SCIENTIFIC STUDY

NEW ERA, NEW HOPE

"We are suffering just now from a bad attack of economic pessimism. It is common to hear people say that the epoch of enormous economic progress which characterised the nineteenth century is over; that the rapid improvement in the standard of life is now going to slow down; that a decline in prosperity is more likely than an improvement in the decade which lies ahead of us. I believe that this is a wildly mistaken interpretation of what is happening to us. We are suffering, not from the rheumatics of old age, but from the growing pains of over-rapid changes, from the painfulness of readjustment between one economic period and another." - John Maynard Keynes, Economic Possibilities for our Grandchildren (1930)*

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FOREWORD

Dear Reader,

The global landscape has been profoundly reshaped by a series of events such as the COVID-19 pandemic, the Russian invasion of Ukraine, escalating inflation rates, ongoing developments in Israel, food shortages, and exacerbated climate change. These occurrences have not only altered our way of life but have also prompted a fundamental re-evaluation of our economic paradigms, necessitating a departure from the prevailing neoliberal principles. As we find ourselves entering a new era marked by geopolitical tensions akin to a new cold war, the imperative for enhanced global cooperation becomes more pronounced than ever. And for that, a paradigm shift to a new economic model is imperative, one that envisions the state and the private sector as collaborative partners, instead of allowing few companies to dictate the availability of vaccines. Furthermore, such a shift needs to enable us all to see the viability of other essential services, such as energy, that should not be contingent on the geopolitical power wielded by individual states. The proposed economic model should also emphasise the active role of the state, not just during times of crisis but also in times of prosperity, reinforcing the concept of the welfare state. This vision extends globally, with affluent states actively contributing to the development of others through tangible and beneficial assistance.

In these challenging times, we are pleased to present to you the publication "New Era, New Hope" that focuses on understanding the implications of such global challenges on the Macedonian economy in the future. Through a dynamic, very interactive, and sometimes heated discussion, the authors, which are distinguished economists, scientists, professors, and experts in their respective fields, working both home and abroad have developed eight chapters into economic, energy, and social issues critical for the future development. By incorporating evidence-based research, yearslong experience and knowledge in an interdisciplinary manner, these chapters are laying out the foundations of the economy that North Macedonia should build as a small country in a globalised world faced by various challenges.

The Friedrich-Ebert-Stiftung is pleased to further promote "New Era, Now Hope", both abroad and within the country, fostering a joint effort to propose solutions and scenarios for overcoming the multifaceted crises that have reshaped the world. We invite you to engage with the diverse perspectives and ideas presented, encouraging thoughtful reflection and dialogue. As Friedrich-Ebert-Stiftung, we remain dedicated to facilitating inclusive public dialogue that will involve all stakeholders in decision-making processes vital for our common and sustainable future.

Ivana Vuchkova, Friedrich-Ebert-Stiftung,
Skopje Office

INTRODUCTION

Dragan Tevdovski

The invisible gorilla experiment is one of the most famous in psychology. In it, the participants watch a short video in which two groups of people, divided into white and black t-shirts, pass each other two basketballs. Then, the participants must count the number of passes between the white team. However, while they are focused on counting passes, briefly in the video, a man dressed as a gorilla also appears between the teams. Interestingly, although the participants in this test managed to count the passes correctly, more than half of them failed to see the gorilla. This experiment clearly shows two things. The first is that we humans often fail to see many things happening around us. The second is that we are not even aware that we are missing something significant.

This publication aims to dive into issues that are very important for the Macedonian economy and are somehow suppressed by the many developments, both in the world and at home. In the world, in recent years, enormous upheavals and wars have started: the COVID-19 pandemic, the Russian aggression against Ukraine, the energy crisis, the war in the Middle East... The world we knew in the last decades is slowly disappearing. Instead of free trade, the world is increasingly talking about protectionism in trade and security in food and energy supply. It is increasingly likely that some geo-economic fragmentation will occur. At home, we constantly face the burden of daily battles between political actors and witness the repercussions of the injustices and obstacles we receive on our way to the European Union. However, in the vortex of all these events, we must not forget the things that are important for the future of the Macedonian economy; that is, we must not turn a blind eye to what is essential in the long term. Moreover, we need to think about how best to face the new era's challenges.

This publication consists of eight chapters. The first one discusses the geopolitical and economic implications of Russia's invasion of Ukraine. The second chapter emphasises the importance of the state's role in dealing with crises. The third one provides ideas on increasing domestic food and energy production. Just energy transitions are the focus of the fourth chapter, while in the fifth we discuss the social protection system. The sixth chapter elaborates on the main determinants of the Macedonian economy's potential product. Chapters seven and eight present guidelines for a new foreign investment policy and a tax system of the new era.

These chapters aim not to set dogmatic guidelines on how and where the Macedonian economy should move. On the contrary, the intention is to open a discussion about the issues that matter to the economy and on which our adaptation to the new coming era will depend greatly. We should not shy away from the new era; instead, we need to open our eyes and environment where and how we move forward. Following the invisible gorilla experiment, we must realise that we have a problem with our selectivity in perception. We need to learn from the past in order to grasp the future. For that, even the great economist Keynes, writing during the Great Depression in 1930, or when transitioning from one era to another, said: "We are suffering just now from a bad attack of economic pessimism. It is common to hear people say that the epoch of enormous economic progress which characterised the nineteenth century is over; that the rapid improvement in the standard of life is now going to slow down; that a decline in prosperity is more likely than an improvement in the decade which lies ahead of us. I believe that this is a wildly mistaken interpretation of what is happening to us. We are suffering, not from the rheumatics of old age, but from the growing pains of over-rapid changes, from the painfulness of readjustment between one economic period and another."[1]

1

A NEW ERA? GEOPOLITICAL AND ECONOMIC IMPLICATIONS OF RUSSIA'S INVASION OF UKRAINE

Mario Holzner and Branimir Jovanović
(The Vienna Institute for International Economic Studies, wiiw)

INTRODUCTION

Russia's invasion of Ukraine has had devastating consequences. In almost a year it has resulted in hundreds of thousands of killed and wounded, about eight million refugees, and a similar number of internally displaced persons. The material damage is estimated to amount to hundreds of billions of euros. The war has also caused the highest inflation in decades, particularly in food and energy prices, increasing poverty all over the world, and pushing millions of people into malnutrition if not outright starvation.

The war will also have far-reaching and enduring consequences that will continue to shape the world for the years to come. The medium-term effects of the war are expected to bring significant and irreversible changes to the global political and economic landscape. It has already caused a separation between the European Union (EU) and Russia, with significant implications for the neighbourhood regions in between, such as the Western Balkans. The conflict has also contributed to a more polarised world, with two major poles emerging around the United States (US) and the EU on one side, and China and Russia on the other. There are concerns that this could potentially lead to a new cold war between the US and China, with areas such as East and Southeast Europe potentially becoming battlegrounds for proxy wars.

Despite the devastating consequences of the war, it also presents an opportunity to address and correct the flaws in our current systems and to transform society for the better. The crisis has brought to light many of the issues that exist within our current systems and has accelerated some of the ongoing processes. Now that so many dysfunctions and challenges became obvious and are openly debated, policymakers have the opportunity to address and resolve them, emerging stronger after the conflict has ended one day.

In this introductory chapter to this study, we aim to highlight the most significant political and economic implications of the war in Ukraine for the Western Balkans, a region that traditionally has been influenced and exploited by both great as well as regional powers over the centuries. Additionally, we want to explore the opportunities that are arising from these changes and suggest how policymakers in the Western Balkans can seize these opportunities.

1.1. POLITICAL IMPLICATIONS OF THE WAR FOR THE WESTERN BALKANS

The ongoing war in Ukraine will have significant political implications for the region of the Western Balkans, which is made up of the six countries: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia. The Western Balkans have strong historical, cultural, economic, and political ties to both Russia and the Member States of the European Union. The region also has a complex history of conflicts and still unresolved political and constitutional issues. Finally, it is in a somewhat ambiguous position, as it aspires to join the EU for a very long time but has not yet been fully integrated, which creates frustrations. All this makes the Western Balkans vulnerable to interference from e.g. Russia, which may seek to increase its presence in the region, or at least to exploit the situation to create conflicts, as a way of diverting attention from Ukraine.

In addition to the potential for increased Russian involvement in the Western Balkans, there are also concerns about China's role in the region. China has shown significant presence in the Western Balkan region in recent years, financing significant infrastructure projects in countries such as Serbia, Montenegro, and Bosnia and Herzegovina. The Chinese President has even made a rare visit to Serbia, and Serbia's President Aleksandar Vucic visited China

in February 2022. In 2019, Serbian and Chinese special police even held joint anti-terrorist exercises in Serbia, including helicopters and armoured vehicles. While the economic ties, particularly in the area of transport infrastructure, are in general beneficial to the Western Balkans, there are concerns that China may seek to transform its current geo-economic foothold into a more geo-political one. This could have serious implications for the region and potentially lead to increased political tensions.

The complicated situation in the region has also contributed to a resurgence of nationalism and ethnic tensions, particularly in Kosovo. Both Albanians and Serbs in Kosovo have used the situation to criticise the other side in an effort to strengthen their negotiating position on outstanding issues, such as the status and jurisdiction of Serb-populated areas and the implementation of the Brussels Agreement on normalising relations between the two sides.

Even North Macedonia, which is part of NATO and has had a rather stable ethnic situation in the past two decades, has seen a resurrection of nationalism in recent months. This has been stirred by the EU's decision from 2022 to once again postpone negotiations with the country, despite its name change in 2018 and meeting all formal requirements for starting negotiations. The EU's proposal for continuing the process, which involves changing the country's constitution to include the Bulgarian people in the preamble, and meeting additional criteria related to the bilateral issues between North Macedonia and Bulgaria, has led to a strengthening of national pride among ethnic Macedonians, who have largely opposed the proposal. Meanwhile, ethnic Albanians have been more supportive of the proposal, leading to increased tensions between the two groups. The situation has been further exacerbated by Russian interference in the country, particularly on social media (Trpkovski, 2022) .

Montenegro has also experienced tensions in 2022 between those who identify as Serbs and those who identify as Montenegrins, which has disrupted the stability of the government. There were tensions in the previous months in Bosnia and Herzegovina, as well, which briefly disrupted the functioning of several public institutions, though they seem to have been inspired by the elections that took place in autumn, and have subsided since.

1.2. ECONOMIC IMPLICATIONS

Russia's invasion in Ukraine has had and will continue to have big economic implications for the Western Balkans. The first of them is related to higher global prices. Immediately after the outbreak of the war, international prices of food, oil and gas increased substantially. That increased prices in the Western Balkan economies as well, bringing the strongest inflationary wave that the region has seen since the hyperinflationary early 1990's. Inflation in North Macedonia reached 20% at one point in 2022, in Montenegro it peaked at 18%, in Bosnia and Herzegovina at 17%, in Serbia at 15%, in Kosovo at 14%. Only Albania managed to avoid a double-digit inflation, with a peak at 8%. Global prices for food and energy stabilised subsequently, and at the end of 2022, they fell to levels close to those before the invasion. But this does not mean that the inflation story is over, by any means. Inflation will remain elevated in 2023 as well, even without new shocks, due to the carry-over effects from 2022. Because of the rise in prices in 2022 inflation rates in 2023 will stay close to two digits in all Western Balkan economies, except in Albania, once core inflation tightens up. Furthermore, inflation will remain elevated even after 2023, because of the decoupling of Europe from Russia. Substitution of cheap Russian gas with more expensive alternatives, such as liquified natural gas (LNG) from the US or Qatar, means that production costs in Europe will be higher than before, implying that a return of inflation to levels close to 2% should not be expected any time soon.

High inflation is causing a chain reaction of problems in the region that are affecting individuals, businesses, and the economy as a whole. As prices rise, the purchasing power of households and companies is eroding, leading to slower consumer and business spending. Inflation also lowers consumer and business confidence, which further reduces spending and investment. This, in turn, contributes to lower GDP growth. Furthermore, the current inflation is disproportionately impacting poorer households, as they tend to spend a larger portion of their incomes on food and energy, compared to wealthier individuals. As a result, the ongoing inflation wave in the Western Balkans will certainly increase the already-very-high poverty and inequality. As the inflation is expected to continue throughout 2023 and to remain elevated beyond that, the war is worsening the medium-term growth prospects of the Western Balkans, and aggravating poverty and inequality over the medium term. While it is unlikely that we are experiencing a repeat of the stagflation of the late 1970s, which also contributed to a significant increase in inequality, there are certainly many similarities with that period.

The high inflation rates have also had an impact on public finances, as they have led to higher interest rates globally, as Central Banks typically follow the interest rate hikes of the US Federal Reserve, with an eye on the stability of their exchange rate. Throughout 2022, most major central banks raised their interest rates multiple times, which in turn increased interbank rates such as the EURIBOR and the yields on government bonds. As a result, the

interest rates at which governments can issue bonds are now significantly higher than they were a year ago. In other words, the era of cheap money has come to an end, and governments in the Western Balkans that could previously issue Eurobonds with yields of 2-3% are now facing interest rates that are three times higher. With interest rates unlikely to decline in the near future, this has important implications for public finances, as governments will have difficulties borrowing and will have to rely more on domestic revenues. To increase domestic revenues, governments may consider introducing more progressive taxes, including wealth taxes.

Regarding energy security, the decoupling between the EU and Russia, especially with regard to gas, is almost completed. Only little Russian gas still flows westward via the pipelines through Ukraine and Turkey. With the help of huge LNG imports and a mild winter, gas storage levels are at record highs for this period of the year. As it appears, Europe is well equipped for the next winter, also due to the ability of its industry to substitute large parts of its gas consumption. In 2022, according to Bruegel, the EU was able to save 12% of its pre-war gas demand. Investment in alternative sources of energy, particularly wind and solar energy plants, is soaring all over Europe and also in the Balkans. Managing the energy transition at a much higher pace than in the years before will be imperative, also for the Western Balkan governments.

With regard to supply chain security, first the Covid-19 pandemic and then the outlook of a new cold war caused disruptions for many European firms, leading them to start thinking about reshoring, nearshoring and friendshoring of labour-intensive production. Many Western Balkan companies are affected by these developments, as they are deeply integrated into European supply chains. Although there may be a temporary decline in industrial production due to these disruptions, these developments also present some opportunities. This might be a chance for the Western Balkans to receive additional foreign direct investment and attract new technologies, capitalising on the stagnation of globalisation, which is taking place since the 2008 financial crisis. Once globalisation shifts into reverse, the Western Balkans might be among the few winners of this process, attracting even more FDI.

1.3. OPPORTUNITIES THAT ARISE FROM THESE CHANGES

The ongoing conflict in Ukraine has presented a number of challenges, but it is also creating opportunities for the economies of the Western Balkans. One such opportunity lies exactly in the sector which has caused most of the challenges - the energy sector. While the Western Balkans do not have their own oil and gas reserves, they do have a significant potential for renewable energy, such as hydro, solar, and wind. By investing in the generation of these energies, the Western Balkans can not only meet their domestic energy needs but also potentially become major exporters of electricity. With electricity prices expected to remain high in the coming years, the Western Balkans could potentially even benefit from the ongoing energy crisis, over the medium term.

Related to this, the Western Balkan economies that have access to the sea have the opportunity to invest in LNG terminals. These terminals would allow the region to import LNG from countries like the US and Qatar, which are expected to become major sources of natural gas for Europe as the continent looks to reduce its dependence on Russian gas. By building LNG terminals, the Western Balkans could secure their own access to natural gas and also potentially generate income by transmitting the LNG to other European countries. Of course, gas may serve as a necessary transitional fuel for a limited time, but it cannot be the dominant source of energy in the long term. To achieve a sustainable future, it is crucial to make the necessary investments in renewable energy sources. Therefore, while gas may be a temporary solution, it is important to prioritise the development of renewable energy sources to ensure a cleaner and more sustainable energy system for the future.

Another opportunity that arises is related to the second source of the current inflationary episode, i.e. food. Prior to the Ukraine crisis, Russia was a significant supplier of agrifood products to the EU, accounting for 3.4% of EU imports of agricultural products. In 2021, the EU imported approximately €5.6 billion worth of agricultural products (food and raw materials) from Russia. However, due to the Ukraine war and the corresponding EU sanctions against Russia, these imports are likely to decline, creating an opportunity for other countries to increase their exports to the EU. Those Western Balkan countries, that have relevant agricultural land, may have a chance to fill this gap by expanding their agricultural production and exports to the EU.

As mentioned above, the Western Balkans have also the opportunity to benefit from two trends that are becoming increasingly popular among international investors: nearshoring and friendshoring. Nearshoring refers to the trend of multinational companies relocating business activities to countries that are closer to their headquarters. This trend gained attention during the COVID-19 pandemic, due to the supply chain disruptions that many companies started experiencing at that time. Friendshoring is a similar concept, where companies relocate their activities to countries with friendly political relations

with the countries where they are based. This trend gained popularity in 2022 following a speech by US Secretary of Treasury Janet Yellen. Both trends are likely to remain attractive in the coming period, meaning that many multinational companies will be seeking new destinations for their investments. The Western Balkans, with their proximity to the EU, good transportation connections, lower labour costs compared to the EU, and sufficient workforce, may be an attractive destination for such investments. But, in order to make the most of this, they have to improve their educational systems, the functioning of their institutions, and their soft and hard infrastructure (Jovanović et al., 2021). Furthermore, they have to try to stop the mass emigration of young people to Western Europe, which can be done by implementing "policies for a good life", that have the potential to improve the quality of life particularly of young families.

1.4. WHAT SHOULD THE WESTERN BALKAN GOVERNMENTS DO TO TAKE ADVANTAGE OF THE ONGOING CRISIS?

The actions that the Western Balkan governments should take to seize the opportunities presented by the current crisis can be summarised as - transforming their economies with a greater role for the government. This transformation should be based on several pillars.

The first pillar is to increase public spending on renewable energy and other aspects of the green transition in order to reduce energy dependence on Russia and the overall reliance on carbon fuels. Moreover, Western Balkan cities are among the most polluted cities in the world. Replacing for instance the use of fossil fuels as a means of heating will also improve the quality of life and health of its populations. In addition, given a likely longer period of elevated energy prices, significant export revenues can be gained from investments in green energy. The increased production of renewable energy should also be accompanied by big investments in the electricity grid and related interconnectors, so that the energy system can bear the burden arising from the new renewable energy influx.

Closely related to this, governments should ramp up investment in infrastructure, in general, not just energy infrastructure. For too long, the focus of transport infrastructure investment was on the construction of new highways and airports. Finally, investment starts to pour into the rundown railway network as well as metropolitan public transport. These investments need to be substantially increased, in order to further improve connectivity of people and businesses as well as to reduce pollution and consumption of fossil fuels, thereby improving the balance of payment and improving the quality of life of the local population.

The third pillar is to significantly increase public investment in social protection, education, and healthcare in order to alleviate the burden of the crisis on the poorest segments of society and promote social mobility. The Western Balkans currently invest very little in these public services, leading to high poverty and inequality, poor educational outcomes, high out-of-pocket healthcare expenses and shorter life expectancy compared to EU countries. By investing more in this soft infrastructure, the Western Balkans can not only protect the vulnerable during the current crisis, but also transform their societies for the better. Moreover, these "policies for a good life", including also a targeted public quality housing initiative at the municipal level, should have the potential to offer young families a decent life in the region and stop mass emigration and rapid ageing of the societies in the Western Balkans.

The fourth pillar is to implement better agricultural policies. These policies should use the region's agricultural potential more effectively, increasing domestic agricultural production, so that the region can fill, at least partially, the gap left in the EU by declining imports of Russian agricultural products. Many Western Balkan governments already have significant agricultural subsidies, but these have often been misused for political purposes and need to be reformed. Agricultural policies should not be limited to subsidies, but should also include education measures for farmers, investments in agricultural infrastructure, such as irrigation systems, and support for selling products on the EU market, including issues related to phytosanitary measures. To be successful, all these policies should be targeted and focused on high-quality products that can be competitive on the EU market.

The fifth pillar is to improve policies for attracting foreign investors. While the Western Balkan governments have tried really hard to attract FDI in the past decade or so, offering various benefits to foreign investors, they have generally failed to attract high-quality, high value added, innovative companies. This is due to the fact that the governments have neglected their structural problems, such as weaknesses in their educational systems and institutions, which deter high-profile investors. To make the most of the trends of nearshoring and friendshoring in the coming period, the Western Balkan governments should adopt a more targeted approach towards FDI, focusing on higher-value added and more productive companies, and attempt to attract them by addressing their structural issues rather than offering cheap labour or low taxes. In fact, educational initiatives can be planned jointly with FDI firms in order to organise vocational training in the framework of a dual education system, as it is found for instance in Austria and Germany.

Another pillar is to introduce more progressive taxes in order to fund all these initiatives, particularly given

the expected increase in interest rates that will make government borrowing more difficult in the coming years. Most Western Balkan economies have more or less flat taxes, and even those which do not have flat taxes, have only mild progressions of tax brackets. This leaves room for improving tax revenues by making existing income taxes more progressive, both for personal income taxes as well as corporate income taxes. Also, social security contributions as well as wealth taxes could be designed more progressive. By taxing higher earners and highly-profitable companies more, Western Balkan governments can not only increase public revenues, but also reduce existing inequalities and limit the influence of a few rich individuals on local politics and media, which is increasingly becoming a problem, not only in the Western Balkans.

Finally, to calm ethnic tensions and reduce nationalism, regional economic cooperation should be improved by supporting and expanding existing regional integration initiatives. Existing initiatives, such as Open Balkan, the Common Regional Market, the Berlin Process, the Regional Cooperation Council, and the Western Balkan Chamber Investment Forum, should be supported and expanded to cover areas not currently included, such as cooperation in social policies, education, healthcare, and culture. Initiatives that do not currently include all countries in the region, such as Open Balkan, should be expanded to include these countries. Regional integration initiatives can go a long way towards improving cooperation in the region, especially if they are understood as a complement and not a substitute to EU accession.

1.5. WHAT SHOULD THE EU DO TO SUPPORT THE REGION?

As much as the Western Balkan governments can do in order to come out stronger from the ongoing crisis, they need more substantial support from the EU in order to achieve that. The EU should change its current approach towards the region, by taking the region much more seriously. This should be a combination of a faster EU integration, greater involvement into resolving the regional political issues, and providing immediate and adequate support to the Western Balkans.

While the EU has made some progress in 2022 towards integrating the Western Balkans, by starting accession talks with Albania and granting candidate country status to Bosnia and Herzegovina, much more needs to be done. The other four countries have not received any additional support, and North Macedonia has even been punished, one might argue. The current plan for the EU accession of North Macedonia, which requires the country to make further constitutional and other changes to satisfy Bulgaria, risks keeping the country stuck in the EU accession process indefinitely. The EU must adopt an alternative approach, by accelerating the integration process for the entire region. This means opening more chapters with Serbia and Montenegro, beginning negotiations with North Macedonia without the current bilateral criteria with Bulgaria, and granting quick visa liberalisation to Kosovo.

The EU integration process will take time to complete, but in the meantime, the EU can show its support for the Western Balkans in other ways. One concrete action the EU can take is to grant full access to the EU budget for the Western Balkan countries. This would increase EU funding for the region by approximately three times, which would have a significant positive impact on the region's economy and society via a massive increase in much needed investment. At the same time, the cost to existing EU member states would be minimal, less than 0.04% of their current GDP (Grieveson et al., 2020) .

The inclusion of the Western Balkan economies in the regular EU budget and its related transfers should be accompanied by an inclusion of the Western Balkans in as many as possible economic segments of the *acquis communautaire*, notably the EU single market, as well as other relevant treaties of the EU, such as the Schengen area or the accession to the euro area, even before a full EU accession. If countries like the Netherlands and France do not want to risk the immediate and full accession of new EU Member States before the decision-making bodies of the EU are reformed and also given the negative experiences that were made for instance with the new EU Member States of Hungary and Poland, then a stepwise accession might be a good alternative to full membership. Voting rights in the EU institutions could be the final stage of EU accession, which would be only granted once the Western Balkan countries' political systems have matured and constitutional problems resolved.

Finally, the EU's stronger presence in the region should be accompanied by increased efforts to resolve long-standing political disputes, such as the status of Kosovo. Diplomatic efforts should be focused on normalising relations between Serbia and Kosovo, and the full implementation of the Brussels agreement. The Franco-German proposal that is currently circulating, that calls for Serbia not to block Kosovo's international integration in exchange for the establishment of an Association of Serb majority municipalities, is a step in the right direction, but more needs to be done. Bigger efforts should be made to encourage cooperation between the two sides, in order to address the current rise in ethnic tensions. This should encompass all areas of life, including culture, sports, science, business and civil society.

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2

THE IMPORTANCE OF THE ROLE OF THE STATE! HOW CAN THE MACEDONIAN ECONOMY BECOME MORE RESILIENT TO CRISIS?

Abdulamenaf Bexheti, Stefan Bouzarovski, Dragan Tevdovski and Mila Carovska

INTRODUCTION

The two dominant schools of economic thought have different views on the role of the state in the economy. Since Adam Smith's time, the classical school firmly believes in the "invisible hand" of the market, which suggests that the market is the best allocator of resources in the economy. Therefore, the role of the state should be as small as possible. Contrary to this, the Keynesian school emphasises the importance of the state's role, noting that "the market is powerless'', especially in times of crisis. Interestingly enough, both are right because the "invisible hand of the market" is most preferred in stable economic times, while in times of crisis, everyone looks for the "visible hand of the state".

Beyond the theories, what does empiricism show? Even the most liberal economies in the world, in crisis conditions, made and are making substantial state interventions to stabilise crisis cycles and turbulent markets. The Great Depression of the last century was also resolved in that way, and state interventions were also crucial during the Global Financial Crisis (2007-2009), as well as in the latest period of multiple shocks - the COVID-19 pandemic, inflation and the energy crisis, which is still ongoing. Due to these state interventions, today's global public debt has significantly increased and exceeds 110% of the global GDP.

The starting thesis of this paper is that the state should have the capacity to deal with crises. There is a consensus among economists that the potential to deal with a crisis is created in "good times" so that when the "bad times" (crisis periods) arrive, we have the potential to deal with it. Prof. Avinash K. Dixit has said: "Good economic times are unsuited to the illusions of economic policymakers and policymakers because they think that bad economic times will never return."

The chapter aims to propose guidelines for improving the capacity of the Macedonian state to deal with crises. The first part of the chapter emphasises the importance of the state's institutional capacity. The second and third parts present the guidelines for the public finance and social protection systems. Improving the capacity of public finances is crucial for the state to respond to a crisis. The social protection system must also be prepared to protect citizens in crisis. The fourth part analyses the state's position in the energy transition that has just begun and will continue in the following decades. The fifth part explains why the Macedonian economy should reduce its import dependence on food and energy.

2.1. THE POSITION OF THE STATE IN TIMES OF ECONOMIC CRISIS

The economy is not a linear phenomenon. It has almost constant oscillations and constant movement in growth and decline. According to the economic statistics of almost a century (1929/33), until today, we constantly have trends and oscillations, sometimes due to external factors and sometimes purely internal ones. The Macedonian economy is not immune to these trends either. Hence, the question arises as to how the state should take care to prevent and not just react post-festum. An organised and functional state should be prepared for such challenges.

In the last three decades, the Macedonian economy constantly oscillated. In almost 15 years (until 2008/9), we were in a recession zone three times, so again, after a decade, we had significant declines due to the internal political crisis. Finally, with the COVID-19 pandemic (2020), we again noticed a negative economic growth. Currently (2022), we are in a challenge because of the COVID-19 crisis effects, but primarily because of the repercussions of the Russian invasion of Ukraine and the high inflation rates felt in many European countries.

The situation is highly complex because the problem is more than limited resources. However, much more

important is the solution, which is even more complex in the circumstances thus created. We can treat it in two critical dimensions. The first is the normative arrangement of the state, starting from the most basic acts to systemic and sub-system legal solutions. Apart from the Constitutional decisions, the legal acts, especially those that regulate particular areas of the economy, are pervasive and voluminous, unclear enough, and even less straightforward to apply. Here is the freshest and most current example. After the energy crisis, there is constant discussion about the need for investments in renewable energy like solar energy. However, the lack of adequate regulation does not allow for efficient and timely investments by citizens and companies. Such a situation should not be observed in an isolated manner from existing power structures and vested interests. So that the example does not remain isolated, here is another one that is much more important and acute. For a year now, the business community has been warning that "we pay a lot in taxes for the existing structure and quality of education", yet in the existing normative solutions and barriers, it takes years to change the program structures, which then have to be "clogged" in the bureaucratic channels of "the regulators"! Moreover, the labour market is becoming more and more asymmetrical! In such a situation, we need normative and systematic restructuring of the economy and, hence, a more flexible system, at least from a normative point of view.

The second and most important is the application of the laws indiscriminately and equally for all individuals, companies and institutions. The public and state administration, the judiciary, the regulators, and even the supervisory institutions are still characterised by a high level of corruption and extremely undisciplined behaviour. The informal economy still accounts for about a third of GDP, which is not only a lost public potential but also creates unequal market conditions (Bexheti et al., 2022).

These two aspects are prerequisites for strengthening and creating efficient institutions. At the same time, a change in the economic model based on investments from both the public and private sectors is needed. If the preconditions are there and a process of consolidation of institutions begins, investments will naturally follow. The state should set preconditions and create a healthy ecosystem. Then, through economic measures, the state should determine and recommend the priorities. The EU integration process will be a "wind at the back" for these activities, especially in the phase of starting negotiations with the EU.

Sectoral policies, such as agriculture and primary food production, energy, construction and infrastructure, education, ecology and circular economy, services, and processing industry should be top priorities. All public non-productive investments should be stopped and replaced by investments in the specified sectors in order to attract private investments, together with international sources (through grants and development credits) to be directed to the above priorities so that we can start strengthening an economy that will be more resistant to crises. In the sphere of management of public finances, assets and potentials, as well as in the sphere of social protection, the role and opportunity of the state is enormous.

How far can we go? Of course, the road is not easy, nor is it simple. At the beginning, a broad political consensus is needed, including the opposition, which, whenever it is, will face the same problems in the future. Critical conceptual and systemic issues need to be modelled together. In the main lines and directions, the so-called "economic agreement for a better Macedonian economy" will aim to look ahead and reach far. Political inclusiveness in creating the model also cannot be easily realised in an environment that lacks a political culture based on dialogue and consensus for critical issues. However, political inclusiveness is mandatory because no sustainable solution is possible without it. If we achieve that, the competition between the political parties will diminish to the realisation of the elements of the agreed long-term plan and objectives.

The current political thinking that goes only between two election cycles must change. The biggest threat, which may not be visible on the surface, is the emigration of young people! Our population is getting older. Furthermore, if we only look at the short term, young people will continue leaving the country and one day, there will be no need for reforms.

2.2. A PUBLIC FINANCE SYSTEM THAT CAN RESPOND TO CRISES

Fiscal space is crucial for the state to respond to a crisis. It represents the space in the state budget that can be used to make tax cuts or specific spending to support the economy without jeopardising the sustainability of the financial position or the stability of the economy. The state can create fiscal space by raising taxes, providing external financing or grants, or cutting lower-priority spending. However, it is crucial to maintain the debt servicing capacity, as well as the macroeconomic position of the country.

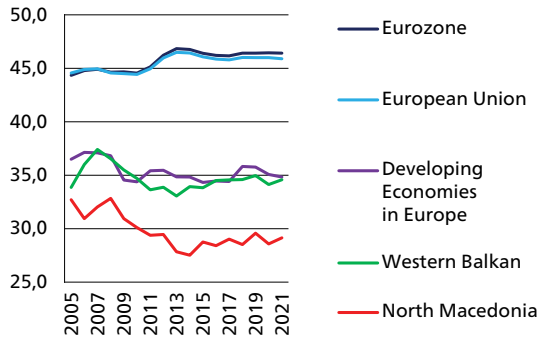
During the COVID-19 pandemic, it was unequivocally seen that countries in the world differ in fiscal space. And so, they were in a different position to provide discretionary fiscal support to businesses and vulnerable citizens. From the start of the pandemic to September 2021, discretionary fiscal spending worldwide amounted to 9.7% of global

GDP. However, it was much lower in developing countries and significantly higher in developed countries (International Monetary Fund, 2021). Fiscal spending was highest in the United States (25.4% of GDP), Australia (18.4% of GDP), and Japan (16.5% of GDP). North Macedonia achieved discretionary fiscal spending of 4.3% of GDP.

In our country, there is an opportunity to increase the fiscal capacity by improving the state's income. Figure 1 shows that North Macedonia has significantly lower incomes than the average of the European Union member states but also the average of the post-transition countries of Europe and the Western Balkans. More precisely, the total expenditures of the general government on average amount to just over 45% of GDP in the member states of the European Union and about 35% of GDP in the post-transition countries of Europe and in the countries of the Western Balkans. In North Macedonia, they are below 30% of GDP, much lower than the averages of all observed groups. The critical direction for improving the state's income, due to the flat and low direct taxes in our country, should be the introduction of progression in direct taxes: personal income tax and profit tax. This would also align with the IMF's recommendations for increasing the progressivity of tax systems (International Monetary Fund, 2021). Moreover, due to the extra profits made by energy companies in this crisis, of course, it is logical to follow the example of the European Union and introduce a tax on extra profits in our country.

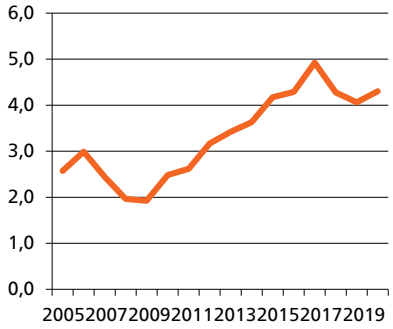
Conversely, consumption tax rates should not be increased, as they will only increase the regressiveness of the tax system. For this reason, citizens with a lower income use almost all of their income in consumption. Therefore, they have a much higher share of the tax (VAT) on their consumption costs if compared to those with a higher income, who, in turn, save part of their income.

Figure 1
Total expenditures of general budget of North Macedonia as % of GDP



Source: International Monetary Fund (2022).

Figure 2
Interest payments of the public debt of North Macedonia as % of public revenues



Source: World Bank (2022)

The second element that requires attention is reducing the public debt. In the period after the external shocks caused by the pandemic and the war in Ukraine, fiscal policy must focus on reducing public debt. It is essential because if we do not prevent the growth of interest payments, they will increasingly occupy the space of the basic needs for public expenditures in education, health and social services and limit the possibility of additional fiscal space. Figure 2 shows the interest payments on the public debt. They recorded continuous growth from 2009 to 2017. Thus, for example, in 2009, they amounted to 1.9% of budget revenues and grew to 4.9% of budget revenues in 2017. Then they decreased in 2018 and 2019 when they amounted to 4.1% of budget revenues, and in 2020 they increased primarily due to the drop in budget revenues due to the pandemic. The ongoing deterioration of financing conditions in global markets will further increase interest payments, complementing the effect of increased debt during the pandemic.

Moreover, a more substantial influence requires the capacity of the state to manage its capital. So far, most of the public's attention goes to the flow of public expenditures. But, much stronger attention should be paid to the state of the country's capital, for example, mineral wealth, land and the like, and how it changes over time.

2.3. A SYSTEM OF SOCIAL PROTECTION THAT WILL PROTECT PEOPLE IN CRISIS CONDITIONS

In order to obtain a more resilient system of social protection, the course should change, and the social system should not be seen only through the prism of policies and institutions for social protection. Instead, the horizon should be holistic, and the interventions should apply parallel to the educational and healthcare systems.

In the area of cash grants, the existing schemes are stable and cover most of the risks. However, their flexibility and infrastructure for quick reaction during a crisis are far from the required level. That is why in the legal solutions for social and children's cash benefits, it is necessary to set opportunities for quick reorganisation in case of increased risks among citizens in the social protection system and to set frameworks to cover those citizens. Who are outside the system (citizens with low incomes) and may need one-time payments in crises.

Centres for social work, as well as the entire infrastructure of the social protection system, such as social services developed at the local level, should adopt special standard operating procedures for handling crises. Additionally, it is essential to determine the economic parameters with which monetary benefits will align regularly and in crises to maintain their adequacy and achieve the necessary effect in the medium and long term.

The coordination of the social protection system, child protection, education and health should occur quickly and according to set clear rules and prescribed procedures. Recent crises have shown that digitization and the use of technology can facilitate the processes of offering and receiving a service. That is why these systems should be connected electronically with a quick exchange of existing data. Such an approach will increase transparency and improve the targeting of users who need services or rights that one of these systems should provide them (for example, health insurance, guaranteed minimum assistance, disability allowance, etc.). The social protection system that lifts people from poverty should link them directly to the labour market activation services. It is necessary to strengthen the capacities of the employment centres and social work centres in this part because the activation and inclusion in the labour market of the beneficiaries of the Guaranteed Minimum Income (GMI) are vital to tackling poverty and reducing the grey economy through which these families supplement their domestic income.

The second obstacle to activation is the low level of education of the people who use support through the social protection system (unfinished primary and elementary education). For these reasons, the funds intended for adult education should increase, and the system should strengthen by establishing a system for validating formal, informal and informal learning. This system would enable the acquisition of qualifications for persons without or with a low level of qualifications, and through this, their greater involvement in the labour market would be expected, with the ultimate goal of reducing the unemployment rate in the country, and thus citizens who are more resistant to crises. It is also necessary to make changes in the Law on Social Protection and in the by-laws, which will enable the beneficiaries who are from families that use GMI to be able to continue using the right even after their employment for a period of 6 or 12 months, to stimulate them to get a formal job, to get out of the grey economy, but also to have a period to reduce their dependence on the right they use.

In support of this, it is necessary to adopt the Law on Social Enterprises, which will allow the establishment of enterprises for work integration, which will work exclusively on raising the skills and capacities of people who are not in the labour market. The adoption of this law will also enable the use of the provisions of the Law on Public Procurement in the section of reserved procurement for social enterprises, which will allow local governments and public enterprises to provide local support for the employment of vulnerable citizens through this mechanism.

The energy crisis also highlighted the challenges with social housing, for which North Macedonia still needs to develop an adequate system. In the coming period, the most important thing is to assess how many families and municipalities need support for the construction of new or renovation of old dwellings with dignified and energy-efficient living conditions to make an investment plan in the following period and establish supporting mechanisms.

Increasing public investment to support long-term development is the only sustainable solution for resilient and developed systems. Such investments are those in the human potential of the social, educational, and health systems. The services, resilience and sustainability of these systems largely depend on the people employed in them. That is why continuous personnel planning, adequate education and adequate working conditions in these systems are the basis of a social system that can respond to crises. Ad hoc solutions cannot provide adequate results to meet the challenges in a crisis. Systems need to start with preparations today in order to be able to respond to crises in the coming decades.

2.4. ENERGY TRANSITION, SECURITY AND INEQUALITY: WHAT IS THE STATE'S POSITION?

The degree of involvement of the state in the creation and implementation of energy policy is a matter of broad social interest. Apart from being the creator and bearer of energy policies, the state can act as the owner and manager of the production, transmission and distribution facilities and as a supplier of multiple forms of energy. In that sense, different institutional elements of the state order, at different administrative levels, can play different roles – as setters and implementers of energy strategies (for example, ministries or other relevant state agencies) but also as

direct actors with an ownership stake in energy systems (for example, local government in the case of district heating systems).

Building an ecologically sustainable, socially just and energy-secure society is only possible with the thorough involvement of the state in legal, public-political and infrastructural terms. In doing so, three key aspects emerge.

First, the state is the founder and regulator of the energy market and, as such, has the power to determine which commercial, institutional or social entities will be in a privileged position. Post-socialist states like RSM are in the process of profound transformation not only of the infrastructural, spatial and technical elements of the energy system but also of the political-economic relations, including the role of the state in the energy sector. The neoliberal approach to the reform of the electric power system required a fundamental change in the overall management structure of this sector, to remove the previously established vertically and horizontally integrated monopolistic relations but also to rebalance the price structures in which there were various forms of implicit state subsidies. to all consumers, especially households (Bouzarovski, 2010).

In North Macedonia, the energy sector reforms implied the establishment of separate legal entities responsible for the various activities (electricity transmission, electricity market operator, production, distribution and supply), previously managed by the authority of the state-owned "Electricity of Macedonia (ESM)". While the two companies that emerged from ESM (ESM - Power Plants of North Macedonia and MEPSO - Macedonian Electric Transmission System Operator) remained under state control, the establishment of a liberalised market for electricity allowed multiple entry of private suppliers and producers in this domain. The increased role of private capital happened in parallel with the rise in electricity prices (although households remain outside the liberalised market for the time being). At the same time, the entry of foreign and private capital into other energy sectors is noticeable - especially the supply and processing of heat, gas, oil and oil derivatives.

The liberalisation of the energy sector in North Macedonia is closely monitored by the Secretariat of the Energy Community in Vienna, using several indicators that quantify, among others, the degree of openness of the gas and electricity markets, as well as the placement of the various commercial, legal and infrastructure functions performed by the relevant organisational units in the sector (Energy Community Secretariat, 2021). In a broader sense, the goal of this process is to enable the creation of an internally and externally integrated energy market. It is a strategic direction that reflects the intentions of the European Union and the many international financial institutions and donors that are active in this sphere.

The fact that the creation of a liberalised energy sector implies a profound transformation in the role of the state in all segments of the sector management mainly remained unnoticed by the Macedonian public. The Strategy for the Development of Energy in the Republic of North Macedonia until 2040 (Ministry of Economy, 2019) briefly reviews the legal and regulatory aspects in the review of the Macedonian energy sector. The limited institutional capacities of the state are noted, but there is no broader discussion about the current and future position of the state in the prevention of corruption (for example, in the sale of energy) or the seizure of public goods (in the construction of private energy capacities) during the energy transition, market and the expansion of low-carbon technologies.

Second, the state can promote the energy sector's environmental sustainability and ensure supply security in a broader sense. The need for a clearly defined state approach to energy transitions is best seen through the rapid spread of private photovoltaic and, to a lesser extent, wind power plants in the Macedonian energy market. Due to their placement in the liberalised energy market, the state is deprived of the necessary instruments to include these energy producers as active participants in reducing import independence, ensuring stable supply, or improving the price security of the state's energy system. At the same time, they themselves are beneficiaries of various state benefits through the financial models enabling their construction, including preferential and "premium" tariffs, public-private partnerships, and the beneficial use of state land.

Measures to prevent and mitigate the effects of climate change require the active involvement of state capacities in segments beyond the narrow boundaries of the energy sector. In recent research on the possibilities of energy solutions with the lowest negative impact on the environment (Čolović-Lešoska, 2022), it is mentioned that "if the locations and the way of development of the capacities for the use of renewable energy sources are not carefully planned, the solutions can be harmful and to put significant pressure on the natural resources of North Macedonia". In order to overcome the possible consequences of sustainable development, the study's authors point out several postulates based on the principles of active involvement of stakeholders and communities in the decision-making process. They underline that renewable energy resources, energy infrastructure, and social and environmental factors "should be an integral part of the spatial planning process, and the relevant institutions should base their site selection decisions on scientific research and data."

Third, the state is the primary actor in ensuring energy justice and fairness. In both global and European frameworks, the energy crisis that occurred in 2021 – with a tendency of further deterioration in 2022 –

led to broad discussions about the need to ensure a more significant share of the state in promoting energy security, environmental sustainability and price stability. Consequently, a substantial review of state functions and roles in the energy-social sphere is needed. Although there are active policies to alleviate energy poverty in RSM, there remains a need for more ambitious and thorough state interventions in all factors contributing to household inequalities regarding energy use and the development of low-carbon interventions. In practice, this implies significant changes and improvements in housing policy (through fundamental improvements in energy efficiency and quality of residential buildings), energy and spatial planning that will decarbonize the transport sector and enable broad use of micro-renewable sources for heat and electricity in the residential sector.

With all this, the question arises - should the state try to close the energy balance in the case of an energy import-dependent state like North Macedonia? Considering that North Macedonia is becoming part of the integrated European energy market, and given the rapidly growing spread of low-carbon energy sources in domestic production (especially solar energy), this issue may be redundant in the near future, but only if: strengthened the democratic and institutional capacities of the state in the management of the energy sector, especially in relation to public control of natural assets, transparency in decision-making; and developing an active and comprehensive program to improve energy efficiency and enhance decarbonization.

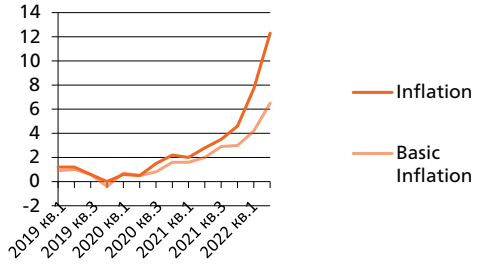
In that sense, and instead of a conclusion, the impression remains that within the current trajectory of development of the energy sector in North Macedonia, fundamental changes are urgently needed in the systemic role and position of the state. The existing neoliberal model reduces its role to a technical regulator and strategic director of energy policies, and if there is political will, the transmission owner and part of the production capacities. However, in the context of the energy crisis, energy security, and energy poverty, there is a clear need for active policies in several related spheres that are relevant to energy (for example, spatial planning, transport, housing, and health) as well as deep involvement of the state in the ownership and management of low-carbon and renewable energy sources. These are issues that deserve broad social debate and public attention.

2.5. WHY IS IT IMPORTANT TO REDUCE IMPORT DEPENDENCE ON FOOD AND ENERGY?

Energy and food prices are highly volatile. The main reason for this is that their supply and demand are highly inelastic in the short term. For example, from the supply side, reduced production by a major food producer due to a drought or other adverse weather event cannot be immediately compensated, and this causes prices to rise. On the demand side, when prices rise, factories cannot quickly replace one type of energy with another in production. Because of this price volatility, economists usually want to know how much inflation (changes in the average level of consumer prices) results from changes in food and energy prices and how much of all other goods and services. That is why one indicator, called core inflation, is used. It shows the average price level change of goods and services, excluding food and energy. Figure 3 shows that core inflation was very close to general inflation in the Macedonian economy until the third quarter of 2020. After that, the general inflation achieves a much more substantial increase than the essential inflation, which means that the changes in the prices of food and energy strongly contribute to the growth of the general inflation.

There are several reasons for the strong growth of food and energy prices in the global (world) economy. Supply disruptions caused by the COVID-19 pandemic and the Russian invasion of Ukraine are key factors that underline the importance of reducing food and energy import dependence. Figure 4 shows that food and energy price growth in the global economy is similar to the oil shocks of 1973 and 1979–1980.

Figure 3
Inflation Trends in the Macedonian economy



Source: National Bank of the Republic of North Macedonia (2022)

Figure 4
Energy and food prices trends in the Global economy

Source: World Bank (2022)

Rapidly increasing energy and food prices cause more negative effects. First, they reduce the real income of households since food and energy participate significantly in their consumption basket. Second, there are severe implications for the income distribution between households, as the share of food in the consumption basket for poorer households is much higher than for households with higher incomes. Hence, the reduction in real income is much more pronounced for poorer households. There are also differences between countries. The effects on income distribution are more felt in lower-income countries. Food accounts for an average of 44% of the consumption basket in low-income countries, 28% in middle-income countries, and 16% in high-income countries. In North Macedonia, the share of food in the consumer basket is significant and amounts to 40%. Third, because energy is one of the key inputs of production, the rapid growth of energy prices affects the reduction of firms' competitiveness, leading to a decline in economic activity. Fourth, rising food and energy prices increase the balance of payments deficit in countries that import a significant portion of food and energy. North Macedonia is precisely such a country, which is a small but highly open economy (140% of GDP).

For these reasons, food and energy security is a critical priority for many countries. Energy security especially gained importance with the oil shocks in the 80s of the last century when developed countries put it at the core of energy policies (Cohen et al, 2011). Moreover, it always gains visibility during global crises. So, for example, in the year immediately after the Global Financial Crisis (2007-2009), the US Senate passed more than 200 acts that contained energy security in the title. The security of the food supply is gaining more and more importance today due to the current geopolitical fragmentation in the world and the war in Ukraine. In addition to the importance of this in terms of the world's food supply, it is worth noting that before the war in 2021, Ukraine and Russia together accounted for 34 % of the world's total wheat exports, 17% of the world's total corn exports, 27% of the total export of barley in the world and similar (European Parliament, 2022).

For us as a small and open economy, food and energy supply security should be seen from two aspects: internal and external. Internal means to stimulate the domestic production of energy and food to reduce import dependence, which would make the economy less vulnerable to external shocks and distortions in supply. At the same time, this must be done with more than subsidies and quotas, but the priority should be the efficiency of production because the economy will not be in better shape.

CONCLUSION

State intervention is essential for getting the economy out of crisis; therefore, the state should be able to deal with crises. And the capacity, that is, the potential to deal with a crisis, can only be created in "good times", although it is often politically unpopular. But, it is more than clear that the current approach of looking only between two election cycles leads nowhere. Only far-sighted policies could ensure the success of the Macedonian economy.

For the public finance system to respond to crises, it is necessary to increase tax revenues. North Macedonia and Kosovo continuously have the lowest incomes as a percentage of GDP in Europe. This should not be done by increasing the VAT, as this will increase the regressiveness of the tax system, but by introducing progressivity in personal income tax and profit tax. In the current conditions, introducing a tax on extra profits, especially for energy companies, can be a valuable solution. Also, an extreme focus should be placed on how the state manages its capital, such as mineral wealth, land, etc.

The social system should be seen more than just through the prism of policies and institutions for social protection. However, the horizon should be set holistically, and the interventions should apply parallel to the educational and health systems. The system should be flexible and, on the one hand, protect citizens at risk and, on the other hand, not allow passivation but aim for activation.

Fundamental changes to the systemic role and position of the state are needed. The existing neoliberal model should be reconsidered in the context of the energy crisis, energy security and energy poverty. Besides the energy sector, the state should have active policies in several closely related sectors (for example, spatial planning, transport, housing, and health) and deep involvement in the ownership and management of low-carbon and renewable energy sources.

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3

HOW TO INCREASE THE DOMESTIC PRODUCTION OF ENERGY AND FOOD?

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INTRODUCTION

Tectonic shifts have been occurring in recent years. The world economy is exposed to shocks coming one after another: COVID-19, the Russian invasion of Ukraine, the stoppage of the supply of energy and especially gas by Russia, the uncertainty and strained relations in Asia, between China and Taiwan, between North Korea and South Korea. All this leads to global insecurity and uncertainty, closure and deglobalization.

In addition to political shocks, the world economy is also affected by several economic shocks: rising prices, especially food and energy prices, declining real incomes, the risk of a prolonged and deep recession, high and growing debt, high inflation and growing interest rates. Instability, uncertainty and volatility are becoming the new economic normal.

Food and energy shortages make economies vulnerable, which requires food and energy supply to become part of macroeconomic and transformational policies.

A key topic in the following chapter is the energy transition in the economy and agriculture. While part two of the chapter will focus on the global trends in energy transition, part three will elaborate on the energy transition of the economy and agriculture in North Macedonia. The chapter is finalised with concluding observations and recommendations.

3.1. GLOBAL TRENDS IN THE ENERGY TRANSITION

Governments and companies worldwide have decided to achieve net-zero emissions of gases with the effect of plastic wrap by 2050. At the same time, the EU countries have set a goal that by 2030, the production of green energy from renewable sources will reach 40%. It leads to an economic transition that will affect all countries and all sectors of the economy. The transition refers to the industries that contribute the most to global emissions – energy, industry, transport and mobility, construction, agriculture, forestry and other activities that use the earth, the industry for waste and waste materials. The sectors that will be most affected are those that directly emit substantial emissions – for example, coal mines, thermal power plants, gas plants, etc. These sectors globally contribute 20% of the world's GDP. An additional 10% are in high-emission sectors such as construction. Therefore, well-designed policies are needed, and climate policies become part of the global macromodel of economic growth.

Effective decarbonization activities include:

- moving away from fossil fuel energy towards zero-emission electricity and other low-emission energy sources such as hydrogen.
- increasing energy efficiency and managing energy demand.
- increasing the production of green energy from renewable sources.
- transition to a circular economy.
- reducing the consumption of energy-intensive products and
- use of carbon dioxide capture mechanisms, storage, and utilisation technology.

All of that predetermines climate and green policies to become an integral part of the macroeconomic policies of every country.

It is estimated that global expenditure on physical goods in the transition period (2021 – 2050) will reach 275 trillion US dollars or 7.5% on average per year of world GDP. According to the McKinsey Global Institute, the largest expenditures are expected in 2026-2030, when they will reach 8.5% of GDP annually. Moreover, these expenditures would differ

significantly depending on whether we are talking about developed or developing countries and whether we are talking about countries producing energy from fossil sources or not. The costs would amount to: for countries producing energy from fossil sources, the expenditure would reach 18% of GDP per year on average; for highly developed countries that do not produce energy from fossil sources, the expenditure would amount to about 5.9% per year of GDP, and in developing countries that do not produce energy from fossil sources, the expenditure would be 9.8% per year of GDP (McKinsey Institute, 2022). According to the same Institute, this transformation of the world economy would lead to the demand for energy in 2050 being 2 to 2.5 times higher than today's demand.

Taking into account that North Macedonia belongs to a group of developing countries on the one hand and that 2/3 of the electricity production is based on electricity from coal-fired thermal power plants, it is estimated that the expenses for the transition of the entire Macedonian economy on this basis would be extremely high, with a high probability that they would reach up to a third of the level of private sector investments in fixed funds.

The energy transition would have far-reaching repercussions on the labour market and on the skills, specialisation and qualifications of the workforce. Parallel to the considerable investments in capital goods, there would be a massive reallocation of the labour force at the level of about 400 million workers. The energy transformation would open an additional 200 million new jobs and close 185 million (IMF, Financial Stability Report, 2022).

The energy transition will be inextricably linked to the automation of processes, digitization of all spheres of the economy and the introduction of artificial intelligence, including in construction, food production and distribution, tourism and services.

3.2. STATE-OF-THE-ART AND FUTURE PERSPECTIVES OF THE MACEDONIAN ECONOMY IN RELATION TO ENERGY AND FOOD PRODUCTION

3.2.1. State-of-the-art in the energy sector

The current state of the art in North Macedonia in terms of energy is presented by several aspects: production capacity, utilisation of renewable energy sources, energy efficiency, energy security, environmental pollution (decarbonization) and energy poverty.

The electricity production system in the country consists of two coal-fired thermal power plants (REK Bitola and REK Oslomej) with a total installed capacity of 825 megawatts (MW), several hydroelectric power plants with a total installed capacity of 695 MW, one combined power plant of fuel oil, several solar plants, several biogas plants and one wind farm. The two coal-fired thermal power plants produce approximately 55% of the country's annual electricity consumption. At the same time, the domestic electricity production has decreased by more than 25% in the last ten years, and the import of electricity in 2021 reached 33%.[2]

The company "Electrani of North Macedonia" (ESM) is the state electricity producer, while MEPSO is the operator of the electricity transmission system in the country. The Austrian company EVN distributes electricity in North Macedonia after entering the market in 2006.

The average consumption of primary energy in North Macedonia per inhabitant is about 1.2 toe (13.9 MWh), which is significantly lower consumption than the average of the European Union (EU) and the average of the countries of the Western Balkans, where only Albania has a lower consumption per inhabitant. If we look at the year 2022, the net electricity consumption had a significant drop of 10.66%, primarily due to the energy crisis and reduced economic activity due to high electricity prices, as well as taking measures for the rational use of electricity.

In North Macedonia in 2022, a total of 9,421 GWh entered the electricity transmission and distribution system, of which domestic producers generated 5,639 GWh of electricity. The production of electricity from thermal power plants amounts to 4,002 GWh. The production of electricity from renewable energy sources, including large hydroelectric power plants, amounts to 1,633 GWh in 2022.[3] The share of renewable energy sources in the gross financial energy consumption in the country is approximately at the level of the EU average. However, although this participation tends to increase over the years, it is still low.

Regarding energy efficiency, from 2005 to 2018, North Macedonia reduced primary electricity consumption by 12.7 %, which is a relatively good achievement. However, the same results from lower electricity production from lignite. On the other hand, final energy consumption in 2018 compared to 2005 increased by 6.2 %, which, as a result, is weaker than only Kosovo and Albania.[4] Furthermore, according to a publication of the State Statistical Office, only 18 % of households in North Macedonia have insulation that does not comply with the requirements of the 2013 Rulebook on Energy Characteristics of Buildings.[5] On the other hand, according to a UNDP study, households are heated in the Skopje Valley; 50.8 % of the buildings have no insulation, and 42 % have weaker thermal insulation than the requirements.[6]

In comparison, only 7.2% of the surveyed households live in buildings with thermal insulation by the requirements of the same Rulebook. In that sense, about 25% of households in RSM use inefficient electric heating stoves, while 60% use inefficient firewood heating technologies. The household sector participates with almost 28% in the final energy consumption.

In terms of energy security, it is essential to emphasise that North Macedonia has a lower level of energy security compared to all other countries of the Western Balkans because it has a significantly higher percentage of electricity imports - in other countries, the dependence on electricity imports ranges from 30% to 40%. In addition, North Macedonia imports the total amount of natural gas and oil products, and in 2018, 9% of solid fuels such as coal.

Regarding environmental pollution, the average CO2 emission per inhabitant in North Macedonia is 3.9 t CO2-eq. It is twice lower value than the EU member states' average (28).

Energy poverty is high in the country. A quarter (25%) of the population in North Macedonia cannot heat their homes. For comparison, in the EU member states, only 7% of the population cannot heat their homes adequately. However, EU member states from the region, such as Bulgaria and Greece, also have high percentages like the country for the population that cannot heat their homes.

3.2.2. Perspectives of the energy sector in North Macedonia (in function of increasing the resilience of the economy and ensuring energy security)

Regardless of the improvements made, the energy sector in North Macedonia is not very favourable if we consider some of its most important aspects, such as the use of renewable energy sources, energy efficiency, energy security, environmental pollution, and energy poverty. However, certain improvements and positive results have been achieved in the last decade. Still, it is necessary to quickly reduce the existing gaps when compared with the EU member states because the competitiveness of the Macedonian economy in the future will largely depend on the success of the energy or so-called green transition.

In terms of legal regulation, the Law on Energy transposes the Third Energy Package for the electricity and natural gas market and the Directive 2009/28/EC on renewable energy sources, as well as the Law on Energy Efficiency, which it is made transposition of Directive 2012/27/EU on energy efficiency, Directive 2010/31/EC on the energy performance of buildings and the package of regulations on energy-efficient products. Also, in 2019, the Energy Development Strategy was adopted, with three scenarios for creating a modern, competitive, and climate-neutral economy by 2050. But it is necessary to refine that strategy due to the changes that occurred in the period after its quality. Also, the National Energy and Climate Plan of the Republic of North Macedonia has been prepared, which contains many comprehensive and detailed measures and policies concerning the achievement of the goal.

In addition to the recommendations in the previously mentioned documents, it is necessary to emphasise several aspects. First, the country should set a clear goal to increase energy production from renewable sources. It could be 40% of energy coming from renewable sources by 2030 and a further continuous increase in that percentage by 2050. The state should also invest in extensive energy facilities, which has not happened in recent decades. In the transition period, investing in producing clean "base energy" and storage capacities from renewable sources.

On the other hand, the state should also stimulate private investments in energy production from renewable sources, especially households and small producers, for their own needs. In addition, it is necessary to create an enabling environment for establishing energy cooperatives as they are becoming increasingly relevant in EU countries and the numerous cooperatives that are part of the RESCoop network. Clear and transparent criteria for granting subsidies for photovoltaic power plants should also be developed as well.

Second, North Macedonia can also benefit significantly if it manages to improve the use of available funds in the European Investment Plan (EIP) for the Western Balkans (2021 – 2027), since a large part is intended for the energy and green transition.

Third, the success of the country's green transition will depend to a large extent on the provision of a qualified workforce, for which the state will have to provide funds for retraining and upskilling of the existing workforce, as well as funds for the primary qualification of the new workforce. And, of course, it will be necessary to make structural changes in the economy to replace industrial capacities from activities that cause environmental pollution with capacities in activities that do not pollute the environment. The new activities should simultaneously be an integral part of supporting the future industrial policy and the strategy for smart specialisation. These policies systematically support the private sector in increasing its competitiveness as well as strengthening the scientific and technological base of the sectors that have a competitive advantage for the countries.

Although in the country there are already institutions that are very dedicated to energy innovation, it

is evident that the technological and innovation infrastructure that includes resources used by the research communities to encourage innovation, such as equipment, databases, access to scientific journals, archives, etc., is missing. Hence, as forth, the country needs to invest in infrastructure, computer systems, and other preconditions needed to create knowledge. It is necessary to improve the readiness of the country to participate in European projects in the energy field. For example, North Macedonia ranks 90th in the world in terms of scientific publications in the field of energy according to the Scopus ranking, which positions it among low-ranking countries. Therefore, the Industrial Strategy and the Smart Specialization Strategy should support the process of building a scientific infrastructure that will develop energy as an area of competitive advantage for the country.

3.2.3. State-of-the-art in food production

Food production in North Macedonia, especially in relation to agricultural products, seems unfavourable and records a continuous downward trend. Thus, despite the generally high potential for domestic food production, in the face of rising food prices globally and the possibility of becoming a net winner, North Macedonia is becoming even more dependent on expensive food imports, which has resulted in pronounced inflationary pressures over the last year.

According to the data presented in Table 1, there is a decline in crop and livestock production value and gross and net added value in agriculture.

On the other hand, as mentioned already, there is a continuous increase in the import of food products. According to the data presented in Figure 5 and Table 2, from 2005 to 2021, the import of food and beverages in North Macedonia increased almost four times. Considering domestic production, it was individual agricultural producers that carried out most of the agricultural activity. At the end of 2020, agricultural and forestry enterprises accounted only for 3.4% of the total active enterprises in North Macedonia.

At the same time, the increase in state subsidies for agriculture recorded an enormous increase. As shown in the data presented from the final accounts of the National Budget of North Macedonia (source: www.finance.gov.mk), from 2005 to 2020, the amount of subsidies for agriculture has increased by almost thirteen times.

3.2.4. Future perspectives in relation to food production

The basic recommendations regarding the policy for increasing domestic agricultural production (food production) are the following:

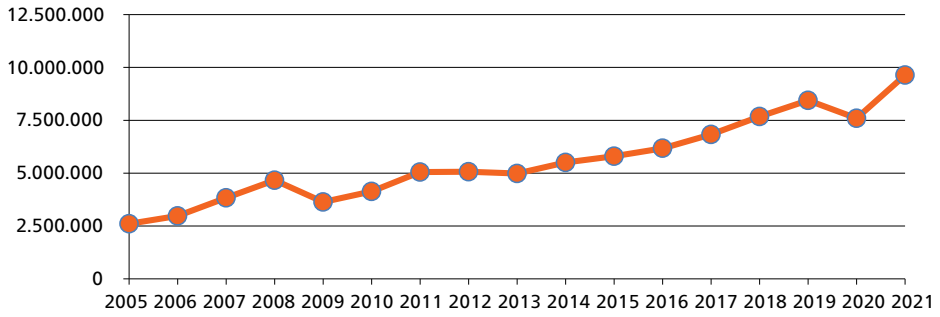
– A complete change in the policy of granting subsidies for agricultural production is needed. The current long-standing practice is input instead of output oriented. Hence, the amount of subsidies is calculated for the planted area of a particular agricultural crop or purchased livestock instead of the achieved agricultural production. That situation should be changed completely in the following ways:

Table 1. Food production in North Macedonia from 2015 to 2020.

	2015	2020
Plant production	64.462	62.290
Livestock production	18.448	18.260
Production of agricultural products	82.911	80.550
Gross value added in agriculture	51.727	48.768
Net value added in agriculture	47.560	44.035

Source: State Statistical office, Report No. 5.1.22.09, Economic accounts in agriculture at constant prices (in millions of denars)

Figure 5.
Total imports of food, beverages and tobacco products from 2005 to 2001 (in thousands EUR



1. Granting subsidies only for primary agricultural production or for an increase in the quality of agricultural production, and
2. Granting subsidies only for a specific (small) number of agricultural crops (products), not for a wide range of products. The choice of crops whose production will be subsidised should be based on an expert's analysis instead of "political criteria".

Table 2. Increase of imports of food and beverages in 2021 compared to 2005 (in %)

Food and beverages	Increase in %
Total	370,0
Food and livestock	258,5
Livestock (except from section 03)	445,2
Meat and meat products	207,2
Dairy products and poultry eggs	348,4
Fish, crustaceans, molluscs, aquatic invertebrates	263,2
Cereals and processed cereals	262,5
Fruits and vegetables	323,3
Sugar, processed sugar and honey	220,8
Coffee, tea, cocoa, spices and their products	271,4
Livestock feed (except grains)	307,9
Various products for food and processing	321,1
Drinks	466,5
Tobacco and tobacco products	249,4

- It is necessary to consolidate the agricultural areas (plots). The current practice, especially regarding the inheritance of land plots, has reduced and fragmented agricultural plots, making them unprofitable for efficient agricultural ("farm") production.
- Investment in acquiring modern knowledge for efficient agricultural production is needed. This measure has yet to be present. In developing the strategy for smart specialisation, smart agriculture has been identified as a key development area, which implies a need for modern technology and tools for information exchange and communication that will increase productivity in agriculture. The strategy should encourage specific measures in the form of subsidies and new sources of financing for producers who apply new technologies and thus modernise agricultural production.
- State investments in modern purchasing centres and storage facilities of agricultural products are needed.
- The market for the purchase and processing of agricultural products in North Macedonia shows clear signs of the so-called "market failure". On the supply side of primary agricultural products, there is a large number of actors who are poorly informed. In contrast, relatively few networked actors are on the demand side of primary agricultural products (production and processing facilities) but are better informed. Thus, pronounced market/information asymmetry and unevenly ample market power arise. The state should play the role of regulator of the market of primary agricultural products through:
  1. providing information on future market signals and trends (prices, etc.) to primary producers of agricultural products;
  2. purchase of primary agricultural products at pre-agreed prices and their storage in state storage facilities and
  3. regulation of contractual relations between bidders and buyers of primary agricultural products.
- The state should make significant investments in irrigation facilities, select suitable seed material for certain types of agricultural crops and develop an efficient system for insurance of agricultural production.
- The Industrial Strategy and the Smart Specialization Strategy should address capacities for more outstanding food production. According to the Smart Specialization Strategy, smart agriculture and food production with high added value are identified as priority sectors with a competitive advantage for the state. The agricultural sector contributes 7% to the national GDP, and the country has over fifty agricultural products with a comparative advantage, large areas of fertile uncultivated land and good geographical positioning with the European market. At the moment, about 10% of the financial resources awarded to private companies financed by the Fund for Innovation and Technological Development are

from agriculture, as well as 4% of applications for patents and industrial property. At the same time, North Macedonia is the only economy from the region participating in an ESFRI project in the thematic area of health and food science. The Institute of Public Health of North Macedonia is one of the 20 beneficiaries, while the University "St. Cyril and Methodius" is one of the 28 participants from the consortium. Participation in this research program will enable the Public Health Institute of North Macedonia to provide high-quality metrology services related to food and nutrition, sustainable development, food safety, quality, environmental safety and human health.

As in the case of energy, what requires attention is the need for cooperation between the private sector and academic institutions. That will mean investments in research and development of innovative products with high added value based on new and modern technologies. There are about fifteen active clusters in agriculture whose role is crucial for developing the sector and strengthening cooperation between academia and industry. Therefore, the Smart Specialization Strategy should support the development of innovative ecosystems targeting specific food production technologies. Such an initiative is already present in Serbia – the Antares project (worth 28 million EUR) implemented by the Biosens Institute to establish a base that will be a European Center of Excellence for advanced technologies in sustainable agriculture and food security. Montenegro has a similar institute, BIO-ICT. North Macedonia should think in the direction of developing a similar centre or connecting with such centres to advance research and development in food production.

Smart agricultural production requires investments in new resources, which generates innovations in a series of auxiliary activities - production of seeds and crops, production of mineral and microbiological fertilisers, production of infrastructure (irrigation systems), production of measuring and control equipment (sensors, databases, information systems for collecting, processing and managing data), biological and chemical means to fight against pests and diseases, as well as modern agricultural equipment. Even though these activities have potential development, many have not yet been developed in North Macedonia.

In addition to agricultural production, North Macedonia has a competitive advantage in food processing with high added value, production of organic and healthy food and development of local food brands, research and development, development of testing laboratories, multi-functional production facilities, increased automation of production, implementation of software for increased productivity in the production of food products and better promotion.

CONCLUSION

The National Energy and Climate Plan of the Republic of North Macedonia mainly respects the strategies and directives of the European Union in the relevant area. The energy transformation of the economy will mean moving away from fossil fuel energy towards zero-emission electricity and other low-emission energy sources such as hydrogen, but also increasing energy efficiency and managing the energy demand. That should be followed by a substantial increase in renewable energy production and a shift towards a circular economy that will gradually phase out energy-intensive products. In parallel, the transformation will include carbon capture mechanisms, storage and utilisation technology. All of that predetermines climate and green policies to become an integral part of the macroeconomic policies of every country.

Achieving these goals will require huge investments by the private and public sectors, not only in the electricity generation sector but also in the distribution and transport sector, in construction, the production of artificial fertilisers, food production, etc. By the end of 2030, North Macedonia will have to reach 40% of the electricity produced from renewable energy sources. It will also be necessary to significantly increase the share of basic electricity to increase the country's energy independence.

Agricultural activity in North Macedonia is mostly carried out by individual agricultural producers. The total number of agricultural enterprises at the end of 2020 reached 1,949, representing 3.4% of the total number of active companies. It is impossible for the mass agricultural production of agricultural products with high quality and high added value. Also, the agricultural areas are scattered, and the subsidies that are input instead of output-oriented, meaning based on quantity or adequate quality, degrade the agricultural production even more.

Overcoming these conditions will first require:

a) consolidation of agricultural lands through appropriate inheritance and tax policy.

b) transformation of production from individual agricultural producers to farm/corporate production and agricultural cooperatives.

c) payment of subsidies according to the quality and quantity of production.

d) stimulating production with high added value, which is further used in the processing industry.

e) encouraging the cooperation of agricultural producers with agricultural institutes and research centres for the introduction of appropriate "know-how" and modern agricultural techniques.

f) improvement of mechanisation and land reclamation systems in the country.

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4

JUST ENERGY TRANSITIONS: CHALLENGES AND OPPORTUNITIES

Stefan Bouzarovski, Dragan Minovski and Ivana Vuchkova

INTRODUCTION

The term "just transitions" is often found in public policies and discourses related to the energy sector's transformation worldwide, including North Macedonia. From a historical point of view, this concept has specific roots and meaning. The idea of just transitions was initially used as a political instrument by trade union movements in the US and Canada during the 1970s and 1980s (Ciplet and Harrison, 2020), mainly in response to the emergence of ambitious policies to reduce water and air pollution (Healy and Barry, 2017). At the same time, it is common for it to propose measures and interventions to prevent or reduce the loss of jobs due to the closure of polluting industries (Abraham, 2017). In this context, just transition proponents and activists advocated for the inclusion of the demands and needs of trade union movements and local communities in environmental policies to preserve jobs and provide livelihood guarantees. The further "globalisation" of just transitions went hand in hand with the rise of sustainable development as a scientific and strategic approach (Stevis and Felli, 2015). Integrating these two paradigms implies compatibility between social and environmental goals in public policies, leading to changes in the dynamics of restructuring industrial capacities and acceptance of social and environmental justice principles as the basis for all state decisions and policies (McCauley and Heffron, 2018).

In the energy sector, just transitions encompass a wide range of measures. Their original thematic framework – whose main preoccupation was energy sources, mostly fossil fuels – is now significantly expanded and simultaneously includes a set of issues related to energy use and consumption (Delina and Sovacool, 2018). For those reasons, one of the most commonly accepted definitions of just transitions implies an approach that aims to identify and resolve social injustices resulting from low-carbon energy transformations (Bouzarovski 2022; McCauley and Heffron, 2018). Many policies and debates about just transitions focus on individual households and homes, which implies interventions in the regulatory framework and socio-technical structure of the housing sector as a whole (Fuller, 2017). At the same time, representatives of civil society organisations and other relevant entities that promote just transitions have expanded from direct forms of political action to a more comprehensive range of indirect influence on knowledge and power structures. There is also a shift in the geographical scope of the concept, integrating the movements and policies present in the Global South ("developing countries") in addition to the traditional historical basis in the Global North ("developed countries") (Kumar et al. 2021). Such enrichment of discourse brings post-colonial global injustices to the fore while emphasising the role of non-governmental actors and gender and racial inequalities in generating diverse trajectories of transformation (Akizu et al. 2017; Caprotti et al. 2021). In doing so, a series of policies and research are emerging considering the drivers and consequences of energy inequalities in the Global South (Samarakoon, 2020).

The extensive scientific literature in the domain of just transitions allows for a more careful breakdown of the different types of measures that support them. Mertins-Kirkwood (Mertins-Kirkwood, 2018), for example, distinguishes between "reactive" and "proactive" policies to promote social justice as a result of low-carbon transitions. In that sense, a broader debate arises whether the fundamentals of capitalism itself, as a socio-economic order based on exploitative terms and relations, are generally able to ensure social justice and sustainable development (Meadowcroft, 2009). On the one hand, there are the proponents of "transformative environmental justice" (Stevis and Felli, 2015) who advocate for fundamental changes in power relations and political economies. This line of thinking questions the regulatory logic of capitalism (Feola, 2019). On the other hand, there are views from

the "technocratic ecological modernism" (White, 2019), which recognizes capacities and possibilities for system reconfiguration within the existing political and economic structures. A key basis of this approach is the argument that the closure of industrial facilities and job losses as a result of environmental policies in one place means the transfer of the affected polluting sectors to other places where the institutional capacities are insufficiently prepared to deal with the complex challenges that such processes bring about (Newell and Mulvaney, 2013).

It is beyond question that the challenges related to just energy transitions have been present in North Macedonia for a long time. This includes the economic consequences of the inevitable closure of carbon-intensive energy production facilities, the spread of renewable energy choices, and the transformation of energy demand in the housing and transport sectors. An open question is how to apply the broad global experiences and knowledge from this domain within the Macedonian context, respecting the specific issues that arise due to several factors, including the structure of the energy sector and the existing social inequalities. At the same time, one should take into account North Macedonia's experience with another recent "transition" that brought major economic, political and infrastructural-spatial shifts while closing a number of ecologically sustainable development paths that were available to the state as a result of the socialist legacy (such as advantages in urban and spatial organisation in terms of transport, and the prevalence of district heating systems).

4.1. JUST ENERGY TRANSITIONS IN THE MACEDONIAN CONTEXT

What needs to be done in North Macedonia in order to implement the obligations arising from the Paris Agreement while ensuring social protection, energy security and economic stability of the country?

The energy transition is not a matter of question or desire but a process that every country, every continent and the world must carry out. Unlike many European countries, where this process is followed and implemented with clear strategies, specific steps and goals and in which all stakeholders in society are involved, North Macedonia needs an energy transition strategy. The private sector, affected by the energy and economic crisis, is well ahead in this process and already invests in renewable energy sources, especially in photovoltaic power plants, to ensure its own needs.

On the other hand, the state, through the state electricity production company, started the energy transition process a few years ago by installing the first photovoltaic power plant (with an installed capacity of 10 MW) within the already existing coal mine within REK Oslomej, but also by including several projects in its development plans, both in terms of electricity production from photovoltaic power plants within the framework of mining energy plants and hydropower plants, with own investments, but also with public-private partnerships, as well as in the area of electricity production from wind power plants and from large hydroelectric power plants. However, with the advent of the energy crisis, North Macedonia started reconsidering its plans to open new coal mines, invest in gas-fired power plants, and use fossil fuels to produce electricity. Unfortunately, the energy crisis caused a backward trend in the energy transition processes. The contradictions in these two plans happening in a very short period confirm the need for a clear energy strategy that the country still needs to develop. In addition, the strategy on its own means nothing if it is not followed by specific action plans that will fulfil the long-term objectives and will be coordinated and monitored by an independent centre, as is the case in other European countries. Bringing all stakeholders on board (state institutions, local authorities, energy companies, civil society, academia, trade unions and local communities) remains a key priority.

At the moment, North Macedonia stands at a crossroads. On the one hand, the country can return to the "business as usual" scenario, which means continuing to use fossil fuels, jeopardising its future. That is not only because using fossil fuels is disastrous for the environment and citizen's health, but it is also harming the economy in the long term. For instance, introducing the so-called "Carbon Border Adjustment Mechanism" (duties for importing carbon-intensive services and products) means additional export taxes and fees for Macedonian products in the EU and the world, making them uncompetitive. On the other hand, North Macedonia can continue the path of a just and clean energy transition and ensure energy security and stability through the increase and diversification of renewable energy production and adequate storage systems, which will contribute to the rapid and robust economic development of the country and increased well-being of citizens.

For this purpose, in addition to an inclusive energy transition strategy guided and coordinated by an independent centre, strong and coordinated investments in innovation and research are needed, followed by clear policies for investing in new energy capacities to deploy renewables. It is necessary to make a map for possible investments in photovoltaic power plants, with clear criteria on the land, location, and space that are optimal in production terms but, at the same time, do not endanger the fertile agricultural land. For instance, the location should not harm the country's alternative and sustainable economic development possibilities.

In that direction, investments in agrophotovoltaics and floating photovoltaic power plants in artificial lakes are needed, but only in line with preserving the ecological and social balance. It is crucial to enable easy and quick installation of photovoltaic power plants at industrial facilities, public facilities and the homes and buildings in the state, which should have priority over all other investors and be supported by favourable loans and grant schemes. Investments in micro-renewable sources like heat pumps in the residential and commercial sectors are particularly important. All of the aforementioned is very important if considering that the possibilities of the transmission and distribution network to absorb new variable production capacities, such as photovoltaic and wind power plants, are limited. Hence, if households and industrial capacities are late with their investments due to complex administrative procedures or financial barriers, while large investors will realise them quickly and easily, their possibilities for using and producing renewable energy in the future may be technically or financially impossible. In this way, the basic principles of the energy transition, which should ensure fair access to cheap and clean energy for everyone, and especially for citizens, while enabling them to be involved in the management structures of the energy system, will be threatened.

Energy storage systems, such as pumped-accumulation plants, battery, and thermal energy storage systems, are also key in this process.

Many would agree that the transition to a market economy in the 90s went without a clear strategy and goals. However, the energy transition, which should be socially just and enable sustainable development, needs to be strategically led in an inclusive process in which all stakeholders participate. That means that citizens need to be at the heart of the energy transition and will own the majority of the energy sector instead of letting large companies and monopolies do so.

4.2. ENERGY ALTERNATIVES AND OPPORTUNITIES FOR NORTH MACEDONIA

The energy transition of North Macedonia will be a long and challenging process from a technical, economic and social point of view if a political consensus is not reached prior and followed by a clear strategy and goals. Nevertheless, that should not discourage anyone. Instead, it should motivate every stakeholder to strive even further for a just energy transition that will grow the country into a regional leader in renewable energy production and storage, given the excellent geographical location and climatic conditions.

It is essential to note that in the last period, significant investments in renewable energy sources by large strategic investors have been announced. Given the recommendations in the previous section, it is urgent to develop a model for citizens' participation in the energy transition very quickly in order to ensure that citizens are not left behind. That can be done by scaling up renewable energy production on a small scale or the so-called "decentralised solar", meaning solar rooftops on houses, residential and public buildings, and industrial facilities. For that, legal and technical preconditions are needed to enable prosumers (already recognized by the law) and energy cooperatives. Strategic investments and investors in the field of energy need to be carefully analysed, and their requests even more carefully considered and accepted. The EU Directive also imposes this on the screening of foreign investments, especially in strategic sectors, which includes energy, and which we, as a country with candidate status for membership in the Union, should transpose into our legislation, both legally and institutionally.

Demands for state-guaranteed purchase of electricity with fixed prices and additional benefits, such as charging for installed capacity and balancing of their production by state-owned companies, will eventually lead citizens, industrial facilities and all consumers in the state to pay higher than market prices, but will also lead to disruption of the liberalised energy market in our country. Investments in renewable energy production in the coming period should be market-oriented without disrupting the liberalised market. If the country offers state aid through subsidies, it should be transparent and available to all investors, not just some. In addition, investors who want to invest in variable production capacities, in conjunction with their production capacities, should set up and install energy storage capacities in proportion to their production. The state, i.e. the community, needs to keep under its control and management all major hydropower facilities because water is a national treasure and the property of all citizens, and as such, no government should sell it or give it under a long-term concession to private investors. , without the citizens deciding on it (but not in parliamentary elections). The significance of large pump-accumulation facilities, such as Cheberen, will be much more significant in the future than what was at REC Bitola until today. Therefore, state companies, supported by the state, should strive to build and operate it in the future.

In addition, it is necessary to invest in other facilities such as pumped-storage power plants, new energy storage and battery systems, and thermal energy storage systems within the existing thermal power plants. It is also important to ensure the socially just component of the energy transition, which means that it should not harm the local economies in coal regions and citizens' well-being. These facilities store excess electricity produced by variable renewable

energy sources but also produce electricity when production from renewable sources is reduced or absent. They are additionally significant because they would employ the same workers who, until yesterday, worked within the existing thermoelectric power plants, and thus, jobs would not be lost. Additional major retraining would not be needed.

In order to ensure a quick and efficient transition to an environmentally sustainable future, it is necessary in the near future for gas to be completely replaced by low-carbon and renewable energy sources. The gasification of our country is an entirely unnecessary project, a project that has no future and will be an overpriced energy museum. In that sense, the absence of a developed gas distribution system can be considered an advantage, as it allows for "leap-frogging" or a transition to other forms of supply without the economic and technical burdens that gas infrastructure can create. At the same time, the possibilities of intervention in the energy demand should be taken into account by stimulating the concept of flexible and active consumers.

The innovative use of space for the combined production of electricity and quality food should be the basis of the future development of our country. Agrophotovoltaics are one of the ways for that, and their application in agriculture is significant both for the energy independence of our country and for the independence in the area of food production and supply. If we have an energy crisis today, we may have a food crisis in the future, so by solving one energy supply problem, we can cause another food supply problem. For this purpose, clear legal frameworks are needed, as well as the creation of clear legal and by-laws that are accessible to all and support all farmers, not just individual large investors. In addition, energy and agriculture come together in the process of energy production from biomass and biogas, a process which, although it is represented in our country, is still not sufficiently attractive and accessible to everyone but to individual larger investors. The possible solution to make this process more accessible to everyone is through energy cooperatives, where all smaller farmers will be able to unite and together through smaller energy cooperatives increase their incomes and become stakeholders in the energy market.

The main reason for the current energy transition is no longer energy security but climate change and all efforts to reduce greenhouse gas emissions and adapt to new climate conditions to ensure a sustainable future for all. The perception is different for a country like North Macedonia, where economic development is closely linked and conditioned by energy security. However, experience shows that many transitions and changes in the past were not foreseen, and therefore, the consequences led to great economic and social damages that conditioned further development. However, the climate change situation and, consequently, the energy transition commitments provide clear directions and a crystal clear picture of how we should consider the country's future development and society in general.

4.3 SOCIAL JUSTICE AND GREEN TRANSITIONS: HOW TO ENSURE A JUST TRANSITION IN WHICH NO ONE IS LEFT BEHIND?

Ambitions in climate commitments must go hand in hand with ambitions for social guarantees so that the changes they will cause do not negatively affect those who have the least in society but, on the contrary, become a catalyst of opportunities for them. Starting from the goals of the Paris Agreement, which North Macedonia signed and ratified in 2017, each country's ambitious climate and energy policies should be based on guarantees of social justice and equality. In that context, the existing socio-economic inequalities should be the leading postulate in the energy transition, which, depending on them, represents a different opportunity, meaning a different challenge for different countries. While in many countries, the energy transition is seen as an opportunity for energy independence, cheaper and cleaner energy, and even an opportunity for citizens and companies to profit, there are countries in which it is perceived as a threat to the existing conventional energy system that offers stability and social security. That is the real challenge for the energy transition in North Macedonia, considering that every fifth citizen lives in poverty (World Bank, 2022), every fourth is affected by energy poverty (State Statistics Office, 2021), and the country faces serious ecological challenges, including highest rates of air pollution in winter times.

First, it is important to emphasise that social and ecological issues are not mutually exclusive but arise from a long-established, unjust economic model (Schirmbeck et al., 2020). During the neoliberal rise, the market did not care for the environment, leading to severe environmental disasters (Stiglitz, 2020), of which socially vulnerable citizens are most affected. That is why the energy transition, which is part of the decarbonization goals of many countries, including the EU, which is confirmed by the European Green Deal (European Commission, 2019), offers opportunities to change the rules of the game by institutionalising state regulation of the market and accounting on the social and environmental elements of economic development.

As a country with candidate status for EU membership and a signatory of the Green Agenda for the Western Balkans (European Commission, 2022), the RSM has the task of ensuring an energy transition that is socially just, through timely determination of the

impacts that the transition will have on:

- The labour market and jobs;
- Local economies and value chains;
- The standard of living and the quality of living of the citizens;
- Poverty and inequality.

In this context, it should be clear that every transition in the past has been followed by changes in the labour market structures. Many jobs and professions have already disappeared with information technologies and digitalization, such as the typist(s) with the advent of the computer. With the increase of renewable energy and the gradual abandonment of coal, jobs in coal mines and electrical engineer(s) specialised in coal-fired thermal power plants. In a country like North Macedonia, where unemployment accounts for 17% and the average salary is 31,871 MKD (State Statistical Office, 2022), jobs in thermal power plants and coal mines, including TPP Oslomej and REK Bitola, are of great importance if taken into account that these facilities employ about 3,800 workers. Moreover, the average salary is 39,324 MKD, significantly higher than the average salaries (State Statistical Office, 2021).

Hence, planning the just transition must undoubtedly begin with planning for the future of jobs, which means responding promptly to any challenges arising as the transition progresses. Since it is a matter of electrical facilities owned by the state, it is the state's responsibility to make a plan for the jobs that will be affected and adequate preparation for the new jobs that will open in the future. Considering the objectives in the Energy Development Strategy of North Macedonia until 2040, which in both the "moderate" and the "green" scenario envisages coal phase-out until 2025, the state assistance should follow:

- the process of closing the coal mines and covering their production losses until official closure;
- financial support to those workers who have remained or will remain unemployed due to the closure;
- the safety and sanatorium work necessary after the closure of the mines.

To enable this process, it is necessary to establish a Center or Fund for a just transition following the example of other countries such as Slovenia, Croatia and Spain, in which all energy capacities, state institutions and unions will participate. Planning requires detailed analyses of the number and structure of employees by age, profession and education. Thus, the state aid measures that will be part of the Just Transition Plan should be based on the cross-section of the total number of employees, the number of employees who naturally reach the end of their working life and retire, and the number of employees whose qualifications correspond to the needs of the new renewable energy production capacities. Active employment measures should cover all the rest through the Program for retraining and upgrading for the transition to the new capacities that will work on renewable energy sources, or that will be offered as an alternative option. It is of great importance to preserve the standard of living and the quality of living. Therefore, the Just Transition Plan should enable even better jobs, that is, the improvement of monthly incomes and the quality of jobs.

Of great importance are the transformations of local economies through value chains. Apart from jobs, the Just Transition Plan for coal-fired power facilities is also necessary due to the economic impact of their closure and transition to clean technologies such as the installation of photovoltaics, wind power plants, pumped-storage power plants or thermal energy storage systems within the existing thermal power plants. This section requires the determination of all direct and indirect economic effects of the operation of coal-fired thermal power plants, both at the local and national level in terms of fiscal implications, but also in relation to all entities that, in one way or another, depend on their operation. Apart from the energy capacities themselves, in determining the impact on the local economies through the value chains, the appropriate state institutions, the local economic and social councils, unions, local civic organizations, chambers of commerce, as well as other stakeholders whose participation in the creation should be included strategies for carbon-neutral development is crucial.

In addition to changes in the labor market, the future of jobs and local economic development, the standard of living and quality of life of citizens must be considered. The benefits of the energy transition for citizens relate primarily to the opportunities for direct participation in the production of electricity and heat energy, such as:

- producers;
- and members of energy cooperatives.

In relation to poverty and inequality, the Law on Energy and the Law on Social Protection provide the legal basis for the annual program for the protection of vulnerable energy consumers, which defines vulnerable consumers and the conditions for the use of funds aimed at them. It also defines the Electricity Supply Rules, which oblige energy suppliers to supply energy (electricity and natural gas) to vulnerable consumers. However, apart from the de jure recognition of vulnerable consumers in the legal

framework, the actual situation must be determined, for which a generally accepted socio-economic definition is needed. The definition should develop clear criteria for identifying vulnerable consumers based on modern theoretical approaches and actual needs in Macedonian society.

According to the current data, 22% of the citizens of North Macedonia live in poverty, and even 25% are affected by energy poverty. At the same time, this condition considers only the lack of heat and maintaining adequate temperatures in one's home during winter. However, several important segments are being forgotten here:

- The possibility of maintaining appropriate temperatures during the summer periods.

- The type of energy sources and appliances used for heating and cooking; are they appropriate; whether they cause pollution in the home that can harm citizens' health (for example, firewood, fuel oil, oil, gas or other non-standard resources).

- The implications on the most vulnerable citizens, such as, for example, women and children, or adults, who are far more vulnerable and spend a longer time in their homes.

- The participation of energy bills in the citizens' total monthly expenses and incomes, which in the last year even exceeded 30% of the consumption basket.

Renewable energy should be available to everyone. If the capacities from renewable energy sources remain in the state's property, then it is necessary to ensure access to all. It can be done in several ways, namely:

- Guaranteed minimum energy for everyone.

- Subsidizing energy bills (e.g., Austria).

- Tariff for vulnerable consumers.

However, one of the goals of the energy transition is the decentralization and democratization of the electricity and heat market by enabling citizens and households to produce electricity and heat themselves. This is possible by installing photovoltaics and thermal collectors on their rooftops or heat pumps in their homes and acting as prosumers or members of energy cooperatives. But, installing new technologies can be a real challenge for vulnerable consumers and citizens with lower incomes. Also, not everyone's home is suitable for installing renewable energy technologies, and the production of renewable energy alone would mean nothing if households do not simultaneously reduce energy consumption. Reducing consumption is possible through rational energy use and investments in energy efficiency (highly efficient building materials, thermal facades, roofs, doors and windows) and household appliances with low electricity consumption. Unfortunately, these investments and investments in production technologies are not equally available to all citizens. Therefore, before approaching complete decentralization of the market and energy transition at the level of households, citizens' possibilities and needs must be assessed, and appropriate programs for subsidies and support must be designed, which will start with the most vulnerable consumers.

CONCLUSION

To be successful and thorough, the energy transition should involve all relevant stakeholders, with citizens playing a key role in the process. In North Macedonia, there are opportunities for transforming the existing energy production and consumption system towards a low-carbon one, with particular emphasis on renewable sources and different forms of energy storage. At the same time, in every part of the system, it is necessary to consider social inequalities, especially about new jobs, the income of the affected citizens, and the degree of involvement in the transition. Energy cooperatives should also be key in this process, and citizens should mainly own, control and manage energy capacities. This means that not only the technical-technological moment should be taken into account but also the ownership structure of the energy capacities and the regulation of the sector as a whole.

North Macedonia has a Strategy for Energy Development until 2040, but with all the changes that have occurred in the past years, it is already outdated. The adopted Energy Development Strategy was based on the Fit for 55 package, the EU Green Deal, and the foundations of CBAM. However, the decline in investment costs of renewable sources and some storage technologies, the sharp increase in the price of natural gas and its supply uncertainty, as well as the additional depletion of coal reserves in the country, require a fundamental review of the Strategy and the adoption of new Energy Development Strategy and Just Energy Transition Plan. In the new strategy, in addition to new production facilities from renewable energy sources, where the leading investors and stakeholders should be citizens as prosumers or members of energy cooperatives, energy storage systems should also be introduced, and there should be less and less space for fossil fuels, both in the area of electricity and heat production, as well as in the area of transport.

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5

A FUNCTIONAL SOCIAL PROTECTION SYSTEM

Mila Carovska, Sanela Shkrijelj, Nikola Popovski

What will our social map look like in the next decade? Will there be improvements for some vulnerable groups, and where can deterioration be expected?

The COVID-19 pandemic marked the end of a phase of progress in poverty reduction. By 2015, the global extreme poverty rate had been cut by more than half. Since then, poverty reduction has begun to slow with slowing global economic growth. The economic upheaval caused by COVID-19, and later the war in Ukraine, brought about a complete reversal in the fight against poverty.

It has become clear that the global goal of ending extreme poverty by 2030 will not be achieved. In 2020 alone, globally, the number of people living below the extreme poverty line increased by more than 70 million. That's the most considerable one-year increase since global poverty monitoring began in 1990. The data confirms that the income losses of the poorest 40 % of the world's population were twice as high as those of the wealthiest 20%.

When it comes to North Macedonia, a similar tendency can be expected. The poverty rate, calculated as persons living below 60% of the median equivalent income, has a downward trend from 27.0% in 2010 to 21.5% in 2015 to 21.8% in 2020. From 2019 onwards, North Macedonia will implement comprehensive reforms to improve the coverage, targeting, and adequacy of the country's social assistance system to provide more effective support for the poor and vulnerable population. One of the fundamental changes was the introduction of the means-tested Guaranteed Minimum Income (GMI) program, which consolidated and replaced several social assistance programs.

The analyses in collaboration with the World Bank indicate that the GMI reforms have led to a significant improvement in targeting: 53% of social assistance beneficiaries are in the poorest quintile compared to around 44% before the introduction of the GMI. In addition, households with GMI are entitled to child and education allowance, which supports precisely the most vulnerable families and their children.[7]

The economic growth accompanied by favourable trends in the labour market (growth in employment and wages) and an increase in pensions and social assistance also contributed to the reduction of the poverty rate in recent years. However, analyses of the impact of the COVID-19 crisis showed that an additional 25,000 people were at risk of being pushed into relative poverty.[8] According to UNICEF research on the effects of the war in Ukraine and the subsequent weakening of the economy, the crisis in North Macedonia is expected to pull another 5,500 adults and 1,600 children into poverty. [9]

This inevitably imposes the need for continued and expanded support for strengthening social protection systems and prioritising funding social protection programs, including financial assistance programs for vulnerable families. The recommendations of international financial institutions, such as the World Bank, point to this with a clear direction for targeted measures, that is, targeted money transfers, which are a much more effective mechanism for supporting the poor and vulnerable groups.

Along with measures that protect the most vulnerable, the state should prioritise reforms that ensure long-term growth. The crises of the past years have clearly shown how progress made in a few decades can suddenly disappear. Investments with the highest return, such as those in education, research, and infrastructure, need to be made now. Efficiency in delivering public services, inevitably linked to digitisation, must be improved. Despite the challenging global and domestic circumstances, the institutions must strengthen their commitment to the economy's growth in the coming period while paying attention to who benefits from that growth.

When we talk about the need to take further measures and adjust policies, it is inevitable to perceive the socioeconomic and demographic specifics that can be

a roadmap for developing the necessary policies and services for advancing social protection.

The data from the census conducted in 2021 show that from 2002 to 2021, the number of young, or as it is called, the able-bodied population fell by 171,317 inhabitants, or 12.4%, from 1,381,352 to 1,210,035 inhabitants. At the same time, the number of elderly population, or over 65 years of age, increased by 17.2%, or from 213,712 to 315,331 inhabitants, which means 101,619 people. Alternatively, if in 2002 the number of the working-age population in the total population participated by 68.3%, it has decreased to 65.9%, while pensioners from 10.6% 20 years ago currently experience 17.2% in the total population.

The ageing of the population imposes many new qualitative and quantitative health, economic, and social problems. Population ageing affects a country's economic growth, savings, investments, production, pensions, labour force, intergenerational transfers and taxes, family structure, life arrangements, migration trends, household demand, and health care.

If all these tendencies are analysed, then the social map of North Macedonia in the coming period indicates the presence of multiple social risks. The ageing of the population is undoubtedly one of the dominant social risks due to the high and growing participation of the elderly population in the total population and requires further development of social services that will respond to the needs of the elderly.

In inclusiveness and accessibility, the state has taken significant steps to increase the volume and availability of quality services in social protection, education, and health so that children and persons with disabilities can use services equally and acquire a quality education. Moreover, they must acquire skills to ensure their entry into the labour market and become independent, active citizens who contribute to themselves and society. However, children and persons with disabilities still face barriers in terms of physical accessibility to exercise their rights, as well as the availability of necessary support services in schools, institutions, and the labour market.

The social protection system's challenges will undoubtedly be significant in the coming years. They will require measures that mean a dignified guaranteed minimum income for the vulnerable families already in the system, which follows the increased cost of living and ensures access to quality health, education, and social care. However, the critical challenge will be how to prevent more people from falling below the poverty line in conditions of an economic and energy crisis whose duration is far from certain.

Who are the citizens that can become vulnerable? What should be the primary goals and elements of social policy?

The future of the welfare state in the whole world is uncertain, including North Macedonia. However, it is essential for the planet's future. The dominant paradigm for thinking about social protection is the social services model.

The demand for social services is continuously increasing due to demographic, economic, technological, and political reasons; supply is limited for economic and political reasons. It is increasingly recognized that social services are only one, often small, factor in determining social outcomes. However, the social services model focuses heavily on inputs. Following the entire life cycle of the individual and the family, especially in a period of health, economic, and energy crisis, the insight is growing that the paradigm of social policy should change from focusing on inputs to focusing on planned results or social goals.

The five giant evils defined by William Beveridge as want (or poverty), disease, ignorance, squalor (or slum housing), and idleness (or unemployment) (Beveridge, 1942), and dealing with them is essentially the development of four major social services – social security, health services, school system, and public housing. All these services are established and organised in different models and different forms practically in all developed countries.

In 1951, Titmus defined a new discipline of social administration or nowadays, social policy, which can be broadly defined as the study of social services and it deals with the historical development of these services, statutory and voluntary, with the moral values implicit in social action, with the roles and functions of the services, with their economic aspects, and with the role they play in satisfying certain needs in the social process.

However, even this setting of social protection, which, although the ultimate goal is the advancement of social goals, uses social services as a means to achieve the goals. In essence, this is a statistical view of social policy in which the development of social policy is indicated by the degree of provision of the state.

The model of social services that corresponds to Titmus's conception has been the dominant paradigm for social policies for years.

Social services in perspective, not as a single tool

The crises that have been happening since 2020 until today, such as COVID-19, the energy crisis, and the increase in food prices, have caused the most

tremendous setback in the fight against poverty worldwide. These same tendencies are also felt in North Macedonia. This shows that all the measures taken so far do not give the expected results.

Social services are essential, yet there is increasing evidence that they are, in many cases, only one influence on achieving various social goals and, in some cases, only a marginal influence.

Although public spending on social security and welfare benefits has grown dramatically, so has poverty. However, poverty depends on employment levels and wage rates, rates of economic activity, childcare costs, housing costs, and food prices.

Without the development of social protection, poverty would, in almost all cases, be worse, but social protection mitigates, not prevents, poverty.

Similarly, health levels depend on many more factors than just health services. Health fundamentally depends on water supply and waste disposal, the environment, diet, exercise, alcohol and drug consumption, and individual genetic makeup.

The education system focuses on the "school years" – roughly ages 5 to 18. However, educational achievement depends on the development during the preschool years, mainly based on the family.

Opportunities for women and ethnic minorities depend on how social services treat them, but more fundamentally, depend on public attitudes and legislation to ensure rights.

That is why the traditional paradigm of social policy or the interpretation of social policy through social services – seems seriously flawed. Beveridge's links between social goals and social services may have been an appropriate way forward in the 1940s, but now appear seriously deficient. It is time to return to the social goals and think broadly about what they are and what is needed for their realisation.

Social goals and their achievement – or not

The purpose of this text is not to discuss the social goals in detail because that requires a comprehensive public debate, analyses, and national consensus. However, many of the possible social goals are widely shared and are already part of national strategic and international ratified documents. A list of goals that a majority would probably support includes reducing poverty, promoting health, educational opportunities for all, decent housing for all, including opportunities for young people to set up independent households, ending disability-related discrimination, age, ethnicity, sexual orientation or religion, promoting social inclusion and community promotion.

Suppose one starts with such societal social goals and asks what is needed to achieve them. In that case, social services undoubtedly have an important role, but so do the economy, the family, and the community.

Currently, with high levels of unemployment, especially youth unemployment, regardless of the quality of social services, there is little chance of avoiding poverty, health damage, and social exclusion. Without the joint pursuit of social goals by all relevant institutions, they simply will not be achieved.

Future social policies based on social goals across all life cycles

New – old vulnerable groups of citizens

Social policies that meet the challenges of modern living will have to focus individually on each stage of life and see the answers to the challenges across all social spheres. A criss only highlights and amplifies already existing risks, which is precisely why social policy should ensure that risks are treated continuously and in the long term to soften the shocks that come with crises.

Childhood - children

Three critical things that affect childcare have changed. First, with smaller and more "nuclear" families, there is less opportunity to practise childcare with siblings, grandparents, cousins, or neighbours. Second, the rise of female employment and gender equality means that mothers are not around as much as they once were. Third, recent evidence from longitudinal studies has shown that a child's future is primarily determined by the time a child is 3 or 4 years old. Thus, formal and compulsory education begins at an age when the life chances of most children are already determined.

If the social goals of equalising opportunities for women and children are to be achieved, then it is necessary to think outside the framework of the school system. Social policy intervention must be in preparation for parenthood and the early years through providing high-quality childcare or introducing compulsory preschool education from the third year for all children.

The relationship between parental and state support must be re-examined to reduce the disparities in life chances.

It is becoming increasingly clear that social spending on child care should continue to grow.

Youth – Young people

The second challenge for social policy concerns young people aged 16 to 21. Youth unemployment is high, now affecting about a fifth of young people. Such unemployment causes not only a loss of income but also a loss of hope. This situation, sooner or later, can threaten the stability of society.

In North Macedonia, every third young person aged 15 to 29 is not in education, employment, or training; their lives are going nowhere. Although almost half of each generation enrols and graduates from college, dignified employment after completing higher education is only possible for some.

There is no apparent social policy solution to these problems at present. More jobs are needed for young people. It is an economic problem. However, society's unwillingness to deal with the economic problem leads to attempts at social service remedies, including schools, retraining, and employment services. The 'blame' then falls either on social services for having little impact on youth unemployment or young people for their inadequacy – even though they are little different from previous generations of young people who were able to find work.

The conclusion is that when it comes to young people, there are limits to what social services can achieve. The social goal of exploiting the opportunities and potential of young people and avoiding lost hope can only be achieved if full employment of young people is set as a goal. Entering the labour market will give each young person an income, a reason to stay in the country, and hope and perspective.

Maturity – Working Poor

Poverty was primarily confined to those who were not at work, so the Beveridge reforms were designed to help the unemployed, sick, or old who could not work. Now, there is a growing number of the "working poor" – earning families who are still in poverty. The answer to this poverty is often sought in subsidising low-paid families through child or other one-off benefits. While these measures provide some relief, they fail to address the underlying problem of low wages. The national minimum wage that was enacted did not address the causes of low wages – workers' lack of skills, productivity, and lack of demand for their workforce.

Again, this economic problem has been attempted to be solved through social services – the extension of social protection to those who work – which deals with the symptoms, not the causes.

In September 2022, the number of registered unemployed persons was 112,464, of which 65,516 had not completed primary or secondary education, and 10,332 had not completed only secondary education. Moreover, North Macedonia has no established system for validating knowledge after formal education. Moreover, these citizens are continuously treated or required to be treated by the social protection system instead of the education system.

If water keeps being added to a leaking container, it is a useless waste of water until the leaking container is fixed. So, the causes of growing income inequality must be addressed if the working poor are to be helped. This situation can be improved only through the joint efforts of the educational system, employers, and the government. Unfortunately, many employers are currently more intent on increasing the income of executives than creating a living wage for workers. A blockade of progressive taxation also came in most employers. Progressive taxation can significantly improve the state of inequality in the country.

In short, the social goal of keeping workers out of poverty cannot be met with social services and subsidies.

Old Age – Retirement

Historically, retirement as a concept barely existed before the Industrial Revolution. In most countries, pensions are the most significant component of social spending. Beveridge's reforms were intended to provide for around half of the working population who lived above retirement age. Then, the number of people who live more than 65 years is increasing more and more. Currently, one-sixth of the world's total population is over 65 years of age, and this is predicted to increase to one-quarter of the world's total population by 2050. The same tendency can be seen in North Macedonia. At the same time, the political force of the pensioners – the grey power – constantly exerts pressure for higher pensions. Many countries, including North Macedonia, fail to adapt to the demographic changes that are taking place. These changes are gradual, but they add up to a considerable change. Pension schemes are in crisis due to the increasing number of beneficiaries and higher benefits.

If we have to talk about what needs to be done, the answers are simple but challenging to implement for the political elites who depend on pensioners.

The options available are for the working population to pay more, for pension levels to fall in income, or for people to retire later.

There are increasing doubts about whether the existing pension schemes suit the new era. The twentieth century presented a brief historical episode in which withdrawal from hard industrial work was a shared experience appropriate for the conditions and times. In the future, work with lower

physical demands may be distributed differently over the life cycle. What seems clear is that today's social policy concerning future retirees is essentially "locked in" to institutionalised pension schemes with a fixed retirement age and is slow to respond to changes in demographics and economic activity. The past model of working full-time until a fixed retirement age followed by retirement with a pension is unsustainable and not what many people want – which can include flexible and partial retirement and ample opportunities for continued community work.

Retirement policy focused on social security institutions loses sight of the social goals that should be the basis of policy.

Old age - Caregiving

For many, the last stage of life involves physical frailty, loss of memory and reason, and dependence on the care of others. However, most older adults remain relatively healthy until shortly before death. What is not in doubt is that the number of older adults is increasing and will continue to grow.

The cost of care is rising rapidly. Families – primarily women, mainly bore these costs in the past. Now, with the model of social services, the state should allocate most of its resources to services for the elderly. What is clear is that years of addiction are likely to increase as medical advances allow more people to stay alive longer. What is clear is that the old social service model of family reliance can no longer cope, and state takeover is far from adequately developed. The economy of care as a concept of social services, but also as a response to specific economic issues, such as unemployment among unskilled workers, should be revived, and more sectors should feel it as a possible response to social goals.

CONCLUSION

Focusing on services has led to a growing conflict between supply and demand, achievement, and aspiration.

Many who deal with social services consider that the main problem is the lack of adequate resources that should be invested in the services. However, focusing on inputs rather than social goals is not an entirely helpful approach to thinking about the future of social policy, given the political constraints on social spending and the limited impact that spending often has on social goals.

Instead of starting from the institutions of social protection, although they are also important, it is necessary to reconsider what social policies are trying to achieve. Once social goals are prioritised, there is more hope that appropriate and effective policies will follow – policies for social services and the economy, families, and individuals.

Recent examples of health, energy, and economic crises show that we must have strategic social goals and ensure we reach them. Ad hoc solutions fail to keep the "water we add to the bowl" because we do not act on the causes.

Additionally, when we have skyrocketing energy costs compounded by the subsistence costs of living for hundreds of thousands of residents in the state, we see major energy companies posting record profits. Suppose mechanisms are not found to tax these excessive profits and use the funds to support the most vulnerable people in these difficult times and reduce growing inequality. In that case, we cannot talk about social policy at all.

Renewable energy sources, much talked about during the energy crisis, are often the cheapest and fastest source of electricity. However, this is only true if we ensure that supply chains work well and without bottlenecks, that new technologies will be available to all, that the workforce has the appropriate skills, and that sufficient funds will be available for initial investment. This suggests that this policy is helpful for the privileged if mechanisms are not made so that the state will provide necessary infrastructure and maintenance for the most vulnerable.

The social policy paradigm needs to change from social services to social goals. Moreover, a national debate is necessary, and then a consensus on what we want to achieve and what kind of country we want to live in. Only then can we discuss the kind of social policy we will create.

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6

HOW TO RAISE THE POTENTIAL OUTPUT OF THE MACEDONIAN ECONOMY?

Dragan Tevdovski, Vancho Uzunov and Gligor Bishev

INTRODUCTION

In the last thirty years, discussions on how to improve the performance of the Macedonian economy have almost always been conducted **from the demand side of the economy.** Thus, it is discussed how to raise the contribution of exports, what the role of public consumption should be, what the private sector's investments should be, and so on. However, these factors that affect the demand only make oscillations around the long-term movement of the economy. Those oscillations represent the expansions or recessions of the economy. Basically, this is **looking at the economy in the short term.**

We must focus on the supply side to look at the economy over the long term. Moreover, the **potential output of the economy and the factors that determine it are crucial.** The line represents the output that the economy would produce if labour and capital were fully engaged and did not create inflation. Furthermore, since, except during wars and natural disasters, labour and capital change relatively slowly, **the potential output is the basis of the long-term movement of the economy.** Expansions and recessions occur as oscillations around potential output.

The purpose of this paper is to present the possibilities for increasing the potential output of the Macedonian economy by raising the contribution of the factors on which it depends. Therefore, the factors that determine the potential output are first presented in the paper. And then, in the following parts of the paper, the factors of production - labour and capital and their total productivity - are discussed separately. Finally, the paper ends with concluding observations.

6.1. THE POTENTIAL OUTPUT

Unlike the actual output, for which a series of realised values exists, the potential output cannot be observed directly. It is a concept, and for its understanding, the following **production function** is used:

$$\boldsymbol{Y = Af(K, L)}$$

where Y represents actual output (real GDP), K represents the capital employed in the year, L represents the number of hours worked, and A represents the efficiency in combining labour and capital. From this, it follows that **actual output is a function that depends on capital input, labour input, and efficiency in their combination.**

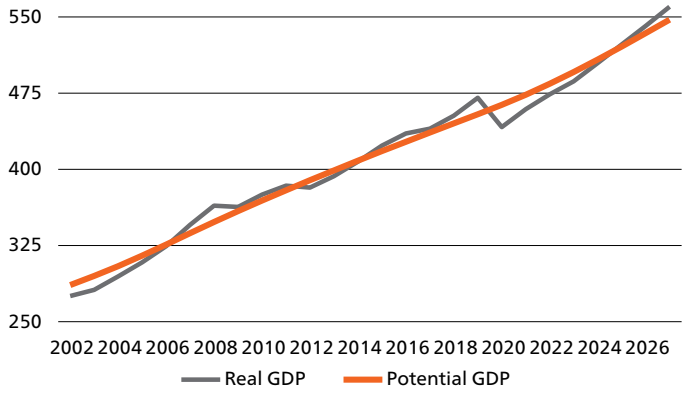
There are several mathematical forms of the production function, and the most commonly used is the Cobb-Douglas production function:

$$Y = AK^{\alpha}L^{1-\alpha}$$

where represents the share of capital (K) in the total input of the factors of production. It is usually assumed that is about 0.3.

To calculate potential output using the Cobb-Douglas function, estimating the values of K and L for which the economy would operate at its potential. In this case, L represents the input of full employment: the number of work hours in the economy during the year when the entire working population would be employed, excluding natural unemployment. It is considered that the economy does not create inflation when it operates at full employment, that is, with unemployment close to the natural unemployment rate. Capital input K is evaluated based on the value of non-resident capital in the economy, assuming capital services are proportional to its quantity. TFP is calculated as a residual after calculating the other elements of the formula.

Figure 6
Movement of the potential output of the Macedonian economy



Source: Authors' calculation using real GDP data from the International Monetary Fund's (IMF) World Economic Outlook Database, with forecast data starting from 2021.

Potential output can be calculated most simply as a trend line of current output (GDP), assuming that future potential output is an extrapolation of that trend. Similarly, the potential product can be calculated through a smoothing technique using a specific filter. Figure 6 shows a potential product of the Macedonian economy using the widely used HP filter (Hodrick-Prescott filter). The figure shows that the potential product does not contain the cyclical fluctuations of the real GDP; that is, the effects caused by the demand (recessions and expansions) have been removed from the potential product line.

Based on the estimated values of the potential output, it can be calculated that the average annual growth of the potential output of the Macedonian economy amounts to 2.7% in the period until 2022, while in the next five years, it would amount to about 2.5%, if the economy continues to develop with the current capacity.

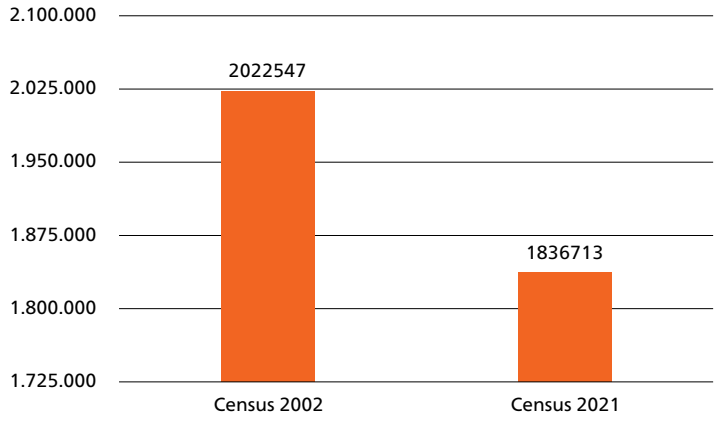
Since the growth of the potential product of about 2.5% can ensure only a slow convergence with the countries of the European Union, in the further part of the paper, we will focus on the more **significant structural changes of capital (K), labour (L) and TFP (A) which may affect the potential output.** Our goal is not to make their econometric prediction **but to share thoughts about how changes could happen in them that would raise the potential output of the Macedonian economy**. Our ultimate goal is to get the public talking about what defines the long-term: K, L, and A.

6.1.1. How to raise the labour contribution (L)?

Regarding the availability of labour in North Macedonia for a long time, almost traditionally, it was considered that the economy has enough - and due to the high unemployment rate, even more than enough - labour, but there is a lack of capital to create capacities (business entities) for employment of the workforce contingent (or able-bodied population). This was primarily due to long-term high unemployment. However, more recent changes with the unemployment rate falling, together with the demographic changes that have occurred over the last 15 to 20 years, as well as (e)migration trends, especially of the younger, relatively well-qualified workforce, actually indicate that the current situation in this sense is completely reversed – the labour force in the country is already an insufficient (rare) factor for the faster economic development of the country. In the future, this will be even more pronounced. The government must start taking active policies to overcome such a situation.

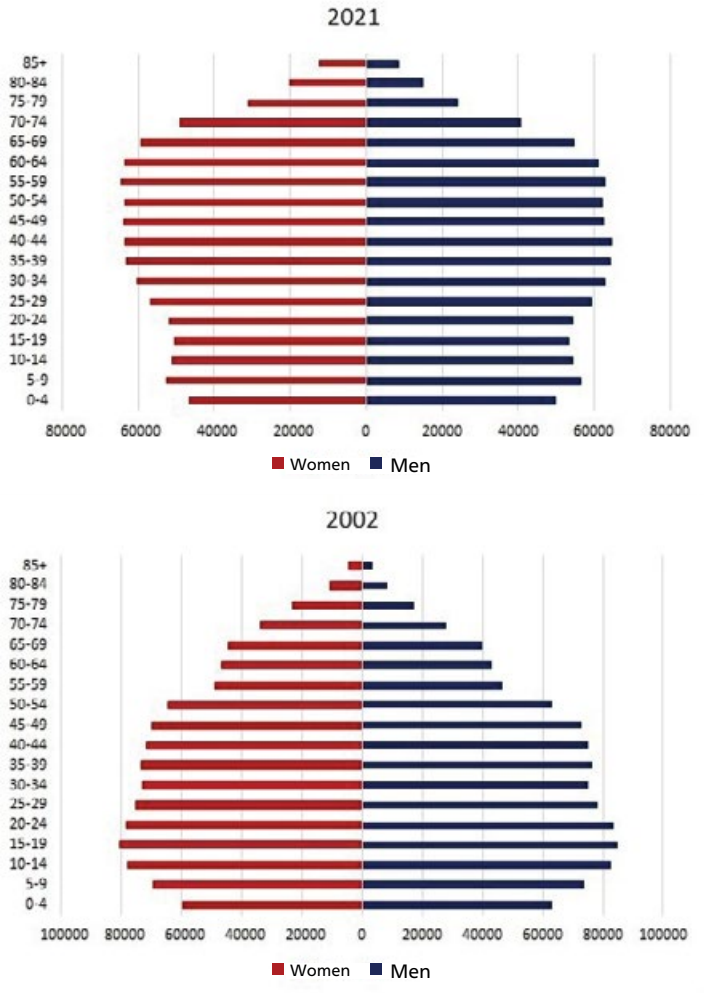
The first data that indicates this finding is the decreasing trend of the total population. Figure 7 indicates a decrease in the total population in the 20 years between the two last population censuses: while in 2002 the number of the total population in North Macedonia was 2,022,547 inhabitants, in 2021, that number was reduced to 1,836,713 inhabitants, which represents a decrease of 10.1%. In the same sense, the rate of natural population growth has a trend of continuous decline, from about 2 per 1,000 inhabitants ten years ago, in five years it was halved (1.3 in 2015) to a zero rate in the pre-pandemic year 2019. At the same time, the negative balance of migrations has increased significantly.

Figure 7
Total population of North Macedonia



Source: State Statistical Office of North Macedonia, MakStat.

Figure 8
Age structure of the population in North Macedonia



Source: State Statistical Office of North Macedonia, MakStat.

In addition to the decrease in the total population, there was a significant change in the population's age structure between the two censuses. According to the data in Figure 8, while in 2001, the majority of the population in North Macedonia belonged to the age group from 10 to 55 years, in 2021, the majority of

the population belonged to the age group from 30 to 75 years. That trend indicates a pronounced process of population ageing in the country. However, the essence of the disadvantage of the existing age structure is even more drastic when the trends are extrapolated into the future: it can be expected that in 15 to 20 years, about half of the population in North Macedonia will be over the working age (over 65-70 years). In addition to the problem of the large percentage of the dependent population and the pressures on the pension fund, that situation will represent *a distinct problem of lack of youth labour force.*

To reduce the negative impact of the lack of labour, it is necessary to take several measures, and the following groups of policies and measures stand out as the most important:

- Increase in average productivity (improving labour force performance);
- Increase in the number of working population;
- Changing the way of time being used

I. The increase in productivity, in principle, depends on three factors:

1. Improving the qualifications of the workforce;
2. Improvement of the technological equipment for work activities and
3. Improvement of the organisation of operations.

II. The increase in the number of working population depends on:

4. Increase in the natural increase of the population (increase in the birth rate);
5. Reducing the rate of emigration (that is, achieving a positive migration balance); and
6. The inflow of labour from abroad.

III. Changing the way of using time, which does not mean only the working time, but the total time, can be achieved through:

7. Influence on changing habits in terms of work engagement and
8. Increasing the number of working days in the year (primarily by reducing the number of state and religious holidays).

Among the three listed groups of policy measures that can influence the reduction of the limitation of the production factor labour, the most powerful, most appropriate, and, in terms of meaning, certainly the most important are the measures listed under point I, i.e., the measures from the domain of labour productivity growth. In the simplest terms, productivity is the output per unit time of an average employee in the economy. Thus, with an increase in the average performance, the limitation of the number of the workforce decreases. A smaller number of well-qualified and highly productive workers produce an equal, or even higher, output than a more significant number of low- or medium-skilled workers.

Having that in mind, productivity viewed from the aspect of workforce qualification depends above all on a) raising the quality of education to enable the acquisition of skills and knowledge for the future and b) much more pronounced (than the existing) engagement of the existing working population in additional training and retraining.

The improvement of the quality of education should be in the direction of the introduction and comprehensive study of a set of knowledge called "skills for the 21st century", which is almost entirely missing in the current public education system of North Macedonia. It is about reforming education in the direction of equipping students with *critical thinking* (the ability to find solutions to problems, not just to follow instructions), *creative thinking* (the ability to think independently and look beyond the stereotypical way of thinking), *collaboration* (ability to cooperate with others and work in teams); *communicating* (ability to hold conversations with others); *information literacy* (understanding of facts and data, graphs, tables, statistical and other data, etc.); *media literacy* (understanding the ways of publishing information); *technological literacy* (knowledge of using information technology); *flexibility; initiative; efficiency and effectiveness; skills for acting in a social environment* (involvement in social networks). Thus, a prepared and qualified workforce in the future will be able to quickly and efficiently adapt to different and diverse jobs because the jobs will change more quickly.

On the other hand, when it comes to the productivity and technological equipment of work processes and activities, in addition to the need to use state-of-the-art equipment (i.e., using equipment of the latest technological generation, not the purchase of second-hand machines and equipment) in all production and service activities, it is imperative to introduce and widely use digital technology and automation. In other words, when labour is lacking, it is most logical, wherever possible, to replace labour with "smart machines." Looking at the long term, this focus must be subject to broad support from the government.

About the measures listed under point II, i.e., the measures from the domain of the increase in the number of able-bodied population, for North Macedonia, the key should be to reduce the net migration, i.e., the difference between those who move out and those who move in. In terms of "controlling" the rate of emigration, the state can realistically influence the general living conditions and, in that sense, influence

the average income of the workforce. This means reducing the difference in income compared to the countries where the citizens live. Furthermore, the primary determinant is the increase in average labour productivity. Thus, the topic "returns" to the increase in productivity, which, in turn, points to another important and related aspect: the more the state manages to raise the average labour productivity, the more the average salary will grow, and thus the dynamics of emigration of the able-bodied population from the country will decrease proportionally. It is a matter of a multiplier effect of increasing productivity (through improvement of qualifications), as well as a causal connection of factors that, in the long term, affect the growth of the potential product of the Macedonian economy. The policy should focus on increasing productivity, while possible administrative measures (for example, to prevent the free movement of the workforce, etc.) will have almost no realistic effect. On the contrary, sometimes they can even have a negative effect.

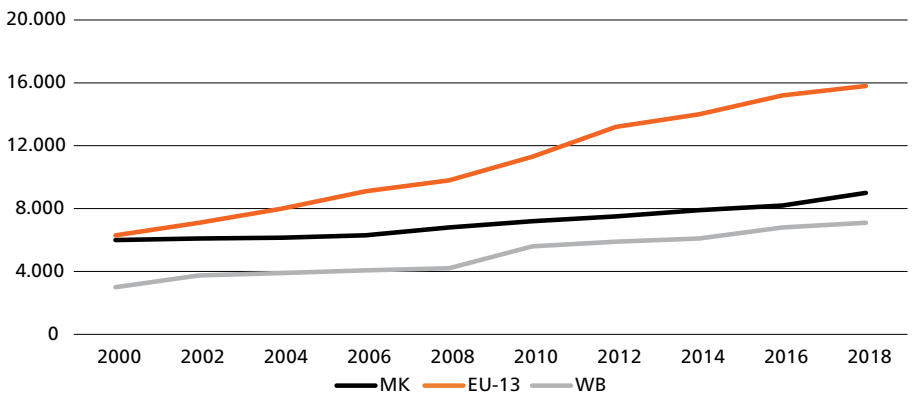
In this context, a brief review should also be made about the impact of scholarships for students from North Macedonia to graduate from (prestigious) universities abroad. In principle, that measure is not wrong. However, the question arises about its effectiveness (cost-benefit analysis). Suppose the same financial resources, instead of sending a small number of students abroad, cover the costs of (good) professors from abroad who will train students at domestic universities and transfer knowledge to domestic professors. In that case, the overall effect and impact on the increase in qualifications and, thus, labour productivity will be higher. Moreover, of course, it is essential to set the direction of internationalisation of domestic education.

Regarding the issue of (de)stimulating the inflow of labour from abroad in North Macedonia as a measure to reduce the effect of the lack of labour in the country, the first is the fact that there is such an inflow in the country even now, and it is not insignificant. However, it is also a fact that it takes place without any state control and strategy. Hence, the first thing that should be done in this sense is to prepare an analysis and adopt a strategy for what kind of - and with what qualifications - labour force from abroad will be accepted in North Macedonia. Given the average salary in the country, it cannot be expected that qualified (and not highly qualified) workers will come from abroad. However, the state can influence some aspects. If, for some sectors, activities, or branches, it is necessary (i.e., valid) to attract a higher-skilled workforce (e.g., IT experts or any other experts), then it would be helpful and cost-effective in that direction to build mechanisms to "support" their salaries through public finances, regardless of whether we are talking about employees in the private or public sector. In any case, this should be correlated with the measure's profitability for subsidising employees' wages in foreign direct investments (factories, etc., in TIDZs), which has been used in our country for over ten years, so they should adopt correct conclusions. Moreover, in the case of subsidising the salaries of FDI employees in TIDZ, it is a matter of "raising the earnings of foreigners with funds from domestic taxpayers," with the fact that, in that case, possible broader multiplier effects from spending public finances are absent.

6.1.2. HOW TO RAISE THE CAPITAL CONTRIBUTION (K)?

Based on the low cost of labour, low and flat taxes, and a limited role of the state in economic development, labour-intensive economic growth did not lead to inclusive and sustainable economic growth. Capital and technology, as drivers of productivity growth, increased slowly. Namely, the growth of investments

Figure 9
Public capital stock, 2017 PPP dollars per capita



Source: IMF Investment and Capital Stock Dataset

in fixed assets, which leads to capital stock growth, was low: 22.4%. Moreover, most of these investments (76%) were related to replacing spent capital. Only 24% referred to fixed asset investments that would lead to a net increase in the companies' fixed assets. This level of private sector investment is insufficient to accelerate growth to around 5% and significantly increase productivity and competitiveness. Private sector investment in fixed assets must increase between 27% and 29% of GDP, especially in the transition era to a green and digital economy. It will also be necessary to facilitate companies' access to financial resources and significantly develop project financing and financing of projects that introduce new, advanced, non-polluting technology.

Also, public capital expenditures were low; in the last two decades, they were around 3% of GDP. It was insufficient to improve the quantity and quality of public infrastructure and support the acceleration of economic growth. North Macedonia will need to double capital expenditures to improve the quantity and quality of public infrastructure and transform it into a fast-growing, sustainable economy (Fiti et al., 2021).

North Macedonia lags behind the EU regarding the quantity and quality of public capital. The state of capital per capita in North Macedonia at the end of 2018 lagged by 50 % compared to the state of capital of newly admitted EU member states. This lag in the early 2000s was 10 % (IMF, Article IV Report, 2022). This imposes a need to redefine the fiscal strategy and the state's role in supporting and financing development.

Investments in education and research and development are low. Education expenditure accounts for 3.7% of GDP, which is low compared to the EU average. Also, the quality and efficient use of funds is low. Public expenditure on research and development is almost non-existent. 2018, they accounted for 0.04% of GDP (Stikov et al., 2020). In modern welfare states, these investments are the engine of economic development. North Macedonia will have to make serious efforts to improve the quality of scientific-educational and research and development institutions to increase these expenditures significantly.

The most significant part (60%) of private investments in fixed assets related to real estate - construction facilities, 32% were investments in machinery and equipment, and only 8.1% or 1.8% of GDP related to investments in other assets that also included investments in research and development (3 to 5 times lower than in highly developed countries). This structure of private sector investments in fixed assets does not support dynamic, sustainable economic development. Moreover, investments in the private sector were mainly oriented toward the traditional sectors: industry, construction, and agriculture. Very few of the investments were focused on services, green and digital economy, tourism, and new product design. The change in the structure of investments in the private sector must be reflected in an appropriate tax policy, a policy supporting private investments in specific sectors, and adequate support of research and development of new products in the private sector.

The primary source of financing private sector investments was depreciation: 76 of total investments. Retained earnings and bank loans accounted for 24% of the financing of total private sector investments.

"Over the past four decades, we have witnessed an explosion of available capital. Today, on a global level,

Figure 10
Structure of private sector investments in fixed assets

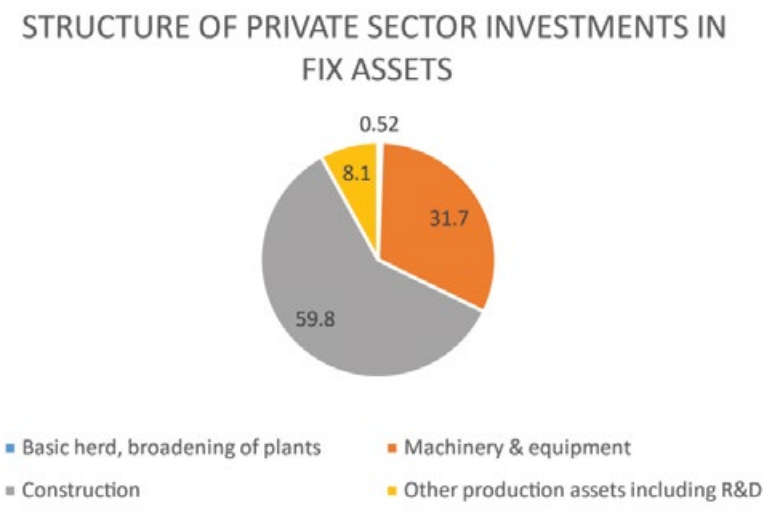
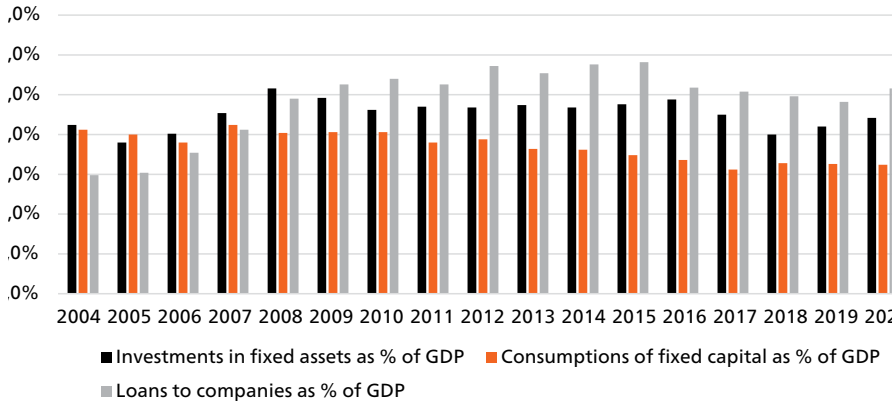


Figure 11
Sources of financing private sector investments



Source: State Statistics Office, National Bank of the Republic of North Macedonia

financial assets amount to 400 trillion US dollars. Exponential growth brings risks and opportunities for investors and companies and forces banks to no longer be gatekeepers of financing.

Young, innovative companies have never had easier access to capital. There has never been so much money available to fund new ideas to become reality. This drives the dynamism of innovation. So, almost every sector has an abundance of disruptive startups trying to become market leaders. CEOs of existing companies must understand these changes and the diverse forms of capital available to remain competitive in smaller, more agile businesses (Lary Fink, 2022)."

Contrary to the global trends in highly developed countries, the banks in North Macedonia remained "gatekeepers of financing," considering the underdeveloped capital market, especially the underdeveloped market of investment funds and corporate bonds.

However, even in such conditions, the share of bank loans in favour of companies is 25.2% of GDP, which is two to three times lower than the share in highly developed and fast-growing economies. In that plan, it will be necessary for the state to take measures to reduce the risk of private investments and bank financing through appropriate guarantee schemes and setting up "firewalls" between new investments and the existing business of investors.

6.1.3. How to raise total factor productivity (TFP)?

Efficiency in combining factors (A) is also called total factor productivity (TFP). It contains **all the institutional and technological features of the economy that determine the efficiency of combining capital and labour to create output.** Of these, five characteristics are considered the most important. These are human capital, the technology used in production, the infrastructure, the business environment and the rule of law, and political and macroeconomic stability.

Human capital quality depends on the workforce's education, knowledge, and health. In order to raise the quality of human capital, we as a society must invest much more heavily in public education and health but also seek results there. It is a complete delusion to think that, in the long run, we will be better when, in fact, we are at the bottom of the lists in all relevant rankings of the education system. It is the same with healthcare.

It is well known that developed countries have a higher level of **technology in production**, and the Macedonian economy, like other countries at this level of development, should receive technology transfers through foreign direct investments (FDI). For the long term to be better, the state should only stimulate FDI that brings a higher level of technology and transfers knowledge and skills to our workforce. In the long run, it will not be better if FDI brings old technologies and uses cheap labor.

Infrastructure is also essential for combining labour and capital. The quality of infrastructure in transport, telecommunications, energy, and finance significantly impacts production.

The business environment and the rule of law in the country are factors that were often discussed here. Historically, we have had improvements and declines, but many things can still be done, especially in the

rule of law. Of course, the long-term economy will be better with a judiciary that is not subject to pressure and with much less corruption in society.

Political and macroeconomic stability is the final characteristic that determines total factor productivity (TFP). Although listed last, it is crucial because more serious disruptions can set the economy back many years. NATO membership provides stability. For the long-term economy, becoming a member of the EU is essential. Undoubtedly, macroeconomic stability, that is, low and stable inflation, reasonable fiscal policy, and sustainable public debt, are an essential prerequisite for an efficient business environment.

CONCLUSION

The economy's growth in the long run depends on the contribution of labour, the contribution of capital, and the efficiency of their combination. In the long run, only these two factors of production and their combination matter. Therefore, in the Macedonian economy, much greater importance must be devoted to them. Fiscal and monetary policy only reduces short-term oscillations around the long-term movement of the economy. The long run cannot be fixed by fiscal and monetary policy if the economy is losing the battle for the factors of production.

The Macedonian economy is facing a solid reduction in the labour factor. This is unequivocally shown by the data from the 2021 Population Census, which shows that the country has lost 9% of its population in the last 19 years (between the two successful censuses). In addition, it can be expected that the ageing of the population will increasingly reduce the share of the working population in the total population. Therefore, from now on, policies should be set to improve the quantity and quality of labour in the economy. The first and most straightforward solution that must be done is to improve the quality of human capital. The quantity of labour, that is, the size of the workforce in the economy, depends on migrations and the birth rate, and to improve them, the country needs a consensus for a long-term demographic policy, which would include goals that should be achieved.

In order to improve capital contribution, investments in the Macedonian economy should be focused on services, green and digital economy, tourism, and new product design. It is also crucial that the Macedonian economy strives to raise investments in research and development.

Combining production, labour, and capital efficiency depends on many institutional and technological factors. Unfortunately, in some of them, such as the rule of law, satisfactory results are not achieved even after thirty years since the beginning of the transition. Moreover, without a severe improvement in these factors, it cannot be expected that the Macedonian economy will succeed in speeding up the convergence with the EU countries.

7

NEW POLICY FOR FOREIGN INVESTMENT AND ECONOMIC GROWTH

Gligor Bishev, Olimpija Hristova-Zaevska,
Branimir Jovanović, Vancho Uzunov

Both globally and in North Macedonia, the attraction of FDI is experiencing a transformation after the COVID-19 pandemic and the war in Ukraine. Although the volume of investment in 2022 exceeded the pre-pandemic level, the challenges of supply chains, the vast increase in energy prices, and political instability led to a revision of how FDI will be attracted going forward and what will be its role in the economic growth model of the host economies. This paper reviews the global flows of FDI and in RSM, critically evaluates the model of attracting FDI through low labour prices, tax incentives, and subsidies, and proposes a model for attracting FDI focused on intensive investment in education, research, and development, building a more equal and strategic relationship between investment hosts and investors and a strengthened role of regional cooperation in attracting FDI.

7.1. FOREIGN INVESTMENT WILL NEVER BE THE SAME AGAIN

In 2020, during the COVID-19 pandemic, global foreign direct investment fell sharply, reaching the lowest level since 2005. The drop was 35%, from 1.5 trillion USD in 2019 to 1 trillion USD in 2020. In addition, the decline was unevenly distributed, as FDI in developed and transition economies fell sharply by more than 58%. In contrast, developing economies saw their FDI fall by 8%, primarily due to relatively stable Asian FDI.[10]

After the acute phase of the pandemic ended, global economic flows began to stabilise, and FDI saw a strong recovery in 2021. In particular, they reached 1.6 trillion USD, more than the pre-pandemic level. The substantial jump from 2021 is still temporary and is mainly due to the significant drop from the previous year. Expectations for 2022 are that foreign investment will either decrease or, at best, be similar to 2021 due to the war in Ukraine, the global spike in food and energy prices, and rising interest rates in international financial markets.

Despite the substantial jump in global foreign investment since 2021, it is still far from the 2016 level of 2 trillion USD and even the 2007 level of 1.9 trillion USD. If seen as a percentage of global GDP, the slowdown is even more evident – global FDI in 2007 was 3.3%; in 2016, it was reduced to 2.6%, and in 2021, it further fell to 1.7%.

This trend of global FDI slowdown began after the global financial crisis of 2007-2008, and economists call it the "globalisation slowdown." There are several reasons for this. The first is that the previous intensive growth of FDI from the 1990s onwards was only an exception in the more extended economic history due to China's opening and the decline of socialism in Eastern Europe. These two things meant opening two substantial new markets for Western companies and, in addition, a lot of cheap labour, which multinational companies enthusiastically took advantage of, investing in these countries. However, after three decades of intensive investment, labour in Eastern Europe and China is no longer so cheap, so multinational companies have less and less financial interest in investing there.

The second reason is that with new production technologies, such as robots and 3D printers, the advantage of locating production in countries with cheap labour is reduced because these technologies cost almost the same in Western Europe and East Asia. The third reason is that the world has been facing increasing political polarisation between the West and the East for the last ten years, leading to economic nationalism and protectionism. Thus, the US and China have imposed mutual tariffs on certain products in what some economists call a trade war between the world's two largest economies.

The COVID-19 pandemic followed this long-term trend of slowing globalisation. The closing of the borders since the beginning of the pandemic, the various measures to prevent the spread of the virus from the

later period, and the millions of people who have fallen ill in the world have disrupted the operations of many companies. This has led to disruptions in global production chains, which for the past three decades have relied on the "just in time" production model, which assumes that the production of different parts of a product is located in different places worldwide. (where production costs are lowest), Then, it is transported to the place where the product is assembled. Due to the pandemic, the production and transport of these parts were constantly interrupted, which meant that multinational companies could not meet the demand for their products, which caused them to lose money. Because of this, many companies have started thinking about relocating their production closer to their headquarters, which is called "near-shoring" in English.

The war in Ukraine has added fuel to the fire, as it increases the political polarisation between East and West. Numerous examples of international companies that decided to leave Russia after the invasion of Ukraine are known, and the latest trend related to this is the relocation of business activities to countries that are their political allies, which in English is called "friends-shoring." US Treasury Secretary Janet Yellen proposed the concept in 2022,[11] to protect global supply chains from external disruption or economic threats and as a kind of economic rapprochement between political friends. The idea is to encourage companies to locate their investments in countries that share the same values as them, that is, in the circle of friends, to reduce dependence on authoritarian regimes and weaken them.

Examples of friend-shoring are already visible. For example, the United States seeks to reduce its dependence on rare metals or microchips and diversify critical resources such as energy, food, and fertilisers. In this case, the friendly rapprochement is reoriented towards Indonesia, Vietnam, and Malaysia. In the USA and the EU, however, there is an intense debate about investments in the production of microchips, which are traditionally imported from Taiwan and China and are necessary for many products. The Japanese government is actively reallocating its companies from China to Japan with a dedicated fund of 2.2 billion dollars, and the EU is building a strategic partnership with Canada.

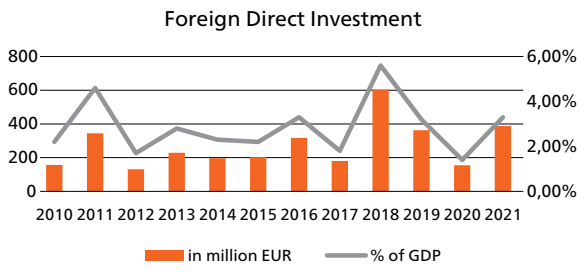
It is becoming more than clear that future FDI will, by definition, have to take place in ever more uncertain conditions, potentially new pandemics, and increased threats of military conflicts and tensions. In parallel with these uncertainties, the competition for talent and technology is becoming a key challenge for investors. Therefore, attracting FDI in the coming period will determine which countries manage to reduce uncertainty and offer talent and knowledge or the ability to create talent to sustainably address the need for staff quickly. It can be said that investors will additionally look for opportunities to relocate business activities to countries where there is sufficient labour force with appropriate knowledge and skills, which is called "talent-shoring" in English.

Following these trends, this crisis is the moment to revise the FDI attraction model in RSM and redefine the role of FDI in the economic growth model. Tax incentives, which were crucial until recently, are less important for investors than access to qualified staff, infrastructure, and simplified bureaucracy. They will be even more limited as a mechanism and because of the international BEPS rules of the OECD for the strengthened control of tax avoidance. Therefore, as a small and open economy, RSM, in addition to an excellent geographical location and proximity to the European market and a country that until recently had a competitive advantage due to lower costs for FDI, is facing a challenge to rethink the model of attracting FDI, especially in the supply side of skilled labour, digitisation, application of advanced technology and innovation.

7.2. THE CURRENT POLICY FOR ECONOMIC GROWTH AND FOREIGN INVESTMENTS IN RSM

In the past two decades, North Macedonia has based its economic growth mainly on the so-called exogenous growth factor model. According to this model, the driving force of growth is foreign direct investment (FDI), which brings in fresh capital, sophisticated equipment and technology, knowledge, and skills, which leads to a permanent increase in productivity, growth in economic activity, and net exports. In the past decade, foreign direct investments ranged at 2.9% of GDP, classifying North Macedonia among the Western Balkans countries with FDI below the average level for this region.

Figure 12



Source: NBRSM, Bulletin, External statistics

Most of the FDI was concentrated in the industrial zones, where the attractiveness for investment was primarily based on the low cost of labour and the tax credit of ten years. This has led to FDI mainly

concentrated in low-skilled "assembly" manufacturing in the automotive, metalworking, chemical, and textile industries. The zone investment model was based on product research and development in the parent companies of the investors and production in the form of assembly in the domestic company. This led to a low contribution of these investments to productivity growth and inclusive growth but an extremely high contribution to export growth and creating a workforce with appropriate habits and skills.

Thus, in the past decade, the total export of goods and services increased by 2.8 times, from 2.7 billion EUR in 2010 to 7.7 billion EUR in 2021, with foreign trade reaching a share of 145%. Of GDP, the coverage of imports with exports of goods reached 71.7% (56.4% in 2010). At the same time, real GDP cumulatively increased by 31.4% in the same period, or an average annual increase of 2.6%, one of the lowest growth rates in the Western Balkans region, and is insufficient for a significant increase in living standards—standard and accelerated convergence towards the EU. During the same period, productivity stagnated, and unemployment fell from nearly 30% to about 14%.

However, the low economic growth rates of the last few decades, the stagnation of productivity, and the absence of appreciable reduction of poverty and inequality indicate that a change of the economic growth model from an exogenous to a domestic-exogenous model is needed. According to this domestic-exogenous economic growth model, FDI remains significant but is not the only growth and development pillar. Domestic investments, research and development investment, and partnerships between domestic and foreign companies are gaining importance.

In that regard, I have already had several positive experiences. The first experience is in the field of computer and information services. The partnership between domestic and foreign entities has increased the export of computer and information services by almost five times in five years, with high added value and growing productivity in this sector. The second example is a domestic-foreign partnership for developing and producing environmentally friendly cleaning vehicles. Through joint investment in research and development, for example, an electric cleaning vehicle was produced in North Macedonia and exported to more than 20 countries.

These examples show that investments based on new technologies, whether foreign or domestic, as well as joint investments in growth and development by domestic and foreign firms, are a much more efficient and productive model of economic growth than the model of attracting FDI based on labour cost arbitrage and a ten-year tax credit. The reorientation towards this new approach will require a different and more active role of the state than the previous one and a new model of FDI attraction.

7.1.3. In the direction of a new model of economic growth and attraction of foreign direct investments

Firstly, the state and the domestic private sector will have to significantly increase **investment in education, research, and development,** which is currently low. Public expenditure in research and development, which catalyses economic growth in 2022, is 0.4% of GDP, compared to an average of 2.19% in EU countries.[12] In addition to increasing investments in research and development, public-private partnerships for research and development of new technologies and businesses will have to be made in the form of incubators and accelerators. Besides being crucial for the domestic economy, its sustainability, and competitiveness, this type of investment is now increasingly affecting FDI, which raises the alarm about the need for a better and more qualified workforce. FDI's training and coaching investments are suitable but insufficient to address this need.

Knowing that research and development are expensive, the thesis is often promoted that developing countries, by definition, can hardly develop advanced technologies, and therefore, their role is to follow – to apply existing technologies. This argument is devastating for developing countries in two respects. First, the personnel in these countries need to have the absorption power to understand and apply the same technologies. For the productive transfer of knowledge that comes with FDI, there needs to be a certain threshold of knowledge that can apply and connect the new knowledge developed through research and development and education. At the same time, in the time of ever more accessible knowledge due to the flow of information, academic networking, and digitalisation, or the time of the fourth industrial revolution, developing countries have a chance to rebound technologically. Otherwise, the alternative is an even more significant lag and technological stagnation, which is not productive for attracting further investments. According to a 2020 study by McKinsey, the technologies of the fourth industrial era will be applied by the most advanced firms in 5 to 7 years and the followers in 10 years.[13] Companies that do not implement them in ten years will likely fail.

Aware of these trends, the countries of the European Union are investing considerable funds in raising the level of basic knowledge, not only in the already developed urban and economic centers of the states

but also in other regions, in order for them to benefit from the investments that come with new advanced knowledge. It has been shown that the most effective approach in research and development is through **building knowledge ecosystems**, where, on the one hand, the corpus of knowledge is increased, and on the other hand, the cost of research is reduced, and the hybridisation of knowledge that leads to innovation occurs. Thus, for example, in the database of European Digital Hubs, one can find more than 600 initiatives spread across almost all European regions that represent ecosystems where companies, industry, and academia collaborate actively to transfer and advance technological knowledge. This policy of active ecosystems is mainly financially supported by state and EU funds and managed by universities or purpose-built organisations. In this way, critical industrial policies and strategies for smart specialisation are implemented because research and development are most effective when there is a **productive context** for industry and academia cooperation.

In the last few years, North Macedonia has followed the trend of digital or startup hubs that should support companies financially and with the knowledge to develop further. However, what is missing is precisely the critical component of scientific knowledge. However, there is also a disproportionate amount of attention devoted to startups, while the technological progress of traditional firms is neglected. Also, the offer of accelerator support or grants can help in opening new firms, financing a particular project of a firm or its liquidity, but not in the deep building of research and knowledge that should then result in the development of a particularly competitive product and thus the development of an entire industrial segment.

Also, as North Macedonia is currently in the final stages of developing a smart specialisation strategy that aims to improve the competitiveness of the domestic economy and domestic firms, it will be critical to invest in research and development in all identified priority areas: smart agriculture, Industry 4.0, ICT, materials and energy. In this way, in addition to supporting domestic companies, they will become better domestic suppliers of FDI, and the necessary knowledge will be created for better links between domestic companies and FDI.

Secondly, economic policymakers will have to abandon the model according to which the state's role in the economy is to be only a "market imperfection" corrector but for the state to play a proactive role in directing investors to strategic investments beneficial to the state. As the famous economist Mariana Mazzucato,[14] convincingly argues a long promoted thesis by Schumpeter, Henderson, and Dossey,[15] the state should have a proactive, entrepreneurial role, i.e., lead and support modern, entrepreneurial policies, i.e., through an appropriate "mission and vision" to direct and support investment, rather than merely correct market imperfections.

Recently, North Macedonia started attracting strategic investments in defined sectors with defined amounts of over 30, 50, and 100 million euros that would be realised according to specific rules. This process should be used to strengthen the capacity and expertise of the state through well-designed public-private partnerships, but also be careful not to weaken the state's role over critical resources such as various natural sources of energy, water, etc. The state must also diversify the attraction of investments, which currently have the largest share in the automotive industry.

In addition, the proactive role of the state means building a connection between state institutions, state universities, and the private sector to implement a shared vision for a productive and technologically advanced economy. According to the European Innovation Scoreboard, in 2022 compared to 2021, North Macedonia recorded a drastic decline in building and nurturing links between firms and academia, staff mobility in science and technology, the use of digital technologies by firms, and a decline in resource productivity. This trend must be urgently changed in the direction of solid links on the so-called triple bond: state – academia –industry proving to be a key mechanism for innovation and technological progress.

Thirdly, it will have to significantly increase and improve **capital investment and infrastructure.** North Macedonia lags behind EU countries in quantity and quality of capital goods. Public capital per capita in North Macedonia at the end of 2018 was almost 50% behind the new EU member states, although at the beginning of 2000, this lag was 10%. The physical measure of infrastructure – such as kilometres of roads and railways, kilowatts of energy produced, indicators of the digital economy, show similar lags. North Macedonia also lags behind in terms of infrastructure quality.[16]

Fourthly, greater reciprocity with foreign investors is needed for the benefits of foreign investments to go in both directions. North Macedonia, especially with the concept of TIDZ, managed to attract certain highly advanced technological companies, whose impact is usually presented through the number of employees and the export of technologically advanced products. However, there is a lack of systematic and not sporadic knowledge transfer in the domestic economy. Due to the lack of highly qualified staff, These shortcomings directly affect the potential of a given foreign company to operate sustainably in the Macedonian context.

In this context, North Macedonia bears the consequences of the geographical dispersion of value-added activities caused by the "great decoupling" of production and research and development, which made developing countries consume or apply, rather than develop, advanced technological knowledge. However, greater access to advanced technologies and machinery with which FDI operates presents a massive opportunity for knowledge transfer that domestic policies should underpin. Therefore, during negotiations with potential FDI, one should not only negotiate the presence of a technological component but also set clear parameters to enable positive externalities and spillover of knowledge from FDI. This can be achieved by motivating and asking investors to establish part of the research and development in RSM and to support concepts such as industrial doctoral students - researchers who are funded by the state and the company, with the aim of knowledge transfer in the domestic economy, and also access to highly qualified staff.

A successful example in this context is India, where, in 1985, Texas Instruments was asked to open a research and development centre specialising in automobile design in Bangalore, which, to date, employs 500 engineers. Because of this research centre, Bangalore is an area where many firms are active in information and communication technologies (ICT) and software related to the automotive industry. This is the result of active government policies to support and make qualified engineers available to strengthen specialisation in the field. Texas Instruments and Microsoft have achieved a high impact in sustainable investments in research and development due to (i) the presence of good universities, (ii) the availability of qualified engineers, and (iii) the existence of a structure of related activities or industrial clusters and ecosystems.

Fifthly, in the future, a new model of attracting FDI and the new model of economic growth of the Macedonian economy, the process of regional economic integration of the Western Balkans, and establishing a Common Regional Market should have a very significant place. Given that the new model of economic growth based on a combination of endogenous and exogenous factors (increase in domestic knowledge, research, and development, as well as through the inflow of knowledge through FDI) should ultimately lead to an increase in productivity and competitiveness of the Macedonian economy, which even today is more excellent about regional (neighbouring) economies/markets than about EU economies. This situation can and should be used as a "springboard" for building competitiveness. In that sense, the "model" built so far had a vital significance for shaping the export structure of North Macedonia, as well as other economies from the region of the Western Balkans, which represents "running away to the Balkans and running to Europe," actually represents limiting factor of faster economic growth. There is (almost) no economic justification for the WB's intra-regional trade to be so minor and less significant than trade with the EU and other countries.

CONCLUSION

The typical regional market will represent an overcoming of the existing position of mutual competition of the countries of the World Bank in attracting FDI. Since all the economies of the WB are underdeveloped and have a very similar (unfavourable) structure, which means that they are almost equally (un)attractive for attracting FDI, they are involved in a "race to the bottom" by giving tax breaks, maintaining low wages, low standards for environmental protection, etc., in order to be attractive to foreign investors. This is how everyone loses; with regional economic integration, the opposite can happen - everyone benefits. For example, regional economic integration will also mean the opportunity to use the effect of economies of scale for domestic production capacities in all countries in the region.

At the same time, the fear of losing (migrating) the labour force to the countries in the region with higher average wages, which would follow from the achievement of complete freedom of movement of the labour force in the region, is unjustified. Migration inevitably takes place and will take place, even if/when there is no complete freedom of labour movement. In order to keep the labour force at home, it is necessary to increase wages in the domestic economy and improve the general living conditions, not to prevent (or ban) free movement. Hostile and administrative measures and barriers never have sound economic effects. Therefore, the new model of economic growth and attraction of FDI in the Macedonian economy should not be based on low wages but on an increase in knowledge and qualifications, and thus on wages, in which sense regional economic integration, over time, will lead to the equalisation of average salaries in all countries, especially seen at the level of branches and activities.

Focusing on a domestic-exogenous model of economic growth, the role of FDI in the domestic economy remains crucial but much better embedded in the strategic approach of the domestic economy. With this approach, the state moves from an enabler of investments to an active entrepreneur, with its strategic agenda and the goal, first of all, to bring systemic spillover of new knowledge, and thus, technological progress and increased productivity of the domestic economy. The recent pandemic and military challenges represent excellent pressure for investors who are moving to near-shoring and

friends-shoring, and at the same time, open a massive opportunity for well-geostrategically positioned economies like North Macedonia to meet the needs of investors and bring technological knowledge and productivity. For this purpose, it should be prioritised to attract investments that will bring and transfer knowledge and thus strengthen domestic productivity and the links of foreign investors with domestic companies. This is possible by actively investing in education, research, and development from both the public and private sectors, building ecosystem support for domestic and foreign companies, strengthening the infrastructure, and building and integrating the Macedonian economy into the regional economic integration of the Western Balkans, which is equally complementary to the priority goal of gradual integration into the EU.

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8

A TAX SYSTEM FOR A NEW ERA

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INTRODUCTION

Public finances, in which the tax system is a fundamental component, represent the most critical subsystem of the economic system. Public finances mainly have three primary functions: the allocative, as a balance of needs and opportunities for providing sufficient public revenues to enable the optimal performance of the functions of the state in providing public goods and services in the comprehensive sense of the word. Then there is the distribution function through which the distribution of public income is carried out according to users - individuals, families, and groups that are threatened and powerless to provide even minimum collective income for life, as well as the development function, which provides support for stable and sustainable development of each country.

The tax system is a set of various public revenues and duties that should be optimal, neutral, and proportionate and function as the model of economic development and social welfare of each country. The tax system of RSM is very regressive and disproportionate to that of EU member states. In our country, indirect taxes still dominate in structure and volume. Consumption taxes burden the middle and poor classes the most, thus exacerbating inequality in society even more. Direct taxes (on personal income, profit, capital, etc.) are low in rate basis and proportionality and primarily affect the middle and poor social strata in a relative sense. At the same time, property and wealth taxes are relatively low, while those on real estate transactions are higher. On the other hand, environmental taxes that will more effectively change environmental awareness and protect the environment have not yet been introduced.

In short, such a tax system provides public revenues of about 27% of GDP, which is, after the Republic of Kosovo, the lowest of the countries in the Western Balkans and over 50% lower than the EU average. Such a tax system can hardly ensure fiscal convergence with the EU standards we aim for.

The analysis in this paper indicates the need for more substantial tax reforms to ensure a more efficient, fairer, and more balanced tax system in North Macedonia.

8.1. GENERAL NEED FOR TAX REFORM IN NORTH MACEDONIA

In general, there is a broad consensus among economists in the country that the tax system as it is, structurally regressive, is not only not in line with EU trends and standards but is not efficient enough and, least of all, fair. The differences exist among some (opposition) economists and mainly among the representatives of big businesses. After two years of the COVID-19 crisis and one year of inflation and energy crisis, now is not an adequate moment for tax reforms.

In addition to the above, the need arises from the fiscal space that was already spent a long time ago, and the need for additional public revenues is increasing more and more. Today, public debt is around 60% of GDP, and if the inflationary and energy crisis due to Russia's military actions in Ukraine continues, the fiscal situation will worsen even more.

The result of tax reform should be optimising the tax system, which in each country depends on the specific economic, social, political, and even cultural conditions.

Fiscal and tax theories have different definitions and concepts of fiscal optimization. One of the more appropriate theories for fiscal optimization is the so-called Brummerhoff's theory (Brummerhoff, 2000) about the optimal choice of tax system resulting from a balance between the inefficiency of the market on the one hand and the inefficiency of the state on the

other. When the state is inefficient in performing its function while the market is completely efficient, the optimal tax "burden" would be the lowest possible, i.e., zero. On the other hand, when markets are inefficient, and the state is efficient, the optimal tax burden is higher. This principle sounds simple, but in practice, it is tough to find the balance between the inefficiency of the market and the state, especially when it comes to developing countries that have underdeveloped institutions but, at the same time, dysfunctional and inefficient markets.

In the case of North Macedonia, as well as in the entire region of the Western Balkans and the whole of Eastern Europe, the inefficient management of public finances, fragile institutions, and the inefficiency of the state calls into question the need to increase the tax burden. However, on the other hand, the inefficiency of the market and the low level of public revenues are arguments in favour of the need to increase tax coverage.

Some theories advocate a negative correlation between the tax burden and economic growth. However, there is no solid empirical evidence that a higher (or above-average) tax burden slows economic growth and vice versa. Even well-founded analyses and research for a prolonged economic period prove the opposite. Two of the most famous examples are Sweden and the USA. The tax burden in Sweden is almost 2: 1 compared to the US (as a % of GDP), but Sweden's average growth rate has been almost 50% higher than the US average growth rate for a quarter of a century (Bexheti, 2017).

Of course, the different political and social systems and the economic models of the two countries have a significant impact in comparison. However, the example shows that the problem of taxes is not only about tax rates; good management and the institutions' capacity are also critical to allocate public revenues adequately and efficiently.

8.2. THE MOST ESSENTIAL FEATURES OF THE MACEDONIAN TAX SYSTEM

As pointed out in the introductory part, the tax system of North Macedonia is regressive, dominated by indirect taxes, which are economically more neutral but socially insufficiently fair. The dominant part, about two-thirds, is made up of tax revenues from indirect taxes (on consumption), while direct taxes (on personal income, profit, capital, etc.) are less (approx. ⅓ of tax revenues). As a percentage of GDP, the tax burden is the lowest in Europe and the Western Balkans region after Kosovo. Apart from this, our tax system is characterised by a wide range of tax (conditional) exemptions and reliefs and insufficient horizontal coverage of taxpayers. The business community mostly debated and irrationally argued about the vertical imbalance, and everything managed to "temporarily withdraw" the mild progression only one year after the initial application in 2019. Even the explanations that it did not give results were not sufficiently argued nor justified. Social fragmentation and uneven distribution of income and property are constantly worsening, which actualizes the need for a fairer tax system but, at the same time, a fairer distribution. Alleviating the inequality in the distribution of income and property should be a constant goal on both sides of the fiscal balance, both on the income side and on the expenditure side.

Table 3. Tax revenues comparison between the EU and the WB as a % of GDP

	2017 година	2018 година	2019 година
Denmark	46,5	45,1	46,9
Belgium	47,1	47,1	45,9
Spain	34,7	35,4	35,4
Great Britain	35,2	35,2	35,3
Iceland	37,6	37,2	35,8
France	48,3	48,2	47,4
Croatia	37,7	38,3	38.7
Slovenia	37,6	37.8	37,7
Bulgaria	29,4	30,0	30.3
North Macedonia	***25,5 %***	***25,8 %***	***25,9 %***
EU average	41,4 %	41,6 %	41,6 %

Source: Eurostat

Due to the lack of other arguments, the business community, above all large businesses, using as arguments the consequences of the crises (COVID-19 and the inflationary and energy crises), at the end of the year (2022), managed to remove the initial proposals for mild progression altogether, debated for more than two years, with almost all interested parties.

The following table best shows the significant differences in tax revenues between some EU member states and the region as a percentage of GDP. However, the most evident difference is in relation to the EU average.

Due to the situation mentioned above with the tax system, the need for reforms was found through a fairer, more efficient, and more transparent modern tax system based on digital technologies and innovations to achieve the fundamental goal of accelerated, inclusive, and sustainable economic growth. Due to this need, at the end of 2020, a Tax System Reform Strategy was drawn up, which, in a transparent and inclusive process with representatives of the academic and business community, was reviewed and debated in several meetings so that, at the beginning of the year (February 2021) the Concept for tax reforms is drafted by an expert working group, again with the participation of representatives from the academic and business community in the Ministry of Finance. The SMART system of public finances, as the Minister of Finance calls it in one of the columns, as a product of the reforms of the tax system and public finances as a whole (open quote) "on the revenue side of taxes should create improved collection and a greater scope of tax capture to create a fiscal space for policies to encourage higher economic growth in the medium term, while on the expenditure side introducing mechanisms for strategic planning, budgeting based on previously achieved results, enhanced control and transparency" (end quote).

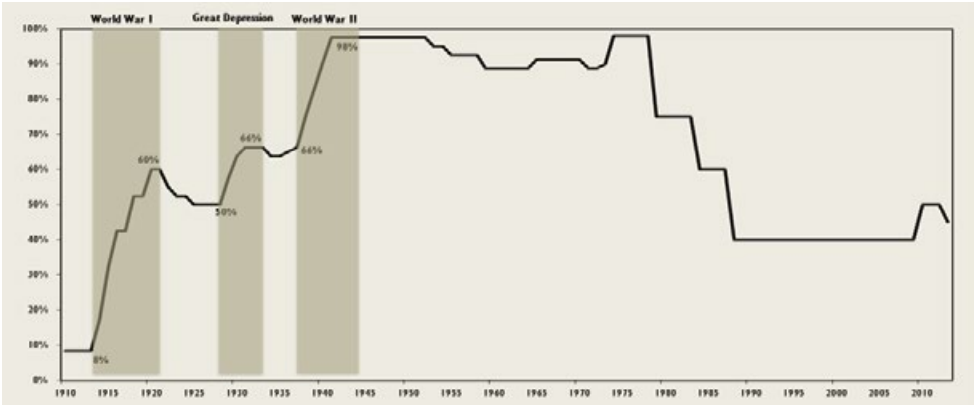
Unfortunately, apart from minor changes in the tax coverage, almost nothing happened in the part of the systemic changes announced for so long and vehemently, especially not in the tax progression. All these announced expectations sound great; only the dilemma remains with which and what institutions all this is possible. Since one of the primary goals of these reforms is the suppression of the informal economy, it should be stated that just these days, the study was published as a scientific project of MANU (Bexhetii A. et al., 2022), which determined the amount of the informal economy from 31.5% of GDP.

8.3. THE MOST SIGNIFICANT TAX CHANGES ALWAYS HAPPENED DURING THE BIGGEST CRISES

Historically, the most significant changes in the tax sphere occurred during the most significant crisis. This is well illustrated by the movement of the top marginal personal income tax rate in Great Britain, shown in Figure 13. At the beginning of the 20th century, it was 8%. During World War I, it increased sharply to 60% due to the British government's increased financial needs due to the war. After the end of the war, the top tax rate dropped slightly to 50% but rose again to 66% during the Great Depression of the 1930s. Then it decreases again, but it rises sharply during the Second World War, up to 98%. The top tax rate remained at around 90% until the late 1970s. Then, after the conservative and pro-business government of Margaret Thatcher came to power, it dropped sharply to around 40%, at which level it remains to this day.

This is happening in Great Britain and all developed countries, including the USA, France, and Germany. There are several reasons. The first is that states always need money during crises to help citizens and companies overcome crises and invest in public goods

Figure 13
Top marginal tax rate in the UK



Source: piketty.pse.ens.fr/capital21c.

and services, and the surest way to provide funds is through progressive taxes. The second reason is that significant crises always show profound class differences in societies, as happened during the pandemic, when 100 million people fell into poverty and the world's billionaires doubled their wealth, which puts pressure on redistribution. The third reason is that major crises create a mood for major economic and social changes as a sort of "reset" of the system after a major victory. Thus, for example, after World War I, the League of Nations was formed; after the Great Depression, many banking and economic reforms were introduced; and after World War II, the existing system of social protection was introduced, with mandatory insurance for workers, and the IMF and World Bank.

The current crisis, caused by Russian aggression against Ukraine, which builds on the COVID-19 pandemic, contains all these components. It is already clear that the states will need money to mitigate the impact of the crisis and make the reforms that will be needed in the coming years. Huge class differences are also evident – millions of people worldwide will fall into poverty due to higher food and energy prices. At the same time, a small number of companies, together with their bosses, will increase their profits several times. Finally, public demands for significant changes in the existing system, both in terms of energy transformation and reducing dependence on fossil fuels, and in terms of more severe changes to meet sustainable development goals are also evident.

The standard answer from history in such situations – taxing the rich through more progressive taxes, is more relevant for North Macedonia than any other country. North Macedonia has one of the highest poverty rates in all of Europe, at 22%. North Macedonia also has the most extensive participation of the wealthiest 1% in the total national income - more than 14% of the income in the country ends up with them. Moreover, these 1% pay effective income tax at lower rates than the poorest 50% of people (Ministry of Finance, 2018). Therefore, it is necessary to introduce a progressive personal income tax as soon as possible.

8.4. IMMINENT NEEDS FOR CHANGES IN PERSONAL INCOME TAX

Moreover, the need to introduce a gentle progression unequivocally arises from all of the above. The initial considerations by the representatives of the competent institutions were "to introduce" a gradual progression. However, at the last moment, before the end of 2022, they decided not to do that. It is most likely under political pressure from big businesses, even though many analysts believe there is no "benefit" from it! The only thing that would be understandable would be that it is not done at the end of the political cycle and when the ruling structure changes the leadership course.

However, we believe that in a reasonable transition period of 3 to 5 years, starting from a system with two rates, the second rate, in the first year, is no higher than 13% to 14%, so that after five years, it reaches 20%. This would also provide enough time for the business community to adjust. When moving closer to the EU, it is likely necessary to introduce a third, more progressive rate with a significantly higher income threshold to target only 1% to 2% of the richest in the country. At the same time, it should be seriously thought about in a future phase, after the progressive (personal) system is consolidated, to introduce the progression of the family system.

In addition to the progression, it is necessary to think about the maximum, if not complete, elimination of paroles and reliefs and other benefits in the current system. First, the taxes should be collected from the broadest possible range of taxpayers to support certain target groups through transfers and subsidies on the expenditure side. This is even more necessary because of the various channels of tax evasion and grey economy on this basis.

For illustration, we will present a simulation that we made with several scenarios and based on actual data from the Ministry of Finance about the fiscal effects of these changes, as follows:

Table 4. Simulation of fiscal effects with several scenarios

Income by group (in MKD)	Income by group (in %)	Threshold for a group (in MKD, annually)	Average income for group (in MKD, annually)
470.402	0 % – 50 %	-	103.458
94.080	50 % – 60 %	163.715	177.282
94.080	60 % – 70 %	191.028	208.023
94.080	70 % – 80 %	227.049	251.029
94.080	80 % – 90 %	276.789	316.560
47.040	90 % – 95 %	373.207	429.761
9.408	95 % – 96 %	509.328	537.109
9.408	96 % – 97 %	568.189	607.026
9.408	97 % – 98 %	653.102	716.711
9.408	98 % – 99 %	795.565	941.309
9.408	99 % – 100 %	1.152.118	3.310.790

Source: Ministry of Finance, processed by the authors

According to the above structure of income by groups, the following two scenarios for the fiscal effects have been made.

In the first scenario, with an initial rate of 10% up to a monthly income of 120,000 MKD (annual 1,440,000 MKD) and above this threshold with only one progressive rate of 15%, the following fiscal effect is obtained on an annual level of almost 15 million EUR.

Table 5. Scenario 1

Number of taxpayers	Average annual income	Amount	Tax at a proportional rate of 10%	Cumulative tax (10+15%)	**Difference**
9.408	3.310.790	31.147.912.320	3.114.791.232	3.994.810.848	880.019.616,00
Total					**14.309.262 €**

Source: Authors' calculation

Second scenario: Keeping the previous progression rate of 10+18%, but at a higher threshold of 120,000 denars per month or 1,440,000 per year:

Table 6. Scenario 2

Number of taxpayers	Average annual income	Amount	Tax at a proportional rate of 10%	Cumulative tax (10+15%)	**Difference**
9.408	3.310.790	31.147.912.320	3.114.791.232	4.522.822.618	1.408.031.386,00
Total					**22.894.819 €**

Source: Authors' calculation

Simulations and calculations result in significant fiscal effects without calculating the effects of other tax elements of this type of tax (base expansion, reduction of exemptions, etc.). Different fiscal results can easily be obtained depending on the choice by changing the rates (both in % and degrees of progression). However, it is undoubtedly evident that the effects are significant. Another is the issue of good management in the efficient and effective allocation of tax revenues in providing goods and services according to priority and quality.

8.5. THE CHANGES SHOULD NOT ONLY APPLY TO PERSONAL INCOME TAX

Another option that seriously asserts itself as very justified when considering tax reform in North Macedonia is the taxation of highly profitable companies in the country. North Macedonia is one of the few countries in Europe where company profits exceed workers' wages. In 2019, the companies' total profits in the country amounted to 249 billion dollars, while the total salaries were 245 billion. This has been the case continuously for the last 15 years, from 2007 onwards. This means the space for collecting additional budget revenues is even greater for the corporate sector than for employees.

In addition to the high profits, they are also very unevenly distributed. The most profitable 100 companies in the country in 2021 made a profit of 735 million MKD (Confederation of Trade Unions of Macedonia, 2021), which is about 18% of the total profit in the economy. There are about 70,000 active business entities in the country, meaning that these 100 companies are 0.1% of the total number of companies. This means that the most profitable 0.1% of the companies realise 18% of the total profit, which is a far greater concentration than the concentration in income.

If a progressive income tax were to be introduced for these 100 companies, with a second rate of 20% for profits exceeding 1 million EUR, the additional budget revenues from this would amount to around 70 million EUR per year, which is not an amount to be underestimated at all.

Therefore, we consider it necessary, at least temporarily, as long as the crisis lasts, to introduce a tax on above-average profits (excess profit tax) for all companies that, due to conjunctural conditions and not to their credit, created above-average profits compared to the period before the crisis. This would be a fair policy and a response to the business community that demanded that tax progression not be introduced in times of crisis, which was accepted! Many European countries, such as Croatia, Italy, etc., have already introduced such measures. However, in our close neighbourhood (Albania), such a proposal is already in the procedure. Calculations for such taxes in the EU, and only for the capitalization of energy companies in the stock markets, show huge fiscal effects. According to a new study, "A Modern Excess Tax," issued recently by the EU-TAX Observatory (M. François at all. September 2022), the fiscal effects of these companies in just one year would amount to tens of billions of euros.

Another option for taxation of highly profitable companies in North Macedonia is introducing a tax on extra profit ("windfall tax"). The EU has already decided to introduce such a tax on its territory, which began to be applied in 2022. The tax will apply only to energy companies; it will amount to 33% of the extra profit, where the extra profit is defined as a profit that is more than 20% higher than the average profit in the last four years. It is estimated that this tax will raise an additional 140 billion EUR at the EU level, which will further be used to mitigate the effects of the crisis.

The extra profit tax defined in this way is the minimum that each EU member is obliged to introduce, while each country can decide to introduce higher tax rates or expand the scope of companies. So far, 10 EU countries have introduced a tax on extra profit. Greece has introduced a tax at a rate of 90% for energy companies. Romania introduced an 80% tax for energy companies and supermarkets. The Czech Republic introduced a tax with rates of 40 to 60% for energy companies and banks. Poland introduced a tax at a rate of 50% for all companies with more than 250 employees.

It is difficult to estimate how much money would be collected from such a tax in North Macedonia because the data on profits for 2022 are not yet available. However, several tens of millions of euros could undoubtedly be collected. The tax could apply to the energy sector, finance, and trade, the three sectors that have had the highest profit growth in this crisis in North Macedonia. According to the data of companies from these three sectors that are registered as joint-stock companies and publish quarterly data for the stock market, profits in these sectors in the first three quarters of 2022 have increased significantly, sometimes even several times.

In the case of (regular) profit tax, all exemptions and reliefs should be annulled, except those based on actual (proven and paid) investments. The calculations from the Ministry of Finance for just cancelling the exemptions of the sports clubs cost tens of millions of euros. This measure would not mean neglecting the sport; on the contrary, it should be supported through targeted transfers, even more than before, but not through conditional exemptions that represent a space for tax evasion.

It is finally time to design a fiscal solution for the environment, such as a green or environmental tax, starting from the basic principle "the polluter pays". This is not only through consumption but also through the exploitation of natural resources (water, land, air). Through an appropriate budget program, these revenues should be fully allocated for environmental protection.

8.6. THE ROLE OF TAXES IN REDUCING INEQUALITY AND ACHIEVING SOCIAL PROTECTION

Effective taxation should provide public revenues and redistribution, ensuring that states can deliver quality public services and infrastructure while reducing inequalities.

An essential characteristic of every state, especially every social state, is that with its tax policy, it must realise the rights of social security and the principle of social justice. First, the pandemic, and now the energy crisis, exposed even more the costs of tax injustice in our country, but also showed the power that states have to act for the public good. Of course, we cannot afford to review the tax policy only in the context of the current crises. We have many other longer-term challenges ahead of us, such as climate change, and they are all social justice crises.

Equal opportunities for life and active social and political participation require a fair distribution of social resources. Economic and social rights, quality education and health care, housing, pensions, and other services have significantly impacted the realisation of the ideal of equality for all. We are talking about several principles of fair social distribution: equality, fair remuneration according to performance, fair satisfaction of needs, and the principle of equal opportunities.

The welfare state has different ways and mechanisms of social benefits and protection of people with low incomes and who are socially excluded. First, there are cash benefits in unemployment benefits, social transfers, pensions, and child and education allowances. Also, we mean free treatment and prevention within the healthcare framework. The welfare state generates income through taxes and duties, which, among other things, finance the social systems. Therefore, social benefits are provided through taxation.

One of the main differences between the different welfare state models concerns the availability of benefits. In welfare state systems that offer universal benefits, anyone in need receives help, regardless of income or economic status. In addition, an actual welfare state is a state that acts preventively. Consequently, thanks to the many high-quality social services available to everyone, far fewer people depend on state welfare. That is why the tax burden on those who earn a higher income should be a feature of states guided by the principle of social justice, compared to liberal and conservative states.

Progressive taxation contributes to:

- reduction of social differences in society;
- increase in total consumer activity, which has a positive effect on economic activity;
- higher public revenues, and thus better and better quality public services;
- slowing down the pace of public debt growth;
- maintenance of more excellent economic stability.

Income equality is one of the most important arguments for a progressive tax system. The progressive tax system functions as a tool to redistribute income from the upper to the middle class and people at social risk. Those who earn the most pay more to the state. This prevents the widening of the gap between the rich and the poor. Those with little income should be supported by those who earn a lot based on their privileged position in society. These taxes should fund education, health services, housing assistance, and other social programs for those who most need them.

From 2019 onwards, North Macedonia will implement comprehensive reforms to improve the coverage, targeting, and adequacy of the country's social assistance system to provide more effective support for the poor and vulnerable population. However, practical cooperation between social work centres and employment centres, which should enable people to be lifted out of poverty through efficient integration of able-bodied recipients of social assistance in the labour market and the availability of social services, remain key challenges. It is also necessary to monitor the efficient and appropriate distribution to persons and families who deserve it according to the prescribed criteria. Analyses of the informal economy leave room for doubt in the individual distribution.

Finally, sustainable growth cannot happen without structural reforms to boost productivity and investment in people, that is, what is called human capital. To do that, it is necessary to have related cross-sectoral policies and programs in education and science, health, and social protection.

CONCLUSION

According to the analysis of the situations in this paper, many conclusions emerge that would be useful to fiscal policymakers, which would be sublimated in the following recommendations:

- Undoubtedly, there is a significant tax regression and the inadequacy of the tax system to the set goals and functions of the fiscal policy. That is why changes are needed, not superficial and peripheral, but essential and deeper.
- The arguments that the crisis period is not suitable for tax reforms do not hold. The most significant tax changes always happened during the biggest crises.
- All data and trends show that the inequality and unfairness of the tax system require the introduction of tax progression. The dynamics, intensity, and height should be determined in consultation with the interested parties but not under the unilateral influence of the business community alone. Hardly any businessman would voluntarily and on his initiative accept tax changes (upward).
- It has not been scientifically proven that tax progression crowds out business, as is often claimed. Even in North Macedonia, there is no proven record of this! The problem is the insufficiently efficient and effective allocation of public revenues. The economy and citizens demand better quality of education, healthcare system, improved infrastructure, a healthy environment, investments into culture, sports, ... and all this is impossible without increasing the tax base and the tax rates.
- The simulations for the fiscal effects on a basis and slight changes show that they should not be neglected. Only with a mild and transitional progression can the clearing of paroles and reliefs and the coverage expansion generate tens to a hundred million euros per year. If they were additionally allocated to education, health, energy, and ecology, they would undoubtedly create increased effects on human capital and development.
- Specific taxes for specific circumstances (time of crisis) should be introduced quickly.
- Tax changes are also needed for a more even redistribution of income and better quality health care. The micro-organizational structures of health institutions (local centres) should cooperate for the constant functioning of the "revolving door" for entry and exit from the health care system. On the contrary, with a long life of residence in a social system, we create a "parasitic" society.
- Environmental taxes should be introduced as quickly as possible, and through dedicated budget programs, they would be exclusively allocated to the function of environmental protection.

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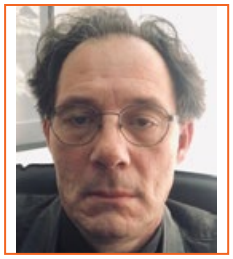

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КОНТУРА
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NEW ERA, NEW HOPE

Looking at the Macedonian economy in the long term through the factors that determine the potential product, namely labour, capital and their combination, i.e. productivity. In the conditions of high migration abroad and the demographic ageing of the population, it is essential to put a much stronger focus on productivity, primarily by improving the quality of education of the future workforce. Attracting capital and securing labour is also essential.

The institutional setting of North Macedonia should take advantage of the opportunities brought by the geopolitical global fragmentation by attracting investments from the European Union due to the geographical location (nearshoring) or as a political and economic ally (friend-shoring).

North Macedonia needs to increase the crisis resilience of the economy by improving the capacity of public finances, strengthening the social protection system, and reducing import dependence on food and energy. Within these frameworks, the economy's competitiveness will largely depend on utilizing the opportunities brought by the energy transition that needs to be socially just.

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