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MARKETING FACTORS INFLUENCING BANK SELECTION IN BOSNIA AND HERZEGOVINA

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Abstract

Conventional banks as well as Islamic banks need to recognize the criteria on which prospective customers establish their bank selection decision. Planning a proper marketing strategy in order to attract new customers is of crucial importance in indentifying these criteria. Examination of the bank selection criteria being employed by bank employees of different banks in Sarajevo is the main focus of this study. Five banks were selected as a sample for the study. In the study, 50 selection factors extracted from relevant literature will be used to determine bank selection. By comparing the means ranking of the factors will be provided from where we will be able to see witch factors have highest importance in selecting the bank.

Key words: *Marketing factors, Banks, Marketing strategy, Bank Selection*
JEL Classification: M31

Introduction

Developed marketing is now the starting point for the survival of banks in a more and more competitive market. Bank marketing includes approach to the consumer. Task of strategic marketing is to direct the banking organization to its action as fully adapted to the market environment. In this context, one of the main tasks for bank managers is to identify the factors that will attract market segment which will take these factors in consideration when making key decisions bank selection. Banks must determine the needs of consumers in each market segment as well as how these consumers evaluate the strength of the bank compared to its competitive. (Bakarić, 2007)

Studies have shown that there is a very large percentage of students that will remain the same bank customers after graduation and during employment period (Lewis, 1982.), so that business banks of Bosnia and Herzegovina in the market segment of students could identify a significant business opportunity (maybe not so much because of the size but rather because of the potential financial strength after graduation and employment).

Bank selection criteria were the topic of many earlier studies. Many researchers such as Anderson et al. (1976), Evans (1979), Kaynack and Yavas (1985), Ross (1989), Kazeh and Decker (1993), Hegazi (1995), Metawa and Almossawi (1998) tried to discover an answer on question ``how customers select banks"?. Banks will easily identify right marketing strategies that are needed to magnetize new customers and keep existing ones (Kaynak and Kucukemiroglu, 1992).

Banks play the most important role in financial institutions in a modern economy. They perform some very important functions for society and in this process extensively influence the level of economic doings, the distribution of income and the level of prices in a country. Because of that with increasing competitiveness in the banking industry, and likeness of services offered by banks, it has become ever more important that banks identify the factors that will determine the base upon which customers decide between providers of financial services (Almossawi, 2001).

The relevant previous studies indicate that a big amount of research effort has been spent to explore bank selection criteria for broad categories of customers (Yue and Tom, 1995). Almossawi (2001) emphasized that one promising segment, younger age group, did not have enough attention. Banks which are planning to manage this vibrant market segment must understand how individuals belonging to such segments select their banks.

Literature Review

The bank selection criteria have been mostly neglected in the relevant literature. Nevertheless, a number of studies have dedicated part of their analysis to the importance of selection factors relative to age of customers. As we could find, in part of their study, Boyd et al. (1994) investigated the importance of bank selection criteria in relation to the age of the head of the household. They found that for the age group under 21 years, a bank's reputation has a major position in determining their bank selection, followed by location, hours of operation, interest on savings accounts and providing convenience and fast service. The least important factors for this age group were found to be the friendliness of bank employees and the modern nature of their facilities (Almossawi 2001).

Kaufman (1967) explores the determinant factors used in decisions of bank selection by consumers and business firms in the USA. He found that the most influential factors reported by households were suitable location to home or place of business, length of bank-customers relationships and quality of services offered by the bank.

Mason and Mayer (1974) assessed the factors that were used in their study and they found that high rankings factor in choosing the bank were:

- friendly personnel;
- favorable loan experience;
- advice of friends; and
- Influence of relatives.

Fitts (1975) did factor analyze on a set of data and he found that, six factors had a big impact on bank attractiveness to customers. These factors are stated as follows:

- full service bank,
- customer orientation,
- a pleasant banking experience,

- convenience of time,
- shopping accessibility, and
- personal influence.

Laroche et al. (1986) in his study explored 140 households in Montreal, Canada, trying to learn how people select their banks in such a competitive banking environment. In ranking the selection factors, results show that friendliness of staff has the major position in the bank decision process, followed by hours of operations, size of waiting lines, convenience of location, and efficiency of personnel.

By using "analytic hierarchy process" Javalgi et al. (1989) in his study found that financial factors are the main criteria in customers' decisions of bank selection. Results and findings of this study demonstrate that financial factors such as safety of fund, interest on savings accounts, and availability of loans are ranked high. Other two factors that followed the main one were convenient location and bank's reputation.

Even there were few important purposes in Erol et al.'s (1990) study on of them was designed to determine the bank selection criteria used by customers of Jordan's conventional and Islamic banks. Results of his study emphasizes that factors which were ranked highly were as follows:

- fast and efficient services,
- bank's reputation and image,
- friendliness of bank personnel, and
- confidentiality of bank.

Haron et al. (1994) conducted a survey of 301 Muslim and non-Muslim commercial bank customers in Malaysia to resolve the selection criteria used in a Islamic as well as in conventional banking environment. Results of the study show that factors that are important in bank selection were valued almost the same by Muslims and non – Muslims. The factors that were ranked highly were as follows:

- fast and efficient services,
- speed of transactions,
- friendliness of bank personnel, and
- confidentiality of bank.

Results of the Holstius and Kaynak (1995) study, where authors tried to determine the importance of selected patronage factors used by Finnish customers in choosing their banks by conducting a survey of 258 bank customers, indicated that the highly ranked factors for Finnish customers were: reception at the bank, fast and efficient services, lower service charges, friendliness of personnel, and perceived confidentiality.

There is also a study that is determining the global preferences of undergraduates regarding existing Croatian banks. In this study, Bakarić, 2007 presented how an Analytical Hierarchy Process (AHP) model can be applied by banks to measure their competitive advantage on different criteria in comparison to other banks..

Methodology

This article focuses on studying the bank selection criteria being employed by employees of five different banks in Sarajevo Canton that are selected as a sample for this study.

A specially designed questionnaire was used for necessary data collection. The questionnaires have been passed to bank employees who were requested to fill them out and to answer the questions which were the second part of the questionnaire. There were two sections of mentioned questioner. The first part of the questionnaire asked respondents to rate the relative importance of 50 potential influencing factors, on their selection decision of banks, using a ten point importance scale (ranging from "most important" to "least important"). The factors were adapted from the relevant literature, personal experience and interviews with banks employees. In the second section of the questionnaire respondents were asked to list five most impor-

tant and five least important items based on their opinion and experience with customers. During the interview they provided explanation what where the reasons for such ranking of factors.

In order to closely present sample for this study banking sector in Bosnia and Herzegovina will be shortly described and list of the banks that are operating in BiH will be provided.

Banking System in Bosnia and Herzegovina

The banking sector in BiH has experienced some important structural and organizational changes in last 20 years. Since The banking sector, together with all other sectors of the economy, was destroyed during the war period 1992-1995. Therefore the post-war reconstruction started since 1996, and has been very difficult for the development of banking system of BiH. In 1997 the Central Bank of BiH was established according to the "Currency board" arrangement, whereby the focus was put on stabilization of the currency and restoring confidence into the financial system, and at the same time "stripping" the Central Bank's instruments of monetary policy. What followed after the establishment of the Central Bank was the introduction of a single currency in BiH market in line with the principle of pegging the national currency KM/BAM (Convertible Mark) to DEM (German Mark) at a fixed exchange rate of 1KM=1DM. The main effect of this was withdrawing from payment system as many as four then existing currencies, i.e., Serbian "Dinar", Bosnian "Dinar", Croatian "Kuna" and German "Mark". Today, KM is pegged to EUR at a fixed exchange rate of 1 EUR = 1,95583 KM. (Efendic, 2011)

At the end of the last century, the banking system went through the processes of consolidation, regulation and privatization. In conformity with the administrative organization of BiH, the legal framework consists of The Law of Banks of Federation B-H (FB-H) and the Banking Law of Republika Srpska (RS). Implementation and enforcement of those laws are controlled by the two bank supervision agencies in BiH, namely the Banking Agency of FBiH and RS, which issuing and banking licenses too. These agencies and regulators didn't support any changes or adoptions in lows on banks for full implementation of Islamic banking.

The concentrated privatization process is finished. And result of this privatization process is that today we have 98% of private domestic or foreign ownership. In the last ten years, confidence in the banking system has been restored and the banking system itself has been significantly developed and strengthened, measured by growth of deposits and the amount of capital. These processes coincided with the process of the concentration of the banking system due to numerous mergers and acquisitions of banks, which further resulted in reducing of the number of banks in BiH. (Efendic,2011)

The banking sector dominates the financial system in Bosnia and Herzegovina. Separately from the leading position of the banking system in the process of financial intermediation, there is a clear tendency of banks spreading into others, less developed segments of the financial system

Commercial Banks

Commercial banks in BIH are enabled for banking actions and operations in relation to the Law on Banks. Taken as a whole, the main share of assets in BIH is today privately owned. Foreign-owned banks have been the main drivers of credit growth. The list of the commercial banks operating in the Bosnia and Herzegovina is given in Table 1. Headquarters of the 19 banks in the list are in Federation of Bosnia and Herzegovina, while headquarters of the 10 of them are in RS.

	Name of the BANK	Center Office	Official Website
1	ABS banka d.d. Sarajevo	Sarajevo	http://www.absbanka.ba
2	BOR banka Sarajevo	Sarajevo	http://www.borbanka.ba
3	Bosna bank international d.d. Sarajevo	Sarajevo	http://www.bbi.ba
4	FIMA banka dd Sarajevo	Sarajevo	http://www.fimabanka.ba
5	Hypo Hypo Alpe-Adria-Bank d.d. Mostar	Mostar	http://www.hypo-alpe-adria.ba
6	Intesa Sanpaolo Banka d.d. Bosna i Hercegovina	Sarajevo	http://www.intesasanpaolobanka.ba
7	Investiciono-komercijalna banka dd Zenica	Zenica	http://www.ikbze.com.ba
8	Komercijalno-investiciona banka dd V.Kladuša	Velika Kladuša	http://www.kib-banka.com.ba
9	NLB Tuzlanska banka dd, Tuzla	Tuzla	http://www.nlbtuzlanskabanka.ba
10	Postbank BH d.d. Sarajevo	Sarajevo	http://www.postbankbh.ba
11	Privredna banka Sarajevo d.d. Sarajevo	Sarajevo	http://www.pbs.ba
12	ProCredit Bank Sarajevo	Sarajevo	http://www.procreditbank.ba
13	Raiffeisen Bank dd BiH	Sarajevo	http://www.raiffeisenbank.ba
14	Razvojna banka Federacije BiH	Sarajevo	http://www.ibf-bih.ba
15	Turkish Ziraat Bank Bosnia dd Sarajevo	Sarajevo	http://www.ziraatbosnia.com
16	UniCredit Bank d.d.	Mostar	http://www.unicreditbank.ba
17	Union banka d.d. Sarajevo	Sarajevo	http://www.unionbank.ba
18	Vakufska banka d.d. Sarajevo	Sarajevo	http://www.vakuba.ba
19	Volksbank BH dd	Sarajevo	http://www.volksbank.ba
20	Balkan Investment Bank AD Banja Luka	Banja Luka	http://www.bib.ba
21	Bobar banka ad Bijeljina	Bijeljina	http://www.bobarbanka.com
22	EEFC Bank, a.d. Banja Luka	Banja Luka	http://www.iefkbanka.com
23	Hypo Alpe-Adria-Bank a.d. Banja Luka	Banja Luka	http://www.hypo-alpe-adria.ba
24	Komercijalna banka AD Banja Luka	Banja Luka	http://www.kombank-bl.com
25	NLB Razvojna banka	Banja Luka	http://www.nlbrazvojnabanka.com
26	Nova banka ad Banja Luka	Banja Luka	http://www.novabanka.com
27	Pavlović International Bank a.d.	Slobomir Bijeljina	http://www.pavlovic-banka.com
28	Unicredit Bank a.d. Banja Luka	Banja Luka	http://www.novablbanka.com
29	Volksbank a.d. Banja Luka	Banja Luka	http://www.volksbank-bl.ba

Source: Banking Agency of the Federation of Bosnia and Herzegovina (20011) and Banking Agency of the Republic of Srpska (20011)

Table 1. Commercial Banks in Bosnia and Herzegovina in 20012

Five banks that are selected for the study are: Bosnian Bank International, ProCredit Bank, Raiffeisen Bank, Turkish Ziraat Bank and UniCredit Bank. Bosnian Bank International is not listed in the table 1 because it is operating as Islamic bank. We decided to consider this bank because B-H has not made any restrictive or economic implementation in banking sector for developing of Islamic banking, so Islamic bank is treated as a conventional one.

Findings of the study

According to personal interviews with the banks employees and questioner that is conducted, in table 1 we can see which factors are most important and which one are least important in bank selection. It should be noted here that every part of Table 2 was used in formulating the methodology and discussing the findings of this study.

Factors	Factors Ranking						
	BBI Bank	ProCredit Bank	Raiffeisen Bank	Turkish Ziraat Bank	UniCredit Bank	Average	Rank
Availability of ATM's in several locations	9	9	10	10	9	9.4	1
Financial stability of the bank	10	10	10	9	8	9.4	2
Debit cards services	10	9	8	10	9	9.2	3
Low interest rates on loans	10	10	10	9	7	9.2	4
Staff confidentiality and trust	10	9	10	7	8	8.8	5
Satisfaction of time waiting for service	8	9	10	9	8	8.8	6
Speed of service from the cashiers	8	9	9	9	9	8.8	7
Friendliness of bank personnel	10	9	9	8	7	8.6	8
Knowledge and skills of staff i	9	10	10	6	8	8.6	9
Professionalism and credibility of staff	9	9	10	8	7	8.6	10
Bank opens afternoon	9	9	9	7	8	8.4	11
Recommendations of friends	9	9	10	6	8	8.4	12
Recommendations of relatives i	9	9	10	6	8	8.4	13
Convenient branch locations	9	8	10	7	8	8.4	14
Ease of opening a current account	7	6	10	10	8	8.2	15
Bank's reputation	9	10	9	8	5	8.2	16
Nearness of the bank to your office or house (residence)	9	9	10	7	6	8.2	17
Personal security of customer	10	9	7	6	9	8.2	18
Availability of large branch network across the country	10	6	10	8	7	8.2	19
Simpler loan procedures	7	8	9	8	9	8.2	20
Convenient ATM locations	7	8	10	8	7	8	21
Low service charges	8	4	10	9	9	8	22
Variety of services offered	10	8	8	7	7	8	23
Loans easily obtained	9	9	8	7	6	7.8	24
Searching for the best possible solutions to the financial problem by staff	9	7	9	7	7	7.8	25
Sufficient number of cashiers	7	5	10	9	8	7.8	26
Speed of loan approval and immediate payout	8	9	7	7	7	7.6	27
Long loan repayment period	9	8	9	5	7	7.6	28
Paying highest interest rates on saving accounts	9	6	7	7	8	7.4	29
Pleasant bank layout, atmosphere and cleanliness	9	8	7	7	6	7.4	30
Sufficient number of bank personnel	7	6	7	9	8	7.4	31
Ability to design the amount and frequency of installments based on your own capabilities	8	5	10	6	8	7.4	32
Available public transport nearby	6	8	10	5	8	7.4	33
Several branches	9	7	7	6	7	7.2	34
Providing credit cards with no annual fees	7	6	8	6	8	7	35
Ease of access to senior bank personnel for consultation/advice	10	7	7	5	6	7	36
Influential marketing campaign	7	8	7	7	6	7	37
Potential customer complaints are managed effectively by the bank's staff	9	8	5	6	7	7	38
Foreign exchange	6	6	9	6	8	7	39
Possibility of partial or total early loan repayment anytime you want	8	7	10	4	6	7	40
Banking by mail	9	9	7	6	3	6.8	41
Brand name	5	8	8	7	6	6.8	42
External appearance of bank	8	9	4	7	5	6.6	43
Appearance and attire of staff	5	7	9	5	7	6.6	44

Reception at the bank	7	9	6	4	6	6.4	45
Convenient location of the main branch of the bank	9	3	9	3	7	6.2	46
Opportunity of telephone banking	9	6	4	8	3	6	47
Availability of parking space near the banks facilities	8	7	5	6	3	5.8	48
Career development programs	8	6	5	5	5	5.8	49
Free gifts for customers	8	5	1	7	4	5	50

Table 2. Ranking importance of bank selection criteria factors among banks employees

The findings reveal that for banks employees based on their experience with customers, the five most influential factors for bank selection were:

1) Availability of ATM's in several locations

2) Financial stability of the bank

3) Debit cards services

4) Low interest rates on loans

5) Staff confidentiality and trust

On the other hand, the least important five factors determining bank selection were found to be:

1) Convenient location of the main branch of the bank

2) Opportunity of telephone banking

3) Availability of parking space near the banks facilities

4) Career development programs

5) Free gifts for customers

From Tables 2 it can be concluded that customers seem to prefer dealing with their banks through automated teller machines (ATM). For this reason the factor "Availability of ATM's in several locations" was among the most important determinant selection factors for respondents. This indicates that, in their bank selection, the new generation of customers tends to put more importance on the factors which give them fast and suitable access to the bank services, rather than factors related to availability of parking space near the banks facilities, career development programs and free gifts for customers. This can be viewed in Tables2 where factors such as ``convenient location of the main branch of the bank '', ``opportunity of telephone banking'', "availability of parking space near the banks facilities", "career development programs" and "free gifts for customers" scored low.

As we mention before, in the second section of the questionnaire respondents were asked to list five most important and five least important items in the based on their opinion and experience with customers. In the tables 3,4,5,6 and 7 we can see how banks employees ranked factors in regard to its importance.

Five most important factors	Five least important factors
1. Financial stability of the bank	1. Free gifts for customers
2. Professionalism and credibility of staff	2. Career development programs
3. Ease of opening a current account	3. Opportunity of telephone banking
4. Loans easily obtained	4. Availability of parking space near the banks facilities
5. Low interest rates on loans	5. External appearance of bank

Table 3. The five most/least important factors in determining bank selection provided by Raiffeisen Bank employees

When we talk about factors that are highly influence bank selection according to Raiffeisen Bank employees' opinion and their experience with customer we can see that "financial stability of the bank" is crucial. The reason for this is that customers want to be sure that their money is safe and that they can trust and stay loyal to the bank that they have selected. Since Raiffeisen Bank is the bank with highest market share in BiH it means that this bank has a lot of customers that are searching for different services. Sometimes happened that banks branches are really crowded and delays in providing services to its customers are possible so factors such as "professionalism and credibility of staff", "ease of opening a current account", and " loans easily obtained" are highly important. On the other hand Raiffeisen Bank employees think that factors such as "free gifts for customers", "career development programs", "opportunity of telephone banking", "availability of parking space near the banks facilities", as well as "external appearance of bank" are not so important in selecting the bank because these factors do not influence life circumstances so much.

Five most important factors	Five least important factors
1. Variety of services offered	1. Convenient bank location
2. Low interest rates on (loans) financing	2. free gifts for customers
3. Professionalism and credibility of staff	3. Career development programs
4. Satisfaction of time waiting for service	4. External appearance of bank
5. Low service charges	5. Available public transport nearby

Table 4. The five most/least important factors in determining bank selection provided by BBI Bank employees

Based on second part of the survey completed by BBI bank employees and according to interview organized with them we can see that one of the most important factors which highly influence bank selection is "variety of services offered". Since this is the only one Islamic bank in BiH and majority of its customers are Muslims "variety of services offered" is extremely important. Also "low service charges", "low interest rates on loans", "professionalism and credibility of staff", together with "satisfaction of time waiting for service" were ranked as five most important factors that are influencing bank selection. In contrast, "convenient bank location", "free gifts for customers", "career development programs", "external appearance of bank" as well as "available public transport nearby" were factors that were ranked with low level of importance in bank selection.

Five most important factors	Five least important factors
1. Bank's reputation	1. Convenient bank location
2. Low interest rates on loans	2. Low service charges
3. Personal security of customer	3. free gifts for customers
4. Financial stability of the bank	4. Sufficient number of cashiers
5. Knowledge and skills of staff	5. Foreign exchange

Table 5. The five most/least important factors in determining bank selection provided by ProCredit Bank employees

Consistent with findings taken from second part of the survey fulfilled by ProCredit Bank employees we found out that five most important factors influencing bank skeleton are:

1. Bank's reputation

2. Low interest rates on loans

3. Personal security of customer

4. Financial stability of the bank

5. Knowledge and skills of staff

On the other hand five least important factors influencing bank skeleton are:

1. Convenient bank location

2. Low service charges

3. Free gifts for customers

4. Sufficient number of cashiers

5. Foreign exchange

Five most important factors	Five least important factors
1. Ease of opening a current account	1. convenient location of the main branch of the bank
2. Availability of ATM's in several locations	2. Available public transport nearby
3. Availability of debit cards	3. Possibility of partial or total early loan repayment anytime you want
4. Low interest rates on loans	4. Reception at the bank
5. Speed of service from the cashiers	5. Ease of access to senior bank personnel for consultation/advice

Table 6. The five most/least important factors in determining bank selection provided by Turkish Ziraat Bank employees

When we talk about findings from Turkish Ziraat Bank employees interviews and filled survey we can see that factors that are the most important in selecting the bank are:

1. Ease of opening a current account

2. Availability of ATM's in several locations

3. Availability of debit cards

4. Low interest rates on loans

5. Speed of service from the cashiers

Reason for this is that majority of the their customers want quick service, they are just tired of BiH bureaucratic system and "Speed of service" , "ease of opening a current account" as well as "availability of ATM's in several locations will keep customer loyal to the bank. On the other hand five least important factors according to Turkish Ziraat Bank employees' opinion and their experience with customers are:

1. Convenient location of the main branch of the bank

2. Available public transport nearby

3. Possibility of partial or total early loan repayment anytime you want

4. Reception at the bank

5. Ease of access to senior bank personnel for consultation/advice

We can see that according to interview customers do not pay much attention on these factors in selecting the bank. For example factor "Ease of access to senior bank personnel for consultation/advice" does not

influence bank selection because customer would need consultation from senior bank personnel only in case of some problems which is not happening that frequent. "Possibility of partial or total early loan repayment anytime you want" is something that already is the practice of all banks and again customers are familiar with it so it will not affect bank selection. And finally "available public transport nearby" and "Convenient location of the main branch of the bank" were the factors that were ranked as low important in bank selection.

Five most important factors	Five least important factors
1. Availability of ATM's in several locations	1. Availability of parking space near the banks facilities
2. Low service charges	2. Banking by mail
3. Personal security of customer	3. Opportunity of telephone banking
4. Speed of service from the cashiers	4. free gifts for customers
5. Simpler loan procedures	5. convenient location of the main branch of the bank

Table 7. The five most/least important factors in determining bank selection provided by UniCredit Bank employees

According to our interviews with the respondents, we found out that the vast majority of customers prefer to use ATMs, not only for their speed and convenience but also for the mental structure of today's people especially young generation who have been very much involved with computer-based activities (e.g. games, Internet, e-mail, programming, etc.) Therefore, to attract new customers and to keep existing ones, banks must provide as many services as possible through their ATMs. Fallowing factors that were ranked by UniCredit bank employees as highly important were "Low service charges" and "personal security of customers" together with "speed of service from the cashiers" and "simpler loan procedures".

If we analyze the findings in terms of ranking importance of bank selection criteria factors as lass important we can see that according to bank employees their customers do not pay more attention on factors such as "availability of parking space near the banks facilities", "banking by mail", "opportunity of telephone banking", "free gifts for customers", "convenient location of the main branch of the bank" which can be seen from the Table 7.

Conclusion

For many years commercial banks in Bosnia and Herzegovina used to offer the same bank products and services to all bank customers.   The raise of competition, seems to go in front the banks to adjust their services structure in order to "determine the bank customer".   As the banking institutions are now attempting to make different themselves from each other, a new era has arrived which would be proven crucial not only for the institutions' market success but for their definite survival. Bank managers are now required to implement the bank marketing philosophy, aiming at identifying and satisfying the particular needs of bank customers.

This study can help bank decision makers to recognize the major factors that may establish bank selection decisions among customers. Such information should help the management of commercial banks in devising proper marketing strategies for reaching and attracting new customers.

Overall the findings of this study are quite similar to findings in previous work in same area. Findings from this study reveal that based on bank employees experience with customers, they place more emphasis on factors like "availability of ATM's in several locations", "financial stability of the bank", "debit cards services" , " low interest rates on loans", "staff confidentiality and trust". Therefore, such factors should be considered seriously by the commercial banks in designing their marketing strategies.

Recommendations

The study reveals that technology plays an important role in the selection of banks. In today's environment, customers require more and more personalized and value added services like ATM. From Tables 2 it can be concluded that the factor "availability of ATM's in several locations" was among the most important determinant selection factors for respondents. This indicates that, in their bank selection, the new generation of customers tends to put more importance on the factors which give them fast and suitable access to the bank services. Such information should help the management of commercial banks in devising appropriate marketing strategies for reaching and attracting customers.

"Financial stability of the bank" together with "staff confidentiality and trust" are the factors which were highly important for customers in selecting their bank. The reason for this is that customers want to be sure that their money is safe and that they can trust and stay loyal to the bank that they have selected. In order to make their customers aware that bank that they selected has financial stability and confidential and trustable staff, promotional programs should be focus on these two factors.

Findings from the survey also indicate that customers place more emphasis on factors like "debit cards services" and "low interest rates on loans". Therefore, such factors should be considered seriously by the commercial banks in designing their marketing strategies. In many countries, the use of debit cards has become so widespread that their volume has overtaken or entirely replaced check and, in some instances, cash transactions. In order to offer low interest rates on loans banks may cut deep into its profit margins. But then they should find a way to offset the low margins. They may do it by having a larger number of customers. A bank with a low interest rate may have many ATM machines and branches in convenient locations; it may have better phone customer service; and its online banking system may have many powerful features. Al of these recommendations may be taken into consideration if bank managers decide to offer low interest rates.

Since the findings of this study are based on bank employees' (service providers') perceptions only, investigating the correspondence between consumers' and service providers' perceptions could be a significant research area among concerned potential researchers. This will help the industry to better understand whether both customers and banks have the same perceptions regarding issues relevant to bank selection criteria.

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SHADOW ECONOMY OF MACEDONIA

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Abstract

Measurement and assessment of the shadow economy is an area of research which is always challenging and surrounded with debate and ambiguity. In this research we use the indirect method used by Kaufman and Kaliberda like the Electricity Consumption Method (ECM) as well as the Multiple Indicators Multiple Causes (MIMIC) approach which is structural modeling using the shadow economy as a latent variable considering several causes and indicators of the SE. The ECM results of SE estimates are discussed within the framework of the possible causes of the SE like: tax and social contributions, social transfers paid by the Government of Macedonia (GoM), regulatory intensity, corruption level, global economic crisis. We also give raw estimates of the shadow employment rate. Next, we discuss the structure of the shadow economy by industries in accordance with the ECM method and we once again discuss the informal economy estimates of CEA done in 2009. The estimates of the SE by the State statistical office in Macedonia are also presented. We finish with the MIMIC estimates and give comparative illustration of all known to us estimates of SE in Macedonia so far.

Keywords: Shadow economy, structural modeling of economy, stationarity of time series, Engle-Granger two step approach, co-integration approach, Augmented Dickey-Fuller statistical test, Philips-Peron statistical test.

Introduction

Measurement and assessment of the shadow economy is an area of research which is always challenging and surrounded with debate and ambiguity. The fact that the shadow economy (SE) by definition captures the activities which are "hidden" and on purpose unexposed to the authorities makes the data directly unavailable.

The shadow economy activities are a fact of life and everyone (more or less) has been in direct contact with shadow economy activities. Most of the countries make attempts in establishing effective shadow economy control mechanisms such as: various policies, system of punishments, incentives for economic growth, awareness rising, tax system reforms, social security system reforms, etc.

The effectiveness of the measures taken against the shadow economy activities are highly dependent on the effective gathering of relevant statistical data on the magnitude of the SE, the frequency of the non-observed economy activities, the sectors where these occur and similar. However, the individuals engaged in the SE activity do not want to be exposed and thus, the collection of accurate data on the magnitude and the size of the SE is difficult to be collected.

All of the attempts for estimation and calculation of the magnitude of the shadow economy within the overall official economy are a challenge and an attempt to estimate the "unknown". There are many variations and controversies starting from the definition of the term "shadow economy" up to the most adequate method for estimation of the size of the SE and its growth rate.

In the next chapters we define the shadow economy and discuss the causes and consequences of the shadow economy. Further we discuss the methods for measuring the size of the SE. In this research we use the indirect method used by Kaufman and Kaliberda like the Electricity Consumption Method (ECM) as well as the Multiple Indicators Multiple Causes (MIMIC) approach which is structural modeling using the shadow economy as a latent variable considering several causes and indicators of the SE. The ECM results of SE estimates are discussed within the framework of the possible causes of the SE like: tax and social contributions, social transfers paid by the Government of Macedonia (GoM), regulatory intensity, corruption level, global economic crisis. We also give raw estimates of the shadow employment rate. Next, we discuss the structure of the shadow economy by industries in accordance with the ECM method and we once again discuss the informal economy estimates of CEA done in 2009. The estimates of the SE by the State statistical office in Macedonia are also presented. We finish with the MIMIC estimates and give comparative illustration of all known to us estimates of SE in Macedonia so far.

Definition of shadow economy

Prior the attempt to measure the size of the shadow economy in Macedonia, it is necessary to define what shadow economy is. Despite the numerous researches done in the area of shadow economy there is no single definition of what shadow economy is.

According to the OECD handbook for "Measuring the Non-Observed Economy"[1] (2002) *"the groups of activities most likely to be non-observed are those that are underground, illegal, informal sector, or undertaken by households for their own final use"* together with the deficiencies of data collection *"are collectively said to comprise the non-observed economy (NOE)".* According to the same source, the non-observed economy is occurring due to seven reasons, categorized into three main areas: (i) underground production, (ii) informal production and (iii) illegal production. The *underground* production is an area where the activities are not recorded due to economic reasons such as tax avoidance, avoidance of social contributions, wages, work hours etc., and statistical reasons for not recording activity due to lack of responsiveness, not updated data and difficulty of the statistical system to capture the changes especially in small sized production activities. The *informal* production refers to data missing due to lack of registration which is usually not legally required such as craftsmanship, farmers, home workers, etc. The *illegal* production refers to activities involving production, sales and distribution of products/services which are legally prohibited.

Others (Startienė and Trimonis 2010)[2] define the non-observed economy as "*the secondary market with trade deals that would be possible in official economy but were taxed or would not be possible at all because of law*".

The shadow economy usually considers the T4, T5 and T6 which is solely the economic part of the non-observed economy (see Figure 1).

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1) http://epp.eurostat.ec.europa.eu/portal/page/portal/national_accounts/documents/OECD_non-observed_economy_2002.pdf

2) http://www.businessjournalz.org/articlepdf/BMR_1205.pdf

Figure 1 ISTAT framework for NOE
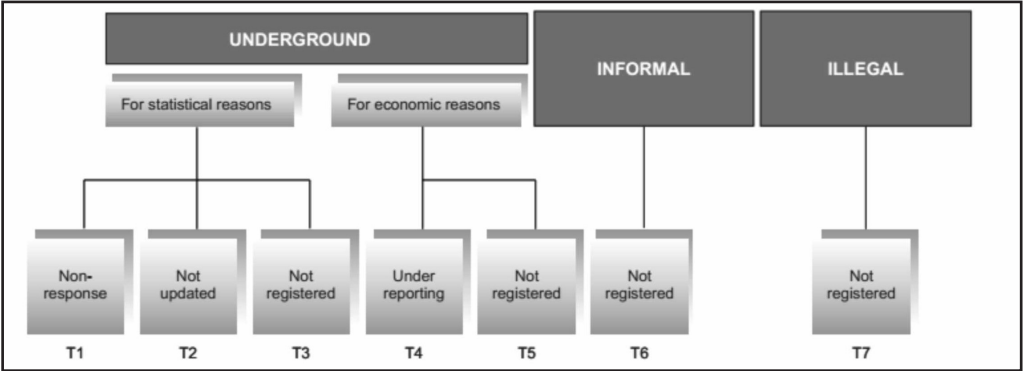
Source: OECD (2002)

Since in the literature there is an overabundance of names suggestive of different situations of this category of economy called unofficial, shadow, black, grey, hidden, unobserved and irregular economy (Alderslade, Talmage and Freeman, 2006) informal, parallel, illegal, subterraneous, etc. this paper would employ shadow economy (SE) as a standard term.[3]

Cause and consequence of shadow economy

Size, causes and consequences of the shadow economy (SE) are different in each country. The causes of the shadow economy are an unexhausted topic for many authors. According to Tanzi (2002) there are four major causes of shadow economy: (1) taxes; (2) regulations; (3) prohibitions; and (4) corruption.

The inexistence of taxes will mean no shadow economy activities which are avoiding taxes. However, in a developed world with developed tax systems and heavy taxes it is expected that the activities for avoidance of tax payment and the shadow activities are increasing.

As the tax rates and the tax levels increase the efforts of the tax payers to avoid tax payment is increasing as well through increased engagement in unreported and nonofficial activities. Schneider's study (2006) demonstrates that the rising burden of taxation (direct and indirect) is the major contributor providing the strongest incentive for the increase of shadow economy. Most often the avoided taxes which are connected with shadow activities are the income taxes, VAT, excise, social security, foreign trade, etc. The level of the tax avoidance and the increase of shadow economy due to tax avoidance are affected by the efficiency of the tax administration and the cost of compliance with tax policies.

The **regulation** level is also proportional with the increase of the shadow economy activities. The countries with a high regulation level are expected to create incentives and pressure for the companies to engage in shadow economy activities. As the businesses face expensive demand from the government bureaucracy or suffer in this hostile environment (Friedman, Johnson, Kaufman and Zoido-Lobatón, 2000) the motivation for shadow economy activities is increasing.

The level of **prohibition** of certain activities in various countries is different, thus the inclusion of these activities in the shadow economy is quite controversial. The **corruption** level is another controversial aspect of whether it should be considered as part of the shadow economy, as it can ultimately potentially distort the market prices.

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3) ibid

Other authors (Marinov, 2008) argue that, besides the tax and regulation issues, the shadow economy is influenced by other socio-economic factors such as: market tradition disappointment of government; limited and low quality of public sector services; corrupted, slow, and closed legislative system; deficiency of administrative capacity and competence of the governments; low tax morality.[4]

According to Chye (2011) all of the causes can be structured in several factors that contribute to SE: (1) Government through low bureaucracy efficiency, low trust level and transparency, unsatisfactory quality of public sector service, and corruption level; (2) Regulation through intensity, slow and closed legislative system, equality under the law and labor market regulation; (3) Taxation through high tax burden and social insurance contribution and tax morale; (4) Economy through recession, unemployment, high public debt and inadequate and slow economy growths; (5) Social ethos through the break in market tradition and culture, public attitude, bribery, urbanization and growth in self-employment.

According to a research on flat taxation effects in Macedonia (CEA, 2008) main reasons for tax evasion of the companies which are directly affecting the shadow economy include excessive tax burden, poor quality of the public services, weak capacity of the Public Revenue Office, politically privileged companies and high labor costs.

The shadow economy within an economy can have significant negative effects including inequality and unfairness of the economic system, as there are individuals who procure the same goods cheaper by not paying taxes and other who pay more expensive goods with taxes included. The same is concerning the sellers of the goods who are either paying (operating in official economy) or not paying taxes (operating in SE). The ultimate negative effect of a serious sized SE can be a competition distortion.

Another consequence of a significant shadow economy is the need for increased taxes for the government to provide the public services. Since only the official economy actors are meeting their obligations and yet both groups (participants within the official and unofficial economy) are using the services, the government may be forced to raise the taxes which have a negative effect on the official economy players through imposing even higher taxes. The reduced public revenues on the other hand mean reduced ability or quality of provision of public goods and service which ultimately will lead more economic actors into the shadow economy.

The existence of shadow economy logically means that the statistical measurement of the main economic indicators which are the basis of creation of the economic policy are distorted which leads to inadequate economic policies. Such policies of harsh taxation and regulatory regimes appear to drive economic agents from the official sector into the unregulated shadow economy (Loyanza, 1998).[5]

Disincentive for foreign investment is another negative consequence of the shadow economy. As the foreign investments are often more regulated, the products of the foreign investments can potentially be uncompetitive in comparison with the domestic competitors who are operating in the shadow economy.

On the other hand, the shadow economy is tolerated for certain reasons. Since the shadow economy is a cash economy it affects the liquidity and as a result, it encourages economic activities and employs people. This is especially a case when the economies are in a transition period since in a period with high unemployment it engages people and solves politically sensitive issues.

Methods for measuring the size of shadow economy

As mentioned before the shadow economy by its nature is "impossible" to be measured with certainty, however there are numerous methods developed for estimating the size of the shadow economy. Commonly, the

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4) It refers to the willingness of individual to pay the right tax at the right time (Maurin, Sookram and Watson, 2003) A declining tax morality tends to increase the size of shadow economy (Torgler, Schneider and Schalteggar, 2009).

5) http://166.111.106.206/bxj/courses/intensive-english-3/sup/Shadow%20Economy.pdf

methods are classified in three groups (i) *Direct methods* which are based on direct data collected through surveys, observations and interviews with economic operators (ii) *Indirect methods* which are endeavoring into determining the extent of the shadow economy by measuring "indicators" of macroeconomic data such as the cash-deposit ratio approach, physical input, etc., and (iii) *Model approach* based on the statistical theory of latent variables, which considers several causes and several indicators of the shadow economy.[6]

The *direct method* approach is not commonly used because its outcome and reliability highly depends on the willingness of the interviewees to reveal truthful answers, as well as the structure and form of the questionnaire. Thus, there are serious difficulties with estimating the actual size of the shadow economy with this approach.

The *indirect method* is estimating the size of the shadow economy based on measuring the differences between national expenditures and revenues, an assessment of the labor market analyzing the differences among the officially registered employment, the unemployment rate and the number of people who are actually employed within the economy.[7] The indirect method with currency demand approach[8] is used in the estimation of the shadow economy in OECD countries (Schneider, Johnson, and Kaufman, 1998). Another indirect method used by Kaufman and Kaliberda is the electricity consumption method[9] which will be the focus of this paper as well as the multiple indicators multiple causes (MIMIC) approach which is *structural modeling* using the shadow economy as a latent variable considering several causes and indicators of the SE.

The objective of the analysis in this paper is to make an attempt to estimate the portion of the shadow economy and its structure. The analysis will also make an attempt to identify the incentives for development and the effect on the economic growth and the competitiveness of the economy. In this research the shadow economy is measured both by the energy consumption method (ECM) and the multiple indicators multiple causes (MIMIC) model.

Electricity Consumption Method: An attempt to estimate the shadow economy in Macedonia

The basic justification of the Electricity Consumption method (ECM) for measuring the size of the shadow economy, is that the electricity consumption in a country is proportional to total economic activity of the country and the changes in electricity consumption which do not correspond to changes in the total activity of the country signifies a proportional change in the size of the shadow economy within the total economic activity.

The electricity consumption is regarded as the single best physical indicator of overall (both official and unofficial) economic activity moving in sync with GDP with elasticity close to one. This means, that the growth of total electricity consumption is an indicator for growth of overall (official and unofficial) GDP.

The expected results are indicators of changes in the shadow economy over the time period analyzed, however without an absolute size of the shadow economy. In order to determine an absolute size of the shadow economy there is a need for a base estimate of the size of the shadow economy in a base year. This estimate is random and depends on other research i.e. attempts for estimation of SE.

This method is used by Kaufmann and Kaliberda (1996) where with replacement (base) measurement an estimate of unofficial GDP can be derived. This is a simple method and appealing however, it is also criticized as: (i) not all shadow economy activities require a considerable amount of electricity and other energy sources can be used (gas, oil, coal, etc.) thus only a part of the shadow economy will be captured. (ii) the technical progress resulted with higher production and electricity efficiency compared to the past concerning both the official and the unofficial/shadow activity usage.[10]

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6) ftp://ftp.econ.au.dk/afn/wp/03/wp03_07.pdf

7) See Friedrich Schneider and Dominic Este, "Shadow Economies Around the World- Size, Causes, and Consequences, Max-Planck-Institute for Research into Economic Systems, 1999.

8) The currency demand approach has been used by Cagan (1958) and further developed by Vito Tanzi (1980-1983).

9) See: Kaufman and Kaliberda, The Underground Economy in Poland.

10) http://ftp.iza.org/dp2315.pdf

In the following text attempt will be made for implementation of the Kaufmann and Kaliberda electricity consumption to be used for estimation of the size of shadow economy in R. Macedonia in the period between 2000 and 2010.

Formula used

$$S_t = S_{t-1} \left(1 + \frac{1}{\mu} gE_t - gY_t \right) = S_0 \prod_{i=1} * \left(1 + \frac{1}{\mu} gE_i - gY_i \right)$$

Where:

St is the shadow economy in year t

So is the output in the shadow economy in base year

gEi is the annual growth rate of electricity power consumption

gYi is the annual growth rate of GDP

μ is the output elasticity of electricity consumption

The size of the shadow economy is derived as a difference between estimates for overall and official economic activities. In order to estimate the shadow economy the data for real GDP and the electricity consumption is collected. The base year for this estimation is 2000. The baseline year proxy for SE as percentage of GDP are former empirical estimate of Schneider[11] estimating the SE in Macedonia in 2000 of 34,1% of the GDP.

In accordance with other research so far the elasticity of GDP and electricity consumption is taken as 1.

Using the Kaufmann and Kaliberda electricity consumption method for Macedonia in the period between 2000 and 2010, the output indicates that the shadow economy trend in the last decade in Macedonia is decreasing.

Table 1 Estimation of the SE using ECM*

|		Estimation of SE using the total electricity consumption method										
		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP	in milion MKD	236.389	233.841	243.970	258.369	272.461	295.052	320.058	364.989	411.728	410.734	424.762
EC	GWh	5.207	5.018	4.973	5.698	5.764	6.227	6.440	6.747	6.897	6.392	6.782
SE%	% of GDP	34,10%	33,23%	31,49%	34,22%	32,75%	32,67%	31,02%	28,14%	25,16%	23,38%	24,01%
St	SE	80.609	77.701	76.833	88.423	89.241	96.399	99.275	102.719	103.609	96.049	101.986
TA	estimated total actitity (GDP+SE)	316.998	311.542	320.803	346.792	361.702	391.451	419.333	467.708	515.337	506.783	526.748

Source: Authors own calculations, raw data from SSO

*Starting from 2007 the largest electricity consumers in Macedonia, started to purchase the electricity on a "free" market, with market prices which are not regulated. In this study, these are not excluded from the total electricity consumption due to (1) consistency reasons - in order to have consistent approach in calculating the SE Index for the observed period (2) more importantly due to the fact that from the data we had on dispose the consumption of the largest electricity consumers could've not be extracted from the total electricity consumption and the GDP data.

The table above presents the inputs used for calculation of the SE in Macedonia for the period between the years 2000 and 2010. As mentioned, the SE estimate through the electricity consumption method relies on an already calculated value of SE in a base year which in our case is year 2000 with a SE estimated at 34,10% of GDP. Although the relative share of the shadow economy within the total economic activity are strongly dependent on the shadow economy in the base year and can be misleading, regardless of the initial base value estimate the dynamic trend of SE in GDP is not affected.

11) ibid

The general trend for the observed period shows that the SE in Macedonia as a percentage of the GDP is declining, from 34,10% in 2000 to 24,01% in 2010. Starting from 2000 until 2010 the SE is declining slowly, by one to two pp per annum in the first half and then in the second half of the period decreases with higher rate to almost three pp per annum. The 2003 SE estimates is an exception when it is increasing from 31,49% in 2002 to 34,22% in 2003. During the year (2002-2003) the annual growth rate of the EC is 14,9% which is much greater than the annual growth rate of the GDP for the same period (5,9%). According to the Kaufmann/Kaliberda method this is an indicator that the total economic activity (including the industry and the households) are using more electricity to produce goods and services that are not captured by the recorded official GDP.

Chart 1. Shadow economy Growth Trends vs. GDP and EC
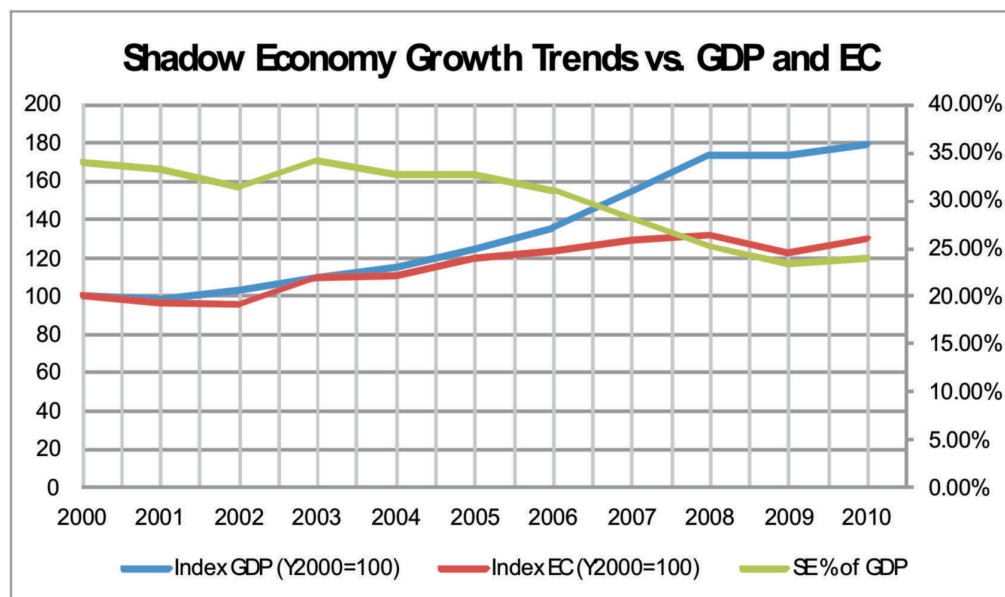
The chart presents the GDP and the EC growth through index versus the estimated/calculated SE as a percentage of GDP. From the chart we can see that the GDP has grown to 180 index points in 2010 while the growth of the EC is not as significant, growing to the 130 index points. Using the electricity consumption method for establishing the SE, we can conclude that in the observed period, higher degree of the produced goods and services with the given amount of consumed electricity energy are recorded in the official GDP, and thus declining the SE.

Table 2 Annual SE growth rate

	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
annual SE growth rate	-2,6%	-5,2%	8,7%	-4,3%	-0,3%	-5,1%	-9,3%	-10,6%	-7,1%	2,7%

As an illustration, even if the base year estimation of the SE (proxy) is altered, the annual growth rate of SE does not alter showing the trend of growth and decline of the SE which can easily be seen from the chart below which considers three arbitrary options as proxy values for 2000 SE: 20%, 34,1% and 40%.

**Chart 2 SE trough ECM with arbitrary base year values**
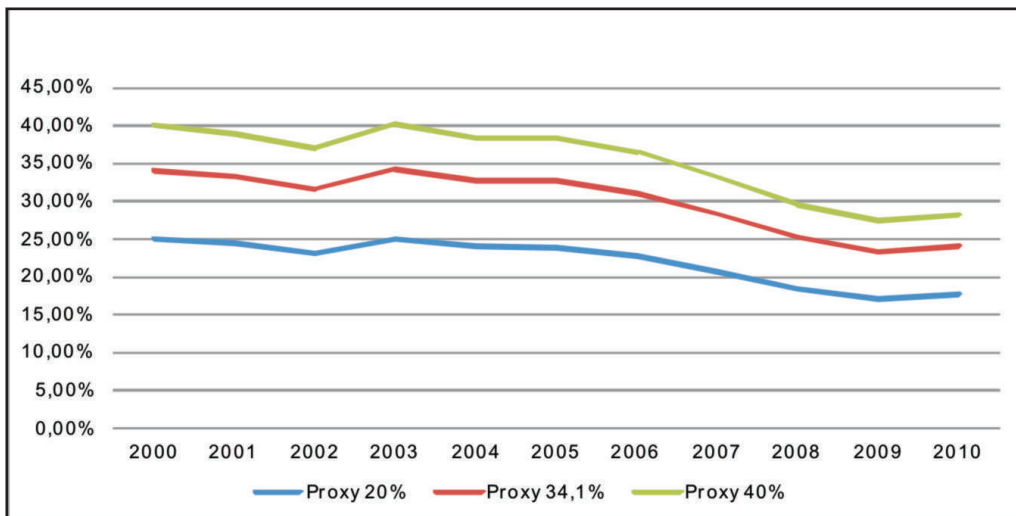
Possible causes of the SE to explain the Electricity Consumption Method's results

The following text attempts to explain the SE trend in Macedonia through discussion about the potential causes of the SE given the Tanzi (2002) taxonomy.

Tax and social contribution burdens to the business sector - The most significant downwards change in the SE movement in the observed period is in 2006/2007. In 2006 the Government of Macedonia (GoM) implemented a new model of taxation, as the previously used progressive taxation model was replaced with the flat taxation model. The progressive rates for profit tax, the personal income tax and withholding tax were replaced with one 10% tax rate, common for all taxes. At the same time, with the introduction of the flat taxation model, the tax base has increased thus making the tax evasion more difficult and creating incentives for the SE economic activities to move in the official economy.

Chart 3 Tax & Social Contribution Burden
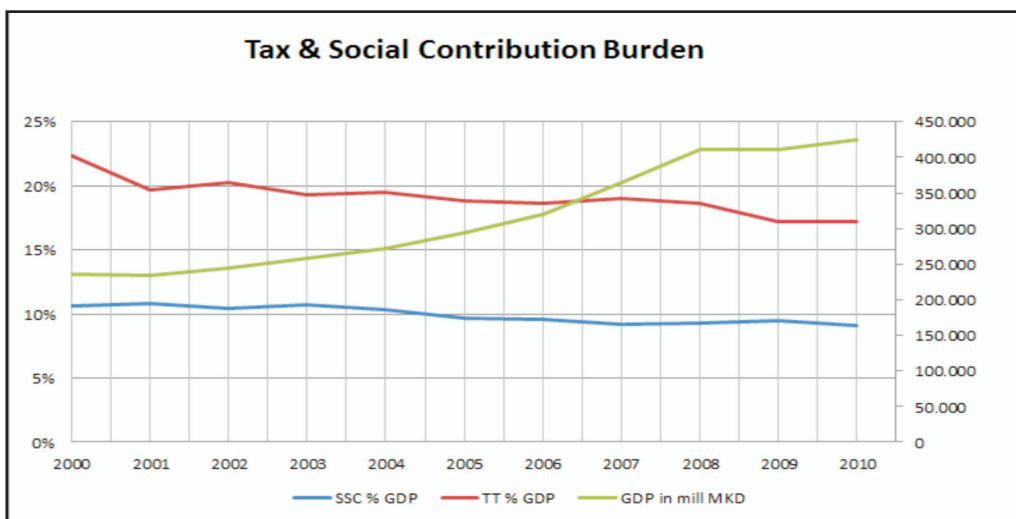
Resulting from the flat taxation model and the wider tax base, the tax revenue from 55.681 million MKD in 2005 increased to 59.575 million MKD in the 2006. In the upcoming years the growth of the tax revenue in the state budged is more rapid. Total taxes expressed as a percentage of the official GDP shows a stable increasing trend until 2009 when the GoM was forced to make adjustments to the profit tax law in order to reduce the influence of the global economy crisis. With the 2009 changes the companies are tax exempt if the profit is reinvested and profit is not distributed to the owners. This has resulted in decrease of the total taxes in the state budget; however the enforcement of the measure has been strictly implemented by the relevant institutions creating positive influence on decreasing the overall SE. In 2009, the GoM reduced the total payroll contributions from 44,9% to 33%, and changed the concept of the net salary which was used until the end of 2008, to a concept of gross salary. With this change, the possibility for tax evasion has been reduced trough new forms of control of the salary payment, and reduction of the payroll contributions and benefits. The initial 2009 plan announced within three years reduction of the payroll benefits to 22% (from the gross salary), which has been postponed indefinitely due to the global economy crises.

The effects of these measures on the SE are evidently positive, providing higher transparency and control to the Public Revenue Office. With higher control of the total number of the employed persons and decreased payroll benefits a significant number of unregistered workers gained stimulus to migrate to the official economy, thus reducing the number of workers previously contributing to the SE.

Table 3 Total Taxes and Social contribution in the period 2000-2010

| year/unit	Social transfers paid by GoM mill. MKD	SSC as % GDP	Total Taxes mill. MKD	TT as % GDP
2000	25.091	11%	52.906	22%
2001	25.363	11%	45.943	20%
2002	25.494	10%	49.447	20%
2003	27.781	11%	49.805	19%
2004	28.072	10%	53.184	20%
2005	28.595	10%	55.681	19%
2006	30.766	10%	59.575	19%
2007	33.457	9%	69.514	19%
2008	38.249	9%	76.559	19%
2009	38.837	9%	70.754	17%
2010	38.687	9%	72.938	17%

Social transfers by the GoM – The increasing of social transfers paid by the business and paid by the government have an opposite effect on the SE. When social contributions paid by the business are increasing, the SE is increasing, and when the social transfers paid by the Government are increasing the SE is increasing as well.

In Macedonia although there have been significant structural reforms in the financial sector and the trade regime, the track record in enterprise reform was weak. As most of the socially owned enterprises have been sold to insiders rather than to strategic investors some of the results are poor company performance and no job creation thus, many of the unemployed participate in the SE employment due to lack of job creation. The number of registered unemployed actually working is registered as such to take advantage of social, health, and unemployment insurance benefits which overestimates the overall unemployment rate.

In the period observed, the total social transfers paid by the GoM as a percentage of GDP, are decreasing (see table 3). In 2000 the total social transfers paid by the government participated with 11% in the GDP and in 2010 with 9% in the GDP, however in absolute numbers the total amount of paid social transfers are increasing until 2008, when they remain steady at 38 million MKD. Analyzing the movements of the SE, in this particular period, the index of SE is decreasing from 28,14% in 2007 to 24,01 in 2010, thus confirming the previously expressed thesis that if the social transfers paid by the Government is decreasing (or stable) the SE is also decreasing. The reason for such dynamics can be explained by the efforts of the Ministry of Labor and Social Policy of "cleaning up" the registry of unemployed and socially deprived as a measure for the unemployed to confirm their status and incomes. This dissimulates the part of the registered unemployed people (who are working in the SE and receiving social transfers from the GoM) to undertake preregistration thus decreasing the total unemployment and the SE.

Regulation intensity - It has been accepted that high level of government bureaucracy and regulation creates hostile business environment (Friedman, Johnson, Kaufman and Zoido-Lobatón, 2000) creating incentives for unofficial economy operations. In order to have an indicator for the regulation level in Macedonia the business freedom index[12] (Heritage International) will be considered. According to the source, the Business Freedom Index[9] (based on the WB Doing Business Study) is a quantitative measure of the ability to start, operate, and close a business that represents the overall burden of regulation as well as the efficiency of government in the regulatory process. Since score of 100 indicates the freest business environment (based on the weighted factors for the time and procedures for starting a business, time, cost and procedures for obtaining licenses and closing the business) the chart indicated that there is notable increase of the business freedom in the period under observation (55 points in 2002 to 65 in 2008 and 80,9 in 2012) situating Macedonia in the category of "moderately free" countries, most of the years below the world average (except 2008 and 2012). If we consider the identified most problematic factors for doing business (as identified by the WB Doing Business Study) and compare these in the last five years still these are the areas of corruption, access to finance, inefficient bureaucracy, policy instability, poor work ethic in national labor force, etc. The significant improvement of the regulation level results from the "regulation guillotine" project for reduction of bureaucracy and regulation burden initiated in 2006 as well as with the progress by reforming the Central Registry.

Chart 4 Business freedom index

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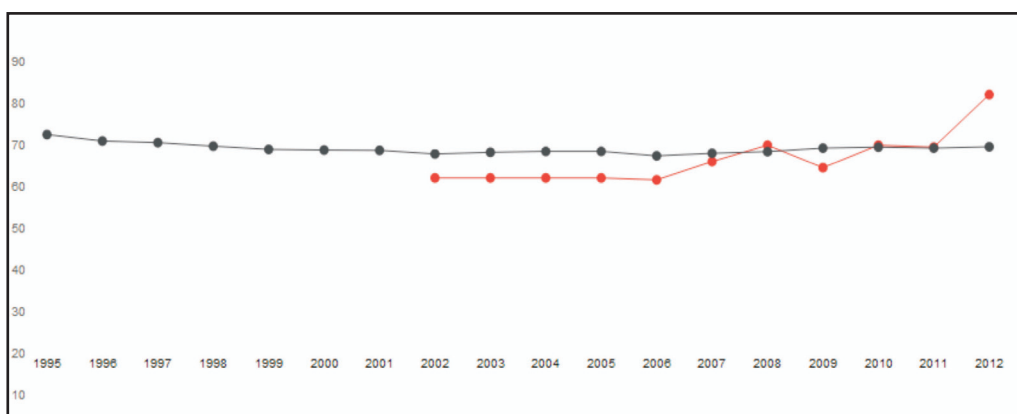
12) The business freedom score for each country is a number between 0 and 100, with 100 equaling the freest business environment. The score is based on ten factors, all weighted equally, using data from the World Bank's Doing Business study (Methodology for the 10 Economic Freedoms)

13) Part of the Economic Freedom Index, Heritage International

The WB Worldwide Governance Indicators among which is the Regulatory Quality reflecting the perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development ranks Macedonia higher in the period following 2006 and the estimate from weak increases to positive stronger values.

Figure 2.

Regulatory Quality – Worldwide Governance Indicator

Regulatory Quality (WGI)

Rank (ranges from 0 (lowest) to 100 (highest) rank)
Estimate (-2,5 weak to 2,5 strong)
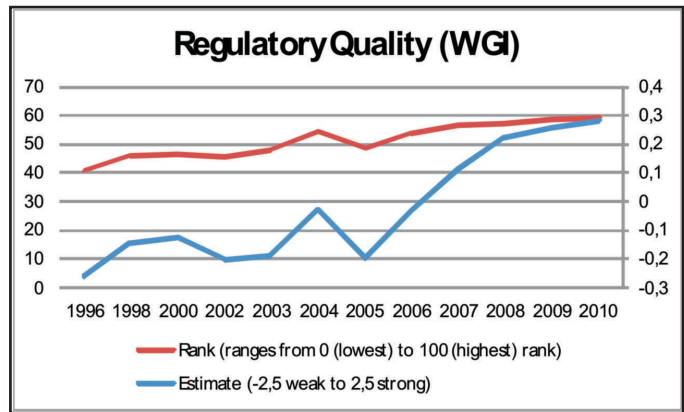
Source: World Bank Worldwide Governance Indicators

The Corruption Level within a country is another factor that boosts the shadow economy activities. In order to determine the level of corruption in Macedonia the Freedom from Corruption Index by Heritage will be considered, as one of the ten economic freedoms (which is based on the Transparency International's Corruption Perceptions Index (CPI)[14]) as a factor which erodes economic freedom by introducing insecurity and uncertainty into economic relationships. According to the index, the corruption level is stable in the period 2002-2004 than increasing and stabilizing until 2008 when it starts decreasing again in 2009 and onwards exceeding the world average (higher index indicates higher freedom from corruption). This trend is generally proportional with the decreasing trend of the shadow economy.

Chart 5. Freedom from corruption index
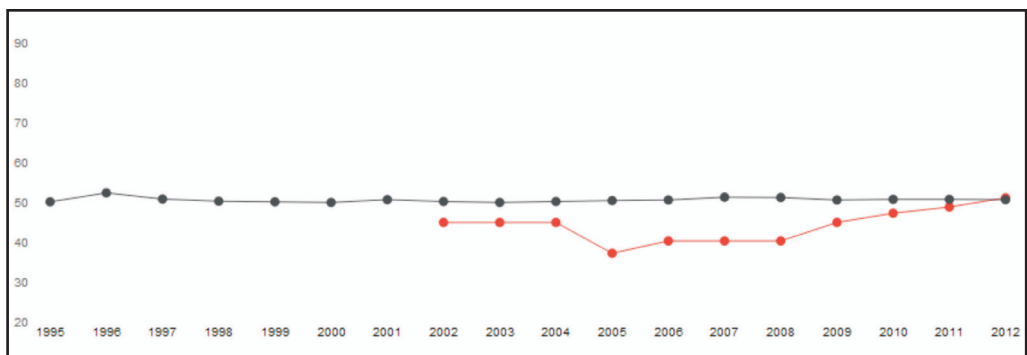
The WB Worldwide Governance Indicators covering Rule of Law reflecting perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence, and Control

14) The CPI is based on a 10-point scale in which a score of 10 indicates very little corruption and a score of 0 indicates a very corrupt government. In scoring freedom from corruption, the Index converts the raw CPI data to a scale of 0 to 100 by multiplying the CPI score by 10.

of Corruption (reflecting perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption), as well as "capture" of the state by elites and private interests grades and ranks Macedonia significantly low and with ups and downs without significant improvement in the last decade on "Rule of Law" indicator and more significant improvement in the "Control of corruption" indicator especially in the period after 2003.

Figure 3

Rule of Law - Worldwide Governance Indicator

Source: World Bank Worldwide Governance Indicators

Rule of Law (WGI)

Rank (ranges from 0 (lowest) to 100 (highest) rank)
Estimate (-2,5 weak to 2,5 strong)
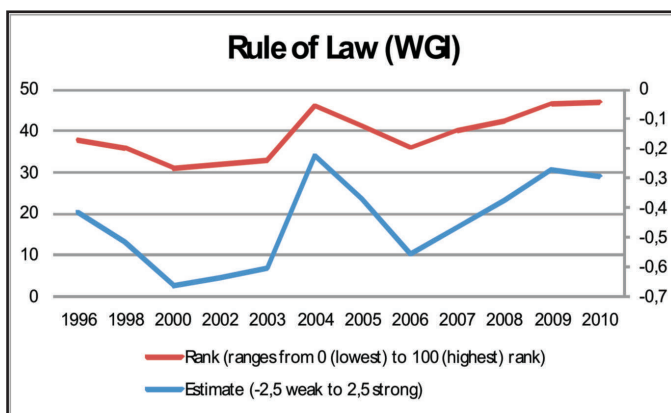
Figure 4

Control of Corruption - Worldwide Governance Indicator

Source: World Bank Worldwide Governance Indicators

Control of Corruption (WGI)

Rank (ranges from 0 (lowest) to 100 (highest) rank)
Estimate (-2,5 weak to 2,5 strong)
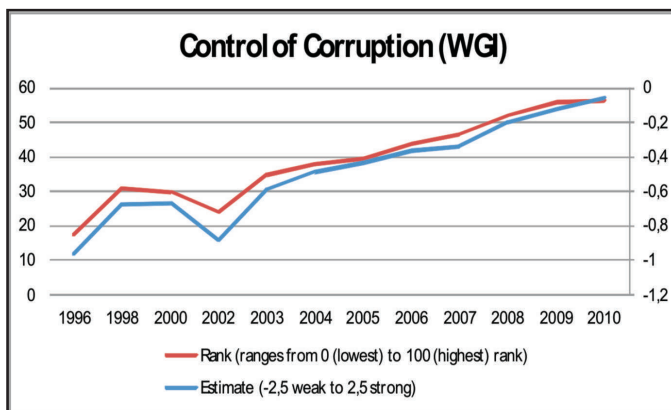
Raw estimates of the shadow employment rate

Macedonia is a country with a very high unemployment rate which can be related to the jobless economic growth. The unemployment rate in 2000 and 2010 was 32%. Meanwhile, the unemployment rate was growing and declining. Comparing 2000 and 2001 the unemployment rate declines by 1% points which can be attributed to the those people who were engaged by the GoM due to the crises in 2001 after which were dismissed, thus making pressure to the unemployment rate in the upcoming years[15]. The official unemployment rate is highest in the period of 2003, 2004 and 2005 established at 37% of the total active population. In the following years, the unemployment rate has been slightly lower decreasing to 32% in 2010. The decrease in 2006 can be explained with the tax relief created with the flat taxation encouraging the businesses to register a significant number of their workers, who have been officially unemployed.

[15] Report on the labor market in Macedonia, CEA, 2005

In the period following 2006 other measures for unemployment reduction have been undertaken. One of which still ongoing, is stimulation of self-employment which has significantly increased, as the number of self-employed from 53.508, in 2005 has increased to 91.095 in 2010.

In line with the above presented, an attempt for estimating the shadow employment will be made based on a simple approximation using the already calculated SE rate as percentage of the GDP using the ECM. If we assume that the unofficial economic output and the unofficial employment have the same percentage share in the economy we can estimate the unemployment rate i.e. the number of individuals who are working, however are officially registered as unemployed. The estimates are indicting lower unemployment rate by 7pp to 13pp compared to the official rate, depending on the year. For instance in 2010 the recalculated unemployment rate is 24% compared to the official 31% by reducing the total number of official unemployed by almost 71.000 officially unemployed. However, this is a simplified estimate and should be considered with caution.

Table 4 Estimated unemployment rate

Year	SE % of GDP	Number of unemployed (LFS)	Unofficial employment	Overall estimated unemployment rate	Official unemployment rate
2000	34,1%	261.711	89.243	21%	32%
2001	33,2%	263.196	87.455	20%	31%
2002	31,5%	263.483	82.978	22%	32%
2003	34,2%	315.868	108.101	24%	37%
2004	32,8%	305.899	100.193	26%	38%
2005	32,7%	320.136	104.594	25%	37%
2006	31,0%	324.766	100.735	25%	36%
2007	28,1%	316.247	89.001	25%	35%
2008	25,2%	306.006	77.004	25%	33%
2009	23,4%	298.814	69.877	25%	32%
2010	24,0%	295.371	70.919	24%	31%

Chart 6

Official vs. Shadow unemployment rate

Official vs Shadow unemployment rate
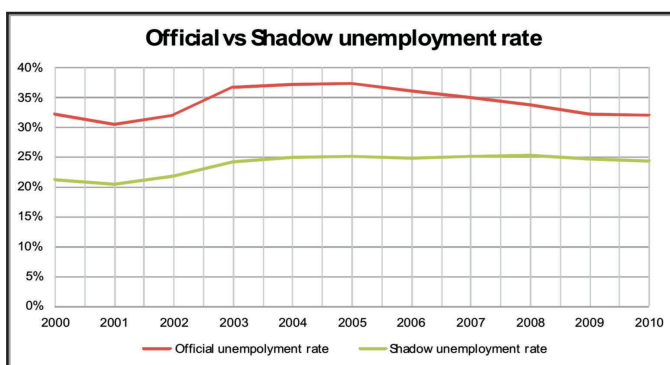
The impact of the Global Economic Crisis

In the end of 2007 beginning of 2008 the world financial markets crashed due to the American mortgage crisis. After a short period of time the crisis spread globally. If we compare the 2010 to 2009 estimates of SE in Macedonia, it increased from 23,38% to 24,01%. This confirms the assumption that during a period of an economic crisis the businesses and the people have incentives for migrating from the official to the shadow

economy in order to sustain their incomes creating pressure on the unemployment rate and to the SE as whole.

Structure of the shadow economy in accordance with the ECM method

The estimation of the shadow economy with the ECM can be brought to a sector level where the distribution of the SE can be observed. The following section considers only the two sectors (1) *industry* (covering steel & iron, non-ferrous metal, chemical, building material, ore-extraction, food and beverage, textile, paper and printing, engineering, other industries) and (2) *all other* (covering transport, households, agriculture and other sectors). We consider that the data for the "other" sectors are more reliable on an aggregated level and not on disaggregated levels as the electricity consumption for example in agriculture can often be intermingled and combined with households due to the registration form. Most of the agriculture producers are small privately owned farm households and the electricity are not adequately counted for the sector while their electricity consumption is counted as household consumption. The same logic goes for the micro sized service sector businesses.

Table 5 ECM method SE as % of GDP

ECM method SE as % of GDP										
Sector	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
(1) Industry	34,1%	34,2%	28,7%	39,5%	40,7%	43,0%	41,8%	37,1%	32,8%	23,9%
(2) Other	34,1%	32,7%	32,5%	30,9%	28,4%	27,6%	25,9%	23,7%	21,3%	22,2%
Total	34,1%	33,2%	31,5%	34,2%	32,8%	32,7%	31,0%	28,1%	25,2%	23,4%

Table 6 ECM method Annual Growth Rate of SE

ECM method Annual Growth Rate of SE									
Sector	2000/2001	2001/2002	2002/2003	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009
(1) Industry	0,3%	-16,1%	37,5%	3,2%	5,6%	-2,9%	-11,2%	-11,5%	-27,1%
(2) Other	-4,2%	-0,5%	-4,9%	-8,0%	-2,9%	-6,2%	-8,5%	-10,0%	3,9%
Total	-2,6%	-5,2%	8,7%	-4,3%	-0,3%	-5,1%	-9,3%	-10,6%	-7,1%

Using the same method of calculation of the SE on a sector level and the same base year estimate of SE, the trends of the SE in the industries and other part of the economy can be estimated. The ECM indicates that as the overall SE aggregate as percentage of the GDP decreases, the industry SE has an increasing trend in the period between 2003 and 2006 after which it decreases. However the industry SE is higher than the other sectors.

Chart 7

Sector SE by ECM
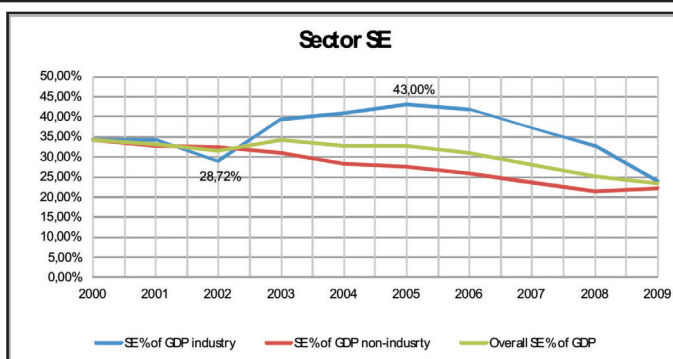
Source: Own calculations

Although the industry sector is expected to have lower share of shadow activities compared to the service sector the implementation of the ECM on the industrial sector shows opposite estimations. The reasons can also be seen as methodological or statistical and should be further investigated.

The handicraft economy takes a serious part of the calculated non-industry SE i.e. the non official economy activities which are usually used by the households. In 2009 a research has been conducted by CEA (CEA, 2009) on the assessment of the handicraft shadow economy in Macedonia using a direct approach (based on specifically designed questionnaires and survey sample of 85 households). The research has been conducted in the ten largest towns in Macedonia and the City of Skopje following the cluster sampling procedure. The research covered the following sectors: additional education, cleaning services, motor vehicle services, home maintenance, green markets, hair style and make up services, software and hardware services, cutting firewood and fortune tellers.

The results indicated that households in Macedonia are spending on average 22,8% from its income in the handicraft economy. The Table 7 for example illustrates that the average annual amount spent by a household on the green markets per annum is 41.645 MKD, which is the largest "recipient" of cash.

Table 7. Household expenditures by handicraft sectors in Macedonia
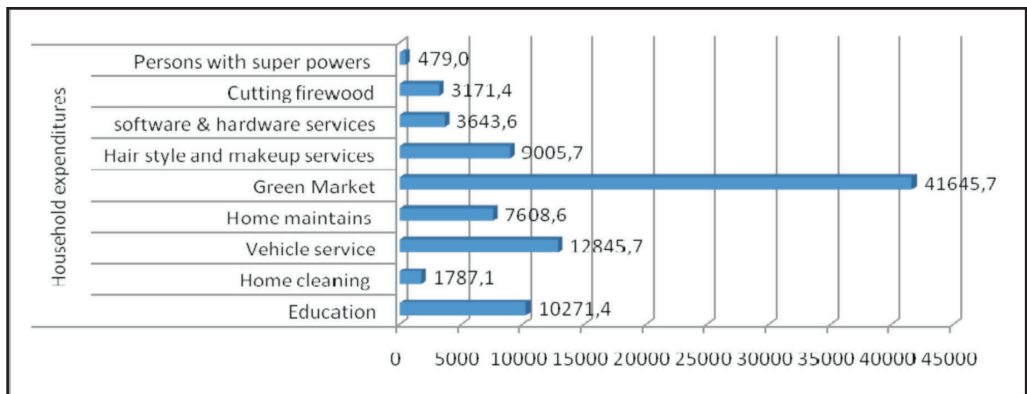
Source: Assessing handicraft shadow economy in Macedonia, CEA 2009

In addition a more concerning fact, assessed by the same research, is that more than 90% of the households have easy or very easy access to the services or products produced in the SE. This means that SE activities are largely present within the Macedonian economy and is easily accessible.

Criticism of the ECM approach

The ECM is one of the models used in the process of estimating the shadow economy of a country. As any other models the ECM model is criticized[16] because: (1) not all economic activities require electricity, other energy sources can be used thus only part of the SE can be captured; (2) the technical advantages result with more efficient usage of electricity applying in the official and shadow economy; (3) there might be considerable elasticity change of electricity/GDP over time. Thus for clearer and more specific policy recommendations it is necessary for further research and attempts to be made for more accurate measurement of the shadow economy.

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16) The Shadow Economy: An International Survey, F. Schneider, D. H. Enste, Cambridge University Press, 2002
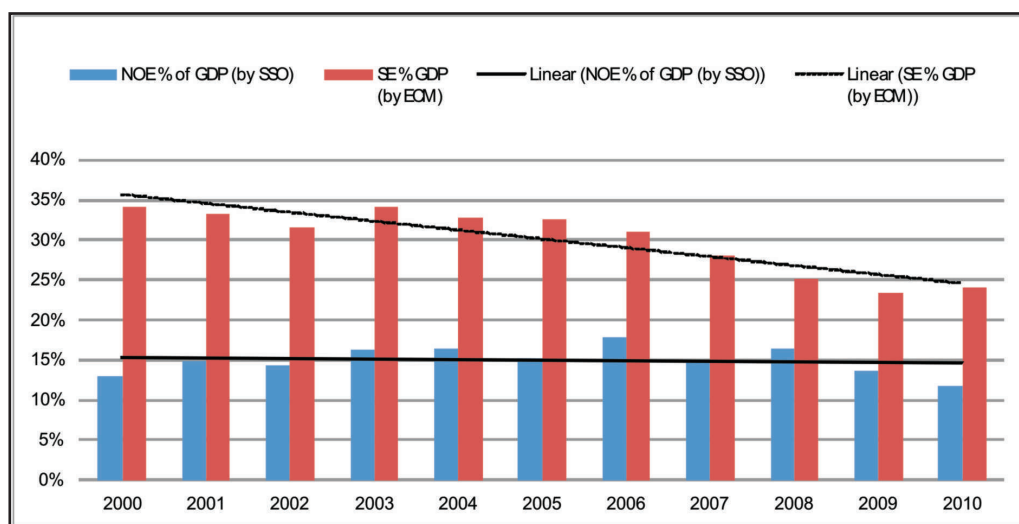
Statistically Measured SE

The SSO of Macedonia, using the OECD Handbook for measuring the non-observed economy and the Eurostat's tabular approach to exhaustiveness, implements adjustments to the GDP data with NOE data. The definition of "non-observed economy" and the methodology of OECD are already covered in previous section of the paper. The officially reported size of the NOE[17] as presented by the SSO is given in the table below indicating a general trend of increase of the SE as percentage of GDP from 2000 to 2006 and reduction from there on.

Table 8 NOE estimated data by SSO

Year	NOE Absolute data (in million denars)	% of GVA	% of GDP
2000	30.604	15,9	12,9
2001	34.815	18,4	14,9
2002	35.179	18,3	14,4
2003	41.026	20,0	16,3
2004	43.368	20,0	16,3
2005	43.832	18,8	15,3
2006	55.726	21,6	17,9
2007	52.061	17,7	14,7
2008	68.057	20,7	16,5
2009	56.136	16,9	13,6
2010	52.510	14,5	11,8

If we compare the absolute rates of SE as reported by the SSO and the estimated SE rates by the electricity consumption method as percentage of GDP, we see quite large differences however the general trends of decrease of the SE is evident by both methods.

Chart 8 ECM SE vs. NOE by SSO

17) In 2007 the methodology of measurement of NOEis revised, for details see annual GDP publications by SSO

MIMIC Model: An attempt to estimate the shadow economy in Macedonia

The model allows to consider the SE as a "latent" variable linked, on the one hand, to a number of observable indicators (reflecting changes in the size of the SE) and on the other, to a set of observed causal variables, which are regarded as some of the most important determinants of the unreported economic activity. The MIMIC Model received its name from Jöreskog and Goldberger (1975), although however the applications of MIMIC models to estimate the SE as an 'unobservable variable' have been done by Frey and Weck-Hannemann (1984).[18]

In order to estimate the SE in Macedonia the analysis conducted by Dell'Anno for Portugal (2007) and Klaric for Croatia (2010) has been followed. An analytical representation of the most general specification (MIMIC 6-1-2: six determinants (Xq), one latent variable and two indicators (Yp)) is utilized in this research to measure the development of the Macedonian SE. This model framework is fundamental to qualify how correctly and comprehensively the MIMIC model is able to evaluate the SE because the model specification starts from the most general specification and continues omitting the variables, which do not have statistically significant structural parameters. In other words, the MIMIC 6-1-2 is the starting specification for subsequent model modification.

Figure 5

The structure of a MIMIC q-1-p model
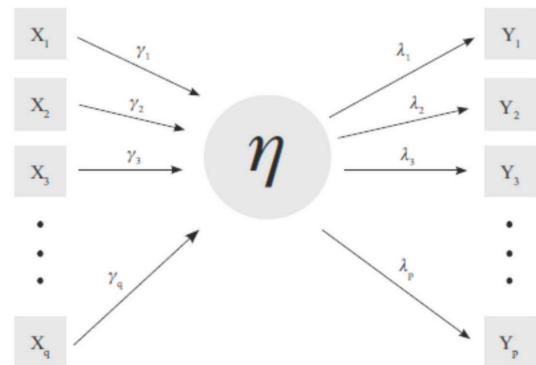
Source: Based on Giles and Tedds (2002)

In order to calculate the SE using the MIMIC approach, the indicators used are (1) real GDP index and (2) M1 monetary aggregates, and as causes the following parameters are used: (1) government employment / total labor force; (2) tax burden ((total direct + indirect + social contributions)/GDP); (3) real government consumption (government consumption/GDP); (4) social benefits paid by government/GDP; (5) self-employment/total active population and (6) unemployment rate.

The augmented Dickey-Fuller and Philips-Peron test has been used to test the stationarity of the time series which provided the following results:

Table 9 MIMIC estimated data

Test	Real GDP Index	M1 Monetary Aggregate	Government employment / total labor force)	Tax burden /GDP)	Real Government consumption	Social benefits paid by government /GDP	Self-employment/ Total active population	Unemployment rate/100
ADF C	-5,409	-5,359	-9,245	-5,607	-6,666	-7,330	-7,311	-5,066
ADF C&T	-5,405	-5,590	-9,086	-5,673	-6,500	-7,228	-7,661	-4,877
PP t-ratio	-18,672	-10,320	-6,862	-17,090	-8,418	-10,800	-7,381	-5,847

Source: Own calculations.

18) http://www.ucema.edu.ar/publicaciones/download/volume10/dellanno.pdf

From the test it can be concluded that the time series of all variables are stationary and integrated of order 1 thus I(1). Next, the Engle-Granger two step approach has been used to see if all of the causes are cointegrated with each of the indicators (the assumption is that there is a long run relationship among these variables). Because all variables are deviations from their means, no constant is included in the regression equations. The algebraic presentation of the results from the regression is:

$$\frac{\Delta GDP}{GDP} = 0,177 \cdot \frac{\Delta EMP}{EMP} - 0,382 \cdot \frac{\Delta GOVCONS}{GOVCONS} + 0,609 \cdot \frac{\Delta GOVEM}{GOVEM} - 0,447 \cdot \frac{\Delta SOC}{SOC} - 0,878 \cdot \frac{\Delta TAX}{TAX} - 0,676 \cdot \frac{\Delta UNEM}{UNEM} + \varepsilon_{t1}$$

$$\frac{\Delta M1}{M1} = 0,056 \cdot \frac{\Delta EMP}{EMP} - 0,018 \cdot \frac{\Delta GOVCONS}{GOVCONS} + 0,355 \cdot \frac{\Delta GOVEM}{GOVEM} - 0,040 \cdot \frac{\Delta SOC}{SOC} - 0,401 \cdot \frac{\Delta TAX}{TAX} + 0,094 \cdot \frac{\Delta UNEM}{UNEM} + \varepsilon_{t2}$$

We analyze the assumed cointegration relationship's residuals by using the Augmented Dickey-Fuller (ADF) test. If the causes are cointegrated with the indicators, we expect the ADF test to reject the null hypothesis of a unit root against the alternative for both error terms i.e. for the residual series and from the regressions above we test if they contain unit roots.

The ADF tests resulted in test statistic ADF1=-5.248 and ADF2=-5.219 thus, rejecting the null-hypothesis of unit roots in both regressions which means that causes are cointegrated with the indicators. The estimated parameters are illustrated in the next table.[19]

Table 10 MIMIC estimated parameters

Variables	GDP	M1	GOVCONS	TAX	SOC	EMP	GOVEM
Parameters unnormalized	0,003884	0,034008	0,000292	-0,059734	-0,044124	-0,010176	0,009418
Parameters normalized	1,000000	8,756972	0,075115	-15,38146	-11,36194	-2,620419	2,425139
t-statistics			(4,10230)	(0,51529)	(7,20741)	(5,72381)	(1,17403)	(1,40155)

t-statistics are for normalized parameters.

The 5% critical value for the parameters is 1,645 thus statistically significant causes are solely the tax burden and the social transfers variables.

Benchmarking for MIMIC

As we previously explained, for calculating the SE using the MIMIC model as in the ECM a base value for SE as percentage of the GDP which has been already established by some other researcher will be used. In this calculation, since the shadow economy as percentage of the GDP has been estimated by the electrical consumption method, thus the value of 34,22% for 2003 will be used as a baseline. In order to determine the SE as percentage of the GDP the benchmarking used by Roberto Dell'Anno (2005)[20] in the case with Portugal (equation 6 in his paper) will be used. The formula for convenience is presented here as well:

$$\frac{\sim \eta t}{GDP\ 2003} \quad \frac{\eta * 2003}{GDP\ 2003} \quad \frac{GDP\ 2003}{\sim \eta\ 2003} \quad \frac{GDP\ 2003}{GDPt} = \frac{^\wedge \eta t}{GDPt}$$

Where $\frac{\sim \eta t}{GDP\ 2003}$ is already calculated (See Table 10 and equation 5 in Roberto Dell'Anno 2005); $\frac{\eta *2003}{GDP\ 2003} =$ 34,22% is the exogenous estimate of SE by the ECM estimate; $\frac{\eta *2003}{GDP\ 2003}$ is the value of index estimated (See Table 10 and equation 5 in Dell'Anno 2005); $\frac{GDP\ 2003}{GDPt}$ is to convert the index of changes in respect to the GDP in the base year in a time series of SE/current GDP; $\frac{^\wedge \eta t}{GDPt}$ is the estimated shadow economy as a percentage of official GDP.

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19) We use E-Views for the regression.

20) The shadow economy in Portugal: An analysis with the MIMIC approach

The results from the calculations for SE as percentage of GDP according to the MIMIC model for Macedonia are:

Table 11: Shadow Economy in Macedonia estimated by the MIMIC approach

Years	2003 (base year)	2004	2005	2006	2007	2008	2009	2010	2011
Shadow Economy	34,22%	44,44%	40,18%	41,32%	52,48%	50,39%	41,58%	40,46%	46,99%

Source: Own calculations

Criticism of the MIMIC approach

As in all other models and methods for estimation of the shadow economy, the MIMIC approach is also criticized. Breusch (2005) critically examines the entire MIMIC approach, as well as its application by Giles and Tedds (2002), Bajada and Schneider (2005), and Dell'Anno and Schneider (2003) to demonstrate the errors and anomalies that might occur when using MIMIC to estimate the size of the SE. The main critique of Breusch (2005) of the MIMIC approach and its applications such as: (1) undocumented data transformations such as differencing, transforming into deviations-from-means, scaling to have unit standard deviation, etc. (2) Estimating coefficients using transformed data and then applying them to the untransformed variables. (3) Sensitivity to the change of units of measurement (4) differencing variables to insure stationarity being unnecessary, inefficient (5) the sign of the unit coefficient during normalization is sometimes chosen simply out of convenience or so that the signs of the other coefficients would make sense, (6) arbitrary benchmarking (7) a single causal variable can dominate the latent variable, etc.[21]

Bringing it all together

Comparing all the estimated results for Macedonia by the ECM and MIMIC approach as well as the estimates of the State Statistical Office of Republic of Macedonia, and other researchers, it can be concluded that generally the SE index in the period analyzed has a decreasing trend and all of the trends are in sync. Of course, due to the difference of the approaches and the methodologies there are differences as well.

The shadow economy estimates calculated by the MIMIC model shows certain differences compared to the ECM and the SSO results mainly due to methodology related to the time lag. Also, the MIMIC ties statistically the SE with the two strongly related causes of SE, the tax burden and the social transfers paid by the GoM.

On first sight in 2006, when the main tax reforms are implemented, the effects on the SE with the MIMIC are not immediately evident. Since the taxation modifications are applied in the last quarter of 2006 it can be assumed that there is a certain time lag for the business sector to implement the modifications and the effects evident (there are no time lags when applying the ECM method). The assumption is that with the MIMIC the taxation reform effects are incorporated in the SE estimates after 2007, when the trend of declining in the next three years starts.

The 2011 increase may be caused by the new wave of economic crisis which confirms the formally thesis that in economic crises larger number of economic entities decides to operate in SE.

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21) http://www.ijf.hr/eng/FTP/2011/1/klaric.pdf

Chart 9 Shadow Economy Measured by Different Methods and Authors
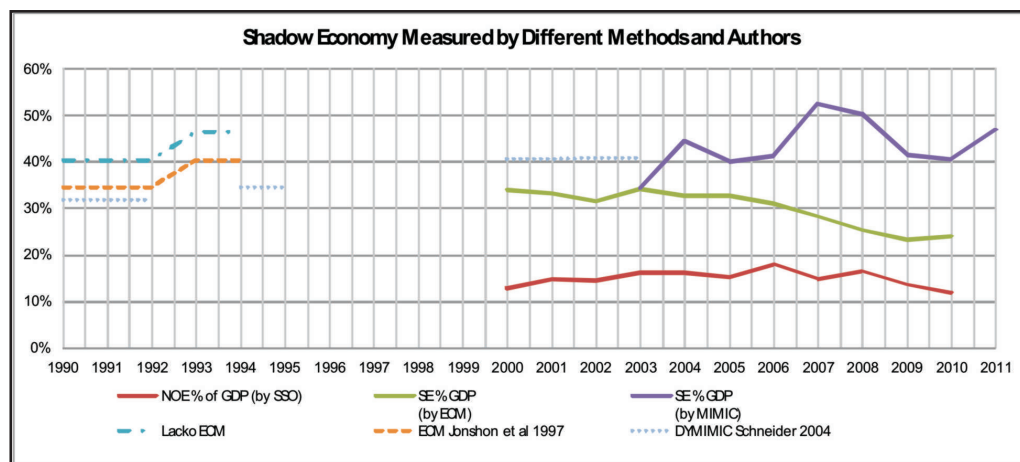
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UDC 336.77:334.012.64]:346.662
336.77:330.567.22]:364.662

MICROFINANCING AS A POVERTY REDUCTION TOOL

PhD Shenaj Hadzimustafa and PhD candidate Hristina Cipusheva

Abstract

This study is conveyed in order to examine the microfinance perceptions in the country based on a survey that gives answers to a set of questions related to the general characteristics of the poor households, their problems, needs, savings, borrowing and financial exclusion.

The findings underline some issues concerning the availability of financial resources offered by the financial institutions in RM to the citizens, with particular focus on microfinance and its use for improvement of the financial and economic situation of the citizens.

The results show very low consumption of the financial institutions' offer in the country. In addition, the concept of microfinance is not widely known by the people in Republic of Macedonia – just 2% in the sample have borrowed from MFI.

As a result, a number of policy issues should be considered by MFIs and the government regarding the improvement of the outreach, the impact, and the legal background of the concept of microfinance in order to offer the citizens better availability to microcredits and loans.

Keywords: credit, borrowing, microfinance
JEL Classification: *G21, O16*

DEFINING MICROFINANCE

There is a great volume written on microfinance from the perspective of the practitioners and economy theorists, which contains valuable insights about the concept of microfinance and its realization and validation. In this study, the microfinance concept would be examined from both retrospective and prospective recourse.

The simplest approach to defining microfinance is given by Robinson (2001) who refers to microfinance as the small-scale financial services, primarily credit and savings, provided to people who farm or fish or herd, who operate small enterprises or micro enterprises where goods are produced, recycled, repaired, or sold,

who provide services, who work for wages or commissions, who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools and to other individuals and groups at the local levels of developing countries, both rural and urban.[22]

Banking the "un-bankable" is also a provision of financial services such as cash transfers and insurance to poor and low-income people. These services generally focus on the entrepreneurial poor - provision of services to low-income clients, women and men, lacking access to other financial institutions. They present client-appropriate lending - simple and convenient access to small, short-term, and repeat loans, with the use of collateral substitutes (for example, group guarantees or compulsory savings) to motivate repayment. They also refer to informal appraisal of borrowers and investments, with simple cash flow and project appraisal for larger and longer-term loans. The provision of secure, voluntary savings services facilitates small deposits, convenient collections, and ready access to funds, either independently or with another institution.[23]

According to Sapovadia, microfinance is "meeting the special goal to empower to under-privileged class of society, poor, women downtrodden by natural reasons or men made, caste, creed, religion or otherwise, the principle of microfinance is founded on a philosophy of cooperation and its central values of equality, equity and mutual self-help. It means providing poor families with small loans to help them engage in productive activities or grow their tiny businesses."[24]

Brigit Helms draws attention that the comprehensive financial system is consisted of micro, meso and macro level. In the micro level, the providers of the financial services are those who offer them directly to poor and low-income clients. The range of those who offer these services is moving from informal moneylenders to commercial banks and saving clubs, and everything that stays in between.[25]

Considering the objectives of microfinance directed towards poverty alleviation and development of micro and small enterprises, the key points of the concept of microfinance are: *the poor, the loans,* and *the social benefit.*

The Poor – clients of microfinance programs are those who are excluded from traditional financial system on account of their lower economic status. In the same time, they refer to micro-entrepreneurs who lack collateral and do not qualify to traditional bank credits. In developing countries, they are engaged in self-employment projects that generate income. The premise is that the poor have skills which remain unutilized or underutilized. It is definitely not the lack of skills that make poor people poor. Unleashing of energy and creativity in each human being is the answer to poverty.[26]

It should be emphasised that the microfinance concept could not be separately viewed from its target group, not consisted by the poorest of the poor, who need other interventions such as food and health security, but by the poor who live at the border of the so called poverty line. These are the poor who could reach more easily a decent quality of life and who have entrepreneurial ideas, but lack access to formal finance. These people usually do not lack finance in a broad sense: they can borrow money from friends, relatives or local money lenders, but of course they cannot access a wider and safer range of services. They need a formal financial institution to rely on, to ask not only for credit, but also saving or insurance.[27] So, they can invest in better nutrition, housing, health, and education for the children. They can create productive businesses, and

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22) Robinson, Marguerite. 2201. "Microfinance revolution: Sustainable finance for the poor." p.9. *World Bank Publications, Washington DC, USA*

23) Judith Brandsma, Deena Burjorjee. 2004. "Microfinance in the Arab states: Building inclusive financial sectors." *UNCDF*

24) V. Sapovadia. Micro Finance - A tool for socio-economic development & Women Empowerment http://topics.developmentgateway.org/

25) Helms, Brigit. 2006. p.28 "Access for all: Building inclusive financial systems". World Bank, Herndon, VA, USA

26) Muhammad Yunus. 2003. "Expanding microcredit Outreach to reach the Millennium Development Goals." International Seminar of Attacking Poverty with microcredit, Dhaka, Bangladesh

27) Chiara Segrado. 2005. "Islamic microfinance and socially responsible investments". Meda Project, University of Torino

recover more quickly in the aftermath of natural disasters. In short, they can take real strides towards break-ing the vicious circle of poverty and vulnerability.[28]

As an effective and efficient financial system offers variety of products and financial innovation to satisfy the different needs of different customers, so should the microfinance system. All of those different clients of microfinance have specific and different occupations and needs, so they should be approached and treated differently.

The microfinance loan is the second element of the trilogy. It is just one of the microfinance services which enable entrepreneurs to satisfy their needs for working capital, or to purchase money for emergency needs, such as illness and other emergencies.

The expansion of the MFI and the increasing understanding of the importance of offering financial services for the poor provoked an appearance of wide portfolio of microfinance products.

Box 1: Types of financial services

Loan products: Low-income households demand loans for both income generation and income smoothing and risk management.

Housing loans: Low-income households seldom have financial resources to buy an already constructed house, rather their life cycle calls for loans for home improvements and progressive house building. There is a close connection between housing and income generation since a house often is used as a shelter and as a place to house income-generating activities. Few MFIs provide housing loans today, but new initiatives are emerging.

Savings: Studies show that even very poor people do save. Savings are often the only way of managing emer-gencies, smoothing consumption, paying for a major life event and taking advantage of a business opportunity. The poorest often prefer to save instead of taking a loan, mainly due to risk and cost aspects.

Micro insurance: Micro insurance is the provision of insurance to low-income households, including insurance for life, health, property, disability, and agriculture (crop). Poor families are especially vulnerable to risk, both in the form of natural disasters, and more regular incidences of accidents and illness. PRIDE and FINCA in Uganda have formed partnerships with American International Group to offer life and disability insurance to its clients.

Money transfers and remittances: In many countries, remittances far outstrip total development assistance, and account for a significant amount of GDP. Microfinance institutions have recently started to enter the remit-tances market, and they will have an important role in reducing the transaction costs of remittances in the future.

Agricultural and rural finance: One of the main reasons why few subsidized rural credit schemes have been successful is that they failed to address the special characteristics, opportunities, and constraints in rural and agricultural credit markets. Special characteristics of rural markets include seasonality in income flows, less defined property rights, and dispersed populations, higher level of price and production risk, and poor physical infrastructure. Agriculture lending is increasingly seen in the context of building permanent rural financial sys-tems rather than separate agricultural credit schemes, and as one among many necessary interventions for food security and rural development.

The microfinance institutions (MFI) are organizations which offer financial services to poor people, access-ing the resources from the banks. These institutions could be: credit unions, commercial banks, non-govern-mental organizations, cooperatives, and sectors of government banks. Some of the MFIs offer not just loans, but different kinds of microfinance services. In addition, we can say that MFIs are playing the role of inter-mediation, transferring the financial and support from banks to the clients. Microfinance has a significant role in bridging the gap between the formal financial institutions and the rural poor. MFI is like a small bank with the same challenges and capital needs confronting any expanding small venture, but with the added respon-

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28) Kofi Annan. Q &A on International Year of Microcredit and importance of microfinance

sibility of serving economically-marginalized populations. Many MFIs are creditworthy and well-run with proven records of success, many are operationally self-sufficient. Nowadays, the appearance of "for-profit" MFIs is growing. On the other hand, non-governmental organizations mainly work in the distant rural areas with no access to banking services.

The social benefit is the third element of the trilogy. It could be seen from every aspect of microfinance. From the perspective of microfinance clients, it helps strengthening their small enterprises. From the perspective of non-clients, in has indirect impact, because they could find jobs in the enterprises developed by microfinance clients or through backward and forward linkages. Successful microfinance activities in many countries have proven that it could be an effective and powerful instrument for poverty reduction by increasing the ability of poor people to raise income, build assets, and reduce their vulnerability in times of economic stress. However, "poverty is not only an outcome of economic processes – it is an outcome of interacting economic, social, and political forces; underlines, the accountability and responsiveness of state institutes, corruption, lack of rule of law, social barriers, gender discrimination, inequalities in voice and access to resources, and social fragmentation and conflicts. That is why with facilitating empowerment through making state institutions more accountable and responsive to poor people, strengthening the participation of poor people in political processes and local decision making, and removing the social barriers that result from distinctions of gender, ethnicity, race, religion, cast, and social status could reduce poverty."[29]

"Social benefits depend on worth, cost, depth, breadth, length, and scope of the loan, but the greatest of these is length."[30] According to Townsend and Yaron (2001), and Khandker (2005), the cost-benefit analysis is essential for measuring the social benefits, but the problem that arises is how to measure the qualitative effects of microfinance, such as tender empowerment, equalities in voice, rule of law, is difficult to put in monetary terms, and the dynamics of those benefits.

In conclusion, microfinance influences on financial constrains such as access to credits, employment opportunities, risk management, by smoothing income and expenditure, and let the potential of the people to achieve their goals.

THE GENERAL PRINCIPLES OF MICROFINANCE

The key principles of microfinance were developed by Consultative group to assist the poor (CGAP[31]), and were approved by the Group of Eight world's leading industrialized countries – G8 who accentuate how access to financial services by the poor could contribute poverty reduction. However, according to the analysis of UNDP, some of these general principles of microfinance do not correspond to the real situation with micro-finance.

The general principles of micro-finance are the following:[32]

> ***Poor people need a variety of financial services, not just loans****. Like everyone else, the poor need a range of financial services that are convenient, flexible, and affordable. Depending on circumstances, they want not only loans, but also savings, insurance, and cash transfer services.*
>
> ***Microfinance is a powerful tool to fight poverty****. When poor people have access to financial services, they can earn more, build their assets, and cushion themselves against external shocks. Poor households use microfinance to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education.*

29) Faheem Jehangir Khan. 2003. "Poverty Reduction Strategies: Role of Microcredit and Empowerment in Realizing Income Opportunities." *Institute for Agricultural Economics and Social Sciences in the Tropics and Subtropics*

30) Mark Schreiner. 1999. "Aspects of Outreach: A Framework for Discussion of the Social Benefits of Microfinance." *Journal of International Development, Washington university*

31) *The CGAP is a consortium of 28 public and private development agencies working together to expand access to financial services for the poor in developing countries.*

32) The Consultative Group to Assist the Poor. "Key Principles of Microfinance." *http://www.cgap.org*

Microfinance means building financial systems that serve the poor. *In most developing countries, poor people are the majority of the population, yet they are the least likely to be served by banks. Microfinance is often seen as a marginal sector-a "development" activity that donors, governments, or social investors might care about, but not as part of the country's mainstream financial system. However, microfinance will reach the maximum number of poor clients only when it is integrated into the financial sector.*

Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people. *Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs. Cost recovery is not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving sustainability means lowering transaction costs, offering services that are more useful to the clients, and finding new ways to reach more of the unbanked poor.*

Microfinance is about building permanent local financial institutions. *Finance for the poor requires sound domestic financial institutions that provide services on a permanent basis. These institutions need to attract domestic savings, recycle those savings into loans, and provide other services. As local institutions and capital markets mature, there will be less dependence on funding from donors and governments, including government development banks.*

Micro-credit is not always the answer. Micro-credit is not the best tool for everyone or every situation. *Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better—for instance, small grants, employment and training programs, or infrastructure improvements. Where possible, such services should be coupled with building savings.*

Interest rate ceilings hurt poor people by making it harder for them to get credit. *It costs much more to make many small loans than a few large loans. Unless micro-lenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs. Their growth will be limited by the scarce and uncertain supply soft money from donors or governments. When governments regulate interest rates, they usually set them at levels so low that micro-credit cannot cover its costs, so such regulation should be avoided. At the same time, a micro-lender should not use high interest rates to make borrowers cover the cost of its own inefficiency.*

The role of government is to enable financial services, not to provide them directly. *National governments should set policies that stimulate financial services for poor people at the same time as protecting deposits. Governments need to maintain macroeconomic stability, avoid interest rate caps, and refrain from distorting markets with subsidized, high-default loan programs that cannot be sustained. They should also clamp down on corruption and improve the environment for micro-businesses, including access to markets and infrastructure. In special cases where other funds are unavailable, government funding may be warranted for sound and independent microfinance institutions.*

Donor funds should complement private capital, not compete with it. *Donors provide grants, loans, and equity for microfinance. Such support should be temporary. It should be used to build the capacity of microfinance providers; to develop supporting infrastructure like rating agencies, credit bureaus, and audit capacity; and to support experimentation. In some cases, serving sparse or difficult-to-reach populations can require longer-term donor support. Donors should try to integrate microfinance with the rest of the financial system. They should use experts with a track record of success when designing and implementing projects. They should set clear performance targets that must be met before funding is continued. Every project should have a realistic plan for reaching a point where the donor's support is no longer needed.*

The key bottleneck is the shortage of strong institutions and managers. *Microfinance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels: managers*

and information systems of microfinance institutions, central banks that regulate microfinance, other gov-ernment agencies, and donors. Public and private investments in microfinance should focus on building this capacity, not just moving money.

Microfinance works best when it measures—and discloses—its performance*. Accurate, standardized performance information is imperative, both financial information (e.g., interest rates, loan repayment, and cost recovery) and social information (e.g., number of clients reached and their poverty level). Donors, investors, banking supervisors, and customers need this information to judge their cost, risk, and return.*

THE HISTORY OF MICROFINANCE

Microfinance is one of those small ideas that turn out to have enormous implications.[33] Speaking about microfinance today, one must recall about Mohhamad Yunus and Grameen Bank in Bangladesh, developed in 1970s. Everything started when the professor of economics in a Bangladesh University - Muhamed Yunus (Nobel Prize winner) started to give small loans to the poor local villagers in 1970. He created his microfinance paradigm basing on his belief in reliability of poor, low-income people, who didn't have collateral to guarantee their loans. With this model, it was shown that poor people could rely on to repay their loans, and that it was possible to provide financial services through market based enterprises to poor people without any subsidy.

But, the roots of microfinance can be traced much earlier, even in the middle ages. In 1946, the Italian monk opened a pawn shop to counter usury practises. Later, in 1515 it was permitted by the Pope Leon X for the pawn shops to charge interest in order to cover their operating costs. In 1700 the Irish Loan Fund System was opened providing small loans to poor farmers without collateral. In 1800, Raiffeisen developed the finan-cial cooperatives, and his movement reached 2 million rural farmers by 1901. In Europe and Latin America, People's Banks, Credit Unions, and Savings and Credit Cooperatives began to emerge.[34] From 1950 to 1970 state-owned development finance institutions offered loans with interest rates set below market interest rates, directed towards development of the agricultural sector.

From 1990s, the term micro credit begins to be replaced by the broader range of services, such as savings, insurance, money transfers, etc, called microfinance. This new system of microfinance characterise with very efficient repayment rate, better than in ordinary commercial banks. The microfinance institutions became important part of the financial systems of the countries, attracting poor people with small businesses to take loans, to put savings or to use insurance services.

UN declared 2005 as a Year of microfinance and sets the following goals:[35] assess and promote the contri-bution of microfinance to MFI, make it more visible, make it inclusive to financial sector, make a supportive system, support partnerships and innovation to build and expand the outreach and success of MF for all.

The future tendencies of this movement are directed to commercialization, development of profitable organ-izations that could attract more capital and become stronger element of the financial system. Specifically, three major challenges define the frontier of financial services - scale, depth, and cost:[36] quality financial services to serve large numbers of people, reaching increasingly poorer and lowering costs.

Many scholars and practitioners agree that after successfully overcoming of these challenges, microfinance would become an integrated part of the financial system. Moreover, the contemporary concept of microfi-nance would be abandoned, and the financial institutions would offer various services to the poor, as their regular, respected and reliable customers.

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33) Beatriz, Armendariz de Aghion; Jonathan, Morduch. 2005. "The Economics of Microfinance". *The MIT Press*

34) Helms, Brigit. 2006. p.4 "Access for all: Building inclusive financial systems". *World Bank, Herndon, VA, USA*

35) Report on International Year of Microcredit and Global Micro-entrepreneurship Award Activities. 2005. UNDP

36) Helms, Brigit. 2006. p.5 "Access for all: Building inclusive financial systems". *World Bank, Herndon, VA, USA*

APPROACHES TO PROVIDING MICROFINANCE

There are two approaches to providing microfinance - poverty lending approach and financial intermediation approach. These two approaches differentiate by the target groups towards which they are directed and the goals that they should accomplish.

Poverty Lending Approach

In this approach, also called "welfarist approach" we are talking more about micro-credit, not microfinance. Most of the institutions which provide micro-credit using poverty lending approach are not sustainable, because they have low cost of their services and their interest rates are too low for full cost recovery. They do not offer saving services. This concept is more about charity. This is justified by the fact that when we are talking about extremely poor people, we know that they need microfinance to satisfy their basic needs, such as food, clothes, shelter, health, etc. This approach by providing credits often provides some complementary services such as skills training and the teaching of literacy and numeracy, health, nutrition, family planning, etc. Using this approach, government and donors provide credits to poor borrowers with interest rates lower than those in the market, so they could reach the poor, especially the extremely poor, the poorest of the poor with credit to help overcome poverty and gain empowerment. Except for mandatory savings required as a condition of receiving a loan, the mobilization of local savings is normally not a significant part of the poverty lending approach to microfinance. One of the successful examples using poverty lending approach is Grameen Bank in Bangladesh and some of its replications in other countries represent leading examples of the poverty lending approach.

Considering this, we can say that commercial microfinance is not appropriate for extremely poor people who are badly malnourished, ill, and without skills or employment opportunities. Starving borrowers will use their loans to buy food for themselves or their children. Such people do not need debt. They need food, shelter, medicines, skill training, and employment for which government and donor subsidies and charitable contributions are appropriate. For these people, microfinance is the next step, after they become able to work.[37]

Financial Intermediation Approach

In contrast, the financial systems approach or "institutionist approach" focuses on commercial financial intermediation among poor borrowers and savers. The MFI which provide these services are mostly self-sustainable. They serve poor people with entrepreneurial characteristics, who need additional financing to develop or increase their businesses, in order to provide income for their households or to increase the consumption. Mainly, their services have higher costs and their clients could pay high interest rates they charge. These MFI arose from the unmet demand for micro-credit which exists worldwide and which is estimated in hundreds of millions of poor people needing small amounts of money or saving accounts or insurance. The government and donors are not appropriate providers of services using this approach, because generally they don't deal with creditworthy borrowers.

In addition, within the past several decades fully sustainable commercial microfinance intermediaries have emerged. These intermediaries provide loans and voluntary savings services to the economically active poor, and they offer easy access at reasonable cost. Their loan portfolios are financed by savings, commercial debt, and for-profit investment in varying combinations. These institutions are able to attain wide outreach profitably, and they represent a globally affordable model.[38]

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37) Robinson, Marguerite. 2001. "Microfinance revolution: Sustainable finance for the poor." p.8. *World Bank Publications, Washington DC, USA*

38) Robinson, Marguerite. 2001. "Microfinance revolution: Sustainable finance for the poor." p.8. *World Bank Publications, Washington DC, USA*

The concept of high-interest rates that is a necessary request when using this approach is justified by the diversified portfolio of these institutions. They serve large number of clients who take small loans, so their operating and transactions costs are very high. Microfinance institutions are necessarily labour intensive. They must maintain and staff many small, widely dispersed outlets that are conveniently located for clients.

However, the interest rates of microfinance services offered with financial intermediation approach are higher than commercial loans, but much lower than rates charged by money lenders and other sources from whom the poor borrow. Also, consideration of the law of diminishing returns[39] shows how the clients who take small loans could pay larger proportion of money as interest to their lenders, because their returns are higher. In the same time, the empirical studies and successful results of the microfinance institutions show that the rate of repayment of the loans is very high which means that the clients of microfinance institutions are creditworthy. The high rate of savings reported by many microfinance organizations demonstrates that the poor can value savings as much as credit.

The financial systems approach focuses on self-sufficiency of the institutions because there is widespread client demand for convenient, appropriate financial service for microfinance, and that is the only way to satisfy that demand. Some famous institutions that provide microfinance under this approach are Bank Rakyat Indonesia (BRI), BancoSol in Bolivia, and the Association for Social Advancement (ASA) in Bangladesh.

The tools of the poverty lending approach are poorly suited for building microfinance on a global scale. Resources for developing microfinance are limited, and donors and governments must choose among options if microfinance services are to be made available to all who can use them. That is why it should be complemented by financial intermediation institutions.

LENDING METHODOLOGIES

Micro-lending methodologies can be divided between group lending and direct lending to individuals. Group lending methodologies provide micro-credit to a group of homogeneous individuals who distribute the loan among them. Group lending involves weekly group meetings, group monitoring of loan repayments and frequently group guarantees, thus enhancing social cohesion and improving clients' financial management skills. Examples of group borrowers are solidarity groups (groups of 4-6 poor urban micro-entrepreneurs), village banks (groups of up to 50 poor individuals in rural areas, frequently women) or credit unions (groups of 50-200 people that are often regulated). Micro-credit to groups is usually provided 10 with a maturity of 6-12 months for working capital purposes. Direct micro-lending to individuals normally targets owners of existing micro-businesses in rural and urban areas and provides loans for working capital and/or asset financing. Loans aim at enhancing micro-enterprise growth or enterprise transformation into small businesses. Credit is frequently given based on the business potential and the borrower's character, but can also involve traditional forms of collateral such as fixed asset charges.

The main contribution of financial and banking services - savings, credit, insurance and money transfers - is to address people's financial constraints and facilitate management of money. Use of financial services can be classified into two broad categories: production and investment purposes, and consumption and risk management. Financial services thus play dual roles: protecting the poor, and promoting their economic well-being and welfare. However, various factors can influence the actual outreach of and impact of microfinance programs, as outlined in figure 1 below. For instance, intra-household power structures and property laws can influence women's access to and use of a loan, entrepreneurs' business skills and the viability of the local economy influence the result of an investment, availability of rural roads and electricity condition both MFIs' operations and households' livelihood activities, and MFIs' terms and conditions influence who gets access to financial services.

39) Beatriz Armendariz de Aghion, Jonathan Morduch. 2005. "The Economics of microfinance." *The MIT Press, Cambridge, England*

Figure 1: The relationship between access to financial resources and poverty reduction
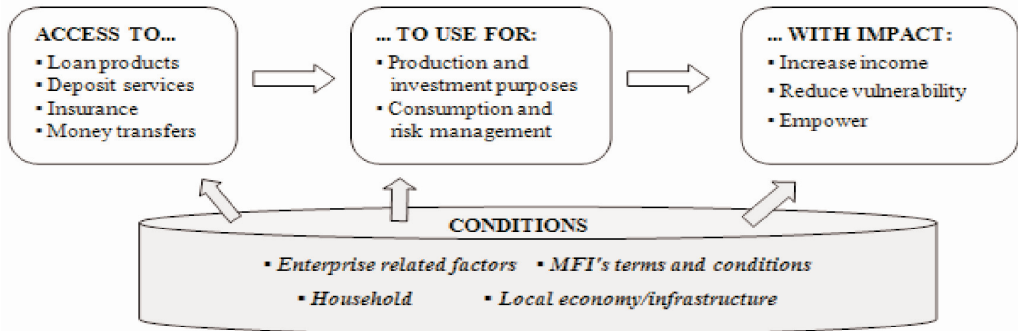
http://www.norad.no/en/tools-and-publications/publications/norad-reports/publication?key=109392, p. 10

GOVERNMENT AND DONOR SUPPORT TOWARDS MICROFINANCE

As concluded in previous part, the microfinance market needs both microfinance institutions and government and donor support to satisfy the emerged demand of microfinance services.

The donor agencies provide funds for private organizations in developing countries. Some donors work just with the governments, providing soft loans for traditional aid activities, such as building roads, hospitals, and schools. They don't support the financial system in the private-sector domain. Wholesale financial institutions called apexes fund the retail microfinance institutions and provide efficient channeling of the funds and technical support.

The donor funding model has not been proven as very successful. There are many obstacles that make it non-efficient. For instance, it showed that it is not consistent. Also large proportion of money is not used effectively, because it often comes to complicated funding mechanism, which makes it to fail. There are many cases when the partners that donors choose are not capable for successful performance. In some cases, poorly conceived programs have retarded the development of inclusive financial systems by distorting markets and are placing domestic commercial initiatives with cheap or free money.[40]

Non-governmental organizations are the pioneers in the microfinance world. They provide microfinance services completely or combined with other services. From the beginning they are committed to financial sustainability. When talking about NGOs working with microfinance in numbers, we can say that the Micro-credit Summit Council has collected information on about 3,000 NGOs that provide financial services to more than 80 million clients. Estimates of worldwide NGOs offering financial services reach up to 9,000. The most famous national NGOs include Bangladesh Rural Advancement Committee (BRAC), ASA, and PROSHIKA in Bangladesh, which have a combined clientele of a staggering 5.6 million people.

It is very well known that in the world of microfinance NGOs are restricted with many constrains in the path of their development and growth. In most of the cases, they are donor dependent, especially the smaller ones, because they are established with donor funds. Their loans range is restricted, their organizational structure and governance structure is not well suited, they could not mobilize savings, because of the legal restrictions, etc.

One way to overcome these obstacles, which is increasingly used in contemporary economy, is the trend of commercialization and independence, while pushing the poverty frontier. This refers to seeking sustainability and becoming independent from unpredictable donor financing and tap commercial sources of funding to fuel growth and reach more poor people. Commercialization doesn't only mean that microfinance is a profitable business, but also products' diversification.

40) Helms, Brigit. 2006. "Access for all: Building inclusive financial systems". *World Bank, Herndon, VA, USA*

The donor agencies use variety of instruments to provide support, such as policy support, technical assistance, grants, loans (which can be offered at subsidized or commercial interest rates, quasi-equity which usually means low-interest loans that can be converted into equity, equity investments in those institutions that can sell shares, and guarantees. These instruments help for: funding financial institutions' loan portfolios, providing technical support to financial institutions and governments (often called capacity building), improving financial institutions' ability to tap domestic capital markets through helping to forge relationships and guarantees, building the skill sets of technical service providers, such as local consulting firms or training facilities, and supporting the operations of networks and associations.

Operating in the macro level, the government support of microfinance could have essential role in building efficient and effective microfinance system with primarily goal to reduce poverty and reach social welfare. The government has a potential to do that establishing financial sector reforms, especially in those countries with a history of huge state involvement, also creating formal national strategies for microfinance, incorporating finance for the poor into their overall development policies, adjusting banking sector regulation and supervision to facilitate microfinance, while protecting poor people's deposits. Governments can further support financial services for the poor by improving the legal framework for contract enforcement and collateral rights, ensuring practically and legally feasible systems of land titling, and ensuring that tax systems do not discriminate against different types of institutions engaged in microfinance.

Many governments' operations are directed towards repressing or eliminating the informal sector, not to improve the management of the formal economy, so to increase its absorptive capacity. The informal sector is in fact the poor people, low-income, unemployed people who are trying to find ways to earn money for their survival. The government should not remove the micro-entrepreneurs from the streets, by sending urban informal laborers back to their villages, because they had usually left them because of unemployment. The main goal of the government should be to integrate these people in the formal sector, and to create macroeconomic environment which will support the contribution of the informal sector in a legal way. Because this sector creates employment, provides income for poor people, recycle and repair goods that would otherwise be treated as waste. They provide cheap food, clothes and transportation not only for those in informal sectors, but also for those low levels in the formal sector, which don't have money for these things. "These people generally have strong survival skills, shrewd business sense, and long experience of hard work, knowledge of their markets, extensive informal support and communication networks, and a fundamental understanding of flexibility as a key to micro-enterprise survival."[41]

THE REPUBLIC OF MACEDONIA MICROFINANCE PROSPECTIVE

A modest research has been done on the subject of MF till now,[42] there are just internal evaluations of the programs by the practitioners, which are not publicly presented and their scope is constrained to sustainability and outreach of the organizations. This information is gathered from discussions with key informants from the institutions.

This study is conveyed in order to examine the microfinance perceptions in the country based on a survey that gives answers to a set of questions related to the general characteristics of the poor households, their problems, needs, savings, borrowing and financial exclusion.

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41) Robinson, Marguerite. 2001. "Microfinance revolution: Sustainable finance for the poor." p.12. *World Bank Publications, Washington DC, USA*

42) See more in: H.Cipusheva, 2008. "The impact of microfinance on poverty alleviation - the case of Republic of Macedonia", Master thesis, SEEU. The present study examined important issues related to the impact of microfinance. The objectives of the study are to evaluate the impact of microfinance on individuals, on households, on small-enterprises and on community. The survey covered 200 individuals, equally presented by incoming and existing clients from two MFI in Macedonia. The sample geographically was taken from the municipality of Shuto Orizari in Skopje, the capital of Macedonia, since this area suffers from high incidence of poverty. The ethnical background of the sample consists of Roma population, from which (70%) are unemployed, according to the state statistics (2002).

RESEARCH METHODOLOGY

The survey of a household financial decision was conducted during the month of December, 2012. For this purpose a structured questionnaire was developed based on which people who were selected according to previously established methodology were surveyed. The survey is conveyed by Center for economic analyses-CEA.[43]

Sample structure

The survey was conducted in 208 households in 21 municipalities in the country. The number of respondents in each region is selected using the official statistics from the National Census of 2002. The sample consists of respondents from urban/rural municipalities that satisfy certain demographic, social and economic criteria relevant for the subject matter of the research.

Field work

The interviews were carried out face-to-face in people's home, using Paper-and-Pencil (PAPI). The selection of the respondents in the urban areas was done in such a manner that the person conducting the poll was obliged to select every fifth house, starting from the municipality premises, considered as static point. In cases when the living premises are unoccupied, or when the citizen does not wish to participate in the poll due to any reason, the person conducting the poll selects the house next to those premises. In rural areas, the selection of the households was performed on both sides of the main country street. Within the household, the person who is of age and whose birthday comes first when calculated from the polling day was selected for interviewing.

KEY FINDINGS

GENERAL INFORMATION

The distribution of the respondents by municipality is shown in table 2. The gender distribution of the respondents is 39% male and 61% female. 88% of the respondents are from urban areas and the rest 12% from rural areas. The ethnicity structure of the respondents is shown in the Figure 2.

Table 1.

Municipality	Percent	Municipality	Percent
Aerodrom	9	Negotino	3
Bitola	8	Ohrid	4
Bosilovo	3	Prilep	7
Cair	8	Resen	3
Cashka	1	Shtip	3
Centar	3	Struga	5
Ceshinovo	3	Strumica	4
Gevgelija	3	Tetovo	7
Gostivar	7	Veles	5
Karpos	3	Zhilce	4
Kumanovo	7	**Total**	**100**

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43) www.cea.org.mk

Figure 2. Ethnicity distribution

Macedoni an 78%

Bosnian 1%
Vlachs 1%
Roma 1%
Turkish 3%
Albanian 16%
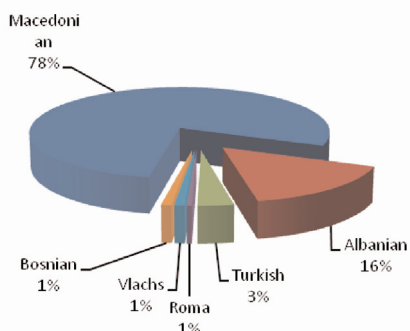
Figure 3. Age distribution

18-25 26-33 34-41 42-49 50-57 58-65 66+

Figure 4. Employment

Other
Unemployed
Student
Pensioner
Housewife
Farmer
Seasonal work
NGO
Private sector
Public sector

0   10   20   30   40   50
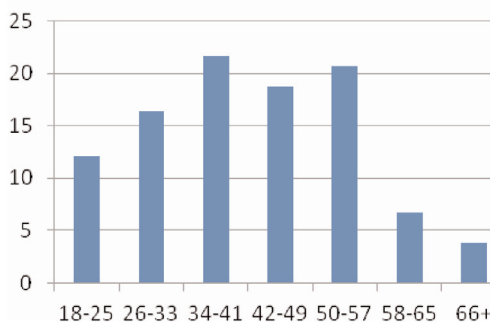
Figure 5. Economic status

<9.000 denars   9.001-15.000   15.001-21.000   21.001-27.000   27.001-35.000   35.001-41.000   >41.001
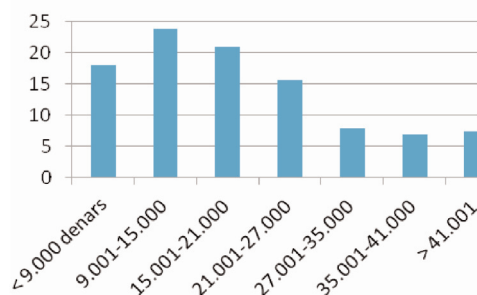
The age distribution shows that the age groups from 26-57 years comprise 77% of the respondents. Majority, 48% of the respondents work in the private sector, whereas 21% in the public sector and 14% are unemployed. The educational profile of the respondents shows 51% participation of the people that own secondary school diploma, and 44% owning university diploma. Almost everybody surveyed has a health insurance and the families with children consist 70% of the respondents, whereas 13% are single without children and 10% are couples without children. The majority (64%) of the families have 3-4 members. 75% of the income sources of the families come from salaries, whereas 15% come from social welfare or pensions. The housing status is 95% represented by own house possession.

FINANCIAL INFORMATION

Most of the respondents (86%) claim that they own bank account. The people that do not have one, give different reasons about it, as given in the figure 6; 61% of them do not have enough money, and 26% think that they do not own the needed documentation and do not trust the banks.

The structure of the responses related to savings shows that 25% of the people have savings, 47% do not save and 22% could not save. 75% of the respondents that have savings keep them at the bank deposit accounts, and some of them keep them at home. Most of the reasons why people save are for no particular reason (31%), family reasons (26%), housing (16%), etc. The high life expenses (60%) and low income (31%) are given as reasons for not saving.

Figure 6. Reasons for not having bank account

Religious reasons 3%
The procedures are too complicated 10%
No appropriate documents (PIC, wage) 13%
No trust in banks 13%
Not enough money to work via banks 61%
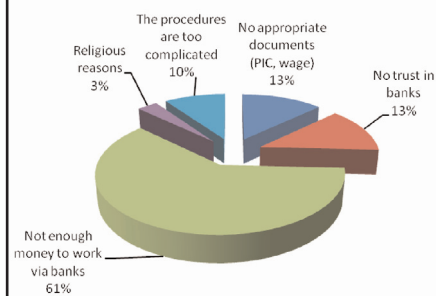
The respondents show little investment/borrowing activity (20%). Most of them get the information on which they base their investment/borrowing decision from the internet; magazines and daily newspapers; bankers, brokers and other financial agents.

WELFARE CONCEPT

The respondents' perceptions about what is the amount of income that distinguish rich people vary from 120.000 denars of income (as a statement of 53% of the respondents) to 60.001-120.000 denars (claimed by 38% of the respondents).

The health, the family and happiness are being considered as the most important aspects of the wealth, whereas the money and the residential property are considered as less important. The intangible aspects of the wealth go beyond the material ones.

The largest share on the type of financial assets that is being owned by the families of the Republic of Macedonia are the transaction account, although a high 55% has no financial assets. The nonfinancial assets are being represented by the own home ownership and cars.

Out of 208 respondents, 92 have claimed that have some kind of debt. Analysed by the type of the debt, 42% have debt represented by the credit lines that are not secured by residential property, 21% for credit card balances and 12% for primary residence. The purposes of the debt ranked by the frequency of appearance are as follow: education, improvement of the primary residence, purchase of primary residence and for urgent or health reasons.

During the last 12 months the people that have borrowed money have done it mostly from the official financial institutions and from relatives and friends. High 65% of the respondents claim that do not borrow at all.

The analyzed households imply that during the last three years 48% have had a reduction in their income. 50% of the ones that have suffered reduction in their income state *the reduction of their salary* as a reason and 43% have stated the *loss of their jobs*, as a reason.

As a main reasons why families who applied for credit were turned down or received less credit than the amount requested are because they are not employed (45%), and they do not have a collateral (20%), or simply, they do not know the reason (31%).

Figure 7. Rich people

Figure 8. Wealth

Figure 9. Financial and nonfinancial assets

Figure 10. Purpose of debt

MICROFINANCE

Concerning the question if the respondents know what MFI is, only 16% answered positively that they do know some MFI, 62% do not know any and 22% do not know what MFI's are. Based on the settlement of the respondents, 17% of the people living in urban areas know MFI's, opposed to the 8% of the people living in the rural areas.
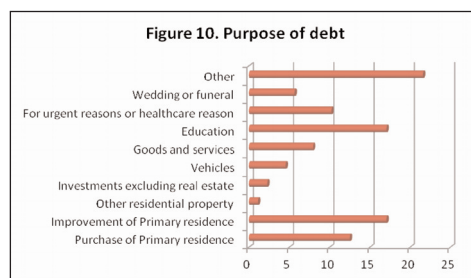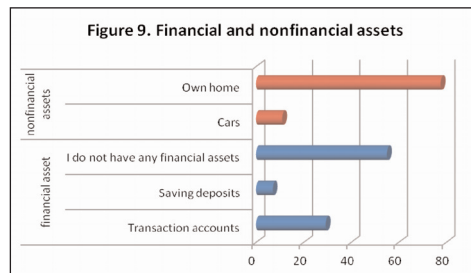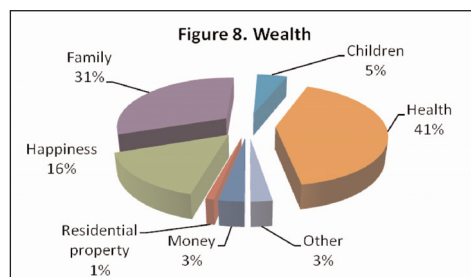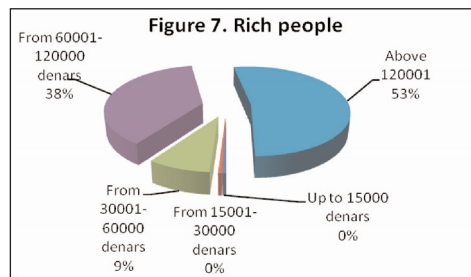
Figure 11. Borrowing institutions
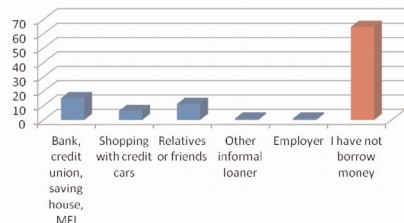
Figure 12. Reduction in income and reasons
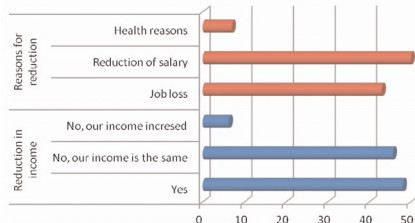
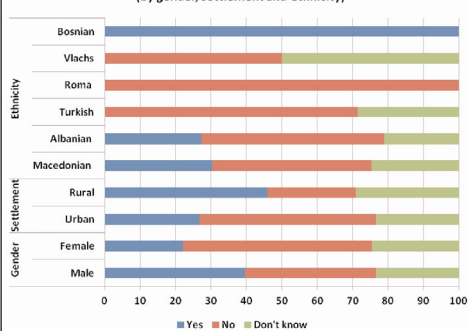**Figure 13. Borrow from MFI for self-employment (by gender, settlement and ethnicity)**

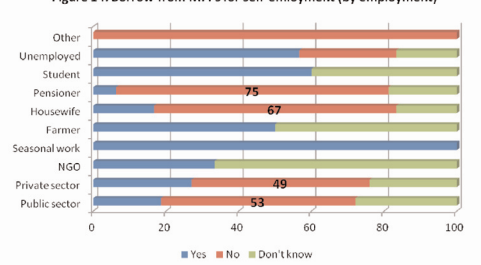**Figure 14. Borrow from MFI's for self-emloyment (by employment)**

Figure 15. Financial management

The percentage of those who have already borrowed or landed money from the MFI's during the last 12 months is very low, just 2%. However, people find interesting the idea for some institution to offer them money for starting a small business or self-employment without any collateral, by group landing - 29% of respondents support this idea; whereas 47% do not want, and 24% expressed that do not know. Male respondents are much more interested in this idea than woman; while the urban/rural distribution shows that 46% of the rural respondents like this idea, opposed to the 27% of the urban respondents. Considering the ethnic background of the respondents, Macedonians (30%), Albanians (27%) and Bosnians (100%) give support to this opportunity.

The age group consisting of people with 18-33 years of age wants to use this opportunity with 44-48% range of positive answers. Students, unemployed people, people working in NGO's and seasonal workers are attracted by this possibility; on the contrary, most negative answers are given by pensioners, housewives and public sector employees.

The possibility to use help with the financial management and realization of little savings is accepted by 43%, and refused by 57% of the respondents. Rural respondents, Albanians, students, NGO's, unemployed and etc., have higher preference towards getting financial management support. The 18-25 age group shows highest readiness for this kind of support.

Figure 16. Support development

Concerning finding useful any kind of help in legalizing their potential businesses, consultancy for business development, and information on the cheapest raw materials, except for the youngest age group, substantial number of respondents from other age groups, especially from 42-49 years is interested in this kind of support. A raising interest comparing to the other previously stressed kinds of support is being shown from the respondents grouped by employment.

Figure 17. Support use

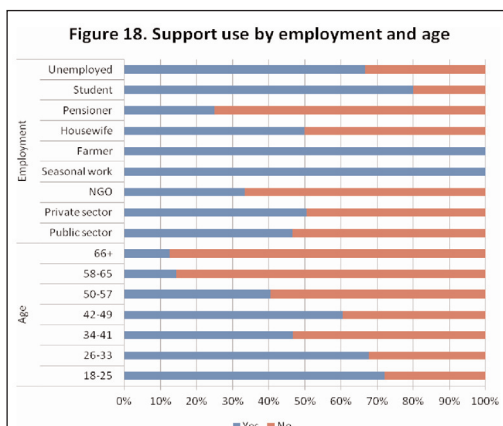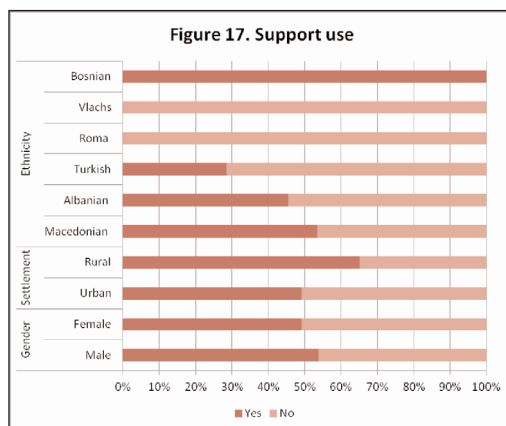Figure 18. Support use by employment and age

The hypothetical financial and consultancy help offered by the existing banking and government institution is appreciated by 51% of the respondents. The rural respondents are more optimistic about this usefulness compared to the urban respondents. Within the age groups categorization, people above 50 and mostly people from 34-41 years are not attracted by this opportunity. Pensioners, people working in NGOs and in the public sector are also less optimistic. Macedonians and Albanians show highest interest in this area.

CONCLUSION

This study underlines some issues concerning the availability of financial resources offered by the financial institutions in RM to the citizens, with particular focus on microfinance and its use for improvement of the financial and economic situation of the citizens.

The results show very low use of financial offer of the financial institutions in the country. Significant part of the people does not possess a bank account because they think that they do not have the documentation needed or do not trust the banks. The situation with savings is also gloomy, since just 25% of people have savings due to the high life expenses (60%) and low income (31%) – almost half of the respondents have suffered from reduction of their income in the last 3 years. A high, 55% has no financial assets.

The investment/borrowing activity corresponds to the situation with the savings - 20%, out of which the largest share is made by the credit lines that are not secured by residential property.

The respondents in the survey borrow because of the several reasons: education, improvement of the primary residence, purchase of primary residence and for urgent or health reasons. They usually borrow from financial institutions or relatives and friends. Some of the respondents were not given loans because they were not employed or did not have collateral.

As long as microfinance services are concerned, the concept of microfinance is not widely known by the people in Republic of Macedonia; the majority of the people living in urban, as well as the rural areas do not know what microfinance is. However, people find interesting the idea for some MF institution to offer them money for starting a small business or self-employment without any collateral, by group landing; men are much more enthusiastic for this idea than women, as well as the rural respondents vs. urban. What is worth to stress is that half of the young people in the sample, aged 18-33 are eager to practice the MF concept and try with self-employment or entrepreneurship.

As emphasized in the literature review, the contemporary MF services include some additional products for their clients, like trainings, help in legalizing businesses, consultancy for business development, and information on the cheapest raw materials. The majority in the sample who expressed willingness to try microfinance, especially those from 42-49 years are interested in this kind of support represented with the additional microfinance services.

POLICY IMPLICATIONS

A wide-ranging framework where many addressed issues concerning MFI should be prepared.

A number of policy issues should also be considered by MFIs and the government regarding improving the outreach, the impact, and the legal background of the concept of microfinance. The critical relationship between risks that borrowers face and risks to the MFI portfolio should be improved and continued role and broader scope for donor investment in microfinance programs should be supported.

Except the borrowing or credits that MFI give, they should also provide "credit plus" services, such as different trainings, development techniques, marketing facilities and business counselling services to their clients, particularly low income groups to help them to sustain their economic activities supported by microfinance.

The demand for credit by the people is not questionable, but their needs go beyond credit for investment or income generation activities, the supply portfolio of MFI should consist of many other different instruments, like savings, insurance, etc. emergency credits for consumption and credits to reduce vulnerability to various risks, credit to diversify the asset base and facilities. Conversely, most of the existing microfinance programs should address the issue of satisfying the demand for financial services derived from the people. Thus, it is of great importance to take into account the differences among the potential microfinance clients and their needs in designing more effective microfinance instruments.

While there are limits to how much microfinance alone can do to alleviate the poverty, appropriate financial products and delivery mechanisms can play an important role in helping clients reduce their vulnerability and improve their capacity to bear risk. Towards this, on the short term a Law on microfinance should be brought that will arrange the terms of use in order to achieve decreasing poverty on the long term.

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POLITICAL ECONOMY OF TETOVO AND KUMANOVO: LEGACIES FROM THE COMMAND ECONOMY

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Hristijan Risteski
Gabriela Dimovska

Abstract

In this paper we illustrate the development of Kumanovo and Tetovo municipalities during the centrally planned economy within Yugoslavia and their share in the local economy of the Socialist Republic of Macedonia. We also illustrate the recent rational behavior of the citizens of Kumanovo and Tetovo that are engaged in the economy of Afghanistan and Iraq. The end use of the remittances that fuel the economies of Tetovo and Kumanovo are different one economy from the other. The possible explanation goes deeper in the characteristics of the early development of the two cities in the socialism before the 1990 when the transition started.

Keywords: transition, remittances, emigrants, political economy.

1. Introduction

Kumanovo and Tetovo are two similar municipalities equally distant from the Capital City of Republic of Macedonia, Skopje. One difference is in the demography and the dominance of the different nationalities in one to another. In Kumanovo, Macedonians are the biggest ethnic group, followed by Albanians and opposite of that the biggest ethnic group in Tetovo are Albanians and followed by the Macedonians. Different ethnic compositions of the population in both municipalities might've been the reason for different priorities by the central governments[44] during the period of Social Republic of Macedonia. And more, different experiences from the period of Social Republic of Macedonia, dominance of one or the other ethnic group, culture and values might've been strongly reflected in the entrepreneurial behavior and economic development of these two municipalities.

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44) Ahmetie's Village, The political economy of Interethnic relations in Macedonia. European Stability Initiative – ESI. 2002.

2. The development of Kumanovo in the Socialist Republic of Macedonia

Kumanovo is a municipality of mixed cultures, religions and traditions. Situated in the northeastern part of Republic of Macedonia, Kumanovo is the intersection of the two most important corridors in the country (Corridor 8 and Corridor 10). By number of inhabitants, Kumanovo is the largest municipality in Macedonia, occupying an area of 509.48 km[2].[45] Today it is a truly multi-ethnic center. Municipality of Kumanovo has 105,484 inhabitants, of which 60.4% Macedonians, 25.9% Albanians, 8.6% Serbs, 4% Roma, 0.3% Turks, 0.2% Vlachs and 0.6% other nationalities.[46] The geographic characteristics allowed Kumanovo region to be inhabited since prehistoric times, as witnessed by a number of archeological sites from this period.

According to the figure from '48 to '81, we can derive a simple conclusion that the population growth in Kumanovo increased steadily during the period. In '81 it started to decline until '94, and then slightly began to rise.

Figure 1:

Population in Kumanovo.
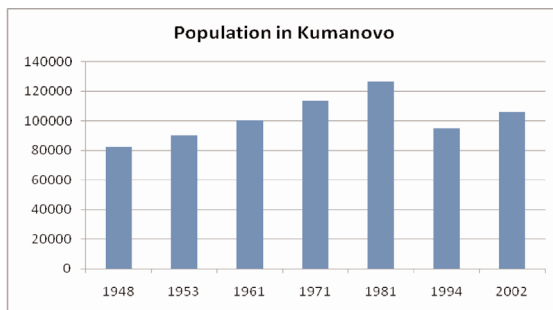
The calculated indices derived from these data showed that the population in '81 compared with '48 increased by 54 percentage points; compared with '53 increased by 40 percentage points; compared to '61 increased by 26 percentage points; and compared to '71 increased by 11 percentage points. The number of inhabitants in '02 was 16 percentage points less than the number of population in '81. According to the number of population in '94, the population in Kumanovo in '02 increased by 12 percentage points. Population growth from '48 to '81 was due to the migration village–town, because of the industrialization. In the eighties, Socialist Republic of Macedonia plunged into a debt crisis so many citizens went temporarily to work abroad and took their families with them.

Because our subject of interest is the economic development of the Municipality of Kumanovo, in the socialism, by analyzing the statistical data, we can illustrate its development during this period.[47]

Figure 2:

Number of business owners-individual

sector in Kumanovo.

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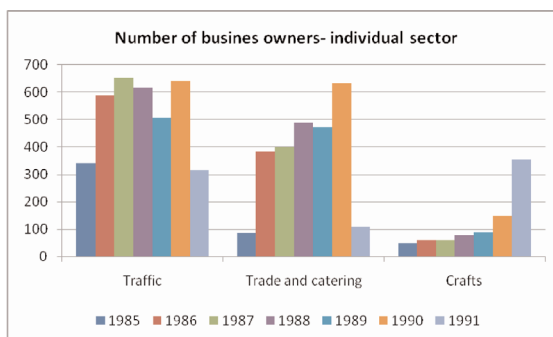
45) Census of Population, Households and Dwellings in Republic of Macedonia, 2002.

46) Census of Population, Households and Dwellings in Republic of Macedonia, 2002.

47) Statistical yearbooks of SRM, 1955, 1956, 1968, 1969,1970, 1971, 1972, 1973, 1974, 1975, 1976, 1977, 1978, 1979, 1980, 1981, 1982, 1983, 1984, 1985, 1986, 1987, 1988, 1989, 1990, 1991, 1992.

Figure 3:

Number of workers in small businesses

Number od workeres in small businesses
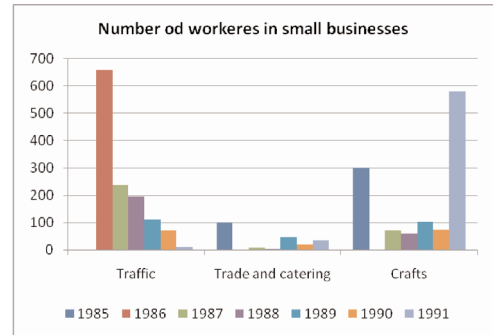
According to the data, in the period between '85 to '91 many small business owners occurred in '90, and many workers in small businesses were employed in the traffic sector in '86. From the figure, we can also note that traffic, trade and catering have been continuously present as number of business owners and the highest percentage of employees came from these sectors in early 80s. The crafts sector experienced high growth during the '91 when the transition toward market economy started. Crafts began to rise in '91, because the industrial production was in closure and restructuring and craftsmanship came as an alternative. Until then, it was suppressed by the other sectors.

The next figures illustrate the representation of organizations and communities by activities. The majority of the organizations were in the non-economic sector, such as social-political organizations-SPO and other organizations, as well as in the education. On the other hand, most common organizations in the mid 80s from economic sector were the industry sector and agriculture and trade sectors. Industry and mining sector in Kumanovo declined significantly in late 80s but agriculture and fisheries increased significantly. These were the stylized facts of the economy in a transition.

Figure 4:

Organizations by activities- economic sector.

Organizations by activities- economic sector
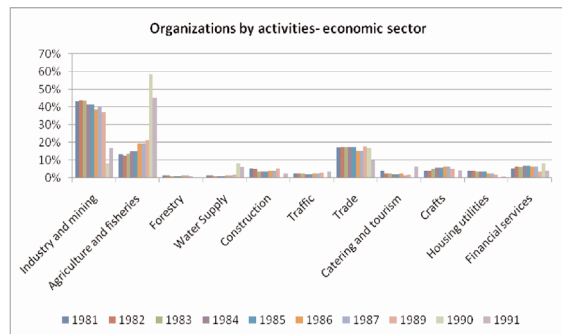
Figure 5:

Organization by activities – non

economic sector.

Organizations by activities - non-economic sector
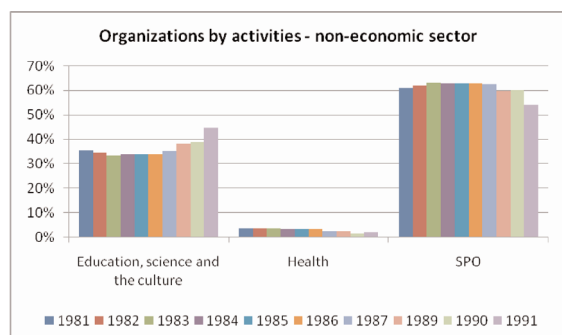
The Employment in Kumanovo has its own growth and decline over the years. In '77 there has been a significant decline in employment and in the coming years it grew. In '90 and '91 there was new noticeable decline in the employment and the reason for this was the deindustrialization because of the transition. If we make comparison between the years '68, '80 and '91 in '68 43% of the population in Kumanovo was employed in the industrial sector, 10% in agriculture, 8% in construction and trade, and insignificant part in the other sectors of the economy. In the non-economic sector in '68 6,73% of the population was employed in education, science and culture and 27% in social and political communities. In '80 in the economic sector, 58% were employed in industry, 11% in agriculture, 10% in trade, 7% in construction and in the non-economic sector, 48% in education, 29% health and 23% in the SPO. In '90 the employment by sectors was: 62% worked in industry (economic sector), 11% education, 40% health, 16% in the SPO, etc. The downward trend in employment in the early '90s was due to deindustrialization.

Figure 6:

Number of workers in Kumanovo.
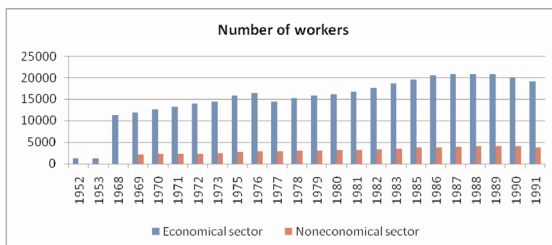
Figure 7:

Number of workers
by activity – economical sector.
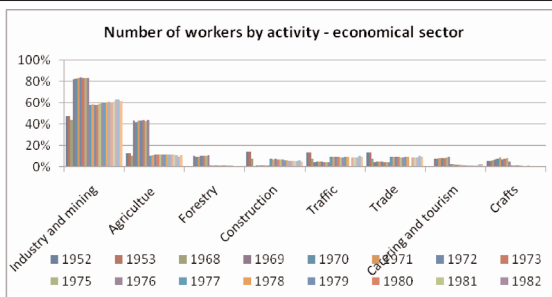
Figure 8:

Number of workers by activity –
non economic sector.
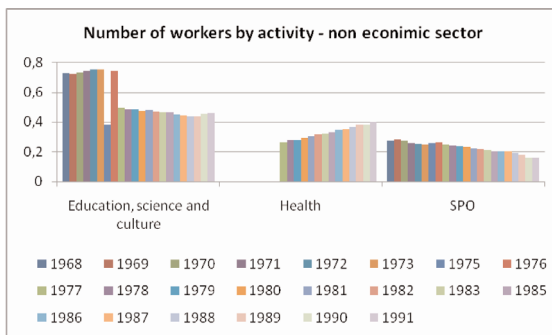
If we look at the national income[48] of Kumanovo as part of the Socialist Republic of Macedonia and the activities in which it was accomplished, most people incomes were realized in industry and mining (44% in '65, 47% in '77 and 55% in '90-) and in agriculture (37% in '65, 24% in '77 or 13% in '90).

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48) National income is calculated in terms of material production. National income in the tables for basic distribution of social product (net value product) concerns newly-created value calculated as depreciation or as total of net pay and surplus production.

Figure 9:

National income, Kumanovo.
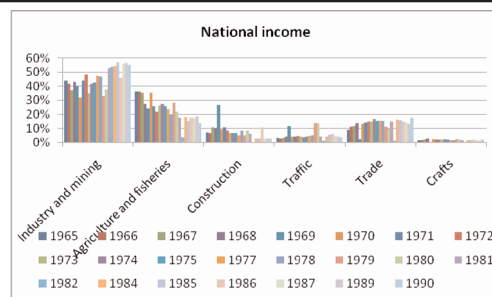
The behavior of the social product[49] is illustrated in the following table. Most of the social product was coming from the industry and mining with a peak in '88, then agriculture, and smaller part to the trade and construction. In the '90s, the percentage of social product created in the industry was reduced, due to the start of the deindustrialization other sectors were picking up.

Table 1: Social Product - Kumanovo

| Year	Social product										
	Industry and mining	Agriculture and fisheries	Forestry	Water supply	Construction	Traffic	Trade	Catering and tourism	Craft	Other services	Total
1976	46%	25%	0%	1%	5%	5%	13%	2%	2%	0%	100%
1977	47%	23%	0%	1%	5%	5%	15%	2%	1%	1%	100%
1978	44%	20%	1%	1%	7%	8%	13%	3%	2%	2%	100%
1979	32%	28%	0%	0%	5%	16%	10%	5%	2%	3%	100%
1980	36%	21%	1%	0%	8%	16%	9%	4%	2%	3%	100%
1981	53%	18%	0%	0%	6%	5%	14%	2%	1%	1%	100%
1982	54%	18%	0%	0%	4%	5%	14%	2%	1%	1%	100%
1984	55%	18%	0%	0%	3%	5%	15%	1%	1%	1%	100%
1985	58%	15%	0%	0%	3%	6%	15%	1%	1%	1%	100%
1986	54%	17%	0%	0%	2%	6%	14%	2%	3%	0%	100%
1987	57%	17%	0%	0%	3%	5%	13%	2%	1%	1%	100%
1988	64%	12%	0%	0%	2%	5%	12%	2%	2%	2%	100%
1989	57%	18%	1%	0%	3%	12%	6%	1%	1%	2%	100%
1990	56%	13%	0%	1%	3%	4%	16%	2%	2%	2%	100%

Source: State statistical office of Macedonia

The personal income in the years analyzed is fluctuating. Personal income in trade has grown by the years, but in the '90 it declined. Traffic and crafts, on the other hand, have been continuously declining, but in '90 it started to grow.

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49) Social product as an indicator of value of final production is shown as total of the national income and depreciation.

Figure 10:

Personal income, Kumanovo.
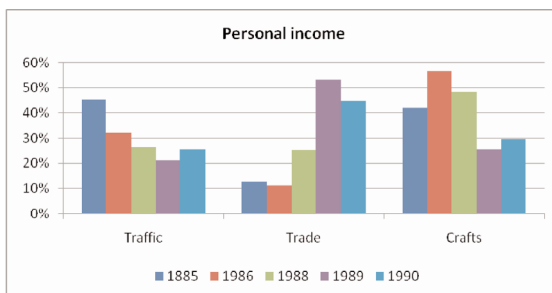
As far as the companies that contributed to the development of the municipality and the community, we can say that Kumanovo in the socialism was versatile in companies from different sectors. A small number of private manufacturing firms in the Kumanovo area rose from the ashes of the socialist industry, taking advantage of the once technological development and the pool of experienced workers and business contacts that were built in the previous system.

Table 2: Factories in Kumanovo, Socialist Republic of Macedonia.

Kumanovo		
Year	Factory/Company	Sector
1946	>Boro Petrushevski- Papuchar	Tobacco
1947 and 1948	>FMK Spark	metal industry
	>CIK Kumanovo	shoe industry
	>Dimche Erebica	wood industry
	>Jug-Turist	transport
	>Prosveta	print
	>NAMA	trading enterprise
1953	>11 Oktomvri	welding and tubes factory
1953	>Kozjak	construction company
	>Agrosnabditel	trading enterprise
1954	>Tekstilopromet	Trading enterprise
	>11 Noemvri	metal processing industry
1957	>Maj	wood industry
1958	>30 Juli	plastic enterprise
	>KRK Kumanovo	leather industry
1960-1970	>Compleks Kumanovo	
	>ZZ Sloga	
	>Todor Velkov	livestock center
	>ZZ Nikushtak	
90's	>SOBIM	motorcycles and bicycles
	>BOSS	shoe industry
	>TUSHEVSKI	shoe industry

Source: Media research

Most of the population from the Municipality of Kumanovo worked in these companies and thus formed the economic and social life, not only of the municipality, but also they helped in the development of the overall economy of the Socialist Republic of Macedonia.

But huge part of the population in Kumanovo, went to work abroad i.e. they accounted 4% of the total population in Macedonia. Of these, 11% were females. Of the total number of workers who have left to work abroad, more than 60% were farmers.

3. The development of Tetovo in Socialist Republic of Macedonia

The municipality of Tetovo is situated in the northwestern part of Republic of Macedonia and 41 km from the capital City of Skopje. Today, the municipality covers an area of 87 km^2. Tetovo is one of the oldest cities in Macedonia in which throughout history mingled many cultures. Tetovo has a favorable geographical position and favorable climatic conditions that allow Tetovo's region to have many clear water springs, benefit that only few cities in Macedonia have.

Municipality of Tetovo, in terms of the population structure is a multi-ethnic community. Out of 86,580 people, 23.1% are Macedonians,70.3% are Albanians, 2.7% Roma, 2.2% Turks, 0.6% Serbs, 0.2% Bosniaks and 0.7% other nationalities.[50]

According to the next figure[51] we can see higher population growth from '71 onwards, than from '48 to '71. Indexes derived from these data can show this more accurately: the population in'81compared with '43 increased by 94 percentage points, compared to '53 increased by 73 percentage points, compared to the '61 increased by 55 percentage points and compared to '71 increased by 24 percentage points (we acknowledge the fact that there might be changes in the territorial composition during the period).

In the next 10 years the number of the population fell substantially, for various reasons, but mainly because of the decline in the industrialization. This transitional fact forced citizens to look for a better life beyond Macedonia's borders. The decline in the number of the population was large, and the biggest reason for this was the Albanians that mainly worked abroad and withdrew their families with them.

Figure 11:

Population in Tetovo.
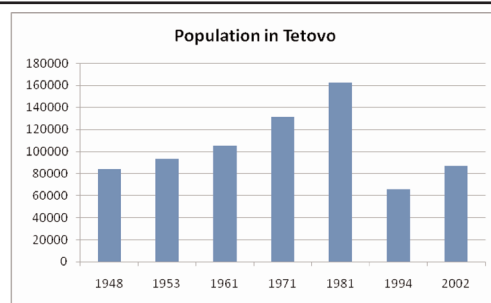
We will also present the economic development of the municipality, analyzing some statistical data.[52] According to the data from the figure, most small business owners and employees were registered in the traffic sector. Traffic and trade developed continuously over the years but declined with the start of transition whereas crafts were growing especially in'91.

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50) Census of Population, Households and Dwellings in Republic of Macedonia, 2002.

51) Statistical yearbook of Socialistic Republic of Macedonia, 1983.

52) Statistical yearbooks of SRM, 1955, 1956, 1968, 1969, 1970, 1971, 1972, 1973, 1974, 1975, 1976, 1977, 1978, 1979, 1980, 1981, 1982, 1983, 1984, 1985, 1986, 198, 1988, 1989, 1990, 1991, 1992.

Figure 12:

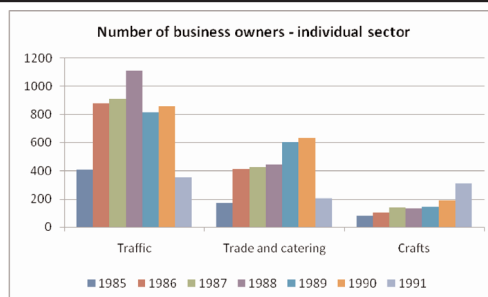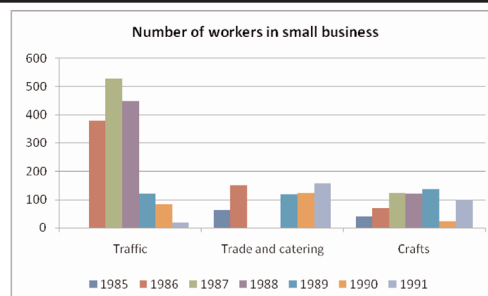Number of business owners – individual sector in Tetovo.

Figure 13:

Number of workers in small business.

The following figure shows in which activities during the period from '83 to '91, were registered most of the organizations. According to this, most organizations were registered in the non-economic sector as socio-political organizations, but also in education, science and culture. In the economic sector most organizations and communities were registered in the industry, agriculture and trade but started to decline with the transition. Other branches developed significantly after '91.

Figure 14:

Organizations by activity – economic sector.
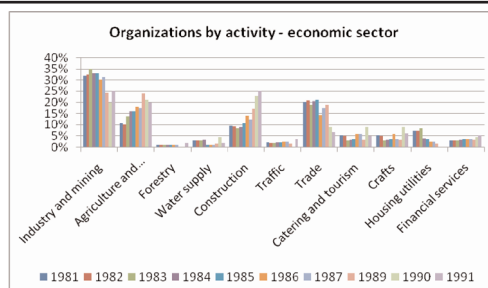
Figure 15:

Organizations by activity – non economic sector.
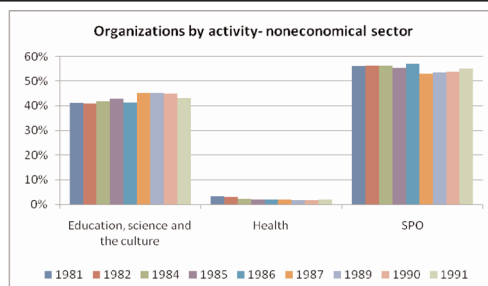
According to the presented data, the number of employees was increasing, but there has been a significant decline in employment in'77 and '78. After the fall, the economy recovered, but back in '90 it declined again because of the start of the transition. The economy continued to decline, while the employment in non-eco-

nomic sector increased. We will make a comparison of the employment in '68, '80 and '91. In '68 in the economic sector, 54% of the total number of employees was employed in industry while 7% were employed in agriculture, in construction 3%, 8% in commerce and insignificant part in the other industries. On the other hand, in the non-economic sector, the same year 76% were employed in education and culture and 24% in the social-political communities. In '80, 62% were employed in the industrial sector, 2% in agriculture, 8% in construction, 12% in trade, while in the non-economic sector, 49% in education, science and culture, 29% health and 22% in the SPO.

Figure 16:

Number of workers, Tetovo.
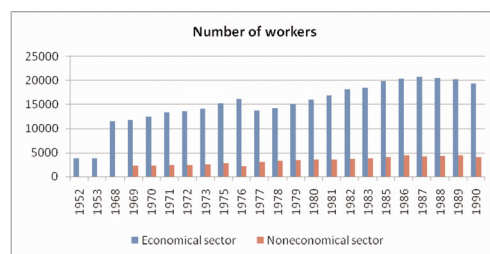
The employment by sectors in '91 was like this: in the economic sector, 65% were employed in industry, 5% in agriculture,8% in construction, 13% in trade, while in the non-economic sector: 46% in education, science and culture, 34% health and 19% in the SPO.

As we explained before, the employment in the industry started to grow, and in the '90s began to decline. Agriculture on the other hand, has a sharp decline at the beginning of industrialization, and later, as well as the other sectors in the economy started to grow, due to the decline of the industrialization.
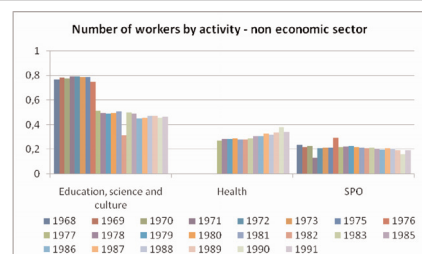
Figure 17:

Number of workers by activity – economic sector.
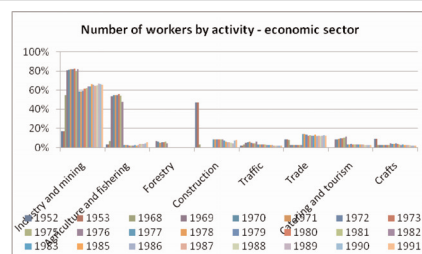
In the non-economic sector, the number of employees was nearly constant, without major fluctuations.

Figure 18:

Number of workers by activity – non economic sector.

National income in Tetovo fluctuated over the years. Most of it was realized in the industrial sector, as follows: 48% in '65, 40% in '77, 48% in '91, in agriculture, 29% in '65, 21% in '77 and '90 and in trade: 12% in '65,17% in '77 and 15% in '90.

Although employment in the mining industry in the late '80s declined, it still remained to be leading driver of the economy, due to the poor development of the other sectors.

Figure 19:

National income, Tetovo.
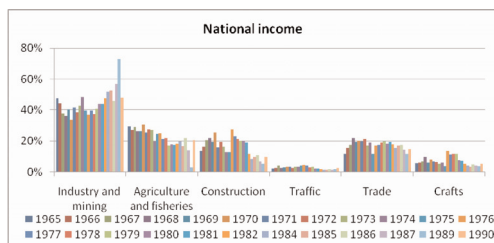
The movement of the social product is similar to the one in Kumanovo. The social product over the years grew continuously because of the industrial development of the country. In the '90s the deindustrialization caused decline of the social product from the industry and that allowed other sectors to get higher shares in the socio-economic processes.

Table 3: Social Product - Tetovo.

Social product										
Year	Industry and mining	Agriculture and fisheries	Forestry	Water supply	Construc-tion	Traffic	Trade	Catering and tourism	Craft	Other services	Total
1976	38%	25%	0%	1%	7%	16%	2%	4%	4%	3%	100%
1977	43%	20%	0%	1%	9%	16%	2%	4%	4%	1%	100%
1978	39%	21%	0%	1%	8%	18%	2%	4%	4%	3%	100%
1979	42%	17%	0%	0%	8%	19%	2%	5%	5%	3%	100%
1980	45%	18%	1%	1%	8%	15%	2%	4%	3%	2%	100%
1981	44%	17%	0%	0%	8%	18%	2%	3%	3%	3%	100%
1982	49%	18%	0%	0%	5%	17%	2%	3%	3%	4%	100%
1984	53%	15%	1%	1%	4%	15%	2%	2%	3%	4%	100%
1985	57%	15%	0%	0%	5%	15%	1%	2%	2%	4%	100%
1986	50%	18%	0%	0%	5%	16%	2%	3%	3%	2%	101%
1987	58%	14%	1%	0%	4%	14%	2%	2%	2%	5%	100%
1988	65%	11%	0%	0%	3%	12%	1%	2%	2%	4%	100%
1989	67%	11%	0%	0%	3%	12%	2%	1%	1%	1%	100%
1990	56%	14%	0%	0%	5%	14%	2%	2%	2%	4%	100%

Source: State statistical office

Personal income over the years was highly variable. It declined over the years in the traffic and crafts sector and grew only in the trade sector.

Figure 20:

Personal income, Tetovo.
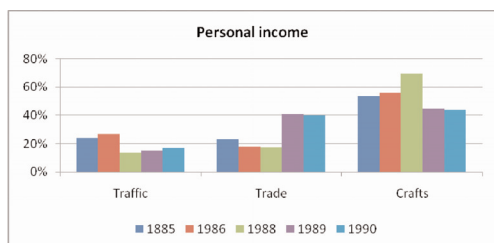
Tetovo's economy was based on some of the largest commercial organizations inherited from the former system and during the transition period the private sector gained a significant position, especially the wood-processing industry, plastics and other trade. Significant socialist enterprises that marked Tetovo's economy are summarized in the following table:

Table 4: Factories in Tetovo, Socialist Republic of Macedonia.

Tetovo		
Year	Factory/Company	Sector
1951	>TETEKS	textile factory
1952	>JUGOHROM	chemical-electro metallurgy
1953	>Edinstvo	fashion apparel
1960	>Agroremont	wholesale and retail
early 60's	>Zito Polog	food industry
	>ZIK Tetovo	agricultural sector
	>SIK JELAK	wood industry
early 90's	>Avtoprogres	automechanika
	>Medicinska Plastika-Tetovo	medical plastic
	>Electometal	electro-metallurgy
	>Tetovogradba	construction company

Source: Media research

In addition we should also mention the workers that left for temporary work abroad. Namely, according to the data from'71, workers from Tetovo that were on temporary work abroad were 10% of the total number of overseas workers from Macedonia. However, only 5% of them were females. Like in Kumanovo, the most common group of people that went to work abroad, were farmers (68% of that total number moved from Tetovo).

4. The differences and the similarities between Tetovo and Kumanovo

In the study above we analyzed Kumanovo and Tetovo, two municipalities that have so many common features and differences. Geographically, they are at the same proximity of the Capital City of Republic of Macedonia, Skopje. We saw that in Kumanovo the deindustrialization took larger part of the businesses whereas in Tetovo the deindustrialization didn't take that much intensity (number of workers in industry on Tetovo remained stable in the late 80s). On the other side agriculture started to rise in the early 90s in Kumanovo whereas the registered agriculture in Tetovo was declining probably because of the non-registered agriculture activities and more citizens leaving Macedonia and Tetovo and going to work abroad compared to Kumanovo.

The geostrategic position of the two municipalities is favorable, given the fact that the main international corridors are passing through or close to their territories and also the proximity of the Capital City of Skopje.

Another feature that connects the municipalities is the ethnic diversity. The biggest ethnic groups in both municipalities are the Macedonians and the Albanians (higher share of Macedonians in Kumanovo and higher share of Albanians in Tetovo).

In terms of the demographic point of view in Kumanovo, we can say that the demographic structure of the population is an important indicator of the dynamics of the population growth and it might be an important element for the development of political economy of the two municipalities.

The population's structure in Kumanovo and Tetovo is heterogeneous, not only in the municipal core, but also in most of the rural areas where there are various nationalities and ethnic groups, with different customs, religion and habits.

Kumanovo has developed industry and is a center of industrial production in the northeastern part of Macedonia. The shoe industry in this municipality has big tradition and persists with decades. Today, in the municipality are operating more than 60 manufacturing shoe companies, making the municipality center for the shoe industry in Macedonia and beyond. The products are intended for Macedonia, the former Yugoslav countries, and also for Bulgaria, Greece, Albania and Italy. Smaller part is exported in the Czech Republic, Slovakia and Germany.

Also, a few years ago, the factory FZC 11 Oktonvri AD Kumanovo began to operate. The factory is for welding pipes and profiles and it employs more than 250 workers and has a major part in the creation of the economy of the municipality.

The economy in the Municipality of Tetovo in the last years has marked increased development. Main developing activities and also industrial pillars of Tetovo are the wood processing industry, construction and building materials industry, agriculture, the textile industry etc. Furthermore, constant development of the economy can be noticed from the permanent achievements of many business objects that operate in the region of Tetovo. 98% of them belong to small and medium entrepreneurship, and only 2% belong to big ones.[53]

Businesses that for the past several years contributed to the development of the Tetovo region are from the wood industry (furniture), construction, food industry and textile industry. These sectors with their capacities and technology became competitive not only on the market in Macedonia but also on the Balkans and beyond. Some of the enterprises that produce furniture for households and offices are equipped with modern technology CNC and have potential to approach to the international markets.

The biggest difference between the cities is the direction of development after the deindustrialization. In Tetovo there is more Albanian population as it is in the proximity of Kosovo and Albania. Many Albanians work abroad and the money they earn there are invested in small businesses in Tetovo and the surrounding area. On the other hand, Kumanovo also has a large percent of Albanian population and the municipality is close to Serbia. The population there started more intensively to go abroad much later with the opportunities arisen in Afghanistan and Iraq.

Thus, another difference between the two municipalities is that while Tetovo have had higher number of "older" emigrants from the 80s than Kumanovo, in Kumanovo higher number of citizens started to go abroad with the opportunities occurred in Afghanistan and Iraq. This might be a reason for the difference of the investing behavior of the migrants in using their remittances. Namely, while in Tetovo the "older" migrants were already supporting their families with fixed assets (houses and vehicles) most of the Kumanovo citizens were sharing the destiny of the early transition challenges in Macedonia. Latter, when the opportunities in Afghanistan and Iraq arise, Tetovo migrants could've start to make rational choices to invest in businesses from remittances from Afghanistan and Iraq while Kumanovo just-started-migrants are still in the "early" wave of choices to invest in houses, flats and vehicles. Also, Tetovo and Tetovo region's citizens never stopped to "export" migrants. The proximity to Kosovo (also a lot of migrants and remittances producing region) provided Polog region (where Tetovo is situated) with a unique pool of migrant's experience. The Kumanovo region on the other side is at the early stage of this "migrant development pool of experience".

We will see more about the behavior of the migrants from Tetovo and Kumanovo and their investment decisions in the next chapter.

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53) http://www.tetova.gov.mk/en/b/31/

5. New realities of transition in Kumanovo and Tetovo

Republic of Macedonia on the beginning of the transition process was sharing the most favored position, but by the time has loosened its pace, and in 2012 is lacking behind its peers. Poor transition results partially can be explained with external shocks and influences, such as the embargo of Greece, wars in Yugoslavia, UN embargo for Serbia, war between NATO and Serbia, wave of 350,000 refugees from Kosovo (17% of Macedonian population) and the internal conflict from 2001. But more important, these poor performances[54] also are result of the poor privatization process, poor restructuring of the economy, poor market liberalization etc. From the survey of EBRD[55] we can see that in 2006 majority of citizens, around 80%, believe that they had better living standard in 1989. In the last survey of EBRD,[56] only one third of Macedonians are satisfied with their life, which is very low compared with 43% in the transition region, or with high 72% in Western Europe.

Figure 21:

Transition in the countries of Central and Eastern Europe.
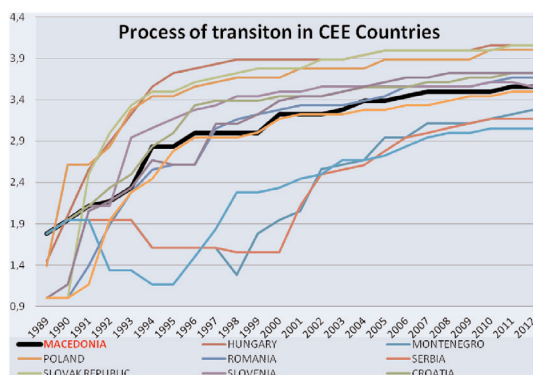
Source: EBRD Transition indicators, author's calculations.

A low standard of living and poor economic performances have lead 21.9%[57] Macedonians to emigrate, mostly in Developed Countries and more recently in the high-risky countries, like Iraq and Afghanistan. Emigration is keeping close relations with the families in Macedonia, which can be confirmed with the amount of transfers of 1.5 billion Euros,[58] or around 20% of the GDP, in 2011. The amount of current transfers is in a constant growth, which signalizes that Macedonians continue to emigrate, and is expecting a higher pace in the near future.

In addition to emigration in NATO military basis, located in highly risky countries, such as Iraq and Afghanistan became very attractive job opportunities, mostly for the citizens from municipalities of Kumanovo and Tetovo. These two municipalities are known for receiving big amounts of money through private transfers. According CEA's Study of determinants and trends in remittance flows in Macedonia,[59] in 2008 the region of Polog, where Tetovo is located, participated with 32.5%, and Kumanovo Region with 6% of the total private transfers in Macedonia. We must point that the number of emigrants who work in the military basis in Afghanistan and Iraq was much smaller, compared to the current number of emigrants.

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54) See more: Long Run Economic Consensus in the Republic of Macedonia. Center for Economic analyses – CEA.2012 (forthcoming)

55) See more: Life in Transition. A survey of people's experiences and attitudes. EBRD, 2007.

http://www.ebrd.com/downloads/research/surveys/lits.pdf.

56) See more: Life in Transition. A survey of people's experiences and attitudes. EBRD, 2011

http://www.ebrd.com/pages/research/publications/special/fyrmacedonia_lits2.shtml.

57) Migration and Remittances Factbook, World Bank 2011.

58) Source. National Bank of the Republic of Macedonia.

59) See more:

http://www.cea.org.mk/documents/proekti/Macroeconomic%20perspective%20on%20remittance%20inflows%20CEA_7%20final.pdf

In 2012 CEA conducted a research about private transfers from Afghanistan and Iraq, from economic emigrants coming from Kumanovo and Tetovo. These are one of the biggest municipalities in Macedonia, whereas in Kumanovo are living 5%[60] of Macedonian population, where the majority of the population (59.6%)[61] are Macedonians, and on the other side in Tetovo are living 3.4%[62] of Macedonian population, where majority are from Albanian nationality (64%).[63] Results from the research are that the biggest reason for working in the military basis is ensuring better future for the children. In addition to that, following reasons are added: low wages in Macedonia, lack of job opportunities and politicization of Macedonian society in recruitments for taking jobs and for other important decisions.

Only 23 percent of the respondents answered that working in the military basis in Iraq and Afghanistan is not a favorable solution, due to the high risk for their life. On the other side, the other three quarters of the respondents believe that working in the military basis in Iraq and Afghanistan is a good solution for themselves and their families. Over 90 percent of respondents answered that they will work in the military basis in Iraq and Afghanistan, regardless if they are able to find a job in Macedonia or not. Money which these workers are sending to their families is far higher than the average annual Macedonian net salary of around 4,000 Euros. In comparison, 35 percent of respondents are sending their family between 10,000 and 25,000 Euros annually. The same percentage of respondents is sending between 25,000 and 50,000 Euros, each year. It is impossible for a low skilled worker to earn that amount money in Macedonia, working as a truck driver, plumber etc. Also, these amounts are far higher from the calculated average of 2,000 US dollars sent by emigrants, in the Study from 2008.
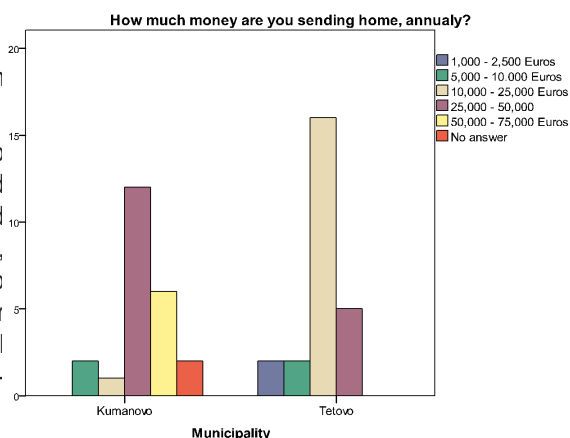
High amounts of earned money, by the persons who work in the military basis in Iraq and Afghanistan, cause changes in the behaviors and habit, in themselves and their family, as well. High number of emigrants in the military basis in Iraq and Afghanistan steamed economic expansion in these municipalities, especially in the real-estate sector in Kumanovo.

From the survey we can see that emigrants from Kumanovo are earning and sending larger amounts of money in Macedonia, compared with the emigrants from Tetovo. The percentage of emigrants who are sending between 25,000 and 50,000 Euros annually is twice as high as in Kumanovo, compared with emigrants from Tetovo. Furthermore, none of the surveyed emigrants from Tetovo were able to earn and send between 50,000 and 75,000 Euros for one year.

Figure 22:

How much money are you sending home from Iraq and Afghanistan.

Larger shares of emigrants from Tetovo who work in the military basis in Iraq and Afghanistan are confident to invest earned money in Macedonia. While on the other site, larger shares of emigrants from Kumanovo don't want or are not confident to invest their money in Macedonia. This is very strong signal about the need for improvement of the business environment in Kumanovo.

How much money are you sending home, annualy?

- 1,000 - 2,500 Euros
- 5,000 - 10.000 Euros
- 10,000 - 25,000 Euros
- 25,000 - 50,000
- 50,000 - 75,000 Euros
- No answer

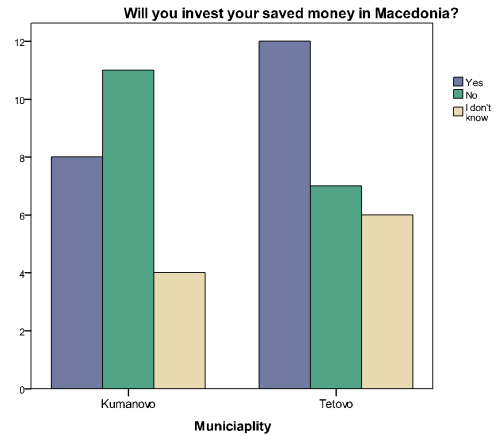
60) Census in the Republic of Macedonia 2002.

61) Census in the Republic of Macedonia 2002.

62) Census in the Republic of Macedonia 2002.

63) Census in the Republic of Macedonia 2002.

Figure 23:

Will you invest your saved money in Macedonia?

The largest part of earned money by the emigrants from Kumanovo, is spent on satisfying everyday family's needs. While on the other side, the largest part of earned money, by the emigrants from Tetovo, are invested in their homes. What's more interesting is that double percentage of migrants from Kumanovo, where the majority of the population are Macedonians, are saving their money in banks or are buying houses and/or apartments. On the other side, the percentage of emigrants who are investing their money on starting businesses is twice as high in Tetovo, where the majority of the population is from an Albanian nationality. Part of this can be explained by the length of experience Albanians have had starting and managing businesses,[64] starting from the period of Yugoslavia. And part of this can be explained by the fact that in Tetovo the "older" migrants were already supporting their families with fixed assets (houses and vehicles) and in Kumanovo the just-started-migrants are still in the "early" wave of choices to invest in houses, flats and vehicles. This certainly requires a more in depth study.

Figure 24:

On what are you spending your earned money in Iraq and Afghanistan?
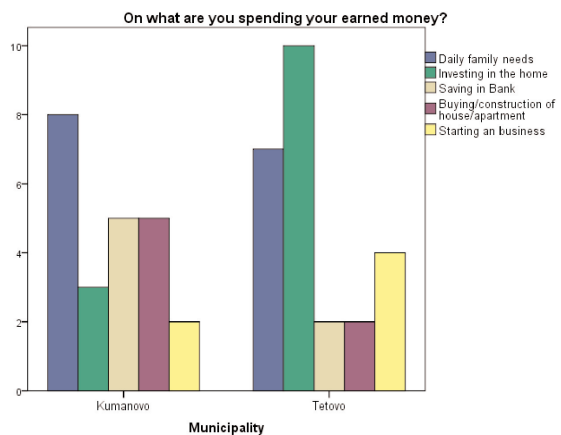
A similar result is given in the next figure. Emigrants from Tetovo are more successful entrepreneurs, compared the emigrants from Kumanovo. The share of emigrants, who were working in the military basis in Afghanistan and Iraq, and who started their own business in Macedonia and are successfully working, is much higher in Tetovo. On the other side, the same emigrants from Kumanovo are much less successful in

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64) See more: Ahmetie's Village, The political economy of Interethnic relations in Macedonia. European Stability Initiative – ESI. 2002.

starting and managing their own business. One of the most important reasons for failure in Kumanovo is pointed to the lack of knowledge and experience for managing a business but another explanation can be purely statistical. Namely, if more businesses are started in Tetovo then it is expected that more businesses will fail in Tetovo. This certainly requires deeper research.

Figure 25:

Are emigrants that start business successful?
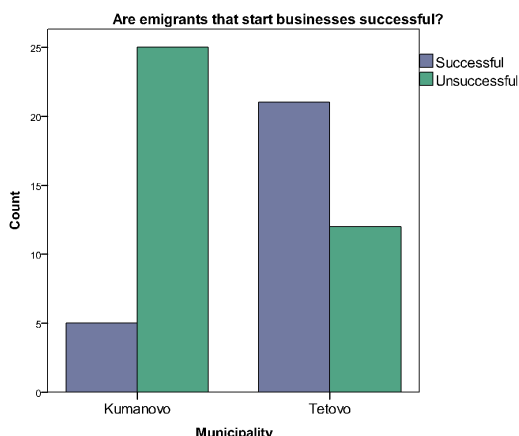
Furthermore, local businesses from Tetovo are experiencing larger positive effects from the emigrants working in the military basis in Iraq and Afghanistan. Close relations with the locals are causing positive effects for the business, besides lower amounts of sent money by emigrants from Tetovo. On the other hand, the same emigrants from Kumanovo are sending larger amounts of money, but local businesses are not feeling strong positive effects from it. Part of this can be explained with buying luxury cars and real-estate and other products in which the local economy of Kumanovo doesn't have significant participation in the production process.

Figure 26:

What is the influence of emigrant's buyers on your business?
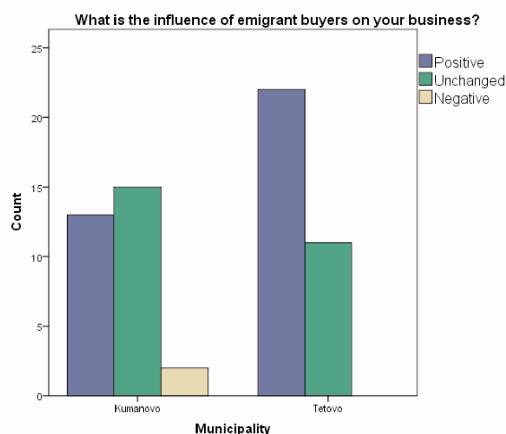
Conclusions

Large state owned enterprises, operating in various industrial sectors, were employing the biggest share of the workers from Kumanovo and Tetovo. With the transition from planed to a market economy, large share of state owned enterprises were working with a fraction of their former production levels[65] or completely stopping the production and going in bankrupts.

Kumanovo and Tetovo were not immune on the poor transition results. Both municipalities experienced negative effects of the external shocks: embargo of Greece, wars in Yugoslavia, UN embargo for Serbia, war between NATO and Serbia, wave of 350,000 refugees from Kosovo or 17% of Macedonian population and the internal conflict from 2001. Furthermore, poor privatization process, restructuring of the economy, market liberalization etc. lead to increasing unemployment and poverty among citizens in both municipalities.

Longer migration history and entrepreneurial experience in Tetovo, makes its citizens being more confident in investing their money in starting business, and at the same time being more successful in running the started businesses. This can be seeing from the increased competitiveness of the businesses from Tetovo, steamed by the modernization and growth of the companies. Authorities from the municipality of Tetovo should be focused on attracting more emigrants for starting businesses. With existing companies and attracting new ones Tetovo is on a good way to became regional industrial center for Macedonia, Kosovo and Albania.

On the other side, due to the increased demand for houses and apartments, by the emigrants from Iraq and Kumanovo, construction activities are booming in this municipality. Citizens from this municipality are less confident to invest their money in Macedonia or starting its own businesses. Furthermore, emigrants from Kumanovo are less successful in running businesses, which partially can be explained with shorter experience for opening new business, starting from the period of Social Republic of Macedonia or this can be just a statistical phenomena.

Having in mind, increased competencies of the municipality of Kumanovo, local authorities must put more efforts for improving local business environment for starting and running business. More concretely, confidence among emigrants for investing their money must be increased and at the same time creating measures for increasing the rate of successfully started businesses.

In both municipalities, politicization of the societies is pointed as one of the biggest reasons for emigrating. This politicization is presented in all important decisions, especially in the process of employment. Finally, this is a message and a case study for the central government that asymmetrical policies are required in running the country and especially in creating the balanced regional development policies.

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Web site of the Municipality of Kumanovo: http://www.kumanovo.gov.mk/

Web site of the Municipality of Tetovo: http://www.tetova.gov.mk/en/b/31/

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65) Ahmetie's Village, The political economy of Interethnic relations in Macedonia. European Stability Initiative – ESI. 2002.

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