

ECONOMY AND FINANCE

THE BIG PICTURE: THE MACEDONIAN ECONOMY IN THE MEDIUM AND LONG TERM

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In a world deluged by irrelevant information, clarity is power.



In order to walk the right path, we need a consensus on where we want to get.



Instead of responding to everyday tumult, we need to address matters of true importance for the long run.

THE BIG PICTURE:
THE MACEDONIAN
ECONOMY IN THE
MEDIUM AND LONG TERM

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FOREWORD

The year 2020 will remain a year of challenges, considered from every possible aspect: economic, social, health, educational and climate - there is no doubt about that. The Covid-19 pandemic which engulfed almost the entire world taught us that we, as a society, are only as strong as the weakest among us. It identified the errors in the system that we built together, highlighting the many disregards we did towards the needs and demands of the many. It taught us to value the health and safety of employees, especially in the labour-intensive sectors, because it showed to us that we all depend on them. A system in which employees blame themselves and their immune system for their health problems, instead of blaming their employment contract, is a system which must undergo series of changes in order to transform into a fair and just society for all.

As part of its activities, the Friedrich-Ebert-Stiftung Skopje Office is facilitating expert group debates on topics which are of vital social importance, thus offering platforms that will develop recommendations for a fair and just democratic society. The global economic challenges, which are not to be neglected, raised a series of questions about the future of the Macedonian economy, which, unable to expand its fiscal manoeuvring space, went into debt in order to save jobs, which are scarce anyway for the working age population. Social reforms implemented in the past several years have managed to buffer the hardest blow on the socially vulnerable citizens. Nevertheless, the consequences of the underfunded public health, the

weak education system and the lack of institutional capacity for protecting workers and safeguarding their health and safety at work, have been visible from the very outset of the crisis, until the very present day.

And while the challenges do not subside--quite the opposite in fact: they have only been augmented since this expert group started developing this scientific study--still possibilities exist for developing a better future if we implement the proper ways and mechanisms for this. As highlighted by the coordinator of this expert group, Prof. Dragan Tevdovski, Ph.D., in order to know which path to choose, first we need to know where we want to get. The motivation for producing this scientific study is to stimulate further debate in this direction, to define the objectives we wish to achieve as a small open economy aspiring towards membership in the EU, and accordingly, to define the appropriate development strategies. Experts involved in the drafting of this study presented "the Big Picture" of the Macedonian economy in the medium and long term, and it should be used as the basis of this topical discussion. The study also pays adequate attention to the educational and social policies, digitalization, and the need to decarbonise the economy in order to cope with climate change. This is the case because the exit from this crisis ought to mark the beginning of a new system in which access to education and universal social care will play a key role, which, on the other hand, means nothing unless we deal with climate change and save our life on Earth as we know it today.

Ivana Vuchkova,
Programme Coordinator,
Friedrich-Ebert-Stiftung, Skopje Office

Nikola Popovski,
Editor of the Scientific Study "The Big Picture"

INTRODUCTION

“In a world deluged by irrelevant information, clarity is power”

- Yuval Noah Harari, 21 Lessons from the 21st Century

The objective of this study is to propose directions for the key economic and social policies in North Macedonia. It is attempting to present the “big picture”, that is, to showcase where we wish to arrive and how to get there. Rather than elaborating on policies in great detail or responding to the multitude of questions constantly raised by media on economic and social policies, the intention of this study is, quite the opposite, to distract attention from the noises of the present day and to focus only on those issues which are truly important and valid when we digress a little and look at the broader perspective.

To look at the “big picture” during “the crisis like no other” is quite a difficult task. The Covid-19 pandemic has caused serious shifts in many segments in a very short time period. The debt levels of many states soared sharply, and the value of public health was put on a pedestal. The world of free trade began its march towards history. Many people started to work from home, whereas inter-personal relations and contacts shifted onto social media and platforms... and surely there will be many similar changes yet to come, and the world cannot be simply looked at from one perspective any longer. An economist alone cannot comprehend the word in full, nor can a sociologist, or an engineer. The “big picture” cannot be seen by someone who only has leftist perceptions of politics, or by a person with just a right-wing orientation and viewpoints. Likewise, the “big picture” cannot be seen only by young people with their ideals and faith in change, but it needs also the voice of adults who will not allow the same mistakes to be repeated again. Finally, the “big picture” cannot be comprehended only from within; it must also be looked at from the outside. This is why we had a heterogeneous group of people working on this

“Big Picture”. If perceived from different angles, the group is comprised of: economists, sociologists and one engineer who graduated from Stanford University; then a current Minister of Education; economists from the Vienna Economic Institute, the Central Bank of Slovenia and an international development agency; professors from the University of Economics, Law and Philosophy in Skopje, and a Professor from the University of Montreal; a renowned banker, as well as two former Ministers of Finance; Keynesians and proponents of the free market; younger and older...

The “Big Picture” is comprised of nine chapters. It starts by defining the objectives and the mid-term expectations. Then, in the initial four chapters it presents the key guidelines for accomplishing these objectives – the necessary structural changes, as well as the mid-term fiscal and monetary policies. They are followed by chapters which elaborate on four elements of utmost significance which will shape tomorrow: export of economy, labour market and social protection systems, education and science.

These nine chapters are not written by individual authors, but quite the contrary, they are the mutual work of two or three authors, with each text finalized through a lengthy debate among all the authors featured in the study. Very often this debate put forward very different, even completely opposing, viewpoints. But ultimately, this group did demonstrate the ability to develop its vision of the “Big Picture”. In doing so, the idea is not to say that this “Big Picture” is the most important and ultimate truth in North Macedonia. No! The main idea is to suppress the multitude of noises of the present day and to stimulate discussion in the Macedonian society about matters which have a true importance for the long run, and also to encourage similar cooperation among seemingly different people in North Macedonia, who will together discuss the “big picture”.

Dragan Tevdovski,
Coordinator of the Expert Group

1

WHERE DO WE WANT TO BE IN THE MEDIUM TERM?

DRAGAN TEVODVSKI AND GLIGOR BISHEV

„Alice: Would you tell me please, which way I ought to go from here? Cheshire Cat: That depends a good deal on where you want to get to. Alice: I don't much care where. Cheshire Cat: Then it doesn't matter which way you go". "Alice in Wonderland" – Lewis Carroll

1.1. GLOBAL TRENDS THAT WILL SHAPE THE FUTURE PERIOD

„Are we all going to be working for a smart machine, or will we have smart people around the machine? ...Home or exile? Lord or subject? Master or slave? These are eternal themes of knowledge, authority, and power that can never be settled for all time. There is no end of history; each generation must assert its will and imagination as new threats require us to retry the case in every age." – Shoshana Zuboff, 2019.

In the second decade of the 21st Century, the highly developed capitalist countries ventured into the so-called "secular stagnation" stage (Larry Summers, 2019). This stage is characterized by mild economic growth, low to zero inflation with deflationary pressures and a surplus of global savings. The consequences of this are negative real interest rates which, in the long run, are not equilibrating the private savings and investments. The need for permanent increased state spending and introducing macro-prudential rules and standards in many sectors have promoted the era of "capitalism led by the invisible hand of the markets and the visible hand of the state". (Rachel and Summers, 2019).

Moreover, the lack of qualified workforces in the highly-developed countries, especially in Germany, the USA, Canada, Holland, and Sweden, has become their chronic economic illness. The period of employment began to expand in parallel with the increased lifespan of citizens, and the retirement age increased to 68 – 72 years of age.

Inequality in income distribution has increased. The gap between the rich and poor is expanding, year after year. Thus, since 2015 the richest 1 percent of the

world's population claims ownership of more wealth than what the entire remaining population on the planet has altogether. This gives rise to enormous inequality in the chances of success in life. Instead of creating a society where everyone, especially the youth, would have equal opportunities, the society increasingly creates a society that offers different opportunities to citizens (Oxfam, 2020). The high discrepancy in income distribution is considered a key factor in insufficient private consumption and private investments.

The voices for a more equitable distribution of income and equal chances in life have become a recurrent topic with many economic and non-governmental organisations. The idea of basic income has emerged as a solution for equal chances in life and an exit from the "secular stagnation" by employing innovative and inclusive long-term economic development.

The Covid-19 pandemic has utterly shattered the model thus far of "privatisation of profits in cases of expansion and socialisation of losses in conditions of crisis". The key measure in the management of economic consequences from the Covid-19 crisis is the increase of available income and expenditures of the population. Spain went the furthest way along in this endeavour, by introducing a guaranteed income for the affected families (Kristalina Georgieva, 2020). The highest budget subsidies for the affected population were approved in the USA, where the replacement rate for the lost income on average amounts to 134 percent (Ganog, Noel, Vavra, May 2020).

The fiscal interventions have reached levels never seen before in the newer chapters of economic history. The budget deficit and state debts are at extremely high levels. According to IMF projections, in the 2019 – 2021 period the level of debt in the highly developed countries will increase by 20 percent and on average reach around 139 percent of the GDP. The level of debt in the developing countries will rise by 10 percent. Thus, the issue of debt management will become the key variable when designing the economic policies in the post Covid-19 period (Georgieva, Pazarbasioglu, Weeks-Brown, IMF, October 1, 2020).

Research and development have become the key drivers of economic growth. In highly developed countries, investments in research and development, along with the investments in non-material assets such as brands, software design, intellectual property, increased from 5.4 percent to 13 percent of the total company revenues in 2016 (McKinsey Global Institute, 2019). These investments are expected to remain at the level of 15 percent of the companies' revenues in the long term, and economic policies to be focused on their incentivising.

The automation and introduction of artificial intelligence in work processes will gain its momentum. The pandemic will be the catalyst for accelerating this process. Economies will create new jobs that will require new skills, knowledge and education. It is estimated that every current 5/6 jobs will be closed by 2030 in the highly developed countries. The highest number of affected jobs will be in the manual and labour-intensive industries: machine installation and repair, utilities, food services, manufacturing, process support jobs and office work. However, no increase in unemployment is expected. At the same time, the demand will increase in the creative professions, professions based on knowledge and research: health workers, professions in wellness centres, sports and recreation, designers and arts, business and legal professions, managers, education and training, customer service and sales, maintenance of real estate and agriculture, transport services. This will entail continuous training and professional development of the professionally active persons.

Investments in a green living environment, and investing in a clean environment, will mean investing in growth. Energy efficient and clean, carbon-neutral settlements and lodgings will be the trait of the new urban living.

The mass migration to a platform economy, both regional and global, will underpin the new world economic order. From health services to banking, the rise of digital platforms has accelerated the era of transformation of corporate business models. According to the World Economic Forum, digital ecosystems will contribute about \$60 trillion to companies' revenues in 2025, which is almost a third of their revenue (Financial Times, June 27, 2020).

Urban and inter-city transport will be revolutionised. In this sector fossil-fuel vehicles will gradually be replaced with electric vehicles and models of car-sharing networks such as **Uber** and **BlaBlaCar**, thus freeing up time and money for a larger mobility of passengers, creating massive shifts in the way societies move from point A to point B.

Online applications such as **Slack**, **Zoom** and many others make teleworking and work from home

possible. **Slack** enables 20 different organisations to join in real-time discussion, also making it possible for their corporate data applications to enable data exchange in accordance with their firewall standards. This will cause mass-scale work from home trends. Presently 1.25 billion knowledge workers spend at least one hour during their working time in front of the computer, according to Forester research (Richard Waters, 2020). It is highly probable that most of these jobs will move to the families' homes.

Research on the behaviour of the individual – as a consumer, producer, saver, investor, tourist, etc., as well as the behaviour of groups - will become a key tool in designing products, services, and processes. Competitive pressures will lead not only to intelligent machines knowing and predicting human behaviour, but also to influencing the way people behave, in order to “modify their behaviour.” In doing so, by analysing data and behaviours they not only understand the needs and preferences of people, but also model and profile their behaviour and preferences. Zuboff refers to such capitalism as “surveillance capitalism”. The purpose of such a model of capitalism is not only to automate the flow of information about human behaviour, but also to automate people, to automate their behaviour (Shoshana Zuboff, 2019).

Such trends will require a strengthening of the regulatory framework, and introducing standards for the behaviour of social networks, data analysis and standards and control when researching the behaviour of economic entities and modelling their reaction, preferences and affinities. This will represent a big challenge, not only for economic freedom and progress, but also for the development of democratic processes. In that regard, coordinated action at national and global level will be indispensable.

1.2. AN OUTLOOK BEYOND THE DEPENDANT MARKET ECONOMY

The varieties of capitalism are one of the key topics of interest of Western political economy. Its idea is to identify the differences in the economic and political institutions of capitalism in different countries and to develop an understandable comparative overview of the functioning of modern capitalism. This area started developing rapidly in the work of Shonfield (1965), later on becoming popular in the work of Albert (1991). The most important work in the area of varieties of capitalism is that by Hall and Soskice (2001) whereby they propose a comprehensive approach to identifying the characteristics of the varieties, according to which developed countries exhibit two variations of capitalism. The first is called liberal market economy, and its main representative is the USA. The second one is called a coordinated market economy,

and its major representative is Germany. Later Nölke and Vliegenthart (2009) introduced a third variety of capitalism called a dependant market economy. It can be defined by examples of former socialist countries from Central and Eastern Europe, and this variety of capitalism fully matches the countries in our region (South-Eastern Europe) including North Macedonia.

The key features of the three varieties of capitalism are shown in Table 1.1. In a liberal market economy, companies ensure the coordination through markets in the context of competition and through formal agreements. Then, in response to price signals, different stakeholders adjust supply and demand of goods and services, often driven by marginal calculations as is often done by the neoclassical economy. In a coordinated market economy, firms often coordinate their activities through non-market relationships. These are networks and associations of companies that are based on cooperation, not competition, which is essentially the liberal model. Therefore, in contrast to equilibrium outcomes of the company's behaviour in market economies that are determined by supply and demand in competitive markets, those outcomes in a coordinated market economy often depend on strategic interactions between companies and other stakeholders, such as trade unions. In a dependant market economy, the coordination of activities within companies is achieved by means of decisions reached internally within the transnational company.

The primary sources of investments in a liberal market economy are the domestic and foreign capital markets, while in a coordinated market economy it is lending by domestic banks or internally generated funds within business networks or associations. The differences between these two sources are that in the former one, it completely depends on the market results of companies, while in the latter case companies can provide financing that does not depend on their achieved results and published financial data. Nevertheless, in the latter case, mechanisms have been developed by which investors can monitor the development of investments, which mainly comes down to information-sharing within the networks and where one of the more important factors is good reputation. Contrary to these two models, the dependable market economy provides funding mainly through decisions of the headquarters of transnational companies or foreign banks that are outside the national economy's borders. It therefore depends on Foreign Direct Investment (FDI) or on lending from foreign banks.

Companies' funding sources are complementary to the manner of corporate governance. In a liberal market economy, this is achieved through a multitude of dispersed shareholders who exercise control outside the firm, while in a coordinated market economy management is exercised by shareholders who are

mainly concentrated within the business network or association and control is exercised from within the company. In contrast, the management of companies in a dependant market economy is exercised through the formal hierarchy of the transnational company and control is exercised by its headquarters.

The industrial relations within the different varieties of capitalism are influenced by the different sources of funding and the corporate governance of enterprises. Bargaining for wages and working conditions in a liberal market economy is pluralistic, market-based, and there are few collective agreements. Unlike the liberal market economy, industrial relations in the coordinated market economy are based on collective agreements at the sectoral level or even at the national level. And, contrary to these two models, the coordination of industrial relations in a dependant market economy is not based on developed institutions such as the market or collective agreements. Transnational companies are seeking cheap labour and have a sound bargaining position, as countries with such a model of political economy are in a race to attract foreign direct investment (FDI). Therefore, the salary amount or working conditions are determined by contracts at the transnational company level.

The education and training system is also closely related to the previously featured characteristics of the varieties of capitalism. Because companies in the liberal market economy are focused on the results they achieve on the markets, efforts are made to develop general capacities and bold investments are made in research and development. The focus of firms in the coordinated market economy is on vocational education and training, considered important for the development of industry specific capabilities or the business network. In contrast, foreign investments in a dependant market economy are attracted by cheap labour and strong tax incentives, which is opposite to the development of heavily-funded public education or significant investments in training by transnational corporations.

High investments in research and development make the liberal market economy a leader in the innovation process. In this variety of capitalism, transfer of innovation takes place through company takeovers happening throughout the market. In a coordinated market economy, the joint ventures of companies play an important role in the innovation process and very often the transfer of innovations takes place within business networks or associations. In a dependant market economy, transnational companies carry out research processes mainly in their headquarters, which is an additional reason why they do not need more serious investments in training and qualification of employees in their branch offices in dependant market economies. The transfer of innovations takes

Table no. 1.1
Characteristics of the three varieties of capital

Institution	Liberal market economies	Coordinated market Economies	Dependant market economies
Coordination mechanism	Competitive markets and formal contracts	Inter-firm networks and Associations	Dependence on intra-firm hierarchies within the transnational enterprises
Primary means of raising investments	Domestic and international capital markets	Domestic bank lending and internally generated funds	Foreign direct investment and foreign-owned banks
Corporate governance	Outsider control / dispersed shareholders	Insider control / concentrated shareholders	Control by headquarters of transnational enterprises
Industrial relations	Pluralist, market-based, hardly any collective agreements	Corporatist, rather consensual, sector-wide or even national agreements	Company level collective agreements
Education and training system	General skills, high research and development expenditures	Company- or industry-specific skills, vocational training	Limited expenditures for further qualification
Transfer of innovations	Based on markets and formal contracts	Important role of joint ventures and business associations	Intra-firm transfer within transnational enterprise
Comparative advantages	Radical innovation in technology and service sectors	Incremental innovation of capital goods	Assembly platforms for semi-standardized industrial goods

Source: Nölke and Vliegenthart (2009), p. 680

place within the transnational company and there are no problems in terms of property rights, as they exist in the networks and associations of the coordinated market economy.

The competitive advantages of the varieties of capitalism are developing as a response to their different features. The liberal market economy is gaining competitive advantages from radical innovations in the technological and service sectors. One such example are the technological giants such as Google, Facebook, and others. The coordinated market economy achieves gradual innovation in capital goods, and the best examples of this are companies in the automotive sector. The dependant market economy is not based on progress in innovations; rather it uses the extremely favourable taxation conditions for FDI, as well as cheap labour working on assembly platforms for semi-standardised industrial goods.

The dependant market economy has enabled significant economic growth, especially in Central and Eastern Europe in the recent decades. Relying on cheap labour and strong tax breaks, it has attracted foreign capital that has changed the countries' export structure. Similarly, in North Macedonia, there has been a positive change in the export structure, replacing the export of raw materials with the export of industrial products, such as automotive parts. But at the same time, this market economy creates hurdles for the long-term growth of the economy. In order to overcome them, there should be clearly set goals that must be achieved in the medium term. The most important one of these is the improvement of

education, research and development systems in order to uplift the capacity of the future workforce, thus boosting productivity of the economy in the long run, while strengthening the institutions of the labour market. The focus of attracting foreign investments should be on those providing higher added value and knowledge transfer. At the same time, it is necessary to increase the state capacities to take care of the interests of citizens and the national companies.

1.3. THE OBJECTIVE OF ECONOMIC DEVELOPMENT AND CONVERGENCE TOWARDS THE EU BY 2030

In the past decade, creators of economic policies in North Macedonia have been oriented towards maintaining stability of the foreign exchange rate and of prices, instead of stabilising the fluctuations of economic activity at the level of the potential economic growth without creating permanent inflationary or deflationary pressures and without a lasting disruption of the payment balance.

In the past two decades, the Macedonian economy has failed to keep pace with the dynamics of the fast-growing economies. Despite the high price stability and the stability of the foreign exchange rate, in the past two and a half decades the gross domestic product (GDP) of North Macedonia has grown by an average of 2.1 percent per year (3.3 percent in the period 2000–2018). This was insufficient to significantly reduce the level of development and the gap in living standards compared to the highly developed

countries, and especially in relation to EU countries. This indicates that price stability and foreign exchange rate stability are not sufficient to accelerate economic growth, although those are its basic prerequisites. The achieved economic growth was significantly below the potential growth of the country. The gap in the living standard compared to the highly developed countries was closing very slowly. Thus, at the end of 2018, the GDP per capita in North Macedonia reached 37.2 percent of the average GDP per capita in the EU.

The utilisation of the main economic growth factor is very low. The labour force employment rate in the country was only 47.3 percent at the end of 2019, compared to 69 percent in the EU (whereas the target employment rate for employment in the EU by 2025 is 75 percent). This indicates that a large portion of the labour force in North Macedonia is discouraged from seeking employment, is inactive or is temporarily working abroad, or works in the informal economy.

The uplifting of the level of potential economic growth of the Macedonian economy will largely depend on well-designed and implemented structural reforms in the medium term, referred to by Stojkov and Besimi (2020) as the “big push”. Only in such conditions can the potential economic growth of the Macedonian economy be raised to a level of 4.3 to 5 percent in the 2020–2035 period. In such conditions, the Macedonian GDP per capita, measured according to the purchasing power parity of the dollar in 2035, would amount to 58.4 percent of the EU average, and employment would be 59 percent. Without comprehensive structural reforms, the potential economic growth would be in the region of 3.5 percent and convergence would continue slowly. At the end of 2035, GDP per capita would be 49.0–52.5 percent of the EU average, and labour force employment would be 53.5 percent.

1.4. FAIR DISTRIBUTION OF INCOME AND POVERTY REDUCTION

According to the conservative ideology, only economic growth is important, but not the relative distribution of income and wealth. Their widespread claim is that when “the pie increases, it is good for everyone, because everyone will get a bigger absolute piece of the pie and the relative distribution is irrelevant.” Conservative theorists even have two excuses for the growing inequality. The first is that inequality is needed for economic growth because it enables savings and investment. It is based on the argument that the income of those who are at the top of the scale is mainly from capital and that they save a lot of that income, while on the other side of the scale – those with low income generally spend it all (Dyan, Skinner and Zeldes, 2004). The idea behind this is for high-wage countries

not to be able to accumulate capital, as the low-wage countries would. Therefore, according to them, the only way to enable long-term growth opportunities is to provide large enough income for the richest. But the problem with this explanation is that in the last decade globally there has been no shortage of savings, but rather a huge supply of liquidity, which Bernanke refers to as “Global savings glut” (Bernanke, 2015). But even if additional savings are needed in order to increase economic growth, there are certainly better ways to do that, such as imposing higher taxes on the rich and using the extra funds for investment (Stiglitz, 2016).

The second explanation is based on the claim that those at the top of the income scale are the main job creators and that if more income was to be directed at them, this would create more jobs. But analyses in developed economies show that entrepreneurs are at different places in the income distribution and that job creation is by no means exclusive to the richest. In addition, Berg and Ostry (2011) show that income inequality is associated with economic instability, which makes the periods of economic growth shorter when inequality is bigger.

There are several reasons as to why inequality is detrimental to economic growth. First, inequality affects the reduction of aggregate demand. This comes from the same argument that was made earlier: those with lower income spend a higher percentage of it than those with higher income. And while declining aggregate demand may be addressed by lowering interest rates and easing regulation, this inevitably leads to consumer expansion, market bubbles and growing debt that allow consumption to be sustained. But, of course, this will all end: the bubble will burst and the economy will enter recession (Stiglitz, 2012).

The second reason is that countries with bigger inequality invest less in public investments which increase productivity, such as public transport, education, infrastructure and technology. This is explained by the fact that the richest feel as if they do not need such public goods, and refuse to create a strong state that will improve the efficiency of the economy, which at the same time might be able to use its powers to redistribute the wealth and income (Stiglitz, 2016).

The third reason is that the disparity of results is linked to the inequality of opportunities for the next generation. Today’s results shape tomorrow’s playing field: winners of high income inequality today can pass on a great advantage to their children in the future (Atkinson, 2015). And this is a problem for economic growth as well, because those who are at the bottom of the income scale are not even close to their potentials and have lower demand in the current period. But more importantly, if the percentage of the poor is high, if public education does not provide for adequate

knowledge and skills, and if access to private education is limited, this also has long-term consequences on productivity and economic growth. The arguments concerning access to healthcare are similar.

The Covid-19 crisis has shown that inequality aggravates the management of health risks, which further deepens the economic crisis. Accordingly, one of the key measures for coping with the crisis is maintaining the living standard of the marginalised population groups.

North Macedonia has the highest income inequality in Europe, if we take as criterion the share of income of the richest 1 percent. According to data of the Public Revenue Office, 1 percent of the population with the highest income generate 14.4 percent of the total revenues of the country. On the other hand, the country has the second highest rate of extreme poverty in Europe, right after Serbia. Thus, the percentage of the population living with below 2 dollars per day is 4.4 percent, whereas the poverty rate is also quite high – 21.9 percent of the population.

The medium-term objective concerning the poverty rate should be its reduction by half from its present level of 10 percent, which will bring us closer to the sustainable development goals of the UN for eradication of poverty.

1.5. STRENGTHENING THE CAPACITY OF THE STATE

Major crises, such as wars and pandemics, always restore the significance of the state. In good (normal) times, often the private sector is described as “good”, “high-quality” and “productive”, while the public sector is “bad”, “unproductive” and “parasitic”. But, in times of crisis, it is the state that should always safeguard the well-being of citizens and companies. The current pandemic is the best example of this, when countries around the world are offering fiscal incentives of unprecedented proportions just to keep jobs, businesses and protect the income of the most vulnerable categories of citizens.

But how big is the capacity of the state to protect its citizens and companies? One of the more relevant publications regarding state capacity is that of Acemoglu et al. (2011), titled: “Emergence and Persistence of Inefficient States”.¹ It states the following:

“The differences in “state capacity” are an important determinant of economic development... Many less-developed economies only have a small fraction

of their GDP raised in tax revenue and invested by the government... Societies with limited state capacity are also those that invest relatively little in public goods and do not adopt policies that redistribute resources to the poor.

In this paper, we construct a political economy model, which links the emergence and persistence of inefficient states to the strategic use of patronage politics by the elite as a means of capturing democratic politics. Democratic capture enables the elite to limit the provision of public goods and redistribution, but at the cost of aggregate inefficiencies.”

The state capacity has two dimensions. The first one is the size of the state, that is, its propensity to collect taxes and then to reinvest them. The second dimension is that of effectiveness, which represents the quality to formulate and implement policies by the public sector.

There are several theories as to what determines the size of a state, measured by its relative share of GDP. The first is the so-called Wagner’s law, according to which there is a long-term tendency for the relative share of the public sector to increase proportionally to the growth of real national income per capita (Wagner, 1911). The main reasons for this are that increasing social complexity requires greater protection and regulatory activity by the public sector; and real income growth affects the relative increase of expenditures in “culture and welfare.” This theory was supplemented by Peacock and Wiseman (1961), who hypothesized that government spending tends to increase in times of war or social upheavals, and afterwards remains at a high level.

Cameron (1978) was the first to explain the size of the state with trade openness. According to this theory, states which are more open have a higher rate of industrial concentration, a tendency to stimulate a better collective bargaining process and stronger unions, which, in turn, lead to bigger demand for state transfers in the form of social insurance, pensions, unemployment insurance and workplace training and qualification. Rodrick (1998) has confirmed the theory of trade openness, in which he denied the explanatory power of collective bargaining and trade unions, and his argument is that state expenditures are used to secure social security from external risks. Similarly, Alesina and Wacziarg (1998) introduced the argument that smaller countries have a larger share of the state (measured via total expenditures in the GDP) and are more open to trade, while the bigger countries can afford having a smaller share of the state (thus lower taxes as well) because they already benefit from a big market which reduces their need to be open for trade. Other more important theories explain the size of the state through ethnic fractionalisation and inequality of

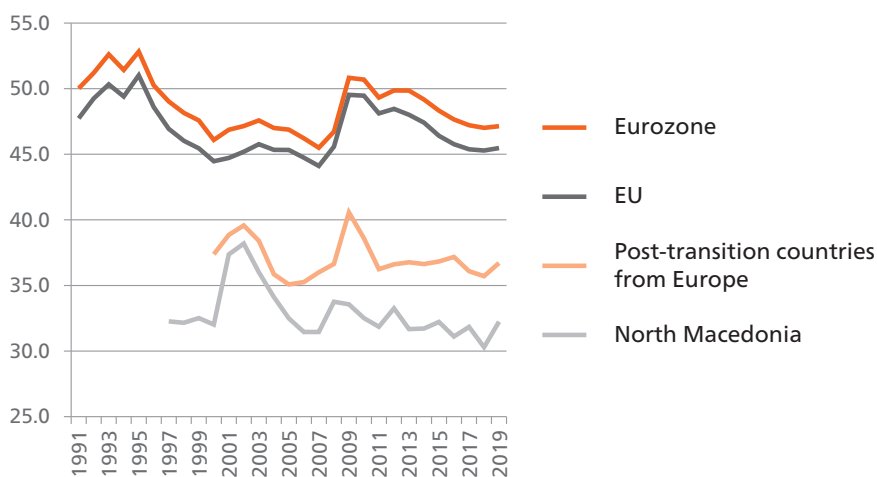
¹ Acemoglu, Daron, Davide Ticchi, Andrea Vindigni (2011), Emergence and Persistence of Inefficient States, Journal of the European Economic Association, 9(2): 177–208.

income, but there are also such theories that develop models of political economy in order to explain them via the electoral system, electoral rules, type of government, etc. Generally speaking, the common feature of the theories is that the state is the one that needs to ensure protection from various types of risks.

What is the state size, i.e. what is the share of the state in the economy of North Macedonia? Chart number 1.1 presents the movement of total general government expenditure as a percent of GDP in the period from 1991 to 2019. North Macedonia has a

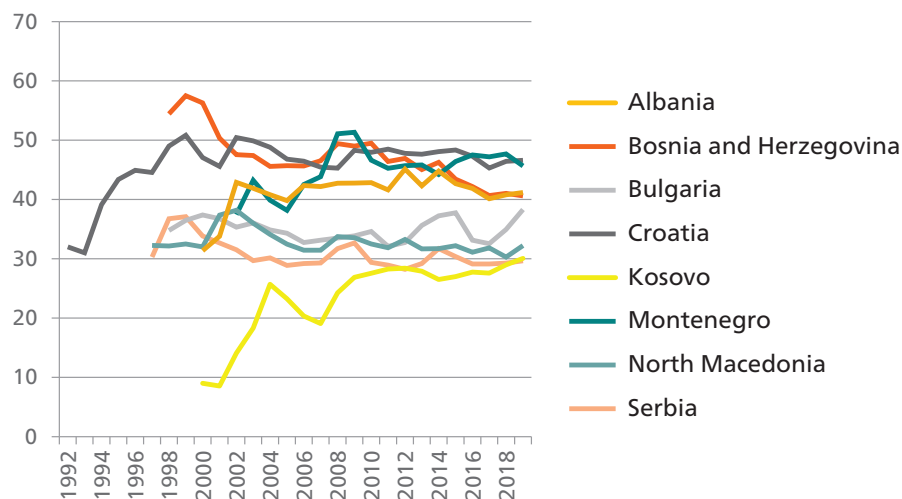
smaller state not only compared to the average size of the states of the Eurozone and the European Union, but also compared to the average of the post-transition countries in Europe (a group of countries that the IMF refers to as: Emerging and Developing Europe). Thus, in 2019, total general government expenditures of North Macedonia amounted to 32.2 percent of GDP, while their average for post-transition countries in Europe was 36.7 percent of GDP, and the averages for the EU and the Eurozone were much higher, amounting to 45.5 percent and 47.1 percent of the GDP, respectively.

Chart 1.1
Total expenditures of general government as % of GDP, from 1991 to 2019



Source: World Economic Outlook, IMF

Chart 1.2
Total expenditures of the general government as % of GDP from 1992 to 2019



Source: World Economic Outlook, IMF

The size of North Macedonia as a state is smaller than the regional standards. Chart 1.2 presents the movement of total general government expenditure as a percentage of GDP in the 1992 – 2019 period in countries of the region of Southeast Europe (SEE). In 2019, North Macedonia scored higher public expenditures only compared to Albania (29.7 percent of GDP) and Kosovo (30.1 percent of GDP). All the other SEE countries had higher government expenditures, ranging from 38.3 percent in Bulgaria to 46.6 percent in Croatia. Therefore, in the medium term, North Macedonia should strive to increase the share of government expenditure as a percentage of GDP and thus to catch up with the average of post-transition countries in Europe.

The effectiveness of the state can be measured by a World Bank indicator, which is defined as: “indicator of perceptions of the quality of public services, quality of the public sector and the degree of its independence from political pressures, the quality of policy formulation and implementation, as well as the government credibility in implementing such policies”. It is calculated as an aggregate indicator that includes several dimensions: rule of law, regulatory quality, control of corruption, political stability and voice and accountability. North Macedonia is continuously ranked in the quarter of European countries that have the lowest state effectiveness. For example, in 2018, all EU countries, as well as most SEE countries, except for Bosnia and Herzegovina and Kosovo, had better state effectiveness compared to North Macedonia.

In order to improve the effectiveness of the state, two strategic goals should exist in the medium term. The first goal is to limit the ability of political and business elites to manipulate the rules of economy and the society. North and Weingast (1989) can help provide more about the theoretical foundations of this goal. On the other hand, the dynamics of its realisation can be monitored through three indicators: rule of law, independence of the judiciary and freedom of the media. These indicators are highly correlated with the dimensions of the composite country effectiveness indicator of the World Bank. For example, the rule of law is highly correlated with the control of corruption, freedom of media with voice and accountability, and the independence of the judiciary is multidimensional. The regulatory quality will gradually improve as the country proceeds through the EU accession chapters.

The second strategic goal is to improve the quality of both pillars of the public sector: health and education. Priority should be given to strengthening public health. Our grappling with the current Pandemic has clearly shown how important it is to have a stable public health system. Similar to this is education. Unfortunately, for many years back North Macedonia has been at the bottom of the PISA ranking when it comes to quality of education, and the World Bank Human Capital Index shows that an 18-year-old person from our country spends an average of 11.2 years in school, but the knowledge is equivalent to 6.8 years of education. Therefore, the focus of the state should be on strengthening the quality of public education.

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2

PRODUCTIVITY GROWTH OF THE MACEDONIAN ECONOMY AND STRUCTURAL CHANGES IN THE MEDIUM AND LONG TERM

VANCHO UZUNOV, BRANIMIR JOVANOVIĆ AND IVANA VUCHKOVA

INTRODUCTION

Numerous analyses indicate that economic performances of North Macedonia in the past two decades have been unsatisfactory. Despite the stability of prices and the exchange rate, GDP grew at an average annual rate of just 2.9 percent, whereas productivity grew very little. Investment, on the other hand, cannot be characterised as low, which indicates that allocation of production factors is extremely inefficient, and that the market mechanism has been “inhibited.” Labour is an underused production factor, although the unemployment rate did drop.

The growth model that has been adopted – based on low labour costs, low and flat taxes and abundant use of import of knowledge and technology through FDI – did not bring about rapid and inclusive economic growth and significantly higher overall living standard. FDI from the technological/industrial development zones create up to 50 percent of the total export of the country, but in the share of GDP they contribute about 2 percent and employ about 3 percent of the employed labour force. Participation of domestic companies in the FDI value chains is almost negligible. The FDI enable a kind of “export” of cheap Macedonian labour, whereas the newly created production value generated through FDI is below 10 percent.

In addition to this, the country remains at quite a low level in terms of its technological specialisation. Domestic companies are using relatively outdated technologies, are not ready to accept new technologies, and many small companies are not ready to innovate. The level of investment in research and development and the introduction of new products and technologies are at extremely low level. The work processes in domestic companies range between low to medium level of automation; very often there is analogue automation and an extremely low level of use of artificial intelligence. Simply put, economic growth and development have not been inclusive, as the benefits of the achieved growth and development are

not widespread throughout the economy and are not widely shared among the population.

Considering this as the starting point, this study aims to indicate several aspects which are considered as most important – in the context of the “big picture” concerning the growth of productivity of the Macedonian economy and the structural changes in the medium and long term.

2.1. DEVELOPMENT STRATEGY BASED ON EXPORT EXPANSION

In order to establish a realistic and feasible basis for growth of productivity and living standards of citizens in the long term, the first task should be the selection of an appropriate *development model* or a *development strategy*. This strategy, in fact, should be perceived as the *framework for all types of economic policies* and all the subsequent measures of the entire national development policy (short-term, medium-term and long-term) need to be aligned with it.

Considering this, amongst the manifold possible development strategies, the most appropriate one for North Macedonia is the development strategy of *export expansion*, or the export-led economic growth.

There are numerous arguments to justify the selection of this development strategy for the case of North Macedonia, but the most important ones are that we are a small economy, with a small market, with a very limited domestic demand in terms of quantity and sophistication, with a relatively low degree of economic development and with limited resources. As all these factors are inter-linked and have a negative mutual influence, according to the theory and the experience of many countries, we consider the export expansion strategy as the most appropriate, whereby the export of products and services would be the main driver of the entire economic development.

The essence and details of the implementation of such a development strategy are well known, but still, we point to several important aspects:

1. The selection of export expansion as a long-term development strategy means that the country's economy **should not** remain (only) a "small open economy", but should gradually transform into an **internationally integrated economy**. This is not the same by any means. Namely, with export averaging about 60 percent of GDP, the economy of North Macedonia can be considered an open economy (although that percentage in other "small countries" is significantly higher). However, the share of activities (primarily industry and agriculture) where almost all export products of North Macedonia are created, in the creation of domestic GDP, is not more than 25 percent. Export services are not included here (there are no adequate data), but it can be concluded that a very large part of North Macedonia's GDP – about 65 percent – is generated in industries whose market target is only the domestic (small) market. This clearly shows that the Macedonian economy is far from being an internationally integrated one, which has to change in the coming period. From the perspective of the share of export in GDP, the successful implementation of the development strategy of export expansion means that this share, in the foreseeable future, should exceed 100 percent. That, in fact, should be the first long-term target of economic policy.
2. In a development model of export expansion, the main driver of development is the export of goods and services (and not "capital investments at any cost" – they are just a policy instrument). However, this should be supplemented by an indication of what kind of export is implied. In that sense, in the case of North Macedonia there should be an increase in the export of goods and services **with a larger component of domestic added value**. This is exactly the weakness of the current practice in North Macedonia – the export of goods is continuously growing at a much higher rate than the GDP growth or the living standard of the citizens, and this is the case because the domestic component of Macedonian export is unskilled and semi-skilled (hence cheap) labour. Reversing that situation is the essence of the development model of export expansion, and that should be set as the second long-term target of the economic policy.
3. When implementing the export expansion strategy, government support **should not** be limited only to primary or secondary sectors, but should also encompass the tertiary sectors, namely the services. In the case of North Macedonia an additional reason for this is that 40 percent of the Macedonian GDP is generated in production service sectors, which is three times more than the share of the entire manufacturing industry (13 percent). Therefore, in spite of the support to the export of goods - which in a systemic context surely does not suffice and needs to be further developed – the economic policy ought to focus also on **supporting export of services** from North Macedonia, where potentials are still underused. Exporting sectors may also be construction, transport, forwarding, and especially information and telecommunications services and tourism (revenue from foreign tourists is considered as export). This needs to be the third long-term target of the economic policy.
4. The development strategy of export expansion implies the existence of a relatively high level of technological development and modernization, which in the case of North Macedonia means building a relatively high level of specialization in the economy, and the gradual development of a relatively high level of competitiveness and competitive capacities in regional and global frameworks. To achieve this, **competitive advantages of the Macedonian economy need to be created, based on high quality labour, technological advancement and innovation**. And since it is a small economy, it can be expected that this will be the case in a relatively small number of sectors. Achieving that specificity is the fourth long-term target of the economic policy.
5. The implementation of a development model based on export expansion means that the country **ought not** rely solely on the import of knowledge/technology (an exogenous growth model, as has been the case so far), but it should be combined also with an endogenous growth model – development of own knowledge, innovations, for linking domestic companies in the FDI value chains that have ventured in North Macedonia, as well as in the regional and global value chains. Even traditional sectors such as agriculture, can also rely on endogenous models if they are oriented towards high-income production with a high share of knowledge and human capital in it. And this should be set as a long-term target of the economic policy.
6. In order to implement successfully the future model of economic development, the position of the government in relation to the overall economy and in relation to the management strategy of economic development has to be **redefined**. In that sense, and according to the latest economic theories and best practices of the 21st century, the modern role of the government in relation to the economy consists in accomplishing the following 6 tasks: a) the government is a **regulator** (but we must add here that it should be a neutral regulator); b) the government is a **corrector** (of market imperfections and negative externalities); c) the government is the **instigator** and **director** (of technological progress, of the ability of business entities to increase productivity, of export, etc.); d) the government is the **creator** and **provider** (of better quality resources: good education and health, physical and ICT infrastructure, of the "Green Agenda", etc.); e) the government is a **redistributor** (of the

newly created value, i.e. a holder of an appropriate policy for social justice and inclusion); and f) the government is also an **“informing party”** (the main agent for reducing the problems arising from insufficient and asymmetric information). But the government should not be the “exclusive selector” of the “winners” (in terms of sectors, activities, branches, or companies, as domains in which the high specialization of the economy will take place).

7. This is followed up by yet another aspect of best practice in good governance, in the sense that the policy-making approach **should not** be purely top-down (and through government selection process, which is a reminiscence of the socialist economic planning model), nor exclusively “bottom-up” and/or “neutral” (which is a reminiscence of the neoliberal “Washington Consensus” model), but it should be a special combination. That is, the modern approach would be: **“cooperation between the public and private sectors on all issues of productivity and social goals”** (K. Aiginger & D. Rodrik, 2020). In this sense, modern industrial policy is defined as “policy that looks beyond GDP growth”, because in addition to the issues of productivity growth and economic growth and development, it also includes all broader social aspects, which is quite correct and acceptable. With this in mind, a special methodology called “smart specialization” has been developed within the EU, which generally defines the areas of specialization of the economy through a process of cooperation between the public and private sectors, but also with the academic community, local entities, civil society, etc. As an approach to conducting the overall economic and especially industrial policy, still in its fledgling years in North Macedonia, it should not only continue, but rather become one of the few main tools of future economic policies. This would be another long-term target of the economic policy.
8. Considering all the aspects above, perceived in operational terms, and with a view to achieving productivity growth, economic development and successful implementation of the development model of export expansion, the government of North Macedonia needs to act through: a) improving the quality and functionality of the institutions; b) solid market regulation; c) developing further its human capital (promotion of education and health); d) investments in material infrastructure (transport, energy, ICT infrastructure, etc.) and e) support for the qualitative aspects of the operation of business entities so they could build “backward & forward” value chains with regional and international companies. However, it is very important to choose wisely and to set up/define the support instruments well. Henceforth, if the plan is to continue subsidising (including here agricultural subsidies), they should be conditioned on a certain “output” (for greater quantity and higher quality), and not on “input”, as is the case now. That is not development. In the same sense, subsidies should be

phased out over time as an instrument of economic policy (until they are completely eliminated in the foreseeable future), and instead, public procurements should gain importance, but must be very well prepared and without any of the distortions that presently exist.

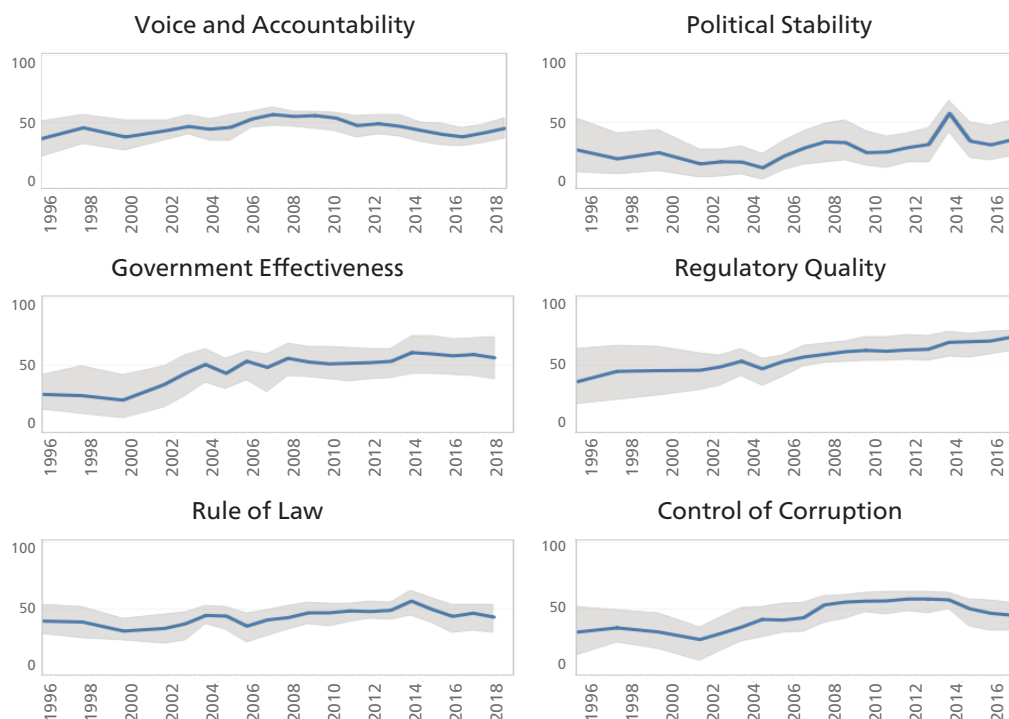
9. Lastly, one should consider the need to ensure a degree of self-sustainability of the economy of North Macedonia, in the context of the current crisis or future similar crises. This primarily refers to the need to have agriculture (i.e. food), medical equipment, disinfectants, etc. Such types of production would ensure some “security” in the wake of a future crisis, however, given the limited capacity of the small economy of the state, we should strive that such activities and sectors also become competitively capable of exporting their products.

2.2. HIGH QUALITY AND FUNCTIONAL INSTITUTIONS

The impact of the quality of institutions on economic growth and development, and especially on productivity is very well known. Nowadays it is a proven fact that the “success” of some countries, much like the “failure” of others, is owed primarily to the institutions (D. Acemoglu, J. Robinson, 2008). The institutions are perceived as “rules of the game in a society or, more formally, as limitations set by the people which shape their mutual interactions” (D. North, 1990, p.3). All three aspects of the definition are important here: that institutions are established by the people (and are not factors which are beyond their control); that those rules of the game imply limitations to human behaviour; and that their primary influence is through the creation of initiatives. For economists, initiatives are the foundation of economic activities. In this regard, many years ago, the World Economic Forum, in its Global Competitiveness Report, pointed out that the degree of economic development and the stage of competitive capacity of the economy of North Macedonia have determined that faster future economic development depends primarily on the capacity of institutions, and not on the availability of resources.

Taking this into consideration, Chart 2.1 below presents performances of North Macedonia against the six main indicators of the quality of institutions according to Worldwide Governance Indicators, in the 1996–2018 period. Progress has been achieved in two of them – Government Effectiveness and Regulatory Quality - but with the remaining four indicators (Voice and Accountability, Political Stability, Rule of Law and Control of Corruption) the situation has not changed, even after such a long period since the independence of the country. This accounts for many of the reasons why the market mechanism in North Macedonia has not been functioning in an optimal way.

Chart 2.1
Performances of North Macedonia against the six basic indicators on the quality of institutions



The reason behind this is well explained in the theoretical literature. It has to do with the notion that North Macedonia is a typical case of a country “victim” of the “see-saw effect”, as well as of the “Iron Law of Oligarchy” (D. Acemoglu, J. Robinson, 2008). The point is that without a real disruption (change) in the relationship between political power *de jure* and *de facto*, the mere *de jure* reform of the institutional “set-up” will not lead to a *de facto* change in the quality and functionality of the institutions. Without going into details and explanations, the experience of many countries shows that such a situation can last for a very long time. However, the belief remains that the intensive implementation of the process of accession of North Macedonia to the EU, which is expected to begin next year, might accelerate this process.

On the other hand, even though we are not able to cover all the aspects of what it takes to develop high quality and functional institutions in North Macedonia, it is important to point out that this does not refer only to the state institutions in the narrow sense of the word (meaning state, municipal and other bodies, organizations and agencies), and hence, we are not talking just about the introduction of state-of-the-art management techniques for those institutions, or about reducing the number of state and public administration employees; that would make the task much easier. Also, this does not concern only the proper regulation of markets (which is a particularly interesting and important topic). Rather, it is about institutions in

the broadest sense of the word, including all laws and bylaws, then the customs, norms, rules, etc., and especially the manner of their implementation in practice (meaning a proper, uncompromised and equal-for-all application of the laws). Practically, it is about reforming and changing the overall social and political “set-up” of the environment in North Macedonia. This will take a long time, but any development in that direction would bear a very favourable effect on productivity growth and accelerated economic development.

2.3. EDUCATION FOR THE 21ST CENTURY

The development and the promotion of education, which should significantly impact technological development and stimulate innovation, are particularly important segments for expanding economic productivity, especially when speaking about the introduction of a development model based on export expansion. This is the previously featured component of the endogenous aspect of the development model. In light of this, it is challenging to indicate the direction in which the education process should be reformed, especially with the focus on the needed upgrade of the curriculum and teaching content.

The guidelines can identify the expectations regarding the direction of technological development and innovation as drivers of productivity growth and economic development. It is very important for North

Macedonia to abandon, as fast as possible, the existing model of development based on abundant use of low-skilled and cheap labour (so-called price competitiveness or competitive advantage based on cheap production factors and “inputs”), and to move towards development based on activities and industries characterised by (at least) intermediate level of technology and technological equipment (the so-called qualitative competitiveness, that is, competitive ability based on quality).

In doing so, we cannot and should not expect that companies from North Macedonia would make world class technological champions, neither in the long term nor in a limited number of activities. The primary objective here should be that national companies from North Macedonia are empowered for large-scale use of medium-level technology. Furthermore, in the existing typical “leader–follower” constellation of companies worldwide, when it comes to their technological development and the level of equipment they use, national enterprises from North Macedonia should be enabled to be the *runners-up to the technological leaders*, which would surely be a giant leap from our present state of being the followers of the runners-up to the technological leaders. This, however, necessitates better (than the existing) average qualifications of the workforce in North Macedonia, as well as growth of innovations. But even in that context, we should not aspire to some “cutting-edge” innovations or pioneering brand new products or services. Innovations can also be quite simple discoveries, but those which lead to improved operation of companies from North Macedonia or facilitate their integration in the regional and international value chains (of the large enterprises).

Henceforth, the advancement and reform of education in North Macedonia should essentially progress in two directions: a) increased and better quality (compulsory) study of mathematics (to help master and practice logical thinking) and foreign languages (for increasing workforce mobility); and b) introduction and study of the “21st century knowledge and skills” which are almost completely non-existent in the present public education system in North Macedonia. In general, this is a matter of reforming education so that it would no longer teach students skills which are already performed by “semi-intelligent or intelligent machines” (and in the future this will be even more obvious), but to give them knowledge and skills that digitalization would not be able to replace, or knowledge and skills that help students acquire qualifications that digitalization will bring along, and which will become ever more important. More specifically, it concerns knowledge and abilities for: critical thinking (ability to find solutions to basic or complex problems, and not just to follow instructions); creative thinking (ability to think independently and to look beyond the stereotypical way of thinking, as well as

the ability to reach decisions); managing people and processes; communication (ability to negotiate); information literacy (comprehending facts and data, charts and tables, statistics and other data, etc.); media literacy (understanding the ways in which information is published); and technical literacy (knowledge of using information technology). This also includes skills for: collaboration (ability to work with others and work in teams); flexibility; initiative; and taking action in a social environment (engaging in social networks).

A workforce that is prepared and skilled in such a manner would certainly be able to quickly and efficiently adapt to different jobs, because jobs will rapidly change in the future. On the other hand, narrow specialization and acquisition of future knowledge and skills, i.e. training of the young workforce only in specific jobs that are presently in demand (in the short term), will lead to the loss of employability of that workforce in the foreseeable future, meaning that again substantial investments and time will be needed for new retraining and requalification of the workforce.

2.4. INCLUSION OF NATIONAL COMPANIES IN THE VALUE CHAIN OF THE “DOMESTIC” FDI AND IN THE REGIONAL AND GLOBAL VALUE CHAINS

The inclusion of domestic companies in the value chains of the FDI which have invested in North Macedonia should be perceived as a process that will create the full multiplier effect of attracting FDI, meaning that productivity and economic growth will rise. At the same time, this process is as necessary as it is difficult to implement. There are several reasons for this, but the most prominent one has been that when implementing the policy of attracting FDI in North Macedonia, so far the primary interest has been placed on employing domestic cheap labour, rather than structural changes in the economy and greater involvement of domestic companies in their value chains. But this has created major technological barriers for domestic firms to become part of the FDI value chain.

Resolving this problem should take place through technological modernization of domestic companies, for which they need to be supported by the government, but also through initialising a different model of attracting FDI in the future: to attract FDI with activities (production) that would be compatible with opportunities of domestic companies to integrate in their value chains. In fact, that is why the future model of economic development of North Macedonia should have a sectoral approach in terms of the attracting of FDI. In light of this, efforts should be made to use the specifics of other activities in the Macedonian econ-

omy, for example agriculture, in terms of actively attracting FDI in the field of food production, because the domestic primary agricultural production would bring a significant input in those value chains. This would help increase the efficiency and specialization also of agriculture in North Macedonia.

Another process complementary to this is the inclusion of domestic companies in regional value chains and the regional (common) market, as well as in the international value chains. The regional market represents great potential for domestic companies in North Macedonia. First, because the competitive ability to place export products and services of Macedonian companies is greater on the regional market compared to the EU market as a whole. Second, because one of the consequences of disrupting economic flows created by the current pandemic is disrupting the existing value chains of EU firms strongly linked to China and other more distant markets. The European Commission is in the process of rethinking such a constellation in the future, and the Western Balkans are becoming increasingly interesting as a space for the future expansion of FDI of EU member-states, as well as for increased integration of companies from the Western Balkans with companies from the value chains of EU companies.

On the other hand, one major problem for stronger economic networking and for the formation of regional value chains of companies from the Balkan economies are the structural characteristics of these economies. That is because the structures of economies of the Balkan countries are similar – which arises from almost the same endowment with production factors, almost the same degree of economic development, a shared past in the same social environment, the same education and health systems and the like – those economies are more competitive with each other rather than being complementary. However, economic structures are changing according to the potential for progress. In that sense, all the economies in the Western Balkans are looking at intensive processes of structural change and adjustment. Thirdly, a process of regional economic integration is under way (first as a free trade area, then as a customs union, and finally as a common market). All this indicates that this potential for future economic development of North Macedonia must not be neglected, or be considered as something of secondary importance, considering the EU market to be of primary importance. Domestic companies should receive all forms of support for this plan to succeed, starting from financial (cheap loans, export guarantees, etc.), by providing information, all the way to supporting performance and venture in the regional markets, etc.

2.5. INVESTMENTS IN INFRASTRUCTURE AND “GREEN AGENDA”

Investment in infrastructure are an important instrument for stimulating economic development, as they boost economic growth in the short term, through the multiplier effect of public investments, as well as in the medium and long term, through increasing the productive potential of the economy. The effects from infrastructural investments are even more explicit in conditions of inhibited economy, as are the present conditions with the Covid-19 crisis. The fiscal multiplier is higher in time of economic crisis, which makes public investments the most effective instrument for overcoming the crisis.

This is even more pronounced in countries with poorly developed infrastructure such as North Macedonia. According to the World Bank, North Macedonia is at the European bottom in terms of infrastructure quality, which is a serious limiting factor for the development of trade, transport and all other economic activities. However, one addition needs to be made here: North Macedonia has overcome the phase of “physical expansion” (or “building from scratch”) of its infrastructure, especially of its road network, which means that future investments would entail adequate maintenance and modernisation of the road network (improvement of its quality rather than quantity). In terms of the railway network, things are opposite, which means that in the railway network a process of intensive construction is yet to come (of course, of the economically justified and sustainable routes). The gas pipeline network in North Macedonia is in a similar state, which means that it has to be completed in full as soon as possible.

In the present crisis, investments in health infrastructure particularly stand out as being necessary, in order for the state to be able to respond to current health challenges, but also to potential future challenges of similar nature. Even if such health shocks were to cease in the future, considering the trend of the population ageing that our country is no exception to, the health sector needs major investments.

Another initiative that has become particularly relevant in the current crisis, although it has been around for a long time, is “green growth”, or “the Green Agenda”. Recognizing the consequences for humanity and the economy caused by climate change, the United Nations as early as in 1997 adopted the Kyoto Protocol, which was preceded by the 1992 Framework Convention on Climate Change (UNFCCC). North Macedonia ratified the Kyoto Protocol in 2004, which sets out, among other things, policies to limit greenhouse gas emissions, as well as the legal obligations of highly industrialized countries, including the European Union. The Paris Agreement, as the greatest success in

climate diplomacy, represents both a proper follow-up and a huge step forward also in terms of the commitments bestowed on countries regarded as “smaller polluters”, which includes ours. According to provisions of this agreement, which provides for limitation of global warming below 2 C, we have an obligation to develop a National Energy and Climate Plan, which will be subject to regular revision and will reflect our commitment as a country in the global fight against climate change.

The regional development banks followed suit, and very early joined this global trend of activities for the mitigation and adaptation to climate change, primarily by conditioning the projects financed by them. The European Union, on the other hand, has been considered the most progressive actor for years in terms of efforts to combat climate change, as evidenced by the European Green Deal, which envisions a carbon-neutral continent by the year 2050, which even during the global pandemic caused by Covid-19 has become a strategic commitment of the Union, and thus an obligation for future members. World renowned economists like the Nobel laureate Joseph Stiglitz perceive the European Green Deal as the mechanism for institutionalizing the state market regulation (during neoliberalism, the market paid no regard to the environment which led us to environmental disasters, global warming and climate change). Put in general terms, “green growth” refers to economic growth that does not disrupt nature, does not pollute nor affect climate change, and is based on preserving the ecological balance. It primarily covers energy-related activities pertaining to a just transition towards renewable energy sources, the circular economy that treats waste as a resource, as well as other activities aimed at mitigating and adapting to climate change. Apart from these global problems, a major local infrastructural problem in our country is the fact that many settlements still do not enjoy the basic benefits of civilization, such as sewerage and water supply. Only 18 percent of rural areas are covered by water network and sewerage, which are “bad statistics” for a country aspiring to join the EU.

In order to respond properly to all these challenges, we need a comprehensive strategy for infrastructural investments for “green growth” which would cover a time period of several decades and all relevant segments. The main segments of such a strategy need to be:

- Improving the transportation infrastructure, with a special focus on railway transport, which is far more environmentally friendly than road infrastructure;

- Investments in renewable energy sources, such as solar energy, for which our country has significant untapped natural and infrastructural potential (for example, decentralized solar capacities on the roof surfaces of public buildings). For example, the study for “EnergyIndependent and Self-Sustainable Karposh” indicates the possibility of covering as much as 75.82 percent of the existing electricity consumption from photovoltaic systems installed on the rooftops of private residential and administrative buildings in the municipality;
- Investments in energy efficiency and transforming all facilities into energy-efficient ones (which requires renovation), which, under the Third Biennial Climate Change Report will entail opening of 10,000 new jobs in our country by 2035;
- Replacing wood and coal as a heating resource for households with environmental resources (solar energy, thermal waters, heat pumps, etc.);
- Investments in public health, which include construction of a new clinical centre, but also renovation of the existing facilities and investment in new equipment;
- Installing water and gas supply networks as well as a sewerage system throughout all the settlements in the country;
- Supporting local production of needed products necessary to meet this end, such as photovoltaic panels, solar panels, environmental means of transport, a building fund for greater energy efficiency etc.
- Promoting green jobs by introducing adequate education programmes, providing a just transition fund which enables retraining and requalification of workers for the needs of the new jobs.

The implementation of such an ambitious and comprehensive public investment strategy will not only stimulate economic growth in the short, medium and long term, but will also represent a step forward to a substantial transformation of the economy and the society, making it more appropriate for the new era and to the strategic commitments of North Macedonia for membership in the European Union. In addition, IRENA (the International Renewable Energy Agency) suggests that investing in renewable energy sources, in accordance with the obligations of the Paris Agreement, will contribute to a 4 percent increase of human well-being, which among other things refers also to the quality of life and jobs.

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3

HOW TO ACHIEVE SUSTAINABLE GROWTH AND ITS POST COVID-19 FINANCING

GLIGOR BISHEV AND JANE BOGOEV

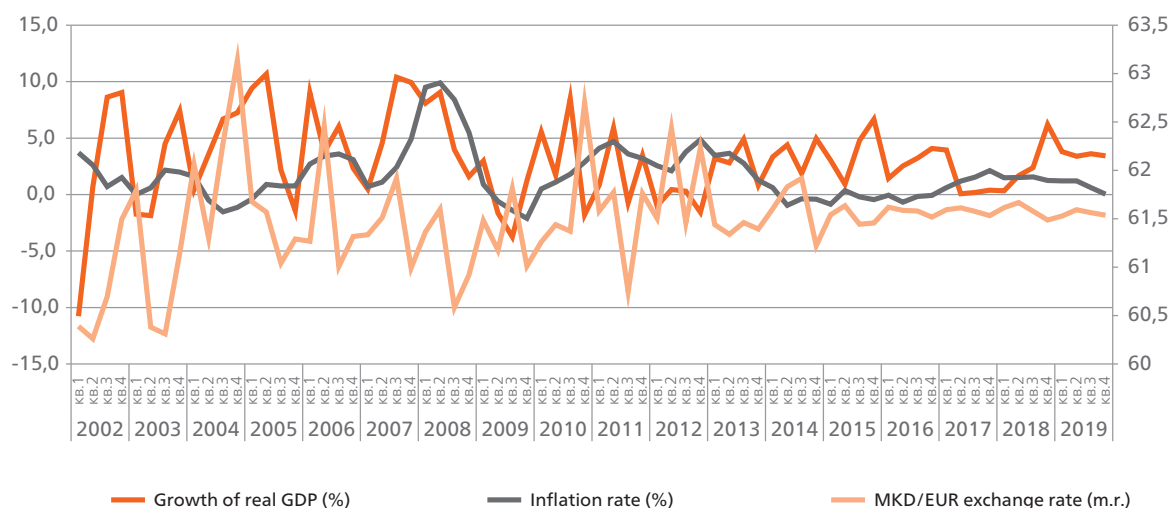
INTRODUCTION

The economy of North Macedonia has suffered severe shocks in the past two and a half decades. Some of the shocks were of an external nature, such as the shock of the Kosovo crisis, and the shock caused by the Global Financial Crisis that began in late 2008 and lasted for several quarters. Starting in 2015, the Macedonian economy was hit by a domestic shock caused by political instability in the country which lasted for two years. With the country’s gradual economic and political stabilisation and its significant progress in the Euro-Atlantic integrations, the country yet again faced the direst of shocks, this time caused by the Covid-19 pandemic. This shock, inflicted by health factors, affected the whole world including the Macedonian economy, both on the supply and on the demand side. Given the structure of the Macedonian economy and its labour intensity, its health risk management and reliance on home-based work, recovery will be very difficult. The pandemic risk will be one of the biggest tests for the stability and resilience of the country in terms of its economic and financial infrastructure, as well as from a social and political point of view.

3.1. SUSTAINABILITY OF GROWTH BEFORE THE PANDEMIC

In the past two decades, the Macedonian economy failed to keep pace with growth dynamics of the fast-growing economies. Despite the high price stability and exchange rate stability over the past two and a half decades, North Macedonia’s gross domestic product (GDP) grew by an average of 2.1 percent a year (3.3 percent in the 2000 – 2018 period), Chart 3.1. This was insufficient to significantly reduce the level of development and the gap in living standards compared to highly developed countries, and especially compared to the EU countries. This indicates that price stability and exchange rate stability are not sufficient to accelerate economic growth, although they are its basic prerequisites. The achieved economic growth was substantially below the potential growth of the country. The gap in living standards compared to the highly developed countries was slowly closing. Consequently, at the end of 2018, the GDP per capita in North Macedonia reached 37.2 percent of the average GDP per capita in the EU.

CHART 3.1
REAL GDP GROWTH RATE, INFLATION RATE AND MKD/EUR EXCHANGE RATE



Source: SSO and calculations

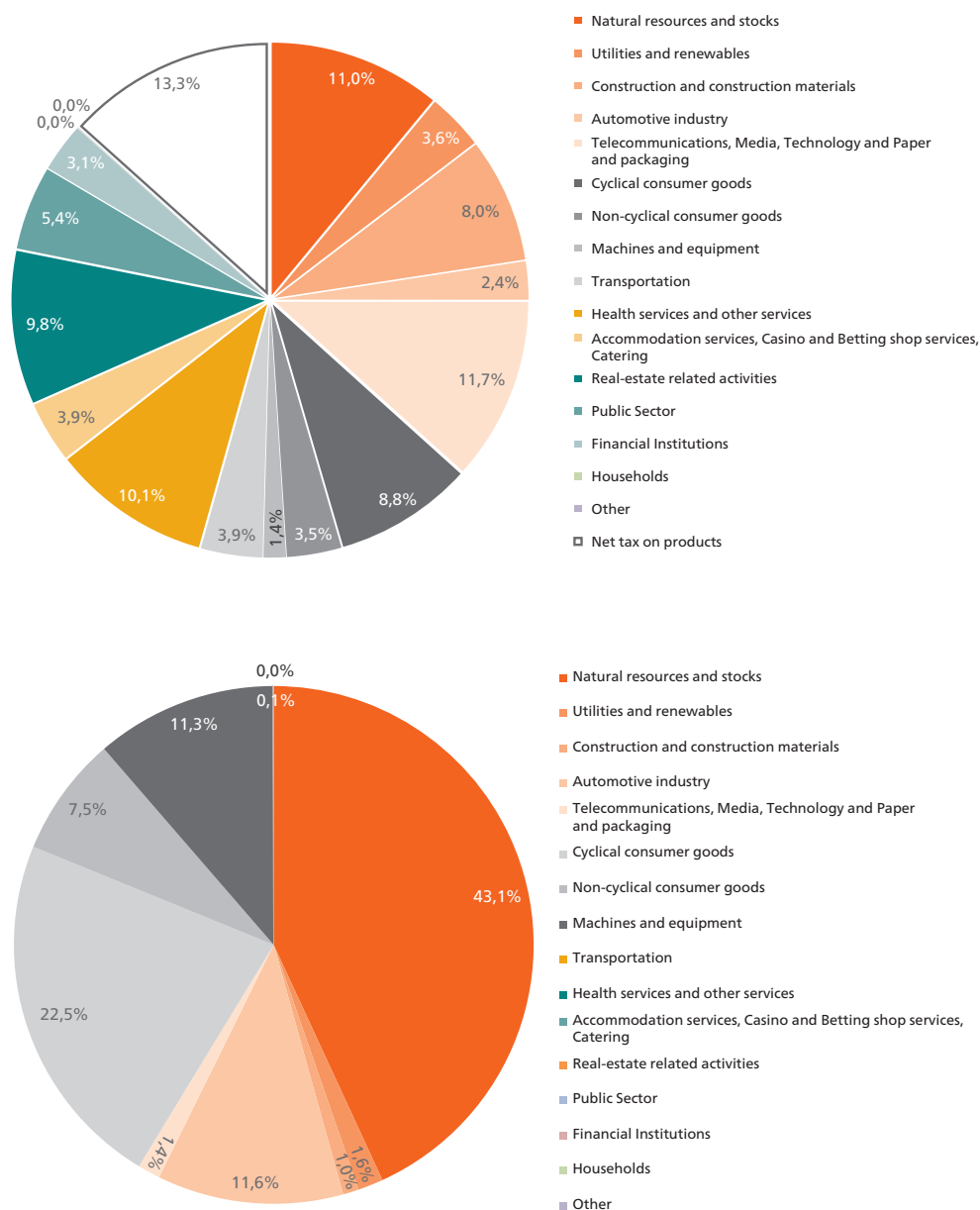
The utilization of the main factor of economic growth is very low. The employment rate of the labour force in North Macedonia was 47.3 percent at the end of 2019, compared to 69 percent in the EU (the EU target employment rate by 2025 is 75 percent). This indicates that a large portion of the labour force in North Macedonia is discouraged from seeking employment, and is inactive or temporarily working abroad, or works in the informal economy.

Clearly the economic growth model in North Macedonia, which is based upon arbitrage of labour costs and arbitrage in income tax rates, does not provide for

a comprehensive inclusive growth which can generate significant added value and an accelerated increase of living standards. This is the feature of economic growth in all six countries of the Western Balkans (OECD, 2019). Production analysis in Western Balkan countries suggests that the technological know-how in the region is at a medium-low level of development. Therefore, attracting FDI based on labour price arbitrage and taxes in the long run is unsustainable (McKinsey Global Institute, 2019).

Through its tax policy and the policy of one euro for construction land, North Macedonia has managed

CHART 3.2
SHARE OF CERTAIN SECTORS IN GDP



Source: SSO and calculations

to attract a significant number of FDI in the economic zones in the assembly areas. The research and development stage for the products is done in the parent companies of the investors, and the assembly is done in the domestic companies. Thus, exports from the economic zones have reached 50 percent of the country's total export. However, their contribution to the country's GDP barely reaches 10 percent, and in terms of the number of employees it reaches around 25 percent (Chart 3.2). The situation is similar in the other Western Balkan countries, where food production and manufacture, metal industry and the automotive and machine industries account for 58.3 percent of total exports, barely 15.3 percent of GDP and 31 percent in the total employment (OECD, 2019).

If we are to analyse in more depth the essence of the growth structure, according to experience gained starting from 2007, we can conclude that growth has been overly concentrated on the models relying on the so-called exogenous growth factor. According to these models, the productivity factor is considered to come exclusively from outside through the import of knowledge (Growth Report 2008, the World Bank). This is achieved in practice by increasing FDI through which foreign investors import sophisticated production equipment to the host country and train the workforce in specific specialized production. Such models have yielded very good results since World War II in Japan, later in South Korea, the East Asian Tigers, and in the past twenty years in China (Growth Report 2008, the World Bank).

Nevertheless, this was not the case with North Macedonia. FDI was more focused on low specialized production (textiles, assembling parts for automotive industries, chemical, industry and metal processing industry) which, in essence, did not help any substantial transfer of technologies and knowledge. Still, FDI significantly helped increase export, and by the end of 2019, export-based FDI reached 50 percent of total exports.

Moreover, unemployment dropped significantly (from around 34 percent), but remained quite high – 17.3 percent at the end of 2019.

Growth and development were not inclusive. The benefits were not widespread throughout the economy and the population. The Gini coefficient, which measures unequal income distribution, although denoting a trend of gradual decline, remained high – 34.2 percent in 2017. The population living on the verge of poverty or social exclusion, before social transfers and pensions, amounted to staggering 40.7 percent of the total population at the end of 2017. After government transfers, and especially as a result of the pensions, the poverty risk rate dropped to 22.2 percent.

3.2. PRODUCTIVITY AND INVESTMENTS IN RESEARCH AND DEVELOPMENT ARE INDISPENSABLE FOR GROWTH

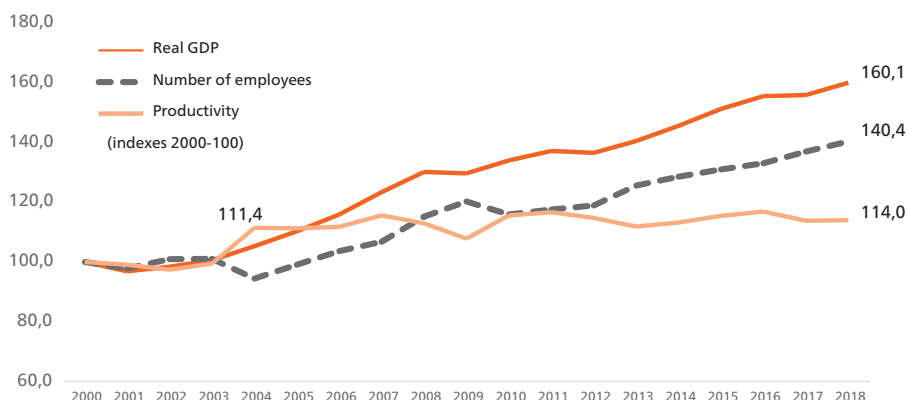
The moderate economic growth is highly correlated with the low productivity growth. In the past two decades, economic growth was driven primarily by employment. The exception here is the 2000 – 2005 period, (that is the period before the intensive promotion of economic zones), when productivity growth was the leading factor of economic growth (with productivity growth of 2.4 percent on average per year). In the 2006 – 2018 period, productivity hardly contributed at all to the economic growth (productivity growth of 0.2 percent on average per year). During this period, employment increased by 3.1 percent per year, or cumulatively increased by 40 percent. This brings us to the conclusion that the economic growth in the past two decades has been labour-intensive in its nature, where the increase in employment was also driven, to some extent, by employments in the public sector. This explains in part why there has been no productivity growth. FDI has not significantly contributed to productivity growth nor increased investments in the workplace. The exceptions are finance and the information and communications sectors where productivity gave a significant boost to growth (Chart 3.3 and Chart 3.4).

The level of investments in research and development of new products and technologies is exceptionally low, around 1.5 percent (twice lower than the EU average). That is the key driver of growth and development in the modern world. Investments in research and development, along with the investments in non-material assets, such as brands, software, design, intellectual property, are on the rise as a share in the total companies' revenues. Their share has increased from 5.4 percent in 2000 to 13.1 percent in the year 2016 (McKinsey Global Institute, 2019).

In light of the above, a great many of the activities are done manually, although in highly developed countries they are fully automated and digitalized or almost do not exist as jobs: toll collection, parking payment, cashier in grocery stores, refuelling at gas stations, employees at information points, cleaners of public spaces, salespersons of tickets for public transport, theatres, cinemas, etc. Moreover, work processes in companies are at medium automation level with a low utilisation level of artificial intelligence. The weaknesses of such a structure of work processes becomes even more pronounced in conditions of pandemic, because more workers are at a higher risk of infection.

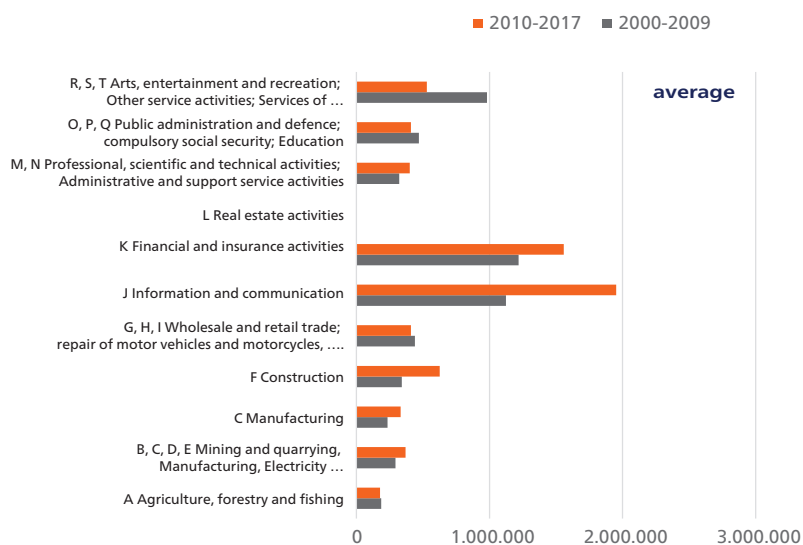
Such a structure of the economy, in addition to the delivery of low economic growth and living standard, makes the economy highly vulnerable to health risks such as that of Covid-19.

CHART 3.3
PRODUCTIVITY OF LABOUR, GDP GROWTH AND EMPLOYMENT



Source: WEO October, IMF and SSO, and calculations

CHART 3.4
PRODUCTIVITY OF SOME SECTORS



Source: SSO and calculations

3.3. THE COVID-19 SHOCK

3.3.1. Global trends with covid-19

Starting in March 2020, the whole world faced a global pandemic that affected all continents of the world simultaneously, with North Macedonia being no exception. The global measures of isolation and closure of the countries' borders, as well as the closure of unnecessary economic activities, led to a drastic reduction of economic activities. The most severely affected economic sectors in which turnover decreased overnight are the services sector (tertiary sector), especially in the area of: tourism, trade, transport, education, etc.

There has been a drastic reduction in industrial production as well, due to shocks from the demand side, but also from shocks on the supply side where, for preventive health reasons, production was terminated for a period of time. All of this not only led to education in economic activity, but also contributed to the disruption of global and regional flows of trade, production and exchange of raw materials.

In conditions of great uncertainty on the world stage, the aversion to risk of investors in the financial markets escalated significantly, which led to a sharp movement of capital, changing its global trends in two respects:

- a) Geographical: a trend of withdrawal of capital from developing countries towards the “safe haven” countries, which are the highly developed countries. FDIs, according to UNCTAD, will drop by 40 percent compared to their 2019 level.
- b) Changing the type of investing of financial instruments, whereby investors started investing in long-term state securities at an increased pace, believing them to be the best protector of value in such turbulent times.

Such capital movements were accompanied by lower interest rates of the world’s key central banks as an incentive to the economy. At the same time, due to increased aversion to risk and mistrust of markets and prospects for economic growth by investors, there has been a steep drop of prices of securities and on world stock markets. The trend of negative returns on long-term securities has deepened even further, reducing thus the central and local government funding to almost historical lows.

This global recession, which is expected to be the second deepest in highly developed countries after the Great Depression in the 1930s, will also severely hit the developing countries. Developing countries, including North Macedonia, will be affected not only by the collapse of domestic supply and demand, but also by the rapid decline in external demand (export) and significantly limited access to external financing of the private sector.

The biggest challenge worldwide will be to maintain liquidity of financial systems at an appropriate level, which will require coordinated action by the leading and local central banks. At this stage, in the short term, private and public sector debt is not the focus of macroeconomic policies. In the long run, this will be a serious challenge to the sustainability of economic growth.

3.3.2. Economic challenges of North Macedonia in conditions of covid-19

The Macedonian economy reflects the same problems that all the other small and open developing economies will face. The trend of moderate economic growth from the past few years will be interrupted. In conditions of fixed foreign exchange rate, fiscal policy will be the main instrument that can be actively used to mitigate the economic downturn.

Moreover, as a result of reduced production, activities in the service sector, rising unemployment, but also the drastic decline in private transfers from abroad that financially supported Macedonian families (in the January - August 2020 period, private transfers from abroad reduced by one half compared

to the same period last year), there is a serious danger of social inequalities on a larger scale. All this will affect the reduction of quality of life, coupled by the possibility for a significant increase in inequality.

On the other hand, fiscal policies also experience serious problems. There is a drastic decline in public revenues due to the above reasons, that is, there is a reduction of direct and indirect tax revenues, while public expenditures are expected to deepen significantly. All this will lead to even deeper budget deficit (estimates range from 5.5 to 9 percent) which, in conditions of stimulative fiscal policy, could reach a larger scale and disrupt the fiscal stability and sustainability of public debt. These problems will be even more pronounced given the fact that there was not enough time to recover the fiscal position from the previous two crises. Consequently, there was not enough time to implement appropriate reforms that would strengthen the principles of operation on the revenue and expenditure side.

3.3.2.1. Short-term measures

The short-term and medium-term solutions will depend on the duration of this pandemic crisis in the world, but also on the need that our economy restructures itself at a more accelerated pace, and positions itself closer to the levels of development and living standards of the EU.

There are multiple scenarios for this:

Short-term scenario – the crisis will last until June 2020, after which the world economies will start opening gradually and recovering to normal flows. The economic crisis would be “V” – shaped. This scenario, which dominated at the outset of the crisis, proved to be unrealistic (World Bank, GEP Report, 2020).

Nowadays we are increasingly speaking of a scenario in which the pandemic will be strong in intensity until the end of the first quarter of 2021, and the economic crisis will be in the swoosh shape –like the “Nike” logo.

Unfortunately, an increasing number of economists and entrepreneurs caution about the long-term presence of the pandemic and do not rule out an economic crisis in the shape of a “W”.

The crisis caused by the pandemic seeks rapid and efficient reaction from fiscal authorities, which should not include complex activities which necessitate legislative amendments that require broader consultations with the affected economic stakeholders.

The only quick and effective tool available to the fiscal policy is to increase discretionary public spending,

especially in the social sphere, which would mitigate the effects of the crisis. At the same time, this entails increased health expenditures in medical staff, medications and equipment caused by the pandemic. There will be also increased medical expenses for the non-infected persons, including the chronically ill, due to their inability to receive health care at all times out of fear from the pandemic (absenteeism) on the one hand, but also due to the overloaded health facilities which are unable to provide some of their regular medical health services.

The fiscal interventions have two main components: a) sustaining the living standard of the population by supporting their income and b) supporting companies. The support to the companies is multidimensional and segmented according to the size of companies. It usually includes four components: deferral of payment of taxes and contributions; direct credit support from the state; guarantee schemes – full or partial guarantee of borrowing from banks; providing recapitalization of companies through public support in the form of capital or hybrid capital instruments.

In such a scenario, a significant deepening of the budget deficit and an increase in public debt is the inevitable outcome. When financing the budget deficit, great care must be taken not to further disrupt the liquidity in the economy, which is already very fragile. Great care must also be taken not to crowd out funding from the banking sector, earmarked to finance the private sector which is already “on thin ice”, and is facing limited (or completely shut) conditions for its external financing.

In such conditions, there are two options for funding the budget deficit, which are:

- a) domestic funding through short-term and long-term securities;
- b) external borrowing from international development institutions and through commercial borrowing (short-term loans from commercial financial institutions and/or long-term borrowing through the issuance of an Eurobond).

The consequences on fiscal policies and the national economy in the mid-term will vary, depending on the different types of borrowing. For example, the excessive short-term borrowing in the country and abroad will help bridge the budget deficit in the short term, but will cause problems in the medium and long term.

Viewed from the short-term perspective, budget interventions will have to be financed through medium and long-term borrowing from international financial institutions, and from private international financial markets through the issuance of Eurobond. This will help import additional foreign savings, avoid crowding out the access to funding for the private

sector and will help maintain foreign exchange rate stability through the inflow of foreign currency from abroad. Borrowing of assets from the domestic financial market should be limited. Thereby, the debt level of the central state government in the next 2 – 3 years must not exceed 65 – 70 percent of GDP (the debt level of highly developed countries is expected to reach 139 percent of GDP).

3.3.2.2. Long-term measures

In the long term, avoiding excessive public debt will require the following options to be considered:

- Restructuring of debt after the Covid-19 crisis, in the sense of longer-term borrowing and giving preference to borrowing from international financial institutions, where conditions are more favourable in terms of maturity dates and interest rates;
- Finalising the privatization of residual parts of enterprises that have already been privatized and privatization of the public enterprises which do not have a monopoly position in the activity and do not represent a public good of relevance for the state;
- Public-private partnership in the field of development of some infrastructure facilities for which the state cannot provide sufficient funds to invest (gasification, power facilities, railway transport, “green energy”, especially in the decentralized energy production, energy efficiency, etc.) based on the experience of EU countries. Strengthening the institutional capacity of the state will be of extreme importance for the formation of public-private partnerships in order to enable their smooth market functioning.
- Efficient use of IPARD funds and of funds from the announced plan of the European Commission for economic recovery and investments for the Western Balkan countries, for the 2021 – 2027 period. These funds should help finance the transport infrastructure in the region (roads, railways, telecommunications), gas and oil pipeline networks, production of “green energy” and increase of energy efficiency. In addition, private sector financing is expected to be facilitated through EIB and EIF guarantee schemes. These activities should significantly invigorate and permanently increase the potential growth of North Macedonia and the Balkans. (European Commission, 2020).

3.4. STRUCTURAL REFORMS AND CHANGING THE GROWTH MODEL

The Macedonian economy will have to permanently increase its growth potential through structural reforms and efficient use of production factors, thus vitalizing growth and accelerating convergence with the EU. A key element for this will be increasing total factor productivity and especially increasing labour

productivity. The only way to achieve this is through technological development, development of know-how, automation and improvement of the business climate in the country.

The Covid-19 crisis will accelerate the economic trends that started after the great economic crisis of 2008/2012. Initially, after 2007, the intensity of trade exchange through global value chains decreased for almost all products. Secondly, services experienced mass expansion in global value chains. Third, the exchange based on labour cost arbitrage is declining within the global value chains. Fourth, the global value chains are increasingly basing their growth on knowledge, research and development. Fifth, value chains are increasingly losing their global character and are becoming regional or national value chains (McKinsey Global Institute, 2019).

The pandemic will greatly incentivize the automation and introduction of artificial intelligence in work processes, which, in addition to other benefits, will make production less vulnerable to similar shocks in the future. Economies will create new jobs that will require new skills and education. It is estimated that presently every 5/6 jobs will be closed by 2030 in highly developed countries. The most affected jobs will be the manual and labour-intensive industries: machine installation and repair, utilities, food services, manufacturing, process support jobs and office work. However, increase in unemployment is not expected. At the same time, demand will increase in the creative professions, professions based on knowledge and research: health workers, professions in wellness centres, sports and recreation, designers and arts, business and legal professions, managers, education and training, customer service and sales, maintenance of real estate and agriculture, and transport services.

North Macedonia, which bases its growth on the labour-intensive growth model, will be strongly affected by these tendencies. According to estimates, every fifth workplace which exists at present will be closed. North Macedonia is late with the transformation of its growth model and the automation, digitalization and introduction of artificial intelligence in the economy. This will also be a challenge for the rapid transformation of the growth model and its transformation into a model based on knowledge, research and development.

The new development model should take into account the current conditions in the country, i.e.: the infrastructural development, geographical location, regional surrounding, availability of production factors, institutional and financial development, available technology and accumulated knowledge. The growth model should, in fact, be based on a combination of import of exogenous growth factors (technology), but at the same time it should strive to develop the domestic

growth factors (endogenous growth model). Thus, in the long run, exogenous growth factors are expected to be completely replaced by the development of endogenous growth factors. Other factors to be taken into consideration are the latest global developments that have changed with the outbreak of the pandemic and that will cause changes to production relations and trade flows. According to latest analyses, there will be a serious shift in the so-called global value chains as well as increased domination of regional value chains and platforms.

In conditions of disturbed global value chains, North Macedonia needs to adjust and find its proper place in the world trade according to its own advantages. Therefore, the Macedonian economy should make every effort to start gradually climbing up the ladder of global value chains by using its resources, knowledge and technology (World Bank, GVC report, 2017). In our opinion, this can be achieved by seeking so-called alternative export markets that have lower specialization levels and would be more in harmony with our degree of specialization in production. The excessive focus on export to highly specialized markets in the European Union did not bear the desired effects because the quality and specialization of our production is still not ready and is not appropriate.

The only way to encourage this is through more active inclusion of national production in the so-called regional value chains (World Bank, GVC report, 2017). Domestic local producers who are at a relatively similar level of specialization and technological development with local producers from neighbouring countries can establish production and trade links to standardize and consolidate production and to gradually find placement in larger and more specialized markets in the European Union. This manner of regional association in production will facilitate regional infrastructural connection in transport, easier mobility of labour and expertise, but also harmonisation of legislation. At the same time, states can further foster local connections by harmonising trade, labour, and labour market regulations through the liberalization of work permits and social security contributions.

Another important factor which the growth model of North Macedonia should focus on is the improvement of conditions for doing business in practice, i.e. to adjust and facilitate legislation and to strengthen its implementation. This way, the domestic (endogenous) growth factors will be encouraged and should be built on a sustainable basis. This will also stimulate small businesses and entrepreneurs who have ideas for creating new innovative products and services that should be one of the important drivers of economic activity.

In terms of rapid growth recovery, it is important to consider the type of manufacturing activity. Empirical experiences show that industrial production has

the largest multiplier, that is, it renders the most direct and indirect links in production by including the largest number of complementary activities compared to the primary and tertiary production sector (World Bank, 2019). At the same time, the industry is hiring the largest number of labour force through direct and indirect production activities, compared to others. Therefore, a relevant analysis should be conducted as to the industrial sectors in which the production multipliers are largest, and we need to incentivise production and technological development precisely in these sectors.

In this field, we need to take advantage of the initiative of the EU and Germany for developing an integrated market of the countries in the Western Balkans. This is a good opportunity to build and develop a regional value chain.

Parallel to this, a national platform of value chains should be built between large and small companies. Large companies should conduct product research and development, while small companies should become part of the production and export chain of complex products. In doing so, large companies would be the ones designing the products, processes, design, brand, and doing the product promotion.

The Israeli model of incentivising should be used to stimulate research and development of new products and processes. The state should support all research and development, regardless of whether it is performed at the company, institute or research centre level, so long as it concludes that the economic entity has adequate staff and has provided 50 percent of the funds for research and development. The difference would be supplemented from the budget in the form of grants, and the achieved effects of research and development would be shared in the same ratio between the private economic entities and the state.

CONCLUSION

The shock brought about by the Covid-19 pandemic has caused the Macedonian economy to face the greatest challenges ever since its independence in the short, medium and long term. Such challenges in fact not only reflect the health and economic effects of the pandemic, but also reflect the long-term structural problems of the economy and growth which have existed for decades back.

In the medium and short term, the economy will be faced with managing all crisis-related expenditures and financing the budget deficit in an efficient and timely manner. In light of this, the fiscal authorities need to responsibly identify the right mixture of funding from domestic and foreign sources, without jeopardizing the sustainability of the public debt in the long run.

In the long run, this crisis is a serious challenge for the whole society, so it should seriously reconsider the future path of growth and development of the country. We propose that there be a wider debate and analysis. The current growth model has failed to give the expected results and is quite vulnerable to various shocks of domestic and external nature. Moreover, the current model does not allow for economic convergence to the EU in a certain optimal period of time. The model, which was labour-intensive and based on FDI inflows, needs to be seriously changed in the following directions:

Development of domestic factors which will stimulate productivity growth, that is, the creation of conditions for the development of new technology and knowledge by improving the business climate, stimulating research and development and supporting domestic entrepreneurship.

Discovering alternative export markets by involving domestic producers in the so-called regional production chains and their further integration into the global production and trade chains.

Stimulating the processes of corporate restructuring of the successful enterprises by enabling their accessibility on the capital markets and better conditions for their further growth. This will encourage their further consolidation and bigger competitiveness in a market manner.

Finally, it should be noted that the recommendations presented in this analysis should be considered as the basis for initiating broader scientific debate by experts in the country, including economic policy makers. Support in finding solutions out of the crisis and setting the economy on the path of long-term sustainable growth by the creators of macro- and micro- policies in the country will be of crucial value, due to the necessary legal regulatory changes and adjustments of the fiscal policy course from the revenue and especially from the expenditure side.

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4

PUBLIC FINANCE AND FISCAL POLICY IN THE MEDIUM TERM

NIKOLA POPOVSKI, BRANIMIR JOVANOVIĆ AND DRAGAN TEVDOVSKI

4.1. THE IMPORTANCE OF PUBLIC FINANCE AND FISCAL POLICY FOR THE ECONOMY AND THE STATE

The significance of the public finance system (PF) for the functioning of the national economy, the state and the society as a whole is tremendous. It is directly correlated with the traditional, but also with the modern, goals and functions that this system provides. The classical conceptions of the public finance system are primarily aimed at securing its allocative function that aims to provide the economy and society with goods (commodities and services) that the market mechanism cannot provide adequately or cannot provide at all due to its imperfection, which is the well-known characteristic of market failure. Very similar to them are problems with the existence of externalities in the economy to which public finance offer appropriate solutions for neutralizing. Today, based on the modern conceptions of public finance systems, they systematically incorporate also the important functions of the secondary redistribution of the primary, i.e. market distribution of incomes in the economy; the stabilization function which is aimed at using the PF system to maintain the dynamic macroeconomic balance; and increasingly also their development function that should provide optimization of the growth rate of the economy and its more dynamic development.

From this point of view, public finances in North Macedonia are systematically modern and well placed and incorporate all the necessary goals and functions. They rely on modern principles and measures of securing public revenues and their spending in the form of public expenditures, which is the essence of fiscal policy. The system is basically aimed at providing a wide range of public goods, although in some sectors they are insufficient (education, health, material infrastructure, etc.), while in others (administrative services, internal security, certain types of social protection, etc.) they are even excessive. Externalities correction mechanisms are provided, although this feature is not sufficiently developed, as evidenced by the numerous

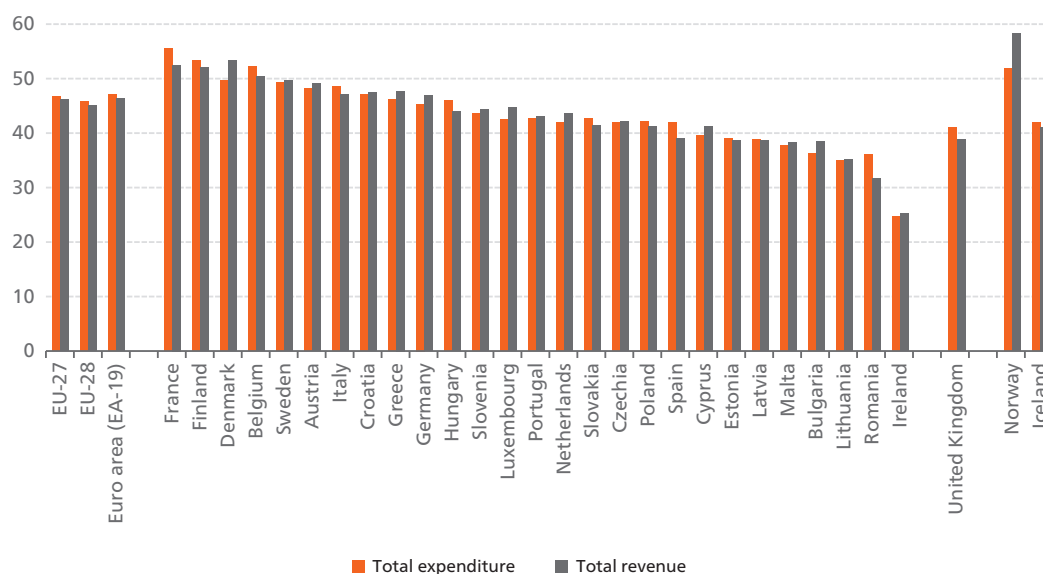
shortfalls in this area, such as air pollution. The redistributive function is less efficient, corroborated by the fact that the social and regional inequalities in the final distribution of income are highly pronounced. The stabilizing function for maintaining the low level of inflation and the fixed exchange rate of the denar is successfully implemented in correlation with the monetary authorities and policy creators, although most often with difficult adjustments by the fiscal policy. The growth and development function is failing, as evidenced by the low rates of economic growth and the generally low level of social development.

The PF system is based on well elaborated and complex tax pluralism, with dominant features of non-distortedness. The structure of public income, to its most part, is based on the introduced taxes and social contributions where consumption taxes dominate (VAT, excise and customs dues), followed by social security contributions (mainly pension and health care), income taxes (corporate revenue tax and personal income tax), as well as the property taxes (property tax, real estate sales tax, and inheritance and gift tax).

Total public revenues in the country are relatively low, and do not even amount to 30 percent of the country's GDP, whereas total public expenditures are a little over 30 percent of GDP. These figures are one of the lowest in Europe. For the sake of comparison, in the EU, the total public revenues and expenditures are over 45 percent of the GDP (Chart 4.1).

Hence we can conclude that the PF system in the country is well positioned and corresponds to modern systems in the world. The structure and types of taxes are standard for the global and market economy of the present day. The system, however, fails in certain segments, which is reflected in the low and insufficient volume of public revenues and expenditures needed by the economy and society, the existing imbalance in the delivery of certain types of public goods and the limited level of income redistribution.

Chart 4.1
Total general government revenue and expenditure in the EU in 2019 (% of GDP)



Government revenue and expenditure, 2019 (% of GDP)
Source: (Eurostat)

4.2. MORE PUBLIC INVESTMENTS, ESPECIALLY IN EDUCATION, HEALTH CARE, SOCIAL CARE AND ENVIRONMENTAL PROTECTION

Although in public debates we can often hear that the budget of our country is large, this is not true at all. The total budget expenditures of our general government in the recent years amount to 30-31 percent of GDP, which is among the lowest in Europe. For comparison, in 2018, in Serbia they accounted for 41 percent of GDP, in Croatia 46 percent, in Denmark 51 percent and in France 56 percent.

Expenditures have a continuous downward trend in the last 20 years (Chart 4.2). At the end of 1990s they were constantly over 32 percent of GDP, then in 2001–2002 they grew to 37 – 38 percent of GDP (due to the 2001 conflict), and then continuously decrease from year to year.

It is not just that our general government expenditures are relatively low, but their structure is also unfavourable. Most of the budget expenditures are for pensions, as high as 30 percent, and the part for social protection (without pension) is only 3.4 percent of the budget. Health accounts for 14 percent of the budget, and education for 10 percent (Chart 4.3).

Compared to other European countries, public investments in education, health and social care (without the pensions) in our country are among the lowest, which further leads to the bad quality of these public services, to the poor results in education according to international rankings, to poor health care and to ine-

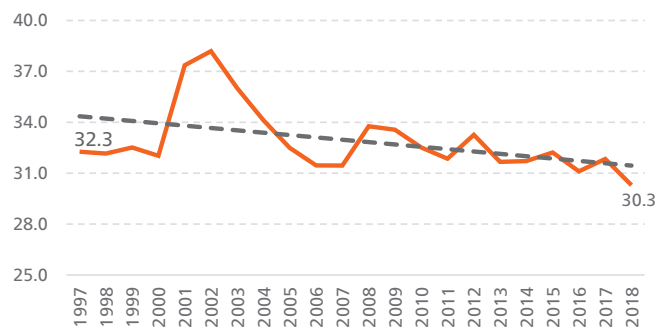
quality in education. On the other hand, expenditures for pensions and public order and safety are among the highest in Europe.

However, problems do not only pertain to the amount and structure of expenditures. The quality of the expenditures is also problematic in different segments. According to World Bank estimates, as much as 13 percent of budget expenditures could be saved, that is, the same quality of public services could be delivered with 13 percent lower expenditures (World Bank, 2015). Of course this percentage can never be reduced to zero, but there is still room for improvement in our country.

A similar problem is the poor execution of the state budget. In 2018, the budget realisation was 95 percent of the initial budget, with the realisation being particularly weak in the capital expenditures which only amounted to 50 percent in 2018 (Chart 4.4). This is not an isolated phenomenon that refers only to this year, but is a general condition that has been present for the past 10 years. The average rate of realisation of capital expenditures in the period 2009 – 2018 is 71 percent on average; one year it was even below 50 percent; it was never over 90 percent; and in only 2 years it was above 80 percent.

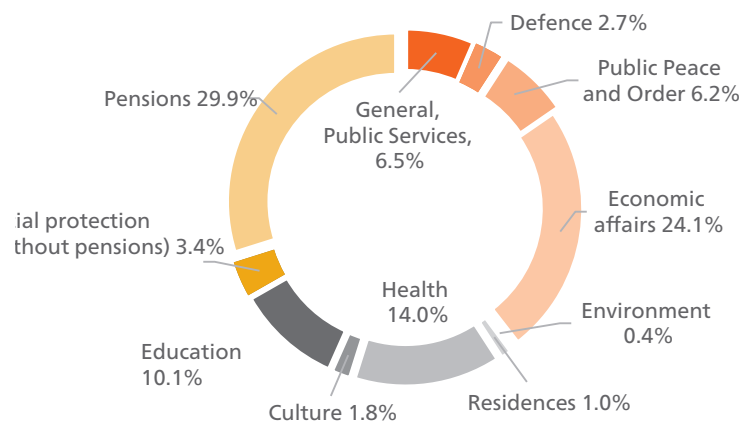
The reasons for the weak realisation of capital expenditures are manifold. On the one hand, there is the tendency for unrealistic projecting of high amounts due to political marketing, while on the other hand, we have weak planning, weak management of state institutions, and the weak project implementation knowledge of the employees in state institutions.

Chart 4.2
Total expenditures of the general government of North Macedonia (% of GDP)



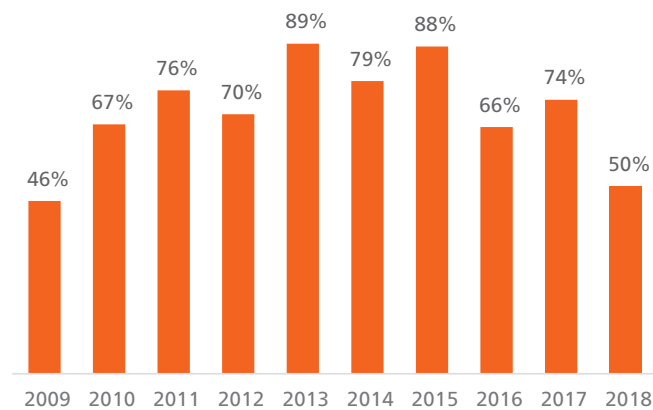
Source: International Monetary Fund, World Economic Outlook Database, October 2019

CHART 4.3
STRUCTURE OF BUDGET EXPENDITURES IN 2018



Source: Ministry of Finance, Budget Final Account for 2018

Chart 4.4
Realisation of state capital expenditures (% of initially announced)



Source: Budget of RM and Budget Final Accounts of RM

RECOMMENDATIONS:

1. To increase public spending in the country, as a percentage of GDP. The current level of 30 to 31 percent of GDP is very low--among the lowest in Europe--and does not provide sufficient funds for high-quality public services.
2. The increase of expenditures should be focused on the segments that are the worst in the country and where investments are lowest, such as social protection, education, health and environmental protection. The share of pensions and public order and safety is relatively high and should not increase significantly. The increase of expenditures should be visible especially in the area of capital expenditures, above all in the so-called "green growth".
3. In parallel with the increase of expenditures, their efficiency must be improved, as well as the level of realisation of budgets. This is closely related to the quality of state institutions, and therefore the need for reforms in this area must be emphasized again. In addition to the reform of state institutions, there is a need for accountability of public officials who act irresponsibly with public finance, that is, who have a high degree of cost inefficiency or a low degree of realisation. This can be achieved by stipulating a clause in the Ethical Code of Civil Servants, according to which officials with low expenditure efficiency or poor performances will have to resign or explain to the Government or Parliament why they have been inefficient or did not enact their budgets.

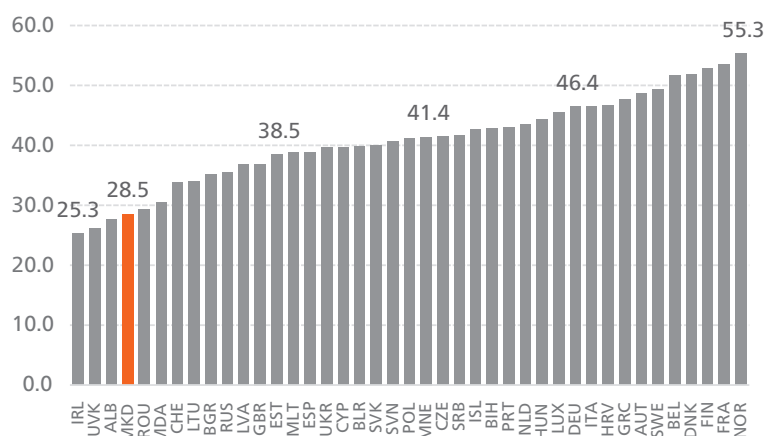
4.3. SERIOUS TAX REFORM FOR HIGHER REVENUES AND LOWER INEQUALITY

Budget revenues in North Macedonia, just like expenditures, are among the lowest in Europe, and are continually on the decline. In 2018, revenues of the general government amounted to 28.5 percent of GDP, which is the fourth lowest level in Europe (Chart 4.5). This is a significant drop compared to the level from 15-20 years ago. In the years 2003 and 2004, for instance, revenues amounted to around 35 percent of GDP.

Besides the low level of revenues, the structure of expenditures is also unfavourable. Social security contributions and indirect taxes (VAT and excise) dominate, and both of them are regressive (chart 4.6). Contributions are regressive because of the ceiling on the amount of contributions that a person can pay, which makes the persons with the highest incomes pay lower contributions, relative to their income. For example, a person making 250,000 EUR a month pays contributions amounting to around 1 percent of income, while a person making 250 EUR a month pays contributions of around 28 percent of the income. The VAT is regressive because its amount is nominally (in denars) the same, both for persons with higher and lower income, but it is higher for the latter group when expressed as a percentage of their income.

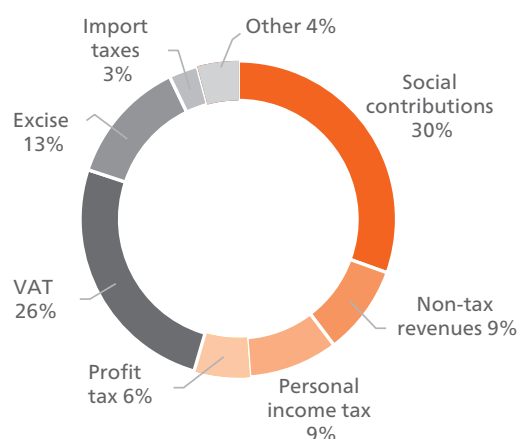
The remaining two important taxes, personal income tax and corporate income tax, are proportional, that is, they are flat – the rate is 10 percent, regardless of the income amount.

Chart 4.5
Revenues from the general government in the European countries in 2018 (% of GDP)



Source: International Monetary Fund, World Economic Outlook Database, Oct. 2019

CHART 4.6
STRUCTURE OF BUDGET INCOME IN 2019



Source: Ministry of Finance

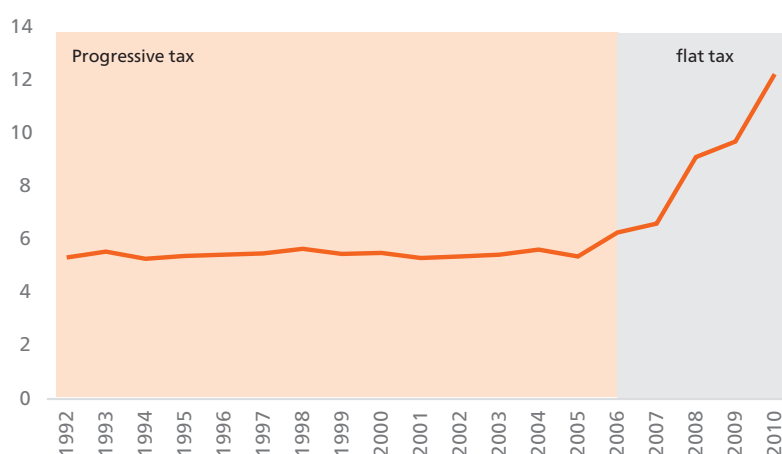
Such a taxation system breeds inequality, the reasons being twofold. The first is that it fails to prevent social disparities from escalating, meaning it fails to impose higher taxes on those who earn more. The second reason is that it fails to provide enough revenues for the state, which prevents it from providing higher quality social protection, which deteriorates the income of those who earn less. As a result, inequality in the country began increasing to drastic proportions following the introduction of the flat tax in 2007 (Chart 4.7). The share of the top 1 percent of the population in the total income before the introduction of the flat tax was around 5 - 6 percent, and after that it began growing dramatically, reaching 12 percent in just a few years, by 2010. According to the latest available data from the Ministry of Finance, in 2017 this share reached 14.4 percent, and was the highest in Europe, compared to countries for which such data exist (Ministry of Finance, 2018). The Gini coefficient, according to the same data, in 2017 was 44 percent, which is also extremely high: much higher than the Gini coefficient from the State Statistical Office, which was 32.5 percent in 2017. It is important to understand that the difference between the Gini coefficient according to the Ministry of Finance and the State Statistical Office occurs due to the different data on which they are calculated. The State Statistical Office calculates the Gini coefficient from a survey that excludes those earning the most, while the data of the Ministry of Finance are generated from administrative data of the Public Revenue Office that include all official revenues in the country, i.e. they also include the most profitable individuals. Hence, data from the Ministry of Finance are more relevant and reliable for assessing inequality.

It is important to point out, at the same time, that the main arguments put forward in defence of the flat tax - that it reduces the shadow economy, encourages investments, increases economic growth and increases employment - are not supported at all. According to a study by Jovanović (2020), the flat tax in Eastern European countries only increased inequality and reduced budget revenues, and had no effect on the shadow economy, investments, GDP and employment.

In light of the above, we need a tax reform that will secure higher government revenues, without causing, at the same time, detrimental effects on the social cohesion, which means that in parallel to the growth of revenue it will also provide reduction of inequality. In other words, the progressive tax has to be reinstated.

Criticisms usually addressed against the progressive tax are that it will drive high-income earners away, that it will force companies to move to other countries, that it will reduce investments, or lead to mass layoffs. These criticisms are unsubstantiated and unsupported by the data. First of all, many Eastern European countries have already abandoned the flat tax (Czech Republic, Slovakia, Montenegro, Albania, Latvia) without suffering any harmful effects. On the contrary, the economic results of these countries after abandoning the flat tax are much better than before (Ministry of Finance, 2018). Moreover, our experience with the return of the progressive tax in 2019 has shown that none of these criticisms is substantiated. After the return of the progressive tax in 2019, employment increased, wages continued to rise, even in the highest paid sectors such as information technology, budget revenues grew more than expected, and

Chart 4.7
Share of the most profitable 1% in the total revenue of the state (%)



Standardized World Income Inequality Database, version 4

economic activity accelerated (Ministry of Finance, 2019). This does not mean that one should not be cautious and that the progressive tax cannot harm the economy if the change is too big, but if it is moderate, as it was in our case in 2019 and in the other Eastern European countries in the past years, there is no reason to fear.

RECOMMENDATIONS:

1. Progressive personal income tax has to be reinstated in the shortest period possible, whereby the tax would have at least 3 rates and would capture at least 2 percent of the persons with the highest income in the country. The focus has to be placed in particular on the top incomes, which would be taxed with a higher rate.
2. To abolish or to significantly raise the ceiling for the contributions, so that they are not regressive. The abolition would cover people with monthly salaries higher than 10.000 EUR (16 average gross salaries), and the income that would be generated would be substantial - over 10 million EUR per year. In parallel, a slight increase of the upper limit of the maximum pension can be considered.
3. To introduce progression on all property taxes - property tax, real estate sales tax, and inheritance and gift tax. Current rates are among the lowest in Europe. Because these revenues are paid to the municipalities, they would be used for local needs. At the same time, the large disproportion between property tax rates and real estate sales taxes should be reduced.
4. Seriously consider introducing a progressive corporate income tax for companies with the highest profits. One possibility is to cover companies with a profit of over 1 million EUR, which would affect about 200 companies in the country. Although this does not concern many companies, the additional revenue from this could be significant, with the benefit being even more striking than the progressive personal income tax, as the profits of these firms are quite high. Progressive profit tax is currently in place in Belgium, France, Germany, Greece, Spain, Hungary, Portugal, and Norway.
5. Direct taxes should remain sectorally neutral, meaning that there should be no lower tax rates introduced for certain sectors. If support to certain sectors is needed, this should be done within the framework of an industrial strategy, and not through taxes.
6. Taxes on polluters should be increased, such as the excise on diesel fuel; excise on coal should be introduced, and there should be gradual introduction of the ETS (Emissions Trading System) system of the EU.
7. The VAT rates should not be changed, except perhaps for certain products.
8. Slowly start abandoning the practice of offering tax exemptions to foreign investors. In order to achieve this without "chasing" investors to other countries, regional cooperation should be initiated for a coordinated tax policy. This would avoid the "race to the bottom", that is, the tendency of the Western Balkan countries to compete with each other with lower taxes and tax exemptions and thus to deprive themselves of state revenues.

9. To follow and quickly accept European and world practices related to some new taxes and practices, such as digital taxation, tax on non-recycled plastics, tax on financial transactions, wealth tax, etc.
10. To audit various utility and administrative fees, as well as other similar public duties that are publicly referred to as “para-fiscal” fees, in order to assess whether some of them should be eliminated or reduced.
11. All these changes need to be made as part of a comprehensive state tax strategy, which will be long-term and widely supported, that is, it will refer to a period of at least 10 years and will not depend on the personal will of individuals, but will be a strategic commitment of the country, such as, for example, the commitment for EU accession.

4.4. STRATEGY FOR THE PUBLIC DEBT AND THE DEFICIT

Contemporary fiscal policy is based on the premise that the budget deficit does not have to be balanced in the short and medium term and that it is more important to have macroeconomic balance than fiscal balance. The existence of business cycles drives the actors of fiscal and monetary policy to seek an exit and to act in an anti-cyclical fashion when necessary. One of the most commonly used fiscal instruments is the creation of budget imbalances, most commonly deficits, by approving lending to the state by the private sector, and as a consequence of that, the generation of a public debt.

These budget imbalances were particularly used during the financial crisis and recession of 2008 and 2009, and today they are used to combat the effects of the pandemic. However, the effects have proven to be modest. The EU, for example, opted for an “unprecedented monetary stimulus, that included a record-high 10 percent of GDP in various fiscal stimulus programmes. None of it has prevented the economy from showing signs of slowing down” (Lacale D, 2020). The GDP of the Eurozone, for example, in Q2/2020 decreased by a record 15 percent compared to Q2/2019. Many other economies have taken combined measures for “spending increases and tax reductions – to support their economies” (J. Honda and H. Miyamoto, 2020). In such conditions, the importance of fiscal policy has even increased, because monetary policy is limited by the existence of interest rates of close to zero percent.

The creation of budget deficits and public debt in North Macedonia is of a more recent date. We entered the transition with a relatively low level of public debt. Their intensive accumulation began in the last two decades through their use in conducting anti-cyclical fiscal

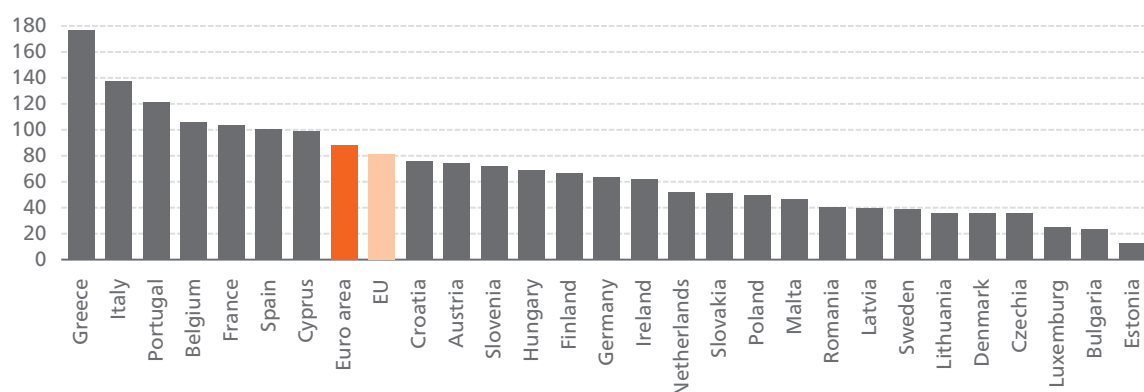
policy, but also for political and electoral needs. High deficits were created during and after the armed conflict (2001–2002) when the deficits were 5.9 percent and 5.2 percent respectively and during the 2012–2015 period, when they reached the annual level of 3.5 percent to 4.2 percent without any particular need. Due to the Covid-19 pandemic in 2020, the deficit may exceed 8% of GDP. In the other years, the deficits were moderate, and in 2005 and 2007 there was a moderate budget surplus of 0.2 percent and 0.6 percent. Such movements have raised North Macedonia’s public debt from around 25.8 percent of GDP in 2007 to 48.9 percent in 2019, with justified concern that the current state of the public debt of 59.5 percent noted in September 2020 (www.finance.gov.mk and www.nbrm.mk) will persist in the future. Some researches show that fiscal impetuses in economies with younger populations has a significant positive effect on growth, while the effect is much weaker in economies with older populations (J. Honda and H. Miyamoto, 2020), but North Macedonia did not benefit from this much either.

The present level of public debt has reached the very ceiling in the category of highly indebted countries (PD > 60 percent of GDP) with the threat of no longer being able to return to the previous category of moderately indebted countries. For clarification’s sake, in the EU also this ceiling of 60 percent of GDP is considered the highest allowed, although most Eurozone members exceeded it by far back in the time when they were coping with the consequences of the financial and economic crisis of 2008–2009 and especially with the new deficits caused by the pandemic on the economies. The current level of public debt of EU-27 is 79.5 percent, and of the Eurozone is 86.3 percent (Q1/2020 – Chart 4.8) (Eurostat, 2020).

The structure of debt of North Macedonia is unfavourable. Its funding requires relatively large and growing funds from the Budget. In 2019, for example, a total of 145.4 million EUR were paid out only for interest, which is 1.29 percent of GDP, whereas in 2018 the total of 135.3 million EUR or 1.26 percent of the GDP was paid out. (Ministry of Finance, 2020, page 14).

By the end of 2019 conclusively, within the structure of the public debt, the external public debt reached 66.9 percent, and the domestic reached 33.1 percent (table 4.1). According to the interest rate structure, 76.2 percent is with fixed interest rate, and 23.8 percent is with a variable interest rate. The debt is mostly “euroized”, so 71.3 percent of the debt is in EUR, 23.2 percent is in MKD, and the rest is in other currencies (4.4 percent in SDR). According to its maturity, in 2019 the average time to maturity of the debt is 5.36 years (external 3.97, and internal 7.51 years). Private creditors hold 66.9 percent of the country’s external debt.

Chart 4.8
Public debt in the EU - 27 (Q1/2020, as % of GDP)



Source: (Eurostat)

Table 4.1
Situation with the public debt of North Macedonia, 2019

(EUR million)	2013	2014	2015	2016	2017	2018	2019
General government debt	2.771,6	3.262,5	3.453,3	3.851,5	3.958,5	4.344,4	4.556,8
Guaranteed public debt	509,8	658,9	774,0	859,9	828,4	857,7	942,2
Non-guaranteed public debt	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total public debt*	3.281,4	3.921,3	4.227,2	4.771,4	4.786,9	5.202,2	5.540,9
External public debt	2.078,7	2.725,1	2.847,5	3.286,0	3.187,5	3.537,8	3.709,3
Domestic public debt	1.202,7	1.196,2	1.379,7	1.425,4	1.599,4	1.664,4	1.831,6
Total public debt as a % of GDP	40,3%	45,8%	46,6%	48,8%	47,7%	48,6%	48,9%

*) As of 2018, the total public debt is the sum of the general government and guaranteed debt. In 2019 (since Q2) the public debt also included non-guaranteed debt of PE and SC established by the state and the municipalities
Source: Ministry of Finance and National Bank of RNM

The situation with the deficit levels and the public debt in North Macedonia is not critical, but the trend is worrisome. General government deficits have become significant and, more importantly, they are already structural. They are not only used as a countercyclical measure, but also serve to make up for the difference between lower levels of public revenue and the increasing need for public spending. The modern state and fiscal interventionism that has intensified in the world in the last decade is only an additional justification for that. As a consequence, given the relatively low growth rates of the economy, the public debt is in a phase of growth that has no end in sight.

For these reasons, the country must face in the future a much more robust and predictable policy of deficits and levels of public debt, including here the introduction of a set of statutory and other rules, above all quantitative, which will be applied – so called “fiscal rules” especially because the monetary policy of

fixed exchange rate will have to persist in the longer run, so the fiscal one would have to bear a larger part of the burden for maintaining the denar exchange rate. The fiscal rules ought to disable the creation of high budget deficits and uncontrolled growth of the public debt. Part of them can be qualitative, but most of them are quantitative. Those of the EU² are some of the most widely known.

The fiscal rules, perceived as numerical constraints on fiscal performances, are “a constant constraint on fiscal policy through simple numerical limits on budget aggregates” (Kopits and Symanski, 1998,

² Introduced by the Maastricht Agreement in 1992, and the Stability and Growth Pact from 1997, they have been limiting the deficit at an annual level of 3% of GDP and of the public debt at the level of 60% of GDP. With the audit of 2005 and the introduction of mid-term budget strategies, a flexibility of -1% to +2% of GDP has been ensured, if structural adjustments are to be implemented.

p. 162). With them, authorities should commit to fiscal sustainability in the medium and long term and to reduce the uncertainty of fiscal policy through institutional constraints. They are used nowadays in the world with increasing frequency, in order to limit discretion in conducting fiscal policy and to control the so-called “fiscal alchemy underlying the capricious fiscal policies” (Leeper, 2011). The fiscal rules are not a complete guarantee that policymakers would not be able to make discretionary decisions, but yet they limit the space for discretion and short-sightedness of policy makers.

At this development stage, North Macedonia needs to introduce fiscal rules that will ensure the sustainability of public finance and will improve performance of the economy by channelling fiscal policy as a whole, and helping stabilize the economy, thus allowing the economic stakeholders to optimize their behaviour (Andritzky, 2011). Some of them could be aimed at limiting the deficit or the primary deficit and the public debt, except in precisely stipulated cases; linking the deficit to the level of the projected growth rate of the economy, or the level of public investments; activating additional restrictions if the interest payments exceed a certain level of GDP (for example 2 percent), etc. In doing so, fiscal rules should not be too strict and should leave room for conducting autonomous fiscal policy focused on the established goals.

Implementation and adherence to the rules would be ensured by law, and a special advisory and low level executive body should be established, tasked with monitoring the situation and proposing solutions. That body would be a kind of a “fiscal council” with a mandate to make assessments and to monitor the implementation of fiscal policy (Kumar M., 2009). According to an IMF study (Beetsma & others, 2018, pp. 6-8) there are 39 independent councils in the world, of which 2/3 have been established after 2008, and 2/3 of them are in Europe. Fiscal rules are needed to set limits for politicians not to pursue their own short-term interests and instead to take into account state interests, while also facilitating the pursuit of countercyclical fiscal policy. The fiscal council, comprised of several quality economists, should monitor the implementation of fiscal rules and provide opinions on the conduct of fiscal policy.

One of the ways to harness the growing public debt in the economy is to resolve it constantly with economic growth rates being higher than the deficit rates. In the long term, this shall cause reduction of the public debt share of the GDP. That option is favourable for North Macedonia, but it presupposes an adequate fiscal discipline without the option of failing growth rates. “Normal fiscal policy consists of debt sales that finance current deficits. Such sales promise higher future surpluses”. (Cochrane, 2020, p. 31). If

there is a failure of the “promise higher future surpluses” the deficit, i.e. the amount of public expenditures, would have to be adjusted immediately.

One of the serious structural problems of public expenditures is the high level of the so-called indiscriminate costs that are inflexible in the short run and limit the scope of activity of the fiscal policy. They are over 80 percent of the total expenditures and are focused on payments of salaries, pensions and health care, and transfers to local self-government units. Hence, longer-term structural changes are needed on the expenditure side, especially in the central budget, in order to enable exercise of the functions of public funding.

The current health pandemic has caused an unprecedented response of the world’s fiscal policies of nearly 11 trillion US dollars, and in our country it brought about an additional deficit of about 6 percent of GDP. Due to the sharp decline in global production and the massive fiscal response to the increase of health capacities, in order to cover for the lost household income and to prevent enormous losses, the world has prepared a fiscal response that “contributed to global public debt reaching its highest level in recorded history, at over 100 percent of global GDP” (Gaspar and Gopinath, 2020). Nevertheless, due to growing morbidity and mortality, policymakers will need to maintain the priority of funding over public health, while preparing for the future major economic changes.

RECOMMENDATIONS:

1. The trends of broadening the current budget deficits and the growth of public debt in North Macedonia are worrisome. North Macedonia must not enter the zone of highly indebted countries, which means that every year it would have problems with ensuring high amounts of funds for servicing this public debt. The control and reduction of the level of public debt should not be done with its rigorous absolute reduction, but with a mathematical combination of future projections of budget deficits and growth rates, where the risk exposure to more drastic upward changes of interest rates in international financial markets is less certain, but still represents a threat in the long run.
2. What is needed is statutory creation of numerical fiscal rules and the establishment of a special public entity (Agency, Council, Institute) with the mandate of a classical fiscal council that will cater for the implementation of rules, analysing the state of affairs and proposing solutions.
3. The situation with the pandemic and its blow to the economy should be resolved with great care, because the enormous fiscal incentives in the form of newly created deficits may not breed the desired results but may significantly increase the level of public debt.

4. In order to enable more space for waging an active and flexible fiscal policy, it is important to reduce the level of the so-called indiscriminate public expenditures by around 10 – 12 percent of the present level and to allow more space for the discriminate public expenditures, especially for those in the central budget.

4.5. NEW INFLUX OF REFORMS FOR APPROXIMATION TO THE EU STANDARDS

The Public Finance Management Reform Programme 2018 - 2020 was the right programme that aimed at setting a medium-term plan for reforming all the important elements of the system with a view to approximating to the EU standards, contrary to the practice of ad hoc change of elements of the system of public finance. It was adopted in December 2017 and served as basis for reforms in several areas.

Fiscal transparency was ensured through manifold measures: introduction of citizens' budget; introducing a legal obligation for budget users for mandatory publication of their financial statements on their websites; regular monthly and quarterly detailed reporting on the state budget; publishing all data from the Ministry of Finance in open format; acceptance of SDDS +, the highest standard for statistical dissemination of IMF data, as the 18th country in the world, and in Europe as the first non-EU member state; legal obligation to fully publish each contract or annex for public procurements on the public procurement website; introduction of public consultations for all key documents of the Ministry of Finance - Fiscal Strategy, Budget, Economic Reform Programme, etc.; preparation of the Open Finance platform, which announces the detailed execution of the budget in real time.

A more efficient and equitable revenue mobilization was the objective of the following reforms: introduction of progressive taxation; introduction of legislation on transfer prices along with improving the capacity of the PRO to monitor them; and a new law on prevention of money laundering with the obligation of declaring the real owner. Additionally, the Ministry of Finance, together with the National Bank, is implementing a strategy to reduce cash payments in the economy with the intention of squeezing out chances of payments in the shadow economy, which consisted of around fifty measures, one of the major ones being reducing the limit of cash payments from 15,000 EUR to 500 EUR.

The pension reform was supposed to ensure the stable functioning of the Pension and Disability Insurance Fund, and indexation of pensions was conducted against consumer prices and social contributions were increased.

Reforms to the system of social transfers by introducing a programme on minimal guaranteed income, as the first country in the Balkans to be introducing this, which will ensure better targeting of social expenditures and reforms to public procurements by introducing a new law by which the system was harmonised with the EU directives.

The digitalization of processes in the more important elements of the system was carried out by means of several measures.³

The improvement of projections in the Treasury of the Ministry of Finance and its networking with the public debt and budget sectors resulted in its non-selective and automatic execution of all liabilities.

The improved public debt management by stabilizing public debt growth (46.6 percent of GDP in 2019 in Q.2), issuing of a Eurobond with the lowest interest rate, first issuance of thirty-year domestic securities, significant reduction of interest rates on all domestic securities, and increasing the maturity of the portfolio, finally resulted in 2019 with the first improvement of the credit rating of the country after 13 years (since 2006).

Additionally, changes to the budget process of municipalities were introduced, by introducing a fiscal rule which limited the revenue side to no more than 10 percent of the average of the last three years, in order to prevent the creation of unpaid liabilities. Moreover, a clearing was conducted of outstanding liabilities in all elements of the public finance system.

Later on, at the end of 2019, several important reforms were repealed, such as: the progressive tax that was replaced by a flat tax, the cash payment limit was increased to 3,000 euros and the fiscal rule in municipalities was raised to 30 percent of the average in the last three years.

The new influx of reforms in the public procurements system in the medium term could be based on the strategy for the 2018 – 2020 period.

³ The introduction of the electronic tax report form by the Public Revenue Office (PRO), the introduction of a paperless customs procedure in the Customs Office and an electronic system for tracking of customs declarations, introduction of a digital system for full tracking of each individual case in the Property and Legal Affairs Office by the citizens.

RECOMMENDATIONS:

1. Ensuring full funding of all electronic platforms and tools which enable fiscal transparency.
2. Publication of tax returns of every citizen on the website of the PRO on a specified day of the year (for example, October 1st), so that citizens would get a full insight, and thus prevent abuses in the system, for instance owners of companies with large movable and fixed assets reporting low income, or people who work in public administration earning very high additional income, etc.
3. Improving the medium-term budget framework by strengthening the fiscal strategy with the budget, establishing fiscal rules and fiscal council, changing the budget calendar, but also introducing new tools for planning new programmes among budget users. The reform should also improve the hierarchical structure of budget users, setting up a clear structure of the ministry which formulates policies, and under which there will be agencies and inspectorates tasked with implementing them, dismissing the option of having more than one agency tasked with the same mandate which reports to a different authority of the ministry, and the like.
4. Developing an information system that will connect all independent existing systems into one integrated public financial management system. The system should provide real-time recording of each obligation undertaken and invoice in order to completely prevent the creation of outstanding liabilities. It is important to prioritize this integrated software project, as its implementation will mean a huge step forward for the public finance system in the next decade.
5. The development of an efficient system for the establishment and monitoring of the concessions and public private partnerships (PPP), which will be part of the MF, in order to prevent possible misuse, providing insight of the public to every concession/PPP and to their manner of execution.
6. Reforms to the system of managing public enterprises in order to reduce fiscal risks connected thereto.

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5

MONETARY POLICY IN THE MEDIUM TERM

GLIGOR BISHEV AND MARIJA DRENKOVSKA

INTRODUCTION

The objective of this paper is, above all, to offer analysis of the challenges and perspectives of the monetary policy of North Macedonia. From the aspect of the international context and global challenges, and considering the characteristics of the national economy and strategic orientation of the state, this study proposes recommendations on the directions and optimal instruments of monetary policy of North Macedonia in the medium term. In light of the two outlined objectives, it has been structured in two parts. The monetary policy of North Macedonia is anchored to the euro area's monetary policy. In that respect, the first section offers a brief overview of the policies of the world's leading monetary authorities, predominantly of the European Central Bank, while discussing their effectiveness and impact on the real economy. The second part of the study follows the topics outlined in the first section by focussing on North Macedonia. In both contexts, we have included the monetary policy responses to the disruptions caused by the recent pandemic of Covid-19. The conclusion sums up the recommendations based on the presented analysis.

5.1. MACROECONOMIC CONSEQUENCES CAUSED BY THE LOW INFLATION RATE

Combating inflation shocks and taming high interest rates has been the major challenge for all central banks in the period between the abolition of the gold-dollar standard in the early 1970s and the 2008 global financial crisis. The post-crisis global macroeconomic developments have brought about new challenges and heralded a new era for the monetary policy and the global economy in general, in an environment of extremely low inflation rates.

The low inflation rate, from a macroeconomic point of view, is undesirable for several reasons. Among other things, in an environment of low inflation rates, a relatively small adverse inflation shock can quickly cause deflation which, according to the

dominant economic literature, has several negative implications. First, deflation causes delays in consumption and investments due to expectations of further price declines. Furthermore, the combination of declining product prices and wage rigidity⁴ negatively affects the profitability of companies and reduces labour demand. And third, in conditions of deflation, the real amount of nominal debt increases, making debt repayment more difficult for households, companies and for the state.

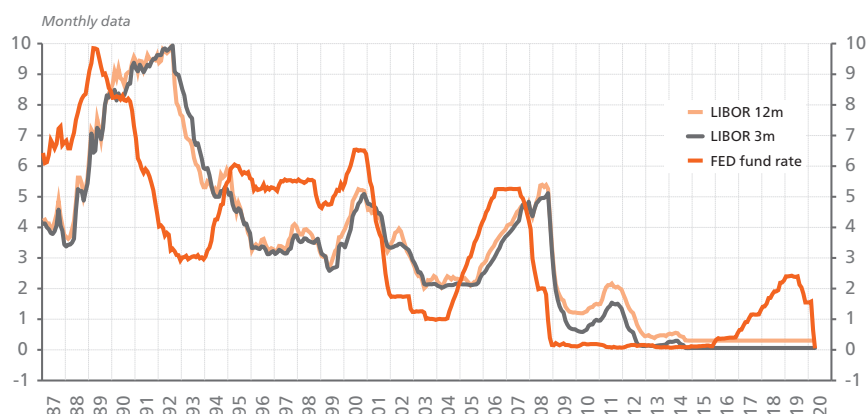
Let us remind ourselves that the nominal interest rate is the sum of the real interest rate and the inflation. Thus, the combination of low real interest rates and the consistent failure to meet the inflation target⁵ of the leading monetary authorities (European Central Bank – ECB, Federal Reserve - FED, National Bank of China, etc.) reduces the manoeuvring space of conventional instruments of monetary policy (through the interest rate) in case of potential negative shocks. To illustrate, with a stable inflation rate of, for example, 2 percent and a real interest rate of 0 percent, inflation-targeting monetary authorities have manoeuvring space of 200 basis points over the nominal interest rate. At lower inflation rates, this space is shrinking. That is why the low real interest rates that prevailed in the last decade are problematic for monetary policies of the leading central banks. They limit the scope for combating low inflation and prolong the return of inflation to the target value.

The equilibrium real interest rate (also known as the “neutral real interest rate”) has generally been

4 In literature, wage rigidity is described with the inertia in their adjustments (in this particular case, a downward adjustment) to their real value and to the price changes.

5 Inflation targeting is a monetary policy in which the central bank pursues an explicit inflation target in the medium term and communicates it to the public. This strategy is based on the assumption that monetary policy can play a role in maintaining long-term growth by maintaining price stability, which, in turn, is achieved by controlling inflation. In such a case, main tool of the central bank are interest rates. (For more information on this type of monetary strategy see Jahan, Sarwat. “Inflation Targeting: Holding the Line”. International Monetary Funds, Finance & Development.)

Chart 5.1
Key interest rates



on a downward trend since the 1980s. Additional to these are the historical values of the key interest rates of the FED and the ECB (Chart 5.1). Equilibrium interest rate (commonly referred to as *in literature*) is the one at which the desired levels of savings and investments are equated. Its value reflects the non-monetary forces (such as demographic factors, productivity and risk aversion⁶) which affect the desired rate of savings and investments.

The low interest rates are primarily important for the years following the global financial crisis given that the “double-dip recession” (Chart 5.2) brought about even bigger uncertainty in the economy. Such uncertainty also impacted the reduction of investments and productivity, increase of savings and reduction of the appetite for high-risk investments which has contributed to the increased share of state investments in the investment portfolios.

From a monetary policy point of view, central banks have few options left as far as conventional monetary measures go. Since the last financial crisis, in addition to the low equilibrium real interest rate in the last ten years, developments on the nominal side of the economy have also been very unfavourable. Many European post-crisis labour markets have been struggling with labour market slack and underused production capacities. Considering that in Europe in the post-crisis period the fiscal position was not supportive of the domestic demand, the European Central Bank has undertaken a combination of expansionary monetary policy measures, such as negative base interest rate, government bond repurchase programme, long-term

refinancing and forward guidance⁷, which is a new way of communicating the future path of the base interest rate to the public.

Certain analyses (Birdsall & Fukuyama (2011), Rodrik (2006), Stiglitz (2008)) corroborate the conclusion above, according to which in the context of European countries, the stalling of the economic growth following the global financial crisis is, to a certain part, a consequence of the return of the Washington consensus⁸, that is, the austerity measures. The sluggish economic growth following the crisis in 2008, in spite of the years of persistently low interest rates, did promote the hypothesis on “secular stagnation”. This is a term coined in the 1930s by the Keynesian economist Alvin Hansen, and this term was reinstated in 2013 by former US Secretary of Finance Larry Summers. According to him, the reduction of interest rates, most likely, will not contribute to the increase of investments and spending, and that the remedy may lay in increased public spending. The reasons for the downward trend in real interest rates are the subject of numerous studies⁹, but Rachel & Summers (2019) in their study look into empirical analysis of the relationship between debt and neutral real interest rate and examine a wide range of theoretical channels which make this relationship possible. By decomposing the real interest rate in developed economies, they single out the factors behind the downward trend of the neutral interest rate which most prevail in the private sector.

6 In the economy and finance, risk aversion usually pertains to the tendency of choosing an action that renders greater variance in potential monetary outcomes, compared to another option with a lower variance in outcomes (but with equal expected value).

7 The ECB initiated this communication regarding its intent to keep interest rates at the existing or lower level in the coming period, in conditions when inflation expectations are stable and economic performance is weak. The aim of this communication method is predominately to reduce interest rate volatility and to stabilize expectations regarding the interest rate that is needed to maintain price stability. (NBRM Quarterly Report, October 2013).

8 See table A1 in Annex A for comparison of policies of the old and the new Washington consensus.

9 Rachel & Summers (2019) offer an overview of quantitative studies on this topic.

Chart 5.2.
Double-dip recession in Europe



Data source: FRED, econstats

According to them (and based on other studies that confirm their findings), the equalization of private savings and private investments will require preserving low interest rates in developed countries for much longer in the future. Expressed in figures, according to this study, we are talking about an equilibrium interest rate between 1 percent and -2 percent in the next 30 years.

5.2. RESPONSE TO THE MONETARY POLICY OF ECB AND FED IN CONDITIONS OF THE COVID-19 PANDEMIC

Just like in the previous crisis, in order to battle the negative effects of the Covid-19 pandemic, FED committed to inject large amounts of dollars into world financial markets. With market expectations that FED will pursue a much more expansive monetary policy than the ECB, the US dollar has depreciated against the euro. Such monetary policy will certainly affect the dynamics of foreign exchange rates which, in turn, play a major role in export competitiveness. In this regard, the other leading monetary authorities have very little manoeuvring space, other than to follow the accommodating policies of the FED and the ECB.

The ECB did this through the following measures: purchase of additional €120 billion bond by the end of 2020 under the existing programme (APP); with temporary additional auctions of assets for temporary liquidity at a deposit rate, and more favourable conditions for the existing long-term refinancing operations (TLTRO-III) for the period between June 2020 and June 2021, with interest rates that may drop down to 50 basis points below the average interest rate on deposit funds. As of late, the ECB introduced a new liquidity programme (PELTRO), consisting of

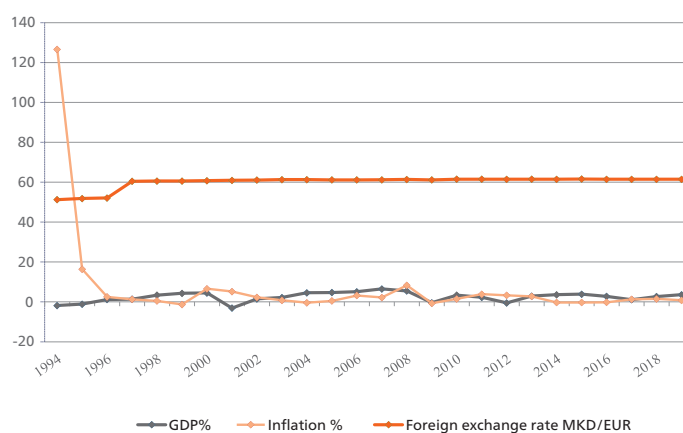
a series of non-targeted operations with long-term refinancing in conditions of pandemic emergency at an interest rate that is 25 basis points below the average of major refinancing operations rate (MRO) until the end of the year.

5.3. THE MONETARY FRAMEWORK IN NORTH MACEDONIA

The currency area of North Macedonia is not an optimum currency zone in the sense of the requirements of the Mundell-McKinnon model. It is a small open economy participating in global production measured through GDP of 0.015 percent, and is a price-taker economy with high currency substitution (share of foreign currency deposits in the total amount of deposits of 41.2 percent), with high transfers in remittances on the average of 17 percent of GDP.

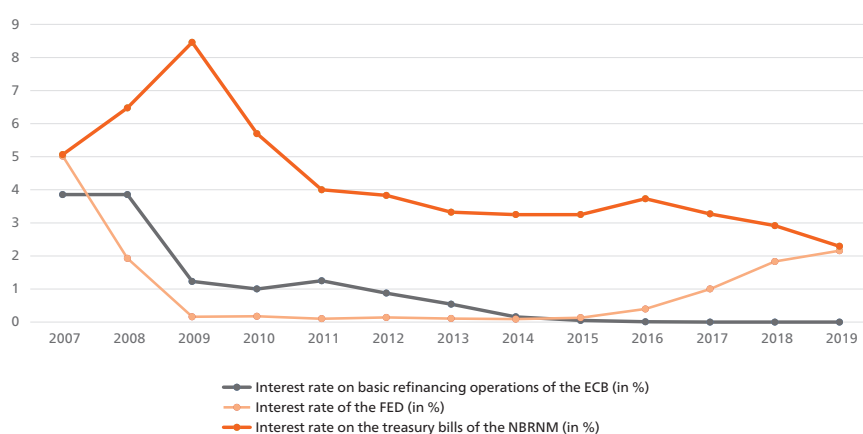
This severely limits the choice of the monetary framework for designing and implementing the monetary policy and reduces it to targeting the foreign exchange rate. Monetary policy creators have officially announced, since the fourth quarter of 1995, that they have been pursuing a strategy of targeting the denar exchange rate against the German mark and since 2001 against the euro. Although two preconditions for targeting the foreign exchange rate were not met--free inflows and outflows of capital from/to foreign countries and developed capital markets--the belief was that high foreign currency substitution and high share of remittances from abroad would help eliminate these shortcomings. This strategy was successful in tackling inflation and suppressing inflation expectations (Chart 5.3). However, with the exception of the 2004 – 2008 period, economic growth was below the potential, and interest rates slowly converged towards interest rates in the euro area, whose currency served as the anchor of monetary policy (Chart 5.4).

Chart 5.3
Inflation rates, GDP and foreign exchange rate



Извор: Статистички серии од НБРСМ

Chart 5.4.
Base interest rates of ECB, FED and NBRNM



Source: FRED St. Louis and NBRNM

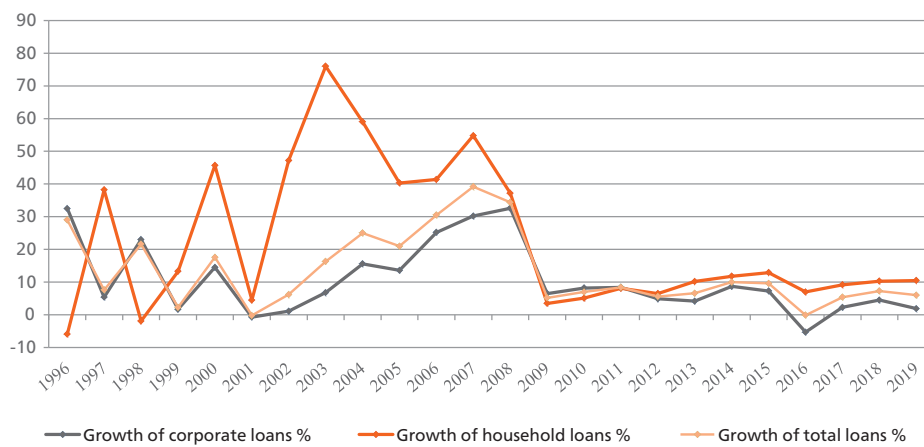
Moreover, in times of crisis, when monetary policy needs to be accommodated quickly, due to the growth of currency substitution driven by uncertainty and flight to secure currencies, and the termination of foreign capital inflows, monetary policy “went against the wind” by increasing restrictiveness, thus reinforcing the effects of the crisis. Hence, during the Great Recession 2008 – 2009, when interest rates and the monetary policy in the Eurozone, which is the anchor of monetary policy, started to relax, in North Macedonia they were tightened and interest rates increased, due to the need to protect the foreign exchange rate and the loss of foreign exchange reserves (Chart no. 5.4). Monetary policy was accommodating with a

two-year delay, following the defreezing of international financial markets and the increase in foreign capital inflows.

Full liberalization of capital transactions with countries abroad only happened in the third quarter of 2019. However, the underdeveloped and shallow capital market continues to be a limiting factor for the strategy for targeting the foreign exchange rate.

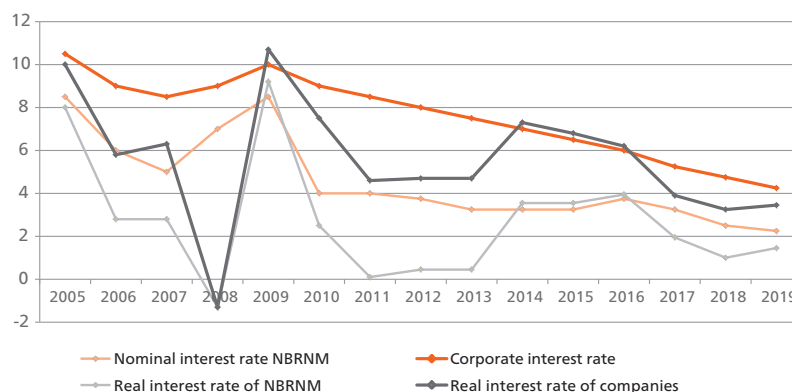
Nevertheless, this strategy delivered solid growth of loans, favourable for the private sector, averaging 6.5 percent per year in the 2009 – 2019 period. However, the growth of corporate loans (4.7 percent, on

Chart 5.5
Loans growth rates



Source: Statistica series from NBRNM

Chart 5.6
Nominal and real interest rates %



Source: NBRNM and own calculations

average per year) was almost twice lower than the growth of household loans (8.6 percent on average per year). In the last three years, corporate loans grew at average annual rate of 2.9 percent (Chart 5.5). This is insufficient to accelerate economic growth to the level of potential, although the level of debt of the corporate sector is low (23.9 percent of GDP).

The real base interest rate of the NBRNM, in conditions of economic expansion, has reduced in the range of 0 to 3 percent per year. Due to the high credit risk, the real interest rates on denar loans to companies were in the range of 4 to 7 percent. In the last two years, they decreased in the range of 0.5 to 1.5

percent (Chart 5.6). However, in conditions of contraction, instead of decreasing, the interest rates increased due to the increase of currency substitution and the cessation of capital inflows and remittances from abroad (in 2009, the real NBRNM base interest rate was 9.2 percent, versus the 2.8 percent in 2007 and -1.3 percent in 2008).

Following the great recession, when designing and implementing the targeting of foreign exchange rate, the Central Bank of the Republic of North Macedonia relied more on the principles of the neo-Washington consensus. It accepted the fact that monetary and fiscal policy should have a more significant role in

stabilizing economic flows. The price stability has remained the primary objective of monetary policy, with the realisation that it must give a significant contribution to the stabilizing of business cycles.

The introduction and adherence to macroprudential standards has become as important as maintaining price stability. Ensuring the stability of the financial and banking sector has become the key issue for maintaining economic stability. The Central Bank has introduced a number of macroprudential standards in the field of banks' capital strength, risk management, and especially the credit risk, standards on the level of debt, the level of growth of loans, liquidity standards and the like. This increases the capacity of banks to absorb shocks and to overcome crises more easily.

Despite the fact that central banks have expanded their arsenal of monetary policy measures: a) quantitative easing: directly injecting funds into the credit and capital markets and influencing long-term interest rates and repurchasing securities (asset purchases), according to the targeting strategy of the foreign exchange rate of NBRNM it cannot use this instrument on a large scale, due to the fact that under this strategy, the purchased assets are foreign currency - euros, b) long-term (2-3 years) of forward guidance and thus coordinating and influencing the shaping of long-term expectations regarding the state of monetary policy, especially the movements of long-term interest rates and macroeconomic developments. Due to the use of interest rates as a primary instrument for stabilizing the exchange rate, the timeline of monetary projections of the NBRNM is limited to 12–18 months.

The fiscal policy must also be orientated on the mid-term, and must have a counter-cyclical function.

Its key function needs to be stabilizing the economic growth at its potential level, and stabilizing the budget deficits and public debt in the mid-term.

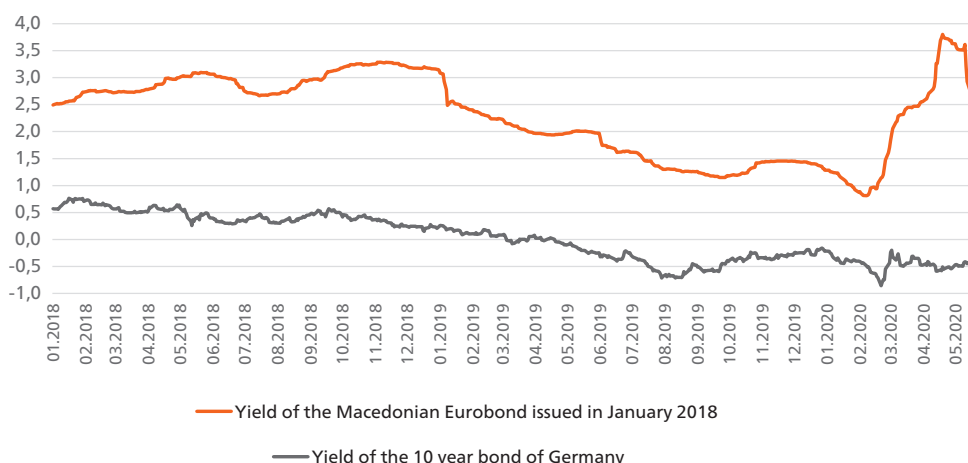
Although the imposition of foreign currency and trading limitations in conditions of recession has become allowed, North Macedonia did not resort to using those instruments following the great recession.

5.4. RESPONSE OF MONETARY POLICY IN CONDITIONS OF PANDEMIC

The reaction of the international financial markets after the outset of the coronavirus crisis followed the same pattern as in the previous economic crises: increased uncertainty, increase of interest rate risk premium, escape to safe and low-risk securities, decrease of capital movement in developing countries.

According to this pattern of behaviour, the yields of the Macedonian Eurobond on the international financial markets tripled for a period of 40 days (from 1.1 percent in February 2020 to 3.60 percent in April 2020), increasing the spread relative to the German bond to ten years from 1.7 percent to 4.10 percent (Chart 5.7). At the same time, remittances from abroad reduced to half, and outflows in euros and dollars increased (increase in currency substitution). The Central Bank faced the dilemma of whether to defend the foreign exchange rate by raising the domestic denar interest rates which the investors demanded, or to try to relax monetary policy in the long run by reducing foreign exchange reserves and/or significantly increasing foreign borrowing. Considering the amount of foreign exchange reserves, accommodating monetary policy in the long run by relying

Chart 5.7
Yields of the Macedonian Eurobond issued in January 2018 and the 10 year bond of Germany



Source: Bloomberg

only on FX reserves is not possible. Quite the opposite, trying to defend the foreign exchange rate through non-sterilized foreign exchange market interventions and lower interest rates might lead to a loss of confidence in the Central Bank in the long run.

Perceived from that point of view, the policy makers (NBRNM and the Ministry of Finance) decided to defend the foreign currency exchange rate in the short run by losing foreign exchange reserves, and to accommodate monetary policy through long-term borrowing from abroad. Thus, from the end of February 2020, the Central Bank started non-sterilized interventions on the foreign exchange market, and finally, in March 2020, it reduced its base interest rate by 25 basis points (to 1.75 percent). In the March – May 2020 period, the Central Bank intervened with around 200 million EUR in the foreign exchange market. At the end of May 2020, the monetary policy was further accommodated by reducing the NBRNM base interest rate by additional 25 basis points to 1.5 percent (Chart 5.8.). Concurrently, liquidity was increased by reducing the amount of treasury bills offered at auction by 30 percent.

Parallel to this, the Central Bank, in coordination with the Ministry of Finance, managed to provide additional financial support in the amount of 1.2 billion EUR, which represents 9.5 percent of the GDP. Thereby, through the IMF Rapid Financing Instrument, EUR 177 million were provided; 160 million EUR were provided through the EU Macro-Financial Assistance Instrument, and 140 million EUR were provided through the World Bank (50 million EUR through the Contingent Emergency Response Crisis and 90 million EUR for the Emergency Covid-19 Response Project). Also, by issuing a Eurobond, 700 million EUR have been secured from private financial markets. Thus, the

accommodative monetary policy should be sustainable in the medium term.

Nevertheless, if predictions that the current crisis will be in the shape of the “Nike” swoosh logo sign (Financial Times, 2020, June 4th) prove to be correct, or even worse, that it will be the same as the previous crisis, it will last longer and assume the shape of “W”, and then long term maintenance of accommodative monetary policy is likely to require additional funding of 5 to 8 percent of GDP.

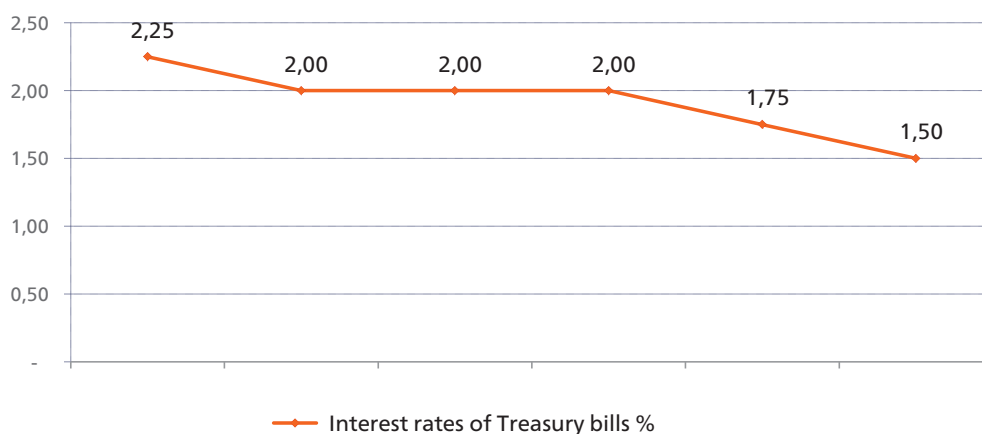
In addition, in early May the NBRNM issued a new monetary and macroeconomic forward guidance for the period till the end of 2022, without projections for change of interest rates, with a remark that the NBRNM will closely follow developments in order to respond to them accordingly.

Concurrent with the accommodation of monetary policy, the Central Bank conducted an adjustment of certain macroprudential standards.

Credit risk standards were relaxed by the end of 2020, which allowed for banks to delay the repayment of loans to companies and households by an average of six months. On average, the companies deferred about 25 percent of the loans, and the household deferred about 55 percent of the total loans on a mass basis. In September 2020, the banks made another deferral of loans to clients, but this time on an individual basis, only to those who lost their jobs or had a reduction in income by more than 10 percent.

In order to enhance the capital strength of banks, the NBRN has recommended retention of the 2019 profit. Most banks did observe this recommendation and did not pay out dividends.

Chart 5.8
Interest rates of treasury bills January – June 2020



Source: NBRNM

Considering the above, it is clear that the capacity to accommodate monetary policy and ease the business cycle in conditions of foreign exchange rate targeting is only possible if the Central Bank reaches borrowing arrangements with certain international financial institutions, a swap arrangement with the ECB like Croatia or if it has significant surplus of foreign exchange reserves and/or currency fund that would be accumulated in periods of expansion. In that regard, we recommend concluding a liquidity arrangement in emergency conditions, in the medium term, with the IMF that would be available to accommodate monetary policy, a swap arrangement with the ECB and/or establishment of a currency fund by accumulating surplus foreign currency inflows in conditions of expansion. In that regard, the first step was already taken with the concluding of agreement between the ECB and NBRNM for use of a repo credit line of EUR 400 million in conditions of the Covid-19 crisis, in August 2020. A condition for using these funds is maintaining the financial instruments which are on the list of ECB interventions. This limits the use of this line to the level of foreign exchange reserves of the monetary system of North Macedonia (banks and the central bank) to the level of foreign exchange assets placed in first-class securities in the euro area countries, which limits the manoeuvring space for adjusting monetary policy. The accumulation of surplus of foreign currency can be done from the existing foreign exchange inflows or through privatization of certain state-owned companies.

Changing the monetary regime and accepting a currency board or targeting inflation is not recommended. The currency board would be a much more rigid regime, which would prevent the accommodation of monetary policy even in the short term, without borrowing from abroad. Targeting inflation in conditions of high uncertainty would undermine the credibility of monetary policy. Accordingly, the NBRNM is recommended to deal with the economic shock caused by Covid-19 with the current monetary policy regime and its promotion to a swap arrangement with the ECB or the IMF. The current monetary policy regime is also recommended for the period of accelerated convergence and EU accession.

Having this in mind, the structural reforms not only accelerate economic growth, but also reduce interest rates and the spread between interest rates in North Macedonia and the euro area. In the short term, the spread between the long-term German bonds of ten years and the Macedonian bonds with approximate maturity is expected to range between 1.75 and 2.25 percent. In the medium term, this spread is expected to decrease somewhere between 1.25 and 1.75 percent, and in the period just before the accession to the EU it is expected to be 0.5 - 1.0 percent.

CONCLUSION

The Covid-19 crisis forced central banks to face new challenges: how to further accommodate the monetary policy in cases of negative interest rate in highly developed countries and to avoid the trap of excessive debts of the private sector.

A new wave of unconventional monetary policy instruments were launched in order to maintain liquidity of financial markets and institutions and to increase the capacity of capital markets to absorb budget deficits.

North Macedonia has accommodated its monetary policy by borrowing foreign assets from abroad: from international financial institutions and private financial markets. In order to equip the NBRNM to adjust monetary policy to neutralize economic shocks more effectively, in the future, it must have an instrument for the rapid lending of assets in the form of an unconditional swap arrangement with the ECB or the IMF. An alternative would be to establish a Currency Board in the periods of economic expansion.

The shift of the monetary policy regime towards a currency board or towards inflation targeting, in conditions of Covid-19 crisis is not recommended. The first regime would make the accommodation of monetary policy even more rigid, and the second regime might undermine confidence in monetary policy. Most probably North Macedonia will keep its foreign exchange rate targeting regime until its integration into the EU.

APPENDIX A

Table 5.1.

Comparison of policies of the Washington consensus in the 1980s, and 1990s and the policies of the international financial institutions from 2010 onwards

Washington Consensus 1980s - 90s	IFIs since 2010
1. Fiscal discipline and expenditure cuts	Same
2. Redirect public expenditures such as subsidies (except defence and corporate bailouts), to support growth with some targeted pro-poor expenditures	Same
3. Tax reform, expanding broad base consumption taxes (VAT) lower corporate tax rates, limited income tax, low/none trade and excise duties	Generally the same
4. Financial liberalization (e.g. reduction of financial regulations for purposes of efficiency and higher savings, privatization of public development banks, market-based interest rates)	Same
5. Competitive exchange rate	Same
6. Trade liberalisation, export-led growth	Same
7. Openness to foreign direct investment	Same, emphasis on PPPs
8. Privatization, promotion of the private sector, characterized as efficient	Same
9. Deregulation (removal or reduction of public regulations, rules and standards on private sector activities)	Same
10. Secure property rights	Same
11. Corporative governance	Same
12. Minimize the state, epitomized as a source of inefficiency and corruption, which imposes limitations on the private sector	Same
13. Flexible labour markets	Same with active labour market programmes
14. "Prudent" capital - account opening	Same but with macroprudential measures to manage capital flows and control as a last resort in the face of large capital flights
15. Independent Central Banks, inflation targeting	Same
16. Minimal social "safety nets"	Same
17. Targeted poverty reduction, microcredits	Same
18. Pension reform, pension privatization	Pension reforms, reduction of social security contributions leading to private saving schemes
19. Commercialization of social services, cost-recovery, user fees, minimal social policies	Same
20. No or limited attention to social groups, inequalities and sources of social conflict	Analysis of inequality and minorities; some targeted interventions.

Source: Ortiz & Cummins (2019) adapted from Williamson (2004, 1- 10); Rodrik (2006, 11-17); Stiglitz (2008); UN (2008).

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6

CHALLENGES AND LABOUR MARKET POLICIES IN THE MEDIUM TERM

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INTRODUCTION

The development of countries, both in the economic and social field, is largely conditioned by labour market trends. This conditionality is multifaceted, so the labour market is also dependant on the demographic, migratory, educational, cultural and other specifics and trends on the national and global level. The Macedonian labour market from the 1990s until the present day has undergone a series of transformations, which include: *structural changes* caused by the withdrawal of direct state control over the economy and growth of private ownership, thus redistributing the number and quality of jobs across different sectors, branches and regions; *institutional changes* – through strengthening of social dialogue, introducing trade union pluralism, establishment of private employment agencies, etc; as well as *legislative changes* which reinforced the legal framework of labour standards, minimal wages and active labour market policies. From a current perspective, the Macedonian labour market again needs transformation, which is a consequence of a series of factors, one of which is certainly coping with the broader impacts of the Covid-19 pandemic. In light of this, this chapter aims to highlight some of the key challenges on the labour market in the medium term, as well as the possible measures and policies for addressing them.

6.1. EMIGRATION TRENDS AND POPULATION AGEING IMPACTING THE LABOUR MARKET

Labour has always been an indispensable economic and development factor which receives a great amount of attention. It is specific, as part of the traditional economic factors of non-material nature and is endogenous in its nature. Its quantitative and qualitative features are very important for the economic development in the short, medium, long and very long term. Labour is represented by the workforce, although in the past 4 – 5 decades science and practice have clearly delineated between the workforce as the agent of labour (with its manual and other physical

characteristics) on one hand, and its skills and knowledge on the other hand. This has caused the addition of one more to the classical three economic factors (natural resources, labour and capital) – the fourth factor which is available technology (technical progress) with its material (technical) and non-material (knowledge and skills) elements. The latter, the knowledge and skills, have become so important for the economy and for development that presently we often refer to the developed economies and even beyond, as the “knowledge-based economies” or “knowledge economies” or even “knowledge-based societies”. This is no surprise, since statistical measurements of the key contributions to development factors have long ago established that the share of residues from the classical three factors (so called TFP) is almost always higher by 50 percent or more than the remaining ones put together. Today, we refer to “human capital” when we think of the input of workforce labour which possesses these characteristics. This is even more relevant for the labour markets, because the agent of this factor, as we said, is precisely the labour force. For its part, the source of labour force is the population with all its known features and characteristics.

The population plays a dual but also conflicting role in the economy and in the social development as a whole. Dual, because at the same time it appears as the agent of production process, i.e. the supply on the one hand, but on the other hand, on the final demand side, it plays the role of the final consumer of the produced final goods and services. Only part of the population performs the former role, and the latter is performed by the entire population. This role is conflicting because, to a bigger or smaller extent, it can be the driving force of development, as much as it can be a limiting factor of development. Overpopulation with rapid natural increase but insufficient economic activity can be an obstacle to development, but also vice versa: insufficient population with a scarce labour force can hamper the full use of natural resources and especially of the physical capital.

The population size as a source of labour force is, essentially, influenced by two factors – the birth and mortality rate and the migratory flows in and out of

the country (immigration – emigration). All four factors have almost equal significance for the population, hence also for the labour force and the economy as a whole.

Population trends in North Macedonia are currently experiencing a very specific era. We are in a development phase where the natural increase and migratory trends are negative, which impacts the rapid decline of the population, hence of the workforce size as well, which can largely affect the labour market.

Historically speaking, the Macedonian population denoted dynamic development in the past 80 years. As can be seen from table 6.1, from 1.15 million in 1948 and 1.3 million in 1953 (State Statistical Office, 1988), the country reached a population of 2.02 million in 2002 (State Statistical Office, 2008).

In the period 1944–2002, North Macedonia underwent a process of demographic transition (a period in which high mortality rates till that date started declining rapidly due to the improved living conditions, and birth rates persisted for a while at a higher level) and we can freely assess that in spite the process of moderate migratory movements, the population has doubled, which also doubled the number of workforce and the number of active population, which are factors for the development of the economy and the country. It is well known that there has not been a population census since 2002, which is why modern data are quite unreliable for analysis. According to the EU estimates, there were 2.1 million inhabitants in North Macedonia in January 2019, of which 16.4 percent are younger than 15, and 14.1 percent are older than 65 (Eurostat, 2020a), which is relevant for the labour market.

In the past two decades, for which we have no precise and relevant data other than estimates, the population numbers in North Macedonia, just as in the other countries in the region and beyond, started to fluctuate, owing to the reinforced migratory trends, especially emigration. For instance, according to estimates of the World Bank it is likely that in the past two to three decades, around 300–400 thousand people have emigrated abroad, which represents some 15 – 20 percent of the total population.

Another serious threat is that the population ageing process (a social, not natural process) is followed suit by the process of declining birth rate, even leading to a negative figure. State Statistical Office data indicate that the natural increase is dropping from year to year: from 15,772 in 1994; 9,083 in 2000; 3,963 in 2008; it dropped to only 1,606 in 2018; whereas in 2019 already, for the first time in history, the natural increase was negative and amounted to -601 persons. (State Statistical Office, 2019, p. 13). This is a worrisome trend, and will most probably remain as such for much longer, and this will largely affect the labour market in the coming 2 – 3 decades. Yet another problem is that the emigration structure of the female population is dominated by women in their fertile period, which will additionally reduce the birth rate in the country. Unlike us, the EU (together with the United Kingdom) for instance, assesses that its population will grow from 512 in 2018 to 525 million in 2044, before it starts to decline (Eurostat, 2019, p. 14).

Considering that North Macedonia is traditionally not an immigration destination, nor can we expect it to be in the near future, the above population trends in terms of natural and migratory outflows will inevitably lead to a decline in the absolute population number, but also of the workforce and active population numbers. Considering the declining size of the working age population, and the growing number of elderly and also very old people in the society, one of the most pressing concerns for the society and the economy (and for policy makers in the future), will be to encourage older people to remain for as long as possible on the labour market as an active population group. In this area we are at a slight advantage, because the expected duration of working life of the population was only 31.0 years in 2016 and 31.7 years in 2019 (figure 6.1 and 6.2.), and this is relatively low compared to European countries where the average is just over 35 years (Eurostat, 2020b).

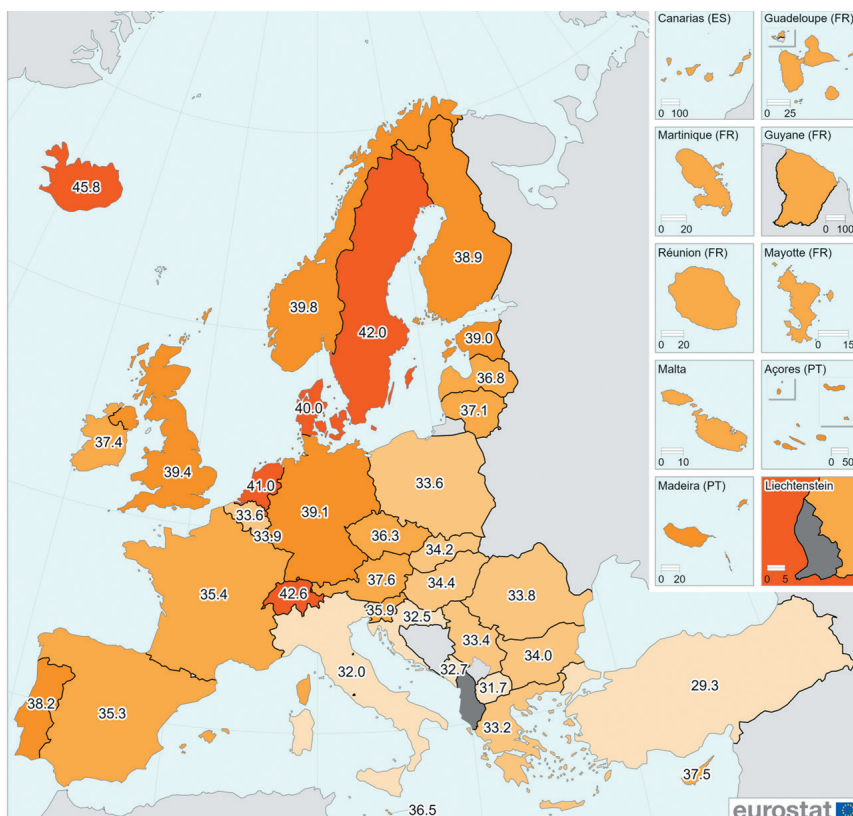
The integration processes of North Macedonia with NATO and especially with the EU will certainly not reverse these trends; quite the contrary, they will only deepen them, based on the aftermath of events and migratory flows in the regional countries that went through these integration processes (Bulgaria, Romania, Croatia, Slovenia). The Bulgarian population, for example, has shrunk from nearly 9 to 7 million in the

Table 6.1
Population trends in North Macedonia 1948 - 2002 (in million)

Year	1948	1951	1961	1971	1981	1991	1994	2002
Population	1,15	1,30	1,41	1,65	1,91	2,03	1,95	2,02

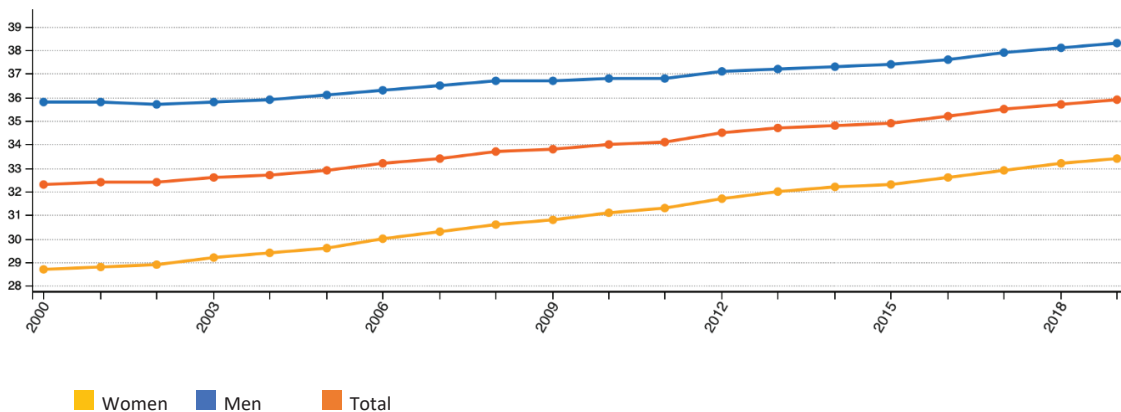
Source: State Statistical Office, 1998 and 2008

Figure 6.1
Expected duration of working life 2019, UK, EFTA and candidate countries



Source: Eurostat, 2020 (ifsi_dwl_a)

Figure 6.2.
Expected duration of working life in time, 2000-2019, EU-27 (years)



Source: Eurostat, 2020 (ifsi_dwl_a)

last 25 years (World Bank, 2013). Namely, the liberal labour market within the EU has caused a process of shifting the labour force from less developed new Member States to the more developed ones which need additional labour force.

It is very likely that in the very long term North Macedonia will need to attract labour from those parts of

the world where demographic trends are still positive, such as parts of Asia and Africa, in order to offset its labour market demand that could be characterized as having a chronically low supply.

The process of population ageing and its absolute reduction can cause other additional problems and challenges to the economy. A World Bank study from

2007 (Chawla et al.) addresses the issues of population ageing in transition and post-transition countries and their repercussions to the labour market; savings and financial markets; health and pension costs; education, etc.

6.2. MISMATCH BETWEEN SUPPLY AND DEMAND AND POSSIBLE SHORTAGE OF LABOUR FORCE

Before the outset of the Covid-19 pandemic, the labour market in North Macedonia suggested upward trends, which could be reflected in the growing activity rate, employment rate (both general and for women), declining total unemployment rate (including the youth unemployment rate), as well as the increased labour supply, i.e. number of vacancies (Table 6.2). Although official statistics, according to the Labour Force Survey, denote a small increase in employment for the first quarter of 2020, it is expected that the pandemic will reverse the performances of the Macedonian labour market.

From the point of view of sectors that absorb the most labour force, LFS data for 2017 show that more than half of employments in North Macedonia (65.1 percent) are concentrated in three economic activities: "Wholesale and retail trade, transport, accommodation and food services" (23.4 percent), followed by "Agriculture, forestry and fisheries" (21.9 percent) and "Industry without construction" (19.8 percent). Of the total industry, the largest share is that of manufacturing, with 16.8 percent of total economic activity in the country (Chart 6.1). Compared to the European Union, with the exception of the agricultural sector - which is one of the three largest sectors absorbing the most labour force in North Macedonia - the other three dominant sectors are the same ("Wholesale

and retail trade, transport, accommodation and food services", "Industry without construction" and "Public administration, education, health, social protection"). What is specific about the agricultural sector in North Macedonia is that it includes a large number of unpaid family workers, so these jobs are quite precarious and low-paid, and this affects a substantial number of employees in this sector.

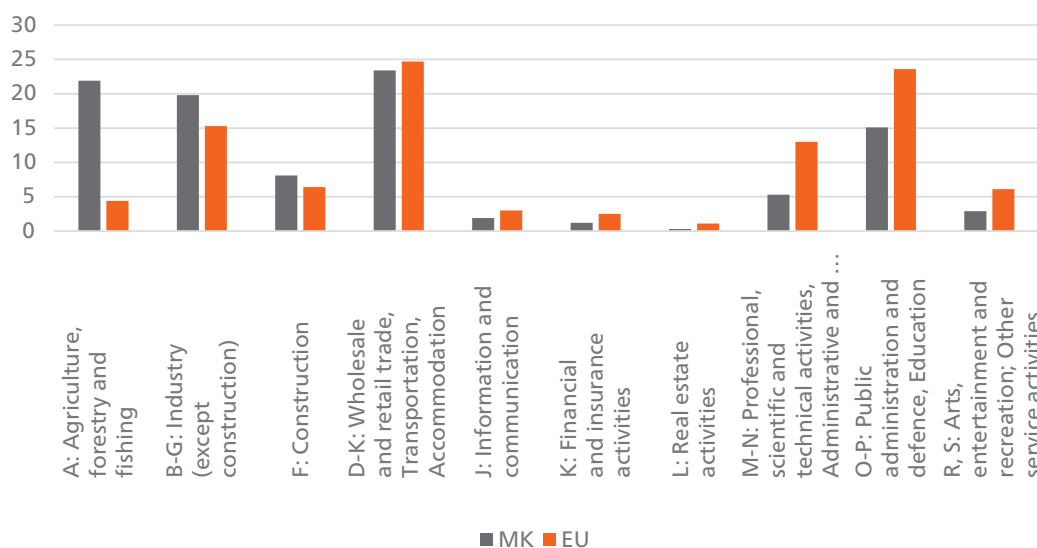
The Covid-19 pandemic is not the root cause of key labour market challenges in the national context, although it will certainly exacerbate and highlight them. Previous research and analyses have already pointed to a mismatch between the labour supply and demand in the country, signifying the "relative deterioration of the position of highly educated workers as a result of the large supply of such workers, the excessive scope of qualifications of workers in services and sales, as well as skilled agricultural workers; and insufficient education of managers" (Mojsoska-Blazevski, 2019, p. 48). According to survey data analysing skills need on the labour market in 2020, in terms of the degree of required knowledge (education) of the expected employments, 8.4 percent will be for people with completed higher education, 9.3 percent will be for people with secondary and college education, a whopping 46.9 percent will be for persons with completed secondary education, and 35.4 percent of employments are expected to be for persons with completed primary education (Employment Agency, 2019). These administrative data, which have an indicative character, point to the need to harmonise the educational profile of the workforce with the respective demand for it. As can be seen from Graph 6.2, in the last few years there has been an increase only in the active population with tertiary education, while the percentage of active population without education and unfinished primary education, as well as the active population with secondary education, notes a decrease.

Table 6.2
Labour market indicators in North Macedonia

	2016	2017	2018	2019	2020/I
Activity rate	56,5	56,8	56,9	57,2	57,4
Employment rate	43,1	44,1	45,1	47,3	48,1
Unemployment rate	23,7	22,4	20,7	17,3	16,2
Activity rate for women	43,8	44,3	44,6	46,6	46,4
Employment rate for women	33,8	34,6	35,8	38,1	39,1
Unemployment rate for youth (15 - 24)	48,2	46,7	45,4	35,6	34,9
Rate of job vacancies	1,3	1,5	1,6	1,6	/

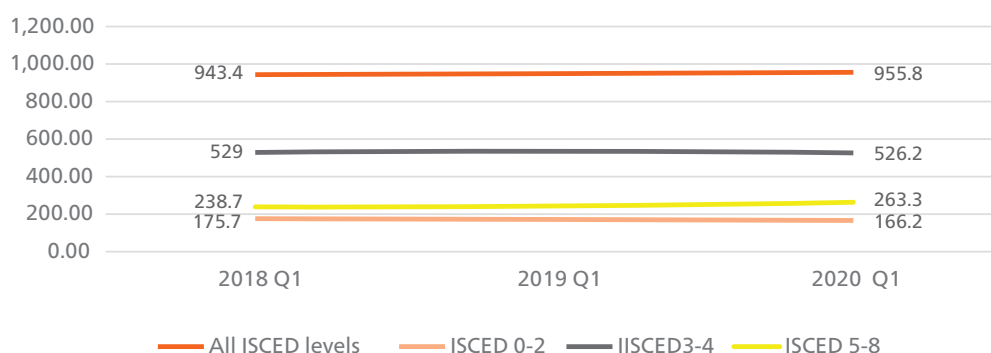
Source: State Statistical Office, MAKStat database; Labour Force Survey, 2020

Graph 6.1
Share of the 10 major economic activities in the total employment in North Macedonia and the EU in 2017



Source: Eurostat, <http://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do>

Graph 6.2
Active population (age 15–64), according to the highest education degree in North Macedonia, in thousands



Source: Eurostat, 2020, Ifsq_agan

Remark: The education degree is aligned with the International Standard Classification of Education ISCED – 2011, with the following meaning: ISCED 0 – 2: Primary education, ISCED 3 – 4: Secondary level of education, and ISCED 5 – 8: Tertiary education.

Such trends displaying a mismatch with the current demand for labour force must inevitably be met with measures like those in the educational policy, as well as through active policies on the labour market. Further to the changes announced in the secondary vocational education and in dual education, changes in higher education are also indispensable. Enrolment policy in higher education is too “liberal” and is neither in harmony with the needs of the labour market, nor does it allow for selection of youth according to their achievements and capacities as criteria. One of the measures which may help overcome this condition and improve the quality of higher education is the return of entrance exams for all universities, which was

abolished in the past as a result of former policies fostering broader accessibility of higher education. Such policies, complemented by the excessive offer of higher education (meaning the large supply of accredited high education institutions in the public and private sector) are some of the factors of mismatch between the offer and demand on the labour market. The entrance exams would be one of the factors which might divert part of the active population towards other professions, based on their potentials and capacities. A closer scrutiny during accreditation of higher education institutions and their curricula in order to avoid this excessive supply and their adjusting to the market needs may additionally help harmonise and align

the labour force profile with the respective demand. Public policies in higher education must better reflect the diversity of needed skills and explore how these skills could be developed over the entire work cycle. This entails analysing the inadvertent consequences in case public interventions change the school – work trajectory, looking into the difference between aiming to build cognitive or non-cognitive skills, understanding how different skills are developed and the dynamics of education on the individual and the choice of a career.

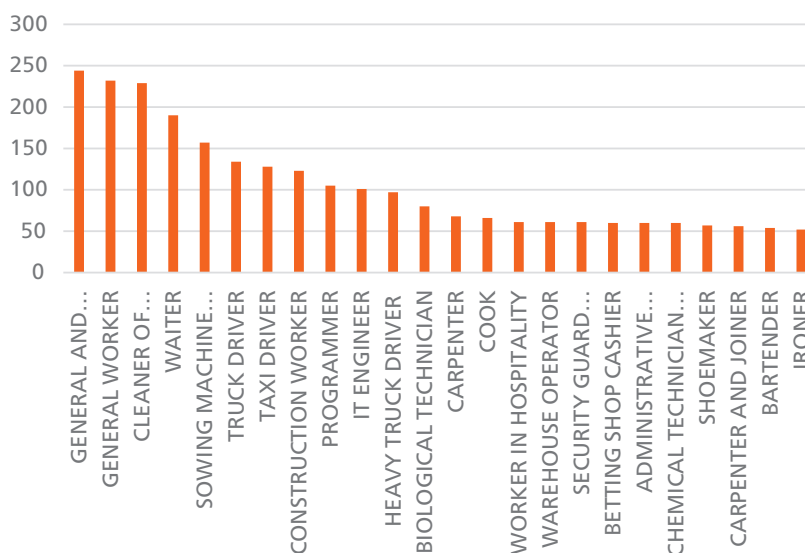
Furthermore, active employment measures and programmes can help persons who have lost their jobs or are unable to manage on their own on the labour market. The offers through active labour market policies for training, upskilling, retraining and employment should be profiled according to labour market needs, but also adjusted according to the educational profile of job seekers, so that it can play an instrumental part. The results of active employment measures should be considered in the medium or long term. Card, Kluve and Weber (2017) conclude that the average impacts of these active measures and programmes are close to zero in the short term, but often become more positive in the medium to long term (two to three years upon completion of the programme). They also discover that there are significant differences in impact by type of programme: programmes that emphasize the accumulation of human capital have the greatest effect, while programmes that help with job searching are less cost-effective in the long run. The impact of these programmes on participants is significantly heterogeneous: for example, women and people who have been unemployed for a long time are reported to benefit the most. Analysis shows that

active employment measures have the greatest impact during times of economic recession. As noted by Heckman, LaLonde, and Smith (1999), many of these active employment programmes still do not pass the cost-benefit test. Even when they are cost-effective, they are rarely associated with skills improvement. In this regard, investments in active employment measures in North Macedonia need to be well targeted, considering that they are only an auxiliary tool, and not a long-term solution to the mismatch between supply and demand.

One of the distinct features of the Macedonian labour market is the lack of labour force in certain specific qualifications that do not require higher education. Data analysis of the Employment Service Agency, in relation to the required professions for which there is the largest number of advertised vacancies (Chart 6.3), shows that except for the position of information technology engineer, as well as for several jobs that require secondary vocational education (biological technician, chemical technician, etc.), in most cases the demand is for manual jobs, which require basic skills and basic literacy. These data also show that North Macedonia is far from a knowledge-based economy.

The possible shortage of workforce, besides the skills mismatch, might also be occurring due to the increasing trend of both young and older people leaving the country, seeking better paid jobs. Such trends need to be additionally addressed not only through education, taxation and employment policies, but also through the integration into the labour market of migrants/third-country nationals legally residing in the country.

Chart 6.3
OCCUPATIONS WITH THE HIGHEST NUMBER OF JOB VACANCIES, ADVERTISED THROUGH THE EMPLOYMENT SERVICE AGENCY OF THE REPUBLIC OF NORTH MACEDONIA



Source: Employment Service Agency, 2020

6.3. UNEMPLOYMENT AMONG YOUTH

Young people face a series of problems for entering the labour market such as: a discrepancy between the acquired knowledge and skills in the formal educational process with the real needs of the labour market; the average period of transition of young people from school to work (2.5 years); as well as the insufficient number and quality of vacancies. Yet an even bigger problem is the large number of young people in North Macedonia (over 130,000 people) who are not involved in education, are not employed, and are not even part of the training process (NEET). Considering the above, and in order to overcome the challenge of reducing the youth unemployment rate, a number of employment policies for youth have been implemented in the past few years, such as: active employment programmes through the operational employment plan, the introduction of “Youth Guarantee”, the introduction of a youth allowance, as well as the adoption of the Law on Internship.

Such measures and policies did bring about an increase of youth employment from 30.2 percent in 2017 to 34.4 percent in 2019. At quarterly level results indicate a positive trend, that is, youth unemployment between 15 and 29, from 43.7 percent in the first quarter of 2015 was reduced to 27.3 percent in the first quarter of 2020.

The year 2017 was pilot year for the “Youth Guarantee” Programme, which is part of the European leading initiatives aiming to provide young people (aged 15 to 29) with a quality employment offer, continued education and training, or internship for a period of four months from the date of registration with the Employment Agency. North Macedonia is the first country in the Western Balkans to have introduced and implemented the Youth Guarantee. The

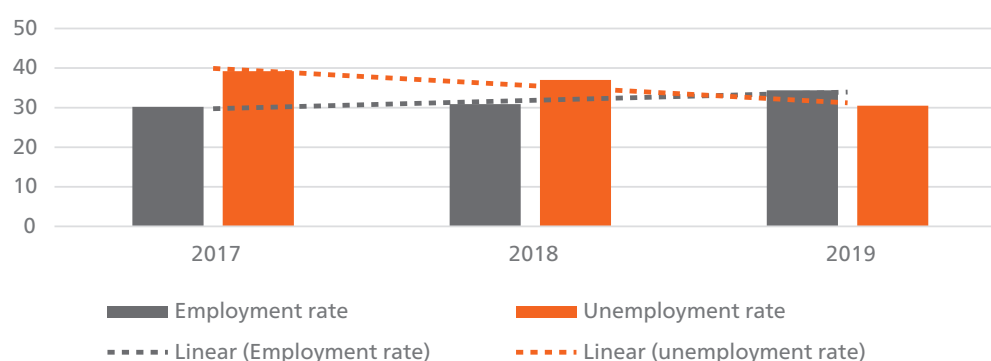
programme is considered successful if at least 30 percent of the involved persons successfully exit it within 4 months, meaning they find employment, re-enter the educational process or are included in active programmes and employment measures.

The implementation plan of the youth guarantee in North Macedonia was envisioned in two stages: a pilot stage in 2018/2019 and a second stage until 2022 when attempts will be made to roll out this plan across the entire territory of North Macedonia, with special emphasis on the three least developed regions: South-Western, North-Eastern and the Polog Region.

A total of 5,266 persons were included in year 2018 (2,694 women), of which 1,916 found employment; while 281 persons were included in one of the active employment measures which do not lead to direct employment, but do increase their employability. Accordingly, the success rate of the “Youth Guarantee” in 2018 amounted to 41.7 percent, thus exceeding the envisaged 30 percent. Also in 2019 the success rate of the “Youth Guarantee” was 35.5 percent, again over the planned 30 percent.

As of the end of July 2020, a total of 14,040 young people joined (6,958 women) of which 3,241 found direct employment or joined one of the active employment measures from the operational plan for 2020 that do not lead to direct employment, but increase their employability (for example 700 young people joined the “Internship” measure). Based on the contemporary situation, we can conclude that despite the specific (unfavourable) conditions in the domestic economy caused by the Covid-19 pandemic, the involvement of young people in “Youth Guarantee” again exceeded the expected threshold of the planned 10,000 people.

Chart 6.4
EMPLOYMENT AND UNEMPLOYMENT RATE AMONG YOUTH AGED 15–29 IN NORTH MACEDONIA



Source: Eurostat, yth_empl_010; yth_empl_090

In cooperation with the real sector and companies working in production, it became obvious that young people need to be encouraged to seek employment in such types of companies. The youth allowance was introduced as a measure and as a result of the joint cooperation between the organization of employers and trade unions, through economic and social dialogue. This allowance amounts to 3,000 denars per person per month for full-time work of young people up to 23 years of age. In June this year, 4,000 people will receive the youth allowance through the Employment Agency.

However, one gap was observed when implementing employment policies for young people, in the segment of preparing youth for employment. In order to overcome this shortcoming, a Law on Internship was adopted which further regulated the rights and obligations of the intern and the employer and ensured benefits for both sides, some of which are indicated below:

- Development of skills and qualifications for easier employment;
- Facilitated selection of employees for the employers following the completion of internship; during the internship period, other than the remuneration for work and personal income tax, the employer has no obligation to pay any of the social security contributions for the intern;
- The internship may last between 1 and 6 months, and is subject to a contract for internship work.

By the end of the second quarter of 2020, a total of 196 employers have benefitted from the opportunities offered by the Law on Internship.

In order to pursue the same trends of reduction of unemployment, and concurrently to achieve an increase of youth employment, the implementation of successful measures must continue, but also new experiences need to be considered and introduced, which have proven to be successful in other countries that have similar problems to ours.

In the coming period it will be important to promote and advance the offer of programmes of non-formal education and lifelong learning, in order to address the lack of technical skills and experience gained outside of formal education, which are necessary for the business sector. Information on these programmes should be available in high schools and should further be promoted throughout studies. This could be facilitated by establishing regional training centres and introducing dual education.

Measures targeting the improvement of youth skills and the reduction of unemployment need to be accessible to all young people. In light of this, we need

to aspire towards greater accessibility of measures and awareness of youth about them, especially when it comes to young people in the rural environments and the vulnerable categories of young people

In addition, communication strategies need to be developed with parents/children from the earliest school age (elementary education), focussing on the fact that occupations that require vocational secondary education enable good earnings and are not “shameful” and in addition help rescue entire generations from long-term unemployment and pursuit of work outside the state borders.

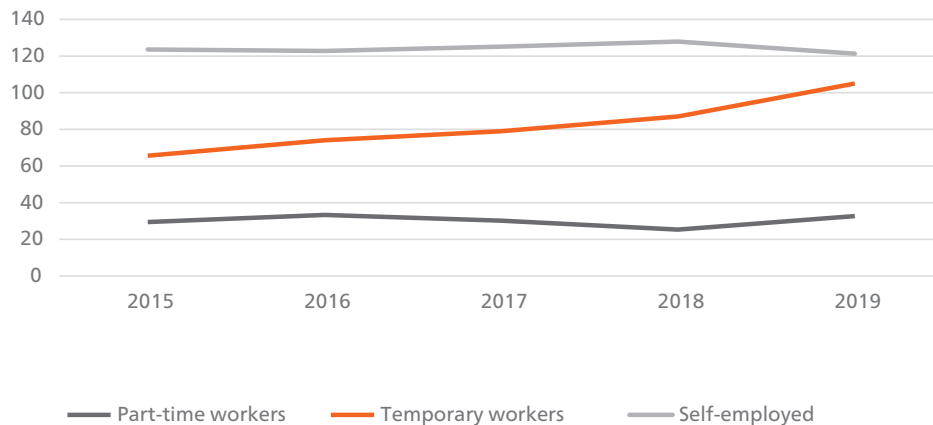
6.4. FLEXIBILITY OF WORKING ARRANGEMENTS

The alternative work arrangements, such as flexible work schedule, work from home, and part-time work, are becoming a growing feature of the global (but increasingly also of the domestic) economy. While these arrangements may facilitate a work-life balance, they are not necessarily beneficial to workers. Many jobs have irregular schedules, so workers are unable to predict their work schedules from one week to the next; many workers are on call or work during evenings, nights and weekends. Additionally, in the national context, non-standard forms of work, as shown by the analysis of the Labour Force Survey and Eurostat data¹⁰, are not a result of their own choice, but of the: inability to find a full-time job (36.4 percent), other family or personal responsibilities (16.4 percent), care for children or elderly people in the family (4.9 percent), illness or disability (2.6 percent), education and training (3.3 percent) and other reasons (36.4 percent).

The Covid-19 pandemic has imposed and stressed the need for flexible work arrangements and work from home. According to the estimation of potential home-based jobs done by Dingel and Neiman (2020), 37 percent of jobs in the United States can be performed entirely from home, with significant variation across cities and industries. These jobs typically pay more than non-home-based jobs and make up 46 percent of all wages in the United States. According to their professional classification, 85 other lower-income economies in the world have a smaller share of jobs that can be performed from home. Developing countries and those with per capita GDP level below one-third of the US GDP level may have only one half of the total jobs that can be performed from home (Dingel and Neiman, 2020). By applying the methodology of Dingel and Neiman to the example of Canada, Gallacher and Hossain concluded that a certain

¹⁰ Eurostat, Main reasons for part-time work, 2020, [lfsa_epgar](#)

Chart 6.5
Non-standard forms of employment in North Macedonia, 2019, in thousands



Source: Eurostat, 2020

category of employees, such as workers at risk of poverty, younger workers, part-time workers, employees in small businesses, seasonal or contract workers, as well as workers without higher education, have a lower tendency and fewer opportunities to be employed in jobs for which remote work or work from home is possible (Gallacher and Hossain, 2020).

The non-standard forms of work bring along the risk of lower union membership, which certainly limits the mechanisms of protection of labour rights.

Workers' rights in our country are, anyways, at one of the lowest levels in Europe, according to relevant international reports on this topic. More specifically, the latest report of the International Trade Union Confederation describes us as a country in which "the Government and/or companies are making serious attempts to suppress the collective voice of workers". Of the European countries, only Serbia, Bosnia and Herzegovina and Romania are at the same level as us, while only Greece, Turkey and Ukraine have a lower rating in this regard.

In addition to the rights being insufficient, they are also often violated. According to research conducted by "Glacen Tekstitec" (TN: Loud Textile Worker), as much as 40 percent of workers in the textile industry are working on fixed-term contracts, 60 percent of workers are working 50 hours a week, and a staggering 70 percent of them are not even paid for overtime work. According to the 2018 Report of the Macedonian Health and Safety Association, 33 people died that year as a consequence of occupational injuries, which equals 4.3 deaths per 100,000 employees, which is the second highest level in Europe and is almost three times higher than the European average of 1.6 deaths. This illustrates that working conditions are bad and occupational health and safety measures are disrespected.

State institutions which have the mandate to safeguard workers' rights, such as the State Labour Inspectorate and the courts are not doing a satisfactory job. According to a survey by the Helsinki Committee for Human Rights, as many as 64 percent of the workers surveyed expressed complete dissatisfaction with the work of the State Labour Inspectorate, and 13 percent expressed partial dissatisfaction. As many as 50 percent of the respondents stated that they are not at all satisfied with the work of the basic courts, and 17.2 percent answered that they are partially dissatisfied.

In the absence of research and proper assessments of the potentials for remote work and work from home in a national context, it is necessary to consider in detail both the opportunities offered by flexible forms of work, but also the risks they entail. As the International Labour Organization (2020) points out, the growing need to work from home, during and after the Covid-19 crisis, imposes an obligation on governments to ensure that those who work from home have the same rights and benefits as those working on premises provided by the employer, which includes equal treatment of pay and other working conditions. According to data highlighted in the National Report on Adaptation of Industrial Relations to New Forms of Work, the "Insufficient legal regulation of work from home has negative effects on the operation of many industries, especially on the information and communication technology industry, which makes companies uncompetitive on the market because they are unable to meet expectations of the workers, and they are facing a lack of skilled labour force which is moving abroad, primarily due to the better quality of life and working conditions abroad" (Trajkovski, 2019, p. 107). In light of this, it is important to further specify the provisions of the Law on Labour Relations regarding employment contracts for work from home, and the other non-standard

forms of employment, in order to identify the rights and obligations of employees and the employer, as well as to ensure ways of making them applicable in practice.

CONCLUSION

Despite all the structural changes and the transformation of the economy and economic activities, the labour force, which is the key agent of labour, still remains one of the basic economic and development factors that substantially participates in the generation of GDP in our country. The growth of the economy, i.e. of GDP, is largely a result of the marginal contribution of labour, especially the manual and lower skilled labour in several important activities for the economy (such as agriculture, construction, manufacture and labour-intensive industries). Certainly economic growth can also be attributed to the share of the most modern and most profitable activities and branches of the economy where knowledge and the most sophisticated skills of the labour force (human capital) are pivotal, and those are the service occupations (health, education, financial services, science, consulting services, software design, etc.) and the production of high-tech goods that are knowledge-intensive (IT products, pharmaceutical, digital devices, sophisticated equipment, etc.).

The workforce in North Macedonia is not characterized by excessive human capital due to the relatively lower level of education and skills it possesses. Its transformation towards a workforce with an outstanding level of human capital must be one of the major tasks of the economic and especially of the educational policies in the medium, long and very long term.

The lack of a high quality labour force and human capital in the future may further deteriorate due to the trends of reduced and even negative natural increase and migratory trends that cause negative balance. Along with the constant natural process of population ageing, this could be one of the key factors that will affect the country's labour market conditions through the long term disruption of labour supply and demand levels by the economy. We should also not rule out the fact that North Macedonia will need additional labour forces, especially those with lower skills and qualifications for certain traditional activities, but it will also need profiles with the highest qualifications and skills in the most modern industries which are in high demand on the regional and global markets, and certainly in demand on the labour market.

Such conditions can be partially overcome by making accelerated and significant structural changes in the economy. These will be supported by active state

– but also by induced market - targeting of the supply of the labour force towards the increased offer of high-quality job opportunities requiring sophisticated knowledge and skills. For these, radical changes are needed in the formal and non-formal education process, which will help compensate for the lack of labour force in some activities and branches (low-income and labour-intensive) and with increased supply in high-income activities and branches that absorb labour which is knowledge-intensive.

The current and medium-term problems with the existence of low and medium-skilled labour force will have to be offset by the sustaining of labour-intensive activities until the remaining existing low-skilled labour is naturally transformed and replaced by a new labour force with a higher level of human capital.

In the field of labour rights, many changes are needed in the medium term, including, among others, the adoption of a new Law on Labour Relations in order to ensure greater protection for workers. The two biggest problems that workers are facing are working on fixed-term contracts which only prolongs their uncertainty, and overtime work which is not paid. Therefore, it will be very important to reduce the maximum duration of fixed-term contracts which is now 5 years, to 6 months or 1 year in the new Law, and to establish a register of overtime work, in order to reduce the risk of workers hired on such contracts of not being paid. Moreover, it is necessary to invest in the State Labour Inspectorate, both in equipment and in new employments, in order to improve its staffing and technical capacities, so that it could discharge its duties more professionally. Of course, the focus on improved efficiency of courts in the field of labour law is inevitable.

The analysis of trends in the Macedonian labour market points to the concern that the combined impact of demographic factors and the structural mismatch between supply and demand affects the flexibility and mobility of the workforce. However, data on past employment cycles and current demographic trends are not sufficient predictors of future labour needs. Policies affecting the labour market are not sufficiently grounded on nationally representative research and data. Other than the Labour Force Survey, which provides an overview of the current state of the labour market, there is no additional research based on a harmonised international methodology, nor actuarial projections, which would encourage new paths in the development of labour market policies. In this regard, conducting a population census is urgently needed, as the basic prerequisite for assessing the scope and structure of the population.

Additionally, nationally representative assessments are needed of the possible lack of skills and qualifications in the labour market, based on projections of

future movements in the national and global economy, rather than on the subjective perceptions of current employers. Matching the skills to the needs of the demand, as well as the abovementioned use of potential influxes of migrants as possible labour force, will not be possible without improved data and research on the future needs and opportunities of the national

and local labour market. Labour market policies based on solid and harmonised data can help facilitate creative collaboration among all stakeholders: individuals, educational institutions, employers, and governments at all levels. To that end, achieving a productive society with a flexible, highly motivated workforce, even in conditions when it is ageing, would be easier to attain.

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7

EXPORT AS THE MAIN DRIVER OF MACEDONIAN ECONOMIC GROWTH

MARIJA DRENKOVSKA, VANCHO UZUNOV AND JANE BOGOEV

INTRODUCTION

This chapter aims to establish a foundation for further discussion on the development of Macedonian foreign trade. It includes an examination of five basic hypotheses related to foreign trade and the country's participation in the global market and trends. At the same time, it seeks to provide certain basic guidelines for the development of the Macedonian export sector that are key for stimulating the country's foreign trade. Considering that this analysis was developed within the context of the umbrella project *The Big Picture: The Macedonian Economy in the Medium and Long Term*, its structure aims to further elaborate and expand on the previous chapters presented in this book pertaining to the topic of productivity growth, and structural changes of the Macedonian economy in the medium and long run. In line with those ideas, our analysis' main proposal is that setting up strong fundamentals for sustainable productivity growth and, consequently, an increase in the living standard, North Macedonia would need to adopt the export-led growth strategy, which is basically a development strategy based on export expansion. That being said, this chapter seeks to elaborate in more detail the aspects of the structure of Macedonian export that would support a sustainable economic growth.

This chapter is structured in seven sections. In the following section we provide a brief overview of the current affairs in global trade and competitiveness. The third section focuses on examining the export sector conditions in North Macedonia, while the subsequent sections provide recommendations regarding the future development of the country's export strategy. Finally, the summarised conclusions of the analysis are laid out in the last section. The analyses in this chapter rely on the authors' own calculations, based on data obtained from the Makstat database of the State Statistical Office of the Republic of North Macedonia with a cut-off date of September 2020.

7.1. TRADE INTEGRATION VIS-A-VIS PROTECTIONISM AND TRADING WARS

Trade integration on a global scale has perceptibly slowed over the past decade. If we are to consider the 1990–2008 period as the golden period, when the global trade in goods and services increased from 39 percent to 61 percent of the global GDP, the broad consensus as of 2016 is that the low growth rates have become “the new normal”. Recent analyses (ECB, 2016; Constantinescu et al., 2015; Haugh, D. et al., 2016), suggest that there is a low probability that world trade would regain its growth rates from before the crisis. The decrease in trade was accompanied by a rise in protectionism, driven by increased non-tariff¹¹ and, as of recently, also by tariff barriers. Trading tensions across the globe escalated in 2018, when protectionist threats from the US administration, including the reactions of their major trading partners, resulted in concrete actions that increased the danger of a trade war. Such events have contributed to a decline in public support for trade openness, while protectionism grew globally.

The perceived risks associated with open trade were not the only factors dragging down the popularity of the globalization idea. The factors in favour of and against globalization are discussed in the work of Gunnella and Quaglietti (2019). In this vein, unfavourable consequences of free trade include the following: increased exposure to international crises, spillovers of negative shocks from abroad, and unfavourable consequences related to distribution of wealth (increasing inequalities both within and between countries) (Antràs, P. et al., 2017; Rodrik, 2011; etc.). On the other hand, international trade allows countries to specialize in the production of goods in which they have comparative advantage, it provides greater

¹¹ The non-tariff barrier limits trade by using trade barriers in a different form than tariffs. Non-tariff barriers include quotas, embargo, sanctions and taxes. As part of their political or economic strategy, some countries often resort to non-tariff barriers in order to limit their scope and quantity of trade with other countries.

diversity of consumer goods, increases per capita income, boosts productivity, and contributes to the reduction of world poverty (World Bank Group; World Trade Organization, 2015).

However, as Gunnella and Quaglietti point out, the benefits of open trade and their distribution across social groups are different for different countries. Some of the most important pre-conditions for full realisation of the benefits of trade openness are certainly the export structure, degree of specialization of export goods, degree of diversification of production and the level of development of institutions in the country.

Considering that currently around 70 percent of international trade takes place through global value chains (GVC), smaller countries and developing countries need to engage in them successfully by figuring out different ways of increasing the added value of their products on the global market. Only by doing so, those countries will be able to build and maintain a competitive edge globally. Higher added value is closely linked to innovation, which can either be aimed at increasing process efficiency or at increasing product quality.

Countries also differ in terms of endowments that include quality of labour force, available capital, and level of knowledge. This is reflected in their diversities in respect to technological development, and consequently, the level of innovation, the type and intensity of research and development (R&D). Considering that developing countries (even those that are more technologically advanced) find it difficult to match the R&D effort of the major industrial nations, or the largest corporations, a different role is recommended (Forbes and Wield, 2000) for the technology followers in the R&D process compared to that of technological leaders. Namely, for a technological follower, the R&D process should be focused on increasing their absorptive capacity, so they can be able to use knowledge from external sources that already exists within the value chains and partnerships with other companies.¹²

In an era of knowledge and intellectual capital imposed by globalization, development of new technologies, and increased competition, countries and companies striving for export-led growth should focus on building and maintaining their own endogenous growth factors. From a macroeconomic perspective, investments in knowledge and increasing innovations have the ultimate goal of increasing production, as is

the case with investments in equipment and machinery. For countries that are strategically orientated towards boosting their economic growth and international competitiveness, intellectual capital is one of the key factors of production for the attainment of these goals.

7.2. THE STRUCTURE OF EXPORT OF NORTH MACEDONIA

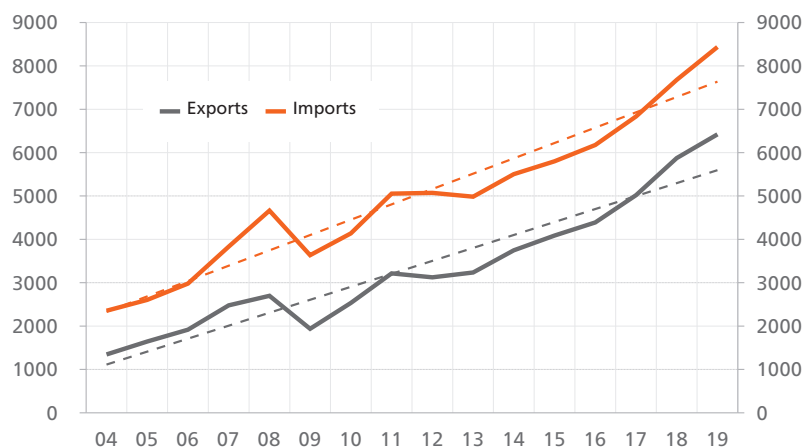
Over the past fifteen years, the exports and imports in North Macedonia demonstrate an upward trend in nominal terms (dotted black lines in Chart 7.1). The evident contemporaneous evolution of the two aggregates indicates that export plays an important role in the country's economic development, but also points to the high dependence on imports (the increase in exports requires an almost proportional increase in imports). This is visible also from the net exports (the difference between the exports and imports) which is practically constant over time.

If we look at the annual growth rates of export and import (Chart 7.2) we can notice that also the growth dynamics of the two aggregates are almost identical, with the average annual growth rate of export for the entire 15-year period being 10.5 percent, while the import growth rate is 9 percent. However, the trend of the annual growth rates of imports and exports (dotted lines in Chart 7.2) is downward. The impact of foreign trade, or the impact of the net-exports in the formation of the GDP in North Macedonia, has a changing dynamic: according to NBRNM data, in the period from 2012 to 2019, foreign trade had a positive impact on the GDP, but only for 3 years (i.e. in 2013, 2017 and 2018), and for the remaining period that impact was negative. This indicates that, despite of the upward trend of exports, we cannot conclude that there was a successful implementation of the export-led growth strategy.

Another important aspect of the country's trade is the structure of exports, analysed according to the type of goods exported and the exporting markets. Chart 7.3 illustrates the export structure of North Macedonia in 2019 according to basic product categories. According to the data two-thirds of North Macedonia's exports are intermediate goods, and the remaining third is almost divided in half between capital goods and consumer goods. Within the group of intermediate goods, over 60 percent are processed industrial procurements, 19 percent are transport equipment and parts and over 11 percent are primary industrial procurements. In the category of consumer goods exports, semi-durable and non-durable products account for almost 60 percent of this group, while durable consumer goods and processed food products account for less than 18 percent.

¹² The benefits from the integration in international value chains and export to foreign markets (in terms of boosting innovation and increasing productivity) are addressed in Grossman and Helpman (1991), and are further supported by empirical analysis of Helpman (2004, chapter 5.6).

Chart 7.1
Export and import of North Macedonia in 2004 – 2019 period, in mill. EUR



Source: State Statistical Office of RNM

Chart 7.2
Annual rates of growth of export and import, in%



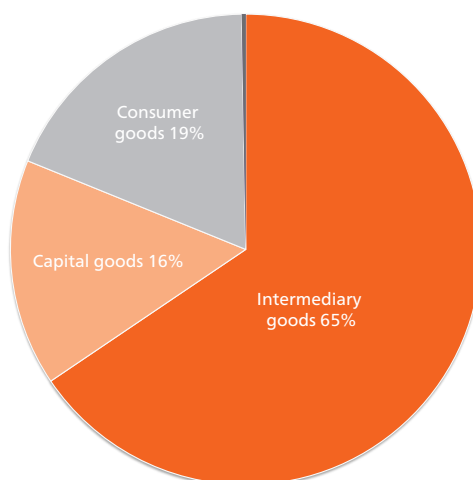
Source: State Statistical Office of RNM

If we look at the distribution of export goods by economic activity (Chart 7.4) we can observe that the large majority (90 percent) belongs to manufacturing products, only around 4 percent are agricultural products, while services are almost negligible in volume. In fact, export services are not recorded in official statistics in North Macedonia. On the other hand, within the manufacturing industry (Chart 7.5), a dominant share is held by chemical products (around 25 percent), followed by parts for motor vehicles (15 percent), parts for machinery and equipment (almost 13.4 percent) and clothing (7 percent), which is the export of textile products made on the so-called "loan basis" (TN: CMT manufacturing). Food products and furniture participate with over 4 percent each, while all other activities are almost negligible. In other words, the share of only three groups of products (parts for catalysts, centrifuges, and electric cables) makes up 30 percent of total export.

When we analyse the country's export structure, a key aspect to consider is its competitiveness and the labour qualification structure of the exports. Chart 7.6 depicts the structure of the average labour qualifications contained in the export goods of North Macedonia in 2019.¹³ The labour force with secondary qualifications (secondary education) occupies the most dominant share in the labour engaged for production

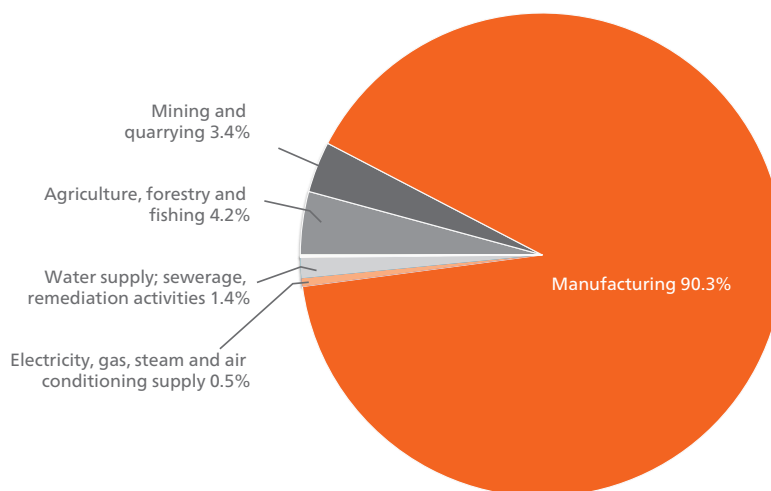
¹³ These data are the authors' own calculations and are obtained by using a "pattern" for distribution of labour, based on its average qualifications, used for the production of goods and services per separate activities. By using that "pattern", based on data on export products of North Macedonia stratified per activities in 2019 (Chart 4), data were generated on the average labour qualifications contained in the export products of North Macedonia in 2019. The distribution of the labour "pattern" by average qualification per individual activity was taken from: Michael R. Peneder (2007), A Sectoral Taxonomy of Educational Intensity, Journal of Applied Economics and Economic Policy, 2007.

Chart 7.3
Exports of North Macedonia according to basic categories of income in 2019



Source: State Statistical Office of the RNM
Note: Products with share of < 0,5% are not indicated in the chart

Chart 7.4
Export products of North Macedonia classified according to activity in 2019, in %



Source: State Statistical Office of the RNM
Note: Products with share of < 0,5% are not indicated in the chart

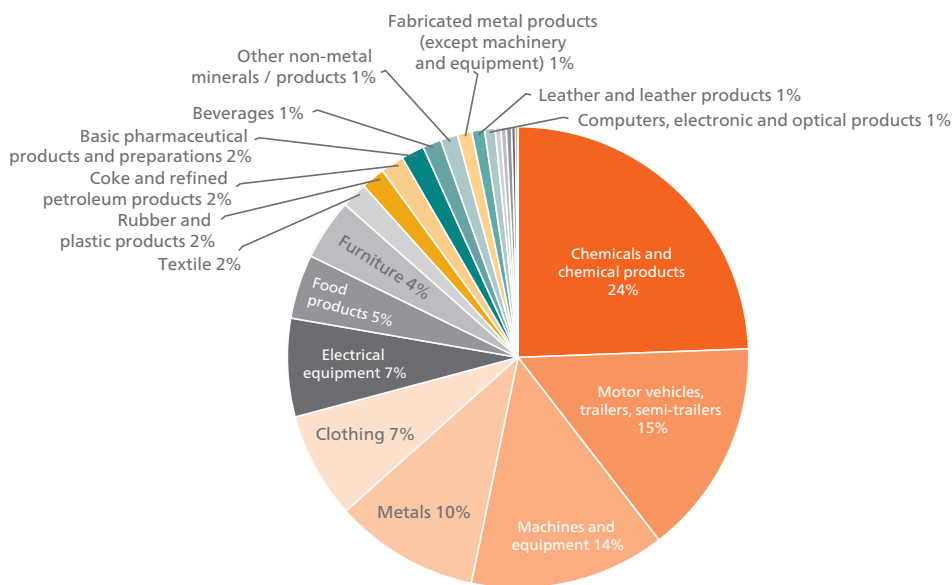
of export goods of North Macedonia, followed by the labour force with very low and low qualifications (without education). On the other hand, the participation of higher and very highly educated workers and qualifications is negligible. The export structure of North Macedonia does not include the services sector. Moreover, by looking at the export structure in the context of the qualification structure of total labour force in North Macedonia it becomes apparent the country is not successful in utilising its workforce potential for producing and creating export goods.

If we examine the structure of Macedonian exports per export markets (Charts 7.7 and 7.8), a notable

growth in export to the markets of the EU Member States can be observed and, among them, to Germany in particular. In the total exports of North Macedonia, the share of export to the EU markets has reached 48.7 percent, mostly at the expense of a decline of export share to all other markets, especially the share of export to the six Western Balkans countries' markets.

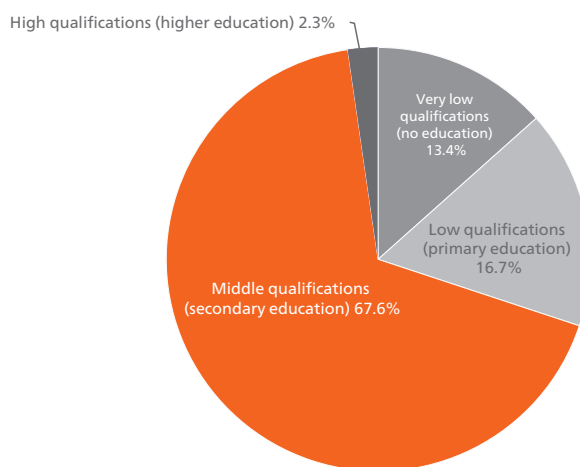
When examining North Macedonia's exports by sectors (as defined per the Standard International Trade Classification (SITC)) and by export markets (Chart 7.8), the highest portion goes to the EU Member States in almost all of the product categories (including food and beverages, and tobacco). An

Chart 7.5
Export products of North Macedonia from processing industry in 2019, in %



Source: State Statistical Office of RNM
Note: Products with share of < 0,5% are not indicated in the chart

Chart 7.6
Qualifications of labour contained in export products of North Macedonia in 2019, in %



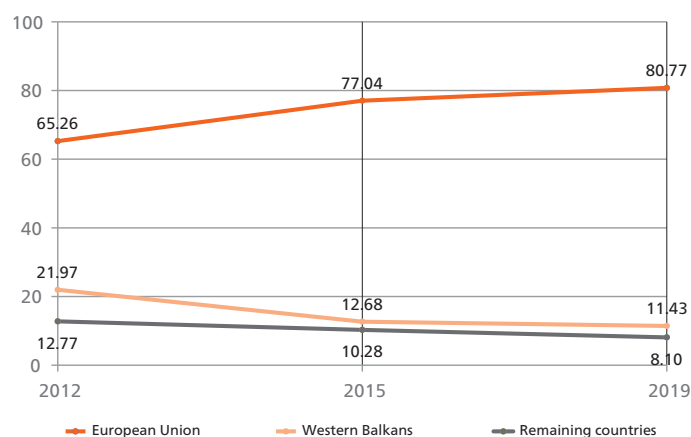
Source: State Statistical Office of the RNM
Note: Products with share of < 0,5% are not indicated in the chart

exception are the categories of mineral fuels and animal and vegetable oils (whose total share in North Macedonia’s exports is extremely low), where the Western Balkan markets dominate.

The data that was used in the analysis indicates that North Macedonia is not particularly successful in implementing an export-led growth strategy, nor has it made sufficient efforts in utilising all of its potential. The export structure, as well as its growth dynamics, is primarily determined by the FDI inflow in the country, whose operations and profitability are heavily based

on the relatively low cost of labour, the low (and flat) taxes in North Macedonia, as well as the technology transfer from abroad. The share of the domestic companies in the value chains of FDI is almost negligible, which confirms the absence of a knowledge spillover effect, and absence of a multiplier effect from attracting FDI. In such a setting, the FDI in North Macedonia, especially those from the technological-industrial zones, create up to 50 percent of the total export of the country, but their contribution to GDP amounts to approximately 2 percent, while their share in the total employment is approximately 3 percent.

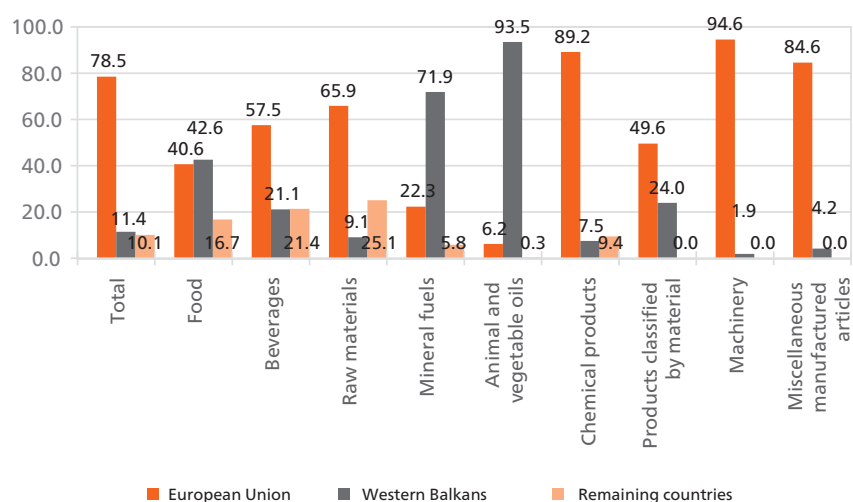
Chart 7.7
Export of North Macedonia per groups of countries in 2012, 2015 and 2019, in %



Source: State Statistical Office of the RNM

Note: Products with share of < 0,5% are not indicated in the chart

Chart 7.8
Exports of North Macedonia according to SITC and most important export markets in 2019, in %



Source: State Statistical Office of RNM

Note: Products with share of < 0,5% are not indicated in the chart

The above description of the state of affairs speaks of the "export" of the Macedonian cheap labour through FDI, whereas the newly created value from production generated by FDI is below 10 percent. On the other hand, the country remains at a low technological specialization level. Domestic companies use relatively outdated technologies and are not ready to accept new technologies. The level of investment in research and development and introduction of new products and technologies are extremely low. Hence, the growing tendencies of North Macedonia's export do not indicate a gradual development of a sustainable export competitiveness of the economy.

7.3. EXPORT IN SOUTHEAST EUROPE AND THE POTENTIAL FOR REGIONAL INTEGRATION

North Macedonia could benefit from a new strategic focus in its foreign trade, which would include identifying "new" export markets. A complementary process would be the inclusion of domestic companies in regional value chains and the regional (common) market. The regional market represents great potential for boosting the export of domestic companies for two reasons: first, the competitive advantage of the goods and services of Macedonian companies on

regional markets is higher compared to that on the EU market; and second, one of the consequences of the current pandemic is the disruption of the value chains between the EU and Chinese companies as well companies from other, distant markets. Additionally, the Western Balkans region is becoming increasingly interesting as a venue for future expansion of FDI from EU Member States, and there is an increasing interest in more holistic inclusion of the Western Balkan companies in value chains of the European companies.

On the other hand, the dynamics of the regional economic integration of the Western Balkans, and the consequent increase of regional foreign trade and exchange, is strongly hindered by several factors. First, the structural characteristics of these economies present a hindrance for a stronger economic connectivity not only among regional companies through the regional value chains, but also with other countries/economies in the wider region (EU Member States). The structures of the economies of the Balkan countries are very similar due to the similar endowment with production factors, small differences in the level of economic development, similar education, health systems and institutional structure in general. Hence, these economies are more competitive with each other rather than complementary to one another. Second, the dynamics of regional economic integration is also hampered by current (but never unresolved) political agendas of certain countries in the region, as well as by existing institutional and procedural barriers to foreign trade. Each country has built its own "system of rules and institutions" for foreign trade, and cooperation between them and their alignment is often hindered for political purposes. It is a fact that customs protection between countries is not a big problem, and lately the situation has improved in terms of transport corridors (but not for rail transport); however this is insufficient. There is a widespread "anecdote" in the region according to which "the Balkan countries are building transport corridors so that trucks carrying goods can reach border crossings faster and then experience longer waiting times there."

However, economic structures are changing concurrently with the potential for progress. In that sense, all the economies of the Western Balkans are facing an intensive process of structural change and adjustment. In addition, a process of regional economic connection is underway (first as a free trade area, then as a customs union, and finally as a common market). All this shows that this potential for future economic development of North Macedonia must not be neglected, nor still be considered as something of secondary importance, while the EU market is of primary importance.

7.4. COMPETITIVENESS THROUGH INCLUSION IN VALUE CHAINS AND TECHNOLOGICAL DEVELOPMENTS

Building on the conclusion from the chapter on productivity growth, we reinforce the proposition that a successful implementation of an export-led growth strategy entails developing a relatively high level of specialization of the economy, a relatively high level of technological development and modernization, and a gradual development of a higher level of competitiveness and competitive capabilities in global frameworks. To achieve this, competitive advantages must be based on a quality workforce, technological advancement and innovations that need to be created. However, given that North Macedonia is a small economy, this is likely to be expected in a relatively small number of sectors.

In this sense, North Macedonia must not only rely on imports of knowledge and technology, but this needs to be combined with the development of its own know-how, innovations, and the linking of domestic companies within the value chains of FDI in the country and within the continental value chains. On the other hand, considering the structure of Macedonian exports per markets (with the enormous domination of the EU Member States' markets), a relatively swift and high-quality implementation of reform processes and the country's accession to the EU will be of pivotal importance. This process, additional to the imposition of new "rules of the economic game" will lead to quality improvement of institutions, particularly to those vital for the proper and solid implementation of said rules, which will additionally contribute in strengthening economic development, particularly though export growth.

7.5. EXPORT OF SERVICES – A SIGNIFICANT ASPECT OF DEVELOPMENT STRATEGY

The Macedonian economy has a specific structure, according to which a relatively large part of domestic GDP (about 40 percent) is generated in the manufacturing services sector. However services, for the most part, are by definition non-tradable goods, and a small number of them are traded outside the country's borders. Moreover, that part of the traded services cannot be easily captured in the statistical indicators due to the nature of their trading which, in certain part, falls in the category of the shadow (informal) economy, whereas the other part takes place virtually, through the digitalization process, which further complicates their accurate recording. In that sense, there is vast untapped potential, which could certainly invigorate the development of economy through export. All these opportunities should be systematically encouraged by the government (economic policy).

CONCLUSION AND RECOMMENDATIONS

Despite the escalating trend of trade tensions worldwide in recent years, protectionism and trade wars should not be the answer to the trade distortions. Trade integration can be extremely useful for small emerging economies and technological followers. The country's export is lacking an adequate contribution to GDP growth, which is mostly a consequence of the country's failure to utilize its potentials. The specific export structure of the country lacks the potential to contribute to the successful implementation of an export-led growth strategy. One of the key steps towards realisation of that strategy is broadening the focus of foreign trade of North Macedonia towards the "new" i.e., alternative export markets. In this con-

text, regional markets represent a great potential for relatively fast invigoration of export of domestic companies in the country.

In an era of the domination of knowledge and intellectual capital imposed by globalization, the development of new technologies and increased competition, countries and companies aspiring towards export-led economic growth should focus on building and maintaining their own endogenous growth factors. Growth of exports to EU Member States in the future should be based on technological development and inclusion in FDI value chains, while export promotion should not be limited only to the export of goods, but should also encompass all export services which will help make best use of the existing untapped potentials in the country.

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8

RESHAPING SOCIAL PROTECTION AND SOCIAL INSURANCE SYSTEMS IN THE MEDIUM TERM

MAJA GEROVSKA MITEV AND MILA CAROVSKA

INTRODUCTION

Social changes which include transformed economic, social, demographic and family structures, inevitably impose the need for changing the systems of social protection and social insurance. Welfare regimes that faced difficulties in adapting to structural changes in the 1990s were called “frozen landscape” by Esping-Andersen, referring to the status quo and the rigidity of continental European welfare state arrangements (Esping-Andersen, 1996). Perceived through the prism of altered social trends in the third decade of the 21st century and the needs they bring about, many welfare states can once again be called the “frozen landscape.” Namely, the adaptation of the welfare systems need to be a continuous process and should not be seen only through the parametric changes of the existing design. New family structures, new forms of employment, new social risks require paradigmatic changes, as well as changing the logic of functioning of social protection systems, that is, from a system of “last resort” to a system of “initial support”, from a system of reciprocity to a system of complementarity and from a curative to a preventive social system.

The reforms of the social protection and social insurance systems in North Macedonia were typical for the beginning of 2000 (introduction of capital-funded pension and disability insurance, changes to the length of insurance in case of unemployment, etc.), and in the last few years with the amendments to the system of social and child protection (2019) when new rights were introduced (e.g. educational allowance), the scope was expanded and reference scales were equalised between different rights, thus improving equality of treatment among beneficiaries. However, the need for further changes is inevitable. In the medium term, social protection and social insurance systems in North Macedonia need to undergo transformation, in order to: cover new social risks, include non-standard forms of employment in social insurance schemes, increase funding and diversify funding sources, expand universality of social rights, as well as to digitalise social protection and social insurance.

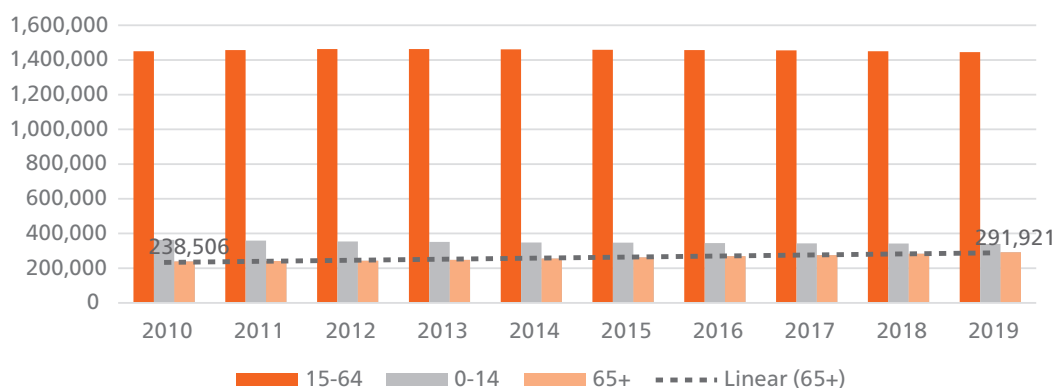
8.1. SCOPE OF NEW SOCIAL RISKS

The scope of social insurance rights is based upon the coverage of expected social risks, such as: birth, sickness and occupational injuries (health insurance), professional adaptation, unemployment (unemployment insurance), disability, old age, death (pension and disability insurance). This traditional approach of “savings” for social risks primarily includes financial compensation for the present risk which the beneficiary is facing. However, considering the demographic changes taking place in the context of the extended life expectancy of people, as well as the changes happening in labour markets in comparison to the growing number of “non-traditional” forms of work, the social insurance is facing the need to expand the scope of the social risks it covers, but also to increase the share of services instead of payments, as a form of social insurance.

Starting from the continuous growth of the population older than 65, which in the 2010 – 2019 period increased by 22.3 percent (Chart 8.1), as well as from the emphasized need for long-term care of this age category which almost tripled in the 2010 – 2018 period (Chart 8.2), discussions about possibilities of introducing long-term care insurance are inevitable. The experience of European countries shows that still the bulk of funds used for providing long-term care for the elderly come from general taxation. The exception to this is Germany, which has mandatory long-term care contributions, while the systems in Luxembourg and Belgium/Flanders have a combination of contributions and taxation.

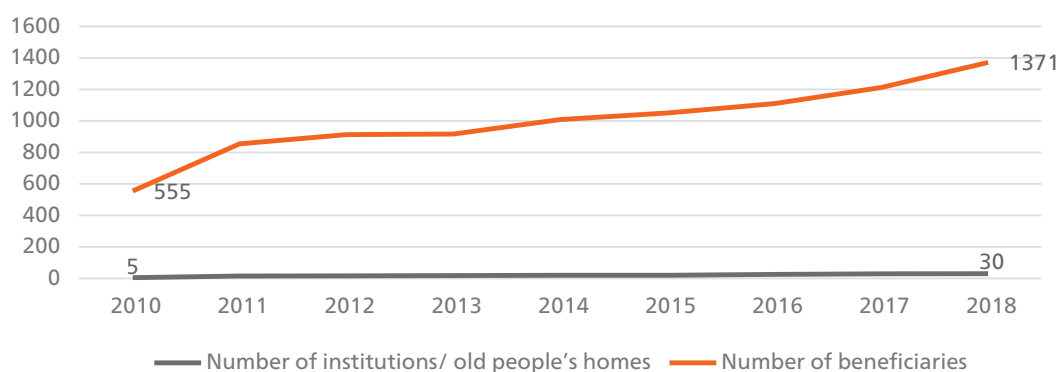
In Sweden, local governments have the right to decide and establish a scheme for financial compensation for long-term care (Spasova et al., 2018). In Germany, which introduced long-term care insurance in 1995, funding (traditionally) has been divided equally between the employee and the employer, amounting to 2.55 percent per month of the gross pay. It covers the costs of care in the beneficiary’s home or the accommodation costs in a long-term care institution. This type of insurance gives preference to care

Chart 8.1
Population structure in North Macedonia according to age



Source: State Statistical Office, 2020

Chart 8.2
Institutions and beneficiaries of institutions/old people's homes in North Macedonia



Source: State Statistical Office, 2019

in the beneficiary's home or assisted living schemes. However, in 2017, about one third of the beneficiaries lived in a long-term care institution, and 50 percent of them were people with dementia (Federal Ministry of Health, 2017). This example of anticipating demographic challenges is also followed by Slovenia, in which the adoption of the Law on Long-Term Care Insurance was pending in 2020. In order to ensure a stable source of funding for growing long-term care costs, Slovenia has simulated several scenarios as to whether the new insurance should be mandatory or voluntary and whether taxes should be increased or an increased social security contribution needs to be introduced. According to Slovenian estimates, this new type of insurance will cost half a billion EUR¹⁴.

In North Macedonia, long-term care is fragmented between the social protection system and the health care system. However, this division does not mean an integrated approach between the two systems and very often the beneficiaries of rights and services for long-term care exercise them through long and complicated procedures, which require visits to both social work centres and health institutions and commissions, depending on the type of disability or disease. Such duality of the long-term care system breeds ambiguity concerning expenditures for its financing. According to Eurostat, disability-related expenditures in 2017 amounted to 1.7 percent of the gross domestic product (GDP), while health expenditures accounted for 4.2 percent of GDP. Introducing an additional contribution for long-term care could improve not only the transparency of expenditures, but also the stability and diversification of financial resources for this purpose. Moreover, contributions for long-term care, in addition to pension, i.e. material protection for old

¹⁴ Media statement of Slovenian Health Minister Aleš Šabeder: <http://www.rprogreso.com/slovenia-health-minister-assures-legislation-of-long-term-health-care-reform-to-address-the-needs-of-ageing-population.htm>

days, would also ensure support to home-based care costs or the costs of accommodation of the beneficiary in an institution. This would significantly affect the improvement of social security among the elderly. Of course, the introduction of a new or increased social insurance contribution for long-term care should also be analysed in the context of the overall burden on the labour costs. The challenges to its introduction in the national context are related to the still low employment rate (47.3 percent), as well as the significant number of employees in the informal sector (15.7 percent). Additionally, the debate about the fiscal policy model, which envisages that social security be fully based on the tax-financed model, should be taken into account, and if it is realised in the medium term, the share of costs for financing long-term care should be properly projected in the tax items. Considering the overall benefits, which in addition to the individual level would also help relieve the family obligations for providing support to the parents by their children, or sometimes to other family members, the expansion of social security with long-term care is an inevitability which, in the medium term, will help North Macedonia upgrade its conservative care system, achieve an accountable and diversified system of financing and providing long-term care, and improve social security among the elderly population.

Furthermore, the scope of unemployment insurance should also be expanded, by including all unemployed people for whom contributions have been paid as eligible beneficiaries, regardless of the reasons for job termination. The current unemployment insurance system has provisions which are in conflict with the rights arising from the employment status. Namely, the Law on Employment and Insurance in Case of Unemployment defines that the financial compensation in case of unemployment cannot be exercised, among others, also by “an unemployed person whose employment is terminated due to: amicable termination of employment, termination of employment with dismissal, and unjustified absence from work for three consecutive or five working days total in a year” (Article 67, Official Gazette, no. 124/19). Such treatment of unemployment does not coincide with the fact that unemployment insurance contributions are paid regardless of the reasons for termination of employment. The logic of this approach probably stems from the fact that contributions are paid by the employer and not the employee personally, so the protection in case of unemployment ought to be “deserved”, i.e. shall be granted only if the reasons for unemployment are not directly linked to the employee himself.

This conservative interpretation of unemployment insurance makes the payment for this contribution meaningless. The latest measures for supporting unemployment as a result of Covid-19 temporarily changed these provisions, so an unemployed person can become eligible for insurance in case of unem-

ployment, regardless of whether the employment was terminated amicably or by dismissal. This temporary measure must be introduced as a guaranteed right to financial compensation in case of unemployment, which can be exercised regardless of the reasons for unemployment. In addition, because the Law on Compulsory Social Insurance Contributions does not define the following categories as payers of unemployment contributions: the self-employed, farmers, seasonal workers; they are also excluded from possible protection in case of unemployment through the social insurance system. One of the measures to be taken in the medium term is the opening of social insurance to these non-standard forms of employment, both in terms of their integration into the system of mandatory payment of unemployment insurance contribution, and also with a view to enable uninterrupted opportunity for their use (further elaborated in the next section).

8.2. ACCESS TO SOCIAL PROTECTION AND SOCIAL INSURANCE FOR NON-STANDARD FORMS OF EMPLOYMENT

In accordance with the definition of the International Labour Organisation¹⁵ the term “non-standard forms of employment” is used as an umbrella term for different employment arrangements which deviate from standard employment. They include temporary employment; part time and on-call work; temporary agency work and other multiparty employment relationships; as well as disguised employment and dependant self-employment.

Data on non-standard forms of employment in North Macedonia¹⁶ according to Eurostat show that in 2019 the number of self-employed persons was 16.2 percent, 13.2 percent were employed on temporary employment contracts and 4.0 percent were employed on part-time arrangements. Self-employment denotes a bigger growth than the conventional full-time employment, whereby the share of agricultural self-employed workers is highest. According to Labour Force Survey analysis, self-employment is most often not a matter of choice, but of lack of available well-paid jobs. It is more a matter of economic survival which can be concluded from the fact that most self-employed people live with income below the average wage amount.

In light of the commitments at the EU level, in the context of the European pillar of social rights, the situation with the legislative, but also effective

¹⁵ International Labour Organization, <https://www.ilo.org/global/topics/non-standard-employment/lang--en/index.htm>

¹⁶ Eurostat, 2020: lfsa_egaps; lfsi_pt_a

access to social protection and social security for the “non-standard employees” in North Macedonia needs improvement. From the aspect of a formal approach to social protection and insurance, the self-employed people are included in the compulsory social insurance, accessible to all economically active persons. An exception to this is unemployment insurance, which does not cover self-employed persons (except those employed by self-employed persons). There is also a difference in the basis on which social security contributions are collected. In addition, temporary workers with contracts for manual and/or intellectual services (service contracts for the non-employed) are excluded from pension and disability insurance, as well as unemployment insurance. Health insurance contributions are mandatory only for those temporary workers whose income is higher than the legal minimum wage. Workers in agriculture are also a special category and are excluded from the possibility of participating in the second pension pillar, as well as in the unemployment insurance.

Further to the lack of formal access, for a number of employees in non-standard forms of employment, the exercise of effective access to social protection and insurance is difficult in practice. Namely, often employers do not comply with the legal provision for extending the fixed-term contracts whose duration is five years, into permanent employment contracts (unless labour inspection is included), so they deliberately terminate such contracts before the end of the five-year period. Also, non-standard workers often face difficulties in meeting the conditions for eligibility to receive social security benefits (e.g. due to periods of termination of contributions). In the case of

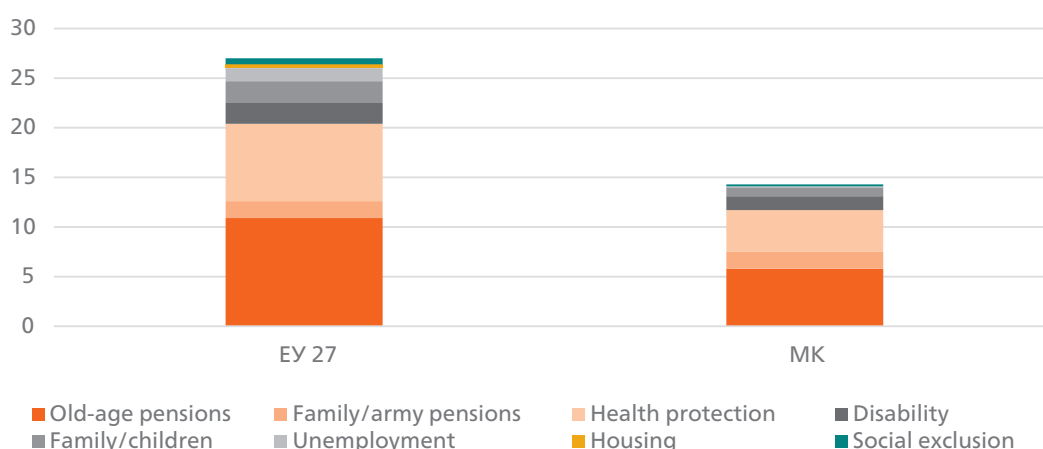
the self-employed, the problems with exercising the rights often depend on the calculation of the basis used for estimating the income on which social contributions are paid.

Having these conditions in mind, it is necessary to open the system of social protection and social insurance to all forms of employment, considering the hybrid nature of working statuses. In that regard, in addition to effective monitoring and inspection over the implementation of provisions on formal access for non-standard employees, it is necessary to adjust the access criteria, the amount and length of contributions according to the specifics related to the of length of working hours and job characteristics (occasional, seasonal work, etc.).

8.3. INCREASE OF FINANCING AND DIVERSIFICATION OF FUNDING SOURCES OF SOCIAL PROTECTION AND SOCIAL SECURITY

Despite the public perception that the country spends a lot on social protection, analyses, nevertheless, especially compared to the countries in the region and beyond, indicate that in terms of its social protection expenditure, North Macedonia is classified in the group of Central and Eastern European countries with low consumption (Spasova and Ward, 2019). Compared to the countries in the region, social protection expenditures in North Macedonia are lower than those in Croatia (21.2 percent), Serbia (19.1 percent), Bosnia and Herzegovina (17.8 percent) and Montenegro (16.8 percent)¹⁷. As can be seen from

Chart 8.3
Social protection expenditures as a share of GDP, according to function, % in North Macedonia and EU 27, 2017



Source: Eurostat, 2020

¹⁷ Eurostat, 2020: spr_exp_gdp

Graph 8.3, according to the ESPROS methodology¹⁸, social protection expenditure in 2017 amounted to 14.3 percent of GDP and did not undergo significant changes in the 2015–2017 period. Pensions have the largest share in social protection expenditures, whereas housing, unemployment and social exclusion expenditures have the smallest share.

With a view to tackling most effectively the key social challenges, such as unemployment, poverty, social exclusion etc., it is important to increase social protection expenditures, that is, expenditures in the domain of social welfare, disability, family/children, unemployment, housing and social exclusion. Reaching the EU average amount of social protection expenditure (26.9 percent) is unrealistic, but allocating between 18 percent and 20 percent from the GDP on social expenditures in the medium term should be a priority target.

Likewise, there is a need for improved diversification of social security funding sources. Dominant sources are contributions (8.5 percent of GDP) and tax revenues (6.7 percent of GDP), while other sources (co-financing, participation, private insurance, etc.) are negligible (0.3 percent of GDP) and do not represent a significant factor in the total revenues for social protection. The financing structure for social protection changed in the 2005–2017 period, at the expense of increased public expenditures, mainly as a reflection of the reforms such as the reduction of social security contribution rates, the transition costs for the pension reform, as well as the ratio of the insured beneficiaries vis-a-vis those paying the contributions. While the sources of pension and health income include contributions and taxes, other branches of social protection, such as social assistance, disability, and child protection are predominantly financed by tax revenues.

With a view to improving the ratio of contributions versus tax revenues, and in order to reduce the latter, it is necessary to avoid public measures and policies that promote exemptions from payment of contributions, as a way of improving labour competitiveness or as an active employment policy measure. Such measures are fatal, both for public perception of the importance of social contributions and for investments in social security in general. Additionally, in order to improve the potential of future sources for medium-term financing of social protection, it is necessary to: introduce additional social contributions to the contracts for temporary or seasonal provision of services (which are currently subject only to personal income tax); gradually formalize undeclared work with lower social contribution rates; provide increased

support for participation in the labour market among women, especially those from less represented ethnic communities such as Albanians, Turks, Roma, etc.

8.4. EXPANDING THE UNIVERSALITY OF RIGHTS BEYOND SOCIAL AND PROTECTION OF CHILDREN

The wider impact of Covid-19 has highlighted the need for transformative and accountable social and child protection systems. Support provided through social services and cash benefits during the first months of the crisis in North Macedonia, which included easing of criteria and conditionality (checking the last month's income instead of the income from the last three months, excluding activation as a condition, easing property ownership criteria), simplified administrative requirements, various methods of communication with clients, should become the new norm and continue after the crisis. The basic logic behind the criteria for accessing most social and child protection rights in North Macedonia has long been based on efforts to avoid fraud, abuse and dependence among clients. Hence, access to social protection and child protection system is "reserved" only for the most vulnerable. The current crisis caused by the pandemic has offered the possibility of replacing that "logic" of the system for social and child protection with an approach based on risk prevention, protection of applicants and expansion of the universality of social and child protection rights.

The initial step towards expanding universality can be taken by removing the income conditionality related to the access to child allowance. The amendments to the Law on Child Protection (Official Gazette, 104/19) have already started this process, by raising the income threshold, which enabled broader coverage of child allowances, i.e. child allowance and education allowance. This change in the income threshold has contributed to increasing the coverage of child allowances from 9,000 children in 2018 to almost 20,000 children by mid-2020. However, child and education allowances are based on income thresholds, allowing access only to those with lower incomes. The introduction of a universal child allowance for all children from birth to 18 years of age would have multiple effects, such as: significant impact on reducing child poverty, easy access during times of crisis and reducing the stigmatization of beneficiaries (which presently exists because of the means testing, property conditionality, etc. of the household of applicants and beneficiaries). In EU countries this universal right to child allowance exists in Austria, Lithuania, Estonia, Finland and Germany.

In terms of the setting of the value/amount of the universal child allowance, it is of utmost importance

¹⁸ ESSPROS – European System of Integrated Social Protection Statistics

not to establish an arbitrary threshold. The recent Universal Child Allowance Report (ODI/UNICEF, 2020) examines three approaches that determine the transfer: 1) in relation to the national poverty line, 2) international poverty lines, and 3) in relation to the average income or consumption of the household. In our national context, the value of the universal child allowance should be determined by considering the minimum wage amount. Namely, in order not to undermine employment levels, the amount of the universal child allowance should be formed by taking into account the amount of the combined rights to financial assistance from social and child protection, whose total amount should not get close to the minimum wage level. The introduction of a universal child allowance will also make redundant part of the existing pro-natalist money transfers, such as the allowance for newborns, or the parental allowance for a third and fourth child. In addition, this would serve the function of strengthening children's rights, reducing inequality, as well as ensuring greater social trust.

Nevertheless, if fiscal projections indicate that required expenditures outweigh the positive benefits of introduction of universal child allowance, then it can be based on an income threshold, which would limit the access of households from the highest income quintile.

Such an unconditional approach based on human rights can also be promoted among some of the rights to financial compensation in the area of social protection. The Guaranteed Minimum Assistance (GMA) (Official Gazette, 104/19), which replaced the previous social financial assistance, has offered a more flexible approach, so that applicants do not have to be previously registered with the Employment Service Agency, introducing higher entitlement payments and equivalent scales that improved equality among beneficiaries from different types of households. However, this basic instrument for tackling income poverty, the GMA is still "torn" between offering income protection and the rigid social risk management procedures. The reciprocal requirements from the GMA beneficiaries in return for the granted right to financial protection is part of the principles introduced by the legislative changes in the middle and end of 2000, which enthroned welfare-to-work as a condition for using the basic right to financial assistance as a form of social protection.

Such a "neoliberal" perception of activation, which was introduced as a condition instead of an accompanying right, did not bear any substantial effects in North Macedonia, so the transition of social protection beneficiaries to the labour market was not particularly evident. In that regard, it is necessary to return the "unconditionally" of the GMA, by removing the activation as a condition for using financial

assistance from the social protection system. The removal of conditionality does not mean that GMA beneficiaries would be prevented from using active employment measures, nor that the activation would be removed as an obligation under the Law on Social Protection. On the contrary, the activation would continue to be offered through the Agency and the Employment Centres, while the Centres for Social Work would guide beneficiaries through their employment opportunities. Only, the financial assistance through the guaranteed minimum assistance would not be abolished, if the beneficiary does not have the possibility to realise the activation.

Considering the educational profile of GMA beneficiaries, such an approach would contribute to the real use of active measures by "employable" beneficiaries, as opposed to the artificial insistence on activating those who do not have a basic education (and who need longer-term investment in training and work skills), nor do they have the necessary work habits. In addition, this approach to the social protection system would restore its primary role of a supporter rather than a controller, and in turn, the other systems such as education, market and labour, etc., would strengthen their role in supporting the socially vulnerable citizens and households. This would also partially reduce the administrative work of the Centres for Social Work and would provide social workers with the discretion to choose the type of support that should be offered to GMA beneficiaries, depending on their abilities and needs.

8.5. DIGITALISATION OF SOCIAL PROTECTION AND SOCIAL INSURANCE

The use of digital technologies in the field of social protection and insurance in the country pertains to certain basic activities such as, for instance, using client software for monthly calculation of integrated payment of contributions, electronic record of working hours, using the programme for selection of adoptive parents in an electronic way, etc. The national public e-services portal is a good start which offers information and insight into required documents for the applicants, but still does not offer possibilities for electronic application for services from the social protection and insurance system.

The wider effects of the Covid-19 pandemic have put under question the traditional model of (physical) delivery of social services and the exercise of social rights. In the context of mitigating challenges related to the pandemic, as well as in the interest of diversified provision of social services and social protection, one of the priorities in the medium term should be the greater applicability of digital delivery of social

protection and social insurance. Of course, such a priority does not mean reducing direct physical contact with the service beneficiaries, nor does it undermine the risk of creating additional social, i.e. digital exclusion of vulnerable categories who cannot use electronic platforms. The goal of increased digitalisation should be to complement the existing social services and to support and combine them, where possible.

Digital solutions in the field of social services include a wide range of possibilities such as: preventive tests for self-assessment of certain social risks, diagnosis, individual and group therapies, case management, outcome measurement, interventions and communication. Mackrill and Ebsen (2017), while analysing digital technology in social work with young people in the local community, point to the example of “MySocialworker” tool. The tool is a digital system aspiring to build a bridge between young people at social risk aged 15 to 23 and their social workers – case managers, and it was tested in three municipalities in Copenhagen, Denmark in 2017. Pointing to the complexity of digital social work, as well as to the need for continuous training in digital technologies and certain ethical aspects, Mackrill and Ebsen highlight that by using the application, customers can monitor their well-being, good habits, disruptions in their life, satisfaction with services used in the municipality, while these features help the social worker assess the risk, progress and use of resources. The app system can also be used to support change and self-help, as it can remind clients of positive behaviour and help them think more systematically about how their lives unfold by tracking changes. The app system is also a way of communicating the client’s perspective on his life on a weekly basis, which is followed by the case manager.

Comparative experiences show that digital solutions are particularly applicable in the care for the elderly, both in their home and in the long-term care institutions. According to analysis of Eurofound (2020), as part of the moduLAAr/Leichter Wohnen project, which was implemented between 2012 and 2015 in the federal state of Burgenland, Austria, 50 homes of elderly people (most of whom lived alone) were equipped with sensors on the doors, windows and in the bathrooms, to help prevent accidents and

to put in place an alerting system. These homes were also equipped with devices which have reminders (for instance, reminders for regular intake of medications) or for social interaction. The Home Event Recognition System – HOMER -- was also developed as part of this project, in addition to the “Own Cloud” platform for interaction between caretakers and relatives.

The digitalisation of social insurance offers greater opportunities for application than digitalisation of social protection and it faces lower risks from an ethical point of view or from the aspect of dehumanizing the activity. Digital platforms in the field of social security make it easier to incorporate non-standard forms of employment, but they also help increase market transparency, reduce transaction costs and offer new efficient and flexible opportunities for companies, as well for meeting the needs of individuals in relation to flexible working hours and independent professions. The International Labour Organization proposes the establishment of a digital social security system for professions that transcend national borders, and which could be run by international financial institutions. According to this proposal, the contributions system would be based on the “pay as you earn” principle of current payment, which would then be paid out on a monthly basis to the national social security systems (Weber, 2018). Such a proposal could be considered to be localized, i.e. to introduce a subsystem within the existing social security system that would apply to professions and contributions that are paid on the basis of a fixed percentage of the agreed salary.

All the above mentioned proposals for reshaping the social protection and social security system are just some of the possible directions and priorities that are recommended to be taken in the medium term in North Macedonia. Undoubtedly, their application requires prior existence of several assumptions, such as: multi-party consensus on the need and acceptability of the mentioned solutions in the medium term, enhanced professionalism in the field of social protection and social security, zero tolerance for political influence and political employments, stipulated annual earmarked funds from the state budget, as well as granting greater powers to the local government in providing services and rights in the field of social protection.

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9

TOWARDS BETTER EDUCATION AND SCIENCE

NIKOLA STIKOV, BRANIMIR JOVANOVIĆ AND DRAGAN TEVDOVSKI

We are shocked to read in the social media that our education is below average, yet at school instead of a competition we seek the easiest way of getting an A. In science we publish papers in predatory journals, and then we complain that not a single Macedonian university can be ranked in the top 1,000 on the Shanghai list. In job advertisements we promote meritocracy, but when the time comes to hire someone with the best CV, then nepotism and plutocracy prevail. We disregard and dodge the rules of the game from the earliest age; no wonder we keep tripping and tumbling when we run out on the field.

This text is a compendium of suggestions of what needs to be done so that our education would start creating scientifically literate minds with a potential to become a highly qualified workforce.

9.1. A MORE EQUITABLE ASSESSMENT FROM EARLIEST AGE

The inexistence of a fair grading and assessment system in the Macedonian education system is the reason why we have inflation of grades, inflation of degrees and general mistrust in the system.

In an ideal world, grades would not exist and we would all be learning out of curiosity and desire to change the society. Since a very small percentage of the population is driven by these motives, in every system there are different types of incentives which stimulate individuals to achieve results. Although most of us are accustomed to the concept of “bonuses” for the best employees in private companies, or promotions for the best employees in public administration, when we want to apply these principles of competitiveness to the youngest, we do so with grades whose interpretation is problematic. Years ago grades indeed were criteria for competitiveness, but in recent years their inflation has contributed to hyper-production of straight-A students from primary education in numbers which exceed the number of enrolment places in the gymnasiums (Maroska-Leova, 2019).

The problem with grades in the Macedonian education system is that there is no clear assessment criterion. Declaratively, whoever solves a larger percentage of a task or test (usually 90 percent) is rewarded with an A. However, what the grade A fails to capture is whether the task was easy or difficult, or whether the other students also managed to solve it. In such conditions, it is very likely that students will work together in order to overcome the A barrier. One desirable type of collaboration is learning together and sharing teaching materials so that everyone gets the highest grade. Contrary to this, an undesirable type of collaboration is plagiarism or seeking strategies to deceive the teacher.

Studies which compare tolerance to fraudulent strategies in education show that in the Eastern countries, cheating at school is tolerated more, compared to the Western countries (Magnus et al. 2002). There are many possible explanations for this phenomenon, which go back to the social order and rule of law. However, one assessment strategy almost without exception reduces the percentage of cheating, and that is assessment in which the grading of individuals depends on the results of the whole class.

Such a type of assessment is called grading on a Gaussian curve. The main assumption is that in each larger group of students the distribution of knowledge is normal (Gaussian), so those who know more than average will deserve a higher grade, and those who know less than average will receive a lower grade. In that case, the teacher’s task is not to determine who has met the criteria for an A, but only to decide what grade the average students will receive and how much better than average they should perform in order to get the maximum grade. The usual strategy is for 20 percent of students to get an A, 60 percent to get a B, about 20 percent to get a C or less, but the distribution of grades is in the hands of the teacher or the educational institution. Such assessment is almost ubiquitous in Western education systems for several reasons (each of which will be elaborated in more detail):

a) It eliminates the danger of the teacher setting very high criteria which no student would be able to meet

If teachers constantly create new tasks, then they will hardly be able to calibrate them at the student level. Sometimes the problems are difficult, so students are not able to solve even half of them; sometimes they are easy, so everyone scores 100 percent. The curve assessment eliminates the problem of calibration and encourages teachers to give more difficult tasks. Students, on the other hand, are not under pressure that they always have to solve everything and that gives them space to be creative.

b) Students themselves have a lower tolerance to cheating

Explained in short, if a student knows that he/she will be getting an A only if he/she performs better than the classmates, this will affect his/her decision whether to tolerate or encourage cheating. Many institutions that use grading on a Gaussian curve are so confident that students will not cheat, that they adopt an honour code (<https://communitystandards.stanford.edu/policies-and-guidance/honor-code>) and do not supervise their students at all.

c) It stimulates students to compete with each other and creates a culture of meritocracy

This is the largest benefit of the curve assessment. It offers the possibility to the most ambitious ones to prove and to assert themselves towards achieving better results. Results do not have to be public, because sometimes their public disclosure can be counterproductive. It would be enough for the student to know his/her grade and the distribution of the others' grades so that he/she would know the ranking compared to the classmates'.

d) The dark side of grading on a curve

Many researchers believe that the education system should be freed from pressures for higher grades and that the reasons for the existence of grades are more economic than educational (Fines 1996). It is also well documented that grading on a curve negatively affects minorities and impairs mental health (Calsamiglia and Loviglio 2019). Moreover this system does not work well in small and homogeneous groups (Dubey and Geanakoplos 2010). Finally, this system makes students from weaker schools get higher grades compared to those studying in prestigious institutions.

Each of these remarks is valid, and this is exactly why a new assessment system must not be introduced overnight. There is always room for a combined approach, where part of the activities is assessed against the Gaussian curve, and part is assessed on an absolute scale. The Gaussian curve works best when the testing

manner is changed too, so students are encouraged to ask questions and be creative in their responses.

On the other hand, the grading on a Gaussian curve already exists in the Macedonian system, but students are not aware of it. What is the state graduation exam if not an attempt to rank all potential freshmen? One point less or more in the ranking can mean the difference between free education and expensive tuition costs. Is it better for students to experience a Gaussian shock at the end of their education, or to get them slowly accustomed to the fact that they will be compared and evaluated on a curve for the rest of their lives? If we all agree that we need the grading curve in business, administration or sports, then why not teach our youth from earliest age that life is a competition?

In conditions of the coronavirus, education institutions are forced to implement new assessment methods. The Ministry of Education came out with a set of recommendations regarding the formative assessment which was greeted with discontent by part of education workers (Poprizova, 2020). The grading on a curve might just fill this vacuum.

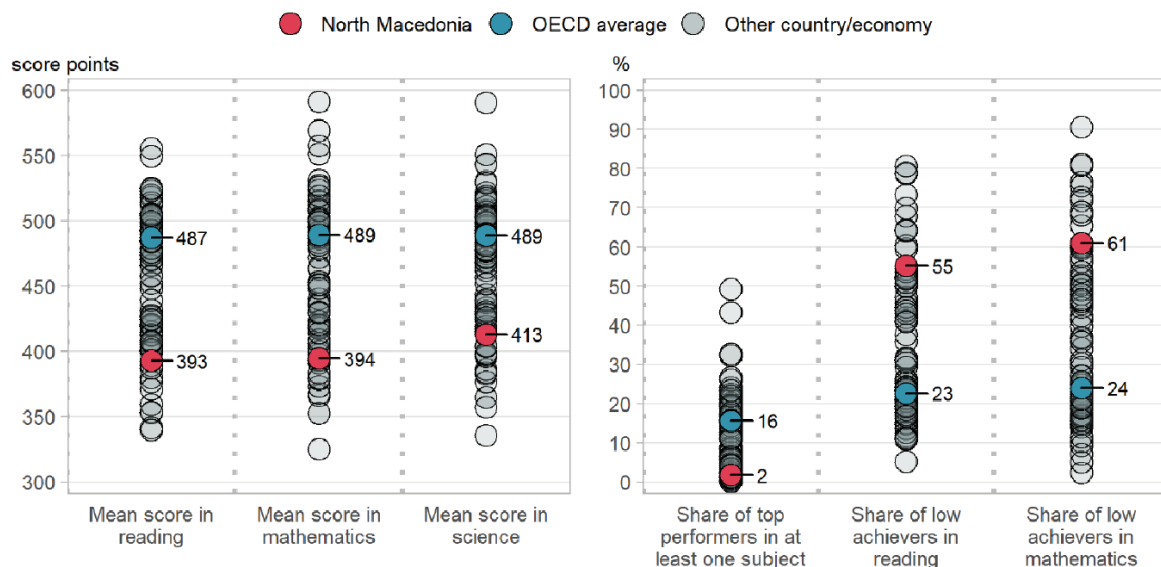
9.2. PISA ASSESSMENT RESULTS

The PISA ranking is an international OECD project aimed to evaluate education systems across the world through mass testing of 15-year-old students in three areas: mathematics, science and reading. As the name suggests, this ranking is actually a curve grading, only in this case the entire education system is graded, and not individual students. Macedonian results are far below the OECD average, and even more worrisome is that only 2 percent of students qualify as students who have met the highest criteria (top performers), compared to 16 percent in OECD countries (Chart 9.1).

In the past 15 years the quality of education has declined on all levels, which is visible from the deteriorated results in the international standardized measurements. For instance, testing of eighth graders as part of the Trends in International Mathematical and Scientific Studies (TIMSS) showed significantly worse results in 2011 than in 1999. The average mathematics score dropped from 447 to 426, the lowest among European countries, and the number of students who reached the minimum standard ("lower international reference point") in mathematics has dropped from 70 to 61 percent. The trend in sciences is even more worrisome, with a decline from 73 to 53 percent (Lameva and Ramadani, 2013).

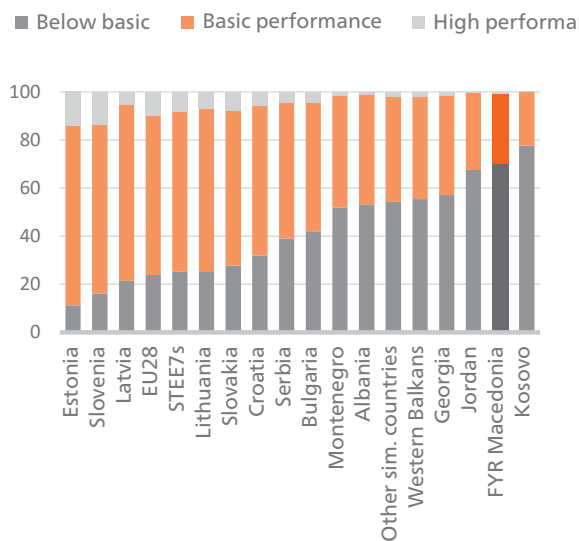
The PISA ranking also reflects these trends, so in 2015 around 70 percent of 15-year-old students failed to master even a basic command of mathematics and reading (OECD, 2019), which ranks us only better than

Chart 9.1
PISA results of Macedonian students compared to OECD average



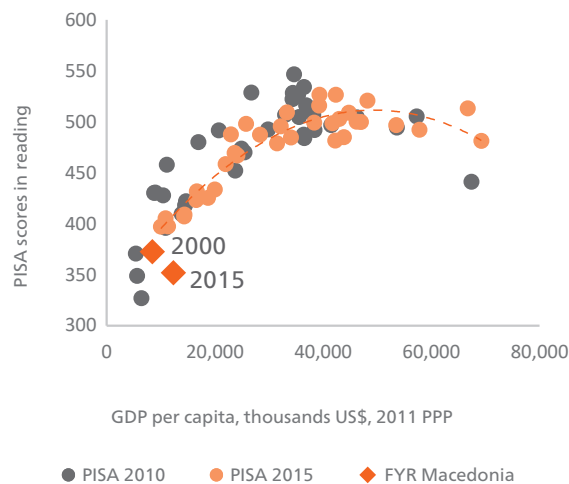
Source: OECD (2019) PISA 2018 Database

Chart 9.2
PISA ranking on the basic command of mathematics and science
Most Macedonian Students demonstrate results below basic in Maths (PISA 2015 results)



Забелешка: Босна и Херцеговина е исклучена од просекот на Западен Балкан.
Source: World Bank (2018) Overview of public finances in North Macedonia.

PISA scores in FYR Macedonia are below expected level (PISA 2015 results)



Забелешка: Резултатите од математиката и науката покажуваат слични резултати.
Пресметки базирани врз ПИСА (ОЕЦД) и СРП.

Kosovo and far below the other countries in the region. The large discrepancy between the strongest and the weakest students is also worrying, as students in the highest quintile scored results as if they had attended two more years of education compared to students in the lowest quintile. Although most countries show an increase in PISA results with the increase in GDP, in our country this is not the case (Chart 9.2). Although the GDP per capita has grown, PISA results have deteriorated.

It is hard to single out one main factor for these devastating results. Another worrisome trend is that timely completion of primary education is declining, and the enrolment rate in all education levels is lower compared to other similar countries. Even in pre-school age, only 55 percent of children from the richest quintile attended pre-school, compared to over 80 percent in Serbia. The percentage is even lower for children from the poorest groups, so only 0.3 percent of children from the poorest quintile attend pre-school.

The World Bank confirms the above rankings, so their 2018 report denotes that North Macedonia is below the world average in terms of test results and the effectiveness of education (learning-adjusted years of school). Although our children complete an average of 11.2 years of education by their 18th birthday, their knowledge corresponds to 6.8 years spent in school. This means that the learning gap in North Macedonia is 4.4 years, compared to the developed countries where on average about 2 years are “lost”.

Yet another problem is the quality of curricula. We introduced the “Cambridge curriculum” in primary schools at an express pace, but its implementation is going very hard due to the incompatibility of the British education system with Macedonian resources.

What can be done in order to reverse these trends?

a) Introducing standardised tests from earliest age

Some education systems place too much emphasis on standardized tests (Ozturgut 2011), but in fact, the earlier children are exposed to such assessment systems, the less pressure they will feel as they grow up. The examples with China and the USA do not correspond to the domestic situation, but they can serve as the starting point of standardising the Macedonian approach to standardised testing.

b) Uplifting the level of teachers (regaining the dignity of the profession)

Starting from kindergartens, the reputation of teachers should be higher, because teaching staff is not sufficiently rewarded for their work. In North Macedonia, the Faculty of Pedagogy has long lost its prestige. We have inflation of diplomas, at the expense of which we have deflation of critical thought. This may also be present in other advanced societies, but they can afford it because they have a tradition of meritocracy. We need to restore the authority and dignity of the teaching profession. The Faculty of Pedagogy should be one of the most prestigious institutions in the country, and its graduates should be well paid and respected. Only this way will their students learn to express themselves in writing, to approach problems analytically and learn for knowledge, and not for grades. If we put things in lower education on sound feet, we will develop new generations who are ready to face the challenges of modern times.

c) Emphasis on digital interactive teaching, scientific literacy and critical thinking

Our education is still stranded in the 20th Century and we make very little use of digital resources available to us. There are many organizations trying to change this, however their efforts are random and not coordinated, without the needed

institutional support. In order to stimulate critical thinking, students must be exposed to innovative teaching methodologies from the earliest age, and these methodologies, in turn, should be developed in collaboration with scientists, businesses and social partners. One such initiative is “Science for Children” (naukazadeca.mk), a display of cooperation between teachers and scientists aimed at scientific culture and mental training. “Science for Children” cooperates with an English non-governmental organization (FuseSchool) and adapts the free teaching content into the Macedonian language. Then this content is synchronized in the Macedonian language and is shared through online platforms.

d) More efficient allocation of resources in education

The key recommendation of the OECD report on increasing competitiveness in Southeast Europe is for countries to increase their budgets for primary and secondary education, as they are far below average compared to countries such as the Czech Republic, Poland or Slovenia. The report also recommends investing in early children’s development, and a salary increase for teachers (OECD, 2018).

The encouraging fact is that progress has been made from 2015 to 2018, but it is hard to believe that significant changes in education can occur in just three years. It is much more likely that the improved results are a reflection of the increased seriousness of the Ministry of Education and Science when implementing the test.

Similar to criticising the individual curve assessment, the question arises as to whether such group rankings should really be the basis for developing educational policies. Averaging and median results always iron out differences between systems and attempts to aggregate a series of socio-economic parameters into one indicator of success. Optimizing an entire system through the prism of a single measurement inevitably leads to Goodhardt’s law which states that when a measure becomes the target, then it ceases to be a good measure.

And yet, in a situation where education is becoming uniformed and the world is globalizing, what else can we do but play the game imposed by the big players? The PISA ranking is far from perfect, but in order to stop caring about it, we must speed up and catch up with the pace set by, if not the developed world, then at least the countries in the region. Only in this way can we make a breakthrough in higher education.

9.3. SHANGHAI LIST

The previous two points have illustrated that primary and secondary education is putting Macedonians into an inferior position on the global labour market. Unfortunately, even those who decide to continue their education are in an unfavourable position.

In the recent years, the increasing number of universities has resulted in an inflation of diplomas. This inflation was part of a national strategy to keep up with the percentage of highly educated staff in Europe, but sadly many of these degrees are awarded in non-innovation-related fields such as business, administration and law. According to the World Bank recommendations, higher education should avoid skills mismatch and should redirect students to science, technology, engineering and mathematics (STEM) as fields with greater potential for innovation.

The ratio of employees with university education among the entire working age population (25-64 years) is 21 percent, but among the younger people (25 to 34 years) we see an increase to 32 percent which brings us closer to the European average of 40 percent. What these figures do not capture is the (non)quality of higher education. For that we have to refer to the Shanghai Ranking of World Universities, where even the highest ranked Macedonian university (UKIM) cannot be counted among the top 1,000.

Although other university rankings do exist, the Shanghai list is particularly important for us because the Ministry of Education and Science has conducted a ranking of the Macedonian universities according to the Shanghai methodology. According to this methodology, 50 percent of the evaluation comes from the quality of education, 36 percent comes from research, and 14 percent from the social impact of universities (ARWU, 2020). Below we have provided analysis of the situation in each of these categories, with concrete recommendations on how to achieve better ratings for our universities.

a) Uplifting the quality of education

Perhaps one of the biggest mistakes in our higher education is that we are attempting to educate staff in all scientific disciplines. A small country needs only a handful of faculties, but of high quality. National strategies need to be developed and we need to make best use of the already available human resources. Here we mean the renowned, already proven academic staff, but also the scientific diaspora that works at world-renowned universities. That way we would be able to promote higher education on several grounds relevant for the Shanghai ranking.

Of the 13 criteria published in the Shanghai methodology linked to the quality of teaching, the ones having the largest share in the final results are the number of professors with the highest level of education and the number of professors with more than one year of international experience.

One measure that might unite the above criteria is the concentration of high-quality academic staff in a small number of academic programmes, and promoting partnerships with foreign institutions that would enable our staff to gain international experience. Although in the past there have been efforts to create such partnerships (signed memoranda of cooperation with several leading universities), what is missing is networking with our scientific diaspora, which can help more specifically in creating collaborations.

In the absence of a national strategy on how to use the Macedonian scientific diaspora, a group of scientists linked to the blog "Qantarot" (qantarot.blogspot.com) have devised a list of Macedonian scientists abroad. The list organizes scientific meetings every Wednesday to which we invite renowned Macedonian researchers. We are currently analysing the list in order to determine the academic fields in which we have the greatest educational potential. This list will be made public soon and we will call on the public to complement it.

This list will play a dual role: (i) it will help us deduce which universities in North Macedonia have been most productive in shaping internationally recognized academic staff, and (ii) it will open the doors to cooperation with internationally known scientists of Macedonian origin.

b) Promoting research

In the Shanghai methodology, scientific publications are key criteria when assessing the quality of research, which need to be peer-reviewed and indexed in the Web of Science.

The Law on Higher Education has undergone several iterations and tightened the selection criteria for university titles, but the definitions of what qualifies as a scientific publication remain flexible. Still many Macedonian scientists publish papers in so-called predator journals, i.e. journals that do not follow the rules of scientific publishing (Danevska et al. 2016; Mehmeti, n.d.). Institutions try to raise the level of scientific papers by offering financial rewards to those who publish papers in impact factor journals, but that is far from enough.

According to the index of the "Nature" journal, Macedonian scientists appear in only 18 papers with a very high impact in natural sciences (Nature, 2020), and most of them are on the list thanks to being part

of large international teams. Consequently, the best way to make an impact is to identify priority areas and collaborate with foreign scientists in those areas.

The coronavirus pandemic has shown that many of these collaborations can take place remotely, so the barriers for our students and professors will be even lower. Many STEM professions allow remote work, and technological innovation makes collaboration easier. This is also a good way not to burden public funds with incentivising science, but to apply for international grants instead.

c) Increasing social impact

This category examines how much scientists receive and give back to the industry. One criterion is the industry's investment in research staff through grants, and the other is the extent to which researchers create intellectual property through which they patent their inventions. It is obvious that this item is exclusively reserved for STEM areas, but it participates with 14 percent in the total evaluation of universities, so it should not be neglected. Issuing patents is an expensive procedure that does not always correlate with social impact (Jaffe and Trajtenberg 2002; National Research Council et al. 2003), especially in countries that do not have a strong culture of intellectual property. On the other hand, industry can indeed help science tremendously, both through direct grants and by promoting a start-up culture.

9.4. RESEARCH AND DEVELOPMENT

Just like individuals having to get used to fair competition among each other, the state must also recognise all scientific fields where we can keep abreast of the rest of the world and develop its research and development strategy which will make us more competitive on the labour market and will place us on the academic map of the world.

Innovations, defined as production improvements and introduction of new products, are indispensable for the sustainable growth of productivity in the economy (Easterly and Levine, 2001). However, North Macedonia confirms the paradox of innovation: developing countries invest less in innovation than developed countries (Cirera and Maloney, 2017). The level of basic and applied research in North Macedonia is extremely low. Gross Domestic Expenditure for Research and Development in the four key sectors (companies, government agencies, higher education and non-profit organizations) altogether accounted for 0.36 percent of GDP in 2017. For the sake of comparison, in the EU countries towards which we aspire, on average they amounted to 2.13 percent of GDP in 2017 (according to the World Bank, 2020).

A possible explanation for this situation is that North Macedonia, like most other post-transition countries in Europe, is living a kind of capitalism that Nölke and Vliegthart (2009) refer to as "dependant market economy". In it, innovations occur as a transfer within transnational companies, which is different from the other two types of capitalism (liberal market economy or coordinated market economy) where the transfer of innovation propels the markets and where joint ventures and business associations play an important role.

Therefore, perhaps our biggest problem is not that we lag behind the developed countries, but that we have lower levels of research and development than our neighbouring countries. To illustrate, R&D accounted for 0.87 percent of the gross domestic expenditure in Serbia, or 0.75 percent in Bulgaria, in 2017. Table 9.1 presents a comparison with some of the more important results of the innovation process with the Western Balkan countries.

The research and development process might be boosted in North Macedonia if steps are taken on the

Table 9.1

Results of innovation processes, North Macedonia compared to the Western Balkans, 2016. (The numbers are absolute and quantify products, production processes, cooperation with universities, and gross-expenditures for R&D from private companies. North Macedonia is lagging behind the Western Balkans in all parameters.)

Measure	North Macedonia	Western Balkans
Introduced new or significantly improved products and/or services in the previous 12 months	49	58
Introduced new or significantly improved production processes or delivery of services in the previous 12 months	37	50
Cooperation with universities in research and development or technological development projects for new products or services in the previous 3 years	8	17
Gross expenditures for research and development of private companies	17	37*

Note: Western Balkans is comprised of: Albania, Bosnia and Herzegovina, Croatia, Kosovo, Montenegro and Serbia. *The figures above concern only Bosnia and Herzegovina, Croatia, Montenegro and Serbia (no data available for Albania and Kosovo). Source: World Bank (2018), p. 153.

supply and demand side of the innovations. On the supply side, the key players are universities, where human capital needs to be strengthened for scientific research. A necessary step that needs to be taken is to tighten the selection criteria for awarding scientific and academic titles, linking it to the publication of scientific papers and works only in journals with an impact factor. This will improve the efficiency of resources used in the national scientific system and will ensure greater acclaim for those who are truly engaged in science.

The second important step is linking universities to the demand in innovations, that is, to the enterprises. Important tool that would incentivize such linking are national grants for scientific projects.

Public policies for supporting development of enterprises should give priority to fostering the rewarding of process results, rather than subsidizing inputs. For example, the programmes of the Ministry of Economy are oriented towards input resources at the enterprise level, such as procurement of equipment and tools, logo and visual identity of products or services, advertising materials, and participation in fairs.

Moreover, policies need to be coordinated and spearheaded towards the same common goal. For years, the Ministry of Economy has been implementing programmes for improving the capacity of domestic enterprises, which are not properly coordinated with the initiatives of the Agency for Entrepreneurship, the Agency for Foreign Investments and Export Promotion and the Fund for Innovation and Technology Development. Additionally, stronger tax incentives could be considered for companies which decide to open research and development centres.

9.5. INVESTMENTS IN EDUCATION AND SCIENCE

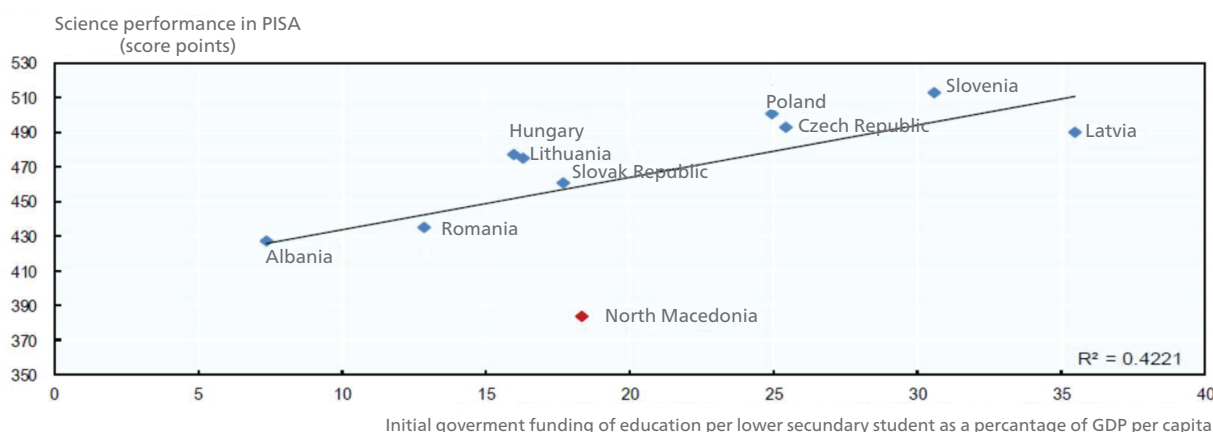
The funds that our state has invested in education in the 2015 – 2018 period amounted to 3.7 percent of the GDP, which is among the lowest in Europe. For sake of comparison, Serbia has allocated 4 percent of the GDP, and Slovenia has allocated 4.9 percent.

The allocations have been constantly declining in the past several years due to two main reasons. First, in the few past years state budgets have been decreasing. More specifically, the state budget in 2012 was 36 percent of GDP, while in 2018 it dropped to 32 percent. The second reason is the declining spending of the projected budgets for education. More specifically, in 2017–2018 period 11 percent of the projected funds for education remained unused, whereas in the previous seven years the percentage was 6 percent.

According to estimates, low investments impact the weak education results (OECD, 2019). Additionally, one third of the schools in the state are in dire need of renovation (OECD, 2019).

In addition to the investments being low, their structure is also assessed as unfavourable. According to a study published by the World Bank, the inefficiency of spending on education in our country is about 20 percent, which is much higher than in other countries in the region (Chart 9.3). In Albania this figure is about 7 percent, in Croatia and Bulgaria about 6 percent, and in Serbia about 5 percent. Examples of expensive projects such as “Computer for Every Child” or textbooks with CDs are well known. In higher education, the state constantly spends large amounts of money on new universities which do not breed any quality.

Chart 9.3
Overview of efficiency in spending of funds on education



Source: OECD review of evaluation and assessment in education in North Macedonia : assessment and recommendation. - Skopje : UNICEF, 2019

With regard to the investments in science, the Independent Academic Union (NAKS) recently published “Analysis of Funding and Conditions in Science in RN Macedonia” (NAKS, 2020). The analysis shows that the funds for science in 2018 are 16 percent lower than those invested in 2010, so the budget share for scientific and research work within the Ministry of Education and Science in the budget of North Macedonia amounts to meagre 0.04 percent.

Hence, it is necessary to increase investments in education and science, both by increasing budget allocation and by improving the absorption of funds. Furthermore, it is of utmost significance to improve efficiency of education investments, that is, to invest funds in well planned projects.

9.6. FUNCTIONALITY OF INSTITUTIONS

We keep pointing out how little we invest in education and science, and when funds are earmarked in the state budget for this, they are either not absorbed or are spent on unproductive things. We adopt strategies for the development of education, which remain a “dead letter” because institutions lack the capacity to implement them.

The Ministry of Education and Science (MES) has adopted an “Education Strategy for 2018 – 2025 with an Action Plan”. This document perfectly depicts the problems in the field of education and science: pre-school education, primary education, secondary education, vocational education and training, higher education and research and adult learning and education. The document also offers solutions to overcome problems, developed in an action plan, with implementation deadlines. However, the impression is that the Strategy is not being implemented. So far, only a Report on implemented activities for 2018 has been published, but there have been no significant reforms or results observed yet.

The example with this Strategy perfectly illustrates probably the biggest problem in our education system, perhaps of our whole society – the non-implementation of drafted strategies, plans and programmes. The problem is not only the lack of political will to implement difficult reforms, but also the lack of capacity of our institutions.

The Ministry of Education and Science lacks sufficient staff with technical knowledge in the field of designing, implementing and evaluating evidence-based policy making. There is no functional infrastructure that would allow such a thing, nor is there a functional information system. There is an Education Information Management System (EMIS) in place, since 2010, which should cover all educational institutions:

the Ministry of Education and Science, all its agencies and all primary and secondary schools in the country, a system that would collect, check, process and publish data on schools, students, teachers and other staff. However, as stated in the Strategy itself, the system has a number of weaknesses: the entered data are considered inaccurate, there are very few people who know how to work with it and the system is rarely used. The department within the Ministry in charge of this system has only two employees.

The agencies which are part of the Ministry of Education and Science and are supposed to ensure, among other things, development of education, adaptation of education to the needs of the society, inspections of educational institutions, are also understaffed, especially lacking in staff with professional skills, which hinders them from performing their important functions. Municipalities, which are responsible for managing primary and secondary schools, also lack sufficient human resources and financial resources to perform this task. Most municipalities have only one person responsible for education, which is absolutely insufficient.

The schools themselves lack sufficient resources and staff for quality implementation of the education process. Teachers have too many responsibilities with the delivery of the extensive teaching content, which they cannot adapt, but have to use it in its entirety, due to which they do not have enough time for individual work with students.

Schools lack enough space and equipment for quality teaching. Although schools have specialized pedagogical and psychological services, they are used only in special situations, and teachers usually do not have ample knowledge in these areas, which is why they often fail to meet the needs of students. Teachers rarely attend professional development trainings, and even in that regard our country is at the bottom of the PISA countries.

Hence, in order to be able to conduct major and essential changes to education, capacities of the education institutions must be increased, and their effectiveness and functionalities must be improved.

CONCLUSION

The road ahead of us is long and painstaking. It is an illusion to think that all the recommendations stated above will be implemented overnight. Still, competitiveness is the key to success of Macedonian education and science, and it can be achieved by fair assessment and grading from the earliest age; increased prestige of teachers and professors; and a national research and development strategy. If institutions find a way to at least endorse part of the recommendations indicated above, results shall not be far behind.

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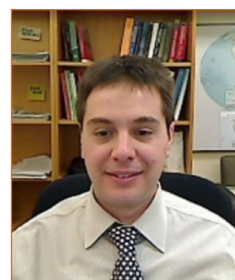
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SHORT BIOGRAPHY OF AUTHORS



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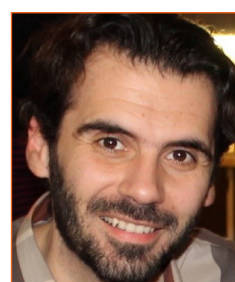
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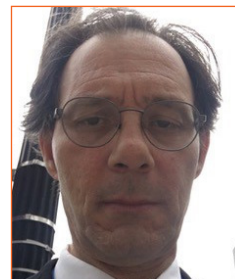
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Nikola Stikov holds an Undergraduate and Doctoral degree from Stanford University in the USA, and currently teaches Biomedical Engineering at The University of Montreal, Canada. He pioneers several international initiatives for a more effective scientific communication in his field of research (neuro-visualization and magnetic resonance imaging), but also strives to make science more accessible to the wider public. Nikola is a visiting professor at FINKI since 2017, and is the founder of the initiatives "Kantarot" (kantarot.mk) and "Science for Children" (nzd.mk).



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Mila Carovska was appointed Minister of Education and Science on August 30, 2020. In the previous 8 months, she served as Deputy Prime Minister for Economic affairs and coordination with the economic sectors, whereas in the period from 1 June 2017 to 3 January 2020, she served as Minister of Labour and Social Policy. Carovska has extensive experience in the field of strategic planning for inclusive development, with numerous expert engagements in the field of social policy and promotion of gender equality and rights of persons with disabilities, excellent knowledge of national and local policies and practices for social inclusion of vulnerable groups, as well as extensive experience in developing and implementing strategies, programs and projects for inclusion of vulnerable groups, experience in conducting analysis and field research.

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THE BIG PICTURE: THE MACEDONIAN ECONOMY IN THE MEDIUM AND LONG TERM



The selection of the export expansion as a long-term development strategy means that the economy of the state should not remain (just) a “small open economy”, rather that it should gradually develop into an internationally integrated economy. This is not the same at all. It means that there should be an increase in export and goods, but also of services with a larger component of domestic added value.



The future model of economic development of North Macedonia should have a sectoral approach in terms of the attracting of FDI, and domestic companies should not be left out. They need to join both the regional and global value chains. The regional (joint) market is a vast potential for domestic companies where they demonstrate higher competitiveness compared to the European level. Herein lies the opportunities created by the disrupted global economic flows caused by the pandemic which will make this region all the more interesting for FDI from the EU and will enable better linking of the domestic companies to the mentioned value chains.



It takes investments in order to promote further the qualifications of the existing labour force, and to ensure growth of innovations. This way the Macedonian companies would be the first followers of the technological leaders, which will help their easier integration into regional and international value chains of the big companies.