

# Evaluating foreign trade specialization and qualitative competitiveness of a transition economy: the case of Macedonia

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**Abstract** A certain country can increase production and welfare only if it produces in industries in which price is not the single factor explaining the competitive edge. This paper attempts to assess the *qualitative competitiveness* of Macedonia as a candidate country for European Union (EU) accession. EU remains a main trading partner of the country, making up around two-thirds of its foreign trade. Having a small economy implies that Macedonia has to rely mainly on export-led growth. As such, addressing external competitiveness has become a more prominent issue than ever before, while improving the competitiveness is quite important in terms of EU accession. We calculate *unit values* to signal the Macedonia's quality position, and then perform a country-specific segmentation of markets according to the *revealed price elasticity* concept (REVELAST 1). The findings suggest that Macedonia exhibits low export unit values due to the country's specialization mostly in industries at the lower end of the quality spectrum. The analysis of product groups indicates a certain weakening—inadequate position prevails both for the levels and the type of competitive performance. The rising number of product groups in the segment with structural problems is particularly worrisome, and specifically for sectors which are the most important for achieving competitiveness with dynamic potentials. The only way for Macedonia to establish an adequate structure of foreign

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trade and higher levels of competitiveness is to create an appropriate environment, so that some product groups of this segment move into the segments of successful quality—and/or price competition.

**Keywords** Trade specialization · Qualitative competitiveness · Transition economy · Unit value · Revealed price elasticity · Standard International Trade Classification

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## 1 Introduction: quality and competitiveness

The empirical evidence on trade patterns reveals the evolution of competitiveness, accounting for some of its different aspects (Benkovskis and Wörz 2012a). The *prices* take much lower role in gaining international competitiveness—the more sophisticated the products are, the easier to preserve will be the firm’s monopoly power. Countries with technology lagging behind will have to specialize in sectors where prices continue to be an important factor of competitiveness (commodities, for example). They position themselves at the lower end of the quality spectrum and build their competitive performance mostly on lower wages and intensive use of energy and/or environmental resources (Wolfmayr-Schnitzer 1998). Yet, the competitiveness based exclusively on prices may easily get lost. The new competitors arrive with much lower absolute costs and, even after adjusting for productivity differences also lower unit labour costs. The consequence is to compete (if possible) with *quality*. However, the concept of quality is very difficult to define precisely, as the consumer taste preferences and their quality requirements change over time. In a certain context, a high quality product could be described as a ‘*good which possesses one or more additional characteristics, which are valued by buyers*’ (Aiginger 2000, p. 4). The attributes which increase the willingness to pay may be either physically measurable (e.g. size, speed) or, they could be intangible (e.g. reliability, design, goodwill). In essence, quality improvements are related to more noble materials, sophisticated capital, skilled labour, research and development, extra stage of processing, etc. Setting standards, benchmarking and submitting to certifications are the other techniques for improving the quality of processes and products. The higher quality, typically, allows for charging a higher price without losing the market—an important strategy for firms to defend their price is to differentiate products along key features or minor details. At market level, differentiation is the way to improve the quality of products over time thanks to innovation. The radical change, which refers to new products with entirely new performance, often leads to changes in industry structures and market shares. The phenomenon that several goods can be ordered according to their quality from the highest to the lowest is commonly referred to as *vertical product differentiation*. The quality-price relationship is typically upward sloping, both because of the higher production costs and the expected advantages for clients, partly reflected in higher margins. This means that consumers, which do not have personal opinion or