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The enabling environment for sustainable enterprises in North Macedonia

Update of the report on the key constraints
on the business environment

Nikica Kusinikova

THE ENABLING ENVIRONMENT FOR SUSTAINABLE ENTERPRISES IN NORTH MACEDONIA

Update of the report on the key constraints
on the business environment

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FOREWORD

In June 2007, the International Labour Conference (ILC) discussed the promotion of sustainable enterprises. The conclusions of this discussion provided an important contribution agreed by the ILO's tripartite constituency of governments, employers' and workers' organizations on how to promote enterprise development in a manner that aligns enterprise growth with sustainable development objectives and the creation of productive employment and decent work.

The ILC Sustainable Enterprise conclusions called for the strengthening of the institutions and governance systems, which nurture enterprises. Strong and efficient markets need strong and effective institutions. Promoting sustainable enterprises is also about ensuring that human, financial and natural resources are combined equitably and efficiently in order to spur innovation and increase productivity. In the past years the ILO has developed and refined a methodology on how to assess the Enabling Environment for Sustainable Enterprises (ESEE).

More recently, in the 2019 ILO Centenary Declaration on The Future of Work, member states reiterated the "importance of the enabling environment to ensure supporting the role of the private sector as a principal source of economic growth and job creation by promoting an enabling environment for entrepreneurship and sustainable enterprises, in particular micro, small and medium-sized enterprises, as well as cooperatives and the social and solidarity economy, in order to generate decent work, productive employment and improved living standards for all".

In the Republic of North Macedonia, within the project on Strengthening Social Dialogue 2019–2021, the tripartite constituents, through the Economic and Social Council (ESC), have requested the ILO its support to build their capacity in the area of the enabling environment to better shape the national economic and social reform agenda. As a first phase of the intervention, an update of the key constraints on the business environment that had been assessed in 2013 has been conducted, addressing the following aspects: where it has improved, where it has not, reforms that were implemented and whether they have led to positive changes. Based on the preliminary results of this update, a series of consultations were undertaken with the representatives from business associations, trade unions and government, with a view to agree on the focus to be given in further assessment and discussions within the ESC on key constraints on business environment, and formulation of a roadmap for further improvements in specific priorities agreed upon by the ESC.

This report presents the update on the key constraints on the business environment, and it was developed in the framework of the project Strengthening Social Dialogue, funded by the European Union and implemented by the International Labour Organization. The work was carried out by Ms Nikica Kusnikova, under the technical supervision of the SME unit in the ILO ENTERPRISE department and the Bureau for Employers' Activities, through its Budapest senior specialist. Strengthening Social Dialogue project in the Republic of North Macedonia provided

valuable technical and administrative support for the completion of this report.

The findings and recommendations from the report provide a comprehensive view on the progress made by the Republic of North Macedonia over the past few years to improve its enabling environment for private sector development. We hope that, with this information, the government and social partners will be encouraged to make further progress in addressing some of the key constraints, with the ILO support.

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LIST OF ABBREVIATIONS

BCM	Business Confederation of Macedonia
B2B	Business to business
CCC	Centre for Civic Communication
DB	Doing Business with the World Bank
EESE	Enabling Environment for Sustainable Enterprises
EU	European Union
FITD	Fund for Innovation and Technological Development
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
ILO	International Labour Organisation
JICA	Japan Development Agency
LFS	Labour Force Survey
MBDP	Macedonian Bank for Development Promotion
MCIC	Macedonian Centre for International Cooperation
MLSP	Ministry of Labour and Social Policy
ORM	Organisation of Employers of Macedonia
R&D	Research and Development
RNM	Republic of North Macedonia
SME	Small and Medium-sized Enterprises
TEA	Total early-stage entrepreneurial activity
USAID	United States Agency for International Development
VAT	Value Added Tax
WEF	World Economic Forum

INTRODUCTION

A competitive market economy based on sustainable enterprises¹ has been, and still remains, one of the key priorities for North Macedonia. The sustainable growth of vibrant, innovative and resilient companies is to a large extent influenced by the environment in which they operate. Thus, the efforts of governments in the country throughout recent years were focused on continually improving the conditions in which Macedonian companies operated and on creating an enabling eco-system for sustainable enterprises. The business environment benefitted from the public policy reforms marked by steady economic growth since 2013, which has been acknowledged by numerous relevant international studies. While the political uncertainty in 2016 and in the first half of 2017 slowed the growth and economic performance of the country, it is expected to recover in the following years.² The new Government Programme 2017–2020 outlines ambitious economic reform. Resolving the long-standing name dispute and as a result, the accelerated accession towards EU and NATO membership are expected to significantly improve the business environment and to trace a route to more productive integration into the global economy. Nevertheless, challenges to economic and sustainable development remain, such as a decline in productivity growth, structural transformation, deficiencies in the labour market, corruption and a weak rule of law.

The Organisation of Employers of Macedonia (ORM) and the Business Confederation of Macedonia (BCM) are committed to supporting the development of a conducive environment for enterprises in North Macedonia. Supported by the International Labour Organisation (ILO) in 2013, they have embarked on an ambitious study of the enabling environment for sustainable enterprises in the country, identifying and assessing key environment factors and providing recommendations to the government. This will also serve as a basis for position papers on behalf of the employers' organisations. The study focused on five key areas identified as priorities for companies in North Macedonia:

- Enabling legal and regulatory environment
- Rule of law and secure property rights
- Access to financial services
- Fair competition
- Entrepreneurial culture

This document serves as an update of the study conducted and published in 2013. It provides an overview of progress in the key indicators according to global indices and world-renowned analysis. It also outlines key policy reforms introduced in the last few years as well as regulations currently in the pipeline. The potential influence of evolving context and subsequent reforms are also taken into consideration, especially in the light of the EU accession process. Where relevant, the report reflects on the recommendations

¹ At its June 2007 meeting, the International Labour Conference (ILC) endorsed the concept of 'sustainable enterprises' as a principal source of growth, wealth creation, employment and decent work. Sustainable enterprises represent the integration of the three components of sustainable development – economic, social and environmental – as interdependent and mutually reinforcing pillars.

² World Bank 2019

provided by ORM and BCM and ways they have been integrated into policy reforms. Finally, the document provides recommendations on the need for further analysis and policy engagement in the key selected area. To reflect on the global sustainability agenda, the report also highlights the Sustainable Development Goals that could be influenced by the latest policy reforms.

Methodology

The methodological approach used in the updated report includes desk analysis and interviews with experts and stakeholders. Desk analysis included the collection of secondary data, based on available documents, reports, studies and strategies. Identification and analysis of relevant laws, policies and measures provided information on the evolving environment for sustainable enterprises. Initial findings have been discussed in consultation with the key social partners in the country.

Nevertheless, it is important to note that this report is not intended to provide in-depth analysis of the business environment and recent policy reforms. Moreover, as most of the recent policy reforms were introduced in the last year-and-a-half, the report outlines their intention, scope and potential effects as identified by the stakeholders while the results and actual impact can be assessed after several years of implementation. It serves as a first step in mapping the changing trends and the key policy developments that have affected the environment in which Macedonian enterprises operate.

ENABLING LEGAL AND REGULATORY ENVIRONMENT

General regulation

The World Bank's study of the overall business environment 'Doing Business' (DB) in recent years has considered North Macedonia as one of the top reformers, ranking the country highly in 10th place among 190 countries³ in terms of ease of doing business (in 2012 the country had ranked 23rd). (Table 1).

Table 1. Ranking in ease of doing business

Year	2012	2017	2018
Rank	23	11	10

Source: Doing Business, World Bank

The Governance Indicators of the World Bank have also notified improvement in the regulatory quality that addresses perceptions of the government's ability to develop and implement policies and regulations that stimulate and promote the development of the private sector. While in 2012 our country's Governance score was 0.35 (Governance score ranging from -2.5 to +2.5), in 2017 North Macedonia improved to 0.50.⁴ (Table 2).

Table 2: Regulatory quality Index

Year	2012	2015	2017
Governance score (-2.5 to +2.5)	0.35	0.43	0.5

Source: Worldwide Governance Indicators (WGI), World Bank

However, it seems that the burden of government regulation is perceived to have worsened in 2018 according to the Global Competitiveness Index (GCI) of the World Economic Forum (WEF). Compared with 2012 when the burden of government regulation was at a level of 3.5 (on a scale of 1-7, where 7 is the lowest burden), in the 2018 report the level was 2.9⁵ (Table 3).

³ Doing Business 2019: Training for reform, The World Bank Group.

⁴ Worldwide Governance Indicators (WGI), World Bank <http://info.worldbank.org/governance/wgi/#reports>

⁵ Global Competitiveness Index 4.0 2018 edition, World Economic Forum.

Table 3. Burden of government regulation

Year	2012	2016	2017
Value (1-7. 7 is the lowest burden)	3.5	3.7	2.9

Source: Global Competitiveness Index (GCI), World Economic Forum

Available analysis indicates that the positive steps towards making doing business easier in the last couple of years are related to the efficiency of construction regulation⁶ and decreasing the costs of the construction permitting process.⁷ Nevertheless, challenges remain in enforcing contracts, in particular the number of days that have significantly increased over the years. To illustrate, according to the data provided by ‘Doing business’, while in 2012, 370 days were needed for enforcing contracts, in 2018 the number of days increased to 634.⁸ Even though there has been some improvement (Table 4), resolving insolvency and offering second chances to entrepreneurs remains a challenge for companies in North Macedonia according to the key stakeholders and experts.

Table 4: Resolving insolvency indicators

Year	2012	2017	2018
Rank	60	30	30
Time (years)	2	1.5	1.5
Cost (% of estate)	10	10	10
Recovery rate (cents on the dollar)	42.2	47.7	48

Source: Doing Business, World Bank

The new National Strategy for small and medium-size enterprises 2018–2023⁹ has identified these challenges and in the first pillar of the strategy the government has committed to simplifying the legal and regulatory environment with a focus on bankruptcy proceedings.

During consultations with stakeholders some have identified pieces of legislation introduced in the last few years which although not directly targeted at the business sector might impact their sustainability and market environment. Such regulation includes the Law on financial companies offering lower, fast loans to citizens and the cash flow control limiting cash payments from €2,000 to €500, which will influence purchasing power and the decisions of consumers and will impact small businesses and retailers. Last year the government introduced protection clauses on low, fast loans, limiting the costs of loans to 55 per cent from the credit amount (otherwise the costs

6 Doing Business 2018: Reforming to create jobs, The World Bank Group.

7 Doing Business 2019: Training for reform, The World Bank Group.

8 Doing Business: The World Bank Group.

9 National Strategy for small and medium-size enterprises 2018-2023, Ministry of Economy, 2018.

sometimes increased up to 500 times the credit amount). However, more comprehensive analysis is needed on the potential impact of these and similar policies on the business environment.

Taxes

In relation to taxes, the DB report indicates that the total tax and contribution rate in 2018 has increased to 13 per cent of profits¹⁰ compared to 9.7 per cent in 2012. While the number of tax payments was reduced from 29 in 2012, to 7 in 2018, the number of hours needed to prepare and pay taxes has not decreased and remains at 119 hours per year which was considered as one of the main challenges companies face in terms of taxation. In line with the tax reforms, the government also changed the system of submitting the annual tax statement for individuals moving to electronic confirmation of pre-prepared statement by the tax authorities. This is expected to decrease the number of hours needed to prepare the tax documentation related to employees and individuals engaged by companies.

In line with the Work Programme of the Government, tax reform in personal income tax was adopted in 2018. The changes in the law introduced a progressive tax rate on labour income (an increased tax rate for income above 1,080,000 MKD per annum), a higher tax rate (15 per cent) on capital income, income from capital gains from securities and interest on term deposits (above a certain threshold). In addition, the maximum basis for the calculation of contributions also increased. On the other hand, untaxed salary portion has increased, thus effectively decreasing the tax rate on salaries. The business community has indicated that these reforms might negatively impact the economy and enhance tax evasion. Since the introduced tax changes are rather new, their effect is yet to be seen in years to come.



Even though taxes in the country remain relatively low, employers are still burdened by administration that requires significant time to comply with and additional costs in conducting the business pertaining to other legislation, including employee costs.¹¹ There is still a lack of comprehensive analysis of the real costs of conducting business as well as analysis of the effects of tax regulation on companies of various sizes. Such analysis is crucial for informed policy reforms that will further reduce the burden of government regulation and will promote private sector development.

Labour legislation

Labour legislation has been a challenge for companies due to frequent changes in legislation and short timeframes for adapting to changes, as well as lack of consistent implementation of the legislation, thus creating unequal conditions for employers in the

¹⁰ Doing Business 2019: Training for reform, The World Bank Group.

¹¹ The enabling environment for sustainable enterprises, ORM and BCM, 2013.

labour market. Based on the labour market efficiency ranking of the GCI, North Macedonia has improved its position in 2018 to 78¹² compared to 94 in 2012. Nevertheless, critical aspects in labour market efficiency seem to have worsened according to GCI, especially in terms of cooperation in labour-employer relations, flexibility of wage determination, and hiring and firing practices.¹³ (Table 5). Trade unions have also indicated stagnation in labour-employer relations and low coverage of workers under collective negotiations, in particular in some sectors such as agriculture.

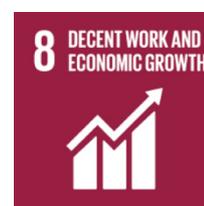
Table 5. Labour market (value 1-7 where 7 is best)

Year	2012	2018
Pay and productivity	4.2	3.6
Cooperation in labour-employer relations	4.1	3.6
Flexibility of wage determination	5.5	4.3
Hiring and firing practices	4.2	3.7
Redundancy costs (weeks of salary)	13	13

Source: Global Competitiveness Index, World Economic Forum

Similar challenges have been noted in the national strategy for small and medium-size enterprises 2018–2023. Furthermore, labour legislation has previously failed to address the trends in today’s economy such as the need for greater flexibility in the working arrangements and increased mobility of the workforce. The policy recommendations of ORM and BCM were in line in the consolidation of labour legislation through the introduction of a new labour law drafted in consultations with the social partners and this improved employer-employee cooperation by enabling various forms of workers’ representation and association in consultations with the trade unions.¹⁴ To improve the implementation of collective agreements, some social partners have suggested that the government could condition the awarding of subsidies to entities that have collective agreements, thus stimulating their implementation.

As part of the policy reforms of labour legislation, in 2017 the government introduced changes in the Law on minimum wage by increasing the statutory minimum wage to 17,370 MKD gross (as of July 2018)¹⁵ using gross salary as the basis for the calculation of social contributions and personal income tax. Previous analysis¹⁶ has indicated that a high minimum wage might lead to transfers from formal to informal jobs, and a decrease in jobs in manufacturing. Thus, the effects of this reform are yet to be analysed. The Ministry of Labour and Social Policy has also initiated a process of drafting new labour law which would consist of two legislative packages: 1) law



¹² Global Competitiveness Index 4.0 2018 edition, World Economic Forum.

¹³ Ibid.

¹⁴ Position paper on enabling legal and regulatory environment, ORM and BCM, 2017.

¹⁵ Law amending the Law on Minimum Wage, Official Gazette 132/2017

¹⁶ The enabling environment for sustainable enterprises, ORM and BCM, 2013.

on labour relations and 2) law on trade unions as separate piece of legislation. The laws are still in the drafting phase and would hopefully lead to systematic solutions based on wider consultations with the social partners and the business community. These reforms, combined with the reforms in the inspection oversight could lead to more balanced and enabling labour legislation.

Conclusions

Overall, progress in the last few years has been noted through a greater ease of doing business and the overall quality of regulation aimed at improving the conditions for development of the private sector – in particular in starting a business, dealing with construction permits, registering property, getting electricity etc. Challenges remain in terms of the burden of government regulation and labour market efficiency and flexibility. The increased taxes on personal income and minimum wage might lead to increased costs of doing business, but the effects are yet to be seen. Comprehensive analysis of the real costs of conducting business for companies of various sizes is crucial for assessing the real fiscal and administrative burden to the companies and how it supports informed policy-making. The process of drafting new labour law is in line with the requirements of employers. The new legislation should strive to adapt to the existing global economic and labour market trends, providing sufficient flexibility in working arrangements but at the same time ensuring workers' security.

RULE OF LAW AND SECURE PROPERTY RIGHTS

The rule of law and secure property rights are the backbone in creating a stable and secure environment for investment and for the growth of businesses. The lack of consistent and full enforcement of regulation impedes long-term planning by companies and stimulates disloyal competition. It creates conditions for a surge in corrupt behaviour, increases the costs of doing business and distorts markets. The rule of law remains one of the key challenges for Macedonian society as identified in international reports and by business corporations. The country has been ranked 57th by the Global Competitiveness Index¹⁷ in transparency of policy-making, which indicates progress from the 76th ranking in 2012. Consultations with stakeholders also confirm that legislation and policies (including state subsidies) are being implemented selectively, placing some companies in more advantageous positions and creating disloyal competition and an unequal playing field in the marketplace (including the labour market).

Property rights and commercial protection

The efficiency of the legal framework in settling disputes has been evaluated as 2.3 (in a range 1-7 where 7 is best).¹⁸ While property rights have to be protected in order to promote investment activity, the same analysis indicates that North Macedonia does not provide a high level of property rights (marked at 3.5 out of 7) as well as intellectual property protection (3.0)¹⁹ (Table 6).

Table 6. Property rights and commercial protection

Year	Efficiency of legal framework in settling disputes	Property rights	Intellectual property protection
2012	3.5	4.5	3.9
2018	2.3	3.5	3

Source: Global Competitiveness Index, World Economic Forum

On the other hand, the Doing Business report has ranked the country high in terms of minority shareholder protection, including the extent of the shareholder rights index, which scored 8 out of 10.²⁰ In this regard, after several years of political blockade, at

¹⁷ The Global Competitiveness Report 2016-2017, World Economic Forum.

¹⁸ Global Competitiveness Index 4.0 2018 edition, World Economic Forum.

¹⁹ Ibid.

²⁰ Doing Business 2019: Training for reform, The World Bank Group.

the end of January 2019 the country entered into the second phase of the Stabilisation and Association Agreement with the EU which would enable EU companies to purchase property in the country and vice versa and to enjoy equal rights as the domestic companies, which in turn is expected to lead towards strengthened property rights.

Rule of law and corruption

Corruption and bribery continue to be widespread in the country, derogating from its economic prospects. The latest Corruption Perception Index 2018 of Transparency International has noted a worsening of the country's score to 37 (on a scale 0-100 where 0 means highly corrupt and 100 means very clean) compared to 42 and 43 in 2015 and 2012 respectively (Table 7). The ranking of the country also dropped to 93 in 2018 (out of 180 countries) compared to 69 in 2012 (out of 176 countries).

Table 7. Perception of corruption (0-100, where 0 means highly corrupt and 100 means very clean)

Year	2012	2015	2018
Score	43	42	37
Ranking	69 (out of 176)	66 (out of 168)	93 (out of 180)

Source: Corruption perceptions Index, Transparency International

GCI of the World Economic Forum shows a high level of incidents of corruption, scoring the country 35 out of 100 (where 100 represent best performance).²¹ Studies from 2015 indicate that 68 per cent of the companies in the country believe that public servants engage in corrupt behaviour.²² On the other hand, the country scores high at 80 on the conflict of interest regulation.²³

To address the issue of corruption, in the last year the country has engaged in key policy reforms. The new Law on preventing corruption and conflict of interest was adopted in January 2019²⁴ and for the first time the new members of the State Commission for Prevention of Corruption were selected in a public process with participation of civil society representatives. At the end of 2015 the Law for protection of whistle-blowers was adopted in line with the highest international standards.²⁵ However, the implementation of this legislation is limited as the available official report on the implementation of the Law from 2017 indicates a lack of awareness and compliance on the part of public institutions.



The public procurement process is particularly vulnerable to corruption, especially taking into consideration that they represent around 12 per cent of GDP. For years, including the latest report on public procurement monitoring conducted by the Centre for Civic

²¹ Global Competitiveness Index 4.0 2018 edition, World Economic Forum.

²² Report on monitoring risks of corruption and organized crime, Macedonian center for international cooperation, 2015.

²³ Global Competitiveness Index 4.0 2018 edition, World Economic Forum.

²⁴ Law on prevention of corruption and conflict of interests, Government of North Macedonia, Official Gazette 12/2019.

²⁵ Protection of whistle blowers, possibilities and practices, Transparency International –Macedonia, 2016.

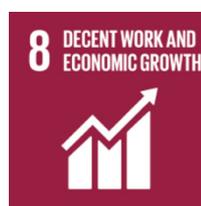
Communications (CCC) the companies involved have complained about the lowest price being the sole criteria in public procurement as well as the mandatory e-auction which additionally reduces prices, thus impeding quality, loyal competition and creating opportunities for corrupt deals. One of the most significant reforms undertaken by the existing government was the adoption of the new Law on public procurement in January 2019.²⁶ According to the analysis of CCC, the law incorporates key changes that if implemented consistently and prudently could prevent misuse and corruption in public procurement by improving transparency, accountability and integrity as well as improving quality. The changes also are in line with the previous recommendations by the employers' organisations. The law reflects the latest EU directive with the most economically advantageous offer as the main criteria. To increase transparency and accountability, the institutions are obliged to publish annual public procurement plans, thus allowing companies to become informed and plan accordingly, to publicise all public procurement contracts and annexes as well as monitoring and reporting on the implementation of the whole procurement and contracting cycle.



More simplified and efficient procurement processes have been introduced by increasing the threshold for obligatory public procurement and through simplified procurement procedures; the electronic auction is not mandatory and a unique capability document has been introduced which is issued once by the Central Registry and then obtained directly by the institutions, reducing the administrative burden to the economic operators. Among other changes the law also includes stimulus for participation by SMEs in public procurement by mandatory (wherever possible) division of the tender into separate lots, payment of sub-contractors directly by the institution and lower fees for submitting complaints. After the tender procedure is completed, companies have the possibility to review all documents related to the procedure, thus learning and improving for the next tendering process. Finally, the Public Procurement Bureau has been introduced with a new, ex-ante control role during the tendering process. The law refers to conflict of interest legislation and explicitly includes anti-corruption provisions.

Inspection oversight

A strengthening of the quality and transparency of inspection oversight has also been considered as a key factor in achieving consistent implementation of the legislation and in creating legal certainty among companies. While the Law on inspection oversight was considered as an effective base, its implementation was inconsistent and often left to discretionary inspectors' conduct and political influence. To address this issue, in 2018 the government drafted a new law on inspection oversight which at present is awaiting parliamentary approval. The new law aims to strengthen good practice and predictability in relation to inspection oversight. The planning of the inspection oversight process is streamlined by methodology based on risk assessment and schedules



²⁶ Law on public procurement, Government of North Macedonia, Official Gazette 24/2019

that will enable companies to be informed in advance by the frequency and timeline of the oversight. It also introduces checklists that the inspectors will use during the oversight process to increase predictability and help companies in their preparations. These measures are being introduced for smaller offences and the focus of the law is to support, educate and promote voluntary compliance by companies.

During consultations, the stakeholders also pointed out that beyond these procedures, the State has to invest in improving technical and human resource capabilities to the inspection authorities so that they are able to professionally and consistently perform their duties and responsibilities. The trade unions have suggested an increased role in the inspection oversight as a potential way to increase transparency and to reduce corruption by inspectors. Policies and practices also need to improve the consistency of the interpretation of legislation by the individual inspectors by decreasing subjective opinions and thus improving the legal certainty among companies.

Conclusions

The rule of law remains one of the key challenges in creating an enabling environment for sustainable enterprises and in the last few years the perception on corruption worsened in the country. Nevertheless, in the last year significant policy reforms have been undertaken in key areas such as anti-corruption legislation, new laws on public procurement and the draft law on inspection oversight. The key challenge remains the political will to consistently implement these policies and to allocate sufficient resources to support effective implementation. It is of utmost importance that the implementation of these policies is supported by ongoing, wider consultations with the business community and the key stakeholders (for example through ESC) to identify bottlenecks in a timely manner and to propose solutions for dealing with bylaws and foreseen challenges.

ACCESS TO FINANCIAL SERVICES

External financing in particular private investment areas is critical to enhancing the growth and productivity of companies and can boost economic activity in the country. In the last decades relevant studies and reports indicated that the companies in North Macedonia, in particular the SMEs, rely mostly on self-financing. When utilising external financing, bank loans are the prevalent financial service used by private companies.²⁷ Companies face numerous challenges in accessing external finance such as: affordability and access for SMEs, lack of information on financing options, a low level of financial literacy within companies for long-term planning etc. Besides the debt funding other sources of financing such as business angels, venture capital, initial market offerings, crowd-funding platforms etc. are scarce and less available to companies in the country. The international reports indicate that over the years the situation has not significantly changed in this regard.

Table 8. Domestic credit to the private sector

Year	2012	2015	2017
% of GDP	47.3	52	50

Source: World Development Indicators, World Bank

Based on World Development Indicators, the domestic credit to the private sector, which in 2012 amounted 47.3 per cent of GDP, grew to 52 per cent of GDP in 2015 while in 2017 it amounted 50 per cent of GDP²⁸ (Table 8). According to the Global Competitiveness Index, the financing of SMEs was marked 3.2 on a scale from 1-7 (where 7 is best performance) while the venture capital availability was marked even lower at 2.2.²⁹

The Competitiveness strategy 2016–2020³⁰ includes a goal to improve access to finance with a certain set of measures including improving financial instruments for SMEs, creating a national credit guarantee scheme for SMEs with capitalisation of €4 million, improving the legislation on business angels, venture capital and other alternative forms, improving financial literacy, support in the development of capital and mezzanine financing etc. However, there is no record that these measures have been implemented and most of them are still in the planning stages. The newly adopted National Strategy on small and medium-size enterprises 2018–2023³¹ also aims to improve access to finance by SMEs under its second pillar. In these matters the government envisages:



²⁷ National Strategy for small and medium-size enterprises 2018–2023, Ministry of Economy, 2018.

²⁸ World Development Indicators Database, The World Bank.

²⁹ Global Competitiveness Index 4.0 2018 edition, World Economic Forum.

³⁰ Competitiveness Strategy with Action Plan 2016–2020, January 2016.

³¹ National Strategy for small and medium-size enterprises 2018–2023, Ministry of Economy, 2018.

- The introduction of new finance instruments
- The revitalisation of the credit guarantee scheme through the Macedonian Bank for Development Promotion (MBDP), while simplifying the procedures and improving the rules and conditions
- Creating an on-line registry of movable assets to be used as collateral
- Introduction of a programme for promoting factors for strengthening transparency and legal certainty
- Simplifying the procedures for the functioning of financial institutions providing alternative financial instruments etc.

This will be complemented with financial literacy education and a wide array of business development services including support in accessing EU funds as requested by employers in the policy recommendations. The strategy is in its early stages of implementation thus its effectiveness and impact are yet to be assessed in the following period. The establishment of the fund for equity and mezzanine decisions on the founding deposit was also promoted as part of the Economic growth plan of the government. The export factoring for companies from North Macedonia exporting their products and services is now available through the MBDP. Last year MBDP decreased the interest rate on factoring from 5 per cent to 4 per cent. In September 2018 the government signed the fifth phase of the contract with the European Investment Bank on €100 million for SME support.

One of the main landmark efforts of the governments in the last few years in providing financial support to innovative projects and companies was the establishment of the Fund for Innovation and Technological Development (FITD) in 2013. Its main objectives are ‘improved access to financial support for innovation and technological development; and promoting and encouraging innovation activities in North Macedonia.’ In 2018 within the Economic growth plan of the government³² under the third pillar, the fund provides financial support to domestic companies to improve innovativeness and technological development of micro and SMEs. In the last year, the fund has increased in scope and in the support measures it provides. Besides the instruments within the third pillar of the Economic growth plan, FITD provides co-financing of up to 85 per cent of the project costs (up to €30,000) for innovative projects in proof of concept or pre-commercialisation phase of start-up and spin-off companies; and co-financing and conditioned loans of up to 70 per cent of project costs (up to €100,000) to SMEs for commercialisation of the concept. According to the information from the fund, as a result of simplified rules for participation and improved information about the available opportunities in 2018 they have provided over €20 million to over 200 companies.³³ While initially serving mostly SMEs and start-ups, in the last year the fund expanded some of its instruments also to larger companies.



³² Plan for economic growth, Government of RNM, 2018.

³³ Interview with the director of the Fund for Innovation and Technology Development, Kapital No. 1009, March 2019.

In the policy recommendations developed by the employers' organisations, the proposed measures also included stimulating purchase of modern equipment and environmental investments in industry. The new Economic growth plan of the government, in the first pillar incorporates measures in this direction which are described in more detail in the next section.

Conclusions

Available information suggests only a slight improvement in access to finance with regard to domestic credit in the private sector and in terms of increases in government financing for innovative projects. New financial instruments are still scarce. While financial education and business services for access to finance are in their nascent stages, their scope is yet to be increased to produce significant effects in increasing the capacity and information of domestic companies to plan and tap into available financial instruments.

The newly adopted government policies such as the National Strategy on small and medium-size enterprises 2018–2023 and the Economic growth plan have incorporated many of the policy recommendations proposed by ORM and BCM. Nevertheless, they are in the early stages of implementation thus further monitoring and evaluation is needed on whether all measures have been implemented and their impact on access to funding.

FAIR COMPETITION

Competition is crucial to the development of a sustainable market economy. Fair competition encourages companies to improve their productivity, to embark on new investments and provide better quality of products and services to their customers and consumers. Lack of competition as well as unfair competition undermines market mechanism and prevents growth of the economy and business enterprises. In recent years the intensity of local competitiveness has increased significantly according to the GCI indices from 85th position in 2012 to 41st position in 2015 with a score of 5.4 (range 1-7 where 7 is highest performance) (Table 9).

Table 9. Local competitiveness and anti-monopoly policy

Year	2012	2015
Intensity of local competitiveness (ranking)	119	41
Intensity of local competitiveness (value, 1-7 where 7 is best)	4.1	5.4
Effectiveness of anti-monopoly policy (value, 1-7 where 7 is best)	3.7	3.9
Degree of customer orientation (value, 1-7 where 7 is best)	4.4	4.8

Source: Global Competitiveness Report, World Economic Forum.

In 2018 the competition in services was scored at 4.3 while the extent of market dominance scored 3.0 which was a slight drop from 2015 when the score was 3.7 (where 7 is best score). The Competitiveness Strategy 2016–2020 has identified that according to international research, the country is ranked among a group of countries in a competitiveness stage where economies are led by efficiency.

In previous years employers have requested that the government provides equal treatment and equal conditions for all companies in the market. In this regard they have requested tailored measures to encourage companies-investors outside of free industrial zones. With the Economic growth plan and the Law on financial support of investments³⁴ introduced in 2018, the government has designed targeted measures for domestic investors based on results and progress rather than projected wishes for investments. Besides the support for innovation and technology development under the third pillar, the



³⁴ Law on financial support of investments, Official Gazette 83/2018.

first two pillars provide an array of subsidies for domestic companies:

► Pillar 1:

- Creating new jobs with 50 per cent over the minimum wage providing 20 per cent support for net salaries
- Support in increasing capital investments and income – reimbursement of 10 per cent (up to 61.5 million MKD) of the purchased equipment or land/property;
- Support in investment projects of particular economic interest of RNM – up to 50 per cent of the overall costs for manufacturing companies that will make an investment of over 1.2 billion MKD or investments of over 246 million MKD and the creation of at least 300 new jobs.

► Pillar 2:

- Non-refundable financial support for companies that have increased their competitiveness in new markets – 10 per cent of the investment costs for expanding to new markets and 20 per cent of the investment costs for improving competitiveness in the Western Balkan markets; a condition is that there must be a 5 per cent increase in market performance in the previous three years
- Support in penetrating new markets and increasing sales – 20 per cent of related eligible costs up to 1,845 million MKD (for participation at international fairs, B2B meetings, foreign market research, certification etc.)

► Pillar 3:

- Support to fast-growing SMEs – reimbursement of 30 per cent of direct costs for technological development up to 10 million MKD for achieving a 20 per cent increase in turnover and a 20 per cent increase in employment in the following 24 months
- Additional support for technological development of micro and small enterprises – with a reimbursement of 30 per cent of direct costs up to 5 million MKD.

The plan also incorporates a support measure for investors in the free industrial zones to stimulate their cooperation with domestic companies. For this ambitious plan the government envisions a 46 per cent increase in the budget for economic development. In the first two pillars around 100 companies have been supported in 2018 – 95 per cent of those being domestic companies. As most of the measures cover a 5-year period the actual impact of the measures can be assessed in the following years.

Innovation

While innovation, research and development are considered key factors to competitive enterprises and economies, the available data indicates that North Macedonia has insignificantly increased its expenditure in research and development from 0.33 per cent of GDP in 2012 to 0.36 per cent of GDP in 2017.³⁵ In addition, R&D was mainly driven and funded by government institutions with just less than half of investment, 20 per cent by the higher education sector while the business enterprise sector invested less than 30 per cent of total R&D expenditure. Numerous policy documents have been adopted in

³⁵ Eurostat data.

recent years to address this issue such as the National Innovation Strategy 2012–2020, national programmes for scientific research and development 2012–2016 etc.; however, the projected goals of 1.8 per cent of GDP by 2020 seem hardly attainable without bold policy reforms in this area. The National Competitiveness Strategy 2016–2020 has also identified the challenge of the SMEs to integrate into international markets and has envisaged support in this regard. The new economic growth plan of the government from 2018 has designed measures to support innovation, technology research and development:

- Support in establishing departments for technology development and research within companies – in the production sector, by reimbursing 50 per cent of the incurred costs for industrial research up to 61.5 million MKD in 5 years.
- Support to SMEs in improving innovation (Pillar 3 through the Fund for Innovation and Technological Development) – up to 70 per cent of incurred investment costs up to 20 million MKD with an obligation for a return of 5 per cent of annual income 5 years after receiving the support (in total not more than 120 per cent of total support).



It is expected that in mid-term such measures will lead to an increase in the investment in research and development from both the public and private sectors.

Informal economic activity

An informal economy represents one of the key challenges in creating fair competitiveness and North Macedonia is considered as a country with a relatively large informal sector. Reducing the grey economy³⁶, reducing corruption and creating equal rules for all enterprises is the key priority reform for SMEs in the period 2016–2018 as indicated in the recent survey within the USAID Project ‘Partnership for better regulation’.³⁷ In the same survey, over 82 per cent of the surveyed companies indicated that the government’s efforts to combat the grey economy are either insufficient or unsatisfactory.

The Labour Market Survey conducted by the State Statistical Office indicated that while in 2011, 25 per cent of workers in the country were in informal employment (without contracts), in 2017 it has dropped to 18 per cent with the number of men in informal employment almost double the number of women. Nevertheless, the number of people in informal employment is 134,285 which is still considered quite high for the country. Around two-thirds of them are engaged in agriculture, and another 10 per cent in the construction sector. Some research has assessed that the predominant form of informal employment consisted of receiving salary in cash (full or part) which was reported by only 50 per cent of the surveyed citizens in 2016.³⁸ Other surveys and analysis has a lower percentage of workers receiving salary in cash. In any case, this form of informal employment is significantly present throughout the economy.

³⁶ Note: Grey economy as a term is used based on the original source of information.

³⁷ Assessment of the business environment in North Macedonia 2018 <https://drive.google.com/file/d/104WMw8BgT0xjH18aJix-DD5L4nuFZv6HI/view>

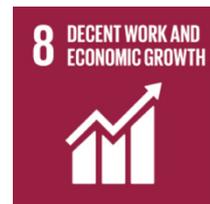
³⁸ Strategy for formalising the informal economy of RNM 2018–2022.

Overall, there has been a noted decrease in informal economic activity. The latest available data from 2014 suggests a 17.2 per cent informal economy adjustment to GDP, even though this adjustment is considered too low and incomplete.³⁹ The prevalent forms are avoiding taxes, irregularities in the implementation of labour legislation, a high level of bribery and corruption, unlawful and undeclared cross-border trading, a high level of cash in financial transactions and implementing business deals in-kind or with compensation, thus avoiding taxes.⁴⁰ While over the years the government has tried to address this issue, many efforts have failed as they lacked proper incentives or did not include comprehensive analysis of the impact on the most vulnerable categories of citizens.

Since 2013 the responsibility for developing action plans for reducing the informal economy has been transferred to the Ministry of Labour and Social Policy. In 2014, a Law on the banning and prevention of unregistered economic activity was introduced. While it is assessed that the implementation of that law contributed to reducing informal business practices in larger volumes it is too narrow to properly address the complexity of this issue.⁴¹

In 2018, the Ministry adopted a National Strategy for formalising the informal economy 2018–2022 that identified the main forms and reasons for the informal economy in North Macedonia. The new policies strive to adopt an approach that moves from combatting and sanctioning the informal economy to efforts to encourage formalisation of informal economic activity. The strategy has four strategic goals:

- Improving the process of measuring, monitoring and identifying the informal economy
- Creation of an improved business environment for the establishment, growth and development of enterprises
- Stimulating and support in the formalisation of informal economic activity (including advising services for formalising the business, promotion of cooperatives and social entrepreneurship, improved social dialogue etc.)
- Strengthening tax morale and reducing tolerance towards informal economy (including public campaigns and educational programmes)



The strategy is in its early stages of implementation. As part of the strategy, the MLSP is planning to conduct evaluation of the implementation in 2020.

Productivity

Relatively low productivity has been identified as one of the key factors impeding the competitiveness of the North Macedonian economy and its enterprises. A recent World

³⁹ Strategy for formalising the informal economy of RNM 2018–2022.

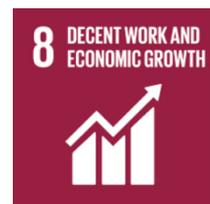
⁴⁰ Ibid.

⁴¹ Ibid.

Bank report⁴² has identified a decrease in productivity growth, in particular labour productivity, influences on economic growth and as it is accompanied by small wage growth it ‘suggests a continued mis-allocation of capital, labour, and land resources’. GCI has noted almost no progress in linking pay with productivity. While in 2012 the country received a score of 3.8 on a scale to 7, in 2018 the score decreased to 3.6.⁴³ World Bank analysis connects lower productivity to incomplete structural transformation to high productivity sectors, relatively high emigration, and the declining quality of the education system. According to the GCI, the country scores relatively low in the quality of vocational training (3.1 out of 7) while the skillsets of graduates scores 3.5. The indices show that it is not easy to find skilled employees as it scores 3.3. In addition, only one in four companies provide on-the-job training and the extent of staff training is scored at 3.0 by the GCI. The human capital in the country faces challenges in adapting to the today’s economic realities and thus to contribute to greater productivity. While some of the government’s measures as part of the economic growth plan are encouraging greater productivity, they have to be accompanied with bold educational system reforms. To support the vocational training of young employees, one of the government’s measures within the Economic growth plan provides reimbursement of 30 per cent or up to 1 million MKD for training and professional development in a particular company or in another company.



Envisaged labour market and welfare system reforms should also seize the opportunity to create incentives for entering the labour market. The newly adopted law on internship which awaits adoption in Parliament will provide new opportunities for employers to provide skill-building opportunities to young people who have completed their formal education and are transitioning to the labour market.



Conclusions

Overall, local competitiveness has improved with the competitiveness of enterprises still based on efficiency rather than innovation. The investment in research and development has only slightly improved over the years and is significantly lagging behind the country’s projections. Low productivity is considered as important factor impeding competitiveness. For enterprises, the informal economy and disloyal competition remain key challenges in achieving higher competitiveness and growth. In the last few years the government has made efforts to address some of these issues. The most notable are the efforts to provide equal treatment for domestic companies and investors to foreign investors within the Economic growth plan of the government. The new strategy for formalising the informal economy 2018–2022 has set the framework for a comprehensive approach in addressing informal economic activity and it will require strong political will, wider coordination and commitment to achieve the desired outcomes. More comprehensive and cross-sector policies are needed to increase productivity – in particular the productivity of the workforce.

42 Seizing a brighter future for all, Systematic Country Diagnostic, World Bank Group, November 2018.

43 Global Competitiveness Index 4.0 2018 edition, World Economic Forum.

ENTREPRENEURIAL CULTURE

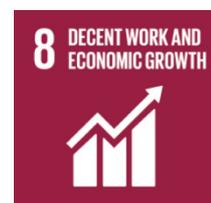
Building and driving vibrant entrepreneurial culture and values is a priority for many countries as it creates the basis for the sustainable development and growth of enterprises. Even though for the last few years North Macedonia was praised for the conditions it provided for starting new businesses, the levels of entrepreneurship activity have not increased and the number of active enterprises in the country continues to stagnate.

Business start-ups and entrepreneurial support

The Total Early Entrepreneurial Activity (TEA) of the Global Entrepreneurship Monitor indicates a general decline in entrepreneurial activity from 14.5 per cent in 2010, to 6.63 per cent in 2013 and 6.5 per cent in 2016. North Macedonia also has one of the lowest Motivational Indexes – i.e. there are only seven entrepreneurs with Improvement Driven Opportunity for every 10 entrepreneurs motivated by necessity.⁴⁴ According to the National Strategy on SMEs 2018–2023 referring to an ILO survey from 2016, slightly above one third of entrepreneurs left the private sector to establish their own enterprises. For the majority the motivation was to become their own boss while the second most frequent reason (30 per cent) was the flexibility of work. Similar to the GEM indicators, for the majority of entrepreneurs the motivation was not connected to seizing economic opportunities. The main factors that impede the business activity identified in the GCI Report 2016–2017 are the policy instability (14.8 per cent), access to finance (13.5 per cent), inadequately educated workforce (12.6 per cent), weak work ethics of the workforce (11.3 per cent) and inefficiency of government bureaucracy (10.7 per cent).

In the last decade governments have been consistently addressing the issue in public policies with little consistency and success. The new strategy on SMEs 2018–2023 incorporates measures to support start-up businesses and to encourage entrepreneurial culture such as:

- Reducing the costs for start-ups by conducting an analysis with recommendations and measures
- Improving business development services, including establishment of one-stop-shops where SMEs can receive information, required licences and permits etc.
- Programme for business management training of companies owned and managed by young people
- Targeted support to enterprises in the IT sector and the green economy

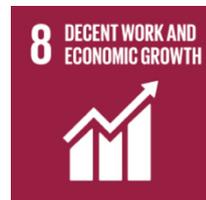


⁴⁴ Global Entrepreneurship Monitor, Global Report 2016/17.

While these measures are plausible, in previous years the size and scope of entrepreneurship support was modest and insufficient to needs. The voucher system for business counselling has been regularly budgeted at 900,000 MKD per annum even though all relevant reports indicate the potential and need to increase the scope and impact. Nevertheless, in the last couple of years, the annual budgets for the Programme of the Ministry of Economy for the development of entrepreneurship, competitiveness and innovation of SMEs have increased from 4,300,000 MKD in 2013, doubled to 8,900,000 MKD in 2016⁴⁵ and multiplied to total amount of 38,390,000 MKD in 2018.⁴⁶ The previous policy recommendations of employers were in line for improving the real environment for doing business and alleviating any barriers for new entrepreneurs. Measures included free legal advice, help-desk services, mentoring of first-time entrepreneurs and advisory support by inspectors in the first two years. The reforms are yet to incorporate and implement such measures even though with support from the Japan Development Agency (JICA) the Agency for Support of Entrepreneurship in 2019 has launched a mentoring programme for start-ups and other SMEs.⁴⁷

Entrepreneurship for women

Progress has been made in the promotion of entrepreneurship by women. In October 2018 the government adopted a National strategy for development of women's entrepreneurship 2019–2023.⁴⁸ The strategy has noted a significant decline in economic participation and access to opportunities by women according to the World Economic Forum. Namely, in 2006 the country ranked 38 (out of 115 countries) with an index of 0.661, while in 2017 the index was 0.636 and the country ranked 96 (out of 144 countries). The gender gap also exists in entrepreneurial activity, with men being around 2.5 times more entrepreneurial active than women.⁴⁹ According to the 2017 data from the Central Registry, around 29 per cent of registered companies are predominantly owned by women and they are mostly small companies. Using gender gap analysis in the economic participation of women and their access to resources and opportunities, the policy identifies key challenges in the area and includes four strategic priorities:



- 1) Creating an enabling business environment for the development of entrepreneurship for women – includes measures for the targeted analysis of policies that influence women entrepreneurs, consistent data collection, improvement of legislation etc.
- 2) Providing systematic support for the development of entrepreneurship for women – including help with accessing finance, improving the knowledge and skills of women entrepreneurs, supporting the transition from unemployment to self-employment and from employee to entrepreneur etc.
- 3) Creating suitable infrastructure for providing support and development – including

⁴⁵ Programme for competitiveness, innovation and entrepreneurship 2016, Ministry of Economy, Official gazette 2/2016.

⁴⁶ Programme for competitiveness, innovation and entrepreneurship 2018, Ministry of Economy, Official gazette 17/2018.

⁴⁷ <http://www.apprm.gov.mk/category/ERR/62674/180>

⁴⁸ Strategy for development of women's entrepreneurship in RNM 2019-2023, Ministry of Economy, 2018.

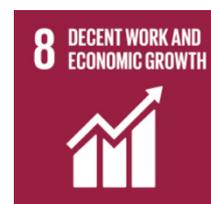
⁴⁹ Strategy for development of women's entrepreneurship in RNM 2019-2023, Ministry of Economy, 2018.

- targeted education and training programmes, business development services, incubators and cooperation with local government and educational institutions
- 4) Promotion, networking and advocacy – promotional activities and strengthening the capacity of business organisations for women.

Education and entrepreneurship

The new Strategy on SMEs 2018–2023 in its third strategic goal incorporates priorities and measures to encourage entrepreneurial culture. It is committed to expanding entrepreneurship education in all levels of education, including education on social entrepreneurship. The strategy places a strong focus on the cooperation between industry, education and the scientific research community. In these matters the government has promoted the concept of the science-technology park as part of the domestic start-up ecosystem that also integrates existing infrastructure, as well as seeking opportunities to support new incubators and accelerators.

While educational reforms have been among the policy priorities for many years, all key stakeholders agree that it does not produce knowledge and skills relevant and needed in industry as part of a modern economy. Furthermore, a significant gap remains in practical skills. In the last couple of years several companies such as EVN Macedonia⁵⁰ have embarked on piloting dual education programmes that were endorsed by the new government and are considered to be integrated into formal educational reform. Larger employers are also exploring opportunities to become providers of certified training programmes. Further efforts are needed to encourage learning through work, including with employers. While the law on vocational education and training declares that employers can enjoy tax benefits if engaging in practical work with pupils, in practice this mechanism does not exist yet.



The new Law on internships is expected to eliminate legal barriers to companies engaging out-of-school youth in practical work, improving the transition from education to the labour market and will send out a strong message about the value of practical work for both companies and the labour market.

Conclusions

Despite efforts to promote entrepreneurship through education and to provide support to self-employment and young entrepreneurs, the levels of entrepreneurial activity in the country have been stagnating in the past few years and most new entrepreneurs have been motivated by necessity rather than by identified business opportunities. The gender gap in economic activity, including entrepreneurship has not significantly improved.

⁵⁰ EVN Macedonia is part of the Austrian EVN Group which provides electricity power distribution and supply in North Macedonia <https://www.evn.mk/default.aspx?lang=en-US>.

The educational system still does not provide the knowledge and skills relevant for the country's economy and for the business sector. Efforts have been undertaken to increase the support to SMEs and start-ups. A new Strategy on SMEs and the first Strategy for the development of female entrepreneurship have been adopted in the last year. Financial support to SMEs through the Ministry of Economy has significantly increased from previous years. Nevertheless, targeted support measures are needed for first-time entrepreneurs, combined with policies to alleviate the administrative burden and cost of start-up business. The new legislation on internships is a step in a right direction in recognising and supporting the acquiring of relevant practical skills among young members of the labour force.

FINAL REMARKS

In recent years positive policy and regulatory reforms have been initiated that are expected to improve the environment for sustainable business. After a period of political crises and stagnation, most of the recent reform processes are beginning to deliver results, having been either introduced in the last year or are in the policy pipeline. As a consequence, there is little analysis on the effects of those policy processes. Even where potential exists, the actual reforms and impacts will largely depend on the political will and capacity for consistent implementation. While the identified five key areas covered by this report remain relevant, further in-depth analysis is needed to properly assess all of their aspects and dimensions in light of new developments in their context and policies.

In light of the new policy reforms it is of outmost importance that the institutions maintain regular and consistent consultations and dialogue with the business sector and other social partners to provide the key stakeholders with sufficient time to analyse proposed regulation and policies and to provide reliable input. The Economic Social Council can serve as a framework for such dialogue as well as other forms of consultation platforms and public-private dialogue.

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LIST OF CONSULTED INSTITUTIONS AND ORGANISATIONS

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- Business Confederation of Macedonia
- Cabinet of the Prime Minister of the Government of RNM
- Association of Microfinance Institutions
- Centre for Civic Communications
- Centre for Development Policies (IDEAS DePo Skopje), USAID Modernising the Inspection Authorities (MIA) Project
- USAID Partnership for Better Business Regulation Project – presentation of assessment results
- Consultations with social partners – Tripartite workshop on Enabling Environment for Sustainable Enterprises

