

Gap Analysis of Macedonia
February 2008

Summary

This analysis attempts to take stock of Macedonia's progress in its transition to a market-oriented democracy with a focus on Macedonia's bid to achieve phase-out thresholds from USG Assistance. Two sets of thresholds are considered, transition progress attained in: (1) Bulgaria and Romania on average in 2002; and (2) Bulgaria, Romania, and Croatia in 2006. Gaps against economic and democratic reform thresholds are examined first. To help ensure that these reform gains are sustained, we next look to see if progress in economic performance and human capital is advancing towards plausible thresholds as well. Peace and security indicators are also examined.

Significant economic, democracy, and education gaps exist in Macedonia against the Romania-Bulgaria-Croatia in 2006 thresholds. The largest gap overall is found in Macedonia's economic performance, though there has been very good progress in recent years towards filling this gap. Democracy gaps in Macedonia are also large, coupled with slow progress at best in meeting these thresholds. Against the Bulgaria-Romania-Croatia in 2006 thresholds, and drawing from our best guess at extrapolating trends, the economic sector gap is estimated to close in 2015, while the democratization gap not until 2017. The human capital gap (broadly defined to include health, education, and vulnerable groups) is almost closed. However, many education challenges remain.

On most elements of counter-narcotics and trans-national crime, Macedonia's indicators are comparable or better than transition region norms. Macedonia falls into the "warning" range in the Fund for Peace's *Failed States Index (FSI)*, where most of the transition countries lie. Of the twelve indicators in the *FSI*, Macedonia scores poorly on four: *criminalization of the state*; *group grievance*; *human flight*; and *uneven development*.

Introduction and Method

This analysis attempts to take stock of Macedonia's progress in its transition to a market-oriented democracy with a focus on Macedonia's bid to achieve phase-out thresholds from USG Assistance. On January 13, 2004, the Executive Committee of State/USAID Joint Policy Council approved the use of a methodology to help determine the timeframe for the phase out of SEED and FSA assistance programs. This methodology uses the four E&E/USAID *Monitoring Country Progress (MCP)* indices (of economic reforms, democratic reforms, economic performance, and human capital) 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. This degree of progress was sufficient for those two countries to earn NATO membership and receive positive indication from Western Europe that EU accession was likely. 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 another set of thresholds: the progress of Croatia, Romania, and Bulgaria in 2006. 2006 is the last year of new USG funding for all three countries and hence represents the actual phase-out year for these countries.¹

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 macroeconomic 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 Kazakhstan lag considerably in reforms and yet are doing relatively well in economic performance (in the case of Kazakhstan) 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.

We attempt to estimate when Macedonia may cross a threshold in the future largely by extrapolating from the past provided a trend in the past is discernable. Adjustments to this extrapolation can then be made on the basis of any additional relevant information. For example, one might expect progress in democratization to slow in a country as it approaches the "ceiling"; i.e., OECD standards. This is certainly what we've seen in the case of the Northern Tier CEE countries. External events will no doubt influence the pace of change as well. In the Balkans, two key such influences are the prospect of EU membership and the status of Kosovo. The prospects of EU membership in the past have

¹ Other sets of thresholds have also been examined and may be worthy of consideration. This includes the progress of the eight Northern Tier CEE countries at the time of graduation from USG assistance (which ranged from 1996 in the case of Estonia to 2000 in Lithuania, Poland, and Slovakia). This also includes efforts to measure sustainable partnerships with the U.S. In this regards, we've introduced two measures: *full sustainable partnership* with the U.S., measured as the standards of progress of the ten CEE countries that are now members of the EU at the time that they became members; and *near sustainable partnership*, measured as the progress of the 11 CEE countries the year that they began accession negotiations into the EU.

largely served as a strong “carrot,” hence favorably influencing the pace of change in prospective members. Currently, however, with EU fatigue, being on the outside of the EU club may mean a slower pace of progress in the future on many transition dimensions. Progress in the Balkans will also hinge in large part on how the Kosovo issue gets resolved.

As will be shown below, Macedonia has seen progress in most areas covered by the gap analysis since the conflict of 2001. However, 2001/2002 represented a low point and, generally, the pace of reforms cannot be expected to continue. Many of the “easy” democratic and economic reforms are completed (but not necessarily implemented or enforced). The next stage of democratic and economic reforms has started but they will take much more political will on behalf of all parties.

In terms of EU pull, EU accession is the priority for all political parties and citizens. Therefore, some “pull” has been experienced as they try to show movement in the reform process. With EU membership looming longer and longer on the horizon, the question will be how much of a “pull” will EU accession have in the coming years. In any event, given the inevitable uncertainties in all country situations, perhaps three scenarios of future trends make sense and are hence used in this analysis.²

Ultimately, phase-out decisions are based on a number of considerations. In addition to the empirical trends and analyses, the phase-out of USG assistance in a country depends in part on the strategic importance of the country to the United States, the effectiveness of USG assistance activities, the receptivity of the recipient country to that assistance, and the involvement of other donors.

Economic and democratic reforms

Figure 1 provides the bird’s eye picture of reform progress in Macedonia in 2007 vis-à-vis the rest of the transition countries and vis-à-vis two plausible phase-out thresholds. Broadly, Macedonia’s reform progress is Southern Tier CEE average. It is close to the Romania-Bulgaria 2002 thresholds in both reform dimensions. It is notably farther from the economic and democratic reform thresholds established by standards of Romania, Bulgaria, and Croatia at the time of phase-out from USG assistance.

Economic reforms. Economic reforms have been progressing in Macedonia at a relatively steady pace, though initial progress was greater in the early 1990s and conflict in the early 2000s contributed to a couple of consecutive years of no gains (*Figure 2*). It seems plausible that Macedonia’s progress in economic reforms (as measured by *MCP*’s economic reform index which draws from EBRD indicators) will meet Romania-Bulgaria 2002 standards anywhere from 2008 to 2012, and the standards of Bulgaria, Romania, and Croatia at phase-out from 2009 to 2016.

² This method of estimating how long it might take a country to achieve a certain threshold differs from the method used during the 2004 phase-out reviews; the latter was based in large part on the pace of change that occurred in Romania and Bulgaria (and not in the country under review).

Figures 3-6 show the components of the economic reform index and Macedonia's 2007 level of economic reform progress in each component relative standards of advanced industrial market economies (a score of "5" by definition), to the Romania-Bulgaria-Croatia in 2006 thresholds, and relative to economic reform progress in Macedonia in 1999. Reasonably good progress has been made in both first stage and second stage reforms, though gaps still remain, particularly in the second stage reforms. This is evident in *Figure 7* which suggests that the second stage reform gaps may not be closed vis-à-vis Romania-Bulgaria-Croatia in 2006 threshold until 2013 to 2020. Macedonia moved forward on one economic reform dimension in 2007 by EBRD measures, second stage competition policy. However, other recent economic reform progress has been noted by the EBRD (albeit not to the extent of changing the measures), including that in the financial sector (with a new banking law and additional incentives for foreign banks), tax reform, and improvements in the business environment in large part in a bid to attract more foreign investment.

Nevertheless, the lag in key second stage reforms is concerning and, without additional progress, economic performance and economic growth will remain muted. The lack of competition policy, infrastructure reform and development, and banking reforms are major impediments to economic growth. Macroeconomic stability has been achieved and represents a solid base for growth but higher levels cannot be achieved without second stage reforms.

Key microeconomic reform challenges also remain, though notable progress occurred in 2007. According to the World Bank's *Doing Business* analysis, Macedonia ranked 75 out of 178 countries worldwide in 2007 in the extent to which its business environment is conducive to enterprise growth.³ The higher the rank, the greater are the constraints to doing business. This represents a notable improvement from Macedonia's 1996 ranking of 92 out of 175. By this measure, microeconomic reforms in Macedonia are less advanced than all of the E&E graduates or phase-out countries, including Romania, Bulgaria, and Croatia, but more advanced than all of the remaining Balkan countries, and most of Eurasia; Georgia, Armenia, and Kazakhstan are the exceptions.

Of the ten business environment areas that contribute to this ranking, two contribute the most towards Macedonia's lagging performance: constraints against (1) employing workers or labor market rigidities (Macedonia ranks 128 out of 178); and (2) closing a business (127). (Macedonia's rank in constraints on trading across borders improved significantly from 2006; improving from 127 to 72).

Figure 9 compares labor market rigidities in Macedonia to those of other transition countries. These rigidities consist of constraints on businesses in terms of difficulties in hiring and firing workers and other employment restrictions (such as limitations in hiring part time work and/or limited time contractors). The higher the ranking, the greater are

³ Scores are based on progress in ten areas, constraints towards starting a business, dealing with licenses, hiring and firing workers, registering a property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business.

the rigidities or labor market constraints from the perspective of the enterprise. In general, according to this dataset, such restrictions remain very high in Macedonia (though so too in some Northern Tier CEE countries). Macedonia ranks 128 out of 178 countries worldwide.

Perhaps anomalously, however, businesses in Macedonia do not perceive labor regulations (or labor skills) as being among the largest constraints to doing business (*Figure 10*). These findings stem from the joint World Bank-EBRD Business Environment and Enterprise Performance Surveys (or BEEPS). The largest constraints toward investments as perceived by senior managers in Macedonia in 2005 were corruption, followed by lack of finance, and the judiciary. Moreover, all three of these constraints increased since 2002 in the minds of managers.

Figure 11 compares such perceptions of corruption in Macedonia with those from other transition countries from 2002 to 2005. Corruption was perceived to be a major constraint in thirty-five percent of Macedonia business managers in 2005, higher than anywhere else in the transition region. Moreover, in contrast to Macedonia, the general trend in the transition region has been a perceived decline in corruption as a major constraint. Business managers in fourteen countries saw a decline in corruption from 2002 to 2005, while managers in only six countries saw an increase in corruption.

As shown in *Figure 12*, Transparency International's *Corruption Perception Index* suggests that corruption remains a key problem in Macedonia, in 2007 just short of the "rampant" corruption threshold as defined by Transparency International. By this measure, perceived corruption in Macedonia is greater than that in the E&E graduate countries (including Romania, Bulgaria, and Croatia), though roughly average for the Balkans.

Democratic reforms. Progress in democracy has been very uneven over time in Macedonia, characterized by three periods of backsliding since the transition began (*Figure 13*). Macedonia has made some notable democracy gains since the 2001 Ohrid Agreement, though no measurable advances occurred in 2006 or 2007 according to the latest data and analysis available from Freedom House; from its 2006 analysis in *Nations in Transit* and 2007 analysis from its worldwide *Freedom in the World*. In light of past trends, Macedonia's democratic reform progress might meet Bulgaria-Romania-Croatia in 2006 threshold anywhere from 2014 to 2020. Relative to the Romania-Bulgaria-Croatia in 2006 thresholds, modest gaps prevail in six of the seven areas measured as of 2006: in electoral process; media; corruption; civil society; national governance; and local governance (*Figures 14-16*).

Figure 17 shows how uneven progress has been across the democracy dimensions. According to these Freedom House measures, independent media may be the most problematic in this regard, having backslid since 2000 with no sign of recovery (as of 2006). IREX's *Media Sustainability Index* provides a somewhat different picture (*Figure 18*). IREX's analysis maintains in fact that notable progress in the sustainability of free media in Macedonia occurred from 2001 to 2006, though regression did occur in 2006.

In fact, the most recent 2007 IREX report states that in general there is concern that “the overall environment for the media—the political, economic, and internal media dynamics—has created a situation where the media have stagnated and regressed in some areas.”⁴ According to this analysis, Macedonia’s media remains “nearly sustainable,” comparable to that found in Serbia and Albania, and less sustainable than that found in Bulgaria, Bosnia-Herzegovina, Romania, and Croatia. None of these countries have achieved a sustainable media sector according to IREX, even Croatia, which had previously crossed this threshold only to regress in 2006.

Democracy sector assessment by USAID/Macedonia. We augment the interpretation of the MCP data with a more detailed sector analysis from USAID/Macedonia below. Overall, the analysis notes recent progress on balance in democratization, including in anti-corruption efforts, the electoral process, civil society and local governance. Progress in independent media has been more mixed.

Corruption. Corruption is the greatest threat to the consolidation of democracy in Macedonia and is the greatest threat to their EU membership aspirations. Corruption, political patronage and undemocratic decision-making have corroded public confidence over time, undermined investors’ confidence in the economy and destabilized Macedonia’s democracy. Political competition is limited, public decisions are driven by a limited circle within the political parties and Executive branch, and there is weak enforcement of laws and statutes to prevent conflicts of interest and influence over government decisions and policies. With weak public administration, “administrative corruption” is also prevalent and destabilizing. USAID’s 2006 (DLG) public opinion survey showed that 82% of the public feel that corruption is a very serious problem, while 63% of the public feel the central government leadership is corrupt. According to the World Bank’s Business Environment Survey, corruption is the major constraint affecting investment decisions in Macedonia. To their credit, the GoM has taken some tangible steps to address corruption in recent years, including establishing an Anti-Corruption Commission, developing the National Judicial Reform Program and developing the State Program for the Prevention of Corruption. However, implementation of these reforms and programs has been slow; improvement in the area of addressing corruption will be one of the key factors defining Macedonia’s EU membership prospects. During this final phase-out period, all USAID programs are coordinated to combat corruption.

Electoral Process. The Mission believes the Freedom House score in its *Nations in Transit* for 2006 does not reflect recent progress in the sector. The 2006 Parliamentary elections were conducted in a manner that was “free and fair and in keeping with international standards”, according to OSCE/ODIHR. In addition, the principal political parties ran campaigns based on political platforms and strategies, breaking from a tradition of negative campaigning that characterized previous elections. The Freedom House 2006 score was based largely on the performance of Macedonia—including the State Electoral Commission (SEC)- during the 2005 local government elections. According to the OSCE/ODIHR, these elections “failed to meet key

⁴ IREX, *Media Sustainability Index 2006-2007* (2007), p. 59.

commitments guaranteeing universal and equal suffrage and the secrecy of the ballot.” Specifically, political parties in certain parts of the country failed to prevent their polling station representatives from intimidating voters, stuffing ballots or otherwise disrupting the democratic process. However, the ability of the SEC to manage the logistical and administrative elements of this election, with little international assistance, was not questioned. USAID has supported the SEC over the years to manage the electoral processes in Macedonia and they currently perform at a high level. Continued high scores for electoral processes will rely more on the political will of the political parties involved, to follow democratic norms, than performance for the SEC or other state bodies.

Civil Society. In a democratic society, the civil sector should serve as the ultimate check on the powers and actions of government. The fight against corruption remains a Mission priority in this phase-out period and without a role for civil society, all efforts will seem partial and biased. Interventions in the legal framework governing civil society and support for the sustainability of NGOs are two of the key factors for the sector moving forward. In terms of legal improvements, the Law on Donations and Sponsorships, which was passed in 2006, allows public interest associations and foundations to receive tax deductible donations. The legal framework, however, lacks a mechanism for granting public benefit status, and it is unclear if organizations will be able to receive tax deductible donations. The Law on Volunteering was enacted in 2007, thus removing any obstacles to volunteering and regulating the status of volunteers. In summary, while progress was made in recent years, USAID believes that continued support is required, to allow Macedonian civil society to develop to the point where they can serve as an effective check on government authority.

Independent Media. There have been mixed results regarding the media recently, with progress in some areas and regression in others (as reflected in the low Freedom House score). In May 2006, the Macedonian Criminal Code was amended to decriminalize defamation. This was major step forward and a basic precondition for freedom of the media and transparency in public life. However, the current government is currently revising the strong Broadcast Law of 2005 and other intervening in the composition and conduct of the Broadcast Council. This represents a serious step backward in the journey toward a truly independent media. USAID will continue to work with journalists and the civil society media organizations to continue to develop journalist professionalism and independence, during the phase-out period.

Rule of Law. The Freedom House indicators and analysis quite accurately present the current situation regarding judicial reform. Progress was achieved in reforming the legal framework, providing increased independence and efficiency in the judiciary, however, the implementation of reforms has been slow. The new Law on the Judicial Council provides for more judicial independence in the nomination, discipline and removal of judges, however political infighting has delayed the appointment of Council members for nearly a year. In another example, the new Law on Courts provides for the establishment of an Administrative Court and a new Appellate Court in Gostivar; however, these courts are still not established. Meanwhile the Law terminated the

jurisdiction of the Supreme Court over the administrative disputes; as such Macedonian citizens have no court protection of their rights in case of breaches by the government. The other remaining laws under the National Judicial Reform Program (e.g. the Law on Court Service, the Law on the Public Prosecutor, and the Law on Public Prosecutor Council) require political will and consensus to move forward, and these are currently lacking. Freedom House's assessment in terms of the case backlog is also accurate. Although USAID has brought about excellent results in reducing backlog in pilot courts,⁵ it will take time to achieve the same results in other courts. The fact that there is no or very little automation of the procedures in the courts is not helping either.

Local Democratic Governance. The successful decentralization of government authority, as prescribed by the Framework Agreement, is a good governance practice, a US foreign policy priority and a centerpiece of USAID Macedonia's Strategy. Since the decentralization process began, in July 2005, the performance of Macedonian municipalities has exceeded expectations, and decentralization is considered a (qualified) success. USAID's is the primary donor program supporting the capacity building of municipalities, helping to develop the systems and train personnel, so that municipalities successfully assume new responsibilities. Municipalities have exceeded Mission expectations in certain critical functions, including financial management and tax administration.⁶ Progress in decentralization has been stalled by a number of factors, including: a) a lack of clarity in the legal framework and procedures related to fiscal decentralization, b) the under-funding of transfers for certain decentralized functions, and c) the infiltration of politics into several aspects of the process, including the administration of the education system. USAID will continue to work with central and local government leaders to keep decentralization moving forward successfully.

Economic performance and human capital

Drawing from the (newly-revised) *MCP* indices, Macedonia compares unfavorably in terms of economic performance by transition country standards (i.e., Eurasian average and lagging the most among the Southern Tier CEE countries). Macedonia is transition region average in terms of human capital progress (*Figure 19*).⁷ This translates into very

⁵ 58% reduction in case backlog for cases older than three years and a 38% reduction for cases more than one year old. This result was achieved in the 10 pilot Macedonia "basic" courts (out of 27).

⁶ The mission has developed a Municipal Capacity Index to assess progress in decentralization. Macedonia's 84 municipalities are rated on progress in five categories: (1) municipal management and financial management capacity; (2) municipal tax administration capacity; (3) transparency and citizen participation in decision making; (4) public records, urban planning, and regulatory management capacity; and (5) provision of more accessible, convenient and customer-oriented services. Scores range from 0 to 100, the higher the score, the greater the capacity. By this measure, progress since 2006 has been impressive: the average score per municipal increased from 23 points in 2006 to 38 in 2007. Only two municipals (Lipkovo and Gradsko) of the 84 municipals did not see progress in 2006-2007.

⁷ The economic performance index includes: (1) private sector share of GDP; (2) export share of GDP times the proportion of manufactured exports to total exports; (3) employment in micro, small and medium enterprises as a percent of total employment; (4) macroeconomic stability (the average of 3 year inflation, external debt as % of GDP, current account balance as % of GDP; and fiscal balance as % of GDP); (5) 5 year economic growth rate; (6) foreign direct investment per capita, cumulative since 1989; (7) uneven

far to go in terms of achieving the Bulgaria-Romania-Croatia in 2006 threshold in economic performance, and coming close to attaining the human capital threshold as measured by Bulgaria-Romania-Croatia in 2006.

Economic performance. *Figure 20* shows Macedonia's economic performance trajectory, characterized by intermittent progress and two periods of stagnation since the transition began (from 1992-1995 and from 2000-2003). Since 2003, advancement overall has resumed and includes more favorable growth rates in exports (9.4% annual average from 2004-2007) and GDP (5.5% in 2007), and perhaps falling unemployment rates (by 3% in the past two years according the World Bank representative to Macedonia). Nevertheless, Macedonia has far to go before its economic performance achieves the Bulgaria-Romania-Croatia in 2006 threshold, or perhaps not until any time from 2012 to 2018.

Moreover, disaggregating the economic performance index (*Figures 21-22*) highlights some imbalances between different aspects of Macedonia's economic performance. In particular, while macroeconomic stability has been very ably maintained (with very low inflation, low external debt, and small current account and fiscal deficits since 2005), and the micro, small, and medium enterprise sector is relatively large and growing, foreign direct investment has been meager, labor market challenges are extremely problematic, the economy has been expanding at a very modest pace (particularly by transition standards), and the gains from that growth have been very unequally distributed.

Economic growth in Macedonia remains very modest by transition country standards (*Figures 23 and 24*). The size of Macedonia's economy still remains below what it was in 1989, about 90% of 1989 GDP. Virtually all transition economies witnessed a sizable drop in output in the 1990s and Macedonia was no exception. However, Macedonia's economic growth since its GDP bottomed out (in the mid-1990s) has been relatively low if not stagnant in some years. More recent years have witnessed higher economic growth in Macedonia, roughly an average annual rate of 4.2% since 2004. However, as is shown in *Figure 24*, even these more favorable numbers are well below regional trends.

Labor market challenges are very significant in Macedonia. *Figure 25* provides an overview of how and to what extent Macedonia's labor market has been adjusting. Changes in employment roughly track, with a lag, changes in GDP, though the drop in employment has been even more significant than the drop in output. By 1997, official employment was only 60% of its level in 1989. As of 2006, total (official) employment

development (a measure from the Fund for Peace's *Failed States Index*; and an attempt to measure development disparities among groups of people across ethnic or religious lines); (8) longer term unemployment as % of total employment; and (9) services as % of GDP. The human capital index includes: (1) per capita income; (2) education gaps (the % of vulnerable education indicators to total education indicators, from USAID working paper #2, pp.76-77) ; (3) public expenditure on education and health as a percent of GDP; (4) life expectancy; (5) under five years of age mortality rates; (6) TB incidences per 100,000; and (7) vulnerable populations (the proportion of children and elderly in poverty at \$2.15 per day. Countries are down-graded a "1" on the "1" to "5" scale on the poverty rates of the vulnerable population if the countries also have a high rate of institutionalized children (and if the score is not already a "1").

in Macedonia remained about 72% of its pre-transition level. Some of this employment drop was to be expected given that “over-employment” (by market economy standards) was likely a key characteristic prior to the transition. Moreover, employment levels are also lower today in virtually all other transition economies, particularly those that have undergone substantial economic and democratic reforms. Employment levels in the Northern Tier CEE on average today are likely not much above 80% of 1989 levels.

Broadly, markets adjust through prices and/or quantity. In labor markets, this means real wages or employment or both. What is so striking about Macedonia is the extent to which both labor market dimensions have changed. Real wages, while largely increasing since 1996, were still less than 60% of pre-transition levels as of 2004 (latest data available). To compare, real wages in the CEE countries on average were above 1989 levels by 2004.

Figure 26 attempts to measure the responsiveness (or elasticity) of employment to economic growth; i.e., how and how much has employment changed with the onset of economic growth (after GDP bottomed out from the transition recession). This is another way to gauge the extent to which economies are experiencing “jobless growth.” Many transition economies, in fact, continue to experience employment contraction while the economy expands. For Macedonia, however, job growth has been coinciding with GDP growth.

However, the growth of employment (and of the economy) in Macedonia has not yet been accompanied by a significant fall in Macedonia’s very high unemployment rate (*Figure 27*). Estimates of Macedonia’s unemployment rates vary widely, and perhaps a more credible estimate of open unemployment (which adjusts for informal economy employment) may be closer to 25%.⁸

The large majority of Macedonia’s unemployed has been unemployed for at least one year (i.e. “long term” unemployed, *Figure 28*). Youth unemployment is also extremely high. In 2005, more than 60% of the Macedonia’s youth labor force was (at least officially) unemployed (*Figure 29*). This is a rate that is higher than what it was in the early 2000s. Unemployment rates also vary widely by ethnic groups (*Figure 30*). Unemployment rates among the Roma are highest, ranging from 53% (from a UNDP estimate) to more than 70% (from an IMF source) at least as of 2001. Unemployment rates among ethnic Albanians were closer to 50% in 2001 (*Figure 30*), though these rates since then (and since the Ohrid Agreement) have likely fallen for this group. Unemployment rates are lowest, though still very high, among ethnic Macedonians, perhaps 28%.

Foreign direct investments in Macedonia remain very modest (*Figure 31*). Cumulative FDI per capita in Macedonia is much lower than that found in the Northern Tier CEE

⁸ This figure is based on an estimate from IMF, *Macedonia: Selected Issues* (October 2006). In addition, more recently, the World Bank’s representative to Macedonia, in a December 2007 interview, contended that the most recent data indicate a fall in unemployment rates of around 3% in the past two years, perhaps from 25-30% to 22 to 27%.

countries as well as in Croatia, Bulgaria, and Romania. Of the Balkan countries, only Albania has attracted less FDI per capita than has Macedonia.

Macedonia's outward orientation, as measured by exports as a percentage of GDP, is greater today than earlier in the 1990s (*Figure 32*). According to the Economist Intelligence Unit, Macedonian exports have increased by more than 8% annually each year since 2004, for a six year annual average of 9.4% from 2004 to 2007.⁹ Macedonia's export share of GDP is above Southern Tier CEE average though less than the Northern Tier CEE average. How large an export sector is relative to GDP is a function not only of competitiveness but also country size; larger economies generally don't need to trade as much as do smaller economies and hence typically have much smaller export sectors relative to GDP. Hence comparing outward orientation between economies of comparable size may be more meaningful. *Figure 33* attempts to do this and shows that Macedonia's outward orientation by this measure is much greater than that found in Albania and Armenia, yet much less than that found in Estonia and Slovenia.

How does Macedonia's macroeconomic performance translate into views by Macedonians about their economic situation and living standards (*Figures 34 and 35*)? Here we draw from 2006 World Bank and EBRD household surveys done throughout the transition region. In short, Macedonia's weak macroeconomic performance translates into dismal views at the micro level. Fifty percent of Macedonians surveyed felt that their living standards in 2006 were worse than what they were in 1989, while only thirty percent viewed current living standards as better than 1989 living standards. Only six transition countries had public perceptions notably worse: Bosnia, Serbia, Hungary, Montenegro, Ukraine, and Georgia. When asked more specifically about economic aspects of their living standards (i.e., views on their present economic situation), Macedonians were even more pessimistic. About 80% in 2006 felt that their present economic situation was worse than that in 1989, while less than 10 felt it was better. Of all the transition economies, only Bosnia-Herzegovina fared worse on this score.

Human capital. As measured by the *MCP* index, Macedonia's human capital may meet the standards of Bulgaria-Romania-Croatia by 2008 (*Figure 36*). However, this aggregate measure masks considerable gaps in education in Macedonia. Moreover, only recently has the level of human capital in Macedonia been restored to what it was in the early 1990s, and recovery has not been steady.

Figures 37 and 38 disaggregate the human capital index and show the gaps against two thresholds: progress of Romania-Bulgaria in 2002; and progress of Romania-Bulgaria-Croatia in 2006. On most human capital dimensions, Macedonia compares quite favorably. Health indicators are reasonably favorable. Life expectancy in Macedonia was 74 years in 2005. Of the transition region, only five countries have a higher life expectancy: Slovenia (78); Czech Republic (76); Croatia (76); Poland (75); and Albania (75). Macedonia's under five mortality rate was 17 deaths per 1,000 children in 2005. This rate is roughly transition region median; 13 countries have rates lower than Macedonia's rate, which is comparable to Ukraine (17), Albania (18), Russia (18),

⁹ Economist Intelligence Unit, *Macedonia Country Report* (January 2008), p. 15.

Moldova (16), and Romania (19). Only six transition countries have TB rates lower than that found in Macedonia (32 incidences per 100,000 persons): Czech Republic (10); Slovakia (12); Slovenia (12); Albania (17); and Hungary (22).

Macedonia's per capita income is low by CEE standards (*Figures 39 and 40*). At \$7,610 in 2006 (in purchasing power parity terms), Macedonia's per capita income is roughly one half of the Northern Tier CEE levels. It is also significantly lower than average income in Bulgaria (\$10,140), Croatia (\$13,680), and Romania (\$9,820). Of the rest of CEE, Macedonia's per capita income in purchasing power parity terms is comparable to that of Bosnia-Herzegovina's average income and higher than that found in Albania, Serbia, Montenegro, and Kosovo.

Macedonia's vulnerable population as defined by poverty rates of children and elderly is a relatively small proportion of the population. 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 Northern Tier CEE countries, including Estonia (6% and 4%, respectively), Latvia (5% and 2%), Lithuania (6% and 2%), Poland (5% and 1%), and notably lower than those found in Romania (21% and 7%). In addition, the rate of institutionalized children (or the rate of children in residential care per 100,000 population aged 0–17) is low in Macedonia: 182 per 100,000 in 2005. This is well below the transition region averages (of 783 per 100,000 in the Northern Tier CEE; 407 in Southern Tier CEE; and 888 in Eurasia).

Education gaps. Education gaps in Macedonia are significant. Public expenditure on education as a percent of GDP in Macedonia fell dramatically from 5-7% of GDP in the early 1990s to almost 2% of GDP in 2004, among the lowest proportions in the transition region (*Figure 41*). Since 2004, these expenditures have risen and may be closer to 4% of GDP in 2007.

Enrollment trends are mixed (*Figure 42*). Primary enrollments remain high. Secondary enrollments have been increasing, though much of the increase has been due to increasing vocational education (a trend which contrasts with the general trend in the region of oftentimes significant drops in vocational enrollments). Tertiary enrollments may be problematic, low (at about 20% in 2005) and not increasing, at least from 2003-2005 (*Figures 42-44*). Higher education enrollment in Macedonia is among the lowest in the transition region, comparable to that in Albania.

Available data suggest that the quality of education in Macedonia is a concern (*Figures 45-47*). Various surveys which attempt to measure functional literacy (or the extent to which the education system produces educations which are relevant and effective in a market economy) show Macedonia's school system performs far below OECD standards and among the lowest within the transition region.¹⁰ Of the transition countries for which data are available, only test results in Albania are as comparably low (*Figure 45*).

¹⁰ Macedonia has participated in three international education surveys: the Trends in International Mathematics and Science Survey (TIMSS), the Progress in International Reading Literacy Study (PIRLS); and the Program for International Student Assessment (PISA).

Of the fourteen transition countries that participated in the Trends in International Mathematics and Sciences Study (TIMSS) in 2003, Macedonia is the only one that lagged notably behind the minimum threshold; its students performed closest to students in Iran, and not much better than students in Indonesia and Lebanon. TIMSS trends over time (from 1995 to 2003) show that significant backsliding has occurred in Macedonia's performance. This is particularly striking since it was the worst performer of the transition sample in 1995.

Macedonian students' performance on the PISA tests in 2003 was far below OECD standards and comparable to Tunisia, Indonesia, and Brazil. Furthermore, PISA test results in Macedonia showed that more than one quarter of Macedonian students was hindered by inadequate heating, cooling, or lighting systems (*Figure 46*). By one analysis (from Math and Science International Reports?), 92% of students in Macedonia are taught by math teachers that have finished only two years post secondary school, while 78% of students are taught by science teachers that have finished only two years post secondary school.

The most recent data on functional literacy are now available from the Progress in International Reading Literacy Study (PIRLS) tests; results from 2006 testing have just emerged and can now be compared with 2001 results (*Figure 47*). The PIRLS assessments attempt to measure student's reading achievement at fourth grade along two lines: reading for literacy experience; and reading to acquire and use information. Of the eleven transition countries that participated in PIRLS in 2001, only students in Macedonia lagged considerably behind the OECD threshold. Macedonia's performance was more comparable to that of Colombia and Iran than Bulgaria. The 2006 test results showed some considerable changes, progress and regression, in students in the transition region. Students in Russia, Slovenia, Slovakia, and Hungary showed significant progress in reading scores from 2001 to 2006, while students in Lithuania and Romania regressed considerably. In Macedonia, in contrast, there was no change in test scores from 2001 to 2006.

The education gap indicator in the *Monitoring Country Progress* human capital index (of *Figures 37-38*), draws from twelve indicators and attempts to measure both the quantity and the quality of education. This measure was derived in the E&E Bureau's working paper, *Education in Eastern Europe and Eurasia #2* (October 2005) which concluded overall, that from a limited sample of sixteen transition countries (for which data exist for a majority of the twelve indicators used to rate the education deficiencies), four countries stood out as the most vulnerable: Albania; Armenia; Macedonia; and Romania.¹¹

Figures 48-49 show how small Macedonia is relative to the Southern Tier CEE countries. Specifically, Macedonia is only four percent of Southern Tier CEE both in terms of population and in GDP. A small economy and country need not necessarily be a liability.

¹¹ R. Murphy, M. Petric, and R. Sprout, *Education in Eastern Europe and Eurasia*, Working Paper #2, Bureau for Europe & Eurasia, USAID (October 2005).

However, one key consideration, as is the case of Macedonia, is the constraint from a limited pool of educated and skilled workforce.

Peace and Security

Finally, we provide some very preliminary analysis in regards to peace and security in Macedonia. As part of the *Monitoring Country Progress* system, and in attempt in part to better align our empirical system with the DFA foreign assistance framework, we are engaged in developing a peace and security index. It's very preliminary, both in terms of how we are proposing to measure peace and security dimensions as well what dimensions to include. On the latter, we have not yet adequately addressed a means to measure defense and police reforms. At this stage, we have developed measures for five main components to the index, though in some countries, including Macedonia, we do not yet have data on one of those dimensions, namely "political engagement," intended as a measure of political integration among the nations of the world.

Macedonia's peace and security measures vary considerably relative to transition region standards and global standards (*Figures 50-62*). On most elements of counter-narcotics and transnational crime, Macedonia's indicators are comparable or better than transition region norms. One key exception is the "criminalization of the state." This variable is drawn from the Fund for Peace's *Failed States Index (FSI)* and attempts to measure corruption or profiteering by ruling elites, the extent of popular confidence in state institutions, and the growth of crime syndicates linked to ruling elites. Using Fund for Peace's scale of 1-10 (the higher the score, the worse the outcome), Macedonia scores a "7.3." Other countries in that range include Albania (7.4), Ukraine (7.5), Lebanon (7.3), Bolivia (7.4), Burundi (7.1), Ecuador (7.5), Venezuela (7.5), Israel (7.3), Mozambique (7.4), and Gabon (7.3).

Figures 55-61 provide limited cross-country comparisons in peace and security conditions by this index. In broad strokes, peace and security conditions in Macedonia are roughly comparable to conditions in Romania, Bulgaria and Croatia, much less favorable than conditions in Slovenia, and much more favorable than conditions in Russia, Pakistan, and Colombia.

Overall, Macedonia falls into the *Failed States Index* "warning" range where most of the transition countries lie (*Figure 62*). Of the transition countries, only Uzbekistan falls into the "alert" range, and only the Northern Tier CEE countries plus Montenegro fall into the "moderate" range. No transition country is considered "sustainable" on the *FSI* index. In addition to the "criminalization of state," Macedonia scores poorly on three other *FSI* indicators: group grievance (the degree to which ethnic or religious groups suffer injustices, atrocities, repression, and scapegoating); chronic and sustained human flight (including brain drain, voluntary emigration of the middle class, and growth of exile communities); and uneven development (group-based inequalities in education, jobs and economic status, group-based impoverishments, and rise of communal nationalism based on group-based inequalities).

Macedonia scores a “7.1” in “group grievance.” Other countries with comparable scores include Iran (7.1), North Korea (7.2), Sierra Leone (7.2), Kenya (6.9), Moldova (7.3), Ukraine (7.0), and India (7.0). Macedonia scores a “7.0” in “human flight.” Other countries with comparable scores include Afghanistan (7.0), Uzbekistan (7.1), Lebanon (7.0), Bolivia (7.0), Ecuador (7.0), Mexico (7.0), and El Salvador (7.0). Macedonia scores a “7.4” in “uneven development.” Other countries with comparable scores include Turkmenistan (7.3), Tajikistan (7.3), Rwanda (7.1) Moldova (7.5), Belarus (7.5), Iran (7.2), Azerbaijan (7.4), Zambia (7.4), Thailand (7.5), and Cuba (7.2).

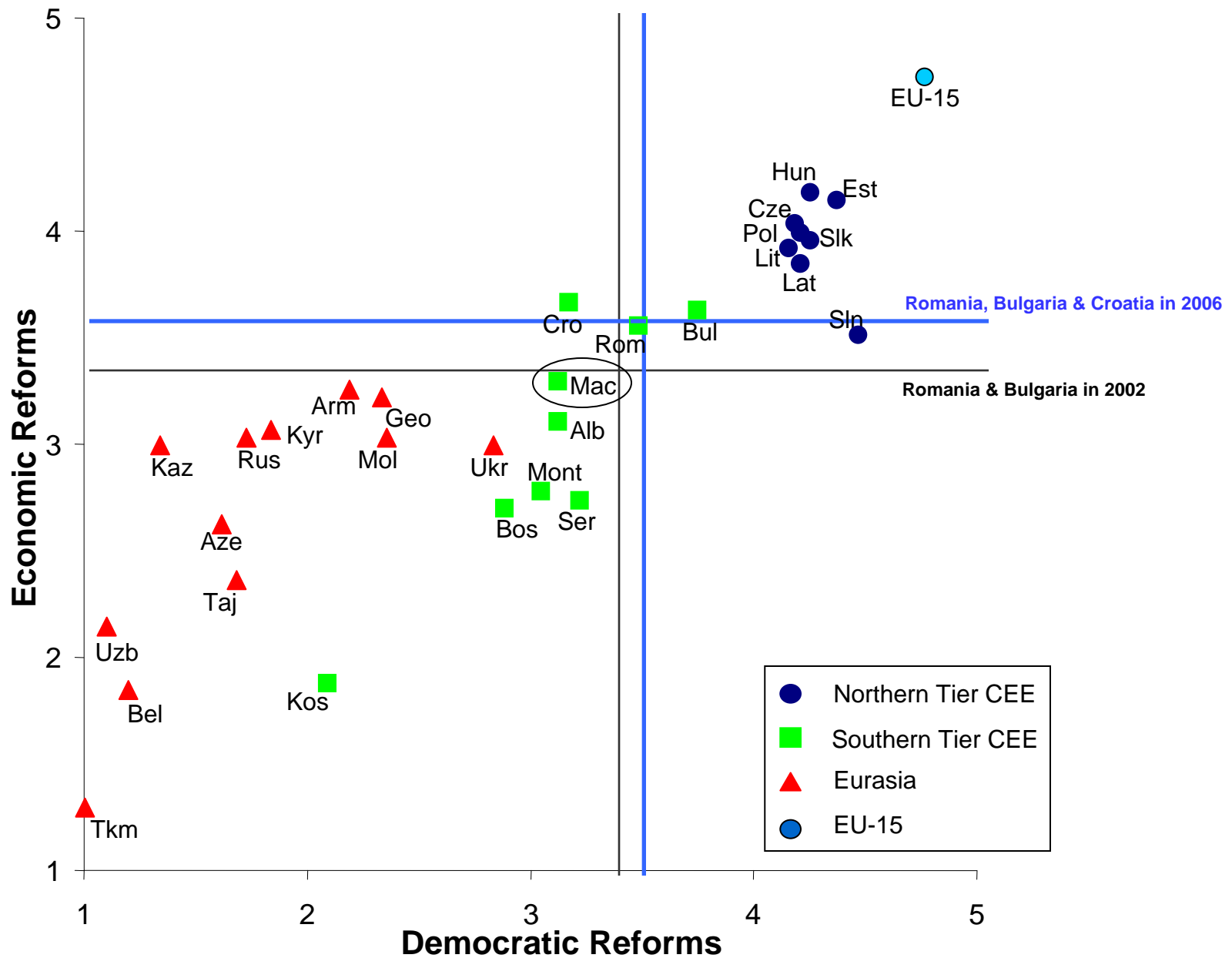
Monitoring Country Progress in Macedonia

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

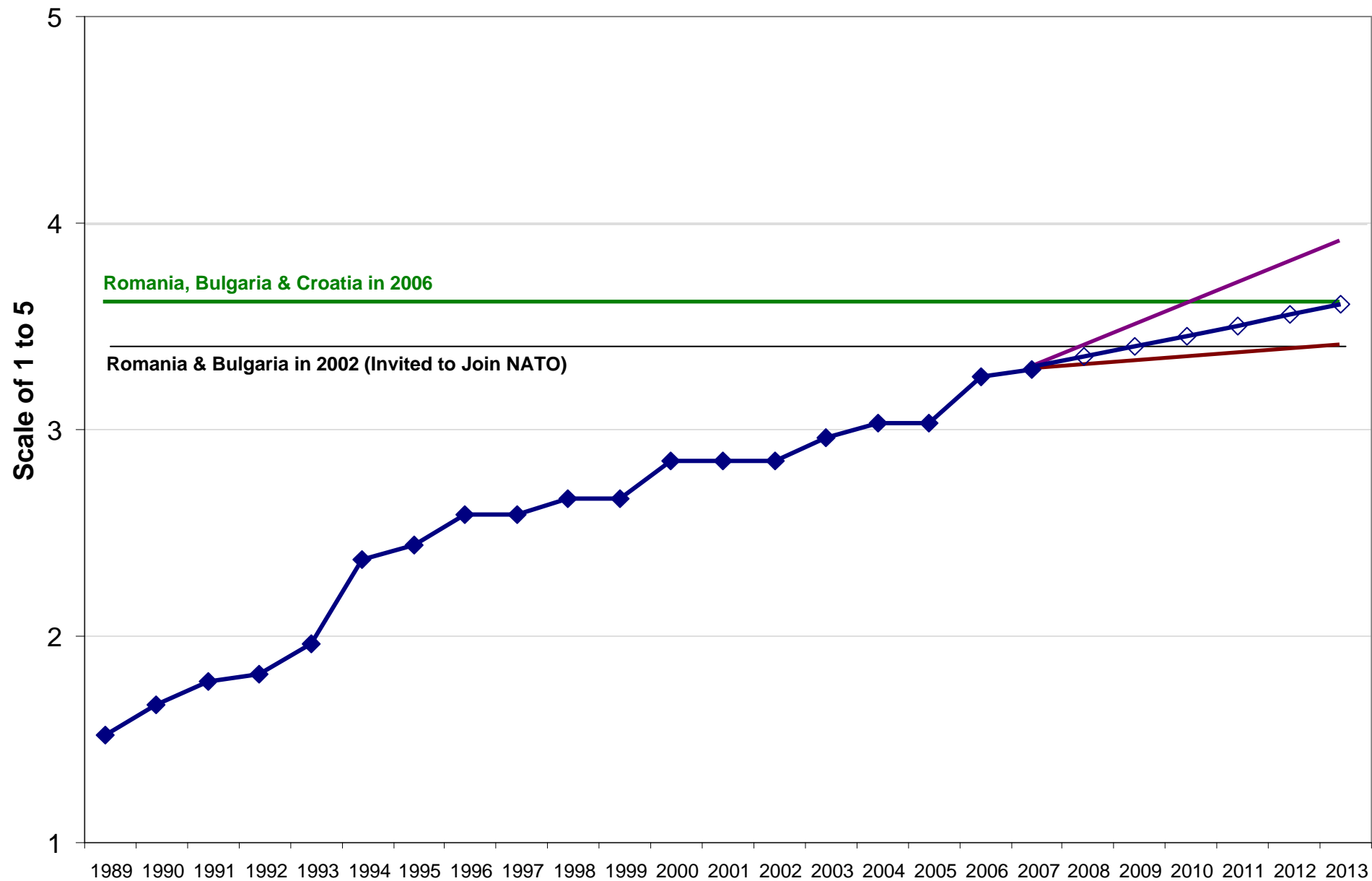
February 2008



Economic and Democratic Reforms in 2007

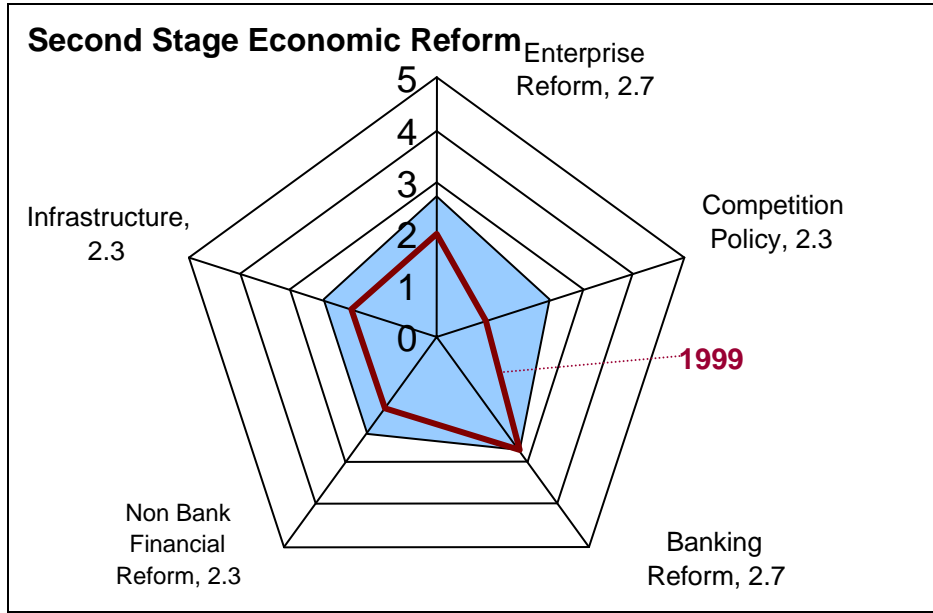
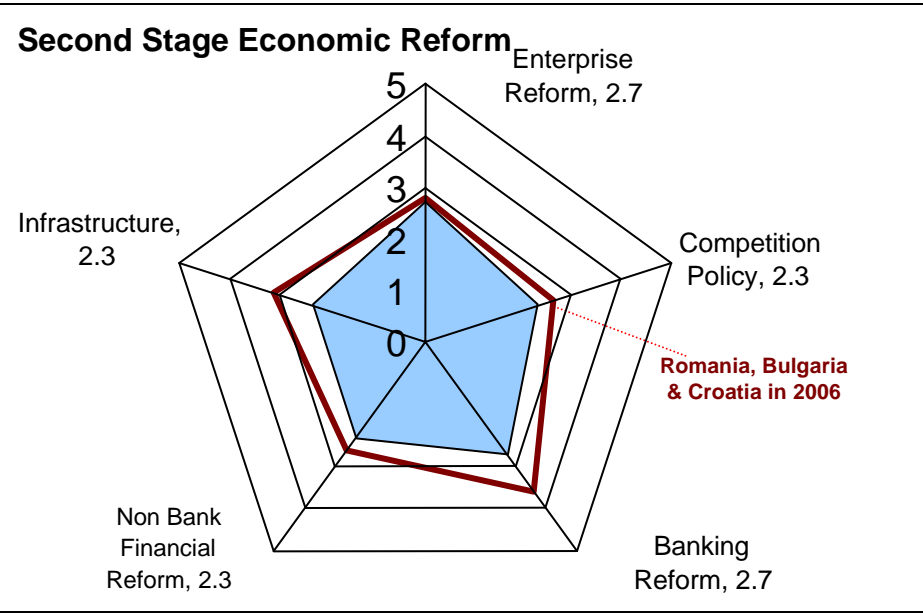
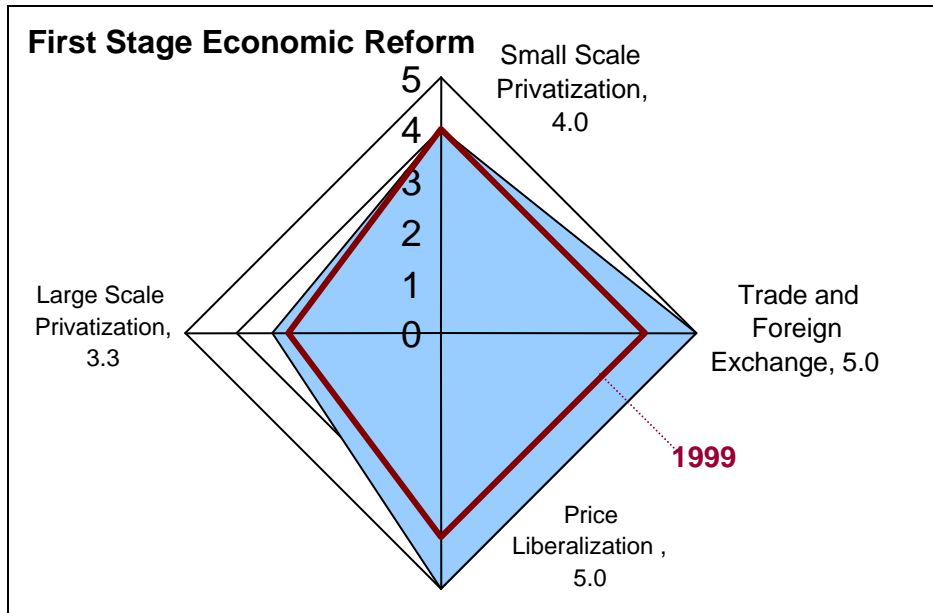
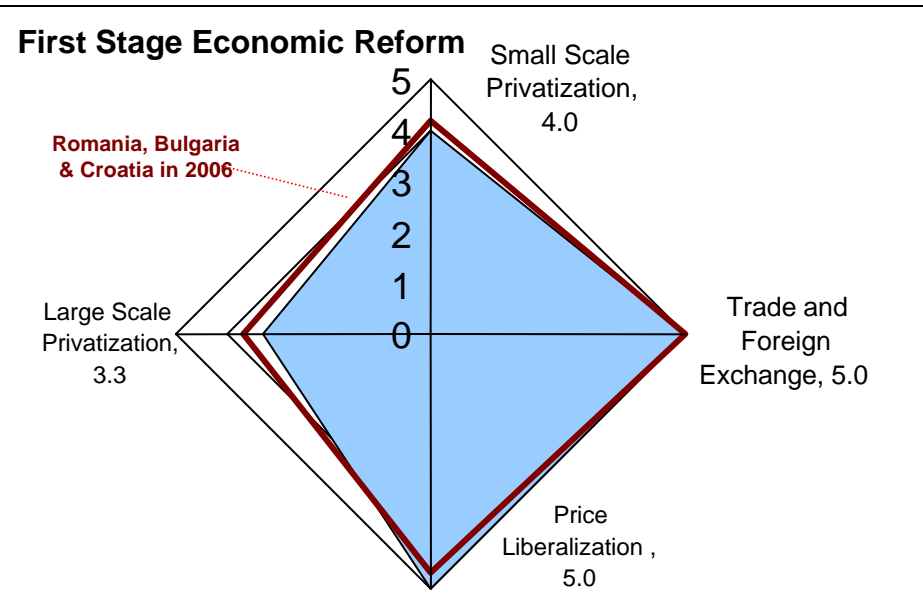


Economic Reforms in Macedonia



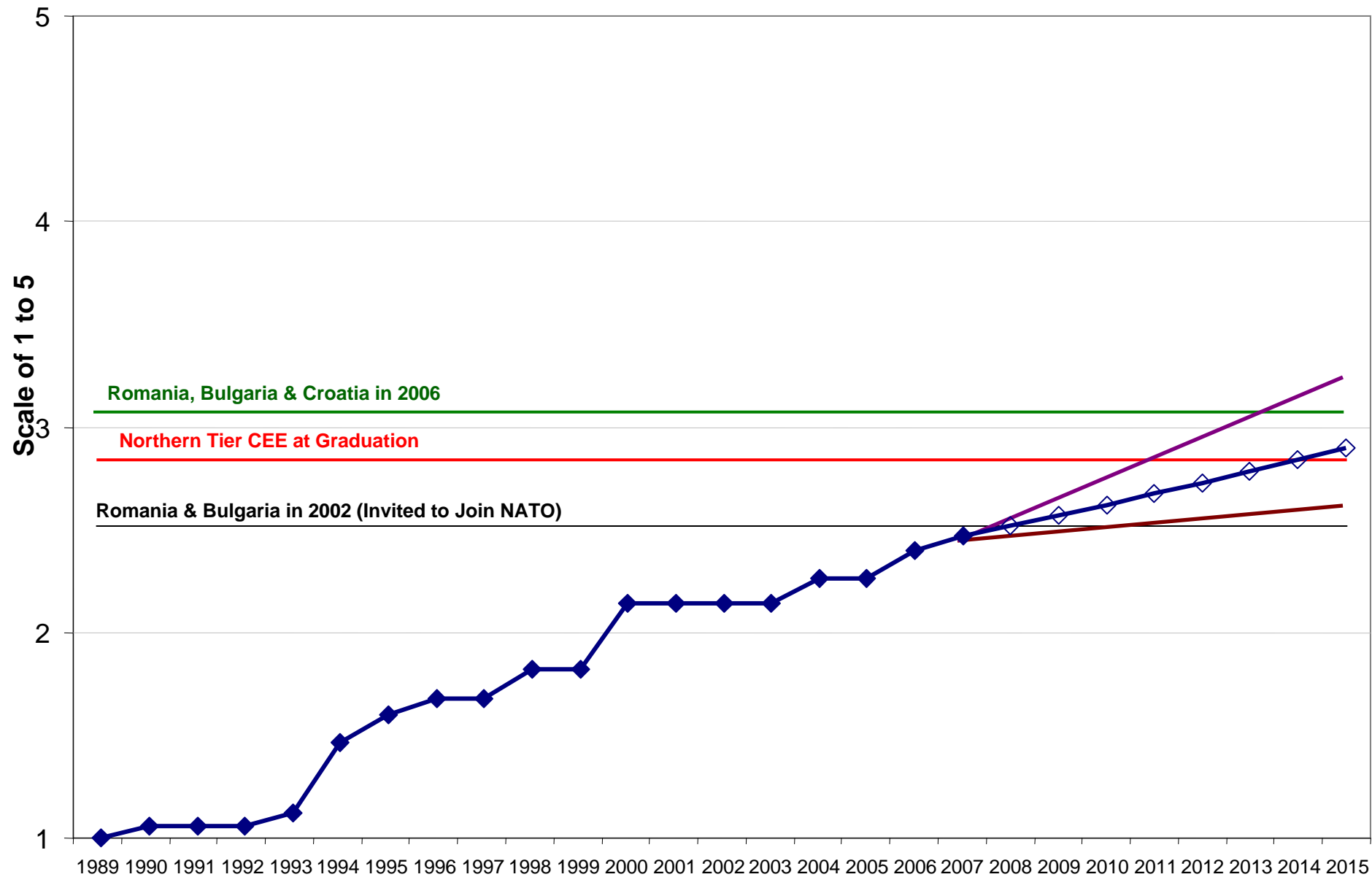
Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID, Monitoring Country Progress in CEE & Eurasia system drawing from EBRD, *Transition Report 2006* (November 2006).

Economic Reform in Macedonia in 2007



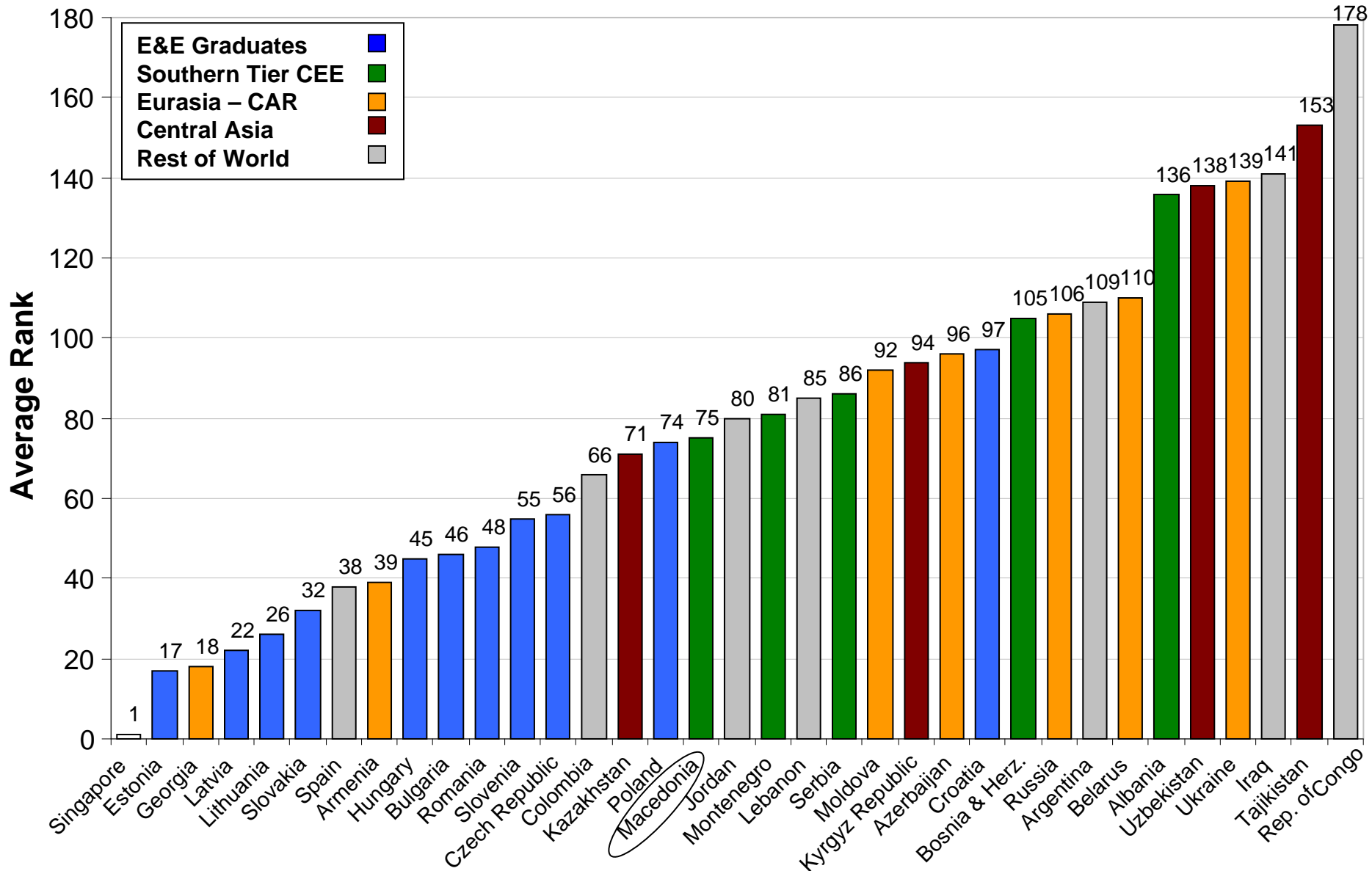
Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #10 (2006)* drawing from EBRD, *Transition Report 2006 (November 2006)*.

Second Stage Economic Reforms in Macedonia



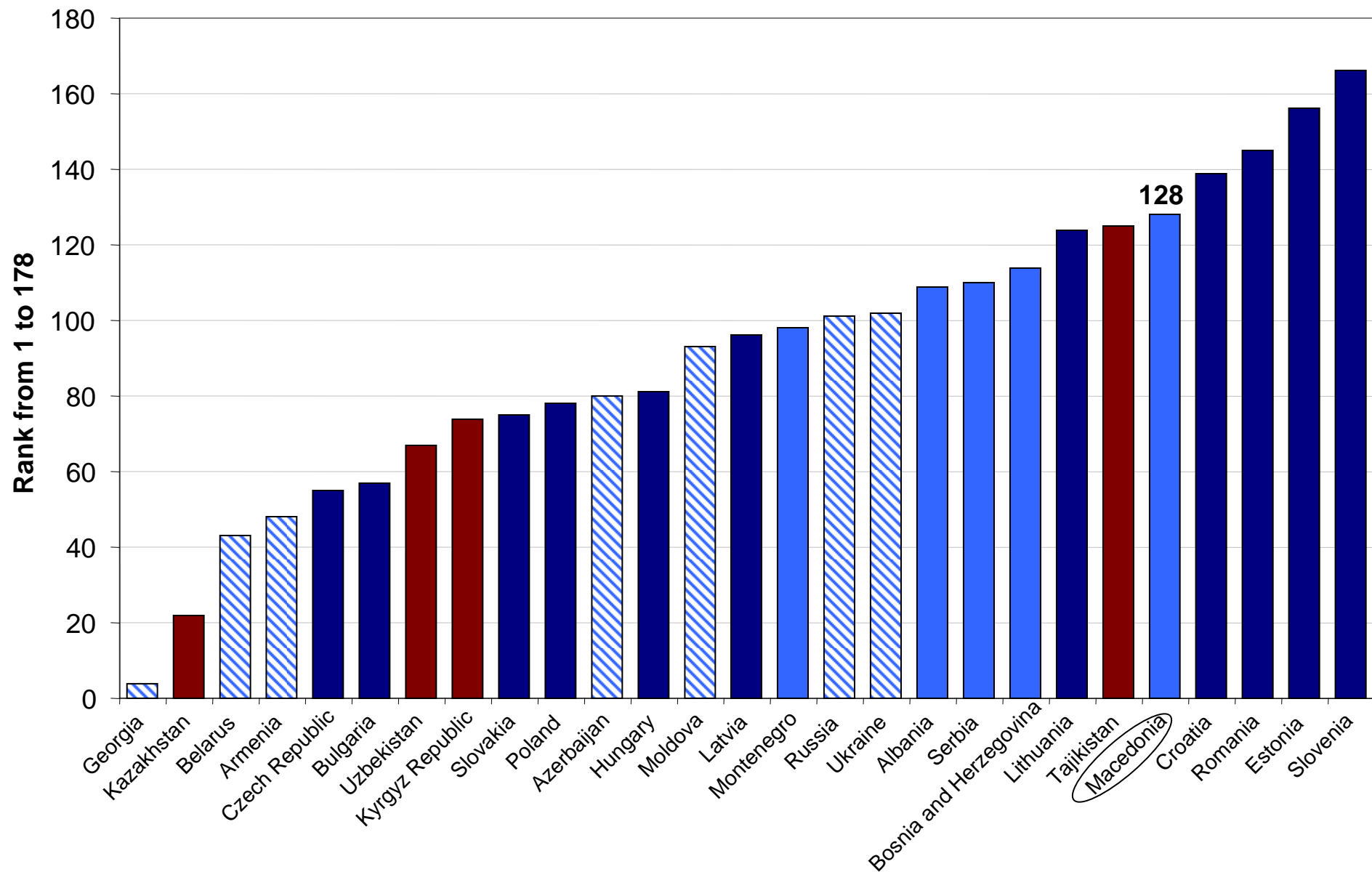
Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID, Monitoring Country Progress in CEE & Eurasia system drawing from EBRD, *Transition Report 2006* (November 2006).

Business Environment in 2007



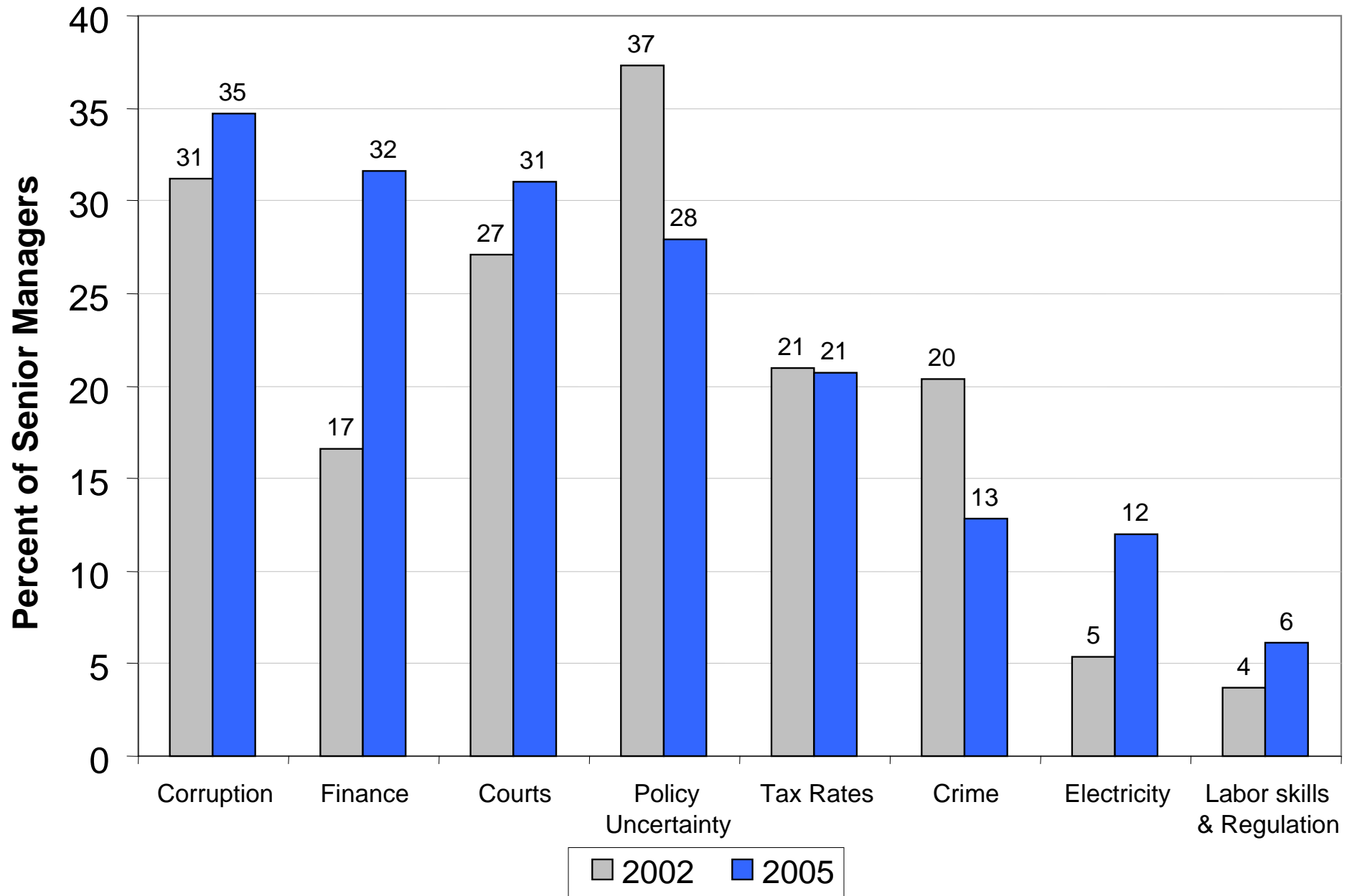
World Bank, *Doing Business in 2008* (2007). Worldwide scores range from 1 to 178 and include 10 topics: starting a business, dealing with licenses, hiring and firing workers, registering a property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business.

Employing Workers in 2007



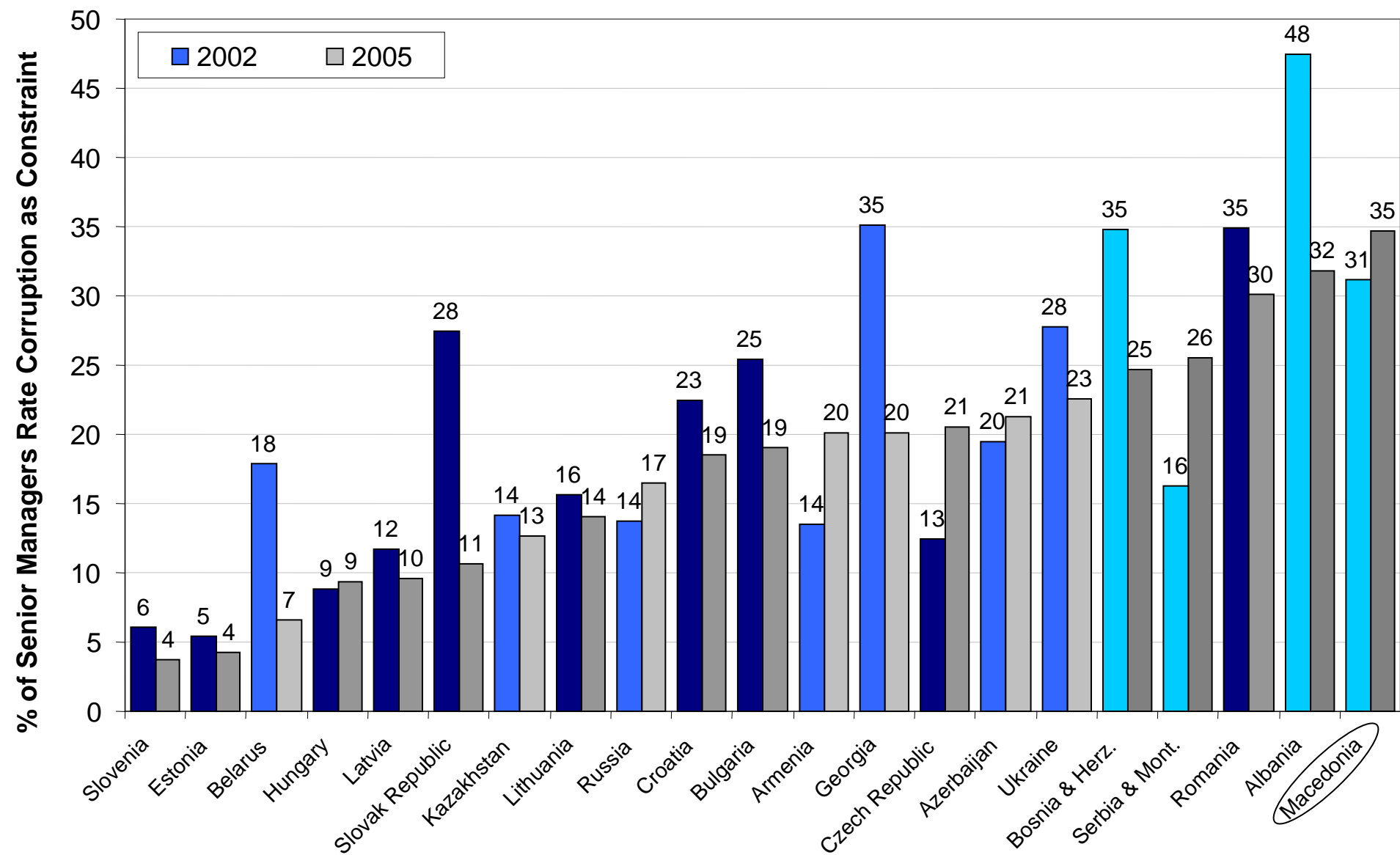
World Bank, *Doing Business in 2008* (2007). Data are an average of 6 indices: difficulty of hiring, difficulty of firing, rigidity of hours, rigidity of employment index, non-wage labor cost and firing cost.

Investment Climate in Macedonia, Major Constraints



World Bank & EBRD, *Business Environment and Enterprise Performance Survey* from World Bank, *World Development Indicators* (2007). Percent of senior managers that rated these investment considerations as a major constraint.

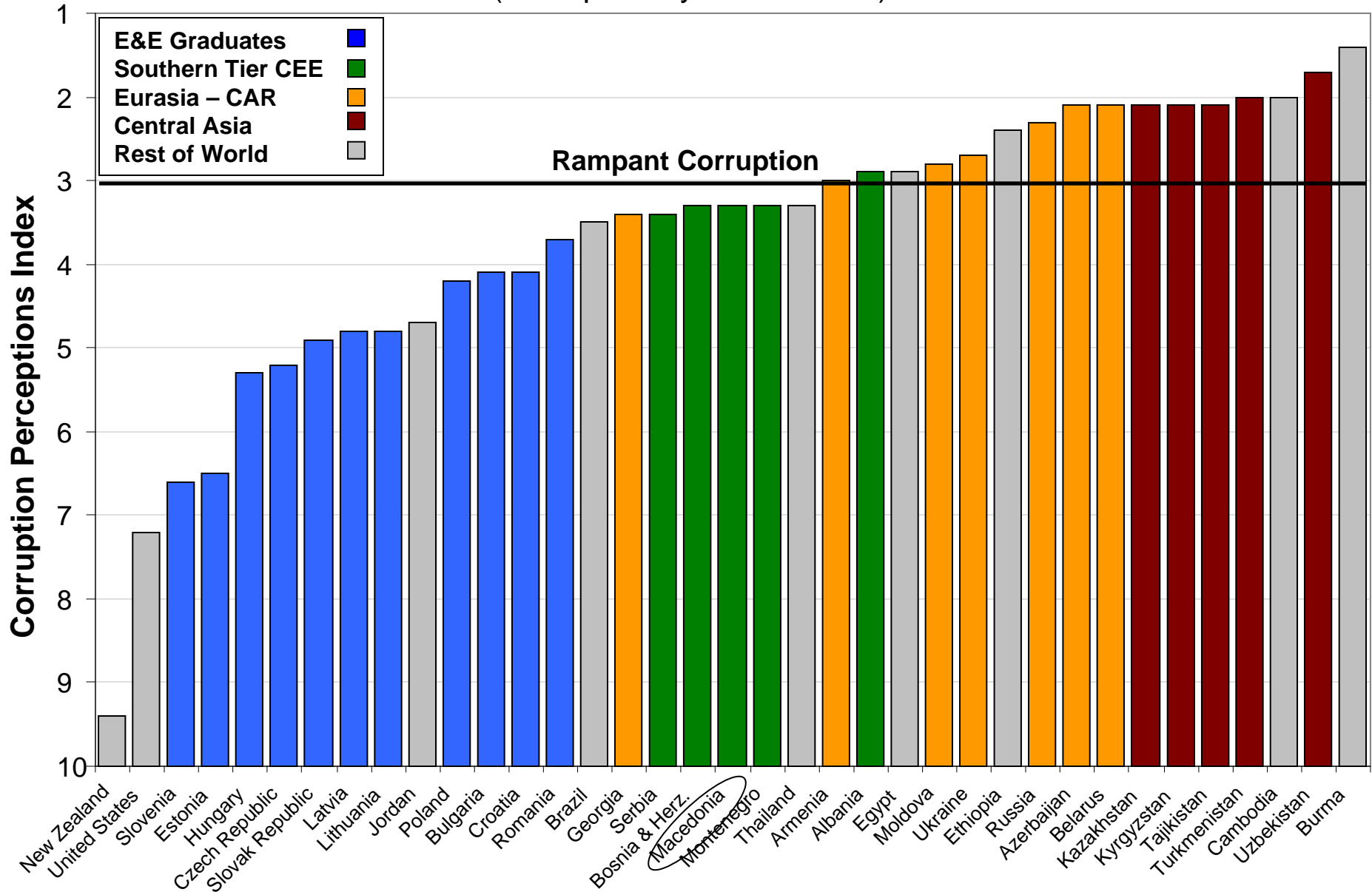
Investment Climate, Corruption as a Major Constraint



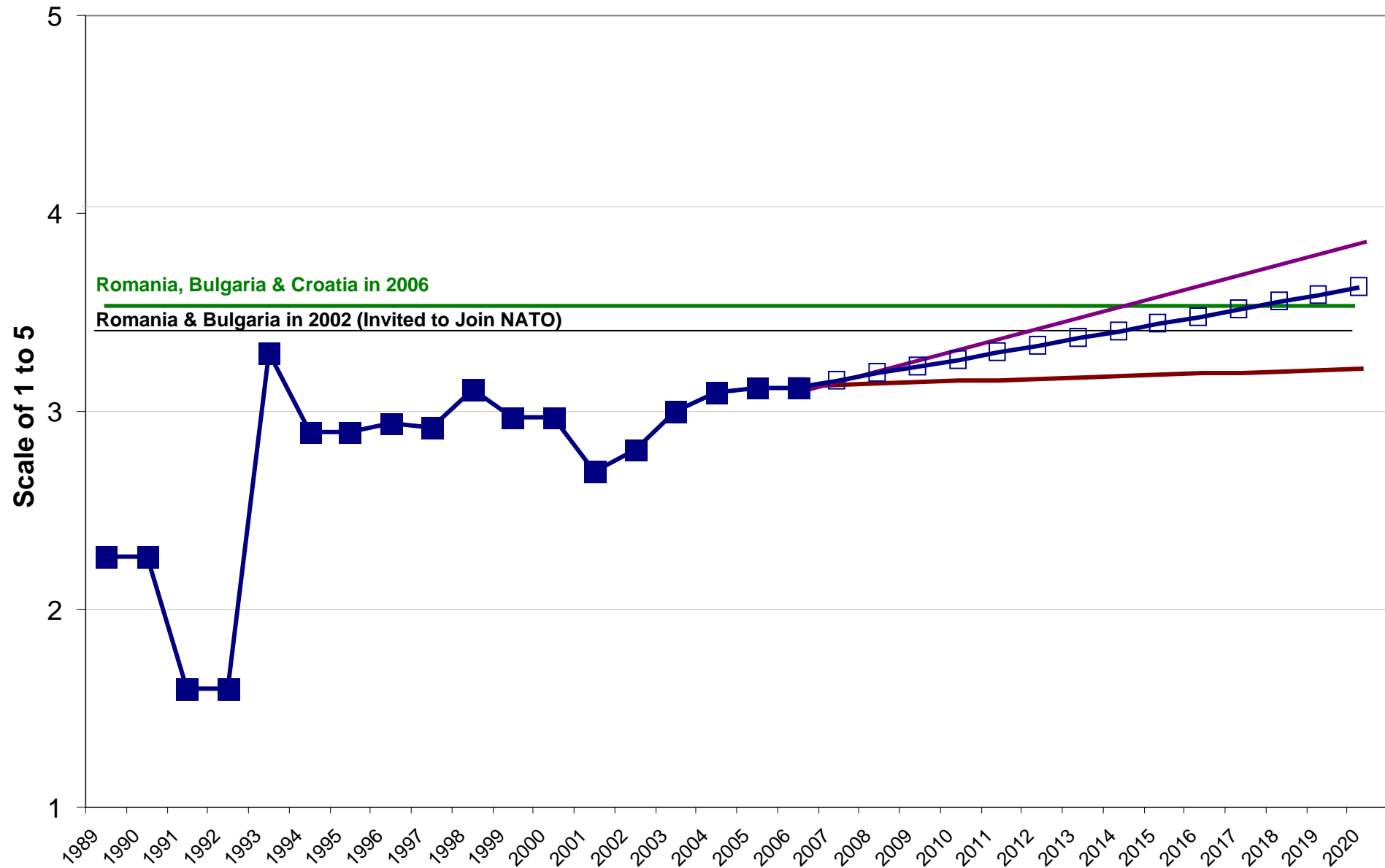
World Bank & EBRD, *Business Environment and Enterprise Performance Survey* (November 2005 and earlier years) from World Bank, *World Development Indicators* (2005). Percent of senior managers that rated these investment considerations as a major constraint.

Corruption Perceptions in 2007

(Transparency International)

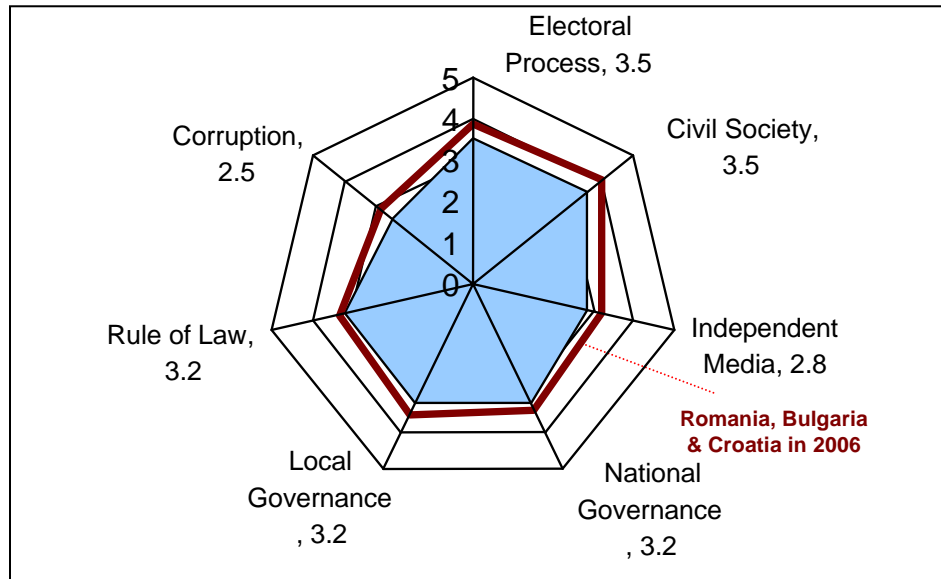
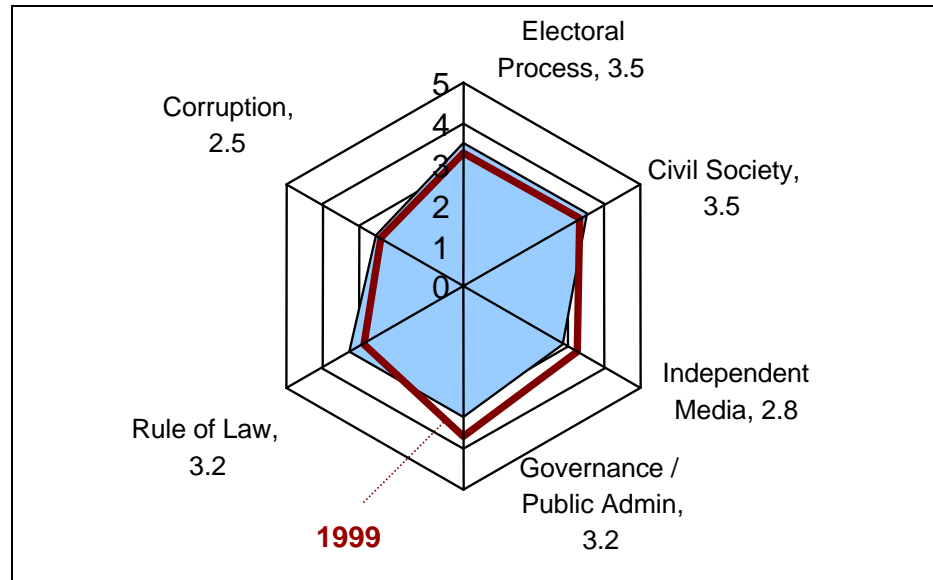
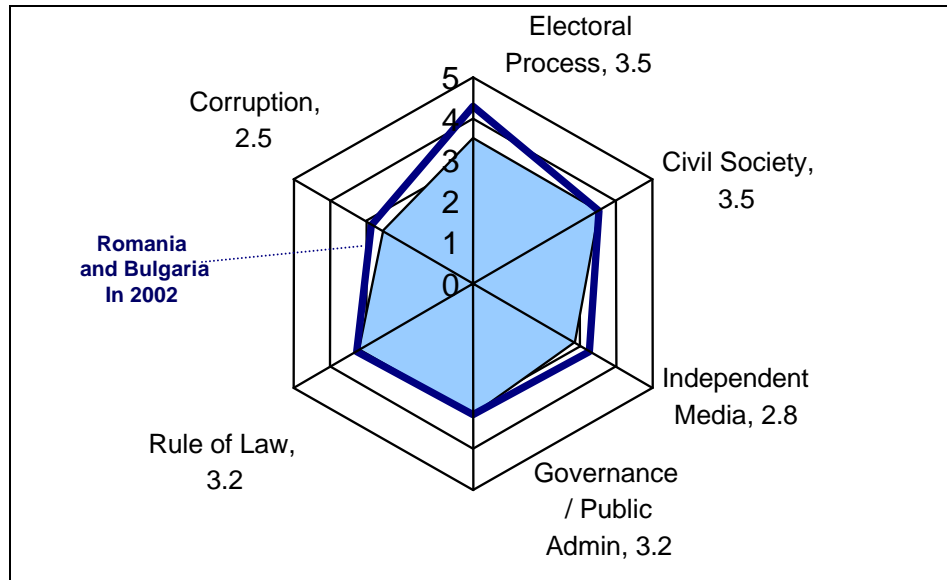


Democratic Reforms in Macedonia

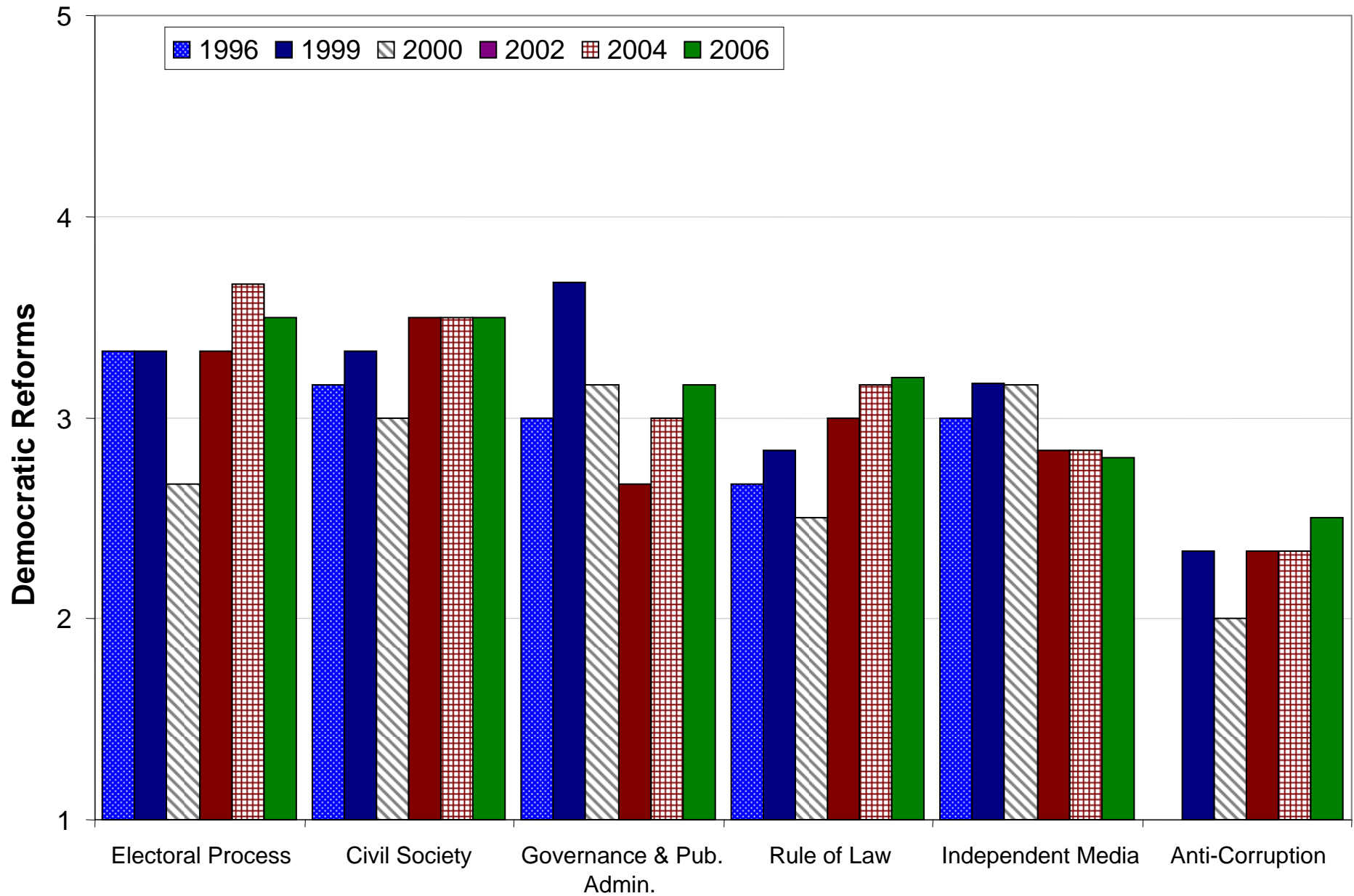


Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID, Monitoring Country Progress in CEE & Eurasia system drawing from *Freedom House, Nations in Transit 2007* (2007) and *Freedom of the World 2006* (2007 and earlier versions).

Democratic Reforms in Macedonia in 2006

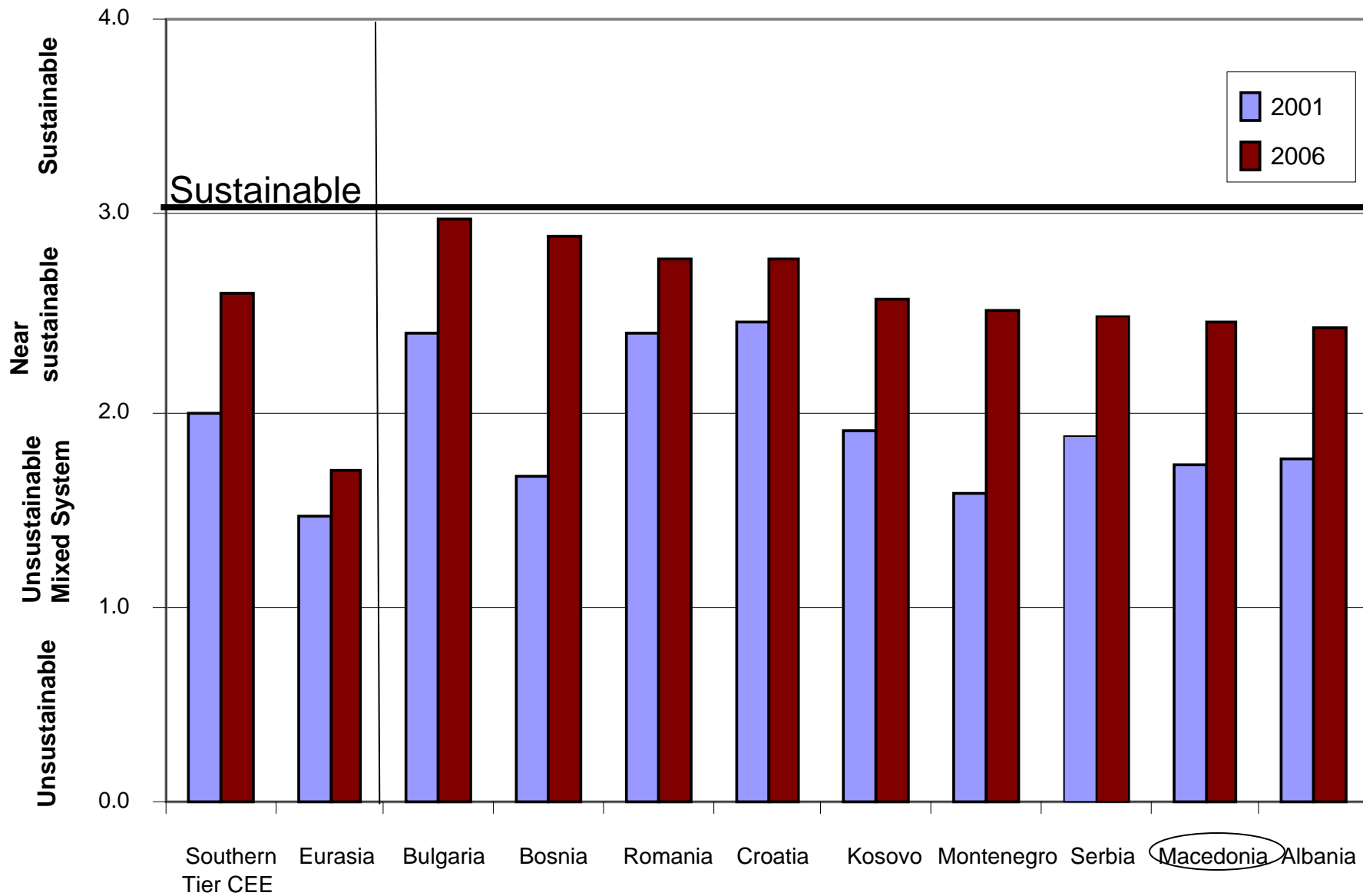


Democratic Reforms in Macedonia

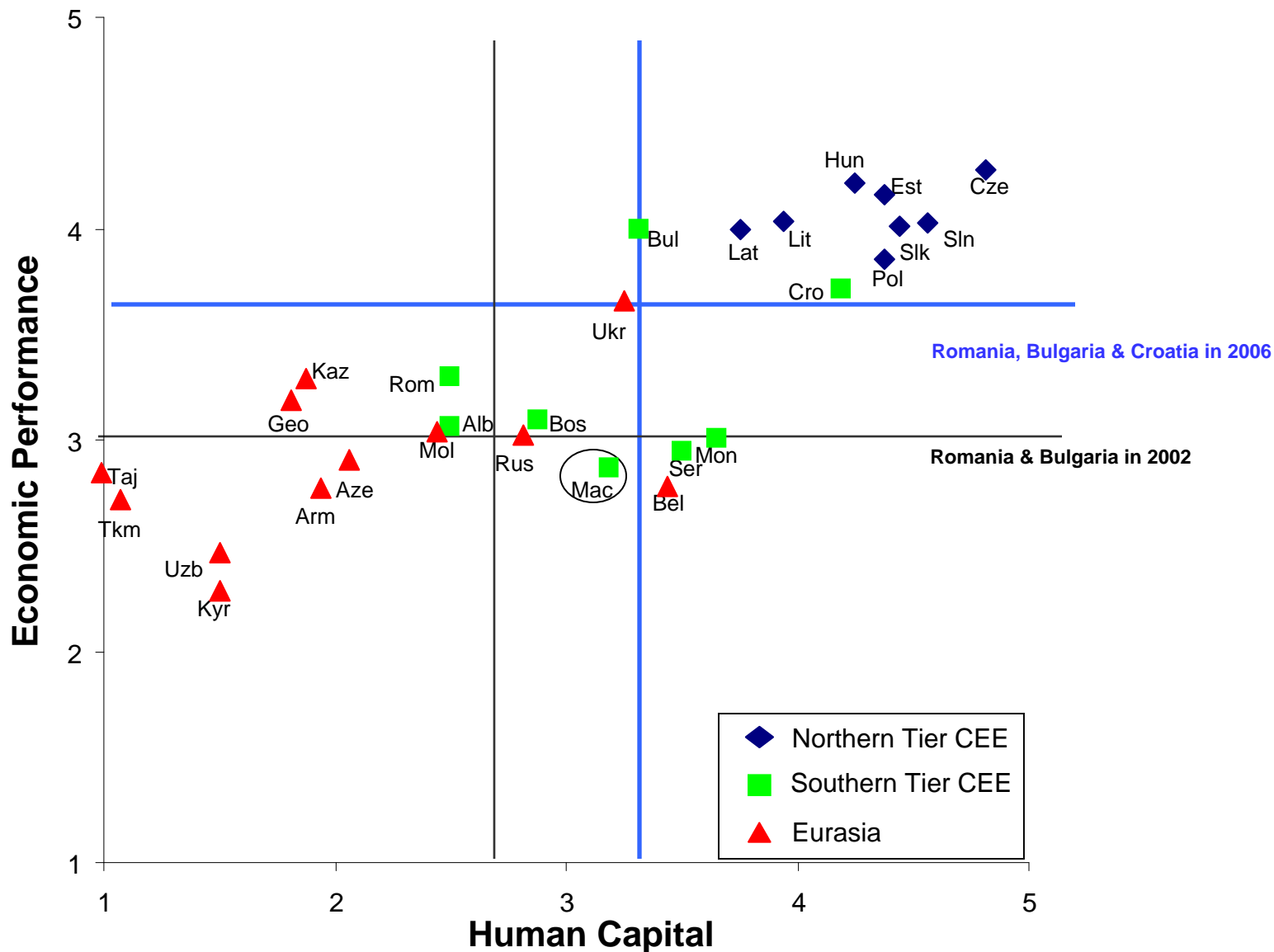


Ratings from 1 to 5, with 5 representing greatest development of political rights/civil liberties. Freedom House, *Nations in Transit* (2006).

Media Sustainability Index

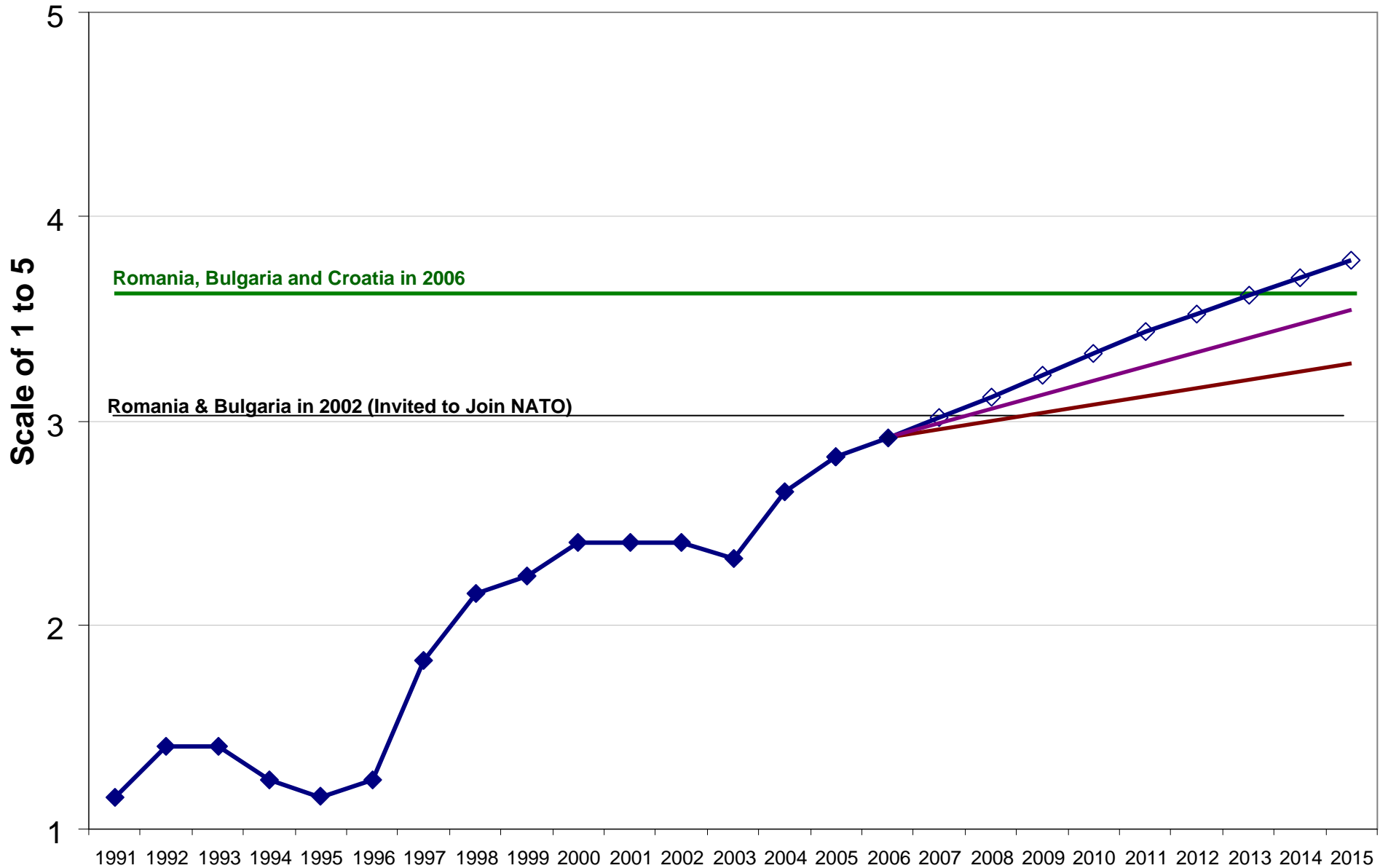


Economic Performance and Human Capital in 2005-2007



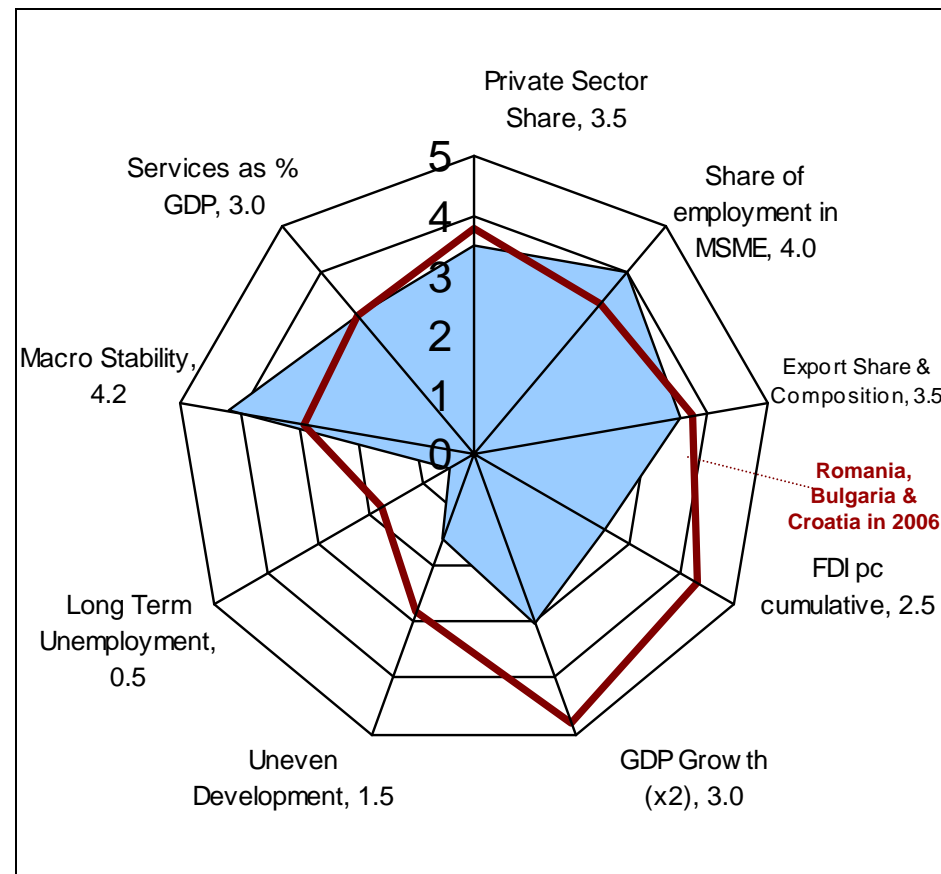
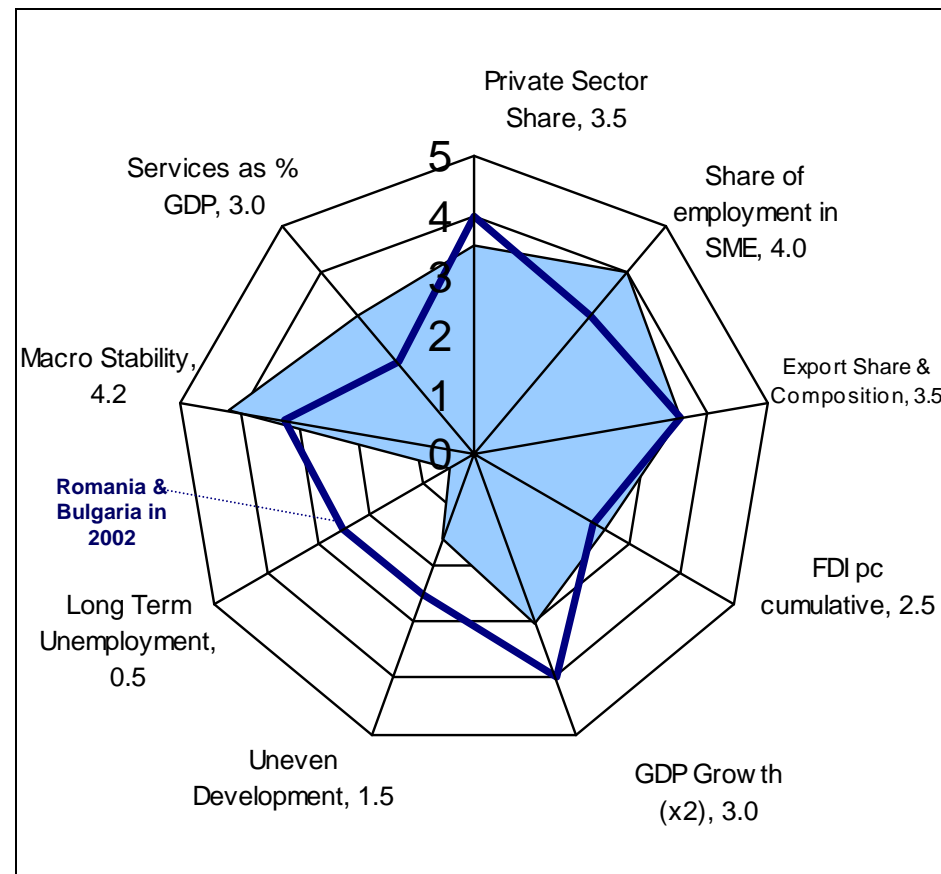
Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, Monitoring Country Progress in CEE & Eurasia #11 (2008 forthcoming) drawing from World Bank, *World Development Indicators 2007* (2007); EBRD, *Transition Report* (November 2007), UNECE, *Statistical Division Database* (2007); Fund for Peace, *Failed States Index* (2007); IFC & World Bank, *MSME Database* (2007); UNICEF, *TransMONEE Database* (2007); World Health Organization European Health For All Database (2007); 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

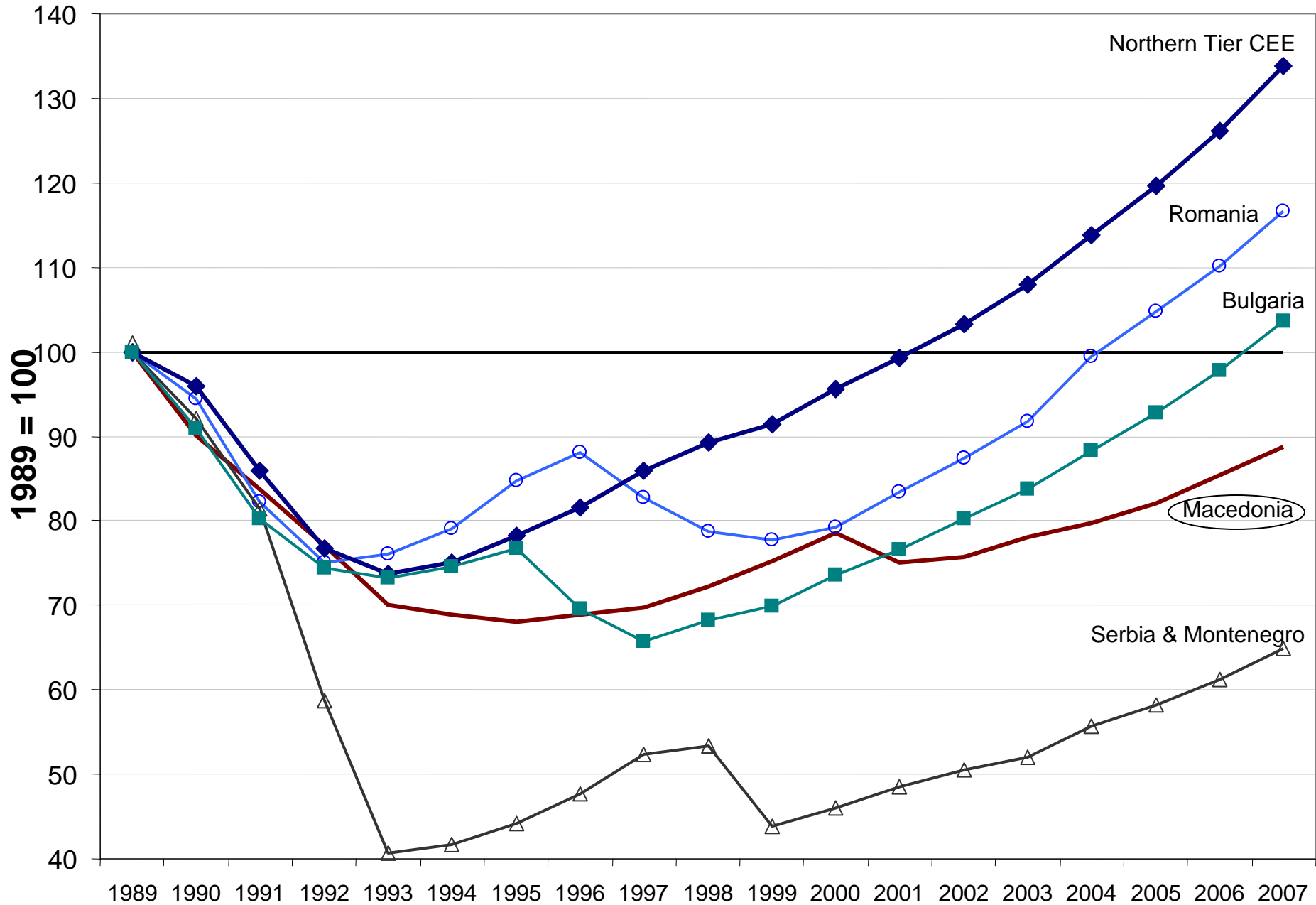


Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, Monitoring Country Progress in CEE & Eurasia #11 (2008 forthcoming) drawing from World Bank, *World Development Indicators 2007* (2007); EBRD, *Transition Report* (November 2007), UNECE, *Statistical Division Database* (2007); Fund for Peace, *Failed States Index* (2007); IFC & World Bank, *MSME Database* (2007).

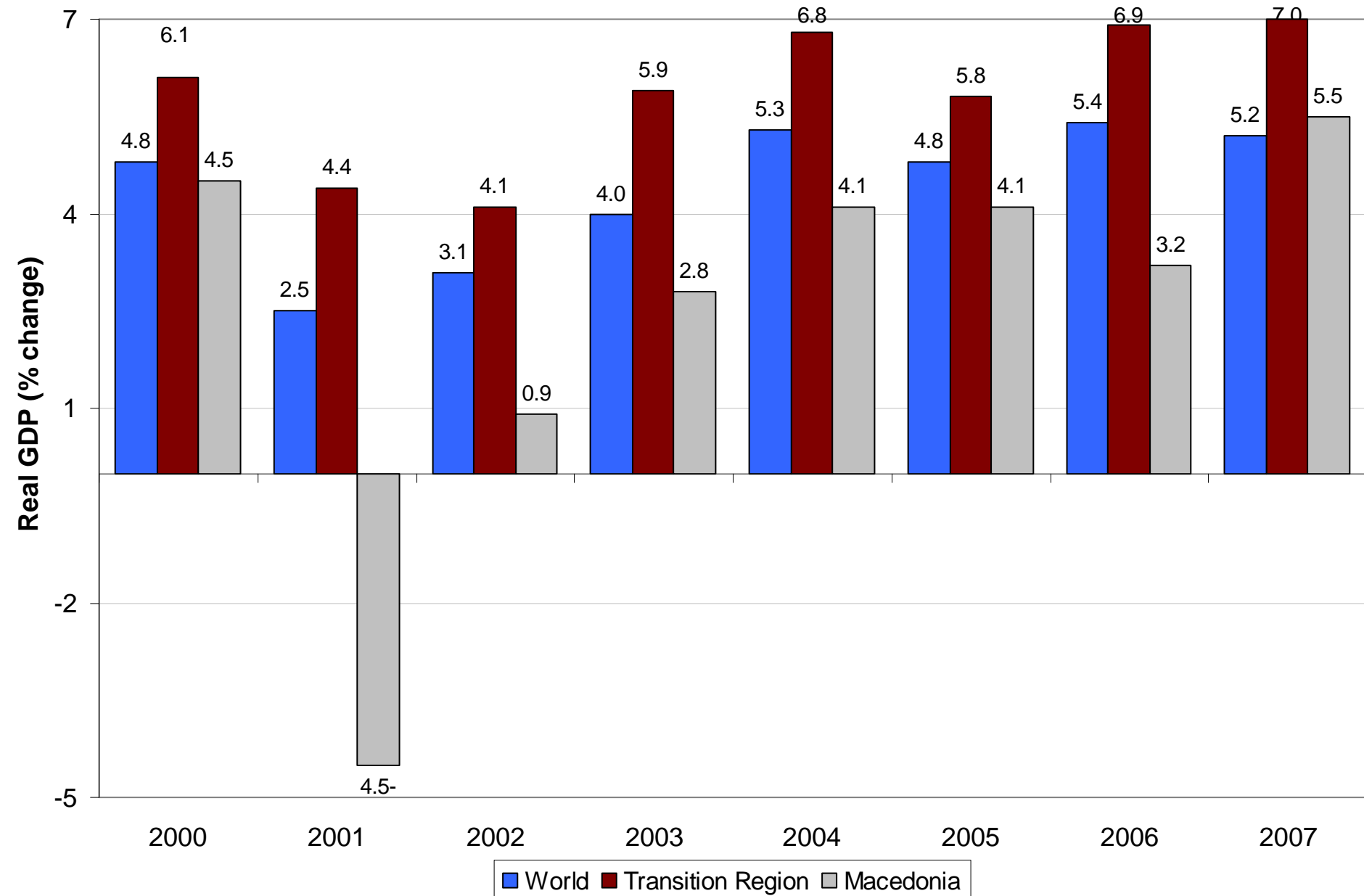
Economic Performance in Macedonia in 2005-2006



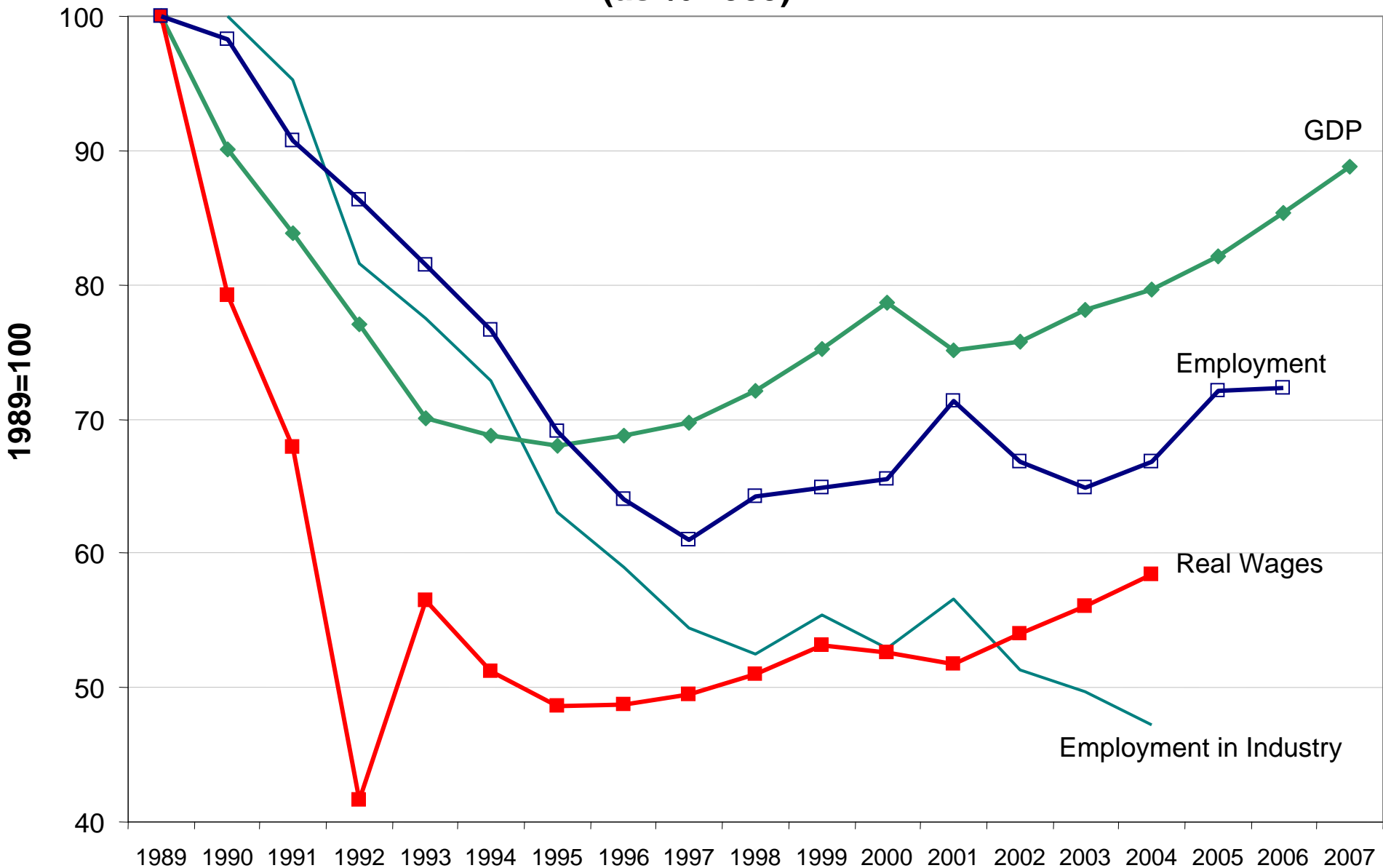
Real GDP as % of 1989 GDP



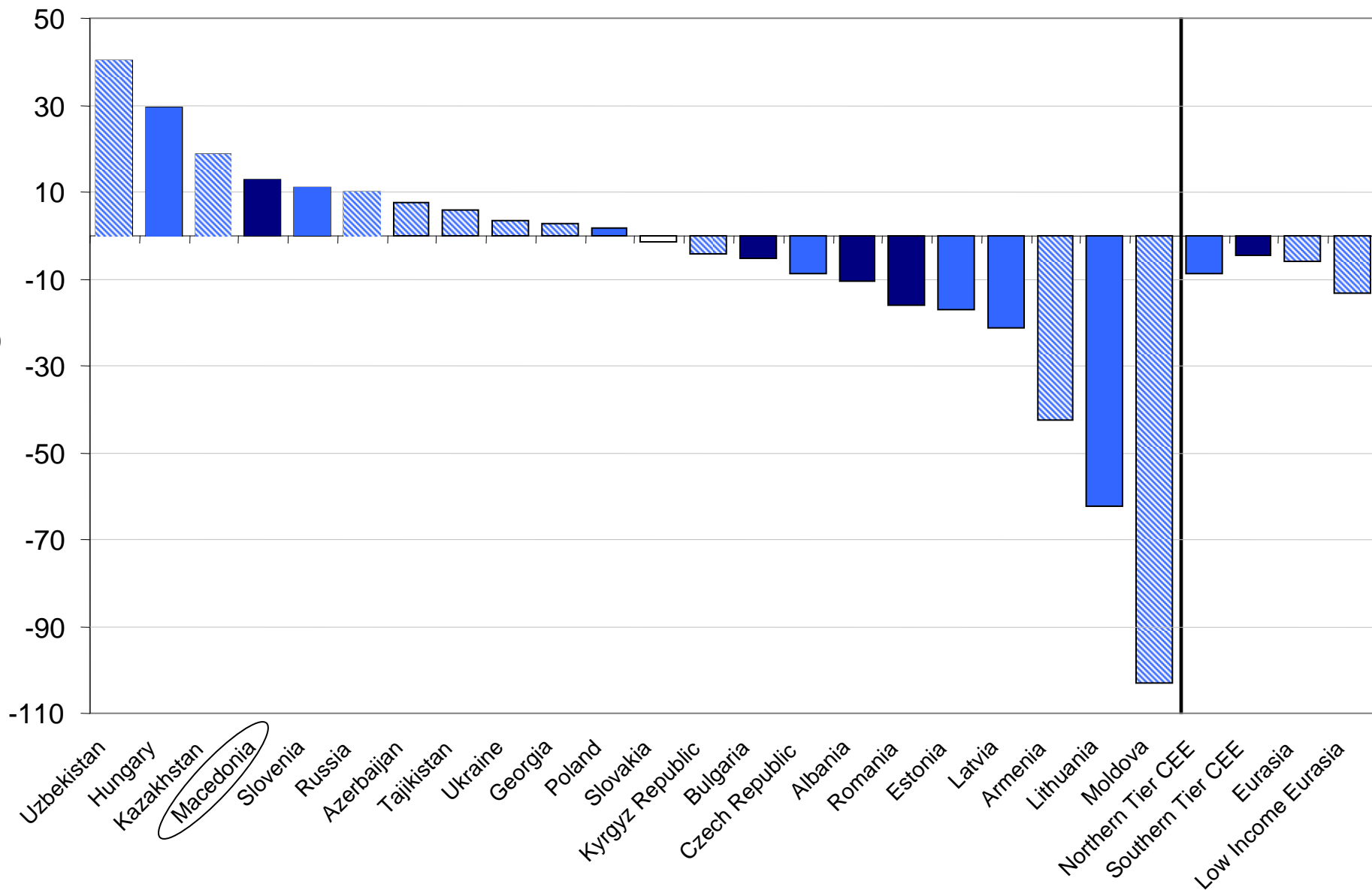
Economic Growth Trends Worldwide



Employment, Real Wages and GDP in Macedonia (as % 1989)

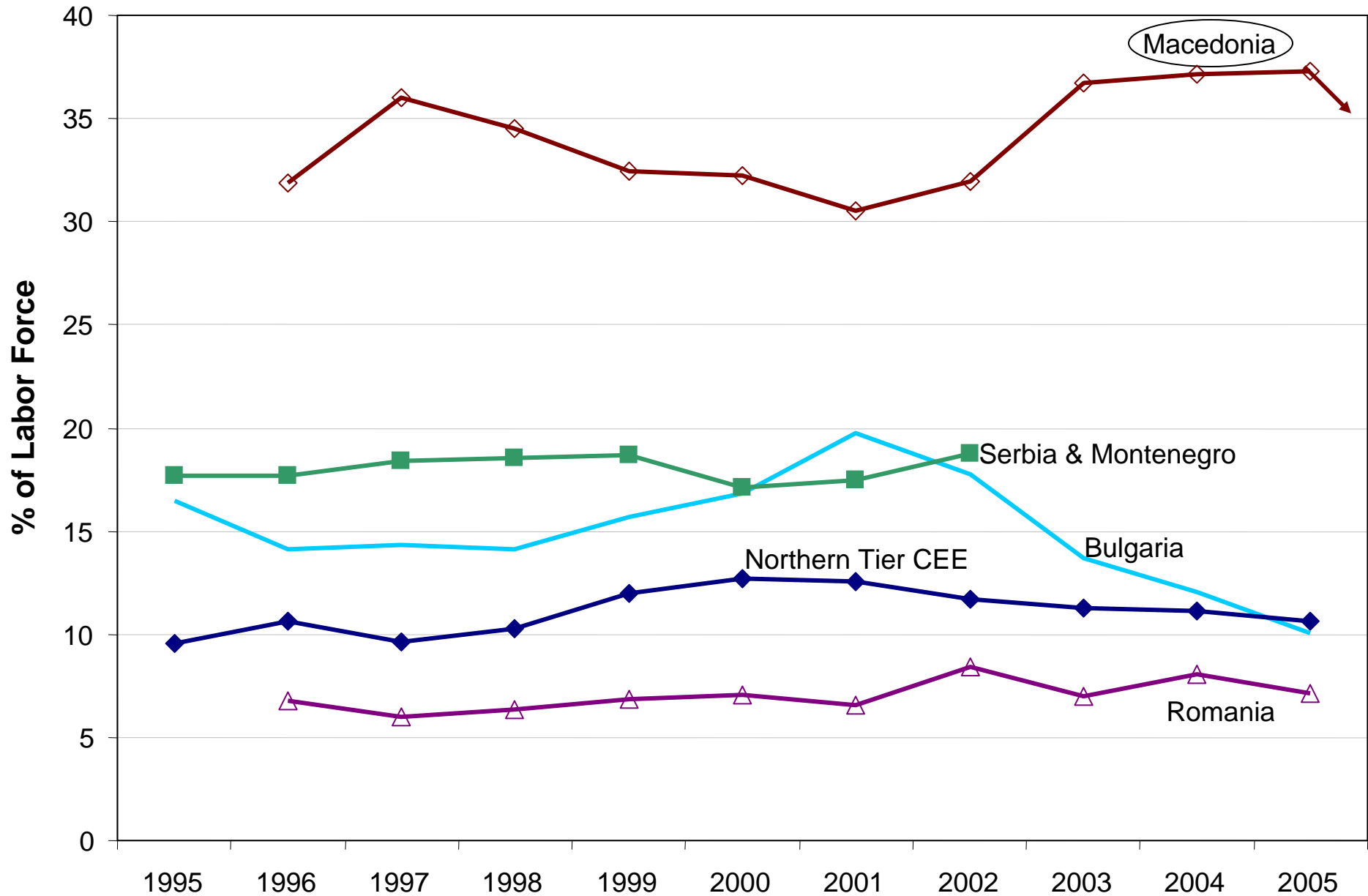


Responsiveness of Employment to Economic Growth

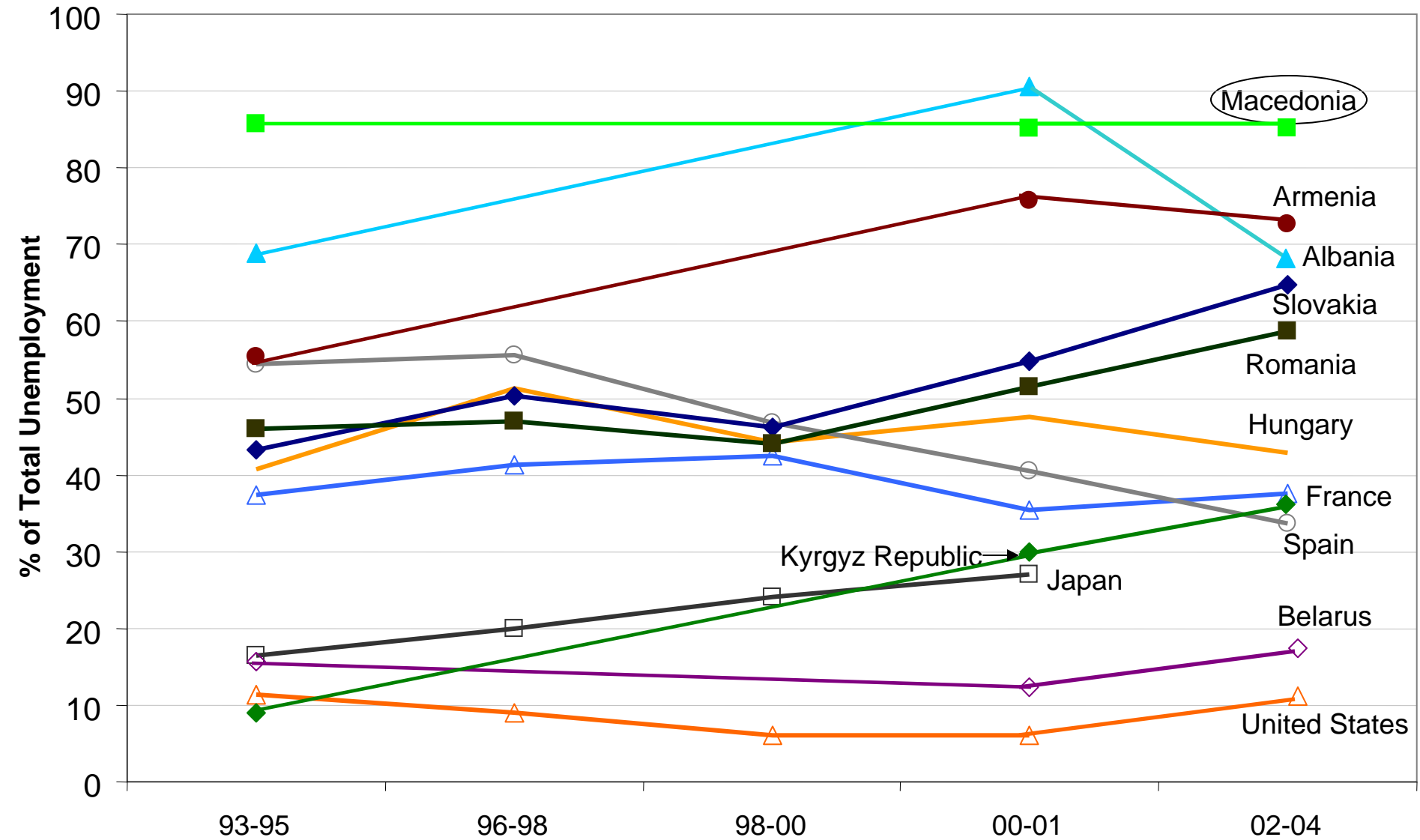


Heinegg, Murphy & Sprout, *Labor Markets in Eastern Europe & Eurasia*, USAID Working Paper #6 (January 2007) drawing from EBRD, *Transition Report 2005* (November 2005). UNICEF, *TransMONEE Database* (December 2005).

Unemployment Rate (Labor Force Survey)

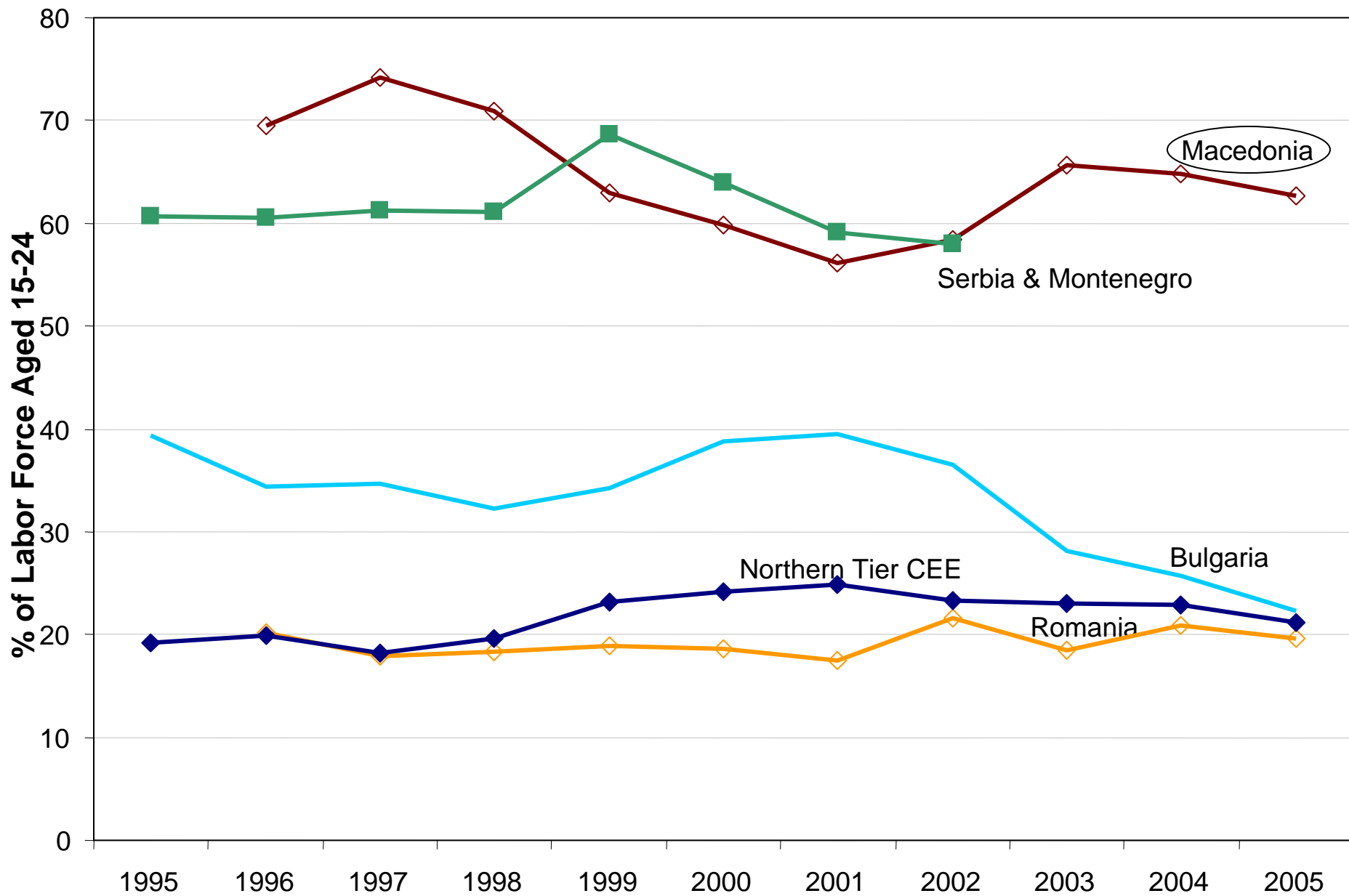


Long Term Unemployment

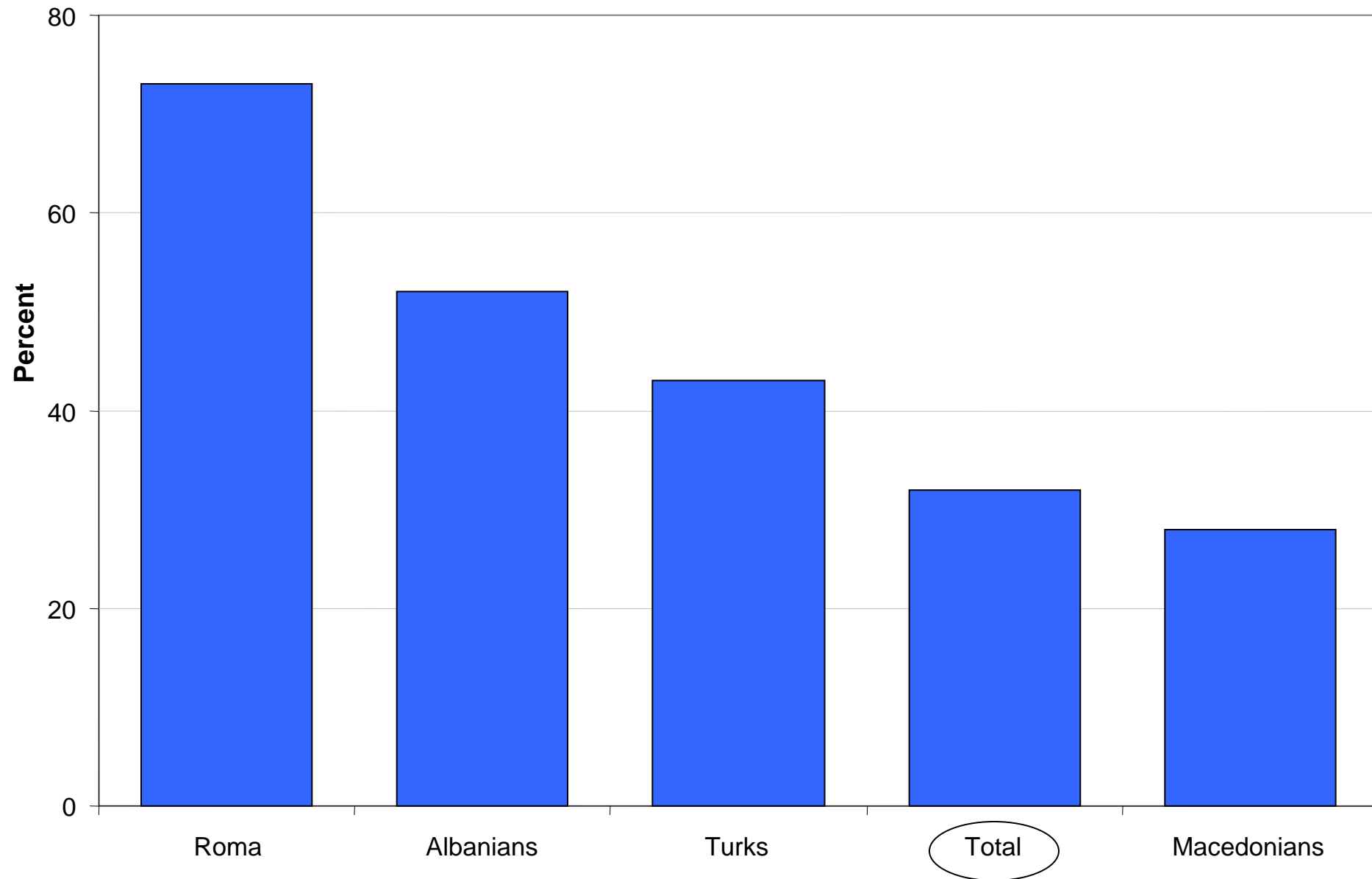


Western Europe includes France, Germany, Spain and Sweden. World Bank, World Development Indicators 2004 (2004); C. Allison and D. Ringold, Labor Markets in Transition in Central and Eastern Europe: 1989-1995; World Bank, Social Challenges of Transition Series (December 1996); Bureau of the Census, Populations at Risk in CEE: Labor Markets, No. 2, prepared for USAID/ENI/PCS (February 1995), UNECE, Trends in Europe and North America (2003) and EuroStat, NewCronos Database (2004).

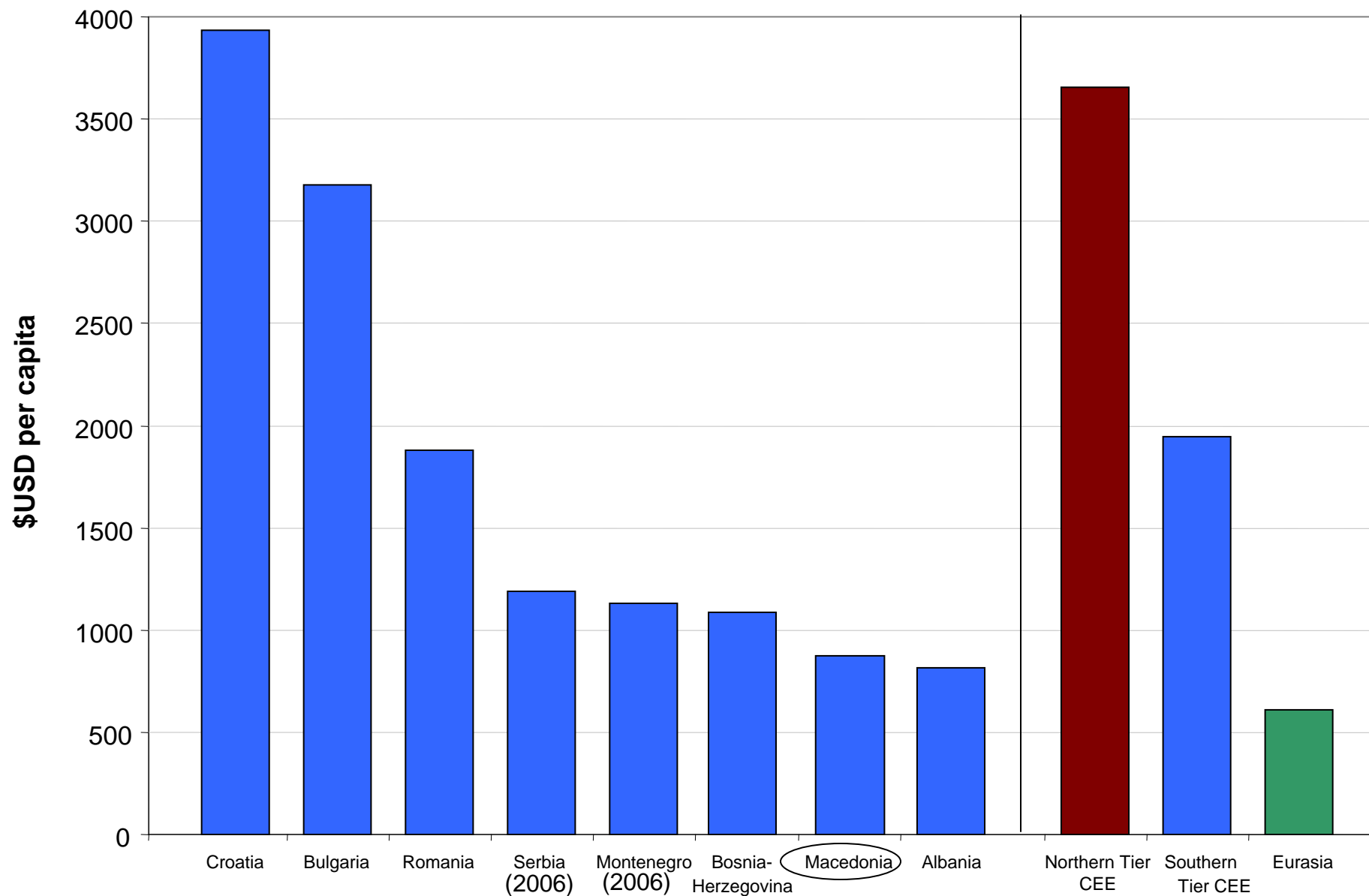
Youth Unemployment (Labor Force Survey)



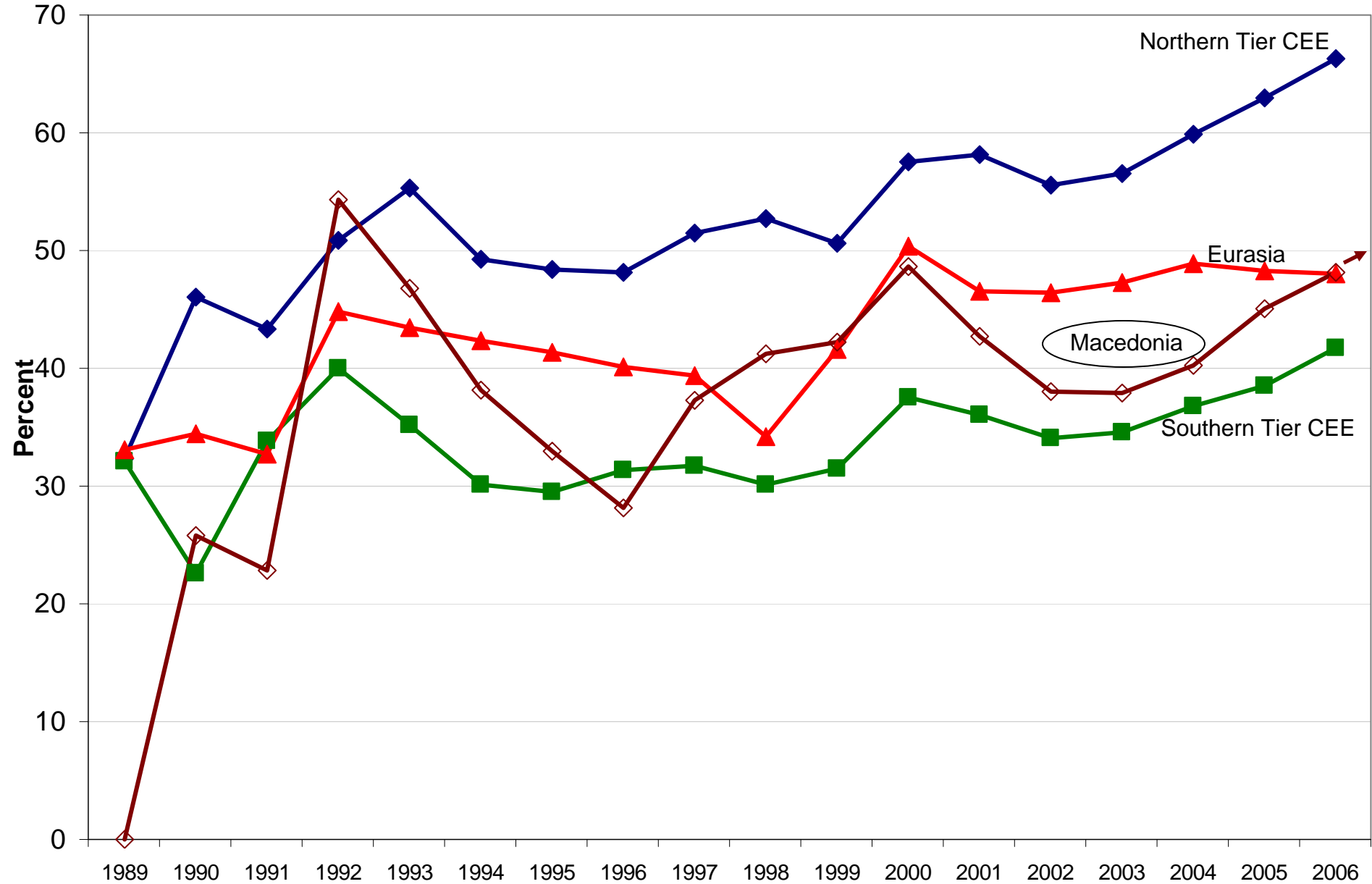
Unemployment Rate Among Major Ethnic Groups in Macedonia, 1996-2001



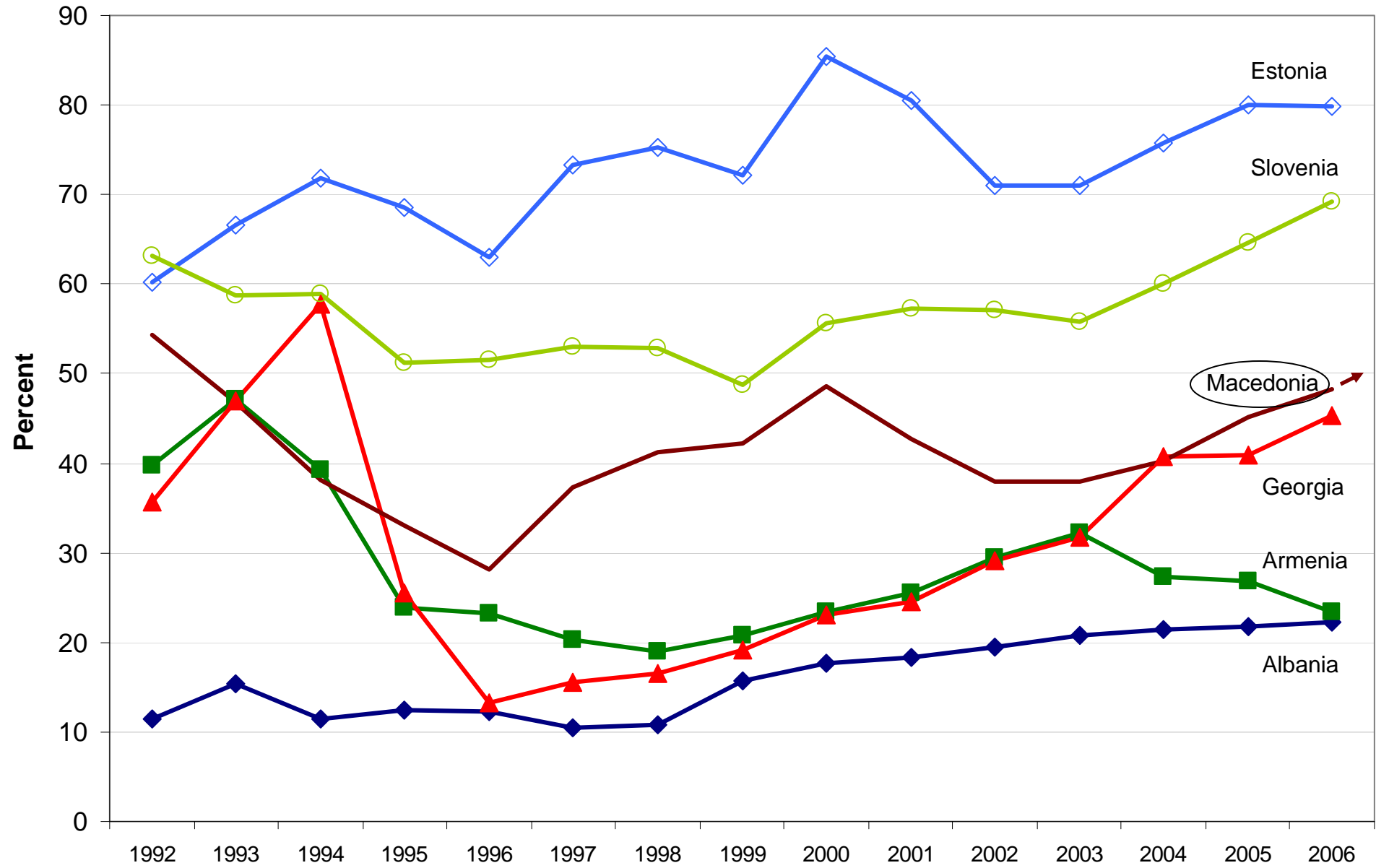
Cumulative Foreign Direct Investment 1989-2007



Exports as % of GDP

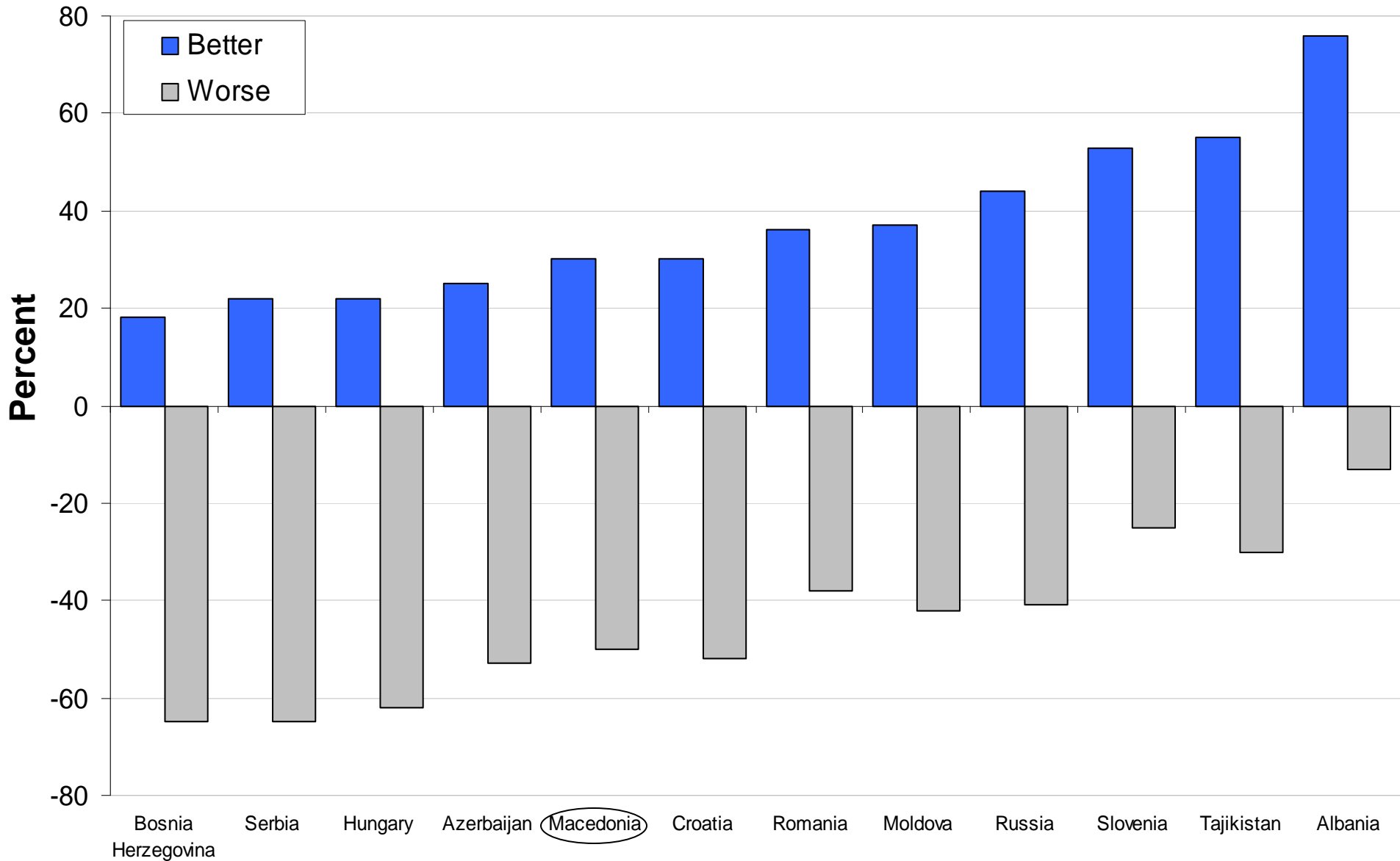


Exports as % of GDP



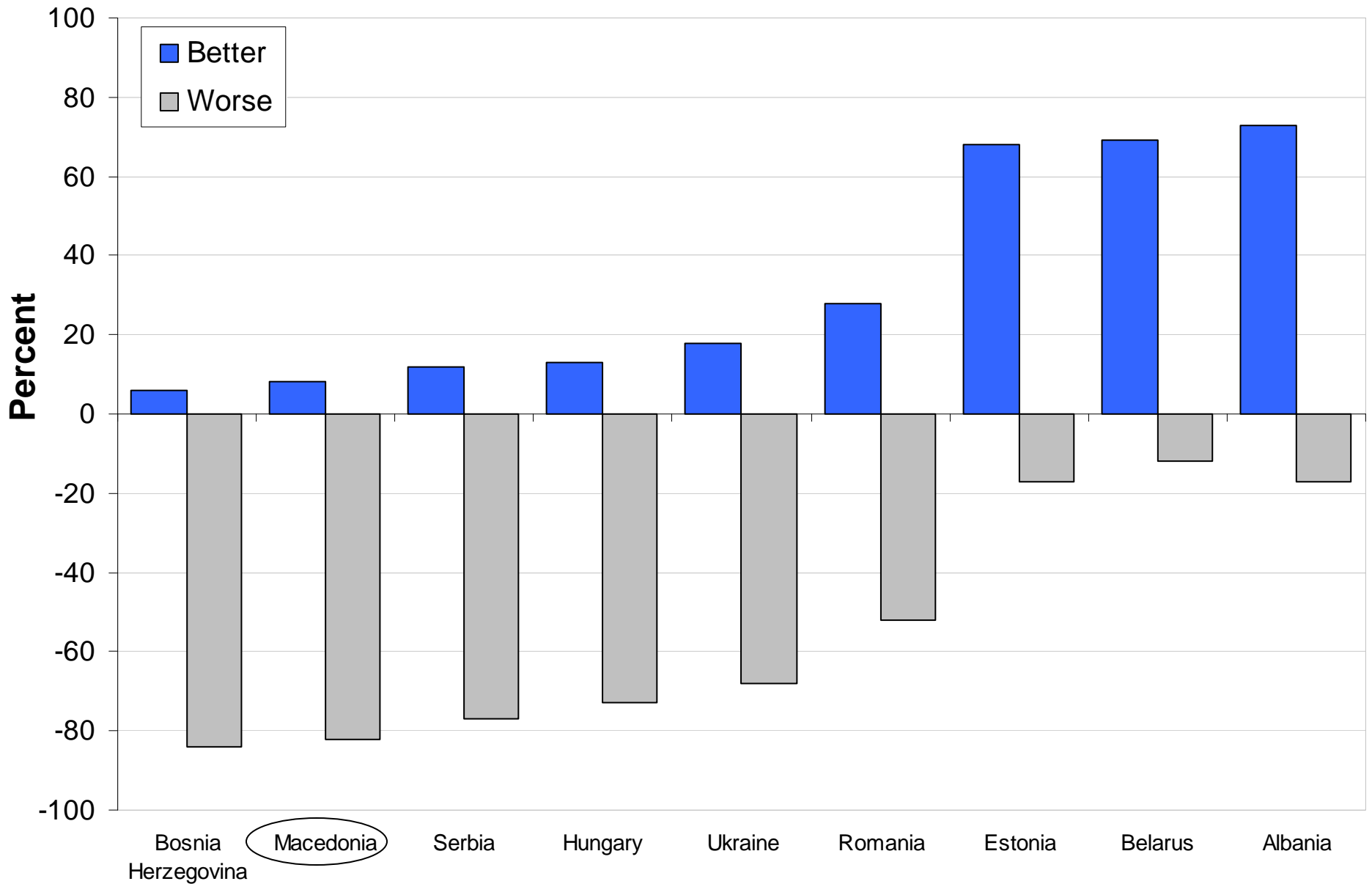
Views on Living Standards

2006 compared with 1989

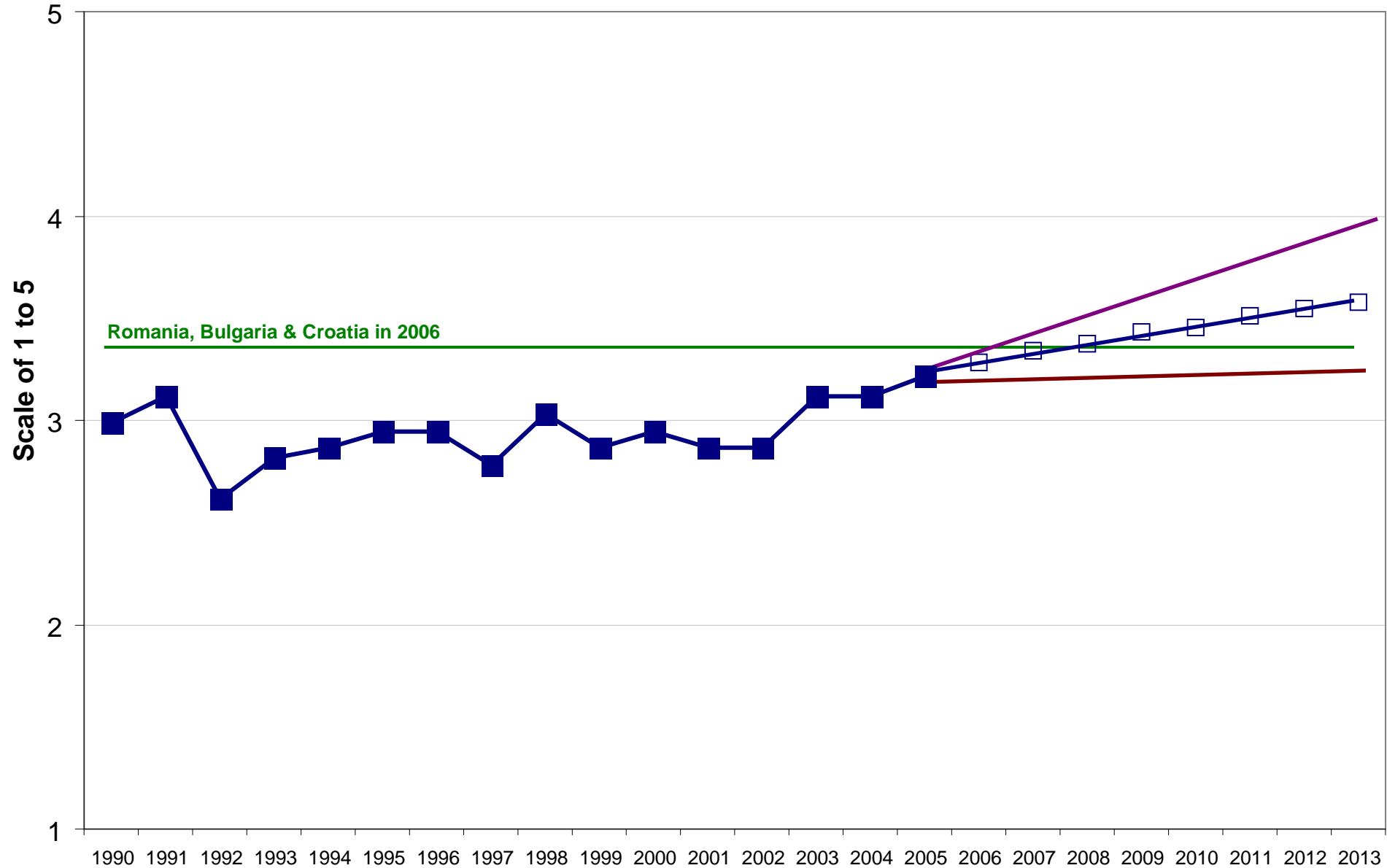


Views on Present Economic Situation

2006 compared with 1989

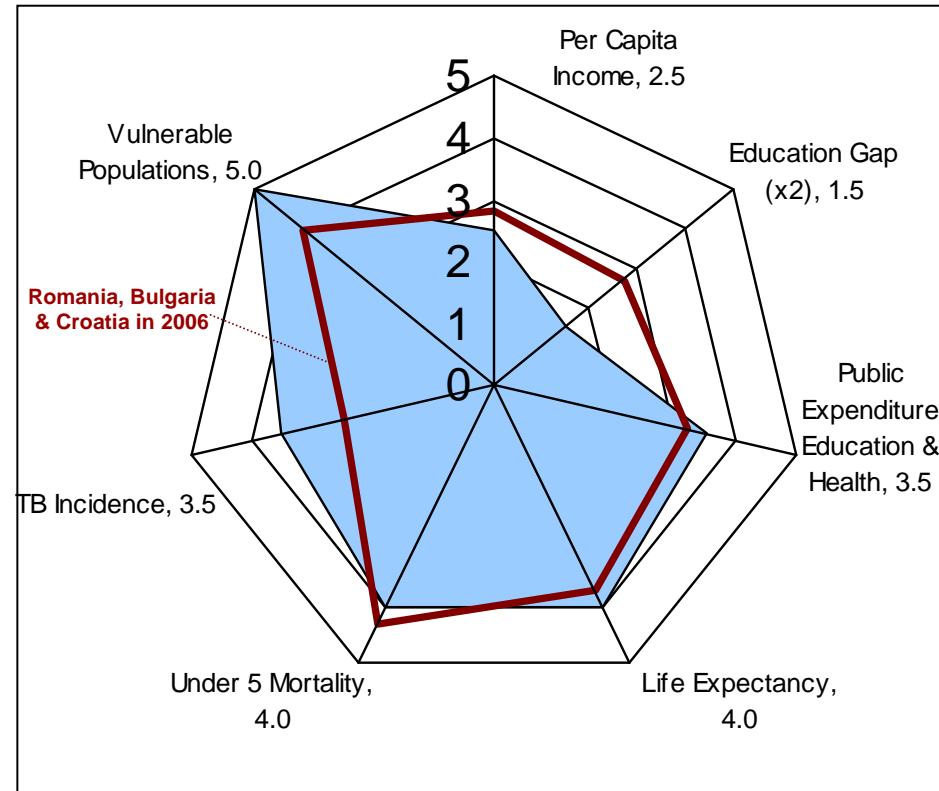
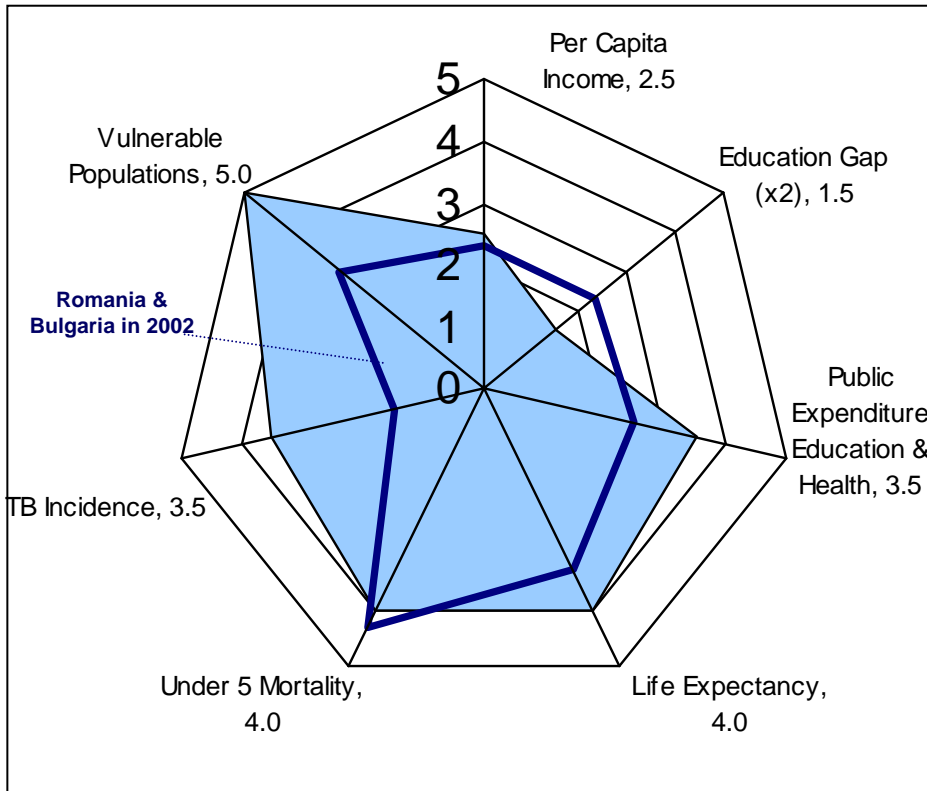


Human Capital in Macedonia



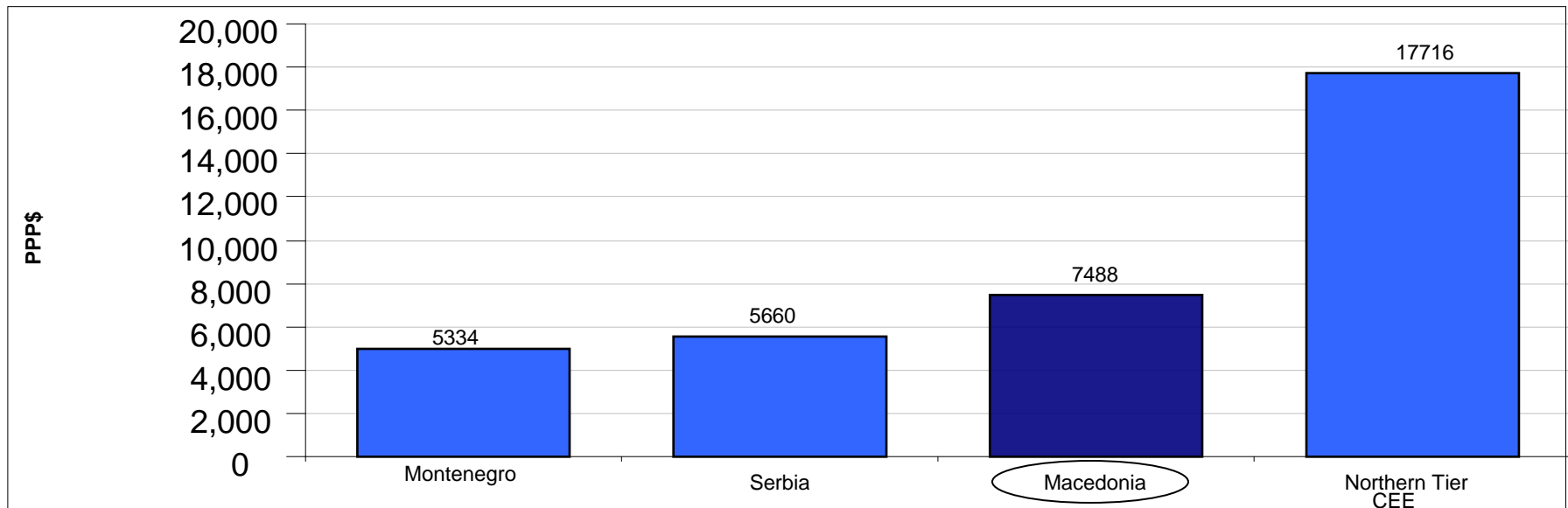
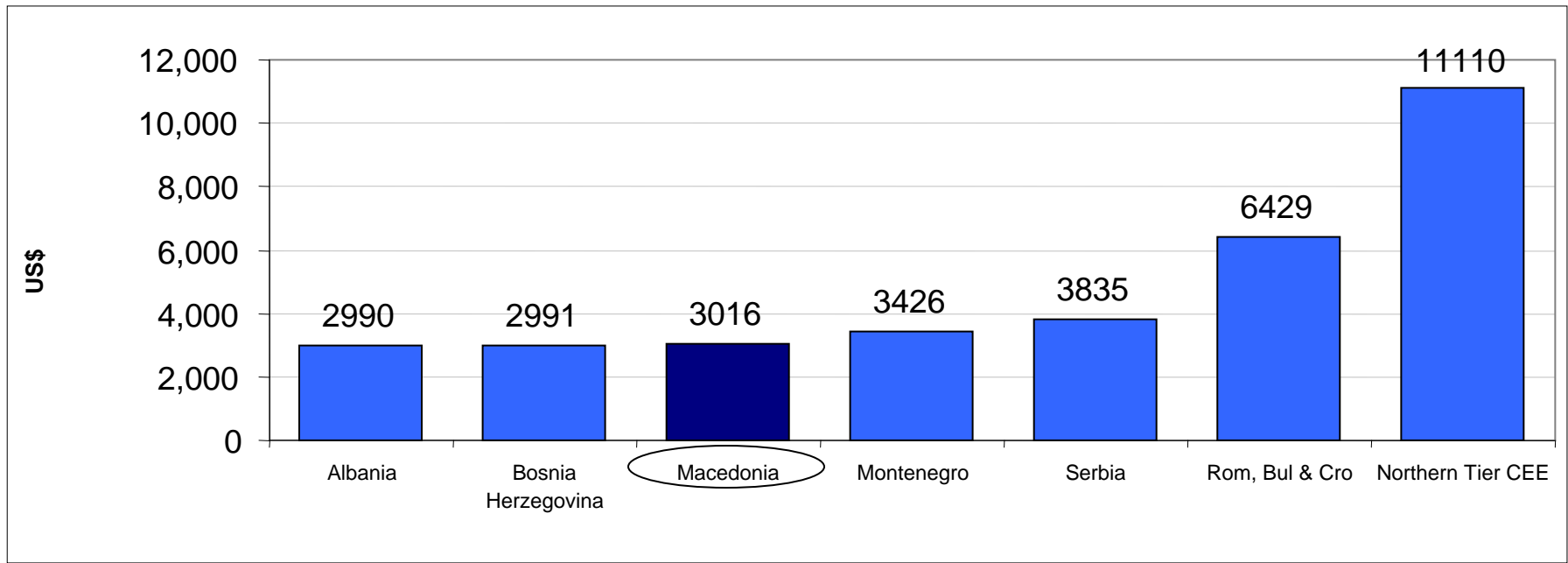
Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID, Monitoring Country Progress in CEE & Eurasia system drawing from World Bank, *World Development Indicators 2007* (2007); UNICEF, *TransMONEE Database* (2007).

Human Capital Index in Macedonia



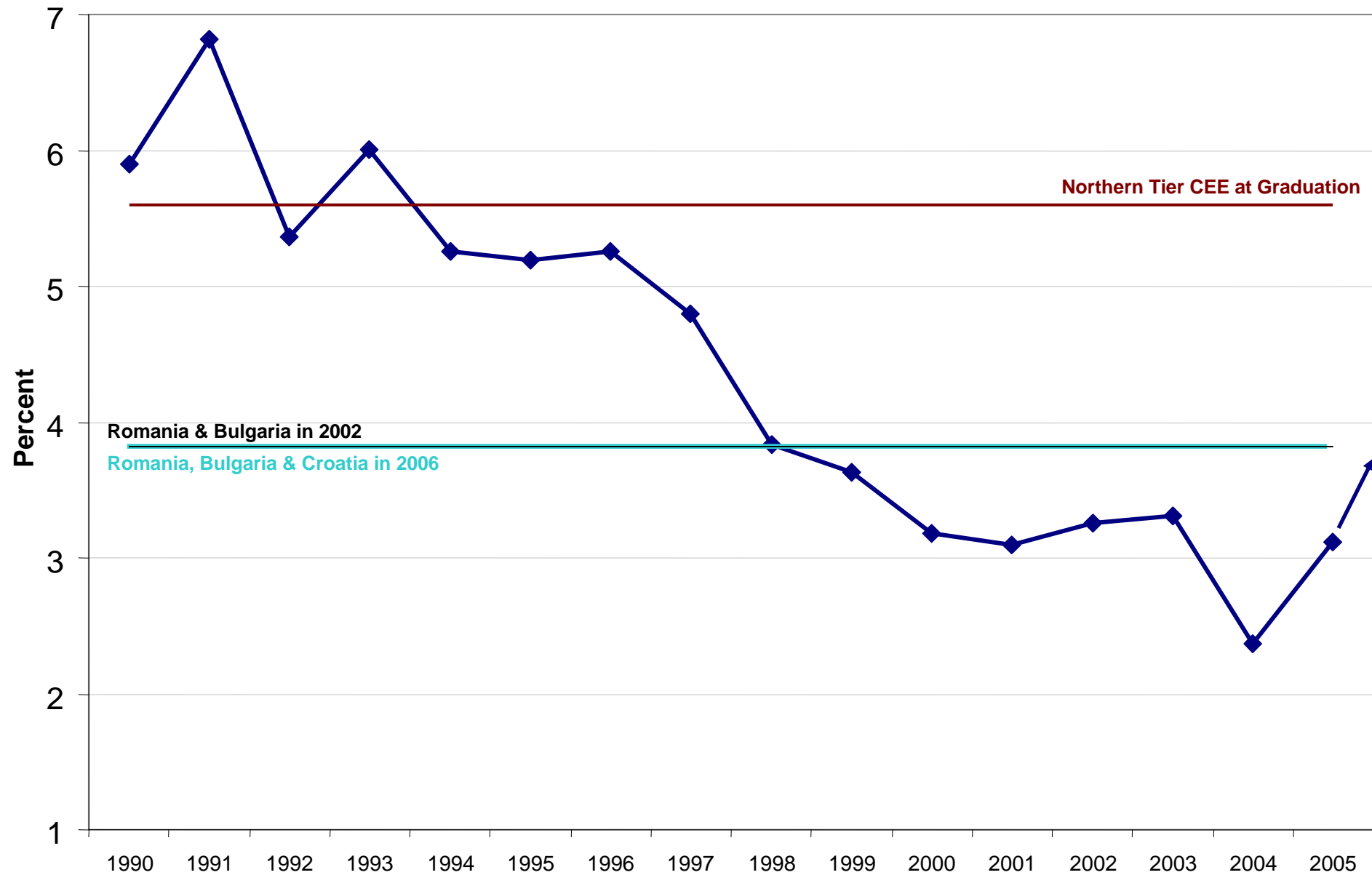
Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, Monitoring Country Progress in CEE & Eurasia #11 (2008 forthcoming) drawing from World Bank, *World Development Indicators 2007* (2007); UNICEF, *TransMONEE Database* (2007); World Health Organization European Health For All Database (2007); 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).

Per Capita Income in 2006

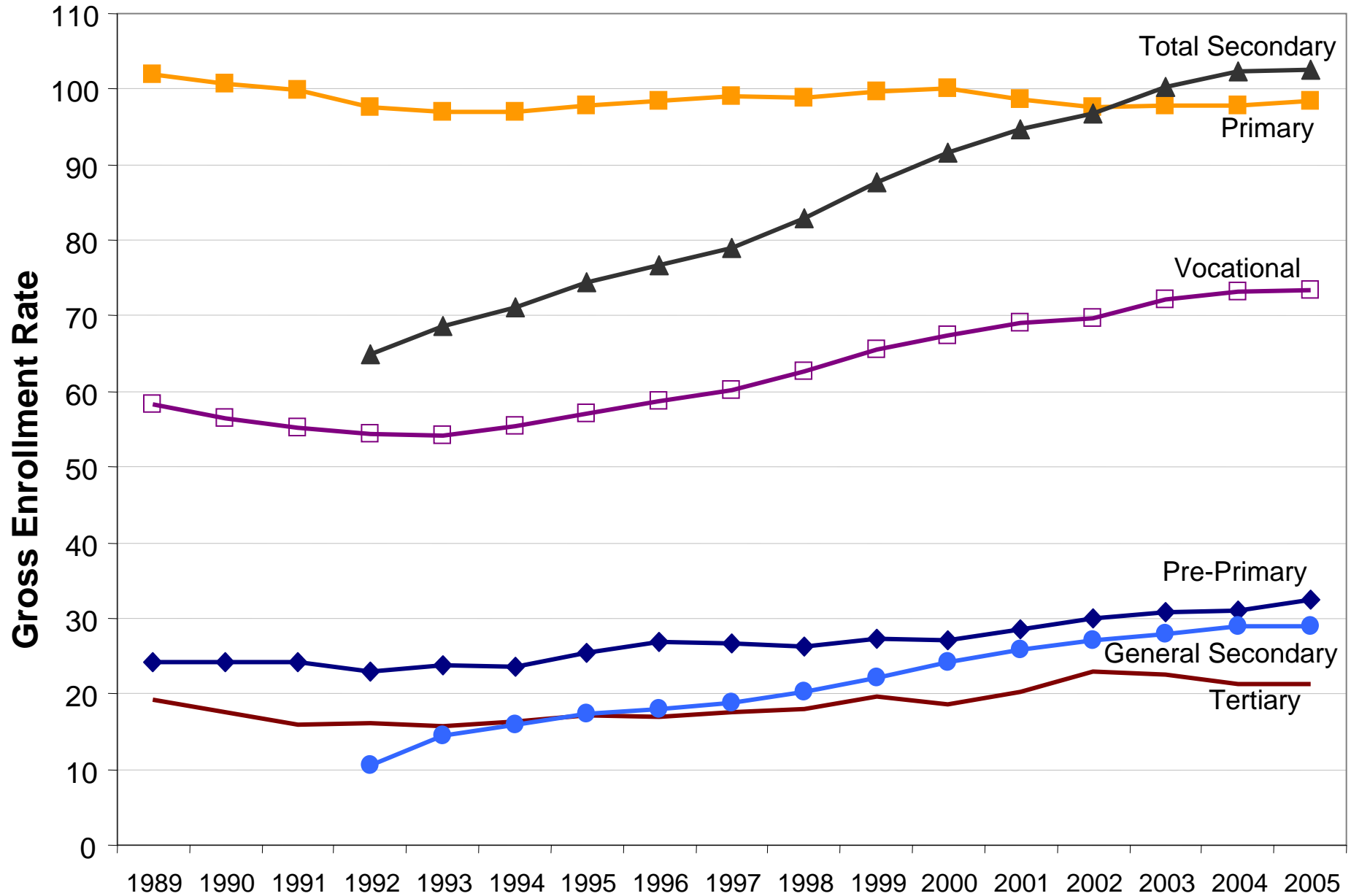


EBRD, *Transition Report Update* (2007) and World Bank, *World Development Indicators* (2007). Purchasing power parity (PPP) income is updated to 2006 with 2006 economic growth rates.

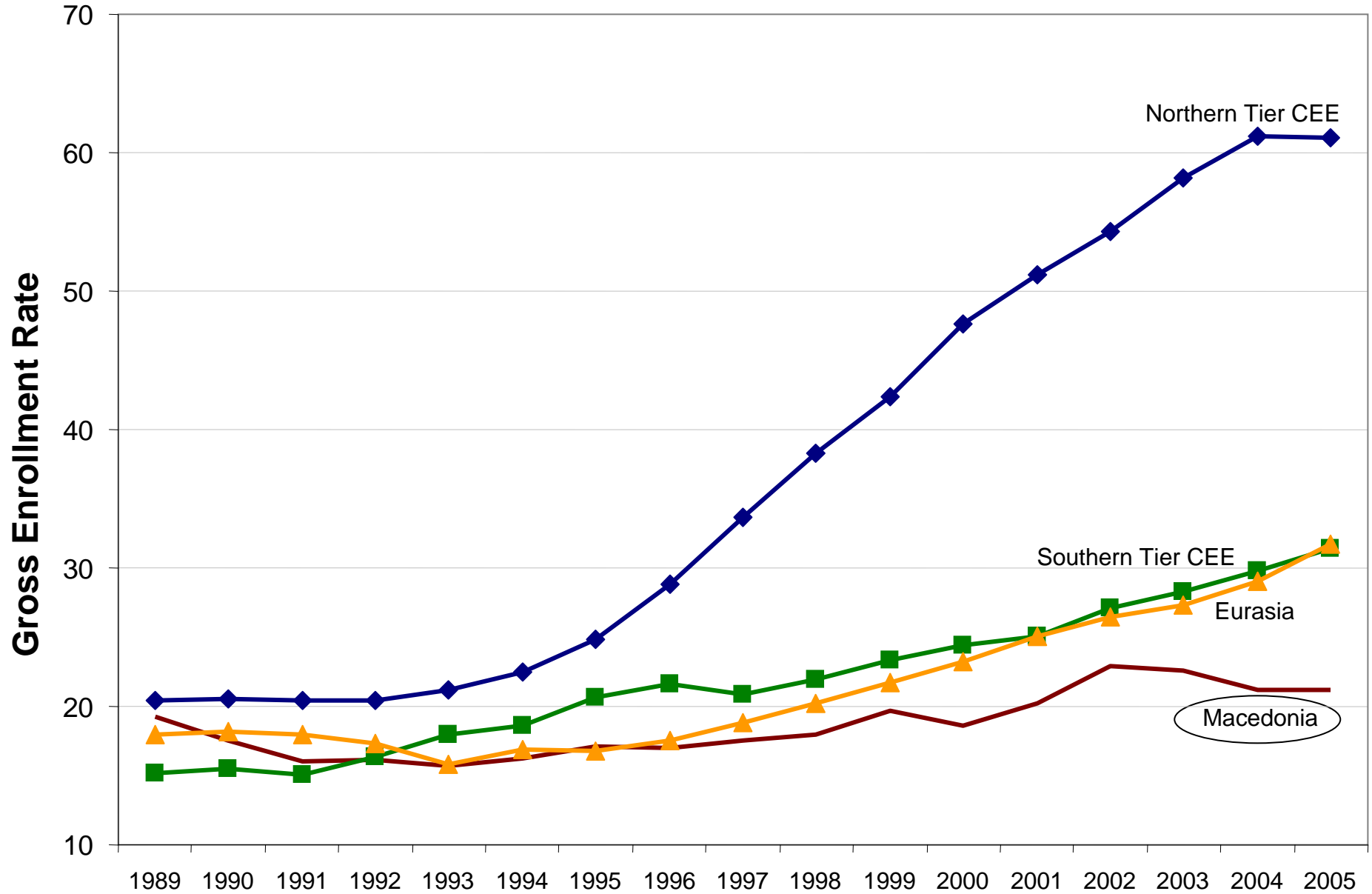
Public Expenditure on Education in Macedonia



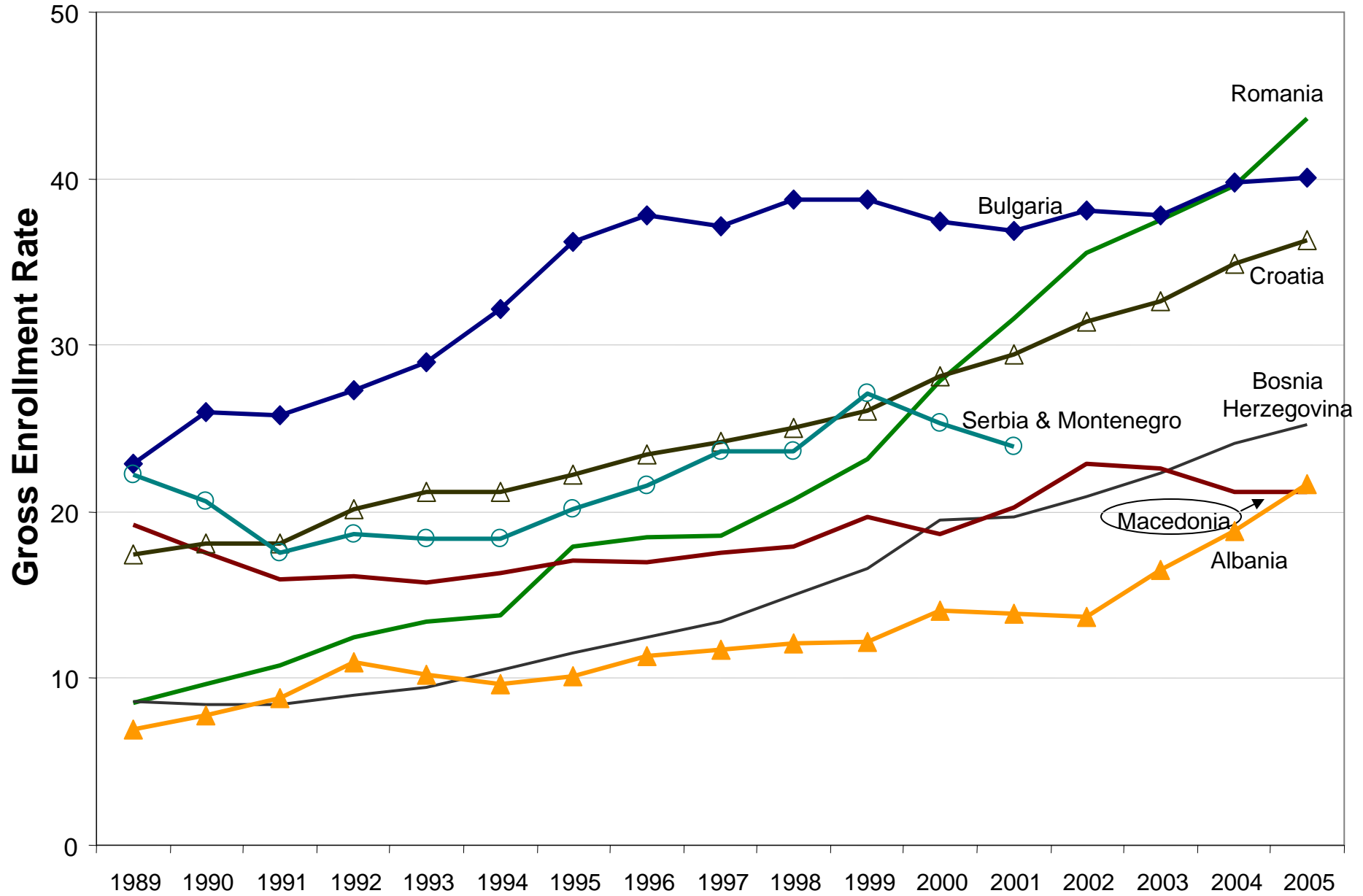
Enrollments in Macedonia



Higher Education Enrollment

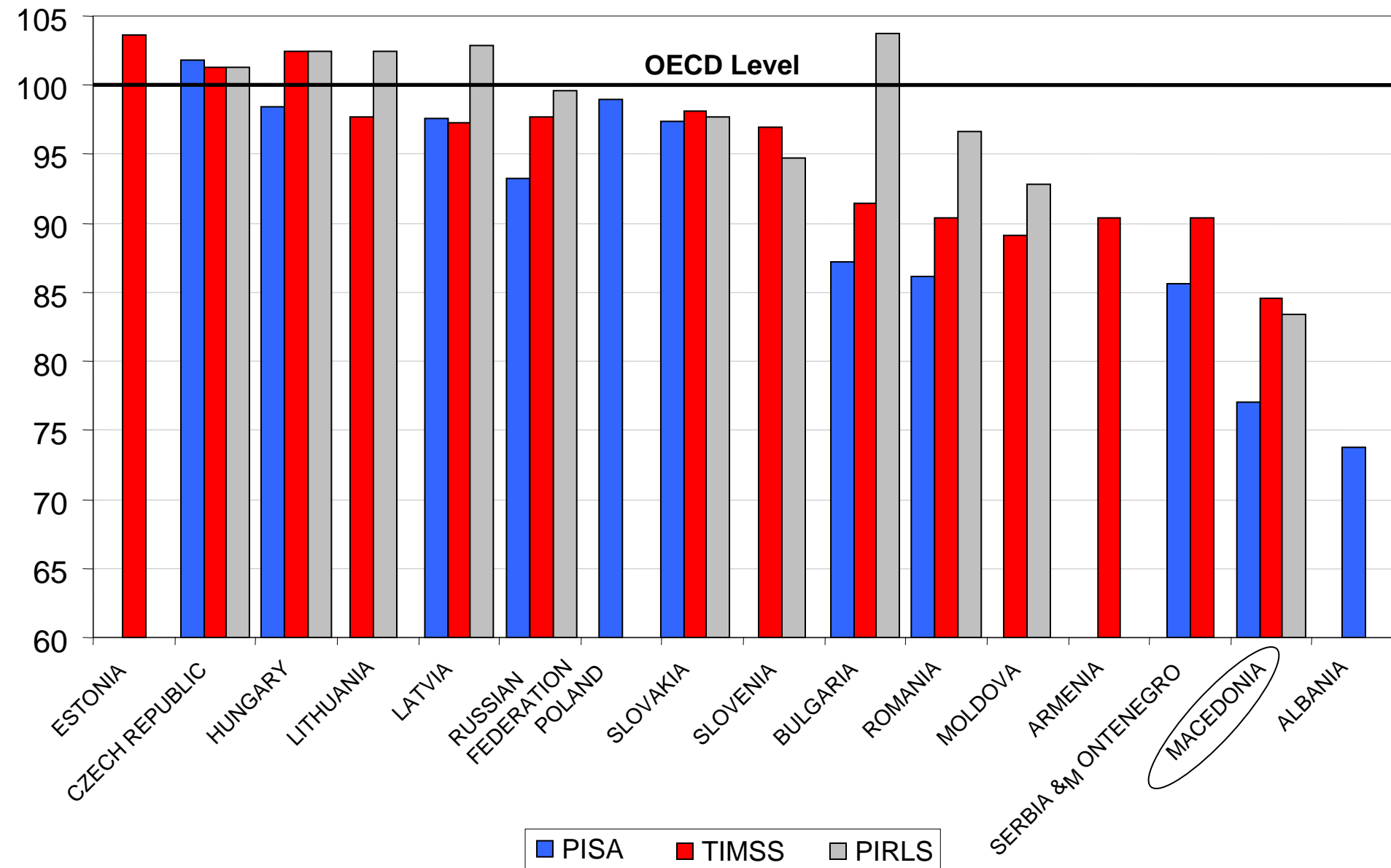


Higher Education Enrollment: Southern Tier CEE

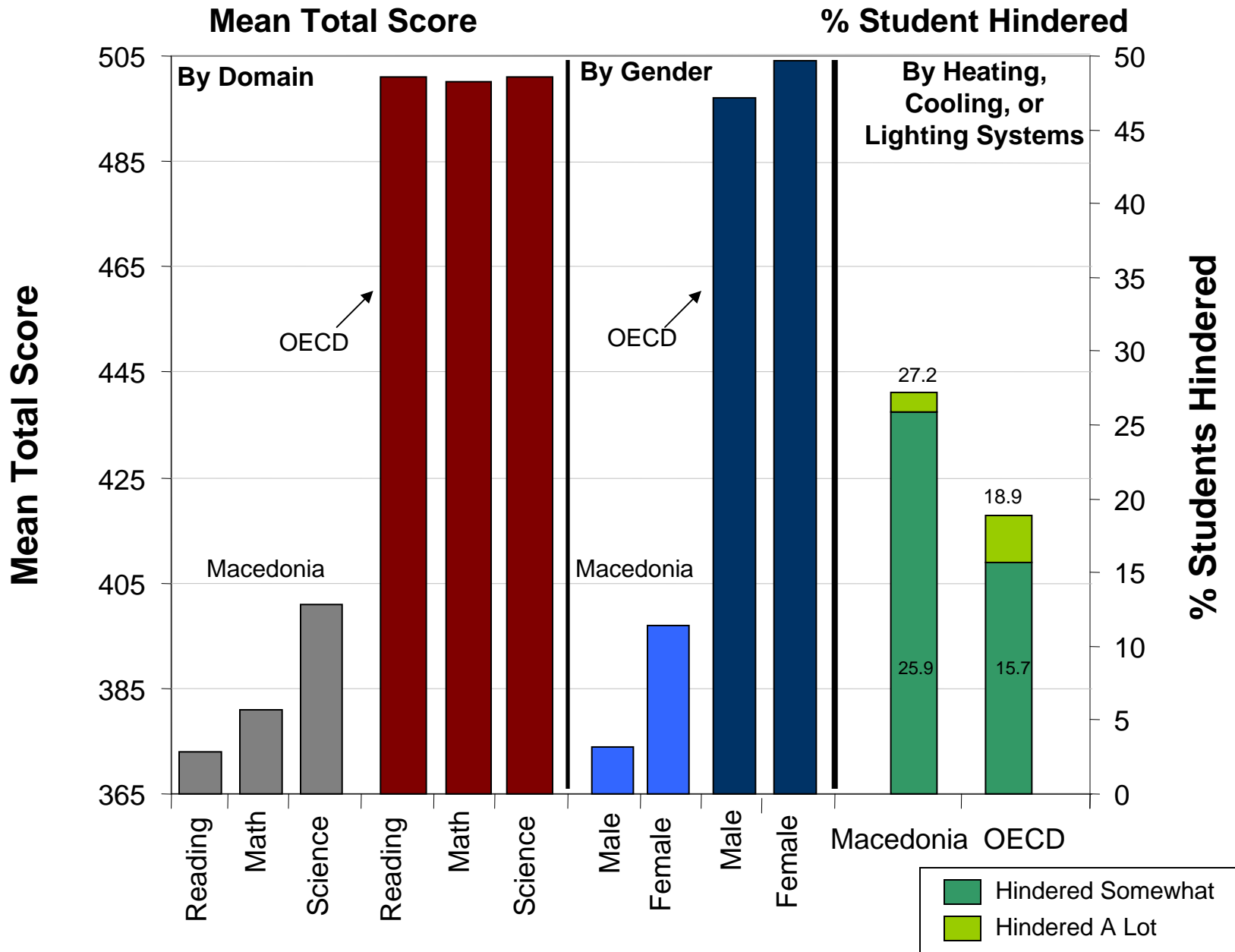


Functional Literacy

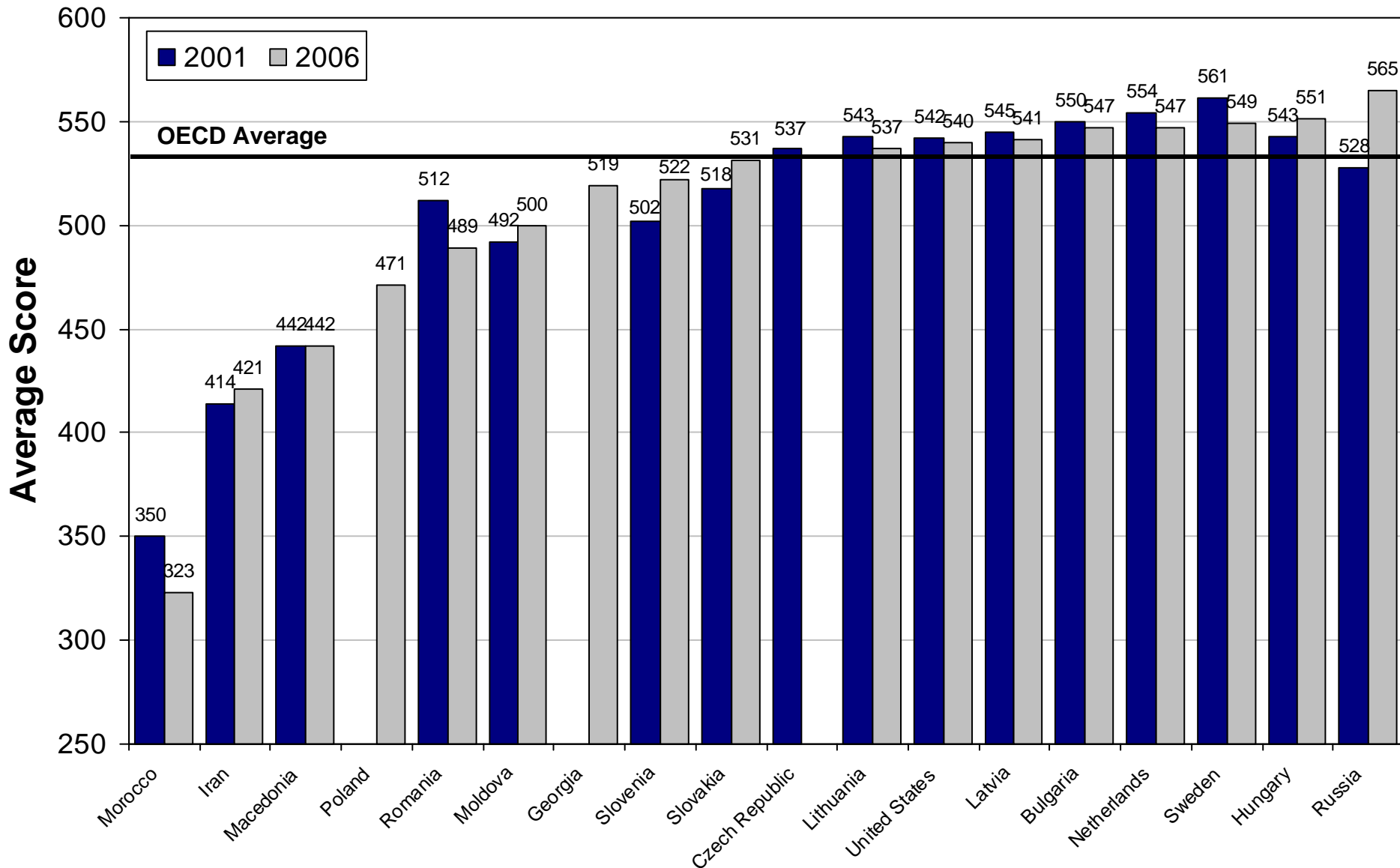
PISA vs. TIMSS vs. PIRLS (2001 – 2003)



PISA Results for Macedonia (2003)



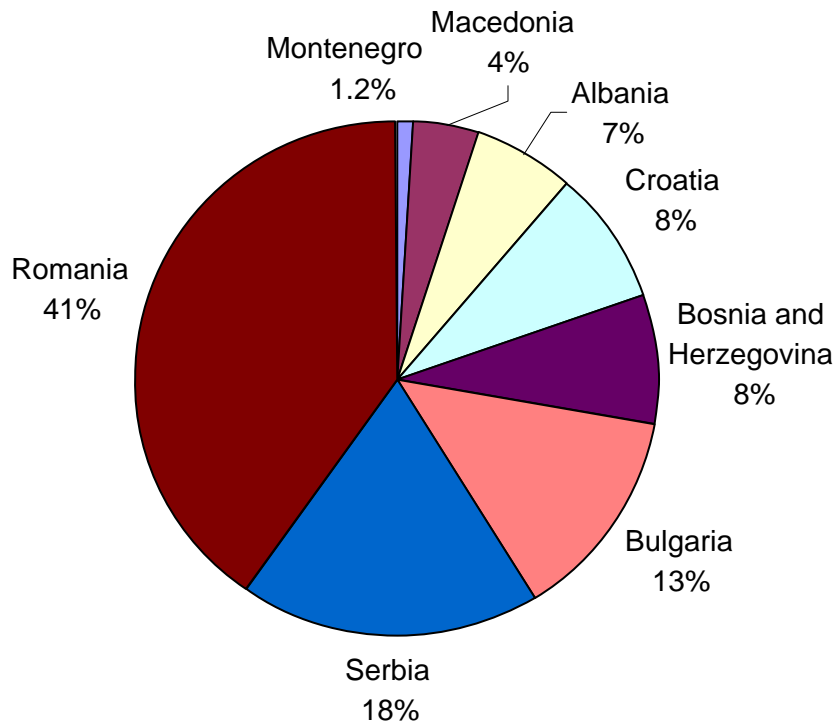
PIRLS, 2001 vs. 2006



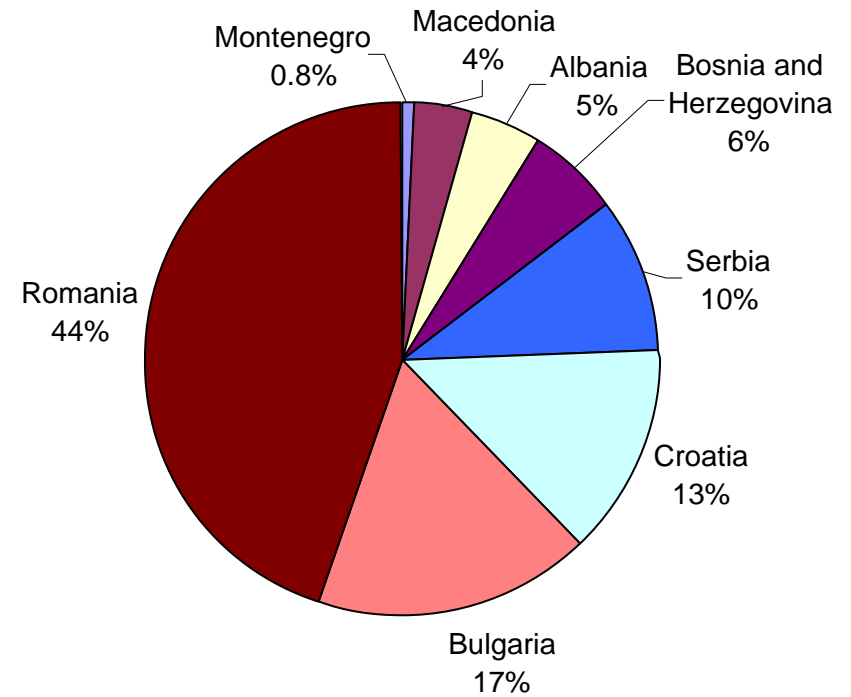
PIRLS assesses students at approximately grade 4. The OECD average is 535 in 2006 and 530 in 2001.. IEA, *PIRLS 2001 International Report* (2003), *PIRLS 2006 International Report* (2007).

Size of Economy and Population in the Southern Tier CEE

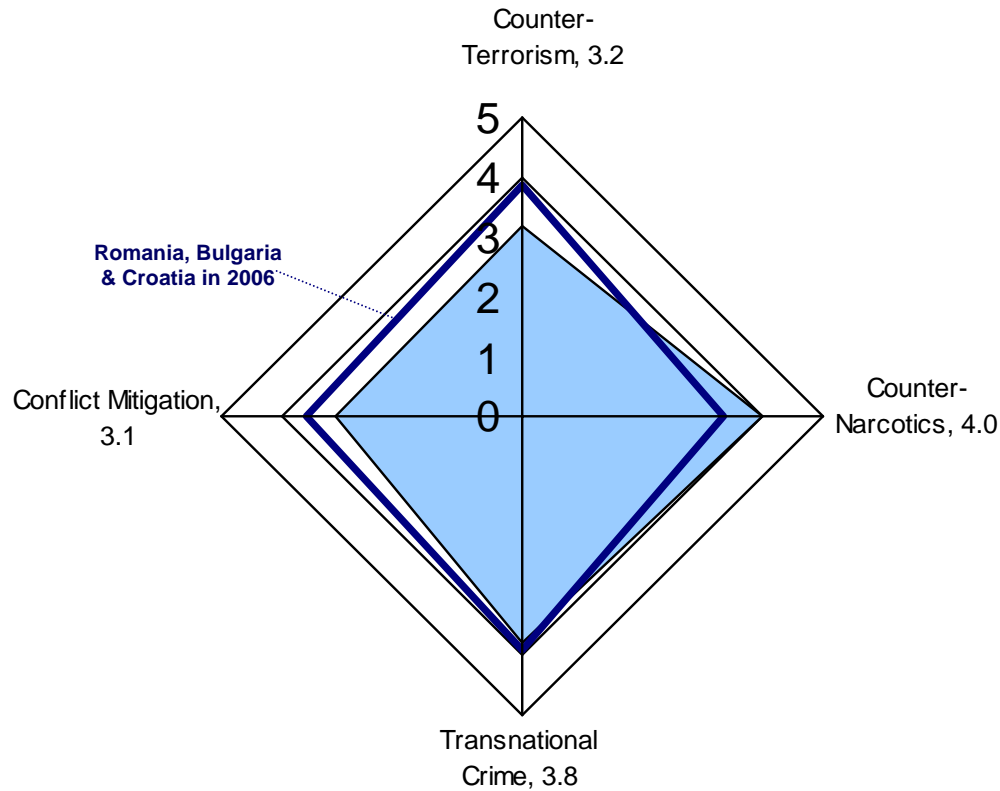
Population



GDP (PPP)



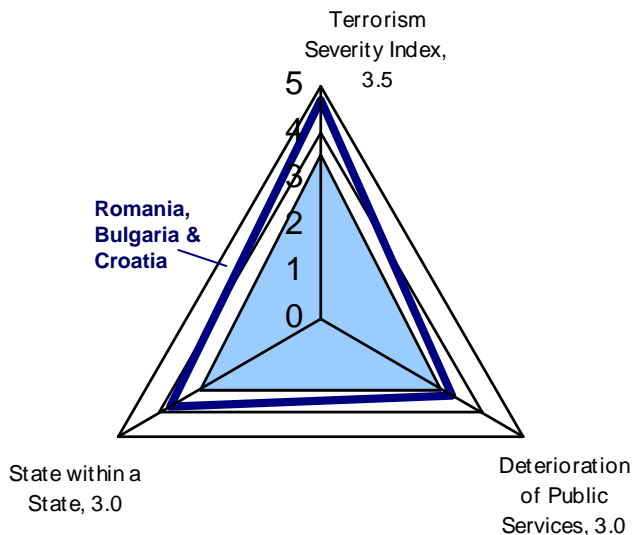
Peace & Security in Macedonia



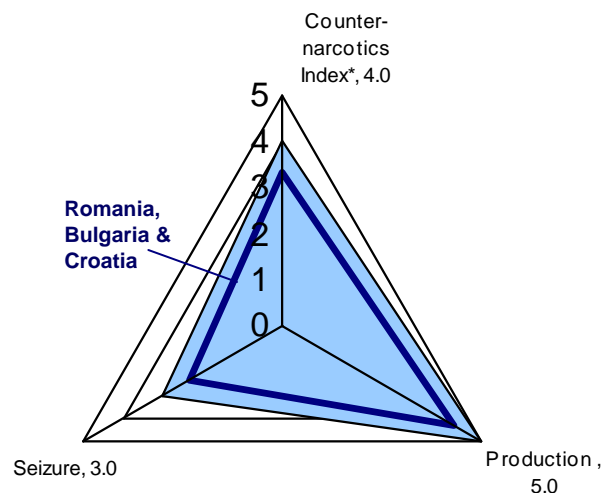
Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, Monitoring Country Progress in CEE & Eurasia #11 (2008 forthcoming) drawing from Fund for Peace, *Failed States Index* (2007); The United Nations Office on Drugs and Crime (UNODC), *2006 World Drug Report*; State Department, International Narcotics and Law Enforcement Affairs, Strategy Report (March 2007); Marshall & Gurr, *Peace & Conflict, A Global Survey of Armed Conflicts, Self Determination Movements and Democracy*, Foreign Policy & A.T. Kearney, *Globalization Index 2007*.

Peace & Security in Macedonia

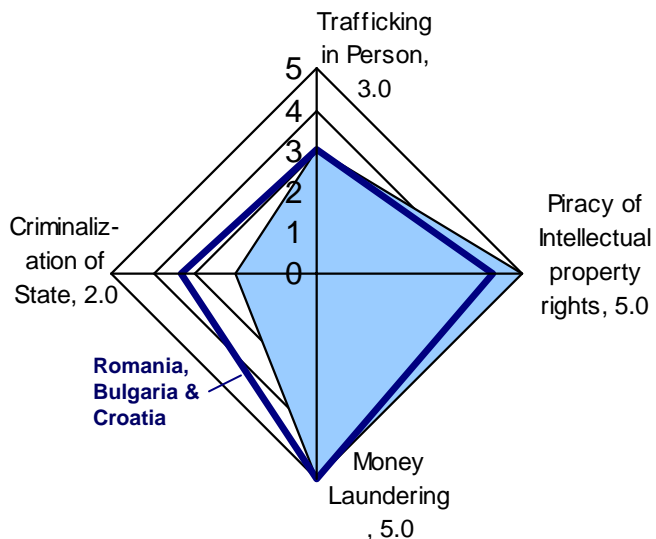
Counter-terrorism



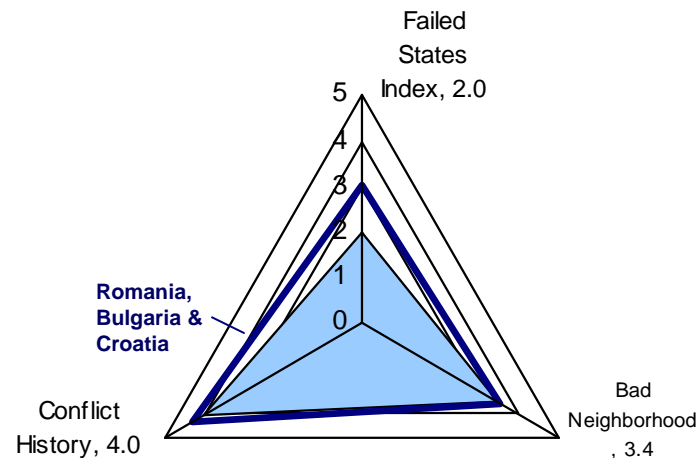
Counter-narcotics



Transnational Crime

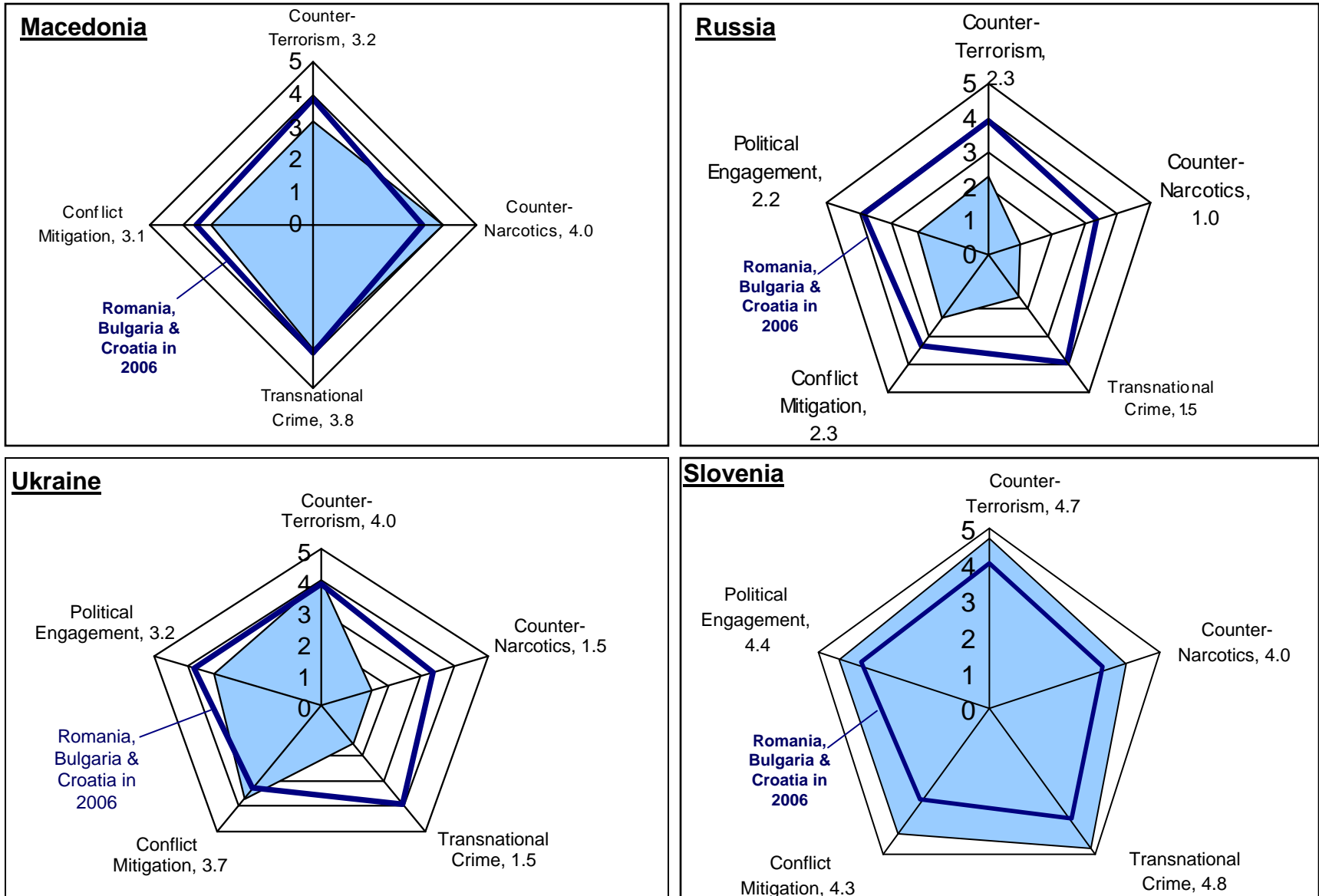


Conflict Mitigation



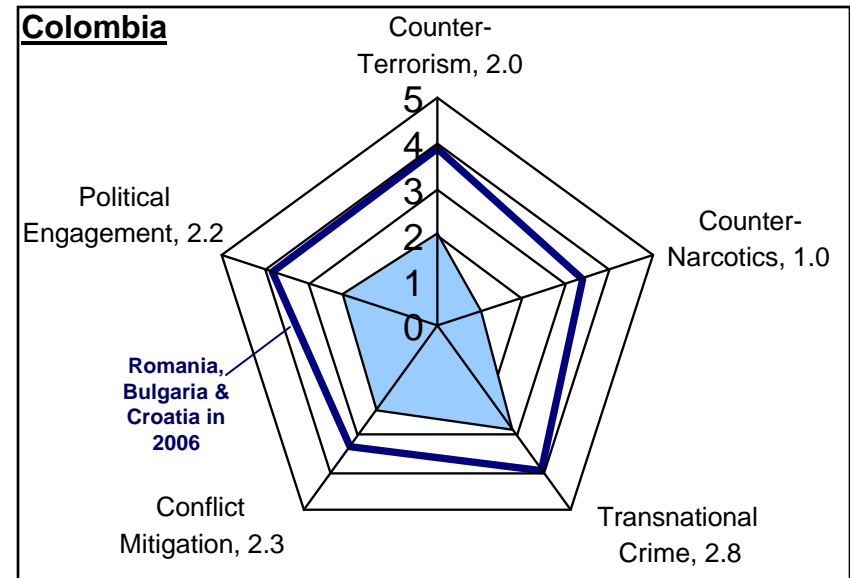
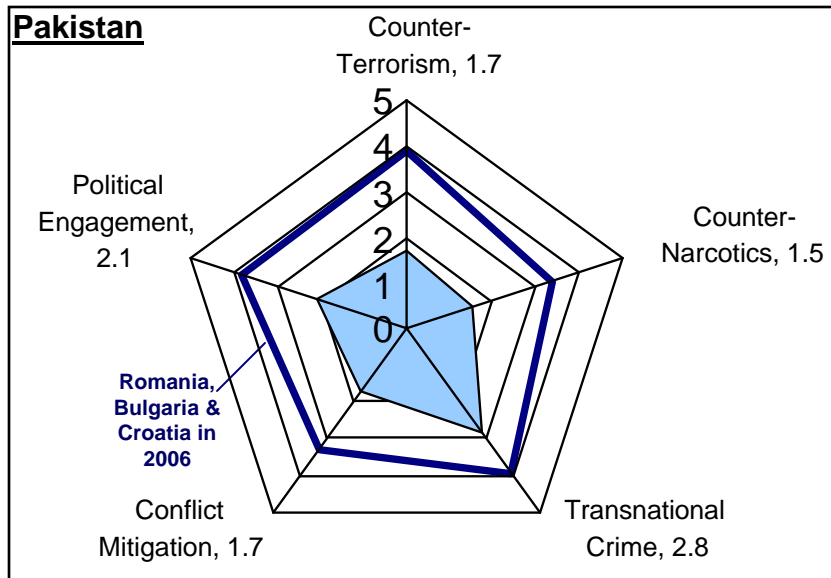
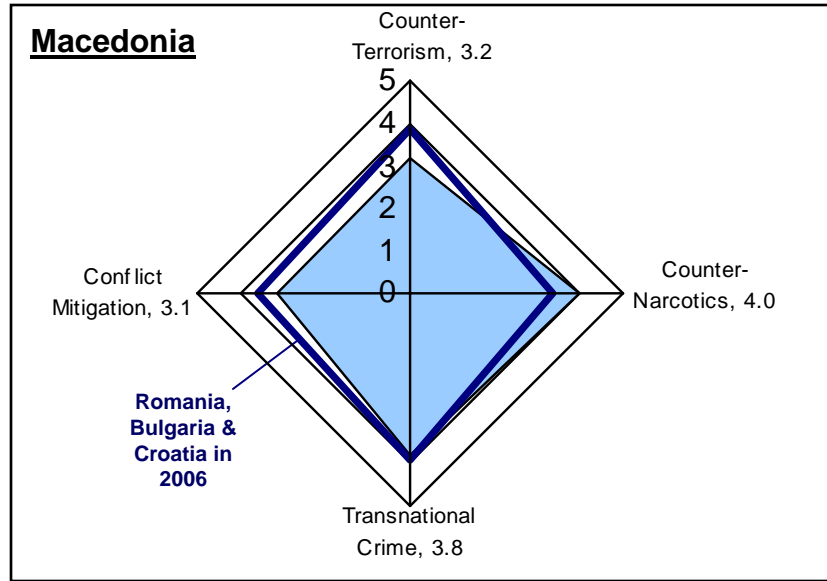
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Peace & Security: Failed States Index

Scale of 12-120

