



WORLD BANK GROUP

# North Macedonia Policy Notes

The World Bank Group

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## Acronyms and Abbreviations

<b>AAP</b>	Ambient Air Pollution	<b>IFMIS</b>	Integrated Financial Management Information System
<b>ACT</b>	Accelerating Coal Transition		
<b>AF</b>	Additional Financing	<b>IT</b>	Information Technology
<b>AKIS</b>	Agricultural Knowledge and Innovation System	<b>ITIS</b>	Integrated Tax Information System
		<b>ITS</b>	Intelligent Transport System
<b>ALMP</b>	Active Labor Market Program	<b>LGBTQI+</b>	Lesbian, Gay, Bisexual, Transgender, Queer, and Intersex
<b>AQM</b>	Air Quality Management		
<b>AREC</b>	Agency for Real Estate Cadaster	<b>LLL</b>	Lifelong Learning
<b>BE-TA-PFMI</b>	Building Effective, Transparent, and Accountable PFM Institutions	<b>LTC</b>	Long-Term Care
		<b>Mbps</b>	Megabits per second
<b>CBAM</b>	Cross-Border Adjustment Mechanism	<b>MEIC</b>	Macedonian Environmental Information Center
<b>CCDR</b>	Country Climate and Development Report		
<b>CCIA</b>	Climate Change Institutional Assessment	<b>MIGA</b>	Multilateral Investment Guarantee Agency
<b>CIF</b>	Climate Investment Funds		
<b>CIT</b>	Corporate Income Tax	<b>MoEPP</b>	Ministry of Environment and Physical Planning
<b>C-JET</b>	Competitiveness for Jobs and Economic Transformation	<b>MoF</b>	Ministry of Finance
<b>CO<sub>2</sub></b>	Carbon Dioxide	<b>MoH</b>	Ministry of Health
<b>COVID-19</b>	Coronavirus 2019		
<b>CPC</b>	Commission for Protection of Competition	<b>MSPDY</b>	Ministry of Social Policy, Demography and Youth
<b>CPF</b>	Country Partnership Framework	<b>MSDP</b>	Market Support and Direct Payments
<b>CRM</b>	Compliance Risk Management	<b>MSMEs</b>	Micro, Small, and Medium Enterprises
<b>CSW</b>	Center for Social Work	<b>MtCO<sub>2</sub>eq</b>	Million tons of carbon dioxide equivalent
<b>DBNM</b>	Development Bank of North Macedonia		
<b>DPL</b>	Development Policy Loan	<b>NCCCA</b>	National Coordination Council on Climate Action
<b>DPO</b>	Development Policy Operation		
<b>DRM</b>	Disaster Risk Management	<b>NCD</b>	Non-Communicable Disease

<b>EBRD</b>	European Bank for Reconstruction and Development	<b>NCTS</b>	New Computerized Transit System
		<b>NDS</b>	National Development Strategy
<b>EC</b>	European Commission	<b>NEET</b>	Not in Employment, Education, or Training
<b>ECA</b>	Europe and Central Asia		
<b>EEF</b>	Energy Efficiency Fund	<b>NOx</b>	Nitrogen Oxides
<b>ERP</b>	Economic Reform Program	<b>NSW</b>	National Single Window
<b>ESA 2010</b>	European System of Accounts	<b>OBL</b>	Organic Budget Law
<b>EU</b>	European Union	<b>OECD</b>	Organization for Economic Co-operation and Development
<b>FDI</b>	Foreign Direct Investment		
<b>FY</b>	Fiscal Year	<b>OFA</b>	Other Financial Assistance
<b>GAP</b>	Growth Acceleration Program	<b>OOP</b>	Out-of-Pocket
<b>GDP</b>	Gross Domestic Product	<b>PCG</b>	Partial Credit Guarantee
<b>GHG</b>	Greenhouse Gas	<b>PEFA</b>	Public Expenditure and Financial Accountability
<b>GMA</b>	Guaranteed Minimum Income		
<b>GW</b>	Gigawatt	<b>PESR</b>	Public Enterprise for State Roads
<b>HIF</b>	Health Insurance Fund	<b>PFM</b>	Public Financial Management
<b>HLO</b>	High-Level Outcome	<b>PHC</b>	Primary Health Care
<b>IBRD</b>	International Bank for Reconstruction and Development	<b>PIM</b>	Public Investment Management
		<b>PISA</b>	Program for International Student Assessment
<b>ICT</b>	Information and Communication Technology	<b>PM<sub>2.5</sub></b>	Particulate matter 2.5
<b>IFC</b>	International Finance Corporation	<b>PPP</b>	Public-private partnership
<b>PRO</b>	Public Revenue Office	<b>SWIS</b>	Social Welfare Information System
<b>PSDI</b>	Public Service Delivery Index	<b>TA</b>	Technical Assistance
<b>QR</b>	Quick Response	<b>TBD</b>	To be determined
<b>R&amp;D</b>	Research and Development	<b>TIMSS</b>	Trends in International Mathematics and Science Study
<b>REPARIS</b>	Road to Europe: Program of Accounting Reform and Institutional Strengthening		

<b>SAMIS</b>	State Aid Management Information System	<b>TSO</b>	Transmission System Operator
		<b>TTFP</b>	Trade and Transport Facilitation Project
<b>SCD</b>	Systematic Country Diagnostic	<b>UMIC</b>	Upper-Middle Income Country
<b>SDG</b>	Sustainable Development Goal	<b>US\$</b>	United States Dollar
<b>SEPA</b>	Single Euro Payments Area	<b>UWWTD</b>	Urban Wastewater Treatment Directive
<b>SILC</b>	Statistics on Income and Living Conditions	<b>WBG</b>	World Bank Group
<b>SMEs</b>	Small and Medium Enterprises	<b>WBIF</b>	Western Balkans Investment Framework
<b>SO<sub>2</sub></b>	Sulfur Dioxide	<b>WDI</b>	World Development Indicators
<b>SOE</b>	State-Owned Enterprise	<b>WFD</b>	Water Framework Directive
<b>SOGIESC</b>	Sexual orientation, gender identity and expression, and sex characteristics	<b>WSS</b>	Water Supply and Sanitation
<b>STEM</b>	Science, Technology, Engineering, and Mathematics		

# Executive Summary

**North Macedonia has seen significant development in social, economic, and institutional sectors, doubling income per capita and advancing from lower-middle-income to upper-middle-income status.** The country has attracted substantial foreign direct investment (FDI) and doubled trade openness in the last two decades, leading to improved living standards and decreased poverty and inequality. Before 2020, the country experienced steady economic growth, driven by stable macroeconomic conditions, deepened trade integration, and FDI—particularly in labor-intensive sectors like automotive production. The emergence of the global COVID-19 pandemic halted growth, leading to inflation and a temporary setback in poverty reduction. With government support, the economy rebounded in 2022, but growth rates have remained below those of regional peers.

**Economic growth over the past decade has benefited low-income households, although disparities persist.** Over 440,000 people moved out of poverty between 2009 and 2019, and the poverty rate (measured at the upper-middle-income poverty line of US\$6.85/day in 2017 purchasing power parity terms) fell from 41 percent to 19 percent. Pro-poor growth was also associated with a remarkably high shared prosperity premium and a significant reduction in overall inequality, with the Gini index declining from 43 to 34 during the same period. Yet, poverty and exclusion levels remain high by European Union (EU) standards, with a third of the population in North Macedonia at risk of falling into poverty or social exclusion in 2020, compared to 22 percent overall in the EU27.

**Women, young people, Roma, and lesbian, gay, bisexual, transgender, queer, and intersex (LGBTQI+) individuals in North Macedonia face enduring social and economic challenges, including significant gender disparities in access to economic opportunities, despite legal and policy improvements.** Female labor force participation is lower than that of men and falls below the EU average. The gap is wider among those with lower education levels and diminishes among those with tertiary education. Care responsibilities largely prevent 43 percent of women from working, versus 4 percent of men. Over half of women experience violence. About 83 percent of the population in North Macedonia use the internet, aligning with regional averages but revealing a significant gender gap. Unemployment of youth who are not employed, in education, nor training (NEET) stood at 18.7 percent in 2023, with high job insecurity. Roma children lack early education, while many Roma adolescents and adults are unemployed or not in school. Discrimination based on sexual orientation and gender identity persists, causing substantial economic losses. Spatial disparities persist, with poverty rates markedly higher in northern regions like Polog and Northeastern region than in the Eastern, Southeastern, Pelagonija, and Vardar regions, where poverty rates are below 10 percent.

**Bridging the income gap with the EU amidst ongoing geopolitical shifts and disruptions in global trade requires rethinking the country's growth model.** At current rates, it would take three to four decades for North Macedonia to bridge the per-capita income gap with the EU. The country's price competitiveness, traditionally driven by low-cost energy and labor in lower value-added sectors, is eroding. An aging population and declining workforce require efforts to boost stagnating productivity and shift investment toward higher value-added sectors. In addition, North Macedonia is highly energy-intensive and suffers from considerable levels of environmental pollution and increasing frequency of extreme weather events.

**The Growth Plan for the Western Balkans offers an unprecedented opportunity for North Macedonia to implement key reforms and accelerate progress.** In May 2024, European authorities approved the establishment of the Reform and Growth Facility in support of the Growth Plan, under which North Macedonia could receive up to €900 million until 2027 upon implementing an ambitious reform and investment agenda focused on macro-fiscal stability, human capital development, private sector development and competitiveness, governance, anticorruption and justice, decarbonization, and air quality management.

**The analysis presented in these policy notes points to three key reforms actions to ensure support for faster, more resilient, sustainable economic growth in North Macedonia:** (1) restore macro-fiscal stability; (2) implement key structural reforms; (3) advance the green and digital transitions.

## 1. Restore Macro-Fiscal Stability

**Generous support provided to help face the impact of multiple crises in recent years has strained public finances, increasing deficits and debt, but strong revenue performance and international support helped stabilize the situation.** The fiscal deficit doubled to 6.1 percent during 2020–23 in the wake of crisis support, pushing public debt to 62 percent of gross domestic product (GDP) by the end of 2023, above the fiscal rule. Despite spending pressures, fiscal consolidation is necessary. The Revised Fiscal Strategy 2024–28 outlined a path to gradual consolidation adhering to deficit rules, but within overly optimistic growth of 5 percent. The revised 2024 budget after the elections, plans a deficit of 4.9 percent of GDP. Given persistent vulnerabilities and uncertainties, however, efforts to stabilize public finances need to rely on a combination of spending consolidation and revenue mobilization. Ensuring stability amidst rising public debt and deficits is crucial as financial market access tightens and inflation remains high.

**Restoring fiscal sustainability and creating more favorable conditions for stronger growth are key to maintaining a positive outlook in the medium-to-long term, but key risks remain.** These risks include low productivity growth and inefficient capital deployment, falling export demand, and inflation-dampened consumption, compounded by limited fiscal space amid high interest rates. To address the risk of declining export demand, the country needs to implement structural reforms in human capital development, connectivity, competition, and the energy sector to boost productivity, inclusivity, and fiscal sustainability, with EU accession negotiations potentially aiding growth prospects.

## 2. Implement Structural Reforms

**The pursuit of long-term growth and convergence with EU standards hinges upon enhancing productivity through structural reforms.** Structural reforms in human capital development, connectivity, competition, and the energy sector, along with EU accession efforts, are necessary. Investing in education and boosting human capital will be key to increasing productivity and steering the country toward a sustainable, inclusive growth path. North Macedonia's Human Capital Index score of 0.56 highlights the urgency of this agenda, suggesting that a child born in North Macedonia will be only 56 percent as productive as she/he could be with complete education and full health. This indicates that the country's education and health systems are failing to respond to today's challenges and falling short of maximizing individual potential.

**North Macedonia initiated a comprehensive social protection reform in 2019, aimed at consolidating and better targeting social assistance programs to shield vulnerable households.** To fully realize the benefits of this reform, however, continuous monitoring and



additional investments are imperative. By 2020, a concerning one-third of the population faced the risk of poverty or social exclusion, a rate notably higher than the EU27 average. Furthermore, over a third of adults expressed their inability to sustain basic household expenses for over two weeks if they suddenly lost their primary source of income. Given these socioeconomic vulnerabilities, it remains critical to finalize the ongoing reform process, closely monitor its outcomes, and address lingering gaps in the provision of social benefits and services.

**Agriculture is vital for North Macedonia’s economy, with important impacts on poverty reduction, growth, job creation, and resilience to climate change and crises.** Yet, despite its importance, the sector’s growth rate has averaged only 1.2 percent over the past decade, hindered by low productivity and competitiveness. Increasing labor and land productivity through capital investments and adopting climate-smart agriculture practices is crucial. Diversification, knowledge innovation, and supporting smallholder farmers and agribusinesses are key drivers for sector transformation.

**North Macedonia requires a more dynamic private sector to accelerate GDP growth and hasten its convergence toward the average EU income level.** The growth of the private sector has been propelled primarily by a handful of export-oriented companies, largely foreign firms in the automotive industry, and by the domestic pharmaceutical and information and communication technology (ICT) sectors. Despite the dominance of micro, small, and medium enterprises (MSMEs) in the economy, productivity growth remains weak or stagnant, digitalization is low, and there is limited integration with regional and global value chains. These factors have hindered the creation of good-quality jobs necessary to retain skilled labor within the country. Regional and international trade is stifled by lengthy bureaucratic processes for cross-border transit, export requirements, and limited digitalization of processes.

**Private sector growth requires deeper financial intermediation, supported by a resilient and stable financial system.** Boosting MSME access to finance, long-term financing, asset-based financing, innovation, and equity financing is needed to stimulate the modernization, digitalization, decarbonization, and productivity growth of companies, as well as the proliferation of start-ups and knowledge-based services. North Macedonia’s financial system is bank-centric and risk-averse, with limited stock exchange activity, limited investment funds, and emerging fintech companies. Insurance and securities markets are underdeveloped. Meeting the growing demand for green financial instruments will be essential to accelerate North Macedonia’s green transition, and further reforms are needed to integrate climate-related risks into regulatory and supervisory frameworks and boost the capacities of regulators and financial institutions alike.

**Reducing the cost of cross-border payments will be critical to enhancing integration.** By modernizing payment systems and joining the Single Euro Payments Area (SEPA), North Macedonia can increase financial inclusion, bring more competition and innovation in payments, and drive down costs for end users in domestic as well as cross-border digital payments. The average cost of sending remittances to North Macedonia is 7 percent of the total transaction amount—far above the Sustainable Development Goal (SDG) target of 3 percent. Furthermore, business-to-business cross-border transfer fees would need be reduced by up to 6 times to reach EU levels.

### 3. Advance the Green and Digital Transitions

**It is possible to decarbonize the domestic economy by reducing net greenhouse gas emissions by 82 percent from 1990 levels by 2030 and by aligning with the EU's Net Zero target by 2050.** A recent World Bank model<sup>1</sup> of North Macedonia's energy system shows that achieving this target is possible, but the costs need to be appropriately managed. This commitment, outlined in the Sofia Declaration, focuses on sector-specific emissions reductions, primarily in the energy sector, with significant investments in energy efficiency and renewable energy. Decarbonization offers various benefits, including enhanced economic competitiveness, increased revenues, reduced import dependence, increased resilience, and better health outcomes. Decarbonization will also help the economy deal with the upcoming EU Cross-Border Adjustment Mechanism (CBAM) and potential carbon taxes, which will adversely affect firms' financial performance. Achieving these goals requires significant transformation across energy sectors, with an estimated cost of US\$5.6 billion until 2050, equivalent to 2.8 percent of GDP per year. Managing the economic transition is crucial, considering its distributional impacts and the impact on environmental sustainability and resilience. Furthermore, fulfilling climate commitments will accelerate alignment with the EU's net zero ambition and facilitate the country's accession process.

**North Macedonia's energy transition is under way, but the speed of the transition is still insufficient.** The domestic energy sector heavily depends on fossil fuels, with 71 percent of energy supplied by oil and coal. This reliance poses risks from volatile markets and security vulnerabilities. The country's economy is among the EU's most energy-intensive, offering the potential for efficiency improvements and renewable energy expansion. Legal, regulatory, financial, and technical barriers hinder progress, however. Investment in the energy transition should be complemented by sustained efforts to decrease energy consumption through improved energy efficiency of both public and residential buildings. The operationalization of the Energy Efficiency Fund is a key step toward scaling up energy efficiency.

**Decarbonizing the economy will require complementary efforts, starting from the modernization of the country's transport infrastructure.** North Macedonia's transport infrastructure, including roads and railways, requires significant upgrades to enhance connectivity and facilitate smoother trade flows. North Macedonia's strategic position on the Pan-European Corridors VIII and X has led to the development of a robust highway and railway infrastructure, but in a context of limited institutional and technical capacity and insufficient maintenance. Moreover, while the National Development Strategy prioritizes green, competitive, and resilient development, the railway Corridor X is grappling with a 70 percent decline in rail freight traffic and the inability to take part in the country's export and import activities. This has triggered an increase in road transport and a doubling of greenhouse gas (GHG) emissions over the past 20 years. Addressing these challenges is essential for establishing a sustainable, integrated, and resilient transport system throughout all phases of infrastructure development and management and to enhance growth by leveraging the country's strategic position in regional and global trade.

**Decarbonizing the economy should improve air quality in North Macedonia.** A recent study estimated that about 2,800 deaths each year are associated with ambient air pollution (AAP). The economic cost associated with health damage from AAP in North Macedonia is on average US\$750 million, equivalent to 6.9 percent of GDP in 2016. Reducing air pollution,

<sup>1</sup> Western Balkan Six Country Climate and Development Report (CCDR), North Macedonia Country Compendium Note. [Publication pending].

with a focus on residential heating, would lower mortality due to air pollution by 23 percent by 2050.

**Investments in digital development, aligned with the EU Digital Agenda 2030, present a strategic opportunity for achieving sustainable growth and resilience.** Central to this endeavor is the enhancement of digital public infrastructure, laying the groundwork for comprehensive digital transformation and fostering public–private partnerships (PPPs). Strengthening the digital development governance framework holds the key to defining and implementing a cohesive digital development strategy.

### Selected Policy Reforms

Policy Measure	Short-term	Medium-term
<b>Macroeconomics and Public Financial Management</b>		
<ul style="list-style-type: none"> <li>Accelerate fiscal consolidation to restore fiscal space and adhere to fiscal rules</li> </ul>	x	
<ul style="list-style-type: none"> <li>Ensure proactive management of fiscal risks, particularly state-owned enterprises (SOEs), PPPs, and legal claims</li> </ul>	x	
<ul style="list-style-type: none"> <li>Revise government finance statistics to ensure alignment with EU (ESA 2010) standards</li> </ul>	x	
<ul style="list-style-type: none"> <li>Improve public financial management through full implementation of the Organic Budget Law</li> </ul>	x	
<ul style="list-style-type: none"> <li>Strengthen the regulatory framework for PPPs to facilitate leveraging private financing for infrastructure investments</li> </ul>	x	
<ul style="list-style-type: none"> <li>Develop a comprehensive and transparent Registry of State Aid and create a more effective State Aid Notification System</li> </ul>	x	
<ul style="list-style-type: none"> <li>Allocate resources in line with strategic investment goals to maximize the use of public funds</li> </ul>		x
<ul style="list-style-type: none"> <li>Strengthen the regulatory framework for PPPs, and corporate governance, oversight, financial transparency, and accountability of SOEs</li> </ul>		x
<ul style="list-style-type: none"> <li>Build up and modernize the tax administration to address existing revenue shortfalls</li> </ul>		x
<b>Financial Sector</b>		
<ul style="list-style-type: none"> <li>Strengthen the design and controls of the partial credit guarantee (PCG) program</li> </ul>	x	
<ul style="list-style-type: none"> <li>Finalize the establishment of a strong financial sector safety net</li> </ul>	x	
<ul style="list-style-type: none"> <li>Integrate payment systems into SEPA</li> </ul>	x	
<ul style="list-style-type: none"> <li>Reinforce the role of the Development Bank of North Macedonia (DBNM) and improve the business environment for factoring</li> </ul>		x
<b>Poverty and Inclusion</b>		
<ul style="list-style-type: none"> <li>Ensure timely survey data availability to monitor living standards and identify population groups vulnerable to shocks</li> </ul>	x	
<ul style="list-style-type: none"> <li>Increase the supply of integrated, affordable, good-quality early childhood education and care, especially among disadvantaged groups</li> </ul>		x
<ul style="list-style-type: none"> <li>Support market-oriented skills development</li> </ul>		x

Policy Measure	Short-term	Medium-term
<b>Private Sector Development</b>		
• Enhance the quality of vocational training	x	
• Boost digital and green skills training	x	
• Improve the labor regulations to introduce more flexible working arrangements for domestic workers and simplify the work permits and visa applications for foreign workers	x	
• Improve the efficiency of both the public and private sectors through accelerated digital transitions	x	
• Improve trade facilitation	x	
• Update the range of support programs for small and medium enterprises (SMEs)	x	
• Implement the State Aid Management Information System (SAMIS)	x	
• Improve firms' access to up-to-date technology and knowhow		x
• Strengthen the centers of excellence		x
• Improve the capacity of selected technology institutions		x
• Align the domestic firms to global requirements on climate change		x
<b>Decarbonizing the Economy</b>		
• Scale up renewable energy	x	
• Improve agricultural practices	x	
• Invest in energy-efficient buildings, industry, and transport	x	
• Encourage private sector participation	x	
• Promote collaboration across ministries	x	
• Put a price on carbon	x	
• Improve waste management		x
• Upgrade transport infrastructure		x
• Implement a just transition		x
<b>Energy and Just Transition</b>		
• Accelerate the operationalization of the Energy Efficiency Fund (EEF)	x	
• Increase institutional coordination and capacity	x	
• Scale up sustainable energy efficiency financing mechanisms		x
• Accelerate deployment of cleaner heating solutions		x
• Reduce energy import dependency		x
• Phase out electricity price subsidies		x
• Invest significantly in upskilling and reskilling programs		x
<b>Digital Development</b>		
• Strengthen the digital development governance framework	x	
• Accelerate digital transformation across economic and social sectors	x	
• Review and improve the cybersecurity framework	x	
• Invest in digital public infrastructure		x
• Invest in digital skills and bridge the gender gap		x

Policy Measure	Short-term	Medium-term
<ul style="list-style-type: none"> <li>Converge progressively toward a policy and regulatory alignment with the EU <i>acquis communautaire</i> (<i>acquis</i>)</li> </ul>		x
<b>Transport</b>		
<ul style="list-style-type: none"> <li>Prioritize focused maintenance of railways infrastructure</li> </ul>	x	
<ul style="list-style-type: none"> <li>Implement policy measures on road vehicle emissions management</li> </ul>	x	
<ul style="list-style-type: none"> <li>Prioritize the resilience agenda for infrastructure</li> </ul>	x	
<ul style="list-style-type: none"> <li>Boost institutional capacity development</li> </ul>		x
<ul style="list-style-type: none"> <li>Decarbonize transport and promote green fleet transition</li> </ul>		x
<b>Environment and Air Quality</b>		
<ul style="list-style-type: none"> <li>Accelerate the implementation of the Green Agenda for the Western Balkans</li> </ul>	x	
<ul style="list-style-type: none"> <li>Complete the national policy and legal framework on air quality improvement</li> </ul>	x	
<ul style="list-style-type: none"> <li>Strengthen institutional capacity</li> </ul>	x	
<ul style="list-style-type: none"> <li>Establish a High-Level Intersectoral Coordination Council on Air Quality Management (AQM)</li> </ul>	x	
<ul style="list-style-type: none"> <li>Enhance monitoring and analysis capabilities</li> </ul>	x	
<ul style="list-style-type: none"> <li>Further strengthen institutional frameworks</li> </ul>		x
<ul style="list-style-type: none"> <li>Mobilize resources in line with the Green Agenda for the Western Balkans</li> </ul>		x
<ul style="list-style-type: none"> <li>Develop and implement plans promoting synergies between AQM and GHG mitigation for regions with high carbon intensity</li> </ul>		x
<b>Municipal Development</b>		
<ul style="list-style-type: none"> <li>Keep strengthening the subnational fiscal framework</li> </ul>	x	
<ul style="list-style-type: none"> <li>Rethink future decentralization</li> </ul>	x	
<ul style="list-style-type: none"> <li>Make the efficient municipal service provision a top priority for municipal authorities</li> </ul>	x	
<ul style="list-style-type: none"> <li>Require the mandatory inclusion of climate and resilience considerations</li> </ul>	x	
<ul style="list-style-type: none"> <li>Explore mobilizing private sector investment instruments</li> </ul>	x	
<ul style="list-style-type: none"> <li>Introduce climate and disaster risks screening and management as mandatory part of municipal strategic documents</li> </ul>		x
<ul style="list-style-type: none"> <li>Improve consistency across the legally binding local planning documents for local self-government</li> </ul>		x
<ul style="list-style-type: none"> <li>Upgrade national and local disaster risk management capacity</li> </ul>		x
<b>Water Security and Climate Adaptation</b>		
<ul style="list-style-type: none"> <li>Implement the existing water laws and strategies in full</li> </ul>	x	
<ul style="list-style-type: none"> <li>Update the water strategy, develop an investment plan, and secure a multiyear investment budget</li> </ul>	x	
<ul style="list-style-type: none"> <li>Strengthen institutional framework and capacity</li> </ul>	x	
<ul style="list-style-type: none"> <li>Improve resource monitoring</li> </ul>		x
<ul style="list-style-type: none"> <li>Invest in water supply and sanitation (WSS) and irrigation infrastructure</li> </ul>		x
<ul style="list-style-type: none"> <li>Initiate sector reform and improve efficiency of service providers</li> </ul>		x

Policy Measure	Short-term	Medium-term
<b>Agriculture</b>		
• Increase productivity and enhance competitiveness of the agri-food sector	x	
• Improve the management of state-owned arable land	x	
• Improve the management of state support to the agri-food sector		x
• Repurpose agricultural support		x
• Address agricultural land abandonment		x
• Develop North Macedonia's Agriculture Knowledge and Innovation System		x
• Design rural development policies that stimulate public-private partnerships and resilient investments in the agri-food sector		x
<b>Jobs and Migration</b>		
• Improve the competitive environment and innovation (see policy note #8 on the private sector)	x	
• Design incentives for hiring vulnerable workers	x	
• Design training incentives for workers	x	
• Review and strengthen the impact of the Youth Guarantee	x	
• Engage the diaspora	x	
• Review unemployment insurance		x
• Implement lifelong learning (LLL) systems and invest significantly in upskilling and reskilling programs for adults		x
• Strengthen the school-to-work transition		x
• Enhance women's employment		x
• Manage migration and Global Skills Partnerships		x
<b>Education</b>		
• Support teachers with structured pedagogy (a package that includes structured lesson plans, learning materials, and ongoing teacher support)	x	
• Improve quality assurance mechanisms at all education levels to promote accountability	x	
• Expand the establishment of professional orientation centers to all secondary schools and career service centers, and use online platforms to improve the employability of young people	x	
• Allocate funds generated through the optimization of school networks to support teacher professional development and reward teachers based on performance		x
• Improve the quality of learning conditions in primary schools by focusing on better learning environments, promoting modern teaching/learning approaches, and increasing the quality of extracurricular activities (extended school day)		x
• Foster job-relevant skills in education and further strengthen the collaboration between education institutions and employers, especially in vocational and tertiary education		x
• Enhance responsiveness of the LLL education system to provide just-in-time skills training for adult learners		x

Policy Measure	Short-term	Medium-term
<b>Health Systems</b>		
<ul style="list-style-type: none"> <li>Leverage the newly established Government Technical Working Group to develop a four- to five-year plan for specific primary health care (PHC) and long-term care (LTC) reforms, with a focus on improved service delivery and financing</li> </ul>	x	
<ul style="list-style-type: none"> <li>Develop a joint strategy on healthy aging</li> </ul>	x	
<ul style="list-style-type: none"> <li>Identify sustainable sources of funding capable of supporting reforms and other strategic health and LTC interventions</li> </ul>		x
<ul style="list-style-type: none"> <li>Reduce inequities across population groups by targeting the high reliance on out-of-pocket (OOP) payments and unmet needs for health and LTC</li> </ul>		x
<ul style="list-style-type: none"> <li>Enable expansions of PHC providers' scope of care</li> </ul>		x
<ul style="list-style-type: none"> <li>Implement stronger performance-incentives in PHC and LTC provider payment mechanisms that improve efficiency and quality of care</li> </ul>		x
<ul style="list-style-type: none"> <li>Develop and implement a comprehensive health and LTC quality improvement plan</li> </ul>		x
<b>Social Protection</b>		
<ul style="list-style-type: none"> <li>Complete the rollout of the Social Welfare Information System</li> </ul>	x	
<ul style="list-style-type: none"> <li>Improve quality of social services and expand their coverage</li> </ul>	x	
<ul style="list-style-type: none"> <li>Conduct long term projections of the pension system before any ad-hoc changes</li> </ul>	x	
<ul style="list-style-type: none"> <li>Finalize the reform of the disability assessment system and the system of employment of persons with disabilities</li> </ul>	x	
<ul style="list-style-type: none"> <li>Expand availability of LTC for the elderly</li> </ul>		x
<ul style="list-style-type: none"> <li>Strengthen the ability of the social assistance system to respond to shocks</li> </ul>		x
<ul style="list-style-type: none"> <li>Consider broadening the guaranteed minimum income</li> </ul>		x
<ul style="list-style-type: none"> <li>Enhance women's employment</li> </ul>		x
<ul style="list-style-type: none"> <li>Consider pension reforms that improve links between the non-contributory and contributory system</li> </ul>		x

## World Bank Engagement

**Over the past 30 years, the World Bank Group has partnered with North Macedonia to implement transformative development programs.** The main sector and investment priorities of the WBG's partnership with North Macedonia are defined through the Country Partnership Framework (CPF), the latest of which covers the period from 2024 to 2028. The overarching objective of the current CPF is to accompany North Macedonia on its journey to becoming more competitive, sustainable, inclusive, and resilient, with a focus on competitiveness, human capital development, and environmental sustainability. Its objectives are closely aligned with the government's Economic Reform Program (ERP) 2023–25, the Growth Acceleration Program (GAP) 2022–26, and the upcoming National Development Strategy (NDS) 2022–42. The CPF is underpinned by the findings of the WBG's Systematic Country Diagnostic (SCD) Update, completed in 2023, the draft Public Finance

Review, and other major analytical works, such as the Trade Competitiveness Diagnostic and State Aid Effectiveness Report and the draft Country Climate and Development Report (CCDR).

**The CPF strategy is articulated in pursuit of three high-level outcomes (HLOs), supported through seven CPF objectives (Table 1).** The HLOs are typically achieved over a time horizon that extends beyond a single CPF cycle and through the combined effort of multiple partners. HLO 1 focuses on improving the quality of public service delivery by enhancing its efficiency and transparency. HLO 2 speaks to the creation of more productive private sector jobs by strengthening the enabling conditions for private sector-led growth and foundational skills. HLO 3 emphasizes support to North Macedonia on increasing climate resilience by addressing key environmental constraints to safeguard the sustainability of economic growth and the quality of life of its population, while contributing to the resolution of global environmental challenges, with a focus on adaptation.

**To achieve each HLO, the CPF maximizes the implementation of existing projects and the delivery of new ones.** The CPF inherits an active International Bank for Reconstruction and Development (IBRD) portfolio of US\$404.03 million in commitments and US\$9.54 million in trust funds and proposes a program of approximately US\$695 million in new IBRD lending and two Western Balkans Investment Framework (WBIF) trust funds totaling US\$17.92 million. This amounts to approximately US\$1.099 billion in IBRD lending and US\$27.46 million in trust funds (Table 2).<sup>2</sup> The current portfolio contributes to CPF outcomes in public finance management, education, social protection, transport, trade, agriculture, and energy efficiency. New activities will complement and scale up the existing portfolio, including by filling knowledge gaps to move from first- to second-generation reforms.

**Table 1: HLOs and CPF Objectives**

CPF HLOs	HLO 1: Improved Quality of Public Service Delivery	HLO 2: More Productive Private Sector Jobs	HLO 3: Increased Climate Resilience
CPF Objectives	Objective 1.1: Strengthen financial management and accountability of public institutions	Objective 2.1: Increase market access	Objective 3.1: Sustain the transition to greener energy sources
	Objective 1.2: Strengthen fiscal sustainability	Objective 2.2: Strengthen foundational skills	Objective 3.2: Scale up climate-resilient infrastructure
	Objective 1.3: Improve social services, in particular for vulnerable populations		

<sup>2</sup> Actual IBRD lending volumes will depend on country demand, overall performance, global economic/financial developments that affect IBRD's financial capacity, and demand by other World Bank borrowers.



Table 2: WBG Existing and Pipeline Portfolio in North Macedonia

Project name	Amount (US\$m)	Focus	Closing Date
<b>Macro-Fiscal Framework and Public Financial Management</b>			
<b>Building Effective, Transparent and Accountable PFM Institutions (P176366)</b>	19.77 (+ 5.32 EU Grant)	To improve the efficiency, transparency, and sustainability of public expenditure and increase the effectiveness of revenue administration.	30-Sep-2027
<b>Sustainability and Resilience Development Policy Operation</b>	100	To strengthen fiscal and social sustainability, safeguard financial sector stability, and boost climate resilience in North Macedonia.	30-Jun-2024
<b>Development Policy Operation</b>	100	To be determined	In preparation
<b>Financial Sector</b>			
<b>Private Sector Development and Access to Finance</b>	40	To be determined	In preparation
<b>Energy and Environment</b>			
<b>Public Sector Energy Efficiency Project</b>	27.4 (+ 2.45 WBIF Grant)	To reduce energy consumption in the public sector and to support the development and implementation of a sustainable financing mechanism for energy efficiency in the public sector.	30-Sep-2025
<b>Energy Transition</b>	40	To be determined	In preparation
<b>Greener Environmental Growth</b>	40	To be determined	In preparation
<b>Human Development</b>			
<b>Social Services Improvement Project</b>	33.4	To expand access to and improve the quality of social services, including preschool services, for vulnerable groups.	30-Jun-2025
<b>Social Insurance Administration Project</b>	15.7	To improve the quality of services in administering social insurance and strengthen the regulatory framework for people with disabilities and hazardous occupations	31-Dec-2024
<b>Primary Education Improvement Project</b>	25	To improve conditions for learning in primary education.	27-Feb-2026
<b>Second Social Insurance Improvement Project</b>	30	To expand access to and improve the quality of social services, including preschool services, for vulnerable groups.	31-May-2029
<b>Health Project</b>	30	To be determined	In preparation
<b>Human Development</b>	80	To be determined	In preparation
<b>Private Sector Development and Innovation</b>			
<b>Private Sector Development and Access to Finance</b>	40	To be determined	In preparation
<b>Digital Development</b>			
<b>Digital Development Agenda</b>	50	(To be determined)	In preparation

Project name	Amount (US\$m)	Focus	Closing Date
<b>Transport and Urban Development</b>			
<b>Road Upgrading and Development Project</b>	113.79 (+ 15.47 WBIF Grant)	To improve transport connectivity for road users along Corridor VIII between Skopje and Deve Bair, and to improve asset management and planning functions in the Public Enterprise for State Roads	30-Sep-2025
<b>Local Roads Connectivity Project</b>	122.80	To improve government capacity to manage local roads and improve access to markets and services, and to provide an immediate and effective response to an eligible crisis or emergency	31-Dec-2024
<b>Local Roads Connectivity Additional Financing (AF)</b>	25	To improve government capacity to manage local roads and improve access to markets and services, and to provide an immediate and effective response to an eligible crisis or emergency	In preparation
<b>Sustainable Municipal Development</b>	50	To enhance financially sustainable and climate-smart municipal service delivery in participating municipalities	In preparation
<b>Regional Trade and Transport Facilitation*</b>	30	To reduce trade costs and increase transport efficiency	15-Dec-2025
<b>Regional Trade and Transport Facilitation 2.0*</b>	30	(To be determined)	In preparation
<b>Agriculture</b>			
<b>Agriculture Modernization Project</b>	50.5 (+ 4.22 EU Grant)	Improve competitiveness in targeted agricultural subsectors and strengthen agricultural public sector readiness for EU accession	30-Jun-2025
<b>Agriculture Project</b>	50	To be determined	In preparation

\* Regional projects.



Macroeconomics  
and Public Financial  
Management



# 1 Macroeconomics and Public Financial Management

## 1. Overarching Messages

**Securing macroeconomic stability, ensuring fiscal sustainability in a context of increased public debt and an elevated deficit, and boosting productivity have become more critical than before, as inflationary pressures persist and access to markets has tightened.** Expansionary fiscal policy measures in recent years have not been matched by strong increases in revenues, thus engulfing growth and slowing down convergence toward European Union (EU) standards. At current growth rates, it would take over three generations to close the gap in living standards between North Macedonia and the countries of the EU. Boosting growth will require improving expenditure and revenue management while boosting productivity. Decarbonization of the economy represents a strategic opportunity for North Macedonia to increase growth and improve fiscal balances. Scaling up decarbonization would promote the creation of more productive, better-paid jobs across the economy. Moreover, putting a price on carbon could strengthen domestic public revenues and maintain international competitiveness ahead of the implementation of the EU Carbon Border Adjustment Mechanism (CBAM).

## 2. Key Challenges

**Owing to fiscal prudence before the recent crises, North Macedonia had sufficient space for countercyclical support when the crises hit; today, however, the country's fiscal position has worsened and there is an urgent need to rebuild buffers.** Relative to other countries in the Western Balkans and EU27 peers, North Macedonia ran higher fiscal deficits in the last decade, while low fiscal discipline in public health institutions, state enterprises, and local governments led to a build-up of arrears.

**Recent evidence suggests that fiscal policy has been largely procyclical and expansionary during electoral years.** The fiscal deficit doubled to an average of 6.1 percent in 2020–23, as the government ramped up crisis support measures to protect living standards and jobs. Consequently, public debt<sup>3</sup> reached 62 percent of gross domestic product (GDP) by the end of 2023, above the newly introduced fiscal rule and 13 percentage points higher than in 2019. Furthermore, expenditure arrears remain high at around 3 percent of GDP, adding to the overall debt. At the same time, after growing below potential and at a lower rate than regional peers, near term growth prospects face several downside risks. These include a slowdown in exports, due to falling demand for cars, and inflation-dampened consumption, which will not be offset by public sector-led investments at the time of 'higher-for-longer' interest rates and eroded fiscal space. Beyond the near term, stagnation in productivity growth, low efficiency of capital deployment, and a weak labor market raise concerns about the country's economic growth potential, as GDP growth declined to a new post-crisis low of only 1.8 percent. Consolidating public finances during good times can instead help the government better mitigate the impacts of business cycle fluctuations, enhance macroeconomic stability, and generate fiscal space so as to respond in times of need. General government expenditure in North Macedonia, at above 41 percent of GDP in 2023 (including the finances of the Public Enterprise for State Roads, or PESR), is higher than the average in the Western Balkans and slightly below the average for EU small states. At

<sup>3</sup> Includes guaranteed and non-guaranteed debt.

the same time, government revenues were around 36 percent of GDP in 2023, suggesting the need to mobilize additional domestic revenues.

**Major infrastructure investments in the making threaten to place additional pressure on medium-term fiscal plans.** The construction of a major highway to Albania, recent public sector wage increases, and new strategic investments in the energy sector that would draw on new tax expenditures add to rising fiscal risks, including through guaranteed purchase liabilities. Bailouts of state-owned enterprises (SOEs) in the energy, railways, postal services, and municipal utilities sectors are becoming larger and more frequent, underscoring the inefficiency, overemployment, and poor corporate governance of SOEs in North Macedonia. The Revised Fiscal Strategy 2024–28 presents a roadmap to gradual fiscal consolidation that adheres to the newly introduced fiscal deficit rules as of 2025, under an optimistic macroeconomic scenario that envisages 5 percent growth in real GDP, on average. Given the persistent vulnerabilities and uncertainties, however, efforts to stabilize public finances will need to rely on a combination of spending consolidation and revenue mobilization.

**Public financial management (PFM) gaps hinder the effective use of public finances.** The 2022 Public Expenditure and Financial Accountability (PEFA) assessment report highlighted medium-term planning and budgeting, management of fiscal risks, assets and public investments, program performance information, accounting and reporting, and revenue administration as focus areas where continued reforms and more improvements are needed. Public access to, and transparency of, national budget resources is also limited, as evidenced by North Macedonia's score of 36 out of 100 on the 2021 Open Budget Survey. Implementation of the PFM Reform Program for 2024–27, including the adoption of the new Organic Budget Law (OBL), have helped to address some of the identified PFM gaps, but significant efforts are needed to tackle all of the shortcomings in the country's overall PFM framework.

**Tax administration requires modernization, particularly in boosting compliance, which could help address high tax erosion.** With a large informal economy, at around 20–40 percent of GDP<sup>4</sup>, North Macedonia's tax revenue-to-GDP ratio (around 31.2 percent in 2023) stands below the EU and Organisation for Economic Co-operation and Development (OECD) averages. The World Bank estimates that foregone value-added tax (VAT) revenue amounts to about two-thirds of total VAT revenue, of which 55 percent is due to compliance issues (such as taxpayer error, tax evasion, and administrative capacity). Even though the Public Revenue Office (PRO) has taken some steps toward improving its compliance risk management (CRM) framework through the adoption of a CRM Unit in 2019 and the development of risk mitigation plans for selected sectors, weaknesses in the CRM framework persist.

**The management of state aid is neither efficient nor transparent and hampered by multiple factors.** Notably, these include: (a) the lack of an updated, comprehensive central registry of state aid, complicating the standard reporting and data exchange mechanisms to be used by the Commission for Protection of Competition (CPC) to monitor the status of such programs; and (b) a suboptimal state aid notification system. North Macedonia has implemented a generous state aid program (mostly grants and tax reductions, but also including other forms, such as guarantees, state shareholding, and goods and service provision under preferential conditions) to foster economic growth and attract foreign direct investment (FDI). As the country moves toward EU accession, and given the impact

<sup>4</sup> Strategy for formalization of the informal economy 2023–2027, Ministry of Finance, June 2023.

of such aid on market competition within the EU internal market, it will have to comply with strict EU standards<sup>5</sup> and monitor approved state aid programs, jointly with the national CPC and as signatory of the Stabilization and Association Act with the EU, in line with the requirements set by the European Commission (EC).

**Decarbonizing the economy is a compelling policy and investment priority for North Macedonia.** However, while more than 80 percent of additional capital investments needed to meet the decarbonization target are expected to be undertaken by the private sector, the existing regulatory environment is still not conducive to raising capital to finance climate change-induced investments. Accessing public-private partnerships (PPPs) can help close the investment gap arising from the net-zero transition. Aiming to align with the EU *acquis communautaire* (acquis), a new draft Law on PPPs addresses the fragmented terms and conditions and the lack of central oversight of fiscal risks related to PPPs, but has not yet been enacted by the parliament, even though it was prepared with World Bank support almost three years ago. Additional efforts are needed to integrate PPPs within the overall public investment management (PIM) framework, ensure consistency between strategic priorities and capital spending, strengthen the institutional system for oversight, and further improve the management and reporting of fiscal costs and risks associated with PPPs. Adoption of a National Green Taxonomy, modeled on that of the EU, will bring more clarity when designing green projects that are eligible for green financing.

**Firm productivity is low and not increasing due to a misallocation of resources.** Many underperforming firms continue to operate in the country, particularly in lagging sectors that host a large share of jobs. Firm entry and exit rates are falling behind those of peer countries, signaling a lack of market dynamism and competition. Productivity dispersion is high, especially in services, which indicates considerable potential gains from the reallocation of resources from less to more productive sectors of the economy. More productive firms account for a smaller share of total employment but also tend to pay higher wages, particularly in services subsectors, where over half of the workforce is employed. The current misalignment between real wage growth and productivity decline may lead to prolonged and elevated inflationary pressures. Promoting a more efficient allocation of resources could help increase productivity, employment, and wages and shift capital and labor to sectors that maximize their use.<sup>6</sup>

**North Macedonia's productivity and fiscal sustainability challenges are further complicated by demographics and migration.** By 2050, more than a quarter of the population is expected to be over the age of 65, as the fertility rate has been cut nearly in half in fewer than three decades. The country has one of the largest diasporas in Europe and Central Asia (ECA). A high proportion of emigrants tend to leave the country in their most productive years, generating labor supply shortages in both high- and low-skill sectors. At the same time, demographic aging due to lower birth rates and higher outmigration are likely to increase pressure on the social protection system and on the provision of public services, as fewer working-age people support the provision of social and health services to a growing number of retirees.

**Increasing growth requires moving forward with pending structural reforms in human capital development, connectivity, market competition, and energy and advancing on the EU accession governance and regulatory agenda.** Convergence with EU peers is low, at 42

<sup>5</sup> To date, the EU has already made several remarks on state aid implementation in North Macedonia related to monitoring its distortive effects on the market, lack of clear policy objective, and different (mostly low) levels of transparency among implementing institutions.

<sup>6</sup> North Macedonia Systematic Country Diagnostic 2023 Update.

percent of EU27 GDP at PPS in 2022, and with current annual per-capita growth rates at 2 percent, it would take over three generations to close the gap in living standards between North Macedonia and EU countries.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Accelerate fiscal consolidation to restore fiscal space and adhere to fiscal rules.** The consolidation should rely equally on revenue mobilization, increased compliance, and spending rationalization. On the revenue side, there is space to increase excise rates for fuel, alcohol, and tobacco; introduce taxes on sugary beverages; further reduce exemptions on VAT and corporate income tax (CIT) rates; and boost compliance. On the spending side, reforms should prioritize rationalization of subsidies and crisis-support programs, coupled with boosting the efficiency of education, health, pension, wage bill, and capital spending. A more sustainable fiscal path can enhance policy predictability and credibility of the government, thereby contributing to lower borrowing costs and refinancing needs.
- 1. **Ensure proactive management of fiscal risks, particularly SOEs, PPPs, and legal claims.** The 2023 EU report assessed fiscal risks in the country as sizeable, including from the road corridor 8/10d project and contingent liabilities arising from PPPs and other off-budget entities, as well as from consistently high expenditure arrears, recent public sector compensation increases, and pension indexation reforms. Strengthening the institutional framework and capacity to identify, monitor, disclose, and ensure accountability for fiscal risks, as indicated in the PFM Reform Program for 2024–27 can help curb unplanned expenditure and contribute to more efficient allocation of public resources.
- 2. **Revise government finance statistics to ensure alignment with EU (ESA 2010)<sup>7</sup> standards.** The 2023 EC progress report for North Macedonia highlights the requirement to comply with ESA 2010 sectoral classification rules and include public enterprises that affect the government deficit and debt to ensure consistency, timeliness, and coverage of government finance accounts. Of particular relevance is the PESR, which was taken off-budget in 2013 despite implementing a significant central government investment agenda, including the construction of corridors 8/10d at a sizeable fiscal cost.
- **Improve public financial management through full implementation of the OBL.** Building on the 2022 PEFA report, the priorities should be to: (a) avoid frequent revisions of annual and medium-term budget plans, due to overly optimistic macroeconomic assumptions, and reallocations from underspent capital to already high current expenditure; (b) eliminate significant deviations in the composition of revenue and expenditure categories; (c) clear public sector arrears by addressing lack of fiscal discipline at the subnational level, as well as poor SOE and health sector management; (d) implement the Integrated Financial Management Information System (IFMIS) on time, by the end of 2025, to support OBL implementation. That, in turn, requires the Ministry of Finance (MoF) to complete the procurement process for the solution provider, develop a unified budget classification/chart of accounts, adopt bylaws for the OBL, and fill vacant positions in the MoF's information technology (IT) department (including the IT Director).

<sup>7</sup> The European system of national and regional accounts (ESA 2010) is the newest internationally compatible EU accounting framework for a systematic and detailed description of an economy.



- **Strengthen the regulatory framework for PPPs to facilitate leveraging private financing for infrastructure investments.** This would require: (a) adoption by the government and parliament of the new PPP law, aligned with EU directive 2014/23/EU, followed by (b) the establishment of a PPP Management Information System; (c) the enactment of bylaws; (d) the strengthening of relevant institutions to design, negotiate, and manage PPPs, as well as associated fiscal risks and liabilities; and (e) robust and broad communication efforts to increase public awareness on PPPs.
- **Develop a comprehensive and transparent Registry of State Aid and create a more effective State Aid Notification System** that will monitor these schemes' cost-effectiveness and impact on competitiveness, ensure coordination of different programs, and strengthen the capacity of the CPC and the institutions providing state aid.

#### Medium-term measures:

- **Allocate resources in line with strategic investment goals to maximize the use of public funds.** Given the limited fiscal space and deficiencies in PIM, priority should be given to strengthening the regulatory framework and the technical capacity of the MoF's PIM unit, as well as developing a public investment project appraisal methodology and criteria for the selection and prioritization of projects and introducing risk-based monitoring and ex-post review of projects, as outlined in the PFM Reform Program for 2024–27.
- **Strengthen the corporate governance, oversight, financial transparency, and accountability of SOEs** to minimize the risk of new liquidity buffers and activation of contingent liabilities, as experienced during the recent energy sector crises.
- **Build up and modernize the tax administration to address existing revenue shortfalls.** Closing the performance gaps in tax administration, in parallel with revenue-enhancing tax reforms, can help boost domestic revenue mobilization, combat tax avoidance and evasion, and support fiscal sustainability over the medium term. The PRO needs to strengthen its operational effectiveness, with a focus on strengthening the tax compliance management system, enhancing selected management functions, expanding its tax revenue management information system (ITIS), and introducing e-invoices.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• <b>A new Public Expenditure Review</b> would provide the analytical underpinnings for policy choices to ensure the medium- to long-term sustainability of public finances.</li> <li>• <b>EU-funded technical assistance (TA) on fiscal governance</b> aims to strengthen macro-modeling and forecasting, promote more efficient PIM, conduct spending reviews, and strengthen the capacity of the Fiscal Council.</li> <li>• <b>The 2024 Climate Public Finance Review</b> provides an overview of the linkages between fiscal policy and climate change and will inform the government on how to better manage climate risks while achieving positive economic, fiscal, and climate outcomes.</li> <li>• <b>The 2023 Health Tax Reform Report</b> provides an overview of current health tax policies and provides recommendations considering the EU accession agenda and the need to expand domestic revenues and address public health concerns.</li> <li>• <b>The Building Effective, Transparent, and Accountable PFM institutions in North Macedonia (BETA-PFMI) project</b> (US\$24.55 million, including a US\$4.78 million grant from the EU) supports the country's efforts to improve the efficiency, transparency, and sustainability of public expenditures and increase the effectiveness of revenue administration. It funds the development of a new IFMIS in support of OBL implementation, development of a new SAMIS, and expansion of the existing ITIS, together with ICT infrastructure enhancements and other advisory support, change management, and training activities.</li> </ul>
<p><b>Potential Engagements</b></p>	<ul style="list-style-type: none"> <li>• <b>As envisaged in the CPF for 2024–28, the WBG envisages a new development policy loan (DPL)</b> that would provide general budget support against reforms that would strengthen fiscal sustainability, competitiveness, and the green transition. The DPL would crowd in additional parallel financing from other development partners, in support of a common set of critical reforms.</li> <li>• <b>A Country Economic Memorandum</b> would be delivered in 2025, with a focus on boosting growth and higher-value-added jobs and deep dives on informality, gender and jobs, and productivity.</li> <li>• <b>An Integrated SOE Framework Analysis</b> could be delivered to provide an assessment of challenges and opportunities with respect to SOEs, either at the national level or in specific sectors.</li> </ul>



# Poverty and Inclusion



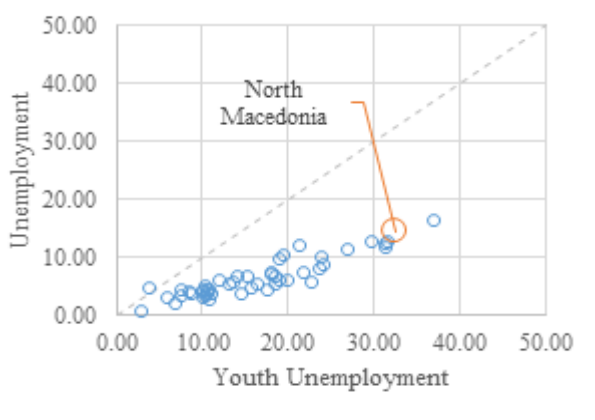
# 2 Poverty and Inclusion

## 1. Overarching Messages

**Economic growth over the past decade has benefited low-income households.** Over 440,000 people moved out of poverty between 2009 and 2019, and the poverty rate (measured at the upper-middle-income poverty line of US\$6.85/day in 2017 purchasing power parity terms) fell from 41 percent to 19 percent. Pro-poor growth was also associated with a remarkably high shared prosperity premium and a significant reduction in overall inequality, with the Gini index declining from 43 to 34 during the same period. Yet, poverty and exclusion levels remain high by EU standards, with a third of the population in North Macedonia at risk of falling into poverty or social exclusion in 2020, compared to 22 percent overall in the EU27. Women, youth, members of ethnic minorities, and of the LGBTIQI+ community are more vulnerable to falling into poverty and deprivation. Investing in people by focusing on foundational skills through early childhood education and developing skills that align with labor markets trends and requirements will be necessary to promote better living conditions to improve people's livelihoods.

## 2. Key Challenges

**Figure 1: Unemployment, and youth unemployment, are among highest in the Europe and Central Asia region**



Note: Total and youth unemployment rates, circa 2022.

Source: SCD Update, based on data from the World Development Indicators (WDI).

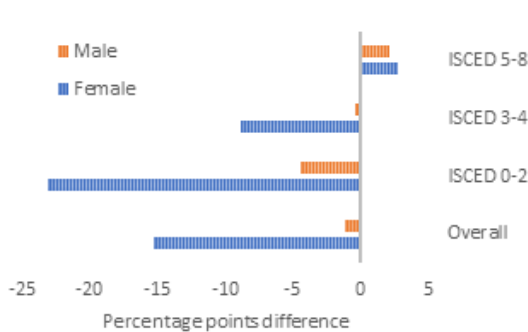
**Fragility and deprivation continue to affect many people.** Despite progress in reducing poverty rates, almost one in five people experience severe material and social deprivation or inability to afford some items considered by most people to be desirable or even necessary to lead an adequate life, compared to 7 percent in EU27. According to data from the recent Life in Transition survey, more than half of adults in North Macedonia described the financial situation of their household as either just managing to make ends meet and unable to save or having to draw down savings or take on debt. If faced with the sudden loss of the main source of household income, more than a third of surveyed adults report that they would not be able to cover basic household expenses for more than two weeks.

**Low human capital dampens opportunities for future poverty reduction.** A child born in North Macedonia today can expect to attain only 56 percent of his/her full productive potential, according to the World Bank's Human Capital Project—one of the lowest levels of human capital in all of ECA. A child who starts school at age four is expected to complete 11 years of schooling by her 18<sup>th</sup> birthday, a level below what would be expected given the country's GDP per capita. Factoring in what children learn reduces the expected years of schooling to only 7.3. Low levels of human capital reduce young people's readiness for the labor market and their productivity. The extent to which companies can find people with the skills required to fill their vacancies is lower in North Macedonia than in other Western Balkans countries, other than Bosnia and Herzegovina.

**Job opportunities and earnings were the main drivers of poverty reduction, but the labor market remains anemic.** During 2009–19, job growth and wage increases accounted for a full 90 percent of the reduction in poverty in that period. The in work at-risk-of-poverty rate in North Macedonia, at 7.9 percent in 2020, was 1 percentage point lower than the EU27 average. The problems lie, rather, with labor market attachment. Some 15 percent of people under 60 lived in households with low work intensity, compared to 8.7 percent in the EU27. The youth unemployment rate, at 32.6 percent in 2022, was above the Western Balkans average and more than double the EU27 average (Figure 1). Long-term unemployment (more than 12 months) among youth (ages 20–29), at 21 percent in 2020—the latest comparable estimate—was seven times higher than in the EU27.

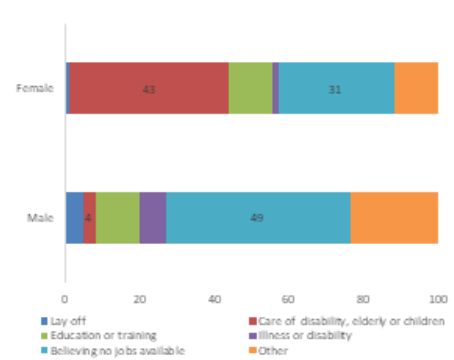
**Women, young people, members of the Roma ethnic group, and LGBTQI+ people continue to experience poor social and economic outcomes.** Significant gender inequalities remain in access to economic opportunities and productive assets, despite considerable improvements in the institutional, legal, and policy frameworks for gender equality. Female labor force participation remains both below that of men and below that of women in EU27 countries, with the gap between North Macedonia and the EU27 having increased over the past two decades. Gender gaps in labor force participation are particularly pronounced among those with low levels of education and disappear completely with tertiary educational attainment. The burden of care, exacerbated by the lack of institutionalized care infrastructure, is a key driver of gender disparities in the labor market, as 43 percent of women are out of the labor force because of care responsibilities, compared to 4 percent of men. Violence against women is widespread, and 54 percent of women report having experienced some form of violence since the age of 15. In 2023, 18.7 percent of young people aged 15–24 were not in employment, education, or training (NEET). About one-quarter of respondents cited unemployment as their most significant challenge, and 37 percent were uncertain that they would be able to keep their jobs in the coming year—the highest share in the Western Balkans, according to a 2022 survey. Just 2 percent of Roma children attend early childhood education or receive professional childcare, significantly below the EU average of 44 percent. The share of Roma NEET adolescents and adults is about 40 percentage points higher than that of their non-Roma counterparts. Surveys indicate that discrimination based on sexual orientation, gender identity and expression, and sex characteristics (SOGIESC) is widespread. The World Bank estimates the annual economic loss due to SOGIESC-based exclusion in the labor market at 0.5 percent of GDP, and the annual fiscal loss at 0.13 percent of GDP.

**Figure 2: Difference in labor force participation rate between North Macedonia and EU27, by sex and education level (ages 15–64)**



Note: Activity rates by sex, age, and educational attainment level (2022, %).  
 Source: Eurostat-WIID-SEE-Jobs Gateway.

**Figure 3: Reasons for economic inactivity (population aged 15–64 years)**



Source: Eurostat 2020.

**Spatial disparities persist over time.** Poverty rates remain elevated in the northern regions of North Macedonia, despite the decline in overall poverty rates during 2009–19. Poverty rates in the Polog and Northeastern regions are above 30 percent, compared to under 10 percent in the Eastern, Southeastern, Pelagonija, and Vardar regions. In 2019, three out of four individuals in poverty lived in the Polog, Northeastern, and Skopje regions.

### 3. Policy Responses for Consideration

#### Short-term measures:

- Ensure the timely availability of survey data to monitor living standards and identify population groups that are vulnerable to shocks.** The lag between the collection and reporting of EU Statistics on Income and Living Conditions (SILC) survey data—the main source of statistics on poverty and inclusion in North Macedonia—remains significant and lags the performance of EU member states and other Western Balkans countries. The latest available data on North Macedonia are from the EU-SILC 2020, compared to 2022 in Montenegro, Serbia, and other EU states. Significant gaps exist related to spatial disparities, as well as high-quality, disaggregated data on gender, vulnerable groups, the Roma ethnic minority, sexual orientation, gender identity, gender expression, and sex characteristics. Data are often incomplete, methodologically inaccurate, or entirely lacking, which hampers evidence-based policy making. The Law on State Statistics does not require the collection of disaggregated data, such that none of the nationally representative surveys provide information about the position of LGBTQI+ people.

#### Medium-term measures:

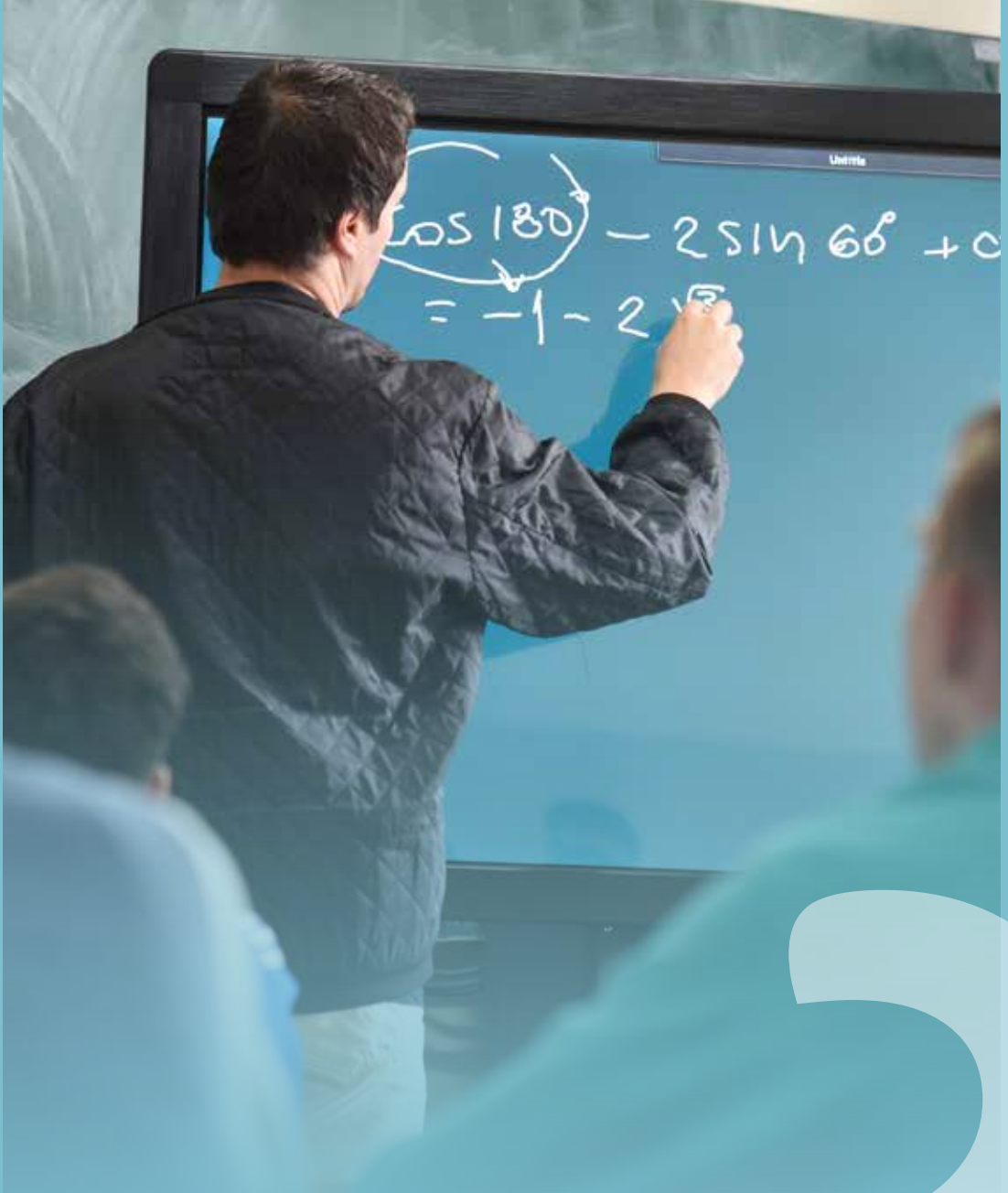
- Increase the supply of integrated, affordable, good-quality early childhood education and care, especially among disadvantaged groups.** Almost nine out of every 10 children under the age of four in North Macedonia do not receive formal childcare. Increasing access to early childhood education not only helps reduce developmental gaps at an early age and increase lifelong learning, but also promotes labor force participation among women, who shoulder the bulk of household care responsibilities. Efforts to improve the availability of early childhood education can be combined with the development of jobs and career opportunities in the formal care economy, particularly for women from vulnerable backgrounds.

- **Support market-oriented skills development.** Further investment in good-quality vocational education and strengthening the involvement of the private sector in curricular development and on-the-job- training can help improve the school-to-work transition and tackle youth unemployment. In addition, investing in local government capacities and programs that provide services targeting the NEET population can help to build and enhance soft skills, boost active citizenship and volunteerism, and support the participation of young people in social life.

#### 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<p>The World Bank Group supports the data development agenda through analytical work that highlights the areas with the most critical knowledge and data gaps, and through the provision of TA to the State Statistical Office on issues related to data collection and analysis.</p> <p>Examples include the recently completed “<b>Economic Cost of Exclusion Based on Sexual Orientation, Gender Identity and Expression, and Sex Characteristics,</b>” the <b>North Macedonia Country Gender Assessment,</b> the ongoing <b>Promoting Jobs and the Care Economy in the Western Balkans</b> project, and TA to support the <b>effective reintegration of Roma returning migrants,</b> with a particular focus on activating Roma women to engage in the care economy. The <b>Social Services Improvement Project</b> and <b>Second Social Services Improvement Project</b> aim to improve access to good-quality early childhood education and care.</p>
<p><b>Potential Engagements</b></p>	<p>The World Bank could provide analytical and advisory support to North Macedonia on the following topics: (i) understanding <b>spatial disparities</b> by analyzing subnational well-being (including poverty and material deprivation, taking advantage of the 2021 Census) to inform the targeting of investments; and (ii) understanding the drivers of high NEET rates among youth, the links to migration patterns, and ways to improve <b>youth employability.</b></p>





Education



# 3 Education

## 1. Overarching Messages

**Investing in education and boosting human capital will be key to steering the country toward a sustainable and inclusive growth path.** North Macedonia's population is declining due to low birth rates and significant emigration, ranking among the top 20 countries globally for emigration, with nearly 10 percent of its population leaving in the past two decades.<sup>8</sup> Its Human Capital Index score is 0.56, meaning that a child born in North Macedonia today will only be 56 percent as productive as a child born in a country with better access to and better quality of education and health. This score falls below the EU average of 73 percent and lags behind top EU performers like Slovenia and Estonia, at 77 and 78 percent, respectively.<sup>9</sup> To narrow these gaps and align with EU standards, North Macedonia needs to prioritize initiatives that enhance the quality of education, ensure inclusion of disadvantaged students across all educational levels, and protect education budgets while promoting efficiency and equity.

## 2. Key Challenges

**Over the past decade, North Macedonia has made significant strides in improving access to education, particularly at the primary and secondary levels, but access to pre-primary and tertiary education remains low at 42 percent and 43 percent, respectively.** Access is notably low for students with disabilities, those in the poorest income quintile, and those from minority groups, particularly the Roma community. Only 10 percent of students in the poorest quintile are enrolled in pre-primary schooling, which has a negative impact on longer-term learning outcomes.

**Learning outcomes have declined since 2018, falling below those of comparable countries in the ECA region.** The latest Program for International Student Assessment (PISA) results, from 2022, show a downward trend in national averages in reading, mathematics, and science compared to 2018. Three-quarters (74 percent) of 15-year-old students in North Macedonia scored below minimum proficiency in reading, at Level 2,<sup>10</sup> compared to 55 percent in 2018, and 65 percent and 66 percent were below minimum proficiency in science and mathematics, respectively, in 2022 compared to 49 percent and 61 percent in 2018. The drop in reading and mathematics scores between 2018 and 2022 exceeded 30 points, equivalent to a year-and-a-half of education.<sup>11</sup>

**Educational disparities persist across different backgrounds.** Performance gaps on PISA 2022 were widest with respect to students' socioeconomic status, where 82 percent of students in the lowest socioeconomic quintiles were below minimum proficiency compared

8 IMF (2023). Emigration, Business Dynamics, and Firm Heterogeneity in North Macedonia.

9 World Bank (2018). North Macedonia Human Capital Index.

10 PISA results group student performance according to six proficiency levels for each subject, from the lowest performing ones (Below Level 2) to the best performing students (Level 6). Level 2 is used as a reference and baseline group and represents the level of proficiency at which students begin to demonstrate the competences that will enable them to participate effectively and productively in life as continuing students, workers and citizens. Students who do not attain baseline Level 2 are referred to as "low performers". Students who attain Level 5 or Level 6 are top performers and well on their way to becoming the skilled knowledge workers of tomorrow.

11 OECD (2023). PISA 2022 Results: The State of Learning and Equity in Education.

to 44 percent of students in the highest socioeconomic quintiles. The same pattern can be observed in the Trends in International Mathematics and Science Study (TIMSS) 2019 data, which show significant extremes in performance categories in math and science. Low education outcomes have deep impacts on the employability of young people in North Macedonia, as confirmed by high long-term youth unemployment rates. Skills acquired through education do not match those demanded by the job market, leading to persistent unemployment and a loss of human capital.

**While efforts to digitalize the education system are underway, disparities persist in access to digital infrastructure and training among teachers.** Efforts to incorporate digital technologies and content into education have focused on curriculum delivery, assessment methods, and administrative processes. Initiatives have included giving students and teachers access to digital learning resources, introducing online learning platforms, and improving connectivity in schools. Challenges persist, however, in terms of unequal access to digital infrastructure and applications and to teacher training.

**Spending on education declined in the past decade, from 5.1 percent of GDP in 2010 to 4.0 percent of GDP in 2020.** North Macedonia spends slightly more on education as a share of GDP compared to regional peers (such as Bulgaria, Montenegro, and Serbia), but far less than other small eastern European countries<sup>12</sup> (1.4 percentage points less) and the EU27 (1 percentage point less). The decline in education spending as a share of overall general government expenditure is equally significant, from 14.6 percent in 2010 to 10.4 percent in 2020. Unlike comparator countries, North Macedonia has not been able to achieve better learning outcomes with similar or lower levels of spending on education.<sup>13</sup>

**Mobilizing more resources for education will need to proceed in parallel with a reduction in spending inefficiencies, starting from a consolidation of the school network.** The current school network is costly to maintain and does not reflect demographic and enrollment trends. Teachers are still being hired in all municipalities, although only eight out of 80 municipalities experienced an increase in enrollment. As a result, the student-teacher ratio in North Macedonia has dropped drastically to 10 students per teacher, well below the OECD average of 15 students per teacher.

**There are important gaps in North Macedonia's education financing framework compared to international best practice.** Institutional arrangements are complex and rely on unclear and outdated financing criteria that do not incentivize multiyear budgeting, nor the optimization and efficiency of resource use and performance. The lion's share of spending is for salaries, with little margin for capital spending and teachers' training. Between 2015 and 2021, average spending per teacher on professional development was a mere €3.5 per year, far less than the calculated average training cost of approximately €40.<sup>14</sup>

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Adopt and ensure the effective application of new funding formulas for pre-university education levels to improve efficiency.** This effort should start with primary education and include performance elements as well as links to national priorities. An ex-post analysis of the reform should be conducted.

<sup>12</sup> The seven small eastern European countries (7SEE) include: Bulgaria, Croatia, Estonia, Latvia, Lithuania, Slovenia and Slovakia.

<sup>13</sup> World Bank (2023). Financing our future: how to improve the efficiency of education spending in North Macedonia.

<sup>14</sup> World Bank (2023). Financing our future: how to improve the efficiency of education spending in North Macedonia.

- **To promote equity, ensure that adequate resources are made available to introduce programs for learning recovery.** Such programs (for example, tutoring programs) would help reduce learning gaps for students from disadvantaged socioeconomic backgrounds (who may face inadequate home support) and learning losses caused by COVID-19.
- **To improve quality, support teachers with structured pedagogy (a package that includes structured lesson plans, learning materials, and ongoing teacher support).** This effort could go hand-in-hand with improved quality assurance mechanisms at all education levels to promote accountability and an expansion in the establishment of professional orientation centers to all secondary schools, as well as career service centers and the use of online platforms to improve the employability of young people.

#### Medium-term measures:

- **On efficiency, consolidate the school network, stop the recruitment of new teachers in areas with low student–teacher ratios, and reallocate excess teachers in primary and secondary education to make spending more efficient.** The savings from such actions can be used to fund a teacher performance reward system and teacher training programs.
- **On equity, reduce the number of out-of-school children and improve enrollment in compulsory levels of education by increasing access to and quality of education.** It would also be useful to explore a voucher system for disadvantaged children to attend private preschools and financial incentives.
- **On quality, allocate funds generated through the optimization of school networks to support teacher professional development and reward teachers based on performance.** The quality of learning in primary schools could be improved by focusing on better learning environments, promoting modern approaches to teaching and learning approaches, and increasing the quality of extracurricular activities (extended school day). There should be a concerted effort to foster job-relevant skills in education and further strengthen the collaboration between educational institutions and employers, especially in vocational and tertiary education. Moreover, enhancing the responsiveness of the lifelong learning (LLL) education system to provide just-in-time skills training for adult learners will require a more prominent role for employers, improved information flows, and a system for recognition of prior learning.<sup>15</sup>

<sup>15</sup> Lessons from the implementation of the recently closed skills project (Skills Development and Innovation Support Project (P128378)) could be applied. For instance, the grant programs supported under the program promote school–industry collaboration and succeeded in increasing the practical training opportunities for students to learn work-based skills and increase their employability.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• The <b>Primary Education Improvement Project</b> (US\$25 million) aims to improve conditions for learning in primary education.</li> <li>• The <b>Social Services Improvement Project</b> (US\$33.4 million) and <b>Second Social Services Improvement Project</b> (US\$30 million) provide cross-sectoral support between the Social Protection and Jobs and Education (early childhood education and care) global practices of the World Bank to expand access to and improve the quality of social services, including preschool services, for vulnerable groups.</li> <li>• The <b>education chapter of the Public Finance Review</b> assesses the efficiency, effectiveness, and sustainability of the financial resources allocated to the education sector.</li> </ul>
<p><b>Potential Engagements</b></p>	<ul style="list-style-type: none"> <li>• <b>Higher education steering mechanisms:</b> funding, higher education financing reform, funding formula, strategic financing options.</li> <li>• <b>Additional financing for the Primary Education Improvement Project:</b> to sustain established mechanisms for ensuring quality in primary education.</li> <li>• <b>Human Capital Project:</b> to enhance the quality and relevance of secondary education and facilitate the school-to-work transition.</li> </ul>



Health Systems







# 4 Health Systems

## 1. Overarching Messages

**While North Macedonia has seen progress in key health indicators and health system improvements in recent decades, significant challenges persist.** Inequitable access to high-quality health care services and inadequate financial protection resulting in high out-of-pocket (OOP) expenditures, for example, comprise long-standing challenges. Meanwhile, as the growth in the number and proportion of older persons increases, the pace of long-term care (LTC) service development has not been sufficient to address the population's growing care needs. A rising non-communicable disease (NCD) burden contributes to the challenge. Targeted reforms within North Macedonia's health and long-term care systems are imperative.

## 2. Key Challenges

**North Macedonia has witnessed progress in key health outcomes; however, the country faces a rising NCD burden and an aging population that, in the absence of health system adaptation, can put this progress at risk.** Between 1960 and 2021, life expectancy increased from 56 to 75 years. Under-five mortality declined from 58 to 5 per 1,000 live births between 1981 and 2021, and infant mortality declined from 53 to 5 per 1,000 live births over the same period. However, regional differences in infant mortality rates—for example, 2.1 deaths per 1,000 live births in Ohrid, compared to 23.8 in Gevgelija, in 2020—indicate issues in service delivery and quality of care.<sup>16</sup> Moreover, the COVID-19 pandemic reversed decades of gains in life expectancy, which declined from 77 years in 2019 to 75 years in 2021, widening the gap with life expectancy in the EU, at 80 years in 2021. This decline is also due in part to the growing burden of NCDs, which accounted for 96 percent of deaths in 2019 (relative to 93 percent in 2000). This increasing burden is driven by a high prevalence of poor health behaviors (such as smoking) and an increase in the proportion of older people with often complex and costly care needs, including for LTC.

**As the number and proportion of older persons increases, the need for quality NCD and LTC services is expected to grow.** As of 2022, the share of the country's population aged 65 years and older reached 15 percent—three percentage points higher than in the World Bank's ECA region (excluding high-income countries), three percentage points higher than the average among upper-middle-income countries (UMICs), and only three percentage points shy of the average among OECD countries. Population projections suggest that the share of people aged 65 and older will reach close to 40 percent by 2040, with the fastest increase expected to be among those aged 80 years and older.<sup>17</sup> As the population ages and the need for both NCD services and LTC grows, policy makers have an opportunity to ensure that older persons, among others, receive good-quality care in a fiscally sustainable manner.

**As the needs of North Macedonia's population evolve, the government has an opening to improve the level and allocation of health spending.** North Macedonia's health system provides a relatively comprehensive basic benefits package, with most of the population

<sup>16</sup> <https://iph.mk/wp-content/uploads/2021/01/ZK-EN-I-del-2020.pdf>

<sup>17</sup> [https://www.stat.gov.mk/publikacii/2023/Proeckii\\_2070\\_en.pdf](https://www.stat.gov.mk/publikacii/2023/Proeckii_2070_en.pdf)

being covered under a social health insurance scheme run by the Health Insurance Fund (HIF). However, domestic government health expenditure is low, both per capita and as a percentage of GDP. Government health expenditure as a share of GDP decreased from 5.0 percent in 2003 to 4.8 percent in 2020, over three percentage points lower than the EU average of 8.4 percent in 2020. Government health expenditure per capita amounted to US\$273.6 (in current US\$) in 2020 relative to US\$2862.2 in the EU and US\$299.9 among UMICs. Similarly, domestic government health expenditure as a share of general government expenditure declined from 14.7 percent in 2000 to 12.8 percent in 2020, below 2020 levels in the EU (15.5 percent) and OECD (18.6 percent). The HIF accounts for most government expenditure on health.

**The relatively low level of public spending on health contributes to high levels of OOP spending.** In 2020, OOP spending on health accounted for 38.9 percent of health spending, far above averages among EU countries (14.4 percent), OECD countries (12.3 percent), and UMICs (30.9 percent). Outpatient medicines are the main drivers of OOP spending, followed by outpatient care. Together, they account for 95 percent of all OOP spending in 2019, with the share spent out of pocket on outpatient medicines accounting for more than three quarters (77.3 percent) of payments. When incurring high OOP, including informal payments, population groups with low incomes are less likely to receive the health services they need.

**In addition to the high levels of OOP spending, underuse of cost-effective primary health care (PHC) services is a key driver of inefficiency.** Inefficiencies prevail throughout the system—for example, hospital bed occupancy is among the lowest in Europe—but they are particularly pronounced at the primary care level. Health promotion and prevention are lacking, and the scope of services that PHC providers can offer is restricted. As a result, many conditions that are avoided and successfully managed through PHC in other countries require specialist and hospital care in North Macedonia, thereby introducing bottlenecks in care delivery, imposing unnecessary costs, and worsening health outcomes. Moreover, instead of harnessing the gains in efficiency and clinical quality to be gained from group practice, most PHC providers continue to operate in solo practices. The efficiency gaps are exacerbated by provider payment systems that do not incentivize efficiency and effectiveness in patient management.

**The government has set up an eHealth system, Moj Termin, to facilitate appointments, but the system could usefully be updated to improve efficiency.** For example, Moj Termin has the potential to be a powerful tool for measuring the quality of care by integrating core quality indicators into its electronic health records and developing dashboards that provide health professionals and policy makers with data on quality metrics. In addition, ensuring that Moj Termin can seamlessly exchange data with other relevant systems, including those at the Ministry of Social Policy, Demography and Youth (MSPDY), may empower LTC providers to deliver more efficient and coordinated care to their patients. Ensuring digital literacy among patients and providers would strengthen the uptake of such reforms.

**An underdeveloped LTC system contributes to inefficiencies, as people go without care and/or face higher OOP costs.** A 2021 report by the EC concludes that care for elderly people in North Macedonia is provided mostly by families or relatives. Of the households with a member in need of LTC in 2016, 63.2 percent were not using professional home care services because of financial constraints and 14.4 percent were not using such services because they were not available. Workforce shortages, due in part to high levels of emigration, contribute to the challenge. The ratio of nurses to people is exceptionally low in North Macedonia (440 nurses per 100,000 in 2019), at less than half the EU average (915

nurses per 100,000 in 2019)<sup>18</sup>.

**The LTC system is characterized by weak integration and a piecemeal benefit structure in which financing is neither transparent nor optimized.** The Ministry of Health (MoH) and the HIF finance health and palliative care interventions. The MSPDY finances the benefits and services provided through the social care system. Certain responsibilities are decentralized to municipal governments, but coordination between sectors and governance levels is lacking. This is due in part to a divided legislative framework, which has given rise to task shifting, overlaps, and other inefficiencies in the system. While data are limited, it is believed that the level of LTC spending is much lower as a share of GDP than the EU average of 1.7 percent. It is also believed that most spending on LTC is dedicated to residential versus home-care services. If true, this would signal the need to draw on a wider spectrum of potential providers to ensure improved use of limited resources.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Leverage the newly established Government Technical Working Group to develop a four- to five-year plan for specific PHC and LTC reforms, with a focus on improved service delivery and financing.** A potential World Bank lending project would assist the government with these reforms.
- **Develop a joint strategy on healthy aging,** in coordination with the MSPDY, with a view toward providing an integrated continuum of services and promoting aging in place.

#### Medium-term measures:

- **Identify sustainable sources of funding that are capable of supporting reforms and other strategic health and LTC interventions.** For example, increasing alcohol and tobacco excise taxes to meet EU standards and implementing a tax on sugar-sweetened beverages could support potential reforms.
- **Reduce inequities across population groups by targeting the heavy reliance on OOP payments and unmet needs for health and LTC.** Measures could include exemptions from copayments or a cap on user charges (for example, for drugs) for the most vulnerable, improved geographical distribution of health facilities and workers, and including palliative and other LTC benefits in the HIF's basic benefits package.
- **Enable an expansion in PHC providers' scope of care.** This could include, for example, implementing recently developed protocols for delegating certain types of care from specialists to PHC providers and ensuring standardized access to LTC services, including palliative care at primary and higher levels.
- **Implement stronger performance incentives in PHC and LTC provider payment mechanisms that improve efficiency and quality of care.**
- **Develop and implement a comprehensive health and LTC quality improvement plan.** Such a plan would clarify the definition of roles and responsibilities, strengthen the capacity of relevant agencies, and enable the development of quality indicators and data systems, including policies to enable their collection and analysis.

<sup>18</sup> <https://eurohealthobservatory.who.int/publications/i/health-systems-in-action-north-macedonia>

## 4. World Bank Group Engagement

Ongoing Support	<b>Advisory and analytical services on LTC</b> , including private sector and financing assessments, are currently under preparation in coordination with the MSPDY.
Pipeline	A <b>concept note for a project that would improve access to quality PHC and LTC services</b> is under preparation, in collaboration with a recently appointed Technical Working Group.
Potential Engagements	In addition to supporting the unfinished agenda in PHC and LTC reforms, new areas of engagement could include <b>stewardship of the private sector in the provision of care services</b> , the <b>scaling of palliative care interventions</b> , and other <b>reforms related to the quality of care and digital health</b> .



# Social Protection



# 5 Social Protection

## 1. Overarching Messages

**North Macedonia initiated a comprehensive social protection reform in 2019; close monitoring and further investments are needed to reap the full benefits of this reform.**

This reform was designed to consolidate and more effectively target social assistance programs to protect vulnerable households. By 2020, a third of the population was at risk of falling into poverty or social exclusion, a rate significantly higher than the EU27 average. Additionally, over a third of adults indicated that they could not sustain basic household expenses for more than two weeks if they suddenly lost their primary source of income. Given these socioeconomic vulnerabilities, it is crucial to complete the ongoing reform process, closely monitor its outcomes, and address the remaining gaps in social benefit and service provision.

## 2. Key Challenges

**The reform of the social protection system in 2019 led to the establishment of one major means-tested poverty alleviation program, the Guaranteed Minimum Assistance (GMA), which is well targeted and proved essential during COVID-19.** Prior to the reform, social assistance spending was comparatively low, highly fragmented across several programs, and skewed toward non-means-tested programs. The targeting and adequacy of social assistance benefits improved following the implementation of far-reaching reforms to the country's social protection system, notably the establishment of the GMA to replace all other means-tested social assistance programs, the introduction of a new means-tested social pension for those aged 65 years and older, institutionalization of a child allowance and education allowance for poor households with children, and introduction of a new targeting requirement for the previously universal parental allowance. By 2021, 56 percent of social assistance spending reached the poorest quintile (up from 44 percent prior to the reform). The establishment of the GMA allowed North Macedonia to act fast during the COVID-19 pandemic, as the government was able to quickly relax the eligibility criteria for the GMA, thereby increasing coverage of poor and vulnerable households with cash benefits during crisis.

**While the impacts of these reforms are still unfolding, other crucial elements of the broader reform process continue—all of which require close monitoring to assess their efficiency and effectiveness.** According to administrative data, coverage of the GMA and child allowance increased until 2021. While this points to some of the early benefits of the reform, there is a need to more closely monitor its full effects and those of the aspects of the reform that are still to be concluded, such as the establishment of the National Registry of Persons with Disabilities, implementation of the unified disability assessment methodology, full implementation of the Social Welfare Information System (SWIS) for administering cash benefits and social services, and changes to the way that professional staff in the Centers for Social Work (CSWs) are organized and perform case management. The impacts of the COVID-19 pandemic, followed by increases in prices arising from Russia's invasion of Ukraine and the growing risks of climate-related disasters, point to the continued need for the social protection system to protect people from these and other increasingly frequent shocks. This requires: (i) redesigning the program for energy-vulnerable consumers so

that it can expand coverage as energy prices rise; and (ii) investing further in the delivery systems and procedures of the GMA and other financial assistance (OFA) to expand coverage more quickly to new households when national or local shocks occur.

**Another explicit objective of the social protection reform, in addition to improving the targeting and adequacy of benefits, is the alignment of incentives for welfare and work.**

While spending on social assistance saw a modest increase, from 1.3 percent of GDP in 2019 to 1.5 percent in 2022, it still trails the Western Balkans average of 1.75 percent and the ECA average of 1.9 percent. Given the socioeconomic challenges, there is a need to further boost the coverage of poverty-targeted social assistance, together with: (i) enhanced outreach and communication for marginalized groups to increase take-up of eligible benefits (emerging evidence from qualitative research suggests that marginalized groups, such as the Roma, face barriers in claiming benefits); and (ii) activation of social assistance beneficiaries who are able to work. The latter entails effective coordination between CSWs and Employment Centers to activate GMA beneficiaries into the labor market, including intensive counseling and support on the one hand and close monitoring of job search efforts on the other. Aligning incentives so that they encourage job searches, training, and eventually taking on a job requires establishing income thresholds that allow GMA beneficiaries to gain access to the labor market without immediately losing access to social benefits.

**The 2019 reform introduced a new model for social services, laying the foundation for increasing access to and improving the quality of social services.**

Social services are now delivered by private providers, with financing from and oversight and monitoring by the MSPDY. However, the coverage of social services remains uneven across geographic areas and types of services. To improve access to services, the MSPDY has committed to increasing funding for service delivery, recognizing the need to explore a larger role for the private market to finance and deliver some services as well as co-payments for some publicly financed services. Service quality is currently assured through the licensing of organizations and staff, with further investments needed to strengthen compliance monitoring and establish quality standards, which will help to ensure the quality of the services provided. Expanding access to home care and day care for elderly people is one aspect of an LTC system. To allow people to age in place with dignity, these care services will need to be complemented by investments in the health system, supported by collaboration between the MSPDY and the MoH on policy direction, financing, and service delivery. In parallel, improving access to care services is anticipated to enable caregivers—primarily women—to enter the labor market.

**North Macedonia faces challenges within its pension system, which is crucial for ensuring poverty protection and consumption smoothing for older adults.**

Payroll taxes contribute 18.5 percent to the pension system, yet the system's sustainability is threatened by ad-hoc policy changes and a lack of long-term actuarial analysis to inform these policy decisions. Given population aging, high emigration, and limited fiscal resources, it is difficult to affordably provide higher pensions. Frequent, uncommunicated changes to pension policy further erode trust in the system. It is essential to minimize redistribution within the pension system and use social assistance programs to target benefits effectively to vulnerable older adults. Comprehensive pension reforms must be integrated with broader policy discussions on enabling older adults to work longer and providing cost-effective LTC, as discussed above, which is crucial as the population ages.



### 3. Policy Responses for Consideration

#### Short-term measures:

- **Complete the rollout of the Social Welfare Information System and ensure its use by all CSWs.** It will be important to reinforce the use of case management in all CSWs and strengthen outreach and communication to enhance access among marginalized groups.
- **Improve the quality of social services and expand their coverage.** This will require further strengthening compliance and oversight functions, and introducing quality standards for social services. There is also a need to continue to increase the number and reach of service providers.
- **Conduct long-term projections of the pension system before any ad-hoc changes.**
- **Finalize the reform of the disability assessment system and the system of employment of persons with disabilities.** It will be necessary to adopt the new disability assessment methodology, establish the Central Disability Certification Coordination Unit, establish Rehabilitation Centers, and adopt the Law on Employment of Persons with Disabilities.

#### Medium-term measures:

- **Expand the availability of LTC for the elderly.** It will be important to coordinate with the MoH to expand the provision of LTC (care and medical services), with a focus on allowing people to remain in their homes longer.
- **Strengthen the ability of the social assistance system to respond to shocks.** This will involve: (i) redesigning the program for energy-vulnerable consumers; and (ii) further investing in the delivery systems and procedures of the GMA and OFA.
- **Consider broadening the GMA.** It will be important to assess the current coverage of the GMA and consider options to expand it to cover more individuals from the bottom income quintile.
- **Enhance women's employment.** Key steps include implementing policies that remove barriers to women's employment, including affordable child care and flexible working hours, and exploring the care economy as a potential job creation avenue for women.
- **Consider pension reforms that improve links between the non-contributory and contributory systems.** Coordination across these schemes would allow for more efficient spending on pensions, whereby general revenues are used to protect the most vulnerable rather than subsidizing those who choose to underreport at the minimum wage level or to contribute merely to meet the 15-year eligibility rule.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• The <b>Social Services Improvement Project</b> and the <b>Second Social Services Improvement Project</b> aim to expand access to and improve the quality of social services and preschool services for vulnerable groups.</li> <li>• The <b>Social Insurance Administration Project</b> aims to improve the quality of services in administering social insurance and to strengthen the regulatory framework for persons with disabilities.</li> <li>• <b>Advisory services and analytics (ASA) on LTC</b> for the elderly are under way, including an assessment of the private market for LTC and LTC financing across the MSPDY and MoH.</li> <li>• ASA on pension policy support to Western Balkans countries.</li> <li>• TA to support the effective reintegration of Roma returning migrants, with a particular focus on <b>activating Roma women</b> to engage in the care economy.</li> <li>• TA on social accountability to <b>enhance access to social assistance among marginalized groups</b>, with a particular focus on the Roma community.</li> <li>• The <b>Public Finance Review</b> provides the analytical underpinnings for policy choices to ensure the medium- to long-term sustainability of public finances.</li> </ul>
<p><b>Pipeline</b></p>	<ul style="list-style-type: none"> <li>• The <b>Human Development Project</b> will seek to enhance the quality and relevance of secondary education and facilitate the transition from school to work.</li> </ul>
<p><b>Potential Engagements</b></p>	<ul style="list-style-type: none"> <li>• <b>Additional financing to the Second Social Services Improvement Project</b> will focus on improving access to employment among vulnerable groups.</li> <li>• <b>LTC for the elderly</b> to improve the provision of good-quality health and care services in home, community, and residential settings across the public and private sectors.</li> </ul>



# Jobs and Migration



# 6 Jobs and Migration

## 1. Overarching Messages

**North Macedonia struggles to create better and higher-paying jobs for its citizens and to maximize the benefits of migration.** To achieve its development goals, and in line with its National Employment Strategy 2027 and its goal of EU integration, North Macedonia must commit to employment-focused growth, focusing on policies that increase the accumulation and utilization of human capital, boost productivity, and ultimately reallocate labor and capital to more productive sectors.

## 2. Key Challenges

**Despite some progress, North Macedonia continues to face significant challenges in generating high-quality, formal job opportunities, with stark inequalities in the labor market—particularly among women and young people—highlighting a serious underutilization of human capital.** While formal employment has increased from 43.5 percent to 56.7 percent since 2010, and informal work dropped from 26.2 percent to 12.2 percent, there is still a shortage of good-quality jobs in the country, fueling emigration. At the same time, an aging demographic diminishes the working-age population, intensifying strain on the labor market and prompting the need to attract foreign skilled labor. This situation is compounded by significant gender and youth disparities, with female labor force participation at only 44 percent compared to 66 percent for men, and youth unemployment at 32.6 percent, alongside an 18.7 percent NEET rate. The underutilization of human capital, with a child today projected to reach 56 percent of their adult productivity potential (and a mere 29 percent when labor market outcomes are considered), indicates a disconnect between educational outcomes, labor policies, social services, and market demand. Without strategic efforts to enhance productivity and integrate the untapped workforce into the formal economy, North Macedonia risks exacerbating its labor market challenges, potentially stalling economic growth and development.

**Emigration impacts labor market dynamics, with limited positive spillovers.** Over the years, 700,000 people born in North Macedonia—about 35 percent of the current population—have moved overseas.<sup>19</sup> However, North Macedonia has not capitalized on this heavy outmigration to bolster economic growth through knowledge transfer, network expansion, remittances<sup>20</sup>, or increased investments, due to inadequate programs for diaspora engagement and investment, as well as widespread corruption.

**A critical bottleneck in North Macedonia's economic progress is its persistently low and stagnant productivity.** This is driven by several interlinked issues. Limited market access stifles international competition and innovation, while many firms are slow to adopt new technologies and continue to use resources inefficiently. Moreover, the dynamics of firm entry and exit, which are crucial for economic growth, are stifled, perpetuating the survival of underperforming businesses.

<sup>19</sup> Major diaspora communities are in Türkiye, Germany, Switzerland, Italy, and Australia. Since 2010, the population count in North Macedonia decreased by 230,000 units.

<sup>20</sup> Official remittances represent currently 3.4 percent/GDP, or less than half of the average in the Western Balkans.

**North Macedonia's labor market has undergone a significant transformation over the last decade, with agricultural employment decreasing to 13 percent and the service sector expanding to comprise over 55 percent of all employment, signaling a move toward jobs with higher economic value.** This shift, however, may expose the shortage of qualified employees and the need to upgrade the workforce's digital literacy, higher cognitive skills, and soft skills required for these emerging service-based roles. While 82.8 percent of women and 84.4 percent of men who are employed have higher education degrees, only 16.1 percent of women and 43.3 percent of men with lower education levels hold jobs, and many are long-term unemployed.<sup>21</sup> Addressing these skill disparities will be crucial to maximize the potential impact of economic transformation.

**The educational system and social protection measures, including Active Labor Market Programs (ALMPs) and adult training, are not adequately preparing individuals for today's labor market and do not address existing skill gaps to ensure the protection of citizens from job loss and income shocks.**<sup>22</sup> To improve employment outcomes and economic productivity, these programs must be realigned to offer targeted, practical training that directly enhances workforce readiness and adapts to current labor market needs. Delivery of these reformed programs requires enhanced administrative capabilities and funding of institutions responsible for implementing ALMPs and training initiatives, ensuring that they have the resources, technology, and expertise necessary to execute these programs effectively and measure their impact. To date, coverage of ALMPs and their responsiveness to emerging market demands are low. Their effectiveness is unknown or, as in the case of the Youth Guarantee, has decreased over time.

### 3. Policy Responses for Consideration

**Several policy responses could help strengthen the availability and quality of jobs in North Macedonia.** These include measures to: (i) increase labor demand in productive sectors; (ii) invest strategically in labor market-relevant skills, including on-the-job training; (iii) address barriers to access to productive employment among women and youth; and (iv) manage the risks and harness the benefits of migration.

#### Short-term measures:

- **Improve the competitive environment and innovation (see policy note #8 on private sector development).** This will include developing a comprehensive investment strategy that shifts away from investors looking for low-cost labor and extensive subsidies and toward higher-quality investments that can open up better-paid jobs, bring research and development (R&D) centers to North Macedonia, and more effectively integrate with the domestic economy. In addition, it will be important to update the range of small and medium enterprise (SME) support programs to focus on increasing SME productivity and growth. To achieve this goal, it is imperative that the government create an even playing field and a productivity-fostering business environment, reducing corruption, favoritism, and opaque regulatory practices.
- **Establish incentives for hiring vulnerable workers.** This could include reducing the cost

<sup>21</sup> The disproportionately high tax burden on low-wage earners, with a tax wedge of 46.3 percent, serves as a disincentive for entering formal employment, exacerbating issues of underemployment and informal labor. This high taxation rate not only discourages work in the formal sector but also discourages the overall economic participation of lower-income groups, further entrenching poverty and limiting economic mobility.

<sup>22</sup> Less than 6 percent of the registered jobseekers receive unemployment benefits (data from March 2024), or less than 9 percent when including those who became unemployed due to the privatization of state-owned enterprises.

of (formal) labor for low-skilled and other vulnerable workers to help address information and labor cost barriers, particularly in sectors with labor shortages.

- **Establish training incentives for workers.** Employers can be encouraged to provide on-the-job training through incentives like individual learning accounts, allowing workers to upgrade their skills independently of employment status, and preparing them for future job markets.
- **Review and strengthen the impact of the Youth Guarantee.**
- **Engage the diaspora.** Members of the diaspora can be mobilized to support economic development through mapping and outreach efforts, cultural exchange events, and financial incentives for investment.

#### Medium-term measures:

- **Review unemployment insurance.** It would be useful to conduct a review of benefit amounts, duration, contributions, and rates to increase coverage and incentivize formal work.
- **Develop a comprehensive LLL infrastructure.** This would support ongoing skills development, with a focus on in-demand green and digital skills. It will be important to invest significantly in upskilling and reskilling programs for adults, including high-quality vocational courses that align with labor market demands, to progressively develop a highly skilled workforce.
- **Strengthen the school-to-work transition.** This can be accomplished by fostering job-relevant skills in education and further strengthening collaboration between education institutions and employers, especially in vocational and tertiary education.
- **Enhance women's employment.** It will be necessary to implement policies that remove barriers to women's employment, including ensuring affordable child care and flexible working hours, and to explore the care economy as a potential job creation avenue for women.
- **Manage migration and establish global skills partnerships.** Global skills partnerships can help balance the retention and migration of skilled workers, ensuring that training aligns with both domestic and international skill needs. In addition, developing migration strategies, including bilateral labor agreements with countries like the Philippines, India, and Nepal can support the strategic integration of foreign workers into the local labor market.

## 4. World Bank Group Engagement

<p>Ongoing Support</p>	<ul style="list-style-type: none"> <li>• <b>(Second) Social Services Improvement Project</b></li> <li>• <b>Primary Education Improvement Project</b></li> <li>• <b>Agriculture Modernization Project</b></li> <li>• <b>Western Balkans Trade and Transport Facilitation, Local Roads Connectivity Project, and Road Upgrading and Development Project</b></li> <li>• <b>Promoting Jobs and the Care Economy</b> assessment of needs for, and staffing of, LTC services for the elderly (including labor and skills shortages, skills mix, and training).</li> <li>• Europe 2020 TF: <b>Supporting Effective Reintegration of Returnees</b></li> <li>• <b>Public Finance Review</b></li> <li>• <b>Gender Assessment</b></li> <li>• <b>Regional initiatives:</b> <ul style="list-style-type: none"> <li>- <b>Western Balkans Trade Facilitation Advisory Project Phase II</b></li> <li>- Support to Western Balkans Common Regional Market Initiative</li> <li>- Regional Private Sector Growth</li> <li>- Regional Remittances and Payments Systems</li> <li>- Regional Financial Stability</li> <li>- Debt Resolution Project Phase II</li> <li>- Manufacturing Value Chains project</li> <li>- Eco-Industrial Parks (WBIF)</li> </ul> </li> </ul>
<p>Pipeline</p>	<ul style="list-style-type: none"> <li>• A <b>Country Economic Memorandum</b> will focus on boosting growth and higher-value-added jobs.</li> <li>• <b>TA on Leveraging Migration for Development</b></li> </ul>
<p>Potential Engagements</p>	<ul style="list-style-type: none"> <li>• A potential <b>Human Development Project</b> would seek to enhance the quality and relevance of secondary education and facilitate the <b>transition from school to work</b>.</li> <li>• Support may be provided for the development of <b>global skills partnerships</b> and strengthening of <b>diaspora engagement</b>.</li> </ul>





# Financial Sector



# 7 Financial Sector

## 1. Overarching Message

**A sustainable economic recovery requires deeper financial intermediation, supported by a resilient and stable financial system.** Increased access to finance among micro, small, and medium enterprises (MSMEs), long-term financing, asset-based financing, innovation, and equity financing are needed to stimulate the modernization, digitalization, decarbonization, and productivity growth of companies, as well as the proliferation of start-ups and knowledge-based services. North Macedonia's financial system is bank-centric and risk-averse, with limited stock exchange activity, limited investment funds, and emerging fintech companies. Insurance and securities markets are underdeveloped. Meeting the growing demand for green financial instruments will be essential to accelerate North Macedonia's green transition, and further reforms are needed to integrate climate-related risks into regulatory and supervisory frameworks and boost the capacities of regulators and financial institutions alike.

## 2. Key Challenges

**MSMEs' access to finance is constrained.** MSMEs usually face greater difficulties in obtaining credit than larger firms. In North Macedonia, banks usually require at least three years of business records, a solid credit rating, and good financial accounts to lend to MSMEs, which limits access, particularly among micro and small firms. Collateral (mostly real estate) is also usually required, a condition that micro firms and small firms cannot meet easily. Banks rarely lend against movable collateral due to limitations in the law on contractual pledges, problematic enforcement, and a non-existent secondary market. Alternative financial products, such as factoring and credit guarantees, which can adequately cater to the MSMEs, are alternatives that address those market gaps.

**The Development Bank of North Macedonia (DBNM) has the potential to play a more significant role on MSME access to finance.** The DBNM's primary tool to support SME access to bank financing has been credit lines to commercial banks, funded predominantly by international financial institutions and focusing on greening the private sector, the proceeds of which are on-lent to SMEs. The DBNM's newly introduced partial credit guarantee (PCG) program may offer a better tool to ease collateral requirements and broaden SME access to finance. Enhancements in the existing sector strategy, as well as of the legal and regulatory framework, corporate governance, risk management, and operational frameworks could boost the efficiency of the PCG program.

**Lack of awareness, a narrow target focus, and operational limitations are constraints to a more robust use of factoring.** The factoring market in North Macedonia is relatively small<sup>23</sup> and is targeted mainly toward corporate clients. Yet factoring can offer an immediate solution for the working capital needs of micro and small companies, due to their limited access to funding, difficulties in managing cash flow, and payment delays<sup>24</sup> (despite prompt payment legislation).

<sup>23</sup> It represents less than 0.5% of the total GDP.

<sup>24</sup> 87 days on average to collect a receivable in 2022, but much higher for micro and small enterprises (100.5 days), enterprises that do not have bank loans (101 days) and enterprises generating losses (144 days).

**A robust financial safety net is necessary to preserve stability of North Macedonia's financial sector against future banking crises.** While the recent adoption of the Law on Financial Stability and the Law on Bank Resolution has strengthened the authorities' ability to monitor and respond to systemic risks, further enhancements are needed to align North Macedonia's financial sector regulatory framework with the EU acquis, including on regulatory aspects of financial risks stemming from climate change. The depositor protection framework needs substantial improvement. It is among the least developed in the region, hampered by a weak institutional environment, an outdated legal framework, and inadequate implementing regulations. Operationalization of the new Resolution Law is essential to enhance the ability to effectively manage failing banks and crisis situations.

**Reducing the cost of cross-border payments is needed.** By modernizing payment systems and joining the Single Euro Payments Area (SEPA), North Macedonia can increase financial inclusion, bring more competition and innovation in payments, and drive down costs for end users for domestic as well as cross-border digital payments. The average cost of sending remittances to North Macedonia is 7 percent of the total transaction amount, far above the Sustainable Development Goal (SDG) target of 3 percent. Furthermore, business-to-business cross-border transfer fees could be reduced by up to 6 times to reach EU levels.

**Financial literacy and financial management practices in micro and small enterprises are particularly weak.** They rely mostly on external accountants whose main responsibility is to prepare financial statements for tax purposes. Improved financial and overall management practices will improve firms' creditworthiness; capacity to invest, innovate, and grow; and resilience to external stresses. The current financial reporting requirements are not fully aligned with International Financial Reporting Standards.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Strengthen the design and controls of the PCG program.** Specific actions include: (i) defining its risk appetite and expected leverage; (ii) revisiting the guarantee coverage and interest rate caps; (iii) setting up a risk-based policy for concentration limits and a framework for control, monitoring, and evaluation; (iv) expanding the potential business volume for partner financial institutions; (v) allowing parallel use of DBNM credit lines and guarantees; (vi) improving the information technology (IT) system for electronic data exchange with partner financial institutions; (vii) strengthening governance.
- **Finalize the establishment of a strong financial sector safety net.** Key steps include: (i) adoption of a new Law on Deposit Insurance and related regulations, in line with international and EU standards; (ii) integration of climate-related risks into the supervisory framework, including conducting climate stress testing; (iii) further alignment with evolving bank prudential requirements in the EU; (iv) enhancement of resolution framework for non-performing loans, including via corporate viability assessments; (iv) operationalization of new EU-aligned bank resolution framework; and (v) establishment of interagency coordination protocols.
- **Integrate payment systems into SEPA. SEPA allows customers to make cashless euro payments.** Joining SEPA will unlock the transformative impact of digital payments and

better satisfy the payment needs of consumers and businesses. Once it joins SEPA, North Macedonia will be connected in real time and without borders to the European payments market, opening up massive opportunities for digital payments growth and reducing the cost of remittances.

**Medium-term measures:**

- **Reinforce the role of the DBNM and improve the business environment for factoring. The DBNM is well-positioned to spearhead the development of factoring.** Strategic measures include revising the selection criteria for SMEs, expanding industry coverage, expanding the offer of non-recourse factoring products and introducing reverse factoring, strengthening IT systems, and introducing an e-factoring application. Initiatives for improving the business environment for factoring include supporting the implantation of e-invoicing at the national level and maintaining a national registry, adopting necessary laws and bylaws, establishing an online platform portal, developing a promissory note register, and establishing a collateral registry.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<p><b>World Bank</b></p> <ul style="list-style-type: none"> <li>• A <b>Sustainability and Resilience Development Policy Operation (DPO)</b> was approved in December 2023 to support North Macedonia's efforts in financial sector climate transition and safeguard financial sector stability. It encompasses reforms to strengthen the financial safety net, enable more effective bank resolution, strengthen the National Bank of the Republic of North Macedonia's macroprudential mandates, and manage climate-related financial risks to help prevent and reduce systemic risks.</li> <li>• <b>Technical assistance is being provided on deposit insurance, NPL resolution, bank supervision (including climate), and bank resolution</b> via better regulatory frameworks and operational procedures and improved capacities of the National Bank of the Republic of North Macedonia, the Ministry of Finance, and the Deposit Insurance Fund.</li> <li>• <b>Technical assistance is being provided on modernization of payment systems</b>, covering payment regulations and other requirements to achieve SEPA readiness, modernizing the payments infrastructure, and implementing reforms related to digitalization and financial inclusion.</li> <li>• The <b>Road to Europe: Program of Accounting Reform and Institutional Strengthening (REPARIS)</b> aims to: (i) further improve SME access to professional accounting and financial management services in the Western Balkans; and (ii) align Western Balkans corporate financial reporting frameworks with relevant EU directives and regulations.</li> </ul>
<p><b>Potential Engagements</b></p>	<p><b>World Bank</b></p> <ul style="list-style-type: none"> <li>• Through an investment project financing operation, the World Bank can support the DBNM in <b>strengthening and leveraging the PCG program and the use of factoring</b> through support for the drafting of laws and regulations, software acquisition, and capacity building.</li> <li>• A regional <b>Payments Systems Modernization Project</b>, under preparation, can further support the national bank with investments in payment infrastructure. Possible TA will be available to support the implementation of SEPA scheme rules (once North Macedonia joins), integration with the European Central Bank TARGET Instant Payment System (TIPS), and the development of overlay services and regional interoperability (for example, QR codes).</li> </ul> <p><b>International Finance Corporation (IFC)</b></p> <ul style="list-style-type: none"> <li>• <b>MSME credit lines</b> (including addressing gender issues and climate transition) with banks, non-bank financial institutions, and regional platforms</li> <li>• <b>Advice and analytics on asset-based financing and recovering debt</b> in the context of IFC's Western Balkans engagement</li> </ul> <p><b>Multilateral Investment Guarantee Agency (MIGA)</b></p> <ul style="list-style-type: none"> <li>• The DBNM may use the <b>MIGA-covered loan facility to finance SMEs</b>, focused on projects related to women in business, digitalization, and climate finance.</li> <li>• The MIGA-covered trade loan facility may provide <b>short-term loans for trade-related payments</b>, aimed at supporting key sectors of the economy.</li> <li>• MIGA may help multilateral development banks attract financing from foreign private commercial banks at attractive terms and conditions.</li> </ul>



# Private Sector Development and Innovation





# 8 Private Sector Development and Innovation<sup>25</sup>

## 1. Overarching Messages

**North Macedonia needs a more vibrant private sector to boost potential GDP growth so that income levels can converge more quickly with average EU income levels.**<sup>26 27</sup> Private sector growth has been driven by a few, export-oriented companies—largely foreign firms in the automotive industry—and by the domestic pharmaceutical and information and communication technology (ICT) sectors. MSMEs are dominant in the economy, but have in recent years exhibited weak or stagnant productivity growth, low levels of digitalization, and limited integration with regional and global value chains. As a result, they struggle to create high-quality jobs that would retain skilled labor in the country. Boosting the productivity and competitiveness of the domestic private sector would require: (i) well-designed and targeted public policies and support programs to attract and preserve high-quality investments (both foreign and domestic); (ii) stronger technology-related services and better-quality infrastructure to boost the creation of higher-value-added products and services; (iii) efforts to foster a strong labor force by reducing mismatches, and through reskilling and upskilling; (iv) improved access to finance, especially for MSMEs; (v) the promotion of digital transitions in both the government and the private sector; and (vi) acceleration of the green transition in the private sector.

## 2. Key Challenges

**The business environment in North Macedonia is not conducive to attracting high-quality investments or promoting exports.** Fragmented, complex, and frequently changing trade regulations, coupled with inefficient public institutions that lag behind in policy implementation, hold back business growth. Regional and international trade is stifled by lengthy bureaucratic processes for cross-border transit, export requirements, and limited digitalization of processes. R&D and innovation are hampered by poorly targeted investment and state aid policies, which in turn limit productivity growth and the creation of better-paid jobs.

**Access to technology and knowhow is limited, and demand from MSMEs is weak.** There are currently only a few centers of excellence providing advisory, technology extension, and innovation services. These centers are small, however, and unfit to meet the needs of the market. Less sophisticated MSMEs typically overestimate their level of technological development and lack awareness of available technological solutions and the benefits they might bring. Firms have not established adequate linkages with academia for innovation and technology transfer to support the introduction of innovative products, services, and processes. The quality infrastructure (including testing, certification, and standards) and export readiness and promotion services are underdeveloped, resulting in less than 4 percent of firms exporting, a low level of export complexity, and a small number of new exporters. Consequently, and as shown by the 2023 Enterprise Survey results, firms in

<sup>25</sup> The financial sector issues are largely excluded or only briefly mentioned in this note since they are already included in a separate Financial Sector Note

<sup>26</sup> North Macedonia currently stands at 42 percent of EU27 GDP per capita in purchasing power parity terms

<sup>27</sup> Potential GDP growth rate has fallen to less than 2 percent per year (CPF FY24-FY28).

North Macedonia lag significantly behind firms in other UMICs in introducing new products and services (at 14 percent and 29.1 percent of firms, respectively) and process innovations (11.8 percent and 18.6 percent of firms, respectively).

**The shortage of skilled and unskilled labor limits firm capabilities.** In 2023, labor shortages continued to be among the top concerns raised by businesses in the Western Balkans. Structural factors, such as rigid regulations that are not aligned with market needs, an aging population, and significant gender gaps, contribute to low labor force participation and high informality in North Macedonia. Despite the labor shortage, unemployment and inactivity remain high, especially among young people, women, and minorities, reflecting a serious mismatch between skills supply and demand. The emigration of skilled professionals out of North Macedonia and regulatory barriers to immigration of qualified workers exacerbate these difficulties.

**Both the public and private sectors need to speed up digital transformation.** Digitalization is low in North Macedonia for both the public and private sectors. Despite major efforts in recent years, the country ranked 80<sup>th</sup> in the world on the 2022 e-Government Development Index, which is low compared to EU countries and some regional peers. Business e-services are uneven across government agencies, and the lack of automatic data sharing among institutions imposes additional time and cost requirements on companies. At the firm level, understanding of and demand for digitalization are quite low, especially among MSMEs. Development of e-commerce capabilities remains at a nascent stage, despite enormous potential, as North Macedonia ranks last in the Western Balkans region on the level of e-commerce. The main challenges include e-invoices, digital fiscal bills, and lack of cross-border delivery.

**The slow pace of the private sector's green transition is due to both regulatory and demand side-barriers.** The upcoming CBAM and potential carbon tax will adversely affect firms' financial performance, as they are ill-prepared to meet the reporting requirements and reduce their carbon emissions. On the demand side, awareness raising and TA are needed. The recent energy crises spurred interest among companies to turn to renewable energy sources (such as rooftop photovoltaics) and improve the energy efficiency of their buildings and production processes, but a lot more needs to be done to improve their energy intensity (created output per energy input). Levels of recycling and waste utilization are extremely low.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Enhance the quality of vocational training** by expanding the use of curriculum modules taught by industry professionals and arranging visits from experts in science, technology, engineering, and mathematics (STEM) education.
- **Boost training in digital and green skills** for firms and all employment-eligible age groups, including youth and women.
- **Improve labor regulations to introduce more flexible working arrangements for domestic workers and simplify work permits and visa applications for foreign workers,** especially technical experts and managerial personnel and their dependents.
- **Improve public and private sector efficiency by accelerating their digital transitions.** On the government side, strengthen the capacity of the relevant line ministry to drive digital transformation reforms and introduce e-government services to reduce the time and cost

of services for the private sector. On the solution provider side, support local providers to develop affordable solutions to meet the specific digitalization and automation needs of MSMEs.

- **Improve trade facilitation by: (1) adopting the draft Law on Single Window for Trade** to allow implementation of the new National Single Window (NSW) system; and **(2) reducing border clearance times** by providing a single system/window for traders to electronically submit regulated and harmonized data to complete foreign trade transactions.
- **Update the range of SME support programs to increase SME innovation, productivity, and growth; align them with the recently adopted Smart Specialization Strategy; and increase the capacity of the DBNM and the Fund for Innovation and Technological Development** to transparently, effectively, and efficiently implement those programs.
- **Implement the State Aid Management Information System and use the collected data for evidence-based policy decision making.**

**Medium-term measures:**

- **Improve firms' access to up-to-date technologies and knowhow, as well as quality and certification services, by strengthening technology extension services and the quality infrastructure.**
- **Strengthen the centers of excellence as key building blocks of the innovation ecosystem.** The aim would be to ensure that the centers become sector-based “go-to places” for technology solutions, including digital solutions for firms. Such services need to be private sector-driven and operated by highly competent professional managers with both academic and business backgrounds.
- **Improve the capacity of selected technology institutions** by strengthening their linkages with businesses and ensuring that they have skilled personnel and first-class equipment to enable them to provide standards, quality, and export certification services.
- **Align domestic firms with global requirements on climate change to help them maintain and increase competitiveness (especially export competitiveness).** This would require adopting and enforcing the law on industrial emissions, integrated permitting, and strengthening the green finance market by mobilizing both public and private resources.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• <b>Regional Trade and Transport Facilitation Project (FY20–25) (Phase 1 allocation to North Macedonia US\$30m).</b> Phase 1 focuses on: (i) facilitating the movement of goods through trade facilitation reforms (including the NSW and improvements in border crossing points); (ii) enhancing transport efficiency and predictability through Intelligent Transport Systems; and (iii) supporting the implementation of provisions to improve market access.</li> <li>• <b>Competitiveness for Jobs and Economic Transformation (C-JET) grant (US\$100,000) to assess the digital and green transformation needs of MSMEs.</b> This work aims to increase the knowledge base and policy-making capacity by identifying gaps between MSME needs for green and digital transitions and available quality infrastructure and technology extension services to support the implementation of the Smart Specialization Strategy.</li> </ul>
<p><b>Pipeline</b></p>	<ul style="list-style-type: none"> <li>• <b>Private Sector Development and Access to Finance (tbd).</b> The design of this project is at an early preparation and discussion stage. It aims to help the private sector become more productive and competitive within the EU accession framework, particularly by providing MSMEs with better access to innovative technologies and finance.</li> <li>• <b>Western Balkans Trade and Transport Facilitation Multiphase Programmatic Approach Project 2.0.</b> This proposed project focuses on reducing trade costs and improving transport efficiency between the Western Balkans and the EU. Tentative components include: second-generation trade facilitation reforms to align with EU trade procedures, national quality systems for exports to meet EU market standards, transport logistics performance, and critical medium- and small-scale investments at key logistics nodes to address key bottlenecks.</li> </ul>



# Decarbonizing the Economy





# 9 Decarbonizing the Economy

## 1. Overarching Messages

**Pressing on the decarbonization agenda to achieve net zero emissions by 2050 is possible, with costs that will need to be managed appropriately.** North Macedonia has committed to reducing net greenhouse gas emissions (GHG) by 82 percent by 2030, compared to 1990 levels.<sup>28</sup> Furthermore, as a signatory of the Sofia Declaration on the Green Agenda for the Western Balkans (2020), the country has committed to aligning with the EU ambition of Net Zero by 2050. North Macedonia also has sector-specific emissions reduction targets, with the greatest focus on emissions from the energy sector.<sup>29</sup> Decarbonization will bring many benefits beyond meeting climate commitments, including, *inter alia*, improved competitiveness of the economy, decreased reliance on imports, increased economic resilience, and enhanced health outcomes.<sup>30</sup> At the same time, decarbonization will require significant transformation of all energy end-use sectors, including in power, transport, industry, and buildings. The total amount of money required to decarbonize the economy is estimated to be US\$5.6 billion until 2050 (about US\$110 per person per year in current 2020 dollars), or 2.8 percent of GDP per year.<sup>31</sup> The economic costs of the transition need careful management, especially with respect to their distributional impacts. Meeting climate commitments will improve alignment with the EU's net zero ambition, limiting further delays in achieving EU accession.

## 2. Key Challenges

**Reducing emissions requires efforts across multiple sectors, starting from the transformation of the domestic power sector.** The largest contributors to emissions in the country are electricity and heat production (36 percent), transport (20 percent), waste (13 percent), agriculture (12 percent), and manufacturing and construction (11 percent).<sup>32</sup> The power sector is essential to North Macedonia's goal of achieving net zero emissions. For electricity generation, the country currently depends on domestic coal (54 percent of generation), gas from Russia (17 percent of generation), and electricity imports (21 percent of total power consumption).<sup>33</sup> Its coal reserves are depleting quickly, however, leading to costly imports, which is exacerbating energy security and affordability concerns. The country's carbon intensity is 2.7 times higher than the EU27 average.<sup>34</sup> The renewable energy target is 38 percent of final energy consumption by 2030.

28 Detailed in its Enhanced Nationally Determined Contribution (NDC) and its National Energy and Climate Plan (NECP).

29 NECP's Emissions reduction targets by sector: energy (-66%), industry (-45%), agriculture (-29%), forests and land (-95%) and waste (-21%).

30 3,800 people die prematurely from air pollution each year and pollution levels in Skopje are 14 times higher than recommended guideline levels from the World Health Organization (WHO).

31 Western Balkan Six Country Climate and Development Report (CCDR), North Macedonia Country Compendium Note. [Publication pending].

32 Data from Climate Watch (2023).

33 Energy Regulatory Commission of North Macedonia (2022). Annual Report 2022.

34 IEA (2021). Indicators for CO<sub>2</sub> emissions and World Indicators. NM vs EU-27: 0.35 vs 0.13 kg CO<sub>2</sub> per 2015 USD PPP (CO<sub>2</sub>/GDP PPP)

**Coal phaseout is planned by 2030.**<sup>35</sup> The closure of the Oslomej and Bitola power plants is expected to make the most significant contribution toward decarbonization over the medium term. Assuming the phaseout of coal by 2030, achieving net zero emissions would require power sector emissions to decrease from about 4.2 million tons of carbon dioxide equivalent (MtCO<sub>2</sub>eq) in 2019 to 0.5 in 2030, to nearly zero in 2040.<sup>36</sup> This implies aggressively scaling up renewable generation from 25 percent (2019) to 97 percent in 2050, installing an additional 1.7 GW of solar and 0.7 GW of wind power generation by 2030 and 5.8 GW of solar and 0.8 GW of wind power generation by 2050. The integration of North Macedonia's energy system through electricity market coupling with neighboring countries—including Greece, Bulgaria, Albania, Kosovo, and Serbia—will allow more efficient energy management, further contributing to decarbonization.

**Transforming transport, industry, and buildings is essential for reducing CO<sub>2</sub> emissions.** Demand for individual transportation would have to shift from cars to other forms of transport (such as walking, cycling, and public transport). This would have to be complemented by investments in the electrification of cars and in freight transport, construction of new railway infrastructure in the eastern part of Corridor VIII, and rehabilitation of Corridor X. Energy efficiency standards will need to be upgraded and enforced, promoting the electrification of building appliances and industrial processes.

**Reducing methane emissions is possible.** Emissions of methane, a significantly more potent GHG than carbon dioxide (CO<sub>2</sub>), can be reduced by improving agricultural practices through more efficient livestock management, manure management, and fertilizer application. Waste collection practices should minimize dumping and divert organic waste from landfills.

**Decarbonizing the economy requires private sector involvement.** The level of investment required to achieve net zero emissions is high, but the private sector would be well placed to meet more than 80 percent of the investment needs.<sup>37</sup> To enable this, the government needs to create a regulatory environment that attracts green investment, including market-based competitive support schemes (such as renewable energy auctions) or PPPs. The government is already taking positive steps in this direction, with the first large-scale solar plant development on the Oslomej lignite coal mine designed as a PPP with the power utility Elektrani na Severna Makedonija. Building on this momentum, facilitating public-private research collaboration, minimizing the administrative burden imposed on green investments, ensuring attractive interest rates, and issuing green bonds would encourage further private sector involvement in the green transition.

**The transition to a cleaner economy needs to be a just one.** The green transition will affect brown industries (and adjacent businesses) in particular as carbon-intensive activities are phased out. Brown jobs provide employment for approximately 6.5 percent of North Macedonia's workforce, but interconnectedness with dependent industries will require the retraining of approximately 17 percent of the workforce in the medium term. The country adopted a Just Transition Roadmap in June 2023, which outlines measures to ensure that those in coal-dependent communities, specifically Pelagonija and the Southwest region, have the necessary skills to adapt to changing workforce requirements. Consistent implementation of this roadmap will be critical to ensure that no one is left behind in the transition.

**Institutional collaboration is essential.** The World Bank's Climate Change Institutional

<sup>35</sup> NECP states the phase-out in 2027, but adjustments are under discussion to postpone it to 2030.

<sup>36</sup> *Idem* footnote 32

<sup>37</sup> *Idem* footnote 32



Assessment (CCIA) shows that North Macedonia's institutional maturity is slightly more advanced than its Western Balkan neighbors on average. However, it lags behind in establishing the organizational structures and coordination mechanisms for climate change action. Such collaboration is crucial for the long-run success of the green transition. The country's Draft Law on Climate Action foresees the establishment of a National Coordination Council on Climate Action (NCCCCA) with an advisory role and a mandate to coordinate the national response to climate change. Timely adoption of this new law and implementation of the coordination council will be crucial to enable the necessary coordination.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Scale up renewable energy.** This would require developing a renewable energy pipeline with clear timelines and competitive support schemes and building storage capacity, such as battery storage and storage hydro.
- **Improve agricultural practices.** It will be important to enhance and enforce regulations around livestock management, fertilizer use, and manure management.
- **Invest in energy-efficient buildings, industry, and transport.** This includes enhancing energy efficiency standards and reinforcing compliance. It will also be useful to set up energy efficiency incentive programs for public and residential buildings.
- **Encourage private sector participation.** This will involve setting up regulations and incentives for private sector investment in clean technology, including auctions and PPPs.
- **Promote collaboration across ministries.** Once established, the NCCCCA will need to be adequately resourced to ensure a comprehensive approach to decarbonization.
- **Put a price on carbon.** Implementing a carbon pricing instrument that aligns with the EU's Emissions Trading System will support decarbonization in North Macedonia. It would also be beneficial to use revenue recycling to support vulnerable populations and incentivize green investments.

#### Medium-term measures:

- **Improve waste management.** This would involve improving waste collection, minimizing dumping, and investing in diverting organic waste from landfills.
- **Upgrade transport infrastructure.** It will be important to ensure that North Macedonia's rail network is compliant with Trans-European Transport Network standards, per the Western Balkans Sustainable and Smart Mobility Strategy.
- **Implement a just transition.** North Macedonia will need to launch the Just Transition Roadmap, focusing on the recently approved Investment Plan supported by the Accelerating Coal Transition (ACT) investment program under the Climate Investment Funds (CIF), and to support the economic diversification of Pelagonija and the Southwest region.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• <b>North Macedonia Public Sector Energy Efficiency Project (US\$27.4 million).</b> This project offers financing for energy efficiency projects, including municipal energy efficiency and retrofitting of health buildings and central government buildings.</li> <li>• <b>Western Balkans Six Energy Sector Programmatic ASA.</b> The focus in North Macedonia is on planning for the coal transition and protecting vulnerable populations.</li> </ul>
<p><b>Pipeline</b></p>	<ul style="list-style-type: none"> <li>• <b>Energy transition support through the ACT under the CIF (US\$85 million in total concessional funds).</b> An Investment Plan has been developed for: (i) investment in retiring and replacing coal-fired power generation assets in Bitola and Oslomej; (ii) regional economic regeneration, with investment in climate-smart industries and businesses; and (iii) energy efficiency and clean heating in coal mining regions (Bitola and Oslomej). The project is in partnership with the European Bank for Reconstruction and Development (EBRD) and IFC. The proposed project may support: (a) grid integration of renewables through transmission upgrades and energy storage; and (b) repurposing of depleted coal mines and assets to be adapted for renewable energy infrastructure.</li> </ul>
<p><b>Potential Engagements</b></p>	<ul style="list-style-type: none"> <li>• Supporting the <b>Just Transition Roadmap</b>, including sustainable heating and supporting private sector participation in green investments.</li> <li>• <b>Energy efficiency projects</b> for the residential sector.</li> <li>• <b>Grid modernization and storage.</b></li> </ul>



# Energy Sector and Just Transition



# 10 Energy Sector and Just Transition

## 1. Overarching Messages

**North Macedonia's energy sector is heavily dependent on fossil fuels and vulnerable to import-related volatility and increased energy security risks.** To reduce the country's reliance on fossil fuel imports—which account for nearly 60 percent of its total primary energy, to manage the risks associated with volatile energy markets as well as increased security risks, and to reduce high emissions (60 percent of GHGs are produced by electricity generation, followed by 10 percent from transport, heating, and agriculture), North Macedonia will need to pursue an integrated agenda to enhance the energy efficiency of both public and residential buildings, scale up renewable energy in line with the targets set in the National Energy and Climate Plan, and promote stronger integration in regional energy markets. Transitioning to a cleaner, more efficient energy sector will require considerable investments that are expected to increase electricity prices and thus potentially increase energy poverty among the society's most vulnerable groups. Advancing in the implementation of the 2023 Just Transition Roadmap will ensure that the benefits of the green economy transition are distributed fairly and that vulnerable people, regions, and communities are not left behind.

## 2. Key Challenges

**Scaling up renewable energy sources and energy efficiency investments.** North Macedonia has committed to an ambitious energy transition and climate change agenda requiring significant investment up to 2030 and beyond. The expansion of renewable energy sources is planned mostly through adding hydropower and solar photovoltaic capacity. Upgrades to the grid system and additional investments in energy transmission and storage should be prioritized to support the integration of new renewable energy capacity. The building sector requires energy efficiency improvements, combined with higher levels of electrification of heating demand and a switch to cleaner heating sources.<sup>38</sup> Legal, technical, and financial barriers are impeding progress, however. Boosting private investment in renewable energy would require addressing existing regulatory and capacity constraints that limit private sector involvement. Although the legal and regulatory framework for the Energy Efficiency Fund (EEF) has been adopted, delays in its operationalization hinder its effectiveness in closing the financing gap and meeting energy efficiency targets, particularly for public building renovations.

**Managing energy security risks.** Reducing energy security risks will be conditional on fulfilling the planned installation of additional generation capacity from renewable sources and energy efficiency targets, especially given the foreseen increase in demand and plans to phase down coal-fired power plants.

**Integrating into the EU electricity market.** North Macedonia faces challenges in regional energy market integration due to infrastructure limitations, regulatory inconsistencies, financial constraints, and heavy reliance on fossil fuels. Addressing these issues requires significant investments, technical advancements, and harmonization of legal frameworks

<sup>38</sup> Based on assessment conducted under World Bank Country Climate and Development (CCDR) report

with European and neighboring countries' standards. Accelerating electricity market integration is a core policy condition for exempting the electricity sector from CBAM payments until 2030<sup>39</sup> and will contribute to reducing energy security risks.

**Protecting the poorest.** Energy sector modernization requires investments that are likely to increase electricity prices, exacerbating North Macedonia's high energy poverty rate. Households in the lowest income quintile spend over 16 percent of their per-capita income on energy. Electricity accounts for more than 75 percent of total energy consumption among households in the poorest income decile and 80 percent among rural households. Social assistance recipients rely even more on electricity. Consequently, low-income households are particularly vulnerable to energy price increases, posing the risk that a larger share of the population will fall into poverty due to an energy price shock. Welfare simulations indicate that a 10 percent increase in energy prices could raise the poverty rate to 20.8 percent, 1.4 percentage points higher than the baseline.<sup>40</sup>

**Taking full advantage of international support for the decarbonization agenda.** The 2023 Just Transition Roadmap delineates the process for achieving a cleaner, greener North Macedonia. To support its implementation, the CIF approved a US\$85 million investment plan in March 2023 under the ACT program, with financial backing from the World Bank Group and EBRD. The plan includes repurposing coal-fired power generation assets in Bitola and Oslomej, promoting regional economic regeneration with climate-smart industries and businesses, and enhancing energy efficiency and clean heating in coal mining regions. Given the labor market challenges in North Macedonia, the Just Transition Roadmap must ensure income support for affected workers and communities, while efforts are needed to diversify economic activities and improve social services in communities that are dependent on thermal power plants and coal mining operations.

### 3. Policy Responses for Consideration

#### Short-term measures:

- Accelerate the **operationalization of the EEF**.
- Increase **institutional coordination and capacity** to implement planned public investments and scale up private capital investments.
- Complete the **liberalization of the electricity market** and converge towards **cost-reflective electricity tariffs to ensure the financial viability of the power sector**.
- Develop a **sustainable heating roadmap**.

#### Medium-term measures:

- Scale up **sustainable energy efficiency financing mechanisms** for the residential, industry, and transport sectors.
- Accelerate deployment of **cleaner heating solutions**, including modernization of district heating systems, prioritizing renewable energy sources, and heat pumps.
- Reduce dependence on energy imports **by investing in clean domestic energy generation**.
- **Phase out electricity price subsidies** while strengthening the program for energy-vulnerable consumers and expanding to all energy-poor households.

<sup>39</sup> Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism

<sup>40</sup> Western Balkan Six Country Climate and Development Report (CCDR), North Macedonia Country Compendium Note. [Publication pending].

- Invest significantly in **upskilling and reskilling** programs, including high-quality vocational courses that align with labor market demands, to progressively develop a highly skilled workforce.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• <b>North Macedonia Public Sector Energy Efficiency Project (US\$27.4 million).</b> The project includes financing for energy efficiency and renewable energy systems in public buildings.</li> <li>• <b>Western Balkans Six Energy Crisis Response Programmatic ASA.</b> The focus in North Macedonia is on planning for the coal transition and protecting vulnerable consumers.</li> <li>• <b>Socioeconomic Assessment of Coal Communities in Kosovo and North Macedonia.</b> As part of the Social Dimensions of Climate Change ASA, the World Bank is preparing an assessment of the current situation, potential impacts, and recommendations for the coal transition in all municipalities that are linked to the activities of thermal power plants.</li> </ul>
<p><b>Pipeline</b></p>	<ul style="list-style-type: none"> <li>• <b>Energy Transition support through the ACT under the CIF (US\$85 million in total concessional funds).</b> The World Bank’s support is envisaged in all three components (see above), with potential investments focusing predominantly on energy efficiency investments, deployment of enabling infrastructure to support the integration of renewable energy sources, and repurposing of depleted coal mines.</li> <li>• As part of the World Bank’s <b>Cooling Facility application for the Green Climate Fund</b>, North Macedonia is eligible to access US\$10.5 million in concessional financing for energy efficiency, which could be integrated into the existing Public Sector Energy Efficiency project.</li> </ul>
<p><b>Potential Engagements</b></p>	<p><b>Private sector mobilization in the energy sector</b></p> <ul style="list-style-type: none"> <li>• <b>IFC</b> will focus on several strategic actions:             <ul style="list-style-type: none"> <li>- <b>PPPs:</b> Structuring and financing PPPs to attract private investment for utility-scale renewable energy projects, setting benchmarks for pricing and contract terms to foster a competitive market environment, and assisting public counterparts, where warranted, to finalize the contractual agreements to be entered into with a private partner, as part of a negotiated deal</li> <li>- <b>Regulatory Framework Enhancement:</b> Assisting in refining regulations to promote competitive auctions for renewable projects and establishing a supportive legal framework for rooftop solar installations, including simplifying the licensing process and ensuring fair grid access</li> <li>- <b>Financial and Technical Advisory:</b> Providing technical advice and financial models to local banks to facilitate loans for individuals and MSMEs investing in renewable energy, especially rooftop solar</li> <li>- <b>Innovation Promotion:</b> Supporting the adoption of advanced technologies like battery storage and upgraded grid systems to improve energy security and efficiency</li> <li>- <b>Independent Power Producers:</b> Supporting renewable energy projects through assistance with investment preparation, as well as finance structuring and investment (own account and mobilization).</li> </ul> </li> <li>• <b>MIGA</b> is engaging with private investors to support their investments in renewable energy projects (such as wind and solar PPPs) through political risk insurance. MIGA is also looking to support renewable energy projects (for example, large-scale hydroelectric power plants) or transmission development via credit enhancement covers for sovereign government and/or eligible state-owned entities.</li> </ul>







# Digital Development



# 11 Digital Development

## 1. Overarching Messages

**Investing in digital development, aligned with the EU Digital Agenda 2030, presents a strategic opportunity for North Macedonia to foster sustainable growth and resilience.**

With a relatively high internet usage rate and widespread access to digital devices among its citizens, the country is poised to stimulate job creation and enhance economic competitiveness. To fully capitalize on digitalization and harness the potential of technologies like artificial intelligence, cloud computing, and big data, North Macedonia should prioritize the development of modern data hosting infrastructure, ensure affordable digital services for all, and promote digital skills among its people and businesses. Given its small economy, North Macedonia could accelerate digitalization through a regional approach within the Western Balkans, focusing on investments in regional digital infrastructure, such as fiber-optic links and large data centers, as well as harmonized telecommunications (telecoms) and cybersecurity policies.

## 2. Key Challenges

**Over four-fifths (83 percent) of North Macedonia's population used the internet in 2021,<sup>41</sup> on par with regional averages, but with a pronounced gender gap.** North Macedonia's internet usage rates place it ahead of 10 of 19 countries in the ECA region. While the rural/urban divide is negligible, with a gap of only 0.7 percentage points in internet use,<sup>42</sup> internet access is lower among women, at 79.2 percent, compared to 83.5 percent among men.<sup>43</sup>

**The quality of fixed internet access is quite high compared to EU countries, but prices remain unaffordable for the poorest.** Internet speed in North Macedonia is relatively high for fixed broadband, at 48 megabits per second (Mbps) in 2023, slightly above the ECA average but about 53 Mbps slower than in high-income countries. Mobile broadband speeds are on par with the regional average.<sup>44</sup> Affordability is a greater challenge, however, as fixed broadband prices<sup>45</sup> are well above the affordability threshold of 2 percent of gross national income<sup>46</sup> set by the Broadband Commission as a threshold for affordability, and mobile broadband prices are at around 1 percent. These high costs maintain a digital divide and restrict the inclusiveness of digital services within the population. Increasing competition on both retail and wholesale telecoms markets would help reduce this key barrier to adoption.

**North Macedonia's data hosting capacity does not compare well with peers, and demand**

41 Data as of 2021. Source: World Bank, Digital Progress and Trends Report 2023

42 MakStat, "Individuals regularly using the Internet (every day or at least once a week), - by type of settlement (urban, other), last available data: 2017.

43 ITU, Individuals using the internet in 2020 by gender.

44 World Bank, Digital Progress and Trends Report 2023, ECA Digest, p.11: Median Internet Download Speed in High Income Country was 95 Mbps in 2023

45 Source: ITU (<https://www.itu.int/en/ITU-D/Statistics/Dashboards/Pages/IPB.aspx>). Fixed broadband prices correspond to fixed-broadband basket (5GB) – value is 2.92 GNlpc; Mobile broadband prices correspond to the average of *Data-only mobile-broadband basket (2GB)* - value is 0.77 GNlpc - and *Mobile data and voice low-consumption basket (70 min + 20 SMS + 500 MB)* value is 1.17 GNlpc.

46 ITU, Republic of North Macedonia Digital Development Country Profile, 2021

**for data and cloud services remains marginal, hampered by low demand from the private sector.** The data hosting market is in its infancy, with little demand for data and cloud services, reflecting the slow digitalization among SMEs and a limited innovation ecosystem.<sup>47</sup> With only six existing data centers, North Macedonia has limited capacity to cater for the adoption of innovative technologies (such as artificial intelligence, cloud computing, and big data) that require the storage and processing of vast amounts of data. The country trails behind Serbia and especially large countries like Ukraine and Türkiye.<sup>48</sup> Encouraging private sector demand and private investment in this segment is key, which will be challenging given the small size of the local market and the capital expenditure-intensive nature of this industry.

**Progress in adopting digital public services requires strong policy commitment and investments.** North Macedonia ranks 80<sup>th</sup> out of 193 countries on the 2022 United Nations E-Government Development Index, far below 13 of 19 other ECA countries. This compares negatively to North Macedonia's rank of 72<sup>nd</sup> in 2020 and suggests that progress is slow. Nevertheless, North Macedonia has developed a satisfactory level of e-participation between the government and individuals, despite its recent introduction (only in 2021) of digital identity.<sup>49</sup> The country ranks 43<sup>rd</sup> out of 183 countries on the United Nations E-Participation Index, behind Albania (22<sup>nd</sup>) and Serbia (15<sup>th</sup>).

**The country suffers from poor quality and accessibility of digitally enabled services, rooted in a lack of user-centricity.** Despite advances in service delivery transformation, important problems persist from the perspective of service users. In 2022, North Macedonia registered an average score of 0.79 on the Public Service Delivery Index (PSDI), which measures the maturity of online public service portals, with a focus on citizen-centric design and universal accessibility. In comparison, the average PSDI score registered in EU countries was more than 0.10 points higher, at 0.88. There are five key reasons for the suboptimal quality and weak user-centricity of digitally enabled services in North Macedonia. First, the digitalization of services has not always been embedded in a coherent reform strategy that combines public administration reform and simplification with digitalization. Second, limited attention has been given to user needs and preferences in the design, and re-design, of digitally enabled services and front-end interfaces. Third, the different delivery channels have not been strengthened in an integrated manner, which is not in line with global and EU directives on the necessity of multichannel delivery. Fourth, access to digital services remains unequal, disadvantaging vulnerable groups, such as poor people, the elderly, less-educated women, and those living with disabilities. Fifth, trust in digital platforms remains limited, owing mainly to corruption concerns and gaps in data protection and information security.

**Cybersecurity is at an advanced level in North Macedonia, which ranks 38<sup>th</sup> out of 182 countries on the Global Cybersecurity Index.**<sup>50</sup> The critical importance of cybersecurity will keep increasing as the country moves toward a digital economy, and continuous improvement of the policy framework, technical resources, in-country capacity, and public awareness are mandatory. Like most countries, North Macedonia is facing a combination of challenges that threaten the resilience of its cybersecurity capacity, and its small size makes it potentially an easier target for cyberattacks. Special attention should be paid to the protection of critical information infrastructure and to general awareness about

47 ICT Industry in North Macedonia, General Mapping report, 2020

48 Data Center Map

49 UNDP, Digital Readiness Assessment, North Macedonia

50 ITU, Global Cybersecurity Index

cybersecurity, data protection, and personal information among the population.

**North Macedonia’s lack of digital skills and critical gender divide is hampering ICT sector growth due to intense competition for technical talent.** North Macedonia’s ICT sector is confronting a significant talent shortage. For example, the country had only 619 IT graduates in 2023,<sup>51</sup> a number that is unlikely to be sufficient to meet the demand from potential employers and could thus limit the chances of organic growth of entrepreneurship in the digital sector. The “brain drain” from North Macedonia’s small economy represents another challenge, in addition to the wide disparity between public and private sector salaries in this field, thereby preventing the government from attracting and retaining the talent needed to develop and operate digital public services.<sup>52</sup> Women represent only 27 percent of the total Gender disparities IT workforce, with the divide growing in senior and management positions, where the gender ratio is 80 percent men and 20 percent women. These gaps pose important challenges for sectoral growth and socioeconomic gains.<sup>53</sup>

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Strengthen the digital development governance framework.** A review of the institutional framework for the digital agenda, including the establishment of a national agency or national authority coordinating all relevant stakeholders and groups, could help North Macedonia in defining and implementing a comprehensive strategy for digital transformation, given: (i) the need for a coordinated and holistic approach to digital transformation; (ii) the strong interlinkages between digital development and all other economic and social sectors; and (iii) the imperative to effectively mobilize the private sector with a clear and predictable environment.
- **Accelerate the digital transformation across economic and social sectors.** This will involve initiating strong public digitalization programs for the government in general and in selected sectors (for example, education, health, and social protection), promoting awareness among SMEs, and establishing innovation hubs to foster the growth of digital markets (such as telecoms, IT integrator, software development, cloud computing, and digital innovation).
- **Review and improve the cybersecurity framework.** This can be accomplished through activities to raise awareness among the population, enterprises, and civil servants about cybersecurity best practices and cyber hygiene. Strengthening the capacity of the National Cybersecurity Council, including its coordination capacity and interinstitutional coordination efficiency in case of incidents, is also essential.

#### Medium-term measures:

- **Invest in digital public infrastructure as a foundation for digital transformation, encouraging PPP mechanisms.** This would include investments in telecoms infrastructure, with the objective of achieving “gigabit” access for the country’s citizens and public institutions, focusing particularly on unserved areas, ensuring the affordability of digital services through market competition, and developing the data and cloud computing markets. Mechanisms to foster the private sector should be assessed and favored whenever feasible.

51 [https://www.stat.gov.mk/PrikaziSoopstenie\\_en.aspx?rbtxt=28](https://www.stat.gov.mk/PrikaziSoopstenie_en.aspx?rbtxt=28)

52 International Organization for Migration

53 ITU, Republic of North Macedonia Digital Development Country Profile, 2021

- **Invest in digital skills and bridge the gender gap.** Key actions will include developing large-scale and inclusive initiatives to increase the level of digital skills among the population and businesses and closing gender gaps, especially by increasing the number of women graduating in STEM fields.
- **Converge progressively toward policy and regulatory alignment with the EU acquis.** This encompasses rules on telecoms markets (the EU's European Electronic Communications Code), data protection (the EU's General Data Protection Regulation), cybersecurity (the EU's Network and Information Security Directive 2 and the EU toolbox for 5G security), digital identity and interoperability (the EU Electronic Identification, Authentication, and Trust Services framework), and competition at the retail and wholesale levels in the broadband market, among others.

#### 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• <b>Analytical support for the Western Balkans:</b> This activity aims to produce an assessment of, and recommendations for, inclusive and safe digital public infrastructure in North Macedonia, Kosovo, and Albania.</li> <li>• <b>Western Balkans Digital Highway:</b> This activity, financed by the WBIF, aims to study infrastructure-sharing opportunities in the Western Balkans region and neighboring countries through the modernization and commercialization of Transmission System Operators' (TSO) fiber-optic cables running alongside energy transmission lines. The first phase, consisting of feasibility studies, concluded in December 2023. A second phase, comprising the preparation of tender documents for TSO telecoms equipment, is under consideration for 2024.</li> </ul>
<p><b>Potential Engagement</b></p>	<ul style="list-style-type: none"> <li>• <b>Participation in a digital acceleration regional programmatic instrument,</b> with a menu of options covering the following topics: <ul style="list-style-type: none"> <li>- User-centric public administrative services</li> <li>- Digital public infrastructure</li> <li>- Quality broadband and data hosting</li> <li>- Digital skills and jobs.</li> </ul> </li> <li>• <b>Digital Development Agenda investment project financing:</b> to be discussed and agreed in line with the country's main development priorities for digitalization.</li> </ul>



Transport





# 12 Transport

## 1. Overarching Messages

**North Macedonia has invested heavily in ensuring the connectivity of the country, given its strategic location at the crossroads of two transport corridors that link the Western Balkans with EU member states.** However, the completion of these corridors, and the connecting local roads, remains a serious constraint to private sector growth, in addition to poor logistics services and inefficient border crossing procedures. Transforming North Macedonia into a logistics and production hub for the region would require three sets of complementary interventions: (i) reinvigorating the rail sector, and associated logistics facilities, to facilitate cross-border transit and trade in goods; (ii) reducing obstacles to trade through measures such as implementing an NSW for trade and the New Computerized Transit System (NCTS) and improving connectivity efficiency and safety in road, and rail transport; and (iii) tackling the carbon intensity of the road sector by shifting current and future traffic to greener modes, including public transport and rail, while increasing the resilience of transport infrastructure to climate change to reduce network vulnerabilities arising from increasingly frequent floods and landslides.

## 2. Key Challenges

**A large maintenance backlog is threatening the sustainability of transport investments.** Two pan-European corridors intersect the country: Corridor 8, running east-west, and Corridor 10, the busiest in the Western Balkans region, running north-south). These corridors increasingly provide high-quality transit routes, while serving the country's main industrial areas, tourist sites, and agricultural production zones. However, there is a significant maintenance backlog on these corridors and on the secondary and tertiary network. In particular, the 9,000-km local road network—a critical contributor to local economic development—has suffered decades of underinvestment, is in poor condition, and has suffered from a severe lack of maintenance expenditures. The railways also face a severe maintenance backlog, resulting in temporary speed restrictions across the network; Corridor 10 is particularly affected. The deterioration in the quality of the network is leading to a loss of rail traffic; while total freight traffic has tripled since 2010, rail freight traffic has fallen by 70 percent.

**Overall governance of the delivery of transport services at the municipal level needs to be improved.** The financial sustainability of municipalities needs to be addressed, with a focus on debt sustainability, revenue-raising capabilities, and funding consistency. The quality and transparency of public expenditures on transport could be improved. The system of oversight is not as developed for small municipal projects as it is for large-scale infrastructure. More emphasis should be given to improving the quality of design and supervision of roadworks, ensuring effective competition in procurement, disclosing maintenance plans, and ensuring consistency in the reporting of expenditures and outcomes. These issues are exacerbated by the lack of capacity at the municipal level, as only a few municipalities can sustain a dedicated roads department. In this context, more consideration should be given to intermunicipal cooperation agreements.

**Border infrastructure is often deficient, and uncoordinated processes, as well as**

**duplication and redundancy on both sides of the border, result in excessive waiting times for traders.** Infrastructure improvements at border crossing points, together with reforms and investments in digitalization and submitting and sharing data prior to the arrival of goods (including via NSWs) for electronic risk management, will speed up the release of most goods and thereby reduce border clearance times by making use of advance and/or post-clearance processing. North Macedonia should establish “green lanes” at the Deve Bair border with Bulgaria and further strengthen the Authorized Economic Operators status of trusted traders to lower risk scores in line with increased trustworthiness.

**SOEs in the transport sector need to be restructured and reformed in accordance with EU standards to improve transport services and maintenance activities.** SOEs in the transport sector account for a significant percentage of central government SOE arrears. The government will need to look at options to improve the operations of railway companies, with the aim of resolving the loss-making passenger services and improving the efficiency and competitiveness of freight services. Such reforms would help the country move gradually toward compliance with EU rail policies. Moreover, most road maintenance is undertaken by state road maintenance companies that are inefficient, operating with old equipment and an aging workforce. There is a need to open up the market to the private sector, particularly for heavy maintenance works, and to revitalize existing SOEs by reinvesting in equipment and introducing a more dynamic workforce. Reforms of these and other SOEs at the Ministry of Transport can only be successful if there is a fundamental shift in the sector’s corporate governance culture. These companies should operate at arm’s length from the ministry and be run by independent, professionally appointed boards of directors.

**The transport sector needs to decarbonize and boost its resilience, both to climate change and to the vulnerabilities of the network.** GHG emissions from the transport sector in North Macedonia have doubled in the past 20 years, accounting for 22 percent of all GHG emissions in 2019. Most growth in emissions results from growing ownership of passenger cars, which saw a 60 percent increase in the last 10 years. The rising demand for road mobility is being met with old, highly polluting vehicle fleets—a major contributor to the poor air quality in North Macedonia.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Strengthen the capacity for road asset management on both national and municipal road networks.** It will be important to address the maintenance backlogs, improve the road network’s resilience to climate-induced shocks, implement the Bridge Management System at PESR, and move all heavier maintenance works to the private sector.
- **Prioritize focused maintenance of railway infrastructure to reduce backlogs, improve reliability, and grow traffic and revenue.** This involves updating the Track Access Charging regime, revising the Public Service Obligation contract, introducing the Multi-Annual Infrastructure Contract, and adjusting the level of annual support for the railway sector.
- **Strengthen trade facilitation measures to promote trade and a competitive transport system.** It will be necessary to improve border facilities, digitize border procedures, and implement “green lanes,” as well as to improve the operation of the main transport corridors through the implementation of Intelligent Transport Systems (ITS) and e-freight.

- **Implement policy measures on road vehicle emissions management, focusing on actions that can enable the adoption and enforcement of medium-term actions.** It will be important to strengthen the enforcement of environmental regulations and ensure that non-compliant vehicles are identified and banned for import. At the same time, it will be necessary to promote a gradual transition toward energy-efficient vehicles by developing an e-mobility strategy and enhanced governance for the e-mobility transition.

**Medium-term measures:**

- **Boost institutional capacity by increasing the professionalism of SOEs. It is necessary to revisit the status of transport sector SOEs, with a view to modernizing and professionalizing their management boards.** The transport sector needs to be opened up to the innovation and efficiency of the private sector, including the promotion of professional services (for design and planning), contractors, and logistics providers.
- **Incrementally improve the climate resilience of national and local road networks.** To this end, it will be important to improve asset inspections, maintenance, appraisal of engineering and non-engineering interventions, and systematic adoption of climate-informed design in road development. Using a Bridge Management System will help plan the rehabilitation of—and future investments in—bridges, which play a critical role in developing a resilient transport network.
- **Decarbonize the transport system and promote green fleet transition.** North Macedonia needs to start developing a public transport fleet renewal strategy, combined with the introduction of a gross cost contract and monitoring systems. It can scale up road vehicle management policies through stricter environmental regulation of second-hand vehicles and promoting the transition to electric vehicles in highly utilized fleets (including taxis, buses, and light commercial vehicles). These fleets benefit the most from the lower operational costs of electric vehicles and can increase the availability of second-hand electric vehicles over the medium term, thereby accelerating overall e-mobility deployment.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• <b>Road Upgrading and Development Project (P149955).</b> The project development objectives are to improve transport connectivity for road users along Corridor VIII between Skopje and DeveBair, and to improve the asset management and planning functions of Public Enterprise for State Roads.</li> <li>• <b>Western Balkans Trade and Transport Facilitation Project (TTFP, P162043).</b> The project development objective aims to reduce the trade costs and increase transport efficiency in Albania, North Macedonia, and Serbia. Phase 1 includes support for the development of NSW, design improvements at the Deve Bair border crossing point, development of an ITS strategy, and its rollout on Corridor X.</li> <li>• <b>Local Roads Connectivity Project (P170267).</b> Through this national program focused on improving local roads and strengthening institutions around municipal asset management, a total of 113 km of local roads have been completed to date and an additional 70 km are under construction.</li> <li>• <b>North Macedonia Sustainability and Resilience DPO (P180587).</b> This project includes a prior action supporting the updating of the Motor Vehicle Tax scheme for the most polluting vehicle categories .</li> </ul>
<p><b>Pipeline</b></p>	<ul style="list-style-type: none"> <li>• <b>Western Balkans Trade and Transport Facilitation Project (TTFP 2.0).</b> Phase 2 of the TTFP is being planned and could include further rollout of ITS along Corridor 8, improvements to the Deve Bair border crossing point, and TA for rail sector activities.</li> <li>• <b>Local Roads Connectivity Project AF.</b> Potential AF is being considered to support ongoing development of local roads, in collaboration with other development partners.</li> </ul>
<p><b>Potential Engagement</b></p>	<ul style="list-style-type: none"> <li>• <b>Support to the rail sector.</b> Support could be provided to advance the railway reform agenda and address shorter-term critical maintenance needs.</li> </ul>



Environment  
and  
Air Quality



# 13 Environment and Air Quality

## 1. Overarching Messages

**North Macedonia's steady progress in recent decades was achieved at high environmental and health costs.** Air pollution is a major health and economic issue, especially in the capital, Skopje, and other urban areas, including those in proximity to thermal power plants. A recent study estimated that about 2,800 deaths each year are associated with ambient air pollution (AAP). The economic cost associated with health damage from AAP in North Macedonia is on average US\$750 million, equivalent to 6.9 percent of GDP in 2016. Reducing air pollution would reduce mortality due to air pollution by a cumulative 23 percent by 2050 and introduce estimated savings of US\$1,281 million (2021) in health spending due to lost work hours. A holistic approach to air quality management (AQM) in the context of the Sofia Declaration on the Green Agenda for the Western Balkans and the EU's Green Deal is needed, recognizing its connection to energy policy and the significant co-benefits of transitioning to a low-carbon economy.

## 2. Key Challenges

**AQM is a pressing, yet still-unattended, priority.** Residential heating is North Macedonia's largest source of PM<sub>2.5</sub> (particles in air of aerodynamic diameter less than 2.5 micrometers), estimated at 48 percent in 2015. Power and district heating plants also contribute significantly to PM<sub>2.5</sub> pollution, at about 26 percent. Other sources include industry, waste burning, and road traffic. Reducing the country's reliance on fossil fuels can cut down air pollution levels, despite the rise in biomass and biofuels to balance the transition to renewables in the near term. Mobilizing capacity and resources for enhancing AQM would yield economic benefits by reducing the significant monetary and health burden posed by AAP and would safeguard productivity by protecting human health and well-being.

**The country has still not prepared the much-needed Air Quality Improvement Program and Air Pollution Control Plan, aligned with the key EU air quality directives.** The 2004 Law on Ambient Air Quality specifies regulations to establish limits and target values for air quality, emissions from mobile and stationary sources, and substances in fuel, and assigns to environmental and health authorities a shared responsibility for setting limits and values for ambient air quality and emissions from stationary and mobile sources. However, transposition is still pending for the most recent EU legislation on industrial emissions and the EU air quality standard for daily PM<sub>2.5</sub> concentrations. World Bank studies show that, if effectively enforced, existing environmental and air quality policies can deliver a strong decline in the emissions of sulfur dioxide (SO<sub>2</sub>) and nitrogen oxides (NO<sub>x</sub>), but not PM<sub>2.5</sub>. Additional efforts are therefore needed to strengthen the legal framework to reduce pollution from domestic heating and from stationary and mobile sources.

**North Macedonia's government and development partners have made some efforts to address air pollution in recent years, but important investment gaps remain.** The key investment priorities include scaling up clean residential heating schemes, reducing emissions from power plants, and implementing clean urban transport systems. The residential sector is by far the largest source of population exposure to harmful PM<sub>2.5</sub>.

associated with the burning of solid fuels in homes<sup>54</sup>. Inefficient and highly polluting firewood stoves and boilers are a widely used heating technology. The problem is particularly acute during the cold season, when peak pollution episodes are exacerbated by adverse meteorological conditions that limit atmospheric dispersion. Emissions from power plants also contribute significantly to fine particulate matter air pollution, followed by industry, transport, and agriculture.

**While the essential institutional structure and coordination mechanisms for AQM are in place, important institutional and capacity constraints still hinder effective implementation of legislation.** The Ministry of Environment and Physical Planning of North Macedonia (MEPP) is the country's principal environmental authority but lacks a dedicated unit for air quality legislation, policy, planning, and implementation supervision. All types of pollution, including air pollution, are under the mandate of MEPP's Macedonian Environmental Information Center (MEIC). The relatively small unit is currently operating beyond its mandate to also cover air quality policy and legislation development, stretching its already limited capacity beyond the core functions of air quality monitoring, analysis, data validation, and reporting. All national-level institutions mandated with AQM functions are severely understaffed, and each year MEIC receives about one-third of the budget required for adequate operation and maintenance of the air quality network. Strengthening institutional capacity to enforce existing air pollution limits is thus a pressing priority. At the local level, municipalities manage the implementation of AQM-related policies, but limited financial resources and technical expertise hamper the ability of most local self-government units to manage air quality effectively.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Mobilize resources for investment to scale up AQM programs.** A priority is the implementation of programs to support the scaled-up replacement of highly polluting and inefficient residential heating systems. Investment would support the introduction of cleaner and more efficient heating systems, such as re/connecting to district heating and using Eco-Design biomass stoves, boilers, or heat pumps. Investment would provide financial incentives for energy-efficient home retrofits, including heating systems and better insulation, targeting energy-vulnerable households.
- **Complete the development of the national policy and legal framework on air quality improvement.** This process will include identifying the most cost-effective measures and scaling up investment in air quality improvements, along with pursuing low-carbon growth.
- **Strengthen institutional frameworks.** There is a need to strengthen institutions to support the green transition and AQM in North Macedonia by implementing the recommendations of the Institutional and Functional Review of AQM, including: (i) putting in place an AQM management unit in MEPP; and (ii) strengthen MEPP's project implementation capacity by establishing a program implementation department within a dedicated AQM unit.
- **Enhance monitoring and analysis capabilities.** This could include, for example, strengthening air quality laboratory and monitoring equipment and capacity to ensure data consistency and reliability.

<sup>54</sup> <https://documents1.worldbank.org/curated/en/116521576516981237/pdf/Air-Quality-Management-in-North-Macedonia.pdf>



**Medium-term measures:**

- **Further strengthen institutional frameworks.** This would include ensuring adequate staffing in MEPP and other agencies, establishing a high-level intersectoral coordination council on AQM at the level of state secretaries or deputy ministers, and implementing local-level capacity building to roll out local air quality improvement plans.
- **Mobilize resources for investment to address non-energy forms of air pollution.** Areas would include public transport improvements, waste management, and industrial pollution.
- **Think about transition planning in high-carbon-intensity regions in the country.** This would involve supporting local government planning for the green transition and AQM improvement and implementing actions to support the transition.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<p>Current support to North Macedonia’s air quality agenda includes two trust fund-supported TA activities:</p> <ul style="list-style-type: none"> <li>• Support for the implementation of AQM plans in three cities by improving local pollution source apportionment analysis and assessing the impacts of selected measures included in the local air quality plans.</li> <li>• An Institutional and Functional Review of AQM function to implement air quality legislation in line with the EU acquis and suggest structural, organizational, and functional adjustments that may be needed in North Macedonia.</li> </ul>
<p><b>Potential Engagement</b></p>	<ul style="list-style-type: none"> <li>• A potential Greener Environmental Growth Project (amount TBD) could leverage the results of the above TA on air quality to support efforts to strengthen AQM by scaling it up to the wider green environmental agenda, as needed, while addressing AQM in the country and reducing particulate emissions from targeted sources in selected areas of North Macedonia. This could focus on AQM programs through investment in residential heating systems, renewable energy technologies, and national- and local-level AQM capacity building. Such support could be provided in synergy with implementation support to the ACT Program, which provides concessional financing for this potential engagement. Possible actions include providing the country’s most vulnerable households with concessional funding to support the replacement of polluting solid fuel appliances and adoption of energy efficiency measures.</li> </ul>





# Municipal Development and Disaster Risk Management



# 14 Municipal Development and Disaster Risk Management

## 1. Overarching Messages

**Improving the living standards of the population and enhancing the country's preparedness for climate change require more effective and efficient public service delivery, and well-performing municipalities are critical for success.** Municipalities in North Macedonia are mandated to deliver key public services at the local level through their own municipal communal services enterprises and thus play a critical role in climate adaptation and disaster risk management (DRM). However, compared to municipalities in other countries, those in North Macedonia have low capacity, with limited access to warnings and inadequate protection from the financial shock associated with disasters. These factors make climate change and disaster resilience a priority in the development of North Macedonia's municipal infrastructure.

**Against the backdrop of multiple external shocks, the sustainable delivery of municipal services calls for an integrated approach to improving the coverage, quality, and sustainability of municipal services.** Strengthening coverage includes ensuring wider catchment areas to improve population coverage overall, as well as mitigating gaps between urban and rural areas. There is a need, therefore, to focus on: (i) strengthening strategic planning, fiscal discipline, budgeting, and asset management at the municipal level, while (ii) building the capacity of local institutions and municipal communal enterprises, and (iii) enhancing citizen engagement in decision making and accountability.

## 2. Key Challenges

**Municipalities face strong constraints to providing public service delivery in an efficient manner, owing to municipal arrears, weak own-source revenue collection, and expenditure efficiency challenges.** North Macedonia's municipalities have been spending comparably less on public services and urban infrastructure than EU peers (64 percent and 84 percent of the regional average, respectively). This trend has been exacerbated by the impact of multiple crises, including the global COVID-19 pandemic, the energy crisis, climate change, and Russia's invasion of Ukraine. Notwithstanding the North Macedonia authorities' increased focus on advancing fiscal decentralization and enhancing responsibility and transparency in municipal service delivery, aggregate municipal arrears in 2023 reached 23.2 percent of total municipal own revenues in 2021. Moreover, there remain important gaps in municipal service delivery. At the local government level, capital spending stood at around 1 percent of GDP in 2023, or approximately one-fifth of overall local government spending. Low capital investment results in part from the accumulation of arrears by local government units, which has in the past triggered recurrent bailouts by the central government. At the same time, it shows weaknesses in public investment management and the low revenue base from which to fund long-term investments. The resulting underinvestment, coupled with the aging of municipal service-related infrastructure and a systematic lack of investment in disaster and climate risk reduction, affects the livability and safety of municipalities. Service efficiency also falls below regional averages, with nonrevenue water at around 65 percent compared to 42 percent in the Danube region and a water utility performance index at 63, compared to 72 in the Danube region.

**Municipalities have limited capacity to manage own-source revenues for both current and capital spending.** Property taxes in North Macedonia average €29.7 per capita, compared to €43.1 in the Western Balkans region overall. Municipal tax rolls often do not fully capture the base, while valuation capacity and political will to raise tax rates are limited. Tariff levels are sufficient only to cover actual operating costs and not to guarantee an adequate level of maintenance, cover depreciation costs, or finance upgrades or new capital investments. Municipalities also face shortages of qualified staff, including appraisers and tax evaluators (who are often underpaid and exposed to corruption), and limited access to software to enhance revenue collection.

**Proper asset management and strategic investment planning are lacking.** Fiscal constraints make strategic planning and prioritization of limited municipal resources essential. Whether funded through donor or own resources, municipalities need to improve planning for the maintenance of existing infrastructure and planning for new infrastructure investments (in terms of both needs and financing), as well as to ensure proper asset management to provide adequate and sustainable services at the local level. That requires strengthening the institutional capacity of communal service enterprises and utility companies, as well as the agglomeration of infrastructure planning and delivery when serving more than one municipality at once (through shared-service contracts or similar). In addition to financial management practices, municipalities and municipal companies (especially the smallest among them and those in rural areas) would benefit from increased investment planning capacity, with a focus on project appraisal to enhance climate and disaster risk considerations and lifecycle costing to ensure adequate funding of infrastructure maintenance.

**Municipalities are not ready to face the impact of climate change.** North Macedonia has a long history of devastating natural disasters, which, coupled with growing population concentration and increased economic activity in urban areas, requires investment in early warning systems and climate-resilient infrastructure and technologies, at both the national and municipal levels, including drainage and greening of urban areas. To date, only a few municipalities have prepared disaster risk preparedness plans and climate change mitigation and adaptation strategies to mainstream climate and resilience considerations into their investments. Furthermore, a backlog exists in compliance on resilience in planning and regulatory measures (for example, building codes and disaster- and climate-informed land use plans). In addition, a large proportion of the building stock is aging. Disaster response vehicles and equipment (such as fire stations and trucks) are neither upgraded nor adequately maintained, and staffing is insufficient.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Keep strengthening the subnational fiscal framework.** There is a need for greater reliance on and better management of own-source revenues, enhanced strategic planning and fiscal discipline, improved efficiency, and better performance among communal service enterprises. The authorities could consider contracting the Public Revenue Office or larger neighboring municipalities to collect the revenues that are owed to smaller municipalities. They may also contemplate introducing incentives to strengthen service delivery and administrative performance in municipalities, building on the nascent own-source revenue performance-based transfer system.

- **Make efficient municipal service provision a top priority for municipal authorities.** This could involve a combination of enforcing the execution of municipal infrastructure maintenance and investment strategies, preparing well-articulated business plans for urban development and for the operation and maintenance of municipal assets, conducting functional reviews and restructuring of inefficient utilities and municipal institutions, and ensuring due accountability and reporting to citizens and national-level authorities.
- **Require the inclusion of climate resilience considerations** when appraising and designing municipal infrastructure investments.
- **Increase local capacity to cope with disaster risks and hazards,** including by enhancing the capacity of municipalities and North Macedonia’s Crisis Management Center.
- **Promote risk-sensitive land-use planning** to minimize construction in high-risk areas.
- **Explore mobilizing private sector investment instruments to complement International Bank for Reconstruction and Development (IBRD) sovereign lending, by leveraging IFC’s experience in structuring and financing sustainable urban infrastructure, including through infrastructure PPPs, to secure access to essential public services,** such as clean water and energy, circular waste management, low-emissions public transport, and “smart city” technologies. IFC can engage in strategic partnerships with eligible municipalities to navigate their fiscal challenges and plan their infrastructure investments in alignment with national goals for sustainable and climate-smart urban development. As part of this approach, IFC can provide direct finance to creditworthy municipalities that can borrow without a sovereign guarantee and/or mobilize private long-term capital for critical infrastructure projects, complemented by advisory support to ensure robust project preparation, successful implementation, and long-term impact.

**Medium-term measures:**

- **Rethink future decentralization by relying on more data-driven regional development analysis.** Insisting on shared-service agreements or mergers, based on new population data, to deliver decentralized and delegated public services should be a priority before further allocation of additional shared tax revenues. The Law on Local Government Units can introduce such reforms, while the Law on Local Government Unit Financing could condition capital transfers with such agreements.
- **Introduce climate and disaster risk screening and management as a mandatory part of municipal strategic documents, urban development strategies, and other local planning documents.** This could include developing methodological guidance and enforcing the provisions of primary and secondary legislation.
- **Improve consistency across the legally binding local planning documents for local government units.** This would enhance effectiveness in implementing sectoral strategies and allocating resources.
- **Upgrade national and local DRM capacity.** The goal would be not only to better respond to disasters, but also to proactively plan for and reduce natural hazards and climate change risks, including adopting the National Protection and Rescue Strategy and its associated Action Plan.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• <b>Local Roads Connectivity Project (FY20–27, IBRD US\$122.8 million).</b> The project's development objective is to improve government capacity to manage local roads and improve access to markets and services, and to support the development and introduction of an easy-to-use road asset management system and the identification of more efficient ways to ensure overall local road network management.</li> </ul>
<p><b>Pipeline</b></p>	<ul style="list-style-type: none"> <li>• <b>Sustainable Municipal Services Development Project (FY25, estimated IBRD €50 million).</b> This project will build on the experience of the Municipal Services Improvement Projects 1 and 2, with the aim of enhancing financially sustainable and climate-smart municipal service delivery in participating municipalities. As such, it will consider both the financial and the climate/environmental sustainability of municipal services, while contributing to improved coverage and quality through a combination of sub-loans to municipalities and performance-based grants.</li> </ul>
<p><b>Potential Engagement</b></p>	<ul style="list-style-type: none"> <li>• The World Bank stands ready to support North Macedonia by providing <b>ASA</b>, including on enhancing PIM and public asset management with a sectoral and institutional focus, and on exploring financing for DRM at the national, local, and sectoral levels, as needed, for seismic resilience, flood risk management, early warning, wildfires, preparedness, and response.</li> </ul>





# Water Security and Climate Adaptation



# 15 Water Security and Climate Adaptation

## 1. Overarching Messages

**North Macedonia's water resources management and water supply and sanitation (WSS) need investments and reforms to become fit for purpose and resilient.** The country shows moderate water stress, with observed and anticipated climate change impacts that could potentially have a disproportionate effect on vulnerable communities. Moreover, in 2020, only 77 percent of the population had access to safely managed water, and only 12 percent to safely managed sanitation,<sup>55</sup> posing a significant risk to both human health and the environment. Against this backdrop, investing in water resources management and WSS, in line with the EU's Water Framework Directive (WFD), Drinking Water Directive, and Urban Wastewater Treatment Directive (UWWTD), and strengthening the country's poorly defined and fragmented institutional, policy, and regulatory frameworks will steer North Macedonia toward a more sustainable and inclusive growth path.

## 2. Key Challenges<sup>56</sup>

**North Macedonia's water resource availability is estimated at 3,074 cubic meters per capita per year.**<sup>57</sup> Available water resources are currently sufficient for the country's various water demands, the largest of which is agriculture, at about 40 percent of total demand. Although sufficient at the macro scale, water resources are distributed unevenly in time and space, with rains concentrated in the periods from October to December and March to May, and average rainfall at 400 mm in the Center and East and 1,400 mm in the West<sup>58</sup>. Concerns for future water scarcity are high, however. Long-term climate change forecasts predict an increase in mean annual temperature and consecutive dry days. Overall precipitation is expected to decrease by 10 percent by 2050 and 14 percent by 2100<sup>59</sup>. The potential decrease in renewable water resources, coupled with growing demand, are bound to increase water stress in the country. This points to the need for effective management and protection of water resources, which is currently impeded by fragmented institutional arrangements, a lack of transboundary coordination, insufficient availability of good data, and limited local technical and institutional capacity.

**WSS services are inefficient due to high levels of nonrevenue water (around 65 percent), the widespread lack of effective wastewater treatment, and extensive deterioration of existing WSS infrastructure.** These difficulties are the result of financing and capacity constraints and weaknesses in the regulatory and institutional framework. For example, there are currently 77 different public utility companies providing a combination of water and sanitation services in North Macedonia, many of them small and localized. In addition, rural-to-urban migration is placing additional stress on services in urban centers.

**Water use in irrigated agriculture is inefficient, owing to the outdated, inefficient, and**

55 WHO/UNICEF JMP (2021)

56 See the World Bank "Water Security Outlook" (2022) for more details.

57 [http://www.fao.org/nr/water/aquastat/data/cf/readPdf.html?f=MKD-CF\\_eng.pdf](http://www.fao.org/nr/water/aquastat/data/cf/readPdf.html?f=MKD-CF_eng.pdf)

58 North Macedonia - Climatology | Climate Change Knowledge Portal (worldbank.org)

59 <https://documents1.worldbank.org/curated/en/949621468090285546/pdf/ACS81790ESW0wh0h0Country0Assessment.pdf>

**underutilized irrigation infrastructure network.** This results in reliance on unregulated private schemes that utilize groundwater. Agricultural land erosion is extensive, often due to poor land and water management, leading to negative impacts on agricultural productivity and increased sedimentation in water courses.

**Poor water quality is common in North Macedonia.** Water resources (ground and surface waters) are clean in their upper course, but worsen rapidly along their middle and lower courses due to untreated wastewater discharged by human settlements as well as by industry and agriculture. Water bodies often do not comply with the quality objectives set for them. Groundwater protection in the country lags behind that of developed countries, although, according to monitoring results, groundwater quality is high. The main sources of water pollution in North Macedonia are industrial and mining wastewater and wastewater from households and agriculture.

**North Macedonia's water sector institutional framework is extremely fragmented, critically affecting effective water governance.** Water-related institutions are structured at the central and local levels. The sector is controlled at the central level by five ministries and six agencies that are wholly or partially responsible for the water sector, with overlapping mandates that are poorly coordinated. Water and sanitation services, on the other hand, are provided entirely by municipalities, with little authority or oversight from the central level. This fragmentation leads to significant friction in effective governance and leads to conflicting mandates and unclear responsibilities.

**Weak institutional capacity makes it difficult to implement policies and measures to protect water resources and provide effective water and sanitation services.** At the central level, there is weak capacity to implement regulations and policies (for example, while enacted, existing water laws and strategies are not implemented) and to effectively plan for investments. At the utility level, there is a general lack of capacity (and funding) to operate water and sanitation services efficiently and with good quality.

### 3. Policy Responses for Consideration

#### Short-term measures:

- **Implement existing water laws and strategies in full.** Although the Law on Waters incorporates most EU water regulations and is well aligned with EU directives, the water legislation is not fully applied in practice and its implementation remains modest. The lack of coordination among competent authorities in the water sector continues to hamper implementation of the “polluter pays” and cost recovery principles, thereby hindering efforts to improve water quality and water use efficiency in both municipal and agricultural water use.
- **Update the water strategy, develop an investment plan, and secure a multiyear investment budget.** While there is a water strategy in place, it needs to be updated and fully translated into a prioritized investment plan. Completing a full agglomeration study, in accordance with the UWWTD, would provide a sound base for planning and prioritizing investments in the sector. Finally, without adequate ongoing investments, WSS utilities will be unable to improve water losses or implement sanitation systems that can make a meaningful contribution to reducing the pollution of water resources. Investments in the water sector will also have a strong impact on climate adaptation. These investments will have to be financed by the public sector and international sources. An effective investment budget will be key.

- **Strengthen the institutional framework and institutional capacity.** There is a need to strengthen and empower institutions, such as the national water council, through the approval of new legislation to support integrated water management and efficient WSS services. It is also necessary to strengthen the capacity of the national energy regulator to support the implementation of an effective tariff system in the water sector.

**Medium-term measures:**

- **Improve resource monitoring.** Adequate water data, including on water availability and demand, are key to making well-informed decisions and engaging in adequate planning (for example, for climate adaptation). As such, closing the information gap through adequate monitoring plans, allocation of adequate resources, and implementation of sufficient monitoring equipment will be key.
- **Invest in WSS and irrigation infrastructure.** Looking ahead, investment in the WSS sector needs to increase significantly if North Macedonia wants to improve water service delivery in the face of a changing climate; comply with the WFD and UWWTD to enhance the efficiency of water supply systems and wastewater treatment, respectively; and reduce environmental pollution, with a direct impact on water quality. Improving irrigation infrastructure would strengthen water management and agricultural water delivery and enhance the WSS sector’s resilience to drought.
- **Initiate sector reform and improve the efficiency of service providers.** The authorities may wish to consider consolidating national government responsibilities regarding the water sector in fewer agencies and aggregating utilities into regional water companies. Key reforms could also include work to improve the efficiency of service provision via reduction of nonrevenue water, introduction of ICT, development of business plans, operational improvements, and proper asset management. Effective maintenance and investment strategies will also be key for financial sustainability.

## 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• <b>Water Security Outlook and Water Governance Assessment (FY24).</b> These two analyses under the Water for Green and Resilient Growth North Macedonia Project are nearly complete. They focus on examining the water security situation and challenges in North Macedonia and the status of and challenges in water governance, respectively. The reports contain recommendations to improve water security and governance and will be published soon.</li> <li>• <b>Utility of the Future Center of Excellence (FY24–30).</b> This program supports utilities in North Macedonia to improve their performance by developing and implementing a 100-day action plan for quick-win, no-regret improvement measures and preparing a five-year business plan. Select utilities will receive more in-depth support on business planning and improvement measures. A thorough assessment of the interlinked policies, institutions, and regulations in the water sector will provide an overview of their status and recommend measures for improvement.</li> </ul>
<p><b>Potential Engagement (Funding TBD)</b></p>	<ul style="list-style-type: none"> <li>• <b>Support the government in updating its water strategy, formulating an investment plan, and completing an agglomeration study (FY25–26).</b> Fundamental to improving the water sector, this work would focus on putting in place the fundamental strategic plans needed to allow for prioritized and properly located infrastructure investments that are both efficient and in compliance with EU directives.</li> <li>• <b>Capacity building of the National Energy Regulator (FY25–26).</b> This work would focus on enhancing the regulator’s capacity to strengthen the economic regulation of water and to support the development of a better tariff system.</li> </ul>





Agriculture





# 16 Agriculture

## 1. Overarching Messages

**Agriculture plays an important role in North Macedonia's economy, including in poverty reduction, growth and trade, job creation, climate change adaptation and mitigation, and food security.** The sector is shrinking, however. Its average growth rate over the last 10 years has hovered around 1.2 percent—well below its potential, and its productivity has remained low and its competitiveness weak. Enhancing growth, increasing productivity, boosting competitiveness, and transforming the agri-food sector will require renewed efforts, including rethinking the role of the state in agriculture. It will also require designing effective and integrated policies and support programs to increase access to agriculture inputs and finance, while ensuring the inclusion of small farmers and the uptake of climate risk management instruments. Moreover, building capacity in the public and private sectors will be key to promoting capital investments to finance innovation, market integration, and resilience to climate shocks.

## 2. Key Challenges

**Low land and labor productivity.** Primary agricultural production is characterized by low land and labor productivity. With an average farm size of less than two hectares and about half of agricultural producers being semi-subsistent, there is limited potential to sell surplus production to markets, produce at scale and higher quality, promote small-scale producers' integration into higher-value agricultural value chains, and introduce innovation. In addition, smaller agricultural producers and agri-businesses lack access to modern technologies and market opportunities, as well as to good-quality agricultural knowledge and skills, including business management, quality management, logistics, financial literacy, and domestic and international marketing. Agriculture competitiveness is also constrained by a lack of access to inputs.

**Short and less competitive value chains.** Smallholder and subsistence producers participate mainly in short and less competitive value chains that typically end at local green or wholesale markets. Contract farming is not widely developed, and transactions—particularly for small producers—remain largely ad hoc. Breaches of contract and delayed payments are frequent issues. Poor post-harvest management and practices, including poor sorting and grading and a lack of suitable packaging for transport, undermine product freshness and quality, thereby limiting competitiveness. In addition, North Macedonia's cold storage capacity is limited, technically outdated, and often not adequately located to serve producers and buyers efficiently.

**Lack of proper management of state-owned agricultural land.** More than 40 percent of the total area of arable land (approximately 240,000 hectares) and 80 percent of pastureland (approximately 570,000 hectares) in North Macedonia is owned by the state. Nearly one-third of the total arable land is either abandoned or not utilized for agricultural production. There is currently no single, unified policy or law on public land, its administration, or its management. The responsibility for protecting and utilizing state land lies with different organizations depending on whether land is arable, pasture, or forest. The Agency for Real Estate Cadaster (AREC) is a national registration agency for all types of land and other real

estate objects. There is no reliable, up-to-date inventory of state land, and the reliability, timeliness, and correctness of data on state land registered with AREC is not known.

**Food safety, veterinary, and phytosanitary issues.** Although food safety standards have improved, food safety and veterinary policies and required infrastructure are not aligned with EU standards. In recent years, the systems have received considerable support from the EU Instrument for Pre-accession Assistance on harmonizing national legislation with the EU acquis, which describes the rights and binding obligations of EU Member States. Aligning food safety standards with EU requirements is essential to successfully grow the food-processing industry and free the movement of agricultural produce in the market. This will also enhance the traceability of products' origin and processing, which will improve access to the market.

**Limited and ineffective public support measures.** Government agricultural support measures, although generous, are limited, ineffective in overcoming sector constraints, and unsuccessful at stimulating investment. Market support and direct payments (MSDP) per output and area/animal represent 80 percent of agriculture budget outlays, on average. The high share of MSDP has raised questions with respect to the effectiveness of this type of support and its capacity to facilitate the necessary structural adjustments, such as land and farm consolidation, productivity enhancement, and modernization through technology investments. The support payments are also skewed toward only a small number of often lower-value products, such as tobacco, which contributes only 5.1 percent to total agricultural output. The support payments provide few incentives for farmers to modernize their practices and have not been effective in alleviating poverty or providing an effective rural safety net. Rebalancing public support from the current MSDP model toward broader rural development measures in line with EU best practices could bring greater efficiency gains at the farm level and allow for better use of public resources.

**Weak Agricultural Knowledge and Innovation System (AKIS).** Overall, the broad support provided under North Macedonia's AKIS has not been able to help overcome the sector's structural constraints. There are too many gaps and weaknesses. For example, the country's public advisory system is narrow in terms of the services and methods provided to farmers. Information and communication provisions are insufficient. Considerable efforts are needed on the environment, especially natural resources management and climate change. Additional work is required on plant protection controls and the sustainable use of pesticides.

### 3. Policy Responses for Consideration

#### Short-term policy measures:

- **Increase productivity and enhance the competitiveness of the agri-food sector.** This includes modernizing the agri-food sector by developing productive, high-value agriculture through: (i) developing new and improving existing irrigation and drainage infrastructure; (ii) developing short value chains; (iii) improving access to finance, technologies, and markets among farmers and agri-businesses; (iv) strengthening extension and advisory services; and (v) improving food safety, veterinary, and phytosanitary services so that they align with EU requirements, particularly Chapter 12 of the EU acquis.
- **Improve the management of state-owned arable land.** This includes: (i) analysis (functional review) and reorganization of state-owned arable land management to enhance productivity and achieve better efficiency and transparency; (ii) revision of existing and/or development of new policies and legislation on state-owned arable land administration and management; (iii) design and creation of a land inventory; and (iv) development of

a state arable land management information system, ensuring its interoperability with those of other institutions to improve data quality and records of leased state-owned arable land.

- **Repurpose rural development support toward capital investment and, especially, broad adoption of innovative technologies.** Higher agricultural productivity, and higher farm incomes, will flow from the adoption of innovative technologies and practices, helping to raise yields, manage inputs more efficiently, adopt new crops and production systems, and improve product quality.

**Medium-term policy measures:**

- **Repurpose agricultural support by reducing the direct payments support envelope, decoupling subsidies so that production decisions are based on comparative advantage, and setting a minimum subsidy threshold below which farmers would not receive agricultural support.** Repurposing agriculture support would increase productivity, enhance competitiveness, and increase the resilience of the agri-food sector. This will help farmers to raise yields; manage inputs more efficiently; adopt new crops, livestock, and production systems; and improve the quality of their products. These gains in the agriculture sector will lead, in turn, to agri-business sector improvements, including investments in infrastructure facilities, such as storage and processing facilities.
- **Addressing agricultural land abandonment.** A package of policy interventions needs to be designed to address the root causes of agricultural land abandonment by integrating and combining land policy and other related policies, such as agriculture, forestry, economics, and taxation. Addressing the problem also requires designing policies that improve farm structures, including scaling up the land consolidation exercise piloted by the government.
- **Developing North Macedonia’s AKIS.** It would be useful to increase public investment in well-targeted research and development to a quarter of the gap relative to research and development in the EU28. Complementary efforts would include creating an enabling environment for innovation in digital agriculture (including low-cost, data-intensive, on-farm digital technology applications) and aligning the knowledge agenda with efforts to boost climate resilience and improve farmers’ access to agroclimatic information.

#### 4. World Bank Group Engagement

<p><b>Ongoing Support</b></p>	<ul style="list-style-type: none"> <li>• The <b>North Macedonia Agriculture Modernization Project (US\$50 million; closing June 2025)</b> aims to boost the productivity and efficiency of farmers through improved access to technical support and finance for farm and agri-processing innovations.</li> <li>• ASA on <b>Greening Western Balkans Agriculture</b> documents opportunities and challenges for greening agriculture in the countries of the Western Balkans, including North Macedonia.</li> </ul>
<p><b>Potential Engagement</b></p>	<ul style="list-style-type: none"> <li>• The <b>Second Agriculture Modernization Project</b> aims to further the transformation and modernization of the agri-food sector; improve the enabling environment for green, resilient, and inclusive agribusiness development; and enhance private capital mobilization. It supports the transformation process through ASA, including on: (i) implementation of the Agriculture and Rural Development Strategy; (ii) the results/impacts of implementation of key agrarian policies; and (iii) the challenges and opportunities in developing the AKIS.</li> <li>• ASA on <b>Sustainable Livestock Transformation in the Western Balkans, Moldova, and Ukraine</b> seeks to contribute to the policy dialogue and knowledge base on green and inclusive livestock development by identifying investment opportunities for addressing production, food safety, and environment risks in livestock value chains in the Western Balkans, Moldova, and Ukraine.</li> </ul>







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