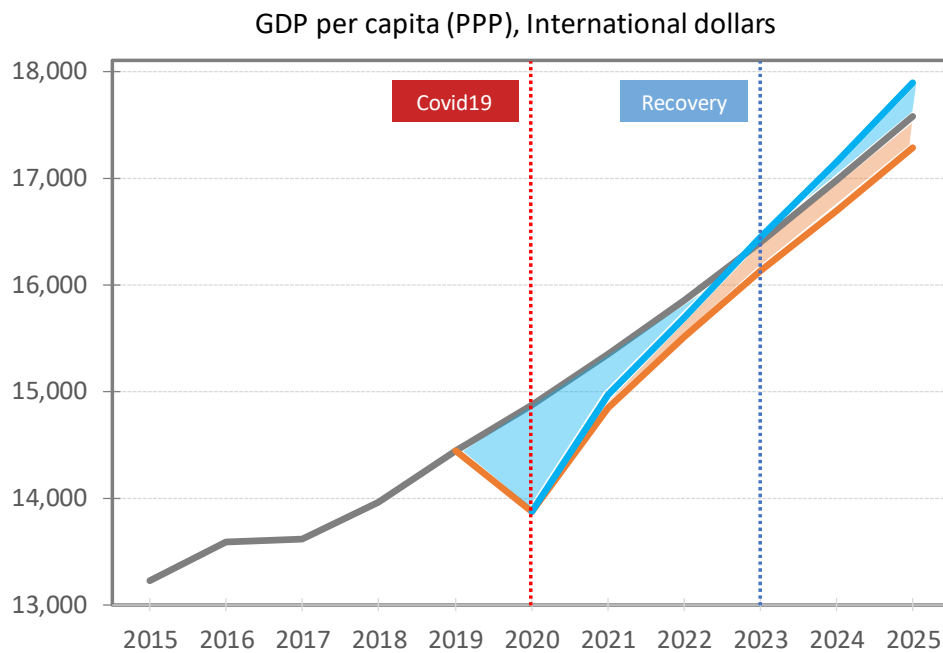




# SOCIOECONOMIC ASSESSMENT OF COVID-19'S IMPACT IN NORTH MACEDONIA [Version 1, June 12<sup>th</sup> 2020]



Skopje, June 2020

## Contents

<b>Executive Summary</b> .....	3	3.4. Findings.....	56
<b>1. INTRODUCTION</b> .....	4	Findings from the analysis .....	56
<b>2. PROJECT OBJECTIVES</b> .....	5	Experiences from other countries and globally.....	58
<b>3. SOCIO-ECONOMIC ASSESSMENT</b> .....	6	<b>4. NEEDS ASSESSMENT DASHBOARD AND SOCIAL VULNERABILITY INDEX</b> .....	59
4.1. Data and Analysis .....	6	5.1. Needs Assessment Dashboard: Tracking the Reopening from a Remote-Access 'Situation Room' .....	59
3.1.1. Macroeconomic Outlook .....	6	5.2. Social Vulnerability Index.....	61
Financial Sector .....	19	<b>5. POLICY EVALUATION AND MONITORING OF POLICY MEASURES</b> .....	61
Public Finance .....	22	5.1. Key Policy Responses as of May 18th, 2020 .....	62
External Sector .....	27	5.2. Evaluation of new proposals .....	66
3.1.2. Sectorial Outlook.....	28	5.3. New Ideas for Economic Recovery ..	67
Agriculture .....	28	<b>6. POLICY RECOMMENDATIONS</b> .....	69
Industry .....	31	References .....	83
Wholesale and retail trade.....	45		
Construction.....	46		
Tourism .....	46		
3.2. Social Vulnerabilities .....	47		
3.3. Methodology.....	52		

## Executive Summary

The UNDP Office in Skopje with its intention to support policymakers in dealing with Socio-Economic Impacts of COVID19, launched a project for Socio-Economic Impact Assessment with the following objective and expected outcomes:

Objective	Expected Outcomes
Socio-economic impact assessment of COVID-19 to support policy response by estimating the overall economic impact, providing disaggregated data about specific vulnerabilities and social groups, as well as evaluating the policy measures and identifying opportunities for better recovery at sectorial and municipal level.	<ul style="list-style-type: none"> <li>▪ Socio-economic impact assessment with several scenarios and sectorial and local level analysis</li> <li>▪ Policy recommendations to mitigate the impact on the most vulnerable segments of the society, including women</li> <li>▪ Evaluation of the adopted and new policy measures</li> <li>▪ Monitoring the impact of Covid-19 and policy response through a Needs Assessment Dashboard</li> </ul>

This document is in a drafting stage and there is still a work in progress with the analysis and policy recommendations. However, due to the immediate needs for policy response by authorities, and as the Government has called a meeting of the Economic Council to discuss the Third Package of Socio-Economic Measures for Policy Response to COVID19 and Recovery, we considered it will be very important to share with the authorities the draft of this document at this stage for discussion and considering the findings of this analysis and some views as potential policy recommendations.

The document is structured along the following lines:

1. Policy recommendations (Evidence-based Comprehensive Policy Framework)
2. Socio-Economic Assessment (Macroeconomic and Sectorial Outlook)
3. Needs Assessment Dashboard and Social Vulnerability Index
4. Policy Evaluation and Monitoring of Policy Measures.

The Socio-Economic Impact Assessment analysis finds serious impact of COVID19 to the economy in North Macedonia of the size higher than the global financial crisis of 2007-2009. It requires accordingly larger socio-economic package, while imposing the need for good public financial management and fiscal sustainability in financing the economic recovery packages. Also, the impact is different, attacking both supply and demand side of the economy and certain sectors has been more affected, especially micro, small, and medium enterprises. Additionally, socially vulnerable groups need special attention and support to fight the impacts from COVID19 in their social wellbeing. Policy recommendations emphasize the need for evidence-based and comprehensive policymaking with followed by a continuous monitoring and accurate policy evaluation process. This will ensure North Macedonia to have a successful policy response to COVID19, fast recovery and moving forward to 'New normal' and focus to growth and reforms as addressed earlier this year in our joint growth study with the Government of the R. North Macedonia: 'The European Pathway of the Republic of North Macedonia: Achieving Faster, More Inclusive and Sustainable Growth'

# 1. INTRODUCTION

Before the pandemic, economic prospects of North Macedonia were encouraging. Economic growth was solid, and unemployment and poverty rates were on a declining trend. The political tailwinds were also very favorable. The country became the 30<sup>th</sup> member of NATO, thereby strengthening its political stability. In March 2020, the EU agreed to start accession negotiations, an important milestone in country's independent history.

However, the rapid spread of COVID-19 pandemic in early March 2020 interrupted the growth momentum abruptly. The ongoing crisis is expected to: (1) result in a short-term, but severe economic downturn; (2) put an upward pressure on unemployment and poverty in North Macedonia, and (3) cause social and psychological problems (a rise in the domestic violence, anxiety, depression). Ultimately, the pandemic will also slow down country's progress in achieving the Sustainable Development Goals (SDGs) in 2020.

Governments across the world are having to make decisions at a very fast pace, without much time to think (Hausmann, 2020). The timely acknowledgment of the new reality prevented a massive pressure on the health system capacity. In addition to the public health prevention measures, the Government of North Macedonia prepared two packages of economic measures for supporting businesses and individuals. An extended lockdown would mean a large loss of income for many workers and businesses. Therefore, a third package of economic stimulus was announced in mid-May 2020, as the largest impact of the crisis is expected in the second quarter of 2020. Even with the government support, companies will face serious and unprecedented cash-flow, supply, and operational problems.

The UNDP Office in North Macedonia has initiated a rapid assessment of the socio-economic consequences of the pandemic. The goal is to provide evidence-based recommendations for the government and the local authorities, thereby contributing to the forward-thinking policies. The UNDP office in North Macedonia has the commitment and the capacity to support government authorities in cushioning the socio-economic impact of the health and economic crisis and paving the way for the post-shock recovery. It is crucial to build economic and social resilience and facilitate orderly adjustment to safeguard the existing development results.

The socio-economic assessment of the impact of COVID-19 on macroeconomic parameters focuses on various **dimensions of vulnerability** and societal groups being already hit or significantly exposed to **these vulnerabilities**.

## 2. PROJECT OBJECTIVES

The first important step in mitigating the economic and social impact of the crisis and supporting the recovery is the socio-economic assessment of the impact of COVID-19 on macroeconomic parameters, institutional gaps and needs with special focus on the most vulnerable segment of the population.

It comprises of the following activities:

*Activity 1.1: Conduct socio-economic impact assessment with several scenarios using traditional and machine-learning approach*

- Adopt a sectoral perspective and devise a ranking of the hardest-hit economic sectors by the estimated costs (losses) as a result of the pandemic outbreak
- Use the macroeconomic estimates to establish the impact to the fiscal capacity of municipalities to provide services under several scenarios

*Activity 1.2: Prepare recommendations based on the calculated econometrics to mitigate the impact on the most vulnerable segments of the society, including women*

- Identify the most affected segments of the society and develop a framework to quantify the impact on each group separately
- Group the proposed recovery/mitigation measures in sequential packages (short, medium, long-term)

*Activity 1.3: Rapid design of a simple and inclusive Needs Assessment Dashboard (NAD)*

- Establish a system to collect and monitor open high-frequency data (on employment, consumer price index, food price index, domestic trade etc.) that will identify the needs of the hardest-hit economic sectors by investigating a combination of falling production, employee layoffs and wage reduction
- Design a Local Social Vulnerability Index (SVI) through careful selection of secondary data to monitor on monthly basis the vulnerability of local communities
- Develop an interactive online tool for visual presentation of the NAD and the SVI

## 3. SOCIO-ECONOMIC ASSESSMENT

### 4.1. Data and Analysis

Wherever possible, the analyses rely on high frequency (monthly) data that give a fresher look on the recession in making in 2020. In other instances, we use quarterly or annual data to uncover important pre-crisis patterns.

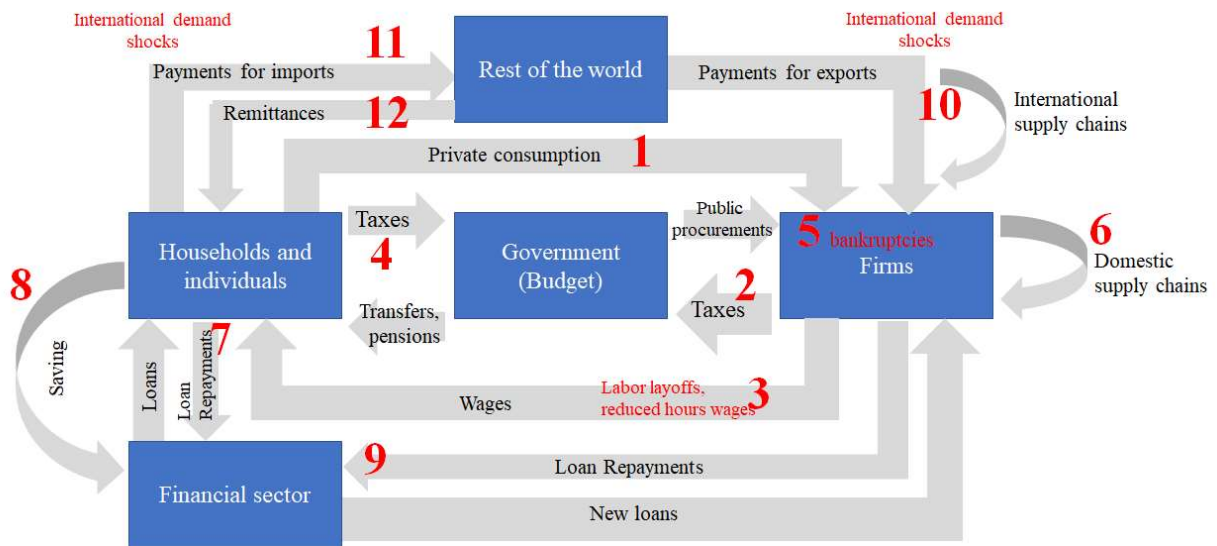
#### 3.1.1. Macroeconomic Outlook

From a macroeconomic perspective, the COVID19 pandemic will produce multiple strikes on the circular flow of the domestic economy, which are briefly explained in Table 1 and illustrated in Figure 1:

Table 1. MCOVID19's multiple strikes

<b>Strike</b>	<b>Brief Description</b>
<b>1</b>	A fall in private consumption, including deterioration in consumer confidence
<b>2</b>	Significant revenue shortfall in collection of indirect taxes (relative to the budgeted amounts), due to material and rapid decline of firms' sales
<b>3</b>	Labor layoffs, reduced working hours and wages, or a combination of them
<b>4</b>	Revenue shortfalls in the collection of personal income taxes and social security contributions
<b>5</b>	Potential bankruptcies (insolvencies)
<b>6</b>	Inter-firm arrears due to low liquidity and disruptions in domestic supply chains
<b>7</b>	Difficulties and delays in loan repayments by households and individuals
<b>8</b>	Composition changes: increased precautionary saving by individuals with relatively stable incomes and borrowing (overdrafts, credit cards, consumer loans) by hardest-hit individuals
<b>9</b>	Difficulties and delays in loan repayments by firms, causing worsening of banks' portfolios of loans
<b>10</b>	Disruptions in the international supply chains on the export side (cancelled or reduced orders, difficulties in collecting the export revenue)
<b>11</b>	Disruptions in the international supply chains on the import side (cancelled or reduced imports of components/inputs)
<b>12</b>	Reduced net inflows of remittances as migrants' incomes abroad shrink

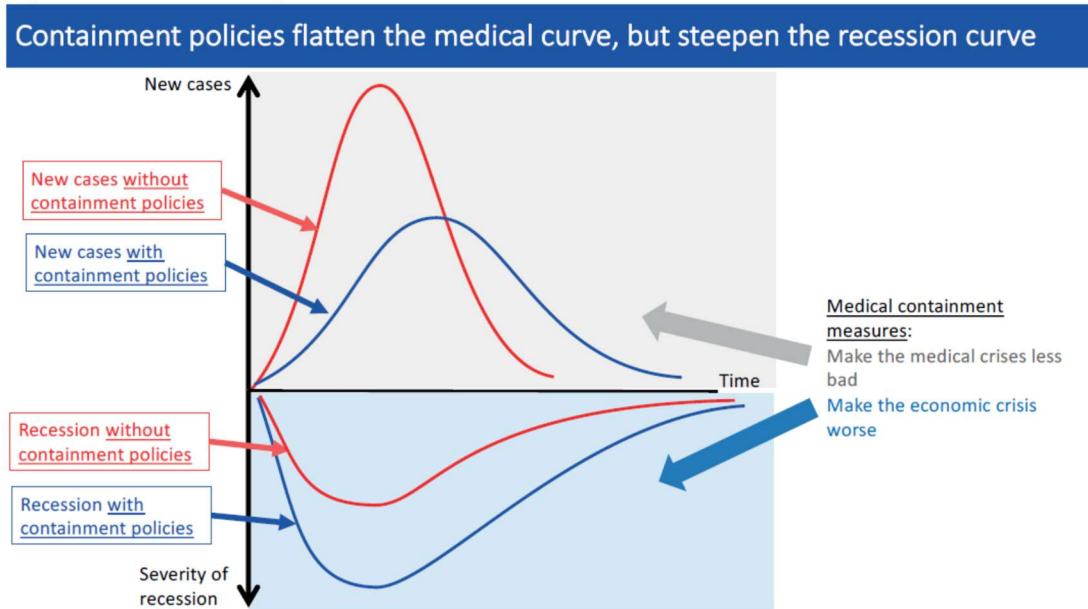
Figure 1. COVID19's multiple strikes in the circular flow of income diagram



Source: Adaptation of a simpler diagram from Baldwin, Richard (2020), "Keeping the lights on: Economic medicine for a medical shock", VoxEU.org, 13 March.

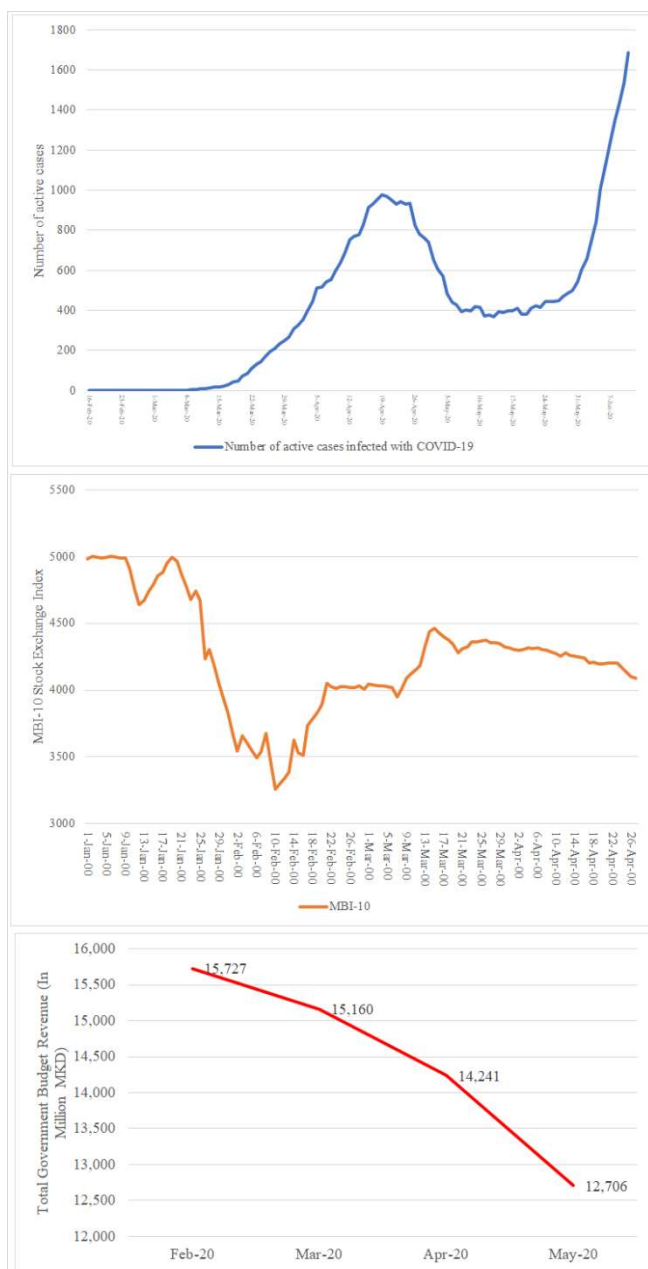
The disruptions caused by these strikes put an upward pressure on unemployment and poverty rates in North Macedonia and threaten to wipe out some of the pre-crisis development results. The containment policies will have a strong impact on the recession curve (Figure 2).

Figure 2. Containment policies and the recession curve



Source: Baldwin (2020).

Figure 3. Health Curve and Economic Curves: Number of active cases infected with COVID-19, the MBI-10 Stock Exchange Index and Total Government Revenue (in million MKD)

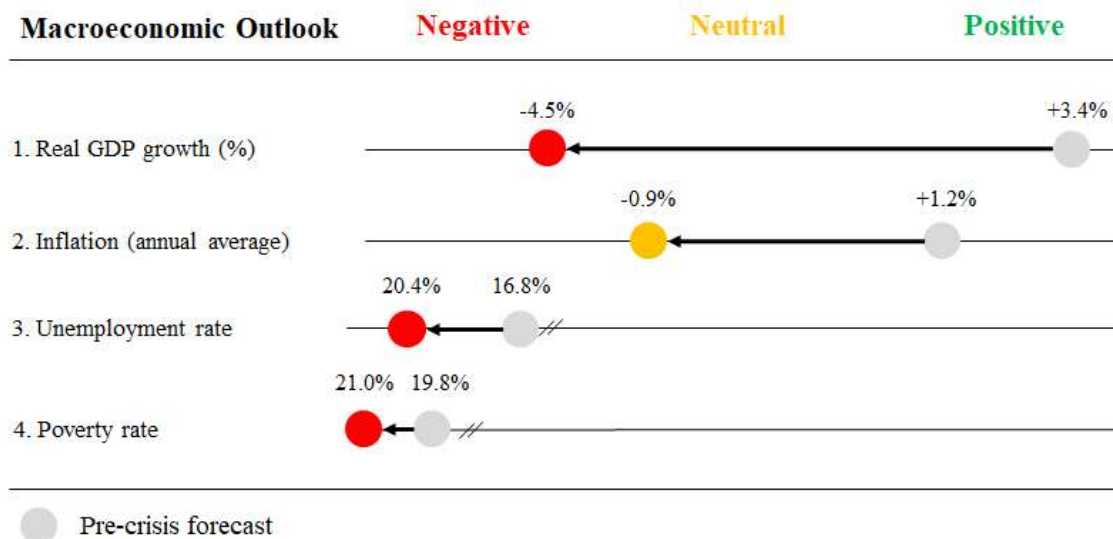


## Real Economy

Instead of a real GDP growth of 3.4% this year, the pandemic will most likely cause a reduction of 4.0%. Due to the lower oil prices and reduced private consumption, the inflation will not be a problem. On the contrary, we may have a fall in the general price level or a deflation of 0.9% this year. The unemployment was on a declining path for almost 14 years and was projected to reach 16.8% this year. However, due to labor layoffs and exceptionally low job creation, it is forecasted that it will increase to 20.4% at end of 2020. These trends will inevitably affect the poverty rate, which according to our forecasts, will increase to 21%.

Even though international organizations and domestic experts expect strong rebound and a growth of 7%, the economy will not be able to reach the pre-crisis level (or the counterfactual scenario without the pandemic and without new government reforms). The cumulative output losses for 2020 and 2021 are estimated at 3.7 Billion EUR.



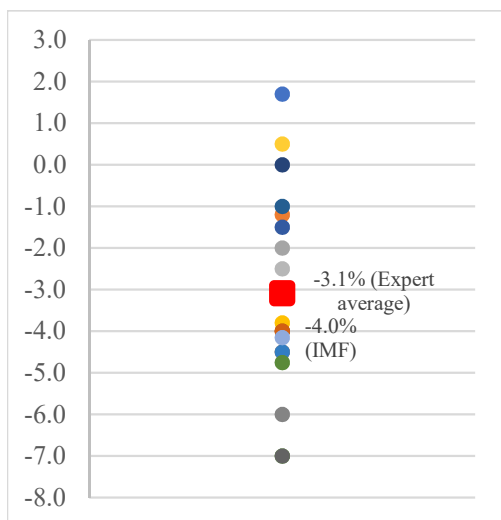


### Output

A mid-April survey of 40 macroeconomists and business executives in North Macedonia displays significant variation in the expected real GDP growth with an average estimate of -2.9% in 2020 (Figure 1). It is less pessimistic – but still unfavorable – than the IMF’s (2020) forecast of a reduction of 4% in 2020. Strong rebound of 7% is expected in 2021 (Figure 2).

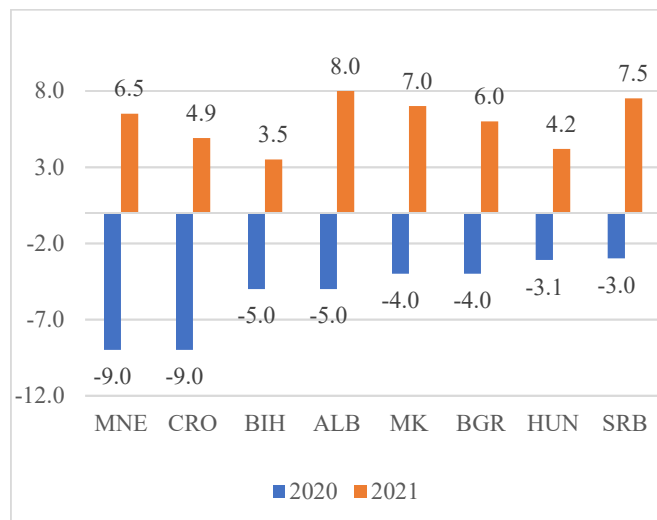
The crisis will have a strong impact in South Eastern Europe. Montenegro and Croatia are likely to be most severely hit because of the expected fall in tourism. Their GDP is expected to fall by 9%. North Macedonia is in the group of moderately affected countries, together with Bulgaria (Figure 3). A survey of 50 macroeconomists and business executives in mid-April 2020 produces an average estimate for a GDP decline of 3.1% in 2020 as opposed to IMF’s projections.

Figure 4. Real GDP Growth Forecasts for North Macedonia in 2020 (in percent)



Source: Survey of macroeconomists and business executives, 10-15 April 2020.

Figure 5. Regional Outlook: Economic Growth in 2020 and 2021 (in percent)

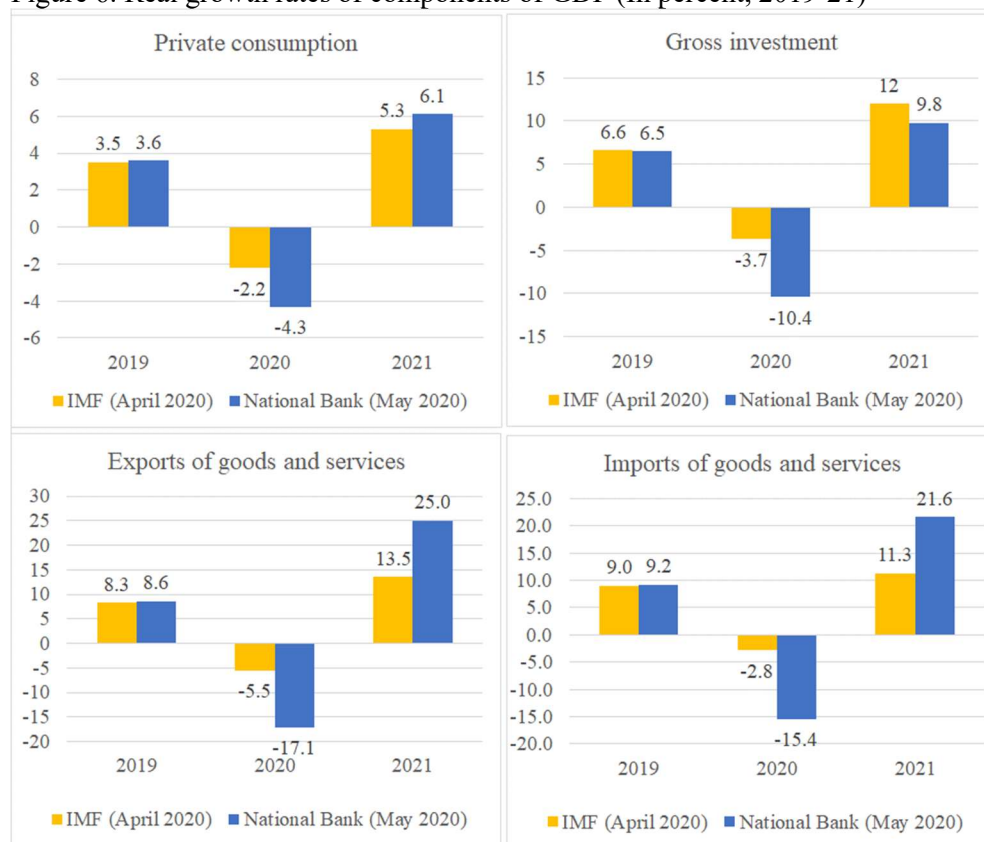


Source: IMF (World Economic Outlook), April 2020.

The negative GDP growth of 4% in 2020 will reflect a reduction of both domestic demand and net exports (net foreign demand). The depressed domestic demand in 2020 will contribute to a reduction of 2.7 percentage points and the fall in net exports by 1.3 percentage points in the overall economic activity (Figure 6). All components of GDP are likely to be negatively affected.

**Private consumption.** Never, except in wartime, has consumer demand dropped so far so fast. A negative real growth between 2.2% (IMF, April 2020) and 4.3% (National Bank, May 2020) is expected in 2020, as a result of the expected labor layoffs, lower and uncertain incomes, slashed spending on travel, hospitality and entertainment is slashed due to regulatory restrictions, a general fall in consumer confidence, and lower net inflows of remittances from abroad. Moreover, individuals with relative stable incomes will increase their precautionary saving and postpone current consumption decisions, particularly on durable consumer goods.

Figure 6. Real growth rates of components of GDP (In percent, 2019-21)



Source: Authors' design based on data from IMF (April 2020) and National Bank (May 2020).

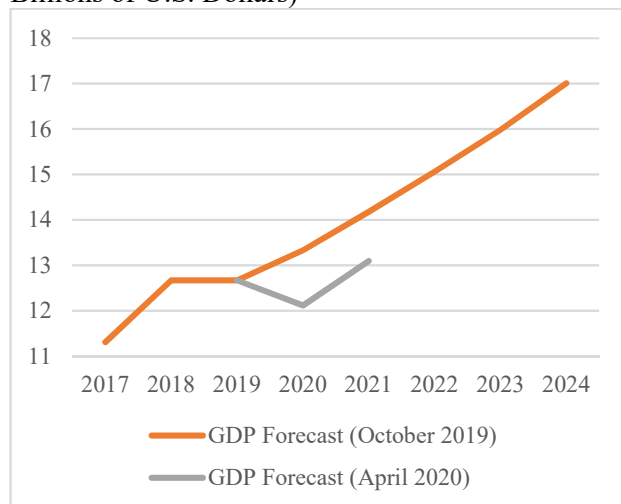
**Gross investment.** According to the National Bank (May 2020) the fall in gross investment will be deep (10.4% in real terms). IMF (2020) is more cautious, since it forecasts that the investment activity would worsen by 3.7% in real terms, reflecting the deferral of private investment towards the end of 2020 and a low execution of government capital expenditure. IMF (2020) forecasts a decline of government investment from initially budgeted 23.8 Bill Denars in 2020 to 12.7 Bill Denars, a reduction of 46.6% in one year. UNCTAD predicts a drastic drop in global foreign direct investment (FDI) flows – up to 40% – during 2020-2021, reaching the lowest level of the past two decades. Net FDI in North Macedonia are also expected to drop.

**Exports of goods and services.** Exports would contract due to weak global demand. The disruptions in global supply chains - as evidenced by cancelled and delayed orders – will lead to an expected fall of exports of goods and services of 9.8% in nominal terms, or 5.5% in real terms. Based on more recent projections, the National Bank (May 2020) forecasts a fall of exports of goods and services of 17.1% in real terms. The crisis impact on the automotive component industry in North Macedonia is particularly uncertain. Around 50 automotive component suppliers are working well below their production capacity in a wait-and-see attitude, causing a significant downside risk on the export side.

**Imports of goods and services.** The projected fall in imports is between 2.8% in real terms (IMF 2020) and 15.4% in real terms (National Bank, 2020). The substantial difference in forecasts reflects the exceptionally high uncertainty. The larger drop in the value of imports is mainly due to the lower price of oil on the global oil market.

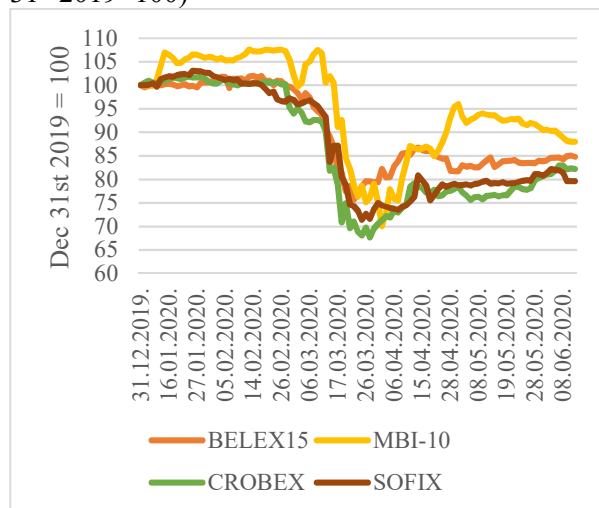
The cumulative output losses compared to the counterfactual scenario without the pandemic are estimated at 2.3 Billion € only for 2020 and 2021 (Figure 7). By the end of 2021, the economy will still not be able to return to the pre-crisis growth trajectory. The deterioration of the economic outlook is also priced into the MBI-10 stock market index (Figure 8).

Figure 7. Output losses in 2020 and 2021 (GDP in Billions of U.S. Dollars)



Source: Based on IMF (2020) forecast.

Figure 8. The Stock Market Indices in 2020 (Dec 31st 2019=100)

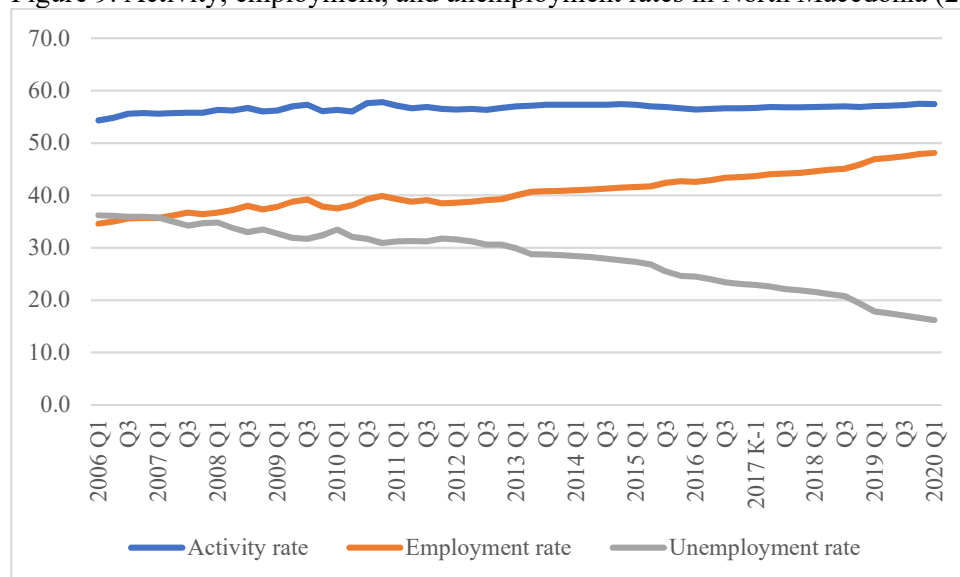


Source: Stock Exchanges in Belgrade, Skopje, Zagreb and Sofia.

### The Unemployment Rate

In the past 14 years, the unemployment rate has been on a declining path reaching an all-time low of 16.6% in Q4 2019. This trend has been accompanied by a rising employment rate and mildly increasing activity rate. However, the official data from the State Statistical Office comes with a significant delay. It does not offer an insight into most recent developments on the labor market in 2020.

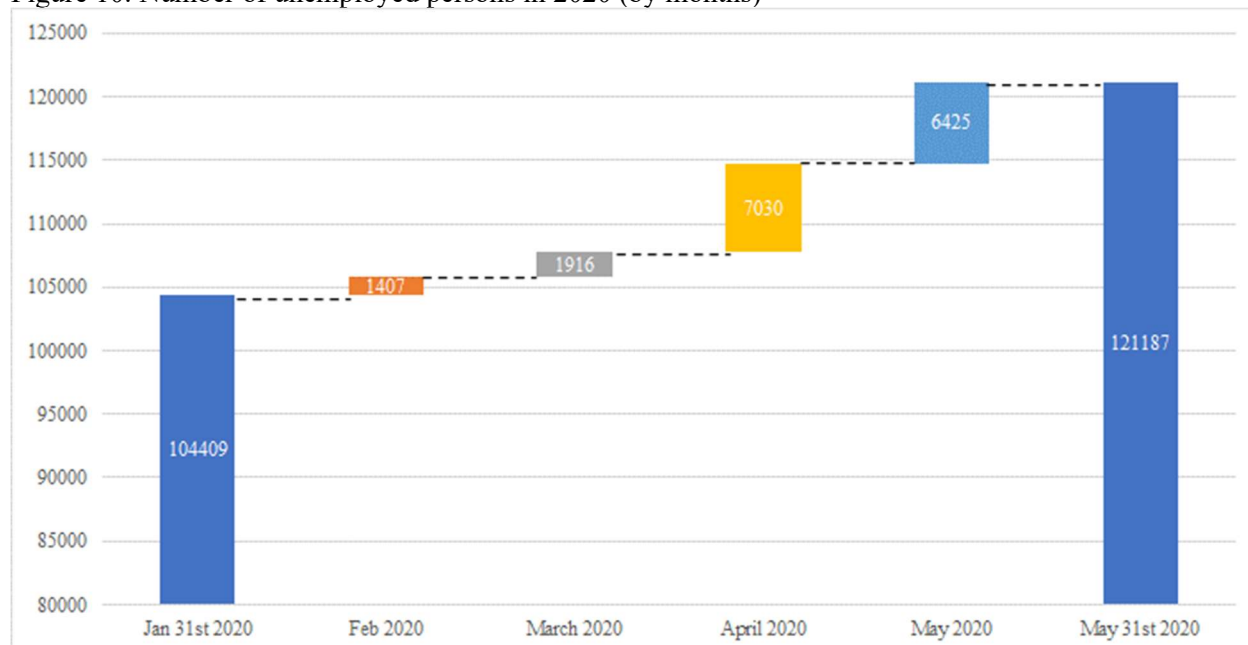
Figure 9. Activity, employment, and unemployment rates in North Macedonia (2006 Q1-2020 Q1)



Source: State Statistical Office, June 2020.

Therefore, we resort to data from the Employment Service Agency which is being regularly published with a monthly frequency. Even though we are fully aware that this is not *the* official source, it gives some clue about the direction and changes in the unemployment dynamics.

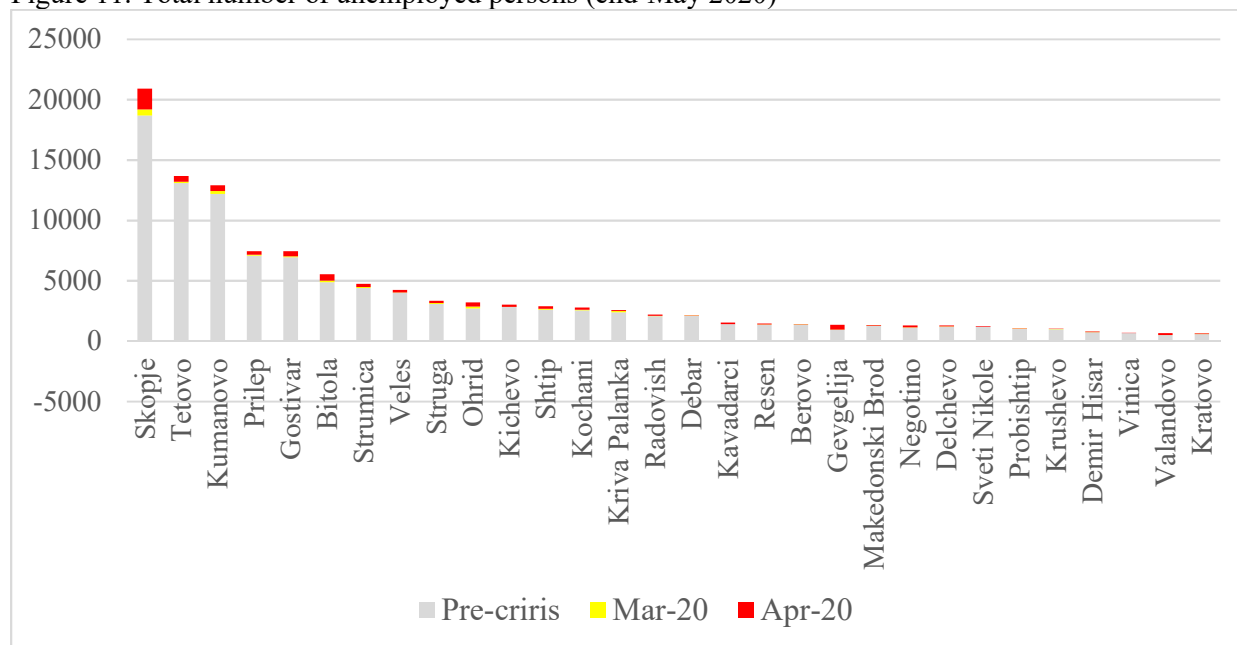
Figure 10. Number of unemployed persons in 2020 (by months)



Since the pandemic outbreak (between Feb 29<sup>th</sup> and May 31<sup>st</sup> 2020), 16,778 persons registered as unemployed (Figure 10). This is a 16.1% increase of the total number of unemployed

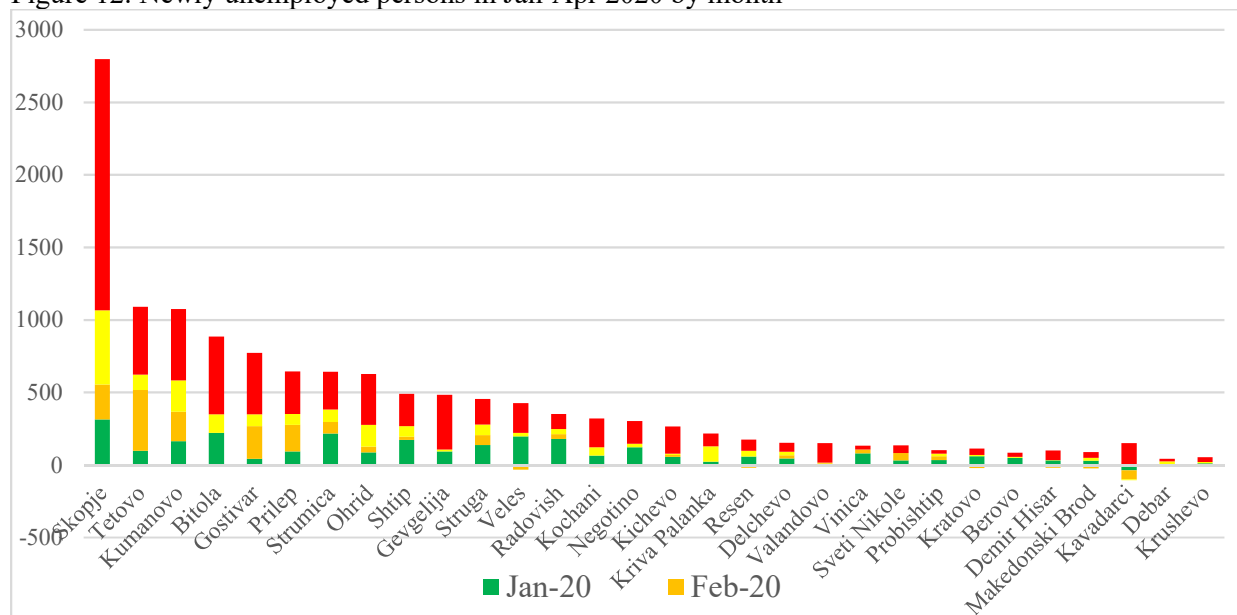
in only three months.<sup>1</sup> The highest number of job applicants is registered in Skopje, Tetovo, Kumanovo, Prilep and Gostivar.

Figure 11. Total number of unemployed persons (end-May 2020)



Source: Based on data from the Employment Service Agency, April 2020.

Figure 12. Newly unemployed persons in Jan-Apr 2020 by month



Source: Based on data from the Employment Service Agency, April 2020.

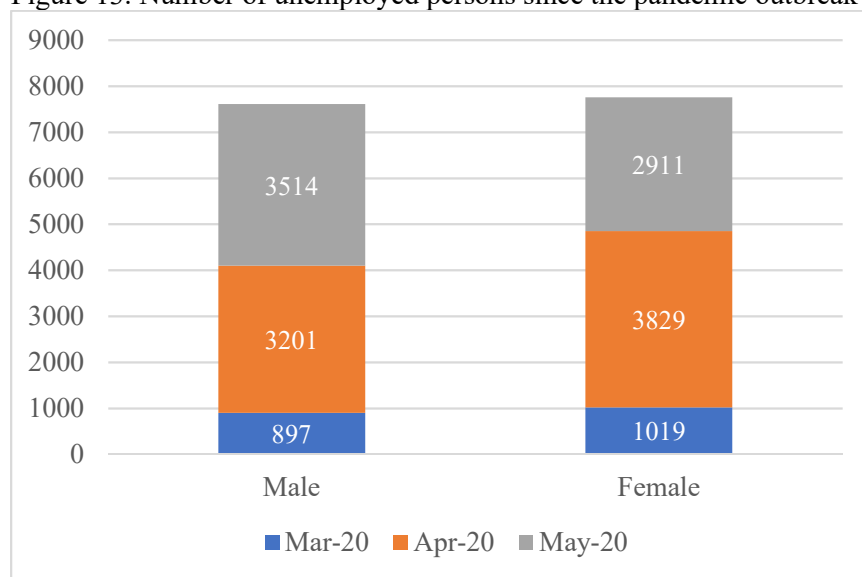
### Women hit hardest by corona economic crisis

<sup>1</sup> The first person infected with Covid19 was registered on March 26<sup>th</sup> 2020.

The declining trend of the unemployment rate will be reversed in Q1 2020, considering the limited job creation during the crisis.

While women are overrepresented in fighting the pandemic, they also suffer more severely from the ongoing social-economic crisis.

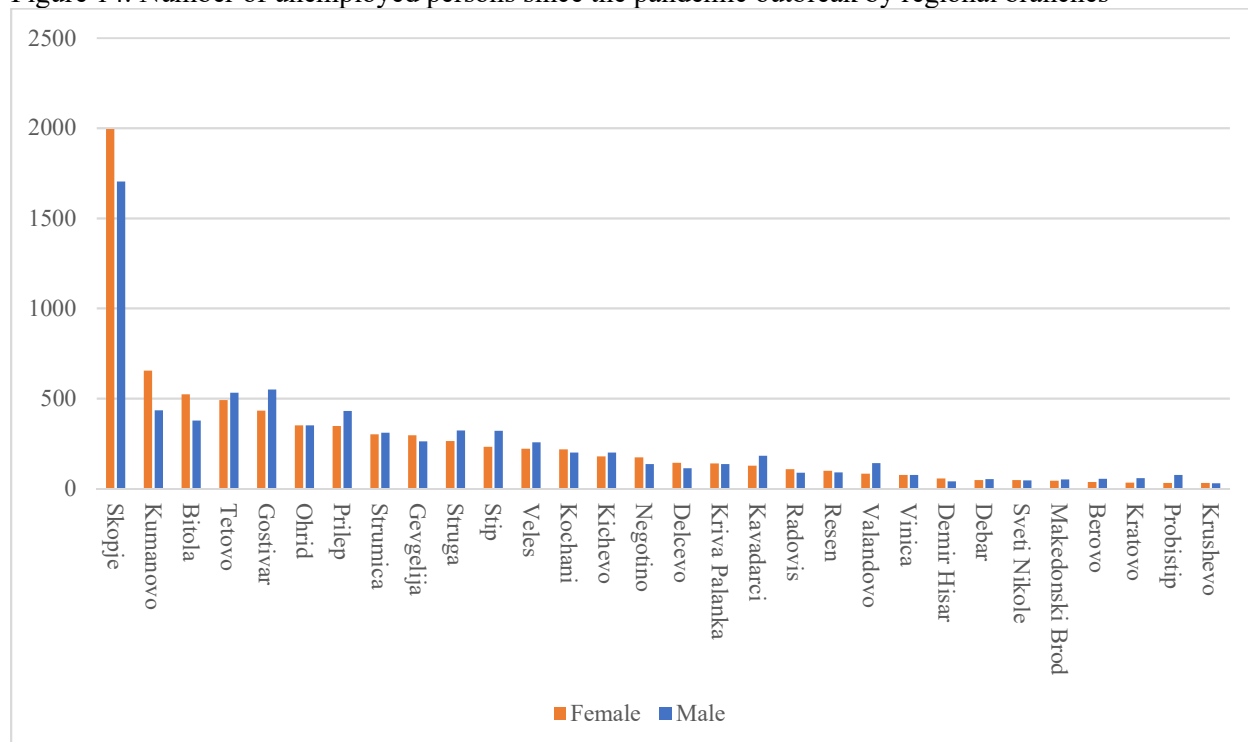
Figure 13. Number of unemployed persons since the pandemic outbreak



Note: Absolute change (newly unemployed persons) in each month since the pandemic outbreak since the pandemic outbreak. Source: Based on data from the Employment Service Agency, June 2020.

Statistical data from the Employment Agency reveal that women from Skopje, Kumanovo, Bitola and Tetovo are paying the highest price.

Figure 14. Number of unemployed persons since the pandemic outbreak by regional branches



Note: Absolute change (newly unemployed persons) in each month since the pandemic outbreak. Source: Based on data from the Employment Service Agency, June 2020.



From a gender perspective, we detect significant vulnerabilities among female job applicants (Table 5). The prevalence of female unemployment is observed in the age category 25-54 years with largest concentration in Kriva Palanka, Kumanovo and Bitola.

Table 2. Number of unemployed female and their share in total unemployment, May 31<sup>st</sup> 2020

Regional Branch	Number of unemp. females	Share of female unemployment in total unemployment (in %)										
		Total	15-19	20-24	25-29	30-34	35-39	40-44	45-49	50-54	55-59	60+
Berovo	714	49.1	50.0	41.2	54.4	55.7	53.2	54.1	54.4	59.4	45.3	31.4
Bitola	3011	52.2	45.1	52.5	54.2	58.0	61.6	56.6	55.0	57.3	50.0	36.3
Valandovo	291	39.8	60.0	49.2	52.1	41.4	50.0	36.2	33.9	39.1	41.0	24.6
Veles	2148	48.0	57.1	49.0	55.7	52.0	53.1	50.4	54.8	52.4	47.1	28.8
Vinica	358	43.7	50.0	42.9	46.9	50.0	60.9	40.0	46.6	53.5	48.6	22.9
Gevgelija	684	45.4	33.3	43.4	56.8	46.3	56.8	51.2	43.0	48.4	45.8	34.5
Gostivar	3745	47.2	38.9	43.5	50.1	53.0	53.8	52.4	49.3	48.7	43.9	30.5
Debar	1060	48.2	57.1	53.2	40.1	51.6	53.9	52.9	53.9	49.8	47.0	21.7
Delchevo	734	50.5	75.0	44.9	49.5	51.8	54.2	56.3	55.2	49.7	51.4	44.5
Demir Hisar	433	52.3	71.4	48.0	55.1	53.4	62.1	70.4	60.8	53.3	47.4	24.7
Kavadarci	785	46.2	47.2	49.4	57.1	52.4	48.7	48.4	51.2	55.6	39.7	28.3
Kichevo	1518	47.5	46.6	47.2	52.0	51.2	52.7	50.8	51.9	44.7	43.9	33.5
Kochani	1295	43.9	38.4	47.4	54.8	50.7	50.2	46.9	47.2	50.0	40.5	28.0
Kratovo	340	50.4	47.4	42.9	45.2	59.6	70.5	66.0	59.0	52.4	54.1	22.1
Kriva Palanka	1441	54.4	44.4	46.0	60.4	63.0	59.1	65.3	59.8	57.5	54.0	31.4
Krushevo	488	46.8	63.0	45.1	53.3	47.0	50.0	44.1	54.3	43.4	51.4	27.0
Kumanovo	6955	52.3	48.1	51.3	56.7	55.8	54.8	57.3	56.4	55.6	51.3	33.6
Makedonski Brod	644	47.5	24.1	45.0	51.3	48.3	56.3	56.8	51.3	56.8	48.7	26.7
Negotino	634	44.5	62.9	46.2	52.0	55.3	60.0	58.6	60.3	49.2	35.5	22.7
Ohrid	1615	47.4	35.5	49.5	55.5	49.4	56.3	52.4	49.8	52.6	49.0	30.4
Prilep	3639	46.3	47.5	47.5	48.2	49.9	53.0	52.3	48.5	49.4	42.5	30.3
Probistip	484	43.6	46.2	42.0	46.7	54.6	53.7	58.4	48.8	42.7	33.6	37.0
Radovish	1157	51.3	56.5	52.0	46.2	58.2	54.8	52.1	52.4	56.1	52.4	41.2
Resen	668	43.7	23.8	41.1	45.8	47.2	46.2	48.6	47.3	46.1	40.8	36.2
Sveti Nikole	521	41.1	36.4	46.8	54.0	46.6	49.4	41.9	50.6	50.0	38.6	27.3
Skopje		50.8	48.0	50.5	54.4	52.9	56.9	57.0	55.6	54.3	48.3	30.3
Struga	1734	47.3	44.1	46.4	54.2	49.7	53.2	48.2	49.6	43.6	50.3	28.6
Strumica	2469	49.3	51.6	54.4	47.1	49.2	52.2	51.8	49.3	50.1	49.6	39.8
Tetovo	6628	47.0	48.0	50.5	56.6	55.2	52.7	49.1	49.5	43.0	38.0	28.9
Shtip	1504	47.7	56.0	48.0	52.7	44.4	49.1	47.7	44.5	56.1	52.3	36.5
<b>Total</b>		48.7	47.8	49.1	53.1	52.8	54.6	53.4	52.5	51.3	46.5	31.5

Note: Data on shares of female unemployment colored with   indicate regional branches with dominant female unemployment. Source: Designed by using data from the Employment Service Agency, June 2020.

### Nominal and Real wages

The nominal wages registered growth of 10.7% in Q1 2020 compared to the same period in 2019 and a year-on-year growth of 7.4% in March 2020.

The wage growth is a combination of several factors:

- the increase of the minimum wage in April 2019 (from 12,165 Denars to 12,507 Denars net wage) and in December 2019 (from 12,507 Denars to 14,500 Denars of the net wage)
- the increase of the wages in the public sector (5% increase for health system employees in September 2019, increase of the wage of 2,900 employees in culture in April 2019, 16% for pre-school children's caregivers in June 2019, 22% increase of the social workers in June 2019 and additional 5% in September, increase of 5% in September 2019 for the employees in the public sector, and an increase of 10% for the employees in the education sector in January 2020);

- the effect of government subsidies for the payment of social security contributions as of November 2019 (the government subsidy is approved if the wage increase per employee is more than 600 Denars per month, but not more than 6,000 Denars), *and*
- payment of various allowances to the wage (bonuses) in January 2020.

Given the low increase of costs of living, the economy-wide real net-wage increased by 10.0% in Q1 2020 compared to the same quarter in the previous year.

An overly concerning crisis-related phenomenon is that 20,977 persons did not receive wage in April 2020.<sup>2</sup>

### Consumer Prices and Costs of Living

The inflation *per se* will not be a problem in 2020, although some items are already experiencing high price increase (e.g., alcoholic beverages, tobacco, and narcotics). The strong rise in *alcoholic beverages, tobacco, and narcotics* is due to the rise of tobacco prices by 4.6% in January-May 2020 compared to the same period in 2019. The annual increase in the price of tobacco is a reflection of the increase in cigarette prices in May 2019 and March 2020, in accordance with the planned annual increase of excise duties on cigarettes by 0.20 denars per piece, as of July 1<sup>st</sup>, 2023.

The strong effect of historically low oil prices and depressed private consumption are likely to result in a deflation of 0.6%.

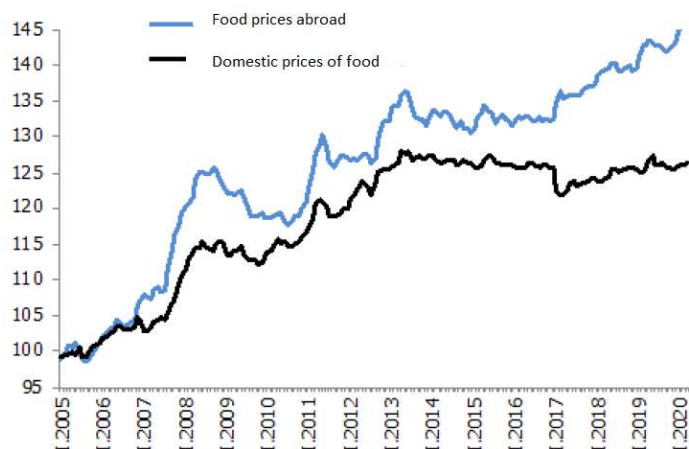
Table 3. Consumer prices in 2020 (year-on-year growth, by month)

Items in the Consumer Price Index	Structure	XII 2019 / XII 2018	I 2020 / I 2019	II 2020 / II 2019	III 2020 / III 2019	IV 2020 / IV 2019	V 2020/ V 2019
<b>TOTAL</b>	<b>1000</b>	<b>0.4</b>	<b>0.6</b>	<b>0.7</b>	<b>0.5</b>	<b>-0.1</b>	<b>-0.2</b>
Food and non-alcoholic beverages	386.6	0.9	0.3	0.4	0.6	1.3	1.5
Alcoholic beverages, tobacco, and narcotics	49.3	5.1	5.0	5.2	4.5	4.6	3.9
Clothing and footwear	70.3	-2.8	-2.1	-1.6	-0.8	-0.9	-2.1
Housing, Water, Electricity, Gas and other fuels	130.4	-0.3	-0.3	0.3	0.3	0.2	0.3
Furnishings, household equipment and routine maintenance	60.4	0.2	0.7	1.0	-0.5	-0.2	-1.1
Health	35.6	1.3	0.3	0.3	0.5	0.4	0.4
Transport	85.2	0.6	3.3	1.5	-1.7	-12	-12.0
Communication	35.9	-2	-0.2	-0.2	-0.3	-0.2	-0.3
Recreation and culture	30.3	0.5	1	2	1.6	0.7	1.0
Education	10.6	-0.3	0.2	0.2	0.2	0.2	0.2
Restaurants and hotels	57.7	-0.2	1	1.1	1.3	1.3	1.3
Miscellaneous goods and services	47.6	-0.1	0.9	1.6	2.6	2.7	2.8
<i>of which: Financial services, n.e.c.</i>	<i>1.1</i>	<i>-2.9</i>	<i>30.2</i>	<i>31.7</i>	<i>31.7</i>	<i>31.7</i>	<i>31.7</i>

As opposed to food prices among the main trading partners (food prices abroad), the domestic prices of food did not experience strong upward trend considering the pandemic (Figure 15).

<sup>2</sup> <https://alsat-m.tv/mk/според-ујп-во-април-плата-не-земале-без/>

Figure 15. Domestic prices of food vs. Food prices in main trading partners (2005-2020)



Source: National Bank (April 2020).

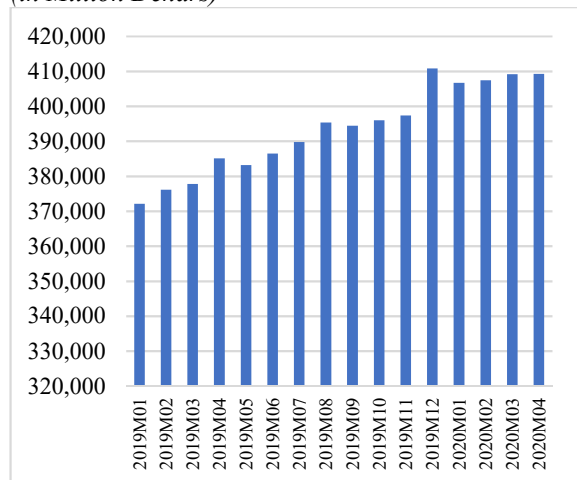
## Financial Sector

**The financial sector is resilient to the crisis. Most banks – especially the systemically important ones - have high capital adequacy ratios and high liquidity to weather the crisis.**

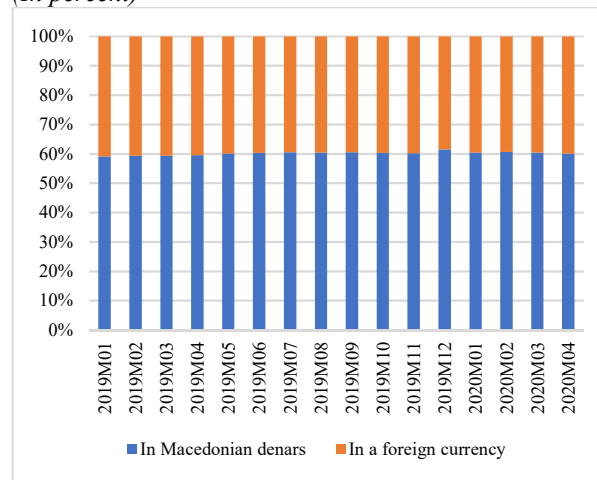
**Deposits continue to rise.** The total amount of outstanding deposits in the financial system at end April 2020 was 409.3 Billion denars, which is 6.3% higher than in April 2019 (Figure 14 – Panel A). The increase in large part reflects higher deposits of households, accompanied by a fall in deposits of the enterprise sector and other sectors. The total deposits at end-April 2020 also increased by 0.4% compared to end-February 2020. There is no notable shift in preferences for foreign currency deposits due to the pandemic crisis (Figure 14 – Panel B).

Figure 16. Total deposits and their currency composition (Jan 2019-Apr 2020)

Panel A. Total amount of deposits  
(in Million Denars)



Panel B. Currency composition of deposits  
(In percent)

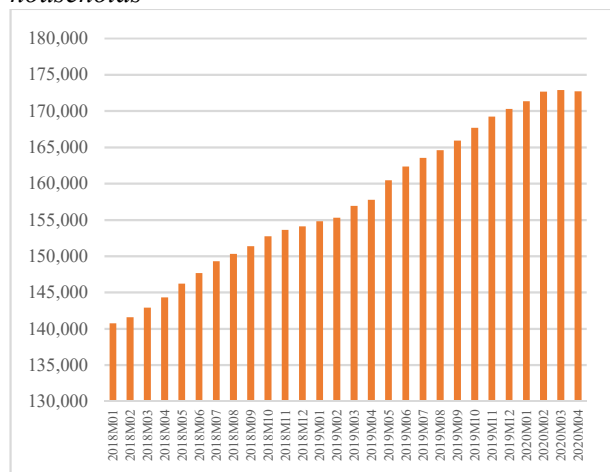


Source: Based on data from the National Bank (May 2020).

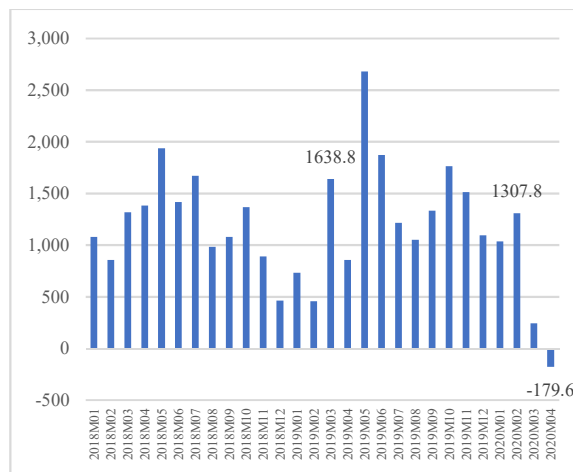
**Credit activity to households is decelerating.** At end-April 2020, the outstanding amount of loans to households from the entire financial sector were at 172.7 Billion denars, or 9.5% higher than in April 2019 (Figure 15 - Panel A). However, the credit activity is decelerating. The total amount of new loans approved only in April 2020 to households was -179.6 Million denars, implying a net repayment of bank loans by the household sector. This is in sharp contrast with new loans approved in February 2020 (1.3 Billion denars).

Figure 17. Consumer loans as of April 2020 (in Million Denars)

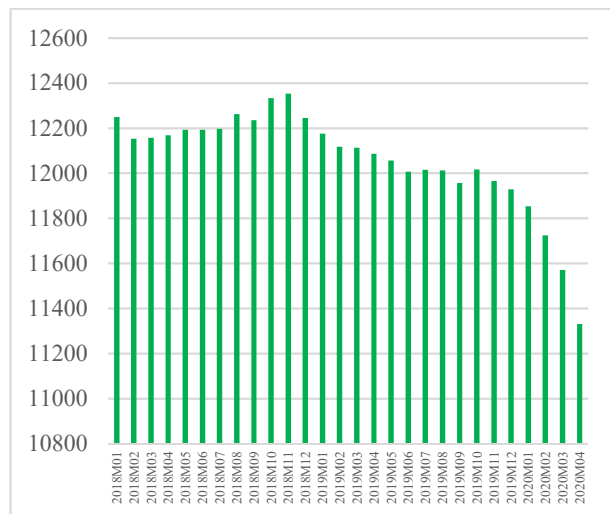
Panel A. Total outstanding amount of loans to households



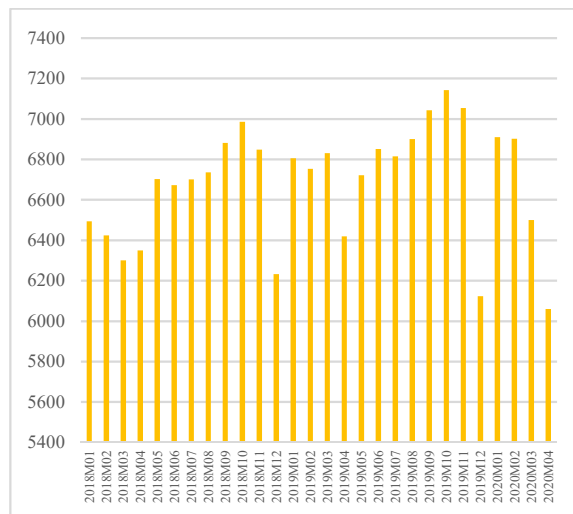
Panel B. New loans to households



Panel C. Outstanding amounts due on credit cards



Panel D. Overdrafts on the transaction accounts



Source: Based on data from the National Bank (June 2020).

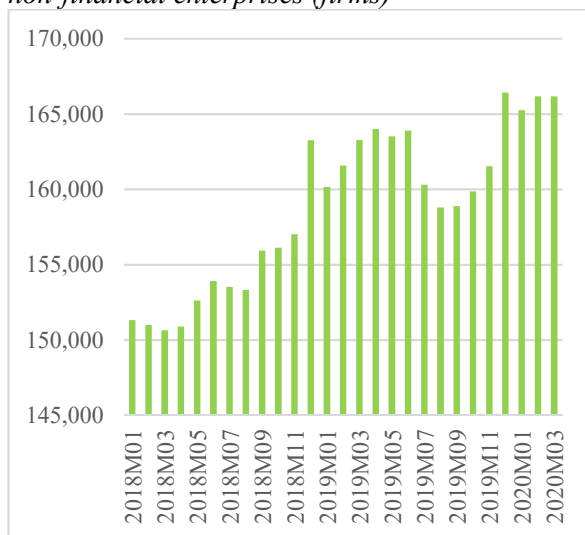
**Precautionary saving is on the rise.** The deceleration of outstanding amounts of consumer loans reflects lower *outstanding amounts due on credit cards* and lower *overdrafts on the transaction accounts*. April 2020 credit card use figures compared to April 2019 are lower by 755.4 Million denars or 6.3% lower. Compared to February 2020, April 2020 figures for the

outstanding amounts due on credit cards are lower by 393.4 Million denars. Moreover, April 2020 figures for the *overdrafts on the transaction accounts* are lower by 841.6 Million denars compared to February 2020. **Both phenomena are a strong indication of the deferral of non-essential consumption and a rise in the precautionary saving.**

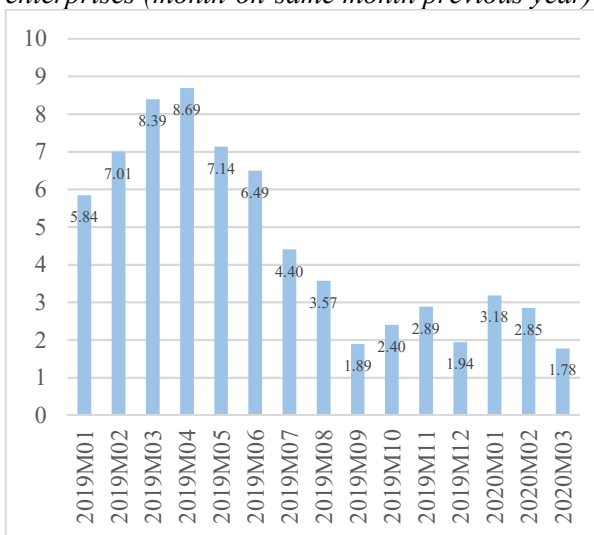
**Loan activity has already plateaued.** Private sector credit in 2020 is forecasted to grow only by 0.5% compared to 2019. Banks and other financial institutions prefer to maintain higher buffers to sustain a potential wave of non-performing loans by firms and households.

Figure 18. Loans to the corporate sector as of March 2020 (in Million Denars)

*Panel A. Outstanding amounts of loans to private non-financial enterprises (firms)*

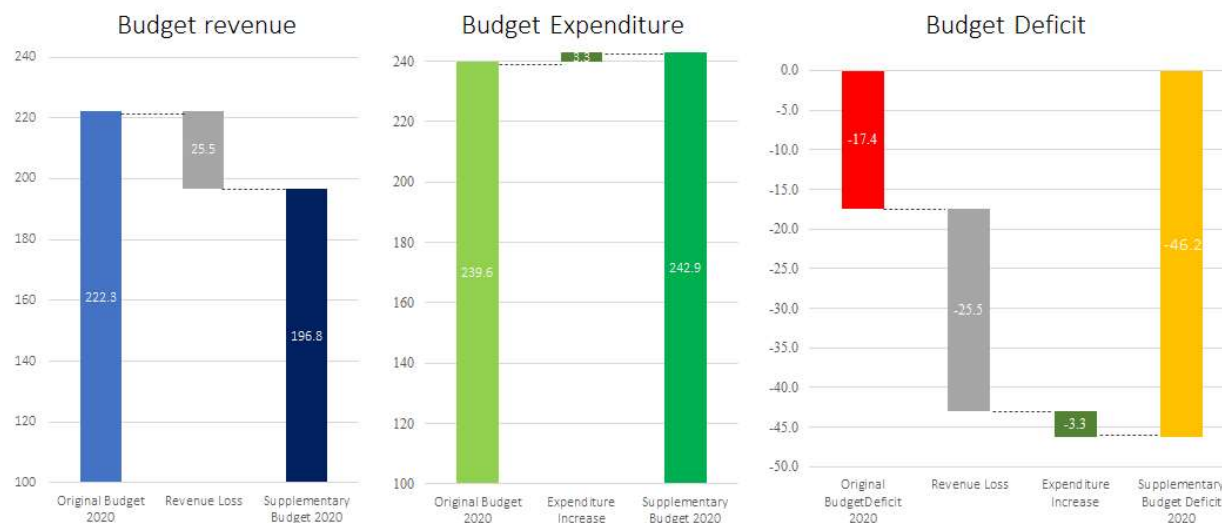


*Panel B. Year-on-year growth of credit to private enterprises (month-on-same month previous year)*



Source: Based on data from the National Bank (June 2020).

## Public Finance



### Budget revenue

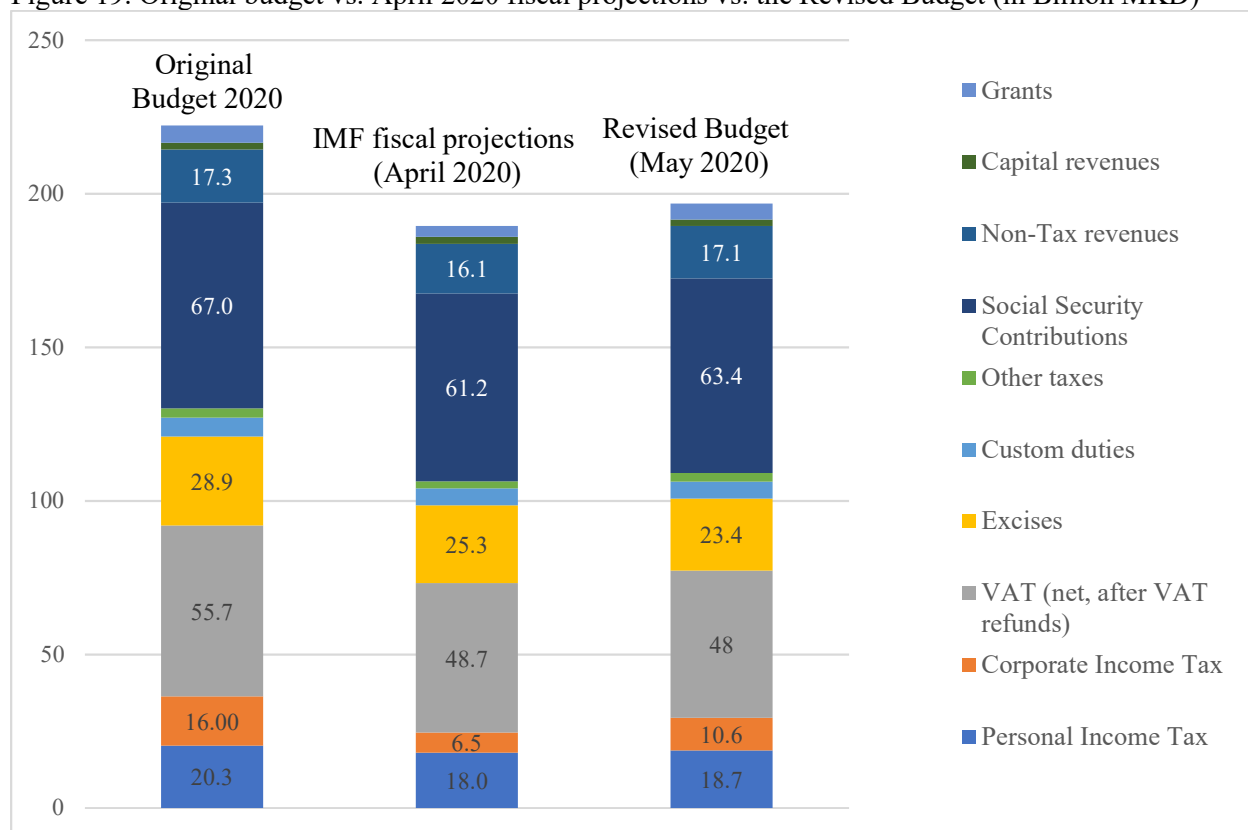
Sizeable revenue shortfalls relative to budgeted amounts are expected in the Revised Budget (Budget Supplement) for 2020. Compared to the already enacted original budget for 2020, general government revenue is now expected to shrink by 25.5 Billion Denars (equivalent to 414.6 Million EUR), which is a reduction of 11.5% in 2020 (Table 7). In absolute terms, the largest revenue shortfall is expected in VAT (net of refunds) revenue (-7.7 Billion Denars), revenue from excises (-5.5 Billion Denars), and revenues from corporate income tax (-5.4 Billion Denars). In relative terms, the corporate income tax revenue is likely to fall by staggering 33.8%, indicating a stark deterioration of profitability (Table 7).

Table 4. Consolidated central government revenue (in Billions of Denars)

	2019	2020				
		Original Budget (December 2019)	IMF's April 2020 projections	Revised Budget (adopted in May 2020)	Revenue shortfall	
					Change (in Billions of Denars)	Change (in percent)
	[1]	[2]	[3]	[4]	[5]=[4]-[2]	[6]=[4]/[2]
<b>TOTAL REVENUE</b>	<b>203.9</b>	<b>222.3</b>	<b>189.5</b>	<b>196.8</b>	<b>-25.5</b>	<b>-11.5</b>
<b>Tax revenue and contributions</b>	<b>178.9</b>	<b>197.2</b>	<b>167.4</b>	<b>172.4</b>	<b>-24.8</b>	<b>-12.6</b>
Personal Income Tax	18.7	20.3	18.0	18.7	-1.6	-7.9
Corporate Income Tax	11.6	16	6.5	10.6	-5.4	-33.8
VAT (net)	52.1	55.7	48.7	48.0	-7.7	-13.8
Excises	26.1	28.9	25.3	23.4	-5.5	-19.0
Custom duties	6	6.2	5.5	5.5	-0.7	-11.3
Other taxes	2.3	3	2.3	2.8	-0.2	-6.7
Social Security Contributions	62.2	67	61.2	63.4	-3.6	-5.4
Pension and disability insurance	41.9	45.4	41.5			
Unemployment insurance	2.6	2.8	2.6			
Health insurance	17.6	18.9	17.2			
<b>Non-Tax revenues</b>	<b>18.8</b>	<b>17.3</b>	<b>16.1</b>	<b>17.1</b>	<b>-0.2</b>	<b>-1.2</b>
<b>Capital revenues</b>	<b>2.4</b>	<b>2.2</b>	<b>2.3</b>	<b>2.1</b>	<b>-0.1</b>	<b>-4.5</b>
<b>Grants</b>	<b>3.9</b>	<b>5.6</b>	<b>3.6</b>	<b>5.2</b>	<b>-0.4</b>	<b>-7.1</b>

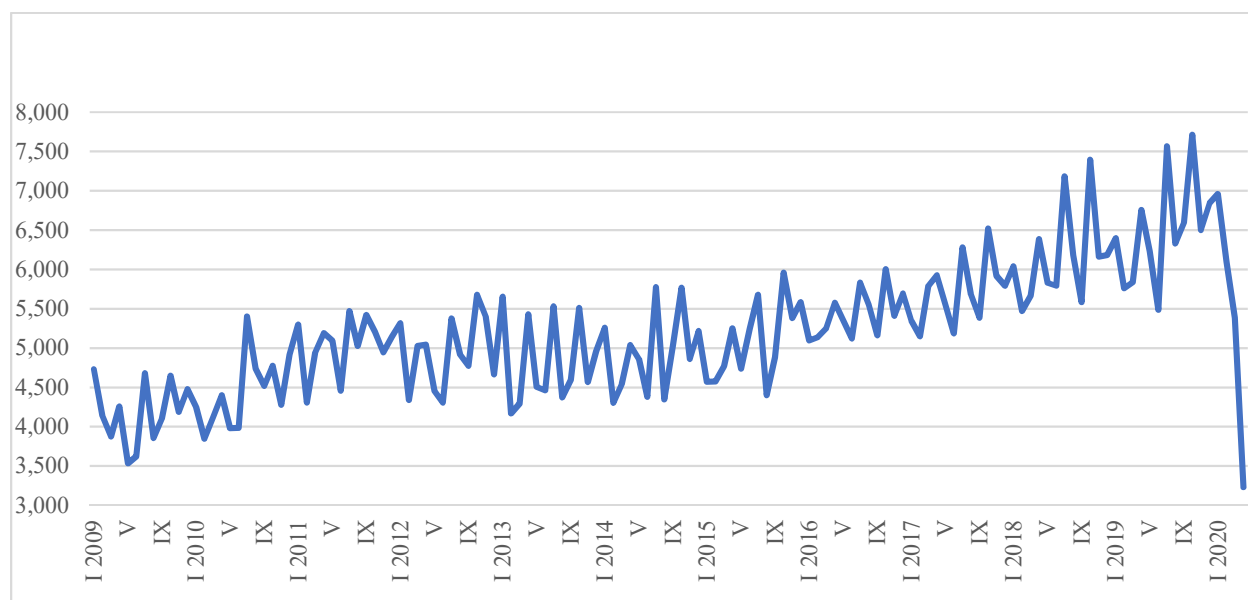
Notes: [1] Local government revenue is not included. [2] Consolidated central government comprises of the central government budget and the extra-budgetary funds (pension and disability insurance, health insurance, and unemployment insurance). Source: IMF (2020) and Ministry of Finance (2020).

Figure 19. Original budget vs. April 2020 fiscal projections vs. the Revised Budget (in Billion MKD)



Source: Based on IMF (2020).

Figure 20. The Great Lockdown and the VAT revenue (gross) in North Macedonia (2009-2020)



Source: Ministry of Finance (May 2020).



We focus on one category of revenue that would significantly affect the local government budgets: the value added tax (VAT).

*The general VAT grant.* Based on the Law on Financing Local Self-Governments and the Degree on the methodology of distribution of revenues from the value added tax across municipalities in 2020,<sup>3</sup> a general VAT grant is allocated to all municipalities. The total amount of this inter-governmental fiscal transfer from the central to the local government is based on a prescribed percentage of the past year's VAT revenue (net) collection by the central budget. Assuming no legislative changes, the general VAT grant to municipal budgets will not be affected by the ongoing crisis in 2020. They will be entitled to 2.34 Billion Denars in 2020, which would be an important monetary relief for their budget. However, the general VAT grant in 2021 will be severely affected by the ongoing recession, as it will be calculated on the realization of VAT (net) revenue in 2020. As presented in Table 5, municipalities in North Macedonia in 2021 would be entitled to 2.16 Billion Denars. The Revised Budget (Budget Supplement) for 2020 suggests a reduction of the general VAT grant by 183 Million Denars [=2160-2343] in 2021 compared to 2020, or by 7.8%.

Table 5. Actual and expected VAT grant for local governments (In million Denars, 2015-2021)

Year	VAT (net revenue)	Percent of last year's VAT revenue (in percent)	Inter-governmental fiscal transfer (VAT grant) to local governments	
			Current situation	Team Proposal
2015	41,694	4.0	1,733	
2016	45,949	4.5	1,876	
2017	47,870	4.5	2,067	
2018	49,254	4.5	2,154	
2019 p	52,059	4.5	2,211	
2020 r	48,000	4.5	2,343	
2021 f	56,100	4.5	2,160	2,240

Note: p stands for preliminary, r for the Revised Budget 2020 (Budget Supplement) and f stands for forecast.

To cushion such adverse fiscal shocks for the already fragile local government budgets, the team proposes a change in the Law on Financing of Local Self-Governments. **The general VAT grant might be calculated as a percentage of the average for the past three years.** Revenue calculated by the revised formula will be less prone to cyclical factors and will provide a more stable source of financing for the LGs in North Macedonia. The revised formula would secure 2,240 Million denars for the general VAT grant in 2021. Increasing the percentage (presently, 4.5%) would also foster fiscal decentralization, although the team believes it should be made conditional on the progress in own-source revenue collection.

#### *Budget expenditure*

The largest cuts in budget expenditure is observed in capital expenditure. Government investment is projected to fall by 46.6% in one year so that part of the budgetary savings is allocated to transfers (current expenditure). **The team proposes more significant cuts in non-**

<sup>3</sup> Degree on the methodology of distribution of revenues from the value added tax across municipalities in 2020 (Official Gazette 132/2019 from June 28<sup>th</sup> 2019), <https://dejure.mk/zakon/uredba-za-metodologija-za-raspredelba-na-prihodite-od-danokot-na-dodadena-vrednost-po-opshtini-za-2020-godina> (In Macedonian only).

**priority current expenditure (travel costs, goods and services, contractual services) to provide room for subsequent economic stimulus packages and as a safeguard against reduction of public sector wages. It will also create a fiscal space for a strong government response to potential second pandemic wave.**

Table 6. Composition of government expenditure in 2020 (In Billion MKD)

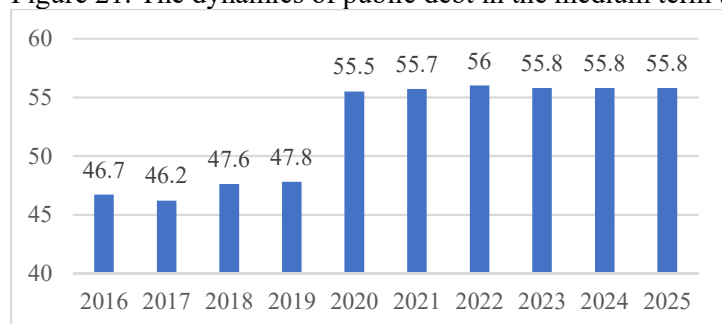
Expenditure category	Original Budget 2020	IMF's April 2020 fiscal projections	Revised Budget 2020 (May 2020)	Change (in Billion MKD)	Change (in percent)
	[1]	[2]	[3]	[4]=[3]-[1]	[5]=[3]/[4]
<b>Current expenditure</b>	<b>215.9</b>	<b>221.5</b>	<b>223.4</b>	<b>7.5</b>	<b>3.5</b>
Wages and allowances	30.6	28.8	30.2	-0.4	-1.4
Goods and services	20.6	17.5	18.8	-1.8	-8.6
Transfers	156.5	166.8	166.1	9.6	6.2
Transfers to Local Governments	21.4	n/a	21.3	-0.1	-0.4
Subsidies and transfers	19.0	n/a	27.9	8.9	46.6
Social transfers	116.0	n/a	116.9	0.9	0.7
Interest payments	8.3	8.4	8.3	0.0	0.0
<b>Capital expenditure</b>	<b>23.8</b>	<b>12.7</b>	<b>19.5</b>	<b>-4.3</b>	<b>-18.0</b>
<b>Total government expenditure</b>	<b>239.7</b>	<b>234.2</b>	<b>242.9</b>	<b>3.2</b>	<b>1.3</b>

Source: IMF (2020) and Ministry of Finance (2020).

**Budget deficit.** The pandemic is likely to lead to increases in debt and deficits beyond those recorded in the Global Financial Crisis. The projected fall on the revenue side and the limited response on the expenditure side would result in a consolidated central government budget deficit of 6.5% of GDP in 2020.

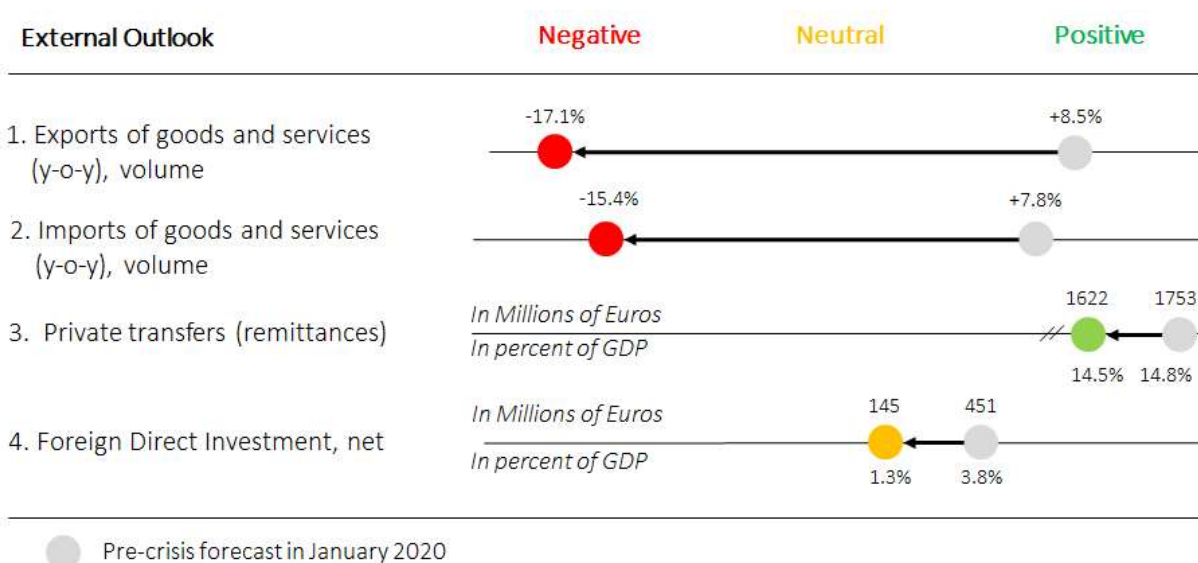
**Public debt.** The public and publicly guaranteed debt (percent of GDP) is expected to jump from 47.8% of GDP in 2019 to 55.5% of GDP in 2020. New borrowing requirements to mitigate the revenue shortfall will be financed by a combination of domestic borrowing (T-Bills and T-Bonds) and external sources (a Eurobond issuance on the international capital market). After reaching the all-time high in 2022 of 56% of GDP, the level of public debt as a share of GDP will stabilize. The team assesses that maintaining a level of public debt below 70% of GDP would be a medium risk for the public finance sustainability.

Figure 21. The dynamics of public debt in the medium term (in percent of GDP)



Source: IMF (2020).

## External Sector



### Trade flows.

Exports of goods and services in 2020 is projected to decline. The main crisis impact is expected in the automotive components industry, as the European automotive industry stopped or reduced production. According to IMF (April 2020), exports will decrease in value (-9.8%) and in volume (-5.5%) in 2020 (Figure 19). Then a strong recovery of 13.5% is expected in 2021. However, a more recent forecast by the National Bank reveals a more dramatic fall of exports in 2020 (-17.1% in real terms) and an extraordinarily strong recovery in 2021 (25%).

Figure 22. Volume of exports of goods and services (in percent), 2019-2021

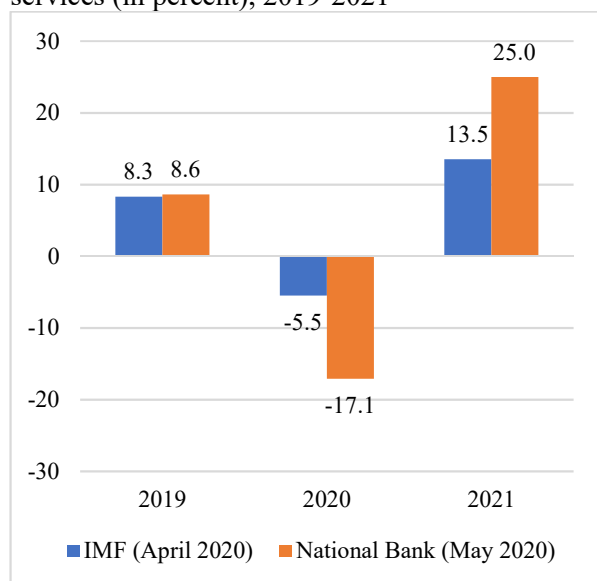
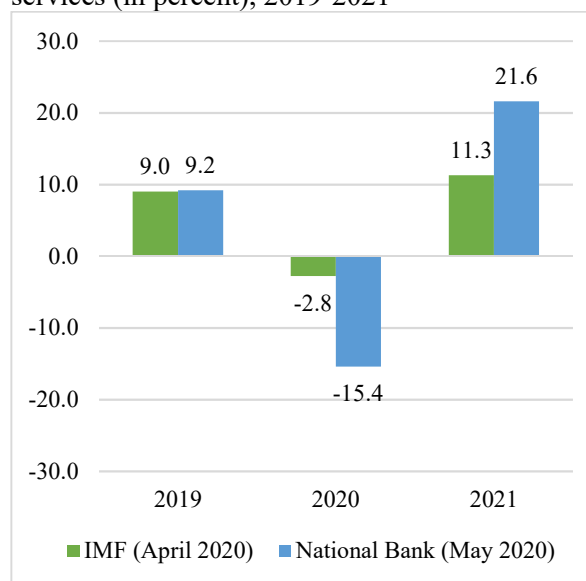


Figure 23. Volume of imports of goods and services (in percent), 2019-2021



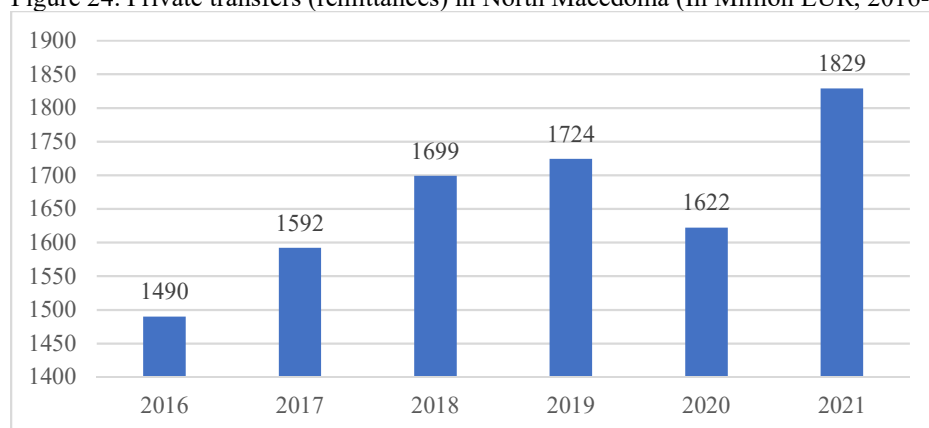
Source: IMF (2020) and National Bank (2020).

IMF (2020) predicts that imports of goods and services will decrease in value (-9.2%) and in volume (-2.8%) in 2020 and then rebound in 2021 by 11.3%. Again, a more recent forecast in May 2020 by the central bank suggests a decline of imports in real terms by 15.4% and rapid recovery in 2021 by 21.6% in real terms. The freefall of imports of goods and services, in fact, will contribute to a less dramatic reduction of the real GDP growth in 2020.

These forecasts underline the need for government support to the export-oriented sector in 2020 to cushion the significant impact on value creation and jobs.

**Remittances are expected to drop by nearly 6%.** Global remittances are projected to decline sharply by about 20 percent in 2020 due to the economic crisis (World Bank, 2020).<sup>4</sup> This would be the sharpest decline in recent world history. In North Macedonia too, remittances and foreign exchange cash exchanges are expected to fall as migrants' income abroad shrink (IMF, 2020). Annual inflows of private transfers are expected to fall by 102 Million € in 2020 (Figure 24). This will affect disposable incomes of recipient households and put an upward pressure on the poverty rate. On the positive side, private transfers are expected to rebound strongly from 2021 onwards.

Figure 24. Private transfers (remittances) in North Macedonia (In Million EUR, 2016-2021)



Source: Based on data from IMF (2020).

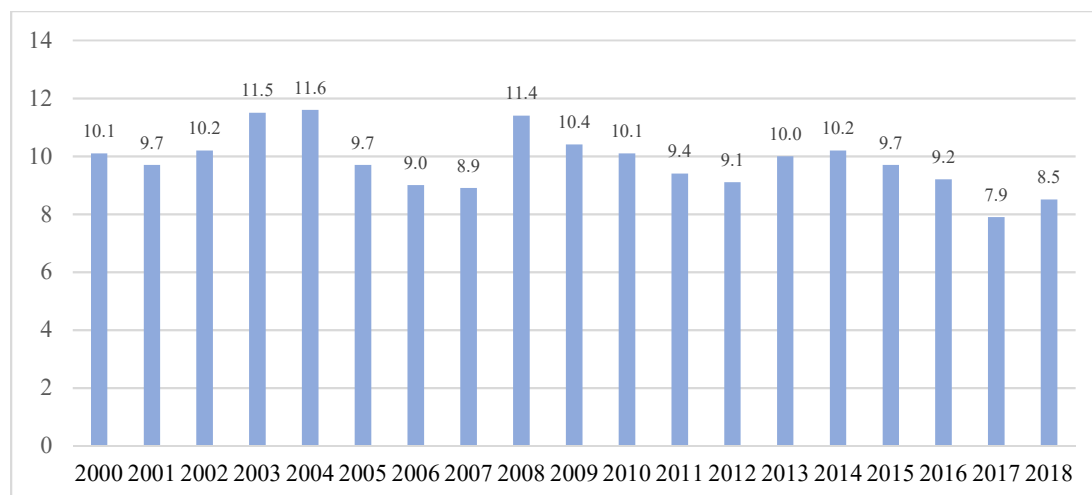
### 3.1.2. Sectorial Outlook

#### Agriculture

**Importance.** With an average share of 9.8% in the formation of GDP, agriculture is especially important sector in the Macedonian economy.

Figure 25. Share of agriculture in GDP (in percent, 2000-18)

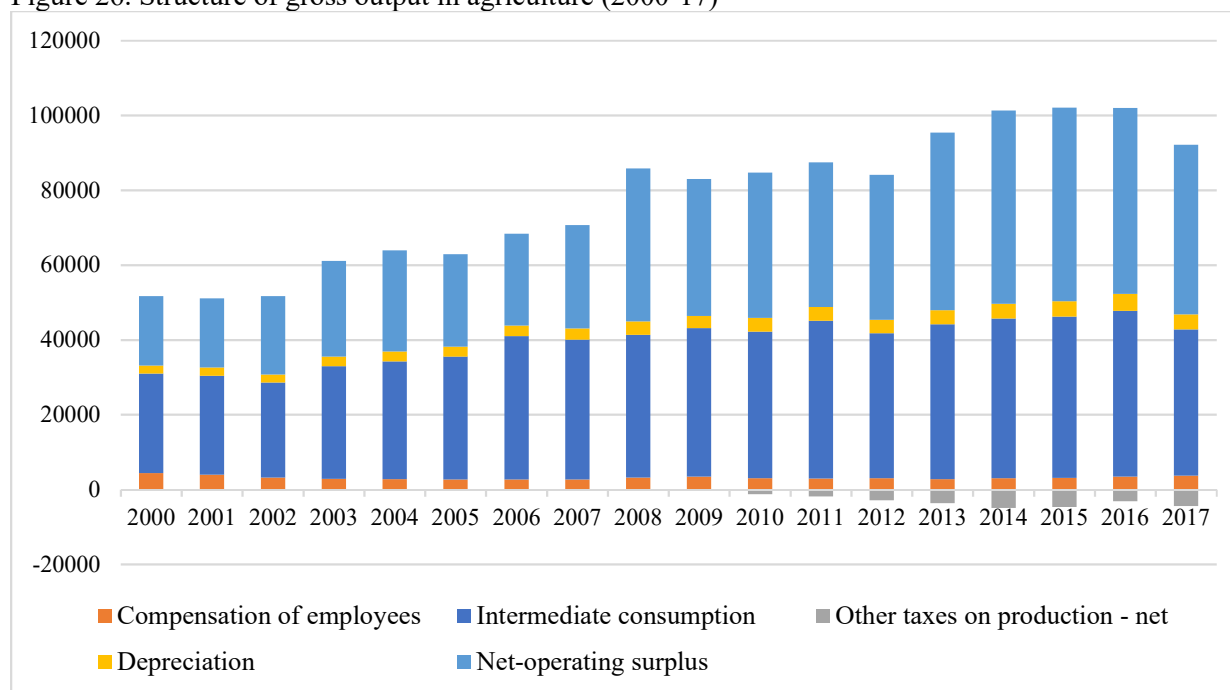
<sup>4</sup> [https://www.worldbank.org/en/news/press-release/2020/04/22/world-bank-predicts-sharpest-decline-of-remittances-in-recent-history?cid=ECR\\_E\\_NewsletterWeekly\\_EN\\_EXT&deliveryName=DM61330](https://www.worldbank.org/en/news/press-release/2020/04/22/world-bank-predicts-sharpest-decline-of-remittances-in-recent-history?cid=ECR_E_NewsletterWeekly_EN_EXT&deliveryName=DM61330)



Source: State Statistical Office, May 2020.

**Profitability.** Agriculture in North Macedonia is a very profitable business with a net operating surplus reaching 51.7% of the total gross output. Put differently, out of 1,000 Denars revenue earned, 517 Denars are profit. In contrast, the compensation for employees in agriculture (the total wage bill) in 2017 was only 4.2% of the total gross output. Out of 1,000 Denars revenue earned, only 42 Denars will be compensation of employees.

Figure 26. Structure of gross output in agriculture (2000-17)



Such massive profits call for major overhaul of the system of agricultural subsidies, which is very generous and ill-targeted.

Table 7. Number of employees in agriculture

Economic activity	2015	2016	2017	2018
<b>TOTAL</b>	<b>519031</b>	<b>534200</b>	<b>548681</b>	<b>567230</b>
<b>A AGRICULTURE, FORESTRY AND FISHING</b>	<b>11133</b>	<b>11665</b>	<b>11725</b>	<b>13287</b>
01 Crop and animal production, hunting and related service activities	8237	8609	8825	10307
02 Forestry and logging	2624	2728	2581	2711
03 Fishing and aquaculture	272	328	319	269

Source: Statistical yearbook (2019).

The total number of employees in agriculture in Q4 2019 down by 8.6% compared to Q4 2018 and down by 13.2% compared to Q4 2017.

Figure 27. Number and structure of employees in agriculture, Q1 2016 - Q4 2019

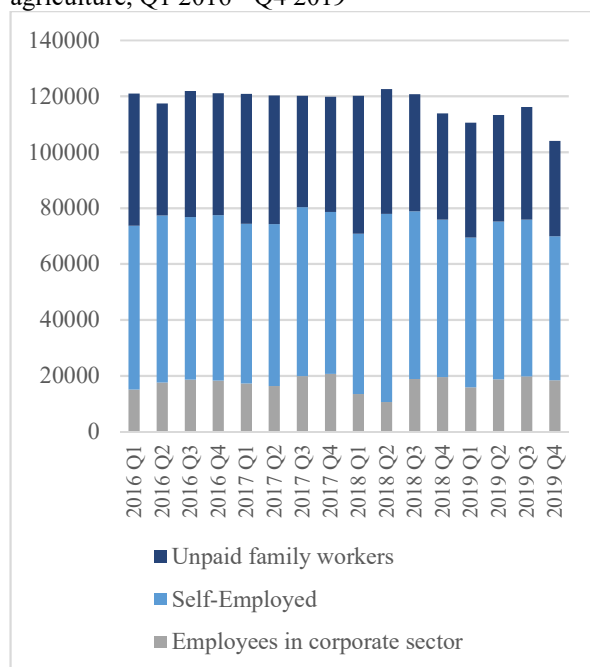
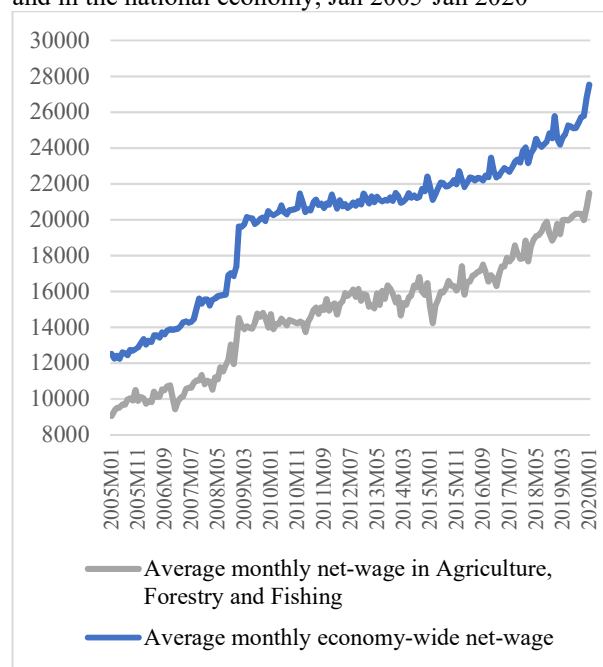


Figure 28. Average monthly net-wages in agriculture and in the national economy, Jan 2005-Jan 2020



The purchase and sale of agricultural products in the first quarter of 2020 was 4.3 Billion denars (€ 69.8 Million) and compared to Q1 2019 decreased by 2.9% (Table 11). It mainly reflects the drop in crop production by 4.5% and livestock production by 8.9%.

Table 8. Purchase and sale of agricultural products (In Million €), I-III 2020

	2019	I-III 2019	I-III 2020	I-III 2020 ----- I-III 2019
<b>Total</b>	320.23	71.88	69.77	<b>97.1</b>
<b>Crop production</b>	162.08	42.20	40.32	<b>95.5</b>
Cereals	22.33	3.06	2.66	<b>86.9</b>
Industrial crops	109.05	36.49	35.26	<b>96.6</b>

Vegetables	30.47	2.61	2.37	90.7
Fodder	0.23	0.04	0.03	78.3
<b>Orchards and vineyards</b>	26.67	0.89	0.99	<b>111.2</b>
Fruit	5.69	0.89	0.99	111.3
Grapes	20.97	0.00	0.00	24.1
<b>Alcoholic beverages</b>	33.86	5.87	7.73	<b>131.6</b>
<b>Livestock production</b>	93.11	22.07	20.10	<b>91.1</b>
Livestock	28.04	6.35	5.75	90.5
Poultry and eggs	12.31	3.18	2.59	81.2
Milk	50.89	12.17	11.36	93.4
Dairy products	1.86	0.37	0.40	110.1
<b>Fish</b>	0.76	0.25	0.09	<b>36.5</b>
<b>Other products</b>	3.75	0.60	0.54	<b>89.7</b>

Source: State Statistical Office (May 15<sup>th</sup>, 2020).

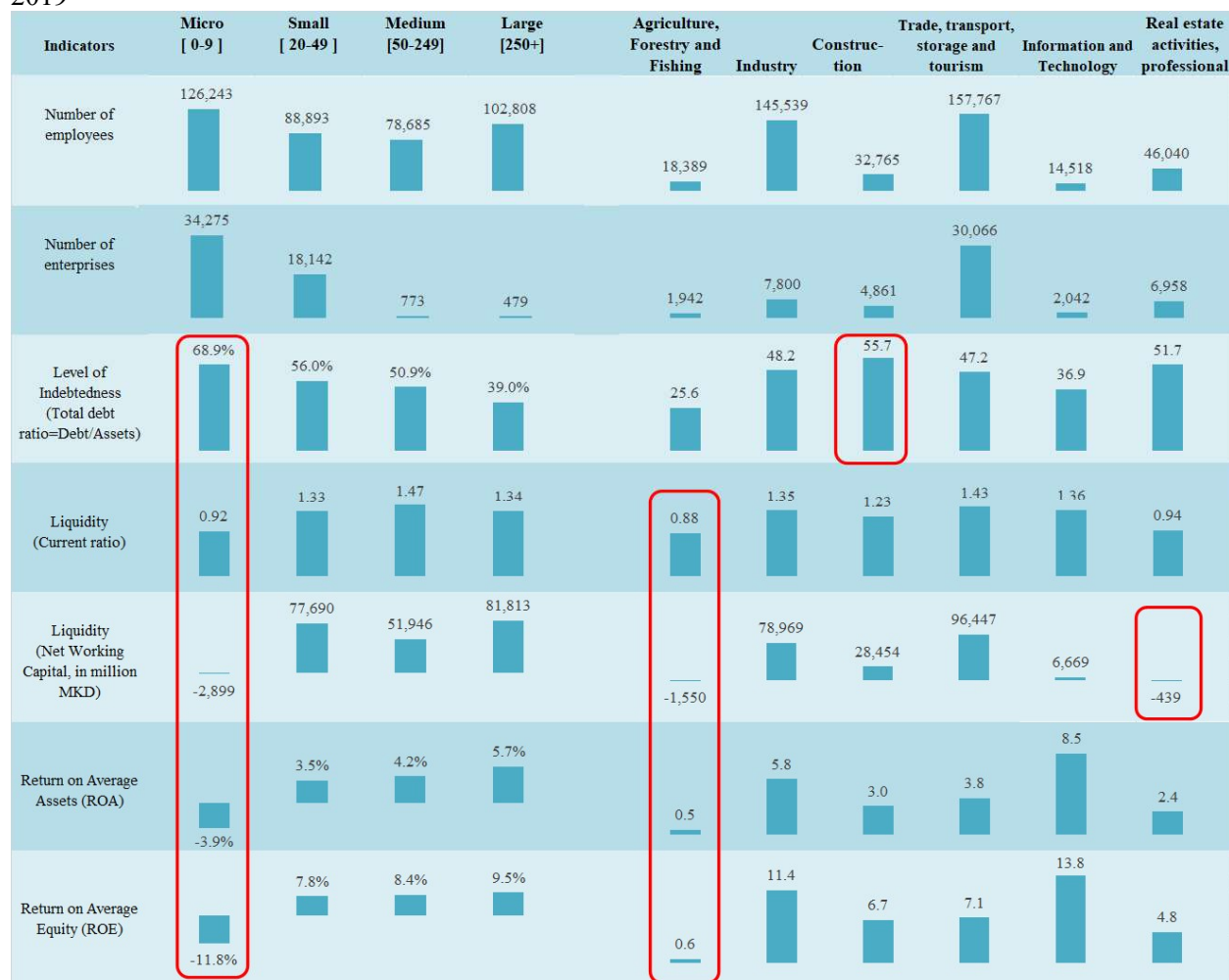
Due to the substantially reduced price of oil and oil derivatives, the prices of inputs in agriculture in April 2020 are lower by 10.2% compared to input prices in April 2019.

**These findings suggest that the COVID19 pandemic impact on agriculture is mild and lessened by the reduced prices of inputs, mainly of *energy, fuels, and lubricants* (-27.8%).**

## Industry

Micro entities (0-9 employees) were very financially weak and vulnerable even before the pandemic outbreak. They were heavily burdened with loans (68.9% of total assets), simultaneously struggling with low liquidity (including negative working capital) and recording losses (equivalent to 11.8% of their capital). The team forecasts that this will be the hardest-hit category (size) of businesses, employing 126,243 persons. A carefully designed government subsidies program for micro enterprises should aim to cushion significant job losses.

Figure 29. Performance by size and economic activity of enterprises (non-financial sector only), Jan 1<sup>st</sup>, 2019



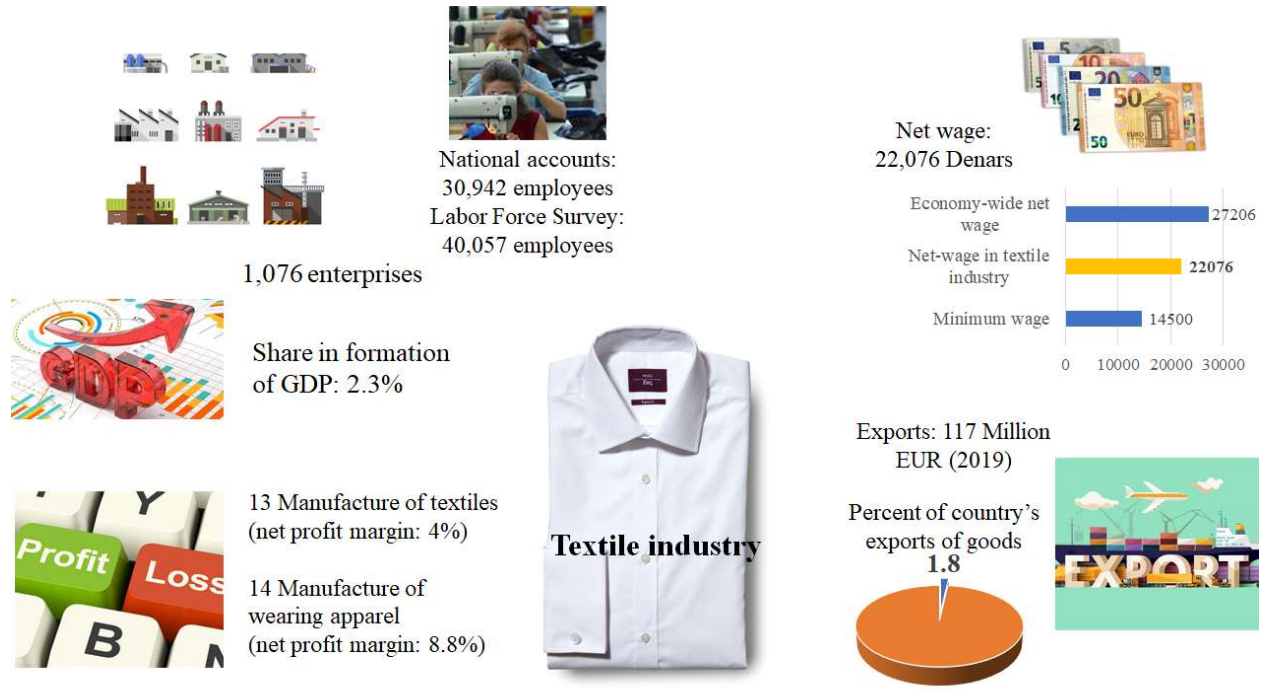
Note: The number of employees in agriculture, forestry and fishing does not include individual (self-employed) producers. Source: Authors' design based on data from the National Bank and the State Statistical Office, April 2020.

### Textile Industry

From a broader perspective, the textile industry consists of *Manufacture of textiles (NACE Code 13)* and *Manufacture of wearing apparel (NACE Code 14)*. These two industrial branches display divergent patterns and trends, justifying a separate investigation. The time horizon of the analysis is 20 years to uncover long-term trends.

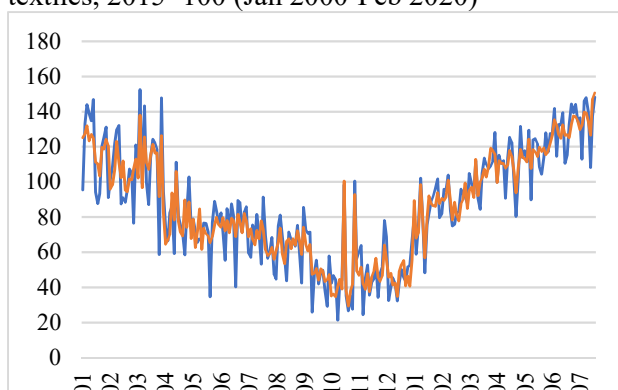
Figure 30. The ID card of the textile industry in North Macedonia





*Manufacture of Textile*

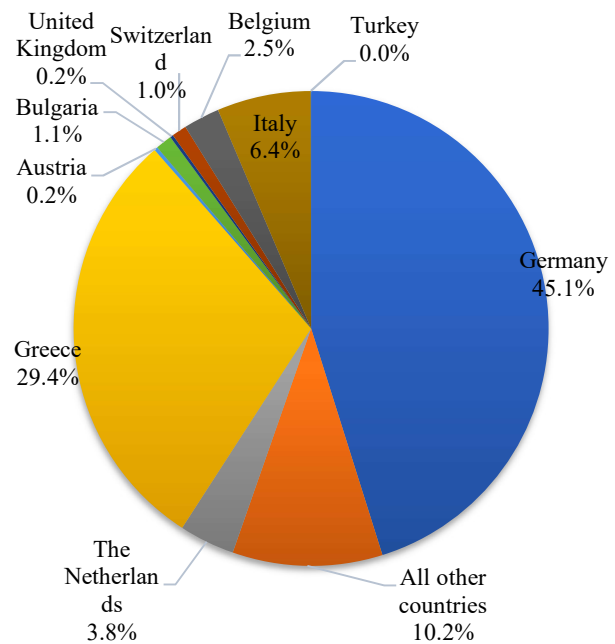
Figure 31. Production volume in manufacture of textiles, 2015=100 (Jan 2000-Feb 2020)



**Production.** After reaching the bottom in 2010, the production volume of manufacture of textile has made a surprising turning point and rebounded strongly. Presently, it is close to an all-time high in the last two decades (Figure 31).

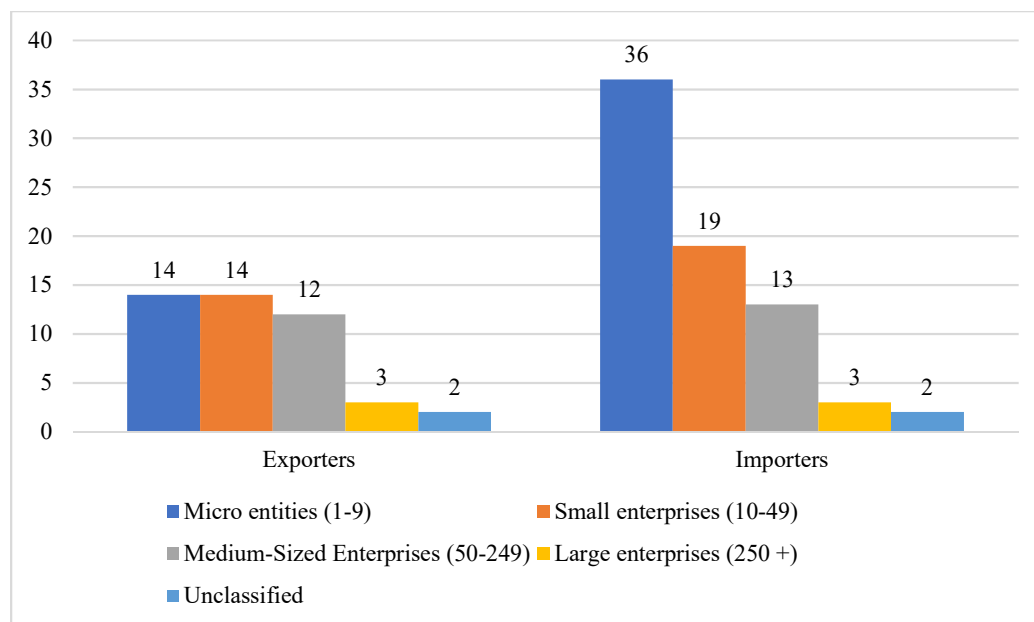
**Sales.** Main revenue from the textile industry primarily comes from the foreign markets (Figure 21). Until the pandemic outbreak, sales was very strong. Only a small portion of the production is allocated to the domestic market. In 2019, the largest demand for textile came from Germany (45.1%), Greece (29.4%) and Italy (6.4%) (Figure 22).

Figure 33. Geographical destination of exports of textile in 2019 (in percent)



**Foreign trade.** The manufacture of textile consists of 45 exporters and 73 importing enterprises. If assessed only by their size, micro entities (1-9 employees) and small enterprises (10-49) dominate the business landscape (Figure 34).

Figure 34. Number of exporters and importers of textile by their size



Source: State Statistical Office (April 2020).

**Employment.** The textile industry as a labor-intensive industry is a large employer. At the end of February 2020, manufacture of textile employed nearly 6,000 workers, whereas the entire textile industry engaged 30,942 workers.

Employees by divisions of activity		2015	2016	2017	2018	2019	Jan 2020	Feb 2020	Mar 2020
13	Manufacture of textiles	5135	5286	6027	7519	6311	6203	6070	5993
14	Manufacture of wearing apparel	31742	30919	30243	28232	26444	25108	25108	24949
<b>Textile industry (National Accounts Data)</b>		<b>36877</b>	<b>36205</b>	<b>36270</b>	<b>35751</b>	<b>32755</b>	<b>31311</b>	<b>31178</b>	<b>30942</b>
<b>Textile industry (Labor Force Survey)</b>			<b>39795</b>	<b>41429</b>	<b>42380</b>	<b>40057</b>			

The number of employees very closely follows the production cycles (Figure 35). However, this is not the case with the net wage. As illustrated in Figure 25, the price competitiveness of domestic firms was maintained by lowering the net wage for the employees. The average net wage in manufacture of textiles at the end of February 2020 was 22,076 Denars, or 14.3% lower than the all-time high net wage at end-2017 (25,758 Denars).

Figure 35. Number of employees in manufacture of textiles, 2015=100 (Jan 2005-Feb 2020)

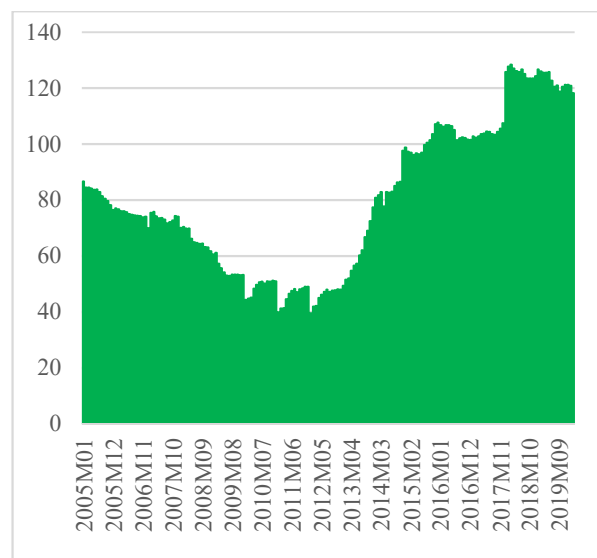
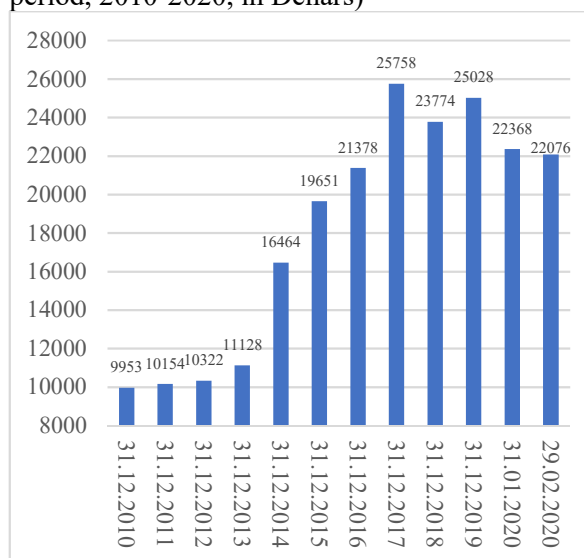
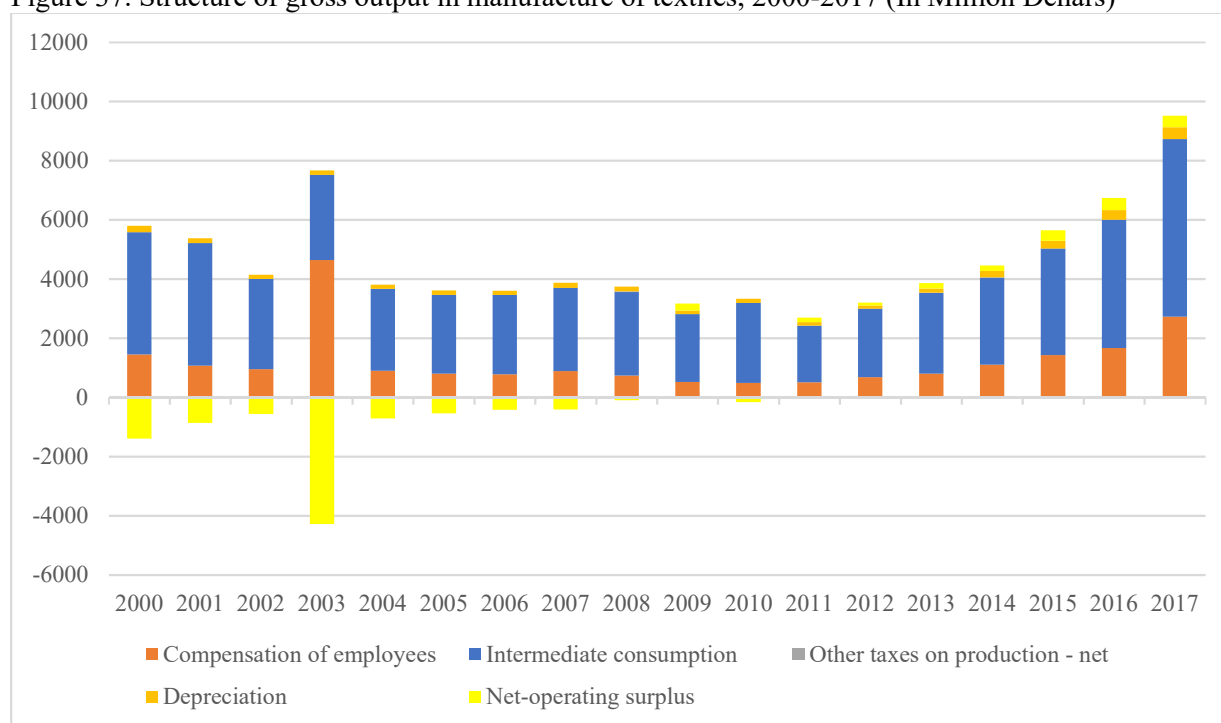


Figure 36. Average monthly net wage paid per employee in manufacture of textiles (end of period, 2010-2020, in Denars)



Source: Authors' calculations based on data from the State Statistical Office (April 2020).

Figure 37. Structure of gross output in manufacture of textiles, 2000-2017 (In Million Denars)



Source: Authors' calculations based on data from the State Statistical Office (April 2020).

### Manufacture of Wearing Apparel

In contrast, the manufacture of wearing apparel is an industry in a structural decline. This “sunset” industry is struggling with difficulties with the fierce international competition and is having more uncertain prospects.

Figure 38. Production volume in manufacture of wearing apparel, 2015=100 (Jan 2000-Feb 2020)

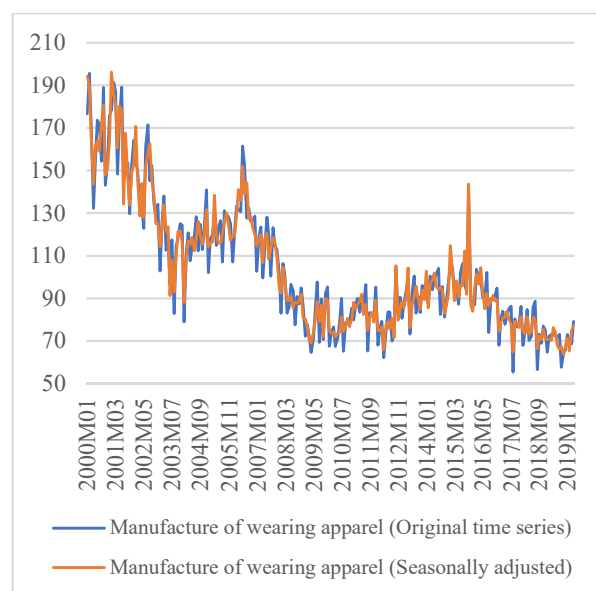
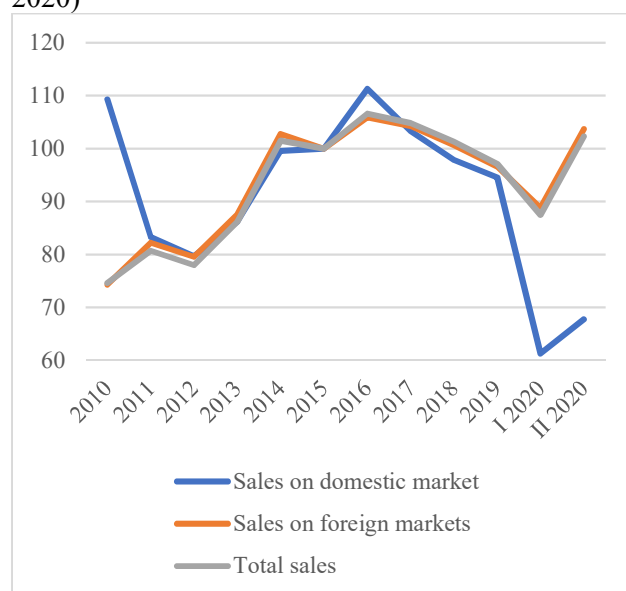


Figure 39. Total sales, sales on domestic and foreign markets of wearing apparel, 2015=100 (2010-Feb 2020)



Source: Source: Authors’ calculations based on data from the State Statistical Office (April 2020).

**Production.** The manufacture of wearing apparel experienced a downward trend in the past two decades. More recently (2019 and 2020), the production volume was stagnating at around 70% of the levels observed in 2015 (Figure 33).

**Sales.** Nearly identical as manufacture of textiles, this sub-industry is primarily serving foreign markets (Figure 28). The sales on the domestic market is exceptionally low and depressed.

This sub-industry is even more heavily dependent on the German economy, which constitutes 61.6% of the external demand in 2019.

Figure 40. Geographical destination of exports of textile in 2019 (in percent)

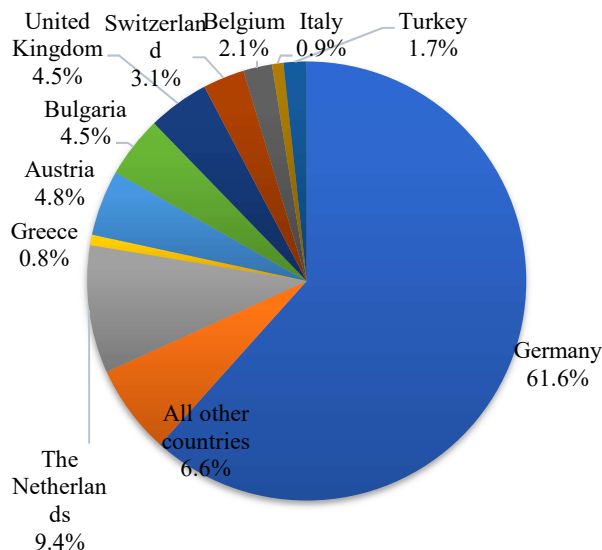
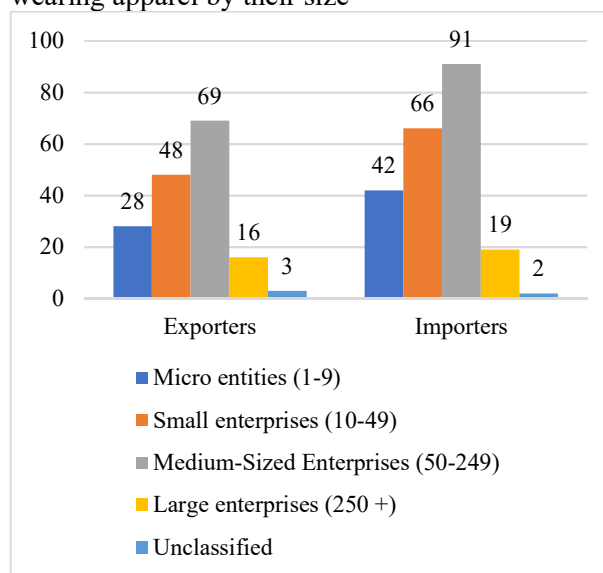


Figure 41. Number of exporters and importers of wearing apparel by their size



Source: Source: Authors' calculations based on data from the State Statistical Office (May 2020).

**Foreign trade.** The manufacture of wearing apparel consists of 164 exporters and 220 importing enterprises. If assessed only by their size, medium-sized enterprises (50-249) dominate the business landscape.

The number of employees has been steadily falling, even before minimum wage was increased.

Figure 42. Number of employees in manufacture of wearing apparel, 2015=100

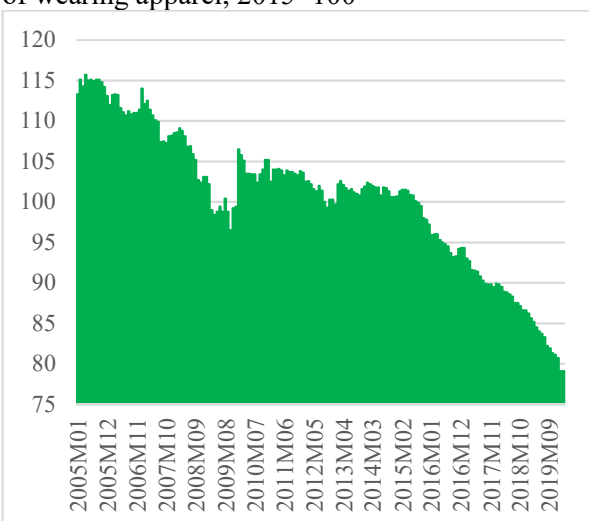
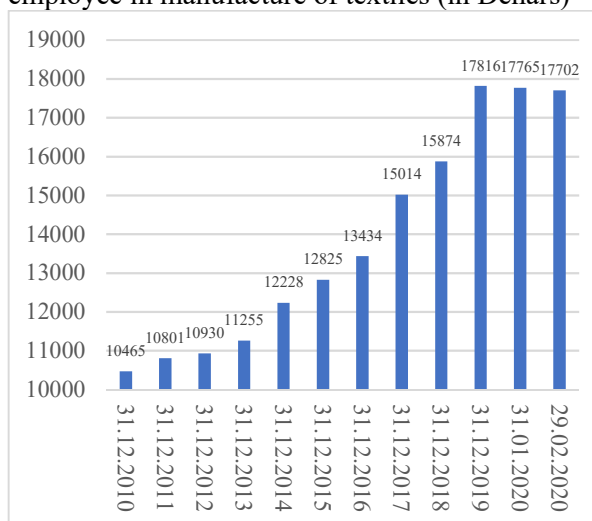


Figure 43. Average monthly net wage paid per employee in manufacture of textiles (in Denars)



Source: Authors' calculations based on data from the State Statistical Office (April 2020).

**Profitability.** Based on the official statistical data, the profitability (net-operating surplus) in this sub-sector is much lower. This is another indicator that the industry is struggling.

Figure 44. Structure of gross output in manufacture of wearing apparel, 2000-2017 (In Million Denars)



Source: Authors' calculations based on data from the State Statistical Office (April 2020).

### General assessment

The production volumes are on a declining path in the first three months of 2020.

Figure 45. Employment and production in manufacture of textiles in 2020

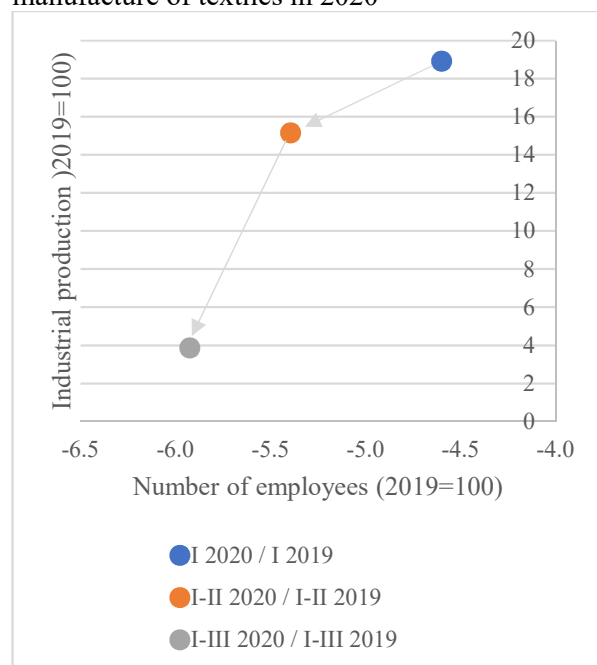
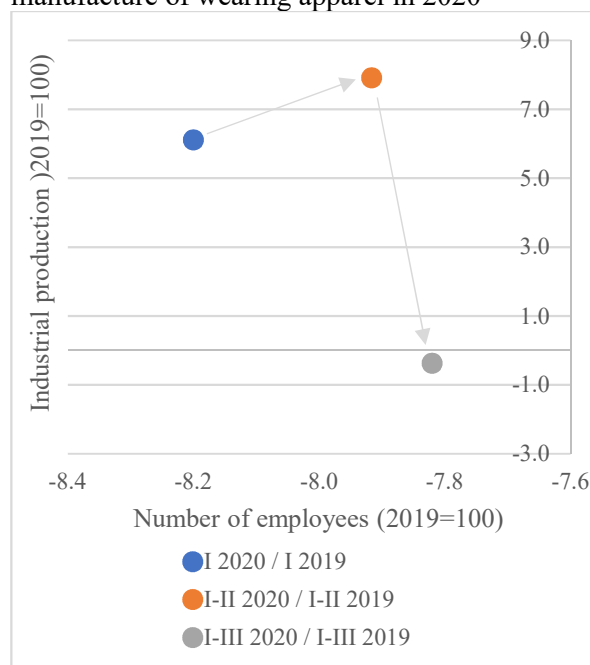


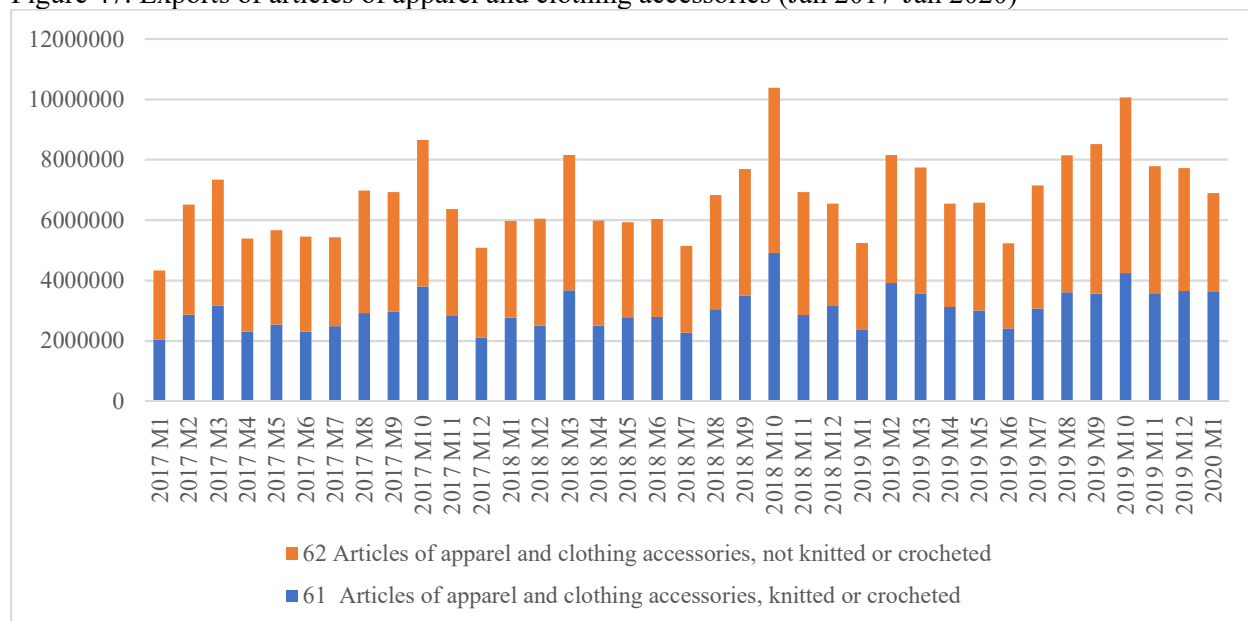
Figure 46. Employment and production in manufacture of wearing apparel in 2020



Source: Authors' calculations based on data from the State Statistical Office (April 2020).

The textile industry exported goods in total value of 117 Million € in 2019, which is 1.8% of country's total exports of goods.

Figure 47. Exports of articles of apparel and clothing accessories (Jan 2017-Jan 2020)



Source: Authors' calculations based on data from the State Statistical Office (April 2020).

The textile industry should diversify its client (buyers') portfolio. Even though Germany is a strong and resilient economy, such a high degree of geographical concentration of textile exports is a sign of vulnerability.

In that sense, the Government measure to finance and promote a digital platform *Marketspace* for global sales of textile products is an important, but not a sufficient step in helping the textile industry. Support for branding strategies, creation of higher value added, and non-price competitiveness should rank high among industry's strategic priorities. Otherwise, the labor force will be absorbed by the faster-growing industries paying higher wages.

### Automotive industry

Bank of America (2020) forecasts a 20% fall in the global demand for automobiles in 2020. After-pandemic market demand may take years to recover to 2019 levels (McKinsey, 2020). The European automotive industry stopped the production affecting around 50 automotive components suppliers from North Macedonia (e.g., Dräxlmaier Group, Kostal, Kromberg and Schubert, Telamon). EU-wide production losses from factory shutdowns amount to 1.23 million vehicles as of April 1<sup>st</sup> 2020, with some 1.11 million workers affected, not including the supply chain.

The car sales among European countries is witnessing a dramatic fall (Italy, Spain and United Kingdom reported a decline of 96-97%, France a decline of 89%, Germany 61% and the production of automobiles registered a collapse of 97% (Viktor Mizo, 2020). These numbers are without a precedent in the modern history. CEOs from the industry (Telamon Corporation and Kostal Macedonia predict an annual decline in the production of the automobile components industry between by 25% and 35%.

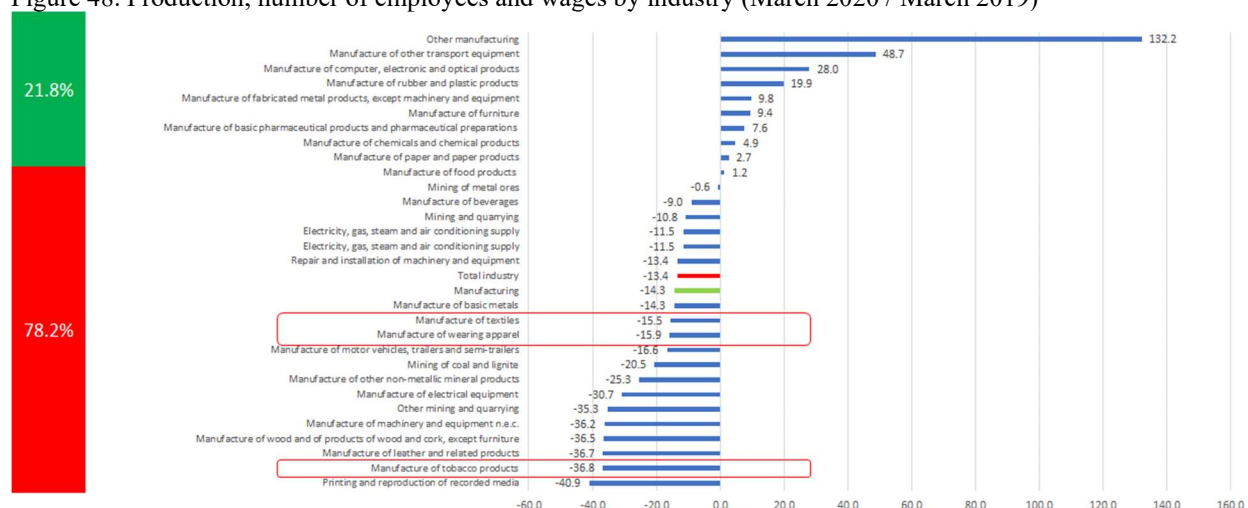
The reduced production volumes and number of orders in this industry will cause the most serious impact on country's exports of goods.



### Other industries

A disaggregated industrial perspective uncovers important developments in March 2020. On average, the industrial production declined by 13.4% compared to March 2019. 78.2% of the industrial production registered a fall. It is important to closely monitor the manufacture of textiles and manufacture of wearing apparel, as these industries employ a lot of workers. They registered a decline of 15.5 and 15.9 respectively in March 2020 compared to the same month in 2019.

Figure 48. Production, number of employees and wages by industry (March 2020 / March 2019)



Source: Authors' design based on data from the State Statistical Office (April 2020).

Figure 49. Another perspective on the same phenomenon (March 2020 Growth vs. Weight of the industry)

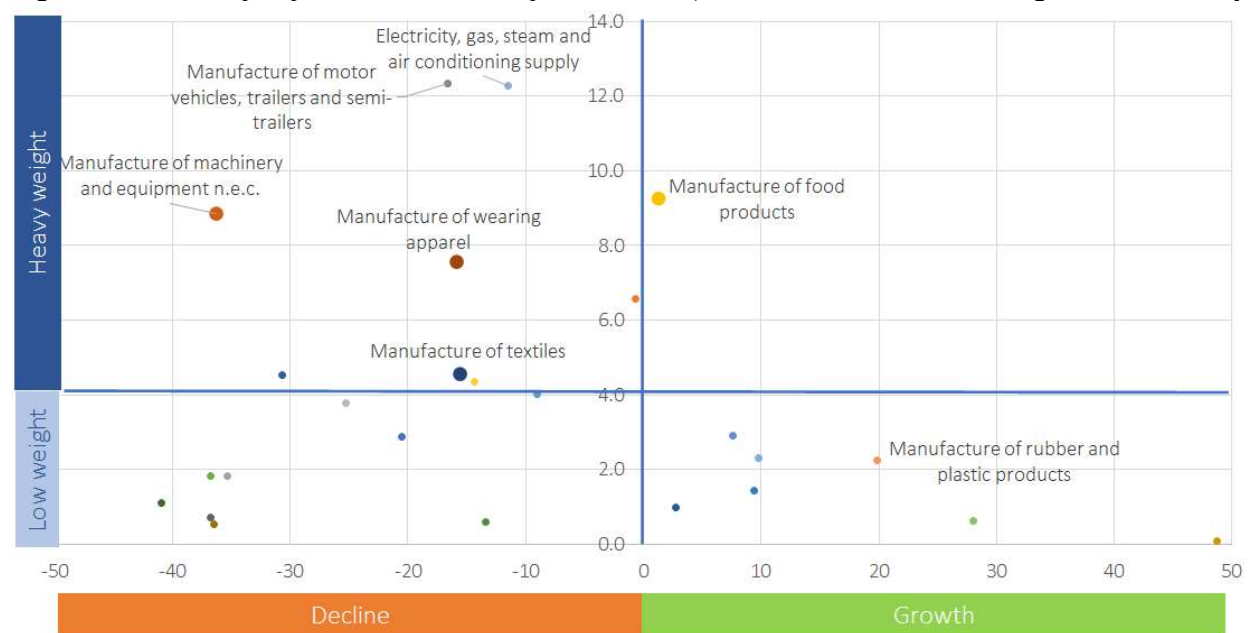


Figure 50. Production and number of employees by industry throughout 2020 (cumulative changes, in percent)



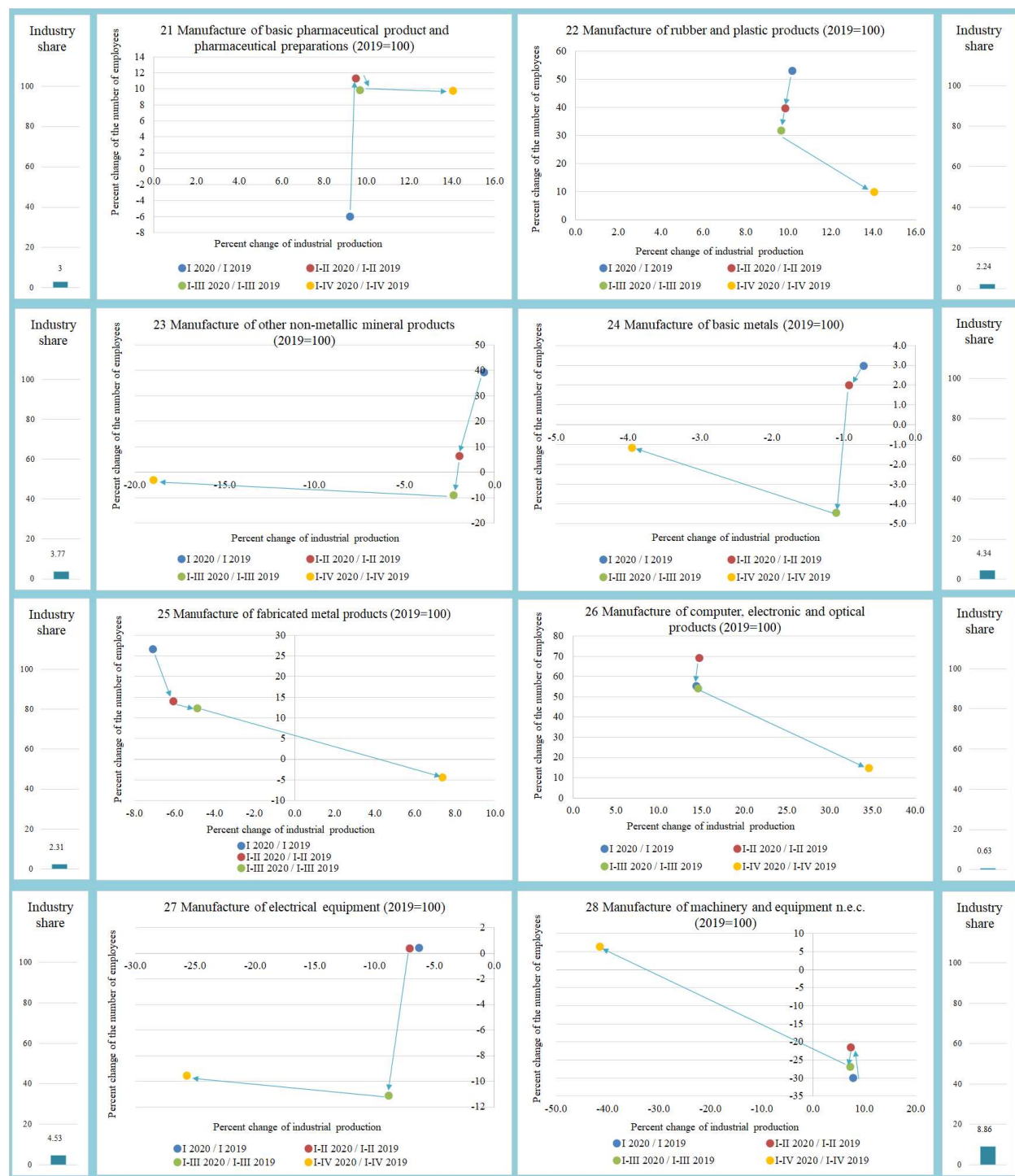
Source: Authors' design based on data from the State Statistical Office (April 2020).

Figure 47. Production and number of employees by industry throughout 2020 (cumulative changes, in percent) (continued)



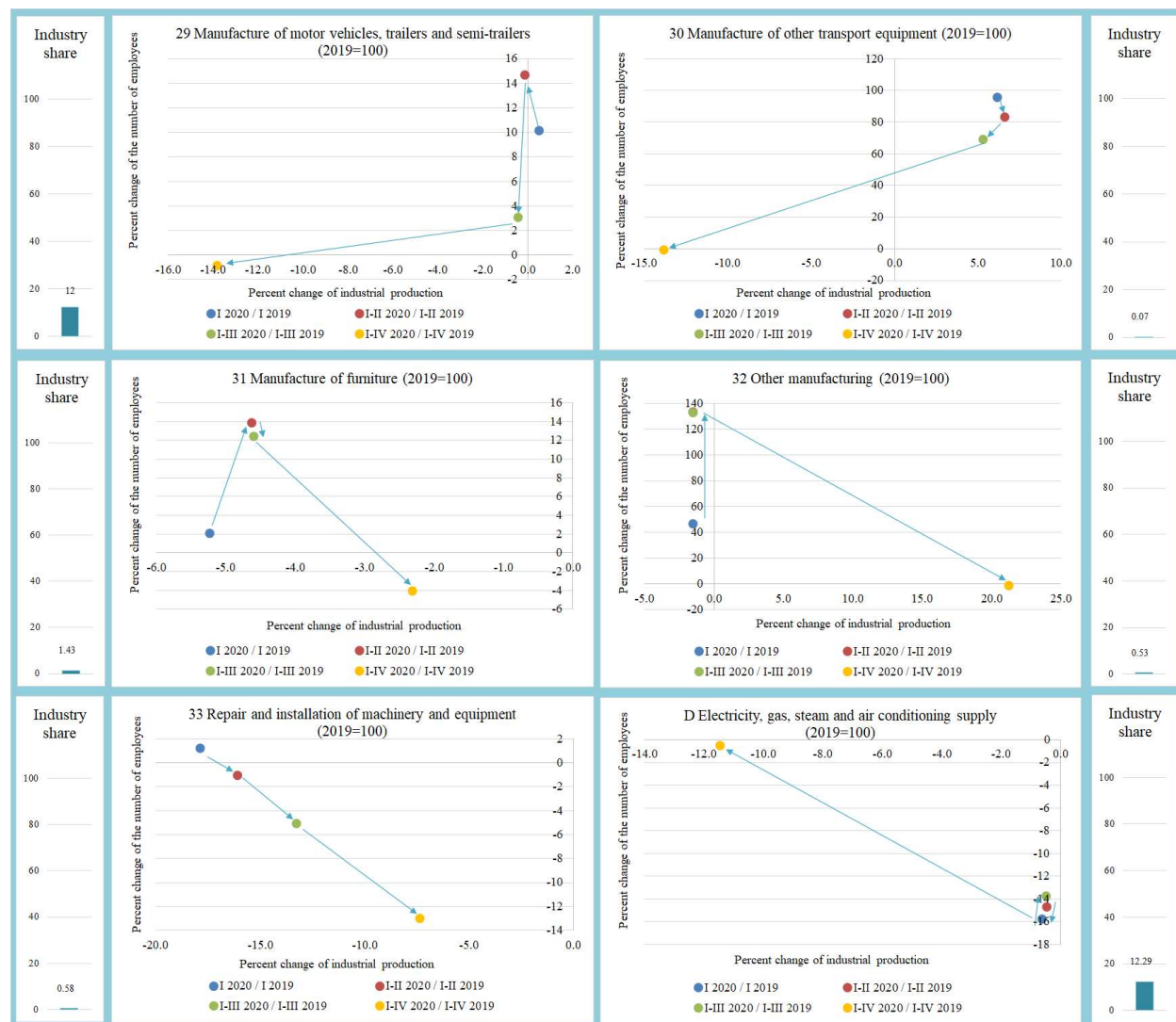
Source: Authors' design based on data from the State Statistical Office (April 2020).

Figure 47. Production and number of employees by industry throughout 2020 (cumulative changes, in percent) (continued)



Source: Authors' design based on data from the State Statistical Office (April 2020).

Figure 47. Production and number of employees by industry throughout 2020 (cumulative changes, in percent) (continued)

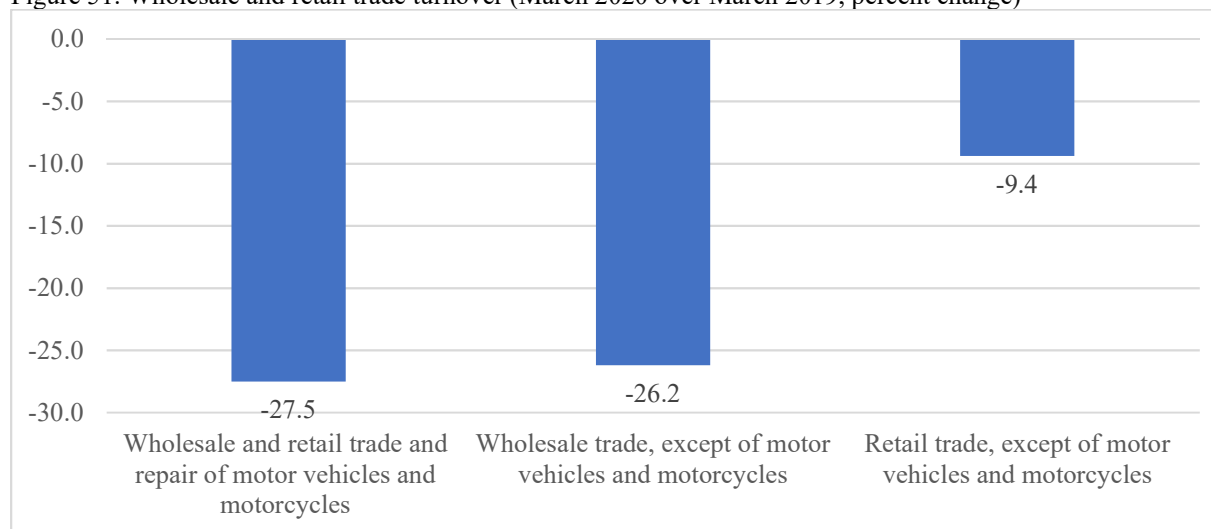


Source: Authors' design based on data from the State Statistical Office (April 2020).

## Wholesale and retail trade

The lockdown, social distancing and forced closures of many stores (incl. shopping malls) led to a dramatic fall in both wholesale and retail trade. This in turn had an immediate negative impact on the budget revenue collection, particularly revenue from excises and VAT.

Figure 51. Wholesale and retail trade turnover (March 2020 over March 2019, percent change)



Source: Based on data from the State Statistical Office (April 2020).

## Construction

The value of contracted construction works abroad experienced a reduction of 24.7% Q1 2020 compared to Q1 2019. Moreover, the value of completed construction works more than halved (-51%). Given that the total value of construction works abroad during the first quarter is small, the implications are not significant.

Figure 52. Value of contracted and completed construction works abroad (January-March 2020, in Million €)

Country where construction activities are performed	Contracted works			Completed works		
	I - III 2019	I - III 2020	I - III 2020 / I - III 2019	I - III 2019	I - III 2020	I - III 2020 / I - III 2019
<b>Total</b>	3.9	2.9	75.3	0.8	0.4	49.0
Bosnia and Herzegovina	1.4	0.6	44.9	-	-	-
Germany	2.1	1.8	86.4	0.5	0.3	51.1
Montenegro	0.2	0.5	237.3	0.1	0.1	97.8
Bulgaria	0.2	0.03	14.7	0.2	0.0	14.7

Source: State Statistical Office (2020).

## Tourism

Tourism and hospitality industry were severely affected during the lockdown. The unprecedented fall in the number of tourists in March 2020 of 67.3% (compared to March 2019) and the number of nights spent (-62.8%) painted a grim picture for the tourist, hospitality, and entertainment industry. It also affected the overall figures for Q1 2020, given that the decline of the number of tourists in the first three months was down by 18.3% and of the number of nights spent by -19.7%.

Figure 53. Number of tourists and nights spent (Jan-Mar 2020 / Jan-Mar 2020, percent change)

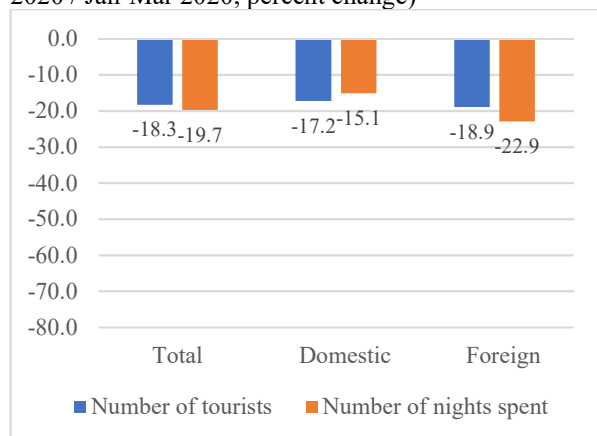
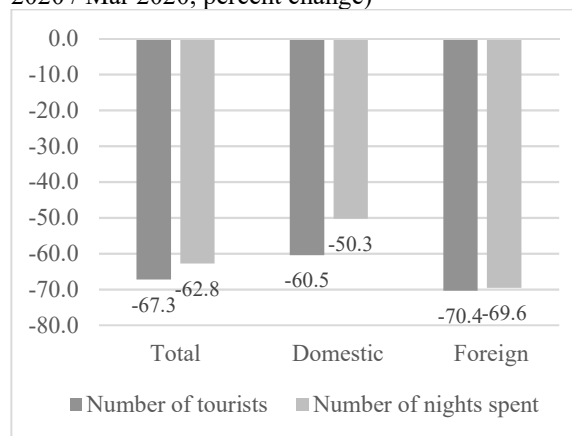


Figure 54. Number of tourists and nights spent (Mar 2020 / Mar 2020, percent change)



Source: State Statistical Office (2020).

The vouchers for domestic tourism for low-income individuals and households is a well-designed measure. However, the payments should be monitored to avoid misuse of government funds. For instance, there is a risk that some hotels or owners of apartments may declare fictitious tourist nights and then split the cash equivalent of the voucher with the “guests”. Nevertheless, if properly scrutinized the government financial support may be well justified.

The destiny of the domestic tourism, hospitality and entertainment industry will also depend on the border controls. In case of open borders with Greece, upper-middle and high-income citizens will opt for seaside summer holidays, thereby negatively affecting the domestic tourism industry.

If the crisis lasts until the end of 2020, historical record losses are expected in the hospitality and tourism sector. The decline in the tourist inflow will be over 80% and the recovery may last until the end of 2027, according to a May 2020 survey by the Union of Chambers of Commerce.<sup>5</sup>

### 3.2. Social Vulnerabilities

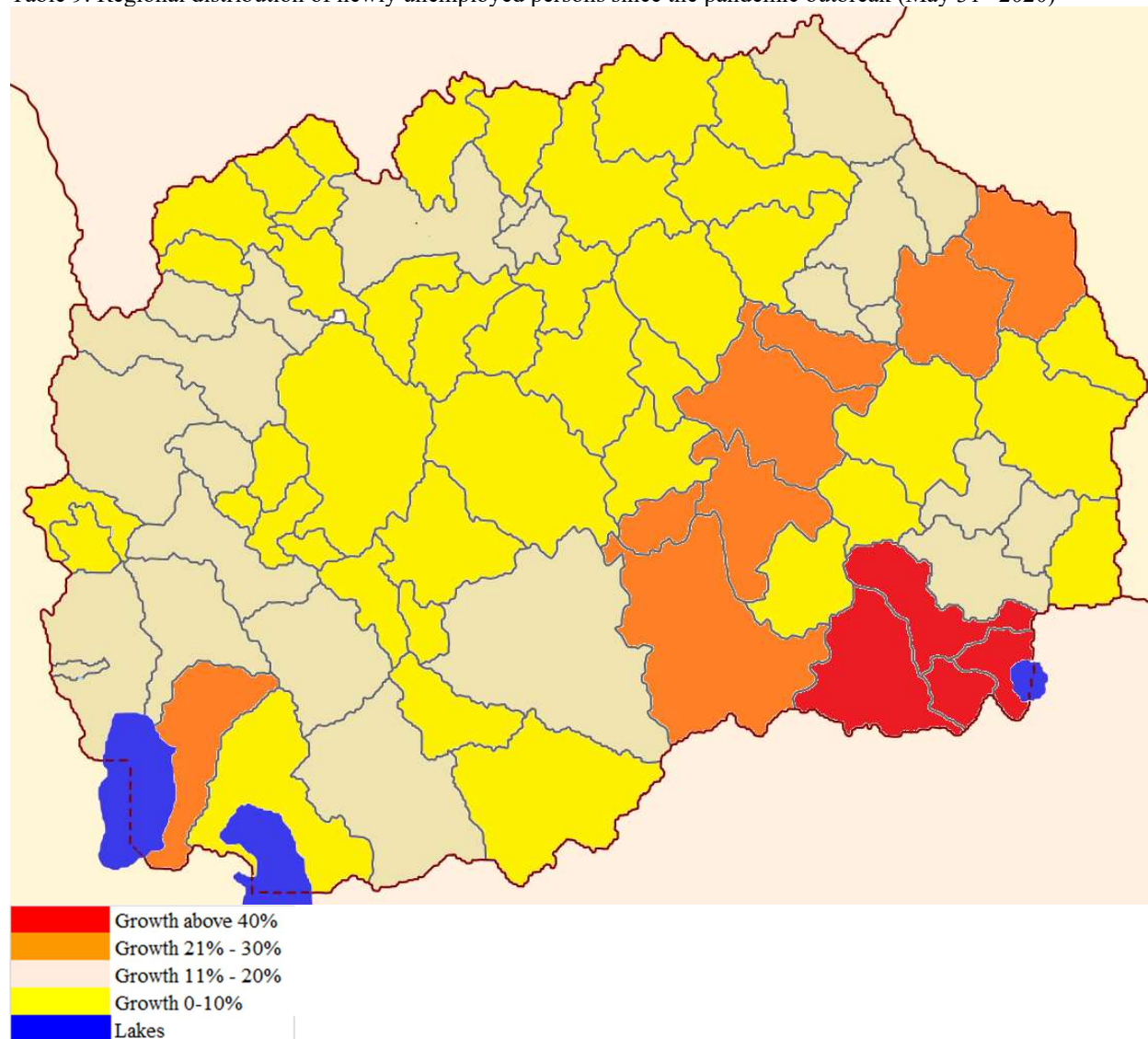
#### Unemployment

We analyze social vulnerabilities from a gender, age, ethnical or regional perspective.

*Gender perspective.* As outlined in Section 3.1, women are hit hardest by the ongoing health and economic crisis. While women are overrepresented in fighting the pandemic, they also suffer more severely from the ongoing social-economic crisis. The sectors that are the most affected — for example, the restaurants, the travel sector, the textile industry — have high female employment. Therefore, more women tend to lose jobs. More important for most people who live with children is the extra childcare needs - everybody with young kids must provide all the childcare suddenly. Much of this extra work falls on women, therefore making it difficult for them to work as usual. Grandparent-provided childcare is now discouraged due to the higher mortality rate for the elderly.

<sup>5</sup> <https://www.24.mk/details/turistichko-ugostitelskiot-sektor-e-najpogoden-od-koronakrizata>

Table 9. Regional distribution of newly unemployed persons since the pandemic outbreak (May 31<sup>st</sup> 2020)

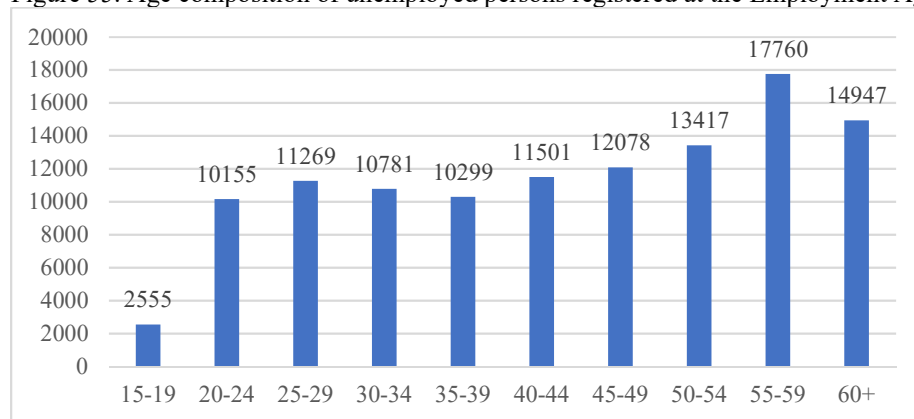


Source: Authors' design based on data from the Employment Agency (June 2020).

*Age perspective.* The age composition of unemployed persons registered at the Employment agency at end-April 2020 reveals that the largest share stems from the age category [55-59 years]. Lower employability of this category is strongly correlated with the problem of long-term unemployment and the depreciation of their working skills (human capital).



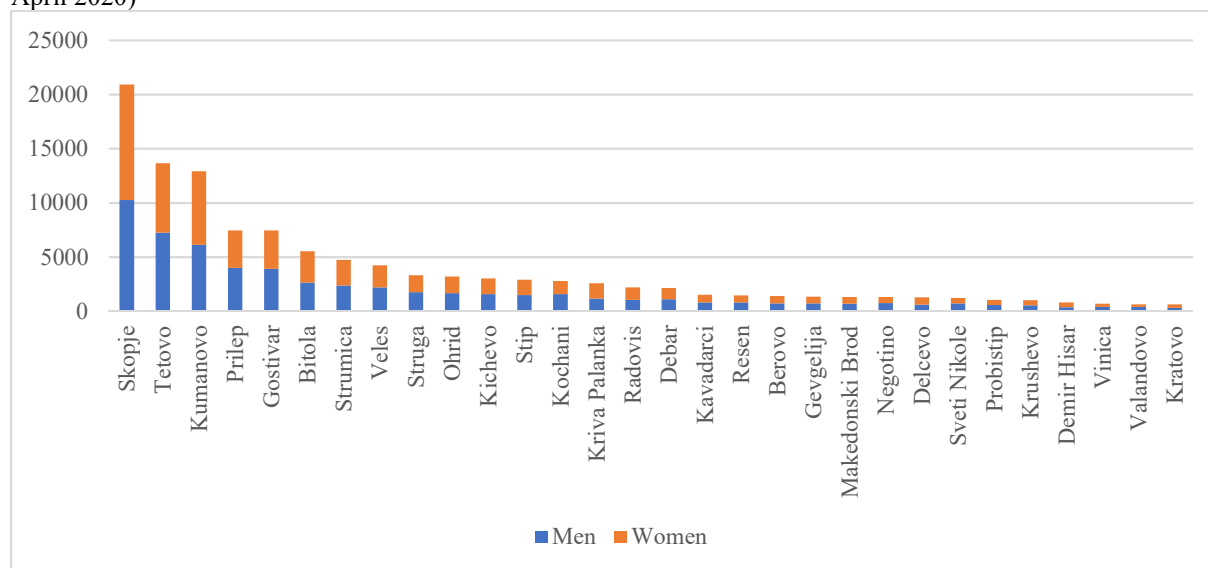
Figure 55. Age composition of unemployed persons registered at the Employment Agency (end-April 2020)



Source: Based on data from the Employment Agency (April 2020).

*Geographical distribution.* In terms of the absolute numbers of unemployed persons, the largest unemployment figures are observed in Skopje, Tetovo, Kumanovo, Prilep and Gostivar.

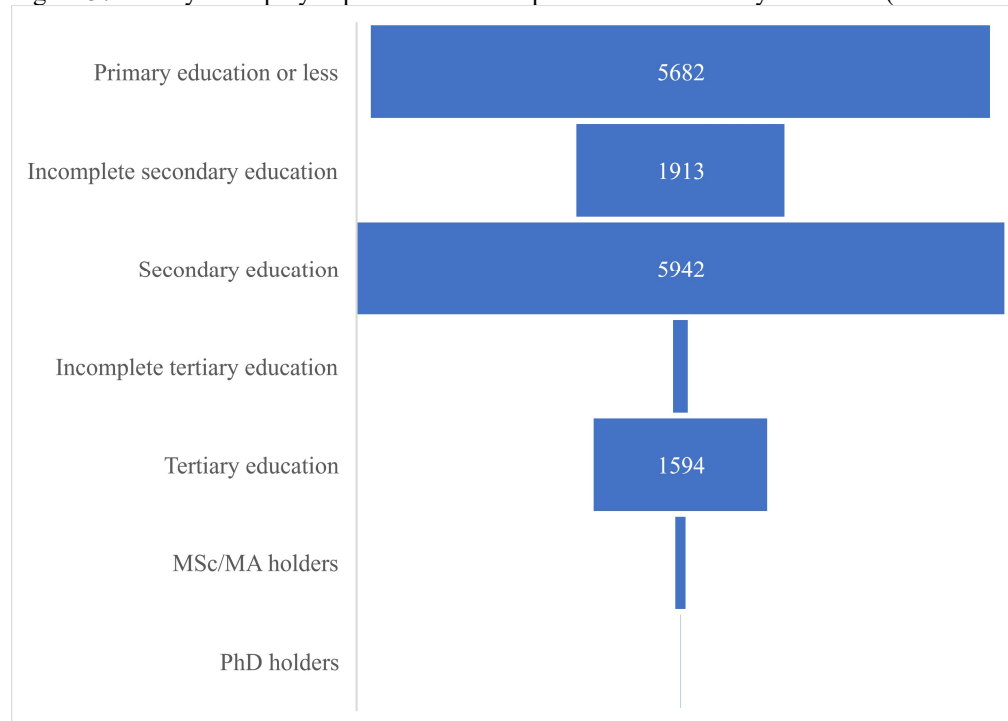
Figure 56. Total number of unemployed persons by gender and regional branch of the Employment Agency (end-April 2020)



Source: Based on data from the Employment Agency (April 2020).

*Education.* Based on data from the Employment Agency, the largest number of newly unemployed persons is either with secondary education or with primary education or less.

Figure 57. Newly unemployed persons since the pandemic outbreak by education (March-May 2020)

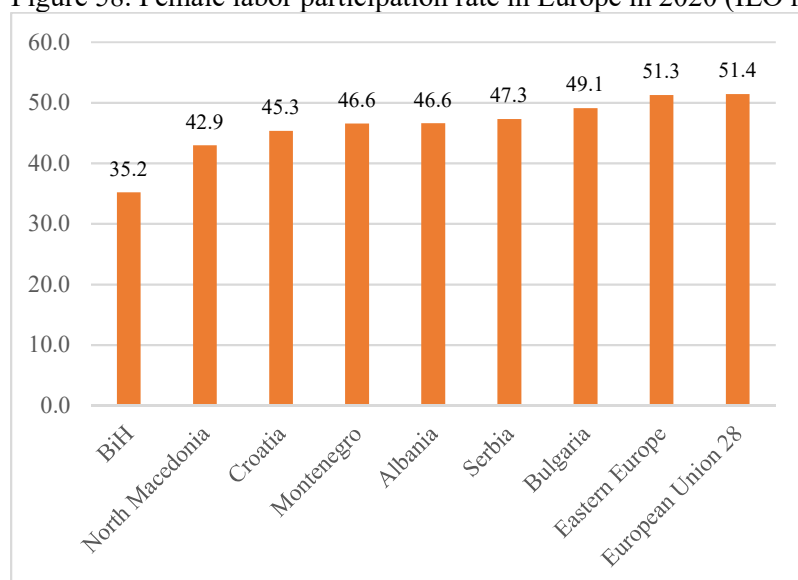


Source: Based on data from the Employment Agency (April 2020).

### Female labor participation

Female participation rate in North Macedonia is among the lowest in Europe (Figure 55). Being economically insecure, women are vulnerable to economic downturns. They are also more likely to be victimized, i.e. suffer domestic violence, stay in an abusive relationship, etc.

Figure 58. Female labor participation rate in Europe in 2020 (ILO modelled estimates)



Source: ILO statistical database (May 2020).

## The Informal Economy

The informal economy in North Macedonia involves economic activities generating output equivalent to 17.4% of GDP.<sup>6</sup> The largest value added is generated by *N3 – Informal production (Producers not required to register)* and *N6 - Producers deliberately misreporting* (Table 13).

Table 10. Activities of and indicators associated with the informal economy (2009-2020)

Activities in the informal economy	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	April 30 <sup>th</sup> 2020
<b>Total value added generated by the informal sector</b>	<b>21.0</b>	<b>19.6</b>	<b>20.0</b>	<b>19.2</b>	<b>18.2</b>	<b>17.2</b>	<b>17.0</b>	<b>17.4</b>	/	/	/	/
N1 - Underground hidden production (legal activities not being reported)	2.2	1.1	0.9	0.7	1.6	1.2	1.1	1.1	/	/	/	/
N2 - Illegal production	0.4	0.3	0.3	0.3	0.4	0.4	0.4	0.4	/	/	/	/
N3 – Informal production (Producers not required to register)	12.1	12.4	11.8	11.4	11.3	10.7	10.1	9.8	/	/	/	/
N4 - Legal persons not surveyed	0	0	0	0	0	0	0	0	/	/	/	/
N5 - Registered entrepreneurs not surveyed	0.7	0.7	0.8	0.7	0.6	0.7	0.7	0.6	/	/	/	/
N6 - Producers deliberately misreporting	5.5	4.9	6	6	4.1	4	4.5	5.3	/	/	/	/
N7 - Other statistical deficiencies	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	/	/	/	/
<b>Other indicators of informal economic activities</b>												
Cash in circulation (in percent of money supply M1)	29.8	28.3	30.3	29.5	28.7	26.3	25.2	24.6	23.7	21.5	20.6	22.9

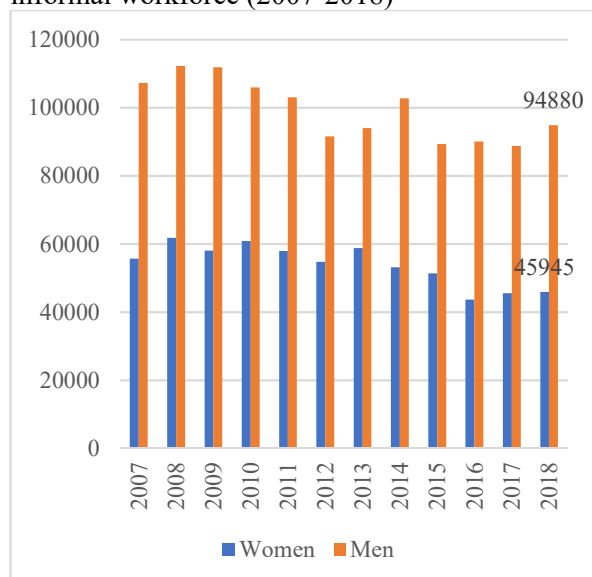
Source: State Statistical Office, National Bank, and authors' calculations.

**Less cash, less informal.** The currency demand model for estimating the shadow economy assumes that shadow (or hidden) transactions are undertaken in the form of cash payments. Therefore, no observable traces for the authorities are left. Although the time series is short, the correlation coefficient between value added in the informal economy and cash in circulation (in percent of money supply M1) is 0.87. This suggests that the reduced use of cash in circulation is indeed strongly correlated with the reduction of the grey economy.

**Men are overrepresented in the informal workforce.** In most countries, the share of women in informal employment exceeds that of men (OECD/ILO, 2019). However, official data reveal that North Macedonia differs from the global pattern: men dominate the informal workforce in North Macedonia (Figures 55 and 56).

<sup>6</sup> An estimate by the State Statistical Office based on the discrepancy method in the System of National Accounts Statistics: SSO (2018) *Gross Domestic Product in 2016*, 3.4.18.01903. According to the European Commission (2010), the non-observed part of the economy consists of: (1) illegal activities where the parties are willing partners in economic transactions, (2) hidden and underground activities where the transactions themselves are not against the law, but are unreported to avoid official scrutiny, and (3) informal activities where typically no records are kept.

Figure 59. Number of men and women in the informal workforce (2007-2018)



Source: State Statistical Office (May 2020).

Figure 60. Share of men and women in the informal workforce (2007-2018, in percent)

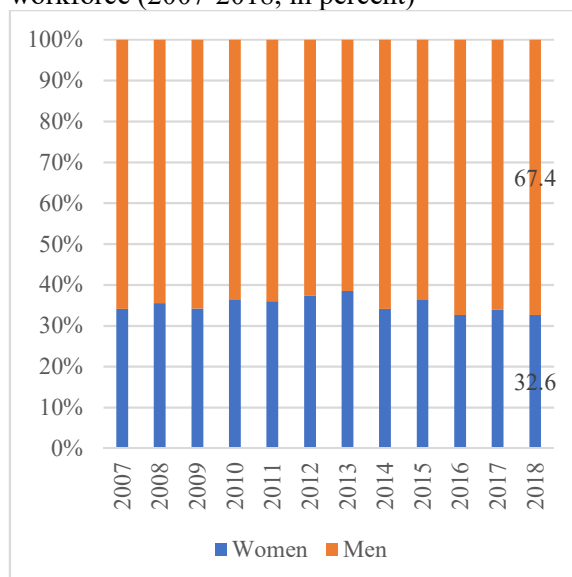
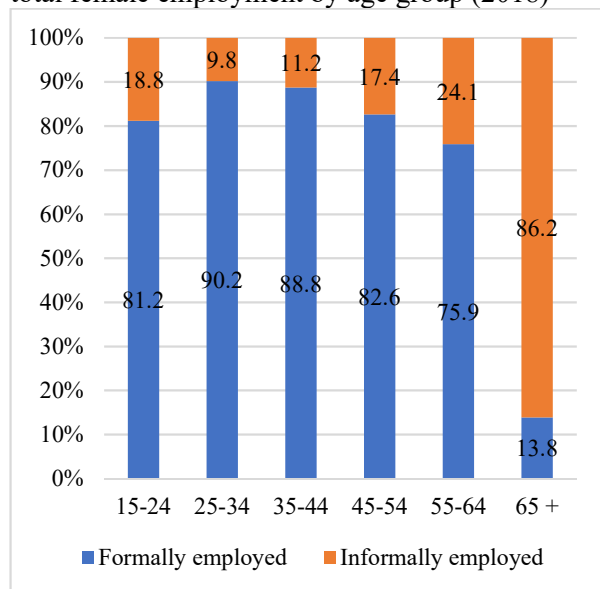


Figure 61. Share of informally employed women in total female employment by age group (2018)



Source: State Statistical Office (May 2020).

The share of informal employment in non-agriculture employment in 2018 was 12.6% for men and 3.6% for women.

**Every sixth woman works informally.** Every sixth woman - or even more precisely 15 women out of 100 - work informally. As presented in Figure 57, the share of informally employed women in total female employment is the highest in 65+ age group (86.2%), 55-64 age group (24.1%) and 15-24 age group (18.8%).

**Women are highly exposed to low-quality informal jobs.** Women are often found in the lower parts of the informal employment hierarchy (domestic workers in private homes, informal sellers on agricultural products' markets, contributing family workers, etc.).

### 3.3. Methodology

Our forecasts of the unemployment and the poverty rates are derived through Machine Learning algorithms (MLAs) and econometric techniques (a dynamic panel model also known as

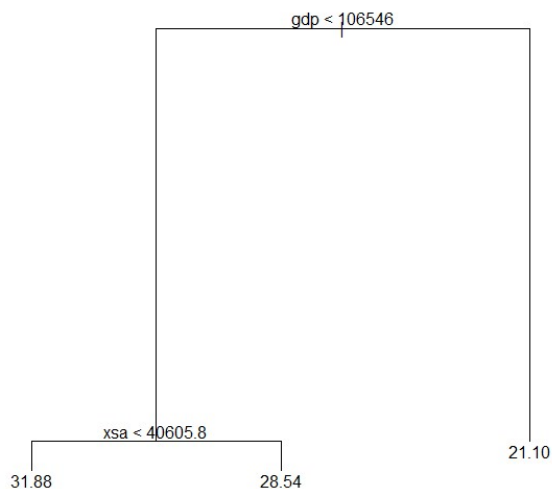
system GMM). Due to the policy nature of the document, we do not provide a detailed technical account of the empirical procedure.

### **The unemployment rate**

The list of potentially relevant predictors of the quarterly unemployment rate (based on the Labor Force Survey) include: real GDP growth, ln (GDP per capita), quarterly change in the volume of exports, consolidated central government budget expenditures, social benefits transfers to households, value added in agriculture, forestry and fishing (A), value added in industry (C-E); total investment, net capital inflows, foreign direct investment and remittances, all expressed as a percentage of GDP, and enrollment rates in primary and secondary education.

Fitting a regression tree on the unemployment rate reveals that GDP (constant prices) and seasonally adjusted series of exports of goods are the best predictors.

Figure 62. Fitting a regression tree for the unemployment rate



Our forecast for the unemployment rate in 2020

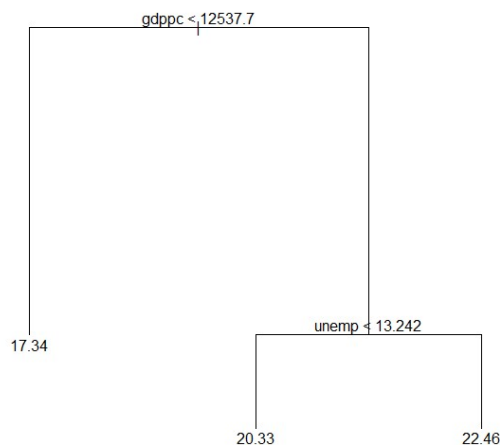
### The Poverty Rate

Poverty data is among the scarcest data with significant gaps between years and substantial delays in their publication. Due to the limited number of observations for the poverty rate in North Macedonia, we decided to pursue a regional approach and include data on poverty rates for Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Montenegro, North Macedonia and Serbia between 1991 and 2019. The list of potentially relevant explanatory variables / predictors of poverty include: real GDP growth, ln (GDP per capita), budget

expenditures, social benefits transfers to households, value added in agriculture, forestry and fishing (A), value added in industry (C-E); total investment, net capital inflows, foreign direct investment and remittances, all expressed as a percentage of GDP, and enrollment rates in primary and secondary education.

We fitted a regression tree for the poverty rate defined as poverty headcount ratio at national poverty lines (percent of population). By using this Machine Learning Algorithm, we uncovered the following regression tree (Figure 63).

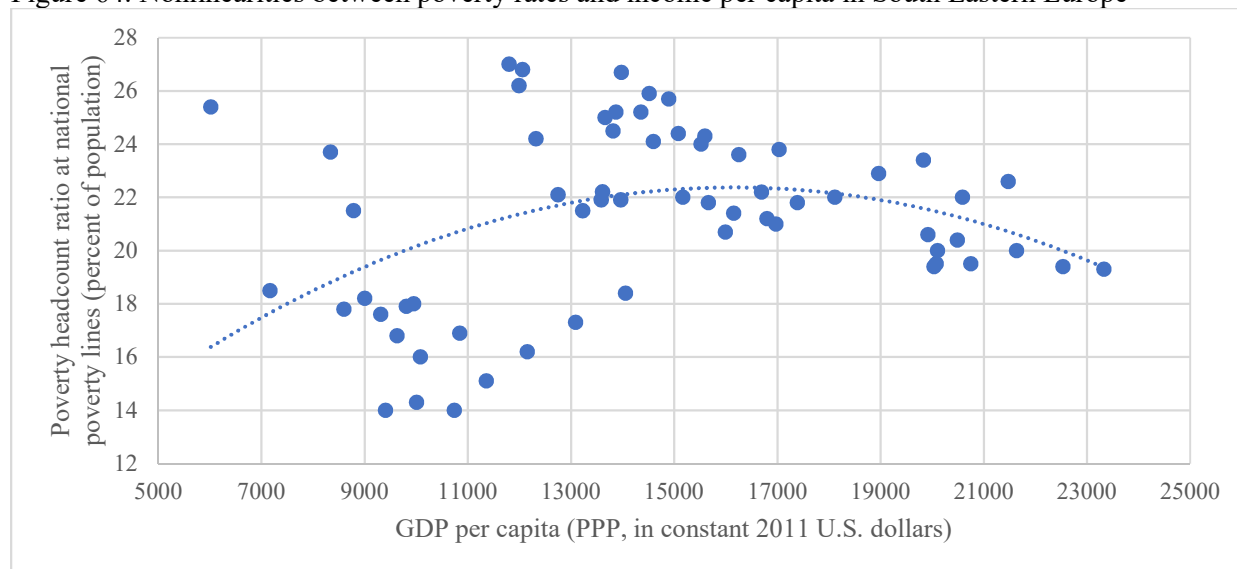
Figure 63. Fitting a regression tree for the national poverty rate



The split at the top of the tree results in two large branches. The left-hand branch corresponds to GDP per capita < 12,537.7 US dollars, and the right-hand branch corresponds to GDP per capita ≥ 12,537.7 US dollars. The tree has two internal nodes and three terminal nodes, or leaves. The number in each leaf is the mean of the response for the observations that fall there. Country-year observations below this income threshold are expected to have a mean annual poverty rate of 17.3%. Country-year observations equal to or above this threshold are then further split based on their unemployment rate. Those with an unemployment rate below 13.2% have a mean poverty rate of 20.3%, and those with higher unemployment rate than 13.2% tend to have higher poverty rate (22.5%).

Hence, out of the list of potentially relevant predictors of the country's poverty rate, the algorithm suggests the level of economic development (GDP per capita) and the rate of unemployment. Before we proceed with examining the relationship between these two variables, we plot the poverty rates against the GDP per capita in South Eastern Europe. As Figure 64 suggest, the relationship might be non-linear.<sup>7</sup> Poverty rates appear to be highest for the country-year observations concentrated in the middle of the range.

Figure 64. Nonlinearities between poverty rates and income per capita in South Eastern Europe



Notes: Data refer to countries from South Eastern Europe only: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Montenegro, North Macedonia, and Serbia. Source: Based on data from World Development Indicators and IMF World Economic Outlook Database (May 2020).

For this reason, we apply a dynamic model and estimate the impact of the level of economic development and the unemployment rate, but because of the non-linearities we also include a squared term for the GDP per capita. What are the main results?

Table 11. Dynamic panel-data estimation, system GMM

Dependent variable: Poverty rate	Coefficient	z	P> z
Poverty rate in the previous year	<b>0.788</b>	8.65	0.000
GDP per capita	<b>6.537</b>	3.91	0.000
GDP per capita, squared term	<b>-0.339</b>	-3.97	0.000
Unemployment rate	-0.005	-0.18	0.857

Note: All terms are expressed in a natural logarithmic form.

The results support the well-known fact that the poverty is a very persistent phenomenon, or put differently, difficult to eradicate. Having a high poverty rate last year increases the probability to register high poverty rate this year too. The forecasted decline of GDP per capita by 4% in 2020 is expected to increase the poverty rate by 1 percentage point in 2020.<sup>8</sup>

<sup>7</sup> The Kuznets inverted U-curve hypothesis that posits the relationship between income and income inequality has met varying degrees of acceptance in the academic circles.

<sup>8</sup>  $e^{6.537 \times [\ln(13817) - \ln(14393)] - 0.339 \times [\ln(13817)^2 - \ln(14393)^2]} = 0.99$  percentage points.

It seems that a simple linear model yields the same conclusions. The estimated impact of GDP per capita from the linear OLS model is remarkably similar to the system GMM estimation, leading to an estimated poverty rate of 19.8% in 2019 and 21.0% in 2020.

Figure 65. Poverty rate versus natural logarithm of GDP per capita in North Macedonia

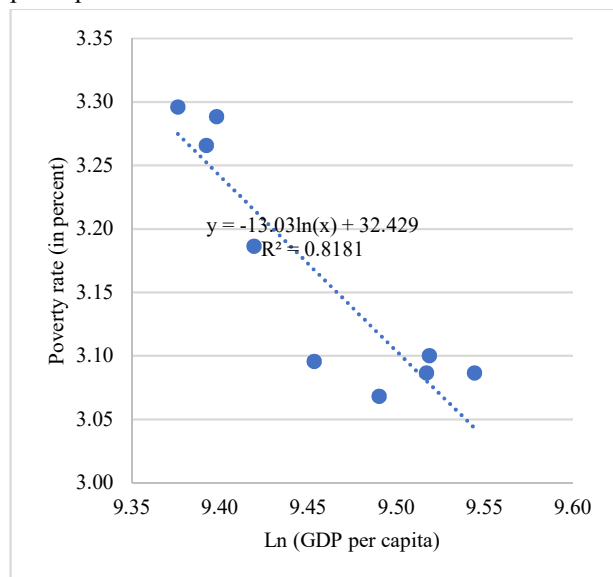
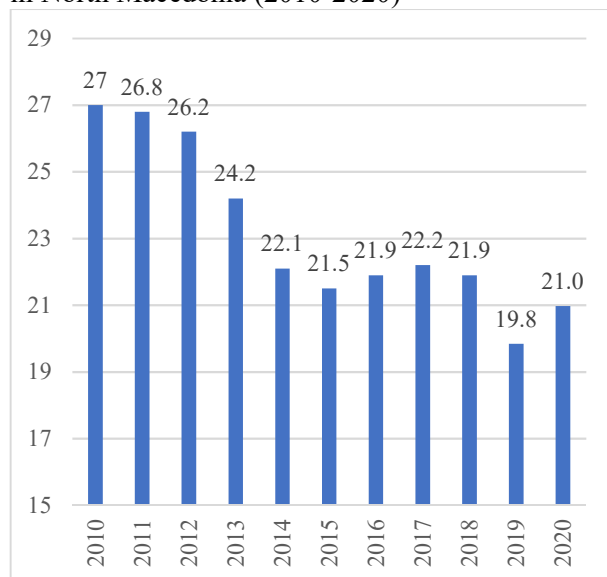


Figure 66. Estimate and forecast of the poverty rate in North Macedonia (2010-2020)



Note: Poverty rate is defined as poverty headcount ratio at national poverty lines (percent of population). Source: Based on data from the State Statistical Office (April 2020).

### 3.4. Findings

#### Findings from the analysis

**This crisis really is different.** The COVID19 induced crisis is more severe than the Global Financial Crisis of 2007-2009. A simultaneous supply and demand shock hit all economies and sectors at the same time.

**The pain concentrated in Q2 2020.** The largest loss in economic output is expected in the second quarter of 2020. There should be a smaller decline in Q3 2020, conditional upon the absence of a second pandemic wave. However, a premature relaxation of health containment measures or the fiscal stimulus would easily lead to a W-shaped recovery.

**Size matters.** In the case of North Macedonia, micro entities and small enterprises were very vulnerable even before the pandemic outbreak. This segment of the economy is highly indebted, with low liquidity (negative net working capital) and loss-making and is likely to suffer the most.

**Precautionary saving on the rise.** Even if the employers restart production by fully observing the national health prevention measures, it will take time for the demand to pick up. Consumers are concerned about the uncertain incomes in near future and postpone non-essential consumption. The slowly responding demand will prolong the economic recovery phase.



**Women hit hardest by the crisis.** Since the pandemic outbreak, women dominate among the newly unemployed persons in March and April 2020, as reported by the Employment Agency. This calls for a gender-sensitive approach in designing the government financial support.

**The automotive components industry is the new vulnerability.** Although financially sound, the suppliers from the automotive components industry are facing worsening prospects. The statistical data and structured interviews with representatives from this industry reveal reduced orders, limited substitution of buyers from People's Republic of China and an expected reduction of the production volume by between 25% and 35%. This is a significant downward risk for both creation of value added and exports of goods.

**Layoffs in the textile industry can have a massive effect.** Textile industry, and especially the manufacture of wearing apparel, are experiencing a significant downturn. As a labor-intensive industry, these layoffs may have a massive unemployment impact.

## Reflections on the Pandemic

“When it comes to small and medium-sized enterprises, the speed with which they receive the necessary support is often one of the most important factors for survival. Although most entrepreneurs often try again after a failure, the available data suggest that about 60 percent of small businesses never reopen after a severe crisis.”

Danela Arsovska, President of the Union of Chambers of Commerce (Sloboden pechat, May 18<sup>th</sup>, 2020)

“Although the state of the economy is changing daily, economic policy makers will need to come up with a vision and strategy to overcome the economic crisis and rebuild economic growth.”

Gligor Bishev, CEO of Sparkasse Bank (Faktor, April 24<sup>th</sup> 2020)

“We design education around schools. Perhaps this is our chance to design education around the learner.”

Viktor Novakovski, Director of NOVA International School

“The ever-changing critical situation in the Automotive Industry requires a standing partnership with the Government. Let us try to save the jobs; Business will recover.”

Georgi Trenkoski, CEO of Telamon Corporation (subsidiary in Skopje)

“Some of us are being directly affected by the pandemic, while the rest are preparing their best lunches, staying at home. After the end of the pandemic, all of us will be affected, a lot of us will not have lunch at all... That will be the real fight without a named virus, without a vaccine and without the opportunity to be counted on TV as a “real victim”. It is a utopia to count on government support because the government budget will be one of the first victims. To be clever and count on your own capacity and performances is the best strategy to survive and stay in a normal mental state.”

Angelka Peeva Laurencic, ImagePR Managing Director

“We will survive the competition, but I am afraid that we will not be able to survive the impact of the pandemic.”

Petar Tashev, Independent artist from Veles (National Radio, May 20<sup>th</sup>, 2020)

“The government should give us at least a glass of water now. It will be too late to receive several bottles of water, after we shut down the business.”

Petar Drobov, Owner of an automotive components store “Autofilter”

“We will accept any health protocol for serving food in our restaurant. If necessary, we will make a distance of five meters between the tables. We just need a chance to reopen”.

Efto Pejovski, Owner of the restaurant “Balkanika”

“The coronavirus crisis is a chance to introduce new policies and innovations into the daily lives of citizens. We must not go back to the previous ‘normal’ which meant thousands of deaths a year due to air pollution. Every Wednesday should be a car-free day, and every Friday a work-from-home day.”

Skopje Smog Alarm, Non-Governmental Association

“Workers are often accustomed to working for a daily subsistence. Payment by hand - after each working day, also known as “day-by-day” style of working - should not be tolerated by a responsible government”.

Slavica Ilijeska

“We are looking for a way to ensure that all workers in our sectors are safe. The guilt that we are not formally registered and cannot exercise our rights now is not only ours, but also yours, because the control system, i.e. the inspectorates, has failed”.

Vlatko Nikolovski, Trade Union for Hospitality and Tourism (May 20<sup>th</sup>, 2020)

Experiences from other countries and globally

## 4. NEEDS ASSESSMENT DASHBOARD AND SOCIAL VULNERABILITY INDEX

### 5.1. Needs Assessment Dashboard: Tracking the Reopening from a Remote-Access 'Situation Room'

To monitor socio-economic developments monthly, we devise a Needs Assessment Dashboard (NAD). It consists of numerous indicators with a monthly or quarterly frequency to capture key socio-economic and selected sectoral developments in a remote-access 'situation room'.

## Need Assessment Dashboard

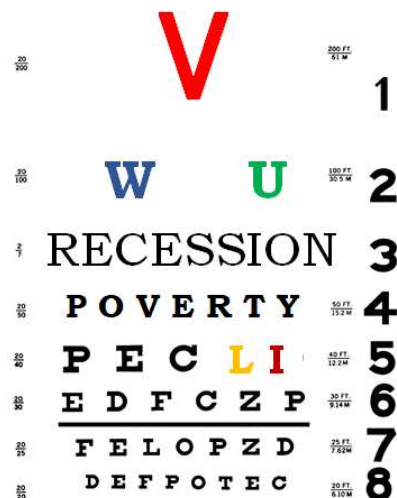
Needs Assessment Dashboard																		
MACROECONOMIC OUTLOOK	Q1 2019			Q2 2019			Q3 2019			Q4 2019			Q1 2020			Q2 2020		
	2019M01	2019M02	2019M03	2019M04	2019M05	2019M06	2019M07	2019M08	2019M09	2019M10	2019M11	2019M12	2020M01	2020M02	2020M03	2020M04	2020M05	2020M06
<b>Real sector</b>																		
<b>Real GDP (quarterly)</b>	3.8			3.4			3.6			3.4			0.2			-11.3		
<b>Unemployment</b>																		
Quarterly unemployment rate (Labor Force Survey)	17.8			17.5			17.1			16.6			16.2					
Number of unemployed persons (LFS)	171329			168180			164702			161242			156627					
Total number of unemployed in Employment Agency	105658	105444	106242	103083	100060	101658	102326	101187	101036	101813	101819	101748	104409	105816	107732	114762		
Monthly change in number of unemployed	10937	-214	798	-3159	-3023	1598	668	-1139	-151	777	6	-71	2661	1407	1916	7030		
<b>Poverty rate</b>	19.8																	
<b>Nominal wages (y-o-y)</b>	2.0	4.5	3.8	3.5	3.1	4.1	4.3	3.8	4.4	3.7	5.0	4.1	12.3	12.5				
<b>Real wages (y-o-y)</b>	0.8	3.4	2.3	1.6	1.7	3.9	3.5	3.0	4.2	3.8	5.2	3.7	11.6	11.6				
<b>Inflation rate (y-o-y, monthly rate)</b>	1.2	1.1	1.4	1.9	1.4	0.3	0.8	0.8	0.3	-0.2	-0.1	0.4	0.6	0.7	0.5			
Food prices	2.0	2.3	2.9	3.2	2.3	0.0	1.0	1.8	1.1	0.9	1.1	0.9	0.3	0.4	0.6			
<b>Fiscal sector</b>																		
Budget revenue (in Million MKD)	14,911	15,124	16,004	17,789	16,737	15,549	17,686	16,521	16,829	19,626	16,424	20,711	15,598	15,729	15,160			
Y-o-y growth rates	11.9	7.6	0.1	4.1	9.8	4.0	13.4	7.4	12.1	15.5	4.3	8.3	4.6	4.0	-5.3			
Tax revenue (in Million MKD)	8,630	8,446	9,509	10,583	9,187	8,784	10,535	10,018	9,633	11,373	9,207	10,824	9,105	8,701	8,331			
Y-o-y growth rates	5.3	7.7	-3.1	-2.0	-4.9	-3.9	11.4	6.0	13.3	7.8	-2.9	-6.3	5.5	3.0	-12.4			
Personal income tax (in Million MKD)	1,174	1,358	1,521	1,584	1,658	1,407	1,611	1,416	1,493	1,612	1,564	2,308	1,404	1,486	1,504			
Y-o-y growth rates	13.8	11.4	11.3	19.8	29.7	9.5	15.6	8.7	9.8	17.1	7.3	-27.1	19.6	9.4	-1.1			
Profit tax (in Million MKD)	841	945	1,645	1,387	872	845	829	965	768	800	760	898	701	777	1,468			
Y-o-y growth rates	-3.1	-43.2	-41.2	34.3	-28.0	-15.9	-35.1	-6.7	-7.0	-16.8	-46.5	6.8	-25.8	-52.8	5.8			
VAT (net) (in Million MKD)	4,165	3,706	4,253	4,854	3,726	3,364	4,964	4,296	4,467	5,516	3,904	4,844	4,424	3,790	3,536			
Y-o-y growth rates	1.8	6.3	7.7	19.0	-18.2	-14.1	10.3	27.3	36.7	-0.6	-4.5	10.2	6.2	2.3	-16.9			
Social Security Contributions (in Million MKD)	4011	4971	5078	5450	5073	4834	5432	5154	5017	5291	5396	6461	4787	5434	5552			
Y-o-y growth rates	4.7	10.3	7.6	16.1	14.1	1.0	13.6	7.5	12.3	9.3	8.5	13.5	19.3	9.3	9.3			
Implied personal income tax for local self-governments	35.22	40.74	45.63	47.52	49.74	42.21	48.33	42.48	44.79	48.36	46.92	69.24	42.12	44.58				
Implied VAT for local self-governments (in Million MKD)	2,211																	
Budget deficit (in Million MKD)	-710	-1986	-509	-1030	-771	-2041	-2345	351	899	2774	-2096	-6167	-1213	-3091				
In percent of GDP (cumulatively over time)	-0.1	-0.4	-0.5	-0.6	-0.7	-1.0	-1.3	-1.3	-1.2	-0.8	-1.1	-2.0	-0.2	-0.6				
Gross general government debt (in percent of GDP)	38.3																	
<b>External sector</b>																		
Export of goods (y-o-y, nominal)	-13.7	14.8	37.0	12.6	10.0	10.4	17.4	10.7	6.8	-6.8	3.9	4.8	10.1	-1.9	-26.8	-60.1		
Import of goods (y-o-y, nominal)	-12.7	16.9	14.6	21.8	13.4	-4.2	16.6	11.1	7.6	-2.1	5.8	20.1	0.5	6.0	-17.7	-50.8		
Current transfers (in Million EUR)	94.13	109.03	118.01	140.26	144.02	122.87	208.42	183.37	156.91	151.36	130.44	164.72						
<b>Financial Sector</b>																		
Growth of total deposits (y-o-y)	10.6	10.3	11.1	13.1	10.4	10.5	10.0	10.0	10.1	9.6	9.3	9.5	9.3	8.3	8.3	6.3		
Annual growth of loans to households (y-o-y)	10.0	9.7	9.8	9.3	9.7	9.9	9.5	9.5	9.6	9.8	10.1	10.5	10.7	11.2	10.2	9.5		
Overdrafts on transaction accounts (y-o-y)	4.8	5.1	8.4	1.1	0.3	2.7	1.7	2.4	2.3	2.2	3.0	-1.7	1.5	2.2	-4.8	-5.6		
Amounts due on credit cards (y-o-y)	-0.6	-0.3	-0.4	-0.7	-1.1	-1.5	-1.5	-2.0	-2.3	-2.6	-3.1	-2.6	-2.7	-3.2	-4.5	-6.3		
<b>SECTORAL OUTLOOK</b>	Q1 2019			Q2 2019			Q3 2019			Q4 2019			Q1 2020			Q2 2020		
	2019M01	2019M02	2019M03	2019M04	2019M05	2019M06	2019M07	2019M08	2019M09	2019M10	2019M11	2019M12	2020M01	2020M02	2020M03	2020M04	2020M05	2020M06
<b>Agriculture</b>																		
Average monthly net wage (in Denars)	19,762	19,190	19,976	19,994	19,955	20,066	20,224	20,331	20,344	20,313	19,981	20,697	21,499	20,995				
<b>Industrial Outlook (y-o-y, 2015=100)</b>																		
Industrial production volume	12	7.3	7.5	5.5	1.2	-2.7	5.8	9.8	6.1	4.2	-2.1	-5.9	0.3	3.5	-13.4			
Employees in industry	1.2	0.8	-0.8	-1.6	-2.5	-2.8	-2.5	-1.6	-2.2	-2.2	-2.8	-2.4	-3.2	-3.2	-4.5			
Sales (turnover) of industry	6.9	14.9	13.5	17.3	11.7	-4.7	11.0	-1.8	-0.9	0.8	3.1	-1.2	12.2	3.5				
Average monthly net wage (in Denars)																		
(B) Mining and quarrying	35,670	31,996	33,922	35,819	35,034	32,912	34,519	33,949	34,203	36,141	34,007	35,902	36,830	32,099				
(C) Manufacturing	20,128	19,850	20,367	20,410	20,926	21,501	21,213	20,974	21,369	21,734	21,975	23,427	23,295	23,359				
(D) Electricity, gas, steam and air conditioning supply	41,605	37,459	38,428	38,864	39,034	38,622	38,082	38,976	38,890	38,978	37,939	39,815	43,404	39,613				
Indicator of economic confidence	20.1	20.5	20.7	20.8	21	21.3	21.2	21.4	21.7	21.8	22.1	22.2	22.6	22.7				
<b>Textile industry</b>																		
	Estimate / Forecast																	

## 5.2. Social Vulnerability Index

# 5. POLICY EVALUATION AND MONITORING OF POLICY MEASURES

Both international financial institutions and national authorities expect an inevitable recession in South Eastern Europe in 2020 (Q2 and Q3) and a strong recovery in 2021. Preferably, it would be a V-shaped recovery, but a possible second pandemic wave in the second half of 2020 could make it a W-shaped recovery. Prolonged stagnation (U), and stagnation without a recovery (L) are also possible scenarios, but with a much lower likelihood.

It is always tempting to propose a more generous economic package to cushion the crisis impact, but this requires larger fiscal space and low/moderate level of public debt. Some of the radical fiscal measures implemented by advanced economies cannot be replicated in North Macedonia. For example, the Danish government committed to provide 90% of the wage of laid off workers due to the COVID-19 crisis. Similarly, the Government of the Netherlands introduced compensation of up to 90% of labor costs for companies expecting a reduction in revenues of 20 percent or more).



**Guiding principles.** The guiding principle is to target support to households to ensure access to basic goods and services and to viable businesses to limit unprecedented layoffs. Another important guiding principle is to deploy resources in a temporary and efficient way and reflect the costs in multi-year fiscal reports.

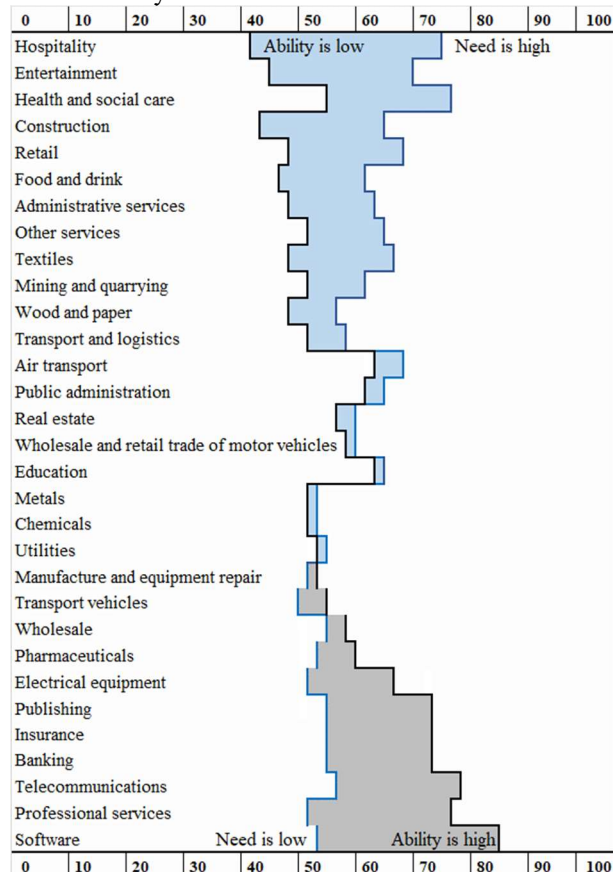
**Likelihood of a U- or W-shaped recovery not to be ignored.** Vigilance in terms of continued health prevention (containment) measures and extended fiscal stimulus (based on an evidence-based Needs Assessment Dashboard) are necessary to avoid a U- or W-shaped recovery. International Financial Institutions are currently not forecasting a significant second wave that would prompt shelter-at-home policies to return. However, this scenario must not be ignored if premature relaxation of containment measures and/or fiscal stimulus takes place.

**Evidence-based policy vs. policy-based evidence.** Public health and economic resilience (business resilience and adaptation, prudent fiscal policies) must not be compromised for short-term political gains. All political parties should contribute to the policy formulation with evidence-based policy proposals, avoiding irresponsible populist measures inviting a high fiscal burden in near future.

**Size matters.** As already explained, micro entities in North Macedonia were very vulnerable even before the pandemic outbreak. Their high indebtedness, low liquidity (negative net working capital) and loss-making history require special government emphasis. They account for a disproportionate share of the vulnerable jobs.

**Public debt sustainability.** Building substantial fiscal buffers from 2021 onwards to combat future non-economic or economic crises and strengthen the public debt sustainability.

Figure 67. Ability to work remotely and necessity to work remotely



Note: Index (0=no need or ability).  
 Source: McKinsey (2020, p. 10).

**Technology reliant institutions.** The institutions will have to become more technology reliant and perform many public services by using digital platforms.

### 5.1. Key Policy Responses as of June 14<sup>th</sup>, 2020

In addition to the urgent measures to address health concerns, the Government of North Macedonia proposed two packages of economic measures since the pandemic outbreak.

#### *First Package of Economic Measures by the Government*

- Measure #1: Loans in amount of 5.7 Million € with zero interest rate to support the liquidity of the micro, small and medium-sized enterprises. Individual loan applications may vary between 3,000 and 30,000 € (grace period of 6 months, and repayment period of 2 years);
- Measure #2: Government subsidies for the employees in companies from tourism, transport, catering and other crisis-hit companies for April, May and June 2020 in amount up to 50% of their average wage in 2019 (condition on no labor layoffs in February 2020);

- Measure #3: Temporary suspension for advance payments of the personal income tax on incomes from independent activities and advance payments of profit tax by companies that suffered the consequences of COVID-19 for March, April, and May 2020
- Measure #4: Temporary ban (price controls) of main food products (bread, salt, oil, milk and dairy products, eggs, flour, pasta, medicaments, and disinfectants)
- Measure #5: Tourism rescue fund of 1.2 Million € to compensate the tourism sector

### ***Second Package of Economic Measures by the Government***

- Measure #1: Financial support of 14,500 Denars per employee for April and May 2020, for crisis-hit companies, if the reduction of the turnover is greater than 30%, Companies paying wages above 39,900 Denars are entitled to 50% relief of company's costs for the social security contributions for each employee. The Government Decree was amended on May 1<sup>st</sup> 2020 so that the employer is eligible for financial support, if the labor layoff has not exceeded the following thresholds: 15% for companies up to 50% employees, 10% for companies between 51 and 250 employees and 5% for companies over 250 employees (for the month when the financial support is being used).
- Measure #2: Direct financial support of 14,500 Denars for sportsmen and sport workers for April and May 2020;
- Measure #3: Direct financial support of 14,500 Denars for 141 independent artists (minimum wage plus social security contributions) for April and May 2020
- Measure #4: Cash compensation for individuals laid off due to the crisis, in amount of 50% of the last received average net wage. Payment duration dependent on the length of the working experience.
- Measure #5: All elected or appointed government officials will receive minimum wage of 14,500 Denars during April and May 2020 (the Constitutional Court has initiated a temporary suspension of this measure in order to investigate its alignment with the constitution);
- Measure #6: Zero management fees for presidents and members of management or supervisory boards of government institutions or public enterprises
- Measure #7: Remuneration of 7,000 Denars per household for persons that are part of the informal economy or unemployed. Minimum guaranteed support based on the incomes of all members of the household.
- Measure #8: Moratorium for the Payment Enforcement Law until the end of June 2020 (During the crisis and six months after the crisis it is forbidden to initiate insolvency proceedings)
- Measure #9: Deferral of loan repayments by the banks. Banks agreed to offer more favorable loan conditions, such as deferral of repayments (up to six months), refinancing, grace period, lower interest rate, etc.
- Measure #10: Reduction of the loan installment for loans by the financial companies by 70%, prolongation of the repayment period by 90 days, reduction of the late payment (default) interest rate from 51% to 31%, all accompanying costs capped at 20% of the loan.
- Measure #11: Deferred payment of rent for social housing for individuals.
- Measure #12: Additional amount of 8 Million € new interest-free loans for the micro, small and medium-sized enterprises (based on the number of employees). Maximum amount of loans: 90,000 € and minimum amount of 3,000 EUR, grace period of 1 year, and loan duration of 3 years
- Measure #13: Loans in amount of 50 Million € with low interest of 1.5% (a European Investment Bank credit line) by the Development Bank of North Macedonia. The loans will be extended via the commercial banks to support the liquidity of the companies
- Measure #14: Ban on initiation of bankruptcy (insolvency) procedures. During the crisis and six months after the crisis it is forbidden to initiate insolvency proceedings
- Measure #15: Mandatory use of the first part of the annual holiday
- Measure #16: Establishment of COVID-19 solidarity fund
- Measure #17: Employed persons that receive contractual payments (royalties) by government institutions / public bodies will be entitled only to 50% of the contractual amount
- Measure #18: Reduction of the interest on the amount due or overpaid amount of taxes and other tax-related fees to 0.015% for every day of late payment, instead of 0.03% as prescribed by the law
- Measure #19: Facilitation of transport of goods, and Measure #20: Simplification of customs procedures

- Measure #21: Government subsidies for the employees in companies from tourism, transport, catering and other crisis-hit companies for April, May, and June 2020 in amount up to 50% of their average wage in 2019
- Measure #23: Price controls (freezing) of citrus fruits
- Measure #24: Ban on exports of wheat and flour
- Measure #25: Further relaxation of loan conditions (grace period for loan repayments, rescheduling the repayment period from 180 to 250 months, lower interest rate, possible refinancing, additional period for classifying the loan as a non-performing one from 90 to 150 days).

#### *Monetary and macro-financial measures by the Central Bank*

- The National Bank cut its policy rate by 25 basis points to 1.75 percent at an extraordinary meeting on March 16<sup>th</sup> 2020.
- The fees for withdrawing and returning cash to the National Bank's central vault have been abolished to minimize any risk of transmitting the virus infection by coins and bills.
- In addition, the National Bank reduced by a third the amount of CB bills offered to banks at the auction held on April 15 2020.
- On financial sector measures, the National Bank has revised its credit risk regulation, to encourage banks to restructure loans temporarily, and has relaxed the loan classification standards for non-performing loans (NPLs).
- It has also reduced the base for the reserve requirement by the amount of new loans to firms in affected sectors and has extended the deadline for banks to submit their first Internal Liquidity Assessment Report in order to allow them to focus on providing credit while maintaining the quality of the loan portfolio.
- The period for alignment with the key reference rate of the central bank in the contracts will be shorter than the current six months.

#### *Third Package of Economic Measures by the Government*

Pillar #1: Direct financial support for the citizens for supporting consumption with a focus of the domestically produced goods and services and crisis-hit sectors

- Measure #1 (1.1): Domestic payment card of 9,000 denars (€ 146) for vulnerable categories and low-income families affected by COVID-19 (Budgeted amount: 1 Billion Denars, €16 Million by the Government), starting from June-July 2020
- Measure #2 (1.2): Encouraging domestic tourism through vouchers of 6,000 denars for citizens plus domestic payment card of 3,000 denars (Budgeted amount: € 16 Million = €11 Million by the Ministry of Economy and € 5 Million by the Government), starting from June-July 2020
- Measure #3 (1.3): Vouchers for high school and university students and youth up to 29 years with a focus on digital and IT skills (738 million denars or € 12 Million, of which € 6.6 million by the Ministry of Education and Science and € 5 million by the Government), starting from June-July 2020;
- Measure #4 (1.4): Cash award for doctors and medical staff of infectious diseases clinics and departments (in the amount of 20% of the basic salary for two months), 50 Million Denars or € 813,000.
- Measure #5 (1.5): Unemployment benefit for people who have lost their jobs due to COVID-19 (150 Million Denars or €2,500,000), starting from May-June 2020

Pillar #2: Direct financial support and support for the liquidity of the private sector and the jobs in the phase of recovery and restarting

- Measure #6 (2.1): Interest-free loans with 30% grant component for micro and small enterprises (MMP) through the Development Bank of the Republic of North Macedonia (1.9 Billion Denars or € 31 Million, with national co-financing of 60 Million denars), starting from September 2020
- Measure #7 (2.2): State guarantee scheme by the Development Bank ([1] State guarantee for commercial loans to support the private sector through commercial banks (with € 10 million of initial capital, the



Development bank can guarantee over € 65 million of new loans for SMEs, assuming that the level of coverage is 50%, and [2] Guarantee scheme through RBSM - Customs fee guarantee for securing the customs debt, so that € 3 million state guarantee would cover € 25 million)

- Measure #8 (2.3): Financial support for the private sector, the economy and the industry (Budgeted amount: 1.5 Billion denars or € 25 Million), Program to strengthen the competitiveness of companies and industry, according to the law on financial support of investments or by amending a special program to help companies that lose markets to regain markets - increase their competitiveness, modernize processes, increase productivity., June-December 2020
- Measure #9 (2.4): Modernization and new markets (60 Million denars, approximately € 1 Million) for a digital platform *Marketplace* for selected industries with a specific focus on textile, shoemaking, furniture and PVC-product industries)
- Measure #10 (2.5): Program for business development industries (100 million denars or € 1.6 Million), Support for Start-up Companies and SMEs to introduce new processes, innovations, penetrate new markets, digitalize, and increase competitiveness, June-October 2020
- Measure #11 (2.6): Rapid Adjustment Tool (MMS Digitization 3.0), (Budgeted amount: 200 Million denars or € 3.3 Million), To provide initial development support to domestic companies with track record and potential for successful operation through financial support for rapid adjustment, June-September 2020
- Measure #12 (2.7): Co-financing of events and conferences with 50% financial support from the government budget up to a maximum amount of 30,000 denars (€488), (Budgeted amount: 15 Million denars or € 245,000), to help domestic hotels and hospitality industry through this program, the state will provide co-financing (costing funds) subsidies for the organization of events, trainings and conferences.

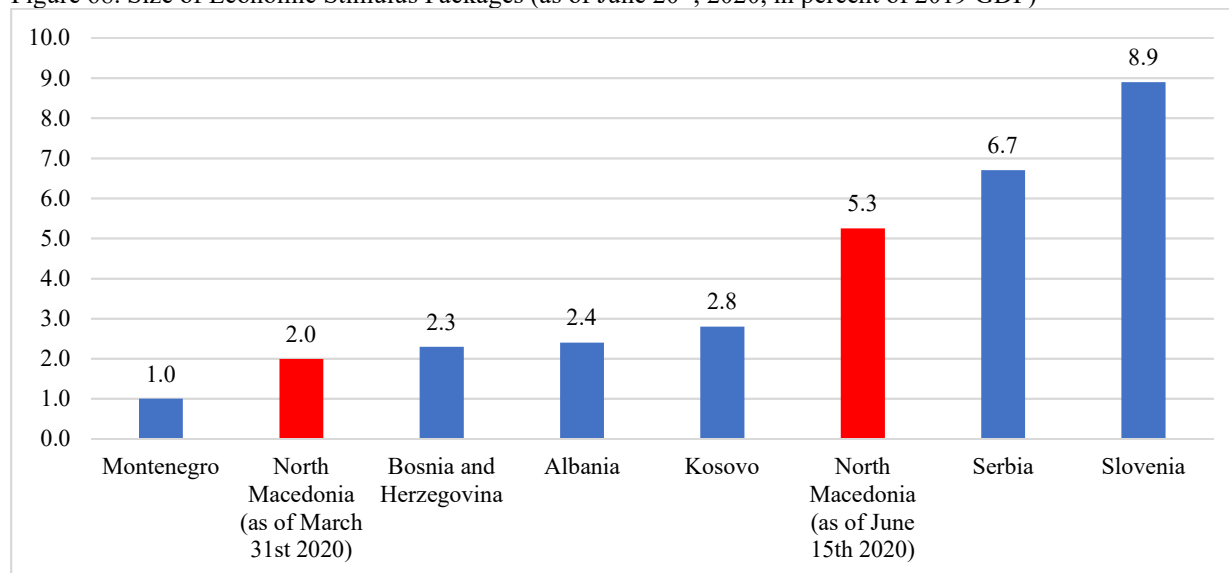
### Pillar #3: Direct support for enhancing the competitiveness of the agricultural sector and farmers

- Measure #13 (3.1): Support for the agricultural sector through the Development Bank of the Republic of North Macedonia (Budgeted amount: 307 Million Denars or € 5 Million), loans with favorable conditions intended for support of micro, small and medium enterprises that perform primary production, processing and exporting of primary and processed agricultural products, May-December 2020
- Measure #14 (3.2): Payment cards for fuel procurement subsidies for the mechanization of farmers, (Budgeted amount: 280 million denars or € 4.6 Million), a subsidy in amount of 50% of the total costs for fuel procurement, May-December 2020
- Measure #15 (3.3) Supporting the restructuring of the production of new products in the processing of grapes (Budgeted amount: 215 Million denars or € 3.5 Million), government subsidies to stimulate grape growers (wineries) to produce alcoholic distillate which will later be used by domestic chemical companies to produce disinfectants needed to prevent another wave of COVID-19 pandemic, September-December 2020
- Measure #16 (3.4) Enabling cooperation between the public and private sector, by modeling public-private partnerships in viticulture and tobacco sector (no fiscal implications), September-December 2020
- Measure #17 (3.5) Reform for efficient use of pastures, pastures for long-term lease, which will give livestock farmers about 500,000 hectares of pastures for grazing livestock, no fiscal implications, September-December 2020
- Measure #18 (3.6) Consolidation of agricultural land - a new opportunity for enhancing the competitiveness, no fiscal implications, September-December 2020
- Measure #19 (3.7) Financing of micro-agricultural entities, (Budgeted amount: 185 Million Denars or € 3 Million), financing of start-up family wineries and farms registered with the Ministry of Agriculture, Forestry and Water Economy and the Food and Veterinary Agency through grants of up to € 10,000 for equipment for processing and marketing of plant and meat dairy products, September-December 2020
- Measure #20 (3.8) Modernization of agriculture, (Budgeted amount: 3.1 Billion Denars or € 50 Million), A project financed by World Bank loan to build two redemption and distribution centers and a modern Agri Hub Platform to connect young entrepreneurs, social entrepreneurs, and farmers to create final value-added products, August-December 2020.

## 5.2. Evaluation of new proposals

**Size of economic stimulus.** As of end-March 2020, the fiscal impact of two packages of economic measures was estimated at 2% of 2019 GDP by the World Bank (Figure 68). In May 2020, a third package of economic measures was announced. The cumulative size of three economic stimulus packages is estimated at 5.25% of 2019 GDP.

Figure 68. Size of Economic Stimulus Packages (as of June 20<sup>th</sup>, 2020, in percent of 2019 GDP)



Source: World Bank (2020) and authors' calculations.

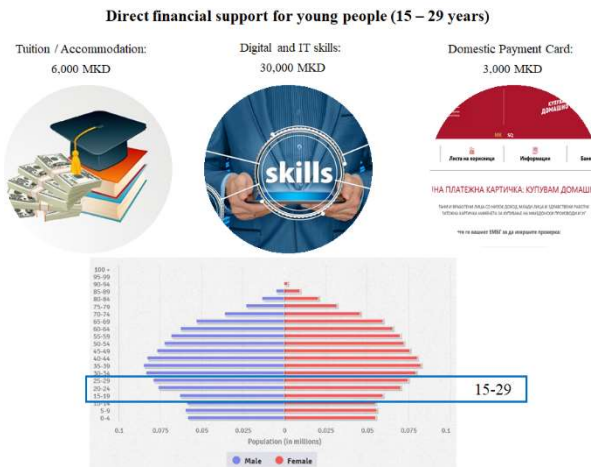
**Alleviating poverty.** To alleviate the Covid19 pandemic impact, the Government of North Macedonia introduced direct financial support for several vulnerable categories:<sup>9</sup>

- **Low-income citizens (unemployed and social assistance beneficiaries).** In mid-June 2020, domestic payment cards were introduced in value of 9,000 denars for approximately 100,000 low-income persons with annual net-income less than 180,000 denars in 2019 and less than 60,000 denars in Jan-Apr 2020.
- **Low-income citizens (employed persons).** Employed persons with net-income less than 60,000 denars in Jan-Apr 2020 are entitled to a one-time direct financial support of 3,000 denars to be spent on domestic products and services.
- **Young people** (between 16 and 29 years) who are part of the public secondary and tertiary education as of May 22<sup>nd</sup>, 2020 are entitled to 3,000 denars to be spent on domestic products and services. Young persons are also entitled to a financial support up to 6,000 denars to cover tuition fees at the University or for accommodation in



<sup>9</sup> <https://kupuвамdomasno.gov.mk/mk/listusers>

- student dormitories and registered accommodation facilities for students and high school students coming from low-income households. They are also offered vouchers of up to 30,000 denars for co-financing of trainings in upgrading IT and digital skills to increase their employability.
- **Health personnel.** Health personnel involved in fighting Covid19 are entitled to an increase of 20% of their basic salary for two months.
  - **Support for tourism.** Regardless of the monthly income of a household, family members earning a personal monthly net-income of less than 15,000 denars are entitled to a domestic tourist voucher and payment card with a value of 6,000 denars (nearly 100 euros). The estimates by the Ministry of Economy and Ministry of Finance are that 117,122 low-income individuals are entitled to this measure.



The effects are multifold: (1) financial support in the midst of the crisis for the social assistance beneficiaries and unemployed persons, (2) stimulus for the private consumption, (3) support for domestic producers of goods and services, and (4) reliance on cashless transactions (fight against the grey economy).

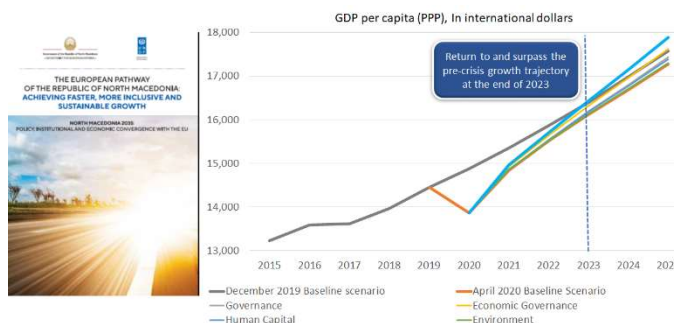
**Evaluation.** Although the domestic payment cards will not eradicate poverty, they are welcome policy measure for poverty alleviation during the period between June and mid-August 2020. These economic measures target social groups where the virus is taking its highest toll. The team recommends planning a second round of direct financial support in autumn 2020, since the social hardship caused by the crisis will continue to linger. A more precise targeting of the financial support can channel funds to the neediest households and individuals. For instance, not all young people in the public secondary and tertiary education system need a financial support of 3,000 denars. These cost savings can be allocated to increase the financial assistance for the vulnerable groups.

### 5.3. New Ideas for Economic Recovery

“The crisis demands a comprehensive approach in which short- and long-term goals are aligned from the beginning.”

Tubiana and Guerin (2020)

Some of the ideas for post-crisis economic recovery are already laid in the UNDP 2020 policy study “The European Pathway of the Republic of North Macedonia: Achieving Faster, More Inclusive, and Sustainable Growth”. Here, we reaffirm some of them and offer new ones.



## Business Recovery

**Access to Finance.** Instead of piling up huge corporate debts, joint stock companies should aim for raising new capital through Initial Public Offers (IPOs). Many limited liability partnerships (“друштво со ограничена одговорност”) should also reconsider the net benefits of legal transformation into a joint stock company. Capital base will be strengthened, high corporate debt burden will be avoided, and liquidity will be improved.

## Environment

**Environment.** Subsidies for greater access to central heating.

## Fighting the Informal economy

The central goal of the authorities should be to make informal activities part of a growing formal economy, offering decent jobs, productivity gains, and economic growth. If the formalization is only understood as tax registration and punitive sanctions for non-compliance with the law, the approach will most likely be counterproductive. **The transition to formality** requires access to better working and living conditions, including access to social protection, followed by the transition to another status.

### *Incentives for formality*

**Tax exemptions / relief.** Newly employed – previously unemployed for let us say, four or five years – can be exempted from the personal income tax for several years or offered a tax relief of 50%, if the net wage is lower than the average economy-wide wage. In that case, the authorities will avoid massive labor layoffs for re-employment under the changed tax regime.

**Minimum wage.** A high minimum wage implies high costs of formalization, and thereby discourages it (Krstić and Schneider, 2015). This effect is already strong, given that the minimum wage currently stands at 54.9% of the average economy-wide net wage, exceeding the recommended level by nearly 15 percentage points. The authorities should wait for the higher average level of net wage before they increase again the minimum wage.

**Facilitate cashless transactions.** The financial market must work better for the citizens. One possibility is the central bank to restrict the excessive fees that credit and debit cards charge to merchants that ultimately get paid by the consumers. This measure will discourage merchants to offer discounts (usually, 5%) for payments in cash.

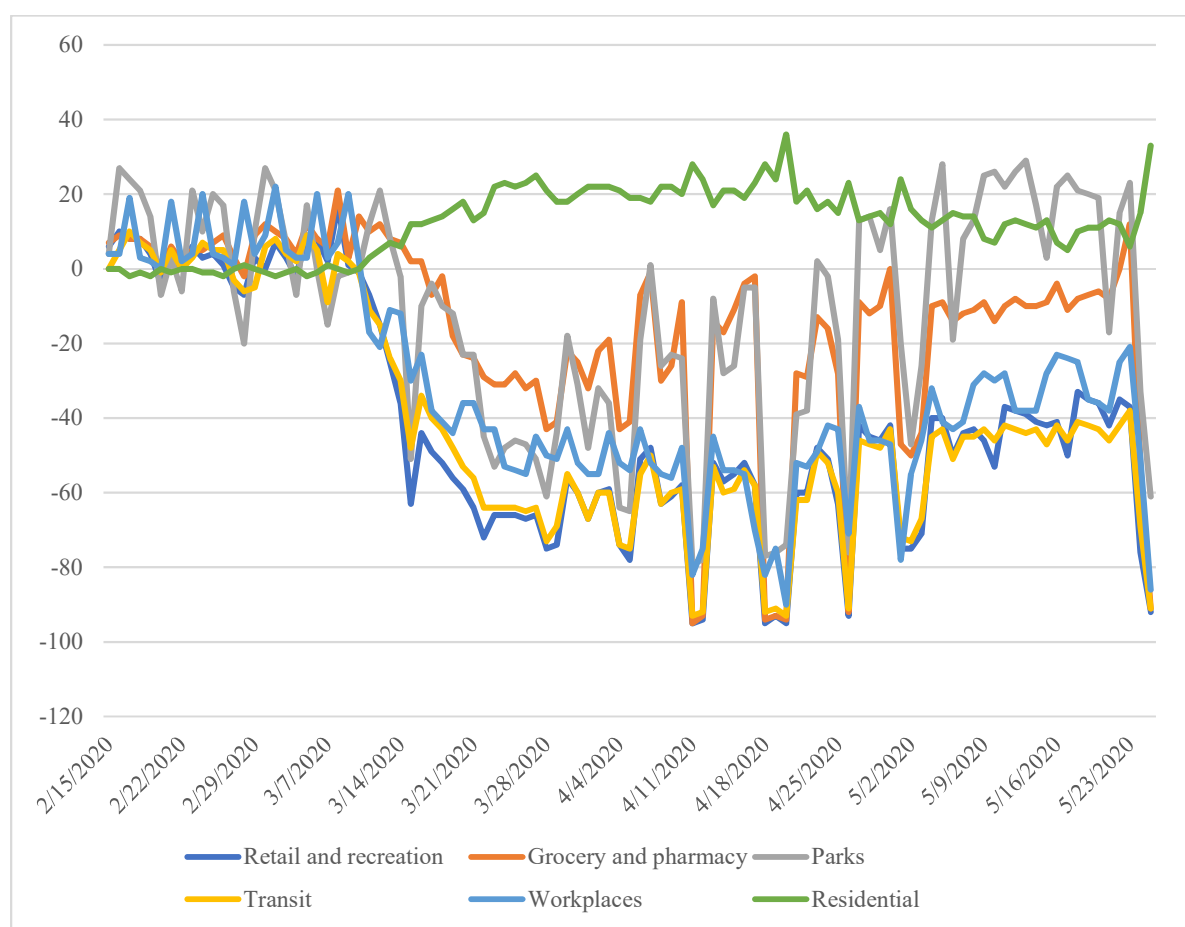
### *Disincentives for remaining informal*

**Abandoning the envelope wage bill.** In addition to a formal written contract, many employers reach a verbal agreement with their employees that an additional envelope wage will be paid. This part of the wage is not declared to the tax authorities.

### Governance

**Decentralizing more powers may be the way forward.** It is time to proceed with the stalled fiscal decentralization by increasing the intergovernmental transfer, *inter alia*, conditional upon the success in own-source collection.

### Global Mobility Trends in North Macedonia



## 6. POLICY RECOMMENDATIONS

“The path to the next normal is uncertain and will differ for each country, sector, and company. There are ways, however, to prepare for the transition.”

## Integrated and comprehensive policy framework

Principles	Pandemic shock response (immediate and short-term)	Post-shock economic recovery and growth (medium and long-term): 'Back to a New Normal'
<ul style="list-style-type: none"> <li>Evidence-based policy framework (data frequency and accuracy)</li> <li>Evaluated policy measures (fiscal and socio-economic impact)</li> <li>Effective targeting design of policy measures</li> <li>Monitoring (needs assessment dashboard and social vulnerability index)</li> </ul>	<ul style="list-style-type: none"> <li>Containment policies (health, human life safety)</li> <li>Social care (social vulnerability, unemployed, poverty)</li> <li>Jobs (protect and subsidy for temporary for restructuring)</li> <li>Businesses (liquidity and solvency)</li> <li>Fiscal sustainability (cash flow, deficit, debt)</li> <li>Macroeconomic and financial stability (prices, exchange rate, external balance, banking sector)</li> </ul>	<ul style="list-style-type: none"> <li>Economic recovery (restarting and restructuring – resilient - businesses, investments, infrastructure)</li> <li>Sustainable, inclusive, and accelerated growth (governance, economy, human capital, environment)</li> </ul>

### 1. Supporting citizens and protecting socially vulnerable groups

Policy intermediate targets	Policy measures
Containment policies	# 1 Healthcare, social distancing, testing, potential relief measures
Unemployment benefits	# 2 Relaxing unemployment benefit schemes
Socially vulnerable groups	# 3 Cash transfers to socially vulnerable groups
Informal economy	# 4 Subsidies and transfers to farmers and the informal sector

### 2. Supporting businesses and saving jobs

Policy intermediate targets	Policy measures
Liquidity support	# 5 Zero-interest loans # 6 Deferral and reprogramming of credit payments # 7 Introduction of guarantee schemes supported by government
Cost reduction measures	# 8 Extension of the government support for minimum wage # 9 Relaxation of criteria for minimum wage support # 10 Reduction of costs for rents and utilities
Revenues' recovery	# 11 Government spending and procurements # 12 Export crediting and guarantee schemes # 13 Income for self-employed
Focus	# 14 Small and Medium Enterprises should be on focus and with respect to sectors that are more affected, while micro-entities are more vulnerable and should have a special treatment
Crisis management	# 15 Crisis management trainings

### 3. Fiscal sustainability, macroeconomic and financial stability

### 3a. Fiscal measures

Policy intermediate targets	Policy measures
Evidence-based policy framework	# 16 Scenario analysis
	# 17 Fiscal and socio-economic assessment of policy measures
	# 18 Monitoring and evaluations
Size of the fiscal package	# 19 According to the socio-economic assessment of the COVID19 impact should be higher than during financial crisis (circa 10% of GDP)
	# 20 Reduce non-productive and unnecessary budget costs
Fiscal space (Public financial management)	# 21 Budget costs re-allocate to finance socio-economic packages of the government to protects social vulnerability groups, support jobs and businesses, as well as public capital investments with higher multiplication factor to economy
Tax administration	# 22 Improve the efficiency of tax revenue collection and shorten the VAT refund period
Public debt	# 23 Issuing Treasury bills, Eurobond or/and a COVID Bond; Borrowing from IFIs
Local transfers	# 24 Revised formula for the general VAT grant
Social responsibility awards	#25 Government award for socially responsible companies to support COVID19 solidarity fund and other similar activities to help

### 3b. Monetary Stimulus

Policy intermediate targets	Policy measures
Interest rates	#26 Lower interest rates (without jeopardizing the price stability)
Central Bank bills	#27 Reduce CB bills stock to inject liquidity in the banking sector
Banking regulation	#28 Relax capital adequacy and reserve requirements (without jeopardizing the banking sector stability)
Exchange rate	# 29 Coordinate additional external financing to maintain adequate foreign reserve coverage
Quantitative easing	# 30 Last resort if there are no possibilities to borrow from abroad and there is no fiscal space to finance the economic packages; but without jeopardizing price and macroeconomic stability

## 4. Back to ‘new normal’, post-pandemic economic recovery and growth

Policy intermediate targets	Policy measures
New Normal and Opportunities	# 31 Environment protection and promotion of carbon-neutral economy

EU Pathway Growth Strategy:  
 Achieving faster, more inclusive and  
 sustainable growth

# 32 Digital economy, reduction of informal economy and internationalization of business sector (re-integration into global value-chain)

# 33 Research and innovations and increased business sector resilience and competitiveness;

# 34 Science, education, and development of human capital

# 35 Healthcare, social development and reduced inequality (income, gender-sensitive vulnerabilities and budgeting, etc.).

# 36 Economic recovery (restarting and restructuring – resilient - businesses, investments, infrastructure)

# 37 Sustainable, inclusive, and accelerated growth (governance, economy, human capital, environment)

## Policy recommendations (Explained)

### # 1 Healthcare, social distancing, testing, potential relief measures

- **Increase the financing for the health system.** The fiscal policy - through the revised Budget for 2020 - must ensure adequate funding for the health system. Medical doctors, technical and administrative personnel should be awarded for their exceptional efforts and entitled to higher wages at least during 2020.
- **Strict rules and protocols for reopening.** The Government can introduce strict rules and protocols for reopening production facilities and shops. For public health reasons, these protocols should not be negotiated with the business sector. There must be high penalties for inobservance of mandatory disinfections, use of respiratory marks, physical distancing, etc. Premature relaxation of containment measures can be costly.

### # 2 Relaxing unemployment benefit schemes

The current system of unemployment benefits is designed as follows:

- *Persons entitled to up to 12 months of unemployment insurance:* The monthly unemployment cash benefit is in the amount of 50% of the average monthly net wage in the past 24 months of employment history of the person. Persons with less than 25 years of employment history receive the unemployment benefit for fewer months (e.g., only a month if the person has only nine months of employment insurance).
- *Persons entitled to an unemployment insurance beyond 12 months (for pregnant beneficiaries or beneficiaries being trained or retrained by the Employment Agency):* The monthly unemployment benefit in the first 12 months is 50% of the average monthly net wage in the past 24 months of employment history of the person, and afterwards 40% of her/his average monthly net wage.
- The unemployment benefit must not exceed 80% of the average monthly economy-wide net wage paid in the previous month.

The team proposes extension of the duration of the right to unemployment benefits, as illustrated in Table 1:

Table 1. Months of Entitlement to Unemployment Benefits

Current Legislation		The Team Proposal	
Entitlement period	Previous employment	Entitlement period	Previous employment
1 month	9 months unhindered or 12 months with breaks	4 months	9 months unhindered or 12 months with breaks
2 months	18 months - 2 years	4 months	18 months - 2 years
3 months	2.5 – 5 years	4 months	2.5 – 5 years



4 months	5 – 7.5 years	8 months	5 – 7.5 years
5 months	7.5 – 10 years	10 months	7.5 – 10 years
6 months	10 – 12.5 years	12 months	10 – 12.5 years
7 months	12.5 – 15 years	14 months	12.5 – 15 years
8 months	15 – 17.5 years	16 months	15 – 17.5 years
9 months	17.5 – 20 years	16 months	17.5 – 20 years
10 months	20 – 22.5 years	16 months	20 – 22.5 years
11 months	22.5 – 25 years	16 months	22.5 – 25 years
12 months	More than 25 years	16 months	More than 25 years

### # 3 Cash transfers to socially vulnerable groups

- **Energy poverty.** The government may introduce utility subsidies for poor households. Covering up to 30% of the electricity bills during May-September 2020 only for households at risk of poverty and social exclusion would address energy poverty.
- **Universal cash transfers to be avoided.** The temptation to introduce universal cash transfers by “giving money to each citizen over 18 years old” should be resisted. The responsible social policy should aim at ensuring adequate support for the most vulnerable at a reasonable fiscal cost. High-income earners do not need cash transfers.

### # 4 Subsidies and transfers to farmers and the informal sector.

- **Introducing new transfers.** The pandemic outbreak is having a disproportionate impact on informal economy workers. They do not have formal jobs, they are not covered by social assistance programs and they work in poor occupational, safety and health conditions. Other countries’ experiences may offer some guidance in introducing new transfers. For instance, Thailand introduced a cash transfer of US\$ 153 for three months for up to 10 million farmers and 16 million workers not covered by the social security program using cashless digital payment platforms. In Vietnam, information from tax and utility bills is used to provide a new cash transfer for informal households and the self-employed who had to temporarily shutter businesses. Farmers that are not covered by any social security program should also receive cash compensation for a limited period during the crisis.

### # 5 Zero-interest loans

- The financial envelope for interest-free (or zero-interest) loans for the businesses should be increased.

### # 6 Deferral and reprogramming of credit payments

- The deferral and reprogramming of credit payments has already been successfully implemented as a measure by the Government. If the situation in autumn 2020 is worsening, the deferral can be extended for additional few months.

### # 7 Introduction of guarantee schemes supported by government

- Credit guarantee models and risk-sharing schemes with banks can also provide access to finance for the affected companies. The guarantees are included in the calculation of the public debt, but they do not require immediate financing (so-called guaranteed public debt). The issuance of guarantees for working capital of companies, for example in the amount of 250 Million EUR, will increase the overall public debt by 2.3 percent (50.7% of GDP at end-March 2020). Depending how severely a sector is hit, the guarantees can cover from 30% to 100% of the amount of loans to

companies. With these guarantees, companies will provide access to finance within 5-7 years with commercial banks, the European Investment Bank and the European Bank for Reconstruction and Development. If a certain amount becomes non-performing after 5-7 years and a company cannot repay the loan, the government will repay it, and it will acquire a claim.

#### # 8 Extension of the government support for minimum wage

- The minimum wage financial support is in the form of a grant if the eligibility criteria are met by the employers. Otherwise, it is in the form of a partial or full interest-free loan. The Government should reconsider extending the financial support for two more months (June and July 2020).

#### # 9 Relaxation of criteria for minimum wage support

- A reduction of 25% of the turnover in one month is already alarming for many businesses. However, the government decree classifies as eligible for government support only those companies that experienced a fall in turnover greater than 30%. This criterion may be too restrictive and a threshold of 20% fall in turnover may be more appropriate. This would be valid for the next wave of minimum wage support. For instance, if the company already experienced a fall of 20% in revenue as of April 2020, it would be eligible for government financial support.

#### # 10 Reduction of costs for rents and utilities

- The costs of utility bills or rents can be immense for certain households. Temporary subsidies for part of the utility bills (30%-50%) is a measure introduced by many governments across the world.

#### # 11 Government spending and procurements

- Procurement procedures for non-priority consumption by the public sector should be postponed. For instance, non-urgent purchases of automobiles for government institutions should be reduced to the minimum possible.

#### # 12 Export crediting and guarantee schemes

- This will help export oriented companies to keep their markets and sustain their position in global-value chain or adapt to new market needs

#### # 13 Income for self-employed

- Subsidies to address self-employed to alleviate their business needs to survive the crisis

#### # 14 Small and Medium Enterprises should be on focus and with respect to sectors that are more affected, while micro-entities are more vulnerable and should have a special treatment

- **Better access to the government financial support.** Micro-entities that will dismiss two employees will not be eligible for government support. This criterion could be relaxed in line with the Croatian COVID19-related legislation, where the threshold for labor layoffs by the micro entities is 40%.

Table 12. Hypothetical situations of labor layoffs

Threshold for labor layoffs	Size of enterprises	Hypothetical size of an enterprise	Hypothetical reduction of number of employees	Reduction in percent	Eligibility for government support
<=15%	<=50	10	-2	-20%	No
<=10%	51-250	200	-18	-9%	Yes

<=5%	>250	500	-24	-5%	Yes
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- **Sector-specific approach.** In addition to the one-size-fits-all approach, special packages should be designed considering the sectors and the size of enterprises. Sectors should be categorized based on the magnitude of the COVID19 quake in several groups (e.g., hardest hit, moderately hit, mildly hit).

Table 13. International Labor Organization's (ILO) assessment of the vulnerability of sectors

Economic sector	Vulnerability
Wholesale and retail trade; repair of motor vehicles and motorcycles	High
Manufacturing	High
Accommodation and food services	High
Real estate; business and administrative activities	High
Arts, entertainment and recreation, and other services	Medium-high
Transport, storage, and communication	Medium-high
Construction	Medium
Financial and insurance services	Medium
Mining and quarrying	Medium
Agriculture, forestry, and fishing	Low-medium
Human health and social work activities	Low
Education	Low
Utilities	Low
Public administration and defense; compulsory social security	Low

Source: ILO Monitor: COVID-19 and the world of work. Third edition, 29 April 2020.

## # 15 Crisis management trainings

- Companies that focus on planning ahead in a longer time horizon are likely to emerge faster from this crisis than others. The Ministry of Economy can organize one- or two-day training in crisis management (short- and medium-term navigation strategies) for the interested entrepreneurs.

## # 16 Scenario analysis

- The scale of the economic impact of coronavirus pandemic is only starting to become clear, but effective government policy responses depend on realistic estimates of the depth and length of the recession.
- The government should develop several macroeconomic and fiscal scenarios with distinct assumptions regarding the depth and length of the recession.
- The current scenario of a real GDP decline of 4% (IMF, April 2020), 3.5% (National Bank, May 2020) or 3.4% (Ministry of Finance, May 2020) is clouded with high uncertainty. The Government should be prepared for several other scenarios, such as W-shaped recovery or U-shaped recovery.
- W-shaped recovery: The possibility of a second pandemic wave must not be neglected. Large fiscal space (buffer) is needed to combat a potential "W"-shaped recovery. In the W scenario, it is important to emphasize that such a scenario can be triggered either by premature "withdrawal" of the health protection containment measures or premature withdrawal of fiscal stimuli and other

government measures for supporting the economic recovery. Hence, decisions on what and when to withdraw should be taken by assessing both dimensions.

#### # 17 Fiscal and socio-economic assessment of policy measures

- The Ministry of Finance should conduct a preliminary assessment of the fiscal and socio-economic implications of all quantifiable policy measures. This will ensure sufficient budget resources for government support of businesses and citizens and careful debt and liquidity management planning. Each policy package should carry at least a preliminary (rough) estimate of the fiscal implications.

#### # 18 Monitoring and evaluations

- A special task force in the Government should regularly monitor and evaluate the impact of the existing packages of economic measures.

#### # 19 Size of fiscal stimulus

- As the pandemic pushes the Macedonian economy into a recession, the economy needs stronger stimulus compared to the presently budgeted amounts. Given that this recession is predicted to be deeper than the one caused by the Global Financial Crisis (2008-09), the size of the economic package should be larger than the 2012 economic stimulus. Present fiscal packages are twice as higher as those during the Great Recession.
- The Fiscal Strategy (2010-2012) highlights that “the total amount of anti-crisis packages in 2009 was 300 Million EUR”. This is equivalent to 4.5% of 2008 GDP. But now the economy is larger. GDP in 2008 was €6,720 Million and GDP in 2019 was € 11,341 Million. The equivalent stimulus package in 2020 would be €510.3 Million. However, this crisis is **different** (the economy is simultaneously hit by a demand and supply shock) and **more severe**.
- According to the socio-economic assessment of the COVID19 impact, the size of the fiscal stimulus should be higher (circa 10% of GDP) than the one during the Global Financial Crisis (4.5% of GDP).

#### # 20 Reduce non-productive and unnecessary budget costs

- **Spending cuts.** The budget users should be instructed to reconsider non-essential budget spending and propose expenditure cuts by 10%-20% (travel expenses, goods and services purchased, non-essential furniture or equipment purchases). By deferring non-essential budget expenses, a fiscal space will be created for pandemic-related spending.

#### # 21 Budget costs re-allocate to finance socio-economic packages of the government to protect social vulnerability groups, support jobs and businesses, as well as public capital investments with higher multiplication factor to economy

- **Cost re-allocations.** Defense spending reallocated toward humanitarian relief for the most vulnerable segments of population is welcomed in a state of emergency.

#### # 22 Improve the efficiency of tax revenue collection and shorten the tax (VAT) refund period

- **Collection of taxes due.** Easier said than done, the Public Revenue Office should make an additional effort to collect a portion of unpaid taxes by firms and citizens. The January 2020 list of taxpayers that have not fulfilled their tax duties reveals a total amount of 10.0 Billion Denars (162.7 Million EUR) taxes and social security contributions being owed to the government budget. The debtors are 1,995 legal entities and 2,515 physical persons.

- **Shortening the VAT refund period.** Full and timely value-added tax refunds can grant businesses access to much needed cash. The refund of VAT to companies should be shortened as much as possible. The inflows from the Eurobond or the “corona” bond issuance should promptly be injected through fast VAT refunds procedure to improve the liquidity of the enterprise sector.

### # 23 Issuing treasury bills, Eurobond or/and COVID Bond; Borrowing from IFIs

- To issue one Eurobond in the amount of 1 Billion € and cover all government financing needs would be a mistake, as it would leave an overall impression of a devastated and a cash-starved economy. In that case, investors would demand a very high interest rate and this would be a debt tower.
- We suggest decoupling (separation) of the regular refinancing needs of the budget from the crisis-related spending needs.
- The regular need for refinancing the issued Eurobond in 2014 in the amount of €500 million with a 7-year maturity period, i.e. until July 2021 should be treated separately. This Eurobond should be refinanced with a separate Eurobond.
- Crisis-related financing should be connected to a special “Corona” bond (or two smaller “Corona” Eurobonds). Every spending must be clearly linked with the economic stimulus and the utilization of the funds must be related to the Eurobond issuance.

### # 24 Revised formula for the general VAT grant

- The general VAT grant might be calculated as a percentage of the average VAT collection in the past three years. Revenue calculated by the revised formula will be less prone to cyclical factors and will provide a more stable source of financing for the LGs in North Macedonia. Increasing the percentage (presently, 4.5%) would also foster fiscal decentralization, although the team believes it should be made conditional on the progress in own-source revenue collection.
- Revenue calculated by the revised formula will be less prone to cyclical factors and will provide a more stable source of financing for the LGs in North Macedonia.

Year	VAT (net revenue)	Percent of last year's VAT revenue (in percent)	Inter-governmental fiscal transfer (VAT grant) to local governments	
			Current situation	Team Proposal
2015	41,694	4.0	1,733	
2016	45,949	4.5	1,876	
2017	47,870	4.5	2,067	
2018	49,254	4.5	2,154	
2019 p	52,059	4.5	2,211	
2020 r	48,000	4.5	2,343	
2021 f	56,100	4.5	2,160	2,240

### # 25 Government award for socially responsible companies to support COVID19 solidarity fund and other similar activities to help

- Government awards and social recognition should be given to companies (both financial and non-financial) that have contributed in kind or in cash to the COVID19 Solidarity Fund and/or have made advance payments of profit tax for the fiscal year 2020. Corporate social responsibility in a state of emergency must be appreciated by the Government.

#### **# 26 Lower interest rates (without jeopardizing price stability)**

- Advanced countries are already considering the introduction of negative interest rates by the central banks. Fully respecting the central bank independence, the management of the National Bank should be encouraged to re-consider the key reference rate in the economy (the interest rate on the Central Bank bills).

#### **# 27 Reduction of the Central Bank bills' stock to inject liquidity in the banking sector**

- Through the regular auctions, the Central Bank can once again reduce the amount of the central bank bills (“благајнички записи”) being offered. This will free bank resources and will strengthen the liquidity of the banking sector. Given the high degree of central bank independence, this measure is beyond the scope of the Government and it is a sole responsibility of the National Bank.

#### **# 28 Relax capital adequacy and reserve requirements (without jeopardizing the banking sector stability)**

- The International Monetary Fund already suggested to the National Bank to explore further steps that make use of the flexibility in the regulatory framework, such as permitting banks to draw down the capital conservation buffer that is designed to be used in periods of stress. The team also believes that this is the right measure, without jeopardizing the banking system stability.

#### **# 29 Coordinate additional external financing to maintain adequate foreign reserve coverage**

- The central bank has been successful in maintaining the price stability. Moreover, it has an excellent record in fulfilling the subordinated objective to contribute to the maintenance of a stable, competitive, and market-based financial system. It should stand ready to act as needed to protect the de-facto exchange rate peg. However, because of the lower remittances and lower net Foreign Direct Investment inflows this year, the foreign reserve coverage is likely to decrease from 114 percent to 87 percent of the IMF's Assessing Reserve Adequacy (ARA) metric by end-2020. The National Bank should inform the Government of North Macedonia about the recommended level of foreign borrowing by the government sector to maintain a comfortable level of foreign reserves.

#### **# 30 Last resort if there are no possibilities to borrow from abroad and there is no fiscal space to finance the economic packages; but without jeopardizing price and macroeconomic stability**

- The central bank must be ready for a last resort lending in case the liquidity problems are intensified, and a financial crisis is looming.

#### **# 31 Environment protection and promotion of carbon-neutral economy**

- Environmental degradation in North Macedonia is a serious problem with potentially harmful long-term consequences not only on production, but more importantly, on the health, quality of life and life expectancy of its citizens. The use of environmental resources is excessive and well beyond the capacity of the country's ecosystems to regenerate (the biological capacity) during the entire history of independence. The transposition of EU environmental legislation has been going for years with a satisfactory performance. The problem of implementation is in the details because many of the obligations given by basic laws have not been completed with needed secondary legislation and supported with needed human, technical and financial capacities. Beside that the problem is also the lack of integration of environmental legislation into the other sectors and shared responsibility of some sectors, such as water, between several institutions.

Post-pandemic environmental policy should focus on the following:

- **Sustaining the impact from the EU-related environmental legislation.** Although a distant future, the Treaty between Member States of the European Union and the Republic of North Macedonia concerning the EU accession would impose incredibly significant costs for businesses. These costs are related to the imposed limitations of emissions of volatile organic compounds due to the use of organic solvents in certain activities and installations, limitation of emissions of certain pollutants into the air from large combustion plants, for each polluter (installation, plant, etc.) in the country.

Table 14. Digital skills of population in European countries in 2019

Country Name	EU28+ EU candidate and potential candidate countries
Finland	5.83
Sweden	5.67
Netherlands	5.63
Estonia	5.43
Denmark	5.42
Luxembourg	5.19
Germany	5.07
Ireland	4.99
Cyprus	4.86
Lithuania	4.85
Belgium	4.83
Slovenia	4.83
Latvia	4.79
Austria	4.78
Czech Republic	4.78
Malta	4.72
Bulgaria	4.65
Slovak Republic	4.59
Portugal	4.52
Romania	4.49
France	4.49
Spain	4.34
Montenegro	4.32
Poland	4.27
Italy	4.17
Greece	4.11
Serbia	4.09
Albania	3.99
Hungary	3.97
Croatia	3.72
Bosnia and Herzegovina	3.70
North Macedonia	3.67

Source: World Economic Forum, Global Competitiveness Report 2019.

- **Transforming the Environmental Costs into Environmental Investment.** Transforming the environmental costs that hamper economic growth into environmental investment that bring potential long-term gains is an issue that merits a separate in-depth investigation.
- **Substantial Environmental investment.** Environmental investment for North Macedonia to align with the EU legislation is estimated at around €3 Billion for the next 10 years, which is roughly 300 Million € per year or 2.8% of the country's GDP in 2018 (Simončič, 2019). Green energy may create important synergies for job creation, technological upgrading, human capital development, industrial restructuring, etc.

### # 32 Digital economy, reduction of informal economy and internationalization of business sector (re-integration into global value-chain)

The pandemic outbreak is already speeding up the digitalization. Businesses must embrace these trends and adapt to the new reality. This is particularly important given the low level of digital skills of population (as measured by the World Economic Forum) (Table 3).

- **Strategic partnering.** The digital economy appears to evolve at breakneck speed. Strategic partnerships between domestic enterprises in traditional sectors and global digital platform corporations should be encouraged.
- **Boosting entrepreneurship in digital and digitally enabled sectors.** Following and adjusting to digital trends is a key to local value creation. In general, firms that invest in ICTs are more productive, competitive, and profitable.
- **The Emergence of Digital Intelligence.** In virtually every value chain, the ability of companies to collect, store, analyze and transform data brings added power and competitive advantages (UNCTAD, 2019). Underestimating the power of big data analytics, artificial intelligence (AI), cloud computing and new business models (digital platforms) can easily result in a rapid loss of competitiveness.

- **High-Paying Jobs of the Future.** Future labor demand will be concentrated in sectors related to caring for others in aging societies, raising energy efficiency and meeting climate challenges, producing goods and services for the expanding consuming class, and investment in technology, infrastructure, and buildings. Successful competition on the European and global markets would require the following jobs that will be in high demand in the next decade: software engineers and developers, data scientists, mechanical engineers, nurse practitioners, financial advisors, medical doctors, occupational therapists, Home health aides, etc. Many of the jobs of the future do require digital skills.
- **Repairing the global value chains.** It is highly likely that many regional value chains may emerge in the post-pandemic recovery period as a substitute for the ‘broken’ global supply chains.

### # 33 Research and innovations and increased business sector resilience and competitiveness

- North Macedonia’s weak innovation performance —no matter whether we look at input or outcome measures— and the fact that social returns from innovation exceed private returns (and may thus lead to underinvestment) may justify government intervention in favor of innovation. The R&D sector in North Macedonia does currently not receive enough attention from the government, but there seems scope to increase on the one hand spending on research undertaken by public research institutions, such as universities, and on the other to promote domestic firms to invest in R&D and innovation.
- **Improve firm-level technology absorption.** The Macedonian economy appears to be at a stage of technology adoption, rather than creation and innovation. As such, strong absorptive capacity is crucial. Firm-level technology absorption must be improved as it may represent an important hurdle for technological catch up and limits the beneficial effect of spillovers generated through foreign direct investment.
- **Real, not declarative collaboration.** A major challenge in North Macedonia is to overcome the lack of synchronization, communication, and cooperation between companies, research institutions and the public sector. Strengthening these links would direct innovative efforts at least in part towards the creation of marketable products and effectively support product innovation in the domestic industry. Partnerships between private businesses and research organizations, possibly also in the form of joint technological parks or incubators, could prove useful in stimulating such co-operations. Efforts to strengthen links between universities and the private business should also be reinforced. Fiscal and financial incentive schemes are options that could be considered in this direction.
- **Technology and quality upgrading.** North Macedonia should have a strong interest in promoting its knowledge-based industries. Modernization of existing production technologies or the introduction of innovative technologies in traditional sectors could significantly improve product quality and lower production costs and therefore contribute to stepping up North Macedonia’s competitiveness on the international market. There is thus a clear case for technology and quality upgrading. A firm may start with an initial specialization in standardized goods, then enter vertically differentiated goods (first by specializing in goods with low quality and price, before gradually moving up the quality ladder), to finally arrive at the stage of new products.

### # 34 Science, education, and development of human capital

- North Macedonia has major deficiencies in human capital —both in terms of quantity and quality— and opportunities to improve the human capital base seem limited. Deficiencies in human capital in North Macedonia start early and compound over time, from early child development, general education, vocational education and training, school to work transition to professional



development. Students do not seem to learn critical thinking at school, and there is a mismatch in terms of skills taught at universities and those required by the labor market. As a result, this is a major obstacle to improved competitiveness and the North Macedonia way towards a knowledge-based economy. This is, in part, the result of the lack of attention policymakers devote to secondary and tertiary education in the country.

### # 35 Healthcare, social development and reduced inequality (income, gender-sensitive vulnerabilities and budgeting, etc.).

- **Health care.** In addition to the immediate policy response, the post-pandemic recovery must include raising sufficient budget resources for public health prevention. The impact of the health sector on the national economy has been largely neglected. Firstly, the health system is an important employer. Second, investment in the public health system - and especially, in the quality of education in the field of medicine - will have long-term benefits for the national economy.

### # 36 Economic recovery (restarting and restructuring – resilient –businesses, investments, infrastructure)

- **From near-term survival to strategic thinking.** In the short run, near-term survival is the only agenda item for many companies. The government subsidies (interest-free loans, wage subsidies and partial relief of social security contributions) helped many micro and small businesses to buy some time to adjust to the crisis. However, the sooner companies switch to planning ahead, the better.
- **Consumer-led recoveries.** As economic conditions worsen, households cut back on spending, especially on non-essential purchases that can be delayed. The ones that most consistently rebounded first after the Great Recession (2008-09), regardless of country, included retail, food and drink, and insurance (Allas et al. 2020). By contrast, recovery would come later for sectors producing mostly intermediary products or capital goods. When the recession started, many of these businesses were still completing customer orders. They could continue operating in crisis for a while. Similarly, when the recovery is afoot, it would take some time for their demand to recover.
- **Export-led sub-sectors tend to bounce back faster than non-export led ones.** Some sectors in structural decline, such as textile manufacturing, may not fully recover by 2021. Focusing on exports can be a life-saving medicine for many businesses.

### # 37 Sustainable, inclusive, and accelerated growth (governance, economy, human capital, environment)

- The sustainable development of the Republic of North Macedonia requires growth acceleration to speed up income convergence and improve quality of life of its citizens. No less important is to ensure that economic growth is inclusive, so that prosperity is enjoyed by a much larger share of the population. This must be accompanied by changes in unsustainable production and consumption patterns, along with energy use, to minimize the depletion of environmental resources. The “battle” for sustainable development is therefore a complex task that requires coherent, integrated, and coordinated reforms. Even though the largest payoff of these reforms is well beyond election cycles, the Government of the Republic of North Macedonia and the international development partners are strongly committed to accept this challenge.
- This development scenario – in which the EU accession becomes clearly achievable – is preferred by an overwhelming majority of the Macedonian citizens. The prospective EU membership of North Macedonia holds strong transformative power that can be used to implement these reforms in a more systematic and vigorous way. Even though without attached conditions, the United Nations’ Agenda for Sustainable Development 2030 is also focusing policymakers’ attention on the country's long-term commitments for improving the quality of life of its citizens. The main

policy recommendations are contained in a joint policy study by the Secretariat for European Affairs and the United Nations Development Program, titled: “The European Pathway of the Republic of North Macedonia: Achieving Faster, More Inclusive and Sustainable Growth”.

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