The World Bank in North Macedonia

Country Snapshot

An overview of the World Bank's work in North Macedonia **October 2019**

NORTH MACEDONIA	2018
Population, million	2.1
GDP, current US$ billion	12.6
GDP per capita, current US$ thousands	6,058
Life Expectancy at birth, years (2018)	76

At a Glance

- The resolution of the name issue with Greece has opened North Macedonia's path to accession to the European Union and its deeper integration into regional and global markets.
- Growth for 2019 is expected to reach 3.1 percent, up from 2.7 percent in 2018.
- The Public Finance and Competitiveness Development Policy Loan supports the Government in reforms to improve the management and transparency of public finances and make public spending more efficient, especially spending on social protection, while also making the tax system more equitable.

Country Context

The historic resolution of the long-standing name dispute with Greece has opened new opportunities for North Macedonia. The country is currently in the process of acceding to the North Atlantic Treaty Organization (NATO), while in mid-October, it expects a decision from the Council of the European Union (EU) on opening accession negotiations.

North Macedonia can use the EU accession process to complete its transition to a well-functioning market economy, strengthen its institutions and the rule of law, and enhance service delivery and the needed infrastructure.

In the past two decades, its economic growth was the most stable in the Western Balkans, income per capita doubled, and the country moved from low-middle- to upper-middle-income status. Its strategic geographic location is also a major asset, given the largely untapped export potential of its agriculture and services sectors.

However, the transition to a well-functioning and inclusive market economy is not yet complete. The low and declining productivity of local firms, weak state institutions, and deficiencies in competition and investment policy and business regulation continue to pose serious structural challenges. A competitive business legal framework has yet to translate into a vibrant private sector that can fully exploit the country's location.

The reform agenda, outlined in the Government Program 2017–20, focuses on economic growth, job creation, fair taxation, support to small and medium enterprises, and reform of social protections for the most vulnerable. Some reforms, such as enforcing budget transparency and strengthening the social safety net, have already been launched.

The World Bank and North Macedonia

The strategic objective of the new Country Partnership Framework (CPF) for FY19–23 is to support North Macedonia's ability to achieve faster, inclusive, and sustainable growth and provide its citizens with greater opportunities for a better life.

The CPF aims to support the Government's program and medium-term strategy, which present a vision of accelerated economic growth with better employment opportunities, social cohesion and inclusion, and a plan to tackle the persistent bottlenecks.

The Government's strategy is consistent with the vision of the recently completed Systematic Country Diagnostic of a better-connected, vibrant domestic economy engaged in the region and beyond as it secures its footing.

The new CPF is based on three interconnected focus areas that will help North Macedonia achieve faster, more inclusive, and sustainable growth. Focus Area I aims to remove some of the bottlenecks that prevent the emergence of a dynamic and competitive private sector by improving connectivity and access to markets through activities that support "hard" and "soft" trade networks and strengthen local firms' technological uptake, innovation, access to finance, and capacities.

Focus Area II will support the development of human capital and skills to boost labor productivity and encourage more inclusive labor market participation. The CPF will also improve the quality and relevance of education, as well as the access to and quality of social services.

Focus Area III will support efforts to mitigate fiscal and environmental vulnerabilities and enhance sustainability by strengthening public financial management and accelerating the transition to a more sustainable energy mix in areas of strong comparative advantage.

Key Engagement

The Public Finance and Competitiveness Development Policy Loan supports the Government in reforms to improve the management and transparency of public finances and make public spending more efficient, especially spending on social protection, while also making the tax system more equitable.

WORLD BANK PORTFOLIO

No. of Projects: 7

Lending: US$407.82 million (of which DPL US$139.2 and and EU IPA - US$17.22 million)

It supports reforms in energy by unlocking the energy sector monopoly and boosting renewables. It also improves public procurement by increasing the access of private sector bidders to public tenders and boosts market competition by introducing risk-based inspections that would reduce the time firms spend dealing with inspections.

Actions taken by the Government under this program include:

- Amending the Law on Pension and Disability Insurance, the Law on Compulsory Capitally Funded Pension Insurance, and the Law on Compulsory Social Insurance Contributions to introduce the price indexation of benefits, harmonize the accrual rates, and create a higher pension contribution rate, all to improve the fiscal and social sustainability of the multi-pillar pension system;
- Enacting the Law on Social Protection and amending the Law on Child Protection to consolidate social assistance benefits, expand the coverage of the bottom quintile, and protect the energy poor, while maintaining good targeting accuracy through the introduction of a guaranteed minimum assistance program;
- Enacting the Energy Law to deregulate electricity generation, open the electricity supply market to all customers, and introduce a competitive support mechanism for renewable energy generation;
- Enacting the Inspection Supervision Law to introduce: (a) risk-based inspections; (b) a provision for inspectors to issue warnings; and (c) a grace period for businesses to correct first-time infractions.

Recent Economic Developments

Growth is strengthening in 2019. Economic growth strengthened in the first half of 2019 to 3.6 percent, its fastest rate since 2016. Wholesale and retail trade were the main drivers of growth, accounting for 1.5 percentage points (pp).

Agriculture contributed a 0.5 pp contribution, while industry contributed 0.4 pp despite a slowdown in manufacturing evident in the second quarter of 2019. Construction also added 0.1 pp, but this is expected to be temporary as surveys for the sector point to positive expectations from companies in terms of contracts, prices, and employment.

On the demand side, the main contributors to growth in the first half of 2019 were investment and private consumption, the latter spurred by rising wages, pensions, and household lending. Net exports subtracted from growth for the second consecutive quarter, as rising exports were not enough to compensate for the growing imports of intermediate, capital, and consumer goods.

Although private consumption is expected to moderate by year-end, investments will strengthen, partly due to an acceleration of public investments. However, net exports are expected to continue to subtract from growth because rising exports will not be enough to compensate for a surge in imports, mainly capital and intermediary goods. Growth for 2019 is expected to reach 3.1 percent, up from 2.7 percent in 2018.

The labor market has continued to improve. Employment went up by 5.2 percent year-on-year (y-o-y) in the first half of 2019 after averaging 2.5 percent in 2018. Most of the new jobs were in manufacturing, transport and storage, administrative services, and entertainment.

The employment rate improved to 47.0 percent—up an annualized 2.3 pp. Unemployment fell to 17.7 percent in the first half of the year, a historic low, and the participation rate stayed at 57.1 percent. It is estimated that for 2019 as a whole, unemployment will decline to 19.4 percent.

Despite a rise in tax and contribution rates, the fiscal deficit widened in 2019. In the first half of the year, government revenues went up 6 percent y-o-y. Higher rates for social contributions were introduced in January, a higher statutory rate for personal income tax was introduced while exemptions were reduced, and tobacco excises were increased. However, spending went up by 8.4 percent y-o-y due to rising pensions, wages, subsidies, and health spending. Capital spending, although rising, is still vastly under-executed. The revised 2019 general government deficit is projected at 2.5 percent of GDP (the World Bank estimate stands at 2.4 percent), up from 1.1 percent in 2018.

Economic Outlook

The outlook for the economy is moderately positive, with annual average growth predicted to be about 3.2 percent through 2021. Investment (e.g., public investment in highways and private investment in energy and tourism) will be the main driver of growth. It will be supported by personal consumption as employment picks up and wages continue to grow, propelled by a higher minimum wage that will mostly affect private sector employees.

Net exports are expected to subtract from growth as external demand weakens somewhat. This baseline scenario is accompanied by rising risks, in particular external risks, as there are increasing signs of a slowdown in the EU and the global economy, affected by global trade disputes and other concerns.

Fiscal consolidation is expected to continue, though more slowly due to new spending programs. The Government has introduced two programs to fight informality, which is estimated at 30–40 percent of GDP, the annual cost of which is estimated to be 0.8 percent of GDP.

Although these programs have been accommodated within the planned deficit for 2019 due to lower capital spending, for the medium term, they should be offset by other spending or revenue measures to avoid increasing fiscal vulnerabilities.

These efforts are intended to tackle informality, which is a major drag on the economy; however, they are unlikely to be successful unless they are accompanied by a strengthening of tax administration, greater inspection efficiency, and improvements in the delivery of public services and in laws affecting the business environment.

Project Spotlight

The Local and Regional Competitiveness Project

The Sherpa Horse Riding subproject improved the capacity of the horseback riding club "Bistra Galichnik" to organize and offer riding tours in the Rekanski region.

This project, funded by the EU, administered by the World Bank, and implemented by the Government of the Republic of North Macedonia, provides a mix of resources and integrated interventions, including investment in infrastructure, services, and linkages at destinations, as well as capacity building, to support tourism growth and facilitate destination management.

The project aims to develop tourism that is inclusive and sustainable in the long term. It is working directly with public, not-for-profit, and private entities in order to deliver financial, economic, and social benefits to local communities and the private sector.

The Local and Regional Competitiveness Project takes an all-inclusive approach to tourism development and destination management. Multiple interventions that tackle the needs of a particular destination are most effective when they are delivered in an integrated way, linked to market demand, and able to address issues ranging from policy to planning, access, infrastructure, and marketing.

The Tourism Development Plans that guide the project's activities in each of the 10 supported destinations incorporate this integrated approach, informed by a strong analysis of demand within the tourist market and of ways the country can best position itself to be competitive.

The Local and Regional Competitiveness Project contributes to the World Bank Group's twin goals of reducing poverty and promoting shared prosperity by helping communities to upgrade their tourism assets and related infrastructure, develop skills, stimulate tourism-related jobs and enterprises, and increase value chain linkages at or around destinations.

The project is also aligned with Bank's engagement in the country by complementing lending and technical assistance activities aimed at supporting growth and competitiveness.

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