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The Effects of the Greek Economic Crisis on the Republic of Macedonia

Abstract. This paper explores the current economic and political situation in the Republic of Macedonia in the aftermath of the most acute period of the international economic crisis, and reviews the prospects for government stability and the possibility of an agreement with Greece over the “name issue” in the coming months.

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The Economic Context

The onset of the world financial crisis in 2007/2008 initially had little effect on the southern Balkans. Most countries – whether European Union members, candidate members of those awaiting an EU relationship – have similar banking systems in which the more speculative aspects of contemporary finance are almost wholly absent. This was not the case with Greece, where banking is closely integrated into wider globalized financial groups and where growing national indebtedness had concerned regional observers for some time.

The debt crisis that developed in Greece in 2009-2010, with the possibility of debt restructuring, a default, and/or a return to the Drachma currency, along with the wider Eurozone’s financial instability has inevitably given rise to concerns about the economic prospects of the Republic of Macedonia. *1 The Republic of Macedonia has a small and weak economy with many trade and business links to Greece, a relatively unstable internal political environment, and problems that undermine good governance. Major Greek investment has in fact been undertaken in economic sectors such as the Republic of Macedonia’s

*1 The name “Republic of Macedonia” for the state is used as a matter of verbal convention only in this article and does not imply any view on the legitimacy of the term “Former Yugoslav Republic of Macedonia” (FYROM), which is also used as a state name by Greece, the Republic of Cyprus, and some international organizations.

Petroleum and food and beverages industries, whereas Greece constitutes a major market for Macedonian exports such as quarrying and mineral products.*2

In general, the gloomy predictions of many commentators in the Skopje press since 2008 about the likely effects of the Greek crisis on political and economic stability in Skopje have not been borne out by events. Such critics have underestimated the stabilizing effect of both the diversification of the Macedonian regional economy in recent years and the growing interconnections with various trade and investment partners such as Turkey, Serbia, Russia Germany and Bulgaria. Although there was a short period of severe funding stress in late 2008/early 2009, the Skopje banks have avoided a crisis, and the early involvement of the International Monetary Fund (IMF) produced public expenditure reductions that avoided the need for a renewal of the three-year stand-by agreement with the IMF that expired in 2008.*3 The government still prioritizes the desire to avoid recourse to the IMF in policy-making. Politics in Skopje is highly symbolic, and there is a widespread belief among all ethnic communities in the republic of Macedonia that their democracy is subject to major manipulation by outside forces.*4 Thus avoiding an IMF intervention is a political as well as an economic priority in Skopje. Risks to macroeconomic stability remain but are not generally thought to be as serious now as a year or more ago.*5

The current account deficit is high but so far has proved possible to finance. The current budget deficit ran about 2.8% of the GDP in 2009, the largest for some years, but it has become increasingly expensive to service the debt as the international appetite for Government bonds declines. Inward capital flows are very important. There was a very sharp decline in inward direct investment in 2009, as in other Balkan countries like Serbia, Montenegro and Croatia.*6 In most cases, this is because most (or all) worthwhile enterprises have been sold or

*2 See James Pettifer, *The Greek Crisis – A Pause*, Defence Academy of the United Kingdom, 10/07. Shrivensham July 2010, available

http://www.da.mod.uk/colleges/arag/documentlistings/balkan/The%20Greek%20Crisis_Web.pdf/view. All websites were accessed on February 15, 2011.

*3 Economist Intelligence Unit (EIU) Reports on Macedonia. London 2008-2011; all reports are available at http://www.eiu.com/index.asp?layout=displayIssue&publication_id=1440000944; World Bank Country Reports. 2008-2010, available at

<http://www.wds.worldbank.org/external/default/main?menuPK==64258544&pagePK=64187838&piPK=64187928&thesitePK=523679&function=BrowseFR&menuPK=64187514&siteName=WDS&conceptattcode=82709&paththeid=COUNT&sortattcode=DOCDT+desc>; International Monetary Fund, Country Reports. 2008 – 2010, available at <http://www.imf.org/external/country/mkd/index.htm>

*4 An interesting analysis of this subject and the politics of Macedonian image manipulation is Andrew Graan, *On the politics of Imidz*, *Slavic Review* 69 (2010), no 4, 835-858.

*5 For more detail, see the EIU Report of September 2010 (above fn. 3). The report is comprehensive but probably underestimates the degree of “grey” and “black” economic activities, and does not raise the issue of government statistical accuracy.

*6 EIU Reports, 2009-2010 (above fn. 3)

Privatized (e.g. the tobacco and steel industries in the Republic of Macedonia), and construction development has been a victim of the global economic crisis. There has been a significant decline throughout Europe in capital flows from richer to poorer countries as many have chosen not to finance holiday houses and second homes.*7 In Bulgaria, for instance, in the early 2000s, vacation homes were the single most important foreign capital inflow in the country. The issue is less important in the Republic of Macedonia because of the nature of its tourist industry, which depends heavily on short-term stays by transit visitors and local customers who are unlikely to want to invest much in a second home. In general, the country has not suffered from a property and construction “bubble” and associated bad bank loans, allowing the Republic of Macedonia to avoid the destabilization that struck “bubble” nations like Spain and Portugal.

Macedonian monetary policy is controlled by the relationship of the Denar to the Euro, at a semi-pegged rate that has remained steady for some years.. Until 2008/09, capital inflows meant that not only could debts be paid off, but that the Euro peg level could be maintained. This is a cause of concern for the future. The current account deficit improved from about 7.3% of the GDP in 2009 to 4.8% in 2010/11, and the trade deficit shrunk by 11% in the same period. Exports are rising, and in February 2009 were up 19% compared to the previous year. *8

Pledges of financial aid have been received from the European Bank for Reconstruction and Development (EBRD), mainly for road improvements, although the Skopje government would prefer that the funding be applied to complete the long-delayed and only partially completed rail link to Bulgaria.*9 An agreement with the World Bank is in force for a four-year partnership strategy. Financial remittances, mainly to the 25% Albanian minority in western Macedonia, are down but remain at a reasonable level, as the majority of the Albanian diaspora work in the German-speaking countries in the EU and also Switzerland, where the economy is healthier than in Greece or Italy. Revenue from criminal activity continues to provide liquidity in the economic system, however undesirable the high level of corruption and lack of business transparency in the Republic of Macedonia is from the point of view of attracting foreign investment.

The relatively optimistic fiscal picture is compromised, however, by sharply rising unemployment, the intense financial pressure on vulnerable institutions such as schools, universities and hospitals, and the poor revenue position of the government, which has led to the closure of diplomatic missions, withdrawal of

7 The Financial Times estimated that as many as 50% of all British owned second homes in Spain are currently up for sale. New inward investment has more or less stopped altogether. Holiday home Sell-off Forecast, Financial Times, 7 January 2011, available at <http://www.ft.com/cms/s/2/09923922-1a8a-11e0-b100-00144feab49a.html#axzz1HRrby8Zi>

8 EIU Reports, 2010 (above fn. 3).

9 See the coverage in Nova Makedonia and other Skopje media during July and August 2010.

Troops from NATO-led coalitions, and reduced public services.*10 The very low public sector salary and wage levels are an incentive to corruption. As a matter of fact, the country's generally stable economic position has been achieved only via rigid central government spending cuts. Further cuts may be required if capital inflows do not improve, and an IMF application might then be unavoidable. Nevertheless, industrial output rose by 8% in the last year, and exports rose over 20% in the first six months of 2010. Income from the important agricultural sector has been healthy as a result of rising world food prices and the benefits gained from local investment in improving product quality in areas such as the alcoholic beverages sector. In that sense, the Macedonian economy has long emphasized primary sector economic activities. Greece extended its border northwards during the nineteenth and early twentieth centuries to achieve economic goals, given that Greece then suffered from a deficit in core agricultural products like cereals. There are tens of thousands of very small agricultural producers whose production and social value is not captured by conventional economic data; their output provides subsistence and social stability for the poorer parts of society in Macedonia, as in most Balkan countries.

The Political Background and International Relations

In the recent period there have been few major decisions or major changes affecting the political structures of the Republic of Macedonia. The framework of interethnic relations established by the international community through the Ohrid Accords, which were signed in August 2001 and ended the short interethnic war that spring/summer, remains in place. On the Macedonian side of the ethnic divide, all political structures are now dominated by the conservative-nationalist Internal Macedonian Revolutionary Organization (IMRO) government of Nikola Gruevski, which controls the presidency, the Parliament and many local governments and other institutions. It governs in coalition with the largest of the ethnic Albanian parties, Ali Ahmeti's Democratic Union for Integration, in a de facto spoils system. Recent elections have been more peaceful than those in the immediate post-Ohrid period but many problems remain in achieving an international standard.*11 The relationship with the European Union remains stalled at an ostensible level because of the dispute over the state's name with Greece, but also over the lack or reform of what Brussels contends are obsolete

*10 See the BBC Monitoring reports on Macedonia between September and December 2010, also for documentation on the failure of "name" discussions initiated by Matthew Nimitz in that period. For Macedonian Albanian views, see Koha and other media for the same period.

*11 Numerous documents exist concerning problems associated with elections in the Republic of Macedonia over the years. For the most comprehensive reports see those issued by the OSCE Vienna office, available at <http://www.osce.org>, searching for the appropriate year/election.

And dysfunctional structures in Macedonia society.*12 The same applies to NATO membership, although the country has supplied troops to U.S. led coalitions. It is an open question whether Skopje could afford the required national level of defence spending for NATO membership in the present economic and fiscal circumstances. Reform is a problem in the military sphere as much as the civilian one, so that, for instance, the officer corps of the army remains overwhelmingly Slav-Macedonian, despite numerous attempts by NATO and other advisers to engineer reforms over the last fifteen years. In the international community, in general, all concern over these and other issues has been condensed into the arguments about the “name” issue, which has been seen as the main obstacle to NATO and EU membership.*13 The thirteen year long United Nations mission of Matthew Nimitz remains active, although his new initiative involving Prime Ministers Gruevski and Papandreu in autumn 2010 did not produce any concrete results and led to some awkward diplomatic exchanges between Athens and Skopje.*14 While the name issue is obviously very important, it is often used to camouflage other, much more serious reservations about the role of the Republic of Macedonia in the world. The uncomfortable fact for the international community is that the Republic of Macedonia’s ability to weather the global economic crisis, which earned the country plaudits from the IMF and other international organizations, is closely tied to informal centralized control in what is still in some senses a semi-socialist or state-capitalist economy. This is particularly the case in the agricultural and food products sectors, which are generally well run and have benefited considerably from the boom in the world food prices. Current grain prices are considerably higher on the local informal market than they are within the EU. The metals sector has also benefited from foreign investment and booming international demand. The rapid economic clampdown that saved the situation in 2008 – 2009 would have been much more difficult to achieve without the political centralization based on IMRO-controlled structures and informal networks in Skopje, much in the same way that Montenegrin leader Milo Djukanovic was able to use the methods of internal patronage networks.*15

Thus there is a contradiction, in the current grim economic circumstances, between the reforms needed for EU membership progress, and the loyal system that so far has avoided major social economic instability. The political ambitions

*12 For example, there has been very poor progress in the exploratory talks with Brussels over a projected date for the opening of full membership negotiations with the Skopje government.

*13 Cf. Biljana Vankovska, David vs. Goliath: The Macedonian Position(s) in the So-called “name dispute” with Greece, *Sudosteuropa. Zeitschrift für Politik und Gesellschaft* 58 (2010), no.3, 436-467.

*14 See BBC Monitoring (above fn. 10), for this period.

*15 James Pettifer, *International Financial Crisis and the Balkans*, *The World Today* 65 (February 2009), no.2, 22,-24, 22.

Of the Macedonian Albanians are usually intimately linked with the situation in neighbouring Kosovo, and it remains to be seen if the difficulties there following the recent elections will lead to the growth of Albanian nationalist sentiment in western Macedonia. This is perhaps unlikely in the short term, as the political leadership of the Macedonian Albanians is fragmenting somewhat into a greater number of parties, none of which is likely to disturb the general Ohrid Accords settlement. The IMRO government has offended Serbia by its recognition of the Kosovo border delineation, an astute move in the light of Macedonia's internal ethnic conflicts, as it has temporarily defused Albanian grievances over Skopje's non-implementation of the Ohrid provisions. The event was also a sign of declining Greek diplomatic influence in the region.*16

At the onset of the Greek crisis, some diplomats were of the opinion that the crisis might force Greece to back down on some long-held positions and embrace a compromise deal with Skopje. This has not happened, however, for the simple and understandable reason that with much of the Greek Left expressing vitriolic opposition to government austerity plans, the last thing the unpopular and psychologically insecure PASOK government wants is to incite the ire of the clerical Right with a major concession over the Republic of Macedonia. The Weak and uncertain leadership of the New Democracy party in Athens exacerbates this problem, as it cedes influence on many issues to the Greek Orthodox Church, which in general is strongly opposed to concessions to Skopje. Northern Greece, which is adjacent to the Republic of Macedonia, has been most seriously affected by the economic crash and is also most influenced by the Church and the clerical Right. A major concession on the name controversy by Athens would prove to be very unpopular.*17

American faith in the viability of a solution is often motivated by the increasing numbers and influence of the Albanian minority in Macedonia, most of whom would prefer a settlement and NATO membership.*18 This is undoubtedly true but it is also true that it would be potentially very destabilizing to the Skopje government to accept a semi-imposed deal by the International Community that depended on the Albanians in a way that many Slavs would interpret as a direct attack on their national identity. The UN Mission of Matthew Nimitz remains dedicated to finding a top-down solution, but how sensible this policy is, given the recurrent political stresses in Skopje, remains an open question. Nimitz's mission is, in essence, a holdover from the Vance-Owen period of international

*16 Cf. Biljana Vankovska, Kosovo: Macedonia's Perspectives, *Sudosteuroopa. Zeitschrift für Politik und Gesellschaft* 56 (2008), no.3, 412-417.

*17 For more on the clerical issues cf. James Pettifer, The Gligorov Regime in Former Yugoslav Macedonia and the Development of Religion, in: Ines Angjeli Murzaku (ed.), *Quo Vadis Eastern Europe? Religion, State and Society after Communism*. Ravenna 2009, 197-206.

*18 Such opinions were articulated in discussions with the author by U.S diplomats and officials in 2009 and 2010.

Activity in the Balkans, when deals could be brokered between strong international negotiators and undemocratic leaders like Milosevic or Tudman and then handed down to local populations. The development of better formal democracy in the Balkans over the last fifteen years has made this perspective rather obsolete. In a reasonably formally democratic state like the contemporary Republic of Macedonia this is a very dubious strategy, as the discussions about the need for a validation referendum indicate. In Greece with its long, if sometimes flawed, tradition of parliamentary government, this is even more the case. In Greece, only the Marxist Left favors a major reorientation of policy towards Skopje, but although support for the communist party (KKE) and smaller Marxist parties is increasing steadily (as the recent Greek local election results in autumn 2010 indicate), they do not exert much ideological influence on Greek policy on this issue. It has been a dangerous issue for the Greek Left dating back to the Greek Civil War (1943 – 1949) and is a low priority at the moment.

In the years since its creation as a new independent state in 1991/1992, the Republic of Macedonia has shown a sure survival instinct in often highly difficult circumstances, including the early Greek economic boycott, difficulties in attaining international recognition, the loss of its original flag and other issues in the 1995 “small package” agreement with Greece, the appalling strains of the Kosovo war refugee crisis, and a full-scale armed conflict with the Albanians in 2011. It has shown generally good sense in addressing the current world economic crisis and for the international community to exert pressure on either government to force through a solution to the name conflict could prove very destabilizing. A better strategy may be to attempt to increase informal economic and regional cooperation to steer both countries through their acute economic difficulties.