

## The transmission mechanism of fiscal policy in North Macedonia: a Bayesian VAR approach

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### Abstract

The aim of this research is to empirically investigate the transmission mechanism of fiscal policy in North Macedonia. We estimate a Bayesian VAR model using quarterly data for the period 2006q1 – 2020q4 and a recursive approach in order to identify exogenous fiscal shocks and an open economy model specification. The findings suggest that the effectiveness of a government spending shock on stimulating output in North Macedonia is limited. Our findings suggest that a tax shock is more effective as a short-term stabilization tool. In line with the 'expansionary fiscal contraction' prediction, our findings suggest that a fiscal tightening will result in a crowding in of output in North Macedonia. The transmission mechanisms of fiscal policy in North Macedonia is consistent with the Keynesian theory suggesting a crowding in effect of fiscal shocks on private consumption, private investment, private employment and real wages. Considering the limited effectiveness of fiscal policy, we recommend that policy makers in North Macedonia give preference to structural reforms that would address these supply-side problems, which in the long term would result in higher output and employment.

**Keywords:** fiscal policy, fiscal multipliers, Bayesian VAR, North Macedonia.

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Academic Journal of Business, Administration, Law and Social Sciences ISSN 2410-3918 (print)

ISSN 2410-8693 (online)

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