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THE STRUCTURE OF GDP AS AN INDICATOR FOR ECONOMIC DEVELOPMENT: A NOTE ON THE ECONOMY OF FYROM

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ABSTRACT

The global economy crisis confirmed the need for development of the production sector in FYROM as a key element for decreasing the trade deficit. The effects of the crisis show that FYROM does not have economic structure capable for development without inflow of foreign capital. The question whether FYROM economic structure is compatible to current level of development and whether the country has sustainable economic development in the last ten to fifteen years should be answered negatively.

In fact, the last economic crisis confirmed that the development model that FYROM applied is not sustainable. Although the privatization process finished, the private ownership and liberalization do not show the expected effects. The companies are not competitive in the international markets, and did not start to create new productive jobs in manufacturing and export oriented sectors. On a macro level, there has been a development model based on fixed exchange rate of the domestic currency and weak economy, chronic trade deficit and reliance on the foreign capital inflow. Obviously, the economic model should be changed.

FYROM needs radical change of the economic policy, with fast restructuring of the economy and new economic and legal conditions for investments in manufacturing and other export-oriented economy sectors. All these should be done parallel to general development of infrastructure and human resources. In order to start the investment cycle, which will invoke faster economic development, there is a need for change in the economic structure, which can be analyzed by the structure of GDP, as the main macroeconomic aggregate in the economy.

KEYWORDS: Economic Model, Industrial Production, Unemployment Rate, Trade Deficit, Fiscal and Monetary Policy

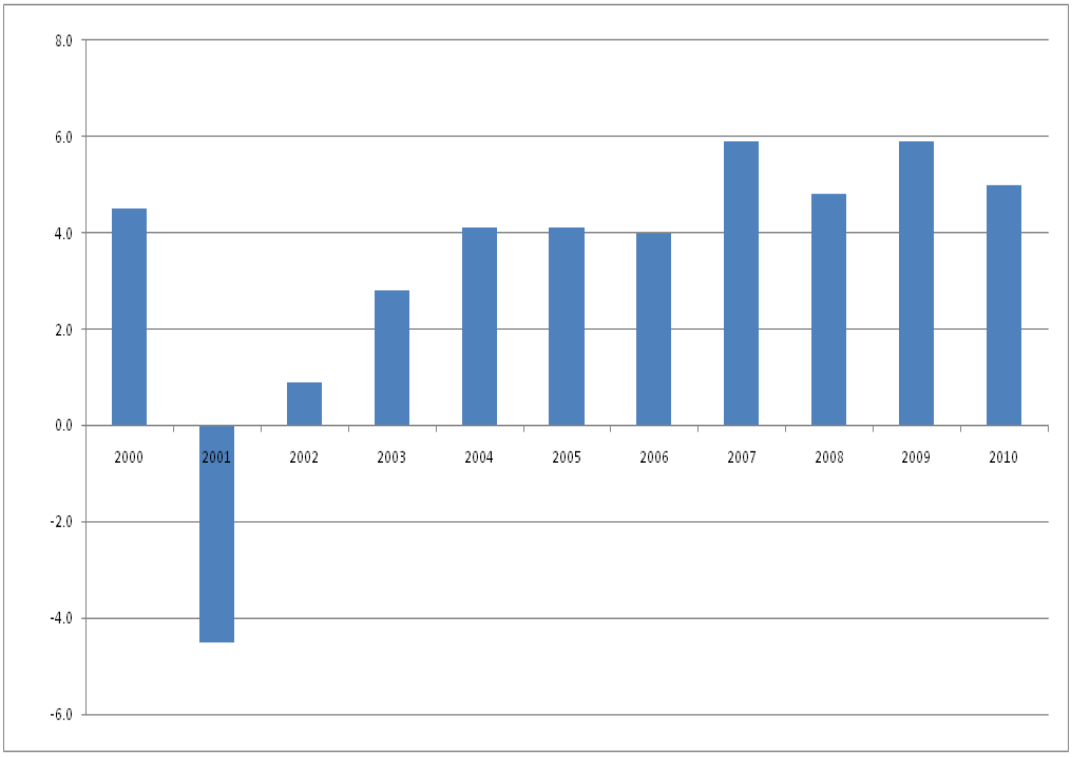
INTRODUCTION

The growth of gross domestic product as a basic macroeconomic generator in every economy is a measure of the success of the economic policy in a country. The expression of other macroeconomic aggregates relative to GDP, such asthe trade deficit as a percentage of GDP or current account deficit of balance of payments as percentage of GDP are irreplaceable macroeconomic indicators.

Table 1: Real Growth of GDP

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP	3,4	4,3	4,5	-4,5	0,9	2,8	4,1	4,1	4,0	5,9	4,8	5,9	5,0

Source: State Statistical Office and NBRM, 2012



Source: State Statistical Office and NBRM, 2012

Figure 1: Real Growth of GDP

From the table and the graph above it can be seen that there is a positive trend in the GDP real growth. The positive dynamics of the real growth of GDP in the period from 1998 to 2010 can be considered as one of the basic points during the recovery period (except in 2001 during a military crisis) in the FYROM economy.

But, if the structure and the elements on which this growth is based are processed, the negative effects of the development will be obvious. The next parts will analyze and elaborate the structure of GDP according to the production model and examine the causes and consequences from the current economic policy.

The Structure of GDP According to the Production Model

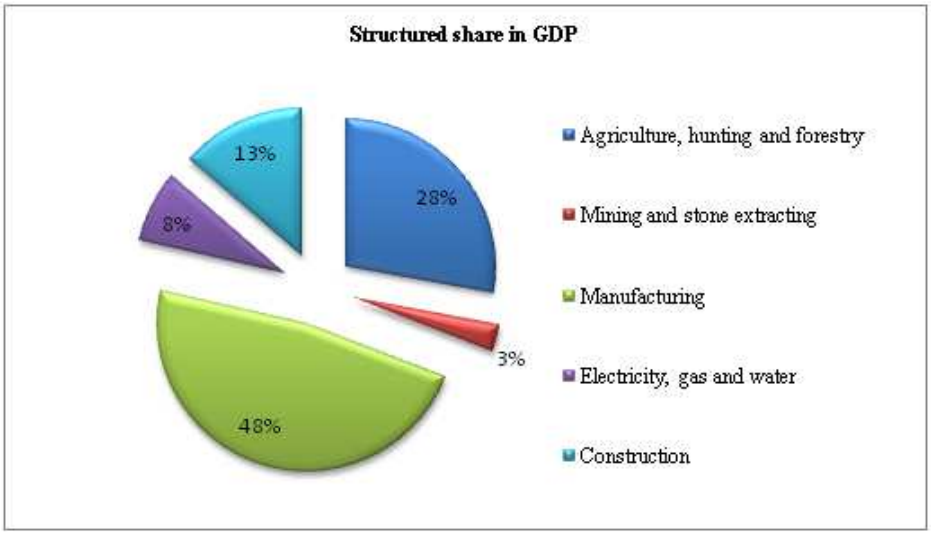
Taking into consideration the structure of GDP according to the production model, about 37% comes from production activities, which with a variation of one or two percentage points stays at the same level for years before the economic crisis, and by 3.3 percentage points lower than the share in 1998.

This structural percentage of production activities as part of GDP is presented in the table and graph below.

Table 2: Structural Percentage of Production Activities as Part of GDP

Production Activities	1998	2007	2008
Agriculture, hunting and forestry	11,4	9,3	10,4
Mining and quarrying	0,8	0,7	1,1
Manufacturing	18,1	18,4	17,8
Electricity, gas and water	4,5	2,7	2,9
Construction	5,8	5,9	5,1
Structural Participation in GDP	**40,6**	**37,0**	**37,3**

Source: State Statistical Office and MBRM, 2012



Source: State Statistical Office and NBRM, 2012

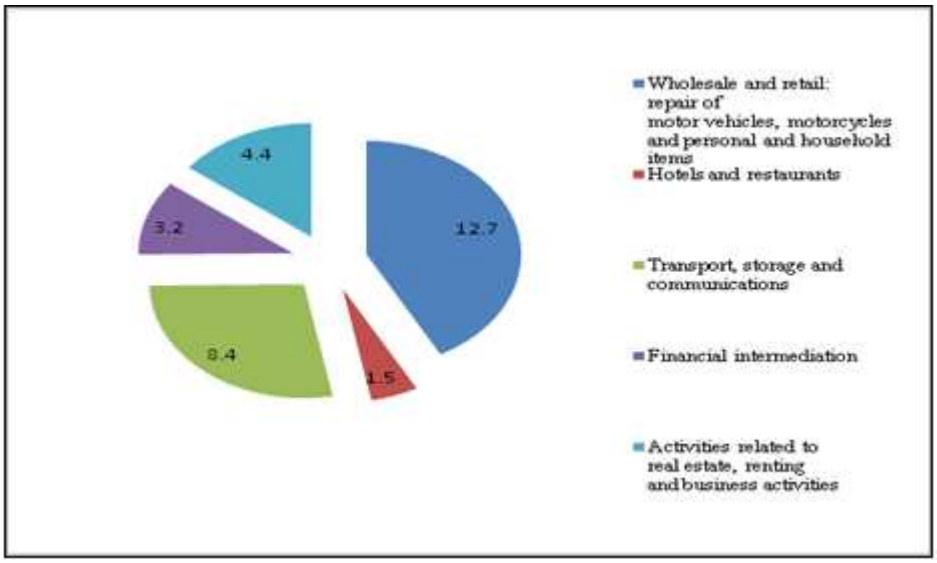
Figure 2: Structural Percentage of Production Activities as Part of GDP

Service activities also contributed over 30% in the GDP, whereas in years before the crisis there has been an increase of the participation of the activities related to real estate and renting. This can be seen from the table and the graph below.

Table 3: Structural Percentage of Service Activities as Part of GDP

Services	1998	2007	2008
Wholesale and retail: repair of motor vehicles, motorcycles and personal and household items	11,2	13,5	12,7
Hotels and restaurants	1,6	1,6	1,5
Transport, storage and communications	7,3	8,3	8,4
Financial intermediation	3,7	3,4	3,2
Activities related to real estate, renting and business activities	2,7	3,6	4,4
Structural Participation in GDP	**26,5**	**30,4**	**30,2**

Source: State Statistical Office and NBRM, 2012



Source: State Statistical Office and NBRM, 2012

Figure 3: Structural Percentage of Service Activities as Part of GDP

However, it must be noted that the structure with a higher share of service activities in comparison to production activities is present in developed countries and is a normal process for these countries. For example, in some EU countries approximately 26% of GDP comes from industry and construction, and although these countries have become rich countries with long, modern and industrially developed economy, the service activities have dominant percentage in GDP. From the rest of 34-35% from the GDP in FYROM derived from the activities of the public sector, through education, health care and social work, public administration and social security with about 18-20%. With a 14-15% share of the total GDP are taxes and other imposts and contributions, additional to the value added which is 85% to 86% from the whole GDP according to the production model.

Table 4: Activities of the Public Sector and Taxes and Other Imposts as Part of GDP

	1998	2007	2008
Public administration and defense, compulsory social care	6,2	6,4	6,7
Education	4,1	3,2	3,1
Health care and social work	4,3	3,5	3,4
Other communal, social and personal service activities	2,5	2,1	2,7
Rents	4,6	5,0	5,4
Less: Bank service	2,6	2,5	2,6
A. The Added Value	**86,3**	**85,5**	**86,3**
B. Taxes on Products	**13,7**	**14,8**	**14,2**
-Value Added Tax and Excise Tax	10,2	13,0	12,7
-Customs and Tariffs	3,5	1,7	1,6
C. Minus: Subsidies on Products		**0,3**	**0,5**

Source: State Statistical Office and NBRM, 2012

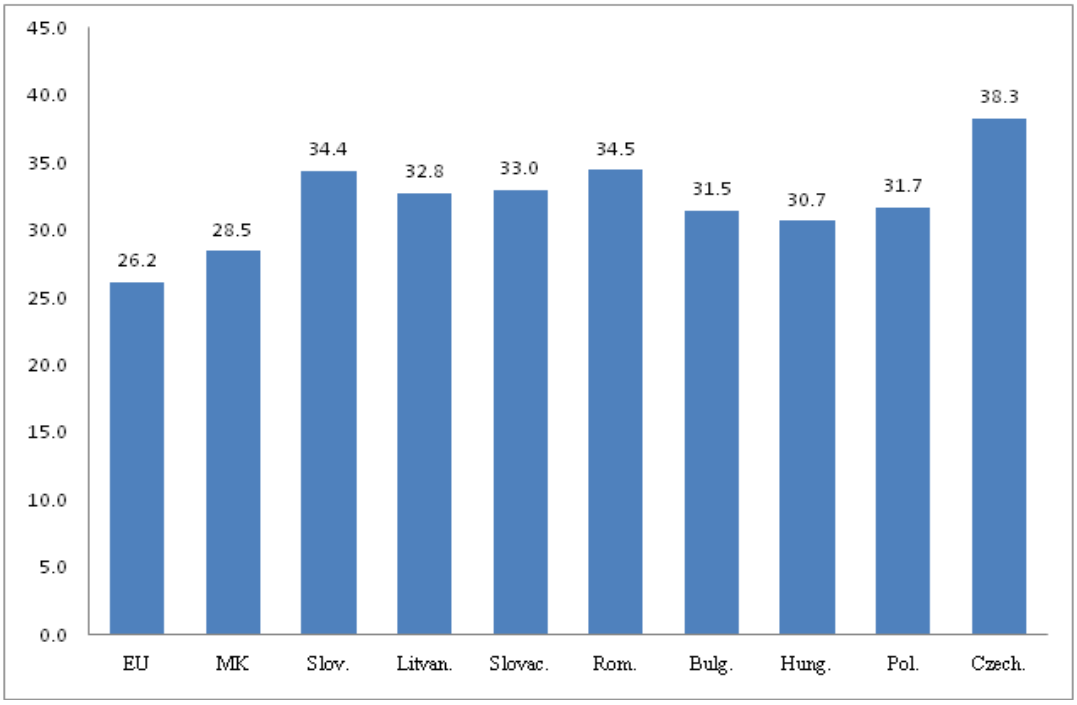
A closer look on 4, if focus is on the structure of gross domestic product without taxes and subsidies in 2008, which is taken for comparison as the year that had the highest real GDP growth, 57% of GDP comes from services, and only 43% of production activities, in which only 26.6% are from industry and construction activities. The minor role that the private production and industrial sector has in the FYROM economy will be more obvious if one excludes the part where the public authorities are entering in the economic activities with, for example, capital transfers.

Thus, it is obvious that GDP growth in recent years has been achieved outside the manufacturing sector, and especially in the area of services, which cannot be offered to the foreign market, thereby to provide rise in exports. After the analysis of the structure of GDP according to the production model, it is obvious that after the privatization process the effects that should be reached from the private property in the segments of efficiency growth of domestic companies, economic recovery and restoration of economic potentials, as well as new productive employment are not at the desired level. If there is a comparison between FYROM and some EU countries and other countries from the region, it can be concluded that the participation of the industry and construction in GDP is at significantly higher level in comparison to the level in FYROM, which is just 28, 5%. This conclusion can be obtained from the table and graphs presented below.

Table 5: Industry and Constriction as Part of GDP in FYROM and Some EU Countries

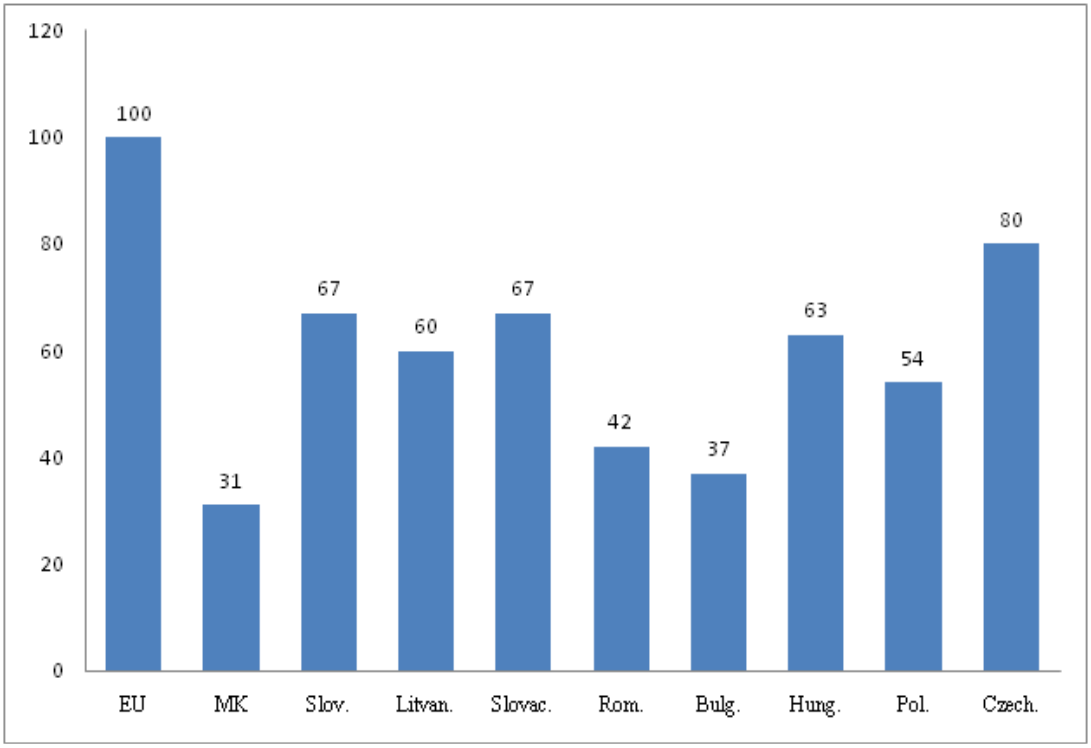
Country	EU	MK	Sloven.	Litvan.	Slovak.	Rom.	Bulg.	Hung.	Pol.	Czech.
Industry and construction	26,2	28,5	34,4	32,8	33,0	34,5	31,5	30,7	31,7	38,3
Per capita/% from EU	100	31	67	60	67	42	37	63	54	80

Source: Statistical Office of the European Union and NBRM, 2012



Source: Statistical Office of the European Union and NBRM, 2012

Figure 4: Industry and Constriction as Part of GDP in FYROM and Some EU Countries



Source: Statistical Office of the European Union and NBRM, 2012

Figure 5: Per Capita / % from EU

The countries shown in the table and the graphs above have higher participation of the industry and construction in the GDP, even though they are at the higher level of economic development in comparison to FYROM when GDP per capita is taken into consideration, where GDP per capita in the case of FYROM is just 31% from the average in EU.

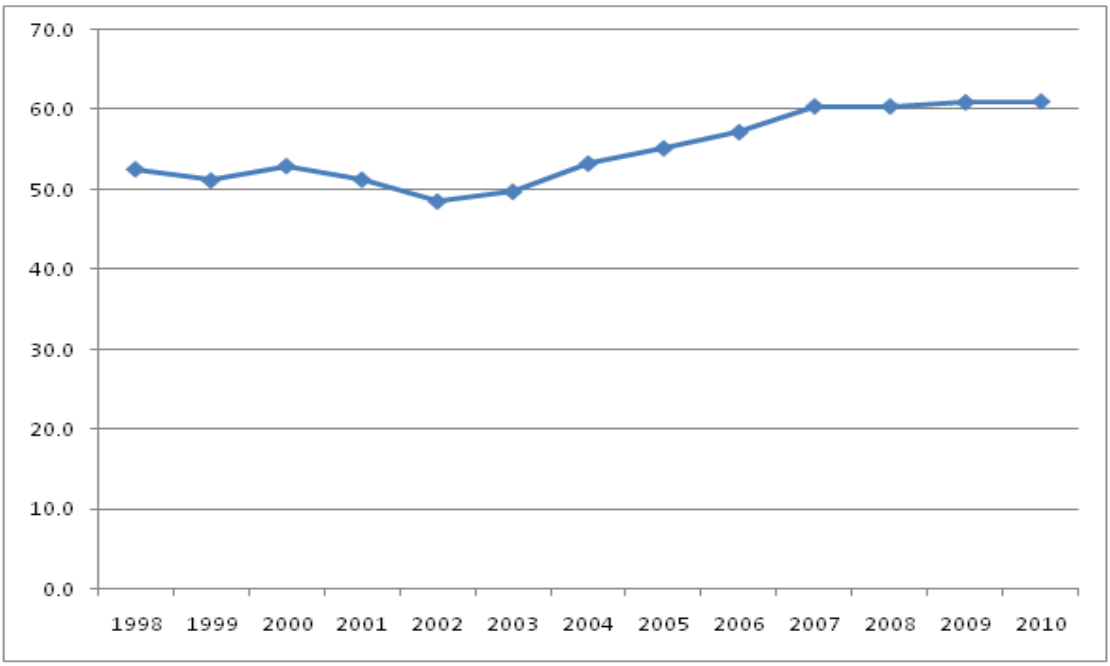
CAUSES AND CONSEQUENCES

The analysis of industrial production with detailed observation on the causes and consequences from inadequate and misleading economic model for development is giving the possible answer on the question about the level of the industrial production during the last twenty years. What happened in FYROM is a dramatic slowdown in the industrial production in the last twenty years, or in other words deindustrialization after 1990, from which FYROMn economy did not recover during the last decade. Even though there were positive signals during the period from 2002 to 2008 before the world economic crisis, the industrial production during this period was half of the industrial production in 1990. While the industrial production in 1998 was half compared to the industrial production in 1990, in 2008 was lower than 40% in comparison to the industrial production in 1990, which is the year when the transformation process from planned to market system started. This can be seen from the comparison of the numbers given in the table below and the graphical presentation of this numbers.

Table 6: Industrial Production (1998-2010) as Percentage from the Industrial Production in 1990

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Ind.	52,6	51,2	53,0	51,3	48,6	49,8	53,3	55,2	57,2	60,4	60,4	60,9	61,0

Source: State statistical office, 2012



Source: State statistical office

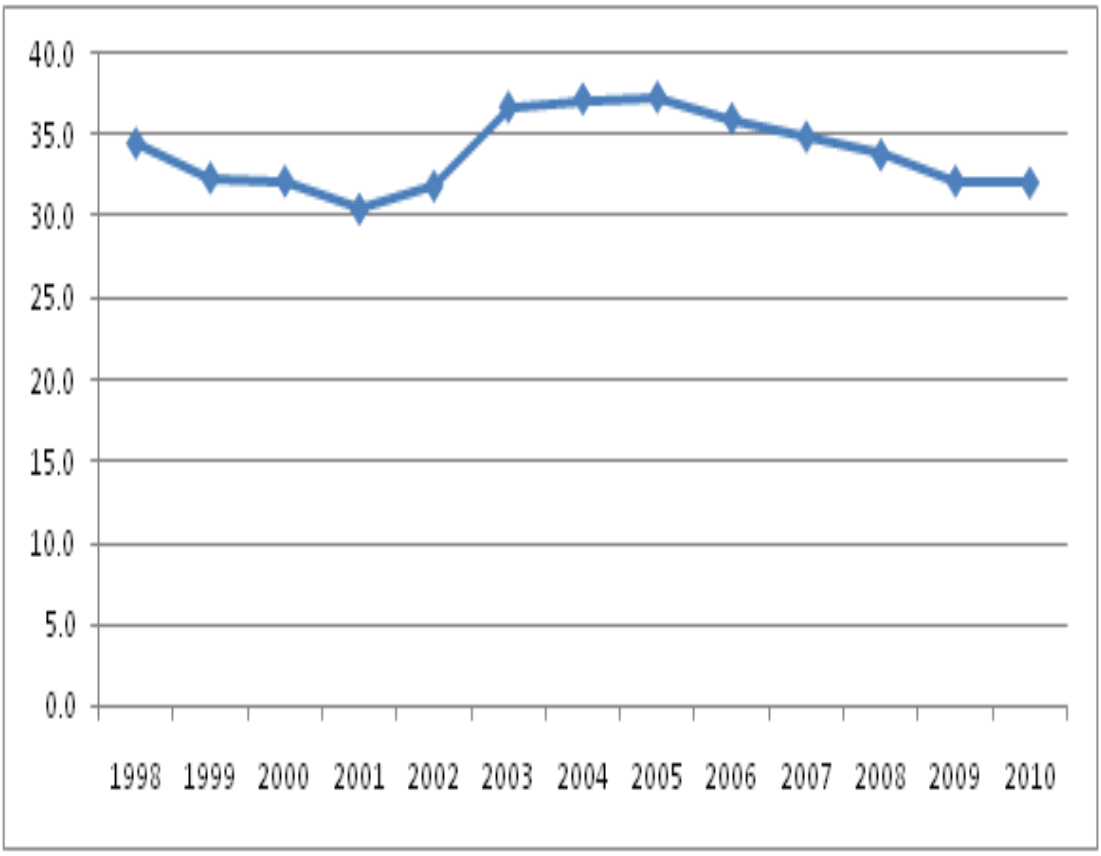
Figure 6: Industrial Production (1998-2010) as Percentage from the Industrial Production in 1990

When employment is analyzed, the results are almost the same. The expected new workplaces as a result from the reformation processes did not reach the expected level, especially in production and export oriented sectors, which can be seen from the table and graph presented below.

Table 7: Unemployment Rate (1998-2010)

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
MK	34,5	32,4	32,2	30,5	31,9	36,7	37,2	37,3	36,0	34,9	33,8	32,2	32,1

Source: State statistical office, 2012



Source: State statistical office

Figure 7: Unemployment Rate (1998-2010)

The new working places are mainly created in the administration and in non-production sectors, sectors that are not export oriented and services such as financial intermediation, real estate operations and other services. According to this, it is obvious that the development model in FYROM during the last twenty years dominantly focused on opening banks, supermarkets, and building luxury commercial and residential buildings.

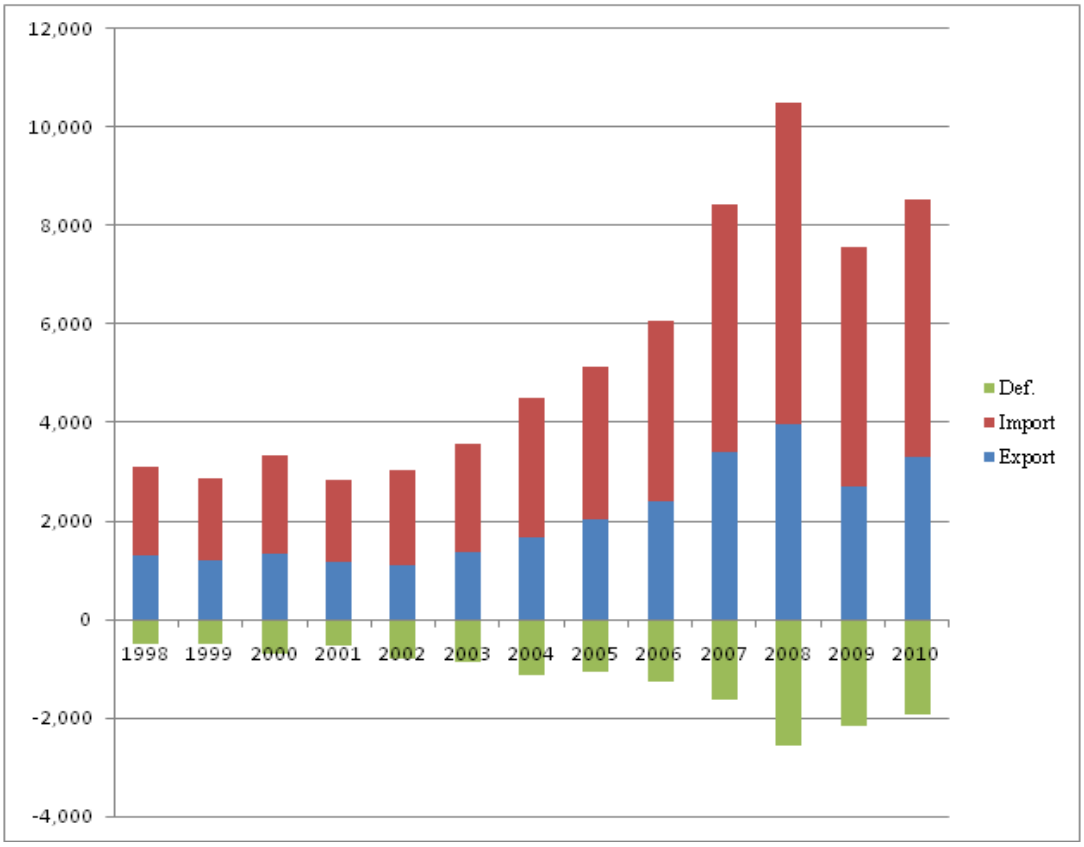
The economic structure, with overemphasized participation of the non-production sector (services), without adequate participation of the production and export sectors, is one of the main factors of permanent economic problems. Insufficient recovery of the production and export sectors is the reason why the import is much higher than the export.

The table below is presenting the trade deficit that has a continuous rise from 1998. From the table it is obvious that in the whole period the export did not manage to overcome 60% from the value of the import.

Table 8: Trade Deficit (1998-2010)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Export	1.291	1.190	1.320	1.155	1.112	1.362	1.674	2.040	2.410	3.391	3.971	2.702	3.295
Import	1.807	1.686	2.011	1.682	1.917	2.214	2.814	3.103	3.671	5.037	6.543	4.871	5.241
Def.	-516	-491	-691	-527	-806	-851	-1.139	-1.063	-1.261	-1.638	-2.574	-2.169	-1.946

Source: State statistical office, 2012



Source: State statistical office, 2012

Figure 8: Trade Deficit (1998-2010)

The deficit of trade balance during these years is covered with the surplus from other components of the current account from the balance of payments. Remittances, particularly private remittances of our citizens, and modest influx of foreign investment, have covered part of the deficit in trade balance during the recent years. But, there are fewer opportunities to cover the trade deficit, in the absence of planned foreign investment and remittances, which is becoming a significant problem in the FYROM economy.

CONCLUSIONS

The existing vulnerabilities in the current development model generally may be grouped in these categories:

- Slow reforms in the real sector, without properly targeted incentives for development of the production and export oriented industries.
- Delay of the regulations and procedures for bankruptcy and liquidation.
- Slow performance in the field of capacity building of state institutions.
- Emphasis of the economic policy only on the exchange rate, i.e. its basic aim to provide price stability, believing that that is the most important condition for economic development.

But in such conditions, where there is a lack of measures to reduce the trade deficit, higher inflation in comparison to the Euro-zone, there are sufficient signals to abandon the policy of forced exchange rate stability which led to a fundamental economic paradox, where we have a strong exchange rate for the denar in a low export economy.

There is a need for changes in the business and investment climate for attracting foreign direct and domestic investments, with their focus on export-oriented sectors in the economy (especially in industry), while designing and establishing a serious mechanism to prevent corruption. This is the only realistic way of establishing a sustainable and stable development of the country and its ability to return the debts. It requires serious changes in economic policy and significant reforms in creating a favorable investment climate.

There are a couple of fiscal and monetary measures that can be implemented. In the fiscal policy there is a need for systematic rationalization of public spending, without reduction of social standards and greater tax burden on labor costs. Also, there is a need for additional activities to prevent the "black" economy. National Bank of the Republic of FYROM needs to take consideration not only for the stability of the exchange rate for the denar, but also for the liquidity of the real sector. There is a need for production sector development and state investment in the infrastructure. Only on the basis of a new economic structure and macroeconomic stability, there will be a sustainable rate of economic growth and improvement in the living standards.

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