The World Bank in North Macedonia

Country Snapshot

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

April 2019

NORTH MACEDONIA	2018
Population, million	2.1
GDP, current US$ billion	12.7
GDP per capita, current US$ thousands	6.1
Life Expectancy at birth, years (2018)	75.7

At a Glance

- North Macedonia stands at a turning point in its history as an independent nation. The historic resolution of the long-standing name dispute with Greece opens new opportunities to promote the development of a dynamic economy well integrated into the region and Europe more widely.
- A new World Bank Group Country Partnership Framework for FY2019–23 will support North Macedonia in developing an environment for a dynamic private sector to enhance export-led growth, strengthen human capital for inclusive development, and build sustainability.
- The economy grew by 2.7 percent in 2018. Supported by consumption and net exports, economic activity picked up in 2018 after stagnating in 2017.

Country Context

North Macedonia stands at a turning point in its history as an independent nation. In 2018, the country took decisive steps to resolve a long-standing dispute with Greece over its official name. The historic resolution of the name issue opens new opportunities to promote the development of a dynamic economy well integrated into the region and Europe more widely.

North Macedonia is well-positioned to seize the opportunities created by this renewed outlook. Its early market-oriented reforms, openness to trade, and prudent macroeconomic management have created an environment of economic stability that has attracted private investment and boosted exports, particularly in manufacturing.

In the past two decades, the country's economic growth has been the most stable in the Western Balkans, income per capita has doubled, and the country has moved from low-middle- to upper-middle-income status.

However, the transition to a well-functioning and inclusive market economy is not yet complete. To take full advantage of new opportunities from the resolution of the decades-old name dispute, North Macedonia will need to implement reforms to become a more competitive, inclusive, and sustainable economy that is capable of closing the income gap with Europe.

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 FY2019–23 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 recently completed Systematic Country Diagnostic vision 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

Social services and the Human Capital Agenda

Building human capital in North Macedonia requires expanding skills to improve the competitiveness of workers. The CPF promotes "investing in people" as a key factor in sustaining inclusive growth over the long term. Ongoing projects will support skills enhancements and the relevance of secondary technical vocational education and training (Skills Development and Innovation Support Project) and the quality and coverage of preschool education (Social Services Improvement Project [SSIP]).

Human capital also needs to be protected to enhance inclusion by shielding poor and vulnerable households from shocks. Direct social assistance is only 1.2 percent of GDP in North Macedonia, and social assistance programs reach fewer than 25 percent of poor households. Moreover, in recent years, social assistance has shifted from cash benefits targeted to poor families to categorical programs.

The CPF will strengthen the overall social protection delivery system for improved services to existing social assistance recipients and vulnerable groups through the SSIP.

A Fiscal Efficiency and Competitiveness Development Policy Financing /Policy-Based Guarantee will support the new social assistance reform agenda aimed at consolidating benefits and expanding the coverage of the bottom quintile while maintaining good targeting accuracy. The CPF will also support second generation reforms to stabilize pension spending and enhance the system's equity.

Beyond skills and social protection, improving health outcomes is also crucial to building human capital and preventing people from losing productive years. Children in North Macedonia have a higher mortality risk than those in other Western Balkan or European countries, and unhealthy lifestyles lead to a high incidence of noncommunicable diseases. The World Bank will consider supporting the Primary Health Care Project in the second half of the CPF.

WORLD BANK PORTFOLIO

No. of Projects: 7

Commitments: $357.3 Million of which:

- IBRD: $322.37 Million
- EU IPA: $34.94 Million

Recent Economic Developments

The economy grew by 2.7 percent in 2018. Supported by consumption and net exports, economic activity picked up in 2018 after stagnating in 2017. Private consumption was the main driver of growth, contributing 2.4 percentage points (pp) because of increases in employment, wages, and lending to households.

Net exports, mainly related to foreign direct investment (FDI), contributed 1.7 pp. The remaining 0.8 pp. came from government consumption, as investments deducted from growth by 2.2 pp. On the production side, wholesale and retail trade and transportation services were the main drivers of growth, contributing 2.3 pp. The manufacturing contribution of 0.6 pp was driven by higher production, mainly of motor vehicles and electric machinery, by foreign-owned firms and by domestic producers of, for example, food and beverages, pharmaceuticals, and basic and fabricated metal products. Construction rebounded in October, adding 0.02 pp to growth, thanks to the launch of public investment projects and a continued recovery of private investment.

The labor market again improved in 2018. Employment grew by 2.5 percent year-on-year (y-o-y) in 2018. Most of the new jobs created were in manufacturing, transport and storage, and professional services. Even though the employment rate improved to 45.1 percent in 2018, more than half of the working-age population is still either unemployed or not looking for work. The unemployment rate fell to a historic low in 2018, averaging 20.7 percent throughout the year.

Wage pressures continue to be high in labor-intensive sectors. The higher mandatory minimum wage continued to put pressure on labor-intensive industries, which requested temporary government support to deal with the increased labor costs. Led by agriculture, manufacturing, trade, and the public sector, real wage growth was 4.4 percent in 2018—more than double the 2017 level. Low-wage labor-intensive sectors saw real wages grow by over 10 percent in 2018, far exceeding the growth in labor productivity over the past several years. Further mandated wage increases may erode the competitiveness of low value-added industries.

External imbalances improved in 2018. The current account deficit declined to 0.3 percent of GDP in 2018 compared to 1 percent in 2017. The continued solid export performance of FDI-related industries, such as motor vehicles and electrical machinery, was supplemented by the growth of exports in such traditional products as iron and steel and furniture. This helped to bring down the goods trade deficit to 16.2 percent of GDP.

The surplus in net services exports remained solid at 3.3 percent of GDP, driven by transport and services for processing manufactured goods. Though net private transfer inflows continued to increase, they were more than sufficient to cover the entire goods and services deficit. Net FDI inflows picked up in the second half of the year, reaching 5.8 percent of GDP in 2018, due to significant investments coming from the United Kingdom. Gross external debt, excluding central bank transactions, increased in September to 77.6 percent of GDP (up 4.5 pp y-o-y), reflecting the January 2018 issuance of Eurobonds.

Economic Outlook

The economic outlook is positive, and growth is expected to gradually rise to 3.2 percent in 2020. The resolution of the name issue is expected to accelerate European Union (EU) accession negotiations, strengthening investor confidence and stimulating growth in the next few years. Large infrastructure projects, in particular roads, and the lifting of the moratorium on local governments' ability to issue building permits will further boost investments. Consumption is expected to remain a stable source of growth, sustained by increases in employment, wages, and household lending. Net exports, especially those that are FDI-related, are expected to contribute positively to growth.

With the political outlook improved, emphasis should now turn to economic reforms. The main challenges to growth will be the low and declining productivity of local firms, weak state institutions, low human capital, a mismatch between skills and the evolving labor market demands of a modern economy, and policy barriers to competition and investment. A more competitive legal framework for businesses has yet to translate into a vibrant private sector that drives growth and jobs.

Project Spotlight

Municipal Services Improvement Project (MSIP)

Renovations at the Jeronim De Rada primary school improve the educational process for students.

For over a decade, the World Bank has been a partner of North Macedonia in improving the transparency, financial sustainability, and delivery of targeted services that are the responsibility of municipalities and their communal service enterprises.

In 2009, the first **Municipal Services Improvement Project** (MSIP - €18.9 million) was approved, followed by two Additional Financings: the first of €37.2 million, provided by the World Bank in 2012, and the second of €15.5 million in 2014, with financing from the EU Instrument for Pre-Accession (IPA) specifically to improve infrastructure services in rural municipalities and rural settlements within urban municipalities.

Of the country's 80 municipalities, 57 participated in the MSIP and received subloans to implement their priority infrastructure projects. The EU IPA-financed component continues to support the implementation of activities in all eligible municipalities.

The main types of subprojects financed include the construction, reconstruction, and rehabilitation of local roads and public buildings, such as schools and kindergartens, including energy efficiency enhancements; improvements in the water supply and sewerage systems; street lighting; solid waste and storm water management; and sports and recreation, among other areas.

For example, with the EU IPA component funds, the "Jeronim De Rada" primary school in Cherkezi village was rehabilitated. The project financed the replacement of the interior carpentry, plasterboards, and floors; renovation of the corridors; repair of numerous holes; and interior painting.

As a result of this intervention, 530 students of the school and 58 school employees will benefit from the improved conditions, making possible a better overall educational process, increased safety and comfort in the school building, and a lower energy bill.

In addition, a new elementary school, "Hasan Tahsini," was built in Gurgurnica, enabling students in grades 1–9 to enjoy better learning conditions, including warmer and more comfortable classrooms.

Some of the other accomplishments of the MSIP include the rehabilitation of more than 16,300 piped household water connections and improved access to regular solid waste collection for over 524,500 people.

The "Country Snapshot" is a bi-annual update, highlighting the country's recent developments, economic outlook and major overview of the World Bank's partnership with the country. You can find the latest updates at http://www.worldbank.org/en/country/macedonia

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