



European Bank
for Reconstruction and Development

North Macedonia diagnostic

2024

Country diagnostics are a tool used by the European Bank for Reconstruction and Development (EBRD) to identify the main obstacles to entrepreneurship and private-sector development in the economies where it operates. They also help to shape the Bank's priorities and project selection in formulating new country strategies. Each diagnostic informs the EBRD's policy engagement with the authorities in that country.

Each diagnostic assesses national progress and challenges in developing a sustainable market economy. Private-sector development and entrepreneurship are at the heart of the Bank's mandate, but in all of the Bank's investee economies the private sector faces a range of obstacles. The country diagnostic highlights the key challenges facing private companies and shows where each economy stands relative to its peers on the Bank's six transition qualities – competitive, well governed, green, inclusive, resilient and integrated – highlighting the main deficiencies and gaps in each.

The diagnostics draw on a range of methodologies and best practices for assessing how large certain obstacles are. Extensive use is made of the Bank's in-house expertise and surveys, such as the Business Environment and Enterprise Performance Survey (BEEPS) and the Life in Transition Survey (LiTS), as well as other cross-country surveys and reports from institutions such as the World Bank, the World Economic Forum and the Organisation for Economic Co-operation and Development (OECD). For some larger countries, the diagnostics also draw on specially commissioned studies of selected issues that are critical to private-sector development.

The EBRD's Country Economics, Strategy and Policy (CESP) team leads the diagnostics, drawing substantially on the expertise of sectoral, governance and political experts in the Policy, Strategy and Delivery (PSD) department and consulting widely with experts across the Bank in preparing the final product. The diagnostics are shared with the EBRD Board during the country strategy process and published during the public consultation period.

The views expressed in the diagnostic papers are those of the authors only and not of the EBRD or its shareholders.

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This report was prepared by Peter Tabak, EBRD Lead Regional Economist for the Western Balkans; Olja Belic, former Economic Analyst for the Western Balkans; Nevena Stevancevic, Economic Analyst for the Western Balkans, and Stasa Perisic Petovar, Economic Analyst for the Western Balkans. The political economy segment of the report was written by Oleg Levitin. The authors are grateful for the contributions and comments provided by Camilla Committeri, Pavle Djuric, Stefan Kostovski, Gary McLean, Eliza Niewiadomska and Milena Popovic Martinelli. Editor: Hannah Fenn.

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1. Executive summary

Economic growth has been sluggish since the Covid-19 pandemic. The country's growth performance was the weakest in the Western Balkans after the global financial crisis, and following the pandemic it recovered more slowly than its peers, reaching the 2019 GDP level only in 2022. Inflows of foreign direct investment (FDI) have been steady at an average 3.6 per cent of GDP in the past decade, although also below that of most of its regional peers.

Productivity and living standards are far below European Union (EU) levels. Gross domestic product (GDP) per capita of North Macedonia, adjusted for purchasing power parity, was at 39 per cent of the EU average in 2023. The rate of convergence with the EU has slowed significantly in the past decade.

Competitiveness has been held back by an unattractive business environment for domestic companies. Small and medium-sized enterprises (SMEs) have struggled to cope with political instability, wide-spread skills mismatches and limited access to finance. Strong FDI inflows, however, have helped North Macedonia become the most open economy in the Western Balkans. North Macedonia has deep trade and FDI ties to the EU, but there is room for further trade opening, especially in services, and closer integration of domestic suppliers into global value chains. The gradual introduction of carbon tariffs will affect the competitiveness of certain exports due to the high carbon intensity of industrial production in North Macedonia.

Improvements to the quality of national governance have stalled in recent years. Decisive steps to fight corruption and informality have yet to be taken. The corporate governance of state-owned enterprises (SOEs) lags best international practice and requires significant improvement.

The green transition is advancing, but there needs to be more investment in energy efficiency and renewables. The authorities have committed to: completely phasing out coal-fired power generation and deploying 1.7 gigawatts of renewable energy by 2030; investing in the power grid and storage for

energy security; and taking measures to support communities affected by the transition away from coal. A cohesive strategic framework on decarbonisation and a regulatory environment conducive to investment in renewables are being developed. The country will need to accelerate investment in sustainable and less-polluting energy sources while enhancing energy efficiency to ensure a lower carbon footprint and better health outcomes as well as improved energy resilience. A reform of energy SOEs and meaningful tariff reform for households, including better targeting for those in need, is necessary for a smooth green transition.

Unemployment has dropped significantly in the past decade, but severe demographic challenges remain.

The population is declining steadily with an ageing profile and persistent emigration. The youth unemployment rate is more than double the EU-27 average as a result of poor education quality, skills mismatches and a difficult transition from school to work. The gender gaps in labour market participation and business ownership, and management remain large.

The financial system has proved resilient in recent years and weathered the pandemic well.

Access to credit remains tight for SMEs, however. In the longer run, the main challenges in the financial sector are the low volume of domestic long-term funding and the significant credit risk arising from the euroisation of banks' balance-sheets, despite visible improvements in this area. Capital markets are underdeveloped, illiquid and shallow, despite recent efforts by the authorities to create a supportive environment.

Significant infrastructure needs are gradually being addressed but better planning is key, given the limited fiscal space and large public investment needs. The quality of road transport, water supplies, and waste and wastewater management all require major improvements. Better cross-border electricity and gas interconnections would help to both balance the system with a larger share of volatile renewables and diversify natural gas provision in order to improve energy security and resilience to shocks.

2. Political and economic overview

Political economy

A landlocked Western Balkans country and one of the former republics of ex-Yugoslavia, North Macedonia has come a long way since independence in 1991. It started from a low point, being among the least developed in the former Yugoslavia, and has been exposed ever since to an unfavourable geopolitical environment. In the past, this included the negative impact of the name-related dispute with Greece, which had, among other things, severe economic consequences, and the legacy of uneven relations with various other neighbours who, at different times, questioned the nation's identity, history, name, religious autonomy and borders. In 2001 this multi-ethnic country went through an armed inter-ethnic conflict, the legacy of which has also affected its political and socio-economic life.

Despite these difficult circumstances, North Macedonia has achieved significant success. During the first two decades as an independent country, it moved further with privatisation than many other countries in the region. During that time, it also developed some of the best ways in the region to attract FDI it set up Free Economic Zones, reformed its tax system, established a “regulatory guillotine” and other business-friendly practices, and diversified its exports. The country consequently became one of the “top performers” in the annual World Bank Doing Business reports and was the first Western Balkans country to obtain the formal status of EU candidate country in 2005. Trade with the EU has been practically liberalised for more than a decade. The country is a member of the World Trade Organization (WTO) and the Central European Free Trade Agreement (CEFTA). However, progress slowed significantly in the previous decade.

North Macedonia actively participates in regional cooperation in the Western Balkans and is part of the “Open Balkans” initiative. While regional cooperation is indispensable for political stability, closer regional integration sends positive signals to investors and is critical for the country's economic prospects. By becoming part of a wider market with a population of more than 20 million people, the country is more attractive to foreign investors. Integration also increases the competitiveness of the relatively small Western Balkans countries.

However, the economic achievements, progress in inter-ethnic reconciliation within the country and some improvements in neighbourly relations were not always accompanied by a better functioning political system and democracy. Among the systemic, long-standing problems are weak institutions, underpinned by a lack of a stable, depoliticised, merit-based civil service, limited administrative capacity, and a poor culture of political dialogue and consensus building. Progress to strengthen the rule of law has been slow and corruption remains a serious problem.

The current governing coalition led by the centre-right VMRO-DPMNE has come to power after it scored a landslide victory in the parliamentary and presidential elections in May 2024. Over the previous seven years, VMRO-DPMNE had been the main opposition party while the governing coalition had been led by the centre-left SDSM. The new coalition government, established on 23 June 2024, has proclaimed an ambitious pro-business-oriented programme of accelerated economic development and modernisation of the country whose results remain to be seen.

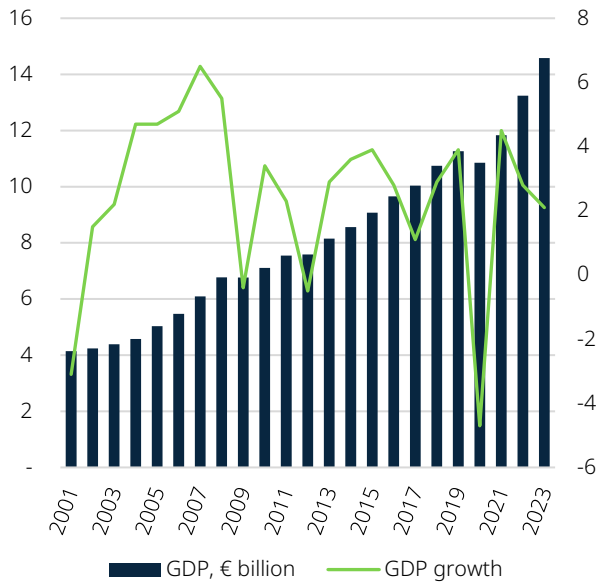
EU approximation remains a key external anchor for reforms. North Macedonia obtained the formal status of EU candidate country back in 2005 and the European Commission has been recommending since 2009 that EU accession negotiations begin. However, due to the lack of consensus in the European Council, it was not able to give the green light for accession negotiations until 2022.

While the landmark “Prespa Agreement” with Greece, which entered into force in 2019, paved the way for the admission of North Macedonia to NATO, a stabilising factor in its own right, this has not been followed by EU accession negotiations in earnest. The latter remains conditioned by the EU, based on Bulgaria's demand to adopt the constitutional amendments related to the status of Bulgarians in the country. Pending the start of EU accession negotiations, the reform and growth facility under the EU's new €6 billion Growth Plan for the Western Balkans represents an important mechanism for steering and supporting comprehensive reforms. The new government of North Macedonia submitted its Reform Agenda under the above-mentioned facility and it was approved by the European Commission on 23 October 2024.

Economic background and overview

Figure 1: GDP growth has been volatile and subdued in the past decade...

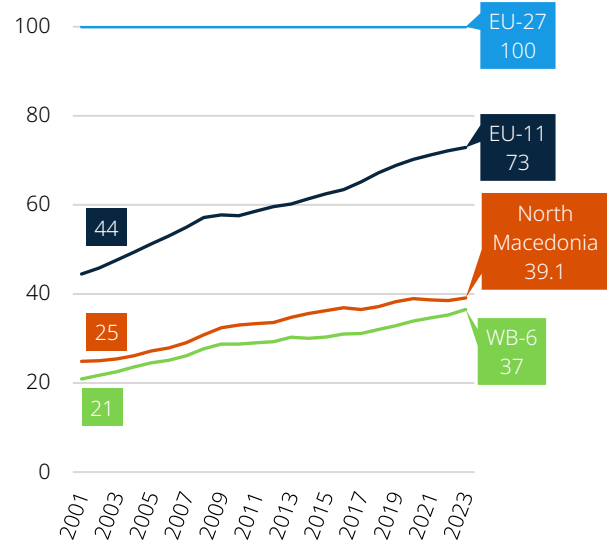
GDP in nominal € billion (left axis) and GDP growth in real terms (right axis)



Source: SSORM.

Figure 2: ...keeping the speed of convergence below the average of Western Balkans peers

GDP per capita, 2017 US\$ at purchasing power parity (PPP)



Source: IMF (2024), authors' calculations.

Note: WB-6 denotes the six countries in the Western Balkans: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia.

Economic growth has been weak following the global financial crisis. North Macedonia has been growing more slowly than its Western Balkans peers over the past two decades, averaging 2.5 per cent annually, and growth slowed further to around 2 per cent after the global financial crisis (Figure 1). As a result, economic convergence to the EU average income level has been slow, leaving the GDP per capita of North Macedonia around half that of the EU-11¹ levels, and around a third of the EU-27 level in 2023 (Figure 2).²

Growth has mainly been driven by services, which account for 70 per cent of output, and two thirds of total employment (Figure 3). Industry is also significant with an increasing share in output in recent years, and a dominant share in total exports (Figure 4). Agriculture still accounts for around 8 per cent of GDP which is similar to its Western Balkans peers, but higher compared to the EU-11 countries.³

North Macedonia is the country in the region that is most open to international trade. Goods exports have tripled in the past decade, reaching over 50 per cent of GDP.⁴ However, owing to a significant portion of materials and goods used in industrial production being imported, and the low complexity of exported goods, the contribution of net exports to value added was negative until 2023, when it switched to positive. This was mainly due to the decline in imports driven by the slowdown in domestic demand and higher services exports.

¹ The EU-11 represents the new EU member states from the central and eastern and south-eastern European regions: Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.

² See Eurostat (n.d.a).

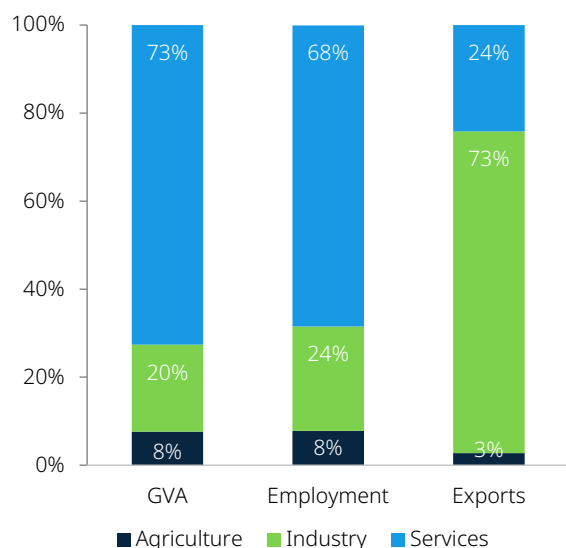
³ See SSORM (n.d.a).

⁴ See NBRM (n.d.a).

Foreign reserves are on an upward trajectory, despite the persistent current account deficit. They reached an all-time high of €4.5 billion in 2023 due to increasing FDI inflows which have been more than enough to cover the current account deficit in the past decade (figures 5 and 6).⁵

Figure 3: Services are the dominant sector in the economy but industrial products are the most relevant in exports

Share of total, in 2023

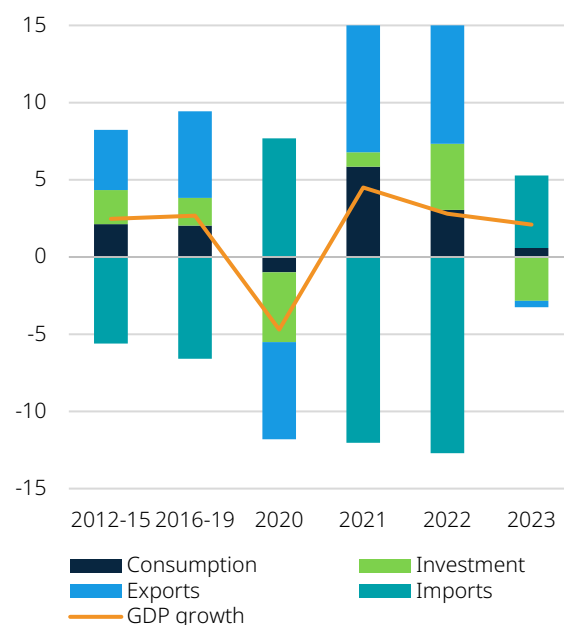


Source: SSORM, NBRM.

Note: GVA = gross value added.

Figure 4: Exports have been an important growth driver in the past decade

Contribution to GDP growth (pp), 2012-15 and 2016-19 are simple averages



Source: Eurostat.

The unemployment rate dropped from 30 per cent to around 14 per cent in the past decade, but it is still among the highest in the region. The employment rate is below 50 per cent and has been stagnating since the pandemic, while the participation rate is declining, unlike in other countries of the region.

This can be explained by the large-scale emigration of the working age population, among other things.⁶ Emigration from North Macedonia (temporary and permanent) more than doubled between 2009 and 2019, and reached 26,700 in 2019.⁷ Foreign sources report that the total number of citizens staying abroad (stock data) rose from about 527,000 in 2010 to almost 700,000⁸ (or almost a third of the country's resident population) in 2020. Based on the World Bank World Development Indicators,⁹ North Macedonia ranked among the top 20 countries in the world with the highest emigration rates in 2020 but emigration rates have declined since then. Among European destination countries, Germany, Italy, Switzerland, Austria and Slovenia had the highest number of immigrants from North Macedonia. Australia, the United States of America and Canada also received more than 400,000 citizens of North Macedonia. Family, employment and studies remained the main reasons for emigration.¹⁰

5 Ibid.

6 See World Bank (n.d.a), (Employment-to-population ratio 15+ modelled ILO estimate, and net migration) and ETF (2020).

7 See Publications Office of the European Union (2020).

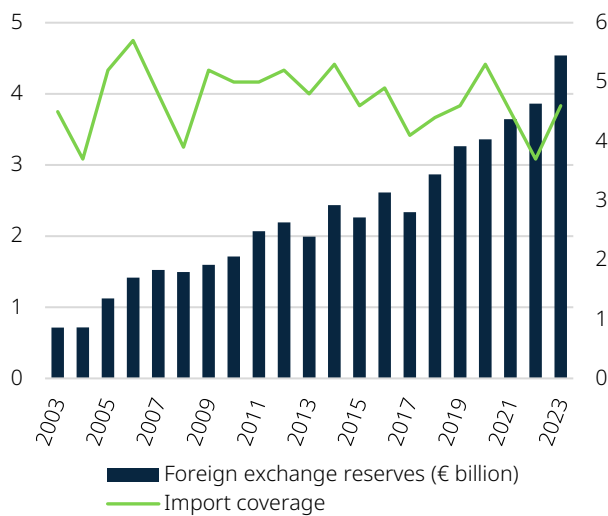
8 See UN DESA (n.d.).

9 See World Bank (n.d.a), Net migration and Population, total.

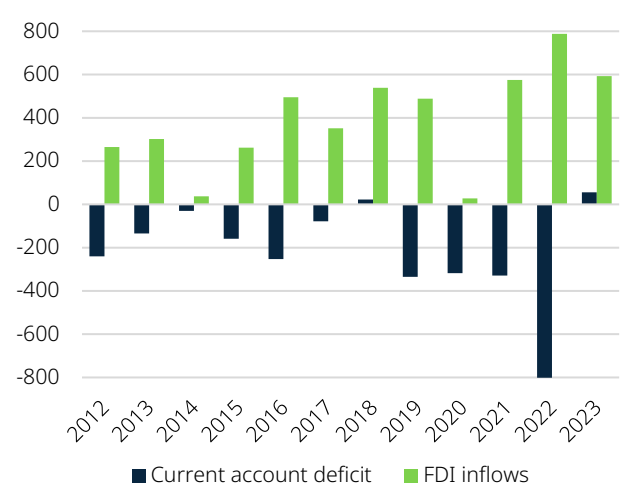
10 See UN Migration (2021).

Figure 5: Foreign exchange buffers remain relatively high... Foreign exchange reserves in € billion (left axis) and import coverage in months (right axis)

Figure 6: ...supported by FDI inflows that finance the current account deficit In € billion



Source: NBRM.



Source: NBRM.

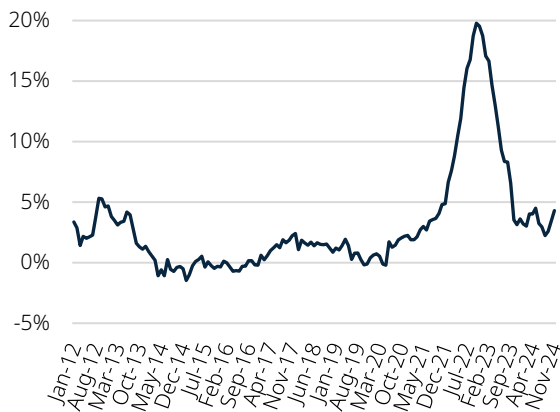
After a decade of relatively low and stable levels, inflation started to rise in 2021, driven by global supply chain disturbances and, later, by Russia's war on Ukraine. It reached a peak of 19.8 per cent in October 2022 (the highest level in the region) and decelerated to 2.2 per cent in August 2024 but was then on an increasing trend in the following months, reaching 4.3 per cent in November (Figure 7). Inflation was predominantly driven by food prices, which grew at the rate of 31 per cent in October 2022.¹¹

To tackle inflationary pressures, the government imposed a set of price caps on basic foodstuffs (including the most popular types of bread, dairy products, pasta, eggs, rice and some fruit and vegetables), which were in effect until the first quarter of 2024. The National Bank of the Republic of North Macedonia (NBRM) tightened its monetary policy in response to inflation, raising the policy rate several times from an all-time low of 1.25 per cent in April 2022 to 6.30 per cent in September 2023, where it remained for a year before it was gradually eased by 0.25 basis points in September, October and December 2024 to a level of 5.55 per cent.¹²

¹¹ See SSORM (n.d.b).

¹² See NBRM (n.d.b).

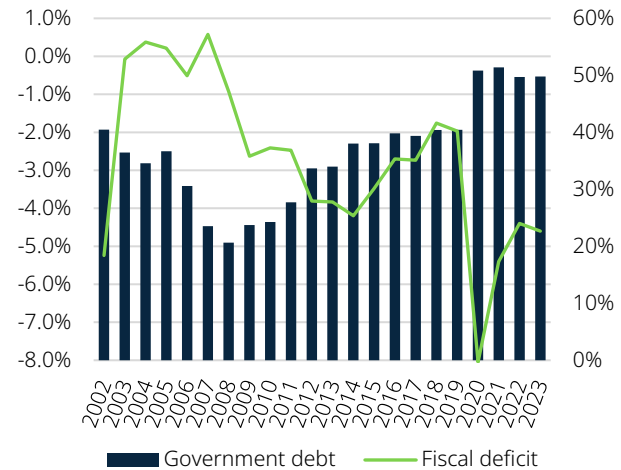
Figure 7: Inflation has been rising to decade highs
CPI index, annual growth rate in per cent



Source: NBRM.

Figure 8: Permanently high deficits in the past decade have been driving public debt above the Western Balkans average

General government deficit (left axis) and debt (right axis) in per cent of GDP



Source: Ministry of Finance of North Macedonia.

Since the financial crisis, the fiscal balance has been negative. The deficit reached a particularly high level during the pandemic and has been falling since then. However, while other countries in the region exploited high inflation in 2022-23 to improve the fiscal situation, the general government deficit in North Macedonia remained the highest in the region, at around 4.5 per cent of GDP.¹³ The challenge in the following years will be to implement fiscal consolidation, reducing the general government deficit to 3 per cent of GDP, while increasing capital investments to above 5 per cent from 4.2 per cent of GDP in 2022, as indicated in the Economic Reform Programme.¹⁴ General government debt increased during the pandemic and remained elevated at around 50 per cent of GDP, while overall public debt (including guaranteed and non-guaranteed debt of public enterprises and local municipalities) was around 60 per cent at the end of 2023. Fiscal strategy forecasts a gradual increase in the debt-to-GDP ratio in 2024, due to increased financing needs for capital expenditures. However, due to higher projected GDP in the following years and fiscal consolidation, debt is expected to be on a declining trend thereafter (Figure 8).

¹³ See Ministry of Finance of the Republic of North Macedonia (2024).

¹⁴ Ibid.

3. Qualities of a sustainable market economy

North Macedonia ranks 17th out of 36 EBRD countries of operation in the 2024 Assessment of Transition Qualities (ATQs).¹⁵ Based on a methodology developed by the EBRD in 2016, ATQs are a measure of six desirable qualities of a sustainable market economy: competitive, well governed, green, inclusive, resilient and integrated. Each quality is a composite index calibrated on a scale of 1 to 10 (best), obtained by combining information on a large number of indicators and assessments.¹⁶ North Macedonia outperforms other Western Balkans countries in four out of six qualities, slightly lagging in the competitiveness and inclusive qualities. Compared with the EU-11, the country lags in all six qualities (Figure 9).

Figure 9: Assessment of transition qualities in 2024

1 – 10 (best)



Source: EBRD Transition Report 2024-25.

Note: WB-5 denotes Albania, Bosnia and Herzegovina, Kosovo, Montenegro and Serbia.

Competitive – Improving the competitiveness of the economy of North Macedonia requires more domestic companies to be included in global value chains and raise productivity

The business environment has attracted FDI but not so much domestic companies, especially SMEs that struggle with the consequences of political instability, widespread skills mismatches and access to finance. Strong FDI inflows, covering the current account deficits, have been supporting export growth and making

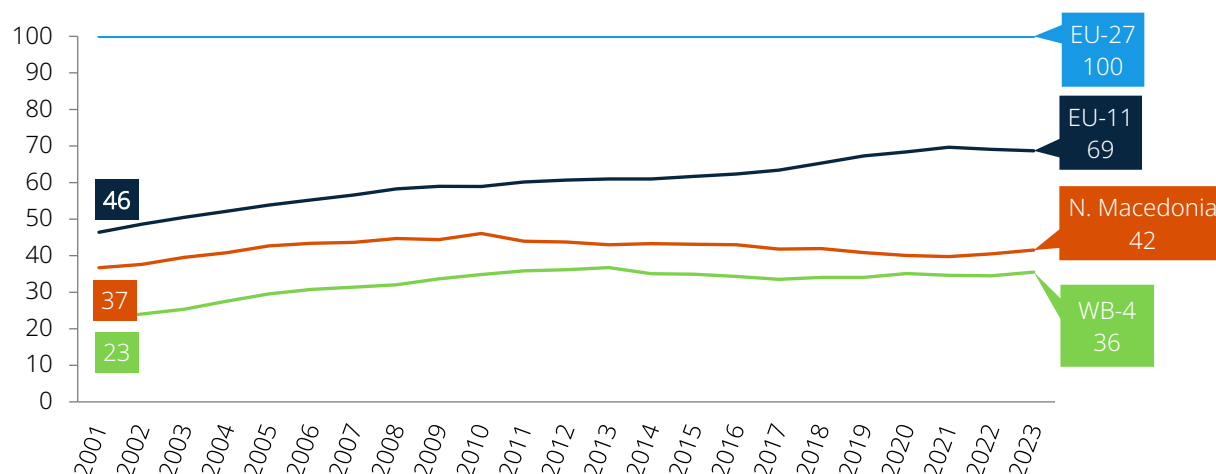
¹⁵ The score is calculated as a simple average of scores for the six transition qualities.

¹⁶ For more detail, please see EBRD (2017), pages 105-16.

North Macedonia the most open economy in the Western Balkans. Recent weakness in the main export destination, the eurozone, makes a diversification of trade partners inevitable. The gradual introduction of carbon tariffs will challenge the competitiveness of certain exports due to the high carbon intensity of industrial production of North Macedonia.

Figure 10: Labour productivity is low

Output per worker in GDP constant 2017 international \$ at PPP



Source: International Labour Organization (ILO).

Note: The recent increase in labour productivity may partly be attributed to the lower number of workers in the labour force survey as the latest population census from 2021 is reflected in the data. The data for Kosovo were not available. WB-4 comprises Albania, Bosnia and Herzegovina, Montenegro and Serbia.

Labour productivity growth has stalled, and the country continues to lag EU comparator countries. Stagnant labour productivity growth implies that economic growth has come from higher employment rather than greater efficiency in production. Firm-level data confirm low and stagnant firm productivity, with the services sector performing particularly poorly.¹⁷ Weak labour productivity growth hinders income and wage convergence: slow growth will not be enough for convergence with the average EU per capita income level in three generations (Figure 10).

The business environment still needs to improve as it continues to be hampered by long-standing structural challenges, such as the sizeable informal sector and unpredictability of parafiscal charges. While there has been some progress, notably in the digitalisation of administrative processes and inspections, the government's approach to improving the business environment remains slow and unsystematic.¹⁸

As in the other Western Balkans economies, the oversized public sector drags down the overall productivity of the economy. The public administration is particularly problematic – oversized even by regional standards while frequently rated as inefficient. SOEs have a monopolistic presence in certain sectors, while enjoying unfair competitive advantages through subsidies and state guarantees.¹⁹ Wages in the public sector are higher than in the private sector and this distorts the level playing field further.

Subsidies make up a large share of the government's expenses, compared with both EU comparators and the region. State aid is offered by many different governmental agencies in an ad-hoc manner and there is no comprehensive registry of state aid or subsidies offered by the government. A Finance Think study has shown that an increase in state aid produces a less than equivalent effect on GDP, indicating low efficiency. Streamlining, better targeting, linking state aid to outcomes, assessing the effectiveness of measures and cost-benefit analysis would help reduce costs while

¹⁷ See World Bank (2023).

¹⁸ See European Commission (2022), EBRD (n.d.).

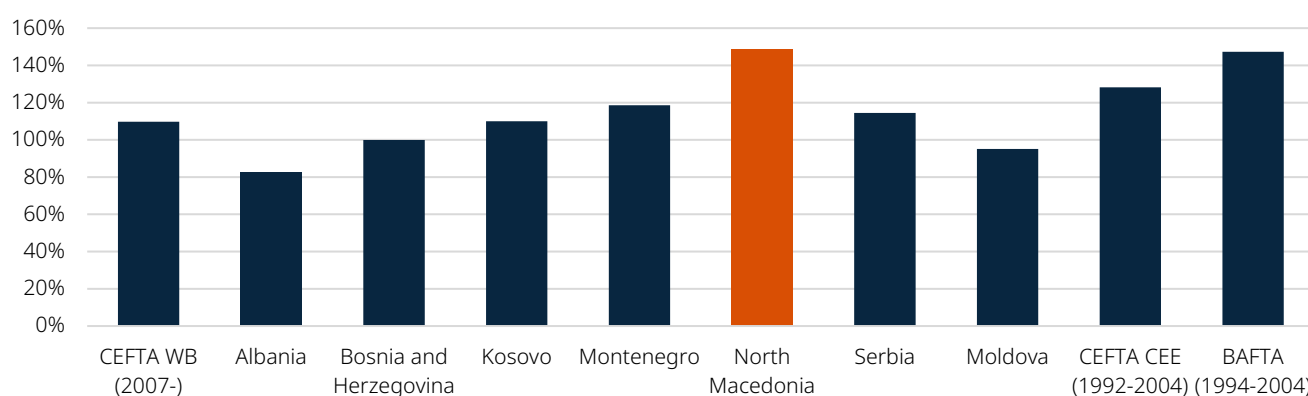
¹⁹ See World Bank (2018), Richmond et al. (2019).

increasing effectiveness.²⁰ In 2022, the pension deficit stood at 3 per cent of GDP (without the transitional cost),²¹ arrears at 3.2 per cent of GDP, and guarantees to SOEs at 8.7 per cent of GDP.²²

Trade openness is among the highest in the world and complexity is increasing (Figure 11). This may have been helped by the fact that North Macedonia became a WTO member in 2003. The country has recently extended the WTO open market rules to public contracts (public procurement and concessions). Nevertheless, comparative advantages are still mainly in low-value-added industries (Figure 12). The structure is also very different in exports towards the EU (around 60 per cent of exports are manufactured goods) and in intra-regional trade (only around 40 per cent of exports are manufactured goods), offering opportunities to increase the size and sophistication of intra-regional (and world) exports.²³ In comparison, in central and eastern Europe manufactured goods make up around 70-80 per cent of exports to all regions.

Figure 11: Trade openness is similar to that of the former CEFTA and BAFTA members

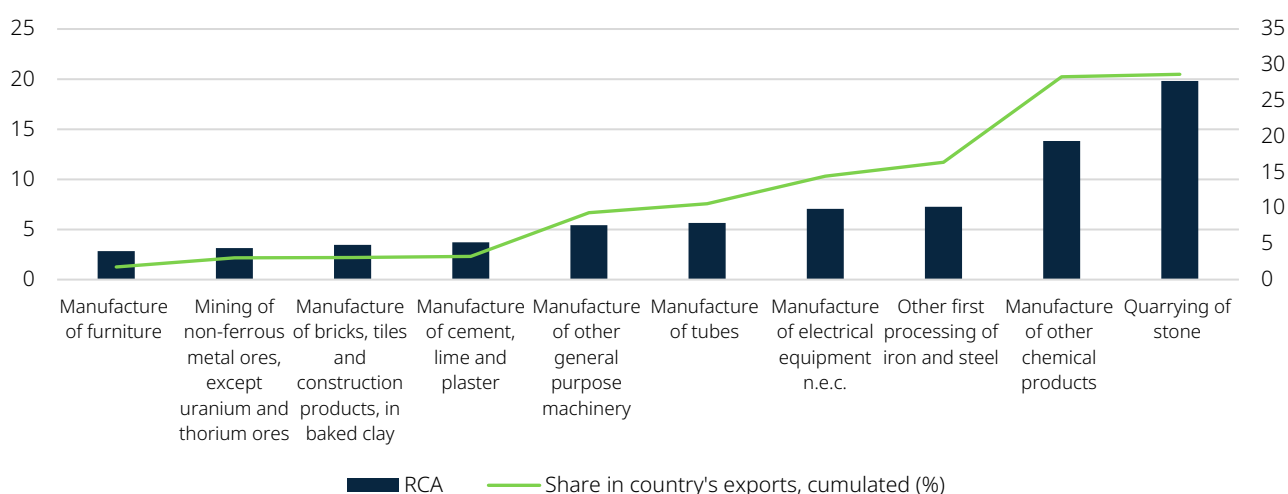
Total goods and services exports and imports, per cent of GDP, in 2023



Source: World Bank, Kosovo Agency of Statistics.

Figure 12: North Macedonia has comparative advantages mainly in the “old” economy

Revealed comparative advantages in exports (left axis) and cumulative share of those products in exports (right axis) in per cent, in 2021



Source: WITS.

20 See European Commission (2022), World Bank (2020).

21 The cost of introducing a mandatory private pension fund (pillar II), when mandatory pay-as-you-go (pillar I) already exists. It is created when a portion of the contributions paid into the mandatory state pension fund is diverted to private funds.

22 See World Bank (2023).

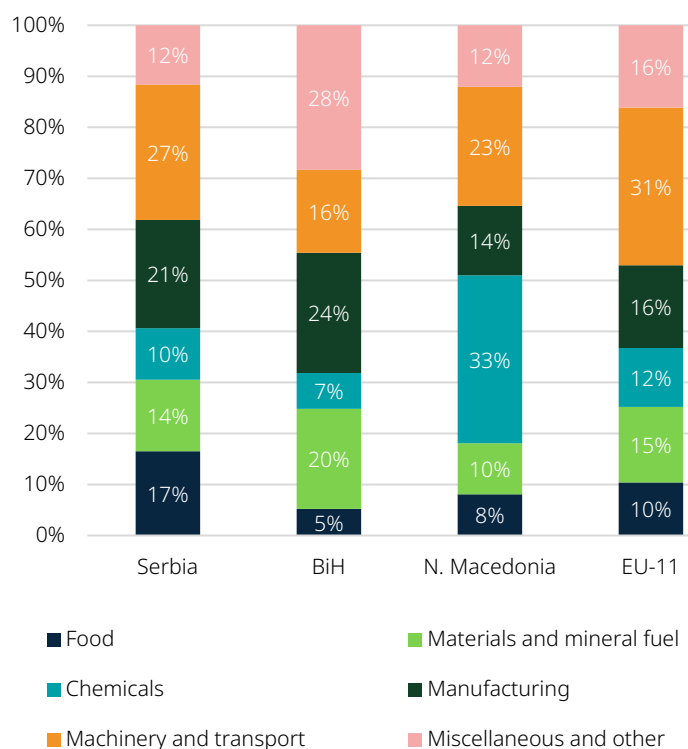
23 See UNCTAD (n.d.a).

Note: Revealed comparative advantage (RCA) is measured as the ratio of the share of a country's export of a certain product to the total world export of that product and the country's share in world exports, based on three-digit NACE classification.

The export basket of North Macedonia has seen the biggest expansion in the past decade in the Western Balkans in GDP terms, and exports have in turn led to economic growth.²⁴ The major success of the previous period refer to the increasing complexity of exports of North Macedonia, largely driven by strong FDI inflows, primarily into the manufacturing sector. While the export basket is becoming increasingly complex, it is also highly concentrated into a few key narrow segments, such as the automotive sector.²⁵

Figure 13: A bulk of exports are in manufacturing and machinery and transport...

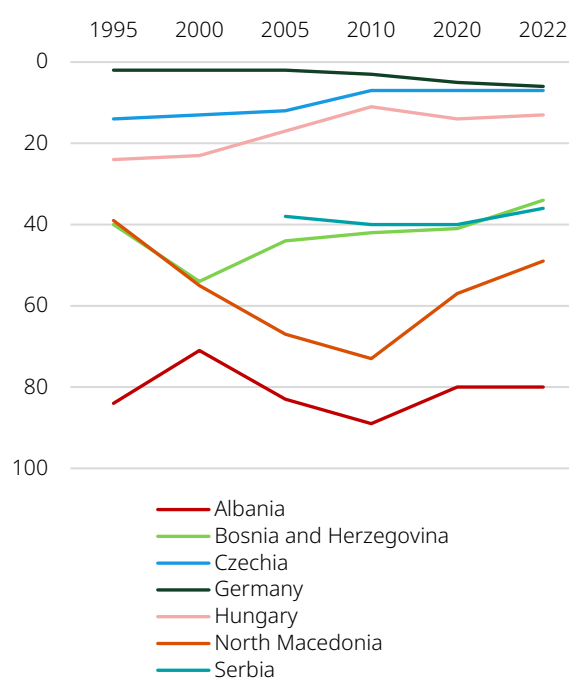
Share of all exports



Source: UNCTAD.

Figure 14: ... but of relatively low sophistication.

Harvard Growth Lab Country Complexity Index ranking from best (1) to worst



Source: UNCTAD.

North Macedonia needs to shift towards higher value-added FDI in order to raise the productivity of the private sector...

The business environment has attracted FDI due to the relatively low cost of labour and energy compared with the EU, the geographical proximity to key markets and a comprehensive package of incentives for investors. While FDI inflows have contributed to developing the manufacturing sector of North Macedonia and created many jobs, the bulk of FDI has gone to low- and medium-value-added manufacturing with limited spillover to the domestic economy.²⁶

...and increase the productivity and competitiveness of the domestic private sector. While investment and trade policies, in general, are competitive (Figure 15), domestically owned companies, especially SMEs, find it difficult to integrate into global value chains and tend to lag in digitalisation or the green transition, resulting in weak or stagnant productivity growth.²⁷ Foreign-owned companies in FDI value chains purchase only around 10 per cent of their inputs from domestic suppliers, and rely on imports instead. SMEs are also more vulnerable to the general shortcomings of the business environment; they tend to be more burdened by political instability, bureaucracy and informality than large companies,

²⁴ See UNCTAD (n.d.a).

²⁵ See World Bank (2020).

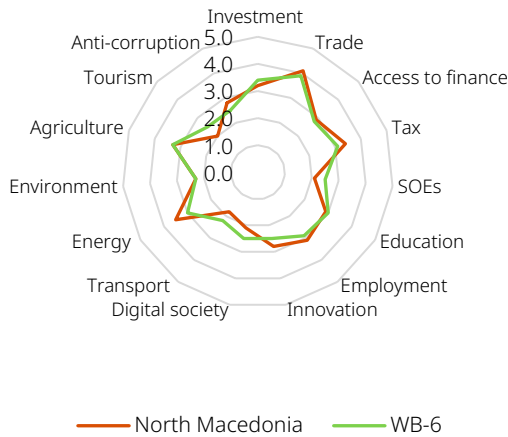
²⁶ See World Bank (2020).

²⁷ See World Bank (2023).

according to surveys such as BEEPS (Figure 16).²⁸ Furthermore, lending standards for SMEs tend to be more restrictive, smaller companies are seen as inherently riskier and are discouraged from bank borrowing.²⁹

Figure 15: Investment and trade policy are competitive...

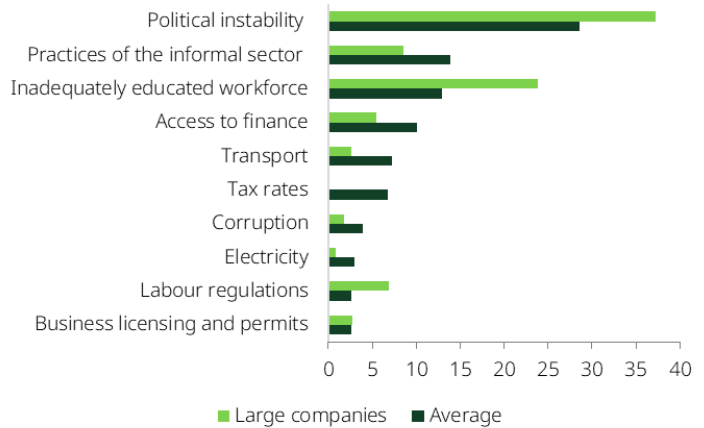
Competitiveness Index 2024 policy scores across dimensions; 0-5 (best)



Source: OECD.

Figure 16: ...but the informal sector and political instability challenge competitiveness

Top 10 obstacles to doing business; share of firms identifying it as such



Source: BEEPS VI.

Note: In industry, construction and services.

The competitiveness of exports of North Macedonia, at present, is supported by the absence of carbon tariffs. Given the upcoming Carbon Border Adjustment Mechanism (CBAM) legislation, countries that cannot get exemption are set to lose export competitiveness based on the carbon intensity of both their energy production and the production processes of CBAM-affected industries.³⁰ There is merit in exploring carbon pricing options to get exemption and accelerating investment into clean energy sources, as the cost of not adapting on time is to be high for the economy of North Macedonia.

Box 1: The CBAM is set to challenge the competitiveness of Western Balkans' exports

The Emissions Trading Scheme (ETS) is the cornerstone of the EU's climate policy. It imposes a cost on CO₂ emissions from highly polluting sectors (such as energy and industry), to encourage the replacement of fossil fuels with clean energy sources. A key challenge for the ETS has been how to incentivise carbon-intensive sectors to reduce their emissions while avoiding the risk of shifting production to locations with less stringent carbon policies (so-called "carbon leakage").

To mitigate this risk, the EU is introducing the Carbon Border Adjustment Mechanism (CBAM). This addresses carbon leakage at the border by putting prices on affected imported products equivalent to the ones within the EU. According to the regulation adopted by the European Parliament in April 2023, the CBAM is to focus on direct emissions from limited industrial sectors with a high risk of carbon leakage (iron and steel, cement and clinker, fertiliser, aluminium and electricity), and indirect emissions from fertiliser, cement and electricity during the transitional period from 1 October 2023 until 31 December 2025. Obligations of the importer during this time will be limited to reporting. Before the end of the transitional period, the product coverage can be extended.³¹ Starting from 2026, free allocation of CO₂ emissions will be phased out and the CBAM will be gradually phased in by 2034. The EU, in parallel, is working on extending the scope of the CBAM regulation to include all sectors subject to the ETS by 2030.

²⁸ See EBRD (n.d.).

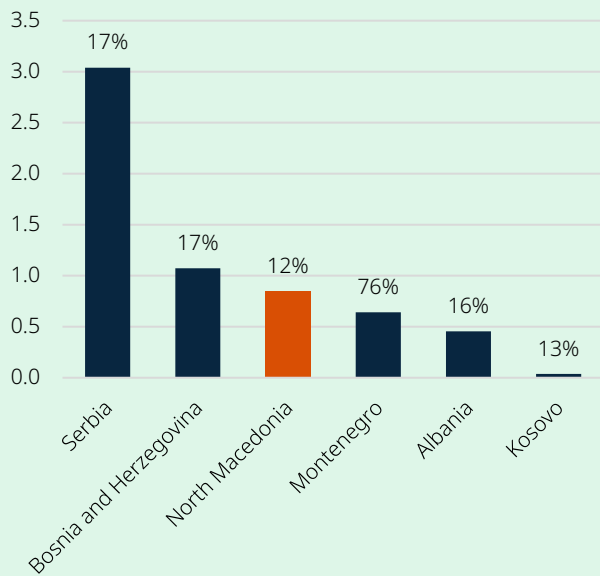
²⁹ See World Bank (2023).

³⁰ See IDSCS (2022).

³¹ The European Council reserves the right to extend the product scope and coverage of indirect emissions before full implementation (1 January 2026), but it needs to submit the proposal to the European Parliament no later than 31 December 2024.

Figure 17: CBAM-affected exports as share of total exports to EU lower than that of regional peers

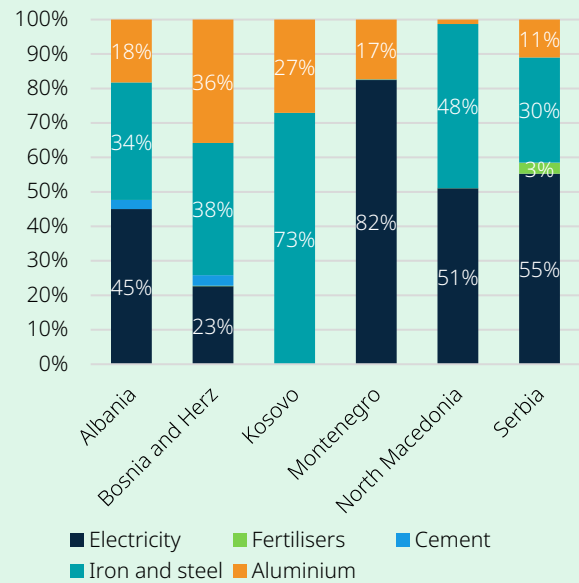
In 2023, in nominal € billion terms and per cent of total EU exports



Source: Eurostat and authors' calculations.

Figure 18: Structure of CBAM-affected exports

In 2023, in per cent



Source: Eurostat and authors' calculations.

Note: Hydrogen exports are insignificant and are not taken into account.

A tight trading relationship with the EU and carbon intensity of the Western Balkans economies make the region vulnerable to the policy. The EU is traditionally the biggest single trading partner for all of the Western Balkans countries. Exports of CBAM products to the EU accounted in 2022 for 22 per cent of all Western Balkans' exports to the EU (Figure 17).³² The most significant impact will be felt by the export-oriented iron and steel as well as aluminium industries, where EU exports account for a large share of overall production (Figure 18). While the effects of the CBAM will depend on the governments' approaches (policy options include implementation of own carbon pricing mechanisms or a request for exemption of electricity until 2030 under certain conditions), the legislation is bound to have a profound impact on entire industries as profit margins shift and countries can lose export competitiveness based on their energy mix.

The government has adopted strategies related to digitalisation. The National ICT Strategy 2023-27³³ sets out a vision for an agile digital future for North Macedonia that focuses on priority areas in the information and communications technology (ICT) sector to meet society's growing connectivity needs, boost competitiveness, improve citizens' daily lives and make businesses smarter. The Smart Specialisation Strategy 2024-27³⁴ focuses on supporting the digitalisation of key economic sectors, including agritech, the electro-mechanical industry and smart buildings.

North Macedonia has improved its connectivity infrastructure, boasting nearly 100 per cent coverage by 4G and 3G networks³⁵ and achieving competitive global rankings in mobile and fixed-line broadband speeds. The rapid expansion of the telecommunications sector, driven by regulatory reforms and alignment with EU standards, has resulted in impressive internet accessibility. However, despite high connectivity rates, about 19 per cent of the population, particularly those aged 60 and above, remain disconnected. The affordability of digital devices is mixed, with smartphones relatively expensive compared with monthly income, while the cost of cellular data is remarkably low. North Macedonia also lacks a cloud infrastructure, which can be an issue for some SMEs and start-ups, as renting cloud services can be expensive. Lastly, both hard and soft ICT infrastructure are largely concentrated in Skopje to the

32 Authors' calculations based on Eurostat data. CBAM products refer to the initial scope as defined in the regulation from April 2023: iron and steel, cement and clinker, fertiliser, aluminium, electricity and hydrogen. Hydrogen has not been included in the data given the insignificant exports by Western Balkans countries.

33 See Ministry of Information Society and Administration of the Republic of North Macedonia (2022).

34 See Government of the Republic of North Macedonia (2023a).

35 See ITU (n.d.).

detriment of smaller cities and rural communities. Half of the population of North Macedonia lives in rural areas, and one-fifth makes its livelihood from agriculture.

There is limited capacity in the private sector to adopt new technologies. A United Nations Development Programme (UNDP) survey shows concerns about budget constraints, a lack of support and insufficient local digital skills. Despite the favourable ranking of North Macedonia in the Global Innovation Index for credit accessibility, there is a notable lack of awareness among survey respondents regarding financial mechanisms that incentivise corporate digital transformation.³⁶

The government-owned Development Bank of North Macedonia was established to provide financing for micro, small and medium-sized enterprises (MSMEs). The Fund for Innovation and Technology Development (FITD) provides 90 per cent funding for projects up to €40,000. FITD financial instruments also support SMEs in developing business ideas and projects. While venture capital (VC) is not available domestically, start-ups can access international VC funds such as South Central Ventures or the Western Balkans Private Equity Fund. The private equity market, too, is at a very early stage of development, with limited investment opportunities. However, fewer financing options are available to large multinational corporations, which therefore tend to self-finance their research and development (R&D) activities. Currently, the government is the leading funding provider for the ICT sector.³⁷

Skopje is emerging as a vibrant hub for innovation that hosts a significant portion of the start-up community and a diverse technology ecosystem. Entities such as MASIT, Startup Macedonia and Macedonia2025 play crucial roles in bridging sectors and advocating for private enterprises, contributing to the global innovation rankings of North Macedonia. To strengthen the broader innovation ecosystem, it is imperative that funding for R&D is increased (in 2020 just 0.38 per cent of GDP was allocated to it). Both hard and soft ICT infrastructure, as well as business support and networking, are largely concentrated in Skopje.³⁸

The cybersecurity landscape of North Macedonia shows some progress, marked by a slight decline in the Global Cybersecurity Index ranking but an improved score. The country's proactive approach includes adopting a National Cybersecurity Strategy and engaging with international partners such as the US Agency for International Development (USAID) and NATO. While the Budapest Convention on Cybercrime is ratified, challenges remain in aligning domestic laws with convention provisions. Public concerns revolve around account hijacking and data privacy, emphasising the need for targeted initiatives and education.³⁹

Well governed – Speeding up public sector governance reform as well as the fight against corruption and informality would help strengthen business confidence

Improvements in the quality of national governance have stalled in recent years, despite the significant catch-up required to reach EU standards. Decisive steps to fight corruption and informality have yet to be taken. The corporate governance of SOEs requires significant improvement.

36 See UNDP (2023).

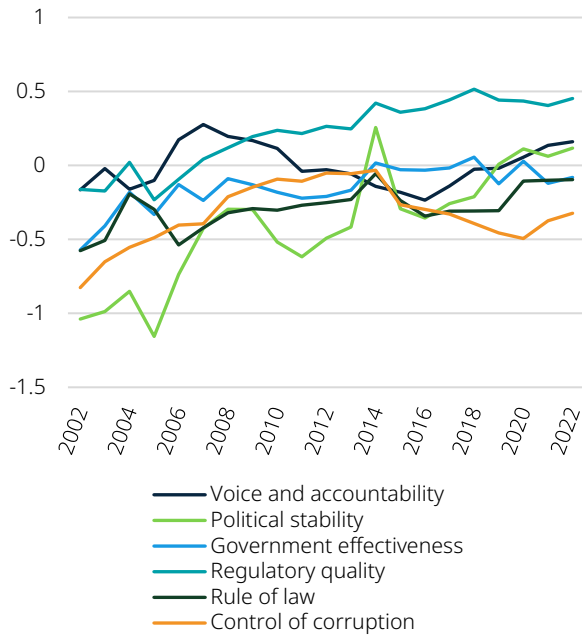
37 See ITU (2023).

38 Ibid.

39 See UNDP (2023).

Figure 19: Governance standards are generally on an improving trend, except the control of corruption...

On a scale of -2.5 (the worst) to 2.5 (the best)



Source: World Bank WGI, authors' calculations.

Figure 20: ...and outperform the other Western Balkans countries, but lag the EU-11

On a scale of -2.5 (the worst) to 2.5 (the best), in 2022



Source: World Bank WGI, authors' calculations.

Governance standards have mostly improved over time and outperform the other Western Balkans countries on average but continue to lag EU levels (Figures 19 and 20). North Macedonia is one of the countries in the Western Balkans (alongside Montenegro) that is perceived as fairly advanced in terms of the regulatory quality – that is, the government's ability to formulate and implement sound policies and regulations that promote private-sector development.⁴⁰ In turn, government effectiveness, capturing the perception of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, is rated relatively poorly, negatively affecting the pace of EU approximation. The European Commission states that North Macedonia is moderately prepared in the reform of its public administration, noting limited progress in the adoption of the new public administration reform strategy and associated action plan. The Commission emphasises that adoption of a new legal framework for human resource development across the public administration is needed to ensure merit-based recruitment across all levels of the civil service. Also, legislation should take on board the recommendations of the State Commission for the Prevention of Corruption on nepotism, cronyism and political influence in the recruitment of public-sector employees and appointment of members of supervisory and management boards.⁴¹

Perception of corruption is widespread, with limited improvement over time. According to the World Bank Worldwide Governance Indicators, control of corruption (measuring the perception of the extent to which public power is exercised for private gain) is the worst performing dimension of governance in North Macedonia.⁴² This sentiment is echoed in the Transparency International Corruption Perception Index, which demonstrates some progress in fighting corruption since the political transition in 2016, but also that perception of corruption remains widespread.⁴³ According to the EBRD's Life in Transition Survey (LiTS) from 2023, 54 per cent of randomly chosen individuals in North Macedonia believe "political connections" is the most important factor for success in life, the highest result in the Western Balkans. This is in stark contrast with the response from the Western European comparators, which give more weight to "effort and hard work" and "intelligence and skills" (Figure 21).⁴⁴ In the future, the quality of governance of public procurements and

40 See World Bank World Development Indicators, regulatory quality estimate.

41 See European Commission (2023).

42 See World Bank (n.d.b).

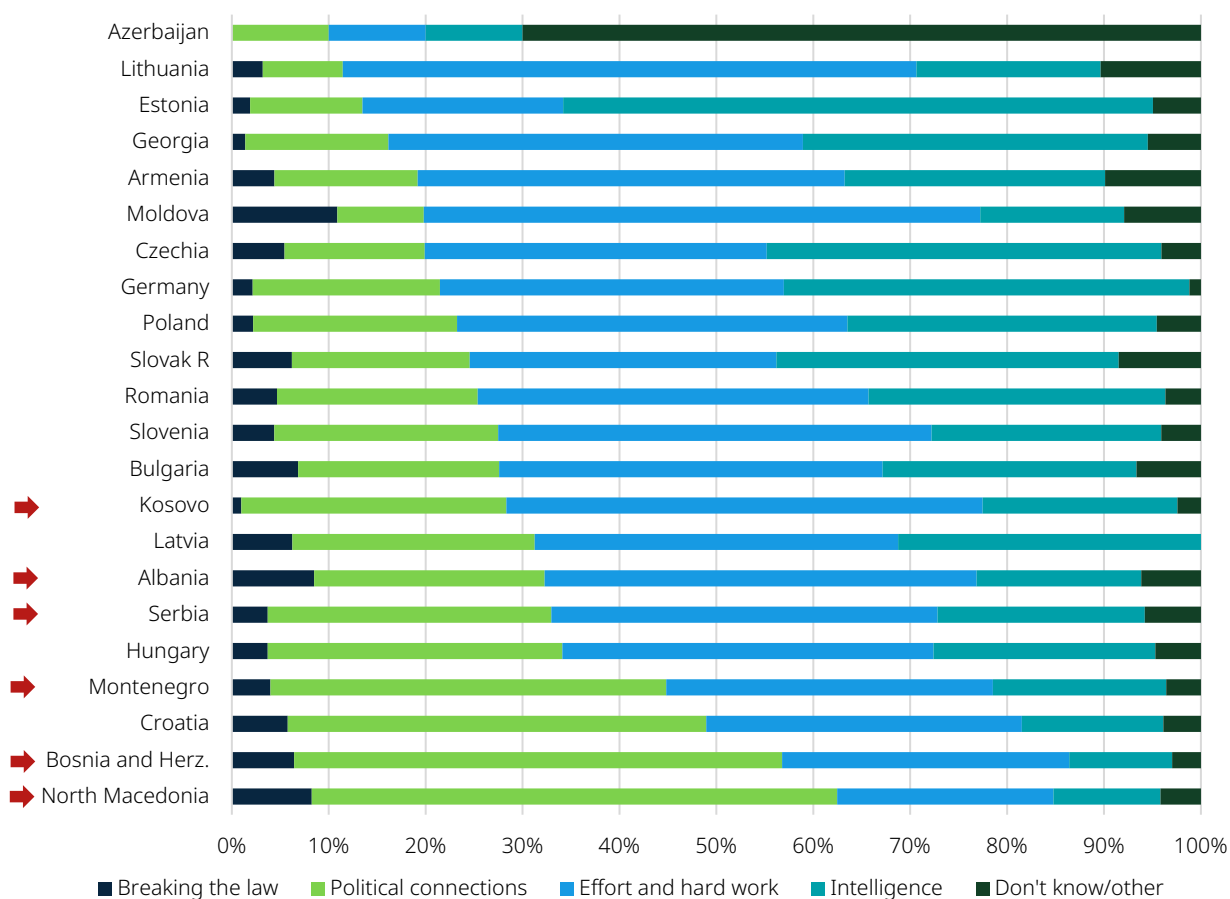
43 See Transparency International (n.d).

44 See EBRD (2024).

concessions shall increase since the country joined the WTO's 2012 Agreement on Government Procurement in 2023 and committed to reforms; yet actual improvements depend on transparency and anti-corruption safeguards being implemented.

Figure 21: Political connections are viewed as the most important factor for succeeding in life

Per cent of respondents, in 2023



Source: EBRD LiTS IV (forthcoming).

Note: Preliminary results as of 21 June 2023. Data for Kosovo, Bosnia and Herzegovina and Czechia are incomplete.

A fair and efficient justice system is key for better governance. A closer look at the World Justice Project's Rule of Law Index points to: weaknesses in the areas of accountability of the government, its officials and agents; corruption in the judiciary; and weaknesses in the transparency and quality of information published by the government, effectiveness of the justice system and strength of regulatory enforcement.⁴⁵ Survey results show that some 52 per cent of citizens of North Macedonia have little trust in the judiciary, making it the least trusted institution, even compared with political parties.⁴⁶ According to the EBRD's BEPS III Survey of Banks conducted in 2021, only 18 per cent of the country's banks perceive courts as fair and impartial (the second lowest result in central, eastern and south-eastern Europe after Serbia and far below the south-eastern Europe and EBRD regional averages), and none of the banks surveyed viewed their court system as quick and efficient.⁴⁷

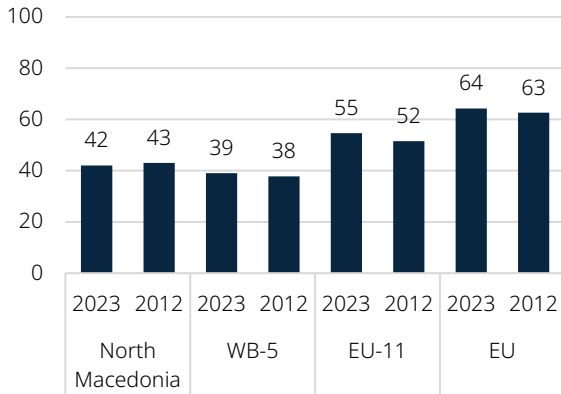
⁴⁵ See World Justice Project (n.d.).

⁴⁶ See Transparency International (2021).

⁴⁷ See EBRD (2022).

Figure 22: Perception of corruption is widespread, with limited improvements over time

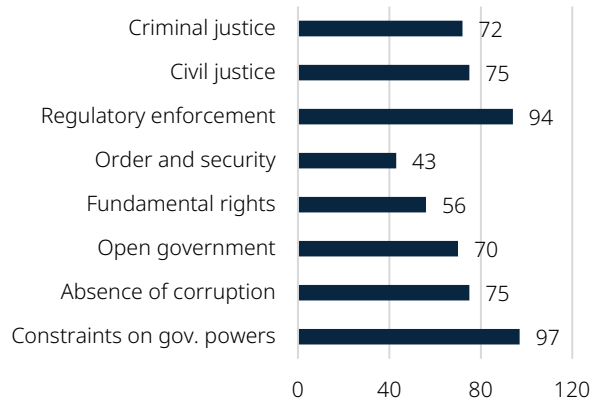
Corruption Perception Index, score on a scale of 0 (the worst) to 100 (the best), in 2023



Source: Transparency International, authors' calculations.

Figure 23: Low ranking of constraints on government powers and regulatory enforcement weaken the rule of law index

WJP Rule of Law Index by sub-indexes, rank out of 140 countries (1 being best), in 2023



Source: World Justice Project.

Informality indicates unresolved complexities in the business environment. North Macedonia ranks well relative to regional comparators but still lags advanced comparators somewhat when it comes to the administrative and regulatory burden on firms according to the EBRD's ATQs. North Macedonia made significant progress in alleviating the administrative burden for businesses in the 2017-19 period thanks to digitalisation, and at the end of 2019 the country launched a dedicated electronic platform offering more than 700 public services online. Despite the remaining gaps, the authorities have made little progress on simplifying administrative procedures according to European Commission progress reports, and businesses report frequent changes to the regulatory framework, uneven enforcement of business regulations and absence of rules in para-fiscal charges as obstacles to doing business. Continuous work on institutional quality, governance and the business climate, as well as improvements in the quality and accessibility of public goods and services, is needed to reduce the incentives to work in the shadow economy and increase the willingness of firms to comply with regulations.

Box 2: Main corporate governance characteristics for privately owned companies and SOEs in North Macedonia

In North Macedonia, SOEs have a generally smaller footprint than those in most other economies in the Western Balkans. The government owns 14 public enterprises (statutory enterprises that are not yet converted into general corporate legal forms) as well as 15 companies (13 joint stock companies and 2 limited liability companies).

There is little public information on how the government exercises its ownership function. There does not seem to be a state ownership policy informing ownership responsibilities and governance standards in the country, and the ownership of SOEs seems to be decentralised and divided among several key line ministries. In addition, the Ministry of Finance collects financial information (revenues and expenditures) from the 29 SOEs and publishes aggregated reports on their financial situation every quarter.

While the number of SOEs is relatively small, the fragmented legal framework raises questions about the quality of underlying practices, primarily with respect to public enterprises. It seems that on average the (supervisory) board plays less of a strategic and oversight role and is more prone to government interference. Also, the internal control system seems to be lacking (that is, public enterprises do not have dedicated internal audit units).

There have been notable steps taken to improve the corporate governance framework and practices of privately owned companies. Independent directors are required, with specific mandates for their presence and roles. Gender diversity on boards has improved since the previous assessment, with average female representation in the largest 10 listed companies in the country being above 20 per cent and expected to improve further due to recommendations of the new Corporate Governance Code.

As of 2023, the largest listed companies must also disclose their adherence to the Corporate Governance Code, following a "comply or explain" approach. While some companies exhibit good compliance, there is room for improvement, especially in disclosing board composition, committee activities and structure of capital.

The presence of audit committees, codes of ethics and whistleblower protection mechanisms suggests a strong framework for internal controls and accountability. Public interest entities (including listed companies and banks) are required to have an audit

committee. However, non-board members can serve on the committee. It seems that the establishment and reporting lines of audit committees vary among different legal frameworks, with some listed companies apparently lacking these essential oversight bodies.

In 2021 the Macedonian Stock Exchange (MSE) introduced a new Code of Corporate Governance, developed with EBRD support, which applies on a "comply or explain" basis to listed companies which fulfil the conditions prescribed in the Listing Rules. *A Guide for ESG Reporting* complements the code, promoting environmental, social and governance considerations. The inaugural monitoring report for 2022 indicates an overall compliance rate of 76 per cent among 27 listed companies, with a positive trend towards higher compliance. The MSE, along with regulatory bodies such as the National Bank of the Republic of North Macedonia for banks, oversees compliance with the Corporate Governance Code.

Green – Strong commitments regarding green transition need to be acted upon

North Macedonia has made important commitments regarding its green transition, including the complete phase-out of coal-fired power generation and the deployment of 1.7 gigawatts of renewable energy by 2030, grid and storage investments for energy security and measures to support communities affected by coal transition. Now it is time to implement them. As both domestic and global risks challenge the status quo, the country will need to accelerate investment in sustainable and less-polluting energy sources while enhancing energy efficiency measures to ensure a lower carbon footprint and better health outcomes as well as improved energy resilience. Development of a cohesive strategic framework on decarbonisation and a regulatory environment conducive to investment in renewables is in progress.

The economy is highly carbon-intensive. Carbon intensity of the economy, measured as CO₂ emissions per unit of GDP, is lower than the average of the other Western Balkans countries, but is 28 per cent higher than the average of the 11 EU member states of central, eastern and south-eastern Europe (the EU-11) and a third higher than that of the EU-27 (Figure 24).⁴⁸ Electricity and heat producers account for the largest portion of CO₂ emissions at close to 60 per cent, followed by the transport sector, which is characterised by an outdated fleet of vehicles. The industrial sector also plays a non-negligible role, causing 14 per cent of CO₂ emissions (Figure 25).⁴⁹ Carbon intensity of industrial energy consumption in North Macedonia is among the highest in the Western Balkans region (together with Bosnia and Herzegovina), above neighbouring Serbia and 54 per cent higher than in the EU.⁵⁰ As a result of high carbon intensity of economic activity and by-product emissions from thermal power plants, air pollution figures are staggering and Skopje frequently tops the list of Europe's most polluted capitals, particularly in winter. The annual mortality rate measured as premature deaths per 100,000 inhabitants attributable to PM_{2.5}, the particulate matter causing the brunt of harm, is double that of the EU as of 2021.⁵¹

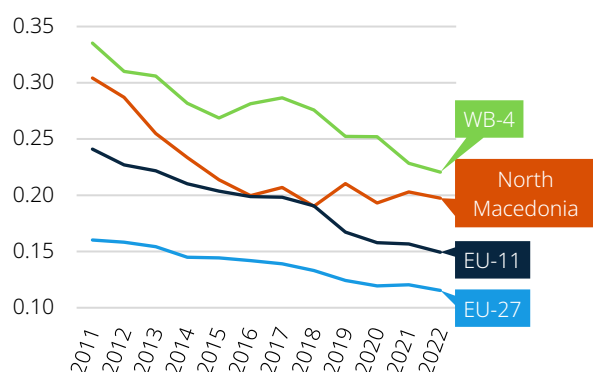
48 Authors' calculations, based on data from World Bank (n.d.a).

49 See IEA (n.d.).

50 Ibid.

51 See Soares et al. (2022) and Belis et al. (2024).

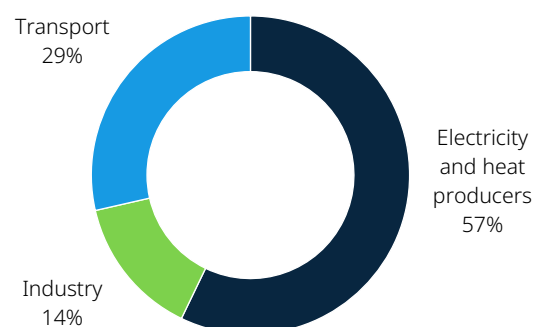
Figure 24: Carbon intensity of the economy is high...

CO₂ emissions, in kg per 2017 PPP \$ of GDP

Source: World Bank WDI.

Note: WB-4 refers to Albania, Bosnia and Herzegovina, Montenegro and Serbia

Figure 25. ...driven by coal-based electricity production.

CO₂ emissions by sector, in per cent

Source: IEA.

The energy sector remains dependent on fossil fuels... Electricity and heat generation in North Macedonia is overwhelmingly based on outdated, inefficient and poorly maintained production capacities. Almost half of the electricity is produced in two thermal power plants (TPPs) commissioned in the 1980s, Bitola and Oslomej, with increasingly low-quality lignite as the key input. As a result, emissions of three harmful gases – sulphur dioxide (SO₂), nitric acid (NO) and nitrogen dioxide (NO₂) – and dust are regularly in breach of limits agreed with the Energy Community Secretariat and set out in the country's National Emission Reduction Plan (NERP).⁵² In 2022, power plants in North Macedonia emitted 7.2 times more SO₂ and 2.4 times more dust than the limit, while only nitrogen oxide emissions were compliant with the emissions ceiling.⁵³

...but the country has committed early to decarbonisation, despite a difficult transition path ahead. North Macedonia was the first Western Balkans country to adopt the National Energy and Climate Plan (NECP)⁵⁴ in June 2022. The country plans to decommission both TPPs, reducing greenhouse gas emissions by 82 per cent compared with 1990 levels. It also set a 38 per cent target for the share of renewables in the final energy supply, aim to increase energy efficiency and keep the share of imports constant, all by 2030. The plan is complemented by a National Energy Strategy for 2020-40. An updated NECP, expected next year, and an adjusted National Energy Strategy are expected, addressing the structural vulnerabilities revealed in the aftermath of the energy crisis.

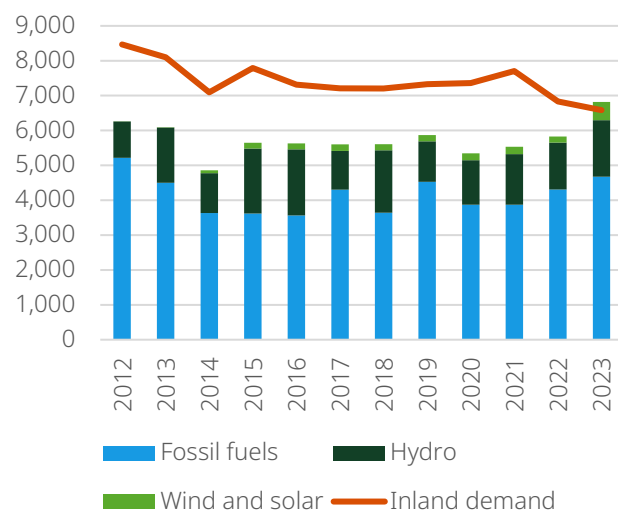
52 The National Emission Reduction Plan (NERP) represents a transition from the Large Combustion Plants Directive to the new (and stricter) Industrial Emissions Directive, where emission limit values are determined at the national level rather than on the level of each power plant, giving more flexibility to the energy sector to align with the standards and plan the dynamics of necessary investment.

53 See CEE Bankwatch Network (2023).

54 The NECP is a comprehensive scenario-based plan, adopted by all EU members, outlining specific policies and measures on energy efficiency, renewables and GHG emissions reduction for the period 2021 to 2030.

Figure 26: Domestic power production is on a declining trend

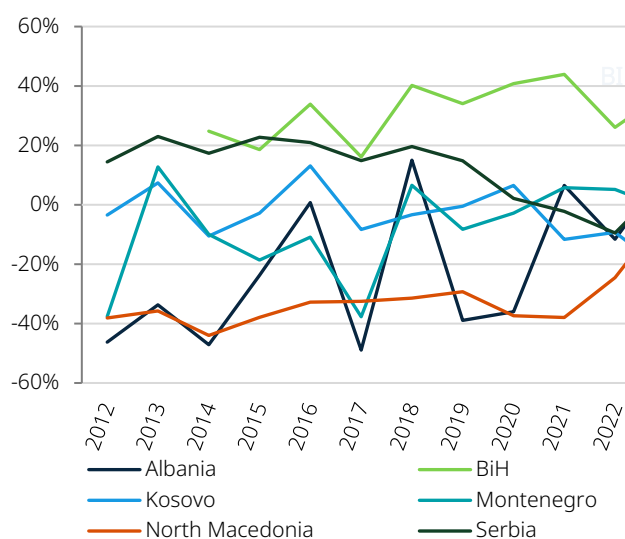
Electricity production by source and inland demand, in GWh



Source: SSORM, author's calculations.

Figure 27: North Macedonia is the Western Balkans' most consistent net electricity importer

Net exports as share of electricity available for final consumption, based on tonnes of oil equivalent



Source: Eurostat, EMBER climate, national statistical offices, author's calculations.

Insufficient domestic energy production results in high reliance on imports... Coal makes up the greatest share of electricity generation (around 50-60 per cent). Coal-based electricity production declined by 25 per cent from 2012 to 2021 but increased again by 20 per cent from 2021 to 2023.⁵⁵ Together with lower consumption, this resulted in small net imports (2.75 per cent of total gross electricity consumption) in 2023 in contrast to 20.7 and 33.2 of gross consumption in 2022 and 2021, respectively.⁵⁶ The second largest source for electricity generation is hydropower, highly dependent on rainfall patterns (Figure 26). The energy sector of North Macedonia is characterised by a high reliance on imports, and the country was the only consistent net importer of energy in the Western Balkans in 2012-22 (Figure 27).⁵⁷ Oil and gas make up a non-negligible portion of total energy supply in the country, 41 per cent and 12 per cent respectively, and are entirely imported.

...and ultimately, vulnerability to external shocks. The structural deficiencies of the energy sector of North Macedonia, most notably an undiversified energy mix and a high reliance on imports, were starkly revealed during the energy crisis in the winter of 2021-22, triggering the proclamation of a state of energy crisis in the country. This measure allowed the state to directly subsidise energy imports through the two state-owned power SOEs and was extended several times since. The current account deficit of North Macedonia in the six-month period from October 2021 to March 2022 widened nearly nine times year on year (to 6 per cent of GDP in 2022 compared with 2.8 per cent in 2021) and the government is estimated to have provided some €760 million in budgetary support to energy companies in the year after October 2021.⁵⁸ To help meet domestic demand, the highly polluting thermal power plant Negotino, fuelled by heavy oil, was reactivated at the end of 2021 for the first time since 2009.

Gas is set to gain importance as a transition fuel. To become less dependent on energy imports, North Macedonia plans to not only increase its use of renewables and improve energy efficiency, but also diversify its energy supply sources by using natural gas, mainly in the industrial sector.⁵⁹ Natural gas is currently sourced from Russia through the Trans-Balkan pipeline with a single entry point at the Bulgarian border. It is mainly used by industrial consumers and three

55 See SSORM (n.d.c).

56 See RKE (2024).

57 See SSORM (n.d.c), authors' calculations.

58 See Zdraveva (2022).

59 Government of the Republic of North Macedonia (2022).

combined heat and power plants, while household consumption is limited to a small number of buildings covered by district heating in Skopje, Kumanovo and Strumica.⁶⁰ The NECP identifies this single interconnection point for natural gas as a potential supply security risk and recommends constructing interconnections with Greece, Kosovo and Serbia as well as improving industrial consumers' access to the gas transmission network. While the pipelines to Kosovo and Serbia would diversify supply routes, the pipeline to Greece would diversify sources, as North Macedonia would gain access to the Trans Adriatic Pipeline (which transports gas from the Caspian region) and the global liquefied natural gas (LNG) market.

North Macedonia has recognised the importance of private sector participation in the renewable energy sector... While hydropower accounts for 24 per cent of power generation, intermittent renewable energy sources such as wind and solar are on the increase and doubled in 2023. Despite this, they are still the smallest sources of power generation at 8 per cent in 2023, but there are significant new ongoing investments.⁶¹ Renewable energy in North Macedonia and in the region has been, traditionally, financed mostly by public sources. To support private-sector participation, policy and regulatory frameworks should take into account the different cost structure of renewable energy investments, characterised by large upfront investment and a low marginal cost of generation. North Macedonia was one of the first countries in the Western Balkans to begin adjusting its regulatory framework and to launch renewable energy auctions for solar energy in 2019, successfully awarding 162 MW of renewable capacity in three rounds of auctions (two feed-in premiums and one public-private partnership) that have taken place since.

...but a more strategic approach to engaging the private sector is needed to achieve the ambitious green transition targets. Having in mind the target for 66 per cent of renewables in gross electricity production by 2030 as set out in the NECP, the country must further leverage the private-sector interest shown in past auctions. The installation of solar panels for self-consumption is encouragingly taking off and in the first half of 2023 alone, the Energy and Water Services Regulatory Commission issued licences for electricity production from renewable energy sources for 278 planned power plants (largely smaller-scale solar PV projects), more than were issued in the whole of 2022. However, it is the utility-scale renewable energy projects that are key to decarbonising the power sector, and which are mainly implemented by the public sector, namely the state-owned power utility, ESM. To ensure a sustainable and cost-efficient green transition, North Macedonia would benefit from a strategic framework governing the gradual rollout of renewable capacity by location and instalment type (including prioritisation), outlining the necessary investments in grid and balancing capacity and accelerating complementary energy sector reforms (including adjusting the auctions model to contract for difference)⁶² to ensure that utility-scale renewable energy projects are commercially viable for private investors.

A transition away from coal will affect a large number of workers and communities. The coal sector has traditionally been an important employer in the Western Balkans, both directly and indirectly. While employment in the coal industry accounts for under 1 per cent of total employment in North Macedonia, the lowest share among Western Balkans peers, it remains much higher than that in most EU member states.⁶³ Most importantly, employment in the coal sector is highly concentrated in a few regions, namely Pelagonia and the south-west, which already face high unemployment and where the coal phase-out will only exacerbate existing economic and social problems. In the spirit of the European Commission Recommendation on Effective Active Support to Employment (EASE), an integrated approach is needed which combines vocational counselling and upskilling/reskilling packages with subsidised schemes to support the unemployed and affected workers.⁶⁴ In line with this goal, North Macedonia launched a just energy transition investment platform towards the end of 2023 to support regional economic diversification and human capital development in line with its Just Transition Roadmap, supported by the European Commission, Climate Investment Funds, the World Bank, International Finance Corporation, EBRD, European Investment Bank, KfW, Council of Europe Development Bank as well as Cassa Depositi e Prestiti.⁶⁵ In addition, US\$ 85 million was approved by the Climate Investment Funds in March 2024 to

60 See WBIF (n.d.).

61 See SSORM (n.d.c), author's calculations.

62 The contract for difference is a subsidy model in which both positive and negative deviations from a fixed reference price are paid out to the contractual partner, meaning that a minimum compensation is guaranteed but revenues are capped. This, in general, results in a smaller subsidy requirement than in the case of fixed premiums.

63 EBRD (2020).

64 European Commission (2021).

65 See EBRD (2023a).

accelerate coal transition in coal-affected regions.⁶⁶ The platform, a vehicle for investment and policy development bringing together government, international finance and the private sector, will target the complete phase-out of coal-fired power, the deployment of 1.7 gigawatts of renewable energy by 2030, grid and storage investments for energy security and just transition measures to support communities affected by this transition. This will reinforce the existing commitment of North Macedonia, as set out in its Nationally Determined Contribution, of reducing its net greenhouse gas emissions by 82 per cent by 2030 compared with 1990 levels. Because the electricity sector is so prominent in the country's emissions profile, with coal historically accounting for over 40 per cent of generation, the energy transition is key to achieving this goal.⁶⁷

Inclusive – Demographic challenges necessitate more effort to strengthen inclusion

The labour market outcomes in North Macedonia have improved, with the country halving the unemployment rate since 2012. Nevertheless, the population has continued to decline due to poor demographic trends, including persistent emigration. Youth unemployment, although declining, has still stayed at more than double the EU-27 average, driven by issues in education quality, skills mismatches and a difficult transition from school to work. The gender gap in labour market participation as well as business ownership and management remain large.

The labour market of North Macedonia has enjoyed moderate positive improvements in the past decade, somewhat interrupted by the pandemic. From 2011 to 2019 the labour force participation and employment rates saw steady but mild increases, led by the improved labour market outcomes for women and young people. The unemployment rate has been on a steady decline since its peak in the mid-2000s and stood at 17.5 per cent at the end of 2019, three times higher than the average EU unemployment rate.⁶⁸ The pandemic interrupted the positive trends, and while the economy recovered faster than expected, labour markets lagged. While the unemployment rate remained on a downward trend throughout the 2020-22 period – helped by stimulus packages – the inactivity rate increased and as of 2024 remains higher than in 2019.⁶⁹

66 See CIF (2024).

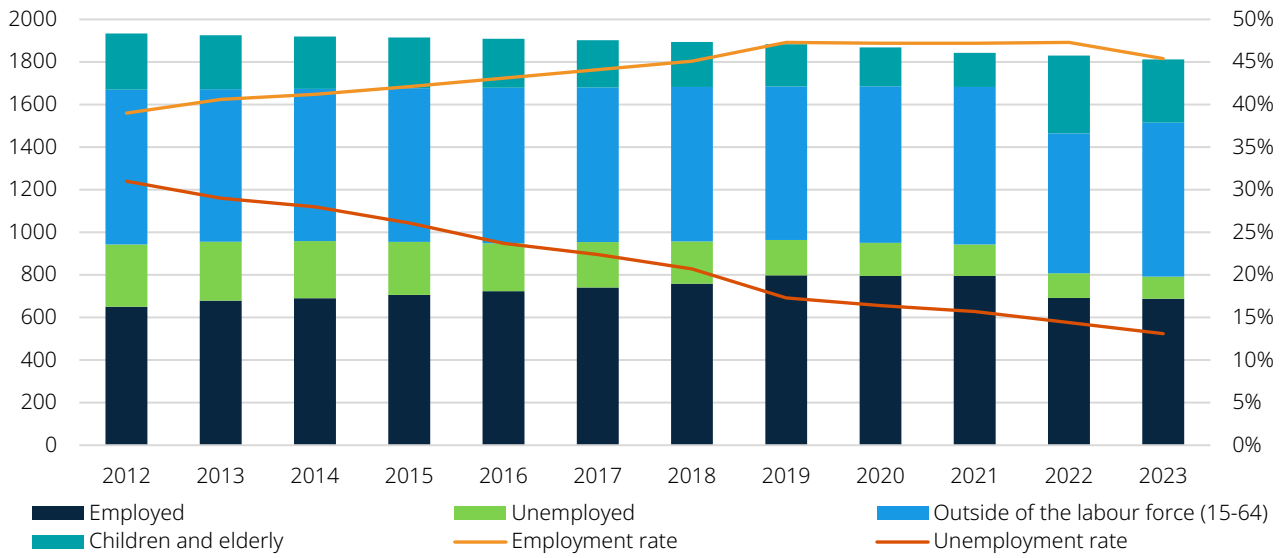
67 See EBRD (2023a).

68 See Ministry of Labour and Social Policy (2021).

69 See World Bank (n.d.a), labour force participation rate, total (of total population ages 15+).

Figure 28: Structural improvements in the labour market were accompanied by a steady population decline

Population in thousands (left-hand side); employment and unemployment rate in per cent of working age population (right-hand side)

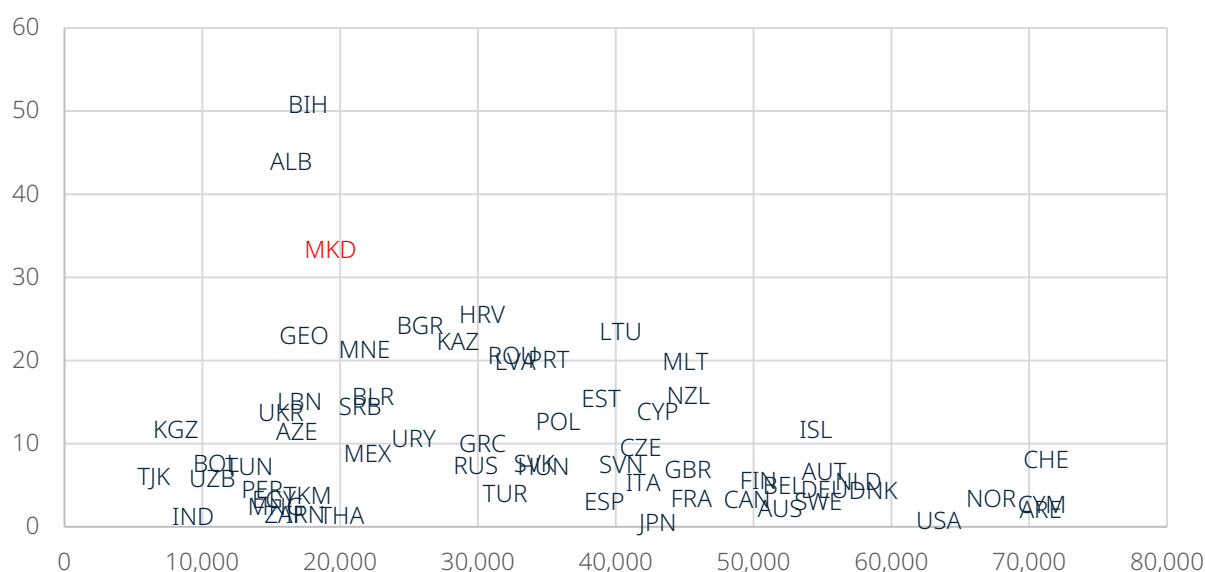


Source: Statistical Office of the Republic of North Macedonia.

However, the availability of human capital is increasingly affected by adverse demographic trends. Improvements in labour market outcomes are partly owed to a decrease in the working-age population. The population is ageing at a similar rate to much richer European countries as birth rates decline and persistently high emigration pressures exacerbate the decline in the working age population (Figure 29). Emigration, together with low birth rates and high informal employment, is contributing to the increasing old-age dependency ratio that in turn may create long-term challenges in the pay-as-you-go part of the pension system (Figure 30).⁷⁰ A Human Capital Strategy, to address these issues, has been in the making for a long time.

Figure 29: Emigration is high even compared with peer countries

Stock of emigrants as per cent of total population in 2020 (vertical axis), GDP per capita PPP in 2017 US\$ (horizontal axis)



Source: United Nations Department of Economic and Social Affairs, WB WDI, authors' calculations.

Emigration is a long-standing challenge. According to the 2021 census, the population decreased by 9.2 per cent over the 19 years since the first census was held. UN data estimate a migrant stock of almost one-third of the population as of the end of 2019, meaning that a third of people who were born in North Macedonia now live abroad (Figure 31). Emigration from North Macedonia accelerated after the country gained visa-free entry to the EU in 2008 and there is a long-standing trend of people from North Macedonia obtaining Bulgarian citizenship to gain entry into the EU job market.⁷¹ In general, migration is skewed towards low- to medium-skilled migrants.⁷² The World Bank lists several key contributors to high emigration, including political polarisation, corruption, eroded trust in public institutions, perception of socioeconomic inequality, persisting intergenerational poverty, low quality healthcare and education systems, and alarmingly high air pollution.⁷³

⁷⁰ See Mitev (2021).

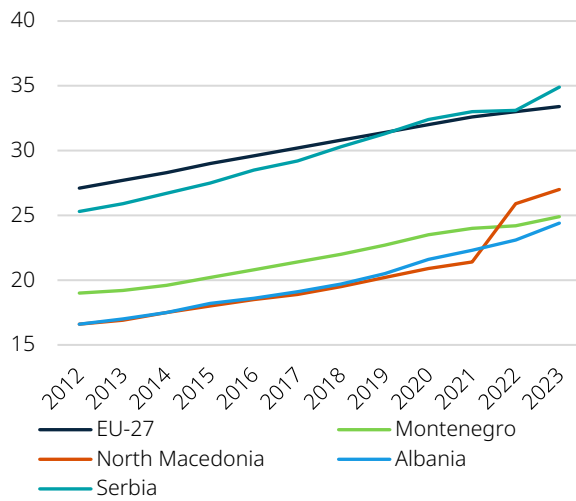
⁷¹ See Mediapool.bg (2022).

⁷² See European Training Foundation (2021).

⁷³ See World Bank (2023).

Figure 30: The old age dependency ratio is converging to EU levels

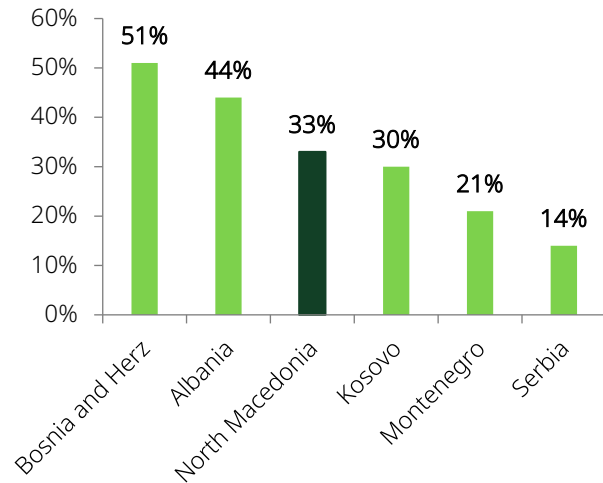
The ratio of people aged 65+ compared with the working-age population



Source: Eurostat.

Figure 31: Emigrant stock in the Western Balkans

Share of population



Source: UNDESA.

North Macedonia is a multi-ethnic society. According to the 2021 census, 58 per cent of the resident population declared themselves as being from North Macedonia, 24 per cent as Albanian, 4 per cent as Turkish and 2.5 per cent as Roma.⁷⁴ The ethnic composition of the country has not changed much over the past 20 years. As a result of the Ohrid Framework Agreement from 2001, guarantees were provided to ethnic Albanians regarding participation in public life and public-sector employment, while Albanian was recognised as an official language. Nonetheless, ethnic Albanians remain over-represented among the unemployed and under-represented in public employment.⁷⁵

The prevalence of long-term unemployment and labour shortages reflects entrenched skills mismatches. In North Macedonia, 79 per cent of unemployment was long term in 2022,⁷⁶ meaning that people have been looking for a job for over a year. For comparison, in the EU-27, 36.9 per cent were long-term unemployed, in Bosnia and Herzegovina 74.7 per cent, and in Serbia 38.7 per cent.⁷⁷ According to the European Training Foundation, high levels of long-term unemployment in North Macedonia largely reflect entrenched skills mismatches; a relative deterioration in the position of tertiary-educated workers as a result of a large increase in the supply of such workers; an over-education phenomenon that is more prevalent than under-education; and the incidence of mismatch variations by economic sectors. Over-skilling is especially high for service and sales workers and skilled agricultural workers and, to a lesser extent, for craft workers and plant and machine operators. Under-education, however, is highest among managers, and less so among technicians, associate professionals and clerical support workers.⁷⁸

⁷⁴ See SSORM (2022).

⁷⁵ See Minority Rights Group (2020).

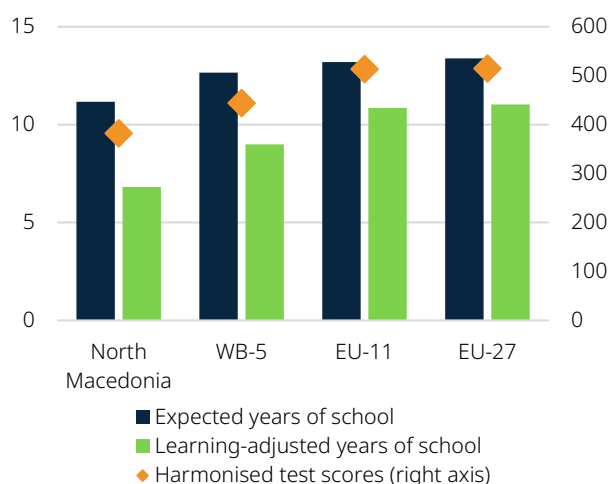
⁷⁶ See SSORM (n.d.d).

⁷⁷ See Eurostat (n.d.c).

⁷⁸ See ETF (2020).

Figure 32: Education gaps are reflected in test results despite high attainment...

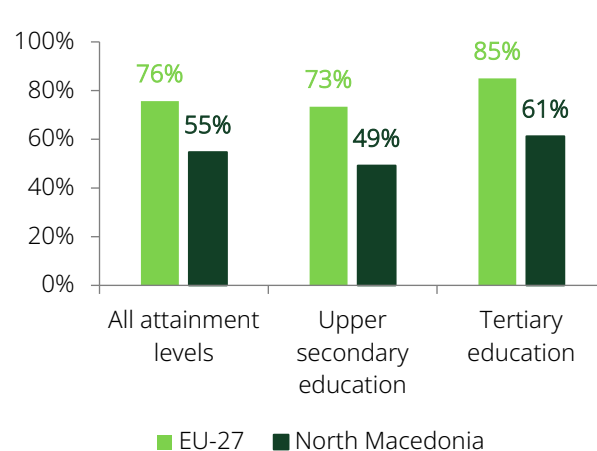
Years of schooling and harmonised TIMMS-equivalent test scores, 0-650



Source: World Bank.

Figure 33: ...and in a difficult transition from school to work

Employment rates of young (15-34), recent graduates (1-3 years) in 2021 based on educational attainment

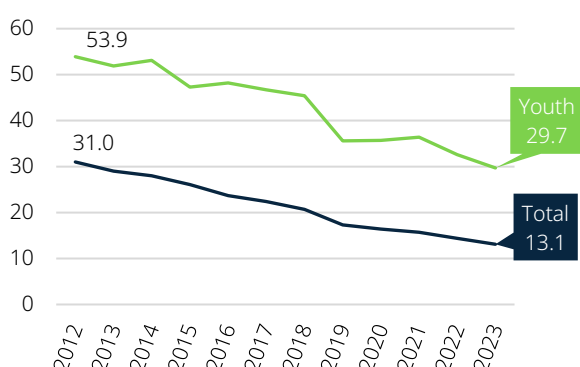


Source: Eurostat.

Young people of North Macedonia have poorer educational outcomes than their regional and EU peers and find it difficult to transition from school to work. Despite improving trends in the population's educational attainment, the quality of educational outcomes stagnates at a level below regional and EU peers (Figure 32). PISA scores of students of North Macedonia are lowest in the Western Balkans, lagging far behind OECD and EU comparator averages in maths, reading and science alike. This is partly attributed to the low share of the budget given to education. Young people are out of work for longer after completing school, youth employment rates are low (Figure 33) and unemployment rates are high compared with both regional and advanced comparators (Figure 34). A child born in North Macedonia today can expect to attain only 56 per cent of his/her productive capacity.⁷⁹ However, the share of young people not in employment, education or training is slowly moving towards the EU-27 average (Figure 35) and, according to ETF data from 2022, North Macedonia performs particularly well when it comes to success with which graduates from the vocational education and training system (VET) move into the labour market.⁸⁰

Figure 34: Youth unemployment is more than double the working-age unemployment rate

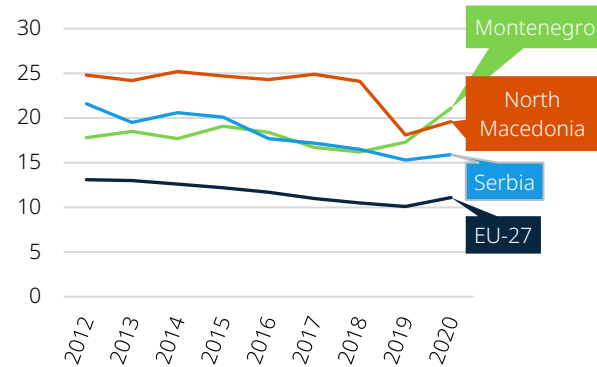
Per cent of youth (15-24) and working age (15-64) population



Source: Statistical Office of the Republic of Macedonia.

Figure 35: The NEET rate is slowly converging towards the EU level

Share of youth not in employment, education or training (15-24), per cent



Source: Eurostat.

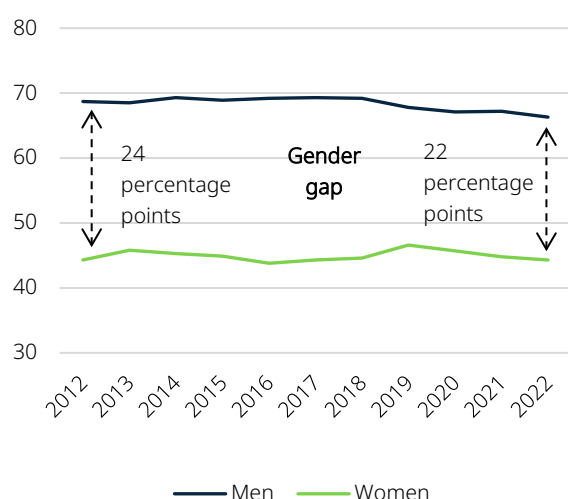
⁷⁹ See World Bank (n.d.a), Human capital index.

⁸⁰ See ETF (2023).

Women are increasingly participating in the labour market, but gaps remain (Figure 36). Low participation rates for women of working age are primarily attributed to household and care responsibilities, with 68 per cent of all inactive women engaged in care duties compared with 36 per cent in the EU. Improving accessibility, affordability and quality of care facilities could help increase women's labour participation.⁸¹ Women are also less represented in business ownership and management than men, but the indicators are better than in other Western Balkans countries (Figure 37).

Figure 36: The gender gap in labour market participation is persistent

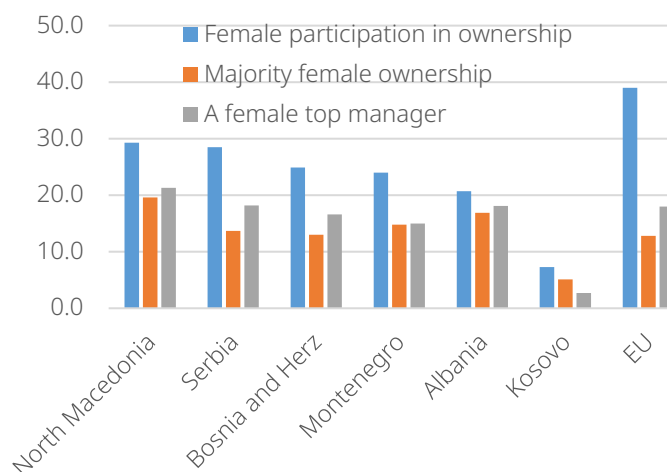
Labour force participation, per cent



Source: Statistical Office of the Republic of Macedonia.

Figure 37: Women continue to be less represented in business

Per cent of firms, in 2019-20



Source: BEEPS VI.

The digital skills gap is still large. The data reveal a significant gap in digital skills between North Macedonia and the EU countries. Only 32 per cent of the population of North Macedonia possess basic or average digital skills, contrasting with the EU average of 56 per cent. Moreover, a mere 3 per cent of individuals in the country have more advanced digital skills.⁸² This emphasises the urgent need for targeted efforts to enhance digital literacy and competency, especially in areas such as programming, machine learning and the Internet of Things (IoT). The National ICT Strategy of North Macedonia outlines dedicated pillars to address these challenges and elevate the digital skills of the populace.⁸³

Resilient – Ensuring energy security during transition from coal is a key challenge

Thanks to a strong regulatory environment, good profitability and improving asset quality, the financial system of North Macedonia has proved resilient in recent years and weathered the pandemic well. In the medium term, tighter monetary conditions may cause credit growth to decelerate, which may hurt SMEs in particular. In the longer run, the main risks remain an insufficient volume of domestic long-term funding and credit risk arising from the euroisation of banks' balance sheets, despite visible improvements in this regard. Capital markets are underdeveloped, illiquid and shallow, although the authorities are trying to create a supportive environment. High reliance on energy imports and outdated generation capacities, together with a strong commitment to decarbonisation, as demonstrated in the NECP, necessitates a rapid transition to renewables and a well-thought-out transition strategy. A reform of energy SOEs, as well as meaningful tariff reform for households, including better targeting for those in need, is necessary for a smooth transition.

⁸¹ Ministry of Labour and Social Policy of the Republic of North Macedonia (2021).

⁸² See UNDP (2023).

⁸³ See Ministry of Information Society and Administration of the Republic of North Macedonia (2022).

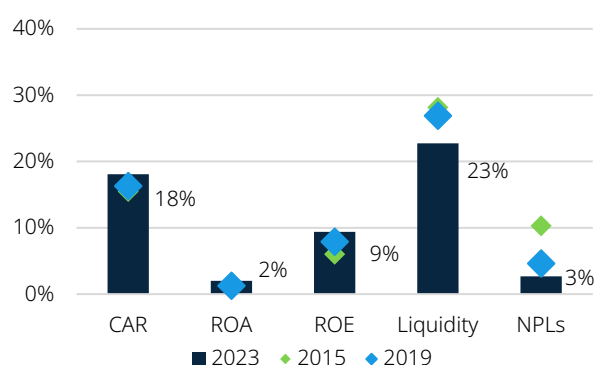
Improving cross-border interconnections both in electricity and gas would help to balance the system with a larger share of volatile renewables and diversify natural gas provision in order to improve energy security and resilience to shocks.

Financial sector

The financial system is dominated by foreign-owned banks that are well capitalised and liquid. As is common in the EBRD regions and the Western Balkans, banks dominate the financial system, with the remainder of the financial intermediation done by insurance and leasing companies as well as pension funds, while the capital market remains underdeveloped. An inaugural issuance of a sovereign bond, targeting domestic retail investors in summer 2023, was welcome. Combined with the increased uptake in pensions, continued retail bond issuance may provide compelling alternatives to low-interest-earning bank deposits, leading to a reduction in excess liquidity in the banking sector, and making the market for deposits more competitive. The National Bank of North Macedonia is in charge of the payment system, financial stability, supervision and regulation of the banking sector and most other financial institutions as well as bank resolution. The capital adequacy ratio is well above the regulatory minimum and the profitability of banks is satisfying (Figure 38).⁸⁴ Domestic credit to the private sector is higher than the WB-6 average and EU-11, but still only half of the eurozone average (Figure 39).⁸⁵

Figure 38: Macprudential indicators point to a healthy banking sector

In per cent

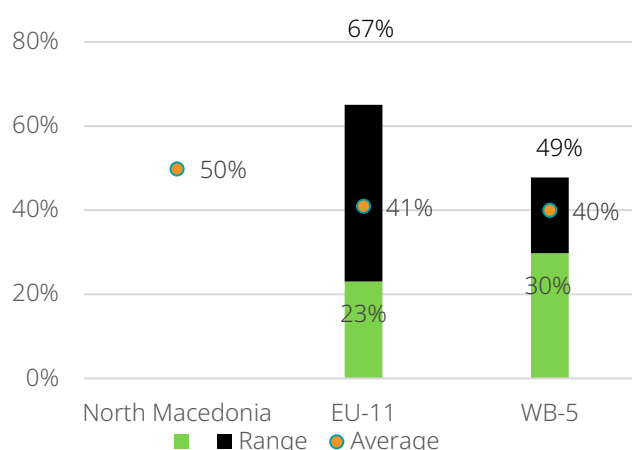


Source: NBRM.

Note: Liquidity is expressed as liquid assets to total assets.
CAR = capital adequacy ratio, ROA = return on assets, ROE = return on equity, NPLs = non-performing loans.

Figure 39: Credit penetration is above regional averages

Domestic credit to private sector provided by banks, per cent of GDP, in 2023



Source: World Bank World Development Indicators.

Key banking sector vulnerabilities are euroisation and maturity mismatches. A high share of foreign currency in lending and deposits is a common problem in the banking system of emerging economies which have experienced recent episodes of macroeconomic instability, causing mistrust in the local currency even after decades of demonstrated macroeconomic stability. Euroisation in North Macedonia is still high, although on a decreasing trend, particularly in 2023, as the sharp rise in Euribor interest rates made borrowing in euros less attractive. The increase in denar deposits is also notable, particularly for corporate deposits, while retail ones are still mostly denominated in euros.⁸⁶ The long-term peg of the denar to the euro mitigates currency risks but limits the effectiveness of monetary policy, and the lack of exchange rate volatility does not incentivise the use of the local currency. The aggregate balance sheet reflects a simple business model funding longer-term loans with short-term deposits (Figures 40 and 41).⁸⁷

⁸⁴ See NBRM (2023a).

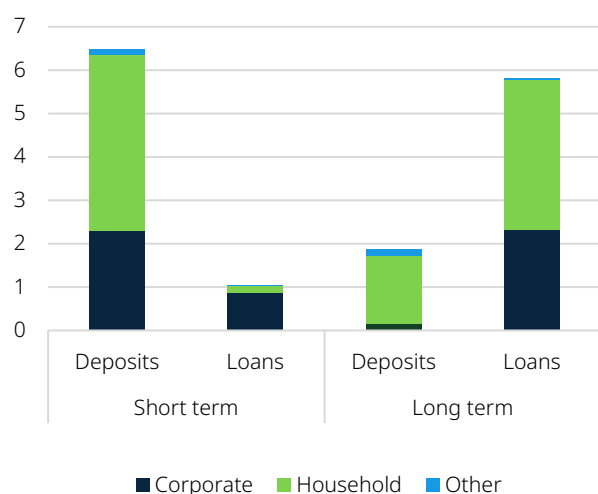
⁸⁵ See World Bank World (n.d.a).

⁸⁶ See NBRM (2023b).

⁸⁷ Ibid.

Figure 40: Long-term bank loans are mainly funded by short-term deposits

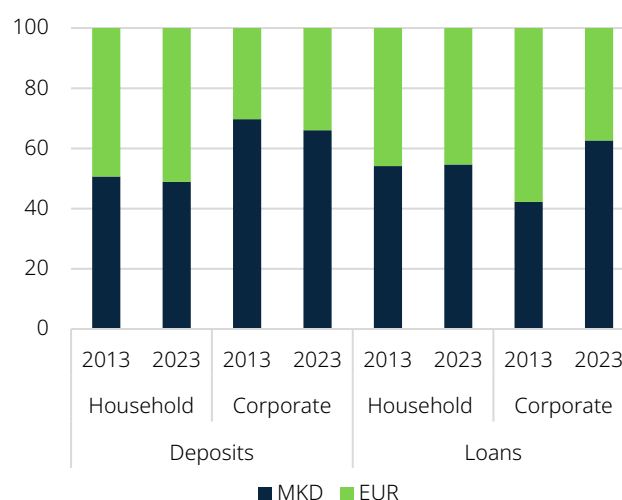
Total amount in November 2023, in € billion



Source: NBRM and authors' calculations.

Figure 41: ...and is highly euroised, raising concerns over credit risk due to currency mismatches between real sector's income and expenses

Percentage share, at the end of 2013 and end of 2023

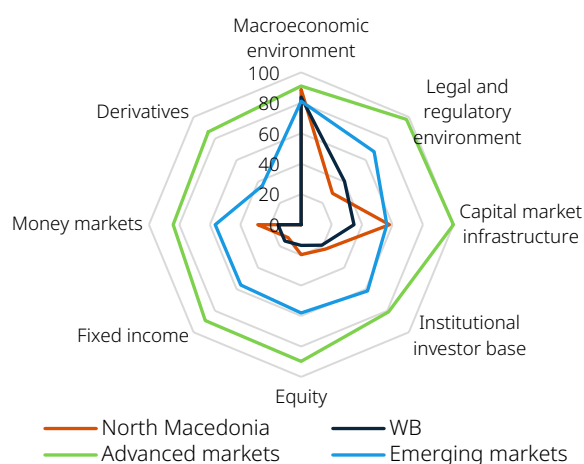


Source: NBRM and authors' calculations.

Capital markets are at an early stage of development. Capital markets make only a limited contribution to financing the economy as they are underdeveloped, illiquid and shallow. According to the EBRD's Financial Market Development Index,⁸⁸ macroeconomic and infrastructure conditions for capital markets are at fairly good levels but the legal and regulatory framework, as well as market outcomes, reflecting the depth, diversification and liquidity of markets across four asset classes (equities, fixed income, money markets and derivatives) are underdeveloped (Figures 42 and 43). A significant reform agenda in the legal and regulatory framework is under way, bringing it closer to EU standards in a few years' time.

Figure 42: Capital markets development in North Macedonia lags EU countries...

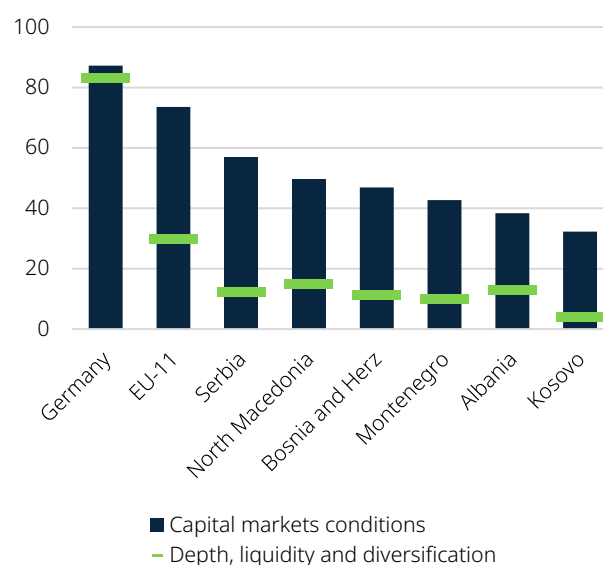
Financial Market Development Index, scores are from 0 (least developed) to 100



Source: EBRD *Transition report 2021-22*.

Figure 43: ...dragged down by poor market outcomes

Financial Market Development Index, scores are from 0 (least developed) to 100



Source: EBRD *Transition report 2021-22*.

88 See EBRD (2021).

Energy sector

Despite the existence of a relatively advanced regulatory framework, the energy market of North Macedonia remains concentrated in terms of both market participation and energy mix. In recent years North Macedonia has successfully implemented key Energy Community requirements in the electricity sector, including unbundling, third-party access and the launch of the day-ahead market in May 2023. However, there are still many weaknesses in the market: the state-owned electricity company ESM (Elektrani na Severna Makedonija) continues to dominate power generation in the country while suffering from a number of inefficiencies; regional integration (energy market coupling) faces delays and undermines the diversification and security of energy supply; and highly polluting coal still dominates a largely undiversified power generation mix.

The European energy crisis of 2022 highlighted and exacerbated the impact of these domestic market failures for North Macedonia. Due to the largely undiversified power generation mix and poor regional energy market integration, the failures of ageing coal-powered thermal power plants and the lack of water for hydropower generation, North Macedonia had little choice but to import high volumes of electricity at record high prices and to declare a state of emergency in the energy sector during the winter of 2021/22,⁸⁹ transferring around 1.3 per cent of GDP to ESM (for electricity production) in 2022, reducing to around 0.8 per cent of GDP in 2023.⁹⁰

Cost pressures on energy prices are a result of the need to replace ageing domestic power generation facilities...

Despite accounting for around 70 per cent of installed capacity in North Macedonia, the state-owned generator, ESM, produced less than two-thirds of domestic generation and just over one-third of total electricity supply in 2021. Underpinning this performance has been an accelerating deterioration of production in two of the largest plants in the country, REK Bitola and TPP Oslomej, both of which are coal-fired and were originally constructed in the 1960s. A long-standing trend of declining domestic production, caused by under-investment in new facilities and the maintenance of existing ones, made North Macedonia particularly vulnerable to energy price volatility.

...and subsidised electricity prices for households. Electricity prices for households are cheaper than in the EU (Figure 44).⁹¹ Below-cost tariffs not only make it difficult for energy companies to carry out the investment needed for the transition of North Macedonia to a greener and more resilient energy sector, but also undermine the development of competition in the retail market. Despite some recent progress, primarily in the form of updates in the design of household block-tariffs in the summer of 2022, deeper structural tariff reform is still needed to address the revenue side of the problem and ensure liquidity of key sector players. Given the relatively high rate of energy poverty in North Macedonia, as in the rest of the Western Balkans, a gradual tariff reform should be accompanied by a robust and well-targeted social support network (Figure 45).

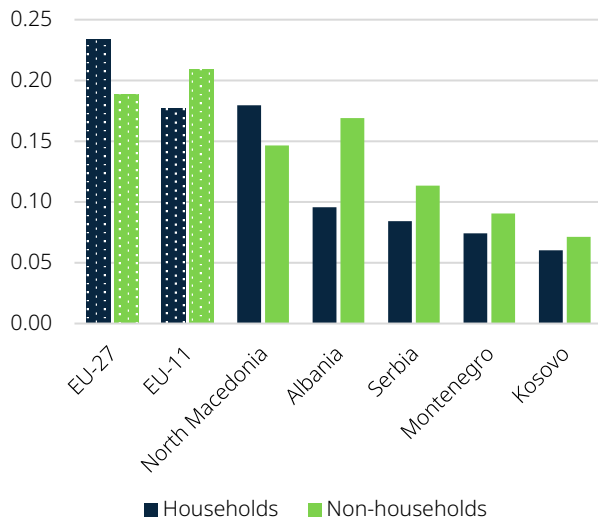
89 European Commission (2024).

90 See IMF (2024).

91 Eurostat (n.d.d).

Figure 44: Electricity prices are lower than in the EU, but are among the highest in the Western Balkans

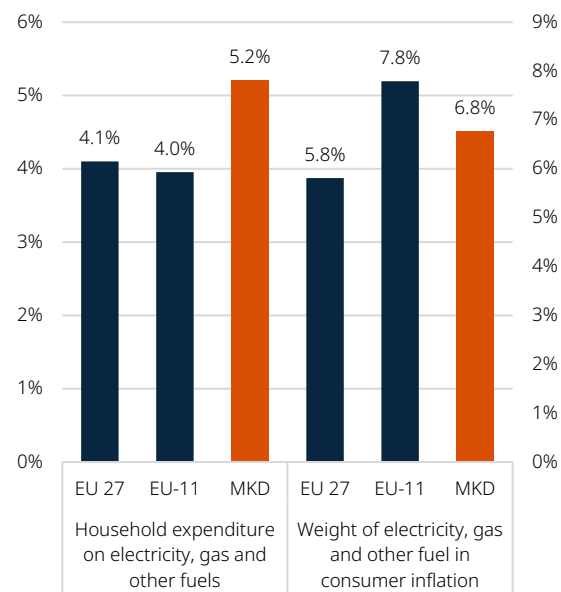
Electricity prices for medium-sized households and non-households, in kilowatt hours, in H1 2023⁹²



Source: Eurostat and authors' calculations.

Figure 45: Households' ability to absorb higher energy prices is limited given the large share of expenditures spent on energy

In 2019



Source: Eurostat and authors' calculations.

Technical problems linked to under-investment add to the financial cost and quality of service. System reliability is poor and out of line with regional peers, impacting both the quality of service for consumers and the financial sustainability of the energy sector as a whole. Electric power transmission and distribution losses, which comprise both technical and commercial losses (theft), are high compared with regional and, especially, European averages,⁹³ while losses due to power outages are higher compared even with peers in central and eastern Europe.⁹⁴ Given the monopolistic nature of the sector, proper incentives for efficiency and effective monitoring by the regulatory authority would be key for achieving progress with this framework.

Poor governance and inefficiency calls for SOEs in the sector to be reformed. ESM remains the main power producer in North Macedonia, with other smaller private companies contributing a small share. The state-owned company, MEPSO, owns and operates the high-voltage transmission network, while the distribution system is owned largely by the private company EVN Elektrodistribucija. The two SOEs tend to be loss-makers, dependent on government subsidies and affected by undue political influence. Reforms targeting governance, efficiency and performance improvements would improve the service quality and financial viability of these SOEs which, alongside the authorities, are key drivers of broader sector reform – notably with regard to boosting the liquidity of the traded market as well as facilitating competition and the market coupling process (first probably with EU members Greece and Bulgaria). A more powerful and effective energy regulator and market operator would greatly help this process.

The gas sector of North Macedonia is significantly less developed, but the country is taking steps to improve the competitiveness and security of supply. North Macedonia remains physically locked into a single supply route through its gas interconnection with Bulgaria. Until recently this interconnection was fully booked by Gazprom, effectively foreclosing the market by precluding the flow of non-Russian gas. However, in accordance with the interconnection agreement signed by the natural gas transmission company GA-MA of North Macedonia (renamed as Nomagas from 2024) and Bulgartransgaz of Bulgaria in 2022, the unused capacity will now be able to be released and allocated in a

⁹² See Eurostat (n.d.b.). Eurostat defines electricity prices for non-household consumers as the average national price in euros per kWh without taxes applicable for the first semester of each year for medium-sized industrial consumers (consumption band Ic with annual consumption between 500 and 2,000 MWh). Electricity prices for household consumers are defined as average national price in euros per kWh including taxes and levies applicable for the first semester of each year for medium-sized household consumers (consumption band Dc with annual consumption between 2,500 and 5,000 kWh).

⁹³ See IMF (2024).

⁹⁴ See EBRD (n.d.).

non-discriminatory way in line with the European Network Code on Capacity Allocation.⁹⁵ This increases competition and allows for a more diverse supply for North Macedonia, as well as a more resilient energy sector as a whole.

Implementing Energy Community requirements for natural gas would help make the sector more competitive. Next steps would include the full unbundling and certification of the transmission system operator (TSO), finalisation and implementation of third-party access rules, data transparency, transposition of the REMIT regulation and the security of supply framework. These improvements would make significant contributions both in their own right, as well as facilitate and maximise the impact of planned new interconnections, notably through a new gas interconnection with Greece (which will give North Macedonia direct access to Greece's diversified LNG supply from Revithoussa and Alexandroupolis).⁹⁶

Energy sector reforms are part of the ongoing Precautionary and Liquidity Line arrangement (PLL) with the IMF and are more broadly determined in agreement with the Energy Community. As part of the policy actions under the PLL, the authorities have committed to phase out electricity subsidies by 2025 while protecting vulnerable households and improving energy efficiency.⁹⁷

Climate change

North Macedonia is vulnerable to the effects of climate change such as droughts and flooding. North Macedonia faces, as does the rest of the Western Balkans region, a high likelihood of temperature increases. Climate change is most likely to affect North Macedonia through more frequent drought, flooding and wildfires. Just in the last five years, floods and heat waves have caused economic losses of nearly €100 million while wildfires resulted in around €180 million worth of damages.⁹⁸

Integrated - Given limited fiscal space, a carefully planned investment and reform agenda is needed to support integration

Significant infrastructural needs, the legacy of years of under-investment, are gradually being addressed but better planning is key given the limited fiscal space and large public investment needs. Road transport dominates and needs significant upgrade. The quality of infrastructure, including water supply, waste and wastewater management, requires sizeable improvement. North Macedonia has increased its trade openness significantly over the past decade, with strong trade and FDI ties to the EU, becoming the most open in the Western Balkans. Nevertheless, there is room for further trade opening, especially in services, as well as stronger integration of domestic suppliers into global value chains.

Infrastructure

North Macedonia has considerable public investment gaps in economic, social and environmental infrastructure...

Despite the relatively small public capital stock, public investment is low compared with regional peers, EU comparators and needs (Figure 46).⁹⁹ The quality of infrastructure, too, has scope for improvement (Figure 47). The government's ambitious Growth Acceleration Plan for 2022-26 aims to tackle this issue by improving the systematic under-execution of public investment and mobilising twice the amount of public investment from private funds.¹⁰⁰

95 See CEE Energy News (2022).

96 See Energy Community Secretariat (2023).

97 See IMF (2022a).

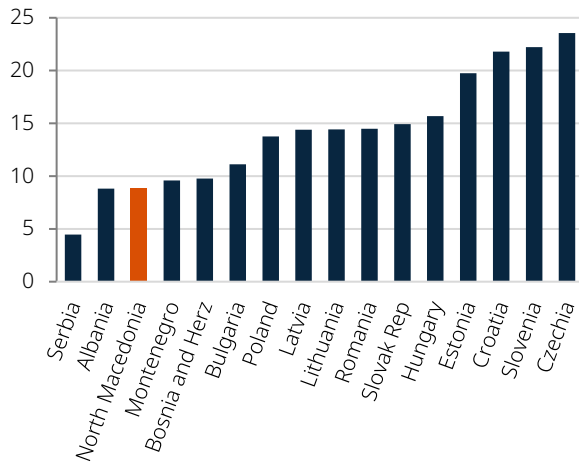
98 See Zdraveva (2022).

99 See IMF (2022b).

100 See Ministry of Finance of the Republic of North Macedonia (2022).

Figure 46: Capital stock, as in the rest of the region, is far behind the EU 11 level ...

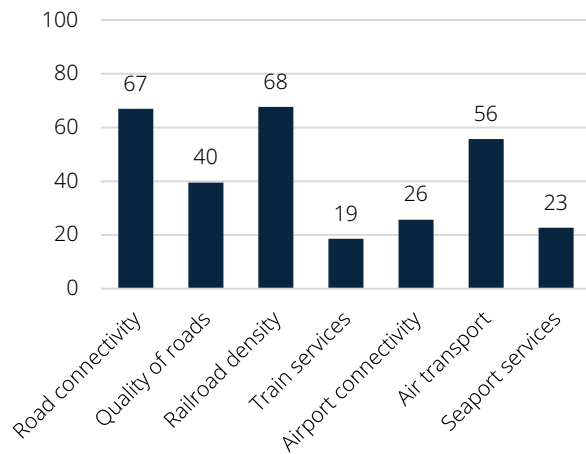
Thousands 2017 PPP dollars per capita



Source: IMF (2021).

Figure 47: Infrastructure gaps are sizeable, particularly in terms of quality

Perception of quality, score 0 – 100 (best)



Source: WEF (2019).

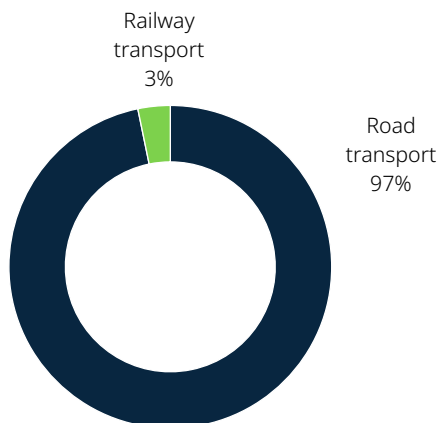
...requiring better management of public investment practices. As repeatedly mentioned in European Commission progress reports, there is significant scope to improve the management of public investment. Implementation of the Action Plan for Improving Public Investment Management (PIM) is heavily delayed, including setting up a dedicated PIM unit in the Ministry of Finance. Key areas for improvement are project prioritisation and selection, as well as multi-year budgeting, hampered by staff shortages and IT requirements.¹⁰¹

Roads are the most prevalent mode of transport (Figure 48). The transport network is moderately well developed, but road safety needs improving given the relatively high incidence of road accident fatalities (Figure 49).

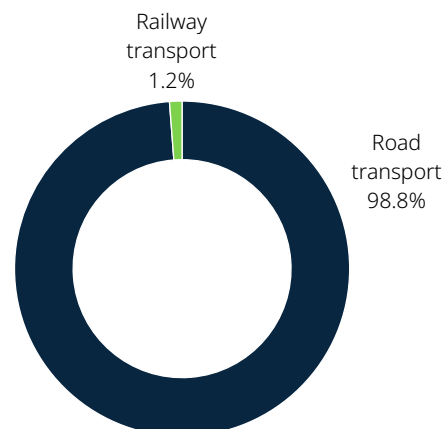
Figure 48: Road is the most popular mode of transport...

Passenger transport (left) and freight (right), share of total kilometres per passenger/tonne in 2023

Passenger transport



Freight transport

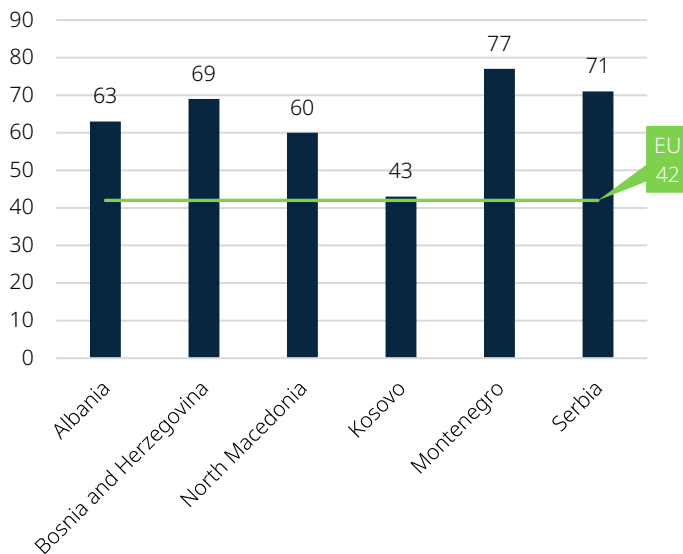


Source: Statistical Office of the Republic of Macedonia.

¹⁰¹ See European Commission (2023).

Figure 49: ...but a high fatality rate begs improvements in road safety

Fatalities per million inhabitants in 2020



Source: Transport Community.

Comprehensive transport reform is set out by the Transport Community Treaty. The first joint rail border crossing between North Macedonia and Serbia is being developed on the Corridor X rail route as part of the Trans-European Transport Network (T-ENT). This will improve connections to the Western Balkans region and is supported by a €5 million loan from the EBRD and a €2.5 million EU grant through the Western Balkans Investment Framework. Furthermore, the Law on Liberalisation of the Rail Transport Market was passed in December 2023, and the rail transport market is now open to new operators.¹⁰²

Public companies play a key role in transport and municipal services but there are questions over their capacity to provide long-term quality of service. There are 29 state-owned companies in North Macedonia, among which are also key players in road, railways and air transport. In addition to state-owned companies, there are some 70 public companies owned by local municipalities and governed by local governments.

The rail network is being modernised. The infrastructure manager and operator were unbundled in 2007, meeting the key requirement of the EU *acquis communautaire*. However, large parts of rail corridors remain closed, railway use is low and other sector reforms are lagging. Railway upgrades and reconstruction are under way for parts of Corridor VIII, which will eventually connect Albania's largest port, Durres, and the Black Sea Port in Bulgaria through Skopje.

Skopje's airport has seen rapid passenger growth over the past decade. The number of passengers travelling through Skopje airport, the country's largest airport, was over 2 million in 2022; more than double what it was a decade prior.¹⁰³ In 2008 the government signed a contract with the Turkish company Tepe Akfen Ventures for a 20-year concession, during which time this company would manage the two existing airports of North Macedonia, Skopje Airport and St. Paul the Apostle Airport in Ohrid. Effective take-over of management took place in 2010.¹⁰⁴

There is scope to improve the quality of municipal infrastructure and service provision. Outdated infrastructure leading to inefficiency across the utilities segment is a result of continual under-investment, as fees charged remain lower than levels necessary to sustain provision. The city of Skopje lost over a fifth of its water in 2020 in "real" or technical losses as a result of leaks.¹⁰⁵ Only 15 per cent of the country is covered by any kind of wastewater treatment.¹⁰⁶ The waste

¹⁰² See EBRD (2023b).

¹⁰³ See TAV Airports (2022).

¹⁰⁴ EX-YU Aviation News (2010).

¹⁰⁵ See Dimeski (2021).

¹⁰⁶ European Environment Agency (2021).

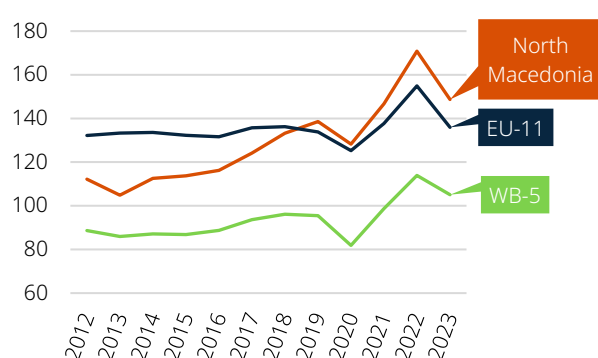
management system is characterised by a low recycling rate and a high reliance on landfill, and over a fifth of the population remains uncovered by waste collection services.¹⁰⁷

Trade and investment flows

North Macedonia is well integrated into global trade flows. The country's openness to trade measured in terms of GDP has seen a significant expansion over the past few decades and the country now scores the highest in the Western Balkans region, with a similar openness to trade to EU-11 comparators (Figure 50). North Macedonia has been a member of CEFTA since 2000, and a signatory of the Stabilisation and Association Agreement with the EU since 2001. The EU remains the country's biggest trading partner.¹⁰⁸

Figure 50: Openness to trade has increased substantially since 2012

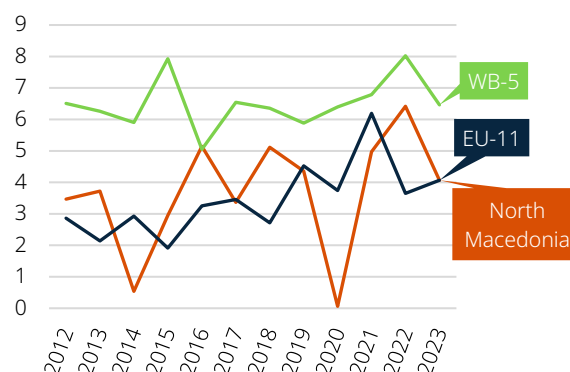
The sum of export and import of goods and services as a share of GDP



Source: World Bank WDI.

Figure 51: North Macedonia is increasingly attracting FDI...

Net FDI inflow as a percentage of GDP



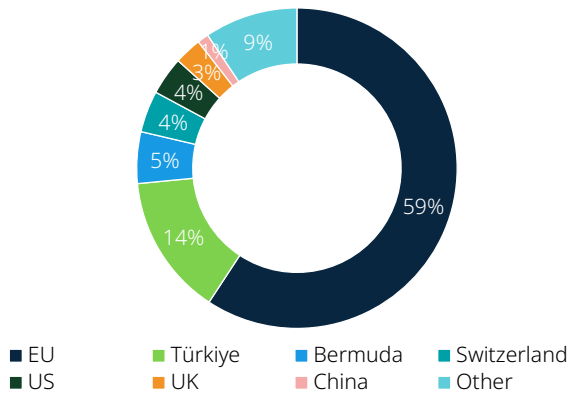
Source: World Bank WDI.

107 See WBIF (2021).

108 See SSORM (n.d.f).

Over the past decade North Macedonia has successfully attracted FDI. FDI has been on an upward trend, amounting to 6.4 per cent of GDP in 2022. However, it did drop in 2023 (as it did in the rest of the Western Balkans countries), most likely because of the global slowdown in economic activity. The country performs similarly to the Western Balkans average in this respect, and better than the EU-11 countries (Figure 51). Most of the FDI comes from EU countries (Figure 52). Given the relatively recent scaling up of FDI to North Macedonia, FDI stock per capita remains low (Figure 53).¹⁰⁹

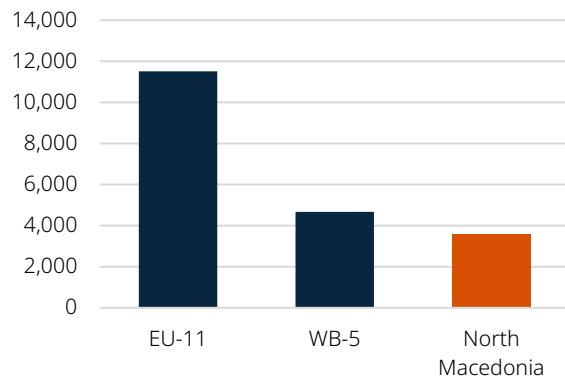
Figure 52:.....primarily from the EU
Share of FDI inflows in 2012-23



Source: NBRM.

Figure 53: FDI stock is low compared with regional comparators

FDI stock per capita in 2022 in US\$



Source: UNCTAD, authors' calculations.

Despite the increase in trade openness, living standards have remained roughly the same. This indicates that small, local companies need to integrate more into value chains, and that greater trade openness, especially in services, is needed to achieve higher value added and higher income levels.

109 See World Bank (n.d.a) (foreign direct investment, net inflows (% of GDP)), NBRM (n.d.c), UNCTAD (n.d.b).

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Abbreviations

BAFTA	Baltic Free Trade Area
CBAM	Carbon Border Adjustment Mechanism
CEE	Central and eastern Europe
CEFTA	Central European Free Trade Agreement
CIF	Climate Investment Funds
ESM	Elektrani na Severna Makedonija
ETF	European Training Foundation
EU11	enlargement countries, excluding Cyprus and Malta and including Bulgaria, Czechia, Estonia, Hungary, Croatia, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia
FDI	foreign direct investment
FiP	Feed-in-Premium
ICT	information and communication technology
ILO	International Labour Organization
IMF	International Monetary Fund
IoT	Internet of Things
LFS	labour force survey
MKD	denar of North Macedonia
NECP	National Energy and Climate Plan
NEET	(young people) neither in employment nor in education and training
NBRM	National Bank of the Republic of North Macedonia
PIM	Public Investment Management
PLL	Precautionary and Liquidity Line
PPP	purchasing power parity
REMIT	Regulation on Wholesale Energy Market Integrity and Transparency
RKE	Regulatorната Komisija za Energetika i Vodni Uslugi i Uslugi za Upravuvanje so Komunalen Otpad na Republika Severna Makedonija (Energy, Water Services and Municipal Waste Management Services Regulatory Commission of the Republic of North Macedonia)
SMEs	small and medium-sized enterprises
SOE	state-owned enterprise
SSORM	State Statistical Office of the Republic of North Macedonia
TSO	Transmission system operator
WB-6	The six economies of the Western Balkans (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, Serbia)
WDI	World Development Indicators
WEO	World Economic Outlook
WJP	World Justice Project
WTO	World Trade Organization

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