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THE GREY ECONOMY IN MACEDONIA: MACROECONOMIC ASPECTS,
IMPLICATIONS AND POSSIBLE PROBLEM SOLUTIONS

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ABSTRACT

Compared regionally, Republic of Macedonia has one of the highest levels of grey economy activity. According to some estimations, it accounts for about 40% of GDP. This high level of grey economy has a direct influence to the main economic indicators, categories and instruments for macroeconomic regulation: GDP value cannot be precisely measured, there are problems in formulating and realization of macroeconomic policy instruments (fiscal policy, monetary policy, social policy, foreign-trade policy), etc. Because of its high value, grey economy is challenging and serious danger for macroeconomic planning and regulation.

By using qualitative, descriptive, statistic and comparative methodologies, this research attempts to locate causes, consequences and the scope of grey economy in Republic of Macedonia. It also presents different ways for measurement of the size of grey economy in the Republic of Macedonia and understands the basic characteristics of the Macedonian case in order to present well-grounded policy recommendations.

The main finding (conclusion) of the paper is the fact that the grey economy in The Republic of Macedonia is a multifaceted phenomenon and the most efficient manner to remove the causes for the occurrence and presence of the grey economy is the improvement of the institutional frame in the country. There is a need for directly focused Government measures that would precipitate the integration of the grey economy in the formal sector, once the right conditions are put in place.

The recommendations that this paper promotes will head exactly in that direction. The main recommendation is directed towards activities and measures of the authorities for preventing and removing the reasons of grey economy appearance and

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punishment of the consequences of this national economy "evil". Another recommendation is for the Government to increase the speed for redefining (changing) its role on the market. Although there are noticeable signs that the situation has been changing, there is a need for widening the awareness of all business players for the necessity of playing by the rules as well as for enforcing the institutional framework, legal order, moral values and the motivators of the country's functional economy.

KEYWORDS: Macroeconomics; Grey Economy; Informal Economy; Formal Economy; Tax Evasion

JEL CLASSIFICATION: E6

1. INTRODUCTION

The "grey" economy has a serious impact on the macroeconomic performance of the country. High levels of grey economy negatively affect the competitiveness of the formal firms due to unfair competition on the domestic market and regulatory burden. They also deter foreign direct investments, which contributes to lower capital inflows and productivity in the country.

The grey economy directly affects other aspects of social life, such as level of crime, rule of law, social conflict, political instability, etc. In general, high grey economy has a direct influence to the main economic indicators, categories and instruments for macroeconomic regulation.

This paper attempts to locate causes, consequences and the scope of grey economy in Republic of Macedonia, as well as to estimate the level of grey economy in the Republic of Macedonia and understand the basic characteristics of the Macedonian case in order to present well-grounded policy recommendations.

The research is based on several methodologies: qualitative, descriptive, statistic, and comparative. Some study findings and recommendations come out from the survey that was carried out on a sample of 1200 respondents.

During preparing this text a substantial amount of domestic and foreign research was consulted, but the analysis is mainly based on the author's own research because the grey economy has been his analytical preoccupation for a longer period of time.

The main finding of the paper is the fact that the grey economy in the Republic of Macedonia is a multifaceted phenomenon. It emphasizes the necessity for the government and its institutions to create different approaches for the creation, affirmation and implementation of the economic reforms, with the purpose of restoring the trust of the citizens in the institutions as components of a consistent, responsible and non-compromising country. The most efficient manner to remove the causes for the occurrence and presence of the grey economy is improvement of the institutional frame in the country. This means improvement of the relations between the government and the economy. The recommendations that this paper promotes will head exactly in that direction.

2. PROBLEM STATEMENT

The Gross Domestic Product (GDP) is the most significant macroeconomic indicator by which the total economic activity of a certain country is measured. According to a globally recognized definition, the GDP represents a sum of the value of all of the produced final goods and services during the period of one year. Its size is measured with the sum of the final spent goods and services in the four main sectors of the economy: households (C), enterprises (I), Government (G) and the foreign-trade sector (X – M), or²:

$$\text{GDP} = \text{C} + \text{I} + \text{G} + (\text{X} - \text{M})$$

On the other hand, the GDP size can be measured as a sum of the expenses for the engaged inputs in the production: salaries (for the employees), interests (for the

² Nenovski, T., *Macroeconomics*, University American College Skopje, 2010, p. 79.

green credits), rents (for usage of a rented land) and revenues (for the entrepreneurs). On the total of these expenses the rate of the indirect paid taxes (VAT, excises) and the amount for the depreciation of fixed assets are added.

The result of the GDP measurement through both methods always has to be the same. Measured like that, the GDP becomes the mirror of the national economy in aspect of its size, structure and growth, and it also represents indicator for international comparison of the domestic economy with the foreign economies.

Going through the numerous turbulent paths in the past 20 years of its transition, the Macedonian economy notes cycle changes in its development. Its GDP has mostly had negative changes, but it also experienced some modest positive changes in the period from 2003 to 2008 (the period before the world economic crises), when GDP started to note a significant real growth rate of 2,8%, 4,6%, 4,4%, 5,0%, 6,1% and 5,0%, for each year, respectively.

Most analyses show the fact that the GDP of the Republic of Macedonia (RM) would have noted significantly higher amounts and rates of real growth, if the transitional development cycle and the numerous shocks that the Macedonian economy had in the past 20 years not caused big structural disorders in the economy, and which were extremely manifested in the permanent growth of the number of unemployed people. Those people had to provide their existence in every possible way, primarily in the so-called informal sector, through inclusion in the different channels of the so – called „grey“ economy.³

3. DEFINITION OF GREY ECONOMY

What is grey economy?

There are various definitions that determine grey economy. It seems that the most dominant and most precise definition is the one which brings the grey economy

³ We are talking about the part of the economy which is not enclosed in the formal economy, because of which different authors define its existence in various ways: not registered, underground, non-measured, non-observed economy, shadow economy, black economy, etc. Generally, that part of the economy in Republic of Macedonia is referred to as grey economy, which, in the literature throughout the world has a different meaning.

in a tight connection with the officially measured GDP: *It encompasses all the unregistered production activities (the ones that create added value), which ought to be a part of the national production.*⁴

In order to determine the size of the grey economy as correctly as possible, as well as its rate in the GDP, we should bear in mind that: 1) we are talking about the added value, not about all the transactions which take part in the informal sector (for example, the capital revenues are not added value); and 2) the grey economy is not the same as tax evasion (nonpayment of or avoiding to pay taxes), because, paid or unpaid, the taxes represent a transfer, not an expense in the economic sense of the word.

4. SIZE, CAUSES AND CONSEQUENCES OF GREY ECONOMY

During the analysis of the macroeconomic aspects of grey economy and the possible solutions for its reduction (fighting), it is necessary to know its orientation size, the causes that it depends on, its influence on the different instruments for the implementation of the macroeconomic policy of the country and the consequences it would cause to the separate macroeconomic categories.

In the Republic of Macedonia there is a widely spread opinion that the grey economy (in different periods) has amounted between 40 and 50% of the GDP. The establishment of the "flat" profit personal tax and the "flat" personal income tax in 2007, the intensive fiscalization during the payment in the retail trade, as well as the more and more intensive usage of payment cards for execution of the payment function of money, created the possibility for the grey economy in 2007 to note downward tendency. The estimations („Biznis", 2007) are that the grey economy is expressed on a level of 35-40% of the GDP. According to the last (2011) research of the Ministry of economy, the grey economy in the Republic of Macedonia during 2011 was around 30%.

⁴ Frey S. Bruno, Schneider Friedrich, *Informal and Underground Economy*, International Encyclopedia of Social and Behavioral Science, Amsterdam,: Elsevier Science Publishing Company, 2000, p. 2

The existence of such a high amount of the grey economy has a direct negative influence on the main economic indicators, categories and instruments for macroeconomic regulation: inadequately expressed GDP rate, problems in the conception and realization of the instruments for the country's macroeconomic policy regulation (the fiscal, monetary, social and foreign trade policy), etc. Mainly, four basic problems that the grey economy imposes can be located:

a. *The number of unemployed and socially endangered persons* is analyzed according to the official data from the State Statistical Office. However, their official number does not show what is the number of people that are involved in any kind of unregistered activities and get an appropriate compensation, which, also, is not registered anywhere. That imposes a dilemma *whether the monetary and fiscal policies are too restrictive or the social policy is not too expensive*. The analysis of the structure of the state budget of the Republic of Macedonia in the previous period shows that in average 1/3 of it is directed towards solving the social problems in the country during a parallel strong presence of the grey economy. In those circumstances, the instruments of the macroeconomic policy of the Republic of Macedonia have a small manoeuvring space in order to stimulate the economic growth of the country more energetically.

b. The second problem is conceived in the *high sum of evaded tax*, which the participants in the grey economy do not pay. That restricts the fiscal policy in the enhancement of its mechanisms for further tax facilitation of the economic subjects, lower debt to the public for providing means for covering the budget deficit (public debt) and enhancement of its development component, which would result with GDP incensement and incensement of the number of employed persons, reduction of the number of unemployed persons and social security users, and further reduction of the grey economy in the country.

c. *The high sum of cash in circulation*, as one of the two substantial elements of the monetary mass in the country, composes the third problem. In the period 1991 – 2008 its average participation, regularly, moved around 50% of the monetary mass

(M1), which determined a high monetary demand and a prevention of the commercial banks to act more efficiently on the financial market, which caused other consequences which will be addressed later in this text.

d. The fourth problem (which was highly manifested in the Republic of Macedonia for a longer period of time in the past) is the fact that the grey economy, if we could put it like that, points to an *"unhealthy" relationship between the Government and the citizens of the Republic of Macedonia*. The citizens (tax payers) manifest(ed) the disaffection of their economic-social status by transferring to the grey economy, thus enhancing the previously mentioned problems.

All of this leads to enhancement of the marginal expenses for production of goods and services in the formal (regulated) sector, increase of their prices and reduction of the total regular offer of goods and services in the country and abroad, with a parallel increase of the unfair competition of the participants in the informal economy (the expenses for production and the prices of their products are lower than the ones in the regular sector) and increase of its desirability for all the participants in the economic transactions.

However, there are some positive elements of the grey economy that can be located. In a great part it is creating the employment in the country. Its lower income expenses condition a bigger labour demand. The grey economy reduces the social problems in the country, compensates the goods and services which the formal economy, because of higher expenses, is not able to offer on the market, increases the purchasing power of the population and prevents social disturbances of bigger dimensions.

Still, the empirical indicators confirm that the damage of the grey economy is much bigger than the benefit, and because of this, a permanent social action for its reduction is necessary.

The causes which condition and stimulate the grey economy are different. The unemployment has the strongest influence on its development. In the period from 1992 to 2010 the number of unemployed persons in the Republic of Macedonia almost

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doubled (from 180.000 to 321.000 citizens), causing high unemployment rate of around 31% (28,7% in 2013).

The jobs that were previously lost and the lack of more energetic measures of the central government for the creation of new jobs forced those persons to enter the grey economy. That statement confirms the results of the performed survey, according to which the major part of the citizens think that the biggest problem they face is unemployment and poverty (73% of the interviewed) and that inability to satisfy their existential needs has the highest influence on the appearance of the grey economy (29%) and the bad economic situation in the country (27%). In a climate of economic degradation or country's stagnation, the grey economy serves as economic and social shelter to those persons, offering them opportunities to make a living, but also for studying, lifelong learning, prequalification, etc. The existence of the numerous unregistered taxi drivers a considerable amount of time after the start of the transition confirms this fact in the best way possible.

In the past 22 years Macedonian economy has faced a strong development of the private sector and the small and medium size enterprises, with a parallel adoption of incorrect and often confusing *solutions in the economic legislative*, which highly influenced the accelerating size and dynamics of the grey economy in the country.

The over burdening with taxes and contributions was one of the main instigators of the grey economy for a longer period of time. This was happening especially until 2007, during the progressive calculation of the personal income tax, when three tax rates were used (15%, 18% and 24%), depending on the amount of the realized income. In that tax system, the increased personal incomes mean an automatically increased tax burdening (the action of a so-called fiscal drug). The easiest way to avoid this is to report a lower realized income or executing an unregistered activity which does not require tax payment. Aware of those consequences, the Government of the Republic of Macedonia accessed the determination of a so-called flat profit tax and a flat personal income tax in 2007 and 2008, with the parallel reduction of their rates to 12% in 2007, and to 10% in 2008. The effect from those measures is already being

felt: the tax payers are more aware on tax ethics, the fluctuation of means in the budget is amazingly getting higher, and the grey economy notes downwards values.

The next more significant cause for the strong presence of the grey economy is the *too emphasized administrative regulation of the "business"*. Dozens of necessary licenses, decisions, certificates, long-lasting procedures for company registration, too numerous administration (the countries with the smallest administration and regulative on the labour market, such as USA, Japan and Switzerland, have the lowest values of grey economy) and other, distract the economic subjects from the formal, and direct them to the informal (unregistered, unregimented, not covered) sector of the national economy. The establishment of one-stop-shop system and the cutting-down on time for company registration to one day, as well as the implementation of the concept of the government for the so-called "Regulatory guillotine" are all directed to the overcoming of that situation, with already visible effects in the domain of the transfer of the informal into formal economy.

In general we can say that grey economy in the Republic of Macedonia exists in a significant size which cannot be neglected during the determination of the GDP rate of the country and during the creation and implementation of its macroeconomic policy. Because of that, a very precise definition of statistical aspect (coverage of the registered activities) as well as of economic aspect (production scale that is realized in that part of the economy) is needed.

5. SCOPE OF THE GREY ECONOMY

There are numerous causes for the different approaches of identification of the grey economy. That helps determine the size of the eroded taxes and how fast and strong the market forces act and by that, how the size and structure of the GDP in the country is determined.

Many authors and institutions define the grey economy in different ways. This conditions different manners for determination of its presence. In this text its presence will be treated as in chapter three. All of the important economic activities in the

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Republic of Macedonia, which because of different reasons cannot be statistically covered, and which have a direct influence on the determination of GDP and on the creation of the macroeconomic policy of the country, will be covered. Hereby, even though the internationally recognized system of national accounts SNA-93 also recommends the inclusion of the illegal (legally unacceptable) activities in the grey economy, in our case that term will not cover the illegal activities, such as the production and distribution of drugs, prostitution, human trafficking, trade with weapons, smuggling of goods, and others because of two reasons: 1) Those activities, according to law, are considered to be forbidden and punishable and their existence should be eliminated as much as possible; and 2) In the current period of the development of the Republic of Macedonia there are no possibilities for a close identification of the size and value of those activities.

According to the mentioned standard SNA-93, the grey economy in the Republic of Macedonia can be located in the following areas⁵:

- 1) Underground production:** Execution of permitted activities which are being hidden from the public institutions with the aim to avoid tax or social security contributions payment. Those activities are highly present in the Republic of Macedonia, and mostly, they are present in the execution of activities from wholesale and retail, real estate trade, property rental, hotel and restaurant work, execution of craftwork (mechanics, repairing, etc.);
- 2) Deliberate misreporting.** This is one of the most common and most important ways of presence of the grey economy in the Republic of Macedonia, which is also confirmed by the indicators of the performed survey. There is existence of misreporting of incomes or reporting higher expenses than the ones that really took place, with the purpose of avoiding or decreasing the amount that should be paid based on taxes, customs or social security contributions. The most common

⁵ United Nations Economic Commission for Europe, *Non-observed economy in national accounts (Survey of national practices)*, United Nations, Geneva, 2003, p 2-4.

cases of this kind of grey economy in the Republic of Macedonia are reporting of lower salaries than the real ones (one part through a bank, and the other part in cash), hiring unregistered employees (the biggest part or 22% of the interviewed pointed out that this is the area where the grey economy is most present), execution of unregistered sales in trade, showing higher expenses than the real ones, not registering the total sales in the accounting books (smaller incomes), etc. For that purpose, very often those companies or individuals lead a double accounting, and only declare the accounting data they choose to the Public Revenue Office.

A notable phenomenon is the appearance of newly created small or medium size private enterprises in the Republic of Macedonia which do not register all of their executed transactions (payment and charging in cash or in kind, payment of salary in cash) or showing in their accounting books certain expenses that serve them for the realization of domestic expenses (usage of automobile, buying furniture, restaurant payment, travel expenses, etc.), and reporting them as intermediate expenses, and in this way reducing the principle for calculation and payment of taxes and contributions. In that manner, the entrepreneurs consciously report higher expenses, and, even, losses, in order to report a lower added value and by that a lower principle for payment of the various payments to the country and the employees.

Final consequences of those activities are: a) underestimated sales, salaries and contributions of the employees; b) overestimated intermediate consumption; c) payment of lower charges than the ones necessary in reality.

3) Unregistered units: The informal sector, usually, consists of small production units (mostly family units). They are not registered in the Central Register because they are not requested to do that with the appropriate legislative. Mostly they are established in the area of agriculture (production for their own needs), construction (building or reconstruction of buildings, houses, apartments, etc., where unregistered construction workers are hired – individuals or groups), wall

painting, service providing (accommodation and meals for tourists accommodated in rooms in buildings that are a private property), households with small domestic production (domestic handmade articles, woodcarving products, paintings, etc.), tailors, etc.;

4) Intentionally not registered units: Having the aim to avoid the payment of different kinds of payments, such as taxes, contributions, expenses for protection during work, etc., some enterprises or individuals intentionally do not register themselves in the Central Register or they do not register some part of their activity in order to realize the same purpose. In that case, their whole production or a certain significant part of it, is not registered (reported) and becomes a component of the grey economy. This group of the grey economy covers the unregistered mechanic workshops, print houses, transporters of goods and passengers, carpenters, shoe cleaners, technical support workers, grocery shops, etc. A typical one is the case of refusing the registration of the salesmen of different kind of products in the so-called green markets in the Republic of Macedonia, and because of this, almost the whole sale on those markets has a characteristic of grey economy, which is confirmed with the results of the survey (10% of the interviewed);

5) Performing activities which the companies are not registered for: In some cases the companies which are registered to perform a certain activity do not engage their selves in it, instead, they perform another activity which is not registered and for which they do not pay the appropriate fees based on taxes, customs, etc. In that way, a company can be registered as a healthcare club or a massage club, and work as a bordello; or a certain night club can perform unregistered gambling activities and not pay any kind of taxes for them;

6) Other uncovered activities: Very common, and with a significant influence on the grey economy size, are the activities which are defined as tips, payment of

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salaries and other contributions for the employees paid in cash, production of certain products (for instance furniture, knitting, clothing, cooked food) for one's own needs, giving lectures for training of pupils and students, money extortion, sale of all kinds of small goods on the car – fairs, street sellers of different products (pretzels, musical tapes, shoe cleaners, nut fruit-sellers), goods bought abroad for which the customs tax has not been paid, etc.

Besides this kind of analytical classification of the resources of the grey economy in the Republic of Macedonia, for the statistical needs of the country, and at the same time for the formulation and implementation of the measurements of the macroeconomic policy of the country, an important issue is the distribution of that phenomenon through sectors. Generally, the grey economy is mostly notable in the trade, industry, agriculture, foreign trade and tourism. The previous classifications refer to, and the empirical data (as they come out of the survey) very much confirm that the grey economy is mostly present in the area of *trade*. This is not surprising information, if we have in mind that in the whole past period of transition of the country the private initiative (small, medium sized enterprises and individual traders) was mostly present in trade and some servicing activities. *The industry*, because of the need of its restructuring (privatization, closing of whole or parts of some capacities, capacities sanction), reduced, and in some areas lost the dominant position in the economy, so the opportunities and the size of its activity in the frames of the grey economy are present in a significantly lower range than in trade. But, the situation can be drastically changed in the upcoming period when consolidation of the commercial area is expected. In the past period more, but nowadays a lot less, the grey economy was present in the *foreign-trading relations* of the country. It was particularly manifested in the part of import of goods and services where the delivering of the necessary documentation either was(is) avoided, or there were/are double invoices during what, only the one with the lower amount was(is) presented to the authorities in-charge, in order to pay lower customs and tax payments to the country.

The development of *tourism* in the country in the past few years enhances the forms of the grey economy in that commercial area. Finally, even though maybe the biggest area of appearance and action of the grey economy is the area of *agriculture*, significant changes do not happen in that area when we consider the relative participation in the grey economy, because in that sphere, meaningful structural changes has been happened.

According to this, the range of the grey economy is miscellaneous and wide. That fact creates serious problems during the analysis of that phenomenon, which can be mainly divided into: a) Impossibility of its precise definition and location, and also a possibility for some important part of the grey economy not to be covered with the determined methodological approach; b) dependence of the models for calculation of the grey economy on, obviously present or necessary presumptions for measurement of its size. The Macedonian statistics, and with it also the macroeconomic policy, are facing such problems.

6. MEASUREMENT OF THE SIZE THE GREY ECONOMY IN THE REPUBLIC OF MACEDONIA

The macroeconomic interest for the grey economy is oriented in two directions: 1) Measurement of its size as a relative co-relation with the official GDP and 2) Finding ways and undertaking measures for transferring the grey economy into the official economy. Activities in the second direction will be much easier after the sources of the grey economy will be identified, and its size will be measured, at least approximately.

Measuring the grey economy is not a simple thing. It is especially hard in the countries in transition, such as the Republic of Macedonia, where the major part of the market activities are performed by the numerous new small and medium size enterprises and traders – individuals, where this measurement is much harder to be accomplished than in big enterprises.

In theoretical analyses and in statistical practices different methods for the measurement of the grey economy are used. Generally, there are three⁶ approaches in order to realize that purpose.

6.1. DIRECT APPROACH

The most simple, and at the same time, most unsafe way to measure the size of the grey economy is performing survey research among the economic subjects where that phenomenon is supposed to be present. The different surveys of that kind refer to the many difficulties for the estimation of the size of the grey economy. Therefore, a part of the interviewed enterprises or individuals avoid giving answers or give incomplete answers to the questions asked. The surveys do not always cover all of the possible participants in the grey economy, and the numbers that figure are too approximate.

Another direct way to measure the grey economy size is to *control the tax refund or the payment of social security contributions* that the Public Revenue Office executes. In that case the total work of the enterprises is controlled and their real values are discovered. The weakness of that system for measurement of the grey economy is conceived in its stringency to solely tax or contributions (un)payment. Since the tax evasion has a redistributive character, its measurement has a small relevance for the „grey” economy measurement in its definition given in the chapter three of this paper.

Therefore, those two methods do not encompass all the grey activities and cannot measure the development of the grey economy for a longer period of time. But those two direct methods can be very useful while providing information for the activities that are comprised with the term grey economy and for the structure of the persons that are active participants in that phenomenon.

⁶ See more in Frey S. Bruno S., Schneider Friedrich, 2000, p. 3-6

6.2. INDIRECT APPROACH (MEASUREMENT OF DIFFERENCES)

The definition and different modalities of the grey economy presence refer to the possibilities for its measurement through the identification of the differences that occur between the official and unofficial statistical indicators and in different markets:

a. For a more accurate determination of the size of the national economy (system of national accounts), the authority responsible for the statistics in a certain country, with the implementation of the available instruments, measures and standards, makes an effort to determine as much as possible the part of the grey economy. That approach, with the tendency of a continuous improvement and adaptation to the international standards (OECD, 1997), is also used by the State Statistical Office of the Republic of Macedonia. Therefore, that institution has developed methodological solutions for:

- data harmonization for the deliberately unregistered producers;
- data harmonization for the producers that are not obligated to register; and
- harmonization of the registration of lower values in production by the registered enterprises.

We must mention that this approach, in most cases, represents the usage of a system of presumptions, because of the insufficient precision of the available data and incomplete coverage of separate sectors (agriculture, construction), which leads to the statement that this measuring method of the grey economy gives lower (more incorrect) results compared with the other approaches, and primarily, compared with the method for measuring the size and differences that appear on the money market.

b. The persons who work in the informal sector usually spend more than their officially reported income. In countries with a strongly developed IT and record-keeping system, it is possible to confirm that difference on individual's level and on aggregate level. But, in the Republic of Macedonia where this kind of record-keeping is just now starting to be established, it is very hard to find those differences. Besides, even when having the most sophisticated systems for the determination of those differences, serious mistakes or mistakes that cover the financial transactions which have nothing

to do with the grey economy are possible (for example, taking consumer loans or spending heritages, gifts, etc.)

c. The next field of measuring is the labour market. The increase of the official unemployment rate, mostly, is a result of the aggravated economic situation the country. At the same time, it is an indicator for the increased engagement of the individuals and legal entities in the informal sector. The surveys of the State Statistical Office for the number of unemployed persons in the Republic of Macedonia and the official number registered in the Employment Service Agency of the Republic of Macedonia, vividly confirm this fact. Namely, the frequent surveys show that the number of unemployed (end of March 2013) in the country is around 275.000 persons, while the number of reported persons, who are seeking for jobs, is around 224.000. While, the occasional surveys, show that around 125.000 persons are reported to be unemployed with the aim to receive, even though it is minimal, financial social aid, of around 3.000 MKD (50 EUR) a month. At the same time, those persons have provided unofficial working engagement such as self-employment, or are employed by other employers where they get financial payment in cash which is not registered. Finally, on the numerous calls and announcements for hiring workers to do seasonal jobs, a very small number of officially unemployed persons apply, because they are already working at other places.

It is unofficially estimated, that around 34,5% - 38% or 95.000-105.000 of the officially unemployed persons in the Republic of Macedonia are employed in the unofficial sector. This means that the real number of unemployed persons is around 18% to 19% (170.000 to 180.000 persons). By undertaking the appropriate measures, such as high financial punishments for the employers, which are foreseen in the new Labour Law in the Republic of Macedonia, that difference can be expected to be significantly reduced, and by this a significant part of the informal economy will be made legal.

d. The fourth area of recognizing certain differences as a way of measurement of the grey economy is the money market. A main presumption for the implementation

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of this approach for measurement of the grey economy is that the payment of its transactions is usually done in cash.

According to the author of this paper⁷, the biggest stimulator of the grey economy in the Republic of Macedonia in the period 1991 – 2010 was the high amount of money in circulation (in country recognized simply as "cash"). Many indicators confirm that the coefficient of money in cash according to the expenses in labor is much higher in the grey than in the formal economy.

According to the National Bank of the Republic of Macedonia data, the average participation of cash in the money mass of the country in the period 2001-2010 was 44%, achieving occasionally 55.82% (at the end of 2001). The comparing indicators show the fact that for longer period of time the Republic of Macedonia noted a record level of money in circulation in global frames. The main factor that imposes that condition is the grey economy. Why is this so?

Cash is a strong stimulator of the grey economy because it provides its owner with anonymity during the execution of payment transactions. Those payments are momentary and they end at the same moment and they cannot be tracked for the purpose of estimation of the eventual illegality of the appropriate payment transaction.

There is a mass emergence of avoiding the payment of the obligations among the economic entities in the Republic of Macedonia, because of the lack of judicial protection of the trustees, lack of efficient mechanisms and instruments for inquiries reimbursement, but also in order to avoid the obligations towards the country (taxes) and towards the employees (social security contributions). This conditions a big part of the transactions to be paid immediately, in cash. In the same direction function the big number of (commonly, deliberately) blocked gyro accounts of the enterprises, and in this situation, they find their way out in the reimbursement of the inquiries and payment of the obligations in cash.

⁷ See more in Nenovski, T., *Economic clearing up*, Nampress, 2008, p.11-20

The big possibility for money "laundering" has a strong impact on the high extent of cash, through payment in cash from depositary, non-residential or other types of accounts, as a special way to avoid the punitive consequences from operating in the area of grey economy.

Finally, another characteristic of the Republic of Macedonia is that the high amount of money in circulation also creates the significant decrease of the inflation rate, which occasionally crosses over to deflation, as well as the long maintenance of the fixed foreign exchange rate of the Macedonian denar. This imposes increase of the money demand (cash) and their maintenance and usage in order to do different financial transactions for a longer period without having risk for cut-down of their nominal value.

It is author opinion that the smaller is amount of cash, the smaller would be proportions of the grey economy. This means that cash does not answer the question what is the absolute size of the grey economy, but it is a strong indicator for estimation of its dynamics. The weakness of this approach for measurement of the grey economy is perceived in the fact that in the Republic of Macedonia there is a high level of economy "euroization", therefore its quantity, and with that, its influence on the grey economy can be hardly determined.

e. The newest approach to grey economy measurement through the system for measuring differences is perceived in the differences of the inputs, and especially in the measurement of the differences of electric energy consumption.⁸ The meaning of this approach is in the calculation how much electric energy would be normally spent for the production of the national income. The surplus of spent electric energy indirectly leads to a calculation of the production in the grey economy. The advantage of that approach is that it employs easily accessible and quite accurate indicators. On the other hand, its weakness is perceived in the fact that not all activities that the grey economy covers use electric energy.

⁸ Ott Katarina, *The Underground Economy in Croatia*, Institute of Public Finance, 2002, Zagreb, Republic of Croatia, p. 9

A general problem of all the previously mentioned approaches for measurement of the differences as a base for measurement of the grey economy is that we must presume that in a certain year the country did not have grey economy. Otherwise, how could we determine the appropriate differences in its expenses?

6.3. ESTIMATION OF THE TAX EVASION

The size of the grey economy can be measured up to a certain level by estimation of the extent of tax evasion.⁹ The increase of burdening of the economic subjects with taxes and social security contributions will probably lead to a tax evasion increase. The reverse relation, of course, is always valid. The reduction of the rates of profit tax and personal income tax, as well as of a part of the social security contributions during 2007 and 2008, contributed to a significant decrease of the tax evasion in the Republic of Macedonia, which is manifested with a high increase of incomes in the central budget, bringing it to a level of unplanned and unwanted surplus in certain periods of that year. Those realizations, are, probably the reason for the major part of the citizens (38% of the ones participating in the survey) to positively evaluate the activities of the current Government of the Republic of Macedonia in the direction of grey economy reduction. However, during the implementation of that approach, we should always have in mind the fact that tax evasion can be caused by and be a result of the inadequate legal frame, administrative barriers, low quality public services, incredibility of the judicial system, etc.

Obviously, there is no unique safe method for measurement of the grey economy. Because of this, a combination of different approaches and methods for realization of that purpose is necessary, because the measurement of the grey economy is not only a problem of the coverage of the national accounts, but it is an extremely important macroeconomic problem as well, which, if not treated adequately, may lead to many wrong analysis and ways of implementation of the macroeconomic policy of the country. Because of that, the grey economy should be permanently

⁹ Ibid, p. 13

measured, especially because of the fact that the Macedonian economy is dynamically changing.

7. RECOMMENDATIONS FOR REDUCTION OF THE SIZE OF THE GREY ECONOMY AND ITS TRANSFER INTO THE FORMAL ECONOMY

The previous analysis confirmed that the grey economy represents a challenge, but also a serious risk for the macroeconomic planning and regulation. That imposes the following dilemma during the determination of the activities of the institutions in charge for the reduction of the presence of that phenomenon: a) Increase of the punishments for the participants in the grey economy; b) Determination and tolerance of the optimal size of the grey economy that has a net present price for the economic policy of the country; c) Undertaking no actions and leaving the grey economy develop by itself; d) Abandoning or modifying the policy that generates grey economy. The final solution seems to be the most acceptable in theory and in practice.

a. Since the objective is to reduce the presence of the grey economy in the country, the main recommendation of this research is to direct the activities and measures primarily to stopping and removing the causes, and afterwards punishing the consequences of that phenomenon. Directly connected with that one is also the recommendation by which the Government of the Republic of Macedonia redefines (changes) its role on the market. Even though (in the last 3-4 years) we can notice serious signs that the situation is changing, still it is necessary to broaden the awareness of all the participants in the economic sector for the sake of respect for the regularity and the defined rules of the game, in the direction of enhancement of the institutional frame, judicial arrangement, the moral values and the stimulators of the economic functions in the country.

b. The multi-dimension of the issue, empirically confirmed with the research results, emphasizes the necessity for the government and its institutions to create a different approach for the creation, affirmation and implementation of the economic reforms, with the purpose of restoring the trust of the citizens to the institutions as components of consistent, responsible and non-compromising country. Only under

these circumstances the citizens will be able to identify with the new liberal values, and not feel them as imposed from the “upper” levels, and consequently see the guilt for the failure of the transition process in the Republic of Macedonia in them.

c. The most efficient manner to remove the causes for the occurrence and presence of the grey economy is improvement of the institutional frame in the country. This means improvement of the relations between the government and the economy. In order to realize that purpose, the government must improve the laws and remaining regulatory solutions more intensively than the way it is done up to now in certain areas of the economy: a new Law on labour relations is adopted, which introduces high punishments (8.000 Euros for the legal person and 500 – 1.000 Euros for the manager), if unregistered employees are found working in the corresponding trade company; a new Law on payment transactions is adopted, by which the possibilities for usage of the payment instruments such as cash, assignation, compensation etc. are eliminated (known as “payment with calculation”), in the case when the gyro account of the economic subject is blocked, and with that the possibility of payment of the obligations based on taxes and social security contributions by using those instruments in order to avoid (completely or partially) is eliminated; implementation not with a reduced, but at the contrary, with an enhanced intensity of the current project “regulatory guillotine” (many studies show the positive relation between the grey economy and the intensity of economic regulation), further enhancement of the regulation of the cash payments and consumptions through intensifying the fiscalization process everywhere possible, and obviously very necessary (for example on the green markets); permanent regulation wherever possible of the additional jobs of persons who, besides the regular one, have additional professional engagements (like the case of the medical doctors); capacity building of the Customs Service with the purpose of stopping further forms of grey economy on the big scale as it was in the previous period; energetic implementation in practice of the newly adopted Law for prevention of money laundering; enhancement of the controlling measures and punishments against the persons who act in unregistered (unreported) forms, but also punishments against the

inspectors and custodians, who ease the previously mentioned deviant phenomenon, etc.

d. The strong presence of the grey economy in the Republic of Macedonia can be vigorously reduced by the reduction of one of its biggest stimulators: the presence of money in circulation. That can be done in many manners¹⁰: by increasing the usage of payment cards and other ways of non-cash payment, such as checks and bills of exchange; establishment of a universal payment card (adopted by all the users of the payment transactions), which will play the role of electronic money, that with the new Law on payment transactions are introduced as the newest financial instrument in the Macedonian economy; reduction of the legal opportunities (cashbox maximum) for withdrawing and usage of cash, as well as limitation of the possibilities for executing different kind of payments in cash (buying agricultural products, extending credits in cash, etc.).

e. In the upcoming period there must be a feeling established in the general public that the tax system is stable and that the tax burdening gets lower and lower, as a result of already reduced rates for certain taxes. At the same time, the practical results of the institutions in-charge (Public Revenue Office, Customs) must build an impression that the probability and possibility for discovering and appropriate punishment of the tax evasion are big. The central government should keep and enhance the current aggressive campaign through the media for the consequences from the substantial presence of the grey economy. Almost certainly, those activities will lead to the increase of the general public awareness of the audience for the need of tax payment and creating anti-heroes for the ones that do not do that.

f. There is no analysis of the grey economy which does not confirm that its reduction is possible by increasing the country's capacity for increase of the extent and quality of the public services. That imposes the need of organizational enhancement, efficiency, qualification and collaboration between the separate authorities and bodies

¹⁰ See more in Nenovski T., *Economic Mirror*, Nam, Skopje, 2002, p. 177-180.

of the central government, reduction of the influence of the central government to economy, rationalization of the public consumption, improvement of the public sector quality (including the further necessary reforms in pension and health system), cutting down of public administration, etc. Generally, we are addressing the need of improvement of the relations between the state and its citizens in all possible forms.

g. To all of these measures and activities for fighting the grey economy, the general impression of the establishment of a lasting and sustainable economic growth of the country must be added, and with that, the reduction of unemployment, the improvement of the standard of living and the increase of the tax ethics of the population, which will lead to a drastic reduction of the currently excessively high rate of grey economy in the Republic of Macedonia.

h. The analysis and the results from the field survey showed¹¹ that the unreported and unregistered jobs are the main source of grey economy in the Republic of Macedonia. That means that the recommendations and measures for grey economy reduction which are mentioned in this research, as well as other research of the economic policy, should primarily be oriented in that direction. The following forms of action could significantly locate and extend the coverage of the grey economy (which will lead to a more precise determination of the GDP rate of the country), together with the usage of appropriate preventive – instructional and punishment measures in order to reduce the presence of the grey economy in the country:

- Enhancement of the controls in the activities (areas) that this research locates as most intensive, regarding the presence of grey economy;
- Follow-up of the already initiated activities of the State Statistical Office for extension of the coverage of that phenomenon and adjustment of the separate official indicators (components of the grey economy) with additional information, evaluations and estimations for the presence and effects of the

¹¹ Bogov, D., *Hidden economy in F.Y.R. of Macedonia and its treatment in the statistical office*, Statistical Office of Republic of Macedonia, 2002.

additional work of persons already employed: seasonal work, short-time work, work of individuals from time to time, etc.);

- During the evaluation of the coverage and size of the grey economy, the data that the Public Revenue Office obtains regarding the size of the achieved results of the enterprises should be used more intensively than until now, and they should be included or used to correct the already included sizes of the economic indicators in the country;
- Based on the indicators obtained with the previously mentioned procedures, the institutions in-charge should execute a theoretical calculation of the size of the value added tax that the subjects obligated by law should pay to the central budget. Based on that, they should have to make approximate estimations for the size of the newly created value in the country and for the areas where that value is created but officially not presented and where in the future the measures should be directed (control and punishment measures) in order to fight for maintaining and enhancing the current aggressive campaign of the central government through the public information means on the consequences from the great presence of the grey economy;
- The statistical system for calculation of GDP should be changed by adding elements that will increase its coverage and with that its authenticity. The efforts that the State Statistical Office makes in that regard, with a more frequent usage of the OECD methodology for grey economy coverage, should continue to improve. In that direction, the official statistics, besides the well-known direct and indirect approaches for the realization of the desired activity (extension of the areas the grey economy covers), should also import new approaches in that function. The usage of the approach for the spent electric energy, even though is not all-embracing and completely competent, would be a good method for location and evaluation of the major part of the grey economy;

- The further activities of the statistical and controlling institutions should, as much as possible, locate and estimate the amounts of the payments in cash and in kind production for their own needs, size of the tips which become a routine in Macedonian economy etc;
- Finally, for easier following and comparison of the presence of the grey economy, it is necessary to unify its definition and presence according to the internationally recognized definitions and criteria in the Republic of Macedonia, like the one of OECD.

Besides the measurement of the added value size of the economy of the Republic of Macedonia, the recommendation to change the concept of presence and measurement of the grey economy is of essential importance for the way that in the future the monetary, fiscal, foreign – trade and social policy will be managed. In other words, the determination and the way of management the macroeconomic policy in the country depends on the as measurement of the grey economy, as precise as possible. Its significant presence, as it happens in the development period of the country, leads to over - or underestimation of the (anti)inflation effects of the monetary and fiscal policy and the effects from the measures for reduction of the unemployment rate in the country.

8. CONCLUSIONS

The grey economy represents a significant part of the Macedonian economy. There are different reasons that cause and stimulate grey economy. The strongest influence comes from the high unemployment in the country, confusing legal decisions, great administrative business regulation, intensive private business sector development and other.

Because of its high value, grey economy is challenging and serious danger for macroeconomic planning and regulation. Knowing that the present Government of the Republic of Macedonia has identified grey economy as one of the important areas that require action. Among the envisaged activities of the government for addressing this issue were:

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- amnestying all businesses that have operated without being reported and paying taxes if they register in a previously defined time frame;
- reducing various taxes paid by businesses;
- simplification of the procedures for obtaining licenses and permits through the Regulatory Guillotine process;
- simplification of procedures in the Public Revenue Administration, etc.

What the program of the Government lacks is direct measures. Namely, the above listed planned activities indirectly affect grey economy activities and put in place conditions for its integration in into the formal sector. However, there is a need for directly focused measures that would precipitate the integration of the grey economy in the formal sector, once the right conditions are put in place. The recommendations of this research are exactly in that direction. The main recommendation is directed towards activities and measures of the authorities for preventing and removing the reasons of the appearance of grey economy and punishing the consequences of this national economy "evil". The government has to increase the speed for redefining (changing) its role on the market. Finally, there is a need for widening the awareness of all business players for the need of respecting the regularity and playing according to the rules, as well as for enforcing the institutional framework, legal order, moral values and the motivators of the country's functional economy.

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UNCONVENTIONAL MONETARY POLICY MEASURES IN A WORLD WITHOUT GLOBAL CURRENCY

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ABSTRACT

After the Great Depression of the 1930s, a key role in outweighing the biggest financial and economic crisis has played the implementation of unconventional monetary policy measures, being used as a policy of ultra-cheap money. The need of their implementation in the developed countries is a proof that the standard measures could not provide a way out of the recession into which they have fallen, and there has been brought into question the functioning of the existing system and relations, especially the functioning of national currencies in the role of world money. It is a fact that the standard measures, through the policy of cheap money, have temporarily showed themselves as a proper vehicle for leading a relaxed monetary and fiscal policy in the developed economies, but in the end they have resulted in financial and debt crisis. However, it is a problem that the way out of recession was looked for within the implementation of unconventional monetary policy measures, by which, in fact, there has been increased the level of its relaxation, and thus the danger of future crises too. It is known that the thing which led to crisis cannot help outweigh it. By implementing unconventional measures within the existing International Monetary System, the crisis can only be carried in other countries and it is not solved permanently. For that reason, it is necessary to be created a global currency as a result of which, the national systems will turn themselves back to the implementation of conventional measures, with no possibilities for carrying the national economic problems into other countries.

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INTRODUCTION

In outweighing the biggest financial and economic crisis after World War II, the most developed countries in the world (the USA, EU, Great Britain and Japan) have mostly relied on the implementation of unconventional measures of the monetary policy. The fact that the way out of crisis has been prolonged in spite of the aggressive implementation of such measures, it has imposed the questions of how effective and adequate they are for permanent outweighing of crises of global dimensions as the last one used to be. It has been showed that the short-term recovery of the economies of the already mentioned countries does not mean their total return on the way of reaching pre-crisis rates of economic growth and employment, and it is difficult to estimate what would be like the consequences of the aggressive monetary policy of cheap money within the countries themselves (strengthening of protectionism, currency and even trade wars). Particularly big are the uncertainties what will happen after there will have to be stopped the stimulation of economies by policy of ultra-cheap money to what, of course, it will come sooner or later because the monetary policy is not all-powerful even with an aggressive policy of ultra-cheap money. After all, if that is possible, there will not be unsolvable economic problems in the modern systems of paper money and floating exchange rates in the inter-currency relations in the world. If the problems of growth and employment are solved through a policy of cheap and ultra-cheap money, the crises are inevitable and will be sharper.

Within the elaboration of the need for taking unconventional measures of monetary policy and for their achievement, we will hold on to the sense of conventional and unconventional measures, to the conditions under which they are implemented and to the question why the most developed countries approach the unconventional measures (countries whose currencies perform also a role of world money) without

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larger fears for the consequences of such approach. The other countries, as a rule, lead monetary policies, as much as they can, directed towards the achievement of stability of the general level of prices in the country, and many of them maintain a fixed rate of national currencies on some of the leading currencies (dollar, euro, yen). Besides that, the behaviour of the second countries is treated like a normal behaviour of the central banks, whereas the aggressive policy of cheap money of the leading economies is approved as a result of the fact that the level of prices does not surpass the set limits of the central banks in spite of the expansive monetary policy. It has not been taken into account the withheld influence of the large sums of money, not only on their own economies, but also on the countries which use their currencies for international payments and/or as monetary reserves.

The moment when the conventional (standard) measures became insufficient for achieving the aims of the monetary policy in the leading countries is of particular significance within this context. This will lead to the outbreak of the biggest financial and economic crisis after the Great Depression of the 1930s and to powerlessness to outweigh the recessive movements by using unconventional measures, first in the USA, then in the Euro Zone and at last in Japan. It has been showed that within the implementation of unconventional measures of the monetary policy, it is seen a vehicle for prompting the economic growth and employment, i.e. a way of getting out of the recessive flows and of reaching the pre-crisis rates of economic growth and employment. However, it is a problem that such expectations have not been accomplished even five years after the outbreak of the crisis.

The results out of the implementation of the unconventional measures impose the question of their achievement – what was expected and what has been achieved, i.e. how large the power of the monetary policy is within the achievement of goals which are not within its competence. It is a fact that it has been made possible the outweighing of the recessive flows (“injecting” large amounts of money within the financial system), but it has not been provided the desired dynamics of economic growth and employment, and it can be said that the achieved results will be brought

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into question if the financial system does not give further support to the emission of cheap money. Within this context, the warnings that the extension of the relaxed monetary policy of FED resembles to the situation when an alcoholic is given alcohol to sober up, seem reasonable. This situation indicates that the possibilities for further use of the unconventional measures have already been exhausted because they are becoming counter-productive both of the aspect of the national and of global economy. This means that it is high time to look for long-term solutions, simultaneously, both for the global and national economies in order to avoid new crises.

This point of view is based on the fact that the relaxed monetary and fiscal policy of the national economies of the USA, of the countries in the Euro Zone and in Japan has an important share in the generation of crisis, and there is no doubt that such policies were made possible by the functioning of their national currencies as world money. This privileged position has enabled them to lead a relaxed monetary and fiscal policy several years before the crisis (irrespective of the reasons – the growth of inequality and the need to be mitigated, insufficient and ineffective supervision and control of the financial institutions, management greed for “too big to fail” etc.), and after the crisis set itself in, it has been striving for withholding the market resolution of the irrationally used credit and budget resources. It is clear that the withholding is still possible. However, in the meantime, as a result of the fact that part of the burden (through the rise in prices) has been carried in the economies of other countries too, it can be expected sharpening of the mutual economic relations, implementation of various protectionist measures, and even waging currency and trade wars. Consequently, this development of events will bring into question the role of the national currencies in the function of world money and it will emphasize the need for creating a global currency, as a result of what it will be reduced the possibility of carrying the national problems in other countries and it will be made possible the responsibility for the position of national economies to be demanded from the political and business *élites*, so that they cannot manipulate the value of money as a powerful

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tool. But, if they do this, then the citizens of their countries will suffer the consequences of those actions in the first place.

Reasons for implementing unconventional measures and types of measures

It has come to implementation of the unconventional measures of the monetary policy in the developed countries after the possibilities for influence of the conventional measures on the achievement of macroeconomic objectives of the national economies were exhausted. This moment coincides with the powerlessness of the central banks to give impetus to the economic growth after the economies have fallen into recession because the key instrument – the discount interest rate has already been lowered to zero, whereas the recovery from recession has been dropped out. Not going into the reasons, for instance, why the economic subjects of the USA remained not enough interested in investing even under favorable conditions provided by the interest rate which the banks could use in order to borrow from the central bank (including here, of course, the indebtedness of the pre-crisis period and the distrust of a quick way out of recession), it is a fact that by lowering the interest rate to zero, the monetary policy was left without conventional resources for economic growth and employment i.e. for as fast as possible way out of crisis. During the recession, the main vehicle – the policy of cheap money was not able to contribute to the expansion of economic activities. The potential investors have been paying off their debts rather than being ready for lending or investing. Some of them even preferred to own cash.

This situation, in fact, forced the Federal Reserve to use and other unconventional measures of the monetary policy in order to accomplish the tasks which are within their competence – the stability of prices and the employment growth. When the central bank did not succeed to encourage the investors by using the policy of cheap money, it approached the implementation of the policy of ultra-cheap money. In order to encourage them to invest, i.e. to create even more favorable conditions, it approached the redemption of treasury and other bonds and mortgage-related securities, having a goal to release some resources which have already been invested

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in securities to the holders of such papers and which would be invested by them again. By means of such redemption, FED pumped up 2.800 billion dollars out of which one part was definitely used and it contributed to the growth of production and employment, but one part was left as cash in the banks or to the other vendors of securities. A good part was returned again in the central bank as a excess reserves on which it has begun to be paid off an interest rate since 2008³. A large part of the resources has ended up as investments in the securities of the Stock Markets (as a result of what the indices of shares of the Stock Markets have already reached the pre-crisis levels) or in purchase of real estate.

Without going into a more detailed systematization and categorization of the unconventional measures, it is enough to observe them in two broad categories: asset purchases and forward guidance, where the key policy is the one of maintaining a low, zero interest rate.

The purchase of assets was an activity of the central banks even before the implementation of unconventional measures of the monetary policy. By purchasing government and other bonds with short-term maturity, they were increasing the offer of money and decreasing the short-term interest rates. When the interest rates fell near zero, the central banks began to purchase long-term government securities in order to reduce the costs of long-term borrowings. These activities are also called quantitative easing (QE). By means of quantitative easing, the long-term interest rates are reduced and because of that, the businesses and households are prompted to invest.

In order to prompt the investment, it has been approached credit easing as well. It comes down to buy-out of private property with the object of reducing the costs of capital within the private sector.

³ „The volume of excess reserves held at the Fed increased dramatically from less than \$2 billion in 2008 to \$1.8 trillion now“ ([Martin Feldstein, Why Is US Inflation So Low?](#) Project Syndicate, Jun. 28, 2013)

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The central banks have been trying to encourage the investors through the forward guidance policy, thus signaling their future policies in relation to the maintenance of quantitative and credit easing and/or the policy of zero interest rate. The central banks implement the forward guidance policy by telling the time until when they intend to keep the low interest rate – for a while, for a longer period of time, to a fixed date or to keep it till they achieve certain goals, as the example of the USA – till the rate of employment is not brought below 6.5% and the inflation does not exceed 2.5% etc. Taking into account the previous announcements and knowing the resource prices and the time during which they will be valid, the interested parties can determine their own economic activity.

For instance, the Japanese Central Bank, in order to outweigh the depressive pressures in the economy, it has announced an inflation target of 2% and unlimited purchase of assets. In order to direct the subjects, the bank has announced that the price target of 2% has to be achieved by doubling the mass of prices during a period of about 2 years.

The implementation of unconventional measures in the Euro Zone began later than in the USA, given the fact that ECB believed that the situation will improve only by reducing the discount interest rate which was far above the American one. Because that did not happen even after the interest rate was reduced to 0.5% and the debt crisis threatened to suspend the euro and to destabilize the European Union, ECB approached the implementation of unconventional measures. It had to solve a formally legal problem about their implementation. According to the regulations, as a central bank, it cannot redeem debts from the countries, but only from the banks. For that reason, it supported the banks so that they could redeem debts from the countries. It is slightly different from the USA, but in essence it is the same, because the debts of the countries have been accumulated in the banks instead in ECB as a result of their business decisions.

In addition to the strengthening of the financial position of the economic subjects, FED succeeded, by using the unconventional measures, to provide the low

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interest rates to be maintained as an important condition for increasing the interest in investment. In this context, the announcements of maintaining the low interest rates during a longer period of time were also an original guide for investors.

The implementation of unconventional measures of the monetary policy has not only ongoing positive impacts but also risks. The programmes of purchasing government bonds involve the risk of accumulating certain losses in the central banks because they purchase the bonds for higher prices and have to sell them for lower prices. It will come to some losses if the expected objectives are achieved by implementing relief measures. This is so because along with the economic recovery, it will come to increase in the long-term interest rates and this will lead to reduction in the prices of government bonds.

The achievement in the functioning of unconventional measures

By implementing the unconventional measures of the monetary policy in the most developed countries, there have been achieved certain results in the recovery of their economies. The USA went out of recession and it is achieving positive economic growth rates, its inflation is below 2%, but it has not reached the pre-crisis rates of economic growth and the rate of employment yet. The countries of the Euro Zone went out of recession, but their recovery is slow. The Japanese economy has marked price movement and outweighing of deflationary pressures.

The positive effects of the functioning of unconventional measures of the monetary policy in the countries, which have currencies performing the function of world money, show that they are useful for the recovery of national economies under conditions of recession, but they are not sufficient for achieving the set goals. The reason has to be looked in the fact that "the increase in money supply following QE has not led to credit creation, to finance private consumption or investment. Instead, banks have hoarded the increase in the monetary base in the form of idle excess reserves. There is a credit crunch, as banks with insufficient capital do not want to lend to risky borrowers, while slow growth and high levels of household debt have also

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depressed credit demand.”⁴ In the same comment, the professor Roubini points out that “all of this excess liquidity is flowing to the financial sector rather than the real economy. Near-zero policy rates encourage “carry trades” – debt-financed investment in higher-yielding risky assets such as long-term government and private bonds, equities, commodities and currencies of countries with high interest rates”.

There are authors who believe that in spite of the huge resources, the unconventional measures of the monetary policy did not achieve the expected results because they were insufficient⁵. In order to be reached the pre-crisis growth rates and unemployment rates, the used resources had to be huger and to be used for a longer period.

Others think that the non-achievement of goals of the unconventional measures of the monetary policy is because of the fact that the biggest American problems are not problems of liquidity, and as a result of that the monetary policy cannot solve the problems of real economy.

There are also opinions according to which it has to be stopped the implementation of unconventional measures as soon as possible, considering the possible negative consequences for the development of national economies and the relations in the world economy. In 2009, the monetary economist Alan Meltzer warned that the Americans will soon become “a nation of inflation”. A year later, OECD called upon FED to raise the interest rates in order to avoid the risks of inflation and in 2011 the representative of the Congress, Paul Ryan warned that the inflation, which is on the prowl, is a terrible thing to debase the dollar.

The contradiction of opinions in relation to the implementation of conventional measures has come to the fore after the announcement of FED for reducing or stopping the redemption of government bonds and mortgage-related securities. The supporters saw a danger of falling back into recession within the reduction and especially within

⁴ Nouriel Roubini, [Bubbles in the Broth](http://www.project-syndicate.org/commentary/Bubbles_in_the_Broth), Project Syndicate, Oct. 31, 2013, www.project-syndicate.org/commentary

⁵ This opinion is also held by the bearer of the Nobel Prize, Paul Krugman, within the columns of the newspaper New York Times

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the cessation of redemptions, whereas the opponents saw a danger of increase in inflation (and of the interest rates as well, and as a result of that – an increase in debt obligations) and tightening of the international economic relations, waging of currency and trade wars (control of the capital movement, protectionism) within the extension of quantitative easing.

It is obvious that the first are expressing an absolute preference for the national interests (until the goals are not achieved), using at the same time the privileges provided by the use of the national currency as an international resource of payment and reserve, whereas the latter being concerned about the consequences of the policy of ultra-cheap money for both the national and global economy, are trying to avoid the negative consequences of inflationary finance (as for example, the wrong capital allocation, the redistribution of income and the decrease in the value of national currencies, and thus the reduction of confidence in them as world currencies).

Being focused on achieving the current national interests, the monetary authorities are expressing a preference for the developing goals at the moment (getting out of recession, reducing the unemployment and achieving higher economic growth), at the expense of the monetary ones which are basically coming down to maintenance of the stability of prices' level. Even when it is mentioned the stability of prices, it is seen in the current level of prices (under conditions of recessionary pressures on the economies) with the purpose of pointing out that there is no danger of accelerating the inflation. Briefly seen, it is so, but it cannot be disregarded the influence that will carry out the pumping up of large amounts of money in the national economies and global economy within the next period. Therefore, it can be told that the suggestions for incorporating a higher rate of inflation as a target of the monetary policy of the central banks (from 4% to 6%) are not accidental⁶. This is a method for legalizing the inflationary financing carried out by "the packages for rescuing the financial systems"

⁶ The main economist of IMF, Oliver Blanchard, was the first who gave the suggestion for targeting the inflation at 4% in an article in co-authorship with others. In relation with this suggestion, The Economist estimated that the idea as an intellectual exercise is very interesting, but as a political suggestion, it is irresponsible. (The Economist, February 18th, 2010). Then, several authors "auction", and thus the rate of targeted inflation increased to 6%.

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because of the earlier extravagant spending (instead of bankrupting the subjects who exaggerated their spending and are not able to pay up the mature liabilities) which ended up with bursting of bubbles or with an increase in the public debts to a level when they cannot be discharged. This is a move which anticipates the future inflationary pressures both of the former implementation of unconventional measures and of their further implementation until the effects of the inflationary financing of deficits are not “distributed”.

In order to be approved the actions for the recovery of national economies in the most developed countries, there have appeared opinions and attitudes according to which there will be no problem if the countries in boom implement measures of control of the inflow and outflow of capital, contrary to the long-time practice of liberalization of capital flows in the process of globalization. This was also heard by the leaders of IMF.

However, it has already been posed the question when it will stop implementation of conventional measures i.e. when the monetary policy will return within the framework of the implementation of conventional measures. But there is no clear answer. There is only a direction by the General director of IMF, Christine Lagarde that “Central banks don’t need to rush ultra-easy money exit”. Nevertheless, the central banks are tormented between the achievement of the desired growth rates and employment and the danger of losing control over inflation and repercussions on the process of globalization. The choice is very difficult because it has to be chosen, as Roubini says, between “kill the recovery to avoid risky bubbles or go for growth at the risk of fueling the next financial crisis”.

Privileged possibility for implementation of unconventional measures

The implementation of unconventional measures of the monetary policy in the most developed countries indicates an increase in the liquidity in their national economies, and given the fact that their currencies perform the role of world money, they have an influence on the international liquidity. It means that this increase in

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liquidity must be observed from the aspect of the need and justification for creating liquidity larger than the market one which is necessary for the functioning of the national economies under stable conditions (in accordance with the competence of central banks) and of the global economy.

The need for larger expansion of liquidity in the national economies has imposed itself because many subjects were not able to fulfill the obligations during the crisis, and bankruptcy threatened them. Because of the fact that there were also “too big to fail” among them, including countries from the Euro Zone, the monetary authorities had to intervene by implementing unconventional measures (because the conventional ones in connection with the discount rate were exhausted) in order to avoid disruptions larger than the potential ones looming out of their implementation. This is, in fact, justification for “the inflationary financing” of rescue projects of huge financial institutions, countries and companies. It is sure that without such measures, it will come to tightening of the internal conflicts between the labour and capital which the political elites are not ready to manage because the internal situation will become even worse. In order to avoid that danger, FED, ECB and JCB were forced to implement non-standard measures, too. Therefore, it can be said that the resorting to such measures does not seem very difficult and responsible for them. Especially, if it is taken into account the fact that during the period of boom, before the fall into crisis, in their countries' economies, there have been implemented relaxed monetary and fiscal policies whose implementation, in fact, has brought down to the financial crisis. If those policies were useful and necessary in “good times”, then they are more necessary under the conditions of crisis. Moreover, one part of the negative consequences will be carried out, after all, in the other countries using dollars, euros and yen by the increase in inflation.

There is no doubt that after the departure from the dollar-gold exchange standard in the 1970s, the implementation of unconventional measures of the monetary policy was made easier by the privileged position of the dollar, euro and yen in the international payments and by the inconsistent international monetary and

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financial system. The implementation of unconventional measures was excluded from the system of commodity money (for instance, from the system of gold validity), it was prohibited and slowed down within the system of gold-exchange standard i.e. gold-dollar exchange standard, whereas it “shook off” in the system of paper money after the abolition of the convertibility of the dollar into gold and the functioning of dollar standard (with floating exchange rates in the inter-currency relations).

Although the relationship between the policies of cheap and ultra-cheap money and the role of national currencies performing a function of world money are not much elaborated, it is obvious that the implementation of unconventional measures of the monetary policy by the central banks whose currencies play an international role for outweighing the national economic crises, is made easier as a result of their position in the international payments (in absence of the global currency). The countries without such a position of the national currencies must not even think about any implementation of measures which “monetize debts” i.e. cover the expenditure over the earnings unless they are ready to risk the stability and development of their own economies. Therefore, the effects of the inflationary financing of deficits have been implemented among the subjects within the borders of the country. Unlike them, the countries whose currencies perform a role of global currency are in a privileged position. Because their currencies are also used as means of international reserves, they are able not only to be credited without interest, but also to carry out part of the effects of inflationary financing of deficits in other countries which are holding exchange reserves in their currency. However, despite the privileges, the monetary authorities are not calm when they are forced to resort to implementation of unconventional measures. They are worried about the danger of rise in prices in the country and even more of the weakening of their national currency value because there is a danger of losing their privileged position for a longer period of time. The effects should not be underestimated.⁷ However, despite the risk, under conditions of crisis, they are

⁷ “It is difficult to estimate the cost to the US of losing the dollar’s position as the leading international currency. But 2% of GDP, or one year’s worth of economic growth, is not an unreasonable guess. With foreign central banks and international investors shunning dollars, the US Treasury would have to pay

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resorting to non-standard measures of the monetary policy in order to outweigh it. It is an important issue, but why they led a relaxed monetary and fiscal policy in the time when, for instance, the American economy was marking satisfactory rates of economic growth and employment. Perhaps, it achieved such rates because of the relaxation of the monetary and fiscal policy.

The fact that the exaggerated privileges of the countries with reserve currencies were also used within the period of boom of their economies (with justification and because of the need for increasing the international liquidity), only points out that it has been insisted on outweighing the objective inconsistencies between the labour and capital by manipulating the value of national currencies, and not on the basis of market principles. The political elites are not ready to face the consequences of bankruptcy, particularly because they had a serious influence on their generation. They always find reasons to approve the concession of stable monetary policy. In the Great Depression in the 1930s, the strengthening of state intervention (by increasing its participation in the distribution of GDP), justified itself by the need for preventing the penetration of Communism, whereas in today's Great Recession, a justification is either the strive "the too big to fail" or the danger of making fascist the countries which are not ready to proportion the expenditure with the values they are creating.

In the period of boom of the national economies, the countries with reserve currencies worked out a compromise between the need for a welfare state (in order to solve a lot of the social and economic problems of the bigger part of population by covering the larger part of the profit) and the interest in keeping the larger part of the capital for itself by implementing a relaxed monetary (expansionist) and fiscal policy (building up debts). Thus, it has been increased the expenditure of both the population and the government, it has been prompted the economic growth and the profits have been rising vertiginously. However, instead of decreasing, the inequality in the societies

more to borrow, even if the debt ceiling was eventually raised. The US would also lose the insurance value of a currency that automatically strengthens when something goes wrong (whether at home or abroad). (Barry Eichengreen, [The Dollar and the Debt Ceiling](http://www.project-syndicate.org/commentary), Project Syndicate, Oct.10, 2013 www.project-syndicate.org/commentary)

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increased and reduced the expenditure. It has been showed over and over again that the inflation (the policy of cheap and/or ultra-cheap money) does not solve the real economic problems, but it only withholds their solving for better days, whereas in the meantime, it is made a distribution of the income at a national and global level. ⁸

CONCLUSION

The implementation of the unconventional measures of the monetary policy in the outweighing of financial and economic crisis in the developed Western economies indicated that the nature of the crisis weakened the standard measures which have been in practice for decades. The change of the nature results from the fact that the crisis is basically a consequence of the uncontrolled and highly relaxed monetary and fiscal policies in separate countries which have been led out from the rules for making money (without endangering the stability of prices at a general level) and for living within the framework of the created values.

The possibility of deviating from the basic market regularities is created with the breakdown of the Bretons Woods monetary system, by abandoning the convertibility of the currency into gold and by transferring the floating exchange rates in the inter-currency relations in the world. Thus, it has been made possible several national currencies, above all, the dollar, euro, yen and pound, to perform a role of world money and by performing that role to obtain the privileges resulting from that, and also to resort to inflationary financing of expenditure (personal, investment, state-controlled), with the possibility for carrying out part of the inflationary pressures in some other

⁸ „Since World War II, labor’s and capital’s shares of income have fluctuated within a narrow band, reports the [White House Council of Economic Advisers](#) (CEA). Prosperity boosted both groups by roughly equal proportions. In 1947, labor’s share of nonfarm business income was 65 percent; in 2000, it was 63 percent. Everyone benefits when labor and capital work in tandem, not in opposition. But as I reported last week, labor’s share has plunged in the past decade. In 2013, it’s 57 percent. This shifts about \$750 billion annually from labor to capital“. ([Robert J. Samuelson](#), Capitalists wait for the recovery, while labor loses out, Washington Post, September 9, 2013)

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economies as well. In this direction are going also the suggestions for increasing the targeted rate of inflation from 2% to 4% or more.

By the implementation of unconventional measures of the monetary policy in the outweighing of the last crisis, the countries with leading currencies intensified the use of privileges to a level of tightening up the relations with the countries in rise and the other less developed countries because of the unfavourable influence on them and on the process of globalization. Therefore, it is necessary to eliminate the exorbitant privilege being an important reason for the generation of crisis and insufficiently effective means for outweighing it, having negative influences not only on the national economies but also on the global economy. The counter-productive effects of the implementation of unconventional measures have practically showed the inevitability of extrusion of the national currencies in the function of world money, i.e. the need for creating a global currency in order to avert the danger of repeating the crisis of global dimensions.

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**CAN ECONOMIC GROWTH BE ENHANCED BY VENTURE CAPITAL
EMPLOYMENT?**

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ABSTRACT

Economic growth is a concern in any economic systems. One of the most prominent direct methods of spurring economic growth is what governments strive to do today - enhancing entrepreneurship and small businesses promotion. And venture capital, as a type of financial support mostly used in these types of ventures, has a role in economic growth. But the relation between venture capital and economic growth has never been explored to the fullest extent. Various researches have been made, concentrating on geographical or historical points at which venture capital employment is positively related to growth. It is agreed that an active venture capital market helps growth. But as a part of each research made up-to-date, different variables have been taken into consideration, with significant variances in results. Therefore, it seems that constructing one-size-fits-all model for this purpose is a task near to impossible. This paper will try to distinguish models by which the relation between venture capital employment and economic growth can be examined. It will reflect on previous researches in various economic systems, as to extrapolate models used, and distinguish useful components and factors for examining this relationship. It must be noted that one of the major setbacks of one unique model for examining the relationship of venture capital and economic growth is the rate of development of the country investigated - depending on the stage its economy is in, various research models need to be implemented. The purpose of this paper is to distinguish between various models for examining the impact venture capital employment has on economic growth, and to suggest the manner of implementing an appropriate method to a specific research on a specific economic system.

KEYWORDS: venture capital, investment, economic growth, entrepreneurship,

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INTRODUCTION

One of the major concerns of every country in the world is economic growth. It is a very delicate issue, since it affects all areas, institutions, citizens and spheres of a country's everyday life. Therefore, one of the most visited economic researches includes factors that may affect economic growth it and how can it be spurred. Many factors have been outlined as crucial, and more than one party can be involved in creating economic growth - the government, the business sector, investors (both domestic and foreign), and much more. How to finance economic growth in particular has been a widely discussed issue. Most governments, especially the ones in developing countries have tried to finance and spur economic growth through the development of the business sector. In particular, this refers to entrepreneurial growth and increase in the number of profitable small and medium-sized enterprises (SMEs)- the backbone of any economy.

Venture capital as a source of financing entrepreneurial endeavours and growing SMEs, has had a major role in economic growth in many countries. There are separate cases where the employment of venture capital has been seen as a method of enhancing economic growth or development, through improving the market for financing innovation and small businesses growth. In its essence, venture capital is a very distinct financing form, operating in a manner different from commercial banks and other debt-financing institutions, on a fairly un-regulated financial market. Venture capital companies are usually companies which invest their funds into different entities, for a relatively short period of time, and expect return on their investment. A common trait of venture capital investors is their eagerness to invest in entrepreneurial companies above all.

The greatest demand for venture capital companies as sources of finance is the USA entrepreneurial market. Here, this type of financing is widely known and used. Actually the American and Canadian entrepreneurial companies used venture capital as a source of finance, especially in periods of growth of their companies. However, this does not

imply that venture capital is not a recognized source of finance in Europe as well. Although not as much as in the USA, the European market is familiar with venture capital. But the relation between employing venture capital and economic growth has never been explored to the fullest extent axiomatically. Various researches have been made, concentrating on geographical or historical points at which venture capital employment is positively related to growth. It is agreed that an active venture capital market helps enhancing growth. But as a part of each research made up-to-date, different variables have been taken into consideration, with significant variances in results. Therefore, it seems that constructing one-size-fits-all model for this purpose is a task near to impossible. Many researchers argue that the research on this subject matter must involve different factors, especially demographic and geographic variables, which may results with different outcomes and relationship mapping each time research is conducted.

1. Theory on venture capital and economic growth

Venture capital funds, although present in some countries ever since the 1950s, are still considered a rather new approach in financing companies. Therefore, theoretical stipulations on the effects of venture capital employment on growth are rarely backed up by empirical researches. However, the theoretical approach argues that as a source of financing, venture capital financing is primarily targeting new, innovative and small companies, with prospects for fast growth, given the adequate financial and managerial support. This comes as no surprise - in a research made in 48 countries the positive correlation between access of finance and market growth has been outlined². As venture capital only increases access to finance, it can be argued that it is positively correlated to growth. In theory, on a large enough scale, such investments can move an economy upwards. Hence, the "myth" of the positive relationship between venture capital and economic growth.

² Rupieka-Apoga, R. Access to finance: Case of the Baltic states. *Journal of Applied Economics and Business*, 1(1).pp.32-38, 2013.

CAN ECONOMIC GROWTH BE ENHANCED BY VENTURE CAPITAL EMPLOYMENT?

The primary issue why venture capital is deemed “entrepreneurial or SME” financing source is its adaptable and flexible nature. As opposed to other forms of financing available to entrepreneurs or SMEs (small and micro companies in particular) - commercial loans, mezzanine financing - venture capital financing is a more available financing source. It requires no regular payment by the investee companies before profits are actually made, and that is why it is seen as a more affordable financing option. Additionally, there is no asset-backed collateral - all venture capital investments are equity-backed, which gives the investee company a sense of security - seeing the investor as truly interested in the success of the company³. But for that reason, venture capital funds do not invest in any given company. Each investment decision underlies a careful screening and auditing process, and investors must be certain of the growth prospect, as to invest in an entity.

This particularity of the venture capital investment cycle is why it is closely related to economic growth in some cases. Because of the nature of this financing method, it is expected that venture capitalist invest only in high-growth prospect companies. If the investments are successful, they have contributed to the growth of the economy.

Venture capital funds finance primarily high-tech, innovative and fast growing companies⁴. Although other investments occur, they are not as important or recurring as these types of companies. The success venture-backed companies have had in certain places (economies) has had an impact on economic growth so much that government incentives have been added to venture capital financing. American venture capitalists, especially in the Silicon Valley and the Boston area, have contributed to economic growth through financing fast growing SMEs and technological innovation. The response of policy makers on this success stories has been to increase supply of venture capital all over the country, as to increase the rate of company growth, thus inducing faster economic growth. According to Cromwell and Schmisser “well

³ Amit, R. et al. Why do venture capital firms exist? Theory and Canadian evidence. *Journal of Business Venturing*, 13, pp.441-466, 1998.

⁴ Seidman, K.F. Economic development finance, 1st ed., pp.240-263. Sage Publications, Thousand Oaks, USA, 2005.

designed venture capital programs can create exceptional financial and economic development outcomes"⁵, meaning that the entities profiting from these investments open high-end jobs, create entire new industries and give back to the country and the community through growth and taxpaying.

The macroeconomic stipulations for correlating venture capital with economic growth include the availability of capital and labor as underlying factors for growth. From here, theoreticians argue that combinations of labor and capital directly affect the level of output, and thus the level of growth⁶. Furthermore, in the model innovations are introduced as they are considered fast boost to growth. Continuing from the macro level, small and entrepreneurial firms are proven to be the main carriers of innovation⁷ although this is truer for new and starting industries, rather than maturing ones. At the end of the assumption is the main reason venture capitalists exist – the funding of innovation and entrepreneurship. Opening of new jobs, increasing export, and most importantly the spillover effect – the possibility of multiplying entrepreneurial spirit and success lead to the main theoretical assumption for the correlation of venture capital and economic growth.

However, it has to be noted that venture capital is not by far the only or most prominent enhancer of economic growth. It is one of the more indirect factors for inducing economic growth. As the link between growth and venture capital is not straightforward, it can be assumed that there is a lot to be taken into consideration when considering stories of successfully using venture capital to create growth, especially having in mind that not all companies can lead to growth. Many venture capital stories have ended famously unsuccessfully as well. Moreover, many governmental ambitions to increase the supply of venture capital have also been rendered fruitless over the years. Despite the effective method for spurring growth, researchers argue (and data

⁵ Cromwell, E. et Schmisser, D. Smart State-Sponsored Venture Capital Programs for Economic Development outcomes, 2011.

⁶ Lerner, J. et Tag, J. Institutions and venture capital. *Industrial and corporate change*, 22(1), pp.153-182, 2013.

⁷ Acs, J.Z. et Audresch, D.B. Innovation in large and small firms: an empirical analysis, *American Economic Review*, 78, pp.678-690, 1988.

is available on secluded cases) that venture capital supply in an inadequate environment cannot do much about economic growth. Three of the most important factors for a suitable venture capital seeding environment⁸ include: entrepreneurial spirit, innovative environment (especially having in mind technological innovation), skilled labor force, intellectual support infrastructure⁹. Therefore, it can be assumed that the impact of venture capital on economic growth will primarily be based on the existence of these factors in an environment. Even in the previous examples of profiting from venture capital investment, it has to be noted that most theoretical approaches do not omit the importance of expecting high growth rates in developed economies, or even more narrowly defines "progressive" countries¹⁰. Therefore, the root of the relation can be seen in other factors. In theory, the assumption that venture capital can affect economic growth is often supplemented with the assumption that economically developed countries can lead to the development of financial options such as venture capital.

2. PREVIOUS RESEARCH ON THE IMPACT OF VENTURE CAPITAL EMPLOYMENT ON ECONOMIC GROWTH

As it was previously stated, the impact venture capital can have on economic growth varies depending on the underlying environment, in terms of entrepreneurial, educational and demographic background. Therefore, it does not come as a surprise that many researches made in different countries on this issue have had different outcomes. As a matter of fact, even researches in one country, the United States of America, made at different periods, have ended in various results. Therefore, this portion will offer a short overlook on previous researches made on this topic, outlining the underlying environmental (demographic/geographic) factors which have led to the diversity of results.

⁸ Although there are more factors for a suitable venture capital environment, these are usually stated as the first "red flags" if venture capital supply fails

⁹ Seidman, K.F. Economic development finance, 1st ed., pp.240-263. Sage Publications, Thousand Oaks, USA, 2005.

¹⁰ Cromwell, E. et Schmisser, D. Smart State-Sponsored Venture Capital Programs for Economic Development outcomes, 2011.

2.1 Researches in the United States of America - various results at various development stages

Many studies have been made since 1946 on the implementation of venture capital in the USA. It is thought as the USA is the birthplace of venture capital – in 1946 the American Research and Development Fund has been constructed by MIT professors and business leaders¹¹. Twelve years later, the first LLP venture capital company was formed. However, venture capital industry has had its rises and declines over this long period. The USA is the first exporter of venture capital funds though, showing that this form of financing is important to its economy.

Out of the many researches made, this paper will concentrate on the few that try to connect economic growth in the USA to venture capital employment. It must be stated that because of the vastness and diversity of the country, a research in the whole country has never given any results that were deemed impressionable. However, such researches show important elements or lack thereof in the implemented models.

In 2011 Samila and Sorenson presented their research on US metropolitan areas and their effect of venture capital employment¹². In the research, a positive correlation was shown between venture capital financing in an area and start-up rate, increase in employment and aggregate income. However, a cloud of doubt appears as it is perceived that perhaps venture capital investors choose the greater growth prospects. On a macro-economic level, there is no research in the USA that can clearly correlate venture capital, growth and entrepreneurship. Because of this assumption, it is often seen that the geographic locations plays a role in the model construction.

Venture capital does stimulate growth through entrepreneurial and start-up activity (Samila et Sorenson, 2011). The stimulation is two-fold: first, the financing of prospect start-ups creates growth, but also, it creates spillover effect – more entrepreneurs strive to receive financing, thus making their start-ups fast growing. Still, it has to be

¹¹ Lerner, J. et Tag, J. Institutions and venture capital. *Industrial and corporate change*, 22(1), pp.153-182, 2013.

¹² Samila, S. et Sorenson, O. Venture capital, entrepreneurship and economic growth, *The Review of Economics and Statistics*, 93(1), pp.338-349, 2011.

mentioned that these results stem from metropolitan US areas. The background of the demographics is the high level of education and high rate of entrepreneurial spirit due to upbringing, beliefs, crowding in large cities, competitive environment etc. The importance of these two factors cannot be stressed enough. Yet, in the USA, because of the large number of successful enterprises in such areas, the lack of success in rural areas has never reached much attention.

Kedrosky argues that at this point venture capital investments are saturated, and that in the future the rapid urban growth this type of financing has provided will be stagnating¹³. The main contradiction in this argument is that US venture capital funds back up the most sustainable and high-growth companies in this period, introducing new IT industries, clean-tech and biotech. These industries rely on knowledge and education, relatively located in urban areas, knowledge parks and research centers. It may be the reason venture capital has been able to contribute to growth through these industries. But scholars argue that outside of Silicon Valley, venture capital has grimmer results. Wyse et Burril have noted in their research¹⁴ that outside high-tech, high-entrepreneurial regions, venture capital cannot affect growth, since it is not accepted by the local business sector. The most affected regions by venture capital have possessed prior traits, entrepreneurial background in particular, that have led to the positive relation of venture capital and economic growth. The ever so praised Silicon Valley has been an achievement never to be duplicated – the unique set of private sector engagement, educational background and Californian geography and specific demographic traits have created a perfect environment to explore the relation between economic growth and venture capital. And it has been a positive one, with effects that cannot be achieved anywhere else in the world, due to the specifics that exist there. Another example is the Boston area, where venture capital has been growth-related, taking into consideration the great educational background. Similar is the situation of

¹³ Kedrosky, P. Right-sizing the US venture capital industry, Ewing Marion Kauffman Foundation, June 2009.

¹⁴ Wyse, R. et Burrill, G.S. Venture capital and economic growth.....A perspective, available from <http://www.wisconsin.edu>, 2004.

the Research Triangle Park where corporate research institutions have been partnering up with higher educational facilities (parts of highly ranked universities). Another background support is the existence of one or several high-growth venture capital success stories (the spillover effect). The example of Austin for one, shows that Dell's success (largely based on venture capital support), has created a highly entrepreneurial environment. The area of Washington D.C. has another important catalyst – government research facilities, combined with excellent education and business sector involvement.

However, cleantech and biotech have contributed to growth in other parts of the USA, and they have been venture capital backed. In such situations, the geographical location and the necessity have been more of a factor than the entrepreneurial background. Examples include AgBio Valley in St. Louis, Michigan tobacco-converted-to-biotech facilities and many more. But it is too early to measure the real effect of these venture capital investments in terms of economic growth¹⁵.

The success of correlating venture capital and economic growth relies on the settings – geographic and demographic factors can lead to various results in the research. At least, that is what can be observed by analyzing only the latest venture capital effects in the USA.

2.2 Sweden

Swedish researchers firmly believe in the positive correlation between venture capital and economic growth. The main theoretical factors endorsing this statement include the reasoning that economic growth is enhanced by innovation and entrepreneurial growth. The Swedish government promotes venture capital investments particularly for this reason – developing an entrepreneurial and innovative market, which is believed to lead to economic growth¹⁶.

¹⁵ Wyse, R. et Burrill, G.S. Venture capital and economic growth.....A perspective, available from <http://www.wisconsin.edu>, 2004.

¹⁶ Lerner, J. et Tag, J. Institutions and venture capital. *Industrial and corporate change*, 22(1), pp.153-182, 2013.

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In comparing Sweden, as a developed country, to the USA in this field, key differences are set on institutional support and lack of rapid financial market development. The Swedish venture capital market has been developed by large on government support – Swedish government has identified the need for venture capital quite quickly, although historically, the market has been developed long after USA's venture capital first boom. With a delay in implementation of almost 30 years, Swedish venture capital has been jump started by the government and commercial banks, which is quite unusual for developing such as financing support. However, the usage of venture capital has been diminished mostly by legal factors – regulations for financing companies, but also labor market regulations. Strict financial market regulations in Sweden have contributed to diminished venture capital usage. When regulations have been made lighter, it has caused a number of unsuccessful investments, thus stagnating rather than promoting economic growth. After several shocks and new regulations on the market, up to 2008 Sweden has become the number one importer of venture capital in the world¹⁷. It comes as no surprise that Swedish scholars promote external venture capital as the essence of growth – the presence of international venture capitalists has been a catalyst in economic growth in Sweden. However, the volatile structure of venture capital investments over the years has been prescribed to several issues: the development of financial market, the tax policy, labor market regulations and technology transfer policies. But Lerner and Tag¹⁸ do not omit the level of entrepreneurial spirit and education as important factors as well. The government's willingness to improve economic growth through better regulations and legislation is the level at which venture capital would affect growth. But the mindset of the demographic is hard to be changed, especially in a short period (less than a century, at the least). Therefore, the environment in terms of educational infrastructure and entrepreneurial demographics play a major role in the model. Both Sweden and the

¹⁷ Aizenman, J. et Kendall, J. The internationalization of venture capital and private equity, *Working paper 14344*, National Bureau of Economic Research, Cambridge, UK, 2008.

¹⁸ Lerner, J. et Tag, J. Institutions and venture capital. *Industrial and corporate change*, 22(1), pp.153-182, 2013.

USA have a high level of both these factors (although in the case of the USA it can be seen as specifically regional). But it has to be taken into consideration that the impact venture capital would have on growth in a society where there is lack of entrepreneurial spirit or adequate education will be null. When analyzing venture capital-economic growth relations, all these factors must be taken into consideration.

2.3 The Baltic Region

In the three Baltic countries which are also EU members and are on the far side of developing countries - Latvia Lithuania and Estonia, venture capital financing is a rather fresh and new method of financing. That being said, it can be understood why it is still scarcely available in some regions or some industries. Since 2006, its availability has been lessening, up until the most recent financial crisis. However, since the end of 2011, a rise both availability and willingness to use venture capital can be seen in all three countries¹⁹. The latest research shows a relation between the level of innovation of a country and the employment of venture capital. The access to venture capital in the Baltic region in the past few years has proven to be a catalyst for innovation, new technology development, job openings and market growth. However, Baltic SMEs are still not content with the level of available financing. And the main reason for the current level of available financing is the current lack of openness and development of these countries' financial markets. Therefore, this research mostly underlines that before correlating venture capital and economic growth, the relation between venture capital and financial market development needs to be examined. Furthermore, it can be concluded that in these countries, the lower level of financial market development does not allow to fully examine the correlation between venture capital and economic growth.

¹⁹ Rupieka-Apoga, R. Access to finance: Case of the Baltic states. *Journal of Applied Economics and Business*, 1(1).pp.32-38, 2013.

2.4 The MENA countries

Middle East and North Africa countries are characterized with a paced development and often political turmoil. However, a 2006 policy brief by the OECD²⁰ has shown that venture capital can be employed in these countries and lead to economic growth through innovation. It has been examined that technology development and innovative businesses are more and more institutionally and governmentally supported in these countries, which both leads to development of the financial market and economic growth. As opposed to the previous examples, in this research it can be seen how a portion of economic growth can lead to developing viable venture capital market instead of the opposite issue. In creating entrepreneurial spirit in these countries, government financing has been the bridge between equity and debt, playing the role of quasi-venture capital investor. OECD's future recommendations include turning away from government financing and creating favorable conditions for both private equity and venture capital financing. Although these favorable conditions themselves are caused by economic growth, it is stated that growth will be enhanced through reduced unemployment, economy diversification and new industries, all of which are considered results of venture capital employment. So it can be considered as a two-way relation in these countries.

The main problem of this research is the establishment of causality. What comes first - growth or economic development? However, it is important for considering research models, since it emphasizes the importance of including causal relations in the research.

2.5 The Philippines

It is easily analyzed how a rather alternative financial source can be implemented in a developed economy, but the same implementation in a developing economy can render very different results. Therefore, the cases of the developing countries are always

²⁰ OECD, Venture Capital Development in MENA Countries – Taking Advantage of the Current Opportunity, Policy Brief – Middle East and North Africa – OECD Investment Programme, Issue 1, 2006.

important to be considered. As it could have been seen in the previous portion, in many developing countries an autocorrelation momentum appears when defining venture capital and economic growth relation. However, this is not the case of every developing country – many have experienced the same effects of the developed countries. The example of the Philippines is one of those. Although venture capital prospects are not as often as in developed countries, they have had positive experience. During a 2002 research on venture capital on the Philippines²¹ the underlying issues for a developing country with the right amount of entrepreneurial spirit have been outlined. Under this study, it is believed that the difference in developing and developed countries is great, and it primarily stems from the different demands of the two types in terms of growth. Therefore, most developing countries are struggling with processes such as privatization, corporate restructuring, and infrastructure. High-tech and innovative businesses are not out of the plan; they just seem more distant because the legal, economical and actual infrastructure yet needs to be built. The problem with such issues is that venture capital funds are not usually interested in investing in the hard industries, where growth is either limited or slow. Moreover, the lack of the aforementioned infrastructure can turn them away from investments. However, in relation to economic growth, should a venture capitalist invest in any of the aforementioned options, it will most definitely contribute to economic growth, provided that the investing grounds are suitable. The conditions for these grounds need to be taken into consideration when discussing developing countries.

2.6 Developing countries in Africa

Many developing countries in Africa have already established venture capital markets, despite unfavorable factors – lack of education, legislation restrictions, political turmoil etc. It is interesting to look through researches made on the topic of venture capital and economic growth in such areas. For example, a 2012 research in Kenya states that venture capital employment is undoubtedly related to the growth of the SME sector in

²¹ Scheela, W. et Chua, R. Venture capital in a Developing Country: The Case of the Philippines, 2002.

Kenya, thus contributing towards economic development²². Venture capital has shown effect on real growth through several issues: opening new jobs, especially for labor force non-employable otherwise, improvement of quality of life (an instance which cannot be observed related to venture capital in developed countries, for example) and increase in wealth. It is interesting to see that despite the insecurity and difficult political situations, Kenya shows a high rate of entrepreneurs and venture capital is amiably employed. This contributes to improving the economic situation.

The lack of capital available for new companies has made a constraint on African countries' growth in the past. It is not surprising that many scholars²³ urged increase in available venture capital for African SMEs over the years – the lower rates of venture capital investments have been in large contributors to economic stagnation. Moreover, the need for venture capital has been taken on another level – competitive advantage through innovation can be supported mainly by this financing option. Since the SME sector is the backbone of any country, it is understandable why this call for increase in venture capital investments has been heard. As opposed to many others perhaps more developed countries, African countries do well in terms of venture capital employment (e.g. the Balkans, where this phenomenon is very scarce). But venture capital has found its place in African financial markets mainly because of the background of the population – so-called “necessity” entrepreneurs are regular in African countries, where there is no other exit from a poor situation other than starting an innovative business. But these entrepreneurs are not the only “new” category established in Africa. New “opportunity” entrepreneurs, working a new angle, an innovative approach, contribute to economic growth even more. These are the entrepreneurs that have actually brought venture capital to Africa, and are creating greater competitive advantages for their

²² Memba, S.F. et al. Venture Capital (VC): Its Impact on Growth of Small and Medium Enterprises in Kenya, *International Journal of Business and Social Science*, 3(5), pp.32-38, 2012.

²³ Patricof, A.J. et Sunderland, J.E. Venture capital for development, *Brookings Blum Roundtable: The Private Sector in the Fight against Global Poverty*, August 2005.

countries. So, although it is a case of many developing countries, in Africa, the impact of venture capital investments begins to show on economic growth²⁴.

3. Factors to be included in the research model

Previous examples varied in research objects and results. It is understandable when such an ambiguous relationship is explored, as is the relation between venture capital and economic growth that results will vary depending on the difference of the research area. There cannot be one economic model for measuring the relationship between venture capital and economic growth. There is no one equation solving the growth problem. As it could be previously seen, results will vary depending on the development not only among countries, but among regions in one country as well. Therefore, models investigating this relationship cannot be generalized; they have to be specific, country or region based. Furthermore, time is another constriction on the researches. Economic growth had more to do with venture capital in the US in the 50s than today²⁵. It is understandable that any research will have to consider that results may only be used as a part of forecast, and not an economic law.

Which factors must be examined before researching on the correlation between venture capital and economic growth? What are the specific factors that may show no or excess relation, rendering results invalid?

First and uttermost, the stage of development of the country (region) must be considered. Though not a distinct factor by itself, it encompasses the factors which must be included in a research model. As it has been discussed previously in detail, developed countries have already established infrastructure and education as well, creating innovative and entrepreneurial people. In developing countries, this may be a problem. In a number of countries the problem with lack of business education is great, and in such an environment venture capital investments cannot flourish. Moreover, the very culture of a people plays an important role in obtaining the entrepreneurial spirit.

²⁴ Patricof, A.J. et Sunderland, J.E. Venture capital for development, *Brookings Blum Roundtable: The Private Sector in the Fight against Global Poverty*, August 2005

²⁵ Wyse, R. et Burrill, G.S. Venture capital and economic growth.....A perspective, available from <http://www.wisconsin.edu>, 2004.

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Aside from the educational/technological background of California, one of the most important factors for the success of the Silicon Valley is considered the specific Californian culture, where each failure is seen as a minor setback, a way to try again. This is a crucial trait in the entrepreneurial spirit. This trait is why California-based entrepreneurs succeed more than Midwesterners in the USA. Or even further, the main difference with the more closed-up European culture, where failure is frowned upon more often. This is the main distinction for the higher rate of entrepreneurship in the USA as opposed to the EU, and as well, the higher efficacy of the relationship model. However, it has to be taken into consideration that grave conditions also nurture entrepreneurial spirit. High percentages of entrepreneurship, though not always backed up with education, occur in African countries, in low-developing regions, where innovation is driven by the willingness to survive in a way. But in researching such a model it has to be taken into consideration that the willingness of the venture capital investors is at stake – investors cannot always get a desired return. Therefore, in such cases, not only the level, but also the source of entrepreneurial spirit must be considered.

Geographical factors are as important as demographic. With new biotech, cleantech, renewable energy companies connected closely to venture capital, geography start dictating the next “place to be” for venture capital investors. What needs to be considered is that economic growth in such places is not only related to venture capital investments – other forms of financing are abundant as well.

Other issues that need to be considered are the legal and political issues in a system. The legislation may speed up growth, or stop it, through inadequate legislation. It is crucial that legislation is favorable for venture capital implementation, meaning that there will be no restriction laws or bureaucratic procedures. Legislation constructed properly leads to openness and growth of financial markets, thus leading to growth of venture capital employment. It is important to note that depending of the system’s construction, there is always a risk of autocorrelation, or the possibility of not

distinguishing the direction in which the relation venture capital – economic growth will go²⁶.

Another issue closely connected to the demographic factor and legislation is the labor market restrictions. The regulations of the labor market must be taken into consideration – when there is corporate security and safety, minimum wage setting and comfort in working in large companies, entrepreneurial spirit seems to diminish²⁷. The comfort of a government job has the very same effect in developing countries, although in long-term periods, can lead to minimizing economic growth. In such cases, the lack of venture capital (since there are no viable investments, no innovative entrepreneurs) may even sketch the relation – lower percentages of growth due to overlooking venture capital funds.

It cannot be stated enough how economic growth is connected to venture capital indeed. Increase in venture capital investments (a very broad model calculation) of 0.1% of GDP can lead to as high as 30% increase in real GDP in a system²⁸. Start-up investments succeeding have even higher impact on real GDP – 96%! However, the restriction on the time component makes it difficult to understand and measure long-term effects of venture capital on growth. Still, it cannot be said that such effects do not exist, or are miniscule. Venture capital does affect economic growth, but all previously stated factors must be accounted for to correctly measure the real impact, in a non-continuous time period.

3. CONCLUSION

This paper has offered both theoretical models and empirical issues to be considered when connecting venture capital to economic growth. One of its main goals is to show that one universal one-size-fits-all model for constructing venture capital – economic growth does not exist. The level of impact venture capital has on growth is directly

²⁶ Meyer, T. Venture capital adds economic spice, Deutsche Bank research, September 12, 2010.

²⁷ Lerner, J. et Tag, J. Institutions and venture capital. *Industrial and corporate change*, 22(1), pp.153-182, 2013.

²⁸ Meyer, T. Venture capital adds economic spice, Deutsche Bank research, September 12, 2010.

linked to the environment in question. It cannot be expected that venture capital can impact growth in the same manner in developed and developing countries. Even more so, even regions in the same country sometimes cannot be measured with one identical model. It is important to have several issues in mind when constructing a model. Firstly, the demographic and geographic characteristics of the environments need to be taken into consideration, not only separately, but in interaction with one another and all remaining factors. Factors that need to be accounted for include political status, legislation, development and restrictions on both financial and labor market, taxation policies and so on. Furthermore, the level of education is crucial to be taken into consideration. However, this does not imply that low-skilled workers environment cannot implement venture capital in pursuing growth; it merely accounts for the rate and direction at which education will affect the relation. This goes for all factors as well. And most of all, the entrepreneurial spirit is deemed as the basis at which venture capital options can be considered, and growth can be related to them. Without it, the dream of economic growth seems unattainable. And even with the presence of venture capital on the market, without sound, innovative entrepreneurial ideas, the relation to growth does not exist in real terms. In the end, the major setback of constructing a universal model for examining the relationship of venture capital and economic growth is the rate of development of the country investigated - depending on the stage its economy is in, various research models need to be implemented. The specific features of each area (country or even region) must be accounted for in the unique model – a separate one for each investigating area.

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**PERSONAL FINANCE: CONCEPT AND STANCE IN THE REPUBLIC OF
MACEDONIA**

Klimentina Poposka, PhD¹

ABSTRACT

In recent years financial education and financial literacy has gained wider attention, particularly after the latest financial crises. Complex financial instruments require renewed knowledge by the clients for their proper utilization. Hence, personal finance attracts attention by the financial institutions, banks, insurance companies, government, and all other parties. The dominant concern is that the consumers lack of necessary knowledge for new financial instruments and products, hereafter they are not in the position always to make solid financial decisions regarding their finance. In countries such as Republic of Macedonia the concept of personal finance has not been widely used or implemented. The empirical research indicates the low level of personal finance management and emphasizes the strong need for developing and implementation the mechanisms and advance tools for personal finance by all relevant parties.

KEYWORDS: personal finance, financial education, financial literacy.

JEL CLASSIFICATION: D14

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1. INTRODUCTION

The economy is still recovering from the most recent financial crisis which has been considered the most severe since the Great Depression of the 1930s. What started with the bankruptcy of the Lehman Brothers Bank in the US spread like the domino effect striking the member countries of the Euro zone where the crisis primarily has resulted in rapid increases in unemployment, deceleration of growth, and economic contraction. Simultaneously, effects like dwindling levels of foreign direct investment, growing budget deficits, contraction of world trade caused reduced access to credit and trade financing.

In such dynamic economy, the personal finance imply as a necessary discipline assisting individuals and families in managing their financial means. Personal finance incorporate economics, management and finance as a disciplines as well as sociology, psychology, counseling. It also include external and internal environment which includes financial markets and institutions, government agencies, economic, demographic and social trends and personal and family factors.²

However personal finance is not only basic concepts connected with math, finance, economics, entrepreneurship or informational technology. It also involves the human beings and in the middle of the economic theory is the assumption that the humans are rational. However, sometimes people do not make rational and optimal decisions. The latest financial crises has practically crushed standard economic theory in two aspects:³ 1) Human beings usually make rational decisions and 2) the market's invisible hand serves as a corrective to imbalances.

2. PERSONAL FINANCE: BASIC CONCEPT

Personal finance encompasses credits and debt product, debt management, retirement plan, insurance, investment, taxes, etc. Variety of instruments require

² Hira K. Tahira, Personal Finance: Past, Present and Future. Networks Financial Institute at Indiana State University. Policy Brif. 2009-PB-10. December 2009. p: 4.

³ Ibid, p:6.

proper tools and adequate financial education for managing personal funds in order to implement financial aims of the individuals and families.

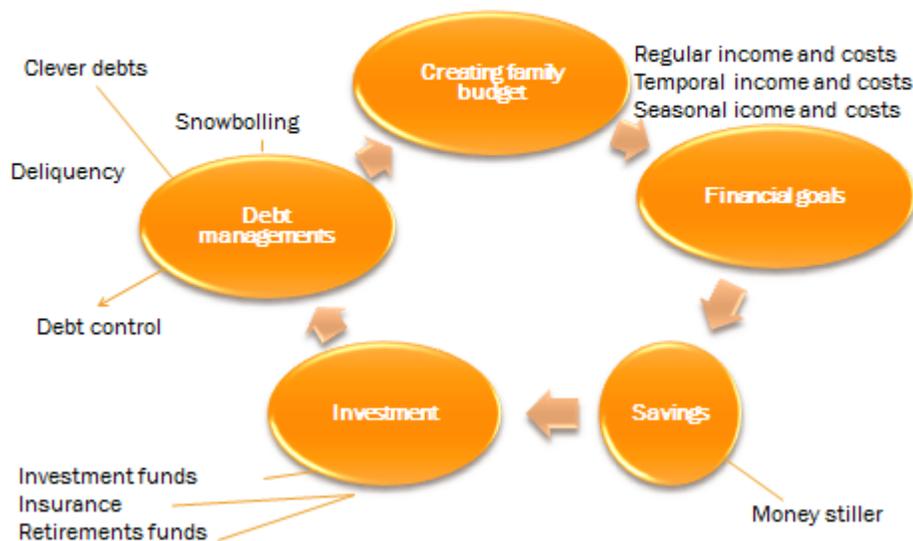
Financial education is about teaching the knowledge, skills and attitudes required to adopt good money management practices for earning, spending, saving, borrowing and investing. It combines economic education with the promotion of entrepreneurial attitudes. Financial education creates an awareness of the benefits of financial planning and builds the capacity of the low-income households to gain control of their financial resources and better manage their scarce capital. In this way financial education enables people to combine information and resources to enhance their economic security and more effectively use financial services.⁴ Hence, the overall goal of the financial education is to ensure that people are equipped with appropriate information, knowledge and skills to make good financial discussion.⁵

Mainstream economist and researchers gave a little attention to the topics of personal finance, instead focusing on broader issues such as financial markets, movement of the money markets, corporate finance etc. The picture 1, point out the main areas of money management with crucial influence on personal finance.

⁴ Matul Michal, Pawlak Katarzyna, Guzowski Krzysztof, Kopanski Sebastian "Plan Your Future". A Trainer's Manual to Deliver Financial Education Workshop. Microfinance center Warsaw. Poland. December 2005, p: 5.

⁵ Hira K. Tahira, Personal Finance: Past, Present and Future. Networks Financial Institute at Indiana State University. Policy Brief. 2009-PB-10. December 2009, p: 12.

Picture 1. Money management



Money management, source: Based on the authors practical work in the delivering workshops in Personal Finance in the period 2009-2013.

The literature provide evidence that financial education has positive financial outcome for the consumers. Namely data⁶ indicate that clients show significant improvement in their financial behavior. For example, clients with pre-counseling had 19% lower rate in 90 days delinquency delay in credit repayment, then clients who didn't receive such counselling.

3. PERSONAL FINANCE IN THE REPUBLIC OF MACEDONIA (FGD)

The concepts of personal finance in the Republic of Macedonia has not been widely used and implemented. Although the lack of knowledge in personal finance can influence on delivering the proper financial decisions by the clients, yet financial institutions are still on the initial phases of implementation of the concepts in personal finance. The research demonstrate that all involved parties could have win win situation

⁶ Lyons C. Angela. Financial Education and Program Evaluation: Challenges and Potentials for Financial Professionals. Journal of Personal Finance. Volume 4, issue 4. 2005. P:57.

by initiating higher awareness in application the tools for personal finance management.

The research based on focus group discussion (FGD) indicate that lack of information direct client to one or another type of institution. Yet, if the would have a proper info, they could make better financial decision for consuming certain financial services.

Table 1. Comparison of credit parameters between Microfinance institutions and Banks ⁷

Credit parameters	Microfinance institutions	Banks
Credit amount	*****	****
Repayment period	*****	****
Interest rate	****	
Monthly installment		*****
Guarantee		****
Staff	*****	*****
Speed of the credit process	*****	*****

Source: Margarita Lalayan, Klimentina Poposka, Needs, attitudes and preferences towards micro enterprise credit and non-financial services by Roma population, Key findings from qualitative market research, conducted by Microfinance Centre for CEE and the NIS, May, 2008.

In the Table 1 we present the perception given by the clients, regarding the competition between the Microfinance institution and Bank. Clients who use the parallel services from Microfinance institution and Bank appreciate Bank service as well. Hence, the staff approach and speed of the services in both cases is strong, whilst the monthly installment is highly appreciated in Bank. Microfinance institution scores better in the credit amount repayment period, whilst some clients also gave preferences to the Bank in both criteria. The group agrees that the interest rate is better with Microfinance institution.

⁷ It should be taken into the account that such comparison presented in the Table has been made by the participants of one FGD. However similar perceptions have been obtained on the other FGDs. Based on qualitative information gathered by FGD (14.04-23.04.2008) in Shuto Orizari.

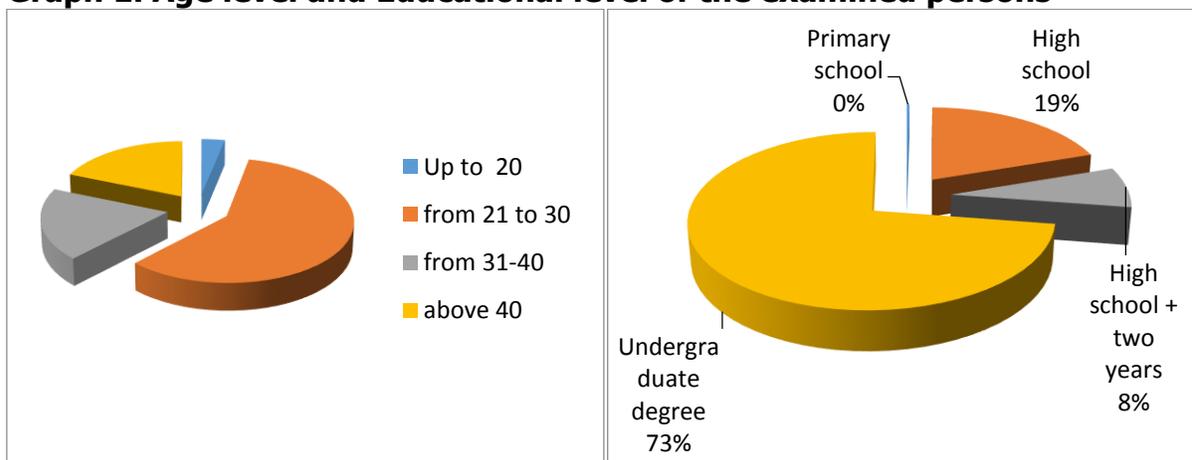
The advertisement channels are widely recognized as being different in both cases, Microfinance institution and Bank. The general perception is that Microfinance institutions do not use marketing channels, while the Banks use lots of TV commercials, brieflets and other marketing tools. Assessment in the methodology indicates that Banks lends individually and collateral requirements are more or less relaxed and affordable for this group. General assumption is that the clients go to Banks not because they have become less poor, but for pure competition reasons. More poor people do not have access and they say "Microfinance institutions are for poor people and Banks are for rich".

General assumption is that if the clients have adequate information for the costs, opportunities and risks in each type of financial institution, they would have better assess what type of products to use for separate financial goals.

4. EMPIRICAL RESEARCH AND METHODOLOGY

In order to quantify the stance and need for implementing tools in personal finance we have implemented the study based on questionnaires conducted on 350 examined persons. The age level and educational structure of the has been presented on the Graph 1.

Graph 1. Age level and Educational level of the examined persons



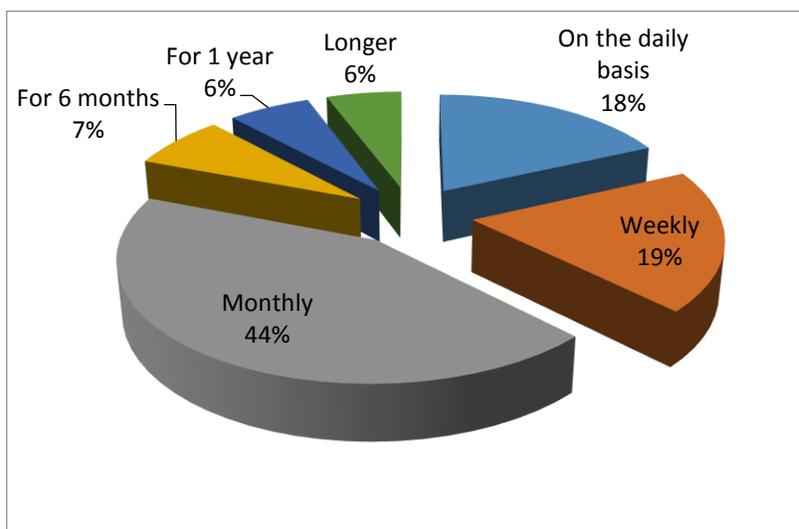
Source: Based on the data from the questionnaires conducted on 300 examined people

The graph 1 clearly indicate dominance of the examined people in the age range from 21 to 30, where we consider that the knowledge for the personal finance concept

should be stronger, as it serves as a base for future. Moreover, the educational structure of the examined people for the personal finance has been characterized as a highly educated with 73% of the examined people with the undergraduate degree. Henceforth the expectations are that the level of knowledge for the financial instruments and its proper utilization, as well as money management in the family would be on high level.

The cost planning represents one of the major tool in managing personal funds. Long-term planning is the indicator for high awareness in managing costs as part of the family budget.

Graph 2. The length of costs planning within the family



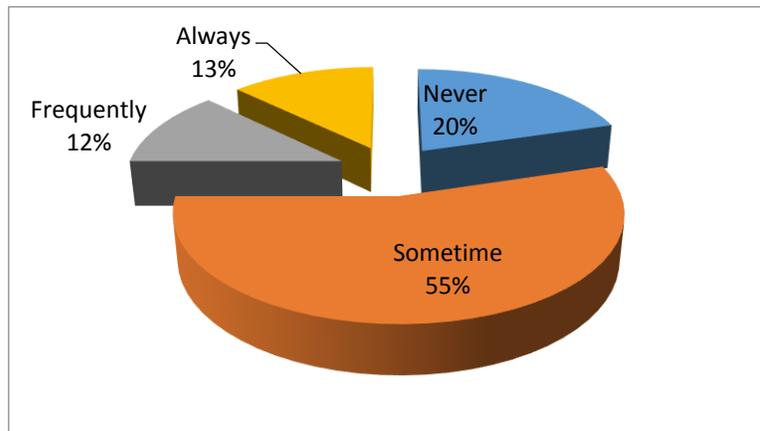
Source: Based on the data from the questionnaires

One of the major problem in money management in personal finance has been short term costs planning. The graph 2 clearly indicate that only 6% of the examined persons plan their costs longer than 1 year. Such results evidently indicate the lack of awareness for imposing long term aims and making structural plans for its fulfillment.

As part of the family budget planning, "urgent fund" or "emergency find" signifies the strong indicator for responsiveness of the money management. A special fund can be set up for emergency expenses. It would be used to pay for emergency events that can happen to any family. If properly managed, an emergency fund provides a basis for the consistent pursuit of financial goals. Thus, if an emergency

occurs, it is less likely that there will be a disruption to the process of saving money towards specific financial goals. Graph 3 demonstrate the percent of the examined people, who are generating the emergency fund.

Graph 3. Emergency fund

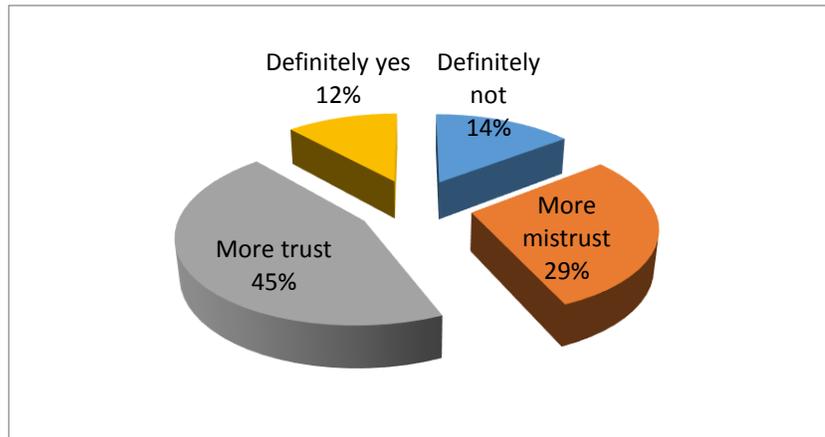


Source: Based on the data from the questionnaires

The results indicated that only 13% are making the urgent fund, whereas others are making frequently, sometimes and never in 12%, 55% and 20% respectively. Such results indicates the need for developing the awareness for necessity of creation of emergency fund and its function. "Aside money" are frequently utilized by the families, however the real use of emergency fund in majority cases is incorrect manner. Lack of "emergency fund" force families to interrupt the fulfilment of the short and long term financial goals.

Although the financial and banking industry has been of the key relevance in the economies with traditional operation, yet people still do not trust to the institutions.

Graph 4. Trust to bank and financial institutions

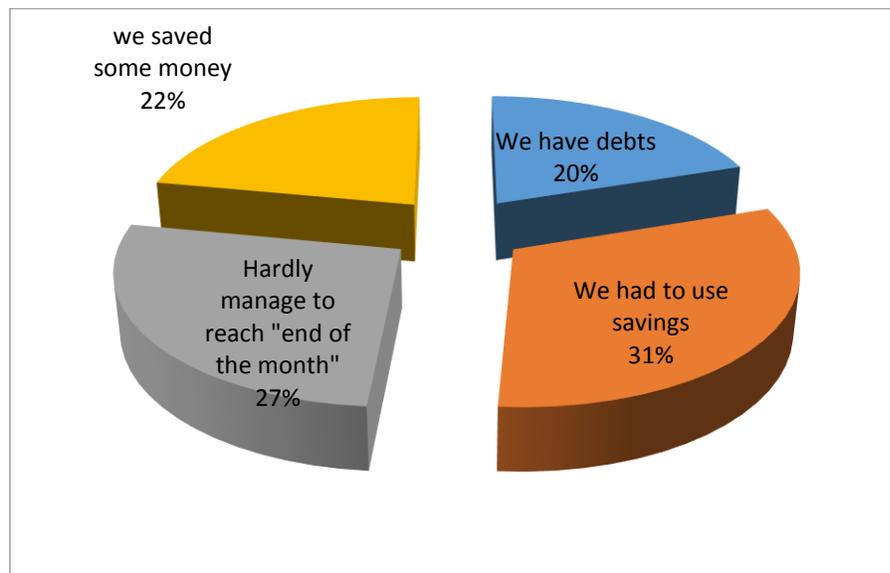


Source: Based on the data from the questionnaires

The research indicates the certain mistrust into the banks and financial institutions. Having in mind that the banks and financial institutions are the most regulated segment, these results indicate that lack of info for exploiting these institutions for the accomplishing the financial needs.

The next graph indicates the ability of managing money in the family. The result also indicate urge need for implementing tools for better money management.

Graph 5. Economic situation in the family

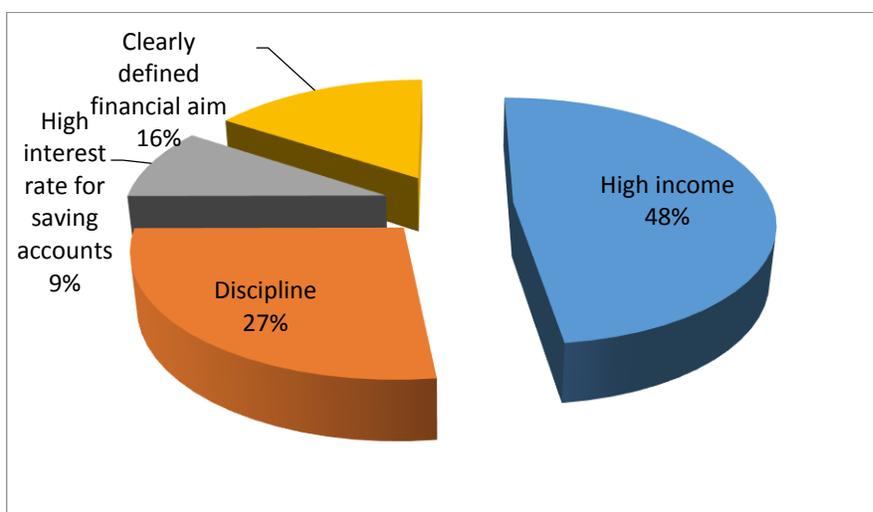


Source: Based on the data from the questionnaires

The presented graph clearly indicate the inability in wise money management, since only 22% of the questioned people are saving some money, whilst others have debts, had to use savings or hardly link “end to end”.

Personal finance concept is based on the foundation that “you don’t need to have lot of money” in order to save, but you need to be well organized in order to set up proper financial aims and to make clear plan how to fulfill them. Opposite to such stance, the funding indicate that majority of examined people consider “high income” as necessity for saving (Graph 6).

Graph 6. Preconditions for saving

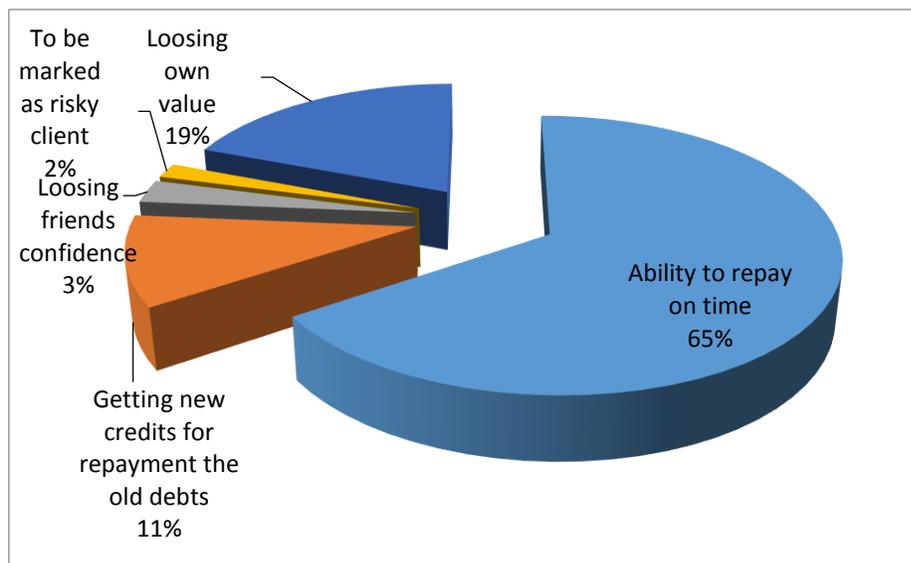


Source: Based on the data from the questionnaires

In the graph 6, 48% of the examined people consider that high income is crucial for saving, and not the other aspects such as clearly defined financial aim or discipline.

In indication of the key risks in the process of taking credits, the ability has been signed as the major risk.

Graph 7. Identified key risks in taking credits



Source: Based on the data from the questionnaires

The presented graph clearly indicate that 65% of the examined people need urgent knowledge for wise money management, since “ability to repay credits” represents the key risk in credit management by the client. Hence by utilization of the proper tools, the client can get the necessary knowledge for defining the real financial goals and calculation of repayment ability without dangerous to delay on credit.

5. CONCLUDING REMARKS

Increased risks in the financial sector and complexity of financial products upsurge the need for renewed knowledge for proper utilization of the in tools in personal finance. The latest financial crises imposed increased debt position, particularly at the low income families, forging people for accurate and cautious money management in order to fulfill their financial goals as well as to avoid over debt.

In the Republic of Macedonia, the research clearly indicate the strong need for increased awareness of proper use of tools for personal finance. Moreover the financial institution should increase their social corporate responsibility in sharing the information for all benefits, risks and costs in exploiting certain financial instruments. Such attitude would have positive impact on the decreasing the nonperforming loans

at the financial institutions and other pitfalls in distribution of their products and increasing the efficiency in their operation. The feedback would be seen by matching adequate financial products with real financial goals of the people, decreasing the level of the delinquency in credit repayments.

The final aim is to increase the competences of the citizens in understanding financial products in order to make a solid financial decision for its utilization. Such effect should be copied not only by the banks, but also by the insurance companies, retirement companies, investment funds, etc. The topics include budgeting, personal property, money flow, short-term investment-cash funds, life insurance as part of personal finance, investment funds in increasing and managing personal funds for long term, pension funds and models for increasing retirement funds, other contemporary methods for accomplishment of long term funds, etc. Empirical evidence from the research in the Republic of Macedonia urge for prompt actions by the all relevant parties such as financial institutions, education and the government for increased awareness and relevance of the tools for personal finance management.

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UDC: 005.574

332.146.2:005.574

**MEDIATION AND CONFLICT MANAGEMENT – CREATIVE STRATEGY
TOWARDS SUSTAINABLE DEVELOPMENT OF THE SOCIETY**

"Everything is related to everything else.

Water always runs downhill.

Nature always laughs last"¹

Elizabeta Spiroska, M.Sc.²

ABSTRACT

This paper is a brief introduction about the mediation as a dispute management practical strategy in the civil dispute resolving. The principal focus is on the following: can mediation as conflict management strategy be linked with successful outcomes aimed to sustainable development of the society? And this paper shows that, mediation could be an innovative activity and process designed to have stakeholders think about the boundaries of the conflict resolution field and ways in which other (till now unconnected) fields can impact and transform the way we think about and practice conflict resolution

The paper is composed of Introduction, two parts and Conclusion. Introduction provides a brief overview of the basic questions about the mediation as a method of dispute resolution. Part I describes the mediation as a conflict management strategy through the socio development context of the conflicts. Part II describes the benefits of mediation in civil dispute resolving. Conclusion gives briefly, useful picture of the assignment of paper.

KEYWORDS: mediation, civil disputes, conflict management, sustainability, development, strategy.

JEL CLASSIFICATION: K19, K49

¹ Tom Frantzen, speaking on *Biodiversity in Mainstream Farming*, First Annual IFFS Kellogg Holistic Management Project Statewide Meeting, Yakima, WA, January 23, 1997.

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INTRODUCTION

Sustainability:

Sustainable processes and institutions meet certain criteria: they do not exhaust resources for the future generations; the capacity of people and institutions is permanently enhanced; and responsibilities and benefits are broadly shared.³

Alternative dispute resolution, or ADR, is the “umbrella term” used to describe the different methods of dispute resolution, outside of traditional methods such as litigation. Achieving equality, efficiency and expertise outside the formal litigation, through ADR, is not a recent idea.⁴ However, the early forms of reconciliation and friendly atmosphere revealed the primary motivation of ADR: achieving a compromise between the conflicting parties and avoiding open disputes as well as violent consequences through the coercive execution of court decisions. ADR encompasses a wide range of processes, ranging from a formal procedure that includes a judge to private proceedings conducted by a neutral third party.

The three basic types of ADR are: arbitration, mediation and direct negotiations. Alternative dispute resolution methods are becoming more popular for resolution of disputes between parties. They are the preferred methods of resolving disputes, a trend that is likely to continue into the 21st Century.

Mediation is a voluntary, flexible and informal process in which a neutral and independent third party, beyond the dispute—a mediator, facilitates the discussion between the parties and actively helps to reach an optimal solution to the conflict, acceptable to all parties, and based on their real interests and thus to reach an agreement. Mediation allows the parties, to resolve the dispute peacefully, out of court,

³ The UNDP Page <http://mirror.undp.org/magnet/policy/glossary.htm>

⁴ The first negotiations in the Bible are between the serpent and Eve in the Garden of Eden. Buddhist tradition recognizes the conflict as an integral part of human behavior and has developed a spiritual and practical guidance to help resolve disputes. In 1800 BC, Syria to resolve disputes with other kingdoms used arbitration and mediation. In 400 BC Athens was established feature - public arbitrator to relieve overburdened courts and to ensure faster resolution of those disputes whose sides believe they can be resolved outside the formal way of justice. Although the option of arbitration was voluntary, the function - arbitrator considered for civil commitment, sanctioned with loss of citizenship.

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through peaceful means, negotiated with the help of a neutral mediator - person of their choice and resolve the dispute without a court judgment. According to this, the goal of mediation is not to determine which of conflicting parties is right or wrong, but to find an acceptable solution that will be of mutual interest to both parties, to establish objective measures for resolving conflicting interests, so that, ultimately, the parties mutually will be satisfied.

The science have identified two basic types of mediation: evaluation and facilitative, and basic difference between them stems from the role of mediator. From a formal point of view, mediation appears as voluntary and mandatory or compulsory.

Originally mediation occurred as a private initiative.⁵ But in its development, the support it receives from the state is very important. The basic criterion for organizational defining of mediation is its relationship with the court, where it appears in the following models: private, quasi-judicial mediation and court-annexed mediation.

Mediation is a quality addition to the judicial system, but is not a substitute for it. If the mediation process does not lead to a reasonable and unobtrusive solution, the parties may return to court proceedings, which means fully respect the free access to the court. Also, mediation process is time limited, which significantly shortened the lengthy litigation.

Although one of the benefits of mediation is a court relief from the excessive number of cases, the application of the mediation, primarily lies in the interest of the parties and its aim is quickly resolving their contentious relationships while improving them. Therefore, mediation is a method of dispute resolution that can benefit any country⁶. It is a practical tool to resolve but also, to prevent and manage conflicts.

⁵ The birthplace of ADR, at least in its most recent form, is the United States of America. Although similar forms of dispute settlement have long existed in China, the study and acceptance of concept of ADR by the Chinese legal circle and business community has been of quite recent origin.

⁶ "I personally believe that when you build bridges to bring something new into a new country or a new setting you need to deal first with the culture and what is going on in that new setting. I had to deal with various cultures, different legal systems and just ignorance on mediation when I started to introduce mediation in a new country. As a result, I decided to build bridges to bring mediation as a tool to resolve conflicts. Alternatively, I wanted to implement mediation in the other countries for the benefit of individuals and businesses..." See: Sgubini, A., Tran, M., Brovchenko, D., Beherns, B., Cardinale, S., Carbone, F., Peres Potenza, G., Folkmann Costa, C.: *International Mediation Legislations*

Mediation provides targeted conflict management tools to stakeholders. Every aspect of mediation`s conflict management toolkit is designed to assist individuals respond more effectively regardless of the nature of the conflict. Mediation conflict management services are tailored to address the specific issues experienced by those involved in the dispute. Combined with the science of conflict management and communication, mediation aims to make dispute a creative spark for change.

I. MEDIATION AS A CONFLICT MANAGEMENT STRATEGY

1.1. Mediation in socio development context of the conflicts

Conflicts are a fact of life. They happen whether people want them or not. Conflicts occur when people pursue goals that clash or are incompatible. Conflict involves people's thoughts (ideas), emotions (feelings and perceptions) and actions (behaviour).⁷

Conflict grounded in social, structural, cultural, political and economic factors is endemic in all societies. Disagreements and misunderstanding are key characteristics of human relationships whether the relationship is a domestic, national or international one. Since disputes are such a critical part of human relationships, many countries have mechanisms to resolve them in a manner, which maintains the cohesion, economic and political stability of the state. This is particularly so with regard to disputes related to commerce because commerce is the engine of growth.⁸ Individuals, businesses and organizations always stress the need for fast decisions and procedures, which support business and personal relationships.

and the Practical Use, 2009, available on: http://www.bridge-mediation.com/wp-content/uploads/2012/12/intern_med_legislations.pdf.

⁷ Forestry Department of the UN, *Negotiations and Mediations Techniques for Natural Resource Management*, 2005, available on: <http://www.fao.org/docrep/008/a0032e/a0032e05.htm>.

⁸The Africanadain Mediation and Community Services Page
<http://www.metros.ca/amcs/international.htm>.

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Conflict management often involves a process of helping parties to "reframe" their conflict, shifting their perception of the conflict or their ways of dealing with it.

There are a number of procedural options for managing conflict and many ways to intervene and assist in conflict, and there's no one best intervention strategy for all situations.⁹ Negotiation and mediation can be found in all cultures' conflict management processes. However, different cultures approach conflict and conflict management in different ways.¹⁰

Conflict resolution objectives are: a good quality solution, disputants' commitment to implementing the solution, efficient use of time, disputants' perceptions that the solution and the process are fair and disputants' sense of empowerment to resolve the current and future conflicts.¹¹ Mediation is appropriate approach, because it encourages consensus building among multiple stakeholders. Resolving conflict can be viewed as a form of collaborative, creative problem solving. For real positive results, it should be borne in mind that, mediation, does not exist in a vacuum. It is not a universal process in isolation. Oposite, it operates against a backdrop of national dispute management culture and institutional rules and regulations,¹² it operates in context detected by

⁹ "...When managers intervene to resolve conflicts, they should consider several objectives. Naturally, the primary objective in many conflict situations is to find a good quality solution to the problem that's causing the conflict. In order to achieve that objective, the disputing parties must collaborate toward finding the best possible solution. In addition, in order for the parties to collaborate toward resolution they need to share information with each other, make concessions, be open to the third party's suggestions, and be realistic about what they consider a fair and effective resolution. Managers also want the disputing parties to be committed to complying with the resolution, because a great idea is worthless if it isn't implemented, and disputants are usually the ones who have to implement or comply with the resolution. Efficiency is another key consideration when trying to resolve disputes. Conflicts must be resolved efficiently so that parties can resume their work. Finally, to maintain morale and motivation, managers should consider fairness for and empowerment of their employees. Appropriately or inappropriately, research shows that managers often select an intervention strategy that asserts their own power and control at the cost of their employees' sense of empowerment and fair treatment.." See: Sojin, R.: *Mediating Conflict*, College of Business, Whrite State University, available on: <http://www.wright.edu/~scott.williams/LeaderLetter/mediation.htm>.

¹⁰ Forestry Department of the UN, *Negotiations and Mediations Techniques for Natural Resourse Management*, 2005, available on: <http://www.fao.org/docrep/008/a0032e/a0032e05.htm>

¹¹ Sojin, R.: *Mediating Conflict*, College of Business, Wrighte State University, 2003, available on: <http://www.wright.edu/~scott.williams/LeaderLetter/mediation.htm>.

¹² Alexander, N.: *What`s law Gots to do with it? Mapping Modern Mediation Movements in Civil and Common Law Jurisdictions*, Bond Law Review, Volume 13, Issue2, Article 5, 2001, p.5, available at: <http://epublications.bond.edu.au/blr/vol13/iss2/5>.

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national dispute settlement culture, legal stakeholders, institutions and regulations. Mediation procedures, also, apply certain rules which in different legal systems are different, but, in general, are based on the principle of interest-oriented solutions to the conflict, which derive from the fact that conflicts can be solved more effectively and more favorable when interests are established rather than the right and power.

The said previously, clearly and unequivocally shows that mediation could be a significant part of the innovative activities and processes designed to have stakeholders think about the boundaries of the conflict resolution field and ways in which other (till now unconnected) fields can impact and transform the way we think about and practice conflict resolution.¹³

1.2. What kinds of civil disputes can be resolved through mediation?¹⁴

Science prevailing notion about this question, is that any kind of dispute can be resolved by mediation.¹⁵ Mediation services, have grown rapidly in many common law jurisdictions since the 1970s. Compared with the common law jurisdictions experience, mediation in civil law jurisdictions took many years for the pioneers of mediation to attract any significant attention from legal practitioners and the wider community. It was not until the latter half of the 1990s that the civil mediation movement began to enjoy more than academic attention.¹⁶

¹³ See: Lee, J.: *Dining in the Dark - Insights for mediation*, 2013, available at: <http://kluwermediationblog.com/2013/11/14/dining-in-the-dark-insights-for-mediation/>.

¹⁴ "The French judicial system works like an attracting magnet: once a case enters, it has a 95% chance of finishing by a court decision (or legal bargaining aiming to anticipate the said decision). In America, the system works like a repelling magnet: when a court is seized, the case has a 95% chance of being settled outside the courtroom and the system has integrated numerous tools to do so (mediation, conciliation, pre-trial conferences, mini-trials, etc)."- Adrian Borbely, available at: <http://kluwermediationblog.com/2011/10/13/civil-or-common-law-what-are-the-sources-of-scottish-judicial-attitudes-to-mediation/>.

¹⁵ Despite this leading standpoint, it should be borne in mind that law is much more than set of rules and regulations. "The law is rooted in culture, and it responds, within cultural limits to the specific demands of a given society in a given time and place....Substitution of one legal tradition for another is neither possible nor desirable..", See: Merryman, J.: *The Civil Law Tradition*, Stanford University Press, Stanford, California, 2007, p.157.

¹⁶ "...Context defines mediation and has a direct impact on how it is practised. National legal contexts reveal historically embedded systemic differences that can provide insights into the reasons behind the rapid expansion of mediation in common law jurisdictions, and the comparatively hesitant development

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Mediation has proven to be particularly successful in resolving disputes in which the parties are in a lasting relationship: labor relations, housing relations, family law, and the permanent business engagements. In addition, mediation is the best way for the disputes which have a strong emotional component and require more therapeutic than a legal approach. Also, if the parties have attempted through negotiations to reach a settlement and negotiations failed, mediation is the next, natural step, especially if the dispute involving several people.

In Australia, Canada, England and USA today ADR exist most courts and tribunals, which means that no category of legal disputes is excluded from the potential application of ADR, and in particular, mediation (there is a broad use of mediation in the legal world even though there is very little legislation that attorneys and mediators rely on).¹⁷ But still, in the process of determining the disputes that will be referred to mediation, it is necessary to have in mind the suitability of the case for mediation, ie, to consider the needs and goals of the dispute and to see the kind of relationship between the conflicting parties.¹⁸ The practice of certain states, shows that there is an automatic referral to mediation of disputes of a certain type, for which the legislator considers, that according to their nature are suitable for mediation.^{19 20} Such is the case

of mediation in civil law jurisdictions..”, See: Alexander, N.: *What’s law Gots to do with it? Mapping Modern Mediation Movements in Civil and Common Law Jurisdictions*, Bond Law Review, Volume 13, Issue2, Article 5, 2001, p.4, available at: <http://epublications.bond.edu.au/blr/vol13/iss2/5>.

¹⁷ See: Alexander, N.: *Mediation in the Modern Millenium*, TC Beirne School of Law, University of Queensland, 2002, p.4, available at: http://espace.library.uq.edu.au/eserv.php?pid=UQ:8893&dsID=Mediation_in_the.pdf.

¹⁸ Whether deep-rooted traditions affect judges’ attitudes towards alternatives to the courts. It is of course dangerous to generalise about judicial attitudes, but deeply affect how legal stakeholders think and work. See: Peters, D.: *It Takes Two to tango, and to Mediate: Legal Cultural and Other Factors Influencing United States and latin Amrican Lawyers` resistance to Mediating Comercial Disputes*, Levin College of Law at the University of Florida, 01.01.2010, p.34-35.

¹⁹ “..All decision-making and behavioral activity involved in identifying, explaining, recommending, and implementing commercial dispute resolution options, like all human choice and action, starts with perception..”, See: Peters, D.: *Forever Jung: Psychological Type Theory, The Myers-Briggs Type Indicator and Learning Negotiation*, 42 DRAKE L. REV. 1, 13, 1993.

²⁰ “..Where the American or the Australian would expect services from the private sector, the European would expect the same services to be provided by the State..”, See: Dagtoglou, P. ‘Diskussionsbeitrag’ in Hoffmann-Riem and Schmidt-Assmann (eds), *Konfliktbewaeltigung durch Verhandlungen*, 1990, p.324. Anyway, there is a real risk if common law success stories are directly translate to an ad hoc civil law stories.

with the civil law countries. In the civil law countries, in order for any new tool of conflict resolution to be effective and to generate enforceable results, it must be incorporated in the legal system by a legislative provision.²¹ Two exceptions to the common law - civil law distinction are the Netherlands and South Africa. The Netherlands is borrowing from both civil law and common law jurisdictions, and so lead the way of mediation innovation in the civil law world.²² The South African`s system is a kind of uncodified civil law, which exist against the backdrop of traditional community dispute management.²³

Equally important to the adequate selection of cases suitable for mediation, is choosing the optimal point when dispute will be referred to mediation. The mediation can be conducted: before commencement of proceedings before the court, after the commencement of litigation, the parties with a contract may provide mediation as the most appropriate way to resolve their mutual disputes and the court may direct the parties to attend a mediation. There is no consensus in the science, about the question when is the right moment the case is ready for mediation, but the view that, it is a component that depends on the individual characteristics of the case. The fact remains that, the success of the entire process of mediation in any legal system depends on the legal instinct, experience and training of the judge, wearing the right decision which dispute at which stage of the proceedings should be referred to mediation.

II. ADVANTAGES AND DISADVANTAGES OF MEDIATION

While mediation cannot guarantee specific results, there are trends that are characteristic of mediation.

2.1. Advantages of mediation

²¹ Sgubini, A., Tran, M., Brovchenco, D., Beherns, B., Cardinale, S., Carbone, F., Peres Potenza, G., Folkmann Cost, C.: *International mediation Legislations and the Practical Use*, 2009, available at: http://www.bridge-mediation.com/wp-content/uploads/2012/12/intern_med_legislations.pdf.

²² Alexander, N.: *Mediation in the Modern Millenium*, TC Beirne School of Law, University of Queensland, 2002, p.4, available at: http://espace.library.uq.edu.au/eserv.php?pid=UQ:8893&dsID=Mediation_in_the.pdf.

²³ Ibidem.

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Privacy and confidentiality. One of mediation's key benefits is its ability to protect the privacy and confidentiality of the participants. Mediation is strictly confidential, both, for the mediator and the participants.²⁴ In addition, the confidentiality of the mediation procedure is developed through the following two aspects: mediation as a private process is not subject to public knowledge and possible media attention and second, the very simple rule: What's said in mediation stays in mediation.²⁵ Mediation confidentiality applies from the first contact with the mediator through the enforcement of a mediated settlement agreement or court order.²⁶ The importance of confidentiality to mediation processes is encapsulated in the following propositions: confidentiality increases the parties' willingness to engage in a mediation and confidentiality enhances the effectiveness of the process.²⁷

Informal and flexible procedures. Mediation is informal. Mediation is not subject to the same procedural requirements and time frames as a formal hearing. With the help of the mediator, the parties set the tone of the mediation session and organize their time in a way that meets everyone's needs. At mediation the parties have a chance to present their ideas in an informal, private setting with the support and advice of their attorney, if they have one. It is a time to be heard and to listen to others.

Mediation is flexible. The mediation process is designed to be flexible and user-friendly,²⁸ to suit the needs of the parties. Mediation can offer flexible alternatives to going to court. A judgment rendered by the court will typically be an award of money. In mediation, parties can design flexible solutions. They have a better opportunity to control the outcome of the dispute.

²⁴ Information learnt through the process cannot be used in any litigation, tribunal, hearing, grievance procedure or similar process.

²⁵ Mediation confidentiality is a multi-faceted concept and is crucial for every well-established statutory framework governs the privacy of mediation.

²⁶ In order to fully understand the parameters of mediation confidentiality, it is crucial to appreciate precisely what mediation is, when the process begins, and when it ends.

²⁷ See: Crosbie, F.: *Confidentiality in Mediation*, available at: http://www.leadr.co.nz/db/images/M_PDFs_articles/confidentiality.pdf.

²⁸ The World Bank Page, <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/ORGUNITS/EXTCRS/EXTMEDIATION/0,,menuPK:64166110~pagePK:64166089~piPK:64166107~theSitePK:471064,00.html>.

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The features as informal and flexible, allow the people involved to find the best path to agreement. The mediator controls the process but the parties retain control of the decision making. Because of this, mediation can deal with multiple parties and a variety of issues at one time.²⁹

Rapid Settlements. Mediation process is always much faster than civil litigation.³⁰ Depending on the circumstances, type of dispute and its complexity, resolution can be achievable in a few days. Some disputes can be mediated in one session over a number of hours, others, will require a number of shorter sessions spread out over a number of weeks.³¹

Lower cost. Mediation is cost-effective. The costs of the civil litigation are reviewed through the following two aspects: as direct: court`s costs and attorney's fees, and indirect related to: time spent, loss of income, bribery and corruption and costs can exceed benefits. Mediation services are available at low cost.

Agreements that are better than Simple Compromises or Win/Lose Outcomes. Mediation is interest-based approach to problem-solving. Mediation encourages the parties to focus on "interests" versus "positions". An interest is concerned with individuals' values, needs, hopes and concerns. It involves understanding the underlying reasons for the conflict. A position, on the other hand, is a fixed determination of either or both parties which is often stated as a demand. Mediation examines the underlying causes of the problem and looks at what solutions best suit

²⁹In family mediation, for example, two children, Mom, Dad and Grandma might be involved. They may need to talk about chores, school performance, curfew, allowances, discipline, and the use of the kitchen", American Bar Association, *How Courts Work*, available at: http://www.americanbar.org/groups/public_education/resources/law_related_education_network/how_courts_work/mediation_advantages.html.

³⁰ See: The Business Standard Page, available at: http://www.business-standard.com/article/pti-stories/india-third-worst-in-resolving-commercial-disputes-report-113103000480_1.html

³¹ "Typically construction litigation cases can take a few months to a year or longer to actually get to trial. CRS had a case in which a party contacted CDRS on a Thursday night. We expedited the agreement to mediate and other paperwork. Four days later, on Monday, CDRS scheduled a jobsite visit at 7:30am, convened the mediation at 10:00am, and concluded with a full settlement by 4:00pm the same day. Incidentally, this was a binding mediation agreement, which guaranteed a full settlement at the end of the mediation process. The project continued on with no loss of time due to the dispute.", Construction Dispute Resolution Services. LLC, *The Advantages of Mediation*, available at: http://www.constructiondisputes-cdrs.com/advantages_of_mediation.htm.

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parties unique needs and satisfy their interests, as opposed to their positions. The goal of problem-solving mediation is to help parties generate a mutually acceptable settlement of the immediate dispute.

Mutually Satisfactory Outcomes. Mediation provides higher satisfaction. The parties own the process. With the help of the mediator, the parties themselves determine both the flow and the outcome of the process, and are therefore more likely to be satisfied with the process as a whole, and the results, in particular.³² People who have the conflict get to decide. The parties have the opportunity to fully explain their positions and explore alternatives for mutual benefit. Also, because of their active involvement, they have a higher commitment to upholding the settlement than people who have a judge decide for them. In working through the issues and generating a number of ideas, the parties are often able to reach a solution that is more creative, or simply not available, through the formal process of a hearing.³³

Mediation deals with feelings. Emotions influence what concessions a person will make, when the person will make them, whether the party will continue to negotiate or reach an agreement, how the party will push another participant, and how a person will react to another's pushing.³⁴ In mediation, each person is encouraged to tell his own story in his own way. Acknowledging emotions promotes movement towards settlement. Discussing both legal and personal issues can help them develop a new understanding about each other.³⁵

For a continuing relationship. Mediation allows the opportunity for parties to reach a settlement and continue together, even to build a better relationship between them. Mediation, helps the parties to examine their interests and possible options in a

³² The Public Service Staffing Tribunal Page <http://psst-tdfp.gc.ca/article.asp?id=4424>.

³³ Ibidem.

³⁴ See: Gehris, M.: Good Mediators Don't Ignore Emotion, Bar Journal - Summer 2005, available at: <http://www.nhbar.org/publications/archives/display-journal-issue.asp?id=291>.

³⁵ American Bar association: *How Courts Work?*, available at: http://www.americanbar.org/groups/public_education/resources/law_related_education_network/how_courts_work/mediation_advantages.html.

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constructive manner and, in this way provides an opportunity to restore good relations. It is a win/win process: no one loses by trying to resolve disputes through mediation.

2.2. Disadvantages of mediation

The criticism directed at the mediation are mostly corrective nature and simply send the message that individual aspects of mediation must be carefully designed and regulated in order to prevent its abuse.³⁶

CONCLUSION

Mediation as a forum where people (both litigants and lawyers) can build enough trust to drop the adversarial facade and come to grips with the reality of the situation in which they find themselves, is facilitative, by definition.³⁷

Mediation stands out as one of the most successful out of court proceedings and its tendency to spread the growing number of disputes, even some who until recently could only be resolved in litigation.³⁸ The rapid growth of alternative dispute resolution, and mediation in particular, has been a reflection of the need to offer clients dispute management processes that better serve their real interests. Increased use of mediation is also result of a growing awareness of the need to manage intra- and inter-organisational conflict as part of an overall risk management strategy. However, interests are the driving force behind every dispute.³⁹ Mediators try to get the parties to consider interests rather than positions. By focusing on interests, parties who are at

³⁶ There has been a rising concern, particularly in California, that mediation confidentiality may have gone too far that the rules protecting it may prevent introducing evidence of mediation misconduct, fostering a public view of mediation as a lawless process. See: Franklin, C.: *Mediation's Confidentiality Controversy*, Daily Journal Corporation, 2013, available at: <https://www.dailyjournal.com/cle.cfm?show=CLEDisplayArticle&qVersionID=80&eid=872569&evid=1>.

³⁷ Kimberlee K. Kovach, Chair elect, ABA Dispute Resolution section; reporter for The Standards of Conduct for Mediators and Chair-elect of the ABA Section on Alternative Dispute Resolution.

³⁸ "The only types of cases that most probably would not be appropriate for Mediation are those involving a serious violent criminal proceeding, and cases involving child abuse or domestic violence.", Beane, L.: *What is Mediation and how does it Work?*, New York Law Journal, October 29, 2007, page 4.

³⁹ Interests can be: substantive – needs such as money, control or resources, procedural – needs relating to the process or the way in which a dispute is resolved and psychological – needs relating to feelings or emotions about the issue.

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an impasse may discover several possible solutions to their problem, and may also discover shared compatible interests.

People mediate because they disagree with one another. People also mediate to resolve conflict. People in conflict have a full range of emotions. These emotions range in intensity depending on the type of conflict, the length of the conflict, and the people involved. Good mediators go beyond what parties say and do to assist the parties to consider those emotions.⁴⁰ It also enables a more micro-behavioural approach to the internal decision-making practices that assumes that the quality of such practices will directly impact the quality of the conflict resolution.

Neighbours, divorcing parents, supervisors and their employees, business partners, and family members have to continue to deal with each other cooperatively. Going to court can divide people and increase hostility. But, mediation looks to the future. It helps end the problem, not the relationship. Mediation demands that people in conflict take responsibility for their problems and try to find resolutions to them.

As a mainstream dispute resolution process, mediation aims to change the conflict management strategy towards creative conflict management as a more democratic and useful decision. As a result of its benefits, mediation is a client-focussed manner against a backdrop of constant socio-political change.⁴¹ Institutional and individual roles and responsibilities have to change, so that new patterns of behaviour will foster sustainable development. These challenges demand new approaches to decision-making and action. They need to be made with the participation of both

⁴⁰See: United States Institute of Peace: *Step 1-Assess the Conflict*, available at: <http://www.usip.org/step-1-assess-the-conflict>

⁴¹ "Mediators are political actors who expend resources because they expect to gain something from a conflict resolution. Mediation may be a policy instrument through which actors pursue interests with little opposition. Ideally, mediation should be evaluated in terms of the participants' goals. Some consequences of successful mediation, such as the fairness of mediation, satisfaction with its performance and an improved relationship between the parties cannot be easily demonstrated.", See: Bercovitch, J: *Mediation and Conflict Resolution*, 2009, available at: <http://www.gsdc.org/go/display&type=Document&id=3610>

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"winners" and "losers", so that some sort of agreement and commitment is reached on the outcome.⁴²

Conflict can lead to productive or positive changes or growth or to the destruction and degradation of relationships.⁴³ Using mediation can improve organizational communications, team building, leadership, systems design, change processes, change management, self-correcting systems to improve capacity for resolution and transformation, shape a context of values, ethics and integrity, form of living, integrate strategically, to build a more peace "able" world, change the way we change. Mediation as conflict management strategy is linked with successful outcomes aimed to sustainable development of the society.

Mediation is balanced process, but powerful. Because of the effects it produces on the way of seeing the conflict and how the conflict resolves, practicing mediation have the potential for changing society for the better, ranging from everyday interpersonal relations, to the most complex.

⁴² See: Sturrock, J.: *The role of Mediation in a Modern Justice System*, 2010, available at: <http://www.mediate.com/articles/sturrockj14.cfm>

⁴³ Moore, C.: *The Mediation Process*, 3th Edition, Jossey-Bass, 2003, p.466

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