

MACEDONIAN COMPETITIVENESS PORTRAIT: STRENGTHS AND WEAKNESSES

IGOR VELICKOVSKI – National Bank of the Republic of
Macedonia, University American College Skopje
MARJAN PETRESKI – University American College Skopje

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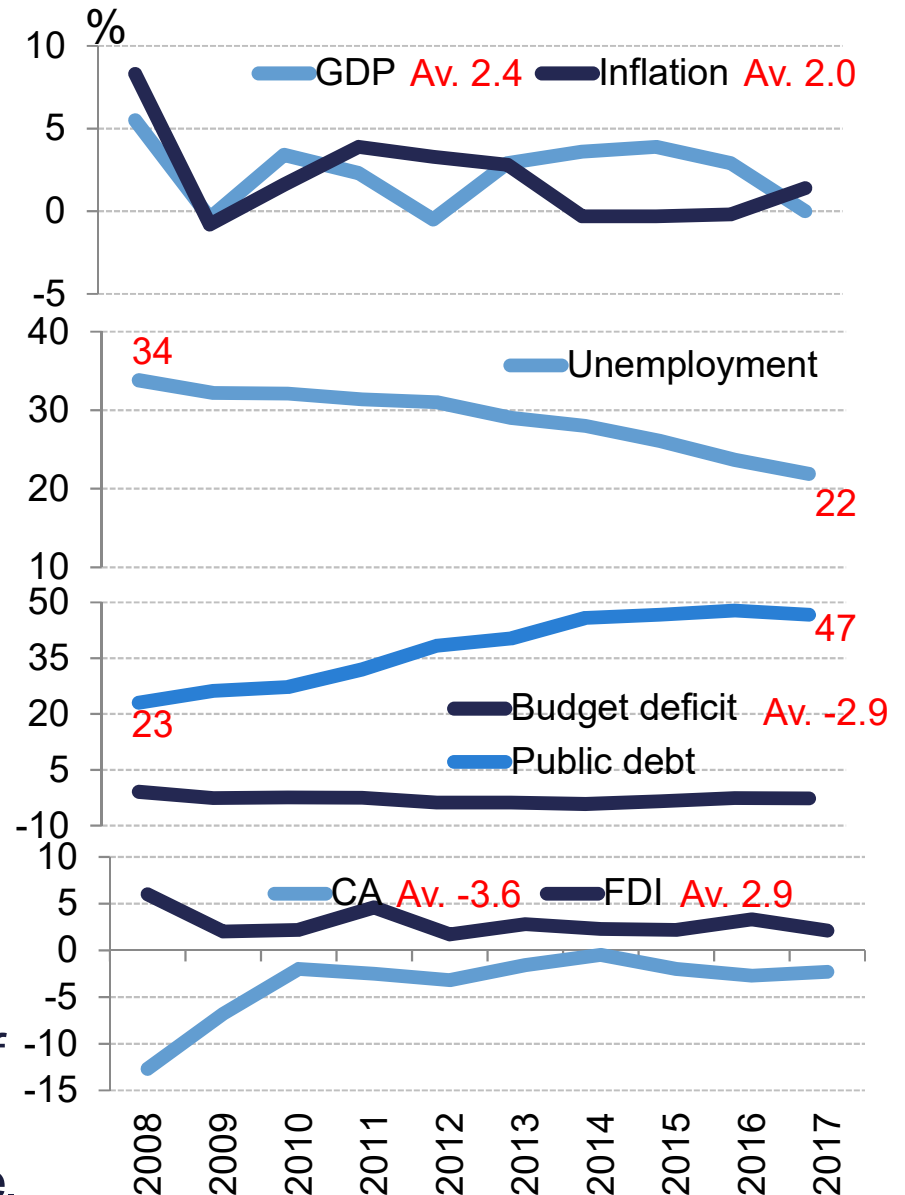


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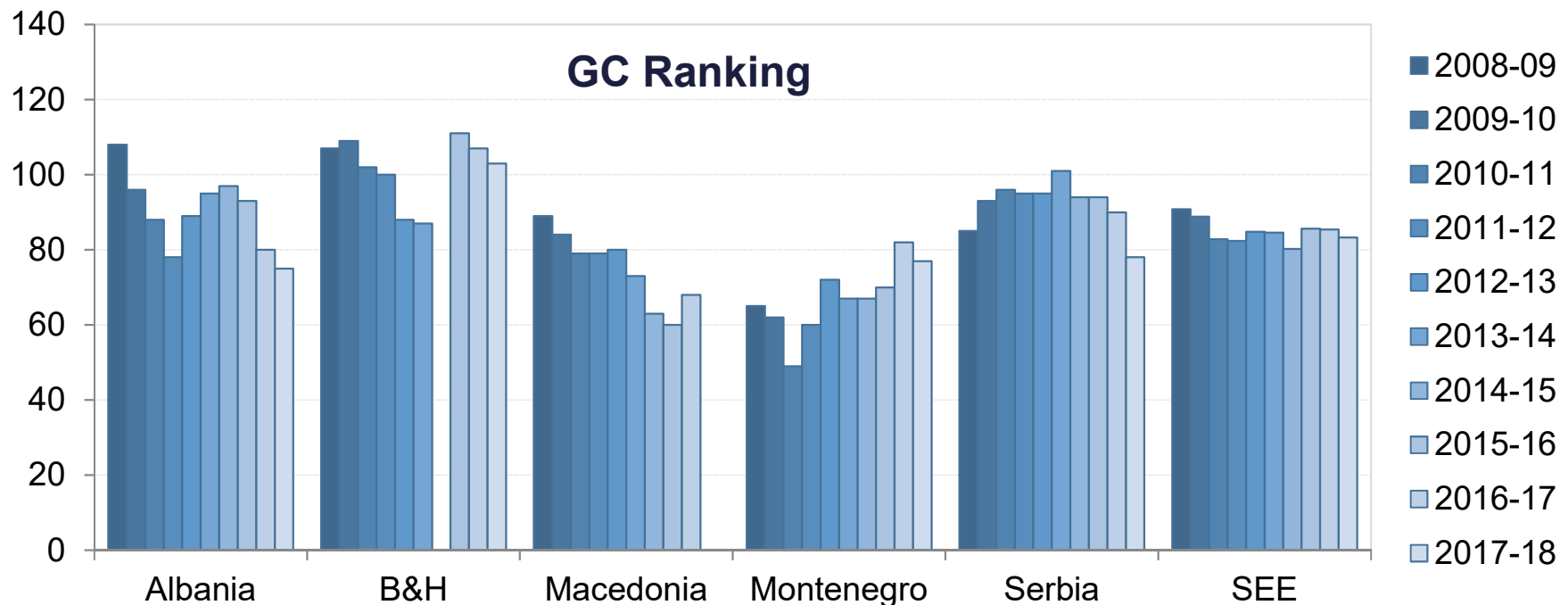
Economic developments in Macedonia

- **Growth** has been subdued in the post-crisis period, then recovered more strongly for a few years and recently was constrained again due to the political instability in the country.
- **Inflation** has been low and stable.
- **Unemployment** remains high, but declined substantially during the recent years.
- The government implemented a countercyclical policy in the wake of the crisis, increasing the **budget deficit** and **public debt** as percentage of GDP.
- **Current account** deficit widened dramatically during the crises, but then reversed to more sustainable levels.
- **FDI** flows registered decline since the start of the crises, but still sufficient to cover the CA gap and support de facto pegged ER regime.



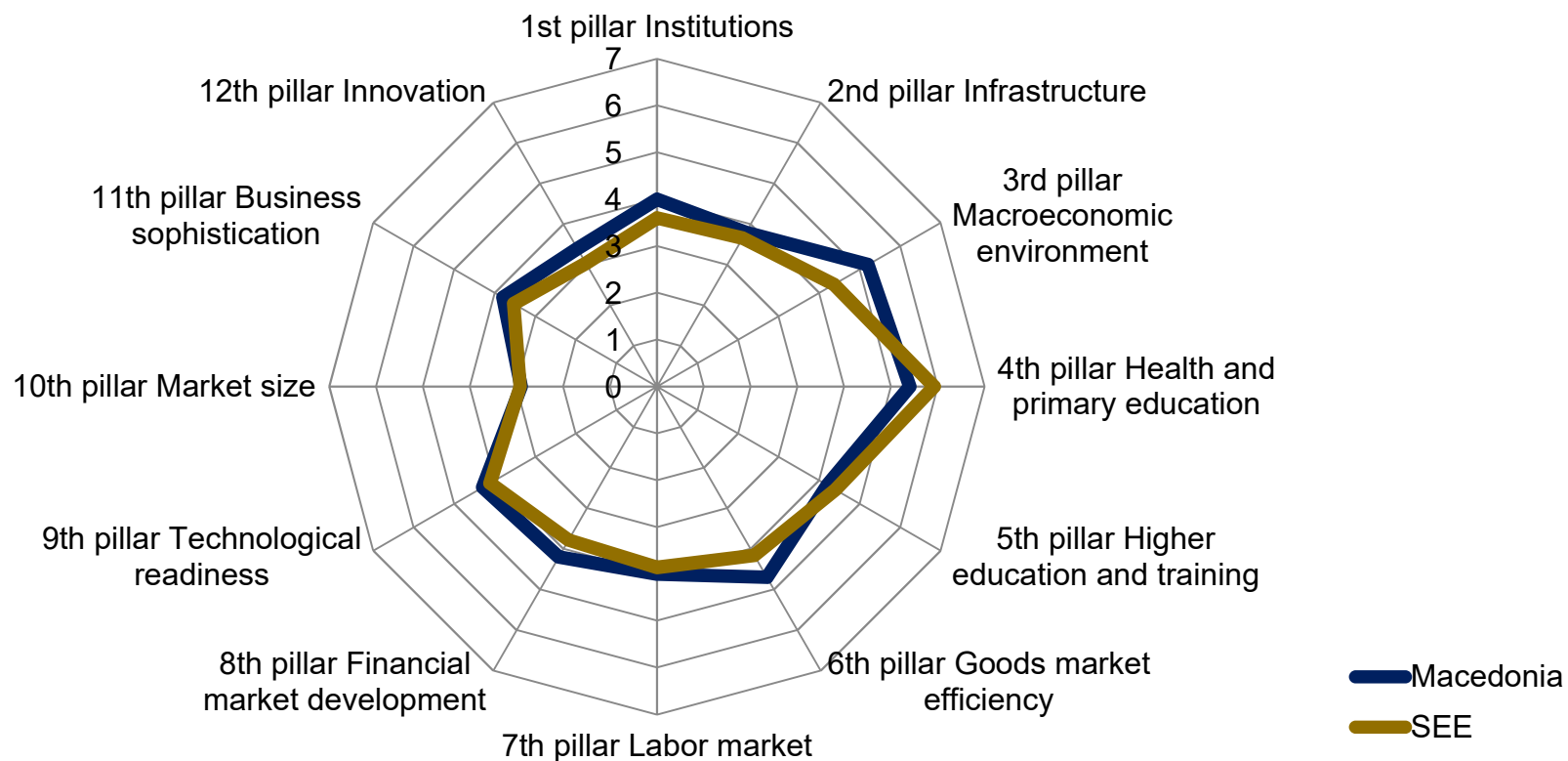
Global Competitiveness Ranking

- Macedonia registered a **significant competitiveness improvement** during the last decade and has the best rank among the SEE countries (rank of 68 according to GCR 2016-17 vis-à-vis rank of 89 in GCR 2008-09)
- In terms of stage of development, Macedonia belongs to the group of **efficiency driven economies** (Stage 2) as all of the SEE countries



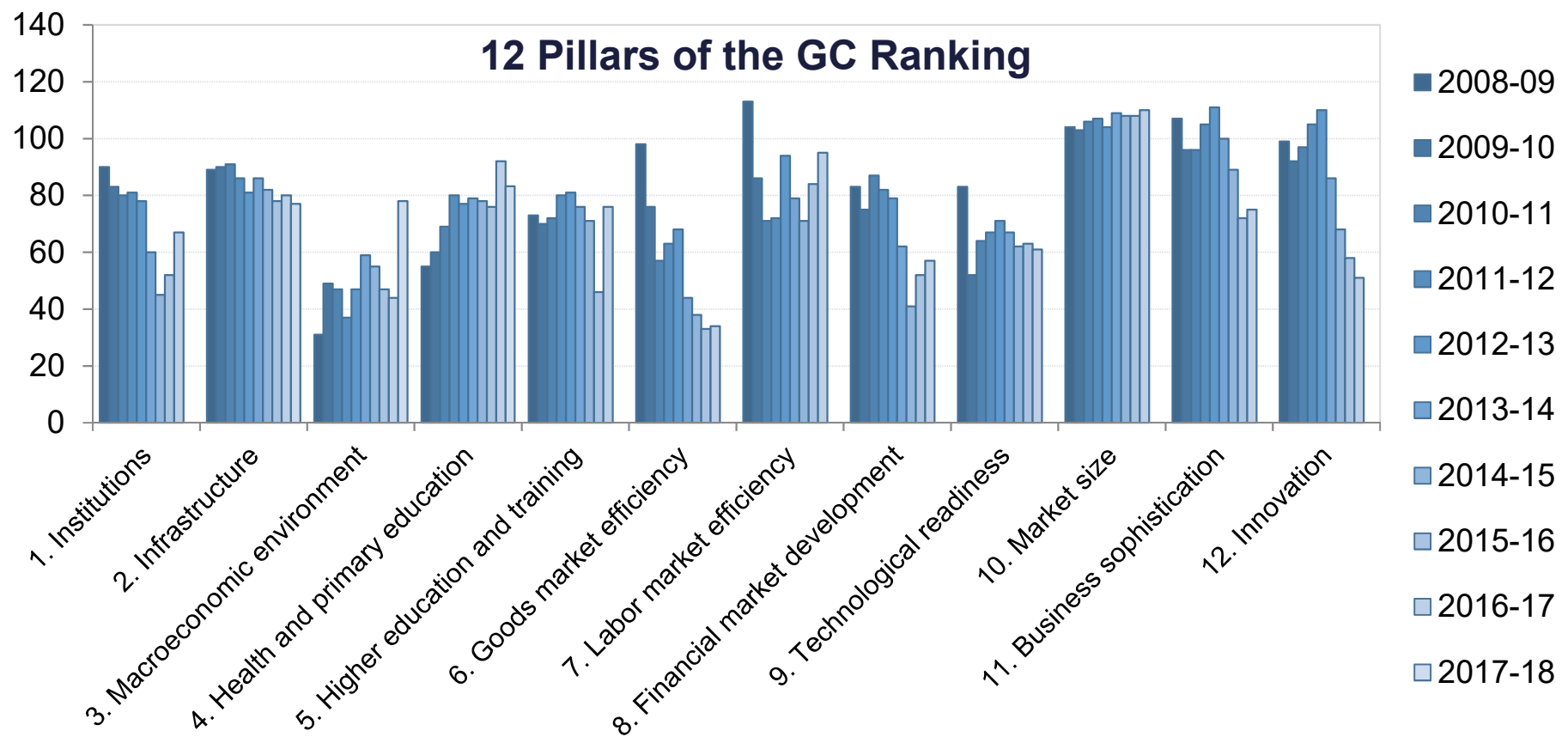
Global Competitiveness Ranking

- In comparative context with SEE countries, Macedonia has **better macroeconomic environment and institutions as well as more efficient goods market**
- On the other hand, developments in **health and education** are **lagging behind** the SEE region



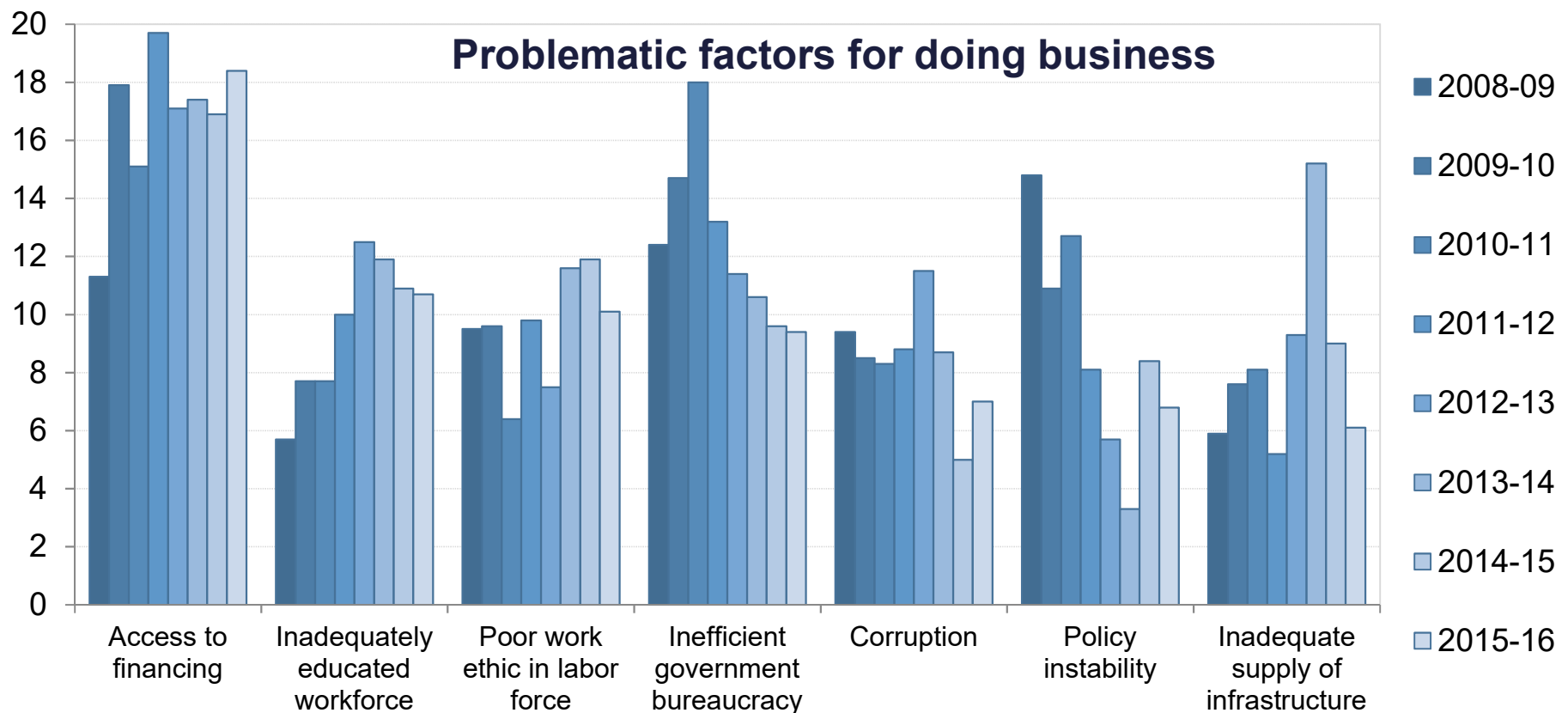
Global Competitiveness Ranking

- **Improvements** are driven by better ranking on institutions, goods market efficiency, financial market developments and innovations



Global Competitiveness Ranking

- Yet, there are many **problematic factors for doing business** in Macedonia
 - **Access to finance** is constantly the most emphasized challenge for corporate sector, accompanied by **labor market imperfections**



Focus on specific issues

- Our further elaboration focuses on the government role as well as the existing weaknesses in five areas relevant for improving competitiveness of the country:
 - **Investment policy**
 - **SME and access to finance**
 - **Education**
 - **Innovation**
 - **Labor market efficiency**

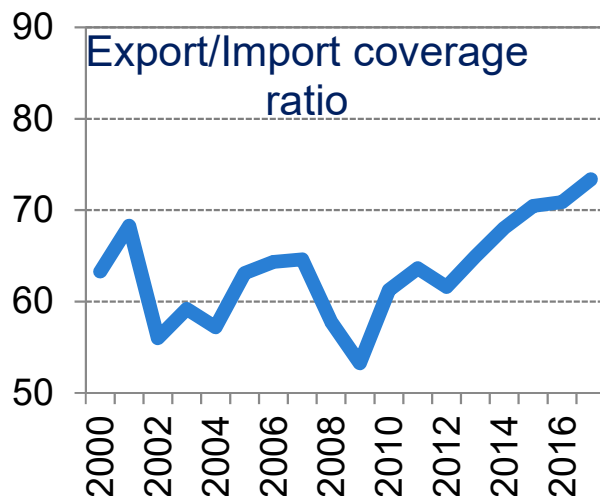
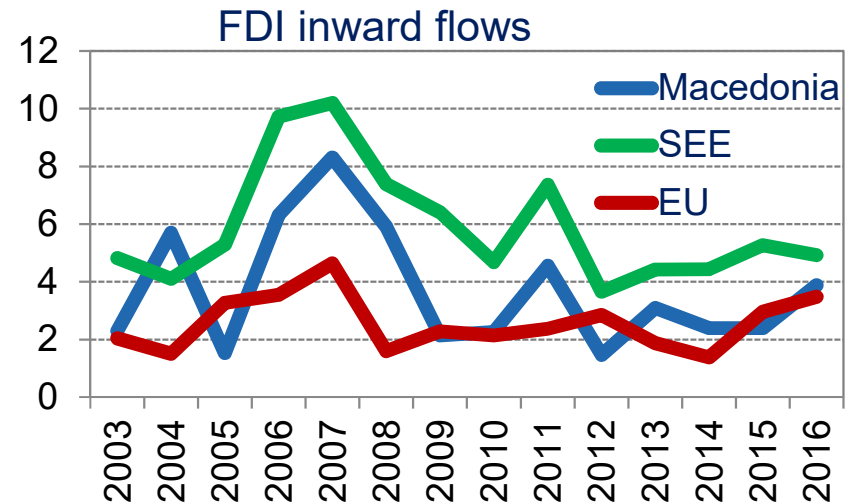
Investment policy

The role of the government

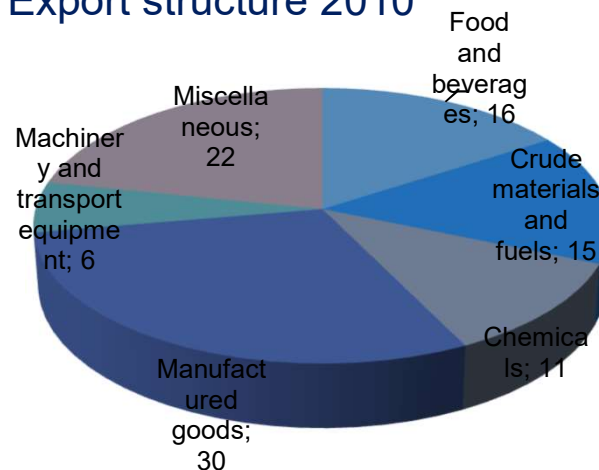
- Macedonia has undertaken plenty of measures to improve the climate for doing business and thus, attract FDI
 - This has been evidenced in the WB **Doing Business** Report (rank of 11 in DBR 2018 vis-à-vis 75 in DBR 2008)
- Macedonia has **operational investment policy** focusing on the protection of foreign investors' rights (equal treatment of foreign investors and the protection of their ownership rights)
- It has also developed and implemented a **strategy to promote and facilitate investments**, including a set up of investment promotion agency
 - **investment promotion** and matchmaking events targeting specific countries or sectors
 - establishment of the Technological Industrial Development Zones offering **incentives for foreign investors** (tax holidays for up to 10 years, for both profit tax and personal income tax, VAT and custom duties exemptions etc.)
 - empirical studies suggest that **the benefits outweigh the costs** of financial incentives (NBRM, 2017; Finance Think, 2016)

Investment policy

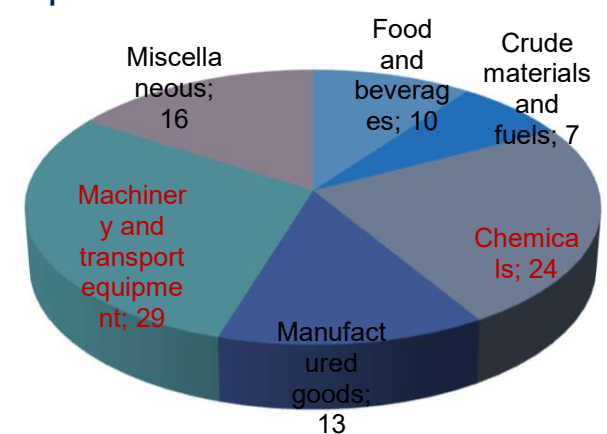
- FDI inward flows in Macedonia were usually higher than in the EU, but underperformed the flows in SEE
- The FDI flows after the crisis caused **a structural change** in terms of:
 - increasing the export/import coverage ratio
 - Improving the export structure in favor of medium- and high-tech goods



Export structure 2010



Export structure 2017



Investment policy

Major Weaknesses

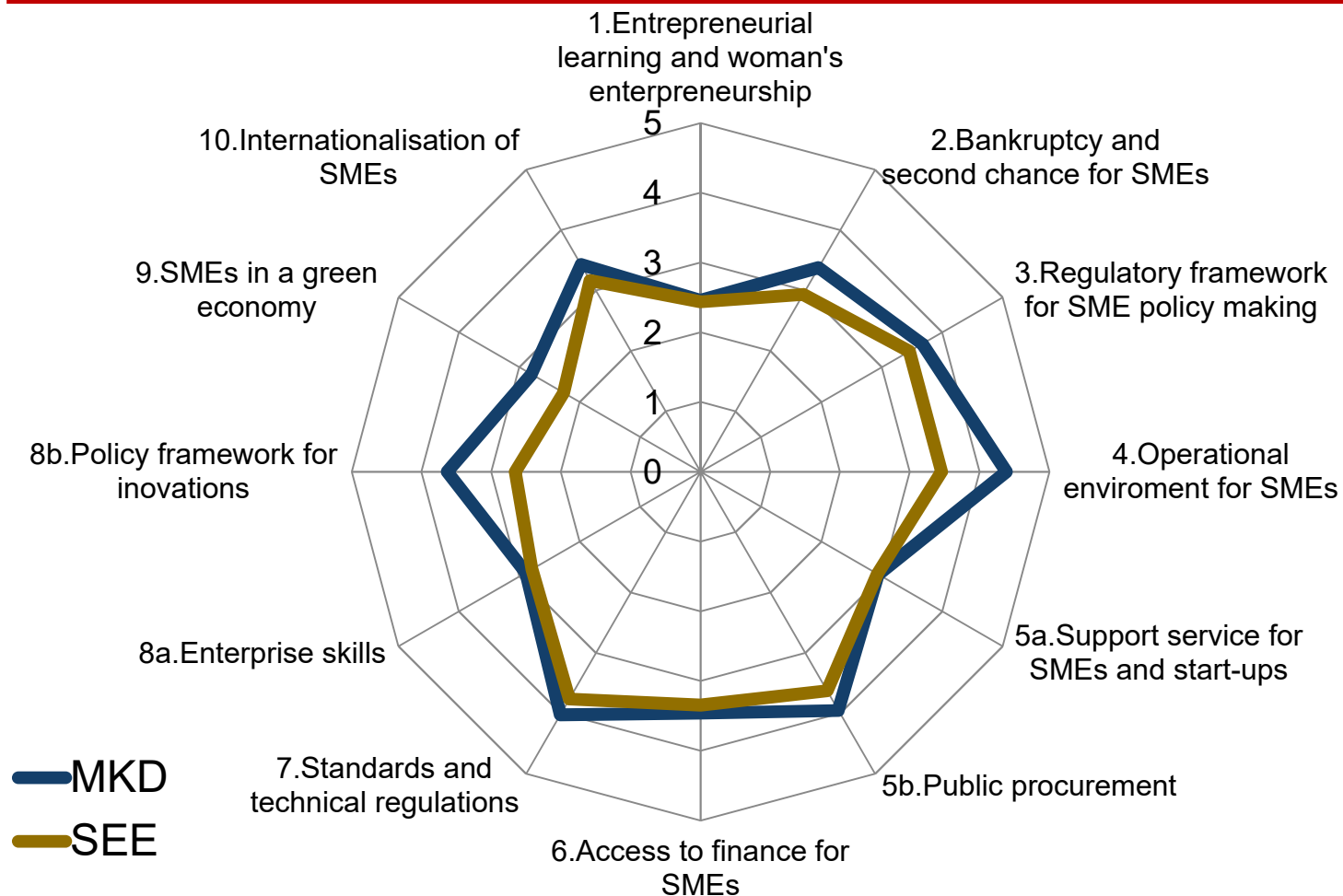
- Existence of administrative ports of call
 - moving towards a **one-stop shop**
- **Uneven treatment** of domestic investors
- **Transparency vs flexibility** in offering financial incentives
- **Weak FDI-SME linkage** practices
 - support foreign investors in building local supplier bases with domestic SMEs

SME development

- The SME sector is an important driving force of overall economic activity
 - represent 99% of all businesses in Macedonia (similar in the EU).
 - provide three fourths of all private-sector employment (two thirds in the EU)
 - generate two thirds of value added (three fifths in the EU)

SME development

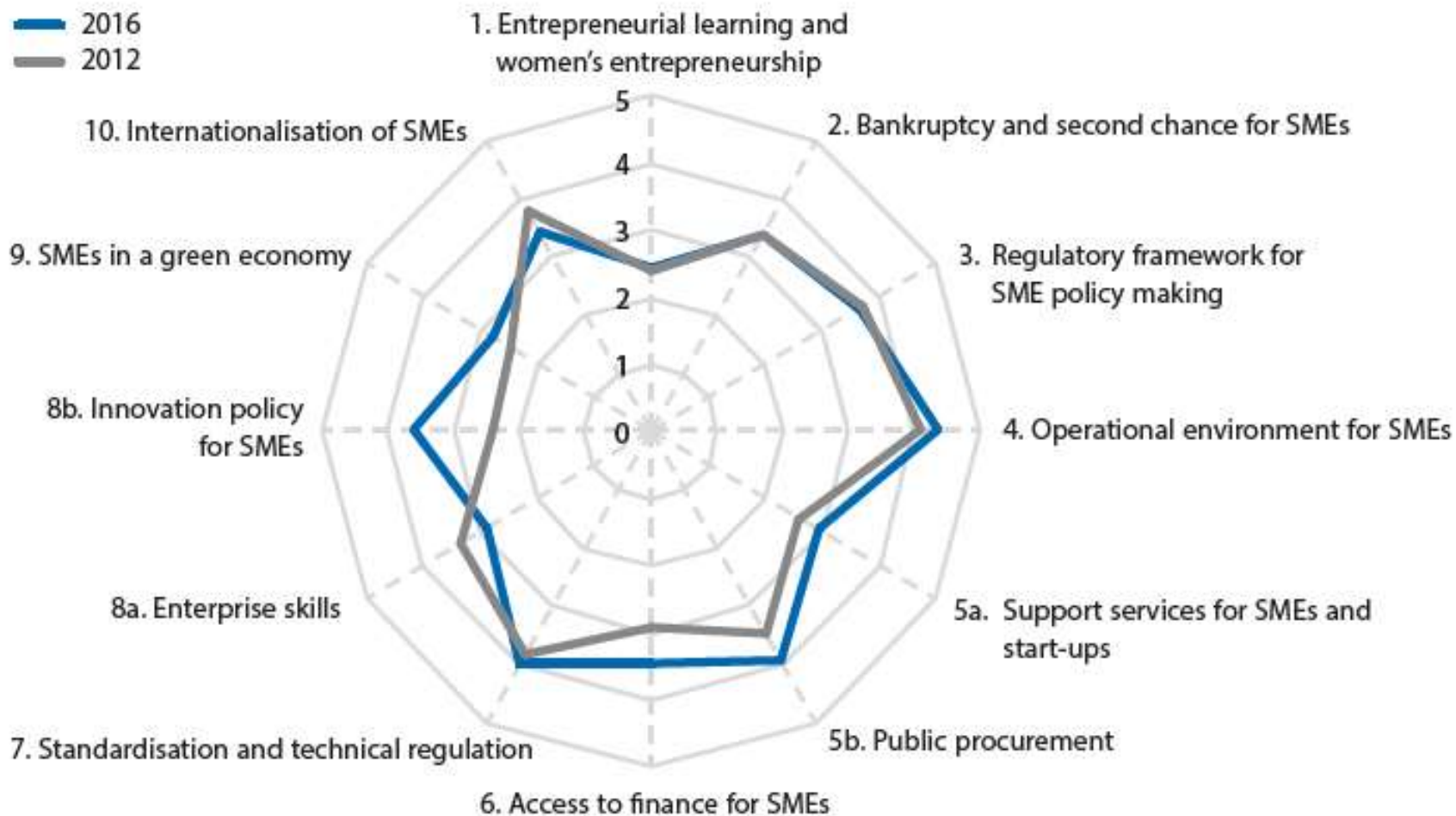
Small Business Act Profile Score for Macedonia and SEE



Source: EBRD, ETF, SEECEL, EU, OECD 2016

SME development

Small Business Act Profile Score for Macedonia over time



Source: EBRD, ETF, SEECEL, EU, OECD 2016

SME development

The role of the government in SME promotion

- A **regulatory guillotine** has been regularly applied since 2006.
- **Company registration** process currently takes one day and a single procedure.
- A **cadastre** is available online, covering 99% of the country's territory.
- Broad **e-governance system** established in recent years.
- A national **strategy for innovation** was adopted, which has established a range of support services for SME.

SME development

Major Weaknesses

- SME perceive **access to finance** as a major challenge to their operations – why?
 - Around 80% of businesses cover their financing needs with internal funds and retained earnings
 - Bank-centric model dominates – only around **one third of total private-sector lending goes to SME**
 - **high collateral requirements** (in a range 150-250%) combined with banks' heavy reliance on (immovable) collateral
 - **higher cost of borrowing** than that in the euro area
 - **Lack of investment readiness** (SME' poor skills in business planning and financial management) vis-à-vis underdeveloped investment banking
 - **High level of grey economy** (around one third of GDP according to some studies) which constraints further the reliance on bank financing
- Absent **SME integration into global value chains**

Education

- The educational system of Macedonia has undergone a **series of reforms**, at all levels
 - With positive intentions, but frequently ad-hoc solutions
 - Resulting in underperformance of students
 - E.g. PISA rankings

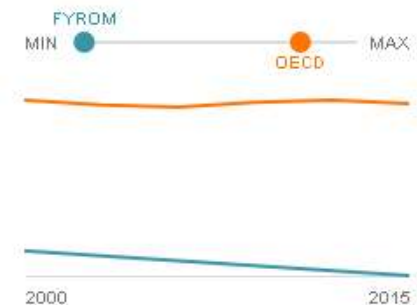
Science



Mathematics



Reading



Education

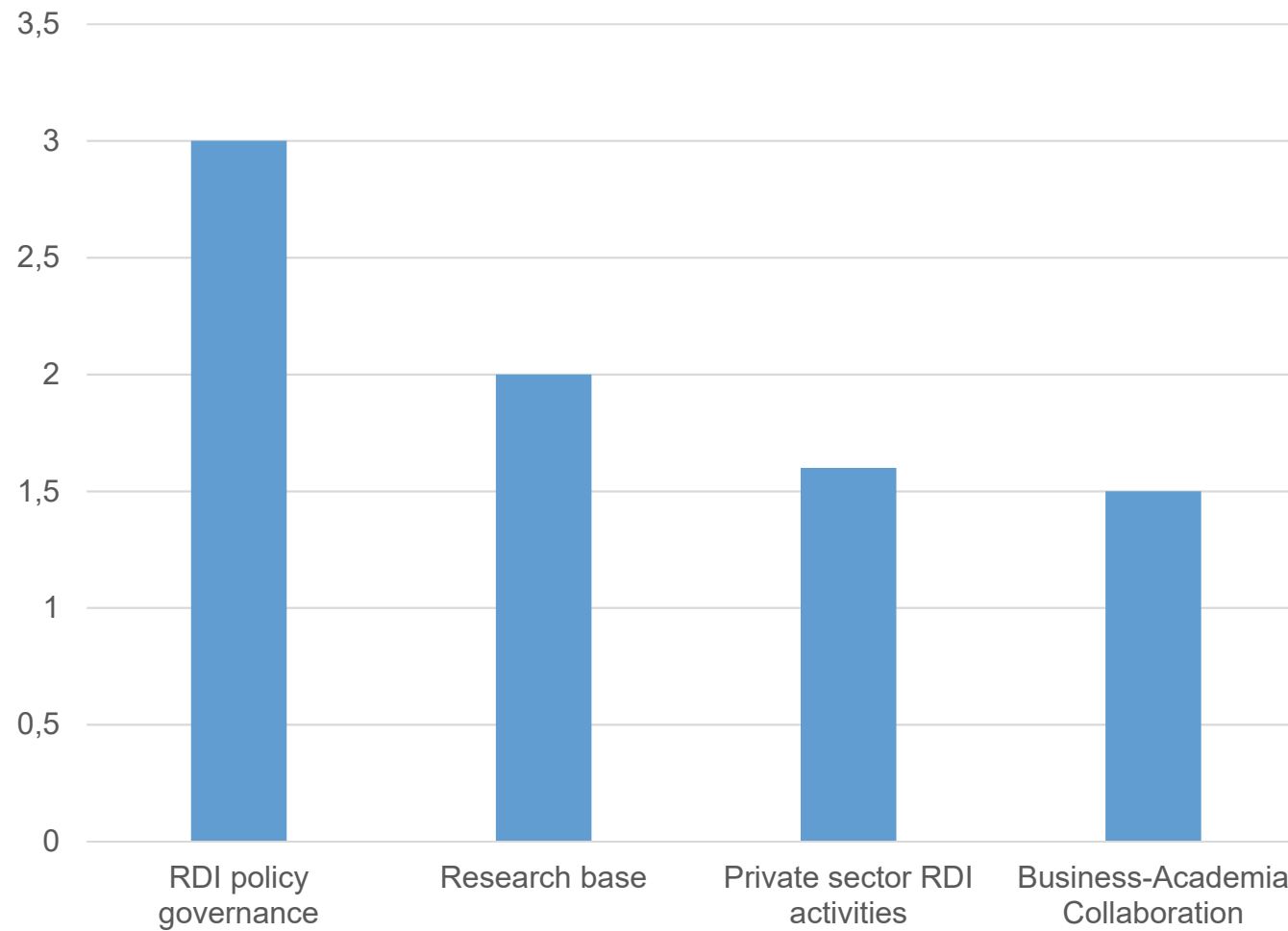
- Challenges

- Improve the quality of education at all levels, rather than quantity (access to)
- Make VET more attractive
- Develop career guidance and profiling, as a key link between the educational system and the labor market
 - Hence, key for competitiveness

Innovation

- The only country in the region with **dedicated innovation strategy**
 - **Fund of innovation and technological development**
 - Funding innovative projects
 - Supporting start-ups and spin-offs
 - Lately, the government introduced the support for start-ups directly in their Plan for economic growth
- Still, **investment in R&D comparatively low**
 - 0.44% of GDP, as compared to 2% of the EU
 - Cooperation between the Ministry in charge of science and economic ministries still very weak
 - The Ministry of Science ceased its program for academic excellence in 2010
 - Limited business-academia cooperation

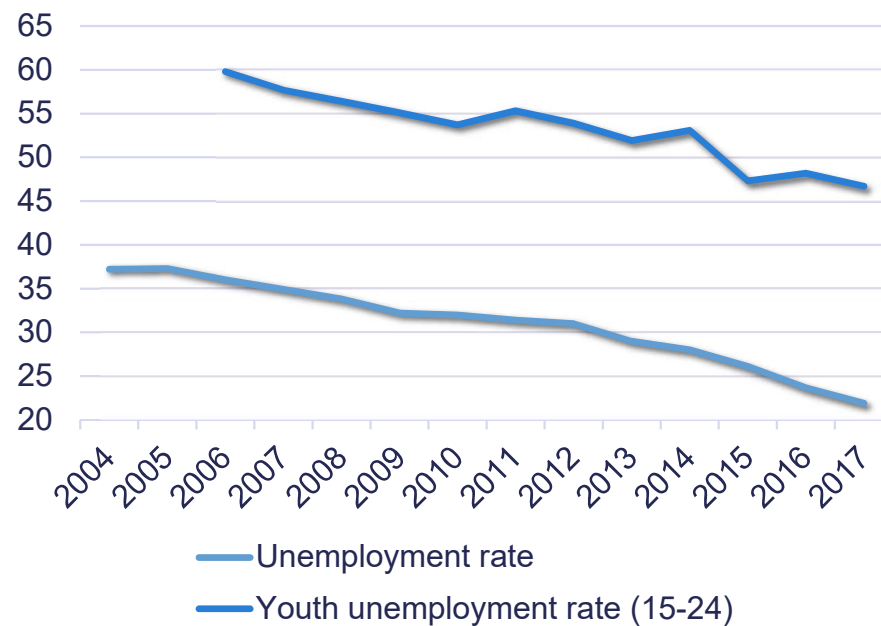
Score of R&D in Macedonia (max 5)



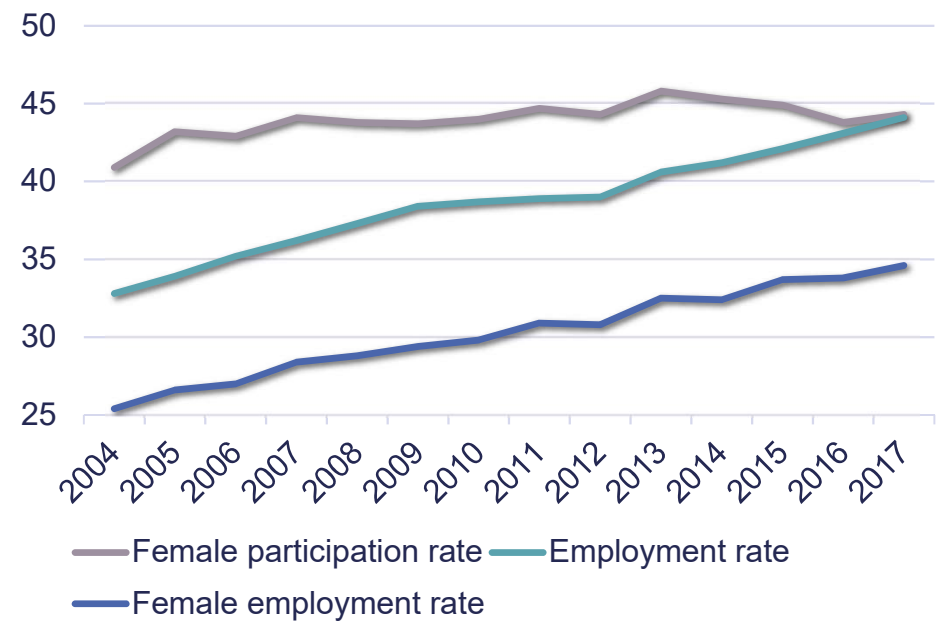
Labor market

- Comprehensive strategy for **fight against unemployment**
 - The core of government economic policy for a decade (2006-2017)
 - Special consideration of **youth and women** (also addressed in other related strategies)
- Instruments
 - The core job-generating activity has been the attraction and setting up of **foreign companies** in the country
 - **ALMPs** (though the spending comparatively lower than on passive measures)
 - “**Macedonia employs**” as a special type of employment policy – providing new employees tax and contribution holidays
- Technically
 - The role of **PES** has been significantly strengthened and modernized
 - The labor market has been **flexibilized** in a multitude of venues (e.g. hiring and firing procedures)
 - The role of **social enterprises** is emerging in the national legislation

Unemployment rates



Employment and participation



Conclusion

- Macedonia has made steady progress during the last decade. In global terms, it has registered **significant competitiveness improvement**.
- Better macroeconomic environment and institutions as well as more efficient goods market are our main **strengths** in the regional context.
- However, **our competitors are not standing still**. They are actively reducing business costs, building infrastructure and stimulating entrepreneurial spirit.
- Therefore, Macedonia has to rapidly improve its **weaknesses** related to SME access to finance and integration into global value chains, quality of education, R&D investments and labour market imperfections.
- These will lay ground for **changing the competitiveness model over the long-term** – from the current low cost wages approach to enhancing competitiveness through greater entrepreneurship, value added and productivity.



Thank you for your attention!

Contacts:

velickovski@uacs.edu.mk

marjan.petreski@uacs.edu.mk