

II. Economic Developments in the Republic of Macedonia

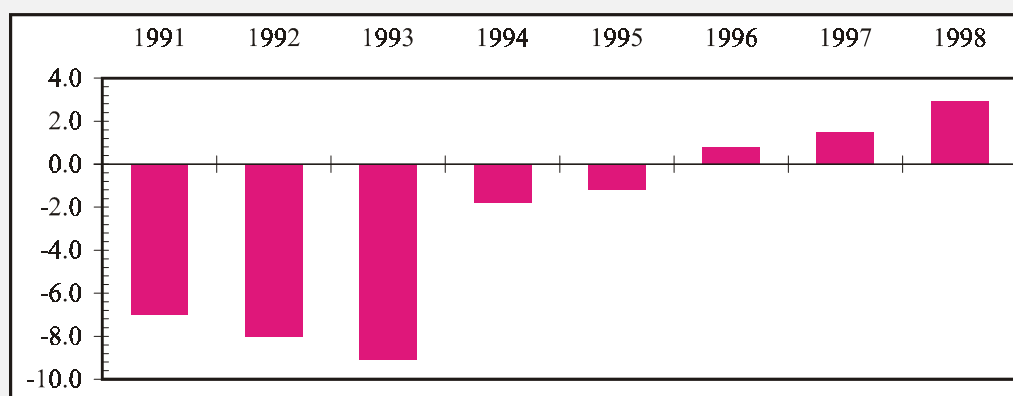
2.1. Gross domestic product

In 1998, the nominal gross domestic product (GDP) of the Republic of Macedonia amounted to Denar 193,153 million,³ or USD 3.5 billion,⁴ which is a nominal increase of 4.4% compared to 1997. In 1998, the real GDP growth was 2.9%, which represents a more intensive growth of economic activity compared to 1997 and 1996, when the growth equaled 1.5%, and 0.8%, respectively. Despite the fact that the economic growth achieved in 1998 has been the highest since the monetary independence, it is lower than projected one by 2.1 percentage points.

Chart 1

Gross Domestic Product

(growth in real terms, in %)



From the point of view of the different sectors, on the supply side, the Macedonian economy growth in 1998 is primarily caused by intensifying of production in the activities with the largest share in GDP, like industry and mining, trade, agriculture and fishing, whose share in GDP is 20.6%, 12.3%, and 11.0%, respectively. From the point of view of the final use of GDP, its growth in 1998 is due to the increment of private consumption, public consumption, and gross investments, while the import of goods and services exceeded the export.

The GDP growth in 1998 was connected with the private consumption and investment, and compared to 1997 they had a nominal growth of 5.8%, and 5.9%, respectively. Herewith, personal consumption share in GDP increased by 1.0 percentage point and reached 75.4% of GDP. At the same time, the share of gross investments in GDP increased by 0.4 percentage points and reached 22.8%. That was a result of the increased share of investments in fixed assets, which was 17.9% of GDP. Because of the low and insufficient level of domestic saving and unfavorable conditions for financing

³ Estimated data from the Statistical Office of the Republic of Macedonia.

⁴ The average Denar exchange rate against the USD for 1998 is used.

investments from domestic sources, the growth of investments was determined by inflow of foreign financial assets. In 1998, the share of public consumption in GDP was 17.5%, and was the same as in 1997.

Table 3
Use of Gross Domestic Product
(structure in %)

	1996	1997	1998
Private consumption	72.1	74.4	75.4
Public consumption	18.1	17.5	17.5
Gross investments	20.1	22.4	22.8
Exports of goods and services	28.2	35.8	40.9
Imports of goods and services	38.5	50.1	56.6
Gross domestic product	100.0	100.0	100.0

In 1998, the share of imports and exports of goods and services in GDP had the highest increase. In addition, the share of exports of goods and services increased by 5.1 percentage points, and reached 40.9%, while the share of imports of goods and services increased by 6.5 percentage points and reached 56.6%. Faster increase of imports relative to exports, in 1998 resulted in a negative share of net imports of goods and services in GDP, which equaled 15.7%.

2.2. Domestic output

In 1998, one of the sectors causing the GDP growth was industrial output, where the growth accelerated. Realized average annual growth of 4.5% exceeded the growth of industrial output in 1997 by 2.9 percentage points. That is exclusively a result of increased production of reproduction materials by 5.8%, because production of means of production maintained the last year level, and production of consumer goods decreased by 1.0%.

The acceleration of industrial output increment in 1998 is a result of: a/ reactivation of production capacities in iron and steel industry and in metal processing after their sale to foreign strategic investors; b/ restructuring of enterprises which have completed the process of privatization; c/ easier access to foreign markets, first of all, to EU markets, after signing the Agreement for trade cooperation with EU.

In 1998, there was an expansion of production activity in a prevailing part of the industrial sector. The production increment was realized in twenty out of thirty two industrial branches, whose share in the total industrial output is 63.8%. Herewith, the tendency of growing number of industrial branches with production growth⁵ continues, although their share in the total industrial output in 1998 is by 11.7 percentage points lower compared to the last year. From the branches with the largest share in total industrial output, the highest increment in 1998 was registered in iron and steel industry (by 37.2%),

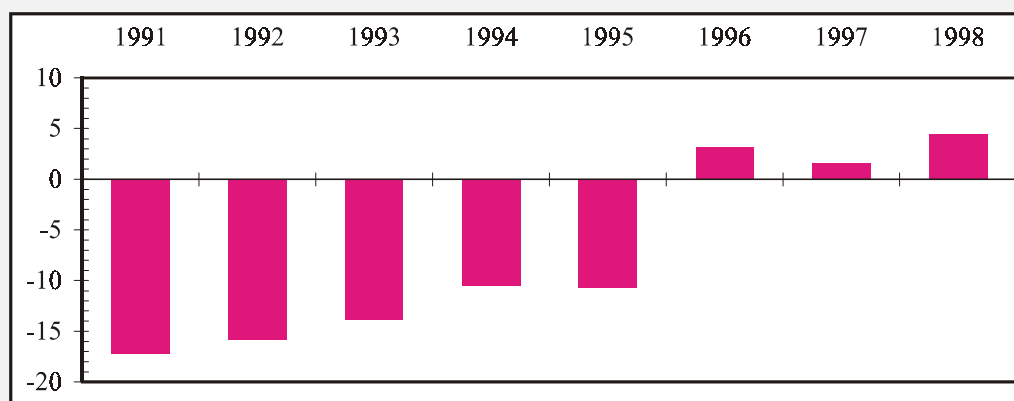
⁵ In 1996 and 1997 output increased in eleven, and eighteen industrial branches, respectively.

metal processing (by 21.8%), finished textile products industry (by 19.0%), and in tobacco industry (by 13.6%). At the same time, the highest industrial output decline was registered in construction materials industry (by 12.1%), manufacture of electrical equipment (by 9.0%), and beverages industry (by 7.8%).

Chart 2

Industrial Production

(growth in %)



Realized growth of industrial output in 1998 is under the projected level by 2.0 percentage points, which is due to a combined influence of internal and external factors. In 1998, industrial enterprises in the Republic of Macedonia faced the problems of outdated technology, high level of amortization of the equipment, and unfavorable economic structure. On the other hand, development in the nearest surrounding (crisis in Kosovo, FR Yugoslavia) caused decrement of the production activity in the branches with the highest decrease in the output, due to the fact that this region is traditional market for their products. Also, the decrement of the prices of metals on the world markets had an unfavorable effect on output of some of the industrial branches.

The changes of industrial output by months during 1998 weren't equal, but they followed the usual changing dynamics from the previous years. In the first half of the year, industrial output realized double digit growth rates, which is due to the low comparative basis from 1997, when some of production capacities did not work at all. In the second half of the year, industrial output was decreasing permanently, which is due to the fall of the prices of metals at the world markets and deterioration of conditions in the nearest surrounding.

In 1998, total agriculture output increased by 3.8%. The growth is a result of increased field crops output by 8.9%, because the livestock output increased only by 0.1%, and fruit orchards and viticulture output decreased by 2.3%, and 5.7%, respectively.

2.3. Prices

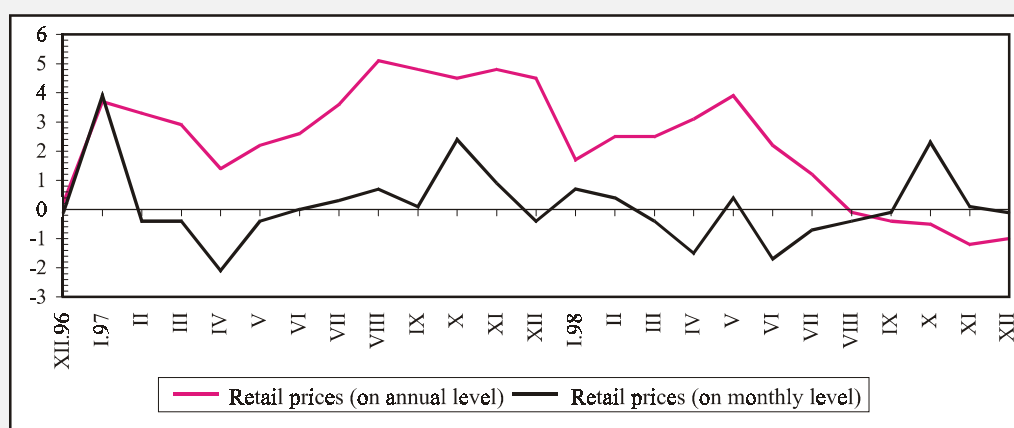
Implementation of the Denar exchange rate targeting strategy contributed to efficient and disciplined conduct of the macroeconomic policies, primarily the fiscal policy,

wage policy, and monetary policy. As a result of that, in 1998 the average annual inflation rate of 0.8% was realized, which has been the lowest rate since declaring independence of the Republic of Macedonia. On December level (December 1998 / December 1997), a deflation of 1.0% was registered. In accordance with the revised monetary policy projection agreed with IMF in December 1998, the projected retail prices growth was 3.0%. The lower inflation rate than the projected one for 1998, and penetration in deflation zone at the end of the year, is due to the following reasons: a/ unexpected excessive fall of prices of agricultural products by more than 25%, because their sale at markets in FR Yugoslavia and Europe was impossible; b/ low import prices, caused by the fall of prices of raw materials and oil at the world markets; c/ continual several-year control of wage growth.

Chart 3

Retail Prices

(% change)



In respect of dynamics, the most outstanding changes of retail prices were registered in April, June, and October. Deflation of 1.5% in April and inflation of 2.3% in October were caused by decreased and increased electricity tariff, respectively, while deflation of 1.7% in June is due to a high fall of prices of agricultural products.

In 1998, the high growth of prices of producers of industrial products, caused by increased inflation expectations of these producers in the period after Denar devaluation in July 1997, slowed down. The Denar exchange rate against the Deutsche mark maintained the stable level after the devaluation, and with a certain time lag has neutralized inflation expectations of producers of industrial products and caused slowing down of the growth of their prices. Despite this tendency, in 1998 the average growth of these prices maintained relatively high level of 4.0%, although they had negative growth rate of 0.2% on December basis. The increment of prices of producers of industrial products did not cause an increase of the retail prices, primarily because of the large supply of goods and competition at the market, as well as the limited consumers' purchasing power.

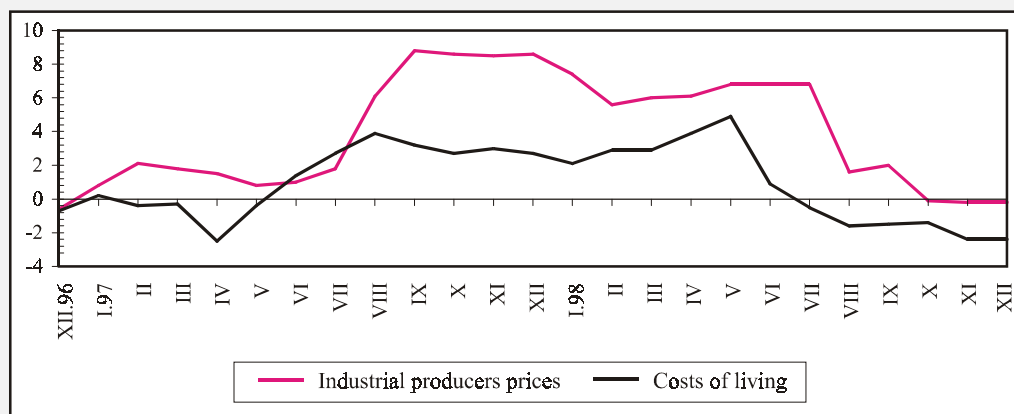
From the structural point of view, in 1998 an increment was registered in all three components of prices of producers of industrial products. On average, prices of producers

of reproduction materials increased by 4.8%, prices of producers of means of production increased by 4.0%, and prices of producers of consumer goods by 3.0%.

Chart 4

Prices of Producers of Industrial Products and Costs of Living

(% change, on annual basis)



In 1998, costs of living followed the changes of retail prices. On December basis, they decreased by 2.4%, while on average they decreased by minimal 0.1%. At the same time, the value of consumption basket decreased by 4.8% on December basis.

2.4. Labor market

Unfavorable condition at the labor market is still the biggest problem of the Macedonian economy. According to the Labor Force Survey,⁶ in 1998 the unemployment rate was 34.5%. In addition, the acceleration of the GDP growth in 1998 didn't produce a significant employment increment, i.e. a reduction of the high unemployment rate. This shows that the increased economic activity is caused primarily by increased labor productivity. At the same time, we could say that the unemployment in the Republic of Macedonia is structural by its nature, which means that, in short term, it could not be considerably reduced.

According to the Survey, 284,064 persons were unemployed in 1998, the unemployment rate equaled 34.5% and was extremely high. The registered unemployment rate is lower by 1.5 percentage points compared to the rate from the last year, but is still higher by 2.6 percentage points than the rate registered in 1996. In terms of the population structure by age and sex, in 1998 the highest unemployment rate (70.9%) was registered with the population aged between 15 and 24, and with the female population (37.6%).

⁶ The Labor Force Survey is conducted by the Statistical Office of the Republic of Macedonia. It is an annual survey, which has been conducted since 1996, during the second half of April. The Survey is based on a sample of 7,200 households, and is in accordance with the standards of the International Labor Organization (ILO).

Rather unfavorable is the structure of unemployed population by level of education. The share of the unemployed population with primary education in the total unemployed active population is 45.6%. If we include the unemployed persons with secondary education, this share increases to 93.3%. Such a profile of the unemployed persons points out that the unemployment problem could not be solved in a short term. At the same time, even 55.4% of the total number of unemployed persons are persons looking for job for four years or more.

According to the Labor Force Survey, in 1998 the number of employed persons equaled 539,762, and the employment rate was 35.9%. The employment rate is by 1.5 percentage points higher than in 1997, but it is by 1.5 percentage points lower than in 1996. The distribution of employed persons by sectors was unfavorable in 1998, because in the private sector 201,319 persons were employed, or 37.3% of the total number of employed persons. From the viewpoint of different activities, the largest number of persons were employed in industry and mining (152,096 persons, or 28.2% of the total number of employed persons), and in agriculture and fishing (102,201 employed persons, or 18.9% of the total number of employed persons).

2.5. Investments

In 1998, investment activity slightly increased, where in fixed assets a total amount of Denar 29,592 million⁷ was invested. Compared to the previous year, investments increased by 6.4% in nominal terms, or by 2.6% in real terms. Because of the low level of domestic saving, the investment activity was financed by foreign capital inflow, where foreign direct investments played a significant role. In 1998, these investments amounted to USD 118 million, which is an increment by USD 102 million, compared to the previous year.

In 1998, the share of the investments in GDP reached 17.9%, which is still insufficient for the acceleration of the growth of Macedonian economy. The insufficient level of investments in fixed assets was caused by the low level of domestic saving, and by the high price of domestic bank credits and their unfavorable term structure. This led to unfavorable structure of investments, and in short term, such structure can not intensify the economic activity. Thus, almost a half of total investments in fixed assets were in utilities and public services (28.9%), and in transport and communications (16.6%) which are useful and necessary in long term, but in short term do not produce some more serious effects for acceleration of the economic growth, while the share of investments in industry and mining was 25.4%.

On the other hand, there was an improvement in investments structure by sectors. The participation of investments in private sector in total investments in fixed assets increased from 49.5% in 1996, and 53.6% in 1997 to 57.1% in 1998. In the last three

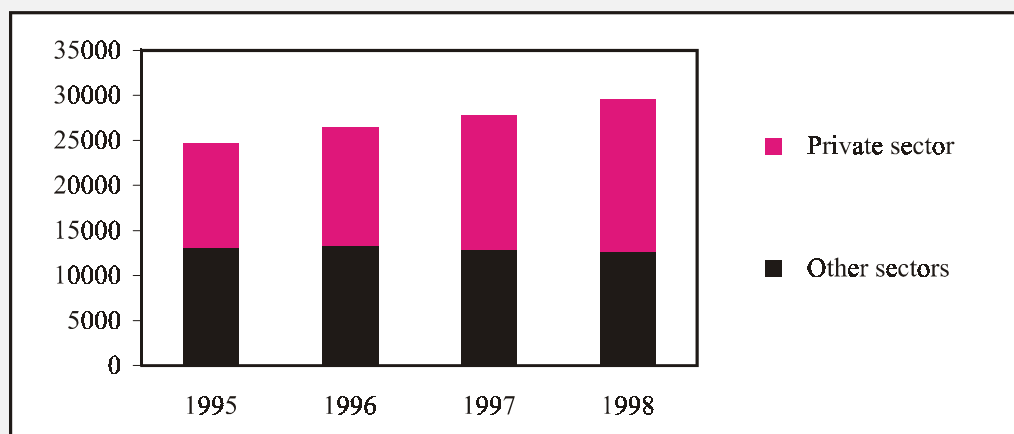
⁷ Estimated data from the Statistical Office of the Republic of Macedonia.

years, investment activity in the private sector is continually realizing double digit growth rates, where the growth in 1998 was 13.3%. On the other hand, total investments in other sectors decreased by 1.5% in 1998. Permanent improvement of investments' structure by sectors, in 1998 also represents the growing role of the private sector as a major generator of the growth of the Macedonian economy.

Chart 5

Investments in Fixed Assets⁸

(in Denar million)



From the view point of different activities, the most remarkable growth is registered in utilities and public services (by 10.9%), in transport and communications (by 10.4%), and in industry and mining (by 7.8%). On the other hand, in 1998 the highest decline of investment activity is registered in agriculture and fishing (by 9.6%), and in tourism and catering (by 9.8%).

2.6. Fiscal policy

2.6.1. Public revenues⁹

In 1998, an inflow of funds in the budget in a total amount of Denar 45,525 million was projected. During the year, Denar 42,655 million was collected, which is lower by 6.3% than the projected level. It is due to the lower than projected collection of main revenues, and the lower than projected inflow of funds from external borrowing (USD 7.4 million from the International Financial Corporation - IFC, and USD 15.3 million as a part of the SAL arrangement with the World Bank have not been received).

In 1998, the main budget revenues amounted to Denar 39,819 million, which is 2.9% lower than the projected level, and their share in total budget revenues was 93.4%.

⁸ Private sector includes investments of private enterprises and investments of agents without a status of legal entity. Other sectors include investments of social, co-operative, mixed, and Government sectors.

⁹ Data source: Ministry of Finance.

In addition, tax revenues create the largest portion of main revenues, with the share of 92.3%. In 1998, tax revenues in amount of Denar 36,863 million, and Denar 2,956 million non-tax revenues were collected, which is lower than projected level by 2.1%, i.e. by 11.9%, respectively. The lower amount of collected tax revenues is due to a lower amount of collected excise, having in mind the fact that in all other categories the collected budget revenues are higher than the projected.

From the structural view point, the lower amount of collected tax revenues is a consequence of decreased collection of domestic taxes of goods and services by 11,7%. The largest discrepancy between the projected and realized revenues (by 15.7%) is registered in collection of excise. It is due to a non-paid excise by "Okta" oil refinery, because of its financial problems.

In 1998, the collection of all other tax revenues was higher than the projected. The highest amount of Denar 10,931 million was collected from personal income tax, income tax, and from other income and capital gains taxes, which exceeds the projected level by 8.8%. In addition, personal income tax exceeded the projection by 9.1%, and income tax by 7.0%. This shows that the income tax rate decrement from 30% to 15% at the beginning of 1997, had a stimulating effect on tax payers in 1998, as well as in 1997. In 1998, from custom duties were collected Denar 6,810 million, or by 12.4% more than the projected amount.

Besides the main revenues, in 1998, larger inflow of funds in the budget is realized through external borrowing in amount of Denar 2,831 million, which is by 37.2% lower than the projected level. At the same time, revenues in the amount of Denar 4 million are realized from transfers and grants, while at the end of 1998 the budget had no short term borrowings from domestic financial institutions.

In 1998, the revenues of the social funds (Pension Fund, Health Insurance Fund, and Employment Fund) equaled Denar 35,618 million. From that amount, Denar 20,717 million¹⁰ refers to Pension Fund revenues. The largest share in this Fund's revenues have wage contributions (64.5%) and Central Government budget revenues (17.5%). The Health Insurance Fund's revenues amounted to Denar 10,641 million in 1998. From that amount, the largest part (63.7%) is collected from health insurance contributions. At the same time, the Employment Fund revenues equaled Denar 4,260 million, where 76.5% came from Central Government budget transfers, and 23.2% from contributions in this fund.

2.6.2. Public expenditures¹¹

In 1998, budget expenditures amounted to Denar 42,623 million. The largest part of the budget expenditures (87.2%) refers to current expenditures, which amounted

¹⁰ The projected value is used for December.

¹¹ Data source: Ministry of Finance.

to Denar 37,171 million. Within the current expenditures, expenditures for goods and services had the highest share of 55.9%, or Denar 20,781 million, of which 76.7% were related to payment of wages and salaries. Second major item in the current expenditures structure are the transfers. In 1998, Denar 14,834 million were transferred for various purposes from the budget of the Republic of Macedonia, which represents 34.8% of total budget expenditures. The largest share in the total transfers had assets spent for social programs (47.7%), and assets transferred into the Pension Fund (24.4%). The third item in the current expenditures structure are interest expenditures. In 1998 the interest expenditures equaled Denar 1,557 million, and were made for payment of interest exclusively on foreign credits.

Capital expenditures and net lending equaled Denar 2,617 million in 1998, and maintained the last year share of 6.1% of the total budget expenditures. The low share of capital expenditures in total budget expenditures represents the unfavorable structure of the budget expenditures. At the same time, half of the capital expenditures, or Denar 1,291 million, were related to investments in fixed assets.

Besides current and capital expenditures, the total budget expenditures also contain the budget reserves, payments of the principal on taken credits, and deposits with the NBRM. In 1998, in accordance with the ESAF arrangement with the IMF, Denar 1,200 million were transferred from the budget of the Republic of Macedonia into the NBRM fund for support of purchase of foreign exchange and for maintaining the stable Denar exchange rate. The deposited amount equaled the projected amount. In 1998 Denar 1,535 million were used for payment of the principal on the external debt, while budget reserves equaled Denar 100 million.

The social funds' expenditures (Pension Fund, Health Insurance Fund, and Employment Fund) amounted to Denar 36,691 million in 1998. The Pension Fund expenditures equaled Denar 20,521 million.¹² Denar 17,730 million, or 86.4% of total Fund's expenditures were used for pension payments, while the rest of the expenditures of this Fund were related to various benefits. The Health Insurance Fund expenditures in 1998 reached Denar 11,906 million. Within this category, 43.5% of the expenditures refer to hospital treatment expenditures. The Employment Fund expenditures in 1998 were Denar 4,264 million, and 95.8% of that amount refer to payments on behalf or for the account of unemployed persons.

2.7. Wage policy

In 1998, the important role of wage policy continued, looking both from macroeconomic, and microeconomic aspect. From macro aspect, wage policy, in coordination with the other components of the macroeconomic policy, was directed towards

¹² The projected value is used for December.

maintaining the achieved macroeconomic stability. For that purpose, in 1998, the limitation on the growth of the wages of economic agents that have not completed their privatization continued, covering about three quarters of the funds aimed for payment of wages. The wage growth limitation was connected with the control of the private consumption, as a component of the aggregate consumption, in order to prevent pressures on the retail prices. From a micro point of view, the wage policy was expected to support the effects from Denar devaluation in July 1997, i.e. by preventing against increase in the operating costs of the enterprises to maintain improved competitiveness at foreign markets.

The nominal average net paid wage per worker in 1998 reached amount of Denar 9,394, which is an increment of 3.7% compared to the previous year. This is a result of the wage increase in the economic and non-economic sector by 4.5%, and 1.6%, respectively. The real average net paid wages per worker increased by 3.7%, where real wages in economic sector increased by 4.5%, and in non-economic sector by 1.6%.

Table 4
Paid Net Wage Per Worker

	In Denar		Nominal increase 1998/97 (in %)	Increase in real terms 1998/97 (in %)
	1997	1998		
Average monthly wage				
Total	9,063	9,394	3.7	3.7
Economic sector	8,888	9,288	4.5	4.5
Non-economic sector	9,469	9,623	1.6	1.6
Wages for December				
Total	9,096	9,694	6.6	9.2
Economic sector	8,913	9,688	8.7	11.4
Non-economic sector	9,524	9,708	1.9	4.4

On December level, wage growth considerably exceeded the increment of average wages, indicating their accelerated growth by the end of the year. Thus, in December 1998 nominal average net paid wage per worker was higher by 6.6% compared to the same month of the previous year, primarily as a result of increased wages in the economic sector by 8.7%. In real terms, in December 1998 average net paid wage is higher by 9.2% than in December 1997, with high real growth of wages in economic and non-economic sector by 11.4%, and 4.4%, respectively.