

Transition in Macedonia Highlights
October 23rd, 2009

Highlights

This analysis attempts to take stock of Macedonia's progress in its transition to a market-oriented democracy. In assessing cross-country comparisons, we look at five dimensions: economic reforms; democratic reforms; economic performance; human capital; and peace & security. We created five indices to correspond to these dimensions. For each of these five indices, initial indicators were converted to a "1" to "5" scale with "5" representing the most advanced progress worldwide.

The salient finding is that considerable gaps exist in economic performance and education quality. Democracy gaps in Macedonia are also large against the Bulgaria-Romania-Croatia in 2006 thresholds and have been stagnant since 2004.

Of all the E&E countries where we have programs, Macedonia is the farthest along overall in economic and democratic reforms (i.e., Figure 1). However, reform progress has been stagnant in recent years, with the salient exception of micro-economic reforms (or business environment reforms) where Macedonia saw impressive gains this past year, increasing its worldwide rank from 71 to 32.

In contrast to progress in economic and democratic reforms, Macedonia is far from the leaders in macroeconomic performance and in human capital. Macedonia's progress in macro-economic performance and human capital has been very asymmetric; i.e., very good relative progress on some dimensions coupled with considerable lagging on others. In economic performance, Macedonia's economy is still not back to its pre-transition GDP level, partly because Macedonia's relatively strong economic growth since 2004 has been interrupted by the global financial crisis. Like most of E&E, Macedonia has been hit hard by the crisis, with a contracting economy of 3% in 2009.

The labor market picture remains very problematic: extremely high unemployment rates that have not been responsive to economic growth; almost nine out of 10 unemployed Macedonians have been unemployed long-term; extremely high youth unemployment that may be falling albeit very slowly (from 70% in the mid-1990s to 60% more recently).

In human capital (and no doubt related to the dismal labor market picture), education challenges are significant with very low tertiary enrollments and very poor test scores on standardized testing.

In peace and security, Macedonia is E&E average, though challenges exist in three of six areas: efforts to combat weapons of mass destruction, counter terrorism, and mitigate conflict.

Introduction and Method

This methodology uses the five E&E/USAID *Monitoring Country Progress (MCP)* indices (of economic reforms, democratic reforms, economic performance, human capital and peace and security). The methodology was approved by USAID and the State Department in 2004 to help determine when countries are likely to achieve benchmark standards based on the average of the scores that Romania and Bulgaria achieved in 2002. These standards were established with the intent to be proxies for when the path to political and economic reform has become irreversible. In this current analysis, we supplement the Bulgaria-Romania 2002 thresholds with Croatia, Romania, and Bulgaria in 2006 (when they graduated from USG assistance).

The *MCP* method employs a two step analysis. First, we examine reform progress (both economic and democracy) and compare country progress against plausible phase-out thresholds. Next, we examine progress in economic performance and human capital. If reform gains are to be sustained, then sufficient progress needs to occur in terms of a reasonably well functioning economy and one that is favorably affecting social conditions or human capital. The sequence is important here. A country must achieve the reform gains before crossing acceptable thresholds in economic performance and human capital. Otherwise the reform gains may not be sustained. Belarus and Turkmenistan lag considerably in reforms and yet are doing relatively well in economic performance (in the case of Turkmenistan) and/or human capital (in the case of Belarus). Yet, the assumption or assertion here is that those favorable indicators will not likely be maintained in the absence of reform progress. It's also important to bear in mind that, in some circumstances, progress in economic performance can forestall reform progress, such as seems plausible in the case of energy-exporting economies.

Another key consideration in the analysis is the importance of the causal relationships between the transition sectors. Economic progress contributes to democratization and vice-a-versa; so, too the relationship between the economic sector and the social sector (or human capital), and democratization and human capital. These inter-relationships were not explicitly taken into account during the phase-out reviews in 2004. However, they do suggest that sustaining the gains in any one sector is less likely to occur if other sectors are lagging considerably.

Economic and democratic reforms

Figure 1 provides the bird's eye picture of reform progress in Macedonia vis-à-vis the rest of the transition countries and vis-à-vis the Romania, Bulgaria and Croatia threshold. Broadly, Macedonia is close to the Southern Tier CEE average in both economic and democratic reform progress. It is close to the Romania, Bulgaria, and Croatia in 2006 thresholds in the economic reform dimension; yet at considerable distance in terms of democratic reforms.

Economic reforms

Macedonia is approaching the Romania, Bulgaria, and Croatia in 2006 threshold for economic reforms. This threshold notes the last year of new USG funding for all three

countries and hence represents the actual phase-out year for these countries. Initial progress in economic reforms was strong at in the early 1990's, but in recent years economic reforms have been progressing at a slow rate (*Figure 2*).

Figures 3-6 show the components of the economic reform index and Macedonia's 2008 level of economic reform progress compared to Romanian, Bulgaria and Croatia in 2006 and Macedonia in 1999. Good progress has been made in first stage reforms with a gap only in large scale privatization; while gaps still remain in the second stage reforms vis-à-vis the Bulgaria, Romania and Croatia threshold in four of the indicators relative to this threshold: competition policy, banking reform, non-bank financial reform and infrastructure reform. Despite good progress since 1999 in first and second stage reforms, Macedonia has only progressed in two areas over the last two years as measured by the EBRD second stage competition policy and banking sector. Completing second stage reforms is necessary for supporting strong and stable economic performance. 2009 data will be released by the EBRD in November.

Macedonia improved in 7 of 10 macro-economic reform indicators from World Bank's *Doing Business in 2010*, namely starting a business, dealing with construction permits, employing workers, registering property, getting credit (information), protecting investors, and paying taxes (*Figures 6 & 7*). This resulted in an improvement in rankings from a 71 in 2008 to a rank of 32 in 2009 making Macedonia the third most improved country in the 183 country sample behind only Rwanda and Kyrgyz Republic. The lower the rank, the more favorable business finds the microeconomic environment to be. Significant strides were made in employing workers (rank of 122 down to 58) and protecting investors (rank of 88 down to 20). This puts Macedonia ahead of all of its Southern Tier CEE neighbors and the Northern Tier CEE average, ahead of Slovakia, Hungary, Slovenia, Poland and the Czech Republic.

We calculated the change in the business climate (*Figure 8*) by calculating the percentile ranking worldwide of each country for scores for the past five years, 2005-2009. Percentile ranking was used since the sample size has increased from year to year. Improvements in business environment reforms made in 2009 put Macedonia ahead of the Northern Tier CEE average.

Democratic reforms

Progress in democracy has been very uneven over time in Macedonia. There were notable democracy gains following the 2001 Ohrid Agreement, and three distinct periods of backsliding around 1991, 1994 and 2001. Freedom House reports no measurable advances occurring in 2006, 2007 or 2008 (*Figure 10*).

Figures 11-13 show the disaggregated components over time. Relative to both the 2006 threshold, gaps prevail in six of the seven areas measured as of 2006: in electoral process; civil society; media; rule of law; national governance; and local governance. Since 1999, democratic reforms in Macedonia have improved slightly in civil society and anti-corruption, though backsliding is evident in media and governance. The 2009 Freedom House report measures no change in the aggregate score but cites an improved anti-

corruption environment due to a revised criminal procedure code and an amended Law on Monitoring and Communication Code. Electoral processes declined due to key international standards not being met in the June 1st, 2008 election.

Contrary to Freedom House, which has shown no measureable change in independent media since 2002, IREX's *Media Sustainability Index* shows backsliding in all five areas of sustaining free media in Macedonia in 2008 and 2009 (*Figure 14*). Supporting institutions declined the most followed by free speech, plurality of news sources, business management, and professional journalism. According to the 2009 *Media Sustainability Index* report, the falling scores are "driven by the huge fines and enormous number of current lawsuits in front of the courts, further fragmentation of the market, and financial dependency of key media on the government advertising that resulted in pro-governmental coverage." Macedonia is no longer categorized with its Southern Tier CEE neighbors as 'near sustainable' but is now considered an 'unsustainable mixed system'.

Macedonia's NGO sector is in "mid-transition," and well short of "consolidation," according to USAID's 2009 *NGO Sustainability Index* (*Figure 15*). According to this measure, Macedonia's NGO sector has not advanced since 2003, but remains more developed than the Southern Tier CEE, ahead of Bosnia-Herz, Albania, Kosovo, Montenegro and Serbia. Of the eight areas tracked, Macedonia's NGO sector lags the most in legal environment and advocacy. Service provision is the most advanced area.

Economic performance and human capital

Progress in economic performance in Macedonia is a 3.0 on a scale of 1.0 to 5.0, slightly above the Eurasian average of 2.9 and only ahead of Southern Tier CEE neighbors Serbia and Kosovo. Unlike progress in Eurasia where economic performance exceeds its performance in terms of human capital, Macedonia is well balanced on the two dimensions, scoring a 2.9 on Human Capital. Macedonia falls short of the Southern Tier CEE average on both dimensions and has far to go in terms of attaining the Bulgaria-Romania-Croatia in 2006 threshold.

Economic Performance

Macedonia's Economic Performance profile is also imbalanced. It scores at the RBC threshold in services and private sector share of GDP, above RBC in micro, small and medium enterprises and energy security, and well above RBC on macro stability. However, Macedonia scores in the bottom ranges on other indicators, labor markets, domestic inequality, GDP growth, FDI and exports.

The global economy is forecast to contract in 2009 (-1.8%), the first time since World War II. The transition region as a whole has been disproportionately hit by the global financial crisis (-5.5%). While economic growth in Macedonia has been over 5% on average from 2000 to 2008, 2009 estimates predict the economy will contract by 3% (*Figure 21*). Macedonia fares better than the Southern Tier CEE estimate of a 3.8% decline in GDP and is comparable to Bosnia-Herz and the Czech Republic, slightly better than Romania, Bulgaria and Croatia (*Figure 22*).

Figure 23 highlights how extensive and how quickly economic activity has fallen. Most of the transition economies went from experiencing economic growth well above the global average and global regional standards in 2007 (and in earlier years) to below global average GDP change in 2009. Macedonia is experiencing an 8.9% drop; from 5.9% growth in 2007 to a 3% decline in 2009.

One of the distinguishing characteristics of much of the E&E region are the very substantial current account deficits, and external financing needs implied from those deficits. The IMF defines “large, persistent current account imbalances” as “current account deficits or surpluses that exceed three percent of GDP for at least three years.” Macedonia has historically had low current account deficits though 2008-2010 numbers are estimated to exceed 5%. A comparison of current account deficits and external debt in 2007 show Macedonia’s macroeconomic stability to have been very ably maintained in comparison to the transition region (*Figure 25*).

FDI in Macedonia is very modest, the second lowest in the CEE, ahead of Albania and Slovenia but closer to the Eurasia average than the Southern Tier average.

The Economic Performance Index includes an energy security indicator, which measures energy dependence (net energy imports as a percent of energy use) and combines it with a measure of energy efficiency (GDP per unit of energy use). In *Figure 27* we divide the transition countries into four quadrants or four categories: (1) energy efficient but dependent; (2) efficient and independent; (3) energy dependent and inefficient; and (4) energy independent but inefficient. Macedonia falls into the quadrant with most transition countries (fifteen), which are relatively energy dependent (large net energy imports) but efficient in energy use.

Labor markets are a significant concern in Macedonia. More than most transition countries, the vast majority of Macedonia’s unemployed have been unemployed more than 1 year (*Figure 28*). The unemployment rate is estimated at 34%. Only Kosovo has higher rates in the transition region. Despite the unemployment rate falling recently (*Figure 29*), Macedonia’s unemployment problem is comparable to estimates of 10 years prior (34% in 1998). This trend of little change over time is consistent with levels of long term unemployment (*Figure 30*). Youth unemployment rates (58% in 2007) and long term unemployment rates (85% in 2007) are very problematic.

Exports as a percentage of GDP, are greater today than earlier in the 1990s and the trend in very recent years has been more favorable (*Figure 32*). This increase, particularly in 2007 is closing the gap between export share in Macedonia and exports in the Northern Tier CEE. In light of the financial crisis, the trend is not growing. In a comparison of outward orientation between economies of comparable size (*Figure 33*), Macedonia continues to be more integrated into the world economy than Albania and Armenia, yet much less than Estonia and Slovenia.

Remittances as a percent of GDP are among the highest worldwide in a number of E&E countries including Macedonia at 8% of GDP (which corresponds to a country rank of 21).

Human Capital

Macedonia's human capital, as measured by the *MCP* index, falls short of the Romania, Bulgaria and Croatia threshold. But the disaggregated components show that on most human capital dimensions, Macedonia compares favorably (*Figure 35*). However, this view unmask a significant education gap.

Macedonia's per capita income of \$9,950 (PPP) is low for CEE standards; short of Romania, Bulgaria and Croatia in 2006 (\$12,103) and the Southern Tier CEE median (\$11,073) and only above two neighbors Bosnia-Herz (\$8620) and Albania (\$7950). On the health dimensions, Macedonia compares favorably. Life expectancy in Macedonia was 74 years in 2007, above the Southern Tier CEE average of 73 years. Macedonia's TB incidence was 26 deaths per 100,000, which is comparable to the Northern Tier neighbors (26 incidence on average) and ahead of Serbia (27), Bulgaria (37), Bosnia-Herz (61), Kosovo (77) and Romania (105). With an under-five mortality rate of 12 deaths per 1,000, Macedonia just falls short of the Southern Tier CEE average of 10 deaths.

Macedonia scores well on vulnerable populations, as defined by poverty rates of children and elderly. At \$2.15 per day, the most recent poverty rate for children in Macedonia is 6%, and for the elderly, 2%. These rates are comparable to those found in some of CEE's wealthier countries, including Estonia (6% and 4%), Lithuania (6% and 2%), and Poland (5% and 1%), and above the Southern Tier CEE average (12% and 7%). The rate of institutionalized children (or the rate of children in residential care per 100,000 population aged 0–17) in Macedonia was 184 in 2007. This is significantly lower than the Northern Tier average 760, Southern Tier average 411, or Eurasian average of 929.

Considerable gaps exist in Macedonia's education gap score. The education gap indicator in the Monitoring Country Progress human capital index draws from twelve indicators and attempts to measure both the quantity and the quality of education. By this measure, Macedonia is below the vulnerable threshold on 9 of 11 available indicators (with primary and secondary enrollments as the exception), making Macedonia stand out as the most vulnerable country in the entire transition region followed by Albania (6 out of 8) and Azerbaijan (5 out of 7).

One area of concern is the public expenditure on education, which fell from over 5% in the early 1990's to 2.9% in 2007. It is well below the transition region averages of 4.4% in the Northern Tier CEE, 3.6 % in the Southern Tier CEE and 3.9% in Eurasia in 2007.

Enrollment trends are mixed with high primary enrollments (93%) but with the 3rd lowest rate in CEE for secondary enrollments (73%). Both pre-primary (23%) and tertiary enrollments (23%) fall below the *MCP* vulnerable threshold (of 30% and 25%). Figures 35 and 36 highlight the decline in primary enrollments from 98% in 2000 to 93% in 2007/2008 which is far below the transition region average of 97.8%. At 93%,

Macedonia's primary enrollments are above but approaching our MCP vulnerable threshold of 91% student enrollment. In 2007/2008 Macedonia's level is most comparable to Bosnia-Herz (92%). But over an eight year time period Macedonia's enrollments decreased by 5%, while Bosnia-Herz's is closed the gap, improving by 7%.

The IEA implemented PIRLS study focuses on the reading literacy aptitude of students in approximately grade four. Macedonian students scored worse than any transition country on the PIRLS test, indicating a serious problem with the quality of education. No progress has been measured since 2001.

Peace and Security

This peace and security (P&S) analysis has been developed to be part of the Europe & Eurasia Bureau's Monitoring Country Progress (MCP) system. The primary product is a P&S index, the components of which are drawn closely from the Director of Foreign Assistance's conceptual framework of peace and security. As with the existing four MCP indices (economic reforms, democratic reforms, economic performance, and human capital), the focus is hence on measuring foreign assistance program-related areas, albeit at a relatively "high" (country progress) level.

As measured by the MCP Peace and Security Indicators, Macedonia scores a 3.2 on a scale of 1 to 5: at the transition region average (*Figure 39*). Disaggregating the P&S index reveals that Macedonia lags considerably in combating weapons of mass destruction and terrorism but reaches the threshold in three of five areas when compared with the average score at graduation of Romania, Bulgaria and Croatia (*Figure 40*).

Monitoring Country Progress in Macedonia

Program Office
Bureau for Europe and Eurasia
U.S. Agency for International Development

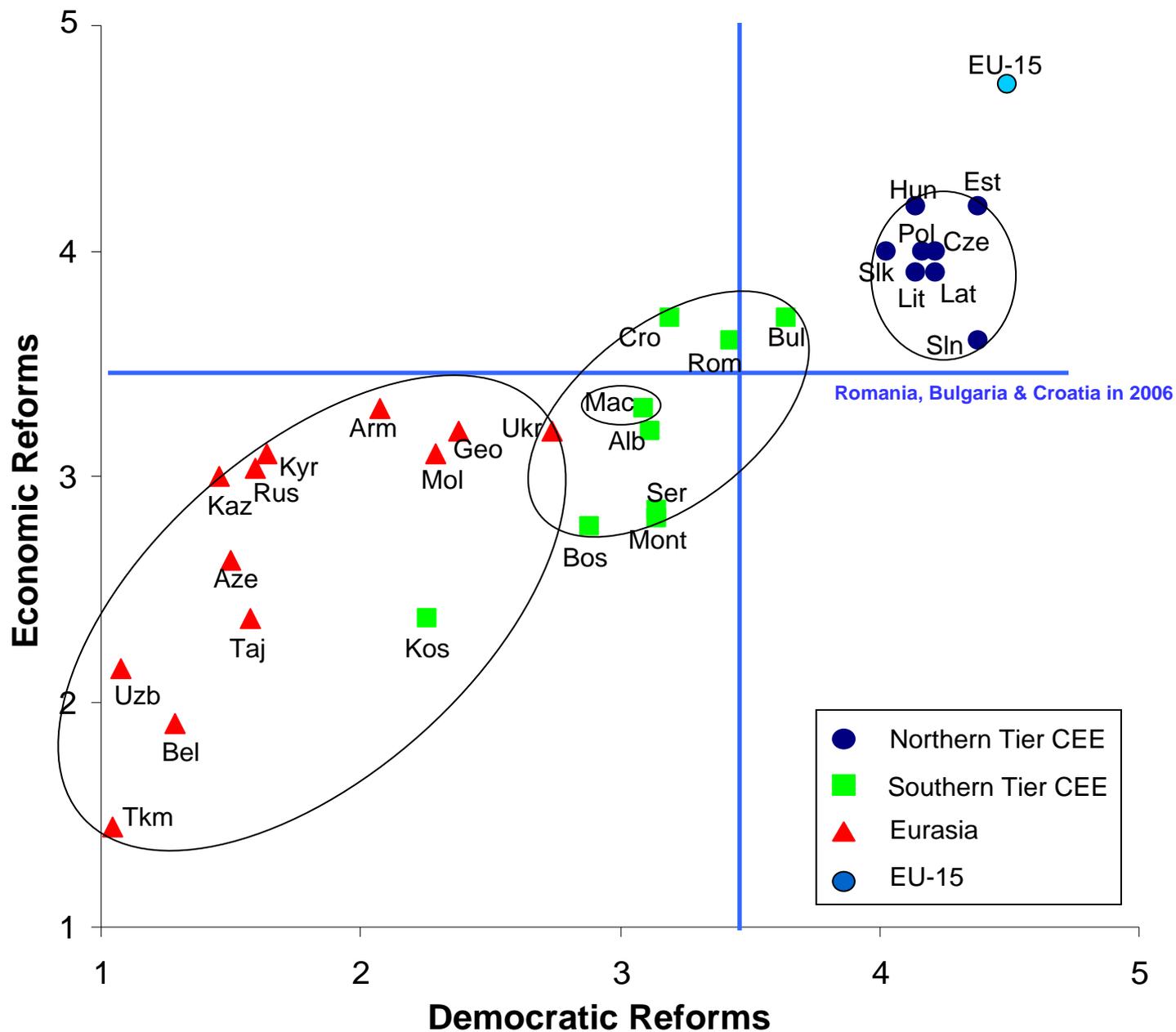
October 2009





Figure 1

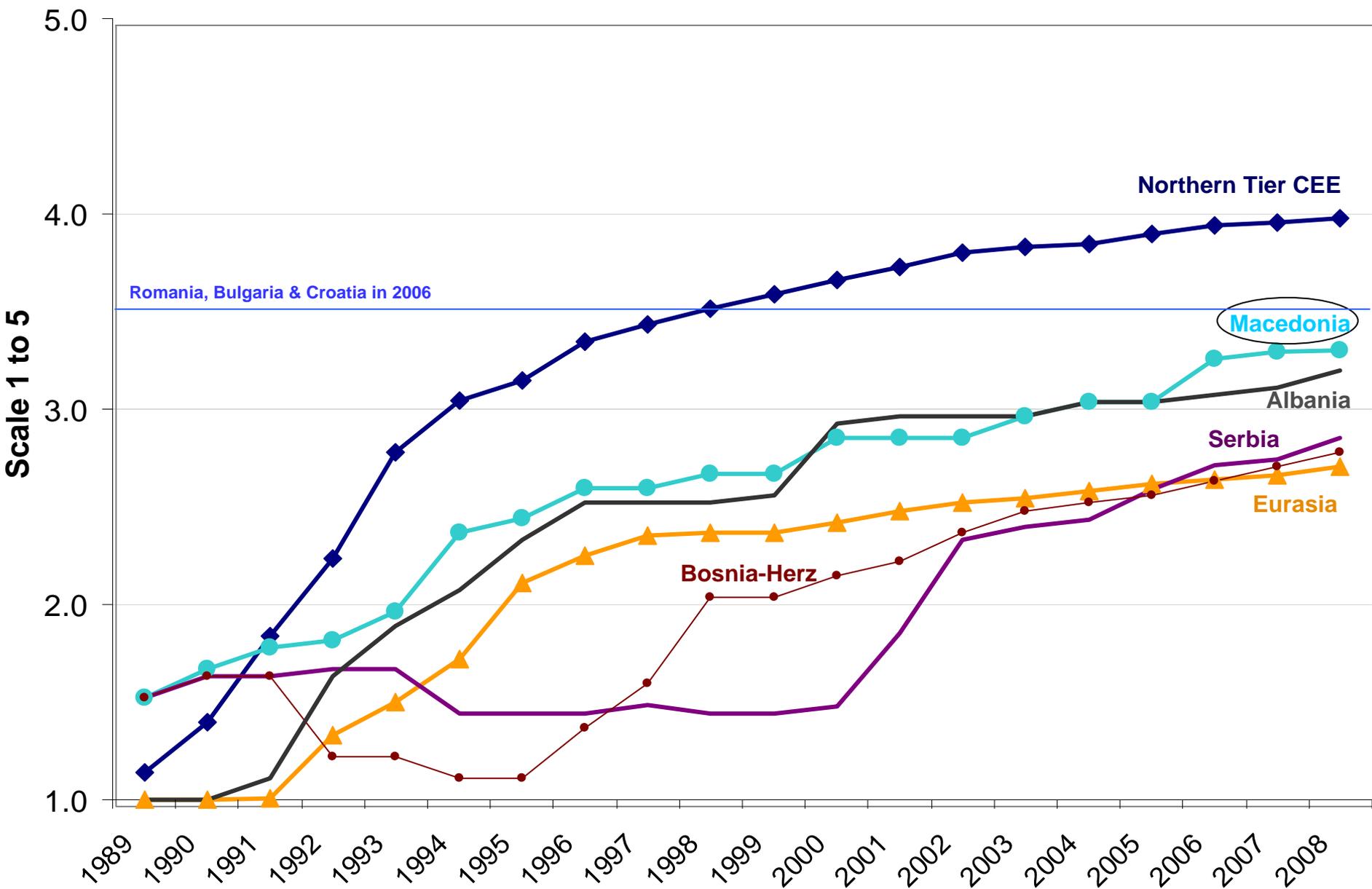
Economic and Democratic Reforms in 2008



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. Freedom House, *Nations in Transit 2009* (2009) and EBRD, *Transition Report 2008* (November 2008).

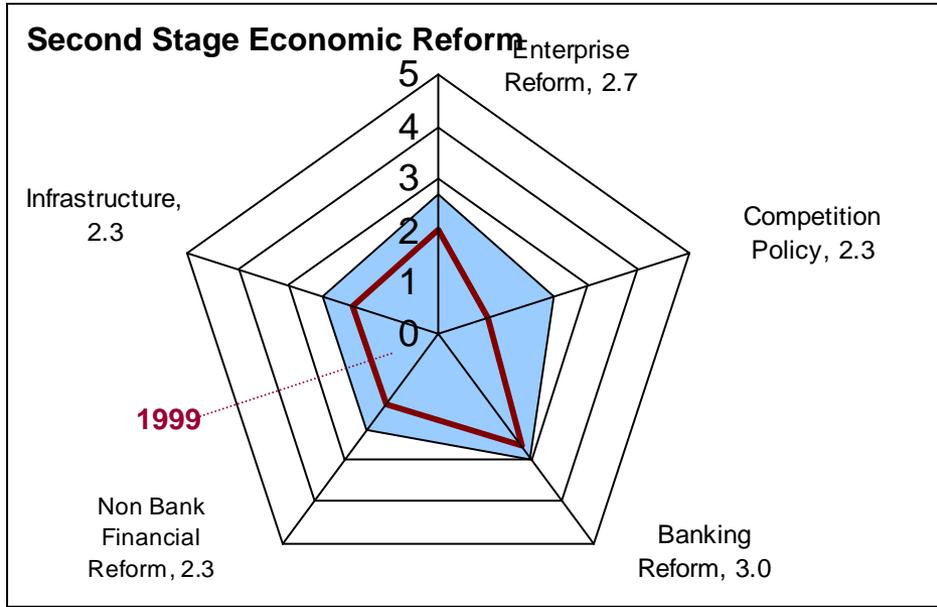
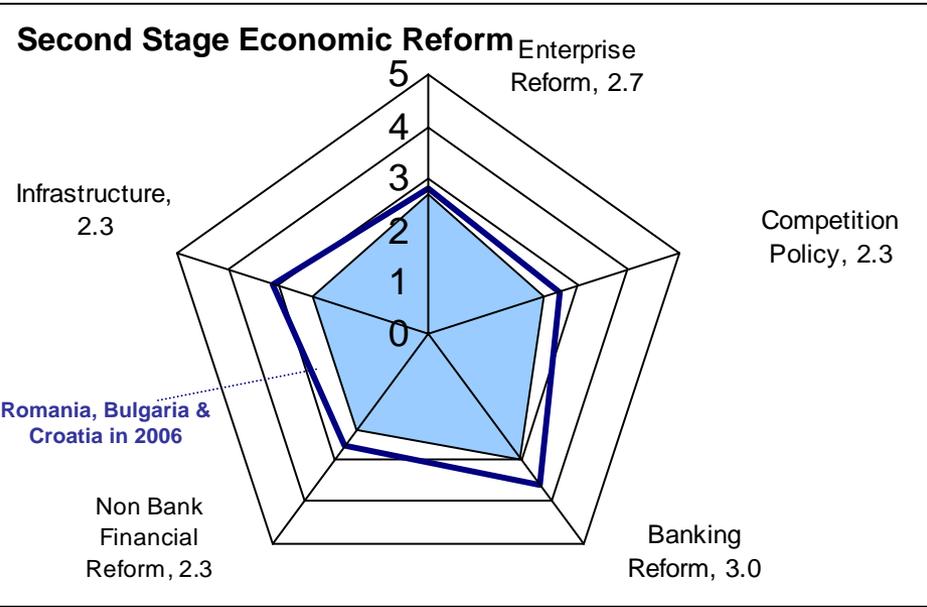
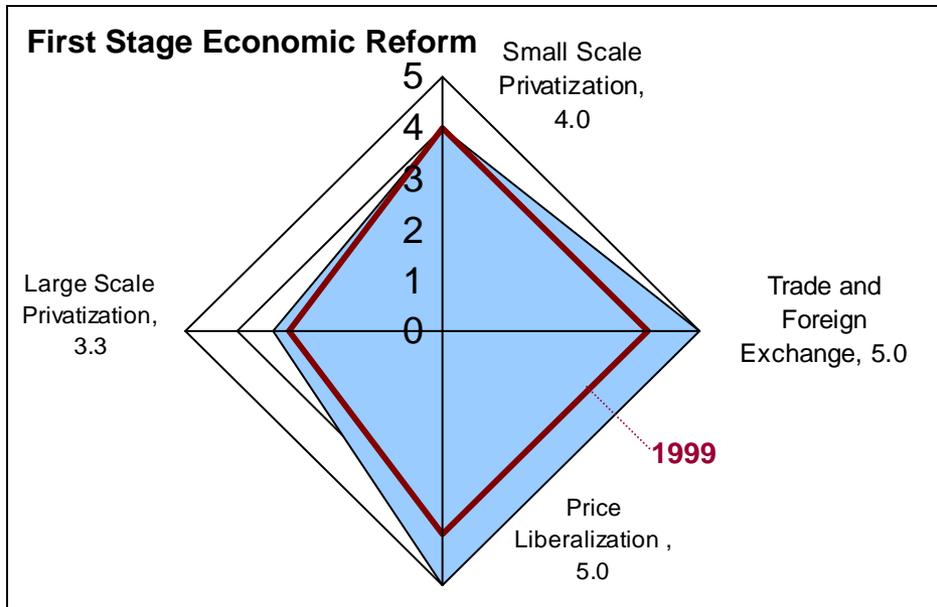
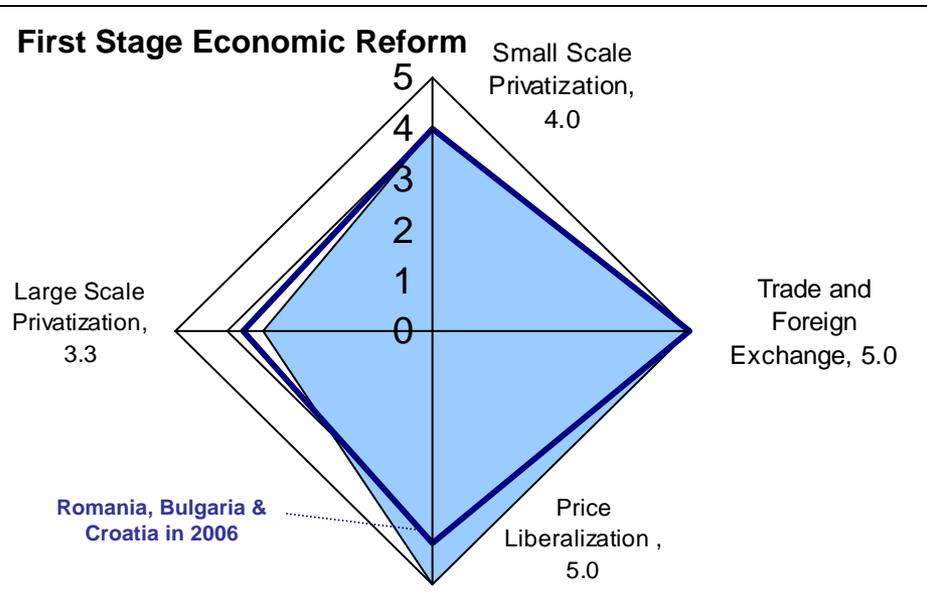
Figure 2

Economic Reform



Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #12* (2009 forthcoming) drawing from EBRD, *Transition Report 2008* (November 2008).

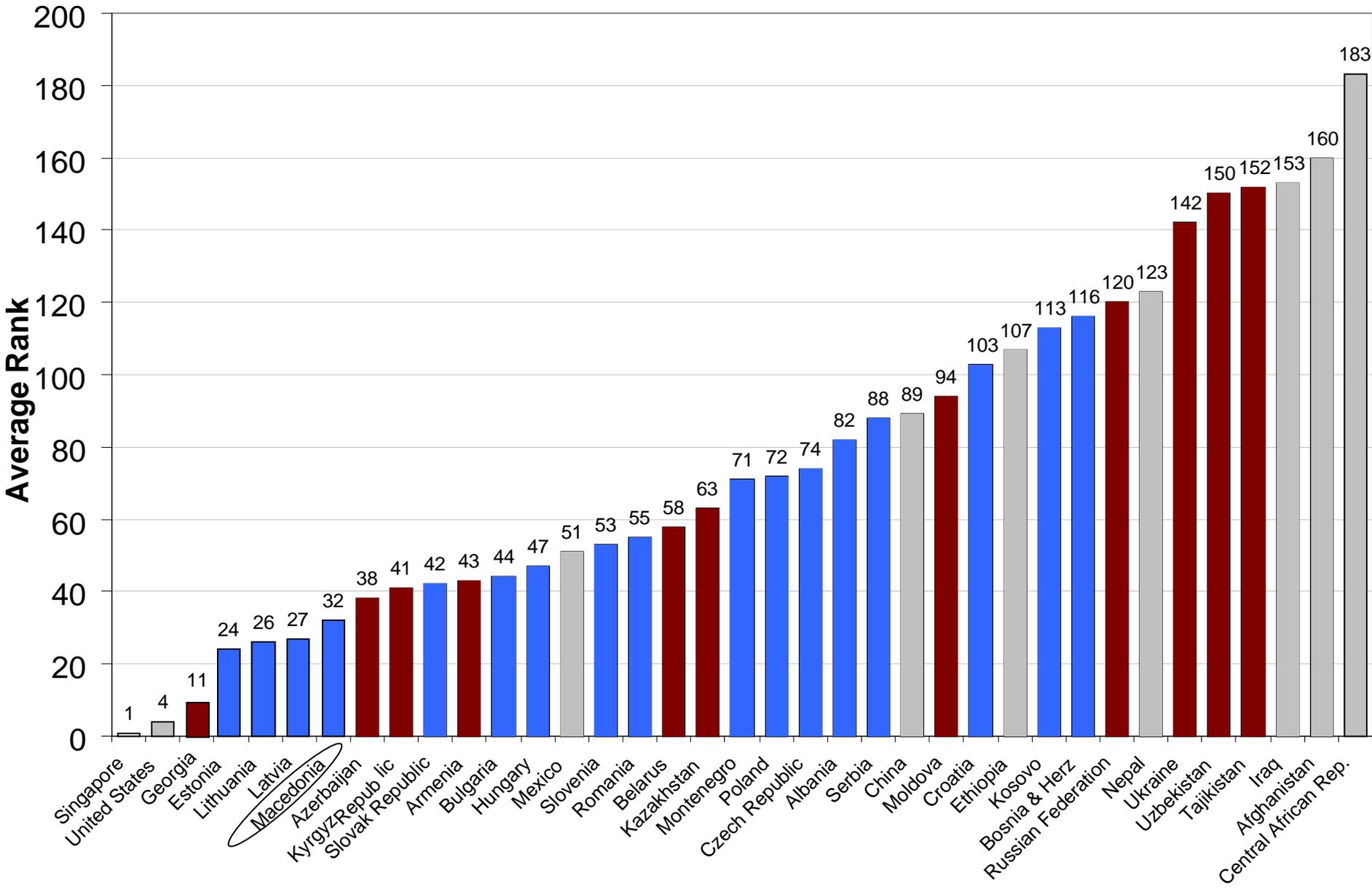
Economic Reform in Macedonia in 2008



Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #12 (2009 forthcoming)* drawing from EBRD, *Transition Report 2008 (November 2008)*.

Figure 7

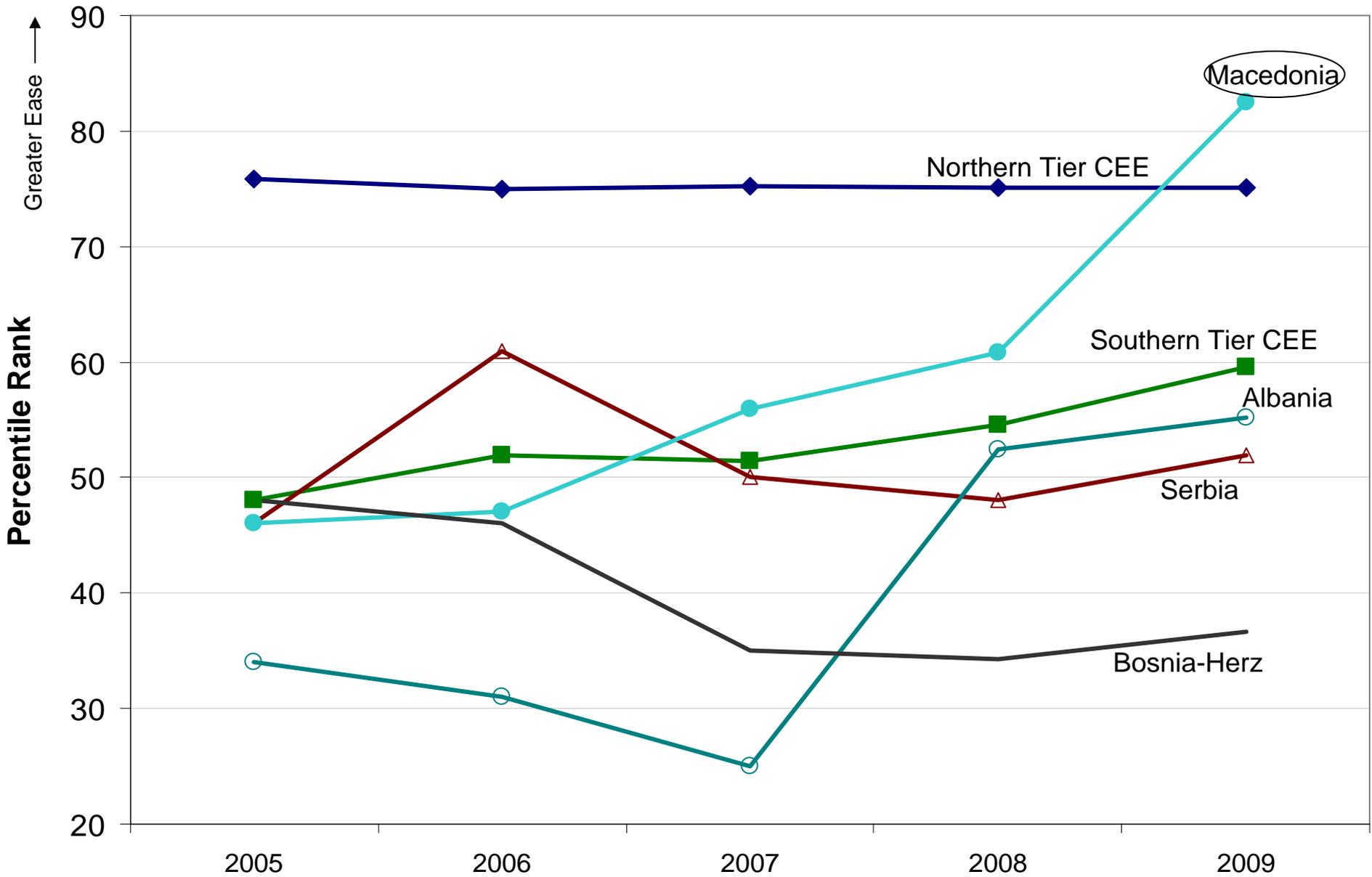
Business Environment in 2009



World Bank, *Doing Business in 2010* (September 2009). Worldwide scores range from 1 to 183 and include 10 topics: starting a business, dealing with construction, hiring and firing workers, registering a property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business.

Figure 8

Business Environment



Employing Workers in 2009

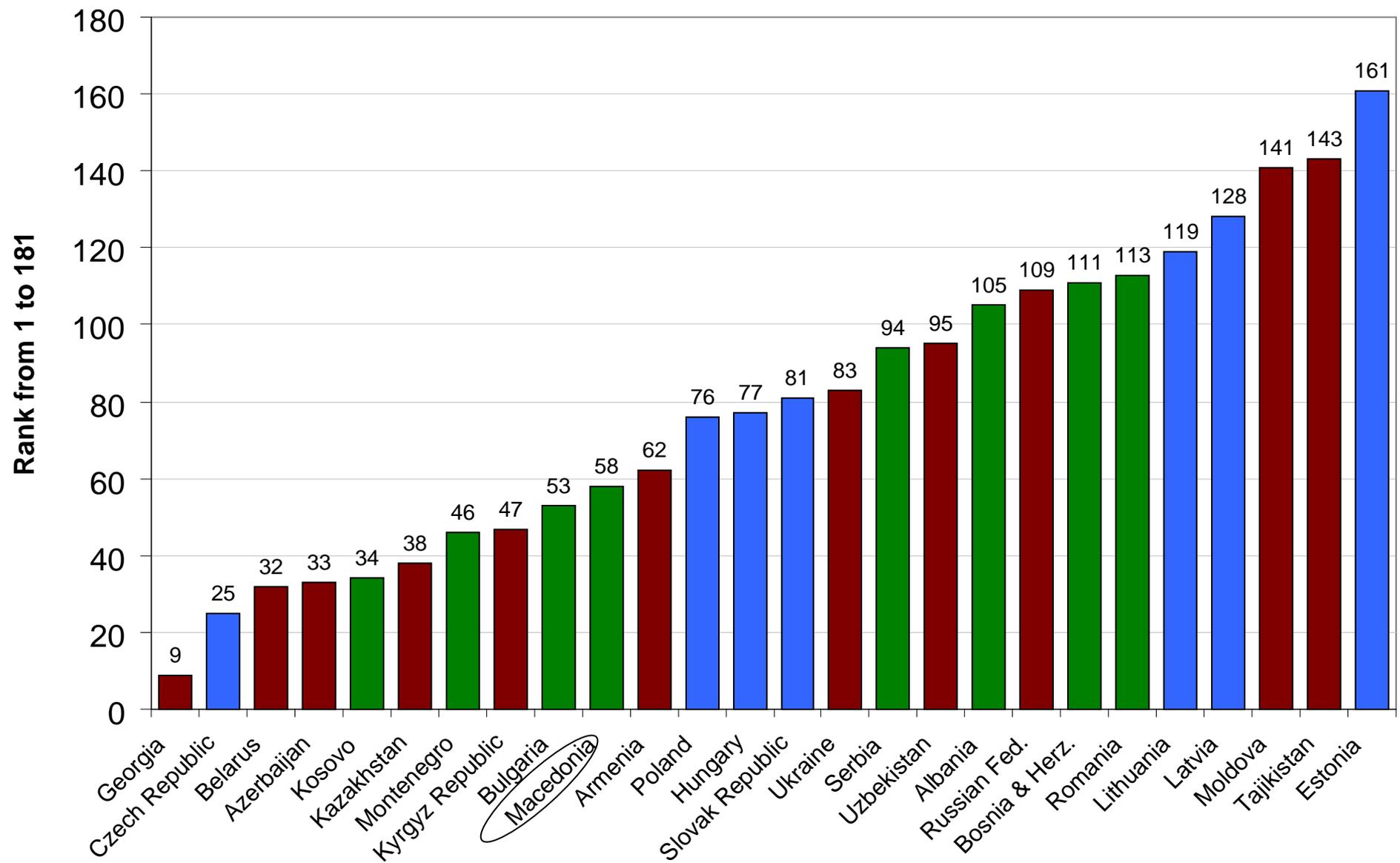
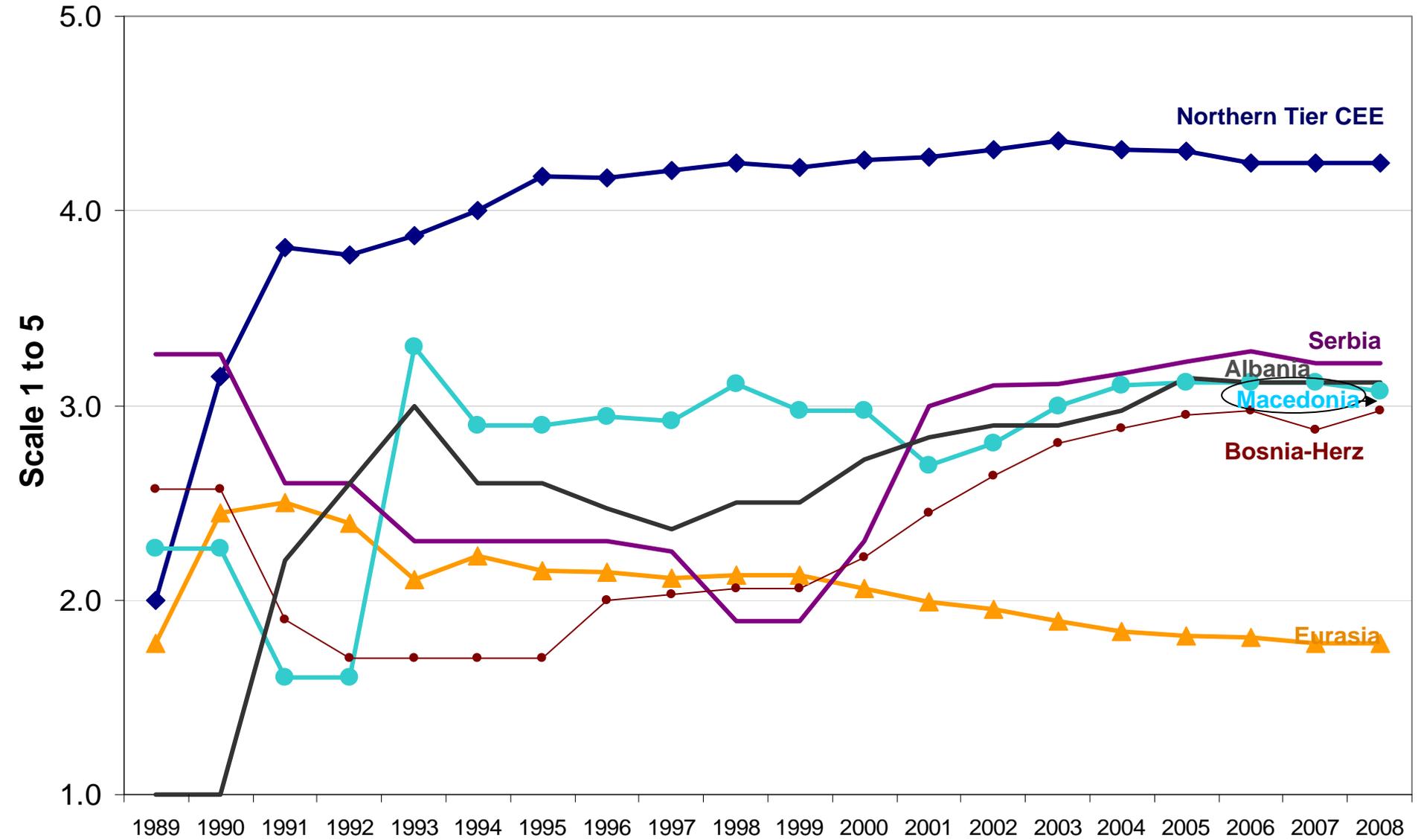


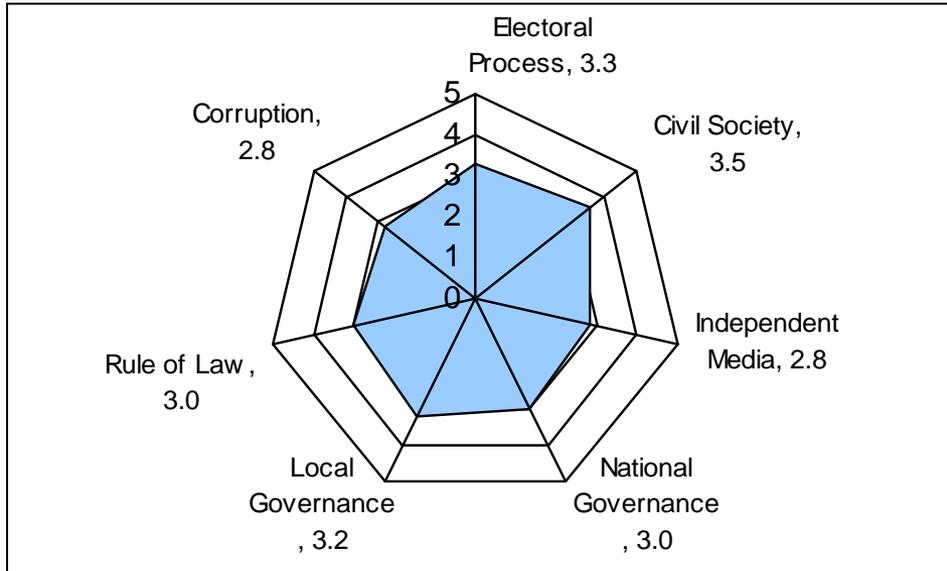
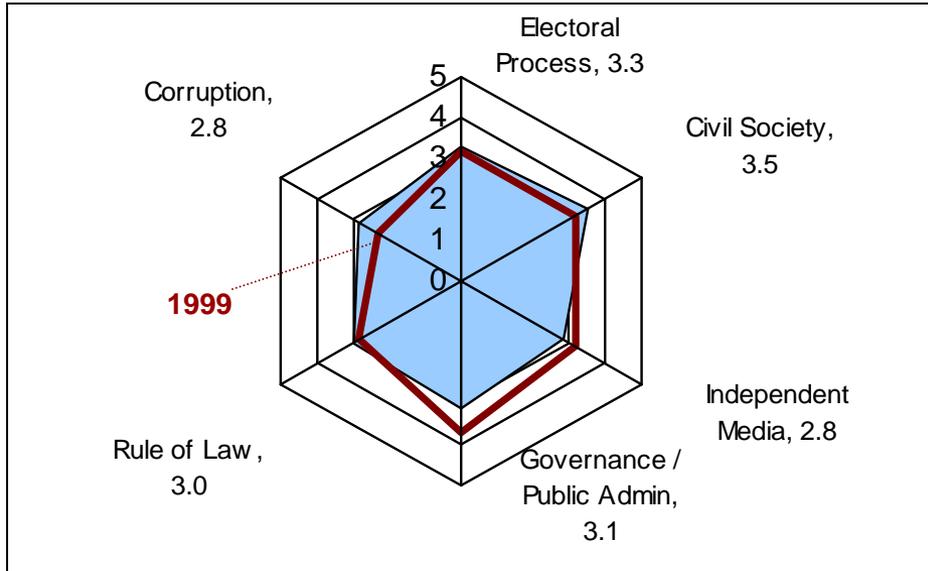
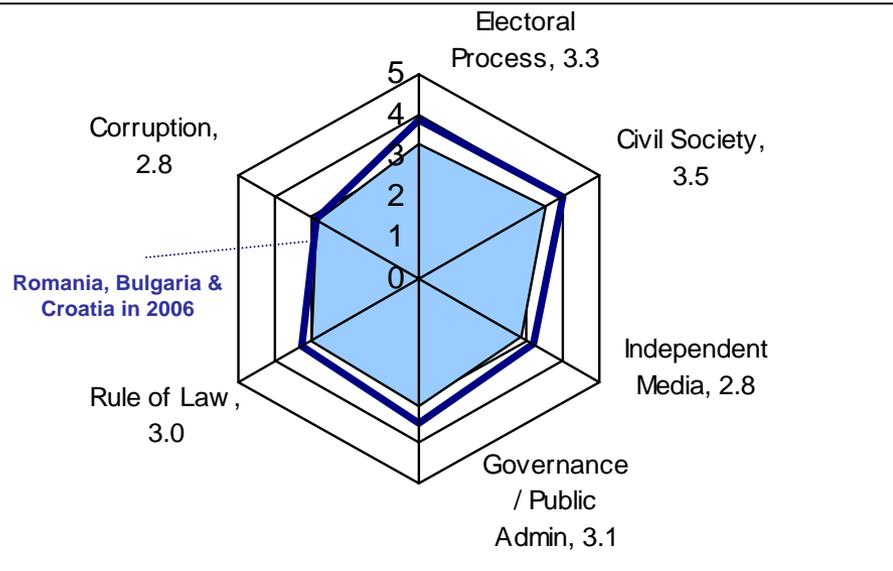
Figure 10

Democratic Reform



Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #12* (2009 forthcoming) drawing from Freedom House, *Nations in Transit 2009*.

Democratic Reforms in Macedonia in 2008



Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #12* (2009 forthcoming) drawing from Freedom House, *Nations in Transit 2009*.

Figure 14

Media Sustainability Index

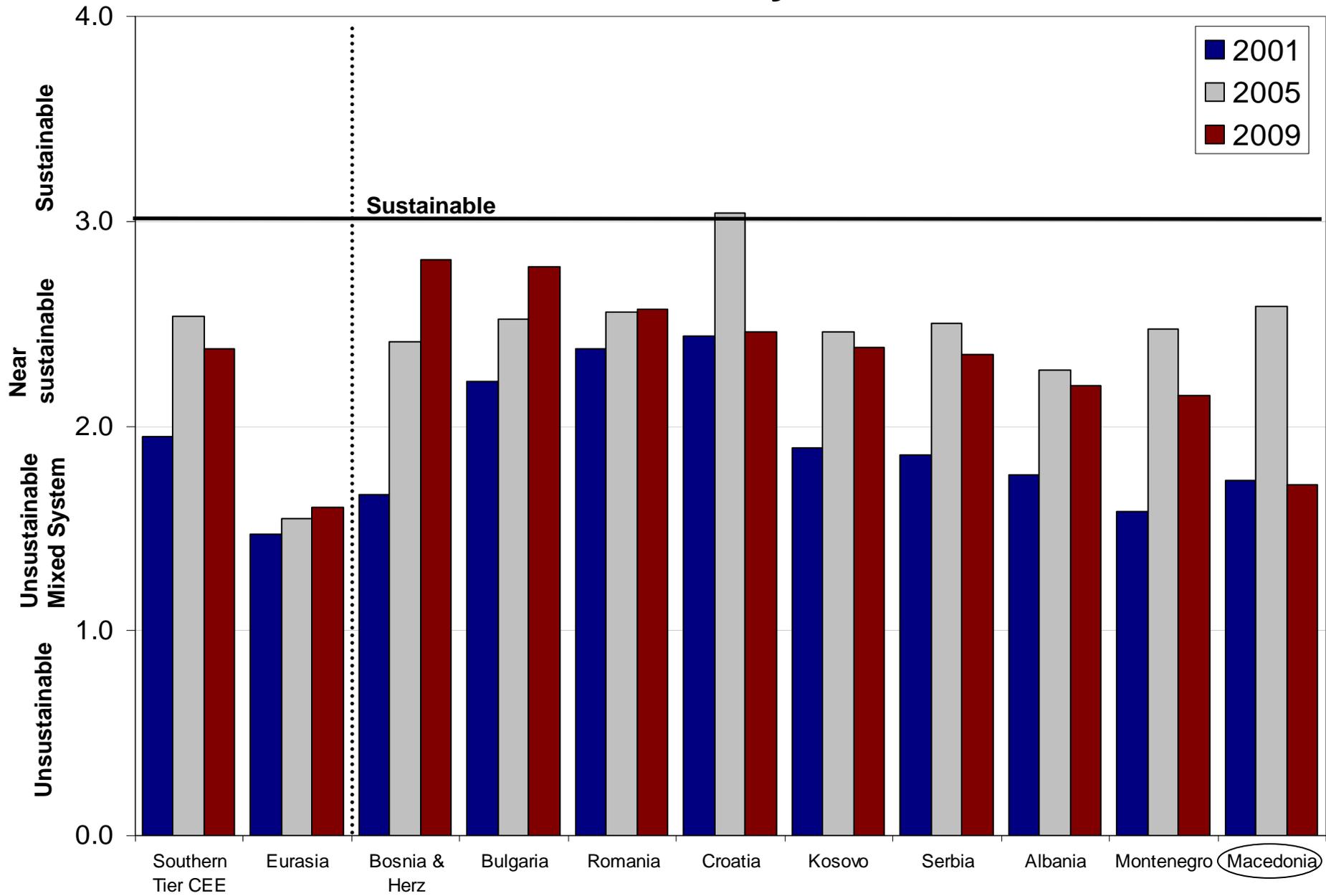
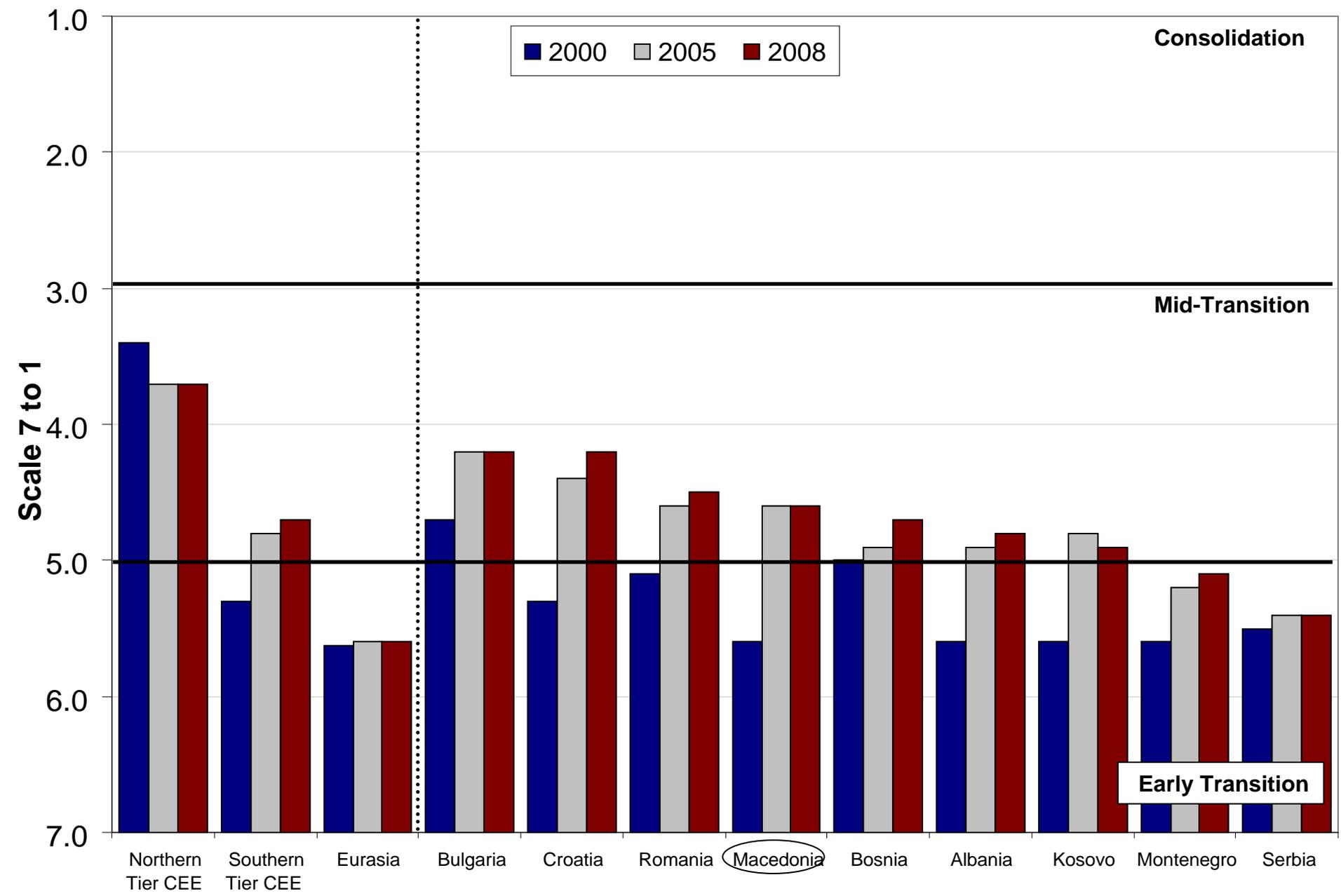


Figure 15

NGO Sustainability Index



USAID, 2009 NGO Sustainability Index (July 2009).

Figure 16

Corruption Perceptions in 2008

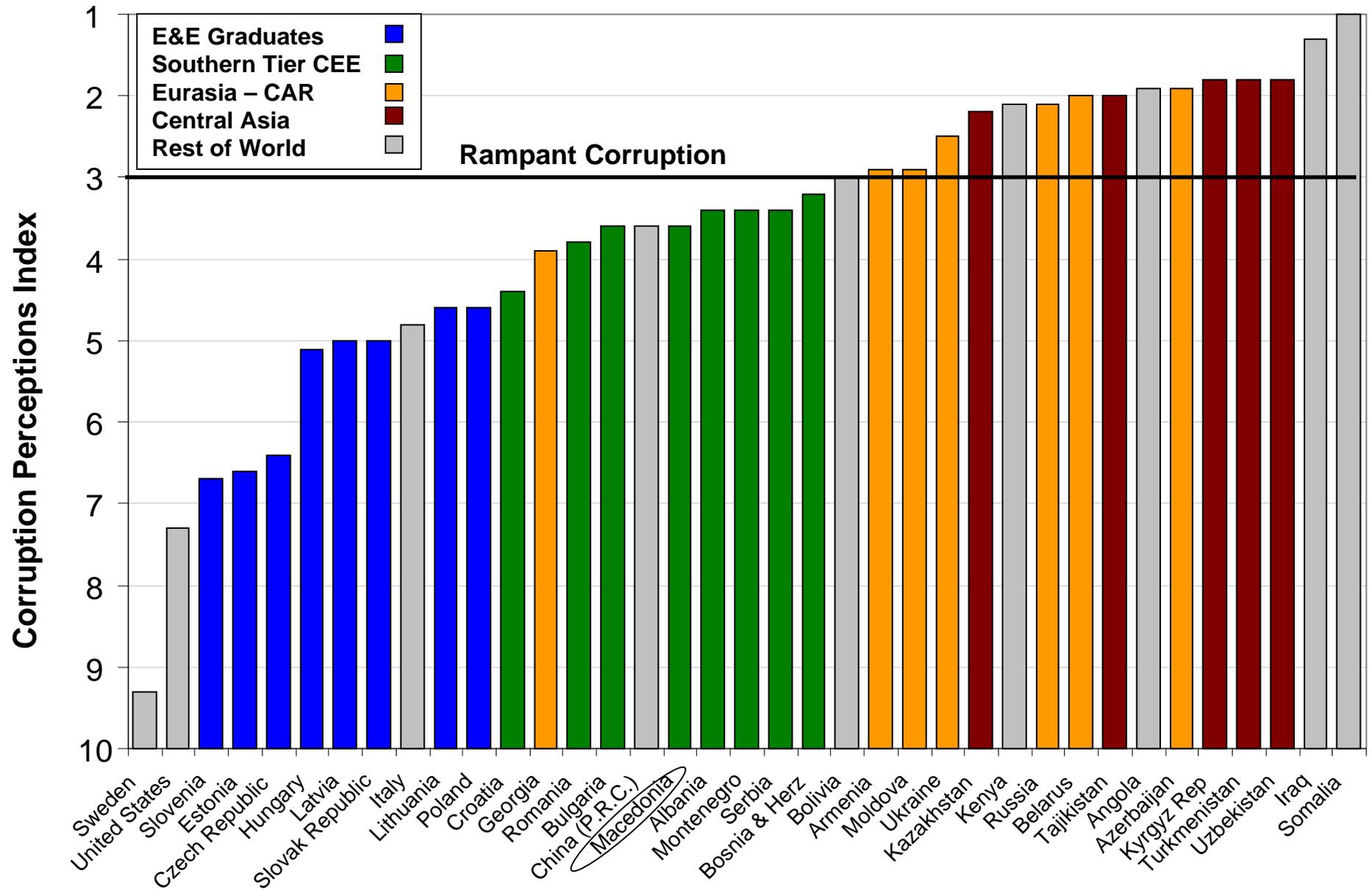
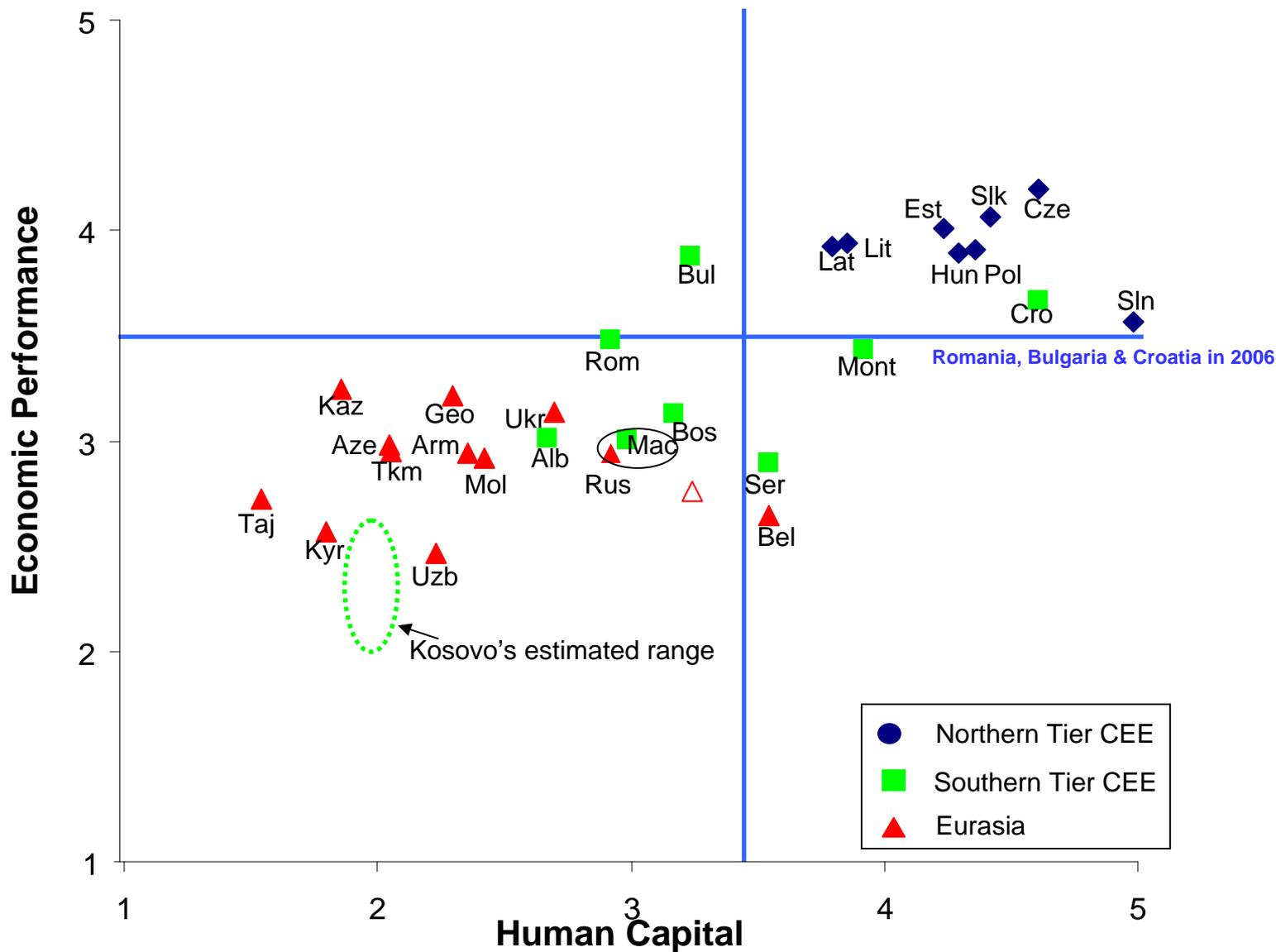


Figure 17

Economic Performance and Human Capital in 2006-2008



Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, Monitoring Country Progress in CEE & Eurasia #12 (2009 forthcoming) drawing from World Bank, *World Development Indicators 2009* (April 2009); EBRD, *Transition Report* (November 2008), UNECE, *Statistical Division Database* (2009); Fund for Peace, *Failed States Index* (2009); IFC & World Bank, *MSME Database* (2007); UNICEF, *TransMONEE Database* (2009); World Health Organization European Health For All Database (2009); IEA, *TIMSS 2003 International Mathematics Report* (2004), *TIMSS 2003 International Science Report* (2004) and *PIRLS 2001 International Report* (2003); OECD, *Literacy Skills for the World of Tomorrow: Further Results from PISA 2000* (2003), *First Results from PISA 2003* (2004) and *International Adult Literacy Survey* (2000).

Economic Performance in Macedonia in 2006-2008

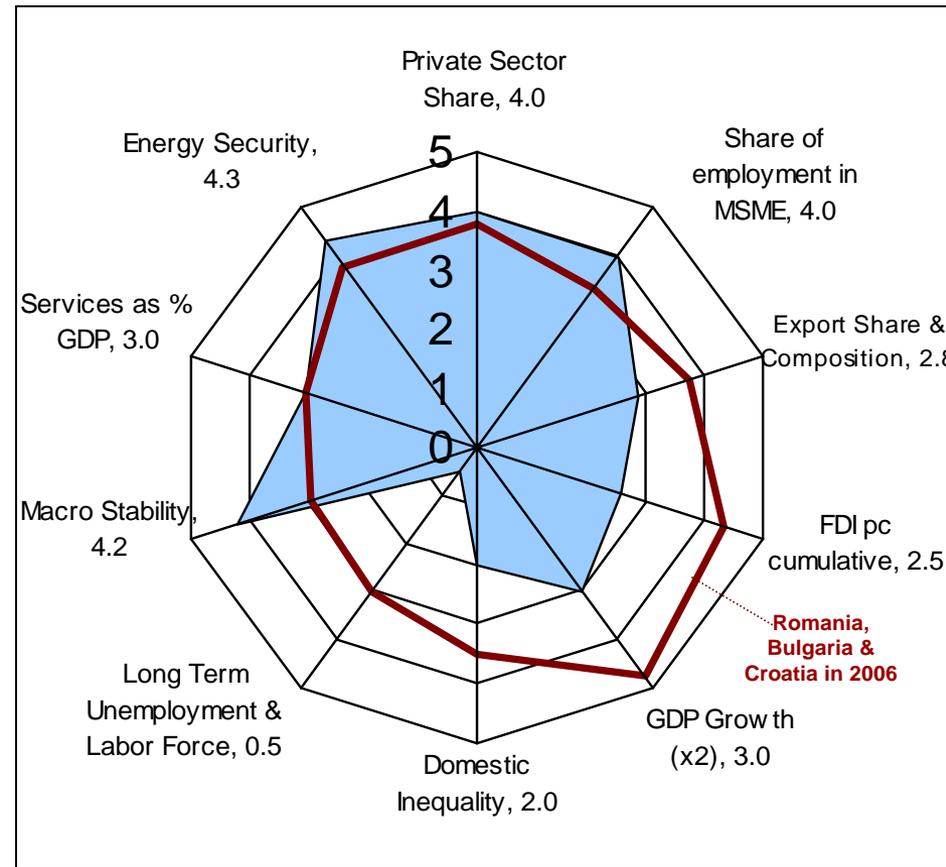
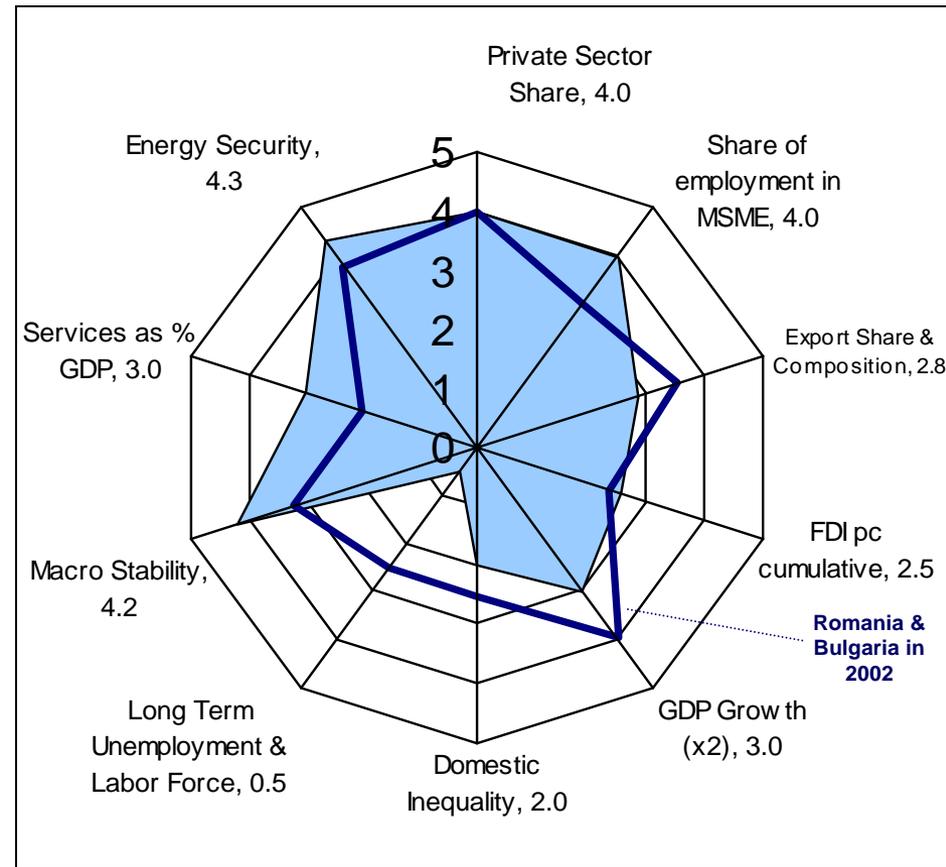


Figure 20

Real GDP as % of 1989 GDP

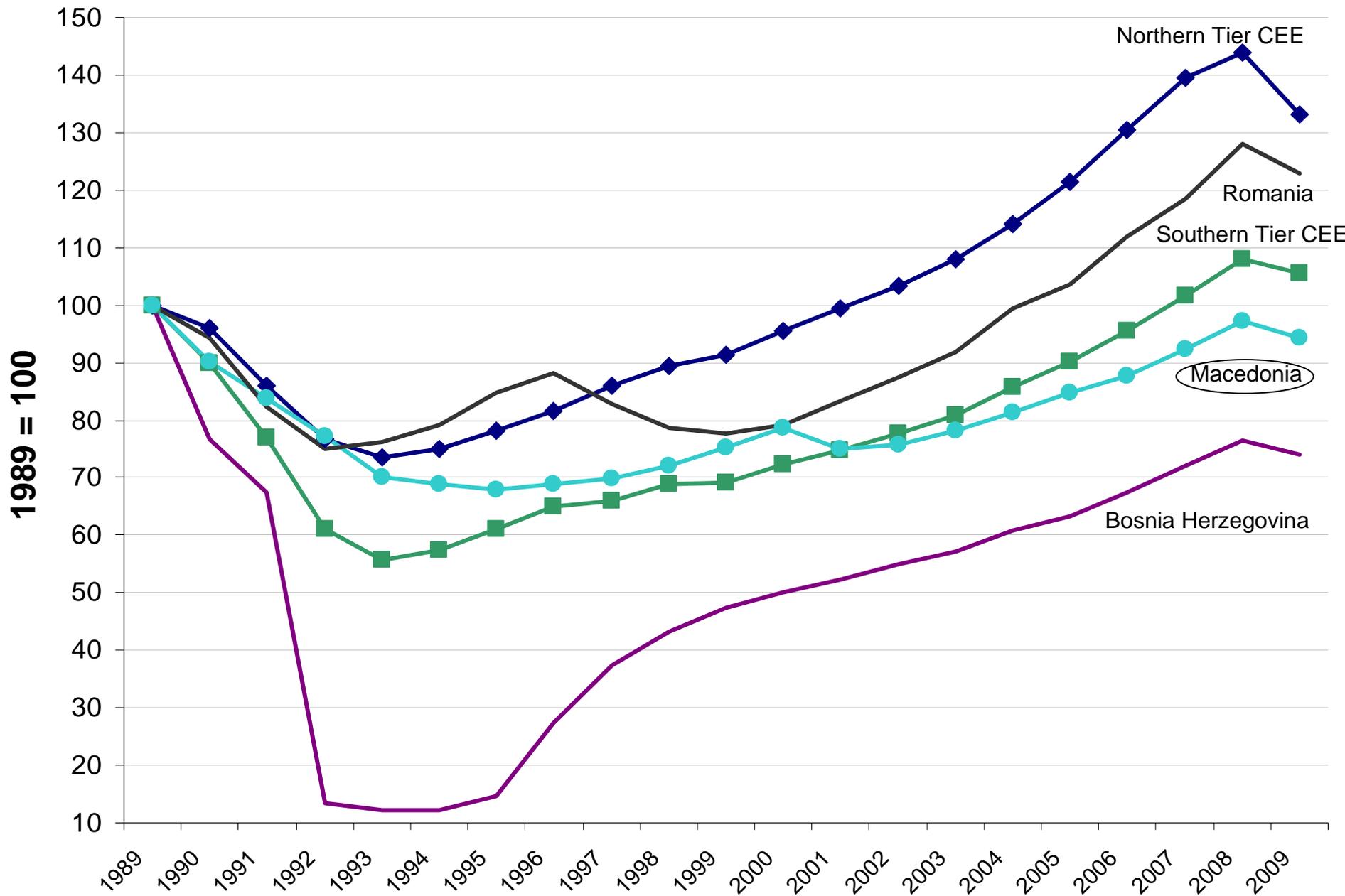


Figure 21

Economic Growth Trends Worldwide

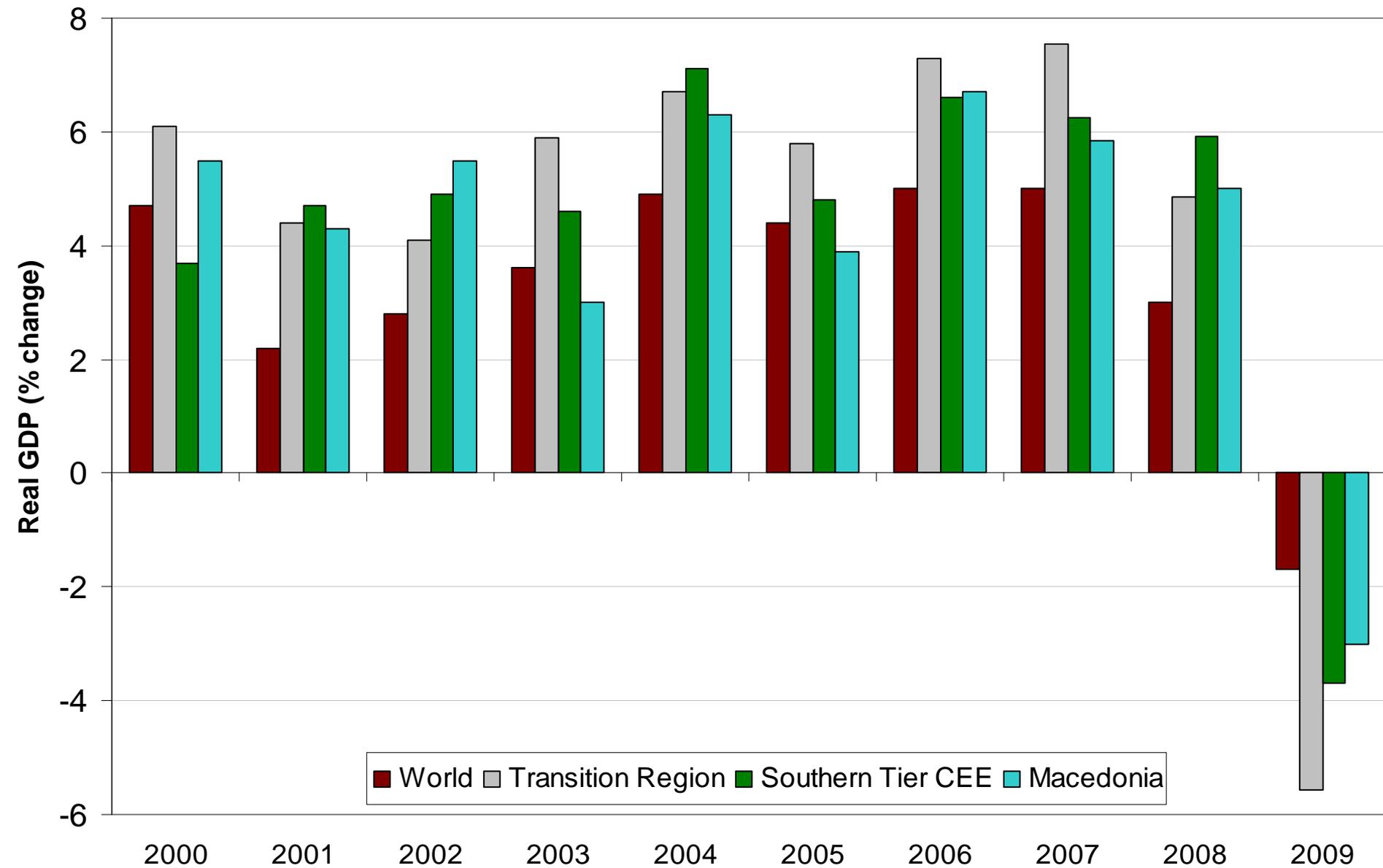
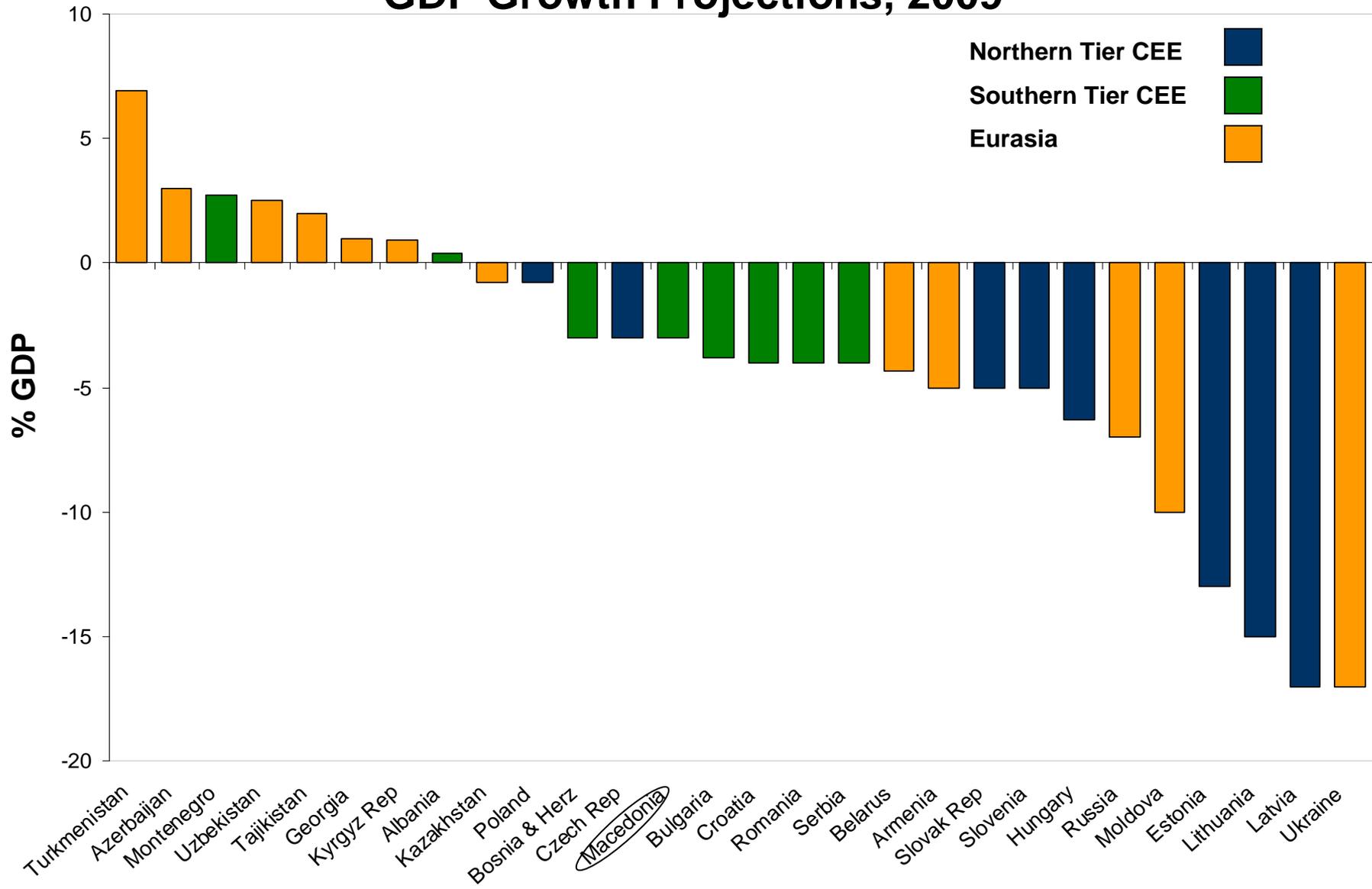


Figure 22

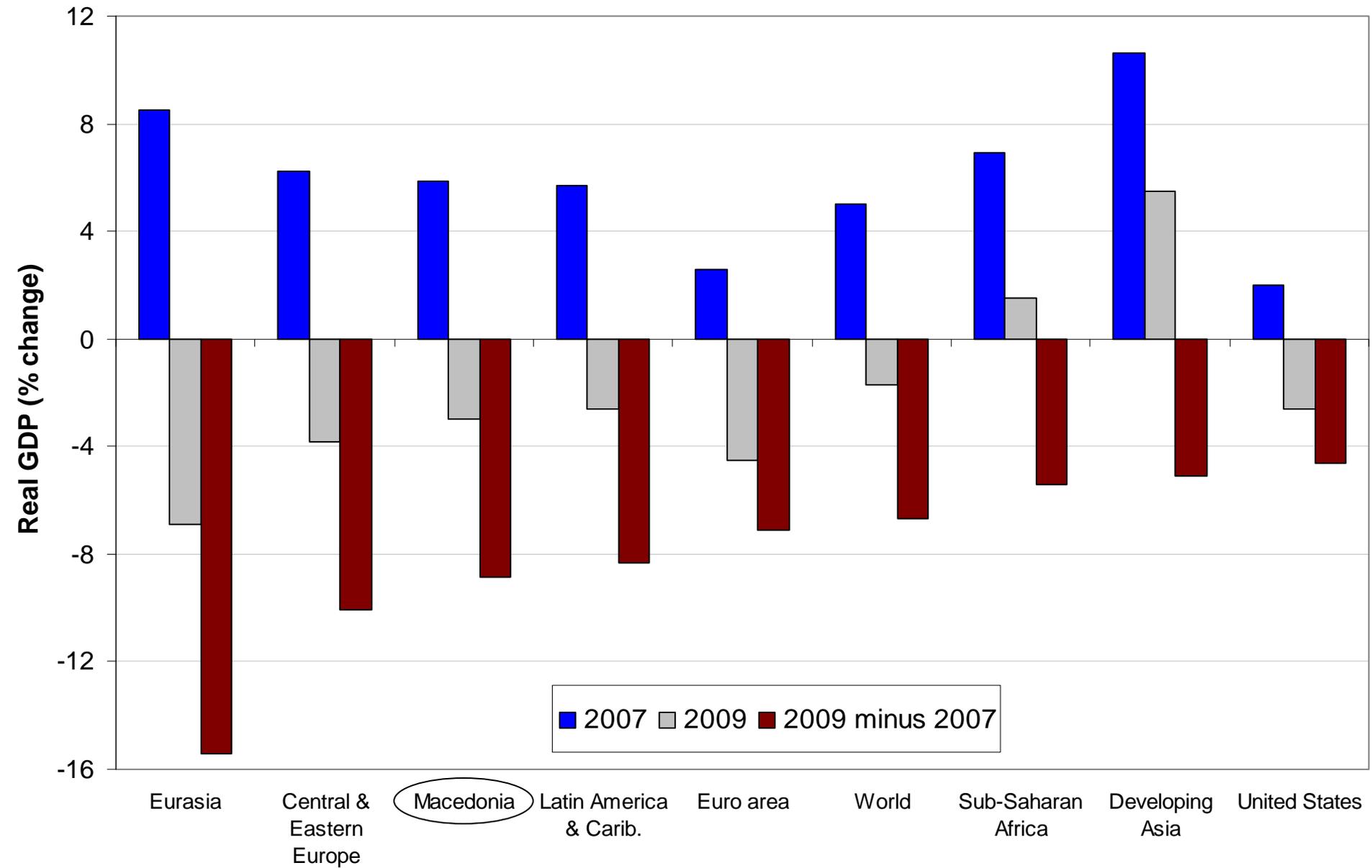
GDP Growth Projections, 2009



IMF, *World Economic Outlook Update* (July 8th, 2009) and EIU, *Various Country Reports* (January – August 2009).

Figure 23

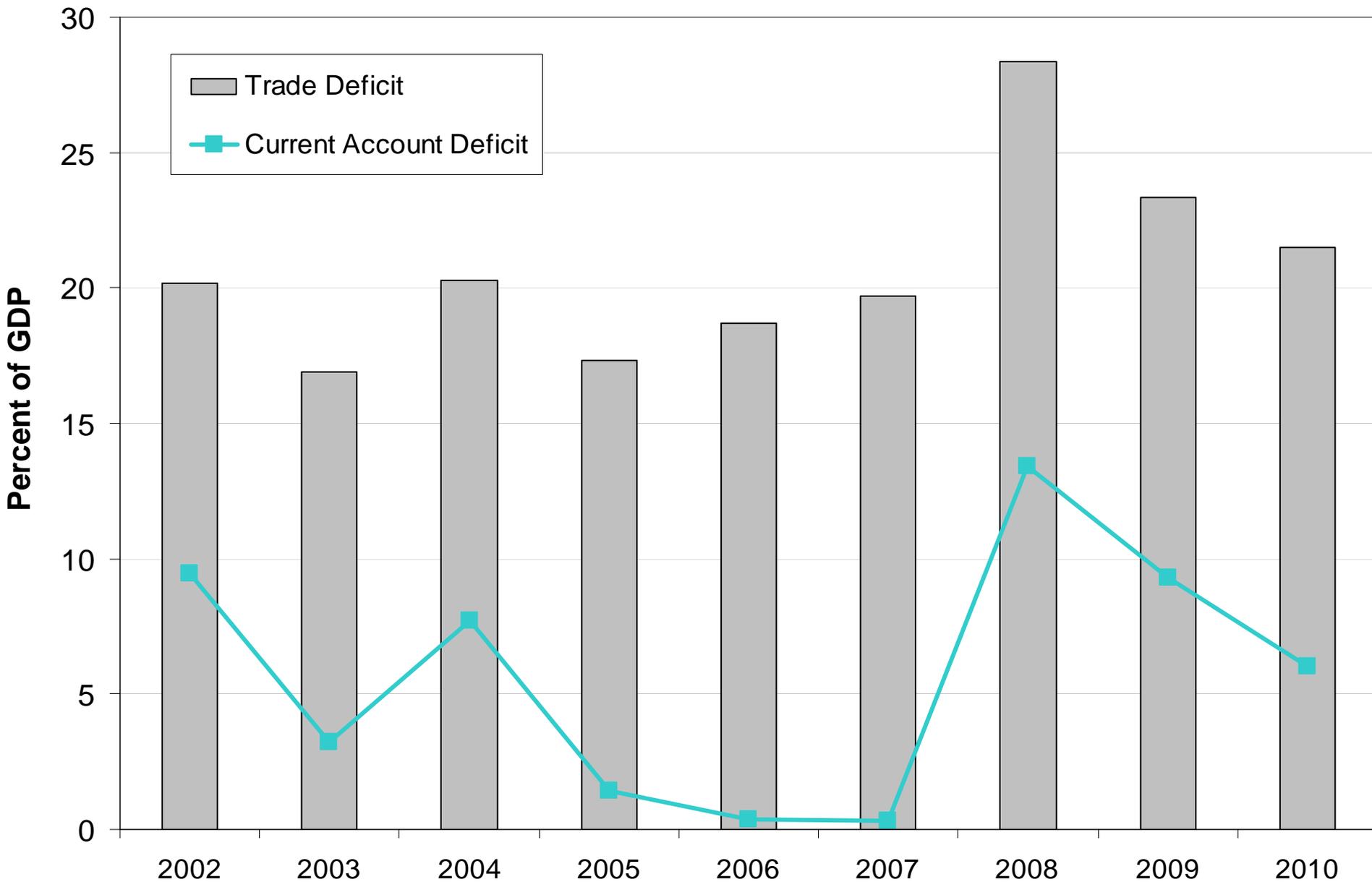
Economic Growth: 2007 vs. 2009



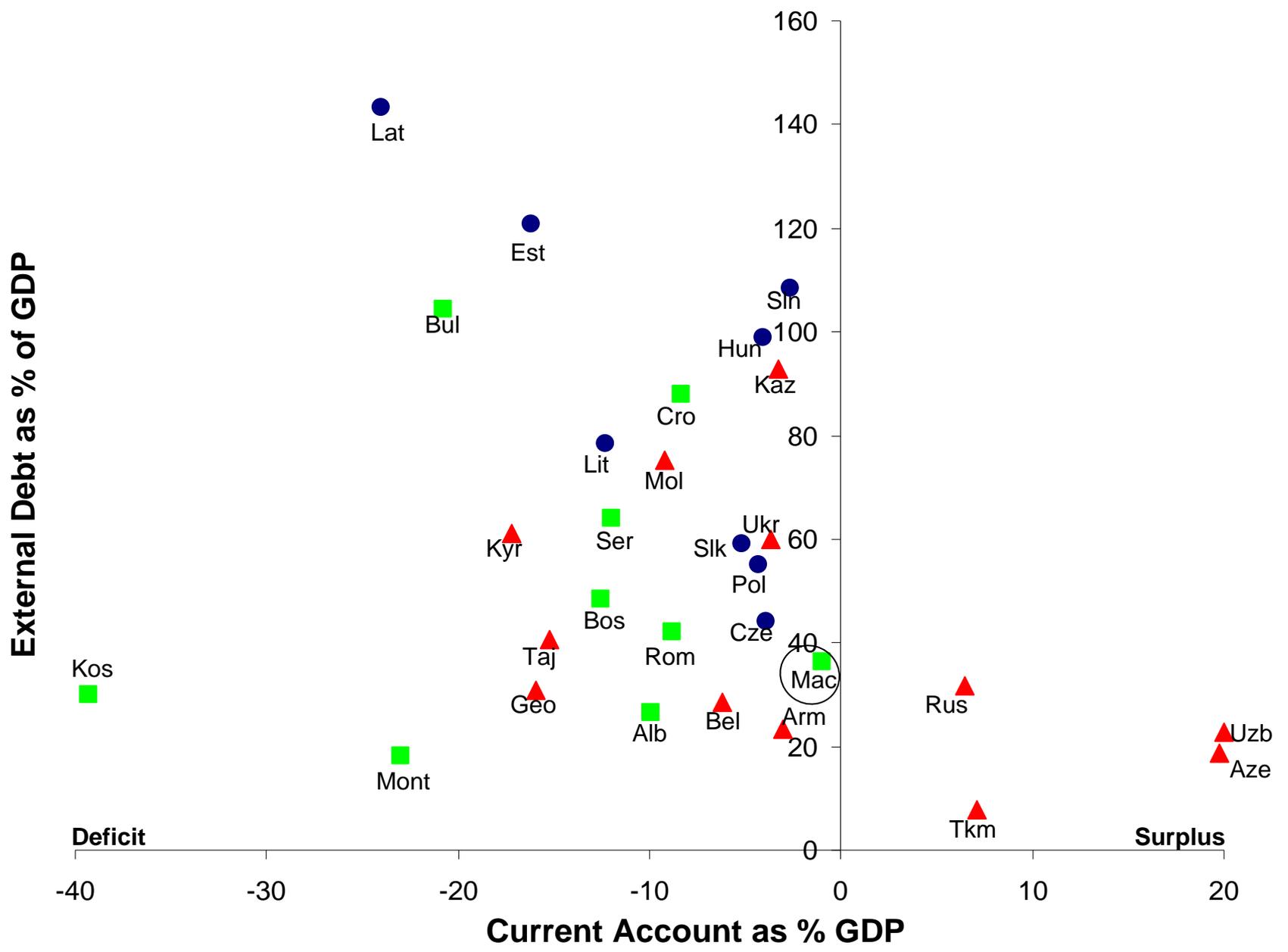
IMF, *World Economic Outlook Update* (July 8th, 2009) and EIU, *Various Country Reports* (January – August 2009). Country growth rates are weighted by GDP in the regional averages.

Figure 24

Current Account Deficit & Trade Deficit in Macedonia



Current Account Balance & External Debt in 2007



Foreign Direct Investment

5 year cumulative per capita, 2004-2008

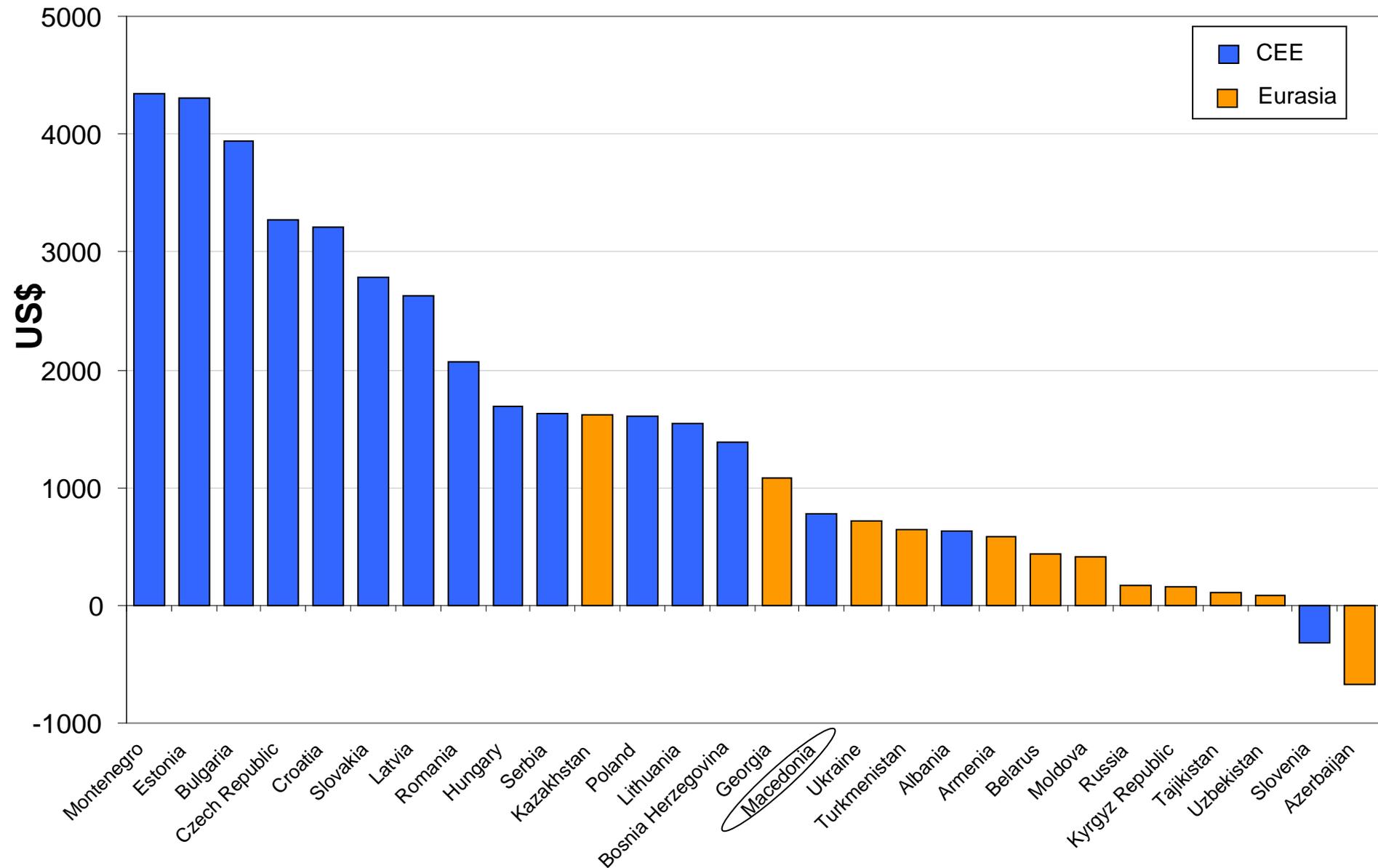


Figure 27

Energy Dependency and Efficiency

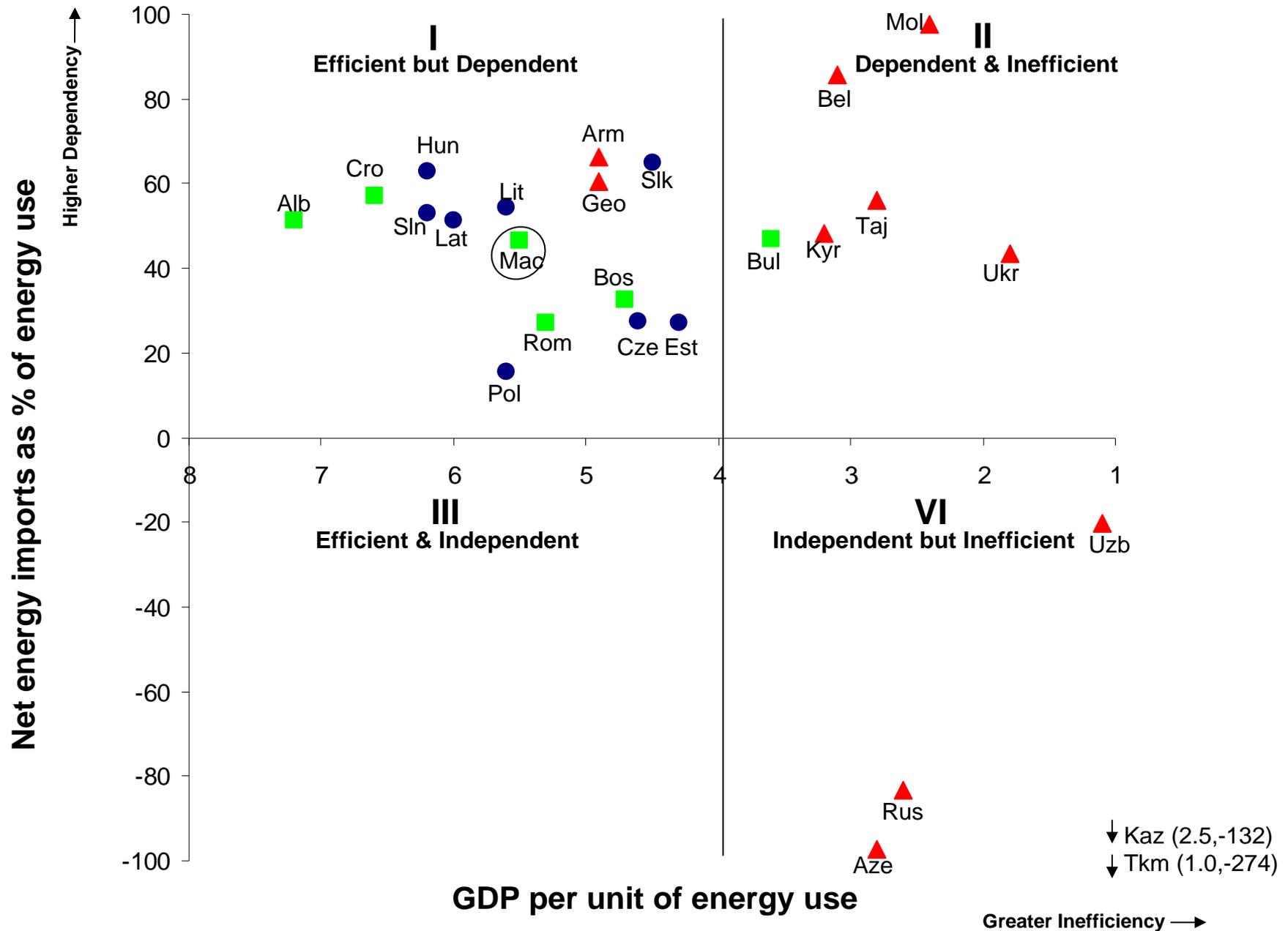
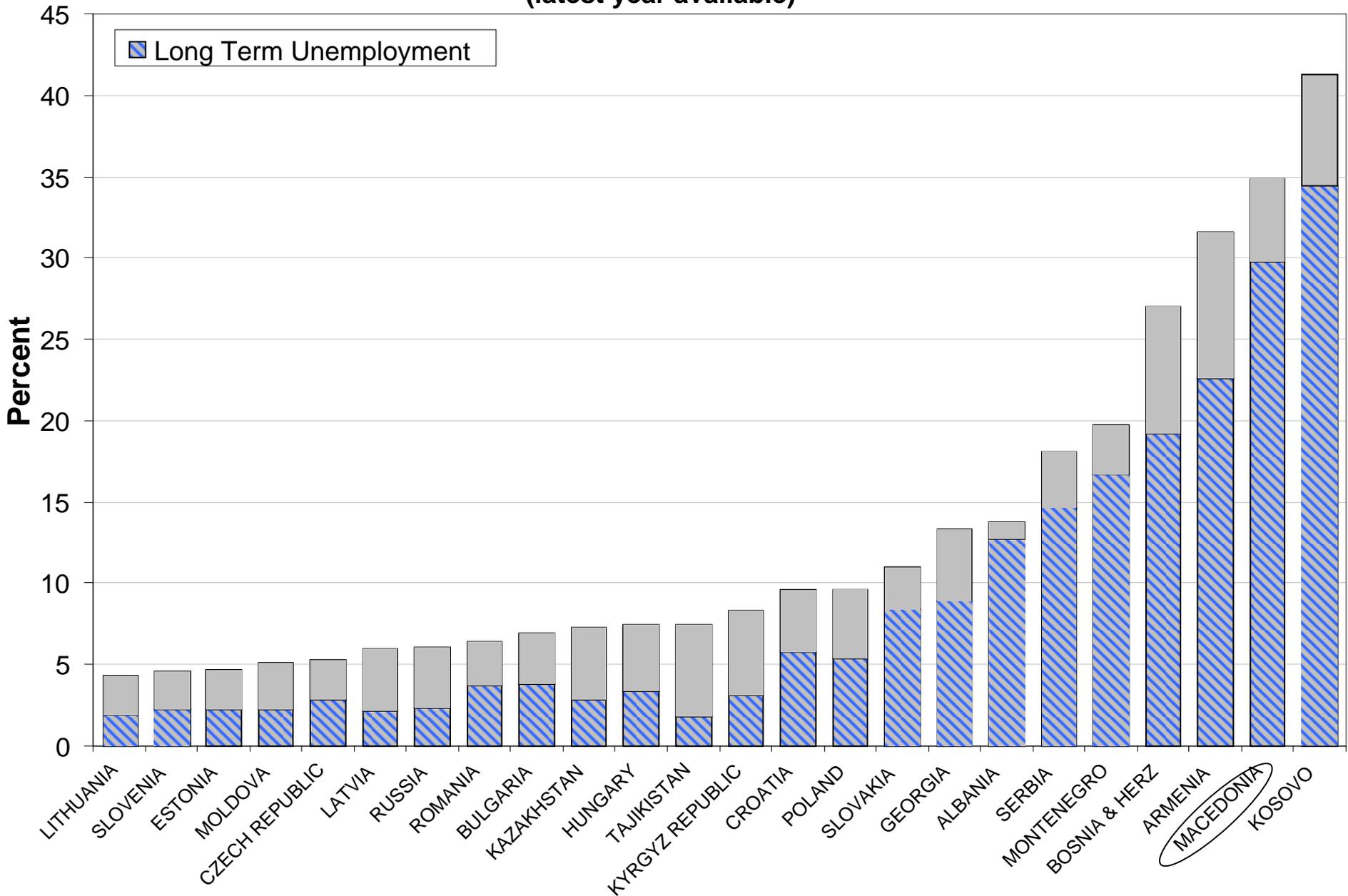


Figure 28

Unemployment Rate

(latest year available)



Unemployment Rates

High Levels with Little to no evidence of falling rates

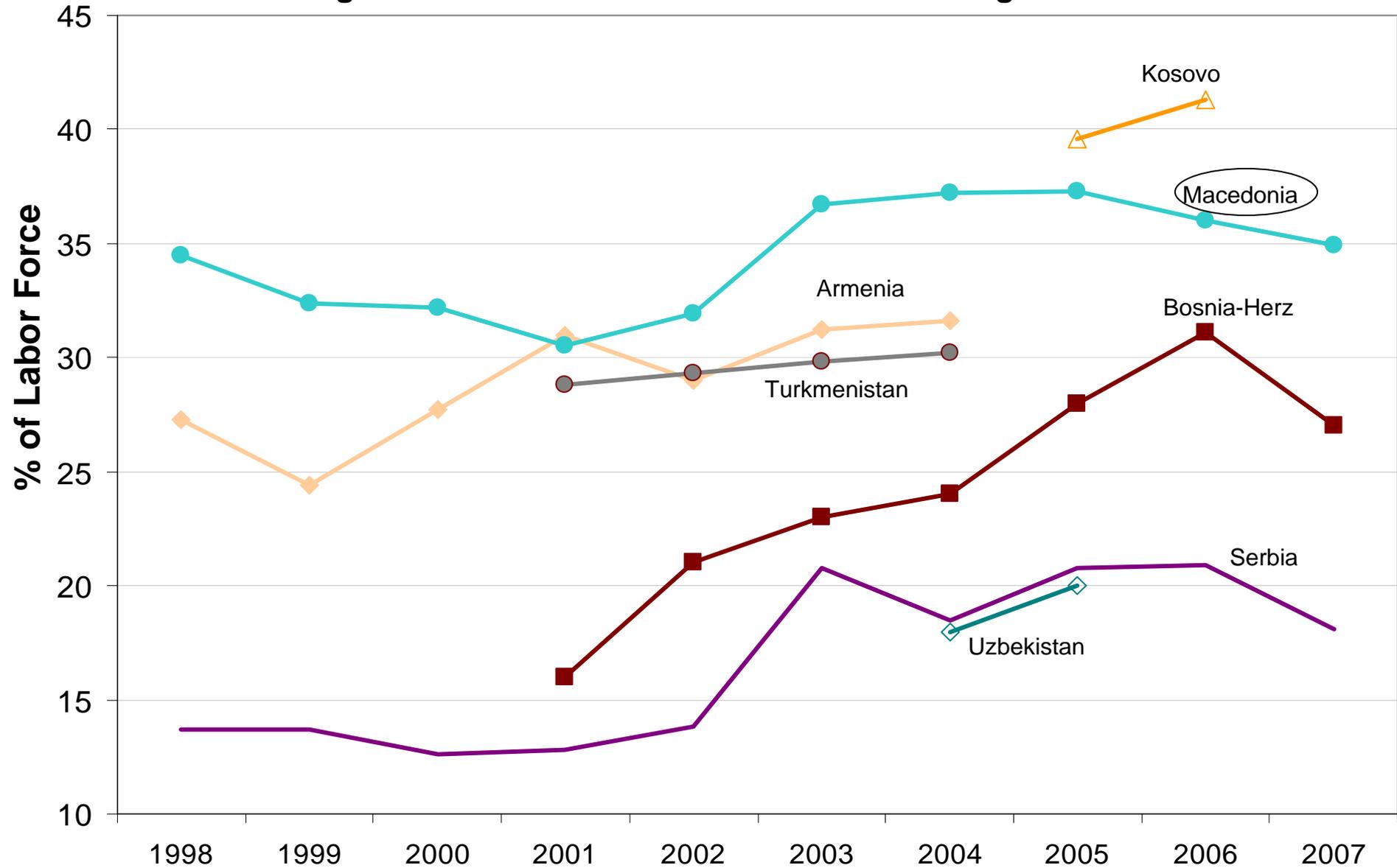
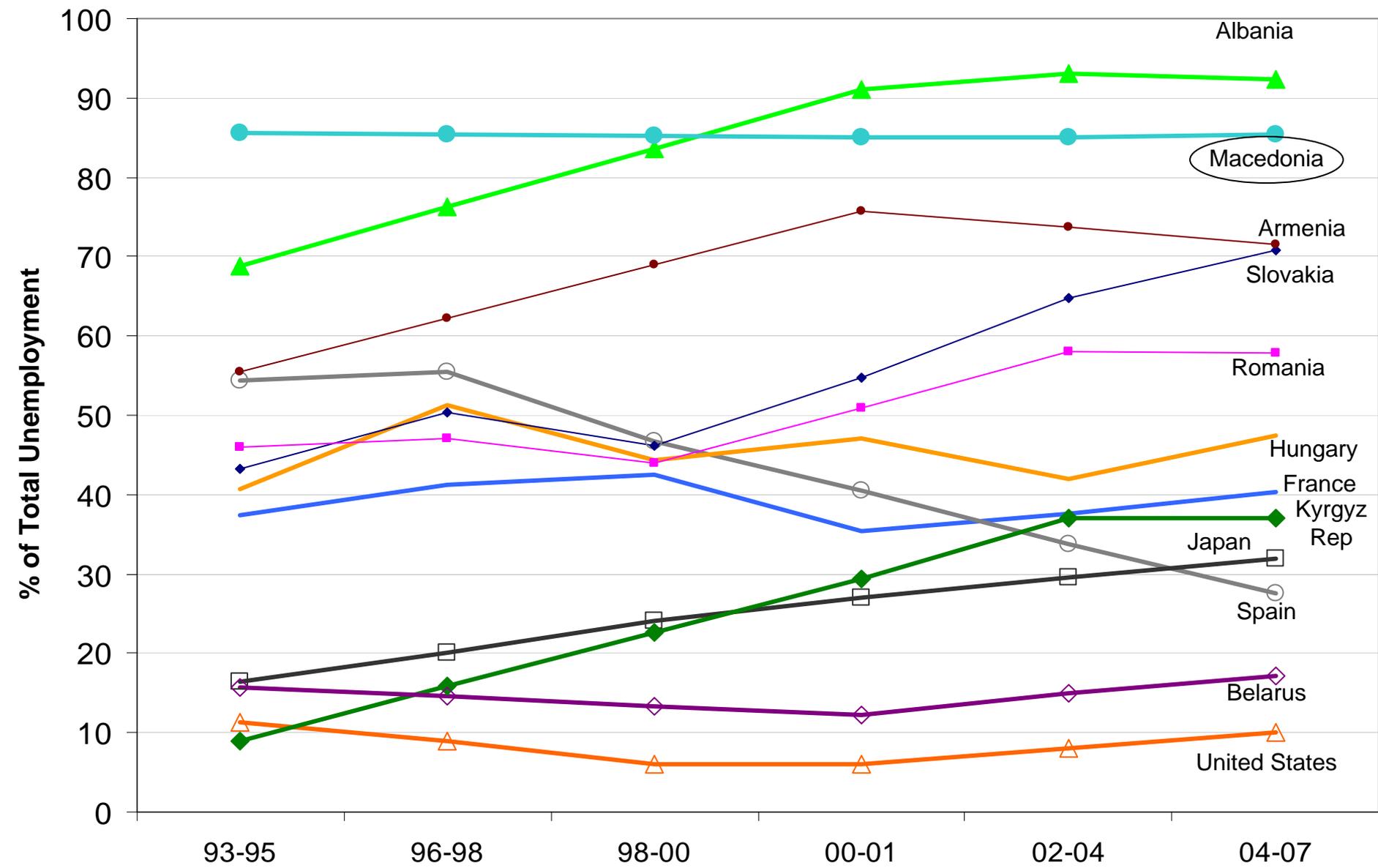


Figure 30

Long Term Unemployment



World Bank, *World Development Indicators* (April 2008); C. Allison and D. Ringold, *Labor Markets in Transition in Central and Eastern Europe: 1989-1995*; World Bank, *Social Challenges of Transition Series* (December 1996); Bureau of the Census, *Populations at Risk in CEE: Labor Markets, No. 2*, prepared for USAID/ENI/PCS (February 1995),

Figure 31

Youth Unemployment (Labor Force Survey)

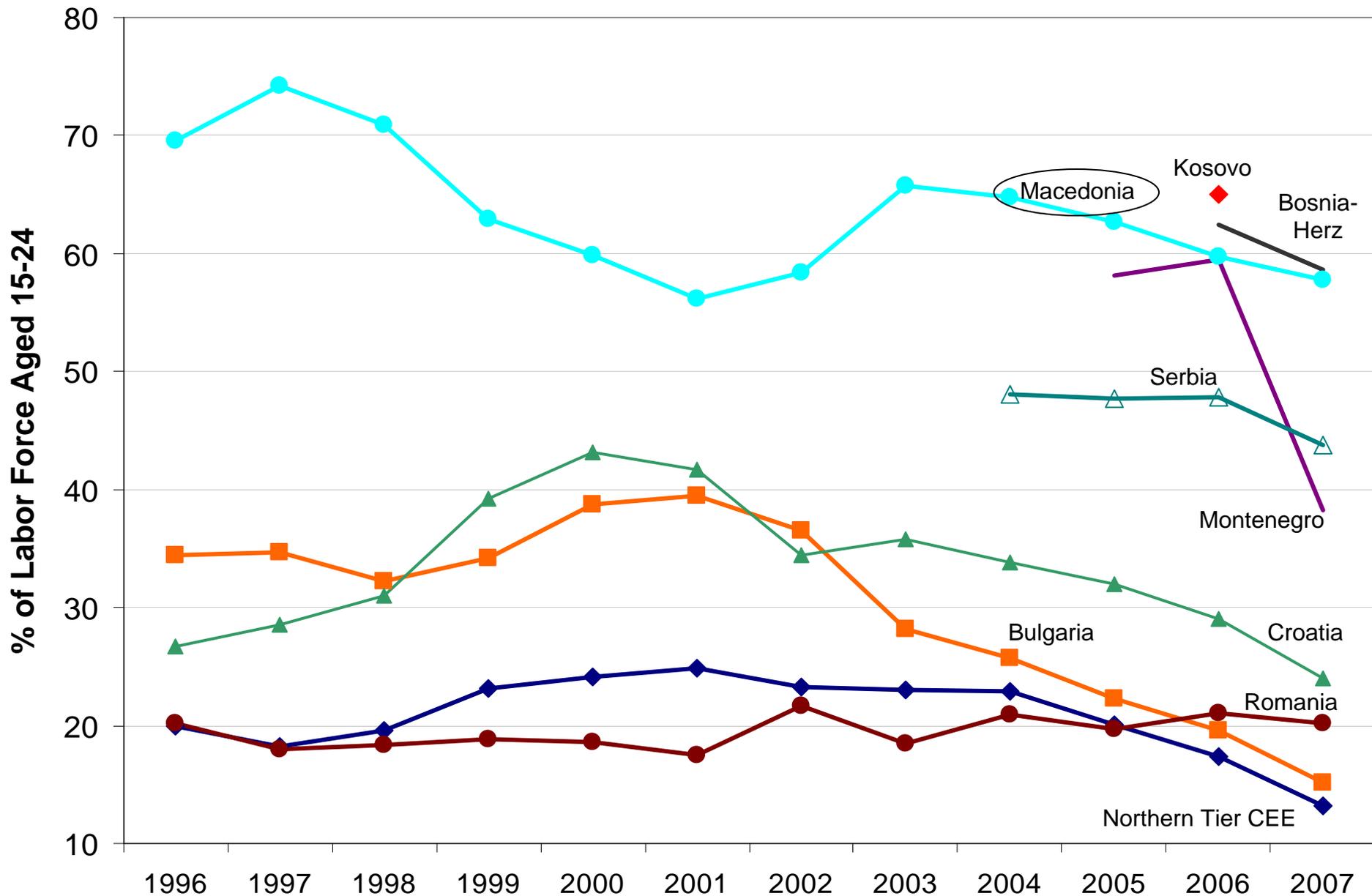


Figure 32

Exports as % of GDP

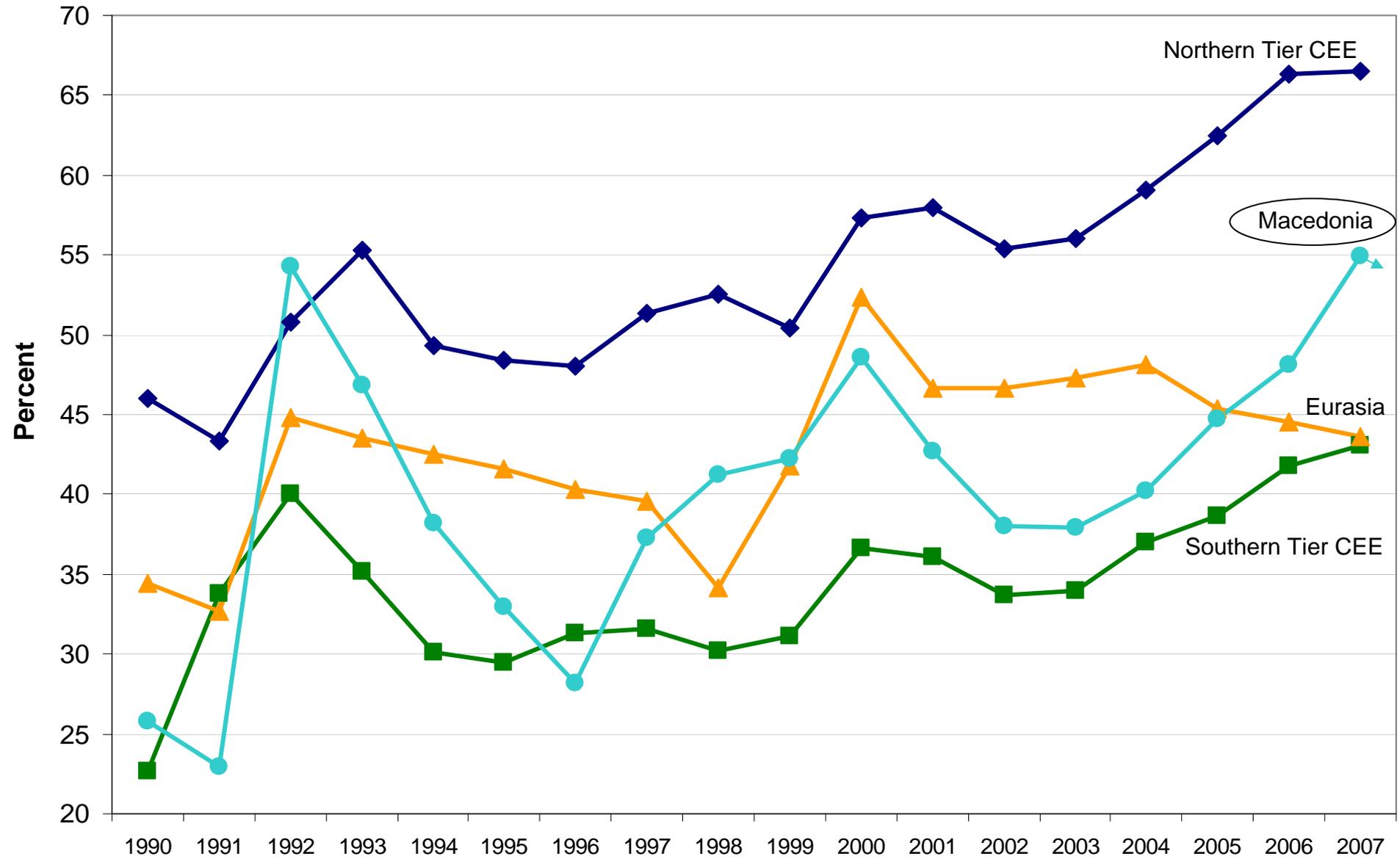


Figure 33

Exports as % of GDP

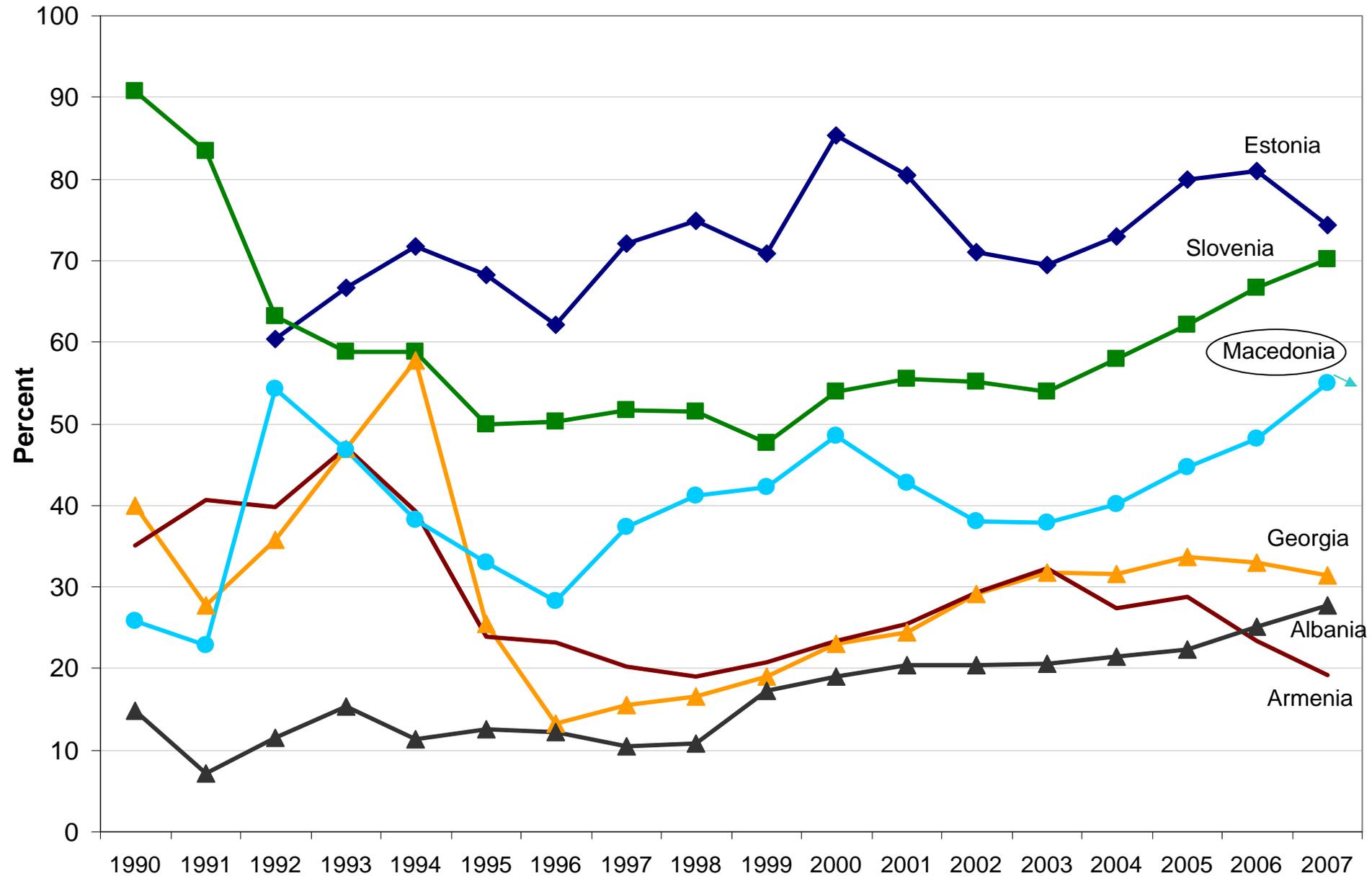
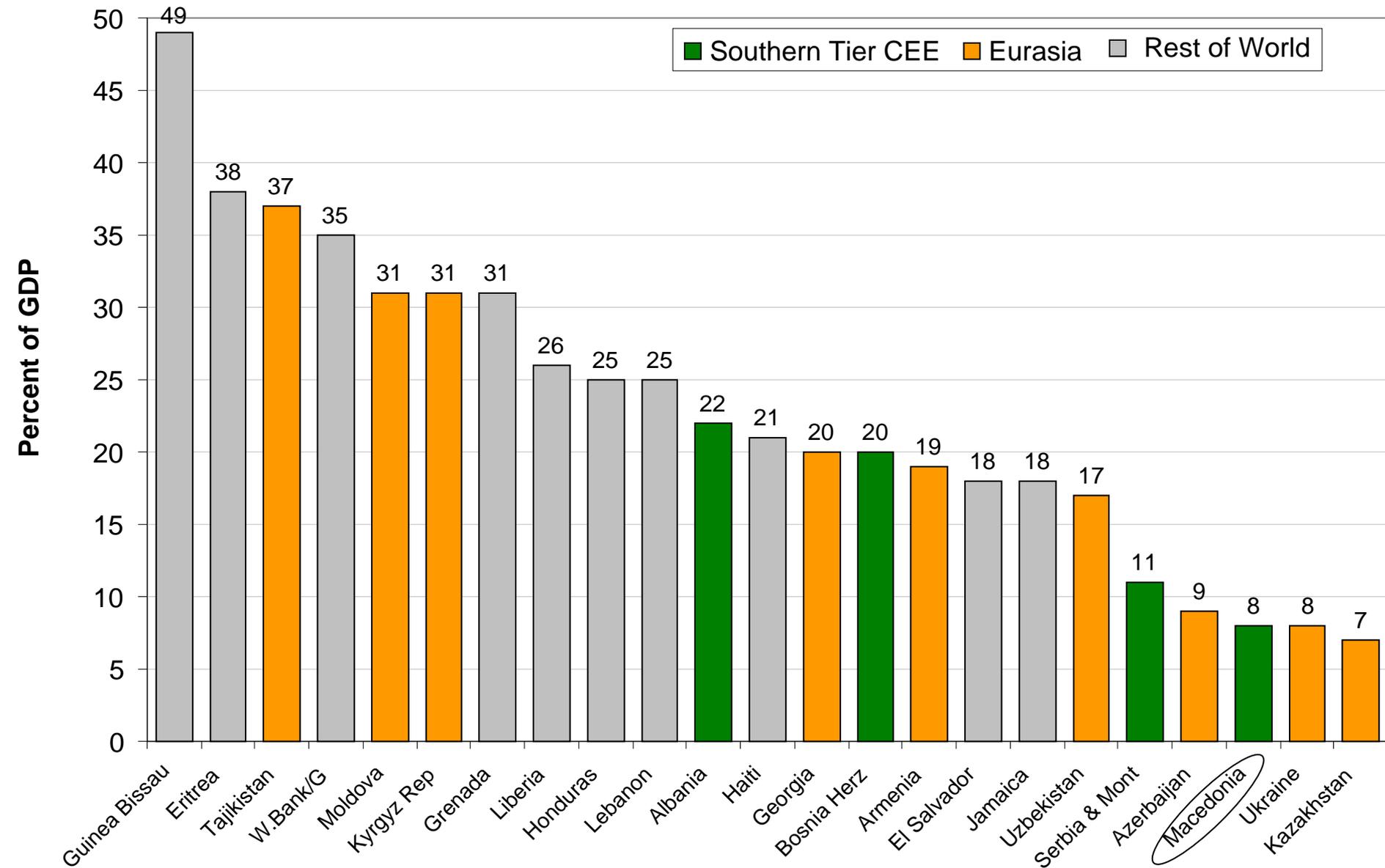


Figure 34

Remittances



Human Capital Index in Macedonia

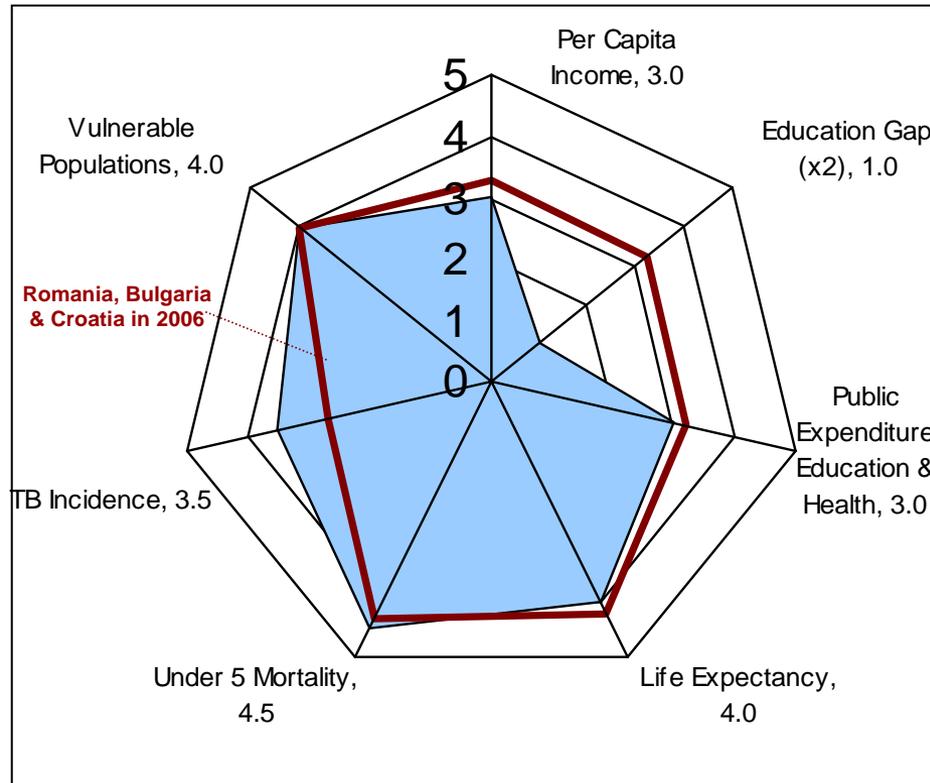
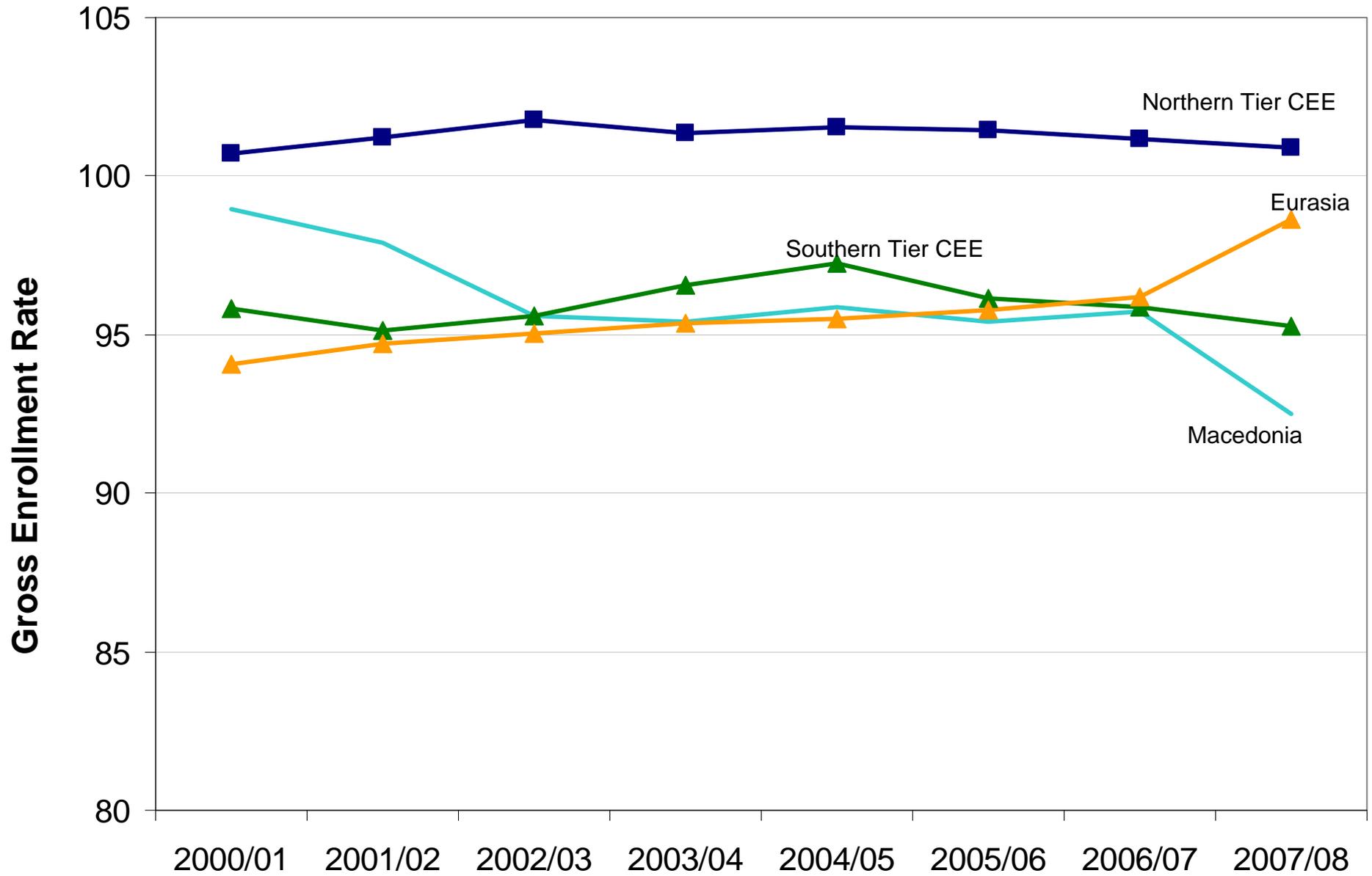
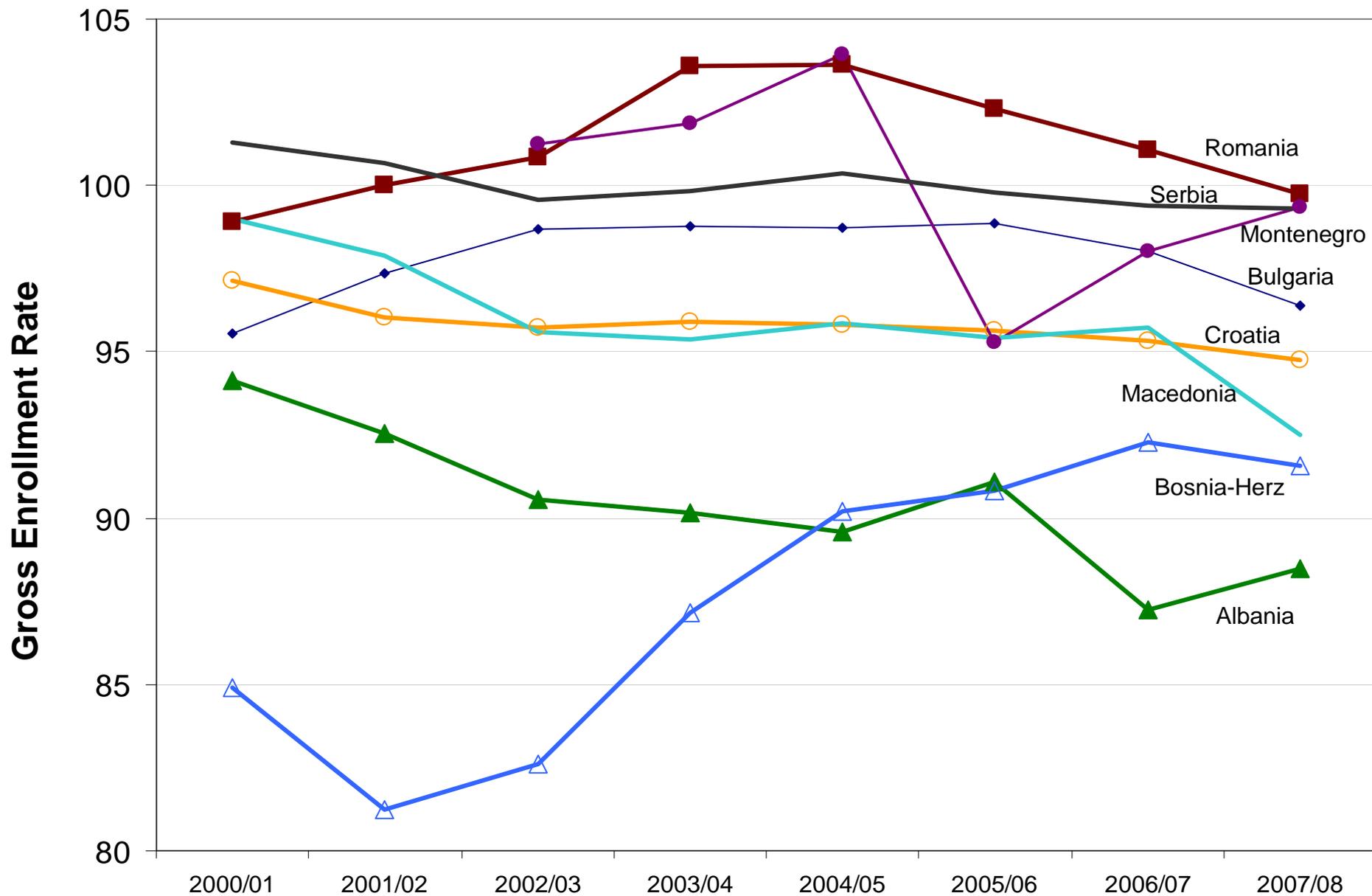


Figure 36

Primary School Enrollments



Primary School Enrollments in the Southern Tier CEE



PIRLS, 2001 vs. 2006

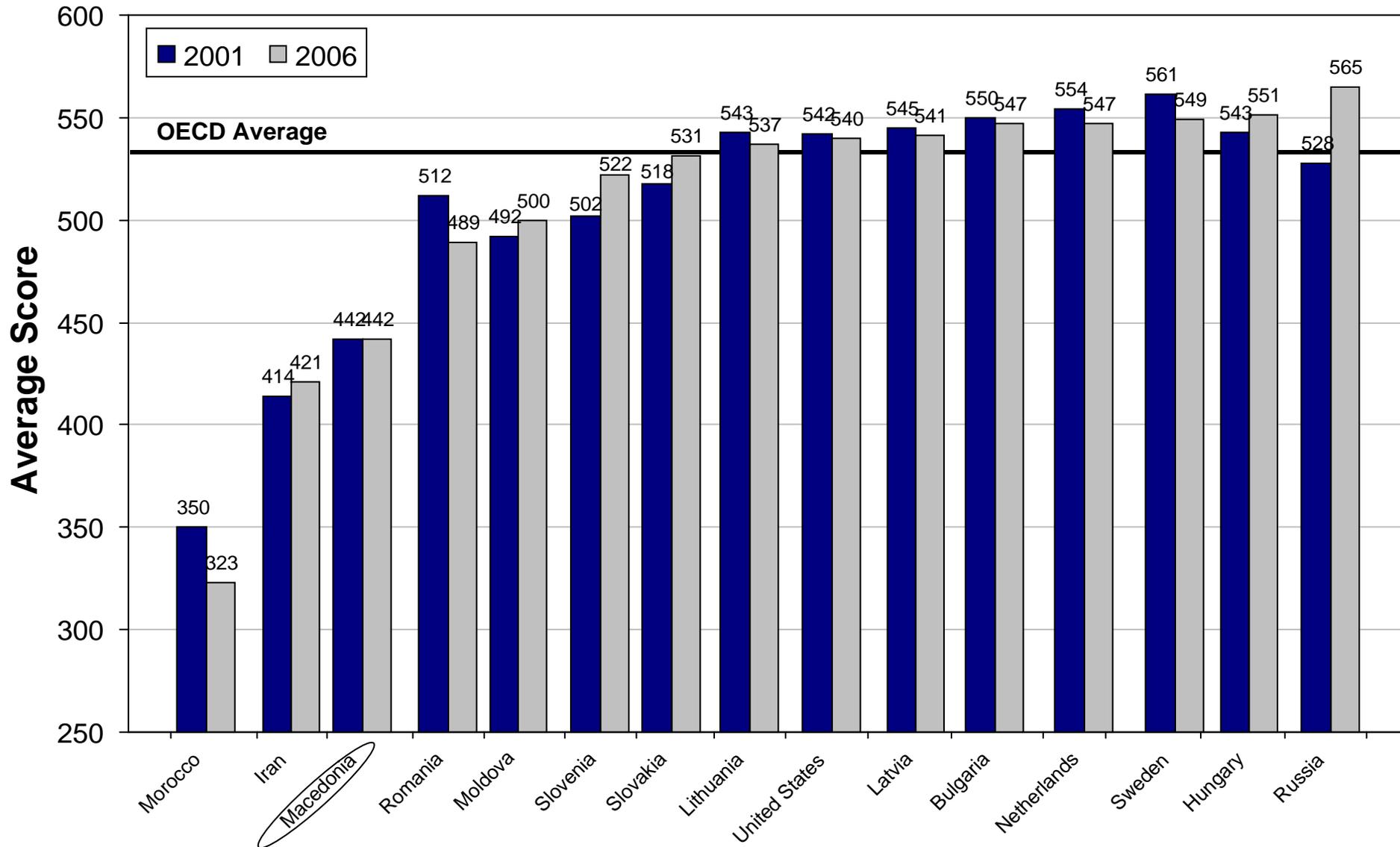
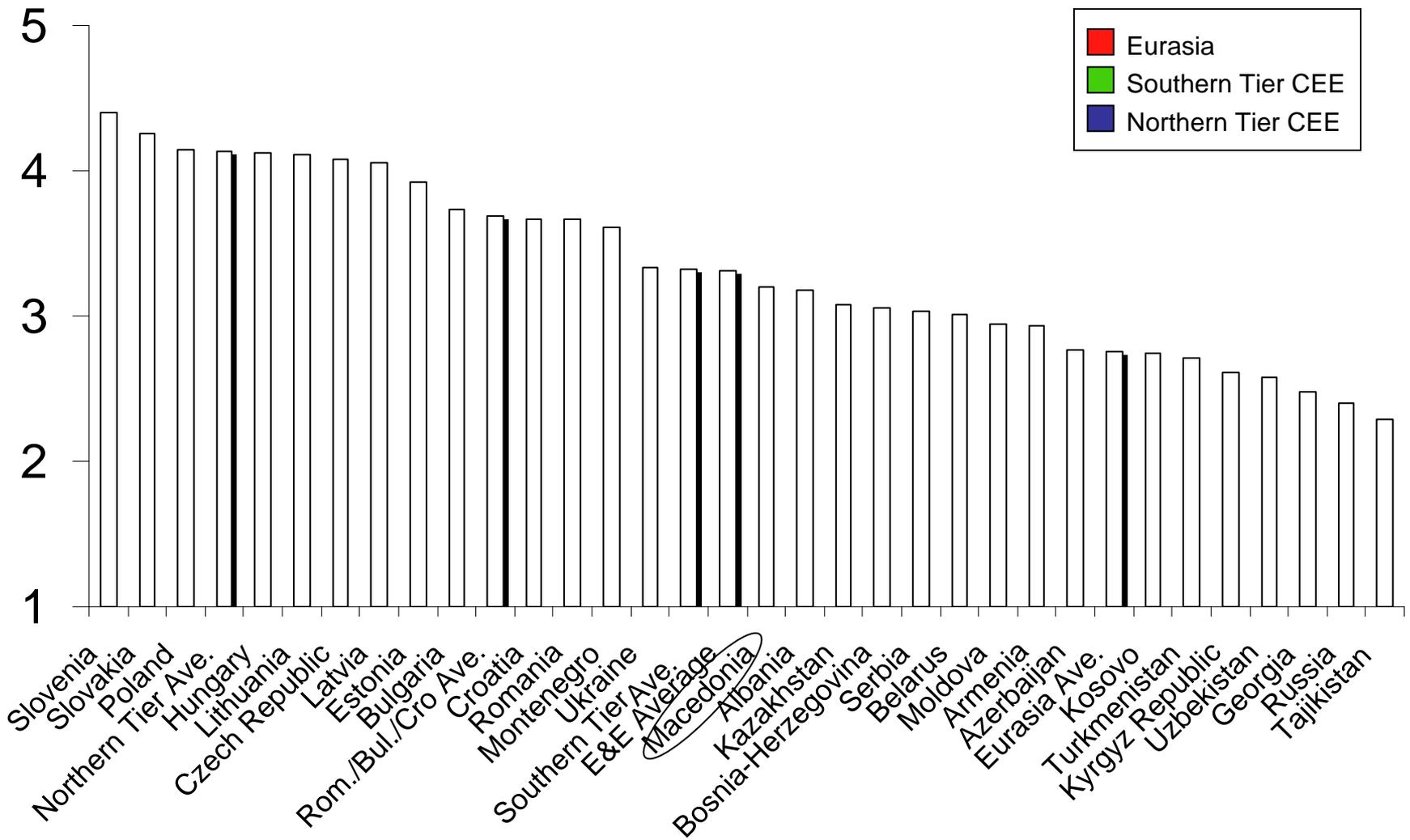


Figure 39

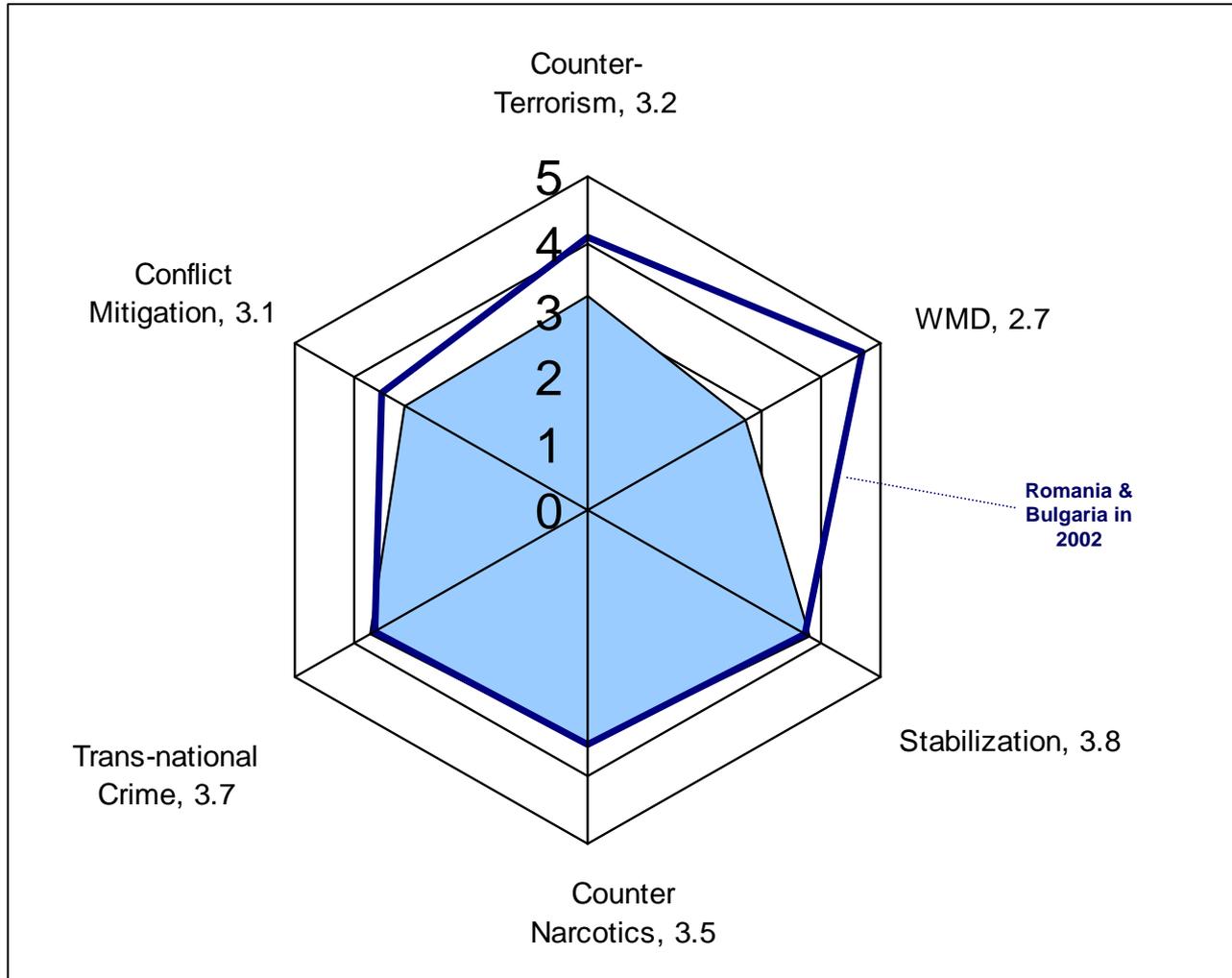
Peace and Security – E&E



US State Department, *Country Reports on Terrorism* (2009); National Counterterrorism Center, (2008-2009); Foreign Policy Magazine and the Fund for Peace, *Failed States Index* (2009); World Bank Institute, *Governance Matters Indicators* (2008); US Commerce Department, *Export Control Policy*, (2009.) US State Department, *Export Control/Border Security Assessment* (2009) Binghamton University, Cingranelli-Richards *Human Rights Dataset*, (2007); UNICEF TransMONEE (2003-2006); World Bank, *World Development Indicators* (2009); A.T. Kearney/Foreign Policy Magazine, *Globalization Index* (2007) UNODC, *World Drug Report*, (2009) ; US Department of State, *Trafficking in Persons Report* (2009); USTR *Special 301 Report* (2009) ;US Department of State, *International Narcotics Control Strategy Report* (2009); Center for Global Policy, George Mason University, *Political Instability Task Force* (2006-0) USAID/DCHA/CMM *Instability Alert List* (2009)

Figure 40

Peace & Security in Macedonia



US State Department, *Country Reports on Terrorism* (2009); National Counterterrorism Center, (2008-2009); Foreign Policy Magazine and the Fund for Peace, *Failed States Index* (2009); World Bank Institute, *Governance Matters Indicators* (2008); US Commerce Department, *Export Control Policy*, (2009.) US State Department, *Export Control/Border Security Assessment* (2009) Binghamton University, Cingranelli-Richards *Human Rights Dataset*, (2007); UNICEF TransMONEE (2003-2006); World Bank, *World Development Indicators* (2009); A.T. Kearney/Foreign Policy Magazine, *Globalization Index* (2007) UNODC, *World Drug Report*, (2009) ; US Department of State, *Trafficking in Persons Report* (2009); USTR *Special 301 Report* (2009) ;US Department of State, *International Narcotics Control Strategy Report* (2009); Center for Global Policy, George Mason University, *Political Instability Task Force* (2006-0) USAID/DCHA/CMM *Instability Alert List* (2009)