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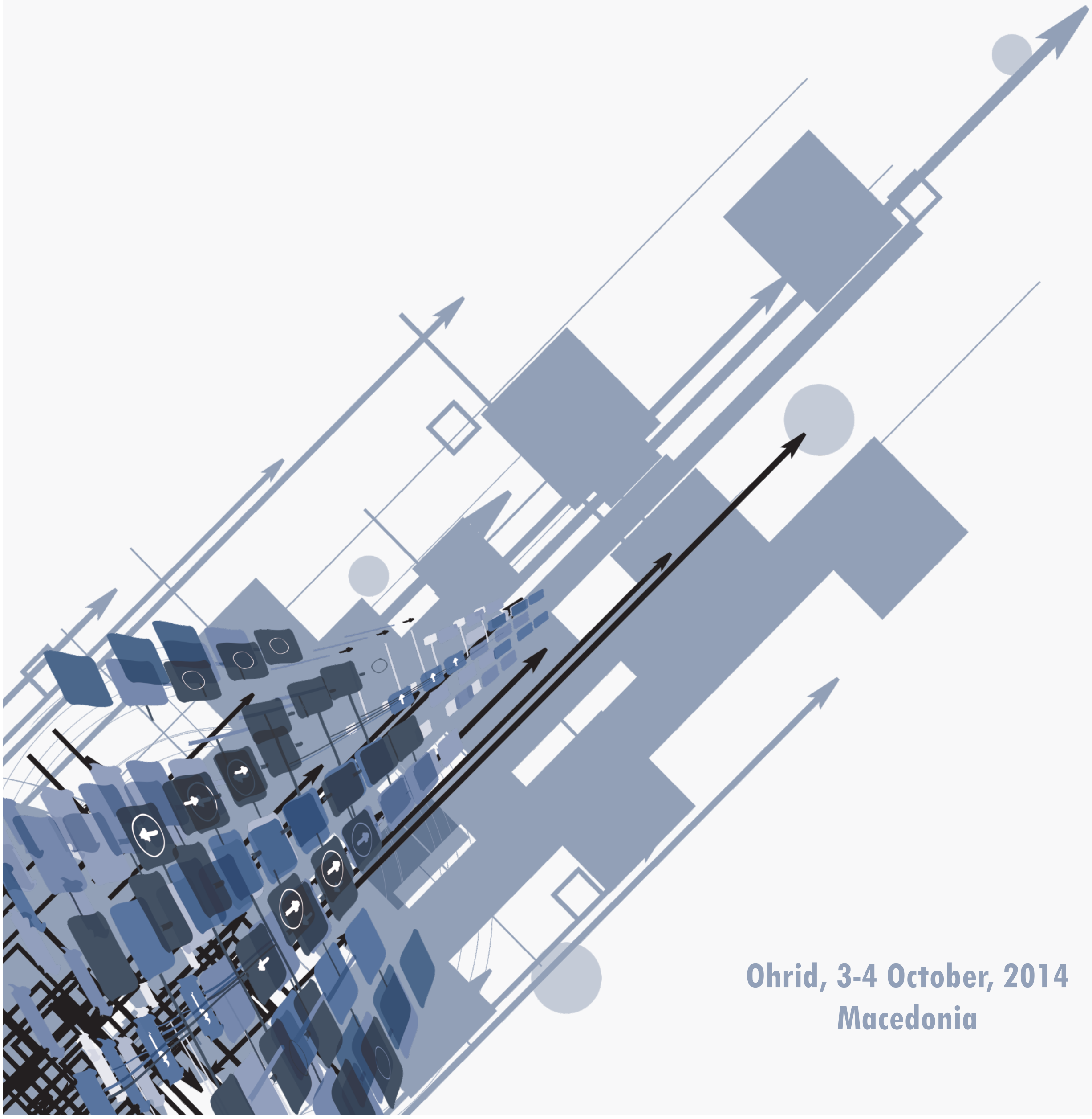
SMEs DEVELOPMENT AND INNOVATION: BUILDING COMPETITIVE FUTURE OF SOUTH-EASTERN EUROPE



Ohrid, 3-4 October, 2014
Macedonia

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CONFERENCE TOPICS

SMEs Internationalization and Innovation

ICT impact on the competitiveness of SMEs

Open innovation for SMEs growth

Innovation policies in SEE

Innovation Management in knowledge-based economy

Challenges of the Social Innovation in SEE

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PREFACE

Nowadays, the South-Eastern Europe (SEE) faces a challenge to increase the innovation capacity as a basic precondition for achieving sustainable growth and competitiveness on the global market. The new strategic direction of the SEE is based upon the ambitious goal to follow the leading world economies and to attain the EU membership. This implies the necessity for SEE countries to adjust towards the main EU developments. In this context, the new EU strategic framework underlines the role of SMEs as a driving force of the European economy. The knowledge intensity and innovation capability of SMEs are becoming the basic pillars for competitiveness and prosperity of the economies. These trends are actually the rationale and idea for organizing a conference that will be focused on further clarification of the role and importance of the innovative SMEs for improving the SEE economic performance.

The main goal of the Conference is to highlight many aspects of the contemporary changes in the SEE countries aimed at increasing innovation and achieving sustainable growth. More specifically, the conference will create a platform for presenting different academic and professional approaches (conceptual, empirical, multidisciplinary, case studies, etc.) and debates about the SMEs innovation developments in the SEE countries. The Conference will provide an opportunity for researchers, practitioners, PhD students and policy makers to give their contribution in considering the issues from theoretical and empirical point of view. In addition, it will offer the possibility to exchange the ideas, build partnerships, share knowledge and experience related to perspectives for improving the SMEs innovation capabilities and enriching the scientific achievements.

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HOW TO ACCELERATE EXPORT-LED GROWTH IN CONTEMPORARY WORLD?

Boshkov Tatjana, PhD[1]

Bishev Gligor, PhD[2]

Abstract

Globalization brings the threat of a weakened SME sector, since its role in (direct) exporting is less than proportional to its size; this reflects the economies of scale characterizing big markets. But globalization can also increase the importance of a strong SME sector, either where direct SME exports are feasible or where SME subcontractors help keep the country's large exporters competitive. Many markets are too small to have enough large firms to curtail the use of monopoly/monophony and oligopoly/oligopoly power, so price-competition and quality-based competition tends to come from SMEs.

Prices of domestic products on international markets are often underestimated because of the poor reputation or ranking the products with a low degree of processing. Namely, it is necessary small and medium enterprises to make efforts in this domain to contribute in a way that they will make the promotion of domestic products, have organized a joint presentation on external markets, will exhibit initiatives for creation of distribution centers. In this regard, the entry of FDI in manufacturing is expected to contribute to the production of high quality products, and distinctive products, which would lead to higher absolute prices, higher productivity and lower unit labor costs of products.

So 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.

In this context, the key factors for realization of these aims are innovation and knowledge that would help for increasing competitiveness as the role of FDIs for productivity and efficiency growth, with support of real exchange rate by stimulating the growth of export, too. The domestic industry by using knowledge, innovation development and upgrading the capacity of the small and medium enterprises can take the necessary changes for its output and increase export performance. All of this can contribute to sustainability of the economic growth and economic integration especially of small economies on which mainly this paper is focused with special emphasis on the Macedonian economy.

Key words: FDI, export, competitiveness, real exchange rate

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INTRODUCTION

Globalization has created new opportunities for SMEs. Progressive globalization has created a new international environment for SME exports from developing countries. The process of world economic integration has involved a broadening and deepening of inter-relationships between international trade and foreign investment flows. Several influences – falling trade barriers, increasing technological progress, migration of technical and professional manpower and highly mobile multinational corporations (MNCs) seeking out new investments – have combined to drive globalization. The end result has been the creation of an international marketplace for goods and services that seems indifferent to national borders and state regulation.

Globalization also brings new challenges. The new international environment provides new opportunities for SME exports from developing countries. It has the potential to offer SMEs in developing countries with access to a global pool of new technologies, skills, capital, markets and hence faster export growth and profits than ever before. At the same time, globalization brings a lot of trade challenges and increase in competition from imports and the entry of new foreign investors for SMEs in domestic markets. SMEs in developing countries have to adjust to the competitive strategies of MNCs in different countries, to public and privately set standard, to changes in international tastes, prices and competitive conditions.

Wignaraja (2003) suggests that globalization opens up new opportunities for export expansion and growth to about 5-10% of SMEs in developing economies. These dynamic SMEs have designed well-adapted marketing strategies and invested in their manufacturing capabilities to bring them up to world standards of price, quality and delivery, hence complying with new technical, environmental and labor standards in export markets. Some have even formed networks or industrial clusters with other SMEs or MNCs to stimulate the emergence of production networks among firms and increase value addition. Such SMEs have expanded their existing domestic market shares, broken into new export markets and continuously upgraded their products and processes. Experience of exporting SMEs from developing countries illustrates the fact that they have pro-actively upgraded themselves.

RER AS A CORNERSTONE OF SME'S EXPORTS 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.

One of the instruments that are crucial for explaining the evolution of the exchange rates, but also an instrument that is important in predicting the development, exchange rate movements - is the balance of payments. In addition, 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. 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. In the context of pro-active upgrading, this means:

-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. While the advance of trade liberalization brings down tariffs and quantitative restrictions, new barriers to trade, such as the technical barriers to trade, TBT, and sanitary and phytosanitary standards, require disproportionate efforts from developing countries and are perceived to be unequally and sometimes unfairly applied by developed countries.

SME AND FINANCE ENCOURAGING

Access to SME trade finance at competitive interest rates can be strengthened through export credit guarantee schemes for SMEs and subcontracting and specialist soft loans for SME export activities. Government should encourage banks as well as private enterprises to provide financial services tailored to SME export-related needs.

The agribusiness sector is important in almost all developing countries, including the more developed ones. The sector is characterized by SMEs that have high backward linkages with the rest of the economy, contribute particularly towards poverty reduction, job creation and improved health and nutrition. Stability of the agribusiness sector also requires diversity of both products and markets and primary attention to sustainability of resources. Also, the agro-industry sector can in Macedonia provide a domestic basis for scaling up of enterprises to the point where they become capable of export. There are also practical difficulties involved in starting up an agribusiness enterprise targeting an international export market from the beginning. In many cases, the domestic and regional markets tend to provide a stepping stone from which SMEs can learn important lessons concerning product quality, timely deliveries and managing risk involved in international business. Where there is an inadequate domestic market, or the products are only attractive for export, considerable effort needs to be put into strategic positioning and reliable production so as to reduce risk of failure. Such effort is obviously costly and requires capacity building of SMEs and export development institutions, including sectoral membership organizations.

The prospects of intensive competition have also given the stakeholders an impetus to assess the weaknesses and strengths of their garment industries. Developing countries having diversified product ranges, including high-end products and markets and countries that have invested in backward linkages and started developing forward linkages are in a better position. Strategies that would support diversification, differentiation and specialization within economies, sectors and at the level of firms appear viable and need to be given consideration in designing trade-related technical assistance. A value chain approach to identify bottlenecks and opportunities for designing strategies aimed at strengthening the competitive edge of firms may be appropriate.

Cluster development strategies are attracting more interest as local SMEs are linking to global value chains. In this respect, cluster development strategies serve both improving competitiveness and improving the ability of local SMEs to insert themselves into global supply chains through linkages with FDI and may be a useful tool for an SME export development and promotion agency, with or with a function in promoting linkages with FDI. Framework conditions for building up SME competitiveness include an SME enabling legal, regulatory and administrative environment, SME access to finance, a supportive SME institutional support structure, availability of appropriate skills and supporting infrastructure, mainstreamed into the national development framework. In this context it is also interest to analyze the particular group of SMEs that are exporting or have export potential and those that are able to insert themselves into the supply chains of FDI enterprises.

RELATIONSHIP BETWEEN FDI AND SME, EFFECTS AND GAINS

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 (Lall, 2001):

- 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 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. As capital investment often follows acquisition in such cases, in order to upgrade equipment and machinery, many employees are likely to require training. Moreover, indigenous managers are likely to enhance their knowledge through interaction with foreign managers, with some possibly benefiting from spending working periods abroad.

There are example where FDI has also made a significant contribution to the development of the “high tech” cluster, through linkages between technology partners (Khalid, 1995). In this case, the role of policy was to enhance the development of an initial clustering of research centres by contributing to the attraction of the city as a destination for inward investment. This was achieved through a combination of establishing a consistent policy framework, offering a degree of predictability for foreign investors and an active promotion programme to attract FDI (OECD, 2010). In literature is known that for developing and transition economies, FDI represents a potential means of growing and diversifying the SME base and achieving greater integration within global networks. In this way, if we thinking how to promote the connection betwen FDI and SME, the answer is 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. 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. In this way, defining the role for policy to attract FDI includes (Srinivasan and Archana, 2011):

-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.

IMPORTANCE OF ELGH IN DEVELOPING COUNTRIES

It is widely accepted among economists that economic growth is an extremely complex process, which depends on many variables such as capital accumulation (both physical and human), trade, price fluctuations, political conditions and income distribution, and even more on geographical characteristics.

The export-led growth hypothesis (ELGH) postulates that export expansion is one of the main determinants of growth. It holds that the overall growth of countries can be generated not only by increasing the amounts of labour and capital within the economy, but also by expanding exports. According to its advocates, exports can perform as an “engine of growth”.

The association between exports and growth is often attributed to the possible positive externalities for the domestic economy arising from participation in world markets, for instance from the reallocation of existing resources, economies of scale and variouslabour training effects. However, these mechanisms are frequently invoked without any theoretical support or any empirical proof.

A substantial amount of research concerning the ELGH in developing countries (DCs) has been carried out during the past 30years. In fact, during the 1990s a new series of empirical studies has been conducted on a number of divergent lines of research, methodologies, time periods and countries. A key aspect concerning early studies is related to both the methodology and the econometric technique used. The theoretical benchmark can be considered in general weak and based on bivariate and ad hoc production functions, while the empirical results derived from traditional econometrics have been highly criticized for being spurious. Therefore, early studies could have been misleading in that they advocated export expansion in an indiscriminate way. In fact, the evidence available is far from conclusive and this situation explains to some extent why this debate still exists in the economic literature.

LINK BETWEEN TRADE, EXPORTS AND GROWTH AND THEIR EFFECTS

Although the theoretical links between trade and economic growth have been discussed for over two centuries, controversy still persists regarding their real effects. In the last decade there has been a surprising and impressive resumption of activity in the economic growth literature triggered by the endogenous growth theory, which has led to an extensive inventory of models that stress the importance of trade in achieving a sustainable rate of economic growth. These models have focused on different variables, such as degree of openness, real exchange rate, tariffs, terms of trade and export performance, to verify the hypothesis that open economies grow more rapidly than those that are closed (see e.g. Edwards, 1998).

Many developing countries were forced to stimulate their export-led orientation even more because most of them had to rely on multilateral organizations to implement adjustment and stabilization programmes to correct imbalances in their basic macroeconomic indicators. The strategy was to encourage a free market through policies that relied heavily on the export promotion approach as one of the most suitable and trustworthy mechanisms. Promoting exports 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 exports and achieving export expansion are beneficial for both developed and developing countries for many reasons, including the following (Rodrik, 1999):

- 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;
- they relaxe 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 (World Bank, 1993).

HOW EXPORT-LED GROWTH IS USED AS A DEVELOPMENT STRATEGY?

Export-led growth refer to a strategy comprising the encouragement of and support for production for exports. The rationale lies in the belief of many economists that trade is the engine of growth, in the sense that it can contribute to a more efficient allocation of resources within countries as well as transmit growth across countries and regions. Exports, and export policies in particular, are regarded as crucial growth stimulators. Exporting is an efficient means of introducing new technologies, both to the exporting firms in particular and to the rest of the economy, so exports are a channel for learning and technological advancement. Moreover, the growth of exports plays a major part in the growth process by stimulating demand and encouraging savings and capital accumulation, and, because exports increase the supply potential of the economy, by raising the capacity to import.

Opening up a country's market to the international markets allows a country more efficient production and allocation of resources as the country can concentrate on the production of goods in which it has a comparative advantage based on its factor endowments. Thus, world trade markets allow producers and consumers of the participating countries to benefit from lower prices, higher-quality products, more diverse supply of goods, and higher growth.

Participating in trade, especially export production and promotion, exposes a country to the latest and most advanced production and marketing techniques, and a "learning-by-doing" process that brings about dynamic innovation and technological diffusion into the economy. It also drives a country to higher production and to economies of scale, which lead to increasing returns.

The investment-savings gap and the foreign exchange gap are major obstacles to the growth and development of many developing countries. Since countries need precious foreign exchange for their development needs (capital goods, industrial raw materials, oil, and food), export earnings are a more efficient means to finance these needs than foreign debt since the latter is vulnerable to adverse exogenous shocks and currency risks that may lead to debt defaults. A similar argument claims that large balance-of- payment deficits, spurred by large import propensities or elasticity's, may be a hindrance to growth for many developing countries. Thus, moderate trade deficits, or trade surpluses, are more desired. This, of course, implies that export growth should be in pace with, or ahead of, import growth.

Export-led strategies allow an expansion of aggregate demand without much inflationary pressure and without the danger of a wage-price spiral, compared with strong domestic demand injections. This partly stems from the real appreciation of the currency that result from large export earnings, which tame inflation and allow real wages to rise. It is important to mention that while the literature on growth and development considers the export-led growth strategy, the "domestic demand-led growth strategy" is not a term defined and used hence it has to be defined here, in particular for purposes of empirical implementation. Therefore, it is not straightforward to place the "debate" between export-led and domestic demand- led growth strategies in a theoretical context.

Export-led growth is an economic strategy which seeks to find a niche in the world economy for a certain type of export. Industries producing this export may receive governmental subsidies and better access to the local markets. By implementing this strategy, countries hope to gain enough hard currency to import commodities manufactured more cheaply somewhere else. Export-led growth is important for mainly two reasons. The first is that export-led growth can create profit, allowing a country to balance their finances, as well as surpass their debts as long as the facilities and materials for the export exist.

There are essentially two types of exports used in this context: manufactured goods and raw materials. The use of manufactured goods as exports is the most common way to achieve export-led growth. Many times these industries are competing against industrialised countries' industries, which often include better technology, better educated workers, and more capital to start with. Therefore, this strategy for export-led growth must be well thought out and planned. Not only must a country find a certain export that they manufacture well, that industry must also be able to make it in the world market competing with industrialised industries. Using raw materials as an export is another option available to countries. However, this strategy has a considerable amount of risk compared to manufactured goods. The terms of trade greatly affect this plan. Over time, a country would have to export more and more of the raw materials to import the same amount of commodities, making the trade profits very difficult to come by.

EXPORT-LED GROWTH IN SEE6

South East Europe’s (or SEE) economy began recovering from the 2012 recession, growing by 2.2 percent on average in 2013, according to the World Bank’s latest South East

Europe Regular Economic Report (SEE RER). The report says the region is projected to grow at 1.9 percent in 2014 and 2.6 percent in 2015 thanks to growing external demand, but significant risks cloud the outlook, including the expected impact of recent flooding in the region.

Table 1. SEE:Real GDP growth, in percent

	2012	2013	2014	2015
Albania	1.3	0.4	2.1	3.3
Bosnia and Herzegovina	-1.1	1.8	2.0	3.5
Kosovo	2.7	3.0	3.5	3.5
Macedonia	-0.4	3.1	3.0	3.5
Montenegro	-2.5	3.5	3.2	3.5
Serbia	-1.7	2.5	1.0	1.5
SEE6	**-0.7**	**2.2**	**1.9**	**2.6**
Note: GDP weight average. 2013 is an estimate. 2014 and 2015 are World Bank staff projections. Source: World Bank.				

Severe floods, in particular in Bosnia and Herzegovina and in Serbia, which occurred in mid-May due to unprecedented rains, have caused a humanitarian crisis with dozens of people dead and millions displaced or left without access to water or power. Housing, crops and livestock have been lost, and major transportation links have been disrupted. The floods will undoubtedly have a negative impact on growth in 2014, though it is too early to measure the full impact. Assessments of damage and reconstruction needs are being launched as initial relief operations continue. For Kosovo, the report noted that it remains the fastest growing economy in the region and that economic growth is projected to accelerate in 2014. Some economists say that Kosovo had a solid economic growth, but it did not create new jobs.

In 2013, each of the six countries of South East Europe marked positive growth rates, with growth at or exceeding 3 percent in Macedonia, Kosovo and Montenegro. In all countries, a good agricultural year and growth in industry supported the region’s economic activity. In fact, from 2013, South East Europe began recovering from recession. Economic growth was possible thanks to the increased demand for regional exports from high-income countries, particularly those in the European Union (EU). The devastating floods in mid-May are a humanitarian disaster for several countries of Southeast Europe, and will impact economic recovery for the next few years in ways that have yet to be fully assessed. According to the report, exports grew by close to 17 percent in 2013, led by particularly rapid growth of Serbian exports. The major increase in 2013 came from the export of machinery and transport equipment, mainly from Serbia and Macedonia. Meanwhile, mineral fuels exports were quite significant in Albania and Montenegro, and base metals were around a quarter of exports from Kosovo in 2013.

The importance of access to international competitiveness as a concept is extremely important for employment and the degree of capacity utilization of Macedonia. It is undisputed that the successful realization of the international economic and financial relations necessarily be aware of what changes are expected in the future in exchange rates. Thus, the existence of the real exchange rate in Macedonia, the products whose price in the country is a low cost can be exported effectively and import products whose price is relatively higher in the country in terms of abroad. In addition to the events and challenges for Macedonia, membership in the EU can improve the industrial situation in Macedonia only if the access largely makes Macedonia location from which foreign investors can serve EU markets if the domestic industry, with aid of FDI, can take the necessary changes to its output, an issue explored in greater detail in the section of the industry. These long-term structural shifts in employment and output, which can be accelerated through accession of Macedonia to the EU, sectoral change can be an important driver of change in aggregate factor productivity and income of workers in different sectors of the economy.

Given the large gap in prices and income per capita between Macedonia and the EU, the price will be accepting an important source of inflationary pressure, and also facing the existing price distortions in the energy, municipal services, etc.. Before access can move this later inflationary factor as driver for access around the time when the effect of inflation on real convergence is combined with the negative short-term effects of EU accession on fiscal balance, falling interest rates and so on. This will require careful management of the exchange rate. That is, if the Macedonian real growth accelerates, Macedonia will be more attractive candidate for EU membership, and it will faces with intense pressures on the exchange rate regime and macroeconomic policies.

The region's domestic demand contracted in 2013. Having this in considerance, some economists suggest Western Balkan countries to shift from an internal demand-driven growth model to one fueled by exports, leading to greater integration in European and global markets. With recovery underway, this moment should be focused on creating an investment climate conducive to export-led growth and enhancing connectedness. Domestic demand was further suppressed by declining remittances to the region in 2013, reflecting a still-sluggish economic recovery and prevailing high unemployment in EU countries. With few new jobs, falling remittances, and limited credit to the economy, household incomes and firms' profits were unable to boost domestic consumption or investment in the region.

Overall, while the recovery has brought growth, countries in the region are having limited success in translating the economic recovery into job creation. Unemployment remained very high in the region at an average rate of over 24 percent in 2013. Persistently high unemployment rates and chronic unemployment are particularly prevalent among vulnerable groups, such as youth, women, and the low-skilled. The report for SEE says that challenges remain and need action in the financial and fiscal sectors. Taming the high and still rising non-performing loans; resuming credit growth to viable corporate borrowers; pursuing decisive consolidation efforts to restore fiscal balance; and reducing public debt would help stimulate economic activity. To sustain growth in the region, the countries need to further strengthen their domestic macroeconomic fundamentals and policies that boost productivity and resilience to external turmoil. In addition, the recent economic recovery is an opportunity to re-launch long-overdue structural reforms. Priorities for growth and jobs creation include macroeconomic and fiscal stabilization, improved competitiveness and connectivity, enhanced skills and labor productivity, and strengthened governance and anti-corruption.

CONCLUSION

The main argument for favouring SMEs is that they are increasingly playing a strategic role in economic growth and development through their contribution to the creation of wealth, employment, and income generation. In more developed economies, the dynamic arguments for the existence of SMEs have been stressed in terms of their being more innovative and constituting a seedbed for the development of new firms.

SMEs are increasingly taking the role of the primary vehicles for the creation of employment and income generation through self-employment, and therefore have been tools for poverty alleviation. SMEs also provide the economy with a continuous supply of ideas, skills and innovation necessary to promote competition and the efficient allocation of scarce resources.

The pre-crisis economic boom started somewhat later than in other emerging Europe countries and was notably more contained the growth pattern in the Republic of Macedonia shared many features with its country peers. Specifically, the non-tradable sector, which absorbed large FDI inflows, was also responsible for higher productivity and output growth during the pre-crisis period. The output growth in the Republic of Macedonia has been mainly explained by improvements in domestic financing conditions and risk premia, larger capital inflows (mostly FDI) and reforms in infrastructure. The main challenges for the Republic of Macedonia are to smoothly absorb FDI inflows and to improve the competitiveness and export performance of the domestic industry. These challenges – and the policy measures needed to tackle them – are very similar to those confronting other countries in the region.

According to this, 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. Maintaining growth and reducing the unemployment in a small and open economy such as Macedonia depends from improved performance of exports, from this point of view the exports of SMEs. On higher level, 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. Also, 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, the importance of access to international competitiveness as a concept is extremely important for employment and the degree of capacity utilization of Macedonia. It is undisputed that the successful realization of the international economic and financial relations necessarily be aware of what changes are expected in the future in exchange rates. In this way, if the Macedonian real growth accelerates, Macedonia will be more attractive candidate for EU membership, and it will faces with intense pressures on the exchange rate regime and macroeconomic policies.

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