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## **FACING THE CRISES AND IMPLEMENTING SUSTAINABLE GROWTH OF MACEDONIAN ECONOMY BY DEVELOPING SMALL AND MEDIUM ENTERPRISES**

### **Abstract**

The positive and negative experiences of the World Economic Crisis should be used for recomposing the world's economic map. For many countries it is a sign for changing the economic model if the country wants to keep up with the new world trends. Republic of Macedonia is one of those countries. The inherited conditions and the required development of the economy suggest the need to introduce a so called *holistic approach* in the creation of the future economic model. In its basis, this model deals with the macroeconomic and financial politics as well as with the process of creating new jobs. The main drivers of that model should be small and medium enterprises (SMEs). The research will show why and how SME's should become spine of the future sustainable economic development. The expected results of implementation of such model are increase of the number of employees, export and country's GDP.

**Key words:** Remodeling; restructuring; diversification; small and medium enterprises; spine; sustainable development.

**JEL Classification Code:** E6

### **1. Introduction**

After the monetary independence (1992) from the former Socialist Federal Republic of Yugoslavia, the economy of Republic of Macedonia went through a period of transition filled

with many internal and external shocks, the last one being caused by the World Economic Crisis. These shocks have disabled a more intensive economic growth.

However, the thorough analysis of the results shows that regardless of the obvious presence of numerous shocks, Republic of Macedonia cannot have a more intensive and permanent economic growth using the existing economic model which has been based on the expected foreign loans and investments. The current economic crisis has revealed numerous disadvantages of the economic model which is being used. This clearly indicates the need for change or/and amendment of the model. The need for remodeling of the economy has become obvious and it involves its reconstruction and diversification.

The aim of this paper is to suggest and present holistic approach in remodeling the economy as a basement for its future long-lasting and sustainable development. The main drivers of that model can only be small and medium enterprises (SMEs). The research will show why and how SME's could become spine of the future modeling and building sustainable development of Macedonian economy.

Analytical, historical, statistical, logical and comparative method will be used for the purpose and the aim of the paper. Expected results and conclusions should justify the need, applicability and justifiability of the suggested model. But, one should be aware that in the next coming short and medium period the Macedonian economy will be faced with many risks and serious threats that can hinder or slow its development, no matter what model would be chosen.

## **2. Remodeling of the Macedonian economy**

Even though there are still many threats, it can be concluded that the World Economic Crisis is at its end. There comes a period of an expansive trend. In the meantime, the positive and the negative experiences from it are being used for recomposing the world's economic map. For many countries it is a sign that there is a need to change the economic model if the country wants to keep up with the new world trends.

Republic of Macedonia is one of those countries not only because of the effects of the crisis, but even more because of the need to establish a solid ground for a future, more dynamic, steady, and sustainable development.

The creation of the new economic model for the Republic of Macedonia has multidimensional directions. Among them are: a) the completion of the already commenced activities for improvement of the business environment as well as taking additional actions for its amelioration; b) reconstruction of the economy; c) increase of the domestic production; and d) harmonization of the macroeconomic instruments.

### **2.1. Improvement of the business environment for the future economic actions**

The new economic model has to be set up in far better conditions for action of the economic entities than the present. This can be achieved by finishing the already started activities and taking up new ones in order to overcome the most serious obstacles for the economic growth which are now identified. Some of them are:

- a) Establishing stable economic policies;
- b) Improvement of the conditions for access to funds for the economic entities;
- c) Improvement of the payment system and the financial discipline in the country;
- d) Advancement of the performance and efficiency of the judicial system;

- e) A more professional and effective public administration;
- f) Decreasing corruption in the public administration;
- g) Intensifying the activities for amelioration of the infrastructure in the country (roads, railways, electro-energetic network, etc.);
- h) Increasing qualified work force;
- i) Decreasing the size of the black economy which, according to several analyses, takes up around 40-45 % of the annual GDP of the country, etc.

## 2.2. Reconstruction of the economy

The economic performance before the economic crisis and the effects after it, suggest the need of creating a new model in Republic of Macedonia in order to stir the domestic production of goods and services which is fundamental for reaching a sustainable economic growth in future. The inherited conditions and the wanted development of the economy clearly suggest the need to introduce a so called *holistic approach* (Nenovski, 20117, 20118, 20119) in the creation of the future middle term model for economic development.

Macedonian economy is small and almost fully open through international trade. That means it has been exposing to international ups and downs, transmitted through trade, the impact of which can be minimised by appropriate macroeconomic policy responses.

Macedonia needs to reinvent its economy and search for new sources of growth. In the new model, the role of services should have to rise, and the production of goods and services should have to become more sophisticated, moving away from unskilled labour-intensive towards technology, skill and knowledge-intensive activities and processes.

Manufacturing will remain an important sector, but its profile will have to change dramatically, such that there is more domestic content and hence more domestic value-added in every unit of exports. The relative importance of resource-based manufacturing would have to rise. This will enable exports to contribute more to gross domestic product.

Macedonia must remain an open economy, with liberal trade and investment policies, as it cannot afford to look inward, given the small size of its domestic sector. Macedonia's economic growth will remain essentially export-driven, **notwithstanding** major changes in export composition or export destination. The so-called 'holistic model' is not about reorienting the Macedonian economy away from exports to domestic consumption, as Macedonia is too small an economy. It is, therefore, in Macedonia's interests to stay trade-dependent, although the composition of its exports of goods and services will need to undergo major changes through export substitution and transformation. Likewise, Macedonia needs to diversify its export market. "Equally important are domestic institutional reforms to reduce the cost and enhance the ease of doing business in the country, increasing international competitiveness" (Mohamed Ariff, 2010). Macedonia cannot integrate with the global economy fully as long as reforms are piecemeal; hence, the merit of a holistic approach, even if gradual, with a clear time frame.

In its basis, holistic model does not only deal with the macroeconomic and financial politics, but also with the process of creation new jobs and providing social care. In order to implement this approach, a suitable reconstruction of the economy is necessary which involves taking up activities to stir the emergence and the development of SME's, increase of the production, and diversification of the offer of goods and services at the domestic and at foreign markets as well.

### 2.2.1. Small and medium-sized companies - the spine of the economy

According to the data of the Central Register of the Republic of Macedonia, at the end of 2010 there were 61,454 registered companies in Republic of Macedonia. Sixty-one thousand two hundred and sixty-two or 99.7% were micro or small and medium-sized companies.<sup>1</sup> They employ 78 % of the officially employed people in the country.

According to this, the small and the medium-sized companies dominate the economic map of the Republic of Macedonia due to their number. However, the data that they employ almost 4/5 of the employed work force in the Republic of Macedonia is even more important. This means that the small and the medium-sized companies have a strong impact on the development of the size and the dynamics of the economic growth of the country and on the maintenance of the socio-economic stability of the country. This fact has been shown to be true during the most intensive period of the Economic Crisis as well. Thus, compared to 2009, in 2010 the number of registered company increased for 6,041 new company. At the end of 2010 there were 506,042 people employed in the small and medium-sized companies which is 14,719 more employees than the previous year. This proves the fact that the small and medium-sized companies have significantly contributed to the amortization of the influence of the World Economic Crisis especially by disabling the emergence and the spreading of its third form – the social crisis (increase of unemployment).

The current state of the small and medium-sized companies, their importance, and the courageous emergence of the new, already mentioned small and medium-sized companies at the height of the Word Economic Crisis, justifies the optimistic and yet real presupposition that the small and medium sized companies would become the crucial element of the future economic growth and they would truly become the spine of the Macedonian economy (Association of Macedonian Chambers of Commerce, 2011).

Namely, with the implementation of the biggest part of the suggested measures [in this article](#), in the following five-year period, more small and medium-sized companies can be started where a substantial part of the unemployed people can be taken on. With serious reconstruction and re-composition of the Macedonian economy, along with the incentives [that will be mentioned below](#), it can be realistically supposed that the number of newly open small and medium-sized companies in the next five years would be on average 11,500 per year i.e. a total number of 55,000 small and medium-sized companies in five years. More than a half of them (around 30,000) would be open by the already existing small and medium-sized companies, while the rest 25,000 companies would be completely new companies funded by the citizens by [engaging their capital](#). By enabling a quick and easy registration, in the next five years, it is possible to have many small and medium-sized companies working in the services sector, agriculture, trade, various segments of the industry, tourism, etc.

The activity of the increased number of newly open small and medium-sized companies would contribute to increase the scope of production of goods and services, to diversify it thus improve and increase the performance of the Macedonian economy in whole (increase of the GDP). This would also mean creation of new jobs and would lead to a steady decrease of, the so

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<sup>1</sup> Among the other characteristics, a micro company is a company where there are up to 10 employees, a small company is a company that employs up to 50 employees, and a middle-sized company is the one that employs up to 250 people. For the use of this paper, all these three types will be referred to as small and medium sized companies.

far, the biggest economic problem to which the Republic of Macedonia has been faced with and that is a high rate of unemployment.

Assuming that during its operation every newly opened SME employs an average of 4 people, over the following five-year period it would employ additional 220,000 people, or 44,000 people annually, with a rising dynamics from year to year considering the ongoing improvement of the economic climate in the country and the achievement of accelerating growth rates. These conditions will drastically reduce the rate of unemployment in the country from its current one, which is approximately 31 percent, to about 22-25 percent at the end of 2015.

Achieving the aforementioned quantification will be neither simple nor easy, unless there are (also) simultaneous relevant structural changes in the economy of RM. In fact, their achievement is directly dependent on the success of establishing a new model for economic growth in RM in the following period, which is described in the following text in this paper.

### **2.3. Increase and diversification of domestic production**

RM's introduction to the global economic crisis and its gradual departure from the crisis points out to several lessons (Nenovski, 2011a) that should be taken into account in shaping the upcoming economic climate in the country:

2.3.1. The Macedonian economy is dependent on the performance of few sectors only: metal industry, textile industry, parts of agriculture, etc. This fact proved to be a strong limiting factor for future economic development;

2.3.2. The Macedonian economy is heavily dependent on the alteration of the prices of its most important export and import products. Occasional increase in metal prices on the world markets has a strong positive impact on the performance of the majority of the Macedonian economy. On the other hand, the growth of energy prices and agricultural and food products, of which the Macedonian economy is also heavily dependent, causes an increase in their input costs (inputs), thus reducing their competitiveness on the world markets;

2.3.3. The supply and the consumption of domestic goods and services on the domestic markets are modest in size, which is a serious limiting factor for the development of the economy.

In order to overcome such weaknesses of the economy, a strategy of protection against future crises should be created, thus ensuring conditions for achieving lasting and sustainable economic development. The activities of the economy policy makers and economic agents in the country, as stated above, now and in the future should be directed in the domination of SMEs and diversification of production of goods and services which are offered at home, but which could also be offered on foreign markets. Measures and actions should be aimed at encouraging existing and newly-emerged companies to operate in the areas of services, agriculture, competing industries (particularly the manufacturing industry), etc. Of particular importance is the encouragement of innovation and not only in the form of newly discovered products, but also as innovation of already existing goods and services. To achieve this goal, we need (Nenovski, Smilkovski and Poposki, 2011):

a) Institutional support to new business ideas and business projects by eliminating regulatory constraints wherever possible and necessary, and by introduction of appropriate financial support;

b) Increase of the supply and consumption of domestic products, which will result in lower dependence of the domestic economy on the world events and the import of final products by:

- Subsidizing domestic production of strategic goods and services as a replacement for the same or similar products, which are now imported from abroad;

- Opening distribution centers for planning, purchasing, sorting, cooling, final processing and distribution of agricultural and food products;

- Encouragement of alternative energy sources: building new national hydro stations as well as small household water supply hydro stations, building windmills, introducing and expanding the network of the gasification network in RM, etc.;

- Increasing the competitiveness of domestic goods and services as a condition for encouraging their exports through cheaper alternative sources of energy, subsidizing the expenses of strategic goods and services and those that are found to have a comparative advantage over the same or similar products in neighboring countries and/or other foreign trade partners of the country;

- Encouragement of domestic investment through the deployment of domestic capital, i.e. savings of firms and citizens in banks and at home;

c) Extension of the already started activities for enhancement of the educational process, which should help overcoming the extensive problem of insufficient or low qualifications of the workforce. According to official data of the competent institutions, about 50 percent of the labor force in the Republic is composed of persons who have not completed their primary education. Of the total number of unemployed (about 324,000 persons), 80 percent are persons with lower education, unskilled, semi-skilled, skilled or qualified people. Despite the big number, there are several missing occupations: electro assemblers, installers of water supply and sewerage network, plasterers, textile workers and others. The unemployed high school graduates accounted for about 14 percent. The remaining 6 percent of the unemployed have completed a university degree. However, within these there are missing work profiles from the area of science, of different specializations of technologists, financial managers or occupations for which there is a great demand on the market by domestic and foreign investors. Accordingly, the competent institutions need to direct attention to increasing the quality of the workforce as a prerequisite for increasing the competitiveness of domestic goods and services on domestic and foreign markets;

d) Strengthening of the infrastructure in the country. The use of budget capital investments, foreign direct investment and diversification of the various forms of public-private partnership should encourage construction and finalization of new and reconstruction of existing infrastructure facilities (roads, railways, gasification network, electricity network, energy facilities, etc.). It should be done prior to or simultaneously with the economic reconstruction (the Polish model is a great example), and not the other way round: achieving sufficient infrastructure without developed economy (for instance, the Greek economy), which in the medium and long term could have adverse effects on the economy;

e) Promoting export. The increased volume of domestic goods and services would be primarily aimed at satisfying domestic needs, which will reduce the heavy dependence on the import of some or most of these goods. Simultaneously, the expected increased number of newly opened businesses and increased productivity of their products will enhance their domestic and international competitiveness. This, complemented by synchronized action of the basic instruments of macroeconomic policy, will increase the volume of goods and services for export. Such an approach will change the current unfavorable export structure dominated by only a few

types of products (textile, metals, some agricultural products, processed oil, etc.). The number of goods and services aimed for export will increase and this will reduce the current excessive dependence of the dominant Macedonian export products on the convergent movements of world markets on which they are offered.

#### **2.4. Harmonization of macroeconomic instruments**

Because of their close interweaving and interdependence, in the upcoming period it will be necessary to harmonize (Nenovski, 2010, p.29) the relations among the most important parts of macroeconomic policy (fiscal policy, monetary policy and foreign economic relations) in the direction of their coordinated actions, which will eliminate the possibility of destabilization of the economy and create conditions for commencement of the process of sustainable and sustained (at least in the medium term) economic growth of the country.

#### **3. Expected results in the medium term**

A newly established model of economic policy will result in multiple positive effects, which will primarily be manifested through the following indicators (Nenovski, Smilkovski and Poposki, 2011):

- Increase of the number of newly-emerged SMEs. In an environment that offers great opportunities for actions in various spheres of the economy, the most easily and most quickly adaptable are the SMEs. This fact will cause the number of the newly-opened SMEs in the next five years to increase by an average of 11,000 SMEs annually. Of course, because of various reasons, in that same period, a number of SMEs will have closed down. However, at the end of 2015 in RM there will be about 100,000 SMEs, which would be about 40,000 SMEs more than their number at the end of 2010;

- Dynamic creation of new SMEs will increase in terms of domestic investment with far larger amounts and rates ever recorded.

Assuming that each newly opened SMEs will start working with an initial capital of 10,000 Euros and if in their further work their capital increased the expected 20 percent annually, then the additional amount of domestic investment in SMEs at the end of 2015 would be about 1.4 billion Euros, i.e. on average around 280 million Euros per year. That average annual amount has not been realized even with the influx of foreign direct investment in the period after the political and economic independence of RM. This fact confirms the conclusion that the relevant institutions should pay attention to stimulating the domestic direct investments, even at a higher level than the foreign direct investment;

- Large number of newly opened SMEs in the following five-year period will be located in different branches of the industry. Their activity in the newly established environment will lead to an increase in industrial production. Fair is the assumption that in the upcoming five-year period, the newly-opened SMEs will contribute to boost (increase) the average annual industrial production by 8-10 percent;

The increased volume of investments by SMEs, coupled with the expected increase in industrial production, subsequently will contribute (in addition to the effects of other components) to increase of the country's GDP by an average of 6 percent annually in the upcoming five-year

period. With such rates of growth of the economy, it is realistic to expect that the Republic of Macedonia will reach the level of economic growth of the EU for 30 years;

- A logical consequence of the increased number of SMEs will be the increased number of new employees. Assuming that every newly opened SME employs an average of 3 persons, the total number of new employees in SMEs in the next five years would be 120,000 people. The number of unemployed would gradually decline so that at the end of 2015 the unemployment rate would amount to about 22-25 percent, dropping from the current 31 percent;

- By applying the aforementioned incentives the volume of production that SMEs will have earmarked for export will increase. At the same time, increase in the production of various goods and services will cause their placement in a certain extent on the domestic market. This will increase domestic consumption of those goods and services with dual positive effect: a) increase in GDP affected by increased domestic consumption, and b) reduction in the consumption of the relevant goods and services provided by import from abroad, i.e. reduction of total imports of the country. Cumulative effect of such movements would gradually reduce the difference between exports and imports i.e. increase the coverage of imports with exports from the current 60 to around 80 per cent;

- Increased exports or reduced imports of goods and services will lead to the gradual reduction of the deficit in foreign trade. It will have a direct positive impact on increasing the domestic GDP, reducing the current account deficit within the balance of payments, increasing state reserves and sharply reducing the need for borrowings of the country. Further positive consequence of such changes will be reducing the public debt, especially debt of the country abroad;

- This newly-created model will not **weaken** the macroeconomic stability. Inflation is projected to move in the defined frames because they are an essential element of the expected future monetary strategy of the National Bank (NBRM) - targeting the inflation rate. Significantly increased inflow of foreign exchange based on increased exports and reduced imports of goods and services will be a guarantee for maintaining stability of the exchange rate. The increased inflow of funds in the budget of the Republic of Macedonia on one, and its rational and productive use on the other hand, will condition the permanent budget deficit to reduce in size and move in sizes from 1 to 1.5 percent of GDP. Finally, the public debt and debt of the country will be reduced and will be significantly under the framework established by the Maastricht criteria. So, the final effect of my new economic model will be to establish and maintain macroeconomic stability as a condition for future long-term, permanent and sustainable economic growth of the RM.

#### **4. Risks and threats**

In the whole of its future development, the Macedonian economy will be faced with more risks, but also serious threats that can hinder or slow its development (Nenovski, 20117, 20118, 20019). Risks and threats can be divided as domestic and external.

The main domestic limitations are coming from massive, but not enough professional public administration, corruption, shortcomings in the judiciary, high “grey” economy” and not adequately qualified labor force.

In the short term, Macedonian economy will be under strong external threats that can jeopardize its growth, and which come from the ongoing financial crisis in Greece. Future development of the economic situation in that country is especially important for RM due to the fact that Greece, totally, is among the six most important trading and investment partners of RM.

Of course, a strong threat to Macedonia's economy can be an eventual expansion of the financial crisis in the rest of the EU. In such a pessimistic scenario, the recession could again return to the EU, and thus in RM, regardless of its orientation towards large EU countries (two thirds of its foreign trade is exercised in relations with EU countries).

In medium and long term, the strongest threat to future economic growth of RM is the problem that Greece has imposed over the constitutional name of the Macedonian state in the world community, and thus the EU and NATO. Skewing of the problem, in conditions when the EU and NATO decision to accept new countries into its membership is conditioned with unanimous decision-making may mean waiting longer at the gates of the EU and NATO. It will mean continuation of its uncertain external political status, with all the known negative effects it can create for the potential economic growth of RM.

## 5. Conclusion

Throughout the entire transition period, the Macedonian economy resisted the numerous bumps and obstacles and showed that there are strengths and opportunities for further movement along the tracks of a lasting and sustainable development. Good base for that is a long term macroeconomic stability, establishing a solid institutional framework and modern, low financial debt and relatively good business climate.

But the global economic crisis has shown that the Macedonian economy has significant weaknesses and indicated the need for its remodeling in order to realize a lasting and sustainable future growth. Given the structure of the domestic economy, it seems that the application of *holistic model* to its remodeling will give the desired results and effects.

That way the economy of the Republic of Macedonia will continue to face obstacles, risks and threats. The biggest risk is the possible expansion of the current debt crisis throughout most of the EU. Strongest, however, threat is the embargo that Greece has set for membership of the RM in the EU and NATO if it does not change its constitutional name. These are extremely serious risks and threats with possible long-term consequences of the implementation challenges that the economy of RM is faced.

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