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North Macedonia: Identifying a development model for the future

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Executive summary

North Macedonia is a small, landlocked country in the Balkans that gained independence in 1991 and has a turbulent history bound up with its pursuit of regional and international recognition. The country is now looking toward the European Union and has been a candidate for accession since 2005. Its economic growth is steady but not strong enough to initiate a significant convergence process. Therefore, a new development model is now needed, but the country's structural constraints and the difficulty in identifying sectors of growth present challenges. North Macedonia has a narrow tax base due to a high level of informality, low willingness to pay taxes, and particularly low tax rates. Government spending levels are relatively modest, despite a shift toward more rigid spending, especially on the pension system. The country has thus managed its public finances carefully over the past twenty years, as demonstrated by its moderate average public deficit and stable levels of public debt, except during periods of crisis. Since 2008, however, successive economic crises have resulted in reduced fiscal space.[1] The current account deficit is gradually narrowing, thanks to the slow but steady reduction in the trade deficit and stable, sizable remittances flows from the North Macedonian diaspora. The current account deficit is financed by foreign direct investment inflows and Eurobond issuances, which enable the country to maintain adequate foreign exchange reserves. These reserves are essential for ensuring the stability of the exchange rate with the euro, against a background of high external financing needs, rising external debt, and the exposure of a significant portion of the banking system to exchange rate risk.

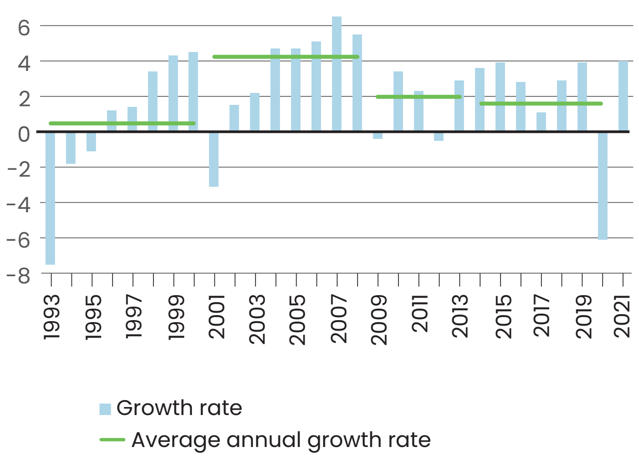
1 Fiscal space can be defined as the government's room for maneuver to allocate resources in pursuit of an objective without jeopardizing the sustainability of the public finances or the stability of the economy.

1. A sluggish economy held back by structural constraints

1.1 – Stable but relatively slow growth over the past two decades

North Macedonia's economic growth appears sluggish, and it has slowed over the past twenty years. The country is sensitive to external shocks, especially from the European Union. The economic changes that have taken place over the past two decades can be shown by breaking the period down into three sub-periods: 2001-2008, 2009-2013, and 2014-2020. The first sub-period covers the bursting of the dot-com bubble up to the beginning of the 2008 global financial crisis. During this sub-period, North Macedonia's average annual growth rate was 4.3 percent (Figure 1). The second sub-period was characterized by the aftermath of the global financial crisis, followed by the European debt crisis, which had a particular impact on the countries of southern Europe. The average annual growth rate for this sub-period was 2 percent, driven down by two episodes of recession in 2009 and 2012. The third and most recent sub-period was characterized by continuous growth (with no years in recession) until the fall in gross domestic product (GDP) resulting from the COVID-19 crisis (see Box 1). The slowdown over this sub-period was particularly marked, especially in comparison to the first sub-period, with an average annual growth rate of 1.3 percent.

Figure 1 – GDP growth rate (in percent)



Source: FMI

Box 1: Impact of the COVID-19 pandemic on the North Macedonian economy

In 2020, the COVID-19 health crisis rapidly turned into a major global economic crisis, although its impact was felt differently in different countries. North Macedonia was hit hard by the pandemic, on both the public health and economic fronts. According to the most recent data (March 2022), the country has recorded nearly 300,000 infections and approximately 9,100 deaths related to the pandemic. This makes it the sixth worst-affected country in the world in terms of deaths per capita, with approximately 435 deaths per 100,000 people. Current vaccination coverage remains limited, with less than 40 percent of the population fully vaccinated. In economic terms, the impact of the crisis on North Macedonia has been felt through various channels: (i) a drop in external demand, primarily related to the recession in the EU; (ii) a drop in revenue related to reduced travel by the diaspora due to prolonged border closures; (iii) a decline in domestic activity due to the various lockdowns and restrictions; and (iv) a decline in investment against the background of a more uncertain international outlook.

The government was able to limit some of the potential effects of the crisis by subsidizing private sector wages, taking on the responsibility for social security contributions for companies that kept employees on, deferring income tax payments, and providing soft loans or guarantees. At the same time, the central bank lowered its main bank rate in order to protect economic activity (-75 basis points to 1.25 percent) and granted a moratorium on outstanding loans to prevent them from being classified as nonperforming. The European Central Bank (ECB) also set up a EUR 400 million repo line to give the North Macedonian banking system easier access to the euro.

Overall, the North Macedonian economy contracted by 6.1 percent in 2020, dragged down by the combined decline in domestic demand (-6.9 percent) and exports (-10.9 percent). The recovery in 2021, estimated at 4 percent, appears to have been driven mainly by domestic demand (+6.4 percent), boosted by the gradual lifting of restrictions and the return of remittances from the diaspora.

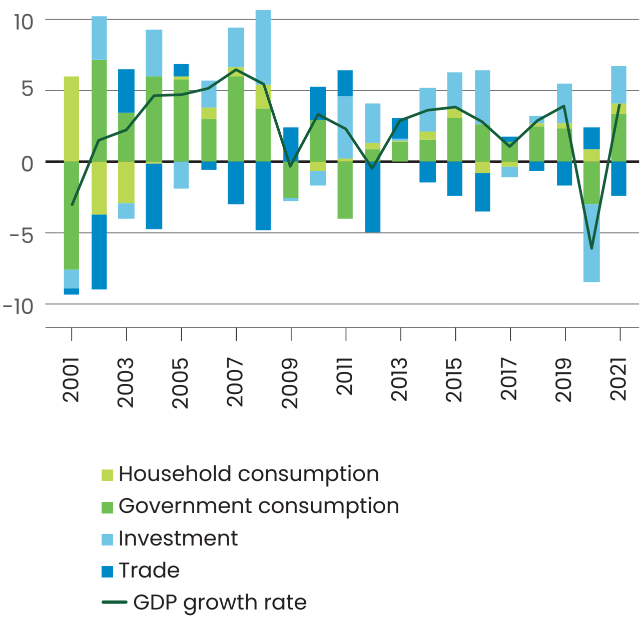
Looking at the North Macedonian economy in terms of the components of demand, GDP is mainly driven by household consumption, which has accounted for almost three-quarters of GDP growth since 2000 (Figure 2). Private consumption made a very significant contribution to GDP growth between 2001 and 2008 (101.3 percent).[2] Remittances from the diaspora (17 percent of GDP) provide structural support for private consumption, which was also buoyed by the growth in bank credit before 2008. Between 2009 and 2013, household consumption was relatively sluggish, contributing negatively to GDP growth, mainly due to the deterioration of the labor market and the slowdown in wage growth. The improvement in the labor market after the financial crisis, accompanied by increased spending on the pension system, boosted growth. Between 2014 and 2020, household consumption thus accounted for nearly three-quarters of GDP growth.

A major shift took place between 2000 and 2020, as investment, which represented an average of 22 percent of GDP over this period, gradually became a driver of growth amid the slowdown in private consumption. On average, investment accounted for 56.4 percent of GDP growth over this period, though with major fluctuations: while this contribution stood at 44.7 percent between 2001 and 2008, it was as high as 78.4 percent between 2009 and 2013, and 67.6 percent between 2014 and 2020. The growth in public investment, from 4 percent to 6 percent of GDP between 2003-2008 and 2009-2013, played a significant role in this shift. The “Skopje 2014” capital city development and construction program boosted investment until 2014, while highway infrastructure projects carried it forward over the following period.

These trends are nevertheless structured around weak productive capacities. As a result, a large share of consumption and investment has been met by increased imports. The structural deficit of the trade balance thus contributed negatively to GDP growth across the period as a whole. Due to the limited role of the state in the economy, government consumption played a more marginal role, accounting for less than 10 percent of GDP growth over the period.

2 This result is possible due to the negative contribution from the trade balance.

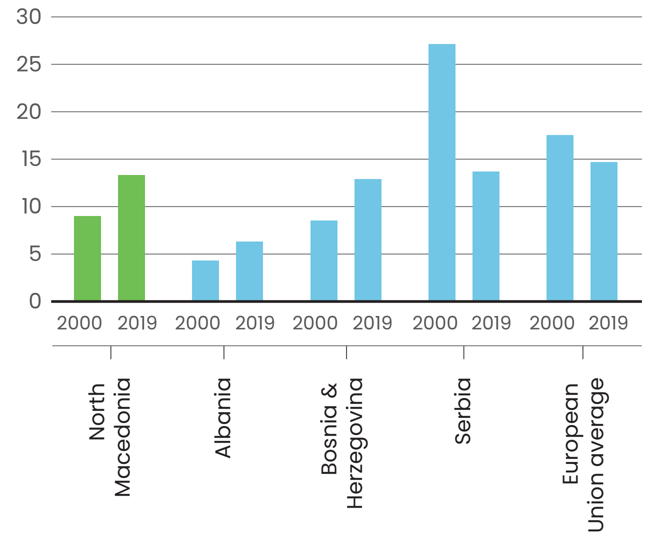
Figure 2 – Contribution to GDP growth by components of demand (in percent)



Source: North Macedonian Ministry of Economy and Finance

At the sectoral level, the structure of the economy has remained much the same over the past two decades (Figure 4). Services accounted for the bulk of economic activity in 2019, representing 64 percent of GDP, and this share has been almost constant since 2000 (62 percent). The agricultural sector has declined slightly, losing 3 percentage points and falling from 12 percent of GDP in 2000 to 9 percent in 2019. Over the same period, industry grew by just 2 percentage points, from 25 to 27 percent of GDP between 2000 and 2019. North Macedonia has been successful in attracting foreign direct investment (FDI), notably due to having one of the lowest tax rates in the region and across Europe as a whole. This investment is largely concentrated in the manufacturing industry, and in particular in the country's Technological Industrial Development Zones (TIDZ). However, the development of the manufacturing sector currently presents a mixed bag, with weak growth of around 4 percentage points in its share in value-added (Figure 3), from 9 to 12.5 percent between 2000 and 2020 (13.3 percent in 2019). While these figures do not represent a significant transformation of the country's economy, the manufacturing sector does appear to be making a more rapid contribution to value-added in North Macedonia than in most of the country's neighbors: in this respect, it remains slightly below the EU average (14.7 percent), but at the same level as Serbia (13.7 percent), though this latter has seen the size of the sector declined by about 13.5 percentage points since 2000 (Figure 3).

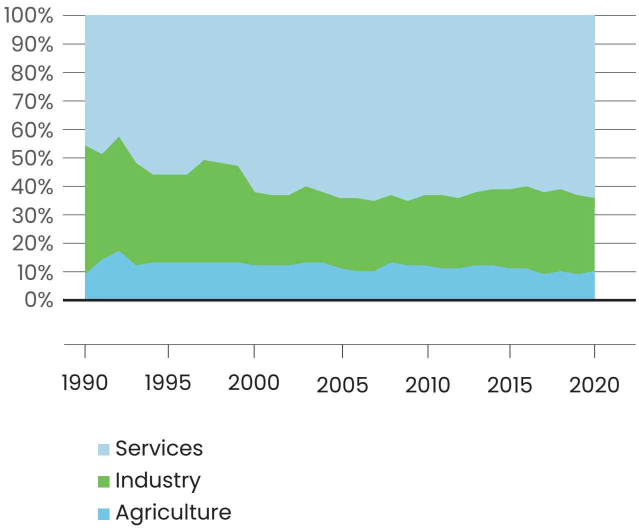
Figure 3 – Share of manufacturing in value-added (in percent)



Source: WDI, World Bank

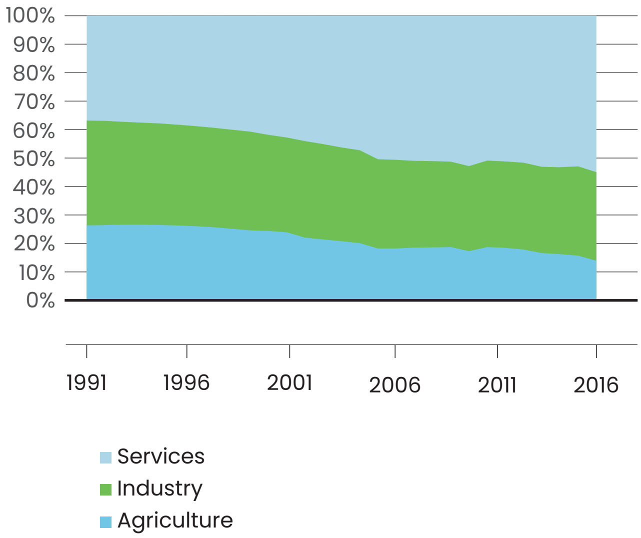
By contrast, the sectoral breakdown of employment has undergone a much more significant change (Figure 5). The service sector accounted for 55 percent of total employment in 2019, compared to 40 percent in 2000, equating to a gain of nearly 15 percentage points. Meanwhile, the share of agriculture in employment has declined by about 10 percentage points, from 25 percent of total employment in 2000 to 14 percent in 2019. As in many other middle-income countries, the share of industry in employment has also declined, from 35 percent in 2000 to 31 percent in 2019.

Figure 4 – Sectoral breakdown of value-added



Source: WDI, World Bank

Figure 5 – Sectoral breakdown of employment



Source: WDI, World Bank

These changes have been accompanied by different productivity trends in the different sectors, as measured by the value-added per worker. With the share of agricultural employment falling faster than the sector's share in GDP, labor productivity in the agricultural sector has thus increased by around a third (+33.7 percent) - though it should be noted that this increase primarily took place during the first sub-period (2001-2008), during which productivity increased by 90 percent. Productivity in the industrial sector has increased by almost 58 percent over the past twenty years, due to the sector's growing share in GDP combined with its falling share in employment. Again, this increase was much more marked in the first sub-period (+31.3 percent), with a decline in productivity seen over the most recent sub-period (-9.4 percent between 2014 and 2019). Finally, as the share of services in GDP has stagnated while the sector's share in employment has rapidly grown, labor productivity in this sector has declined by nearly 15 percent in twenty years. Overall, the most notable productivity gains were achieved in the 2001-2008 sub-period (+25.1 percent), with labor productivity tending to stagnate in the sub-periods that followed.

1.2 – The challenge of identifying a development model

North Macedonia's economic growth, therefore, remains slow, and its medium- to long-term outlook appears relatively uncertain. Since 2014, private consumption and investment have driven growth, with the former boosting wholesale and retail trade, transport, and tourism, and the latter stimulating the construction sector, in infrastructure and private housing, and the manufacturing sector. Despite this, growth remains relatively sluggish, and the manufacturing sector is not producing the anticipated spillover effects.

At present, none of the potential alternative scenarios to this growth model appear to be sufficiently advanced, concrete, or feasible. North Macedonia became a candidate for EU membership in 2005, and at present there is no end in sight to this seventeen-year-old process, the outcome of which remains uncertain even beyond the fact that talks are currently being blocked by Bulgaria. Yet the North Macedonian government still sees accession to the EU, in terms of both the journey and the final goal, as the country's road to development. EU membership might indeed help to shift some of the current obstacles to the country's development. Progressive convergence toward European standards, particularly normative standards, may promote improved governance and free competition, and the goal of membership has the potential to overcome political divisions and act as an accelerator, enabling economic catch-up. As an EU candidate country, North Macedonia is also able to benefit from EU funding via the Instrument for Pre-accession Assistance, a mechanism that complements the funding received from bilateral and multilateral donors. Used to develop infrastructure and growth sectors, such funding may enable the country to grow more rapidly.

However, regulatory convergence and financial support alone cannot act as catalysts in the absence of a medium- and long-term development strategy. The government's European ambitions must be accompanied by a comprehensive review of the economy's engines of growth and priority sectors.

Certain sectors stand out, including agribusiness, the automotive industry, information technology and digitization, green tourism, renewable energy and energy efficiency, or the strategy of capturing some of the industries relocating from Southeast Asia. Some of these sectors are indeed potential sources of growth. North Macedonia was the breadbasket of the former Yugoslavia and modernizing the agricultural sector and developing value chains would allow this to become an export sector. Similarly, the automotive sector is already well established. Moving beyond the assembly stage would create more value-added at the local level and enable a gradual move away from the TIDZ model (see Box 2). The country has relatively well-educated youth, and new technologies and digitization could help retain some of those tempted to emigrate, modernize the public administration, and reduce corruption. The country's location, topography, and natural resources represent assets for growing a model of tourism more aligned with new modes of travel. Phasing out coal and improving building insulation will be key sectors. Finally, nearshoring, which at this stage remains a promise at the global level, may enable the country to increase its industrial production thanks to its proximity to the EU, Russia, and Turkey.

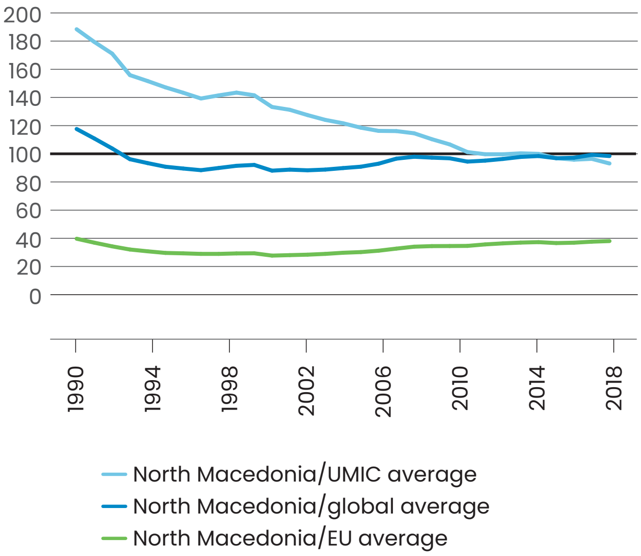
What North Macedonia lacks, however, are concrete measures and a comprehensive action plan—one that also factors in the risks posed by climate change—for turning these sectors into industries capable of creating local value-added and jobs. The government's Economic Reform Programme 2021-2023 (Ministry of Finance 2021) does not, for example, propose ways to develop the industrial and services sectors or to boost the labor market, and while it does set out specific measures for energy efficiency, renewable energy, and the agricultural sector, it does not mention tourism. EU membership, which has implications beyond the strictly economic, thus represents a path for the country's development. But while it may act as a catalyst for the transformation of North Macedonia, it cannot do so alone. The government needs to map out an alternative, or an independent path, to ensure the country's long-term future.

1.3 – Mild economic convergence held back by sluggish demographics and low labor market inclusivity

Due to weak economic growth, driven down by sluggish demographics, the country has only just started down a tentative path toward economic convergence. In 1991, North Macedonia's GDP per capita was 111 percent of the global average (Figure 6). Following a low point in 2004, when it fell to 87 percent, it now stands at 98 percent of the global average. Compared to the world as a whole, GDP per capita in North Macedonia thus appears to be lower in 2020 than it was at independence, although it is now on the up. Convergence with EU GDP per capita has also been slow, returning in 2020 to the initial level it had at the time of independence (38 percent), after a low point of 27 percent in the early 2000s. By contrast, North Macedonia is not only not converging with, but moving away from, the average GDP per capita of the countries in its income group, the upper-middle-income countries (UMICs).

While its GDP per capita was 179 percent of the UMIC average in 1991, in 2020 it was only 93 percent, with a steady decline taking place over this period.

Figure 6 – Change in GDP per capita (in percent)



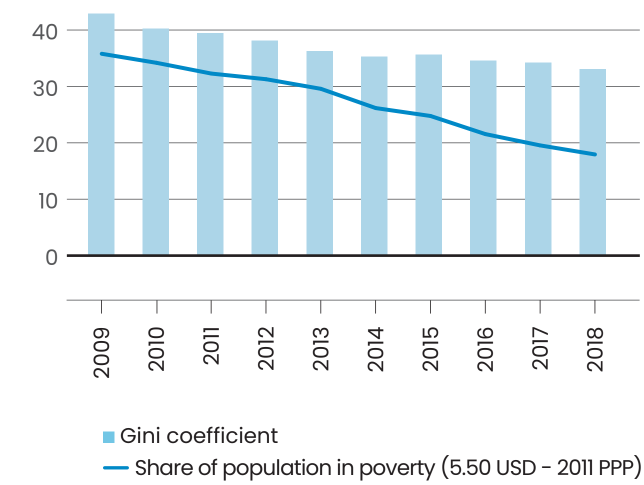
Source: WDI, World Bank

Despite this, due to relatively inclusive growth, North Macedonia's poverty rate has fallen. Based on the UMIC poverty line of US $5.50 per day (2011 PPP), the poverty rate has halved in ten years (Figure 7), falling from 35.7 percent of the population in 2009 to 17.9 percent in 2018 (World Bank 2018). This decline has however been slower than the average for the UMICs, which have seen a dramatic reduction in the share of the population living in poverty, from 44.2 percent to 17.4 percent over the same period. North Macedonia's poverty rate is on a par with Serbia's (19.3 percent in 2017), better than Albania's (34 percent in 2017), but worse than Bulgaria's (6.9 percent in 2018).

The underlying trend behind the decline in poverty in the country appears to be the reduction in income inequality, with the incomes of households at the bottom of the distribution appearing to have risen faster than those at the top. The improved living conditions of the population in the lower deciles have enabled a fall in the poverty rate and the Gini coefficient, which has dropped by almost 10 points in ten years in North Macedonia (33 in 2018) (Figure 7). The country is an exception to the rule since although these figures put it among the average of the countries in the region, its trend is particularly positive. Most of its neighbors are seeing stagnation or only a modest decline in their Gini coefficient, or even an increase (7.5 points increase in Bulgaria). Overall, while inequality in North Macedonia appears to be lower than in Bulgaria (41.3 in 2018) and Serbia (36.2 in 2017), it is on a par with that in Albania (33.2 in 2017).

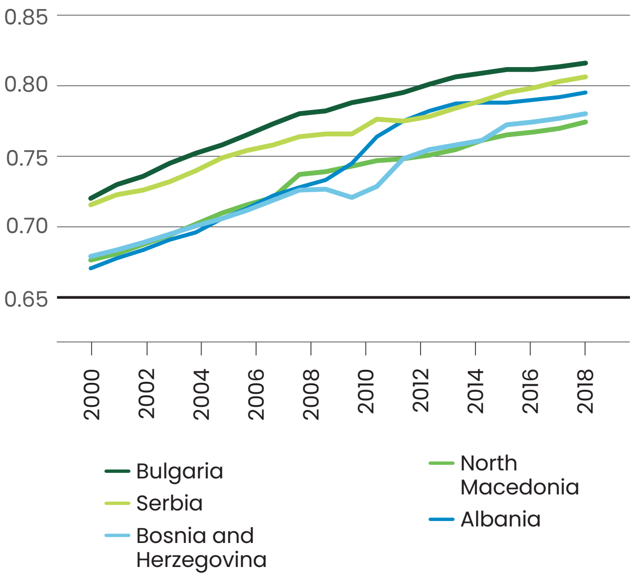
Conversely, North Macedonia's Human Development Index (HDI) is below that of other countries in the region (UNDP 2020). While Albania and Bosnia and Herzegovina had a similar HDI to North Macedonia in 2000, they now rank above it (Figure 8). North Macedonia has made slower progress, particularly since 2008, and the country is now significantly behind in this area. It is ranked 82nd out of 189 countries, behind Bulgaria (56th), Serbia (64th), Albania (69th), and Bosnia and Herzegovina (73rd). The country's low ranking is due in part to low GDP per capita and education indicators.

Figure 7 – Poverty rate and Gini coefficient



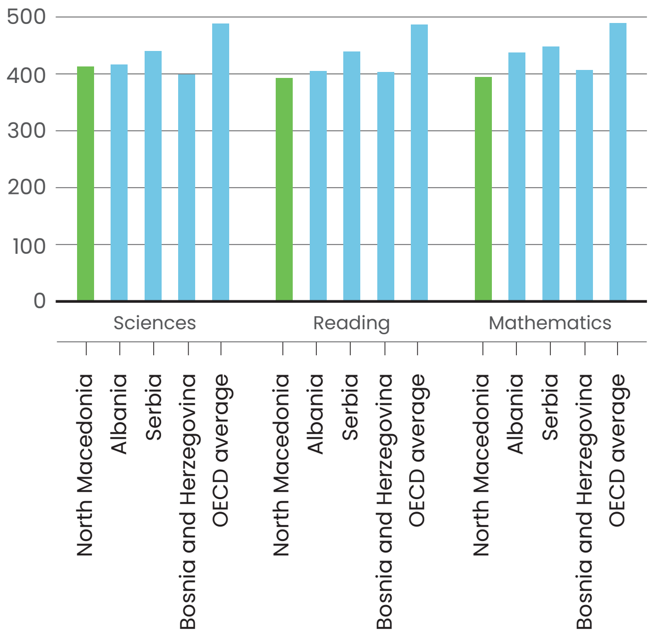
Source: WDI, World Bank

Figure 8 – Human Development Index



Source: UNDP

Figure 9 – PISA score (2018)



Source: OECD

Education is a structural issue for North Macedonia, which has the lowest mean years of schooling in the region (9.6 years, compared to the average across its neighbors of 11.7 years—a gap of nearly 2 years). Similarly, in qualitative terms, the country lags far behind in the OECD's PISA rankings (OECD 2018), ranking last among the countries in the region in mathematics, science, and reading. Overall, the country is far below the average of comparable countries, and even further below the OECD average (Figure 9).

The inclusivity of North Macedonia's labor market appears to be particularly low. First, it is characterized by low participation: only 66 percent of the population aged 15 to 64 is active in the labor market (Figure 10). Except for Bosnia and Herzegovina, this is the lowest figure in the region, just below Croatia (67 percent) and Serbia (67.6 percent). Labor force participation is also 7 percentage points below the average in the EU (73.5 percent) and for UMICs (72.5 percent). In addition to the low participation rate, the unemployment rate remains high, though it is rapidly declining: in 2019, 17.3 percent of the workforce was out of work, down from 32 percent at the beginning of the decade. North Macedonia's unemployment rate is the highest in the region, for which the average is just 8 percent, and most significantly, it is three times higher than the UMIC average (6 percent in 2019).

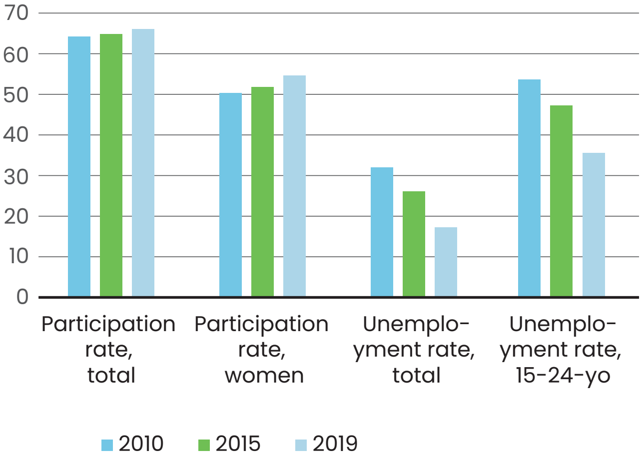
These data are however put into perspective by several qualitative details. North Macedonia's most recent census was conducted in 2021,[3] with the previous one dating back to 2002. Estimates were produced for the country's resident population between these years, but no figure would be able to reflect precisely the reality. The size and characteristics of the diaspora also add to the challenges of establishing an exact figure. While some of the diaspora live and work abroad all year round, others commute between certain European countries (Italy, Germany, and Switzerland in particular) and their country of origin. It is therefore difficult to pin down the exact size of the workforce. In addition, as simply registering with the unemployment system leads to automatic entitlement, the unemployment figures may be overestimated, as some individuals in informal employment or not resident in North Macedonia may still be counted as unemployed. These details are corroborated by upward pressure on wages, including a 45 percent increase in the minimum wage since 2017, while some sectors are reportedly even experiencing labor shortages.

It remains that, in addition to the sluggish growth in the economy, which stifles job creation, the North Macedonian labor market has numerous problems. The issue of the reservation wage—the wage at which a person is willing to work—is a prime example. Due to a combination of factors—higher salaries in the bloated public sector, remittances from the diaspora acting as a disincentive to work, and a mismatch in perceptions between actual and expected salaries, particularly due to comparison with the diaspora—the reservation wage appears to be high in North Macedonia. The country's labor market thus combines a high reservation wage with a background of mass unemployment—despite labor shortages in some sectors—, a low participation rate, and high levels of emigration for work.

3 The preliminary findings of the 2021 census were published in March 2022.

Low labor market inclusivity is reflected in the exclusion of young people and women. Youth unemployment is at a record high, with over a third (35.5 percent) of young people aged 15-24 unemployed in 2019. This is the highest level in the region, and more than double the average in UMICs (15.7 percent) and the EU (16.8 percent). It is further compounded by gender inequalities, which remain particularly prevalent, with women's labor force participation (54.7 percent) more than 20 percentage points lower than that of men (77.2 percent). The unemployment rate for women is also higher than for men (18.4 percent and 16.5 percent respectively). Finally, the size of the informal sector, which accounts for 20 percent of employment, is another sign of precariousness.

Figure 10 – Labor market indicators (in percent)



Source: WDI, World Bank

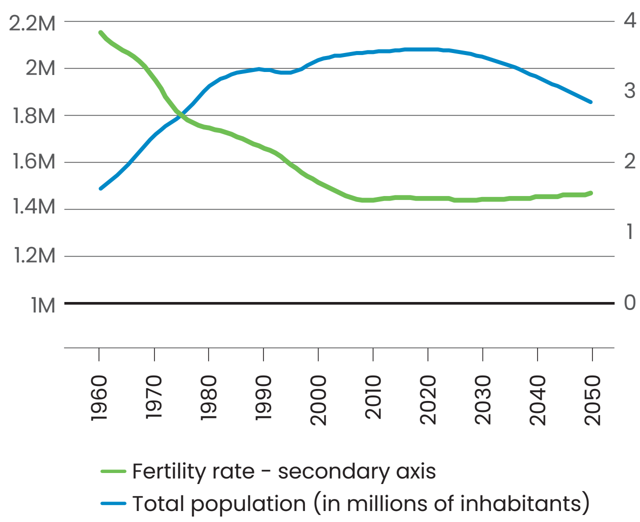
All of the problems discussed above—the slow pace of convergence, the poor labor market, the low level of education—are reflected in the country's demographic trends. According to the United Nations, in 2020 the country had a population of 2,083,380 (Figure 11).[4] This is about 48,000 more than twenty years ago, and 90,000 more than when the country gained independence in 1991. Its

4 The preliminary data from the 2021 census indicate that the number of inhabitants residing in North Macedonia is 1,836,713. The number of non-residents is thought to be 260,606, giving a total population of 2,097,319. The total population figure derived from the census is therefore close to that provided by the UN. However, the non-resident population is thought to have been underestimated. Given the preliminary nature of the census data, and to be consistent with the UN projections, this report uses data from the *World Population Prospects*.

population growth has therefore been remarkably slow, increasing by an annual average of just 0.14 percent over the last thirty years.

This low population growth mainly results from a low birth rate and high levels of emigration, which have offset the increase in life expectancy. The latter rose from 71.3 years in 1991 to 75.8 years in 2020 and constitutes the main positive driver of North Macedonian population growth. The birth rate, however, is declining, and the replacement level—the fertility rate at which the population remains stable over time—has not been reached since independence. The number of children per woman was over 3 in the 1960s and had gradually declined to 2.1—the replacement level—by the turn of the 1990s. Since 1991, the fertility rate has thus been below the replacement level and has declined steadily to 1.5 children per woman. The low birth rate is compounded by emigration. Since the 1950s, North Macedonia is thought to have lost 500,000 inhabitants through negative net migration, with the migration deficit since independence estimated at 141,000 people, or about 7 percent of the 2020 population.

Figure 11 – Total population and fertility rate



Source: *World Population Prospects*, United Nations

The inflection point of these combined trends appears to have been reached in 2020, when the country's population is estimated to have declined for the first time since independence. According to UN projections, this trend is not only expected to continue, but to worsen. By 2050, the country is projected to have only 1,856,775 inhabitants: a decrease of 226,605 people, or an 11 percent fall in its population.

This demographic slump poses multiple challenges. The fall in the birth rate is leading to a gradual decline in the share of working-age population, accelerated by the emigration of the younger generation in search of job opportunities abroad. Meanwhile, the labor market is stagnating due to a lack of pressure from new entrants, reinforcing the desire to emigrate. A self-perpetuating negative spiral thus appears to be at work. Population aging, combined with the decline in the share of working-age population, has resulted in an increase in the share of the dependent population, in this case pensioners. The funding of the pension and social security system is thus increasingly reliant on a smaller share of the population, and in the medium to long term this could threaten the sustainability of the current pension funding model. The positive side to the country's relatively massive levels of emigration is that it has a sizable diaspora: currently estimated at 500,000 people, equivalent to around a quarter of the country's population. The strong, enduring ties between the diaspora and its country of origin are reflected in data from the tourism (travel and transport sectors), the construction sector (through investment in housing and second homes), and remittances. The latter represents around 17 percent of GDP, contributing to strong consumption and the reduction of the current account deficit.

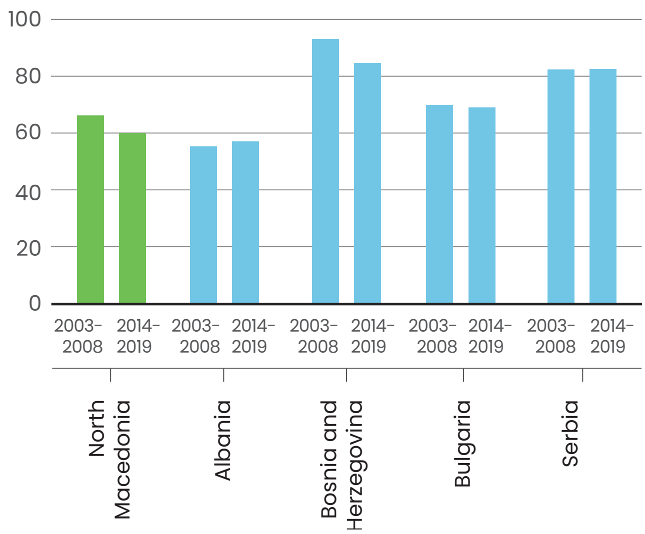
2. Limited budgetary imbalances and a permanent external constraint

2.1 – Limited state interventionism in the economy

One of the main issues for North Macedonia is the difficulty of identifying a comparative advantage that can be leveraged as a driver of growth. The country faces structural obstacles linked to its landlocked, narrow territory, small and aging population, and lack of a skilled workforce. It cannot, therefore, base its development solely on natural or human capital. The country's comparative advantage instead stems from a political choice made by the government, namely a particularly attractive tax regime for businesses.

Contrary to the trend generally seen during the economic development process, the role of the state in the North Macedonian economy is relatively small and has declined over this period. The size of the state, understood here as total government revenue and spending as a percentage of GDP (Figure 12), thus declined between 2003-2008 (66 percent of GDP) and 2014-2019 (60 percent of GDP). Across the region, only Bosnia and Herzegovina and Bulgaria also saw a decline in the size of the state between these two periods, and only Albania (54 percent) had a smaller state than North Macedonia over the period 2014-2019.

Figure 12 – Total government revenue and spending (in percent of GDP) Average 2003-2008 and 2014-2019



Source: IMF, WEO

Looking at the figures in detail, government revenue averaged 28.6 percent of GDP over the period 2014-2019. This is below the earlier period (2003-2008), when it averaged 33 percent of GDP (36 percent of GDP in 2003), and is relatively low: by comparison, within the region, only Albania (27.3 percent of GDP) has more limited resources. Overall, government revenue grew only moderately over the recent period, from 27.7 percent of GDP in 2014 to 29.6 percent in 2019. No major changes took place, either in terms of the ratio to GDP or in the composition of revenue. Tax revenue grew marginally, from 16.1 percent of GDP in 2014 to 16.9 percent in 2019. Non-tax revenue stood at 2.7 percent of GDP in 2019, up from 2 percent in 2014. Similarly, social contributions—to the pension, unemployment, and health systems—increased only slightly, from 8.4 percent of GDP in 2014 to 9 percent in 2019.

The low level of government revenue is down to the structure of the North Macedonian economy and the policy choices made by the government. A significant share of the country's economic activity is in the informal sector, which—though estimates vary[5]—is estimated to account for around a third of GDP and 20 percent of employment. This undeclared activity represents a shortfall in government revenue. Informality can result from either the desire of taxable entities to conceal their income or the shortcomings of the tax authorities. In the case of North Macedonia, both of these factors appear to be at play: the shortcomings of the tax authorities exacerbate the low baseline willingness to pay tax, which stems in turn from high levels of corruption and the poor quality of institutions.

5 Depending on the definition and methodology employed, the size of the informal sector ranges from 10% to 45% of GDP.

Informality alone cannot, however, account for the low level of government revenue. The levels of informality in Bulgaria and Montenegro, for example, are thought to be equivalent to that of North Macedonia,[6] but government revenue in these countries stood at 34 percent and 42 percent of GDP respectively between 2014 and 2019—6 and 14 percentage points higher than in North Macedonia. The situation in North Macedonia is also down to political choices. The country is characterized by particularly low tax rates—value-added tax of 18 percent, corporate tax of 10 percent, and income tax varying between 10 percent and 18 percent—that are below those in the Balkans and the EU. The main purpose of this low tax regime is to stimulate economic activity, but it results in a low tax burden and less revenue for the state. The development of the TIDZ (see Box 2) is based on the same rationale and represents a significant loss of government revenue. All of these factors help account for the low level of government revenue in North Macedonia.

Box 2: The development of North Macedonia's TIDZ

Businesses—mostly foreign—are attracted to the Technological Industrial Development Zones (TIDZ) by the zero tax rate, in a country geographically close to the European market. The TIDZ have brought the country to the attention of foreign—mainly German and American—investors and manufacturers, a significant achievement that enables North Macedonia to stand out from among its Balkan neighbors.

While the lack of data is a major obstacle to analyzing the impact of the TIDZ, several observations can nevertheless be made. FDI in these zones accounted for an average of between 20 and 30 percent of the FDI received by the country between 2007 and 2014 (CEA 2016). Given that FDI accounted for around 4 percent of GDP over this period, a high estimate would put TIDZ-related FDI at around 1.2 percent of GDP: a significant amount for a country with a structural current account deficit (see section 2.3). These zones have also contributed to job creation, against a background of high levels of unemployment and low labor force participation, with data from the World Bank (2018) reporting a total of around 14,000 jobs created in the TIDZ between 2011 and 2016. However, this remains a relatively small figure in relation to the size of the population in work (1.8 percent). Therefore, in quantitative terms, the positive impact of the TIDZ on the North Macedonian economy currently appears to be limited to a communications asset used to raise the country's profile abroad.

The small positive contribution of the TIDZ to the economy is also offset by major negatives. Most of the companies located in the TIDZ are in the automotive and textile sectors, with a small number in other sectors (agriculture, IT services, equipment, and machinery). The foreign companies attracted by the low tax regime have only loose ties to the local economy. The TIDZ thus have several major drawbacks: i) limited spillover effects on the economy; ii) a limited impact on the trade balance; iii) a high cost to the public finances; iv) a distortion of competition; and v) a deadweight effect.

i) The limited spillover effects, primarily due to weak local ties, are mainly due to the nature of the industrial activity, which consists of assembly work. Value-added in North Macedonia remains limited, since the supply—the inputs—is not domestically produced but imported, reducing the multiplier effect on local production. In addition, this type of work does not require specific skills, and wages are low. Downward pressure on wages is strengthened by the fact that companies based in the TIDZ have chosen this location in order to benefit from a comparative cost advantage. The impact in terms of additional consumption is therefore limited.

6 IMF (2019).

ii) Weak local value-added also limits the impact on the trade balance. The TIDZ now account for around 50 percent of goods exports from North Macedonia, a figure that highlights both the weakness of the North Macedonian export-based industry and the considerable role that these zones play in the country. Since the launch of the TIDZ in 2007, the share of goods exports in GDP has increased from 30 to 47 percent in 2019. This is a significant gain and can therefore be partly attributed to stimulation from the TIDZ. However, since the country is currently seen as an assembly site, and due to the low share of locally produced inputs, exports from the TIDZ have driven higher imports, which also grew between 2007 and 2019, although at a slower pace, from 53 to 65 percent of GDP. While the TIDZ have contributed to reducing the trade deficit and, more broadly, have helped finance the current account deficit via FDI, they present a mixed picture overall.

iii) Companies in the TIDZ benefit from zero taxation, paying no corporate tax, social or employer contributions on wages, value-added tax, or customs duties. The duration of these exemptions is theoretically limited to 10 years, but the land is made available free of charge for 99 years. These benefits are decisive for company relocation, but they have significant collective costs, in both direct and indirect terms. The direct costs result from the state covering salary contributions, such as pension contributions, and providing land and connections to the water and electricity networks, while the indirect costs result from the lost revenue to the state of the taxes that a business located outside of the TIDZ would have had to pay. Some estimates put the total cost to the public finances at EUR 20,000 per job created in the TIDZ. This is a significant amount, especially compared to the country's minimum wage (EUR 359 per month, or EUR 4,308 per annum).

iv) Due to the benefits for companies located in the TIDZ, these zones have a distorting effect on competition, both inside and outside the country. Inside the country, as the zones mainly benefit large foreign companies, the tax advantages of the TIDZ give them a clear comparative advantage over local companies. This puts North Macedonian companies, in particular small and medium-sized enterprises (SMEs), at a disadvantage, hindering the development of a local industry capable of exporting. Outside the country, competition is distorted between companies operating in the TIDZ and companies located in the Balkans or within the EU, as the zero tax burden within these zones is the lowest in Europe. While EU membership remains North Macedonia's stated goal, it is unclear whether this distortion of competition is compatible with EU regulations. The TIDZ are also exacerbating the race to the bottom currently underway in the Balkans, at least in tax terms, undermining the tax base for the public finances.

v) The tax advantages conferred by the TIDZ have also created a deadweight effect in certain sectors, in particular the textile industry. Many companies operating in this sector have moved their activities from outside to within the TIDZ in order to receive the tax benefits, representing a deadweight loss for the public finances. The scale of this loss is demonstrated by the fact that, in the textile sector, as many jobs have been created in the TIDZ as have been destroyed outside these zones.

Finally, since the type of work carried out in the TIDZ does not require major capital investment, the companies operating there are highly mobile, moving in and out of countries based on the tax advantages. The risk is that if North Macedonia's tax policy changes, these companies will pull out, along with the associated FDI and jobs.

Government spending, meanwhile, represented 31.4 percent of GDP on average over the period 2014-2019, with no major annual variation. This is lower than over the earlier period when it stood at 33.2 percent of GDP (36 percent in 2003). Only Albania has lower government spending (29.8 percent). Government spending in North Macedonia as a share of GDP has been characterized by low volatility since 2006, averaging 32 percent of GDP, with a high point of 33.8 percent in 2008 and a low point of 30.3 percent in 2018. Its composition has been notably stable over time, with current spending representing around 29 percent of GDP, and capital expenditure around 3 percent. A slight change in the composition of current spending is however apparent, with spending on wages and salaries declining by 3 percentage points between 2006 and 2019, from 7 percent to 4 percent of GDP, and spending on goods and services falling by 1.5 percentage points to 2.4 percent of GDP in 2019. Conversely, transfers have increased by 4.5 percentage points, reaching 21.4 percent of GDP in 2019. Looking at these figures in detail, the largest increase in transfers was seen in spending on the pension system, which saw its share in GDP rose from 8 percent to 9.3 percent between 2006 and 2019. Interest on the public debt increased by 0.3 percentage points to 1.2 percent of GDP in 2019. It increased on both domestic debt (+0.1 percentage points to 0.4 percent of GDP) and external debt (+0.2 percentage points to 0.8 percent of GDP).

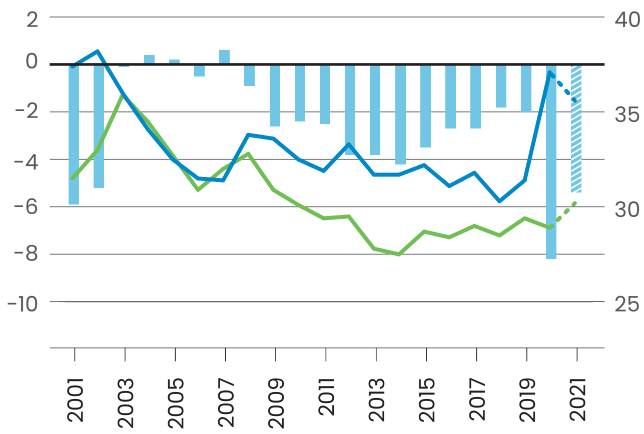
Analyzing the composition of government spending reveals several things. First, on average, current spending represents almost 90 percent of total government spending. The share of spending on investment, which would in theory improve potential growth, is therefore relatively small. Second, government spending has gradually shifted toward more rigid, less sustainable items. This is particularly true about the pension system, for which the deficit is currently estimated at around 4 percent of GDP, and which—bar a major reform—is likely to require increased spending and face decreased resources due to the country's demographic trends, which combine an aging population with an exodus of young potential taxpayers. It is also the case for subsidies (+1.1 percentage points between 2006 and 2019), particularly in the agricultural sector, and interest on public debt. While the latter remains under control, it has doubled since 2008, from 0.6 percent to 1.2 percent of GDP, reflecting the decline in concessional loans and the increase in public debt. Finally, the country's government spending is characterized by low efficiency. According to a study by the World Bank (2018), government spending in key sectors such as education, health, and infrastructure has performed relatively poorly, and if efficiencies were made, the same results could be achieved with a 13 percent reduction in government spending. By way of example, North Macedonia's spending on education is among the highest in the region, but with below average outcomes. Infrastructure also appears to be expensive in regional terms.

2.2 – Shrinking fiscal space

Despite these issues, these trends have resulted in the accumulation of primary and total fiscal surpluses, which, combined with strong growth, led to a sharp fall in public debt between 2000 and 2008. Between 2003 and 2008, the average primary surplus was 0.8 percent of GDP, while the average budget deficit was kept to under 0.1 percent of GDP (Figure 13). The total public debt ratio, including publicly guaranteed debt, fell by 29 percentage points, from 57 percent of GDP in 2000 to 27.6 percent in 2008 (Figure 14). Indebtedness then rose again rapidly, primarily as a result of successive financial crises, from the subprime crisis (2008) to the eurozone debt crisis (2010-2012). On the one hand, the slowdown in growth affected the denominator of the debt ratio, with two episodes of recession in 2009 and 2012, while on the other, the budget deficit widened to an average of 3.2 percent between 2009 and 2014, as revenue declined due to the economic downturn while spending remained at pre-crisis levels. As a result, the public debt increased by 18 percentage points to 45.8 percent of GDP in 2014.

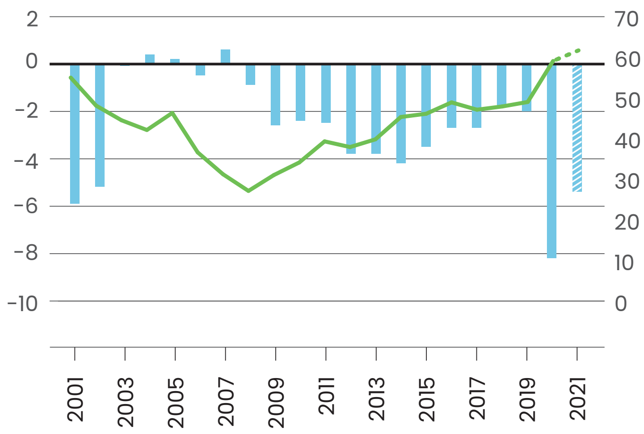
The stabilization of the debt ratio over the recent period was brought to a halt by the COVID-19 crisis. Between 2015 and 2019, the controlled budget deficit, which averaged 2.5 percent over the period, accompanied by a relatively strong average growth of 2.8 percent, kept the debt ratio below 50 percent of GDP. However, the pandemic resulted in a significant deterioration of the public finances, and public debt is thought to have hit 62.2 percent of GDP at the end of 2021, equating to a rise of 13.8 percentage points in two years. GDP contracted by 6.1 percent in 2020, and recovery is estimated at 4 percent in 2021, with the country not projected to return to the level of GDP recorded in 2019 until 2022. This effect on the denominator has been exacerbated by the increase in the public deficit. In 2020, the slight contraction in government revenue (28.9 percent of GDP, or -0.5 percentage points compared to 2019) and above all the major increase in spending (37.1 percent of GDP, or +5.7 percentage points compared to 2019) pushed up the public deficit, which stood at 8.2 percent of GDP in 2020. While the economic recovery in 2021 is thought to have enabled government revenue to recover (30.2 percent of GDP), the maintenance of support for the economy meant that government spending fell only marginally (36.6 percent of GDP). The public deficit is therefore expected to be high in 2021 (5.4 percent of GDP). By 2026, assuming average annual growth of between 3.5 and 4 percent, and a gradual decline in the primary public deficit to less than 2 percent in 2025, the public debt ratio is projected to remain at the present level.

Figure 13 – Fiscal balance, government revenue, and spending (in percent of GDP)



Source: IMF, WEO

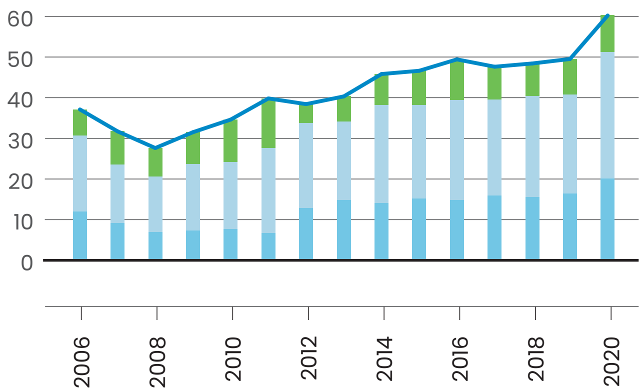
Figure 14 – Fiscal balance and total public sector debt (in percent of GDP)



Source: IMF and North Macedonian Ministry of Finance

The breakdown of the total public debt demonstrates a high level of stability between domestic debt, i.e., debt held by residents but that may be in foreign currency, and external debt (Figure 15). Domestic public debt accounted for a third of the total public debt in 2020 (20 percent of GDP), the same share as in 2012 (12.8 percent of GDP), with external public debt thus representing two-thirds of total public debt in 2020 (40.1 percent of GDP), the same share as in 2012 (25.6 percent of GDP). Domestic debt increased by around 8 percentage points between 2012 and 2020, and external debt by 15 percentage points over the same period. The publicly guaranteed debt of state-owned enterprises increased by 4 percentage points over the period, from 4.7 percent to 9 percent of GDP.

Figure 15 – Breakdown of total public sector debt (in percent of GDP)



Source: IMF and North Macedonian Ministry of Finance

The maturity of total public debt commitments dropped sharply during the eurozone crisis but has been increasing since 2013: it fell from an average of 5.5 years in 2009 to 3.8 in 2012, then increased back to 5.3 by 2020. This increase can be attributed to domestic debt, the maturity of which has been significantly extended: this was 6.8 years in 2020, up from 1.3 in 2012. In 2016, around 48 percent of domestic securities were due in the short term (one year or less), compared to 25 percent in

2020. The lowering of interest rates, driven by the ECB, which has spread to North Macedonia, has enabled securities to be issued with a longer term. The maturity of the external debt has shortened slightly, however, from 5.2 years in 2012 to 4.4 in 2020.

While the government's strategy of extending maturities represents a safeguard, the composition of the public debt is characterized by several vulnerabilities. First, two-thirds of public sector debt is held by non-residents, mainly as a result of the size of the country and the limited depth of the financial market. While this ratio is stable, demonstrating a certain appetite from international investors for the country, any reversal of this trend or greater reluctance to invest could cause problems. Second, around three-quarters of public sector debt is held in foreign currency: 69 percent in euros and 6.2 percent in special drawing rights (IMF), compared to 24 percent in the North Macedonian denar. The risk from fluctuations in the North Macedonian currency is limited by the fixed exchange rate regime. However, the high exposure of the public debt to the euro increases the pressure on the central bank to maintain the exchange rate peg. In a scenario in which there is strong pressure on external balances, the impact on the public finances would increase the country's vulnerabilities. Finally, it should be noted that while three-quarters of securities are fixed-rate, a quarter is a variable rate—and given the level of rates over the past few years, the rates on the latter are likely to increase. This scenario is all the more plausible due to building inflationary pressures, leading to the prospect in the medium term of the gradual normalization of the ECB's monetary policy and the unwinding of quantitative easing.

Another vulnerability related to North Macedonia's public finances is the country's public financing needs—consisting of the sum of the public deficit, short-term debt, and medium- and long-term debt amortization, as a share of GDP. North Macedonia's public financing needs are structurally high, averaging 15.9 percent of GDP between 2009 and 2019. They hit 19.2 percent of GDP in 2020 and are estimated to have been 17.1 percent of GDP in 2021. The gradual increase in the public debt ratio automatically increases debt amortization, compounded by the increase in the public deficit due to the crisis. The current period also coincides with the beginning of a phase in which several repayments of Eurobonds issued in the previous decade will fall due, with approximately EUR 500 million to be repaid in 2023 and 2025.

The latest debt sustainability analysis for North Macedonia (IMF 2021) highlights these vulnerabilities. The country is particularly vulnerable to all indicators concerning public financing needs, namely a shock to GDP growth, the primary balance, interest rates, the exchange rate, and contingent liabilities. In terms of the debt profile, the vulnerabilities stem from external financing needs, the debt held by non-residents, and the debt held in foreign currency.

However, despite these vulnerabilities, North Macedonia retains investor confidence and appears to be weathering the crisis well. This is demonstrated by trends in the country's Eurobond issuances, with its eighth and latest issuance in March 2021 raising EUR 700 million over 7 years at a rate of 1.625 percent. At the peak of the COVID-19 crisis (May 2020), the country was able to issue the same amount over 6 years, at a rate of 3.675 percent. More broadly, the recent period has confirmed the government's appetite for Eurobonds, which have jumped from just 9.4 percent of external public debt in 2013 to nearly 64 percent in 2020. Eurobonds provide greater flexibility and responsiveness in meeting public financing needs, particularly in comparison to funding from bilateral and multilateral donors. The funding provided by the latter has almost stagnated in value, and its share has greatly decreased, from 61 percent to 35 percent of the external public debt between 2013 and 2020.

2.3 – Relatively contained external risks

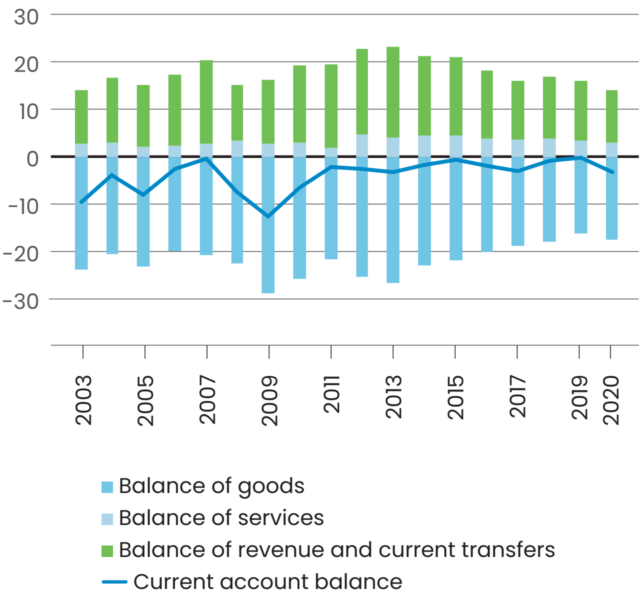
North Macedonia's current account has not recorded a surplus for the past twenty years, and as such it can be considered structurally in deficit. The current account deficit does, however, remain relatively controlled, at an average of 3.9 percent of GDP between 2000 and 2020. Crucially, the underlying trend is positive, with an average of 5.7 percent between 2003 and 2008, then 3.2 percent between 2009 and 2013, and finally 1.6 percent between 2014 and 2019.

The current account deficit is mainly driven by the balance of goods, which is structurally and deeply in deficit (Figure 16). The balance of goods deficit averaged 21.4 percent of GDP over the period 2000-2020. Apart from a deterioration between 2009 and 2013 (24.4 percent of GDP on average), peaking in 2012 at 26.5 percent of GDP, it improved over the period, averaging 18.6 percent of GDP between 2014 and 2019, compared to 22.5 percent of GDP between 2003 and 2008. The gradual narrowing of the balance of goods deficit over the period is the result of exports growing more rapidly than imports: while imports of goods relative to GDP increased by 29 percentage points between 2003 and 2019, exports of goods increased by 32 percentage points over the same period. The increase was particularly striking over the recent period, with exports of goods rising by 15 percentage points between 2014 and 2019, and imports of goods by 11 percentage points.

Looking at the data in detail, exports of goods are being driven by the growth of manufactured goods, which accounted for 83.3 percent of total exports in 2019, compared to 70 percent of exports in the early 2000s. This increase comes mainly from machinery and transport equipment, whose share rose from 6 percent to a third of goods exports between 2003 and 2019, linked to activity in the TIDZ, and from chemicals, which rose from 5 to 25 percent. Meanwhile, exports of a number of other manufactured products have collapsed, such as clothing, whose share fell from 30 to 6 percent between 2003 and 2019, and iron and steel (from 38 percent in 2008 to 9 percent in 2019). Goods imports are also being driven by the growth of manufactured goods, which accounted for two-thirds of imports at the end of the period, compared to less than 50 percent in 2003. There has been a striking increase in imports of intermediate goods, which represented 40 percent of imports in 2019, compared to less than 20 percent in 2003, again in conjunction with the development of the TIDZ. The share of imports of petroleum products is increasing and now represents a quarter of goods imports.

The balance of services, on the other hand, mitigates the trade deficit resulting from the balance of goods, as it has been in surplus over the whole period and is further improving. The balance of services surplus was an average of 2.8 percent of GDP between 2003 and 2008, and 3.7 percent over the periods 2009-2013 and 2014-2019. Service exports are supported by strong ties with the North Macedonian diaspora, which supports the travel and transport sectors.

Figure 16 – Breakdown of the current account (in percent of GDP)



Source: IMF, BOPS

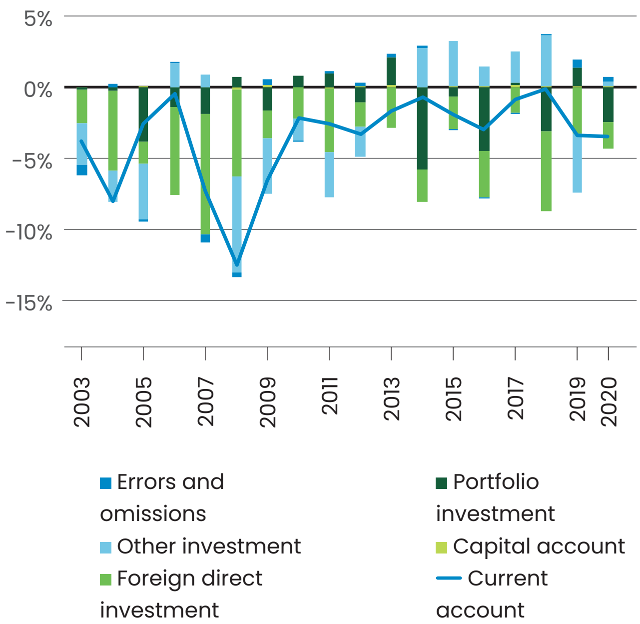
A wider current account deficit is prevented by current transfers, mainly remittances from the North Macedonian diaspora. These transfers are increasing, demonstrating the strong and enduring ties between the local population and those living or working abroad: they grew from an average of 15.7 percent of GDP between 2003 and 2008 to 17 percent of GDP between 2014 and 2019.

The current account deficit is generally financed by net FDI flows, which stood at an average of 4 percent of GDP between 2000 and 2020 (Figure 17). Net FDI was sustained before the 2008 crisis, at an average of 5 percent of GDP between 2003 and 2008, driven in particular by the TIDZ. It then slowed down during the period 2009-2013 (2.6 percent on average) but held up relatively well. It has not yet returned to pre-2008 levels, averaging 3.1 percent of GDP between 2014 and 2019. However, as the slowdown in FDI has been accompanied by the gradual reduction in the current account deficit, the latter has remained for the most part covered by these relatively stable flows that are less sensitive to external factors.

While FDI flows appear to be sufficient over the period to finance the current account deficit, this is not the case every year, due to erratic net flows of other forms of investment, averaging 0.8 percent of GDP between 2003 and 2020. These flows, which include deposits from non-residents, depend largely on the behavior of the diaspora and foreign companies. They are influenced by economic cycles within the EU and fluctuate based on agents' perceptions of risk. Foreign companies, meanwhile, make little use of the local banking system. Thus, in connection with the development of investment in the TIDZ, local subsidiaries of foreign companies receive trade credits and advances. These foreign debt flows often take place as part of internal company financing.

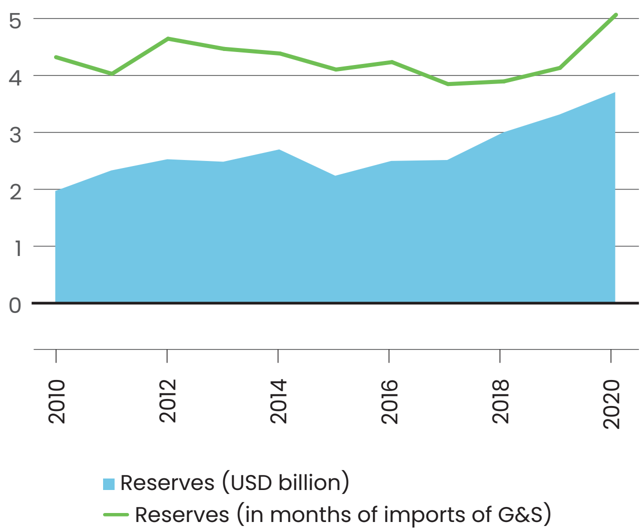
Portfolio investments are also more unstable, being dependent on the behavior of foreign investors, on internal or exogenous shocks, and above all on Eurobond issuances and repayments. They are therefore inherently more volatile. Between 2003 and 2020, net portfolio flows averaged 1.1 percent of GDP, a quarter of FDI. An increase can be seen over time: while they represented 1.1 percent of GDP between 2003 and 2008, net portfolio flows stood at 2 percent of GDP over the period 2014-2019, due in particular to the frequency of Eurobond issuances by the North Macedonian government, with annual issuances over this period, except in 2017 and 2019, amounting to a total of USD 1.7 billion. In total, in its history, North Macedonia has issued Eurobonds eight times, and these have played a major role in financing the current account deficit.

Figure 17 – Breakdown of current account financing flows (in percent of GDP)



Source: IMF, BOPS

Figure 18 – International reserves (excluding gold)

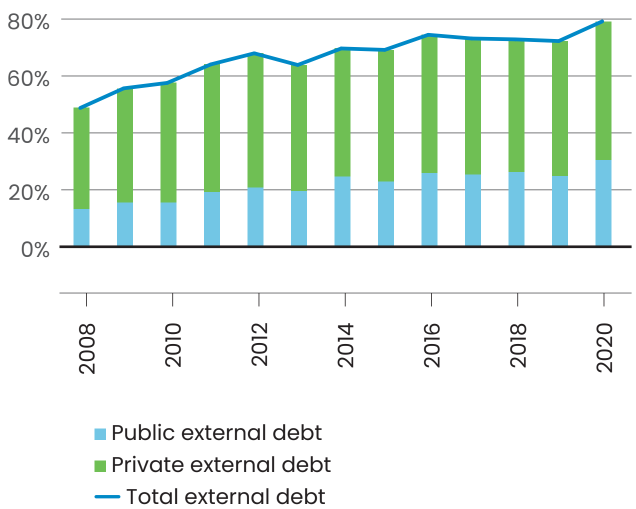


Source: IMF, BOPS

The regular financing of the current account deficit, whether through FDI inflows or Eurobond issuances, has kept foreign exchange reserves at a relatively comfortable level (Figure 18). These increased over the period, from around EUR 1 billion in 2006 to over EUR 3 billion by the end of 2021, excluding gold reserves. On average, they represent between 3.5 and 4.5 months of imports of goods and services, which appears to be an adequate level, particularly given the country's fixed exchange rate with the euro, and they were above the threshold established by the IMF in its ARA (Assessing Reserve Adequacy) metric over the entire period.

These debt flows, needed to finance the current account deficit, have however resulted in an increase in the total external debt (Figure 19), which grew by around 30 percentage points in 12 years, from 48.9 percent of GDP in 2008 to 79.3 percent in 2020. The rise is partly due to the increase in public debt, in particular via Eurobonds, and partly due to intercompany loans linked to FDI. The sustainability of the external debt remains sensitive to any changes in the exchange rate, making it all the more necessary for the Central Bank to maintain a fixed exchange rate with the euro. A shock to the current balance could also have a significant impact on external debt.

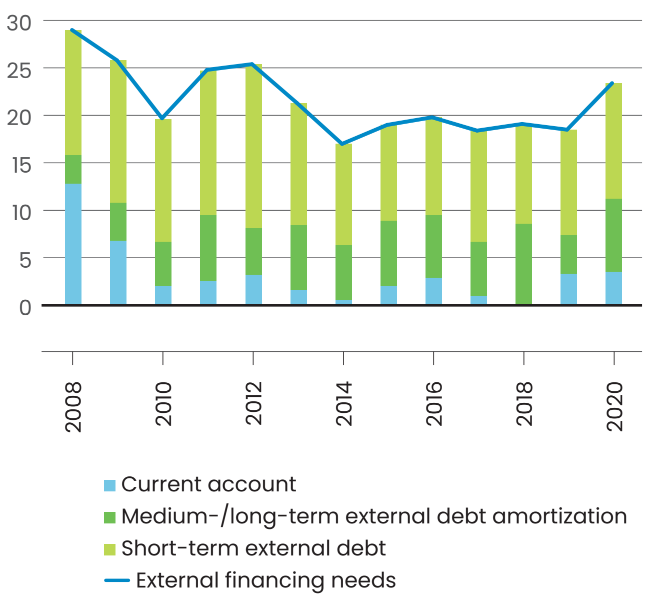
Figure 19 – Breakdown of the external debt (in percent of GDP)



Source: North Macedonian central bank

While the increase in total external debt stock is gradually leading to an increase in medium- and long-term debt amortization, the gradual reduction in the current account deficit is helping to stabilize external financing needs (Figure 20). However, these needs remain high and have stood at an average of 20 percent of GDP since 2008. The share of the current account deficit in the external financing needs has greatly declined (from over a quarter to less than 15 percent), while medium- and long-term debt amortization has increased (from 10 percent to a third). It should however be noted that the external financing needs are structurally increased by the short-term external debt, which on average represented half of the needs over the period. Although sensitive to a potential economic downturn, and of course to exchange rate risk, the short-term debt includes relatively stable items that would not require the use of reserves: deposits from non-residents (around 45 percent of the total short-term external debt) and intercompany loans linked to FDI (also around 45 percent).

Figure 20 – Breakdown of external financing needs (in percent of GDP)



Source: IMF (WEO) and World Bank (IDS)

The main external vulnerability ultimately stems from the banking sector, and the large share of loans and deposits held in foreign currency. In 2020, 43.7 percent of loans were held in foreign currency, compared to 56.3 percent in the North Macedonian denar. In the same year, 42 percent of deposits were held in foreign currency. The country's central bank is pursuing a medium- to long-term strategy of "denarization" of the banking system, but this has thus far had a limited impact. The share of loans held in foreign currency, for example, has declined by only 3 percentage points since 2010. Meanwhile, the share of deposits held in foreign currency has declined more significantly, by about 15 percentage points since 2010, although this share appears to have been stable since 2014.

This high proportion of loans held in foreign currency constitutes a vulnerability, as the households and businesses that take out these loans receive income in denar but are required to repay them in foreign currency. Any change in the exchange rate, and in particular any depreciation of the denar, would lead to higher costs for borrowers and potential repayment difficulties. At the macroeconomic level, this vulnerability is echoed by the exchange rate risk incurred on the country's external debt.

The central bank's monetary policy is therefore crucial in order to mitigate the exchange rate risk. While price stability remains the central bank's primary objective, maintaining a fixed exchange rate with the euro is a secondary objective, as this supports price stability. The latter is secure due to low inflation, averaging 1.5 percent over the last ten years, with little volatility.

According to Mundell's impossible trinity and given the fixed exchange rate, the imperfect capital mobility in North Macedonia gives a certain degree of independence to the central bank, which typically maintains a spread of around 300 basis points on the ECB's main bank rate. This room for maneuver enables the central bank to react to a crisis. Since the beginning of the COVID-19 crisis, it has thus reduced its spread on the ECB rate, which is now at 175 basis points, to support economic activity. This policy is facilitated by regular inflows of foreign currency and the coverage of external financing needs, which have kept reserves at a sufficient level. Maintaining the credibility of the fixed exchange rate requires the country to attract capital and maintain adequate foreign exchange reserves. The central bank's monetary policy is thus torn between supporting economic activity, which requires an accommodative policy and attracting capital, which requires a more restrictive policy. This policy is also facilitated by the agreements in place between the ECB and the North Macedonian central bank to provide swap and repo lines for euro liquidity.

The independence of North Macedonia's central bank is therefore limited by external constraints, and in particular by the actions of the ECB. While it has room for maneuver in the short term, as was seen during the COVID-19 crisis, any change in the ECB's rates must necessarily be passed on in the medium to long term, notably to maintain foreign exchange flows. The likely upcoming tightening of the ECB's monetary policy will thus lead to higher rates in North Macedonia, with a possible impact on economic growth.

In order to gain autonomy from ECB policy and reduce exchange rate vulnerabilities, the central bank is pursuing a "denarization" strategy, which began tentatively in the 2000s but has gathered pace since 2018. This sets different reserve requirements for different deposit currencies, with higher requirements for foreign currencies. Measures are also being considered to limit banks' foreign currency exposure and to develop a local capital market.

At present, North Macedonia's development model has limited vulnerabilities but insufficient drivers of growth. The long road to EU membership is a beacon of hope for the country's future, but it cannot rely on this alone. Determining a model based on the specific features of the national economy, its strengths and weaknesses, remains crucial to ensuring the country's future development.

List of acronyms and abbreviations

BOPS	Balance of Payments Statistics (IMF)
CEA	Center for Economic Analyses (Skopje)
FDI	Foreign direct investment
HDI	Human Development Index
PISA	Programme for International Student Assessment (OECD)
PPP	Purchasing power parity
TIDZ	Technological Industrial Development Zones
UMIC	Upper-middle-income country
UNDP	United Nations Development Programme
WDI	World Development Indicators (World Bank)
WEO	World Economic Outlook (IMF)

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