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SPECIAL EDITION

Contents

THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

A SHORT ECONOMIC OVERVIEW

KEY FACTS

The former Yugoslav Republic of Macedonia is a small, land-locked economy with a population of 2 million and a GDP of € 4.3 billion (2004). This equals about 0.04% of the GDP of the EU-25. Per-capita GDP in terms of purchasing power is roughly at 25% of the EU-25 average (€ 2,170 at current exchange rates). Population growth has been averaging about 0.2% per year in recent years. Key industries of the country are manufacturing (15% of GDP), trade (14% of GDP) and agriculture (11% of GDP). The country's openness to trade is relatively high, with total trade (exports and imports of goods and services) amounting for some 100% of GDP. The main export commodities are textiles and steel. About 55% of total trade is EU trade.

Macroeconomic background

The country's economy was one of the most underdeveloped in the Socialist Federal Republic of Yugoslavia (SFRY). After 1991 the separation from its traditional markets as well as the loss of financial support from the federal budget of the SFRY aggravated the economic recession, which had already clouded the last years of its membership of the SFRY. Furthermore, the economy was hampered by the interruption of crucial north-south trading routes by regional conflicts. During most of the first half of the 1990s, the economy had to cope with the sanctions imposed by the United Nations on the remainder of the SFRY. Moreover, in 1994-1995 Greece imposed a trading embargo on the former Yugoslav Republic of Macedonia due to the dispute regarding the country's name.

As in many other newly independent transition economies, the first years of transition were marked by a sharp decline in economic activity. Key factors were the breakdown of traditional production links and financial intermediation, the loss of preferential trading arrangements and a surge in inflation, reaching 1700 percent in 1992. By 1994 economic activity had declined to about three-quarters of the production level before independence. During 1993 and in early 1994 the authorities implemented a stability-oriented policy mix, by pursuing a tight fiscal policy, limiting the growth of credit and wages and pegging the currency to the German mark. As a result, inflation declined to single digits and output started to expand again. However, the trade embargo by Greece during 1994-1995 slowed down economic recovery.

The years 1996-2000 were characterised by relative economic stability and slow, but important, structural reforms. Privatisation gained speed and first steps were taken towards liberalising the labour market. The trade regime was liberalised in 1996. In mid-1997 a step devaluation of the currency took place, which triggered neither a significant acceleration of inflation nor any noteworthy improvement in export performance. In 1999 the war in neighbouring Kosovo led to a sudden influx of a large number of ethnic Albanian refugees. The uncertainties created by the war in Kosovo also had a negative impact on financial markets, leading to liquidity bottlenecks and pressure on the exchange rate.

The crisis in 2001 led to a period of increased economic uncertainty. GDP declined by 4.5% in 2001, while the financial costs of the crisis pushed the public-sector deficit up to about 7% of GDP.

The former Yugoslav Republic of Macedonia - Main economic trends

		2000	2001	2002	2003	2004	2005	
Gross domestic product	ann. % ch	4.5	-4.5	0.9	2.8	4.1	3.7	1st half
Private consumption	ann. % ch	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	
Gross fixed capital formation	ann. % ch	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	
Unemployment [1]	%	34.8	33.9	34.8	39.6	39.3	38.0	1st half
Employment [1]	ann. % ch	0.3	-1.7	-0.1	-1.9			
Wages	ann. % ch	4.4	1.1	6.4	4.9	3.5	2.2	Jan-Jul
Exports goods and services	% of GDP	42.2	48.6	42.7	38.0	37.9	n.a	
Imports goods and services	% of GDP	52.2	63.5	56.6	58.2	54.8	n.a	
Current account balance	% of GDP	-1.9	-6.5	-9.5	-3.3	-7.7	N.A.	
Direct investment (FDI, net)	% of GDP	4.5	11.8	2.1	2.0	2.8	N.A.	
CPI	ann. % ch	6.6	5.2	2.3	1.1	-0.4	0.4	Jan-Nov
GDP Deflator	ann. % ch	8.2	3.6	3.4	0.3	1.3	n.a	
Import prices	ann. % ch							
Interest rate (3 months depo)	% p.a.	11.2	10.0	9.6	8.0	6.5	6.6	Jan-Sep
3 months T.B yield	% p.a.	N.A.	N.A.	N.A.	N.A.	8.49	10.3	Jan-Sep
Stock markets	Index	N.A.	1000	1095	1179	1352	1775.6	Jan-Sep
Exchange rate MKD/EUR	Value	60.7	60.9	61.0	61.3	61.3	61.3	Jan-Sep
Nominal eff. exchange rate	Index	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	
Central government balance[2]	% of GDP	2.5	-6.3	-5.6	-0.1	0.7	N.A.	
Public sector debt [2]	% of GDP	48.0	48.8	42.9	39.0	37.6	N.A.	

1: LFS data; 2: GFS data.
Source: Eurostat, ECOWIN, national sources

Since 2001 the economy has returned to positive growth rates, although the speed of recovery is rather slow. By 2004 real output was some 17% above the 1996 level. However, this was still 10% below pre-independence levels. In nominal terms, GDP was MKD 265 billion (€ 4.3 billion) in 2004. Rough estimates of the size of the informal sector suggest that about one third of economic activity might not be registered, especially in the low-value-added service sector and in small enterprises.

Central government finances registered considerable deficits in the early years of independence, but were brought close to balance in the second half of the 1990s. However, the crisis in 2001 and its aftermath brought a major increase in public spending, which resulted in significant general government deficits. In 2003 and 2004, public finances were again close to balance. Nevertheless, the social security system constitutes a major drain on public finances. With respect to public debt levels, the former Yugoslav Republic of Macedonia is in a relatively favourable position with a total public sector debt-to-GDP ratio of some 40% at the end of 2004. Slightly more than 60% of this debt (27% of GDP) is financed externally.

The external accounts show substantial deficits. The main factor behind these imbalances is the trade account, which deteriorated substantially during the second half of the 1990s and reached more than 20% of GDP in the early 2000s. This widening trade gap reflects increasing commodity imports which are not counterbalanced by exports. The trade deficits are financed to a large extent by current transfers amounting to some 10% of GDP (workers' remittances, donations, etc.) and, to a smaller extent, by FDI, which amounted to some 2% of GDP in recent years. Total external debt accounted for some 45% of GDP at the end of 2004.

The former Yugoslav Republic of Macedonia joined the Bretton Woods institutions in 1993 and has since then benefited from substantial technical and financial support. The country has also benefited from EU support in the form of CARDS projects and macro-financial assistance.

Structural change

When the former Yugoslav Republic of Macedonia became independent, its economic structures strongly reflected the specific features of the economic and social system in the SFRY, into which it had been integrated for nearly five decades (1944-1991). While based on communist principles, Yugoslavia had developed a very particular economic model, where large parts of the means of production were "socially owned" (i.e. not owned by the State but by the employees), with a relatively high degree of local self-determination. As a result, economic operators enjoyed a comparatively high level of freedom and independence. Private ownership of production means was possible, and prices were to a large extent determined by market processes. However, one important feature of this system was the de-facto soft budget constraint for socially-owned enterprises, which allowed politically well-connected enterprises easy access to credit from the banking sector and gave them the possibility to accumulate huge arrears of unpaid taxes, social contributions or payment obligations to other companies. This practice allowed unviable enterprises to survive, albeit at the expense of a sharp deterioration in the health of the financial sector and price stability.

The former Yugoslav Republic of Macedonia - Main indicators of economic structure (2004)

Population (average)	*Million*	2.0
GDP per head	*€ PPS*	:
	% of EU-25 average	25e
Share of agriculture in:		
- gross value added[1]	*% of total*	13.4
- employment[1]	*% of total*	10.1
Gross fixed capital formation	*% of GDP*	16.3n
Gross foreign debt of the whole economy	*% of GDP*	38.0
Exports of goods and services[1]	*% of GDP*	37.9n
Stock of foreign direct investment	*Million €*	115.0
	€ per head	56.7
Employment rate	*% of 15-64 age group*	33.8
Long-term unemployment rate	*% of labour force*	33.5

1: 2003; e: estimate; f: forecast; n: national sources;
Source: Eurostat

During the five decades when the former Yugoslav Republic of Macedonia was part of the SFRY, its economic structures had undergone significant reorientation and modernisation, with a strong emphasis on transport infrastructure and industrialisation. These efforts transformed the basically agricultural economy into a semi-industrialised one, with considerable emphasis on the textile and metal industries. As in many other transition economies, restructuring started with an economic structure which was dominated by manufacturing (48% of the total value added in 1990, including mining). The share of the trade sector was also relatively high (nearly 20% of total value added), while agriculture amounted to about 10%. Tourism accounted for only 2%. During the first half of the 1990s the economy appears to have diversified. Available data indicate, for this period, a significant decline in the importance of manufacturing and mining and an increase in the role of agriculture, while trade appears to have remained fairly constant. This trend was also reflected in the employment structure, with a decline in employment in the manufacturing sector, while the share of employment in the service sector, such as transport but also public administration, increased. The share of agriculture in total employment has remained substantial (if unpaid family workers are included, the share of persons in the agricultural sector was about 22% in 2003).

The commodity structure of exports was highly concentrated before independence, with manufactured goods (manufactured iron, textiles, etc.) accounting for more than 75% of total exports. Since then the range of commodity groups has diversified to some extent, reflecting the diversification of trading partners. On the import side, the share of industrial intermediate products has declined, while the share of consumer products has increased. Concerning trading partners, the former Yugoslav Republic of Macedonia started with a strong orientation towards the markets of former Yugoslavia (to which about three-quarters of the country's industrial output was exported). To a large extent this reflected preferential trade arrangements among the members of the SFRY. Trade with other immediate neighbours was relatively low during the Yugoslav period, as Albania increasingly reduced international trade while trade with the Council of Mutual Economic Assistance (CMEA) area faced political obstacles. Nevertheless, compared to transition economies which traded either in the framework of the Soviet Union or through CMEA agreements, trade integration with Western countries was relatively high. However, the embargo imposed by the United Nations on the remainder of the SFRY and the trade boycott by Greece had a strong – although probably to a large extent only temporary – impact on regional trade flows. The share of exports and imports to and from the EU has increased from some 43% of total trade in 1990 to about

55% in 2004, to some extent due to increased trade with Greece. The share of exports to the former SFRY (Serbia and Montenegro, Croatia, Slovenia and Bosnia and Herzegovina) "recovered" from 22% in 1992 to some 30% in 2000, but slipped back to about 28% in 2004.

The labour market situation was already difficult when the country became independent but has further deteriorated since then. As a result of the economic crisis in the SFRY in the late 1980s, the former Yugoslav Republic of Macedonia entered independence with an unemployment rate of approximately 24%. The restructuring of the economy has led to an overall decline in labour demand, as the low growth dynamics and the poor business environment have failed to create a sufficient number of job opportunities. A high tax burden on registered labour and the lack of flexibility of the labour legislation to allow for part-time and fixed-term jobs are other major reasons for the low job creation in the former Yugoslav Republic of Macedonia. As a result, the participation rate, i.e. the share of working age population (15-64 years) which is economically active, has remained particularly low (some 55% of the labour force in 2004), especially among women and, even more so, among ethnic minorities. The employment rate has basically remained static at an extremely low level with fewer than 40% of persons of working age being registered as employed. Officially registered unemployment rose to some 39% of the labour force in 2004. However, officially registered unemployment also includes persons who register as unemployed mainly in order to be included in the health insurance system. The Employment Agency was established in 1997. The Agency's budget amounts to some 3% of GDP (€ 127 million in 2004). Unemployment contributions cover about 16% of its revenue while budget contributions cover about 80% (2.5% of GDP). 97% of its expenditure is on unemployment benefits.

After independence, the authorities succeeded in establishing the institutions that are necessary for the functioning of a market economy. Important examples are the establishment of a largely independent National Bank in 1992, the establishment of a stock exchange in 1996, the creation of financial sector supervisory and regulatory bodies in the late 1990s and the establishment of a Treasury in 2000. Modernisation of the tax system has started although important challenges still lie ahead, the most prominent ones being to improve tax collection and address the informal sector. In the financial sector, tensions created by the collapse of the pyramid scheme in 1997 were overcome, while other challenges, such as weak governance and the existence of a relatively high number of relatively small banks, persist.

Overall, the pace of reform has been relatively slow. To some extent this reflects the periods of economic crisis and hardship caused by regional or ethnic conflicts. However, even during periods of relative economic stability (e.g. from 1996 to 2000, or after 2001) progress with reforms has been slow in many areas or has turned out to achieve only suboptimal results.

Socio-economic developments

Economic and social disparities among the eight NUTS III regions are relatively high, despite the small size of the country. In particular, the differences in infrastructural endowment and income levels between the capital and rural areas are significant. GDP per capita in purchasing power standards (PPS) is nearly twice as high in the capital region (approximately 50% of the EU average, compared to a national average of some 25% of the EU average). Moreover, social disparities seem to have been widening. During the period 1998-2002, the capital was the only region with positive growth in per-capita income. Labour mobility appears to be rather low despite significant differences in unemployment rates between regions, ranging from 30% to 50% of the labour force.

KEY ACHIEVEMENTS AND CHALLENGES

The economy has achieved a high degree of macroeconomic stability, with low inflation, balanced public finances and low public indebtedness. Price and trade liberalisation, as well as privatisation, are largely completed. The financial sector appears to be stable. The labour force is equipped with sound basic education and the country's endowment of transport and telecommunication infrastructure is fairly good. Economic integration with the EU is well advanced.

However, the functioning of the market economy is impeded by institutional weaknesses, such as the slow and cumbersome administrative procedures, shortcomings in the judiciary and limited progress in land and property registration. As a result, the business climate is not conducive to stimulating investment, particularly foreign direct investment, and growth. In addition, the functioning of the labour and financial market is deficient, which impedes the reduction of the particularly high unemployment and hinders credit provision to enterprises. Domestic and foreign investment has been insufficient, resulting in low productivity growth and a deterioration in competitiveness. The existence of a considerable informal sector leads to major distortions in the economy. The commodity structure of exports is unbalanced. At this stage, the economy would thus face major difficulties in sustaining competitive pressures in the single market. Addressing the identified weaknesses by proceeding with structural reforms should contribute to enhancing the functioning of the market economy and its competitiveness.

TABLE

European Commission, ECFIN-D-1

The former Yugoslav Republic of Macedonia

		2000	2001	2002	2003	2004	200404 Q4	200501 Q1	200502 Q2	200503 Q3	200509 Sep	200510 Oct.	200511 Nov.
1 Output and demand													
Industrial production [1.2]	Ann. % ch	3.6	-3.0	5.3	4.7	-12.7	4.3	6.1	7.9	-6.6	9.4	3.3	
Gross domestic product [1.3]	Ann. % ch	4.5	-4.5	0.9	2.8	4.1	2.2	2.7	4.7	:	N.A.	N.A.	N.A.
2 Labour market													
Unemployment [2.1]	%	34.8	33.9	34.8	39.6	39.3	38.0	38.6	37.4	:	:	:	:
Employment [2.2]	Ann. % ch	0.3	-1.7	-0.1	-1.9	:	:	1.0	1.0	:	:	:	:
Wages [2.3]	Ann. % ch	4.4	1.1	6.4	4.9	3.5	4.5	3.1	1.4	2.4	3.1	:	:
3 International transactions													
Exports of goods [3.1]	Ann. % ch	28.3	-9.9	-8.6	2.2	11.6	21.7	25.8	33.4	14.5	17,6	:	:
Imports of goods [3.2]	Ann. % ch	37.9	-13.9	8.2	-3.8	14.5	24.2	8.7	19.3	9.0	17.8	:	:
Trade balance [3.3]	% of GDP	-17.7	-14.1	-21.4	-18.4	-20.9	-22.0	-12.4	-22.8	:	N.A.	N.A.	N.A.
Exports goods and services [3.4]	% of GDP	42.2	48.6	42.7	38.0	37.9	:	:	:	:	N.A.	N.A.	N.A.
Imports goods and services [3.5]	% of GDP	52.2	63.5	56.6	58.2	54.8	:	:	:	:	N.A.	N.A.	N.A.
Current account balance [3.6]	% of GDP	-1.9	-6.5	-9.5	-3.3	-7.7	-8.6	-1.4	-7.5	:	N.A.	N.A.	N.A.
Direct investment (FDI, net) [3.7]	% of GDP	4.5	11.8	2.1	2.0	2.8	3.1	2.3	2.2	:	N.A.	N.A.	N.A.
4 Prices													
CPI [4.1]	Ann. % ch	6.6	5.2	2.3	1.1	-0.4	-1.3	-1.3	0.0	0.8	1.1	0.9	0.2
GDP Deflator [4.2]	Ann. % ch	8.2	3.6	3.4	0.3	1.3	:	:	:	:	N.A.	N.A.	N.A.
Producer prices [4.3]	Ann. % ch	N.A.	N.A.	N.A.	-0.2	1.2	2.6	1.9	2.7	4.5	5.0	4.3	2.9
5 Monetary and financial indicators													
Interest rate (deposit) [5.1]	% p.a.	:	:	:	:	:	:	:	:	:	5.6	5.7	:
Bond yield/T- Bills 3 M, Average [5.]	% p.a.	:	:	:	:	8.5	9.1	9.9	10.5	10.4	10.2	9.8	8.9
Stock markets [5.3]	Index	:	1000	1095	1179	1352	969.2	1322.4	1988.2	2028.9	2288.4	2486.5	2425.3
Exchange rate MKD/EUR [5.5]	Value	60.73	60.91	60.98	61.26	61.32	61.45	61.41	61.38	61.20	58.72	61.23	60.26
6 Government balance and debt													
General government balance [6.1]	% of GDP	2.5	-6.3	-5.6	-0.1	0.7	:	:	:	:	N.A.	N.A.	N.A.
General government debt [6.2]	% of GDP	48.0	48.8	42.9	39.0	37.6	:	:	:	:	N.A.	N.A.	N.A.