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## ASPECTS OF THE MACEDONIAN ECONOMIC GROWTH

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**Abstract:** Long-term economic growth of any country depends on three factors: labor force developments; capital accumulation; and total factor productivity (TFP). In the era of increased global migrations that affect all the economies and significant demographic challenges, which imply a slow decline in working age population over time, and investment rates which create fixed capital and which are unlikely to remain stable on high and needed level, total factor productivity (TFP) - driven by structural reforms, could be the main driver of future growth. Current developments and demographic projections in Macedonia suggest that labour force will slowly decline by about few percentage points in the few next decades. At the same time, Macedonia will continue to struggle with unusual high unemployment rates. Its current unemployment rate of about 25 percent is among the highest in Europe. Consequently, it will take significant time for unemployment to come down. The contribution of capital accumulation to growth is likely to be small but positive. Investment as a share of GDP currently is around 25-26 percent. Investment in fixed capital is expected to recover very slowly over the medium term, including as a result of the need to replace capital and improve technological base of the economy, but it is unlikely that it can raise to the higher levels and jeopardise the absolutely low level of consumption and living standards which is only about 1/3 of the average in EU. The financial sector is also unlikely to be able to support investment growth for the long-term future, as it is characterised with relatively low level of development. It means that the investment ratio can't increase by significant percent and exceed 30 percent of GDP over the medium or long term. Therefore, the contribution of capital accumulation to economic growth even increasing is not expected to be very important. From that point of view it seems that growth, therefore, critically depends on the contribution of total factor productivity, mostly driven by structural reforms and strong institutional reinforcement. But it is not an easy task at all. For example, in the period from 1970 until 2008, an average annualized TFP growth in the euro area was estimated on 1.2 percent only. Macedonian economy probably had very low TFP growth of less than 1 percent. TFP is seldom taken as a function of the structural reforms. In that case the results of the overall reform implementation in Macedonian economy in the last decade has been very poor. Despite numerous, seldom very controversial legislative initiatives, the implementation of reforms has lagged. Institutional' efforts and commitments remain limited, incomplete, even wrong or negative ones. In this context, it is no longer plausible to assume that Macedonia could reach TFP rates that are needed or that are at least above the EU or euro-area average. A more realistic scenario is that Macedonia's reform effort would be adequate with bringing TFP growth to around 1 percent. This, together with the contributions of labour and capital accumulation would imply a long-term growth rate of only a few percent's (about 2,5-3,5 percent's). This is still very limited development and requires continued structural reforms to be delivered at a much faster pace than achieved so far.

**Keywords:** long-term growth, labour force, investments, TFP.

## АСПЕКТИ НА МАКЕДОНСКИОТ ЕКОНОМСКИ РАСТ

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**Резиме:** Долгорочниот економски раст на земјите зависи од три фактори: движењето на работната сила, акумулацијата на капиталот и вкупниот (тотален) фактор на продуктивноста (ТФП). Во ерата на зголемени глобални миграции што влијаат на сите економии и значајните демографски предизвици што вклучуваат намалување на работоспособното население со текот на времето, како и инвестициските стапки што го креираат фиксниот капитал и за кои е неизвесно дека можат да останат стабилни и на високо и посакувано ниво, вкупниот фактор на продуктивноста воден од структурните реформи може да биде главниот двигател на идниот раст. Тековните движења и демографските проекции во Македонија сугерираат работната сила полека ќе се намали за неколку проценти во идните неколку декади. Во исто време Малкедонија ќе продолжи да се соочува со невообичаено високи стапки на невработеност. Нејзината сегашна стапка од околу 25 отсто е меѓу највисоките во Европа. За намалувањето на невработеноста ќе биде потребен значаен временски период. Придонесот на акумулацијата на капиталот кон растот е позитивен но мал. Инвестициите како дел од БДП сега се на ниво од околу 25-26 отсто. Се очекува на среден рок тие да се обновуваат споро

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како резултат на потребата за обнова на фиксниот капитал и подобрување на технолошкото ниво на економијата, но не може да се очекува тие да се зголемат на повисоко ниво и да го загорзат апсолутно ниското ниво на потрошувачка и на животен стандард што се проценува на само околу 1/3 од оној на просекот на ЕУ. Финансискиот сектор исто така нема можности да го поддржи долгорочниот раст во иднина бидејќи и тој се карактеризира со релативно ниско ниво на развиеност. Тоа значи дека инвестициската стапка не може значајно да се зголеми и надмине 30 отсто од БДП на среден и долг рок. Затоа придонесот кон растот на акумулацијата на капиталот не може да биде многу значајна. Од таа гледна точка се чини дека економскиот раст критички зависи од придонесот на ТФП, силно воден од структурните реформи и силното институционално зајакнување. Но тоа не е лесна задача. На пример, во периодот 1970-2008 просечниот годишен раст на ТФП во земјите од евро-зоната е проценет на само 1,2 отсто. Македонската економија веројатно има придонес на ТФП од под 1 отсто. ТФП често се смета како функција на структурните реформи. Во тој случај резултатите од вкупната имплементација на реформите во македонската економија во последнава декада беа многу скромни. Покрај бројните, често контроверзни иницијативи, нивното спроведување доцнеше. Институционалните напори останаа ограничени, нецелосни, па дури и погрешни и негативни. Во таа смисла веќе не е веројатно да се претпостави дека Македонија може да достигне ниво на раст на ТФП што е потребно или е на ниво на она на просекот на ЕУ или евро-зоната. Пореално сценарио е дека македонските реформски напори би биле адекватни да го овозможат растот на ТФП од околу 1 отсто. Ова, заедно со придонесот на работната сила и акумулацијата на капиталот, ќе овозможи долгорочна стапка на раст од неколку проценти (2,5-3,5%). Тоа сè уште би бил ограничен раст кој бара структурните реформи да се спроведуваат со многу побрзо темпо од досегашното.

**Клучни зборови:** Долгорочен раст, работна сила, инвестиции, ТФП.

## 1. INTRODUCTION

The economic growth measured by the rate of the real GDP in Macedonia in the last two and a half decades was varying, but in average it was relatively poor with only about 2 percent per year in the period 1993-2015.<sup>13</sup> This results due to many noneconomic, as well as many economic factors. The main noneconomic factors were heavy independence process in the first half of the 90-es of the last century, relatively instable region with conflicts at the end of the century (1992-1995 – Bosnia-Hercegovina, Croatia, 1999 Kosovo, Serbia); than extraordinary long period of democratic and free market economy transition which seems is not finished yet, including long periods of internal political crisis (1995, 1999, 2001-2002, 2005, 2011-2012, 2015-2017) and finally the internal ethnic conflict in 2001. In such a surrounding economic achievements and reforms were not easy nor very successful. The economy itself was also mostly suffering of establishing its own newborn institutions and finding new markets, traditional economic structure and low productivity creating exports concentrated in only a few sectors, mainly textiles and clothes, nonferrous metals and agricultural products, accompanying with low international competitiveness and technological base. Institutional support of the economy was very weak and seldom very corruptive. Investments rates of about 20-22 percent of GDP were low comparing with the needs for the renewal of the economy and with the rates in other middle-income economies. Absolutely high unemployment rate varying about 30 percent during the most of the period is still a heavy burden for the economy. As an effect of those factors there were periods of recessions (1993-1995, 2001, 2009, and 2012) and periods of high growth based on increased external demand and export prices (1998-2000 and 2004-2008). See Table 1.

Table 1. Rates of the real GDP in Macedonia (1993-2015)

year	1993	1994	1995	1996	1997	1998	1999
rate (in %)	-7,5	-1,8	-1,1	1,2	1,4	3,4	4,3
2000	2001	2002	2003	2004	2005	2006	2007
4,5	-3,1	1,5	2,2	4,7	4,7	5,1	6,5
2008	2009	2010	2011	2012	2013	2014	2015
5,5	-0,4	3,4	2,3	-0,5	2,9	3,6	3,8*

\*preliminary data

Source: NBRM statistical data ([www.nbrm.mk](http://www.nbrm.mk))

<sup>13</sup> Authors calculation on the base of data published by the National bank of Republic of Macedonia (<http://www.nbrm.mk/?ItemID=750FC531FC3D1B49B16440313562D400>)

Following this dynamic of the economic growth on the middle and long term Macedonian economy will not be able to arise significantly the living standards of its population or to integrate itself fully in the EU and global economy and the long term consequences could be even more negative. This paper is researching some possibilities for the long term growth of Macedonian economy and the economic factors which could improve it. Research will be focused on a closer look to some global factors that will determine future Macedonian economic growth and certainly the most important economic factors of domestic origin.

## 2. GLOBAL FACTORS THAT DETERMINE GROWTH

From the economic point of view the world has changed a lot over the past 25 years, and it will not stand still. Macedonia is in a group of the emerging and developing countries which represent some 85 percent of the world's population and nearly 40 percent of world GDP. Those economies during a period faced more progress for more people than at any time in history: living standards are improving, GDP/pc grows, child mortality is down, life expectancy is up; absolute poverty has declined, school enrollment is on the rise. Although a good part of this development is due to the success of China, there has been a broader trend of economic convergence between the poorer and the richer nations. Maybe this was not as fast as it should be, but a trend exists. Because of mentioned problems Macedonian economy was on the periphery of these trends. Despite prosperity, rising economic inequalities become a phenomenon in many countries today, no matter if they are within high or middle and low income group. Because of this the "past economic achievements seem at risk. What this tells us is that governments must work harder to make growth inclusive, so that all people can benefit from the positive trends."<sup>14</sup> But there are some other important global factors that will determine growth in small economies like Macedonian.

Within the past decade, after the global recession, the global recovery has been weak and fragile, and this continues to be the case today and years to come. In its latest World Economic Outlook Update of January 2017 IMF project a global growth in the next two years of 3,4 and 3,6 percent respectively where the main engine still will be the emerging market and developing economies with dynamic of 4,5 and 4,8 percent growth. In the advanced economies, while there are some good signs for better dynamic, the overall growth outlook still remains subdued, projected on 1,9 and 2,0 percent in 2017 and 2018.<sup>15</sup> Further, the commodity exporters have been hit hard by low commodity prices, and countries like Macedonia could suffer from it. In such an economic surrounding, low productivity growth and high levels of debt in the world could further depress investment and expectations of future global demand and growth.

One of the most crucial factors for growth of economies with high level of foreign exchange is trade. Macedonian annual value of the foreign trade is equal or bigger of its GDP. Since World War Two, world trade was the engine that has propelled economic progress. Trade was growing twice faster than the rate of global GDP until the crises of 2008 but since then has fallen below that pace. This is largely due to weaker global overall demand, but also to the increase in protectionist trade measures in the last five years.<sup>16</sup> At the same time, the challenge is to make sure that the gains from trade are widely shared between exporters and importers in order to achieve as much as possible inclusive growth.

Also there are global and regional the macroeconomic and structural policy priorities. The current global economy can be described as state of low growth, low inflation, and low interest rates which is bad for financial stability, bad for employment, and finally for higher growth. The world economy and each country need a set of structural reforms that could provide the biggest effect on growth and productivity. Countries need more public investments because better roads and airports, more power plants, modern schools and universities and high-speed internet are essential components of modern public infrastructure. The current low interest rates could provide an opportunity to make these necessary investments—and finally to boost growth. Fiscal and monetary policy in advanced and emerging economies should remain moderate expansive at this stage. While supporting demand in general, the research shows that monetary policy could add a further boost to GDP when infrastructure investment is debt-financed. In fact, the impact on GDP would be almost twice as large and the debt ratio would fall, compared to the case without monetary support.<sup>17</sup>

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<sup>14</sup> Lagarde Christine, Managing Director of the IMF: "Boosting Growth and Adjusting to Change", Speech delivered on Northwestern University, Chicago, Illinois, USA, September 28, 2016, p. 1

<sup>15</sup> IMF: "World Economic Outlook Update", IMF, Washington, D.C., USA, January 16, 2017, Table 1

<sup>16</sup> IMF: "World Economic Outlook", Chapter 2, Global Trade: *What's Behind the Slowdown?*, IMF, Washington, D.C., USA, October, 2016, Ch. 2.

<sup>17</sup> IMF: "World Economic Outlook", Chapter 3, *Is It Time for an Infrastructure Push? The Macroeconomic Effects of Public Investment*. IMF, Washington, D.C., USA, October, 2016, Ch. 3.

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On the other side the World Economic Forum is promoting global inclusive growth strategy which consists of 17 policy areas as: employment, education, financial services, infrastructure and health services, entrepreneurship, fair taxation, and other. Macedonia should approach them carefully too. Especially because there are signs that economic slowdown in the middle income economies is on the horizon. “Since 2010, growth has been slowing in emerging market economies... growth has remained well below pre-crisis (2003-08) rates and, by 2014, had fallen below its long-term (1990-2008) average.”<sup>18</sup> The slowdown in emerging markets has been unusually synchronous and has affected a number of countries, especially large ones. “A synchronous and persistent slowdown has been underway in emerging markets since the post-crisis rebound of 2010, narrowing the growth differential between advanced economies and emerging markets. The slowdown has been driven by both external and domestic factors, and has had both cyclical and structural components.”<sup>19</sup> This is a case with Macedonian economy too.

### 3. FUTURE MACEDONIAN GROWTH

In its Staff Concluding Statement<sup>20</sup> of the 2016 Article IV the IMF Mission noted that recovery of the Macedonian economy from the global financial crisis has been solid, but growth has slowed down. Real GDP growth averaged around 2,5 percent during 2010-2015 compared to 4 percent during 2003-2008 mostly reflecting a slowdown in potential growth as experienced by other countries in the region. Although contribution from capital has held up, lower contributions from labor and negative TFP growth is estimated to have nearly halved country's potential output growth in post-crisis years. High structural unemployment, low labor force participation and ageing population cast a lasting shadow on the longer-term economic outlook. As policy support and stimulus from infrastructure investment tapered off, growth may lose steam unless reforms to improve productivity and labor's contribution are put in place. The main concern is negative TFP growth.

Therefore it is clear that future long-run growth will generally depend on three main factors:

- a) labor force developments;
- b) capital accumulation; and
- c) total factor productivity (TFP).

In the era of significant demographic challenges, which imply a slow decline in working age population over time, and investment rates, that are unlikely to remain on high and needed level, total factor productivity (TFP) — driven by structural reforms — could be the main driver of future growth.

The contribution of labor to growth is expected to be negative. Demographic projections suggest that working age population will slowly decline by about few percentage points in the next few decades. At the same time, Macedonia will continue to struggle with high unemployment rates for decades to come. Its current official unemployment rate is around 25 percent, the highest in the EU. Consequently, it will take significant time for unemployment to come down. Expectations are that it could reach 20 percent by 2025, 15 percent by 2040, and under 10 percent only by 2060 if higher and sustainable growth take a place. Long-run labor force participation<sup>21</sup> is expected to increase gradually from about 50 to around 70 percent, in line with the overall EU trends. This suggests that the contribution of labor to long-run growth could be only around 1 percent derived as the change in employment growth.

The contribution of capital to growth is likely to be positive, but small. Investment as a share of GDP currently is around 25-26 percent. While investment is expected to recover very slowly over the medium term, including as a result of the need to replace capital and inventories, it is unlikely to rise to the much higher levels. Moreover, the financial sector is unlikely to be able to support investment growth for the foreseeable future, as it still struggles with exceptionally low level of development compared with the world. That said, the investment ratio to increase by about 6-7 percent to over 30 percent of GDP over the medium and long run, is still not possible. Therefore, the contribution of capital to growth is expected to be only symbolic of 0.7-1,2 percent derived as the change in capital stock, of about 1 percent on average.

Growth, therefore, probably critically depends on the contribution of TFP, driven by structural reforms. For example the calculations show that, from 1970 until 2008, average annualized TFP growth in the euro area was 1.2 percent. Macedonia probably had very low TFP of less than 1 percent. Looking forward, TFP is a function of the

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<sup>18</sup> Didier T., Ayhan Kose A., Ohnsorge F. and Sandy Ye L.: “*Slowdown in Emerging Markets: Rough Patch or Prolonged Weakness?*”, PRN 15/04, WB Group, Washington, D.C., USA, Dec. 2015, p. 5

<sup>19</sup> Ibid, p. 7

<sup>20</sup> IMF Staff Concluding Statement of the 2016 Article IV Mission, 30.09.2016

<sup>21</sup> “*Active Population in the Republic of Macedonia*”, Results from the Labor Force Survey, III quarter 2016, State Statistical Office of Macedonia, News Release No: 2.1.16.34, 09.12.2016

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ambitiousness of structural reforms. However, the record of the overall reform implementation in Macedonia since 2007 has been uneven. Despite numerous legislative initiatives, the implementation of reforms has lagged. And the authorities' efforts and commitments remain limited or incomplete, even negative ones. In this context, it is no longer plausible to assume that Macedonia could reach TFP rates well above the euro-area average. A more realistic assumption is that Macedonia's reform effort would be commensurate with bringing TFP growth to maximum of around 1 percent, slightly below the historical euro-area average. This, together with the contributions of labor and capital would imply a long run growth rate of only a few percent (about 2,5-3,5 percent). This is still very limited development and requires continued structural reforms to be delivered at a much faster pace than achieved so far. That is the only way Macedonian economy to be able to grow at higher levels.

This leads towards some critical questions focusing, respectively, on economic growth, public policies, mainly fiscal and monetary and structural issues including effective institutions. The starting point is that every public policy discussion should also discussing growth – sustainable growth. This approach is necessary and in line with a big dilemma what kind of policy mix of fiscal policy, monetary policy, and structural and institutional reforms should support stronger and more sustainable growth.

Ultimately, confronting the challenges faced by Macedonian economy: poor public service delivery, slowing growth, corruption, relatively high poverty rate, unemployment, to name a few, requires rethinking the process by which state and even non-state actors interact to design and implement policies, or what the WB World Development Report 2017 calls “governance” as a process through which state and non-state actors interact to design and implement policies within a given set of formal and informal rules that shape and are shaped by power in order to create growth.

#### 4. CONCLUSION

Due to many noneconomic and many economic factors the economic growth in Macedonia in the last two and a half decades was varying, but in average it was relatively poor with only about 2 percent per year in the period 1993-2015. Following that dynamic of the economic growth on the middle and long term Macedonian economy will not be able to arise significantly the living standards of its population and integrate itself fully in the EU and global economy. Consequences could be even more negative. This paper is researching some possibilities for the long term growth of Macedonian economy and the global and domestic economic factors which could improve it. Some of the global factors of limitation are weak and fragile global recovery, slowdown in the global trade, persistent structural problems and state of low growth, low inflation, and low interest rates in the world. On the other side the recovery of the Macedonian economy from the global financial crisis has been solid, but growth has slowed down with negative TFP growth. Since the labor force could have negative and capital accumulation positive but not important contribution to growth on the long term, the total factor productivity (TFP) could be the main driver of future growth driven by strong structural and institutional reforms which could lead to growth rates which will be much higher than certain annual 3 percent.

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