

The Competitiveness Position of The Republic Of North Macedonia: Opportunities And Weaknesses¹

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Abstract

Competitive advantage is a prevalent concept and one of the essential tools for faster integration of the national economy in the global market, which is projected to result in increased exports, higher growth, improved living standards, and long-term prosperity. For small, open economies like the Republic of North Macedonia, this global integration is crucial for domestic enterprises to sell and compete on the global market. This study aims to analyze the Macedonian economy's competitive position from 1996-2019 to identify weaknesses and potential bottlenecks that would result in recommendations for policymakers. This study used two indicators – the real effective exchange rate (REER) and the WEF global competitiveness index (GCI) – to give a descriptive analysis of the Macedonian economy's competitive status. Looking at the REER statistics, one may infer that movements are mostly balanced.

The second indicator, the WEF's global competitiveness index (GCI), as a multidimensional indicator, measures various aspects of competitiveness. This index shows that the Republic of North Macedonia has the lowest score in innovation capability and needs to work on that part to improve its ranking. To put it another way, REER does not show any notable improvements or declines in the Macedonian economy's competitive position between 1999 and 2020, even though the REER index is slightly declining.

Keywords: competitiveness, competitive advantage, REER, GCI, external trade.

JEL Codes: F10, O24, P45

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Introduction

The disintegration of the Yugoslavian Federation resulted in new smaller economies that needed to pay closer attention to external openness and successful integration in the international movements of labor and international trade. To do so, the economies had to transform into open national economies with free movement mechanisms into the international goods, services, technology, and capital markets. According to the economic theory and its realistic representation, the external openness of small open economies significantly impacts their growth performance. Economic agents must be self-sufficient in their operations, have market flexibility, and accept responsibility for their success or failure.

The Republic of North Macedonia, one of those small former Yugoslavian economies with a population of around 2 million, cannot benefit from economies of scale (Petkovska & Jovanovic, 2015). Therefore, it needs to pursue an export-based growth strategy to improve growth and prosperity. Furthermore, only the foreign market can provide an accurate picture of the national economy's efficiency and competitiveness. The export expansion improves domestic company performance, increases flexibility, and supports external debt payments by increasing foreign capital inflows.

This research paper first provides definitions of competitiveness and competitive advantages. It then looks at the Macedonian economy's competitiveness using the real effective exchange rate (REER) and the global competitiveness index (GCI) for 1996-2019. Additionally, it compares the other local economies' export and import trends with the Macedonian economy and looks closely at the export potential to identify opportunities and weaknesses. The analysis of these variables provides a solid basis for future recommendations for policymakers when creating competition policies and future improvements in the Macedonian economy's competitive position.

This study aims to provide insight into the Macedonian economy's competitive position, identify some of the country's weaknesses, and provide policymakers with some recommendations. The motivation for this research comes from the lack of available literature on the country of North Macedonia. The existing literature usually takes only one or a few aspects of competitiveness and needs to look at the overall competitiveness level of the country. For instance, Eftimovski and

Milenkovski (2012) focus on the Knowledge Index for the years 1995 and 2009/10, while Tuna, Georgiev, and Nacka (2013) focus on the tobacco industry for the period 2005-2010.

1. Competitiveness and Competitive Advantage

Competitiveness has many definitions, so according to the IMD World Competitiveness Center, competitiveness "analyzes the facts and policies that shape the ability of a nation to create and maintain an environment that sustains more value creation for its enterprises and more prosperity for its people" (S. Garelli, *IMD World Competitiveness Yearbook 2009*). According to OECD, competitiveness measures a country's advantage or disadvantage in producing and selling its products in international markets to maintain or improve the population's real income. According to Velloso (1991), international competitiveness is defined as a country's capacity to maintain and increase its market share in the global market by adhering to international standards for production efficiency and quality. The World Economic Forum, also one of the most cited definitions, defines competitiveness as "a set of institutions, policies, and factors that determine the level of productivity of a country," which in turn "sets the level of prosperity that an economy can earn." Competitiveness is closely tied to the economy's ability to generate and sustain long-term growth when defined in this way. To put it another way, more competitive economies are predicted to have more excellent growth rates.

When talking about competitiveness, Michael Porter's and Porter's diamond are inevitably to be mentioned. According to him, every national economy's primary economic purpose should be to improve long-term growth and offer its citizens a more excellent quality of life. Long-term growth can be achieved only through the efficient use of resources, such as labor and capital (Petkovska & Jovanovic, 2015). He goes on to say that defining competitiveness at a national level is incorrect. Instead, one should examine the economy's various sectors, as well as their sub-sectors. Porter proposes the idea of competitive advantages, sometimes known as Porter's "diamond" of competitiveness, to explain why one firm has a competitive advantage over other local and foreign enterprises. This "diamond" is formed from four fundamental factors: factor conditions; demand conditions; related or supporting industries; and firm strategy, structure, and rivalry. Companies can obtain a competitive advantage using the right combination of those factors.

Competitiveness can be observed at three levels: macro, mezzo, and micro. On a macro level, competitiveness refers to a country's ability to manufacture and distribute goods and services on worldwide markets and compete with goods and services produced by other countries to raise its population's living standards. The micro aspects of competitiveness concern domestic enterprises' ability to compete, grow and gain profitability in the market. In contrast, the mezzo aspects are concerned with the competitiveness between economic sectors in a country. These three levels are, in essence, linked. More substantial company competitiveness leads to higher sector competitiveness and a better overall competitive position for the economy. The opposite is also true. In some ways, competitiveness is an aggregate indicator of a country's international rating; it is a mix of the performances of enterprises, sectors, and the economy as a whole (Petkovska & Jovanovic, 2015).

This paper will use two of the most common indicators when analyzing competitiveness: the real effective exchange rate (REER) and the global competitiveness index (GCI), to observe the competitive advantage of the Macedonian economy and its competitive position concerning other local economies.

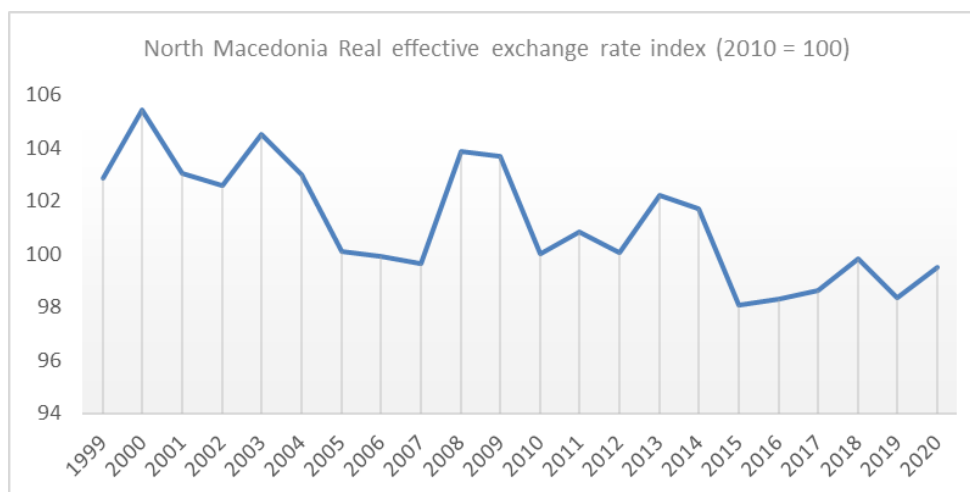
2. The Real Effective Exchange Rate (REER)

The actual exchange rate measures the national currency's undervaluation or overvaluation. If the national currency is undervalued, it will boost competitiveness by making domestic items more affordable to foreigners, boosting exports and GDP. On the other side, an inflated domestic currency will negatively impact competitiveness. The real exchange rate is the domestic and foreign prices ratio of saleable goods. The consumer price index is commonly used to estimate the domestic prices of tradable goods.

Regarding competitiveness, the real effective exchange rate (REER), defined as the ratio between domestic prices and the prices of the country's most important trading partners, is a more informative metric. REER is defined as a ratio of domestic to foreign prices; thus, an increasing trend indicates a genuine appreciation of the home currency, which reduces competitiveness (Јовановиќ, 2015). Figure 1 depicts the REER trend in the Republic of North Macedonia from 1999 to 2020. Between 1999 and 2020, there was a slight downward trend, with the REER index

decreasing from 103 to 100. Regarding growth rates, the average rate of change is almost zero, which shows that REER movements were substantially balanced during the study period. In economic terms, this indicates that REER does not show any substantial advances or deterioration in the Macedonian economy's competitive position between 1999 and 2020.

Figure 1. Real effective exchange rate index in the Republic of North Macedonia (1999-2020)



Source: <https://data.worldbank.org/indicator/PX.REX.REER?locations=MK>

Even though REER is one of the most used indices of an economy's competitive standing, one cannot exclusively rely on one indicator to conclude a country's competitive position, mainly since REER only provides data on one component - price competitiveness. Prices are a key competitive factor, particularly in economies with lower per capita incomes, where the market is more sensitive to price fluctuations, and in marketplaces with standardized products (such as the commodity markets). When it comes to more sophisticated items (items with a higher degree of finalization), however, the relevance of price as a competitiveness factor decreases, while the influence of so-called non-price competitiveness variables increases. Non-price competitiveness elements such as product quality, shape, use, certainty, reliability, delivery time, guarantees, servicing, and so on have become increasingly relevant in the previous three decades, according to the empirical

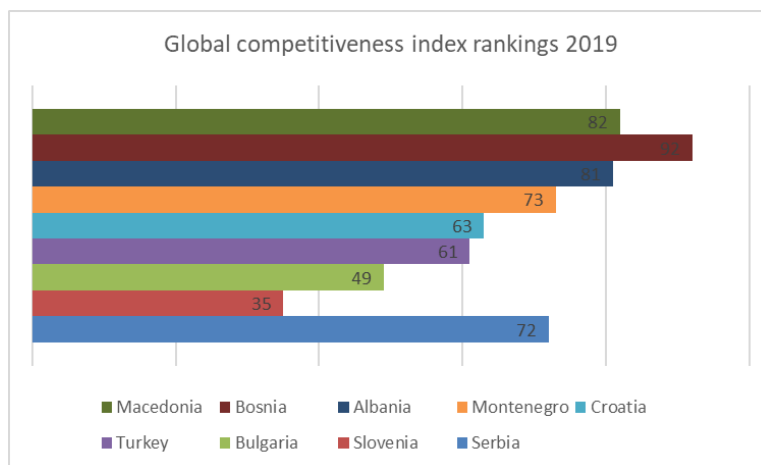
literature. Using non-price competitiveness variables allows organizations to be more flexible in their business plans, influence buyer preferences, and create demand for targeted items.

3. Global Competitiveness Index (GCI)

Since competitiveness is a complicated mixture of numerous aspects of a country's economy, it cannot be measured solely by one indicator, as previously stated. This explains why many institutions have developed a variety of methodologies, models, and indicators targeted at measuring, estimating, and comparing competitiveness between countries. The World Economic Forum created one of the most widely used methodologies for determining competitiveness (WEF). The WEF methodology considers various elements that influence a country's competitiveness. Unlike other techniques, it begins at the micro-level, i.e., a country's economy is competitive if its enterprises are competitive on the global market (Schwab, 2019).

The WEF's global competitiveness index is a multidimensional indicator that measures various aspects of competitiveness (unlike the REER index, which is focused solely on price competitiveness). In some ways, the WEF index describes a country's various stages of development through the dynamics of economic growth. Every country begins at stage one, when essential factors determine growth, then moves on to stage two, when the country develops and invests, and finally, stage three, when the country focuses on stimulating innovation and research to sustain and enhance growth. Following this logic, the WEF index divides economies into three stages: factor-driven, efficiency-driven, and innovation-driven, with each stage reflecting a higher level of economic complexity. The overall index is a weighted average of three sub-indices: basic requirements, efficiency enhancers, and innovation and sophistication elements. The weights of these sub-indices are different for every country; the country's development level determines them. For example, suppose a country is defined as being in the factor-driven stage, where fundamental elements drive growth. In that case, the sub-index of basic requirements will have the highest weight in the total index and, as a result, the most significant impact on the country's competitive position.

Figure 2. Global competitiveness index rankings (2019)



https://todata360.worldbank.org/indicators/gci?country=BRA&indicator=632&viz=line_chart&years=2007,2017

Figure 2 depicts the GCI in the Balkan countries (and Turkey) in 2019. The results placed Bosnia and Herzegovina at the 92nd position, followed by North Macedonia at the 82nd position and Albania at the 81st position, then Montenegro and Serbia at the 73rd and 72nd position, Croatia at the 63rd, Turkey at the 61st, Bulgaria at the 49th position, and finally Slovenia at the best 35th position. With an all-time high GCI of 57.33 and a second-to-last competitive position compared to other countries in the region, the Republic of North Macedonia is struggling with its competitive level.

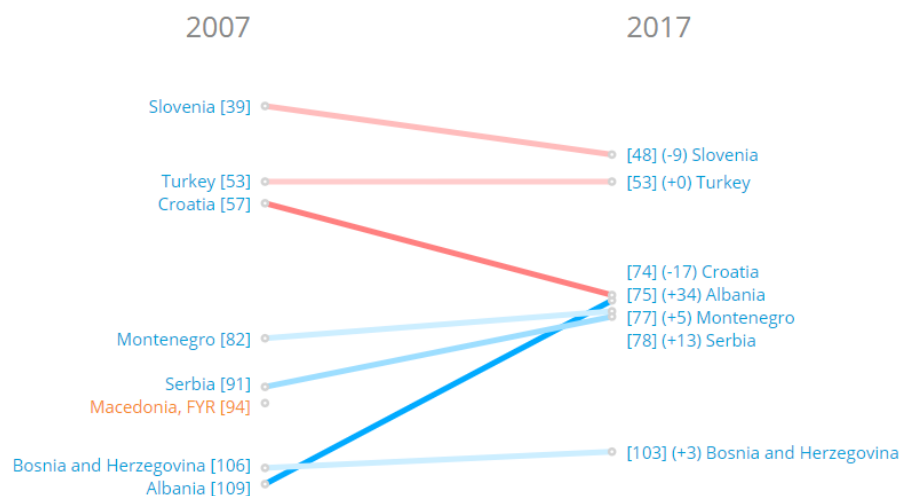
Looking at the period prior to 2019, the situation is not much different. Figure 3 represents the competitive position of North Macedonia and the selected local economies over the period 2007 - 2017. The world median ranking is also there for better comparison. When looking at the competitive position of the Macedonian economy over time, the global competitiveness index shows that it has been improving over time and deteriorating over the last few years. The index's value has risen from 94th in 2007 to the all-time lowest 60th in 2015 to 68th in 2016 from 137 countries. There is no information for North Macedonia for 2017. This was a prosperous decade for North Macedonia since the country climbed the ladder to 26 places.

Similar results witnessed Bulgaria and Albania improving their rankings on the ladder of world GCI rankings. Bulgaria, from the 79th position in 2007, went down to the 49th position in 2017,

jumping by 30 in rank. Albania, from the 109th position in 2007, improved its position to 75th place in 2017, jumping in rank by 34 places. Serbia and Montenegro also made slightly less impressive improvements. Serbia went from 91st place in 2007 to 78th place in 2017, going up by 13 places on the ladder of 137 countries, while Montenegro improved by five places in rank from the 82nd in 2007 to 77th position in 2017. Turkey is the only country in the region that, despite the slight fluctuations during 2007-2017, managed to stay in the same 53rd position. On the other side, Slovenia and Croatia went down for several ladders. Slovenia went down by 9 in rank for the Global Competitiveness Index from 2007 to 2017. From the 39th position in 2007, the country went down to the 48th position in 2017. From the 57th position in 2007, Croatia ranked 74 out of 137 countries in 2017. The country that performed worse in the region during that decade was Croatia which went down by 17 in rank.

Compared to the world median of 70, all countries in the region, except for Slovenia and Turkey, were above the world median, which signifies the need for further improvement in all six Balkan countries.

Figure 3. Global competitiveness index rankings 2007-2017



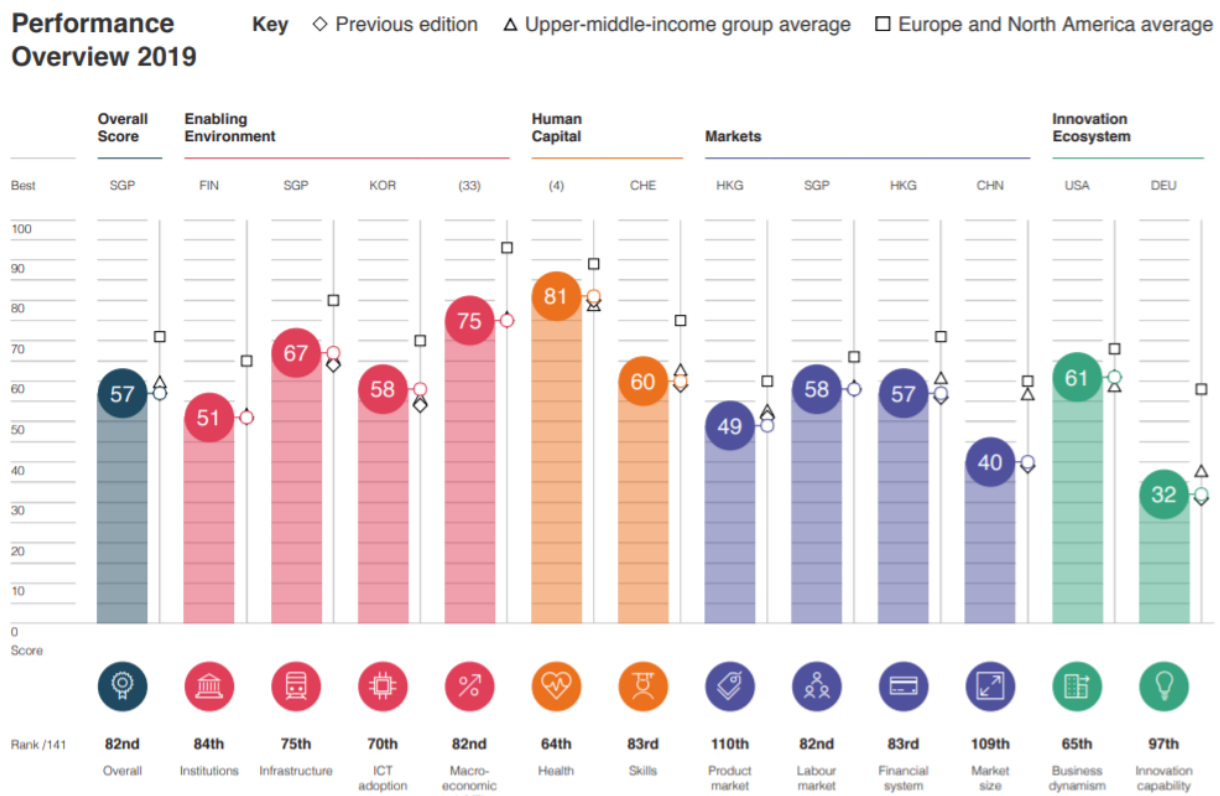
https://todata360.worldbank.org/indicators/gci?country=BRA&indicator=632&viz=line_chart&years=2007,2017

Following, the study observes the sub-indices from 2019, which show that the Republic of North Macedonia has the best ranking in the Enabling environment, i.e., the basic requirements, whereas

the worst in the area of Innovation Ecosystem, i.e., the innovation and sophistication factors (Figure 4). This is an expected result given that North Macedonia has moved from the first stage, when growth is determined by primary factors, to the second, efficiency-driven stage, when the country develops and invests. The country needs to prepare to transition from the second stage to finally reach stage three of development when it focuses on stimulating innovation and research to sustain and enhance growth.

The weakest performance in innovation is not expected. Still, it is essential to start preparing for the transition by investing in policies promoting sophisticated business practices and innovation. This result also implies that competition policies must be focused on promoting competitiveness and growth in the second stage of development, such as investing in health, education and skills, product and labor market efficiency, financial market development, and market size.

Figure 4. Performance overview of the global competitiveness index and the sub-indices (2019)



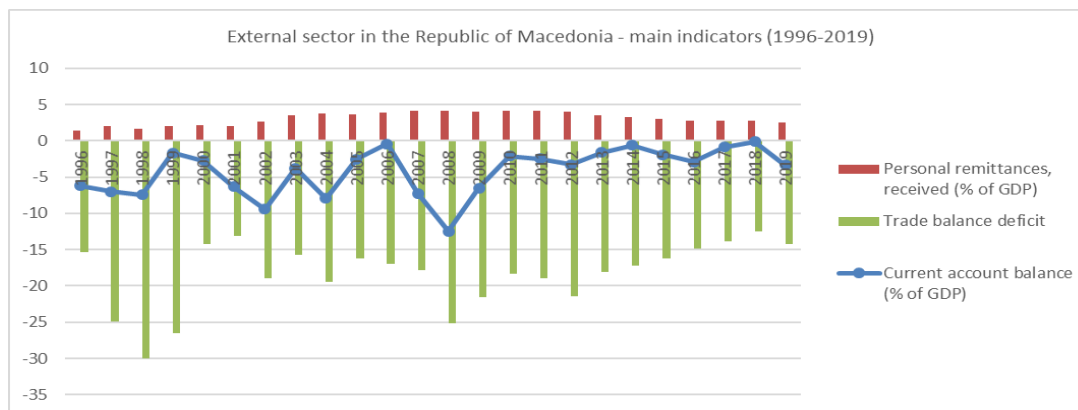
Sources: http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf

4. External Trade

Competitiveness and external trade are intertwined: a country's competitive position affects its exports, affecting its trade balance and current account deficit. This explains why increases in competitiveness are critical for small and open economies with a negative trade deficit like the Republic of North Macedonia. Following is a descriptive analysis of the external sector's movements in the Republic of North Macedonia, the export and import trends of the country compared to other selected local economies, as well as the structure of the exports.

During 1996-2019, the Republic of North Macedonia's average current account deficit amounted to 4.2% of GDP (Figure 5). The negative trade balance, which accounts for over 18 percent of GDP simultaneously, explains most of the deficit (average value for the period). As a result, of these features, the external sector is highly vulnerable to major external shocks, which can result in massive external imbalances. For example, as can be observed from the figure, a significant widening of the current account deficit and a considerable increase in the negative trade balance in 2008, the year before the global financial and economic crisis began. In 2008, the trade balance accounted for 26% of GDP, which was explained by increased domestic demand. This resulted in an increase in imports that was not matched by an equal export gain. This circumstance demonstrates how critical competitiveness and external trade structure improvements are for the current account balance's long-term sustainability and the country's overall economic stability and growth.

Figure 5. External indicators in the Republic of North Macedonia (1996-2019)



Source: Author's calculations with data from the World Bank and macro trends databases
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From 1996 to 2018, the average growth rate of goods exports was roughly 4.7% (WITS, 2020). Macedonian businesses mainly export to EU nations and the area. Table 1 below is represented the top five export and import partner countries of the Republic of North Macedonia from the last available data in 2019.

Table 1. Exports in the Republic of North Macedonia, five top countries (2019)

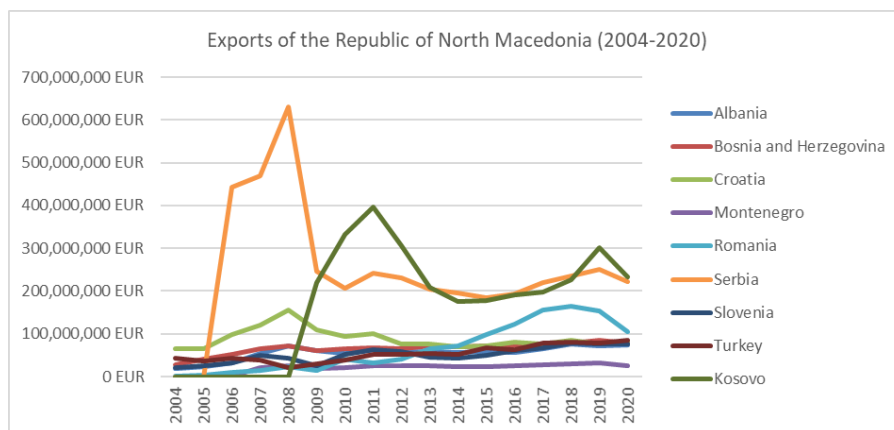
North Macedonia top 5 Export and Import partners		
Market	Trade (US\$ Mil)	Partner share(%)
Germany	3,502	48.73
Serbia, FR(Serbia/Montenegro)	611	8.50
Bulgaria	351	4.89
Belgium	239	3.32
Italy	195	2.71

Source: <https://wits.worldbank.org/countrysnapshot/en/MKD>

Germany is North Macedonia's biggest partner in terms of export and import, encompassing almost half of the country's total trade. In terms of US\$, the two countries exchanged goods worth 3,502 million US\$ in 2019. The following four biggest North Macedonia trade partners in terms of 2019 were Serbia, FR. (8.5%), Bulgaria (4.89%), Belgium (3.32%), and Italy (2.71%). Looking at the trends of the exports of all these countries, they have an increasing trend through the years.

Of the regional countries, during the period 2004-2020, the Republic of North Macedonia exported the most to Serbia and Kosovo (Figure 6). The export to Serbia was explicitly high during the period 2006-2009, reaching the highest pick point in 2008, amounting to around 631.5 million EUR. In 2009 when the country noticed a decrease in exports to Serbia, the same year noticed an increase in exports to Kosovo. For the next several years, from 2009 – 2013, Kosovo became the first on the list of regional countries that imported Macedonian products. From 2013 until 2020, Serbia and Kosovo are close to being top regional importers of Macedonian goods. Croatia held third place from 2004 -2014, replaced by Albania in 2014.

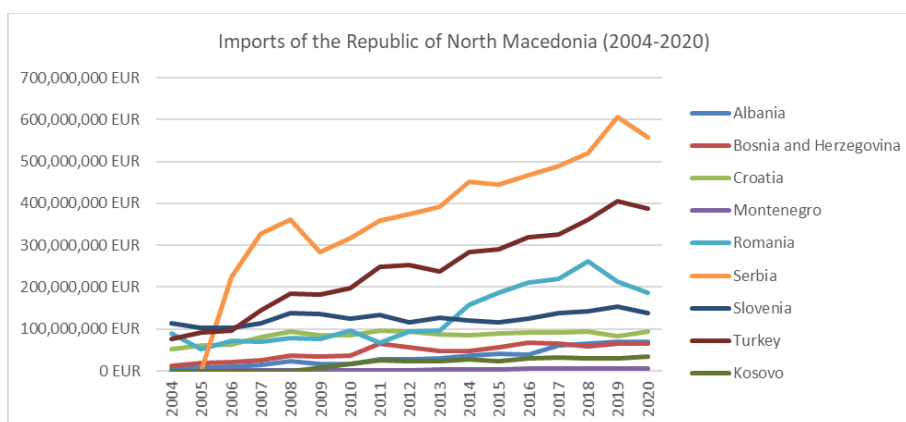
Figure 6. Exports of the Republic of North Macedonia (2004-2020)



Source: [State Statistical Office](#)

Looking at Figure 7 showing the imports of North Macedonia, it is noticed that Serbia is once again undoubtedly on the top. Serbia's exports to North Macedonia have continued to increase throughout 2005-2020 with the same tendency. Next in line is Turkey, which is also witnessing an increase in exporting Turkish goods to North Macedonia. The third place of biggest regional importers to North Macedonia was held by Slovenia in the period 2004 – 2013, being surpassed by Romania from 2014 to 2020. In Figures 6 and 7 in 2020, a decrease in imports and exports from all regional partner countries of North Macedonia can be noticed. This decrease was due to the situation with the Covid19 pandemic crisis and the closing of the borders.

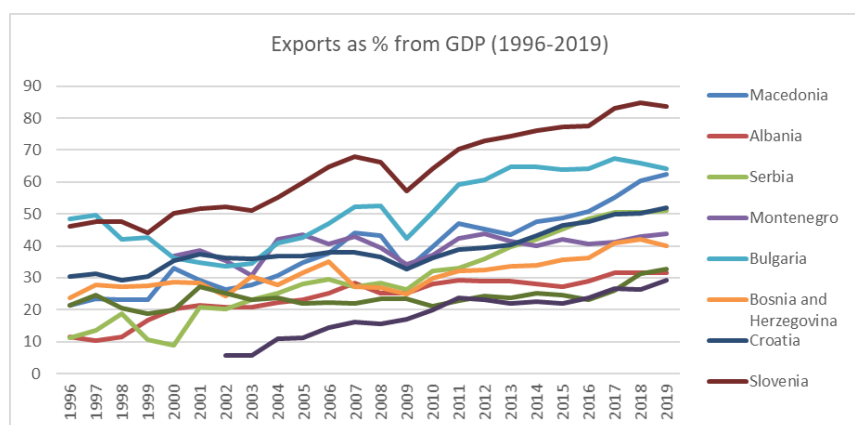
Figure 7. Imports of the Republic of North Macedonia (2004-2020)



Source: [State Statistical Office](#)

To better compare the exports as a percentage of the GDP, the study compares the Republic of North Macedonia with the other selected regional countries for 1996 – 2019 (Figure 8). All the selected countries from the region notice increasing trends of exports as a percentage of the GDP, with Slovenia leading the group, followed by Bulgaria. The steep rise in Slovenia started in 2003 when Slovenia entered the EU. The same situation happened with Bulgaria entering a trend of increase since 2007 when Bulgaria became a member of the EU. North Macedonia is currently in third place among the region's countries in terms of exports as a percentage of the GDP.

Figure 8. Exports as % of the GDP (1996-2019)



Source: <https://data.worldbank.org/indicator/NE.EXP.GNFS.ZS?locations=MK>

The Republic of North Macedonia exports a variety of commodities and manufactured goods, including iron and steel, chemical products, apparel, machinery, electrical equipment and electronics, and tobacco. To identify the potential export opportunities by-product of the Republic of North Macedonia, as well as the weaknesses such as low productive capacity, underdeveloped transport infrastructure, concentrated markets, and an inadequate business environment, Table 2 represents the following data:

Table 2. Export potential of the Republic of North Macedonia

Product group code / description	Exports (US\$ thousand)	What is the product's export potential in...?				Technology level	Price stability	Prominence of SMEs	Female labour participation
		Europe and Central Asia	non-OECD	OECD	Unrealized potential				
381512 Supportd catalysts,w precious metal/comps thereof as the activ subs	409,548								
720260 Ferro-nickel	283,083								
7306Xc Other welded tubes and pipes, of a kind used for oil or gas pipelines, of ir	58,621								
720851 Hot roll iron/steel, not coil >600mm x >10mm	121,328								
842139 Filtering or purifying machinery and apparatus for gases nes	113,766								
720221 Ferro-silicon, containing by weight more than 55% of silicon	48,734								
220429 Grape wines nes,incl fort&grape must,unfermtd by add alc,in ctr > 2l	41,856								
720852 Hot roll iron/steel, not coil >600mm x 4.75-10mm	47,459								
620520 Mens/boys shirts, of cotton, not knitted	94,666								
853710 Boards,panels,includg numerical control panels,for a voltage <=1000 V	58,191								
721070 Flat rolled prod,i/nas,painted,varnished or plast coated,>/=600mm wide	46,629								
640610 Uppers and parts thereof, other than stiffeners	22,345								
300490 Medicaments nes, in dosage	48,278								
730630 Tubes,pipe & hollow profiles,iron or nas,welded,of circ cross sect,nes	25,096								
720230 Ferro-silico-manganese	30,892								
160100 Sausage&sim prod of meat,meat offal/blood&food prep basd on these pro	12,060								
620630 Womens/girls blouses and shirts, of cotton, not knitted	47,063								
151219 Sunflower-seed/safflower oil&their fractions reind but nt chem modifd	10,596								
020410 Lamb carcasses and half carcasses, fresh or chilled	18,541								
6403XX Other footwear, outer soles of rubber/plastics uppers of leather	38,740								

Notes: Top 20 products listed in decreasing order of their export potential to the world. Development indicators are relative to the country's current situation, green indicating performance above its trade-weighted median and red otherwise. A blank cell indicates that data are not available. A blank cell in export potential means that the product was not consistently demanded over five years by any country in the respective region. Exports (US\$ thousand) correspond to average exports to the world over the period 2009-2013.

Source: <https://www.intracen.org/country/the-former-yugoslav-republic-of-macedonia/>

The table above shows that the Republic of North Macedonia concentrates its export on mainly supported catalysts. It has more than 50% unused export potential in almost all other industries. As a small country with an open economy, the changes in the country's domestic economy are heavily influenced by external markets and changes in world prices. This high degree of export concentration in only a few critical industries, whose proportion of global export is declining, and the high levels of unused export potential for all other industries for most of the markets, are two significant vulnerabilities in the Macedonian economy. Suppose the Republic of North Macedonia wants to boost economic growth and raise citizens' living standards. In that case, it will be critical to consider the links between competitiveness, the external sector, economic growth policies that

promote export diversification, improvements in the energy sector (to reduce reliance on energy imports), and increased competition.

Conclusion

This study used two indicators – the real effective exchange rate (REER) and the WEF global competitiveness index (GCI) – to give a descriptive analysis of the Macedonian economy's competitive status. Looking at the REER statistics, one may infer that movements are primarily balanced. To put it another way, REER does not show any notable improvements or worsening in the Macedonian economy's competitive position between 1999 and 2020, even though the REER index is slightly declining. However, as a result of the complexity of the competitiveness, the REER index is not sufficient when measuring the country's competitive status purely, as it only provides data on one side of competitiveness — price competitiveness. Price competitiveness refers to the ability of enterprises (or countries) to sell lower-cost goods. Non-price competition criteria, such as product quality, shape, usability, certainty, reliability, delivery speed, guarantees, and services, are becoming increasingly relevant today.

The WEF's global competitiveness index (GCI) is a multidimensional indicator that measures various aspects of competitiveness. The study concludes that the Republic of North Macedonia has the lowest score in innovation capability and needs to work on that part to improve its ranking. However, this is expected since the country is in the second stage of development, i.e., the efficiency-driven stage. Suppose the country wants to improve its competitive position in the medium term. In that case, competition policies should focus on developing human capital capacity, increasing products and labor market efficiency, and developing financial markets and market size. In order to prepare for the transition from the second to the third stage of growth, the Republic of North Macedonia will also need to invest in policies that support advanced business practices and innovation.

External trade is another concept intertwined with competitiveness. The Macedonian economy is highly reliant on exports in a few industries, making the Macedonian economy more vulnerable to adverse external shocks. The negative trade balance accounts for about 26% of GDP, while the average growth rate of goods exports was roughly 4.7% (1996-2019). Macedonian businesses were

mainly exported to Germany, followed by Serbia, Bulgaria, Belgium, and Greece. Of the regional countries, the Republic of North Macedonia exports the most to Serbia and Kosovo while importing most goods and services from Serbia and Turkey. Analyzing the unused export potential, the opportunities and the weaknesses were also recognized.

Long-term economic growth relies heavily on competitiveness. Competitiveness gains are contingent on adopting a "healthy," business-oriented economic policy, responsible and accountable behavior by all economic agents, and a stable political and economic environment. Attitudes toward competitiveness as a critical factor in the Macedonian economy's integration into global economic trends should be reflected at all levels of the economic and political system. Competition policies and policies that promote exports should receive special attention and support to reduce the degree of concentration, increase the competitiveness of Macedonian companies on the global market, attract new foreign direct investment, and improve long-term economic growth and the standard of living in the economy.

Finally, it is clear that although North Macedonia still has a long way to go before it can compete with innovation-based economies, it is showing a slight inclination to move in that direction. In general, Macedonia should step up its efforts to provide better high education and training, new infrastructure, more sophisticated corporate practices, and more innovations to increase its competitiveness.

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