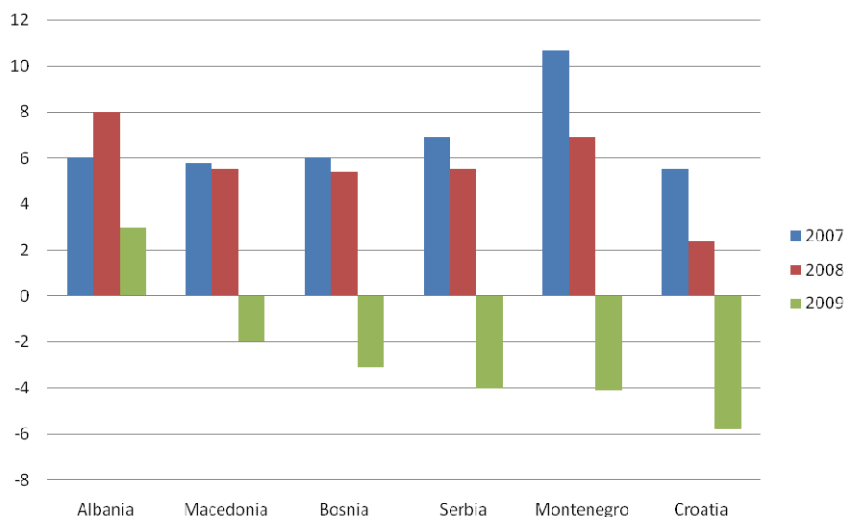


Figure 1 Real GDP growth rates 2007-09
Source Table 2

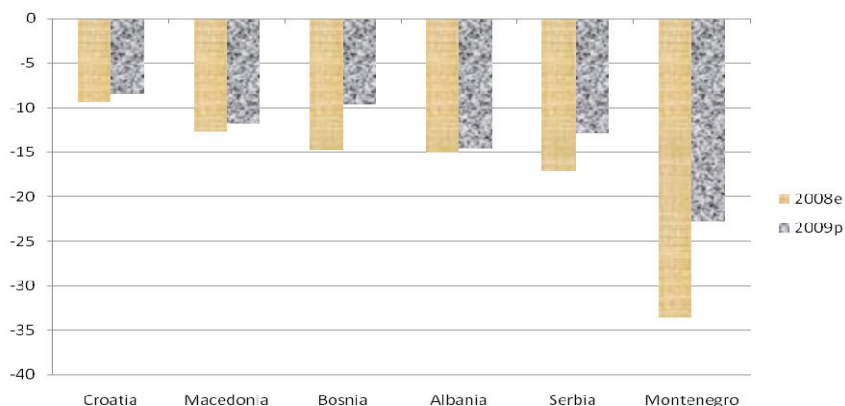


Figure 2: Current account deficits, estimates and projections, 2008-09 (% GDP)
Source: EBRD online data

The Western Balkan countries are in a vulnerable position in relation to the economic crisis because they all have chronic current account deficits. These must be financed by capital inflows or foreign borrowing. The current account deficit for Macedonia for example is over 10% of GDP, and even higher in Albania and Montenegro. Countries which maintain a fixed exchange rate (Bosnia through its currency board, Kosovo, Montenegro by adopting the euro as legal currency) are not in a position to correct their deficits through depreciation of the currency. Croatia and Macedonia,

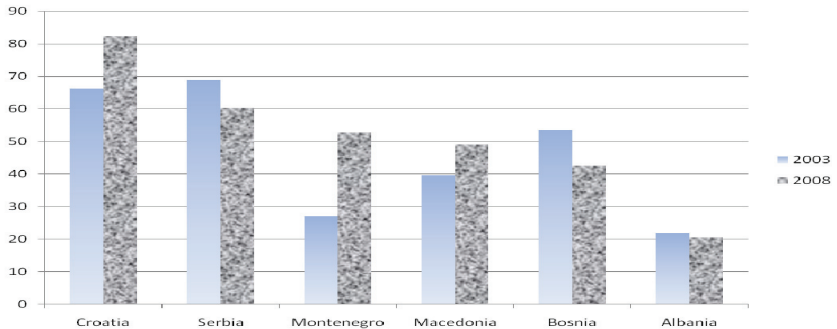


Figure 3: Foreign debt (% GDP)
Source: EBRD online data

which peg their currencies to the euro, are in a similar position. Current account deficits have nevertheless shrunk due to rapidly falling imports as domestic demand has contracted (see Figure 2, p. 8). This has been a benefit to the countries and has mitigated economic instability.

Over time some countries have built up large stocks on international debt (see Figure 3 above). This is especially problematic for Croatia whose external debt has increased to over 60% of GDP by 2008. Albania has a relatively low foreign debt and has been able to borrow its way through the crisis. Macedonia was able to issue a €175m Eurobond in July 2009, but only at an interest rate of 10%. However, as yet the Western Balkan countries have not reached the stage of Greece whose international credit rating has been downgraded due to excessive debt. This is mainly because most countries had maintained relatively low government budget deficits below 3% of GDP before the crisis began (see Figure 5, p. 14). By 2009 however the government budget deficits had increased dangerously in the cases of Serbia, Bosnia, and Albania. Macedonia was in a relatively good position in this respect, with government budget deficit of less than 3% of GDP even in 2009.

3 Transmission mechanisms

Four main external transmission mechanisms have relayed the economic crisis to the region. Firstly, exports collapsed on a global scale following the demise of the Lehman Brothers bank in October 2008. Secondly, reduced demand for labour in the core market economies has had a negative impact on remittance flows on which some countries are heavily dependent. Thirdly, the global collapse in credit has caused foreign banks in the region

	Exports	Imports
Croatia	-18.1	-25.7
Macedonia	-24.1	-28.4
Albania	0.8	-12.1
Bosnia	-12.4	-27.2
Montenegro	-35.7	-26.6
Serbia	1.3	-17.1
Kosovo	-20.4	0.7

Table 3: Exports and Imports, October 2009 (% change compared to October 2008)
Source: EC (2009)

to scale back their landing to both businesses and households, and this has reduced both domestic business investment and demand for durable goods. Fourthly, inflows of foreign direct investment have hit some countries in the region harder than others.

3.1 Exports

One of the main transmission mechanisms of the crisis has been external demand for exports from the EU, the main trading partner for the region. A sharp collapse in merchandise exports in the region took place between Q2 2008 and Q2 2009, with exports in almost all countries falling by more than 20% over the year. In October 2009, exports were significantly below the level a year earlier in Croatia, Macedonia, Bosnia, Montenegro, and Kosovo. In countries which had been able to depreciate their currencies, exports held up. The devaluation in Albania was 11.4% against the euro, and in Serbia the depreciation was 14.6%. At the same time, declining domestic demand led to sharp reductions in imports, and for this reason the current account deficits also fell. The reduction in imports was dramatic, reaching over 25% in Croatia, Macedonia, Bosnia and Montenegro. This suggests that the reductions in GDP may have been far greater than indicated in Table 1 on page 7.

In Croatia,¹ exports of goods for outward processing were especially badly hit, falling by 77% over the year², while exports after inward processing fell by 22%. Overall, Jovičić (2009) has studied the relationship between the degree of trade integration to the EU market and the timing and intensity of the onset of the crisis effects among the Western Balkan countries.

¹ The data refer to the first 11 months of the year up to November (State Statistical Office, First Release, No: 4.2.1/11). Total exports fell from HRK64.1bn in 2008 to HRK50.6bn in 2009, a fall of 21% over the year.

² Data from Croatian Statistical Office, December 2009

2008 Q1	2008 Q2	2009 Q1	2009 Q2	% change Q1	% change Q2
51.92	64.92	46.29	58.86	-10.8%	-9.3%

Table 4: Macedonia, change in net remittance inflows, Q1-Q2, 2008-09, (US\$m)

Source: State Statistical Office Macedonia, Monthly Statistical Bulletin, January 2010.

She finds that while those with a high degree of integration experienced the crisis sooner, those with a lower degree of integration experienced a larger decrease in production.

3.2 Remittances

Remittance flows have been a key transmission mechanism for the impact of the economic crisis. Bosnia, Albania, and Serbia³ stand out with very high shares of remittance income in GDP. Remittances have so far held up in Albania and Serbia. Data on remittances are by their nature difficult to obtain and the reliability of the data is questionable.

For Macedonia, remittances come from mainly the Diaspora in EU countries and the USA, both of which have been adversely affected by the global financial crises. According to the results of a recent household survey carried out in Macedonia in September 2009 (Bartlett et al. 2010), 7.4% of families in that country receive remittance incomes. The average amount of remittances received in the twelve months prior to the 2009 survey was 400 Euros (25,690 denars). According to the National Bank of Macedonia, remittances contributed 20% of GDP (US\$1.2 billion) in 2007. The most recent available data indicate that In the first two quarters of 2009, net remittance inflows to Macedonia declined by 10% in each quarter, compared to the same period in 2008 (see Table 4 above).

3.3 The banking sector and credit growth

Financial integration brought about by the extensive penetration of foreign banks in the region has contributed to high economic growth in the region over the last decade, but it has also encouraged credit booms and over-borrowing, which has increased vulnerability of the region to the economic crisis (EBRD 2009). Montenegro and Macedonia experienced very high credit growth, which had reached over 50% p.a. in 2007, before being sharply scaled back in 2008 as the crisis took effect. Early in 2009, the multi-

³ Kosovo also relies highly on remittances to finance its economy, but the data is sparse and unreliable.

	Credit	Deposits
Croatia	-0.5	-0.3
Macedonia	14.5	-0.3
Albania	12.1	58.0
Bosnia	-2.8	-1.6
Serbia	20.3	16.5

Table 5: Growth of credit and deposits October 2009 (% change compared to October 2008)

Source: EC (2009)

national development banks provided substantial financial support for commercial banks in the region. Together with the home and host country governments, the European Commission, and the affected banking groups, an agreement known as the “Vienna Initiative” was reached to ensure co-ordinated crisis management. Under the agreement, host governments provided deposit insurance and liquidity support for the banks, EU-based parent banks agreed to recapitalise and refinance their subsidiaries in the region, home governments agreed to allow bank groups to access financial resources without restrictions, and the multilateral development banks provided large-scale financial support. This policy response was designed to ensure that foreign owned banks would not pull out of the region, but would refinance loans which they had placed in the private sector in the regional economies. This agreement has held against possible defections so far, and has stabilised the banking system in the region. Consequently credit growth has also held up in some countries, including Macedonia, Albania, and Serbia. Deposit growth has held up in Albania and Serbia, possibly reflecting counter-cyclical remittance flows.

However, signs of strain among regional banks are beginning to emerge. The most troubled bank has been the Bavarian Hypo-Alpe-Adria bank which was sold to BayernLB for €1.6bn in 2007. Having expanded to 12 countries since 2000 the HAAB had expanded employment in the region from 1,000 to 7,500. It became over-exposed to bad loans in Croatia and lost €520m in 2009. BayernLB had put more than €1bn more capital into the bank in 2007 and 2008, in addition to an injection of €900m from the Austrian government. However, none of this was sufficient to rescue the bank, which has now been taken into state ownership by the Austrian government. Reportedly, Greek banks have stopped making transfers to South East European subsidiaries, leaving them to fund lending entirely out of local deposits⁴.

⁴ Patrick Jenkins and Kerin Hope (2009) “Greece sees few glimmers of hope”, Financial Times, 15/12/09.

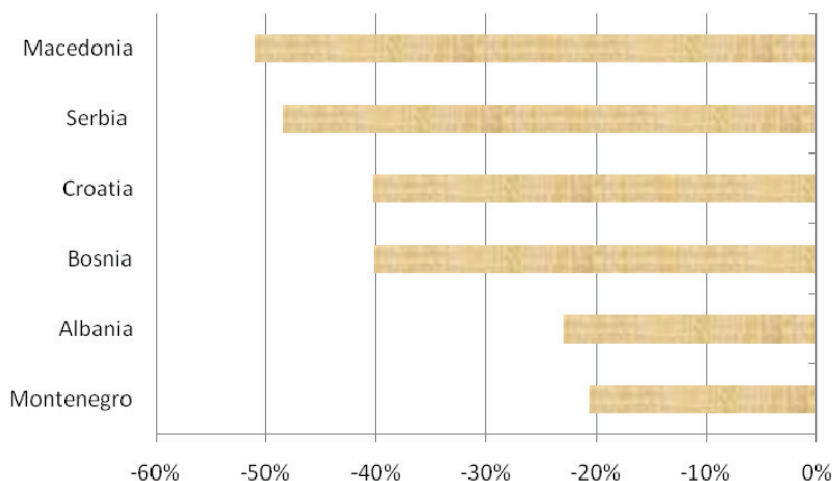


Figure 4: Fall in FDI inflows 2008-09 (%)
Sources: IMF, central banks and EBRD estimates.

3.4 Foreign direct investment

A major impact of the economic crisis has come through sharp reductions in the inflows of foreign direct investment (FDI). This has been more problematic in the countries in which FDI had reached large scale especially Croatia. FDI has been concentrated in a narrow range of sectors and has been distributed unevenly through time, and strongly linked to privatisation in sectors such as telecommunications, banking, and oil refining. Croatia has been the recipient of the largest share of FDI inflows.

Figure 4 above shows that the largest fall in FDI inflows has been in Macedonia, where FDI fell by 51% between 2008 and 2009, despite the very generous incentives that have been put in place to attract FDI into the country.

4 The social impact in the Western Balkans

The economic policies of the international institutions and the domestic governments have moderated the impact of the adverse external environment. The impact of the crisis on the region would most likely have been much greater if it had not been for a concerted and effective policy re-

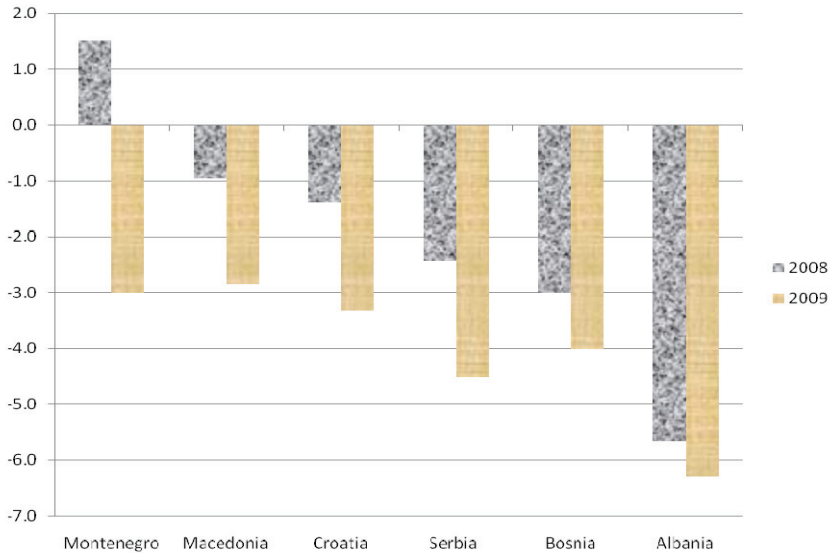


Figure 5: General government budget balance (% GDP)

Source: EBRD online data

sponse from international institutions, ranging from IMF support programmes, to tailored agreements between international institutions and commercial banks to ensure continued lending to the region. IMF support programmes have been directed towards Bosnia and Serbia, and there has been little conditionality attached to these rescue programmes. There has also been a robust response by national governments. Following the example of policies adopted in the advanced economies, these have included deposit guarantees, liquidity injections, and recapitalisation of banks.

On the side of fiscal policy, the countries are far more constrained than the developed economies being less able to raise finance on the international markets to cover external deficits. Most were fortunately in a relatively favourable position in relation to government budget deficits, as they had been seeking to reduce these in line with IMF advice and the pre-accession programmes for EU membership (see Figure 5 above). In 2008, only Albania had a government budget deficit in excess of 3% of GDP. Budget deficits have increased sharply in all countries, even though several of them have adopted contractionary fiscal policies based on cuts in social expenditure. The Serbian government has suspended public sector pay, and has announced that it will cut the public sector workforce by 10%. Croatia introduced a public sector salary freeze and a wide range of spending cuts in 2009. In Macedonia, the budget deficit tripled between 2008 and 2009 from

	2006	2007	2008	Q3 2009	Nov/Oct 2009	Forecast 2010
Croatia	16.6	14.8	13.2	14.3	16.1	10.0
Macedonia	36.0	34.9	33.8	31.7	..	35.6
Albania	13.9	13.4	12.8
Bosnia	44.2	42.9	40.6	42.1	42.3	..
Montenegro	14.7	11.9	10.7	10.4	10.9	..
Serbia	21.6	18.8	13.6	15.7 (a)	16.6	..
Kosovo	44.9	43.6	47.5

Table 6: Unemployment rates in the Western Balkans (%)

Source: Ecofin 2009 Q4, Note (a) Q2 2009

1% to 3% of GDP, and the cost of funding the deficit in international markets has risen to 10% on recent government bonds issues. The IMF has recommended that the government should cut the deficit to 1.5% of GDP, which will inevitably mean cuts to already low social budgets.

4.1 Unemployment

Unemployment had been on a falling trend in all countries up to 2008. However, the impact of the economic crisis has led to reversals in most countries (see Table 6 above). By Q3 2009 unemployment had begun to increase in Croatia, Bosnia, and Serbia. In Macedonia, unemployment continued to fall, although at very high levels, from 33.8% in 2008 to 31.7% in Q3 2009. By November 2009, unemployment in Croatia had rise to 16.1%, almost back to the level of 2006. Unemployment was also increasing in Bosnia, Montenegro and Serbia. Forecasts prepared by the DG Employment in Brussels foresee a rather optimistic downward trend in Croatia where unemployment is expected to fall to 10% by 2010, a seemingly unrealistic expectation. For Macedonia, unemployment is expected to reverse its downward trend and reach 35.6% in 2010, back to the levels of 2006.

4.2 Pensions

In response to difficulties in financing the growing cost of pension expenditures, several countries have introduced pension system reforms (see Bartlett and Xhumari, 2007). Pro-market reforms in Croatia and Macedonia have transformed the inherited universal systems of pensions into a diminished ‘first pillar’ state pension element, a ‘second pillar’ fully funded private pension element, and a ‘third pillar’ additional private voluntary fund. A similar pension system was created in the UNMIK administered province of Kosovo in 2002, which involved the payment of flat rate €40 to all pension-

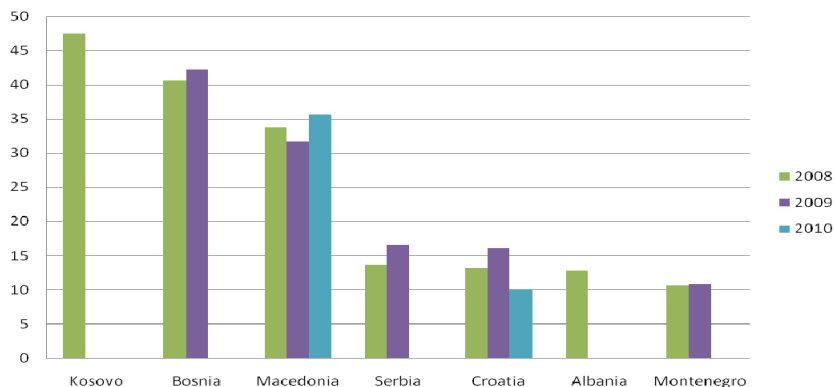


Figure 6: LFS unemployment rates (%) with EC forecasts for 2010 Source: Ecofin 2009 Q4, Note (a) Q2 2009

ers aged over 60 years of age, and a compulsory contribution by employees into the Kosovo Pension Savings Trust, which has invested the entire proceeds abroad in foreign investment funds on the basis that funds in foreign banks would be more secure than those invested in Kosovo. In contrast, limited reforms to the pay-as-you-go state pension system which fall short of radical privatisation have been introduced in Albania, Montenegro and Serbia. Policy responses to the crisis in pension provision have been varied. One response has been to change the indexation formulae. Serbia has announced the suspension of indexation for 2009 and 2010, with a return to inflation indexation beyond 2010 in accordance with the agreement with the IMF. Croatia has announced a suspension of indexation in 2010. Macedonia has restricted pension indexation to 20% of the gross wage from July to December 2009. Kosovo has guaranteed only the nominal value of contributions for those retiring in late 2008 and 2009. Another response has been to increase the retirement age: Croatia has announced an increase in the retirement age for women to 65.

The Macedonian pension reform introduced a three pillar pension system which combines both pay-as-you-go and the fully funded elements. The first pillar is a compulsory pension insurance based on the pay-as-you-go model. The second pillar is a fully funded pension, compulsory for individuals who took up work for the first time since January 2003 and for all new entrants to the labour market. The third pillar is a voluntary fully funded pension insurance for contributors employed before January 2003. Pensioners above 65 years old are guaranteed a minimum pension when they retire, subsidized from the state budget if the insured person does not reach it from their employment.

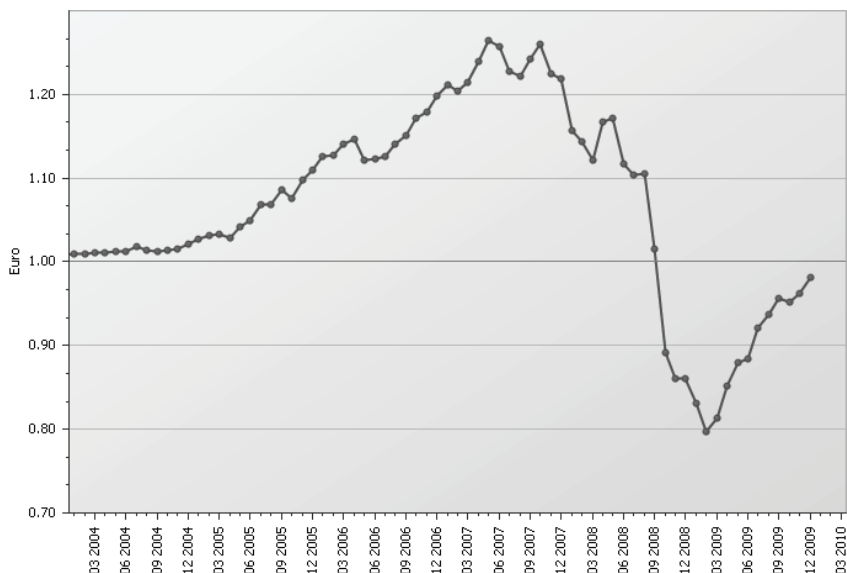


Figure 7: KPTS Share Price Since Inception Source: KPST website

The reform of the first pillar has also involved a gradual increase in the retirement age, a decrease in the replacement rate, a change in the pension indexation method, the ending of early retirement, and a change of the pension formula. Within the second pillar, contributions for compulsory fully-funded pension insurance are invested in two private pension funds, both of which are majority owned by Slovenian banks. By design, the returns to these investments are not guaranteed, and depend upon the performance of the funds. Moreover the fees and charges imposed by the private pension funds are relatively high, with an entry fee of 7.9% compared to less than 1% charged by the Croatian funds. Management fees are also relatively high. Given the high fees and the relatively small size of the Macedonian funds, it seems unlikely that they will provide a pension to participants greater than they would have received under a state managed system. An independent assessment carried out on behalf of the World Bank has raised concerns about the introduction of the privately managed second pillar pension scheme in Macedonia, on the grounds that the projections for future pensions made in designing the scheme were overly optimistic (Fornero and Ferraresi 2007).

The crisis has led to serious problems for both private and public pension systems in the region. The collapse in the value of financial assets has led to sharp falls in the value of pension funds accumulated under fully-

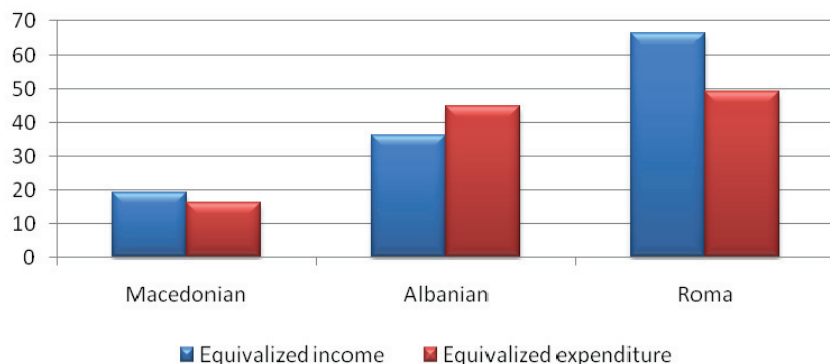


Figure 8: Poverty Headcount
Source: Bartlett et al. (2010)

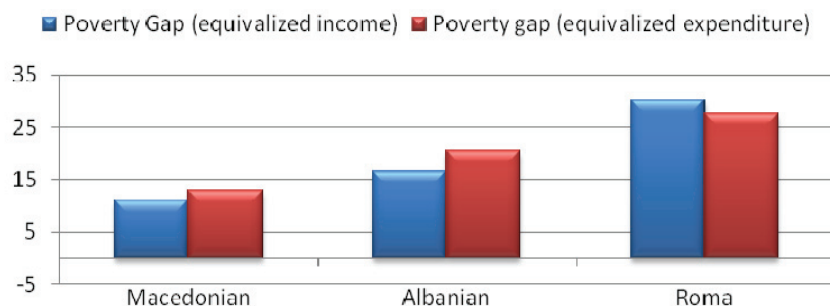


Figure 9: Poverty gap by ethnic group (by income and expenditure)
Source: Bartlett et al. (2010)

funded private pillars of the private pension systems introduced in Croatia, Macedonia and Kosovo. The crisis has also worsened the financial deficits in public pension systems by reducing contribution revenues (World Bank 2009). The collapse in global share prices has led to sharp falls in the unit values in the funds under management in the second pillar elements of the private pension schemes introduced under the pension system reforms. The destruction of value in the pension funds is especially dramatic in Kosovo, where the entire pension fund has been invested in financial assets managed by foreign banks in EU countries, and the value collapse has reduced fund unit prices below their starting position in 2004 (see Figure 7, p.17).

In Macedonia, private pensions funds the accounting unit value of the assets fell from 115 to 100 between January 2008 and January 2009, before rallying to 117 in the case of the NLB pension fund and 121 in the KB First

pension fund⁵.

The World Bank, which sponsored the privately funded pension schemes in the region, has now admitted that privately funded pension schemes are vulnerable to the falls in the prices of the assets in which the funds are invested, declaring in its latest report that the crisis has “revealed the vulnerability of benefits to the vagaries of the financial markets” (World Bank 2009: 16).

5 The social impact on households in Macedonia

The quality of life in FYR Macedonia has been adversely affected by the global economic crisis, as shown by the findings of a representative household survey carried out in September 2009⁶. The survey asked people numerous questions about their living conditions and quality of life. Almost one third of people (31%) considered that their lives had worsened over the 12 months prior to the survey while only half as many (15%) considered that their life had improved⁷.

The survey also provided up to date information about the relative distribution of poor households, defined as those that have equivalised income or expenditure below the poverty threshold of 60% of median equivalised income or expenditure.⁸ Unemployment is a primary cause of poverty, with the poverty rate among the unemployed at 38%. Figure 8 on page 18 shows the poverty rate by ethnic group. Overall, there is a greater level

⁵ Agency for the Supervision of Fully Funded Pension Insurance, MAPAS, Skopje, online data

⁶ The survey covered 1,000 households across the whole of Macedonia as a random sample that was nationally representative. It was carried out by the Brima polling agency, on behalf of a research team at the South East European University (SEEU) in Tetovo, in a project funded by the UNDP Skopje.

⁷ The question was “How has your life changed in the past twelve months?” 1= improved; 2= has not changed; 3= got worse.

⁸ Household income (expenditure) is measured by the household survey. Equivalisation is made on the basis of the OECD modified scale, which assigns a value of 1 to the household head, of 0.5 to each additional adult member and of 0.3 to each child. Household incomes (expenditures) are divided by the equivalised number of people in the household (two adults would equal 1.5) to establish income per person. Once the number of households that are below the 60% of the median equivalised income (expenditure) has been estimated, the number of people in those households is aggregated to estimate the percentage of the population in poverty (the poverty headcount).

Quintile	Whole country	Rural 2008	Rural 2009	Urban 2008	Urban 2009	Macedonians	Albanians	Roma
1	4%	5%	4%	6%	3%	5%	2%	3%
2	10%	11%	10%	12%	9%	12%	8%	7%
3	15%	17%	16%	17%	15%	16%	13%	12%
4	22%	23%	22%	23%	22%	22%	21%	19%
5	49%	41%	48%	41%	50%	45%	56%	59%
	100%	100%	100%	100%	100%	100%	100%	100%
s80/s20	13	8	11	7	16	9	30	18

Table 7: Income inequality in Macedonia

Source: Bartlett et al. (2010)

of poverty among the ethnic Roma and Albanians than among the ethnic Macedonians. This is partly to be explained by the larger family sizes of the former two groups, rather than simply a question of lower levels of economic development or discrimination.

The poverty gap measures the average distance of individuals in poverty from the poverty line of 60% of the median equivalised income or expenditures, as a percentage of the poverty line. In terms of equivalised incomes, ethnic Macedonian households have the lowest poverty gap of around 12%, and ethnic Albanians it is just over 15%, and is highest for the Roma at over 25%. Again this is partly to be explained by larger family size among the ethnic Albanian and Roma communities.

The data in Table 7 above reveal a remarkable extent of inequality with the bottom fifth of people receiving less than one twentieth of equivalised income, while the top fifth receive almost one half of income. The ratio of the top to bottom quintiles is 13, indicating a large gap between the richest and the poorest people. The gap is even wider in the urban areas. The highest degree of inequality is found among the Roma and the ethnic Albanian communities, with the income ratio between the richest and the poorest fifth of ethnic Albanians reaching as high as a staggering 30 times, more than twice the average level of inequality for the country as a whole.

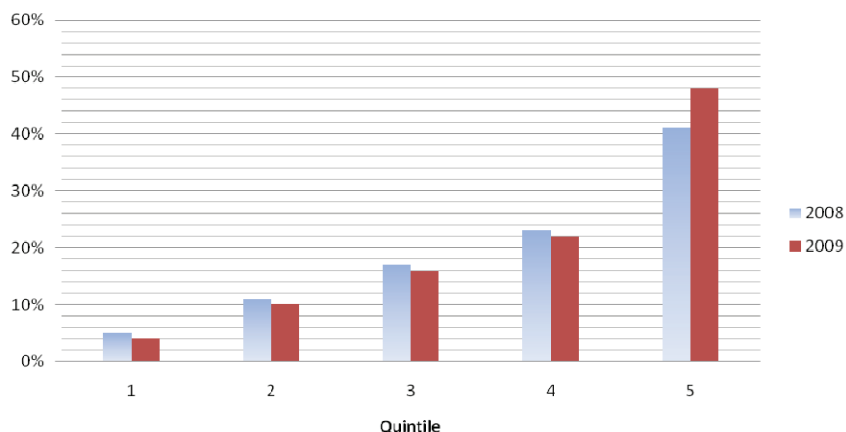


Figure 10: Rural equivalised income shares by quintile, 2008-09 (%)

Source: Table 5, p. 12

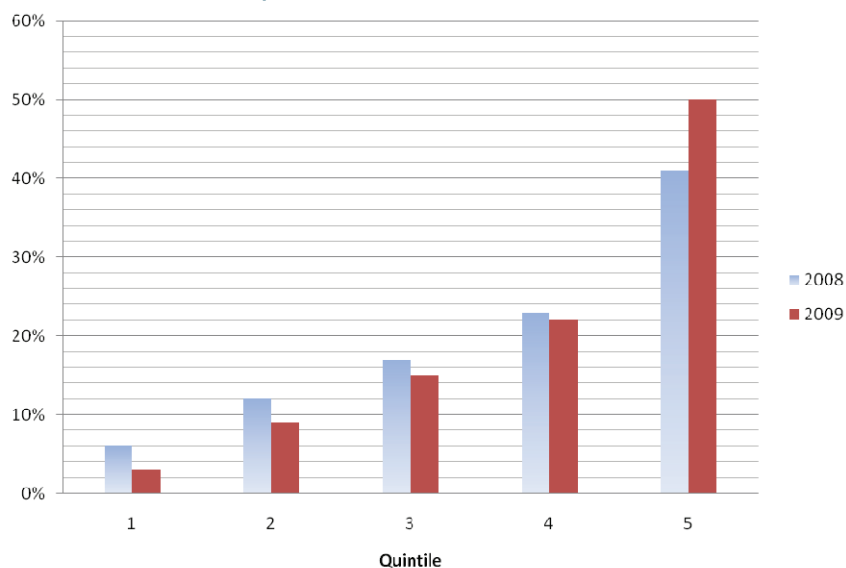


Figure 11: Urban equivalised income shares by quintile, 2008-09 (%)

Source: Table 5, p. 12

Compared to the results for 2008, inequality has significantly widened. In rural areas the share of equivalised income of the poorest quintile fell from 5% to 4%, while that of the richest quintile increased from 41% to 48%. In urban areas the respective changes were for a fall of the share of the poorest quintile from 6% to just 3%, while the share of the richest quintile in-

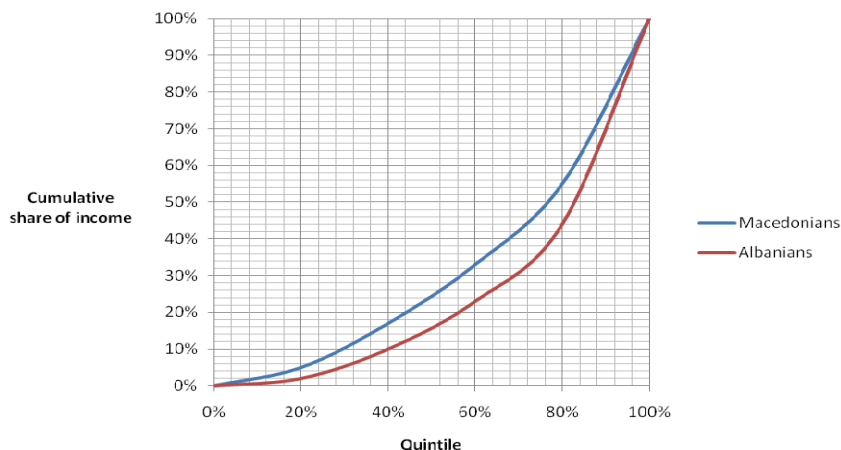


Figure 12: Lorenz curve for equivalised income by ethnic group, 2009

Source: Table 5, p. 12

creased from 41% to 50%. At the same time the ratio of the richest to the poorest quintiles increased from 8 to 11 in rural areas and from 7 to 16 in the urban areas. This sharp increase in inequality in just one year has come about as the economic crisis began to impact on the country.

Comparing with the 2008 survey (UNDP 2009), the economic situation of households has worsened. In 2009 three fifth (60%) of households reported some or great difficulties in making ends meet, compared to just over one half (55%) in 2008. Thus, the financial crisis has had a noticeable impact on people's standard of living. Elderly people have the greatest difficulties in making ends meet live with 64% of the age group 55-64 reported difficulties in realizing their objectives. Very few households (12%) had saved any money during the 12 months prior to the survey, while over twice as many (27%) had borrowed money.

The unemployment rate in the third quarter of 2009 by ILO methodology was one of the highest in Europe (31.7%), which was nevertheless down from 33% in the same period in 2008⁹. According to the findings of the household survey, only two-fifths (40%) of the unemployed are actively looking for a job. Fewer ethnic Albanians (31%) are actively looking for work than ethnic Macedonians (43%). Many have become discouraged from looking for work, especially ethnic Albanian women. In addition, ethnic Albanians find it harder to obtain employment in the public sector. Consequently, they are more likely to substitute work in their own businesses, as business

⁹ State Statistical Office, News Release, 2.1.9.29, 23rd December 2009

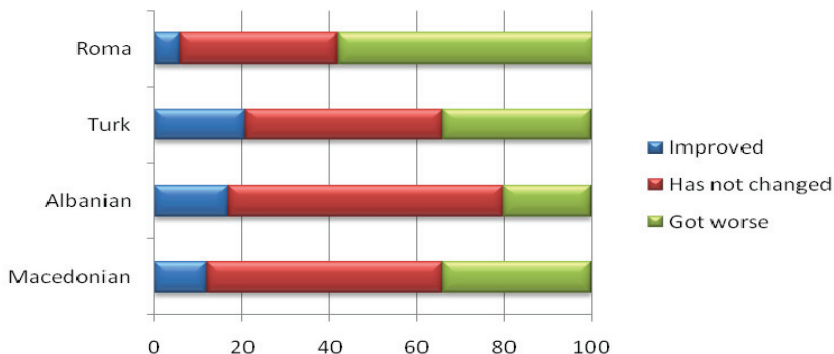


Figure 13: has your life changed in the last 12 months?

Source: Bartlett et al. (2010)

owners and entrepreneurs. In terms of pay, ethnic Macedonians are less satisfied than ethnic Albanians. Almost half of ethnic Macedonians feel badly paid (47%) while only just over a quarter (29%) of ethnic Albanians feels that way. According to the survey, over two fifth (44%) of people in work are unsure whether they will keep their job. Inhabitants of rural areas, women, and ethnic Macedonians all feel most insecure in their job. Only a quarter of respondents claimed that their job offers good prospects for career advancement. Ethnic Albanians are more optimistic than ethnic Macedonians (46% vs. 23%) in this respect.

6 Ethnic tensions and political instabilities in Macedonia

The survey reveals far worse impact of the crisis on the ethnic Macedonian population than on the ethnic Albanian population.

As shown in Figure 13 above, the global crisis has affected the majority ethnic Macedonian population harder than the ethnic Albanians. The explanation may be that the crisis has especially affected the larger companies where ethnic Macedonians predominate, and who also comprise the majority of skilled workers.¹⁰ In the third quarter of 2009, the industrial production fell by -13.1% on an annualised basis.¹¹ Particularly badly affected were

¹⁰ 27 % ethnic Macedonians work in large companies in comparison with just 13% ethnic Albanians and 31% of ethnic Macedonians are skilled manual workers, in comparison with just 15% of ethnic Albanians; for more details see Bartlett et al. (2010).

¹¹ National Bank of the Republic of Macedonia, Monthly Information 11/2009, December 2009, Table 4, p21.

Worsening of interethnic relation in the country over last 6 month

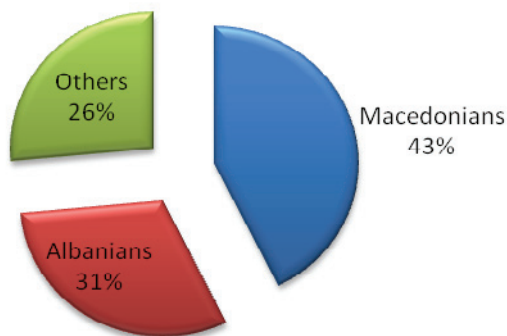


Figure 14: perceptions that inter-ethnic relations have worsened over the previous 12 months, by ethnic group

Source: Bartlett et al. (2010)

sectors which have a higher density of larger companies and of skilled workers such as the manufacture of refined petroleum (-36%), manufacture of basic metals (-42%), manufacture of electrical machinery and equipment (-52%) and manufacture of transport equipment (-21%). This may be behind the high level of life dissatisfaction of the majority ethnic group.

The economic crisis appears to have led to a heightened sense of inter-ethnic tension in the country. A quarter (26%) of respondents thought that inter-ethnic tensions had worsened in the twelve months prior to the survey, whereas only one tenth (11%) thought they had improved. In relation to their 25% share of the population, a relatively large proportion of ethnic Albanians perceive that inter-ethnic relations had worsened in the 12 months prior to the survey (see Figure 14 above).

Over one third (35%) of people considers that there is a high risk of violent ethnic conflict. Perceptions are slightly more gloomy among ethnic Macedonians than among the ethnic Albanians (see Figure 15, p. 25). It is remarkable that almost half of the respondents (48%) in the Skopje region consider that the risk of violent ethnic conflict is high.

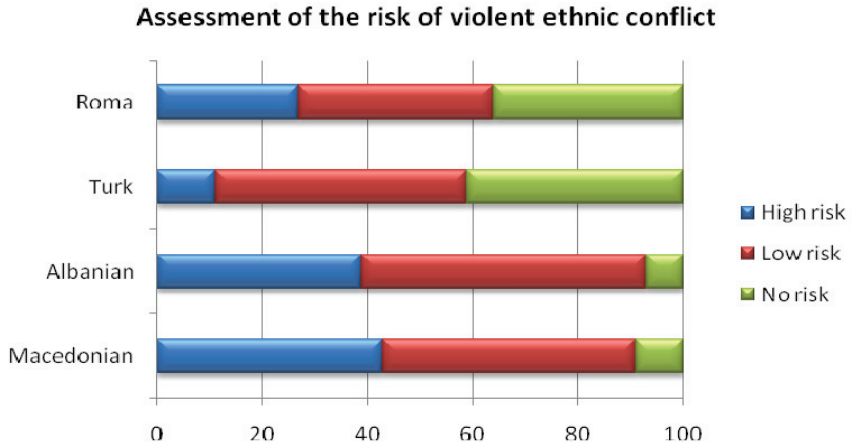


Figure 15: Proportion of people who assess the risk of ethnic conflict as high, low or non-existent, by ethnic group, 2009
 Source: Bartlett et al. (2010)

7 Conclusion: implications for regional stability

Although the effects of the crisis have been most immediate in countries which have been more integrated into the global and EU markets, the impact of the crisis has gradually spread throughout the region, as the effects have spilt over across countries, through the transmission of collapsing export demand, falling remittances and a collapse in foreign direct investment. The crisis has impacted adversely on social conditions. Unemployment has begun to rise and private pension funds have seen the values of their assets reduced threatening the livelihoods of future pensioners. Several governments have already introduced drastic budget cuts, frozen public sector pay, or announced cuts in public sector employment. Social expenditure on health, education, and housing is likely to diminish in future years. In Macedonia, as in other countries, the social impact has been dramatic. The country has been forced to raise funds on international capital markets at a high price, while the budget deficit, low before the crisis began, has increased substantially foreshadowing impending cuts in social expenditure.

In analysing the implications for regional stability, I focus here on the case of Macedonia where the Ohrid Framework Agreement (OFA) sealed a temporary truce between the ethnic Macedonian and ethnic Albanian po-

litical parties, based upon a radical decentralisation and power sharing in the state institutions. However, progress in implementing the agreement has been slow as ethnic Albanians are still underrepresented in the government, and the police, and fiscal decentralisation has not followed political decentralisation. Yet the two sides share common ground in a desire for EU and NATO membership, and this perhaps more than the OFA has maintained political stability in the country in the face of the economic crisis. As yet, politicians have not used ethnic mobilisation as a tool for imposing radical austerity measures. Yet, the ominous events surrounding the publication of the Macedonian Encyclopaedia in November 2009 showed that ethnic tensions remain just below the surface, and that radical forces are able to mobilise support on a large scale and in a short time. The tension was brought to an end only by a joint announcement of leaders of each ethnic political party in the government that the incident would not be allowed to be used as an excuse to stoke inter-ethnic tension. However, as the results of the household survey indicate, ethnic tension persists among ordinary people. Many people consider that ethnic tensions are increasing, and many also fear an outbreak of ethnic violence in the future. Fortunately, so far, ethnic tensions have been contained. Nevertheless, some groups including skilled workers in manufacturing industry have suffered badly from the crisis, industrial output has fallen dramatically in traditional sectors such as textiles and metals, and income inequality has increased. If the joint aim of NATO membership and EU accession are further significantly delayed or thwarted by outside interests in the coming months and years, it may be that this fragile truce will break down and political stability of the country will be once again imperilled.

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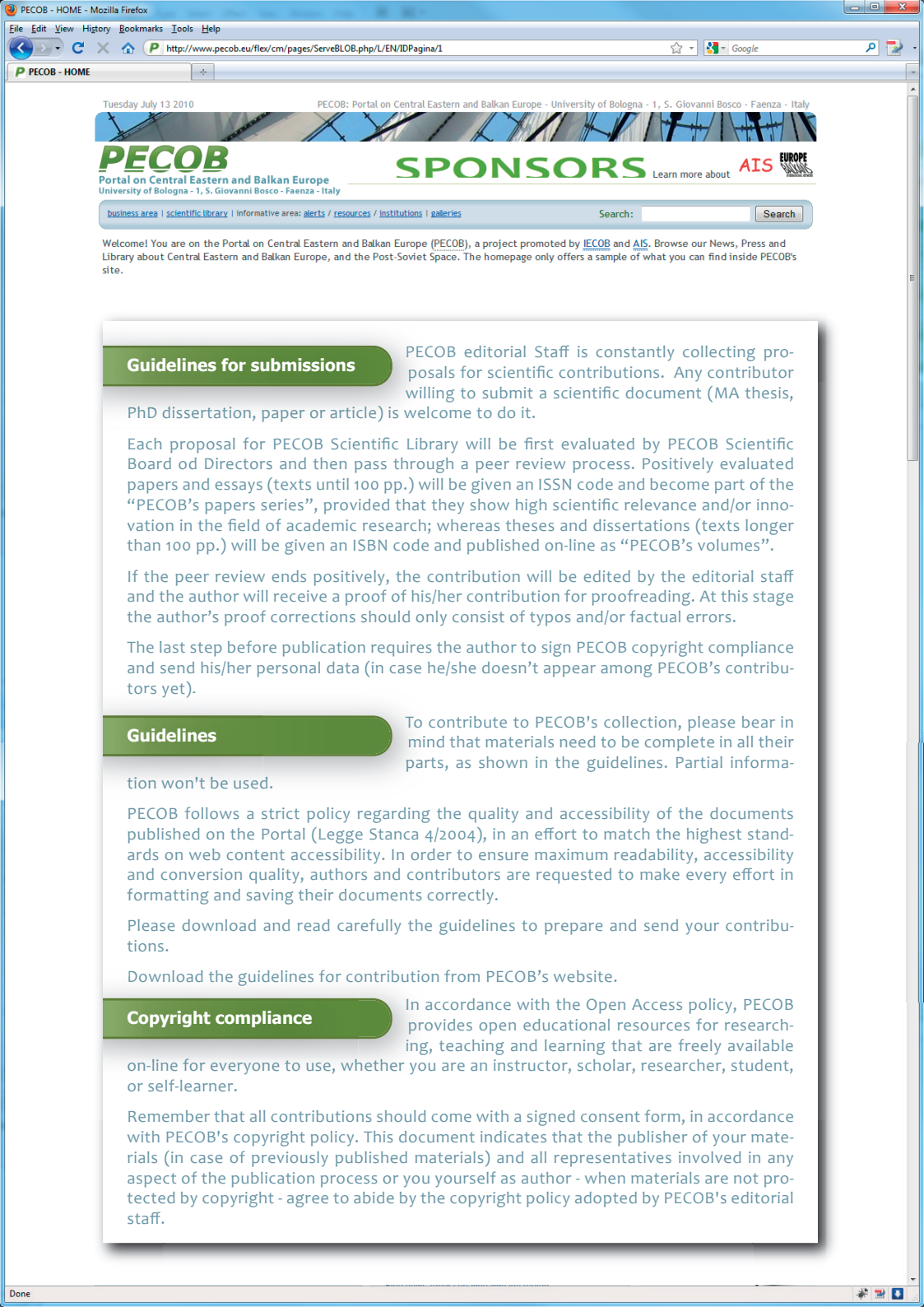
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