

Macedonia

Status Index (Democracy: 7.55 / Market economy: 6.61)		7.08	Management Index		5.56
HDI	0.797		Population	2.0 mn	
GDP per capita (\$, PPP)	6.6794		Population growth¹	0.7 %	
Unemployment rate	N/A		Women in Parliament	19.2 %	
UN Education Index	0.87		Poverty	N/A	
			Gini Index	28.2 (1998)	
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003.					

A. Executive summary

Macedonia has recovered from the severe security crisis in 2001. The internationally mediated framework agreement of Ohrid established a new power-sharing system between the Macedonian majority and the Albanian minority. Proportionate ethnic Albanian representation in the police force was ensured in 2004 by the annual additional employment of 500 minority policemen. However, the state's monopoly on the use of force is still contested in some rural areas in western Macedonia. Parliamentary elections are free and fair, but presidential elections in 2004 were accompanied with irregularities just as in 1999. The independence of the judiciary is still restricted by weak professional standards, carelessness and corruption. Macedonia's party system is characterized by two great Macedonian parties, with a very low rate of voters moving between both parties, and a dominant party with an overwhelming majority in the Albanian camp. The party system still follows political battle lines drawn at the time of Macedonia's independence.

The economy has continued to recover since 2001. Growth of GDP in 2003 is estimated at approximately 3.2%, macroeconomic stability has been preserved, inflation is low and monetary policy continues to be based on a de facto near-peg of the denar to the euro. Good progress was observed in privatization; the private sector made up 60% of GDP in 2003. Price and trade liberalization and banking sector supervision standards are well-advanced, but the regulatory framework for non-bank financial institutions remains weak. However, there is little sign yet of a sustained take-off in growth. The reported unemployment rate remains over 30% and GDP per capita remains low, at \$1,885 in 2002. The economy continues to run a large trade deficit, officially more than \$1 billion in 2004. However, experts

estimate the actual deficit to be approximately \$3 billion. Foreign debts continue to grow, reaching more than \$1.7 billion in March 2004.

The IMF standby program, approved in April 2003, is on track and the government has made significant progress in reducing the large budget deficit. In the infrastructure sector, structural reforms and privatization in the field of energy and railways are on track.

There is a basic consensus about democracy and market economy among Macedonia's current political leadership, and governmental parties show good will in surmounting the ethnic gap dividing the society. However, opposition parties generally aim to exploit ethnic divisions via populist behavior. The current Albanian opposition party, the DPA, is a hard-line extremist party with a strong grassroots structure and for which support among the electorate is growing again. The main Macedonian opposition party VMRO-DPMNE, wavering between populist nationalism and moderate conservatism, has approximately one-quarter of the population's support. However, an internal party conflict between hard-line extremists and moderate nationalists remains undecided. The situation in Kosovo could pose further security risks to Macedonia.

B. History and characteristics of transformation

Industrialization of Macedonia's primarily rural society began in the 1960s, when the Yugoslav socialist regime suffered economic crisis. The process of industrialization was accompanied from the start by an imposed economic development policy that relied on heavy industry, growing foreign debt and high (20%) unemployment. The steady decline in industrial production since the 1980s led to an unemployment rate increase and shifted jobs to the service sector and small enterprises, which today provide more than 70% of jobs. Economic transformation has been slow, with foreign policy factors impeding progress. A diplomatic conflict with Greece over the state's name led to Greece's trade boycott of Macedonia in 1994 and 1995. The United Nations' embargo against Yugoslavia destroyed trade relations with Macedonia's formerly most important foreign trade partner. Continued regional instability—the war in Kosovo—has hurt in particular the few sectors of the economy that had brought in foreign currency (tourism, textiles, and delivery of aid to Kosovo). Macedonia was the last of the former Yugoslav republics to begin economic transformation; the act of transformation of June 1993 took effect in 1994. To avoid repercussions from the collapse of the Serb-Yugoslav dinar, the country sought in 1992 to establish its own currency.

Political themes and conflicts frequently overshadow and dominate transformation. Society in this multiethnic state is characterized by the near total

separation of two ethnic groups into Macedonian and Albanian societies. Even the job market is segregated along ethnic lines, with Macedonians in the run-down state enterprises and ethnic Albanians in the private informal economy. While interethnic relations had already deteriorated rapidly in the 1980s, when Macedonia attained independence in 1991-1992, even minority rights that had been assured were restricted. Nationalist intellectuals then set the tone in the "government of experts." The government's national intransigence was met head-on by ethnic Albanian parties that challenged the legitimacy of the new state.

Kiro Gligorov's election as president in January 1991 signified a change in course. Gligorov implemented power sharing that kept ethnic tensions from erupting into violence. All previous limitations on minority rights were revoked and the largest ethnic Albanian party was brought into the government. However, this model of proportional ethnic representation in government was not mirrored in Macedonian society, which remained split. Structural problems, such as the under-representation of ethnic Albanians in the government and administrative system and the dispute over mother-tongue education, showed little improvement. Additionally, a new law on local self-government in 1996 divided the former 34 municipalities into 123. Several rural Albanian municipalities thus lost almost all public institutions or infrastructure, much of which remained in the urban Macedonian centers. During Gligorov's presidency, freedom of information and of opinion was guaranteed by the constitution; no official censorship was employed. However, in reality, all printed dailies were controlled by the state until the first independent daily newspaper "Dnevnik" was founded in 1996. Important decisions were made behind closed doors under the leadership of the president.

After the September 1998 elections, when the post-communists lost power and the more nationalist of the Macedonian (VMRO-DPMNE) and Albanian (DPA) parties formed a coalition government, far-reaching reforms were promised. Instead, the government split into various power centers. The allocation of cabinet posts had a particularly negative effect, in that departments were used as arenas for the pursuit of Macedonian or ethnic Albanian interests without interference from the other side. Conflicts in the region (Kosovo) worsened relations between the Macedonian majority and the ethnic Albanian minority. Corruption scandals and elections fraught with irregularities, including the 1999 presidential election and 2000 local elections, further discredited the political system. In the spring of 2001, mounting Macedonian-Albanian tensions and repercussions of the Kosovo war finally led to a situation bordering on civil war in various parts of the country. Only international mediation ended the fighting. The August 2001 Ohrid Framework Agreement called for a restructuring of the political system to allow greater use of the Albanian language, guarantees of equitable ethnic Albanian representation in government institutions, and decentralization of powers from the central state to the municipal level.

C. Assessment

1. Democracy

1.1. Stateness

The successful implementation of the August 2001 Ohrid Framework Agreement, in the area of ensuring equitable ethnic-Albanian representation in the police force, did much to establish the state monopoly on the use of force in the country's western regions during the period under study. Nevertheless, territorial enclaves remain where it does not work. The forming of a new government in November 2004 was complicated by an armed group of former UÇK-members, who occupied a rural suburb of the capital Skopje for two months. Support for the Ohrid Agreement among the Macedonian majority is slowly growing. But the major Macedonian and Albanian opposition parties, VMRO-DPMNE and DPA, are favoring mono-ethnic nation-states achieved by a change of borders and an exchange of population, or have at least strong reservations against the Ohrid process. The secular order of the state was confirmed by the Agreement. However, there are still de facto close ties between the state and the Macedonian Orthodox Church, to which two-thirds of the population belong. All questions concerning the Macedonian Orthodox Church are treated as questions concerning the identity of the state. In addition, a 1997 law gives the Macedonian Orthodoxy a privileged position among the Christian Orthodox population, because it requires that there should be only one church organization for each confessional group.

Whereas the state's fundamental infrastructure extends throughout the entire territory, it is undermined by the limited capacity of its institutions. The further employment of members of the minority population in the administration, and especially in the police force, during the period under study has reduced some of the former deficiencies.

1.2. Political participation

The constitution prescribes universal suffrage and the right to campaign for office. General elections are held and accepted to fill leadership positions. However, especially in the western parts of the country where most of the Albanian population lives, presidential elections are plagued by irregularities and manipulations. For example, an OSCE report on the presidential election in April 2004 noted ballot-stuffing, identical signatures on voter lists, intimidation in and around polling stations, and bad vote-counting processes.

Political parties employed pressure and even violence to prevent voting, or to force the electorate to vote. Instead of the elected government department per se having the real power to govern, governmental parties employ the state structure to enforce their own interests. As a rule, freedom of information, of opinion, of association and of assembly is not restrained. The landscape of interest groups is still barely differentiated and has little political relevance. Similar to society as a whole, civil society organizations are stamped by ethnic segregation. Among the six daily newspapers in 2004, there are pro- and anti-government tendencies and one is a populist boulevard daily. A new independent daily was founded in 2004.

1.3. Rule of law

Constitutionally, the Macedonian political system is a parliamentary system, leaving mainly representative functions to the president. However, in reality the balance of power within the executive branch has been tilted toward the president since independence in 1991/92. In the previous period from 1998 to 2002, the power of the government had increased under the weak presidency of Boris Trajkovski, especially following the military conflict in 2001, when the relations with his own party, the VMRO-DPMNE, deteriorated and he had lost most of his popular support. With the election of the previous head of government, and for twelve years leader of the main governing party the Social-democrats, Branko Crvenkovski, became again in spring 2004 the country's most powerful figure as the president and head of state, subject only to weak parliamentary control.

Public administration has been politicized. The high degree of administrative centralization has enabled ruling parties to control civil service appointments, placing politically loyal persons in key administrative positions. Close links between political power and access to economic resources exacerbate the ensuing problems. During the period under study, these matters have improved. A number of decentralization laws designed to reinforce the powers of elected local offices and enlarge substantially their responsibility, are in proposal.

The Constitutional Court's monitoring function has limited effectiveness because its members are elected by parliament with a simple majority, enabling the governing majority to influence the composition and, as a likely consequence, the jurisdiction of the court. According to a survey conducted in November 2004 among members of the judicial profession, widespread corruption among lawyers is regarded as an obstacle for the regular work of the courts. Fifty percent of the respondents said that they do not get information about reform measures in the judiciary via regular institutional means but by normal print media. Political and bureaucratic corruption in Macedonia is perceived as high; however, measures to combat corruption are generally applied by those who have won elections to settle accounts with their political opponents. The Constitutional Court does not protect

all basic rights, but rather only a few, such as freedom of opinion and freedom of association. Furthermore, Article 50 of the constitution assigns the same responsibility to the normal courts without defining jurisdictional boundaries.

1.4. Stability of democratic institutions

Frequent political blockades and parliamentary boycotts hamper the efficiency of parliament. Voting for absent members of parliament by their colleagues was common until it was outlawed officially in June 2003. The main opposition parties the VMRO–DPMNE (representing ethnic Macedonians) and the DPA (representing ethnic Albanians) each took the stage as nationalistic rabble-rousers within their own ethnic camp. They reject the Ohrid Framework Agreement.

1.5. Political and social integration

The party system is not defined by clear distinctions of political ideology or socioeconomic disputes as the main divide. Rather, its orientation still follows political battle lines drawn at the time Macedonia attained independence. The political parties are more mechanisms for distribution of patronage than real engines of democratic inclusion. The extraordinary power given to the leaders by internal statutes leads to a lack of democratic accountability within the parties.

Since independence, there have been three large political camps, the Albanians, SDSM and VMRO-DPMNE, each with a support of about a quarter of the electorate, while the remaining quarter of the population elected smaller post-communist parties such as the Liberals or the Democratic Alternative. Electoral volatility between these camps has been limited, although the mixed majoritarian-proportional electoral system, in force until 2002, caused big swings in parliamentary majority relations.

The high voter turnout (more than 70%) in successive parliamentary elections does not reflect confidence in the political system. A study by the local opinion poll company BRIMA from November 2003 showed that only about 10% of the respondents trusted representative institutions. The landscape of interest groups is still barely differentiated and has little political relevance. Their support is strongest when ethnic issues are concerned. The development of a civil society is rudimentary at best.

2. Market economy

2.1. Level of socioeconomic development

Macedonia's GDP per capita amounted to \$1,885 in 2002. According to the World Bank, gross national income per capita was \$1,980 (at exchange rates) and \$6,720 (at purchasing power parities) in 2003. A very large portion of the working-age population is unemployed, or engaged in low productivity or occasional work. According to the State Statistical Office, the unemployment rate for 2003 rose from 31.9% a year before to 36.7%, of which 84.5% were long-term unemployed. Moreover, over 70% of those under 25 are said to be without jobs, and among the Albanians, it is nearly 90%. The Office for Employment reports even higher numbers.

However, analysts believe that real unemployment is lower than registered unemployment (i.e. unemployed persons registered by the Office for Employment) because many of the registered unemployed have jobs in the informal economy. Real unemployment is estimated to be at 25%. A national action plan adopted to boost employment in 2004 by 3% failed. A great part of the population depend on subsistence or traditional, subsistence production. The trend to settle in the rural suburbs of the cities, where agriculture is possible, is unbroken. More than 10% of the employed population does not receive a wage. The last published results about poverty are from 2001. With 24.6% of the population living below the national poverty line of €2.50 per day, Macedonia is the poorest country in Europe.

2.2. Organization of the market and competition

Macedonia's progress in transition has been steady but rather slow. Macedonia lags behind those countries in Southeastern Europe that are candidates for EU accession, as measured by the EBRD transition indicators. Macedonia is continuing to make progress in implementing the legal reforms necessary for a free market economy, but there are significant deficiencies in the implementation of new laws. While the bankruptcy law modified in March 2004 fares comparatively well, the country has no specialized bankruptcy courts; and in district courts skills and specialization are missing. A new company law was passed in the parliament (April 30, 2004). Macedonia has adopted an action plan for harmonizing its laws with the EU. Efforts are underway to amend Macedonia's telecommunications laws. Amendments to the Energy Law were adopted in early 2003 to create an independent energy regulator. A law on the national electricity company, envisaging privatization, was approved by parliament on March 24, 2004. Laws enacted in 1999 regulate the formation of monopolies and cartels.

The Stabilisation and Association Agreement with the European Union came into force on April 1, 2004. Macedonia now has a very liberal trade environment and has recently signed free trade agreements with all its neighbors. Since April 2003, the country has been a member of WTO. In recent years, banking supervision standards were reinforced and existing legislation amended. However many banks have weak balance sheets and a high percentage of non-performing loans (15.1% at end of 2003). The banking sector remains highly concentrated and privatized with three banks holding about three-quarter of total deposits. Capital markets are still either inactive or non-transparent and the implementing capacity of supervising authorities is weak. The country has virtually no access to international capital markets.

2.3. Currency and price stability

Over the past decade, different governments have generally adhered to strict monetary and fiscal policies. Inflation, which rose during the security crisis, is now low again with 1.2% in 2003. While Macedonia's current account deficit was drastically reduced in 1999-2000, it has since risen to its previously higher level. Since the mid-1990s, monetary policy has been based on a de facto near-peg of the denar to the euro (before to the DM). The peg has been maintained at approximately the same rate for nearly eight years, only shaken temporarily during the recession 2001-2002. The central National Bank was able to lower significantly the interest rate on central bank bills during the first half of 2003. While a new governor of the National Bank was appointed in May 2004, monetary policy is not expected to change significantly in the short term. A substantial fiscal consolidation was achieved during 2003 with a major reduction in the general government deficit to 1.1% of GDP, as a result of disciplined fiscal policy. The National Bank NBRM is an independent agency.

2.4. Private property

Property rights and the regulation of the acquisition of property are well-defined in principle. However, to make laws fully effective, the court system must be strengthened. Corruption remains a serious obstacle to business in Macedonia and contributes to a difficult investment climate in addition to perceived political and security risks. Macedonia ranked 106th in Transparency International's 2003 Corruption Perceptions Index for 133 countries. However, measures to combat corruption were in the past generally applied by those who had won elections in order to settle accounts with their political opponents. In 2003, parliament adopted a modern and advanced secured transactions law supported by the World Bank. In a survey by the EBRD in 2003 on the enforcement of secured transactions, Macedonia scored relatively high. The Concession Law (April 2, 2002) is

regarded by EBRD as one of the most advanced in Southeastern Europe, although it is not yet sufficiently tested in practice. Privatization is now close to completion. According to the EBRD, the private sector represents 60% of GDP in 2003. State ownership in the banking sector is as low as 14%.

2.5. Welfare regime

Social networks do not cover all risks for all strata of the population. Poverty is widespread among households characterized by unemployment and lack of education. Roma are particularly disadvantaged. The social security system in Macedonia is in a state of uncertainty and upheaval. Only 20% of the unemployed receive benefits. Macedonia's insurance sector is one of the smallest in Europe in relation to the population. The state-run guaranteed and comprehensive healthcare service remains intact on paper, but in practice suffers from an acute lack of funds. Public expenditure in health dropped from 9.2% of GDP in 1990 to 5.8% in 2002. Macedonia introduced a two-tier pension system in 2005. Women are under-represented in public life, although things improved a bit in the last years, with a relatively high number of women now in parliament and politics.

2.6. Economic performance

During the period under review, the economy recovered from the national security crisis of 2001 and the recession 2001-2002. GDP is on the rise again, at 3.2% in 2003; 4% was predicted for 2004, but there are signs that it is lower. Industrial production increased by 4.7% in 2003 after a decline in 2001 and 2002, but in 2004, stagnation or modest growth is probable. The economy is simply not strong enough to relieve unemployment solely via jobs created by the domestic private sector and moderate GDP growth. Macedonia remains a place with foreign direct investments of only \$94.25 million in 2003 and \$141.22 million in 2004. The economy continues to run a large and growing trade deficit officially estimated at more than one billion dollars in 2004. However, experts suspect that the real deficit is about \$3 billion. Foreign debts continue to grow. They reached more than \$1.7 billion in March 2004. Macedonia's current account deficit was 6.3% of GDP in 2003 and approximately 5.8% of GDP in 2004.

2.7. Sustainability

Ecologically compatible growth receives only minor consideration. Environmental awareness is rudimentary. Macedonia has a well-developed state system of primary, secondary and university education. According to the UNESCO Institute for Statistics, Macedonia's public expenditures on education

amounted to 4.1% of GDP in 2001. In 2004, parliament decided to establish a third state university in Tetovo with Albanian language instruction as secondary to the private university in Tetovo that opened in 2001. Thanks to the high standards and the well-funded financial sources of the private university, it is possible that in the long run the education levels of Albanian students will surpass those of the Macedonians.

3. Management

3.1. Level of difficulty

Macedonian society is comparatively well-educated and its workforce well-trained. This could not, however, make up for the collapse of existing economic structures, interethnic strife as the crux of domestic politics, extreme regional instability, an inefficient state administration, persistent challenges to the state monopoly on the use of force, scant resources and a small market. The lack of internationally competitive enterprises is a major obstacle for economic development. Additionally, the banking sector is drastically short of capital and there have been widespread local allegations of money laundering and financial malpractice by management trying to fill the gap in capital availability.

Cheap imports, mostly but not exclusively from Greece, have significantly destabilized the traditional economy and have driven many small producers out of business. Particularly in terms of structural constraints, Macedonia's difficulty level of transformation is very high. Several violent incidents with a criminal or political background demonstrate that Macedonia's statehood is still not 100% secured. During socialist times, there was virtually no dissident movement or a civic self-organization among urban intellectuals as in other parts of the former Yugoslavia. Civil society is rudimentary at best. Society and the political elite are split along ethnic and national lines. Although the Ohrid Accords have overall been successfully forced through the legislative process, there has been little sense of growth in contact between the two main communities. Resource constraints are a severe obstacle to balance the facilities available for different ethnic communities. The goal for equitable Albanian ethnic representation, which means boosting Albanian public sector employment as required by Ohrid, and the need to slash state employment and the size of the administration could become conflicting aims.

Profile of the Political System

Regime type:	<i>Democracy</i>
System of government:	<i>Parliamentary</i>
1. Head of State:	<i>Boris Trajkovski</i>
Head of Government:	<i>Branko Crvenkovski</i>
Type of government:	<i>oversized coalition</i>
2. Head of State:	<i>Branko Crvenkovski</i>
Head of Government:	<i>Hari Kostov</i>
Type of government:	<i>oversized coalition</i>
3. Head of Government:	<i>Vlado Buckovski</i>
Type of government:	<i>oversized coalition</i>
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. Effective number of parties denotes the number of parties represented in</p>	

3.2. Steering capability

During the period under review, Macedonia had three coalition governments, built by the same parties: Social Democratic Union of Macedonia (SDSM), Liberal-Democratic Party (LDP) and the Albanian Democratic Union for Integration (DUI). The ruling coalition has a sound majority of 76 (of 120) parliamentary deputies. Between January 2003 and March 2004, Branko Crvenkovski, who was the social democrat party leader since independence, led the government. After President Boris Trajkovski's surprising death in an airplane accident in February 2004, Crvenkovski left the position of prime minister and was elected president in April 2004 in the second round with more than 60% of the vote.

The new Prime Minister, Hari Kostov, elected on June 2, 2004, had no party affiliation and thus lacked a strong power base in the ruling coalition. On November 15, he handed in his resignation, accusing the government of a lack of consensus and teamwork in achieving Macedonia's strategic goals. He criticized the Albanian coalition partner DUI in particular for being interested only in the implementation of the Minority rights of the Framework Accord, and not in market oriented reforms.

A new government led by Vlado Bučkovski (SDSM) was elected in December 2004. Bučkovski has strong support in the ranks of his party and is a man with a commitment to Europe and reform. However, he is also widely seen as inexperienced.

The overall aim of all three governments was to facilitate EU membership. On March 22, 2004, Macedonia submitted its formal application for EU membership. The governments consistently made efforts to harmonize its laws in line with the EU. As part of the Stabilisation and Association Agreement with the EU, Macedonia is engaged in a process of further harmonization of the domestic telecommunication sector with that of the EU. While the country's macro-economy was shaken during the recession of 2001-2002, the government was able to re-establish stability.

Further efforts were made in the infrastructure and energy sector. In the infrastructure sector, an independent energy regulator was set up in 2003; a restructuring plan for the power company has been approved and its privatization program is on track. To accompany the decentralization process, a package of new laws on public companies, and water sector regulation was prepared. The water-sector law was enacted by the end of 2004. A railways restructuring plan was agreed upon with the World Bank in spring 2003, which included debt restructuring, layoffs and the division and commercialization of the company. However, progress has been slow, it was only in spring 2004 that debt restructuring, and the first layoffs began. Although the Kondovo crisis in December 2004 ended with the peaceful withdrawal of the armed group, it contributed to a culture of non-punishment for violent acts, because peace was reached beyond the institutional framework of law and justice. Albanian political leaders engaged in direct negotiations with the members of the guerrilla group.

All three governments have been committed to democracy, the implementation of the Framework Agreement and a market economy. The government seems to be well aware that the gap between laws and their implementation undermines the utility of these laws, and diminishes the confidence of local and foreign investors and traders in the legal system as a whole. Structural problems of institutions continued, as is to be seen in the case of the new Law of Municipal Boundaries. This law was not decided by parliament and government, but through direct negotiations of the party leaders, who represent the narrow interests of their own ethnic constituencies. The powerlessness of the head of government was demonstrated when, for more than two months, Prime Minister Trajko Kostov failed to reach an agreement within the government for a new law on municipal boundaries. Initially, when the president took over the initiative, things improved and a solution was first reached by direct negotiations of the president with the

leader of the Albanian government party, Ali Ahmeti, mediated by the U.S. ambassador. However, this experience of impotence in the face of the president contributed to Kostov's resignation early in November 2004.

The political leadership shows little willingness and ability to learn, since the government did not draw on its experiences with the 2001 crisis in order to manage the occupation of Kondovo by Albanian paramilitary groups. As in 2001, political leaders initially ignored and downplayed the problem.

3.3. Resource efficiency

Public administration reform is just beginning. General government expenditure was reduced from 41% of GDP in 2002 to 36% in 2003, which led to a decrease in the general government deficit from 5.7% in 2002 to 1.2% in 2003. The number of employed in the public administration is still high, currently at 128,000.

Coordination and cohesion among the coalition parties is much better than in previous governments. However, on sensitive interethnic questions like decentralization or the Kondovo crisis, the government is also faced with a possible split into ethnic camps. Structural problems accompany the government's ambition to reduce the public administration. According to the standby agreement with the IMF (April 2003), employment in public administration should be reduced approximately 4% annually. However, one of the demands of the Ohrid Framework Agreement is to ensure equitable Albanian representation in the administration through an increase in the number of employed. With the annual additional employment of policemen from minorities since 2002, the number of people employed in the police force increased by about 20%.

One of the most important reasons for the defeat in 2002 of the VMRO-DPMNE-led coalition government was, by general consent, the widespread public perception that the then-ruling coalition was thoroughly corrupt. Well aware of that, the SDSM-led coalition government of Prime Minister Branko Crvenkovski set up an independent Anti-Corruption Commission, responsible to parliament and headed by an administrator with a professional police background. Nevertheless, previous behaviors are still practiced. Foreign investors are still faced with the problem that the lower administration tries to get some kind of "dividend," otherwise enterprises will be confronted with public inspection. Generally, the weak enforcement of the legal framework has led to corruption. Further progress will not be reached until one of Macedonia's weakest institutions, the judicial system, is improved.

3.4. Consensus-building

There is a basic consensus about democracy and market economy among Macedonia's current political leadership. However, it appears that populist

political actors could influence the political agenda. Although the referendum against the Law of Municipal Boundaries failed because too few people voted, it took much pressure to prevent people from voting; the pressure was applied via the clientele network of the ruling parties of the Macedonian majority, and via the additional decision of the U.S. administration to recognize Macedonia under its constitutional name. Opinion polls at the end of September 2004 showed that a majority of those questioned planned to vote, with an overwhelming majority voting against the law. Further questions indicated that, not only Opposition voters opposed the plans but also a large proportion of pro-government voters opposed decentralization.

How anti-democratic veto actors are able to influence the performance of constitutional rules was obvious in January 2005, when VMRO-Narodna, now the biggest opposition party in parliament, appealed for amnesty for the former minister of domestic affairs in 2001, Ljube Boškovski (VMRO-DPMNE), who is accused of killing six foreign workers from Pakistan on their way to Greece in Skopje in March 2002. The assassinated six had nothing in common, neither with the security crisis of 2001 or with international terrorism. However, Boškovski, who was the responsible minister, wanted to deal with this matter in order to present himself as a defender of Macedonia and a fighter against al Qaida. VMRO-Narodna's ambition was not immediately rejected by all parties. The governing Social Democrats had long had an ambiguous stand, and even the Albanian parties at first explored whether their constituency could profit from a new law of amnesty, before rejecting the matter.

As a guardian of the traditional Macedonian nationalism and heir of the partisan movement in World War II, the governing Social Democrats attract the great majority of the Macedonian voters in the western parts of the country, who are most affected by the ethnic conflict. In this way, they are able to neutralize extremist forces there. The same can be said about the DUI as the successor of the UÇK in the Albanian camp.

The political leadership is trying to prevent ethnic conflicts from escalating. The further employment of members of the minority community in the security forces did much to calm interethnic conflicts in local communities. According to Macedonian government data from 2004, the share of Albanian police officers was raised to 16.9%. However, this policy cannot reduce existing ethnic divisions. All violent incidents in Albanian villages since 2003 were handled cautiously. Yet, all of these incidents, even those with a simple criminal background, led to frictions and rumors within the coalition.

Nikola Gruevski, president of the major Macedonian opposition party, VMRO-DPMNE, tried to lead the party toward the political center and a more moderate conservatism as a reformer and technocrat. Gruevski was supported by the central

committee of VMRO, but not by its parliamentary group. A majority of VMRO-DPMNE deputies established a new parliamentary group and party loyal to the former nationalist leader Ljubčo Georgievski, the so-called VMRO-NP. This split indicated that a large part of the party did not fully accept the Ohrid Agreement, considered the decentralization laws a blow to Macedonia's national interest, and opposed power sharing among the ethnic communities.

Traditionally, civil engagement is rather undeveloped in Macedonia. Interpersonal solidarity is largely limited to kinship networks, and clientele networks dominate politics. Frustration, indifference and mistrust are widespread and led for the first time to a low electoral turnout in the first round of the presidential elections in 2004. In general, Albanian voter turnout is between 10 and 15 percentage points lower than that of the Macedonians. The dominance of one big party with an overwhelming majority, which controls nearly all spheres of politics in the Albanian camp, leads to a lack of inner-Albanian pluralism, leaving little or no space for civil opposition. This contributes to a culture of violent protest instead of civic culture, especially among the rural Albanian population. DUI failed to change this situation, although their leadership is more pluralistic than that of the monolithic DPA. One reason for its failure may have been the weak organizational structure of the party.

The political leadership is not very active in enabling the participation of civil society actors in the political process. Nevertheless, the government has continued the process of decentralization.

Consisting of the antagonistic actors of the security crisis in 2001, the government is now a kind of reconciliation project: in general, however, it does not do much to heal the wounds in society, but rather shrouds them in silence. Memories of the violent civil- and interethnic war in World War II are instrumentalized by all major political actors against their political opponents.

3.5. International cooperation

Macedonia's governments have worked with bilateral and multilateral international donors and effectively used international assistance for most items of their domestic reform agenda. International assistance by states and international credit lenders (IMF, World Bank, EBRD) is of great importance and was at 2% of GDP in 2003, twice as high as foreign direct investment. Between 2002 and 2004, Macedonia received €126 million from EBRD with strategic priorities in the corporate sector, financial sector and infrastructure. In addition to receiving €100 million in humanitarian aid from the EU, Macedonia received €51 million from the EU programs CARDS and PHARE & Obnova in 2004 to advance minority rights and decentralization. The IMF standby agreement was approved in April

2003 and is largely on track. The EU supported police reforms.

The government tries to act as a credible and reliable partner, and the strict and successful policy of macroeconomic stability underlines its credibility. The World Bank Board has honored that by adopting a new three-year Country Assistance Strategy in 2003, with the possibility of funding up to \$165 million between mid-2003 to mid-2006, provided substantial progress is made on structural reforms.

Macedonia's government actively and successfully developed cooperative regional and international cooperation and integration. Free trade agreements were concluded with all neighboring states. Macedonia actively participates in the South East Europe Regional Electricity Market process and makes important efforts to get the bilateral free trade agreements in the region implemented. After a severe slump in the 1990s, the Union of Serbia and Montenegro is once more Macedonia's leading trade partner with about 36% of total trade and one of the rare cases where Macedonia has an export surplus. Despite the lasting conflict over the Macedonian state's name, relations with Greece are very good and Greek enterprises are highly committed to Macedonia's economy. However, the U.S. decision to recognize the state by its preferred name "Republic of Macedonia" in October 2004 has worried Greece and may block or slow down the EU accession process.

4. Trend of democratic and economic development

4.1. Democratic development

Stateness, political participation and the rule of law have all significantly improved since the elections 2002, after the severe crisis in 2001 when Macedonia's political leadership became fragmented and demoralized. The state monopoly on the use of force in the country's western regions was re-established with some remaining exceptions. Minority rights were expanded, improvements made to the representation of ethnic Albanians and decentralization continued. Police and army reforms have advanced and an open discussion of problems in the judiciary has begun in 2004.

The structural problems of democratic consolidation remain. The authoritarian structures within parties are a weak element of Macedonia's democracy. Because the former direct majority electoral system, which forced distrust among the ethnic groups concerning the size of the electoral districts, was replaced in June 2002 by the proportional system, the general practice of ethnic voting causes no problems at the level of parliamentary elections. However, presidential elections are regularly faced with difficulties. Since Albanian candidates have no chance to win in the decisive second round, when Albanian candidates are out of the race,

most Albanian voters do not want to vote for a Macedonian candidate.

However, the power game within the government induces the governing Albanian party to mobilize the Albanian electorate in favor of the candidate of her coalition partner. This was the case not only in 1999, when the DPA executed much pressure on the voters, but also in 2004, when reaching the necessary quorum of 50% voter turnout was in doubt. While the quorum secures the collective rights of the Albanians (no president can be elected without them), in practice their individual rights are often violated by the Albanian parties which exert undue pressure on Albanian voters. The shift to a proportional electoral system in 2002 largely solved this problem for the parliamentary elections, but ethnic voting and ethnic confrontation in electoral campaigns continued to burden presidential elections. The problem is further complicated by the shift of power from the government and parliament to the president, thus contradicting the parliamentary system of government envisaged by the constitution. In 2004, the president was elected mainly by members of one ethnic group, the Macedonians, while half of the Albanian electorate voting in the first round stayed at home.

4.2. Market economy development

Macedonia's level of development has improved slightly in the past five years. Per-capita GDP has increased only slightly since 2000, which is due primarily to the security crisis in 2001, which ruined a sound state budget. Unemployment and the percentage of persons living in conditions of absolute poverty have increased. Social safety nets and health care have not become significantly better equipped to prevent social exclusion.

The institutional framework of a market economy has improved. Privatization is nearly complete. Efforts to harmonize Albania's laws with those of the EU are underway and foreign trade is being liberalized. The legal framework for private sector development has been strengthened. Attempts to reform the banking sector have begun and a regulatory framework for electricity and telecommunication companies has been established.

Overall, economic development has improved slowly but steadily, with a moderate growth of GDP, reaching the level before the crisis 2001. Inflation and the budget deficit declined to a low level, but foreign direct investment is stagnating at a rather low level, while the country's foreign debt continues to grow.

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004

Growth of GDP in %	4.5	-4.5	0.9	3.1	n.a.
Export growth in %					
Import growth in %					
Inflation in % (CPI)	5.8	5.5	1.8	1.2	n.a.
Investment in % of GDP	n.a.	19.1	20.7	19.8	n.a.
Tax Revenue in % of GDP					
Unemployment in %	32.2	30.5	31.9	36.7	36
Budget deficit in % of GDP	1.8	-7.2	-5.7	-1.2	n.a.
Current account balance in billion \$	-75.4	-244.7	-320.8	-378.0	n.a.

Source: EBRD; 2003: estimate. Inflation (annual average); Investment: Nardona Banka na Republika Makedonija <http://www.nbrm.gov.mk>

D. Strategic perspective

Although significant progress has been made since autumn 2002, Macedonia must increase efforts to secure stateness. Incidents similar to the Kondovo affair are likely to occur in the future. To avoid further incidents, the ruling coalition will need to successfully implement a decentralization process after local elections in March 2005 and fill the security vacuum in bordering rural villages. Certainly, developments in neighboring Kosovo will affect the question of Macedonian stability.

Macedonia will face problems, similar to those surrounding Hari Kostov's resignation in 2004, which are related to the political power gained by the presidential office and were present in the presidential elections. Macedonia's constitutional order urgently needs to clearly define presidential powers and the role of the presidential office in a multi-ethnic society. Developing an inner-Albanian pluralism is of similar importance. The modernization of Albanian society, which is still rather traditional and rural, can be expected with the improvements made to Albanian educational opportunities over the last five years.

In the short term, economic transition will entail more costs and unemployment will not be reduced significantly—especially when the government implements the annual 4% reduction of those employed in the bloated public administration. Employment losses can be absorbed only if the private sector develops dynamically enough to generate sufficient numbers of new jobs. The growth of the private sector should be driven both by foreign direct investment and by the spread and maturation of domestic business. This will require macroeconomic and legal stability, as well as a reliable and professional public administration.

External supporters should target their support primarily toward strategic foreign

investors and local export-oriented companies. Particular attention should be given to small producers that were driven out of business by imported goods, particularly in spheres like meat production. The potential for small and medium-size businesses to create additional employment is large. International organizations and agencies should simultaneously ensure that cooperative behavior and economic reforms yield tangible benefits for large parts of the population. Removing visa restrictions imposed on Macedonian citizens by EU member states would be very important and have broad impact.

The EU and other Western states and organizations should continue to provide financial assistance at the current levels. Considering the low rate of foreign direct investments and the negative trade-balance, a drastic reduction in donor support could render the fiscal position unsustainable. Western assistance should focus particularly on improving the quality of Macedonia's judiciary and public administration. The country needs a public ethos and a civil service that is protected against corruption and politicization, and committed to the highest professional standards. A viable civil service is a prerequisite to providing the necessary framework for private sector development and the capacity to prepare for EU membership.