| Balkan Political Economy Series |

FROM TRANSITION TO TRANSFORMATION: AN ECONOMIC ANALYSIS OF NORTH MACEDONIA (1991-2023)

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An Economic Analysis of North Macedonia (1991-2023)

Editors: Ahmet Lokce, Andrijana B. Danevska

Edition: 1st Edition

BUP No. of Publication: 52

Name of Book Series: Balkan Political Economy Series

Book Series Editor: Ahmet Lokce

No. of Publication Within Book Series: 1

Design: Seyfullah Bayram

eISBN: 978-608-4868-54-5

DOI: https://doi.org//10.69648/ISOI2613

This edition is published by the Balkan University Press in Skopje, North Macedonia, 2025

Makedonsko Kosovska Brigada, Skopje 1000

Balkan University Press is a brand of the International Balkan University.

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BUP BALKAN UNIVERSITY PRESS

EDITORS

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LIST OF ABBREVIATIONS

AI	Artificial Inteligence
AIC	Actual Individual Consumption
APPRM	Agency for Promotion of Entrepreneurship of the Republic of Macedonia
AWU	Annual Work Unit
CEFTA	Central European Free Trade Agreement
CET1	Common Equity Tier 1
CIT	Corporate Income Tax
COSME	Programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises
CPI	Consumer Price Index
DESI	Digital Economy and Society Index
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECM	Error Correction Model
EEA	European Economic Agreement
EEN	Enterprise Europe Network
EESC	European Economic and Social Committee
EFF	Extended Fund Facility
EFTA	European Free Trade Association
EIB	European Investment Bank
EICC	European Info Correspondent Centre
ERL	Emergency Recovery Loan
ESG	Environmental Social and Governance
EU	European Union

EUR	Euro
EUROSTAT	Statistical Office of the European Union
FAOSTAT	Food and Agriculture Organization Database
FDI	Foreign Direct Investment
FITD	Fund for Innovation and Technological Development
FSA	Financial System Assessment
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GG	General Government
GNP	Gross National Product
GNP/pc	Gross National Product Per Capita
GTZ	German Agency for Technical Cooperation (now GIZ)
GVA	Gross Value Added
HDI	Human Development Index
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communication Technology
IFAD	International Fund for Agricultural Development
ILO	International Labour Organization
IMF	International Monetary Fund
IPA	Instrument for Pre-accession Assistance
IPARD	Instrument for Pre-accession Assistance in Rural Development
IoT	Internet of Things
JSC	Joint-Stock Company
LARD	Law on Agriculture and Rural Development
LCR	Liquidity Coverage Ration
LER	Local Economic Development
LLC	Limited Liability Company
MAFWE	Ministry of Agriculture Forestry and Water Economy
MANU	Macedonian Academy of Sciences and Arts
MCA	Macedonian Competitiveness Activity
MKD	Macedonian Denar
MSME	Micro Small and Medium Enterprises

NARDS	National Agricultural and Rural Development Strategy
NATO	North Atlantic Treaty Organization
NBRM	National Bank of the Republic of Macedonia
NBRNM	National Bank of the Republic of North Macedonia
NKIP	National Committee for Innovation and Entrepreneurship
NOB	National Liberation War
NPL	Non-Performing Loan
NSFR	Net Stable Funding Ratio
OECD	Organisation for Economic Cooperation and Development
OZT	Organisations of Associated Labor
PCL	Precautionary Credit Line
PES	Public Employment Service
PIT	Personal Income Tax
PPP	Purchasing Power Parity
PRGF	Poverty Reduction and Growth Facility
R&D	Research and Development
RCA	Revealed Comparative Advantage
RESS	Regional Enterprise Support Services
RNM	Republic of North Macedonia
ROAA	Return on Average Assets
ROAE	Return on Average Equity
RWA	Risk-Weighted Assets
SAA	Stabilisation and Association Agreement
SEPA	Single Euro Payments Area
SFRY	Socialist Federal Republic of Yugoslavia
SME	Small and Medium-sized Enterprises
SOE	State-Owned Enterprise
SSO	State Statistical Office
STF	Systemic Transformation Facility
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TIDZ	Technological Industrial Development Zones

UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
USA	United States of America
USD	United States Dollar
VAR	Vector Autoregression
VARMAX	Vector Autoregressive Moving-Average with Exogenous Variables
VAT	Value Added Tax
VET	Vocational Education and Training
WB	World Bank
WB6	Western Balkans Six
WTO	World Trade Organization
WTTC	World Travel and Tourism Council

Contents

Foreword

The economic transformation of North Macedonia over the past three decades is a story of persistence, adaptation, and structural reforms. This book tries to capture that journey with clarity and in-depth analysis, by offering a comprehensive overview of the policies, sectors, and institutional changes that have shaped the country's post-independence economy.

This first volume of the Balkan Political Economy Series begins by setting the historical and institutional context preceding independence, providing essential background to understand the structural limitations and opportunities that framed Macedonia's post-socialist transition. The chapters of this book explore the fundamental policy choices and challenges of the immediate post-independence period, focusing on macroeconomic stabilization, privatization, debt management, and fiscal reforms, and highlighting how these decisions shaped the path of economic development. Special focus is given to the transformation of key sectors: agriculture, banking, and trade, where the chapters present not only empirical assessments but also policy insights that can guide future decision-making. The inclusion of the chapters on remittances and the labor market dynamics further enriches the analysis by acknowledging the role of the diaspora and workforce dynamics in shaping macroeconomic stability and competitiveness.

At the same time, the book does not stop at economic metrics. It integrates the political economy of EU integration, the evolution of small and medium-sized enterprises (SMEs) as the backbone of employment and innovation, and finally, the challenges ahead for sustainable development, making a convincing case that economic transformation depends not only on growth, but on building strong institutions, inclusive policies, and continuous innovation.

The narrative progresses from historical context through sectoral analysis to strategic foresight, and the structured sequence of chapters captures the complexity and interconnectedness of the Macedonian economy. Therefore, it offers a valuable resource for scholars, policymakers, students, and all those interested in understanding the multidimensional processes of economic transformation in a small country.

The Editors

Chapter 1

Initial Economic Policies, Challenges of Post-Independence, and Macroeconomic Efforts

Nikola Popovski[1]

After the end of World War II until 1991, Macedonia was a federal republic within the Yugoslavian socialist federation and was economically developing itself as a part of the federal economic system, respecting its own specifics and needs. In that period, the country evolved from an agrarian underdeveloped economy into an industrial developing economy with high rates of investments, relatively high rates of economic growth, dynamically rising domestic industrial and construction sectors, accompanied by the development of the existing agricultural sector. This approach enables fast growth of the service sectors, especially trade, transportation, and financial services.

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According to the World Development Report (World Bank, 1978), for example, annual average economic growth rate in 1960-1976 (period of 17 years) was 6,5%, that of GNP/pc (Gross National Product Per Capita) was 5,6% industry and services was growing with 6,5 and 11,2% respectively; gross domestic investment was increasing by average rate of 5,3% annually reaching more than 30% of the Gross National Product (GNP) and external public debt was below 8% of GNP. Basic physical and social infrastructure was advancing, complemented by the initial rise of domestic educational, health, culture, and science sectors.

The economy was based on state and social ownership of the capital, combining the method of indirect planning of economic development with a more limited reliance on the market mechanism as a regulator of economic activities. In the period when the former socialist federation collapsed, the Macedonian economic structure had characteristics of a typical developing socialist economy with a relatively high contribution of sectors like industry, agriculture, and trade (Table 1).

Table 1: Economic activities by sectors in Macedonia in the years 1990-1992 (before and after the independence of 1991) measured at prices of 1991[2]

Sector	**Rate of Change**			**Structure in % 1990**		
	1990	1991	1992	1990	1991	1992
Total Economy	-10	-13,4	-14	100	100	100
Industry	-8	-20	-15	42,7	39,4	39
Agriculture	-10,2	18,6	1	11,5	15,7	18,5
Forestry	-9,4	1,5	2	0,7	0,8	1
Water economy	-3,7	8,1	1	0,5	0,7	0,8
Civil engineering	-8,1	-23,5	-20	8,6	7,6	7
Traffic	-15,1	-20	-12	5,5	5,1	5,2
Trade	-13,1	-16	-25	21,3	20,7	18
Catering & Tourism	-1,8	-15	-20	2,6	2,5	2,4
Crafts	-2,3	3	-2	2,3	2,8	3,1
Municipal services	-17,1	1	1	1,4	1,7	2
Other Production Activities	-12,1	-7	-14	2,9	3	3

Note. Data from "The Anti-Inflation Program of the R. Macedonia" (April 1992), Appendix, p. 2

2 Structure based on the measurement of gross social product by the previous socialist methodology which is slightly different from that of measuring GDP by the international statistical and World Bank (WB) method which was introduced in Macedonia after 1993. Sectors were also not harmonized.

Large parts of the economy, specifically the industrial sector, were structured to work and develop within the federal economy as a whole and were mostly complementary to that of the other federal republics.

Economic development had a satisfactory dynamic until the mid-eighties, when serious economic problems arose with rising inflation, unemployment, and foreign debt on one side and more and more enterprises with serious losses on the other side, pressing in that sense the living standards and economic perspectives. It exploded as a problem in the period of 1988-1990, together with massive political turbulence and uncertainties in the country.

Already existing similar political, economic, and social problems and changes in the region of Eastern Europe, including the Soviet Union, accelerated the processes of dissolution of both the socialist political and economic system and the Yugoslav federation.

Macedonia started a long and inspiring journey toward great social changes, at the same time, leaving the federation by proclaiming its independence and building a democratic system with a market-oriented economy. The beginning of the process was marked with more challenges than solutions on the path. After the successful referendum for the sovereignty and independence of the country held on September 8, Macedonia declared its independence on November 17, 1991, by adopting the new Constitution in the Assembly of the Republic of Macedonia.[3]

3 The name of the country from November 17, 1991, is Republic of Macedonia. Starting from January 11, 2019, it is changed in Republic of North Macedonia.

It was a necessary precondition to start the new economic system and policy, and to establish a modern and functioning market economy. Of course, it was not easy at all. Economic problems from the previous system transferred to the new reality and even became more severe and challenging. The complete internal, regional, and global surroundings and atmosphere were totally unfavorable for a systematic transformation and transition toward a new system. Some crucial state functions which previously were on a federal level was not established in Macedonia (defense, foreign policy, monetary system, customs and some other services etc.), wars in part of ex-Yugoslavia erupted dramatically, the new and independent state of Macedonia was not welcomed or even accepted from some of its neighbors for many historical and current strategic reasons. Some of them, namely Greece, opposing the name of the country and supported by the EU member countries, even block the Macedonian membership in the United Nations (UN), which has turned into some serious problems, most of all not being internationally recognized by most of the countries in the world. That problem existed for two long years until April 8, 1993, when Macedonia became a UN member country, not using its constitutional name, but the reference within the UN.[4] This initial problem exhausted the country and its economy since “the process of transformation is inevitably painful, particularly in an era in which the entire world economy is undergoing rapid change. It was vital that

4 The reference “the Former Yugoslav Republic of Macedonia” within UN and other international or regional European organizations, including bilateral relations with some countries, exists 26 years until January 2019.

everyone in society should have a stake in the success of the transformation." (Eatwell et al., 2000, p. 158).

On top of the political and international problems, experiencing a not very smooth path to independence and other very serious problems, the economic transition and transformation of the country were not pushed aside. On the contrary, the country underwent systematic and continuous economic reforms. Some of them were more and less successful, which can be expected in a very dramatic and turbulent political period, and a very specific regional and international moment.

The First Dramatic Years of Transition

The economic performance of the Macedonian economy in the last years of the socialist period, mostly the second half of the 80-ties of the 20th century, was not improving and kept getting worse. Naturally, it was not possible to stop it easily, and the negative trends didn`t stop in the period of gaining independence and the first years of transition toward a market economy. Practically, it was the toughest economic period, and not only economically, in the last half a century of the country's existence.

The economic activities were declining sharply, and all economic indicators were showing a classic case of persistence and terrible recession. The basic economic indicators were depressing (Table 2), and the primary attention was toward preservation of the existing economic activities in order to keep the living conditions and standard of living of the population.

Table 2: Basic macroeconomic indicators for Macedonia 1991-1994

Year	Real GDP growth (%)	Unemployment rate (%)	Inflation rate (%)	
			Consumer Price Index (CPI)	Retail Price*
1990	-9,9	156.323**	596,6	608,4
1991	-6,2	24,5	110,8	114,9
1992	-6,6	26,3	1511,3	1690,7
1993	-7,5	27,7	362,0	349,8
1994	-1,8	30,0	128,3	121,8

Note. Data from the "Statistical yearbook of R. Macedonia 1995 and 1999", Statistical Office of R. Macedonia, Skopje, R. Macedonia, 1995 and 1999, p. 163 and pp. 558-559 / For GDP: WB, European Bank for Reconstruction and Development (EBRD) 2002 and NBM web data.

*Official measurement of inflation rate until 1999. Since 2000, it has been CPI.

**The absolute number and percent on the current methodology were not calculated.

Internal and regional problems, loss of traditional markets in the region, unexpected bankruptcies of many companies, disturbed channels of the external trade, and practically having no foreign exchange reserves in the country were severe. Unemployment was increasing, and the inflation rate was in the range of hyperinflation. Economic activities were declining.

Although the main actual problems in that period were not only, not even mostly, economic ones, and the attention was focused on safeguarding the core state functions, independence building, and securing peace and stability, the economic problems were not neglected. Immediately after the formal declaration of independence, the government and institutions, such as the National Bank and others, directed by the new Constitution and the parliamentary laws and regulations, started to create missing state institutions, acts, regulations, and measures of the economic policy to fight the recession and economic decline and to stabilize the economic activities.

One of the very first programs introduced was the so-called Anti-Inflation Program 1992, which was adopted by the Parliament of the Republic of Macedonia on April 26, 1992, simultaneously with the law for the introduction of the new national currency the "denar". This program was not a complete stabilization program but was aimed at tackling the most urgent task of the Macedonian macroeconomic policy "to administer the increasing hyperinflation which has started with a monthly inflation rate of approximately 50%. The harmful consequences of inflation are well known, and they resulted in the cessation of any kind of rational production on one hand, and in extremely socially unfavorable distribution effects on the other hand. Due to these reasons, the endeavor against inflation has no other alternative." (The Anti-Inflation Program, 1992, p. 1). The factors that have been identified as major generators of the hyperinflation were a combination of several factors, such as the financing of the enormous Federal budget deficit by monetary emission[5]; costs arising

5 At that time Macedonia was still using the ex-Yugoslav federation currency dinar which was not under any control of the Macedonian authorities and that's why a law for introduction of the new national currency denar, was accompanying the program.

from disintegration of the federal economic area; rapid fall of the national economic activities; economic blockades to which the Republic of Macedonia was exposed regarding the previous factors; strengthening of the inflation expectations, which were transformed into a self-generating stimulator of the hyperinflation; and others.

The instruments used were classical ones:

- Monetary policy in order to change the existing old monetary unit with the introduction of a new currency and the "initial volume of monetary mass which is to be established" (The Anti-Inflation Program, 1992, p. 2). To create confidence in the new currency and in order to reduce the outflow of local into foreign money, a real positive interest rate, which would be from 5% for three-month deposits to 12% for time deposits for three or several years, was introduced. This restrictive approach to monetary policy was created to provide the accumulation of non-existent foreign exchange reserves. The need to provide foreign financial support of at least 200 million US$ to generate adequate foreign exchange reserves was raised. Since it was not possible to organize the operation of foreign exchange market within rather short period, and since the situation of foreign exchange inflow was rather unfavorable, the official rate of denar was brought closer to the market one and was established at a level of 360 units for 1 German mark, the currency of the Germany in that time.
- Fiscal policy to determine the level of budget consumption, with the basic assumption that it should not include the obligations for financing public debt (the

foreign exchange saving deposits, banks rehabilitation, and foreign debt). Although it seemed that the budget was mainly balanced, there were some indications that, de facto, there was a deficit due to the time discrepancy between the revenue inflow and expenditures. It was projected that the share of public consumption should be reduced to a level of 35% of the GDP, which means a real decrease of public consumption of 23%, and of the budget revenues of approximately 27%. It was assumed that unless adequate fiscal adjustment is made within the entire Anti-Inflation Program, the monetary policy would be too restrictive and would not be able to stand the burden of stabilization by itself, simultaneously creating intolerably high contraction of production and employment. But probably exactly that happened. During the early transition years, from 1992 to 1994, the fiscal policy was pro-cyclical. Namely, the budget deficit in 1992 was -9,8% and in 1993 even -13,7%. In this period, the budget policy was an important generator of the very high inflation the Macedonian economy faced." (Fiti, 2018, p.193).

- Income policy to moderate the decrease in production and employment incorporated two components: price control and wage control, which were applied on a temporary basis. This means that all wages were frozen at the payment level of March 31, 1992, and all nonmonetary personal income was suspended. These measures were created to be applied for a period of at least six months.

The program was dealing with some basic limitations and some possible weaknesses in its implementation:

negative balance of payment position; extremely low level of foreign exchange reserves; insufficient supply and weak competition on the local market; and possibly a lack of funds for mitigating the social consequences arising from the implementation of the program.

This initial program gave some very limited results, but trends in inflation, unemployment, and recession were not stopped, and it continued, as seen from the data shown in Table 2.

The second wave of macroeconomic reforms and stabilization efforts was launched some 18 months after the initial. The document "Stabilization Program of the Government of the Republic of Macedonia" was officially declared on December 15, 1993. It was more comprehensive and better structured than previous ones and gave better results. Its aims and structure were similar, but it didn`t concentrate only on short-term and narrow economic policy measures. On the contrary, it opened an immense problem of serious economic transition of the society, addressing the basic structural and institutional reforms on a huge scale.

The program started in very unpleasant economic and political circumstances. There were functional economic sanctions introduced by the UN on out important trade partners – Serbia and Montenegro; Greece imposed their own economic blockade on trade, transport and foreign trade with Macedonia; approach to the international financial markets was very limited; economic activities continue to decline; macroeconomic stability was maintaining; and internal and external deficits was continuing widening. The general financial and fiscal situation was disturbing.

"The average wage in the period of January – September 1993 was only about 100 US$." (Stabilization Program, 1993, p. 2). In such conditions, the aim of the stabilization policy focused on:

- financial discipline and wages freezing in both the private and public sectors;
- liberation of the controlled prices while keeping very limited price control of just a few products;
- measures for increasing the public revenues with a simultaneous decrease in the level of public spending and cutting the general government (GG) fiscal deficit to about 6% of GDP;
- budgetary support for the structural reforms;
- restricted monetary policy directed toward decreasing the aggregate demand in the economy;
- repealing of the so-called "selective" credits for agriculture from the National Bank;
- finding a foreign financial support for financing the Balance of payment and increasing the level of the foreign exchange reserves;
- other measures and policies.

Most of these measures were put into effect immediately at the beginning of 1994 and continued in the years to come, giving a lot of positive results, although the population, the economy, and the country were paying a high price for it. However, it was necessary. Proof of it was the fact that in the next years inflation decreased, the recession turned into slow growth, the financial sector stabilized, fiscal deficits declined, foreign exchange reserves increased, and the currency stayed stable.

Still, the unemployment problem persists and continues to increase steadily. In the years to come, this will become the most important economic issue, together with the problems of a low income for a significant part of the population. Data on these trends are shown in Table 3.

Table 3: Some basic macroeconomic indicators for Macedonia, 1995-2000

Year → Indicator ↓	1995	1996	1997	1998	1999	2000
Real GDP (%)	-1,1	1,2	1,4	3,4	4,3	4,5
Unemployment rate (%)	35,6	31,9	36,0	34,5	32,4	32,2
Inflation – CPI average (%)	15,9	3,0	4,4	0,8	-1,1	5,8
GG budgetary balance (% of GDP)	-1,2	-0,5	-0,4	-1,7	0,0	2,4
Current account of BoP (% of GDP)	/	/	/	-7,8	-1,8	-2,7
Foreign debt (% of GDP)	32,1	26,5	30,3	41,1	40,9	41,0

Note. Data from NBRM, 2025

When it came to monetary policy, in this period, it was crucial. Two phases can be distinguished from the point of the types of implemented monetary strategies for achieving price stability in the Macedonia: “the first phase (1992–1995), when a monetary targeting strategy was applied; and the second phase (from 1995 onwards), when an exchange rate targeting strategy was applied (Fiti, 2018, p.133).

Still, the most important part of that program was the initiation of the structural changes in a very systematic manner. These reforms were long-term oriented and crucial. They covered all sectors of the economy and institutional changes. Some of the most important ones were:

- restructuring, rehabilitation, and stabilization of the banking sector with a package of many measures;
- corporate sector restructuring, including privatization and denationalization of the property nationalized during the socialist system, its new organization as trade companies, privatization of the residential and housing sector;
- labor market liberalization and social protection measures for those concerned about it;
- changes in the pension fund system.

Reforms were undertaken in the economic system and institutions, too. Its goal was to build a system and institutions relevant and effective for the functioning of the market mechanism. Some institutions were extinguished, some reorganized, and some established. For example, the Ministry of Finance was completely reorganized to be able to coordinate macroeconomic policies and changes, the State Statistical Office (SSO) was tasked with collecting and calculating data needed for monitoring and further planning of the development, etc.

In that period, a decision to start a wide and strategic cooperation with the International Monetary Fund (IMF) and WB in promoting economic and structural changes was crucial. Those institutions gave a lot of policy and technical, as well as financial support, to the economy and institutions in the next two decades, to the benefit of the country.

Macroeconomic Stabilization and Post-Transition Challenges in North Macedonia

At the end of the first decade of the transition and after it, macroeconomic stability in the narrow sense was already met, some basic problems solved, many reforms done, and economic life and activities came into a more stable period, which faced completely new challenges. On one hand there was: a) stable and moderate inflation rates of a few percent, sometimes intercepted with some very low deflationary tendencies in some years; b) stable exchange rate of the national currency with fixed rate against German mark of 27 denars since May 1993, and later of 31 denars since 1997 which later transferred into euro (EUR) which replaced the German mark in 2000 and since than the denar is pegged to the euro stabilizing the Macedonian economy during a period of inflation and economic uncertainty in early years of independence and transition; c) rising foreign exchange reserves which meet the target of projected 4 months import and rice from 15 million US$ in the moment of independence to a EUR 1.416,7 million in 2006 and EUR 4.538,4 million at end 2023; d) moderate current account and fiscal deficits of a few percent; e) stable and maybe conservative banking sector; and f) economic growth rates which was not sufficiently high but was giving a good ground for a further improvements (See: Table 4).

Table 4: Macedonian GDP 2008 – 2023 (volume, per capita, growth rates)

Year	GDP at current prices (in million denars)	GDP per capita in Euros	GDP in million Euros	GDP real growth rates (%)
2008	414.890	3.308	6.772	5,5
2009	414.622	3.300	6.767	-0,4
2010	437.296	3.459	7.109	3,4
2011	464.186	3.665	7.544	2,3
2012	466.703	3.680	7.585	-0,5
2013	501.891	3.948	8.150	2,9
2014	527.631	4.141	8.562	3,6
2015	558.954	4.382	9.072	3,9
2016	594.795	4.659	9.657	2,8
2017	618.106	4.839	10.038	1,1
2018	660.878	5.175	10.744	2,9
2019	692.683	5.423	11.262	3,9
2020	669.280	5.236	10.852	-4,7
2021	729.445	6.443	11.836	4,5
2022	816.084	7.978	13.243	2,8
2023	897.694	7.978	14.583	2,1

Note. Data from the Statistical Office of R. N. Macedonia, 2024

In its annual Progress Report 2006 for Macedonia, the EU Commission stated that "Economic stability was maintained, with balanced public finances, low inflation and improving external accounts. The improved reserve position has strengthened confidence in the stability of the foreign exchange regime and has allowed for a lowering of interest rates. Overall, the macroeconomic policy mix has succeeded in maintaining economic stability, although key challenges such as high unemployment and low investment persist." "The Republic of Macedonia has achieved a sufficient degree of macroeconomic stability." (European Commission, 2006, pp. 20–22)

On the other hand, problems with living standards, income level, and overall quality of life were still a problem. The country and its economy are ranked by the WB in the group of upper-middle income economies. Macedonian per capita GDP in 2008 was EUR 3.308, in 2016 was 4.659 and in 2023 it was EUR 7.978 (Ministry of Finance, 2025) and the margin for upper-middle income economies according to the WB data in 2023 is between USD 4.466 and USD 13.845, but the Gini index is relatively high with value of 37,1 in 2019 by the WB data (World Bank, 2024a) which shows relatively uneven distribution of the income. Still, the good news is that the index is on a decreasing path from its value of 39,2 in its peak in 2001. On the other side, the United Nations Development Program (UNDP), in its very relevant and applauded annual publication Human Development Report for 2023/2024, ranked Macedonia as a country with High human development and the value of the index of 0,765 in 2022 (UNDP, 2024, p. 275) where the value of High HDI (Human Development Index) is ranked in margins of 0,700 – 0,799. In that context, Macedonia is third from the bottom on the European continent.

Macroeconomic stability in the second phase (1997-2016) and mostly in its third phase (2017-2023) of transition was marked by a slow but permanent decline in unemployment and its rates, which, according to the official data, had its peak in 2003-2008 with rates between 33,8% and 37,3%. It is very interesting that in that year, the Macedonian economy had historically the highest growth rates - the average economic growth rate in the consecutive 5 years of 2004-2008 was 5,3% (NBRM, 2025), but the unemployment was still increasing, which is controversial. Since then, it started to decline, regardless of economic cycles and existing domestic or external shocks on the economy: political in 2015; pandemic in 2020; energetic and price shocks 2020-2023. Finally, the unemployment rate reached "only" 12,4% at the end of 2024 (Statistical Office of Macedonia, 2025). This controversial economic data of unemployment rates in Macedonia, as well as in some other transitional economies in the region (Serbia, Bosnia and Herzegovina, Croatia), is due to two factors: natural changes in population, which are negative, and a net negative migration balance.

Natural changes in the population in Macedonia in the first two and a half decades of the 21st century were dramatic. The number of live births decreased rapidly, and the number of deaths increased due to a change in the age structure of the population. Macedonian natural changes of population were symbolic but positive until 2018, and after that, starting from 2019, a permanent and growing pace of negative changes began, which influenced the unemployment rates too. Just for illustration of this here are the numbers of live births in the country (Statistical Office of R. Macedonia, 1988, 1992-2024) in 1952-2024 as follow: in 1952 was 51.054 live births, in 1962 was 43.200, in 1982 39.789, in 1992 was 33.238, in 2002 was 27.761, in 2012 was 23.684, in 2022 was

17.771, in 2023 was 16.737 and 15.662 in 2024. It is obvious that every next decade the number of live births is reduced by approximately 6.000 annually, and the pressure on the supply side of the labor market is lower.

Table 5: Total Fertility Rate in Macedonia 1990 – 2023

Year	2005	2012	2019	2023
Fertility rate	1,46	1,51	1,3	1,5

Note. Data from Statistical Office of R. Macedonia, 2024

The main reason for this trend was and still is the declining fertility rate (Table 5), which is not an isolated case but a common one for Europe. "Falling fertility rates will have far-reaching economic and social consequences across the world. Globally, the total fertility rate - the average number of births per woman — has halved to 2,2 over the past 50 years. In Europe, however, it is already at an average of 1,46 - significantly below the approximate replacement rate of 2,18, where fertility compensates for mortality and thereby the population replaces itself from one generation to the next. Fertility transitions are projected to accelerate over the course of this century, resulting in a shrinking population and a sharp increase in the share of the elderly population." (Cevik, 2025, p. 3). Falling fertility rates are already causing far-reaching social and economic consequences.

Migration of the population is also a crucial factor in the decline of unemployment in the case of Macedonia. Official data on it does not exist, but it is possible to make some estimates based on official census data on population and data on natural changes in population. It differs a lot. When Macedonia became independent, its population was

1.945.932 according to the Census 1994; 2.022.547 by the Census 2002; and 1.836.713 by the Census 2021 (Statistical office of Macedonia, 1999, 2008, 2024). It is obvious that in two decades between 2002 and 2021, the population declined by about 200.000 persons, or 10% of its population, and that the natural change in population is much smaller than that. Also, the age structure of the population changed with a higher average age, so the labor market was suffering from a smaller supply of the working force, especially if we assume that most of the emigrants from the country were young persons at an early working age and emigrated searching for decent and well-paid jobs. According to the WB research, factors leading to emigration in West Balkans are multifaceted (World Bank, 2024b, p. 11): "Economic motives are a key driver, but other factors also play a role – migration policies in destination countries; family reunification; dissatisfaction with the quality of education and health systems; and perceived corruption."

Those two groups of factors were dominant in the declining unemployment rate in Macedonia since the creation of new jobs; that is, the newly employed people and the rising employment rate did not absorb the working force. Namely, the number of employed people in 2000 was 549.846 (employment rate 35,8%); in 2013, it was 678.838 (employment rate 40,6%), and 694.506 persons in 2024 (employment rate 45,8%), which is not too different. As shown, the number of employed people increased from 2013 to 2024 by only 15.668, but the number of unemployed people declined from 277.219 in 2013 to 98.273 in 2024, resulting in a decline of 178.946 people. (all data from: Statistical Office of Macedonia, 1992-2024). One can ask if about 160.000 persons became inactive or simply emigrated.

During the second phase of transition, Macedonia made its first important steps toward integration into the European Union (EU), first with the conclusion of the Stabilization and Association Agreement in 2001, which entered into force in April 2004, and later with the status of candidate member state in 2005. Since 2009, the Commission has recommended to the Council to open accession negotiations with Macedonia but unfortunately, mainly for a pure political reasons (blockades from Greece because of the name of the country and from Bulgaria about the historical issues) this did not happen for a two long decades until present days, although in April 2018 the Commission "repeated its unconditional recommendation to open accession negotiations" (EU Commission, 2019, p. 3). As a candidate for a member, and according to its own rules, since 2006 the EU started to issue a regular annual EC Report on the candidate state in form of Commission staff working document accompanying the document "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee (EESC) and the Committee of the Regions".

It is very remarkable that when referring to a condition of a market economy functioning in the country, all Reports indicated very clearly that Macedonia is in phase where it "has made some progress and is at a good level of preparation in developing a functioning market economy" (EU Commission, 2019, p. 5; 2021 p. 6; 2024, p. 8) or earlier in 2006 "the full functioning of the market economy is still impeded by weaknesses in the judiciary, administrative bottlenecks, a low degree of legal certainty, a high number of unsettled property disputes, and considerable labor market imbalances." (EU Commission, 2006, p. 22). Aside from many successes and achievements, this showed the weakness and failure in the efforts of the country to develop a functioning market economy during the whole period of economic transition.

The regular IMF document under the Article IV Consultation for the Republic of North Macedonia 2023 notifies that "The EU accession process will be a good opportunity to tackle long-standing structural issues related to high emigration rates, low productivity growth, and governance issues, which thus far have dampened growth and convergence with the EU. These factors have since 2010 stalled convergence with the EU, following a period of faster convergence before then." (IMF, 2024, p. 6). But it also warns that "North Macedonia faces significant medium-term challenges. Arresting emigration and boosting productivity are crucial for re-accelerating income convergence with the EU. North Macedonia is also exposed to climate change and will be impacted by the EU-Carbon Border Adjustment Mechanism." (IMF, 2024, p. 3). Addressing these challenges requires, among others, improving the business environment and the rule of law, and even accelerating the green transition, which is a typical transitional or post-transitional problem of economies like Macedonia. This issue refers to the center of the structural reforms of the economy.

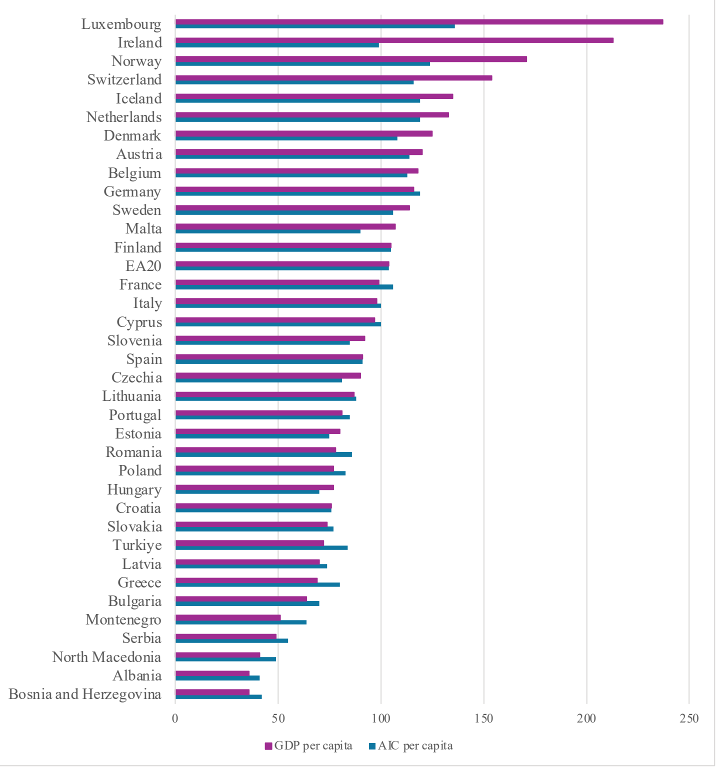
Evaluating Transition Outcomes: Growth, Inequality, and the Costs of Convergence

When it comes to overall achievements and failures from the transition period, including all phases in the last three decades, the indicators show an unbalanced position. Economic growth rates in aggregate are insufficient and unstable; inflation in general is under a control with occasional failures caused mainly by external factors, macroeconomic stability basically was maintaining, unemployment is high and at last started to decline to acceptable levels in post-transition period, but the living standards are still on relatively low level, especially if comparing with an EU average levels and the distribution of the income is relatively inappropriate.

Macedonian per capita GDP in 2023 is only 41% of the average of the EU, and actual individual consumption (AIC) per capita is 49% of that of the EU (Eurostat, 2024, pp. 3-4). (see: Figure 1). Today, in post-transitional years, Macedonian wages are relatively low, and "average monthly net wage paid per employee in December 2024 was 43.587 denars."[6] (Statistical Office of Macedonia, 2025, p. 2), While the minimum legal wage in February 2025 is only 22.567 denars or EUR 367, the lowest in non-EU economies in the region.

6 709 euros

Figure 1: Volume Indices of GDP and AIC Per Capita, 2023, (EU=100)



Note. Data taken from Eurostat, 2024

Summarized transition results and results from the macroeconomic policies in the period after independence can be interpreted in different ways and can be subject to moral or political judgments and understandings, but the data are available, and some more relevant data are shown in Table 6.

Data indicates some of the successes and some failures of the whole process. Most of them are not in line with the expected ones, although a lot of effort and resources were used to improve. In its Country Climate and Development Report for North Macedonia – Country Compendium of September 2024, the World Bank stated that "Macedonia has been converging with the EU in terms of gross domestic product (GDP) per capita (from 34 percent of the EU-27 average at purchasing power parity (PPP) in 2009 to 41.5 percent in 2021) and poverty has decreased.", but also added its` painful finding that "its sustained growth has been achieved at high environmental and health costs" (World Bank, 2024c, p. ix). Still, there are also some good perspectives ahead. Macedonia's economy is expected to show moderate growth in the medium term, with public finances continuing to be strained.

Table 6: Indicators for the Macedonian economy after a long transition period, 1991-2024

	GDP volume in billion US$	GDP/pc in US$	Agriculture sector share of GDP (%)	Unemployment rate (%)	Gross investments as % of GDP	FDI as % of GDP	Coverage of import with export (%)
Appropriate year after independence	1,704 (1993)	820 (1993)	15,5 (1992) 12,0 (1995)	27,7 (1993) 30,0 (1994)	13,7 (1992) 15,1 (1993)	4,2 (1998) 2,4 (1999)	73,2 (1993) 68,5 (1998)
2023 2024	15.765 16.810	8.696 9.186	6,6 5,6	13,1 12,5	29,6 30,3	3,3 7,5	74,7 70,3

	Rate of inflation, average CPI (%) * Retail prices	Budget balance GG (% of GDP)	Public debt (% of GDP)	Bank weighted interest rates on denar loans (%)	HDI (rank and value of the index 0-1)	Gini coefficient (1-100)
Appropriate year after independence	349,8* (1993) 112,8* (1994)	-13,4 (1993) -2,9 (1994)	39,2 (2003) 37,6 (2004)	151,7(1994) 21,0 (1998) 16,0 (2003) 8,5 (2013) 5,6 (2019)	80. 0,748 (1994) 72. 0.813 (2006) 80. 0,757 (2017)	32,4 (1998) 39,2 (2001) 42,9 (2009) 37,9 (2011) 35,6 (2015) 33,5 (2019)
2023 -2024	9,4 (Eurozone = 5,78) 3,5 (Eurozone = 2,4)	-4,9 -4,7	56,9 61,9	5,4 5,9 (Q1-3)	83. 0,765 (2022)	36,9 (2021)

Note. Data from Statistical yearbooks of Macedonia 1995 – 2024; WB: WDR & WDI 1993-2024; Ministry of Finance Macedonia web data; National bank of Macedonia web data; UNDP: HDR 1993-2023; and author calculations.

Although positive medium-term economic prospects exist, economic challenges like geopolitical tensions and conflicts, and energy supply and price uncertainties pose significant risks. Increasing public expenditures that could make fiscal space tighten, and public debt reaching 62% of GDP, the challenges are still ahead.

Main Initial Structural Reforms

Structural reforms always and everywhere are the hardest ones, which absorb a lot of dedication, effort, time, finances, and patience. It needs focus, endurance, and maybe most of all, a broader social and political consensus. Usually, this kind of reform never ends in a dynamic environment, and exactly that is the case with the global economy for a very long time, and structural reforms just build up one after another.

There were no possibilities for Macedonia to freeze or postpone the structural reforms from the very beginning of the independence and transition process. Together with independence and the transition into a completely new social and economic system, the country began with structural reforms on a wide basis. To avoid endless explanations about the need, choices, and results from the reforms, they will be just mentioned, keeping their general chronological order.

Of course, the process of building a basis for a functioning market economy is not possible without private property and the existence of the market mechanism. So those more institutional reforms started from the very beginning. The privatization process on a comprehensive basis started almost immediately and came into power in 1993, according to the Law on privatization, which accepted the already begun but unfinished and relatively small-scale privatization conceived by the previous federate state. Privatization accepts the model of paid privatization with benefits for workers and managerial priority privatization. In the end, privatization mostly turned into a model of managerial capital redemption in installments, which caused numerous social and even political problems. The main privatization law included the privatization of the former socialist, so-called social ownership in most of the sectors. In this process, the privatization of the state (different from social) owned capital, mainly in public enterprises, the state agricultural lending (not the agricultural companies which were privatized, but the lending), urban lending, and the state-owned housing and residential stock. All of those were privatized in parallel by separate laws, except agricultural lending, which was given as a concession to the existing companies at that time, individual farmers, and newly registered companies. Public enterprises were not privatized but went into organizational restructuring, and some of their parts were privatized later.

Banks and other financial sector institutions were privatized, restructured, and later financially rehabilitated. These processes were followed by processes of restitution and compensation of previously nationalized capital, agricultural and urban land to the former owners after the Second World War and the constitution of a People's (later Socialist) Republic of Macedonia within the Yugoslav federation.

Another reform covered price control, massive liberalization, labor market liberalization, and serial changes in the Labor law, collective agreements, and institutions regulating the labor market. Maybe smaller but not unimportant changes were made in the two important pillars of the social policy – pension and health funds, which were relatively well-established and structured even during the previous system.

Many new institutions necessary for the functioning of the market as an integral mechanism were established, such as the Antimonopoly Commission, the Security and Exchange Commission, regulatory bodies for private pension funds, for the regulation of the insurance market and companies, for energy, for railroad transportation, pharmaceuticals, and many more. Most of them were established in the period 1993-1998, and some even later. This was an important step in the transition to the functioning of the market mechanism.

Important changes were made to some classical industrial policies in many sectors. Under the pressure of new technologies, new policies, and global competitiveness needs, the economy started to restructure toward modern sectors and headed for knowledge and technology-based sectors with a bigger participation of highly educated and skilled human capital. The Macedonian economy was not a great example of economic transition success, but it has undergone a huge transformation. The main structural changes are those of the composition of economic activities. Macedonian economy passed through a period of deindustrialization, partly as a process of natural structural changes and move into service sectors, but partly because it was not able and failed to keep its own, relatively well-developed socialist industrial sector at the desired level. In the same period, the processes of permanent relative decline of the agricultural sector continue as well. In this regard, it should be borne in mind that agricultural land covers almost 50 percent of the surface area of the country, and forests cover approximately one-third (Landau & Ilieva, 2022), which represents a good precondition for the agriculture and forestry sectors.

In that sense, the Macedonian economy seriously dematerialized its activities. This newly emerged structure is shown in Table 7.

Table 7: Sectoral structure of the Macedonian economy (as a % of GDP)

Sector ↓Year →	1992	2008	2023[1)]
Agriculture, hunting, and forestry	15,5	10,0	6,6
Manufacturing and mining, Electricity, gas, and water supply	27,9	21,0	17,2
Construction	3,5	4,9	6,0
Wholesale and retail trade; repair of motor vehicles, motorcycles, personal, and household goods	5,1	12,2	18,9[3)]
Hotels and restaurants	1,5	1,4	
Transport, storage, and communication[4)]	5,1	8,0	4,9
Financial intermediation	4,2[2)]	2,7	2,8
Real estate, renting, and business activities		4,2	11,2
Professional, scientific, and technical activities; Administrative and support service activities	/	/	4,6
Public administration and defense; compulsory social security	5,4	6,5	11,9[5)]
Education	5,5	3,0	
Health and social work	5,7	3,3	
Other community, social, and personal service activities	2,4	2,6	3,0[6)]

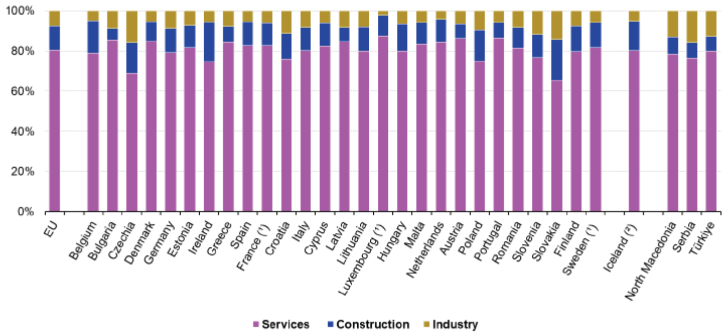
Imputed rents	6,5	6,9	
Taxes on products, less subsidies	11,7	13,2	12,9
GDP Total	100,0	100,0	100,0

Note. Data from “Statistical yearbooks of R. Macedonia 1999 – 2024”, Statistical Office of Macedonia and “GDP of the R.N. Macedonia in 2023 - preliminary”, Statistical Office, News Release, No: 3.1.24.07, 18.10.2024.

1. new classification of sectors.
2. include Real estate, renting, and business activities.
3. include Transportation and storage, Accommodation, and food service activities.
4. data for 2023 is for Information and communication.
5. include compulsory social security; Education; Human health and social work activities.
6. include Arts, entertainment, and recreation.

Material goods participation (agriculture, hunting and forestry, manufacturing and mining, electricity, gas, and water supply) reduced their participation in the economic activities by half in the first year of transition, namely from 43,4% to 23,8%. Other activities belong to the service sectors – more than three-fourths of GDP. This reflected the structure of the active enterprises in 2022 (see Figure 2). About four-fifths of all enterprises active in the business sectors in Macedonia were within the services sector, providing work for over three-fifths of the total number of people employed (Eurostat, 2024, pp. 2–3). Additionally, when looking at the EU level and comparing with the Macedonian structure, it can be noted that is not lagging and is in line with the other economies.

Figure 2: Structure of active enterprises by sector, business economy, 2022 (%)



Note. Data from Eurostat, 2024

Conclusion

During the early 1990s of the 20th century Macedonia experienced dramatic processes of gaining independence and building its own political system and state institutions; transition toward democracy and market economy; and macroeconomic efforts to stabilize the economy and basic economic activities which was totally disturbed by the collapse of the socialist system and the Yugoslav federation including political tensions, violence and wars in the region. Those three processes were not consecutive but were happening at the same time, and that caused some additional problems for the processes. Still, from the very beginning, the efforts for macroeconomic stabilization and economic reforms were not put aside or underestimated and left as a non-priority. On the contrary, from the very beginning, it was a high priority.

The first anti-inflation program was introduced as early as April 1992, and it give some limited but very important results such as confronting hyperinflation and introducing national currency, strong but partial fiscal efforts toward keeping existing and building the new institutions and enabling the functioning of key state and social functions as well as controlling the transitionally disrupted economic activities. By the end of 1993, a new and comprehensive Stabilization program was implemented, which had further but stronger anti-inflation policies, incorporating the very important structural reforms and a massive process of privatization as part of it. In the following two years, it managed to achieve the basic outlined results: inflation was brought under control, and the currency was fixed and pegged to a hard currency, financial and fiscal stabilization, a long-term recession turned into slow but steady economic growth, and a recovery of production and trade relations. Most of the basic macroeconomic indicators become positive, except low rates of employment and high rates of unemployment, which will continue in the next transitional decades. Living standards were slightly sacrificed, but structural reforms fulfilled some basic goals, except that the privatization process became controversial and caused a lot of problems.

Further macroeconomic policies and different reforms in the next two transitional decades give controversial results. Mostly followed by economic growth, control of macroeconomic stability, and of the fiscal and external deficits, they did not produce a significant increase in productivity, living standards, and visible prosperity. Occasional recessions, short periods of increased inflation, and rising fiscal deficits push the public debt to a level of over 60 percent of GDP. The primary distribution of income produced high inequality, and the secondary redistribution didn`t stop the rise in the Gini coefficient. The overall limited achievements resulted in stagnation of human development measured by HDI. Still, the Macedonian economy has made enormous structural reforms, and after three long decades of transition, some two-thirds of its GDP is generated in the service sector. Maybe the biggest problem, which still exists on one hand, is low income and unacceptable levels of living standards, and on the other hand, limited progress in developing a functioning market economy – a phrase so often used in the EU reports regarding the state of the Macedonian economy.

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Chapter 2

Privatization of Capital Companies in the Republic of North Macedonia

Nikola Dacev[1]

Since the 1980s, developed and developing countries have privatized state-owned enterprises (SOEs) in different ways, at different times, and at different rates. Privatization has become an issue of such importance that it has generated a large and ever-growing academic literature of its own. Economists, political scientists, legal scholars, and sociologists have all added their voices to the debates on the explanation of privatization and the reasons for its rise. There is, in consequence, now no shortage of explanations of what privatization means and what drives its spread (Zaifer, 2017).

Privatization is a broad term that generally refers to transferring public or governmental functions or services

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to private entities. Privatization of government functions involves a “host of arrangements,” including public-private contractual relationships where private entities provide goods or services for the government or the public (Congressional Research Service, 2017).

Under socialism, the corporate and economic systems in the Republic of Macedonia were largely state-controlled. All major industries were owned and operated by the state, and the concept of private property and corporate governance was minimal. With the country’s independence in 1991, significant changes were needed to create a market-friendly legal environment. Therefore, Macedonia began a process of political, economic, and legal transformation. This process significantly influenced the development of corporate law and the country’s economy. The changes were necessary to adapt the economy to new market conditions and integrate Macedonia into global economic and legal structures. The reforms in corporate law undertaken between 1991 and 1996 were related to privatization and market liberalization, enacting new company laws and investments. The most immediate task was the privatization of SOEs. The socialist model of collective ownership was replaced by a system encouraging private ownership. In this context, the corporate legal framework was revamped to allow private businesses to emerge. In 1996, Macedonia enacted the Law on Trade Companies, which created the legal foundation for the formation and operation of private companies, including limited liability companies (LLCs) and joint-stock companies (JSCs). This law aligned corporate governance structures with those common in market economies, establishing frameworks for corporate formation, management, shareholder rights, and bankruptcy. As part of its transition to a market economy, Macedonia needed to build an environment that would attract both domestic and foreign investments. New laws were introduced to ensure legal protection for investors, including laws on intellectual property, competition, and tax incentives. Privatizing state-owned enterprises was one of the main tasks of the Macedonian governments of the 1990s. The government adopted several methods, including direct sales, voucher privatization, and employee buyouts. As privatization proceeded, the government introduced reforms to ensure a legal and regulatory framework that would support the newly privatized businesses, including corporate governance standards and investor protections. The rise of private companies helped diversify the economy, reduce the state's role, and foster competition. While privatization represented a necessary step toward market reform, the process was not without its challenges. Some of the key issues that arose during the privatization of social capital in Macedonia included inefficiencies, a weak legal and institutional framework, social consequences, and economic and political stability. In many cases, the privatization process was marred by inefficiencies, corruption, and a lack of transparency. Many state-owned enterprises were sold at below-market prices, and the privatization process often lacked clear legal frameworks and regulations. This led to a concentration of wealth in the hands of a few individuals or groups and hindered broader economic development. The legal and regulatory environment in Macedonia was still under development during the early stages of privatization. This created uncertainty for both domestic and foreign investors, as the protection of property rights and the enforcement of contracts were not always guaranteed. Privatization also had social consequences. Many employees of state-owned enterprises were laid off or faced uncertain futures, leading to protests and dissatisfaction. The reduction of state-owned jobs also created social unrest, particularly in regions where former state-owned companies had been major employers. Macedonia's transition to a market economy coincided with a period of political instability and economic hardship. The country faced challenges such as high unemployment, inflation, and an underdeveloped banking sector. The early years of privatization were difficult, but they laid the foundation for future economic reforms. Macedonia stabilized its economy over time and integrated it into the global economy. However, challenges in corporate law and further development of the economy remain, with an emphasis on European integration and improving the legal framework for investments.

This chapter aims to analyze privatization in all its positive and negative aspects and determine the main reasons for the issues the country faced, focusing on the regulations and their implications during the period of privatization between 1991 and 2001. Therefore, the Law on Transformation of Enterprises with Social Capital in North Macedonia will be analyzed, which typically addresses the legal process by which enterprises, particularly those with state or social capital (such as publicly owned or semi-public enterprises), are transformed, restructured, or privatized. The chapter will also cover the beneficiaries of the privatization of socially owned capital who acquire ownership and control over the previously state-owned enterprises, as well as those who benefit from improved efficiency, increased investment, and the broader economic benefits that may follow. Also, analyses will be made on the decentralized and autonomous transformation, where the enterprise becomes the central actor responsible for defining and executing its transformation. This model can promote efficiency, accountability, and faster decision-making, particularly in privatization or restructuring. However, it also comes with risks such as a lack of oversight, potential inequalities, and employee displacement. As such, while the enterprise enjoys greater freedom, it also carries significant responsibilities in managing its transformation effectively and aligning with economic and social interests.

Corporate Law and Economic Development in Macedonia After 1991

During the socialist era, corporate law in Macedonia was oriented towards state control and a planned economy, where companies were state-owned and centrally managed. After 1991, Macedonia transitioned to a market economy, which required harmonizing corporate law with the principles of a free market and private ownership.

Figure 1: Corporate law reforms in the 1990s in Macedonia

One of the first major steps was the adoption of new laws that regulated private ownership, investor rights, and the organization of companies. Legislation began to allow the privatization of state-owned enterprises and encouraged the creation of private companies. In 1996, a new Law on Trade Companies was adopted, which set the legal framework for the formation of various types of legal entities (joint-stock companies, limited liability companies, and others). This law facilitated privatization and the creation of new private companies. The adoption of the Law on Trade Companies in the Republic of Macedonia accelerated the process of radical reorganization of economic entities that began with the adoption of the Law on Enterprises in December 1988 and the Law on Transformation of Enterprises with Social Capital, and created normative foundations for organizing an economic organizational structure based on ownership and entrepreneurship. It turned out that privatization based on the Law on Enterprises could not simply take over the known and generally accepted solutions in the organization and functioning of economic entities in a market economy. This forced the project's promoter in the new Law on Trade Companies of 2004 to opt for radical forms of entrepreneurial organization (Belicanec & Nedkov, 2008, p. 5).

The privatization process was fraught with challenges, including problems with privatization strategies and often unfair distribution of assets. With the advent of the new economic model, Macedonia began its efforts to attract foreign investment. For this, it was necessary to create a stable legal framework for corporate activities, including laws on investment protection, tax incentives, and infrastructure construction. The transition to a market economy was a long and difficult process, requiring significant economic reforms. In the first years after independence, Macedonia faced economic crises, high inflation, and a high unemployment rate. However, there was constant work on structural reforms and increasing economic stability. The collapse of Yugoslavia had disrupted trade routes, which hurt Macedonia's exports and industrial production. The World Bank and IMF played a crucial role in guiding the country through its economic reforms, with a focus on fiscal consolidation, stabilization programs, and economic liberalization. The legal reforms were aligned with the structural adjustment programs that encouraged deregulation, trade liberalization, and the creation of a more flexible labor market.

The reforms undertaken in the direction of trade liberalization meant that the initial problems with import barriers and controls were removed, which allowed for increased imports of goods and new technologies. After 1995, Macedonia began to actively attract foreign investment, especially in sectors such as the textile industry, automotive and electronics industries, as well as agriculture. Among the most significant reforms was the introduction of free economic zones (for example, in Tetovo and Ohrid), which encouraged foreign investors with tax breaks and other benefits. The establishment of these zones was a direct response to corporate law reforms, aiming to create a favorable investment climate. The liberalized market allowed for the emergence of new businesses, although state-owned enterprises still represented a significant portion of the economy. After 1991, the banking system was also reformed. The new banks were subject to regulation by the the Central Bank of Macedonia (today the National Bank of the Republic of North Macedonia), which controlled the monetary system and was tasked with stabilizing inflation and the exchange rate of the Macedonian denar (MKD). Through the privatization of banks and the establishment of new financial institutions, Macedonia strengthened its market economy. Periods of high inflation and economic crises were overcome in the second half of the 1990s. The authorities began to modernize the manufacturing sector, focusing on small and medium-sized enterprises, which became the main driver of economic growth.

From the early 2000s onwards, Macedonia's economy began to stabilize. Corporate law reforms, combined with stronger macroeconomic policies, laid the foundation for steady growth. The country's GDP grew at an average annual rate of around 4-5% during this period (Ministry of Finance of the Republic of Macedonia, 2005).

As mentioned above, one of the key successes of the 2000s was attracting foreign direct investment (FDI). The Macedonian government introduced numerous incentives, including tax breaks, free economic zones, and other financial incentives, to attract foreign investors.

The global financial crisis of 2008-2009 impacted Macedonia, with a reduction in export demand, lower remittances from the Macedonian diaspora, and a slowdown in FDI inflows. However, the country's relatively small financial sector and prudent fiscal policies helped mitigate some of the adverse effects. Following the crisis, the Republic of Macedonia sought to recover by improving its business climate, with continued reforms to corporate law and a focus on boosting exports, especially in sectors like agriculture and manufacturing. These efforts were part of a broader strategy to reduce the country's dependency on external loans.

While the add (RNM) has made significant strides in developing its corporate law system and fostering economic growth, several challenges remain, particularly in improving the quality of governance, the efficiency of the legal system, and the overall business environment. As Macedonia seeks EU membership, there is increasing pressure to align its corporate law with European Union standards. This includes stronger protection for minority shareholders, more transparent financial reporting, and improved corporate governance practices. Legal reforms are also needed to enhance judicial efficiency, protect intellectual property rights, and tackle corruption. Despite improvements in attracting foreign investments, North Macedonia still faces challenges related to the regulatory burden, bureaucracy, etc. Companies continue to report difficulties in dealing with inefficient public services, inconsistent application of laws, and slow administrative processes. The key sectors for growth are information technology and start-ups, energy and infrastructure, and agriculture and tourism. One of the most promising sectors in North Macedonia is the IT industry, which has attracted significant interest due to lower labor costs, a skilled workforce, and favorable tax policies. The government has implemented measures to support IT start-ups, including incubators, venture capital funds, and a growing focus on innovation add (R&D). The energy sector, particularly renewable energy, presents opportunities for future growth. North Macedonia has abundant natural resources, including hydroelectric potential and wind energy, which, if properly harnessed, could boost the economy and make it less reliant on imported energy. Agriculture remains an important part of North Macedonia's economy. Reforms in the agricultural sector, including landownership and modern farming techniques, could improve productivity. Tourism also holds potential, especially in the context of North Macedonia's cultural and natural heritage, which could be further leveraged with the right legal and policy frameworks.

The Beginning of the Modern Development of Commercial Companies in the Republic of Macedonia

This chapter examines and analyzes in detail the procedures for the privatization of enterprises with social and state capital and the transformation of enterprises into commercial companies in the Republic of Macedonia. The focus of the chapter is on the whole legal framework regulating the process of transformation of state enterprises, especially the Law on Transformation of Enterprises with Social Capital. The decentralized and autonomous model for the transformation of socially owned enterprises that Macedonia established in the 1990s is analyzed from various aspects. The role and the work of the Agency for Privatization of the Republic of Macedonia are also the subject of analysis in this chapter, among other entities as well.

The chapter also covers the employee participation in corporate governance in Macedonia in accordance with the country's constitutional concept of employee representation and in accordance with the Law on Trade Companies, particularly as they relate to the beneficiaries of the privatization of socially owned capital.

The Legal and Economic Foundations of Privatization in Post-Socialist Macedonia

The privatization process in post-socialist countries, including the Republic of Macedonia (now part of North Macedonia), marked a critical shift from state-controlled economies to market-driven systems. The procedure involved the transfer of ownership of socially owned enterprises (social capital) to private individuals, groups, or companies. In the case of Macedonia, the early stages of privatization in the 1990s were a crucial turning point for the development of modern commercial companies in the country. Privatization was seen as the primary solution to the inefficiencies and stagnation of socially owned companies, which were often poorly managed and burdened with outdated technology, low productivity, and financial instability. The transition was designed to spur economic growth, increase efficiency, and reduce the fiscal burden on the government (Dallago et al., 1992).

However, it would be a mistake to assess the relevance of the privatization program of a country by looking at the revenue generated by the government. The set of objectives that privatization programs are meant to achieve is much broader and involves, as a fundamental component, the improvement of microeconomic efficiency. Indeed, in general, there are four explicit objectives in those programs: i) to achieve higher allocative and productive efficiency; ii) to strengthen the role of the private sector in the economy; iii) to improve the public sector's financial health; and iv) to free resources for allocation in other important areas of government activity (usually related to social policy) (Sheshinski & Lopez-Calva, 1998, p.7).

Unfortunately, in Macedonia, these objectives were not completely achieved.

In North Macedonia, the privatization process involved the establishment and structuring of capital companies to manage the transition of state-owned assets into private ownership. By the late 1990s and early 2000s, several newly privatized firms began to emerge as key players in the Macedonian economy. These included companies in various sectors such as manufacturing, banking, retail, and services. These capital companies played several important roles that are shown in Figure 2.

Figure 2: Roles of the capital companies in North Macedonia

Management of Privatization	Capital companies were tasked with overseeing the privatization of socially owned enterprises. This process was often carried out through a combination of methods, including public tenders, auctions, and the sale of shares to private investors. The capital companies acted as intermediaries between the state and the private sector.
Creating Market-Oriented Companies	The creation of capital companies marked the shift toward the modern, private sector-driven economy. These companies were structured to function within the free market, which required them to adopt modern business practices, financial strategies, and corporate governance models.

Investor Participation	In many cases, capital companies issued shares or bonds to attract private investors. This allowed Macedonian citizens to buy shares in former state-owned enterprises, either individually or through investment funds. The participation of private investors was essential for establishing a vibrant private sector and promoting local entrepreneurship. Many former employees of state companies went on to establish their businesses, leading to a diversification of the economy.
Attracting Foreign Investment	The privatization process also aimed to attract foreign capital. Foreign investors were encouraged to participate in privatization, either through direct acquisition of companies or via joint ventures with local capital companies. This brought in not only financial capital but also management expertise, technology, and access to international markets, improving productivity and efficiency in several sectors.
Increase Market Competition	The entry of private companies into previously monopolistic or oligopolistic markets helped increase competition, improve product quality, and reduce prices. This helped modernize the Macedonian economy and integrate it into regional and global markets.

Improve Corporate Governance	As privatized companies became more market-driven, there was a push toward adopting better corporate governance practices. This included improved financial management, transparency, and accountability, which helped build investor confidence.

Regarding the basic legal framework, it can be noted that with the adoption of the Constitution of the Republic of Macedonia in 1991, constitutional preconditions were created for a radical abandonment of social ownership, i.e., the so-called social capital. The Constitutional Law on the Implementation of the Constitution of the Republic of Macedonia stipulated the adoption of a law on the manner of transformation of social ownership, which would regulate the procedure in which the change of social ownership would be carried out, primarily into private ownership. This radical and comprehensive process could not be achieved under the Law on Social Capital and the complementary implementation of the Law on Enterprises. A new legal basis for the privatization and transformation of social enterprises, as well as a Law on Trade Companies, was needed. For these reasons, the preparation of a Law on the Transformation of Enterprises with Social Capital and a Law on Trade Companies was initiated.

Related to the Law on Enterprises from the Socialist Federal Republic of Yugoslavia, it can be said that the Law established socially owned enterprises designed to advance a theory of "communism with a human face." Essentially, the people employed by the enterprise were the nominal owners as representatives of the public at large, but in fact, they did not hold title to shares, nor could they transfer their ownership. "Everybody but nobody" was the owner. At the same time, the management of socially owned enterprises was effected through workers' councils (Macedonia Business Law Handbook, 2013).

In Macedonia, the expectation that the Law on Transformation of Enterprises with Social Capital and the Law on Trade Companies would be adopted simultaneously did not materialize. The first was adopted in 1993, and the second only three years later, i.e., in 1996. In this intermediacy, i.e., in the period from 1993 to mid-1996, the organization of joint-stock companies and limited liability companies was carried out according to the provisions of the Law on Enterprises. Therefore, after the adoption of the Law on Trade Companies, it was necessary to harmonize the privatized enterprises organized as joint-stock companies and limited liability companies with the Law on Trade Companies.

Later, the Law on the Transformation of Socially Owned Enterprises and Cooperatives Managing Agricultural Land and the Law on the Privatization of State Capital were adopted.

The privatization of social capital and the transformation of social capital enterprises are based on a series of provisions that constitute a consistent whole. They are not explicitly formulated in the text of the Law on the Transformation of Social Capital Enterprises but can be deduced from how the legislator approaches the privatization of social capital and the transformation of social capital enterprises. These provisions can be obtained by analyzing the entire text of the Law on the Transformation of Social Capital Enterprises, and in particular by analyzing its general provisions (Article 1-32b). It is very important to note that the concept of the Law on the Transformation of Enterprises with Social Capital in terms of privatization of social capital and transformation of enterprises with social capital is constituted based on the aforementioned provisions.

The object of privatization was non-nominated social capital. Enterprises that have anonymous, non-nominated social capital, i.e., social capital over which no one has yet acquired ownership rights, entered the transformation. Given that the ownership rights over the enterprise are incorporated either in stock or in a share, it can be said that the object of privatization was only social capital that was not represented in stocks or shares. The basis on which the privatization of social capital and the transformation of enterprises with social capital was based was the search and finding of the owner of the enterprise, i.e., the constitution of an ownership structure over the enterprise. Namely, to establish an ownership function in a company, which is an essential and defining characteristic of a company, it was necessary to find someone who would become the bearer of rights and obligations that would enable him to participate in the management of the company and decide on its fate, to control the operations of the company, to participate in the business results of the company (profit and loss) and, finally, to whom the right of ownership over the company becomes part of his property and who freely disposes of that right. Therefore, the main goal of the Law on the Transformation of Enterprises with Social Capital was to determine the enterprise's owner, not the simple privatization of social capital.

In the transformation procedure, the enterprise was immediately transformed in terms of ownership. The ownership transformation was complete and without any remaining undetermined social capital. The Law on the Transformation of Enterprises with Social Capital, unlike the Law on Social Capital, no longer recognizes the category of "residual social capital". Upon completion of the transformation procedure, the enterprise that has entered into transformation in its entirety receives a new owner, thus avoiding cases of an abnormal situation in which the joint-stock company (JSC) i.e. the (LLC) holds part of the shares, i.e. a stake in itself based on retaining "residual social capital". Namely, for that part of the social capital that will not be privatized, the enterprise issues stocks, i.e., shares, to the Agency of the Republic of Macedonia for Privatization, whereby the enterprise no longer has social capital that does not have a specific owner. The procedure for final ownership restructuring applies not only to social enterprises that begin the transformation under the Law on Transformation of Enterprises with Social Capital but also to social capital enterprises that have begun the transformation but have not completed it based on the Law on Social Capital. With the application of the Law on Transformation of Enterprises with Social Capital, the "residual of social capital" should be removed in enterprises with mixed ownership as well. Namely, in this type of enterprise, it is a question of completing the process of privatization of social capital, more precisely, of privatizing the "remainder of social capital".

Decentralized and Autonomous Transformation: The Enterprise as the Central Subject of Change

The Republic of Macedonia has chosen the model of decentralized and autonomous transformation. This model's content is based on the right of the enterprise itself to be the bearer of all activities related to the transformation, including the initiative to start the processes of privatizing social capital and transforming the social enterprise into a company. This means that the enterprise itself will start and lead the transformation process, not a body or organization outside it.

Centralized transformation has been carried out in almost all countries of Eastern Europe. In conditions of centralized transformation, the enterprise is an object of privatization and nothing more. Hence, the state sells the enterprise. The idea of decentralized transformation is based on the view that the enterprise, and not an entity outside it, should carry out the transformation procedure. No one can take away that right from the enterprise. If the enterprise does not initiate the transformation procedure within the specified deadline, it may lose the right to transform itself. Then, the right to initiate and implement the transformation procedure is transferred to the Agency for Privatization of the Republic of Macedonia.

The transformation process is autonomous, meaning the enterprise itself makes the decision. The decision on transformation is always made by the management body of the enterprise that wants to carry out the transformation.

Only when it comes to a large enterprise, the decision is made in agreement with the Agency. However, even in this case, the Agency does not decide on the transformation of the large enterprise but only gives its consent for its adoption, which means that the Agency is involved only after the decision on transformation has been made. The Agency participates in the decision-making process in enterprises and ends with the decision on transformation being made by their management bodies. It can be said that even in the case of a large enterprise, the decision on transformation is made by the enterprise itself, not the Agency.

In the model of the Agency's organization adopted in the Law on the transformation of enterprises with social capital, the Agency combines its functions as an organization that performs professional consulting work in the transformation process and the functions of the fund/funds as a financial organizations that dispose of the funds generated by the sale of state (social) capital, including such assets as shares and certificates for shares in the transformed enterprises. In this sense, it can be said that the Agency has the role of a trustee for holding the shares and stocks until privatization is carried out.

The role of the Agency is essentially limited to three areas: participation in the management of the companies; holding the transferred shares and stakes from the transformed assets and disposal of the assets it generates.

The Law on Amendments to the Law on Transformation of Enterprises with Social Capital, adopted in January 2002, regulates in more detail the methods and procedure for the sale of shares and stakes that were issued to the Agency in the transformation procedure. These amendments were necessary to establish the rules for the sale of the residue of shares and stakes that, in the final phase of privatization, were increasingly concentrated in the Agency (Law on Amendments to the Law on Transformation of Enterprises with Social Capital, 2002).

Consequently, amendments to the Law were adopted in 2003, 2004, and 2005 (Law on Amendments to the Law on Transformation of Enterprises with Social Capital, 2003).

The funds generated by the Agency, i.e., the funds collected by the Agency based on the transformation of enterprises with social capital, were transferred monthly to a special republican account. Thus, these funds did not enter the budget of the Republic of Macedonia directly but were kept in a special account until their purpose was determined. The purpose of the funds was determined by the Assembly of the Republic of Macedonia by adopting a program for the funds, and upon the proposal of the Government of the Republic of Macedonia.

The autonomy of the enterprise concerning the decision on the transformation refers in particular to:

a. The decision to initiate the transformation procedure within a certain period, and even if the enterprise does not do so within the period specified by the Law on the transformation of enterprises with social capital, the right to initiate and implement the transformation procedure passes to the Agency,

b. The decision on the privatization techniques and the manner of transformation of the social enterprise into a trade company, and

c. To decide who and under what conditions will be offered to participate in the ownership of the enterprise created by the transformation. No one can force the enterprise to proceed with the transformation, but by missing the deadline, it permanently loses the right to transform itself autonomously.

Socially-owned enterprises autonomously initiated and conducted the transformation procedure under the Law on the Transformation of Socially-owned Enterprises, but the initiation of the transformation procedure was conditional on the consent of a competent state authority. In contrast to the Law on Socially-owned Enterprises, which introduced privatization that was not controlled at all by the state, the Law on the Transformation of Socially-owned Enterprises introduced only limited control over the privatization of social capital and the transformation of social capital enterprises. Control was reserved for the Government of the Republic of Macedonia, not for the administrative authorities. Control was not comprehensive but was limited to the initiation of the transformation procedure. The Government Commission for Privatization assessed whether the proposed transformation complied with the conditions, manner, and procedures prescribed by the Law on the Transformation of Socially-owned Enterprises. If this was determined, a decision would have been issued for granting consent to initiate the transformation procedure.

In the Law on the transformation of enterprises with social capital, in the control procedure, the Agency was only required to provide an opinion to the Government Commission on privatization on whether the proposed transformation was under the conditions, manner, and procedures prescribed by the Law on the transformation of enterprises with social capital.

Although these legal amendments were generally aimed at achieving a faster, more efficient, and fairer privatization process, which would result in better private and economic activity, as well as greater transparency in the management of state capital, the privatization process was and remains controversial, with much criticism of the methods of implementation, especially regarding the sale of state assets at low prices or the failure to protect the interests of workers.

Acquisition of Ownership of a Socially Owned Enterprise or Social Capital According to the Principle of Paid Privatization

In principle, ownership of a socially owned enterprise or social capital cannot be acquired without payment. The Law on the transformation of socially owned enterprises starts from the premise that only the one who will invest funds in the enterprise is sufficiently motivated to take care of the efficient and successful operation of the enterprise. It should be added that this Law, in principle, rejects the free acquisition of ownership of the enterprise, regardless of whether it is a simple distribution of free shares or stakes or a distribution of so-called vouchers with which shares or stakes in the enterprises being transformed can be further purchased. Of course, it cannot and should not be considered that the principle of paid privatization is being deviated from by introducing discounts in favor of a certain category of beneficiaries of the privatization of social capital. The introduction of discounts and benefits in the payment method, i.e., preferential purchase in the privatization procedure of social capital, is aimed at stimulating employees to participate in the transformation procedure of their enterprise and become owners of a part of their enterprise. The only deviation from the principle of paid privatization is the solution contained in the Law on the transformation of enterprises with social capital for issuing free shares or stocks of the pension and disability insurance fund.

The value of the enterprise is determined by an appraisal. The principle from which the Law on Transformation of Enterprises with Social Capital starts is that the transformation of enterprises is carried out based on the estimated value of the enterprise. Therefore, with the transformation carried out based on the Law on Transformation of Enterprises with Social Capital, rights of the company (shares and stocks) are acquired that can be immediately traded according to the rules that apply to the transfer of those rights in general, that is - under the conditions prescribed by the Law and the provisions of the Statute, i.e. the founding agreement. This means that the shares issued by the enterprises being transformed acquire the properties of shares under the Law on Securities without carrying out the procedure prescribed by the Law on Trade Companies and the Law on Securities.

The value of the enterprise, according to Article 7, paragraph 1 of the Law on the Transformation of Enterprises with Social Capital, is the difference between the value of the enterprise's assets and other rights (total assets) and the value of the enterprise's liabilities, including liabilities to legal entities and individuals based on their permanent investments in the enterprise. Permanent investments of legal entities in the enterprise that, by association, joint venture, or on another basis, were introduced into the enterprise without an obligation to return and without the right to participate in the profit based on that investment are not considered liabilities of the enterprise. It should be added that the value of apartments is not included in the value of the enterprise, and the ownership transformation of the housing stock of the enterprise is carried out according to the provisions of another law. The value of the enterprise also does not include state capital invested for special purposes in enterprises, and the objects of the social standard were under a special sales regime. Therefore, in the procedure for determining the value of the enterprise, the identification of the state capital and the value of the objects of the social standard had to be carried out. The Ministry of Finance prescribed the method of determining the assets that constitute the state capital.

According to Article 9 of the Law on Transformation of Enterprises with Social Capital, the value of the enterprise is determined according to the Methodology that was adopted by the Government of the Republic of Macedonia at the proposal of the Agency (Methodology for the Assessment of the Value of Enterprises with Social Capital, 1993).

The determination of the value of the enterprise was carried out by legal entities and individuals authorized by the Agency, and the determined value of the enterprise was expressed in German marks in 2002, and then in euros due to the conversion of German marks into euros. The Agency could also exercise a type of control over the objectivity of the assessment conducted. It had the right to request another authorized appraiser to exercise control over the estimated value of the enterprise.

Article 2 of the Law on Transformation of Enterprises with Social Capital lists the enterprises and other legal entities that are subject to transformation under its provisions, which are the following: social enterprises, enterprises in mixed ownership when, based on the social assets invested in them, ownership rights over the enterprise have not been acquired, and organizations of associated labor and business communities that carry out economic activity and are not yet organized as enterprises.

The main object of transformation, under the Law on Transformation of Enterprises with Social Capital, was social enterprises as enterprises that operate exclusively with social capital, based on which no ownership rights over the enterprise have been acquired. These are enterprises with anonymous, non-nominated social capital, based on which no one has yet acquired any ownership rights over the enterprise. It can be said that the main goal of the Law on Transformation of Enterprises with Social Capital was primarily the transformation of social enterprises into capital-type trading companies. Namely, with the implementation of the Law on Transformation of Enterprises with Social Capital, the social enterprise disappeared, as an inappropriate organization of entrepreneurship. The identical status to the social enterprise in the process of transformation of enterprises with social capital is also held by the limited liability companies in social ownership established by the social enterprise, but in such a way that the established limited liability company holds the entire share in itself. Namely, in such companies, their founder (the social enterprise) has consciously renounced the acquisition of ownership rights over the limited liability company by taking a share.

Transformation, under the Law on Transformation of Enterprises with Social Capital, also includes enterprises in mixed ownership that have started the transformation and have not completed it, leaving a part of the social capital for which they hold the shares. In most cases, this is a procedure initiated and conducted under the Law on Social Capital, i.e., when the privatization of the social capital is carried out by issuing internal shares. In these enterprises, the privatization has been carried out partially, so a so-called residual social capital appears. For these reasons, enterprises that started the privatization of social capital according to the provisions of the Law on Social Capital and organized themselves as joint-stock companies, i.e., limited liability companies in mixed ownership, had to complete the privatization of social capital that had been started, since they were already organized as trading companies.

As for the organizations of associated labor and business communities, the Law on Transformation of Enterprises with Social Capital treats them as enterprises with social capital. So, these are organizations of associated labor and business communities that carry out economic activity, which should, or could, have harmonized their organization and operations with the provisions of the Law on Enterprises during 1989, but did not do so.

Enterprises That Are Not Subject to Transformation Under the Law on Transformation of Enterprises With Social Capital

The Law on Transformation of Enterprises with Social Capital, with the provisions of Article 3, initially excluded from the privatization of social capital and the transformation into trade companies the enterprises listed and indicated in this Article. It would be more accurate to say that their transformation was postponed until the adoption of other laws regulating the conditions, methods, and procedures for the transformation of these enterprises and organizations. Paragraph 1 of Article 3 establishes that transformation under the Law on Transformation of Enterprises with Social Capital is not performed on:

- Enterprises and organizations for which it has been determined by law and by a decision based on law that they perform work and activities of special social interest, i.e., public service, or have the status of a public enterprise;
- Enterprises and other legal entities that manage waters, forests, land, and other public goods, apartments, and business premises;
- Socially owned enterprises whose activity is organizing games of chance;
- Enterprises that, under the law, have a monopoly position, except for the parts or companies that they have established, and for which it will be determined that they do not have a monopoly position.

With the adoption of the Law on Public Enterprises, the Law on Macedonian Railways, the Law on Telecommunications, the Law on Energy, the Law on Broadcasting, the Law on Communal Activities, the Law on Public Roads, the Law on Forests, the Law on Waters, the Law on Games of Chance, the Law on Livestock, the Law on Veterinary Medicine, the Law on Insurance and other laws, the state defines its position towards the position and organization of enterprises and organizations that perform activities and work of special social interest, i.e. public service or have the status of a public enterprise and has decided to privatize some of them. In doing so, it has also established the special conditions and criteria for their privatization.

Undoubtedly, the greatest difficulties in the application of the provisions of Article 3, paragraph 1 of the Law on the Transformation of Enterprises with Social Capital were caused by the provision of point d) of paragraph 1 of Article 3 of the Law, which stipulates that the transformation under the Law on the Transformation of Enterprises with Social Capital is not carried out on enterprises that, under the law, have a monopoly position. This is understandable given the fact that the antimonopoly legislation in the Republic of Macedonia, i.e., the Law against restriction of competition and the Law against unfair competition, was adopted at the end of 1999. Also, paragraph 2 of Article 3 of the Law on the Transformation of Enterprises with Social Capital stipulates that banks and other financial organizations, insurance organizations, and agricultural cooperatives will be transformed and that they will receive a specific, i.e., known owner (by another law). The privatization of social capital in banks was carried out indirectly, through the privatization of enterprises.

The social capital in insurance companies was privatized under the special conditions set out in the Insurance Law and under the general conditions of the Law on the Transformation of Socially Owned Enterprises.

Enterprises over which bankruptcy proceedings were opened could also proceed to transformation under the conditions set out in Articles 80-86 of the Law on the Transformation of Socially Owned Enterprises.

Beneficiaries of the Privatization of Socially Owned Capital

The category of beneficiaries of the privatization of social capital includes persons (natural and legal persons) who, through the transformation of socially owned enterprises, can acquire ownership of the enterprise, and in certain cases, only ownership of the social capital. Paragraph 1 of Article 24 of the Law on the Transformation of Socially Owned Enterprises stipulates that domestic and foreign, natural, and legal persons can participate in the transformation under equal conditions. Paragraph 2 of Article 24 of the Law stipulates a restriction only for enterprises and other legal entities in which the social capital participates with more than 30% in the value of the enterprise. Namely, such enterprises and legal entities cannot acquire ownership over another enterprise, i.e., ownership over the social capital.

The Law on the Transformation of Enterprises with Social Capital is very liberal in terms of the participation of foreign individuals and legal entities in the transformation of enterprises with social capital, and especially in terms of the acquisition of ownership over the enterprise by foreign individuals and legal entities. In this regard, this Law differs from a large number of privatization laws in several countries of Eastern Europe, which provide for various restrictions in terms of the acquisition of ownership over the enterprise.

The differences between the beneficiaries of the privatization of social capital arise in two directions:

- In terms of the conditions under which some of them can acquire ownership of the enterprise, i.e., ownership of the social capital, i.e., whether or not they have a preferential position when purchasing shares in the enterprise being transformed, i.e., how and under what conditions they can use those privileges;
- In terms of the advantage in purchasing shares, i.e., purchasing the enterprise of some beneficiaries over others, such as the case of the preferential right to purchase a small enterprise by employees.

The conditions under which each of the beneficiaries of the privatization of social capital will acquire the right to ownership of the enterprise are prescribed by law and depend on the technique, i.e., the techniques for privatization of social capital that will be chosen. It depends exclusively on the decision to transform the enterprise adopted by the management body of the enterprise being transformed. But one more thing: ownership of the transformed enterprise cannot be acquired without the consent of the person who becomes a co-owner of the enterprise. Without such consent, ownership of the enterprise is acquired only by the Pension and Disability Insurance Fund.

In this general framework, the category of beneficiaries of the privatization of social capital should include: employees and former employees of the enterprise being transformed, the Pension and Disability Insurance Fund, and former owners and their legal heirs.

In the group of potential beneficiaries of privatization, a special place is occupied by employees and former employees of the enterprise being transformed. This group includes:

- Employees who worked in the enterprise, or rather in the complex form of the organization being transformed, for at least two years before the decision on transformation was made (current employees);
- Persons whose employment relationship with the enterprise being transformed has ended and who have worked in it continuously for at least two years (former employees);
- Retired workers who have worked continuously in the enterprise being transformed for at least two years. (former employees).

The preferential position of current and former employees of the company being transformed is realized in two directions:

- They have a priority right in acquiring ownership of the company in which they work or have worked, and
- They have the right to purchase shares under preferential conditions, i.e., stakes in the company being transformed.

The most striking case of the priority right of employees in acquiring ownership of the company is in small companies when applying the technique of purchase of the company by employees.

The right to purchase under preferential conditions is expressed through the right to purchase shares and stakes at a discount. Namely, current and previous employees of the company being transformed had the right to purchase shares or stakes at a basic discount of 30% of the nominal value of the shares or stakes, increased by 1% for each full year of service in the company. Restrictions are prescribed in paragraphs 1 and 2 of Article 26 of the Law, where a maximum of 30% of the value of the shares issued by the company being transformed can be purchased under preferential conditions and the amount of the shares or stakes at a discount cannot exceed the amount of 25.000 German marks. In paragraph 2 of Article 25, there is another restriction that stipulates that the right to preferential purchase of shares or stakes can be exercised only once in one company.

The Pension and Disability Insurance Fund is the most privileged beneficiary of the privatization of social capital. Any social enterprise that begins the procedure for privatization of social capital and transformation into a joint-stock company, i.e. a limited liability company, as well as a joint-stock company or a limited liability company in mixed ownership that carries out further privatization, during the procedure for transformation, i.e. further privatization, should issue shares, i.e. a certificate for a share of 15% of the total value of the issued shares, free of charge to the Pension and Disability Insurance Fund. According to paragraph 2 of Article 19 of the Law on Transformation of Enterprises with Social Capital, the shares, issued to the fund are priority shares and in the name of the fund, give the right to a dividend of at least 2% per year and a proportional share in the remainder of the profit if the ordinary shares are paid a dividend above this amount; do not give the right to vote in the company's assembly and in case of bankruptcy or liquidation of the company, they provide the right to a proportional share in the division of the remainder of the bankruptcy estate. The fund can sell the shares, i.e., the stakes.

The Law on the Transformation of Socially Owned Enterprises does not treat former owners and their legal heirs as direct beneficiaries of the privatization of social capital in the full sense, but only as virtual beneficiaries of the privatization of social capital, i.e. the Law only protects and ensures the rights related to their status as former owners or their legal heirs, to the right of ownership over the enterprise, i.e. to parts of the enterprise being transformed. For example, former owners or legal heirs against whom nationalization was carried out or in some other way property was seized that is now in an enterprise being transformed, are allowed to protect, i.e., secure their claims (rights) through the issuance of shares, i.e., transfer of the right of ownership over real estate. This matter was further regulated and clarified with the adoption of the Law on Denationalization in 1998, which began to be applied in 2000 after the amendments and supplements were adopted. (Nedkov et al., 2003)

Conclusion

After 1991, Macedonia began building a market economy with significant reforms in corporate law and the economy. The development of corporate law after 1991 has been crucial in facilitating the country's economic transformation from a state-controlled system to a more market-oriented economy. The legal reforms introduced, including those in corporate governance, privatization, and foreign investment, have significantly fostered business development and economic growth. In this regard, privatizing social capital in the Republic of Macedonia was pivotal in the country's transition to a market economy. In the long term, the privatization process helped Macedonia integrate more fully into the global economy. The organization of capital companies played a central role in facilitating this transformation. While the privatization process faced significant social and economic challenges that required continued reform and adaptation, it also laid the groundwork for the development of modern commercial companies, spurred entrepreneurship, and contributed to the growth of a competitive private sector. From the analysis in this chapter, it can be concluded that the philosophy of self-management was reflected in the country's approach to privatization. Rather than a top-down approach, enterprises were responsible for proposing the privatization model they wished to follow, preparing all the documentation, and carrying it out according to the laws and under the supervision of the Agency. Even though the legal framework had some deficiencies, it was not the main reason for the issues that arose in the period of privatization in Macedonia, but the non-implementation of the laws regulating this area, especially the Law on Transformation of Enterprises with Social Capital.

The legacy of privatization continues to shape the country's financial landscape, influencing the development of its commercial sector and its broader economic trajectory. But as we have seen in this chapter, the Republic of North Macedonia still faces challenges, particularly in improving the rule of law, reducing corruption, and aligning its corporate and legal frameworks with EU standards. As the country continues its journey towards European integration, further reforms in corporate law, along with continued economic diversification and innovation, will be essential for sustaining growth and attracting high-quality investment.

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Chapter 3

Public Debt in North Macedonia: Historical Overview and the Challenge of Sustainability

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North Macedonia, as a small open economy, is facing rising public debt. Since 2008, the public debt in the country has increased by approximately 160%. The increase in public debt in the early years after independence was a sign that the Macedonian economy was becoming more trustworthy among international creditors. However, the constant increase of public debt has raised the question of its sustainability and has been a hot topic among academia and the public in the last decade. To inform this debate, we

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are analyzing the historical aspects of public debt in North Macedonia, and we are aiming to provide evidence-based conclusions regarding its relationship with the three main budget expenditure categories, that is current expenditures, capital expenditures, and transfers, thus covering one important aspect of its sustainability.

Our analysis showed three distinct periods concerning public debt. The first one is from 1991- 2004, marked by the economic and political transition of the country and the evolution of public finances regarding public debt. The early years after independence were marked by low public debt, primarily due to the limited access to capital markets, the economic transition to a market economy, and the inflow of financial assistance from international organizations.

The second is from 2005-2019, marked by the enactment of the Law on Public Debt and the first Eurobond issued by the country. This period is characterized by rising debt levels but still maintaining moderate indebtedness.

The third period started in 2020 and is still ongoing at the moment of writing this chapter. It is marked by an increase in public debt to finance the rising budget deficits that are the result of the consequent crises in this period: the pandemic, the energy crisis, and the inflation crisis.

The public debt to GDP indicator has generally maintained its level below the Maastricht criteria threshold for a long time. The biggest increase in public debt is seen in the post-COVID period. According to the public finance data, in 2024, the level of public debt to GDP was 62%, which is above the Maastricht criteria and poses the question of its sustainability. In this chapter, despite providing a historical overview of public debt in North Macedonia since its independence, we analyze the relationship between public debt and the rising current, capital, and social expenditures as a phenomenon that must be closely observed to prevent any missteps on the path toward fiscal sustainability.

Independence, Transition, and Development (1991-2004)

As a former Yugoslav republic, Macedonia became independent on 8 September 1991; however, until 26 April 1992, the country had no economic independence (National Bank of the Republic of Macedonia [NBRM], 1992). This is the official date when the Macedonian market started to function as a monetary zone, independent from the Yugoslav Dinar, opening a new chapter in Macedonian independent monetary policy. This was an incredibly challenging period for the Macedonian economy and society because of the harsh trade and economic relations due to turbulent circumstances in the region. Facing North, the Yugoslav wars left the Macedonian economy physically cut off from the European market and trade routes. To the south, the political embargo imposed by Greece following the country's independence left North Macedonia economically isolated, with no access to energy markets or trading channels through the nearby Greek port of Thessaloniki.

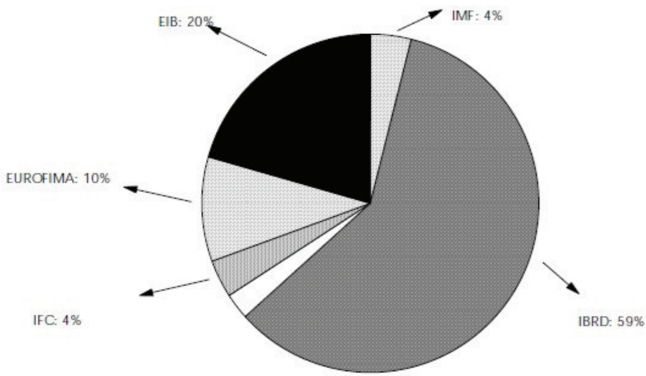
Regarding public debt, it should be noted that at that point, the country was still in the process of succession of the credit agreements with the Socialist Federal Republic of

Yugoslavia (SFRY). Under conditions of an unresolved division of rights and obligations from the former SFRY with international financial institutions and insufficient foreign currency inflows, repayments of foreign loans were mainly not carried out in the first year of independence. Resolving this issue was directly related to Macedonia's admission to international financial organizations and finding joint solutions for obtaining new loans and refinancing existing ones. In 1992, the Macedonian government negotiated with delegations from the International Monetary Fund and the World Bank to find solutions to overcome this transition period and fulfill its financial obligations towards the World Bank, the leading foreign creditor at the time. In addition, due to the low price of the debt on secondary financial markets, part of the debt was repurchased by the Macedonian government from the foreign commercial banks in the amount of USD 10,6 million, with USD 1,1 million of its own foreign exchange funds and USD 0,8 million from short-term foreign financial credit.

As per the National Bank of the Republic of Macedonia Annual Report 1992, the country's debt status concerning foreign loans at the end of 1992 amounted to USD 842,1 million. According to international accounting standards, the amount of total debt includes all overdue obligations related to principal, accrued interest, and penalties for overdue interest.

The amount owed to international financial institutions in 1992 was 252,5 million dollars, representing 30% of the total debt. The most significant part of the debt was owed to commercial banks - 42%, while government and other creditors amounted to 28% of total debt. The largest portion of the Republic of Macedonia's debt to international financial institutions was owed to the World Bank – International Bank for Reconstruction and Development (IBRD) (59%) and the European Investment Bank (EIB) (20%), as shown in Figure 1.

Figure 1. Foreign creditors of public debt in Macedonia (1992) (NBRM, 1992)



In the last quartile of 1993, debt payments to service the country's debt to the Soros Foundation, the International Monetary Fund, and the International Bank for Reconstruction and Development, as well as payments for imports of oil, raw materials, and repro materials, caused pressure on the foreign exchange reserves. These payments were prioritized because they represented a condition for using new loans from the World Bank. In this regard, the Republic of Macedonia made agreements to use the new instrument from the World Bank for financing the countries in transition, i.e., the Emergency Recovery Loan (ERL). This loan aimed to stabilize the transitioning economy and support the fiscal restructuring of the young country. As of December 31, 1993, Macedonian debt amounted to USD 702,9 million – 37% was owed to commercial banks and 34% to international financial institutions, while government and other creditors amounted to 29% of total debt. This year, the debt obligations towards foreign commercial banks were not repaid, including the debt towards the Paris Club – an informal group of creditor countries (National Bank of the Republic of Macedonia, 1993).

At the beginning of the following year, the total debt obligations toward the World Bank (IBRD) were paid out as a strategic decision to finance future debt. To settle the debt to the World Bank, aid was received from donor countries in the amount of USD 20 million, short-term loans from the Soros Foundation totaling USD 17,5 million, and the first tranche of the Systemic Transformation Facility (STF) arrangement from the International Monetary Fund in the amount of USD 17,1 million. Following this, Macedonia was approved for a World Bank loan in the first half of 1994 in the amount of USD 80 million. This year, Macedonia also intensified negotiations with foreign bilateral creditors (the Paris Club) and foreign private commercial banks (the London Club) to regulate the debt obligations towards them. These debt obligations were to be addressed with the anticipated Stand-by arrangement for the Republic of Macedonia with the International Monetary Fund in 1995. In addition, the government initiated preliminary contacts with other multilateral creditors, primarily with Eurofima and the European Investment Bank, to find solutions for normalizing relations with them through the regulation of overdue, unpaid credit obligations. As of December 31, 1994, Macedonian debt amounted to USD 737 million – 37% was owed to commercial banks and 35% to international financial institutions, while government and other creditors amounted to 28% of total debt (National Bank of the Republic of Macedonia, 1994).

Until the end of 1995, the total debt amounted to USD 1.235 million, which is a 67,6% increase from the previous year. This increase is due to new debt occurring towards the International Monetary Fund, World Bank (for support of the financial sector and social reforms), IBRD (for road infrastructure), EBRD (for the energy sector and advancement of flight control), and the USA (bilateral commodity credit for corn). The United States of America (USA) was also the largest lender from the Paris Club with 31%, followed by Germany with 29%, France with 10%, Italy with 6% and Switzerland with 5%. Together, these countries amount to up to 85% of the total debt towards the Paris Club. This year was marked by the timely payments of all debt obligations towards the IMF, World Bank (IBRD, IDA, IFC), and EBRD (National Bank of the Republic of Macedonia, 1995).

The debt at the end of 1996 was lower than the previous year, at 1172 million MKD. This decrease is due primarily to the decrease in debt obligations towards the London Club. The new debt balance with this group was stated after the country concluded an agreement with the club in October 1996, when Macedonia assumed 5,4% of the total debt of SFRY based on principal and 3,65% of the debt based on unpaid interest and penalties (National Bank of the Republic of Macedonia, 1996).

At the end of 1997, the total external debt of the Republic of Macedonia amounted to USD 1.126 million. The external debt at the end of 1997 was reduced by USD 45.5 million compared to the end of 1996 (National Bank of the Republic of Macedonia, 1997). The largest part of this decrease was due to payments of debt obligations towards multilateral creditors, such as the European Investment Bank. Those payments were a precondition for a credit agreement with the EU. Payments for servicing concluded debt agreements during 1997 were executed regularly. In 1997, new credits totaling $134,3 million were utilized. Of this amount, $105,1 million came from multilateral creditors, with the largest portion of $63,6 million coming from credits provided by the International Development Association for development and reconstruction projects.

The external debt of the Republic of Macedonia significantly increased in 1998 and amounted to USD 1.398 million at the end of the year. Compared to the 1997 total debt, in 1998, the debt increased by 19,2% (National Bank of the Republic of Macedonia, 1998). The increase was primarily due to the high utilization of funds, which exceeded repayments on the due debt. Despite the increase in debt, the country maintained its position as a moderately indebted country. However, the increase in external debt resulted from a combination of factors, including the persistent current account deficit and borrowing to finance economic activities and infrastructure projects in the country.

At the end of 1999, Macedonian debt amounted to USD 1.494 million, an increase of 2,7% compared to the previous year. This year, the utilized credit from the International

Development Agency (IDA) was intended for urgent import projects, the European Investment Bank for road construction, the IBRD for transport projects, and the European Bank for Reconstruction and Development for the steel industry. Regarding bilateral creditors, in 1999, the largest creditor was Taiwan (USD 23 million) (National Bank of the Republic of Macedonia, 1999). This year, the country's debt obligations towards the Paris Club were under a one-year moratorium due to the unfavorable economic situation in the country as a result of the escalation of the regional crisis in Kosovo and Yugoslavia. Macedonia was supposed to finalize the successful implementation of the ESAF arrangement with the IMF this year; however, due to the negative external shock caused by the SFRY crisis, the necessary conditions for the full implementation of the arrangement were not met, and it was subsequently terminated.

The debt balance at the end of 2000 compared to 1999 was slightly decreased (by 0,4%). In 2000, Macedonia successfully conducted negotiations with the International Monetary Fund, which resulted in the approval of the Extended Fund Facility (EFF) and Poverty Reduction and Growth Facility (PRGF) arrangements. In addition, in 2000, Macedonia signed multiple agreements with the World Bank and its affiliates, as well as the European Union and the European Investment Bank (National Bank of the Republic of Macedonia, 2000).

As of December 31, 2001, the total external debt of the Republic of Macedonia amounted to USD 1.440 million (National Bank of the Republic of Macedonia, 2001). The country faced a security crisis in 2001, which resulted in reduced economic activity which also impacted foreign borrowing. Compared to the previous year, the debt decreased by USD 48 million or by 3,2%. The reduced indebtedness is attributed to higher loan repayments amidst a decline in disbursed funds from foreign creditors.

The next year, the debt amounted to USD 1.613 millions. This increase in indebtedness stemmed from a greater amount of funds drawn from long-term loans, amounting to USD 175 million, or 38% more than the previous year. In 2002, Macedonia was still in the category of low-debt countries with medium-income levels. The ratio of total debt to the average export of goods and services over the last three years (118,1%); the ratio of debt servicing to the average export of goods and services over the last three years (17,2%); the ratio of interest payments to the average export of goods and services over the last three years (3,9%) (National Bank of the Republic of Macedonia, 2002). The external debt to GDP ratio is 40,25% (National Bank of the Republic of Macedonia, 2005). During 2002, new loans and credits were signed with IDA for cultural and youth development projects, EBRD for the reconstruction of the Ohrid Airport, and Italy for the Streževo Hydropower Plant Project.

The total external debt of the Republic of Macedonia, based on utilized short-term and long-term loans, amounted to USD 1.812 million at the end of 2003 (National Bank of the Republic of Macedonia, 2005). This rise in external debt was largely a result of positive exchange rate differences, occurring in the context of a significant depreciation of the US dollar against other currencies. Additionally, the increase in debt was influenced by a higher amount of disbursed funds from long-term loans, totaling USD 73,6 million. The country is classified as a low-indebted country with a medium income level. The external debt to GDP ratio is 36,99% (National Bank of the Republic of Macedonia, 2005).

At the end of 2004, the Republic of Macedonia's external debt amounted to USD 2.034 million, of which 96,5% represented long-term liabilities and 3,5% were short-term liabilities (National Bank of the Republic of Macedonia, 2004). Compared to the end of the previous year, total external debt increased by 11,1%. Despite the rise in external debt, the indicators of the level of indebtedness for 2004 show a positive trend. According to the values of key indicators, the country is classified as a low-debt country. The indicator of total external debt to GDP reflects moderate indebtedness (36,89%) (National Bank of the Republic of Macedonia, 2005).

Eurobonds and the Law on Public Debt (2005-2019)

The total external debt at the end of 2005 amounted to EUR 1.928 million, an increase of 26,2%, primarily due to a higher amount of utilized funds relative to repaid principal and public sector borrowing through the issuance of Eurobonds in December 2005. Despite the increase in total external debt, the indicators of the level of indebtedness for 2005 remained in the same debt category as the previous year. The external debt to GDP ratio is 44,28% (National Bank of the Republic of Macedonia, 2005).

This year is marked by an important event in the Macedonian economy—the issuance of a 150 million euro Eurobond on the London Stock Exchange, with a ten-year maturity rate and a coupon interest rate of 4,625%. Facing insufficient domestic savings and modest inflows of foreign investments, transition economies (Croatia, Bulgaria, Romania) have turned to this financing possibility on the foreign capital markets. Before the issuance of the Eurobond, Macedonia was given BB+ and BB credit ratings by Standard & Poor's and Fitch Ratings, respectively. The interest rate of 4,625% was relatively favorable compared to other 10-year bonds issued by countries in the region. The demand for Macedonia's Eurobonds was exceptionally high, reaching €593 million—four times the offered amount. This highlighted strong investor confidence in Macedonia's financial instrument. The investors (investment banks, investment funds, and asset management companies) came mainly from the UK (33%), Germany (31%), European countries (22.5%), the USA (12%), and Asia (1.5%).

In July 2005, the Law on Public Debt was introduced, aiming to regulate the management, purposes, and procedures of public debt. This was partly due to the European integration and fiscal reform efforts towards increasing debt sustainability and transparency.

Efforts to reduce external public debt in 2006 resulted in a decrease in the total amount of external debt (EUR 1.830 million). At the beginning of 2006, the total debt to the London Club of Creditors was fully repaid (National Bank of the Republic of Macedonia, 2006). On the other hand, the external debt of the private sector showed an increase, indicating a greater use of external sources to finance the needs of domestic entities. The main indicators of external debt show that the country remains in the low to moderate debt zone, which creates positive perceptions of the economy as a whole.

At the end of 2007, the gross external debt amounted to EUR 2.711 million, reflecting an annual increase of 8,7%. This trend is driven by a rise in debt in the non-financial actors, the banking sector, and intercompany debt. This increase was offset by debt reduction in the government sector and early repayments to some foreign creditors (Paris Club, IBRD, IMF, and EIB). Compared to 2006, in 2007, there is a slight decline in the debt-to-GDP ratio (from 36,4% to 29,02%) (Ministry of Finance, 2007).

For 2008, the debt-to-GDP ratio was 23,9% (Ministry of Finance, 2008). Gross external debt amounted to EUR 3.3506 million, which is 51,5% of GDP, representing an 18% increase compared to the end of 2007 (National Bank of the Republic of Macedonia, 2008). This debt dynamic primarily reflects the rise in private sector external debt amidst the global economic crisis, with the corporate sector accounting for the largest share. Simultaneously, there was also an increase in public sector external debt as foreign loans were drawn, while the banking sector experienced a decrease in indebtedness on an annual basis.

2009 was a period of crisis, when the international capital markets showed high caution and reduced confidence. However, the gross external debt of the country in 2009 showed an increase and amounted to EUR 3.839 million, an increase of 16,2% compared to the end of the previous year.

The increase in public external debt primarily stemmed from higher state borrowing and domestic economic entities. In the previous three years, the public sector's debt showed decreasing trends because of the favorable economic circumstances that resulted in low deficits. In July 2009, amidst an expanding budget deficit and the need for additional funding sources for budget expenditures, the government issued a Eurobond on the international capital market in the amount of EUR 175 millions with a maturity date of January 2013 and an interest rate of 9,875%. For 2009, the debt-to-GDP ratio was 27,1% (Ministry of Finance, 2009).

Unlike in 2009, when the growth of gross debt was almost equally driven by increases in both public and private sector debt, in 2010, the primary factor for the growth was the increase in private sector debt, primarily driven by short-term commercial loans provided by the corporate sector to foreign partners and the investment of foreign exchange reserves in long-term bonds outside the country. This structure of gross debt is predominantly composed of intercompany borrowing and trade credits—types of borrowing that carry lower risk compared to purely financial loans. In 2010, the debt-to-GDP ratio was 28,2% (Ministry of Finance, 2010).

In January 2011, the Republic of Macedonia entered into a new financial support arrangement with the International Monetary Fund in the form of a Precautionary Credit Line (PCL). In March 2011, the Government of the Republic of Macedonia withdrew EUR 220 million from the total available funds of EUR 390 million arrangement for the first year (National Bank of the Republic of Macedonia, 2011).

The function of this arrangement is to provide the country with insurance against potential negative shocks that could create an urgent need for external financing during the arrangement's duration. This means that the funds are not immediately drawn up; instead, they are made available, allowing the country to quickly access them if a negative risk materializes. In 2011, the net debt position improved for the second consecutive year. In contrast to the previous several years, when private-sector borrowing was the main driver of total debt growth, in 2011, the increase was primarily due to the rise in public-sector borrowing.

In 2012, public finances faced significant challenges in the absence of domestic economic growth. The increase in the budget deficit created a greater need for financing, which was met through the high liquidity of the domestic financial market. This allowed the central government to begin altering the maturity structure of domestic debt by issuing more long-term bonds, contributing to the development of the domestic market. As a result, the central government's debt-to-GDP ratio rose to 33,8%, up from 27,8% the previous year (Ministry of Finance, 2012). Although this remains at a moderate level, such dynamics indicate the need for greater caution in monetary policy in the upcoming period.

The deficit and the need to finance it led to a further increase in central government debt, which reached 35,8% of GDP in 2013 (National Bank of the Republic of Macedonia, 2013). The annual increase in debt was entirely due to the rise in domestic government borrowing (by 25%), while external debt recorded a decrease (of 1,3%). This decrease was attributable to the exclusion of loans from the Public

Enterprise for State Roads from the central government's debt following its status change from a state fund to a public enterprise at the beginning of 2013.

In July 2014, the government issued the third Eurobond on the international capital market with a value of EUR 500 million, a maturity of seven years, and an interest rate of 3,975%. Based on this, inflows of EUR 491 million were realized. The central government debt in 2014 amounted to EUR 3.246,4 million, representing an increase of 17,8% compared to the previous year (National Bank of the Republic of Macedonia, 2014). This increase in indebtedness was driven by the issuance of the new Eurobond, whereas domestic debt recorded a slight decline. The public debt of the Republic of Macedonia, which includes state debt and guaranteed public debt, was 46% of GDP (Ministry of Finance, 2014).

The central government debt in 2015 reached EUR 3.433,2 million, marking a moderate increase of 5,8% compared to the previous year. The central government debt-to-GDP ratio stood at 37,8%, reflecting a slight decline of 0,3 percentage points compared to 2014. This decrease was entirely due to a reduction in external debt through repayments to foreign creditors, i.e., in December 2015, the fourth Eurobond was issued in the amount of EUR 270 million. Those funds were used for early repayment of obligations under the IMF's PCL and the repayment of the matured Eurobond issued in 2005 (National Bank of the Republic of Macedonia, 2015). In 2015, the debt-to-GDP ratio was 46,5% (Ministry of Finance, 2015).

In July 2016, the government borrowed money from international markets through the issuance of the fifth

Eurobond, amounting to EUR 450 million, with an interest rate of 5,625% and a maturity of 7 years. In 2016, the central government debt amounted to EUR 3.851,5 million, representing an increase of 11,5% compared to the previous year. The annual growth in debt was primarily due to an increase in the government's external borrowing resulting from the issuance of the new Eurobond, along with a simultaneous rise in domestic debt. In 2016, the indicator of public debt as a percentage of GDP was 47,8% (Ministry of Finance, 2016).

In 2017, the country managed its public debt within the limits established by the Fiscal Strategy 2017-2019, ensuring compliance with the cap of 60% of GDP for public debt. The Ministry of Finance effectively serviced all obligations arising from public and state debt, spending EUR 536,7 million on principal and interest payments. In 2017, the indicator of public debt as a percentage of GDP was 47,6% (Ministry of Finance, 2017).

As per the yearly report of the Ministry of Finance, the public debt of the country at the end of 2018 amounted to EUR 5.202 million, representing 48,5% of GDP (Ministry of Finance, 2018). With this level of public debt, the Republic of North Macedonia remained a moderately indebted country. In January 2018, the Republic of North Macedonia issued its sixth Eurobond in the amount of EUR 500 million, with a coupon interest rate of 2,75% and a maturity period of 7 years, expiring in 2025. It was issued on the international capital market and was intended to finance budgetary needs and refinance prior obligations. The interest rate of 2,75% was the lowest historically achieved for any of North

Macedonia's Eurobonds, reflecting the high confidence of international investors in the prospects of the Macedonian economy.

In 2019, the level of public debt to GDP did not significantly increase and amounted to 48,9%, while all obligations matured in 2019 were duly serviced (Ministry of Finance, 2019). This year was marked by changes in the Law on Public Debt. One of the main amendments to the Law was the expansion of the definition of public debt to include the non-guaranteed debt of public enterprises. This expansion of the definition has increased transparency of the public debt and aligns with the recommendations of international institutions.

Latest Developments on Macedonian Public Debt (2020-2024)

The spread of the coronavirus in 2020 affected economic activity and contributed to an increasing need to finance the budget deficit. Accordingly, the public debt at the end of the year was 60,2% of GDP, an 11,3 percentage points increase compared to the previous year (Ministry of Finance, 2020). The increase was also influenced by the expansion of the legal definition of public debt. As per the latest amendments to the law, the public debt is defined as the sum of government debt, the debt of public enterprises established by the state or municipalities, the municipalities within the City of Skopje, the City of Skopje, and the commercial companies wholly or predominantly owned by the state or the municipalities.

In 2021, it was a year of significant growth due to the improvement of the health crisis, increased consumer demand, and government support for the economy. The public debt to GDP ratio was 60,8% of GDP (Ministry of Finance, 2021). Since May 2019, the definition of public debt has included the non-guaranteed debt of public enterprises and joint-stock companies established by the state or municipalities, the municipalities within the City of Skopje, and the City of Skopje. To finance the increased budgetary needs, the country issued the eighth Eurobond in March 2021 in the amount of EUR 700 million with a historically low interest rate of 1,625% traded on the London Stock Exchange.

The public debt of the Republic of North Macedonia at the end of 2022 was 59,7% of GDP, while in 2023, it was 62,1% of GDP (Ministry of Finance, 2022; Ministry of Finance, 2023). Amid the ongoing health crisis and a war starting at the European margins that influenced the beginning of the energy and inflation crisis, the unfavorable conditions pushed the indicator of public debt to GDP to surpass the red line of the Maastricht criteria. In March 2023, North Macedonia issued its eighth Eurobond on the international capital market in the amount of EUR 500 million with a coupon interest rate of 6,960%. The bond was intended to finance budgetary needs for 2023 and to refinance the fifth Eurobond from 2016.

In September 2024, North Macedonia's parliament approved a €500 million loan from Hungary's partly state-owned Exim Bank. The purpose of this loan is to support the economy through loans to commercial companies with a low interest rate (1,95%), and to support the country's budgetary needs. Facing criticism regarding the transparency and effectiveness of this loan, together with public debt exceeding 62% in 2024 and prolonged fiscal stimulus since 2020 with a budget deficit of 5% of GDP that is the highest within the Western Balkans region (WB6), the World Bank recommends optimization of public spending and enhanced tax collection in North Macedonia (World Bank, 2024).

Empirical Study on Public Debt Sustainability

Public spending as a share of GDP should go up during booms and down in recessions, while deficits increase in booms and decrease in recessions. Instead, according to Alesina (2006), in some Organization for Economic Cooperation and Development (OECD) countries, fiscal policy is generally counter-cyclical, and these countries have accumulated large amounts of public debt in the past. Some economists refer to fiscal policy as “active” or “passive,” depending on its responsiveness to government debt shocks (Leeper, 1990). Reinhart and Rogoff (2010) find that across both advanced countries and emerging markets, high debt/GDP levels (90 percent and above) are associated with notably lower growth outcomes. In addition, although at moderate levels, public debt should improve welfare and enhance growth, Cecchetti et al. (2011) show that beyond the threshold of 85% of GDP, public debt starts to drag growth downwards. The financial recovery in 2021 in the aftermath of the COVID-19 pandemic was a period of low, even negative interest rates in Europe. However, since the start of the war in Ukraine and the rise in inflation, the monetary policy has tightened, resulting in rising interest rates. According to Holzner (2022), higher interest rates could make it difficult to refinance public debt both in the core and in the peripheral economies, with a potential threat of widespread recessions, particularly in emerging markets.

Empirical studies focusing on North Macedonia regarding the relationship between different expenditure categories and public debt are limited and tend to focus only on the relationship between public debt and economic growth (Nikoloski, 2020; Velichkovska & Sadiku, 2019; Miftari & Ziberi, 2019; Shaqir, 2019; Cvetanoska Mitev & Trpevski, 2020; Dzambaska & Lozanoska, 2015; Dzambaska, 2014; Shkodra et al., 2022).

Our study contributes to the literature by investigating the relationship between the three main budget categories in North Macedonia - the current, capital, and social protection expenditure categories and public debt, trying to provide evidence-based conclusions and add to the debate on public debt sustainability in North Macedonia concerning budget expenditure structure.

For this purpose, we have employed a Vector Autoregressive Moving-Average with Exogenous Variables (VARMAX) model, using quarterly data covering the period from the first quarter of 2008 to the second quarter of 2022. This empirical investigation aimed to determine the relationship between capital expenditure, social expenditure, and current expenditure and the public debt in North Macedonia.

An important limitation of this study is the limited public debt data. The Ministry of Finance published no data before 2002. This was mainly because, during this period, the young Macedonian state had not yet established good practices in fiscal transparency and statistical data collection. In addition, for the period between 2002 and 2008, the Ministry of Finance of North Macedonia published only yearly data. Due to the short time series, the small number of observations, and the degree of freedom problem, this study utilized quarterly data instead of yearly data.

Academic debates often elaborate on the question of whether the public debt is increasing for the purpose of financing capital expenditure and fostering economic growth or for the purpose of covering the rising current expenditure and transfers. Accordingly, we use the following variables:

- Public debt as a percentage of GDP – "PD"
- Current expenditure in million MKD - "CRE"
- Capital expenditure in million MKD – "CE"
- Transfers in million MKD – "TR"

Current expenditures, capital expenditures, and transfers are the three main budget expenditure categories, and answering the question of their relationship with public debt could give an important indication of public debt sustainability. We also add two control variables in the model:

- The economic growth rate – "GDP"
- Public revenues in million MKD – "PR"

When adding control variables (exogenous variables) to a Vector Autoregressive model (VAR) model, the model is extended to a VARMAX model. Here's the typical representation of a VARMAX (p, q) model with k exogenous variables that can be written as such:

$$Y(t) = c + A1 * Y(t-1) + A2 * Y(t-2) + \ldots + Ap * Y(t-p) + B * X(t) + \varepsilon(t)$$

Table 1: Results from the VARMAX model

Variable	Coefficient	p-value*
dCRE		
dCRE lag 1	-0,64	0,00*
CE lag 1	-0,13	0,66
dTR lag 1	-0,08	0,90
dPD lag 1	334,27	0,06**
GDP	25,91	0,81
dPR	-0,20	0,11
dCE		
dCRE lag 1	0,05	0,41
CE lag 1	-0,05	0,67
dTR lag 1	-0,13	0,67
dPD lag 1	-61,91	0,44
GDP	27,41	0,59
dPR	0,09	0,13
dTR		
dCRE lag 1	-0,04	0,08**
CE lag 1	-0,02	0,65
dTR lag 1	-0,52	0,00*
dPD lag 1	59,85	0,09**
GDP	-19,79	0,38
dPR	0,00	0,09**
dPD		
dCRE lag 1	0,00	0,37
CE lag 1	0,00	0,83
dTR lag 1	0,00	0,56
dPD lag 1	-0,06	0,60
GDP	-0,25	0,00*
dPR	0,00	0,21

The positive and significant coefficient in the equation, where the current budget expenditure is the dependent variable, suggests that public debt is significant in explaining changes in current expenditures. In addition, the negative and significant coefficient in the equation, where the public debt is the dependent variable, suggests that economic growth is significant in explaining the changes in public debt. In addition, according to the impulse response functions presented in Figure 2, we can conclude that the shock in public debt is followed by a short-term increase in the current budget expenditures. Furthermore, the calculation of the Granger Causality Wald test showed that the variable public debt predicts the trend of the variable current budget expenditure with a significant level of 6%.

Figure 2: Impulse response function

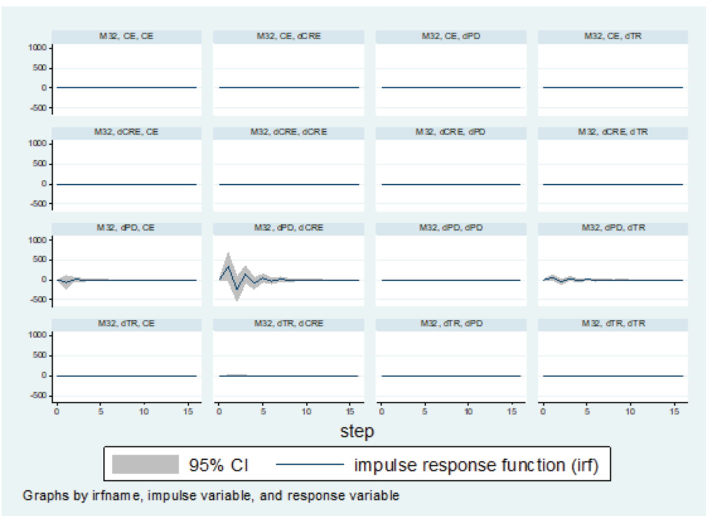


Table 2: Granger causality test results

VAR-Granger causality Wald test Ho: There is no Granger causality Ha: There is Granger causality			
Equation I am running a few minutes late; my previous meeting is running over. Excluded	**chi2**	**df**	**Prob > chi2**
dCRE			
CE	0,19	1	0,66
dTR	0,01	1	0,90
dPD	3,49	1	0,06**
All	4,75	3	0,19

The econometric analysis results are consistent: the results from the VARMAX model, the impulse response functions, and the causality tests also show that public debt correlates with increased current budget expenditures.

Conclusion

This book chapter tackles the historical aspects of public debt in North Macedonia since its independence and provides an empirical study of the relationship between public expenditure and public debt, evaluating the level of sustainability of public debt from a unique perspective, thus filling a gap in the relevant literature.

This analysis shows three distinct periods regarding public debt in North Macedonia. The independence of the country was followed by an economic and political transition. Naturally, the public finances of the country faced a transition period on their own. In this first period (1991-2004), North Macedonia inherited a part of the Yugoslavian debt and relied on international financial institutions for debt restructuring. Slowly, the public debt was rising, reflecting the country's acceptance in international financial markets, but it succeeded at maintaining a moderate level of indebtedness. The second period, from 2005 to 2019, was marked by successive governments issuing Eurobonds to finance various public expenditures. While still in the group of moderately indebted countries, this increase in debt was problematic due to the low fiscal transparency and sustainability and the questionable effectiveness of the government projects that were funded. In the third period after 2020 until today, the country has faced consecutive global crises, the pandemic, the energy crisis, and the inflation crisis, resulting in increased public needs and debt. In 2024, the public debt to GDP indicator was 62%, which is two percentage points above the Maastricht criteria, raising the important question of public debt sustainability.

To contribute to the debate on public debt sustainability in North Macedonia, we have investigated the relationship between the current budget expenditures, capital expenditures, and budget transfers versus public debt, trying to provide evidence-based conclusions about public debt sustainability in North Macedonia concerning expenditure structure. The econometric analysis showed that the increase in public debt in North Macedonia is followed by an increase in current budget expenditures, which often lack the much-needed redistributive effect in the economy. In addition, the results from the econometric analysis show that economic growth in North Macedonia is related to lower public debt, aligning with the stance that economic growth and increased public revenues decrease the need for borrowing.

Although the public debt-to-GDP ratio of 62% does not necessarily indicate unsustainability, it does set the alarm for sustainable fiscal management. Fiscal transparency is the first step towards accountability. Improved realization of capital expenditures is crucial while incorporating a prudent approach to current budget expenditure. To conclude, while the level of public debt is not concerning, its increase and the lack of effectiveness of public spending could be problematic, as the servicing of public debt is fueled by economic growth.

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Chapter 4

Tax Reforms and Fiscal Revenues in North Macedonia: From Transition to Stability

Luljeta Sadiku[1]

After the declaration of political independence in 1991 and monetary independence in 1992, Macedonia's economy moved along a difficult and long path of transition with multiple political and economic shocks. The first half of the transition period in the 1990s was marked by a sharp decline in economic activity, reflecting a deep recession with a negative real GDP growth for five consecutive years, reaching as low as -6,6 % and -7,5 % in 1992 and 1993, respectively[2]. Besides, the country faced severe hyperinflation caused by macroeconomic instability and the lack of institutional capacity to effectively manage monetary and fiscal policy.

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2 Data provided from World Development Indicators, World Bank.

The budget deficit, largely financed through monetary expansion, i.e., seigniorage revenues, led to uncontrolled inflation and prevalent insolvency in the financial system (Fiti, 2018; Raveni, 2022). The asserted measures in 1994-95 aimed at stabilizing the economy, necessitated the implementation of a restrictive monetary policy, strict fiscal discipline, and constraints on credit expansion for the public enterprises, resulting in price stabilization in 1996 and prevention of the decline of output (IMF, 1998)[3].

Unfortunately, the prolonged economic transition caused the country many economic and social negative repercussions in the first decade of the new century, including, among others, slow economic growth, high unemployment rates, deep fiscal deficit, and persistent corruption. Additionally, the long transition has contributed to an unstable business environment and difficulties in implementing necessary reforms for EU integration, impeding long-term economic development and sustainability. From the social perspective, it has led to declining public trust in institutions, income inequality, and an increase in poverty, as well as high emigration and a significant rise in brain drain (Cipuseva et al., 2013). In fact, this process was marked by numerous setbacks that severely impacted the economy of the country, including the name issue, political instability, and other structural weaknesses in the domestic economy (Sadiku et al., 2015; Sanfey & Milatovic, 2019). On the other hand, the transition involved major economic reforms, privatization,

3 The process was facilitated by the IMF, Systemic Transformation Facility that with the first drawing approved on February 14, 1994, supported the economic stabilization.

and trade liberalization, yet it was often hindered by internal and external crises, such as the 1999 Kosovo conflict, the 2001-armed conflict, the 2008 global financial crisis, and recently the COVID-19 health crisis and energy crisis. Despite all these challenges that significantly affected public finances, North Macedonia made great efforts to revive its economy. The steps forward have been driven by sound recovery measures, efforts for the attraction of direct foreign investment, and strengthening trade relations, particularly through agreements with the European Union and the regional partners. Furthermore, infrastructure development, digital transformation, and policy measures supporting SMEs have contributed to economic stabilization in the last two decades. The remaining challenges have to do with North Macedonia's commitment to economic and institutional reforms to facilitate its path toward sustainable growth and European Union integration.

Among various economic reforms in the first decade of transition, tax reform was imperative, and its adaptation to a market-based economy faced significant challenges. The early tax system struggled with tax compliance and high informality as well as weak institutional competence, making tax collection difficult. Additionally, the lack of public trust in the newly established tax administration resulted in numerous policy changes and weak enforcement mechanisms that led to high levels of tax evasion. These challenges highlighted the need for stronger administrative reforms, better compliance strategies, and improved fiscal policy coordination to ensure long-term economic stability for the country. Therefore, the aim of this study is to assess the effects of tax reforms, with special emphasis on the flat tax, on tax collection and fiscal stability. The lack of empirical evidence on this matter was an inspiration to undertake and produce such a comprehensive inquiry for the case of North Macedonia, intending to fill the gap in the existing literature.

The following section elaborates on the historical context of tax reforms; the third section provides a descriptive analysis of the effects of tax reforms on fiscal revenues. The fourth one provides an econometric assessment, estimating the effects of tax reforms on tax collections. It also displays the results and discuses on the main findings derived from the model. Section five concludes and provides indications for further research.

Historical Context and Importance of Tax Reforms in North Macedonia

In the early transition period, the tax system of North Macedonia was transformed and was adapted to a market-based tax system, unlike the previous period of a centrally planned tax structure, which relied heavily on a state-controlled economy. Distinct from the objectives of tax reforms of developed countries, transition countries gave special priority to changing the old tax structure and replacing it with taxes that have been applied in developed nations, although with some specificities of time and countries (Tanzi, 1991; Bexheti, 2017).

In 1992, the "Concept for the New Tax System of the Republic of Macedonia"[4] was developed, and upon this framework, significant reforms were implemented in 1994, including the replacement of the previous schedular tax system, which taxed different income sources separately, with a global income taxation approach, such as the personal income tax (PIT), that was implemented to ensure a more comprehensive calculation of individual earnings. In corporate taxation, the corporate income tax (CIT) was introduced, aimed at creating a more equitable and transparent business environment based on a progressive rate structure. Whereas for the consumption taxation, initially the existing turnover tax on goods and services was retained; however, following necessary preparations, the Value-Added Tax (VAT) was introduced on April 1, 2000. It was the key reform that replaced the turnover tax of the socialist system, thereby improving revenue collection efficiency and aligning with European Union standards. The VAT tax rate was set at 18% on most goods and services, whereas preferential rates of 5% and 10% were determined on essential items. While the taxation on specific goods that are subject to excise duties is imposed on alcohol and alcoholic beverages, tobacco products, energy products, and electricity. As for property tax, the existing solutions of taxation were almost maintained, such as property tax, inheritance or gift tax, and the ownership change of real estate. Customs rates are also applied as another indirect

4 This concept was developed under the leadership of Ksente Bogoev and Zhivko Atanasovski, considering the new economic circumstances that were essential for the changes in the tax system.

tax which in 2000 participated with 11,8 % in the total tax revenues of the central government budget (Table 1). However, in recent times due to the high level of trade liberalization it accounts for considerably lower reaching around 3% of total tax revenues and 0,9% of GDP in 2019 (Ministry of Finance, 2020).

Table 1. The participation of indirect taxes in the total tax revenues in the central government budget (2001-2005).

Indirect taxes	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
VAT	34,2	35,9	37,7	44,7	49	49,4
Excise duties	24	22,7	19,8	20,3	19,7	20,2
Customs duties	11,8	10,1	9,6	10,7	8,7	7,2

Note. Data is taken from Bulletins of the Ministry of Finance of the R. N. Macedonia

The next major tax reform took place in 2007 and 2008 with the shift from progressive to flat tax on personal income and corporate income, with rates of 12% and 10%, respectively. During this period, North Macedonia focused on tax simplification and competitiveness to attract foreign direct investments and to boost economic growth (PWC, 2023). The 10% flat tax made North Macedonia one of the most competitive tax regimes in Europe. Also, the social security contributions were gradually reduced to ease the burden on businesses and increase formal employment.

Even though the flat tax increases the income inequality and the likelihood of unequal income distribution (Sadiku et al., 2023; Brzezinski & Akarsu, 2025), it has an opposite effect on tax evasion. It reduces the tax burden on employers for hiring the factors of production, i.e., labor and capital.

Also, this method of taxation is easy to apply and leads to relatively smaller distortions of economic activities. Thus, in the context of North Macedonia, it contributed to increasing the tax base by reducing the possibilities for tax evasion, creating conditions for a gradual reduction in the size of the shadow economy in the country. The study of CEA (2008) highlighted that the main reasons for tax evasion by companies, which directly affected the size of the shadow economy in the country, were the tax burden, especially the high labour costs. The positive effects of this tax reform began to be seen in the following year, i.e., 2008, with tax revenues increasing significantly, but the same trend did not continue in 2009, due to the global financial crisis. Therefore, in 2011, the government was forced to make some adjustments to the law on corporate income tax, i.e., reducing the tax burden on businesses, by paying taxes only on distributed profits, in order to reduce the negative impact of the crisis.

As a matter of fact, the financial crisis of 2008-2009 led to the need for more fiscal stability, as the tax revenues as a percentage of GDP declined, creating fiscal space problems for the capital government spending that led to a permanent increase of public debt in the subsequent period. This situation caused a huge debate among policymakers for the revision of the flat tax system in 2019, replacing it with a progressive tax of a 15% rate for higher income earners while maintaining the 10% rate for lower earners. However, due to economic concerns and resistance from businesses, this was later reversed in 2020, and the progressive tax model was abandoned in favor of a 10% flat tax once again (KPMG, 2023).

In the most recent period, the government strengthened tax enforcement mechanisms and introduced digital tools to improve tax compliance and reduce the informal economy. The tax system has focused on making taxation more equitable and sustainable. Also, green taxation and environmental reforms have been initiated. New policies have been introduced to incorporate environmental considerations, such as carbon taxation and incentives for sustainable business practices. The Tax Strategy 2021–2025 agenda aims to enhance fiscal discipline, improve tax collection, and align the tax system with EU standards. It emphasizes sustainability and digitalization, introducing green taxes and expanding digital tax services to improve compliance (World Bank, 2021).

The Effects of Tax Reforms on Fiscal Revenue

Tax reforms have a decisive role in shaping countries' economic performance, influencing government revenue, investment, and economic growth (OECD, 2010; Bekoe et al., 2016; Sadiku et al., 2018). The several tax policy changes in North Macedonia, including VAT reforms, shifts between progressive and flat taxation as well as measures to improve tax compliance have significantly impacted fiscal revenue, affecting both tax collection efficiency and economic stability of the country.

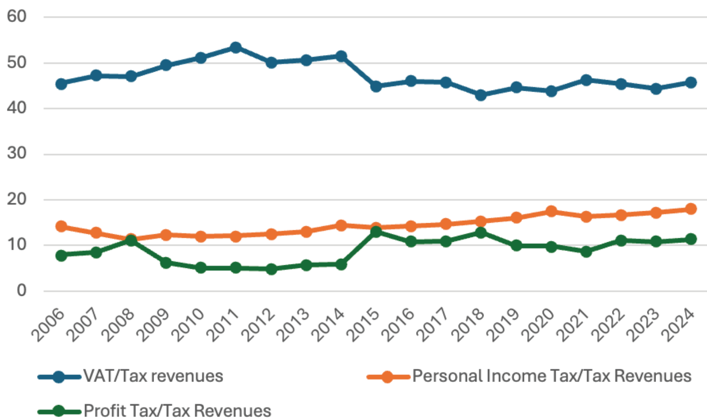
The adoption of VAT that replaced the outdated sales tax system improved revenue collection by broadening the tax base. VAT, in fact, remains one of the most important revenue sources for the government (Finance Think, 2022). While the flat tax reform of 2007 was an effort to boost tax compliance and reduce informal economic activities (PWC, 2023), it was expected to contribute to an increase in tax revenues. However, these reforms have had mixed effects on North Macedonia's tax revenues. Some reforms successfully increased tax collection, while others led to revenue fluctuations. According to the Public Revenue Office, VAT contributes over 40% of total tax revenue annually, making it the largest single source of fiscal income (Public Revenue Office, 2023). This can also be confirmed by observing the time series data displayed in Figure 1.

The relatively high dependence on VAT underlines a tax structure that heavily relies on consumption rather than income or corporate profits. This substantial dependence on VAT highlights the need for improving tax efficiency, considering the potential for increasing tax revenues (World Bank, 2024). Looking at the trend and patterns, the share of VAT in tax revenues increased steadily until around 2012, after which a decline is observed, particularly starting from 2015. This decline is attributed to the political instability at that time, which resulted in economic slowdown and reduced domestic consumption in the subsequent years.

The flat tax initially led to a short-term drop in revenue from PIT, but improved long-term compliance and increased foreign direct investment. A study by Finance Think (2022) indicates that foreign investment grew by 15% in the five years following the reform. Rising employment levels and wage growth may have contributed to the higher share of personal income tax over time. However, unlike VAT and

PIT, CIT revenues exhibit more volatility. The reintroduction of progressive taxation in 2019 resulted in revenue decline, as some high-income earners engaged in tax avoidance (see Figure 1).

Figure 1. VAT, personal income tax, and profit tax as a percentage of total tax revenues



Note. Calculations by the author as % of total tax revenues based on data from the Ministry of Finance of R. N. Macedonia

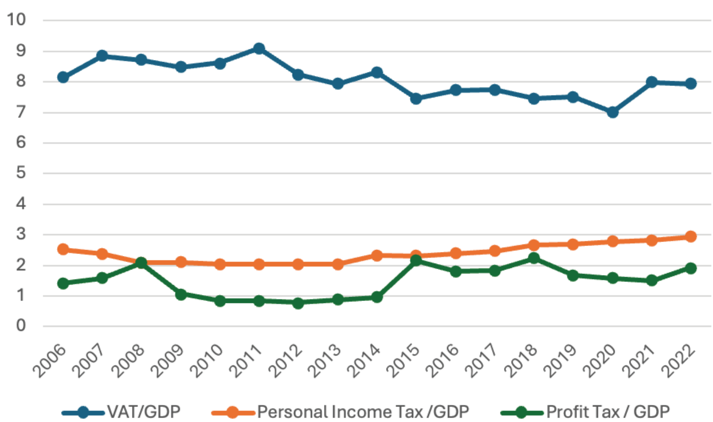
Also, notable declines are observed in 2009 and 2016, which can be attributed to the global financial crisis and political crisis in the country, respectively. Recent efforts to digitalize tax administration have led to a 5% increase in tax revenue collection, according to the Ministry of Finance. These measures help reduce tax evasion and enhance transparency (Ministry of Finance, 2023).

Regarding VAT as a percentage of GDP, one can observe that it remains relatively steady, fluctuating between 8% and 9% for the period 2006-2014 (Figure 2). Surveying the trend, there are some noticeable declines, particularly around

2012 and 2015, where the ratio appears to decrease slightly before recovering. In 2020, there was a deeper drop due to the COVID-19 pandemic, but the ratio picked up again in the following years. Compared to regional countries of the WB6, North Macedonia assembles only 8,1% of VAT revenues as a percentage of GDP in 2023, which is far below the regional average of 12,52% (Table 2).

The ratio of PIT to GDP remains relatively stable, with a slight upward trend over time. From around 2014 onwards, the ratio shows a gradual increase, indicating growing revenue from personal income taxation relative to GDP. Despite the lower PIT rate, North Macedonia collects 3,2% personal income tax revenues as a percentage of GDP in 2023, which is higher than the regional average 2,93% of WB6 (Table 2).

Figure 2. VAT, personal income tax, and corporate income tax as percent of GDP



Note. Calculations by the author as % of GDP based on data from the Ministry of Finance of R.N. Macedonia and the State Statistical Office of R.N. Macedonia

The corporate income tax as a percentage of GDP starts at a low level but exhibits a sizable increase in 2008 (Figure 2). A sharp drop is visible in 2009 and 2010 because of the global financial crisis, after which the ratio remains low until a significant rise in 2015. Afterwards, it fluctuates and in 2023 it reached 2,0% of GDP, which is lower than the regional average, but higher than in Bosnia and Herzegovina, Kosovo, and Montenegro (Table 2).

Table 2. Personal Income Tax Rate and Personal Income Tax Revenues as % of GDP in Western Balkan countries, 2023

Countries	**VAT- Rate**	**VAT Revenues as % of GDP**	**PIT Rate**	**PIT Revenues as % of GDP**	**CIT Rate**	**CIT Revenues as % of GDP**
Albania	20%	9,3%	23 %	2,2%	15%	2,2%
Bosnia and Herzegovina	17%	17,0%	10 %	1,7%	10 %	1,7%
Kosovo	18%	13,8%	10 %	2,6%	10 %	1,9%
North Macedonia	18%	8,1%	10 %	3,2%	10 %	2,0%
Serbia	20%	11,0%	20 %	4,2%	15 %	2,9%
Montenegro	21%	15,9%	15 %	3,7%	15 %	1,6%
WB6 Average	19%	12,52%	14,66%	2,93%	12,5%	2,05%

Note. Compiled from North Macedonia Public Finance Report, World Bank (2024)

As a summary, North Macedonia's tax revenue structure and the fiscal system are vulnerable to economic downturns affected by consumption. The increasing contribution of personal income tax emphasizes a gradual diversification of revenue sources. Meanwhile, corporate income tax revenues remain volatile, potentially reflecting economic cycles and policy changes. These trends indicate the need for an efficient tax strategy that ensures fiscal stability while promoting more sustainable economic growth (World Bank, 2024).

Econometric Assessment

This chapter tries to shed light on the effects of tax reforms on tax revenues collected and fiscal stability of North Macedonia, considering the yearly data for the period 2000-2023. For this purpose, the Error Correction Model (ECM) has been used, which can estimate short-run dynamics while ensuring long-run equilibrium. The general equation that will be used to estimate those effects is as follows:

$$log(Y)_t = \beta_0 + \beta \ log \ X_{it} + \delta ReformDummy_t + u_t$$

Y_t is the dependent variable denoting the logarithm of total tax revenues, while X_{it} is a vector of control variables including the logarithm of real GDP, the logarithm of employment rate, and the logarithm of trade, and *ReformDummy* is the dummy variable capturing the tax reform. is the error term. Additionally, for a robustness check, other control variables will be incorporated in the model, such as FDI and gross fixed capital formation (one by one), to assess the stability of the explanatory variables. These variables are not included in the main model to keep the degrees of freedom higher, as the time series are annual, and every additional explanatory variable decreases the degrees of freedom. is the dummy variable denoting the tax reform, concretely the introduction of the flat tax rate taking the value 0 for the period before its introduction (2000-2006) and one after, counting the period (2007-2023). The short-run equation (Error Correction Term):

$$\Delta \log(Y)_t = \gamma_0 + \sum_{i=1}^{p} \gamma_i \Delta X_{t-i} + \lambda EC_{t-1}$$

Where λ is the coefficient that measures the speed of adjustment to equilibrium and through the following equation is estimated the error correction term which captures the long-run equilibrium relationship between tax collection and other economic variables. It measures how far the system is from equilibrium and determines the speed of adjustment back to equilibrium in response to short-term shocks.

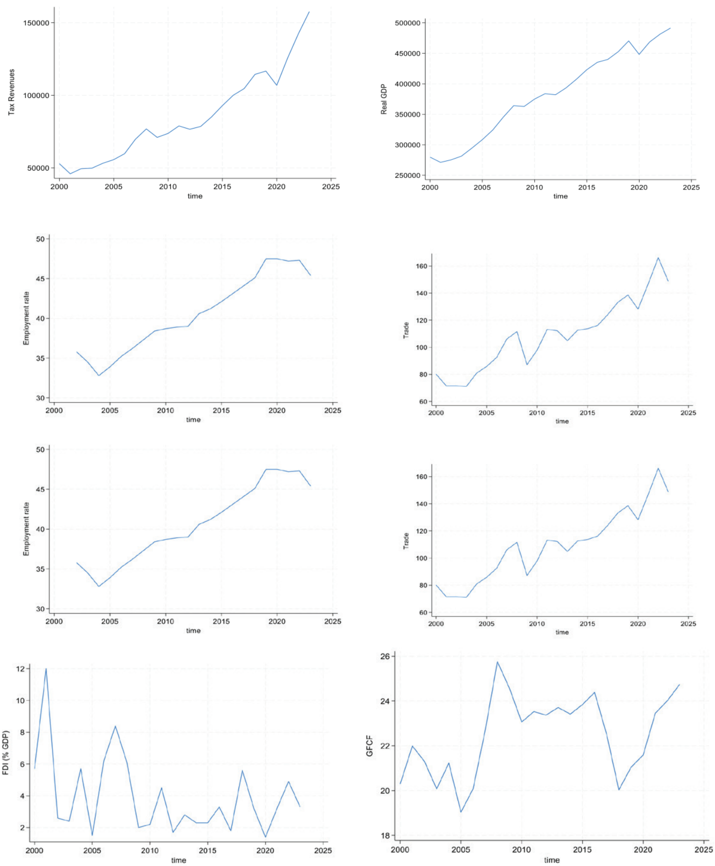
$$EC_{t-1}=logY_{t-1}-[\beta_0+\beta logX_{it-1}+\delta ReformDummy_{t-1}]$$

Data and Variables' Description

The study uses annual data for the period 2000 – 2023, which are provided from the State Statistical Office, the Ministry of Finance of North Macedonia, and World Development Indicators (World Bank). The quarterly data for tax revenues were not available for the period before 2010. Thus, the annual time series is used in the estimation process. The low number of observations may reflect the degrees of freedom and the consistency of the results; however, several tests are performed to ensure the reliability and validity of the model.

Figure 3 represents the time series for the used variables in the econometric models. The first variable is the total tax revenues, then the real GDP, employment rate, trade as percent of GDP, FDI as percent of GDP and gross fixed capital as percent of GDP, respectively.

Figure 3. Variables used in the econometric estimation.



Note. Data from State Statistical Office, Ministry of Finance of R.N. Macedonia, and World Bank

Before proceeding with the ECM model, the stationarity test of the time series is performed, based on Augmented Dicky Fuller (DF) and Philips Perron (PP) tests. The following (Table 3) provides the results of both tests for all variables used in the regression models, considering first the optimal lag length for every variable based on AIC selection criteria. The data that exhibit a trend, the test is adjusted to account for it.

Table 3: Augmented Dickey-Fuller (ADF) and Philip-Perron (PP)

Variables	**Test**	**Test statistics**	**p-value**	**Test statistics**	**p-value**
		Levels		First difference	
Real GDP	ADF	-1,518	0,8230	-3,797	0,0167
	PP	-1,705	0,7485	-4,980	0,0000
Employment	ADF	-2,243	0,4654	-3,060	0,0297
	PP	-2,758	0,2129	-4,380	0,0000
Tax revenues	ADF	1,387	0,9971	-3,718	0,0040
	PP	2,025	0,9987	-5,356	0,0000
Trade	ADF	1,916	0,9986	-3,779	0,0031
	PP	2,946	0,8241	-3,774	0,0032

The results imply that all the variables, such as tax revenues, real GDP, employment rate, and trade, are nonstationary in their levels, exhibiting a unit root, but they are transformed to stationary in their first difference (Table 3).

Empirical Results

Before proceeding with the estimation of the coefficients based on the ECM model, a cointegration analysis is performed using the Johansen test to check if a long-run relationship exists among the variables that exhibited non-stationarity in the levels. The results of the test imply a stable long-run relationship (with only one cointegrating vector) for the combination of variables of tax revenues, real GDP, tax reform, employment rate, and trade. Since the trace statistic is 61,1715 and greater than the 5% critical value of 47,21, the null hypothesis of no cointegrating relationship (rank=0) is rejected. These results suggest that the ECM is appropriate for capturing both short-run and long-run dynamics among these variables. Every other combination of considered variables in Figure 3 resulted in an unstable long-run relationship, since FDI was found to be stationary at the level.

Table 4. Johansen Cointegration Test

Maximum Rank	**Params**	**LL**	**Eigenvalue**	**Trace statistic**	**Critical value 5%**
0	4	83,861315	-	61,1715	47,21
1	11	102,10584	0,82405	24,6825*	29,68
2	16	108,59131	0,46080	11,7115	15,41
3	19	114,43422	0,42677	0,0257	3,76
4	20	114,44708	0,00122	-	-

Regression Results of the Impact of Flat Tax Reform on Tax Collection

The regression results presented in Table 5 show that real GDP positively affects tax revenue in the short run. The coefficient of this variable is highly statistically significant, which was an expected result. Surprisingly, the employment rate has a significant negative coefficient that comprises an unexpected outcome. This coefficient remained negative and stable under additional model specifications by adding other variables in the baseline model, such as FDI and fixed capital. It implies that higher employment may not immediately translate into higher tax collection in the short run, possibly due to tax exemptions for new jobs. Trade also has a significant effect, indicating that it contributes positively to tax collection, though this result was expected. The coefficient of the dummy variable denoting the flat tax reform is positive and statistically significant. Thus, the implementation of tax reforms is associated with a 5,83% increase in tax revenues, suggesting that the reform had a significant and positive impact on tax collection efficiency in the short run.

The coefficient of the error correction term is -0,443 and statistically significant, indicating that 44,3% of the disequilibrium from the previous period is corrected in the current period. This suggests a relatively fast adjustment towards the long-run equilibrium, ensuring that any short-term deviations in tax revenues are corrected over time.

Table 5. ECM results for the effects of tax reform on tax revenues

VARIABLES	Coefficient	Std. Error	t-statistics	p-value
Short-run effects				
	2,592***	0,27210	9,54	0,000
	-0,0274***	0,00649	-4,22	0,001
	0,00109***	0,00025	4,06	0,001
Tax Reform Dummy	0,0583***	0,01730	3,37	0,004
Error correction term				
	-0,443**	0,17110	-2,59	0,035
Model diagnostics				
R-squared	0,859			
F-statistic	24,32			
Post estimation tests				
Breusch-Godfrey Test (p-value)	2,860 (0,0908)			
Breusch-Pagan Test (p-value)	0,30 (0,5848)			
Jarque-Bera Normality Test (p-value)	(0,0631)			

The model explains 85,9% of the variation in tax revenues, indicating a strong fit. Based on the F-statistic (24,32), the model is highly significant overall, meaning that the explanatory variables jointly explain a significant portion of tax revenue changes.

The model can be considered reliable based on post-estimation diagnostic results. Breusch-Godfrey serial correlation test (p = 0,0908) indicates that there is no significant serial correlation in the residuals, meaning that the model does not suffer from autocorrelation issues. Also, the Breusch-Pagan heteroskedasticity test (p = 0,5848) suggests that there is no evidence of heteroskedasticity, confirming that the variance of residuals is constant. Jarque-Bera normality test (p = 0,0631) is slightly above 0,05, suggesting that the residuals are approximately normally distributed, which supports the validity of the model's inferences.

Conclusions

The Republic of Macedonia has experienced a difficult transition period since gaining independence in 1991, facing severe economic, political, and institutional transformations. This phase was accompanied by structural challenges, including hyperinflation, high unemployment, weak institutional capacity, and economic volatility. In response, the country undertook a series of measures and reforms aimed at boosting economic growth, improving governance, and improving fiscal stability. Among these, tax reforms played a fundamental role in the country's economic development. Recognizing the need for a more efficient, transparent, and business-friendly tax system, Macedonia implemented several tax policy changes since its independence, including two major reforms, such as the introduction of VAT in 2000 and the flat tax system in 2007. The last one simplifies taxation, reduces distortions, and attracts investment by setting a uniform tax rate for personal and corporate income.

For assessing the effects of flat tax reform on tax revenue collection and fiscal stability, an Error Correction Model was used in which a dummy variable is incorporated representing the flat tax reform introduced in 2007. This variable emerges as a key determinant of tax revenue dynamics in the short run. The estimated coefficient suggests that the implementation of the flat tax system led to a significant increase in total tax revenues. This finding provides strong empirical support for the argument that the shift to a flat tax regime had a positive impact on tax collection efficiency. The results suggest that despite the reduction in personal and corporate income tax rates to a uniform of 10%, the reform broadened the tax base, possibly due to improved compliance, lower tax evasion, and enhanced economic activity. The flat tax system was expected to simplify tax administration, reduce distortions in the economy, and encourage both domestic and foreign investment. Furthermore, the reform may have contributed to higher labour market participation, particularly by reducing the incentive for informal employment, leading to an overall increase in taxable income. However, the long-term implications of the reform should be interpreted cautiously, as the sustainability of increased tax revenues may depend on other structural factors. The error correction term suggests that any deviations from the long-run equilibrium are corrected at a speed of 44,3% per year, indicating a relatively fast adjustment process. These results support the conception that tax policy reforms can play a crucial role in shaping fiscal performance, with the flat tax reform in North Macedonia serving as an example of how a simplified tax structure can enhance revenue mobilization in the short run. Further research could examine whether these effects persisted over time or if other macroeconomic factors influenced the trajectory of tax revenues in the post-reform period.

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Chapter 5

Evolution of the Macedonian Banking Sector Since 1991: Empirical Assessment of Its Growth and Solvency

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The banking sector had the greatest transformation during the 80s and 90s of the 20th century due to several trends, such as globalization, deregulation, digitalization, and re-regulation. With the momentum of Macedonian independence on the 8th of September 1991, the Macedonian banking sector was directly affected by all these trends, faced with the greatest challenge of establishing an independent National Bank and

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a comprehensive regulatory framework that would be used as key pillars for its further development. Furthermore, globalization and the development of information and communication technology (ICT) have been increasingly encouraging the interconnection of banks, companies, and individuals. Agility, reliability, and the level of automation in the execution of financial transactions have been gaining crucial importance for a long period. On the other hand, deregulation in the banking sector has opened opportunities for diversification of banks' incomes from performing services such as investment banking, bancassurance, financial leasing, factoring, trading with financial derivatives, etc. The priority in banking operations is no longer exclusively money, but the successful management of its assets and the increased trust of customers. In that direction, every bank must approach a timely and adequate strategic assessment, analysis of risks and capital, and re-examination of reliability when introducing new electronic (mobile) products, or artificial intelligence (AI) financial tools. Novelties in the financial sectors by the application of modern technology and Fintech development speed up business processes and increase the need for organizational, structural, and operational adaptability. Banks that do not apply the new technology on time (due to high initial costs or technical problems) risk losing customers to those who are the first to enter the market. Today, re-regulation is a continuous process that facilitates and guides banks and banking in their endless transformation concerning the evolving needs of customers, the introduction of new financial products, and the usage of advanced information and communication technology. Therefore, it is of crucial importance for Macedonian banks to adopt universally acceptable standards and codes of banking operations as well as to apply and monitor internationally recognized experiences and best banking practices.

This chapter is aimed at researching and understanding the growth and development of Macedonian banks and the banking sector, as well as determining their perspectives in the new digital economy. Deep research will be performed to analyze the process of establishment, transformation, growth, and development of the Macedonian banking sector ever since the country's independence. Based mainly on the secondary data, a comprehensive analysis of the Macedonian banking sector will be made. The chapter entails theoretical and applied analyses, divided into five thematic parts, which will answer the following main research questions:

1. How have Macedonian banks evolved and transformed from public to private banks?
2. What was the impact of the country's macroeconomic environment on the growth and development of the Macedonian banks?
3. How did the financial crisis and the COVID-19 pandemic impact the banking sector's performance and capital adequacy?
4. Do legislative changes help the banks increase their solvency and stability?
5. What are the challenges for the Macedonian banks from the process of digitalization and Fintech development?

The chapter finishes by presenting the key findings and conclusions from theoretical and applied research. In the future, to ensure their development, Macedonian banks will increasingly have to focus on building capacities by applying sophisticated technology, training, and data infrastructure, that is, building appropriate strategies to be able to bear the pressure of modern open banking much more easily.

Overview of Macedonia's Banking Sector Before and After Independence

The banking sector in North Macedonia before and after its independence in 1991 is characterized by many changes, varying from legal reforms to regulatory harmonization with structural transformations, like the privatization of banks, introduction of modern banking practices and principles, aligned with the principles of market economy. Before Macedonian independence, its banking system reflected the features of the socialist model that characterized Yugoslavia. More precisely, in the period after the National Liberation War (NOB) up until 1992, the periodization of the banking system, based on the most significant structural changes, is divided into five phases (Trpeski, 2009):

1. Establishment and development of the banking system during the administratively centralized period (1945-1951), characterized by the establishment of the new socialist banking system, in accordance with the changes in the socio-economic system. During these six years, the majority of banks were liquidated, and the most important banks were placed under state control.

2. Banking system development based on self-management conditions (1952-1970). This period of pre-independence transformation of the banking system marks the shift from a mono-bank banking model to a decentralized one. The mono-bank model (from 1952) intended to concentrate all of the financial resources under state control, and only the National Bank of Yugoslavia operated. However, the realized inefficiencies led to reforms in 1954, thereby establishing the National Bank (in 1961), and also specialized banks and communal banks to increase the effectiveness of businesses and local governments.

3. Based on the new laws and constitutional amendments in 1971 and 1972, a new banking system (1971-1976) was set, where the National Bank of Yugoslavia was transformed into a system of national banks, including the National Bank of the Republic of Macedonia (NBRM)[4] in 1973. The Macedonian central bank, managed by a Council and a Governor and appointed by the Republic Assembly, had the main functions of issuing primary loans, supervising banks, and regulating foreign exchange transactions. In 1971, the three major banks- Stopanska Banka - Skopje, Komercijalno-Investiciona Banka - Skopje, and Komercijalno-Investiciona Banka – Bitola were merged into one institution, Stopanska Banka Skopje. Additionally, Jugobanka - Belgrade, Ljubljanska Banka - Ljubljana, and Komercijalno-Investiciona Banka – Bor were still operating during this time period.

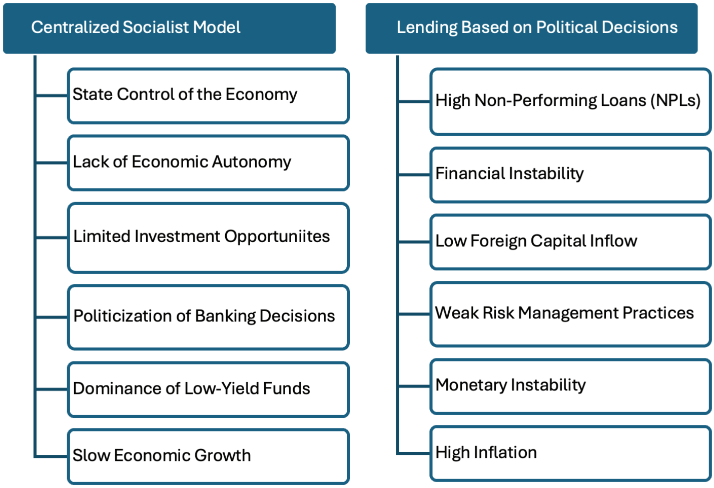
4. Period of transformation of the banking system based on self-managed association of labor and resources (1977-1989),

4 In this chapter NBRM is used as abbreviation for the National Bank of Republic of Macedonia for all the events before 2019, while for the events after 2019 the abbreviation NBRNM is used for the National Bank of Republic of North Macedonia.

which reflects the complex but structured approach of the banking system, driven by the 1974 constitution. With the introduction of the concept of associated labour, a significant shift in the financial system was made aimed at the centralization of social funds, by directing financial resources toward organizations of associated labor (OZT). This led to a highly fragmented banking structure, with different types of banks that serve distinct roles. For instance, internal banks operated within the OZT organizations, managing their financial needs. However, when larger financial support was required, the main banks provided broader funding for OZT activities at a local level. To ensure liquidity and enhance efficiency, associated banks were established, which were focused on improving banking operations. Lastly, banking consortia were formed, which functioned temporarily or indefinitely for the facilitation of long-term investments. By 1979, in Macedonia, there were 1 associated bank, 27 main banks functioning as municipal banks, 3 business units, and 62 bank branches (Trpeski, 2009). The fragmentation of the banking system hurt the economy, which was seen through excessive regionalization, political influence over loan approvals, and prioritization of borrowers' interests over banks' performance, leading to worsening liquidity, efficiency, and profitability of banks. This resulted in the introduction of a new Law on the Fundamentals of the Banking and Credit System in 1985 that required that banks must adhere to the principles of profitability and efficiency when approving loans. Additionally, during 1986-1987, further banking reforms were introduced, encouraging independent banking operations. However, even though these reforms were intended to improve capital efficiency, structural inefficiencies remained, disrupting Macedonian economic growth.

5. Organization of the banking system based on the market economy principles (1990-1992) meant shifting away from state control to capital-driven banking. During this transition, the greatest problems arose from the suboptimal allocation of financial capital (during the 70s and 80s of the 20th century), i.e., capital allocation was a combination of central planning and arbitrary political decisions (Kljusev et al., 2006). In that sense, banks lacked incentives to monitor the credit risk and be financially disciplined, thereby generating a high level of non-performing loans (NPLs). Additionally, the severity of this problem was enhanced by the simultaneous impact of several macroeconomic and microeconomic shocks coming from the distancing of the newly independent republic from the Yugoslav model. Banks faced a systematic financial crisis that occurred in the initial phase of the transformation, defined by liquidity shortages and an increase in insolvency. The financial crisis was further reinforced by the problems of adverse selection and moral hazard, which was seen through hyperinflation, disruption in trade, investment and production, restrictive monetary policies, accumulation of debts (seen through non-monetary settlements between buyers and sellers), company's failure to adapt to market conditions, soft budget constraints, unclear process of ownership transformation etc., which led to disruption in economic activities (see Figure 1). Due to the long years of economic mismanagement in the 70s and 80s in the 20th century, the banking sector in North Macedonia, as well as in the other newly independent countries, was facing many weaknesses, coming from its infrastructure, lending based on political decisions, worsened financial health, and absence of appropriate regulatory framework for a swift transition.

Figure 1: Diagram of Macedonian banking sector weaknesses and their impact on the economy



This pre-independence period, that asked for structural changes in the Macedonian Banking sector, shows the features of banking systems characteristic of central planning economies where: i) banks were financing public companies, thereby used as instruments of state policy; ii) allocation of funds was based on achieving social objectives, not on profit maximization; iii) concentration of financing in certain sectors, leading to economic imbalances.

On a micro level, banks were suffering from the already established operational procedures and outdated practices, a lack of expertise for corporate governance and oversight, thereby increasing the share of nonperforming loans (NPLs) in their credit portfolio, which, on the other hand, hampered households' and investors' trust. (Kukic, 2020) This meant that the new government of independent Macedonia was supposed to respond with stabilization measures and reforms to support the market-oriented banking sector.

Rehabilitation and Privatization of the Banking System

The banking crisis of the 1990s initiated the implementation of several financial stabilization programs aimed at rehabilitating the banking sector. The key components of the banking rehabilitation included the establishment of an institutional framework and supervision, introduction of rehabilitation and recapitalization measures, and finally, the enhancement of financial stability and risk management practices. With monetary independence in 1992, the NBRM was established as an independent central bank, which took over control of the monetary policy and was authorized for bank licensing and supervision. The increased share of NPLs in banks' active and the increase of foreign exchange liabilities, forced the need for rehabilitation and reform of the banking sector during 1995. Therefore, on 16.03.1995, the General Assembly adopted the Law on rehabilitation and reconstruction of part of banks in the Republic of Macedonia (Official Gazette, 14/95). The Law included measures (according to Article 2 and 3) for: i) removal of liabilities from banks' balance sheets based on citizens' foreign currency savings deposited during the SFRY; ii) removal of claims and liabilities from banks' balance sheets based on used foreign loans and iii) restructuring of Stopanska Banka

AD – Skopje, which included its rehabilitation, restructuring and privatization.

The first and second types of measures were focused on linear bank rehabilitation, which included the complete removal of old foreign currency savings and on-demand deposits from commercial banks' deposits, totaling 1.44 billion German marks. Additionally, the second measure was directed at removing banks' balance sheets of claims and liabilities under loans received from foreign creditors (Paris Club), in a total amount of 262 million US dollars, and with later amendments to the law, the list was expanded to include the Zurich Club, in a total amount of 524 million US dollars. These liabilities were covered by issuing bonds or loans fully guaranteed by the Government of the Republic of Macedonia, while the banks would still be engaged in the technical operations of servicing these obligations to depositors.

The third measure, rehabilitation, restructuring, and privatization of Stopanska Banka AD Skopje (which represented 2/3 of the banking system), was intended to stabilize the bank, remove the NPLs, and privatize it under the National Bank supervision and the government. The management of bad loans was undertaken by the Bank Rehabilitation Agency, and at the same time the bank's capital base was being rehabilitated by issuing long-term government bonds (for 6 million denars, with a maturity of 15 years, with monthly interest calculation at the discount rate and its annual payment) (Kljusev et al., 2006). With this recapitalization, the budget expense becomes clearly identifiable, and the state Agency has delegated the right to collect these claims to provide funds to cover the obligations under the bonds.

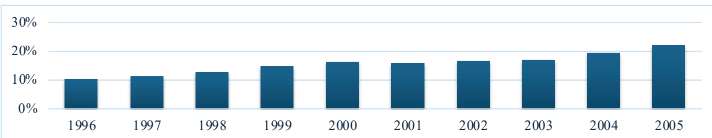
The management of this banking crisis had a centralized approach, which allowed for speed in the rehabilitation, termination of banks' dependence on their insolvent clients and enterprises, and a faster restoration of confidence in the banking system in general. However, the greatest disadvantage of this approach is that it does not allow for the use of the information and personnel advantage of the banks about the state agency for rehabilitation; having sufficient financial and human resources on the side of the Agency for effective management of bad loans; a higher degree of possibility for political influence; higher direct budgetary cost of the rehabilitation than the decentralized approach; and increase in the problem of moral hazard, meaning increase in the expectations for repetitive state rehabilitation of banks.

The privatization of Macedonian banks started in 1997 and was enhanced in 1999 when the Government adopted the Law on Guaranteeing the Investment of a Strategic Investor. Between 2000 and 2003, the three major state banks were sold to foreign and domestic investors, i.e., Stopanska Banka AD Skopje, Komercijalna Banka AD Skopje, and Investbank AD Skopje. The sale to foreign investors led to the infusion of capital in the Macedonian banking system, and most importantly, the introduction of modern banking practices (Cvetkoska et al., 2021), expertise, and signaled a shift towards market-oriented banking practices.

The inflow of foreign capital led to enhanced operational efficiencies, an increase in competition among banks, and an expansion of the range of offerings of products and services. This can be seen through the National Bank's yearly reports, where the trend of increase in banks' capital during 2000 showed an increase in banks' capitalization and capital adequacy. The ratio between the balance and off-balance sheet positions and banks' equity was 19,9%, noticing an increase of 2,6 pp from 1999. In terms of capital adequacy, after amending the methodology for the calculation of the equity capital, the average for the Macedonian banking sector was 36,7%, while the lowest capital adequacy ratio (analyzed by separate banks) was 23% (NBRM, 2001). Additionally, the increase in the deposit potential of banks and their capital position led to a liquidity increase during 2000, where the share of the liquid active in the total active was 45,4%, noting an increase of 6,5 pp from 1999. Finally, out of 22 banks, 18 banks had noted profits, while 4 banks had negative financial results. However, the profitability indicators, i.e., ROAA (return on average assets) and ROAE (return on average equity), were below the international standards, 0,8% and 3,8% respectively, highlighting the further need for increasing efficiency and utilizing the profit potential. This required a further increase in the public and investors' trust, enhancing the regulatory environment and its synchronization with international trends, and finally promoting competition in a stable, sound, and market-driven banking sector.

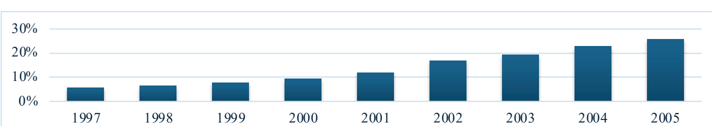
If an additional analysis is made on the conditions in the Macedonian banking sector as of the end of 2005, it can be noted that the banks have an increase in the financial intermediation indicators, in comparison with 2004, thereby being the driver of economic activity through enhanced crediting of the private sector. As shown in Figure 2, it can be seen that on average, a yearly increase of 2,9 percentage points was recorded in the share of bank placements in GDP, reaching 22,3% in 2005, indicating enhanced financial intermediation (NBRM, 2006). As a comparison, this indicator was approximately 15% in 2000 and 12% in 1996, showing the increased financial potential of Macedonian banks in intensifying economic activity.

Figure 2: Share of credit in GDP (in %) (NBRM, 2006)



The increase in lending can be explained by the change in banks' credit policies and focus on retail credit, an increase in the variety of loan offerings, but foremost can be explained by the increase in deposits' share in GDP (see Figure 3), which on the other hand reflects the increased confidence of all economic entities in the banking system. The deposit potential in the Macedonian Banking sector at the end of 2005 has increased by 18,3%, reaching 78.511 million. denars, with household deposits share being 68,9%, companies' share of 28,7%, and 2,4% share in total deposit potential belonging to non-financial, non-profitable, and other entities (NBRM, 2006).

Figure 3: Share of deposits in GDP (NBRM, 2006)



Despite the large volume of activities, Macedonian banks in this period (2004-2005) were characterized by relatively high solvent and liquid position, i.e. at the end of 2005, compared to 2004, the liquidity of the banks increased by 1,7 times, while the level of banks' capital adequacy, was significantly higher than the legally required minimum level of 8%. Finally, banks' profitability was overcome in 2005 with a calculated ROAA of 1,32% and ROAE of 8,1%. The positive trend in the profitability of the banks reflected the increased level of total income realized, as well as the increased cost efficiency of the banks.

Growth and Stability of the Macedonian Banking Sector

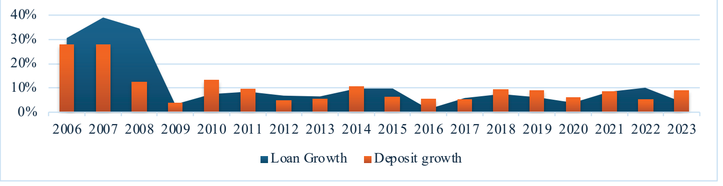
The Macedonian banking sector has had significant growth and stability since its independence, supported by economic liberalization efforts, i.e., privatization of state-owned financial and non-financial institutions, the introduction of new banking laws and laws on investments, taxation, and trade, and finally, the promotion of foreign direct investment. Empirical evidence shows that FDI in North Macedonia was used as the main instrument for the establishment of new companies, increasing employment, trade openness, and economic development. (Dobrota et al., 2021; Saiti & Trenovski, 2021). Furthermore, market liberalization resulted in greater foreign investment in the banking industry, and by the end of 2003, direct and indirect state control of bank capital had fallen to 13%. Foreign ownership accounted for 48,6% of total bank capital, mostly from adjacent countries, resulting in increased competition, efficiency, and the adoption of modern banking practices (EBRD, 2004). To bring Macedonian legislation into compliance with international norms, especially those established by the Basel Accords, new banking laws were passed, out of which the most important are the Law on Banks (introduced in 2007 to allow for alignment with Basel II and Basel III standards); and the Law on National Bank of Macedonia (introduced in 2002) and the Law on National Bank of North Macedonia (2010) directed at enhancing the NBRM's supervisory role.

These changes promoted trust in the banking sector by emphasizing risk management, capital sufficiency, and customer protection. The national bank was strengthened by taking on a more active role in the banking industry supervision. Simultaneously, the financial system became more stable overall as a result of the implementation of strict stress testing, enhanced supervision, and guaranteed adherence to revised capital requirements.

From 2006 onwards, the Macedonian banking sector continued to develop dynamically, with a significant increase in deposit potential, reaching 29,4% of GDP (i.e., 3,5 pp increase compared to 2005). The growth of the deposit base, the expansion of financing sources for banks, increased competition, and positive perceptions of overall economic activity enabled further growth in the supply of credit, which reached 26,1% of GDP, an increase of 3,8 percentage points compared to the previous year (NBRM, 2008). This reflects the dynamic and resilient development of the banking sector, followed by a decrease in NPLs, improvement in credit quality indicators, and expansion of bank credit.

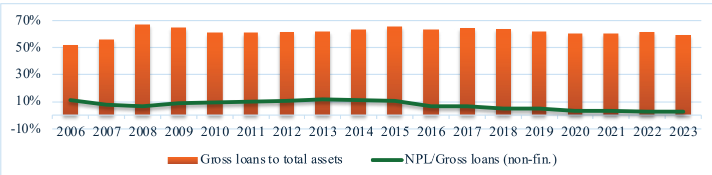
The period from 2005 to 2023 shows a mirror in the deposit and loan growth rates, showing a generally positive correlation, but at the same time shows the influence of external factors such as the financial crisis, political crises, COVID-19, and economic cycles (see Figure 4).

Figure 4: Loan growth (y-o-y in %) vs. Deposit growth (y-o-y in %) (NBRM, n.d.)



During these challenging periods, the banking sector exhibited stability and resilience. Overall, during this period, both trends show growth; there are significant differences in the annual growth rates. For instance, in the period between 2005 and 2007, there was a dynamic phase in financial intermediation, showing how banks and borrowers are benefiting from favorable macroeconomic conditions. Between 2008 and 2009, due to the economic slowdown and the impact of the financial crisis, in terms of decrease in loan demand and increased cautiousness of financial institutions, deposits had the lowest growth rate of 3,85%, while the loan growth rate decreased to 3,46% in 2009. From 2010, deposit and loan growth rates started recovering, but not at the same pace. Even though deposits grew at a higher rate during 2011 and 2012, in 2012 and 2013, the loan growth rate overcame the deposit growth rate, reaching its peak in 2014 at 9,92%, when the economy stabilized and banks were more secure and confident in their ability to manage risks when lending. From 2015 to 2020, both rates for deposit and loan growth were lower than in previous years, with the loan growth rate at its lowest level (1,26%) in 2016, reflecting slower economic activity. However, by 2022, the loan growth rate increased to 10,14%, and in 2023, it slowed to 4,27%, indicating stabilization in the post-pandemic recovery period.

Figure 5: Liquidity and credit exposure ratios (NBRM, n.d.)



The data shown in Figure 5, for the period between 2006 and 2023, is used for analyzing the liquidity position and the credit risk exposure by using the gross loans to total assets and NPLs as a percentage of gross loans, respectively. The highest peak of 67% was the liquidity indicator in 2008, showing the period of credit expansion (between 2006 and 2008). However, during the 2009 financial crisis, this ratio declined to 61% and from 2010 onwards reflected cautious lending and a prudent liquidity management strategy. The credit risk exposure, i.e., the quality of the loan portfolio and risk of loan defaults, is shown through the NPL ratio, where in 2006 it is at 11,2% reflecting increased credit risk. Even though it declined in 2008 to 6,8%, the financial crisis in 2009 led to an increase to 9,1%, which remained above 9% until 2015. Starting from 2016, there was a turning point, where this ratio fell to 6,6% and continued dropping to the historical lowest level of 2,8% in 2023, signaling improved risk management practices and asset quality.

Figure 6: Banking system performance (measured by ROAA) and economic growth (measured by GDP growth rate) (NBRM, n.d.)

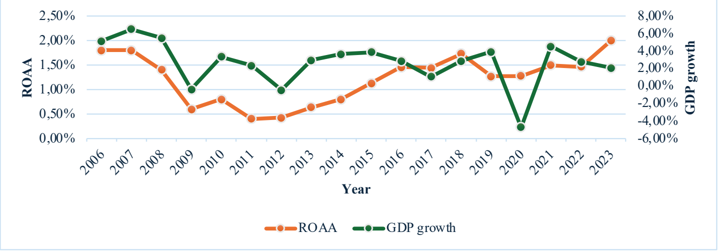


Figure 6 provides insights into the banking sector's profitability and its response to macroeconomic fluctuations, in terms of GDP growth rate. It can be noted that during 2006-2007 ROAA (1,80%) reflected a profitable banking sector corresponding to the robust economic growth (5,1% to 6,5%, respectively). Due to the global financial crisis, in 2008, GDP growth rate declines, also reflecting and decline in banking sector's ROAA, leading to the sharpest decline in 2009 (0,60%), coinciding with economic contraction (-0,36%), indicating reduced lending activity, higher provisions for bad loans, and weaker financial intermediation. From 2010 to 2020, ROAA improved to 0,80% (in 2014), peaking at 1,73% (in 2018), aligned with moderate GDP growth and improvement in credit conditions. Even though the COVID-19 crisis in 2020 led to economic contraction (-4,69%), the banking sector remained resilient, with ROAA at 1,28%, suggesting strong capital buffers and risk management practices.

Additionally, during the COVID-19 pandemic, like many central banks in advanced economies, NBRNM rapidly responded by developing and implementing various tools to ensure access to ongoing lending to the private sector and to maintain banks' liquidity. Measures undertaken by the NBRNM were aimed at relaxing the financial conditions and referred to (NBRNM, 2020):

- Reduction in interest rates, treasury bills, and decisions to reduce the amount of mandatory reserves. The reference interest rate was reduced to its historic lowest level from 2,25% to 1,25%.
- Enabling direct financial support for small and medium-sized enterprises that become insolvent due to the coronavirus crisis,
- Temporary changes in crediting methods and conditions,
- Reduction of interest rates for late payment of tax obligations, as well as interest for excessive subscriptions,
- Extending the deadline for the delivery of bank financial statements with an objective assessment of their liquidity,
- Zero interest rate for loans taken from the development bank and others.

Through the monetary instrument - open market operations, NBRNM released, in total, the amount of 15 billion denars (around EUR 250 million), which was expected to provide further support to banks' credit activity, and to have a greater impact on their performance. (Danevska, 2020) Undertaking counter-cyclical action, by injecting liquidity into the economy and loosening the monetary policy, NBRNM on the micro level managed to reduce or prevent the bankruptcy of companies (especially banks and financial institutions), reduce unemployment, that is, managed to maintain the level of employment within a certain limit. On the macroeconomic level, such expansionary monetary policy (undertaken at that time by almost all central banks in the world) led to higher inflation in the economy. During the COVID-19 pandemic, only one Macedonian bank ceased to operate. Namely, due to previously identified weaknesses in the risk management process on 12 August 2020, the NBRNM has decided to open bankruptcy proceedings against one medium-sized Macedonian bank (Eurostandard Banka AD Skopje). The main reason for such action was the bank's insolvency for a longer period (even before the pandemic). As stated in the Decision of NBRNM, the capital adequacy ratio of the Bank was lower than a quarter of the one prescribed in Article 65 of the Law on Banks of the Republic of North Macedonia (NBRNM, 2020). All other banks have successfully managed with the pandemic and from 2021 to the present day, have achieved a growing rate of ROAA with a positive upward trend.

The post-pandemic recovery, 2021-2023, saw further improvement, with ROAA reaching 2,00% in 2023, marking the highest profitability level in nearly two decades, despite slowing economic growth.

From the above data shown and descriptive analysis, it can be noted that the Macedonian banking sector has shown dynamic growth and resilience from 2006 to 2023, with increasing deposits and credit supply, despite the external shocks such as the financial crisis (2008), the political instability (2014-2015), and COVID-19 (2020-2021). While credit risk exposure improved significantly, reflected in the declining share of NPLs in total active, and profitability reached its highest level in 2023, fluctuations in loan and deposit growth rates surely mirrored economic cycles and macroeconomic conditions.

Banking Regulation and Basel Standards in North Macedonia

In North Macedonia, banking regulation is anchored in the Law on the National Bank and the Banking Law, with the National Bank of the Republic of North Macedonia (NBRNM) serving as the supervisory authority. The country has progressively integrated Basel standards into its regulatory framework to align with the best international practices. This alignment reflects Macedonia's commitment to building a resilient banking sector capable of withstanding financial pressures, with significant progress noted in risk and capital management systems. Following the legal regulations and regulatory requirements, Macedonian banks have made significant progress in developing the processes of risk and capital management. From the conducted research by Stanoevska et al. (2023), according to which 100% of the banks responded positively, it is evident that all Macedonian commercial banks have established an adequate risk management system, i.e., special practices (responsibilities, policies, and controls) for risk management. Regulatory requirements concerning risk management are defined in the Risk Management Decision issued by the NBRNM and published in the Official Gazette since 2011.

Banking laws, regulations, and supervision implemented by the NBRNM, as presented in Table 1 below, are in compliance with the Basel standards recommendations for calculating capital requirements covering risks and conducting supervision of banks. The large compliance of the Macedonian legislation with Basel standards is confirmed by the Financial Sector Assessment Program (FSAP), which is a joint program of the by the IMF and the World Bank (WB) for Financial System Assessment (FSA) of the country. Moreover, according to the assessment conducted by the European Banking Authority (EBA) and adopted by the European Commission (EC) on 1st October 2021, Macedonian banking regulation and the manner of conducting supervision of banks are equivalent to those implemented in the EU. North Macedonia is among 26 countries in the world (including the US, Canada, Japan, and New Zealand) that meet these standards (EBA, 2021). This is another confirmation that domestic regulation and supervision contribute to the stability and integrity of the financial system, efficient and adequate protection of the users of financial services, cooperation between all participants in the financial market, independence, efficient supervision, as well as efficient implementation of international standards. This positive assessment provided by EBA facilitates the access of domestic institutions to the international financial market, cooperation with the supervisory bodies in the EU, and brings advantages in conducting national monetary policy.

Table 1: Compliance of the Macedonian Banks with Basel Standards

Basel I (1988)	Macedonian banks have adopted principles to enhance their resilience against credit risks.
Basel II (1999-2004)	Starting from 2010, Macedonian banks gradually aligned with Basel II, improving internal risk assessments and regulatory reporting mechanisms (NBRM, 2010). However, challenges persisted in fully implementing advanced risk modeling techniques due to regulatory limitations and the need for enhanced data analytics capabilities.
Basel III (2008-2010)	Since 2017, Macedonian banks have made significant strides in adopting Basel III provisions, particularly in improving capital adequacy ratios (NBRNM, 2020).
Basel IV (2017-2028)	Further alignment is needed to enhance risk management and meet future regulatory changes under Basel IV.
Basel V **(2023 - working on the new concept**)	NBRNM is working to mandate real-time regulatory reporting of risk and capital assets.

Since December 2016, amendments to the Banking Law and regulations on the methodology for determining the capital adequacy have led to the harmonization of the Macedonian standards with Basel III. These updates introduced stricter capital definitions, protective capital buffers, and liquidity requirements, aligning with European Regulation 575/2013 on prudential requirements for credit institutions and investment firms. The most significant change to the Law refers to the obligation for banks to maintain the so-called protective layers of capital. The main objective of the protective layers of capital is to provide increased protection of the banks' solvency position, especially in conditions of a significant increase in the losses realized.

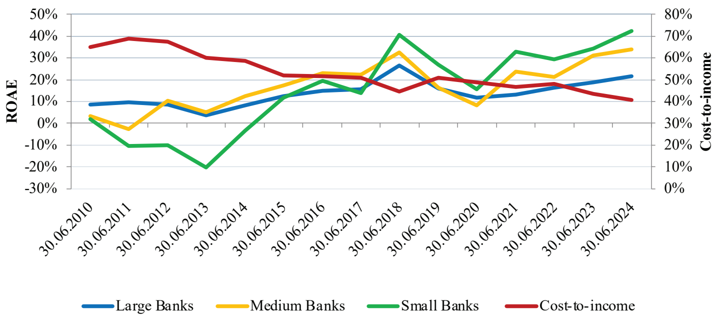
Impact of Basel Standards on Solvency and Stability of the Macedonian Banking Sector

Today, Macedonian banks apply Basel III standards for own funds (e.g., Common Equity Tier 1 and Additional Tier 1 capital), capital buffers, leverage ratios, and the Liquidity Coverage Ratio (LCR), while using Basel II's standardized approaches for risk-weighted assets (RWA). According to the existing Macedonian regulation, the adequate level of capital required to cover the risks with Macedonian banks is the sum of the capital required to cover the:

- credit, currency, operational risk, as well as market risks;
- settlement/delivery risk;
- risk of the other contracting party and the risk of price changes of goods;

If the impact of the Capital Accords (Basel II and Basel III) on the Macedonian banking sector efficiency is analyzed, it can be seen from Figure 7, that three main downturns of efficiency (measured by cost-to-income ratio, for banking sector) and profitability (measured by return on average equity - ROAE, for each group of banks) are highlighted in all three groups of banks. There was a significant decline in the indicator ROAE, especially in the small group of banks from 2011 to 2013 because of Basel II implementation, from 2016 to 2017 because of the Basel III standards implementation, as well as in 2020 due to the COVID-19 pandemic.

Figure 7: ROAE and cost-to-income ratio by groups of banks (NBRNM, 2024)

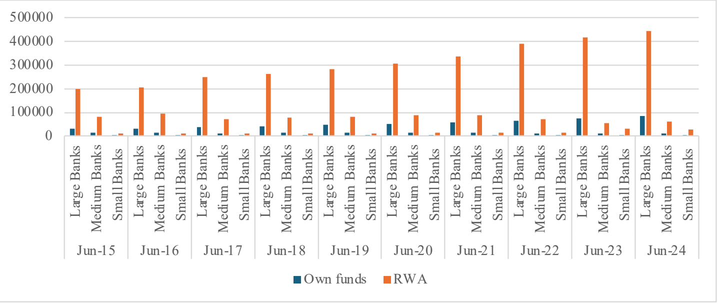


Also, the amendments in the legislation due to the implementation of Basel II (2011-2013) and Basel III (2016-2017) had an enormous impact on capital position, especially among the small and medium Macedonian banks. Capital Accords led to enhanced capital strength and improved risk management practices in banking operations, but at the same time, they entail significant additional costs for banks during the implementation process. Their practical application continuously requires:

- A progressive increase in the bank's capital strength;
- Extensive preparation and expertise (know-how) for financial regulators, supervisory authorities, and banks;
- Significant legal and regulatory changes;
- Adoption of modern technology; and need for
- Intensive international cooperation between relevant authorities.

Macedonian banks meet the prescribed rules under Basel III for the capital adequacy ratio, in terms of both capital quality and quantity. Data from June 2024 reveals that large banks, which dominate the sector with 81,85% of own funds and 82,85% of RWA, have significantly strengthened their solvency positions since 2015, with own funds increasing by 175,97% and RWA by 124,55%. This resilience contributes to the stability of the broader Macedonian financial system, reducing the risk of systemic crises. In 2020, the same five large banks covered 75% of the Own Fund and 75,21% of the RWA of the total Macedonian banking sector. These data confirm that the consolidation and dominance of the five largest banks are increasingly strengthening. Analyzed in terms of own funds and risk-weighted assets, it can be concluded that a light weakening of the solvency position is noticed in the group of medium-sized banks, primarily as a result of decreased risk-weighted assets and a slight decline in own funds. However, in general, the own funds of all Macedonian banks are quite satisfactory with an increased tendency over the last decade (see figure 8). The increase in the solvency, especially in the group of small banks, is primarily due to recapitalization through investing in Tier I (the increase in capital instruments in CET 1) at the end of 2022.

Figure 8: Capital Adequacy Structure by Groups of Banks (Own Funds vs. Risk Weight Assets in million denars) (NBRNM, 2025)



Regarding the leverage ratios introduced by the Basel standards as an additional instrument for the protection of the banks' level of capital, all Macedonian banks are above the proposed minimum leverage ratio of 3%. Namely, as of June 30, 2024, Macedonian banks report leverage ratios of 12,2% for large banks, 11,3% for medium, and 11,4% for small banks, reflecting low leverage and greater stability (NBRNM, 2024).

The increase in the regulatory requirements implies a huge burden on banks, leading to a reduction in their current profitable activities and making them less cost-effective. As Stanoevska (2020) has emphasized, unlike the banks from BCBS member states, Macedonian banks were faced with the need to quickly adapt to the new legislation requirements in much shorter periods. As a result, in the short run, the Capital Accords implementation harmed banks' profitability. However, in the long run, there is still a trend of increasing the ROAE and strengthening the solvency position in all three groups of Macedonian banks. The banking system's solvency is expected to continue improving, especially because NBRNM has decided to increase the countercyclical capital buffer, which will begin to be implemented in the coming period (NBRNM, 2024).

The adoption of Basel III standards has especially profoundly enhanced the solvency and stability of Macedonian banks through several key mechanisms:

- **Requirements for High-Quality Capital.** Basel III mandates a minimum Common Equity Tier 1 (CET1) ratio of 4,5%, ensuring banks hold high-quality capital to absorb losses. Macedonian banks started to calculate the CET 1 ratio from March 2017. As of June 2024, at the banking sector level, it is 18,2%, far exceeding the minimum, indicating robust solvency of the Macedonian banking sector.
- **Imposing Capital Buffers.** Requirements such as capital conservation buffer and countercyclical buffer compel banks to maintain additional capital during economic upturns, which can be utilized in downturns, enhancing stability.
- **Calculating Risk-Weighted Assets.** By tying capital requirements to the riskiness of assets, Basel standards encourage prudent lending and investment, reducing the likelihood of insolvency.
- **Calculating Leverage Ratio (**the rate of indebtedness measured as the ratio between the share capital and the total balance sheet and off-balance sheet bank assets, set at a minimum of 3% limits of excessive borrowing). On average, Macedonian banks report leverage ratios of

12% at the banking sector level, reflecting low leverage and greater stability.

- **Imposing Liquidity Standards:** The Liquidity Coverage Ratio ensures banks have sufficient high-quality liquid assets to meet short-term obligations, while efforts are underway to introduce the Net Stable Funding Ratio (NSFR) for long-term liquidity. These measures mitigate liquidity risks, a key factor in bank stability.

The Basel framework, particularly Basel III, has enhanced the solvency and stability of Macedonian banks to withstand financial shocks by strengthening capital requirements, introducing stringent risk management measures, and establishing new liquidity requirements. Today, the banking sector maintains its stability and reliability in operations. In 2024, the banking system's profit increased by 23% (the rates of return on average capital and reserves reached 20,2%), with net interest income making the largest contribution, which was higher by almost 15%. Capital adequacy of 19% reached one of the highest levels in the past two decades, contributing to greater resilience in the banking sector. Hence, 10% of the funds remain free, above the required minimum level, and together with protective layers of capital occupy around 37% of the total own funds of the banking system that can be used to address challenges of different nature and intensity (NBRNM, 2024).

Empirical Evidence on the Impact of the Macroeconomic Environment on the Macedonian Banking Sector

From the data and descriptive analysis shown in the previous parts of this chapter it can be noted that the Macedonian banking sector has shown dynamic growth and resilience from 2006 to 2023, with increasing deposits and credit supply, despite external shocks such as the financial crisis (2008), the political instability (2014-2015), and COVID-19 (2020-2021). While credit risk exposure improved significantly, reflected in the declining share of NPLs in total active, and profitability reached its highest level in 2023, fluctuations in loan and deposit growth rates surely mirrored economic cycles and macroeconomic conditions. Multiple regression analyses were employed to determine the impact of the macroeconomic environment, measured by economic growth, i.e., GDP growth rate, inflation, unemployment, political stability, absence of violence/terrorism, and government effectiveness, on the banking sector's financial performance from 2006 to 2023. The regression model included secondary data derived from publicly established reports by the National Bank of the Republic of North Macedonia and the World Bank, as shown in Table 2.

Table 2: Description of Variables Used in Multiple Regression Analysis

Variables	**Measurement**	**Source**
Dependent variable		
Return on average equity **(ROAE)**	ROAE = Total Equity/Total Average Assets Used as a measure of the profitability of the banking sector.	NBRNM
Independent variables		
GDP growth rate **(GDPgr)**	Y-o-y growth rate of GDP in % based on 2015 constant prices. This value is used to capture the effect of current economic conditions on current banking profitability.	WB data
Inflation **(InF)**	Annual % change in CPI. Current or lagged value in the past period is used to present the effect of price changes on current banking profitability, through interest rates, customer behavior, and loan repayments.	WB data

Unemployment (**UnM)**	% Share of the labor force that is without work but available for and seeking employment in the total labor force. This variable intends to reflect the labor market conditions from current and previous periods and their potential impact on the banking sector, considering that high unemployment can affect current banking profitability through loan demand and repayment capacity.	WB data
Political stability and absence of violence/ terrorism **(PsAvt)**	Aggregate indicator, ranging from -2,5 to 2,5, reflecting the current perceptions of the likelihood of political instability and/ or politically motivated violence, including terrorism, where 2.5 indicates high political stability and absence of violence/terrorism, which affects	WB data

Government Effectiveness **(GE)**	Aggregate indicator, ranging from -2,5 to 2,5 reflecting the current perceptions of the government in terms of quality of public services, civil services and the degree of government independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies, where 2,5 indicates high level of government effectiveness.	WB data

Based on empirical evidence from the conducted multiple regression testing, the results show that the model (see Equation 1 and Table 3) is very well-fitted with $R^2 = 0,8470$ and is statistically significant at 1% level. The mean VIF value of 3,88 indicates that on average, the predictors in our model do not exhibit severe multicollinearity.

Equation 1: Regression model

$$Y_t=\beta_0+ \beta_1\ GDPgr_{1t}+ \beta_2\ InF_{(t-2)}+\beta_3\ UnM_{(t-2)}+ \beta_4\ PsAvt_t+ \beta_5\ GE_t+ \epsilon$$

Table 3: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0,9203	0,8470	0,7705	0,1988	2,36
a Predictors: (Constant), GDPgr, InF, UnM, PsAvt, GE					
b.Dependent Variable: ROAE					

The results for the regression coefficients (see Table 4) show that the banking sector in North Macedonia had a statistically significant impact coming from all the observed predictors, where:

- **GDPgr** had a positive influence, statistically significant at the 5% level, i.e., a 1-unit increase in GDP growth rate was associated with a 0,610 increase in ROAE, under the assumption that other variables remain constant.
- **InF** had a negative and statistically significant influence (at 5% level), i.e., a 1-unit increase in two years lagged inflation was associated with a 0,003 decrease in ROAE, holding other variables constant.
- **UnM** with a statistical significance of 1% had also negative influence over the banking sector's profitability, i.e., a 1-unit increase in the previous two years unemployment was associated with a 0,008 decrease in the current year ROAE, holding other variables constant.
- **PsAvt** had negative and statistically significant (at 10% level) banking sector ROAE, where 1 unit increase in this aggregate indicator was associated with 0,067 decrease in ROAE, holding other variables constant, or 1 unit decrease in political stability, such as destabilization

or overthrowing by unconstitutional or violent means, including politically-motivated violence and terrorism, has a positive effect on the banking sector ROAE, while holding other variables constant.

- **GE**, i.e., government effectiveness, had a positive and statistically significant impact (at 1% level) on the ROAE, where a 1 unit increase in the perception of the government's ability to implement policies and deliver public services, i.e., government effectiveness, is associated with a 0,4 increase in ROAE, holding other variables constant.

Table 4: Regression Coefficients

Independent variables	**GDPgr**	**InF**	**UnM**	**PsAvt**	**GE**	cons	
Dependent variable **ROAE**	0,610 (0,213) **	-0,003 (-0,002) **	-0,008 (0,002) ***	-0,067 (0,031) *	0,4 (0,688) ***	0,686 (0,214)	
Mean VIF							3,88
Notes: Standard errors are reported in parentheses, and *, **, *** indicate significance levels of 10 %, 5 %, and 1 %, respectively.							

Challenges from Digitalization and Fintech Development

Throughout this transformation, stabilization and growth of the Macedonian banking sector were crucial, with the regulatory frameworks established by the central bank and supportive government policies being crucial. North Macedonia's financial system is bank-based and conservative, characterized by banks' significant role in financial intermediation and economic activities. The Macedonian banking system, belonging to the European Continental model, consists of universal banks that may offer commercial and investment banking services. Moreover, given the stage of financial development that corresponds with economic development, it means that Macedonian banks are primarily focused on commercial banking activities, i.e., they follow a traditional banking model. Additionally, the banking sector in North Macedonia is characterized by a significant presence of foreign capital, i.e., a continuous stable increase is noted, whereas as of June 2024, foreign capital's share in the banking system is 78,9%. The entry of foreign capital into the Macedonian banking sector has had several significant impacts, such as the increased competition in terms of better services and more competitive pricing for banking (Cvetkovska & Cikovik, 2017), introduction of advanced technologies and new banking products (Stanoevska, 2020), improved efficiency and profitability and finally consolidation in banking system and reducing the number of banks while increasing the quality and variety of services (Cvetkovska & Cikovik, 2017). This can be seen through the increase in profitability and efficiency indicators on the banking level, increased digitalization, and the variety of services when supplying the banking market.

From this standpoint and by looking towards the future, the banking sector in North Macedonia is challenged with further transformations requested by technological disruption and shifts in consumer behavior. On a global scale, information and communication technology has been redefining financial services, starting from 1967 (first ATM installed), the establishment of the first online-only banks during the 90s in the 20th century in USA, the introduction of the Open banking and PSD2 directive in 2008, and Bitcoinv1 in 2009, the introduction of Google wallet (2011) and Apple pay (2014), and the introduction of the BaaS model (Banking-as-a-service) which led to the establishment of digital-only banks. Not going closer to the present day, and by comparing the transformation that already occurred in developed countries with the state of the Macedonian banking sector, it can be stated that North Macedonia lags behind. The two key drivers of Fintech Innovation (Financial Stability Board, 2019), i.e. advanced technology and changes in consumer preferences, did not have the assumed impact as in developed economies, due to the lagged implementation of *legislation* that allows for entry of Fintech companies into the banking sector, secondly due to the consumers being reluctant to use digital banking services, especially those coming from older generations. In other words, even though E-banking is important for Macedonian customers, their lack of knowledge in this area and the lack of banks' pressure and encouragement to use E-banking services hinder the process of full embracement of digital solutions on both sides of the banking market. Moreover, until 2022, Macedonian banks' digital products were primarily in the area of payments in domestic and foreign currency, application for loans, and basic operating activities, such as checking balances, changing card limits, and locating nearby ATMs (Danevska et al., 2022). According to the same research conducted by the authors in 2022, Macedonian banks stated that the adoption of digital solutions required high costs in their development and many difficulties.

Based on the empirical evidence on the state of digitalization in the Macedonian banking sector, as of 2022, 67% of banks in North Macedonia are close to greater digitalization, while 33% would engage in Fintech innovation as a long-term commitment, despite the trend towards increased digitalization in operations (Danevska et al., 2022).

Even though the missing in the offerings of fully digital solutions offered by Macedonian banks was reported due to the lagged and appropriate adoption of a regulatory framework that would support and the growth and integration of fintech companies in North Macedonia, as of January 2023, the new Payment Services and Payment Systems Act was enacted. The new Law enabled the modernization of the payment services industry and the entry of new Fintech providers. According to the Law, in the payment ecosystem, the payment institutions, electronic money institutions, and payment system operators are defined. According to Article 11, payment institutions and e-money institutions, in addition to payment services, can also:

- Provide operational and related auxiliary services connected to the provision of payment services (currency conversion, storage services, data storage and processing),
- Manage a payment system, and
- Perform other activities that do not constitute payment services.

Additionally, the electronic money institution may issue electronic money. Moreover, payment institutions and electronic money institutions are not allowed to accept deposits or other repayable funds from the public, nor to advertise the performance of such activities. The funds received by payment institutions and electronic money institutions from the users of payment services do not constitute deposits or other repayable funds. The implementation of this Law opened the door for non-bank financial institutions that use advanced technologies to compete with incumbent Macedonian banks in the payment area, and if following the pattern from the UK, China, later on these Fintechs may compete and in the credit area, mainly focusing on the retail and SMEs lending market.

Additionally, the National Bank of the Republic of North Macedonia has adopted the Fintech Strategy for Financial Regulators - Harnessing the Opportunities and Benefits of Technological Innovation in the Financial System, 2023-2027, in April 2023, focusing on technological innovation, regulatory alignment, and financial inclusion. The four main benefits were considered to be brought up, in terms of:

- lower price for financial services;
- provision of a wider range of products and services
- bringing financial services closer to the customers and
- increase in the efficiency of the regulation and compliance with international practices.

This Strategy is expected to further push the development of the Fintech sector and, more importantly, to significantly influence the business models of traditional banks. (Danevska, 2021) This transformation poses a variety of challenges for the Macedonian banking sector. They can be grouped into the following categories:

1. Institutional capacity of the NBRNM and other regulators in the financial system to monitor and supervise financial ecosystems that comprise traditional/incumbent and non-traditional players such as Fintech startups, payment aggregators, and e-money institutions. This asks for continuous upgrades in supervisory tools, education, and training of regulators in digital finance, and ensuring that both banks and new Fintech entrants follow the same rules, especially in areas like payments, data protection, anti-money laundering, and cybersecurity.
2. The implementation of digital and fintech solutions, pushed by the key drivers, requires robust and secure IT systems and interoperable digital infrastructure. As already mentioned, the conventional banks in North Macedonia have already stated that the costs are high for the full embrace of digital banking. Additionally, with the introduction of Open Banking, as part of the new Law on payments and payment systems, there is a need for seamless API-based integrations, which pose not only a financial but also an operational burden for banks. Additionally, there is underdeveloped interoperability between banking and Fintech systems, which limits the scope of potential collaboration and innovation.
3. The greatest challenge from the transformation towards digital banking and Fintech integration comes from the workforce specialized in multidisciplinary areas, i.e., in banking, financial innovation, data analytics, and cybersecurity. According to Eurostat (n.d), the level of digital skills of Macedonian citizens is comparatively low, i.e. 35% of Macedonian population held only a basic

level or above basic level of digital skills relative to 54% of the population in the EU-27, and 36,75% of the citizens in the Western Balkan countries.

4. Another major challenge lies in consumer adoption and confidence in digital banking and the usage of innovative and creative financial solutions. For instance, the traditional cash payment method still dominates in RNM, especially among the older generation in the market (Dimitrieska et al., 2022). The reasons behind that are due to a lack of Internet, a lack of a digital wallet, and a lack of trust, but also due to the opinion that online payment is complex. On the other hand, even among the youngest generation Z, the reasons for not using online payment are due to distrust in online payment or a lack of a card. The middle generations as reasons for not paying online state the lack of trust in it and lack of sufficient knowledge. In this case, it can be concluded that there is a lack of digital literacy needed to fully engage with Fintech services, but also a lack of financial literacy (Danevska et al., 2022).
5. Despite the opening of the market to non-bank financial institutions, the Fintech ecosystem in North Macedonia is still in its infancy, i.e., financial institutions that use advanced technology are offering "fast loans" in small amounts and to retail clients. Furthermore, the innovations in the payment area cannot be seen. Furthermore, the concentration in the banking sector limits the space for smaller and more agile Fintech entrants to thrive unless initiative-taking regulatory support for competition and innovation is provided.

6. With increased digitalization comes the rising threat of cyberattacks, which can have systemic implications. Banks must invest heavily in cybersecurity infrastructure, risk management frameworks, and incident response mechanisms. Both banks and Fintechs must ensure that they manage sensitive customer data responsibly and securely.

Conclusion

The banking sector in North Macedonia has gone through a substantial transformation, i.e., from a state-controlled system to a market-oriented financial system aligned with the European continental model. Faced with many difficulties and burdens coming out of the post-independence period, the banking sector has been revived by regulatory reforms, increased foreign capital participation, and lagging but steady digitalization. The sector's stability, profitability, solvency, and conservative nature have provided a solid foundation for economic activity and financial intermediation, even in the greatest global economic downturns.

While recent regulatory changes, such as the Payment Services and Payment Systems Act, the Fintech Strategy 2023–2027, and the support by the Central Bank to initiate innovations in the payments area, signal a commitment to modernization, and its digital transformation, the sector still faces many challenges in terms of digital infrastructure, regulatory implementation, consumer readiness, and most importantly cybersecurity. Going forward, North Macedonia's banking sector must fully embrace innovation while ensuring regulatory consistency, financial inclusion, and consumer trust. In the future scenarios of banks and banking ecosystems, effective collaboration between regulators, banks, and Fintech companies will be essential for achieving a balanced and competitive digital financial ecosystem that can drive broader economic growth and regional integration.

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Chapter 6

Three Decades of Agricultural Transformation in North Macedonia: Structural Change, Production Trends and Policy Support (1994–2023)

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Ana Kotevska[2]

Agriculture is a cornerstone of North Macedonia's economy, providing employment, supporting rural livelihoods, and ensuring national food security. The sector is characterized by a dual structure of predominantly small-scale, family-operated farms and a minority of larger commercial holdings. Over the last three decades, the agricultural sector has experienced a complex transition shaped by broader political and economic shifts, as the country moved from post-socialist transition, including the breakup of Yugoslavia, market liberalization, and a series of institutional reforms

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aimed at aligning with the European Union Common Agricultural Policy.

Despite considerable public investment and progressive alignment with EU agricultural frameworks, the sector continues to face persistent structural and productivity challenges, with inefficiencies in land use, technology adoption, and value chain integration. Understanding the trajectory of agricultural sector development in parallel with evolving policy frameworks is essential for assessing policy effectiveness and identifying gaps that hinder sectoral transformation. Studies of this kind provide a necessary evidence base for refining agricultural and rural development strategies, particularly in candidate countries undergoing EU accession. An analysis linking sectoral performance with policy instruments and budgetary commitments contributes to more targeted, equitable, and results-oriented policymaking. Given the importance of ensuring food security, employment opportunities, and sustainable rural livelihoods, as well as climate resilience, regular empirical assessments of agricultural performance and policy impacts are more important than ever.

In that context, this chapter aims to provide a comprehensive overview of the structural changes and policy developments in North Macedonia's agricultural sector over the period 1994–2023. The analysis focuses on three core dimensions: (1) agricultural sector performance trends; (2) structural characteristics of the agricultural economy (including labor, land, and output composition); and (3) the structure and evolution of agricultural policy budgetary transfers. By situating these developments within six key policy periods, this chapter explores the extent to which agricultural policies have addressed sectoral challenges and aligned with broader development and EU integration objectives. Finally, in identifying key turning points in policy design and implementation, and assessing their impacts on agricultural performance, the chapter seeks to contribute to the better understanding of policy-sector alignment and inform future strategic directions.

For this purpose, the chapter adopts a descriptive, time-series analytical approach to examine structural changes, production trends, and the composition of agricultural policy budgetary transfers in North Macedonia's agricultural sector over the period 1994 to 2023. The analysis covers different time spans for various indicators, depending on data availability.

The analysis focuses on a set of key variables, including gross value added (GVA), crop and livestock output, agricultural labour input measured in annual work units (AWU), land use, and total livestock populations. Both nominal and real values are used to capture the effects of price fluctuations and to assess trends in constant terms. To obtain real values, nominal agricultural output and GVA figures were deflated using implicit deflators indices (SSO, 2025), based on the reference year 2020 (2020=100), thus allowing for consistent comparisons across time. The data for this analysis were primarily sourced from the SSO, which provides official national statistics on agriculture, economic accounts for agriculture, and labour input. Additional validation and supplementary data were drawn from Statistical Office of the European Union (EUROSTAT) and Food and Agriculture Organizational Database (FAOSTAT) databases, particularly for standardizing definitions and ensuring methodological coherence.

Data on agricultural policy support, where available, were sourced from the APMC Database (described in more details in Kotevska et al., 2024), which compiles information from multiple institutions including the Agency for Financial Support to Agriculture and Rural Development, the Ministry of Agriculture, Forestry and Water Economy (MAFWE), national budget and expenditure records, among others. Additional data were obtained from published secondary sources (Galev & Dimitrievski, 2001; Dimitrievski et al., 2010), following the same categorization framework applied by the APMC model. The APMC model (Agricultural Policy Measures Classification Tool & Database) was developed specifically for the analysis of the agricultural policies developments in the Western Balkan economies in the process of preparing for European Union accession (Rednak et al., 2013; Volk et al., 2014), and it uses the EU two-pillar concept of policy measures (Pillar I: market interventions and direct payment; and Pillar II: rural development; complemented by the other support to agriculture as Pillar III).

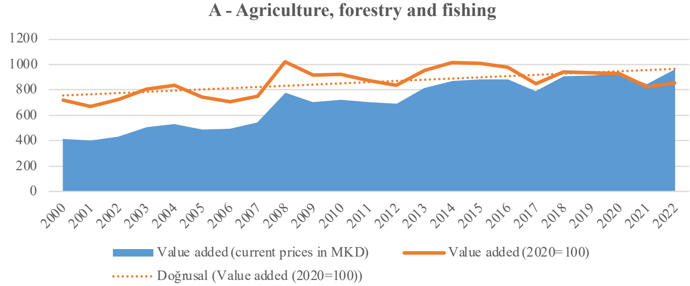
All monetary values were converted to EUR using annual average exchange rates provided by the National Bank of North Macedonia.

Agricultural Sector Dynamics: Structural Challenges, Labour Trends, and Production Shifts

North Macedonia's agriculture plays a key role in the country's economy, as one of the major contributors to the national GVA. Although the sector's GVA has gradually increased, its relative share in the country's GVA has declined, from 11,7% in 2014 to 8,1 % in 2023 (SSO, 2024). This phenomenon is mainly due to the growth of other sectors in the economy, and the sector's contribution to the GVA still remains relatively high, compared to, for instance, that in the EU (1,3% at EU-27 level in 2023, EUROSTAT, 2025).

In nominal terms, value added in the agriculture, forestry, and fishing sector increased from EUR 413 million in 2000 to EUR 964 million in 2022 (Figure 1). However, despite the rising performance of the sector in nominal terms, the sector's real output has stagnated and significantly contracted in recent years, pointing to structural inefficiencies or external shocks affecting its productivity (Aramyan et al., 2024). The dominant small-scale structure, fragmented land holdings, inefficiencies in agricultural value chains, and unfavorable age and education demographics, combined with the impacts of climate change and inadequate infrastructure, contribute to the agricultural sector's vulnerability, affecting both its productivity and long-term sustainability (FAO, 2020; Martinovska Stojcheska et al., 2024; Kotevska et al., 2024).

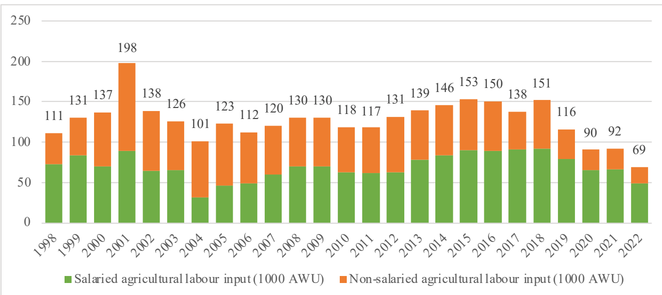
Figure 1: Gross value added of the agriculture, forestry, and fishing sector



Note: Data taken from (SSO, 2025)

Employment in the agricultural sector has seen a marked decline over the years. North Macedonia's agricultural workforce shrank from 127 thousand in 2014 to 60 thousand in 2023, and its share of total employment fell from 18% to 9%, respectively (SSO, 2024). The measurement in AWU confirms this continuous downward trend since the early 2000s, declining from a peak of 198 thousand AWU in 2003 to 69 thousand AWU in 2023 (out of which around one-third is non-salaried agricultural labour). This reduction reflects both structural shifts in the sector and broader rural labour market dynamics. The decline could not be entirely attributed to increased productivity within agriculture, but rather to a migration trend towards more lucrative sectors, urbanization, and demographic shifts, including rural depopulation (Martinovska Stojcheska, 2024; MAFWE, 2022). Salaried labour input, while also decreasing, has followed a more moderate trajectory, stabilizing around 49 thousand AWU by 2023 (Figure 2). Nevertheless, employment quality in agriculture is characterised by low wages, job instability, and poor working conditions. Compared to the average wage in the country, wages in agriculture are lower by 22% (SSO, 2015). Agricultural workers typically face seasonal employment with limited access to social protection, making the sector less attractive, especially for youth. The persistent low productivity poses these challenges and contributes to rural-urban migration. Availability (and cost) of workforce is becoming one of the major hurdles to the sector, raising concerns about the sector's long-term sustainability.

Figure 2: Evolution of agricultural labour (in thousand AWU)



Note: Data taken from Economic Accounts in Agriculture, SSO 1999-2006; SSO, 2025

The ageing workforce is another main issue facing the sector. Only 4% of agricultural holders are younger than 35 years of age, 34% are between 35 and 54, and the majority or 62%, are more than 55 years of age (SSO, 2017). Data from the farm registry shows that the share of young farm holders of registered agricultural holdings up to 40 years of age is about 14% (MAFWE, 2021). Lacking quality of life and lower wages compared to other sectors deter young people from settling in rural areas and engaging in agriculture, seeing the sector as less attractive than other livelihood and professional options (Martinovska Stojcheska et al., 2024).

The structure of agricultural holdings in North Macedonia is primarily characterised by small, fragmented family farms. The average size of these holdings is approximately 1.8 hectares, with around 61% of producers farming less than 1 hectare (SSO, 2017; MAFWE, 2022). Over fifty per cent (eighty-nine thousand) of farms generate an annual output value of less than EUR 2000 (SSO, 2017). This fragmented structure results in low productivity and poses significant challenges in achieving economies of scale (UNCT, 2023; FAO, 2022). Most agricultural holdings are family-owned and individually operated, with a smaller percentage being corporate or cooperative entities (UNCT, 2023; MAFWE, 2022). The legal status of these holdings is largely informal, which restricts access to credit and formal markets.

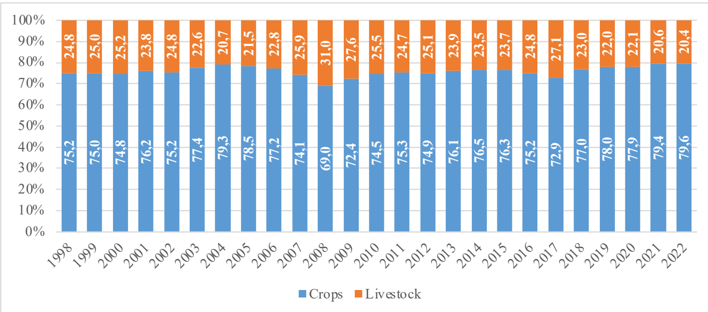
The data on agricultural land use in the Republic of North Macedonia from 2005 to 2024 reveal several notable structural dynamics within the sector (Figure 3). Total agricultural area remained relatively stable over the period, averaging around 1.250 thousand hectares, though a significant dip occurred between 2007 and 2009, largely due to reductions in pasture and cultivated land. Cultivated land shows a slight but steady decline, decreasing from 546 thousand hectares in 2005 to 507 thousand hectares in 2024, driven primarily by a reduction in arable land, which fell from 448 to 408 thousand hectares over the same period. This trend suggests increasing land abandonment, urbanization pressures, and a shift in land use patterns. Perennial crops such as orchards and vineyards remained relatively stable, with modest growth observed in orchards. Pastureland remains the dominant land use category, comprising over 55% of the total agricultural area. The overall stability of total agricultural area masks these underlying shifts, which have implications for productivity, sustainability, and land management policies in the sector.

Figure 3: Agricultural area by category of use (in thousand hectares)

Note: Data taken from SSO (2025)

The composition of agricultural commodities output in North Macedonia has remained consistently dominated by crop production, accounting for approximately 75–80% of total output over the 25-year period (Figure 4). Crop output's share increased from 75,2% in 1998 to 79,6% in 2022, with minor fluctuations. Conversely, the share of livestock output declined steadily, from 24,8% in 1998 to 20,4% in 2022, with a temporary increase observed during the late 2000s, peaking at 31,0% in 2008. This shift indicates a gradual structural reorientation of the agricultural sector toward crop production, possibly reflecting changing market demand, production incentives, or declining competitiveness in the livestock subsector.

Figure 4: Crop and livestock output in total agricultural commodities output

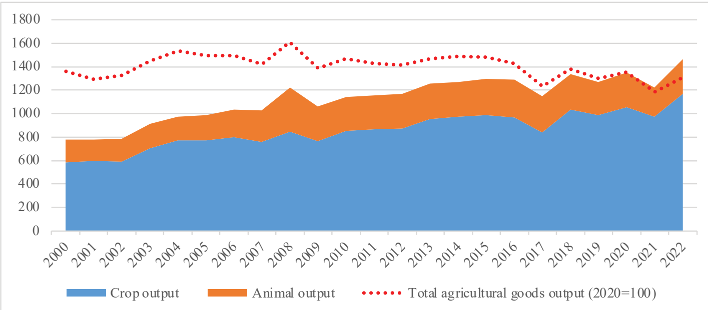


Note. Data taken from SSO (2025)

Crop production has kept a generally upward trajectory over the years, increasing from EUR 563 million in 1998 to EUR 1.167 million in 2022 in current prices, with notable accelerations in the early 2000s and post-2010 period. Animal output demonstrated a slower and more fluctuating pace, peaking in 2008 at EUR 379 million before flattening around EUR 300 million in 2022. The total output of agricultural goods reflects these combined dynamics, growing from EUR 750 million in 1998 to EUR 1.465 million in 2022 (Figure 5).

When adjusted with 2020 implicit deflators, the data suggest that the agricultural sector in North Macedonia has experienced stagnation in real output over the past decade. Although nominal values of agricultural goods output show a clear upward trend, real output peaked as early as 2008, but has since failed to maintain that momentum. In 2022, the total agricultural output in real terms was lower than in most of the years in the previous period. This pattern indicates that the real productive capacity has remained largely flat or even declined in certain years. Such stagnation reflects the structural inefficiencies, the effects of climatic variability, limited technological adoption, as well as the sector's insufficient resilience to external shocks (such as Covid-19 or the war in Ukraine affecting agricultural productivity).

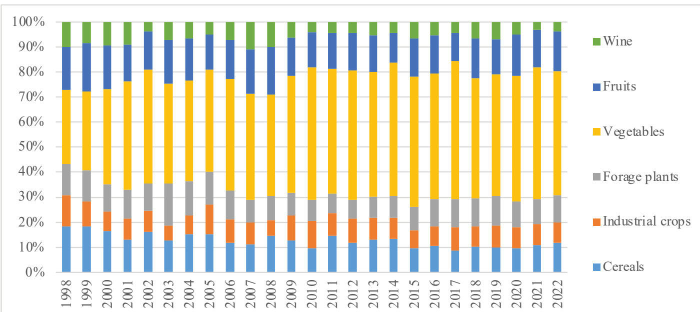
Figure 5: Total agricultural commodities output, by crop and animal output (in million euros)



Note. Data taken from SSO (2025)

Between 1998 and 2022, agricultural output in North Macedonia showed notable variation across crop categories, with vegetables consistently comprising the highest share in value terms (Figure 6). Vegetable output increased steadily and tripled from EUR 167 million in 1998 to EUR 579 million in 2022, reflecting rising demand and comparative advantage. Recent evidence, however, illustrates that although North Macedonia is still a net exporter of vegetables, there is a decreasing trend in the Revealed Comparative Advantage (RCA) index in the period from 2010 to 2022, from 2,7 to 2,2, respectively (Martinovska Stojcheska et al., 2021; Martinovska Stojcheska, 2024). At the same time, Albania significantly improved its vegetable exports and in 2022, with an RCA index of 4,2, had the highest comparative advantage among the Western Balkan economies. As expected, Serbia is the only country with a positive RCA index for fruit in the Western Balkans context, considering the total agri-food trade. Fruit output in North Macedonia had nearly doubled in the past period, but volumes produced are fluctuating significantly, especially due to adverse weather events. The share of cereals in the total crop output has halved over the last decades.

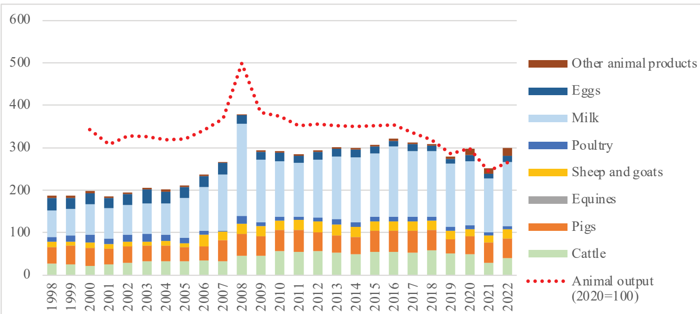
Figure 6: Crop production output value, shares by major crop subsectors



Note. Data taken from SSO (2025)

Output from livestock production in North Macedonia has experienced uneven growth over the past decades, with notable variation across livestock commodities. Milk remains the dominant contributor, with its value peaking at EUR 216,3 million in 2008 following the entry of Swedmilk (Tuna, 2014), before experiencing a significant decline and stabilizing at relatively consistent levels thereafter. Pig and cattle production have followed divergent paths: while pig output remained relatively stable, cattle output grew modestly but declined significantly in 2021. Sheep, goats, and poultry have contributed modestly, with poultry output declining steadily after the early 2000s. Egg production has also declined, falling from EUR 30,6 million in 1998 to just EUR 14,1 million in 2022. When deflated to constant 2020 prices, the real value of animal output peaked in 2008 and has since followed a downward trajectory, reflecting the structural weaknesses in the livestock sector, including reduced herd sizes, limited investment, and vulnerability to market and climate shocks, which have constrained its capacity to sustain growth (Figure 7).

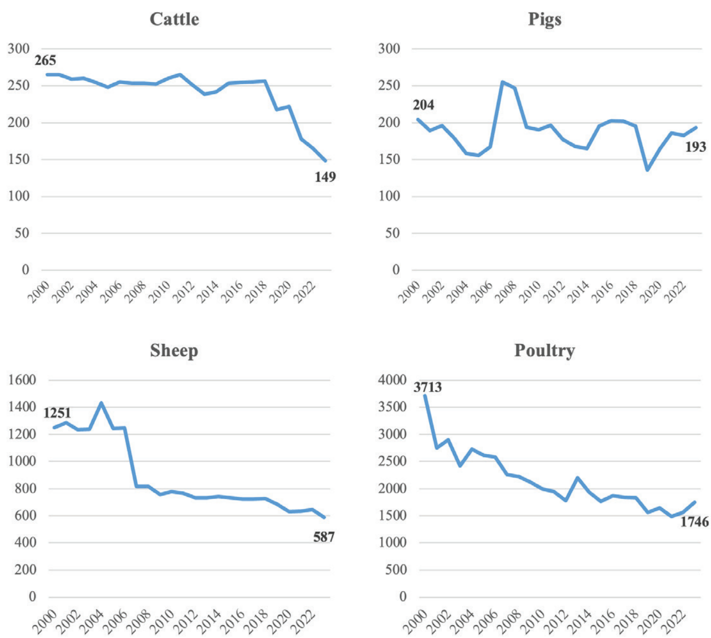
Figure 7: Livestock production output value, by major crop subsectors (in million EUR)



Note. Data taken from SSO (2025)

The livestock population dynamics in North Macedonia reveal major changes in numbers over time. Namely, cattle numbers remained relatively stable until 2018 but have since declined markedly, falling from 256 thousand in 2018 to 149 thousand in 2023 (Figure 8). Similarly, the sheep population—historically one of the most significant—dropped from over 1,2 million in the early 2000s to 587 thousand by 2023. Poultry stocks exhibited a consistent downward trend, halving from over 3,7 million in 2000 to 1,75 million in 2023. These declines, particularly in recent years, suggest reduced profitability in the livestock systems, the effects of rural depopulation, disease pressures, etc. The persistent contraction in animal numbers may pose risks to food security and rural livelihoods if not addressed through targeted policy interventions and investment in modern, resilient production systems.

Figure 8: Number of animals in major livestock subsectors (in thousand heads)



Note. Data taken from SSO (2025)

Agricultural Policy Development: Evolution, Reforms and Alignment with EU

Since its independence, the Macedonian agricultural policy development followed several evolving periods (five to seven years long), each characterized by a specific policy focus, main guiding documents, and policy instruments (Table 1).

Table 1: Development of the Agricultural Policy of the Republic of North Macedonia

<table>
<tr><th rowspan="2">Period</th><th rowspan="2">Main focus</th><th rowspan="2">Main document</th><th rowspan="2">Main policy instrument</th><th colspan="2">Average annual budget (million EUR)</th></tr>
<tr><th>nominal</th><th>real*</th></tr>
<tr><td>1991-1995</td><td>Market liberalization</td><td>(former Yugoslav policy)</td><td rowspan="2">Market price and intervention support</td><td>31,43**</td><td>n.a.</td></tr>
<tr><td>1996-2000</td><td>Privatization</td><td>Strategy for Agricultural Development 1996</td><td>7,45</td><td>n.a.</td></tr>
<tr><td>2001-2006</td><td>SAA (2001)
WTO membership (2003)
EU candidate (2005)</td><td>Agricultural Developmental Strategy to 2005</td><td>Direct payments (since 2004)</td><td>7,16</td><td>6,93</td></tr>
</table>

Period	Main focus	Main document	Main policy instrument	Average annual budget (million EUR)	
				nominal	**real***
2007-2013	Policy consolidation/ Harmonization with the EU CAP	NARDS 2007-2013 IPARD I 2007-2013 LARD 2007 & 2010	Predominant direct payments, limited but growing rural development measures	68,14	66,34
2014-2020	Further policy harmonization with the EU CAP	NARDS 2014-2020 IPARD II 2014-2020		125,94	123,20
2021-2027		NARDS 2021-2027 IPARD III 2021-2027		154,74**	144,67

Note: Galev and Dimitrievski, 2001 (period 1994-2001), Dimitrievski et al. 2010 (period 2002-2009), APMC database North Macedonia 2024 (period 2010-2023; *real values calculated with 2020 as base year), **average for 1994-1995, and 2021-2023

This whole period can also be split into a pre- and a post-EU candidate country status (2007 being the break point), which is also reflected in the dominant policy instrument and the corresponding budgetary allocations to the agricultural sector and the rural development (discussed in the next section).

The first period, from 1991 to 1995, starts with the country's independence in 1991 and the building of its own agricultural policy. The initial Macedonian agricultural policy was based on the principles and measures inherited from the former agricultural policy of the Socialist Federal Republic of Yugoslavia. Price liberalization, characteristic of this period, resulted in drastic price increases, a decrease in the population's relative purchasing power, hence a decrease in demand, and subsequently decreasing production. Therefore, the policy was based on market interventions through tariff protections and trade limitations, and subsidizing the prices of certain agricultural products. This policy approach, along with the low budget of the MAFWE (around 1% of the country's budget), further emphasized the challenges of this sector, putting family farms in a subordinate position vis-à-vis the large farm enterprises (agro-combinates, agricultural companies and cooperatives).

The second period, from 1996 to 2000, was characterized by the process of privatization, the numerous *ad hoc* policies, and their frequent changes as government actions of "putting out fires". This limited the possibilities of monitoring and evaluating the effects of the applied measures, which was additionally accentuated by the delayed payment of the support. The first step in redefining these conditions was the adoption of the first Strategy for agricultural development in 1996, and by setting six strategic goals for enhancing better use of the resources (land, labour force, means of production, irrigation systems, as well as by-products), encouraging production structure and technology in line with the market needs, and following the trends from the developed countries.

The third period, from 2001 to 2007, is characterized by the start of the process of integration of the Republic of Macedonia towards the World Trade Organization (WTO) and the EU. The Stabilization and Association Agreement (SAA) with the EU, signed in 2001, the full membership in the WTO in 2003, and the EU candidate status received in December 2005 increased the necessity to redefine the goals of the agricultural policy. Since the goals set in 1996 did not reflect the new needs, a new Agricultural Development Strategy for the Republic of Macedonia for 2005 was prepared and adopted, defining goals consistent with the National Strategy for Economic Development of the Republic of Macedonia. These goals were more market-oriented, gradually preparing the agricultural producers for market liberalization, thus focusing on improved agricultural income, competitiveness of the sector, effective public and private institutions, safe and healthy food, optimized and sustainable use of resources, and sustainable rural communities for rural development. During this period, the agricultural support was mainly with a group of market-price measures, such as subsidies for produced quantities of selected products (wheat, milk, lamb meat), guarantee price for more significant products (wheat and tobacco), intervention purchase (wheat and tobacco), customs protection (ad valorem). Certain shifts towards the gradual approximation to the EU's Common Agricultural Policy (CAP) initially occurred in 2004 by introducing the producer support based on payments per area cultivated, or the number of livestock heads.

The fourth period, spanning from 2007 to 2013, is marked by the consolidation of both the structure and size of the policy. During this time, the country was regarded as a moderate reformer in its transition process (Csaki & Zuschlag, 2004). Signs of policy consolidation began to emerge nearly two decades after independence, largely driven by the government's aspiration to align more closely with EU policies in preparation for EU integration. The country sought to enhance the capacity of its domestic economy to operate within the EU single market and to align with EU standards on food quality and safety. To support this goal, a series of strategic and operational documents was developed. In June 2007, the first strategic document with a seven-year timeframe was adopted: the National Agriculture and Rural Development Strategy (NARDS) for the period 2007–2013. This was followed by the adoption of the Law on Agriculture and Rural Development (LARD) in November 2007, which was later replaced by a new, revised version in April 2010. The updated LARD remains the primary legal framework guiding the implementation of agricultural policy in the country. Although it has been supplemented by numerous additional laws and bylaws addressing specific issues, it continues to serve as the foundation for agricultural and rural development regulation. As part of the legislative harmonization with the EU acquis, a National Program for the Adoption of the Acquis was adopted. Institutional reforms focused on establishing new institutions where necessary (for example, the Agency for Financial Support to Agriculture and Rural Development, acting as a paying agency in line with the EU practice), reorganizing existing institutions, and strengthening their human resources to effectively implement legislation aligned with EU standards. NARDS outlined annual programs in three distinct areas: agriculture (primarily direct payments), rural development (including the modernization and restructuring of the agricultural sector), and aquaculture. Since the adoption of NARDS, the core instrument of national agricultural policy has been direct payments, granted per hectare in crop production or per head in the livestock sector.

The fifth period, spanning from 2014 to 2020, represents a continuation of the previous phase, marked by a more intensive alignment of agricultural policy with the EU CAP. During this period, the priorities for agricultural policy development in the country were once again redefined and further refined through the adoption of the second NARDS 2014–2020. The updated strategy emphasized key priority areas such as the restructuring and modernization of the agri-food sector, market regulation, socio-economic development in rural areas, enhancement of human capital in agriculture, food safety standards, and sustainable management of natural resources (MAFWE, 2014). It also identified some aspects requiring further adjustment to bring the Macedonian agricultural policy closer to the CAP model. These included the recognition of the need for increasing support for rural development, gradually decoupling direct payments, expanding agro-environmental measures, and enhancing support for young farmers, cooperatives, and vertical integration within the agri-food chain. Additionally, the strategy emphasized the need to address climate change mitigation, improve waste management, and promote energy efficiency.

The sixth period, covering 2021 to 2027, continues the trajectory set in the previous phase. It is guided by the updated NARDS 2021–2027. The NARDS aligns its overarching goals with those of the EU CAP, adopting the nine specific objectives and one horizontal objective outlined by the EU framework. Despite this formal alignment, no substantial changes have been made to the existing policy measures or their implementation practices.

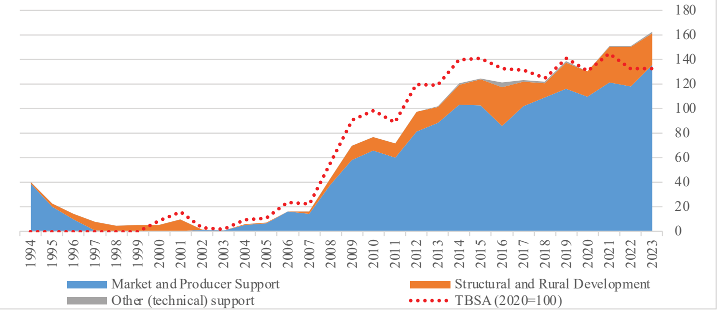
Further adjustments toward alignment with the CAP have been anticipated to take place upon the country's accession to the European Union and full membership status (MAFWE, 2014; MAFWE, 2021). However, due to the slow pace of the EU integration process, no specific timeline has been established for the complete harmonization of the country's agricultural policies with the CAP. Moreover, the continuous reforms within the CAP itself present an additional challenge, as the evolving policy framework makes the EU CAP a moving target in terms of the conditions that must be met.

Budgetary Transfers to Agriculture

In the early years following the country's independence (1994–2001), agricultural policy primarily focused on price subsidies, infrastructure development projects, and trade policy. Producer support was provided either through price subsidies for selected commodities or as input subsidies for purchases of seed and credit access, which continued until 1997 and 1996, respectively. However, price subsidies were discontinued between 1998 and 2001, during which time the state only supported developmental projects in the agricultural sector.

In the period from 2002 to 2007, budgetary support for agriculture in Macedonia remained quite low, with the lowest amount recorded at just EUR 1,86 million in 2003. However, support began to rise since 2004, and direct payments to producers became the dominant form of agricultural support, both in absolute terms and relative to other measures, accounting for 95,6% of total agricultural support. On average, direct payments made up 87,2% of the total budgetary support, with fluctuations ranging from 74,1% in 2003 to 97,5% in 2006. These payments were provided per hectare for crop production, per head for livestock, and per quantity sold for milk and tobacco. In addition to direct payments, producers received input subsidies in most of these years, while other market interventions were not implemented. Support for rural development through budgetary transfers remained relatively low throughout this period.

Figure 9: Budgetary support to agriculture and rural development, 1994-2023 (in million EUR)



Note. Data from Galev and Dimitrievski, 2001 (period 1994-2001), Dimitrievski et al., 2010 (period 2002-2009), APMC database North Macedonia 2024 (period 2010-2023)

Budgetary transfers to agriculture have shown a continuous increase since 2008, rising from EUR 43,1 million in 2008 to EUR 162,3 million in 2023, and until recently among the leading in the region in terms of budgetary transfers to agriculture per capita or per hectare (Martinovska Stojcheska et al., 2021; Kotevska et al., 2024). When adjusted to real values with 2020 implicit deflators, the budgetary transfers to agriculture peaked in 2014, after which the level of support relatively stagnated (Figure 9). Over this period, there has been no significant change in the structure of agricultural support, with direct producer support measures remaining dominant, accounting for 83,4% of the total. Rural development measures and the general support to agriculture measures make up a much smaller share of the budget, at 16,4% and 0,7%, respectively. The share of structural and rural development measures exceeded 20% only in 2016 and 2022, as part of efforts to increase their share to 30%, as outlined in the NARDS, but their overall contribution remained modest. Throughout the entire period from 2008 to 2023, direct payments have remained the primary policy instrument, comprising 77,9% of the total budget. These payments are coupled (55% are based on area or livestock head, and 45% are linked to output) and are conditioned on cross-compliance measures to ensure adherence to good agricultural practices. Nearly a quarter of direct payments during this period (23,7%) were allocated to tobacco, the most heavily supported commodity. Arable crops, not linked to specific crops, received about 10% of the support, while vineyards (grapes) accounted for 10,3%. Single fruits and vegetables received 5,2% and 4,8%, respectively. Among headage payments, sheep and goats received the highest share

(12,4%), followed by milk and beef (6,1%), and the output payment for milk (from cows, sheep, and goats combined) at 7,6%. Market support, variable input subsidies, and disaster payments remain negligible, making up just 0,6%, 2,6%, and 1% of the budget, respectively.

The primary funding for agricultural policy comes from the national budget. Nevertheless, since 2007, the country benefited as a pre-accession country from support under the Instrument for Pre-Accession Assistance for Rural Development (IPARD) in three programming periods, distributed on the basis of the National Agriculture and Rural Development Plan for each of those periods: IPARD I (2007-2013), IPARD II (2014-2020), and IPARD III (2021-2027). The IPARD Programs were prepared in line with the three main government program documents (Accession Partnership, National Program for the Adoption of the Acquis Communautaire, and the National Development Plan or the National Strategy for Agriculture and Rural Development). The indicative plan of the maximum EU contribution per Program was EUR 60 million for IPARD I and II, and EUR 97 million for IPARD III. This budget has been allocated through three measures: Investment in agricultural holding (Measure 101/M1); Investment in processing and marketing of agricultural and fishery products (Measure 103/M3); Farm diversification and business development (Measure 302/M7); as well as Technical support (Measure 501/M9).

The implementation of the IPARD programs began with the announcement of the first public call for each cycle: in December 2009 for IPARD I, April 2017 for IPARD II, and September 2023 for IPARD III. By the end of 2024, a total of twenty-seven public calls had been issued. Since 2011, when the first IPARD payments were disbursed, a cumulative amount of EUR 52,5 million in EU funds has been paid out (APMC, 2024), accounting for 2,9% of the total agricultural budgetary transfers between 2008 and 2023.

Discussion and Conclusions

The development of the agricultural sector in North Macedonia over the past three decades has been closely intertwined with broader economic transitions and evolving policy frameworks. From the early 1990s, when the country shifted from a centrally planned system to a market economy, through periods of privatization, international trade integration, and ongoing EU alignment, both the structure and performance of agriculture have undergone notable changes. However, this transition has been uneven, marked by nominal growth but stagnation in real output, a steadily shrinking and aging workforce, fragmented land holdings, and limited technological modernization. Policy instruments—especially direct payments and rural development programs—have played a central role in shaping sectoral outcomes. Despite increased financial support and harmonization with the EU's CAP, key challenges persist, raising questions about long-term sustainability and competitiveness.

The agricultural transformation in North Macedonia over the past three decades -considering structural changes, production trends, and policy support - can be summarized across the following key periods:

- Market liberalization (1991-1995): During this period, the agricultural sector experienced significant disruption as the country transitioned from a centrally planned economy to a market-driven system. The market liberalization policies introduced by the government had a profound impact on agricultural output and production. The sector's GVA remained relatively stable in nominal terms. Agricultural employment was still high, but the foundations for future structural inefficiencies were laid, which would later manifest in the next decades. The lack of state intervention in setting prices led to market volatility, affecting the sustainability of agricultural activities, particularly for small-scale farmers.

- **Privatization (1996-2000):** As privatization took place, the agricultural landscape began to shift. However, the sector faced challenges in adapting to a market-based economy, with inefficiencies in land use, technology adoption, and productivity. The fragmented nature of agricultural holdings persisted, and farmers struggled to transition to modern, private production systems. Land abandonment and fragmentation of holdings were evident, further intensifying productivity challenges. Agricultural GVA showed gradual increases, though it remained insufficient to counteract the negative effects of small-scale farming. Employment began its gradual decline, setting the stage for the reduced agricultural workforce seen in subsequent periods.

- Trade liberalization and international alignment (2001-2006): This period marked a shift towards alignment with international trade agreements, including the WTO and the EU's SAA. As a result, agricultural policies began to emphasize the adoption of modern agricultural practices, though full integration into the EU's agricultural framework had not yet occurred. The introduction of direct payments in 2004 signaled the start of financial support for farmers. Agricultural GVA showed nominal growth, but real output stagnated, indicating that the sector's productivity was not keeping pace with nominal growth. Employment continued to decline, as many workers migrated to urban areas or sought work in other sectors. Small-scale farm holdings remained predominant, but there was a slow trend towards modernizing agricultural practices in response to novel policies.

- **Policy consolidation (2007-2013)**: The strengthened focus on harmonizing North Macedonia's policies with the EU's Common Agricultural Policy further pushed the need for modernization of the agricultural sector. During this period, the introduction of IPARD I and more robust direct payments facilitated a transformation towards more competitive, market-oriented agricultural practices. The agricultural sector saw notable growth in nominal terms; real output, however, showed signs of stagnation, with some agricultural subsectors experiencing slow productivity growth. The agricultural land area remained stable, but cultivated land decreased slightly, with a growing focus on crop production, especially vegetables, which had better market prospects. The employment in agriculture continued to decline, and the wage disparities remained an issue.

- **Further policy harmonization (2014-2020).** This period was marked by deeper policy alignment with the EU, with increased efforts to improve productivity and rural development. Investments in rural infrastructure, better access to EU-funded programs, and a broader range of direct payments helped the sector stabilize, although it continued to face structural challenges. The sector's nominal GVA increased significantly, particularly in vegetables. Land use dynamics showed a trend toward abandonment and urbanization, with decreasing areas of cultivated land and an emphasis on perennial crops like orchards and vineyards. There was a slow but steady decline in livestock output, reflecting the sector's vulnerability to market fluctuations and climate risks. The agricultural workforce continued its downward trend, as well as the structural inefficiencies and external shocks, such as the more pronounced effects of climate change and external crises (e.g., COVID-19).

- Recent developments (2021-2027): The agricultural sector's GVA continued to rise in nominal terms, whereas real output stagnated. However, some improvements in crop production and rural development initiatives are expected in the long run. A shift toward crop production remains evident, with vegetables maintaining a significant share of total agricultural output. The sector faces increasing challenges related to livestock production, particularly the decline in cattle, sheep, and poultry numbers. The agricultural workforce continues to shrink, with younger generations showing less interest in agriculture. Support from the EU (IPARD III) became more substantial, and beneficiaries were better prepared to use it, as a sign of the country's better preparedness to EU policy implementation. The most recent period focuses on deepening integration with the EU and advancing sustainability in agriculture (Dimitrievski & Martinovska Stojcheska, 2023). Efforts to modernize the sector, including promoting digitalization, climate resilience, and improving rural infrastructure, are seen as critical to ensuring long-term agricultural viability.

The following table (Table 2) summarizes the main developments and policy orientations in North Macedonia's agriculture by key reform periods, highlighting their corresponding sectoral outcomes and performance indicators.

Table 2: Sectoral and policy convergence in Macedonian agriculture by key periods

Period	**Sector and policy developments**	**Key indicators**
1991-1995: Market liberalization	• significant market disruption • introduced market liberalization policies • lack of market prices intervention led to market volatility	• relatively stable agricultural GVA • high agricultural employment • foundations for future structural inefficiencies
1996-2000: Privatization	• shift agricultural landscape challenges in adapting to a market-based economy	• gradual increases, though still insufficient, of agricultural GVA • gradual decline of employment in agriculture • evident land abandonment and fragmentation

Period	**Sector and policy developments**	**Key indicators**
2001-2006: Trade liberalization and international alignment	• alignment with international trade agreements, including WTO and the EU's SAA • slow trend towards modernizing agricultural practices	• introduction of direct payments in 2004 • nominal growth of agricultural GVA, but stagnated real output • continued decline of employment in agriculture • predominant small-scale farm holdings persist
2007-2013: Policy consolidation	• policy consolidation with the EU's CAP • introduction to more robust direct payments and increased budgetary support • introduction of IPARD I	• notable growth in nominal terms; but signs of stagnation of real output • some agricultural subsectors show slow productivity growth • continued decline in employment, with wage disparities compared to other sectors • slightly decrease of cultivated land, with a growing focus on crop production, especially vegetables

Period	Sector and policy developments	Key indicators
2014-2020: Further policy harmonization	• deeper policy alignment with the EU • significant number of budgetary transfers to agriculture and rural development • investments in rural infrastructure • better access to EU-funded programs	• significant increase of sector's nominal GVA, particularly in vegetables • trend of abandonment and urbanization of land • decreasing areas of cultivated land • steady decline in livestock output • continued downward trend of agricultural workforce • structural inefficiencies and external shocks (climate change and external crises)

Period	Sector and policy developments	Key indicators
2021-2027: Recent developments	• deepening integration with the EU • efforts to modernize the sector, (digitalization, climate resilience, rural infrastructure) • advancing sustainability in agriculture. • more substantial support from EU (IPARD III) and improved preparedness to use it	• continued rise in nominal agricultural GVA, though stagnant real output • continued shrinking of workforce, with younger generations less interest in agriculture • evident shift toward crop production, vegetables leading total output • decline in livestock capacities (cattle, sheep, and poultry numbers)

In general, the findings suggest that the agricultural sector in North Macedonia has experienced contrasting trends between nominal and real growth. Although the sector has shown considerable increases in nominal output over the years, real output has largely stagnated, especially in the last decade. This stagnation is attributed to persistent structural inefficiencies, limited adoption of modern technologies, and the increasing impacts of climate change and external shocks. These challenges have undermined productivity gains and exposed the sector's vulnerability. At the same time, the agricultural workforce has seen a continuous decline, driven by urbanization, rural depopulation, and the migration of labour to more attractive and higher-paying sectors. Low wages, precarious working conditions, and an aging population have further exacerbated the labour shortage in rural areas, raising concerns about the sector's long-term sustainability. Moreover, the structure of land use and farming operations continues to constrain agricultural development. Though public support for agriculture is relatively high, and until recently among the leading in the region, it is predominantly directed toward low-value commodities, leading to suboptimal use of resources. The sector remains dominated by small, fragmented family farms, with a significant share of holdings producing minimal economic output. This fragmentation limits the potential for achieving economies of scale and hinders investment in modernization and competitiveness. In parallel, the total area of cultivated land has been steadily decreasing, reflecting both land abandonment and urban development pressures. These structural and demographic dynamics emphasize the need for a more targeted and transformative policy approach to revitalize the sector, improve productivity, and ensure its resilience in the face of ongoing challenges.

To remedy these challenges, the agricultural policy in North Macedonia must take a more strategic, long-term, and inclusive approach. First and foremost, policies should prioritize structural transformation by supporting farm consolidation and incentivizing the formation of cooperatives and producer organizations to improve economies of scale and market access. Strengthening land tenure security and simplifying procedures for land purchase, leasing and consolidation would also help unlock underutilized land and attract investments.

Another critical pillar is investment in modernization and innovation. Public support should focus on improving access to modern technology, mechanization, digital tools and solutions, and climate-smart and resilient agricultural practices, especially for smallholders. Expanding advisory services and facilitating knowledge transfer, particularly to young and new farmers, can improve productivity and sustainability while also making agriculture more attractive to younger generations.

To address the labour crisis and rural decline, policy should support rural revitalization and youth engagement through tailored start-up support, targeted subsidies for young farmers, and investment in rural infrastructure, services, and quality of life. Creating stronger rural-urban linkages and improving working conditions, such as fair wages and access to social protection, can help retain and attract a skilled workforce in the sector.

Given the growing risks from climate variability, external shocks, and market volatility, enhancing the resilience of the agricultural sector should be another policy priority. This includes developing risk management tools, such as crop insurance and early warning systems, promoting diversification of production systems, and supporting sustainable resource use, particularly water and soil conservation. Of course, only providing such tools without the capacity building component would not yield the desired outcomes. Hence, the paramount importance of knowledge and functional agricultural knowledge and innovation information systems is once again emphasized.

Finally, improving policy coherence, monitoring, and evaluation of mechanisms is vital. Agricultural policy should be more data-driven, transparent, and better aligned with EU CAP principles and national development objectives. Strengthening institutions and inter-sectoral coordination, alongside effective use of available national and EU funds (such as IPARD), will be essential to implement these reforms and ensure the long-term viability and competitiveness of North Macedonia's agriculture.

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Chapter 7

Trade Policies, Dynamics of Export-Import Activities, and Effects of Globalization In The Republic of North Macedonia

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International trade continues to be a significant driver of global economic growth and development. New trends in international trade are based on three main pillars: technological advances, geopolitical shifts, and sustainability awareness. Technological advance enables intensive use of online platforms, AI and automated logistics, Internet of Things (IoT), digital payments, e-commerce, and trading with creative services. Geopolitical shifts are changing the map of international trade by creating new alliances between countries at the bilateral and regional levels. Sustainable

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awareness is focused on green commerce, green logistics, climate change, and the realization of the environmental, social and governance (ESG) goals. These changes affect all countries, both developed and developing.

The Republic of North Macedonia will have to face all the challenges and opportunities offered by the new world trade. However, to understand Macedonia's foreign trade, it should be analyzed from a historical perspective, its evolution through different periods, its size, structure, instruments used, foreign trade policies implemented, integration and contractual processes, strategic partners, etc. The aim of this chapter is to show the struggle of this small, land-locked, and open country in the large foreign trade arena.

This chapter covers five thematic units related to the place and role of foreign trade in the Republic of North Macedonia. The first topic analyzes the beginnings and the state of Macedonia after its secession from the SFR Yugoslavia and gaining independence in 1991. After independence, the country faced major internal and external challenges. From the aspect of foreign trade, the country continues with trade liberalization, whereas it demonstrates high import dependence on raw materials, energy inputs, food products, modern machinery and equipment, but also exports (basic metals, metallurgical products, chemical products, textiles, leather, food, tobacco, beverages) due to the low absorption capacity of its own economy. From the very beginning until today, the country has been in a chronic deficit in international trade, with a constant disequilibrium in the Balance of Payments. Its efforts to internally deal with the political, economic, legal, and social transition (privatization, restructuring of companies and big capacities) are under strong pressure from the external unfavorable environment, such as the northern and southern blockades and embargoes, the military crisis in 1999, internal conflict in 2001, and open problems with neighbors. This small economy managed to strengthen after 1995, when several Free trade agreements were signed with Slovenia, Croatia, Serbia, Bosnia and Herzegovina, i.e. the countries of the former Yugoslav federation. After that, trade successes followed, such as joining the World Trade Organization, signing the Stabilization and Association Agreement (SAA) with the EU, joining Central European Free Trade Agreement (CEFTA), signing bilateral trade cooperation agreements with Turkey and Ukraine, etc. The effects of these integrative and contractual relationships are described in more detail in this first part of the chapter.

The second topic is related to the impact of globalization on the Macedonian economy. The fragile and vulnerable economy, which has failed for years to stabilize, innovate, become competitive, and offer quality, fails to utilize the benefits of globalization. On the contrary, it is under the influence of all globalization processes, such as the energy crisis, financial crisis, the Russian/Ukrainian war, Covid-19, new military hotspots, and climate change.

The third part of the chapter concerns the attraction of foreign investments that help the economic development of the country in the absence of adequate domestic savings. According to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report, the largest investments are recorded in manufacturing (35%

of total FDI), followed by the finance and insurance sector (21%). The country has a favorable legal framework that provides numerous incentives for foreign investments. These benefits for investors are complemented by the Law on Technological Industrial Development Zones (TIDZ) and the Law on Financial Support for Investments. Macedonia is also making efforts to fully align and harmonize with the standards and practices of the European Union.

The fourth topic of the chapter provides an overview of the trade performance of the Republic of North Macedonia from independence to the present. The country's export and import activities are presented and interpreted. They are analyzed by periods, size, structure, impact on GDP and the importance of strategic partners. In general, the structure of exports is particularly narrow, undifferentiated, uncompetitive, and without significant success on the international market, which cannot cover the country's imports. The deficit is financed by credits, reprogramming of matured debts, depletion of state reserves, and small capital inflows from foreign direct investments.

The last part of the chapter analyzes the new international trade trends that Macedonia must join. Once again, the country finds itself in an unfavorable external environment and a political labyrinth from which it cannot easily get out. However, it must catch up with successful countries and work on measures that are emphasized by important international institutions. The measures relate both to further internal economic consolidation (reducing corruption, poor customer service, excessive bureaucracy, political interference in the judiciary, lack of government capacity, shortcomings in the rule of law), but also measures that can intensify its trade. (investments in transport infrastructure, export diversification, increasing the number of strategic partners, innovations, electronic exchange, etc.) North Macedonia ranks 54th among the 132 economies on the Global Innovation Index 2023, which shows poor economic innovation performance.

Based on the topics, this chapter aims to answer the following research questions:

- What are the effects of the trade policies implemented by North Macedonia in the period 1991 to 2023?
- What is the foreign trade performance (dynamics of export and import activities, their size, structure, major partners) of the Republic of Macedonia in the period from 1991 to 2023?
- How foreign direct investments and technological industrial development zones influence the economic growth of the state.
- How Globalization impacts the Macedonian economy and,
- What are the future foreign trade perspectives of North Macedonia?

This chapter ends with a conclusion and recommendations for a more successful integration of the country into international flows. In principle, although Macedonia is a small and open country with a favorable investment policy, due to various internal and external problems, it fails to fully integrate into the international market, nor to take advantage of the benefits of globalization.

Beginnings and the Trade Situation of the Republic of Macedonia After Gaining Independence in 1991

After secession from Yugoslavia and gaining independence in 1991, Macedonia found itself in a difficult and unenviable situation, pressured by internal and external problems. After the separation from SFR Yugoslavia, Macedonia, as the poorest of all the republics, found itself in an even more difficult economic situation, with a declining GDP, a negative trade balance, insufficient capital to finance its economy, no technological innovations, outdated equipment in industrial and agricultural facilities, high unemployment, and a declining living standard of its people. The country's economy was dependent on the needs and demands of the Yugoslav market. That large market, where it belonged, with approximately 20 million inhabitants, now has shrunk to 2 million people. The installed capacity in the industrial and agricultural sectors has become too large in relation to the absorption capacity of the domestic economy. In the frame of Yugoslavia, Macedonia produced mainly metallurgical products, metals, processed metals and alloys, chemical products, textiles, leather, and tobacco. Now, without that market and export possibilities, the production has become suboptimal and unprofitable. What was once produced for a large market now has difficulty finding consumers within a small country. Macedonia was under pressure to find ways to export its production.

On the other hand, Macedonian economy was heavily dependent on imports of strategic goods, such as energy inputs (gas, oil, coal), raw materials (wool, dyes, leather, metal sheets, timber, fertilizers, agricultural-chemical products), equipment (machinery, modern equipment, means of transportation, agricultural and construction machinery), foodstuffs (wheat, corn, sugar, cooking oil, meat and meat products). This high dependence of the economy on critical raw materials and energy inputs could not be covered by the low value of exports. The higher value of imports compared to the limited value of exports resulted in a negative trade balance, i.e., a deficit in trade transactions. All of this created pressure for the country to open up more and engage more intensively in international trade (Bogoev, 1999).

Although the country's strategy was trade liberalization and export orientation, they were not achieved easily. Internally, the country faced a political, economic, legal, and social transition and transformation that required significant structural reforms. The economic situation was unfavorable, with steep falls in GDP, high inflation, a high unemployment rate, and large fiscal deficits. (PwC North Macedonia, 2025). The production, infrastructure, and agricultural capacities were characterized by technical and technological obsolescence, suboptimal utilization, unproductiveness, and high dependence on energy products and raw materials. Due to inadequate assortments, limited market, lack of managerial and marketing skills, limited innovations, and almost no foreign investments, the Macedonian economy was uncompetitive and unprepared for the external market (Blazevski, 1999). The industrial and agricultural sectors needed restructuring, modernization, adjustments, innovation, and the introduction of new products.

Externally, Macedonia found itself in an unfavorable position that negatively affected its aspirations to intensify foreign trade. Macedonian economy was hit by blockades and embargoes in 1994, a military crisis in 1999, an internal conflict in 2001, and constant conflicts with its neighbors. In such conditions, where exports stagnated, imports increased, and the foreign trade deficit grew constantly, reaching 8,2% of GDP in 1998. The following Table illustrates the foreign trade of Macedonia in the first five years of independence (1994-1998).

Table 1: Foreign trade of the Republic of Macedonia in the first five years of independence (NBRM, 1999)

mil.US$					
	1994	1995	1996	1997	1998
I. Trade in goods					
1. Export of goods	1.086	1.205	1.147	1.237	1.322
2. Import of goods	1.271	1.424	1.464	1.623	1.722
Deficit	-185	-219	-317	-386	-400
II. Trade in services					
1. Export of services	172	185	154	128	131
2. Import of services	326	385	309	273	303
Deficit	-154	-200	-155	-145	-172
III. Total Current Account Deficit	-158	-321	-288	-276	-290
Share of GDP	-4,7	-5	-6,5	-7,4	-8,2
GDP	3.390	4.456	4.412	3.713	3.547

Globalization, Trade Policy, and Effects on the Macedonian Economy

Globalization is about the connectedness and interdependence of world economies and cultures (National Geographic Encyclopedia, 2025). A more comprehensive definition of globalization is provided by the Peterson Institute for International Economics (2024), according to which globalization describes the growing interdependence of the world's economies, cultures, and populations, brought about by cross-border trade in goods and services, technology, and flows of investment, people, and information. It is the process of free movement and exchange of products, services, capital, and people between different countries and regions of the world. Globalization as a multidimensional process is present in all segments of modern societies, such as the economy, culture, politics, law, sociology, communications, technology, information, etc. Most authors agree that economic globalization dominates over other forms of globalization and defines the striving of companies to go beyond their national boundaries and engage in international trade flows in order to make a profit.

Since independence, a clearly expressed strategic priority of the Republic of Macedonia has been inclusion in Euro-Atlantic structures and international trade. This priority is not only clearly expressed by the citizens of Macedonia, but also represents a condition for economic growth. Significant milestones that mark Macedonia's path towards more intensive involvement in international trade are (State Statistical Office, 2025):

2004 - SAA with the EU: Preferential trade agreement, asymmetrical in favor of Macedonia, meaning that products from Macedonia can enter the EU markets duty-free;

1. 2002 - Free Trade Agreement with European Free Trade Association (EFTA) whose member states are the highly developed countries Norway, Iceland, Liechtenstein and Switzerland. This EFTA Agreement covers several areas, such as free movement of goods, trade in various agricultural products, recognition of workers' qualifications, use of consultants, investments, state subsidies, etc.
2. 2006 - A free trade agreement with CEFTA which includes non-EU countries from Southeast Europe such as Albania, Bosnia and Herzegovina, Serbia, Kosovo, Montenegro and Moldova. This agreement enables free trade in industrial and agricultural products, as well as in the service sector and e-commerce.
3. 2021 - The Republic of North Macedonia is a signatory to the Open Balkans initiative, conceived as a Mini-Schengen that should ensure easier trade between North Macedonia, Serbia, and Albania. Tripartite agreements for cooperation and the intensification of regional trade were signed in Skopje.
4. The Republic of North Macedonia has also signed bilateral trade agreements with the Republic of Türkiye, Ukraine, and the United Kingdom of Great Britain and Northern Ireland.

As of 2023, and according to official data, North Macedonia has 5 free trade agreements covering 40 partner countries (including 27 EU member states, 4 EFTA countries, 7 CEFTA members, plus Turkey and Ukraine). Approximately 67,5% are with European Union member states, providing extensive customs relief and improved market access to the European market (CEFTA,2025).

Also, the Republic of North Macedonia became part of the WTO in 2003, a candidate country for EU membership in 2005, and a member of the North Atlantic Treaty Organization (NATO) in 2020. All of these agreements and initiatives have given Macedonia easy duty-free access to more than 650 million consumers worldwide. However, despite this opportunity and the country's high trade openness, it is noticeable that Macedonia is not taking enough advantage of globalization. The most significant reasons are the low competitiveness of the domestic industry, low productivity, and the low rate of innovation and new technologies (Miteva-Kacarski, 2023).

According to the 2022 Report of the Swiss Institute of Technology in Zurich, the overall globalization index for 188 countries is 61,41 points. The average global economic index for 182 countries is 59,06 points. Macedonia, with an economic globalization index of 68,91 points, is ranked 56th worldwide. Within Europe, the average economic globalization index was 76,79 points for 41 countries in 2022. The highest value was registered in the Netherlands, 89,79 points, and the lowest value in Russia, 43,37 points. Macedonia ranks 35th out of 41 European countries. Economic globalization is measured based on two dimensions: actual economic flows and restrictions on trade and capital. The data for Macedonia are given in the following table:

Table 4: Ranking of North Macedonia according to the Index of Globalization, 2022 (KOF Swiss Economic Institute, 2025)

Index of Globalization 2022 North Macedonia	
	points
Overall globalization	68,99
Economic globalization	68,91
Political globalization	71,16
Social globalization	66,76

The following table shows where Macedonia is positioned in relation to other European countries, and especially the Western Balkan countries.

Table 5: Global ranking of Macedonia according to the Economic globalization index, 2022 (KOF Swiss Economic Institute, 2025)

Selected Countries (out of 41 total)	**Economic Globalization Index 2022**	**Global Rank**
Netherlands	89,79	1
Belgium	88,05	2
Ireland	87,65	3
Switzerland	96,96	4
Luxembourg	86,35	5
UK	81,91	14
Germany	81,85	16

France	81,28	17
Montenegro	78,62	22
Greece	78,26	23
Slovenia	77,74	24
Croatia	76,62	27
Serbia	73,31	28
Bulgaria	71,44	32
Albania	69,85	34
N. Macedonia	68,91	35
Ukraine	64,48	36
Russia	43,37	41

The latest value from 2022 is 68,91 points of the economic globalization index for North Macedonia. Having in mind that the world average is 59,16 points, based on data from 184 countries (The Global Economy, 2022) and the fact that historically, the average for North Macedonia from 1991 to 2022 is 57,31 points, it can be concluded that the country even demonstrated a lower cumulative percentage than the world average. The minimum value, 31,8 points, was reached in 1994, while the maximum of 71,3 points was recorded in 2017.

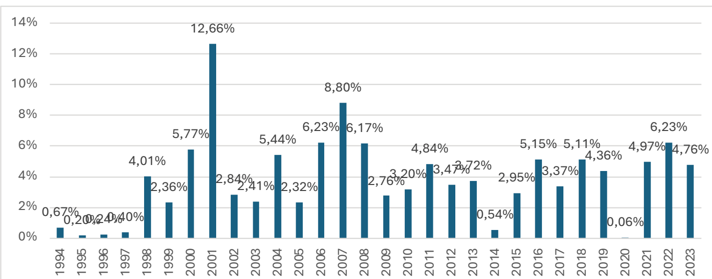
The external problems that Macedonia has faced since independence until today, such as UN sanctions against the Yugoslavia in 1992, an economic embargo against Macedonia by Greece in 1994, a military crisis in Kosovo in 1999, an internal conflict in 2001, the global financial crisis in 2007/2008, the European debt crisis in 2011/2012, the Covid-19 pandemic in 2020/2021, a military conflict between Russia and Ukraine in 2022, and deteriorating relations with Bulgaria in 2023, certainly affect the country's inclusion in international trade. However, Macedonia ranks last according to the economic globalization index in the region and the Western Balkan countries due to internal reasons as well. The World Bank in its Trade Policy Strategy 2.0 Report for North Macedonia (2022), as well as Selimi (2012), list the following significant internal problems that do not allow for a more intensive inclusion of the country in international trade:

- High level of corruption and organized crime;
- No digitalization of important government processes that make investment decisions hesitant and susceptible to corruption;
- Gaps in road and rail transport, with the need for greater investments and an emphasis on road safety;
- Small number of signed bilateral and multilateral free trade agreements, as well as a small number of strategic partners;
- Inadequate export structure by products, services, and capital that needs greater diversification and greater trade openness related to services;
- Low productivity of the domestic economy, low quality of offered products, without innovation, entrepreneurial, managerial, marketing capabilities and skills, without focused research and development;
- Inadequate distribution and use of European funds, etc.

Foreign Direct Investment as a Significant Factor for the Development of the Macedonian Economy

Despite the sincere intentions, efforts, and commitment of the governments of the Republic of North Macedonia, since its independence until this day, no large foreign investments have been observed in the country. Macedonia ranks last among the countries in the region in terms of attracting foreign direct investments. For example, in 2023, Macedonia realized USD 0,7 billion in foreign investments or 4,76% of GDP, while other countries in the same year recorded higher investments, Serbia USD 4,89 billion, Bulgaria USD 4,41 billion, Bosnia USD 0,94 billion, Romania USD 8,41 billion, Turkey USD 10,64 billion, etc. In all the years from 1994 to 2023, it is noted that Macedonia achieved FDI in only single digits as a % of GDP, except in 2001 (Selimi, 2012).

Figure 6: FDI as a % of GDP, 1994-2022 (World Bank, 2025)



The Macedonian government introduced the Law on Technological Industrial Development Zones in 2008, as well as the Law on Financial Support for Investments. Foreign investors have received truly excellent benefits in terms of using a ten-year tax exemption on personal and corporate income, free access to public services, job creation and capital investment subsidies, and financial support to exporters. Investors who have shown interest in entering Macedonia are those from the automotive industry, with the main operations relating to the assembly of automotive parts, the manufacture of various components for automobiles, etc. Foreign investors invest most in labor-intensive products, due to low labor costs. As of 2022, there are 14 TIDZs in which about 40 companies operate. Their exports contribute up to 50% of total exports but contribute very little to the country's economic development, with an approximate 2% increase in GDP (Drenkovska et al., 2020). This means that the share of domestic companies in the value chains of foreign investors is insignificant, i.e., there is no knowledge spillover effect from attracting FDI. Domestic companies continue to operate with outdated technology, with minimal investment in research and development, without innovation and launching new products (Drenkovska et al., 2020).

A more alarming fact is that FDI creates unfair competition towards local businesses that produce the same or similar products and export them to the same markets, and do not receive the same benefit packages as foreign investors. In this way, they discourage and hurt the competitiveness of domestic exporters (World Bank, 2020).

The following are the biggest hurdles for foreign investors entering the Macedonian market, as indicated in many academic papers, government documents, and even on the websites of large investors (Mauritius Trade Easy, 2025):

- High percentage of corruption and organized crime;
- Lack of transparency;
- Lack of digitalization of a large number of procedures required for investment;
- Excessive and inefficient bureaucracy;
- Political interference in the judiciary;
- Inadequate transport and other facilitating infrastructure;
- Poor; customer service and communication difficulties,
- Low labor productivity;
- High structural unemployment and training deficit;
- Important size of informal economy and
- Conflicting political landscape;
- Shortcomings in the rule of law and contract enforcement.

The authorities in the country must pay attention to these alarming points if they want to attract more foreign investment to the country. It is positive that Macedonia is making efforts to fully align and harmonize with EU standards and protocols regarding FDI (such as digitalization, green energy, renewable energy projects, IT services, etc.).

Trade Performance of The Republic of Macedonia from Independence to 2023

Based on the analysis of Macedonia's foreign trade performance, it can be concluded that there have been no major positive developments in the entire analyzed period of 32 years. The Macedonian economy has struggled to deal with trade challenges. Although the regulation for trade liberalization has been adopted, it has not brought much fruit. All indicators show that the Republic of Macedonia is not a country with developed foreign trade. This is due to inadequate export organization, unfavorable distribution of exports of goods and services, a small number of strategic partners, inadequate volume, dynamics, and structure of exports, unattractive assortments for consumers, etc. (Selimi, 2012). Foreign trade performance can be analyzed from the following aspects:

Dynamics and volume of export and import activities from 1991 to 2023

Having in mind that the most successful transition countries have an export that is 50-70% of the GDP, the next Figure shows that the Republic of Macedonia is far from showing foreign trade success (Export Strategy for the Republic of Macedonia, 1999).

Namely, in the period of 24 years, i.e., from independence in 1991 to 2015, data shows a constantly low % of export in GDP, which on average is 35,53%. Significant export movements occurred in 2015 (48,74% of the GDP), and they rose in the following years, reaching a maximum of 72,79% of the GDP in 2022. However, the increasing exports, especially the export of goods that have a dominant share of total exports, do not contribute to a significant growth of the economy. (Export Promotion Strategy, 2024-2027). For example, in 2022, exports reached a maximum amount of USD 10,14 billion, and economic growth was only 2,2%. So, high export rates do not result in an increase in the GDP, i.e., the economic development of the country. This means that there is a positive correlation between exports and economic growth, but that relationship is not very significant. This can be explained by analyzing Figure 2.

Figure 1: % of Export in GDP of Macedonia (1991-2023) (World Bank, 2025)

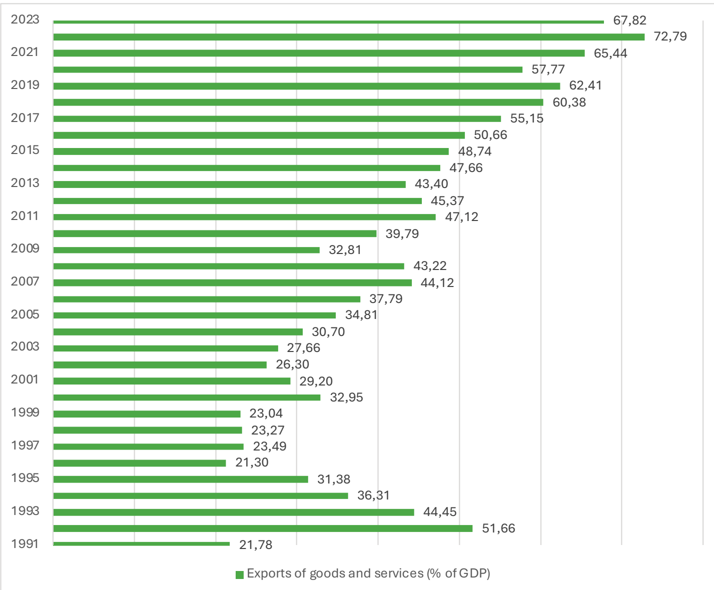
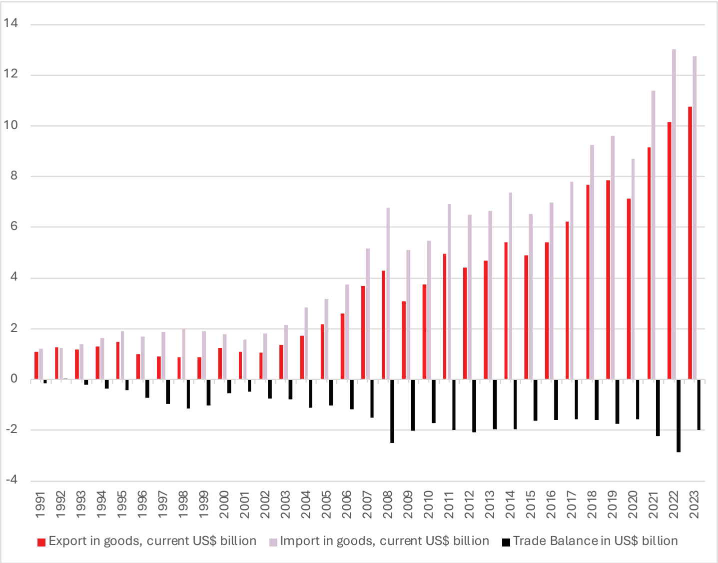


Figure 2: Export, import, and trade balance (deficit) of North Macedonia, in $ billion (1991-2023) (World Bank, 2025)



The explanation of the weak correlation between the exports and the growth of the Macedonian economy should be sought in the low added value, i.e., high 'import component' of the trade. In 2023, exports as a percentage of GDP amounted to 67,82%, while imports reached a fantastic 80,85% of GDP. Almost throughout the entire analyzed period, imports were far higher than exports, indicating a chronic deficit in Macedonia's international trade. The trade deficit shows an increasing tendency from US$ 2,09 billion in 2012 to almost US$ 3 billion in 2022 (or an increase of US$ 1 billion). According to the Export Promotion Strategy 2024-2027, another important reason for the low added value of exports is the unfavorable export structure of the domestic companies. The majority of the domestic companies' export products have little added value and a low degree of finalization.

Export Distribution

The Republic of North Macedonia, for almost the entire analyzed period (1991-2023), has a limited, narrow number of strategic partners, which makes demand for products unstable, insecure, and uncertain. A high percentage of foreign trade, with a small number of strategic partners, always means a higher risk for the normal functioning of a given economy. In the years after gaining independence, the 1990s, Macedonia cooperated with 14 trade partners, of which the following five were its strategic partners: Germany, FR Yugoslavia, the USA, Italy, and Greece. These countries together absorb around two-thirds of the Macedonian total exports. (Export Strategy, 1999). Other countries with which it cooperates are Slovenia, Bulgaria, Ukraine, Croatia, the Netherlands, Switzerland, Russia, Austria, and Türkiye.

The percentage share of strategic trading partners in Macedonia's exports and imports for 2022 is shown in the following Table.

Table 2: Strategic trade partners of the Republic of North Macedonia (SSO, 2022; www.statista.com)

Main Export partners, 2022		Main Import partners, 2022	
Country	% share in total exports	Country	% share in total imports
Germany	44,6%	United Kingdom	16,4%
Serbia	8,1%	Greece	14,6%
Bulgaria	4,7%	Germany	9,5%
Greece	3,3%	Kosovo	8,4%
Italy	2,9%	Serbia	7,7%
Hungary	2,8%	China	5,1%
United Kingdom	2,4%	Bulgaria	5,1%

The most important trading partner for the Republic of Macedonia is Germany. Almost 45% of Macedonian exports go to Germany. Trade between these two countries reaches a quarter of Macedonia's entire trade turnover (Federal Foreign Office of Germany, 2025). These trade relations with Germany, but also with the most important trading partners from the EU (Bulgaria, Greece, Italy, Hungary), should be nurtured and deepened. Also, the potential for exports to other EU countries should be analyzed. The Export Promotion Strategy 2024-2027 already mentions the Czech Republic, Romania, and Belgium as EU countries where Macedonia can place its exports. Countries that are not in the EU, but with which trade exchange can be intensified, are Turkey, Switzerland, and Great Britain. Also, one should not forget the major markets where Macedonia can place its exports, such as the USA, Canada, China, India, and the countries of the Middle East (Iraq, Qatar, Saudi Arabia). Although the diversification of exports to all of the listed countries is planned in the Government's Action Plan 2024-2025, it should still be kept in mind that this task is not easy, given the country's export structure and organization. Namely, increasing the number of strategic partners and diversifying exports was also discussed in the 1999 Macedonian Academy of Science and Art (MANU) Export Strategy. It is necessary to have a systematic approach for entering other markets, setting priorities, and involving domestic companies in the supply chains of foreign corporations in the country and their regional connections.

Export Structure

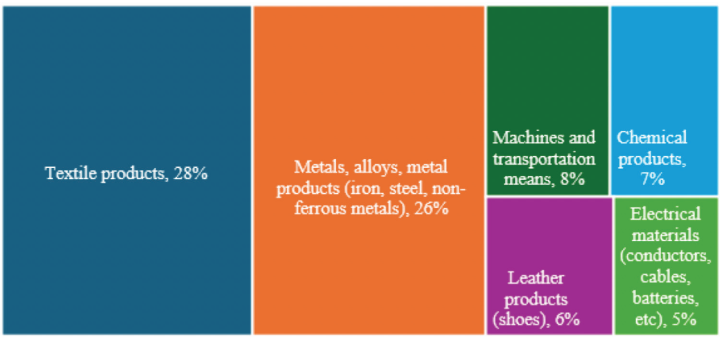
Regarding the export structure, it can be noted that it is narrow-spectrum and vulnerable, focused on a certain number of groups of industrial products. Macedonia exports products from industry (97%) and agriculture (3%), and services are almost negligible. The export of services is not registered in the official statistics of the Republic of Macedonia (Drenkovska, Uzunov, Bogoev, 2020). In analyzing exports in 1998, it can be noted that total exports amounted to USD 1.322 million, in which industry participated with USD 1.280 million (97%), and agriculture with USD 33 million (3%). Exports by product groups, as well as imports for 1998, are presented in Table 3.

Table 3: Structure of export (I and II) and import (III) by group of products, 1998 (MANU, 1999)

I. Export of industrial products, 1998		**III. Import of goods, 1998**	
Textile products	28%	Meat and meat products	24%
Metals, alloys, metal products (iron, steel, non-ferrous metals)	26%	Grain and grain products	18%
Machines and transportation mean	8%	Fruits and vegetables	9%
Chemical products	7%	Sugar beet and processing	7%
Leather products (shoes)	6%	Coffee, tea, spices	7%
Electrical materials (conductors, cables, batteries, etc.)	5%	Milk and milk products	6%
Minerals and mineral products	4%	Tobacco and tobacco products	5%
II. Export of agricultural products, 1998		Animal feed	4%
Tobacco and tobacco products	38%		
Beverages (wine, juices, etc.)	24%		
Fruits and vegetables	21%		
Lamb and mutton	4%		

Exports of industrial products are primarily distributed in 7 product groups, whereas the first three groups, textile products, metals, and metal products, and parts for machinery and transportation means, account for more than 60% of total exports. Such narrow diversification of exports makes trade vulnerable because, with unstable, uncertain demand for these products, production will also be at risk.

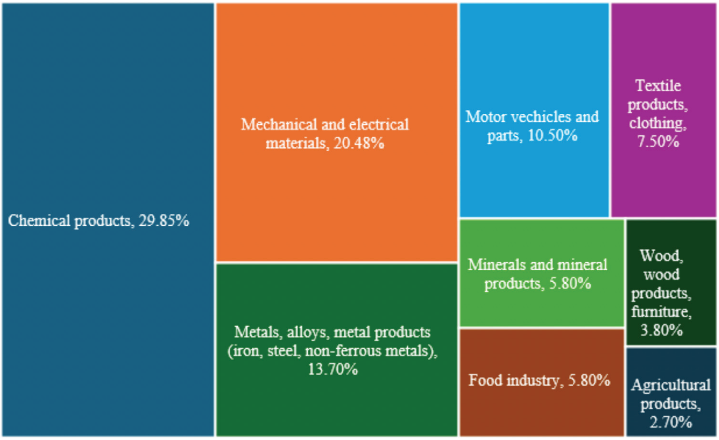
Figure 3: Export of industrial products, 1998



Note. Own calculations, based on the Export Strategy for the Republic of Macedonia (MANU, 1999)

The export structure in 2021 is similar to that of 1998 (see Figure 3 and Figure 4), with a small inclusion of wood, wood products, and furniture (3,8%). Industry again has a dominant share of exports, while agricultural products account for 2,7%.

Figure 4: Export of industrial goods, 2021

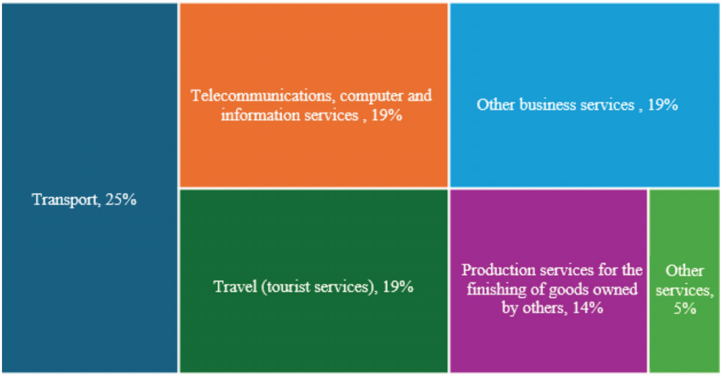


Note. Own calculations, based on the Export Promotion Strategy of the Republic of North Macedonia 2024-2027 (Ministry of Economy, 2024)

The most important export sector in 2021 is the chemical and related industry with 29,8% of the country's total exports. The second most important export industry is the mechanical and electrical industry with 20,4%, followed by the metal and metal-processing industry with 13,7%. These three industries together account for over 60% of total exports.

The analysis of exports in service, shown in the following figure, is interesting and promising.

Figure 5: Export of services, 2021



Note. Own calculations, based on the Export Promotion Strategy of the Republic of North Macedonia 2024-2027 (Ministry of Economy, 2024)

In the future, a significant increase in the ICT services can be expected, which will bring the highest added value to the domestic economy. Also, the agricultural sector, as well as the wood industry, especially furniture, has great potential for further development and export. Although the production of parts and components for the automotive industry has a large share of exports, which is the result of foreign companies involved in FDI, this does not have a great benefit for domestic companies that are not involved in the cooperation and exchange of knowledge and know-how with foreign companies. The main pillars of exports will continue to be the chemical industry, metals and metal-processing industry, and mechanical and electrical industry. Traditional industries that were important for Macedonia's exports, for which it was recognizable, such as the textile industry, leather, and minerals, will have an increasingly smaller share in exports (Ministry of Economy, 2024).

International Trade Trends Important for the Macedonian Economy

International trade in recent years has faced several challenges and undergone significant innovations. It is very important for Macedonian businesses to monitor developments in international trade to respond appropriately to these challenges and more effectively seize the benefits it offers. North Macedonia is primarily oriented toward the markets of the European Union and the United States. However, a new dimension has emerged in this process with the growing influence of the BRICS group of countries — Brazil, Russia, India, China, and South Africa. This shift is particularly relevant in the current geopolitical context, where trade tensions are intensifying, notably due to the United States' efforts under former President Trump to reduce its trade deficit with China, resulting in the imposition of tariffs on goods from BRICS countries. These developments underline the need for Macedonian businesses to stay agile and informed about shifting global trade alliances and regulations. New trends in international trade can be divided into the following groups (Hossam, 2024):

1) Expansion of digital trade

Technological development enables greater digitalization of business processes, which is changing the way companies operate in the international environment. Digitalization means the use of digital technologies, such as the Internet, AI, and cloud computing, which reduces costs and increases efficiency. Digitalization is especially important for small and medium-sized enterprises that can easily enter the global market and use the trade benefits.

2) Increasing sustainability and social responsibility

Another emerging trend in international trade is the adoption of sustainable practices, the promotion of green trade initiatives, environmentally responsible trade practices, and compliance with global trade and climate goals. In this direction, trade companies are pressured to use electric transportation, renewable energy, circular economy models, eco-packaging, etc. The pressure for greater investments in the use of sustainable practices comes from regulators and consumers who are becoming increasingly aware of the environmental and social impact on global trade.

3) Addressing geopolitical shifts

Globally, significant challenges are occurring that enable increased protectionism, trade wars, and the formation of new alliances at the bilateral, regional, and multilateral levels. In recent years, a large number of countries have wanted to protect their domestic industries from foreign competition. By pursuing a policy of protectionism, they introduce increased tariffs, trade barriers, and quotas, and hinder international trade. It is very important for companies to be informed about such protectionist steps, so that they can develop strategies to reduce the risks of protectionism and trade wars. This can be achieved by seeking new markets, diversifying supply chains, forming strategic partnerships with local businesses, etc.

4) Resilient supply chains

Strengthening supply chains and investing in their automation for greater adaptation and reduction of vulnerability to various natural or social crises and disasters. Real-time adaptation of logistics is particularly important for more efficient customer service.

5) Growth in Trade in Services

The expansion of service exports, particularly in the ICT sector, i.e., software development, graphic design, digital marketing, as well as in tourism, finance, consulting, and education, is a growing trend. The COVID-19 pandemic accelerated the shift to remote services, opening new avenues in global trade. However, Macedonia faces a clear shortcoming in the export of services. There is significant untapped potential in this area, and focused efforts are needed to stimulate service exports. To address this, Macedonia should aim to: i) develop strategic support for service-oriented industries, especially in ICT and creative sectors; ii) invest in digital skills and infrastructure; iii)encourage cross-border collaboration and outsourcing; and, iv) pursue market diversification, particularly in regions where digital services are in demand.

By diversifying both markets and services, Macedonian businesses can enhance export resilience and reduce dependence on traditional goods sectors.

Conclusion and Recommendations

The Republic of North Macedonia, in the analyzed period from 1991-2023, very modestly engaged in international trade due to numerous internal and external problems. A large number of experts and theorists offer solutions for the country to reduce the trade deficit, increase export performance through changes in the export structure, increase the number of strategic partners, sign more bilateral and multilateral trade agreements, increase FDI, trade in services, etc.

However, the recommendations can be divided into two large groups: the business climate change and increasing export results (World Bank, 2020; Dimitrieska, 2016; Bilic & Durmishi, 2019).

The business climate can be improved with a number of measures, such as:

- Investments in research and development, innovation, modernization, and increasing the competitiveness of domestic companies,
- Digitization of a large number of business processes,
- Increasing labor productivity,
- Signing of new forms of cooperation between domestic companies and foreign investors (ensuring spillover knowledge effects to domestic companies and reaching higher added value),
- Investments in domestic infrastructure, such as railways, roads (and their safety), gasification, electricity, and renewable energy;

- Improving export results also includes a number of measures, such as: (Drenkovska, Uzunov, Bogoev, 2020)
- New strategic focus, identifying new export markets and including domestic companies in regional value chains and the regional market.
- Conclusion of trade agreements with a larger number of EU and non-EU countries (Turkey, Romania, Austria, China, Maghreb countries, etc.)
- Expanding trade through offering ICT services, tourism, healthcare, agricultural products, and their processing, foodstuffs, furniture, etc.
- Signing agreements for mutual recognition of professional qualifications with countries in the region for the inclusion of qualified young people in the service markets.

To achieve such a complex set of policy actions, strong high-level political support is needed.

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Chapter 8

Remittances as a Stabilizing Force: Their Role in Covering North Macedonia's Trade Deficit

Sani Saidi[1]

Remittances are defined as "the sum of flows from non-emigrant temporary workers and longer-term emigrants." In general, these private transfers play a significant role in developing countries in transition, representing one of the biggest external financing sources for their economies. Nevertheless, the remittance inflows have experienced considerable fluctuations in recent years, mainly as a result of the COVID-19 pandemic, but not only. Hence, causing a serious impact on the recipient countries and economies. Another related concern for the respective countries is the constant rise of the trade deficit, where one of the financing sources for its coverage is accounted remittances. Thus, these developments and the relationship between both

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macroeconomic indicators are crucial for many developing countries. Likewise, ongoing research and study on this matter are of great interest and importance.

The heavy reliance on remittances of Western Balkan countries, and in particular, of North Macedonia, has several macroeconomic effects on the countries. North Macedonia is a small landlocked economy that possesses a large diaspora community and likewise receives large inflows of remittances. Herein, remittances represent one of the most significant external financing sources for North Macedonia, after foreign direct investments. However, remittance inflows into the country have experienced fluctuations and followed a decreasing trend in recent years, a phenomenon that represents a real concern for its national economy and policymakers. On the other hand, the constant increase of the trade deficit, especially in developing countries and, in this case, in North Macedonia, too, has become a greater concern. Meanwhile, the county's trade deficit is considerably covered by remittances (Svrtinov et al., 2012; IMF, 2014; Ebibi & Spaseska, 2022). Another external financing source that has covered the country's trade deficit through the years is the foreign direct investments, which is regarded as a more stable and the largest source of financing (Unevska & Jovanovic, 2011). For that reason, in this study, we will additionally take data and analyze other indicators that influence the trade deficit, such as FDI and inflation. Likewise, to be able to make a comparative analysis and a better assessment of the real impact of remittances on the trade deficit in regard to the other indicators.

These reasons support the initiative to investigate the impact of remittances on the trade deficit of North Macedonia and make it worth undertaking a thorough research. There are two research objectives set in this study: 1) to examine how remittances impact the trade deficit of North Macedonia and find out their correlation; and 2) to enrich the existing available research and literature on remittances and trade deficit with a recent study. For this purpose, the following research questions are constructed: a) How do remittances affect the trade deficit of North Macedonia? and b) What is the relationship between remittances and trade deficit?

The chapter is structured as follows. The next section is reserved for theoretical background and existing studies, where the available literature and recent research on this topic are presented. The third section briefly presents an overview of the data and information on the chosen variables and indicators, part of the study. Whereas, the fourth section is determined by empirical insights and comparative analysis, where the findings and results of the study will be outlined and explained, followed by related discussions. The last section is reserved for the key findings and future directions.

Theoretical Background and Existing Studies

Remittances have continuously increased in volume and importance in the last few decades, especially in developing countries. Remittances can be a catalyst for private savings and per capita income (Koska et al., 2013; Anwar & Cooray, 2015; Drinkwater et al., 2003). Notably, they have grown faster than the private capital flows and official aid, becoming one of the most significant external financing sources for developing countries. On the other hand, the continuously increasing trade deficit, mainly in developing countries, has become a concern in itself. Thus, the role of remittances in balancing the deficit and their serious fluctuations in recent years as a result of many factors emphasize the importance of undertaking more research on this specific issue. Also, the potential implications sprout from the development and relationship of both macroeconomic indicators, representing considerable impact for the policymakers, diaspora community, and well-being of citizens.

Besides several general studies undertaken, the literature review provides only a few evidence about the relationship between remittance inflows and the trade balance in the recipient countries (Tung, 2018). Thus, there is a need for further studies that will examine the effect of remittances on the trade deficit of developing countries and, in particular, on the trade deficit of North Macedonia and Western Balkan countries.

Generally, the recorded high level of deficits in transition countries has raised concerns regarding the extent to which it poses serious risks for the respective economies. However, the widening of the deficit, to some extent, has been attributed to the preparation of the transition countries for EU membership (Dauti, 2024). According to Unevska and Jovanovic (2011), the current account deficit was mostly due to the high trade deficit, which is only partially offset by the high level of remittances. The positive impact of remittances on the current account is confirmed by Bugamelli and Paterno (2009), pointing out that workers' remittances play a significant role in financing the current account deficit. For instance, Bouhga-Hagbe (2004) also found, in their analyses, that "remittances almost cover the trade deficit". In addition, Buch and Kuckulenz (2010) in their research highlight the positive impact of workers' remittances on the current account, indicating that remittances provide a significant source of funds, but also additional savings for economic development. Based on a recent study of Ademi et al. (2022), an increase in emigrant remittances measured through private current transfers improves the trade balance of North Macedonia.

The literature identifies two channels through which remittances affect the receiving countries' trade balance: the exchange rate and the savings channels. Through the exchange rate channel, remittance inflows may be so significant in volume as to result in the appreciation of the real exchange rate of the receiving economy (Farzanegan & Hasan, 2016). Another way to show the importance of remittance inflows is to compare them with other types of capital flows (Shera and Meyer, 2013). For example, from a financing point of view, FDI is the main source for financing the current account deficit, which is usually considered a more stable source of financing (Unevska & Jovanovic, 2011).

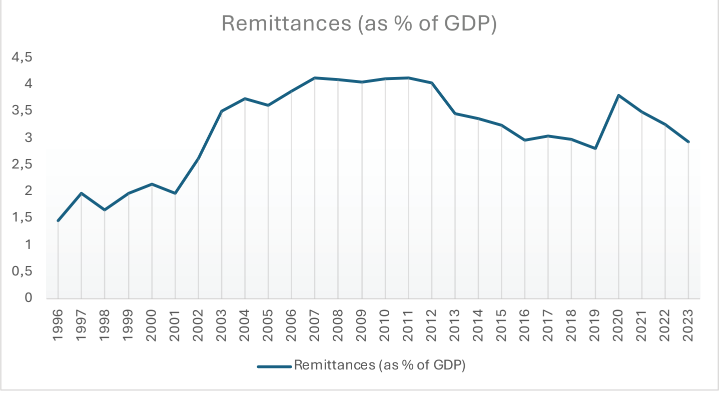
Meyer and Shera (2015) analyzed the impact of remittances on the current account in Albania, Bosnia and Herzegovina, Serbia, Bulgaria, Romania, Moldova, and North Macedonia. Hence, found that remittance inflows contribute to the improvement of the current account balance in the observed economies. Also, Sekiraca and Luboteni (2020) in their study have shown that the current account balance in the Western Balkan countries has been positively influenced by foreign direct investments and remittances, considering them as main financing sources. Cakajac et al. (2023) in their research show that remittances have become an important factor in current account deficit reduction in Serbia, where the results indicate that the role of remittances in financing the current account deficit in Serbia in the 2007-2021 period increased by approximately 10%. In this direction, also, Dukic and Bodroza (2022) found that remittances are an important factor in neutralizing the balance of payments deficit in Serbia, and their findings confirmed that in the 2010-2020 period, the inflows of remittances were sufficient to finance 78% of the current account deficit, on average.

Concerning the impact of remittances on the trade deficit of Macedonia, the IMF report in 2011 shows that private transfers, including remittances, are the major source of financing the country's trade deficit. Mughal et al. (2008) claim that remittances financed 90.6% of the trade deficit of the Macedonian economy in 2006. A preliminary research undertaken by Bucevska (2011) suggests that migrant remittances have played a vital role in financing between 80 and 90 percent of the Macedonian trade deficit. The main source of financing the constantly increasing trade deficit of Macedonia is remittance inflows (Svrtinov et al., 2012). Consequently, the IMF (2014) report on Macedonia states that private transfers, including remittances, are among the major sources of financing for the country's large trade deficit. The private remittances in Macedonia consist of remittances from immigrants by formal channels, cash transfers by informal channels shown as net redeemed money from the foreign exchange market that are channeled through the banking sector, and the rest of the remittances (mostly rents, pensions, etc.) (Disovska & Netorovska, 2015). Also, Ebibi and Spaseska (2022) found out that private bank remittances are a significant source of financing the current account deficit of the balance of payments from foreign direct investment, in the period 2015-2020. Whereas Disovska and Nestorovska (2015) claim that private remittances are not a stable source of current account financing, and therefore, the sudden stop of remittances inflow is a great danger for the stability of the current account. On the other hand, Hien (2017) argues that the increase in remittances may affect an appreciation of the exchange rate, which causes the price of exports to increase and the price of imports to decrease, which may lead to an increase in the trade deficit.

An Overview of the Remittances, Trade Deficit, Inflation, and FDI

Initially, it is significant to provide some information, data, and trend analysis of the main indicators used in this respective study for the country of North Macedonia. Hereby, one of the main indicators, remittances, their development trend, and volume during the years within the observed period 1996-2023 will be analyzed. North Macedonia is one of the countries that has a considerable diaspora living abroad, mainly in the EU countries, and thus, has received significant amounts of remittances over the years. Hence, remittances represent one of the key sources of external financing for the country and consequently, make a notable contribution to the national economy. Concerning the pattern and pace of remittances in North Macedonia, in general, from 1996 until 2012, followed an increasing trend with minor decreasing fluctuations from time to time, especially from 2000 onwards, experienced higher increasing rates reaching the peak in 2007, accounting for 4,1% of the country's GDP, which rate maintained for couple of years. Whereas, from 2012, remittances began to decrease constantly for several years until 2019, accounting for 2,8% of the GDP. Then, during the period 2019-2020, it experienced again a short but considerable one-year increase from 1 percent, reaching 3,8% of GDP in 2020. While in the last three years, as a result of many factors, including the pandemic of COVID-19 and energy crises, respectively, an upsurge in inflation, the flow of remittances has constantly declined, returning to the level of several years earlier, accounting for 2,9% of GDP. Nonetheless, below in the graphical presentation, it can be easily observed that remittance flows for all consecutive years and the development pace in North Macedonia.

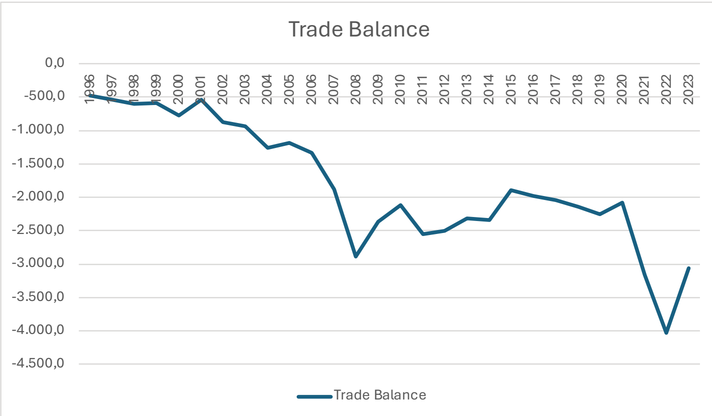
Figure 1: Remittance Flows in North Macedonia (1996-2023)



Note: Author's Elaboration on World Bank Data

Concerning the trade balance, the country is constantly operating under a trade deficit and has experienced an increasing trend during the whole period, with rare fluctuations in the pace of the trade balance. For instance, from a deficit of 479 million USD, which level was maintained approximately for several years with a permanent minor increase, until the period 2006-2008, during the global financial crisis, the deficit experienced a drastic increase from 1.337 million USD (2006) to -2.892 million USD (2008). More than doubled in only a two-year period. Beginning in 2009, a decrease in the trade deficit was registered, ranging between approximately 1.900 and 2.300 million USD, depending on the respective year, until 2020, similar levels were noted. Then, from 2021-2022, a sudden increase in the trade deficit was registered, reaching the highest level in the country's history, accounting for -4.031 million USD (2022). In the last year, 2023, a decrease was noted, and a deficit of -3.056 million USD was registered. As may be seen in the graphical presentation below, the country in general has experienced a constant increase in the trade deficit during the period (1996-2023).

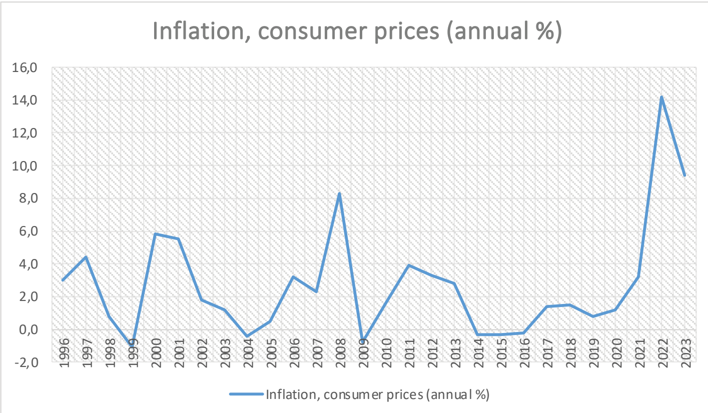
Figure 2. Trade Balance of North Macedonia (in millions of $US)



Note: Author's Elaboration on IMF Data

Regarding inflation, North Macedonia, mainly during the whole period, has experienced moderate inflation and stable rates ranging between 1% and 4% on an annual basis. A higher rate of inflation was first registered in 2000 at 5,8%, then, in 2008, accounting for 8,3%, and the record was noted in the last years, respectively, in 2022, when the country registered a double-digit inflation of 14,2%. In general, inflation has had an uneven pace, with several fluctuations, mainly minor, but in three periods, drastic oscillations or considerable increases in inflation rates have been registered. Hence, based on the inflation rates for the respective years, the impact of inflation varied in the trade deficit of the country.

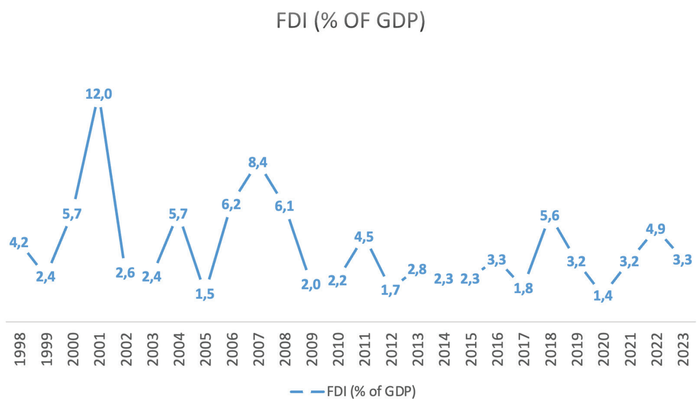
Figure 3. Inflation in North Macedonia (1996-2023)



Note. Author's elaboration based on the data of the Statistical Office of North Macedonia

Undoubtedly, another macroeconomic indicator that influences or contributes to the coverage of the country's trade deficit is foreign direct investment. After conducting an analysis of the FDI inflows received by the country in the period from 1998 to 2023, it can be noted that an average of approximately 4 % of GDP inflows of FDI were received by North Macedonia. Most of the time, the range of FDI inflows has been between 3-5 % of GDP, and only in some respective years are registered considerably higher inflows, such as in 2001, where were registered inflows from 12 % of GDP (highest peak) and later in 2007, inflows from 8,4 % of the GDP. In the last year, in 2023, the inflows decreased even below the usual average, respectively, to 3,3 % of the GDP. Below can be seen the FDI inflows throughout the whole period and the following development pace.

Figure 4. FDI Inflows in North Macedonia (1998-2023)



Note. Author's Elaboration Based on the Data of the State Statistical Office of North Macedonia

Empirical Insights on Trade Deficit Coverage and Comparative Analysis

In the beginning, a correlation analysis is performed for the purpose of determining the inter-variable relation between trade deficit and remittances, inflation, and FDI (see Table 2). Thus, the results from the conducted correlation analysis suggest a negative correlation between trade deficit and remittances, as well as between trade deficit and inflation. While the results suggest a positive correlation between trade deficit and FDI.

Table 2. Correlation Matrix

	TD	REMIT	INFL	FDI
TD	1,0000			
REMIT	-0,5248	1,0000		
INFL	-0,5156	0,0081	1,0000	
FDI	0,1993	-0,1940	0,3719	1,0000

Regarding the results of regression analysis provided in Table 3, it can be seen that the number of observations is 26. The results indicate a negative relationship between remittances and trade deficit, revealing that for every unit increase in remittances as a percentage of GDP, the trade deficit decreases by USD 549, holding other factors constant. Even based on the p-value, it is observed that p is 0,002, which is less than 0,01 and thus has a 1% significance level. The coefficient of determination is 0,6380 which means 63,8 % of variations in the trade deficit can be explained by the chosen explanatory variables of this model. Also, the F-statistic is 12,93, greater than the critical value, and hence, at least one regression coefficient is not zero, meaning that the model has explanatory power.

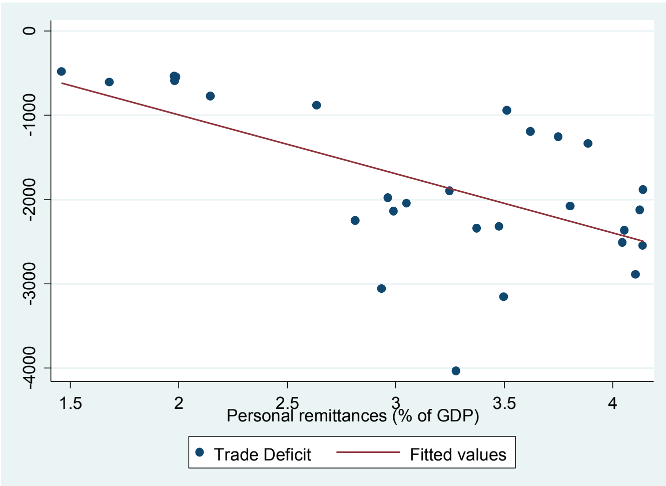
Table 3. Results of the Time Series Regression Model

Source	SS	df	MS	Number of obs = 26 F(3,22) = 12,93
Model	12659934,6	3	4219978,19	Prob > F = 0,0000 R-squared = 0,6380
Residual	7181683,02	22	326440,137	Adj R-squared = 0,5887 Root MSE = 571,35
Total	**19841617,6**	**25**	**793664,703**	

TD	Coef.	Std. Err.	t	P > I t I	(95% Conf. Interval)
REMIT	-549,7636	159,8002	-3,44	0,002	-881,169 -218,3582
INFL	-161,767	34,93573	-4,63	0,000	-234,2193 -89,31477
FDI	128,0328	51,63682	2,48	0,021	20,94463 235,1211
_cons	-177,6247	598,5679	-0,30	0,769	-1418,978 1063,729

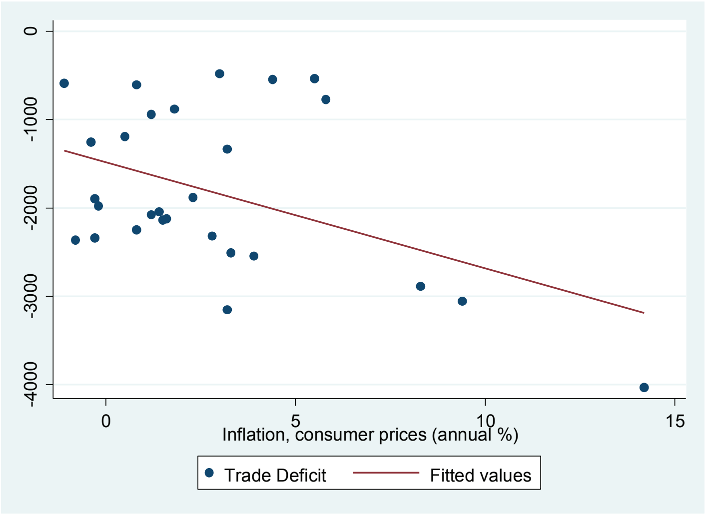
Based on the results of the regression model, we reject the null hypothesis and confirm the alternative hypothesis that an Increase in the volume of remittances decreases the trade deficit of North Macedonia. In Figure 3, the presentation of the relationship between trade deficit and remittances is shown in a scatter plot.

Figure 5. Graphical representation of the relationship between trade deficit and remittances



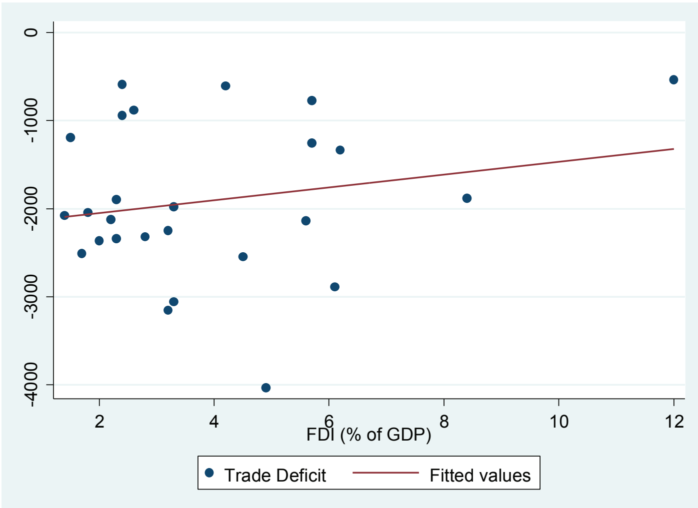
Whereas the result show that the other independent variable respectively inflation, based on the t-statistics which value is even one point greater than the remittances, normally, much greater than the critical value, its coefficient is highly statistically significant and based on p-value, which is 0,000 that is less than 0,001 and thus, have 0,1% significance level. Concerning the last variable, FDI, based on the results, the coefficient is also statistically significant with a p-value of 0,021, being statistically significant at a 5% significance level.

Figure 6. Graphical representation of the relationship between trade deficit and inflation



The sprout effect from the regression analysis suggests that an increase in FDI follows with an increase in trade deficit, even though it is a small one, but it is an interesting finding, taking into consideration that in general, FDI is perceived as an external source that covers the trade deficit, which is not the case in this study. The same result and relationship between trade deficit and FDI is confirmed by the correlation analysis undertaken, which you may find graphically represented below.

Figure 7. Graphical representation of the relationship between trade deficit and FDI



Key Findings and Future Directions

Remittances have proven to be significant external sources, especially for emerging and developing countries, delivering several impacts on recipient countries. Herein, the recent fluctuations in the remittances inflows as a result of different factors have raised serious concerns for many national economies and, by themselves, produce respective effects. Another indicator of interest in this study is the trade deficit, which is constantly increasing and has become a significant challenge for the respective countries, as well as for North Macedonia. So, these recent developments and the correlation between both macroeconomic indicators arouse our interest to conduct this respective study, where we examined the impact of remittances on the trade deficit of North Macedonia.

Based on the results from the conducted empirical analysis, it is proven that remittances significantly impact the trade deficit of North Macedonia, respectively, and are one of the sources that considerably cover the trade deficit of the country. Consequently, an inverse relationship between trade deficit and remittances was confirmed, meaning that an increase of 1% in remittances decreases the trade deficit by 0,5%. Meanwhile, regarding the other explanatory variables in the study, it appeared that inflation significantly affects the trade deficit, whereas findings suggested that FDI has a positive relationship with trade deficit, an interesting fact that was perceived to be the opposite.

In the future, it would be interesting and worth researching to widen the study on remittances and the trade deficit by including more explanatory variables, using quarterly data, and constructing a more developed regression model. Furthermore, use a panel data model in order to analyze the trend in other countries and be able to make a comparative analysis within the group of developing countries. Hence, make a more comprehensive and complete study that will assist policymakers, diaspora, and researchers for future studies.

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Chapter 9

Labor Market Dynamics and Productivity Trends in North Macedonia

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North Macedonia has gone through an economic change from a centrally planned economy to a market economy that has completely altered the labor market and ways in which productivity is organized. This chapter measures labor market indicators like employment, unemployment, and participation, and reflects on changes in labor productivity over the last 15 years. In doing so, this chapter examines changes to labor market outcomes and productivity growth resulting from structural reform (European Union integration), changes in foreign direct investment (outward and inward), changes to technology (especially digital infrastructure), developments in the labor market policy environment, and the effects of the COVID-19 pandemic on employment.

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North Macedonia is a landlocked country located in the center of the Balkans, whose economy has been completely transformed since independence was declared in 1991. As a former socialist republic of Yugoslavia, North Macedonia inherited systems of economic planning, industrial structure, and levels of employment geared toward full employment. However, independence from Yugoslavia resulted in a radical dislocation of the economy through trade interruptions, wars in the region, and the loss of former Yugoslav business relationships and markets, which plunged the economy into economic crisis. GDP fell substantially in the early 1990s, inflation soared, and unemployment exceeded 30%.

The transition towards a market economy was neither quick nor easy. In 1993, the Law on Transformation of Enterprises with Social Capital established the direction of reform and the legal foundation for privatization. By the early 2000s, more than 80% of state-owned enterprises had been privatized, but the pace of privatization and dispossession of state assets varied, lacked transparency and impartiality, and weakened institutional capacity. The economy continued to exhibit fragility as much of the economy was informal, relying on remittances, informal income and external support. Nonetheless, there began to emerge institutions for legal and institutional improvements, and with a broader context of external anchoring via an EU accession strategy, which has since begun to instill a more stable path for employment and investment.

The post-2001 experience was transformative when North Macedonia signed the Stabilization and Association Agreement with the EU and normalized politics following the internal conflict, which opened the possibility for much deeper international engagement. Unemployment, as a major structural challenge, continued to impact North Macedonia in the 2000s and 2010s. Various governments have engaged with labor market exclusion, with programs like the Operational Plan for Employment and labor activation strategies meeting with varying success. More recently, there has been a focus on promoting digital literacy, providing encouragement for SMEs, and developing vocational education and training systems (VETs) which match labour market demand.

In this chapter, we will explore these important developments and specifically focus on labour market dynamics and productivity trends over the past two decades. We will consider changes in employment, participation, and unemployment, and take into consideration the role of structural reforms, external shocks, including the impact of COVID-19, as well as technological diffusion. In addition, we will consider how digital transformation, green skills, and sectoral changes have implications for labour productivity, and what policy levers can help support more inclusive and resilient labour market outcomes. Ultimately, the aim is to examine how North Macedonia can support its policies, human capital, and institutional arrangements that would help support the efficiency and effectiveness of improvements in both employment and productivity.

Economic Transformations and Social Structures

The shift from a centrally planned economy to a market-based economy in North Macedonia marks one of the most significant socio-economic shifts in the context of its recent history. Following independence in 1991, North Macedonia confronted severe challenges associated with restructuring its economy while managing social peace and security of employment. The collapse of state-owned enterprises brought a wave of job losses to the economy, and the private sector at the time could not hire enough individuals to absorb these displaced workers. The economic and institutional changes brought about through trade liberalization, the establishment of property rights, and the creation of a regulatory environment favoring a market system allowed a competitive and flexible labour market to develop. Although this transformation enabled change in the economy, it also came with social costs such as increasing unemployment and the creation of labor informality.

In the first decade of the 2000s, North Macedonia continued with its market reforms and built more and deeper connections to the regional and global economic systems. The signing of the Stabilization and Association Agreement with the EU in 2001 and its membership in the CEFTA in 2006 signaled that North Macedonia had become more open than ever to trade and investment. These agreements committed North Macedonia to improve its competitiveness and generate employment opportunities for its people by setting clear parameters for the country's attractiveness to foreign investors. The result of these changes would grow important economic activities, particularly light manufacturing, ICT, and business services, which would ultimately start to absorb labor opportunities and raise productivity levels in prioritized activities.

However, structural weaknesses remained. The labour market was segmented. Unemployment was pronouncedly higher in the rural areas and among females. Across the economy, certain areas benefited from their integration into the global supply chain or upgrades in technological operating practices. Others struggled to strengthen their performance, with low capital intensity, inadequate infrastructure, and poorly skilled workers. Accordingly, public policy for labour hardly kept pace with a rapidly evolving labour landscape. Reforms in the educational and vocational training systems appeared to be consistently behind the rapidly changing labour system. A significant proportion of the working-age population remained unemployed or underutilized.

Labor market change has grown increasingly complicated in recent years, due to new challenges of a global character and the demographic changes occurring within the nations of North Macedonia and its regional peers. North Macedonia has experienced population aging, youth emigration, and increased pressure to move towards greener and digital forms of production, among other pressures. Taken together, these new pressures have made policymakers begin to think more integratively about what relationships to unpack between labor market performance and productivity change in the long run. The necessity of examining issues of reskilling the workforce, developing a culture of lifelong learning, and sustaining opportunities for labor market participation across non-represented groups is now wholly encompassed in economic development strategy. These are significant and costly political tasks. In the context of labor market change and recent social changes in North Macedonia's economy, the only way to fully understand how to undertake its economic transformation will require a focused analysis of employment trends, labor market institutions, and productivity-enhancing strategies. Each of them will be analyzed in the following sections.

Institutional Reforms and the Shift in Labor Policy

In North Macedonia, the transition from a socialist labor system to one that is market-oriented was characterized by several waves of institutional and legislative changes, influenced by the historical context of Yugoslav self-management, as well as the new realities of the newly founded state of North Macedonia. In the socialist arrangement, employment was assured, workers were allocated by the state, and as an employee, social services were available at the workplace to nearly all citizens. The transition from this system in the early 1990s was abrupt, creating a socio-economic shock with a great number of mass layoffs and no preparation to assist in the transition. To counter this situation, North Macedonia developed key labor reform legislation, including the Law on Labor Relations in 1993, that formalized the ideas of labor contracts, the obligations of employers, and procedures for termination. The establishment of the Public Employment Service (PES) in the mid-1990s was another institutional reaction to growing unemployment. However, the PES did not have adequate capacity procedures, funding, or digital infrastructure to track job seekers, to enforce compliance, or to provide active labor market measures.

The privatization process, which took hold until 2003 and went forward quickly, had a significant hand in intensifying labor market segmentation. Previously employed industrial workers, especially older, less educated males, found themselves struggling to reenter employment, and the rates of informal employment in all sectors of the economy grew in sectors like retail, construction, and agriculture. By 2005, the informal economy employed about 30% of employment according to national statistics.

Reforms progressed rapidly just prior to EU candidacy (2005), which consisted of strengthening labor inspection regimes, formalizing labor relations, and efforts to decentralize employment services; however, enforcement continued to lag. Though there were ILO and EU technical cooperation programs to enhance institutional modernization, much of the implementation fell short at the municipal government level, and there was insufficient municipal government awareness and interest. Social dialogue has stagnated as unions have member losses and collective agreements have shrunk to represent a smaller and smaller portion of the labor force.

In 2006, the government initiated the first National Employment Strategy (2006-2010) with a framework emphasizing activation policies, youth employment, and supporting vulnerable groups. Annual updates of the

Annual Employment Operational Plans since 2007 have continued with wage subsidy programs, self-employment grants, training, etc., yet few people have participated in the programs, relative to labor market need.

By the 2010s, various international partners such as the World Bank and the EU Delegation to Skopje started to promote performance monitoring tools and labor market data systems, though progress was slow. Administrative fragmentation, variable political commitment, and under-investment in workforce training limited reform potential. Recently, the move towards digital administration and the implementation of the Youth Guarantee pilot created a new phase of experimentation in the labor market, while many of the fundamental issues remain in place.

The country's experience reflects the centrality of sustained policy commitment to labor outcomes, including long-term investment in labor institutions. Without active monitoring structures, well-trained labor officers, and adaptable legislation, no matter how sound, reforms often fail to create improvements in labor market outcomes for vulnerable groups.

FDI and Labor Market Development

Foreign direct investment has served as the primary mechanism for directing labor demand and productivity in North Macedonia since its independence. Initially, the privatization of state-owned entities during the late 1990s and early 2000s occurred with FDI involvement. The privatization phase stabilized vital industries (such as glass, plasterboard, and minerals) and introduced international business practices into these sectors. Subsequently, FDI began to increasingly focus on labor rights sectors such as textiles, automotive parts, and IT services. In all instances, this resulted in job creation and contributed to the modernization of North Macedonia's industrial production.

The government began refocusing FDI efforts in roughly 2005. This was formalized when TIDZs (Directorate for Technological Industrial Development Zones) were established to create export-oriented, labor standards incubators. (TIDZs also provided tax advantages, infrastructure support, and a favorable regulatory environment). Their initiation and locations throughout the country led to the mid-sized investment function, and foreign investments employ 2.000 people in North Macedonia. Companies such as Johnson Matthey, Lear Corporation, and Gentherm opened TIDZ facilities in North Macedonia, creating thousands of jobs in the process and incorporating many local production forms into evolving global value chains. While many of the jobs created were in light manufacturing, which involved standardized processes that required little formal education, they also required essential components of reliability, discipline, and basic technical skills.

While FDI has created jobs and stimulated exports, it has nevertheless also signaled deeper structural problems in the domestic labor market. In many instances, foreign investors reported dealing with difficulty in finding workers with appropriate skills, especially highly skilled technical and engineering employees. This illustrates a longstanding skills mismatch between the outputs of the education and training system and the evolving demands of modern industry. Furthermore, FDI-related jobs have tended to be primarily job creation in urban or semi-urban areas, fueling regional disparities in job creation and productivity growth.

Beyond job creation, there are questions regarding the quality and sustainability of jobs created by investment made possible by FDI. Those taking jobs in TIDZs tend to be paid less and are placed in more precarious work than jobs within a domestic firm or the public sector. There are also a few documented cases of spillover/multiplier effects into the broader economy, such as technology transfer and local suppliers developed to feed TIDZ plants, or any increased regional innovation.

That said, FDI remains an important source of economic dynamism in North Macedonia, especially while the country continues to grapple with EU standards. For sustainable growth, any balanced strategy for future economic development and recovery will take not just FDI to attract capital, but deeper domestic capacities to absorb and benefit from FDI, through upgrading skills, supply chain integration, and improved labor protections.

Trends in GDP Growth, FDI, and Labor Productivity

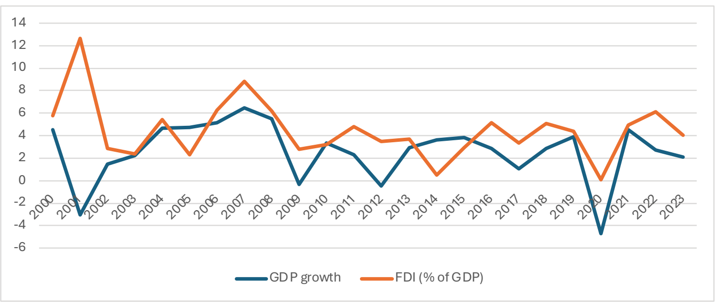
The rate of GDP growth experienced in North Macedonia has fluctuated due to factors present in the region, along with the performance of the global economy. The country achieved moderate GDP growth in the early 2000s before it suffered a series of shocks from the 2008 global economic crisis. In recent times, government policies to promote foreign direct investment have resulted in expanding sectors such as manufacturing and information technology, while the TIDZs have attracted multinational corporations and generated jobs. However, in some circumstances, increases in economic activity are not accompanied by increases in standards of living for the whole population, highlighting the need for policies that address inequities in growth and encourage a more inclusive path to development.

North Macedonia's trajectory over the last 20 years has been characterized by variable GDP growth rates and variable FDI as % of GDP – the data can point to a movement of growth, shocks, and recovery conditioned by both domestic and international economies and experiences (Figure 1). At the start of the 2000s, the country experienced a challenging period of ups and downs, with negative GDP growth in 2001 characterized by an unstable and unsafe environment arising from the internal conflict.

As FDI grew to over 12% of GDP, most likely fueled by privatizations and the entry of foreign capital to priority sectors, the following period (2003 to 2008) experienced an economy characterized by continuously positive and sustained GDP growth of above 5%. In part, this growth was co-founded by improvements in macroeconomic stability, by reforms that positively impacted important sectors of the economy, and by expectations of accession to the European Union, which, collectively, improved investor confidence.

However, FDI remained volatile, influenced by external risk factors as well as the slow and incomplete pace of reforms. The increasing growth trends were then disrupted by the global financial crisis (2008-2009), which, ultimately, caused a sharp contraction of economic activity as the already positive GDP growth rates drastically dropped in 2009. During this time, investors became highly risk-averse, further disrupting capital flows to the country and leading to declining trends in FDI. The years 2010-2013 showed a weak but unpredictable recovery in GDP growth that can be reflected in the ongoing fluctuations in FDI inflows and uncertainty in the global economy, and significant domestic risk factors that impacted investor sentiment.

Figure 1: Trends of GDP growth and FDI (as % of GDP) in North Macedonia (2000-2023) (World Bank, 2025)



Between 2014 and 2019, the period was associated with a more stable economic phase with GDP growth rates of 2% to 4%. The period was characterized by strong macroeconomic management and a degree of political stability that provoked a phase of consistent but modest economic growth. However, foreign direct investment was still inconsistent while changing in relation to standard variations in external economic conditions and investors' confidence. The most shocking period occurred in 2020, as the COVID-19 pandemic caused a steep alteration of economic activity that instigated a steep economic decline. Due to lockdowns, disruptions of global trading, and a decline in domestic demand, GDP suffered a severe contraction. Concurrently, foreign direct investment destined for North Macedonia decreased steeply as foreign direct investors ceased or delayed investments in the country due to uncertainty in the global economy. Even though foreign direct investment decreased in 2020, the years following 2020, especially between 2021 and 2023, showed signs of recovery. Growth rates for gross domestic product experienced moderate rebounds prompted by post-COVID-19 economic reopening, government stimulus, and revival in consumer spending and business activity. While foreign direct investments experienced recovery, they remained at levels that were less than their near peak observed in 2000-2008. This economic and investment transition shows the robust link of North Macedonia's economic growth characteristics to the global economy, as well as the extent to which foreign investment affects labor market conditions and productivity performance. Foreign direct investment is commonly known to create jobs in existing firms as well as labor-market disruption when that job creation occurs. And foreign firms, especially those that have used North Macedonia as a "landing pad" for export production, tend to hire in lower to medium-skilled jobs that, for all intents and purposes, stifle further productivity performance unless accompanied by complementary investment in education, vocational training, and innovation capacity. While many FDIs, particularly in TIDZs, have achieved considerable improvements in operational efficiency and output per worker, productivity improvements have not necessarily been widespread. The majority of employment created remains low-skilled, and broad-based productivity improvements will be limited, unless foreign investment is leveraged for directly linked investments in workforce development. North Macedonia has to ensure that foreign investment originally leverages productivity improvements across the economy through workforce development, if foreign investment is intended to lead to long-term improvement for productivity growth and sustainable, inclusive development. Although considerable amounts of FDI activity have occurred along with the country's economic expansion, volatility provides indication of the risk factors it faces in maintaining steady and consistent levels of investment. Macroeconomic stability, improvements in the business environment, and providing investor confidence will be essential in sustaining future economic growth and improving North Macedonia's competitive position in an increasingly globalized economy.

Labor Market Trends and Structural Reforms

The developments in North Macedonia's labor market were driven by combinations of structural reforms, exogenous economic shocks, demographic changes, and new social policies. This section provides an overview of how all these forces have evolved over two decades of labor market key variables—employment, unemployment, and participation—and examines the broader social implications of those developments (welfare dependency, inequality, and labor market inclusion of vulnerable groups). The analysis is based on national and international data and will show how changes in the economy have influenced not only the number of jobs available but also the quality of work and the well-being of the people who create jobs.

Employment, Unemployment, and Participation Rates

The shift in North Macedonia's economy has affected a number of social structures. At its core is the privatization of state-owned enterprises, which is typically the engine of market liberalization, as it ruined the traditional employment model and diminished workers' job security. This development especially affected vulnerable or marginalized groups such as women, youth, and those from rural areas. As industries adapted to new patterns of business, the process of urbanization accelerated, as many from the rural population relocated to cities for better opportunities.

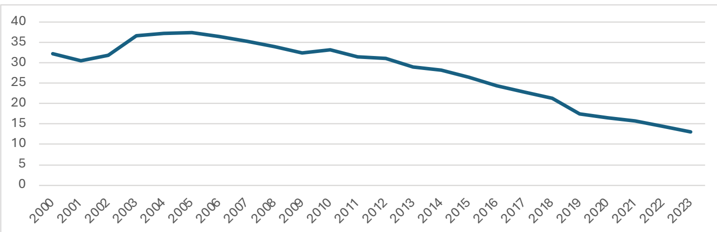
The privatization of the state-owned enterprises resulted in major job losses, especially in sectors no longer competing in the global economy. A World Bank report documented that North Macedonia had an unemployment rate of over 37% in the early 2000s, among the highest in Europe at that time (World Bank, 2005). The public sector, which had been an important employer during the socialist period, was reduced in size to decrease employment, resulting in additional unemployment and underemployment. The expansion of the informal economy has become an adaptation strategy for many who lost their jobs or could not attain formal employment. Bartlett (2008) found in their research that informal economic activity accounted for nearly 30% of GDP in the early 2000s. The informal economy produced some income and employment, but also contributed to limited social protection and poverty.

Over the past two decades, the unemployment rate in North Macedonia has steadily and significantly declined due to shifts in the economy, the labor market, and government policy. The unemployment rate at the start of the period in 2000 was extremely high; greater than 30% of the labor force was unemployed. The early 2000s were an uncertain economic time with poor business conditions and insufficient job creation, which maintained an elevated unemployment rate. From 2001 to 2005, unemployment remained consistently high, peaking in 2004 at approximately 37%. This period was also marked by structural economic adjustments, from a socialist to a capitalist economy, and to portray the uncertainty of the market, the overall difficulties in attracting foreign investors. Despite some industries still privatizing, there was also an excess labor supply from the declining state-owned enterprise labor market.

Following 2005, the unemployment rate began a steady decline, presenting the first early signs of a more fortified labor market. Job creation was aided by rising foreign direct investment together with developing key sectors such as manufacturing, trade, and services. By 2010, the unemployment rate was at approximately 30%, nonetheless, it retained one of the not only highest but is statistically significant in comparing the region, illustrating persistent rigidities and structural inefficiencies in the labor market.

The 2010s began to show more significant upward improvements as the government implemented labor market reforms with vocational training and active employment policies promoting more labor force participation. Further declines in unemployment were also supported by the stability of the macroeconomic environment, improved by increased private sector investments.

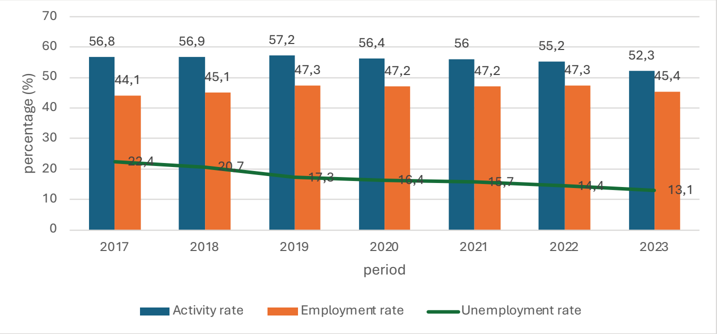
Figure 3: Unemployment, total (% of total labor force) (national estimate) in North Macedonia (2000-2023) (SSO, 2025)



Between 2015 and 2019, the country experienced a more rapid decline in its unemployment rate, dipping below 20 percent for the first time in many years. The improvement in the unemployment rate was propelled by a range of factors, including improved labor market policies, a more favorable business environment, and participation opportunities in both domestic and export manufacturing. Youth and long-term unemployment rates began to decline, demonstrating possible signs from employment programs targeted for specific groups; thus, demonstrating a change towards some effect of positive, productive labor. The labor market continued to face challenges with persistently high levels of informal employment, as well as mismatched labor supply.

In the last few years, the labor market in North Macedonia has gone through significant shifts, reflecting widening economic trends, structural shifts within the market itself, as well as external factors, including the COVID-19 pandemic. The data reflects a gradual decline in both the activity rate and the unemployment rate, and a relatively stable employment rate (Figure 2). In 2017, the labor market in North Macedonia reported an activity rate of 56,8%, an employment rate of 44,1%, and an unemployment rate of 22,4%. At this time, North Macedonia was still facing structural issues related to labor market deficiencies, including the nexus of supply and demand of labor, high youth unemployment, and limited job creation in high-value-added sectors. By 2018, the labor market showed some improvement, with an activity rate of 56,9%, an employment rate of 45,1%, and a reduced unemployment rate of 20,7%. This trend continued, with an employment rate of 47,3% and a decreased unemployment rate of 17,3% in 2019. The increase in employment can be associated with economic growth, a modest amount of foreign investment, and targeted labor market policies that promoted an increase in the labor market participation of the workforce. While the employment rate increased over this time, the activity rate showed less of a change, which speaks to continued challenges with labor force participation rates, especially among women and the youth.

Figure 2: Labor market in North Macedonia (%) (activity rate, employment rate, unemployment rate) (2017-2023) (SSO, 2025)



COVID-19 and Labor Market Disruptions

The arrival of the COVID-19 pandemic in 2020 interrupted this positive trend; however, although COVID-19 contributed to a decline in employment, its effect on total labor market activity was relatively muted compared to the labor market's relationship with movements in the GDP. The activity rate fell slightly to 56,4% and while the employment rate also fell slightly to 47,2%, the unemployment rate fell to 16,4%. The relative stability of employment levels during this period can be attributed, at least in part, to government policies, including wage supplements and the provision of support to businesses. The labor market remained stable in 2021 and 2022, with the employment rate at around 47,2%-47,3%, while the unemployment rate decreased to 15,7% in 2021 and 14,4% in 2022. The economy recovered from the impact of the pandemic and helped sustain employment; however, the declining activity rate (56% in 2021 and 55,2% in 2022) suggests that some of the movement out of the labor force was due to individuals leaving the workforce entirely. It is possible they became discouraged or found other options outside of working.

By 2023, North Macedonia's labor market had undergone further structural adjustments. The activity rate had fallen more noticeably to 52,3%, while once again, the employment rate remained relatively high at 45,4%. In parallel, the unemployment rate had decreased to 13,1%, which marked the lowest level observed in the period examined. While again this is a positive development, it must be viewed with caution as the falling activity rate reflects that part of the working-age population may have withdrawn from the labor market entirely, and it raises important questions concerning long-term labor force participation, skills mismatches, and the success of employment policies. On the whole, the labor market data reveal a gradual improvement in employment and a constant decline in unemployment over time. But it is evident that, with the decreasing activity rate, there is also a need for policy responses to promote greater participation in the labor force, improve job quality, and mitigate structural barriers that inhibit entry into and retention in labor markets. Active vocational training, increasing labor market flexibility, and provision of conditions for the creation of higher-quality jobs will be critical to achieve sustainable growth in labor markets across North Macedonia.

Welfare, Inequality, and the Most Vulnerable

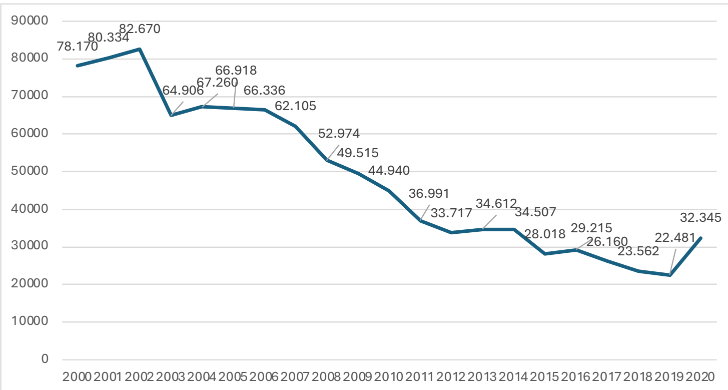
In addition to shifts in employment and participation, North Macedonia's changing labor market has also altered welfare systems and the country's social framework. Economic dislocation, long-term unemployment, and the prevalence of informal work have put strain on the social safety net and generated income insecurity for much of the population. Exploring how labor market trends and welfare policies are intertwined is paramount to considering the inclusive and sustainable development of the country. The next section focuses specifically on how these policies have influenced trends in social assistance, the health care and education systems, and the socioeconomic circumstances of vulnerable groups.

Changes in Welfare Systems

The welfare system in North Macedonia was greatly affected by the economic reforms. In the socialist period, the state provided comprehensive healthcare, education, and social protection. With the market reform, the state faced financial limits, resulting in public spending on welfare services being reduced compared to the previous periods of organized welfare. While adjustments to modernize the welfare systems have been implemented, considerable challenges remain in the form of chronic financial instability and regional inequities.

In the case of healthcare reform, although there were improvements made to access and organize primary care, quality and availability have been significantly different between urban and rural living situations. The education sector similarly encounters challenges associated with obsolete curricula, and a disassociation between graduates' skill sets and the requirements of the labor market. These disparities underscore the critical need for appropriate investments in human capital to foster economic development and social cohesion.

Figure 4: Beneficiaries of social assistance (number of households) in North Macedonia (2000-2020) (SSO, 2025)



At the beginning of the new millennium and as North Macedonia entered into the 21st century, the number of households utilizing social assistance illustrated the socio-economic status of the country. In the year 2000, a rough estimate of 78.170 households were relying on social assistance (Figure 4). This number would peak at 82.670 households by the year 2002 as a result of the hardship of transitioning economies. As North Macedonia adjusted to reform and integration, the number of households receiving social assistance fluctuated in measuring both progress and failure. The number decreased in 2004 to 67.260 households, which can be considered a sign of economic stability, although the decline was gradual, and households remained at the high 60.000 range for the rest of the observation. The more substantial change, however, only began after 2007 when the number of households receiving social assistance declined from 62.105 in 2007 down to 49.515 households in 2008 and 44.940 households in 2009. This indicated there was a continued decline in the new decade, with 36.991 households in 2010 and 28.018 households in 2015. Each of these observations coincides with North Macedonia's continued effort to recover the economy, rearranging social policies, and a slow decrease in unemployment. For the final years of observation, the prevalence levelled off for all households receiving assistance, plummeting from 22.481 households in 2019 to 32.345 households in 2020. The latter two years' change can likely be attributed to outside influences.

The COVID-19 pandemic ruptured North Macedonia's social and economic fabric and worsened preexisting vulnerabilities. Drangovska (2022) emphasizes that low-income households bore the brunt of the pandemic, worsening disparities, and unemployment. These concerns reflect global trends in poverty alleviation, where welfare gains were temporarily reversed by the pandemic. For most of the past three years, the share of the global population living on $2,15/day and $6,85/day did not change, indicating the magnitude of the pandemic's effects.

Rising Inequality and the Effect on the Vulnerable Groups

In North Macedonia, economic liberalization has increased the gap between those with higher incomes and those with lower incomes. Urban areas, particularly Skopje, almost exclusively benefit from a greater investment focus and new job opportunities, and rural areas continue to lag behind. The government has implemented programs aimed at reducing the gap between rich and poor, such as targeted subsidies and social assistance to those in need, but these efforts generally fall short and do not reduce the gaps between rich and poor in society. In order to reduce inequality in North Macedonia, there will have to be broader-based efforts to improve access to education, healthcare, and economic opportunities. Although economic liberalization has led to growth in the national economy for some sectors of society, it has contributed to widening the gap between the wealthy and the poor in society. National statistics regarding income inequality, represented through a Gini coefficient, provide evidence of continued inequality gaps.

Figure 5: Income inequality in North Macedonia, measured by the Gini index (2007-2021) (SSO, 2025)

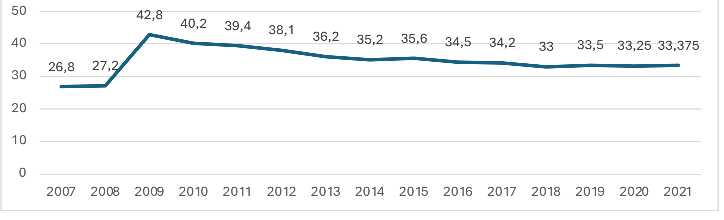


Figure 5 presents trends in income inequality in North Macedonia, as calculated by the Gini index, for the years 2007 to 2021. The findings show a steep rise in inequality, starting at 26,8 in 2007 and peaking at 42,8 in 2009, which is the highest inequality value observed overall in this time frame. This spike in inequality likely mirrors the effect of the global financial crisis on the country's economy and, thus, income inequality. After peaking, the Gini index generally declined to a level of 33 in 2017. Following 2017, the index seemed to generally hold steady at about the same Gini index value, fluctuating minimally between 33-34, and finally observing a Gini index value of 33,375 in 2021. The decline in income inequality after 2009 depicts an increasing process of income inequality reduction, potentially resulting from social or economic policy or interventions and/or efforts to improve the economy. Additionally, the holding steady in the later years may suggest that income distribution had reached an inequality level that had been reasonably established. Altogether, the figure provides an account of rising income-based inequality during a period of economic crisis, then a period of decline, followed by stabilization, which depicts the evolving socioeconomic conditions in North Macedonia.

Additionally, the number of households receiving social assistance in North Macedonia from the early 2000s to 2020 illustrates a complex story of economic resilience against continued hardship. Starting with the 78.170 households receiving assistance in 2000, the number increased to a 2002 high of 82.670. It subsequently came down episodically, indicating the impact of the economic and social reforms. By 2004, the total of households on social assistance had settled at 67.260 and, in the following years, remained within the low to high 60.000s, which again demonstrates a slight reduction, or improvement in terms of alleviating poverty and attaining stability in society. Relief from the declining dependence on Government support came in 2007, with a significant decline in households receiving assistance from 62.105 to 49.515 in 2008 and down again to 44.940 by 2009. By 2010, the number of households receiving assistance dropped to 36.991 but continued to decline into the future, i.e., down to 28.018 households by 2015, and bottoming out at 22.481 in 2019, before rising to 32.345 again in 2020, possibly due to global economic factors.

The advantages of economic reform policies went to certain segments of society, especially atypical segments with access to capital and political positions. Moreover, economic growth and development of urban areas, and more certainly, urban development processes, still disproportionately separate urban from rural, so to speak; poverty rates in urban areas were almost double those in the early 2000s (UNDP, 2002). Those displaced, such as the elderly, women, and ethnic minorities, also tended to be the most vulnerable groups in a changing economic context and a lack of social safety nets. Women's participation in the labor force is below EU averages, with cultural norms and insufficient assistance for childrearing both playing a part. Ethnic minorities are similarly disadvantaged with respect to education and employment, primarily resulting in poverty and exclusion.

Labor Productivity and Technology Adoption

Over the years, labor productivity in North Macedonia has exhibited progress, mainly propelled by the influx of new technologies and positioning in global supply chains. The government's emphasis on digitalization and increasing FDI led to some overall improvements in key sectors, including automotive components and information technology.

Labor productivity in North Macedonia shrank early on during the transition period of the early 1990s, as traditional sectors collapsed and there was insufficient investment in new technologies. As noted by the World Bank, labor productivity growth was negative in the early years of the transition; however, there was an improvement in labor productivity growth by the late 1990s, as the economy normalized and various reforms began to take hold (World Bank, 2005).

The transition from labor-intensive industries to more capital and knowledge-intensive sectors meant that there was a need to re-skill the labor force, which was a slow and complex process. Over time, though, improvements in labor productivity were made as the economy diversified and new industries began to develop. Increased labor productivity was achieved by the introduction of new technology and management processes, particularly in manufacturing and services.

Figure 6: Labor productivity growth rate (%) in North Macedonia (2000-2018) (World Bank, 2025)

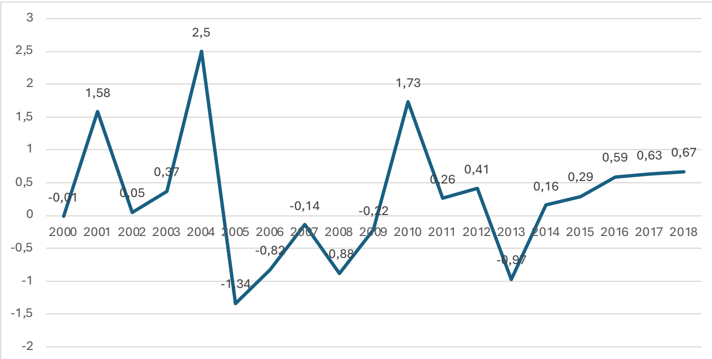


Figure 6 represents the trend of the labor productivity growth rate in North Macedonia over the period 2000-2018 for which data is available. The increase in labor productivity has been highly variable in the millennium since 2000. In 2000, productivity experienced a slight decline of -0,01%. Productivity increases again to 1,58% in 2001 and drops to 0,05% in 2002. After that process of oscillation, the productivity escalation reached its highest mark of 2,5% in 2004, only to decline to -1,34% in 2005. Productivity continued to remain negative in subsequent years with declines of -0,82% in 2006, -0,14% in 2007, and -0,88% in 2008. Then in 2009, there is a slight improvement with -0,22%, and the following year, productivity increases to 1,73% in 2010. From there, productivity declined to 0,26% in 2011, increasing to 0,41% in 2012, only to drop again to -0,97% in 2013. The growth in productivity turned positive and continued to improve from 2014 on, with a growth of 0,16% in 2014, 0,29% in 2015, 0,59% in 2016, 0,63% in 2017, and finally a growth of 0,67% in 2018. In the meantime, as the economy transitioned from labor-based industries to more capital-intensive and knowledge-based industries, the labor force needed to be upskilled, and that upskilling process was slow and challenging. Eventually, labor productivity improved as the economy innovated and diversified, creating a number of new industries, and as new technologies were adopted, resulting in more efficient processes in manufacturing and service businesses.

Despite all of these gains, there still exist elements of the economy that are structurally inefficient. If the education system did have this gap, it would be able to realize the full productivity potential. Although the workforce is more educated, there are still graduates who do not have the practical skills that employers are looking for in their workforce. This is often more concrete in skilled electrical and/or engineering occupations, and those qualifications do not require an evident skill from the rest of society.

Labor Productivity and Technological Transformation

The interrelation between labor productivity and technology adoption continues to play a crucial role in the economic transition of North Macedonia. The significant growth in internet penetration—from 2,5% in 2000 to upwards of 83 percent in 2021—illustrates the magnitude of digital transformation, in relation to a significant positive impact on labor productivity. Nonetheless, Besimi and Mazllami (2019) point out that technological advancements, in order to realize the anticipated productivity gains, must be supported by investments in education and training, as well as the ability to adapt to open-source technologies. The inclusion of green skills in economic transition, as suggested and explored by Nedanovski and Daniloska (2022), opens a way to bring sustainability into the labor market approach. Developing the green skills of a labor force would contribute to increased productivity, while at the same time achieving improved environmental outcomes (Petreski et al., 2024).

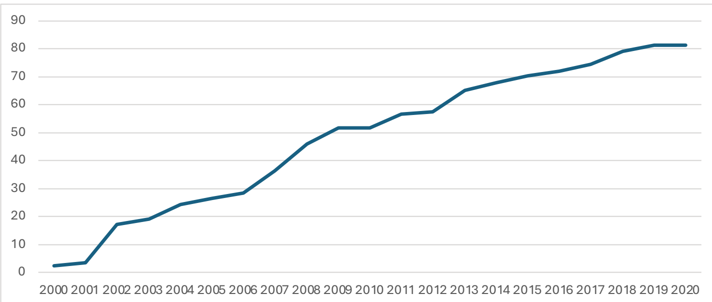
The story of technology adoption is a double-edged sword. To some extent, technology has enabled businesses to be more competitive in international markets; that is, it has facilitated businesses to enter international markets. To some extent, technology has displaced low-skilled workers, which has further exacerbated social inequality. To do its part in alleviating the transition of low-skilled labor, initiatives to retrain these workers and promote lifelong learning have begun, yet have been limited given a lack of investment and coordination.

The Role of Technology Adoption in Economic Transformation

New technologies have fueled a significant change in the economy of North Macedonia. In particular, the introduction of ICT has transformed businesses' operations, allowing businesses to become more efficient, reach new markets, and innovate. According to data from Index Mundi (2025), the percentage of internet users (as an indicator of the spread of ICT) in North Macedonia increased from 2,5% in 2000 to over 70% by 2015.

The government has also played a role in enabling technology adoption via a number of strategies, including developing ICT infrastructure, promoting R&D, and establishing technology parks and innovation centers. This initiative has helped create a supportive ecosystem tailored for entrepreneurship and innovation.

Figure 7: Internet penetration - Individuals using the Internet (% of population) in North Macedonia (2000-2020) (Index Mundi, 2025)



Internet penetration, an indicator of technological development, highlights this growth. Starting from just 2,49% in 2000 and 3,47% in 2001, by 2002 the number of individuals using the internet in North Macedonia grew exponentially to 17,33%. In the following years, they continued to grow, with 19,07% in 2003, 24,44% in 2004, 26,45% in 2005, 28,62% in 2006, and 36,3% in 2007. In 2008, the penetration increased to 46,04%, climbing further to 51,77% in 2009 and 51,9% in 2010, implying that now 50% of the population was online. The usage continued to increase with 56,7% in 2011, 57,45% in 2012, 65,24% in 2013, 68,06% in 2014, 70,38% in 2015, 72,16% in 2016, 74,52% in 2017, and 79,17% in 2018, and peaked in both 2019 and 2020 at

81,41%. At the same time, the number of active business entities shows the shifting climate of business. Starting with 75.497 in 2010, dropping to 73.118 in 2011, it sprang back to 74.424 in 2012, and dropped again to 71.290 in 2013. In addition, according to the Gini coefficient, which reflects income inequality, there was a fluctuating but overall drop in the Gini coefficient from 2007 to 2021. Finally, during this time, the competitiveness of North Macedonia dramatically shifted. The interplay between all of these factors demonstrates that entrepreneurship, social welfare, and economic competitiveness are all intertwined in North Macedonia (Figure 7).

Challenges and Opportunities in Technology Adoption

Even though there has been progress in the promotion of technology usage, challenges to the widespread adoption of technology remain in North Macedonia. A major challenge lies in the digital divide between urban and rural areas, as often, rural areas may not have access to a high-speed internet connection and other digital infrastructure. A report by the European Commission states that in 2015, only 50% of rural households had access to broadband internet, compared to 85% of urban households (European Commission, 2015). There needs to be further investment in education and training to develop a workforce with the skills to thrive in an economy driven by technology. The World Bank has emphasized how improving the quality of education and aligning education to labor market needs has supported technology adoption and innovation (World Bank, 2017). However, the opportunities for technology adoption are significant. Firstly, through the development of the ICT sector, job creation is being generated, and there is potential for further development in the economy. Secondly, digital entrepreneurship continues to grow and diversify the economy with new opportunities in e-commerce, software development, and digital marketing.

Conclusion and Policy Recommendations

The fate of North Macedonia's labor market over the past three decades indicates the massive burdens and complicated opportunities of moving from a socialist to a market economy. Along the way, there have been considerable structural reforms, foreign direct investment, global economic shocks, demographic trends, and shifts in technology. Many areas of change have been visible in the labor market - declines in unemployment, which have gone from over 30% in the early twenty-first century to about 12% in 2023, issues faced in various sectors adopting new technologies and modernizing, reported increases in labour productivity - but the majority in visible change can mask significant barriers that continue to delimit inclusive, resilient, and sustainable labor market development.

The drop in unemployment from over 30% in the early 2000s to approximately 12% in 2023 represents a major achievement, suggesting the economy was more successfully absorbing labor and generating employment (State Statistical Office, 2025). While this is a positive glance, this figure conceals residual vulnerabilities underneath. The labor force participation rate decreased, which indicates that a significant part of the working-age population, and particularly women, youths, and discouraged workers, is not engaged in significant labor market participation. Additionally, informality occurrence continues at high rates, especially amongst recipients in the agricultural, construction, and retail industries, which could signal compromises in job quality, social protection, and productivity growth.

There have been episodes of improvements in labor productivity since the changes and investments in digitalization and technology, and the importation of export-oriented foreign direct investment. However, these gains have been sporadic and uneven across sectors. The full realization of the potential for productivity growth is inhibited by ongoing skills mismatches, a skills development system that has lagged behind, poorly aligned education with labour market demand, and insufficient investments in research and innovation. Alongside this, the technologies that have enabled globalization and scaling up in some sectors have also excluded low-skilled workers in sectors that are immediately and particularly vulnerable to automation and restructuring.

While the government's attempts to lure foreign direct investment, including through the development of TIDZs, have generated new jobs and contributed to increased exports, the expected transformative spillover effects on the rest of the economy have not yet materialized. The focus on jobs has come in the form of a number of low and mid-skilled jobs, which limits the potential for wage increases and for wider human capital development. Additionally, labour market institutions and policies have struggled to keep pace with the changing nature of work. Employment activation programs remain poorly resourced and inconsistently targeted, even though they do provide support to unemployed workers, while existing social protections have been inadequate in addressing entrenched inequalities and achieving inclusive wages.

The COVID-19 pandemic revealed and intensified some of these structural weaknesses. While some of the worst employment losses during the pandemic were compensated for by government support measures, the precariousness of the labor market, and particularly the weak relationship between economic growth and quality jobs, was increasingly clear. The pandemic also sped up the process of digitalization and highlighted the need to develop a labor force that is more agile, skilled, and capable of responding to the future.

For North Macedonia to address these interrelated challenges, it needs a coherent, comprehensive, and future-focused labor and productivity strategy. The first priority should be to strengthen the connections between our education systems and labor market needs. This includes making changes to curricula (including VET), VET, and increasing the availability of digital skills and green skills in our education system. To ensure that students develop critical competencies and concepts and theories that will be valuable to the economy, we need to facilitate collaboration between education providers, employers, and the government.

In addition, to help workers cope with technological change, in particular displaced workers from traditional sectors or low-quality jobs, there needs to be greater investment in lifelong learning and reskilling programs. Policies must also be developed to facilitate the transition of low-skilled workers and older workers into more productive work while at the same time dismantling barriers to women and marginalized groups from fully participating in the workforce, better access to childcare services, and improved options for flexible work arrangements, along with investment in adult education would serve both equity and productivity purposes.

The quality of jobs can be improved, and labour protections can be developed by formalizing informal work in these current economies and providing greater coverage of social insurance as well as collective bargaining. Labour inspection services need to be strengthened, while formalization procedures can be simplified, so that both employers as well as workers are encouraged to enter the formal economy. Tax and benefit systems could also be modified to encourage formal employment, so that there are fewer incentives for informal work. It is essential to formalize informal work and expand social insurance and collective bargaining coverage. Increasing the capacity of labour inspection services and simplifying how formalization can happen will lead to both workers and employers deciding to enter the formal economy. At the same time, tax and benefits systems must be reimagined so that they do not disincentivize formal employment. This will narrow the incentives between formal and informal work.

The government must make building innovative ecosystems and enhancing local value chains a national priority for productivity. Beyond simply bringing FDI into the country, the government should also facilitate domestic firms' development to build the capability to upgrade, enter global markets, and adopt productivity-elevating technologies. This can include measures such as enhancing the availability of finance, tax breaks for innovation, business development services for SMEs, etc. Given that it has been evident from the analysis here, the government must also pay particular attention to rural and lagging regions to ensure that productivity growth is geographically inclusive and does not simply amplify existing divides.

Last but not least, the capacity of institutions must be enhanced to better design, implement and monitor labour market policies. This includes investment in data systems to provide real-time information about the labour market and to foster coordination across ministries. The labour market and productivity agenda cannot operate in isolation from other categories of policy, but should complement national development strategies as they relate to industrial policy, innovation, social inclusion, and environmental sustainability.

There is a potential for the combination of the right mix of appropriate policies through institutional reform, and sustained public investment to build a labour market that provides not just more jobs, but better jobs - jobs which empower people, and strengthen communities whilst fostering long-term economic prosperity.

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Chapter 10

How Small and Medium Enterprises (SMEs) Have Run Economic Growth and Adapted to Transition: A Case Study of North Macedonia's Entrepreneurial Landscape (1991-2023)

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Small and Medium Enterprises drive economic change in emerging and developed economies because they create employment opportunities, increase innovation, and diversification of the industrial sector. Most economies depend on SMEs as they contribute greatly to GDP, exports, and social cohesion. The OECD (2020) states that SMEs are more than 99% of businesses globally while creating 60-70% of employment in most economies. SMEs provide significant sustainable development value through their responses to market change and technological advances and through

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their creation of local economic opportunity (Acs et al., 2018). SMEs have been particularly visibly influential in transformation and post-socialist economies such as North Macedonia, where they function as structural economic transformers. The arduous process for the country started immediately after the downfall of Yugoslavia in 1991.

This was a full transition from the economic system, which was controlled and planned by the state, to a system that is based on rules that are derived from the market. This is also confirmed and explained in the research that was done by Bartlett & Bukvic in 2001, which states that Macedonia's initial period of independence faced strong economic challenges such as hyperinflation and other difficult trade regulations. All this process of transition was accepted differently by the SOEs and the SMEs. SOEs had difficulties adopting and accepting all these new conditions that are imposed by the markets. On the other hand, SMEs used this as an opportunity to catch up and implement more easily these market conditions. All the reforms that were taken did not stop SMEs from dealing with all the newly imposed administrative barriers, more difficult financial access, increased interest rates, and the overall changes to the regulatory framework. Because of all the above-mentioned reasons, SMEs became more significant for all contributors to the economy of the country. According to the Annual Report on European SMEs 2023 (Di Bella et al., 2023) 99,7% of the total number of enterprises in the Macedonian non-financial business sector (NFBS) are SMEs, employing 74,5% of the total employment in NFBS. All these companies are more than their importance for the employed; they also support industrial variety while driving growth in exports and technological advancements. Research conducted by Acevska et al. (2002) has outlined important features of Macedonian SMEs, i.e., that:

- The business operates as a privatized section of an old state-owned enterprise or as a firm that started within the last decade of the 20th century.
- The business operates with fewer than 50 employees and depends strongly on domestic market demand.
- SMEs operate within the manufacturing or agricultural sectors and maintain legal registration for multiple business activities to enhance market adaptability.
- The country demonstrates substantial reliance on imported raw materials, which shows Macedonia's strong dependence on foreign trade according to EBRD (2019).

Over the last three decades, or in other words, after the independence of the country, all the changes, such as technological improvements, digitalization, and a newly formed legal and economic framework, have been the most important drivers of the transformation of the Macedonian SMEs. This chapter analyses this economic development and examines the role of SMEs in their path from 1991 to 2023. Firstly, the historical development of SMEs is discussed, and after that, their impact on the Macedonian economy is analyzed.

The Rise of Macedonian SMEs

SMEs are very important elements of economic development because they are the main drivers of employment and industrialization. However, the term "small and medium-sized enterprises" began to be officially used in the Republic of Macedonia (now North Macedonia) after 2001, as part of the country's efforts to align with European standards for business classification and enterprise development, particularly in the context of economic transition and the EU accession process. Therefore, in the national statistical databases there is a lack of structured information on the number of SMEs starting from 1991 to 2002. During the 1990s, terms such as "small businesses" or "private firms" were commonly used, but there was no formalized or standardized definition of SMEs according to European criteria. Institutional support for small businesses was limited, and official statistics did not categorize enterprises based on their size.

The key milestone that enabled the formal and institutional approach to defining, supporting, and SME development was the adoption of the First National Strategy for the Development of SMEs (2002-2012) on 30 July 2002, using legal and economic criteria similar to those employed in the European Union. In parallel, the Agency for the Promotion of Entrepreneurship (APPRM) was established in 2002 as a key institutional body dedicated to SME development and support.

In the 2004 Law on Trade Companies Article 470 classifies large, medium, small, and micro traders, from the point of view of keeping accounts. Additionally, the concept has gained a concrete legal foundation through the Law on the Support and Development of Small and Medium-Sized Enterprises (published in the Official Gazette No. 145/04), and the Company Law enacted in 2004 (published in Official Gazette of RM No. 28/04), which provided clear definitions and classifications of SMEs, where:

- A micro-sized commercial entity shall be a commercial entity that, in each of the last two accounting years, or in the first year of its operations, has met the first criterion and at least one of the second and third of the following criteria:

  1) the average number of employees, based on working hours, is up to 10 employees;

  2) the gross annual revenues acquired from any source do not exceed 500.000 EUR in MKD equivalent.

  3) not more than 80% of the gross revenues of the commercial entity to be acquired from one client/consumer from an individual who is related to this client/consumer.

  4) all rights to participate in the micro-company to be owned by not more than two natural persons.

- A small-size commercial entity shall be a commercial entity that, in each of the last two accounting years, or in the first year of its operations, has met the first criterion and at least one of the second and third of the following criteria:

  1) the average number of employees, based on working hours, is up to 50 employees;

2) the annual revenues are less than 2.000.000 EUR in MKD equivalent, and the total turnover is less than 2.000.000 EUR in MKD equivalent, or

3) the average value (at the beginning and at the end of the accounting year) of the total assets is less than 2.000.000 EUR in MKD equivalent.

- Medium size commercial entity shall be a commercial entity that, in each of the last two accounting years, or in the first year of operations, has met the first criterion and at least one of the second and third of the following criteria:

    1) the average number of employees, based on working hours, is up to 250 employees; and 2) the annual revenues are less than Euro 10.000.000 EUR in MKD equivalent.

    3) the average value (at the beginning and at the end of the accounting year) of the total assets is less than 11.000.000 EUR in MKD equivalent.

As a result, starting from 2004, official data on the SME sector have been published, as shown in the tables below. SMEs accounted for 99,18% of all registered enterprises in the country in 2003, employing 76,59% of the total workforce and contributing 69,1% to the national GDP.

Table 1: Share of micro, small, and medium-sized companies in the national economy in terms of number of companies, employment, and GDP 2003 (Government of the Republic of Macedonia, 2005)

Enterprise Size	Number of Enterprises	Share in Number (%)	Number of Employees	Share in Employees (%)	Share in GDP (%)
Small	55.267	98,34%	269.583	58,41%	50,7%
Medium	475	0,84%	83.917	18,18%	18,4%
Total SME	55.742	99,18%	353.500	76,59%	69,1%
Large	459	0,82%	108.060	23,41%	30,9%
Total	56.201	100,00%	461.560	100,00%	100,0%

Table 2: Share of micro, small, and medium-sized companies in the national economy in terms of export 2003 (Government of the Republic of Macedonia, 2005)

Enterprise Size	Number of Enterprises	Export (US$ Thousands)	Export (Euro Thousands)	Share in Total Export (%)
Large	93	580.661	511.853	42,5%
Medium	195	177.567	156.546	13,0%
Small	1.886	542.486	479.259	39,8%
Undistributed	312	62.538	56.155	4,7%
Total	2.486	1.363.252	1.203.813	100,0%

SMEs' function is particularly important in transition economies, such as North Macedonia, and from the data for 2003 they had prevailing presence in the private sector and their influence on employment and gross domestic product is more than evident. Foreign studies confirm this tendency. According to the OECD (2020), SMEs represent over 99% of companies globally and employ between 50% and 70% of the workforce in most economies. The World Bank (2021) also points to their job creation role, with seven out of ten jobs created across the world being created by SMEs, emphasizing their pivotal position in addressing structural unemployment. As Storey (2016) outlines, SMEs are in an advantageous position to promote innovation and economic stability due to their flexibility and capacity to adapt to new economic facts.

Similarly, Acs et al. (2018) argue that SMEs lead to economic growth due to enhanced competition, productivity, and efficiency in the market. Since they are diverse and decentralized, they can respond quickly to the needs of the market and innovate in ways that larger companies cannot.

In addition to employment and GDP, SMEs also contribute significantly to the country's export performance. Table 2 illustrates that in 2003, small enterprises alone contributed 40% of national exports, while medium-sized firms added another 13%. Together, SMEs were responsible for more than half of Macedonia's total export value, reinforcing their role in external trade and international market integration.

According to all the above-mentioned reasons, it can be said that during all periods of financial instability in one country, SMEs played a role as stabilize of the economy. SMEs played an important part in integrating displaced workers into a market-oriented employment system (Hashi & Krasniqi, 2011) and the SMEs act as crucial catalysts for innovative processes and technological progress, away to their employment generation capabilities.

Difficulties and Constraints Faced by SMEs In Macedonia

SMEs in Macedonia operated within a context marked by institutional fragility, financial constraints, and policy uncertainty, as common features of transition economies. While some firms have demonstrated adaptability, the overarching narrative remains one of persistent barriers that hinder the full development and competitiveness of the SME sector.

The most critical barrier was their access to finance, where SMEs struggled to secure funding on acceptable terms. Interest rates on bank loans were prohibitively high, ranging between 8% and 12%, well above the rates available in most Western European countries (EBRD, 2019). Additionally, collateral requirements were excessively stringent. According to the World Bank (2020), the collateral demanded from small businesses was and remains often beyond their capacity, effectively excluding many from credit markets.

The underdevelopment of private investment ecosystems, such as venture capital and angel networks, further restricted alternative financing options (OECD, 2020). This left SMEs heavily reliant on traditional banking, which was risk-averse and ill-equipped to serve the dynamic needs of smaller enterprises. Though some government and donor-backed financing schemes existed, their reach was limited, and their long-term effectiveness remained uncertain.

Beyond finance, institutional and bureaucratic barriers presented further complications. Business registration was a time-consuming process, often requiring excessive paperwork and multiple administrative interactions (World Bank, 2020). This not only discouraged formalization but also delayed market entry and expansion for aspiring entrepreneurs.

Furthermore, regulatory frameworks were frequently unstable and lacked transparency. SMEs often operate in a climate of policy uncertainty, which undermines long-term business planning. Inconsistent enforcement of laws and regulatory fragmentation across agencies compound these issues. According to Hashi and Krasniqi (2011), post-socialist countries like Macedonia continue to struggle with weak rule of law and unclear institutional mandates, which inhibit the establishment of a predictable business environment.

Additionally, and unlike their counterparts in developed economies, Macedonian SMEs lack access to essential support structures such as business incubators, technology parks, and public R&D programs. These deficiencies stifle innovation, reduce competitiveness, and limit the capacity of firms to scale (EBRD, 2019). Public-private partnerships, where present, are typically underfunded and poorly coordinated.

The structural difficulties facing Macedonian SMEs must be understood within the broader legacy of the post-socialist transition. The collapse of Yugoslavia and the subsequent market liberalization processes introduced economic volatility, institutional voids, and a vacuum of entrepreneurship support. As Bartlett (2012) highlights, underdeveloped banking systems and weak institutional arrangements characterized the early transition period, with effects that continue to reverberate today. For example, in the 1990s, extremely high interest rates and limited access to credit hampered SME growth. Over time, although macroeconomic stabilization and partial EU alignment have occurred, deep-rooted inefficiencies remain. Many firms continue to face high transaction costs, over-taxation, and limited protection in commercial disputes.

Despite all these difficulties, some SMEs have attempted to adapt through digitalization. Investment in ICT infrastructure and online platforms has enabled certain firms to circumvent spatial and market limitations (Macedonian Chamber of Commerce, 2021). Digital tools have supported process automation, market expansion, and customer engagement. However, even these developments are uneven. Many SMEs lack the digital literacy, infrastructure, or capital to implement technology-led strategies effectively. The diffusion of innovation remains constrained by the broader ecosystem's inability to provide technical and financial support.

For SMEs in Macedonia to truly fulfil their potential as engines of economic growth and diversification, substantial reforms were needed. These reforms were assumed to improve financial accessibility, streamlining bureaucratic processes, enhancing regulatory transparency, and investing in a coordinated national SME support system. Until such measures are systematically implemented, the challenges faced by Macedonian SMEs will continue to outweigh the opportunities.

Public Policies in SMEs Development

During the late 1990s and early 2000s, Macedonia improved its market reforms while following deeper integration with the European Union. The initiatives established very important progress toward stronger economic integration with the EU. The fall in trade barriers and better market access enabled small and medium-sized enterprises to grow their exports and join European supply chains while improving their competitiveness. When Macedonia implemented EU-standard policies, these resulted in increased business transparency and more efficient regulations. Also, it has established stronger legal protections for companies and enabled them to function more effectively while drawing in investments. The rise in investor confidence brought about increased capital inflows that helped modernize Macedonia's industrial sector and infrastructure. The investments led to economic diversification and productivity improvement, as well as the generation of employment opportunities, which enhanced the economic stability of Macedonia in the long run (Bartlett, 2020). North Macedonia attempted to improve private-sector development and economic stability through banking sector reforms that improved financial inclusion and promoted business development. The reforms addressed the main difficulties and served as a key to establishing a better environment for SMEs to grow and develop.

From the mid-2000s, financial solidity and banking sector stabilization lowered interest rates below 10%, easing the borrowing conditions and stimulating investment. The schemes extended the available finance for SMEs to enable them to expand their business and invest in technology upgradation, along with accessing new markets.

SME incubators, export promotion organizations, and innovation funds created a support system stimulating entrepreneurial creation. They established necessary support systems that provided start-up firms with access to funding, guidance, and the capability to enter new markets. Early programs were instrumental in building an entrepreneurship and business innovation culture.

At the same time, the national policy framework for the development of the economy in the Republic of Macedonia was established and positioned in line with broader European policies of promotion of entrepreneurship, competitiveness, and SME development. This alignment was the foundation for working out the national SME Strategy.

The Government of the Republic of Macedonia signed in 2002 the Memorandum with the European Commission on accession to the European Charter for Small Enterprises, whereunder the policies of SMEs development began. It was envisioned that the Ministry of Economy would prepare the first National Strategy for the Development of Small and Medium-sized Enterprises (2002-2013), which additionally included a "Program of measures and activities to support the development of entrepreneurship and competitiveness of small enterprises in the period from 2003 to 2006".

In accordance with the Small Business Act of the European Union, the SME Strategy should (Government of the Republic of North Macedonia, 2018):

- Create an environment in which entrepreneurs and family businesses can thrive and in which entrepreneurship is rewarded.
- Create a favorable business environment for all SMEs, including family businesses, through a simplified legal and regulatory framework, adoption of a new SME law and revision of the Law on the Establishment of the Agency for the Support of Entrepreneurship of the Republic of Macedonia, improved policymaking and coordination, as well as through improved business development services and better access to finance.
- Ensure that honest entrepreneurs who have been subject to bankruptcy quickly receive a new opportunity, meaning that the strategy would improve bankruptcy procedures and introduce an information campaign to promote a second chance for entrepreneurs who have previously failed.
- Formulate the rules in accordance with the principle of “Think of the little ones first”, where a special instrument for impact assessment of the regulation, known as the SME Test, is introduced, to analyze the ex-ante effects of all legislative proposals relating to SMEs.
- Enable the state administration to be available to meet the needs of SMEs, by improving the creation of policies and coordination within the SME sector, improve social dialogue, improve data and analysis on the SME sector, strengthen the representation of the SME sector, and increase the impact of business and financial services by creating an online SME Portal.

- Facilitate access to finance for small businesses and develop a legal and business environment that supports timely payment in trade transactions, by improving access to finance through the creation of a register of movable property, introduction of factoring, revitalization of the credit guarantee scheme, and improvement of financial literacy.
- Help SMEs better exploit the opportunities offered by the EU single market, by strengthening the ties with EU SME support programs, while improving SMEs' access to government services for export promotion, and developing strategic industrial value chains and clusters.
- Promote skills upgrading in SMEs and all forms of innovation, by including entrepreneurship at all levels. In this context, education and training support innovation in the SME sector by enabling the creation of better networks between academia and industry, including support for R&D, and the establishment of new science and technology parks and innovation incubators.
- Empower SMEs to turn environmental challenges into business opportunities by supporting the development of "green SMEs".
- Encourage and support SMEs in taking advantage of growth in international markets by promoting a more productive and competitive SME sector, which will improve its internationalization.

This strategy was revised in 2007, and a new Program for the Development of Entrepreneurship, Competitiveness and Innovation for Small and Medium-sized Enterprises

(2007-2010) was adopted. The Program of Measures and Activities to Support the Development of Entrepreneurship and Competitiveness of SMEs (2002-2006) was prepared as a supporting document to the first national SME strategy. The Program set out priorities for improving the business environment and the performance of the SME sector, focusing on:

- Creation of entrepreneurship and competitiveness.
- Building a favorable economic environment and improving the degree of economic freedom;
- Promoting entrepreneurship and non-financial forms of support;
- Security financial forms for support for the development of entrepreneurship;
- Implementing a program to create competitiveness.

Although there was no specific strategic framework for SMEs in the period 2013-2017, the Government continued to support the sector by implementing a set of measures defined in the annual programs of the relevant institutions.

In March 2016, the State Audit Office issued a report on SME development and support that focused on SME development provisions in policies and legislation, as well as the impact of financial and human resource development programs. This report recommended improvements in:

- SME Coordination, i.e., harmonization of legislation, especially the Law on the Agency for the Support of Entrepreneurship and the Law on Trade Companies, for the application of a single classification of SMEs and ensuring equal treatment by institutions implementing state aid and support measures.

- Improving communication between policymaking and the development of SME programs at central and local levels; and developing strategic policies for entrepreneurship, support, and development of SMEs.
- Efficient use of resources in terms of analyzing the roles, functions, and the long-term sustainability of SME support agencies.
- improving communication between central and local SME development agencies, and where necessary, expanding the range of SME development services; and
- Monitoring and evaluation, by establishing an integrated management system performance, which includes monitoring and evaluating the participation of SMEs in macroeconomic indicators (e.g., GDP, exports, labor force, productivity).

In 2017, a new National Strategy for SMEs was prepared, covering the period 2018-2023. It is built on the achievements of the previous strategy and the priorities defined by the Government, considering the EU policy frameworks and objectives. It set its priorities for improving the business environment for the development of small and medium-sized enterprises, while strengthening efforts to improve competitiveness and innovation.

The Strategy was designed around three strategic objectives. First one, to create a conducive business environment that encourages entrepreneurship and investment, second one to help SMEs in Macedonia become highly productive and competitive participants in European and other international markets, and the third, to drive the economic competitiveness of Macedonia by further strengthening the entrepreneurial and innovative capacities of SMEs. This strategy sought to maintain the reform momentum achieved by the Government and to deepen these reforms wherever possible, and in that sense, the Republic of Macedonia has made significant achievements in its economic and business reforms. In that sense, the World Bank ranked Macedonia tenth in the world according to the Ease of Doing Business Index (Doing Business in 2017), which represents a jump of six places compared to the previous year. According to the World Economic Forum's Global Competitiveness Index, the Macedonian economy ranked 60th in 2015-16, which represents a significant jump compared to 80th place in 2012-13.

However, the assessment of Ministry of Economics and Labor (2024) showed that due to several factors that affected the implementation of this strategy, such as the lack of adequate technical and financial resources, the Covid-19 pandemic, the energy crisis and the war in Ukraine, the results were not fully achieved regarding the set 3 strategic objectives. Due to this, and with the expiration of the validity of the previous Strategy, together with new global trends and priorities of the new Government, the need to prepare a new Strategy arose. On this basis, the Ministry of Economy and Labor developed the new National SME Strategy for the period 2025-2030, supported by the Delegation of the European Union to the Republic of North Macedonia (EUD) in providing technical expertise.

Programs and Services for SMEs Development

Over the past decade, North Macedonia has made considerable progress in building a secure institutional framework dedicated to the growth and development of SMEs. This new environment is a product of a strategic plan that aims to foster entrepreneurship, stimulate innovation, and generally enhance the competitiveness of the country's economy. Supported by a combination of national institutions, local initiatives, and global capacity, the institutional framework has become more sophisticated and responsive to the needs of the SME sector. At the top of this structure is the Agency for the Promotion of Entrepreneurship (APPRM, 2007), the central government institution responsible for the implementation of SME-related policies.

APPRM's task is in the area of promoting entrepreneurship and developing small business growth with demand-driven projects backing national strategic interests. The agency is central to the development of institutional infrastructure for the development of entrepreneurial capacity and competitiveness of SMEs. Its key activities include coordination and implementation of international and domestic support initiatives, provision of financial and non-financial support, and development of focused interventions aimed at improving SME performance and survivability in a rapidly changing economic environment. APPRM is supported by initiatives undertaken by a network of employer and business associations as intermediaries in the relationship between the state and business. These include the Chamber of Commerce of North Macedonia, the Union of Chambers of Commerce, the Northwestern Macedonia Chamber of Commerce, the Chamber of Crafts, the Employers' Organization of Macedonia, the Business Confederation of Macedonia, and the Businesswomen's Association, among many others. There are over 20 bilateral and local business associations in various branches of the economy, four of which have national coverage. They provide advocacy, training, market access, and networking, and are excellent partners in policy development and implementation for the promotion of SMEs. Additionally, the SME Forum, which was established in 2006 as a dialogue forum, enhances this involvement of the stakeholders even further.

Also, a key pillar of the innovation economy is the National Committee for Innovation and Entrepreneurship (NKIP), established in 2011. The Committee is made up of representatives from the most suitable ministries, academia, and the private sector. It plays a strategic role in the formulation of innovation policy, cross-government coordination, and budget expenditure alignment with government priorities. NKIP also oversees the work of the Fund for Innovation and Technological Development (FITD) pre-screening of innovation programs before they are submitted to the government for approval, and formulating proposals for policy based on European best practice and international trends. It also evaluates the general innovation ecosystem, including intellectual property rights, and makes recommendations for a better innovation ecosystem for innovation-driven entrepreneurship.

The FITD in North Macedonia was formally established in December 2013 under the framework of the Law on

Innovation Activity and as part of the country's National Innovation Strategy. The FITD, being the most dynamic instrument in the national innovation policy, works to enhance the innovation and technological development of the micro, small, and medium-sized enterprises (MSMEs). Its mission is dedicated to co-financing innovative ventures, deployment of new technologies and business models, and knowledge transfer development between business and academic spheres. High-growth companies and start-ups are specifically targeted by the Fund, offering high-level support to commercialize research, establish "spin-off" companies, and develop business-technological accelerators. These initiatives are formulated not just to increase the competitiveness of individual firms but also to help create employment, improve productivity, and bring about long-term economic change.

Consistent with the identification of the role of human capital in building a sustainable entrepreneurial culture, the National Center for Development of Innovation and Entrepreneurial Learning launched the National Network of Entrepreneurship Educators in 2011. This network unites professors from universities, academic staff, and secondary school teachers engaged in entrepreneurship education. Its primary objective is the exchange of good practices, the improvement of curricula at all education levels, and the strengthening of pedagogical foundations for entrepreneurship teaching. Through continuous professional development and peer learning, the network seeks to equip future generations with entrepreneurial mindsets and skillsets.

At the local level, North Macedonia has also developed a network of support institutions aimed at making entrepreneurship services more available to regions and communities. Regional Business Centers, like the five Regional Enterprise Support Services (RESS) in Skopje, Strumica, Veles, Kumanovo, and Bitola, and additional APPRM offices in Ohrid, Tetovo, and Gostivar, play a crucial role in enhancing access to information, resources, and training for entrepreneurs at the local level. The fact that there are specialized agencies such as the Enterprise Development Agency in Prilep and the Roma Business Information Center in Skopje proves to be an inclusive approach to enterprise development.

Furthermore, business incubators and start-up centers are critical to the growth of early-stage companies. SPARK Incubator in Bitola (established with Dutch and later USAID support), Youth Entrepreneurship Service Incubator in Skopje (funded by Norwegian aid), and the World Bank-supported incubator in Strumica provide infrastructure, mentorship, and access to finance for start-up companies. Additional start-up facilities in Tetovo and Skopje, supported by SINTEF and the Austrian Development Agency, respectively, emphasize the role of international collaboration in developing local innovation capacities.

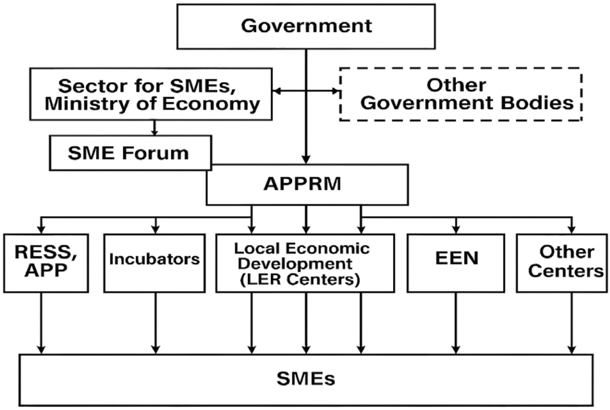
The integration of Macedonian SMEs into the European economy is also aided by the Enterprise Europe Network (EEN), which delivers tailored services for helping companies seek cross-border collaboration, compliance with EU regulations, and accessing EU funding instruments. At the same time, eight regional planning centers aid strategic planning and coordination at the statistical region level.

Universities have also emerged as significant stakeholders in the SME support infrastructure. The Business Start-up Center and the National Center for Innovation Development and Entrepreneurial Learning in the Faculty of Mechanical Engineering at Ss. Cyril and Methodius University in Skopje bridges the gap between science and practice, offering incubation services and entrepreneurship education to students and researchers.

Finally, the ecosystem is supported by an emerging market of business advisory services provided by some 250 independent consultants and consulting companies (Socijalendijalog.mk, SIYB Market Assessment Report, 2020). These stakeholders provide specialized knowledge in business planning, access to finance, market research, innovation management, and internationalization, complementing the activities of donor-funded programs and public institutions.

Briefly, North Macedonia has developed an interdependent and multilayered institutional ecosystem intended to empower SMEs and foster innovation. This ecosystem, founded upon public-private partnership, international collaboration, and territorial coverage, has become a strategic driver of inclusive and innovation-led economic development in the country.

Figure 1. Institutions supporting SMEs



Note. Strategy for SMEs 2018–2023 by the Ministry of Economy of North Macedonia (2018).

The above figure illustrates the institutional arrangement that underpins SMEs in North Macedonia. At the top of the chain, there is the Government, which exercises its influence through the Ministry of Economy, that is, the Sector for SMEs. Alongside it, other government authorities make input into policymaking concerning SMEs. There is the SME Forum that acts as a consultative platform for cooperation and dialogue among stakeholders. At the hub of SME policy enactment is the Agency for the Promotion of Entrepreneurship, a coordinating body that mediates strategic planning and operationally oriented aid for SME development.

With the coordination of APPRM, a variety of intermediary institutions offer targeted support to SMEs. These include the Agency for Promotion of Entrepreneurship (APP) and RESS, and business incubators in which young businesses are incubated, and Local Economic Development (LER) centers where economic activity in the region is fostered. In addition, internationalization and cross-border collaboration are facilitated by the Enterprise Europe Network, with other expert centers providing bespoke services. These institutions supplement one another and form a comprehensive, multi-level support mechanism designed to encourage innovation, competitiveness, and sustainable development of SMEs in the country.

Funding Programs for SMEs in North Macedonia

The Government of North Macedonia has demonstrated a sustained commitment to strengthening SMEs as a cornerstone of economic development, employment generation, and European integration. This commitment is reflected in the formulation of the Action Plan for European Partnership (2016), which explicitly prioritizes SME development.

Program formulation and implementation for SME support have been notably inclusive, involving a wide spectrum of stakeholders. Key actors include the Ministry of Economy, the Macedonian Chamber of Commerce, artisan associations, regional and local entrepreneurship promotion centers, NGOs, private sector consultants, international development partners (such as USAID, EBRD, UNDP, and the World Bank), and SMEs themselves. This multi-stakeholder approach has aimed to align national SME policy with the broader objectives of competitiveness and EU convergence.

At the national level, financial commitment has been channeled through the Agency for Promotion of Entrepreneurship. (In 2004 and 2005, the government allocated approximately 20 million MKD from the national budget to support the operations of APPRM and to co-finance projects that deliver non-financial assistance to SMEs. However, the scale of domestic funding remains modest relative to needs, highlighting the continued importance of international financial cooperation in bolstering the SME sector.

A diverse range of bilateral and multilateral credit lines has provided critical financial support to SMEs, often on subsidized terms to enhance accessibility. Key international funding sources include:

- Germany: KfW and DEG credit lines totaling €21,5 million
- Italy: Government-supported credit line of €12,7 million
- Netherlands: MEDF fund contributing €6,2 million
- European Investment Bank (EIB): APEX loan of €16 million
- EU PHARE Program: €10,3 million
- EBRD & local banks: Joint loan facility of €25 million via NLB Tutunska Banka AD Skopje and others

These credit instruments are generally distributed through commercial banks, offering concessional terms intended to overcome traditional SME financing barriers. By late 2003, most of these credit lines were already deployed, with only partial balances remaining.

Beyond mainstream credit lines, donor-supported microfinance institutions have played a vital role in serving underserved micro and small enterprises. Notable USAID-backed initiatives include the SME Financing Fund, Savings

House Moznosti, SEAF Capital Fund, and FULM Savings House, together injecting over $19 million into the sector. Other countries such as the Netherlands, Sweden, and Germany have supported institutions like ProCredit Bank, which has emerged as a leading example of microfinance-focused banking in the country.

Equally important are the non-financial assistance programs, co-funded primarily through EU mechanisms such as PHARE and CARDS. These programs have supported:

- Institutional capacity-building within the Ministry of Economy
- Development of quality infrastructure and standardization institutions
- Establishment of the European Info Correspondent Centre (EICC) and the European Business Association
- Human resource development and enterprise skills upgrading
- Procurement of equipment for national quality systems and redesign of microcredit delivery models
- These interventions aim to reinforce the institutional foundation for SME development and alignment with the EU market and quality standards.
- Regional Development and Decentralization Efforts

Donor programs have also supported regional and inclusive service delivery. For example, the Macedonian Competitiveness Activity (MCA), co-financed by USAID and German Agency for Technical Cooperation (GTZ), led projects on technology transfer and private sector development, which have targeted the improvement of entrepreneurial skills, clustering, and foreign direct investment attraction. Similarly, bilateral donors such as International Fund for Agriculture Development (IFAD) and Switzerland have funded decentralized SME support through regional hubs like PREDA in Prilep, promoting localized service provision and inclusivity.

The funding landscape for SMEs in North Macedonia reflects a multifaceted, high-level integration model that combines domestic initiatives with robust international support. The coordinated involvement of public institutions, private actors, and international donors has created a comprehensive support structure addressing finance access, innovation, institutional development, and competitiveness.

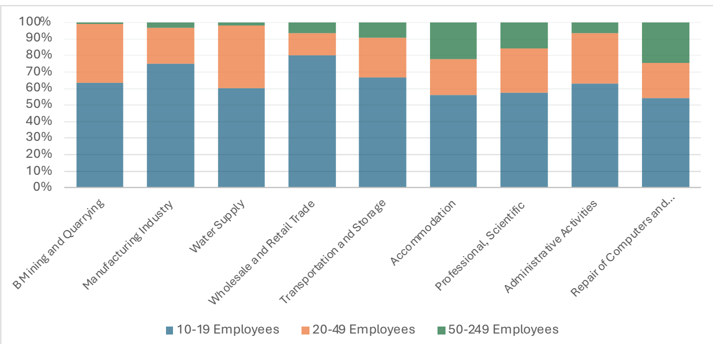
Analysis of the Development and Contribution of SMEs to the Macedonian Economy

The established support structure, discussed above, not only addresses key difficulties faced by SMEs, such as access to finance, innovation, and institutional development, but also reinforces the central role that SMEs play in the national economy. The following table provides a detailed overview of the distribution of enterprises in North Macedonia by economic sector and size, based on the number of employees. It serves as a key indicator of the structural composition of the country's business landscape and highlights the role of SMEs across various industries. This data is essential for understanding employment patterns, identifying sectoral strengths, and shaping targeted policy measures to support enterprise growth and development.

Structure of SMEs by Sector

The distribution of firm size and sectoral composition of (SMEs in North Macedonia is an important indicator of the state of the economy, industrial structure, as well as the character of entrepreneurship. As evident from Figure 1, based on the State Statistical Office of North Macedonia (2022) data, SMEs remain concentrated in the low-employment sectors, with a prevailing presence of small firms in nearly all sectors of the economy.

Figure 1. The distribution of enterprise size by sector, based on the number of employees (State Statistical Office of North Macedonia, 2022)



The chart shows the number of enterprises with 10–19, 20–49, and 50–249 employees in key industries with intentional exclusion of micro-enterprises with fewer than 10 employees to allow easier assessment of the "small-to-medium" spectrum. This account shows that firms employing between 10 and 19 workers make up the modal firm size of all industries, often covering more than 60% of all SMEs covered in the sample. This pattern is well exhibited in low-capital intensity, high-labor industries such as repair of household and computer equipment, professional, scientific, and technical activities, as well as accommodation and food services.

Such industries tend to face low entry barriers and low fixed capital requirements, making it easy for high concentrations of small enterprises and single-owned businesses to be present. Their nature tends to involve specialist human capital and customized services, which makes them very suitable for micro and small firm structures but less compatible with scale-up (OECD, 2019). These environments usually have companies working with limited market niches, which results in large firms that remain small out of choice or necessity.

With industries such as manufacturing, wholesale and retail trade, transportation and storage, there is a more balanced size composition. While the 10–19 workers category still dominates, there is a distinctly higher incidence of firms with 20–49 employees, and to a lesser extent, 50–249, suggesting higher formalization, business expansion, and possibly incorporation into national or local value chains. These sectors are more likely to be of greater fixed capital intensity, process standardization of processes, and dependence on supplies, and hence can accommodate expansion at levels beyond the micro-enterprise level (World Bank, 2020).

Interestingly, even more capital-intensive sectors such as mining and quarrying, water supply, and waste management also have a largely low-firm nature. The statistics demonstrate that there are firms of the 20–49 and 50–249 sizes, but they are low in proportion. This emphasizes structural constraints in realizing scale economies in North Macedonia, even in sectors where capital intensity would confer a natural advantage to large companies. This may be due to investment finance challenges, technology capabilities, sophistication in regulation, and market sizes (European Commission, 2023).

Moreover, medium-sized firms (50–249 employees) are constantly underrepresented in every sector. In nearly every case, this group has the lowest rate of businesses, which confirms the presence of a “missing middle” among SME sizes. This phenomenon, widely documented in transition and developing economies, illustrates systemic hindrances that discourage small businesses from growing into medium-sized firms. Major constraints are limited access to long-term finance, low managerial capacities, labor market rigidities, low digitalization, and limited access to local and foreign markets (UNCTAD, 2021; OECD, 2022).

The implications of such a trend are two-way. On the one hand, dense small business density reflects an entrepreneurial dynamic base and simplicity in accessing formal business registration. On the other hand, it also reflects economic ecosystem structural bottlenecks. These bottlenecks hold back firms from achieving economies of scale, adopting cutting-edge technologies, accessing export markets, or investing heavily in innovation and human capital. The productivity gap between micro/small firms and large firms is thus wide, resulting in slower aggregate productivity growth and loss of competitiveness (European Training Foundation, 2021).

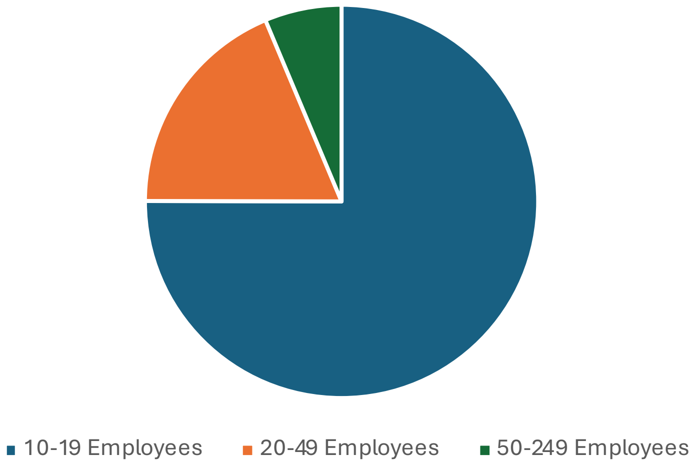
Policy responses to overcome these challenges must therefore go beyond the role of supporting firm survival. Instead, they must strive to drive business growth and transformation through the encouragement of formalization, technology uptake, and expansion of access to finance and skilled personnel. Strategic public investment and target programs must target sectors with demonstrated scaling potential, namely manufacturing, ICT, and logistics, through industrial park development, cluster-based support facilities, innovation vouchers, and digitalization incentives (Government of North Macedonia, 2023).

In conclusion, while the figure confirms the dynamism and involvement of small businesses in the North Macedonian economy, it also represents the imperative need for policy programs that foster firm growth, enable employment expansion, and stimulate the growth of a sound medium-sized enterprise sector. It is crucial to rectify these structural distortions to enhance productivity, export performance, and the susceptibility of the SME sector.

Distribution of Enterprises by Number of Employees

Distribution of employment sizes of enterprises is one of the important indicators of business maturity level, growth potential, and structural transformation of the national economy. For North Macedonia, distribution according to number of employees offers important information on the level of formalization, firm dynamism, and overall private sector conditions for development. Figure 2 presents the percentage distribution of businesses employing 10–249 persons, categorized into three size classes: 10–19 persons, 20–49 persons, and 50–249 persons, based on official statistics published by the State Statistical Office of North Macedonia (2022).

Figure 2: Distribution of enterprises by number of employees (data for 2022)



Note. Data taken from the State Statistical Office of North Macedonia, 2022

As the figure depicts, most firms, over two-thirds, are in the 10–19 employee category, which constitutes the lower limit of small firms in the EU and national classification systems. That so large a majority is captured by this category signifies a high prevalence of minimally scaled businesses that often fall into conventional services, retailing, and low-technology manufacturing. These are typically owner-controlled or family-controlled businesses, which often utilize informal networks, low capital involvement, and flexible labor arrangements (OECD, 2019).

The 20–49 employee category, or the highest tier of the small business size class, is a much smaller proportion of firms. These types of firms are more likely to be more formally organized internally, with clear organizational lines of command, conventional operating routines, and a relatively higher focus on productivity and market development. Their profile is higher in light manufacturing, warehousing and freight handling, and wholesale trade industries. Significantly, these companies tend to be involved in local or regional value chains, acting as suppliers to large companies or independent producers with limited specialization (World Bank, 2020). Their share is still low, reflecting structural barriers that prevent the evolution from smaller-rank businesses into this more durable and growth-driven category.

Firms with 50–249 employees classed as medium-sized enterprises by global definitions form the lowest share of the distribution. This underrepresentation reflects a structural "missing middle" issue, as already mentioned before, where not many firms can expand beyond the confines of a small business paradigm. This sector typically entails substantial capital investment, organizational capacity, and professional manpower, and access to wider and more competitive markets. The comparative low level of such firms in North Macedonia reflects the challenges faced by most small firms in increasing operations, accessing finance instruments, acquiring advanced technology, and accessing skilled labor (UNCTAD, 2021; ETF, 2021).

This distribution profile has profound implications for the general economic structure and productivity potential of the Macedonian SME economy. First, the dominance of the 10–19 employees' group indicates the weak and fragmented nature of the private sector, especially in confrontation with external shocks. Such firms have low profit rates, limited formalizations, and small technological abilities. Second, the absence of medium-sized enterprises reduces the capacity of the economy to benefit from economies of scale, process specialization, innovation activity, and outward-oriented growth (European Commission, 2023). Medium-sized firms in most economies are also commonly known to act as intermediate nodes connecting micro-enterprises and large firms, and in fulfilling crucial roles within industrial upgrading and supply chain integration. Their absence within the Macedonian context threatens the emergence of robust value chains and limits opportunities for structural change.

Size structure also influences job stability and job quality. Very small enterprises generate less stable, low-wage, and informally structured jobs, whereas medium firms tend more frequently to generate more formal, high-quality, and more stable jobs. Therefore, over-representation in the smallest size classes can limit social welfare gains as well as pro-poor economic growth.

To help address these disparities, a variety of policy interventions must be used. While public policy must favor small firms' resilience and survival, it must also favor scaling-up processes. Policies that facilitate access to credit offer incentives to technological upgrading and formalization, reduce regulatory burdens, and offer managerial training can favor the sustainable growth of small firms. Sectoral programs, particularly manufacturing, ICT, and green economy sectors, must target graduating firms from 10–19 to 20–49 and above, supported by sector-specific financing tools such as growth funds, credit guarantees, and digitalization grants (OECD, 2022; Government of North Macedonia, 2023).

Briefly, the employment-size distribution of North Macedonian firms highlights both the dynamism and weakness of the SME segment. While small firms form the backbone of the private sector, their limited size and growth constraints pose structural risks to long-term competitiveness, entrepreneurship, and employment generation. The overcoming of the supremacy of the lower-tier small business segment and building a robust segment of medium firms must be a priority strategic goal for enduring development.

Challenges and Opportunities Faced by Macedonian SMEs

To better understand the current setting and strategic direction of North Macedonia's SMEs, the full SWOT analysis is required. SMEs are instrumental to North Macedonia's economic dynamism, accounting for over a quarter of exports and showing a 53 % surge in innovation-driven activity since 2014. With improved support services for access to finance, innovation, and internationalization, SMEs are increasingly driving GDP growth and competitiveness.

Economic dynamism in North Macedonia comes from good trade performance (trade/GDP ≈ 159 %) as well as a productive manufacturing export policy. Meanwhile, the ICT sector is quickly emerging, generating further revenues of €1,65 billion and contributing €664 million of exports in 2024, showing a growing contribution to GDP growth and diversification of exports (OECD, 2024; ITU, 2023; International Trade Administration, 2024). This analytical tool allows the overall evaluation of the internal strengths and weaknesses of the SME sector, as well as the external opportunities and threats it faces in a dynamic and competitive environment. Grounded in empirical data, institutional accounts, and long-term policy development, the following SWOT analysis provides a concise but in-depth overview of the determinants of SME growth, resilience, and competitiveness. It serves as the foundation for the identification of policy priorities and strategic interventions to enhance the contribution of SMEs to sustainable economic progress.

Table 3: SWOT Analysis: Macedonian SMEs (1991–2023)

Strengths	**Weaknesses**
Represent over 99% of active enterprises and employ 75% of the workforce. (International Labour Organization, 2022)	Limited access to finance due to high interest rates (8–12%) and strict collateral requirements.
Key contributors to GDP, exports, and innovation.	Complex and bureaucratic regulatory environment, slow business registration, and licensing delays.
High resilience during economic transition periods (post-Yugoslavia).	Skills mismatch in education; lack of trained workforce in ICT, manufacturing, and technical fields. (European Training Foundation, 2023; European Commission, 2024)
Strong performance in trade, manufacturing, and IT sectors.	Digital divide: low penetration of e-commerce, cloud, automation, and data analytics.
Successfully absorbed public sector layoffs and reduced unemployment from 32,4% (2000) to 16,4% (2022).	Fragmented sector: dominated by micro-enterprises with limited growth capacity.

Benefited from EU integration reforms and institutional support (e.g., APPRM, FITD).	Urban-rural divide: 80% of SMEs are in urban areas; rural regions lack infrastructure.
Opportunities	**Threats**
Deeper integration into EU and international markets.	Intense competition from large domestic and EU firms with better resources and brand power.
Growing potential for digital transformation, automation, and innovation in SMEs.	Vulnerability due to dependence on a narrow export base (EU and Balkan markets).
Promoting women, youth, and rural entrepreneurship.	Brain drains emigration of skilled professionals weakens SME talent pool.
Access to EU grants, donor financing, and national innovation funds (e.g., FITD, EEN, APPRM).	Persistent inflation, raw material shortages, and global supply chain disruptions.
Investment in green technologies and sustainable practices.	Lack of venture capital and investor networks to support high-growth SMEs.

The North Macedonian SME landscape between 1991 and 2023 is a dynamic force for economic growth and a structurally handicapped sector. Constrained access to finance, particularly for start-ups and micro businesses, is one of the most important of these problems, with no credit history and high interest rates suppressing development. Bureaucratic regulatory processes and underdeveloped venture capital markets further significantly deter business establishment and growth. These institutional weaknesses are compounded by labour market distortions, especially in ICT and technical fields, and an expanding digital divide that marginalizes most SMEs from access to technological innovation. Rural-urban disparities also accelerate inequality, with 80% of SMEs located in urban belts, pushing rural economies into underdevelopment and underservicing.

Despite these weaknesses, the SWOT analysis reveals strong strengths and budding opportunities. Macedonian SMEs are well-established and stable within the local economy and contribute significantly to employment, GDP, and exports. The very complex SME system of support for the country, led by institutions like APPRM and FITD, provides valuable training, finance, and innovation support. EU integration alongside access to finance sources like IPA and the programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) presents regulatory harmonization and international growth potential. Concurrently, green transition and digitalization offer a potential for higher productivity, access to markets, and sustainability. Women, youth, and rural entrepreneurs are an untapped reserve for greater economic participation. Leverage of these resources, coupled with strategically addressing current weaknesses, positions North Macedonia for the full exploitation of its SME sector's potential in generating sustainable, inclusive, and competitive growth.

Conclusion

The history of SMEs of North Macedonia between the years 1991 and 2023 is a history of entrepreneurial activity, not in isolation; it is proof of the broader political, social, and economic transformation.

When North Macedonia transitioned from a centrally planned socialist economy to a market economy, SMEs were no longer simply post-displacement survival means for displaced labor and potential entrepreneurs, but in themselves agents of structural economic change. Their development reflects the entrepreneurial dynamism of an economy during economic liberalization, global integration, and digital globalization. In the early independence period, SMEs began to emerge in their natural course in this vacuum, without policy intervention at first, through entrepreneurial resilience and networks by word of mouth. Gradually, as it dawned on the government just how important a role SMEs could play in labor absorption, encouraging local production, and cutting down imports, policies began to yield results. The First National Strategy for SME Development (2002–2013) was a watershed that involved formal definitions, legal protection, and a policy foundation on the best European practices. The subsequent years witnessed the institutionalization of SME support increasingly become a reality.

The establishment of agencies like APPRM and the FITD, the development of national strategies as a reaction to the Small Business Act, and European program coordination (like the Enterprise Europe Network) created increasingly more favorable circumstances for the growth of SMEs.

These policy tools encouraged entrepreneurship through the provision of schemes in finance, export promotion, funding innovation, and capacity building. However, access to finance remains the most widely cited hurdle for Macedonian SMEs. High interest rates, immature venture capital markets, and inflexible collateral policies severely restrict the growth potential of micro and start-up enterprises. Bureaucratic hurdles, slow registration processes, uneven policy implementation, and complexity in regulation are additional complications exacerbating the problem, discouraging the formal economy's attractiveness to potential entrepreneurs.

Labour market issues are equally critical. Macedonia experiences a skills mismatch: the education system does not keep pace with evolving demands of the economy, particularly in ICT, engineering, and digital services. SMEs cannot thus hire the needed skilled labour, and emigration (brain drain) diminishes the available talent pool. These constraints restrict innovation, productivity, and take-up of technology, positioning SMEs behind in a more digitalized, more competitive globalized economy.

The sector's role in national GDP, employment, and exports cannot be questioned. SMEs have played a pivotal role in stemming unemployment from 32,4% in 2000 to 16,4% in 2022 by providing jobs to all sections of the population, especially after privatization. Their penetration into the EU's and Balkans' markets has deepened Macedonia's trade integration. A few sectors, such as light manufacturing, IT, and agro-processing, have become regional leaders, taking advantage of EU proximity, tariff-free trade concessions, and cheap skilled labor. Digitalization was both a barrier and an opportunity for real change during recent years.

Macedonian SMEs are adopting digital technologies, such as automation, cloud computing, e-commerce, and data analytics, not only to survive but to expand. 60% of the SMEs have already embraced some digital technology, according to the Macedonian Chamber of Commerce (2021) statistics. These innovations are enhancing productivity, creating new channels for markets, and engaging customers more intensely. Digital platforms have enabled companies to leapfrog geographies, especially for companies in the technology and services space. Nevertheless, the lion's share of micro-enterprises, especially rural ones, still lack the capabilities, infrastructure, and financial resources needed to go digital. Furthermore, Macedonian SMEs are increasingly adopting sustainable business models. Catalyzed by EU convergence and green policy push, a new generation of "green SMEs" is emerging. They adopt energy efficiency, circular economic thinking, and eco-innovation in their practices, not only to stimulate cost savings and environmental gains but to access new market potential. This is a vital steppingstone to make sure Macedonian economic development is linked to broader sustainability and climate goals.

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Chapter 11

Restoring Enlargement Credibility Amid Declining Enthusiasm: (New) Prospects for Upholding the Macedonian EU Integration Process

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Leposava Ognjanoska[2]

The path of the Republic of Macedonia[3] to EU membership has been a complex and challenging journey, marked by significant milestones, diplomatic hurdles, and a series of reforms required for alignment with EU standards. This process has been influenced by a combination of internal factors, such as political stability, governance reforms, and economic modernization, as well as external influences,

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3 This is the preferred name for the country that will be used throughout the chapter by the authors, with the exception of direct quotations where another form of the country's name may be used.

particularly the EU's geopolitical interests in the Balkans. The Republic of Macedonia's accession to the EU has been a lengthy process, with setbacks in the form of disputes, particularly with neighboring countries, and slow-moving bureaucratic processes.

The EU and the Republic of Macedonia signed the Stabilization and Association Agreement in April 2001, ten years after the country declared independence. The Republic of Macedonia applied for EU membership in 2004 and was granted candidate status in December 2005, making it the first among the Western Balkan nations to reach that milestone. EU Visa liberalization came into effect in December 2009. Nevertheless, twenty years on, accession negotiations have not yet begun in earnest, while other neighboring candidate states have each progressed in the integration process, surpassing the Republic of Macedonia.

One of the most significant stumbling blocks on the nation's road to EU accession was the long-standing name dispute with Greece, which objected to the use of the name "Macedonia." Greece, as an EU member state, was able to veto the country's progress in both the EU and NATO, creating a diplomatic impasse that lasted for more than two decades. Under considerable diplomatic pressure from the EU and NATO, the Republic of Macedonia agreed to change its name to the Republic of North Macedonia in 2019 to end the dispute with Greece. The Prespa Agreement was met with resistance from parts of the Macedonian population, which rejected the proposed name change in a nationwide referendum in September 2018 (BBC, 2018), leading to protests. Still, the Agreement had broad support from the international community, particularly the EU and NATO, which saw it as a model for conflict resolution in the Balkans. The Macedonian government at the time had hoped the move would finally unlock its Euro-Atlantic integration. However, while the country was able to join NATO, its membership in the EU remained blocked.

The new French methodology on enlargement (European Commission, 2020) , introduced in 2020, and an ensuing Bulgarian veto, further exacerbated the Republic of Macedonia's EU integration prospects and meant that the EU was unable, or unwilling, to keep its promises following the Prespa Agreement. In 2020, Bulgaria blocked the opening of EU accession talks with the Republic of Macedonia, citing issues related to the interpretation of history and the protection of a Bulgarian minority in the country, stemming from Bulgaria's non-recognition of the Macedonian nation and language. Despite domestic and international protests (Fouere, 2022), the EU incorporated Bulgarian conditions in its accession criteria in 2022, through the so-called "French proposal", moving the goalpost yet again.

The latest country progress report by the European Commission was generally positive about the progress made by the Macedonian side, in particular regarding the country's full alignment with the EU's Common Foreign and Security Policy (European Commission, 2024). On an institutional level, in 2024 the new Macedonian government established the Ministry of European Affairs, replacing the Secretariat for European Affairs, whose competence include coordinating and harmonizing the work of state institutions with EU bodies, as well as preparing the Macedonian version of EU law (acquis communautaire), in preparation for the country's membership in the European Union.

However, the decades long EU integration process, together with the continued imposition of bilateral conditions by some EU member states, which are unrelated to the Copenhagen criteria and instead serve for those states to exert pressure over Macedonian governments for concessions related to issues of national history and identity, mean the EU has lost much of its credibility in the Republic of Macedonia. The most recent move by the EU to decouple Albania from the Republic of Macedonia on its EU accession path only served to further deepen the sense of alienation from the EU among Macedonians (Marusic, 2024).

This chapter examines (new) prospects for upholding the EU accession process in the Macedonian context, with a particular focus on the loss of credibility in the EU's enlargement intentions, amid declining enthusiasm for further enlargement both within the EU and within the Republic of Macedonia. The chapter is a case study that uses a mixed methods approach, both for its data collection and data analysis. Qualitative data is collected from various texts and documents, such as official EU reports, policy documents, statements by policymakers, and academic literature, which are then analyzed to provide a comprehensive assessment of the challenges and prospects for enlargement, particularly focusing on the shifting criteria and external conditionalities imposed on candidate countries. Moreover, the chapter incorporates quantitative methods such as public opinion surveys and economic data to illustrate the trends and declining enthusiasm for EU integration within the Republic of Macedonia, but also the costs of non-integration on both sides - the candidate countries and the EU. Furthermore, a comparative analysis is employed on the wider economic gains of enlargement in the case of Central and Eastern European countries as EU member states and the stalemate situation of the Western Balkans candidate countries. This multi-source approach allows the authors to contextualize the political, economic, and societal dimensions of the EU accession process, highlighting the implications of enlargement fatigue and differentiated integration as potential pathways forward.

Declining Enthusiasm: A Wider Context

By scholars and policy-makers alike, the EU has been described as a soft power (Cross, 2013; Michalski, 2005), a civilian power (Telo, 2007; Duchene, 1973), or a normative power (Manners, 2002), which is applicable to its relation to the Western Balkans region. The phrase “soft power” was first formulated by Joseph Nye in 1990, who defined soft power as “the ability to get what you want through attraction rather than coercion or payments” (Nye, 2004, p.3). Former Commissioner for External Relations and the European Neighborhood Policy Benita Ferrero-Waldner viewed the EU’s soft power, including the use of economic inducements and conditionalities, as one of the EU’s defining features (Nielsen, 2013). Indeed, the EU has been able to shape other countries’ policies by using financial “sticks and carrots,” such as “trade agreements and development assistance, both typically accompanied by conditionality clauses” (Nielsen, 2013, p.729). Of course, according to Nye’s original concept, economic power is a form of hard power, given that the use of negative/positive conditionality, financial aid, sanctions, embargoes, or preferential trade agreements serves to pressure smaller countries into complying with more powerful countries (Nye, 2004).

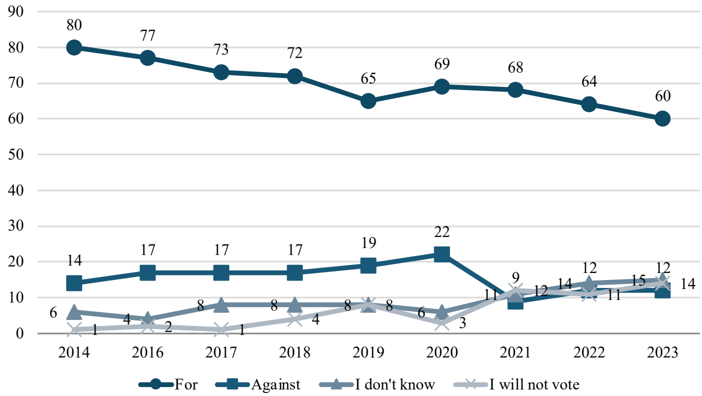
Thus, excluding economic incentives, the EU's most efficient soft power instrument was the membership incentive for candidate states (Ushkovska, 2017). As one scholar observed, the "policies of enlargement [...] represent the first external policies of the European Union where the notion of soft power was explicitly formulated in official public discourses" (Tulmets, 2007, p.201). The prospect of membership serves to entice other countries into voluntarily following the EU's leadership, since they envision a future of prosperity and development similar to that of wealthy EU members, which would surpass any short-term economic aid. This alone has motivated the Republic of Macedonia and all other Western Balkan nations to pursue accession negotiations and conform to various EU accession criteria. As Nye explains it, "the goal of joining the EU became a magnet that meant the entire region of Eastern Europe oriented itself toward Brussels" (Nye, 2004, p.77). Simultaneously, the membership incentive assisted the EU in the spread of its policies, norms, and values, and, according to former EU Commissioner for Enlargement Olli Rehn, it served as a tool for reforming other countries into prosperous democracies (Tulmets, 2007).

The EU's engagement with the Western Balkans is not merely about the accession of individual countries, but about fostering a more stable and cohesive region as a whole. One of the key factors in the Republic of Macedonia's accession journey has been the role of regional cooperation and stability. The Western Balkans remain one of the EU's most volatile regions, and the EU's enlargement policy has always been linked to the broader goal of reducing the potential for conflict.

Nevertheless, over the past decade, the EU has faced growing skepticism about the benefits of further enlargement, particularly following the accession of the last wave of Eastern European countries between 2004 and 2013. The 2008 financial crisis, the migration crisis of 2015, and rising Euroscepticism within member states have all led to a cooling of enthusiasm for further expansion. Enlargement fatigue has been compounded by concerns over the EU's ability to absorb new members, as well as fears that the Union's internal cohesion might be undermined by further enlargements. The EU's own internal crises have made it increasingly difficult to maintain the momentum of enlargement. Public support for the EU has declined in many member states, driven by fears about immigration, the rise of populist movements, and concerns about the EU's handling of the Eurozone crisis. In this environment, expanding the Union to include new, economically weaker, and politically diverse states has become a more contentious issue. As a result, several countries in the Western Balkans, including the Republic of Macedonia, have found themselves facing prolonged delays in the accession process, despite having met many of the necessary conditions.

The loss of a credible membership perspective has negatively impacted the way in which the Macedonian people perceive the European Union. In addition to this, the Eurozone crisis (together with the ensuing austerity measures and budget cuts), the migrant crisis, the Covid-19 pandemic, and Brexit have all exposed EU weaknesses and internal squabbles, resulting in a loss of EU reputation (Cross, 2013). In the Macedonian case, public opinion polls show that only 60% of Macedonians in 2023 would vote for EU membership if given the option. This is a whopping 20 percentile drop from 2014, when 80% of respondents were in favor of joining the bloc (Damjanovski, 2023). Graph 1 shows the steady decline in approval for EU membership among Macedonian citizens over the course of the last decade, and the most recent data point represents the lowest level of support for EU membership to date. Hence, we can see a clear trend of diminishing enthusiasm among the Macedonian population and a weakening of the EU's appeal, which can be explained by an accumulated disillusionment due to decades of unsavory conditionalities placed on the Republic of Macedonia by some member-states and the suspended EU enlargement process. For example, 65% of Macedonian citizens are opposed to the new constitutional amendments required by Bulgaria and the EU in order to begin accession negotiations, including 80% of ethnic Macedonians (Velinovska, 2023).

Figure 1: "If next week there is a referendum for membership of the Republic of Macedonia in the EU, how would you vote?" (Damjanovski, 2023)



The EU's favorability rating dropped from 50% in 2018 to 45% in 2021 (NDI, 2021), exacerbated by crises such as the Covid-19 pandemic, during which the EU seemingly neglected the Western Balkans, damaging its reputation of solidarity and partnership with the region (Ushkovska, 2023). For example, 47% of Macedonians viewed the EU as the country's most significant donor in 2020, while only 22% did so in 2022 (Velinovska, 2023). Nevertheless, even with the decline in enthusiasm, ultimately, Macedonian citizens remain EU-oriented and persistent in the objective of full EU membership. For example, 49% of respondents continue to believe that the EU should be the Republic of Macedonia's main economic partner, while 32% see the bloc as the country's best ally (Velinovska, 2023). This leaves the door open for finding ways forward to restoring EU integration process dynamics, in particular when the costs of non-integration and benefits of full membership are considered.

The Costs of Non-integration and the Benefits of Fully-Fledged Membership

Within the European Union, the beginning of 2025 marked an important milestone for the European integration process – full inclusion of Bulgaria and Romania in the Schengen area. During the decision-making process, the European Economic and Social Committee highlighted the economic costs that not only Bulgaria and Romania but also the EU face due to their exclusion from the Schengen Area (European Economic and Social Committee, 2024). As the report suggested, their non-membership has hampered the free movement as the main pillar within the EU single market, resulting in overall reduced economic integration, trade barriers, and decreased efficiency for businesses and citizens. Hence, it emphasized the importance of both countries' inclusion for the overall functioning of the European market and suggested that continued delays could further harm economic prospects as businesses in Bulgaria and Romania incur billions annually due to border controls, with these costs ultimately affecting consumers' and workers' health. Expressed in numbers, Bulgaria has faced EUR 834 million in costs annually, while Romania has lost EUR 2,32 billion, thus highlighting the economic burden of their partial Schengen membership.

This point is used to emphasize the costs of non-integration for both the EU and candidate countries at any stage of the European integration process, while also serving as a reminder of the substantial benefits of full membership. The decades-old logic of European integration relies on aligning the economic interests of the European countries to provide better living standards for their citizens and increase economic prosperity. This approach has also been drawing on liberalist theory, which argues that economic interdependence reduces the likelihood of war (Rosecrance, 1986; Angell, 1933; Cobden, 1903) - a principle central to the foundation of the European Communities (Schuman, 1950). Economic advantages of EU membership are mostly reflected in the single market, which is the most praised and least disputed benefit, despite the developments that impose concerns regarding the European values crisis (Ognjanoska, 2022). Despite all the pitfalls of the European integration process, different waves of enlargement throughout the years proved that membership would allow for a strengthening of the economies.

The case of Spain, Portugal and Greece verifies this thesis - their economies were weaker compared to those of some Community members at that time, but joining the Community allowed the new southern member states to access a larger market through increased trade thus stimulate economic growth (Gilland & Chari, 2001, p. 218). For example, between 1986 and 1991, average GDP growth in Spain increased by 4% yearly (Instituto Nacional de Estadistica, 1992). The economic impact of this process started long before accession with the Preferential Trade Agreements (PTAs) between the EC and Spain (1970) and the EC and Portugal (1972), which resulted in the further opening of European markets to the latter countries and paved the way for an economic model based on exports (Royo, 2007, p. 28). The EU membership perspective served as a key factor that influenced the actions of both policymakers and businesses to adapt to such reforms. On the other hand, the Mediterranean enlargement of the EU has contributed to the creation of new sources of resources for further expansion of the internal market. Accession of Austria, Finland, and Sweden to the EU was also made possible on the basis of their previous integration into the European Economic Agreement (EEA), which provided for extending the internal market and thus served as a stepping-stone to full EU membership.

Nevertheless, the most comparable data pertains to the Central and Eastern European countries for which the enlargement policy, as it was established, facilitated the transformation of the overall political and economic system. In their case, establishing a functioning market economy and the capacity to cope with competition and market forces meant transforming the centrally planned economies into functioning market economies and the capacity to compete with the European single market.

Table 1. Real GDP per capita in PPS and current account changes with regard to CEECs

Country	1999	2007	Change 1999-2007	2009	2011	2013	2015	2017	2019	2020	2021	2022	2023
Bulgaria	27	37	10	44	46	46	49	52	55	57	60	62	64
Czech Rep.	70	80	10	87	84	85	89	92	95	96	92	89	90
Estonia	42	68	26	65	72	76	77	78	83	85	85	84	80
Hungary	53	63	10	65	67	68	70	69	73	75	75	77	77
Latvia	36	55	19	53	58	60	62	64	66	69	71	69	70
Lithuania	39	60	21	57	67	73	75	79	83	87	88	88	87
Poland	49	53	4	60	66	67	70	70	74	79	79	78	77

Country	1999	2007	Change 1999-2007	2009	2011	2013	2015	2017	2019	2020	2021	2022	2023
Romania	26	42	16	52	52	54	56	63	69	72	72	74	78
Slovakia	51	67	16	72	76	77	78	70	70	74	74	71	74
Slovenia	81	89	8	86	84	82	81	84	87	88	88	89	92

Note. Data from Eurostat, n.d.

The presented data suggest that growth and living standards among the EU Member States from Central and Eastern European countries have undoubtedly increased, although this achievement is not equally sustainable everywhere. These trends occurred in the pre-accession period in the framework of the economic transition and integration towards the single market and achieved significant convergence that further increased after accession. From 1999 to 2007 - within the most intense period of the accession process, countries like Estonia, Lithuania, and Poland experienced notable increases in Real GDP per capita, reflecting the positive impact of EU membership perspective which can be related to the adoption of EU *acquis*, improved systemic infrastructure, and enhanced political stability. Being integrated into the global markets, such as the EU single market, also includes higher exposure to the global financial shifts. Thus, the 2008 global financial crisis caused some disruptions in terms of slowing down the economic growth or stagnation in subsequent years. Nevertheless, by 2011-2013, many CEECs had stabilized, and some, such as Poland and Slovenia, continued to see upward trends. Latest data from 2023 shows a diversified but largely positive economic trajectory across the countries, which proves that the EU accession fosters long-term growth.

The economic advancement of Central and Eastern European countries has also contributed to the enhancement of institutional quality. As economies grew and integrated further into the European market, institutional frameworks strengthened to support business activities, transparency, and economic freedoms. Therefore, some of the indicators have been signaling a more business-friendly regulatory environment, also reflecting policy reforms, and suggesting reduced corruption and stronger governance mechanisms (Keereman et al., 2009). Hence, the case of CEECs has demonstrated the anticipated benefits of full EU membership in terms of economic gains but also in institutional strengthening. The progress has reinforced the EU as a normative power in the global scene and set similar expectations for future enlargement rounds on the basis of a comprehensive policy guided by accession criteria and conditionality.

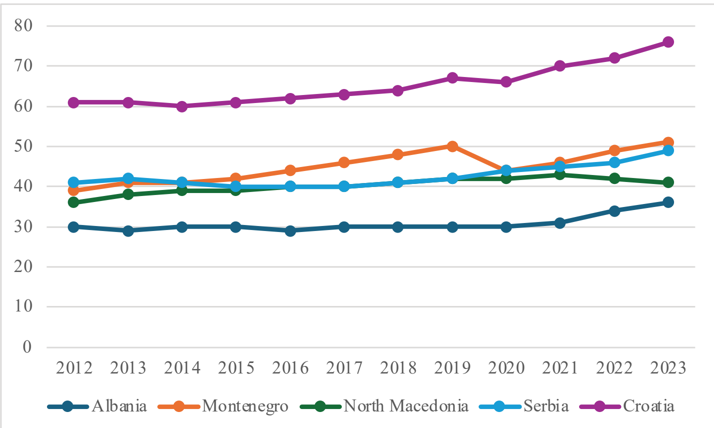
However, the achievements of the enlargement policy have not yet been repeated regarding the Western Balkans, whereby only Croatia managed to join the EU more than a decade ago. Uncertainty about membership prospects has weakened the capacity and transformative power of the EU in the region, which is reflected in the health of the countries' economies that lag behind the European standard. Hence, the discussed phenomenon of the costs of non-integration can be observed in the figures presented below, particularly if compared to the economic performance of Croatia as an EU Member State.

Table 2. Real GDP Per Capita in PPS in WB Candidate Countries

Country	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Albania	30	29	30	30	29	30	30	30	30	31	34	36
Montenegro	39	41	41	42	44	46	48	50	44	46	49	51
Macedonia	36	38	39	39	40	40	41	42	42	43	42	41
Serbia	41	42	41	40	40	40	41	42	44	45	46	49

Note: Data from Eurostat, n.d.

Figure 2. Convergence Gap – WB countries and Croatia as EU member states



Note: Data from Eurostat, n.d.

For the Western Balkans' citizens, EU membership is still perceived as an embodiment of European values and principles of democracy and rule of law, but the economic prosperity and freedom to study and work in the EU are the top two expectations which remain the most important association with the EU membership benefit (Balkan Barometer, 2024). However, even though the majority of Western Balkan citizens consider the positive impact of EU integration on their economy, there is some variation in the intensity of this belief across the region and for the second year in a row, there is a decline in the belief that EU membership would be beneficial for their economy (Balkan Barometer, 2024). This decline goes hand in hand with the decline in the overall support for EU membership in the Western Balkans, even though the positive sentiment still prevails.

Moreover, it should be highlighted that democracy and the rule of law cannot make lasting inroads into the enduring poverty of the Western Balkans (Ognjanoska, 2022). Socio–economic reforms appear increasingly relevant to the rule of law (Hogic, 2024). Hence, the current Enlargement Methodology (European Commission, 2020) also recognizes this correlation by merging the rule of law chapter 23 - Judiciary and fundamental rights, and 24 - Justice, Freedom and Security with the economic criteria. Finally, the linkage amplifies the costs of non-membership but also the lack of tangible European prospects in the region.

The Concept of Differentiated Integration

The EU's enlargement fatigue and doubts about the EU's ability to absorb new members brings about the need to reconsider (new) prospects for upholding the dynamics of the EU integration process. One of them is the idea of differentiated integration, which has been sporadically mentioned by scholars as an option for Western Balkan countries, but ultimately under-explored, or dismissed as politically imprudent.

The term “differentiated integration” was used by former European Commissioner for Enlargement, Olli Rehn, as a concept for a successful future of the European project almost two decades ago (Rehn, 2007). Rehn argued that neither the federalist idea, nor the Eurosceptics view would win the debate on the future institutional shape of the European Union, and he presented the idea of differentiated integration as a way to strike the right balance between “unity and diversity, homogeneity and heterogeneity” of member state’s interests (Rehn, 2007). The need for differentiated integration within the EU, also referred to as multi-tiered integration, of two-speed integration, arose from the diverse, and at times seemingly incompatible, views by EU member-states on the ultimate form of European integration. Former German Foreign Minister Joschka Fischer stated in a speech in 2000 that the founding members created the union without a “blueprint for the final state” (Fischer, 2000). While many EU officials and state politicians would argue that the sole logical direction the EU can take is that of a full-fledged federation, the finality of the European integration process was never defined in any specific terms in either a written form or in the form of a consensus between constituent states.

The preambles of the EU Treaties emphasize the commitment assumed by all member-states to “continue the process of creating an ever closer union among the peoples of Europe.” Furthermore, Article 1 of add Treaty of European Union

(TEU) states that the existing treaty "marks a new stage in the process of creating an ever-closer union among the peoples of Europe", solidifying an ideal of European integration, the level of which remains vague. It is precisely this undefined form of the "ever closer union" which has been the cause of many a disagreement between member-states, all of which have demonstrated a distinct understanding and preference for what the end result of the European project should be. Expressions of a two-speed Europe are seen in how some member-states have accepted the Euro, others have not, some member-states form part of the Schengen zone, others do not, and this has not been a cause for major concern until now. The states that want a deeper union should not be prevented from doing that. If other states do not want to rush in that direction, their opinion should also be respected.

Proposals for differentiated integration within the EU have gone even further, amid the internal challenges facing the EU in the last few years and the visible dissonance between member-states on common EU policies, such as migration policy. These divisive outlooks on the direction of EU integration prompted the European Commission to publish a white paper on the future of Europe in 2017, containing a total of five possible scenarios. Among these, Scenario 3 has garnered a great deal of attention, proposing a multi-speed EU, titled "Those who want more do more". The White Paper describes as "coalitions of the willing" the groups of member-states which opt to cooperate more closely in areas such as taxation and social policy, as well as joining capabilities for a common defense. Other states, which may not wish to participate in those groups with special legal and budgetary arrangements, would remain dedicated to supporting the single market, with the option to potentially join the more integrated bloc later on.

The argumentation in support of this concept within the EU is twofold. First, it would be a truly democratic option within the EU where each state could decide for itself the level of integration it wishes to pursue, without the pressures that come along with the need for a unanimous vote. Second, it would put an end to the slow and ineffective work of EU institutions caused by the sometimes long and impossible negotiations between states on policies, as each state tries to best serve its national preferences. A two-tier Europe would be arguably more sustainable, albeit less united.

Most studies concerning differentiated integration focus on intra-EU institutional arrangements between existing member states. However, it may be necessary to extend this concept to the relationship between the EU and candidate states and apply the legal and political alternatives that differentiated integration already allows within the EU to the context of the Western Balkans' integration process (Milenkovic, 2024). In light of the very slow process of EU enlargement, this approach may enable the EU to maintain some of its transformative power and influence in the region, in the absence of the full membership option.

Nevertheless, it is important to recognize that multi-tier integration comes with its own set of controversies. Firstly, if given the option, the Republic of Macedonia, as well as other candidate states, would opt for full and immediate membership in the EU, rather than an alternative arrangement whereby the prospect of full accession is sidelined. The current definition of differentiated integration is 'the process whereby European states … opt to move at different speeds.' However, suppose we are to extrapolate this concept to the case of the Republic of Macedonia as a candidate state. In that case, the agency is removed from the hands of the country. The definition of differentiated integration would be amended to 'the process whereby European states … opt for other (non-EU) states to move at different speeds' towards European integration (Economides, 2010). Furthermore, depending on the political form of the offered differentiated integration, political leaders in the Republic of Macedonia may choose to suspend further accession negotiations if the membership card is completely removed from the table. The reaction of skepticism and concern toward such a proposal may resemble that expressed concerning the Open Balkan Initiative by Macedonian Prime Minister Hristijan Mickovski, when he stated that the Initiative should never be a substitute for full EU membership (Fokus, 2023), since many in the country perceived it as an undesired consolation prize presented to the Western Balkans by an enlargement-weary EU.

Secondly, the application of differentiated integration for candidate states upon their accession to the EU lends itself to the idea that this could create a "class" distinction between member-states, creating the perception of a club within the club, with some states left looking in from the outside. It is already expected, following the example of Bulgaria and Romania, that should the Republic of Macedonia become a full member of the EU, membership in the Schengen area or the Eurozone would be delayed, possibly by a decade.

Furthermore, depending on the contractual arrangements of the Republic of Macedonia's accession, it could mean a reality where the country is excluded from certain decision-making processes of the EU, a situation reminiscent of that prior to the EU's enlargement. Multi-tier integration in the EU implies that "citizens' rights derived from EU law start to vary depending on whether or not they live in a country that has chosen to do more" (European Commission, 2017).

Current Frameworks and Proposals for Upholding the European Integration Dynamics

The integration process, designed to enable the European perspective of the Western Balkans as promised at the Thessaloniki Summit in 2003, has already entered its third decade. Meanwhile, the overall context has changed, especially since February 2022, following Russia's aggression against Ukraine, as the EU found itself confronted with a stark geopolitical reality. Given that the questions of security and regional influence became more pressing than ever, it has generated a need to act without further weakening or delaying bold decisions regarding enlargement. This political context resulted in the rapid granting of candidate status to Ukraine and Moldova and the opening of accession negotiations within a year.

Nevertheless, despite the renewed interest in strengthening the Enlargement agenda within the EU, this pressure has yet to be translated into concrete decisions in terms of the Western Balkans. Moreover, the current state of play implies that the EU will need to engage simultaneously on integrating two different regions – the Western Balkans and the Eastern Partnership (Milenkovic, 2023), thus shedding new light on the modalities of applying the differentiation principle and multi-tier integration to advance the process. In addition to Article 49 TEU which sets the conditions for joining the EU, the legal framework for the EU's external relations regarding the principle of differentiation is outlined in Article 8 TEU, which allows for the development of special relationships based on cooperation and shared values, while Article 217 from the Treaty on the Functioning of the European Union (TFEU) further permits the conclusion of agreements establishing associations with reciprocal rights, obligations, and common actions.

The challenge refers to creating an approach that would still enable the Union to maintain its transformative impact in the region, despite the relatively slow pace of European integration and the various obstacles as discussed above, while taking into consideration both scenarios – potential membership or continuous non-membership. As this hurdle is not a new one, there have been some previous attempts to reinvigorate the EU's leverage in the region in the absence of a predictable accession process. Some of these proposals focused on strengthening regional cooperation by creating a Regional Economic Area as an initiative within the Berlin Process in 2017, or the Common Regional Market presented in 2020 as another stepping-stone to further pre-accession integration with the EU. However, these regional initiatives can only have a limited impact due to the small size and low level of economic development of the region's economies and lack of credible EU leverage through incentives (Ognjanoska, 2022). Hence, the proposal on staged accession to the EU containing a detailed roadmap for a more structured, gradual, and reversible accession process in institutional and legal terms (Emerson et al, 2022) has become the central focus of current discussion on reforming EU Enlargement policy as well as the broader future of the Union. This template has been further upgraded with other concrete proposals on phasing in into individual EU policies and programs as intermediate goals, whereby access to the single market stands out as the most tangible and impactful incentive.

The report of the German-Franco Working Group on EU institutional reforms, published in 2023, highlights the principle of differentiation as a basis for the overall transformation of the EU, reflecting on both dimensions – internal and external. It outlines that the EU already has various differentiation mechanisms needed to accommodate the diverse preferences of the current and future EU Member States, such as transition clauses, temporary derogations, enhanced cooperation, permanent structured cooperation, or conditional participation. However, protecting the rule of law is set as a non-negotiable principle in the EU, emphasizing that any disagreements overrule of law standards cannot be solved by differentiation within the EU. Hence, differentiation also has its lists and should not allow for any compromises on fundamental values – instead, rule of law conditionality should be even further enhanced for access to the single market and receiving EU funding. Tackling the external dimension of differentiation, the Report suggests that "it may be mutually beneficial for all to design a path towards different levels of integration or some form of looser association for new or current Member States." The main idea is to develop the European integration process in concentric circles including one larger circle of Associate Members, that would be granted access to the single market and adherence to common principles, as well as to other frameworks such as the European Political Community as an outer tier for political cooperation without having to be bound to EU law. Therefore, external differentiation should be structured in a way that does not undermine the ultimate prospect of EU membership – neither as an alternative nor as a precondition, but rather as a framework that would enable gradual 'phasing in' of current candidate countries into selected EU policies with a focus on the single market.

Although the EU and its institutions have yet to take concrete follow-up steps regarding the overall transformation of the European integration process, the Growth Plan for the Western Balkans, adopted by the European Commission in November 2023, has been presented as a game-changer for the overall process. Given its goal of accelerating the region's economic convergence with the EU, it considers the economic gap of Western Balkan economies, which stand at only 35% of the EU average, while focusing primarily on integrating the Western Balkans into the EU single market, deepening EU-related reforms, and increasing pre-accession funding. The Growth Plan is structured around four key pillars. The first pillar focuses on integration into the EU single market, recognizing it as a major driver of economic growth, by outlining seven priority areas: free movement of goods, services, and workers, access to the Single Euro Payments Area (SEPA), facilitation of road transport, energy market integration and decarbonization, participation in the digital single market, and integration into industrial supply chains. This instrument also builds upon the initiatives for enhanced regional economic cooperation through the Common Regional Market based on EU rules and standards in order to overcome market fragmentation and improve the economic cohesion of the region. The third pillar is centered on accelerating fundamental reforms by requesting WB countries to develop and implement a Reform Agenda, which serves as the main conditionality mechanism for access to the final pillar that involves financial support.

It can be concluded that this instrument incorporates the principles of conditionality and differentiation, as it aims to bring forward some of the membership benefits ahead of full integration into the EU. Overall, the Growth Plan represents a strategic shift in the EU Enlargement policy by offering gradual economic integration to incentivize reforms for eventual EU membership, which still stands as an uncertain goal. However, as in the case with most of the instruments that have been employed previously, its potential to reinforce the EU's transformative power in the region depends on the consistency regarding its implementation, clear application of conditionality, and swift execution with more tangible results. Finally, the trend of introducing instruments based on differentiation principles reflects the reality caused by the stalemate in the accession process and enlargement fatigue, initially prevalent within the EU but now increasingly evident among candidate countries. Economic growth in the region, if driven by these initiatives, could create a new positive cycle, and ultimately bring the Western Balkans closer to the EU, at least economically, but also provide the socio-economic preconditions for deeper political reforms focusing on the rule of law.

Conclusion

The EU integration process for the Republic of Macedonia has encountered significant hurdles, and the EU's commitment to the country's accession has been repeatedly evaluated, as the candidate state has struggled to meet the EU's stringent criteria while navigating complex political and societal dynamics. One of the key issues has been the EU's inconsistent messaging regarding its commitment to enlargement. On the one hand, the EU has repeatedly stated that the future of the Republic of Macedonia and the rest of the Western Balkans lies within the Union. On the other hand, the slow pace of progress and the increasing obstacles to accession have led to diminishing enthusiasm and a growing sense of disillusionment within the region.

The decades-long process of EU integration, characterized by the continuous imposition of bilateral conditions that extend beyond the Copenhagen criteria, has undermined the Republic of Macedonia's trust in the EU. After the Prespa Agreement, the country awaited the opening of formal accession negotiations, but the postponement of the start of talks in 2019 signaled to many in the Republic of Macedonia that the EU was unwilling to deliver on its promises. This political maneuvering has eroded the EU's credibility in the eyes of many Macedonians, with the recent decision to decouple Albania's EU accession process from that of the Republic of Macedonia further deepening the sense of alienation. As a result, the EU's role as a soft power impacting political and economic reform in the region has been substantially weakened. Public opinion among Macedonian citizens on EU membership has been shaped by the prolonged imposition of external conditions and the absence of tangible benefits that would justify continued adherence to EU requirements.

Despite the decline in enthusiasm, Macedonian citizens still view the EU as a crucial economic partner. Nearly half of the population believes that the EU should remain the country's primary economic partner, reflecting the importance of the EU's single market and the economic prosperity it brings. However, this relationship is increasingly characterized by pragmatism rather than the aspirational hope of full integration. The promise of EU membership, once a powerful magnet, now carries less weight, especially given the EU's internal challenges, such as the phenomenon of 'enlargement fatigue.' There has been growing reluctance among some EU member states to expand the union further - economic concerns, waves of Euroscepticism, concerns about migration, and internal divisions on policies and tackling crises have made enlargement a contentious issue within the union. Still, the EU must balance its internal challenges with the external need for regional stability and integration, making enlargement a strategic priority rather than a negotiable issue.

The EU's economic incentives, particularly the integration into the single market, remain one of the most compelling reasons for countries in the region, including the Republic of Macedonia, to pursue EU accession. This economic argument is rooted in the liberalist theory that suggests economic interdependence reduces the likelihood of conflict and increases prosperity. However, the slow pace of enlargement means that the success experienced by Central and Eastern European countries following their EU accession could not be replicated for Western Balkan countries. The uncertainty surrounding the EU's enlargement process has led to a significant gap in the transformative power of the EU in the region. The absence of a clear membership prospect has undermined the EU's ability to bring about the reforms it once successfully advocated in other Eastern European nations. Without a clear path to full integration, the Republic of Macedonia's progress toward meeting EU criteria has slowed, and its economy remains relatively underdeveloped compared to EU member states. The challenges posed by non-integration are apparent when comparing the economic performance of the Republic of Macedonia with that of Croatia, which has experienced significant growth as a result of its EU membership.

The need for a more flexible and differentiated approach to EU integration has become increasingly apparent. The concept of multi-tiered or differentiated integration, where countries are allowed to participate in certain EU policies or frameworks without full membership, may offer a way forward for the Western Balkans. By allowing countries like the Republic of Macedonia to integrate into the EU's single market or participate in political cooperation through frameworks such as the European Political Community, the EU could maintain its influence in the region. This model would not replace the possibility of full membership, but would offer an interim solution that provides some of the benefits of EU integration while avoiding the stagnation that has characterized the current enlargement process. The EU's Growth Plan, which incorporates elements of differentiation and conditionality, offers a potential framework for gradually reintegrating the Republic of Macedonia and other candidate states into the EU's economic structures. By working toward integration in the single market and encouraging adherence to EU values without immediate membership, the Growth Plan could stimulate economic development and political reform in the region. However, its success depends on consistent implementation, clear application of conditionality, and tangible results that can reinvigorate public support for EU membership.

While political leaders in the Balkans may suspiciously view this approach as a retreat from the goal of full EU accession and an abandonment of the enlargement process, the concept of differentiated integration offers a potential way forward from the current stalemate. By providing partial integration into the EU's economic and political frameworks, the EU could maintain its influence in the region, stimulate economic growth, and create the conditions necessary for deeper political reforms. However, for this approach to succeed, the EU must ensure that it remains committed to the goal of full membership for candidate countries, while offering concrete benefits that can sustain the region's aspirations for a better future. Accession should be framed as a mutually beneficial partnership that offers both the candidate countries and the EU a shared future in a more integrated Europe. The EU should provide tangible benefits at each stage of the process, including support for regional cooperation and integration into the EU's single market, to keep candidate countries motivated and engaged.

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Chapter 12

Economic Transformation of North Macedonia Post-1991: Challenges and Opportunities for Sustainable Development

Ahmet Lokce[1]

The economic development of North Macedonia since independence has been influenced by multiple structural transformations, together with shifting geopolitical alignments and sector changes. When socialism collapsed, it led to the dismantling of the former Yugoslav economic framework that kicked off a lengthy period of reform, including privatization, trade liberalization, and institutional change. North Macedonia maintains its position as a small open economy between Eastern and Western spheres while it strives to maintain equilibrium between its internal economic targets and outside economic forces.

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Demographic decline, together with labour market instability, has proven to be a major issue. The combined effects of decreasing birth rates, continuing skilled worker migration, and an aging population decreased the working-age population while putting strain on the pension and healthcare systems (Cvetkoska et al., 2025). The employment rate of North Macedonia stands below its EU and regional counterparts, with noticeable gaps between different age groups and gender and ethnic cohorts. The youth unemployment rate, alongside female underemployment in rural areas, along with informal employment in low-skilled industries, creates barriers to inclusive economic development (Topuzovska-Latkovikj et al., 2024). The economic productivity faces barriers from the wide gap between educational output and labor market requirements.

Economic transformation led the country from farming and basic production to service industries, advanced manufacturing, and new digital industries. The manufacturing sector has made a comeback through foreign investments in TIDZs, while agriculture has lost its former major position. Industrial production faces ongoing difficulties because of outdated infrastructure, insufficient technological levels, and weak connections of domestic suppliers to worldwide value chains.

SMEs now play a more important role in the business sector, although they continue to be under-represented in international markets. The employment capabilities and innovative spirit of SMEs remain strong despite their challenges with digitalization, EU standard compliance, and financial support. Export activities have become more successful because of foreign-led manufacturing of automotive parts and electrical devices, while trade remains focused on limited sectors that mostly export to EU countries, especially Germany.

Foreign direct investment functions as a transformative force that drives growth within industrial sectors and service industries. Investment flows have improved export competitiveness while creating jobs and bringing technological advancements to focus on the manufacturing and energy sectors. The amount of foreign investment in North Macedonia shows frequent changes and mainly focuses on a few specific locations. Higher-value investment opportunities remain elusive because of weak institutional strength and regulatory instability, along with EU accession delays, especially in knowledge-based sectors.

The economic advancement of North Macedonia directly correlates with its international status. EU integration functions as the main driving force for North Macedonia to achieve legal standardisation and access new markets while modernizing its institutions. North Macedonia deepens its relations with China by accepting infrastructure and energy projects through China's concessional lending and Belt and Road Initiative collaborations. These engagements have improved connectivity and physical capital formation while sparking issues regarding debt exposure, governance transparency, and long-term strategic alignment.

Transport and infrastructure corridors, including Corridors VIII and X, serve as key elements to enhance the logistical position and trade connectivity of the country. North Macedonia has received infrastructure investments for highways, railroads, and intermodal hubs to become the transit country of the region. The logistical competitiveness suffers from inadequate freight infrastructure combined with variable digital customs integration and administrative inefficiencies that result in supply chain inefficiencies and border crossing delays.

Digital transformation stands out as a fundamental sector for structural evolution. The ICT sector growth, together with broadband infrastructure development and e-government service expansion, established digitalization as the primary driver of modernization. The digital divide exists between rural and urban communities, while digital literacy skills remain low in many population groups, and startup development faces major structural barriers. The adoption of modern technology by local companies remains limited, while weak data protection mechanisms impede the development of a complete digital economy.

The country's developmental prospects will succeed based on its capability to convert obstacles into unified policy solutions. A resilient and inclusive economy needs policies that boost labor market participation, enhance institutions, while speeding up industrial modernization and SMEs export readiness, and EU standard alignment for digital and environmental strategies. Strategic planning, targeted investment, and sustained governance reform enable North Macedonia to reframe its development path during a time when demographic, technological, geopolitical, and environmental pressures converge.

Demography, Migration, and Labor Market in North Macedonia

The population of North Macedonia has been on the decline since the early 1990s, and the key factors behind the decline are reduced birth rates as well as continued emigration of citizens. Right after the country's independence in 1991, the population was approximately 2,1 million people. Nevertheless, in the last few decades, demographic shifts resulting from the economic transition, political uncertainty, and changing social relationships have led to the continued decline of the population. As of the latest calculation, the population of North Macedonia is estimated at 1,79 million people, which is in line with demographic trends typical of post-socialist economies of the Balkans (World Bank, 2024).

The fertility rate was 2,3 births per woman in 1991, and it has dropped to 1,43 births per woman in 2023. This figure is below the replacement level of 2,1, which is the level required to maintain population stability (United Nations, 2024). If the trend continues, the fertility rate is expected to drop further to 1,35 by 2030, which will increase the rate of population decline and the burden on social welfare systems (Eurostat, 2024). The main factors behind the low levels of fertility are increasing economic uncertainty, changed attitudes towards career and family, extended time in education, and the high migration of young citizens (OECD, 2024).

The population aging is another important demographic issue. In 1991, the elderly population was 9,5 percent of the total population. By 2000, this share had increased to 11,3 percent, and by 2023, it was 16,4 percent (State Statistical Office of North Macedonia, 2024). This demographic shift is expected to persist, and the following patterns are projected: at least 20 percent of the population over 65 years of age by 2030. It is expected that by 2050, this figure will rise, and more than 25 percent of the population will be over 65 years of age (European Commission, 2024).

North Macedonia's population is ethnically diverse, with the latest census indicating that Macedonians constitute 58,44% of the population, followed by Albanians (24,30%), Turks (3,86%), Roma (2,53%), Serbs (1,30%), Bosnians (0,87%), and Vlachs (0,47%) (State Statistical Office of North Macedonia, 2021). This diversity has had a notable impact on labor market participation, economic disparities, and social policy design. Empirical research shows that certain ethnic minorities—particularly Roma communities and rural Albanians—are disproportionately affected by unemployment and educational inequality, resulting in systemic exclusion from formal labor markets and professional advancement opportunities (Bartlett & Uvalic, 2022).

Since the country became independent in 1991, the former Yugoslav state of North Macedonia has had one of the highest rates of its population leaving the country, especially the knowledgeable workers; hence, it is one of the countries in the Western Balkans. About 700.000 people, some 35 per cent of the current population, have left the country in search of better job opportunities and a better standard of living (State Statistical Office of North Macedonia, 2024). Emigration has risen over the past few decades especially since the early 2000s due to the economic stagnation, political instability and weak labor market conditions that prevailed in the country, with large numbers of professionals, especially in the health care, engineering and information technology sectors, migrating to Germany, Switzerland and Italy (International Labour Organization [ILO], 2023).

The consequences of emigration are two-sided. First of all, the massive departure of the highly educated and skilled personnel has led to brain drain, which has adversely affected the human development acumen of North Macedonia. The ILO (2023) estimated that about 25 per cent of the country's skilled workforce has left the country since the 1990s, and the healthcare sector has been particularly hit. Almost 30 per cent of the newly trained doctors in North Macedonia leave the country within the first five years of graduation to pursue better salaries, improved working conditions, and more promising career opportunities abroad, according to Gashi et al. (2023).

Secondly, this sustained population outflow has worsened demographic issues, including the aging population and low birth rate. Remittances from the diaspora, which have been a significant source of economic income for North Macedonia and have been estimated to account for 3,4% of the country's GDP, are a short-term advantage, but the long-term consequences of the depletion of the labor force are not worth it (World Bank, 2024). North Macedonia has not been able to develop strategies to tap the diaspora for investment and technological exchange, while some of its neighbors have (Petreski & Mojsoska-Blazevski, 2021). If the current rates of emigration continue, the population of North Macedonia may decline to 1,6 million people by

2050, and the labor force will be further reduced (European Commission, 2024). The working age population (15–64 years) is expected to decrease by more than 20% which will affect the labor market sustainability. The country will likely continue to experience further economic doldrums and the pressure on the pension system unless intervention is made (OECD, 2024).

Finally, mitigating the long-term effects of brain drain necessitates the establishment of a structured diaspora engagement strategy. Such a strategy should aim to attract investments from the expatriate community, facilitate knowledge and technology transfer, and create pathways for the voluntary return and reintegration of skilled migrants into the domestic economy (Petreski & Mojsoska-Blazevski, 2021). North Macedonia's labor market has undergone substantial transformations since its independence from Yugoslavia in 1991. During the early transition period, the country faced economic restructuring, industrial collapse, and high unemployment rates, which led to widespread labor market instability (World Bank, 2023). The transition to a market economy resulted in deindustrialization, privatization of state-owned enterprises, and a decline in manufacturing employment (European Commission, 2024).

North Macedonia experienced major job creation through service sector expansion and foreign direct investment attraction alongside government labour programs during the past twenty years (OECD, 2024). North Macedonia remains plagued by structural labour market issues, while different demographic groups show differing unemployment patterns, and workforce participation endures as a challenge. North

Macedonia experienced major changes in its unemployment rate after gaining independence through both economic changes and government policies. The unemployment rate of North Macedonia rose to 23,4% when the country became independent before reaching its peak of 36,39% in 2006, then decreased to 32,0% in 2010. The State Statistical Office of North Macedonia reports that the unemployment rate decreased to 14,8% in 2022 before reaching 13,08% in 2023 and 12,3% during the third quarter of 2024 (State Statistical Office of North Macedonia, 2024; Macrotrends, 2023). The decreasing unemployment numbers show positive results from labour policies, but North Macedonia needs additional structural changes because its rates exceed EU averages.

A nation's working-age population's engagement with the economy drives labor force participation rates, which show how well the population participates in work activities. North Macedonia faces difficulties with labor force participation because its rates stay lower than EU and regional standards despite better unemployment statistics. The labor force participation rate in 1991 started at 57,17% but dropped to 52,59% by 2023 while remaining below the 74,6% EU average for the same period (European Commission, 2024; TheGlobalEconomy.com, 2023). Multiple demographic and labour market factors, such as an ageing population, workforce migration to EU nations, and persistent skill mismatches between available workers and available jobs, have led to decreased workforce engagement. The workforce participation remains limited due to both informal employment sectors and insufficient programs that would help discouraged workers return to the labour market.

North Macedonia faces youth unemployment as a major labour market problem since youth unemployment rates exceed the overall national employment rates. The youth unemployment rate in North Macedonia reached 29,5% during 2023, which made the country one of the highest youth unemployment performers in Balkan nations (ILO, 2024).

North Macedonia faces labor market inefficiencies because women remain under-represented in the workforce which prevents the country from achieving inclusive economic growth and social equity. The labor force participation rate between women and men showed a 24,1 percentage point difference in 1991 because women participated at 49,7% while men participated at 73,8% according to the ILO 2024 report. The gender gap between workforce participation rates has shown minimal reduction throughout the last thirty years. The 2023 statistics from the State Statistical Office of North Macedonia and IEMed (2024) showed female participation in the workforce at 42,2% compared to male participation at 63,4% which resulted in a 21,2 percentage point gender gap (IEMed, 2024; State Statistical Office of North Macedonia, 2024).

North Macedonia has experienced a total transformation in its employment structure. At the beginning of the transition period, the economy depended mostly on agriculture and traditional manufacturing industries, which were the result of the former Yugoslav economic structure. The World Bank (1992) and the State Statistical Office of North Macedonia (1995) reported that agriculture made up about 31,6% of employment, while industry claimed 38,3% and services employed 30,1% of the total workforce in 1991.

The subsequent thirty years brought substantial changes because of privatization alongside industrial decline, urbanization, rural emigration, and service sector expansion. The employment distribution has experienced total inversion since 2023. The agricultural sector now makes up 9,7% of employment, while industry represents 30,4% and services account for 59,9% of total employment (State Statistical Office of North Macedonia, 2024; Statista, 2024). The economic liberalization, together with technological advancements and consumer demand for intangible services, has triggered this global shift (OECD, 2024).

The services sector has expanded rapidly in urban areas through investments into ICT infrastructure alongside retail, education, and tourism, which generated new employment possibilities for younger and more educated people. The ICT sector produced 6,5% of GDP in 2022 while providing employment to more than 20.000 ICT professionals, thus establishing its position as a crucial economic competitiveness factor (Petreski & Jovanovska, 2022). The agricultural sector faces a dual challenge of low productivity, together with an aging rural population and limited modernization, which has caused its GDP and employment contribution to decrease (European Commission, 2024).

The industrial sector maintains its importance for export activities and foreign investment through TIDZs, yet its employment growth remains below the level of capital investment received. The employment-generating potential of the sector remains restricted by structural challenges that include outdated technology alongside low value-added production and skills mismatches (World Bank, 2024).

ICT sector represents one of the most dynamic subsectors in the services industry because it has shown substantial growth during recent years. The ICT industry generated 6,5% of North Macedonia's gross domestic product during 2022, thus demonstrating its expanding role in the national economy. The sector maintained a workforce exceeding 20.000 professionals, which demonstrated both the rising need for digital solutions and the country's strategic plan to establish itself as a technological services center (Petreski & Jovanovska, 2022). ICT services have experienced rapid growth because of foreign investment and government support for digital entrepreneurship and the expanding number of skilled workers available in the labor market. The positive developments in the ICT sector need policymakers to address talent retention issues, skills mismatches, and digital infrastructure development requirements. The services sector of North Macedonia has experienced significant growth through tourism, which now drives both economic expansion and sectoral diversification. International tourism remained underdeveloped in North Macedonia after independence in 1991 because the country registered only 94.000 foreign arrivals during that year (UNWTO, 1992). International tourist arrivals in North Macedonia reached 1.211.570 during the year 2023, which represented a 12-fold growth from 1991 levels (State Statistical Office of North Macedonia, 2024). The current numbers demonstrate an 18,3% growth compared to 2022, when tourism showed robust recovery patterns from COVID-19 (European Commission, 2024).

The sector's share in total employment has increased considerably, from 1,2% in 1991 to about 4,7% in 2023, providing approximately 28.000 direct and indirect jobs in hospitality, transport, cultural tourism, and local crafts (World Travel & Tourism Council [WTTC], 2024; State Statistical Office of North Macedonia, 2024). Likewise, the tourism sector's contribution to GDP rose from less than 1% in 1991 to 4,5% in 2023, a rise attributed not only to the increase in tourist arrivals, but also to better facilities, service delivery, and government policies to foster the sector (OECD, 2024; WTTC, 2024). The country's position in the Balkans and the existence of natural resources and cultural attractions, including Lake Ohrid and the Old Bazaar of Skopje, have improved its appeal. Investments in transportation corridors, airport infrastructure modernization, and EU-supported tourism development have been critical in improving competitiveness. The rural areas of Mavrovo, Berovo, and Prespa have also seen an increase in eco-tourism and agritourism activities as tourism has assisted in the development of rural areas (European Commission, 2024).

Manufacturing has historically served as a cornerstone of North Macedonia's economy, contributing significantly to employment and industrial output. In the immediate post-independence period, the industrial sector—including manufacturing—accounted for approximately 34,7% of GDP in 1991 (World Bank, 1992). However, the sector's relative contribution to GDP has since declined due to structural transitions, the collapse of formerly state-run industries, and an overall reorientation toward services. By 2023, manufacturing output stood at approximately $1,83 billion, accounting for 14,9% of GDP, reflecting a long-term contraction in relative industrial prominence despite some short-term growth (Macrotrends, 2024; OECD, 2024).

Employment in manufacturing has also shifted significantly. In the early 1990s, around 25% of the labor force was engaged in manufacturing (ILO, 1994). By 2023, this figure had declined to 14,6%, revealing both a reduction in employment and increasing capital intensity in production (State Statistical Office of North Macedonia, 2024; ILO, 2024). This decline is attributed to outdated infrastructure, limited digital and technological innovation, and persistent mismatches between the supply of skilled labor and the needs of modern manufacturing industries (OECD, 2024).

Despite these challenges, manufacturing remains a vital sector. Key industries such as automotive components, electrical machinery, textiles, and food processing continue to form the backbone of export-oriented production. The creation of TIDZs since the early 2010s has helped attract foreign direct investment, contributing to the modernization of select subsectors. Companies such as Johnson Matthey, Kromberg & Schubert, and Van Hool have established operations within TIDZs, collectively generating over 25.000 jobs by 2023 (World Bank, 2024). These zones offer incentives like tax holidays, infrastructural support, and regulatory streamlining, acting as vital industrial policy tools for employment and growth. To sustain and revitalize the sector, North Macedonia must invest in the modernization of outdated facilities, improve vocational training systems to align with labor market demands, and establish stronger linkages between domestic SMEs and international production networks (European Commission, 2024).

The agricultural sector has shown a more pronounced decrease in its economic value and workforce engagement during this time. In 1991, agriculture represented 17,6% of GDP and employed about 26,4% of the workforce (World Bank, 1992; ILO, 1994). The sector now contributes only 6,6% to GDP while employing 9,3% of the workforce in 2023, indicating a significant shift away from rural and subsistence farming, according to Statista (2024) and OECD (2024). The sector faces multiple drivers that cause its decline, including aging rural populations, fragmented land ownership, insufficient mechanization, and increasing climate risks. The European Commission (2024) reports that rural to urban migration has reduced the agricultural workforce. The informal nature of small-scale farming operations, combined with limited access to credit and technology, leads to decreased productivity and earnings.

North Macedonia faces major workforce problems that negatively affect its economic growth because of ongoing skills mismatches and widespread informal employment. The education system's failure to match labor market requirements creates substantial recruitment problems for employers since 60% of firms face difficulties finding skilled employees (OECD, 2024). The labor market of North Macedonia will experience substantial changes until 2030 because of economic growth, population changes, and industrial developments. The unemployment rate will drop below 10% when foreign direct investment maintains job growth and labor market reforms succeed, according to the Vienna Institute for International Economic Studies (2020). The expansion of vocational training programs and employment incentives will lead to higher labor force participation rates, reaching 58-60% according to the European Bank for Reconstruction and Development (2024). The government focuses on youth employment through expanded apprenticeships, digital economy programs, and entrepreneurship initiatives to develop new career paths for young professionals (OECD, 2024). The country faces the risk of worsening technical, healthcare, and ICT labor shortages because of inactive reforms, which would reduce its economic growth potential and global competitiveness in digital and knowledge-based markets (World Bank, 2023).

Trade in North Macedonia: Export-Import, SMEs, and Economic Competitiveness

North Macedonia has experienced a major shift in its trade structure since gaining independence in 1991 by moving away from its fragmented post-Yugoslav system that operated within regional boundaries toward a more open, globalized, export-oriented trade structure. The early 1990s brought about the breakdown of integrated supply chains, together with declining industrial competitiveness. The country has moved toward EU and international market integration through trade liberalization and export diversification while facing ongoing structural challenges (Trošić & Arnaudov, 2024).

North Macedonia has one of the highest trade exposures in Southeast Europe, with trade openness increasing from 87% in 2000 to 133% in 2024 (World Bank, 2024). Nevertheless, the advantages of being highly integrated into trade are diminished by a persisting trade deficit. In 2024, the exports stood at €8,3 billion and the imports were at €11,4 billion, leading to a trade deficit of more than €3,1 billion, which has been increasing over the past five years (State Statistical Office, 2024). This is mainly due to the fact that the country imports energy, capital goods, and consumer products and has a weak domestic value-added manufacturing base. North Macedonia's export composition is dominated by a few key sectors, mostly driven by foreign direct investment in TIDZs. In 2024, automotive components and electrical equipment represented 44% of total exports, followed by iron and steel (13%), pharmaceuticals and chemicals (10%), and agricultural and food products (7,5%). This marks a stark contrast from the early 1990s when agriculture and textiles were central to the country's export profile (Ministry of Economy, 2024).

The country's export destinations have remained concentrated in the EU. Germany continues to dominate, absorbing 46,5% of total exports, followed by Serbia (9,1%), Bulgaria (6,5%), Greece (5,7%), and Italy (4,1%) (European Commission, 2024). This high dependence on a narrow group of European markets, especially Germany, exposes North Macedonia to external demand shocks and regulatory changes in EU industrial sectors. Since 2005, Germany's share in North Macedonian exports has risen from 34% to over 46%, reflecting deepening integration into the EU's manufacturing value chains.

On the import side, Germany (12,6%) remains the top partner, followed by China (10,3%), Greece (8,7%), and Turkey (7,3%). Imports are largely composed of fuel, electrical machinery, industrial inputs, and finished consumer goods (OECD, 2023). North Macedonia's energy dependence has been particularly detrimental during recent global commodity price surges, amplifying the trade deficit in 2023–2024 (Trošić & Arnaudov, 2024).

North Macedonia has actively pursued trade liberalization as a development strategy. The EU SAA, signed in 2001, provides preferential access to EU markets and underpins the country's regulatory alignment agenda. Membership in the CEFTA has further deepened regional economic integration, supported by the implementation of the CEFTA Additional Protocols on trade in services and dispute resolution (Mani, 2024). Bilateral trade agreements with Turkey, Ukraine, and the EFTA states have broadened market access. However, many of these agreements remain underutilized due to insufficient institutional support for exporters and limited private sector awareness.

Despite some progress, regulatory convergence with EU standards remains sluggish. North Macedonia continues to lag in implementing product certification frameworks, digital customs infrastructure, and agri-food export standards—critical elements for tapping into high-value EU markets. Digital customs reform was launched in 2023 but is still in early-stage deployment, particularly in integrating digital signatures, e-payments, and risk-based customs controls. These deficiencies weaken the competitiveness of exporters and limit the realization of the country's preferential trade agreements.

Compared to the early 1990s, when foreign trade was constrained by obsolete infrastructure, a narrow export base, and minimal international exposure, the trade profile of North Macedonia in 2025 is considerably more diversified, technologically aligned, and globally connected. Nevertheless, long-standing vulnerabilities remain: the structural trade deficit, dependence on imported energy and inputs, and low SME export penetration continue to restrict the strategic potential of trade as a driver of inclusive and sustainable growth.

SMEs are the foundation of the private sector of North Macedonia. SMEs are the backbone of North Macedonia's business sector, and as of 2024, SMEs make up 99,7% of all businesses, account for 61,5% of the national GDP, and employ 74,6% of the labour force (European Commission, 2024; OECD, 2023). The SME sector, which started from the post-socialist privatization wave, has grown into an essential driver of employment and innovation. SMEs are still under-represented in international trade. SMEs are not very much involved in exports, and this has been the situation for the last decade, due to structural challenges like limited access to finance, weak export capacity, and challenges in meeting EU standards (ITC, 2023).

The analysis by sector shows that the SMEs that engage in exports are mostly found in manufacturing, professional services, and wholesale trade. Many operate as subcontractors in European automotive and electronic supply chains and supply intermediate goods to foreign partners (EBRD, 2023). Export readiness has attempted to be built through government-led programs, including export vouchers, customs training, digitalization incentives, and e-certification support, but uptake has been modest. CEFTA Additional Protocol 6 and the CEFTA 2021–2025 Action Plan, which are supported by the EU, have promoted digital and sustainable trade facilitation in the region of North Macedonia and other countries by promoting cross-border procedures harmonization and non-tariff barrier reduction (Boorová et al., 2024).

Production Capacity in North Macedonia: Industrial Development and Factory Output

North Macedonia's industrial base has undergone a profound transformation. In the immediate aftermath of Yugoslavia's dissolution, the country experienced deindustrialization, a collapse in exports, and a severe loss of manufacturing output due to the erosion of intra-Yugoslav trade networks. From 1991 through the late 1990s, GDP derived from industry dropped from over 20% to below 16%, accompanied by a steep decline in employment and capacity utilization (Daskalovski & Risteska, 2025). Since the early 2000s, however, North Macedonia has progressively rebuilt its industrial sector, bolstered by foreign direct investment, export-driven policies, and the development of TIDZs.

In the first quarter of 2025, the industrial sector contributes around 21,3% of GDP, up from approximately 16% in 1995. Employment in industry accounts for nearly 30% of the national workforce, a significant recovery from the transitional lows of the 1990s (World Bank, 2024). Manufacturing forms the bulk of industrial activity, constituting 79% of the sector, led by automotive components, food processing, textiles, and base metals (State Statistical Office, 2024). Yet, manufacturing value-added per capita remains around €2.800, just half the EU-27 average of €5.600, underscoring the persistent productivity gap (European Commission, 2024).

The automotive components and electronics sector has emerged as a core export engine, particularly within TIDZs. Firms like Johnson Matthey, Kromberg & Schubert, Kostal, and Van Hool have collectively created more than 25.000 jobs and account for 43% of all exports (Ministry of Economy, 2024; Zakic, 2024). These firms benefit from tax holidays, infrastructure grants, and duty-free access to EU markets. The success of this sector illustrates the effectiveness of investment targeting, although over-reliance on foreign supply chains and low local value-added remain key concerns.

The food processing industry continues to leverage North Macedonia's agricultural production but suffers from bottlenecks in storage, logistics, and export certification. Exports of wine, canned vegetables, and dairy products remain robust, with Germany, Serbia, and Greece among the main markets. Yet, limitations in cold chain infrastructure and outdated production technology continue to hold back the sector's global competitiveness (FAO, 2023; Pontara et al., 2024).

The textile and apparel sector, once dominant in the 1990s, is in decline due to rising labor costs and aging technology. In the first quarter of 2025, it still employs roughly 24.000 workers and contributes about 7,8% to total exports. Revitalization of this sector will depend on modernization, environmental compliance, and access to niche EU markets for sustainable textiles (OECD, 2024).

The production of metal and steel remains important in Skopje and Kavadarci and is supplied to regional and EU markets by companies such as Makstil and Feroinvest. Nevertheless, the sector is highly exposed to fluctuations in global prices and energy costs. The fact that 40% of industrial power is imported as electricity increases the vulnerability of North Macedonia to changes in energy prices (IMF, 2024; Mehmedi et al., 2024).

In order to address these challenges, North Macedonia has established 15 TIDZs, which have attracted more than €1,6 billion in investment and will have more than 100 firms by 2025. These zones provide corporate tax holidays for ten years and fast-track regulatory procedures. They have been a key driver of FDI-led industrialization and EU supply chain integration (Free Zones Authority, 2024; Burucs, 2025).

However, there are several systemic barriers that hinder industrial growth. The local supplier base is still underdeveloped, which hampers the ability to retain value in the country. Furthermore, technical labour shortages in the areas of engineering, IT, and production supervision have become critical. More than 60 percent of firms experience difficulties in hiring due to skill shortages, lack of investment in vocational training, and brain drain (ILO, 2024; Osmani & Ahmeti, 2021).

Growth is also limited by infrastructure gaps. Weaknesses in the electricity distribution network, limited broadband in rural industrial zones, and underdeveloped rail freight logistics remain major constraints. Furthermore, industrial energy dependency, especially on imported fossil fuels, poses long-term risks. North Macedonia has started solar and wind projects, but the industrial sector remains carbon-intensive and vulnerable to supply chain volatility (Zakic, 2024). The World Bank projects that industrial output will be 22,5–23% of GDP by 2030, provided that FDI inflows continue, the workforce is up-skilled, and the country aligns with EU trade and sustainability standards (Pontara et al., 2024). Deeper integration into CEFTA value chains and regulatory convergence under the EU accession framework will be crucial to achieving long-term industrial competitiveness and export resilience.

Foreign Direct Investment in North Macedonia: Trends, Challenges, and Future Prospects

Economic development of North Macedonia significantly depends on Foreign Direct Investment. The early transition period from 1991 to 2001 saw little FDI inflow because of political instability, coupled with decayed infrastructure and Yugoslav market fragmentation, limited annual inflows to under €100 million (Osmani & Ahmeti, 2021). After signing the EU Stabilization and Association Agreement in 2001, the country started its structural reform and liberalization drive, which created a better investment environment. Annual FDI inflows into North Macedonia rose to €645 million by 2024 after hitting €354 million in 2020 and €604 million in 2022 despite the ongoing post-pandemic uncertainty (World Bank, 2024).

The FDI to GDP ratio in North Macedonia has been modest at 3,1% from 2015 to 2024 because Serbia and Albania have maintained higher ratios at 4,7% and 4,4%, respectively (Pontara et al., 2024). The country stands out because of its location between EU and Balkan markets, as well as its stable currency peg and low corporate tax rates, and membership in CEFTA, EFTA, and EU markets. Since 2005, the establishment of TIDZs has become the most significant tool for development. Over 100 export-oriented companies now operate in these zones, which have attracted €1,6 billion of investment and generated 45% of exports and 25.000 jobs (Free Zones Authority, 2024).

Manufacturing takes the lead position among FDI recipients because it includes both automotive component production and electronics. The companies Johnson Matthey (UK), Kromberg & Schubert (Germany), Kostal (Germany), and Van Hool (Belgium) have established production bases in the country due to tax breaks, customs benefits, and affordable operating expenses (Daskalovski & Risteska, 2025). The TIDZs in Skopje and Tetovo are the main destinations for these investors who enhance employment in the region and strengthen North Macedonia's connections with European supply networks. Sparkasse (Austria), Halkbank (Türkiye), and NLB Bank (Slovenia) control 80% of retail banking assets through their combined presence in the financial sector. Photon Energy (Netherlands) and Akuo Energy (France) have led the way in expanding energy sector investment through their solar and wind generation projects. The Austrian firm EVN operates as the main electricity distributor in the country while simultaneously working to upgrade the power grid and enhance its resistance.

Geographically, North Macedonia receives most of its investment from Germany (22%), the United Kingdom (14%), Austria (12%), and Turkey (9%), with Chinese concessional infrastructure investment making up less than 3% (Osmani & Ahmeti, 2021; Zakic, 2024). The expansion of foreign direct investment has not solved the issue of institutional fragility, which hinders sustainable FDI growth. Investors identify three main concerns, which include unpredictable regulatory procedures, inconsistent judicial enforcement, and delays in land registration (Gjurovski et al., 2024). The EU accession delays create a negative impression that drives away investors from the high-tech and pharmaceutical industries. The problem becomes more complex because of skill shortages, as labor costs in Europe remain low, yet more than sixty percent of businesses struggle to find qualified personnel in automation, engineering, and ICT fields (ILO, 2024).

The North Macedonian government has implemented policies that show both positive and negative aspects when compared to other countries. The TIDZ incentives stay competitive, but the country trails behind regional peers in terms of investment facilitation measures, including digital permitting systems, investor aftercare services, and integrated logistics hubs. The infrastructure development in North Macedonia shows uneven progress because Skopje has good highway access, but secondary corridors and intermodal logistics infrastructure need further development (EBRD, 2023).

The World Bank predicts that North Macedonia will receive more than €800 million in annual foreign direct investment during 2030 when the country implements faster reforms in land-use planning, customs modernization, and labor upskilling (World Bank, 2024). The country needs to diversify foreign direct investment into emerging sectors like agrotech and fintech, as well as AI-based manufacturing and green energy, to achieve sustainable and inclusive development. The proposed tools include performance-based tax credits and skills academies with investor co-financing and digital one-stop shops for foreign investors. North Macedonia must provide long-term predictability and skilled labor combined with regional integration benefits to succeed in attracting sustainable capital because of increasing global competition.

Global Engagements: EU Integration and China's Economic Influence

Since gaining independence in 1991, North Macedonia has adopted a two-pronged geopolitical strategy where the primary focus is on the EU integration process while also expanding its ties with China through the Belt and Road Initiative. The country's regulatory, trade, and infrastructure development trajectory has been influenced by this dual strategy, which has created modernization prospects, although it raises questions about sovereignty, standards, and policy coherence.

In July 2022, North Macedonia started EU accession talks, which were a major step forward after 30 years of institutional change and political concessions. North Macedonia's economic and legal transformation began through EU integration following the 2001 Stabilization and Association Agreement. North Macedonia relies heavily on the EU because its trade structure with Europe remains virtually unchanged since the early 2000s, with EU trade representing 74% of exports and 61% of imports in 2024 (Eurostat, 2024). Germany takes 47% of North Macedonia's exports to the EU because the country mainly sends automotive components, together with industrial electronics and intermediate products, to Germany. Bulgaria and Greece follow with 7% and 6% respectively, while Italy ranks fourth with 5%.

North Macedonia faces greater challenges in integration because of non-tariff barriers, especially in regulatory harmonization with EU product standards, intellectual property enforcement, and food safety and customs discrepancies (IMF, 2023). The country's judicial system remains inefficient, while public procurement remains opaque and anti-corruption enforcement is weak, which prevents North Macedonia from aligning with EU Chapter 23 and 24 benchmarks (European Commission, 2023).

EU support for North Macedonia's convergence includes over €1,2 billion from the Instrument for Pre-Accession Assistance (IPA III), which will focus on digital governance, energy transition, public administration reform, and infrastructure modernization from 2021 to 2027. The Instrument for Pre-Accession Assistance (IPA) has financed major projects that include railway infrastructure upgrades along Corridor VIII and customs system digitization and renewable energy grid expansion. North Macedonia has experienced poor fund absorption because of administrative weaknesses and poor coordination between agencies, which led to a 38% implementation rate of disbursed funds by mid-2024, according to the EBRD (2023).

China has developed a strong economic presence in North Macedonia through its Belt and Road Initiative framework. North Macedonia became a member of the 16+1 framework in 2012 and received important infrastructure funding from Chinese state-owned corporations. Two of the most important BRI-funded projects in North Macedonia are the Kičevo–Ohrid highway, with a price tag of €373 million, and the Miladinovci–Štip expressway, valued at €206 million, which Exim Bank financed and Sinohydro constructed. These infrastructure projects have enhanced logistics connectivity, though they have received criticism regarding their non-transparent tender processes, insufficient environmental evaluations, and rising debt burden (Markovic et al., 2021; Jovanović & Stojadinović, 2025).

As of 2023, North Macedonia maintained €1,2 billion in bilateral debt with China, representing 12% of its external public debt, while this amount remains within manageable limits (European Commission, 2023). The situation may become more challenging regarding refinancing and interest rate adjustments in the future. Chinese firms operate strategically across renewable energy sectors as well as telecommunications industries. Solar and hydroelectric installations receive funding from PowerChina and CNEEC alongside Huawei, which takes part in early-stage 5G network infrastructure development. Huawei faces Brussels' scrutiny because the EU monitors data security risks in candidate countries while demanding they complete EU-wide telecommunications risk assessments (OECD, 2023).

The trade relations between China and North Macedonia have grown since 2000, but they continue to be unbalanced. China stands as North Macedonia's fourth-largest import source in 2024, while providing 10,2% of total imports, which consist of industrial equipment, consumer electronics, and construction materials. The majority of Macedonian exports sent to China include unprocessed raw materials, including ferroalloy metals and minerals. The trade deficit with China persists because North Macedonia depends heavily on Chinese upstream inputs for manufacturing and construction, while importing more goods than it exports.

The Western Balkans face EU concerns about Chinese expansion because Brussels fears governance weaknesses, excessive debt, and unwanted penetration into essential sectors. The EU has proposed measures for investment screening enhancement and infrastructure development, which should follow the EU Green Deal and environmental due diligence standards. North Macedonia continues to see China as a flexible funding source, but policymakers recognize the need to balance EU accession goals against Chinese capital inflows.

North Macedonia needs to adopt EU-aligned reforms as its strategic priority. North Macedonia must improve judicial independence while implementing EU-standard public procurement rules and enforcing major infrastructure project anti-corruption compliance. North Macedonia needs to implement a formal investment screening process modelled on the EU FDI Regulation (EU) 2019/452 to reduce national security threats from foreign ownership of critical infrastructure.

The North Macedonian government should establish new trade relationships by focusing on markets in the Middle East, Central Asia, and North America, as well as develop technology transfer agreements, R&D partnerships, and SME integration programs to build economic resilience. North Macedonia must decrease its dependence on Chinese financing by accepting EU-based and multilateral development bank investments to guarantee both fiscal stability and policy autonomy. The external economic strategy of North Macedonia depends on two parallel paths that link EU integration with Chinese engagement. The country needs to uphold European values together with environmental standards and institutional integrity to achieve sustainable growth. Strategic policymaking, together with careful priority setting, enables North Macedonia to become an investment destination and a regulatory partner in the European economic area.

Corridors: Transport and Trade Infrastructure in North Macedonia

North Macedonia's geographic location in Southeast Europe has long positioned it as a pivotal land transit hub connecting Central Europe to the Aegean Sea and Western Europe to the Middle East. Since its independence in 1991, North Macedonia has aimed to leverage this strategic advantage to become a regional logistics and trade center. However, legacy infrastructure, underdeveloped intermodal systems, and administrative inefficiencies have slowed progress, limiting its capacity to fully integrate into European and global supply chains.

The country's transport infrastructure is anchored by two major Pan-European corridors—Corridor VIII (east-west) and Corridor X (north-south)—both central to North Macedonia's logistics modernization strategy. Corridor VIII connects the Adriatic port of Durrës (Albania) with the Black Sea port of Varna (Bulgaria), passing through Tetovo, Skopje, and Kumanovo. Corridor X, a more economically active axis, links Austria and Hungary through Serbia and North Macedonia to the Greek port of Thessaloniki. As of 2025, over 60% of North Macedonia's freight transit moves via Corridor X, emphasizing its importance in north-south trade dynamics.

Substantial investments have been made to modernize these routes. Projects like the Skopje–Veles–Gevgelija highway (€500 million) and Kičevo–Gostivar expressway have been co-financed by the EU's IPA III, the European Investment Bank (EIB), and the EBRD. In addition, €300 million has been allocated to electrify and modernize the railway segment of Corridor VIII toward Bulgaria, with a view to full integration into the Trans-European Transport Network (TEN-T) by 2030. Still, only 32% of rail lines are electrified, and railway transport continues to lag behind road logistics in efficiency and usage.

The EU's Economic and Investment Plan for the Western Balkans (2021–2027) earmarks over €9 billion in connectivity investments for the region, with North Macedonia set to receive nearly €700 million in transport modernization. These include digital border management tools, smart traffic systems, and investments in Skopje and Ohrid airport capacity, all crucial to increasing both trade volume and mobility. However, public procurement inefficiencies, implementation delays, and corruption risks have slowed infrastructure absorption and execution, a recurring issue since the early 2000s.

Beyond infrastructure, North Macedonia's logistics ecosystem continues to face constraints such as slow customs processing, high transport costs, and a lack of cold chain and warehousing infrastructure, especially critical for agri-food exports. These deficiencies are reflected in the World Bank's Logistics Performance Index, where North Macedonia ranked 84th out of 160 countries in 2022, trailing Serbia (54th), Albania (70th), and Bulgaria (53rd). This performance underscores the need for stronger institutional coordination, digitalization, and logistics-sector liberalization to compete with regional peers.

The 1990s marked the beginning when regional integration started to serve as a separate goal from EU membership. The Western Balkans Open Borders initiative, known as "Mini-Schengen," under the new name Open Balkan, started in 2019 as Albania, North Macedonia, and Serbia worked together to remove border controls, unify customs systems, and create a unified market for workers and goods across Western Balkan countries. However, it cannot be said that the "Western Balkans" initiative has been very successful. In fact, this formation was essentially intended to accustom the countries to the EU integration process and, from another perspective, to reduce the influence of external countries on these states and even to exclude them.

The exclusive nature of this approach generates both potential advantages and difficulties. The Open Balkan initiative promotes regional trade facilitation through reduced non-tariff barriers, which decrease logistics expenses while drawing investments. The initiative produces external partnership fragmentation, which weakens geopolitical stability and excludes Turkey and China from Western Balkan relations despite their historical stabilizing presence through infrastructure and capital investments.

North Macedonia needs to expedite its infrastructure modernization efforts and regulatory standardization to maximize its corridor advantages and boost its logistics competitiveness. The country needs to finish investments in Corridor VIII and X alongside the development of multimodal logistics centers in Skopje and Tetovo, and complete customs digitalization according to EU single-window standards. North Macedonia should establish stronger public-private partnerships for infrastructure management because they enhance project execution capacity while green transport solutions, including low-emission freight corridors and electric rail, help the country achieve EU Green Deal objectives and sustainability targets.

Digital Transformation in North Macedonia: Progress, Challenges, and Opportunities

North Macedonia has slowly developed from an analog system to a digital one and is now moving toward a digital economy. The first post-socialist period was characterized by a very poor and fragmented telecommunication environment, a very limited physical infrastructure, and almost no internet usage. Nonetheless, in the last twenty years, the ICT market liberalization of the 2000s and the subsequent growth of mobile and broadband networks have made digitalization a cornerstone of economic modernization.

The current digital infrastructure development in North Macedonia has been significant, with the country placed at 55 out of 100 in the Digital Economy and Society Index (DESI) index of 2025, below the EU-27 average of 66,8, but showing improvement from 2022 (European Commission, 2024). Internet penetration today is 84,6% compared to 8% in 2000 and 74% in 2015. Mobile broadband coverage of 4G/4G+ is at 96,3% while 5G is in the pilot phase in Skopje and Tetovo, and commercial deployment has been delayed because of legal and spectrum licensing issues (OECD, 2024; World Bank, 2023). The digital divide between urban and rural areas is significant, with only 47% of rural households having access to fixed high-speed internet, which hampers digital inclusion in peripheral regions.

Public sector digitalization has increased, especially through the growth of the e-Government Services Platform (eGov), which now offers more than 120 digital services, including tax filing, social security registration, and digital ID issuance. However, citizen uptake is still low, with 31% of residents using digital public services, citing lack of trust, poor design, and lack of support for older users (European Commission, 2023). The Digital Agenda for the Western Balkans, funded by IPA III and EU regulatory alignment, continues to work on simplifying digital identity and integrating biometric authentication.

ICT is becoming an essential sector of the economy, employing more than 22.000 people and accounting for 6,7% of GDP in 2024, and is one of the most dynamically developing service sectors. North Macedonia is increasingly seen as a nearshoring destination for IT outsourcing, particularly in software development, cybersecurity, and fintech. Companies like Endava, Seavus, Netcetera, and Semos are expanding their operations, while blockchain and AI startups face structural challenges related to limited venture capital ecosystems (EIB, 2024). The startup ecosystem is developing, with Skopje-based startup hubs like Startup Macedonia and Seavus Accelerator supporting early-stage companies, but R&D investment is a concern at 0,22% of GDP compared to the EU-27 average of 2,3% (European Commission, 2023).

The pandemic has accelerated e-commerce growth through a 41% increase in digital transactions between 2020 and 2024. The broader market adoption faces challenges because of both high last-mile logistics costs and digital payment fees, and insufficient protection standards for buyers, particularly targeting rural SMEs. The digital maturity of North Macedonian SMEs shows low levels of adoption because 77% of them do not use cloud computing or advanced analytics. Industry 4.0 technology adoption of AI, IoT, and robotics exists mainly in foreign firms operating inside TIDZs. The World Bank (2024) reports that domestic manufacturing faces challenges in digitization because of outdated equipment combined with skill shortages and expensive digital upgrade costs.

The banking industry experienced powerful digital expansion through online transaction rates reaching more than 58 percent. Local fintech platforms Halkbank Digital and Stopanska mBanking and iPay.mk experienced rapid growth in their user base numbers. The presence of unregulated crypto assets alongside poor data protection measures and digital security vulnerabilities continues to put the system at risk. The country maintains no complete cybersecurity and data protection law that meets EU GDPR standards, thus exposing both public institutions and private organizations to digital attacks in 2025 (OECD, 2024).

Digital transformation in North Macedonia remains restricted because the population shows limited digital skills, as 42% lack basic digital abilities, while only 18% of technical vocational training students choose IT or technical programs.

An integrated digital development strategy should be implemented by the government to resolve these systemic obstacles. Key measures include: rural areas should receive improved broadband infrastructure through public-private partnerships; the 5G spectrum allocation process needs speedup, and digital literacy should be integrated into early education curricula, while a national cybersecurity framework based on EU standards must be established. Research and development incentives, together with innovation grants, should drive the advancement of AI along with green technology and blockchain solutions, while tax benefits for digital equipment upgrades should boost SME competitiveness. The implementation of user-centered design and multilingual support will build user confidence in e-government platforms, which will drive citizen participation. Through coordinated policy reform combined with private sector participation and EU-aligned digital regulation, North Macedonia can establish itself as a competitive node in the emerging European digital single market while closing its internal digital gap.

Conclusion

North Macedonia experienced economic change through systematic reform efforts and developing trading agreements and sector advancements across many decades. The upcoming period will establish new economic prospects based on four major factors which include demographic shifts and technological disruptions and geopolitical changes and environmental stress. Economic sustainability for North Macedonia requires strategic vision and institutional flexibility in addition to ongoing reforms because the country faces a multifaceted future.

The demographic situation represents the most important issue that the country faces today. The country faces an aging population and decreasing birth rates while sustaining emigration that transforms both its labor force and economic potential. North Macedonia possesses an opportunity to reassess its labor and social policies instead of viewing these population trends only as restrictions. North Macedonia can reduce the impact of decreasing population through better workforce participation among women and youth, and by developing programs to bring back diaspora members. The solution requires policy initiatives that surpass retention strategies to activate and reintegrate labor forces while developing an inclusive workforce.

Artificial intelligence and robotics, along with digital platforms, currently transform global economic competitiveness through technological advancement. North Macedonia needs to consider technology adoption as a fundamental strategic matter. Technology adoption through automation enables organizations to boost their productivity levels while making their industries more modern and their public services more efficient. The country's success will be achieved by its commitment to digital education, along with its ability to link vocational systems with new market requirements and domestic innovation promotion. The long-term competitiveness of the country will depend on the development of ownership over advanced technologies from the adoption phase.

The economic path of North Macedonia remains significantly affected by its geopolitical standing among nations. EU integration for North Macedonia provides both a structural framework for legal alignment and access to funding alongside lasting institutional stability. This process keeps its speed and reliability in an unknown state. North Macedonia needs to adopt EU standards as its fundamental governance and development model instead of concentrating only on accession procedures. EU norms provide a basis for regulatory credibility and investor confidence regardless of North Macedonia's short-term membership status.

North Macedonia faces both strategic advantages and systemic risks because of its growing ties with Chinese-funded infrastructure and digital connectivity projects. Modernization has accelerated through investments in highways, renewable energy, and telecommunications, but these initiatives have sparked concerns about procurement openness and increasing debt exposure, as well as EU standard conformity. North Macedonia should develop a balanced international economic strategy that combines strategic independence with rule-of-law principles and European direction maintenance.

The environmental situation functions as a major factor that affects all other aspects. The current environmental instability causes substantial harm to three main economic sectors, which consist of agriculture, energy production, and tourism operations. Climate change will cause its impacts to become more severe in the upcoming years, thus putting stress on food security, together with infrastructure and rural livelihoods. The Balkan region can expect rising migration because neighboring countries face climate-driven population shifts. The resulting changes will affect urban development, together with public service delivery and labor market stability. North Macedonia needs to dedicate efforts toward climate resilience by adopting renewable energy systems and sustainable land management, while building green infrastructure that matches EU climate targets.

North Macedonia's ability to reach sustainable, inclusive growth depends on how well it transforms generational change from a threat into an opportunity. The formation of policies requires adaptive approaches with forward-thinking perspectives, and they should cover multiple sectors at once. The nation needs to establish powerful institutions and implement modern educational frameworks while developing regional connectivity and deepening digital and environmental integration as its main strategic priorities.

The time has arrived for North Macedonia to move beyond previous reforms because current methods no longer meet the required standards. The country needs to establish an innovative economy based on openness while ensuring sustainability and maintaining strategic independence to achieve forward-looking resilience. A clear and purposeful approach by North Macedonia will secure its position in the European landscape transformation and establish it as an example of adaptive transformation for the Balkans.

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CIP - Каталогизација во публикација

Национална и универзитетска библиотека “Св. Климент Охридски”, Скопје

338.2.025.88(497.7)”1991/2023”(082)

FROM transition to transformation [Електронски извор] : an economic analysis of North Macedonia : (1991-2023) / [editors Ahmet Lokce, Andrijana B. Danevska]. - Skopje : Balkan University Press, 2025. - (Balkan political economy series / Ahmet Lokce ; 1)

Начин на пристапување

(URL): https://ibupress.com/Pages/Book/Details?id=SwAAAA. - Текст во ПДФ формат, содржи 429 стр., илустр. - Наслов преземен од екранот. - Опис на изворот на ден 30.09.2025. - Фусноти кон текстот. - Белешка за уредниците: стр. [4-5]. - Библиографија кон главите

ISBN 978-608-4868-54-5

а) Економска транзиција -- Македонија -- 1991-2023 -- Зборници

COBISS.MK-ID 67027973

Editor of the publication: Ivana Beciragic