



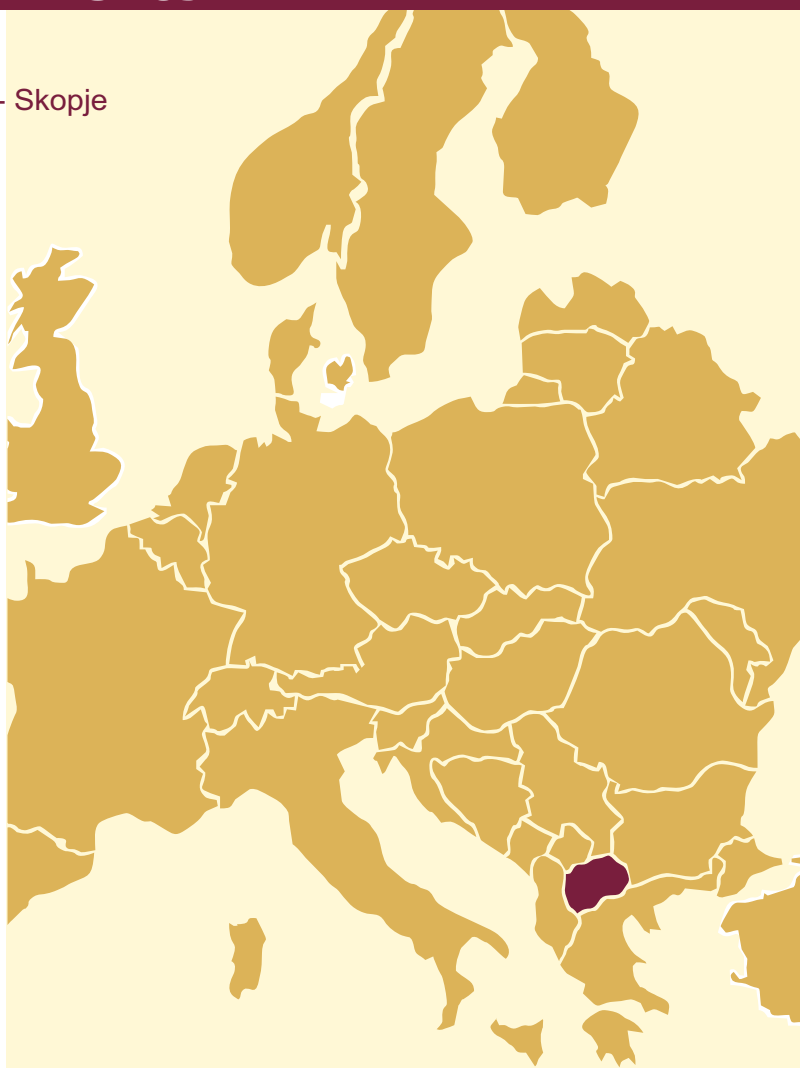
Универзитет "Св. Кирил и Методиј"
ЕКОНОМСКИ ИНСТИТУТ
— 1952 —

ISSN 1857-7741 (on line)
UDK - 338

Economic development

ЕКОНОМСКИ РАЗВОЈ

Journal of
The Institute of Economics - Skopje
Year. 17
No. 3/2015



Economic Development

Економски Развој

JOURNAL OF THE INSTITUTE OF ECONOMICS - SKOPJE

Year.17 No.3/2015

Skopje, December, 2015

Economic Development

Published by:

Institute of Economics - Skopje, University "Ss. Cyril and Methodius",
Republic of Macedonia

Editor in chief:

Biljana Angelova, Ph.D. (Institute of Economics - Skopje, Macedonia)

Editorial Board:

Biljana Angelova, Ph.D. (Institute of Economics - Skopje, Macedonia)

Diana Boskovska, Ph.D. (Institute of Economics - Skopje, Macedonia)

Natasha Daniloska, Ph.D. (Institute of Economics - Skopje, Macedonia)

Vasile Dinu, Ph.D. (Academy of Economic Studies, Bucharest, Romania)

Angelo Manaresi, Ph.D. (Alma Mater Studiorum - University of Bologna, Italy)

Maja Micevska Scharf, Ph.D. (Netherlands Interdisciplinary Demographic
Institute, The Hague, Netherlands)

Goran Penev, M.Sc. (Institute of Social Sciences, Belgrade, Serbia)

Ivan Tchalakov, Ph.D. (University of Plovdiv, Bulgaria)

Secretary of editorial board: Sretanka Gjorgjievska

Cover design: Koco Fidanovski

Computer preparation and printing: MAR-SAZ Skopje

UDK -CIP Catalogue record from National and University Library
"St. Kliment Ohridski"- Skopje

Address:

Institute of Economics-Skopje

Prolet 1

1000 Skopje

Republic of Macedonia

phone: +389 2 3115 076

fax: +389 2 3226 350

E-mail: eis@ek-inst.ukim.edu.mk

Published three times per year

Available on the websites: www.ek-inst.ukim.edu.mk

Abstracted/indexed in: **EBSCO** Publishing Database,
Central and Eastern European Online Library (**CEEOL**)

Price: 350,00 MKDenars; 15 EUR

The Ministry of Education and Science of the Republic of Macedonia has financially participated in printing the journal. In accordance with the decision No.07-3266/20 as of 11 July 1999 by the Ministry of Finance of the Republic of Macedonia, a reduced tax rate has been paid for publishing "Economic Development".

CONTENTS

Biljana Angelova, Blagica Koleva

THE ROLE OF INTERNAL AUDIT IN RISK MANAGEMENT
SYSTEM OF THE COMPANIES

(Original scientific paper)(1-10)

Tatjana Petkovska, Biljana Jovanović

EXPORT AND FOREIGN TRADE COMPETITIVENESS IN THE
REPUBLIC OF MACEDONIA

(Original scientific paper)(11-28)

**Vasil Popovski, Mirjana Borota Popovska, Marija Topuzovska
Latkovikj**

FIRM'S INNOVATIVENESS PERFORMANCE AS A MATTER OF
STRATEGIC DETERMINATION: MISSION STATEMENT
INNOVATION VALUE

(Original scientific paper)(29-46)

**Marija Ackovska, Neda Petroska- Angelovska, Marija Magdinceva-
Sopova**

POSSIBILITIES FOR DEVELOPMENT OF AGRO-TOURISM
AND GASTRONOMIC TOURISM IN THE REPUBLIC OF
MACEDONIA

(Original scientific paper)(47-62)

Diana Boskovska, Biljana Angelova, Vesna Georgieva Svrčinov

SIMPLIFIED CUSTOMS PROCEDURE IN THE REPUBLIC OF
MACEDONIA AND IT'S FISCAL EFFECT

(Original scientific paper)(63-76)

Klimentina Poposka, Elena Mihajloska

FINANCING START-UPS AFTER THE 2008 FINANCIAL CRISIS
IN THE EUROPEAN UNION: OVERVIEW OF PRACTICES IN
SWEDEN

(Original scientific paper)(77-92)

Zoran Janevski, Elena Davitkovska, Vladimir Petkovski

BARRIERS OF IMPLEMENTING OPEN INNOVATIONS IN
MACEDONIAN SMEs
(Original scientific paper)(93-106)

Elizabeta Djambaska, Aleksandra Lozanoska

CAPITAL EXPENDITURES AND THEIR IMPORTANCE FOR
THE ECONOMIC GROWTH IN THE REPUBLIC OF
MACEDONIA
(Original scientific paper)(107-120)

**Vesna Georgieva Svrtinov, Diana Boskovska,
Aleksandra Lozanoska, Olivera Gjorgieva Trajkovska**

EURO ZONE DEBT CRISIS: THEORY OF OPTIMAL
CURRENCY AREA
(Original scientific paper)(121-136)

Zoran Janevski, Gabriela Zafirovska

THE USE OF NONVERBAL COMMUNICATION IN
ENTREPRENEURIAL CONTEXT
(Original scientific paper)(137-148)

Katerina Hadzi Naumova- Mihajlovska, Natasha Daniloska

SWOT ANALYZES FOR IMPLEMENTING THE CONCEPT OF
TQM AS WAY OF WORKING IN ASSOCIATION'S PRODUCERS
OF ORGANIC PRODUCTS IN REPUBLIC OF MACEDONIA
(Original scientific paper)(149-162)

Iskra Stancheva Gigov, Darko Bezanoski

INNOVATION AND ITS PERSPECTIVES IN REPUBLIC OF
MACEDONIA
(Original scientific paper)(163-176)

Marko Andonov, Zoran Mihajloski, Elena Davitkovska, Vesna Goceva

MAIN CHALLENGES IN THE IMPLEMENTATION OF
REGIONAL DEVELOPMENT IN THE REPUBLIC OF
MACEDONIA

(Original scientific paper)(177-194)

Marika Baseska Gjorgjieska, Tatjana Petkovska Mirchevska, Dusica Nedelkoska

THE IMPLEMENTATION OF PSYCHOGRAPHICS IN
CUSTOMERS' LIFESTYLE DETERMINATION: THE
MACEDONIAN FURNITURE MARKET

(Original scientific paper)(195-210)

Marjan Bojadjiev, Ninko Kostovski, Katerina Buldioska

LEADERSHIP STYLES IN COMPANIES FROM REPUBLIC OF
MACEDONIA

(Original scientific paper)(211-222)

Evica Delova Jolevska, Ilija Andovski

RETAIL LOANS IN THE BANKING SYSTEMS OF SERBIA,
CROATIA AND MACEDONIA WITH SPECIAL EMPHASIS OF
RETAIL PORTFOLIO OF MACEDONIAN BANKS

(Original scientific paper)(223-240)

Ilija Gruevski, Stevan Gaber

CLASSICAL CORPORATION TAX SYSTEM: THE CLASSICAL
MODEL OF PURE "DOUBLE" TAXATION OF COMPANY'S
INCOME

(Original scientific paper)(241-254)

Nikolche Jankulovski

DISPARITIES AMONG REGIONS AND THE REGIONAL
DEVELOPMENT- CASE OF REPUBLIC OF MACEDONIA

(Original scientific paper)(255-276)

Gligor Bishev, Tatjana Boshkov

EXPORT-LED GROWTH IN SEE6 – FACTS AND
RECOMMENDATIONS: THE CASE OF REPUBLIC OF
MACEDONIA

(Professional paper)(277-306)

Natasha Daniloska, Katerina Hadzi Naumova Mihajlovska

RURAL TOURISM AND SUSTAINABLE RURAL
DEVELOPMENT

(Professional paper)(307-320)

Jadranka Mrsik, Danica Vukovic Trpkov

THE CUSTODIAN BANKS AND THE EVOLUTION OF THE
EMERGING CAPITAL MARKETS: THE CASE OF MACEDONIA

(Professional paper)(321-334)

Mimoza Serafimova, Zlatko Jakovlev, Cane Koteski

INTRA-ENTREPRENEURSHIP MANAGEMENT IN TOURIST
ORGANIZATIONS IN THE EAST REGION OF R. MACEDONIA

(Professional paper)(335-346)

Vera Zelenović, Nenad Vunjak, Vera Mirović

MONEY LAUNDERING IN SERBIA

(Professional paper)(347-366)

Maja Panova, Kiril Postolov

UNCONVENTIONAL METHODS FOR SELECTING HUMAN
RESOURCES- POLYGRAPH AND HONESTY (INTEGRITY)
TESTS

(Professional paper)(367-378)

Snezhana Hristova, Jelena Tast

THE EMERGENCE AND SIGNIFICANCE OF LOCAL
ECONOMIC DEVELOPMENT

(Reviews)(379-398)

Authors` guidelines(399-400)

Editing instructions.....(401-404)

Dear reader,

"Economic Development", published by the Institute of Economics – Skopje, is an academic journal in the field of economic development and has been an important medium for 14 years. The main goal of "Economic Development" is to provide intellectual platform to the wider academic and professional publics, and promote the development of economic thought in the country and the world. The interest and need for publishing of the journal were continuously increased all these years

On the path of development of the economic thought and building a wide network of research and professional cooperation with other countries in the world, we set new goals, criteria and challenges in order to improve the journal's quality. In this regard, during 2010 and 2011, significant changes have been made in editorial policy, design and its availability to broader academic and professional public in the region and worldwide. As result of all this changes, starting from no.3/2010 "Economic Development" will shift into international journal, will be published in English language and will be distributed in all countries of the region and worldwide.

This academic journal covers theoretical and empirical researches in the field of economic and social development, demography, education, corporate governance, international economics, international management, administrative management, corporate and public finance, economics and tourism management, agricultural policy and agricultural management, marketing and marketing management, entrepreneurial management and other areas in the field of social sciences.

The journal "Economic development" has an open approach in accepting and publishing the papers reviewed by an international editorial board consisting of three domestic and five foreign experts. The journal is available in print and online form, through the database of academic papers published by the Institute.

Skopje, May 2015

prof. Biljana Angelova, PhD
Editor-in-chief

UDC 657.6-051-057.3]:005.52:005.334(497.7)
Original scientific paper

Biljana ANGELOVA¹⁾
Blagica KOLEVA²⁾

THE ROLE OF INTERNAL AUDIT IN RISK MANAGEMENT SYSTEM OF THE COMPANIES

Abstract

Taking into consideration the need and the requirements of the management, as well as the structure and the size of the company and its business, there are differences in the internal audit as well. Except the analysis of the accounting data, the verification for compliance with the law, detecting errors and illegal operations, the internal audit is increasingly directed towards the process of risk management to meet the demands of the business uncertainty and to enable the management for appropriate business decision making.

The subject of the research is the role of the internal audit in the risk management of a company, while **the purpose** of the research is to examine and evaluate the contribution of the internal audit in the management of risks in the Macedonian enterprises. For these purposes, a research was conducted in 30 Macedonian enterprises during which their managers / heads were surveyed as well as 48 internal auditors on the territory the Republic of Macedonia. The research has led to the conclusion that internal audit has a significant impact on improving the quality in the process of risk management.

Key words: risk management, internal audit, contribution, operation scope, responsibility.

JEL classification: M4, M41, M42, M48

¹⁾ PhD, "Ss. Cyril and Methodius University" in Skopje, Institute of Economics – Skopje, Republic of Macedonia, e-mail: angelova@ek-inst.ukim.edu.mk

²⁾ PhD, University "Goce Delcev", Faculty of Economics, st."Krste Misirkov" 10-A, 2000, Shtip, Republic of Macedonia, e-mail: blagica.koleva@ugd.edu.mk

Introduction

The need for organizing internal audit in the enterprise is designed for unstable operating environment, growth and development of the enterprise, business risks that the company faces with and many other factors. The task of the internal audit is an examination of the business transactions and evaluation of the realization of the set plans and objectives i.e. an evaluation of the system for internal control and management in order to improve the operation of the enterprise. The internal audit must be conducted in an independent and objective manner. Depending on the organizational positioning in the enterprise, the quality of work of internal audit is different. According to the International Standards of the Professional Practice on the Institute of Internal Auditors, the internal audit should be organized independently, out of the business functions in order to ensure full independence of the internal audit in determining the scope of activities, work performance and result announcement. The internal audit has a particularly important role in the risk management of enterprises with which this work is going to continue to deal with and for which purpose an empirical research in Macedonian companies was conducted.

1. Approach and operation scope of internal audit in enterprises

Managing in the process of internal audit contributes to more efficient decision-making and because of that the areas of operation should be as broad as possible despite the examination of the accounting data which include checking the compliance with the law, evaluation of financial risks, detection of criminal activities and mistakes etc. However, depending on the needs and the requirements of management, as well as the structure and size of the enterprise, the scope of the internal audit is different. The internal audit usually performs one or more of the following activities: a review of the accounting system and the systems of the internal controls; examination of the financial and business information (identification, estimation, classification and reporting on those information); examination of the efficiency, effectiveness and economy of the business decisions; examination of the compliance with the law and professional regulations, as well as the policy management. In order to respond effectively to the demands of the management, the internal audit uses different approaches in the implementation of the

activities. To impose the pace of work, the uncertainty and the size of the business operations, the internal audit leads to selecting a suitable approach for a certain area of operation. The internal audit can use the following approaches:

- The approach overcorrections refers to the reviewed documentation based on which the business events are recorded and financial statements are compiled, overcorrections by the internal audit (eg. overcorrections of the inventory in the enterprise).
- The approach verification requires a review of the financial statements and all the business activities as well as determining the compliance with the established standards and procedures.
- The system approach is based on the synthesis and the upgrade of the previous two approaches, and can be applied to all the activities of the internal audit. It implies assessing of the officially established system based on the remarks of the internal audit or the examination of the employees. After that the system approach determines whether the established system is functioning correctly by conducting various tests, questionnaires and similar. Finally, based on the reports of the internal audit a comparison with the previously performed internal control is carried out, with which the function of the internal controls themselves is also examined, as well as the disadvantages and weaknesses of the established systems.
- The cyclic approach refers to the classification of transactions within a certain cycle and requires knowledge of the flow of transactions and the ways of controlling.
- The approach for risk assessment is an approach which is increasingly used as a consequence of the turbulent operation full with uncertainties and dangers. Adapting to the modern way of working, the internal audit evaluates all the risks of the operation in the enterprise and provides an advisory role in managing and reducing the risks for a smooth operation of the enterprise.
- The matrix approach uses a tabular view of the important decisions, solutions and possibilities for choice which ensure visibility and comparability.

The application of the above given approaches provides the internal audit a proper assessment of the business activities, as well as a guidance for further action in order to increase the additional value and to improve the operation of the enterprise.

2. Internal audit in the process of risk management in enterprises

The complex environment in which the enterprise operates requires an analysis of the previous and current condition as well as a prediction of the future movements. Whether the enterprise will successfully realize the set goals in the changed operating environment, will seize new opportunities for achieving additional value and will avoid potential hazards that are present on the markets depends on the risk management of the company. The internal audit directs more towards the risk management process in order to ensure that the management brings appropriate business decisions. In fact, it is necessary to understand the risk as a potential danger that could endanger the implementation of the set plans. However, if it is identified on time, except that it can be removed or at least mitigate the negative effect, sometimes the potential danger can turn into a competitive advantage which leads to additional profits. Risk management has become essential in modern business. The existence of a process for risk management is separated from the establishment of the internal audit in the enterprise, which means that enterprises that do not have organized internal audit can manage risk. The internal audit is present in risk management through examining the process used for risk management in order to reduce risk at a level acceptable for the company.

After the goals set by the management, the internal audit identifies all risks that are a threat to the operation of the enterprise. Determining the level of risk that is acceptable for the enterprise is an obligation and responsibility of the management, while internal audit provides useful information and suggestions which help the management in decision making. The main role of the internal audit in the risk management of the enterprise refers to the following activities: "providing assurance for the processes of risk management, providing assurance for the regularity of the risk assessment, evaluation of the process for risk management, evaluation of the reports on key risks and evaluation of the method for managing key risks." If the established processes for risk management do not identify, evaluate and manage risk in an appropriate and efficient manner, the secondary role of the internal audit is found in providing advice and recommendations to the management regarding the identification and evaluation of risks, improvement of the process for risk management, proposing a strategy for risk management and similar. Under no circumstances the internal

audit should make decisions on risk management independently, or take responsibility for it. The enterprise management is the one that determines which strategy the company will use to defend against potential risks for which it bears responsibility.

3. Stages of the process for risk management in enterprises

The process of risk management starts with identification of the risk. During the identification of the risk, the internal audit includes an analysis of the risks that can affect the value of the enterprise, no matter whether it is from a physical, financial, human or non-material value. Then, the internal audit needs to analyze the environment which can affect the fulfillment of the given operations and assess the risk of fraud or accident, with which also contributes to the creation of plans to prevent crime. The conditions for the second and the third step of the process for risk management is the identification of the risk, after which it is necessary to measure the risk. In order the internal audit and the management to know what the defined risk specifically means for the enterprise, a measurement of the risk of certain methods is conducted (direct evaluation of probability, risk factors, weighted matrix, etc.). The measured risk needs to be ranked in order the management to plan business activities on whose realization the defined risk impacts. The systematization of the risk can be done in three ways: absolute systematization which involves classifying risks according to the size; relative systematization which groups risks in low, medium and high risks, and the matrix systematization which places the greatest risk at the top and the components of the control unit at the sides. Although there is no universal solution for effective risk management, it is required a knowledge in a phase of the process of risk management, methods and techniques of risk management, communication skills, interviewing and objective analysis from the internal audit. Thus it is contributed to reducing the risk on a level acceptable to the enterprise through an appropriate set process for risk management.

4. Results

In 2014 a research was conducted on a total of 30 companies and 48 internal auditors in the Republic of Macedonia. The following table

gives an overview of the activities of the internal audit on the enterprises which were analyzed.

Table 1: Activities of internal audit

Activities of internal audit	Percent	Rank
Assessment of the performance (operation) of the enterprise	88.9%	1
Assessment of the compliance with the law	75.1%	2
Assessment of the financial risks	71.6%	3
Detection of errors and illegal activities	71.2%	4
Assessment of the effectiveness of the internal control system	68.8%	5
Contributions to Corporate Governance	44.5%	13

Source: Author's research.

According to results of the survey, a total of 88.9% of enterprises think that the most important activity of internal audit is the assessment of the enterprise operation. According to the importance the following activities are given: activities for assessment of the compliance with the law (75.1%), assessment of the financial risk (71.6%), detection of errors and illegal activities (71.2%) and assessment of the effectiveness of the system for internal control (68.8%).

To test the existence of differences in views of the respondents from the Macedonian enterprises, average scores for each category of respondents are calculated (managers of enterprises and internal auditors) in terms of contribution of the internal audit to the quality of the process for managing the risks of the enterprise. In this survey the Likert scale was applied.

Table 2: Average assessment of the respondents for the contribution of the internal audit in the quality of the process for risks management.

Group of respondents		F	As	Sd
Contribution of the internal audit in the quality of the process for risks management	Internal auditor	48	3,81	0,842
	Manager	30	3,93	0,907

Source: Author's research.

The arithmetic mean, or the average assessment of the internal auditors is 3.81 with a value of a standard deviation $sd = 0.842$, and the arithmetic value of the managers is 3.93, with a value of a standard

deviation of 0.907. In order to test the differences of the average estimations of the respondents a t-test for independent samples is applied.

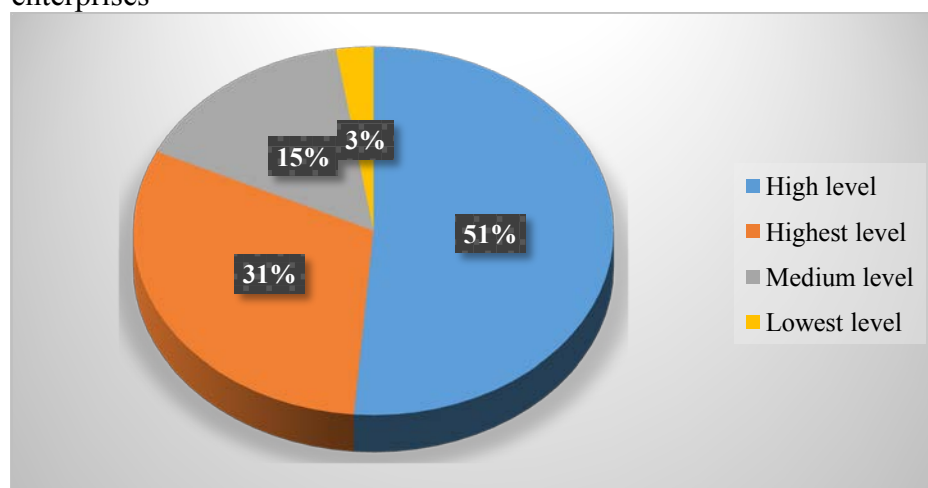
Table 3: Testing differences in average assessments of the respondents for the contribution of the internal audit on the quality of the process for risk management - t-test for independent samples

	Levand test for equality of variance		T-test for equality of arithmetic means						
	f	Sig	t	df	Sig (2-way)	Diffe- rence of AS	Standard error of differences	95% interval of confidence of differences	
								Up	Down
Assumption for equal variances	0,032	0,858	-0,599	76	0,551	-0,121	0,202	-0,523	0,281
Assumption for unequal variances			-0,588	58,215	0,559	-0,121	0,205	-0,532	0,290

Source: Author's research.

According to the given results (see Table 3), with an assumption for an equal variance, the value of the empirical $t = -0.559$, for an empirical difference of significance of 0.551 (bigger than 0.05). Hence, we can conclude that the average assessment of the respondents has no statistically significant difference. So considering that, it can be pointed out that all of the respondents from the research sample believe that internal audit significantly contributes to the quality in the process of risk management in enterprises.

Chart 1: Involvement of the internal audit in the activities for risk assessment as a phase of the process for risk management and internal audit contribution to the quality of the process for risk management in enterprises



Source: Author's research.

Aimed at respondents' attitudes about the involvement of the internal audit in the activities for risk assessment as a phase of a process for risk management and an internal audit contribution to the quality of the process of risk management in the enterprises, the following conclusions have been drawn: respondents in whose enterprises there is an active involvement of the Internal Audit Department in the risks assessment, as a phase of an overall process of risk management, consider that the internal audit significantly contributes to the quality of risk management taking also into account that more than half (51.3%) consider that internal audit contributes on a high level to the quality in the process, 30.8% believe that the contribution is on the maximum level. Smaller proportion of respondents (15.4%) believe that the internal audit

contributes to this process of a medium level, while only 2.5% believe that the impact of internal audit is insignificant.

Conclusion

In every day operations the Macedonian enterprises are exposed to numerous risks. The objectivity and the independence of the work of the internal audit among other things, depends on the organizational positioning of the internal audit in the enterprise. The risk management in the enterprises is considered as a necessary "tool" in the process of their survival. The research of the role of internal audit in the risk management in the enterprises occurs as a result of the involvement of internal audit in the activities for risk management in the enterprises, i.e. on the process of internal audit itself. The responsibility of the internal audit refers only to express the opinion on the effectiveness of the applied method for risk management, while the establishment of a process for managing risks as well as making decisions regarding the elimination of the disadvantages and improvement of the process of risk management, is a responsibility for the management. The survey included a total of 78 respondents, internal auditors and managers. According to the conducted survey it can be pointed out that internal audit can significantly contribute to improving the quality in the process for risk management of companies, and therefore its role has greatly influenced the overall operation of the Macedonian enterprises.

References:

1. Andric, M., Krsmanovic, B., Jaksic, D., AUDIT – theory and practice, Becej, Proleter, 2004.
2. Auditing Handbook, Volume 2 of the Accounting and Auditing Handbook, The Institute of Chertered Accountants in Australia, Prentice Hall, 1992.
3. Andrew D. Chambers, Georges Selim, G. Vinten, "Internal Auditing", London, 1987.
4. Hayes, R., Schilder, A., Dassen, R., Wallage, P., *Principles of Auditing - An International Perspective*, Banja Luka, Association of Accountants and Auditors, 2002.

5. Hein D. Cheril, Holt E. Paul: „International Accounting”, Houston, 1998.
6. McNamee, D., Selim, G. M., *Risk management: Changing The Internal Auditor's Paradigm*, Florida, The institute of Internal Auditors Research Foundation, 1998.
7. The Institute of Internal Auditors Research Foundation, Professional Practice of Internal Auditing., Association of Accountants and Auditors, 2006.
8. Tusek, B., Pokrovac, I., *A research of internal audit in the risk management process in Croatia*, "Collections of the Faculty of Economics in Zagreb", Zagreb, Faculty of Economics, 2009.
9. Vitorovic, B., *Internal controls and internal audit*, Association of Accountants and Auditors of Serbia, 2004.
10. International Auditing Guidelines and statements on Auditing, IFAC, New York, INTOSAI Auditing standards, International Organization of Supreme Audit Institutions, June, 1992.

UDC 339.137(497.7)
339.564(497.7)
Original scientific paper

Tatjana PETKOVSKA¹⁾
Biljana JOVANOVIĆ²⁾

EXPORT AND FOREIGN TRADE COMPETITIVENESS IN THE REPUBLIC OF MACEDONIA

Abstract

Competitiveness is one of the most popular concepts in contemporary macroeconomics. Having a competitive advantage on the targeted market means higher profit on a micro level and higher growth and living standard on a macro level. Competitive advantage is one of the key instruments for faster integration of the national economy in the global market that, in turn is expected to lead to higher exports and higher overall growth and long-term prosperity of the national economy. External trade and integration in the world market are especially important for small and open economies such as the Republic of Macedonia. Domestic companies will need to internationalize their production and business activities in order to be able to sell and to compete on the world market. The goal of this study is to provide insight about the competitive position of the Macedonian economy, to identify some of the weakness in this area and to propose some guidelines for the policy makers. Today, economy with competitive advantages and strong external sector can withstand the challenges of the constantly changing global environment, thereby providing strong economic growth and higher living standard for its citizens.

Key words: competitiveness, competitive advantage, real effective exchange rate, export, import, external trade.

¹⁾ PhD, University Cyril and Methodius – Skopje, Institute of Economics – Skopje, Republic of Macedonia, e-mail: tanja@ek-inst.ukim.edu.mk

²⁾ Head of Real Sector Developments Unit Monetary Policy and Research Department, National bank of the Republic of Macedonia, e-mail: PetkovskaB@nbrm.mk

JEL classification: F41, F43

Introduction

Transformation of the Republic of Macedonia after disintegration of Former Yugoslavia required higher external openness of the Macedonian economy, as well as successful integration in the international movements of labor and international trade. To do so the country has to improve its external competitiveness. There are certain preconditions that must be met as a support for these processes. Namely, the economy has to be transformed into an open national economy with all the mechanisms to provide free movement of the economic subjects on the international goods', services', technology's and capital markets. The economic agents must have business independence, market flexibility, as well as responsibility for their success or failure.

Economic theory predicts (and this is, also supported by practical experience) that in small and open economies the external sector and exports have an important impact on their growth performance. The Republic of Macedonia is small economy with a population of two millions. With this size, left alone, the Republic of Macedonia is unable to take advantage of the economies of scale; to enhance growth and prosperity the Republic of Macedonia must implement a growth strategy based on export. Export expansion is an efficient mechanism to improve performances of the domestic companies, increase their flexibility and to support external debt servicing by providing higher inflows of foreign capital. Additionally, the true picture for the efficiency and competitiveness of the national economy can only be tested on the international market.

This study starts with a discussion of the definition on competitiveness and competitive advantages. In the second section we analyze the competitiveness of the Macedonian economy by looking at two indicators – the real effective exchange rate and the global index of competitiveness. Additionally, we present an overview of the export and import structure in order to identify the key weakness in the external sector. The theoretical predictions and the data analysis in the second section expected to provide solid foundation for formulating guidelines and recommendations for competition policies and future improvements of the competitive position of the Macedonian economy.

1. Competitiveness and competitive advantages – definition and characteristics

There are many formal definitions of the term competitiveness. In developed countries competitiveness is closely associated with growth dynamics³. The academic definition of IMD World Competitiveness Center states that competitiveness “analyzes the facts and policies that shape the ability of a nation to create and maintain an environment that sustains more value creation for its enterprises and more prosperity for its people” (S. Garelli, *The Fundamentals and history of competitiveness*, IMD World Competitiveness Yearbook 2009). According to OECD, international competitiveness is a measure of a country's advantage or disadvantage in producing and selling its products in international markets, in order to sustain or increase the real income of the population. International competitiveness is connected with the country's ability to sustain and/or improve its share in the global market by following international standard for efficiency and quality of the products (Velloso, J.P.R., *International Competitiveness and Creation of an Enabling Environment* 1991). Competitiveness depends upon country's capacity to export its products, to use its resources efficiently and to increase the productivity and living standard of its citizens (Haque, *I.U.I International Competitiveness: Interaction of Public and Private Sectors*, Washington, D.C.: World Bank, 1991).

One of the most cited definitions of competitiveness is the World Economic Forum that “competitiveness is set of institutions, policies, and factors that determine the level of productivity of a country”⁴. In turn, “the level of productivity sets the level of prosperity that can be earned by an economy”. Defined in this way, competitiveness is directly related to the capacity of the economy for generating and sustained growth in the long-run. In other words, it is expected that more competitive economies will tend to have higher growth rates. Many factors influence the competitive position of a country such as labor, human capital and education, investment and technology, macroeconomic environment and stability, innovation, institutions etc.

Competitiveness can be analyzed on three levels – macro, mezzo and micro. On a macro level competitiveness is the ability of a country to

³ Kovačević, M., *Faktoji konkurentnosti domaćih preduzeća na inostranom tržištu*, Tržište, novac, kapital, Beograd, br.3 / jul-septembar 2005.

⁴ *World Economic Forum*, <http://www.weforum.org/> (20.04.2014)

produce and distribute goods and services on the international markets and to compete with the goods and services produced by other countries, which will, ultimately, enhance the living standard of its citizens⁵. The mezzo aspects of competitiveness refer to the competitiveness between economic sectors in a country, whereas the micro aspects are connected with the ability of domestic companies to compete, grow and increase profitability on the market. In essence, these three levels are interconnected. Higher competitiveness of the companies leads to higher competitiveness of the sector and to better competitive position of the economy as a whole. The opposite also holds. Competitiveness is a combination of the performances of companies, sectors and the economy as a whole; in a way it is an aggregate indicator for the international rating of a country. Interconnection between different levels of competitiveness has been acknowledged by UNCTAD as “the ability of the national economy to export is a result of the success of its companies, their dynamics and their ability to compete, as well as from the complex set of structural parameters of the environment in which they are working”⁶.

When it comes to competitiveness one cannot surpass the contribution of Michael Porter. According to him, the fundamental economic goal of every national economy should be to increase long-term growth and to provide higher living standard for its citizens⁷. This goal is largely determined by the productive use of the resources, i.e. the labor and the capital. From here, he concludes that it is wrong to define competitiveness at a national level. Instead, one should look at the specific sectors in the economy, as well as at their sub-sectors. In order to give answer for the competitive advantages that one firm has as opposed to the other domestic and foreign firms, Porter postulates the theory of competitive advantages less formally known as the Porter’s “diamond” of competitiveness. The “diamond” of competitiveness consists of four fundamental factors that determine the competitive advantages of the economic sectors of one country – factor conditions; demand conditions; related or supporting industries; and firm strategy, structure and rivalry.

⁵ Milisavljević M., Todorović J., *Marketing strategija*, Univerzitet u Beogradu, Ekonomski fakultet, 1995, str.127.

⁶ UNCTAD, *Trade and Development Report 1987*, Geneva, 1987.

⁷ Kovačević, M., 2004. *Dugoročne tendencije, stanje i ograničenja rasta konkurentnosti privrede i izvoza Srbije*. Ekonomski anali: Savetovanje ekonomista, privrednika i bankara „Ekonomsko finansijski odnosi – Konkurentnost privrede i izvoza”. Beograd, 16. i 17. septembar 2004, str.39.

According to Porter, companies can gain competitive advantage by using a combination of factors from domestic environment embodied in the “national diamond”.

Competitive advantage refers to the ability of the company to outperform other companies in the same industry or market in order to accomplish its pre-defined goals. In other words, competitive advantage is a combination of factors that allow the company to gain a unique market position, superior compared to the other firms. In a world of dynamic changes and high degree of uncertainty on the global, as well as one the national markets, firms are actively searching for new factors of competitive advantages instead of relying solely on cheap labor and resources⁸. In other words, competitive advantage is a specific “answer” of the companies to constantly changing environment. Some of the factors that enhance firm’s ability to gain competitive advantage are: innovation and change; strong value system, adaptability and growth strategy that takes into account the principles of the global market⁹. All in all, a company that sells on the international market identifies its competitive advantages by matching its specific abilities with factors that are critical on the targeted market. At the moment when the company acquired specific abilities that are unique as compared to other companies on that market (other companies need to spend significant amount of time or finance to acquire such ability) the company has a competitive advantage on that market.

2. Competitiveness and external trade in the Republic of Macedonia

In this section we present an analysis of the competitive position of the Macedonian economy based on two indicators – the real effective exchange rate and the global competitiveness index constructed by the World Economic Forum. The purpose of the descriptive analysis is to provide overview of the current degree of competitiveness of the economy, to identify some of the weaknesses and to propose guidance for

⁸ Jović M., *Inovacioni aspekt strateške konkurentnosti*, <http://www.ien.bg.ac.yu/download/wp02-02pdf> (15.02.2012)

⁹ more detailed in: Петковска Т.” *Иновациите - значаен фактор за унапредување на конкурентноста на малиите и средни претпријатија (МСП)*” paper published in” Научен собир, Зборник на трудови: Претприемништво - иновации и конкурентност”, Економски Институт - Скопје, Скопје 2008, стр.22.

future policies. Having in mind the interconnection between competitiveness and external sector we close the section with a discussion for the structure of the exports and imports of goods.

2.1. The Real Effective Exchange Rate

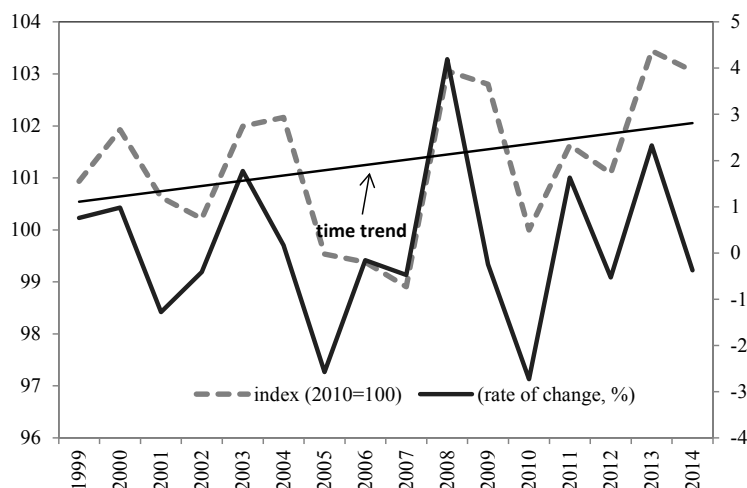
The real exchange rate is an indicator for the undervaluation/overvaluation of the national currency. If the national currency is undervalued that will have positive impact on competitiveness as domestic products will become cheaper for the foreigners and this will have positive impact on exports and growth. On the other hand, if the domestic currency is overvalued that will have negative consequences for competitiveness. The real exchange rate is defined as a ratio between domestic prices of tradable products and foreign prices. Domestic prices of tradable products are usually proxied by the consumer price index¹⁰.

When it comes to competitiveness it is more informative to look at the effective indicator i.e. the real effective exchange rate (REER) which is defined as the ratio between domestic prices and the prices of the most important trading partners of the country¹¹. Graph 1 shows movements in REER in the Republic of Macedonia for the period 1999-2014. REER is defined as a ratio between domestic and foreign prices; hence an upward movement means real appreciation of the domestic currency and it has a negative effect on competitiveness. In the period 1999-2014 there is a mild upward trend - the value of the REER index has increased from 101 to 103. Looking at the growth rates, they average rate of change is very close to zero (for the whole period average growth rate is 0.2%). In 2013 one can notice signs of real appreciation, but the intensity is very small. All this suggests that in the period under analysis movements in REER has largely been balanced. In economic terms this means that REER doesn't indicate any significant improvements or worsening of the competitive position of the Macedonian economy in the period 1999-2014.

¹⁰ Alternatively, REER can be calculated also by using the producer prices or unit labor costs.

¹¹ Јовановиќ Б., *Фактори на економскиот раст во транзициските економии, со посебен осврт на земјите од Југоисточна Европа и Република Македонија*, докторска дисертација, Економски институт – Скопје, Скопје, 2015, стр.221.

Graph 1: Real Effective Exchange Rate in the Republic of Macedonia in 1999-2014



Source: World Development Indicators database,
<http://data.worldbank.org/data-catalog/world-development-indicators>
(18.10.2015)

REER is one of the most widely used indicators for the competitive position of the economy. However, it will be wrong to draw conclusion regarding one country's competitive position solely relying on one indicator. Namely, as mentioned in the previous section competitiveness is a multidimensional concept, whereas REER gives information only for one aspect – the price competitiveness. Prices are important competitiveness factor, especially in countries with smaller income per capita as the market in these countries is more sensitive to changes in prices, as well as in markets with standardized product (such as the commodity markets). However, when it comes to more sophisticated products (product with higher degree of finalization) the importance of price as a competitiveness factor loses its significance, whereas the influence of the so-called non-price competitiveness factors becomes more important. Namely, in the last three decades the empirical literature concludes that non-price competitiveness factors such as quality of the product, shape, use, certainty, reliability, speed of delivery, guarantees, servicing¹² etc. are becoming increasingly important. The use

¹² Rakita, B., *Medjunarodne marketing strategije*, Konzorcijum Ekonomskih instituta Jugoslavije, Beograd, 1989, str.212.

of non-price competitiveness factors leads to greater flexibility of the business strategies of the companies, influences the preferences of the buyers and increases the demand for targeted products.

2.2. Global Competitiveness Index

Competitiveness is a complex combination of many characteristics of the national economy and therefore, as previously mentioned, one can not measure competitiveness only by using one indicator. This explains the existence of many methodologies, models and indicators constructed by different institutions aimed towards measuring, estimating and comparing competitiveness between different countries¹³. One of the most popular methodology for measuring competitiveness is developed by the World Economic Forum (WEF). The WEF methodology consists of many factors that determine the competitive position of a country and unlike other approaches, it starts from the micro level i.e. the economy is competitive if its companies are competitive on the world market.

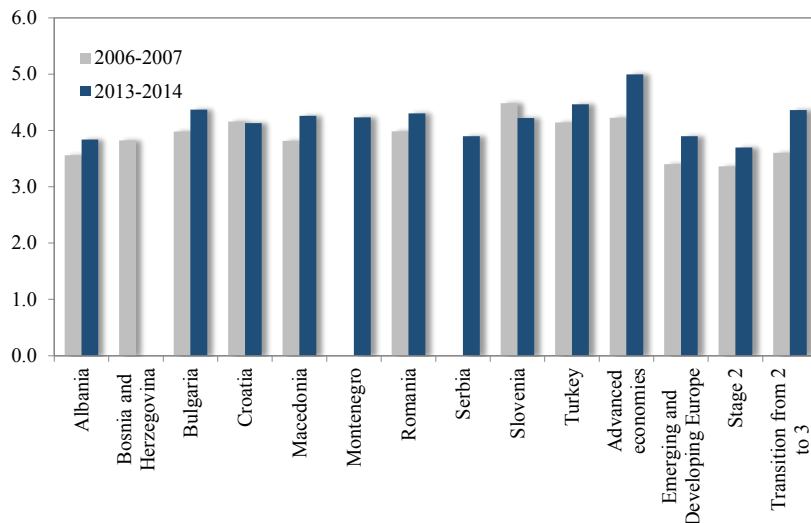
WEF global competitiveness index is a multidimensional indicator that captures different dimensions of competitiveness (unlike the REER index that was focused solely on price competitiveness). In a way, WEF index captures different stages of development of a country. Non-technically, the index describes the dynamics of the economic growth – at the beginning every country starts from stage one when growth is being determined by basic factors, then, in the second stage the country develops and invests, whereas in the third stage, in order to sustain and enhance growth, the country is focused on stimulating innovation and research. Following this argument, the WEF index separates countries into three stages: factor-driven, efficiency-driven, and innovation-driven, each implying a growing degree of complexity in the operation of the economy. Technically, the total index is weighted average of three sub-indices – index of basic requirements, index of efficiency enhancers and index of innovation and sophistication factors. The weights of these sub-indices are not equal for every country – they

¹³ Different methodologies might give different results and conclusion. Besides World Economic Forum, institutions that measure competitiveness and factors of competition are: World Bank (WB), European Bank for Reconstruction and Development (EBRD), International Institute for Management Development (IMD), National Competitiveness Council, Herritage Foundation. Indicators constructed by these institutions provide information on certain characteristics and dimensions of competitiveness.

depend on the country's stage of development. For example, if the country is classified to be in the factor driven stage where growth is generated by the basic factors, then the sub-index of basic requirements will have highest weight in the total index and, consequently it will have highest impact on its competitive position.

In 2014 Republic of Macedonia was ranked on place 63 (out of 144 countries) with a global competitiveness index of 4.3. Compared with the countries from the region this is relatively good competitive position (Graph 2). This score is in line with the regional average (4.2) and above the average values of the index for emerging and developing Europe (3.9) and for stage 2 economies (3.7). Analyzed through time, one can notice continuous improvement in the competitive position of the Macedonian economy as measured by the global competitiveness index. Namely, the value of the index has increased from 3.9 in 2006 to 4.3 in 2014, followed by an upward movement in the world competitive ranking of Macedonia - from place 84 (out of 122 countries) in 2006 to place 63 (out of 144 countries) in 2014.

Graph 2: Global competitiveness index in selected countries in the period 2006-2007 and period 2013-2014



Source: <http://www.weforum.org/reports/global-competitiveness-report-2013-2014>

Table 1 gives the WEF global competitiveness index and its rang, as well as the sub-indices for the Republic of Macedonia for the period 2006-2014.

Table 1: Global Competitiveness Index* of the Republic of Macedonia for the period 2006-2014

	2006	2007	2008	2009	2010	2011	2012	2013	2014									
	index	rang	index	rang	index	rang	index	rang	index	rang								
Global Competitiveness Index	3.9	84	3.7	94	3.9	89	3.9	84	4.0	79	4.1	73	4.3	63				
Basic requirements	4.4	69	4.2	72	4.4	68	4.3	73	4.4	70	4.0	69	4.5	71	4.6	70	4.6	64
1st pillar: Institutions	3.1	102	3.3	102	3.6	90	3.7	83	3.8	80	3.7	81	3.8	78	4.0	60	4.3	45
2nd pillar: Infrastructure	2.8	80	2.9	85	2.9	89	3.0	90	3.5	91	3.7	86	3.6	81	3.6	86	3.7	82
3rd pillar: Macroeconomic environment	5.0	40	5.0	53	5.5	31	4.8	49	4.9	47	5.3	37	5.0	47	4.9	59	4.9	55
4th pillar: Health and primary education	6.5	46	5.7	47	5.7	55	5.5	60	5.7	69	5.5	80	5.6	77	5.6	79	5.6	78
Efficiency enhancers	3.5	89	3.4	98	3.6	92	3.8	85	3.8	83	3.8	87	3.8	84	4.0	76	4.1	69
5th pillar: Higher education and training	3.9	67	3.5	75	3.8	73	3.9	70	4.0	72	4.0	80	4.0	81	4.2	76	4.3	71
6th pillar: Goods market efficiency	3.7	100	3.8	98	3.9	98	4.1	76	4.2	57	4.3	63	4.3	68	4.5	44	4.6	38
7th pillar: Labor market efficiency	4.1	103	3.9	112	3.9	113	4.2	86	4.4	71	4.3	72	4.1	94	4.2	79	4.2	71
8th pillar: Financial market development	3.6	74	4.0	83	4.0	83	4.1	75	4.0	87	3.9	82	4.0	79	4.1	62	4.5	41
9th pillar: Technological readiness	2.7	91	2.8	90	3.0	83	3.9	52	3.6	64	3.7	67	3.8	71	3.8	67	4.0	62
10th pillar: Market Size	2.1	92	2.5	106	2.7	104	2.9	103	2.8	106	2.8	107	2.8	104	2.9	109	2.9	108
Innovation and sophistication factors	3.2	86	3.1	101	3.2	105	3.2	93	3.2	97	3.1	104	3.1	110	3.4	94	3.5	76
11th pillar: Business sophistication	3.5	91	3.3	108	3.5	107	3.6	96	3.5	96	3.5	105	3.4	111	3.6	100	3.8	89
12th pillar: Innovation	3.0	79	2.9	92	2.9	99	2.9	92	2.9	97	2.8	105	2.8	110	3.1	86	3.3	68

* The Global competitiveness index moves for 1 to 7.

Source: The Global Competitiveness Report, World Economic Forum, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014 and 2015.

The analysis of the sub-indices shows that in the case of Republic of Macedonia the best ranking is scored in the area of basic requirements, whereas the worst in the area of innovation and sophistication factors. This is an expected result given that Macedonia has moved from the first stage in the second, efficiency driven stage. This result also gives some powerful implications for the policy makers. First, competition policies need to be focused on factors that promote competitiveness and growth in the second stage of development, such as investing in education and training, goods and labor market efficiency, financial market development, the ability to use the benefits of existing technologies and market size. Second, Republic of Macedonia will need to prepare for the transition from the second stage in the third stage of development. As seen from the table this is the area where Republic of Macedonia has weakest performance which doesn't come as a surprise in the current setting. However, it is important to start the preparation on time and to invest in policies that will promote sophisticated business practices and innovation.

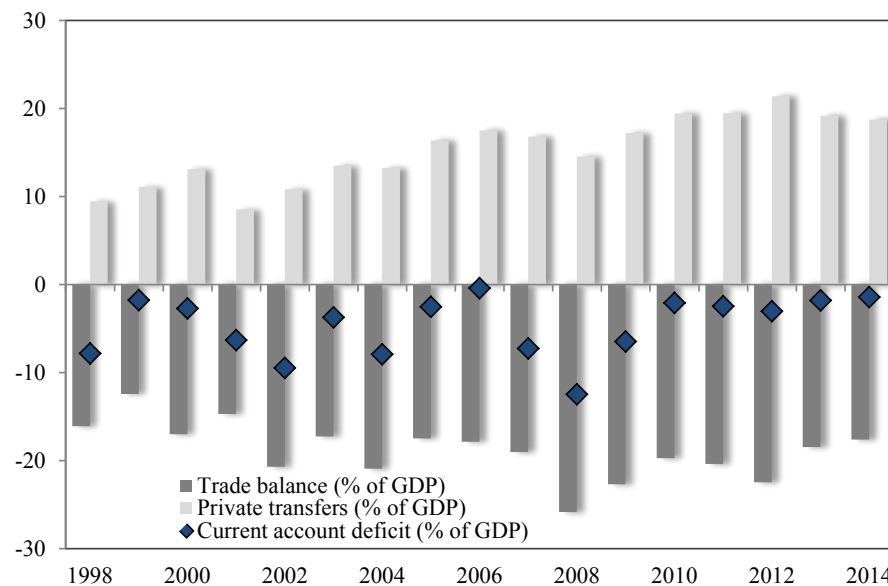
2.3. External trade in the Republic of Macedonia

Competitiveness and external trade are interconnected concepts – better competitive position of a country means higher exports, and consequently, better trade balance and smaller current account deficit. This explains why improvements in competitiveness are of great importance for small and open economies, with negative trade balance such as the Republic of Macedonia. In this section we present a descriptive analysis of the movements in the external sector in Republic of Macedonia, as well as analysis of the structure of Macedonian exports and imports of goods.

The average current account deficit in the Republic of Macedonia in the period 1998-2014 has accounted for 5% of GDP (Graph 3). The largest part of this deficit is explained by the negative trade balance, which, in the same period, is equal to, almost 19% of GDP (average value for the period). These characteristics make the external sector very vulnerable in case of large external shocks which in turn can produce huge external imbalances. For example, in 2008, the year before the start of the global financial and economic crisis, we saw large widening of the current account deficit and significant increase in the negative trade balance. Trade balance accounted for 26% of GDP in 2008 and this was explained by increase in domestic demand and consequently, increase in

imports that was not followed by increase in exports with the same intensity. This situation outlines how important are improvements in competitiveness and changes in the external trade structure for the sustainability of the current account balance, as well as for the overall economic stability and growth in the country.

Graph 3: External sector in the Republic of Macedonia in the period 1998-2014 – main indicators



Source: National Bank of the Republic of Macedonia and State Statistical Office.

The average growth rate of exports of goods for the period 1998-2014 is around 10%. Macedonian companies are exporting mainly in the EU countries and in the region. Namely, statistical data shows that among the ten most important exporting partners of the Macedonian companies, whose average share in total exports for the period 1998-2014 is around 70%, the only country outside the region is the United States¹⁴. Closer analysis of the data reveals changes in trends among separate countries. First, one can notice a decline in the share of Greece over the period – Greece was contributing with 15% in the total exports

¹⁴ Ten most important trading partners on the export side are Germany, Serbia, Montenegro, Greece, Italy, Netherlands, United States, Croatia and Switzerland. Source: National Bank of the Republic of Macedonia.

in 2006 and with only 4.6% in 2014. The second more significant change in the structure of the trading partners is the decline in the share of Serbia (from 19% in 2007 to only 5% in 2014). However, this change is mainly statistical – up until 2009 export in Serbia was also including exports to Kosovo. Starting from 2009, after proclamation of Kosovo independence, Kosovo is included in the category “export to other countries”. This change can be clearly seen in the data – in 2009 there is a significant fall in the share of Serbia and increase in the share of the “other countries”¹⁵.

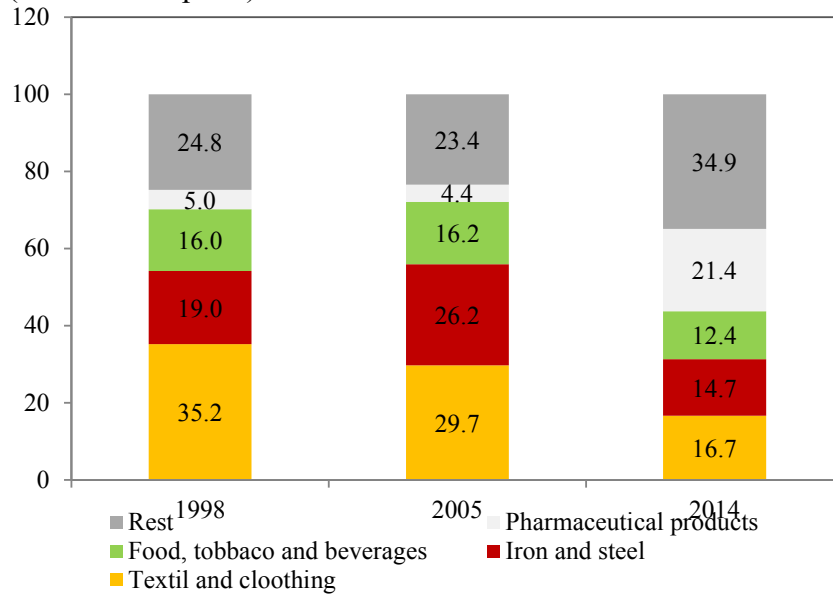
When analyzing trends in exports in Republic of Macedonia, special attention needs to be devoted to the sectoral structure of the exports. Namely, data shows high degree of concentration of exports in three sectors – “food, tobacco and beverages”, “iron and steel”, and “textile and clothing” (Graph 4). Starting from 2010 there is an increase in the share of pharmaceutical products and this is explained by an entry of a new foreign company in this sector (“*Johnson Matthey*”). High degree of concentration of exports in only few sectors whose performance, in turn, depends heavily upon movements in the world prices and external demand, has negative influence on economy’s ability to adjust and absorb negative external shocks. The episode in 2008/2009 provides a good overview of the negative consequences for the domestic economy and growth. Besides high concentration, additional problem with Macedonian export is decline in attractiveness of some of the key Macedonian exporting sectors on the world market. Namely, World Trade Organization (WTO) data shows that the share of exports of iron and steel in the world export has declined from 3% in 2005, to 2.6% in 2012, whereas the share of textile has declined from 1.9% in 2005 to 1.5% in 2012¹⁶. This means that, in the future, we might see decline in the external demand for our products and consequently lower export growth rates.

¹⁵ Source: National Bank of the Republic of Macedonia and own calculations.

¹⁶ World trade organization,

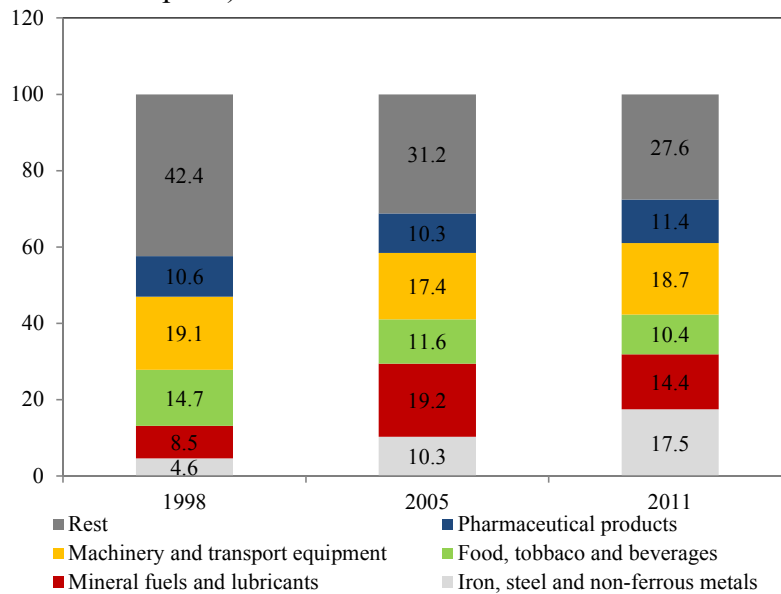
http://www.wto.org/english/res_e/statis_e/tradebysector_e.htm (20.04.2014)

Graph 4: Exports of goods in Republic of Macedonia
(% of total exports)



Source: National Bank of the Republic of Macedonia and own calculations.

Graph 5: Imports of goods in Republic of Macedonia
(% of total imports)



Source: National Bank of the Republic of Macedonia and own calculations.

The average growth rate of imports of goods for the period 1998-2014 is around 10%. Analysis of imports of goods by main trading partners shows higher diversification in comparison to exports; however, as in the export case, the main trading partners are the EU countries and countries from the region. Additionally, Russia appears on the list of the most important partner countries¹⁷ which is explained by the high import of crude oil and oil derivatives given the fact that Republic of Macedonia is not oil producing country. This is also the main reason why the sector “mineral fuels” appears among the most important sectors on the import side (Graph 5). Besides this sector, the export and import sectoral structure look quite similar. Sectors “food, tobacco and beverages”, “iron and steel”, and “textile and clothing” that dominated the exports structure, account for one third of the total imports. The appearance of same sectors as dominant on the export and import side points out to high import-export dependence of the external trade of the Republic of Macedonia. Second problem that can be identified when analyzing the import structure is that Macedonian economy is highly dependent on imports of crude materials and imports of energy (this two categories account for around 62% of the total imports in 2014)¹⁸. Given that prices of these products are adjusted on the world market (some of them are commodity products) each positive or negative shock will automatically be imported in the domestic economy.

Republic of Macedonia is small and open economy. In line with this, developments in the domestic economy depend, to a high degree, on the developments in the external markets and changes in the world prices. Descriptive analysis in this section point out to two important weaknesses of the Macedonian economy - high degree of export concentration in only few key sectors, whose share in the world export is decreasing and high dependence on import of crude materials and energy. Having in mind the linkages between competitiveness, external sector and economic growth policies that promote diversification of exports, improvements in the energy sector (to decrease dependence of energy imports) and increase competition will be of great importance if Republic of Macedonia wants to enhance the growth of the economy and increase the living standard of its citizens.

¹⁷ National bank of the Republic of Macedonia (<http://nbrm.mk/>) and own calculations.

¹⁸ Ibidem.

Conclusion

In this study we presented descriptive analysis of the competitive position of the Macedonian economy by using two indicators – the REER and WEF global competitiveness index. Looking at the REER data one can conclude that movements are largely balanced or, in other words, REER doesn't indicate any significant improvements or worsening of the competitive position of the Macedonian economy in the period 1999-2014. However, it will be wrong to draw conclusion regarding one country's competitive position solely looking at the REER given that it gives information only about one aspect of competitiveness – the price competitiveness. Price competitiveness means that companies (or countries) that sell cheaper products will be more competitive. On the other hand, today, non-price competitiveness factors, such as quality of the product, shape, use, certainty, reliability, speed of delivery, guarantees, servicing etc. are becoming increasingly important.

WEF global competitiveness index is a multidimensional indicator that captures different dimensions of competitiveness. According to WEF methodology WEF Republic of Macedonia is classified to be in the second stage of development i.e. in the efficiency driven stage. Republic of Macedonia wants to enhance its competitive position on the medium run, competition policies should be focused on developing the human capital capacity, increasing goods and labor market efficiency, financial market development, promoting the ability to harness the benefits of existing technologies and market size. Additionally, Republic of Macedonia will need to invest in policies that will promote sophisticated business practices and innovation in order to prepare for the transition from the second stage in the third stage of development.

Furthermore, competitiveness and external trade are two interconnected concepts. The negative trade balance, is equal to, almost 19% of GDP (in the period 1998-2014). More detailed analysis of the external trade structure points out to several structural weaknesses that need to be addressed. First, high degree of export concentration in only three sectors - "food, tobacco and beverages", "iron and steel", and "textile and clothing" – that accounted for almost two thirds of the total export in the period 1998-2014. Second, high export-import dependence – same sectors turned out to be dominant on the import and export side. Third, high dependence of the Macedonian economy on imports of crude materials and energy – products whose prices are formed on the world

market which increases the vulnerability of the Macedonian economy in case of a negative external shocks.

Competitiveness is an important enhancer of long-term economic growth. Improvements in competitiveness are conditioned on implementation of “healthy”, business oriented economic policy, responsible and accountable behavior of all agents in the economy and stable political and economic environment. The attitude towards competitiveness as an important factor that will facilitate integration of the Macedonian economy in the world economic trends should be embodied in all levels of the economic and political system. Special attention and support should be devoted to competition policies and policies that promote exports sector in order to decrease the degree of concentration, increase competitiveness of the Macedonian companies on the world market, attract new foreign direct investment and enhance long-term economic growth and the standard of living in the economy.

Bibliography

1. The Global Competitiveness Report, World Economic Forum, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014 и 2015.
2. Јовановиќ Б., *Фактори на економскиот раст во транзицискиот економи, со посебен осврт на земјите од Југоисточна Европа и Република Македонија*, докторска дисертација, Економски институт – Скопје, Скопје, 2015.
3. Jović M., *Inovacioni aspekti strateške konkurentnosti*, <http://www.ien.bg.ac.yu/download/wp02-02pdf>
4. Kovačević, M., *Dugoročne tendencije, stanje i ograničenja rasta konkurentnosti privrede i izvoza Srbije*, Ekonomski anali: Savetovanje ekonomista, privrednika i bankara „Ekonomsko finansijski odnosi – Konkurentnost privrede i izvoza”. Beograd, 16. i 17. septembar 2004.
5. Kovačević, M., *Faktori konkurentnosti domaćih preduzeća na inostranom tržištu*, Tržište, novac, kapital, Beograd, br.3 / jul-septembar 2005.
6. Milisavljević M., Todorović J., *Marketing strategija*, Univerzitet u Beogradu, Ekonomski fakultet, 1995.
7. НБРМ (<http://nbrm.mk/>)

8. НБРМ
(<http://nbrm.mk/?ItemID=529E21A79694BB4DBB68D3DDA1E7D78D>)
9. Петковска Т., *Иновациите - значаен фактор за унапредување на конкурентноста на малиите и средни претпријатија (МСП)*, реферат на Научен собир, Зборник на трудови “Претприемниство - иновации и конкурентност”, Економски Институт - Скопје, Скопје 2008.
10. Rakita, B., *Medjunarodne marketing strategije*, Konzorcijum Ekonomskih instituta Jugoslavije, Beograd, 1989.
11. UNCTAD, *Trade and Development Report 1987*, Geneva, 1987.
12. World Development Indicators database,
<http://data.worldbank.org/data-catalog/world-development-indicators>
13. World bank, <http://www.worldbank.org/>
14. World Economic Forum, <http://www.weforum.org/>
15. World Trade organization,
(http://www.wto.org/english/res_e/statis_e/tradebysector_e.htm)

UDC 334.72:001.895]:303.43
Original scientific paper

Vasil POPOVSKI¹⁾
Mirjana BOROTA POPOVSKA²⁾
Marija TOPUZOVSKA LATKOVIKJ³⁾

**FIRM'S INNOVATIVENESS PERFORMANCE AS A MATTER
OF STRATEGIC DETERMINATION: MISSION STATEMENT
INNOVATION VALUE**

Abstract

Many authors have expressed the view that the mission statement should be the 'starting point' for effective strategic management. Despite the scarcity of persuasive empirical data, mission statements continue to be developed, disseminated, and valued, and researchers continue to be interested in analyzing them from different perspectives.

The light motive for this particular study is the assumption that if innovation is a critical strategic advantage for an organization it should somehow be reflected in the mission statement, having in mind that innovation should not be a reactive process but part of a strategy that gives direction. But, the question that arises is: Is this a practice in the world of business? Therefore the relationship between mission statements and firm's innovativeness is in the focus of this research paper.

The missions statements published online on the official web sites of the 30 first ranked most innovative companies in world by Forbes are units of analysis for this research. As a control sample the mission statements of the 30 last ranked (but still) innovative companies were also analyzed. For the needs of the research a data content analysis is used, as the most appropriate research method for mission statement

¹⁾ PhD, Institute of Economics, University "Ss. Cyril and Methodius" – Skopje,
e-mail: vasil@ek-inst.ukim.edu.mk

²⁾ PhD, Institute for Sociological, Political and Juridical Research, University "Ss. Cyril and Methodius" – Skopje, e-mail: mborota@isppi.ukim.edu.mk

³⁾ PhD, Institute for Sociological, Political and Juridical Research, University "Ss. Cyril and Methodius" – Skopje, e-mail: marija_t@isppi.ukim.edu.mk

analysis. The collected qualitative data are being coded, quantified and analyzed in SPSS.

The research methodology can be considered as new and innovative mainly because it makes the missions measurable (for innovativeness, more precisely) and it is applicable and replicable by other scholars and on different samples.

Key words: Innovation, Strategic management, Mission statement content analysis.

JEL classification: O 310

Introduction

The natural role and importance of mission statements have been examined for over three decades in the management literature (Pearce, 1982; Pearce and David, 1987; Powers, 2012; David, David and David, 2014). The mission statement is a formal written document intended to capture an organization's unique purpose and practices (Byars, 1981, 1984; Campbell, 1989, 1993; Campbell and Yeung, 1991; David, 1989; 1993; Germain and Cooper, 1990; Ireland and Hitt, 1992; Klemm, Sanderson and Luffman, 1991; McGinnis, 1981; Pearce, 1982; Pearce and David, 1987; Want, 1986; Steiner, 1979). An organization's mission statement should answer some 'really fundamental questions', such as: Why do we exist? What are we here for? What are we trying to accomplish?

Mission statements often address multiple audiences, or stakeholders, including a firm's management, employees, customers or clients, shareholders, and other residents of the communities, countries, and world where it does business (Abrahams, 1995; Amato & Amato, 2002; Bart, 1999, 2000; Collins & Porras, 1991; Klemm, Sanderson, & Luffman, 1991).

Below are the mission statement components and explanations that Pearce and David (1987, 1989, and 2007) provide which are generally recognized and accepted today among both practitioners and academicians in the field of strategic management:

- 1) *Customers* – who are the enterprise's customers?
- 2) *Products or services* – what are the firm's major products or services?
- 3) *Location* – where does the firm compete?

- 4) *Technology* – what is the firm's basic technology?
- 5) *Concern for survival* – what is the firm's commitment to economic objectives?
- 6) *Philosophy* – what are the basic beliefs, values, aspirations, and philosophical priorities of the firm?
- 7) *Self-concept* – what are the firm's major strengths and competitive advantages?
- 8) *Concern for public image* – what are the firm's public responsibilities, and what image is desired?
- 9) *Concern for employees* – what is the firm's attitude toward its employees?

Because of this, many authors have expressed the view that the mission statement should be the 'starting point' for effective strategic management. According to Ireland and Hitt (1992) mission is important for all types of organizations because: effective mission defines the fundamental, unique purpose, distinguishes the organization from others that are in the same business, identify scope of business operations, in terms of products and markets. Mission statements serve to provide motivation, general direction, company image and set of attitudes that guide organizational actions (Ireland and Hitt, 1992).

The authors like Drucker (1974), Pearce and David (1987) agree that the need for strategic planning appears to be a foregone conclusion to the changing demands of the environment. Mission statement is increasingly perceived as an indication of a high quality strategic planning effort, firms that have developed a comprehensive mission statement should outperform those with a weak or no mission statement (Pearce and David, 1987).

Empirical evidence to support a link between corporate mission statements and performance is not plentiful or conclusive (Bart & Baetz, 1998; Bart et al., 2001; Peyrefitte & David, 2006). When the financial performance of firms with and without a mission statement was compared, three studies found no significant differences (Bart & Baetz, 1998; David, 1989; Klemm et al., 1991). In contrast, two other studies found that firms with mission statements did perform better (Rarick & Vitton, 1995; Stone, 1996).

One of the earliest studies compared the content of the statements of high performing *Fortune* 500 firms to the content of those of low-performing ones, and the researchers found that the high-performing firms included three of the components - corporate philosophy, self-

concept, and concern for public image - significantly more often (Pearce & David, 1987).

Despite this scarcity of persuasive empirical data, mission statements continue to be developed, disseminated, and valued, and researchers continue to be interested in analyzing them from different perspectives.

For instance, David, David and David (2014) in their latest paper offer some new methodological directions about the mission statements analysis. The authors anticipate that future research will determine that customer-centered mission statements are positively associated with measures of customer satisfaction⁴. According them, such a finding could significantly alter, for the better, how mission statements are used, perceived and examined in both management and marketing.

As a necessary background to innovation activity, firms have (explicitly or not) to make decisions about the types of markets they serve, or seek to create, and the types of innovations they will attempt there. Therefore the light motive for this particular study is the assumption that if innovation is a critical strategic advantage for an organization it should somehow be reflected in the mission statement, having in mind that innovation should not be a reactive process but part of a strategy that gives direction. But, the question that arises is: Is this a practice in the world of business?

Innovation plays a key role in providing sustainable competitiveness advantage, achieving social and economic development of the countries, increasing employment and success of organizations. Innovation is defined as the ability to recognize market opportunities and to transform them into external and internal business strategies (Sundbo, 1995); the strategy is the framework for innovation development. New ideas and new ways of doing things are the main ingredients in sustained business success. To innovate means literally to bring in or introduce something new – some new idea, method or device (Adair, 2007). Having new ideas – is also indicated by such words as ‘creation’ or ‘invention’ (Adair, 2007). According to the Austrian economist, Schumpeter (2000) “Innovations are the composite of two worlds, namely, the technical, and the business; so when only a change in technology is involved, this is just an invention; but as soon as the business world is involved, it becomes an innovation.”

⁴ American Customer Satisfaction Index (ACSI).

The Oslo Manual for measuring innovation (OECD, 2005) defines four types of innovation:

- 1) Product innovation – A good or service that is new or significantly improved. This includes significant improvements in technical specifications, components and materials, software in the product, user friendliness or other functional characteristics;
- 2) Process innovation – A new or significantly improved production or delivery method. This includes significant changes in techniques, equipment and/or software;
- 3) Marketing innovation – A new marketing method involving significant changes in product design or packaging, product placement, product promotion or pricing; and
- 4) Organizational innovation – A new organizational method in business practices, workplace organization or external relations.

It (OECD, 2005) also gives an interesting classification of the innovation by the type of novelty (new only to the firm; new to the industry in the country or to the operating market of the firm; new to the world).

Innovation providing factors and the features that distinguish innovative organizations from the non-innovative, has long been a subject of scientific research (Ahmed, 1998; Amabile, 1988; Kirckpatrick and Hamel, 2004; Shefer ve Frenkel, 2005;).

Empirical evidence to support the link between innovativeness and mission statements can be found mostly in the work of Christopher Bart, who tried to measure the impact of mission on firm innovativeness (1996) and succeed to confirm the existence of significant differences in the content and characteristics of mission statements between innovative and non-innovative organizations (1998).

In Bart's earlier study (1996), which involved a survey of 75 senior managers (CEO's and presidents) from some of Canada's largest industrial and advanced technology companies, innovativeness practices/behaviors were operationalized in terms of 15 dimensions. These practices were cited by Deutschman (1994) as important contributors to performance in high tech firms. They have also been cited in both the academic and practitioner literature over the years and include:

- 1) Seeking out and delighting difficult customers;
- 2) Striving constantly to build customer loyalty;

- 3) Promoting the cannibalization of one's own products within the firm;
- 4) Using small teams to organize work around projects;
- 5) Willing to make critical technological decisions significantly ahead of the competition;
- 6) Accepting constant re-organization as a way-of-life;
- 7) Undertaking cooperative ventures with one's rivals/competitors (i.e. 'competition');
- 8) Fostering an 'egalitarian' culture;
- 9) Striving to sell unique and highly differentiated products/services;
- 10) Promoting the use of electronic communication to aid communication throughout the firm;
- 11) Placing an extraordinary emphasis on recruiting the 'right' people;
- 12) Sharing key strategic information with all employees;
- 13) Glorifying, honoring and celebrating the people who create new products and services;
- 14) Helping employees become world-renowned experts in their fields; and
- 15) Granting employees time to learn/self-renew through sabbaticals.

The more a manager reported that each of these practices was followed within his/her organization, the more innovative - or 'pro-innovation' - the firm was expected to be (Bart, 1996). The analysis showed that 12 of 15 innovativeness behaviors were practiced to a large extent. Managers reported low usage rates for three of the behaviors: promoting cannibalization; undertaking cooperative ventures with rivals; and granting sabbaticals. Each of these behaviors/practices represents a fairly major departure from what many might consider the status quo in most organizations today. Consequently, it is in attempting to adopt these behaviors where one would expect to find the greatest resistance to change (Bart, 1996). The findings clearly suggest that seeking to achieve high levels of practice for some of the innovativeness behaviors will yield positive and significant benefits. If managers wish to encourage selected innovativeness behaviors among their employees, this particular research suggests that those behaviors should be written down and that the first place to write them is in the context of the mission statement. As a major finding and conclusion of this study is that the impact of mission on firm innovativeness appears to be an extremely powerful one, although the impact on new product performance outcomes appears to be indirect (Bart, 1996).

In the next research study, Bart (1998) examined and analyzed the content of mission statements from 72 North American corporations. Specifically, 25 mission statement components⁵ were analyzed to determine if there were any differences between innovative and non-innovative organizations:

- 1) Organizational purpose or raison d'être;
- 2) Statement of values/beliefs/philosophy;
- 3) Distinctive competence/strength of the organization;
- 4) Desired competitive position;
- 5) Competitive strategy;
- 6) Relevant critical stakeholders identified;
- 7) Specific behavior standards and policies to be observed;
- 8) Statement of general corporate aims/goals;
- 9) One clear and compelling goal;
- 10) Specific financial performance targets/objectives;
- 11) Specific non-financial performance targets/objectives;
- 12) Definition of the business;
- 13) Specific customers/markets served;
- 14) Specific products/services offered;
- 15) Statement of self-concept/identity;
- 16) Statement of desired public image;
- 17) Identification of the business' location;
- 18) Definition of technology;
- 19) Concern for satisfying customers;
- 20) Concern for employees and their welfare;
- 21) Concern for suppliers;
- 22) Concern for society;
- 23) Concern for shareholders;
- 24) Statement of vision.

In addition, the rationales behind the creation of the mission statements in both types of firms were also examined and compared. Mission statement 'rationales' have been defined as those forces motivating the development and use of a firm's mission statement in the first place. Those cited most frequently (Bart, 1996b, 1997) were adopted as the basis for operationalizing the mission statement drivers:

- 1) To create a common purpose for the organization;
- 2) To define the scope of the organization's activities and operations;
- 3) To allow the CEO to exert control over the organization;

⁵ There is one component less/missing in the Bart's (1998) list.

- 4) To create standards of performance for the organization;
- 5) To help individuals identify with their organization. Its aims and its purpose (and to encourage those who do not to leave);
- 6) To promote shared values among organizational members;
- 7) To promote the interests of external stakeholders;
- 8) To motivate and/or inspire organizational members;
- 9) To help refocus organizational members during a crisis;
- 10) To provide a sound basis for the allocation of organizational resources.

The findings suggest that there are some important mission components (as competitive strategy, behavior standards, one big goal, specific financial objectives, non financial objectives, technology defined, concern for survival; concern for employees, concern for shareholders, and a statement of vision) and rationales (as common purpose; maintaining shared values; considering external stakeholders; and inspiring employees) which are better understood and more often used by the innovative companies and it is these to which managers should pay especially close attention.

The conclusion is that the innovative firms manage to articulate the required behavior standards in their mission statements more effectively. Non-innovative firms may argue the need for behavior standards (in their mission rationales) just as forcefully and persuasively as innovative firms. The difference is that the non innovative firms don't seem to mean it or want it as much (Bart, 1998).

The relationship between mission statements and firm's innovativeness is in the focus of this research paper while in the same time it introduces a new measurement approach.

Methodology

The innovation characteristics literature is particularly still lacking in a consensus on research method and approach. According the recommendations of Tornatzky and Klein (1982) from their earlier study: "Ideal innovation characteristics studies should utilize replicable and potentially reliable measures of innovation characteristics as perceived by decision-makers... The ideal study should utilize an appropriate research design, i.e., experimental, survey, or secondary data analysis... And the ideal study should focus on innovations in organizational (not

individual) settings so that the studies will have implications for the organizational innovation process..."

The research methodology can be considered as new and innovative mainly because it makes the missions measurable (for innovativeness, more precisely) in some extent, especially if we agree with Bart (1996) that how mission statements differ from traditional goal statements and objectives is in their lack of quantitative specificity (i.e. there are no measurements or metrics stated).

Mission statement long-term use by corporations has been characterized by significant change, however, especially in the format and delivery of these statements. Nowadays, they can be often found on corporate Web sites (Stallworth Williams, 2008), which makes them available to a broader public audience. That's why the missions statements published online on the official web sites of the 30 first ranked most innovative companies in world by Forbes are units of analysis for this research. As a control sample the mission statements of the 30 last ranked (but still) innovative companies were also analyzed.

In case where company didn't have a web site or published mission statement online it was disqualified from the future analysis. Nor similar documents (as corporate strategy, strategic plan, vision, values, or CEO's statement) were acceptable as a mission statement replacement, for greater validity of the research design. The mission statements were usually searched at the main web site page or in the separate tabs on the site titled as: (our) mission; about (us); home; history; (company) overview; or were accessed via web site search engine. In case no English language was incorporated on the company's web site, the Google Chrome page translation option was applied.

For the needs of the research a data content analysis is used, as the most appropriate research method for mission statement analysis. The collected qualitative data are being coded, quantified and analyzed in SPSS. Content analysis has been defined as a systematic, replicable technique for compressing many words of text into fewer content categories based on explicit rules of coding (Berelson, 1952; GAO, 1996; Krippendorff, 1980; and Weber, 1990). Holsti (1969) offers a broad definition of content analysis as, "any technique for making inferences by objectively and systematically identifying specified characteristics of messages". What makes the technique particularly rich and meaningful is its reliance on coding and categorizing of the data (Stemler, 2001). The basics of categorizing can be summed up in these quotes: "A category is a group of words with similar meaning or connotations" (Weber, 1990,

p.37). Explicit concept analysis locates what words or phrases are explicitly in the text, or the frequency with which they occur (Carley, 1990). Two basic methodological approaches are generally used – dictionaries and translation rules. In the dictionary approach, a dictionary or thesaurus is constructed that contains key concepts or categories and their associated synonyms and equivalent phrases or words (Fan, 1988, Carley, 1984).

In that manner, the coding protocol is the following: each mission component, as defined by Pearce and David (1987, 1989), was analyzed separately and 5 points/scores are given to the elements/phrases which contain the following words⁶: *innovative; invention; new; first; unique; advanced; extraordinary; superior, modern; originality; novelty; shift; change; revolution; evolution; renovation; alteration; transformation; creation; discover; upgrade; improvement; reform and promotion*; and as well as all the substantives, verbs and adjectives which are etymologically generated from these words. As the sampling units of analysis - organizational mission statements primarily exist to serve in the business context, and the selected companies belong to the business sector, the methodological approach doesn't make a distinction between "invention" (the discovery of new technical knowledge and its practical application to industry) and "innovation" (the introduction of new technical methods, products, sources of supply, and forms of industrial organization) as defined by Schumpeter (2000). In cases where a mission statement didn't possess all the components, the particular variable code-field was marked as a missing value. In case there was a component present but there was an absence of any of the words from the innovation synonyms list - the code field was marked with zero (Component Innovativeness Value=0). The total score gained through this specific measurement makes the so-called *mission statement innovation value* (MSIV). The correlation between the value for Innovation Premium⁷ of each company from the sample(s), as an indicator for innovation according the Forbes methodology and the MSIV has been analyzed. The frequency with which each innovativeness practice/behavior was

⁶ Online dictionaries (Thesaurus, Oxford Business, Cambridge, and Merriam-Webster) are consulted for the innovation synonyms list development.

⁷ The Innovation Premium is a measure of how much investors have bid up the stock price of a company above the value of its existing business based on expectations of future innovative results (new products, services and markets). Members of the list must have \$10 billion in market capitalization, spend at least 2.5% of revenue on R&D and have seven years of public data.

mentioned in each of the mission statements was counted too. Total scores that each component gained from the sample was calculated. The existence of any differences between the mission statements of the first ranked and the last ranked companies from the list (of the world's most innovative companies), was as well subject of interest.

It was expected that the findings will confirm the existence of a positive relation between the firm innovativeness performance and strategic planning/management. Therefore the main aim of this research paper is to provide an answer for the following research questions:

- 1) Is the firm innovativeness explicitly articulated in the mission statements of the innovative companies?
- 2) Which components of the mission statements usually contain the innovativeness characteristics?
- 3) Is there positive correlation between the innovation premium and mission statement innovation value?
- 4) Are there any significant differences in the mission statement innovation value between the first ranked and the last ranked world's most innovative companies?

The research target sample is shown in the table below.

The Innovation Premium values are calculated in August 2014.

Table 1: FORBES rank list of the World's most innovative companies

Rank	Company	Innovation Premium (%)	Online mission Available
1	Salesforce.com	75,9	✓
2	Alexion Pharmaceuticals	71,4	✓
3	ARM Holdings	65,6	✓
4	Unilever Indonesia	65,1	✓
5	Regeneron Pharmaceuticals	64,7	✓
6	Amazon.com	62,4	✓
7	BioMarin Pharmaceuticals	58,9	✓
8	CP All	57,8	✓
9	VMware	57,6	No
10	Aspen Pharmacare Holdings	57,1	No
11	Vertex Pharmaceuticals	56,8	✓
12	Red Hat	56,4	✓
13	Hermes International	55,7	No
14	Hindustan Unilever	54,7	✓

15	Monster Beverage	54,1	No
16	The Priceline Group	52,5	No
17	Rakuten	51,9	✓
18	Marriott International	51,7	No
19	Fastenal	50,9	✓
20	Chipotle Mexican Grill	50,5	No
21	Stericycle	50,1	✓
22	Cerner	49,6	✓
23	Coloplast	49,6	✓
24	Henan Shuanghui Investment	49,6	✓
25	Tingyi Holding	48,6	No
26	Hengan International Group	48,2	✓
27	AmBev	47,9	✓
28	Express Scripts	47,8	✓
29	Iliad	47,3	No
30	Netflix	47,2	✓
71	AmerisourceBergen	36,5	✓
72	Coca-Cola	35,8	✓
73	SGS	35,8	No
74	H&M	35,8	No
75	Oriental Land	35,5	✓
76	Paychex	35	✓
77	Colgate-Palmolive	34,9	✓
78	Ecolab	34,8	✓
79	Anheuser-Busch InBev	34,6	✓
80	Hershey	34,3	✓
81	Autodesk	33,9	✓
82	Inditex	33,7	No
83	Grupo Bimbo	33,7	✓
84	Procter & Gamble	33,7	✓
85	Yahoo Japan	33,7	No
86	Danone	33,6	✓
87	ST Engineering	33,6	✓
88	Inner Mongolia Yili	33,5	✓
89	Sodexo	33,2	✓
90	Kuehne + Nagel	33,2	✓
91	General Mills	33,1	✓
92	BRF	33,0	✓
93	Assa Abloy	32,8	✓
94	Nidec	32,5	✓

95	Walmex – Wal-Mart de Mexico	32,4	No
96	Bajaj Auto	31,7	No
97	Experian	31,6	✓
98	Clorox	31,5	✓
99	Sherwin-Williams	31,4	No
100	Digi.Com Berhad	31,3	✓

Source: <http://www.forbes.com/innovative-companies/list/>, page visited online at 12.02.2015

Results

Only 67% sampling units (N=40) of the total target sample (N=60) are qualified as valid for the research sample, equally divided in the both subsamples (N_{top ranked}=20, N_{bottom ranked}=20), as in 33% cases there is no mission statement published online on the firm's WEB site.

Innovation elements are present and explicitly articulated in 72.5% of the sample (N=40). The mission statement components which most frequently contain the innovation indicators are: Philosophy (N=12) and Products or services (N=10), while less frequently are: Location (N=0); Concern for employers (N=1) and Technology (N=1)⁸.

The bi variant correlation analysis in SPSS has registered an existence of a positive and statistically significant correlation between Premium Value and Mission Statement Innovation Value (R=.381, p<0.05) which gives an answer to the general research question and confirms the main hypothesis:

H₁=There is positive correlation between Premium Value and Mission Statement Innovation Value

H₀= There is no positive correlation between Premium Value and Mission Statement Innovation Value

From this finding it can be concluded that there is definitely a positive correlation between the firm's innovativeness performance and the strategic planning, which is the aim of this research paper.

The analysis showed the following statistically significant findings as well: moderate positive correlation between Premium value

⁸ The technology is highly present in the analyzed mission statements, but mostly as a firm's product/service, not as an organizational resource.

and the Component's Innovation Value for Products or services ($R=.421$, $p<0.05$); strong negative correlation between Premium value and the Component's Innovation Value for Concern for public image ($R=-.899$, $p<0.01$).

Table 2: Correlation matrix

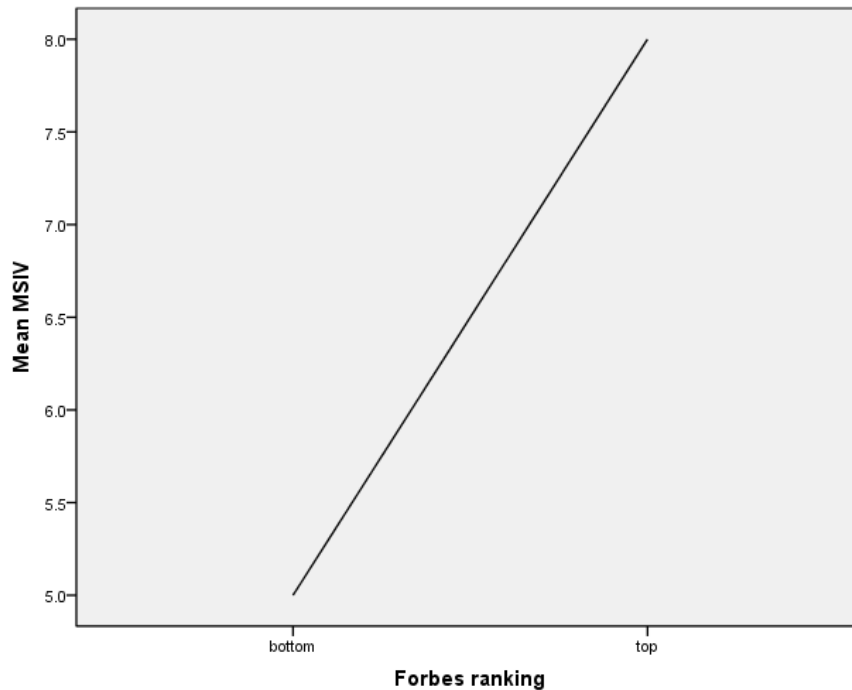
		Premium Value	Component: Products or services	Component: Concern for public image	MSIV
Premium Value	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	40			
Component: Products or services	Pearson Correlation	.421*	1		
	Sig. (2-tailed)	.032			
	N	26	26		
Component: Concern for public image	Pearson Correlation	-.899**	-.364	1	
	Sig. (2-tailed)	.000	.376		
	N	10	8	10	
MSIV	Pearson Correlation	.381*	.497**	.333	1
	Sig. (2-tailed)	.015	.010	.348	
	N	40	26	10	40

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

As expected, the total MSIV score for top ranked innovative companies is obviously higher ($MSIV_{Total\ score}=155$) than for bottom ranked ones ($MSIV_{Total\ score}=100$).

Figure 2: MSIV mean comparison of the top and the bottom ranked innovative companies by FORBES



But although the comparison of the MSIV means of the both subsamples has shown that the top ranked innovative companies have higher average Mission Statement Innovation Value ($M=8.00$), than the bottom ranked ones ($M=5.00$), the applied non-parametric analysis by the Independent-Samples Mann Whitney U Test showed that the distribution of MSIV is the same across categories of Forbes ranking ($p>0.05$) which rejects the second research hypothesis:

H_2 =There are statistically significant differences in the MSIV between the Forbes first and last ranked innovative companies

H_0 = There are no statistically significant differences in the MSIV between the Forbes first and last ranked innovative companies

Conclusions

This paper develops and applies new innovation measurement approach based on a mission statement content data analysis with a detailed coding protocol which makes it applicable and replicable by other scholars and on different samples.

It successfully gives an answer to the main research question, by confirming the existence of a positive and statistically significant correlation between the Mission Statement Innovation Value and the Premium value, meaning both the values grow proportionally. With this kind of finding it can be concluded that the firm innovativeness performance is definitely positively related with the strategic planning/management of the company. The results show that companies which incorporate the innovation in their missions are generally more innovative than the others which don't emphasize the innovation as a strategic priority or strategic objective.

Mission components that most frequently articulate the innovation are *Philosophy* and *Products or services*, while the innovation is less or not at all articulated by the *Location* and the *Concern for employers*.

As a recommendation this paper implies that companies which aim to increase their innovativeness performance should rethink about their business goals, to align them with the strategy and if required - to revise their strategic plan and rewrite their mission statement.

References:

1. Bart, C. K. (1996b) 'High tech firms: Does mission matter?' *Journal of High Technology Management*, Vol.7, No.2, pp.209-225.
2. Bart C. K. (1997) 'Industrial firms and the power of mission', *Industrial Marketing Management*, Vol.25. pp.1-13.
3. Bart. C. K. (1996a) 'The impact of mission statements on firm innovativeness'. *International Journal of Technology Management*, Vol.11, Nos. 314, pp.479-493.
4. Bart, C. K. (1997). Industrial firms and the power of mission. *Industrial Marketing Management*, 26, 371-383.

5. Bart, C. K. (1998). A comparison of mission statements and their rationales in innovative and non-innovative firms. *International Journal of Technology Management*, 16(1), 64-77.
6. Bart, C. (1998). Mission matters. *CPA Journal*, 68(8), 56-57.
7. Bart, C. (1999). Making mission statements count. *CA Magazine*, 132(2), 37-39.
8. Bart, C. K. (2000). Lasting inspiration. *CA Magazine*, 133(4), 49-51.
9. Bart, C. K., & Baetz, M. C. (1998). The relationship between mission statements and firm performance: An exploratory study. *Journal of Management Studies*, 35(6), 823-853.
10. Bart, C. K., Bontis, N., & Taggar, S. (2001). A model of the impact.
11. Berelson, B. (1952). Content Analysis in Communication Research. Glencoe, Ill: Free Press.
12. Byars, L. L. (1984) Strategic Management: Planning and implementation. Harper and Row, New York.
13. Byars, L. L. (1981) 'Organizational philosophy and mission statements'. *Planning Review*, 15, 4, pp.32-36. Campbell, A. (1989) 'Does your organization need a mission?'. *Leadership and Organization Development*, 3.
14. Campbell, A. (1993) 'The power of mission: Aligning strategy and culture'. *Planning Review*, Special Issue.
15. Campbell, A. and Yeung, S. (1991) 'Creating a sense of mission', *Long Range Planning*, 24, 4, pp. 10-20.
16. Carley, K. M. (1984) Constructing Consensus. Doctoral dissertation, Harvard.
17. David, F. R. (1989) 'How companies define their mission', *Long Range Planning*, 22, I, pp.90-97.
18. David, F. R. (1993) Strategic Management. Fourth edition, Macmillan, New York.
19. Fan, D. (1988) Predictions of public opinion from the mass media: computer content analysis and mathematical modeling. New York, NY: Greenwood Press.
20. Germain, R. and Cooper, M.B. (1990) 'How a customer mission statement affects company performance,' *Industrial Marketing Management*.
21. Holsti, O. R. (1969). Content Analysis for the Social Sciences and Humanities. Reading, MA: Addison-Wesley.

22. Ireland. R. D. and Hitt, M. A. (1992) 'Mission statements: Importance, challenge and recommendations for development', *Business Horizons*, May-June.
23. Tornatzky, L. G., & Klein, K. (1982). Innovation characteristics and innovation adoption-implementation: A meta-analysis of findings. *IEEE Transactions on engineering management*, (EM-29).
24. Klemm, M. Sanderson, S. and Luffman, G. (1991) 'Mission statements: Selling corporate values to employees'. *Long Range Planning*, Vol.24, No.3, pp.73-78.
25. Krippendorff, K. (1980). *Content Analysis: An Introduction to Its Methodology*. Newbury Park, CA: Sage.
26. McGinnis, V. J. (1981) 'The mission statement: A key step in strategic planning', *Business*, November-December, pp.39-43.
27. Pearce, J. A. (1982) 'The company mission as a strategic tool', *Sloan Management Review*, Spring, pp.15-24. 24 Pearce, J. A. and David, F. R. (1987) 'Corporate mission statements: The bottom line', *Management Executive*, 1, 2, pp.109-116.
28. Sundbo, J. (1995). Three paradigms in innovation theory. *Science and Public Policy*, 22(6), 399-410.
29. Schumpeter, J. A. (2000). Entrepreneurship as innovation. *Entrepreneurship: The social science view*, 51-75.
30. Steiner. G. A. (1979) *Strategic Planning: What every manager must know*. New York, The Free Press.
31. Stemler, S. (2001). An overview of content analysis. *Practical Assessment, Research & Evaluation*, 7(17).
32. U.S. General Accounting Office (1996). *Content Analysis: A Methodology for Structuring and Analyzing Written Material*. GAO/PEMD-10.3.1. Washington, D.C.
33. Want, J. H. (1986) 'Corporate mission', *Management Review*, August, pp.46--50.
34. Weber, R. P. (1990). *Basic Content Analysis*, 2nd ed. Newbury Park, CA.

**UDC 338.48-6:63(497.7)
338.48-6:641/642(497.7)
Original scientific paper**

**Marija ACKOVSKA¹⁾
Neda PETROSKA-ANGELOVSKA²⁾
Marija MAGDINCEVA-SOPOVA³⁾**

**POSSIBILITIES FOR DEVELOPMENT OF AGRO-TOURISM
AND GASTRONOMIC TOURISM IN THE REPUBLIC OF
MACEDONIA**

Abstract

Agro-tourism and gastronomic tourism as an integral part of alternative tourism represents a major opportunity to improve the performance of agricultural holdings and the economic prosperity of rural areas in the country.

The paper starts from the standpoint that global changes in the world's main development directions initiate new trends in the field of tourism needs, it sets new challenges for the tourism offer, and the trends indicate increasing demand for alternative forms of tourism. In this context, the paper stresses the role of agro-tourism as a form of alternative tourism which contributes farmers to increase their income through various forms of activities.

Particular attention is paid to labor contribution, agrotourism to the creation of new or to the generation of added value to the traditional production of food and wine, rural culture, as well as certain activities related to farming. Alternatively, agro-tourism can contribute to the

¹⁾ Ph.D, associate professor, Institute of economics-Skopje, University "Ss. Cyril and Methodius",
e-mail: marija@ek-nst.ukim.edu.mk

²⁾ Ph.D, associate professor, Institute of economics-Skopje, University "Ss. Cyril and Methodius",
e-mail: neda@ek-nst.ukim.edu.mk

³⁾ Ph.D, University "Goce Delcev". Faculty of Tourism and Business Logistic-Stip,
e-mail: marija.sopova@ugd.edu.mk

initiation of new businesses that have no direct link to agriculture. This research is mainly perceived that businesses related to agrotourism have aims as: to keep farmers on farms, provide new jobs, improve living standards of the rural population and to increase the volume of economic activity in specific rural areas.

Empirical research is based on interviews and focus groups in selected rural areas. Participants in interviews and focus groups from all backgrounds, to one way or another, are related to agro-tourism and gastronomic tourism.

Key words: Agro-tourism, gastronomic tourism, rural development, Republic of Macedonia

JEL Classification: Z32; Q12; Q13

Introduction

Global changes in the main development directions secular initiate new trends in the field of tourism needs, it sets new challenges for the tourism offer. Secular trends indicate increasing demand for alternative forms of tourism. In this type of tourism belongs agrotourism also, that as newer selective form tourism is developing with accelerated dynamic.

Agrotourism as a form of alternative tourism contributes farmers to increase their income through various forms of activities. Agrotourism can contribute to the creation of new or to the generation of added value to the traditional production of food and wine, rural culture, as well as certain activities related to farming. Alternatively, agrotourism can contribute to the initiation of new businesses that have no direct link to agriculture. Some of the businesses associated with agrotourism is seasonal, while others may offer services throughout the year, but they all have same goals: to keep farmers on farms, provide new jobs, improve living standards of the rural population and increase the volume of economic activity in specific rural areas .

In Macedonia there are vibrant rural areas where they still cherish the traditional lifestyle of farming, breeding of plants and animals. It is an important base for attractive motivic development of agro tourism. Unfortunately, these potentials , tourist insufficiently evaluated and put into operation in attracting foreign and domestic tourists in that there is more interest in this kind of tourism. Agrotourism in the country is far

from long-term , strategic organized and supported but lately appear numerous private and government initiatives for the development and financing of agro-tourism (mostly indirect) and paying more attention to coordinated regional approaches to agro-tourism as a strategy for growth and development of private rural business.

There is a lack of knowledge nationwide for agrotourism and gastronomic tourism, limited level of information of their added value on farms around the country.

1. Theoretical aspects of agro-tourism and gastronomic tourism

Agrotourism and gastronomic tourism are rapidly becoming important factors in the growth of rural and regional communities. We think there are two key factors for this growth. The first factor is related to the changes in the agricultural sector such as structural and market adjustments that forced the farmers to seek additional sources of income particularly agrotourism and gastronomic tourism. And the second factor is related to the increasing desire of people from the city to rural life and the origin of the food they consume. Wine tourism and recreation slowly come to life in this area can provide visitors an opportunity to enrich their knowledge for food and wine and the style of living on a farm.

The combination of these trends and incorporates that cause changes in the rural sector and in consumer preferences and changing traditional views towards agriculture as a sector. With the development of agrotourism can be slow and some negative trends in the village such as rural-urban migration and temporary or permanent migration to town.

These trends are forcing some rural and regional areas to use innovative ways for diversification of existing products and services. These diversifications lead to significant changes in farming communities. Many farmers who receive only income from farming are facing financial and existential problems. They must also be adjusted in various ways such as expanding farms, specialization in the production of food and animals, selling land, machinery and goods, or searching for employment outside the farm. Agrotourism and gastronomic tourism represent one way of diversifying agricultural economies.

Agrotourism is business or activity that attracts visitors on a farm or rural community to enjoy in agricultural products and natural

surroundings.⁴ This definition is based on the assumption that agrotourism and gastronomic tourism are different from the general categories of tourism. In this paper the regional agrotourism is assumed to be closely related to gastronomic tourism. He is identified with the act of going to a particular region to visit the farm, winery or object in any way connected with food (restaurants, markets, production and processing facilities, natural attractions, etc.) for enjoyment, education or active participation activities and events .

The nature of agrotouristic regions vary and depend on natural resources, competitive advantages (type in production of certain products, gorgeous vistas, traditions, events, celebrities, etc.) etc. Agrotourism involves different stakeholders, educational and monitoring activities that occur on farm, agrotourism and also recreational outdoor activities such as fishing, hiking, horseback riding and the like. Agrotourism has an educative role as wine tours and wine tasting, cooking classes, educating students, work the farm, etc. Agrotourism associated with recreation and entertainment as festivals of food and wine, carnivals and so on. As well as accommodation in rustic style, offering local products and specialties, individually picking of products sold on local agricultural markets.

Companies that deal with agrotourism and gastronomic tourism can contribute to increasing the income of farmers through replacement of production or by supplementing the traditional farm operations with innovative activities.⁵ Different types of farmers operations can take different forms. They can produce food or to have nothing to do with the processing of land. They can generate new or unique crops or animals, or to add value to traditional production. They can generate new or unique crops or animals, or to add value to traditional production. They may provide recreational or education services. They can use traditional farming practices or introduce alternative methods such as organic production. They can be seasonal or year-round work. But they all have the same characteristic: contributing farmers and farmers to stay on the farm and in the village.

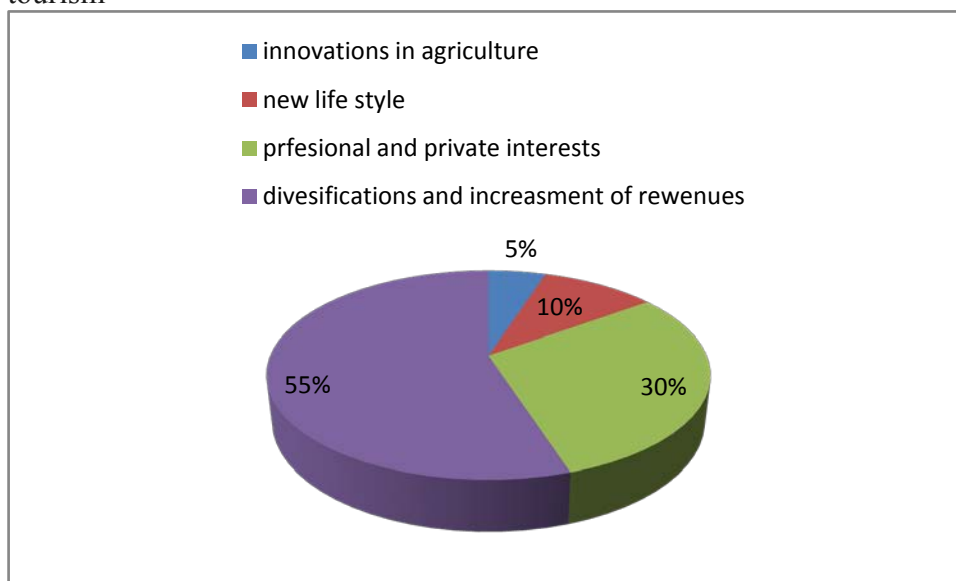
⁴ Agritourism: Frederic P. Miller, Agnes F. Vandome, John McBrewster 2010, p.43.

⁵ Agritourism: [opportunity for farm diversification in Nevada](#): Kynda R. Curtis, Joseph Monson, Nevada Cooperative Extension ,2005 p. 6.

2. Reasons for dealing with business in agro-tourism and gastronomic tourism

For the purpose of this paper empirical research⁶ was conducted so that many different reasons can be recognized as motivation to engage in business related to agrotourism and gastronomic tourism. The desire to increase or retention of revenue is the most common reply from the respondents of questionnaire, about what motivates them, next follows the answer that they require a new way of life and then the desire to educate people about farming and rural issues. Other reasons are that people want to work from home and develop a home business that would leave to their children.

Figure 1: Main reasons for practicing agrotourism and gastronomic tourism



Source: Obtained data from conducted research

As for the results made in an interview about the motivations for practicing agrotourism and gastronomic tourism they are that: most of respondents 50 % said that diversification of income is the main reason to keep agrotourism and gastronomic tourism. About 30 % said that they

⁶ Research was conducted during the period june-july 2015 on 60 respondents in the Republic of Macedonia.

are dealing with the business from professional and personal interests and 10 % said they wanted a new way of life. About 10 % said they wanted to make a change from strictly agricultural activity like to introduce something new.

These responses show that people are giving up agriculture in the whole to keep agrotourism and gastronomic tourism, but are interested in additional earnings and labor diversification

As related to previous research, main reasons for practicing agrotourism and gastronomic tourism can be treated and explained as follows:

a) Increasing of income diversification

Overall access to agrotourism can be divided into two main groups: one where, access and dealing with agrotourism is mainly opportunistic, and existing facilities are used that use informal marketing tools and lack any major investment; and second one, where dealing with agrotourism is core business and have invested in facilities and infrastructure, and strive to promote their business.

Many farmers mention the benefits of income from agrotourism providing cash flow in times when there is a slowdown in income from farming, or when prices of agricultural products and meat are small and do not meet the needs .

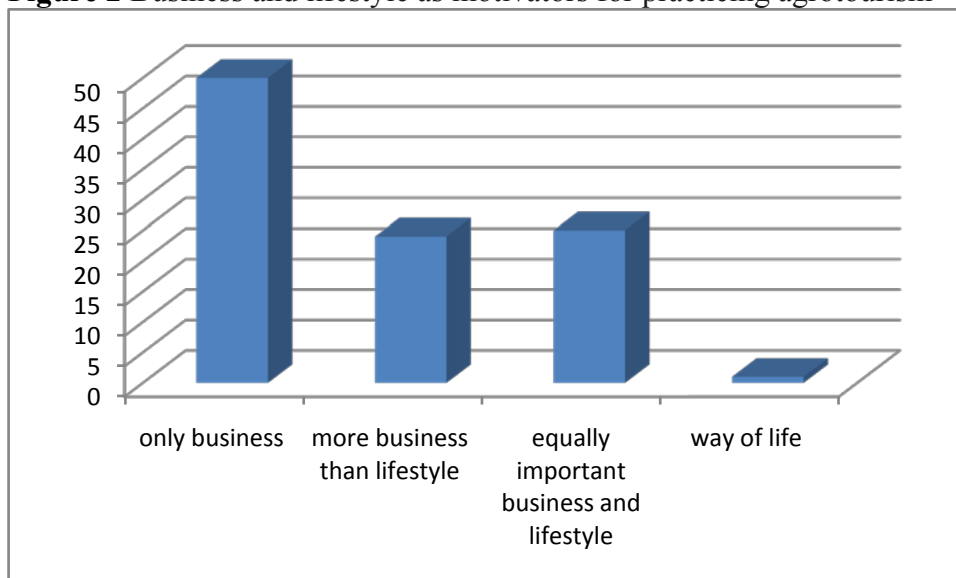
b) Way of leaving

Respondents who motivator for practicing agrotourism and gastronomic tourism are finding in way of life are elaborated in Figure 2. The Diagram shows however that not only the way of life but also the business is significant reason for practicing in agrotourism. The 50% reported that only attracts business alike, while 24% reported that more business than lifestyle attracts to keep agrotourism. From farmers 25% stress that is equally important business and lifestyle, while 1% said that just the way of life is motivation factor.

What refers to this part of the questionarie there were interesting additional explanations from respondents as: an elderly couple said that retired people and that this is more a way of life; others said they work hard 5 days a week and on the weekend keep agrotourism; third stated

that because of the investment in agrotourism it was increasingly accepted as a business and a way of earning.

Figure 2 Business and lifestyle as motivators for practicing agrotourism



Source: Obtained data from conducted research

Some managers stressed that it is paid more to sell their organic farm products ,which is a kind of agrotourism, than to transport them in stores.

3. Benefits from agrotourism and gastronomic tourism

Agrotourism and gastronomic tourism can produce food and wine in terms of diversification of the business and to generate additional earnings during the transition to new approaches and opportunities for creating new revenue for themselves and the local community. For manufacturers agrotourism and gastronomic tourism act as an inventor of new markets and products through better interaction with consumers and other participants in the chain .

In terms of generating income, agrotourism and gastronomic tourism is helping farmers through:

- Create a recognizable name for their agricultural products.

- Helping consumers in educating the farming and rural heritage of the region.
- Generate increased incentives for environmental protection and natural resources that are important for visitors.
- Switching to the economic development and opportunities in rural communities by attracting tourists (who still can shop, eat and stay locally).⁷

Main benefits of agrotourism and gastronomic tourism are social and economic benefits for the local community, increasing employment, increasing the sustainability of local farmers and helping to restore the life of the village and so on.

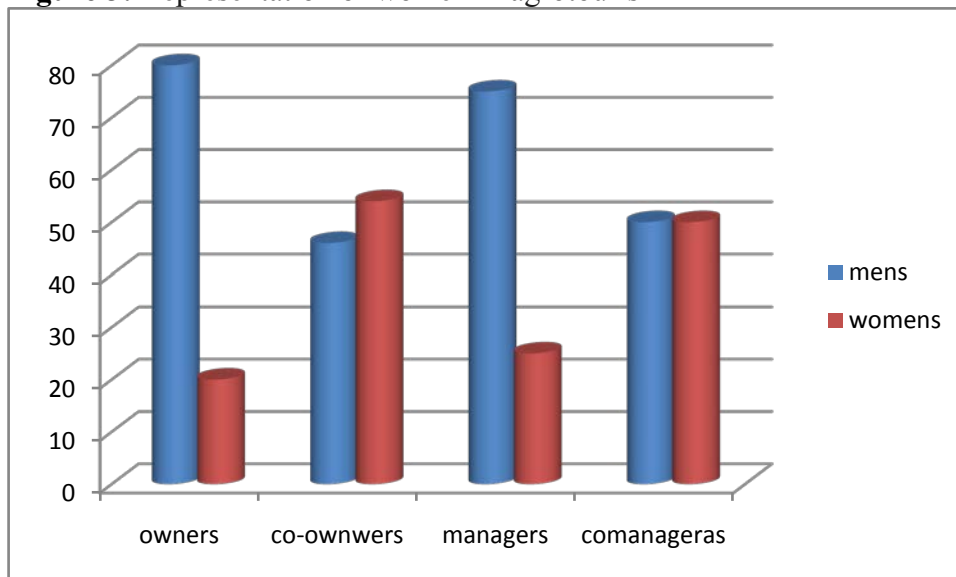
Except the above-mentioned other benefits from agrotourism and gastronomic tourism are opportunities to improve the role of women in business, involvement of young people and the development of the local business sector. Women are very involved in agrotourism and gastronomic tourism. Although research shows that women as full ownership represented 20 % and 25% as main managers, these figures are slightly higher than the representation of women in other industries .

The research showed that women as co - ownership of a gastronomic business agrotourism are more represented than men with 54 % or as co -managers represented 50 %.

Agrotourism and gastronomic tourism provide numerous opportunities for women including employment in the family business, working from home and networking. Many respondents involved in this business confirm that women play an important role in agrotourism initiatives. It is not a rare case where women lead agrotourism business or work in a restaurant or shopping while the men work on the farm. There are indications that some farmers do not have manifested initiative for agrotourism until women have. Business that is based on tourism provides additional opportunities for women in agribusiness.

⁷ [Rural tourism and sustainable business](#) : Derek R. Hall, Irene Kirkpatrick, Morag Mitchell, 2005 p.32.

Figure 3: Representation of women in agrotourism



Source: Obtained data from conducted research

Agro-tourism and gastronomic tourism have the potential to attract young people in rural communities and agriculture by providing employment. There are numerous examples where dealing with agrotourism and gastronomic tourism is handed over to the next generation of the family.

4. Identification of main barriers for agrotourism and gastronomic tourism in the Republic of Macedonia

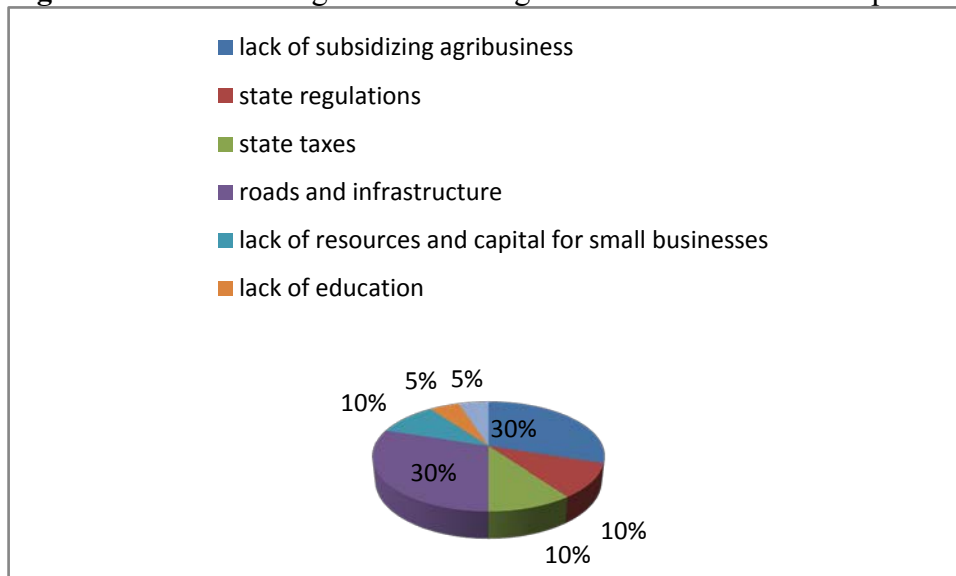
There are different obstacles for agrotourism and gastronomic tourism development. For the purpose of these paper obstacles in agrotourism and gastronomic tourism are determined through interviews and focus groups in all regions. Prioritized for managers barriers are:

- Lack of subsidies
- Roads and Infrastructure
- Regulations (building permits , food safety , etc).
- Government taxes and insurance
- Lack of institutional understanding of agribusiness
- Lack of resources and capital for small businesses

None of the listed barriers are stressed as most important but the answers varied depending on the type of agrotourism dealing with respondents. However most of barriers that were mentioned are as follows: lack of subsidizing agribusiness 30 %, state regulations by 10 %, state taxes at 10 % , roads and infrastructure 30 % , availability of capital of 10 %.

Increasing urbanization in rural areas are not reflected negatively on agribusiness and gastronomic tourism but rather in some regions they improve business through better accessibility and infrastructure. The results are presented illustratively on Figure 4.

Figure 4: Barriers for agrotourism and gastronomic tourism development



Source: Obtained data from conducted research

Some of the barriers mentioned in the interview are:

- Global financial crisis
- Fluctuations in the wine industry
- Animal diseases (swine flue , avian flu , etc.).
- Competition from other tourist attractions in the region
- Small business awareness in the region

5. Recommendations for the development of agrotourism and gastronomic tourism in Macedonia

Recommendations for development of agro-tourism and gastronomic tourism are related to: coordination, support and other assistance in agrotourism development. This includes government, industry or community initiatives that will provide strategic guidance and support over agrotourism individual scale. A number of these types of support are identified by participants in the interview, such as:

- ***Marketing and Market Research***

- Agricultural markets
- Informal cooperation
- Restaurants and chefs of traditional food with local produce
- Communications with consumers
- Wine roads and culinary events
- Formal regional coordination

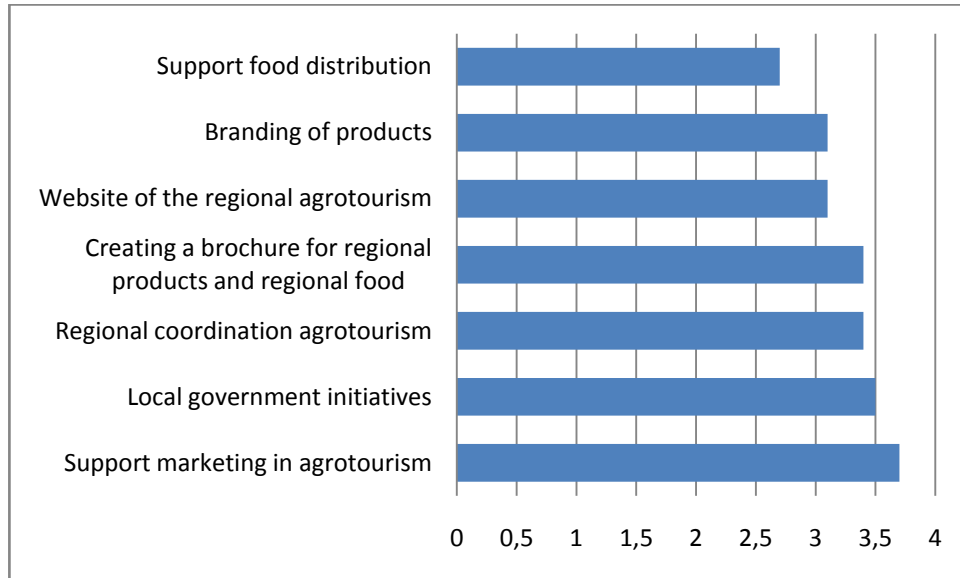
From the conducted research and received information about what type of support is needed, there were different views, but we can prioritize them as follows:

- Support marketing in agrotourism
- Local government initiatives
- Regional coordination agrotourism
- Creating a brochure for regional products and regional food
- Website of the regional agrotourism
- Branding of products
- Support food distribution

Below is an illustrative view of the priorities of farmers in this part for need of support from state institutions. It should be noted that some respondents had other ideas as the state can not help, but due to the isolation of cases they are not listed in the text and below in Figure 5

Scale of 1 to 4m on **Figure5** represents the importance of the support according to respondents in the interviews. Scale is explained as follows: 1- No matter; 2 - Somewhat important; 3 - Important; 4 - Very important, Advertised support for tourism development performed tests ranges from 2.7 to 3.7 or an average importance of 3.25 indicating that the importance of moving in the field is from important to very important.

Figure 5 Level of importance of needed supports for agrotourism development



Source: Obtained data from conducted research

According to the first two tests, the most important supports are: Support marketing in agrotourism and local government initiatives. All others are below 3.5 as in the upper area of importance. These catalysts and institutional support in agrotourism and gastronomic tourism summarized in 4 key motivators: marketing and market research; tourism network; clusters and links; and integration and support.

Strategic approach to regional agrotourism and gastronomic tourism

During the research for this paper we are convinced that there is a regional development coordination and support agroturizamot in some municipalities. It remains to be confirmed whether this action contains all activities for sustainable development of agrotourism and gastronomic tourism. Here are some of the activities that need to be addressed at regional strategy for agrotourism:

- Market research
- Strategic Planning
- Develop principles for agroturism region

- Regional marketing coordination, including local website
- Support systems for local food distribution
- Program of mentoring and education
- Development of quality standards for products and services
- Support local coordination

Creating a strategic plan or framework to support the development of regional agrotourism and gastronomic tourism is important for the future sustainability of such initiatives. Identification of potential problems or opportunities, discovering new partners and ways of financing are important in the early stages of development of regional agrotourism and gastronomic tourism. The consequence of not having a clear strategy leads to the proliferation of unsustainable projects in this business sector. The split development of agrotourism in separate stages is also very important. What refers to strategic planning, it should be done by regions or municipalities.

- ***An organizational support***

It is evident that successful agrotourism and gastronomic tourism unfurnished good organizational coordination. And also it is evident that this requires appropriate involvement of boards with their own members as well as nongovernmental organizations. Adequate organizational structures in its membership is required to have members of the tourism and agricultural sector for better coordination and organization of plans, initiatives and projects.

It is thought that this kind of support may not be required in the long term, but coordination at the local level takes an important role in the initial and early stage where it is difficult to rely solely on volunteerism.

Conclusion

Agro-tourism is generally additional activity on the farm which integrates tourism in agri-business. Regional agrotourism is assumed to be closely related to gastronomic tourism. He is identified with the act of going to a particular region to visit the farm, winery or any object that is connected with food (restaurants, markets, production and processing facilities, natural attractions, etc.), for enjoyment, education or active participation activities and events.

Agro-tourism and gastronomic tourism has benefits for the farmer and the consumer. For farmers benefit is the sale of products and services to generate additional funds. Important for consumers to authentic

recreational and aesthetic experiences that consumers will see, taste, hear, smell and feel.

Agro-tourism and gastronomic tourism in the country do not have a long tradition. These selective forms of tourism actualize the past ten years and yet, despite the great potential they hold no significant role in. The integrated tourist offers of the Republic of Macedonia, nor significantly contributes to improving the performance of agricultural holdings and diversification of their business.

Recommendations for development of agro-tourism and gastronomic tourism are related to: coordination, support and other assistance in agrotourism development. This includes government, industry or community initiatives that will provide strategic guidance and support over agrotourism individual scale.

Bibliography:

1. Agritourism. M.Sznajder; L. Prezezborska; F. Scrimgeour April 2009
2. Agritourism enterprise on your farm or ranch: George, Holly and Ellie Rilla 2000
3. Agritourism: looking at new horizons: Kelly Nicholson-Yost, Ontario Agricultural Training Institute, Canadian Farm Business Management Council – 1996
4. Agritourism: market segmentation profile of potential and practising tourists... Lindsay Justine Speirs - 2003
5. New directions in rural tourism: Derek R. Hall, Lesley Roberts, Morag Mitchell – 2003
6. Agritourism: Frederic P. Miller, Agnes F. Vandome, John McBrewster – 2010
7. Considerations for agritourism development: Sea Grant New York, Cornell University, State University of New York, 1998
8. The New Agritourism: Hosting Community & Tourists on Your Farm: Barbara Berst Adams – 2008
9. Rural change and sustainability: agriculture, the environment and communities: Stephen Essex – 2005
10. Agritourism in New York State: opportunities and challenges : Duncan Hilchey – 1993
11. Managing sustainable tourism: a legacy for the future : David L. Edgell – 2006

12. Agriculture in transition : P. Milone – 2009
13. Toward Sustainable Agricultural Systems in the 21st Century: Committee on Twenty-First Century Systems Agriculture, National Research Council – 2010
14. Agritourism: opportunity for farm diversification in Nevada: Kynda R. Curtis, Joseph Monson, Nevada Cooperative Extension – 2005
15. Driving rural development: policy and practice in seven EU countries - Deirdre O'Connor – 2006
16. Tourism and the environment: regional, economic, cultural, and policy issues: Helen Briassoulis, Jan van der Straaten – 2000
17. Ecotourism and sustainable development: who owns paradise?: Martha Honey – 2008
18. Managing tourism growth: issues and applications : Fred P. Bosselman, Craig A. Peterson, Claire McCarthy – 1999
19. Agritourism in Europe: Jenny McKelvie, Mintel International Group Ltd – 2004
20. Food safety at farmers markets and agritourism venues: Desmond Ansel Jolly, Carol Fitzgerald, University of California, Davis. Small Farm Center – 2005
21. Agritourism: health and safety guidelines for children . Michael Humann, Barbara Lee, National Children's Center for Rural and Agricultural Health and Safety, National Institute for Occupational Safety and Health. 2005
22. Cultivating agritourism: tools and techniques for building success: Peter Wilder Williams, Kathryn Lack, Kim C. Smith – 2004
23. Rural tourism and sustainable business : Derek R. Hall, Irene Kirkpatrick, Morag Mitchell - 2005
24. Ecotourism: impacts, potentials and possibilities? Stephen Wearing, John Neil – 2009
25. Rural tourism and recreation: principles to practice: Lesley Roberts, Derek Hall - 2001

UDC 339.543:336.14.055.2(497.7)“2009/2013”
Original scientific paper

Diana BOSKOVSKA^{*)}
Biljana ANGELOVA^{)}**
Vesna GEORGIEVA SVRTINOV^{*)}**

SIMPLIFIED CUSTOMS PROCEDURE IN THE REPUBLIC OF MACEDONIA AND IT'S FISCAL EFFECT

Abstract

In order to improve the competitiveness of Macedonian companies on foreign markets are introduced simplified customs procedures in 2005. The introduction of this type of customs procedure aims to use a range of positive effects that provide this type of customs procedure such as reducing the time and cost of performing these procedures, increase the effectiveness of economic entities in foreign trade, flow of revenues (direct and indirect tax revenue) and so on.

Scope of this research work is the fiscal effects of the use of simplified customs procedures in the country, which are realized in the period 2009 to 2013. The focus of research is the direct fiscal effects are achieved by the application of simplified customs procedure. Analysis determined that the application of simplified customs procedure achieved positive fiscal impact to the budget of the Republic of Macedonia. But despite this positive trend, remains to be working in this area, because as a country in terms of the application of this procedure we are lagging relative to the other countries, particularly in view of the developed countries.

^{*)} PhD, associate professor at the Institute of Economics-Skopje, University „Ss. Cyril and Methodius“-Skopje, e-mail:diana@ek-inst.ukim.edu.mk

^{**)} PhD, full professor at the Institute of Economics-Skopje, University „Ss. Cyril and Methodius“-Skopje, e-mail:angelova@ek-inst.ukim.edu.mk

^{***)} PhD, assistant professor at the Institute of Economics-Skopje, University „Ss. Cyril and Methodius“-Skopje, e-mail:vesna@ek-inst.ukim.edu.mk

Key words: simplified customs procedures, fiscal revenue, customs, VAT, excise, fees.

JEL classification: H25, H29

Introduction

Macedonia is an example of a small and open economy. As such, its economic growth and development is essentially determined by the level of foreign trade, especially by the export component.

To enable the improvement of the competitiveness of Macedonian companies in foreign markets were introduced simplified customs procedures. Namely, customs procedure is conducting numerous activities for certain goods described and defined by numerous documents through strict adherence to the legal regulations in order to be released for free circulation, exported or transiting through the customs area.

The simplified customs procedures are tools for relief, and also to reduce the cost of mediation, advocacy and terminal costs. Also they have significant impact on reducing the time required for completion of customs formalities enabling increased efficiency and effectiveness, but also the consistency and continuity in planning, import and export of products and goods. The adoption of the Customs Act 2005 (Official gazette no. 39/2005) and the Regulation on the implementation of the Customs Act (Official gazette no. 66/2005) began implementation of simplified customs procedures in our country in foreign trade exchange.

The use of simplified customs procedures implies multilateral effects. First, here are the direct and indirect effects on fiscal grounds. Direct fiscal revenues primarily relate to the customs. Indirect fiscal effects are a result of increased foreign trade operation of the companies through the greater competitiveness and accessibility of foreign markets, that will provide higher revenues in the budget on the basis of personal income tax and on the basis of income tax.

1. Effects of the application of simplified customs procedure

Application of simplified customs procedures allows customs supervision and control to raise to a higher level and to establish a higher

quality of the customs procedure. Nevertheless, they have certain effects, positive and negative which are discussed below. Namely, the application of these procedures provide

(http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/evaluation_customs_union_en.pdf):

- import, export or transit to carry out outside of the customs terminals;
- import, export or transit to carry out outside from the working hours of customs offices, 24 hours 7 days a week, 365 days a year, regardless of holidays and weekends;
- reduction of formalities, and also reduce the role of intermediaries, i.e. of the terminals and shippers in the customs procedure;
- avoid the high amounts of terminal fees for staying on the terminal, for weighting, and others;
- avoid the crowds on terminals, avoiding waiting for clearance the following day if the vehicle does not come on line for clearance during the working hours of customs offices, as well as avoiding the waiting on the terminal for the weekends and holidays;
- avoid the traffic jams on the roads and border crossings.

Initial findings from the application of simplified customs procedure or so called local clearance are more than encouraging and give positive results in terms of arrival of customs goods to its contractor on the time, facilitating business planning, and developing the existing system of exchange. Thus, from the perspective of participants in international trade it enables more efficient operation of companies, avoiding overload on the customs terminals, no shipping and bank guarantees, thereby the custom procedure becomes simplify, shorten and less expensive, allowing faster turnover of capital, establishing a high-quality internal control and the etc. In the same time the firms perform the customs alone, without coming to the customs terminals. Customs officers coming into the company headquarters, which provide to simplify customs procedures, and in the same time it's avoiding the retention goods at the border, paying multiple fees, bank guarantees and sipping services, but on the other hand it provides 24 hours working time and the whole process takes place without major delays.

In terms of the state, the application of simplified customs procedures have positive results in terms of direct fiscal impact on the budget of the country, and a step closer to the harmonization of

legislation of the Republic of Macedonia to the EU regulations. However, there are still some anomalies and deficiencies that need to be overcome, which primarily reflected in the conditions to be met by applicants for approvals to use the simplified customs procedure.

Furthermore, from the company point of view as the main obstacle to the introduction of simplified customs procedure is the cost accounting and keeping adequate records of the goods, shipments, the time of release of the good for the required procedure, possession of an instrument of security and so on. However, the relief which is obtained by the use of simplified customs procedures, brings more benefits than costs in the procedure for clearance of goods.

Also, for some companies meeting the above conditions is increasing costs throughout the year. In order for these companies be able to use simplified customs procedures, there are companies that deal with logistics (shipping), receiving permits for authorized recipient or sender, and authorizations for local customs clearance of import and export, which can implement simplified customs on behalf of another company, but on its full responsibility.

2. Fiscal effects on the budget of the Republic of Macedonia on the basis of using simplified custom procedures

This paper presents an analysis of the revenue budget of the Republic of Macedonia as a result of the application of simplified customs procedure. Firstly, it's presented the main items of revenue in the budget of the Republic of Macedonia, that are relevant to obtain valid conclusions related to the rationalization of the application of simplified customs procedures and its fiscal impact to the budget of the Republic of Macedonia.

Table 1. Budget revenues based on import and export of goods in applying simplified customs procedures for period 2009 – 2013 (in million MKD denars*)

Year	Total revenue collected from customs procedures	Collected revenues from simplified customs procedures	Participation of revenue of simplified custom procedures
2009	53.181	5.068	9,53%
2010	55.654	7.441	13,37%
2011	61.724	16.666	27%
2012	64.020	19.206	30%
2013	61.883	17.946	29%

Source: Custom administration of Republic of Macedonia– own calculation from the Reports of working of Custom administration -

<http://www.customs.gov.mk/DesktopDefault.aspx?tabindex=0&tabid=57>

http://www.customs.gov.mk/Uploads/godisen%20izvestaj%202010%20KOMPLET_6%20web.pdf,p.12,

http://www.customs.gov.mk/Uploads/Godisen_izvestaj_2011.pdf, p.30-31,

<http://www.customs.gov.mk/Uploads/GODISEN%20IZVESTAJ%202012.pdf>,p 33,

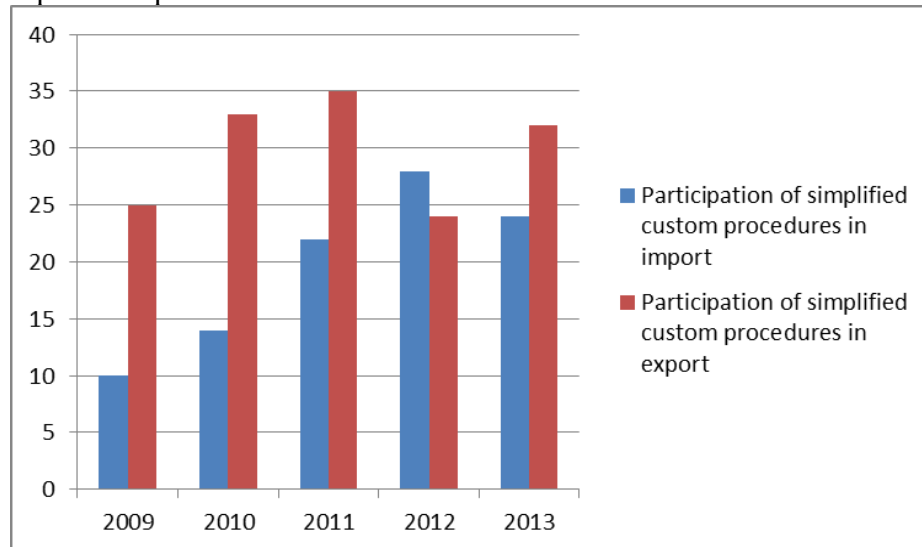
<http://www.customs.gov.mk/html/GODISEN%20IZVESTAJ%202013%20MK%20FINAL%20hiRez.pdf> ,p 31,35 и 52

* 1 Euro= 61,5 denars

Table 1 presents data on total revenues that are collected by the customs procedures in the period from 2009 to 2013. Namely, in 2009 the income from customs procedures amounts to 53 181 million, of which the simplified customs procedure proceeds amount to 9.53%, or 5.068 million. In 2010 simplified customs procedure accounts to 13.37% of the total revenue of customs procedures. Already in 2011, the share of simplified customs procedure increases nearly double that is even 27%, in 2012 the percentage of its share has risen to 30%, but in 2013 reported a marginal fall in the share of 29%, which is certainly not neglect.

Figure 1 shows the contribution of simplified customs procedures in import and export of goods in the state, given in percentage terms.

Figure 1. Participation of simplified customs procedure in imports and exports for period 2009-2013



Source: Custom administration of Republic of Macedonia -
<http://www.customs.gov.mk/DesktopDefault.aspx?tabindex=0&tabid=57>,
http://www.customs.gov.mk/Uploads/godisen%20izvestaj%202010%20KOMPLET_6%20web.pdf, p. 12,
http://www.customs.gov.mk/Uploads/Godisen_izvestaj_2011.pdf, p.30-31,
<http://www.customs.gov.mk/Uploads/GODISEN%20IZVESTAJ%202012.pdf>, p. 33,
<http://www.customs.gov.mk/html/GODISEN%20IZVESTAJ%202013%20MK%20FINAL%20hiRez.pdf>, p. 31,35 и 52

From the given structure of revenue in the budget of the Republic of Macedonia in the period from 2009 to 2013, in Figure 1, it can be concluded that the percentage of the simplified customs procedures for import of goods in the first four years was much lower than the exports of goods. Namely, in 2009 the application of simplified customs procedures for export was doubled in terms of its application in imports. In 2010, the situation is similar, but in 2011 and 2012 shows its increased application and imports (especially in 2012 when simplified customs procedures for import exceeds the same procedure from export). But in 2013 data represents approximation of the percentage of imports and exports of goods, which means that the application of simplified customs procedures are increasingly being applied to the import.

From the above data, calculations and analysis can come to the conclusion that in the last period in the country are made greater efforts

customs procedure to simplify, in order to shorten the time of clearance and to reduce costs, which means that the simplified customs procedure in Macedonia from year to year is more and more applicable.

3. Analysis of direct tax revenue in the budget of the Republic of Macedonia on the basis of using simplified custom procedures

As mentioned on the basis of simplified customs procedure is derived direct and indirect tax revenue. In the following part of the paper makes a detailed analysis of the direct fiscal revenue that is derived from the application of simplified customs procedures such as customs, VAT, excise taxes and fees, for the period 2009-2013.

3.1. Fiscal revenue based on customs

Customs are fiscal revenue that burdening consumption. Because some of their features they are considered a type of indirect tax, which is collected at the import, export or transit of goods through the customs territory of a state. According to the OECD as other taxes and customs duties are included in the subset of taxes, because they have all of their features. For these reasons they have the status of mandatory cash payments for consumers (payers). Also literature doesn't define against service for the paid customs duty, which again gives character as taxes to the customs.

Customs provide fiscal revenue, but in the same time represent an instrument to regulate international trade of goods and services, and protects the domestic production from foreign competition.

With the introduction of simplified customs procedures, actually has an additional benefit to the economy. Namely, in the same time while the level of the custom rate remains unchanged, the greater efficiency in providing the needs of foreign goods through this procedure would be provide greater efficiency of domestic production and it's protection from foreign competition.

Table 2. Participation of income based on customs from applying simplified procedures in total revenues

Year	Revenue from customs based on import (% of the total revenue)
2009	20,22 %
2010	33,97 %
2011	29,43 %
2012	30,6 %
2013	32,79 %

Source: <http://www.customs.gov.mk>, accessed on 15.01.2015

The data in Table 2 confirm that the application of simplified customs procedure in Macedonia are increasingly applied in the import, i.e. its percentage share is increased in the budget revenue of the Republic of Macedonia in the analyzed period. In 2009 revenues in budget from the application of simplified customs procedures account about 20.22% of total revenue collected from customs duties, but it's reached about 32.79% in 2013.

3.2. Fiscal revenue based on VAT

Value added tax in the country was introduced by a special law from April 1, 2000, that presents a greater approximation to the standard solutions in the tax systems of the EU countries. VAT Act is in accordance with the Sixth Directive, relating to VAT is fully compatible with the European model. Value Added Tax is a consumption tax which is calculated at each stage only for the amount of the value added, so this tax is no with cumulative effects.

When it comes to foreign trade in the country, fiscal revenue in respect of VAT is a major source of fiscal resources that flowing into the budget of the Republic of Macedonia.

Table 3 presents data on the percentage of the total amount collected in respect of VAT in the application of simplified customs procedures in the period of 2009 - 2013. VAT revenues on simplified customs procedure is increased from 47.8% in 2009 to the 59.54% in 2013.

Table 3. Participation of income based on VATs from applying simplified procedures in total revenues in the period 2009 - 2013

Year	Revenue of VAT from imports (% of the total revenue)
2009	47,8 %
2010	57,9 %
2011	61,47 %
2012	60,82 %
2013	59,54 %

Source: <http://www.customs.gov.mk>, accessed on 15.01.2015

3.3. Fiscal revenue in respect of excise

Excise appear as the oldest form of consumption tax, so with it's introduction in the practice for the first time is applied idea to taxing the consumption. The tax on specific goods and services, known as excise duties, according to international classification, charged in turnover of certain number of products and can be introduced at any stage of production or trade.

Usually excise taxed products for mass consumption. In fact, this type of products have inelastic demand and price elasticity of demand greater than one.

In accordance with the various laws in the countries, so the excise tax is different, but they are concentrated mainly in three categories of products including: petroleum products (mineral oil), alcoholic beverages and tobacco products. In some countries, besides these three categories are covered and other products, such as coffee, sugar, salt, tea, cars, some luxury products and others.

Within the total budget revenues of the Republic of Macedonia in the period 2009-2013, and generated revenues based on excise duties on imports and exports of goods in the state with the application of simplified customs procedure.

Following the data of the Customs Administration, which are presented in Table 4, we come to the conclusion that the simplified customs procedure is more and more in application.

Table 4. Participation of income based on excise from applying simplified procedures in total revenues in the period 2009 - 2013

Year	Revenue of excise from imports (% of the total revenue)
2009	0,63 %
2010	1,26 %
2011	1,47 %
2012	0,02 %
2013	2,15 %

Source: <http://www.customs.gov.mk>, accessed on 15.01.2015

This is supported with the data shown in the table above, or the percentage of the total revenue collected in respect of excise duties on imported goods in the application of simplified customs procedure in the period 2009 to 2013. The lowest income from excise duties on imports of goods in the application of simplified procedures are recorded in 2012 when the percentage is minimal 0.02%, the second is the income recorded in 2009, which is 0.63%. In 2010, that in 2011 was recorded almost doubled income from 1.26% and 1.47%. In 2013 has the highest income from excise duties on imports of goods in the application of simplified customs procedure it is 2.15%.

3.4. Fiscal revenues based on fees

As fiscal revenues, that contributing to an increase the revenues in the budget of the Republic of Macedonia represent fees that are charged for import and export of goods from one country. The Republic of Macedonia has adopted regulations for the type and customs fees for the services rendered in the customs procedure, regardless of whether those services are made in regular or simplified customs procedure. In accordance with the Customs Law, customs authorities charge fees for its services rendered in customs procedures.¹

Certainly, fiscal revenues on Budget on the basis of fees allow participating in the budget of such revenue, which is due to the increase in the application of simplified customs procedure. The following will

¹ Custom Law of Republic of Macedonia (Official gazette no. 39/05, p.2)

show revenue on the budget of the Republic of Macedonia realized in the application of simplified customs procedures, and on the basis of the collected fees in that procedure.

Table 5. Participation of income based on fees from applying simplified procedures in total revenues in the period 2009 - 2013

Year	Revenue of fees from imports (% of the total revenue)
2009	31,35 %
2010	6,87 %
2011	7,64 %
2012	8,56 %
2013	5,52 %

Source: <http://www.customs.gov.mk>, accessed on 15.01.2015

As evident from Table 5, percentage of the total revenue collected from fees is declined, with application of simplified customs procedures for import of goods in the country. Revenues from simplified customs procedures based on the fees of imports in 2009 accounted for 31.35%, which in 2010 was drastically reduced at only 6.87%. The next two years, the share of revenues from fees on imports, in applying of the simplified procedures, amount to 7.64% in 2011, i.e. 8.56% in 2012. In 2013 there has been a decline in the share of revenues from fees at only 5.52%.

Conclusion

Based on the analysis in this paper can be concluded that the simplified customs procedure is more and more application. Namely, its share in the budget of the Republic of Macedonia from 9.53% in 2009, rising to over 30% in 2012, i.e. 29% in 2013. Increasing the use of simplified customs procedure is evident to exports and imports of goods. The percentage share of simplified customs procedures for imports from 11% in 2009 increased to 25% in 2013, and in exports from 25% in 2009 increased to 33% in 2013. With imports of goods in the state flow revenue in the budget on the basis of customs duties, VAT, excise duties and fees. Analyzing revenues on those grounds in the period 2009 to 2013 concluded that the largest share in the revenue budget is derived in

respect of VAT, which in 2009 contributed 48%, and in 2013 even with almost 60%.

From the data of the analysis, it can be concluded that the application of simplified procedures for import and export clearance at the border crossings, most exporters have benefited so far, which includes specific effort by the Customs Administration and inspection services in order to increase this type procedure for import too. Also, the results of the analysis show that the application of simplified customs procedures have not been applied in the manner, form and level as it is the case in developed countries. This can largely be attributed to the fact that this type of customs procedures applied in relatively short period of time in country.

References

1. Atanasovski Zivko, Javni finansii, Ekonomski fakultet, Skopje, 2004.
2. Custom Administration of Republic of Macedonia, Annual report of the custom administration in 2008, 2009, 2010, 2011.
3. Customs Administration of the Republic of Macedonia (CARM) 2009, Customs/Newsletter of the Customs Administration of the Republic of Macedonia No. 12, CARM, Skopje.
4. Customs Administration of the Republic of Macedonia (CARM) 2010b, Guidelines for simplified procedures, CARM, Skopje.
5. Customs Administration of the Republic of Macedonia (CARM) 2011b, List of licences approved in EXIM, CARM, www.customs.gov.mk.
6. Customs Administration of the Republic of Macedonia (CARM) 2012b, 'Customs administration twenty years for the future of Macedonia', CARM, Skopje.
7. Biljanovska Jovanka, Atanasovski Zivko, Carinski sistem i politika, Ohrid, 2006.
8. Biljanovska Jovanka, Megunarodna trgovija, Ohrid, 2009.
9. Chandana Karunaratne, Ashani Abayasekara, Impact of EPZs on poverty reduction and trade facilitation in Sri Lanka, working paper, ASIA-PACIFIC RESEARCH AND TRAINING NETWORK ON TRADE, Working Paper, NO. 134, OCTOBER 2013

- (<http://www.unescap.org/sites/default/files/AWP%20No.%20134.pdf>).
10. Custom law (Official gazette of Republic of Macedonia no. 39/2005).
 11. Gordhan, Pravin (March 2007), Customs in the 21st Century, World Customs Journal, Vol. 1.
 12. Ivaković Čedomir, Durbek Sanja, „Customs representation in simplified customs procedures in Republic of Croatia”, *Promet-Traffic_Traffico*, vol. 17, 2005, no.4.
 13. Hoekman, B., and Nicita, A., "Trade policy, trade costs, and developing country trade", Washington DC, World Bank Policy Research Working Paper Series No 4797, 2008.
 14. Haughton, Michael, and Remi Desmeules, Recent Reforms in Customs Administrations, 2011, *The International Journal of Logistics Management*, Vol. 12, No. 1.
 15. Hausman, Warren H., Hau L. Lee, and Uma Subramanian (2005), "Global Logistics Indicators, Supply Chain Metrics, and Bilateral Trade Patterns," Fifth Draft (October 10, 2005) (Washington: World Bank).
 16. Heaven, Trevor D. (1992), The Role of Customs Administration in the Structure and Efficiency of International Logistics: An International Comparison, *The International Journal of Logistics Management*, Vol. 3, No. 1, pp. 63–72.
 17. Hors, Irène (2001), "Fighting Corruption in Customs Administration: What Can We Learn From Recent Experiences?" Working Paper No. 175, OECD Development Centre.
 18. Jackson, J., (1997), *The World Trading System: Law and Policy of international Economic Relations*, Cambridge: Blackwell, 1997.
 19. Jovanovski Pance, Javni finansii, Evropski univerzitet, Skopje, 2006.
 20. Jurkovic Pero, Javne finansije, Masmmedia, Zagreb, 2002.
 21. Justin Zake, Custom administration reform and modernization in Anglophone Africa-early 1990s to mid-2010, IMF working paper 2011/184.
 22. Regulation on the implementation of the Customs Law (Official gazette no. 66/2005).
 23. Reforming the regulatory procedures for import and export: guide for practitioners, Small and medium enterprise department, The world bank group, June 2006.

24. State statistical office, Publications, <http://www.stat.gov.mk>
25. Single authorisation for CPEI Single authorization/simplified procedures Imports Transit Export Customs http://ec.europa.eu/taxation_customs/customs/procedural_aspects/general/centralised_clearance/index_en.htm
26. The WTO and preferential trade agreements: From co-existence to coherence, World Trade Report 2011.
27. http://www.worldcustomsjournal.org/media/wcj/-2014/1/WCJ_V8N1_Tosevska-Trpcevska.pdf
28. http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/evaluation_customs_union_en.pdf

UDC 334.722(485):[338.124.4:336.7(100)]2008/-“
Original scientific paper

Klimentina POPOSKA¹⁾
Elena MIHAJLOSKA²⁾

FINANCING START-UPS AFTER THE 2008 FINANCIAL CRISIS IN THE EUROPEAN UNION: OVERVIEW OF PRACTICES IN SWEDEN

Abstract

The paper analyses the effect of the 2008 Financial Crisis (FC) on both start-ups levels and capital availability for their formation. Namely, start-ups have gained crucial significance in the post crisis period for the economic recovery through scaling down the excessive levels of unemployment. Despite of major efforts by the European Union (EU) to encourage entrepreneurial activity, the number of start-ups on EU-level has decreased severely in 2008. Availability of financial capital has been recognized as one of the biggest obstacles for new business formation. Sweden has been the only country which has not only shown resilience in terms of higher levels of new business formation, but has also has produced many highly innovative start-ups in the post crisis period. Comparing data from the EU and Sweden on the number of new births and capital availability, we seek to better understand the reasons behind the success of Swedish start-up ecosystem and provide recommendations for increasing entrepreneurial activity in other European countries.

Key words: Financial crisis, SME start-ups, new business formation, European Union, Sweden

JEL classification: G01, 052, M13, G21

¹⁾ Ph.D, Institute of Economics-Skopje, University Ss. Cyril and Methodious-Skopje, Republic of Macedonia. E-mail: klimenti@ek-inst.ukim.edu.mk

²⁾ MSc, Elena Mihajloska, Coordea Outsourcing. E-mail: mihajloskae@gmail.com

Introduction

The 2008 Financial Crisis is one of the most severe downturns in history. The failure of the financial markets caused contraction of economic activity, bankruptcy of many financial institutions which instantly affected the private sector where major closures of large companies took place laying off aggregate numbers of workers. Unemployment levels rose high, trade plummet and capital markets froze. It was a period of slow economic activity, high risk aversion of business participants and low investment levels.

The 2008 Financial Crisis remembered, not only for its severity, but also for its scope. What started with the bankruptcy of Lehman brothers in the US spread across Europe initiating the “domino effect” among the member countries. The interconnectedness of the financial sector caused cascade of default, contagion, contracting credit and collapsing economic activity in every European country with minor differences in its depth. Ireland, Greece and Spain were the most severely affected countries whose GDP-debt ratios exceeded the 60% limit of the Maastricht agreement.

Given that start-ups commercialize innovative ideas and contribute significantly in the job creation, start-up activity became essential for the economic recovery. Financing has been recognized as major bottleneck for start-ups which has been only emphasized during the 2008 Financial Crisis. Namely, financial crisis have two contrasting implications on the business environment. From one side, high unemployment levels are expected to initiate business formation due to lack of job opportunities. In addition, the lower cost of the capital decreases the opportunity costs for starting a business stimulating entrepreneurship even more. On the other side, the decreased demand, reduced disposable income, and especially the more difficult access to finance diminishes the potential for high rates of start-ups in these conditions (Reynolds et al 1994; Fairlie 2013). After the crisis, the risk aversion of investors was high and banks imposed additional collateral requirements for credit approval especially for start-ups with no history of payments. Finally the Basel III implied higher and stricter capital holdings in banks which limited the amount of capital available for credit (IFF,2014: 25-30). Finance availability especially for startups has become even more challenging which alongside with the decreased demand implies poor chances of survival of startups (Vetter and Kohler 2014: p.2).

The paper at hand aims to provide better understanding of the impact of the crisis on business formation activity through analyzing fluctuations of capital availability for start-ups in the EU. For that reason, it compares and analyzes data from the pre-crisis (2004-2007) and post-crisis period (2008-2012) for better enhancement of changes in behavior both on the financing side and the entrepreneurial side. In addition the paper compares start-up funding on EU level and investments in Sweden. This Nordic country has been recognized as the most resourceful start-up hub in Europe and has attracted majority of the venture capital invested in Europe in the last five years (Davidson, 2015). The question emerges whether the high entrepreneurial activity has caused the flow of venture capital in Sweden in accordance of Kreft and Sobel's theory (2005), rather than models suggesting that increased capital would spur start-ups. The paper further investigates Swedish culture and heritage for better understanding of the high levels of start-up activity and investments in Sweden.

The paper is structured as follows. First, we look into the overall Index of SMEs Access to Finance which is later divided into Equity-finance sub-index (EFI) and Debt-finance-index (DFI). Next, the equity financing is analyzed in more depth where the funding is decomposed at seed/early funding stage and later stage which provides essential insight on start-up financing opportunities. Later, we seek to investigate if fluctuations of capital levels are reflected in the number of start-ups by providing data on the number of new births on EU and Sweden's country level. The analysis shows greater resilience of Sweden which has managed to sustain an increasing start-up activity throughout and after the hit of the crisis. In the end the paper provides recommendations and lessons learned from the Swedish market applicable in other European countries. The conclusion gives closing remarks on the subjects, highlighting the areas for future research and improvements of start-up ecosystem in the EU. Note that the terms new business formation/creation, new births and start-ups have the same meaning and will be interchangeable used throughout the paper.

1. Financial capital availability in the post-crisis period: comparison between EU countries and Sweden

Start-ups have always struggled to find the right type and amount of funding and with the contracting of the market, the availability of real

capital become scarce. In addition to personal funds, entrepreneurs have two main sources of financing: debt-financing and equity financing. Debt financing as source of capital provides SMEs with the needed financial resources mainly through bank loans which can provide both, short-term and long term financing for different purposes (Hisrich et al, 2010: p.313-314). However, the higher capital holdings requirements in banks made debt financing in the form of credits more difficult to obtain. Bulgaria, Ireland and Latvia had highest unsuccessful applications rates of 36%, 27% and 26% respectively in 2010. Bulgaria also had the highest drop in success rate of loan applications from 87% in 2010 to 43% in 2007, followed by Ireland, Denmark and Lithuania. In contrast, highest success rates had Finland, Poland and France (European Commission Report, 2011). Regardless, in 2014, 37% of European SMEs not older than 2 years were accessing funding through credit lines (SAFE, 2014).

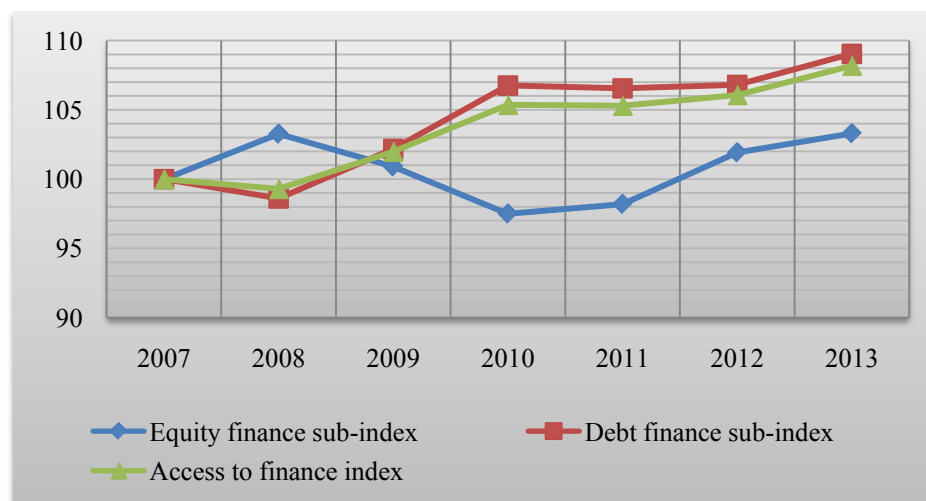
However, the hit of the crisis has not only caused tightening of financial supply but has also resulted in weak financial demand from the private sector. The business environment become risk reluctant environment where entrepreneurs' avoided going further into debt and postponed the realization of their innovative ideas Namely, SMEs got discouraged by the contracting conditions on the market and the high rejection share of credit applications. Chances for financing young start-ups with no history of payments, significant collateral or proven profitability of the business were even less optimistic The final outcome was underutilized use of resources which hinders entrepreneurial activity and economic growth (IFF 2014: p.8).

1.1 Index on SMEs Access to Finance

To better understand the fluctuations of the capital available of start-ups the paper presents the Index on SMEs Access to Finance (SMAF) which encompasses the Equity sub-finance index (EFI) and the Debt-sub-finance index (DFI) (Graph 1).

Not surprisingly, the SMAF index hit its lowest point in 2008 at the very outbreak of the Financial Crisis. The two sub-indexes have had divergent patterns. Surprisingly enough the DFI reached its peak in 2008. This emphasizes the importance equity financing has gained during the hardest period of credit tightening.

Graph 1 Index on SMEs Access to Finance, EU-28, 2007 - 2013



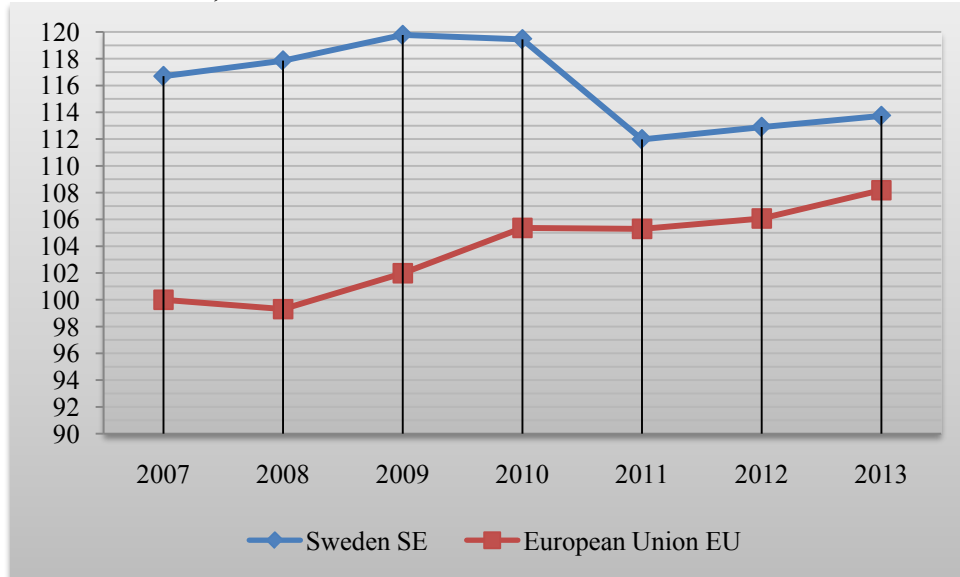
Source: Adapted data from EC:

http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/index_en.htm#, Accessed on 10 August, 2015

However, the index dropped significantly in 2009 before regaining strength in 2010 after which reported a constant incline. In contrast, the DFI was stagnant from 2009 to 2011, but still at higher level in comparison to the EFI index. Note that the DFI takes into account the interest rates on loans and overdrafts which have decreased significantly during the period of 2008-2013. This may have resulted in the increase of the index which does not necessarily reflect the real situation in the economy. As a result the SMAF score in total has increased between 2007 and 2013 (EC, 2013).

In addition, the next graph provides comparison between the SMAF Index on EU-level and Sweden. We can notice that capital availability in Sweden is higher from the very beginning, but has also shown greater resilience in the crisis year of 2008. However, it stagnated in following years before a sharp decline in 2011.

Graph 2 Index on SMEs Access to Finance, comparison between EU-28 and Sweden, 2007 - 2013



Source: Adapted data from EC:

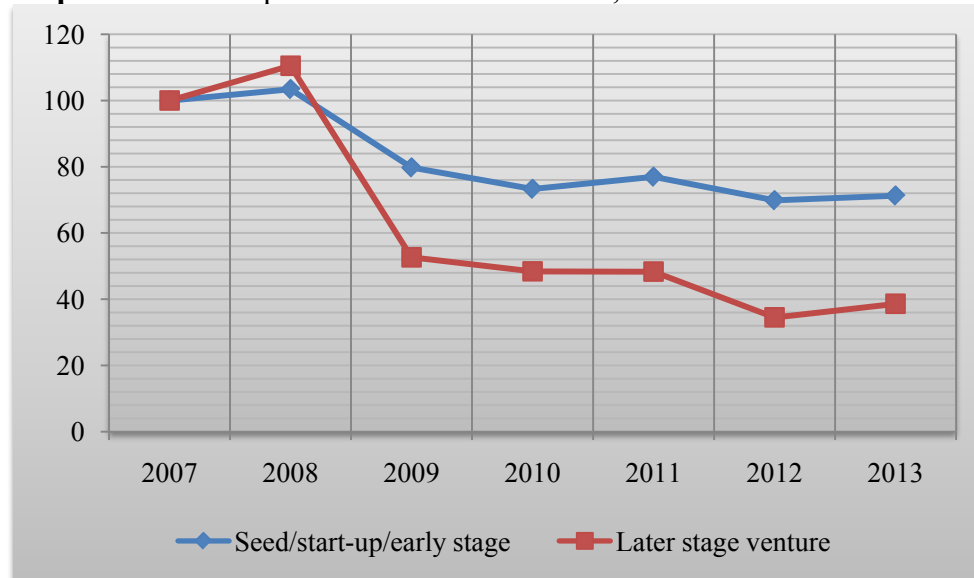
http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/index_en.htm#, Accessed on 10 August, 2015

The later downturn of capital availability in 2011 in Sweden can be explained as a postponed effect of the crisis. Nevertheless, even at its lowest point, the SMAF index in Sweden remained higher than the EU-average level. Although the index gives good general picture of capital levels and funding accessibility, we are also interested in investors' behavior and willingness to fund new ideas in the post-crisis period. For that reason the next article further investigates the venture capital market with focus on equity investments in the early stage of business formation.

1.2 Venture capital market

Private equity has been identified as crucial for enabling start-ups access to finance. After the 2008 financial crisis and the tightening of credit availability its importance for start-up financing has amplified as we saw from Graph 1. For that reason, first we illustrate the situation of the venture capital on EU-level. Surprisingly, the seed and early stage financing held up better than the later stage financing on the venture market (Graph 3).

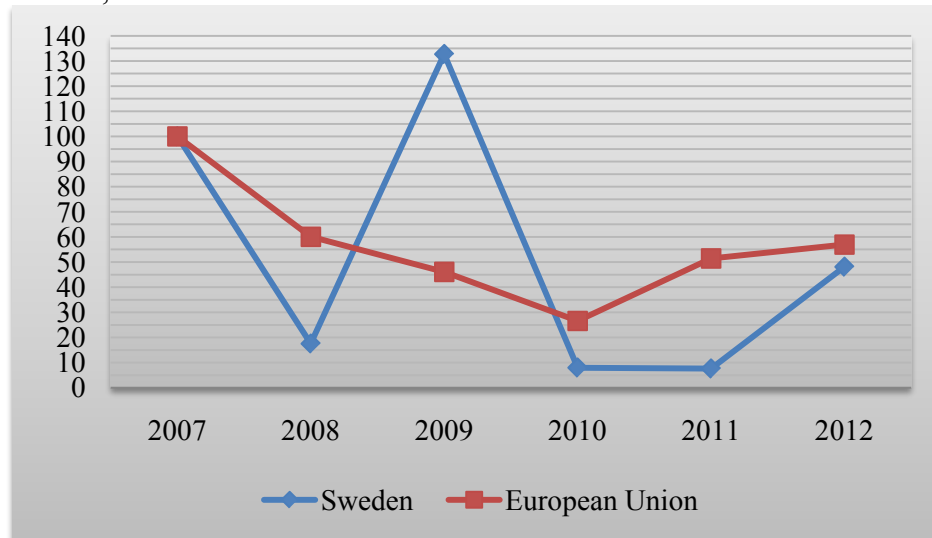
Graph 3 Venture capital investments in the EU, 2007-2013



Source: OECD, *Entrepreneurship at glance*, OECD Publishing, 2014: p.22

Regardless, the venture capital market reported an overall decrease of 50% in investments despite increasing efforts on EU level for directing venture capital investments into new businesses with focus on innovative start-ups.

Graph 4 Early stage equity investments, comparison between EU-28 and Sweden, 2007 - 2012

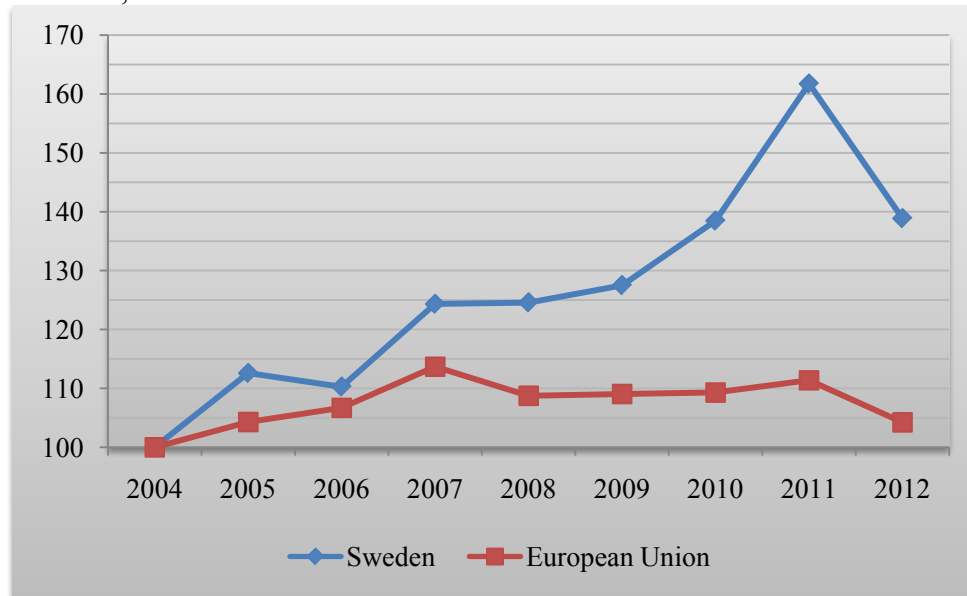


Source: Adapted data from EVCA (2014). "European Private Equity Activity Data 2007-2013", Available at: <http://www.evca.eu/research/activity-data/annual-activity-statistics/>, Accessed on 10 August 2015

However, the situation has been slightly different in Sweden. Namely, the venture capital market in Sweden has experienced major fluctuation during and after the financial crisis reaching its peak in 2009 (Graph 4) when start-up investments on EU-level were plummeting.

One explanation of the 100% increase in Swedish early stage investments can be the booming high-tech startup scene of Sweden which erupted in 2009 and has attracted majority of venture capital investments and business angels. Sweden has been recognized as the second most resourceful tech hub in the world, right after the Silicon Valley with 6.3 billion-dollar tech companies per million people (Davidson, 2015). However, further investigation is needed to better explain the sudden downturn in 2010. Although, as mentioned before this can be a postponed effect from the hit of the crisis.

Graph 5 Number of Start-ups, comparison between EU-28 and Sweden, 2007 - 2012



Source: Adapted data from Eurostat:
<http://ec.europa.eu/eurostat/web/structural-business-statistics/entrepreneurship/business-demography>, Accessed on 10 August, 2015

Nevertheless, we see that investments start to pick up quickly in 2011 at a greater pace in comparison to the EU-average.

The resilience and determination of Swedish entrepreneurs is even more highlighted in the number of new births of enterprises which has experienced a constant rise in the period of 2004-2011. In contrast, start-up levels on average in the EU have been either decreasing or stagnating after 2008 (Graph 5).

Graph 5 only confirms the above discussion on success of Swedish start-ups in comparison to the EU average. Scholars have argued that companies operating in small markets away from the epicenter of innovation like the Silicon Valley and physically away from demanding customers are highly disadvantaged. The Uppsala model vouches for gradual international expansion and steady increase of engagement in foreign markets (Forsgren, 2002). In contrast, in today's interconnected and digital world, "Born Globals" are becoming more the rule, rather than the exception. Skype, Spotify and Candy Crush are only few examples of Swedish start-ups which have altered the way we

communicate, exchange information or entertain ourselves and have obtained global presence on the market from the very beginning. Innovative ideas like these have managed to attract one fifth of the total venture capital invested in the EU in the first three quarters of 2012 (EVCA, 2015). The success of Sweden has attracted the attention of investors, entrepreneurs and researchers. Great part of the success lays in cultural characteristics and heritage of engineering which are next explained.

2. Lessons learned from Sweden

The data presented in the above sections confirmed the success of the Swedish start-up ecosystem which has successfully encouraged high number of start-ups, particularly innovative start-ups. The innovativeness and success has attracted even more entrepreneurs and investors in Sweden spurring further the entrepreneurial activity. In other words, the presence of SMEs and developed private sector signals that a particular industry has low entry costs and high margins. Furthermore, high rate of SMEs suggests that regions have positive attitude towards new start-ups and entrepreneurship is perceived as alluring opportunity. Additionally, in condition of increased risk and uncertainty, start-ups are more likely to flourish in such environments.

Note that, the data also showed that investments levels have not been always high in Sweden either, and have experienced major capital contractions in 2008 and 2010 (Graph 4). Regardless, start-up activity has continued to increase throughout the observed period of 2004-2012 (Graph 5). Actually, much of Sweden's success is contributed to cultural characteristics, new trends in technology and their tendency to take advantage of these novelties to create more competitive products and services on a global level. The next section identifies the reasons which have led to the creation of the innovative business environment and highlights the lessons learned from Sweden.

2.1 International perspective

Companies originating from this region have created products and services for the global consumer. Globalization enabled by telecommunication technologies and the internet has been accredited for the convergence of cultures and creation of global consumers which have

similar preferences regardless of country of origin. Swedish companies have capitalized on these global trends and took an international perspective for their start-ups creating products and services for the global consumer. Sweden thrived because of, not in spite of, its small market. Statistics shows that Swedish company expands internationally twice as fast in comparison to a company from another European country with similar population and market to Sweden (Davidson, 2015). Although, proposed by Swedish researchers (Johanson & Vahlne, 1977) the Uppsala model of gradual expansion does not apply here.

2.2 Leading digital economy

The Nordic countries have been recognized as world digital leaders for 2015 by the Digital Economy and Society Index (European Commission, 2015). Sweden takes the second place with 92% of households having broadband internet access and 48% daily usage of social media usage (Statista, 2015). Furthermore, Stockholm and Oslo recently became the two first cities in the world with **publicly available 4G networks**.

Companies have also used this opportunity and introduced novelties on the market which improve the quality of life in Sweden and make products and services more easily available. For example, Selecta, which owns snack machines all over the Stockholm Metro, recently introduced **mPayment**, enabling their customers to get a cold Coke or a sandwich in the middle of the night, even if they do not have cash. As for buying tickets and goods using mobile phones has become mainstream. Actually, Sweden has been recognized as the most **cash-free society** on the planet (Russell, 2014).

2.3 Tech-savvy generation

Sweden's tech-savvy, Facebook-obsessed population and sleek design sense together with its roots in engineering make Sweden the hottest spot for investors hunting the next big thing. Additionally, Sweden is a country known for its early adoption of new technology, both on individual and business level. Technologies enabling the digital transformation of companies are big nowadays in Sweden among which cloud computing has taken a focal point. From one side cloud technologies have initiated new wave of entrepreneurs who have created innovative services and products like the well-known Spotify, KLARNA, eBuilder, and CityCloud among many others. On the other side many

start-ups have used the cloud technologies to overcome initial obstacles such as lack of financial capital and difficulties of finding right talent. The new technologies have provided start-ups **scalable pricing models** which do not require huge start-up investments or extensive tech knowledge lowering the entry-barriers for SMEs (Entreprenörskaps forum, 2012).

4. Conclusion and recommendations

The fluctuations in the number of start-ups and capital presented in this paper illustrated the destructive effect that the FC has exerted on entrepreneurship. Moreover, the crisis has caused excessive credit tightening shrinking the capital available for start-ups. In such conditions private equity has been identified as essential for reviving start-up activity after the crisis. The analysis on EU data showed that regardless of the extensive efforts of the member countries for increasing financial support of start-ups, investment amounts have stayed below pre-crisis levels. Even in the case of Sweden which has attracted majority of the EU venture capital, early stage investments have decreased dramatically in 2008 and 2010. Regardless such trend, start-up activity has continued to grow in this Nordic country. Such course opens a new direction of research in the field of entrepreneurship. Namely, in recessive period where risk aversion prevails additional incentives are required for increase in start-ups creating.

According to Kreft and Sobel (2005), an area with high entrepreneurial activity will cause the flow of venture capital, rather than models suggesting that an increased capital would spur start-ups. Finally, training individuals to be more independent and autonomous by teaching those skills for coping with adversity will create the potential in individuals to become entrepreneurs even in contracting conditions (Krueger and Brazeal 1994). From the example of Sweden we saw that creating a culture for curiosity, early adoption of technology and global perspective of the market can contribute greatly in higher number of entrepreneurs and success of newly formed businesses. Particularly, in the present digital era of interconnected markets, global consumers and cloud technologies, start-ups can leverage these technologies to cut costs and reach consumers across the globe, as well as recruit top talent in remote locations.

Finally, we argue that potential entrepreneurs will perceive self-employment as an alluring opportunity when witnessing more success stories, as it is the case in Sweden where in a very short period many start-ups gained global presence and success. Policy makers, communities and other influential actors in the economy can help shaping these perceptions in favor of start-ups. Primarily, communities can increase the consciousness of rewards for business formation by publicizing stories of newly founded businesses (Krueger and Brazeal 1994).

According to the entrepreneurial cognition theory, perception and interpretation play a crucial role in circumstances characterized with asymmetric information and uncertainty (Forbes 1999). According to Yates and Stone (1992, cited in Krueger & Brazeal 1994), personal perceptions and interpretations about self-efficacy highly influence the decision for new venture creation in situations with high risk and uncertainty. Namely, if entrepreneurs feel capable of executing task such as the creation of new venture, they would do so, despite the destabilizing effect of the financial crisis. High self-efficacy can help entrepreneurs perceive potential opportunities in the changing environment, instead of postponing the commercialization of their business ideas for better times. Finally, Ajzen's theory for planned behavior identifies perceived feasibility and desirability as crucial for taking entrepreneurial action (Forbes 1999). In this sense, policy makers should not only be looking at the incentives pulling or pushing people to engage with entrepreneurship, but also at the drivers for success and growth of their business. Identifying the main reasons for low survival rates of SMEs will help shaping more effective policies and programs for support of business formation in the EU.

The above discussed conclusion and suggested actions are expected to initiate and nurture more entrepreneurial population referring both to potential entrepreneurs and investors. The result would be higher levels of equity capital and number of start-ups.

References

1. Davidson, L., (2015). How Sweden became the startup capital of Europe, The Telegraph, 28 June, 2015, Available at: <http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/11689464/How-Sweden-became-the-startup-capital-of-Europe.html>, Accessed on: 14 August, 2015
2. Entreprenörskapsforum (2012). CLOUD COMPUTING Challenges and Opportunities for Swedish Entrepreneurs, Available at: http://entreprenorskapsforum.se/wp-content/uploads/2012/11/N%C3%A4ringslivet_i_Cloud_Webb.pdf, Accessed on 14 August, 2015
3. European commission (2013). “A recovery on the horizon?” , Final report, Annual report on European Smes 2012/2013, Gagliardi, D., Muller P., Glossop E., Caliandro, C., Fritsch M., Brtkova G., Bohn U., N., Klitou D., Avigdor G., Marzocchi C., Ramlogan R.,
4. European Commission (2015).The Digital Economy and Society Index (DESI), Digital Agenda for Europe, A Europe 2020 Initiative, Available at: <http://ec.europa.eu/digital-agenda/en/desi>, Accessed on 14 August 2015
5. European Commission Report (2011). Statistical annex of European economy [online].Directorate general ECFIN economic and financial affairs. Available from: http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/statistical_annex_spring2010_en.pdf, Accessed 5 August 2014.
6. Eurostat database (2014). Available at: <http://ec.europa.eu/eurostat/data/database>, Accessed on 5 August 2014
7. EVCA (2014).“European Private Equity Activity Data 2007-2013”, Available at: <http://www.evca.eu/research/activity-data/annual-activity-statistics/>,Accessed on 5 August 2014
8. Fairlie, W., R., (2013). “Entrepreneurship, Economic Conditions, and the Great Recession”, *Journal of Economics & Management Strategy*, Volume 22, pp. 207–23.1
9. Forbes, D. P. (1999). Cognitive approaches to new venture creation.*International Journal of Management Reviews*, 1(4), 415-439.

10. Forsgren, M. (2002). The concept of learning in the Uppsala internationalization process model: a critical review. *International business review*, 11(3), 257-277.
11. Hisrich, D., R., Peters, P., M., Sheperd, A., D. (2010). "Entrepreneurship", McGraw-Hill Irwin, 8th edition, 2010.
12. IFF (2013). Restoring financing and growth to Europe's SMEs, Bain & Company, Inc. and the Institute of International Finance, 2013
13. Kreft, S. F., & Sobel, R. S. (2005). Public policy, entrepreneurship, and economic freedom. *Cato J.*, 25, 595.
14. Krueger, N. F., & Brazeal, D. V. (1994). Entrepreneurial potential and potential entrepreneurs. *Entrepreneurship theory and practice*, 18, 91-91.
15. OECD (2014). *Entrepreneurship at a Glance*, OECD Publishing, http://dx.doi.org/10.1787/entrepreneur_aag-2014-en, Accessed on August, 2015
16. Reynolds, P., J. Storey, J. D. and Westhead, P. (1994). "Cross-national Comparisons of the Variation in New Firm Formation Rates, Regional Studies", Vol. 28:4, pp. 443-456
17. Russell H. (2014). Welcome to Sweden - the most cash-free society on the planet, The Guardian, Available at: <http://www.theguardian.com/world/2014/nov/11/welcome-sweden-electronic-money-not-so-funny>, Accessed on 10 August 2015
18. SAFE (2014). Survey on the Access to Finance of Enterprises, Available at: http://ec.europa.eu/enterprise/policies/finance/data/index_en.htm, Accessed on 5 August 2014
19. Statista (2015) Available at: <http://www.statista.com/markets/422/topic/523/sweden/>, Accessed on 14 August 2015
20. Vetter, S., Köhler, J. (2014). Business demographics and dynamics in Europe, Deutsch Bank Research, 2014.

UDC 334.72.012.63/.64:001.895]:303.6(497.7)
Original scientific paper

Zoran JANEVSKI¹⁾
Elena DAVITKOVSKA²⁾
Vladimir PETKOVSKI³⁾

BARRIERS OF IMPLEMENTING OPEN INNOVATIONS IN MACEDONIAN SMEs

Abstract

Open innovation is a concept of growing acceptance in the field of innovation management. It is based on the idea that companies can leverage the knowledge generated externally to improve their innovation performance. Shorter innovation cycles, the rising costs of industrial research and development, and a lack of resources have motivated many organizations to change their innovation strategies towards implementing open innovations. However managing open innovation process in SMEs is more difficult and complex than it is the case with large enterprises. The reasons behind the low integration of the open innovations in SMEs generally can be found in their limited organizational, financial and human resources. By conducting a survey among 63 SMEs in Republic of Macedonia, current open innovation practices and barriers are searched. Findings revealed that the low capacity of the SMEs to deal with the open innovation process, low awareness of the benefits of the open innovation process, and lack of knowledge on protection of intellectual property rights are concluded as the main constraints in adapting open innovation practices.

¹⁾ PhD, Assistant Professor, "Ss. Cyril and Methodius" University, Institute of Economics – Skopje, Prolet No.1, e-mail: zoran.janevski@ek-inst.ukim.edu.mk.

²⁾ PhD, Assistant Professor, "Ss. Cyril and Methodius" University, Institute of Economics – Skopje, Prolet No.1, e-mail: elena@ek-inst.ukim.edu.mk.

³⁾ PhD, Research Assistant, "Ss. Cyril and Methodius" University, Institute of Economics – Skopje, Prolet No.1, e-mail: vladimir@ek-inst.ukim.edu.mk.

Keywords: open innovation, SME, open innovation process, open innovation barriers, open innovation awareness

JEL Classification: O31

Introduction

The open innovation is a concept of growing acceptance in the field of innovation management. It is based on the idea that companies can leverage the knowledge generated externally to improve their innovation performance. Open innovation is based on the traditional innovation process which represents a crucial aspect of promoting the growth and development of SMEs. But establishing a system for implementing the process of innovation, which is time consuming and very complex process, is usually a great financial burden for the SMEs, and providing long-term finance for innovation would have a devastating effect on them.⁴ Therefore, new ways of innovation must be looked for, in which open innovation represents a viable alternative for companies. Shorter innovation cycles, the rising costs of industrial research and development, and a lack of resources have motivated many organizations to change their innovation strategies towards implementing open innovations.⁵ Open innovation is defined as “the purposive use of inflows and outflows of knowledge to, respectively, accelerate internal innovation, and expand the markets for external use of innovation process”.⁶ Open innovation can be a part of any of the four different types of innovation: 1) innovation in process of production, 2) innovations in business model, 3) innovations in product and 4) innovation in organization. All of these types of innovations can be made easier through the concept of open innovation, by creating a mutual trust between the SMEs and their innovation partners and joining their resources in creating innovations.

⁴Zimmermann Volker, (2014).KfW SME Panel 2013: How German SMEs finance their innovations, KfW Economic Research, p. 1.

⁵Gassmann Oliver and Enkel Ellen (2004), Towards a Theory of Open Innovation: Three Core Process Archetypes, Institute of Technology Management, University of St. Gallen, Switzerland, p. 2

⁶Chesbrough Henry (2006), “*Open Innovation: The New Imperative for creating and Profiting from Technology*”, Harvard Business School Press, United States, p. 2.

The SME sector in Macedonia is very important for the economy. According to the State Statistical Office data,⁷ the number of active business entities in the Republic of Macedonia in 2014 was 70,659 and SMEs represent 99.7 percent of them. They engaged about 76.7 percent of total number of employees and created 65.6 percent of the value added.⁸

According to the Innovation Union Scoreboard 2014, Republic of Macedonia is a modest innovator ranking 31st out of 35 countries with *Summary Innovation Index* of 0.2458 much below 0.5539 which is the EU average. The situation with SMEs' innovation is even worse. Macedonia is ranked 31st based on *SMEs innovating in-house* indicator (0.0155), and 19th regarding *Innovative SMEs collaborating with others* indicator (0.3590) which gives some perception on open innovation adoption by the SMEs in Republic of Macedonia. Regarding innovation outputs, *SMEs introducing products or process innovations* indicator is 0.5938 (ranked 15th) and *SMEs introducing marketing/organizational innovations* indicator is 0.3615 (ranked 24th).⁹ So, the open innovation is still a relatively new process in Republic of Macedonia with only small portion of enterprises actually practicing it.¹⁰ The reasons behind the low commitment to the innovation in general can be seen in the lack of innovation network, limited funding opportunities and lack of venture capital, and very small percentage of GDP devoted to research and development¹¹. Larger enterprises can allocate much more assets into the research and development program; on the other hand, SMEs rely on their new ideas, knowledge of consumers and commitment to innovation, which all together increase their chances for market success. But, the lack of information and data concerning the process of open innovation is one of the possible reasons for low level of awareness for the process of open

⁷State Statistical Office of Republic of Macedonia. 2015a. Number of active business entities, 2014. News Release No: 6.1.15.14. Available at: <http://www.stat.gov.mk/pdf/2015/6.1.15.14.pdf> [Accessed 18 May 2015]

⁸State Statistical Office of the Republic of Macedonia. 2015b. MAKStat Database. Available at <http://makstat.stat.gov.mk/pxweb2007bazi/Dialog/Saveshow.asp> [Accessed 18 May 2015].

⁹European Commission (2014), Innovation Union Scoreboard 2014. European Commission, Brussels

¹⁰Josimovski Sasho (2011), "Thematic Report 2011 under Specific Contract for the Integration of INNO Policy Trend Chart with ERAWATCH", Pro Inno Europe, pp. 9-12.

¹¹Ibid, pp. 13-15.

innovation amongst the Macedonian SMEs.¹² Also, the lack of networking structure at national and regional level on tackling open innovation issues can be foreseen as one of the crucial problems for implementation of open innovation process particularly in SMEs.

This paper concerns level of awareness and constraints for adoption of open innovation strategies in SMEs in Republic of Macedonia. The constraints have been categorized referring to the four open innovation aspects: human constraints, general constraints, policy constraints, and constraints that have evolved due to the rise of global competition¹³

1. Theoretical review

Open innovation is a distributed process of innovation based on purposively managed knowledge flows across organizational boundaries, using pecuniary and non-pecuniary mechanisms in line with each organization's business model.¹⁴ This means knowledge inflows to the focal organization (leveraging external knowledge sources through internal processes), knowledge outflows from a focal organization (leveraging internal knowledge through external commercialization processes) or both (coupling external knowledge sources and commercialization activities).¹⁵ The traditional (closed) innovation system has some serious shortcomings and there is an urgent need of establishing a contemporary innovation system – an open innovation system. The contrasting principles of closed and open innovation include:¹⁶

¹²Ibid.

¹³Rahman Hakikur and Ramos Isabel (2013), "*Challenges in Adopting Open Innovation Strategies in SMEs: An Exploratory Study in Portugal*", Issues in Informing Science and Information Technology, Volume 10, p. 435.

¹⁴Chesbrough Henry and Bogers Marcel (2014), "Explicating Open Innovation: Clarifying an Emerging Paradigm for Understanding Innovation" in *New Frontiers in Open Innovation*, eds. Chesbrough H., Vanhaverbeke W., and West J., ISPIIM, Dublin, pp. 3-28.

¹⁵Ibid.

¹⁶Chesbrough Henry (2006), "Open Innovation: The New Imperative for creating and Profiting from Technology", Harvard Business School Press, United States, p. 2.

Closed Innovation principles

- The smart people in the field work for us.
- To profit from R&D and Innovation, we must discover it, develop it, and ship it ourselves.
- If we discover it ourselves, we will get it to the market first.
- The company that gets an innovation to the market first will win.
- If we create the most and the best ideas in the industry,
- We should control our IP, so that our competitors don't profit from our ideas

Open Innovation principles

- Not all the smart people in the field work for us. We need to work with smart people inside and outside the company.
- External R&D and Innovation can create significant value: internal R&D and Innovation is needed to claim some portion of that value.
- We don't have to originate the research to profit from it.
- Building a better business model is better than getting to the market first.
- If we make the best use of internal and external ideas, we will win.
- We should profit from others' use of our IP, and we should buy others' IP whenever it advances our business model.

There are two important kinds of open innovation: outside-in and inside-out. The outside-in part of open innovation involves opening up a company's innovation processes to many kinds of external inputs and contributions. Inside-out open innovation requires organizations to allow unused and underutilized ideas to go outside the organization for others to use in their businesses and business models.¹⁷ In contrast to the outside-in branch, this portion of the model is less explored and hence less well understood, both in academic research and also in industry practice. In order to further improve the scientific capabilities and

¹⁷Chesbrough Henry (2015), *"From Open Science to Open Innovation"*, Institute for Innovation and Knowledge Management, ESADE, Science Business Publishing, p. 2.

commercialize the research output from projects such as the LHC,¹⁸ new businesses and business models must be identified, explored, and undertaken.¹⁹

In addition to being beneficial for large "firms as well as for small and medium-sized enterprises (SMEs),²⁰ SMEs can open their own innovation processes to implement internal ideas otherwise unexplored, to ensure access to external ideas, to enable better utilization of their partially hidden innovation potential, to share the wealth and efficiency in resource allocation(e.g. per unit cost accounting basis),to extend their potential for growth via alliances and or attraction of funding, to be offered ample opportunities by larger companies to access resources/knowledge otherwise far too expensive for them.²¹

The Government of Republic of Macedonia has implemented several strategies regarding innovation, wherein we can recognize certain elements of open innovation; however, this field is not fully regulated and there is no significant practical implementation of open innovation.

2. Empirical research

The research aims to acquire knowledge about open innovation adoption by SMEs in Republic of Macedonia. The focus is to identify SMEs characteristics especially related to their innovation activities in general, and in open innovation process in particular. **The main goal is to identify Macedonian open innovation trends and practices and identify obstacles constraints for open innovation adoption.** Several specific objectives of this research are:

¹⁸See Boisot, Nordberg,Yami and Incquevert, Collisionsand Collaborations: The Organization of Learning in the Atlas Experiment at the LHC, (Oxford University Press: 2011) for one detailed description of the institutions governing the science at CERN.

¹⁹Chesbrough Henry (2015), "*From Open Science to Open Innovation*", Institute for Innovation and Knowledge Management, ESADE, Science Business Publishing.

²⁰Chesbrough Henry (2006), "Open Innovation: The New Imperative for creating and Profiting from Technology", Harvard Business School Press, United States, p. 2.

²¹Open Innovation Benefits For SMEs, - project funded by the European Collaborative and Open Regional Innovation Strategies – EURIS, The Interregional Cooperation Program INTERREG IVC and Co-financed by ERDF under INTERREG IVC program of the European Union.

- To assess the level of open innovation awareness amongst Macedonian SMEs
- To assess the open innovation adoption by SMEs
- To identify the key actors involved in open innovation process in Macedonia
- To recommend measures to improve open innovation adoption rate by SMEs

The survey was conducted using a questionnaire as a research tool for data collection. The questionnaire was developed and placed online using the Google Drive and communication via emails with a request to fill in the questionnaire were sent to 63 SMEs. Responses were received from 36 respondents, representing 57 percent response rate which is much higher than the average response rate of 35.7 percent for studies that utilized data collected from organizations.²² Still, the margin of error for this sample size is 16.7 percent, so the survey results are not representative, but only indicative and will use as a pilot for tuning the final design of full research that will be carried out in the next phase.

Respondent sample is consisted of 21 micro, 14 small and 1 medium enterprises belonging to the industries represented at the Table 1.

Table 1 – SME survey sample by sector

Sector	
Information and communication	33.3%
Wholesale and retail trade; repair of motor vehicles and motorcycles	30.6%
Manufacturing	25.0%
Accommodation and food service activities	8.3%
Electricity, gas, steam and air conditioning supply	2.8%
Grand Total	100.0%

Source: *Authors' research*

Almost one fifth of all enterprises (19.4 percent) do not have innovation budget at all, and 44.4 percent spent only 0-1 percent from their income on innovation activities (Table 2).

²²Baruch, Yehuda & Holtom C. Brooks (2008), "Survey response rate levels and trends in organizational research", *Human Relations* vol. 61 no. 8, pp. 1139-1160.

Table 2 – Percentage of income spent on innovation activities

Percent from income spend on innovation	Percentage of enterprises
0	19.4%
0-1%	44.4%
1-2%	8.3%
2-4%	25.0%
15%+	2.8%
Grand Total	100.0%

Source: *Authors' research*

SMEs in Macedonia do not pay much attention on innovation activities. The results also show that 72.3 percent of all enterprises do not have employees dedicated to any innovation activities (16.7%) or only 0-3 percent of the employees are part of some innovation activities in the company (55.6%)(Table 3).

Table 3 - Employees dedicated to innovation activities

Percent from all employees dedicated to innovation	Percentage of enterprises
0	16.7%
0-3%	55.6%
3-6%	11.1%
6-10%	2.8%
15-20%	8.3%
30%+	5.6%
Grand Total	100.0%

Source: *Authors' research*

The results shows that 83.3 percent of all SMEs have not heard about the concept of Open Innovation, and 94.4 percent have no knowledge about Open Innovation concept at all. Despite the low awareness amongst Macedonian SMEs, 54.5 percent of all SMEs have cooperated with other companies or organizations in any of their innovation activities, so the SME are not aware of, but still they use the Open Innovation concept.

Table 4 - Main innovation partners of Macedonian SMEs

Type of Innovation Partner	Mean	n	Response rate
Suppliers of equipment, materials, components or software	7.50	21	38.2%
Clients or customers from the private sector		9	16.4%
Government, public or private research institutes		8	14.5%
Universities or other higher education institutes		7	12.7%
Clients or customers from the public sector		5	9.1%
Competitors or other enterprises in the sector		5	9.1%
Consultants or commercial labs institutes		0	0.0%

Source: *Authors' research*

Table 4 illustrates the type of innovation partners of the SMEs. According to the results the most common partners into their innovation activities are their suppliers (38.2 percent) and clients from the private sector (16.4 percent). The most unlikely partners of the SMEs in innovation activities are the clients from the public sector, competitors and consultants or commercial labs.

Table 5 - Open Innovation Concept per type of Innovation

Purpose of use Open Innovation		n	Response rate
Product Innovation	Yes	28	84.8%
	No	5	15.2%
Process Innovation	Yes	15	83.3%
	No	3	16.7%
Business Model Innovation	Yes	21	80.8%
	No	5	19.2%
Organization Innovation	Yes	20	87.0%
	No	3	13.0%

Source: *Authors' research*

Table 5 shows the percentage of SMEs that intent to use or are already using the concept of Open Innovation for different type of innovation activities. According to the results, all four types of

innovation activities are appropriate to be implemented with the Open Innovation concept.

The research shows that 80.6 percent of the SMEs have dedicated no part of their innovation budget for Open Innovation activities, have no dedicated employees for open innovation and also have no product developed in the last three years which is based on the open innovation principles. 19.4 percent of all respondents spent 0-5 percent of their innovation budget on open innovation activities, resulting in 0-10 percent of their new products developed implementing open innovation concept.

According to the answers provided by the SMEs presented on Table 6, the key constraints regarding Human Resources are the scarcity of skilled employees in their companies (93.3 percent) and the high level of the wages which is burden for their financial condition (36.7 percent). The Key general constraints are the lack of knowledge to implement new technology (54.5 percent) and the lack of skilled workers on the Macedonian labor market (51.5 percent). In an era of globalization and enormous influence that Internet technologies have on people's private and professional life, the competitiveness constraints to adoption of the open innovation competition constraints, or activities that should be undertaken to compensate the barriers related to competition. The first one is to increase the quality of the products/services (72.7 percent) and to increase the marketing activities (66.7 percent). The last aspects of the constraints for implementing Open innovation in SMEs are the so called policy constraints.

Table 6 – Key constraints in implementing Open Innovation in SMEs

Key Constraints	n	Response rate
Recruiting Constraints		
Scarcity of skilled employees	28	93.3%
Wages of the skilled employees are too high, it is a great burden for us	11	36.7%
General Constraints		
Lack of knowledge in implementing new technology	18	54.5%
The labor market lacks skilled workers	17	51.5%
Competition Constraints		
Increase quality of product/service	24	72.7%
Increase marketing activity	22	66.7%
Policy Constraints		
Government policies, laws and regulations	19	73.1%
Unfavorable business climate	17	65.4%

Source: *Authors' research*

The last aspects of the constraints for implementing Open innovation in SMEs are the so called policy constraints. Macedonian SMEs have identified the following two key constraints: 1) problems with the government policies, laws and regulations that are not in favor of the open innovation concept, and 2) the unfavorable business climate presence in the country.

From all aspects of problems identified by the Macedonian SMEs with the adoption and implementation of the Open Innovation concept in their innovation activities the ultimate key constraint is the problem with the lack of skilled employees involved in the business.

Results presented on Table 7 shows that according to the SMEs themselves three main factors important for successful implementation and practice of Open Innovation concept in SMEs are: Support by the top management, Collaborators' training on Open Innovation and Allocation of enough resources (including employees, time and budget) dedicated to Open Innovation.

Table 7 - Factors affecting success of implementing Open Innovation concept in SMEs

Open Innovation Success Factors for SMEs	n	Response rate
Support by the top management	19	57.6%
Collaborators' training for Open Innovation	18	54.5%
Allocate enough resources (employees, time and budget)	14	42.4%
Managing an idea generation process (selection and prioritization of the ideas)	11	33.3%
Managing the intellectual property (protection and valorization)	11	33.3%
Ability to measure Open Innovation success in Enterprises	9	27.2%
To have a corporate culture that promotes idea-sharing	7	21.2%
Support by the middle management	3	9.1%
Existence of systematic and organized approach for acceptance of external ideas	3	9.1%
Proper selection and encouraging of partnerships	3	9.1%

Source: *Authors' research*

Conclusion

SMEs on their innovation path can follow two possible approaches. The first one is to perform the innovation activities fully in-house (so called close innovation), but for small firms this is a big challenge because they typically struggle with lack of financial resources, scant opportunities to recruit specialized workers, poor understanding of advanced technology, and so on. The second approach is to adopt an innovation model to use ideas and knowledge from outside the firm's boundaries, so called open innovation concept.

The awareness of Macedonian SMEs on Open Innovation is not satisfactory. It is evident from the research results that in general they do not pay proper attention on innovation activities (both closed and open), but the fact that they do not have even idea and information on good SMEs open innovation practices and strategies should raise a 'red flag' among all innovation stakeholders in the country.

The research finds that the two main constraints for the low level of open innovation adoption rate by the SMEs are the problem related to

the scarcity of skilled employees and the problem with the government policies, laws and regulations that are not supportive to the open innovation paradigm.

Despite overcoming both key constraints depend more on innovation policy makers, the SMEs themselves could make some actions to improve as well. The research suggests that the most obvious measures are to build a strong commitment and support for open innovation concept by the SME's top management (in most cases the owners of the firms), and to take joint activities with firm's collaborators and partners with focus on promotion and training on Open Innovation concept.

Literature

1. Baruch, Yehuda & Holtom C. Brooks (2008), "Survey response rate levels and trends in organizational research", Human Relations vol. 61 no. 8, pp. 1139-1160;
2. Chesbrough Henry (2006), "Open Innovation: The New Imperative for creating and Profiting from Technology", Harvard Business School Press, United States.
3. Chesbrough Henry (2015), "From Open Science to Open Innovation", Institute for Innovation and Knowledge Management, ESADE, Science Business Publishing.
4. Chesbrough Henry and Bogers Marcel (2014), "Explicating Open Innovation: Clarifying an Emerging Paradigm for Understanding Innovation" in *New Frontiers in Open Innovation*, eds. Chesbrough H., Vanhaverbeke W., and West J., ISPIM, Dublin, pp. 3-28
5. Gassmann Oliver and Enkel Ellen (2004), *Towards a Theory of OpenInnovation: Three Core Process Archetypes*, Institute of Technology Management, University of St. Gallen, Switzerland.
6. European Commission (2014), *Innovation Union Scoreboard 2014*. European Commission, Brussels.
7. Josimovski Sasho (2011), "Thematic Report 2011 under Specific Contract for the Integration of INNO Policy Trend Chart with ERAWATCH", Pro Inno Europe.
8. *Open Innovation Benefits For SMEs*, - project funded by the European Collaborative and Open Regional Innovation Strategies – EURIS, The Interregional Cooperation Program INTERREG

IVC and Co-financed by ERDF under INTERREG IVC program of the European Union.

9. Rahman Hakikur and Ramos Isabel (2013), “*Challenges in Adopting Open Innovation Strategies in SMEs: An Exploratory Study in Portugal*”, Issues in Informing Science and Information Technology, Volume 10.
10. State Statistical Office of Republic of Macedonia. 2015a. *Number of active business entities, 2014*. News Release No: 6.1.15.14. Available at: <http://www.stat.gov.mk/pdf/2015/6.1.15.14.pdf> [Accessed 18 May 2015];
11. State Statistical Office of the Republic of Macedonia. 2015b. MAKStat Database. Available at <http://makstat.stat.gov.mk/pxweb2007bazi/Dialog/Saveshow.asp> [Accessed 18 May 2015]
12. Zimmermann Volker (2014), *KfW SME Panel 2013: How German SMEs finance their innovations*, KfW Economic Research.

UDC 336.5:338.121(497.7)"2005/2013"
Original scientific paper

Elizabeta DJAMBASKA¹⁾
Aleksandra LOZANOSKA²⁾

CAPITAL EXPENDITURES AND THEIR IMPORTANCE FOR THE ECONOMIC GROWTH IN THE REPUBLIC OF MACEDONIA

Abstract

This paper considers the public expenditures in the Republic of Macedonia, especially the capital expenditures and their structure in the period from 2005 – 2013. The analysis identifies and explains their effects on economic growth in the country. Most of the public expenditures in the Republic of Macedonia consist of current expenditures, transfers, purchase of goods and services, while the share of capital expenditures is low. There is a trend of slight increase of capital expenditures but they are mostly financed through borrowing, which decreases their impact on the economic growth. The analysis indicated that the reform of the public expenditure structure in the country is necessary, as the public expenditures grow slower compared to GDP growth. The reforming measures should aim to increasing the capital expenditures, especially those that refer to investments that drive economic growth.

Key words: Fiscal Policy, Public Expenditures, Capital Expenditures, Economic Growth, Republic of Macedonia

JEL classification: E62, H5, H50, O110, P240

¹⁾ Ph.D., Ss. Cyril and Methodius University in Skopje, Institute of Economics – Skopje, Republic of Macedonia, e-mail: beti@ek-inst.ukim.edu.mk

²⁾ Ph.D., Ss. Cyril and Methodius University in Skopje, Institute of Economics – Skopje, Republic of Macedonia, e-mail: sandra@ek-inst.ukim.edu.mk

1. Classification of public expenditures

The public expenditures have various classifications. Their classification allows better analysis of the nature, functions and importance of public expenditure. Also, it facilitates their planning, reporting and control. Public expenditures have similar characteristics in any fiscal system, either in developed economies or developing countries. Thus, costs can be regular or extraordinary, depending on the time when they occur; personal and material in respect of the object of spending, whether they are intended for salaries and benefits for employees in public administration or related to purchases of goods and services to carry out public functions. All expenditures are realized as Government expenditures and expenditures of local governments.

The most important classification of public expenditures is their division on productive public expenditures and transfers. The classification comes from the English theorist Arthur Pigou³ who divided expenditures to real (current) and transfers. In recent times, this division has been expanded to real, investment and transfer public expenditures.

The current and investment expenditures compose the group of productive expenditures. The proper quantification and targeting of productive expenditures is a powerful tool of the state to encourage economic activity and promote economic growth. In the category of productive expenditures, investment expenditures are known as capital expenditures. Capital expenditures contribute to economic activity and realization of higher GDP. Indirectly, they provide an increase of public budget revenues through taxation on the conducted works. Their presence is of particular importance in the fiscal system when the economy is in recession.

The transfer expenditures are productive expenditures too, but they do not affect directly the real GDP. However, there are indirect positive effects on the economy through income redistribution. The transfer expenditures provide translocation of the funds from national budget to actors on national or local level, thereby increasing their ability to satisfy their needs.

³Arthur Pigou, *A Study in Public Finance*, 1928, www.questia.com/read/30362402/a-study-in-public-finance

2. The economic effects of public spending

The public policy analysis pays special attention to determining the impact of public expenditures and income redistribution on economic stabilization (stable prices and full employment), the improvement of foreign trade, maintaining a stable exchange rate and encouraging economic growth. Special importance is given to government decisions and the impact of the state as a market participant. Taxation is one of the ways through which the state directly affects economic activity. Another way is through public spending. Public procurement for the functioning of the state apparatus, such as materials and equipment costs, wages of the administration, transfers, interests and repayment of public loans affect aggregate demand and aggregate supply. Public purchases of the state, in particular of information technology and electronics, pharmaceutical products (in countries with compulsory health insurance), weapons and ammunition, military vehicles (aircraft, submarines, ships and automobiles), as well as products from the aeronautical industry (satellites, spacecraft and equipment) directly increase the aggregate demand.

In addition, public expenditures have indirect influence, too. Administration salaries and various types of transfers also influence the aggregate demand through increase of the purchasing power of their recipients. However, there are monetary aspects in the economy that affect the trend of public expenditures. The level of public spending is determined by the level of supply and demand in the economy, which is under influence of inflationary and deflationary movements in the economy.

Another important aspect that should be analyzed with regards to the public expenditures is their financing. In the case when public expenditures exceed public revenues, financing of the excess of the budget spending could be done by taking loans at home and/or abroad or by issuing T-bills. Both cases rely on borrowing, which could have very demanding and far-reaching implications in the future. On the other hand, higher public expenditures result in increased aggregate demand, which disturbs the macroeconomic balance, leads to inflation and rise of the public debt in the economy. In the case when public expenditures are lower than public revenues, the budget is in surplus. This could have positive effects only if the economy is in expansion. Otherwise, this condition has many negative aspects. Reduced public spending reflects into lower total aggregate consumption. This leads to reduced economic

and investment activity, deflation and lower interest rates, which negatively affect the economic growth.

Proper management of the public expenditures is crucial, as there are many multiplicative effects of public investment. Public investment primarily cause an increase in employment and national income and result in increased engagement of the production factors available in the country (capital, raw materials and labor). Implicitly, higher production have positive influence on income and aggregate demand. In addition, the investment in infrastructure, science and education, new knowledge and technology, health, environment and other areas of public interest contribute to the overall economic development of the country. In this respect, identification of the priorities for public spending must be done according to the needs and specifics of the country. There are evident differences between the priorities of public expenditures, among developed, developing and underdeveloped economies. Developed economies give priority to science and technology, human resource development and social welfare. Other countries mostly face lack of resources for such expenditures and mostly have current costs and expenses in their national budgets.

3. The structure and characteristics of public expenditures in the Republic of Macedonia

The volume of public expenditure in the Republic of Macedonia is determined each year following the procedure and conditions established by law.⁴ The classification of expenditures in the national budget includes public expenditures of the central government, public expenditures of local authorities, transfers of social security funds, health fund, as well as other transfers relevant for conduction of state's functions. The amount of total public expenditures depends on the scope of the legally defined functions and responsibilities of the state, its institutions and the policy of financing of the public expenditures at the national level.

The public expenditures in the Republic of Macedonia for the period 2005-2014 are presented on the Table 1. The relative share of each category into the public expenditures is presented on Table 2.

⁴ Budget Law, Official Gazette no. 79/93, 3/94, 15/99 and 11/2001

Table 1 Total Public Expenditures in the Budget of the Republic of Macedonia for the period 2005-2014

- In million denars

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Budget Expenditures	100219	105744	117436	140265	139393	142692	148649	155840	159505	168063
1. Current Expenditures	90027	96478	103695	120201	125965	127358	130939	137083	142894	150440
Wages and Salaries	22835	23421	23607	20828	22699	22638	23147	22714	22566	23096
Goods and Services	12984	12927	14813	18749	16220	14681	13958	14652	14877	15467
Transfers	51597	56607	62401	77980	84601	86865	90363	95501	100845	106787
2. Interests Payments	2611	3137	2874	2644	2445	3174	3471	4216	4606	5090
3. Capital Expenditures	10192	9266	13741	20064	13428	15334	17710	18757	16611	17623

Source: Statistics of the National Bank of the Republic of Macedonia,
<http://www.nbrm.mk/?ItemID=709DEDEDF66C8544A9F4A27DBF6EDA07>

As evident from the data, transfers are the most important category into the structure of public expenditures in the Republic of Macedonia over the analyzed period (2005-2014). The relative share of transfers ranged from 51,48% in 2005 up to 63,54% in 2014 (Table 2), indicating continuously rising trend. Also, the absolute value of transfers rose by 106% over the period 2005-2014 (Table 1). Another category which takes significant proportion of total public expenditures is related to wages and salaries. The share of this category in the total expenditures noted a declining trend over the period, falling from 22,79% in 2005, 15,57% in 2011 and down to 13,74% in 2014 (Table 2). However, the absolute value of the wages and salaries have not changed significantly over the period.

Table 2 Structural Share of the Public Expenditures in the Budget of the Republic of Macedonia for the period 2005-2014

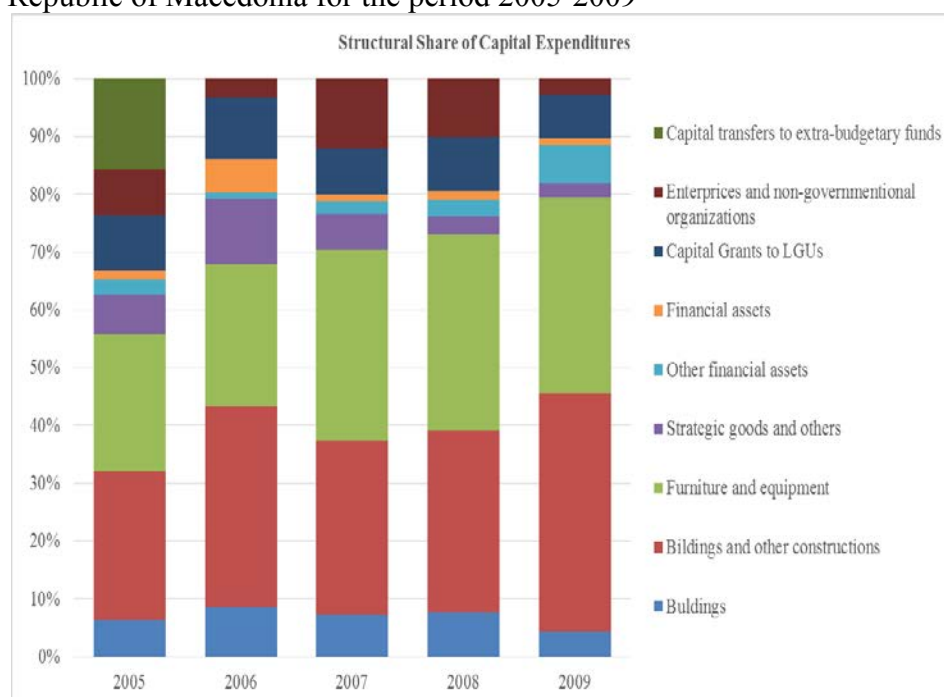
- %

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
1. Current Expenditures	89,83	91,24	88,30	85,70	90,37	89,25	88,09	87,96	89,59	89,51
Wages and Salaries	22,79	22,15	20,10	14,85	16,28	15,86	15,57	14,58	14,15	13,74
Goods and Services	12,96	12,22	12,61	13,37	11,64	10,29	9,39	9,40	9,33	9,20
Transfers	51,48	53,53	53,14	55,59	60,69	60,88	60,79	61,28	63,22	63,54
2. Interests Payments	2,61	2,97	2,45	1,89	1,75	2,22	2,34	2,71	2,89	3,03
3. Capital Expenditures	10,17	8,76	11,70	14,30	9,63	10,75	11,91	12,04	10,41	10,49

Source: authors calculations according to the official data from the Statistics of the National Bank of the Republic of Macedonia, www.nbrm.mk

The most remarkable changes into the absolute value of the structure of public expenditures was noted in the category of capital expenditures. The allocations for this category increased by 73% over the period 2005-2014 (Table 1). On the other hand, the share of capital expenditures rose from 10.2% in 2005 up to the highest level of 14.30% in 2008 and have later stabilized to around 10.5% in 2014.

Figure 1 Structural Share of Capital Expenditures of the Budget in the Republic of Macedonia for the period 2005-2009



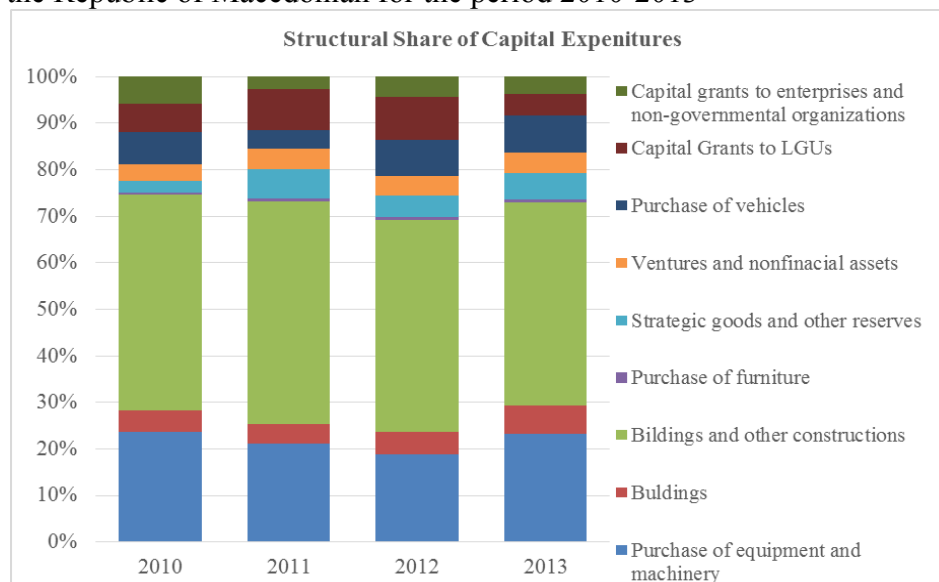
Source: Final Statement of the Budget of the Republic of Macedonia, Official Gazette of the Republic of Macedonia number 25/2007, 111/2008, 112/2008 and 119/2010

Given the significant increase of the capital expenditures in absolute terms, as well as their impact on the economy discussed in the previous section, we would provide further analysis of their structure. The available data for the structure of the capital expenditures in the Republic of Macedonia are classified in two periods: 2005 - 2009 (Figure 1) and 2010 - 2013 (Figure 2). These data refer to the structure of realized expenditures in the Central Budget of the Republic of

Macedonia. The difference between the two periods is attributable to the legal changes of the classification of costs under capital expenditures.⁵

The analysis referring to the period 2005-2009 indicate largest share of the category buildings and other constructions in the capital spending, ranging from 25,84% in 2005 up to 41,29% in 2009 (Figure 1). No changes of classification of this cost occurred between the analyzed periods, so the data for two periods are fully comparable. The category buildings and other constructions has been also dominant into the period 2010-2013 (Figure 2). Its largest share of 48% in total capital expenditures was registered in 2011. The referent values for 2012 and 2013 were 46% and 42%, respectively.

Figure 2 Structural Share of the Capital Expenditures in the Budget in the Republic of Macedonia for the period 2010-2013



Source: Final Statement of the Budget of the Republic of Macedonia, Official Gazette of the Republic of Macedonia number 138/2011, 114/2012, 157/2013 and 107/2014

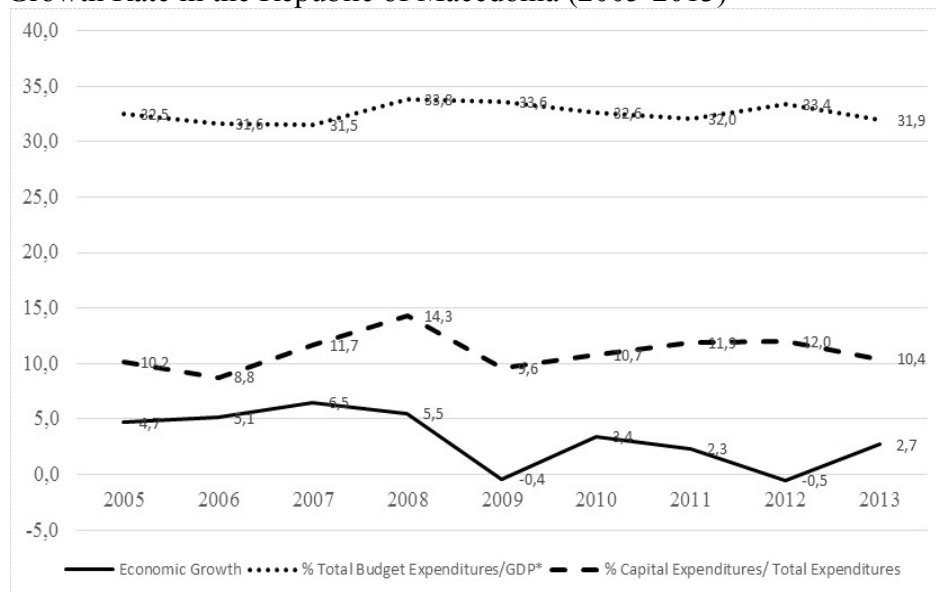
Another category that have absorbed significant part of the capital expenditures is related to purchase of furniture and equipment. This category is not fully comparable for the two analyzed periods, as the

⁵ Pursuant to Article 13 paragraph 3 of the Budget, on June 9, 2009 the Minister of Finance adopted a new Regulation on classification of expenditures, which is applied from January 1, 2010. According to this regulation, capital expenditures are detailed divided in specified capital expenditures subcategories.

Regulation of 2009 introduced division of these expenditures in three separate subcategories: purchase of vehicles, purchase of furniture and purchase of equipment and machinery. This share in the period which is taken in consideration presents simple sum of the previously mentioned subcategories and it is around 30%. More precisely, 23,61% in 2005, 33,9% in 2008, 27,13% in 2012 and 31,06% in 2013. These expenditures are increasing the public spending, but because they are unproductive spending, they are not encouraging the investment activity.

The structure of public expenditures provided above indicates certain increase of the capital expenditures, but their impact on the economic growth has not been significant. On the contrary, the level of public expenditures in GDP in the analyzed period did not register notable changes (Figure 3). There has been certain increase of the level of the economic growth, too, but the public expenditures have not significantly boosted the growth.

Figure 3 Trend Line of Share of Public Expenditures in GDP, Share of Capital Expenditures in Total Government Expenditures and Economic Growth Rate in the Republic of Macedonia (2005-2013)



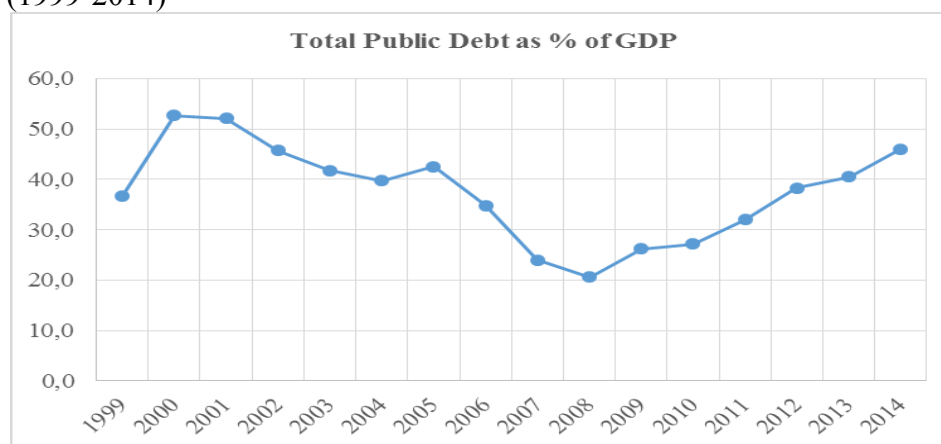
*- the calculations are made using the official data for realized total government expenditures from the Final Statement of the Budget of the Republic of Macedonia published in the Official Gazette of The Republic of Macedonia

Source: authors calculations according to the official data from the Statistics of the National Bank of the Republic of Macedonia, www.nbrm.mk; Official Gazette of The

Republic of Macedonia, number 25/2007, 111/2008, 112/2008, 114/2009, 114/2012, 157/2013 and 107/2014; Statistical Yearbooks 2005, 2006, 2007, 2008, 2009 and 2010; <http://www.stat.gov.mk/pdf/2014/3.1.14.06.pdf>; State Statistical Office of the Republic of Macedonia, Statistical Review: National Economy and Finances, no. 3.4.14.04/793 (2014), <http://www.stat.gov.mk/pdf/2014/3.1.14.06.pdf>

In a situation when there is no significant impact of the public expenditures on the economic growth, the question that arises from these analyses is how the increased levels of expenditures are financed. Given the structure of the national budget, it may be concluded that the increased capital expenditures are financed with increased borrowing. Confirmation of this could be found in the increased public debt. The Chart 4 presents the changes in public debt expressed as a share of GDP. The share of public debt in GDP increases in the same years when the capital expenditures rise.

Figure 4 Total Public Debt as % of GDP in the Republic of Macedonia (1999-2014)



Source: Annual Report on Public Debt Management of the Republic of Macedonia, 2014, 2013, 2012, 2011, 2010, 2009, 2008, 2007, 2006, Ministry of Finance of the Republic of Macedonia, www.finance.gov.mk

However, the increase of the public debt in the Republic of Macedonia coincides also with the global economic and financial crises from 2008. There is a continuous trend towards increasing of public debt as a percent of GDP in developed, as well as in developing countries. The measures of fiscal policies that increase expenditures, especially capital expenditures directly affect the level of public debt. In the case of Macedonia, the stock of public debt is not a large percentage of the GDP, and therefore, it could be argued that it is not posing threat to the

economy, but the rapid rate of increasing the public debt is alarming. Therefore, more attention should be paid to fiscal consolidation and boosting of economic activity.

4. Comparative analyses of the public expenditures in the Republic of Macedonia and other countries

More clear perception about the public expenditures in the Republic of Macedonia and their importance could be made by comparison with the state of affairs in other countries. In this respect, very important indicator is the percentage of public expenditures as share of real GDP. The Table 3 presents the share of public expenditures of GDP in some selected countries, including EU members and countries from the region.

Table 3 Public Expenditures Share of GDP

- Expense In % of GDP*													
Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Austria	39,5	39,6	39,2	39,6	42,3	38,6	38,0	37,5	37,5	38,4	38,8	37,5	38,3
Belgium	42,1	42,7	41,1	42,3	40,6	43,3	40,0	39,9	41,4	44,0	42,7	43,6	44,8
Bosna and Hercegovina	na	na	na	35,6	33,5	33,6	34,8	36,9	38,6	40,6	39,9	38,8	39,8
Bulgaria	30,5	29,7	31,0	32,0	32,9	31,2	29,8	29,0	28,9	30,7	30,3	30,3	31,3
Croatia	38,7	37,0	35,7	34,7	34,7	34,2	33,5	33,8	34,1	36,4	37,4	36,8	36,6
Czech Republic	30,8	32,5	34,3	34,3	32,5	33,0	32,7	31,1	31,3	34,5	34,0	33,6	33,1
Denmark	33,9	33,6	33,5	34,1	33,6	31,9	31,1	34,9	35,6	40,8	41,1	41,8	43,1
Estonia	29,4	27,8	27,6	27,6	27,4	26,6	26,3	26,2	30,3	35,7	33,9	31,2	30,9
Finland	34,0	33,2	34,4	35,0	34,8	34,9	34,4	32,7	33,5	38,2	38,4	38,0	39,1
France	43,2	43,5	44,5	44,9	44,4	44,7	44,0	43,3	43,6	46,9	48,3	46,4	47,0
Germany	30,8	30,3	30,8	31,3	30,2	30,3	29,0	27,8	27,9	30,8	31,1	28,6	28,3
Greece	42,6	42,1	41,4	40,5	41,0	41,4	41,1	43,3	46,2	50,7	49,3	52,8	53,8
Hungary	41,3	41,0	43,0	42,9	41,9	42,1	43,6	42,9	44,5	45,3	44,0	45,3	43,5
Macedonia	na	na	na	na	na	28,9	29,6	29,3	30,6	31,3	30,1	29,0	29,4
Serbia	na	na	na	na	na	na	na	36,8	38,0	38,0	38,7	37,6	39,2
Slovenia	38,1	39,0	38,3	38,6	38,5	39,0	38,0	35,1	36,6	41,2	41,7	42,5	42,3
Romania	na	na	25,8	23,5	23,2	24,0	25,3	26,1	33,1	44,7	40,4	35,2	33,6
Turkey	25,0	24,8	25,7	25,4	25,8	na	na	na	31,2	37,7	35,4	33,3	33,6

*- Expense is cash payments for operating activities of the government in providing goods and services. It includes compensation of employees (such as wages and salaries), interest and subsidies, grants, social benefits, and other expenses such as rent and dividends.

Source: International Monetary Fund, Government Finance Statistics Yearbook and data files, and World Bank and OECD GDP estimates; data.worldbank.org (31.8.2015)

As evident from Table 3, the share of public expenditures in GDP in the Republic of Macedonia⁶ was 28,9 % in 2005, with changing trend in the upcoming years. More specifically, it rose to 31,3% in 2009, then down to 30,1% and 29% in 2010 and 2011, respectively and 29,4% in 2012. If we compare these data with the share of public expenditures in GDP in the developed and developing countries, we can conclude that the share of public expenditures in GDP in Macedonia is lower than in most of other countries, and, arguably, below the level that ensures optimal satisfaction of the public needs funds. Therefore, in Bosnia and Herzegovina, the public expenditures amount to around 40% of GDP in the analyzed period while in Serbia, the share varies from 36,8% in 2007 to 39,2 in 2012. Countries like Romania, Bulgaria, Czech Republic, Estonia, Turkey, Slovenia and Croatia have similar share of public expenditures in GDP such as the previously mentioned countries. On the other side, the level of public expenditures in GDP in developed countries is higher. According to the data from the countries included in Table 3 Austria, Denmark, Finland, Germany, France and Greece have share of public expenditures of minimum 40% of GDP.

In accordance to the previous discussion about the increased level of capital expenditures in the Republic of Macedonia and their link to the economic growth, it would be interesting to look at the data about economic growth in other countries. The table 4 presents the growth rate in previously discussed countries.

As shown in the Tables 3 and 4, the countries with higher public expenditures as share of GDP usually have higher growth rates. As argued above, the capital expenditures have positive impact on the economic growth in the country, but also the increased level of GDP and economic growth rate has positive influence on the level of total expenditures. The analyses of the public expenditures in the Republic of Macedonia lead us to the conclusions that increased expenditures did not indicate increased economic activity. The public expenditures are mostly consumption, instead of investment oriented, resulting into increasing budget deficit.

⁶For the comparability of the results we use the shares that were calculated considering the methodology of the expenditures of the World Bank

Table 4 Economic Growth Rate

Country	GDP Growth (annual %)*														
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Austria	3,4	1,4	1,7	0,8	2,7	2,1	3,4	3,6	1,5	-3,8	1,9	3,1	0,9	0,2	0,3
Belgium	3,6	0,9	1,6	0,9	3,4	1,9	2,6	3,0	1,0	-2,6	2,5	1,6	0,1	0,3	1,1
Bosna and Hercegovina	5,5	4,4	5,3	4,0	6,1	5,0	6,2	6,8	5,4	-2,9	0,7	1,0	-1,2	2,5	1,2
Bulgaria	6,0	3,8	4,5	5,4	6,6	6,0	6,5	6,9	5,8	-5,0	0,7	2,0	0,5	1,1	1,7
Croatia	3,8	3,4	5,2	5,6	4,1	4,2	4,8	5,2	2,1	-7,4	-1,7	-0,3	-2,2	-0,9	-0,4
Czech Republic	4,3	3,1	1,6	3,6	4,9	6,4	6,9	5,5	2,7	-4,8	2,3	2,0	-0,8	-0,7	2,0
Denmark	3,7	0,8	0,5	0,4	2,6	2,4	3,8	0,8	-0,7	-5,1	1,6	1,2	-0,7	-0,5	1,1
Estonia	9,7	6,2	6,1	7,5	6,5	9,5	10,4	7,9	-5,3	-14,7	2,5	8,3	4,7	1,6	2,1
Finland	5,6	2,6	1,7	2,0	3,9	2,8	4,1	5,2	0,7	-8,3	3,0	2,6	-1,4	-1,3	-0,1
France	3,9	2,0	1,1	0,8	2,8	1,6	2,4	2,4	0,2	-2,9	2,0	2,1	0,2	0,7	0,2
Germany	3,0	1,7	0,0	-0,7	1,2	0,7	3,7	3,3	1,1	-5,6	4,1	3,6	0,4	0,1	1,6
Greece	4,0	3,7	3,2	6,6	5,0	0,9	5,8	3,5	-0,4	-4,4	-5,4	-8,9	-6,6	-3,9	0,8
Hungary	4,2	3,7	4,5	3,8	4,8	4,3	4,0	0,5	0,9	-6,6	0,8	1,8	-1,5	1,5	3,6
Macedonia	4,5	-3,1	1,5	2,2	4,7	4,7	5,1	6,5	5,5	-0,4	3,4	2,3	-0,5	2,7	3,8
Serbia	7,8	5,0	7,1	4,4	9,0	5,5	4,9	5,9	5,4	-3,1	0,6	1,1	-1,0	2,6	-1,8
Slovenia	4,2	2,9	3,8	2,8	4,4	4,0	5,7	6,9	3,3	-7,8	1,2	0,6	-2,6	-1,0	2,6
Romania	2,1	5,7	5,0	5,2	9,1	4,3	8,7	6,3	7,9	-6,8	-0,9	2,3	0,4	3,5	1,8
Turkey	6,8	-5,7	6,2	5,3	9,4	8,4	6,9	4,7	0,7	-4,8	9,2	8,8	2,1	4,2	2,9

*-Annual percentage growth rate of GDP at market prices based on constant local currency. Aggregates are based on constant 2005 U.S. dollars. GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources.

Source: World Bank national accounts data, and OECD National Accounts data files

Therefore, the growth of public expenditure should be addressed to the increased capital investment as investments in infrastructure, science and education, new knowledge and technology, health, environment and others public investments that positively affect the economic activity. That would also contribute to higher ability of the state to allocate more funds to the capital expenditures, oriented towards boosting economic growth.

Conclusion

The majority of public expenditures in the Republic of Macedonia consists of current expenditures, transfers to other levels of government and expenditures for purchasing goods and services, while capital expenditures are insignificant. This means that public expenditures have

predominantly fiscal nature, instead of supporting role to economic growth and development. The share of current expenditures is dominant, while the share of capital expenditures is minimal, although their share in total expenditures in the analyzed period in the country has increased. Compared to other countries, the share of public expenditures in GDP in the Republic of Macedonia is lower, and implicitly, below the level that ensures optimal satisfaction of the public needs. In this regards, the reform of the structure of public expenditures in the country is necessary, in terms of enhancing the development role of the public expenditures. Therefore, the measures must be targeted to increasing the capital expenditures towards investment in infrastructure, science and education, new knowledge and technology, health, environment and other areas crucial for ensuring economic development of the country.

References

1. Angelovska Bezovska, A., Bogoev, J. Mitevska, A. And Kadievski Vojnovik, M., (2011), „Investigating the Cyclical Behavior of Fiscal Policy in the Republic of Macedonia during the Period of Transition”, Croatian Economic Survey:Vol.13 No.1.
2. Addison, T., Roe, A., (2006), „Fiscal policy for Development: Poverty, Reconstruction and Growth (Studies on Development Economics and Policy)”, Palgrave Macmillan.
3. Anatasovski, Z. (2004), „Public Finance”, Faculty of Economics – Skopje.
4. Blejer, M., (1997), „Macroeconomics Dimensions of Public Finance”, Routledge Studies in the Modern World Economy.
5. Blejer, M. (2001), „Fiscal policy and Economic reform”, Routledge Studies in the Modern World Economy.
6. Bogoev, K.(1968), “Fiskalna Politika”,Skripta, Ekonomski fakultet Skopje, II Nepromenjeno izdanje, Skopje.
7. Gray Williamson, C., Lane, M. T. (2007), „Fiscal Policy and Economic Growth: Lessons for Eastern Europe and Central Asia”, World Bank.
8. Gruber, J., (2007), „Public finance and Public policy”, Palgrave Macmillan, 2 edition.
9. Ministry of Finance of the Republic of Macedonia, www.finance.gov.mk

10. National Bank of The Republic of Macedonia, www.nbrm.mk
11. Pigou Arthur, (1928), A Study in Public Finance, <https://www.questia.com/read/30362402/a-study-in-public-finance>
12. Seidman, L.(2008), „Public finance”, (McGraw Hill, Series in Public Finance), McGraw Hill/Irwin, first edition.
13. State Statistical Office of the Republic of Macedonia, www.stat.gov.mk
14. Ulbrich, H. (2002), „Public finance in Theory and Practice”, South Western College Pub, first edition.
15. The Public Enterprise Official Gazette of the Republic of Macedonia, number 31/1998, 25/2007, 111/2008, 112/2008, 114/2009, 119/2010, 138/2011, 114/2012, 157/2013, 107/2014.
16. World Bank, www.data.worldbank.org

UDC 339.738(4-672EU)
Original scientific paper

Vesna GEORGIEVA SVRTINOV¹⁾
Diana BOSKOVSKA ²⁾
Aleksandra LOZANOSKA³⁾
Olivera GJORGIEVA-TRAJKOVSKA⁴⁾

EURO ZONE DEBT CRISIS: THEORY OF OPTIMAL CURRENCY AREA

Abstract

Creation of a monetary union, carries along certain costs and benefits. Benefits of monetary union mainly stem from reducing transaction costs and eliminating exchange-rate uncertainty. On the other side, a country that joins a currency union, therefore gives up the opportunity to select a monetary policy, that it regards as optimal for its own circumstances.

In this paper we explain the criteria of optimum currency area (OCA): degree of trade, similarity of business cycles, degree of labor and capital mobility and system of risk sharing. Viewed through the prism of these criteria, EMU is currently far from being an optimal currency area, especially in fulfillment criteria of labor mobility and fiscal integration.

The aim of the paper is to highlight certain shortcomings of the EMU, such as its vulnerability to asymmetric shocks and its inability to act as predicted by the theory of optimum currency areas. Furthermore, we explain the reasons behind the difficulties that the euro area faced, and the problems that led to the outbreak of the sovereign debt crisis. At

¹⁾ PhD, "Ss. Cyril and Methodius University" in Skopje, Institute of Economics-Skopje, Republic of Macedonia, e-mail: vesna@ek-inst.ukim.edu.mk.

²⁾ PhD, "Ss. Cyril and Methodius University" in Skopje, Institute of Economics-Skopje, Republic of Macedonia, e-mail: diana@ek-inst.ukim.edu.mk

³⁾ PhD, "Ss. Cyril and Methodius University" in Skopje, Institute of Economics-Skopje, Republic of Macedonia, e-mail: sandra@ek-inst.ukim.edu.mk

⁴⁾ PhD, "Goce Delcev University" Faculty of Economics, Republic of Macedonia, e-mail- olivera.trajkovska@ugd.edu.mk.

the end, we laid out several steps that could be taken or conditions that could be met in the euro zone in order to move toward optimization.

Key words: euro zone, debt crisis, optimal currency area, business cycles, convergence criteria.

JEL classification: F15, F21, F23, F31, F36, F44, F45

Introduction

The creation of the euro was supposed to be another triumphant step in the European project, in which economic integration has been used to foster political integration and peace (Krugman, 2012: 582- 587). In the past, almost every country in the EU has had its own currency, sometimes as a symbol of sovereignty. As the process of integration went deeper and deeper, majority of the countries gave up on their own currencies and accepted common currency. The new regime was completely in the line with the “impossible trinity” theory, which explains that it is impossible to have monetary sovereignty, capital mobility and fixed exchange rate at the same time, because these are mutually exclusive goals. According to the theory, all countries, which initially joined the Monetary Union, have sacrificed their monetary sovereignty in order to get exchange rate stability and capital mobility.

At the beginning, general public of the European Union believed politicians who promised that introduction of euro would contribute to economic growth, reduce unemployment and bring monetary stability. Unfortunately, today, it is clear that the introduction of euro did not succeed in preventing the constant decline of the growth of European economy and that the single currency has different impacts on the individual euro zone countries.

Debt crisis in the euro zone grew out of the U.S. financial crisis of 2008-2009. A slowing global economy exposed the unsustainable financial policies of certain euro zone countries. Several countries in the euro zone have borrowed and spent too much since the global recession began, causing them to lose control of their finances.

1. Did EMU countries fulfill Maastricht Convergence Criteria?

In order to explain the reasons of euro zone crisis we will start with Maastricht Criteria for convergence. Before the entrance in the EMU, the countries have to fulfill criteria for convergence, as outlined in the Maastricht Treaty: (1) price stability (average inflation rate of no more than 1.5% above the average of the three best-performing Member States); (2) low interest rates (no more than 2% above the three best Member States); (3) minimal annual budgetary deficits (not exceeding 3% GDP) and debts (not exceeding 60% GDP) and (4) currency stability. The purpose of these criteria was to bring the euro zone member and candidate countries into closer economic convergence.

Here below, we are analyzing six EMU countries: Germany, France, Austria, Greece, Italy and Spain. As we can see from the charts presented below, some of these countries in some periods before and after entrance in EMU, didn't fulfill those criteria's.

Table 1: Inflation, consumer prices (% per annum)

	1999	2001	2003	2005	2007	2009	2011	2013	2014
Germany	0.57	1.98	1.03	1.55	2.3	0.31	2.07	1.50	0.91
France	0.53	1.63	2.11	1.74	1.49	0.09	2.12	0.86	0.51
Austria	0,56	2,66	1,35	2,30	2,17	0,51	3,27	2	1,61
Greece	2.64	3.37	3.53	3.54	2.89	1.21	3.33	-0.92	-1.31
Italy	1.66	2.79	2.68	2	1.82	0.75	2.74	1.22	0.24
Spain	2.31	3.59	3.04	3.37	2.79	-0.29	3.2	1.41	-0.15

Source: OECD

Table 2: Long-term interest rates, total (% per annum)

Country	Jan-07	Jan-08	Jan-09	Jan-10	Jan-11	Jan-12	Jan-13	Jan-14	Jan-15
Germany	4.02	4.03	3.07	3.26	3.02	1.82	1.51	1.76	0.39
France	4.07	4.15	3.6	3.52	3.44	3.18	2.17	2.38	0.67
Austria	4.06	4.22	4	3.75	3.54	3.27	1.92	2.13	0.54
Greece	4.28	4.4	5.6	6.02	11.73	25.91	11.1	8.18	9.48
Italy	4.26	4.4	4.62	4.08	4.73	6.54	4.21	3.87	1.7
Spain	4.07	4.18	4.15	3.99	5.38	5.4	5.05	3.78	1.54

Source: OECD

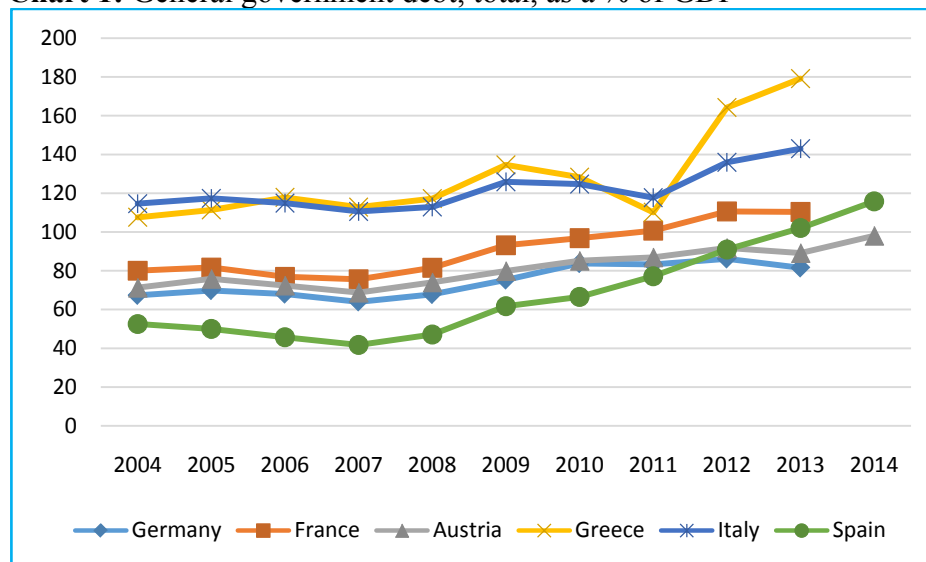
From the table 1, we can see that selected EMU countries have different inflation rates. The periphery countries, Greece, Italy and Spain, had higher inflation rates than the group of countries from the core of the euro zone, in our research, Germany, France and Austria.

Table 3: Government deficit/surplus, as a % of GDP (million EUR)

	Germany	France	Austria	Greece	Italy	Spain
2003	-4,1	-3,9	-1,8		-3,4	-0,4
2004	-3,7	-3,5	-4,8		-3,6	0
2005	-3,3	-3,2	-2,5		-4,2	1,2
2006	-1,5	-2,3	-2,5		-3,6	2,2
2007	0,3	-2,5	-1,3		-1,5	2
2008	0	-3,2	-1,4		-2,7	-4,4
2009	-3	-7,2	-5,3		-5,3	-11
2010	-4,1	-6,8	-4,5		-4,2	-9,4
2011	-0,9	-5,1	-2,6	-10,2	-3,5	-9,4
2012	0,1	-4,8	2,2	-8,7	-3	-10,3
2013	0,1	-4,1	-1,3	-12,3	-2,9	-6,8
2014	0,7	-4	-2,4	-3,5	-3	-5,8

Source: Euro stat database.

Chart 1: General government debt, total, as a % of GDP



Source: OECD

Because of higher interest rates their exchange rates were growing in real terms and they were gradually losing competitiveness in

foreign trade, which (unlike in the past, before entering in EMU) it would not be possible to compensate by currency devaluation, but could only be coped with by a decrease of the domestic prices of the internationally traded goods and services or by higher unemployment (Sinn, 2010) We have to take into account that in EMU, countries cannot carry out currency devaluation because they have euro. On the other side, ECB can not lead restrictive monetary policy for the countries which suffer inflation, if other countries sustain price stability.

Before the euro zone was formed in 1999, interest rates on average were between 4.5 and 5 percent. The exception was Greece, which was paying 8.5 percent to borrow. Interest rates began rising and the spread began growing in 2009, when Greece registered a 5.6 percent interest rate and Germany only 3.07 percent. In the following years interest rates in Greece continued to rise and reached 25.91 percent's in 2012. Unlike Greece, interest rates in Germany, as well as in France and Austria remain low. The same like in Greece, Italy and Spain have had higher interest rates than core EMU countries (Wolff, 2012).

If we analyze other Maastricht criteria, the maximum debt which is allowed by the EU, we can see that none of the mentioned countries met that standard. Even in the core countries, government debt as a percent of GDP was higher than 60 percent. In the periphery countries, government debt was more than 100 percent of GDP.

In relation on deficit spending, countries sometimes approached zero, or even spent less than they took, but in some years, especially after 2009, deficit spending was more higher than what was permitted by Maastricht criteria. (see table 3). One of the main reasons for government deficit is “shadow” or “underground” economy, i.e. largely untaxed transactions which occur outside the normal channels, which undermine the government ability to collect revenue. The main example for widespread shadow economy is Greece, where tax revenue as a percent of GDP was approximately 20 in the period between years 1999-2014. For comparison, in Germany, tax revenue was approximately 10% of GDP during the same period.

2. The euro zone crisis and the theory of optimum currency area

2.1. Theory of optimal currency area

We will continue our explanation of the reasons behind euro zone crisis with the theory of optimal currency area.

An optimum currency area (OCA) can be defined as the optimal geographical area for a single currency, or for several currencies, whose exchange rates are irrevocably pegged. OCA is a region, or area, where the benefits of sharing a common currency outweigh the costs; an area where a single currency would create the greatest economic efficiency, or benefit. (Koziara, 2013).

The theory of optimal currency area is developed by Mundell (1961), and proposes a set of necessary conditions for monetary unions and provides an analytical framework to assess risks and opportunities a region might be confronted with. According to Mundell (1961), there are four main criteria for an optimal currency area:

- Openness, with respect to trade in goods and services, is the most obvious OCA criterion, since trade is affected most directly by elimination of transaction costs and exchange rate uncertainty.
- Labor and capital mobility throughout the area. Ease of labor mobility includes the ability to travel via simplified visas and lack of cultural barriers, that hinders free movement. Capital mobility between areas that trade frequently with each other, can facilitate overall trade and boost economies.
- Similar business cycles. Similarity of shocks and business cycles is an important determinant for the effectiveness of a homogeneous monetary policy. When one country experiences a boom or recession, other countries in the union are likely to follow. This allows the shared central bank to promote growth in downturns and to contain inflation in booms. Should countries in a currency union have idiosyncratic business cycles, then optimal monetary policy may diverge and union participants may be made worse off under a joint central bank.
- Fiscal transfers. Countries should be prepared to use fiscal transfers to even out some of the regional economic imbalances within the currency union. This means the distribution of money to the regions experiencing economic difficulties (Mundell, 1961: pp 657-665).

A group of countries which score well in these categories, should theoretically be able to successfully adopt a single currency and expect to benefit from it.

2.2 The macroeconomic benefits and costs of being a member of EMU

The most direct and immediate benefits of monetary union are reduced transaction costs and the elimination of exchange-rate uncertainty. This primarily refers to the costs incurred when doing business or conducting an economic transaction, with a different country with a different currency. The complexity of over a dozen currencies in such a relatively small geographic area (such as Europe) in which to conduct business would presumably lead to many inconveniences over the need to exchange currencies at varying exchange rate are benefits to an optimal currency area.

Another benefit is enhanced efficiency and competitiveness of the European economy. Consumers will benefit, as increased price transparencies will promote Europe-wide competition. Travelers in the euro zone does not have to carry a different currency for each county that he/she will visit and subsequently, transaction costs are reduced (Svrčinov, et al, 2014).

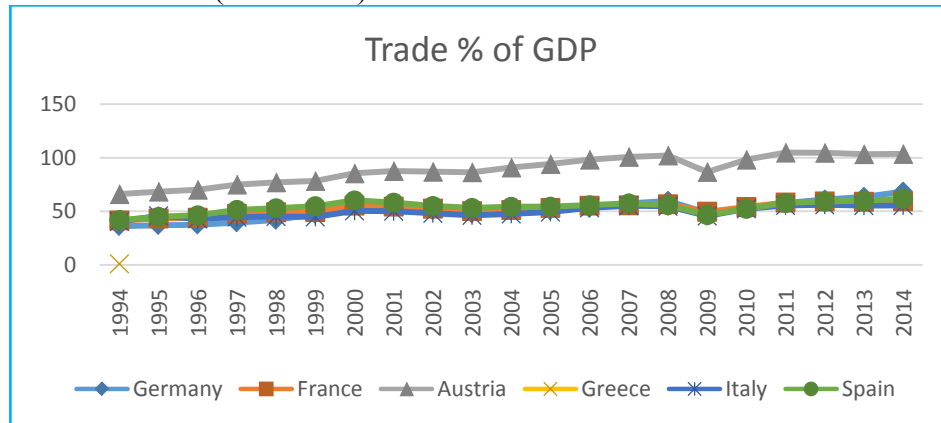
Furthermore, the elimination of exchange rate uncertainty will result in saved hedging costs for companies that previously hedged exchange rate risk. Reduced transaction costs and elimination of currency risk will promote cross border investment and trade. Each can invest in the other country without worrying about the potential loss, if the exchange rate changes adversely (Kozziara, 2013).

One of the most important benefit is increased capital mobility, or the flexibility with which investors, whether individuals or businesses, can move capital throughout an area. In an optimal currency area, labor like capital, should be mostly mobile; that is, workers should be free and able to move from one part of the region to another, depending on where employment is most available.

Before the creation of the euro, there was big optimism that the common European currency might produce an explosion in intra-European trade. Unfortunately, that hasn't happened, but trade has risen modestly, as a result of the single currency. Also, capital inflows in form of foreign direct investment, didn't rise dramatically, but they have had

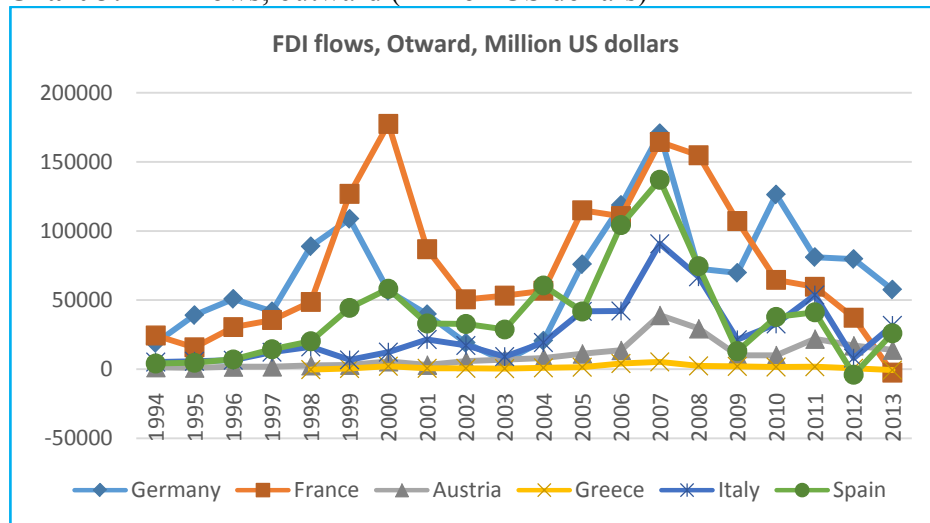
cyclical movement, which due to different economic cycles (see Chart: 2 and Chart: 3).

Chart 2: Trade (% of GDP)



Source: World Bank

Chart 3: FDI flows, outward (million US dollars)



Source: OECD

The main cost of a monetary union is the loss of national monetary and exchange rate policy independence. The currency union implies a single monetary policy and a single exchange rate for all member countries. A country that joins a currency union gives up of the opportunity to select a monetary policy that it regards as optimal, for its own circumstances (Pasimeni, 2014: pp. 173-204).

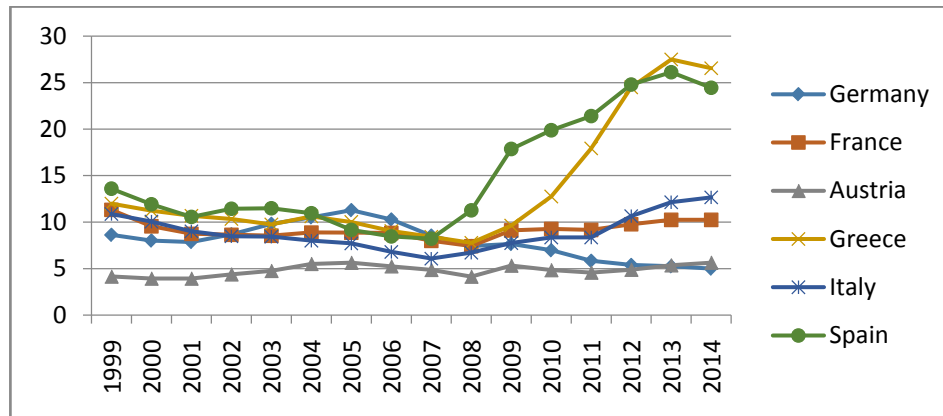
When a regional shock strikes one region of a currency area, such as a drop in demand for a region-specific commodity, and unemployment rises in that region, all else remaining equal in other regions of the currency area, what are policymakers, or the central banking authority to do? Increasing the money supply would stem unemployment in the affected region, but would cause inflation in other regions, where no comparable economic shocks are felt (Svrčinov et al, 2014: pp.57-64).

2.3 The Euro zone: an Optimal Currency Area?

Subsequently, we will see that none of the criteria for an optimal currency area, which we have mentioned previously, has fully satisfied in the euro area.

The mobility of labor force is relatively low in Europe, because the euro zone countries have differences in cultures (different languages, different work customs, different forms and institutions of government etc) which discouraging EU residents in their labor movement. If EMU countries have had high labor mobility, they should had similar unemployment rate. But, from the chart below, we can see differences in the rate of unemployment in different countries.

Chart 4: Harmonized unemployment rate (HUR), total, as a % of labor force



Source: OECD.

Another criteria for evaluating whether or not countries comprise an optimal currency area is whether or not they have similar business cycles; that is, whether or not they experience similar shocks and growth

rates. In the case of the euro zone, on one hand we have the industrial and export-oriented countries, like Germany and Austria, and on the other hand, the import-oriented, service-based economies, like Greece, Italy and the other periphery countries (Koziara 2013). Industrial, export-leading “core” countries have improved their current account positions substantially, over the life span of the euro zone. On the other side, the current account positions of some of the euro zone’s peripheral members have fallen, as is evidenced in the table below.

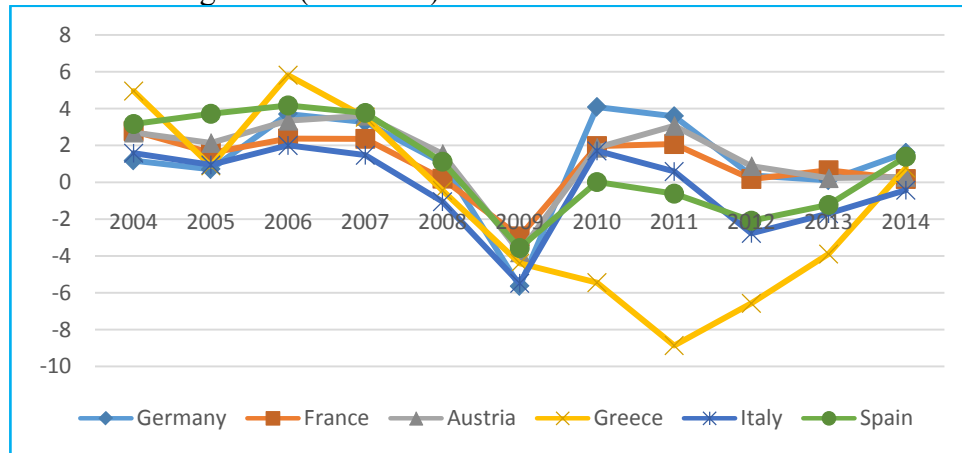
Table 4. Current account balance, total (as a % of GDP)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Germany	4.62	5.67	6.74	5.6	5.74	5.64	6.1	6.8	6.47	7.55
France	-0.02	0.04	-0.29	-0.95	-0.83	-0.83	-1.54	-1.43	-0.84	-0.84
Austria		3.30	3.82	4.52	2.62	2.88	1.49	0.95	0.77	0.77
Greece					-10.8	-9.99	-2.43	0.57	0.90	0.90
Italy	-0.94	-1.54	-1.42	-2.84	-1.93	-3.47	-0.51	0.93	1.93	1.93
Spain	-7.49	-8.98	-9.64	-9.25	-4.28	-3.92	-3.17	-0.27	1.44	0.79

Source: OECD

It is also important to note changes in gross domestic product, because GDP is viewed as an indicator of a country’s standard of living. If we analyze GDP growth between core countries on one side, and periphery countries on the other, we can note significant divergences in growth. Germany, France and Austria experienced decline in GDP only in 2009, whereas countries of the periphery experienced a decline in GDP from 2008 until 2014.

Chart 5. GDP growth (annual %)



Source: World Bank

The free circulation of capital has been established in Europe in parallel with the development of the single market. The criteria of fully liberalizing of capital mobility can be considered as fully satisfied by the EMU. But, the problem which arises from capital liberalization was massive capital movement from Europe's core to its periphery, leading to an economic boom in the periphery and significantly higher inflation rates. Matters were quite different, however, when private capital flows from the core to the periphery came to a sudden stop, leaving the peripheral economies with prices and unit labor costs that were well out of line with those in the core. Suddenly, the euro faced a major adjustment problem. This was the kind of problem that theory of optimum currency area has warned about: that it is very difficult to handle without currency devaluation. Internal devaluation i.e. restoring competitiveness through wage cuts as opposed to devaluation has proved extremely hard (Krugman, 2012).

Furthermore, the size of budget transfers, another criteria for OCA, at the euro zone level is very small. There is a certain degree of international solidarity among the EU member states, but its level is incomparable with the degree of solidarity inside the USA. There is no EU budget to carry out fiscal federalism or to rescue a member state in economic difficulties.

However, since 1999, the EMU has been working with an extremely limited common budget and with an explicit no-bail-out clause

in the Treaties, which means that any risk arising from potential asymmetric shocks, would have remained national.

The fiscal capacity condition is clearly the least satisfied in the case of the EMU and it is considered as its “major design failure” (Bordo, 2010).

2.4 The building up of the EMU in light of the OCA theory

In this part we will laid out several steps that could be taken or conditions that could be met in order to move EMU toward optimization.

- Increasing the degree of labor mobility and reducing cultural barriers within the euro zone. An important step which is made towards this direction is the Erasmus Program, which is a foreign-exchange program for university students, that permits them to study in another EU country, and thus obtain valuable international and cultural exposure.
- Achieving macroeconomic convergence amongst member states in the euro zone. If countries forming a monetary union have similar cycles, the single monetary policy can therefore be suitable for all of them. Different cycles between countries, on the contrary, lead to more asymmetric macroeconomic shocks, which can be amplified by the same monetary policy.
- Maintain sustainable government debt. Debts are arguably the biggest threat to economic convergence, as they have caused financial crises. For this purpose it is important to establish an enforceable set of convergence criteria, similar to those outlined in the Stability and Growth Pact.
- Implementing a banking union with powers to supervise all banks in the euro zone. ECB should be lender of last resort to governments, in the same way that national central banks already are. But, we have to be aware about moral hazard, which will have to be addressed somehow.
- Central authority with a relevant budget, which will ensure a certain degree of redistribution for automatic compensation for troubled regions. A supranational mechanism of fiscal transfers would be needed as an automatic stabilizer to mitigate asymmetric shocks.

- At the end we have to be aware about successful experiences of monetary unifications, that tell us that political union may represent an important prerequisite for an effective economic and monetary union i.e. the objective of a full monetary and economic union is unattainable without a political union (Bordo, 2010). However, EMU followed an opposite approach (Pasimeni, 2014: pp. 173-204)

Conclusion

In the years prior to the Greek crisis, the euro was seen as a symbol of success of the European project, but the failure of the euro to ensure economic stability throughout Member States, particularly peripheral countries, has now become a symbol of EU failure.

While the Euro zone was seen as the ideal candidate for testing optimal currency area theory in the years prior the global financial crisis, there is now considerable doubt whether or not the Euro zone sustains the criteria necessary to be labeled as an optimal currency area. Substantial economic divergence among member states increased the EMU's vulnerability to asymmetric shocks. The lack of labor mobility or a transfer payment system, limits the EMU's crisis adjustment capabilities. The common fiscal capacity is the main missing element for the euro zone to be qualified as a more efficient currency union.

Furthermore, EMU is composed of two different types of economies: "Core" (Germany, France, the Benelux countries, Austria, Finland) and "Periphery" (Greece, Ireland, Portugal, Spain, Italy, Cyprus). The condition of similarity of business cycles between this group of countries was not fully satisfied.

The single currency did not meet the expectations even in the area of mutual convergence of the participating economies as concerns the growth and inflation rates. Some of the euro zone countries stopped complying with the criteria for stability of public finance that were underlined in the Stability and Growth Pact.

We can conclude that if a country considers to join monetary union, it should evaluate the extent to which a monetary policy designed for the currency union as a whole, would be the best one for itself. Also, country should be aware that the main loss of participation in an optimal currency area is losing autonomy over fiscal and monetary policy, and

with it, the loss of interventional tools that could be used to stabilize the economy in the event of a regional shock.

References:

1. Artner, A. and Rona, P. (2012), "*Euro skeptic - The theory of the optimum currency area and the practice of the Euro*" In: Romanian Journal of European Affairs Vol. 12, No. 2, June 2012, (http://rjea.ier.ro/sites/rjea.ier.ro/files/revista/rjea_vol.12_nr.2_site.pdf);
2. Bordo, M.D. (2010), "*The Euro needs a fiscal union: Some lessons from history*" In: SOMC Symposium New York City, October,2010, (http://web.xrh.unipi.gr/attachments/1551_somc_Oct_Bordo.pdf) (12.10.2012);
3. Ferry, J. and Merler, S. (2012), "*Sudden stops in the euro zone*". In: Vox EU, WorkingPaper, April2012, (<http://www.voxeu.org/article/public-capital-flows-replacing-private-flows-eurozone-what-it-means-policy>). (02.04.2012);
4. Goodhart , C.A.E. (2013), "*Lessons for monetary policy from the euro-area crisis*" In: Special Conference Paper: The Crisis in the Euro area, May 2013, (<http://www.bankofgreece.gr/BogEkdoseis/SCP201317.pdf>);
5. Koziara, B. (2013), "*The Euro zone: An optimal currency area?*"The University of Michigan, (<http://deepblue.lib.umich.edu/bitstream/handle/2027.42/98925/bkoziara.pdf?sequence=1>) (25.04.2013);
6. Konya, I. and Krause, M.U. (2012), "*Wage rigidity and search frictions in Europe and the US*" In: Munich Personal RePEc, November 2014 (http://www.eea-esem.com/files/papers/eeaesem/2012/2467/KonyaKrause2011_ECBDec13.pdf) (24.11.2014);
7. Krugman, P. and Obstfeld, M. (2009), "*Case study: Is Europe an optimum currency area?*" In: International economics theory & policy Boston, Mass.: Pearson, Addison Wesley, pp. 582- 587 (<http://www.economia.unam.mx/cedrus/descargas/InternacionalEconomics.pdf>);

8. Mongelli, F.P. (2008), “*European economic and monetary integration and the optimum currency area theory*”, In: Economic Papers 302, February 2008, (http://ec.europa.eu/economy_finance/publications/publication12081_en.pdf);
9. Mundell, R. (1961), “*A theory of optimum currency areas.*” The American Economic Review, September 1961: pp 657-665;
10. Pasimeni, P. (2014), “*An optimum currency crisis*”, In: The European Journal of Comparative Economics Vol. 11, n. 2, pp. 173-204, (<http://eaces.liuc.it/18242979201402/182429792014110201.pdf>);
11. Rankov, M. (2013), “*Optimum currency area criteria in the Greece*”, In: Eurasian Journal of Economics and Finance, 1(1), p.25-34 ([https://eurasianpublications.com/pdf/ejocaf/EJEF%203%20%20Optimum%20Currency%20Ar
a%20Criteria%20in%20the%20Greece.pdf](https://eurasianpublications.com/pdf/ejocaf/EJEF%203%20%20Optimum%20Currency%20Area%20Criteria%20in%20the%20Greece.pdf));
12. Svrčinov, G.V., Trajkovska G.O. and Temjanovski, R. (2014), “*Cost and benefits of adopting Euro*” In: Applied Sciences and Business Economics Volume 1, Issue 3, pp.57-64, (www.bzujournal.org/archives/volume-1-issue-3);
13. Verhelst, B. and Van den Poel, D. (2010), “*Price rigidity in Europe and the US: A comparative analysis using scanner data*”, Ghent University, Faculty of Economics and Business Administration 10/684 (<https://ideas.repec.org/p/rug/rugwps/10-684.html>);
14. Wolff, G. (2012), “*A Greek deal -the end of the euro zone crisis?*” University of Washington, Brueghel. February 2012, (<http://www.bruegel.org/blog/detail/article/584>) (21.02.2012).

UDC 334.722:316.772.2(497.7)
Original scientific paper

Zoran JANEVSKI¹⁾
Gabriela ZAFIROVSKA²⁾

THE USE OF NONVERBAL COMMUNICATION IN ENTREPRENEURIAL CONTEXT

Abstract

The first association of nonverbal communication is the body language. It is a skill, ability for someone to understand the message that is sent from the interlocutors. Body language is especially important in the business communication. With the proper understanding and use of the nonverbal communication everyone can see the ability and the will for collaboration, team work and the preparedness for changes. With the improvement of the body language, significant steps in the development of the individual's potential and achievement of the set goals can be made. This is especially important for the proper management of the entrepreneurial small business. For the entrepreneurs, small business's owners and the business leaders who are facing a lot challenges in their work and fight with the ruthless competition, knowing and implementation of the nonverbal communication is the best tool that they have in their job.

This research analyzed the connection between the entrepreneur's personal characteristics and nonverbal behaviors. The result of the study suggests that while Macedonian entrepreneurs are becoming aware of the power of nonverbal communication, they still don't make their business decisions based on the analysis of nonverbal communication.

Keywords: entrepreneurs, nonverbal communication, body language, message, organization

¹⁾ PhD, Institute of Economics – Skopje, “Ss. Cyril and Methodius” University,
e-mail: zoran.janevski@ek-inst.ukim.edu.mk.

²⁾ MsC, Sparkasse Bank, e-mail: gabriela_zafirovska@yahoo.com.

JEL Classification: L26

Introduction

The business sector is the essential part of every economy, and the institutional and regulatory frameworks provided by the governments play an important role in its success. However, many people share the opinion that the business success still lays in the hand of the entrepreneurs who starts and run their own businesses.

There are a lot of evidence on large firm's importance for the growth and technological activities in different sectors and countries (Patel and Pavitt, 1991; Malecki, 1993). However, caused by the turbulent changes in recent years in the functioning of the national economies, followed by the global financial market crisis which significantly changed the working environment of the companies in general, the importance of the small businesses management and entrepreneurship has grown (Kennickell, Kwast and Pogach, 2015). Entrepreneurship itself cannot be separated from the personal characteristics of the owner-entrepreneur, his/her knowledge, experience, skills and attitudes, or so-called human factors (Širec and Močnik, 2010). One of the most important skills relevant for the whole process of entrepreneurship is communication skill. The challenge of communication is for the entrepreneur to communicate effectively enough for the stakeholder to at least continue the relationship, or even better, to extend it, for example, as a business partner, as an employee or as a finance provider. This is important because entrepreneurs need to create credibility and get legitimacy to be able to get resources, both financial and human, in the start-up of a business, but also in the growth phase as well (Shane, 2003). Previous research had shown that entrepreneurs often suffer from liability of newness, as they lack a track record for the business (Lounsbury and Glynn, 2001). Since this is the case, they have to draw on alternative forms of communication (Aldrich and Fiol, 1994) and they need to think strategically regarding communication (Hitt, Ireland, Camp and Sexton, 2001). However, it is not fully clear how they are to accomplish this, but certainly the improving skills and intensify the use of nonverbal communication is a proper way to succeed.

1. The use and forms of nonverbal communication

People often do not say what they think, or while communicating try to hide certain information. Everyone has their own flaws and nobody is perfect, but everyone can shine before others if that is what he desires. In the business world, sometimes comes to certain frauds resulting in massive damages. To avoid these potential problems, the entrepreneurs, owners of small businesses, need to understand nonverbal communication and predict what their interlocutor really thinks and whether he/she is telling the truth.

Whenever talk to someone, the body with a variety of small gestures, moments, changes in posture and facial expressions, facilitates speaking. Most people are unaware that daily they use the silent language when communicating (Goman, 2011). Nonverbal communication, or also known as body language, represents an unconscious response to what is being said, in what position is the interlocutor placed and what is the atmosphere of the discussion (Goman, 2008).

Verbal and nonverbal messages may mutually coincide or differ. Most often what makes an impression on others is not what it is said, but rather what it is not said, and can be read it through the body language. Nonverbal messages more precisely clarify the verbal messages. Sometimes the verbal and nonverbal symbols disagree. One might say: "That's fine", but if the voice is tense and the person does not look at the recipient, then the question is on what symbol does the recipient trust – verbal or nonverbal? When verbal and nonverbal symbols are in conflict, the recipient usually trusts the nonverbal communication (Means, 2012, p.69).

Nonverbal communication in fact, is about the way people sit, walk, stand and express themselves through certain gestures. It can be conscious (deliberate) or unconscious and can take the following forms (Gjorgjievska, 2013, p.132):

- **Body movement** – includes movement of the hands, head, feet, legs, body position, eye movement and facial expression.
- **Hands and palms** – the person should *always keep hands open* when starting a conversation. Throughout history, open palms were interpreted as openness, honesty, a sign of truth. *Pointing gestures* seem aggressive, so they should be avoided. The person should also avoid *gestures that last more than three beats*, because they may hint that the person is set

dictatorial and wants to order. If a person wants to highlight a particular point or to even emphasize the meaning of that point that can be achieved by *pressing fist*.

- **Attitude, body posture** – The position of a person can be closed or open. The positive attitudes towards the other are usually followed by tilting forward, especially when sitting. While the negative or hostile attitudes are signaled by tilting backwards.
- **Facial expression** – the person should be aware of all the gestures that are served to the interlocutor, and include mouth movement, use of eyebrows, use of cheeks, head movements, eye contact etc. Eye contact is especially important. People that look away are either really nervous, lie or something else distracts them. When people look down, they experience unpleasant emotions, or they are really upset.
- **Physical characteristics** – body type, attractiveness, height, weight, hair color and complexion.
- **Touch** – represents an important nonverbal behavior. The person needs to distinguish between body contact and touching.
- **Artifacts** – all personal items or stuff that brings the person which communicate with.
- **Space** – Robert Sommer defined what is called personal space as the area around each person, in which it does not want others to enter, unless they are called (Wainwright, 2000).
- **Voice (paralanguage)** – all aspects of voice, which are not strictly a part of the verbal message, and include the tone and voice, speed and volume of the message, pauses and hesitations between words.
- **Environment** – physical and psychological environment in which the communication takes place. This includes furniture, design, lighting, temperature, smells, colors, sounds in the room etc.

Scratching the surface of the nose, neck or other body part or rubbing of the eyes generally indicate discomfort, inconvenience, embarrassment, boredom. *Hand placed under the chin* usually means that a decision is being made or judgment for what it is being said. Very often used gesture is *friction on the palms of each other*. Friction on the palms of each other expresses a positive expectation. *Palm in palm*, known as interlocking fingers is another frequently used gesture worldwide.

Although seemingly it looks as if it were a self-confident person, however, the researches show that it is actually a gesture of frustration (Pease, 2014, p.38).

The body language is no longer an enigma. Today, people are in condition to study all the signs of the human nonverbal behaviors and to use them as supplement of the verbal messages. People make very important decisions and conclusions based on the body language. Taking care of all this dimensions of nonverbal communication, which are explained above, the individual could be one step ahead. With the language of the business, it would mean that nonverbal communication helps entrepreneur in the process of making important decisions on hiring, promotion, making partnerships and collaborations, identifying potential customer, improving marketing and sales, etc.

2. The entrepreneur and his/her competence regarding nonverbal communication

Making the correct decision within the given time frame is a crucial factor for a successful entrepreneur today. Entrepreneurs are in constant interaction with all stakeholders from the internal and external environment of the company, so knowing how to effectively communicate using both, verbal and nonverbal communication can help them managing their businesses with great success. According to many studies communication skills are in top priorities for entrepreneurs and small business owners (Montagno, Kuratko, and Scarcella, 1986).

Those in business must be prepared in such a way as to make their face agree with the message that the consumer expects to receive. The communication experts agree that when two people have a face-to-face conversation only a small fraction of the total message they share is actually contained in the words they use. A portion of the message is contained in the tone of voice, accent, speed, volume, and inflection. However, approximately 93% of it is understood through nonverbal communication behaviors (Stoker, 2013). The combination of gestures, postures, facial expressions, and even clothing can support or interfere with the verbal messages that a person delivers.

The entrepreneur who has just established his/her company has to decide whom to hire on all position into the organization. Many individuals will apply for the open positions, and he/she should choose the best of them. It happens very often that all candidates who apply for

the job to have all the necessary qualifications with respect to knowledge, experience and other skills that are required. The entrepreneur is facing a difficult task, and in such situations, usually the one who left the best impression on the face-to-face interview, gets the job. The first impressions are the most important and they help the entrepreneur to make a better decision. It is considered that the first five minutes are the most critical period when it comes to a meeting between two individuals. This is the period when the impressions are formed, retained and later on it's even possible to strengthen them (Pease, 2014, p.84). Only the entrepreneur who understands nonverbal communication and who can successfully read the personalities and their characters will more likely do the right choice and hire the right person.

Also, when running a meeting, an entrepreneur who understands nonverbal communication will much easily persuade his/her employees to follow the company's vision. He/she will much effectively convey his viewpoints and opinions without insulting other employees. He/she will know how, in which way, which tone and voice color to address them and to be taken seriously. He/she will much easily impose his/her own authority, but still to not act offensively. He/she will much easily spot whether any of the employees has lost the motivation, does not feel well, is disgruntled or has any kind of open issue and thus will know how to choose the right way to approach and help him. Employees' (dis)satisfaction always influences the business results of their organizations.

When the entrepreneur needs to convince the potential buyers of the superiority of company's product and make them come up with a positive decision for buying, only if he/she understands gestures and expressions customers make and pays attention whether they have locked feet or legs, whether their hands are open or closed, the way of their posture etc, he/she can easily get into the psyche of the customer and see if they are hesitant or not. If the entrepreneur notices that the buyer takes a more defensive stance, he/she will immediately know that he/she needs to change his/her approach and to apply a new one that will bring a positive sale.

The entrepreneur who understands nonverbal communication and applies body language will much easily succeed in negotiations with the suppliers. He will apply those gestures that will present him as a person full of confidence, reliability and honesty, and certainly all people want to cooperate with such persons. On the other hand, through body

language he will see if the other party i.e. the suppliers or the competitors are honest and do not intend to do something vile and unexpected.

3. The use of nonverbal communication by entrepreneurs in Republic of Macedonia

To make up the whole picture about the use of nonverbal communication by entrepreneurs, it was necessary to make a research on actual and potential entrepreneurs in Macedonia, in order to determine how much they know about nonverbal communication and how much they are using it in their business activities. One portion of the respondents hasn't shown any entrepreneurial behavior, so they are treated as non-entrepreneurs.

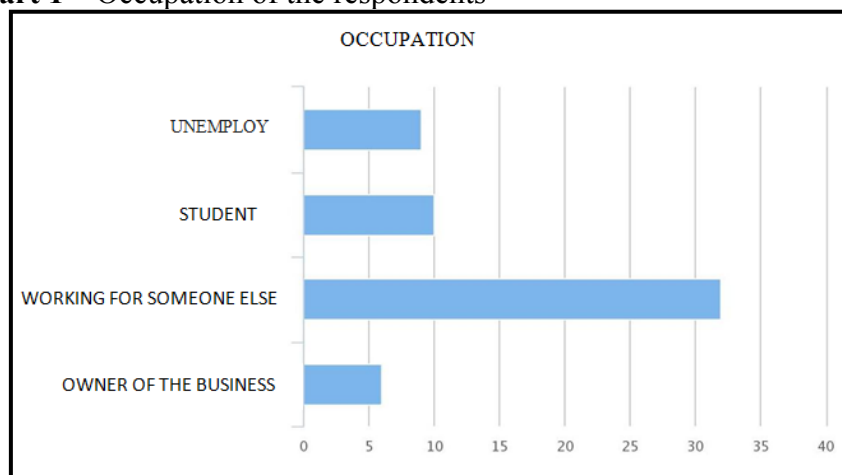
The survey was conducted anonymously electronic questionnaire from 19.01.2015 to 09.02.2015 on the sample of 58 individuals, 48% male, and 52% female. Most of them are aged between 18 and 24 years (40%), and 35% of individuals were in the age between 25 and 34. According to their answers about education level, it was shown that the biggest part of all respondents have higher education (87.7%), and the rest of them have secondary education (12.3%).

In order to separate the individuals and get results of how much of them are really entrepreneurs, the occupation they had at the moment was used as one of the main parameters.

The research shows that 43% of all respondents (31 individuals) have already started their own business (6 individuals) or work as an employee, are unemployed or study at a university and have a plan to start one in the next 3 years (25 individuals) (Chart 1).

Owning a business and the intention to start a new business in the next 3 years were the main variables how to distinguish the entrepreneurs from the respondents who are non-entrepreneurs. The additional control variables how to determine entrepreneurial behavior were the "self-initiative", "attitude towards taking risk" and "attitude towards entrepreneurial teams".

Chart 1 – Occupation of the respondents



Source: Authors' research

According to the question “Are you ready to always take an action without being pushed by someone else?” 96.6% of individuals gave positive answer (Chart 2).

Chart 2 – Self-initiative respondents



Source: Authors' research

Most of the respondents (85.7) properly understand the importance of the team for the entrepreneurial process, and are ready to participate in such a team (Chart 3).

Chart 3 – Team player respondents



Source: Authors' research

The research shows that 90.9% of all respondents are calculated risk-takers when it comes to business (Chart 4).

Chart 4 – Risk taker respondents



Source: Authors' research

After distinguish between entrepreneurs and non-entrepreneurs has been done, the next step of the research was to find out how much the entrepreneurs know about nonverbal communication and how often they use it. Although 61% of individuals were usually more concentrated of what they say, they also pay much attention to movements that another person is making with their bodies while talking.

Table 1 – Knowledge and use of nonverbal communication by entrepreneurs

Knowledge and use of nonverbal communication	Entrepreneurs
	14 female / 17 male
Pay attention on the body position and their movements	13 (92.8%) / 15 (88.2%)
Pay attention more on what the other person is doing	3 (21.4%) / 8 (47.0%)
Consider that the hands gestures are one kind of a message	13 (92.8%) / 16 (94.1%)
Consider that body language is a conscious process	1 (7.1%) / 5 (29.4%)
Consider that body language isn't the same all over the world	4 (28.6%) / 11 (64.7%)
Know that in Japan the "ring" gesture means money	1 (7.1%) / 3 (17.6%)
Consider that the slow steps mean self-confidence	5 (35.7%) / 6 (35.3%)
Consider speaking rapid means greater credibility	2 (14.3%) / 5 (29.4%)
Consider watching aside means dishonesty	5 (35.7%) / 8 (47.0%)
Consider crossed arms means a threat	9 (64.3%) / 8 (47.0%)

Source: Authors' research

Even 88% of individuals consider that the each hand gesture is a kind of message.

The results from the research on nonverbal knowledge and nonverbal communication practice of the Macedonian entrepreneurs are presented in Table 1.

Most of the entrepreneurs, both male (88.2%) and female (92.8%) are very much aware about the importance of the body language and its manifestation. In line with this statement goes the fact that 94.1% of male entrepreneurs and 92.8% of female entrepreneurs understand that different hand and palm gestures are being used to send different messages.

But, at the same, they do not know how to correctly interpret the exact meaning and secret messages sent through these gestures and body language in general. For instance, only 35% both male and female entrepreneurs understand properly the meaning of walking slow as walk of someone with power and self-confidence. The same with the position of the interlocutor, when he/she look aside while talking. Only 47% of male entrepreneurs and 35.7% of female entrepreneurs know that it means a sort of dishonesty or keeping something secret.

Male entrepreneurs do not know the right meaning of the crossed arms, because only 47% say that it is a kind of closed defensive shield, blocking out the outside world. From the other hand, female entrepreneurs know much more about this gesture (64.3%), and are aware that shields act in two ways: one is to block incoming attacks and the other is a place behind which the person can hide and perhaps not be noticed. Crossed arms may thus indicate anxiety which is either driven by a lack of trust in the other person or an internal discomfort and sense of vulnerability (that may, for example, be rooted in childhood trauma).

The voice as a form of nonverbal communication is the most unknown by the Macedonian entrepreneurs. 29.4% male entrepreneurs and only 14.3% female entrepreneurs understand speaking rapid in line with greater credibility.

It is also interesting that opposite to what is the situation with similar researches in other countries, Macedonian female entrepreneurs know and use less body language in their business activities than their male counterpart.

Conclusion

It is a fact that nonverbal communication helps entrepreneurs to move further in terms of their business success. People who better understand nonverbal communication and use it more frequently, are more likely to be better in daily negotiations, cooperation and making all important business decisions. The research results show that there is a huge difference between the uses of nonverbal communication by the Macedonian entrepreneurs and her use in other countries. In other countries, nonverbal communication is part of the organizational culture and a topic into the overall business strategies of the organizations.

The analysis has shown that the entrepreneurs are aware of the the nonverbal communication and its characteristics, but what is more important, they are aware also for the benefits that come with its use. However, they don't take the body language so seriously when it comes to making business decisions. The results show that the entrepreneurs have only the basic knowledge of nonverbal communication, they know how important it is, but only small part of them fully understands it. Only a small part of them really knows the nonverbal communication with all her dimensions: voice (paralanguage), environment, artifacts, space, facial expression, and environment. What is also interesting result from this research is that men entrepreneurs are much more aware and familiar with the nonverbal communication that the female entrepreneurs.

Literature

1. Aldrich, H. E., and C. M. Fiol. (1994). "Fools rush in? The institutional context of industry creation". *The Academy of Management Review*, 19, 645-670.
2. Gjorgijovski B. (2013). *Delovno Komuniciranje [Business communicating]*. Faculty of Economics – Skopje.
3. Goman, C. K. (2008). *The Nonverbal Advantage: Secrets and science of body language at work*. San Francisco: Berrett-Koehler Publishers, Inc.
4. Goman, C. K. (2011). *The Silent Language of Leaders: How Body Language Can Help – or Hurt – How you Lead*. San Francisco: Jossey-Bass.

5. Hitt, M. A., Ireland, R. D., Camp, S. M., and D. L. Sexton. (2001). "Guest editors introduction to the special issue: Strategic Entrepreneurship: Entrepreneurial strategies for wealth creation". *Strategic Management Journal* 22, 479-491.
6. Kennickell, A. B., Kwast, M. L., and J. Pogach. (2015). "Small Businesses and Small Business Finance during the Financial Crisis and the Great Recession: New Evidence from the Survey of Consumer Finances." *Working Papers -- U.S. Federal Reserve Board's Finance & Economic Discussion Series* 1-94. *Business Source Complete*, EBSCOhost (accessed August 28, 2015).
7. Lounsbury, M., and M. A. Glynn. (2001). "Cultural entrepreneurship: Stories, legitimacy, and the acquisition of resources". *Strategic Management Journal* 22, 545-564.
8. Malecki, J. E. (1993). "Technology and Economic Development: The Dynamics of Local, Regional, and National Change". *Economic Geography*, 69 (1): 94-98.
9. Means, T. (2012). *Delovna Komunikacija [Business Communication]*. Skopje: Ars Lamina.
10. Montagno, R. V., Kuratko, D. F., and J. H. Scarcella. (1986). "Perception of entrepreneurial success characteristics". *American Journal of Small Business*, 10, 25-32.
11. Patel, P., and K. Pavitt. (1991). "Large Firms in the Production of the World's Technology: An Important Case of Non-Globalization", *Journal of International Business Studies*, 22 (1): 1-21.
12. Pease, A. (2014). *Body Language: How to Read Others' Thoughts by Their Gestures*. Manjul Publishing House Pvt Ltd.
13. Shane, S. (2003). *A general theory of entrepreneurship – The individual-opportunity nexus*. Cheltenham, UK: Edward Elgar.
14. Stoker, J. (2013). *Overcoming Fake Talk: How to Hold REAL Conversations that Create Respect, Build Relationships, and Get Results*. McGraw-Hill Education.
15. Širec, K., and D. Močnik. (2010). "HOW ENTREPRENEURS' PERSONAL CHARACTERISTICS AFFECT SMES' GROWTH." *Our Economy (Nase Gospodarstvo)* 56, no. 1/2: 3-12. *Business Source Complete*, EBSCOhost (accessed September 1, 2015).
16. Wainwright, G. (2000). *Teach Yourself Body Language*. McGraw-Hill/Contemporary Books.

UDC 005.6:631.147]:005.52:005.33(497.7)
Original scientific paper

Katerina HADZI NAUMOVA – MIHAJLOVSKA¹⁾
Natasha DANILOSKA²⁾

**SWOT ANALYZES FOR IMPLEMENTING THE CONCEPT OF
TQM AS WAY OF WORKING IN ASSOCIATION'S
PRODUCERS OF ORGANIC PRODUCTS IN REPUBLIC OF
MACEDONIA**

Abstract

The relationship between total quality management (TQM) and organic production is clear and easy understood because the both are concepts in which basis lies multidimensional of quality. Practice show that association's producers of organic production in Republic of Macedonia are face serious problems in performance and continues present on the market because of poor organization of associations. So, the attempt of the paper is to explore the possibility of implementing the concept of TQM as way of working in association's producers of organic production of Republic of Macedonia.

Key word: TQM, organic production, association, Republic of Macedonia

JEL classification: Q12; Q13

Introduction

The modernization and industrialization of agriculture after World War II in order to meet the needs of the growing population and improve the living standards, led to intensive degradation, soil pollution

¹⁾) PhD, Institute of economics – Skopje, e-mail: katerina@ek-inst.ukim.edu.mk

²⁾) PhD, Institute of economics – Skopje, e-mail: natasha.daniloska@ek-inst.ukim.edu.mk

and disruption of natural ecosystems. This condition stimulated interest in the development of concept that provides an environmental protection and aims towards greater social justice – sustainable development. One important approach to sustainable development, which at the same time gives a good quality and safe product and has seen intense growth in the country, is organic farming. Organic agricultural production is a way of life that some people practice their enduring quality of life and the continuation of the existence of nature and hence can be said that organic production and consumption of organic food is a choice. Among them awareness and knowledge about organic production is very high and they produce an organic life philosophy - quality in all aspects of life.

TQM have proven very valuable to companies and organizations as an integrative approach anchored in the belief that long-term success depends on unique commitment to quality in all departments of an organization. It is a complex and multidimensional management system aimed at agribusiness is mass, proportion and continuous quality improvement in all areas of production and economic (business) and social activity. Given that organic farming is a way of growing plants and livestock products and their processing principle to create quality in all aspects, there was a logical exploration of the possibility of application of TQM as a way of organization and operation of associations of producers of organic products.

The main objective of the paper is to determine the development of the association in respect of the operation according to the principles of TQM. For that purpose research in the paper is based on analysis of data obtained through interviews with the members of associations of producers of organic products in Republic of Macedonia on a previously prepared questionnaire. On that ground is performed SWOT analysis in order to determine the capabilities and weaknesses of the associations of producers of organic products on the mode of operation according to the principles of TQM. The subject of research is the concept of TQM and the operation and organization of association's producers of organic products in Republic of Macedonia.

1. The relationship between TQM and organic production

Organic agriculture is best known as a farming method aims to produce healthy and quality food products to the population without adverse effects in the environment that may jeopardize the balance in

nature. It relies on the ethical principles of the protection and improvement of the environment and an economically viable production with distinctive organoleptic quality. The organic production use methods and techniques that are consistent with the principles of nature and thus leads to sustainable development. What makes it different are the procedures of production and the way of certification. The procedures of organic production arising from the characteristics and specificities of way this production, and it is the way of fertilizing the soil, the method of dealing with weeds, the way of dealing with diseases and pests, how to care for animals that are cultivated in the breeding, nutrition and treatment. The certification of organic production says that during the production there is applying exactly certain standards, which provide a special product quality. The first international standards for certification of organic production introduces International Federation of Organic Agriculture Movements (IFOAM) and they are intended to assist national certification organizations around the world to establish their own standards, taking into account the specific national conditions. Certification of organic products is a formal and documented procedure by which a third party (certification body) assures that organic standards are respected. The certification process is based on the control of major documentation of farm i.e. each input and output of the manufacturing system. Only in special cases, perform additional chemical analysis. Also, manufacturers wishing to obtain a certificate must provide accurate records for each production stage and every business transaction. So, farmers and the other participants in the production, processing and marketing creates precise database or accurate information system.

It can be concluded that organic farming is a production system is based on respect for and implementation of quality standards, but at the same time the production of quality food requires management to continuously monitor the developments and changes and adapting and improving their knowledge and skills, with full commitment to quality in all aspects of operations. This approach represents the overall quality management (TQM). Full quality management emerged as a result of the realization that quality is created in the working process in all organizational units of the company. With this concept the quality out of the proceedings and is expanding in all departments and acquires a new dimension, not only quality products but also the quality of work and working arrangements. Activities for exercise, providing, maintaining and developing the quality rise to the level of the most important goal and task of the overall operation and development of the company as a

whole, and in every part separately. TQM should provide: product quality, including quality of project preparation and implementation; quality of service they assumed accurate delivery; quality relationships associated with care for the product and the man; quality management, which refers to the ability to make the right decisions and to ensure their effective enforcement and a new "culture" in the company oriented towards quality.

TQM is result from the idea that the management is organized with an orientation towards quality, based on the approach plan-perform-check-correct, improve the participation of all stakeholders. In TQM quality is achieved by the application of established principles of leadership, customer satisfaction and employee participation at all, focus on facts and continuous improvement. Based on the principles of TQM, and using the experience of QMS process model and the model of excellence ISO / CD 9004, the quality gets a new dimension and meaning - quality of life and sustainable development. Quality is moving towards the concept of sustainable development that establishes a balance between technological development necessary for economic prosperity and survival of the environment and society as a whole. The overall quality of society or Total Quality Society - TQS increasingly insist on increasing social responsibility in order to improve the environmental sustainability of society. BEST model is the new dimension of quality and is based on new principles of sustainability:³

- **Biophysics** and environment
- **Economy**
- **Society**
- **Technology**

Access to quality in this model is developed to integrate the various standardized management systems aimed at redefining and promoting harmonized sustainable development of society and the environment.

2. Characteristics or organic agriculture in Republic of Macedonia

The agriculture is very significant for the national economy of the Republic of Macedonia. Besides the many policies and economic

³ Heleta M., "Menadžment kvaliteta", Univerzitet Singudum, Beograd, 2008, стр. 82

problems, that were previously stated, this sector has indicated an important flexibility, and for this period it has contributed significantly to the social and economic stability. The total share of the agri-food sector, coupled with the food industry, accounts for approximately 8.9% of the GDP.⁴

Biological diversity in agriculture is especial important for persistence of people, primarily because of gratification of basic needs for food. With civilization development has create new type with better quality. But, in time, many of types and breed were destroy as genetic resource. Types, sorts and races who are domestic for Macedonia should be save above all for economic, science, cultural, socio-economic and ecological arouse. Republic of Macedonia characterize with traditional agriculture especial in mountain areas. Organic agriculture is close to traditional agriculture, so it has a potential for development.

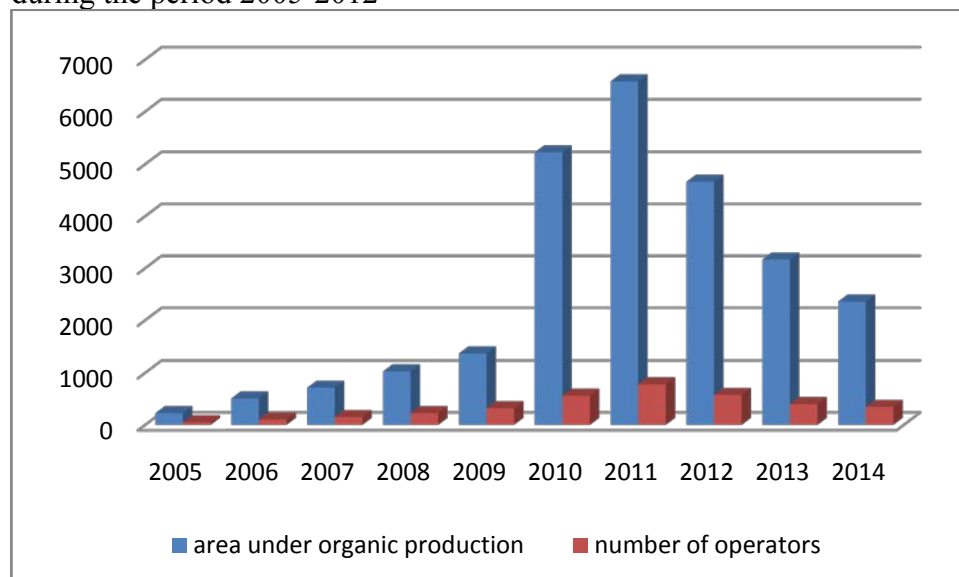
The first farmers began dealing with organic production according to the principles of the previously known buyers in the country are observed in 1998 in Ohrid, Strumica and Kumanovo. After that, provides expertise to create a draft legal basis for organic production as part of the support of environmental NGO's launched the project "Local initiatives to organic farming."⁵ Following the development of the EU Regulation, Ministry of Agriculture, Forestry and Water Management in 2008 began drafting a new law on organic agricultural production, fully harmonized with the EU Regulation 834/2007. Law on Organic Agriculture came into force in 2010 and it regulates the production, preparation, processing, finishing, storage, transportation, distribution, marketing, sale, labeling and control of organic products that are used in the methods of organic production.

In total cultivated land, organic production is 2,74%. The graph 1 clearly shows that the interest for the conversion of this production is intensive growth especially in the period 2005-2011, last three years the interest is decreases.

⁴ Statistical Office, http://www.stat.gov.mk/Publikacii/MakBrojki2014_mk.pdf, 19.3.2014

⁵ National Strategy and Action Plan for Organic Agriculture of the Republic of Macedonia (2008-2011), MZSV 2007

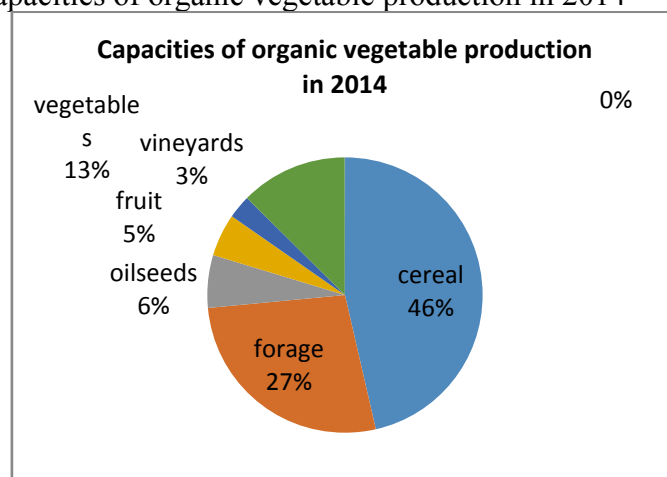
Graph 1 Area under organic production and the number of operators during the period 2005-2012



Source: Ministry of Agriculture, Forestry and Water Management of Republic of Macedonia,

http://www.mzsv.gov.mk/organsko_zemjodelsko_proizvodstvo2013.pdf, 19.03.2015

Graph 2 Capacities of organic vegetable production in 2014



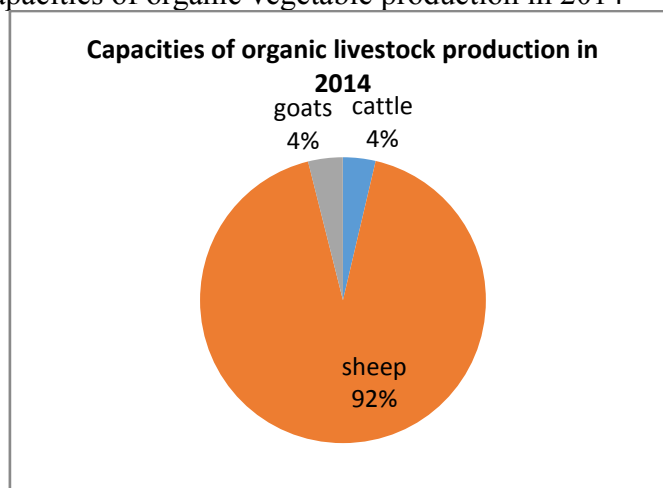
Source: Ministry of Agriculture, Forestry and Water Management of Republic of Macedonia

http://www.mzsv.gov.mk/organsko_zemjodelsko_proizvodstvo2013.pdf, 19.03.2015

The reason for that is the inadequate internal organization of producers of organic products and insufficient quantity ranking. That forces the manufacturers their products sold as conventional, for lower price in terms when it would have sold as organic products leads to reduced interest in this way of production.

Leading crop in organic vegetable production are cereals with 896.4 ha production area, and in organic livestock production are sheep breeding with 53484 numbers of sheep. (Graph 2 and 3)

Graph 3 Capacities of organic vegetable production in 2014



Source: Ministry of Agriculture, Forestry and Water Management of Republic of Macedonia,
http://www.mzsv.gov.mk/organsko_zemjodelsko_proizvodstvo2013.pdf,
19.03.2015

Organic production in the Republic of Macedonia is recognized because of traditional mode of production in some regions where they are produced. Macedonian consumers often say they are "ecologically, quality and our". The organic sector in the country is by no means a homogeneous economic area. As part of agriculture is characterized by a heterogeneous structure in which besides agriculture, are included environmental, social, health and economic structures. The organic sector in Republic of Macedonia is composed by producers, cooperatives, associations, counseling stakeholders, control and certification bodies and government institutions involved in the implementation of organic farming policy.

3. Condition and circumstances of association's producers of organic products in Republic of Macedonia

The main holder in organic sector in Republic of Macedonia are the individual producers of organic production usually in form of family farm i.e. farm in which family members are the main labor force. Family farms are mainly manufacturers of primary production and the main objective is the production destined for the market, and a small part of their own household. The size of family farms is different, but it is a small integrated farms or farms which also has vegetable and organic livestock production because organic farming is characterized by a circular system of cultivation. Despite this, the main purpose for affiliation of producers of organic products is development and promotion of organic production and education and join market of producers. One of the simpler and acceptable strategies are strategy of integration and coordination. Basically, this strategy is aimed at encouraging collaboration and developing a marketing approach to production. The strategy of integration and coordination combine two or more parts of the production process - processing - marketing and are determined common management approach. The success of this depends primarily on the manager or president of the association. He plays a key role because within a society at the same time effectively and efficiently operates two types of activities - production and marketing and to work in coordination with the members of the association and to have the support of them. Integration may be horizontal and vertical.⁶

Horizontal integrated association is generated on the market with similar products, where the layers of each marketing level combine to increase market power. This integration strategy is formed on the basis of voluntary membership usually in small groups of farmers related manufacturers for its activity (e.g., fruit producers, breeders of cattle, etc.). This strategy is the best way for manufacturers to choose the product that best sold within strictly specialized groups of agricultural products (e.g., apples, milk, etc.). In this way of integration, individual farmers and agribusiness managers can independently or jointly manage the procurement of inputs and implementation of production and processing, but always together either in marketing and sales of products.

⁶ Sekovska B., Anakiev B., „Zgolemuvanje na konkurentnosta na zemjodelskite proizvodi preku zaednichki nastap na zemjodelskite zdruzhenija“, Zdruzhenie na agroekonomistite na Republika Makedonija, Skopje, 2004, str.8

The vertically integrated associations are form wherein within an association of producers combine ownership or control of the successive stages in the production and marketing of agricultural products. The success of vertically integrated agricultural societies depend on top management, he should have the experience, the support of members, to know the activities of the association or the production of agricultural products produced successfully integrate and coordinate numerous activities, successfully manages the marketing activities, and thus, successful placement market. Vertical integration may be directed to the initial stages of the production process, i.e. connectivity in primary production and procurement of materials for input or to the final stage of the production process - consumers, or processing of products, transport and marketing activities. Vertical integration enables coordinated production, efficiency between operations in order to achieve low cost. In the organization of agribusiness has great importance as it affects the ability of decision-making of farmers, and thus affects the control of resources and have the opportunity to be able to actively change the characteristics of the market.

Associations are often present form of jointly organizing the organic sector in the country. The main purpose of pooling individual producers of organic production is common procurement of raw materials in order to be cheaper and timely, obtaining loans, purchase of equipment and other fixed assets, planning of distribution channels and their common use in order to make production more competitive, exercising the rights to influence relevant government institutions when making important laws and regulations that are in the interests of producers and end what matters most, successful research and performance in the market and discovering new markets and new market segments.⁷

The highest form of association in the country's Federation of Producers of organic products (FPOP) aimed at providing coordination and leadership of the organic movement in the country. In its composition has nine regional associations and form the union of producers of organic products for the development of organic production in the country and to broaden their social interest. Members have equal participation in the work of the Federation by the authorities of the Federation: Assembly, Management Board, Supervisory Board, Expert Committee and club partners. Although producers are linked the mode of

⁷ Ibidem

production and certification, they are faced with several problems like insufficient quantity of production of certain sale, disorganized export of organic products and fragmentation-existence of several associations of producers of organic products of the same products in the same region. In order to solve the presented problem requires a new approach to management which is based on a set of multidimensional quality, and it can be observed in terms of products, but also in terms of operation and functioning in all spheres of social life. The application of the full quality management (TQM) as a means of organization and operation of associations of producers of organic products are getting a new dimension and the ability to win market, to achieve a recognizable brand and generally higher level of development in terms of quality assurance.

4. Analyzes of condition of association's producers of organic products in Republic of Macedonia

According to the Central Registry of the Republic of Macedonia as the only institution that maintains records of producers associations of organic food, there is no exact number of registered associations of producers of organic food because they are registered with the Law on Associations and Foundations based on Articles 5, 18 and 20 belong to organizations and non-profit sector in which data associations are protected in accordance with regulations to protect personal data and classified information. The questionnaire was sent to the highest form of organized associations in the country - Federation of Producers of organic products which includes nine regional associations, of which four (4) Associations ("Organik kaki" – Valandovo, "Aronia" - Gevgelija, "Ovcepolški eko-proizvodi" - Sveti Nikole and "Eko-Sar" - Gostivar) and sixty-five (65) members - manufacturers responded to the questions.

The research results show that in the associations of producers of organic products there's a basis for the implementation of TQM in operation primarily due to recognition of organic products under the concept of TQM - total quality in production and operation, cost reduction and customer satisfaction. The organic products are the result of a way of thinking for growing crops targeted quality in every way to achieve customer satisfaction and better market position and successful business. Quality in organic products does not imply only organoleptic quality of the product but also the concept of sustainable development that establishes a balance between technological development (which is

necessary for economic prosperity) and survival of the environment and society as a whole.⁸

All producers define organic production as the principles of TQM as an essential tool for competitiveness of organic products indicate exceptional product quality. Producers have space to express their opinions and ideas and participate in all final decisions regarding the operation of the association. Also, many respondents answered that associations aim and strategy, and are related to increasing the quality of work. Smaller development exists in the implementation of changes (in more than half of the respondents are not made any changes to the operation), teamwork - very little is represented hence cooperation and communication between members takes place only if there is a problem. Also, training is often unplanned and apply the technology of production, consulting and cooperation with scientific - research, universities and other educational institutions and they are producing, and very little about the operation and organization of the work of associations.

Based on the results is made SWOT analysis on the application of TQM as a way of organization and operation of associations and it showed that there are strengths and opportunities for the application of TQM in the associations of producers of organic products, as well as weaknesses and threats. Recognition of organic products as a product of the concept of TQM is strength parallel to meet customer requirements and develop cooperation and communication. Hence, the resulting opportunities for the application of TQM as a way of organization and operation of associations of producers of organic food as a reorganization of the structure and operation of associations or leaving the managerial approach to work and go to work proactively with the leaders. As weakness occurs, the absence to changes will cause incomplete training of TQM or improper application of TQM.

⁸ Hadzi Naumova-Mihajlovska K., "Opportunities and prospects for application of TQM into association's producers of organic products in the Republic of Macedonia", Doctoral dissertation, Institute of economics – Skopje, 2014

Table 1

SWOT analyzes for implementing TQM as way of working in association's producers of organic products in Republic of Macedonia

Strengths	Weaknesses
<ul style="list-style-type: none">-Identify the organic product as a product of the concept of TQM-Participation of all members of the adoption of certain decisions-Existence of a comparison with the competition-Developing cooperation and communication-Satisfying customer requirements	<ul style="list-style-type: none">-Low developed cooperation with scientific research, academic and educational institutions-Absence of change-Low use of consulting services-Irregular, unplanned and unstructured training members-In decision the last word has the president of the association- The vision and objectives of the association are the short-term- Lack of contract farming
Opportunities	Threats
<ul style="list-style-type: none">-Abandonment of the management approach to work and transition to work proactively with leaders-Reorganizing the structure and operation of associations-Develop teams associations-Promotion of cooperation and communication-Improving education and training of members of the associations	<ul style="list-style-type: none">- Incomplete training for TQM- Inadequate application of TQM- Unclear defined goals;

Source: own researches

The SWOT analysis of the associations of producers of organic products have found their capabilities and weaknesses which helped in finding solutions that can help in the design and implementation of complete quality management. These are called critical points and relate to the quality policy, education and training and integrating quality in organizing through continuous improvement, benchmarking and reengineering.

Associations of producers of organic products should comply quality policy of economic, social and environmental character of organic production. Basically, the policy should be directed to the

leading idea of the organic movement - creating production in accordance with the principles of the cycle of nutrients, maximum use of natural resources, maintaining the natural balance, enabling people to live in accordance with human rights UN to meet their needs, making profit on production and satisfaction of this production that includes a secure environment.

The education process should take place in the form of the cycle where the final result is to improve the knowledge and ability to promote all the functions in the operation of the association. This cycle is the initial stage in the creation of associations "learning organization." It is necessary that it does not happen only when required or in case of a problem, but a habit and routine. Consequently, existing knowledge constantly exploiting the strategic goals of the association and it is easily prepared to face the changes that followed.

TQM in the organization is a way of managing people and business in order to achieve customer satisfaction and pleasure for members or employees. For this purpose it is necessary for effective leadership or leadership, teamwork and continuous improvement. The first step in the process is all members of the associations understand that their job is very important part in the operation and organization of associations and requires full commitment. It is a process that never stops and where it is happening gradual improvements. No matter how good the, always can be achieved better since the changes in the environment are permanent.

Conclusion

The organic products are the result of a way of thinking for growing crops targeted quality in every way to achieve customer satisfaction and better market position and successful business. Quality in organic products does not imply only organoleptic quality of the product but also the concept of sustainable development that establishes a balance between technological development (which is necessary for economic prosperity) and survival of the environment and society as a whole. In this regard TQM increasingly has or will have a role to increase the social responsibility of business and its practices in order to improve the environmental sustainability of society. The SWOT analysis shows that there are strengths and opportunities for the application of TQM in the associations of producers of organic products, as well as weaknesses and

threats. The implementation of TQM as a management technique in the associations of producers of organic products should be directed to complying quality policy of economic, social and environmental character of organic production, education and training of members of associations and integrating quality in organizing through continuous improvement, benchmarking and reengineering as guidance (prospects) to change the way of cooperation and communication among members of the associations and the associations between levels.

References

1. Hadzi Naumova-Mihajlovska K., “Opportunities and prospects for application of TQM into association’s producers of organic products in the Republic of Macedonia”, Doctoral dissertation, Institute of economics – Skopje, 2014
2. Heleta M., “Menadžment kvaliteta”, Univerzitet Singidum, Beograd, 2008
3. Ministry of Agriculture, Forestry and Water Management of Republic of Macedonia,
http://www.mzsv.gov.mk/organsko_zemjodelsko_proizvodstvo2013.pdf, 19.03.2015
4. National Strategy and Action Plan for Organic Agriculture of the Republic of Macedonia (2008-2011), MZSV 2007
5. Sekovska B., Anakiev B., „Zgolemuvanje na konkurentnost na zemjodelskite proizvodi preku zaednichki nastap na zemjodelskite zdruzhenija“, Zdruzenie na agroekonomistite na Republika Makedonija, Skopje, 2004
6. Statistical Office,
http://www.stat.gov.mk/Publikacii/MakBrojki2014_mk.pdf, 19.3.2014

UDC 334.72:001.895(497.7)
Original scientific paper

Iskra STANCHEVA-GIGOV*)
Darko BEZANOSKI)**

INNOVATION AND ITS PERSPECTIVES IN REPUBLIC OF MACEDONIA

Abstract

In contemporary world innovation is equally important factor for competitiveness in both the world and the domestic market. The country's ability to sustain economic growth and competitiveness is in the activation of innovation and learning. Hence, the innovation present a challenge for any one country and company in particular for those companies that are exposed to international competition.

Taking into account the importance of innovation in the modern world, this paper considers the issue of innovation of the Republic of Macedonia as well as opportunities for its improvement. For this purpose is analyzed the data available in several commonly cited and used indexes of innovation. The working hypothesis in this paper is that the Republic of Macedonia regarding the innovation is a typical example of a Southeast Europe region and together with the other countries of the region is far from the innovative leaders and significantly lagging behind the EU-28 average. The major findings of the paper confirm that Macedonia is a "modest innovator", a typical representative of the South Eastern Europe (SEE) countries, and based on the perceived strengths and weaknesses, there is still much to do to improve its current condition of innovation.

*) Ph.D., Institute of Economics - Skopje, R. Macedonia, E-mail: iskra@ek-inst.ukim.edu.mk

**) M.Sc., E-mail: darko_topce@yahoo.com

Keywords: innovation, indexes, Macedonia, Southeastern Europe, competitiveness, opportunities and prospects

JEL classification: O 31, O 38

Introduction

In the modern world, innovation and knowledge become the most important source of market success and sustainable competitive advantage. Therefore, in such an environment the issue of measurement and understanding of innovation of companies and countries is essential.

The importance of innovation for each country can be perceived also in the large number of studies that have been conducted for the innovative features of the countries and regions. The traditional approach to measuring innovation is based on parameters such as the number of patents and published articles in scientific journals per million people, i.e. investment in research and development. But, with the predominance of understanding that innovation is a multidimensional phenomenon, currently for evaluation of innovation are used complex models based on ten parameters. Using such models, based on innovative features, world economies are ranked by various annual reports.

However, there are two problems. The first problem arises from the fact that there are many definitions of innovation and as result of that there are many different measures i.e. operationalization of innovation. This leads in a number of research results that differ from each other. The second problem is related to the fact that the analysis found in existing reports are mainly associated with the most innovative countries or those with the greatest change in the level of innovation, and that small countries with average features are poorly mentioned in the analysis. But, after a recent study¹ found that innovation in low and middle-income countries have a much greater impact on economic growth than in developed countries, has increased the need for better understanding of the innovative performance of these countries. This result can be better understood if it is known that the innovation activity in low and middle-income countries enables more efficient and faster absorption of imported technology, and thus multiply the effect of growth.

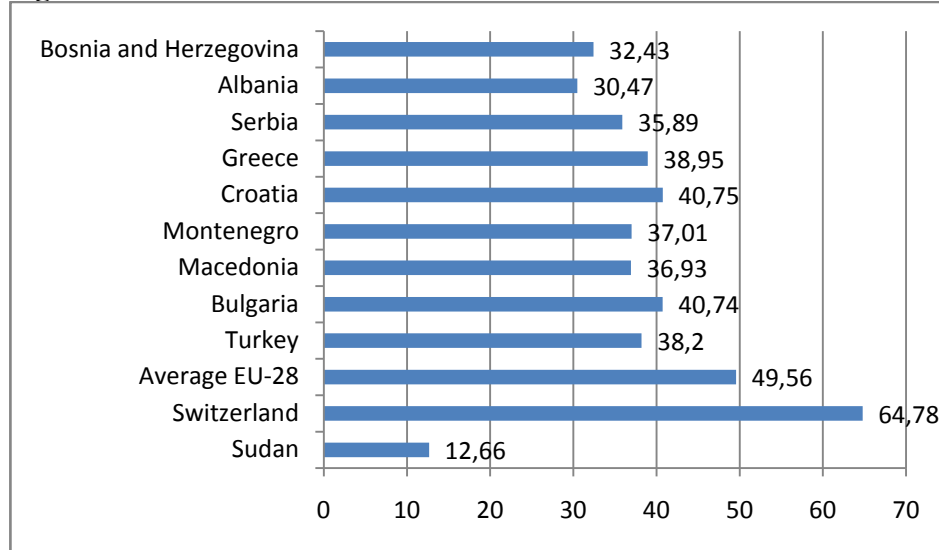
¹ Intelligence Unit, Innovation: Transforming the way business creates, Economist, 2007

Given that the Republic of Macedonia is categorized into countries with medium level of development, implies the need to overcome these problems. For this purpose, on the basis of data from multiple sources, it is necessary to analyze its innovative performance, to compare with the other countries of SEE the region and leading countries, especially those of the EU, and to provide insight into the strengths and weaknesses of the innovative policy and practice. Hence the idea of this paper to answer the question: how much is innovative Macedonian economy? For this purpose are analyzed the data available in several most commonly cited and used indexes of innovation. These are: the Global Competitiveness Index, the Global Innovation Index, the Index of Knowledge Economy and Innovation Index of the EU.

1. The Macedonian innovative potential

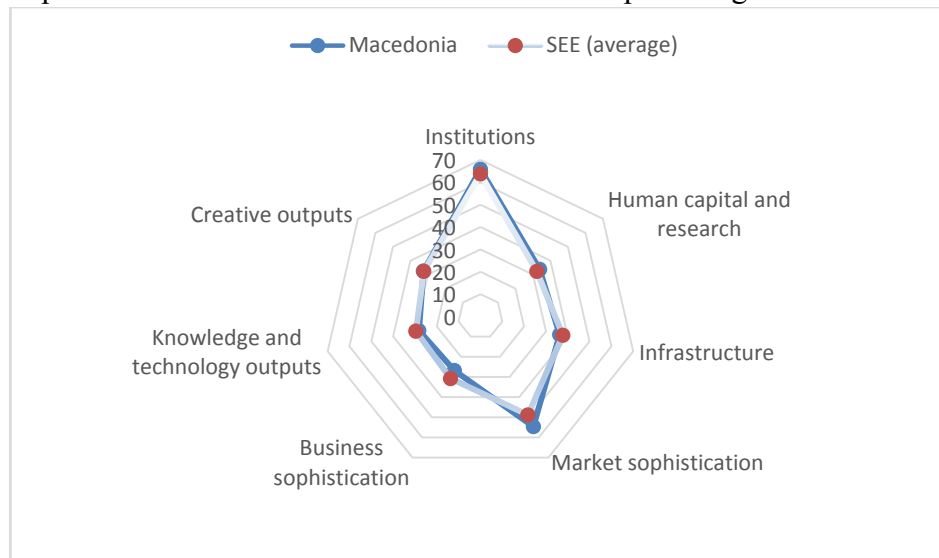
In order to obtain a general idea about the level of innovation development in the country it is first necessary to realize where it is located in relation to the most innovative and most non-innovative country in the world, then compared to the average of the EU-28 (to which it wants to be a part), and compared to the region of SEE that it actually belongs. The Figure 1 presents the values of global innovation index for the world leader in innovation (Switzerland), and the worst-ranked nation in innovation (Sudan) as minimum and maximum values, the values of the average EU-28 and the values of that index for each of the SEE countries separately. Consideration of innovation in the country in these coordinates shows that it is more lagging behind the world leader in innovation than it is before most non-innovative country in the world. Specifically, the difference in value of the innovation index of Switzerland and Republic of Macedonia is 27.85, and Republic of Macedonia and Sudan is 24.27. Figure 1 also shows that the Republic of Macedonia and other countries of Southeast Europe are significantly below the EU-28 average.

Figure 1. The Global Innovation Index 2014 in certain countries



Source: Prepared by the authors based on data from Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, The Global Innovation Index 2014: The Human Factor in Innovation, Cornell University, INSEAD, and the World Intellectual, 2014

Figure 2. Comparison of the global innovation index's elements in the Republic of Macedonia and the South East Europe average



Source: Prepared by the authors based on data from Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, The Global Innovation Index 2014: The Human Factor in Innovation, Cornell University, INSEAD, and the World Intellectual, 2014

Overall globally, according to the Global Innovation Index 2014, Macedonia is in the first half of the countries according to the innovative performance. It is seen as a typical representative of the South East Europe (Figure 2).

According to this index, the relative advantages of the Republic of Macedonia are in the business environment, particularly in the context of ease of starting a business (ranked 3rd place) and as another advantage can be highlighted also human resources, particularly in the area of education, but not in the research system. The weaknesses are evident in the non-participation of industry in financing and implementation of research and development, in the weaknesses of the institutions and political instability, and of course in the insufficient funds allocation, i.e. low gross expenditure for Research and Development (R&D) in the whole economy. Additional problem for Macedonia is of course the general infrastructure.²

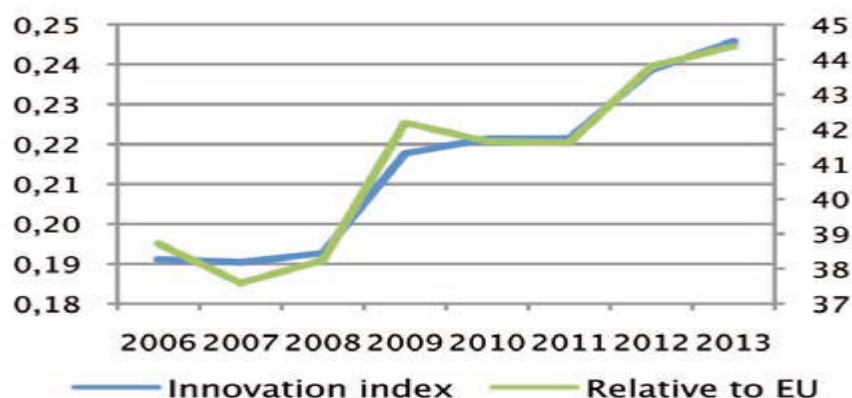
It can also be concluded that according to efficiency innovations in the latest Global Innovation Index the country is in the middle compared to other countries. Namely, it is on 82th place out of 143 countries and is located before the Greece (85th place), Bosnia and Herzegovina (101st place), Montenegro (106th place) and Albania (131st place), but it is far behind Turkey (11th place), Bulgaria (24th), Croatia (36th place) and Serbia (46th place).³ This index, unlike the index of innovation (which is a weighted average of all seven categories) is the quotient of the sub-index that describes the results of innovative activities (last two categories) and sub-index that describes the investment in innovation (the first five categories). It is independent of the degree of development of the country and shows the capacity of the state to overcome the main weaknesses to achieve better results of innovation activities in unfavorable conditions. Regarding of this index it is particularly important to know that as in any division, a higher result can be obtained in two ways – by increasing the numerator or denominator reduction. In Macedonia's case, the high coefficient of efficiency, unfortunately, is much more a consequence of modest investments in innovation, then the excellent innovation results. Hence, according to the

² Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, *The Global Innovation Index 2014: The Human Factor in Innovation*, Cornell University, INSEAD, and the World Intellectual, 2014, p. 265

³ *ibid*, p. 140, 156, 160, 172, 189, 225, 251, 265, 270

results it can be seen that Macedonia does not have a high capacity to overcome the main weaknesses to achieve better results of innovation activities under unfavorable conditions.

Figure 3. Innovation in Macedonia



Source: Innovation Union Scoreboard 2014, The innovation union's performance scoreboard for research and innovation, European Commission, 2014, p. 74

Macedonia under the EU Innovation index is in the group of countries categorized as “modest innovator”, which is the last of the categories of innovators determined according to this index. Macedonia is well above average in Youth education (which coincides with the results in the Global Innovation Index 2014) and the Contribution of medium-high-tech product exports to the trade balance (where it is taking 4th place overall) and also its growth performance (3.7%) has been almost double than that of the EU.⁴ Innovation performance has been increasing between 2006 and 2013. The country has been catching up to the performance level of the EU: its relative performance improved from 38% in 2008 to 44% in 2013 (Figure 3).⁵

Macedonia is well below the EU average which is very easily detectable by the left side of Figure 4 below. Hence, major weaknesses are found in the following categories: public-private scientific co-publications, Community design, research and development expenditures

⁴ Innovation Union Scoreboard 2014, The innovation union's performance scoreboard for research and innovation, European Commission, 2014, p. 28

⁵ Ibid. 74

in the business sector and community trademarks. The strengths are far less present and relate to non-research-development innovation expenditures and youth with upper secondary level education.

Growth performance in separate categories which is shown on the right side of Figure 4 shows that significant growth rates are observed in Community trademarks, new doctorate graduates and most cited scientific publications. Other high growth indicators are non-EU doctorate students and population with completed tertiary education. A strong decline in the growth is observed in the research and development expenditures in the business sector, PCT patent applications and public-private scientific co-publications.

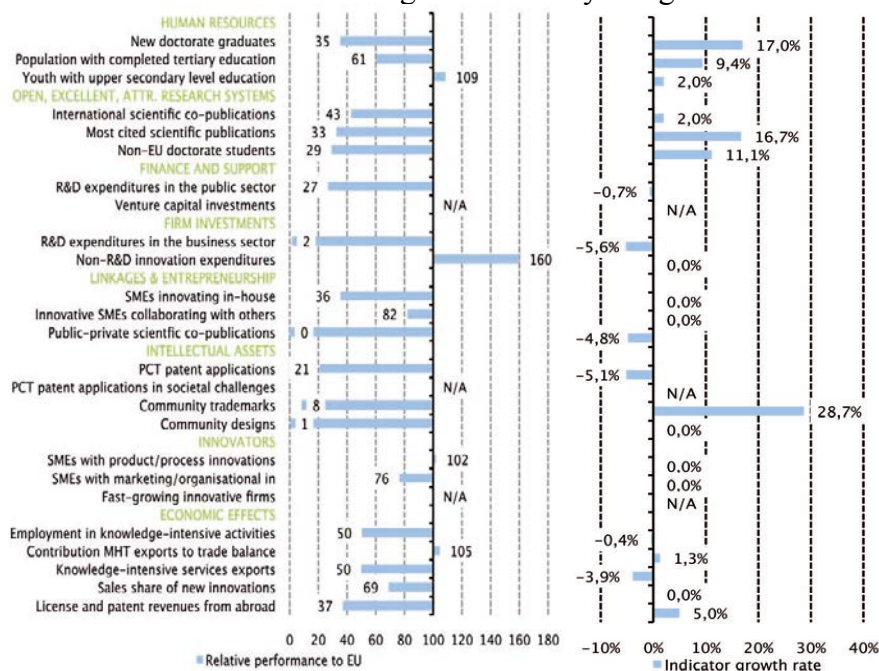
These not very favorable results for the innovation of Macedonian economy are also confirmed by the Global Competitiveness Index which in a separate pillar measures and expresses the situation with innovation. Also according to this indicator the economy can't much to boast in terms of innovation capacity, the quality of scientific research institutions, the expenditures to companies for research and development (R&D), availability of scientists and engineers, as well as in terms of the number of patents (under the Patent cooperation - Patent Cooperation Treaty (PCT)) per million people.

It is also worthwhile to note and comment the data on innovation in the Republic of Macedonia according to the Index of knowledge economy in 2012.⁶ According to this index, Republic of Macedonia in terms of the overall level of preparedness of the country for the knowledge economy is not in remarkable position compared to other countries in the region. Namely, it is positioned on 57 th place, only ahead of Turkey and Albania, and on the 69th place in terms of the pillar that refers to innovation. Thereby Macedonia has moved forward by 16 positions due to the development of its economic incentive and institutional regime (EIR), innovation and ICT pillars, especially pillar economic incentive and institutional regime, which is moved forward by 34 places.⁷

⁶ The latest available data are for 2012.

⁷ www.worldbank.org/kam, p. 7-8

Figure 4. Relative achievement of innovation in the Republic of Macedonia in terms of EU and growth rates by categories



Source: Innovation Union Scoreboard 2014, The innovation union's performance scoreboard for research and innovation, European Commission, 2014, p. 74

An additional fact about the Macedonian economy's innovation is that compared with developed European countries, innovation potential in the private sector in Macedonia is in a worse position, as follows: market access, funding sources and investing in research and development of new products. It is estimated that the total investment in science in the country does not exceed 0.5% of GDP, according to which Macedonia is still among the countries with the lowest amount of investment in science, compared to developed countries and to the region. This is also evidenced by the very low level of participation of gross expenditure on research and development (GERD) in the GDP in Republic of Macedonia. The share of science in GDP in the country is 0.22%⁸, which doesn't show great progress compared to previous years

⁸ These are last available data relating to 2010 according to Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, The Global Innovation Index 2014: The Human
170

when the rate was about 0.18%. Macedonia lags behind EU countries (where the average is 1.67) and other developed countries such as the US - 2.79% and Japan - 3.34%⁹. Worrying fact is that Republic of Macedonia also is lagging significantly in comparison with neighboring countries, i.e. SEE countries which all except Albania (0.15%) and Bosnia and Herzegovina (0.02%)¹⁰, receives more than 0, 4% of GDP, while Slovenia and the Czech Republic already allocated over 1% of GDP and Croatia around 1%. According to these data, we can see that the country is lagging behind the EU when it comes to the intensity of investment in research and development, which is a prerequisite for all of the technological and economic progress of the country. According to these data, we can see that the country is lagging behind the EU when it comes to the intensity of investment in research and development, which is a prerequisite for all of the technological and economic progress of the country. It should also be noted that companies in the country although innovate, they invested few resources in research and development. For example, the gross expenditure on research and development funded by businesses (% of total gross expenditure on research and development) accounted for only 11.5% of total gross expenditures on research and development in 2012, compared with 53 % in the EU.¹¹ Also, the results of the OECD research in 500 Macedonian companies conducted in 2011 show that half of the companies do not offer any form of training for their employees in the context of innovation.¹² Moreover another interesting fact is that the relationship between companies and universities or research institutions in the country is extremely rare, although firms that have established formal links with academic circles tend to be more innovative.

Factor in Innovation, Cornell University, INSEAD, and the World Intellectual, 2014, p. 307

⁹ The data for the EU, US and Japan are for 2012 based on Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, *The Global Innovation Index 2014: The Human Factor in Innovation*, Cornell University, INSEAD, and the World Intellectual, 2014, p. 307

¹⁰ The latest available data for Albania relate to 2008 and for Bosnia and Herzegovina relate to for 2009 according to Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, *The Global Innovation Index 2014: The Human Factor in Innovation*, Cornell University, INSEAD, and the World Intellectual, 2014, p. 307

¹¹ According to the Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, *The Global Innovation Index 2014: The Human Factor in Innovation*, Cornell University, INSEAD, and the World Intellectual, 2014, p. 332

¹² *Innovation Strategy of the Republic of Macedonia 2012-2020*, p. 14

Considering all above mentioned results it can be concluded that the country needs a lot of work in the context of improving the innovation of the national economy.

2. Opportunities and prospects for improving innovation in the country

The main findings that are drawn from far analyzes on Macedonian economy's innovation is that although some aspects of the innovations policy are covered by public institutions and strategies still has not developed a comprehensive policy framework for the national innovation system and there are many challenges and opportunities to encourage innovation in the country. Namely, although the companies are making some innovations, they provide a little funds for it, hence the creation of innovation in the country is still at lower level.

First should be noted that for supporting innovation, creating new technologies and the flow of information in the public and private sectors are needed adequate conditions such as human capital, access to finance, legislation on intellectual property rights and business climate.

Regarding the human capital can be noted that there have been made two positive actions in the education system in the country, such as: extending the duration of primary education and the establishment of the Council for Vocational Education and Training and the Centre for vocational training to comply the school curricula with vocational training. This initiative is particularly relevant given that there are important gaps in terms of having skills in the country. But much more remains to be done in the field of adult education because it is considered only in the context of retraining the unemployed and very few employees are trained to maintain and develop their skills while employed i.e. companies invest a little in the training of their employees.

The innovations arising from the creative action of people. Therefore, the development of a set of talented and trained human resources is essential to foster innovation and economic growth in Macedonia. Policies should ensure that education at all levels prepare people for the labor market, by providing capabilities that help businesses to be innovative and competitive. Hence, it is important to adapt the education policy to develop the skills required for innovation, improving the quality of vocational training and the promotion of lifelong learning and greater relevance of university education in terms of innovation.

Innovations and activities related to research and development in research institutions and the private sector are limited by the significant lack of finances. Gross expenditure on research and development (GERD) in the Macedonian economy, as shown above in the paper, represent only 0.22% of GDP, which is low compared to the average share of about 0.5% in the economies in Southeast Europe.¹³ In order to resolve this issue, the Ministry of Education and Science predicted opening of 189 sophisticated laboratories, to improve the Macedonian research facilities. From these laboratories, seventy-nine are already equipped. These investments provide an important opportunity, but their use requires the mobilization of human and financial resources, and stronger cooperation between science and industry.¹⁴ The access of companies to finance for their development is perhaps one of the major obstacles, particularly in terms of innovation activities which often carry higher risk and have long-term nature. Therefore financing through alternative sources such as creating a network of business angels and venture capital funds, which are little observed in other countries of Southeast Europe, is one of the possibilities to improve the innovative activity in the country.

The regulatory environment has significantly shaped medium and long term scope and directions of innovation activities. It includes many aspects of innovation systems such as standards, public procurement activities and intellectual property rights. Quality and effective implementation of regulations is crucial to a sound business environment that supports innovation activities of domestic companies and attracting foreign direct investment. For further enhance the network of innovation and competitiveness in the country, there have been numerous efforts to create a favorable regulatory environment for businesses. For example, implemented reforms, such as improving the ease of starting a business, helped Macedonia to rank as a country in the region with the best position. Then it is implemented the project Patent.mk to encourage patenting, cooperation between business and academic circles and innovation. However, although the regulation of industrial property rights is very advanced in the country and has ratified most international frameworks for intellectual property rights still implementation of the legislation on intellectual property rights need to be improved.

¹³ Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, *The Global Innovation Index 2014: The Human Factor in Innovation*, Cornell University, INSEAD, and the World Intellectual, 2014, p. 307

¹⁴ *Innovation Strategy of the Republic of Macedonia 2012-2020*, p. 13

The innovative activity of companies is particularly important and it has contributed to the success of their operations, which can be seen in the significant increase in turnover and profits and the higher probability that these companies will export more after the introduction of innovations. But in Macedonia although firms innovate, they invested little resource in research and development. As we have seen the gross expenditures of research and development funded by businesses (% of total gross expenditure on research and development) accounted for only 11.5% in 2012 and according to the results of the OECD half of the companies do not offer any form of training for their employees. These are real problems that need to be addressed in the future, and which would have an important contribution to improving current state in Macedonian innovation. Most beneficial for the further development of the innovative potential of the companies would be the existence of plans to support development of staff training or support for the exchange of know-how between the companies. Given that most companies are unaware of existing initiatives to support innovation, increasing the awareness of companies about the importance of innovation and related support measures should be a priority.

Companies rely more on internal knowledge for innovation than the external knowledge, and because of that cooperation between companies and other stakeholders is limited. Research institutions are currently faced with a lack of cooperation with business and lack of labor mobility. Although firms that have established formal links with academic circles are more innovative, however the relationship between companies and universities or research institutions is extremely rare. Hence, the way to increase the innovation capacity of a country is to strengthen links between businesses themselves and between businesses and research institutions. It will facilitate the flow of knowledge. For this purpose it is necessary encouraging business networks and clusters, embed foreign and innovative companies in the national innovation system, supporting cooperation between research institutions and businesses and strengthening relationships with the Diaspora. Although several attempts have been made to increase these relations in the country, there is still need for improvement.

All previously mentioned options leads to the creation of an effective national innovation system, which is created by all stakeholders together and which is open to the world. Considering modern conditions, research and innovation should be at the core of policies of the Macedonian economy. Thus, it is necessary to provide adequate financial

support for all activities that lead to the realization of the following objectives: strengthening the propensity of businesses to innovate, strengthen human resources for innovation, creating a regulatory environment to support innovation and increase the flows of knowledge among the innovation actors.

Conclusion

Previous findings provide a good basis to answer the main question in this paper - how innovative is the Republic of Macedonia? According to the Innovation Index of the European Union in 2014 Macedonia is a "modest innovator" with below average performance. Similar to these are also estimates of the other reports. Overall, according to the Global Innovation Index 2014, Macedonia is in the first half of the countries according to innovation performance and together with other countries of Southeast Europe is far from the leaders in innovation and significantly behind in terms of average EU-28th. Also, Republic of Macedonia in terms of innovation is a typical example of a country in this region, with the exception that more efficiently use the limited resources and have greater market sophistication to achieve innovative results. Having this in mind, the paper proposes a series prospective opportunities for intensification of innovation activities in the Macedonian economy.

The general conclusion that can be drawn from the paper is that the Republic of Macedonia has made some progress in improving the innovation system, but it is insufficient. Available opportunities is necessary to use and well synchronized, in order to reinforce the advantages of the innovative sistem and to overcome the anomalies that prevent its development. All this is provided to improve the competitiveness and economic development in the country based on knowledge and innovation.

References

1. Chaminade, C., Edquist, C., From theory to practice. The use of the systems of innovation approach in innovation policy. Forthcoming in Innovation, Learning and Institutions, HAGE, J. & de MEEUS, Oxford University Press, 2006

2. Chaminade, C., Edquist, C., Rationales for public policy intervention in the innovation process: A systems of innovation approach, in: Kuhl handbook, Cheltenham, UK, 2008
3. European Commission, Final report of the Bussines Panel on future innovation policy, Reinvent Europe Through Innovation, From a Knowledge Society to Innovation Society, 2009, http://ec.europa.eu/enterprise/policies/innovation/files/panel_report_en.pdf
4. Innovation Strategy of the Republic of Macedonia 2012-2020
5. Innovation Union Scoreboard 2014, The innovation union's performance scoreboard for research and innovation, European Commission, 2014
6. Intelligence Unit, Innovation: Transforming the way business creates, Economist, 2007
7. OECD, "The OECD Innovation Strategy: Getting a Head Start on Tomorrow", OECD, Paris, 2010
8. Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, The Global Innovation Index 2014: The Human Factor in Innovation, Cornell University, INSEAD, and the World Intellectual, 2014
9. www.worldbank.org/kam

UDC 332.14/.15.075.2(497.7)
Original scientific paper

Marko ANDONOV¹⁾
Zoran MIHAJLOSKI²⁾
Elena DAVITKOVSKA³⁾
Vesna GOCEVA⁴⁾

MAIN CHALLENGES IN THE IMPLEMENTATION OF REGIONAL DEVELOPMENT IN THE REPUBLIC OF MACEDONIA

Abstract

Regional development is a current issue not only for the Republic of Macedonia but also for the whole European Union. This problem has just started to attract the attention in the Republic of Macedonia. Europe urges and favours the idea that the development should not be addressed only locally, within the municipality, but from another higher level, that is, regionally. In this paper the authors will specifically explore the institutional forms for implementation of the regional development in the country. Therefore, the aim of this paper is to explain the institution in charge of implementation of the regional policy of the Republic of Macedonia. Thus, the legal status of Bureau for Regional Development as the body having separate legal entity within the Ministry of Local Government and the Centres for Regional Development will be in particular presented. Macedonia is, namely, divided into 8 statistical regions on NUTS 3 level as well as the same number of centres

¹⁾ PhD, Associate Professor, School of Law, University American College Skopje, "Treta Makedonska Brigada" 60 Skopje, e-mail: andonov@uacs.edu.mk

²⁾ PhD, Associate Professor, School of Law, University American College Skopje, "Treta Makedonska Brigada" 60 Skopje e-mail: mihajloski@uacs.edu.mk

³⁾ PhD, Assistant Professor at St. Cyril and Methodius University Skopje, Institute of Economics, Skopje e-mail address: edavitkovska@yahoo.com

⁴⁾ Civil servant, Ministry of Local Self Government – Bureau for Regional Development, M.H.V. Jasmin n. 20, 1000 Skopje, Macedonia e-mail address: vesnagoceva@hotmail.com

responsible for development and promotion of development of separate regions. There will be special emphasis toward legal position and status of these centres under current legislation (2007 Law on Balanced Regional Development and other regulations concerning the regional development of the Republic of Macedonia). Also, the legal position and status of the Bureau for Regional Development as administrative body which takes care for regional development and should be understood as a chief implementer of regional policy in Macedonia will be specifically presented.

Keywords: Regional development, Regional policy, Bureau for regional development, Institutional forms, Centres for regional development.

JEL classification: R 5, R 58

Introduction

Regional development is a theme that is relevant not only in the Republic of Macedonia but in the whole European Union. This is a problem that has only recently started to gain popularity in the country. The European Union has long been divided in the manner “Europe into regions”. Europe has been trying to push the idea of not thinking just locally and municipally, but at a higher level – the regional level. Although the European Union is one of the richest regions in the world, still there is a great inequality between different regions within it. You can safely say that in a country there is different development among its regions.

The regional policy of the European Union is a policy of investing in creating jobs, competitiveness, economic growth and improved quality of life. The regional policy includes solidarity by the EU towards the less developed countries and regions, concentrating resources in areas where there are large developmental differences. On the other hand, in recent times there is a new understanding of the concept of regional policy between members of scientific circles, weighing towards the fact that from solidary, it should be restructured and transformed into competitive. The meaning of this new thinking incorporates abandonment of the process of “growing up” of certain regions which are expected to cooperate with regions that are less developed, thus helping the disadvantaged regions and cities.

To achieve these goals of regional policy, each EU Member State is entitled to decide on national level about how and which institutions would carry, lead, implement and coordinate this policy. As project leaders and implementers, there have always been different institutions. Nowadays, Europe spends a substantial part of the Budget on the regional policy and cohesion policy of its member states. “The biggest part of the regional spending is reserved for the regions with GDP under 75% of the Union’s average, in order to improve their infrastructure and the development of the human and economic potential,” (Gerg et al.; 2010 p. 3). Innovation and research, as well as sustainable development and training at work in less developed regions, are funded in all EU member states. A small part of these funds is allocated to cross-border cooperation and interregional cooperation projects.

Legal base of the Regional Development

The Law on Balanced Regional Development was adopted on 22 May 2007. The Law regulates the principles and objectives of the policy makers to promote balanced regional development, regional development planning, financing and resource allocation for balanced regional development, monitoring and evaluation of the implementation of planning documents and projects and other issues related to regional development. Legally defined regional development is the process of identifying, promoting, managing and exploiting the development potential of the planned regions and areas with specific development needs. The policy of regional development is a system of goals, instruments and measures aimed at reducing regional disparities and achieving balanced and sustainable development of the Republic of Macedonia. The law set the framework for the future passing of the whole documentation on national, regional and local level. (Anon. 2007)

For strategic and long term planning, as well as promoting regional policy, a ten-year strategy was developed. One of the main strategic documents through which regional development is planned in the country, apart from the National Development Plan and the Spatial Plan of the Republic of Macedonia, is the Strategy for Regional Development of the Republic of Macedonia, which was adopted in 2009 with a validity period from 2009–2019. The strategy is a multi-sectoral document, in which two approaches are applied with the definition of objectives – sectoral and regional. The strategy respects the principles

and purposes of the Law on Balanced Regional Development, such as balanced and sustainable development of the territory of the Republic of Macedonia, based on the model of polycentric development, reduction of disparities between and within the planning regions, and increasing of the quality of life of all citizens, increasing of the competitiveness of the planning regions by strengthening their innovation capacity, optimal use and valorisation of natural resources, human capital and economic characteristics of the planning regions. The model of polycentric development is focused on reducing disparities in the development between planning regions, which involves allocating more support to the less developed regions. The programs for development of regions must be aligned with the Strategy. (Anon. 2009)

Just like Law, Strategy also defines the same makers of regional development policy, as well as the implementers. The strategy has assessed the capacity of the main carriers for regional development in the country. The results of the assessment showed that the available institutional capacity for regional development in the country is quite limited. (Anon. 2009 : 74) Insufficient capacity arises from the long absence of policy and system for regional development in the country. The process of capacity building has been identified as a priority in the strategy, which should be a continuous process of upgrading to create a base of trainers in the field of regional development and providing training of trainers in order to use unified methodology for knowledge transfer.

According to the Law, art. 15 of the Law on Balanced Regional Development, the policy holders for promotion of balanced regional development are:

- the Government of RM
- the Council for Balanced Regional Development of the Republic of Macedonia
- the Ministry of Local Government
- the Council for Planned Regional Development. (Anon. 2007)

The Bureau for Regional Development and the Centres for Development of planning regions also participate in the planning of regional development and implementing the planned documents for regional development. The Strategy expanded the list of actors with the units of local government which should apply with proposals for funding in order to maximally utilize the available financial resources for regional

development and other ministries relevant to the design and implementation of regional development policy, which have defined Regional Development in their programs – Ministry of Finance, Ministry of Economy, Ministry of Transport and Communications, Ministry of Agriculture, Forestry and Water Management, the Ministry of Labour and Social Policy, Ministry of Education, Ministry of Environment and Spatial Planning and the Ministry of Culture. What is essential is good coordination between primary carriers of regional development policy and national ministries to harmonize the mutual programs and activities that may have an impact on regional development.

Therefore, for the purposes of this paper, we would consider separately the Ministry of Local Government as the policy holder for Regional Development, Bureau for Regional Development as the main body and implementation centres for development of regions, as regional level to implement this policy. The Council for Regional Development of the Republic of Macedonia is the coordinator of regional policy, which includes Ministers of 8 ministries, the Minister for Local Government, 8 presidents of councils for Regional Development and chaired by the Deputy Prime Minister for Economic Affairs. The Council for Regional Development is a political body comprised of the mayors of the region.

Figure 1: Relevant institutions for promotion of balanced regional development

Policy makers	
Council for Balanced Regional Development of the Republic of Macedonia	National level
Ministry of Local Government	National level
Council for Planned Regional Development	Regional level
Operational institutions	
Bureau for Regional Development	National level
Centres for Development of planning regions	Regional level

Source: The Law on Balanced Regional Development, *Off. Gazette*, No. 63/07

The reform of the policy included also preparation of the National Strategy for Regional Development, which, in accordance with the National Development Plan is the leading document destined to reduce the disparities among the Macedonian regions and consequently, in a more advanced stage, help reduce the existing gap between the European and the Macedonian average development index. The Strategy defines the paths that should lead to equal development of the regions in the period between 2009 and 2019 and points out two overall objectives: improvement of the competitiveness of the regions achieved through sustainable development and promotion of greater demographic, economic, social and spatial cohesion of the planning regions. (Cvetanovska and Angelova 2012 : 11)

The Role of the Ministry of Local Government

The Ministry of Local Government is responsible for adoption and creation of the regional development policy and the process of decentralization. The Macedonian Law on Local Self-Government was enacted in 2002, with a wide consensus from the most influential parties in Macedonian politics. (Davitkovska and Stefanovski 2011 : 203-217). In cooperation with other ministries that deal with regional development, it defines and implements policies to promote balanced regional development, in accordance with the objectives of the Government's policy and the program documents for Macedonia's integration into the European Union. The Council for Regional Development of the Republic of Macedonia is a political body formed by the Government; it coordinates policy to promote balanced regional development with sectoral policies and the macroeconomic policies of Macedonia, it determines the draft strategy for regional development, gives prior approval for programs for Regional Development, initiates consideration of the issues of regional development, which require coordination between the Government, the units of the local government and other stakeholders, as well as performs other duties specified by law. The Council for Regional Development is established for each region, and it is composed of the mayors of the municipalities that are part of the planning region.

The implementer of the policy of Regional Development is the Bureau for Regional Development as a separate entity within the Ministry of Local Government.

The Idea of the Bureau for Regional Development

The efforts that are being made for a faster and more comprehensive development of the areas in the country that are lagging behind in their development have been continuously monitored and systematically elaborated since 1974. The regional policy has undergone several stages so that today we have already adopted the Law on Balanced Regional Development (2007) as a European law (passed according to the example of the Republic of Slovenia) and specific regulations that implement the policy of balanced regional development.

The Bureau for Regional Development is operational body responsible for implementing regional policy in the country. Historically, the institution, or together with its institutional predecessors, has existed for nearly four decades. Although it has repeatedly changed its legal forms, the Bureau in essence remains the only institution that is continuously engaged in implementing policies to promote balanced regional development.

- The operational body responsible for funding the development since its inception in 1974 until today operates in the following legal forms:
- National Fund for crediting faster development of underdeveloped areas, which was formed in 1974. The institution was established under the Law on National Fund for crediting faster development of underdeveloped areas (Anon. 1974);
- Agency for underdeveloped areas, with the Law on encouraging the development of economically underdeveloped areas. (Anon. 1994)
- Bureau for underdeveloped areas, which is the legal successor of the agency. The institution was established with the Law on Organization and Operation of the State Administration (Anon. 2000)
- Bureau for Regional Development, an institution established by transformation of the Bureau for Economically Underdeveloped Areas of 01 January 2008 in accordance with the Law on Balanced Regional Development (Anon. 2007)

The Bureau for Economically Underdeveloped Areas was transformed into Bureau for Regional Development in 2008 and assumed the role of a real task force for the implementation of regional policy in

the country. The Bureau for Regional Development has separate legal entity within the Ministry of Local Government.

The Bureau for Regional Development performs the following tasks:

- Prepares analytical documentation on the development of strategic and operational planning documents for regional development,
- Produces the proposed methodology for the preparation of planning documents,
- Prepares annual reports on the implementation of the Action Plan of the Strategy
- Produces the draft decision on the criteria and indicators to identify areas with specific development needs,
- Produces the draft list of areas with specific development needs
- Prepares the draft criteria for the level of development of Local Government and the Regions,
- Prepares the draft act on classification of local government units and regions according to their level of development,
- Provides technical assistance to the Centres for Regional Development, in the preparation of programs for development of regions and performs other activities related to regional development,
- Informs stakeholders about the types and volume of funds and instruments to encourage regional development,
- Establishes and provides maintenance of the information system for regional development in cooperation with the National Institute of Statistics, and
- Performs other duties related to regional development, defined by law (Anon. 2007)

The Bureau for Regional Development, as provided by the Law on Balanced Regional Development, has an immediate direct communication with implementers of regional development policy. With the new law it is clear that the Bureau has been deprived from many obligations that should be executed as a true institution for implementation. It deals with only purely technical matters (Goceva 2011 : 41). It has been shown as an institution capable to be able to undertake

any additional actions that should naturally be assigned to it, no matter whether they are activities which are currently performed by the Ministry of Local Government or any other department or agency. That would facilitate the work, and transfer of powers from one institution to another will be avoided in case of misunderstanding and inability to produce evidence by law.

Centres for development of planned regions

In accordance with the Law on Balanced Regional Development (Anon. 2007), as one of the carriers in regional development planning and implementation of planning documents for regional development is the Centre for Development of planned regions (Art. 12-2b, The Law on Balanced Regional Development), The Republic of Macedonia is divided in eight regions, with different level of development. The funds are allocated to the regions on the basis of a Decision of the Government of the Republic of Macedonia on classification of the planning regions according to the level of development. Furthermore, in the same law, the legislators are trying to define the Centre for Development of planned regions, and thus determine its legal status (Anon. 2008). Therefore according to the law, a Centre for Regional Development has been established, in favour of performing professional activities relevant to the development of the planning region. This centre is established for each region and the founders are the municipalities within the planned region. The decision to establish the centres adopted by the local government should closely regulate its organization, operation and financing. The Centre is a legal entity and its headquarters are located in the local government unit which has the largest population in the planning region.

The lawmaker governs how the head of the Centre is elected as well as their mandate and the budget, which comes from the budgets of local governments that are part of the planning region.

The Law, in a separate article, lists the powers of the Centre for Regional Development. Thus, under Article 26 of the Law, the Centre:

- prepares a draft program for regional development,
- prepares proposals – Action Plan for implementation of the Programme for Regional Development,
- prepares proposals – projects for regional development and for areas with specific development needs,

- coordinates activities related to the implementation of the Programme for Regional Development and realizes projects for regional development,
- prepares an annual report on implementation of the Programme for Regional Development,
- provides information to stakeholders on the implementation of the program for regional development and other issues related to regional development,
- provides professional and technical assistance to local governments in the preparation of their development programs,
- provides professional services to associations and other stakeholders in the preparation of projects for regional development
- encourages cooperation between municipalities within the planning development,
- implements projects to promote regional development, funded by the European Union and other international sources,
- promotes the development possibilities of the planning area and
- performs professional and administrative – technical work for the council for development of the regional development.

In order to determine the legal status of the Centre, the legislator has not invested much effort nor paid enough attention to it. It raises the question of the nature of the legal status of the Centre derived from the question of what kind of institution it is. If we take the general law, we can locate that such a centre would arise from Article 14, which refers to the inter-municipal cooperation. But the fact is that as a separate organ of the local administration, the centre is not provided for in this general law (Anon. 2002). This is perhaps due to the fact that this law was enacted five years before the adoption of the Law on Regional Development. So the basis for the legal status of the Centre should be sought in this law. As noted by the provisions of this law, the Centre is defined as a body which performs professional activities relevant to the development of region. The legislator did not attempt to define the nature of this body nor whether it is a public company established by the local government, public institution performing activities of the public or some kind of pairs

local authority established by the local government unit to perform professional activities (Davitkovski 2012 : 21).

According to the Law on the organization and operation of the administrative bodies (Anon. 2011) as authorities on the territory of the Republic of Macedonia that perform professional activities, there are the administrative bodies established by the Republic. So for this kind of institutions and similar ones, the legislator set the competence at central level, which does not mean that the local governing units cannot establish similar bodies. Yet it remains an open question about the nature of the activities of this centre and it will result in the type of organizational form through which the professional activities that are crucial for regional development will be realized.

The dilemma that there are inconsistencies regarding the nature of the centre exists. First, in the analysis of the decisions brought forth by the municipalities participating in the eight regions, as well as the registrations at the Central Registry of the Republic of Macedonia, where these centres are all registered under the code 01.4 – local government, without specifying and defining the legal status and dominant competence in performing professional work of these centres.

To be able to expect for the Centres for Regional Development to really exist in the future as organizational forms that are of utmost importance for the regional development, certain measures should be taken. The next amendments to the Law on Balanced Regional Development in Article 24 should precisely define the organizational form of the Centre and its legal status and, in particular, greater autonomy in Founding Act should be provided, which would allow editing and original organization, operation and financing of such organizational forms exclusively to the development of the planning region. One of the most highly proposed legal forms under which the CRD's should operate was a consulting firm. (Stojanova et al. 2012 : 30)

According to the needs of the region, it should be left at free disposition of the founder, that the act of establishing a centre is to provide a new and specific jurisdiction as well as specific educational preparation which should be required for the head of the centre, and it should be especially made available for the assets of the local government units that are part of the planning region for themselves to predict the appropriate financing of the centre. In this way, the Centre for Regional Development will result from the needs and specificities of the local government, as legal and organizational form that the founders of the centre prefer and mostly know about the regional development.

Overview of the situation regarding Regional Development starting from 2009

For the regional development policy to develop in the right direction in line with EU requirements, the Republic of Macedonia has started this process by passing the Law on Balanced Regional Development in 2007 which was the basis for the adoption of the Strategy for Regional Development of the Republic of Macedonia 2009–2019. Two additional Action Plans 2010–2012 and 2013–2015 were adopted for the implementation of the Strategy. During the following years, all regulations were passed to implement the policy, such as the decision to classify regions according to their level of development, the decision on determination of areas with specific development needs (at national level), programs for development planning regions (at regional level) and local development strategies (at local level). This largely opened the door for the process of legislation in line with the European standards. Based on the Law at end of 2008 and beginning of 2009 the Centres for Regional Development were established, whose main task is to participate in the development of the region by finding and applying for funding projects to boost economic growth and development of the region, as well as highlighting its competitive value. This set up a network of institutions in charge of this policy. The results of these newly established institutions can be seen only in the last 2 years, with the application of mature regional projects to the Regional Development Bureau and through the use of the EU funds. The whole system that was set up with the law and a new strategy was new for all parties involved and quite a lot of time was lost to meet the need for adequate staffing of the centres and the national institutions as well. The problem arises in that the regional policy is a complex field and a multisectoral policy. In a way there is a gap between policy and the system that runs the Ministry of Local Government and the policies of other ministries. The Funds from the Ministry of Local Government and Regional Development Bureau are divided according to the Decision for classification of regions according to the degree of development of the regions (the old decision was valid until 2012 and for the period from 2013 to 2017 a new one was made), while other ministries share according to their own criteria without paying attention to balanced development. Centres for regional development programs in almost all the ministries are not recognized as institutions which can apply for projects. In the period 2009 to 2012, the Bureau for Regional Development announced 3 public calls for proposals

in which the Centres could participate with their own projects on the development of regions and local government development in areas with specific development needs and development of the villages. In 2010 there was no public call as yet because the projects from 2009 were still being paid and implemented. During these 3 public calls a total of 187 projects were funded to promote balanced regional development. The Law established the right of use of funds as 1% of GDP. In the past five years (2008–2012) of the implementation of the Law on Balanced Regional Development, the Ministry of Local Government and Regional Development Bureau accounted for 839.7 million, which represents only 0.04% of GDP. In 2009 major funding 0.06% or 243 million MKD were provided, but with the passing of time the percentage of the funds was reduced in 2012, and only 0.02% of GDP was allocated. According to the statistics of the Government, in accordance with the programs of the ministries and other state institutions, for the year of 2012 the allocated funds directly or indirectly provide promotion of regional development and they amount to 1.5% of the GDP. Starting from what is said above, we are coming to the conclusion that despite the priorities and objectives of the Strategy for a balanced and polycentric development, the funds are not spent according to a unified way. Macedonia faces the problem of ineffective coordination between nonlinear ministries and the overlapping of responsibilities. The justifications by linear ministries for not using the degree of development of the regions refer to the specific area they cover. Therefore, we can say that the Ministry of Health and its programs for drug delivery and treatment of people with diabetes cannot divide their services by regions according to their level of development, but according to a need for therapy for diabetes in a given region or municipality. This is quite true, but there are programs that can include this criterion.

As a conclusion to all of this, the following can be stated:

- The legal framework is set almost entirely in the country, but it is not fully respected by the linear ministries which have programs for regional development.
- The institutional framework has strong fundamentals, with established network of institutions implementing this policy and leading the policy from the highest national governing units to the units of local government, which should be the main beneficiaries of this policy.

- Since the implementation of the Strategy in 2009, there has been significant progress in the sense of capacity building for the implementation of regional policy and the use of national resources as well as the European funds (this would include IPA). Regional development centres are already starting to be recognized as a serious factor in the use of these funds and the assistance to the local governments for collecting funds for projects.

Concluding Remarks

Although the European Union is one of the richest places in the world, it spends nearly a third of its budget for the regions that are lagging behind in their development. The most recent recommendations of the European Commission to the Republic of Macedonia for regional policy are concerning the correct allocation of funds under the principle of balanced development and proper implementation of this policy. Statistics show that the funds earmarked for regional development are not shared by the key for balanced development, but most remain in the city of Skopje. The whole economy was (and in great extent is even now) concentrated in and around the city of Skopje. This resulted in unfavourable polarized development, by favouring the development of cities to the detriment of villages and the achieved monocentric development, with the biggest concentration of economic activities in the capital city (Slaveska 2000 : 159). In order to be able to endure as a state in the European family, it is necessary and it is required to create similar and competitive regions even before we become a member state. Our budget is modest and limited regarding the funds for regional development, so we should use the pre-accession funds that offer great opportunities for the candidate states for membership in EU. The joint regional economic policy constitutes one of the pillars for achieving the economic and social cohesion between the constitutive parts of the Union.

Although the allocation of funds from the budget is performed by other departments in accordance with the Regional Development Strategy, it still does not guarantee proper implementation of regional policy and should therefore be reconsidered. The institutions involved in the distribution of funds to promote balanced regional development funds are not allocated according to the degree of development of the regions.

The Council for Regional Development of the Republic of Macedonia as the coordinator of this policy could certainly help in proper understanding and execution of the policy and policy coordination between ministries, municipalities and centres as regional level.

The function of the Bureau is marginalized in the Law on regional development. It cannot happen that the body which should be a key player in the field of regional policy is to be stuffed with purely technical work. The Bureau for Regional Development, as implementer of the regional development policy in the country, has to work on improving its effectiveness. In this regard, the Bureau must continue to concentrate on improving the internal functioning in order to continue improving its capacity as an institution, and to continue to work to improve its performance or the quality of its activities in order to achieve functional results in the implementation of the regional development policy. Raising efficiency will mean a further transformation of the institution into a modern European institution in the future, the accession of the Republic of Macedonia to the European Union will play an important role in the implementation of EU regional policy and the promotion of regional development.

The Bureau should be given the status of Regional Development Agency, which will no longer be under the Ministry of Local Government, but would be directly under the Government. It would be granted credentials that all regional development agencies in European countries have. It is required that an agency should be composed of highly trained personnel and staff who will be ready to address all the needs of the municipalities, as well as the other requirements of the European Union. It would organize trainings in all the regions from different areas of regional development. It would be the coordinator of the centres for the development of regions, which, on the other hand, would use their experiences for the development of their region. The Ministry is a huge institution and the Agency in this case would be carrying out their functions promptly and efficiently. Then there would be an institution which would derive the policy – the ministry, and a body that implements this policy – the Agency. In addition to this, the Agency will be the trainer and will connect regions. In any case it would have the function of a bridge between local and central government. Knowing the problems of local government, regional development centres would be able to propose laws and acts, which could in practice work well.

Also, according to the needs of the region, it should be left at free disposition of the founder, that the act of establishing a centre is to provide a new and specific jurisdiction as well as specific educational preparation which should be required for the head of the centre, and it should be especially made available for the assets of the local government units that are part of the planning region for themselves to predict the appropriate financing of the centre. In this way, the Centre for Regional Development will result from the needs and specificities of the local government, as legal and organizational form that the founders of the centre prefer and mostly know about the regional development.

All of the abovementioned is an excellent basis for implementation of the regional policy in the right direction and continuation of building the necessary and capable institutions for implementation of this policy.

References

1. Anon. (1974) Law on National Fund for crediting faster development of underdeveloped areas, *Official Gazette*, No. 48/74.
2. Anon. (1994) Law on encouraging the development of economically underdeveloped areas, *Official Gazette*, No. 02/94.
3. Anon. (2000) Law on Organization and Operation of the State Administration, *Official Gazette*, No. 58/000.
4. Anon. (2002) Law of local self government, *Official Gazette*, No. 05/02.
5. Anon. (2007) The Law on Balanced Regional Development, *Official Gazette*, No. 63/07.
6. Anon. (2008) Decision on Classification of the Planning Regions According to the Level of Development for the Period 2008–2012, *Official Gazette of RM*, No. 162/2008.
7. Anon. (2009) Strategy for Regional Development of the Republic of Macedonia, *Official Gazette of the Republic of Macedonia*, No.119/09.
8. Anon. (2011) Law on the organization and operation of the administrative bodies, *Official Gazette*, No. 58/200, 44/2002, 82/2008,167/2010, 52/2011.
9. Clark, G. et al. (2010) *The Role of Development Agencies and Companies*, Organising Local Economic Development, OECD.

10. Cvetanovska, B. and Angelova, B. (2012) *Establishment and organization of regional development in Macedonia. Challenges and perspective*, PECOB Portal on Central Eastern and Balkan Europe University of Bologna – Forlì Campus, Bologna.
11. Давитковска, Е. and Стефановски, И. (2011) *Традиционален насирои нов јавен менаџмент. Зборник во чест на професор Наум Гризо*, Правен факултет “Јустинијан Први”, Скопје.
12. Давитковски, Б. (2012) *Правен статус на центарот за развој на планскиот регион*, РЕГИНФО, Скопје.
13. Гоцева, В. (2011) *Институции надлежни за регионален развој – Компаративни искуства*, Југореклам, Скопје.
14. Славеска, Т. (2000) *Регионалната економска политика на Република Македонија*, Economy Press, Skopje.
15. Stojanova, V. et al. (2012) *Improving Regional Policy in Macedonia – Sharing the German and Slovenian Experience*, EFB, New Business Education Foundation, Skopje.

UDC 366.12:684.4]:658.8:005.52(497.7)
Original scientific paper

**Marika BASESKA GJORGJIESKA,
Tatjana PETKOVSKA MIRCHEVSKA,
Dusica NEDELKOSKA ***)

**THE IMPLEMENTATION OF PSYCHOGRAPHICS IN
CUSTOMERS' LIFESTYLE DETERMINATION: THE
MACEDONIAN FURNITURE MARKET**

Abstract

Psychographics has emerged as an important method of market and marketing research, especially of consumer behaviour research. Understanding the consumer behaviour issues is essential for the decision making process and market positioning of companies. The purpose of this paper is to analyse the possibilities for using this method in the market research process in Macedonia.

AIO technique as one of the most significant psychographic methods is used in the research, conducted on the sample of 136 customers with 55 AIO and VALS statements divided into 16 factors. By using the empirical research, this paper demonstrates the importance of the consumer's psychographic characteristics and the influence of their lifestyles on the decision making process in the case of furniture market. The results of the research in this paper and the way of implementation the psychographic as a method of marketing research could be very useful for the decision making of small, medium and large companies.

Key words: psychographics, AIO, marketing research, lifestyle, furniture market

*)Marika Baseska Gjorgjieska, Ph.D., Faculty of Economics, University St. Kliment Ohridski-Prilep, e-mail: marika.baseska@uklo.edu.mk
Tatjana Petkovska Mirchevska, Ph.D., Institute of Economics, University St. Cyril and Methodius-Skopje, e-mail: tatjana@ek-inst.ukim.edu.mk
Dusica Nedelkoska, Ph.D., F.I. "Vitamina" AA Prilep,
e-mail: duned2002@yahoo.com

JEL Classification: M310, M390

Introduction

The strong competition, the customers with specific and very precise needs and demand provoke the necessity of better understanding the customers and their behaviour throughout the buying process. Markets nowadays are heterogeneous and usually the mass marketing research tools are not successful enough in determination of consumer satisfaction. That's the reason for emerging need of using the research methods that deeper investigate the consumer behaviour while buying. Taking into consideration that the lifestyle of customers depends and influences on the customers' behaviour and decision making process the psychographics methods are increasingly used.

The purpose of this paper is to analyse the possibilities for using this method by the Macedonian companies in the market research process. AIO technique as one of the most significant psychographic methods is used in the research, conducted on the sample of 136 customers with 55 AIO and VALS statements divided into 16 factors. By using the empirical research method, this paper demonstrates how consumer psychographic characteristics and their lifestyles influence the decision making process of furniture customers.

1. Literature review

Conceptually any business strategy should be based on understanding, meeting and even exceeding the needs of target segments (Wind & Bell, 2007, p.223). Some authors since 1964 have stressed that traditional demographics traits such as age, sex, income, education levels are no longer sufficient to serve the basis of marketing strategy and neither demographic traits such as values, tastes and preferences were more likely to influence consumers' purchases than their demographic traits (Yankelovich & Meer, 2006).

Using the results of the research in US in 1991, Peterson in one of the very few empirical studies of segmentation and SME's found that small and medium sized companies tend to use demographic and geographic customer variables to segment the market, rather than

lifestyle variables. He surveyed Small Business Institute client firms in the US and found that 73.8 percent of small manufactures utilized some form of segmentation and target marketing (Hine & Carson, 2007, p.207). But, these data could be limited in helping enterprises generate insights of the customers and Companies need for more customers' information about how people spend their money and time.

Researchers as well as practitioners believe that there is a link between lifestyle of customers and the way they make decision in the process of buying products on the market (Baharun, 2011, pp. 5040-5047). Understanding the consumer behaviour is essential for companies in order to target the right consumer segments. As per Surdu (Surdu, 2012), Nike and Adidas focus on demographic, psychographic and behavioural segmentation, dividing the markets by sex and age as demographics, and interests and activities as psychographics variables.

Marketers' use of psychographic variables for market segmentation has been developing during the past decades. Psychographics has emerged as an important method of market and marketing research. This method is used to understand consumers' behaviour and the way they make decision in buying process. Lately, such researches have been used by the Companies as the innovative method of the market and marketing research.

Psychographics is one of the several generic methods in segmenting the market and customers into groups based on lifestyle and personality characteristics. It is a market segmentation approach in which people are grouped according to their lifestyle, values, beliefs, attitudes. Psychographic segmentation can divide customers to different social classes and predict future needs and wants of people as marketing strategy (Sarli & Tat, 2011, p.6). Wells concludes that „psychographics can supplement demographics in interesting and useful ways“(Wells, 1975, p.202).

2. Theoretical background

The term "psychographics" as a technique has been used from the beginning of the 20th Century. More precisely, it was used during 1920's to describe people by their looks. It was later used during 1920's to describe a technique for classifying people by attitudes. Afterwards, it was developed by the researches in the late 1960's in order to provide a better profile of consumers and to give a picture of what they want,

believe and think. There are many "fathers" of the term psychographics. According to most of the researchers, it is Emanuel Demby who declared himself as a pioneer in psychographic research in 1974 (Demby, 1989, p.21). He defines psychographics as „the use of psychological, sociological, and anthropological factors, such as benefits desired (from the behaviour being studied), self-concept, and lifestyle (or serving style) to determine how the market is segmented by the propensity of groups within the market – and their reasons to make a particular decision about a product, person, ideology, or otherwise hold an attitude or use a medium“(Demby, 1989, p.26). Since 1975, it has been concluded (Wells, 1975), that psychographic methods have offered a way of describing consumers that have many advantages over alternative methods, even though much work on reliability and validity remains to be done. Psychographic methods have offered new ways, new dimensions and new vocabulary of customer's profile name. Many companies know who buys their product, but not why these specific people buy their product.

Psychographics includes social class, lifestyle, personality and other demographics variables. Psychographic segmentation provides dividing of different markets on the basis of lifestyle and values (Michman, et al., 2003, p.13). Beatty, Homer and Kahle (1988, pp.375-380) made segmentation by using VALS and LOV methods and showed that by measuring psychographics variables, most important values and their ranking can be identified. Tam and Tai (1998, p.61-77) have applied psychographic segmentation at Chinese female markets. They found out psychographic statements and they stated that psychographic variables depend on time and circumstances of socio-economic situation and that they are changeable. Also, a researcher should rigorously apply existing similarities and differences among consumers. Lin (2002, p.249-268) confirmed that combining segmentation variables like demographics and psychographics simultaneously can create precise information of sub-markets. Group of researches (Ahmad, et al., 2010, pp.227-243) presented that one of the best approaches for better understanding of the customers is psychographic segmentation. In their research in 2014 they obtained result consistent with previous studies in the marketing literature, that lifestyle is an important potential factor influencing the future consumers' behaviour (Ahmad, et al., 2014, pp.124-145). Sarli and Tat (2011, p.6) concluded that psychographic segmentation is a precise technique in order to adopt products towards consumers' needs and wants. Suragh et al. (2013, p.172-187), used this approach to define segments of female and male college students and examine substance

(cigarettes, other tobacco products, alcohol, and marijuana) use differences in US and concluded that psychographic segmentation can identify young adult subgroups with differing psychographic and substance use profiles and inform health campaigns and message targeting youth. According to Mullen (2013, p.110), psychographics is defined as quantitative research intended to differentiate and aggregate consumers in terms of psychological dimensions. In fact, by psychographic research, a different types of customers' profiles could be created and connected with their psychological motivations in the decision making process. Using the psychographics rather than other techniques in market research, these profiles produce much richer descriptions of potential target segments (Boone, 2014, p.292).

Also, psychographic segmentation can be used to create advertising that will influence consumers to think warmly about a particular brand (Yankelovich & Meer, 2006, p. 3). Psychographics by Zografos and Alcroft evaluates the beliefs, opinions and interests of consumers by measuring psychological characteristics (religious beliefs, opinions about crime, personality characteristics, leisure activities) rather than demographic characteristics of consumers (Zografos & Alcroft, 2007).

2.1. Using AIO method for psychographics segmentation

AIO (activities, interests, opinions) concept is a technique used in psychographic analysis for measuring consumers' lifestyle. From a historical perspective, the creator of this technique is William Wells. According to a study published in 1979, authors of this technique are Leo Burnett and William Wells, who developed it at the late sixties of the XX century (Madden, 1979). By using this technique, analyses can be made regarding activities, interests and opinions of consumers. Customers are usually asked questions in the form of conclusions and they are required to respond depending on the degree of agreement and disagreement.

In general, AIO psychographic studies are using the series of reports (list of psychographic statements) that are designed to keep in mind the various relevant aspects of consumer personality, buying motives, interests, attitudes, beliefs and values (Dj, et al., 2014, p.154-163). The way of life, however, can be measured by asking consumers questions about their attitudes, as activities, interests, and opinions (AIO method) (Konu, 2007, p.303-314). Activities are related to the fact that consumers work, shop and spend their leisure time. The way people carry

out their work, the types of their hobbies, are the important characteristics in describing the consumers profile and their behaviour on a specific market. Interests relate to the consumer's priorities in food, fashion, recreation, technology products which help marketers to create proper marketing message to the targeted customer. Opinions respond to the views of consumers about world events, economic situation, politics, culture, morality.

In general, this technique has been implemented on a large sample using a standard questionnaire containing many questions that require an answer based on how much they agree or disagree with the given conclusion. The questions are clear, unambiguous and precise. There are general and specific questions to assist the marketers' detection of pros and cons of a brand. Thus, some authors in 1971 made 300 AIO items (views) and Cosmas in 1982 used a questionnaire with 250 views (Vyncke, 2002, p.448). The questionnaire can be sent by mail, or marketers can use telephone and internet. This psychographics or lifestyle research usually takes the starting point of the AIO extensive research that leads to diverse lifestyle typologies using cluster analysis techniques (Vyncke, 2002, p.448). Responses of consumers ranging from "completely disagree" to "completely agree" are measured with Likert's scale. Based on the AIO technique it is possible to group consumers with similar responses into market segments. These statements or responses are called „Inventory“.

Besides the AIO technique, VALS (Values and Life-styles) psychographic technique is used for psychographic segmentation and it is available as worldwide classification system of the customer market. SRI Consulting Business Intelligence's VALS program (Hawkins, 2010, p.495) is the most popular tool of psychographic research by marketing managers helping them to develop effective strategies. Hawkins argued that the original psychographics focuses on measuring Activities, Interest and Opinions contained in inventory AIO (Dj, et al., 2014, p.154-163). VALS was developed at Stanford Research Center in the USA, by Arnold Mitchell in 1978, and makes systematic classification of nine groups of adults under nine different values that appear through lifestyle. VALS technique is most popular when it comes to psychographics analysis. It serves to develop more effective strategy of businesses worldwide. It could be used in all stages of marketing. VALS is used by companies as the technique to obtain information that will help them and can be implemented in all phases of the marketing process. However, in

this paper we will use AIO and some of VALS statements in order to determine how the consumer clusters depend on their lifestyle.

3. Psychographic research of furniture market in the Republic of Macedonia

3.1. Methodology and Research Methods

The data of the study of lifestyle of the furniture consumer in the Republic of Macedonia were collected using a self-structured questionnaire consisting of three parts.

The first part of the structured questionnaire contains questions about obtaining the consumer demographics, such as sex, age, education and income.

The second part has 55 AIO and VALS views. The views are formulated views of the Wells and Tigert activities, interests and opinions of people on certain things. Several of them are those of the SRI questionnaire (SRI Consulting Business Intelligence Research Programs). The respondents could answer by using Likert's five point scale from "completely disagree" to "completely agree".

In the third part of the questionnaire respondents answered about their furniture choices and what affected their choice when buying furniture.

The on-line questionnaire was conducted in the period of March to September, 2013. Actually, 136 valid questionnaires were collected. Respondents were divided on the basis of factor and cluster analysis with SPSS-20.0 software. By reducing the number of variables, factor analysis procedures tend to retain as much as possible of the information and make other significant variables easy to work. Using Principal Component Analysis (PCA) as a method of extraction, the number of variables was reduced from 55 to 16 factors that served to divide consumers with k-means clustering on the special features and the way of life. This method is very suitable to form segments of consumers, because usually there are no prior information on the number of segments and variables associated with the groups. PCA was designed to better explain dimensions between different variables, and clustering was made after that. The factor and cluster analysis were made on the basis of a questionnaire that included variables closely related to lifestyles and values of consumers. Adequacy was assessed using the Bartlett test and

test KMO (Kaiser-Meyer-Olkin). In this research KMO showed value of 0.664, Bartlett test was Sig. .000, both indicating that the questionnaire variables of the lifestyle are suitable for the Principal Component Analysis (PCA). Oblimin with Kaiser Normalization was used as a method of rotation. After that Hierarchical cluster analysis was done which resulted in two clusters. Because it was a large sample, and according to research of many experts in this area, the most appropriate use of k-means (k-environments, where k is the number of environments) cluster analysis was to define the cluster centers. All survey respondents were connected to the nearest center. As best solution 4 groups were designated-clusters of consumers, because k-means cluster analysis allows to choose the number of clusters and to use a large database.

3.2. Results and Discussion

The descriptive statistics of the 136 respondents is shown in Table 1. The respondents are Macedonian nationwide, consisting of female (n=92, 67.6 %) and male (n=44, 43.5%). Majority have high education (n=75, 55.1 %). Most have salary between 20 000 and 50 000 Macedonian denars¹ (see Table 1).

The data in the following table shows the division of consumers according to their values and AIO's. This table allows us to characterize the clusters by variables and by median factors. Thus, the consumers in cluster 1 want to buy branded goods as such the third and fourth cluster. This is evident from the values of the final cluster centers. When interpreting the data, 6.00 was taken as the lowest value.

Thus, any value greater than this, was considered a valid interpretation and explanation of each cluster. The highest values in each cluster separately for each factor that participated in clustering, show the most relevant features of that cluster or group.

¹Denar is Macedonian currency, 1€≈62MKD

Table 1: Gender, Salary and Education of Macedonian customers				
	Frequency	Percent	Valid Percent	Cumulative Percent
1 Male	44	32.4	32.4	32.4
2 Female	92	67.6	67.6	100.0
Total	136	100.0	100.0	
	Frequency	Percent	Valid Percent	Cumulative Percent
1 <10 000	2	1.5	1.5	1.5
2 10 000-20 000	21	15.4	15.4	16.9
3 20 000-30 000	50	36.8	36.8	53.7
4 30 000-50 000	49	36.0	36.0	89.7
5 >50 000	14	10.3	10.3	100.0
Total	136	100.0	100.0	
	Frequency	Percent	Valid Percent	Cumulative Percent
1 Elementary	2	1.5	1.5	1.5
2 High	45	33.1	33.1	34.6
3 Faculty	75	55.1	55.1	89.7
4 MSc or PhD	14	10.3	10.3	100.0
Total	136	100.0	100.0	

Source: Calculations based on own survey data

In the interpretation of each value for each factor all the variables that contain the factor with a value greater than 6.00 were taken into account (see Table 2).

Table 2: Final Cluster Centers

Factors	Clusters			
	Accomplishers	Traditionalists	Economists	Practitioners
Traveling	2.13	1.68	1.66	2.46
Price	6.08	7.51	12.75	11.30
Brand	10.27	8.95	10.38	10.08
Decision	6.87	6.22	6.84	6.65
Angry	.09	.09	.10	.09
Family	7.87	7.93	9.38	11.98
Community	8.33	4.90	6.19	7.29
Tradition	2.21	3.10	3.41	3.18
Payment	2.67	2.25	2.41	2.86
Uncertainty	.12	.14	.16	.15
Diversity	2.67	2.17	2.75	2.67
Panache	6.27	4.54	5.41	5.88
Life	.04	.03	.03	.03
Education	10.33	6.22	7.50	9.17
Clothing	1.43	1.62	2.08	2.74
Activity	13.80	8.68	12.25	6.83

Source: Calculations based on own survey data

The research profile of consumers sample in this paper is more focused on price, quality and family life in the decision making process. The educational level of the respondents is high, which means that promotional activities of Companies especially in furniture market could specialize in particular media and they can use this method to segment market and target the right customer (see Table 3).

Table 3: Macedonian clusters and their characteristics

CLUSTERS	CHARACTERISTICS
Accomplishers	The first cluster (15 members according to the number of cases per cluster) consists of people who love sports activities. This can be seen from the highest obtained factor activity value, which contains attitudes 11, 16, 17, 18 and refer to sports activities, sports, visiting sport events and reading sports pages in newspapers. So, this group prefers attending a sport event more than going to a dance. Members of the group often play sports, enjoy talking about sports and usually read the last pages of the newspaper designed for sports hindsight. Sometimes, they are able to influence friends' decision when buying (variable 35 - factor

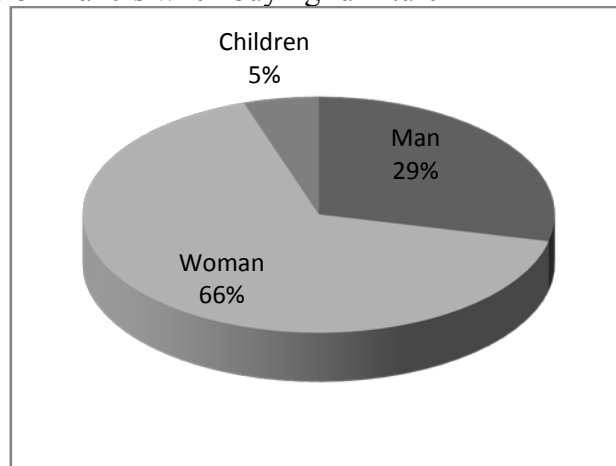
	Education). They believe in education which according to them should be paid by the Government (variable 39 - factor Education). They consider education as necessity to find themselves (variable 40 - factor Education). They are fond of branded clothing, and believe that sometimes it is worth to pay more to get more quality. This is evident from the high value of the factor Brand (10.27). They are active in the community in every field and they are interested in politics. They are the boldest of all clusters. They dress stylishly and want to be in contact with other people. They like to watch the latest movies and they want to be always updated about the circumstances. The colours and products packaging are important for them. We named this cluster as Accomplishers. They enjoy talking and believe in education. This cluster is consisted mostly of women aged 30-40 years.
Traditionalists	The second cluster has 41 members. Majority of this cluster want branded products. However compared to the first cluster, product price plays a significant role in the selection. This is confirmed with the highest average value of factors allocated to the factor analysis. So, factor Brand provides data that describe this cluster as cluster of people who spend a lot of time with friends talking about products and trying to stick to famous brand names. This cluster is consisted of both men and women aged 40-55 years, who live an active life practicing sports activities. (Factor Activity indicates the average of 8.68). The cluster members keep order and discipline in their home. They love their children and family and they don't want to dissolve the home. Education is somewhat important to them, but less than to other three clusters. Compared to other clusters, they are less interested in novelties. They are named as Traditionalists.
Economists	The third cluster (32 of the total number of respondents) is economy oriented. The price of the product is the most important for them. The cluster factor Price has the highest average of 12.75. They often know how to negotiate and check the price of the product in several stores. They are family oriented and like to buy branded products. They want to be part of the social events and often participate in them.
Practitioners	The fourth segment (48 of 136 subjects) is the largest one. The average age of the members is 30-40 years. Product price, family and education are the most important to them. They are the largest group of consumers at Macedonian market. Surprisingly, men dominate this group. They wish

	proven name of products (factor Brand with a mean of 8.10), but they are reluctant to pay for it (cost factor by averaging 11.30). They are called Practitioners and they are home oriented. Also, they are committed to the family and believe in education that according to them should be paid by the Government. It is considered that they are well IT educated because they always have the answer to the questions regarding the Internet and computers.
--	--

Source: Calculations based on own survey data

The characteristics of Macedonian customers which were included in the survey are showed in Tab. 3. Most of the respondents in Macedonia, as per Cluster analysis made with SPSS, were named Practitioners. The consumers' profiles, their activities, interests, opinions and values could be valuable information for the companies and marketers in creating ads for the target market segments. In the case of Practitioners profile they should address to the price, family and education in their ads. Also, one of the very important data refers to the gender characteristics in the decision buying process of furniture in Republic Macedonia.

Figure 1: Decision makers when buying furniture



Source: Calculations based on own survey data

Also, according to the results shown in Fig. 1, women in the families are mostly involved and in charge of the decision making process of buying furniture, which means that they have the key role in this process.

This brief analysis shows the importance of using the psychographic method in market research for the Companies in general, and the importance of determining the psychographic consumers profile for the positioning of the offerings in using the appropriate marketing and promotional tools, based on the lifestyle and values of the target segments.

Conclusion

By using the psychographic methods in defining and segmenting the target markets, companies could define the consumer characteristics as important information in creating their marketing strategies. Psychographics is a new technique, rarely used on the Macedonian market. In this paper, by using primary research, the psychographic is used for defining the consumer characteristics, their segmentation and profiles on the furniture market in Macedonia. The results of the research in this paper and the way of implementation the psychographic as a method of market research could be useful for the small, medium and large companies especially on the furniture market.

The received data from the questionnaire shown in this paper could be important information about the lifestyles of the consumers as a company input in creating successful marketing strategies.

The purpose in using psychographics as a precise technique is to adapt products towards consumers' activities, interest, opinions, needs and values. In other words, psychographics as a method for market research of Companies' customers will reduce cost of ads, increase the profits, as enterprises will be familiar with consumer's needs and wants and will serve them, or will target only one group of customers which require their products. The benefits of psychographic studies have implication for marketing planning by Companies. Product development, pricing decisions, product distribution and promotion strategies can be based upon knowledge of the psychographics segmentation for customer's values, attitudes, lifestyle, willingness and ability to pay.

References:

1. Ahmad, N.; Omar, A.; Ramayah, T. (2010) *Consumer Lifestyle and Online Shopping Continuance Intention*. Business Strategy Series. 11(4), pp.227-243

2. Ahmad, N.; Omar, A.; Ramayah, T. (2014) *A lifestyles study on purchasing behaviour of Malaysian online consumers*, 5th International Conference on Business and Economic Research, Malaysia, pp.125-145
3. Assael, H. (1985) *Consumer Behavior and Marketing Action*, Kent Publishing Company, Boston, Massachusetts, p.23
4. Baharun, R. (2011) *The market segmentation in Malaysia by using psychographic dimensions*, African journal of business management; 5(13): pp.5040-5047, available at [www.academia.edu/803575/The market segmentation in Malaysia by using psychographic dimensions](http://www.academia.edu/803575/The_market_segmentation_in_Malaysia_by_using_psychographic_dimensions) [accessed 12 November 2013]
5. Beatty, S. E.; Homer, P. M.; Kahle L. R. (1988) *Problems with VALS in International Marketing Research: An Example From an Application of the Empirical Mirror Technique*. Advances in Consumer Research, Association for Consumer Research, Volume 15, pp.375-380
6. Boone, L.; Kurtz, D. (2014) *Contemporary Marketing*, Cengage learning, p.292
7. Ciurea, .; Demyen, S. (2013) *Impact of innovation upon the dynamics of Romanian small and medium sizes enterprises*, Annals of the University of Petroșani, Economics, Vol. 13(1), p.61-72
8. Chin-Feng L. (2002) *Segmenting customer brand preference: demographic or psychographic*, Journal of Product and Brand Management, 11(4), 249-268
9. Demby, E. (1989) *Psychographics Revisited: The Birth of a Technique*, Marketing Research, Vol. 6. No. 2, p. 26-29 and Marketing News, Vol. 23 Issue 2, p.21
10. Dj, I.; Prihantoro, Bambang GH.; Noor F. (2014) *Adoption of Psychographic Model in Determining Factors That Influence Insurance Interest and Perception (Case Study on Micro, Small and Medium Enterprises in the Province of Yogyakarta)*, The First International Credit Union Conference on Social Micro_nance and Community Development, BKCU Kalimantan - Gunadarma University, p.154-163)
11. Friesner, T. (2014) *Consumer behaviours, Segmenting Publics in America*, available at <http://www.marketingteacher.com/segmenting-publics-in-america/>, [accessed 01 August 2014]

12. Ghosh, I. (2014) *VALS Psychographics: A New Way of Market Segmentation in India*, The International Journal of Business & Management, Vol 2, Issue 4, available at <http://theijbm.com/april2014/5.BM1404-017.pdf>, [accessed 15 September 2014]
13. Hawkins, D.; Mothersbaugh, D.; Mookerjee, A. (2010) *Consumer behaviour: Building Marketing Strategy*, 11/e, Tata McGraw Hill, 2010, p.495
14. Hine, D.; Carson, D. (2007) *Innovative methodologies in Enterprise Research*, Edward Elgar Publishing, p.208
15. Konu, H.; Tuohino, A. (2007) *Segmenting potential tourists in well-being sector in Eastern Finland*, 16th Nordic Symposium in tourism and Hospitality, Journal of Vacation Marketing, p.303-314
16. Kotler, F.; Lejn, K. (2009) *Marketing menadzment*, (translated book on Macedonian), Data Pons, Skopje, p.250
17. Madden, M. (1979) *Lifestyle of library users and nonusers*, no. 137, available at https://www.ideals.illinois.edu/bitstream/handle/2142/3950/gslisoccasionalpv00000i00137_ocr.txt?sequence=2, [accessed 1 November 2013]
18. Michman, R. D.; Mazze, E. M.; Greco, A. J. (2003): *Lifestyle marketing, Reaching the new American consumer*, Praeger publishers, p.13, 18
19. Mullen, B.; Johnson, C. (2013). *The Psychology of consumer Behavior*, Psychology Press, p.110
20. Nedelkoska, D. (2011) *Metodi za istrazuvanje na profilot na citatelite na knigi vo Republika Makedonija vo funkcija na opredeluvanje na nivnoto odnesuvanje vo procesot na kupuvanje knigi*, master thesis, Economic Faculty Prilep, Macedonia, p.95
21. Nedelkoska, D. (2014) *Vlijanieto na zivotniot stil na potrosuvacite vrz promotivnite strategii na kompaniite*, doctoral dissertation, Economic Institute, Skopje, Macedonia, p.173
22. Sarli, A.; Tat, H. H. (2011) *Attracting Consumers by Finding out Their Psychographic Traits*, International Journal of Fundamental Psychology&Social Sciences ISSN 2231-9484, IJFPSS, Vol.1, No.1, pp. 6-10, Sep, pp.6

23. Sarli, A.; Tat, H. H. (2011) *The role of Psychographic for distinguishing main categories of consumers based on lifestyle, personality and value variables*, Int. J. Eco. Res., ISSN: 2229-6158, (4), 29-34, online@www.ijeronline.com, [accessed 20 May 2013]
24. Suragh, T. A.; Berg, C.; Nehl, E. (2013) *Psychographic Segments of College Females and Males in Relation to Substance Use Behaviors*. Soc Mar Q. Author manuscript; available in PMC Apr 9, 2014, published in final edited form as: Soc Mar Q. 19(3): 172–187
25. Surdu, C. E. (2012) *Market analysis for athletic footwear*, available on <http://cristianasurdu.co.uk/work/athletic%20footwear%20report.pdf>, [accessed 21 June 2014]
26. Tam, J.; Tai, S. (1998) *Research note: The psychographic segmentation of the female market in Greater China*, International Marketing Review, Vol. 15 Iss: 1, pp.61-77
27. Vyncke, P. (2002) *Lifestyle segmentation: From Attitudes, Interests and Opinions, to Values, Aesthetic Styles, Life Visions and Media Preferences*, European journal of communication 17 (4), p. 448, available at http://www.sagepub.com/clow/study/articles/PDFs/07_Vynck.pdf, [accessed 9 January 2012]
28. Wells, W. (1975) *Psychographics: A Critical Review*, Journal of Marketing Research Vol. XII (May), pp.196-213
29. Wind, Y.; Bell, D. (2002) *Market segmentation*, Chapter 11, available on file:///C:/Users/Dusica/AppData/Local/Temp/0702_Market_Segmentation.pdf, [accessed 1 October 2014]
30. Yankelovich, D.; Meer D. (2006) *Rediscovering market segmentation*, Harvard Business Review, (d.yimg.com/kq/groups/10114558/1535182291/name/Week6.pdf), [accessed 12 June 2014]
31. Zografos, C.; Allcroft, D. (2007) *The Environmental Values of Potential Ecotourists: A Segmentation Study*, available at <http://zsdh.library.sh.cn:8080/FCKeditor/filemanager/upload/jsp/UserImages/1175482707187.pdf>, [accessed 09 December 2013]

UDC 005.322:316.46]:334.72:303.6(497.7)
Original scientific paper

Marjan BOJADJIEV ¹⁾
Ninko KOSTOVSKI ²⁾
Katerina BULDIOSKA ³⁾

LEADERSHIP STYLES IN COMPANIES FROM REPUBLIC OF MACEDONIA

Abstract

The paper presents the results of survey of the characteristics of the leadership in the business sector in Republic of Macedonia. The predominant leadership style remains to be the autocratic, while the age, gender, training and experience abroad influence the choice. This research, despite its limitations, is expected to inspire deeper probes why the authoritarian style of management, despite being not suitable for the new industries, new times and new profiles of the work force, remains to be dominant and the most preferred in the practice of the Macedonian businesses and how it affects the competitiveness of the national economy.

Key words: management, leadership, leadership styles, organizational culture

JEL classification: M00, M10, M14

¹⁾ Prof. Dr. Marjan Bojadjev, Rector, University American College Skopje, Macedonia, E-mail: provost@uacs.edu.mk

²⁾ Prof. Dr. Ninko Kostovski, Professor, University American College Skopje, Macedonia, E-mail: kostovski@uacs.edu.mk

³⁾ Katerina Buldioska, MBA Global Impact Ltd. Skopje, Macedonia, E-mail: buldioska@gmail.com

Leadership versus management

While Adizes (2004) argues that the leadership is just a fancy name for the old lady known as management, others indicate their main different starting points: leader focuses on the vision, manager on the task (Crom and Levine, 1994); managers manage, leaders lead (Miller at al. 1996); management reacts, leadership transforms (Taffinder, 1995); manager controls, leader inspires (Hollingsworth, 1999); while manager is doing things right, leaders do right things (Drucker, 2003). For those who claim that the leadership is different than the management, it is a wider concept and much more focused on the communication, motivation, encouragement and involvement of the people (Crom and Levine, 1994). Leadership motivates people to carry out their tasks as leader wants and expects (Mullins, 2005). It is ability of a person to influence, motivate and enable others to contribute to the effectiveness and success of the organization (House, 1971). It is a vision, idea and direction and it requires ability to motivate people to complete their tasks without being closely supervised (Bennis, 2001). The effective leadership, while emphasizing the importance of the work the employees perform, positively affects the motivation (Fullan, 2001).

Leaders must be able to operate in complex and uncertain circumstances (Fullan, 2001). Since most of the people understand the change as a threat, leadership should help them to accept it as an exciting challenge (Hooper and Potter, 1999). Changing the culture of an organization is a difficult task, but the leaders are in the best position to implement such change (Jex at al., 2008). Finally, it mitigates the management of any dissatisfaction on the side of the employees (Crow at al., 1995).

Approaches to leadership

The development of the organizational behavior theories from their inception up to the present did not manage to solve the old dilemma whether leaders are born or trained (taught). There are confronting opinions also whether the leadership style should (can) adapt to the situation or not. Moreover, there are some new theories that streamline the leadership to a two-sided relationship of giving and taking, a series of business deals between the leader and his followers, one by one, and

there are some who select a particular talent, namely their charisma, as the key factor for the success of the leaders.

The so called qualitative approach to the leadership gives more attention to the selection process, since the leadership cannot be created or learned through training (Drucker, 1989). Thomas (2004) points seven qualities that the leaders must possess: enthusiasm, integrity, determination, equality, affection, modesty and confidence. Bennis compiled another set of features: challenger of the present state, inspirer, visionary, a role model. The main disadvantage of this approach is that such lists tend to be long and even divergent. Robbins (1997) while analyzing twenty different studies on the leadership discerned 80 various qualities, but only five of these qualities were listed in more than four studies. In some of the studies there were even contradicting traits listed. We can only add that the opinions obtained from the close associates of some of the much praised corporate leaders are opposed to their carefully built public image. For some of his co-workers Steve Jobs was utterly narcissistic. By some biographers, Henry Ford had nothing against the Nazism, Wald Disney was a racist. And for some managerial ethics watchdogs, Michael Eisner was opportunistically drafting various teachers of his children as they were progressing from the kindergarten to the universities, to be members of the Disney Corp. board. No wonder, for some Eisner is the acceptable, almost glorified, face of corporate waste and self-awareness, if not aggrandizement (Forbes and Watson, 2010).

Behavioral approach to the leadership shifts from the personal characteristics to the way how the leaders behave in certain situations. The Ohio State Leadership Studies first indicated to the two basic dimensions of the leadership: consideration (for the subordinates) and initiating the structure. Latter, in the Michigan Studies, those two mayor dimensions were personalized in the so called employee centered versus job centered leaders. Represents of the first group care to establish trust of the followers, respect their needs and evaluate their ideas. They try to help even with personal problems of their subordinates. Leaders focused on the initiation of the structure see subordinates not as valuable, but as easily replaceable resources. Blake and Mouton (1964), and Blake and McCause (1991) perceive the good leadership as a combination of two orientations: task and people. Juxtaposing these two dimensions on a grid they concluded that the best leader should have both high and balanced. Such leaders design the work to achieve the objectives of the organization concurrently meeting the needs of the subordinates for

growth, experience and participation (Blake at al., 1964). Heinrich von Pierer distinguishes between the transactional and transformational leadership. The transactional leader is concerned with the routine and standard transactions and checks (1) whether the employee understands the duties and (2) whether is motivated to do the work (Harris and Hartmann, 2002). In organizational terms, the transformational leadership means precisely transformation of the organization (Bass and Rizzo, 2005).

When analyzing the successful organizations in the United States, Likert (1961) noted that they were all persistent in pursuing same leadership style for a prolonged period of time. His findings are in striking opposite to the situational approach to the leadership that claims that there is no such a leadership style that would work always and be appropriate to every situation. Moreover, the ability of the leader to choose leadership style that best fits the situation is the main prerequisite of his success (Harris and Hartmann, 2002). The effectiveness of a given leadership style depends on the situation in which the leader is, thus the main task of a leader is to analyze the situation and to adapt his behavior to the demands of the situation (Jackson and Thomas, 2008). According to Fiedler, three variables determine the situation and affect which style is the right style: (1) the extent to which the group accepts the leader and is ready to follow him, (2) the extent to which the task can be structured with detailed instructions and procedures and (3) the power of the position (level of formal authority) that the leader has on the subordinates. Fiedler concluded that the leaders oriented to the relationships are most effective in situations of good leader - member relations, unstructured task and low positional power and in the cases of bad leader-member relations, unstructured task and low position power. The task oriented leaders are most effective in good leader - member relations and high structure of the task regardless of the power of the position; when the task is less structured, but the leader has strong position power and in the case of bad leader-member relations, low structured task and weak position power.

Vroom and Yetton in 1973, and together with Arthur Jago in 1988, proposed decision tree of possible behaviors of the leader depending on: (1) whether the decision must be of high quality, in other words what would be the consequences of possible mistake; (2) whether the acceptance of the decision by the team is necessary for the implementation; (3) whether the leader has enough information to make the decision independently; (4) the extent to which the problem is

structured; (5) whether the people will accept the decision even if it would come solely from the leader, (6) whether the subordinates feel the goals of the organization as their own; and (7) whether a conflict among the subordinates is possible regarding the “best” solution to the problem. The Path – Goal Theory was originally proposed by Evans and amended by House and Mitchell in 1970-s. is considered an extension of the Vroom’s theory of expectations. As explained by Northouse (2013) leaders select specific behaviors that are best suited to the employees' needs and the working environment so that they may best guide the employees through their *path* in the obtainment of their daily work activities (*goals*). Based on the leader’s assessment of the (1) employee, (2) the task and (3) the environment characteristics, he chooses between four styles of leadership: directive, supportive, participative and achievement oriented.

The contemporary discourses in understanding the leadership include a spectrum of insights starting from charismatic leadership and ending with the Leader –Member Exchange theory. Charismatic leaders induce strong emotions among the followers and create a sense of identification with them and with the organization. They know how to use their charisma to motivate the followers, who trust them unconditionally. They transform the personal needs of their followers into the collective values, preferences and aspirations. Followers of these leaders are fully dedicated to the mission of the collective and are ready to run many extra miles (Boas at al., 1993). However, excessively charismatic leader can bring his business in trouble faster than his rational counterpart. With his too-distant vision he "inspires" but disregards and even downplays the realities (challenges) of the present-argues Bloomfield (2003). Others claim that the organizational science in general is preoccupied with only the positive and the constructive aspects of the charismatic leadership, while in the practice it has a wide dark side. A Toxic Triangle could be easily made of a destructive leader, susceptible followers and poor social environment (Padilla at al., 2007). It is easy to see this triangle in almost all fraud scandals in the “two big to fail” companies from Enron, WorldCom, up to the Lehman Brothers.

The Leader - Member Exchange Theory (LME) sees the leadership as a process of personalized one to one relationship between the leader and his followers. They both, affecting each other, agree on the subordinate’s role. However, in time, the subordinates are gradually classified by the leader into two groups: people “in the leader’s group” and people “in the outer group”. People “in the leader’s group” are

trusted; enjoy greater discretion on how to perform the work and various other benefits. People from the “outer group” are estranged from the leader as he thinks that they are bad employees and not loyal to him. Consequently, they do not get any attention from the leader, do not get assignments that would be challenging for them and practically are not used enough. If we agree on the mayor arguments of this theory, the advice to the followers would be to try to get into the "leader's group" by voluntarily engaging in more activities, while the leaders are advised to try to rebuild the relationship, to use more "wandering around management" throughout the organization and to offer more opportunities for career development (Maslyn and Uhl-Bien, 2001). The major objection to this theory is the notion that the people out of the attention of the leader might be there because they are refusing to be blind followers, while the members of the leader's group might be nothing but an opportunistic clique that systematically undermines any attempt of the leader to see the whole picture and thus to reestablish his relationship with the others in the organization. In other words, managers who pursue this sort of leadership could intentionally or not, but easily help drawing of the lines of their own toxic triangle. Examples include situations like that of Parmalat when the inner group of managers was betting on their own company default, Siemens where a small group of managers entered a mega bribery scheme to boost the faltering sales, the Volkswagen managers who in order to obtain support from the worker bribed their union leaders and many similar.

Findings of the Study

Our Study involved 50 leaders at various levels of management in selected business entities in the Republic of Macedonia. The *questions* related to their style of leadership were in form of statements. The respondents were giving chance to choose between "almost never" and “almost always" depending on the extent to which the particular statement corresponds to their comprehension of the most appropriate to the given situation, leadership style.

Likert (1961) discerned four different types of leadership: exploitive, benevolent, consultative and participative. Hersey and Blanchard also talk about four specific leadership behaviors: directive, "sale" when the leader tries "selling" his decision, participatory and delegating. However, for the purposes of our research we choose Clark's

questionnaire from 2004, that follows the three basic styles of leadership, originally defined by Kurt Lewin as autocratic, democratic (we adopted it as a participatory) and Laissez-faire.

The results show that the majority of respondents (40%) incline towards the autocratic leadership, 32% towards participatory and 28% to the Laissez-faire style. In other words, the most preferred style of leadership is, or remains to be the autocratic.

Table 1. Preferred leadership Styles of the Macedonian business leaders

Style of Leadership	Respondents	Percent
Autocratic	20	40%
Participatory	16	32%
Laissez-faire	14	28%
Total	50	100%

Indicative is the difference between the preferred (practiced) leadership styles in the case of the male vis-à-vis the female respondents. While among the former, the dominant style is the autocratic (43%), the majority of the latter (women) prefer the participatory style (41%).

Table 2. Preferred leadership styles and the gender of the respondents

Style of Leadership	Male Respondents		Female Respondents	
Autocratic	12	43%	8	36%
Participatory	7	25%	9	41%
Laissez-faire	9	32%	5	23%
Total	28	100%	22	100%

Regarding the level of the management, the autocratic leadership style prevails both in the case of the leaders at the lowest and that of the highest level of management, while the Laissez-faire style is the most preferred by the middle management.

Table 3. Styles of the leadership by the level of management

Managerial level	Preferred style					
	Autocratic		Participatory		Laissez-faire	
Top level managers	7	58%	3	25%	2	17%
Middle level managers	5	24%	7	33%	9	43%
Line managers	8	47%	6	35%	3	18%

The results show that the age of the leader influences the preferences, too. In the group of the leaders between 21 and 30 years of age, 55% of the respondents prefer Laissez-faire style, and then comes the participatory style with 27%, while the autocratic style is preferred by only 18% of the respondents. In the group between 41 and 50 years of age, the most frequent is the autocratic style (53%), followed by the Laissez-faire style with 26.67% and the participatory style with only 20%. In the group of the respondents over 50 years of age, the autocratic style is dominant with high 62.5%, followed by the participatory style (37.5%), while the Laissez-faire style is not present at all.

Table 4. Styles of the leadership and the age of the respondent

Age	Preferred style					
	Autocratic		Participative		Laissez-faire	
21 - 30	2	18%	3	27%	6	55%
31 - 40	5	31%	7	44%	4	25%
41 - 50	8	53%	3	20%	4	27%
50 +	5	63%	3	37%	0	0%

In addition, managers with some foreign career experience are more inclined towards the participatory style (42%). Similar is the situation with the leaders who had a chance to be trained abroad (50%) and with those who are members of some professional business associations. On the other hand, the autocratic style is dominant among the leaders who have not attended any management training program (52%).

Conclusion

Despite the reservations in relation with the limited representativeness of the sample, with the impossibility to control the interview environment and the influence of the current mood of the participants during the interview, the findings of our survey are consistent with similar research done by some other analysts like that of Popovski (2001) who in Macedonian companies finds three distinct types of organizational culture: conservative, entrepreneurial and flexible. According to him, the businesses characterized by conservative organizational culture have vertical hierarchy and strict division of labor, decisions are made at the top, there is no teamwork and the communication is primarily top-down, slow and inefficient. In such organizations a mentality of subordination prevails and the applied leadership style is autocratic. The entrepreneurial organizations are adaptable to the changes in the environment, but in terms of leadership the authoritarian style dominates, too. In the organizations that nurture the flexible model of culture people are respected based on their expertise and competence and thus the most appropriate leadership styles is participatory, or even the Laissez-faire style (Popovski, 2001).

It must be stressed that during the early stage of the growth, when the direct involvement of the founder is instrumental and when the directing of the subordinates and frequent communication of the vision is needed, the autocratic style is the most practical style to use. Moreover, by swiftly mobilizing and redirecting the organization towards the changed situation and the new priorities, the autocratic style can be helpful in the situations of financial or any other crisis, too. However, in all other situations, the autocratic style leads to managers overloaded with trivial and routine tasks, who are lost in the details. Leaders who practice the participatory style have much more time to devote to the analysis of the environment, monitoring of the changes and to the timely preparation of their organizations to respond to these challenges, either with seizing the opportunities or avoiding the threats or both simultaneously. Moreover, these leaders grow talent internally and the leadership transition in these organizations is not a difficult exercise. The Laissez-faire leadership is suitable for organizations based on strong decentralization, self-managed teams, that work on projects that require highly creative people such as that in software or in the creative industries. For the sake of the truth, this style is much less present in the

“brick and mortar” manufacturing even in the developed parts of the world.

The results of our survey offer certain guidelines on how to improve the leadership in the Macedonian business sector. A better gender balance, rejuvenation of the management teams, planned gradual withdrawal of the founder of the entrepreneurial businesses could prove useful recommendations. In the larger enterprises: strengthening the human resources departments, development of training plans for the management in soft skills, internships for young managers in selected companies abroad, formal business education of the technical staff on the MBA programs with concentration on the organizational sciences. Advice is also to educate the current leaders to realize the link between the old-fashion leadership and the overall competitiveness of the country and to be motivated to cut that vicious circle. This research is expected to inspire more probes into the broader social and cultural reasons why the authoritarian style, despite being not suitable for the new industries, new times and new profiles of the work force, still remains to be dominant and the most preferred style in the practice of the Macedonian businesses leaders.

References:

1. Adizes, I., (2013) *The ideal Executive, A New Paradigm on Leadership*, Adizes Institute, 2004
2. Bass, M. and Riggio, E. (2005) *Transformational leadership*, Psychology Press, Boston
3. Bennis, W. (2001) *The New Leadership* in Crainer, S. and Dearlove, D. Financial Times Handbook of Management, Pearson.
4. Blake, R., Mouton, J., Barnes, L. and Greiner, L. (1964) *Breakthrough in Organization Development*. HBR 42(6), 133-155.
5. Bloomfield, S. (2003) *Charismatic Leaders are Passé*, Professional Manager, 12 (1).
6. Boas, Sh., House, P. and Arthur, M. (1993) *The Motivational Effects Of Charismatic Leadership: A Self-Concept Based Theory*, Organization Science. 4 (4).
7. Clark, R. (2004) *Concepts of leadership*. Retrieved from <http://nwlinc.com/~donclark/leader/leadcon.html>

8. Crow, M., Hartman, J. (1995) *Can't Get No Satisfaction*, Leadership and Organization Development Journal, 16 (4).
9. Drucker, P. (1989) *The Practice of Management*, Heinemann Professional
10. Drucker, P. (2003) *The essential Drucker The Best of Sixty Years of Peter Drucker's Essential Writings on Management*, Regan Books
11. Forbes, W., Watson, R. (2010) *Destructive Corporate Leadership and Board Loyalty Bias: A case study of Michael Eisner's long tenure at Disney Corporation*, Cass Business School Presentations at <http://www.cass.city.ac.uk>
12. Fullan, M. (2001) *Leading in a Culture of Change*, Jossey-Bass.
13. Graen, B. Uhl-Bien, M. (1995) 'The Relationship-based approach to leadership: Development of LMX theory of leadership over 25 years: Applying a multi-level, multi-domain perspective', Leadership Quarterly, 6 (2).
14. Harris, J., Hartman, J. (2002) *Organizational Behavior*
15. Hollingsworth, J. (1999) 'Squadron Leader, Purpose and values', The British Journal of Administrative Management.
16. Hooper, A., Potter, J. (1999) 'Take it from the TOP', People Management.
17. House, J. (1971) 'A Path-Goal Theory of Leadership Effectiveness', Administrative Science Quarterly, 16.
18. Jex, M. Britt, C. and Thomas, W. (2008) *Organizational Psychology – A Scientist – Practitioner Approach*, John Wiley and Sons, Inc.
19. Levine, S. and Crom, M. (1994) *The Leader in You*, Simon and Schuster.
20. Likert, R. (1961) *New Patterns of Management*, McGraw-Hill.
21. Maslyn, J., Uhl-Bien, M. (2001) *Leader-Member Exchange and Its Dimensions: Effects of Self-Effort and Other's Effort on Relationship Quality*, Vanderbilt University
22. Miller, S., Catt, E. and Carlson, R. (1996) *Fundamentals of Management: A Framework for Excellence*, West Publishing.
23. Mullins, J. (2005) *Management and Organizational Behavior*, Prentice Hall.
24. Northouse, P. (2013) *Leadership: Theory and Practice*, SAGE Publications Inc.

25. Padilla, A., Hogan, R. and Kaiser, R. (2007) '*The toxic triangle: Destructive leaders, susceptible followers, and conducive environments*', *The Leadership Quarterly* 18.
26. Поповски, В. (2001) *Влијанието на организациската култура врз деловноста на претпријатијата*, Економски институт Скопје.
27. Robbins, S. (1997) *Organizational Behavior*, Prentice Hall International.
28. Taffinder, P. (1995) *The New Leaders: Achieving Corporate Transformation through Dynamic Leadership*, Kogan Page.
29. Thomas, N. (2004) *John Adair Handbook of Management and Leadership*, Thorogood Ltd.
30. Vroom, H. (1974) *The search for a Theory of Leadership*, in J.W. McGuire, *Contemporary Management: Issues and View-point*, Prentice-Hall.

UDC 336.77:339.37(497.11)
336.77:339.37(497.5)
336.77:339.37(497.7)
Original scientific paper

Evica DELOVA JOLEVSKA ¹⁾
Ilija ANDOVSKI

**RETAIL LOANS IN THE BANKING SYSTEMS OF SERBIA,
CROATIA AND MACEDONIA WITH SPECIAL EMPHASIS OF
RETAIL PORTFOLIO OF MACEDONIAN BANKS**

Abstract

The aim of this paper is to evaluate the movements and quality of retail loan portfolio in banking systems of three sample Balkan countries. The quality of retail credit portfolio is important because is determinant of future credit growth and at the end influences on consumption in the economy. Another important aspect is the growth in past crisis years, at which products is achieved and is there trend in accumulation of future risks. The analysis will be focused to compare data for trends of growth and quality of retail portfolio in Macedonia, Serbia and Croatia. The comparative analysis will give answers for the different share structure of products in retail portfolio, different trends of movements and quality of portfolio measured through NPL ratios by products. Also the analysis should give answers for drivers that are key factors of vulnerability of retail portfolio which can be input for further strategies of development in retail segment. The retail portfolios in sample countries that are chosen, had similar rates of growth before the financial crisis, the banking systems are dominantly owned by foreign countries and the economies were influenced by the financial crisis. Still, Macedonian retail portfolio has trend of growth in the past 3-4 years, opposite of Serbian and Croatian portfolios and the quality of the portfolio is much better. Special

¹⁾ Evica Delova Jolevska PhD, University American College, Skopje,
e-mail:evicadj@uacs.edu.mk
Ilija Andovski, PhD., e-mail:iandovski@yahoo.com

emphasis will be given on future risks in Macedonian retail portfolio, given the opposite trends from the sample countries.

Keywords: Retail portfolio, NPL, banking systems, growth rate

JEL classification: G21, G01

Introduction

The last fifteen years have witnessed many significant developments in the banking sector in Central Europe and South Eastern Europe (CESEE). This also influenced the banking systems of Balkan countries. Large number of international banks entered in Balkan countries banking system and significantly changed banking practices and contributed to high credit growth in corporate and retail loan portfolio. The retail loan portfolio had two digits rate of growth, and there was trend of debiting in circumstances where the risk management of this portfolio was not on the highest level and not all risk was anticipated. This fast credit growth led to a build-up of imbalances and risks (EIB, 2014). Even without financial crisis effects following the fast credit growth, this kind of growth is factor itself for deterioration in the portfolio in future (Espinoza and & Prasad, 2010). The banking sectors of three sample countries were caught by the financial crises still in high credit growth because of the time lag on the financial crisis effects. The effects from the financial crisis were felt at the end of 2008 and the beginning of 2009. Most of the studies make empirically proven link between GDP movement and the quality of the portfolio (ECB, 2013) which can easily be confirmed in the sample countries. This led to deterioration in retail loan portfolio quality in two ways: worsening of the credit ability of households and very low or negative growth, which in combination with the materialization of the past portfolio deteriorated all indicators for quality. Still the differences in the product structure of retail portfolios and the impact of financial crises was different in each of the sample countries which led to different movements and quality of the portfolio.

While there is still evidence of a financial penetration gap, a new banking model is emerging (EIB, 2014), with international banks calling for greater independence for their subsidiaries and a more balanced funding model, based on domestic resources. At the same time the recovery in lending has been slow, reflecting a mixture of demand and

supply factors. Moreover, the international banks operating in the region have started to be more selective with regard to their CESEE strategies, clearly discriminating between countries and committing only to those markets that clearly offer long-term opportunities. This trend also affects the retail credit strategy and appetite for risk of Balkan banking sectors.

Finally, among the other goals, one of the main goals of all banks is to produce adequate return for its shareholders. So the return which can be gained is one of the main drivers that can influence on future retail portfolio developments in sample Balkan countries. So the quality of portfolio, which through impairment affects the return of a portfolio, has impact on the future credit growth. This affects the economic development through the credit activity which influence on the consumption. Thus creating a spiral and deterioration in portfolio quality create low economic growth and low growth creates further deterioration in the portfolio.

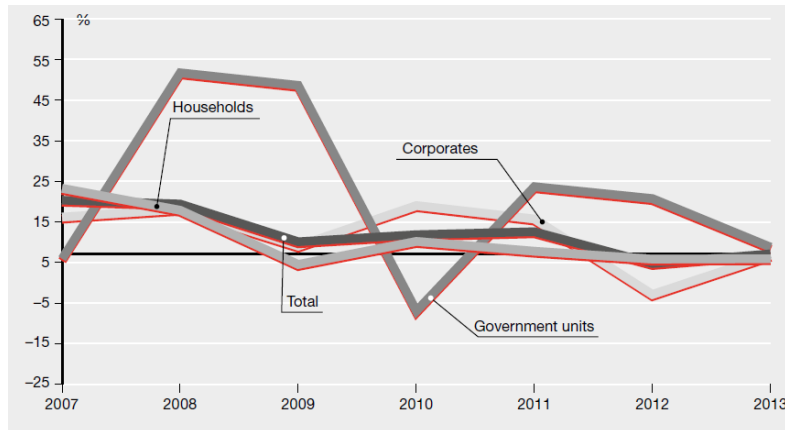
The aim of the analysis will be to reveal the differences in retail portfolio trends and quality in the sample countries. Special focus will be given on the credit growth in retail segment after the financial crises and the quality of the portfolio. Also, the retail portfolio will be analyzed by product in order to determine if there is different behavior regarding product portfolio quality.

Retail portfolio developments after the financial crisis in sample countries

What is common for the retail loan portfolio in the sample countries is the two digits growth in the period before 2008. That was period after the ownership transition was finished and in all sample countries western foreign banks are dominant owners in the banking system. Also, what is common for the sample countries banking systems was the low level of debt of the households. So the financial crisis found the banking systems of sample countries in high growth and the effects of the crisis influenced on the growth rates with 12-18 months delay.

As can be seen from Figure 1, in Croatia the retail loan portfolio registered growth rates until 2009. After 2009 the growth rates are close to 0 or negative. The deleveraging strategy of banks in this segment caused decrease of seven percentage points in the five-year period of household loans in total structure, to 43.1% of total loans at the end of 2013.

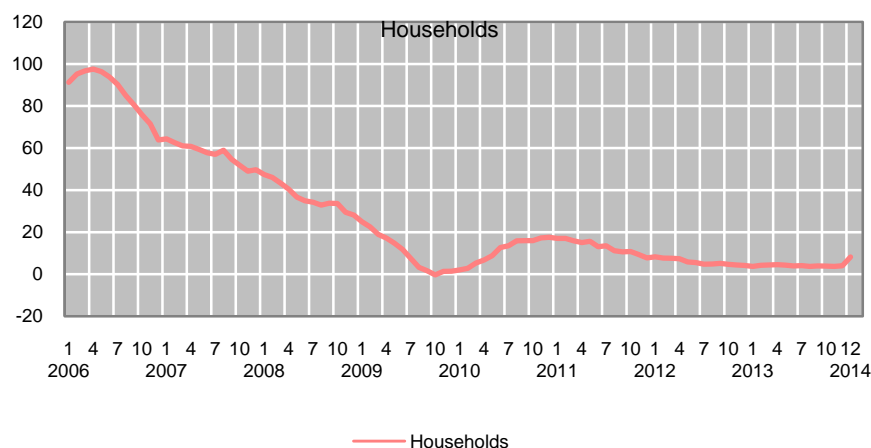
Figure 1: Rates of change of retail loan portfolio in Croatian banking system



Source: Banksbulletin 27, Central Bank of Croatia

According to Croatian Central Bank (Croatian Central Bank, 2014) lending to the private sector especially households was still weak, as a result of the increased bank cautiousness, but also of the suppressed demand of the private sector, especially of households. Also the deleveraging in retail portfolio is due of the trend of slight changes in the structure of loans to that sector and the strengthening of the share of loans used for servicing various other liabilities to creditors which is explanation why only consumer loans have growth. This trend (Croatian Central Bank, 2015) of deleveraging continued in 2014 also, and contributed for decreased share in total credit exposure. The trend of retail portfolio growth in Serbian banking sector was similar as in Croatia (Figure 2). Still, the effects from the financial crisis had impact on retail portfolio growth 10 months later, in the four quarter of 2009.

Figure 2: Rates of change of retail loan portfolio in Serbian banking system

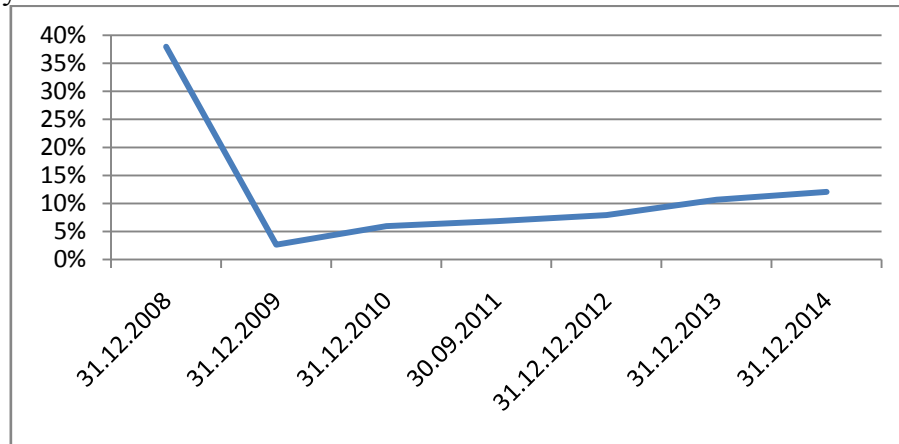


Source: Banking sector of Serbia, Fourth Quarter Report 2014, Central Bank of Serbia

Real credit growth started slowing down in early 2008. According to Central Bank of Serbia the credit growth picked up temporarily in 2010 as a result of interest subsidies for liquidity loans, consumer loans and investment loans, subject to Government Decree. So after 2011 when the retail credit growth was driven from consumer loans, in 2012 and 2013, the retail portfolio stagnates with growth rates close to 0. In 2014 there was slightly increase in retail portfolio, which was due primarily for housing loans mostly as a result of depreciation of the dinar exchange rate of 1.8% in Q4. So the increase was not a result of real credit activity.

Macedonia is outlier regarding the retail growth. Macedonian banking system felt the impact from the financial crisis in 2009 when the retail portfolio growth was decreased to 3% after 38% in 2008. This was year for stabilization of the banking system after rapid growth. After 2009, opposite from trend in Serbia and Croatia, the retail portfolio in Macedonian banking system has growth rates between 6-11%. In 2013 and 2014, especially in 2013, the growth in non financial loans was driven mainly from retail loans.

Figure 3: Rates of change of retail loan portfolio in Macedonian banking system



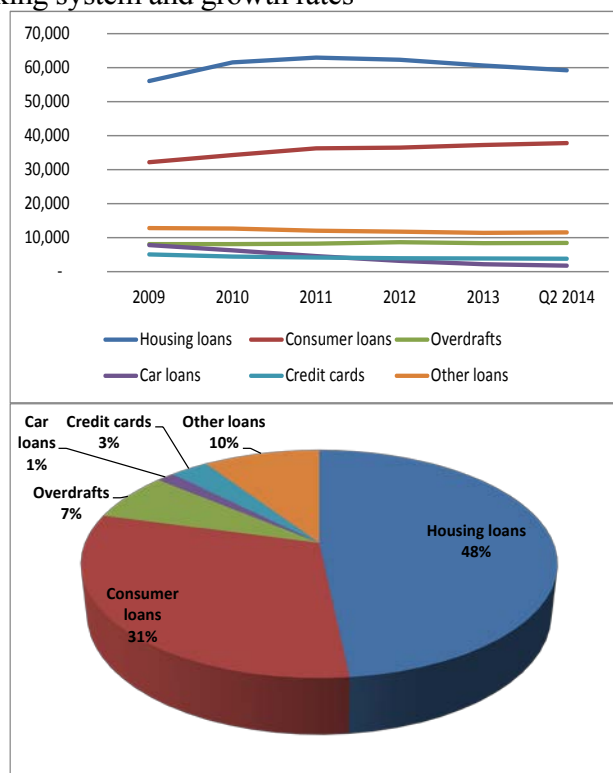
Source: Report on risks in the banking system of the Republic of Macedonia for quarters, Central Bank of R.Macedonia

The reasons for the opposite trend of retail portfolio in the banking system of Macedonia will be analyzed from few aspects: structure of retail portfolio by product, level of NPL, unemployment rate in sample countries and exposure per capita. The structure of retail portfolio by product and the growth of exposure by product should give hint for the quality of growth. Deterioration of loan portfolio quality (Moinescu&Codirlaşu, 2013) increases the capital requirements and erodes credit institutions' own funds, compressing capital adequacy ratio. Under threat of recapitalization, bank loans supply is adjusted by strengthening credit standards. But a lower credit flow in the economy affect consumption and investment, which then causes changes in production through a multiplier effects. Feedback effect from the real economy to credit markets will further worsen the quality of bank portfolios, prolonging the persistence of macroeconomic shocks. So the NPL ratio is important predictor of portfolio growth. The macroeconomic variables unemployment rate and exposure per capita have direct influence of the movements in retail portfolios.

Structure of retail loan portfolio in sample countries by product

The analysis of the retail portfolio structure in Croatian banking system at Q2 2014 shows dominant share of housing loans with 48% share and consumer loans with 31 % share (Figure 4). Still, the trend in the last 2 years is upward only for consumer loans and all the other products have opposite trend. This is mainly due of the effects from the financial crisis and slow recovery process in the aftermath which influenced with deleveraging in housing loan portfolio. The growth of consumer loans can be interpreted as a way banks to stop further retail portfolio decline and to undertake diversify portfolio. Taking into account their purpose, the banking system is financing current consumption of the population and the portfolio is fragile of movement of unemployment rate, life expenses and interest rates.

Figure 4: Structure of retail loan portfolio by product on 30.06.2014 in Croatian banking system and growth rates

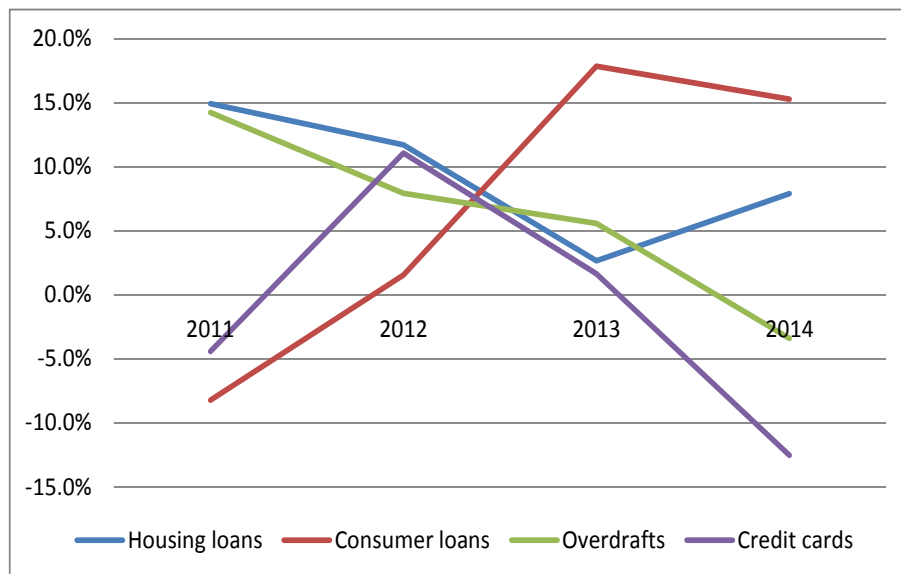


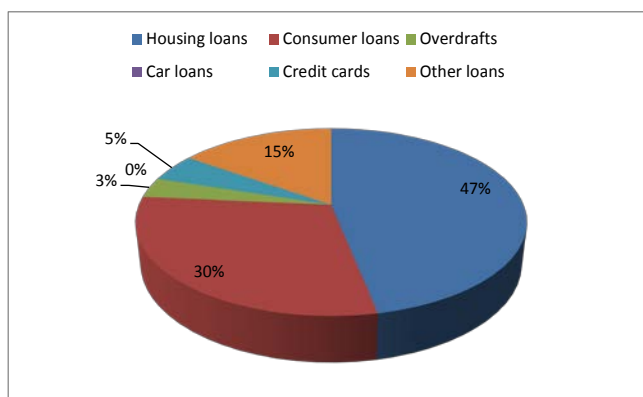
Source: Banks bulletins, Central Bank of Croatia

Although the level of NPL ratio is important determinant of future portfolio growth, in circumstances where the demand for household loans is low, the consumer loans registered an increase besides the 25% NPL ratio. Still the new portfolio probably is created for new clients and the high NPL ratio is due to the effects from the financial crises and also from the fast growth before 2009.

The structure of retail portfolio and the trends in Serbian banking system are very similar to the one in Croatian banking system. Dominant portfolio is household loans with 47% share and the second largest are consumer loans with 30% share (Figure 5). In 2012 and 2013 only the consumer portfolio registered an increase while all the other portfolios stagnate. In 2014 the growth in retail segment was driven by housing loan portfolio increase which was due on devaluation of the national currency in Q4 2014.

Figure 5: Structure of retail loan portfolio by product on 12.2014 in Serbian banking system and growth rates

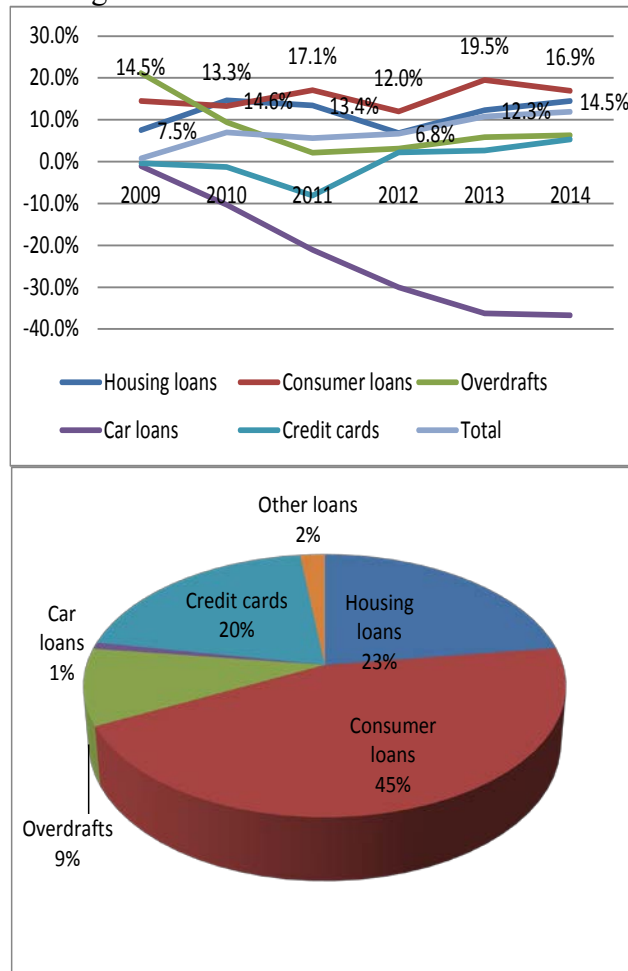




Source: Banking sector of Serbia, Fourth Quarter Report 2014, Central Bank of Serbia

In Macedonian banking sector the structure of the portfolio is totally different (Figure 6). The consumer loans are dominant ones with 44% share, and the second largest portfolio is the housing loans with 22% share. Also significant difference is the share of credit cards with 21% opposite to 3% and 5% in the other sample countries. The size of part of the credit cards has the features of consumer loan so the share of consumer loans is even bigger. The growth of retail portfolio in the last two years in Macedonian banking system was driven by consumer loans and housing loans. The growth of the housing loans, which is different from other sample countries, is due to few factors. Most important factors are the promotional low interest rates from 3-5 years which were quite different from the previous period and the decrease of prices of residential property. Also the housing portfolio is with the best quality and the share in total retail portfolio is still small. The growth of consumer loans, besides the low interest rates is due to the worst quality of corporate portfolio. In order to achieve growth with the same approval criteria and same clients, the maturity of corporate loans is continuously increasing and in the last 2 years the maturity is increased from 66 to 75 months average maturity. The analysis by clients' shows that in 2014, from the total growth, 57% is due to new clients. There are two possibilities that explain this kind of growth. Either the low interest rates attracted clients that didn't like to raise consumer loans before or the low rates with easing of approval criteria regarding maturity period, made clients that were not suitable for granting loan before as clients that meet the approval criteria.

Figure 6: Structure of retail loan portfolio by product on 09.2014 in Serbian banking system and growth rates



Source: Report on risks in the banking system of the Republic of Macedonia in 2014, Central Bank of R. Macedonia

NPL ratios at retail portfolio in sample countries banking systems

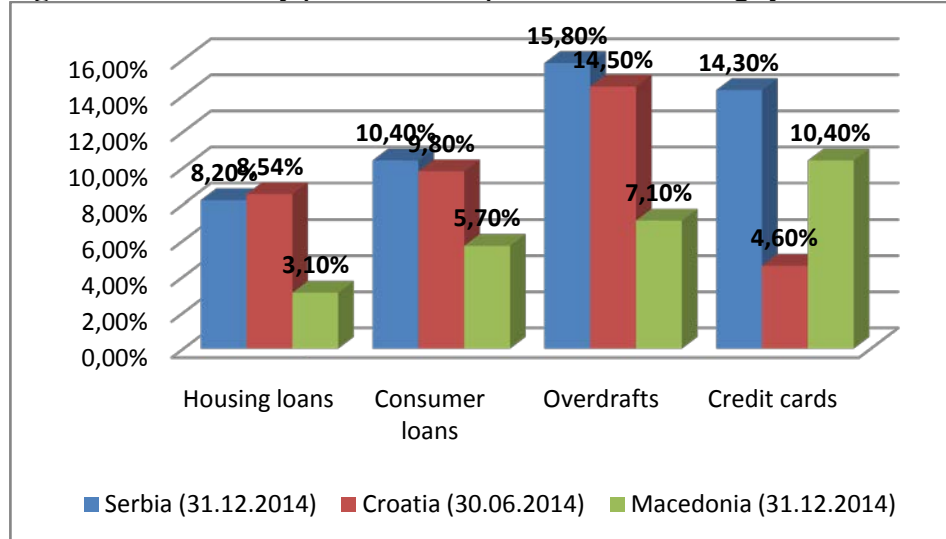
One of the main drivers that has influence on the future growth strategy of banks and the decision making process is the level of NPL loans. If the NPL ratio for certain product is increasing it can be expected the future growth of exposure toward that product to decrease. This phenomenon creates spiral, the worsening conditions in economy creates

bad loans, and the high NPL ratios reduce the credit activity and worsen the economy even further which feedbacks again with higher bad loans. This connection is empirically confirmed. According to Moinescu and Codirlaşu (Moinescu & Codirlaşu, 2013), large swings in credit flow (deleveraging or excessive financing) are associated with high levels of non-performing loans rate two years later, as the consequences of extreme values in both sides of the distribution of credit growth are similar in terms of risk level in the medium term. The feedback effects deepens recession through bank financing channel, as the credit elasticity dynamics to the change in non-performing loans ratio is slightly higher than one.

Another thing that is important in NPL ratio analysis is the growth rate. If the growth rate is low, because of the natural rate of aging, the NPL ratio will be higher over time. As it was mention in the previous section, there was trend of deleveraging in retail portfolios in Croatia and Serbia. Only retail portfolio in Macedonian banking system had above 10% growth in the last two years.

The analysis of NPL ratio shows that Macedonian banking system has retail portfolio with better quality. The differences in the housing and consumer loans, which are dominant retail products, are evident (Figure 7). The NPL ratio in housing loans is highest in Croatia, and is three times larger than NPL ratio for the same product in Macedonia. Serbian NPL ratio for this product is somewhere in the middle. Higher NPL ratio in Serbian and Croatian banking system compared to Macedonian can be explained by few factors: more growth in this product in the past, rise of unemployment rate, more exposure per capita which in combination with the previous factor contributed for higher NPL ratio and off course the negative or close to zero growth rate.

Figure 7: NPL ratio by product in sample countries banking systems



Source: Reports on Central banks on sample countries

Housing portfolio in Macedonia with NPL ratio of 3% is the product with best quality. In the last two years this is the portfolio with second highest rates of growth. This is due on favorable conditions of lending with low “promotional” fixed interest rates in the first 3-5 years which allowed access for clients that were not suitable for lending previously. The low interest rates were due of changes in banks strategies and redirecting of the credit activity towards retail because of the higher NPL ratios in corporate portfolio. The competition in retail segment and the excess of liquidity contributed for low interest rates for retail loans and growth in this segment. This growth is not risk free. When the period of fixed interest rate will pass, and the rate will be increased especially if in that period there is interest growth environment, it can be expected NPL ratio to increase.

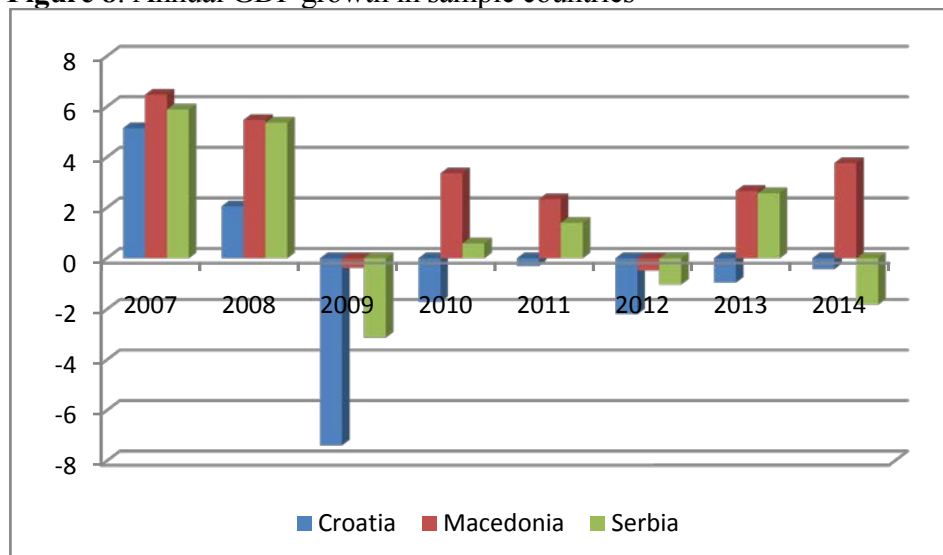
The difference in NPL ratio at consumer loans is not as great as housing loans. Still, the NPL ratio for consumer loans in Macedonian banking system is 4.7 and 4.1 pp below the other two sample countries. The main reasons are: the high growth in exposure towards consumer loans in Macedonia which absorbs the natural rate of aging, the growth in maturity which contributes to lower monthly burden and maintaining the unemployment rate against the increase in the other two sample countries.

Determinants of quality of retail portfolio

The literature identifies two sets of factors to explain the evolution of NPLs over time (Klein, 2013). One group focuses on external events such as the overall macroeconomic conditions, which are likely to affect the borrowers' capacity to repay their loans, while the second group, which looks more at the variability of NPLs across banks, attributes the level of non-performing loans to bank-level factors. If we focus on macroeconomic factors, most of the economists identify GDP movement as key one (Rajan & Dhal, 2003). Also, the unemployment rate (Klein, 2013) is another factor that influence on NPL loans. Finally of course the level of NPL is influenced by the indebtedness of the population. Higher exposure toward population makes the banking system less resilient of macroeconomic shocks.

As can be seen from figure 8, the financial crisis had different impact in the sample countries. Croatian economy felt the crisis in 2008 and the impact in 2009 on GDP was much greater than in the other two sample countries. Also if we compare the GDP growth in the years 2008-2013, when the effects from the financial crisis and the EU debt crisis were felt, Macedonian economy was more resistant than the sample countries. This is explanation of the better quality of the total portfolio on banking system and also on the retail portfolio. Also, the GDP growth can explain the growth of the retail portfolio, opposite of the deleveraging trend in other sample countries.

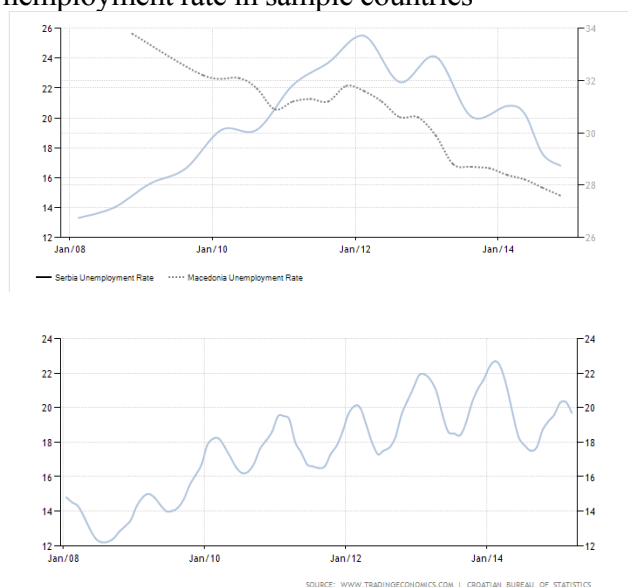
Figure 8: Annual GDP growth in sample countries



Source: World Bank database

The second important macroeconomic indicator that can influence the quality of the portfolio is the unemployment rate. The trend of unemployment rate is different in all sample countries (Figure 9).

Figure 9: Unemployment rate in sample countries



Source: www.tradingeconomics.com

The unemployment rate in Macedonia is decreasing. Even if the movement is not completely real and partially is due on the manner on the records of unemployed persons, still the unemployment is not increasing. If we have in mind that only employed persons are eligible for exposure, the general conclusion is that this is one of the main reasons for preserving the good quality of the portfolio. In Serbia, the unemployment rate had increasing trend till 2013 which explains the deterioration in quality of portfolio. There is decreasing in unemployment rate in 2014 which will have positive impact on the quality of the portfolio. Upward trend, although cyclical depending from the season and tourist season, has the unemployment rate in Croatia. The upward trend of unemployment rate in Croatia and Serbia till 2014 explains the deterioration in quality of retail portfolios in their banking systems.

The retail exposure toward GDP and per capita are indicators for indebttness of the population and can indicate for future risks especially if movements in GDP and unemployment rate are expected. As can be seen from table 1, most vulnerable of unexpected movements and most indebttneted is the population in Croatia. The financial crisis confirmed that fact and Croatia has highest level of retail NPL. Another factor that contributed to this fact were the loans in Swiss frank, and after the appreciation of the frank toward the euro, the monthly burden of this clients was increased.

Table 1: Retail exposure to GDP and per capita in sample countries

Country	retail exposure/GDP	retail exposure per capita	retail exposure per capita/average salary
Croatia (06.2014)	38.94%	5,245 USD	6.54
Serbia (12.2014)	17.60%	760 USD	1.92
Macedonia (12.2014)	21.10%	1,106 USD	2.53

Source: World Bank database

The indebttness of population in Serbia is lower than Macedonian population, still the quality of retail portfolio is better in Macedonian banking system. This can be explained by the fact that the impact from financial and EU debt crisis, measured through GDP movement and unemployment, was much higher in Serbia than Macedonia. Also, the NPL ratios for retail portfolio in 2009-2010 in Serbia were higher which

was due on the higher growth in portfolio in the previous period and weak credit standards.

Still, at a time when the standard of living of the citizens is endangered because of the deepening economic crisis, the data shows that Macedonian citizens borrowing more unsecured retail loans (Mahmudi, 2013). If total citizens borrowing achieve almost 1.8 billion euro, almost 45 percent off total structure of retail portfolio belongs to consumer loans. Moreover, the credit cards portfolio at the end of September 2014 reached to 378 million euro which is third predominant required and predominate weight in entire retail structure if to this adds portfolio of 176million in overdrafts it is clear that two third of the Macedonian retail structure is consisted from unsecured loans. This data show that citizens of Macedonia had borrowed from banks in order to fulfill the general needs respectively purchasing durable and non durable goods as well as to pay the current bills. Although the current quality of the retail portfolio is good, still the banking sector is especially vulnerable in movements in employment rate, life expenses and wages. Any bigger movements in these three categories can materialize the credit risk that banks in Macedonia have taken in retail segment in the last 3-4 years.

Conclusion

The analysis in the three sample countries on trends and quality of retail portfolio shows different movements. All three sample banking systems faced with high credit growth in retail portfolio until 2008-2009 when effects from financial crisis were felt. Still, although the trend of deterioration is present in all sample countries the intensity and effects are quite different. This is due to macroeconomic performances during the crisis regarding GDP movement and unemployment rate. GDP reduction off course is connected to macroeconomic policy. Macedonia before the crisis was low indebted country which was used by economic policy makers to increase the debt in crisis in order to overcome the negative impact of the crisis. Also Macedonian economy didn't face with increased unemployment which contributed the quality of retail portfolio to remain stable. This is the main reason why Macedonian retail portfolio, measured through NPL ratio, is with much better quality than the other sample countries. The other reason is the growth in retail segment that is

present in retail portfolio in Macedonian banking system in the last 4 years which contributes for better NPL ratio. Also, in Macedonian banking sector the structure of the portfolio is totally different. The consumer loans are dominant ones with 44% share, and the second largest portfolio is the housing loans with 22% share. Also significant difference is the share of credit cards with 21% opposite to 3% and 5% in the other sample countries. The size of part of the credit cards has the features of consumer loan so the share of consumer loans is even bigger. The growth of retail portfolio in the last two years in Macedonian banking system was driven by consumer loans and housing loans. The growth of the housing loans, which is different from other sample countries, is due to few factors. Most important factors are the promotional low interest rates from 3-5 years which were quite different from the previous period and the decrease of prices of residential property. Also the housing portfolio is with the best quality and the share in total retail portfolio is still small. The growth of consumer loans, besides the low interest rates is due on the worst quality of corporate portfolio. In order to achieve growth the maturity of consumer loans is continuously increasing and in the last 2 years the maturity is increased from 66 to 75 months average maturity. The analysis by clients' shows that in 2014, from the total growth, 57% is due on new clients. There are two possibilities that explain this kind of growth. Either the low interest rates attracted clients that didn't like to have consumer loans before or the low rates with easing of approval criteria regarding maturity period, made clients that were not suitable for granting loan before as clients that meet the approval criteria. Still, two third of the Macedonian retail structure is consisted from unsecured loans. This data show that citizens of Macedonia had borrowed from banks in order to fulfill the general needs respectively purchasing durable and non durable goods as well as to pay the current bills. Although the current quality of the retail portfolio is good, still the banking sector is especially vulnerable in movements in employment rate, life expenses and wages. Any bigger movements in these three categories can materialize the credit risk that banks in Macedonia have taken in retail segment in the last 3-4 years.

The real problem in all sample countries is how to revive the real sector. Without recovery in the real sector, the credit growth in retail segment could be a strategy for a short period of time. When growth opportunities will be exhausted, after same time gap, this portfolio will face with deteriorating quality as a result of low or negative growth and nature rate of aging.

References

1. Central Bank of Croatia.(2013). *Financial stability report for 2012*.(No.11, VII 2013). Zagreb:Publishing Department.
2. Central Bank of Croatia.(2014). *Banks Bulletin for 2013*.(No.26, VIII 2014). Zagreb:Publishing Department.
3. Central Bank of Croatia.(2014). *Financial stability report for 2013*.(No.13, VII 2014).Zagreb:Publishing Department.
4. Central Bank of Croatia.(2014). *Financial stability report for 2014*.(No.14, II 2015).Zagreb:Publishing Department.
5. Central Bank of Serbia.(2014). *Annual Financial Stability Report – 2013*.(ISSN 2217-6942). Belgrade:Publishing Department.
6. Central Bank of Serbia. (2014). *Banking sector of Serbia, Fourth Quarter Report 2013*. Belgrade:Publishing Department.
7. Central Bank of Serbia. (2015). *Banking sector of Serbia, Fourth Quarter Report 2014*. Belgrade:Publishing Department.
8. ECB. (2013). *Non-performing loans - What matters in addition to the economic cycle?*(No.1515). Frankfurt am Main.
9. EIB.(2014). CESEE Bank Lending Survey.Vienna.
10. Espinoza, R. A., & Prasad, A. (2010). Nonperforming loans in the GCC banking system and their macroeconomic effects. *IMF Working Papers*, 1-24.
11. Klein N,. (2013). Non-Performing Loans in CESEE: Determinants and Impact on Macroeconomic Performance. *IMF Working Paper, European Department*.
12. Mahmudi C. (2013). Comparison between Macedonian and Albanian Retail Banking Sector. *International Journal of Academic Research in Accounting, Finance and Management Sciences, Vol. 3, No.3, July 2013, pp. 171–179*.
13. Moinescu B.G.,&Codirlaşu A. (2013). Lending, economic growth and nonperforming loans: empirical evidences from the new EU member states. *Working Paper, Project "PN-II-ID-PCE-2011-3-1054 - Uncertainty, Complexity and Financial Stability*.
14. Rajan R. and Dahl S.C. (2003). Non-performing Loans and Terms of Credit of Public Sector Banks in India: An Empirical Assessment. *Occasional Papers, 24:3 Reserve Bank of India*.

Ilija GRUEVSKI¹⁾
Stevan GABER²⁾

**CLASSICAL CORPORATION TAX SYSTEM: THE CLASSICAL
MODEL OF PURE “DOUBLE” TAXATION OF COMPANY’S
INCOME**

Abstract

The majority of experts agree that taxes are distortionary in nature. This is relatively true for all of the different groups of taxes, but for the corporate taxes is exceptionally obvious. Previously, we’ve managed to explain the distortive effects that arise from the isolated implementation of corporate taxes, a condition which assumes total abstraction of the personal taxes. In the article presented below, we introduce the personal taxes in our analysis as well, with intention to explore the investment decision from the shareholder’s point of view. With other words the intention is to analyze the effects from the integrated implementation of both, the corporate and the personal taxes, a phenomenon commonly referred as “double taxation”. For that purpose, we explore the properties of the Classical Corporation Tax System, which is widely considered as a classical example model of the pure “double” taxation of corporate income. The basic methodology utilized for the research is the EMTR (the effective marginal tax rate) and its analytical frame, which is additionally modified and extended to express the conditions that define the Classical Corporation Tax System. Hopefully, the investigation of the theoretic properties of this traditional approach in corporate taxation, will prove serious limitations

¹⁾ PhD, “Goce Delcev University” in Stip, Faculty of Economics, Republic of Macedonia, e-mail: ilija.gruevski@ugd.edu.mk.

²⁾ PhD, “Goce Delcev University” in Stip, Faculty of Economics, Republic of Macedonia, e-mail: stevan.gaber@ugd.edu.mk.

and distortions of the referred model, which are mainly concentrated in the field of corporate finance and the allocation criteria.

Keywords: corporate income tax, cost of capital, effective marginal tax rate, classical corporation tax, debt, new equity issues, double taxation.

JEL Classification Numbers: H25, H32, D92

Introduction

Recently, we've described and explained the distortions that usually arise from the isolated implementation of corporate taxes, a condition which assumes total abstraction of the personal taxes. In this article, we also include the personal taxes in our analysis, with intention to explore the investment decision, not only from the company's perspective, but from the shareholder's point of view as well, a condition commonly referred as "double taxation". This phenomenon is granted to fact that the corporate tax base (i.e. the corporate income) cannot be limited only at the corporation observed as a form of legal entity. Usually, under the Classical Corporation Tax regime, after the initial taxation at corporate level, corporate profits are distributed to the shareholders in a form of dividends, capital gains or interest payments, and are subject to additional taxation at personal level. The ultimate consequence of the referred phenomenon is imposition of an additional "extra" burden on total corporate profit expressed integrally from its source to its destination. In total, this "excessive" taxation of corporate profit is considered unfair and eventually leads to distortions of the economic activities of firms.

For example, it is a commonly known truth that borrowed capital is a superior source of finance from the taxpayer's point of view, as a result of the usual and widely excepted treatment of interest payments. In practice, since companies are allowed to deduct interest payments from their corporate income tax base, the system subsidizes the debt source finance in a manner that the action reduces the opportunity cost (the discount rate) of the debt-financed investment. This gives a certain advantage to the debt finance, since it is tax preferred in front of equity, which oppositely is fully taxed. The last triggers unfavourable behaviour of the company, to use more borrowed capital, thus increasing the risk of

bankruptcy and insolvency of the firm. The last presents the most common and typical distortion of corporate finance, induced by the traditional, “classical” treatment of corporate profit. But, the leading economic organizations such as the OECD, have made a break-through in the sphere of business taxation, proposing some alternative models of hybrid tax systems, that are much or less distinctive from the classical approach and more evenly allocate the burden across the different sources of finance.

The point of this article is not to discuss the relevant tax systems (the idea is preserved for some other occasions), but to identify, describe and elaborate the effects from corporate and personal taxes implemented parallel on earned unit of company’s income. For that purpose, we explore entirely the properties of the Classical Corporation Tax System at the moment, which is widely considered as a classical example model of the pure “double” taxation of corporate income and more importantly, employ it as a benchmark model for the function of measurement against the alternative systems intended to be analyzed in future.

1. Modifying the basic methodological frame

We pay our attention in this article, exclusively on the investments financed with new equity issues (external equity). As we know from business practice, equities could be found in 2 (two) fundamental forms: external equity (new equity issues), which provides the equity capital for the ongoing projects externally, through issues of the new company’s shares on the capital market; and retained earnings (retentions of profit), which are formed from the company’s accumulated (non-distributed) profit and are usually subject of reinvestment. The models of taxation discussed in this article, could be easily applied in the investment scenario covered with retained earnings as well, of course modified with its specific circumstances. With the purpose to achieve more detailed, systematic approach in exploration of the attributions and specificities of the models, we decided to study them separately, and dedicate this article only for the new equity finance. Other reasons for this are the limited space, minimizing the risk for confusion, and providing a better comparison of the effects. The basic methodology is consisted of the effective marginal tax rates analytical frame (EMTR), which is additionally modified and extended to express all newly occurred conditions that define “double” taxation of corporate profit.

To recall, according to Devereux & Griffith (1999, 2002, 2003), the effective marginal tax rate is defined as³:

$$[1] \quad \tilde{p} = \frac{(1-A)\{\rho + \delta(1+\pi) - \pi\}}{(1+\pi)(1-t)} - \frac{F(1+\rho)}{\gamma(1+\pi)(1-t)} - \delta$$

In order to isolate the pure effects that arise from the imposition of the code, as well as to simplify the calculation for the purpose of a better illustration of the effects, once again, we suggest the following assumptions: the net-present value of depreciation allowances is assumed 0 ($A = 0$), there is no inflation in the economy ($\pi = 0$, $\rho = r$), the rate of economic depreciation is assumed to be 0 ($\delta = 0$) and the real interest rate is positive ($r > 0$). If we consider the previous assumptions and label m^d as the personal tax rate on dividend income, z as the effective personal tax rate on capital gains, m^i as the personal tax rate on interest income and c as the tax credit rate allowed for dividends paid, then the tax discrimination variable requires the form of:

$$[2] \quad \gamma = \frac{(1-m^d)}{(1-z)(1-c)}$$

The shareholder's discount rate transforms to:

$$[3] \quad \rho = \left(\frac{1-m^i}{1-z} \right) r$$

And the general form of the cost of capital rearranges to:

$$[4] \quad \tilde{p} = \frac{\rho}{(1-t)} - \frac{F(1+\rho)}{\gamma(1-t)}$$

³ Detail elaboration of the referred methodology is shortened here, for the reason of limited space. More information could be found in: Gruevski I. (2013) "Corporate taxes and their potential effects on investments", Economic Development, Skopje.

Recognizing the fact that under existence of personal taxes, the financial constraints variable F^{NE} when the project is financed with new equities is measured as:

$$[5] \quad F^{NE} = -\frac{\rho(1-\gamma)}{(1+\rho)}$$

Derives a cost of capital for this alternative investment of:

[6]

$$\begin{aligned} \tilde{p} &= \frac{\rho}{(1-t)} - \frac{-\frac{\rho(1-\gamma)}{(1+\rho)}(1+\rho)}{\gamma(1+t)} = \frac{\rho}{(1-t)} - \frac{-\rho(1-\gamma)}{\gamma(1-t)} = \frac{\rho\gamma}{(1-t)\gamma} - \frac{(-\rho + \rho\gamma)}{(1-t)\gamma} = \\ &= \frac{\rho\gamma + \rho - \rho\gamma}{(1-t)\gamma} = \frac{\rho}{(1-t)\gamma} \end{aligned}$$

While under the same conditions, the financial constraints variable F^{DE} when the project is financed with debt:

$$[7] \quad F^{DE} = \frac{\gamma[\rho - r(1-t)]}{(1+\rho)}$$

Generates cost of capital for the debt-financed investment alternative of:

[8]

$$\begin{aligned} \tilde{p} &= \frac{\rho}{(1-t)} - \frac{\frac{\gamma[\rho - r(1-t)]}{(1+\rho)}(1+\rho)}{\gamma(1+t)} = \frac{\rho}{(1-t)} - \frac{[\rho - r(1-t)]}{(1-t)} = \frac{\rho - [\rho - r + rt]}{(1-t)} = \\ &= \frac{r - rt}{(1-t)} = \frac{r(1-t)}{(1-t)} = r \end{aligned}$$

Before we proceed, we'd like to refer to our main analytical tool, and that is, the investment tax wedge coefficient defined as $(\tilde{p} - r)$. Depending on the relation between the cost of capital \tilde{p} and the real

interest rate r , we can distinct 3 different conditions. The first condition is when the effective tax burden is positive ($\tilde{p} > r$) and as a result of that, the tax system depresses the investment activities. In terms of integrated taxation of company's income, this means that both, the economic rent and the normal return are effectively taxed. The second condition is when the effective tax burden is equal to 0 ($\tilde{p} = r$), when the tax system is neutral to the investment decision. In other words, under these conditions, the normal return of corporate profit is left from taxation and only the extra profit is being subject to taxation. And the third and the most preferable condition from the investor's point of view is when the effective tax burden is negative ($\tilde{p} < r$), when the tax system supports the overall investment. Here, the investment is being effectively „subsidized“ by the system, enabling the investor to legally escape from taxation a rate of return higher than the normal rate of return. In perfect economies without presence of taxes, the cost of capital is identical with the real interest rate ($\tilde{p} = r$) and the economic agents are completely indifferent between the investment decision and the decision to save. The existence of the national tax system diverges the difference between the cost of capital and the interest rate and therefore creates a positive tax wedge ($\tilde{p} > r$).

2. Recalling the effects from the corporate tax imposed individually on capital income

In order to create foundation for comparison and differentiation between the effects, in this section we briefly recall on the possible outcomes from the scenario where the corporate tax is solely applied on capital income. As it has been described, the isolated implementation of corporate income tax creates uneven distribution of the burden across the different sources of finance (see Table 2 from below). The investment tax wedge on the debt-financed investment is measured as:

$$[9] \quad \tilde{p} - r = 0$$

While for the equity-financed investment:

$$[10] \quad \tilde{p} - r = r \left[\frac{1}{(1-t)} - 1 \right]$$

Or if calculated farther:

$$[11] \quad \tilde{p} - r = \frac{rt}{(1-t)}$$

Usually, all equity-financed investments, regardless their form, are more discriminated against the investments covered with debt. The first ones are levied with an effective positive tax burden that is determined in proportion of the level of the corporate income tax rate t . At the other alternative, the zero burden on investment indicates on the presence of neutrality in taxation.

3. The Classical Corporation Tax System (CCT)

Now, we introduce in brief the so-called „classical“ approach in corporate taxation, which has been traditionally the most used and widely practiced form of corporate tax. Actually, the Classical System posts a true representation of what is known as „double“ taxation and a classical example of the pure separate taxation of corporate income. It will serve as a baseline model for comparison of the other systems discussed furtherly. So, what is the Classical Corporate Income Tax System?

Basically, the CCT is a rudimentary form of corporate tax that treats the corporate income in a conservative and fundamental way. It's a system of taxing companies in which the company is treated as a taxable entity separate from its own shareholders. The profits of companies under this system are therefore taxed twice, first when made by the company and again when distributed to the shareholders as dividends and capital gains. Formally, there is no integration at all between the corporate and the personal income tax under the CCT system. In the essence of the Classical Corporation Tax is double taxation of corporate income. Such a tax system discriminates against the incorporation of business ideas, restrains the supply of equity finance necessary for their economic utilisation, reallocates resources from the corporate sector to the unincorporated one and thus causes an efficiency loss to the whole economy (Harberger, 1962). The need to eliminate these drawbacks led to tax reforms aimed at integrating the taxation of corporations and their owners. (Kari and Yla-Liedenpohja, 2002: 1). So, how could we express the true nature of this typical form of corporate tax and illustrate the effects from it in terms of the proposed methodology?

Technically speaking 'A Classical System makes no allowance for "double" taxation', so the dividend income is subject to corporate income tax and is taxed again as personal income" (Devereux and Griffith, 1999:49). The authorities impose the corporate tax at the corporate level differently from the personal taxes at the stockholder level and at the same time do not allow any tax credit on dividend distributions ($c = 0$). Usually, the combination of the levels (percentage points) of the different tax rates falls under discretion of the policy maker. Considering this, we can identify the CCT system as $(t, m^d, m^i, z, c = 0)$.

CCT in debt-financed alternatives. It is easy recognized that the CCT produces a zero investment tax wedge variable if we take in account expression [8] from where we see that the cost of capital in this alternative is equal to the real interest rate:

$$[12] \quad \tilde{p} - r = r - r = 0$$

A conclusion is drawn that, if the overall integrated effect from the corporate and the personal tax is observed, in every case when the investment project is financed with external debt, the system will be neutral to the investment decision, *ceteris paribus*. The introduction of personal taxes do not affect these investments in a different way rather than the case of isolated application of the corporate tax, so it is evident that the „double“ taxation effect is not present here.

CCT in equity-financed alternatives. The implications of the conditions of the classical system in this alternative is initially found in parameters γ and ρ :

$$[13] \quad \gamma = \frac{(1 - m^d)}{(1 - z)(1 - c)} = \frac{(1 - m^d)}{(1 - z)} \text{ and } \rho = \left(\frac{1 - m^i}{1 - z} \right) r$$

Including these in term [6], the cost of capital will become:

$$[14] \quad \tilde{p} = \frac{\rho}{(1 - t)\gamma} = \frac{\frac{(1 - m^i)r}{(1 - z)}}{(1 - t)\frac{(1 - m^d)}{(1 - z)}} = \frac{(1 - m^i)r}{(1 - t)(1 - m_d)}$$

And finally the investment tax wedge will transform to:

$$[15] \quad \tilde{p} - r = \frac{(1 - m^i)r}{(1 - t)(1 - m^d)} - r = r \left[\frac{(1 - m^i)}{(1 - t)(1 - m^d)} - 1 \right]$$

Accordingly, in this case the effects from corporate taxation very often depend on the cross-effects from the personal taxation (Gruevski, 2013: 154). Expression [15] shows that the investment decision in this basic and most extended version of taxation of corporate income is determined largely from the inter-relation between the different personal tax rates (m^i and m^d) and the corporate tax rate t . It is also self-evident, as we can see from the absence of symbol z , that the effective personal tax rate on capital income is nonrelevant for the present model of taxation. The effect from „double“ taxation is quantified with the term $(1 - m^i)/(1 - t)(1 - m^d)$. Actually, it represents the combined corporate and personal income tax liability of the CCT, which may have variable values depending on the different dimensions of the relevant tax rates imposed by the code. For example, if we take the actual situation in Macedonia, where $m^i = 0\%$ (0,00), $m^d = 10\%$ (0,10) and $t = 10\%$ (0,10), the combined tax liability would be 0,2345 or 23,44% and with real interest rate of 10% (0,10) would yield an effective tax rate on investment of 0,0234 or 2,34%. If we assume that an interest income tax of 5% has been introduced lately $m^i = 5\%$ (0,05), then the combined tax liability would be 0,1728 or 17,28%, producing an effective tax rate on investment of 0,0172 or 1,72%. On the other hand, if the corporate and the dividend tax are increased on 20% $t = m^d = 20\%$ (0,20) and $m^i = 0\%$ (0,00), it is obvious that the investment tax wedge will additionally increase even on 0,0562 or 5,62%. In the following Table 1 some possible combinations of the relevant tax rates and the possible outcomes are presented and interpreted in terms of the investment tax wedge coefficient.

Table 1: Illustration of the possible combinations of tax rates and their effects on investment under the CCT system

Possible combination of tax rates	Example	Investment tax wedge ($p^* - r$)	Effects on equity – financed investment	Effects on normal return and economic rent	Effects on corporate finance	Effects on efficiency (allocation criteria)
$t = m^d = m^i$	10%, 10%, 10%	1,11%	limiting	normal return and rent taxed	favors debt	distortive
$t > m^d = m^i$	20%, 10%, 10%	2,50%	limiting	normal return and rent taxed	favors debt	distortive
$t > m^d > m^i$	30%, 20%, 10%	6,07%	limiting	normal return and rent taxed	favors debt	distortive
$t > m^d < m^i$	20%, 10%, 28%	0,00%	indifference	rent taxed only	indifferent	neutral
$t > m^d < m^i$	10%, 5%, 30%	-1,81%	stimulative	subsidized	favors equity	distortive
$t = m^d > m^i$	20%, 20%, 10%	4,06%	limiting	normal return and rent taxed	favors debt	distortive
$t = m^d < m^i$	10%, 10%, 19%	0,00%	indifference	rent taxed only	indifferent	neutral
$t = m^d < m^i$	10%, 10%, 30%	-1,36%	stimulative	subsidized	favors equity	distortive
$t = m^d = 0, m^i$	0%, 0%, 10%	-1,00%	stimulative	subsidized	favors equity	distortive
$t = m^d, m^i = 0$	10%, 10%, 0%	2,34%	limiting	normal return and rent taxed	favors debt	distortive
$t = m^i, m^d = 0$	10%, 10%, 0%	0,00%	indifference	rent taxed only	indifferent	neutral
$t = 0, m^i = m^d$	0%, 10%, 10%	0,00%	indifference	rent taxed only	indifferent	neutral
$t = m^d = m^i = 0$	0%, 0%, 0%	0,00%	indifference	rent taxed only	indifferent	neutral

Source: Author's calculations and interpretations

Of course, the Classical System of Corporation Tax could produce in theory some favourable outcomes, despite its infamous reputation. As we can see from the Table, an increase in corporate and dividend tax will generally increase liabilities and the burden on investment, while an increase in interest income tax will decrease tax obligations and vice versa. If the combined liability of the corporate and the dividend tax from the denominator is higher than the interest tax liability from the

nominator, the investment tax wedge will be positive, with limiting, distortive effects on the equity-financed investment. If this combined liability is equal to the interest tax liability, regardless the level of the mandatory tax rates, the system will be neutral and indifferent concerning the investment decision.⁴ And in the third option, every time when the combined liability is less than the nominator, with no respect to the level of tax rates, the system will create favourable conditions, stimulating the equity-financed investments through subsidization of the normal rate of the return. Usually, the authorities avoid the last condition in order to escape any additional refunds, and the second one is unlikely to be found also. The circumstance that sustains a positive tax burden, actually represents a reflection of what is known as a true CCT system. So, the Classical Corporation Tax assumes a positive (non-zero) tax rates with a corporate income tax and a dividend income tax equal or higher than the interest income tax and a right to the company to deduct the interest payments from the corporate income tax base.

We may conclude that the CCIT as we know it, produces in total, the highest amount of taxes paid on a single unit of corporate profit, entails double taxation, and possess a large distortive potential on corporate finance, but as mentioned, only if the interest payments are being continuously deductible from the tax base and the tax rates met with the appropriate specifications. Under the conditions of Classical System, the normal return and the extra profit at its source and its destination are effectively streamed by the means of taxing regime. But if we put aside these limitations, certain advantages open some new frontiers and possibilities for the CCT. For instance, the incorporated principle of CCT for separate and independent taxation of company's income enables the corporate tax from the first stage to act as a withholding barrier for the personal taxes imposed in the second stage. Another positive attribution is the simple tax structure. The CCT's in-built simplicity without any complex rules for exempting flow-throughs of capital income raised the idea for the Classical Corporation Tax as a global mean of tax harmonization in an international context. These present only a handful of the positive features of CCT acknowledged from the literature (for more see Kari and Yla-Liedenpohja, 2002).

At the finishing point, the effects from taxation on investment performance are summarized in Table 2, and the qualitative attributions of the analyzed basic model tax systems are given in Table 3.

⁴ A positive burden can occur even when the relevant tax rates are identical ($t = m^d = m^i$), a situation which is else known as „Flat Tax Rate System“ (see Row 2 from Table 1).

Table 2: The effects from taxation on investment performance

Only corporate taxes	Investment tax wedge ($\tilde{p} - r$)
<i>Debt</i>	0
<i>New equity issues</i>	$r \left[\frac{1}{(1-t)} - 1 \right] \text{ or } \frac{rt}{(1-t)}$
Classical Corporation Income Tax System (CCIT)	
<i>Debt</i>	0
<i>New equity issues</i>	$r \left[\frac{(1-m^i)}{(1-t)(1-m^d)} - 1 \right]$

Source: Summary and review of author's calculations

Table 3: Summary of qualitative attributions of the basic model of Classical Corporation Tax

Model of tax system	Effects on debt finance	Effects on new equity finance	Effects on economic rent	Effects on normal return	Withholding function criteria	Location - specific criteria	Overall allocation criteria
<i>CCT</i>	favors	discriminates	taxed	taxed	withholds rents and normal return	source & residence based	distortive

Source: Author's interpretations

Conclusion

In this article, we explored the investment decision from the shareholder's point of view under the terms that define the Classical Corporation Tax System. The goal was to analyze the effect from the integrated implementation of both, the corporate and the personal taxes, a phenomenon commonly referred as "double taxation". Actually, the CCT is a system of taxing companies in which the company is treated as a taxable entity separate from its own shareholders. The profits of companies under this system are therefore taxed twice, first when made by the company and again when distributed to the shareholders as

dividends and capital gains. The consequence is imposition of “extra” burden on total corporate profit from its source to its destination. This effect is due to the combined corporate and personal income tax liability, which may have variable values depending on different dimensions of the relevant tax rates imposed by the code. Generally, an increase in corporate and dividend tax will increase liabilities and the burden on investment, while an increase in interest income tax will decrease tax obligations and *vice versa*. In total, this “excessive” taxation of corporate profit is considered unfair and eventually leads to distortions of the economic activities of firms. The distortion of corporate finance presents the most common and typical limitation of the “classical” treatment of corporate profit, which encourages over optimal usage of debt on the account of equity. At the finishing line, we may conclude that the CCIT as we know it, produces in total, the highest amount of taxes paid on a single unit of corporate profit, entails double taxation, and possess a large distortive potential on corporate finance, triggering recently a wave of reforms aimed at integrating the taxation of corporations and their owners.

References:

1. Brys B., Heady C. (2007) “*Fundamental reform of corporate income tax in OECD countries*”, A tax policy study, Paris;
2. Corporate Income Tax Code of the RM;
3. Department of the U.S. Treasury (1992) “*Integration of the individual and corporate tax systems, Taxing business income once*”, Washington D.C;
4. Devereux M.P., Griffith R. (1999) “*The taxation of discrete investment choices*”, The institute of fiscal studies, Warwick University;
5. Devereux M.P., Griffith R., Klemm A. (2002) “*Corporate Income Tax Reforms and International Tax Competition*”, Economic Policy publications, no. 35;
6. Devereux, M.P., Griffith R. (2003) “*Evaluating tax policy for location decisions*”, International Tax and Public Finance, 2003;
7. Gruevski I. (2013) “*Corporate taxes and their potential effects on investments*”, Economic Development, Skopje;
8. Harberger A.C. (1962) “*The Incidence of the corporation income tax*”, Journal of Political Economy, University of Chicago press;

9. Institute for Fiscal Studies (1991) *“Equity for companies: a corporation tax for the 1990s”*, Fourth report of the IFS Capital Taxes Group, London;
10. Kari S., Yla-Liedenpohja J. (2002) *“Classical corporation tax as a global means of tax harmonization”*, CESifo working paper, Munich;
11. Leibfritz W., Thornton J., Bibbie A. (1997) *“Taxation and economic performance”* An OECD study;
12. Ministry of finance of the RM;
13. OECD (2004) *“Recent tax policy trends and reforms in OECD countries”*, A tax policy study, Paris;
14. OECD (2007) *“Fundamental corporate tax reform”*, A tax policy study, Paris;
15. Personal Income Tax Code of the RM;

UDC 332.14.053.2(497.7)
Original scientific paper

Nikolche JANKULOVSKI*)

**DISPARITIES AMONG REGIONS AND THE REGIONAL
DEVELOPMENT – CASE OF REPUBLIC OF MACEDONIA**

Abstract

The main objective of this research paper is to indicate the disparities between regions in direction of encouraging and developing balanced regional development of the Republic of Macedonia. For the purpose of this research comparative analysis of the condition of the economic development of Local Government Units of Republic of Macedonia is being conducted. The procedure for sample selection was based on principle for making regional representative sample, which will define the region in accordance to its definition by the State Statistical office of the Republic of Macedonia.¹ According to data base, which is made on basis of the following indicators: GDP per capita at municipal level, number of citizens in the municipality, size of the territory of the municipality and number of settlements that gravitate towards the municipality, there are 22 municipalities² in the realized total sample, from each planning region in the country, representing 30% of the municipalities from each planning region. For the purpose of the reasearch comparative analysis of the conditions in the Local Government Unitsis being conducted. The analysis of the indicators that refer to economic – social index (total incomes in terms of GDP, total

*) Ph.D., University St. Kliment Ohridski – Bitola, Republic of Macedonia,
e-mail: nikolcejankulovski@yahoo.com

¹ NUTS 3 – Republic of Macedonia is divided in eight planning regions: Vardar, Eastern, Southwestern, Southeastern, Pelagonija, Polog, Northeastern and Skopje planning region

² Vardar region (Veles, Kavadarci and Caska), Eastern region (Stip, Probistip and Berovo), Southwestern region (Kicevo, Makedonski Brod and Oslomej), Southeastern region (Stumica, Valandovo and Dojran), Pelagonija region (Bitola, Prilep and Demir Hisar), Polog region (Gostivar and Bogovinje), Northeastern region (Kumanovo and Kratovo) and Skopje region (Centar, Kisela Voda and Saraj).

expenses in terms of GDP), analysis of financial capacity of municipalities in Republic of Macedonia (capacity and structure of original incomes, capacity and structure of budget transfers and donations, participation of municipalities' original incomes in the total budget revenue) shall be presented in this thesis, and a matrix of indicators for incomes and expenses per planning region will be presented.

Key words: Plan regions, Republic of Macedonia, Planning, Financial instruments, Economic development

JEL Classification: R11, R12

1. Determining criteria for research realization

Criteria for determining municipalities which represent the sample for examining the fiscal indicators and indicators for expenses, were created for processing of data that are necessary for measuring the unevenness in the development of planning regions. The criteria that are the base of the research and data processing from all 84 municipalities in the Republic of Macedonia, are following:

a) Number of citizens in the municipality (large municipalities - over 50.000 citizens, middle municipalities from 10.000 to 50.000 citizens and small municipalities - below 10,000 citizens);

b) Number of settlements that gravitate towards the municipality (large municipalities - over 50 settlements, middle municipalities – from 10 to 50 settlements and small municipalities - less than 10 settlements);

c) Size of the territory of the municipality (large municipalities - above 780 km², middle municipalities from 390 to 780 km² and small municipalities - below 390 km²).

d) Level of gross domestic product per capita in the municipality (large municipalities from 35060,30 to 51405,80 MKD per capita, middle municipalities – from 18714,70 to 35060,29 MKD per capita and small municipalities – from 2369,00 to 18714,69 MKD per capita) and

e) At least one Local Government Unit from each planning region must be rural municipality.

According to presented data from the detail review, in the representative sample there are 30 % from total number of municipalities that meet the criteria, separately from each planning region. Vardar

planning region – three from nine municipalities, Eastern planning region – 3 from 11 municipalities, Southwestern planning region – 3 from 11 municipalities, Southeastern planning region – 3 from 9 municipalities, Pelagonija planning region – 3 from nine municipalities, Polog planning region – 2 from 8 municipalities, Northeastern planning region – 2 from 7 municipalities and Skopje planning region – 3 from 11 municipalities.

2. Analysis of total budget revenue and expenses in terms of gross domestic product per purchasing power parity in local government units

The basic two indicators in all Local Government Units in the Republic of Macedonia are incomes and expenses. These two indicators are broken down into a number of sub-indicators, according to the official classification of revenue and expense items of Local Government in Republic of Macedonia.

One of the most commonly used and recognizable methods for determining the level of fiscal decentralization in almost every developed country is participation of total incomes and expenses of Local Government Units in the gross domestic product of each country. The total incomes and expenses from all Local Government Units of Republic of Macedonia, processed from LGU's concluding sheets, i.e. their percentage share in GDP per PPP of municipality in MKD.

Table 1. Budget revenue in terms of GDP per planning regions for 2010, 2011 and 2012

REALIZATION PER YEAR	2010	2011	2012
Vardar region			
Veles	1,10%	3,20%	4,40%
Kavadarci	4,30%	4,60%	6,00%
Caska	1,40%	3,90%	4,60%
Eastern region			
Stip	1,30%	3,90%	5,80%
Probistip	1,80%	3,40%	6,30%
Berovo	4,70%	4,20%	4,80%
Southwestern region			
Kicevo	3,60%	4,30%	5,90%
Makedonski brod	2,20%	4,90%	13,60%
Oslomej	2,90%	3,00%	3,50%
Southeastern region			
Strumica	5,60%	4,80%	6,30%
Valandovo	4,60%	3,90%	3,60%
Dojran	6,20%	6,20%	11,50%
Pelagonija region			
Bitola	4,00%	4,00%	4,80%
Prilep	3,70%	3,90%	4,70%
Demir Hisar	3,60%	3,80%	4,60%
Polog region			
Gostivar	0,90%	3,50%	4,20%
Bogovinje	1,60%	1,90%	1,80%
Northeastern region			
Kumanovo	3,80%	3,90%	4,00%
Kratovo	2,30%	3,60%	6,10%
Skopje region			
Centar	7,80%	11,30%	19,40%
Kisela Voda	3,10%	3,40%	5,20%
Saraj	2,40%	0,60%	1,30%

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia

Table 2. Budget expenses in terms of GDP, per planning regions for 2010, 2011 and 2012

REALIZATION PER YEAR	2010	2011	2012
Vardar region			
Veles	1,00%	3,20%	4,40%
Kavadarci	4,00%	4,50%	6,00%
Caska	1,30%	3,90%	4,60%
Eastern region			
Stip	1,20%	3,90%	5,80%
Probistip	1,70%	3,40%	6,30%
Berovo	4,40%	4,20%	4,80%
Southwestern region			
Kicevo	3,50%	4,30%	5,90%
Makedonski brod	2,20%	4,90%	13,60%
Oslomej	2,70%	3,00%	3,50%
Southeastern region			
Strumica	5,50%	4,80%	6,30%
Valandovo	4,00%	3,80%	3,60%
Dojran	5,40%	5,80%	11,50%
Pelagonija region			
Bitola	3,70%	3,90%	4,80%
Prilep	1,20%	3,80%	4,70%
Demir Hisar	3,50%	3,70%	4,60%
Polog region			
Gostivar	0,90%	3,30%	1,40%
Bogovinje	1,80%	1,70%	1,10%
Northeastern region			
Kumanovo	3,70%	3,80%	3,90%
Kratovo	2,30%	3,60%	6,10%
Skopje region			
Centar	6,60%	9,90%	19,10%
Kisela Voda	2,00%	3,20%	5,70%
Saraj	2,30%	0,60%	1,30%

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia

From the analysis, it can be ascertained that in the analyzed period, there is an increase of local incomes and expenses in Republic of Macedonia. This is a result of increasing the tax base and improving the municipality tax payment (total incomes), that is the increase of

competences from central to local level, without appropriate level of transfers for their financing (total expenses).

3. Analysis of indicators of incomes and indicators of expenses per planning regions

The presented analysis of the characteristics for development of planning regions provides insight in the existing condition into a number of segments significant for regional development. Starting from the big disparities between the planning regions development, the focus in the analysis is put on interregional differences. The identification of disparities and wherever possible - the reasons for their occurrence, is made in order to obtain solid base for planning the regional development.

3.1. Vardar planning region

According to previously determined criteria for research realization, the municipalities Veles, Kavadarci and Caska were subject of research in Vardar planning region.

In the analyzed period, there is a small increase in participation of tax incomes in total incomes, excluding rural municipalities (Caska), which indicates the fact that urban municipalities from Vardar planning region are in condition to generate increased level of tax incomes, which is a result of increasing the range of tax base, as well as the influence of increased fiscal effort due to transfer of competences from local to central level.

In the balance of current operating activities in terms of current operating expenses negative values are noted, which represents absence of credit potential of Local Government Units from this planning region for taking credit liabilities (borrowings).

Excluding rural municipalities, Vardar planning region also notes increase of capital expenses in terms of level of accomplishment of current operating expenses. This indicates high level of realization of financial resources intended for capital projects. This indicator indicates nearly same engagement of financial resources for current operating purposes, as for realization of capital projects. This is sufficient ascertainment for the commitment of Vardar planning region in the realization of capital projects.

Table 3. Indicators of incomes and indicators of expenses, Vardar planning region, 2010, 2011 and 2012

REGION	VARDAR REGION								
CITY	VELES			KAVADARCI			CASKA		
REALIZATION PER YEAR	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %
Indicators of incomes									
Tax incomes / total incomes	16,30	17,80	22,70	18,70	21,50	21,30	27,60	10,30	12,70
Donations/ total incomes	0,00	0,00	0,00	0,50	0,00	0,00	0,00	0,00	0,00
Tax incomes / other personal incomes	85,00	70,90	65,50	58,70	55,90	47,50	78,50	53,30	51,50
Indicators of expenses									
Current operating balance/ current operating expenses	-63,80	-73,20	-57,30	-59,20	-50,90	-33,60	-58,70	-82,60	-77,30
Capital expenses / current operating expenses	16,40	6,20	23,60	19,50	26,7	48,30	21,10	4,90	6,50
Capital expenses / total budget expenses	9,00	5,80	19,00	16,30	21,10	32,50	17,00	4,60	6,00
LGU capital expenses per capita /capital expenses of central budget per capita	36,10	18,20	55,80	80,20	94,20	130,10	28,20	18,10	18,40

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia.

Analyzing the balance of capital expenses in terms of total budget expenses, it can be ascertained that the level of investing activity of municipalities from this region is relatively stable. This condition is a result of increased budget expenses in the analyzed period.

3.2. Eastern planning region

According to previously determined criteria for research realization, the municipalities Stip, Probistip and Berovo were subject of research in Eastern planning region.

Regarding the tax incomes in terms of total incomes, certain flexibility of this trend is noticed. This indicates the fact that bigger Local Government Units from Eastern planning region are in condition to generate stable level of tax incomes, which is a result of increased tax base, as well as the influence of increased fiscal effort due to transfer of competences from local to central level.

In the balance of current operating activities in terms of current operating expenses negative values are noted, which represents absence of credit potential of Local Government Units from this planning region for taking credit liabilities (borrowings).

Eastern planning region also notes increase of capital expenses in terms of level of accomplishment of current operating expenses. This indicates high level of realization of financial resources intended for capital projects. This indicator indicates nearly same engagement of financial resources for current operating purposes, as for realization of capital projects. This is sufficient ascertainment for the commitment of Vardar planning region in the realization of capital projects.

Analyzing the balance of capital expenses in terms of total budget expenses, it can be ascertained that the level of investing activity of municipalities from this region is relatively stable. This condition is a result of increased budget expenses in the analyzed period.

Table 4. Fiscal indicators and indicators of expenses,
Eastern planning region, 2010, 2011 and 2012

REGION	EASTERN REGION								
CITY	STIP			PROBISTIP			BEROVO		
REALIZATION PER YEAR	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %
Indicators of incomes									
Tax incomes / total incomes	24,1	26,30	29,11	23,10	12,90	12,80	11,30	10,80	11,50
Donations/ total incomes	0	1,4	2,10	5,90	0,00	4,10	7,20	5,00	6,60
Tax incomes / other personal incomes	87,40	78,60	73,60	50,10	39,70	26,60	72,90	67,50	57,40
Indicators of expenses									
Current operating balance/ current operating expenses	-59,50	-63,30	-46,00	-35,50	-64,60	-26,60	-79,50	-81,20	-76,20
Capital expenses / current operating expenses	7,80	9,10	27,00	31,40	16,40	35,70	19,00	15,60	16,00
Capital expenses / total budget expenses	11,5	10,00	37,10	45,70	19,60	55,70	23,50	18,50	19,10
LGU capital expenses per capita /capital expenses of central budget per capita	34,10	34,60	105,2	66,40	54,30	151,40	101,1	64,20	51,60

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia.

4.3. Southwestern planning region

According to previously determined criteria for research realization, the municipalities Kicevo, Makedonski Brod and Oslomej were subject of research in Southwestern planning region.

In the analyzed period, there is a small increase in participation of tax incomes in total incomes (at bigger municipalities), which indicates the fact that urban municipalities from Southwestern planning region are in condition to generate increased level of tax incomes, which is a result of increasing the range of tax base, as well as the influence of increased fiscal effort due to transfer of competences from local to central level.

In the balance of current operating activities in terms of current operating expenses negative values are noted, which represents absence

of credit potential of Local Government Units from this planning region for taking credit liabilities (borrowings).

Excluding rural municipalities, Southwestern planning region also notes increase of capital expenses in terms of level of accomplishment of current operating expenses. This indicates high level of realization of financial resources intended for capital projects. This indicator indicates nearly same engagement of financial resources for current operating purposes, as for realization of capital projects. This is sufficient ascertainment for the commitment of Southwestern planning region in the realization of capital projects.

Analyzing the balance of capital expenses in terms of total budget expenses, it can be ascertained that they are increased, which indicates increase of the level of investing activity of municipalities from this region. This condition is a result of increased budget expenses in the analyzed period.

Table 5. Fiscal indicators and indicators of expenses, Southwestern planning region, 2010, 2011 and 2012

REGION	SOUTHWESTERN PLANNING REGION								
CITY	KICEVO			MAKEDONSKI BROD			OSLOMEJ		
REALIZATION PER YEAR	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %
Indicators of incomes									
Tax incomes / total incomes	21,10	24,90	20,20	20,60	10,00	6,30	7,50	8,40	10,70
Donations/ total incomes	0	0,40	0,20	0,00	0,00	27,50	0,00	0,00	0,00
Tax incomes / other personal Incomes	63,90	77,10	76,50	41,50	52,70	27,40	52,90	52,60	58,30
Indicators of expenses									
Current operating balance/ current operating expenses	-61,50	-61,10	-66,40	-26,20	-79,30	-46,10	-83,20	-79,90	-76,80
Capital expenses / current operating expenses	13,60	16,30	22,70	30,40	8,10	58,30	12,30	19,90	22,30
Capital expenses / total budget expenses	15,70	19,50	29,70	43,70	8,80	139,90	14,10	24,90	28,90
LGU capital expenses per capita /capital expenses of central budget per capita	58,30	69,60	89,80	79,40	38,80	532,40	40,90	59,30	52,00

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia

4.4. Southeastern planning region

According to previously determined criteria for research realization, the municipalities Strumica, Valandovo and Dojran were subject of research in Southeastern planning region.

In the analyzed period, there is relatively stable participation of tax incomes in total incomes, excluding rural municipalities, which indicates the fact that urban municipalities from Southeastern planning region are in condition to generate increased level of tax incomes, which is a result of increasing the range of tax base, as well as the influence of increased fiscal effort due to transfer of competences from local to central level.

In the balance of current operating activities in terms of current operating expenses negative values are noted, which represents absence of credit potential of Local Government Units from this planning region for taking credit liabilities (borrowings).

Excluding rural municipalities, Southeastern planning region also notes small increase of capital expenses in terms of level of accomplishment of current operating expenses. This indicates good level of realization of financial resources intended for capital projects. This indicator indicates nearly same engagement of financial resources for current operating purposes, as for realization of capital projects. This is sufficient ascertainment for the commitment of this planning region in the realization of capital projects.

Analyzing the balance of capital expenses in terms of total budget expenses, it can be ascertained that the level of investing activity of municipalities from this region is relatively stable. This condition is a result of increased budget expenses in the analyzed period.

Table 6. Fiscal indicators and indicators of expenses, Southeastern planning region, 2010, 2011 and 2012

REGION	SOUTHEASTERN REGION								
CITY	STRUMICA			VALANDOVO			DOJARAN		
REALIZATION PER YEAR	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %
Indicators of incomes									
Tax incomes / total incomes	28,10	27,8	28,90	9,40	14,00	12,30	30,80	31,90	24,80
Donations/ total Incomes	0,9	0,2	0,60	2,60	0,00	0,30	0,60	9,70	26,70
Tax incomes / other personal Incomes	58,2	67,7	62,20	42,40	64,90	66,80	83,30	71,70	67,60
Indicators of expenses									
Current operating balance/ current operating expenses	-26,00	-46,40	-29,70	-71,50	-76,10	-78,30	-40,80	-29,20	-38,90
Capital expenses / current operating expenses	33,30	23,50	34,00	13,50	10,00	15,40	27,80	32,50	40,10
Capital expenses / total budget expenses	50,1	30,7	51,70	15,70	11,10	18,20	38,60	48,10	67,30
LGU capital expenses per capita /capital expenses of central budget per capita	222,5	110,3	143,8	13,70	7,80	37,20	181,3	186,7	310,5

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia

4.5. Pelagonija planning region

According to previously determined criteria for research realization, the municipalities Bitola, Prilep and Demir Hisar were subject of research in Pelagonija planning region.

In the analyzed period, there is small increase of participation of tax incomes in total incomes, excluding rural municipalities, which indicates the fact that urban municipalities from Pelagonija planning region are in condition to generate increased level of tax incomes, which is a result of increasing the range of tax base, as well as the influence of increased fiscal effort due to transfer of competences from local to central level.

In the balance of current operating activities in terms of current operating expenses negative values are noted, which represents absence of credit potential of Local Government Units from this planning region for taking credit liabilities (borrowings).

Pelagonija planning region also notes small increase of capital expenses in terms of level of accomplishment of current operating expenses. This indicates high level of realization of financial resources intended for capital projects. This indicator indicates nearly same engagement of financial resources for current operating purposes, as for realization of capital projects. This is sufficient ascertainment for the commitment of this planning region in the realization of capital projects.

Analyzing the balance of capital expenses in terms of total budget expenses, it can be ascertained that the level of investing activity of municipalities from this region is relatively stable. This condition is a result of increased budget expenses in the analyzed period.

Table 7. Fiscal indicators and indicators of expenses, Pelagonija planning region, 2010, 2011 and 2012

REGION	PELAGONIJA REGION								
CITY	BITOLA			PRILEP			DEMIR HISAR		
REALIZATION PER YEAR	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %
Indicators of incomes									
Tax incomes / total incomes	22,90	26,10	32,20	18,20	22	27,50	9,90	14,90	12,30
Donations/ total Incomes	0,90	0,70	1,10	0,00	0,00	0,00	0,10	1,60	0,30
Tax incomes / other personal Incomes	77,90	71	65	86,90	69,50	62,40	74,10	75,90	66,80
Indicators of expenses									
Current operating balance/ current operating expenses	-59,70	-52,40	-33,60	38,50	-59,70	-41,20	-76,30	-79,50	-78,30
Capital expenses / current operating expenses	21,40	19,70	27,50	51,00	15,80	25,40	3,70	4,10	15,40
Capital expenses / total budget expenses	27,20	24,60	37,90	105,2	24,20	34,20	3,90	4,30	18,20
LGU capital expenses per capita /capital expenses of central budget per capita	96,60	75,60	88,50	71,60	72,60	79,30	16,00	15,30	47,00

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia

4.6. Polog planning region

According to previously determined criteria for research realization, the municipalities Gostivar and Bogovinje were subject of research in Polog planning region.

Table 8. Fiscal indicators and indicators of expenses, Polog planning region, 2010, 2011 and 2012

REGION	POLOG REGION					
CITY	GOSTIVAR			BOGOVINJE		
REALIZATION PER YEAR	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %
Indicators of incomes						
Tax incomes /total incomes	21,80	23,80	29,10	1,60	1,90	2,00
Donations/ total incomes	0	0,90	1,50	0,00	0,00	0,00
Tax incomes / other personal incomes	88,00	87,90	90,30	44,00	54,70	66,90
Indicators of expenses						
Current operating balance/ current operating expenses	66,50	-66,90	68,80	-80,90	-67,70	-62,40
Capital expenses / current operating expenses	43,20	13,60	38,90	9,80	7,20	15,30
Capital expenses / total budget expenses	76,50	15,80	67,60	15,70	11,20	18,20
LGU capital expenses per capita /capital expenses of central budget per capita	47,30	44,30	35,60	20,70	11,80	11,30

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia.

In the analyzed period, there is a small increase in participation of tax incomes in total incomes, which indicates the fact that urban municipalities from Polog planning region are in condition to generate increased level of tax incomes, which is a result of increasing the range of tax base, as well as the influence of increased fiscal effort due to transfer of competences from local to central level.

In the balance of current operating activities in terms of current operating expenses an increase is noted, which represents good credit potential of Local Government Units from this planning region for taking credit liabilities (borrowings).

Polog planning region notes flexibility of capital expenses in terms of level of accomplishment of current operating expenses. This

indicates good level of realization of financial resources intended for capital projects. This indicator indicates same engagement of financial resources for current operating purposes, as for realization of capital projects. This is sufficient ascertainment for the commitment of this planning region in the realization of capital projects.

Analyzing the balance of capital expenses in terms of total budget expenses, it can be ascertained that the level of investing activity of municipalities from this region is relatively stable. This condition is a result of increased budget expenses in the analyzed period.

4.7. Northeastern planning region

According to previously determined criteria for research realization, the municipalities Kumanovo and Kratovo were subject of research in Northeastern planning region.

In the analyzed period, there is an increase in participation of tax incomes in total incomes, excluding rural municipalities, which indicates the fact that urban municipalities from Northeastern planning region are in condition to generate increased level of tax incomes, which is a result of increasing the range of tax base, as well as the influence of increased fiscal effort due to transfer of competences from local to central level.

In the balance of current operating activities in terms of current operating expenses, except at bigger municipality centers, an upward trend is noted, which represents good credit potential of Local Government Units from this planning region for taking credit liabilities (borrowings), while in rural municipalities this indicator notes downward trend, which indicates absence of credit potential.

Northeastern planning region notes flexibility of capital expenses in terms of level of accomplishment of current operating expenses. This indicates good level of realization of financial resources intended for capital projects. This indicator indicates same engagement of financial resources for current operating purposes, as for realization of capital projects. This is sufficient ascertainment for the commitment of this planning region in the realization of capital projects.

Table 9. Fiscal indicators and indicators of expenses, Northeast planning region, 2010, 2011 and 2012

REGION	NORTHEAST REGION					
CITY	KUMANOVO			KRATOVO		
REALIZATION PER YEAR	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %
Indicators of incomes						
Tax incomes /total incomes	22,10	23,90	44,50	13,50	8,80	5,30
Donations/ total incomes	0	0,10	0,00	0,00	0,30	2,30
Tax incomes / other personal incomes	78,20	80,20	74,80	72,60	63,20	48,10
Indicators of expenses						
Current operating balance/ current operating expenses	-66,30	-64,20	-7,30	-38,50	-85,60	-82,00
Capital expenses / current operating expenses	14,30	15,90	40,80	69,50	5,00	39,90
Capital expenses / total budget expenses	16,70	18,90	72,10	229,30	5,30	66,70
LGU capital expenses per capita /capital expenses of central budget per capita	63,20	60,20	88,00	193,70	17,60	162,30

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia.

Analyzing the balance of capital expenses in terms of total budget expenses, it can be ascertained that the level of investing activity of bigger municipalities is relatively stable, while at smaller municipalities this indicator indicates decrease of investing activity.

4.8. Skopje planning region

According to previously determined criteria for research realization, the municipalities Centar, Kisela Voda and Saraj were subject of research in Skopje planning region.

In the analyzed period, there is flexibility in participation of tax incomes in total incomes, excluding rural municipalities, which indicates

the fact that urban municipalities from Skopje planning region are in condition to generate increased level of tax incomes, which is a result of increasing the range of tax base, as well as the influence of increased fiscal effort due to transfer of competences from local to central level.

Skopje planning region also notes increase of capital expenses in terms of level of accomplishment of current operating expenses. This indicates high level of realization of financial resources intended for capital projects. This indicator indicates nearly same engagement of financial resources for current operating purposes, as for realization of capital projects. This is sufficient ascertainment for the commitment of this planning region in the realization of capital projects.

Analyzing the balance of capital expenses in terms of total budget expenses, an increase can be ascertained, which indicates increase of investing activity level of municipalities in this region. This condition is a result of increased budget expenses in the analyzed period.

Table 10. Fiscal indicators and indicators of expenses, Skopje planning region, 2010, 2011 and 2012

REGION	SKOPJE REGION								
CITY	CENTAR			KISELA VODA			SARAJ		
REALIZATION PER YEAR	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %	2010 in %	2011 in %	2012 in %
Indicators of incomes									
Tax incomes / total incomes	25,70	27,20	18,40	28,60	35,50	49,90	9,60	49,60	54,90
Donations/total incomes	0	0,00	0,00	0,00	0,20	0,00	2,80	1,20	0,00
Tax incomes / other personal incomes	74,60	87,70	61,20	72,80	76,60	74,80	90,10	88,20	87,60
Indicators of expenses									
Current operating balance/ current operating expenses	180,3	164,1	12,20	-12,50	-34,90	-8,30	-87,80	19,90	38,90
Capital expenses / current operating expenses	52,80	86,60	77,90	29,50	24,40	41,60	11,50	51,10	53,90
Capital expenses / total budget expenses	431,6	652,8	355,1	42,00	32,40	72,10	13,10	108,1	123,5
LGU capital expenses per capita /capital expenses of central budget per capita	651,6	850,2	998,4	70,70	76,70	159,10	31,70	28,40	46,40

Source: Own processing based on official data from the State Statistical Office of Republic of Macedonia and Finance Departments in all Local Government Units in Republic of Macedonia.

4. Matrix of indicators of incomes and expenses per planning regions

According to previously made analysis of indicators of incomes and expenses at Local Government Units from the planning regions, it can be ascertained that at bigger municipalities there is increase of tax incomes in each planning regions, total incomes of municipalities, which is a result of increased range of tax base, thus charging the tax incomes. According to the analysis, there is absence of credit potential in large part of the regions, considering the ascertained negative values of the indicator current operative balance on current operating activities, excluding Skopje planning region, wherein upward trends of this indicator are noted.

The municipalities from the planning regions, also note increase of capital expenses in terms of the level of accomplishment of current operating expenses. That indicates the fact that there is high level of realization of financial assets intended for capital projects. This is the case in larger municipalities from the planning regions.

From the analysis of the balance of capital expenses in terms of total budget expenses, it can be ascertained that the level of investing activity in bigger municipalities from the planning regions is relatively stable.

Conclusion

The regional policy has special place in the development of national economies and economic integrations. The implementation of this policy contributes to economic and social cohesion of the regions, i.e. members in the economic integrations.

The regional development is of particular importance for Republic of Macedonia. This is because of inherited problems related to uneven regional development which has limiting effect on the rational use of available production resources and on the development not only of the regions, but the whole country. Considering the significance of the regional development policy, a particular attention should be paid to the creation and accomplishment of macroeconomic policy and development policy.

The research analysis show that without efficient regional policy, and in that context without support of economically underdeveloped areas, Republic of Macedonia will not be able to accomplish the transitional period successfully, and include in the globalization of the world economy. What is missed in this area should be compensated as fast as possible.

There are really big differences between the municipalities (regions) in Republic of Macedonia regarding their size, according to the number of citizens, regarding their area, rural, i.e. urban character, population density, economic characteristics, field configuration – mountainous or flat etc. According to this, the monotypic character of the municipalities should be left behind, and a polytypic character of them should be implemented, and according to that different kinds of municipalities would have different types of competences.

References:

1. Bertelsmann Foundation and World Bank (2002): Local Economic Development Developing and Implementing Local Economic Development Strategies and Action Plans.
2. Bishev G., Parat D. (1998): Money and Banking Idioms, Phrases and Articles. EnglishMacedonian, Danimaks, Skopje.
3. Boex, J. (2001): An introduction overview of intergovernmental fiscal relation, Fiscal Policy summer training courses at GSU-Atlanta.
4. Griffiths Alan & Wall Stuart (2004): Applied Economics, Prentice Hall.
5. Jankulovski N. (2012): Financing local government units in the context of balanced regional development of the Republic of Macedonia. Institute of Economics, Skopje.
6. Loughlin, J. and others (2002): Option for Reforming Local Government Founding to Increase Local Streams of Founding: International Comparisossns, Cardiff University, Cardiff.
7. Martinez Vazquez, Jorge and Boex, Jameson (1997): Fiscal capacity:an overview of concepts and measurements issues and their applicability in the Russian Federation, GSU.
8. Molle W. (2001): The Economics of European Integration, Ashgate, London.
9. www.stat.gov.mk (State statistical office)

**UDC 339.743:[334.72:339.564(4-12)
339.743:[334.72:339.564(497.7)
Professional paper**

**Gligor BISHEV*)
Tatjana BOSHKOV*)**

**EXPORT-LED GROWTH IN SEE6 – FACTS AND
RECOMMENDATIONS: THE CASE OF REPUBLIC OF
MACEDONIA**

Abstract

Globalization brings the threat of a weakened SME sector, since its role in (direct) exporting is less than proportional to its size, and in the same time it can also increase the importance of a strong SME sector. The recommendations are on building relationships with financial institutions, especially with banks, to facilitate funding to SMEs. In this context, it is useful to identify where SMEs are dealing in foreign currency and seek opportunities to provide value-adding advice in areas such as managing foreign exchange risks and forecasting currency needs. The key factors for realization of these aims are innovation and knowledge that would help for increasing competitiveness with support of real exchange rate by stimulating the growth of export, too. This can contribute for sustainability of the economic growth and economic integration especially of small economies on which this paper is mainly focused with special emphasis on Macedonia.

Because of the fact that Southeastern European countries rely mainly on exchange rate anchors to reduce inflation, the appreciation of the real exchange rate among countries in the region is significant, although it is slightly lower when compared to countries in the EU member states. As a result, the SMEs of these countries suffer from loss of competitiveness. This can be clearly seen from the movements of the

*) PhD., Executive Director and Chairman of the Board, Sparkasse Bank, Macedonia.
E-mail: Gligor.Bishev@sparkasse.mk

*) PhD., Faculty of Tourism and Business Logistics, University "Goce Delcev", Stip
E-mail: tatjana.boskov@ugd.edu.mk; tatjana.boskov@gmail.com

deficit on their current account, which are important in all these countries. Using the exchange rate as anchor for inflationary expectations, on long run have been effective so far, producing a low and stable inflation rates. However, in periods of low inflation and deflationary pressures, exchange rate anchors do not allow sufficient space for fiscal and monetary stimulus. In this respect, policy makers are under following dilemma: to deviate from exchange rate anchor and increase the space for fiscal and monetary stimulus; to accelerate structural reforms and competitiveness and on short run deepen the recessionary pressures; and to increase foreign debt and thus increase scope for fiscal and monetary stimulus while preserving the exchange rate anchor.

Economic policies can be instrumental for growth in the near- and the medium-term in SEE6. On the fiscal side, sustained reform effort is needed to address structural rigidities in the budgets of SEE6. Priorities include: changes in the composition of public expenditure toward investment and away from wages, public expenditure targeting and prioritization as well as improvements in revenue collection and the broadening of the tax base, among others. On the monetary policy side, with regional inflation at a very low 1.2 percent and big output gaps remaining, some scope for short-term easing of monetary conditions exist, especially in those countries where deficits have begun to decline.

Above facts and real situations are our challenges for making analysis and contribution in this area.

Key words: export, competitiveness, real exchange rate, Macedonia

JEL classification: O 11

Introduction

Like many countries in the early stages of transition, South-eastern European countries rely mainly on exchange rates to reduce the inflation. In many countries, exchange rate helps to reduce the inflation to lower single digits since 2004. Albania's managed float and informal inflation targeting were also successful in keeping inflation low, while in Romania, inflation, although declining under the managed float, remains

close to double digits. Since 2000 Serbia has shifted between nominal and close to real exchange rate targeting (with important regime shifts in early 2003 and 2005).

Inflation first declined with the exchange rate anchor, but an increasing external deficit prompted a shift to a managed float in 2003. However, inflation resurged, as suppressed administrative prices were readjusted and growing euroization contributed to an increased pass-through from the exchange rate to prices. The regime shifts may also have adversely affected monetary policy credibility, as indicated by the growing euroization. The exchange rate anchors and sluggish structural reform put pressure on competitiveness. Fixed or nearly fixed exchange rates can lead to unsustainable real appreciation and loss of competitiveness, unless fiscal and incomes policies remain tight and structural reforms boost productivity. For example, in Serbia, the exchange rate anchor in 2002 became unsustainable as large real wage increases and slow structural reforms eroded competitiveness and increased the external deficit. Pressures for real appreciation in the region also arise from the large inflows of foreign currency. The evolution of EU export market shares also suggests that Macedonia may have lost competitiveness, while most others have increased their share in the EU market. The real effective exchange rates data (REER) show a large appreciation in Bulgaria, Romania, and Albania in recent years, which at least in the former two is likely to reflect changes in market fundamentals in terms of increased productivity. In the remainder of the SEE, there is no clear trend with real appreciation and the REERs have remained relatively flat in the past few years.

1. RER as a cornerstone of SMEs export performances

At the macroeconomic level, sound government policies and the ability to stabilize a competitive real exchange rate are the cornerstone of promoting exports. A competitive real exchange rate provides an incentive for exports. Moreover, an outward oriented, market-friendly trade regime, which emphasizes the dismantling of import controls and tariffs (permitting access to inputs at world prices), and streamlined bureaucratic procedures, *i.e.* export and import procedures, modern

customs administration and efficient value added tax administration will facilitate exports, including from SMEs.¹

The impact of exchange rates on trade in a given country, as in Macedonia, example for small and open economy, should be seen in the context of continued integration of supply chains. Exports, generally, include high import content and impact of foreign currency-exchange appreciation or depreciation on any finished product because it is complex. If the depreciation of the exchange rate makes its exports of finished products "cheaper", it makes imported components "expensive" for domestic producers. Maintaining growth and reducing the unemployment in a small and open economy (such as Macedonia) depends from improved performance of exports. Improving the performance of exports can also help to preserve macroeconomic stability by closing the gap in the current account to avoid wasting supplies and to stop the growth of external debt. Improving performance requires improving export competitiveness. In the short term, competition may be related to the level of the real exchange rate, which provides internal and external balance. The appreciation of the real exchange rate with respect to its equilibrium level reduces the incentives and the ability of manufacturers to compete in foreign markets, since a significant part of production costs paid in local currency. In the long run, real exchange rates are assumed to converge to its equilibrium level, and competitiveness is more related to the productivity of the economy. So, firm-level strategies are fundamental to development of exports by an SME.² However, accomplishment of a pro-active upgrading menu, requires easy and cost-effective access to information on consumer demand and new technologies, training and advisory services to upgrade management practices, a skilled pool of labor in the country to select from, testing, quality assurance and certification institutions, and most importantly access to finance to upgrade technologies.³

¹ Srinivasan,T.N. and V.Archana.2011."Determinants of Export Decision of Firms." *Economic and Political Weekly*, 46(7):49-58

² Tas, Nilgün (2002), "International Experience in SME Promotion", paper presented at the *Public-Private Consultation Workshop on SME Development*, UNIDO-Center for Industrial Research and Development, Vientiane, 25 April.

³ Fidrmuc, J. (2004), "The Endogeneity of Optimal Currency Area Criteria, Intra-Industry Trade and EMU Enlargement", *Contemporary Economic Policy*, Vol. 22, No. 1, pp. 1-12.

In the context of pro-active upgrading, this means:⁴

- ✓ systematically acquiring production and product design capability
- ✓ improving measurement, standards, quality and productivity
- ✓ recruiting qualified staff and training
- ✓ forging sub-contracting links with other firms
- ✓ making use of technology institutions and other business services
- ✓ actively seeking foreign buyers and marketing agents.

Technical assistance in the areas of quality management, productivity improvement is needed to help SMEs comply with the product standards and regulations applied in export markets.

2. How to promote the connection between fdi and sme in accelerating country's growth?

Foreign direct investment is an integral part of an open, international economic system and a major potential catalyst for development. The potential benefits of FDI for host economies include:⁵

- ✓ increasing the supply of capital
- ✓ technology and knowledge transfer
- ✓ the generation of employment and human capital
- ✓ the effect on enterprise development.

An additional source of capital is clearly important in countries where financial constraints act as a major barrier to development. The extent to which potential positive externalities from FDI are achieved in practice is likely to be affected by a variety of factors at the macro- and micro- levels. Human capital spillovers from FDI in developing countries appear to be mainly indirect, occurring more as a result of government

⁴ Hudson, M, Smart, A and Bourne, M, *Theory and practice in SME performance measurement systems*, International Journal of Operations and Production Management Vol 21, No 8, pp1096-1115, 2001

⁵ Ayyagari, Meghana., Thorsten Beck, Asli Demirgüç-Kunt (2003), "Small and Medium Enterprises Across the Globe", World Bank Policy Research Working Paper 3127, August, Washington D.C.

policies seeking to attract FDI through enhanced human capital, than directly from MNEs themselves. However, human capital spillovers can occur where FDI involves the acquisition of a local firm by a foreign company.

Key policy issues are related with creating conditions to attract foreign investors together with policies to encourage and facilitate different forms of cooperation between inward investors and domestic SMEs.

In this way, defining the role for policy to attract FDI includes⁶:

- ✓ promotional activities
- ✓ creating an appropriate and effective legal and regulatory framework
- ✓ capacity building programmes for potential suppliers that include training and quality assurance
- ✓ wider role of business support services and other intermediaries, which might include partner searching facilities.

Promoting the connection between FDI and SME, is a way of creating effective policies which are based on seeking large number of locations in the world with similar characteristics, which clearly affect the bargaining position of individual governments with potential investors and represent key factors that policy makers need to consider for attracting and exploit the potential benefits of FDI.⁷ In the absence of other locational advantages, competition between places typically focuses on offering lower costs.

Key policy issues are related with creating conditions to attract foreign investors together with policies to encourage and facilitate different forms of cooperation between inward investors and domestic SMEs.

⁶ Srinivasan,T.N. and V.Archana.2011."Determinants of Export Decision of Firms." *Economic and Political Weekly*, 46(7):49-58

⁷ ACCA (2012a), SME Internationalisation in Central and Eastern Europe.

In this way, defining the role for policy to attract FDI includes:⁸

- ✓ promotional activities
- ✓ creating an appropriate and effective legal and regulatory framework
- ✓ capacity building programmes for potential suppliers that include training and quality assurance
- ✓ wider role of business support services and other intermediaries, which might include partner searching facilities.

The export-led growth hypothesis (ELGH) postulates that export expansion is one of the main determinants of growth. According to its advocates, exports can perform as an “engine of growth”.⁹ Promoting export would enable developing countries to correct imbalances in the external sector and at the same time assist them in ensuring that their domestic economies made a full recovery. As part of an outward strategy, a new set of policies rapidly became a key component for policy makers in developing countries involved in adjustment and stabilization programmes.

According to the most authors as well as multilateral institutions would agree that promoting export and achieving export expansion are beneficial for both developed and developing countries for many reasons, including the following:¹⁰

- ✓ they generate a greater capacity utilization;
- ✓ they take advantage of economies of scale;
- ✓ they bring about technological progress;
- ✓ they create employment and increase labour productivity;
- ✓ they improve allocation of scarce resources throughout the economy;

⁸ Ayyagari, Meghana., Thorsten Beck, Asli Demirgüç-Kunt (2003), “Small and Medium Enterprises Across the Globe”, World Bank Policy Research Working Paper 3127, August, Washington D.C.

⁹ Henriques, I. and Sadorsky, P. (1996). “Export-led growth or growth-driven exports? The Canadian Case”, *Canadian Journal of Economics*, 29, 3 (August): 541-55.

¹⁰ Henriques, I. and Sadorsky, P. (1996). “Export-led growth or growth-driven exports? The Canadian Case”, *Canadian Journal of Economics*, 29, 3 (August): 556-67.

- ✓ they relax the current account pressures for foreign capital goods by increasing the country's external earnings and attracting foreign investment; and
- ✓ they increase the TFP and consequently the well-being of the country.

3. Export-led growth in SSE6: where and what next for companies?

Southeastern Europe can draw experience from recent new EU member states with monetary framework during accession. Exchange rate regimes during accession had shown different variations, which indicate the importance of fundamentals and associated policies in the implementation and achievement of macroeconomic stability¹¹. Some of the larger recent EU members gradually moved from exchange-rate-based stabilizations to more flexible monetary policy as transition progressed. South-eastern Europe has very lower speed of reforms and lower growth rates. Related to this, capital inflows to the region are very smaller and have shown greater dispersion between countries.¹²

Regardless the exchange rate regime, the appreciation of the real exchange rate among countries in the region is significant, although it is slightly lower when compared to countries in the EU member states. As a result, these countries suffer from loss of competitiveness. This can be clearly seen from the movements of the deficit on their current account, which are important in all these countries. For example, the current account deficit in 2007 ranged from 3.1% of GDP in Macedonia to 36.2% of GDP in Montenegro¹³. Using the exchange rate as hope for inflationary expectations have been effective so far, producing a low and stable inflation rates. In terms of high import dependence and the relatively slow implementation of structural reforms realized in increased

¹¹ Schadler, S., P. Drummond, L. Kuijs, Z. Murgasova and R. van Elkan (2005), "Euro Adoption in the Accession Countries: Vulnerabilities and Strategies", in S. Schadler ed. *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, IMF.

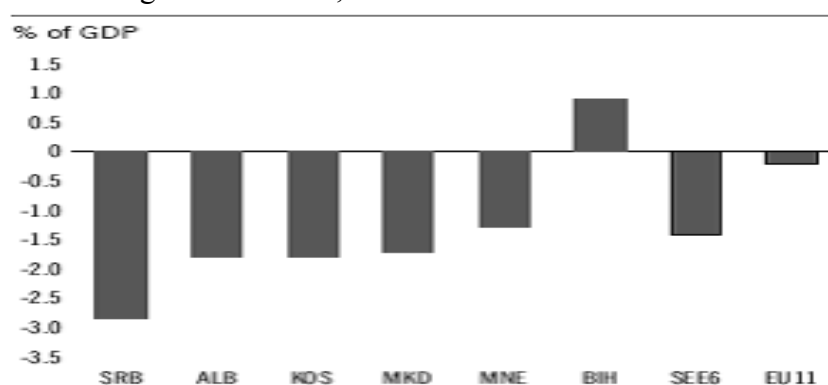
¹² Greenaway, D. and Sapsford, D. (1994). "What does liberalisation do for exports and growth", *Weltwirtschaftliches Archiv*, 130, 1: 152-74.

¹³ European Commission (2007), *The EU Economy 2007 Review, Moving Europe's Productivity Frontier*.

export potential, contributed to the importance of high trade deficit, which was largely financed by high private transfers.¹⁴

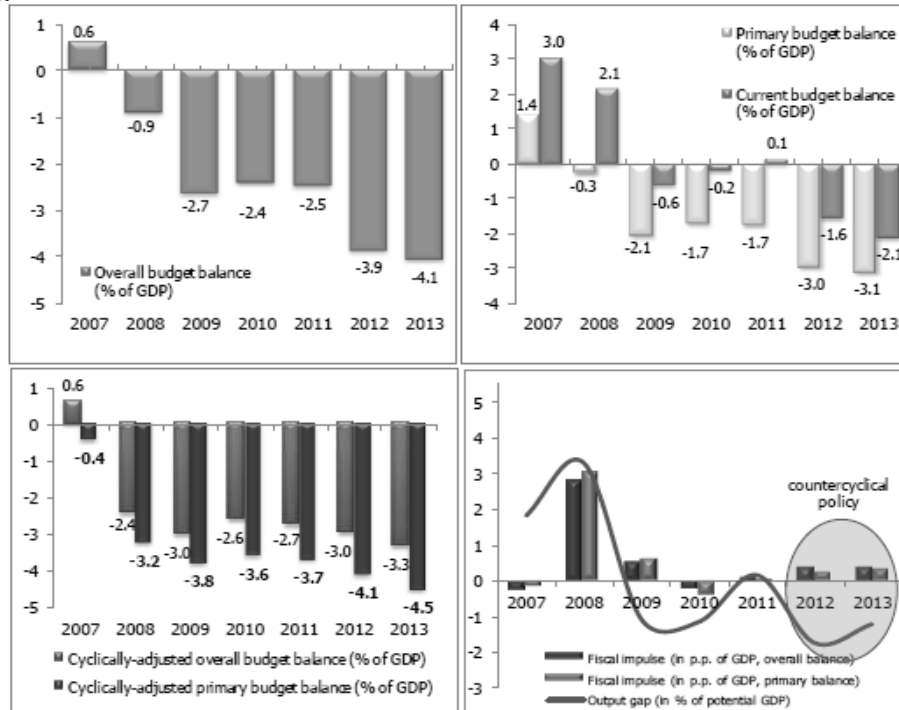
Most countries have seen declines in revenue as a share of GDP (Figure 1) and international trade taxes have performed especially badly. Receipts from international trade taxes declined by an average of 0.5 percent of GDP between 2009 and 2013, associated with shrinking imports. Albania and Montenegro were hit especially hard by falling VAT receipts, suffering declines by 0.5 percent of GDP and over 1 percent of GDP respectively relative to 2009 levels as a result of slow or negative economic growth. Only in Bosnia and Herzegovina did revenues increased slightly largely due to the success of the Indirect Tax Authority.

Figure 1: Change in Revenues, 2009–13



Source: World Bank staff calculations.

¹⁴ ACCA (2012a), SME Internationalisation in Central and Eastern Europe

Figure 2.3.4: Fiscal indicators for Macedonia

Source: Ministry of Finance of the Republic of the Macedonia and NBRM calculations.

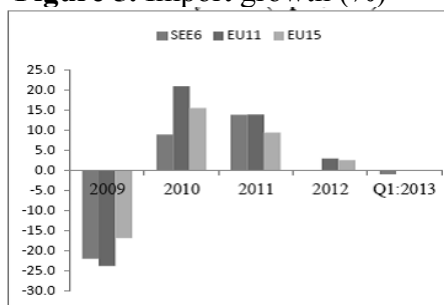
The analysis of the discretionary changes in the fiscal policy suggested further countercyclical policy. The total structural deficit increased to 4.5% from 4.1% in 2012, amid simultaneous increase also in the structural primary deficit from 3% in 2012 to 3.3% in 2013 (Figure 2)¹⁵. Consequently, as in 2012, a positive fiscal impetus was given, which, according to the structural primary balance was slightly higher than in 2012. If the analysis includes the output gap, than the fiscal policy was countercyclical also in 2013. Financing of the budget deficit on a net basis in 2013, was done through auctions of government securities, and the rest of the required net inflows was provided from external sources. Reports also showed that also in 2013 there was a trend of increased borrowing through government bonds versus the moderate reduction of the borrowing through Treasury bills.

¹⁵ NBRM (2013), *Annual Report*.
286

Due to the close economic ties, external factor in SEE6 highly correlated with development of events in the EU. In 2012 SEE6 experienced a drop in trade, current account deficits, FDI and transfers. In the first quarter of 2013 exports is driven by FDI and the improved economic performance of the EU. While current account deficits and trade balances deteriorated in 2012, in the first quarter of 2013 they registered reverse. Reducing the demand for EU goods SEE6 led to a decline in the region which began in 2011 and continued in 2012 (Fig. 3 and 4).

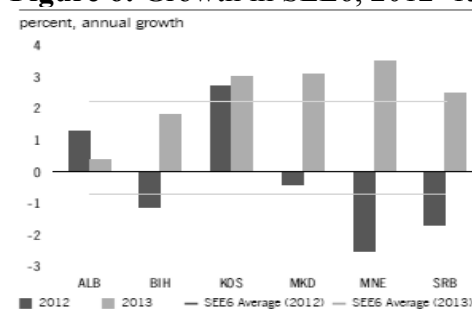
From the first quarter of 2013, exports are likely to improve in future for the entire region. Imports remained unchanged in 2012 and fell again in the first quarter of 2013. Movements in terms of trading, also play a major role in explaining the growth trends of imports through SEE6. Prices for energy imports fell sharply in 2009 and increased significantly in 2010, while in 2011 remained at the same level in 2012 and declined in 2013. In Macedonia, the imports in the second half of 2012 was falling faster, because domestic demand and industrial production continued to decline which is an example for the first quarter of 2013 too (Fig. 5), mainly due to weak domestic demand and economic activity.

Figure 5. Import growth (%)



Source: IMF, World Bank

Figure 6: Growth in SEE6, 2012–13



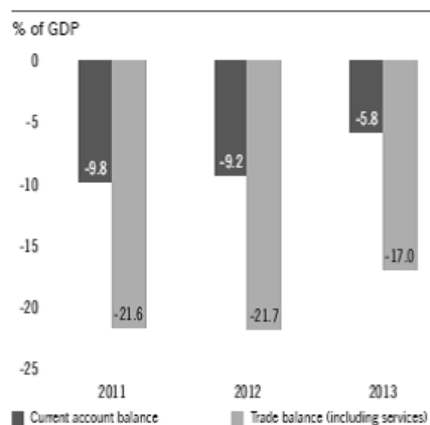
Source: National statistics offices, and World Bank.

The SEE6 countries exited from recession in 2013 with economic growth supported by the recovery in high-income countries, particularly those in the European Union (EU). After a 0.7 percent decline in 2012, the average real GDP of SEE6 grew 2.2 percent in 2013 (Figure 6). All six SEE countries marked positive growth, with growth at or exceeding 3

percent in Kosovo, FYR Macedonia and Montenegro. Only in Albania did economic growth slow in 2013 compared to 2012, though it remained positive. External demand for SEE6 exports was the key driver of this growth recovery, reflecting an improving European and global economy.

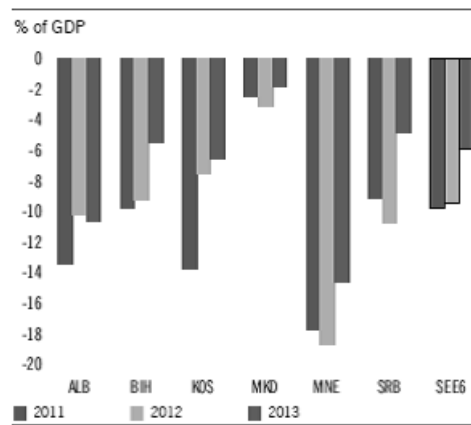
An export-led recovery combined with depressed domestic demand resulted in a significant narrowing of current account imbalances in all SEE6 countries. The increases in exports and the declines in imports lowered the trade deficit of SEE countries by 4.7 percent of GDP and the current account deficits by 3.4 percent of GDP in 2013 (Figure 7, Figure 8). Exports to the EU grew strongly, especially in Bosnia and Herzegovina, FYR Macedonia, and Serbia. Montenegro's and Kosovo's share of exports to the SEE region increased. Manufactured goods were the largest share of exports from SEE6 followed by machinery and transport equipment. Jointly they comprised over 60 percent of exports in 2013 in the region. The major increase in 2013 came from export of machinery and transport equipment from Serbia. Exports in FYR Macedonia grew also on the back of machinery and transport equipment as well as chemical materials. Mineral fuels exports were quite significant in Albania and Montenegro, while base metals were around a quarter of exports from Kosovo in 2013.

Figure 7: SEE6 Current Account and Trade & Service Balances



Source: Central banks, IMF WEO, and World Bank.

Figure 8: SEE6 Countries' Current Account Balance



Source: SEE6 Central Banks.

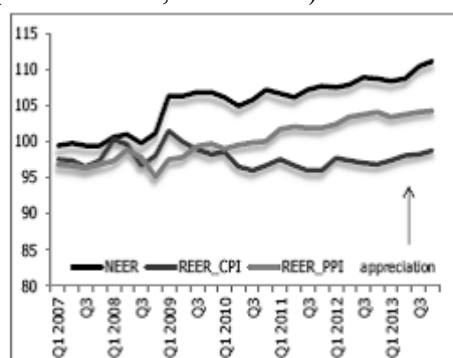
The reports by NBRM showed improved performance in the current account in 2013 due to the improved balance of goods and services, amid reduced net inflows in current transfers and higher net outflows in income¹⁶. The reduction in the trade deficit by 3 percentage points of GDP was mainly caused by a narrowing of the energy deficit, although the non-energy had the same, however significantly milder effect. The individual components of trade registered divergent movements. Exports, driven by the enhanced activity of the new capacities in the economy with foreign ownership, registered an annual growth of 3.2%, while the reduced demand for energy products and the annual decline in energy prices reduced the import component, causing an annual decline of 1.5%. Divergent movements in exports and imports caused stagnation of total foreign trade on annual basis.

The exports of the companies from the industrial development zones were the most important driver of Macedonian exports in 2013, increasing their resilience, amid still unfavorable global conditions that caused a decrease in the exports of the metal industry.¹⁷ Also, increased exports of new companies were sufficient for offsetting the significant decline in the exported petroleum products, caused by the simultaneous reduction of the exported quantities and lower export prices. Price competitiveness indicators of the Macedonian economy showed a negligible appreciation of the Denar in 2013. The CPI-deflated real effective exchange rate rose by 0.9%, while the PPI-deflated REER recorded an annual appreciation of 0.4%. The change was entirely caused by the movement of the nominal effective Denar exchange rate, as a result of the appreciation of the domestic currency against the Russian Ruble and Turkish Lira, with favorable slower movements of domestic relative to foreign prices.

¹⁶ NBRM (2014) *Recent Macroeconomic Indicators*, Review of the Current Situation.

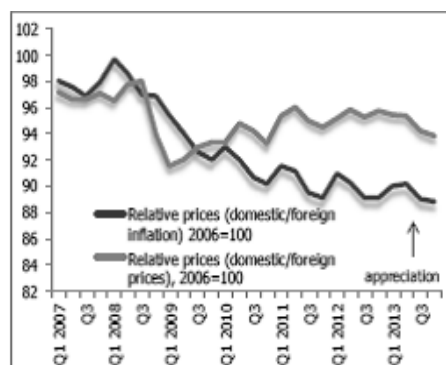
¹⁷ Daviddi, R. and Uvalic, M. (2003), Exchange Rates Regimes in the Western Balkans and their evolution toward EMU, First Alumni Annual Conference on "Governing EMU" European University Institute, Florence

Figure 9. NEER and REER (CPI and PPI, 2006=100)



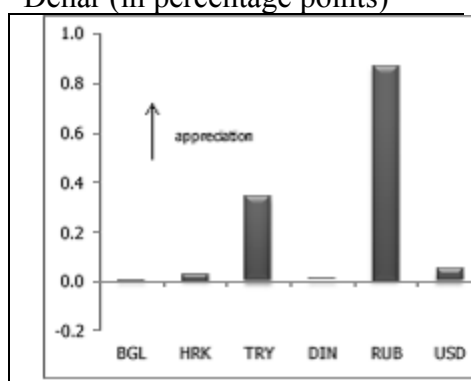
Source:NBRM

Relative prices (2006=100)



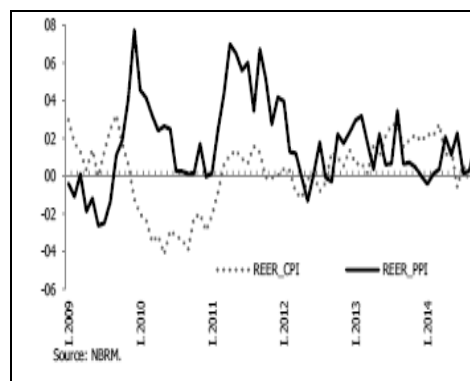
Source:NBRM

Figure 10. Contribution to the annual change of NEER of the Denar (in percentage points)



Source:NBRM

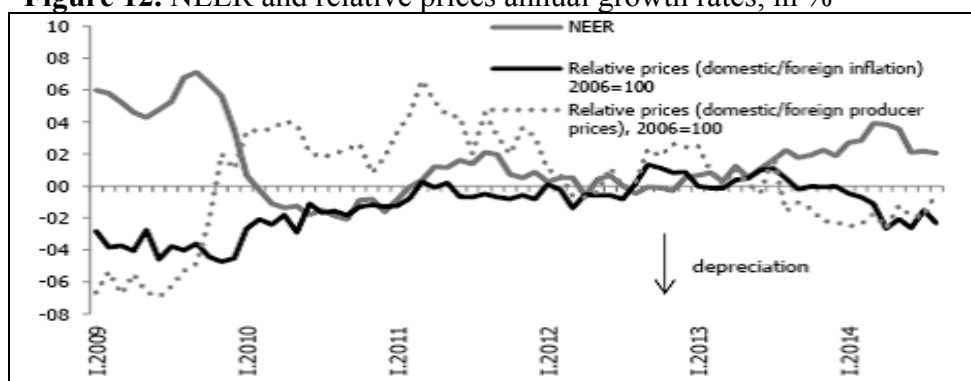
Figure 11. REER annual changes, in %



Source: NBRM

In August 2014, price competitiveness indicators of the domestic economy registered divergent movements on an annual level. When this is compared with the same month of the 2013, the REER deflated by consumer prices depreciated by 0.3%, while the REER deflated by producer prices appreciated by 1.6% on an annual basis.

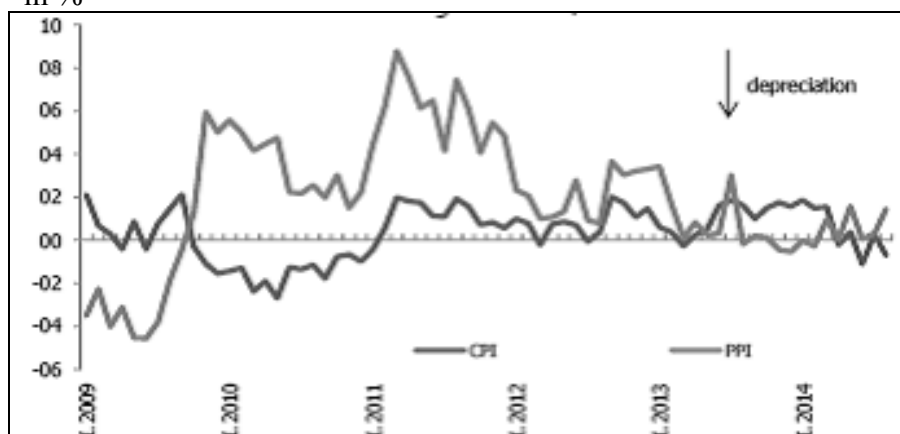
Figure 12. NEER and relative prices annual growth rates, in %



Source: NBRM.

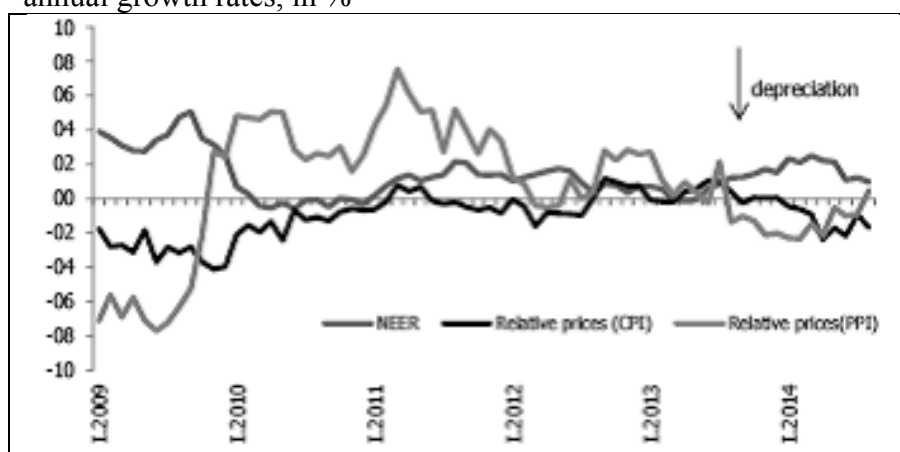
Depreciation of the Ukrainian hryvnia, Russian ruble and Turkish lira against the denar had a influence for the further appreciation of the nominal effective exchange rate by 2% on an annual basis, and this caused upward pressures on both REER indices. The growth of foreign consumer prices and as faster growth in foreign versus domestic prices of industrial products, led to a decline in relative prices by 2.3% and 0.4%.

Figure 13. REER, excluding primary commodities annual growth rates, in %



Source: NBRM.

Figure 14. NEER and relative prices, excluding primary commodities annual growth rates, in %



Source: NBRM.

The movement of the REER¹⁸, excluding primary commodities, indicates similar movements in the domestic price competitiveness. The REER deflated by producer prices appreciated by 1.5%, while the REER deflated by consumer prices depreciated by 0.7% on an annual basis. Figure 13 show that due to decline in domestic prices, relative CPI registered an annual decline of 1.7%. Also, relative prices of industrial

¹⁸ NBRM (2014) *Recent Macroeconomic Indicators*, Review of the Current Situation.

products recorded a growth of 0.5%, driven by higher domestic prices. NEER appreciation continued in August 2014, annual change driven by the depreciation of the Turkish lira and the Serbian dinar against the denar.

Economic policies can be instrumental for growth in the near- and the medium-term in SEE6. Priorities include: changes in the composition of public expenditure toward investment and away from wages, public expenditure targeting and prioritization as well as improvements in revenue collection and the broadening of the tax base, among others. On the monetary policy side, with regional inflation at a very low 1.2 percent and big output gaps remaining, some scope for short-term easing of monetary conditions exist, especially in those countries where deficits have begun to decline.

However, caution needs to be exercised in the economies with flexible exchange rates to ensure that these do not come under pressure. In terms of financial sector policies, addressing the high NPLs would be critical to ultimately restoring the growth of credit and supporting entrepreneurship and job creation.

4. Discussion and recommendations for ongoing developments in SEE6 and Macedonia

The region that provides greater long-term rate of real economic growth, and sustainable GDP growth based on profitable production with sufficient export content has a better chance of attracting foreign capital. Namely, international investors rightly expect to achieve high rates of return on invested capital in that region enjoying long-term sustainable economic growth. Thus, the trend of the movement of the real exchange rate euro / dollar mostly affect the sustainable rate of real economic growth, which is associated with net capital flows.

Financial stability and the efficient allocation of macroeconomic level appear in each economy as an indirect product of successful political coordination. Variables such loans, the cost of funds and the real exchange rate are not aim of any instrument; transparency limits the extent to which they could be involved in decisions. The experiences of this region confirmed that alternative monetary and fiscal regimes, giving

adequate political support, can provide very well low inflation. Much more difficult for assessment are the risk characteristics of the regimes.

In Southeast Europe, the conspirators for fixed and floating regime can easily underestimate the dangers which monetary policy are facing with during pre-assessment period.¹⁹

- ✓ Hard pegging is linked with the region with credible policy management, and they insulate the economy from shocks to the nominal exchange rate. But they may accelerate the expansion of non-hedging borrowing in foreign currency, and they put a high premium on the flexibility of the real sector in terms of shocks.
- ✓ Meanwhile, the dynamics of inflation can question the early adoption of the euro as an exit strategy from that pegging. Flexible exchange rate facilitates the adjustment, and as part of a coordinated political effort can help in slowing the growth of risk in the balance sheet items. But to the extent that such risks are created over time, these modes offer no more than qualified safety valve in case of exogenous or policy caused shocks.
- ✓ Regarding the stability of the money, i.e. price and exchange rate stability, in Maastricht Treaty is guaranteed that the stability of the price level is the main priority of monetary policy in the Euro area. What will be the actual performances of the monetary policy of the ECB does not only depend on the formulation of monetary policy objectives but also from the real sector movements in the economy.
- ✓ It can be estimated that the real effects of monetary policy will be influenced by two conflicting groups of real factors. The increasment of competitiveness of the society will act to strengthen the internal and external power of the euro, and therefore the attractiveness of the euro as an international currency too. On the other side, there is a potential danger that may arise from low rates of economic growth combined with pressures in the direction of large fiscal deficits, which were

¹⁹ Greenaway, D. and Sapsford, D. (1994). "What does liberalisation do for exports and growth", *Weltwirtschaftliches Archiv*, 130, 1: 152-74.

associated with lower rates of growth and a greater participation of old population.

- ✓ The challenge of managing rapid financial convergence is something that calls for risk-averse macroeconomic policies. But it also depends to a large extent by strong structural policies. Structural reforms are key to strengthening the tradable sector and other productive activities, but also in providing capacity for sharing resources between sectors and generally adjustment to the economy over time.
- ✓ The process of real convergence should have a balanced path of economic growth, with manageable external current account and real exchange rate dynamics during the convergence, as well as adequate capacity for adjustment in the medium term. Challenges for fostering sustainable growth and preserving financial stability on the road to EU accession, are with full complementarity.
- ✓ What can be concluded from the first aspect of the monetary framework which is best suited for managing the real and nominal convergence on the road to the euro, starts exactly from the view that inflation targets seem to have a better set of available tools than those that peg for managing the process of convergence with balance towards adopting the euro.
- ✓ The main risk for targeters are excessive fluctuations in exchange rates, but if the policies are aimed at macroeconomic stability, the probability to make this reality is reduced. Then, the possibility danger is excessive appreciation of the nominal exchange rate, which is likely to lead the country toward expensive interventions or reduction of domestic interest rate that could fuel a credit boom. Options are limited for those who peg.

Leaving hard pegging before adopting the euro brings danger of losing the confidence and depreciation of the currency, which can create a deep recession in negative effects on the debt of households and firms in the country (where the debt is high euroized), as in the Baltic countries. If the output is well communicated as a transition step towards early adoption of the euro, the recession may not occur or would be mild, in the country would become better positioned to contain inflation. Here the danger is that the appreciation of the nominal exchange rate can shift

and leads to loss of competitiveness or worsening already weak competitive position. Therefore, the risks of leaving highly pegged should be carefully measured prior to considering such an action. Well-timed and well prepared step of revaluation on "pegging" may be another option to consider if the competitiveness is not in question. The risks here are the positive effects on wealth of the euroization debt and would increase demand at a time when current accounts are already high in these countries.

The role of the exchange rate as a nominal anchor derives from the characteristics of the domestic economy, as a small and open economy that is highly dependent on the import of primary commodities. Also, Macedonian exchange rate can be used as an instrument for export performances of the country.

Macedonian policymakers should create policy with several aims focused on exchange rate policy because:

- A competitive real exchange rate provides an incentive for exports
- The impact of exchange rates on trade should be seen in the context of continued integration of supply chains
- Exports generally include high import content and impact of foreign currency-exchange appreciation or depreciation on any finished product because it is complex. If the depreciation of the exchange rate makes its exports of finished products "cheaper", it makes imported components "expensive" for domestic producers.
- Maintaining growth and reducing the unemployment in a small and open economy such as Macedonia depends from improved performance of exports.
- Improving the performance of exports can help to preserve macroeconomic stability by closing the gap in the current account to avoid wasting supplies and to stop the growth of external debt.
- Improving performance requires improving export competitiveness.
- An outward oriented, market-friendly trade regime, which emphasizes the dismantling of import controls and tariffs (permitting access to inputs at world prices), and streamlined bureaucratic procedures, *i.e.* export and import procedures, modern customs administration and efficient value added tax administration will facilitate exports, including from SMEs.

According to the expectations from reports by NBRM, the inflation will slow down also in 2015, when it will approach the historical average and equal 2%. Also, in 2015, it is expected that the current public investments will continue, and as there are expectations for new infrastructure projects²⁰. It is estimated that these developments in the export sector and the strengthening of investment activity will create positive transmission effects on both the labor market and the expectations, and thus be a factor for further increase in the household consumption. It is expected that the GDP growth in 2015 it would speed up even more and reach 4.4%. Given the high openness of the economy, the risks to the projected growth continued to result from the global environment and developments in the external environment.

By the end of 2015, the credit growth is projected to accelerate and it would reach 8.5%. Projections for 2015 show that the external position can provide further increase in the foreign reserves and their maintenance at appropriate level. In addition, in 2015, widening of the current account deficit by 5.7% of GDP is expected, mainly due to the fall in private transfers. Despite the moderate deterioration on the current account, it is estimated that its negative balance will be fully financed by capital inflows, mainly coming from foreign direct investment and external borrowings for infrastructure projects. It is expected that the foreign direct investments will gradually increase in 2015 at 4.5% of GDP, respectively. In 2015, prudent fiscal policy is expected, with gradual consolidation of the budget deficit and relatively stable level of public debt. The fiscal policy is important factor that influence the monetary policy setup, while the adequate coordination of these policies is crucial for creation and maintenance of the macroeconomic stability. After the risen level in 2013, the budget deficit is expected to fall gradually and it would range about 3% of GDP on a medium run. Hence, in 2015, it would equal 3.2% of the GDP. The primary budget deficit should be equal 2.2% of the GDP in 2015, respectively.

SEE6 growth in 2015 is expected to accelerate to 2.6 percent on average. All six SEE economies are expected to contribute to the increase in growth rates as external demand firms up and domestic demand begins to recover. Albania, Bosnia and Herzegovina, Kosovo and Serbia are all projected to have higher or the same growth in 2015 than in 2014. In

²⁰ NBRM (2014) *Recent Macroeconomic Indicators*, Review of the Current Situation.

2015, SEE6 economies are projected to grow slightly slower than the average for the EU11 countries (2.6 percent compared to 2.7 percent growth for EU11).

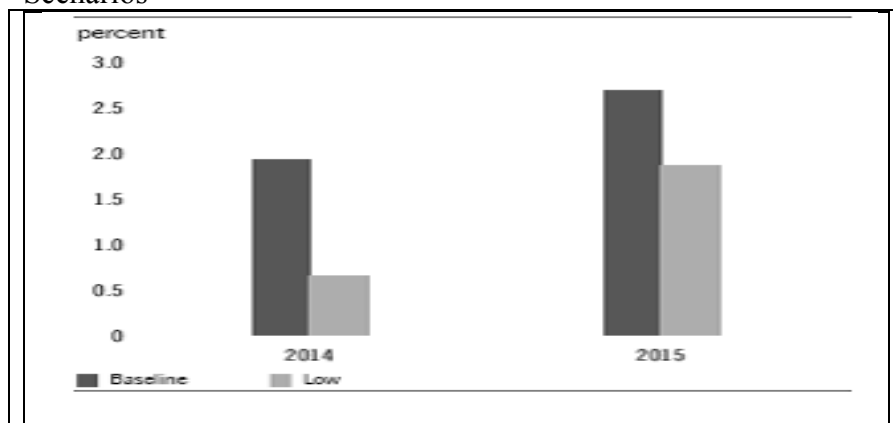
These external and domestic risks, if they materialize, will affect negatively the prospects for growth in the SEE6 countries and slow the nascent economic (Figure 15)²¹. In an extreme case of major deterioration of economic conditions driven by the materialization of above risks, SEE6 output growth in 2014 would less than halve (to 0.6 percent) of the baseline projection (of 1.9 percent). In 2015, growth would drop by a third (to 1.7 percent) from the baseline (2.6 percent).

A recent analysis focuses on EU member countries and shows that expanding the growth potential through structural reforms in a stable macroeconomic environment drives strong income convergence. Translated to the SEE6, it means that removing structural rigidities in the macroeconomic policy mix, increasing global integration, improving the economy's productive potential and competitiveness, enhancing skills and labor productivity, and strengthening institutions would ultimately contribute positively to income growth and convergence.²²

²¹ IMF (International Monetary Fund). 2012b. *International Financial Statistics*. Washington.

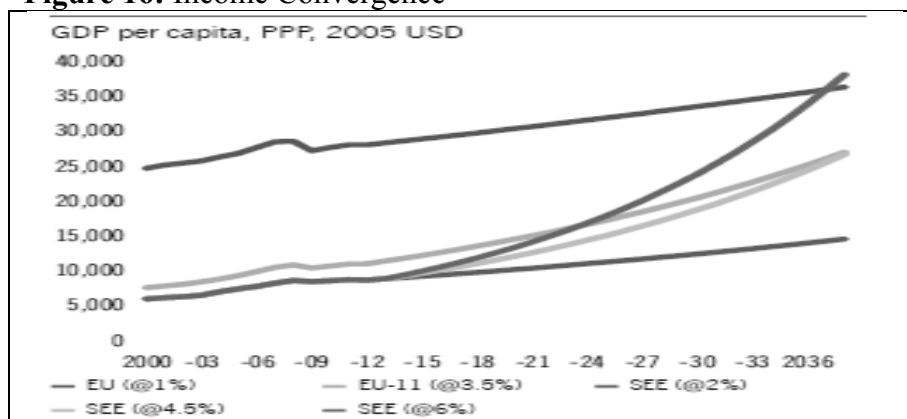
²² O'Brennan, J., *The EU and the Western Balkans: Stabilization and Europeanization through Enlargement*, London: Routledge, 2008.

Figure 15: SEE6 Real GDP Growth Rate under Baseline and Low Case Scenarios



Source: World Bank staff.

Figure 16: Income Convergence



Source: World Bank staff.

Boosting incomes in the medium to longterm with the aim of converging with EU standards will mean not only maintaining the pace of reforms—but also converting reforms benefits into robust and equitable economic growth. Both of these are proving challenging. The reform pace appears to have slowed during the financial crises. Countries will need to take advantage of the economic rebound to relaunch the reform and convergence processes. There is evidence suggesting that improvements in the business climate should be broad rather than targeted toward specific sectors, as growth and employment creating firms tend to be young and dynamic, but not concentrated in any

particular sector. Improving trade links in terms of logistics, institutions and regulations will be important to take advantage of the EU market. In addition, governments need to provide reliable and streamlined processes that guarantee EU safety standards are met for exporting firms, particularly for agricultural exporters. Improvements in governance standards—including the rule of law—will be closely linked to the EU integration process. But reforms required by the EU will also help to boost economic growth in SEE6 countries.

Such reforms are essential to boost labor demand, reduce unemployment, address the challenges driven by demographic changes and improve prosperity for all in SEE6. Increasing employment is essential to reduce poverty and to bring about shared prosperity in SEE6. Since the major source of income for most households is through selling labor, increasing employment opportunities and ensuring that workers have the skills necessary to take advantage of these opportunities are essential to increase the income generation capacity of the entire population.

Conclusion

The analysis shows that large potential gains could be reaped from structure reforms. Reports indicate that Euro-area GDP could be around 6% higher after ten years if Member States adopt measures to halve the gap vis-a-vis the average of the three best-performing Member States in each of the reform areas considered. When the structural reform will be successfully implemented, it promises growth of the economy. Growth effects are significant and higher growth potential can also stimulate investment demand and help to restore investment to pre-crisis level. Analyzing reforms it could be noticed that reforms that labour force participation yield the largest output effects in the short to medium run. Reforms relating to product markets can lead to large output gains. Structural fiscal reforms that shift the tax burden away from labour towards less distortionary taxes could be implemented relatively rapidly and boost employment and growth already in the short to medium run. Differences across countries mainly reflect where a country stands relative to “best performance” for different structural indicators. Performance gaps are particularly large in participation rates and tax structures, and reforms in these areas can deliver the largest effects.

There are positive cross country spillovers of structural reforms, adding up to 10% to the gains in output in the long run. The demand effect boosts imports and supports trading partners' growth, though this is partly offset by the competitiveness effect. Trade balance effects are relatively small and can turn negative where the demand effect dominates the competitiveness effect. Reforms lead to significant improvements in fiscal positions and can yield sizeable reductions in debt-to-GDP ratios in the medium/long term, alleviating the need for further consolidation measures and contributing to long-term debt sustainability.

How Macedonia could reach and sustain higher rates of export-led growth thus speeding up the process of economic convergence too?

The researches offer options that include increasment of the labor contribution to economic growth by raising labor participation and reducing unemployment. The second options means improvement of allocative efficiency. This understands promotion enterprise restructuring and reforming product market regulation as including regulation in the infrastructure sector. Next options is focused on deepening trade integration by promoting export-oriented FDI and developing the supply of exportable goods, meaning that Macedonia would need to integrate its logistics infrastructure. Accelerating the process of economic convergence will be supported by fostering technological progress. The recommendations are focused on policy-makers, inviting them to identify what policies are politically feasible and to be checked for their consistency with the overall objective of raising and sustaining economic growth.

Next, these strategies need to generate institutional requirements that are commensurate with the existing institutional endowment of Macedonia. This will lead to a near-term focus on deepening trade integration and fostering innovation, while measures related to expanding labor participation and employment could be adopted more gradually with a long-term perspective.

These measures would better position the country to fully benefit from EU Accession and to better manage the effects of the global

financial crisis, by strengthening Macedonia's international competitiveness

- In addition to the policy measures directly recommended for deepening trade and fostering innovation, the following complementary policy initiatives would be required:
 - Advancing *enterprise restructuring* (privatization) and the promotion of stronger *market competition* (improving product market regulation and de-regulation).
 - Adjusting the *life long learning system* to market needs, encouraging *labor training* by firms, and improving the supply of (selected) skills by possibly reviewing *migration rules* for labor market segments where the skills-gap is binding.
- Political resistance to the trade and innovation measures associated to the proposed strategy is likely to be comparatively low, with the exception of enterprise restructuring efforts. *Compensatory policies* for workers negatively affected by enterprise restructuring should be considered.
- Preliminary evidence on the positive association between access to non-banking finance and total factor productivity suggests further examination of the role of non-banking financial institutions in the selection of investment opportunities and thus in fostering growth in Macedonia.

Summarizing, there are starting point to introducing high integration for structural adjustments and growth:

- 1.faster productivity and quality catching – up
- 2.faster wage catch-up
- 3.faster upgrading of commodity structure leading to a faster disappearance of asymmetries in income and price-elasticities

- 4. impact on invisible and income accounts: more trade and transport services (balance impact neutral); more tourism in both directions; more deficits in other services (here lies one of EU's comparative advantages; more personal transfers
- 5. impact on capital movements: more FDI and portfolio investment; easier access to credits and better conditions for debt servicing
- 6. greater pressure towards reducing the "undervaluation" of the national currencies: speed up of institutional changes and market functioning will increase convergence of price structures; more pressure to achieve a higher level of international purchasing power because of greater tourist flows and more imports; more pressure to achieve monetary stability and use of the nominal exchange rate as an anchor with the view of coming closer to the Maastricht criteria
- 7. greater openness of EU market.

References:

1. ACCA (2012a), SME Internationalisation in Central and Eastern Europe
2. Ayyagari, Meghana., Thorsten Beck, Asli Demirgüç-Kunt (2003), "Small and Medium Enterprises Across the Globe", World Bank Policy Research Working Paper 3127, August, Washington D.C.
3. Daviddi, R. and Uvalic, M. (2003), Exchange Rates Regimes in the Western Balkans and their evolution toward EMU, First Alumni Annual Conference on "Governing EMU" European University Institute, Florence
4. Edwards, S. (1998). "Openness, productivity and growth: What do we really now?", *Economic Journal*, 108, 2, (March): 383-98.
5. European Commission (2007), *The EU Economy 2007 Review, Moving Europe's Productivity Frontier*.

6. Fidrmuc, J. (2004), "The Endogeneity of Optimal Currency Area Criteria, Intra-Industry Trade and EMU Enlargement", *Contemporary Economic Policy*, Vol. 22, No. 1, pp. 1-12.
7. Greenaway, D. and Sapsford, D. (1994). "What does liberalisation do for exports and growth", *Weltwirtschaftliches Archiv*, 130, 1: 152-74.
8. Henriques, I. and Sadorsky, P. (1996). "Export-led growth or growth-driven exports? The Canadian Case", *Canadian Journal of Economics*, 29, 3 (August): 541-55.
9. Henriques, I. and Sadorsky, P. (1996). "Export-led growth or growth-driven exports? The Canadian Case", *Canadian Journal of Economics*, 29, 3 (August): 556-67.
10. Hudson, M, Smart, A and Bourne, M, *Theory and practice in SME performance measurement systems*, *International Journal of Operations and Production Management* Vol 21, No 8, pp1096-1115, 2001
11. IMF (International Monetary Fund). 2012b. *International Financial Statistics*. Washington.
12. Kemal, A. R., ud Din, M., Qadir, U., Fernando, L. and Colombage, S. S. (2002), *Exports and Economic Growth in South Asia. A study prepared for the South Asia Network of Economic Research Institutes*
13. Lall, S. 2001. *Competitiveness, Tecnology and Skills*. Cheltenham, UK: Edward Elgar.
14. NBRM (2013), *Annual Report*.
15. NBRM (2013), *Annual Report*.
16. NBRM (2014) *Recent Macroeconomic Indicators* ,Review of the Current Situation.
17. NBRM (2014) *Recent Macroeconomic Indicators* ,Review of the Current Situation.
18. O'Brennan, J., *The EU and the Western Balkans: Stabilization and Europeanization through Enlargement*, London: Routledge, 2008.
19. OECD. 2010. *Report on G20 Trade and Investment Measures, September 2009 to February 2010*. Paris and Geneva: OECD, WTO and UNCTAD.
20. Rodrik, D. (1999). *The New Global Economy and Developing Countries: Making Openness Work*. Washington D.C.: Overseas Development Council, Essay No. 24.

21. Schadler, S., P. Drummond, L. Kuijs, Z. Murgasova and R. van Elkan (2005), “Euro Adoption in the Accession Countries: Vulnerabilities and Strategies”, in S. Schadler ed. *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, IMF.
22. Schadler, S., P. Drummond, L. Kuijs, Z. Murgasova and R. van Elkan (2005), “Euro Adoption in the Accession Countries: Vulnerabilities and Strategies”, in S. Schadler ed. *Euro Adoption in Central and Eastern Europe: Opportunities and Challenges*, IMF.
23. Srinivasan, T.N. and V. Archana. 2011. “Determinants of Export Decision of Firms.” *Economic and Political Weekly*, 46(7):49-58
24. Tas, Nilgün (2002), “International Experience in SME Promotion”, paper presented at the Public-Private Consultation Workshop on SME Development, UNIDO-Center for Industrial Research and Development, Vientiane, 25 April.
25. Wignaraja, G. 2003. “Competitiveness Analysis and strategy.” In Wignaraja, G., ed. 2003. *Competitiveness Strategy in Developing Countries*. London: Routledge.
26. World Bank (2012b): *Golden Growth, Restoring the lustre of the European economic model*, World Bank, Washington, DC.
27. World Bank (2013c), *Global Economic Prospects June 2013: Looking for stable ground*, World Bank, Washington, DC.
28. World Bank (2013d), *World Development Report: Jobs*, World Bank, Washington, DC. World Bank, Washington, DC.
29. World Bank (2013e): *Western Balkans Activation and Smart Safety Nets AAA Synthesis Note*, Mimeo, World Bank, Washington, DC.
30. World Bank. 2011. *World Development Indicators*, <http://databank.worldbank.org>.

UDC 338.48-6:379.845
332.146.2:[338.48-6:379.845
Professional paper

Natasha DANILOSKA¹⁾
Katerina HADZI NAUMOVA-MIHAILOVSKA²⁾

RURAL TOURISM AND SUSTAINABLE RURAL DEVELOPMENT

Abstract

Tourism is one of the largest and fastest growing industries today, characterized with immanent need for constant diversification of products and destinations offered. Recent trends in this industry indicate increased demand for new alternative types of tourism, among which most popular are nature-related and rural tourism.

This paper aims to increase an understanding of the importance of rural tourism for sustainable rural development and is therefore divided into two sections. In the first section the definition and main forms of rural tourism will be given. This section provides an overview of rural tourism, types of rural tourism, and its benefits for rural areas. Second part of the paper is dedicated to explanation of the concept and principles of sustainable rural development and identification of role of rural tourism in it. The paper concludes with recommendation of some ways of enhancing development of the rural tourism, which can contribute to the sustainable rural development. Main intention is to point out possible solutions and concepts that will revitalize rural area features and activities will make them tourist attractive and will incorporate rural tourism within the social, cultural, and economic elements of rural areas.

Key words: rural tourism, sustainable rural development

JEL classification: Q01, Q15, Z32

¹⁾ PhD, Institute of economics – Skopje,
e-mail: natasha.daniloska@ek-inst.ukim.edu.mk

²⁾ PhD, Institute of economics – Skopje, e-mail: katerina@ek-inst.ukim.edu.mk

Introduction

The process of globalization, together with the dynamic development of modern technologies of mass communication erases boundaries between sovereign state, allowing unrestricted flow of goods, people, idea and capital. In such constellation, tourism has emerged as one of the most dynamic and fastest growing industries worldwide representing about 6% of international trade in goods and service and accounting for 30% of the world's export of commercial services. Globally, tourism also ranks fourth as an export category, after fuels, chemicals and automotive products.³ It is estimated that thanks to the touristic sector GDP globally will rise from 9.2% (US \$5,751 billion) in 2010 to 9.6% (US \$11,151 billion) by 2020. The contribution of tourism to employment is also expected to rise from 8.1%, or 235,758,000 jobs across the world in 2010, to 9.2%, or 303,019,000 jobs, by 2020.⁴ Along with this astonishing numbers, the tourism industry will also have cope with bigger responsibility for its wide impacts, on the economy, on the environment, on societies and on cultural sites.⁵

The complexity of tourism and tourism needs of the world population lead to the change of tourism demand. Various scholars emphasize that the motivations of tourists to visit destinations have changed dramatically and now tourists are more interested in specific things, enthusiastic activities and, most importantly, in the quality experience of touristic products and services. Recent trends in tourism industry indicate increased demand for new, alternative and specific types of tourism. These types of tourism must possess certain characteristics that are well known to the local population so they can be established and respected as a real touristic product. Such an offer should possess unique values that will emphasize authenticity, uniqueness, etc., and can be used for promotional activities. Also, it should be explored, researched and designed according to the requirements of specific customers. Alternative and specific types of tourism most commonly are realized through vacation activities and/or arrangements within special facilities or destinations that are interesting for some groups of people

³ World Tourism Organization (UNWTO) Tourism Highlights, 2010, available at: http://www.unwto.org/facts/eng/pdf/highlights/UNWTO_Highlights10_en_HR.pdf

⁴ Travel and Tourism Council (WTTC), Progress and Priorities Report, 2010, available at: http://www.wttc.org/bin/pdf/original_pdf_file/pandp_final2_low_res.pdf

⁵ Dowling R., Moore S.A., Newsome D.: „Natural area tourism, ecology impacts and management”, Channel View, New York, 2001, pp.123-128.

with special interests or affinity (school and student youth, elderly people, women, persons with disabilities etc.), where tour operators provide all kinds of special facilities worldwide (nature, sports, wine, culture, painting, adventure, opera). In the same time, the development of the environmental movement in the 1980^s helped to the development and the increasement of the availability and the range of holiday types which was more environmentally friendly than these which was associated with traditional touristic offer. This environmentally friendly tourism types can be broadly defined “as forms of tourism that is made to be friendly to the environment and to respect social and cultural values of the communities, and which allow both hosts and guests to enjoy positive and worthwhile interaction and shared experiences”. All this gives a chance for rural areas to become equally involved with the contemporary tourism offer. Of course, such an offer has to be accompanied with a certain potential and adequate human resources who can engage those potentials on tourism market. All this puts rural tourism in a strategic position to make a positive contribution to the sustainability of rural areas and the development of the surroundings and their communities.

Rural Tourism

For tourism to be considered as rural tourism, it should have characteristics that are typical and specific to a rural area including small settlements, low population densities, agriculture-based economies and traditional societies. This type of tourism unites all special forms of tourism in rural areas. Main contextual characteristic of rural tourism is that it meets the needs of urban man for free space and gives him new experiences of nature and rural life and thus is in contrasts with urban space. Rural tourism is performed upon area that is originally used as a living and working space of rural population and agricultural producers that is area covered with arable, uncultivated and inhabited space outside the cities. It consists of the traditional village and rural architecture, together with entire rural landscape where traditional culture, specific knowledge and skills, habitation, clothing, nutrition, folk dances, songs and legends are developed, created and vivid. The unity of all this elements represents the distinctive and valuable part of the tourist value that should be integrated into rural tourism offer. This complexity of rural tourism resulted with many definition, each of them having specific aspect in focus. Namely, according to geographic and demographic

definitions, rural tourism is: “A multi-faced activity that takes place in an environment outside heavily urbanized areas. It is an industry sector characterized by small scale tourism business, set in areas where land use is dominated by agricultural pursuits, forestry or natural areas”. Product-related definitions point out that: “The rural tourism product could be segmented to include such product components as rural attractions, rural adventure tours, nature based tours, ecotourism tours, country towns, rural resorts and country-style accommodation, and farm holidays, together with festivals, events and agricultural education”, while tourist experience-related definitions see that: “Rural Tourism should be seen as offering a different range of experience to those offered in big cities” and that “the emphasis in rural tourism is on the tourist’s experience of the products and activities of the area”.⁶

Consequently, in an attempt to unite all previously mentioned definition, rural tourism have to possess following characteristics:⁷

- Located in rural areas.
- Functionally rural-built upon the rural world’s special features of small and medium size enterprise, open space, contact with nature and the natural world, heritage, „traditional” societies and „traditional” practises.
- Rural in scale-both in terms of buildings and settlements-and, therefore, usually small-scale.
- Traditional in character, growing slowly and organically, and connected with local families. It will often be very largely controlled locally and developed for the long term good of the area.
- Of many different kinds, representing the complex pattern of rural environment, economy, history and location.

Together with above mentioned characteristics, one must bear on mind that most important element for development of rural tourism and rural areas are tourist activities. Yet, achieving sustainable rural development and establishment of attractive rural destinations requires far more than natural resources or favorable conditions for recreation in nature. Indeed, apart from the aforementioned potential, development and

⁶ Lane B.: „What is rural tourism”, *Journal of sustainable tourism*, Volume 2, No.7, 1994, pp. 63-72

⁷ Roberts, L., Hall, D.: „Rural Tourism and Recreation: Principles to Practice”, *Leisure and Tourism*

Management Department, Scottish Agricultural College, Ayr, UK, 2001, p. 17.

sustainability of a rural tourist destination requires presence of different types of services to guests accompanied with systematic approach to preserving the environment.

The diversity of tourist activities included within rural tourism includes heritage tourism (sometimes also called cultural heritage tourism), nature-based tourism/ecotourism, agritourism, as well as partnership-based approaches, such as scenic byways and heritage areas.

Segments of rural tourism products:⁸

- Agrotourism, in which tourists see and participate in traditional agricultural practices without destroying the ecosystems, the host bases.
- Eco-tourism, as a form of tourism that presents natural resources while maintaining the values and local population welfare.
- Cultural, ethno or cultural heritage tourism, mainly related to culture, history and archeology of the area destination.
- Natural tourism, mainly preferred for its recreational value (hunting, fishing, horse riding etc.) or activities related to events, festivals, etc.

Major form of rural tourism is agritourism, which refers to the act of visiting a working farm or any agricultural, horticultural or agribusiness operation for the purpose of enjoyment, education, or active involvement in the activities of the farm or operation. It includes taking part in a broad range of farm-based activities, including food processing, farmers' markets, „petting” farms, roadside stands, and „pick-your-own” operations, shearing sheep, mowing, engaging in overnight farm stays and other farm visits, as well as visiting agriculture-related festivals, museums, and other similar attractions.⁹ Agrotourism become popular in the late nineteenth century and by the end of the twentieth century has become even more attractive. To an agricultural producers and farmers it represents a possible option to complement and increase revenue from the estate and also to diversify the risk associated with agribusiness in general. Agrotourism is common in many parts of the world and is becoming increasingly popular. In same time, agrotourism is very

⁸ Smith V., Eadington W.: „Tourism alternatives, potentials and problems in the development of tourism”, Wiley, Chichester, 1992, p.32

⁹ Ryan, C.: „Equity, management, power sharing and sustainability-issues of the “new tourism”. Tourism Management, 2002, pp. 17-26

important for rural communities as well as for urban areas. It can provide several advantages: income, employment, use accommodation, activities, natural resource conservation, recreation and education.

Despite its benefits, it is important to point out that agritourism is not an acceptable form of business activity for all agricultural producers and farmers. Namely, those wishing success in agrotourism must possess specific personal characteristics, as well as suitable resources within their households and premises where they wish to pursue this activity. Having necessary physical and natural resources and people who will provide needed service to the guests, is an absolute imperative. Additionally, there must be an adequate legal system that will enable establishment of a proper businesses entity, and the existence of the necessary support from the local community. In terms of personal characteristics, rural entrepreneurs (agricultural producers and farmers) primarily have to be open, very motivated for this job and ready to make their everyday life „shared” with guests, as well as to have some managerial skills. Of course, as for any other type of business, starting capital is needed, accessible location and adequate resources related to the character of the service offered.

Eco-tourism is one of the latest forms of rural tourism. Typically, it is primarily connected with protected areas, the use of simple lodging, the strict application of environmental legislation, and with a limited number of visitors. Eco-tourism can be developed in protected areas or even undiscovered areas, but main requirement that chosen locations must not be disturbed, that is, the environment, the natural harmony of the original appearance of the landscape remains untouched. Within the broader tourist industry eco-tourism is a growing market niche, with the ability to be an important tool for sustainable development. At the same time, it often operates quite different from other segments of the tourism industry, because eco-tourism is defined through its results in sustainable development: protection of nature, education of visitors about sustainability and benefits for the local people. The most common reasons offered by ecotourists for undertaking a given trip are a desire to enjoy scenery and nature, and to encounter new places and experiences with the imperative to „get away from it all” of less importance to the ecotourist than, say, the adventure tourist. What is typical for each eco-tourism is that eco-tourists usually seek experiences that give them a sense of closeness with the natural activities and the local population. At the same time, ecotourism generates income for conservation and economic benefits for communities living in rural and remote areas. The

attributes of ecotourism make it a valuable tool for conservation. Its implementation can:¹⁰

- give economic value to ecosystem services that protected areas provide;
- generate direct income for the conservation of protected areas;
- generate direct and indirect income for local stakeholders, creating incentives for conservation in local communities;
- build constituencies for conservation, locally, nationally and internationally;
- promote sustainable use of natural resources;
- reduce threats to biodiversity.

One of the risks of introducing ecotourism into a rural areas is that they can become dependant on tourism to generate income. This can be risky because tourism is a notoriously volatile economic activity, which is subject to booms and busts. Ecotourism is also very seasonal and the tourism market tends to fluctuate over time.

Cultural, ethno or cultural heritage tourism is one of modern tourism industry's most dynamically developing branches, in today's global tourism market both from the theoretical and the practical point of view. Cultural tourism in rural areas is mainly related to culture, history and archeology of the destination. This type of rural tourism concentrates on local traditions and people as the main attractions and can be divided into two types: The first and conventional type is where tourists experience culture through museums and formalized presentations of music and dance in theatres, hotels or occasionally in communities themselves. In many instances, this has lead to the „commodification” of culture as it becomes adapted for tourist consumption, often resulting in degradation of the hosts' cultural traditions. The second type is more anthropological and contains a strong visitor motivation for learning from indigenous culture rather than simply viewing an isolated manifestation of it. This type of tourism is often a companion to, or an element of, ecotourism. Interesting about this type of tourism is that it is considered to be domestic and international tourism with since for the both tourists it is enjoyable to visit historical monuments and monumental heritage, including cultural landscapes, which are located in the rural areas. In same time, cultural tourism gives them an opportunity to experience the

¹⁰ Conservation by Design: „A Framework for Mission Success : The Nature Conservancy" , Arlington, Virginia, 2001, p. 210

places and activities that authentically represent the cultural heritage of local communities.

Natural tourism, mainly preferred for its recreational value (hunting, fishing, horse riding etc.) or activities related to events, festivals, etc. Natural tourism mostly refers to the process of visiting rural areas for the purpose of enjoying the scenery, including plant and animal wildlife. Nature-based tourism may be either passive, in which observers tend to be strictly observers of nature, or active (increasingly popular in recent years), where participants take part in outdoor recreation or adventure travel activities.

Rural Tourism for a Sustainable Rural Development

The concept of sustainable development in general has been around for centuries but it was not until 1987 that official use of the term „sustainable development” received international attention and recognition, when it was defined as: „development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.¹¹ After many years of research and practice, nowadays sustainable development is mostly understood as a holistic concept with complex interrelation between social, economic, and environmental aspects of development. Also, depending on the circumstances in which it is being applied, sustainable development can mean many different. In order to better understand its complexity, one popular framework, called „Sustainable Development Triangle”¹² shows sustainability issues as being classified into three broad categories: social/political, environmental and economic issues.

¹¹ World Commission on Environment and Development, called Brundtland Report in 1987

¹² World Conservation Strategy. Developed in partnership by The World Conservation Union (IUCN), United Nations Environmental Programme (UNEP), World Wide Fund for Nature (WWF). (1991). World Conservation Union, available at: <http://www.gatewest.net/~green/from/11.html>

Figure 1. Sustainable Development Triangle



Source: World Conservation Union, 2003

From the Figure 1, we can clearly see that main aim of sustainable development is to provide a balance between the economy, the environment and society. As shown on Figure 1, principal idea is that all sides are interdependent and must coexist in order to promote successful long-term development. Clearly, within this broader understanding of sustainable development, we can place the definition for sustainable rural development, namely: „Rural Development is a deliberate process of sustained and sustainable economic, social, political, cultural and environmental change, designed to improve the quality of the life of local population of a rural region”¹³.

Although tourism in general is not mentioned into the original definition, it is not hard to conclude that it can be incorporated into sustainable development concept if it respects its three main principles. After our discussion about essence and types of rural tourism, it is not hard to see considerable overleaping between core principles of rural tourism and sustainable development. Thanks to its variety and holistic approach, rural tourism can make significant contribution to rural economies. In the context of sustainable rural development, its contribution can be seen not only in financial terms, but also in terms of

¹³ Dower, Michael: „Concepts and Principles for Sustainable Rural Development”, Paper on the Euroacademy Summer School. (Held from 9-21st of August, 2002, in Gotland). Developing Sustainable Rural Tourism *Thematic guide. Pan-European Summer Academy for Sustainable Rural Development*. 2002, p.16

jobs, nature conservation, adoption of new working practices, and the revitalization of passive and poor rural areas.

In financial terms, rural tourism not only provides additional income for agricultural producers and farmers, but it also contributes to both job retention and job creation for the population in rural areas. New jobs are typically available in hotel and catering services, but also in transport, retailing, and in information/heritage interpretation. While benefits of job creation are obvious, we must point out that job retention is not less valuable since for many families it is absolutely crucial for their survivor.

Since the rural tourism is interrelated with many services, it also can trigger expansion of complementary businesses. Even those rural businesses not directly involved in tourism can benefit from tourist activity through developing close relationships with tourist facilities where local foods can be used as part of the tourism offering in a locality.¹⁴ Together with the job creation, business opportunities that arouse from rural tourism are especially important for young rural population since they can secure their future.

Since the pleasant feeling of the guests is one of the most desired things to achieve, rural tourism encourages conformity to an ideal image of community which can result in growth of personal ties and community solidarity. Thus the basis for community solidarity shifts from shared cultural background to shared image.¹⁵ Additionally, in rural tourism the „sense of place“ is a fundamental element in both the tourists' and host community's feelings of what makes the area attractive to visit and live in. This sense of place is maintained partly through rural museums which play a vital role in preserving heritage.¹⁶

Finally, one of the crucial preconditions for development of rural tourism is the landscape and its preservation. Only with protection of the environment and preservation of the unity of rural areas, rural tourism will bring previously mentioned economic and social benefits. Namely, rural tourism can work as a form of sustainable development if it is

¹⁴ Boo, E.: „Making Ecotourism Sustainable: Recommendations for Planning, Development, and Management“. In T. Whelan (Ed), *Nature Tourism: Managing for the Environment*, Washington, DC: Island Press., 1999, pp. 187-199.

¹⁵ Honey, M.: „Ecotourism and Sustainable Development. Who owns Paradise?“, Island Press, Washington D.C., 1999, p. 82

¹⁶ Lindberg, K.: „Economic Impacts. In D. B. Weaver (Ed.), *Encyclopedia of Ecotourism*“ (363-378). New York: CABI International, 2001, pp. 363-378.

includes all three areas of the sustainable development triangle and brings benefits to current and future generations.

Conclusion

In this paper we have made an attempt to outline the connection between rural tourism and sustainable rural development. Analysis and comparison of both concepts made it clear that rural tourism represents a real opportunity for the revival and sustainable development of rural areas. However, in order for rural tourism to fit within the patterns of sustainable development and bring benefits to the local communities, protect the environment, and be economically viable, it must be comprehensive and account for the complexity of issues that have been mentioned in this paper. Additionally, we must bear in mind that every rural area is special, but thanks to its many types, rural tourism can contribute to their developing as a tourist destination and as a place pleasant to live, work, visit and investment.

Development of rural tourism is influenced by many factors that varies greatly among rural regions and depends on a host of factors including work force qualifications, characteristics and seasonality issues. Therefore, not all rural areas are equally attractive to rural tourists and simply providing accommodation facilities does not guarantee success.

In fact, a positive outcome is by no means guaranteed without sincere and foolhardy participation of the local community. If rural population love and respect their landscape, their way of life, their dialect, their cuisine and their heritage-they will develop valuable touristic product that can support sustainable development of the area. However, it needs to be said that rural tourism is not the magical solution to all rural problems but thanks to its benefits, it certainly is one of the many opportunities that rural communities must consider when facing the challenge of sustainable rural development.

References:

1. Boo, E.: „Making Ecotourism Sustainable: Recommendations for Planning, Development, and Management". In T. Whelan (Ed), *Nature Tourism: Managing for the Environment*, Washington, DC: Island Press., 1999.
2. Conservation by Design: „A Framework for Mission Success : The Nature Conservancy" , Arlington, Virginia.
3. Dower, Michael: „Concepts and Principles for Sustainable Rural Development", Paper on the Euroacademy Summer School. (Held from 9-21st of August, 2002, in Gotland). *Developing Sustainable Rural Tourism Thematic guide. Pan-European Summer Academy for Sustainable Rural Development. 2002.*
4. Dowling R., Moore S.A., Newsome D.: „Natural area tourism, ecology impacts and management", Channel View, New York, 2001.
5. Honey, M.: „Ecotourism and Sustainable Development. Who owns Paradise?", Island Press, Washington D.C., 1999.
6. Lane B.: „What is rural tourism", *Journal of sustainable tourism*, Volume 2, No.7, 1994.
7. Lindberg, K.: „Economic Impacts. In D. B. Weaver (Ed.), *Encyclopedia of Ecotourism*" (363-378). New York: CABI International, 2001.
8. Roberts, L., Hall, D.: „Rural Tourism and Recreation: Principles to Practice", Leisure and Tourism Management Department, Scottish Agricultural College, Ayr, UK, 2001.
9. Ryan, C.: „Equity, management, power sharing and sustainability-issues of the "new tourism". Leisure and Tourism Management Department, Scottish Agricultural College, Ayr, UK.
10. Smith V., Eadington W.: „Tourism alternatives, potentials and problems in the development of tourism", Wiley, Chichester, 1992.
11. Travel and Tourism Council (WTTC), *Progress and Priorities Report*, 2010, available at:
http://www.wttc.org/bin/pdf/original_pdf_file/pandp_final2_low_res.pdf
12. World Commission on Environment and Development, called Brundtland Report in 1987.

13. World Conservation Strategy. Developed in partnership by The World Conservation Union (IUCN), United Nations Environmental Programme (UNEP), World Wide Fund for Nature (WWF). (1991). World Conservation Union. 2003, available at: <http://www.gatewest.net/~green/from/11.html>
14. World Tourism Organization (UNWTO) Tourism Highlights, 2010, available at: http://www.unwto.org/facts/eng/pdf/highlights/UNWTO_Highlights10_en_HR.pdf

UDC 336.76:336.714(497.7)
Professional paper

Jadranka MRSIK¹⁾
Danica VUKOVIC TRPKOV²⁾

THE CUSTODIAN BANKS AND THE EVOLUTION OF THE EMERGING CAPITAL MARKETS:THE CASE OF MACEDONIA

Abstract

The development of an efficient capital market in the emerging countries is a long-term and diligent process. Building a modern financial infrastructure is crucial in this progress, by enabling effective flow of capital and mitigation of risk to markets when financial activities increase and internationalize. The custodians are one of the fundamentals of the financial infrastructure in running clearing and settlement systems.

Though the legal and infrastructural frame is completed and well established since the very beginning of the evolvement of the capital market, the custody services in Macedonia are relatively new banking service. The objective of this paper is to examine the role of the custodian banks on the Macedonian capital market.

The development of custody services opens good opportunities for entrance of new foreign and domestic institutional investors on the Macedonian market. In this paper we will evaluate the role of the custodians on the development of the Macedonian capital market by employing the pension funds who are their main institutional clients and we will compare the results with the Croatian custodians. We will make recommendation for further development of the custody activities based on the conclusions from our research.

Keywords: custody services, pension funds, institutional investors, capital markets.

¹⁾ Jadranka MRSIK, PhD, assistant professor, University American College, Skopje, Republic of Macedonia, E-mail: jadranka.mrsik@uacs.edu.mk

²⁾ Danica Vukovic Trpkov, M.Sc., Custody Account Officer, NLB Tutunska Banka AD Skopje, Skopje, Republic of Macedonia, E-mail: danicavukovic@yahoo.com

JEL classification: G23, G21

Introduction

The custodian banks have been serving many roles in emerging capital markets development, not only introducing the investor base, but also helping clients in understanding local tax and legal regime, improving liquidity and being a vital part of the trading cycle. The custodian services are novelty on the Macedonian capital market.

The Macedonian stock exchange was operating almost two decades and it is still in immature stage. Macedonia is among the lesser developed markets, together with Bosnia and Herzegovina, Serbia and Ukraine, in the categorization of the emerging European countries based on the level of development of their capital markets made by Iorgova and Ong (2008: 6-23). Therefore, the main goal of this paper is to evaluate the role of the custodians on the Macedonian capital market.

The custodians provide custody services to a variety of customers, including mutual funds, investment managers, retirement plans, bank fiduciary, agency accounts, bank marketable securities accounts, insurance companies, corporations, endowments, foundations, and private banking clients (Comptroller's Handbook, 2002). In Macedonia, custody services are mainly used by institutional investors (investment fund, pension funds, and insurance companies), but also from non-resident physical and legal entities that invest on the Macedonian market.

Institutional investors have made significant impact on the capital market overall development in the emerging countries and have shown evident growth (Mrsik and Delova-Jolevska, 2014: 197-212). The assets of the institutional investors in CEE (Central and Eastern Europe) countries are still small. In this region the institutional investors in Hungary and Poland show largest assets volume, with 10.4% and 7.6% for the institutional investors, 8.6% and 10.3% for insurance companies and 11% and 11.9% for pension funds' assets. The percentage of the assets relative to the GDP is lowest in the emerging markets of Albania, Bulgaria, Romania, Serbia and Ukraine. In these countries the assets of investment funds are from 0.4% to 0.7% from GDP, the assets of insurance companies move from 1.4% to 3.6% and pension funds' assets go from 0.1% to 3.8% of GDP. In the middle are Croatia, Czech Republic, Greece, Slovak Republic and Slovenia with similar assets

volume of the institutional investors relative to their GDP (World Bank, 2014). Between the institutional investors pension funds have the major role on the Macedonian financial market. The market share of the insurance companies in 2013 is 2.24% of Macedonian GDP. The assets of the investment funds are still very low with only 0.16% of the GDP. The pension funds' assets show significant growth through the years and in 2013 have 5.95% of the GDP (Authors' calculations: Data from World Bank, local regulators MAPAS and ASO-Insurance Supervision Agency, pension funds and investment funds annual reports).

The pension funds, primary the mandatory pension funds, being a key institutional investor on this market, are the main factor in the development of the custodian services on this market and main instigator in their further improvement, specialization and sophistication. Private pension funds are new financial institutions on the Macedonian financial market, starting their work in 2006. Their main role is managing the assets of their members with minimum risk and maximum rate of return and the custodian is responsible of the safety of these assets. In the beginning of the work of the pension funds, the role of the custodian was done by the Central Bank (from 2006 till 2008). From 2009, this activity was transferred to two commercial banks (MAPAS, 2014).

Custodian and custody services

Custody is a relatively new service on the financial markets that relates to the storage and management of assets on behalf of a client (Chan et al 2007). Custody comprises keeping the assets safe and these assets include shares, bonds and other investments. Custody services are approved either as part of the banking license, or as an add-on certification to a banking license.

Along with the globalization, the role of the institutional investors as financial intermediaries has grown. The market value of the assets collected by institutional investors in some of the developed countries exceeds 100%. In 2013 in Luxembourg the assets of investment funds are larger than the GDP, 6,407.2%, in Ireland is 832.3% and in Denmark 100.5%. The assets of the insurance companies are 325.8% of the GDP in Luxembourg in 2013, 103.2% in France and 100.1% in Denmark (OECD, 2014).

In Europe's emerging countries the growth of the institutional investors, such as investment funds, insurance companies and pension

funds, has played an important part in transforming these countries in market economies. The shortage of reliable custodian services was an institutional bottleneck for investors in Central and Southeastern Europe. Therefore, it was recognized by the governments as a necessity for strengthening the local financial infrastructure. Custody services are essential and compulsory by law for the institutional investors (investment funds, insurance companies and pension funds), which have strict internal audit rules requiring high-standard custody services (Pohl et al, 1995: 14-26).

The development of domestic institutional investors increased the importance of their role. On the other hand, foreign institutional investors have played a significant promoter role in the improvement of the institutional infrastructure of emerging market economies. Deregulation and modernization was a characteristic of the financial sector in emerging markets. The continued progress of restructuring and modernization in the banking sector contributed to the involvement of the banks in the institutional sector activities, including money management services in Central and Southeastern Europe. Demographic developments in correlation with the pension reforms in this region were the most important determinants of the growth of the domestic institutional sector (Blommestein, 1997: 5-29). Iorgova and Ong (2008: 6-23) support these correlations, noting that in emerging Europe, the growth of traditional institutional investors, especially pension funds, had played an important role in the transformation of countries in the region into market economies by enhancing market competition and having balancing influence in the bank-dominated financial systems.

Model and data

For reviewing the role of the custody banks descriptive statistics will be used in this research. The development of the private pension system in Macedonia and Croatia will be measured by calculating the ratio of total private pension assets to national GDP. The volume of the assets of the voluntary pension funds is still insignificant on both Macedonian and Croatian market and the mandatory pension funds' assets are predominantly in total pension assets. Measurement will be made for the period from 2006 till 2013, since in 2006 the mandatory private pension funds started their operation on the Macedonian market.

We will use data from the pension funds and the commercial banks performing custody services for these funds.

The ratio of income from custody services for pension funds to non-interest income of the custodian banks will be used for measuring the development of custody services in Macedonia and Croatia. The ratio will be calculated for the period from 2009 to 2013, when the commercial banks in Macedonia started to operate as custodians. The income from custody services for pension funds will be measured in relation to the non-interest banking income. These calculations will also be made with income from the total pension funds on both Macedonian and Croatian market.

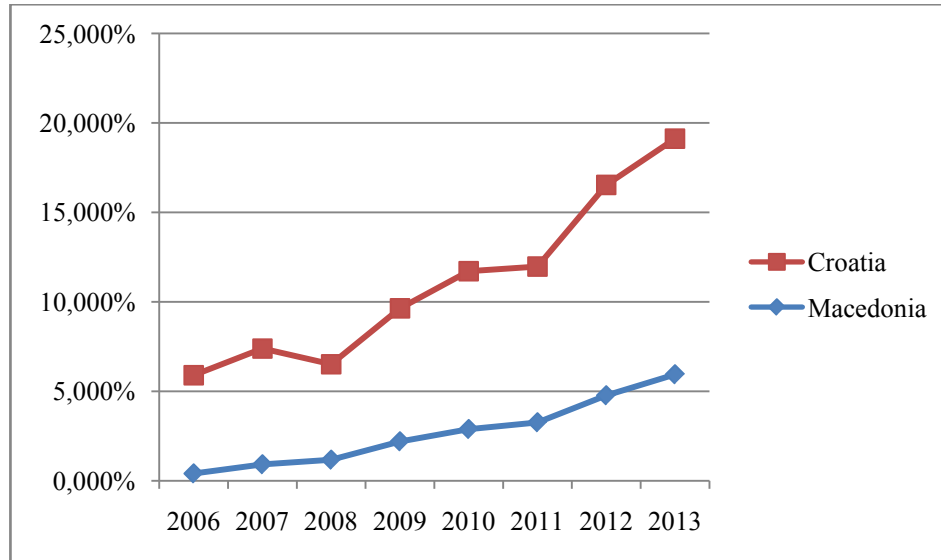
We will use comparative data analysis of the private pension system and custody services for pension funds between Croatia and Macedonia. We select Croatia for doing the comparative analysis because of the similarities and the experience between these two pension systems on one hand. The pension systems of the both countries have the same background as they have been part of the Yugoslav Federation (SFRY) and became independent countries in 1991, on the other (Golubovic, 2008). The pension reform in Croatia was carried out in 1999 by applying the three-pillar system of pension insurance and the second pillar-mandatory private pension insurance was introduced in 2002. Macedonia introduced the reform in 2000, and implemented the second pillar in 2006 (Fornero and Ferraresi, 2007: 2-29). However, similarity between these countries' pension systems is the regulatory obligation of having the assets of the private pension funds safely kept under custody keeping (HANFA, 2014: 72-93; MAPAS, 2014). The results will show the impact of the private pension funds on the Macedonian capital market and the important role of the custodian bank in providing trustworthy institutional investors.

Result

The importance of the pension funds as institutional investors in Macedonia and Croatia is shown by assets to GDP ratio for both markets. The calculation is done for the total pension fund's assets (mandatory and voluntary) from the inception of the pension funds in 2006 till 2013. As it is evident from the Figure 1, the role of the pension funds is growing on the Macedonian and even more on the Croatian capital market. Managing substantial amount of assets, the pension fund industry will continue to

grow, opening on path for further development of the custody services offered on these markets.

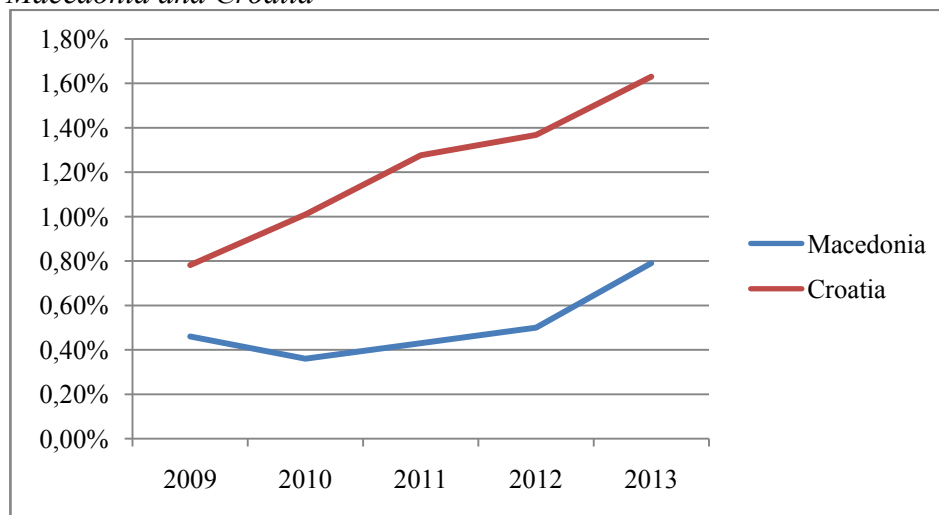
Figure 1: Importance of pension funds relative to the size of the economy in Macedonia and Croatia



Source: Authors' calculations; Data from World Bank, local regulators MAPAS and HANFA and pension funds annual reports

The role of the custodian bank in the operation of the pension funds is measured by calculating the development of the custody services in Macedonia and Croatia, quantifying the ratio of income from custody services for pension funds to total non-interest income of the custodian banks. The fees from custodian services for pension funds are still insignificant, compared to other bank services non-interest revenues, but having in mind that these services are relatively new on the Macedonian market, as well as in Croatia, there is a place of their further improvement and gaining additional fees and income. By enlarging the confidence of the people in investing, and their trust in the private pension funds, the potential of the still immature and young Macedonian financial market is large.

Figure 2: *The development of the custody services for pension funds in Macedonia and Croatia*



Source: Authors' calculations; Data from World Bank, local regulators MAPAS and HANFA and pension funds' annual reports

The statistics coefficient correlation between the pension assets/GDP ratio and custody revenues/total non-interest revenues is positive and strong, 0.85 in Macedonia and 0.93 in Croatia. This coefficient is calculated for the period from 2009 till 2013, when custody services are undertaken by the commercial banks in Macedonia.

Conclusion

The role of the custodians emerged and developed with the expansion of the institutional investors (pension funds, investment funds and insurance companies). The growing importance of the role of institutional investors guided by private pension funds represents the most important change in the emerging capital markets in recent years. As Iorgova and Ong (2008: 6-23) explain, the development of a local institutional investor base is essential for supporting local capital markets.

On the Macedonian financial market, custody services are a new banking service, offered by only two commercial banks since 2009. These services are used mainly by the private pension funds. The size of the other users, the investment funds and insurance companies, measured

as the asset volume relative to the Macedonian GDP is minor. Pension funds are the key institutional investor on this market and the main instigator in the development of the custodian services, further more in their improvement, specialization and sophistication. Custodians have a very important role in the pension funds operation as largest institutional investors on this market.

The assets of the pension funds in Macedonia show linear growth through the years, and by 2013 they reach 6% of the country's GDP. Having a mandatory second pillar of the pension system means additional obligatory mobilization of funds, resulting to supplementary growth of the assets volume. This on the other hand, enlarges the assets that custodians will keep safe. The strong linear correlation between the growth of the pension assets and the revenues from custody services, illustrates that with further enlargement of the volume of the pension funds' assets the income made from custody activities will raise as well with same intensity. The ratio custody revenues relative to the total banks' non-interest revenues indicates growth through the years and by 2013 is 0.79%.

The pension funds expansion was improving the range of services offered by the custodians, as well. The improvement of custody services on the Macedonian market opens possibilities for entrance of new institutional investors on this capital market, as well as foreign portfolio investors. Growing trading volumes of private pension funds and the progress of their investment portfolios are drivers for development in assets under custody. The custodians need to follow the advanced requirements of clients, consequently to improve the quality of their services by investing in technology, people and expertise.

References:

1. Agency for Supervision on Fully Funded Pension Insurance. (2014). *Report on The Developments in The Fully Funded Pension Insurance, 2013*. MAPAS. [Online] Available at: <http://www.mapas.mk/index.php/site-administrator/izvestai-za-kfpo> [Accessed 1 November 2014]
2. Agency for Supervision on Fully Funded Pension Insurance. (2013). *Report on The Developments in The Fully Funded Pension Insurance, 2012*. MAPAS. [Online] Available at:

- <http://www.mapas.mk/index.php/site-administrator/izvestai-za-kfpo> [Accessed 1 November 2014]
3. Blommestein Hans J., (1997). *Institutional Investors, Pension Reform and Emerging Securities Markets*. OECD. [Online], pp 5-29, Available at: <http://core.ac.uk/download/pdf/6441709.pdf> [Accessed 25 October 2014]
 4. Bodiroga-Vukobrat, (2011). *Pension, Health Care and Long-term Care. asisp Annual National Report 2011*. [Online], pp 2-16, Available at: http://socialprotection.eu/files_db/1155/asisp_ANR11_Croatia.pdf [Accessed 24 February 2015]
 5. Chan Diana et al., (2007). *The securities custody industry, European Central Bank, Occasional paper series*. [Online] Available at: <https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp68.pdf> [Accessed 22 November 2014]
 6. Citibank N.A., (2007). *The Role of Custodian Banks in the Development of Capital Markets. Asian Investor*. [Online] Available at: https://www.citibank.com/mss/about_us/articles/docs/2007/citi_sibos.pdf [Accessed 3 November 2014]
 7. Comptroller of the Currency Administrator of National Banks, (2002). *Custody Services. Comptroller's Handbook. Asset Management*. [Online] Available at: <http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/custodyservice.pdf> [Accessed 3 November 2014]
 8. Davis E Philip, (2005). *The Role of Pension Funds as Institutional Investors in Emerging Markets. Brunel University and NIESR. Korean Development Institute conference, Population Aging in Korea: Economic Impacts and Policy Issues, Seoul, March 2005*. [Online], pp 2-16, Available at: https://www.kdi.re.kr/data/download/attach/7798_4_3.pdf [Accessed 14 April 2015]
 9. Financial Reports, AZ Fond Voluntary Fund, Available at: <http://www.azfond.hr/izvjesca-i-publikacije/dobrovoljni-mirovinski-fond-financijska-izvjesca/> [Accessed 27 October 2014]

10. Financial Reports, AZ Fond Mandatory Fund, Available at: <http://www.azfond.hr/izvjesca-i-publikacije/obvezni-mirovinski-fond-financijska-izvjesca/> [Accessed 27 October 2014]
11. Financial Reports, Erste Plavi Mandatory Fund, Available at: <http://www.ersteplavi.hr/default.aspx?id=67> [Accessed 27 October 2014]
12. Financial Reports, Erste Plavi Voluntary Fund, Available at: <http://www.ersteplavi.hr/default.aspx?id=68>
<http://www.ersteplavi.hr/default.aspx?id=69> [Accessed 27 October 2014]
13. Financial Reports, PBZ Croatia Osiguranje Mandatory Fund, Available at: <http://www.pbzco-fond.hr/aboutus/reports2.aspx> [Accessed 27 October 2014]
14. Financial Reports, PBZ Croatia Osiguranje Voluntary Fund, Available at: <http://www.crosig-trecistup.hr/default.aspx?id=37> [Accessed 27 October 2014]
15. Financial Reports, Raiffeisen Mirovinski Mandatory Fund, Available at: <http://www.rmfi.hr/default.aspx?id=342> [Accessed 27 October 2014]
16. Financial Reports, Raiffeisen Mirovinski Voluntary Fund, Available at: <http://www.rmfi.hr/default.aspx?id=343> [Accessed 27 October 2014]
17. Financial Reports, Societe Generale - Splitska banka, Available at: http://www.splitskabanka.hr/Portals/8/PDF/Press/Godisnje_izvjesce_za_2013_030614.pdf
<http://www.splitskabanka.hr/rezultati-pretrazivanja?q=godisne+izvjesce> [Accessed 15 November 2014]
18. Financial Reports, Hypo Alpe Adria Banka, Available at: http://www.hypo-alpe-adria.hr/home.nsf/pages/o_nama-godi%C5%A1nje_izvje%C5%A1%C4%87e-192 [Accessed 15 November 2014]
19. Financial Reports, Hrvatska Postenska Bnka, Available at: <http://www.hpb.hr/?hr=financijska-izvje%C5%A1%C4%87a> [Accessed 15 November 2014]
20. Financial Reports, Komercijalna Banka AD Skopje, Available at: <http://www.seinet.com.mk/AdvSearch.aspx> [Accessed 15 November 2014]

21. Financial Reports, KB Mandatory pension fund, Available at:
<http://www.kbprvo.com.mk/web/guest/76>
[Accessed 18 November 2014]
22. Financial Reports, KB Voluntary pension fund, Available at:
<http://www.kbprvo.com.mk/web/guest/77>
[Accessed 18 November 2014]
23. Financial Reports, Macedonian Central Bank, Available at:
<http://www.nbrm.mk/?ItemID=D5F12A56409FFD43903EC90DA19F2258> [Accessed 3 December 2014]
24. Financial Reports, NLB Tutunska Banka AD Skopje,
Available at:
<http://www.nlbtd.com.mk/default.aspx?mId=84&lId=1>
[Accessed 15 November 2014]
25. Financial Reports, NPF Mandatory and Voluntary pension fund,
Available at:
<https://www.nlbnpf.com.mk/web/guest/finansiskiiizvestai>
[Accessed 18 November 2014]
26. Fornero Elsa and Ferraresi Marco Pier, (2007). *Pension Reform and the Development of Pension Systems: An Evaluation of World Bank Assistance, Background Paper Macedonia Country Study*, The World Bank Washington, D.C. [Online], pp 2-29,
Available at:
http://ieg.worldbank.org/Data/reports/macedonia_pensions_wp.pdf
[Accessed 28 October 2014]
27. Golubovic Velizar, (2008). *The functioning of the pension insurance system in the countries of former Yugoslavia, South-East Europe Review*. [Online] Available at:
http://www.seer.nomos.de/fileadmin/seer/doc/Aufsatz_SEER_08_04.pdf [Accessed 1 December 2014]
28. HANFA, (2012). *Annual Report, 2011. Croatian Financial Services Supervisory Agency*. [Online], pp 45-69, Available at:
<http://www.hanfa.hr/EN/nav/109/godisnje-izvjesce---engleski.html> [Accessed 25 February 2015]
29. HANFA, (2014). *Annual Report, 2013. Croatian Financial Services Supervisory Agency*. [Online], pp 72-93, Available at:
http://www.hanfa.hr/getfile/42468/HANFA_AR_ENGL%202013_01_04_2015_FINAL.pdf [Accessed 25 February 2015]

30. Insurance Supervision Agency, (2014). *Annual Report of The Insurance Supervision Agency, 2013*. [Online], pp 17,
Available at:
http://www.aso.mk/index.php?option=com_fjrelated&view=fjrelated&id=0&Itemid=96&lang=en [Accessed 1 May 2015]
31. Insurance Supervision Agency, (2012). *Annual Report of The Insurance Supervision Agency, 2011*. [Online], pp 19,
Available at:
http://www.aso.mk/index.php?option=com_fjrelated&view=fjrelated&id=0&Itemid=96&lang=en [Accessed 1 May 2015]
32. Insurance Supervision Agency, (2010). *Annual Report of The Insurance Supervision Agency, 2009*. [Online], pp 15,
Available at:
http://www.aso.mk/index.php?option=com_fjrelated&view=fjrelated&id=0&Itemid=96&lang=en [Accessed 1 May 2015]
33. International Bank for Reconstruction and Development, The World Bank, (2014). *Financial Inclusion, Global Financial development report 2014*. [Online] Available at:
<https://openknowledge.worldbank.org/bitstream/handle/10986/16238/9780821399859.pdf?sequence=4> [Accessed 8 December 2014]
34. Iorgova Silvia and Ong Li Lian, (2008). *The Capital Markets of Emerging Europe: Institutions, Instruments and Investors. International Monetary Fund Working Paper*. [Online], pp 6-23,
Available at:
<https://www.imf.org/external/pubs/ft/wp/2008/wp08103.pdf>
[Accessed 10 April 2015]
35. Macedonian Stock Exchange. *History of the Macedonian Stock Exchange*. [Online] Available at:
<http://www.mse.mk/mk/content/22/1/2008/history> [Accessed 30 April 2015]
36. Mrsik Jadranka and Delova-Jolevska Evica, (2014). *Institutional Investors and Their Impact on The Local Stock Markets in Small Developing Economies. Horizons Series A, May 2014, Vol.13, p.197-212, 16p*. [EBSCO Host] [Accessed 1 April 2015]
37. NBRM, (2015). *Basic Economic Indicators, Macedonian Central Bank*. [Online] Available at:
<http://nbrm.mk/?ItemID=750FC531FC3D1B49B16440313562D400> [Accessed 20 May 2015]

38. OECD, (2013). *Pension Markets in Focus, 2013*. [Online] Available at: <http://www.oecd.org/pensions/PensionMarketsInFocus2013.pdf> [Accessed 30 October 2014]
39. OECD, (2014). *Pension Markets in Focus, 2014*. [Online] Available at: <http://www.oecd.org/daf/fin/private-pensions/Pension-Markets-in-Focus-2014.pdf> [Accessed 9 March 2015]
40. Pohl Gerhard et al, (1995). *Creating Capital Markets in Central and Eastern Europe. World Bank Technical Paper Number 295*. [Online], pp 14-26, Available at: https://books.google.mk/books?id=pwSB7cl2Lq8C&pg=PA19&pg=PA19&dq=custody+services+in+central+and+eastern+europe&source=bl&ots=30o73Zrqe3&sig=f_71SVWUwRxRUbcFvlfMBfgYLPi&hl=mk&sa=X&ei=ue80VdXWG6P7ywONrYDQCQ&redir_esc=y#v=onepage&q=custody%20services%20in%20central%20and%20eastern%20europe&f=false [Accessed 1 April 2015]
41. The World Bank, (2013). *Reversal and Reduction, Resolution and Reform; Lessons from the Financial Crisis in Europe and Central Asia to Improve Outcomes from Mandatory Private Pensions*. [Online], pp 2-7, 37-40, Available at: <http://documents.worldbank.org/curated/en/2013/05/18042086/reversal-reduction-resolution-reform-lessons-financial-crisis-europe-central-asia-improve-outcomes-mandatory-private-pensions> [Accessed 1 November 2014]
42. The World Bank. *GDP Per Capita Data*. [Online] Available at: <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD> [Accessed 1 December 2014]
43. The World Bank. *World Development Report 2014*. [Online] Available at: <http://econ.worldbank.org/> [Accessed 10 November 2014]

UDC 338.486.2:005(497.7)
Professional paper

Mimoza SERAFIMOVA¹⁾
Zlatko JAKOVLEV²⁾
Cane KOTESKI³⁾

INTRA-ENTREPRENEURSHIP MANAGEMENT IN TOURIST ORGANIZATIONS IN THE EAST REGION OF R. MACEDONIA

Abstract

This paper is focused on the main results from the research embarked in the line of employees which work in tourism and catering in Macedonia. On top of this, on paper there is an idea to evaluate the current situation of the intra-entrepreneurship skills and abilities of the employees in the tourism field and to discover the deepest obstacles for their entrepreneurship development in the tourist sector. For this goal, self-administrative questionnaire has been distributed between the managers and employees that work in the tourist agencies and objects on several locations in Macedonia.

Besides, on paper there are several concrete standards which implementation would make the process of effective internal management easier, which would make the managers and employees confront in the tourism and tourism sector in Macedonia. The contribution of this paper is that the solution of this question makes the under-developed academic work in Macedonia in this segment richer.

Key words: intra-entrepreneurship, management, tourism, quality standards.

¹⁾ Corresponding author: Mimoza Serafimova, Ph.D., assistant professor, Faculty of Tourism and Business Logistics, University Goce Delcev, e-mail: mimoza.serafimova@ugd.edu.mk

²⁾ Zlatko Jakovlev, Ph.D., associate professor, Faculty of Tourism and Business Logistics, University Goce Delcev. e-mail: zlatko.jakovlev@ugd.edu.mk

³⁾ Cane Koteski, Ph.D., assistant professor, Faculty of Tourism and Business Logistics, University Goce Delcev. e-mail: cane.koteski@ugd.edu.mk

JEL classification: M, M2, M11, M21

Introduction

According to some researchers, the intra entrepreneurship tourism organizations often need new kinds of people which could associate the two worlds: entrepreneurship and corporation. Basically, all the skills that characterize intra entrepreneurs are very different from the skills that are needed according to the traditional corporate management plan entrepreneurs, and the differences are displayed in Table 1. This is how, unlike the entrepreneurs, the intra-entrepreneurs need skills to develop a team and to firmly understand the business and market reality, and are also characterized with features of leadership and fast decision-making by the successful owners-managers. Because of this, during the development of entrepreneurship, the task of the managers in the organization is to identify those individuals that own managing skills, to manage projects in the company itself and their management skills through which a successful project would be lead.

Picture 1: Managing skills of the entrepreneurs

Ability to undertake multi-complexed roles
--

Understanding the surroundings Encouraging open discussions
--

Creating options for effective management

Creating coalitions of supporters

Source: Bostjan Antoncic and Robert D. Hisrich, *Clarifying the intrapreneurship concept*, Journal of Small Business and Enterprise Development, Number 1, 2003, pp.11.

Review of the literature

Every institution, including the tourist-catering, has a need of implementing its own individual management system appropriate with its internal structure and dynamics through using of the concepts and

standards set by its unique philosophy and structure of the individual and professional structures of the managers and employees and their knowledge.

Lolwana (2006:359), points out that new approaches towards creating a quality adopted by the European Frame of Qualifications (EFQ) as model, only confirm the need of public criteria and standards, in terms that the improvement of the institutions could be evaluated, through practicing a form of a system of managing quality (SMQ). This, leads to the question-is this enough to evaluate the improvement quality of the institution, if you start with the fact that most approaches towards ensuring quality through the process of intra entrepreneurship, tend to not seek the answer of two important questions:

- How could the management process improve?
- In what part of the processes are there any problems?

Heinz, P (2003:64) defines the process of quality management as a “systematic management of procedures applied to ensure acquiring a certain quality and improvement of quality, which would provide trust from the crucial participants in the existing process of management and the acquired results”.

The process of providing quality of the management process has the following main goals:

- Precise and thorough identification, definition and description of the expectations and need of the clients.
- An independent revision and following the quality, acquiring information for the ones that are implemented, managed or somehow contribute to the improvement of quality.
- Providing measurable criteria for everyone included in the process, to have a clear, thorough and correct understanding of the standards for quality of the organization process.
- Providing resources and systems which could help achieve the needed quality.
- Make sure that the ones that are implemented have skills, abilities, knowledge and motivation to create and deliver the appropriate quality.
- Make sure that the ones that manage, have tools and skills to follow the quality and ability to communicate and change the criteria to improve the needed standards. (Education sector, 2004).

The authors James, Meng, and Roberts as important, list the following barriers of the intra-entrepreneurship:

Traditional corporate structure-the hierarchy nature of the big companies is not appropriate for entrepreneurship attitude, with a significant distance between the layer of top management and the lower layers of work force, which results with a thin relationship between the management and employees.

Corporate culture- the nature of the corporate structure where description of the work assignments are rigidly implemented which leads to suffocating the innovations.

Standard performances of the giant enterprises- enforced by the big businesses, especially short-term, could reflect badly on the development of the intra entrepreneurship project, which could often have a long term nature. In large companies, short-term profit generally is used as a main measurement of the success of the company.

Procedures of planning- in the big companies, the way of planning could suffocate the entrepreneurship.

Ownership as a whole- and its connection to the independence in making decisions is one of the main motives in entrepreneurship. This is not often in big companies where independent decision-making is almost impossible.

Management mobility- in the big companies there could be a lack of association for specific projects, especially if they are long-term.

Inappropriate upgrading system- in many large companies, there are often inappropriate methods of upgrading creative employees.

Basically, all these barriers could be sublimed as a condition of the organization called organizational arteriosclerosis, which means aging of the organizational stands of the enterprise, or its conservative and bureaucratic attitude towards changes.

1. Development of intra entrepreneurship competences in employees as a modern management approach

Research methodology

From all the above, it's concluded that there is a real need of increasing the quality of the work practices, acknowledged from improving personal skills of the managers, to create a working

environment in which the employees would be motivated to implement the personal development of their own competences and abilities to participate in managing the working process, which would increase the organizational orientation for effective satisfaction of the needs of participants in the working process and environment.

This is exactly what defines the research subject-the need of setting a model of corporate-integrative-entrepreneurship management as a crucial factor for improving the work of tourism organizations.

Starting from the fact that management in the tourism organizations is realized even in the absence of a functional system of quality standards, this is aimed to provide a continued improvement and adjustment of the management process and the true responsibility of the employees whose improvements in managing and integration of the process would result in development intra entrepreneurship as a function of development of individual and institutional aspects of the organizations.

Collecting the information was aimed at the following aspects:

- Real consciousness of the employees for the existing important aspects of quality of the work processes in the organizations.
- Level of active including of the employees in the project management.
- Participation of the managers in improving the effectiveness of the employee's work.
- The need of continued education of the employees, as part of the strategic management of the organizations.

This research has shown the attitude towards changes through activities and commitment for institutional changes which refer to accepting the need of change of the existing system, which would improve the functionality of the institutional management levels.

The focus is set on integration of managers and employees, which would contribute to increasing the quality of work and increasing the results of all users as an aspect of the whole institutional and socio-economic development.

Individual changes are associated with changes in each of the tourism organizations separately, which would be recognized in more effective approach by the employees in the management process with the work projects. This improvement would manifest in bigger and better cooperation team, mutual respect, experience exchange, positive critics and self-criticism, and motivation for permanent internal and

external education, which would significantly decrease the social „rubbing“ in both vertical and horizontal bases.

The research sample includes:

- sample of organizations that deliver services (8);
- sample of organizations that deliver both service and production activities (16);
- sample of managers/from all levels (31);
- sample of employees (267).

The sought attitudes and opinions were aimed towards:

- evaluation of the existing practice through following the attitudes and opinions of the consciousness for existing aspects of intra entrepreneurship management, through including the employees and the suitability of the existing management processes;
- suggestions to increase the effectiveness of individual employees, the need of new intentions for management and suggestions in the management process with the organization projects, creating effective working plans and measuring crucial, i.e exit results.

The data analyze referring to the existing management process has come up with two general conclusions:

- a. There hasn't been defined a coordination between the levels of the management system (horizontal and vertical) and the employees.
- b. There is a lack of effective communication between all the crucial factors in this process.

Aiming to provide high quality, transparent and easier understanding of the process of management for everyone included, defining the strategic goals of human resources in function of its organization is needed a permanent measurement by:

1.1. Standard: MANAGEMENT with human resources in function of entrepreneurship work organization

Parameter: organization managers should practice systematic management, aiming to provide recognition, development and practicing key competences for the employees in order to manage-

programmes that provide mission and strategy to fulfill their professional needs.

Indicators:

- Adopting politics of providing and developing abilities for management of the employees.
- Adopting criteria of employment and practicing of their definition.
- Systematic identification of the needs and planning of a sustainable competence development.
- Existing of a continued professional development, training and presentations.
- Implementation of a process of organized learning, suitable skills and qualifications.
- Development of methods-mentorship in fields of future employment.

Besides that, for defining documented sources of evidence for implementation of these standards, the following is needed:

- Existing functional diagram of organizational structure in function of descriptions and responsibilities of all the set levels of operative management.
- Adaptation of the changes and innovations needed for an effective process: processes of adaptation of new work assignments, evidence of the processes of succesful adaptation, presentations and regular feedback for their performances.
- Reports and analyses of the results from following the work processes.
- Reports and analyses of the evaluation of the process predicted by all the impacted parties.

The strategy of planning, prediction of the unfavorable conditions and applying corrective measurements, needed to synchronize with actions of improvement, could be expressed in two forms:

- a. Strategic options-prediction of maximum and minimum of the expected fulfillment.

The implementation of this type of improvement would be measured by:

1.2. Standard: EXISTING ACTIONS for improvement of the planning process

Parameter: Organizations aim towards a sustainable improvement in the key indicators based on systematic evaluation of the intra entrepreneurship effectiveness of the work process, resources and feedback from the clients.

Indicators:

- Using tools for system development, which allow quality feedback of the impacted parties.
- Existing of an external evaluation process (for productivity control).
- Setting of identified indicators for the aims of this project.
- A process of constant self-control of internal indicators.;
- Providing activities for comparison.
- Transparency of the planned activities for improvement referring the organization strategy.
- Continuing the process of developing professional competences and evaluation of the personal presentation (class staff).

Documented sources of evidence for implementation of this standard:

- Concept of evaluation includes setting indicators and analyses.
- Implementation of average measurement-internal evaluation of the changes referring to the processes in the organization.
- Using comparative reports as a measurement for external comparisons.
- Internal evaluation of the achieved annual activities.
- Internal evaluation in sync with the evaluation criteria on state level, including trend indicators from previous evaluations.

a. Strategic alternatives-success of the development process of specific scenarios for every assumed circumstances for a certain period of time, would be followed by:

1.3. Standard: Measuring key results

Parametar: Institutional measurements of results refering to the key components of the long term strategy for the clients' satisfaction.

Indicators:

When choosing indicators, it is essential to find the answers to the following questions:

- Are the impacted parties satisfied?
- Are the employers satisfied by the achieved knowledge and skills referring to the employees on the workplace?
- What results are gotten in the process of evaluation?
- Which part of the process makes them successful in the labour market?
- How does the entire work in the educational institution look like?
- How to successfully implement the program that refers to the clients' demands?
- How to successfully achieve the financial goals?

Documented sources of evidence for implementation of this standard:

- Number of participants in the work programmes.
- Traffic or the amount of educational services provided in further professional education.
- Regular measurement of the clients' satisfaction.
- Results of measurement of the clients' satisfaction.
- Analyses of the responses.
- Review and analyses of the number of assumptions and improvement in the development of the organization strategy, two groups are needed:
 - a. analytical activities-collecting and treatment of different data referring the organization of the environment by the analytical teams;
 - b. synthetic activities-setting criteria, strategic goals and strategic scenarios implemented by the development team.

All of these listed segments are useful to provide an effective management of the quality improvement of the process, which would enable growth and development of:

- integration of the change of the existing condition;
- transfer of change;
- spiral correlation with the previous and following state.

Besides, they should be documented and timely delivered to the management team and to all the employees for following the achievements and further implementation of the developing results, in terms of planning the future staff resources and all the steps, follows the

market's quality needs of the work force that works in the immediate and wider environment, which directly impacts the quality of the tourist companies, and thus the development of the community. This approach of the listed problem would allow participation and personal development of all participants in both work and control of the processes, thus contributing for an effective organizational learning and improved organizational responsibilities.

Conclusion

Transition states confront difficulties in management of the human resources, because this style has barely been practiced twenty years, and it has been renewed on deep bases of unproductive government, inefficiency and work time inefficiency and the process of producing services and goods. This research has shown that managers and employees are aware of the need of speed change through standards for quality and their significance is seen as a crucial key in the management skills, and it's crucial to achieve an effective rival advance of the companies. This alone does not mean fast and effective process, but it's a step towards quality and improvement.

References

1. Antoncic, B. and Hisrich, R. (2003). *Clarifying the intrapreneurship concept*, Journal of Small Business and Enterprise Development, Number 1, pp.11.
2. Lolwana, P. (2006). The history of falling matric standards. In V. Reddy (Ed.), *Marking Matric. Colloquium Proceedings* (pp.18–29). Cape Town: HSRC Press.
3. Haynes, P., Fryer, G., (2000). Human resources, service quality and performance: a case study. *International Journal of Contemporary Hospitality Management* 12 (4), 240–248.
4. James C. S. Meng, Edward B. Roberts, (2006). *Understanding Barriers to Innovation and Intrapreneurship in an R&D Organization*, The International Center for Research on the Management of Technology, Cambridge, pp.7-11.

5. Pinchot, G. (1984). Who is the Intrapreneur? In: *Intrapreneuring: Why You Don't Have to Leave the Corporation to Become an Entrepreneur*. New York: Harper & Row. pp.28 – 48.
6. Sathe, V. *Corporate Entrepreneurship: Top Managers and New Business Creation*. Cambridge University Press, 26 June 2003.
7. Heinonen, J. 1999 Epilögi. Teoksessa *Julkisten palvelujen laatu ja kilpailukyky* (The Quality and Competitiveness of Public Services) (Mäki, Katja – Sorri, Taija). Valtiovarainministeriön hallinnon kehittämissosaston tutkimukset ja selvitykset 2. Helsinki, 180-181.
8. Nielsen, R. P., M. P. Peters, and R. D. Hisrich. (1985) Intrapreneurship strategy for internal marketscorporate, non-profit and government institution cases', *Strategic Management Journal*, 6(2), pp. 181-189.
9. Серафимова, М. (2014) Претприемништвото и комуникацискиот менаџмент „2-ри Август“ Штип.

UDC 343.9.024:336.7(497.11)
Professional paper

Vera ZELENović¹⁾
Nenad VUNJAK²⁾
Vera MIROVIĆ³⁾

MONEY LAUNDERING IN SERBIA

Abstract

Money laundering means the legalization of criminal capital of the acquired business, or financial transactions to disguise the real origin of the money and other forms of capital market. This phenomenon is characterized by both developed and developing countries. Subject of this paper is to define the phenomenon of money laundering, as well as processes, methods and techniques used, and that can be found in the first two chapters of this work. Next chapter is about analysis of the situation regarding money laundering and organized crime in Serbia, based on the reports of the relevant institutions involved in combating against money laundering and organized crime. These are followed by concluding remarks.

Key words: money laundering, organized crime, techniques, legislation, reports

JEL codes: P3

¹⁾ Corresponding author: Vera Zelenović, PhD., Associate professor, University of Novi Sad; Faculty of Economics, Subotica, E-mail: vera.zelenovic@ef.uns.ac.rs

²⁾ Nenad Vunjak PhD., Ph.D., Professor, University of Novi Sad; Faculty of Economics, Subotica, E-mail: vunjakn@ef.uns.ac.rs

³⁾ Vera Mirović, PhD., Assistant professor, University of Novi Sad; Faculty of Economics, Subotica. E-mail: vera.mirovic@ef.uns.ac.rs

Introduction

The term 'money laundering' comes from the English word money laundering, which means the legalization of criminal capital of the acquired business, or financial transactions to disguise the real origin of the money and other forms of capital (www.informator.rs) market. It consists of falsifying financial documents and manipulating the system of inter-bank transactions. In recent years, manifested in tax evasion, illegal trade in drugs and arms, in organized gambling, prostitution and racketeering, as well as the privatization of capital in the former socialist countries of Eastern Europe, as well as organized criminal channels in the West. Another definition of 'money laundering' is: *"The conversion or transfer of property, knowing that such property is derived from serious crime, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in committing such an offence or offences to evade the legal consequences of his action, and the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from serious crime"*. (European Communities, 1990).

The UN defines it as *"Money laundering is a process which disguises illegal profits without compromising the criminals who wish to benefit from the proceeds. It is a dynamic three-stage process that requires: first, moving the funds from direct association with the crime; second, disguising the trail to foil pursuit; and third, making the money available to the criminal once again with the occupational and geographic origins hidden from view"*. (United Nations, 1997).

The infiltration of dirty money is a serious problem for national economies. Purchase of shares, property, establishment of a 'dirty investment funds' and use of the banking system for the disposal of such assets is a threat to the credibility of the whole country, especially for the safety of the financial and banking system.

Given that 'washers' of money do not seek to achieve the highest rate of the money they get washed, but for them more important is place, or investments that will enable the easiest and fastest recycling money, money can travel from countries with good economic policy in which higher rates are achieved, to the countries with poor policy and low returns from investment. Thus, for money laundering can happen that free capital could be invested invest less rational, which can greatly disrupt the existing economic trends. Money laundering and other illegal

activity are causing a regressive distribution of income and making big spending power of individuals in terms of general recession. This distorts the structure of consumption, especially among the rich, and transforming the existing social statistics by emerging of new social groups of the rich. Large funds earned from money laundering affect the demand for luxury goods, the increase in home prices and some consumer goods, all of which encourages speculation and inflation. Forms of working practices which are consistent with the law started to be considered less valuable. Illegality is becoming a fundamental principle of economic activity. This sequence of events is leading economy in ruin. Factors that facilitated and sponsored the explosion of money laundering (Banerjee, 2015):

1. The globalization of markets and financial flows, most evident in the advent of the Internet. The creation of the single market means that money can now travel in nanoseconds, meaning that multiple jurisdiction leaps are made effortlessly on a daily basis.
2. Deregulation of financial markets has brought with it no consistency or coherence in respect of anti-money laundering regulations; simultaneously today's global market place has brought with it very few if any restrictions.
3. Globalization implies global competition, meaning more competitors and increasing pressure to deliver profits. The proceeds of crime are massive meaning that the people who control them can yield great influence with legitimate businesses, which are hungry, sometimes even desperate for profits.

The funds involved in money laundering are increasing rapidly and the most recent estimate provided by the FATF suggests that the aggregate size of global money laundering is between 2% and 5% of world economic output, or between \$590 billion and \$1.5 trillion, most of which is gained from illicit drug trafficking, but also from corruption, fraud and organized crime (Banerjee, 2015).

The European Union is not able to circumvent the problem of financial destruction and money laundering, especially since the risk of money laundering was brought in connection with its own unique individual market. The research of different areas of money laundering and criminal groups that are active in the European Union has indicated the international spread of this phenomenon. Since stringent legislation prevents financial institutions to easily wash illegally gained profits, money launderers are increasingly oriented towards the financial institutions that are not yet fully or properly regulated by the regulations

of some member states of European Union. Since they do not have the same obligations as the financial sector they are not allowed to carry out banking activities in order to earn commissions, particularly those used in the placement stage for the introduction of cash to the financial markets. This phenomenon is particularly indicative in Belgium, Italy and the Netherlands, where groups of criminals are moving their business from the major commercial banks in that they will not issue any reports of suspicious transactions, the so-called second-class bank, and which usually take care of offshore companies. These are the various types of services for cash payments, insurance, currency exchange, brokers, and others involved in the transfer of funds with different degrees of perfection and ability.

Money laundering undermines the democratic political structure and political stability. In terms of legal uncertainty and developed corruption there has been reduced interest of foreign investors to invest in that country. Money laundering and corruption, which is its common side effect of creating a dangerous threat to state sovereignty and authority of government, is a violation of democratic values and the work of public institutions. In this way you encourage traditional forms of tax evasion, evasion of law, smuggling and escape the financial resources which together increases the tax burden for those who pay taxes. The most significant consequences of money laundering (Bošković, 2000) are:

- 1) Decline in private sector legal business;
- 2) Impact on exchange rates and interest rates;
- 3) Economic instability and disruptions;
- 4) Reduce state revenues and the weakening of control of economic policy;
- 5) Threat of reform or privatization;
- 6) Declining reputation of the country.

Money laundering has a direct impact on reducing transparency and health of the financial markets, the important determinant in the effective functioning of the entire state. Money derived from criminal activities often corrupt officials of the financial markets, causing long and difficult repairable damage market credibility. Money laundering can corrupt parts of the financial system and prevent the successful management of banks and supervisory authorities. The IMFund and the World Bank can increase their participation in the global fight against financial abuse and money laundering by publicize in general terms both the need to put in place the necessary economic, financial, and legal

systems designed to protect against financial abuse and money laundering and the role that the Fund and the Bank are playing in helping meet this need.

1. Theory - Methods of money laundering and side effects

New information technologies, flexible transfers of money, the liberalization of international financial transfers, many financial professionals with significant financial resources available to the criminal milieu, banks that have serious problems with the maintenance of daily financial liquidity, that allows them financial investments and profits, all of that represents conditions that favor the technology and facilitate money laundering, and enter a 'dirty' money into legal financial flows. The technique for money laundering comprises three stages through which the money goes (Banerjee, 2015):

1. Stage of placement or stage of investment,
2. Stage of layering or stage of concealment,
3. Stage of integration.

Figure 1: Technique for money laundering



Source: Banerjee, Money laundering in the EU, 2015,
<http://people.exeter.ac.uk/watupman/undergrad/ron/index.htm>

1. In the phase of investments or loans, illegal profits are being introduced into the legal financial system. Cash acquired through criminal activity will be paid into bank accounts, usually under the guise

of a regular activity, a phase of investment. Most often the deposits invested for some legal business, where the payment is done in cash, such as for example, garages, luxury boutiques, galleries, commission, restaurants, antique shops and the cash generated or something similar to that. In case when crime is mixed with legal business income that reduces the possibility of tracing the “hot money”.

2. When cash is converted into bank deposits, the next step in the process of money laundering is concealment or the coating phase, which is accomplished by transferring funds from one account to the accounts of various banks in the world, deceptive subjects, as well as, other financial institutions, in order to cover all original source and destination of initial capital crime. Money is moving with many transactions whose main goal is to conceal the connection between money and criminal activity from which they derive. The true purpose of these transactions is to conceal the traces of movement of money and to make it difficult for anyone who tries to discover where the money comes from.

3. The last phase of money laundering, where it re-enters into legal economic flows, is the integration phase. The money is invested in legitimate businesses or invests, after which it emerges as the money that comes from lawful activity. The popular method of integration of money gained from criminal actions into legal businesses is buying a property, such as office buildings, warehouses or apartments. The goal of this stage of money laundering and procedures is to transfer the money acquired through criminal activities in which the law does not prohibit.

Money laundering methods involve financial transactions whose volume is extremely profitable and very attractive for legitimate financial firms that handle them. The flow of money laundering ranges from illegal economy to investment in the legitimate economy. From subtle methods and mechanisms used by professional money launderers, there are following methods (Layton,2006):

1. *Smurfing* was implemented as the initial form of washing, although it requires a lot of time. This method proved to be successful and therefore, it is widely used. It is a simple technique that involves a large number of participants who open several bank accounts, after which payments are made in small denominations, with the characteristic diversity of currencies. In this way, cash amounts originating from the criminal sphere flow into the financial system, and they are usually transferred from bank to bank in the form of a term deposit and perform fast transactions, to ensure removal of the source of funds.

2. *Artificial companies* are one of the most common methods of washing, as they allow ways to absorb money on the basis of non-existent services. The business of these companies is often, but not necessarily, associated with offshore centers. Money laundering through so-called "Facade" (shell or front) companies is often used, especially when it comes to larger sums. This is realized by "dirty" money arriving at the commissioner or Shell Company that serves as a cover in a country that does not make too many questions about the money origin or where are still applied strict principles of banking secrecy. This company transfers money to another company, which is usually in an offshore center, and represented by the nominal owners or local lawyers, and then the money is being transferred to the bank in a bank of "tax havens". In the final stage, the money is invested in a legitimate business or a reputable financial institution-front, often in a country where the "dirty" money originated from.

3. *Casinos* are used for money laundering since the first established casino in Las Vegas and are becoming increasingly similar to banks since they are cashing checks, exchanging foreign currency, providing safe deposit boxes for depositing, granting loans and paying out large sums of gains in checks. The methods are extremely subtle.

4. *The National Lottery* has become very topical for money laundering. Since tickets have no personal identity, criminal actors can contact the winners and offer to buy the winning ticket with premium, which would ensure funds in a bank account in the form of lawful income. For the foregoing reasons, there is the increasingly common practice of photographing all the gains which exceed \$ 50,000, in order to prevent this occurrence.

5. *Trading Art and antiques* is another well-known method of money laundering. It is not uncommon that money launderer repurchases his stuff on reserve prices on auction, if the maximum offered purchase price is insufficient, and then he transfers them to another auction, this time in another city in order to restart the process.

6. *The method of "washing machine"* exists on the current account in the country with weak exchange control, and in countries where they strictly observe the principle of confidentiality of accounts and stakes. According to the method of "washing machines" there are the following stages of money laundering (Ristić, Ristić, 2012) :

1. Phase "Prewash", when funds enter the financial system or the country with weaker control of money origin;

2. Phase "Washing" when the funds are used to purchase legitimate assets;
3. Phase "Recycling" in which the funds are returning in the legal form to the country of origin.

7. *The method of "barter" (bartering)* implies that stolen domestic goods serve as legal assets abroad with the appropriate discount. This method is less sophisticated, but still widely used.

8. *"Wrong billing" (miss-invoicing)* of exports and imports and falsification of data in the instruments of international payments and customs declarations is another method of money laundering.

9. It is important to mention the claims for compensation for the payment of insurance for goods that never existed. Otherwise, in insurance are well known purchases of insurance policies "with dirty money" that can be prematurely cashed at a discount to "clean" check insurer or used as collateral for a bank loan.

Money laundering can take many forms, because the fact that money laundering techniques are constantly changing. In practice, it is likely that only a combination of several indicative factors or suspicious transactions may mean that it is likely that the money laundering actually takes place.

2. Methods

The paper used the method of content analysis and statistical method, the primary source of information, with relevant books and sites, especially when it comes to research and data analysis related to money laundering in the Republic of Serbia.

3. Analysis of the situation regarding money laundering and organized crime in Serbia

Establishing a modern and comprehensive legal framework in line with relevant international standards is one of the key system requirements for an effective fight against money laundering in the Republic of Serbia. All state agencies, that are responsible for combating money laundering, evaluate the effectiveness of the legal framework and take care of his promotion in accordance with requirement. Since the

primary purpose of money laundering concealment of commission of other serious crimes, the crime of money laundering has much wider negative impact on society in the whole. Therefore, reforms aimed at preventing money laundering have become one of the most important tasks of government establishment after the political changes in October 2000. Organized criminal group 'wash' money in Serbia by (Bošković, 2000):

- Participate in the privatization of social capital
- Establish companies whose main activity is foreign trade and foreign exchange management
- Participate in tenders for projects financed from public spending (such as public work and even large investments in infrastructure)
- Competing for public procurement.

Since the Republic of Serbia is in the EU accession process and in order to harmonize legislation with EU standards, there have been adopted many laws and decisions of the competent authorities that affect the prevention of and fight against organized crime, money laundering and terrorist financing(Serbia, Ministry of Finance, 2015):

- National Strategy for Combating Money Laundering and Terrorism Financing;
- National Strategy for Combating Organized Crime;
- Law on Prevention of Money Laundering and Financing of Terrorism;
- Law on Seizure and Confiscation of the Proceeds from Crime;
- Law on the Protection of Personal Data;
- Act on the liability of legal persons for criminal offenses, etc.

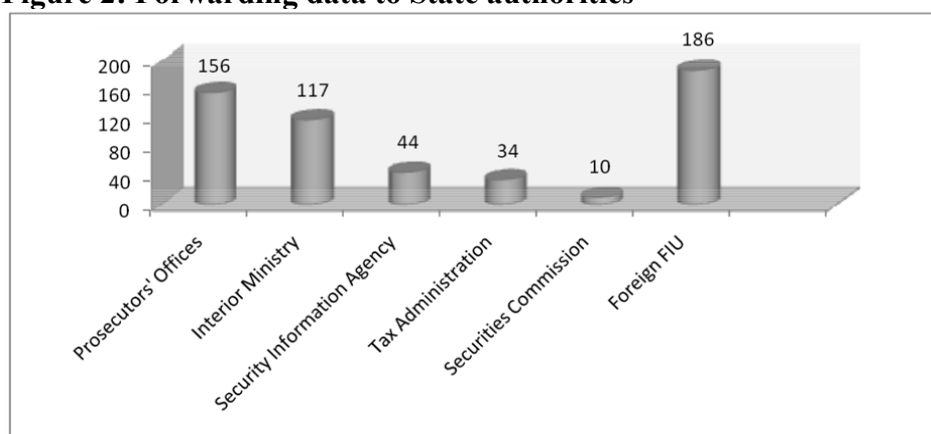
The adoption and implementation of the National Strategy for Combating Money Laundering and terrorist financing is of the broadest importance to all citizens of the Republic of Serbia and is an important step in the process of joining the European Union. National Strategy for Combating Money Laundering and terrorist financing has four strategic directions (National Strategy, 2008):

- 1) Reducing the risk of money laundering and terrorist financing through strategic planning, coordination and cooperation of all participants in the system.
- 2) Preventing the introduction of property that is suspected to be the proceeds of crime into the financial system and other sectors, and detection and reporting already entered the property.

- 3) Spotting and eliminating the threat of money laundering and financing of terrorism, punish perpetrators and confiscation of illegally acquired property.
- 4) Qualified personnel trained for effective participation in all aspects of the system for combating money laundering and financing of terrorism and public understanding of the role and plans of competent authorities.

A total of 811 reports were sent to the APML in 2012 about transactions reasonably suspected to be money laundering or terrorism financing (STRs) and 266,436 reports on cash transactions (CTRs).

Figure 2: Forwarding data to State authorities



Source: Republic of Serbia, Ministry of finance, (2013)

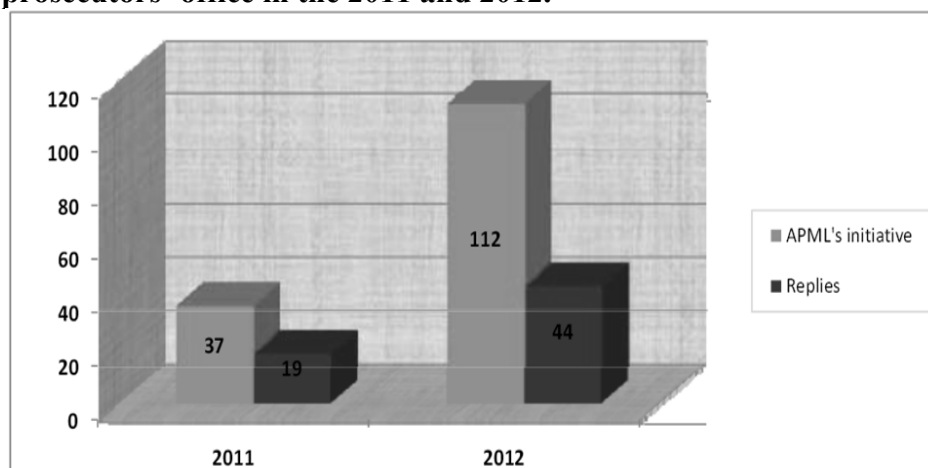
http://www.apml.gov.rs/REPOSITORY/971_godisnji-izvestaj-za-2012-cir.pdf, p.6

Most of the reports in 2012 were sent to prosecutors' offices, i.e. 156, of which 112 were filed at the APML's initiative. Most of the reports to the prosecutors' offices were delivered over a suspicion that the criminal offence of tax evasion was committed followed by placement of the proceeds using newly founded business entities, investing into their business activities, and using it partly for personal needs of those involved in the fictitious business transactions. Such placement of the money suspected to have originated from tax evasion, disguising of the origin of the funds followed by their integration in the legitimate financial system was the indicator for the suspicion on the money laundering offence. Besides the suspicion caused by the activities of the subjects of the APML's analyses, a large number of cases was

transferred over a suspicion that the transactions analyzed in relation to certain persons indirectly point to the links between these persons and the organized criminal groups or individuals under investigation for drug trafficking and human trafficking.

Comparing these statistics with the 2011 statistics, when 56 reports were shared with the prosecutors' offices, we note an increase in the number of reports sent to prosecutors' offices. All cases of suspicious money laundering or terrorist financing are reported by the APML to the prosecutors' offices given the fact that the prosecutor has a coordinative role in investigations, according to the Criminal Procedure Code.

Figure 3: The ratio of the number of forwarded information to prosecutors' office in the 2011 and 2012.



Source: Republic of Serbia, Ministry of finance, (2013)

http://www.apml.gov.rs/REPOSITORY/971_godisnji-izvestaj-za-2012-cir.pdf, p.8

The following table is a breakdown of data from the APML's databases relevant to the transportation of money across the borders of the Republic of Serbia in 2011 and 2012:

Table 1: The amount of money transferred through Serbia

Incoming	2011	2012	Outgoing	2011	2012	Transit	2011	2012
AUD	566,800	193,820	EUR	204,415	185,345	CHF	70,600	115,000
CAD	94,000	142,930	USD		19,980	DKK		367,000
CHF	1,230,500	1,285,810				EUR	8,682,410	4,151,435
DKK	1,900	367,000				NOK		425,000
EUR	11,473,695	16,840,201				GBP	15,600	
GBP	27,800	68,410				USD	365,200	171,400
NOK	1,510,000	180,600						
PLN		30,000						
SEK	428,110	318,810						
RSD	3,941,930	9,574,000						
USD	1,230,840	998,920						

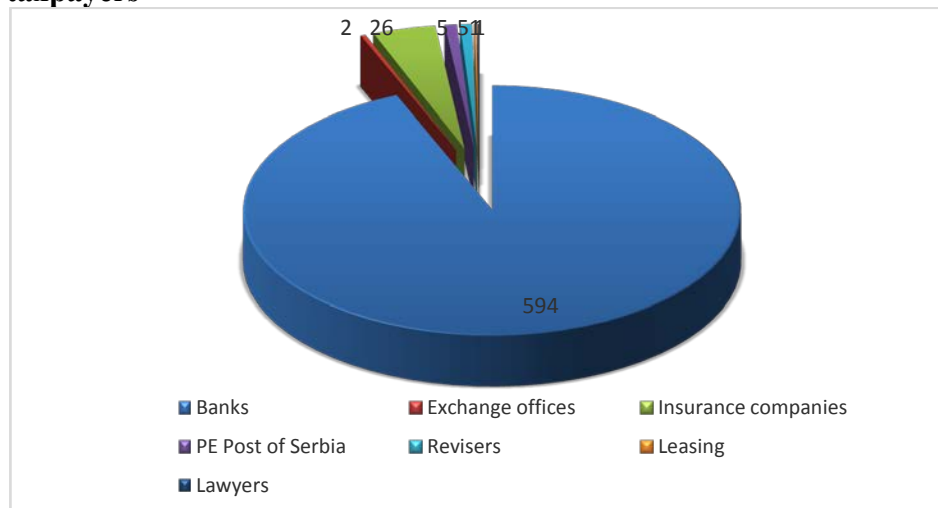
Source: Republic of Serbia, Ministry of finance, (2013)

http://www.apml.gov.rs/REPOSITORY/971_godisnji-izvestaj-za-2012-cir.pdf,
p.10

As can be seen from the table above, the amount of money transported into Serbia is considerably higher than the amount of outgoing transportation. A large share of the funds is transported into Serbia by Serbian citizens working abroad. Other individuals too transfer funds to Serbia, the origin of which cannot be established. Also, a large amount of cash is recorded as being only in transit through Serbia; this is most likely the case of foreign citizens in transit to their countries of origin, most frequently Turkey, from the West European countries where they work.

During 2013, the Directorate for Prevention of Money Laundering in Serbia has received 634 reports of suspicious transactions, of which the largest number, even 594 were reported by banks, while other transactions were reported by other payers, as shown in the following Figure 4.

Figure 4: Share of registered reports of suspicious transactions by taxpayers

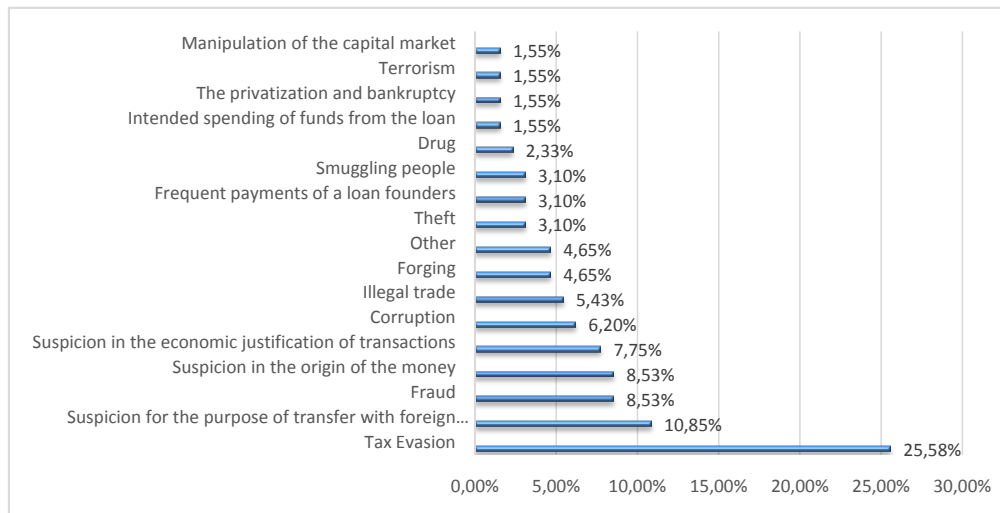


Source: Republic of Serbia, Ministry of finance, (2014)

http://www.apml.gov.rs/REPOSITORY/1152_uspn-godisnji-izvestaj-2013.pdf
p.3

Reported (Figure 5), 233,140 reports of cash transactions, while the agents for money transferring provided information to Administration for 63.203 people for suspecting that money transfer transactions indicate doubts about the money laundering. The Administration receives the largest number of data related to the existence of grounds for suspicion of money laundering from banks. Based on obtained data, the most suspicious transactions were reported in Raiffeisen Bank, CommercialBank, Bank Intesa and Piraeus Bank (Republic of Serbia, Ministry of finance, (2014)). Reported suspicious transaction is information from the taxpayer which indicates activities on the client accounts rated as suspicious on the basis of the available indicators. Only after the conducted analysis of reported suspicious transactions to the Administration, drawing on all available sources of data, can be expressed doubts about the possible existence of some illegal activity. Suspicion of depositing, raising and transferring money for which there is no economic or other logical explanation is mentioned in almost 20% of total reported transactions. Then there is the suspicion of payments on accounts of legal entities, which are then further transferred to the benefit of private individuals and raised in cash, as well as doubts related to cash payments to the accounts of companies under the loan founders.

Figure 5: Suspicion of offenses



Source: Republic of Serbia, Ministry of finance, (2014)

http://www.apml.gov.rs/REPOSITORY/1152_uspn-godisnji-izvestaj-2013.pdf

p. 4.

Speaking about the reasons why they reported certain transactions as suspicious, the largest number of cases indicates tax evasion, then doubts about the purpose of the transfer abroad, mostly transfers from the country, deception, doubts the origin of the money in cash transactions, doubts the economic justification of transactions as well as other doubts shown in the following chart. The trends of money laundering in Serbia (Republic of Serbia, Ministry of finance, 2013).

depend on many factors such as:

- the level of Serbia's economic development (GDP and standard per capita);
- level of development of individual industries or economic sectors that may attract or that attract investment;
- poor legislation which may provide opportunities for money laundering or financing of terrorism;
- exposure to international financial flows;
- existence of institutions and organization at national level against money laundering and terrorism financing;
- resilience to the influence of crime on the economic and financial systems;
- Existence of awareness of the detrimental effect of money laundering and terrorism financing on the country.

The APML in 2012 initiated a project to integrate all data sources that it holds in order to allow for consolidation of data from multiple analytical sources and a single logical presentation of all data through standardized report forms. In addition, all the data will be kept in an optimal way in a uniquely structured data warehouse so as to improve the speed of searches and protect data from loss. By implementing a business intelligence (BI) solution the analytical and reporting process will be improved retaining maximum flexibility in their use. This project also intends to develop an important module to rate transactions according to the level of ML/TF suspicion, which would be fully integrated with the existing TMIS and DCM systems. Despite the active efforts invested, the APML was not successful in providing for adequate business premises that would fit the number of staff envisaged in the new organization and jobs systematization.

Given that money laundering and terrorist financing are in most cases an international phenomenon, a large number of initiatives were launched in the framework of international organizations in order to establish generally accepted standards in this area. Serbia has ratified the following conventions which become an integral part of domestic law (Republic of Serbia, Ministry of finance, 2015):

- a) The United Nations Convention on the illegal traffic of narcotic drugs and psychotropic substances, adopted on 19th December 1988 in Vienna, known as the Vienna Convention. Ratified in December 1990.
- b) Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, adopted on 16th May 2005, in Warsaw, also known as the Warsaw Convention. Ratified in March 2009.
- c) The United Nations Convention against Transnational Organized Crime and its supplementary protocols, adopted in Palermo 12-15th December 2000, better known as the Palermo Convention. Ratified in July 2001.
- d) The Council of Europe Criminal Law Convention on Corruption, adopted on 27th January 1999 in Strasbourg. Ratified in December 2005.
- e) The United Nations Convention against Corruption, adopted on 31st October 2003 in New York. Ratified in October 2005. International Convention for the Suppression of the Financing of Terrorism, adopted on 9th December 1999 in New York. Ratified on 1st July 2002.

In recent years, authorities in Serbia have intensified their efforts to build capacities to combat economic crime in general, including the prevention of money laundering and terrorist financing. As explained in the previous section, in September 2008, the Government of the Republic of Serbia adopted the National Strategy for Combating Money Laundering and Financing of Terrorism and the Action Plan for the implementation of the national strategy for the period 2009-2013, which was adopted in April 2009. Some progress in the development of the institutional capacity of the Ministry of Finance and Justice was achieved through the implementation of the project for the fight against economic crime in Serbia (PACO Serbia) funded by the European Agency for Reconstruction (EAR), and implemented by the Council of Europe. A final report PACO Serbia identified a number of specific issues that need special attention when it comes to control money laundering and terrorist financing.

In 2010 in cooperation with the EU, Serbia started the project Moli Project against Money Laundering and Terrorist Financing in Serbia. The mere fact that the EU has expressed its interest to invest 2.2 million Euros in the project, tells how money laundering is present in Serbia, and thus represents a major threat not only to countries in the region, but also for the EU.

Table 2: General information about the project Moli – Serbia

Name of project	Project against Money Laundering and Terrorist Financing in Serbia (MOLI-Serbia)
Project area	Serbia
Budget	EURO 2.200.000,00
Funding	The European Union (90,91%) and the Council of Europe (9,09%) The Government of the Republic of Serbia (EURO 65.000,00 - in the equipment)
National contribution in goods	
Implementation	Council of Europe: Economic Crime Division, Directorate of Cooperation, DGHL
Duration	36 months(15. November 2010. – 15. November 2013.)

Source: MOLI Serbia: Project against Money Laundering and Terrorist Financing in Serbia
http://www.coe.int/t/DGHL/cooperation/economiccrime/corruption/Projects/MOLI_Serbia/Default_en.asp

This technical assistance project is to contribute to achieving the goals and represent a tool to support the implementation of reforms in the following areas (Republic of Serbia, Ministry of finance, 2010):

- Ensuring that the system for combating money laundering and terrorist financing in Serbia is in compliance with relevant international standards;
- Raising public awareness of the threat posed by economic crime to the daily life of citizens and society as a whole, as well as the need for the state to take effective measures to mitigate these threats;
- Strengthening the capacity of the Prevention of Money Laundering (APML), police, prosecutors, judges, financial institutions and other professionals and organizations so that they can perform their duties more efficiently in terms of prevention and control of economic crime, money laundering and financing of terrorism;
- Securing and strengthening mechanisms for effective coordination and cooperation between different institutions;
- Increasing the effectiveness of the fight against money laundering and financing of terrorism by strengthening the role of information technology as a tool for collecting and analyzing financial data.

Conclusion and Implication

Money laundering is a latent phenomenon and in almost all countries and states are trying through various measures to prevent or delay the appearance of a smaller or greater success. In today's global conditions, crime tends to be commercialized and this should be understood in terms of taking those actions, which to people involved in it makes a profit, benefit and advantage, and in such a context, finances occupy an important place. Given the large number of countries involved in an illegal way of doing business and modest suppression of these crimes, it is obvious that the financial crimes, as a way of compromising financial sphere, have become truly global problem.

Prevention of money laundering is not at the legislation, but on elimination of those causes and events that lead to deviant behavior, which are present in Serbia in a large number. There is no reliable data about the extent of money laundering in Serbia or how much illegally

acquired money there is, that occurs in our country and then it is washed in other countries, but the fact is that Serbia is a suitable destination for owners of "dirty" money. The Law on Prevention of Money Laundering defined actions and measures to detect and prevent money laundering, and also, the Serbian national economy confronted organized money laundering.

Using past experience and current legislation of countries in combating money laundering, as stated in the paper, Serbia can develop its own strategy to combat this phenomenon, taking into account the specifics of Serbia and all its attendant problems of transition. How serious problem is money laundering, that transcends national boundaries, tells a current project between the EU and Serbia called Molly. The end of transition will be more or less painful depending on the defined national strategy, the commitment to radically change the practice acquired in accordance, and how much are we ready to endure on that way. For that reason, there is big need for a broad social consensus on combating money laundering, where the help of citizens and the media is of great importance.

Money laundering can have short-term consequences, which usually occur within two years, and may be long-term, usually lasting more than four years. Some effects last for more than ten years. Research shows that the costs and benefits of prevention of money laundering are incomparable.

The negative effects of money laundering on economic development is difficult to quantify. Money laundering has a direct effect on economic growth in the real sector. The diversion of resources to less productive activities and enabling domestic corruption and crime, weaken economic growth. Money laundering leads to divert spending and savings and transformation of the existing social structure of the formation of social groups, the new rich, considering that criminals are investing large resources of the profits gained through money laundering in the so-called 'sterile investment' (real estate and luxury items, like Serbia for example). Given that laundered money is the income on which tax is not paid, money laundering can have a huge impact on government revenue due to the reduction in tax revenues. Money laundering has a negative impact on economic growth in each country, as well as in Serbia.

The process of ownership transformation of economy, as one of the elements of the transition, has opened opportunities for money laundering, which can be done through various forms of participation in

the privatization of the economy: joint ventures, purchases of shares of our company, capitalization and so on. Devastating consequences for efforts in privatization also causes money laundering. Due to unfair competition, money launderers can win fair buyers who have had previously owned enterprises. Important sectors of the economy could be affected, and all this would lead to speculative and non-competitive approach to performing in these sectors. Also, due to lost confidence in our banking system, it is possible that some of the illegal proceeds which originated in the country are being washed in financial institutions in other countries.(Fijat, 2012)

References

Books:

1. Boskovic M, (2000). "Current problems in combating corruption" Belgrade, Police academy, pg.213,
2. Fijat Lj, (2012). „Measures against Money Laundering in Banks“ Foundation Andrejević, pg.18-22

Internet source:

1. Banerjee R, (2015).Money laundering in the EU, <http://people.exeter.ac.uk/watupman/undergrad/ron/index.htm>
2. Stessens G,(2000). Money Laundering-A New International Law Enforcement Model, Cambridge University Press, Cambridge
3. European Communities (EC), (1990). Article 1 of the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime. <http://conventions.coe.int/Treaty/EN/Treaties/Html/141.htm>
4. International Monetary Fund, (2001). Enhancing Contributions to Combating Money Laundering: Policy Paper. <http://www.imf.org/external/np/ml/2001/eng/042601.htm>Layton J, (2006). How Money Laundering Work, HowStuffWorks.com. <http://money.howstuffworks.com/money-laundering.htm>
5. MOLI Serbia: Project against Money Laundering and Terrorist Financing in Serbia http://www.coe.int/t/DGHL/cooperation/economiccrime/corruption/Projects/MOLI_Serbia/Default_en.asp

6. National Strategy for Combating Money Laundering and terrorist financing, (2008). Official Gazette of RS br.89/08 http://www.apml.gov.rs/REPOSITORY/430_nacionalna-strategija.pdf
7. Republic of Serbia, Ministry of finance, (2010). Administration for the Prevention of Money Laundering, brochure-aml <http://www.apml.gov.rs/eng34/tdoc/Administration-for-the-Prevention-of-Money-Laundering.html>
8. Republic of Serbia, Ministry of finance, (2010). Administration for the Prevention of Money Laundering, [www.apml.gov.rs/srp544/file/ p.2](http://www.apml.gov.rs/srp544/file/p.2)
9. Republic of Serbia, Ministry of finance, (2015). <http://www.apml.gov.rs/srp34/tdoc/>
10. Republic of Serbia, Ministry of finance, (2012). Report on the Work of the prevention of money laundering
11. Republic of Serbia, Ministry of finance, (2013). http://www.apml.gov.rs/REPOSITORY/971_godisnji-izvestaj-za-2012-cir.pdf
12. Republic of Serbia, Ministry of finance, (2014) http://www.apml.gov.rs/REPOSITORY/1152_uspn-godisnji-izvestaj-2013.pdf
13. Ristić Ž, Ristic K, (2012), Money laundering, parallel money and corruptive transition http://www.meste.org/fbim/fbim_srpski/FBIM_najava/V_Ristic.pdf
14. United Nations, (1997). United Nations Global Programme Against Money Laundering. <http://www.molin.org/gpml.htm>

UDC 005.953.2:159.9.072
Professional paper

Maja PANOVA^{*)}
Kiril POSTOLOV^{)}**

**UNCONVENTIONAL METHODS FOR SELECTING HUMAN
RESOURCES- POLYGRAPH AND HONESTY (INTEGRITY)
TESTS**

Abstract

A polygraph (a lie detector) and honesty (integrity) tests are unconventional methods for selecting human resources in companies. They are used for testing employees' honesty and integrity by detecting the veracity of their answers, as well as for detecting people who are predisposed to immoral behavior. Since the companies have confronted with loss and waste made by the employers with immoral behavior, they are using more and more honesty and integrity tests to detect the employers who act immorally and irresponsibly. Some of the companies don't have trust in the traditional standardized tests for selecting human resources and therefore they've decided for using unconventional methods for selecting human resources. The polygraph has been still used in America besides it has restricted use by law. Nowadays, the honesty (integrity) tests have been used intensively because of the criticism of the polygraph and its restricted use.

Key words: polygraph, honesty (integrity) tests, immoral behavior

JEL classification: M54

^{*)} M.Sc., Ss. Cyril & Methodius University, Republic of Macedonia,
e-mail: nnadja19@yahoo.com

^{**)} PhD, "University Ss. Cyril and Methodius University-Skopje",
e-mail: kirilp@eccf.ukim.edu.mk

Introduction

Testing people' honesty and integrity is done with polygraph (lie detector) and written tests in order to assess whether candidates behave immorally. The polygraph is a lie detector and it verifies the truthfulness of candidates' statements. The polygraph tests are used as a selective method to test the truthfulness of applicant's statements and for a choice of new employees in the government, banks, treasury, jewelry's and workplaces which are attractive to potential robbery.

The polygraph is used also for detection of spies. The losses, which are made from dishonest and immoral behavior of the staff, are measured with millions, even billions dollars. The polygraph tests are used in American companies even though they are restricted by law. The disadvantages and criticisms of polygraph resulted in popularization of honesty (integrity) tests. Tests consist of questions that need to be answered with yes or no. Integrity tests are valid as a method for identifying person's characteristics, but there isn't enough predictive validity whether a person will steal, abuse their confidence, disclose official secrets etc. In the last years significant efforts are being made to increase the predictive validity of honesty tests and the experiences of their implementation are very positive, so the arguments against their use are opened to question. The employers use integrity tests as mechanisms to hinder the employment of unethical persons, to reduce fraud and theft in the workplace, as well as to raise staff' awareness that dishonesty will not be tolerated.

Polygraph

The theory of polygraph is: "If a person doesn't answer the question correctly, his physiological changes in his body will detect deception during a part of the polygraph examination". (Alder, K. 2002:11-33)¹

¹ Mathis, R. L., Jackson, J. H. (2008), "Human resource management", 12 ed., Thomson South -Western translated by Џонс, М., Димитриевски, В. Д., Матис, Р. Л., Џексон, Џ. Х. (2010)," Управување со човечки ресурси", 12изд., Скопје: МАГОР, с.240.

The Methods used to conduct polygraph tests were made, examined and validated in the USA and were used for many years.²

George Bolander and Scot Schnell described the polygraph. The instrument consists of the rubber sleeve, a pressure reducing device, Marey's tambour, a light glass lever and stylus, a roll of smooth paper and a kymograph or a motor driven drum for winding up the paper. The instrument is so designed that it is peculiarly sensitive to small changes in blood pressure.³ The polygraph is a lie detector and it verifies the truthfulness of candidates statements. The polygraph tests are used as a selective method to test the truthfulness of applicant's statements and for a choice of new employees in the government, banks, treasury, jewelry's and workplaces which are attractive to potential robbery.⁴ The polygraph (lie detector) is used to measure and record physiological changes in candidate's body such as blood pressure/volume, heart rate and certain resistance changes.

The polygraph was invented in 1921 by John Augustus Larson, a medical student at the University of California at Berkeley and a police officer of the Berkeley Police Department in Berkeley, California. In some countries polygraphs are used as an examination of criminal suspects or candidates for sensitive public or private sector employment, US law enforcement and federal government agencies such as the FBI and the CIA.

The examiner typically begins polygraph test sessions with a pre-test interview to gain some preliminary information which will later be used to develop diagnostic questions. Then the tester will explain to the candidate how the polygraph is supposed to work, emphasizing that it can detect lies and that it is important to answer truthfully. Some of the questions asked are "irrelevant" or IR ("*Is your name Fred?*"), others are "diagnostic" questions, and the remainder are the "relevant questions. Criticisms have been given regarding the validity.

The National Academy of Sciences (NAS) in the USA found that the majority of polygraph researches were unreliable, unscientific and

² Euro Poligraf Center, "The advantages of polygraph testing", Bucuresti: Singular Labarator de expertiza poligraf (detector de minciuni) autorizat cu sistem de control al rezultatelor, 2012

<http://www.poligraf-center.ro/index.php?page=105&lang=EN>, < Experti certificati***tarife avantajoase***Programari...> (10.01.2014), p.1.

³ Боландер, Ц., Шнел, С.(2010), "Управување со човечки ресурси", 15, USA: South-Western, Cengage Learning, c.267.

⁴ MBA Knowledge Base, "Type of tests taken in the Selection process", <Type of tests taken in the Selection process> (08.01.2014).

biased, based on the 57 research studies of polygraph examination. In Canada, the polygraph is regularly used as a forensic tool in the investigation of criminal acts and sometimes in the screening of employees for government organizations. Despite legal restrictions the polygraph testing is used in the United States in front of juries under certain circumstances. In many other states, polygraph examiners are permitted to testify in front of judges in various types of hearings. By August 2013 the U.S. federal government had begun indicting individuals who stated that they were teaching methods on how to defeat a polygraph test. The polygraph is used for detection of spies, but it failed to detect them. There are numerous cases where spies successfully passed polygraph examination.

Recent research indicates that Functional Magnetic Resonance Imaging (fMRI) may benefit in explaining which parts of the brain are active when subjects use artificial memories. Most brain activity occurs in both sides of the prefrontal cortex, which is linked to response inhibition⁵

The United States Employee Polygraph Protection Act of 1988 prohibited the use of the polygraph, either for pre-employment screening or during the course of employment. But some federal state and local institutions as well as some part of the private sector (security companies, pharmaceuticals companies) are allowed to use polygraph tests to every single person who's considered for a job.⁶ The polygraph testing can be used by National Security and Defense, companies which have access to confidential information, certain strategic industries such as nuclear power, Ministry of Justice or FBI. Private companies are also allowed to use it in the following cases: to recruit candidates for security jobs, people who have access to narcotics or people who examine narcotics, because they can cause economic damage.⁷ If the employer wants to use polygraph tests to his employees, he is supposed to give adequate reasons for doing that for ex. a lot of economic losses, interrogating suspects etc.⁸

⁵ "Polygraph", Wikipedia, the free Encyclopedia,

<http://en.wikipedia.org/wiki/Polygraph>, (10.01.2014), p.1-9.

⁶ Dressler, G. (2005), "Human Resource Management", 10ed., 2 Part, 6 Chapt., Recruitment and Placement, Prentice Hall Inc., cited by Cook, C. "Employee Testing and Selection" the University of West Alabama, PowerPoint Presentation <[PPT]Employee Testing and Selection> (10.01.2014), s.42.

⁷ Dessler, G.(2003), "Human Resource Management", 9 ed., New Jersey: by Pearson Education, Inc., Prentice Hall, Upper Saddle River 07458, p.199.

⁸ Dessler, G. (2008), "Human Resource Management", 11 ed., New Jersey: Upper Saddle River Pearson Prentice Hall, p.236.

Mark Cook and Barry Cripps say that there is little basis for the validity of polygraph tests. They state particular problems:

- High rate of people called “*the false positive*” seem to hide something, but they may be nervous when answering truthfully.
- The criminals and psychopaths, who don’t consider lies in the same way as the other people, can deceive the polygraph by reacting differently to lying.
- The spies can easily hide their physiological reactions and can easily deceive the polygraph instrument.(Cook, M., Cripps, B., 2005:251)⁹

The polygraph tests are currently used in criminal investigations. A lot of damages and losses have been made by stealing, deceit, malversation, espionage, betrayal of confidential information, money laundering etc. There are some reasons why the polygraph is used as selective method in companies:

- The necessity to eliminate or minimize the factors that cause disastrous consequences of theft, malversation, betrayal of confidential information, money laundering etc.
- Making efforts to find honest, responsible and confidential candidates for sensitive workplaces
- The necessities of honest staff in banks and financial institutions, as well as companies that work with money, securities, valuable items etc.
- Companies are forced to prevent themselves from these negative occurrences.

The losses, which are made from dishonest and immoral behavior of the staff, are measured with millions, even billions dollars. In the middle of 20th century the American companies lost 65 and 75 billions annually. The polygraph tests are used in American companies even though they are restricted by law and they are 98% used in private companies. (Cascio, F.W., 1995:204)

Psychologists, sociologists, humanists and non-governmental organizations took part in campaign against polygraph tests. They thought

⁹ Cook, M. and Cripps, B. (2005),” Psychological Assessment in The Workplace: A Manager' Guide”, England: John Wiley & Sons, LTD, translated by Sočkovič, J i Barišič, M.(2009),” Psihološko procjenjivanje na radnome mjestu: Vodič za menadžere”, Zagreb, Školska knjiga, s.251.

that polygraph tests weren't reliable because they test emotional state and nervousness but not honesty and dishonesty.¹⁰

Honesty (integrity) tests

Testing people' honesty and integrity is done with polygraph (lie detector) and written tests in order to assess whether candidates behave immorally.¹¹ The disadvantages and criticisms of polygraph resulted in popularization of honesty (integrity) tests. There are different honesty (integrity) tests:

- for determining the candidates views on dishonest and inappropriate behavior
- for checking person's characteristics
- for determining candidates' views on work, working morale, work behavior and discipline etc.

There are as well as tests for checking persons views on disclosure of official secrets, professional ethics etc.

Testing should be done by competent persons. Tests consist of questions that need to be answered with yes or no.

Combinations of integrity tests and lie detector are used in some companies. If the results are equivalent from the both methods, it's a good predictor for selecting a moral person. If the results aren't equivalent the test is repeated or another tests are used by the companies for a choice of new employees. Integrity tests are valid as a method for identifying person's characteristics, but there isn't enough predictive validity whether a person will steal, abuse their confidence, disclose official secrets etc.

The following reasons are listed as arguments against their use:

- weak predictive validity
- from a moral and psychological view point testing isn't allowed without agreement of the examinee
- a person mustn't be characterized as a dishonest person or a person with morally unacceptable behavior, with predisposition for stealing or other manipulations with outvalid evidence and concrete deeds

¹⁰ Цветковић, Н., Тасић, З., Стаменковић, С., Кулић, С. (2013), "Неконвенционални методи селекције кандидата за посао", *Pravno – Ekonomski Pogledi*, br.1/2013, <Pravno-Ekonomski Pogledi br.1/2013 Nekonvencionalni...> (03.01.2014), s.4-8.

¹¹ <[PPT] Testiranje i selekcija kandidata za posao PowerPoint...> (03.01.2014).

- their use is against the Right to Work law, as one of the universal human rights. The candidates are eliminated in a questionable way, there by their human rights aren't realized.

In the last years significant efforts are being made to increase the predictive validity of honesty tests and the experiences of their implementation are very positive, so the arguments against their use are opened to question.¹²

Theft is one of the greatest evil, that a lot of companies face it and suffer huge losses. That is the reason of the demise of many small companies. That is the biggest reason for the companies to use this kind of test. These procedures are recommended for the screening of individuals as well as for preventing of theft:

- making direct insensitive questions
- more listening than talking
- verification whether the person uses credit
- review of the recommendations for employment and personal references
- test for detecting consumption of drug
- testing with integrity tests such as paper and pencil and psychological tests for detecting certain types of behavior of the person
- obtaining information from police whether the person has a criminal record¹³

It can be seen that the integrity tests are included in the above-mentioned procedures.

Jackson, S.E., Schuler, R.S., Werner, S. stated that the theft made by employees, is the main cause of 30% of the bankruptcy cases of companies. Inexplicable losses of cash, trade goods, tools and supplies are a major problem and the companies are forced to invest huge sum sin providing the system and greater control. Of the 9000 employees surveyed by the Ministry of Justice, 30% of them admitted that they steal from their employers. The

¹² Цветковић, Н., Тасић, З., Стаменковић, С., Кулић, С.(2013),“Неконвенционални методи селекције кандидата за посао“, *Pravno – Ekonomski Pogledi*, br.1/2013 <Pravno-Ekonomski Pogledi br.1/2013 Nekonvencionalni...> (03.01.2014), s.4-8.

¹³ Dressler, G. (2005),” *Human Resource Management*”, 10ed., 2 Part, 6 Chapt,“Recruitment and Placement”, Prentice Hall Inc., cited by Cook, C. "Employee Testing and Selection" the University of West Alabama, Power Point Presentation <[PPT]Employee Testing and Selection> 10.01.2014 slide 6-45.

integrity problem can a company cost a lot. (Jackson, S.E., Schuler, R.S., Werner, S., 2009:247).¹⁴

The American professor James Wimbush thinks that most of the selective models for human resources did not give the expected results as a result of the limited knowledge of managers. The survey has shown that 57% of managers think that integrity tests have no validity. But recent research on American employees at the age of 18-22 years who had access to money, showed that 53% of them were stealing regularly from the company. According to the above-mentioned American professor the reasons are: poor salary, notice of dismissal, poor working conditions and employees do not consider stealing as a negative phenomenon. The professor thinks that the latest versions of honesty and integrity tests are considerably improved and they are worth to use in organizations.¹⁵

The below-mentioned questions are used in some of the integrity tests in order to check the candidates' attitudes in terms of theft and their previous experiences:

- *according to you is it okay to take something from the organization that has a high profit?*
- *according to you the theft is getting the part you deserve?*
- *Is it okay to manipulate with the prices of commodities when the store has too high-priced commodities for personal profit?*¹⁶

The employers use integrity tests as mechanisms to hinder the employment of unethical persons, to reduce fraud and theft in the workplace as well as to raise staff's awareness that dishonesty will not be tolerated. Sometimes the examiners consciously generate false positive answers because of restrictions of these tests. These tests can violate people's privacy and to be offensive in terms of the structure of the questions. They can generate false positive information too. Robert L. Mathis and John H. Jackson say that the results of a survey of US employers, showed that 28% of

¹⁴ Jackson, S. E., Schuler, R. S., Werner, S. (2009), "Managing Human Resources", 10ed., USA: South-Western, a part of Cengage Learning, p.247.

¹⁵ "Održano predavanje prof. James Wimbusha o modernim trendovima u razvoju ljudskih resursa", Nezavisni hrvatski sindikati, 16.01.2007
www.nhs.hr/novosti/odrzano_predavanje_prof_jamesa_wimbusha_o_modernim_trendovima_u_razvoju_ljudskih_resursa_4253/, (04.01.2014), s.1,2

¹⁶ Pavlović, N. "Selekcija zaposlenih", <PPT- Selekcija zaposlenih PowerPoint Presentation> (03.01.2014).

employers use honesty and integrity tests. While 22% of them use the same tests to detect affinity for violence.¹⁷

Candidates, who apply for filling the vacancy in the administration, take the integrity test. The State Employment Agency prepares a ranking list of five candidates who take the integrity test.¹⁸

Integrity tests are used to determine whether a person has a tendency towards counterproductive behavior at work. The tests predict lying, poor performance, sabotage, theft as well as absence or leaving work. According to Suket the integrity tests (that evaluate person's characteristics) are undercover to the purpose of testing. Personality tests are often used as integrity tests. Hogan and Hogan constructed personality test which was applied as integrity test that identified the characteristics of a person connected with theft. It was shown that people with affinity to theft were exhibitionists and had less sense of guilt for their actions.¹⁹

Extensive researches have shown that some of these methods provide reliable information and predict dishonest behavior. The integrity tests are selective method for a choice of new employees for filling the working positions that included working with money.²⁰

Conclusion

In the last years we are witnesses to the media constant reports on various types of malversation of working positions, theft and manipulations. The companies' huge losses are due to dishonest behavior of their employees and they are considered to be the main reason for using the integrity tests as a selective method for a choice of new employees. Now the companies are not satisfied with the traditional methods for a choice of new employees, so they

¹⁷ Mathis, R. L., Jackson, J. H. (2008), "Human resource management", 12ed., Thomson South –Western translated by Џонс, М., Димитриевски, В. Д., Матис, Р. Л., Џексон, Џ. Х. (2010), "Управување со човечки ресурси", 12изд., Скопје: МАГОР, с.239.

¹⁸ Бошковска-Златкова, Н. "Администрацијата нервозна поради новите правила", Нова Македонија, бр.22323 среда 06.07.2011, www.novamakedonija.com.mk/NewsDetal.asp?vest=7611845101&id=9&setIzdanie=2323 (07.11.2014).

¹⁹ Николоски, Т. (2000), "Психологија на трудот", Скопје: Универзитет "Св. Кирил и Методиј", Филозофски факултет, с.148.

²⁰ Selection tests/HRM/Free Online Lessons, Lesson 19, www.zainbooks.com, Free IELTS Practice Test <Human Resource Management-ZainBooks.com> SELECTION TESTS:Characteristics of Properly Designed, (08.01.2014), p.3.

often use unusual resources looking for more skillful and more adequate employees. Even the polygraph has restricted use, it is used evidently by the companies in the USA. The findings about the advantages and disadvantages, and experiences in using the tests in the USA and other highly developed countries, are very useful. In our country the honesty (integrity) tests have been recently used to select staff who have been shortlisted for filling the vacancy in the administration. I think the tests will be used more intensively by the companies in the future and the testing will be in combination with other standard and conventional selective means for a choice of loyal and honest employees.

References:

1. Боландер, Ц., Шнел, С.(2010), "Управување со човечки ресурси", 15, USA: South-Western, Cengage Learning.
2. Cook, M. and Cripps, B. (2005), "Psychological Assessment in The Workplace: A Manager' Guide", England: John Wiley & Sons, LTD, translated by Sočkovič, J i Barišič, M.(2009), "Psihološko procenivanje na radnome mjestu: Vodič za menadžere", Zagreb, Školska knjiga.
3. Dessler, G. (2008), "Human Resource Managemen", 11 ed., New Jersey: Upper Saddle River Pearson Prentice Hall.
4. Dessler, G. (2003), "Human Resource Management", 9 ed., New Jersey: by Pearson Education, Inc., Prentice Hall, Upper Saddle River 07458.
5. Dressler, G. (2005), "Human Resource Management", 10ed., 2 Part, 6 Chapt., "Recruitment and Placement", Prentice Hall Inc., citted by Cook, C. "Employee Testing and Selection" the University of West Alabama, Power Point Presentation <[PPT]Employee Testing and Selection> 10.01.2014.
6. Jackson, S. E., Schuler, R. S., Werner, S. (2009), "Managing Human Resources", 10 ed., USA: South-Western, a part of Cengage Learning.
7. Mathis, R. L., Jackson, J. H. (2008), "Human resource management", 12ed., Thomson South –Western translated by Џонс, М., Димитриевски, В. Д., Матис, Р. Л., Џексон, Џ. Х. (2010), "Управување со човечки ресурси", 12изд., Скопје: МАГОР.

8. Euro Poligraf Center, "The advantages of polygraph testing", Bucuresti: Singular Labarator de expertiza poligraf (detector de minciuni) autorizat cu sistem de control al rezultatelor, 2012 <http://www.poligraf-center.ro/index.php?page=105&lang=EN>, <Experti certificati***tarife avantajoase***Programari...> (10.01.2014)
9. "Održano predavanje prof. James Wimbusha o modernim trendovima u razvoju ljudskih resursa", Nezavisni hrvatski sindikati, 16.01.2007 www.nhs.hr/novosti/održano_predavanje_prof_jamesa_wimbusha_o_modernim_trendovima_u_razvoju_ljudskih_resursa_4253/, (04.01.2014)
10. Pavlovič, N. "Selekcija zaposlenih", <PPT- Selekcija zaposlenih PowerPoint Presentation> (03.01.2014).
11. "Polygraph", Wikipedia, the free Encyclopedia, <http://en.wikipedia.org/wiki/Polygraph>, (10.01.2014)
12. MBA Knowlegde Base, "Type of tests taken in the Selection process", <Type of tests taken in the Selection process> (08.01.2014).
13. Selection tests/HRM/Free Online Lessons, Lesson 19, www.zainbooks.com, Free IELTS Practice Test <Human Management-ZainBooks.com>Resource SELECTION TESTS: Characteristics of Properly Designed, (08.01.2014)
14. Николоски, Т. (2000), "Психологија на трудот", Скопје: Универзитет "Св.Кирил и Методиј", Филозофски факултет.
15. Цветковић, Н., Тасић, З., Стаменковић, С., Кулић, С. (2013), "Неконвенционални методи селекције кандидата за посао", *Pravno –Ekonomski Pogledi*, br.1/2013 <Pravno-Ekonomski Pogledi br.1/2013 Nekonvencionalni...> (03.01.2014).
16. Бошковска-Златкова, Н. "Администрацијата нервозна поради новите правила", Нова Македонија, бр.22323 среда 06.07.2011, www.novamakedonija.com.mk/NewsDetal.asp?vest=7611845101&id=9&setIzdanie=22323 (07.11.2014)

Snezhana HRISTOVA*)
Jelena TAST**)

THE EMERGENCE AND SIGNIFICANCE OF LOCAL ECONOMIC DEVELOPMENT

Abstract

This paper makes a case that discerning what globalization means for local economic development strategies, structures and policies becomes a formidable governance challenge today. The thesis of this paper rests on the assumption that Local Economic Development (LED) policies as an integral part of the global socio-economic development, continuously occupy a greater importance in the overall economic development in less-developed countries as a way of resisting the forces of globalization. The main goal of this research paper is to find quantitative and qualitative justification for an appropriate governance structure for fostering local economic development. First, we argue that globalization debates engender controversy. One of the views is that it is a process which engages with trade, communication, technology, culture and the flow of capital across national boundaries and another that globalization has led to marginalization and exclusion because of downward pressures on systems of social protection, changing labour market conditions and increasing inequality in wages. Then, drawing on large national surveys of local economic development policies, the paper explores the policy strategies for community development that localities are employing as a response to globalization. Finally, the special focus of this paper has been given to the case of local economic development in the Republic of Macedonia.

Key words: Local Economic Development (LED), globalization, economic policy, Macedonia.

*) PhD, University American College Skopje, e-mail:shristova@uacs.edu.mk

**) PhD, MIT University, e-mail:jelena.stajik@hotmail.com

JEL classification: O 21, O 22

Introduction

The starting premise of this paper is that globalization involves not only benefits, but also has costs or potential problems that some critics see as great perils. The transformation induced by globalization has contributed to the expansion of the world economy, caused major shifts in the composition and location of production and consumption activities and reduced the ability of national and local governments to act unilaterally. As a result it has reshaped the way millions of people earn their living and the way societies are organized, which in turn has huge implications on how natural resources are used. The challenge world face today is how can it harness the opportunities whilst at the same time limiting the potential costs of globalization.

The costs of globalization could lead to conflicts of various types, whether at the regional, national or international level. One such cost or problem is that of who gains from its potential benefits. There can be substantial equity problems in the distribution of the gains from globalization among individuals, organizations, nations, and regions. Indeed, many of the gains have been going to the rich nations or individuals, creating greater inequalities and leading to potential conflicts nationally and internationally. Some have suggested the possibility of convergence of incomes globally based on the observation that the poor nations are growing at a faster rate than rich nations. The reality, however, is that a small group of nations, the "tiger economies" of East Asia, have been growing at rapid rates, while the least developed nations of Africa, Asia, and South and Central America, Europe have been growing at a slower rate than the rich nations. These poor nations are thus becoming increasingly marginalized. The result has been not a convergence but rather a divergence or polarization of incomes worldwide, with the rapid-growth economies joining the rich nations, but with the poor nations slipping even further behind. This growing disparity leads to disaffection and possibly even international conflicts as poor nations seek to join the club of rich nations and have-not nations struggle with the have nations for their share of world output. This issue of distribution is a major challenge in the process of the globalization of the world economy.

1. Globalization v. Localization

The main hypothesis of this paper is the following one. LED policies as an integral part of the global socio-economic development, continuously occupy a greater importance in the overall economic development in less-developed countries as a way of resisting the forces of globalization. Paper work results from the conviction that negative aspects of globalization, such as marginalization and economic disparities, are a key component of global imbalance, and they create a significant challenge for national economies. Their major goal is to create adequate policies of structural adjustment in which to deal with such negative aspects. Localization is the route to achieve this. Localization has to be the route forward for a country that wants more jobs, better social conditions, and an improved environment. It is becoming increasingly clear that to tackle unemployment and rebuild healthy, stable and sustainable societies can only be done when citizens and nations take back control of their economies. Localization does not mean walling of the outside world. It means nurturing locally- owned businesses which use local resources sustainably, employ local workers at decent wages, and serve primarily local consumers. It means becoming more self-sufficient and less dependent on imports. Control moves from the boardrooms of distant corporations and back to the community where it belongs. Jerry Mander, one of the most immanent contemporaries in this area, actively opposes economic globalization. His aim is to shift economic thought and policy in search of new economic models that will lead the twenty-first century and to promote the idea of opposing the paradigm of globalization. His primary means of accomplishing this is to turn to so-called local economies as the most successful resistance to globalization. After Mander "Economic globalization has strong logic that is twofold destructive." His viewpoint is such that it not only improves the living standards of the vast majority of the world's population, but also that it contributes to its decline. Even today most of the world's population adheres to a relatively traditional economy. Those traditional economies in many cases are not poor and those who are poor are mostly impoverished because of the politics of the Neoliberal economics."¹ Turning to so-called localization will allow the promotion of local and small economies that are different, rely on themselves, and

¹ Mander, Jerry; Goldsmith, Edward (ur.) (1996), *The Case against the Global Economy*. San Francisco: Sierra Club Books;
<http://www.scottlondon.com/interviews/mander1.html>

are connected to external forces but do not depend on them. One benefit of a localized economy is that it dismantles economic activities into smaller segments that can be more easily managed and that connect people who make decisions. This means connecting the capital in one place and sharing the surveillance on the greatest possible number of people.

The word localization denotes several initiatives which are aimed at creating and preserving an intimate social atmosphere which is based on communities that work through direct relationships, that have their own self-control, and that are supported by a cooperative and participatory logic. Following this view, the best response to the evils of globalization can only be what is termed as re-territorialism, or a re-binding of the place and the local community, which includes the revival of old or inventing new local manufacturing activities. This is an economy and culture that is being spread more and more beyond national borders and it is a point of view that leads to the discovery, creation, and promotion of numerous local initiatives around the world. Localization projects include small family initiatives in agriculture, petty local trade, local exchange systems with the use of local currencies, and participatory forms of local government. Many of these initiatives or offers are based on the idea that culture, community, and economy are rooted in specific geographic locations that require constant support and preservation. It is felt that these initiatives based on such ideas and values form an inseparable part of the community and economy as a whole and should thus be protected.² Helena Norberg, who agrees completely with the opinions of Mander, strongly promotes local initiatives and points out their significant contribution to economic development. She states: "The awareness of the devastating consequences of economic globalization is growing more and more, but a point that is so often overlooked is the belief that the solution to the problems arising from it lies in the localization of economic activities". Societies today are faced with a two choices. One approach, which is already supported by governments and industry, is of an increasingly globalized economy whereby the distances between producers and consumers will continue to grow. The other approach is built from the base and focuses on a reduced distance between producers and consumers. It highlights the benefits of strong

² Norberg-Hodge, H. (1998) "The Pressure to Modernize and Globalize", in eds. Mander J. Goldsmith E. "The Case Against the Global Economy, and for a Turn Toward the Local", Sierra Club Books, 1998
http://www.sjsu.edu/upload/course/course_5710/Norberg_pressure_to_modernize.pdf

local economies based on more regionally located production. Norberg claims that globalization is the most significant contributing factor in the breakdown of local economies within many national economies. Although some may feel her beliefs are absurd, they are augmented by her study of the detrimental effects that globalization has had on numerous societies. She has performed research on various cultures which include heavily-industrialized America, socialist Sweden, rural areas in Spain, and the Ladakh, who are the traditional peoples of Tibetan Plateau. The conclusion she has drawn from her research has formed the basis of her arguments in support of the localized economic approach. Norberg personally performed the studies of the Ladakh, and it from them that she has formed the strongest of her arguments. "When Norberg first came to Ladakh, the western conventional economics had not yet arrived. What existed was a system in which producers and consumers were closely related and the economy was reliant on the local community". After two decades of development a number of fundamental changes occurred. The local people became dependent on food and energy which were thousands of miles away from them. Prior to this, the Ladakh local economy was considered strong and entirely capable of sustaining its people on its own. With the advent of globalization it was now being attacked by the products of factory farms located across the Himalayas. This food, which arrived from the distance in huge quantities, was much cheaper than the food being grown within the local community. For many Ladakh it was simply no longer viable to continue farming.

The same process not only influenced the production of food, but a whole range of goods including clothes, household utensils, and building materials. The imports from the distant parts of India could often be produced and distributed at lower prices than the goods that were produced locally. Such a situation was able to arise primarily due to strong subvention and outside support for the industrial infrastructure. The ultimate effect of these changes was a complete disruption of the local economy of the Ladakh people. It has adversely affected the general welfare of the local community which is inextricably tied to the health of their economy. These trends found within the globalized economic system demonstrate how the negative consequences of that system are able work their way through to other areas and worsen the overall condition of both communities and cultures. Children who traditionally studied farming and agriculture from their relatives and neighbors now had to study in schools with a Western educational system to prepare for

specialized jobs in the industry. In Ladakh the availability of these jobs was very rare and as more people moved away from the farms the number of unemployed Ladakh grew exponentially. Moreover, the direction and action of the economy, which was once controlled locally, was now being determined from more global market forces, and this resulted in a growing instability and an increase in poverty. Almost overnight a range of social problems appeared, including crime, family breakdown, and homelessness. As the Ladakh people were moving away from their land their awareness of the limitations of local resources changed. Pollution was rising, and the population grew. All of this served to exacerbate the emerging problems. Norberg sharply criticizes the conventional economists who ignore these negative impacts and she points out that such impacts are not as easily measurable as monetary transactions. She also criticizes their justification for the changes according to which regions like Punjab have comparative advantages over Ladakh in food production. This gives Punjab an economic sense to specialize in producing food, while the Ladakh need to specialize in other products, so they can trade each other. Barry joins the same point of view and he charges that governments worldwide promote these trends with the assurance that their "sick" economies will recover only if they are directed towards economic globalization. Ironically, these policies have undermined the economy not only of local and regional communities, but even to national level.³

Although Norberg feels that it is quite unrealistic for modern economies to be fully converted to localized ones, she does suggest that if national economies move towards the promotion of localization, they will be able to solve a series of serious economic problems. Both, Mander and Norberg, absolutely agree that the paradigm of localization does not necessarily imply the denial of globalization and trans-local resistance. But they do feel that this context means taking safety measures to protect economies from adherents of the globalization school thought and the implementation of their neoliberal globalization policies. It is a new way of protectionism, which means maximum boost of the local trade within the different self-congratulatory local economy and reducing the trade with the distant countries. "The new protectionism pursued the idea that the global economy has not only failed to abolish the old protectionism, but also (in the name of multinational companies

³ Norberg-Hodge, Helena (1996), .Shifting Direction: From Global Dependence to Local Interdependence., p.393-406 .

and international banks) implements a protectionist tactic whose purpose is to destroy the capabilities of local communities so they can preserve their own viability and sustainability of their natural environments."⁴ Moreover, both of them emphasize that if local initiatives remain isolated in their actions, they will lose their significance. This, however, will not happen if they are an integral part of the economic policy of governments, as an institutional basis for promoting a far different economy policy. In light of these points of view and assumptions we are able to conclude that although globalization is a general process it is important that development take place in local communities. New development concepts require the states, i.e. the governments, to give up some of their responsibilities and to delegate them to the development entities of lower levels of government, i.e. to the level of regional and local authorities. One of the results of globalization is that the economies and governments of Nation-States have become too large to effectively solve specific problems of their citizens. These types of problems can only be successfully dealt with the active participation of both citizens and local communities at all levels of organization (municipalities, regions). The modern state needs to strengthen their interactions with local governments and to work to develop partnerships with them. Such a relationship would serve to significantly increase the overall functionality of the society as it adapts to global trends. It would also serve to allow greater movement of both capital and labor and would provide citizens with a better quality of life and general standard of living.

2. Local Economic Development (LED) Policies in a Globalizing World

What is LED? Actually it's a process in which the local authorities cooperate with the public sector, business community, and NGOs, in order to create more appropriate environment for economic development and for unemployment decreasing. Its objectives are to stimulate investments that will promote sustained high growth in a local community. LED focuses on the region's potential and identifies specifically what local stakeholders can and need to do to ensure their local community reaches its potential. In this context, Local Economic

⁴ Norberg-Hodge, Helena (1996), *Shifting Direction: From Global Dependence to Local Interdependence*, u Mander e Goldsmith (ur.), p.393-406.

Development assesses a community's comparative advantage, identifies new or existing market opportunities for businesses, and reduces obstacles to business expansion and creation. LED activities should have an impact on the economic viability of the entire city and surrounding region not just a particular sector of the local economy. It aims to enhance competitiveness and thus encourage sustainable growth that is inclusive.⁵

How far has the importance of the role of local economies in the global context been accepted and incorporated as a policy strategy? According to OECD: "One of the most important trends in recent years that is associated with the emergence and the growing importance of the politics of local economic development is exactly the change in the orientation of economic and social policy in a direction away from the approach of "top down development " and so-called sectoral policy, to the approach of "bottom up development" and local development strategies."⁶

The path towards globalization is dependent upon continuous government investments. It requires the building-up of a large-scale industrial infrastructure, including roads, mass communications facilities and energy installations. This is adhered to the "top down development approach" and drawn up with the goal of attracting foreign investments to the most accessible sectors unfortunately fail to encourage economic development in remote and less significant areas. Unlike this approach, the so called "bottom up" approach generates support for endogenous development and can be far more effective in stimulating overall economic development in the long term. This is accomplished by implementing concepts such as support for entrepreneurship, developing human capital, fostering innovation, creating public-private partnerships and the building of a network of local institutions. Switching to so called "bottom up" and endogenous (local) development strategies is highly conducive to the creation of new theoretical concepts regarding the process of economic development, especially the development of new theories about the growing importance of the local environment for the competitiveness of businesses.

⁵ Bertelsmann Foundation and World Bank (2002): Local Economic Development – Developing and Implementing Local Economic Development Strategies and Action Plans, December.

⁶Giancarlo Canzanelli, (2001): Overview and learned lessons on Local Economic Development, Human Development, and Decent Work, ILO Working paper.

From this paragraph some of the positive attributes of LED, such as the ability to determine problems at the local level and to implement procedures and measures aimed at solving specific local problems, are evident. It is because of these that LED has acquired a growing consensus among economic policy makers to become an integral part of the overall development of national policy. Local economic development as means by which to integrate local levels should actually unite the regional policy. Every local community will have to find a way to integrate in order to respond to evolving global change. This should be accomplished in order to strengthen its economy and to resist the sort of crises that the above national system underwent. To create integration it is necessary to have cooperation, mutual trust, partnership, and respect for the rules. It also implies that neither level nor any constituted authority of any level can independently manage the national system. The relations between local government and authority levels and national levels are not one-sided. They do not move from top down nor bottom-up, they are multilateral and move in all possible directions.⁷

Decentralizing the policies of national governments is being increasingly performed. It is re-animating the developmental processes by demonstrating the competence of local government to operate effectively. Local development concepts perceive development as an in common effort of public and private entities and local communities. It is obvious that this is a complex approach to development, which not only requires a review of the role of the state, but also an examination of the ability and willingness of local communities to take the role in managing their own development and futures. Local economic development is especially important for underdeveloped regions, localities that are in decline, those with high unemployment and poverty, those that have low levels of social services, and for areas with other such negative attributes. Local authorities in such unstable environments are becoming increasingly important factors in what motivates the mobilization of citizens, knowledge, capital, and alternative programs of employment. Hence, local economic development as an objectively determined mode of modern economic development can be the most important dimension in the process of reducing poverty and increasing equality. The LED as a policy of structural adjustment is a key link in the creation of values in the national economy. It exploits the developmental potential of local

⁷ Giancarlo, Canzanelli, 2001 Overview and learned lessons on Local Economic Development, Human Development, and Decent Work, ILO Working paper.

resources and in doing so creates economic and financial conditions that allow more regional areas to participate in and to also benefit the national economy.

According to prof. Uzunov⁸, "a main centripetal force for the development of the national economy is the strength and attractiveness of each LED territory (municipality) and how they (should) be creating power and the ability to attract capital to the local (economic) territory. In the final analysis, it crucially depends on the dynamism of local economic development." In this quote, prof. Uzunov indicates that the process of local economic development is the process of creating "niche" economic environments at the local level, those which will pull forward and progress by maximally exploiting the opportunities that come from the global environment. The process of creating a niche economic environment at the local level involves the creation and utilization of specific local advantages and better utilization of existing facilities which can generate the opening of new jobs and increase the welfare of the community. Most importantly, each local region should completely exploit its own potentials to increase the welfare of the community. The achievement of these imperatives will not only mean the creation of competition within the local economic regions, but also within the national economy. That is, "If the attractiveness of local economic regions represents the force of attraction of developmental factors, i.e. it is a centripetal force to locate developmental factors, than the technological progress is the centrifugal force in locating these developmental factors.

The achievement of these imperatives will not only mean the creation of competition within the local economic regions, but also within the national economy. That is, "If the attractiveness of local economic regions is represented by the force of attraction of developmental factors, it can be viewed such so that locating developmental factors is a centripetal force, and the technological progress is the centrifugal force in locating these developmental factors. Success in economic development is achieved only with the correct combination of centripetal and centrifugal forces and thus would actually achieve economic development of the given local economic region."⁹ Because of the ability to create a favorable business environment,

⁸ Uzunov, Vancho, 2001: Globalization and Economic Development-Theory and Politics, Law Faculty, Skopje.

⁹ Uzunov, Vancho, 2001: Globalization and Economic Development-Theory and Politics, Law Faculty, Skopje.

adequate conditions for sustainable development, and growth of small and medium enterprises, the role of local economic development should be greater than ever. Its influence is necessary in order to apply the new development approach, i.e. focusing on endogenous (internal) development and on using the potential of local human, institutional, and natural resources. The processes of economic development should begin at the local level and the national-economic level should present a macroeconomic policy. This is the essence of the process mentioned before which was referred to as access from bottom to top or the "bottom up approach". Today, many countries continue to design and monitor policies on local economic development. The significance of the role of LED policy has not only become more developed in the U.S. and EU countries, but also in third world and the transition countries. Also, the European Union is becoming more active in supporting and outlining the policy of LED through its structural funds and other initiatives. In the modern conditions of globalization, the world is faced with the paradox of increasing the importance of the local economic development. LED policy becomes more important when the new economic policies are based more on endogenous development in order to reduce the technological and organizational lag and to enhance the ability of less developed localities to attract investment. Growth and development exercise only those sites that manage local comparative advantages to transform the global competitive advantages.¹⁰

To summarize, the meaning and importance of LED can be emphasized through following:¹¹

Local- refers to a process of valuing the endogenous potential, making optimal use of the already existing local capacities.

Economic- is directed towards the identification of investment opportunities, supporting entrepreneurial activities and facilitating the access to (new) markets.

Development - is the process that is aimed at promoting an improvement in the living and working conditions of the community through the creation of new jobs, the retention of existing jobs and the generation of income. Various LED Approaches are: public-private partnership approach to assess/seize economic comparative advantage, small business approach for innovation, private investment and job

¹⁰ Nikolovska Natalija, 2002, Regional Economy, UKIM.

¹¹ Bertelsmann Foundation and World Bank (2002): Local Economic Development – Developing and Implementing Local Economic Development Strategies and Action Plans.

creation, regional approach leveraging the resources of surrounding areas, sector-cluster approach supporting the most promising sectors by bringing together business, educational institutions, NGOs and government etc.

3. Preconditions, Opportunities and Ways for Local Economic Development in the Republic of Macedonia

Republic of Macedonia welcomed the beginning of the process of transition with having highly centralized economic and political system. However, in the middle of the 1990s, the need for gradual decentralization started to arise. In the corpus of authorities that were transferred from central to local level, the one that is particularly emphasized is the duty regarding the local economic development.

Nowadays, LED policies are becoming key drivers of employment growth and competitiveness at the local level, and they are also a way of boosting the economic growth and development of the local economy. After more than ten years of pluralistic living, the constitutional amendments of 2001 and the new law of Local Self-Government in 2002 definitely marked the beginning of the process of decentralization and the development of a system of modern local government in the Republic of Macedonia. As a country with serious aspirations toward NATO and the EU Macedonia, in terms of regional and local economic development, must have one basic goal. This goal is to create a consistent system of goals, institutions, and instruments for balancing the social and economic development throughout the country. This should be sought to be accomplished by integrating general (national interests), regional, and local (special interests) in implementing an efficient, balanced, and sustainable economic development plan. Two instances confirm this commitment. First was the very adoption of the new Law of Local Government in 2002, whereby the responsibilities of local services substantially increased with LED becoming one of the first duties (authorities) to be shared on a local level. The second moment was adoption of the Law of Balanced Regional Development in 2007. With this law the principle of partnership was established as a fundamental principle that underpinned the policy for regional development where it has been highlighted the need for cooperation in the preparation, implementation, monitoring, and evaluation of planning documents for regional development between the central and local governments.

Furthermore, through the principle of subsidiary, it was emphasized the importance of the role of local government in regional development by demonstrating how the need for cooperation in planning is the main operative when it comes to the preparation, implementation, monitoring, and evaluation of programs and activities for economic development.

During the paper research a questionnaire method was used. The survey was conducted in 2011/2012 year. These questionnaires were forwarded to all municipalities and more than 55% have submitted their responses, with 44 municipalities, including the City of Skopje, responding. There are 30 urban, or 68.2%. The other 14, or 31.8%, are rural municipalities. The research has shown the main hypotheses that LED policies as an integral part of the global socio-economic development, should occupy a greater importance in the overall economic development in Macedonia as a way of resisting the forces of globalization, can be absolutely confirmed. Herewith, the current socio-economic situation is characterized by the economic and social degradation of most municipalities, the spread of inequalities between urban and rural areas, and the prevalence of a monocentric structure with emphasis on the capital city, ie having large disparities between the periphery and the center. The largest part of financial resources, investment (including FDI), knowledge, science, culture, and other human and social funds are in Skopje. Because of the problems that emerged during the transition many municipalities have a huge number of unemployed people and the development of industries that employ many people is on a very low level. The manifestations of the poverty of rural communities as well as the social and technical degradation are still evident. With the considerations in mind, the necessity of keeping active LED policy becomes more acute because it can create better conditions for economic development in local communities and it will increase the employment and general welfare of the citizens.¹²

But is the local economic development a reality or is it just a needed authority? The main conclusion of the survey is that in comparing it with some other authorities in municipalities, LED still does not show very successful performance. One positive note, however, is that 2011, in comparison to the previous years, did show a positive trend. It is also evident that problems exist in areas that are crucial for the smooth functioning of municipalities in the implementation of the LED. Some of those problems are: securing increased revenue, reducing state debt, the

¹² Law on Local self-government, Official Gazette of Republic of Macedonia 5/2002.

ability to independently manage land and land projects, and the need for accelerated implementation of plans for balanced regional growth. The role of the government, both in terms of monitoring the situation and in terms of transferring appropriate experience to the areas that are demonstrating a need for competency (providing policy to support the development of small and medium enterprises) has been evaluated as insufficient. Therefore, it appears that in order to solve the problems of LED there is a need for more dynamic and effective dialogue and cooperation between central and local governments.

Strategically planned LED is increasingly being used by Macedonian local communities to strengthen the local economic capacity, improve the investment climate, and to increase the productivity and competitiveness of local businesses. The main problem that these municipalities are facing is the inability to fully implement the activities and projects that are planned in the strategic documents. This means that the available LED strategies are often not compatible with the LED needs of the municipalities. They are not usually based on the actual needs and opportunities of the municipality, nor are they based on the way they perform the prioritization of activities. The results of the survey indicate the most common problems that prevent the municipalities from effectively implementing their plans for LED. These include: lack of financial resources, which was cited as the main reason, lack of support from government departments, and a low level of planning on the part of the government.

It is also evident that there is still no progress in understanding that good design concepts in the politics of LED should be based much more on competitive rather than on comparative advantages. It also seems that the significance of so-called new factors in LED such as human resources, knowledge, quality of physical and social infrastructure, and building and strengthening the institutional capacity, are neither sufficiently understood nor valued. The essence of an LED strategy should be comprised by multiple elements that have great importance for the acceleration of Local Economic Development. Those elements are: promotion of competitiveness by stimulating the inflow of FDI growth of SMEs, entrepreneurship and attracting investments, improving business environments, development of infrastructure and the development of human resources. In case of Macedonia, communities follow this trend, but by giving priority to the development of infrastructure. Next comes the attraction of investments, then the support

of SMEs, the development of agriculture, and finally the development of human resources.

The implementation of LED strategies should result from both the specific needs of the municipality and also its future economic potential and projected capacity. The effective organizational structure and building capacity of LED management and administration needs to be absolutely confirmed. Development will depend on the improvement of individual skills and institutional capacities. This improvement is essential for the implementation and success of strategic plans. Generally municipalities will need to provide specific and adequate organizational structure (both in department and unit) that will focus on development needs. This structure will integrate the activities of all the other administrative functions of the municipality. Such functions include: finance, utilities, urban planning, education, etc. They also need to provide not just an outlined or conceptual plan but a real structure of organizational approach by making appropriate job descriptions and filling them with quality administration. It is quite clear that possessing high quality and highly developed management as a resource will be crucial for the successful implementation of local development initiatives. There is almost no municipality or municipal leadership who feels that there is no need for qualitative changes in the way of management. Common indicators which point to this condition are: a typically bureaucratic state, a low level of understanding of the concepts and mechanisms for LED, lack of expertise in staff, inadequate qualification standards for management, and so on. It is the erosion of managerial capacity and the lack of procedural skills and their application which directly and adversely affect the performance of municipalities. The existing educational structure of the population is also very unfavorable and most municipalities do not have quality human resources necessary to encourage and monitor economic development.

Among other things, this means that it is necessary to go beyond providing a basic financial and administrative structure. If the goal of boosting economic growth and development of the local economy is to be achieved what is also needed is a stronger emphasis on elements such as training of the workforce, development of skills, encouragement and means for higher education, etc.

Last, but not the least, fiscal and financial aspects of the process of decentralization remain the most important and most complex challenges: improving the financial health of municipalities. This can be accomplished with the inclusion of external funds in local development

and by encouraging more evolved and established powers to take a more active role in local economic development.¹³ Despite the positive trends observed in the allocation of municipal budgets for LED, the funds are still relatively small. The municipalities have very little financial resources to deliver their development needs, and most of the budget is spent on meeting the current operational and administrative needs. This proves that LED is still not considered of key importance or focus. One positive sign is to see municipalities in control and making decisions with their own funds in regards to the implementation of LED. This indicates that some progress has been made in improving their financial health. However research has shown that municipalities are still financially dependent to a large extent on the central government regarding the implementation of LED policies. Additionally, it shows that there is a sufficient interest in fundraising from the private sector for building the public-private partnerships (PPP), which actually represents a largely untapped opportunity to engage in more capital investment within the municipality. Finally, if the analysts acknowledge the fact of the enormous differences between municipalities in terms of their income, it would imply a variety of different opportunities to stimulate LED. Provision and maintenance of sustainable long-term sources of financing activities in the field of LED is a significant challenge for local government.

In determining the budget of local government activities in the field of LED, municipalities must compete for limited funds namely directed toward accomplishment of other authorities such as urban planning and health and education. Hence, there is a critical need that local governments must understand that LED represents a potential driver of future revenue growth. Local government must understand that successful activities in the field of LED will influence the increase in the overall economic activity in the local economy and thus the increase of local government's budgets. Finally, in order to improve the situation, Macedonia should create polycentric policies of development that will contribute towards the prevention and elimination of disparities and will also have the goal of creating conditions for optimal utilization of available natural economic, human, and cultural resources in specific developing regions. The policy of polycentric development should generate enormous internal migration and this will stimulate growth and

¹³ Nikolov Marjan, (2006) Local Finances – Case study from Romania, Bulgaria and Macedonia, Center for economic analysis, Skopje.

development in intermediate-size and smaller municipalities in order to maintain and increase vitality in more rural parts of the regions.

Conclusion

In the conditions of global imbalances, in order to resist the marginalization caused by globalization, national economies are faced with the challenge to create adequate policies of structural adjustment, by emerging of new development concepts that require governments to give up some of their responsibilities and to delegate the development at the level of regional and local authorities. Nation-state becomes too wide framework for solving specific problems of citizens who can be successfully dealt only with the active participation of local communities. Communities are pursuing different LED policies to lower production factor costs (land, labor, and capital) relative to other local entities, though, for example, tax incentives or other subsidies for businesses. They also are pursuing world-class community policies, developing innovative production capacities to gain a niche in the global economy via, for example, public-private partnerships, encouragement of research and development, and efforts to attract foreign investment. And to a lesser extent, they are pursuing entrepreneurial mercantile policies and human capital policies. The former builds on local resources to encourage small businesses to form and grow rapidly by, for instance, providing seed capital and technical marketing assistance to these businesses, which has the result of diversifying the local economic base.

The Republic of Macedonia has had highly centralized economic and political system by the beginning of transition process. In the middle of 1990s the need for its state organization decentralizing started rising. Since 2001, Macedonia's macroeconomic strategy has sought to accommodate the forces of globalization and ensure the country's re-entry into the global economy. One key component of restructuring for globalization has been a shift in the burden of responsibility for economic development from national to local government level and of the promotion of local economic development (LED) across. Following the main thesis of this paper it can be concluded that in case of Macedonia there is a need for the LED policies to be an integral part of socio-economic development and to cope with globalization. But, so far, the experiences from practice have been proving the fact that local economic development is still not considered of key importance or focus and that

the existing administrative and territorial setup and functions that derive from the related legislation in Macedonia do not comply with the needs of economic growth and development on local level. It also seems that the significance of so-called new factors in LED such as human resources, knowledge, quality of physical and social infrastructure, and building and strengthening the institutional capacity, are neither sufficiently understood nor valued. The essence of an LED strategy should be comprised by multiple elements that have great importance for the acceleration of Local Economic Development. Those elements are: promotion of competitiveness by stimulating the inflow of FDI, growth of SMEs, encouraging entrepreneurship and attracting investments, improving business environments, development of infrastructure and the development of human resources.

References

1. Acocella Nicola (2005): *Economic Policy in the Age of Globalisation*, Cambridge University Press.
2. P. Thirlwall (2003): *Growth and Development – With Special Reference to Developing Economies*, Palgrave.
3. Association for Local Economic Development (2005): *Handbook for Creating LED Strategy*, VNG International April.
4. Giancarlo Canzanelli (2001): *Overview and learned lessons on Local Economic Development, Human Development, and Decent Work*, ILO Working paper.
5. Bertelsmann Foundation and World Bank (2002): *Local Economic Development – Developing and Implementing Local Economic Development Strategies and Action Plans*.
6. Law on Local self-government, Official Gazette of Republic of Macedonia 5/2002.
7. Mander Jerry; Goldsmith, Edward (1996): *The Case against the Global Economy*. San Francisco: Sierra Club Books; <http://www.scottlondon.com/interviews/mander1.html>
8. Meyer-Stamer Jörg (2003): *Participatory Appraisal of Competitive Advantage PACA: Launching Local Economic Development Initiatives*, www.mesopartner.com

9. Norberg-Hodge, H.(1998) “The Pressure to Modernize and Globalize”, in eds. Mander J. Goldsmith E. “The Case Against the Global Economy, and for a Turn Toward the Local”, Sierra Club http://www.sjsu.edu/upload/course/course_5710/Norberg_pressure_to_modernize.pdf
10. Norberg-Hodge, Helena (1996), .Shifting Direction: From Global Dependence to Local Interdependence., u Mander e Goldsmith (ur.), p.393-406.
11. Nikolovska, Natalija. (2002): Regional Economy, UKIM.
12. Nikolov Marjan (2006): Local Finances – Case study from Romania, Bugaria and Macedonia, Center for economic analysis, Skopje.
13. Uzunov Vancho (2001): Globalization and Economic Development-Theory and Politics, Law Faculty, Skopje.
14. OECD/LEED (2000): Best practices in local development.
15. OECD (2003): Entrepreneurship and Local Economic Development – Programme and Policy Recommendations.

Authors' Guidelines

General Guidelines

- The paper will be written entirely in English (following the **Editing Instructions**).
- All articles are subject to peer review and scientific categorization and should not exceed 4000 words. Based on that, the paper can be categorized as: 1) original scientific paper; 2) professional paper 3) reviews.
- A soft copy of the manuscript is required to be sent to eis@ek-inst.ukim.edu.mk. **The authors are entirely responsible for the content of their article.**
- Each author may submit a maximum of two papers per one issue (as single author and/or as co-author).
- All submitted manuscripts should not be previously published and not under consideration for publication elsewhere.
- Upon submission of manuscripts the editorial board will: 1) sends the paper to peer reviewer 2) informs the author about possible suggestions or comments on the manuscript that need to be revised or 3) informs the author that the paper has been rejected. Only positively reviewed manuscripts are published in the Journal. Provided the manuscript is refused, (the editor is not obligated to present reasons for refusal), the author may submit the paper elsewhere. Submitted manuscripts will not be returned to the author. Once the manuscript is accepted for publication, the author must not publish the paper in other journal.

Note

- The logical connection between the title of the article, abstract, key words, main content and conclusions should be respected.
- Articles that do not comply with all the requirements specified in the Editing Instructions will not be accepted for publication.

Admission fee:

85 EUR/paper

5.000 MKD/paper

The admission fee is payable after authors are notified that the paper is sent to a peer review

Beneficiary: Institute of Economics (University Ss. Cyril and Methodius-Skopje)

Bank account (national): 160010853278810

International Bank account (IBAN): MK07 1007 0100 0096 782

Bank name: Народна Банка на Република Македонија

National Bank of the Republic of Macedonia

Address: Bul. Kuzman Josifovski Pitu, No. 1 □

1000 Skopje

Republic of Macedonia

SWIFT code: NBRM MK 2X

Contact: Sretanka Gjorgjievska,

secretary of the Journal (sretanka@ek-inst.ukim.edu.mk)

URL: <http://www.ek-inst.ukim.edu.mk/>

Editing Instructions

NAME AND LAST NAME will be written with capital letters, left alignment, 12 points, bold, being followed by asterisks, and in the footnote the didactic and scientific degree, the position and place of work of the authors e-mail are indicated (Times New Roman, 10 points) *

(12 points) <Blank line 12 point high>

(12 points) <Blank line 12 point high>

THE TITLE OF THE PAPER WILL BE WRITTEN WITH CAPITAL LETTERS, CENTERED, Times New Roman, 12 POINTS, BOLD

(12 points) <Blank line 12 point high>

(12 points) <Blank line 12 point high>

<Tab> **Abstract:** (Times New Roman, 12 points, Sentence case, bold, left alignment)

The text in the Abstract will only be in English and will have between 100 and 200 words, a single line spacing, justify alignment, Times New Roman, 12 points. (The abstract should summarize the content of the paper. Do not make references nor display equations in the abstract.)

(12 points) <Blank line 12 point high>

<Tab> **Keywords:** (Times New Roman, 12 points, Sentence case, a single line spacing, justify alignment, bold). Maximum 5 words, in English, Times New Roman, 12 points.

(12 points) <Blank line 12 point high>

<Tab> **JEL Classification:** (Times New Roman, 12 points, Sentence case, justify alignment, bold). Times New Roman, 12 points, (http://www.aeaweb.org/journal/jel_class_system.php).

(12 points) <Blank line 12 point high>

(12 points) <Blank line 12 point high>

Introduction (Times New Roman, 12 points, Sentence case, left alignment, bold)

(12 points) <Blank line 12 point high>

* Assoc.Prof., Ph.D., University of Ss. Cyril and Methodius, Republic of Macedonia, [e-mail](#)

(The introduction of the paper should explain the nature of the problem, previous work, purpose, and the contribution of the paper. The contents of each section may be provided to understand easily about the paper.)

(12 points) <Blank line 12 point high>

1. THE TITLE OF THE CHAPTER: Times New Roman, 12 points, , capital letters, bold, numbered with Arabic numbers, left allignment.

(12 points) <Blank line 12 point high>

<Tab> The text paragraphs of the paper will be Times New Roman, 12 points, justified allignment, single line spacing. The paper will be edited on A4 format (210 x 297), page setup, top/bottom 2,54 cm; left/right 2,54 cm. The size of a <Tab> is 1,27 cm.

(12 points) <Blank line 12 point high>

1.1. Subchapter. Subchapters can be used in the text, numbered with the number of the chapter and a number showing the number of the subtitle within the chapter. The subchapters are Times New Roman, 12 points, Sentence case, bold.

(12 points) <Blank line 12 point high>

<Tab> **Conclusion:** (Times New Roman, 12 points, Sentence case, bold, left allignment)

The text in the Conclusion will be written in Times New Roman, 12 points, justify alignment, single line spacing.

CITATIONS: *Quotations and notes* should be elaborated as footnotes and marked successively with Arabic numbers¹. The scope of quotations and notes should be limited to 15 lines. Abbreviations such as "ibid", "op. cit" can be used.

PRESENTATION OF THE MATHEMATICAL EQUATIONS

(10 points) <Blank line 10 point high>

The mathematical equations will be Times New Roman, 11 points, centred and numbered on the right with Arabic numbers between round brackets.

¹ **Author's surname, Initial of first name:** Title of book, Edition (only include this if not the first edition), Publisher, Place, Year, page (Times New Roman, 10 points, justify allignment, single space)

(10 points) <Blank line 10 point high>

$$X^2 + Y^2 = Z^2 \quad (1)$$

(10 points) <Blank line 10 point high>

PRESENTATION OF TABLES, GRAPHS AND PICTURES (12 points)

Title of the table, graph, picture or other illustration (Times New Roman, 12 points, Sentence case, bold, left allignment)

<Blank line 12 point high>

Tables, graphs, pictures and other illustrations should be presented in Arabic consecutive numbers. The references or data sources of the tables and graphs should be cited below, preceded by any additional comments or explanations. Tables, graphs, pictures and other illustrations are prepared in black and white techniques presented appropriately in the text. All graphs and illustrations and diagrams should be additionally submitted in their original electronic form (jpg, gif, xls, and alike).

<Tab> **References:** (Times New Roman, 12 points, Sentence case, bold, left allignment)

References should appear at the end of the paper, listed in alphabetical order by the names of authors (*Harvard System of Referencing* *Guide*, <http://libweb.anglia.ac.uk/referencing/harvard.htm>)

References will be written with Times New Roman 12 points, justify allignment, numbered with Arabic numbers.

- For books the required elements for a reference are:

Author's surname, Initial of first name: Title of book, Edition (only include this if not the first edition), Publisher, Place, Year

- For journal articles the required elements for a reference are:

Author's surname, Initial of first name: Title of article, Full Title of Journal, Volume number (Issue/Part number), Year, Page numbers

- For journal articles from an electronic source the required elements for a reference are:

Author's surname, Initial of first name: Title of article, Full Title of Journal, Volume number (Issue/Part number), Year, Page numbers if availalble, Available at: include web site address/URL(Uniform Resource Locator), [Accessed date]

- For newspaper articles the required elements for a reference are:

Author's surname, Initial of first name: Title of article, Full Title of Newspaper, Day and month, year before page numbers and column line.

- For websites found on the world wide web the required elements for a reference are:

Authorship or Source: Title of web document or web page, Year of the document, Available at: include web site address/URL(Uniform Resource Locator), (Accessed date)