IMPROVING THE ECONOMIC POTENTIAL, IDENTIFYING THE FUTURE SOURCES OF GROWTH

High-level Economic Policy Conference

THE ECONOMIC POLICY RESPONSE TO MEET THE GROWTH CHALLENGES

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STRUCTURE OF THE PRESENTATION

I.  Macedonia At-a-Glance
    Sound macro performance and improving micro foundations

II. Growth Outlook
    Short-term challenges and long-term perspective

III. Challenges and Policy Response
    Targeted interventions to address key constraints

IV. The World Bank’s Role
    A reliable partner of choice in providing solutions
I. MACEDONIA AT-A-GLANCE

Sound macroeconomic policies and improving micro-foundations:

- Strong track record on macroeconomic performance and generally favorable sustainability prospects
- Improving key social and human development indicators
- Rapidly improving business environment
- Increase in FDI recently
Strong performance on macroeconomic policies

Vertical axis: as percent of GDP.
SEE includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Montenegro, Serbia and Macedonia
Source: World Bank Staff calculations
I. MACEDONIA AT-A-GLANCE (CONT’D)

Strong performance on macroeconomic policies

Vertical axis: as percent of GDP
SEE includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Montenegro, Serbia and Macedonia
Source: World Bank Staff calculations
Gradually improving social and human development indicators

- Life expectancy is increasing and health indicators are generally decent
- Education enrollment has picked-up

However:
- Unemployment remains exceptionally high
- Poverty rates are stagnant
## I. MACEDONIA AT-A-GLANCE (CONT’D)

### Improving micro foundations

<table>
<thead>
<tr>
<th>Indicator</th>
<th>DB11</th>
<th>DB12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ease of Doing Business</td>
<td>34</td>
<td>22</td>
</tr>
<tr>
<td>Starting a Business</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Construction Permits</td>
<td>147</td>
<td>61</td>
</tr>
<tr>
<td>Getting electricity</td>
<td>119</td>
<td>121</td>
</tr>
<tr>
<td>Registering Property</td>
<td>67</td>
<td>49</td>
</tr>
<tr>
<td>Getting Credit</td>
<td>45</td>
<td>24</td>
</tr>
<tr>
<td>Protecting Investors</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>Paying Taxes</td>
<td>24</td>
<td>26</td>
</tr>
<tr>
<td>Trading Across Borders</td>
<td>70</td>
<td>67</td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td>65</td>
<td>60</td>
</tr>
<tr>
<td>Closing a Business</td>
<td>55</td>
<td>55</td>
</tr>
</tbody>
</table>

Source: Doing Business Report
II. GROWTH OUTLOOK

Growth differentials are lower, but so are growth rates.

Real GDP growth, in %

- Countries: MKD, SEE, EU10
II. GROWTH OUTLOOK (CONT’D)

Short-term challenges

• **Preserve stability and growth in an uncertain environment**

• **Channels of transmission of shocks**
  – Export demand and prices of metals
  – Reduced FDI and other inflows and financial sector risks

• **Mitigating factors**
  – Sound macro-policies and a resilient financial sector
  – Healthy pipeline of FDI
II. GROWTH OUTLOOK (CONT’D)

Long-term perspective

- **Framework for growth – The EU convergence model**
  - The EU convergence model may be shaken but still represents the most viable alternative for rapid development

- **However, reaping the benefits of stronger EU integration would require concerted efforts in number of areas:**
  - Macedonia does well on macroeconomic policies
  - Trade and finance is gradually improving
  - But enterprise sector is lagging behind and innovation is insufficient
  - More needs to be done on labor markets (especially skills)
  - Efficiency of Government spending needs to increase
## III. CHALLENGES

Identifying the challenges

<table>
<thead>
<tr>
<th>WEF Competitiveness Report</th>
<th>MKD</th>
<th>EU-12</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macroeconomic environment</td>
<td>5.34</td>
<td>4.92</td>
<td>0.42</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>3.66</td>
<td>4.43</td>
<td>-0.77</td>
</tr>
<tr>
<td>Innovation and sophistication</td>
<td>3.14</td>
<td>3.71</td>
<td>-0.57</td>
</tr>
<tr>
<td>Technological readiness</td>
<td>3.67</td>
<td>4.54</td>
<td>-0.87</td>
</tr>
<tr>
<td>Higher education and training</td>
<td>3.98</td>
<td>4.84</td>
<td>-0.86</td>
</tr>
<tr>
<td>Health and primary education</td>
<td>5.53</td>
<td>6.21</td>
<td>-0.68</td>
</tr>
<tr>
<td>Institutions</td>
<td>3.68</td>
<td>4.08</td>
<td>-0.40</td>
</tr>
<tr>
<td>Goods market efficiency</td>
<td>4.26</td>
<td>4.42</td>
<td>-0.16</td>
</tr>
<tr>
<td>Labor market efficiency</td>
<td>4.33</td>
<td>4.41</td>
<td>-0.08</td>
</tr>
<tr>
<td>Financial market efficiency</td>
<td>3.94</td>
<td>4.32</td>
<td>-0.38</td>
</tr>
</tbody>
</table>

Source: World Economic Forum Global Competitiveness Report
III. POLICY RESPONSE

Preserve macroeconomic stability:

– Especially important given the small size of the economy, high degree of openness and exchange rate regime

– Need monetary and fiscal policies that keep prices stable, risks manageable and exports competitive
III. POLICY RESPONSE (CONT’D)

Investments

- To close the infrastructure gap
- To generate jobs and enable productivity gains
- To ensure sustainable growth

<table>
<thead>
<tr>
<th>Good practice</th>
<th>Macedonia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments &gt; 25% of GDP</td>
<td>Only since 2007</td>
</tr>
<tr>
<td>Public Investments 5-7% of GDP</td>
<td>Yet to be achieved</td>
</tr>
<tr>
<td>Public resources complemented by PPPs</td>
<td>Still in infancy</td>
</tr>
</tbody>
</table>
III. POLICY RESPONSE (CONT’D)

Investing in human capital

• Education

<table>
<thead>
<tr>
<th>WEF Competitiveness Report</th>
<th>MKD</th>
<th>NMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quantity of Education</td>
<td>4.6</td>
<td>5.9</td>
</tr>
<tr>
<td>Quality of Education</td>
<td>4.1</td>
<td>4.5</td>
</tr>
</tbody>
</table>

Percent of firms saying skills are a problem

Source: World Bank / EBRD BEEPS

• Health and social protection will also be critical to ensure stronger social cohesion
III. POLICY RESPONSE (CONT’D)

Technology transfer

– Mostly through FDI and foreign trade

– However:

  – Trading patterns reveal an unsophisticated, stagnant and concentrated export basket

  – FDI has picked-up but some important FDI appear to be isolated from the domestic economy

  – Enterprise support programs are too small and too fragmented to be effective
III. POLICY RESPONSE (CONT’D)

Technological classification of Macedonia’s exports: 1994-2009
III. POLICY RESPONSE (CONT’D)

Evolution of export sophistication and GDP per capita
(2002-08)

- Macedonia
- Bosnia and Herzegovina
- Slovak Republic
- Croatia
III. POLICY RESPONSE (CONT’D)

Effective government

- Leadership— a coherent long-term and well communicated growth strategy
- Implementation
- Rule of law

Source: Worldwide Governance Indicators
Source: World Economic Forum Global Competitiveness Report

<table>
<thead>
<tr>
<th>Governance Indicators</th>
<th>MKD</th>
<th>NMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voice and Accountability</td>
<td>52.6</td>
<td>74.1</td>
</tr>
<tr>
<td>Political Stability</td>
<td>29.2</td>
<td>71.0</td>
</tr>
<tr>
<td>Gov’t Effectiveness</td>
<td>48.3</td>
<td>72.2</td>
</tr>
<tr>
<td>Regulatory Quality</td>
<td>59.3</td>
<td>80.1</td>
</tr>
<tr>
<td>Rule of Law</td>
<td>46.9</td>
<td>71.1</td>
</tr>
<tr>
<td>Control of Corruption</td>
<td>56.5</td>
<td>65.7</td>
</tr>
</tbody>
</table>

Source: World Economic Forum Global Competitiveness Report
Source: Worldwide Governance Indicators
IV. THE WORLD BANK’S ROLE

• The WB is helping the country address a number of these challenges:
  – Modular competitiveness assessment (trade competitiveness and 4 sector notes – auto parts, agriculture, logistics, textiles)
  – Labor market review
  – Higher education TA
  – Agriculture public expenditure review
  – Infrastructure investments (energy, roads, municipal infrastructure)
  – Green growth agenda
Thank you for your attention

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