



# North Macedonia Systematic Country Diagnostic Update 2023

April 2023



**THE WORLD BANK**  
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# Content

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**Updated country context since the 2018 SCD and where is North Macedonia today?**

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What key emerging trends will shape its development?

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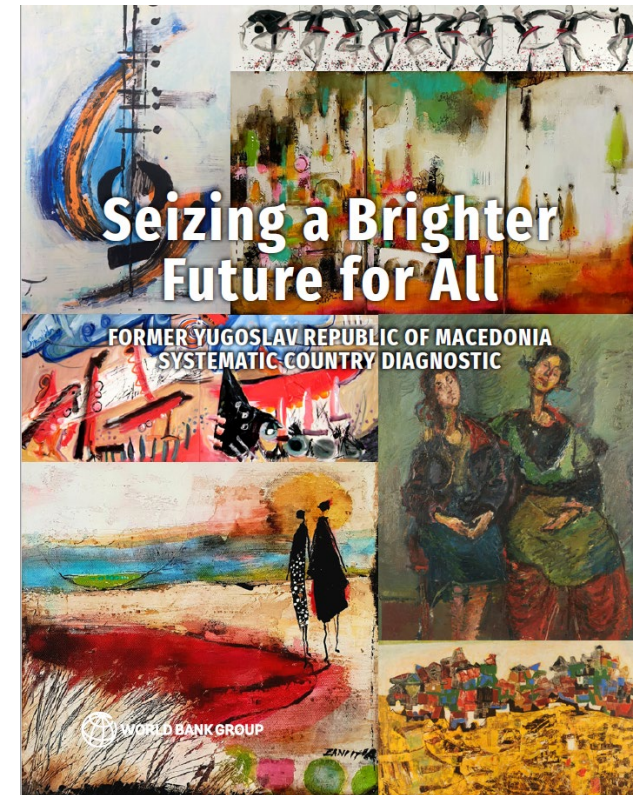
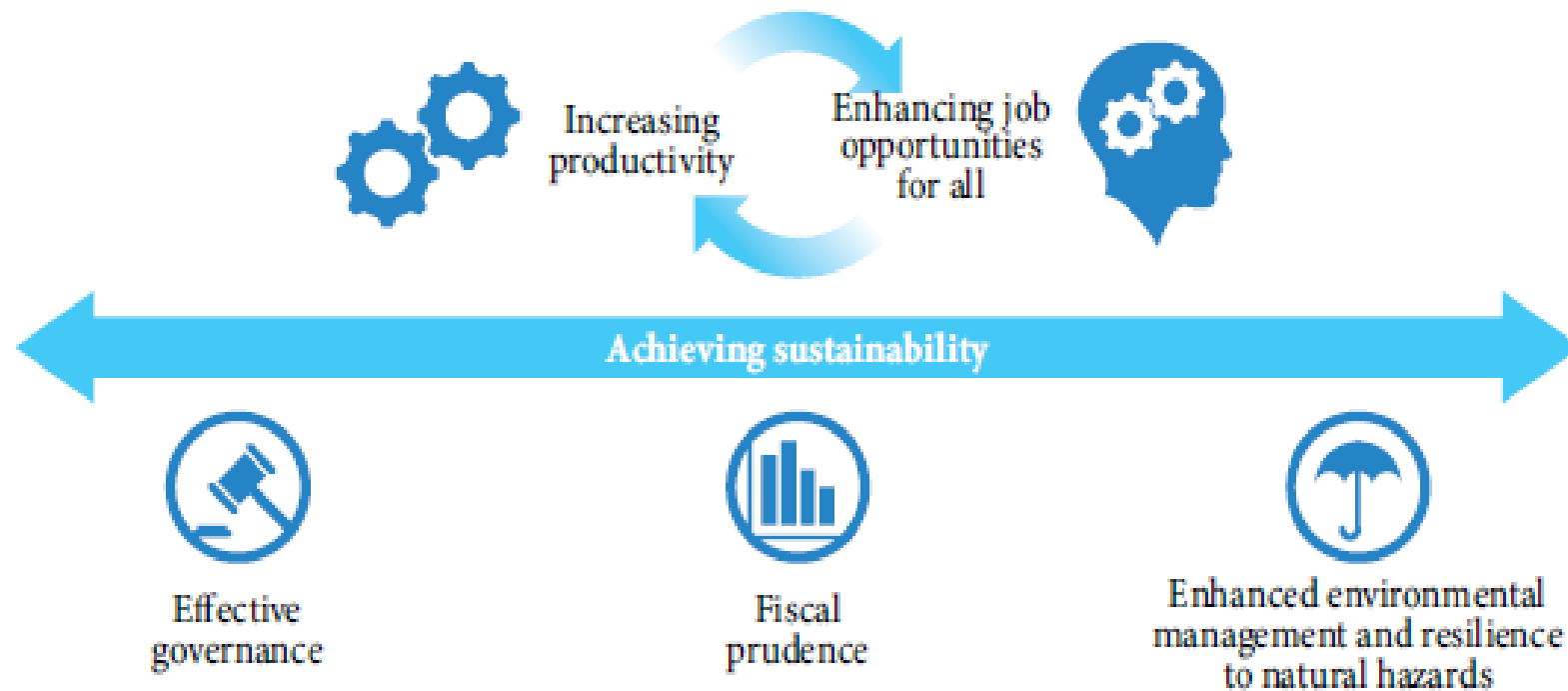
**What are the constraints for sustainable, inclusive, and resilient growth?**

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High-Level Objectives and Priorities

# 2018 SCD Storyline remains largely valid to this day

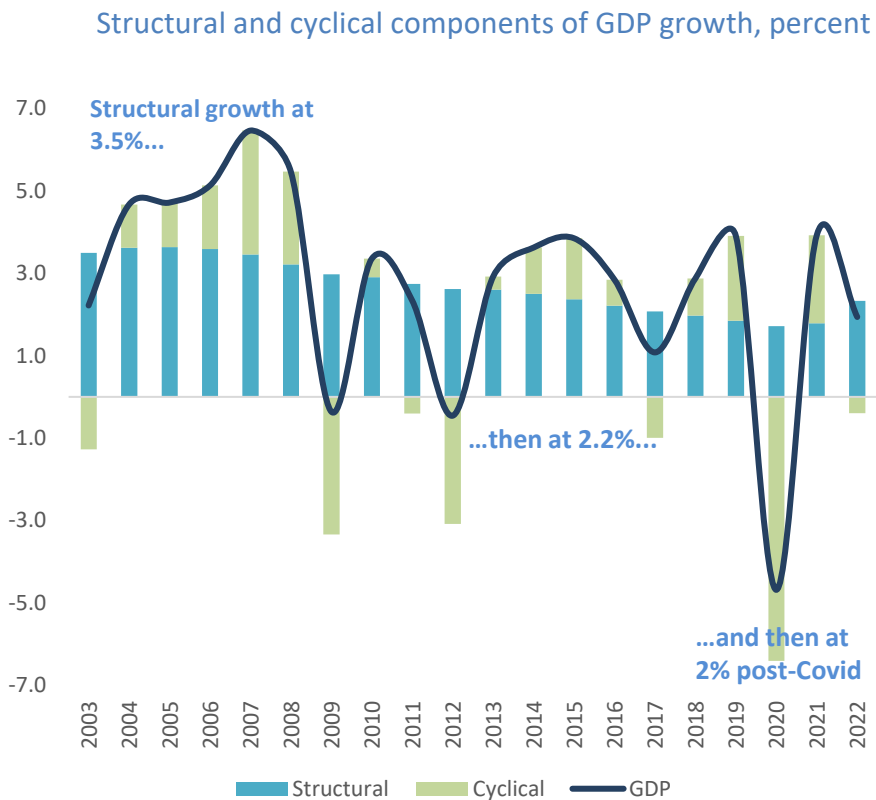
Faster, more inclusive, and sustainable growth will require...



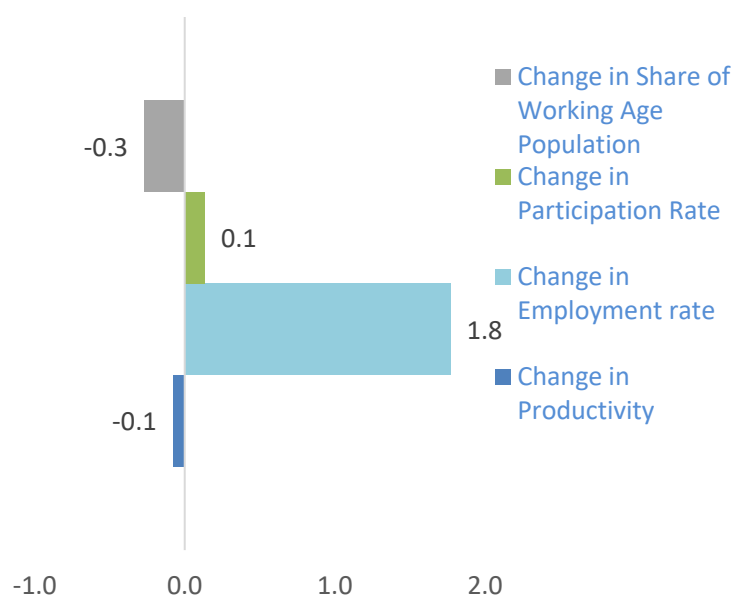
The launch of the EU accession process is the new opportunity.



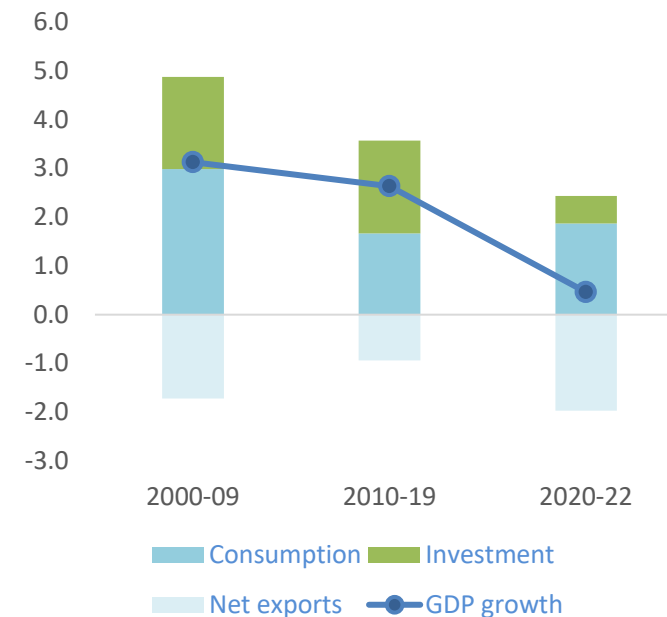
# Economy recovered fast after the pandemic, based on employment-led growth and consumption



Shapley Decomposition of Per Capita GDP Growth, 2017-2021, Percent



Decomposition of GDP growth over time, percentage points



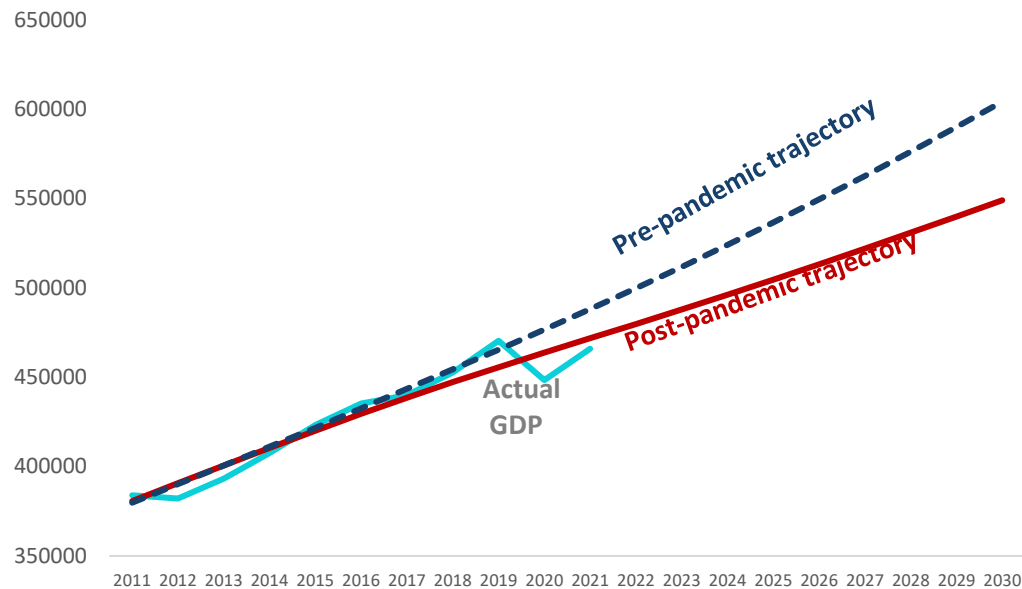
Source: State Statistical Office and World Bank staff calculations.

**Growth recovered fast, but potential growth dropped to 2% post-Covid-19.**

**Net exports contributed negatively to growth, while consumption led the recovery, as employment improved.**

# But potential growth slowed and EU income convergence remains weak...

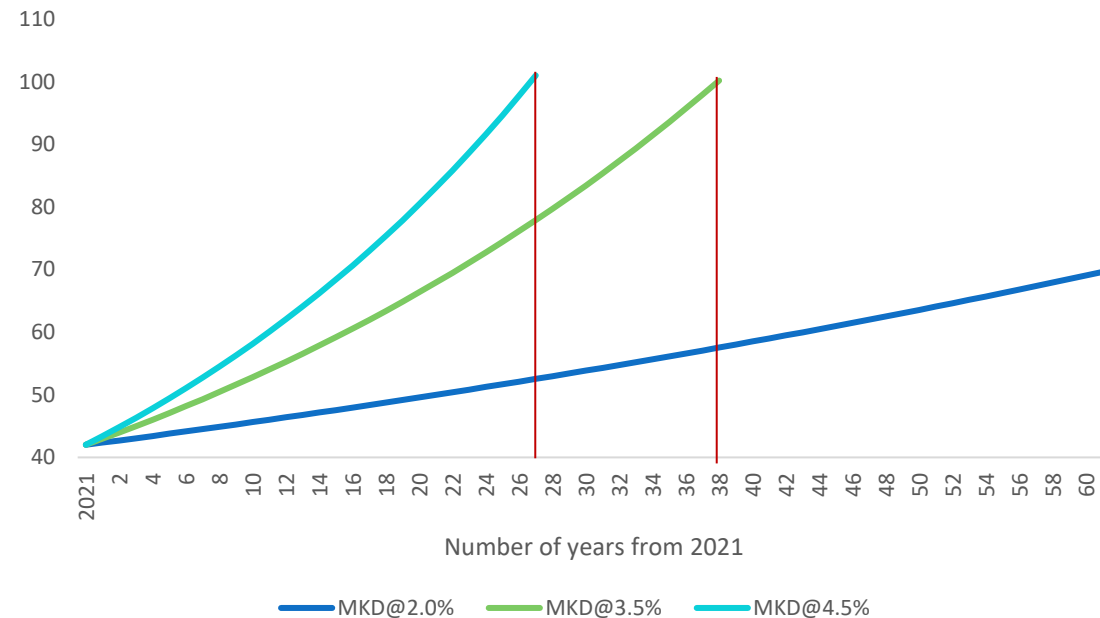
Potential growth pre- and post-pandemic, MKD million



Source: State Statistical Office and World Bank staff calculations.

**Pandemic left permanent welfare scars for Macedonian citizens.**

Every percent counts: simulation of convergence of GDP per capita (at PPS) with EU

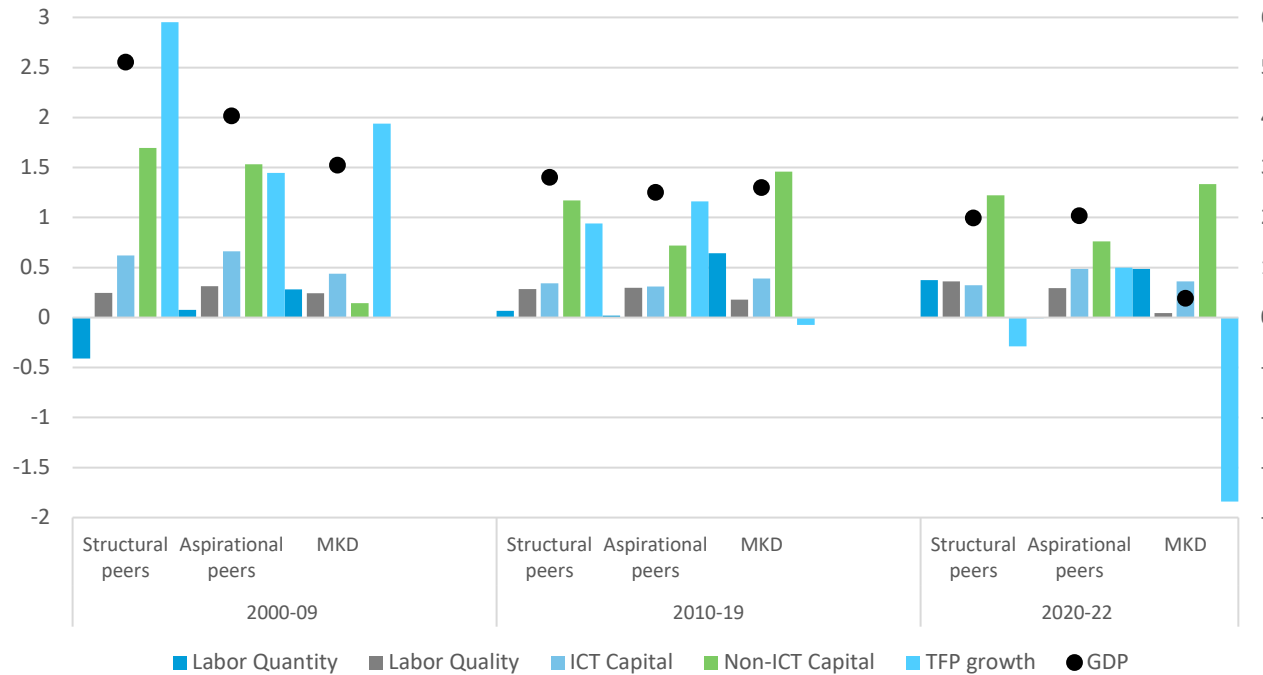


Source: Authors' calculations based on data from WDI and Eurostat.  
Note: EU27 long-term per capita growth at 1.16%.

**Convergence with the EU income level improved: at 41.5 percent of EU27 in 2021 (3 pp up since 2019). But with the current growth rate the EU average will not be reached within three generations.**

# ...due to low and declining productivity, skills, and demographic

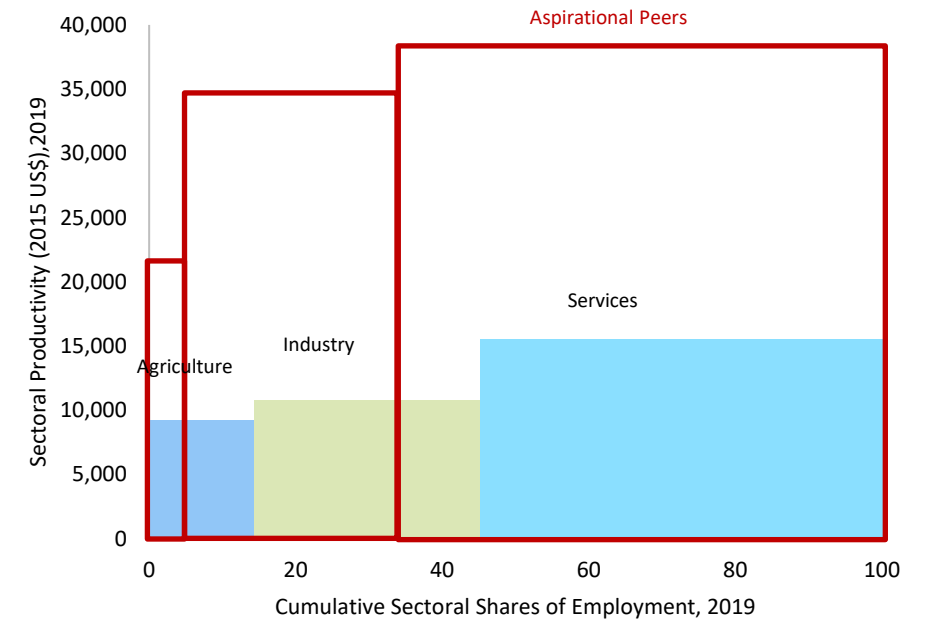
Labor, capital and TFP contribution to growth, percentage points



Source: TED.

**TFP contributed most to growth prior to the GFC but remained largely muted or negative in the period that followed. Labor productivity was at 16.5 percent of EU27 in 2021.**

Productivity remains low across all segments of the economy

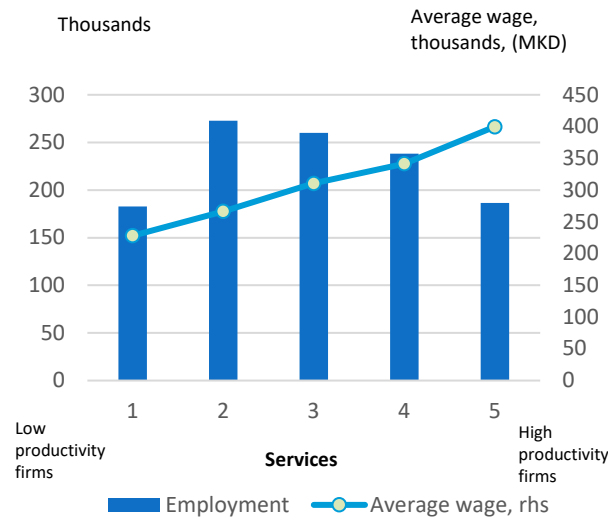
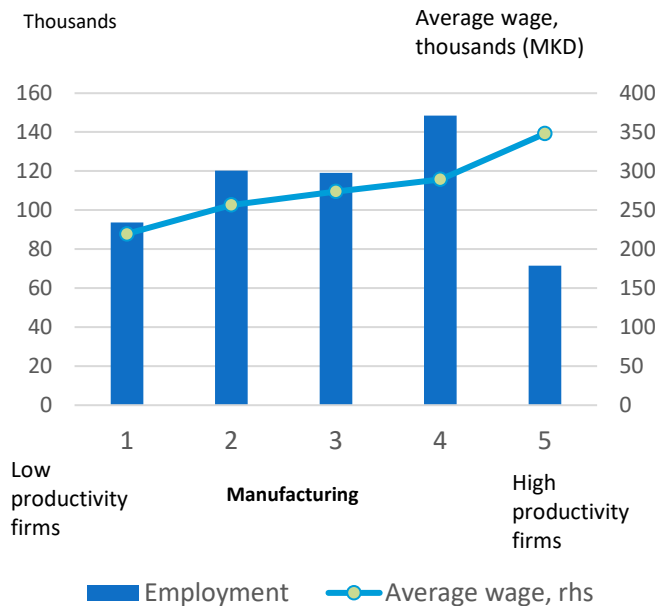


Source: Eurostat. Note: Aspirational peers are Croatia, Estonia, Latvia, Lithuania, Slovak R., Slovenia.

**Value added per worker is the lowest in industry compared to aspirational peers, although two-thirds of employment is in services at 40 percent productivity level of its peers.**

# Inefficient allocation of resources dragging productivity; more productive firms pay higher wages that helps reducing poverty

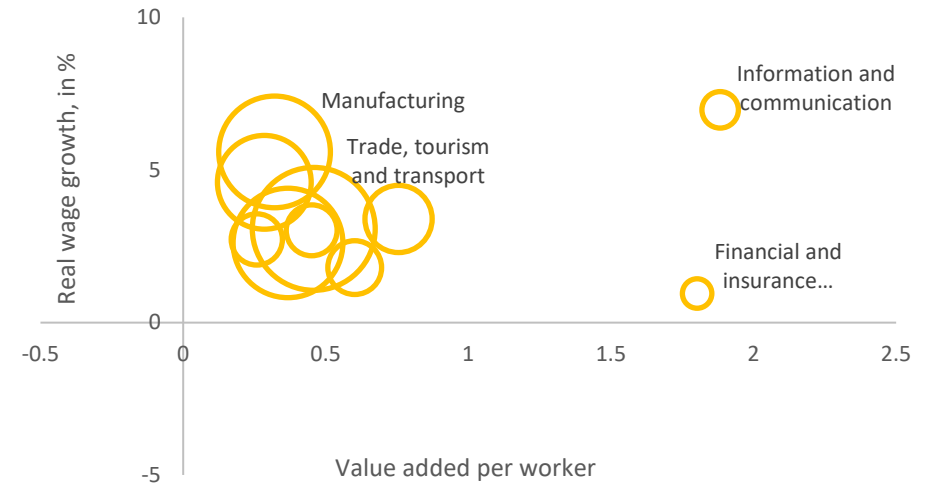
Employment and the average level of wages (by within industry TFPR quintile, 2018-2020)



Source: Authors' calculation based on data from the Central Registry.

**The most productive service firms paid on average 28 percent higher wages compared to the least productive service firms (2016-2020).**

Average annual growth in real wages, percent and value added per worker (bn MKD, 2017-2021)

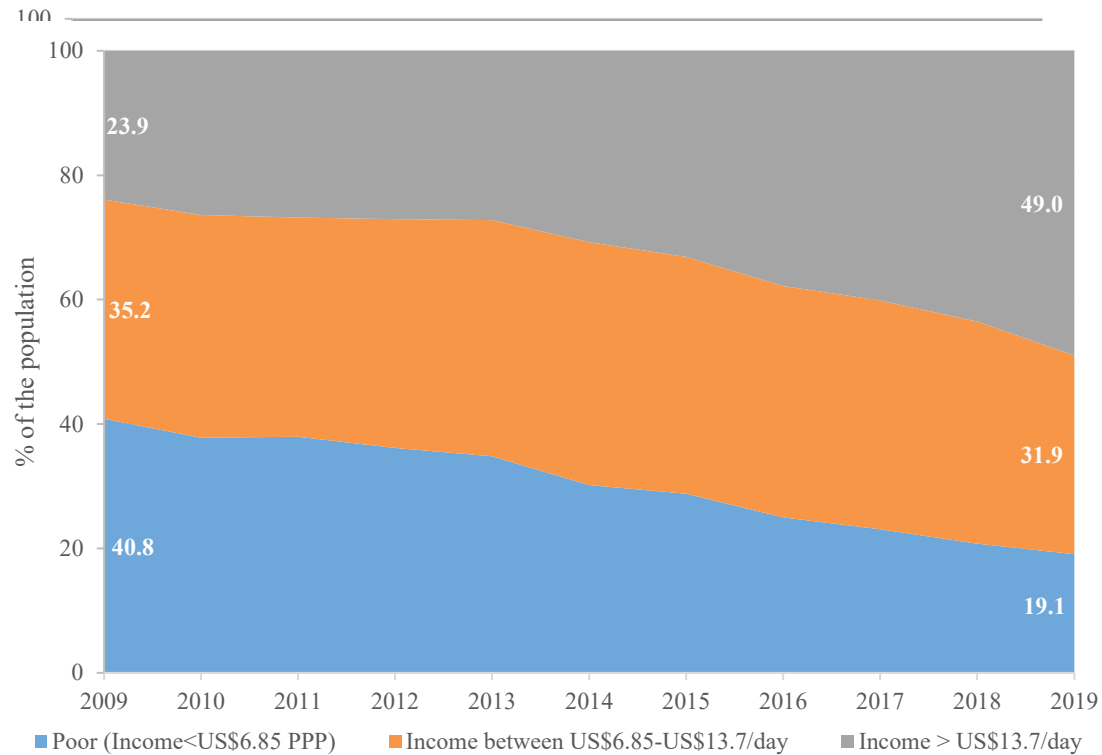


Source: Authors' calculation based on data from the State Statistical Office.  
Note: The size of the circles represents the size of the industry in terms of employment.

**Wage growth was strongest where value added per worker was highest (in ICT). However, largest employment in low productivity sectors.**

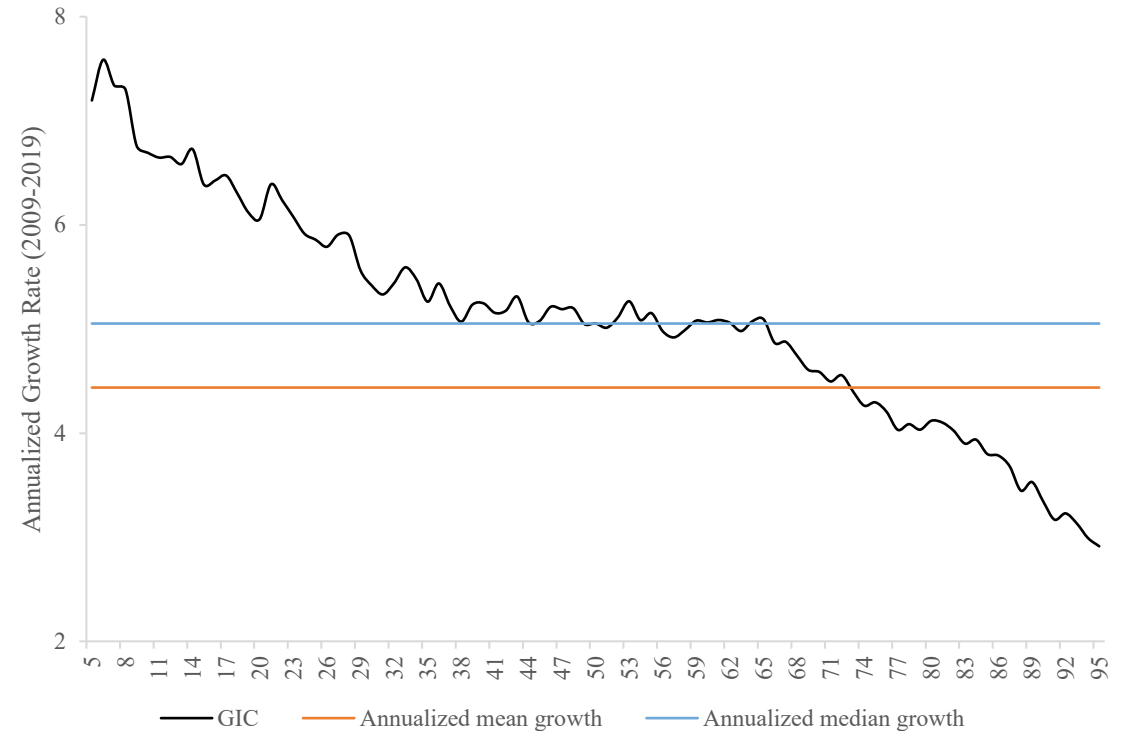
# While economic growth continued to benefit the less-well off, poverty remains relatively high, and about one-third of population remains vulnerable to shocks

Evolution of poverty in North Macedonia, 2009-2019



**In 2019, about one-third of the population remained vulnerable of falling into poverty if hit by a shock, such as pandemic or the energy crisis.**

Growth incidence Curve (GIC), 2009-2019



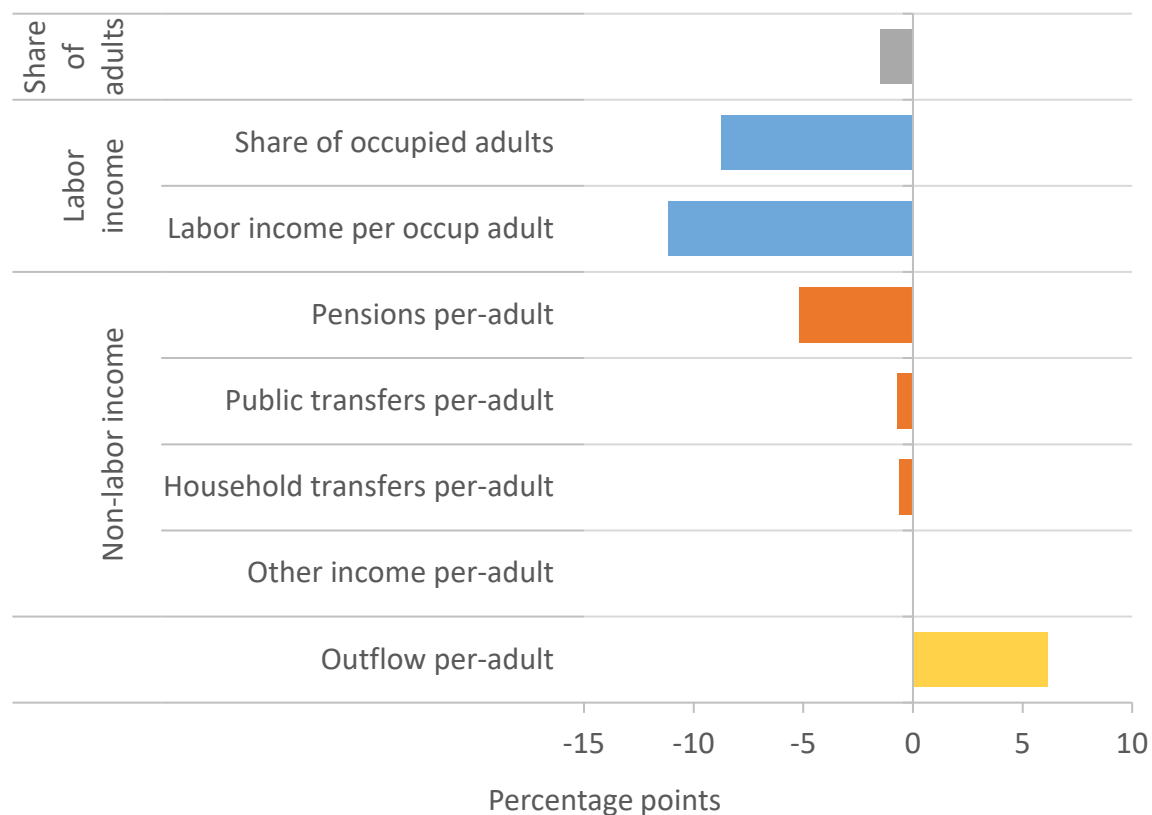
Source: Author's calculation based on SILC 2009-2019.

**The poverty reduction was led by a solid increase in incomes of the bottom 40%. Income growth contributed to approximately two-thirds of poverty reduction, while redistribution contributed the rest.**



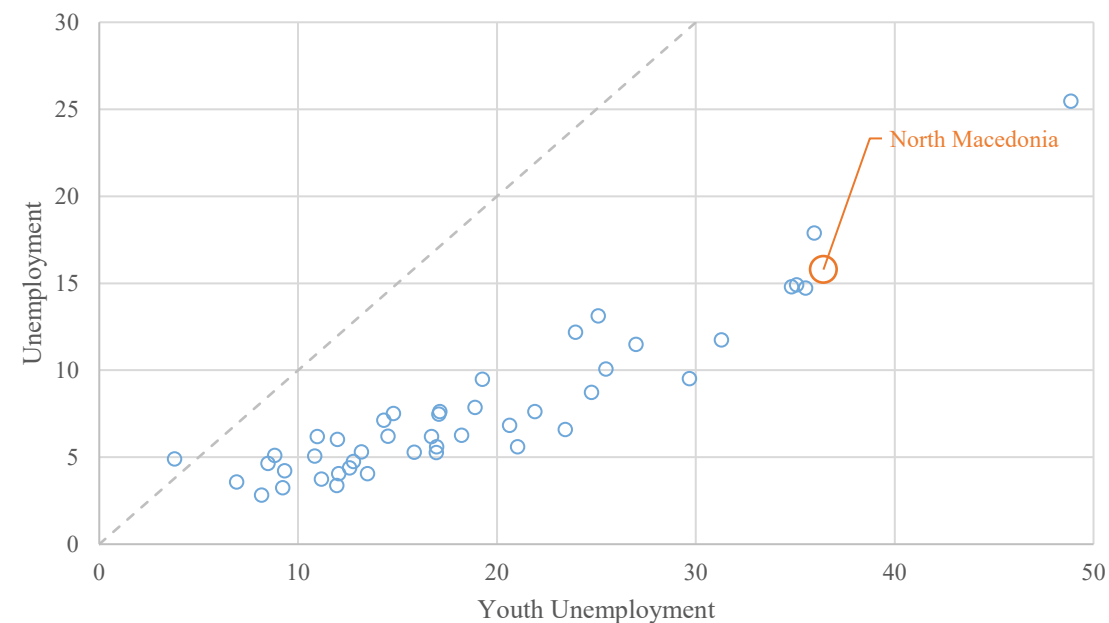
# Poverty reduction was driven primarily by improvements in employment opportunities and increases in labor earnings

Contribution of income components and employment to the change in poverty, 2009-2019



Source: Author's calculation based on SILC 2009-2019.

Total and youth unemployment rate, circa 2021

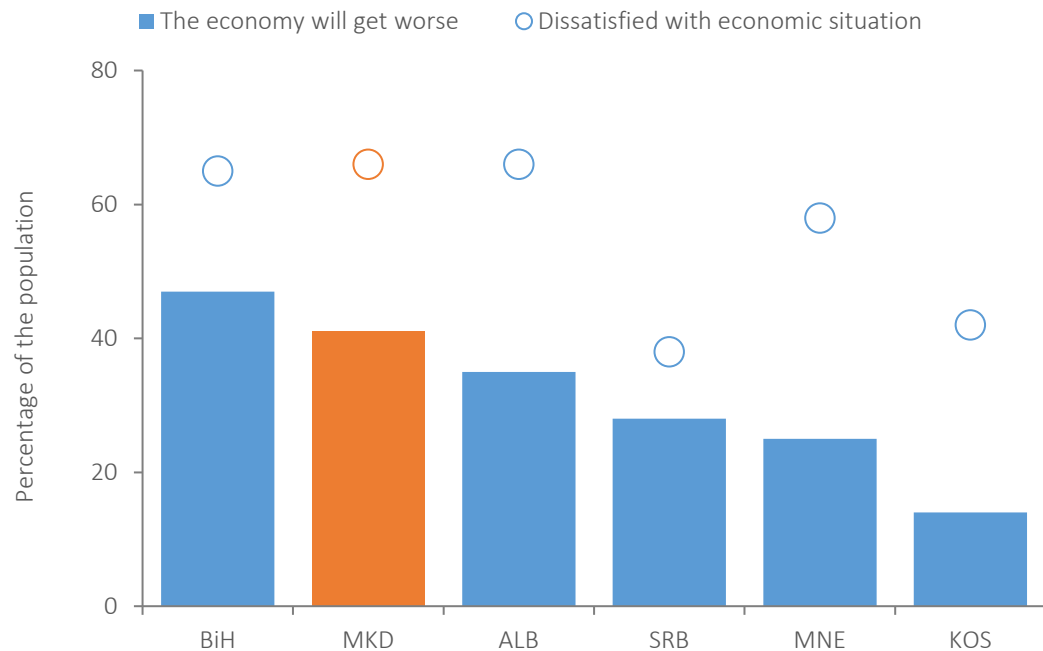


Source: WDI (last update 09/16/2022).

**However, the country still faces significant labor market and skills challenges.**

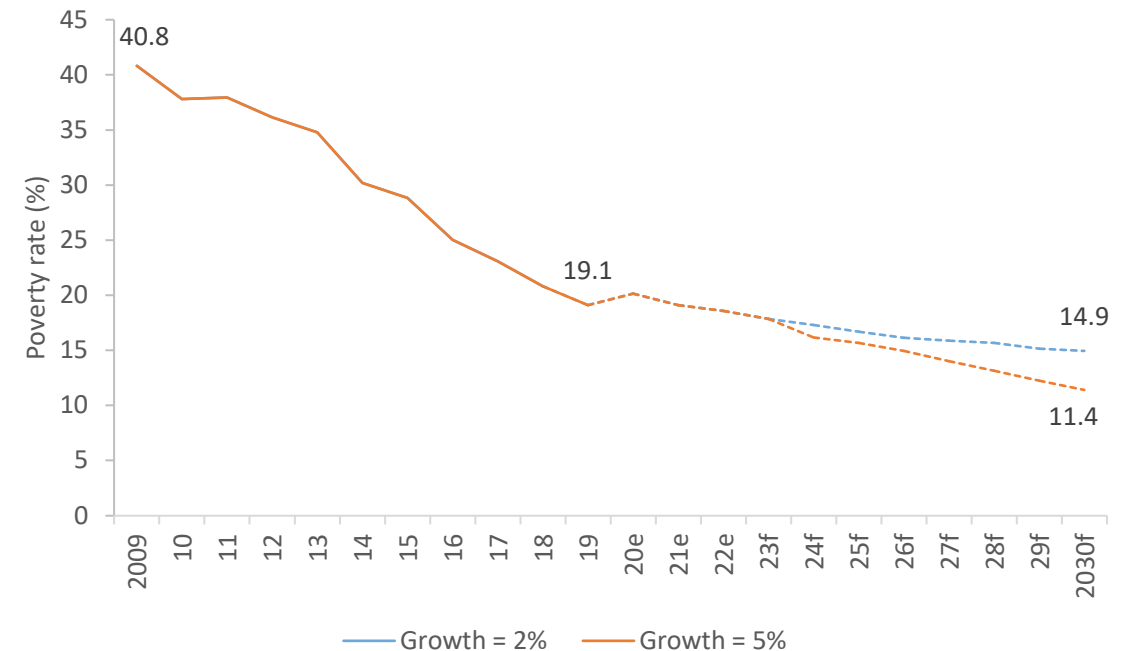
# Inequality remains high, perceptions of inequality are relatively negative, and poverty reduction requires considerable effort going forward

Percentage of individuals who are dissatisfied with the economic situation and percentage who think that the state of the economy will get worse within the next 12 months, 2022



Source: Balkan Barometer (2022) Balkan Public Sentiment Index – Expectation Index, 2022.

Poverty projections under two growth scenarios



Source: Author's calculation based on SILC 2009-2019. Note: Actual data: 2009-2019. Nowcast: 2020-2022. Forecast are from 2023-2030.

**Despite recent progress, perceptions about the future are pessimistic: 66% are unsatisfied with the economic situation and 41% considers that the situation will get worse in the coming year.**

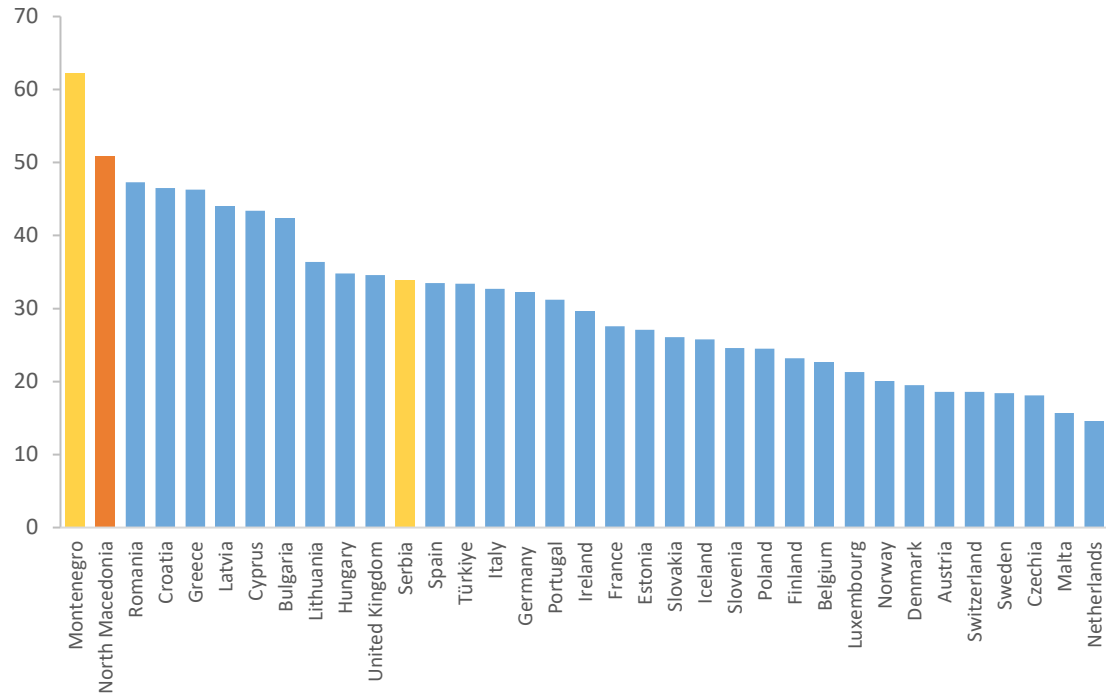
**Even with a robust growth of 5% since 2024, more than 235 thousand people would still be poor by 2030.**



## **Recent Challenges and Opportunities**

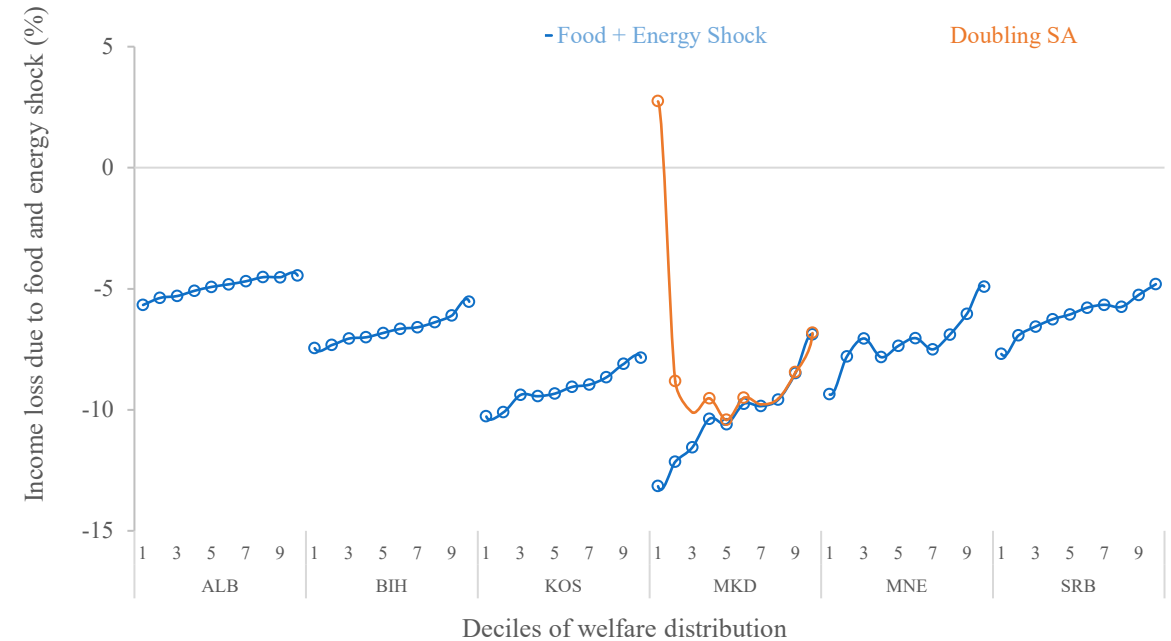
# The war in Ukraine, the energy crisis, and rising inflation threaten to erase recent poverty reduction gains

Inability to face unexpected financial expenses, 2021-22



Source: Author's calculation based on Eurostat.

Simulated welfare percentage changes after the combined food and energy price increases

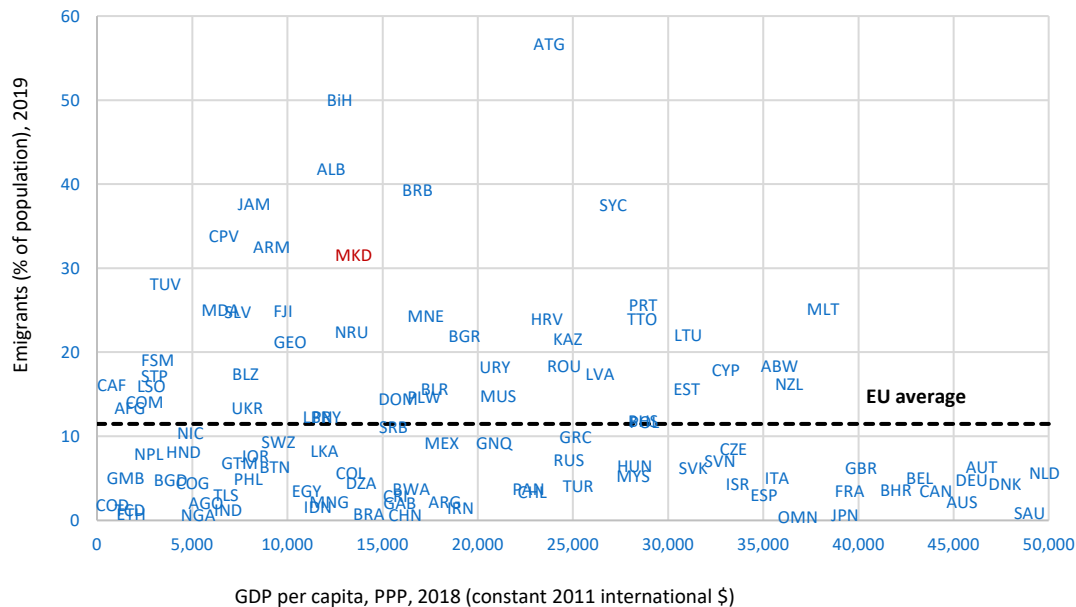


**The simulated impact of higher food and energy prices is substantial and markedly regressive. Increasing GMI benefits can help mitigate the impact of higher prices for the poorest but does little to help the vulnerable.**

**Keeping the dwelling adequately warm is a challenge for 24% of population and 40% of the B60. About half of Macedonians are vulnerable to shocks as they were unable to face unexpected expenses in 2021.**

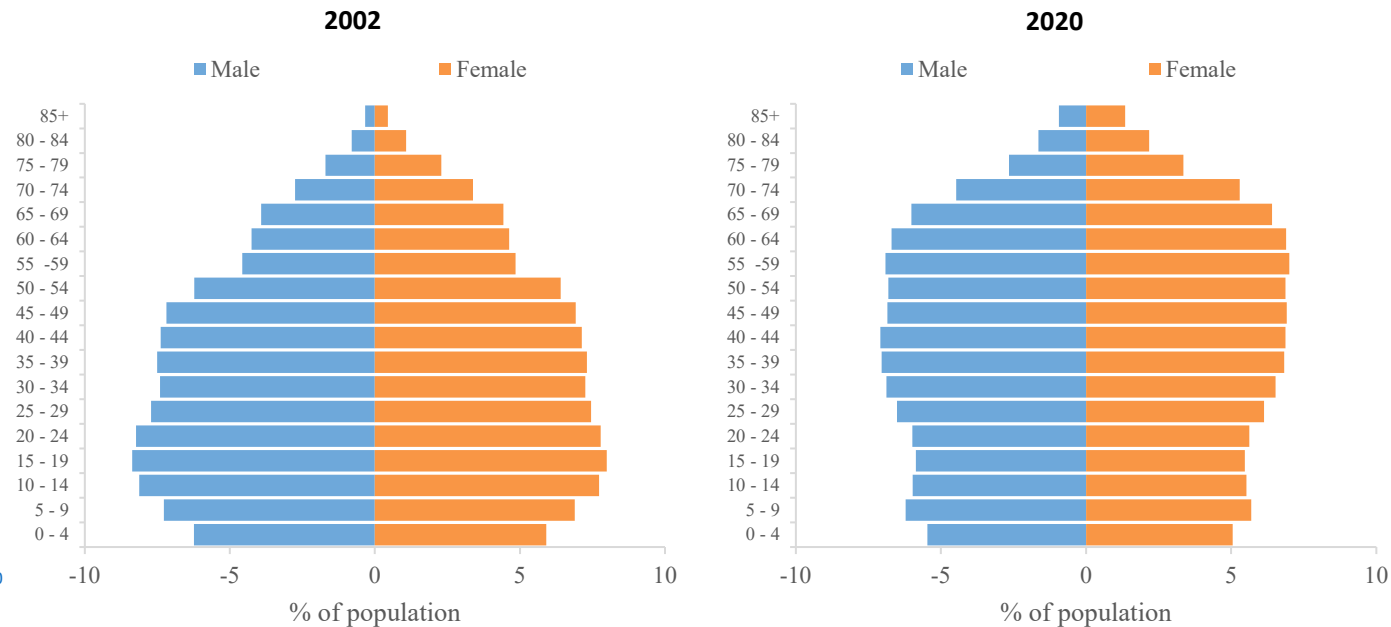
# North Macedonia is losing its human capital

The country has among the highest population of emigrants in ECA



Source: UN DESA 2019.

Population is getting older and shrinking.



Source: State Statistical Office.

**Unemployment is among the highest in ECA and is among the major concerns—a push factor. On the other hand, wages in the EU are much higher—a pull factor. Despite having a significant diaspora community around the world, remittances have limited contribution to household incomes.**

**The population is aging rapidly with adverse impact on productivity, labor market, and social spending.**



# The EU accession and benefits of it within the generation reach



## **Economic benefits are already there...**

- FDI from EU member states: 64% of total stock of inward FDI comes from EU and has been increasing by 7% pa since 2018.
- EU grants to North Macedonia: IPA I and II until 2020 app EUR 1.3 billion. IPA III assumes much higher allocation (60% higher than received so far).
- Exports to EU: 77% of all exports (up 15 pp from 2011; the largest in the Western Balkans) and has been increasing by 9% pa since 2018
- Tourist nights spent by EU citizens: 51% of total in 2021 and increased by 28% pa since 2018

## **...so is the solidary support and safeguards during shocks.**

- Protection of health and transportation routes during the pandemic
- Safeguarding reserve buffers during the war in Ukraine outbreak
- Securing energy supply during the recent energy crisis

## **Coming next:**

- Legislation alignment with the acquis and professional and accountable institutions
- More balanced regional development spurred by grant funding
- Supporting Green Agenda, and Just transition
- Strengthening human capital and closing opportunity gaps

# What are the constraints for creating faster growth?



**Business environment**

- State aid and trade policies
- Product market regulation
- Access to finance

**Sectoral policies**

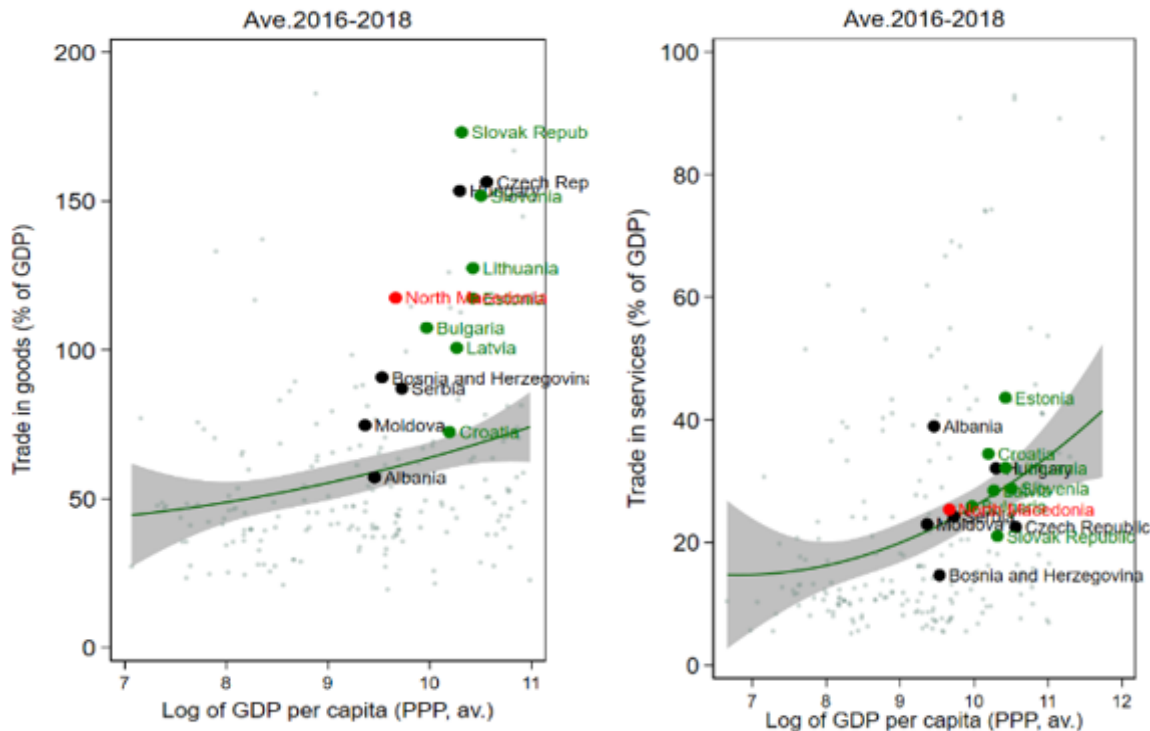
- Infrastructure
- Agriculture
- MSMEs

**Institutional drivers**

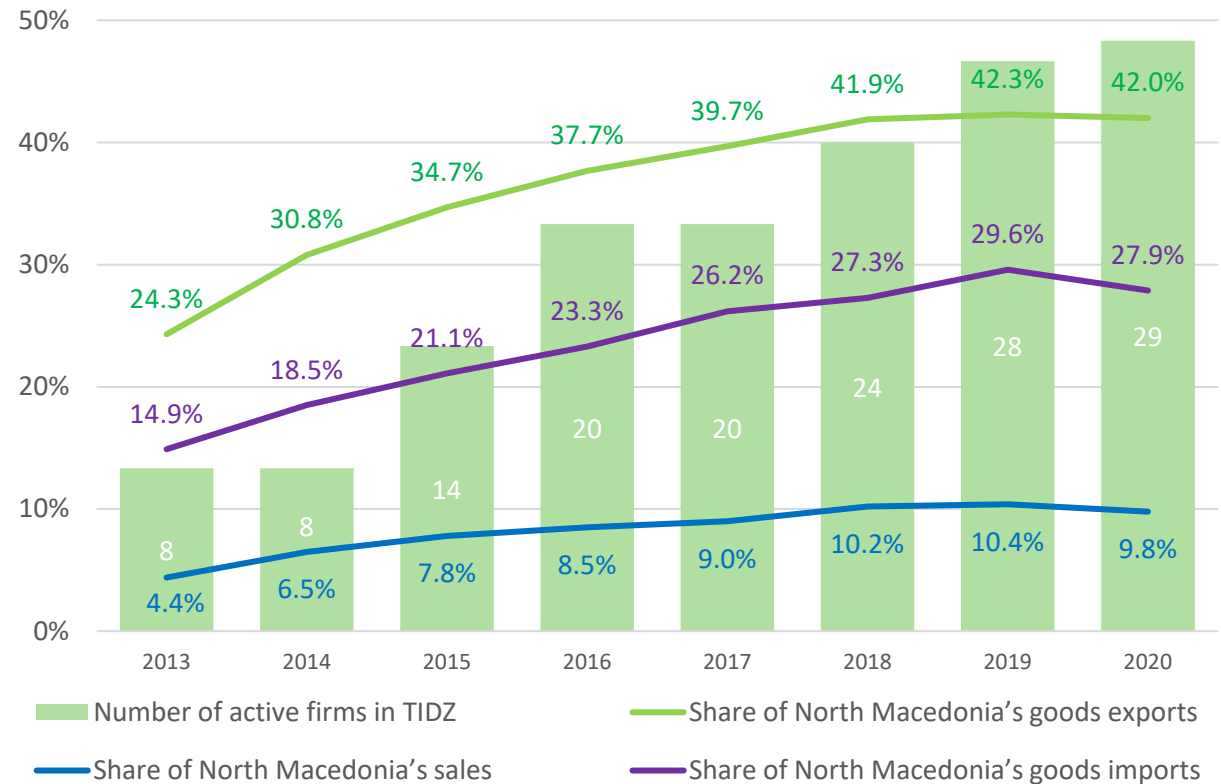
- Governance
- Digitalization
- Procurement

# Increased trade integration but high concentration, high cost, and low spillovers

Merchandise trade openness was stronger than trade openness in services, where the country has not made significant improvement in the past decade



42 percent of exports is delivered by a handful of TIDZ firms that are part of GVCs; they outsource locally <15 percent of all purchases but cost 5 percent of fiscal revenues.

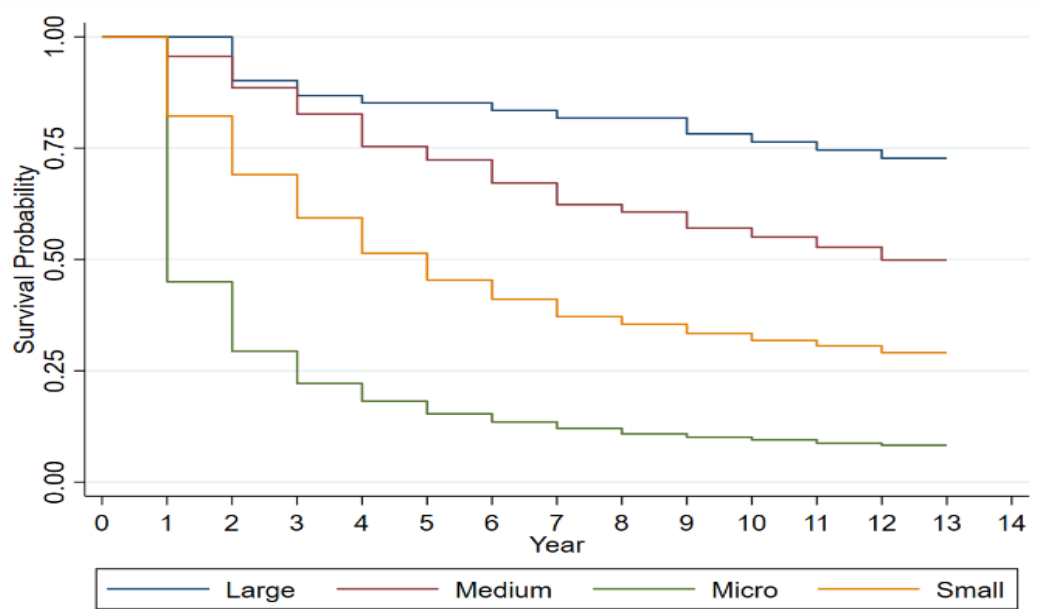


Source: World Development Indicators. Note: Trade openness is the ratio of exports plus imports over GDP. Empirically, the relationship between trade openness and per capita income is linear. The curve shows the average of trade openness conditional on a given per capita income. The grey band represents the 95 percent confidence interval.

Source: Customs firm-level transactions data. Note: the bubbles represent the value of exports in 2020 of each sector.

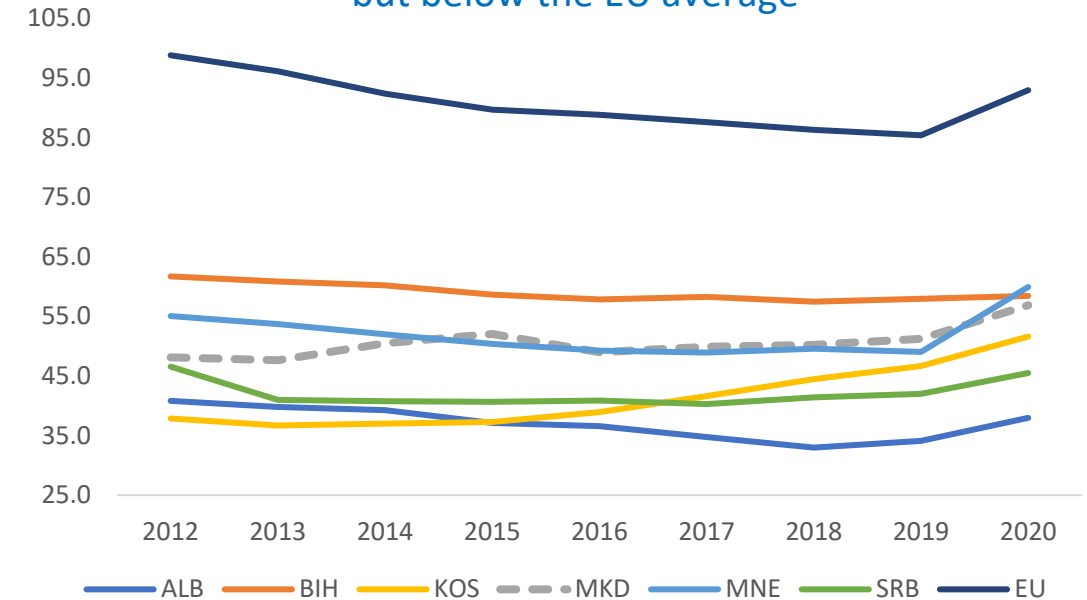
# Private sector is dominated by credit-constrained MSMEs concentrated in low value-added sectors and low productivity

Only one in two micro exporters survives past the first year



Source: Customs firm-level transactions data.

Credit to private sector as percent of GDP ranks high among WB peers, but below the EU average

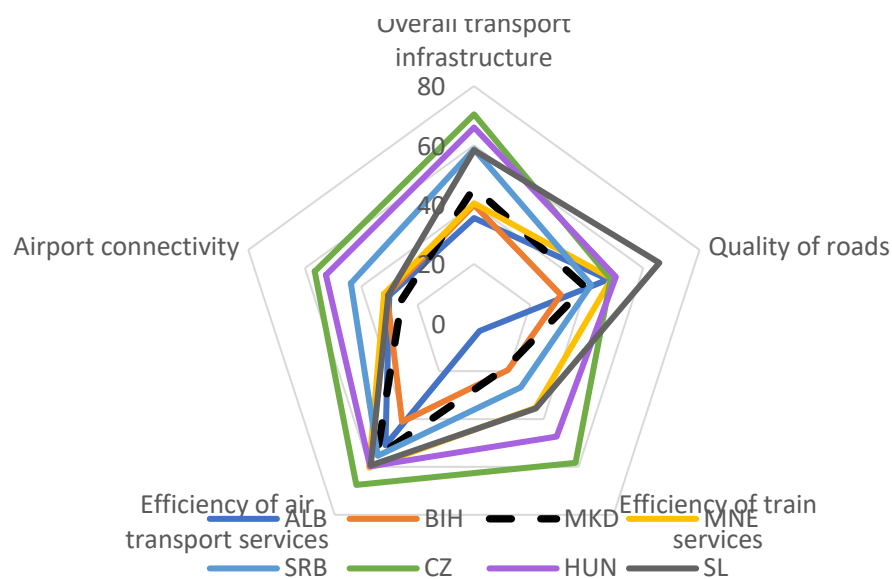


Source: Central banks, Eurostat.

**89% of firms are micro (1-9 employees) while only 3% medium and large firms. North Macedonia is ranked behind the rest of the Western Balkans in terms of domestic competition (WEF GCI, 2019).**

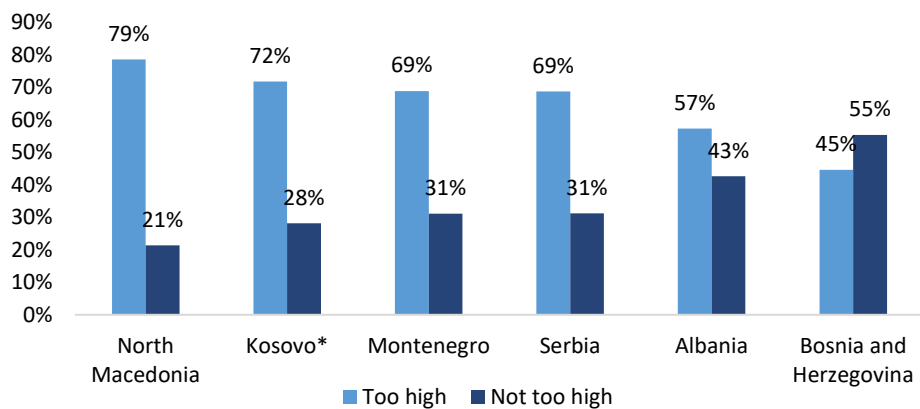
**Bank financing is limited for MSMEs due to conservative bank lending policies, lack of financial literacy and high collateral requirements. Financial inclusion is improving (account ownership is 85 percent for 15+), while financial literacy among the adult population in North Macedonia is low.**

# Connectivity gaps limit trade and integration, as well as productivity and transformation of the labor market



Source: World Economic Forum, The Global Competitiveness Report 2019.

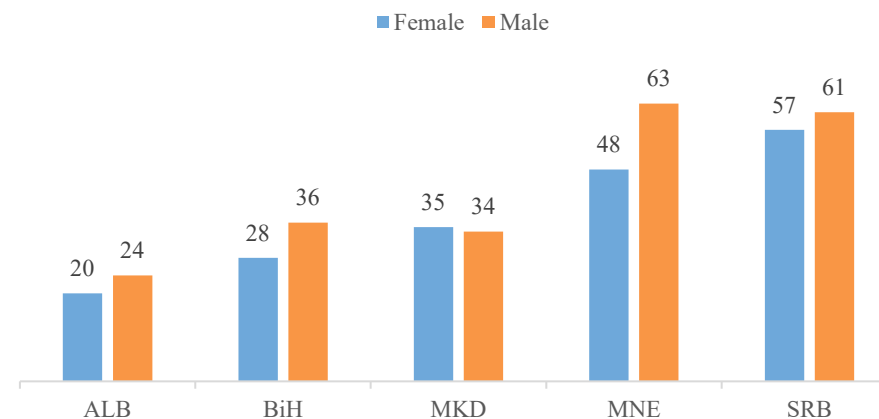
Transport-related infrastructure and logistics performance improved but businesses consider cross-border transaction costs to be high



Source: Balkan Barometer 2021.

The scope of women and men with basic or above basic level of digital skills in the country is relatively low

Basic/above overall digital skills (% 25–54-year-olds, 2019)



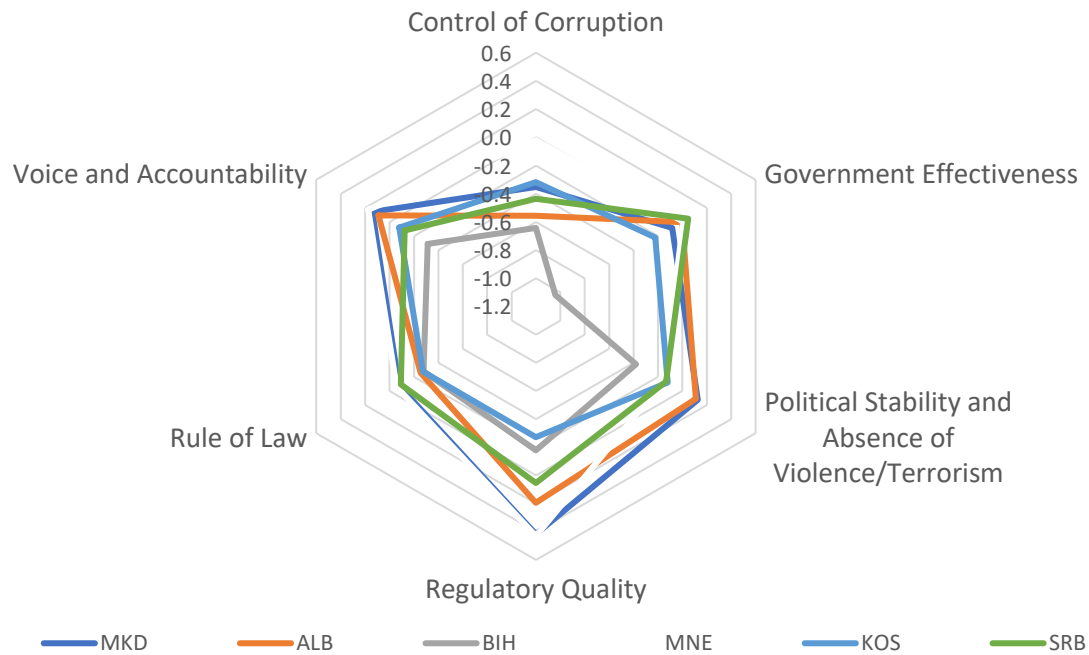
Source: Country Gender Assessment.

- **High-speed broadband infrastructure is underdeveloped and underutilized creating a 'digital divide'.**
- **Lack of workforce to sustain the development of the Digital Economy. Women still have lower STEM fields enrolment rates; however, this gap has been narrowing.**
- **Lack of competition in mobile communications market with potential negative market outcomes such as high tariffs, low quality of service, and innovation.**

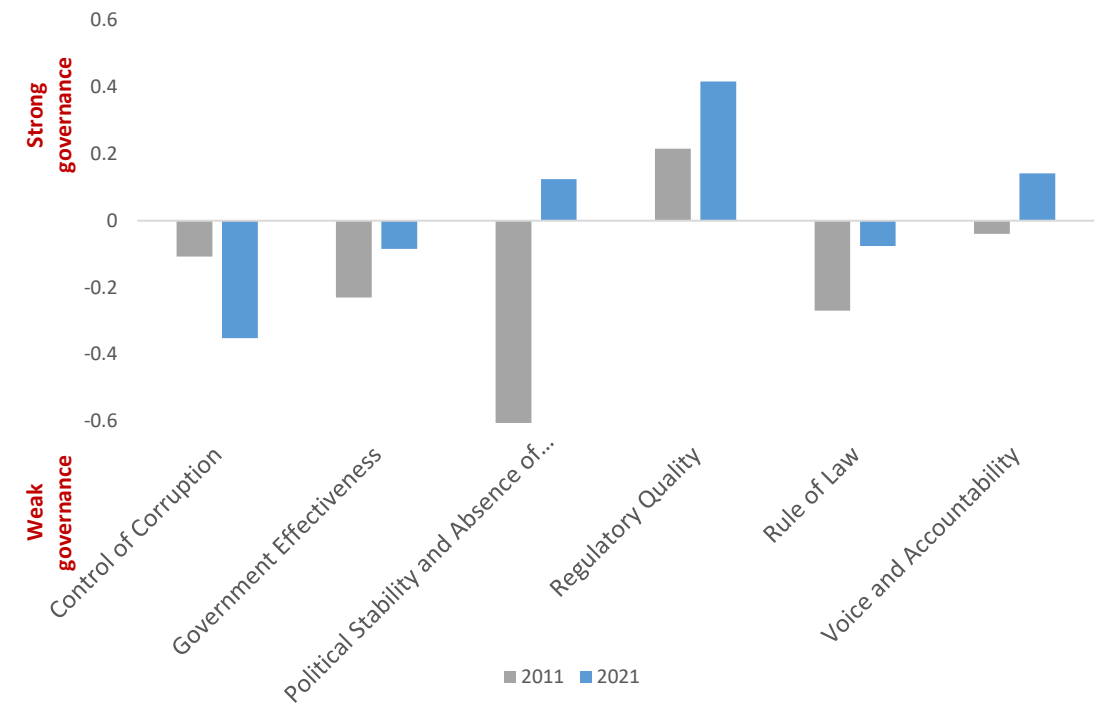


# Governance and institutional gaps still constrain the country's potential

Compared to regional peers, North Macedonia was a middle performer, having the lowest score on control of corruption and the highest score on regulatory quality



Since 2021, North Macedonia improved the score on all governance indicators, except for control of corruption



Source: World Governance Indicators 2021.

**Governance priorities remain the same: need to secure rule of law and build capable public institutions that are accountable to citizens. The country is assessed by EU as moderately prepared in public administration, functioning of judiciary, and the fight against organized crime.**

# What are the constraints for creating inclusive growth?

## Low labor participation

Skills

Labor market regulation

Activation

## Low human capital

Health

Education

## Exclusion

Rural – urban divide

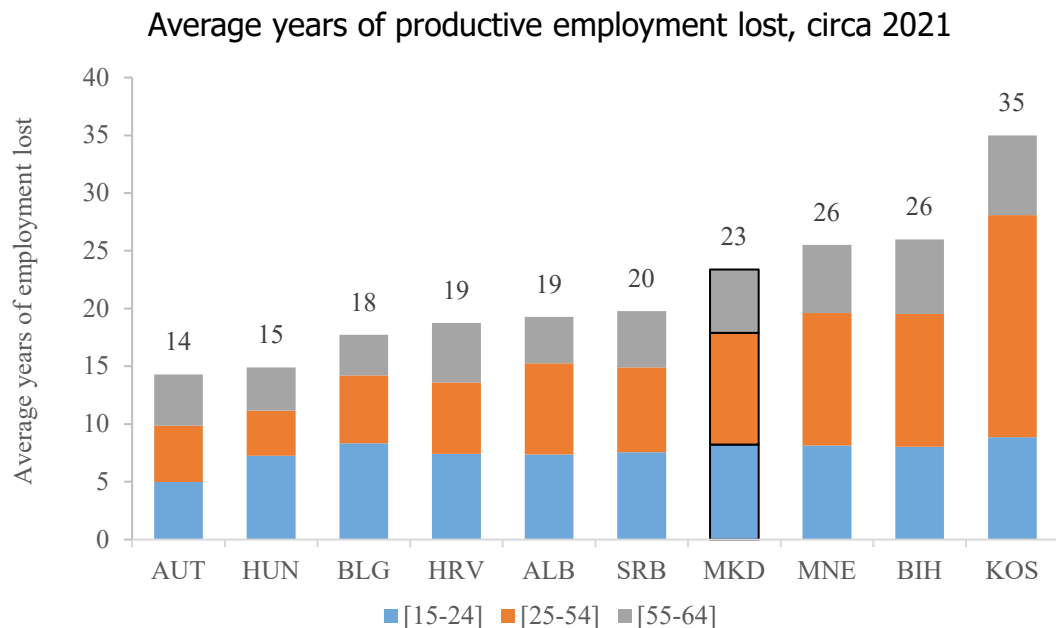
Ethnic, gender and SOGI

Social assistance coverage



# Labor market challenges, youth unemployment, and skills are continuous issue

Labor market challenges result in significant waste of working years



Source: Own elaboration based on data from SEE Jobs Gateway. Note: The figure shows the average years of employment potentially lost, which is equal to the share of total working years for the age group minus the employment rate for the same age group in 2021 based on SEE Jobs Gateway and on Arias et al. (2014).

**An average worker loses approximately 23 years of productive employment through his life.**

Firms also face difficulties finding workers with the right skills

Biggest Obstacles to Firms in North Macedonia in 2019 (percent of firms choosing an obstacle)

	North Macedonia	Europe & Central Asia
Political instability	28.6	10.7
Practices of the informal sector	13.9	13.3
Inadequately educated workforce	13.0	13.0
Access to finance	10.1	9.8
Transportation	7.3	4.7

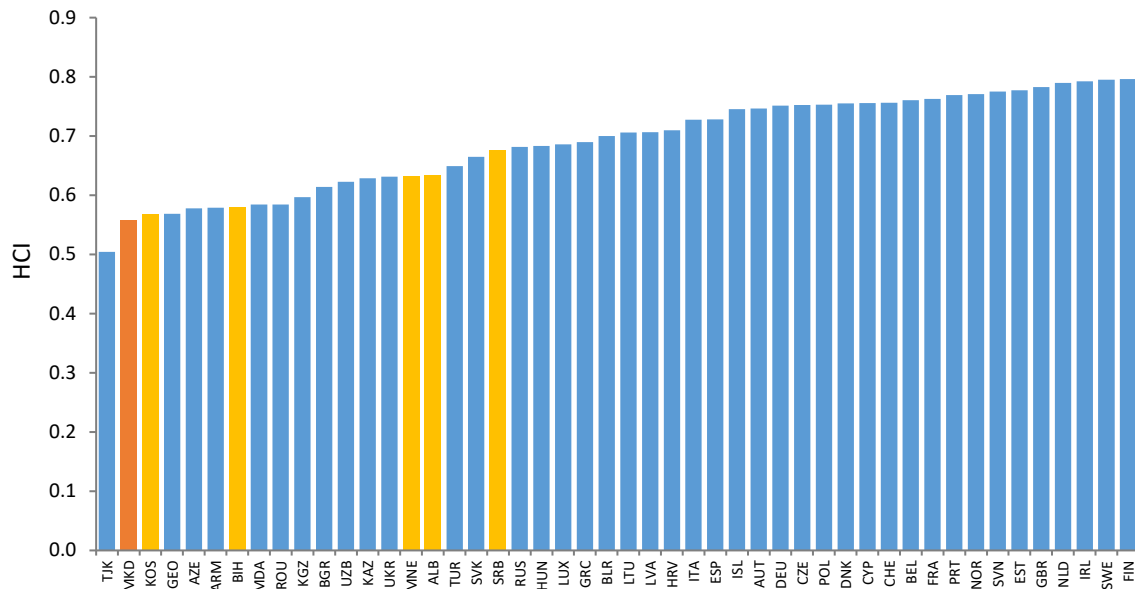
Source: World Bank. Enterprise Survey 2019.

**North Macedonia's Global Talent Competitiveness Index rank plunged from 51<sup>st</sup> in the 2015–18 to 75<sup>th</sup> in the 2019–22.**

# Still weak quality of education, while the health service delivery suffers from high inefficiency and equity concerns

Ramping up enrolment rates but also strengthening quality and equity is key

Human Capital Index, 2020

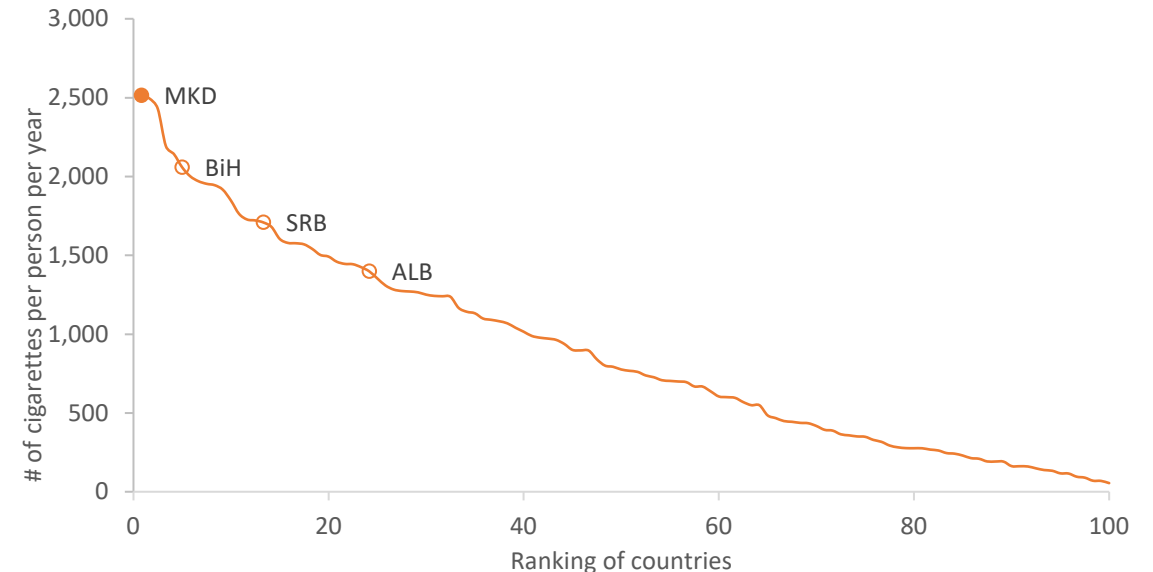


Source: The Human Capital Project (World Bank 2021).

**A child born in North Macedonia today can expect to attain only 56% of her/his full productive potential—among the lowest in ECA.**

North Macedonia is a major consumer of tobacco and allocates large subsidies to tobacco growers

Ranking of countries based on the number of cigarettes smoked per person per year: age  $\geq 15$ , 2019



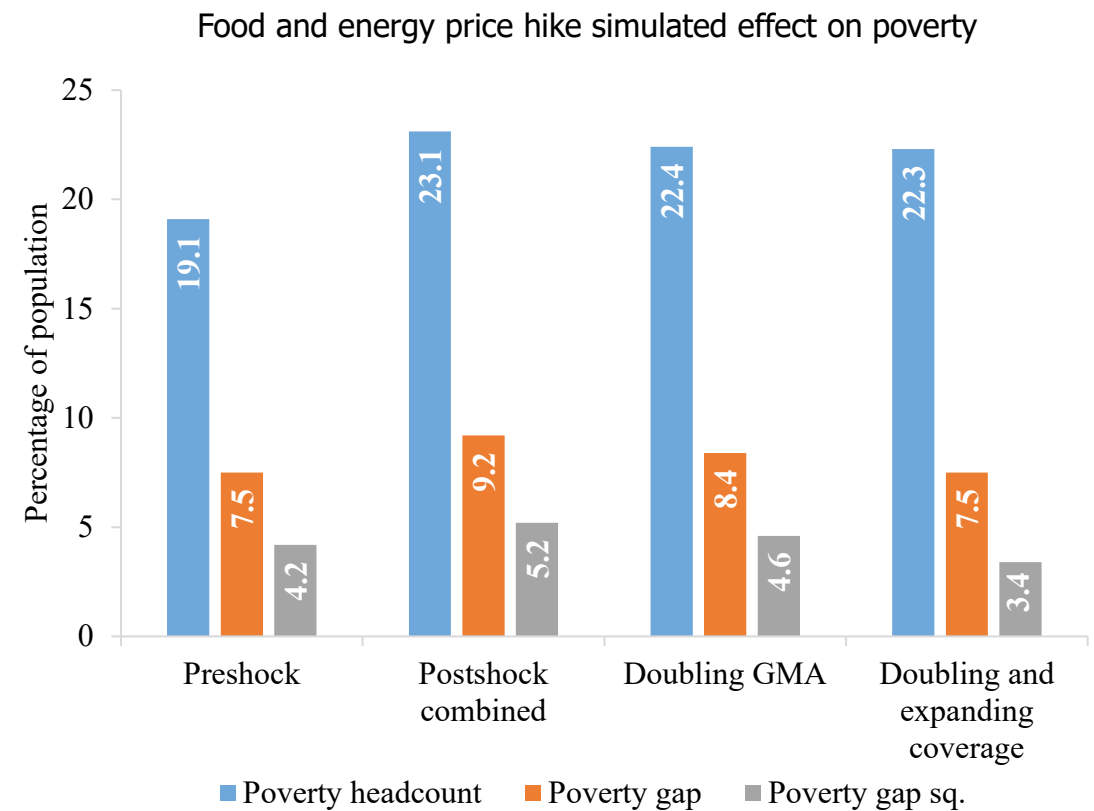
Source: Author's calculation based on The Tobacco Atlas.

**Challenges remain in the management of noncommunicable diseases, and the health service delivery suffers from high inefficiency and equity concerns.**

# Despite some progress, social assistance has still low reach and high exclusion errors

- **The country implemented reform of its social assistance programs in 2019, which appears to be improving coverage, targeting, and adequacy.**
- **The Guaranteed Minimum Assistance has proven to be an important aspect of the Government's response to shocks.**
- **However, child protection remains low and requires further efforts to improve coverage and adequacy.**

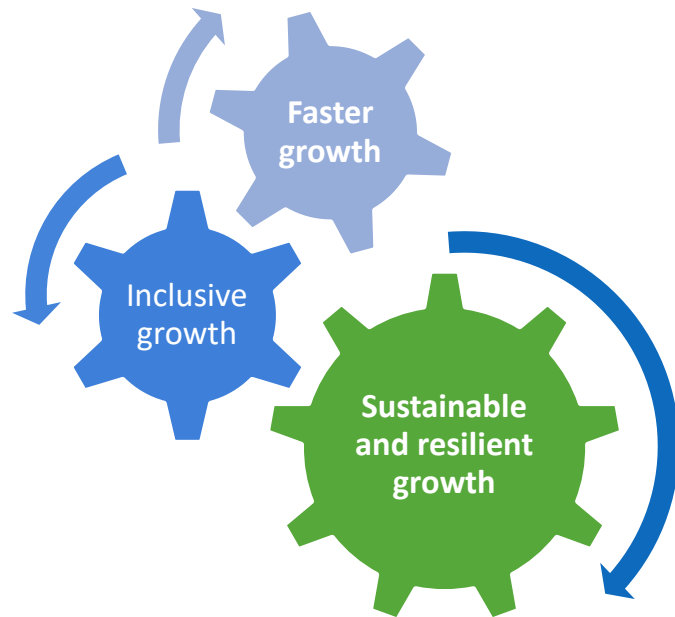
Higher food and energy prices can be partially mitigated by social assistance



Source: World Bank simulations based on 2019 consumption data from the HBS and income data from the SILC.



# What are the constraints for creating sustainable growth?



## Fiscal sustainability

Tax exemptions

Spending inefficiency

Public finance management and rules

## Environmental sustainability

Air pollution

Energy efficiency

Natural environment

## Climate resilience

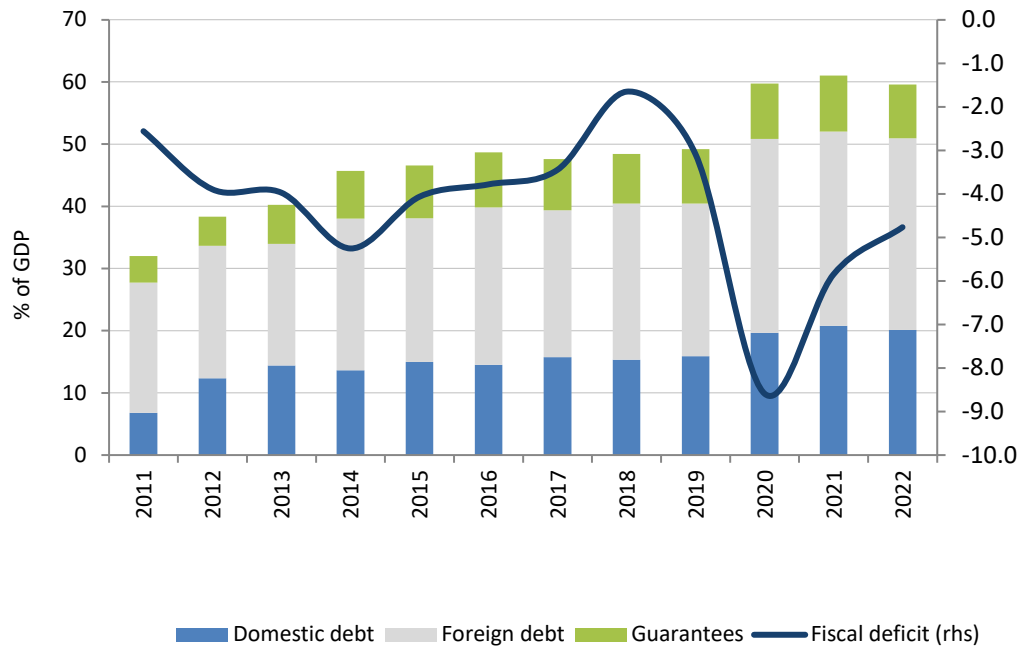
Decarbonization and just transition

Disaster risk management and adaptation

Green finance

# Fiscal space eroded and sustainability concerns surged amidst financial tightening and new fiscal pressures from aging and climate change

Fiscal deficit and debt, percent of GDP



Source: Ministry of Finance, PESR. Debt includes also non-guaranteed debt.

**North Macedonia ran higher fiscal deficits when compared to EU27 and WB6 peers and since 2011 public debt has nearly doubled.**

Public finances, percent of GDP

Country	GG expenditure		GG revenue		Difference - expenditure	Difference - revenue
	2011	2021	2011	2021		
Albania	28.9	31.5	25.4	27.0	2.6	1.6
Bosnia and Herzegovina	58.2	44.8	56.6	42.3	-13.4	-14.3
Kosovo	29.7	30.1	28.5	28.7	0.4	0.2
Montenegro	44.6	45.6	39.5	43.6	1.0	4.1
Serbia	42.3	47.4	37.7	43.3	5.1	5.6
<b>North Macedonia</b>	<b>34.2</b>	<b>39.2</b>	<b>31.7</b>	<b>33.4</b>	<b>5.0</b>	<b>1.7</b>
WB6	39.7	39.5	36.6	36.2	-0.2	-0.4
Small EU states*	42.8	45.2	37.8	40.9	2.4	3.2
EU27	49.1	51.6	45.1	46.9	2.5	1.8

Note: \*includes Bulgaria, Croatia, Estonia, Lithuania, Latvia, Slovakia, Slovenia.

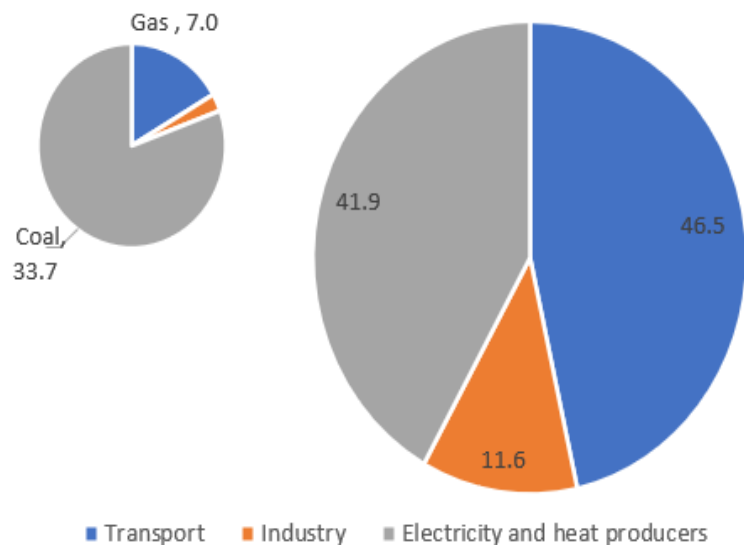
Source: National statistical institutes, Ministries of Finance and Eurostat.

**Government revenues to GDP ratio is one of the lowest while spending ratio reached the WB6 average. Yet, low spending efficiency and high mandatory spending (80 percent of spending) undermine the impact on growth.**

# Growth has been highly energy intensive, as fossil fuels dominate energy supply, and air pollution is becoming a serious problem

The use of coal and petroleum means that the energy mix is emission intensive, although declining

Share of GHG emissions by sector, percent, 2020

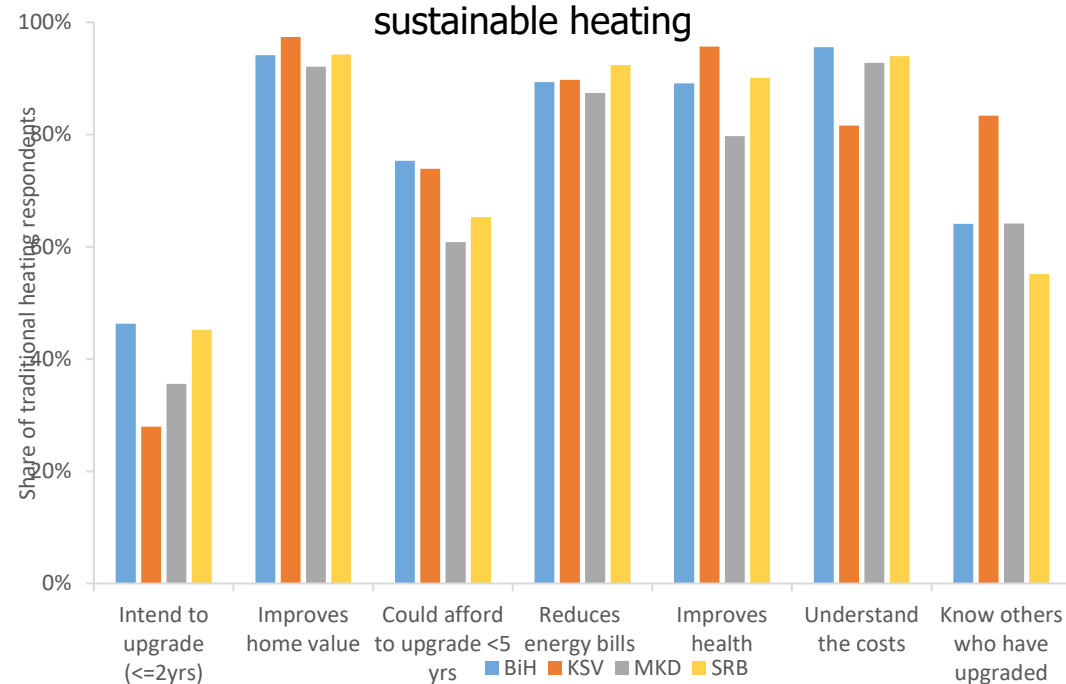


Source: IAEA database.

**Energy intensity is almost three times higher than the EU average, as domestic power generation relies on lignite (60%).**

North Macedonia is one of the countries most affected by ambient air pollution (AAP) in the world

Intentions to upgrade heating technology and attitudes towards sustainable heating

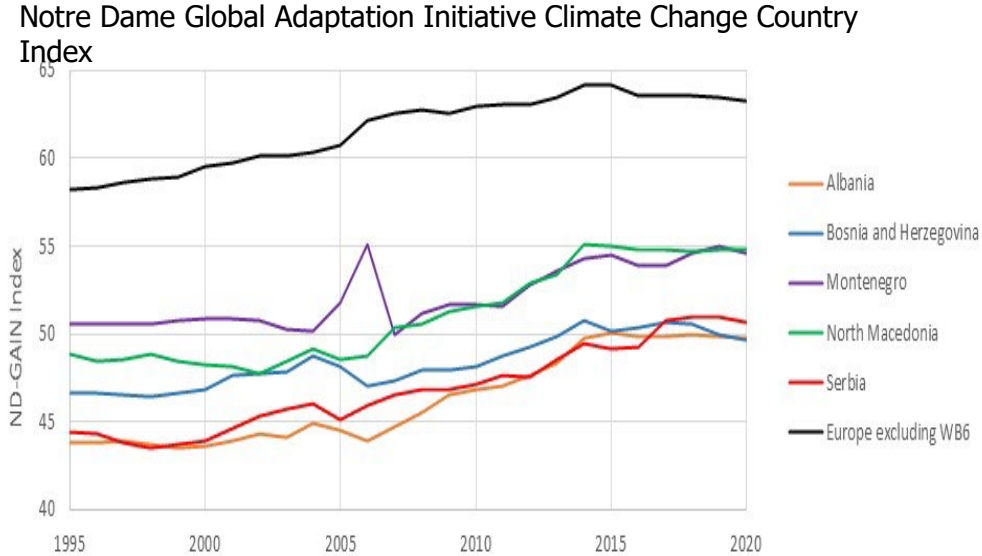


Source: World Bank survey 2022

**The residential sector is the largest source of PM2.5 in the country. The economic cost associated with the health damages from AAP at 6.9 percent of the 2016 GDP.**

# Focus needed on climate change adaptation policies to boost resilience but also on decarbonization to boost its competitiveness

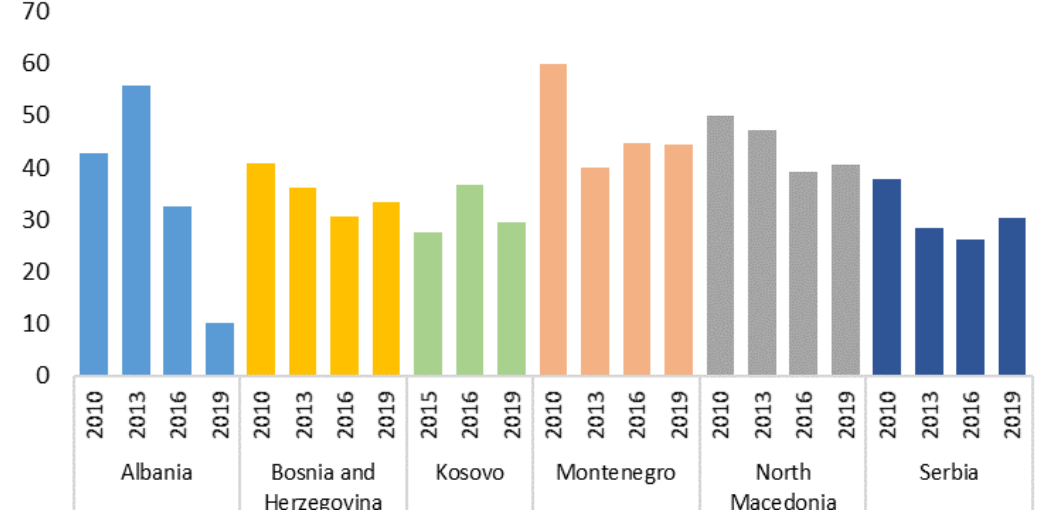
North Macedonia is one of the most vulnerable countries to climate change in ECA and the most exposed to climate extremes



Source: University of Notre Dame, WDI

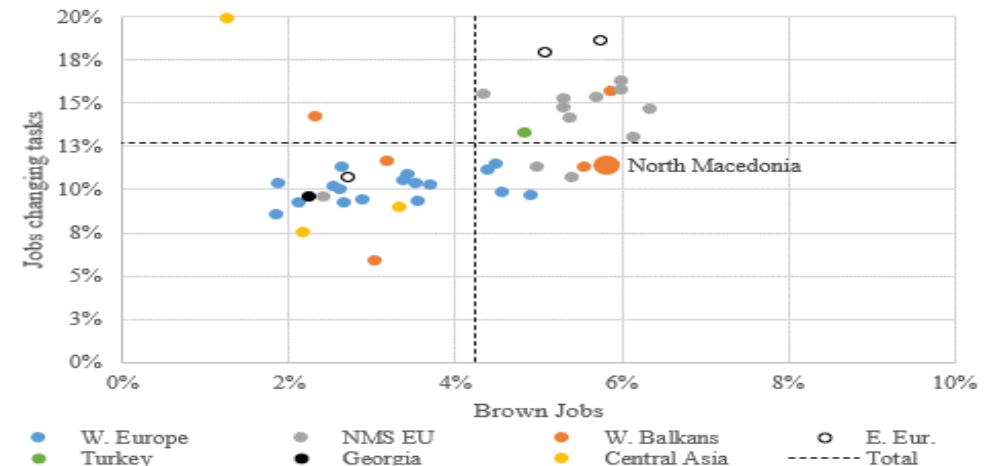
**Resilience index improved (to 54) but still significantly worse than EU average of 63.30 in 2020. 76% of the population considers climate change a serious or very serious problem—the highest in the region.**

Carbon-intensive exports as a share of total exports in terms of value (%)



Source: Western Balkans Regular Economic Report, Fall 2021.

Share of brown and jobs changing tasks (%)



Source: World Bank, SEE Jobs Gateway, November 2022.

# Emerging High-level Objectives and Priorities

## Sustainable, inclusive, and resilient growth

HLOs

**More accountable service delivery to citizens**

**Strengthened human capital formation and closing opportunity gaps for all**

**Induced creation of better paid jobs**

**Strengthened household resilience to climate change and lowered carbon intensity and air pollution**

**Mitigate the impact of the political instability through establishment of medium-long term strategic and spending priorities**

**Endow people with quality and relevant skills throughout the life cycle**

**Close the gaps in transport, energy, and other connectivity infrastructure for international and intranational connectivity**

**Accelerate decarbonization and ensure energy security**

**Secure rule of law and build professional public institutions that are accountable to citizens**

**Reduce disincentives and remove barriers to labor market participation, especially for women and youth**

**Increase financial intermediation and inclusion**

**Scale up adaptation to climate change and improve preparedness, response and recovery from natural disasters**

**Ensure fiscal sustainability by reducing fiscal risks, improving the efficiency of spending, and enhancing revenue mobilization**

**Improve efficiency and access to quality public services for vulnerable and in rural areas**

**Improve the competitive environment and foster innovation**

**Improve public and private financial resilience to natural disasters**

Priorities



